"Zydus Wellness Limited Q2 FY15 Post Results Conference Call"

November 5, 2014

MANAGEMENT: **DR. SHARVIL PATEL - CHAIRMAN**
DR. GANESH NAYAK - DIRECTOR
MR. ELKANA N. EZEKIEL – MANAGING DIRECTOR
MR. VISHAL GOR – HEAD OF INVESTOR RELATIONS
MR. AMIT JAIN – CFO

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Zydus Wellness Limited's Q2 FY-'15 Post Results Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Elkana Ezekiel – Managing Director, Zydus Wellness Limited. Thank you. And over to you.

Elkana N. Ezekiel: Good Evening and Welcome to the Post Result Teleconference of Zydus Wellness Limited for the Second Quarter of FY-2015. We have with us, Dr. Sharvil Patel – Chairman; Dr. Ganesh Nayak – Director; Mr. Amit Jain – CFO; and Mr. Vishal Gor – Head of Investor Relations at Cadila Healthcare Limited. During the quarter gone by, on a consolidated basis, our total income from operations was up 5.5% year-on-year to Rs.1,030 million. Our gross margins as a percentage of total income from operations have increased marginally to 69.8% for the quarter from 69.6% during the same quarter previous year mainly due to better realization. Earnings before interest, depreciation, and tax was up by 1.1% year-on-year to Rs.258 million, EBITDA margin stood at 25%. Profit before tax was up 4.6% to Rs.306 million. Excluding the impact of increase in depreciation charge due to revision in useful lives of the assets, growth in PBT was 6.6% year-on-year. Net profit was up by 8.3% to Rs.273 million. Excluding the impact of increase in depreciation charge due to revision in useful lives of the asset, growth in net profits was 10.4% year-on-year.

Let me share some highlights of the operations for the quarter: During the quarter we launched a 1 Re. sachet pack of Everyuth Tulsi Turmeric Face Wash which is a first in India and intended to provide convenience and better access to consumer. Our new initiative of Sugar Free's 'Donate your Calories' was launched where each pack sold will result in a contribution to the well-known NGO Akshaya Patra which runs the mid-day meal program for school children. While this initiative has the social components, this will also encourage consumers to adopt a healthier lifestyle and bring them closer to the brand.

On Nutrilite, to strengthen, we have launched an upgraded base formulation with Omega 3 at the same price. This initiative targeting retail consumers will provide an additional reason for adoption of the brand in a competitive market.

To give you an update on the implementation of our new go-to-market strategy, in the last quarter, we have almost entirely completed implementation of the new distribution strategy.

To summarize – we have replaced company-managed sales representative as the first line of feet on street with distributor representatives managed by a team of company sales supervisors. This will be in line with standard FMCG industry practice. Additionally, we have also consolidated distributor territory and reduced the total number of distributors to ensure that each one has a viable scale and remains engaged in the business. This system though standard across the industry is new to us and will take some time to settle down, especially in the context of the supervision of the distributor representatives, streamlining of their working, and the engagement with distributors who are now more invested in the business than they were earlier. Thank you, and we would now start the Q&A session. Over to the coordinator for the Q&A.

Moderator: Thank you very much, sir. We will now begin the question-and-answer session. We have our first question from the line of Sheetal Bhat from Catamaran Capital. Please go ahead.

Sheetal Bhat: Sir, we came across this range of products, the Zydus Nutriva which has nutritional supplement drinks like GRD, etc., So we were wondering that considering we are a health wellness company, why do not we have these products under our umbrella of Zydus Wellness?

Sharvil Patel: Hi, this is Mr. Patel. That is a different line of business which is more driven towards the medical fraternity in terms of prescription. So this is very highly dependent on the need of every individual patient which is the prescription-led portfolio. So it has less alignment with the kind of business which we do which is not only pharmacy level coverage, but also retail level coverage. So I think these are independent in terms of their ways of marketing and that is why they have not looked into it, and we have something similar which is Actilife, which is something that we want to take forward in terms of Zydus Wellness.

Sheetal Bhat: The reason I asked this is I understand that some of these products are not necessarily prescription-driven like GRD. So just wondering as in why some of the products could not be added to the Actilife portfolio or taken under our umbrella?

