"Zydus Wellness Limited Quarter-3 FY '20-21 Post-Results Q&A Session with Analyst and Investor Conference Call"

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the Zydus Wellness Limited Quarter-3 FY '20-21 Post-Results Q&A Session with Analyst and Investor Conference Call. If a participant is connected on both the webcast and the audio bridge, you are requested to mute the audio from the webcast to avoid echo. To ask a question, participants are requested to click on the link for instructions to dial into the audio call. I now hand the conference over to Mr. Tarun Arora, CEO. Thank you and over to you, Sir.

Tarun Arora: Thank you. Good Afternoon and Welcome to the post results teleconference of Zydus Wellness Limited for Quarter-3 Financial Year 2020-2021.

We have with us Dr. Sharvil Patel – Chairman; Mr. Ganesh Nayak – Director; Mr. Umesh Parikh – CFO; and Mr. Vishal Gor – Senior Vice President (Corporate Finance) at Cadila Healthcare Limited.

With the festival season kicking in during the quarter and continued revival of the overall economy, the quarter gone by witnessed strong surge in growth rate of our business as well. Most of our major brands have witnessed double digits sales growths as a result of which we recorded a strong growth of 15.6% at net sales level for the quarter and 14.7% at total revenue from operations. The reasons for lower growth and total revenue from operations level during the quarter is due to lower other operating income in the form of GST budgetary support as the same is discontinued for our Sitarganj plant from December 2019 onwards. In continuation with our strategic initiative to pay down debt of the company during the quarter, the company has fully redeemed non-convertible debentures of Rs. 15,000 million. In the process of buying back its own non-convertible debentures, the company has paid one-time debenture redemption premium of Rs. 1321 million out of which Rs. 342 million is regarded as exceptional item in our financials for the current quarter. To support the redemption of non-convertible debentures, company has taken low-cost debt of Rs. 5650 million bearing the interest of 5.01% per annum.

Let me take you through the highlights of the consolidated financial performance of Quarter-3, Financial Year 2020-21:

During the third quarter of Financial Year 2020-21, our total income from operations stood at Rs. 3816 million up by 14.7%. EBITDA was up by 32.7% year-on-year to Rs. 495 million, PBT after exceptional item was up by 131.9% year-on-year to Rs. 17 million. Net profit was down by 59% year-on-year at Rs. 17 million. With that, let me share some of the highlights of operations for the quarter gone by.

We continued our thrust-on marketing initiatives to grow the categories and increase market share of our brands during the year. To enumerate a few:

On the Glucon-D front, during the quarter, new product Glucon-D ImmunoVolt witnessed good traction in the market, TV and digital media were used to drive awareness of the Glucon-D ImmunoVolt. Glucon-C Immuno Fizz was launched in December '20 to tap the market of immunity booster products in our effervescent format. The launch will be supported with digital initiatives.

On the Complan front for the first time over three years, Complan reach as per Nielsen has crossed 5 lakh outlets. We continue to invest behind the brand through consumer offers of DC comic superhero figuring. To participate in the sachet market targeted towards South and East, we launched Complan 18 grams sachet at Rs. 5 per pack.

On the sweetener front, during the quarter gone by, Sugar Free has witnessed a strong double digit growth backed by consistent investments in mainline and digital media, innovative campaigns like Sugar Free Chef activation on Diwali and 21 day no sugar challenge were launched on digital media.

Sugar Free also launched Sugar Free D'lite Chocolate in domestic market through e-commerce platform which was supported with a holistic digital campaign active across search, social medial, influencer activation, and marketing initiatives across e-commerce portals. Sugarlite witnessed a strong growth during the quarter, the growth was supported through media along with impact properties covering TV, print, and digital medium.

A unique influencer led Sugarlite screen test campaign was executed in digital during the festive season to build advocacy and adoption. On the Nycil, the brand further extended itself into a new format of sanitizing wipes building on the previous launch of hand sanitizer.

On the Everyuth front, emerging out of the COVID blues, the brand has posted a strong double-digit growth backed by investments in TV campaigns for the flagship face scrub and peel off mask portfolios to boost the consumer demand. The new launch of aloe vera gel was also supported with a digital campaign.

On the Nutralite front, the brand witnessed further recovery and has reached to 90% of pre-COVID levels. We have seen sequential improvement across the portfolio including institutional business, we are hopeful that we will be able to come close to the normal level by the end of Quarter-4.

