"Hikal Limited Q4FY19 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Hikal Limited Q4 FY19 Earnings Conference Call. 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 date of this call. These statements are not the guarantees 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 '*' then '0' on your touchtone phone. Please note that this conference call is being recorded. I now hand the conference over to Mr. Sameer Hiremath – Joint Managing Director and CEO. Thank you and over to you, sir.

Sameer Hiremath: Thank you. Good afternoon and a very warm welcome to everyone present at our Q4 and FY'19 Earnings Call. I am Sameer Hiremath -- CEO and Joint Managing Director and along with me I have Anish Swadi – President (Business Development and Strategy) as well as Strategic Growth Advisors, our Investor Relations Advisors.

I am pleased to interact with all of you on this Earnings Call for Q4 and FY'19. I hope you have received our investor 'Press Release' and 'Results' by now. For all those who have not, you can view these from the stock exchange websites and our (company) website.

We have continued our strong performance for the FY'18-19 with the growth of 22.3% in revenues, 23.3% growth in EBITDA and 33.5% growth in net profit. The improvement in EBITDA margins by 20 basis points from 18.6% in FY'18 to 18.8% in FY'19 is driven by higher volume offtake by customers, improved realization and various operational cost rationalization initiatives we have worked on and implemented in the last financial year.

The Pharmaceuticals division which is 59% of our revenues has registered YoY growth of 25% for Rs.753 crores to Rs.939 crores. We have witnessed good volume growth from our existing as well as new products. We were able to fulfill the higher volumes due to the debottlenecking exercises we had carried out at our Bangalore and Panoli manufacturing facilities at the start of the year.

In our Pharmaceuticals division, 50% of revenues come from the Contract Manufacturing business while the balance are contributed for our own products portfolio, consisting mainly of generic API. Currently, we have a total of 15-17 products under Contract Manufacturing and 12-13 products under our generic product portfolio which also includes products under development. During the year we have been seeing increased enquiries for our generic product portfolios from the Japanese market and the approval of our Bangalore facility by Japanese regulatory agency PMDA in May 2018 will help us to strengthen our position further.

Our Crop Protection division's revenue grew by 19% from Rs.547 crores in FY'18 to Rs.650 crores in FY'19. Approximately 80% of the revenue for our Crop Protection division is from Contract Manufacturing and the balance 20% is from our own products. Contract Manufacturing has approximately 10-11 products and we have 5-6 of our own product portfolio which covers the Crop Protection, Specialty Chemicals and Biocides business. Geographically, Latin America and Europe are our major markets with each contributing 25-30% to division revenues followed by Japan and US with 20% each and the balance is the rest of the world.

With Chinese manufacturing and manufacturers facing constraint due to the government's crackdown due to environmental concerns, we have seen a pickup in our volumes in the year gone by and we expect the growth in demand to continue in the current year as well.

On the balance sheet front, our gross debt as on March 2019 is Rs.665 crores and our net worth stands at Rs.756 crores. Our working capital is reduced by 20-days from 140-days as on March 2018 to 120-days as on March 2019. This is due to better operational efficiency.

In FY'19, we have initiated a CAPEX of Rs. 350 crores which should be completed in next 18-24-months, of which major investments will be at Panoli facility where we are adding multi products manufacturing facilities along with the associated infrastructure for both the Pharmaceuticals and the Crop Protection businesses. This will be funded by a mix of debt and internal accruals. The average asset turnover on this CAPEX is expected to be around 1.5x.

During the year, we received an upgrade from ICRA for our working capital facilities and long-term loan facilities from 'A-' to 'A'. Our short-term facilities also have been upgraded from 'A2+' to 'A1'.

The Board of Directors has recommended a final dividend of 60% per equity share with the face value of Rs.2 per share subject to approval of shareholders. Together with interim dividend declared earlier, total dividend for the financial year of 2018-19 will be Rs.1.20 per share.

Based on our current capital expansion plans, we expect to grow by 10-15% next year. This is expected to accelerate to 15-17% in the subsequent two to three years once the entire CAPEX is onstream. We expect an improvement of 50 basis points in EBITDA margin in the next year.

With this I conclude my opening remarks. We can now open the floor for questions.

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

S Padmanaban: My question is specifically on, if you are looking at both the divisions, Crop Protection and the Pharmaceuticals division, I believe we have presence in domestic as well as exports, where we have done relatively better in the fourth quarter vis-à-vis the full year, so can you give the geographical mix of the sales? Can you also throw some light on the Crop Protection margins that has come off quite drastically which is also reflecting in the gross margins which has been little lower than expected and also lower on YoY basis?

