



“Zydus Wellness Limited Q2 FY-19 Post Results Conference  
Call”

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**MR. NITIN PAREKH – GROUP CFO, ZYDUS WELLNESS LIMITED**  
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**Moderator:** Ladies and gentlemen good day and welcome to the Zydus Wellness Limited Q2 FY19 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 the conference call, please signal an operator by pressing ‘\*’ then ‘0’ on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Tarun Arora – Chief Operating Officer and Whole-time Director, Zydus Wellness Limited. Thank you and over to you sir.

**Tarun Arora:** Good evening and welcome to the post result teleconference of Zydus Wellness Limited for Quarter 2 financial year 2018-19 as we have with us Dr. Sharvil Patel - Chairman, Mr. Ganesh Nayak – Director, Mr. Nitin Parekh – Group CFO, Mr. Umesh Parekh – CFO and Mr. Vishal Gor – Vice President (Corporate Finance) at Cadila Healthcare Limited.

As you are all aware that we have entered into a definitive agreement to acquire 100% of equity shares of Heinz India Private Limited, the subsidiary of Kraft Heinz jointly with Cadila Healthcare Limited on October 24, 2018. This acquisition offers us the right fit in terms of well-entrenched brands in the fast-growing categories of food, nutrition and skin-care. It will be an ideal addition to Zydus Wellness portfolio supporting our aspiration to grow in the consumer wellness space by providing multiple choices to consumers and leapfrog amongst the leading FMCG companies within India. It will create and enhance infrastructure and distribution reach for Zydus Wellness which will have a combined strength of five manufacturing facilities, 1800 distributors and nearly 2 million consumer touch points. We look forward and welcome the employees, consumers, partners and all stakeholders of Heinz India to the Zydus family.

Let me further shares with you the highlights of quarter gone by:

The quarter gone by has seen good growth largely led by Everyuth and Nutralite brands. As a result the company reported consolidated income to operations of Rs. 138.21 crores representing growth of 11.9%. Our domestic sales growth stood at 12.2%. The reported profit after tax stood at 41.41 crores. During the quarter gone by our key brands namely Sugar Free, Everyuth Scrub, Everyuth Peel Off have maintain leadership positions have maintain leadership positions in their respective categories.

Coming to the consolidated financial performance of Quarter 2, financial year 201819; the terms adjusted income from operations EBITDA, PBT and PAT exclude central capital subsidy income of Rs. 1.6 million recognize during the Quarter 2. The adjusted total income from operations has increased by 11.7% year-on-year to Rs. 1380.6 million. Our reported EBITDA was up by 10%, however, adjusted EBITDA was up by 9.5% year-on-year to 38.37 crores. Adjusted profit after tax was up by 12.7% to 46 crores. Adjusted net profit was up by 13.9% to 41.28 crores. With this Quarter 2 performance our half year growth of total income from operation stands at 18.4% on a GST comparable basis and excluding one-offs. Adjusted net profit was up by 24.1% excluding one-offs.

With that let me share some of the highlights of operations for the quarter gone by:

We continued our thrusts on marketing initiatives to grow the categories and market share of our brands during the year. To narrate a few; on Sugar Free brand during the last quarter we invested behind brand through a media campaign to drive new Sugar Free thematic TVC, launched a new TVC campaign which was about increasing relevance and rallying up safety credentials around the brand using engrossment of WHO and USFDA for the sugar substitute category. This is the first time ever that Sugar Free is building on safety credentials on TV. Sugar Free Green Veda launch was further amplified through a new TVC campaign for the product coupled with branding and sampling drives in stores in key outlets in key cities. We also launched a new range of packaging across the entire Sugar Free portfolio to harmonize the complete product range and sub-brands. As we speak, we have launched our new product Sugar Lite, a 100% natural blended sugar but with 50% less calories than normal sugar. It is a unique product, first time in the industry that has taken a more than a year to develop. It is being launched on a digital medium first and will be followed by other trade channels. We believe it has the potential to become a major business driver going forward.

On the Everyuth front during the quarter gone by of, Everyuth has continued delivering good growth across all segments. We have continued to support all our segments through various campaigns to drive the category penetration. The tan removal range of products was backed by various media campaign create visibility drives through gritty advisors and promoters thereby establishing the new range on ground.