Sharvil Patel: We will look into it and we will take your suggestion and also evaluate it to see how much of it as a prescription support versus just basic OTC and then we will take a call to appraise you on that.

Sheetal Bhat: Also under the same GRD umbrella, there is a product called GRD Sugar Free. So considering they are using our brand name of Sugar Free, is there some royalty arrangement or something that we have or any benefit that Zydus Wellness derives out of lending the Sugar Free brand name?

Sharvil Patel: No, we do not have.

Moderator: Thank you. We have the next question from the line of Sonali Salgaonkar from Axis Capital. Please go ahead.

Sonali Salgaonkar: My first question is could we have an approximate segment wise breakup of revenues and margins?

Elkana N. Ezekiel: As a policy, we do not share segment wise margins, profitability and sales, but suffice to say that all the businesses are fairly healthy.

Sonali Salgaonkar: My second question now that we have an update on the distribution overhaul which completed last quarter. Would it be fair for us to assume that the benefits of these will start flowing through from H2 FY-'15?

Sharvil Patel: So I think as Mr. Elkana earlier spoke about it, the alignment of distributors and distributor reps has been done now, at the same time we have also started to focus more on areas where we are getting larger business in terms of geography. So I think you will see some positive growth coming in from the next financial year.

Sonali Salgaonkar: Next financial year as in FY-'16 or the coming quarters?

Sharvil Patel: There will be improvement in the coming quarters but real impact of it will start from financial year FY-'16.

Sonali Salgaonkar: Sir in that terms, just as an extension of this question, would there be any guidance for revenues or margins for FY-'15 that you would like to give?

Sharvil Patel: We do not give future guidance but as you can see we have improvement on quarter-on-quarter happening versus the last quarter, so you will see that improvement, but we do not have specific guidance right now.

Sonali Salgaonkar: Sir just two book-keeping questions with reference to the consolidated balance sheet, there are just two observations that I had and wanted to check on that. Firstly, the short term loans and advances have zoomed up from Rs.46.6 million to Rs.572.2 million in this quarter. Is there any particular reason for that? And would it be fair for us to assume that it will revert back to its normal levels?

Amit Jain: Yes, it will come back to its normal level in the first quarter of next financial year.

Sonali Salgaonkar: So, we would continue to look at these elevated levels in FY-'15, is it right?

Amit Jain: Yes, till 31st March 2015 it will remain, in the first quarter of next financial year it will come down to normal levels.

Sonali Salgaonkar: Any particular reason why it has zoomed up so much?

Amit Jain: Some inter-company loan has been given.

Sonali Salgaonkar: Which we expect the repayment to happen in Q1 FY-'16, is it?

Amit Jain: Yes.

Sonali Salgaonkar: My last question is again consolidated balance sheet the fixed assets over the past 6-months seem to have marginally declined from Rs.954.4 million to Rs.919.1 million. Again, any specific reason for the decline in fixed assets?

Amit Jain: It is mainly depreciation charge which has gone up in line with the New Companies Act 2013.

Moderator: Thank you. We have the next question from the line of Prakash Aggarwal from CIMB. Please go ahead.

Prakash Aggarwal: Just trying and understanding in terms of the strong balance sheet we have, are we looking at any brand acquisition is that our core focus area and that is the reason why we are able to say that fiscal '16 will be much stronger?

Sharvil Patel: So we are actively looking at acquisitions and in most of the publicly available information which is there in terms of brands available-for-sale we have been always participating in it and we hope that we will be successful in buying the right kinds of product for our portfolio.

Prakash Aggarwal: Would it be fair to expect that with alignment of distribution reps and mode also reducing the number of distributors, we could see the cost also going down and sales to increase, is that a fair assessment or?

Elkana N. Ezekiel: The way we are working with the distributors is because they are investing for the first time in our business, there is some amount of support that we are providing to them to bridge the additional expenses, particularly on the manpower front. In the medium to long term, we expect that the cost will come down.

Prakash Aggarwal: So is this a new set of distributors or we are pruning our existing set of with a more focused approach?

Elkana N. Ezekiel: In most cases, we have consolidated the original set down to a smaller group, in a few cases when there was a need, new distributors were added, but by and large we have retained the original sets.

Prakash Aggarwal: And last understanding question is in terms of our advertisement and sales promotion expense, every first quarter we have a higher spend and then it starts to moderate. So is this a planned one and why that strategy?

