



“Zydus Wellness Ltd. Q4 FY17 Post Results Conference
Call”

May 29, 2017



**MANAGEMENT: MR. TARUN ARORA -- COO & WHOLETIME
DIRECTOR, ZYDUS WELLNESS LIMITED
MR. NITIN PARIKH -- CHIEF FINANCIAL OFFICER,
ZYDUS CADILA GROUP
MR. AMIT JAIN – CHIEF FINANCIAL OFFICER, ZYDUS
WELLNESS LIMITED
MR. TUSHAR SHROFF -- SENIOR VICE PRESIDENT,
CORPORATE FINANCE, ZYDUS WELLNESS LIMITED
MR. VISHAL GOR – HEAD, INVESTOR RELATIONS,
CADILA HEALTHCARE LIMITED**

Moderator: Good Day, Ladies and Gentlemen and Welcome to the Zydus Wellness Limited Q4 FY'17 Post Results Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*', then "0" on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Tarun Arora – COO & Wholetime Director, Zydus Wellness Limited. Thank you and over to you Mr. Arora.

Tarun Arora: Good Morning and Welcome to the Post Result Teleconference of Zydus Wellness Limited for Q4 Financial Year 2016-17. We have with us Mr. Nitin Parikh – Group Chief Financial Officer, Zydus Cadila Group; Mr. Amit Jain – CFO for Zydus Wellness; Mr. Tushar Shroff -- Senior Vice President, Corporate Finance and Mr. Vishal Gor – Head of Investor Relations, at Cadila Healthcare.

The year gone by has been a challenging year with demonetization impacting sales in the second half of the year; however, we have seen a good recovery in demand post the demonetization during the fourth quarter.

For the full year, we have witnessed improvement in the growth rates for all our flagship brands, that is Sugar Free, Everyuth and Nutralite. As a result, the company registered an overall consolidated growth in income from operations of 14.4% for the fourth quarter and 8.6% for the financial year ended 31st March 2017. During the year gone by, our key brands namely, Sugar Free, Everyuth Scrub and Everyuth Peel Off have maintained leadership positions in their respective categories.

Coming to the Consolidated Financial Performance of Q4 Financial Year 2016-17: Our total income from operations was up by 14.4% year-on-year to Rs.1,215 million. Our gross margins saw a decline of 290 basis points and stood at 62.2%. The reduction in gross margins was primarily driven by increase in prices of key input materials. Our earnings before interest, depreciation and tax was up by 12.5% year-on-year to Rs.267 million; EBITDA margin as a percentage of total income from operations decreased by 30 basis points and stood at 22%. Profit before tax was up by 10.2% to Rs.335 million. Net profit was up by 9.1% to Rs.297 million.

Coming to the Financial Highlights: During the year gone by on a consolidated basis, our total income from operations was up by 8.6% year-on-year to Rs.4,626 million. Our gross margins as a percentage to total income from operations decreased by 40 basis points and stood at 64.4%. The decrease was mainly due to increase in the prices of key input materials in the second half of the financial year gone by. Earnings before interest, depreciation and tax were up by 8.5% year-on-year to

Rs.991 million. EBITDA margins as a percentage to total income from operations stood at 21.4%. Profit before tax was up by 6.2% to Rs.1,240 million, net profit was up by 5.5% to Rs.1,090 million. Our consolidated cash position at Rs.4,627 million including investments made in the liquid funds. Our consolidated CAPEX for the year was Rs.280 million.

Our new production unit at Sikkim commenced its commercial production during the fourth quarter. Our return on net worth stood at 21.0%.

With that, let me share some of the “Highlights of Operations of the year gone by.” We continued our thrust on marketing initiatives to grow the categories and market share of our brands during the year; to narrate a few, on Sugar Free front, during the year, the launch of two new advertising campaigns featuring our brand ambassador Parineeti Chopra with the tagline of “Smartness Waali Sweetness” has driven growth of Sugar substitutes category and market share of our brand. We continued focus on strengthening consumer connect through various category in building initiatives like promotion for culinary SKUs and other popular touch points like festival-linked consumer activations that is Durga Pooja, Christmas and all other such events.

We launched new Sugar Free Green, a 100% natural variant, made from Stevia during the fourth quarter to further drive the growth of the category. We have launched it in both table top as well as culinary formats to drive consumption of beverages and desserts by everyone in the family, including kids. We believe Sugar Free Green has immense potential and would help grow the Sweetener category. Going forward, the brand task remains to recruit new users and we would be investing behind “Consumer Education” and the new initiative, “Sugar Free Green” as well as continue to engage consumers through various activations. We also have intent to increase our investments and efforts in digital space to complement conventional touch points.

