“Hikal Limited
Q4 FY2021 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Hikal Limited Earnings conference for Q4 FY2021. This conference call may contain forward-looking statements about the company, which are based on the beliefs, opinions, and expectations of the company as on the date of this call. These statements are not the guarantee of future performance and involve risks and uncertainties that are difficult to predict. 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 "*" and "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sameer Hiremath - Managing Director - Hikal Limited. Thank you and over to you, Sir!

Sameer Hiremath: Thank you. Good afternoon and a very warm welcome. I am Sameer Hiremath, Managing Director and along with me, I have Mr. Anish Swadi, President Business Development and Strategy, Mr. Kuldeep Jain, our Chief Financial Officer and Strategic Growth Advisors, our Investor Relations Advisors. We hope you and your family members are safe and healthy and are all taking all the precautionary measures considering the second wave of COVID-19. I am pleased to interact with all of you on our Q4 FY2021and FY2021 call. I hope you have received our earnings release, presentation, and results. For all of those who have not, you can view these from the Stock Exchange and our website.

With the country undergoing a severe second wave of COVID-19 infections, we are ensuring that we are following all the necessary guidelines to safeguard our employees as well as ensuring that the manufacturing operations and all our sites are running smoothly.

Talking about our Q4 performance, revenue for the quarter was Rs. 532.5 Crores registering a Y-o-Y growth of 40% and Q-o-Q growth of 15%. Our EBITDA came at Rs.109 Crores, which is the growth of 55% Y-o-Y and 20% Q-o-Q. EBITDA margin saw an improvement of 188 basis points to 20.5% compared to 18.6% in quarter 4 of last year. The improvement in EBITDA margin is due to higher volumes, a favorable product mix and business excellence initiatives.

Our pharmaceutical division registered a strong revenue growth as well as an operating profit growth for the quarter. The division recorded revenue of Rs.298 Crores, which is higher by 32% on the Y-o-Y basis compared to Rs. 226 Crores in Q4 of last year and by 11% compared to Q3 of FY2021. The EBIT for the division came in at Rs.51 Crores, which is a Y-o-Y growth of 53% and Q-o-Q growth of 6%. This translates to an EBIT margin of 17% in Q4 FY2021 as compared to 14.6% in Q4 FY2020 – an expansion of 240 basis points.

On an annualized basis the division reported revenues of Rs. 1,060 Crores, a Y-o-Y growth of 19%. The EBIT for the year grew by 33% to Rs. 170 Crores as compared to Rs. 128 Crores last year. The division registered an EBIT margin of 16%, which is an improvement of 160 basis points for the entire year.

The performance in the division was driven by strong growth in volumes and key products. The business excellence initiatives, which have resulted in cost optimization and capacity improvement, enabled us to meet increased market demand and maintain margins. We filed an Enzymatic process DMF for Sitagliptin Phosphate Anhydrous, which have generated a strong customer interest in various regulated markets. The supplier concentration and location de-risking for key raw material has also been carried out and done strategically.

I am happy to share that we have recently filed the US DMF for Favipiravir API and are now ready to supply commercial qualities to both the global and domestic markets. If you recall, we had completed the successful development on this API and its intermediates last year in the record time. Back then it was approved in Japan for treatment of COVID-19 while it was undergoing clinical trials in various countries as an experimental treatment of COVID-19. Currently, it is being approved in many countries as a primary line treatment for COVID-19. With the second wave of COVID-19 leading to unprecedented pressure on the supply of medicines across the globe we are more than geared to play our part in the fight against the virus. Favipiravir has proved to be effective in mild cases. With the usage of this drug gaining confidence across the globe we are confident of supplying the API very soon.

Also, I am sure you would have gone through our press release on the 10-year multiproduct deal that we have entered in the Animal Healthcare vertical. We are gearing up to build a new multipurpose plant for supply of these niche products and the development for of this molecule is in the process of starting. The commercial supply of this product is expected in the coming years. We are optimistic about the animal health business and we will create this into a new vertical as we see strong traction in the coming years with multiple new projects and new clients.

Our CDMO pipeline is healthy, and we are evaluating various new opportunities for early-stage molecules. We are in talks with several new customers including some promising prospects in the US, Europe, and Japan. We have increased our marketing presence in the US, and we expect to get more traction on the ground, increasing our share of wallet with existing and new customers.

Our crop protection revenue for Q4 was Rs. 235 Crores, which is a Y-o-Y growth of 54% and 21% Q-o-Q. The EBIT for the division was Rs. 48 Crores compared to Rs. 28 Crores in

Q4 FY2020, which is a growth of 72% Y-o-Y and Rs. 30.8 Crores in Q3 FY2021, which is a growth of 55%. The EBIT margin for Q4 FY2021 was 20.3% compared to 18.2% in Q4 of the year and 15.9% in Q3 of this year. On an annualized basis, this division registered a growth of 7% to Rs. 661 Crores which is a 4% growth in EBIT to Rs. 103 Crores.

The strong performance in the division was driven by orders, which were deferred in H1 due to pandemic and all successfully executed in H2 of the last year. New fungible capacities have come on stream through the capex incurred over the 12 to 18 months. We have commercialized a new fungicide with a Japanese customer in our CDMO business and we expect to scale up this product in FY2021-FY2022. We have increased our sales team to capture new opportunities on the contract manufacturing side. Our pipeline is healthy with a mix of early and commercial products for existing and new customers.

On the balance sheet front our gross debt as of March 31, 2021, is Rs. 610 Crores as compared to Rs. 646 Crores as on March 31, 2020, a reduction of Rs. 36 Crores. Our net debt to equity ratio has improved to 0.61 as compared to 0.71 last year. Our net debt to EBITDA has also improved to 1.8 times as of March 31, 2021 as compared to 2.1 last year. On the working capital front, we are at 112 days.