On Nutralite front, Nutralite has continued to deliver good volume growth largely led by institutional segment with retail segment also showing a positive progress. We have continued to focus on investing behind Nutralite Mayo through various ongoing campaigns supported with print media and sampling in key cities.

On the international business front, we continue to build our presence in international markets during the quarter with the export of Nutralite in new markets like Qatar and Sri Lanka. We have also launched Sugar Free Delight Chocolates in Middle East countries like Bahrain, Oman and UAE. As per MAT September '18 report of Nielsen, the Sugar Free substitute category growth rate was at 1.3%. Sugar Three has maintained its number one position with a market share of 93.9%. The scrub category has grown by 13.1%, Everyuth Scrub has maintained its number one position in the market share of 32.6% which is an increase of 90 basis points over the same period last year. The Peel Off Mask category has grown by 17.8%. Everyuth Peel Off Mask has maintained its number one position with the market share of 84.7%.

To conclude sharp positioning, consumer led innovations and a strong sales and distribution capability have helped build a sustainable growth momentum for business over the last few quarters with the new acquisition using the same fundamentals that is Wellness will emerge as a stronger and sizable consumer wellness player in the market delivering value to all its

stakeholders. Thank you and we will 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 Sameer Raj from Reliance Mutual Fund. Please go ahead.

**Sameer Raj:** I have two sets of questions, one on the existing operations. So, if one looks at growth rate this quarter, the lowest in last five quarters, any particular reason may be its due to festive season so if you can clarify that? And also you can clarify the sharp increase in employee cost for this quarter. And my second set of questions related to this acquisition. So, if you can throw some light on what is going to be the exact financing structure, whether it's going to be joint acquisition within us and Cadila Healthcare and how it's going to be EPS accretive for the company? And also if you can throw some light on what kind of payback is there you expect for this acquisition.

**Tarun Arora:** Let me take the first question on the growth for this quarter. I think growth for this quarter has to be seen in the context of what happened last year with the base effect where we had a very low quarter in Quarter 1 and much better Quarter 2 as the numbers came back with the stock refilling of our trade channels. Sequentially it is in fact much better than the last 3-4 years where we have had a 2% to 3% improvement on sequential basis for this quarter. This is just a base effect which shows slightly lower growth than what we have seen in last five quarters and we believe the momentum to continue. At 12% I think we will maintain the double-digit as we have always promised you, just the difference in the base effect to our current quarter versus last quarter and we should look at therefore a half year one as combined numbers.

**Sameer Raj:** Employee cost if you can just throw some light because employee cost has gone really sharply this quarter.

**Umesh Parikh:** In the employee cost as compared to the last year, last year there were certain vacancies during the quarter that have been filled up and there is certain HR expansion which has taken place and therefore you see a growth in employee cost this quarter

**Tarun Arora:** And that is the second element also that there are these temporary which we had also mentioned for our promotions on the Everyuth category we employ under the marketing promotion certain people on a temporary basis that gets into employee cost.**Sameer Raj:** So, this quarter they are slightly elevated and they will get normalize in the future quarter, is it correct trend to read?

**Tarun Arora:** That's how we will anticipate that, at least for the beauty advisors fees. As far as new people that we have filled up the vacancies its fine that will sustain.

**Dr. Sharvil Patel:** Let me give you a background of the acquisition is. The acquisition of Heinz India brands which include Complian, Glucon D, Nycil and Sampriti, give us the great opportunity in creating scale and strong presence for Zydus Wellness. Combine together the market is valued

at 11,000 crores while the Zydus Wellness gets a share of 15% in the combined market with strong revenues increasing is three times to 1700 crores and the combined EBITDA of 350 crores. This helps us concentrate our position into the nutrition health segment.. The purchase price consideration for this was 4595 crores which is at a significant discount to current listed Indian consumer peer and in line with precedent consumer healthcare transaction. From our point of view looking at the strong cash flows and the business profitability of this business is we are very confident on the earnings growth and with the prudent financial discipline we are looking to fund the transaction for 1/3<sup>rd</sup> of the transaction will be done through debt and 2/3<sup>rd</sup> by equity.