On the Everyuth front, we have continued to support Scrub and Peel Off to drive the category penetration through various media activities and TV campaign during the year. Scrub range has been relaunched with new packaging and new campaign to drive a category penetration and build on the natural equity. We have witnessed revival of growth rates for Face Wash with a relaunch of our Face Wash range with fresh, new and contemporary looking packaging. We also recently relaunched Tulsi Turmeric Face Wash with improved product and packaging during the fourth quarter. The initiative was supported by a 360 deg. campaign to drive awareness.

Going forward, we have series of new products in our innovation pipelines across each of our key segments: To start with, we are launching Scrub for problem-prone skin with neem and papaya as the ingredients in Q1 of 2017-18. We believe these innovations backed with strong marketing investments will help us grow Everyuth franchise ahead of the category.

On the Nutralite front, we have witnessed a strong volume growth versus subdued growth rates witnessed in the category over the last few years. This growth rate is largely led by institutional segment. We have also seen positive progression in the retail segment in the last quarter. To widen the reach, various regional media campaigns were launched in select cities. This was complemented with on-ground activations to drive trials and further strengthen Nutralite credentials. During the Q4, Nutralite premium range was relaunched with new packaging and improved taste. We also launched two new flavored variants in the premium range.

Going forward, we are planning a new multi-media campaign to strengthen Nutralite taste and health credentials along with the awareness of new flavors. We have more exciting new products in our innovative pipeline and will get rolled out over the next few quarters.

On the International Business front, we have opened markets like Saudi Arabia, Qatar, Oman and Myanmar to build our international business by entering into new countries. Going forward, we see opportunities to initiate our business in at least four to five more countries and expand our product portfolio in existing as well as new markets.

As per MAT March '17 Report of Nielsen, the Sugar substitute category growth rate has improved to 9.3% from 6% reported a year ago. Sugar Free has maintained its #1 position with the market share of 94.5% which is an increase of 80 basis points over the same period last year. The Scrub category has grown by 4.1%. Everyuth Scrub has maintained its #1 position with the market share of 31.6%. The Peel Off Mask category has grown by 4.6%. Everyuth Peel Off Mask has maintained its #1 position with the market share of 90.3%.

On GST front, we are gearing up for the new tax regime, working closely with our business partners for a smooth transition. With the stable recovery in demand post demonetization we are confident to continue improvement in the growth rates for us. We will continue to relentlessly focus on executing our strategy and we will continue to invest in building a sustainable platform for the future.

Thank you and we will now start the Q&A Session.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin with the Question-and-Answer-Session. The first question is from the line of Abneesh Roy from Edelweiss. Please go ahead.

Abneesh Roy: Sir, my first question is on the Sugar substitute. One is we have seen Honey market in the last two years explode because of Patanjali's disruptive pricing. So it seems that it has not had an impact at least in the last one year because your Sugar substitute market growth rates have expanded. So do you see that as a risk? Second is in terms of penetration and distribution for your products, if you can take us through for all the three sub-segments, how is the distribution scale up in the next two years?

Tarun Arora: Honey is not covered in the Sugar substitutes category. It is a separate category as per Nielsen. So this constitutes largely the sweeteners, natural and artificial. So that is the number we are capturing in this Nielsen reporting. Overall, we have seen an improvement at the category growth levels and largely we believe our initiatives of growing the categories working and that is what has moved from 6% reported last year to 9.3% this year in terms of category growth rates. Getting on to the penetration and distribution, we have seen specifically where we drive the category and capture through Nielsen which is Sugar Free we have seen just in last quarter itself growth of almost 3% points of the distribution over a year earlier. So our efforts on growing the penetration and distribution for each of these categories is consistent and we are going to be doing actions at sub-channel levels where we see grocers participating more and more in the Sugar substitute category unlike earlier it was largely only chemists. While we are growing the chemists but we are also seeing more grocers participating. We are also seeing some new channels delivering better. Modern Trade growth has also improved over last 1-1.5-years and we think there is still potential to grow more. That is the new very fractional right now but if the eCommerce also developed, so we will work on that. At overall level, we see about 4.2 lakh outlets servicing Sugar substitutes category and we are working to grow it further through our efforts. As far as the other segments are concerned, again, Nutralite, I talked about, our focus is key cities, we still see largely a very urban phenomena and we are since being the pioneer and the leader in the category, our effort is to category building initiatives there as well. So we see a lot of BOOT stores and grocers growing the category and we are working with them. Our intent of launching the flavors was also because there were concerns on taste, etc., people were used to more butter. So some of these new flavors help people evaluate, relook at this category and grow the category and that is really what is working. Everyuth, anyway is part of a much larger category and we are participating in that to grow the business.