This year also saw an improvement in the return profile of our company with the return on equity improving by 450 basis points to 15.2% in FY2021 from 10.7% last year. Our ROCE has improved substantially to 16.1% in FY2021. With the capex on-stream and new high value product gaining traction, we are confident of improving a return profile further over the next 2 to 3 years.

On the cash flow front for FY2021, we have generated a strong net cash flow from operations of close to Rs.180 Crores, a majority of which has been used towards capex and debt repayment.

We have recently completed the construction of a new production block and a development and launch plant (Unit 2) in Bengaluru. This plant will cater to key starting materials and intermediates and APIs to meet the growing demand from our innovator manufacturing customers. The facility will add a new quality control laboratory, with the state-of-the-art equipment to meet global compliance standards. We will also be going for an FDA inspection on this site very soon. We have also completed the construction of majority of our balance capex program and have started the commissioning process for many of these units. The commissioning will be completed over the next 2 quarters starting this quarter. The capex will be fully on stream from the second half of this financial year.

The new capacities will enable us to grow our topline and improve our profit margins along with return ratios sustainably over the coming years.

Based on the strong performance for the year, the Board of Directors have recommended a final dividend of Re.1 per share, which is 50% of face value along with an interim dividend of Re.1 per share declared in February 2021, taking the total dividend for the year to 100%, which is Rs.2 per share.

In terms of future outlook, we expect to grow our topline rather 15% to 20% along with improvement of 50 to 100 basis point of EBITDA margin per annum over the next 2 to 3 years. This growth will be driven by our ability to convert a sizable number of enquiries and projects from our global customers into concrete businesses, backed by global shift in strategy of creating an alternative to China.

The performance linked incentive scheme under the Atmanirbhar Bharat Initiative of the Government of India along with the China+1 strategy is beginning to present immense opportunities of growth for us. The Hikal team is very excited by the tremendous growth opportunities available to our company over the next 2 to 3 years, which will catapult us into the next growth orbit. With this we will now open the floor for Q&A. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Chirag from DSP Mutual Fund. Please go ahead.

Chirag Dagli: Thank you for the opportunity. If we look at the 2 years CAGR for your FY2019 to FY2021, I see a 4% kind of growth. Is this the indicator of the underlying volume or activity levels in the business that you have seen in the past 2 years or is there something else in this there are prices have come down?

Sameer Hiremath: Sorry, could you repeat, Sir, your volume was not very clear in the second half of the question?

Chirag Dagli: Sure, when I look at the 2 years CAGR FY2019 to FY2021, I see a 4% CAGR in sales and EBITDA, is this an indicator of the underlying volume or underlying activity of the business or is it the volume have been much higher prices have come down?

Sameer Hiremath: I think FY2020 was an aberration year for us. I think that was due to a one-off case, if you take out FY2020, we have shown consistent growth over the least 5 to 6 years and the growth this year was driven by volumes, pricing has been stable, and they are coming from new products and volume growth that was the reason for the growth this year. So I do not think we should look at FY2020 as a true indicator of the performance that is aberration and one-off.

Chirag Dagli: Fair point. Sir, when you look at the 10-year deal who are the partner fund our capex and how different will economics be for deal versus rest of the business?

Sameer Hiremath: Well, the partner is funding the capex, a large part of the capex is being funded and it is a long term contract, it is a 10-year contract as we had given in our press release. It is very different on existing project because the partners putting their money where his mouth is, putting the skin in the game, so they are committed to buy a certain minimum volumes and the minimum volume guarantees is in the contract, so it is a pretty nice contract that we have got over the next 10 years.

Chirag Dagli: Will the margin profile will be lower than the rest of the business because of he is funding it?

Sameer Hiremath: No, it will not be. These are niche molecules, and the margins are going to be in as per our company average margin right now, which is expected to be around 50%.

Chirag Dagli: The asset intensity of this deal will be similar to our rest of the business?

Sameer Hiremath: Yes, all our new projects as I had mentioned in the last few calls, we are looking at an asset turnover of at least 1.5 and this project will also be at 1.5 type of asset turn. We are very particular about the type of projects and the margins that we have in the businesses and the new capexes.

Chirag Dagli: Have you quantified the capex of the deal?

Sameer Hiremath: Sorry?

Chirag Dagli: Have you quantified the capex that you will put for the 10-year deal?

Sameer Hiremath: No, the capex is not quantified because the first part is the development of the molecules, first year and then the capex will start after that. That is all in work-in-progress with the customer, to give a broad understanding.

Chirag Dagli: Understood. Thank you for the opportunity.

Moderator: Thank you. The next question is from the line of Sajal Kapoor from Unseen Risks. Please go ahead.

Sajal Kapoor: Good afternoon, Sameer, and congratulations for signing this landmark 10-year deal and I have not seen any other complex API player in India announce such 10-year deal in either human or animal pharma, I know Hikal has been investing and building capabilities in this niche animal pharma domain over the years, but it still is very well executed and congratulations again. Just a couple of questions, one is India is well ahead of China when it comes to CEP filings, but talking about Hikal specifically, our recent CEP filings look very interesting, we received 5 to 6 CEP approvals so far this calendar year versus just 2 last years, I know CNS and diabetes are some Hikal's core domains, but in some cases we have multiple filings for the same molecules so Venlafaxine as an example, we had HCl in 2018 and Venlafaxine process B last year, then this year we had got process C, we also have first-to-file in DMF in diabetes I mean this sounds like a significant shift in our strategy and so how do you see the opportunity landscape for both the CNS and the diabetes in the key regulated markets?

