# "Hikal Limited Q1 FY2022 Earnings Conference Call"

## August 06, 2021

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**Moderator**: Ladies and gentlemen, good day, and welcome to the Hikal Limited Q1 FY2022 earnings conference call. This conference call may contain forward looking statements about the Company, which are based on the belief, 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 is being recorded. I now hand the conference over to Mr. Sameer Hiremath – Joint Managing Director & CEO. Thank you and over to you Sir!

**Sameer Hiremath:** Thank you**.** Good afternoon and a very warm welcome. I am Sameer Hiremath – CEO & Joint Managing Director of Hikal and along with me I have Mr. Anish Swadi – President of Business Development and Strategy, Mr. Kuldeep Jain – our Chief Financial Officer and Strategic Growth Advisor, our Investor Relation Advisors.

We hope you and your family members are safe, healthy and are continuing to take all the precautionary measures. I am pleased to interact with all of you on our Q1 FY22 earnings call, which is a change for our half yearly calls. I hope you have gone through our earnings release, presentation, and financial results for the quarter. You can find these on the stock exchanges and on our website too. As an organization, we continue to follow all the necessary guidelines to safeguard our employees as well as ensuring that manufacturing operations are not hampered due to COVID-19 reasons. Our Company-wide vaccination drive has so far covered nearly 85% of our total employees including our contract work force with the first dose of vaccine while the drive for second dose is also on track. We have instituted a special welfare program for our employees and their families who are affected by the COVID-19 pandemic. We began the previous quarter impacted from the effect of the second wave of COVID-19. While the impact was not a severe as the first wave and did not lead to complete shutdown, it did have some impact in delayed delivery of raw materials and manpower availability. This in combination with a temporary halt in supply of industrial oxygen in the month of May as our Taloja facility also had an impact on the Q1 FY22 financial performance. However, we used this opportunity to perform annual maintenance activities in order to mitigate the loss of production. We reaffirm our full support to the decision to divert the oxygen from industrial use to medical use for the greater good as the priority is public welfare.

Now, let me take you through the financial performance. Talking about our Q1 performance, revenue for the quarter was Rs. 457 Crores, registering a year-on-year growth of 29%. Our EBITDA came at Rs.96 Crores, which is a growth of 82% year-on-year, EBITDA margins saw an improvement of 606 basis points to 21% as compared to 14.4% in Q1 of last year. The improvement in EBITDA margins is due to higher volumes, favorable product mix, our business excellence initiative and higher operating leverage. HIBEX - the business excellence initiative of the Company which has been put in place has enhanced the Company's overall performance by increasing throughput and reducing cost of our existing products. It has helped us to improve our efficiency and meet increased market demand. The Company's cost of financing has reduced due to lower rates of interest which augurs well for the Company and we expect the benefits to continue accruing. The Company has moved to the new favorable corporate tax regime, the effective tax rate will be approximately 26% as compared to 35% in the last financial year.

Our pharmaceutical division registered a strong revenue growth as well as an operating profit growth for the quarter aided by the superior product mix and higher operating leverage. The division recorded a revenue of Rs.274 Crores, which is higher by 28% on Y-o-Y basis compared to Q1 of last year. The EBIT for the division came in at Rs.48 Crores which is a Y-o-Y growth of 121%. This translates to an EBIT margin of almost 18% compared to 10% in Q1 of last year, expansion of 730 basis points. This past quarter we received local approvals to start producing API at our Panoli site and we will also be undergoing US FDA approvals and certification at this site shortly. An additional new multipurpose production block will also be commissioned at our unit-1 Jigani site in Bengaluru in the next quarter. We have started supplies of Favipiravir API during the past quarter.