Mayo portfolio specifically retail business delivered good performance because of increase demand for the category. Nutralite chocospread which was launched in July '20 continued to delivery steady business in e-commerce and modern trade channels.

On the go-to-market front, we are in the face of taking our direct reach to half a million outlets by end of Quarter-4 as a part of Project Vistaar. By end of December '20, we have already crossed 4 lakh outlets serviced by our Speed Post. This is being supplemented with digitization of our content concept. E-commerce continues to grow rapidly at 240% for the quarter, Modern trade has also seen sequential recovery.

International business has seen a growth of more than 300% during the quarter and the integration of all Complan markets is complete now. International business contributed about 3% of the total revenue.

As per MAT December '20 report of Nielsen, Glucon-D has maintained its number one position with a market share of 58.3 in the Glucose powder category. Complan has a market share of 5.5% in the MFT category, Nycil has maintained its number one position with a market share of 35.7% in the prickly heat category which is an increase of 213 basis points over the same period last year. Everyuth scrub has maintained its number one position with a market share of 34.8% in the facial scrub category, which is an increase of 82 basis points over the same period last year.

As the worst seems to be over, we foresee further improvement in the economic environment. We are fully prepared with the increased demand for Glucon-D and Nycil due to onset of season. We see growth momentum continuing for all our brands in the coming Quarter-2.

Thank you and we will now start the Q&A session, over to the coordinator for the Q&A.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin the question and answer session. The first question is from the line of Tejas Shah from Spark Capital. Please go ahead.

Tejas Shah: Hi team thanks for the opportunity and congrats on recovery on numbers, Tarun you spoke at length about our interventions, in fact you have been highlighting for a while on the intervention that we are making on distribution, branding, NPDs, so if we have to breakup the recovery in the quarter would we attribute more to distribution or underlying demand is also showing good recovery or it is NPD, if we have to rank the drivers in terms of contributing to the recovery in the quarter?

Tarun Arora: That is a hard one but having said this I think both demand growth as well as distribution our interventions both together have contributed. The good part is that this growth has come despite Nutralite not growing in itself substantial portion in this quarter, so we are quite positive about both the macro environment as well as lot of work which the team has put in place to make this happen.

Tejas Shah: So is it fair to assume that the distribution interventions or expansions that we have made is yet to show in numbers and we can expect much better momentum from that driver alone in coming quarters?

Tarun Arora: No, not really because I think distribution expansion is already showing its momentum because like I mentioned that while a reasonable portion of our business despite being under pressure we have been able to move, a good example is the Complan which is after at least three to four years or maybe longer, has crossed 5 lakh outlets as per Nielsen, so that is a clear reference of our reach really building up for the brand and improving the momentum for the brand. we have seen a good traction for the brand, so some of these things are already showing up even in external data.

Tejas Shah: Sure, second we launched nine products in 2020, if you can comment on hits and misses based on the performance so far?

Tarun Arora: So these two of them are very, very recent Immuno Fizz and sanitizing wipes, so it is early days but yes the journey is harder in some of these. In terms of things that are shaping up well within what we have launched, I think ImmunoVolt and chocolate spread are giving me the most confidence in building up well. Sanitizer has slowed down, actually it built up pretty well but I think the whole category has slowed down so badly and there is such a substantial proliferation of the brand that it is now doing much less than one would expect it to do, but we are on the grid looking at building it at as a portfolio, but it will take some time before we can decide which way to go, we had a long-term view on it but with such a large ramp up of so many local brands and so many other initiatives, we will have to see how it shapes up, but the immunity platform with ImmunoVolt as well as chocolate spreads are Nutralite, I think they are building up on a consistent platform right now. We are very positive about what we are launching in this quarter on Nutralite.

Tejas Shah: Are you referring to ghee?

Tarun Arora: Yes, Nutralite Doodh Shakti range.

Tejas Shah: On gross margin since acquisition and merger, this is first quarter when we are seeing YOY improvement in gross margin, you called out benign milk prices is one of the drivers, so what is the outlook on raw material prices and margin pressure at gross margin level?

Tarun Arora: At an overall level our exposure on commodity is substantial, so while milk has been better than last year, but we see the inflation coming up, but I think we should be in control as far as milk is concerned we should be in sync with what we have been doing over last few quarters. Sugar and DMH are also fine, I think the only concern right now as I see over and I cannot really predict a very long term, but over next couple of quarters, the only raw material which is worrying me is palm oil which is at a very substantially higher than normal levels, so that could have some level of impact, most other input at acceptable level and in sync with what historical numbers are, so we should be okay with that.