Sameer Hiremath: You are absolutely right. The opportunity is looking very good on the diabetes front and the CNS front. I will answer your first part of your question. The reason why we are filing process B, process C is to remain competitive in the molecules and we want our global leadership position in some of the products that is why we are in and hence we keep filing improved processes. That is on the CNS side. On the diabetes side, diabetes demand for product is increasing. One of the unfortunate side effects of COVID is that many people are now getting side effects that the insulin generation in the body is coming down, so diabetes drugs consumption around the world is increasing along with some other types of diseases that the people are getting due to COVID even though people are recovering, so we are seeing and even before COVID, diabetes was a very hot sector to be in and growth was expected, it is only getting intensified post the COVID that has hit, all of us in the last one year.

Sajal Kapoor: That bodes very well for us going forward, right?

Sameer Hiremath: Yes, and many of drugs will be launched in the next couple of years, in the next 2 to 4 years the drugs will come on stream, some are coming on stream next year and we have a pretty large and healthy portfolio of diabetes drugs.

Sajal Kapoor: Sure, look forward to that. Secondly, Sameer on the animal healthcare side, I know you already have CDMO relationships with top innovators in US, so for example get patented and coccidiostat drug, I would not name the innovator that you supply to that animal pharma CDMO deal and you have that relationship with this global tier 1 innovator. What could be the opportunity for a technology focus player like Hikal given that India as a country has significant advantage in the CDMO space and Hikal is very well positioned, not just in animal pharma, but across cross signs as well as human pharma to significantly improve our profile in the CDMO space and help our margins in the process, so just wanted to see and check your medium term sort of outlook on CDMO space in particular because the gross margins are significantly better in this space and if you could do more in CDMO overall our blended margins will significantly improve?

Sameer Hiremath: Yes, so CDMO currently our split is about 50:50 between CDMO and generic APIs, but with this whole China+1 and this COVID happening there is a lot of new projects coming like the ten-year contract, we just signed, we have several other projects in discussion so the animal health vertical itself will grow, the human health CDMO will also tremendously grow and the growth is getting accelerated and the margins of the business are better in the CDMO compared to the generic API space, so we are working on that and we expect the numbers to look very healthy and growth to be pretty strong in the CDMO space over the next two, three, four years.

Sajal Kapoor: Yes, given the fact that our gross margins are south of 50% and I think there is significant potential for gross margin improvement over a period of let us say two, three years, is that a fair assumption?

Sameer Hiremath: Yes, that is true, because as I have mentioned all our new products are well for 50% gross margin, the new CDMO businesses, our blended gross margin will improve as a company.

Sajal Kapoor: Thank you so much for all the responses and congratulations again.

Moderator: Thank you. The next question is from the line of Sudarshan Padmanabhan from Sundaram Mutual Fund. Please go ahead.

Sudarshan P: Thank you for taking my question and congrats on great set of numbers. My question is on the capacities earlier we were talking about probably looking at about Rs. 500 Crores or Rs. 520 Crores a quarter a kind of peak run rate and now we are talking about supplying Favipiravir in both India as well as US, I believe there is some debottlenecking, so at this point of time what is the kind of debottlenecking we have done and what could be the sales incrementally we can get until the newer capacities come in the second half?

Sameer Hiremath: Favipiravir started getting enquiries and we have started the manufacturing and it is being ramped up as we speak so we are currently using our existing plants and debottlenecking that. So it is quite uncertain to satisfy the demand because COVID, it is currently very strong demand whether it will continue, we have to wait and watch, as of now demand is strong and we are catering to the demand over the next two quarters.

Sudarshan P: Sir, post the debottlenecking, what would be the peak revenue potential quarterly from the current capacity until the new capacity come in?

Sameer Hiremath: We already are close to 90% to 95% with the Q4 type of numbers, so as the new capacities come on stream by the second half of this year we will start seeing some uptick in the quarterly numbers.

Sudarshan P: Second is on this 10-year contract specifically for this animal health, can you give some colour with respect to what is the kind of opportunity one can expect say third year or fourth year some commercialization because I believe it is a little long drawn because I mean it, it start from FY2024 onwards right, so some colour with respect to what one can expect because we are talking about this being a separate division, I would believe that this could probably scale up to meaningful level say in the 5 to 6 years or so?

Sameer Hiremath: Yes, unfortunately we are bound by confidentially with our customers, we cannot disclose numbers and more details about this, but the whole idea is to grow animal vertical to about Rs. 500 Crores in the next four to five years and this will be helping to get that number. This will be one of the projects that will get us towards it and there are other opportunities also that we are looking at in the animal health space.

Sudarshan P: With respect to this CDMO opportunity, I mean if you can give some colour with respect to how many projects we are working and what is the size that is expected to go from the current level because it is not only Hikal, what we are seeing is there is a big inflection point that is happening for the entire industry because of the China+1 story and I think we are hearing several companies are talking quite bullishly on this, a little bit more colour on this?

Sameer Hiremath: Yes, we have in both our divisions, currently in our pharma business we are about 7 to 8 products in the CDMO development pipeline and in our crop business we have about 4 to 5 products in our CDMO pipeline under development. And this is only increasing on a quarter-to-quarter basis as the enquiries keep coming in. This year we have seen a huge increase in the a number of enquiries, many of these have been converted to business and there has been a huge spike I would say in the last 12 months in customers interest.

Sudarshan P: Any commercialization that one can expect from any of these of products that you are already having?

Sameer Hiremath: Some will happen by end of this year. I think in the second half of this year, we will start, and it will be ramped up in FY2023 and FY2024 where there will be the big jumps. There is a year or so required for validation and then it gets ramped up and then it takes 1 or 2 years for them to get approval or so. I mean, the positive thing is a number of enquiries have increased tremendously in the last 12 months, which will get converted into business.