Our crop protection revenue for Q1 was Rs.183 Crores which is a Y-o-Y growth of 31%. The EBIT for the division was Rs.32 Crores which is an increase of 89% compared to Q1 of last year. The EBIT margin was 17.4% for this quarter compared to 12.1% in the Q1 of last year. We have commercialized a new fungicide for a Japanese customer in our CDMO business last year as highlighted in the last call. This quarter, we have successfully ramped up the production and increased volumes to our customer. Our business development team has been ramped up to capture new opportunities on the contract manufacturing and development side. Several new opportunities have been received from newer existing customer and our pipeline has a healthy mix of opportunities. Towards the end of July, the Raigad region experienced unprecedented and very heavy rainfall. Due to this, our Mahad site located in this region bore the brunt of severe flooding. We immediately took a safe shutdown at the site to ensure safety of our employees. We have mobilized all the necessary resources required from our various sites to assist in the cleanup, restoration, and safe restart of operations at the site. We have completed most of the cleanup and the repair to the damaged equipment is ongoing. All efforts are being made to ensure safe restart of operations at the earliest.

Post several hurdles faced due to the pandemic, our capex program is back on stream. We have commissioned additional capacity at development and launch plant in Bengaluru. This is primarily for our new development pipeline in our CDMO business. We expect to complete several ongoing projects in the next few quarters of this year. We are working across our supply chain to minimize disruptions caused through the pandemic. We have initiated efforts to backward integrate the key starting materials of the primary active pharmaceuticals ingredients and active ingredients, and are collaborating with local manufacturers to reduce our dependency on China. We have taken pro-active steps to develop both local and other non-China region based suppliers. We also partnering with European suppliers in certain specific areas for supply chain security. We have seen some success in the past quarter with our de-risking strategy and will continue the next few quarters to further develop and intensify and diversify our supply base. Currently, we are experiencing cost escalation in raw material prices due to shortages. In addition, freight rates have substantially increased over the past few months due to the pandemic situation and repercussions from the Suez Canal incident in the last quarter.

Hikal has successfully established a strong footfall in the pharmaceutical and crop protection business. In line with our vision, we have set a bold aspiration of driving sustainable and profitable growth and moving to Hikal 2.0. As part of our transformational journey and as we have conveyed in the previous call, we have already engaged a leading global consulting firm to work along with us which will enable us to pivot our growth in a sustainable manner. The journey forward will entail accelerating growth in our existing pharma and crop protection business as well as investing in emerging business verticals such as animal health and biocides. We have started our transformation journey to move to Hikal 2.0 in the quarter. In terms of the outlook, we stand by our projected growth in topline at a CAGR of high teens along with improvement of approximately 100 basis point improvement EBITDA margin per annum over the next two years to three years. This growth induced on multiple drivers starting with our ability to convert numerous new product enquiries and new projects from top global customers into concrete business backed by a global shift in strategy of creating an alternative to China by focusing on our core strength. There is a shift in global supply chains towards the China plus one strategy. We believe that India is likely to be a big beneficiary of this shift. The policy support from the Indian Government through schemes like performance linked incentive scheme under Atmanirbhar Bharat is likely to provide opportunities for us in the near term. We have significant tailwinds in our business and are working towards capitalizing on several of them.

With this, we will now open the floor to Q&A. Thank you.

**Moderator:** Thank you very much. We will now begin the question-and-answer session. Anyone who wishes to ask a question may press "*" then "1" on their touchtone telephone. If you wish to remove yourself from the question queue you may press "*" then "2". Participants are requested to use handsets while asking the questions. Ladies and gentlemen please limit your questions to two per participants. Should you have a follow-up question, request you to rejoin the queue. The first question is from the line of Rohit Nagraj from Emkay Global Financial Services. Please go ahead.

**Rohit Nagraj:** Thanks for the opportunity. The first question is sequentially we have seen a dip in both our crop protection as well as pharma business, so have there been any postponement of orders because of the logistical issues or the export orders and will that effect come in subsequent quarters? Thank you.

**Sameer Hiremath:** To answer your question, I mean there has been no deferment of orders. Our first half is always smaller half as compared to the second half of the year historically and there is no impact of any delay of any orders, it will all pick up in the second half of the year.