**Sameer Raj:** But any structure we are able to finalize if you can throw some more light whether it will be 100% acquisition by Zydus Wellness or even Cadila Healthcare....

**Dr. Sharvil Patel:** We have 100% acquisition by Zydus Wellness. The further details in terms of exact structure will be decision made by the board and the management will provide certain options to the board. So, as I said it will be 1/3<sup>rd</sup> debt and 2/3<sup>rd</sup> equity and more details of it will be able to share once we are able to have the discussion with the board and get clearance from the board in the next few days.

**Sameer Raj:** The couple of more things on acquisition if I can just get clarification from you. What has been the past growth rate of this entity in the last 2-3 years and the numbers which you said are for which particular year?

**Dr. Sharvil Patel:** The numbers are for that entity is July '17 to June '18.

**Sameer Raj:** And what has been the past growth rate of this entity?

**Dr. Sharvil Patel:** I think it will be around 7% to 8% CAGR.

**Sameer Raj:** What kind of payback we would expect for this acquisition like we would expect your investment to...

**Dr. Sharvil Patel:** Once the structure is finalized and the financing finalize, we will be able to give you the exact payback. But as you said we are very confident with the strong growth in profits that we see with the combined entity, the structure will be efficient from that point of view. And if you look at specifically this last 6 months then the growth is 12% now for this business.

**Sameer Raj:** That's improving growth rate?

**Dr. Sharvil Patel:** Yes.

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

**Tejas Shah:** Just wanted to know the flagship brand of the acquired entity which is Complian, the HFD category itself had a very struggled in recent past and things are improving largely led by leader in last four quarters also. So, just wanted to understand your thoughts on the category and how you are saying the long growth runway on the category.

**Dr. Sharvil Patel:** So, first the largest brand among the four brands is Glucon D and not Complian. However the big potential in terms of turnaround is for the Complian brand. We see multiple opportunities for many of these brands. First I mean the legacy of all of these products has been pharmaceutical and they have been a strong problem solution oriented products that have been developed erstwhile owned by GSK. So, we see tremendous potential in terms of bringing more innovation and science into in many of these brands and specifically Complian. Complian the whole category has been challenged because in the last couple of years when the companies are looking to divest obviously you see suppression of promotional spends and creating pool in the market. So, I think because large brands are getting transacted there was a slowdown in terms of how do we create further penetration into the business. If you look at these brands the penetration levels are still very low whereas the recall levels of these brands are above 90%-95% so there is tremendous understanding of the product but very little promotional input that has gone into some of these brands. Also specifically for Complian the whole segmentation has not been done which has been done by other leaders in this category. So, looking at different age groups and brain solution oriented products catered to the different needs of the different age groups as well as the immediate needs that are necessary, you can see significant amount of segmentation that is possible by which we can launch more innovative portfolio and build different segment for the whole MFD category. So, that also provides tremendous amount of opportunity. I think from Zydus' point of view being strong and innovation and trials we will build on that and be able to launch more tailor-suited product for this with enhanced science and value that we can bring to the consumer. So, we will look at the top of the pyramid, bottom of the pyramid, the rural expansion that we intend to do for these brands which has not been done before. So, lot of those things are going to unlock value for Complian, Glucon D brand.

**Tejas Shah:** Based on the numbers that we have, is it a fair understanding that Nycil would be the fastest growing brand among the acquired portfolio and the Complian would have some de-growth in the recent years.

**Dr. Sharvil Patel:** No, Glucon D and Nycil have been growing better than the market in what they represent and have gained share and in Complian while the last 7-8 years they have lost share, in the last 6 months they have been growing in the double-digit.

**Tejas Shah:** Second the Ghee brand it doesn't sync with at least the way we understand with your overall functions food portfolio and the personal care portfolio that we have. Do you have an option and are you okay divesting some of the acquired portfolio brands in future?