Elkana N. Ezekiel: It is a planned one, because this is in line with the seasonal nature of the markets that we operate in. The Skin Care market tends to peak in the summer months.

Prakash Aggarwal: Since we have already started to see some growth on a sequential as well as y-o-y perspective, as you rightly said, quarter onwards you will start seeing some growth but fiscal '16 is where we could expect some very broad level double-digit growth?

Elkana N. Ezekiel: Yes.

Prakash Aggarwal: Any color on operating margins?

Elkana N. Ezekiel: No, we do not have any guidance.

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

Tejas Shah: Just wanted to check if you can run down us through category wise growth rate and market share that we have at the end of the first half FY-'15?

Elkana N. Ezekiel: The category growth rates we can share with you; in the case of Face Wash, the category is growing at about 17%, in fact the market size is about Rs.1,475 crores right now, the Scrub category is growing at 15% and the size of the category is Rs.196 crores and the Peel-offs segment is Rs.70 crores in size and it has declined at 6.7% on a 12-month basis. This is for the 12-months ended September as reported by Nielsen.

Tejas Shah: And sir would there be any number for Sugar Free on this?

Elkana N. Ezekiel: The Sugar Free market size is Rs.296 crores and it has grown at 12%.

Tejas Shah: Would it be fair to assume that the market share would have remained stable at least in last 2-3 quarters?

Elkana N. Ezekiel: Yes, that is fair.

Tejas Shah: And we are not gaining market share either anywhere?

Elkana N. Ezekiel: No, they are more or less stable.

Tejas Shah: Sir, just wanted to get your sense on this whole distribution rejig initiative that we started a couple of quarters back. If I recall numbers correctly, we were trying to consolidate from some 3000 odd distributors to 1000, but it was supposed to happen in a gradual manner, so in that whole process are we done with the whole process of pan India?

Elkana N. Ezekiel: We have been following the timetable, in fact, we ran a pilot in seven cities starting October last year and we have gone national from the month of April-May this year. So we are on track as far as our timetable is concerned. What I said earlier still holds which is this system is a standard operating practice in the industry and we are new to it hence it is taking some time for us to settle down.

Moderator: Thank you. We have the next question from the line of Ranvir Singh from Sharekhan. Please go ahead.

Ranvir Singh: On margin front, just if you could indicate that second half, can I expect to be better than 1st half in terms of operating margin?

Elkana N. Ezekiel: We are not giving any such guidance.

Ranvir Singh: So not to be specific, but just I wanted some indication, whether the Q-o-Q traction which we have seen in this quarter is sustainable or how it will be?

Sharvil Patel: Currently, we are not able to give the guidance because our marketing plans are underway for the calendar year launch for many of our products.

Ranvir Singh: Any guidance for tax rates for FY-’15 and ’16 if possible?

Amit Jain: Tax rate will broadly remain at the current level at around 9% to 10%.

Ranvir Singh: And the alignment we are talking about that distributors and reps, whether the impact of this is partly reflected in this quarter or it has just started and more is to be seen in latter course of time?

Elkana N. Ezekiel: It is partially reflected in this quarter because one of the things we had to do when the distributors were consolidating was to take back some of the stocks which was lying in excess. So there is a pipeline opportunity lost in terms of sales and it will take some more time to get completed.

Ranvir Singh: We saw in Everyuth segment though the competition is still there. Whether we have been able to protect our market share here in this segment?

Elkana N. Ezekiel: We more or less have held market share consistently for the last 1.5 to 2-years, there has been competition. which has come and gone including some international players, and there are pockets of regional strengths, but broadly speaking, our market shares remain fairly consistent.

Moderator: Thank you. We have the next question from the line of Amit Purohit from Dolat Capital. Please go ahead.

Amit Purohit: I understand you do not give segment wise breakup, but I just wanted to know which is the segment which grew the fastest in this quarter, was it Sugar Free for sure in terms of growth?

Elkana N. Ezekiel: Yes, Sugar Free has grown the fastest.

Amit Purohit: The numbers that you talked about sir 12%, this is referring to the growth for us or for the industry as such?

Elkana N. Ezekiel: That was the category size for the industry as reported by AC Nielsen on a 12-month ended September basis.