**Rohit Nagraj:** Thank you. The second question is in terms of molecule development, so how are we currently placed and what is the timeline for the next two to three years in terms of commercialization of molecules across both crop protection and pharma segment? Thank you.

**Sameer Hiremath:** Well we have several products under development and if you look at our crop protection business, we have 7 to 8 products under development at any given time in pharma business a little bit more about 10 to 12 products under development. Apart from this, we also have our own generic pipeline of own products which we are developing. In the crop side, we are launching three new molecules this year and in the pharma side we will be launching around four new products this year which will be a mix of own products and CDMO.

**Rohit Nagraj:** Right, understood. That was really helpful. Just one last clarification on the ten-year multiproduct deal, any further update on this? Thank you so much.

**Sameer Hiremath:** The contract was signed as you are aware in the last call as well and we have already started the work on the project and the project is moving as per the timeline. Everything is on track.

**Rohit Nagraj:** 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**: First question is that input raw material inflation is not visible in our margins, so has that been completely passed on or if the operating leverage which is covering it on?

**Sameer Hiremath:** There are two reasons for it**,** one is that there is a pass through cost for most of our raw materials with our customers which was also asked I think in the last investor call, so there is very little impact to us on the margin. Secondly, wherever there is an impact on our costing, we have improved our operations leverage and operation efficiency. The raw material prices have definitely increased in the pandemic and there is a big issue right now also with shortages due to logistics and freight charges, but we are able to mitigate that to a large extent.

**Dhaval Shah**: Which raw material any specific where there is a large increase, if you can quantify?

**Sameer Hiremath:** The basic chemicals and some solvents have gone up because crude oil price have gone up but mostly the transportation prices have really gone up, freight cost have really increased, you might have seen a lot of newspaper articles on this and there is a huge increase especially in the large two – three months freight fare have gone up exponentially but we have a pass through clause with our customers**,** so we do not take much of the hit.

**Dhaval Shah**: So, pass through is with each new PO which is made, so is it at a new price or how is it the pass through?

**Sameer Hiremath:** We have Annual price, and then we are reconciliation clause. If there is a runaway price increase, then we can take it up to the customer we can adjust in every PO.

**Dhaval Shah**: Okay. Second question is on the Favipiravir contribution if you can share?

**Sameer Hiremath:** Yes, wedid do some Favipiravir sales in the first quarter. It is about 2% of our pharmaceutical division right now. A small product, a niche product we are just doing whatever best we can to help with the cause of COVID.

**Dhaval Shah**: Okay and capex is incurred and what is the amount we should be capitalizing in the current year?

**Kuldeep Jain:** We discussed in the last meeting as well. Capitalization will be close to Rs.300 Crores for the entire year to which Rs.75 Crores has already been done in Q1.

**Dhaval Shah**: Okay, how much you said Sir?

**Kuldeep Jain:** Rs.75 Crores we have already done, capitalization in Q1.

**Dhaval Shah**: Okay and next year you are yet give any guidance on the capex side?

**Sameer Hiremath:** No, we started our capex about two years ago. We had to put in capex by about Rs.300 Crores which is being completed by end of this year but we also in the meantime we acquired significant new contracts, one of which is that ten year contract, and apart from that we are also acquiring some new big contracts which we are working with our customers, for which we will need even more capacity, so we are looking at this but we expect to put in a fresh phase of capex in the next two years which we will start putting the capex in the ground in the next few quarters, which should be another Rs.250 Crores over the next two years but this we will start once the earlier capex is over. We will start that next item.

**Dhaval Shah**: Okay, so Rs.250 Crores over 2023-2024.

**Sameer Hiremath:** Yes. FY2023-FY2024

**Dhaval Shah**: Okay, got it. With the same sort of capital matrix of the turnover, asset turnover margins.

**Sameer Hiremath:** Yes, we have that very strict guidance in our Company and we do not do anything if they are not fitting in those norms. We try to do even better but there is a bare minimum we will try to achieve.