Sameer Hiremath: I think your first question was regarding the geographical mix of our products. Rather than get into the quarter wise, I will talk about the annual mix. If you look at from an annual perspective, for the Crop Protection business, our local business is about 20% of our sales and our exports business is about 80% of our sales, in the Pharmaceuticals business also it is very similar split and from a geographical perspective, about 50% of our revenues in the US market, 30% is in Europe and about 10-15% is in Japan and rest of the world. The next question I believe was regarding the Crop margin which have come off in Q4. Again, I would like to say, I think the quarter is only a phasing issue, that is due to the product mix but on an annualized basis our crop margins have actually improved compared to the previous year from a margin perspective.

S Padmanaban: What was the domestic pie last year – was it very similar, the 20%?

Sameer Hiremath: Yes, it is about similar, a few percentages here and there but there is no major drastic change compared to the last year.

S Padmanaban: Even the margins is transitionary, it is largely due to the mix which would basically even out for the full year and even as we move forward?

Sameer Hiremath: Yes, our business is more representative on an annualized basis rather than quarter on basis. There could be slight changes on QoQ, but a good perspective is if we look at on an annual basis in our business.

S Padmanaban: With the new capacities, can you give us some outlook with respect to the opportunity that we are seeing because I think over the last couple of years the Pharmaceuticals Business of course has scaled up much faster with much better margins. How do we see the trajectory over here – do we still believe that margins can continue to inch up higher as we have better utilization in the new capacities and as probably we also move into a scenario where the agrochemical export as you mentioned the Active Ingredients prices are lower and therefore the demand or the need for quality input produces will also be there compared to what it was earlier?

Sameer Hiremath: There has been a few changes globally in the chemicals industry, if you look at the last couple of years – One is that there has been a big issue of the China impact which all of you I am sure aware of. Lot of the production was happening in China but because of the environmental issues in China, lot of manufacturing is moving to India. And also companies that have a strong track record from a compliance perspective, not only with the FDA, but also from environmental compliances, for both of which Hikal has had a good track record in the last 10-20 years and hence we are able to attract higher margin, higher value products. So, the CAPEX that we are putting in is for more high value products because if you look at this year as well our value growth is significantly higher than our volume growth this year. So, we made the transition in the last one or two years where we started moving into more high value products which will also automatically result in higher margins. So, we are pretty confident that there will be a margin expansion gradually on YoY basis and in a sustainable manner.

S Padmanaban: Out of this overall 22% growth or even between the sub-segments for the full year basis, how much would broadly be the volume growth and how much would be driven by prices?

Sameer Hiremath: The volume growth is only 2 - 2.5% for the Company while the value growth is over 22%. Value is because of higher margin products; we have got price increases. Because of raw material price increases, we were able to pass on the price increases to our customers and also to ensure that our EBITDA margin will not suffer because of that.

S Padmanaban: And the new capacities will pave way for better volumes as well going forward?

Sameer Hiremath: That is correct.

Moderator: Thank you. The next question is from the line of Rajesh Kothari from Alpha Accurate. Please go ahead.

Rajesh Kothari: You just mentioned that volume growth is 2% and value growth is 22%. Out of this value growth of 22%, how much would be due to increase in price versus product mix?

Sameer Hiremath: It is about 50:50 approximately. I do not have the correct detailed breakup. But it is close to that.

Rajesh Kothari: Can you give the further breakup between Crop Protection and Pharma, how is the volume growth, price growth and product mix growth?

Sameer Hiremath: I will give you the volume growth and the value growth. For Pharma, the volume growth was about 8-9% while for Crop protection was almost flat. Value growth for Pharma was 25% and for Crop protection was 19%. About 50% is the price increase and 50% is the higher value products in both the segments. We are moving to more Complex APIs and complex Agrochemicals products.

Rajesh Kothari: From here on in your Crop Protection and Pharma both segments again, how one should look at PBIT margins?

Sameer Hiremath: On EBITDA basis as a company for next year we are targeting at least 50 basis points expansion and as and when the new capacity and the new products come onstream over the next two to three years, we expect sustainable expansion in the business YoY.

Rajesh Kothari: So, this additional CAPEX which you are putting up, when will this capacity be available from?

Sameer Hiremath: It will take about 18-24-months. Some of it will come onstream by middle of FY'21 and some of it will come, say, by end of FY'21.