Sudarshan P: One final question from my side was, as the previous participant also pointed out, I mean we have some really good products specifically in the development side and some of the newer generation product and with the capacity coming in, between this legacy portfolio that we have across gabapentin and other products and also the newer products that are there across the Gliptins, and Celecoxib, etc., again if I say that in the next 2 to 3 years, what would be the shift that will happen from this legacy molecules to the newer molecules and as you mentioned earlier, since the new molecules come with much better gross margins, so where do we see the gross margin for the company itself in terms of the thought process?

Sameer Hiremath: I mean, every year we are adding about 8% to 10% of revenues from new products that is run-rate that we are currently running at and these are 50% plus gross margin type of margin profile, so we expect the blended gross margins of the company to be an excess of 50% as we move into two, three, four years from now.

Sudarshan P: Thanks a lot and I will join back in the queue.

Moderator: Thank you. The next question is from the line of Rohit Nagraj from Sunidhi Securities. Please go ahead.

Rohit Nagraj: Thank you for the opportunities and congrats on great quarter as well as the multiyear contract. Sir, first on the multiyear contract, so I understand that we have been doing this for innovators for a fairly long time, so what is the differentiating factors between this contract and the earlier contracts because I think we already have some of the dedicated blocks for some of the innovator companies where we have been supplying since past may be five years, 10 years or more than that so except for the funding part which will come from the partner, what are the other contours which are different? Thank you.

Sameer Hiremath: First of all, I mean, we were able to sign this contract during the peak of this COVID, which is a quite remarkable achievement by both the customers and for us and we were able to sign a landmark contract for us. I think that was the differentiating factor. The contours of the contract, a, it is 8 to 10 year contract. Typically, contracts are three to five years, whereas this is a 10-year contract, which is extendable beyond that. And these are all niche molecules and at one point, they are talking about 10 molecules. They are not talking about

1 or 2 products and then we will see, we will ramp up and we will see how we perform. The customer has instilled confidence in us and has decided that they will outsource 10 products at the same time to us with volumes, with pricing, everything has been tied up, so it is very a different type of contract I would say with a long-term horizon and this opens up a totally new avenue potential for what we can do with other customers and the differentiating chemistry, new technologies, there are a lot of unique features in this project and we are working very closely with the customers, we will become a preferred supplier, it is actually top-tier global pharma company and it will open up very new opportunities for us with not only with this client but many other global innovative pharmaceutical companies will look at Hikal very differently now.

Rohit Nagraj: Thanks. Sir, the second question was in terms of the current products, which we are manufacturing, so how many of those products are currently in the stage of commercialization, how many of them are in the growth stage and how many of them with the saturation stage, just a proportion of the total revenue basket for pharma as well as for agro segment. Thank you.

Sameer Hiremath: In pharma we currently have 10 to 11 products, which we are making in CRAMS, which have volumes that are quite steady. We have 14 to 15 of our own propriety products, which are growing even though some of them are older molecules, they are still having growth and have life left in them. In the pipeline there are 7 to 8 products in the pharma CRAMS pipeline, which are at various stages of execution and 3 to 4 of our own products, which are under DMF filing and scale up and commercialization. On the crop side, we have 10 to 11 major projects under CRAMS, some of them, even though they may be older CRAMS molecules, are still growing because customers are getting approval in new markets and new formulation that they are launching. Many other crop customers are relaunching their old products with new formulations and new technologies. So, our older CRAMS products in Crop are also showing a growth and we have 9 to 10 proprietary products in crop, which are growing, but the exciting part is that we have got 3 to 4 new CRAMS projects of significant scale under various stages of discussion and finalization and two large proprietary products, which are under commercialization and scale up as we speak. So they is a lot happening in the company compare to where were two, three years ago.

Rohit Nagraj: That is really interesting to know. Sir, just a concurrent question to this, so what are the new platforms or chemistries that we have entered in the last may be two to three years because you have given a very healthy pipeline of products across both the segments. So probably it must have fetched us or it must have propelled us to explore some newer platforms as well as the chemistry, so what would be both? Thank you.

Sameer Hiremath: Enzymatic chemistry is what we have been successful at. In the last couple of years, we have commercialized a few molecules. Even the latest DMF that we filed last quarter for Sitagliptin, was an Enzymatic process. Pregabalin is Enzymatic process. So, we have two large commercial products in the Enzymatic space. Flow chemistry continues to be where we have done a lot of work and we are scaling that up as we have seen a lot of traction from customers. With the new custom manufacturing enquiries, a lot of enquires are high potency are coming our way. That is an area that we are actively look at and evaluating to enter into that that segment as well.

Rohit Nagraj: Understood. Sir, just one last book-keeping question, what was the capex in FY2021 and what is the plan for FY2022 and FY2023? Thank you.

Sameer Hiremath: We currently have a CWIP of about Rs. 250 Crores odd, if we look at our balance sheet. And we are spending, as we mentioned, Rs. 300 Crores over two years that was the plan that we had made two years ago. We actually spent about Rs. 60 Crores from a cash outflow basis last year.

Rohit Nagraj: Thank you so much and best of luck, Sir.

Moderator: Thank you. The next question is from the line of Jigar Valia from OHM Group. Please go ahead.

Jigar Valia: Thanks for the opportunities. My question is with regards to this 10-year deal, just a clarification it is also a new client win or it is an existing client relationship?

Sameer Hiremath: It is a new client relationship.

Jigar Valia: Great and double congrats. Second is this would be mainly for regulated markets requiring FDA approvals or it would be a global supplier across all markets?