**Dhaval Shah**: Got it. Great Sir, good luck. Thank you.

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

**Viraj Mehta:** Great numbers Mr. Hiremath. Sir, just a couple of questions, first was if I look at our gross margins, they are at 16 quarter high, just wanted to understand in your view, are these roughly 50% gross margins sustainable number?

**Sameer Hiremath:** Sorry, if you could repeat, I could not hear your last part what you said?

**Viraj Mehta:** These kind of gross margins in your view are these sustainable in a slightly longer term?

**Sameer Hiremath:** We have given guidance for what we expect the margins to be I mean quarter-to-quarter there could be little up and down depending on the product mix, but we had a favorable product mix for sure in Q1, but whatever guidance we gave 100 basis points improvement in margin year on year I think we stick to that.

**Viraj Mehta:** Right and just my last question can you talk a little bit about the scale up in Pregabalin and how has that worked out and what is the scale you are kind seeing in that product and how have been the spreads in Pregabalin and Thiabendazole**?**

**Sameer Hiremath:** How has been what, sorry I could not hear you in the last, you are not very clear?

**Viraj Mehta:** Scale up in Pregabalin and Thiabendazole**?**

**Sameer Hiremath:** Thiabendazole volumes are growing every year, I mean there is a marginal growth in Thiabendazole volume every year because it is a very old mature product but the volumes are growing in low single digit for Thiabendazole but Pregablin, we commercialize a few years ago, we have already a significant ramp up in the last financial year, for this financial year we are expecting even steeper rise in volume and we are getting approvals in new markets like the Japanese market just opened up a few months ago. We are the primary supplier in Japan to almost all the companies there, Europe volumes are increasing, we are getting some new approvals in United States, so we are seeing lot of interest in Pregabalin, and we have got a very strong cost position and we have a strong good technology on that, so we see this becoming very large molecule for us in the next one year to two years.

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

**Moderator:** Thank you. The next question is from the line of Sandeep from East Lane Capital. Please go ahead.

**Sandeep:** Sameer, I have two questions, one is if you could just talk a little bit about Hikal 2.0, how different would it be from current Hikal in terms of technologies, manufacturing infrastructure, the kind of products you can do, just a broad sort of three years to four years outlook, how different will the organization look in the medium to long term?

**Sameer Hiremath:** Hikal 2.0 is something that we have been working on for the last year or so and then we have formalized this through global consulting that we brought on board in the last quarter but the whole emphasis on Hikal 2.0 is having global leadership and becoming a global Company in the fine chemical space catering to the pharmaceutical industry, crop protection industry and creating two and if not two at least one new vertical of animal health and taking it to the next level and that is really how we are accelerating our growth in margins and also achieving revenue growth which is far excess of what we have been doing historically. It is based on five key strategic pillars, one is manufacturing excellence to setup large flexible manufacturing asset with high levels of digitization industry 4.0. The second is to work on complex chemistries and new technologies, the third is to de-risk our supply chain and to digitize our supply chain, the fourth is to become from a strong in EHS which we think Hikal is already a strong player on EHS to become a leader in value creation through ESG and sustainability and the fifth is to improve our customer addition, to become more customer centric to approach the key account management. Along with this we are looking at digitization across the value chain in our Company and we are also looking at opportunities for partnership, alliances and even potential M&A going forward, so it is based on seven pillars and which we are looking at our growth strategy of Hikal 2.0 over the next five years.

**Sandeep:** Understood and can you talk about you have mentioned this year how many products you would be launching but just a funnel for crop protection and pharmaceutical both on the CDMO side, how do you see that developing, how many are in phase-3, phase-2 or these are more products it will be getting genericized and you will be working with the innovators, just a flavor of that would be very useful?