Rajesh Kothari: Would you like to give some more color in terms of the opportunities which you are now working on because as you rightly mentioned that the focus is on the more value added products, so if you can give little bit more details on that in both the segments?

Sameer Hiremath: As I mentioned, we have several molecules that we are developing. The strategy is to deliver complex products. I think lot of the APIs we are doing are on the Complex Generics side. Even on the Custom Manufacturing side, we are getting involved with Complex products, for our customers on the innovator side. In the Crop Protection side, our own proprietary products that we are developing are also Complex AIs and we are also undertaking our own registration on the Crop Protection side which are coming on-stream in the next one to two years, which will also help us in catering to the markets and also improving our margin profile going forward.

Rajesh Kothari: So, this CAPEX which you are looking at, I think you mentioned Rs.325 crores which we started in FY'19?

Sameer Hiremath: Rs.350 crores.

Rajesh Kothari: You are looking for asset turnover, you said, of the incremental CAPEX, you are looking at 1.5 because I think last time you had mentioned 1.75, just I am slightly rechecking that question?

Sameer Hiremath: No, that also includes infrastructure CAPEX. If you add that, its about 1.5, but for the growth CAPEX, (it) will be close to 1.75. It depends in that range; 1.5-1.75.

Rajesh Kothari: So, let us say you are around Rs.500, 550 crores kind of revenue that you are looking for once the CAPEX comes in, it may take about two, three years once it starts the production?

Sameer Hiremath: The CAPEX will come on stream in 1.5-years approximately and about 1.5-years after that it will take, so 3-years at least it will take.

Rajesh Kothari: If you do the broad breakup of this, then how much do you think will come from generics versus CRAMS?

Sameer Hiremath: Current mix is about 50:50 on the Pharma side, it is about 80:20 on the Crop side, but as a company we are moving more towards 50:50 hybrid model. So, for the new CAPEX that we are putting in place, it is a combination of Contract Manufacturing and own generic products. So, I think we are targeting around 50:50 split between the two.

Rajesh Kothari: For CRAMS, do you think you have a significant visibility in terms of products and the kind of programs the customers are looking at, when you are putting up this CAPEX?

Sameer Hiremath: We do these capex (for CRAMS) only based on long term contracts. We are signing contracts. Based on that, we are putting lot of CAPEX which is backed by long-term contracts.

Rajesh Kothari: Because you mentioned in the beginning that there was a higher offtake from customers. So, is it driven more by their products in turn getting success in the market, if you can give again some little bit further topping to this?

Sameer Hiremath: If you look at our Pharma business, there has been a higher demand growth because the volumes have increased in our products. All our products on the generic side in Pharma has seen growth in high single digits to low double digits … all of them are growing in that perspective. So, volume continues to grow. On the Custom Manufacturing side, many of the products are in phase-2, phase-3 and they are being launched. So, those volumes also going up. On the Crop Protection business, similar situation, there is volume growth taking place.

Rajesh Kothari: The growth assumptions what you are giving is with or without assuming any one-off product success?

Sameer Hiremath: All our plants are multi-purpose and we have multiple products for every plant. So, we de-risk our products and there is no reliance beyond a certain percentage on any individual product. So, we have de-risked our product portfolio significantly. So there is not a single product in the company that contributes to more than 10% of our total sales.

Rajesh Kothari: If there is any one-off major success, that can further add to your revenue growth?

Sameer Hiremath: Yes.

Moderator: Thank you. The next question is from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.

Pritesh Chheda: The new CAPEX that we are doing, that will start coming in FY'21, is that what you mentioned?

Sameer Hiremath: It will come on-stream end of FY'21. The full benefit will come from FY'22 onwards.

Pritesh Chheda: What capacity utilization are we operating currently at?

Sameer Hiremath: 75-80% is current levels, that is the recent capacity. By doing some debottlenecking for this year, that is why we are talking of little muted growth this year but the big growth will happen from FY'21, '22 onwards.

Pritesh Chheda: When we generally look at chemical companies at 17, 18% of top line growth, there is usually an amount of operating leverage which plays out. But in our case I am not seeing it. So, on operations if you have any comments as to why the extent of operating leverage is fairly less?

Sameer Hiremath: In our business, we have to invest well in ahead of time in fixed cost and manpower, in R&D, capital expenditure, infrastructure. It will catch up but there is a lag effect of a couple of years and that is the reason why we are not currently seeing the big leverage, but once the entire CAPEX comes on-stream, I think that is when you see the big operating leverage.