**Dr. Sharvil Patel:** First and foremost, I think all brands have a strategic rationale for Zydus so I don't think that I would not completely agree with the statement that you just made. If you look at the whole Complian and Glucon D segment they represent significantly and our Sugar Free and Nutralite as a food's category we have become very significant and relevant. Also they are all targeted towards the mother and the family and obviously the youth for majority of them are for the children. So, there is a great synergy in terms of how do we build value proposition for this segment in this area. Also if you look at from a historical point of view the science backing that these brands have had legacy brands and how Zydus also continues to do so will be very significant. On Nycil side our Everyuth and Nycil will have a great synergy in terms of portfolio and we will be able to push strongly in the cosmetic and other channels strongly. If you look at our distribution, the strong distribution that gets generated because of our grocers in or and some of those channels on the Heinz portfolio side versus the chemist cosmetic stores and modern format from Zydus side will bring significant synergies to improve penetration and drive better sales, better growth for all of the brands together. Even the Sampriti Ghee brand which we have and the Nutralite butter substitute we have significant synergies in going B2B market and also potentially build the B2C market there. So, we do not see any of them being non-core to us and we can see value creation for majority of the three brands there including Sampriti as well.

**Tejas Shah:** If you can share some details on the team structure of the acquired entity and how are you planning to run it, would be a separate entity because I believe on media you mentioned that it might another subsidiary so if you can share some details on that.

**Dr. Sharvil Patel:** So, it has about 800 people based with the party manufacturing and then the office's end and the frontend salesforce. We intend to run it is as it is right now with helping add resources in terms of certain experts and certain strategy consultants to make sure that we are aligned on terms of the midterm and long-term strategy for this brand. But the current team that we inherit will run the business and the team has been build over the last one year or so and we are confident that this team can drive value and we will hope to supplement it by bringing in some resources from our side.

**Moderator:** We have our next question from the line of Kaustubh Pawaskar from Sharekhan Limited. Please go ahead.

**Kaustubh Pawaskar:** Just moving to the acquisition front, you just mentioned that in Complian in HFD category there is lot could be done and obviously would be focusing on how the brand sales and prospects would enhance. So, in that terms obviously you would be spending more on promotional and advertisement front, so initially should we expect it will result in reduction in margins because the focus would be more on realigning the distribution, more on promotional fronts and how you will be looking at each brand to improve the penetration? So, initially should we expect margins to be on the lower end because higher spends would be on the advertisement and promotional front?

- Dr. Sharvil Patel:** I think collectively the total A&P spends for the business we will have substantial amount of value as total and I think with we would be able to bring significant synergies in buying because of the large base that we will be able to create so that will definitely help us create better value of the dollar or the rupees that we are about to spend. So, currently I think he is some of these categories like Complian definitely will need more input. But I think in the overall scheme of things we should be able to bring good synergies to be able to maintain a steady momentum which is led by sales growth and then obviously driven by A&P spend.
- Kaustubh Pawaskar:** And just one clarification, in the press release of the acquisition you mentioned that the acquisition would be earnings accretive. So, can you just clarify of whether it is going to happen immediately or it will take some time for the accretion.
- Dr. Sharvil Patel:** It will take some time. Immediately it won't be because there will be a debt on the company. But with the strong cash flows that we will generate over a period of time it will be accretive.
- Kaustubh Pawaskar:** And can you throw some light on how the working capital of the acquired company because you have a negative working capital and obviously have a strong cash flow so how the working capital of the acquired company would be?
- Dr. Sharvil Patel:** They have a similar working capital like us; they are also negative working capital.
- Kaustubh Pawaskar:** Again on the performance front, can you just share the growth rates of the each category I have just missed that?
- Dr. Sharvil Patel:** I won't have the growth rates of each category.
- Kaustubh Pawaskar:** For Zydus Wellness, Sugar Free, Peel Off Mask.
- Dr. Sharvil Patel:** We don't give individual growth rates. But in this quarter Everyuth and Nutralite have had a significant growth; Sugar Free has had low growth because of a larger base last year in the preceding quarter compared to this quarter because of GST and the trade push that we have done.
- Kaustubh Pawaskar:** So, Sugar Free should come back on...
- Dr. Sharvil Patel:** This quarter.
- Kaustubh Pawaskar:** Better growth from Quarter 3, is it a right understanding?
- Dr. Sharvil Patel:** Yes in fact Sugar Free has done better than last quarter. It's just a base effect that its numbers are lower otherwise the momentum is pretty good. Last year Quarter 1 had gone down significantly lower and Quarter 2 been much better that's the reason of growth being not so balanced.