Sameer Hiremath: It is an FDA, European and all global markets, it would be a regulated market, non-regulated market, we will be the global supplier for all these 10 molecules for them, around the world, which will also require FDA and European approvals.

Jigar Valia: Understood, so the approval process how much time would it take and since this was a dedicated animal block would it be less stringent as compared to your regular pharma audits?

Sameer Hiremath: No, it is not. It is going to be on our existing FDA-approved site that we already have. So the site has already been approved by FDA in Panoli, so we expect these approvals. And that is why we said even though the contract is signed we expect the commercialization to happen from FY2024 assuming the timelines for approvals as well.

Jigar Valia: Understood and these are existing products it is global manufacturing, is it?

Sameer Hiremath: Yes, it is site transfer.

Jigar Valia: It is site transfer, great. And lastly, since the partner is largely investing into this, is there any possibility of even shifting the existing animal health product to this plant or may be moving some other client relationships into this front or this is dedicated?

Sameer Hiremath: No, the site has space for expansion. This production train will be dedicated to the client, but the plant will have space to add on new clients adjacent to it.

Jigar Valia: Thank you so much and congrats.

Moderator: Thank you. The next question is from the line of Viraj Mehta from Equirus PMS. Please go ahead.

Viraj Mehta: Sir, what I wanted to understand is if I look at your commentary over last two calls, as in over last one year, you seem far more confident of growth but if I then look at the numbers that you are saying, the number commentary remains the same, so you are saying the same 15% to 20% growth with same 50-100 basis points margin improvements, you have got a new contract, the outlook is far more positive than earlier then why this not translating in your guidance?

Sameer Hiremath: I think our target is to grow and to exceed whatever we tell our investors, you are right, I mean our commentary has been to be more confident. We are confident of our business, we like to be a little conservative and we like to overperform and over deliver than whatever we say rather than try and tell everything is rosy. There are a lot of uncertainties with COVID right now, so hence we are trying to be a little conservative on our growth aspects. Obviously if COVID goes away and which we all hope it does, things will improve, we have got strong business, we have our clients lined up, product lined up, contracts signed up and we hope to be on the higher end of the range we are talking about going forward.

Viraj Mehta: Sure and in terms of the new contract that you have signed if the capex is done by your partner, a major capex, what kind of payback would you expect in this business.

Sameer Hiremath: It is a three to four years payback.

Viraj Mehta: Including working capital that you will have to invest in the business or just the capex part?

Sameer Hiremath: No, everything. We look at the IRR, the total including working capital all costs, yes.

Viraj Mehta: Sir, just the last thing the tax rate, which normalizes from FY2022 just wanted to reconfirm that?

Sameer Hiremath: Yes, the tax rate last year was 35% because of MAT credit that we had, from this financial year we are down to 26%?

Viraj Mehta: 25% or 26%?

Sameer Hiremath: 25 point something.

Viraj Mehta: Sure, got it, but basically it normalizes to normal tax rate regime now?

Sameer Hiremath: Yes,. So, almost 10% (of the PBT) to the P&L will be the difference.

Viraj Mehta: Thank you so much and best of luck.

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

Dhaval Shah: Congratulations to the team. Sir, coupe of questions, firstly you clarify on the capex as per the cash flow it is Rs. 157 Crores, spend on the purchase of property and plant, correct, so now how much is left for the FY2022?

Sameer Hiremath: Can, I ask my CFO to answer this. Kuldeep has these numbers. Kuldeep you take this call to answer?

Kuldeep Jain: If you look at last year we have discussed about Rs. 350 Crores capex, out of this we have already spent Rs. 160 Crores, so we are estimating another 200 Crores in the 18 months period.

Dhaval Shah: Something will spillover in 2023 as well?

Kuldeep Jain: Yes, looks like that.

Dhaval Shah: Rs. 200 Crores over FY2022-2023 and apart from this the regular maintenance led capex how much would that be?

Kuldeep Jain: It will be close to Rs. 50 Crores.

Dhaval Shah: For FY2022?

Kuldeep Jain: Yes.

Dhaval Shah: Got it and there is a slight stretching in receivable days is my reading correct?

Kuldeep Jain: No, not really. What is happening because of this performance for the quarter and our receivable day still remain may be one or two days here and there because of the turnover to the extent of Rs. 530 Crores for this quarter the receivables are according to that.

Dhaval Shah: And your working capital should remain around this level over the next say at least 2 years?

Kuldeep Jain: Certainly, our target is to reduce basically the working capital but looking at the current scenario we are having higher inventory of some of the raw materials. So, we will have to really try to maintain at this level even if we are targeting to reduce it further.

Dhaval Shah: Great, got it. Now, I have question on the agrochemical division, so when you mentioned CDMO, so the CDMO would be you would be reporting the business, which you would do with the innovators in that?

Sameer Hiremath: Yes, CDMO is all innovator business and own products at proprietary, which we develop on our own.

Dhaval Shah: It would have both proprietary generic as well as the innovator?

Sameer Hiremath: No, CDMO is only custom manufacturing with innovators.

Dhaval Shah: With innovators, so for example if a product has just gone off patent and the generic is also launched by the innovator would you be reporting and if you are making the product will you reporting the CDMO or the other side?

Sameer Hiremath: It is a technology transfer, and there is an agreement with the customers then CDMO, yes, we develop it, and we are free to sell it then it is our own product.

Dhaval Shah: Now, when you will be targeting the new molecule in the agrochemical what could be the broad criteria for selecting a molecule for the CDMO business?

Sameer Hiremath: Well, the chemistry, the value, the turnover, the margin, the business, the growth potential on the product, the type of customers whether they are competing products or these product are sustainable, are they likely to get banned over the next four, five, 10 years, so all this is that when we look at a CDMO product.