Pritesh Chheda: And you said it will take three years for the CAPEX from the date it gets operationalized to fully utilize the CAPEX?

Sameer Hiremath: I said 1.5 years after getting fully operational; 3-years from today to get fully utilized. And obviously there will be lower utilization earlier, but we will ramp it up.

Moderator: Thank you. The next question is from the line of Niteen Dharmavat from Aurum Capital. Please go ahead.

Niteen Dharmavat: My question is with respect to the raw material which is coming from Chinese market. So, how is the situation now with respect to availability and rates?

Sameer Hiremath: Availability has improved but prices have not eased off since the last 12-18-months. But we have been able to ensure that we passed on the increases to our customers. We do not see any issue with availability on the products and we have got multiple options and we are also de-risking China to a large extent by setting up alternate vendors in India so that ensuring that the security and supply is maintained for all our products.

Niteen Dharmavat: My second question is slightly generic in nature. What are the top-three challenges that you are facing as an organization currently other than the high capacity utilization you are running which is going to result in some muted growth this year?

Sameer Hiremath: First of all, I do not think 10-15% is a muted growth. I think growth is growth after all. But to come back to your next question about what are the top-three challenges, I think the first challenge for the chemical industry in general for Indian companies, I think the environmental laws are getting extremely stringent. National Green Tribunal, the local villages and towns are becoming very stringent. So, the environmental protection and environmental compliance is one of the biggest challenges for the chemical industry. And the ease of doing business I think which was also promised, has not percolated at least to our sector as what was expected from the government. I think we are expecting more easing on the way the business is done. And third I think is obviously the FDA in our Pharma business gets more and more tighter and more and more stricter. And these are the top-three things but we have to be in top of this and continuously focus on these three things to ensure that we are compliant and we have a sustainable way of working.

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

Rohit Nagraj: Sir, we are undertaking all the registration on our Crop Protection business. So, what is the exact strategy and what is the kind of investments that are needed for the same?

Sameer Hiremath: The strategy is that Hikal will register its own products and will own its own registration and then we will tie up with marketing companies in different geographies and formulation companies who will formulate and distribute our products. But the registration of the technicals will belong to Hikal and the investment is not much, it is about a million dollars per year in registration, it is not a very large number.

Rohit Nagraj: On the R&D front, last five years we have spent close to about Rs.250-odd crores on R&D. So, how the pipeline looks like and when we would see the benefit from the same growing to our revenues?

Sameer Hiremath: The benefit has already started and that is the reason the last two years if you notice our growth has accelerated and every year the R&D developing about four to five molecules on the Pharma Generic side, two to three products on the Crop side and about four to five CDMO projects. And all of this will ensure that we maintain our growth rates going forward. The R&D investment is only beginning to pay off now.

Rohit Nagraj: If I am right, you said that guidance for this year is 10-15% and next year it will be 15-17% because of the expansions that are coming?

Sameer Hiremath: That is correct.

Moderator: Thank you. The next question is from the line of Navin Shah from ValueCrest Investment Advisors. Please go ahead.

Navin Shah: Sir, my first question is if we look at the current year, we have demonstrated very good growth of around 22-23%. But when we see the margins, there has been not much improvement. So, what would be the reason for the same?

Sameer Hiremath: As I mentioned earlier, we are investing in the fixed cost ahead of schedule for our CAPEX, there is a lot of increase in manpower, R&D expenditure is going up, capital expenditure has already started and a lot of infrastructure expansion, especially for environmental compliance upgradation and quality compliance upgradation has already been done in this year. Once the entire CAPEX comes on-stream, I think the operational leverage will come on to fruition. Also, the last one year or two years, the raw material prices from China have gone up. Although we have been able to pass on the price increases to our customers, our percentage margins have not gone up because selling prices have gone up but input prices have also gone up. So, it is a combination of all the three factors.

Navin Shah: Because when we look at the growth like you mentioned 2% is the volume growth and the balance is from price increases and the mix improvement. So, then we should have seen improvement into the gross margins. But gross margins have actually remained flat if we compare them YoY?

Sameer Hiremath: Raw material prices did go up. As I mentioned, we could pass on the increases.

Navin Shah: But do we see a scenario where we have taken price increases and the benefit of that will flow into the current year?

Sameer Hiremath: It could happen. The prices in China are easing off but not to the extent. We will wait and watch. It is very unpredictable in China. So, we are a bit conservative on that side.