Tejas Shah: Did we take any price hike in the quarter?

Tarun Arora: In the last quarter no, but going forward we are planning to take.

Tejas Shah: Last one for Umesh, in today’s budget Honorable FM announced that goodwill no longer will be allowed to be depreciated or amortized in the tax books, so any impact or calculation that we should be worried about on our numbers?

Umesh Parikh: Yes, so goodwill will not be classified as a depreciable class of assets under the income tax act and we are evaluating the impact of it on our books, so far it is very good that we have not created so much of deferred assets in our book on a conservative basis, but on a going forward basis, yes, we will have to assess and come back.

Tejas Shah: Okay, so what should we go with effective tax rate for next two or three years on P&L at least?

Umesh Parikh: we will assess and come back to you soon.

Moderator: Thank you. The next question is from the line of Kaustub Pawaskar from Sharekhan. Please go ahead.

Kaustub Pawaskar: Good Afternoon Sir, congrats for good set of numbers, Sir my question is on your distribution strategy, according to the presentation the endeavour is to have a reach of five lakh outlets by March 31, 2021, so going ahead over the next two years what kind of distribution expansion you are looking at?

Tarun Arora: This is about our direct distribution, of course the overall reach for Zydus Wellness is more than 2 million outlets and we continue to organically grow it. This was a specific project we had taken to maximize our existing assets to deliver a better direct reach, of course there would be continued organic work on this space. We also expect as the branch expand and the equity improves, there will be a further pull and expansion of our availability across, so therefore it is an ongoing exercise, but this was a specific intervention which was planned at the time of acquisition and will help and is likely to complete on March 21. Further any other specific projects we will share, but we will continue to expand our distribution as we go along in organic way.

Kaustub Pawaskar: Sir, my second question is the small pack under the Complan, smaller scales you have launched, this is specifically to South or you want to take this into other market as well because East and South are main markets for us?

Tarun Arora: The Rs. 5 sachet is specific to South and East, and therefore, it has been launched only in South and East. The North and West markets do not respond to our Rs. 5 sachet, there the sachet size are little bigger, it is 75 gram of Rs. 30 sachet, which we launched about few months back already which we have shared, so this is more of South and East initiative.

Kaustub Pawaskar: Any initial response?

Tarun Arora: Initial response is very good, the Rs. 30 sachet which we launched in North and West, some of the markets we are seeing a continued pull for it and similarly even the Rs. 5 sachet we have been able to achieve all our direct distribution targets. We are seeing repeat demand also on this, so we are confident that this will help us build up the business going forward as we aspire to do.

Kaustub Pawaskar: Sir, last one on the margin front, our aim is to have margins at around 20% over a period of time, but now we are spending you know advertisements and even on the gross margin front going ahead, if inflation continues to be there it will have impact on the gross margin, so considering that what is your margin aspiration for FY '22?

Tarun Arora: I think our aspiration has not changed and through a mix of gross margin improvements as well as being prudent on our overheads, we still are on track for that and you will, we will stay on track to do a 20% two years down the line and the improvement should happen now, so we will see that improvement.

Moderator: Thank you. The next question is from the line of Sanjay Manyal from ICICI Securities. Please go ahead.

Sanjay Manyal: Sir, just one question on your prepayment premium charges you have paid almost 130 odd crores and then simultaneously I missed the point about what kind of debt you have taken and at what interest, so in the entire arrangement was the repayment of NCDs is it really beneficial to overall scheme of things?

Umesh Parikh: Yes, it has been beneficial and as you can see in the finance cost also, finance cost has reduced substantially from 35.25 crores it has gone down to 9.87 crores and on a yearly basis, we see a net improvement about 100 odd crores in the finance cost going forward.

Sanjay Manyal: Okay, but we have taken the additional debt, so given our cash flow, cash flows are pretty strong and we also raised almost means I think we had a approximately 1300 crores cash including the funds raised, so where we sort of required to take that additional debt which we have taken?

Umesh Parikh: Immediately, we have to redeem 1500 crores and from QIP and then we had a cash of 1000 crores, so we are falling short by 500 plus some premium amount that we had to pay, and therefore, we resorted to the borrowing, but the borrowing came at much cheaper rate, which is at 5.5% compared to 9.14% earlier and we will be repaying this over a tenure in next 30 months.

Sanjay Manyal: The second question on your chemist channel front, what kind of targets we have, what is the reach we have in the chemist channel and what kind of target we have over the next few years?