Dhaval Shah: Like to be specific like for example, what could be the broad annual volume of that product globally would it be like 500 to 1000 tonnes or higher range, what sort of market share would we looking at for the molecule?

Sameer Hiremath: Many of the new CDMO products the potency is very high compared to the pharma space, so volumes are on the 300 to 500 tonnes type of levels. There are a few 1000 tonnes type of products, but they are lower priced, we will get high price, high margin products, which are about 300 to 500 tonnes annualized volumes with the range that what we are targeting in that, but the selling price is the higher for those products.

Dhaval Shah: On the non-CDMO part, what could be our strategy, how would we growing and what will be the products, which you are looking at?

Sameer Hiremath: We are developing our own portfolio of a few products every year. In crops we have got two molecules in advanced stages of registration, with the global launches. And we also have a speciality chemical portfolio of biocides. There we also have our own product under development, which is also being brought in that product base, so it will be more selective, but the growth will come from the CDMO space I think on the crop side and the medium term at least, there are lot of opportunities on CDMO and there are pretty large contracts to be acquired now, long-term contracts.

Dhaval Shah: All these would be intermediates or AI?

Sameer Hiremath: Hikal has been now the few companies that make active ingredients and we have made a lot of on-patent active ingredients for our customers and we are getting a lot of advanced intermediates, may be N-1, N-2, we do not do very basic chemicals. I think where there are multiple stages, where there is complex technology, chemistry, and environmental requirement is where we come into play and it makes a differentiate ourselves.

Dhaval Shah: So, more advance and AI so you can also get a higher share of the entire chain?

Sameer Hiremath: Value chain, yes, that is correct.

Dhaval Shah: So, there are lot of molecules that are going off patented in agrochemicals so over a 5-year period what size of business could this become agrochemical business for you?

Sameer Hiremath: Over 5-year period, our target is too cross Rs. 2,000 Crores in the agro business, tripling from where we are today.

Moderator: Thank you. The next question is from the line of Pranay Dhelia from Panchtantra Advisors LLP. Please go ahead.

Pranay Dhelia: Sir, congratulations on a very good set of numbers. As shareholders we are very elated and thank you for the performance. Sir, I would want some elaboration on the debt repayment plan as an investor I am always very scared for companies which have debt and this is the company, which is very dear to me, I have been holding these shares for almost 7 years now, so I have just been through thick and thin and finally as a shareholder we have been rewarded by when do we expect to become debt free, Sir?

Sameer Hiremath: Sir, if you notice our debt, and since you have been long-term shareholder and thank you for that in Hikal. Debt has been more or less in this level for the several years in spite of growing our revenues substantially and we have actually reduced our debt over the last few year on an annualized basis, which we have reduced our debt and we expect this debt to be at the optimal level and again net debt to equity ratio if you look at the numbers it has come down substantially over the last three, four years. I mean ours is a capital intensive business, we were required to put a capex every year to grow and our interest cost as a percentage of our sales is coming down year-on-year, total absolute increase outgo is also coming down, you must have seen the numbers, so we also getting a reduced interest rates because our credit rating is improving so this is our confidence by the Rating Agencies, by our bankers and, yes, the target is to get debt free and may be in the next four to five years that is our goal but we will need to keep, and have some debt on our balance sheet because if you get very fine interest rates and this is all pre-tax, so it is a pretty good way to finance our growth.

Pranay Dhelia: So, are we looking at debt equity ratio below 0.25 in the next three years?

Sameer Hiremath: Today we are at 0.6, so let us take one step at a time I mean we will keep coming down year-on-year at least. It will move down every year since we have moved than the last three years.

Pranay Dhelia: That is about it. Thank you so much and once again congratulations we become a $billion company soon.

Moderator: Thank you. The next question is from the line of Rahul Jain from Credence Wealth. Please go ahead.

Rahul Jain: Thanks for the opportunities and congratulations for a good set of numbers. Question asked by the previous participant you mentioned that we have done about Rs. 150 Crores of capex so out of Rs. 350 Crores of capex, further capex will be done in the next 18 months and you have mentioned that Rs. 157 Crores amount which is there is cash flow, now in the previous call, which was September Q2 call, which was done in November, you had mentioned that in September 30, 2020, we had spent about Rs. 200 Crores and the balance Rs. 100 Crores out of the Rs. 300 Crores of planned capex will be spent in the balance stage of the year and you are hopeful that you will spend it by Q1 of FY2022, the commercial will start, somewhere I am finding a disconnect between the two things?

Sameer Hiremath: No, you are right. It was supposed to start in Q1 now because of COVID situation developing there have been slight delays and some of our capexes and instead of coming on-stream by Q1, they are coming on-stream by the end of Q2.

Rahul Jain: That is fine. That is acceptable. I think somewhere you mentioned now is the balance capex will be done in 18 months, so am I getting confused somewhere. Let me ask a straight question, we had planned Rs. 300 Crores capex out of which how much is completed till March 31, 2021, what is the balance amount would be spent in the next three to four months so that we start with our commercial in Q2 of FY2022?

Sameer Hiremath: Kuldeep could you take this if you have the numbers, the numbers please?

Kuldeep Jain: Rahul that is a mathematical calculation, if you look at today, we have CWIP to an extent of Rs. 250 Crores. We have capitalized assets worth Rs.60 Crores so this makes a Rs.300 Crores and out of this Rs. 100 Crores will be carried forward from the previous year, so that makes a difference, and we are estimating Rs. 200 Crores going forward in the next 12 to 18 months so that is how our capex plan is and this is excluding the new agreement, which we have signed.