Navin Shah: Sir, at what percentage of our raw material we will be buying from China?

Sameer Hiremath: It is currently about 30% but we are bringing that down as we speak, it will come down significantly below that in the next two to three years.

Navin Shah: Like you said this year FY'20 we are looking at a growth of 10-15%. Are we expecting similar growth in both the segments or any of the segment is expected to do better than the other?

Sameer Hiremath: This is a blended growth. It will be 1 or 2 percentage here and there up and down between the two businesses, and more or less in line with this number.

Moderator: Thank you. The next question is from the line of Ankit Gupta from Bamboo Capital. Please go ahead.

Ankit Gupta: In FY'19 we have done CAPEX of close to Rs.130 crores. So, does it include a portion of CAPEX of Rs.350 crores that we are planning to complete in another 18-months?

Sameer Hiremath: Yes, it does because our CAPEX cycle, as mentioned in November conference call, had already started by then, so some more was done last year, and the balance is being continued and will be continued and completed in next 18-months.

Ankit Gupta: The entire Rs.350 crores will come in one shot or let us say some portion of that will be completed in FY'20 and some portion will be completed in FY'21?

Sameer Hiremath: Yes, it will come in phases one-by-one.

Ankit Gupta: Secondly, on your product pipeline, if you can specifically talk about some of the products which you are expected to launch on those agro and pharma side, on CRAMS as well as your own proprietary generic products, if you can just give a brief color on that?

Sameer Hiremath: We launch about three to four DMFs of our own on the generic API side which are on the CNS and the anti-diabetic portfolio products like Gliflozins, Gliptins as we have done in the past. On the CDMO side, unfortunately, we are bound by confidentiality. So, we cannot speak about the names of the products. On the Crop Protection side also, the proprietary products that we are launching are the mix of fungicides, insecticides and herbicides and they are a blend of all three. And the Custom Manufacturing again, we are bound by confidentiality, we are not allowed to speak on that.

Ankit Gupta: How many of the products are in pipeline on Contract Manufacturing in both Pharma and Agro which you are expecting to launch in FY'21, '22?

Sameer Hiremath: In Pharma, there are four to five products in the CRAMS pipeline. Three to four products under development every year on the generic side which we will file. In the Crop Protection side, we have got three to four products in the CRAMS pipeline and we expect to file about two to three proprietary products every year.

Ankit Gupta: I was just going through your DMF filings for Pharma products, some of Gliptins and Pregabalin expected to launch in the next two, three years. So, these are highly competitive products with 15-20 DMF filers and as per the last con-call we are expected to generate good amount of revenue from this new product. So, any view on the competition which is expected to come up in this segment and how are we so hopeful about getting the revenue from the segment?

Sameer Hiremath: That is a good question. The question earlier was about R&D expenditure. I think Hikal has done a lot on the R&D in the last four, five years in really differentiating (us) through technology. Our Pregabalin process is a very unique process. We have a cost leadership position which benchmark the pricing with the market and we believe we have a unique process. We have already made some launches. And through our technology differentiating and our quality that we are able to offer to our customers, we are pretty confident that we will be among the top-one or two players in these products.

Ankit Gupta: Any target revenue that you have in mind to be generated from these new products in three years down the line when your CAPEX will be completed, and we would have ramped it up significantly?

Sameer Hiremath: Any product that we are now looking at on the generic side, we are looking at a minimum revenue of at least Rs.50 crores per product, it has to be in excess of Rs.50 crores per molecule.

Ankit Gupta: On Contract Manufacturing side, any product that can contribute Rs.50-100 crores of revenue over the next three, four years?

Sameer Hiremath: It is a blend. I think we have two, three products that we are looking at with these numbers and they are being developed and scaled up and we expect them to ramp up in the next two, three years.

Ankit Gupta: Out of the Rs.350 crores CAPEX, how much of that is proposed to be spent for backward integration?

Sameer Hiremath: The molecule that we are developing, we are doing a lot of backward integration ourselves. I do not have the correct number, but at least 20, 25% will be used for backward integration of the total CAPEX.

Ankit Gupta: Last question on the gross margin side. This quarter, we have seen the lowest gross margin over the past eight quarters. Do you expect that this is the sustainable gross margin or because of the

China issue the raw material price pressures will continue to impact our gross margins going forward?