**Sameer Hiremath:** Yes, if you look at our crop protection side, we are currently having about five to six products under development or under launch at any given time and that is the kind of pipeline that we are looking at and we have actually seen that number increase year-on-year and this year we will be launching three of those products out of which one is in development. On the pharma side, we have about seven to eight products on CDMO side and three to four API under development and we again expect to launch almost 50% of that in this year and the next year as well, so the pipeline is pretty healthy, we are looking at. We have also strengthen our R&D center in Pune, we have got new labs and we have increased the man power in our scientific strength and we are seeing increased tractional number of RFPs and enquiries increasing, so these number will start moving upward as part of our Hikal 2.0 initiative, the idea is to increase the number dramatically upwards over the next few years.

**Sandeep:** And if I may ask one last question, just the opportunity you see in Sitagliptin, that is a large volume product you have clean chemistry and enzymatic processes, what kind of an opportunity it could be, is it a very large, exciting opportunity?

**Sameer Hiremath:** Well, It goes off-patent after a few more years, so it is going to be a competitive molecule but we expect to be like what we have done in Pregabalin, get kind of a leadership position in the product because we have got a good traction, we have already got customer approvals again we have got approvals in Europe and Japan has also approved us as a supplier and then we are talking to many other customers, so it could be a pretty significant molecule, it is still three years to four years from expiry but we are doing a lot of work and the process is very unique and we have an enzymatic green process, so we believe that we are quite hopeful that it will become very big molecule for us, the time will tell but we are working towards that.

**Sandeep:** Thank you.

**Moderator:** Thank you. The next question is from the line of Mithun Mehta from Lucky Investments. Please go ahead.

**Mithun Mehta:** Good evening to the entire team and congratulations on a great set of numbers and great execution. Sir, wanted to know from you as within your crop protection and pharma, as to top five products and top ten products contribution, is it possible for you to quantify that number so that we can get some understanding?

**Sameer Hiremath:** I have a number for the top ten customers, I can give you that. In pharma division, top ten customers contribute to around 70% of our revenue, but they have multiple products each. In our crop protection division, our top ten customers contribute again to 75% of our revenues slightly higher than the pharma but it is with multiple products, no single customer in our either pharma or the crop business contributes to more than 10% of our business and no single product apart from Gabapentin contributes to more than 7% or 8% of our total business.

**Mithun Mehta:** Okay, great. If you recall in our previous Q4 conference call, you did allude to the fact that incrementally our gross margins for new products will be in excess of 60% or closer to 60%, so is it the reason why our gross margins are looking far more healthier today than what they were used to before, if you could just throw light on that?

**Sameer Hiremath:** Well, new products as I have been saying in the last several conference calls new products contribution in gross margin is higher than the old existing molecules and as new products come in, some of which have come in Q4 and more have come in Q1 because there are favorable product mix, there is definitely improvement in gross margin which is likely to sustain going froward as we launch more and more new molecules. So, I do not know the number 60%, but it is definitely in excess of 50%.

**Mithun Mehta:** So, this year and next year if you can just give us a road map of new product introduction in crop protection and pharma in your CDMO as well as own products?

**Sameer Hiremath:** I think just somebody has asked this question before I will just repeat that, we are doing three products in crop protection side and four products on the pharma side that we are launching this year.

**Mithun Mehta:** And subsequently, in FY2023?

**Sameer Hiremath:** It is about the same I think every year we will go up even more slightly probably, the idea is to intensify our business as part of Hikal 2.0.

**Mithun Mehta:** Okay and how many such products would be there in your pipeline currently in your pharma and crop protection, how many products you would be working at this juncture?

**Sameer Hiremath:** Answer is again I mean so we currently have in the crop protection side about 5 to 6 molecules that we are currently working on, six products actually to be exact and on the pharma side we have got 11 to 12 products that we are currently working on in the pipeline.