- Kaustubh Pawaskar:** On the margin front this first half the margins have almost been flat on YOY basis across margins and with input cost rising, so what's your take on the margins? Are we looking for any price increase in the coming quarters?
- Dr. Sharvil Patel:** I think you have to also have to understand that we do operate a strong margin above industry averages and so from that point of view we have been able to maintain margin in spite sometimes the input price increases on certain area. So, we continue to make sure that we remain efficient in terms of obviously improving margins but we must understand that we are at strong margin right now.
- Moderator:** We have the next question from the line of Akshat Vyas from India First Life. Please go ahead.
- Akshat Vyas:** Just a clarification in your earlier call you had mentioned that this acquisition which is a 4594 it will be done in terms of 2/3<sup>rd</sup> equity and 1/3<sup>rd</sup> debt, right?
- Dr. Sharvil Patel:** Yes.
- Akshat Vyas:** And this is 100% acquisition by Zydus Wellness, right?
- Dr. Sharvil Patel:** That's correct.
- Moderator:** We have the next question from the line of Anirudh Jain, individual investor. Please go ahead.
- Anirudh Jain:** My question is regarding integration of Human Resource, so basically Heinz is a MNC and their salary structure will be pretty much different from ours. So, how things are going to pan out there, any clarity on those factors?
- Dr. Sharvil Patel:** No, so one is we don't have all those details right now to give you an informed view. But our current thesis on this is that business will be run independently right now and the current team that we are inheriting is obviously currently doing a good job in the last couple of quarters and we continue to build on that and make sure we continue to grow in the coming season.
- Anirudh Jain:** We recently launched Delight chocolates in export market, so instead of export market why we didn't start it with Indian market?
- Dr. Sharvil Patel:** It's a very premium priced product and we see an immediate opportunity in terms of the pricing from export point of view. Once we are able to scale it up and bring it and make it right we might also launch it in India.
- Moderator:** We have the next question from the line of Jignesh Makwana from Asian Market cap securities. Please go ahead.
- Jignesh Makwana:** Just want to know since now we have full fledged presence into the HFD category so can we expect ActiLife to be brought back into our system?

- Dr. Sharvil Patel:** As part of the strategy we are evaluating all opportunities. ActiLife is meant for the adults and it has also great therapeutic benefit. We are evaluating all opportunities and once we are clearer we will be able to guide you on that.
- Jignesh Makwana:** And when can we expect these deal structure and deal funding will be finalized and when can we start consolidating the numbers?
- Dr. Sharvil Patel:** Quarter 4 of FY19 is when the deal will get closed so we will start consolidating after that.
- Jignesh Makwana:** On better substitute category, what was the growth on the category level and how is our market share in that front?
- Dr. Sharvil Patel:** On that we don't get category information from Nielsen so it's very difficult to give. But we have significant double-digit growth and we keep on improving our share.
- Moderator:** We have the next question from the line of Bhavya Sanghvi from Fortress Group. Please go ahead.
- Bhavya Sanghvi:** My question would be on Sugar Free Green. I wanted to know how is the product building up in the market and could you throw some light on how it received in this quarter?
- Dr. Sharvil Patel:** Sugar Free Green is on its own as a franchise reached the market share of 3%. We have seen a sequential improvement in the numbers on Sugar Free Green so we are seeing a good adoption on Sugar Free Green.
- Bhavya Sanghvi:** What would be the percentage...has the international revenue got up to a certain level that you could be reported, is it reached that level?
- Dr. Sharvil Patel:** No, its 3% to 4% of sale right now but it is growing very fast. But I think you will take three years when it will become significant.
- Moderator:** Thank you. Ladies and gentlemen that was the last our question. I now hand the conference over to Mr. Tarun Arora for his closing comments.
- Tarun Arora:** Thank you everyone and wishing you a very happy Diwali. We will connect next quarter. Thank you very much.
- 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.