Sameer Hiremath: No, I think this quarter the gross margin was primarily lower on the Crop Protection side because of the product mix. I think that is the reason why the gross margins were the lowest in the four quarters. But we do not view this business from a quarterly basis. I think the annualized basis is a true reflection of the margins and a correct reflection. So, this is just a one-off. I do not think we will see these kinds of margins unless there is a major issue.

Ankit Gupta: Because of the issues in China in March, and the blast that we have seen in March, we have been hearing a lot of Agrochem and Pharma API manufacturers seeing very high increasing trend in enquiry. So, any views on that? Are we also seeing that in our business?

Sameer Hiremath: Definitely, we are seeing lot of enquiries coming in from China. So, lot of the CAPEX that we are doing right now is also linked to that and we are accelerating our CAPEX and trying to finish it as soon as possible, because the demand is getting pretty strong in our business, there is a very strong pull from the customers demand for products.

Moderator: Thank you. The next question is from the line of Neelam from Perpetuity Ventures LLP. Please go ahead.

Neelam: My first question relates to Gabapentin. What is your current capacity in the same, how much has it contributed to your revenue in this year and how has it grown?

Sameer Hiremath: From a capacity perspective, we are in excess of 1500 tons volume of Gabapentin and it contributes to about still less than 20% of the total revenue of the company.

Neelam: My second question is on the product and client concentration. So, the top-5 products and top-5 clients in both Pharma and Crop Protection each, can you please highlight on that?

Sameer Hiremath: I have the top-10 customers rather than the top-5 customers. So, the top-10 customers contribute to about 75% of revenue on the Pharma side and the top-10 customers on the Crop side contribute to 80% of our revenue.

Neelam: What about products?

Sameer Hiremath: Apart from Gabapentin which is about 20% which is also de-risked to a large extent because you have over 70 customers in Gabapentin. So, no single customer they have very large reliance on. No other product contributes to more than 7%, 8% of our total revenues.

Moderator: Thank you. The next question is from the line of Pratik Kothari from Unique Investment Asset Management. Please go ahead.

Pratik Kothari: Sir, just wanted to confirm, for FY'19 you said overall volume growth was 2%?

Sameer Hiremath: That is correct.

Pratik Kothari: But when we do somewhere around 13, 14% in the first half, then what was the volume growth in the second half?

Sameer Hiremath: I do not have the division quarter wise split in front of me. You can write to us. We can get back to you.

Pratik Kothari: Second, in the middle of last year FY'19 we had stopped this FX hedging. What is the view on that currently and have we started hedging back?

Sameer Hiremath: No, currently the markets are very volatile and our recommendation given to us is wait and watch currently and we will take a view after the elections are over.

Pratik Kothari: So, currently, we are leaving all our contracts open?

Sameer Hiremath: That is correct. We have a natural hedge anyway to our business.

Pratik Kothari: Yes, given it is more volatile currently, should not the need for hedging be more persistent now than earlier?

Anish Swadi: We have a free float. So, basically the free float right now for the company is less than 30% because we import raw materials which offset the revenue sales that we have and then we have foreign exchange loan repayment. Anytime it goes above 30%, then we put into place our hedging policy which is what it dictates.

Pratik Kothari: Overall what would be our revenue shares from Japan? I missed that.

Sameer Hiremath: Pharma business is lower, about 10% and the Crop business is close to 15%.

Moderator: Thank you. The next question is from the line of Rohit Ohri from Progressive Share Brokers Private Limited. Please go ahead.

Rohit Ohri: Hi, Sameer. Hikal keeps surprising quarter-by-quarter, year-by-year. I just remember that two years ago we were around 10 billion and that was a milestone that we achieved and today we are at around 1 billion of earned profit. So, the surprises keep coming from the company which is a great thing. As usual, I have one question, two parts: I am aware of the long-term prospects of Hikal and the transformation that is taking place and the amount of R&D and the focus that is on the technology transfers and the investments that are done in technology. My question is that are you looking at certain alternative chemistries maybe in the segments of flow chemistry or maybe bromination, chlorination or fluorination as such?

Sameer Hiremath: Thanks, that is an excellent question. As I mentioned earlier, we are differentiating our offering through technology and we are getting more and more involved in more complex generics and the Crop Protection products. So, the thrust in R&D is to acquire and implement new technologies and flow chemistry definitely is a focus area for us. We are commercializing. As we speak, a couple of products which are in the scale up mode and by the end of this year, we will have commercialized a couple of molecules. We are also looking at lot of products on the Biocatalysis side where we have had success by commercializing a few molecules. It is also greener. It also reduces the environmental footprint and also quality profile is very strong and superior. On Bromination, we are already doing that on a large-scale chlorination, hydrogenation and we are only expanding that business going forward. So, going forward, Hikal will be working on very complicated technologies and being known globally, as one or two of the top players on that space on the chemical engineering and chemical technology perspective.