- Abneesh Roy:** Sir, what is the percentage coming from Modern Trade for Sugar substitute?
- Tarun Arora:** Each of our brands approximately deliver about 13%-to-15% from Modern Trade, which is index much higher than the overall FMCG category.
- Abneesh Roy:** In terms of the GST rate, are you at largely the 28%?
- Management:** Nutralite, we are at 18%, while for Everyuth we are at 28%.
- Abneesh Roy:** So you plan to take the price hike, pass it on completely or based on the other market participants?
- Management:** We are still evaluating it. Sugar Free and Everyuth we do not see any challenge. Nutralite we might have to take it.
- Abneesh Roy:** Currently, the things which have moved to 28% those will be 24% broadly right?
- Management:** No, they are more or less at neutral rate only because we get some excise recredit also.
- Abneesh Roy:** So they are at what rate?
- Management:** Current rates are more or less comparable with the old rates.
- Abneesh Roy:** 28%?
- Management:** Yes.
- Moderator:** Thank you. The next question is from the line of Tejas Shah from Spark Capital. Please go ahead.
- Tejas Shah:** Sir, if we see the growth for this quarter, the scheme after long time in terms of that, we cross that hump of Rs.110 crores of quarterly run rate. So just wanted to know, was it more of a channel refilling after demonetization part of because that is what you indicated in the previous quarter or retail offtake itself a very strong in this quarter?
- Tarun Arora:** So we have seen a good offtake also like we mentioned in Sugar substitutes category. Specifically, we have got good support and Everyuth which was very important for us. So it was not just channel filling. We have seen a good momentum at the offtake level as well. There was a good wedding season which helps the Peel Off category. So we have seen a good response at consumer level there as well. Nutralite, I think

we have consistently been growing well now for some time for last few quarters and with the launch of new variants also it has only supported the growth.

Tejas Shah: Sir, Nutralite growth will be driven by HoReCa or retail as well this quarter?

Tarun Arora: Good news is both and equally very well. So that is one of the things we have been talking about that we want the consumer side the retail segment to catch up with Horeca side, we have seen this quarter good support from both the segments.

Tejas Shah: Sir, this quarter there seems to be very high pressure on gross margins, it is somewhere down by 40 basis points. So are we planning any price increase to mitigate the same in coming year?

Tarun Arora: No, we are seeing improvement in the oil prices which was broadly the main reason for driving our gross margins down. That has improved. We are not going to be taking any significant prices to change the order of things. I think it is a temporary phenomenon. So we hope to improve gross margin.

Tejas Shah: Will Stevia numbers be part of this quarter's numbers?

Tarun Arora: Yes, we started rolling it out in March. So a small proportion of it is there. It is still going to be a small part of the overall business. We are hoping to build it because the category building work is on.

Tejas Shah: Sir, how has been the response so far?

Tarun Arora: Response so far is fairly good and we are going to be building it step-by-step.

Tejas Shah: Sir, do you believe that in initial stage Stevia might cannibalize your base variants demand in terms of Artificial Sweetener?

Tarun Arora: In short-term, certainly no. Over a period of time, as people realize the benefits of it, some part may happen, but that should be fine with us because at the end of it, we are molecule-agnostic and it should be good for the consumer is how we have focused on. With our market share, that is least of our concern, the focus is growing the category and getting new as well.

- Tejas Shah:** There were some confusion regarding Northeastern states level exemptions there will be a grandfathering clause and all. If you can help us to understand how it will impact our numbers if at all they were impacted?
- Management:** As per current going, they have been saying that the benefit would be grandfathered. So obviously whatever benefits we are getting in the current regime will continue in the GST regime as well. That is what the thing today.
- Tejas Shah:** If I heard revenue figure correctly, you said that 58% of that benefit will be taken care of because that will be by central government and balance 42% which accrues from the state government would not be compensated, so just wanted clarification from your side?
- Management:** CGST is the tax which will belong to central government which is say in Everyuth is coming to 14% which is more or less equal to current excise duty. So there will not be any impact on the benefit side.
- Tejas Shah:** Our direct effective tax rate for next two years?
- Management:** Direct will continue at the current level for next two years.
- Moderator:** Thank you. The next question is from the line of Kaustubh Pawaskar from Sharekhan. Please go ahead.
- Kaustubh Pawaskar:** Sir, my question is on Sugar Free Stevia again. We have seen that this year your growth in Sugar Free was about 9.3%. So would Stevia and whatever initiatives you are taking in improving the category penetration, so should we expect it in next two years the category growth will be back to about 15-16% which was in your earlier days?
- Tarun Arora:** That exactly is our endeavor to drive it to but we will have to see it play it out.
- Kaustubh Pawaskar:** What was your market share in Nutralite?
- Tarun Arora:** We have stopped tracking Nielsen in market shares because it captures only such a small portion of the category that it is non-useful, we have not tracked it post December '15, so we have not got the recent data. But there are one or two more players, we recognize that our actions drive the category. So we are more focused on growing the category and growing the business.