Tarun Arora: I will not be able to share specifics in terms of chemist deal, but as a part of our Project Vistaar where we are taking our direct distribution which was earlier before acquisition close to about 2.4 lakhs to 3.4 lakhs as a part of integration now to 5 lakhs. We are also seeing a substantial improvement on our chemist reach also directly. We used to be close to about 3.5 to 4 lakhs availability and our direct service of chemist outlets was a part of it. Now, we should be able to see a 20%-25% improvement even in our chemist direct reach as well as a part of this Project Vistaar, which will benefit all our brands actually not just Sugar Free which anywhere relies heavily on it, but Complan, Glucon D, and Nycil, all will gain out of this chemist expansion

Sanjay Manyal: Sure, lastly on any guidance on the advertisement spends and this quarter is almost 14%-15% kind of advertisement in marketing spend, is it largely on the media spends or any other promotional part is also there?

Tarun Arora: Two parts of your question first on Everyuth, I think last quarter has been high double digit for the Everyuth. We believe the momentum will continue, it is gaining both from our investments in advertising of Everyuth as well as a better distribution, so Everyuth is on a good trajectory as we see and on an overall level, I think our last quarter spends were both on media as well as digital platform, TV as well as digital platforms, we have also used the print, so we have used a mix of platforms. We have also used a lot of influencer media where we have reached out to several influencers on Sugar Free and SugarLite and reaching out to the consumers through the influencer and on the digital platforms, so we have used a wide variety of media.

Moderator: Thank you. The next question is from the line of Shirish Pardeshi from Centrum Broking. Please go ahead.

Shirish Pardeshi: Hi, Tarun and Umesh, Good Evening and thanks for the opportunity, my question is pertaining to the malt and health food category, I think we have seen the leader had some supply chain issue, was it that reflected in terms of our, I am not getting into specific of category growth, but in your assessment has it helped you to gain some market share or improve your distribution?

Tarun Arora: Which category?

Shirish Pardeshi: I am saying health food drink category.

Tarun Arora: Okay, so we have heard some of the players talking about the supply issue, we have not faced any supply issues over the last few quarters, but we have seen last quarter has been fairly good in terms of our ramp of our brand Complan in last quarter, so we will continue to see a good demand for it. As far as the market share is concerned, it is slightly up but nothing substantial to write about, we are seeing a distribution up, we hope that it will also translate into a better market share as we build up, I am still confident of having the numbers we had planned about again by end of June-July.

Shirish Pardeshi: Tarun, you just mentioned that you have got a differential pack, one is you said that you have a pack which is made for Western and Northern market and you have a different pack sachet size for the South and Eastern market, which market do you think will have a better benefit in terms of penetration and then conversion in to our large packs?

Tarun Arora: I think structurally both the markets are different and fortunately for both South and East and North and West, there are States which are showing good traction of our brand. In fact Tamil Nadu has been a little bit of our channel State, we are seeing that some recovery there first time after almost one to one-and-a-half years and with the sachet I think it will help us go deeper, so that is a market which structurally responds very well to this 18 gram sachet market, sachet as a place. The northwest has the good performing market for us and there as the market is structured towards 75 grams sachet we are responding with that and there also we are seeing a good uptick on that, so I think both will have a very different approach. Growth wise there are certain states in both these Southeast and Northwest which is showing a positive traction, at least three states are showing a very good traction.

Shirish Pardeshi: I am still harping on the food portfolio, do you think we need, we have a product right or sachet right or this strategy right or do we think we need to have a different version or different price point or a different product to get a penetration?

Tarun Arora: I think we are maximizing, optimizing on our current proposition and our product, it is a product which has done well over the years in between the product was changed. We are working with consumers and looking at how can we keep getting better at both proposition as well as product and if there are some changes over next few quarters, we will of course share but right now I think within what we had, we have started gaining momentum from consumers within that proposition as well as the product perspective, our executions were a big issue from the past which I see a substantial improvement today as we speak.

Shirish Pardeshi: Okay, just last question from my side, on the gross margin expansion, I think now fairly we have integrated our portfolio which we have acquired from Heinz and what I wanted to understand, what kind of cost levers we have been able to pull which is reflected into the gross margin expansion for the erstwhile portfolio of Heinz and what we have not yet applied and which you think can come in '22?