Rahul Jain: Can I take Rs. 200 Crores is the new additional capex over the next 18 months over and above the Rs. 300 Crores, Rs. 350 Crores, which we have planned, which is getting completed by Q2, is that correct?

Kuldeep Jain: Not exactly. The total remains Rs. 350 Crores, out of this we have already done Rs. 150 Crores, and Rs. 200 Crores will be happening in the next 18 months, this is excluding this new contract.

Rahul Jain: Fair enough. Sir, with regards to the margin improvement you have been mentioning in the previous calls also, today also you mentioned about having an improvement of 100 bps per annum over a period of next two, three years, so this year our new capex will go on stream and I understand the capacity ramp up will take almost two years, if I am right so I am still confident that for this current year FY2022 we can see 100 bps improvement in the EBITDA margins?

Sameer Hiremath: We have been taking about 50 to 100 BPS consistently and this year we did 70 basis points, and we believe that 50 to 100 BPS is our target is to achieve 50 to 100 BPS and in spite of the capex we believe that we are confident of these numbers.

Rahul Jain: Sure, but you mentioned sometime back about gross margin because of the new projects, new products coming in, our overall gross margins should move up in the range of 50% plus over a period of next three to four years. We are quite happy with that. Can I then conclude that 300 BPS of improvement in gross margin, and with some operating leverage kicking in from this year 4% or 5% improvement in the EBITDA margins over a period of next three to four years, so somewhere are we targeting over a period of next four years EBITDA margins to move in the range of around 24% somewhere near that?

Sameer Hiremath: Yes, we have achieved close to 100 basis points every year we will automatically get about 400 basis points, 300 basis points to 400 basis points in that range we should be able to achieve. That is our target.

Rahul Jain: For crop protection, you had mentioned previously or in a previous call you had mentioned that you have some big product, which are under finalization stage and you could see a steep jump in the crop business in the next couple of years whereby the crop business to catch up pharma business also in the next few years, so if you could share some more details where do we stand with regards to that as we speak today?

Sameer Hiremath: Yes, I think it is on track. I mean the crop business is growing, will grow quite quickly and there is a lot of capex coming on-stream, we are acquiring some new contracts on the crop contracts are very large volume, large value projects and they come on-stream much faster, they get ramped up much faster than the pharma space. From acquisition to full commercialization, it is a much shorter lead time compared to pharma, where in pharma the regulatory approvals take a long time and the ramp up is faster. So we believe that it will catch up, it will start growing at a faster pace than pharma in the next two, three, four years.

Rahul Jain: So, this product launch is going to happen somewhere now, or commercialization will be happening in the next three to five months or is it started for the new products?

Sameer Hiremath: We have not started, maybe in the second half of this year they will starting.

Rahul Jain: Second half means?

Sameer Hiremath: First year is small, and in second year it will get ramped, in two to three years they are going to peak, but pharma takes a longer time.

Rahul Jain: Sure, and Sir, what will be the overall capex now in FY2022-FY2023 excluding the long-term contract animal healthcare, let us exclude that, so what is the planned capex for FY2022-FY2023?

Sameer Hiremath: Immediate plan is to complete the existing capexes that we have and start commercializing them. As we acquire new businesses we will see and if some substantial contracts as the one which just signed have come our way, then we will look at these capexes on a case to case basis and when we do finalize them we will share them with you in the next call and when we have any updates on this.

Rahul Jain: Just one last final question, in your presentation you have mentioned about appointing a consultant for overall strategic exercise to identify newer opportunities and meet your strategic goals in the next four, five years, if you could quantify or if you could share something more on the strategic goals?

Sameer Hiremath: We have just hired the consultant. So the strategy is being formulated and currently, just it is very early days. So when we have something to announce that we will be happy to share it with you. They have just come on board, just a few weeks ago.

Moderator: Thank you. The next question is from the line of Dipen Sheth from Crystal Investment Advisors. Please go ahead.

Dipen Sheth: Thanks for the opportunity. Sir, I am little puzzled with, or maybe I do not know enough about the business, I will be happy to stand corrected here, is it clearly understood that CDMO is juicier part of the business compared to our own products if you just were to go by margin opportunity is that correct?

Sameer Hiremath: Yes, overall I would say CDMO has, if you pick the right products, CDMO does have better margin opportunities, unless there is an early generic launch which you could then you could have some…

Dipen Sheth: There are exceptions, but broadly the opportunities being there?

Sameer Hiremath: Broadly yes, I agree that.

Dipen Sheth: The reason I am asking this question is that CDMO as the fraction of the business mix has actually significantly fallen in FY2021 if I go by slide 19 unless there is a mistake there in presentation. Both in pharma as well as crop protection, the pharma has come down by as much as 13% points in the mix in the pharma revenue and in the crop protection it has come down by another 7%, 8%-odd is that an error in the colour coding there or I am reading something wrong?

Sameer Hiremath: Where is that information, I am not able to see?

Dipen Sheth: Slide #19 or slide 18, it is numbered 18, but it is in the 19th page in the Q4 results presentation.

Sameer Hiremath: I have got it, so from that 41% odd and own products about 59%. This is actually a product mix, it is just for one-off annualized phasing, some of our own products are launched last year, but CDMO will continue to remain about 50% of our business.

Dipen Sheth: In fact, it is interesting that you should make comments about enriching the margin over a period of time and we saw some 60 BPS to 70 BPS improvement this year right in EBITDA margin on a blended basis, but gross margins are actually down by close to 120 BPS, is there some inconsistency interpreting the data?

Sameer Hiremath: Sorry, I cannot hear you, it is not very clear?