Rohit Ohri: Second question again on the Panoli plant. In the last con-call you said that we were looking for certain inspections for FDA and then we are getting the approvals by the end of 2019. So, do you see that we are on track to get forward with the Panoli plant or do you see any hiccups or something as such?

Sameer Hiremath: The first significant development is that we have had environmental clearances received for the Panoli site. So, all the expansions have been approved by the state government and from the center. And from the FDA perspective, we are ready, I mean, when the FDA wants to come, we are ready to face the inspection, we are filing products in the next five, six months from the site and which will trigger an FDA inspection, so we are getting ready for that.

Moderator: Thank you. The next question is from the line of Chirag Patel from Atom Investments. Please go ahead.

Chirag Patel: Just a couple of questions: The first one is regarding ROCE or the return on capital employed on your Pharma business. It seems rather low. So, what ROCE can we realistically expect on your Pharma business going forward, any sort of color please?

Anish Swadi: When we look at the ROCE, we look at basically the company wise; currently we are 14.8% as we see it. Look, the target is to get to around 18% as the best-in-class company. The Pharma business currently has a legacy portfolio. As we introduce new products into the portfolio, which are higher value, higher margin products, automatically the ROCE will improve. One of the things we also do which kind of eats up into ROCE is they are fully backward integrated. So, we have utilized a lot of our quality facilities for making the early stage intermediates. But that helps to the security of supply. But as you go in further, as we build the economy of scale, you see the ROCE improve across the company, not only in the pharma division.

Chirag Patel: So, 18% will be the blended between Agrochem and Pharma, both right?

Anish Swadi: That is the ideal rate that we are shooting for right now. If you have seen in the last two years, we have gone from 10% to over 14.5%.

Chirag Patel: When do you think you will be hitting this 18% mark? In the next three, four years or sooner?

Anish Swadi: That is correct, in the next three, four years once we get the economies of scale, once the CAPEX comes into play, once the new products also commercialize and hit their running stride, we will see that.

Chirag Patel: And then it should likely be staying above 18 at least if not significantly above following that?

Anish Swadi: That is what we are working towards.

Chirag Patel: What according to you is the long-term prospects of Chemistry Pharma because at present there is a lot of chatter on biologics, biosimilars and the disruption it can cause to the traditional Chemical Pharma business?

Anish Swadi: As long as we keep taking medicines, Chemical Pharma will be very much there to stay. Yes, there is a lot of talk of biologics, biosimilars and I think innovators are moving towards it; however, the small molecule business is also growing which requires chemical development. What we are doing is utilizing technology to be a differentiator. So, we are utilizing, as Sameer mentioned earlier, is we are looking at Biocatalysis to differentiate from the regular chemical processes. These are cleaner, these are greener processes, and they are more sustainable. We are not getting into Biologics at this time nor are we doing Biosimilars, but I would not say we would not do it in the near future. Today we are a very focused company, we have got our target set out for us and the focus is on executing and reaching those goals.

Chirag Patel: But you think that the chemistry pharma will not just die away anytime soon just because of the biologics coming into the horizon?

Anish Swadi: No, I do not.

Moderator: Thank you. The next question is from the line of Apurva Mehta from AM Investments. Please go ahead.

Apurva Mehta: We are currently in the pharma side, 50% we are on the Contract Manufacturing, we are 50% on the Generic. Going forward in next two, three years, what kind of mix we can see in this – are we focusing more towards the generic product side and we want to increase that pie or what are your thoughts on that?

Sameer Hiremath: The aim is to have a hybrid model which is between contract and generic. But I think for the next two to three years, as we launch our own generic molecules, there may be a slight increase in the generic percentage. But the objective is to try and have a balanced portfolio between

Generics and Contract Manufacturing. In both the businesses, we are seeing a lot of opportunities now more and more. So, we are pretty confident that we will be able to maintain, maybe slight one or two years could be little up and down, but we will target 50:50 split also going forward from a medium to long-term horizon.

Apurva Mehta: So, on the Crop side, currently our own product is at 20%. So, what kind of shift we can see over there?