Tarun Arora: From a gross margin perspective, there are two or three things which have worked since you asked about it, one is of course we have been able to work out better trade terms with our partners, which has created a better win-win, we have been able to do business at a lower margins while giving them a better ROI, so that has led to an improved realizations while working with them and lower spending on trade support, so that is one. Second is we have gone back at least while there are limited options of working together but at least they were in packaging material etc, there were some commonalities which we have been able to negotiate to get better. Third is a longer term from a gross margin perspective is the capability on buying commodities which we are building. We already have some bit of capability having purchased oil and something from wellness side, old Zydus side and side which understands milk and sugar and dextrose, so we are pulling that whole capability together to become better and stronger in terms of our capability on estimating the movements of commodity, which is still a very difficult task given the way World is moving, but that is clearly something which can give us a little bit of delta from a gross margin perspective. From the overhead side, while you did not ask we have seen improvements on our people cost as well as some of our logistics cost which we have driven very high together at a combine level.

Sharvil Patel: If I can add one more Shirish, is also because we are going with, because we are using milk and producing SMP and other byproducts, I think we are going to do lot of value addition, so that overall realization for this whole people will definitely go up with better product mix coming in these lines.

Shirish Pardeshi: Just one last question, on the crude palm oil, you said there is an inflationary pressure, I just wanted to understand what percentage of our raw material basket crude palm oil forms and do you buy locally or we import?

Tarun Arora: I will not be able to share the percentage, but I can tell you it is third largest commodity that we buy, we do not import, we buy as a refined palm oil from some of the suppliers based in India who in turn purchase from global supply chains.

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

Tejas Shah: Just one follow-up from my side, as you mentioned in opening remarks that Complan has registered highest distribution in recent times, so just wanted to understand is the distribution in the category footprint is under index versus our market share?

Tarun Arora: Not really but actually Tejas over the years as our market share drop from mid-teens to mid-singles, the distribution also substantially dropped so they go hand in hand, one is the equity impacted the distribution, second is also the internal team also was losing momentum on this, so our distribution as a percentage is we have a fair presence, but we need to expand our availability to drive market share, so it is our need for driving or improving our distribution to drive our business momentum, but it is not under index to our market share.

Tejas Shah: Okay, and Complan in its past glory days put the distribution twice, thrice of our current distribution footprint or was the number not that high?

Tarun Arora: Maximum was 6.5 lakhs and it dropped down to 4.5, we have already been able to take it to 5 lakh plus which is also only in the last quarter, so we want to build on further on that momentum.

Tejas Shah: So this addition that we are planning for balance three months also, it will be focusing on particular two-three top categories of ours or it will be much more generic and then we will try to push all our products portfolio and in that funnel?

Tarun Arora: This direct distribution usually is a subset of the reach of all each of these brands because there is an element of indirect distribution which also comes through, which is reflection of the equity and the category it plays, so when the remaining outlet direct distribution drive is not focused on only one brand, it will benefit across the portfolio. It will help us improve our quality of distribution to make all the SKUs available in the outlets that we reaching which may already may be serviced by wholesale or any ways, so the impact of this direct distribution drive is of course the numbers but it is about making all our important products available which may not flow through in the indirect channel, so 5 lakhs to more than 2 million total availability, the ratio 1:4 is more fair and have a right mix from a general trade perspective.

Tejas Shah: Fair enough, and the category saliency so now you and market leader both are kind of trying to revive the category with your respective approach and investments, are we seeing any uptick at category level as well which is much more sustainable, and you are seeing greenshoots of category also showing signs of very sustainable growth from here on?

Tarun Arora: Hard to say because any reliable data and if I really look at Nielsen data, I think Nielsen is still not reporting a category revival, so I am assuming that most of the growth is our own action, but I think somewhere underlying which Nielsen I cannot fully rely completely on, I will have to collaborate what other companies have also done in the performance which my guess will reflect a better sense of how the category is responding, our own momentum is good but I am not sure of other brands, so I will have to pull everything together and triangulate how the data is showing.

Tejas Shah: Last one on this I know you do not like to give brand wise number, but just indicative would Complan growth be higher than average company growth or in line?

Tarun Arora: Complan is, the base Complan is growing in double digits so that should be a fair thing for the last quarter to share.

Moderator: Thank you. Ladies and Gentlemen, as there are no further questions from the participants, I now hand the conference over to the Management for their closing remarks. Thank you and over to you.

Tarun Arora: Thank you everyone and we will see you next quarter.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of Zydus Wellness Limited, that concludes this conference. Thank you all for joining us and you may now disconnect your lines.