Dipen Sheth: The question is that you have been guiding for and actually achieving an improvement in EBITDA margin, this year you achieved close to 60 BPS to 65 BPS right and I find that difficult to reconcile with actually the slip in the gross margin this year so there is more than 120 BPS slip in the gross margin and that also goes contra to what you are guiding us in terms of broader direction in the business, as we move forward, so maybe you have done it out of operating leverage or other expenses, which is a large item and maybe we will have to take a look at that breakup once your annual report comes out, but on an average is this also some kind of aberration and I should not see this too seriously because FY2021 gross margins are lower than FY2020 on a blended basis?

Sameer Hiremath: Kuldeep, can you take this, and just answer this from a number perspective?

Kuldeep Jain: See, if you look at this, I'm not having all the components right now. They are somewhere in the in the raw material cost, they are somewhere in the other factory expenditure, they are somewhere in the other expenses, what you say is not correct, so can we really connect separately for this purpose.

Dipen Sheth: I will certainly do that.

Kuldeep Jain: I will leave you with the thought that the raw material cost plus the stock adjustment.

Dipen Sheth: But just the computed gross margins from the results period. I am not going just by a blind EBITDA margin, the computed gross margins from the results period and the gross margin I am just taking the raw material cost plus the stock adjustment, gross margins have actually contracted by 120 basis points?

Kuldeep Jain: That is not right. We will have discussion on this and connect separately.

Dipen Sheth: I am happy to do that Sir. While the details of specific products and their respective contributions to the revenue or profit mix are not know and I completely understand that. Is it fair to assume that that there is not too much of a skew in terms of how products contribute to let us say EBITDA or overall profits, let us say if I was to tell you that maybe one-third of your products are they contributing two-thirds of the profits, is this skew that bad or we kind of uniformly spread out? I know it will never be completely uniform, but I am trying to understand vulnerability to particular product going up or down during the year are we too skewed towards any product or set of products?

Sameer Hiremath: No, I think that they are very skewed, it is about quite uniform more or less. There is no skewing that way. We have a very large basket of products.

Dipen Sheth: Thank you, Sir. That will be all from my side.

Moderator: Thank you. This is the last question from the line of Rajesh Kothari from Alpha Advisors. Please go ahead.

Rajesh Kothari: Goode evening Sir. Congratulations for good set of numbers. My first question, just on capex side, I think currently we have capital work in progress of roughly about Rs. 250 Crores, correct?

Sameer Hiremath: Yes.

Rajesh Kothari: Out of this, Rs. 250 Crores, how much is for pharma and how much is for agro?

Sameer Hiremath: Almost 50:50.

Rajesh Kothari: Current year basically how much capex you are seeing? What is the capex plan for the current year?

Sameer Hiremath: Last year we spent about Rs. 60 Crores, and this year we will spend balance Rs. 200 Crores over the next 18 months.

Rajesh Kothari: The plant, which we will start commencement you said by Q2 and that is basically how much of the capital work in progress will get into gross block by Q2 end?

Sameer Hiremath: About one-fourth.

Rajesh Kothari: So, basically you are saying roughly Rs. 60 Crores to Rs. 70 Crores will enter into gross block in Q2 that is it?

Sameer Hiremath: Kuldeep, will you take this?

Kuldeep Jain: As you know, both of the projects got delayed because of COVID. We are at very advanced stage and we are estimating that all should get over by second quarter, so we have estimated almost Rs. 100 Crores to be capitalized in the next two quarters.

Rajesh Kothari: And balance?

Kuldeep Jain: Balance would be again quarter 3, quarter 4 and something will go also go in the next year.

Rajesh Kothari: Let us assume by next year September 2022, you are right now Rs. 250 Crores capital work in progress plus you are going to do another Rs. 200 Crores in the next 18 months, so let us assume roughly about Rs. 125 Crores current year, am I right, so Rs. 250 plus Rs. 150 roughly we will get 400 Crores, of this Rs. 400 Crores, Rs. 100 Crores you said it will get capitalized by October 2021?

Kuldeep Jain: Right.

Rajesh Kothari: How much will get capitalized by March 2022?

Kuldeep Jain: As I said that depends on how fast as we can complete our projects.

Rajesh Kothari: So, by September 2022, do you think Rs. 400 Crores will be capitalizing in gross block?

Kuldeep Jain: September 2022?

Rajesh Kothari: Yes.

Kuldeep Jain: Should be possible if everything goes well.

Rajesh Kothari: Understood and in terms of this new capex which is coming on stream and which is in gross block, in terms of asset turn how one should look at it?

Kuldeep Jain: We have already said that we are targeting 1.5 times.

Rajesh Kothari: Targeting 1.5 times. Got is, Sir. Great and thank you and wish you all the best.

Moderator: Thank you. That was the last question. I would now like to hand the conference over to Mr. Sameer Hiremath for closing remarks.

Sameer Hiremath: Thank you. I would like to reiterate that looking at the growth opportunities over the next two to three years, we would be continuing our growth momentum, our target is to grow our topline by 15% to 20% CAGR along with 50 to 100 basis points improvement in the EBITDA margins. As you all know, the second wave of COVID-19 has created a shortage of oxygen. Currently, we have not experienced any issue at any of our manufacturing sites and all of them are running smoothly as we are categorized as essential services industry; however, if the oxygen supply situation does not improve, where no oxygen has been provided to the industrial units as of now, we may experience some marginal impact on one of our product line in our one of our crop protection sites, if it does happen we will keep the investors and the stock exchange informed accordingly. We hope the new COVID situation does improve, and things will come back to normal. I would like to take this opportunity to thank everybody for joining the call. I hope we have been able to address all your queries. For any further information kindly get in touch with the Strategic Growth Advisors, our Investor Relations advisors. Thank you once again. Goodbye and stay safe.

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