Sameer Hiremath: On the Crop side, we are moving towards almost 50% of our own products in the three to four years. We are launching two, three new molecules every year of our own and that is a big change in the Crop side.

Apurva Mehta: How is the pipeline for the Contract Manufacturing being where lot of talks are there, lot of people are de-risking from China because of environment reason, so what kind of pipeline do you see? Are we seeing more people coming and having talks with us for Contract Manufacturing or something like that?

Sameer Hiremath: Yes, the customer visits have increased substantially in the last one year and more so in the last six months, so we are seeing a lot of enquiry, a lot of interest and we are tying up, but everybody wants to see some steel on the ground, some commitment to CAPEX and we are telling our customers we are building the plant, showing them the plant, so we are getting more and more enquiries and people are willing to sign up pretty quickly now with us.

Apurva Mehta: If a customer starts visiting from today, what type of normally a timeline is there where he starts giving you quantity which is a remarkable quantity to come in?

Sameer Hiremath: It depends. On the Pharma side, it is obviously longer because we have to do approvals and things. Pharma side can be between 24 to 36-months depending on the type of product. On the Crop side it is faster; it could be between 12 to 24-months.

Apurva Mehta: When we were talking about the Japanese customers being more aggressive nowadays, so how do you see that shift happening and where do we see Japanese customer, the pie which is currently 10% to 15% go to-in the next two to three years?

Sameer Hiremath: The Japanese business is definitely growing pretty strongly with the PMDA approval in Japan. We are launching several of our APIs in Japan as well. We think that Japanese business will go closer towards 15% to 20% in the next few years of the total business.

Moderator: Thank you. The next question is from the line of Akash Manghani from BOI AXA Mutual Fund. Please go ahead.

Akash Manghani: I noticed that you mentioned fixed asset turnover on the incremental CAPEX would be in the range of 1.5 to 1.75. I am looking at the financials of the company over the last seven or eight years barring the last financial year, the asset turns never really went beyond one. So, the question is what are the new products you are doing incrementally which will allow you get this sort of significantly high asset turn -- is it just a function of much higher pricing in the market prevailing currently because of effect of what is happening in China or there is a sea change in what you are doing in this new CAPEX versus what was there in the business earlier? That is the first question? The second question is what will be the incremental margins on this new capacity that you would be generating? And third is how are you going to fund the CAPEX?

Sameer Hiremath: I will answer the first question first. I think that was regarding why you are seeing the asset turnover will be between 1.5 to 1.75 which has historically being closer to one. Historically, lot of the CAPEX was to do with Greenfield site and older legacy products which has kind of depressed the asset turnover ratio. A lot of that was also used for infrastructure creation in the past. Going forward we are working on more Brownfield type of projects. As a percentage of the total CAPEX, growth capex percentage is higher. Secondly, the product mix and types of products we are getting into are more high value-added, more complex generics with a higher margin perspective. Thirdly, with the whole China scenario taking place and as a company that has a good environmental and quality compliance track record, now we are able to get better margins than where we were a couple of years ago. I think the combination of all three, due to which we are pretty confident that between 1.5 to 1.75 asset turnover is achievable for a new CAPEX. Your second question was where do you see the EBITDA margins for the new products with the new CAPEX. I think we feel pretty confident that we will meet excess of 20% EBITDA margins for the new molecules.

Akash Manghani: Is it 20% or in excess of 20%?

Sameer Hiremath: In excess of 20%.

Akash Manghani: How will you fund this project? How much already on the ground done?

Sameer Hiremath: We have done out of Rs.350 crores, Rs.140-odd crores in the last year and the balance Rs.200 plus crores or a little bit more will be done in the next 18-months. It is a blend of internal accruals and debt about 50:50 split.

Akash Manghani: Incrementally, over the next two to three years, is the working capital cycle of the business going to be similar to what it has been or it should improve or what are your thoughts on that?

Sameer Hiremath: It has come down from about 140 days to 120 days in the last 12-months, by about 20 days this year, and we expect to make improvements year-on-year going forward.

Akash Manghani: Where would you want to aspire to be?

Sameer Hiremath: About 100 days.

Moderator: Thank you very much. Ladies and gentlemen, due to time constraint that will be the last question for today. I will now hand the conference over to the management for closing comments.

Sameer Hiremath: Thank you. I would like to take this opportunity to thank everyone for joining this call. I hope we have been able to address all of your queries. For any further information, kindly get in touch with Strategic Growth Advisors, our Investor Relations Advisors. Thank you once again and have a good evening. Good bye.

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