Kaustubh Pawaskar: So you mentioned in your initial comments that Nutralite, the growth was largely volume-led and it was a strong volume growth. So you are talking about the quarter or you are talking about the financial year 2017?

Tarun Arora: Quarter specifically but overall for the year as well.

Kaustubh Pawaskar: Sir, in your February 2017 Presentation and in your initial comment as well, you mentioned that there is a launch of Face Wash and in your comment also you mentioned that the relaunch has helped you to see a recovery in terms of sales. So can you just elaborate on that what exactly you have done and how you are planning to go about the Face Wash category as a full?

Tarun Arora: So Face Wash is a category for where we have been losing ground for almost 3-4-years and this financial year gone by and more so in the last quarter we have seen a good recovery on Face Wash. There are a few actions which I listed on – One was the packaging which I think was not working from a consumer perspective, so more contemporary looking packaging, upgrading our products. More importantly, Tulsi Turmeric Face Wash which consumers had liked the earlier when it was launched but there were some learnings which we had on why it was not growing at the pace it could. So we have reformulated it, we have got a clinically tested claim on that which we have got done with the new packaging and stronger go-to-market and it is now getting supported in the TV as well. We have got a very good response. We believe by series of actions both at the product and promotion level we see a larger playing Face Wash at least recovery from where we have been in last 3-4-years.

Kaustubh Pawaskar: What is your current distribution reach and how it has grown on YoY basis?

Tarun Arora: At overall level, we are close to about 800,000 outlets as a company. We are seeing 2-3% growth rates reported by Nielsen.

Kaustubh Pawaskar: Sir, what are you expecting it in FY'18 and '19 your distribution growth because you have your distribution strategy as a whole in FY'17, so now it has been in place?

Tarun Arora: Our focus is two-fold – one is I think by improving our quality of distribution, we are able to place our NPDs better in the distribution. At overall level, it will be a function of the category we are playing. So we are focusing more on the direct coverage at overall reach with Nielsen reports, it maybe just 2-3% but the quality of coverage which is better direct reach, I think we are seeing a better value in our distribution revamp and it syncs in well with our new product launches that we are working on.

Kaustubh Pawaskar: About ActiLife nothing has been heard for last few quarters. So what is the say of the product or whether you are planning to relaunch it with new formula or something like that?

Tarun Arora: We shall share once we are ready in a couple of quarters with the new set of work on that.

Moderator: Thank you. The next question is from the line of Tejas Shah from Spark Capital. Please go ahead.

Tejas Shah: Sir, this quarter we are hearing from a lot of FMCG companies that they are worried about disruption cost by GST transition and especially the wholesale channel. So just wanted your view on the same and what proportion of our revenue is exposed to the wholesale channel as on today?

Tarun Arora: I mentioned in my presentation as well. We obviously see some challenges coming forward both from the organized retail who will be better prepared, there could be wholesale disruption. We will have to see, we will have to take it as it comes. We are preparing ourselves. We are working with our business partners both at the backend as well as the frontend to minimize these disruptions. Wholesale contributes to reasonable portion of our business, maybe 30-35% depending upon various brands have different size and scale of wholesale contributions. But we are working with our business partners, hope to reduce their disruption. But what happens at the industry level, we will have to see.

Tejas Shah: Coming back to your growth momentum, if I see the numbers, which were one of the best numbers in last as many quarters '16 at least, So do you believe that what are the factors which contributed to this kind of growth this quarter? You are seeing them continuing even building in for budgeting in for GST in this year. I do not want the numbers or guidance. But do you see the uptick in the momentum continue in FY'18 as well?

Tarun Arora: So we are driving our business on a series of actions and inputs that we are working on and we believe they are sustainable from a consumer perspective. There will be some challenges which we will face; we had demonetization in Q3, we have GST possible disruption coming forward. So we will take things as they come and manage that environment. But our actions largely driven by what I talk about organic approach on new product launches, expanding our international foray, though very-very small. Some of these actions will continue and build on the business. So, directionally, from a medium-term, I do not see a big challenge in direction of our

work. So we should see a double-digit growth over a period of time, in between some quarters maybe hard, which is more environment-led.

Tejas Shah: Considering the new product development pipeline in terms of variants that we have, are we planning to increase A&P as a percentage of sales that number materially?

Tarun Arora: Nothing as of now. We are trying to balance within our existing budgets and focus more on the portfolio play and that is how we manage even now. But if there is a large exciting NPDs we will take that NP up and share that.

Moderator: Thank you. As there are no further questions, I now hand the conference over to Mr. Tarun Arora for closing comments.

Tarun Arora: Thank you very much and we will reconnect in the next quarter.

Moderator: Thank you. On behalf of Zydus Wellness Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.