Amit Purohit: And we took a price increase in mid of first half. So you are saying 12% was a category growth when you say 12% category?

Elkana N. Ezekiel: That is right.

Moderator: Thank you. We have the next question from the line of Sheetal Bhat from Catamaran Capital. Please go ahead.

Sheetal Bhat: Sir, wanted to confirm with you that the market share numbers that you just shared are at the company level or are at the retail level? And two, that if you could give us some color on the Sugar Free sales either by geography or where the customer lies, is it a psyche customer or urban customer, etc.,?

Elkana N. Ezekiel: The category data which I shared is basically the size of the category as reported by AC Nielsen on a 12-months ended September basis and the growth data they reported is for the category for the same period.

Sheetal Bhat: Sir if you could also tell me about the Sugar Free, what kind of customer do we target or what is the distribution by region in India, any color on that?

Elkana N. Ezekiel: The product is available in about 295,000 outlets across the country and this is a combination of direct and indirect distribution. In terms of the brand's appeal, it appeals to two distinct consumer sets – one is people who are suffering from lifestyle diseases like cardiovascular problems, diabetes and so on and they are the intuitive and natural audience for the brand; second is the set of consumers who are lifestyle conscious and basically trying to live a healthier life in terms of reducing their stress levels, sleeping more, eating healthy and generally maintaining their body weight, that is why Sugar Free has a role to play. In terms of region wise, again, I would not be able to share the information here at this point of time.

Sheetal Bhat: The short term loans and advances that are on the balance sheet, which company have we given them to and at what interest cost is this loan at?

Amit Jain: That loans and advances is given to some Ahmedabad-based company and it is short term in nature and the rate of interest is 13%.

Sheetal Bhat: Sir, is this a related party?

Amit Jain: No.

Moderator: Thank you. We have the next question from the line Raj Mehta from PPFAS Mutual Fund. Please go ahead.

Raj Mehta: First one was that you have launched a cheaper version of Nutrilite that is Nutrilite Omega. Is it due to the competitive pressure? And what would be the price differential between the Nutrilite and Nutrilite Omega?

Elkana N. Ezekiel: The Omega-3 product that we launched is not a discount product, it is actually a premium product which was launched in January 2013, specifically targeting a premium consumer who has a more evolved health need. That product was launched at the price of Rs.90 versus Rs.55 for tubs of 200 grams.

Raj Mehta: And what is the response that you are getting for Actilife in the market?

Elkana N. Ezekiel: Actilife is fairly flat right now.

Raj Mehta: Another was the Piramal distribution deal with Equal. How does it affect our market share in the Sugar Free segment?

Elkana N. Ezekiel: If you look at the market share data in the last 3 to 4-months the Equal market share has come down, they were at a high of 1.8 as of June 2014, they are now down to 1.2 in September.

Moderator: Thank you. We have the next question from the line of Sonali Salgaonkar from Axis Capital. Please go ahead.

Sonali Salgaonkar: Sir, just one follow up question from me. You mentioned that Sugar Free category has grown the highest amongst the three categories. So just wanted to understand the gross margins have improved by only 20 bps year-on-year for this quarter. So just wanted to understand why would the gross margin not improve more than what it has improved while Sugar Free which is a high profitability segment has grown the sharpest?

Elkana N. Ezekiel: Overall Nutrilite has also done well and in general has a lower margin than Sugar Free. That has impacted the business.

Moderator: Thank you. We have the next question from the line of Deep Shah from Corporate Database. Please go ahead.

Deep Shah: I am Deep Shah from Corporate Database. I just wanted to like, what is the capacity utilization that we are running right now?

Amit Jain: It is about 55% at present.

Deep Shah: When do you expect we can use the capacity fully, is there any plans for that?

Elkana N. Ezekiel: It will be a function of how quickly we grow, but we expect that it will be good enough for the next 3 to 4-years.

Deep Shah: For next 3 to 4-years, we do not need to add any CAPEX?

Elkana N. Ezekiel: Absolutely.

Moderator: Thank you. As there are no further questions I now hand the floor back to Mr. Elkana Ezekiel for closing comments. Over to you, sir.

Elkana N. Ezekiel: I want to say thanks to all of you and we will meet again in the next quarter.

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