**Mithun Mehta:** Right and all of these products would be patented, or they would be generic also?

**Sameer Hiremath:** They are a Combination. The CDMO is more patented, the APIs are generic.

**Mithun Mehta:** Yes, I have a very broad question to you, since we track this sector for many years now, we have seen very successful wealth creation that has happened in this particular sector, be it Divis, be it PI Industries, be it many other companies, Hikal obviously was a one which was kind of lacking behind for obvious reasons which seems to have done phenomenally well in last 12 months and therefore we will continue our good work. Just a question to you, where do you see yourself with Hikal 2.0, three to four years from now, do you believe firmly that we can build a very scalable business in both pharma and crop protection?

**Sameer Hiremath:** Yes, that is exactly what Hikal 2.0 is all about, its excellence and leadership in both our pharma and crop protection business I mean we are one of the few companies that have both the verticals, some of our competitors are trying to do what we have done. We were doing it well, we have a track record and we are seeing traction and growth accelerating now in both the segments because we have a very good track record on compliance, EHS, ESG. Our growth is going to intensify and we are going to get faster, our margins are going to get even better going forward.

**Mithun Mehta:** Okay.

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

**Pranay Dhelia:** First of all, many congratulations on the stellar numbers and being a billion-dollar Company. If I recollect last call, I have said shareholder let's look for 1 billion and you did it much sooner than expected and I hope that this is the starting point as you said and as a shareholder, we will be happiest to become a $5 billion Company which I am sure the management will help us. Two questions, one is what is the total debt you have on the books and are you looking to raise any further debts for the capex that you are planning or your internal cash flows will be good enough?

**Sameer Hiremath:** Well, current debt on our books has actually come down, it was Rs.616 Crores at the end of March, now it is Rs.595 Crores, it has come down because our working capital has reduced considerably in the last quarter because of operating leverage and improvement in efficiencies, what is the second question?

**Pranay Dhelia:** Not the second question continuation of this was do you have to raise more debt, or it will be done through internal accruals only, the capex that you have planned?

**Sameer Hiremath:** It is a combination of both internal and debt because our cost of debt has also come down significantly, interest cost has come down, as you can see our finance cost in our numbers have also come down, so everything is manageable, and this is going to our total debt numbers are coming down and percentage of….

**Pranay Dhelia:** You said at last call FY23 end you look to get debt free**?**

**Sameer Hiremath:** Debt free, did you think that. It is very optimal debt I think, our debt is no cause of concern. We have significant coverage on our debt, and it is very manageable level, debt equity actually has come down from 0.71 in FY2020 to 0.64 in FY2021 to 0.56 in Q1 of this year, so it already is coming down on a continuous basis, obviously we will work on bringing it down even further next few quarters and next few years.

**Pranay Dhelia:** My second question is that how much of revenue will be further accrued from the two new capacities that you are looking as in Q2 FY2022?

**Sameer Hiremath:** Well it takes a year or 2 years to ramp to full volumes because of validation and customer approvals, regulatory approvals but once you get those in place, we expect asset to about 1.5 for the new capex.

**Pranay Dhelia:** You expect 1.5 X asset turnover?

**Sameer Hiremath:** Yes.

**Pranay Dhelia:** My last question what is the impact on the Mahad plant, how much of a revenue decline are you expecting, revenue EBITDA you are expecting for this quarter?

**Sameer Hiremath:** Well, unfortunately the Mahad-Raigad incident took place on 22 July – 23 July and we had to take a safe shutdown of our operation. The plant is currently shut as we informed the stock exchanges well and we are currently undergoing repair and cleaning up of the site. We are putting all the efforts to try and start the operations in the next two to three weeks.

**Pranay Dhelia:** How much loss in terms of revenue?

**Sameer Hiremath:** Mahad site contributes to about 15% of our total Company on an annualized basis, so say out of action for about four to five weeks, then you can get that number.

**Pranay Dhelia:** 15% four weeks to five weeks. Okay fine Sir. Thank you so much.

**Moderator:** Thank you. The next question is from the line of Aditya Khemka from Incred Asset Management Company. Please go ahead.

**Aditya Khemka:** Thanks for the opportunity. Sir, two clarifications, first of all, you said Mahad site 15% of total revenue, is that right?

**Sameer Hiremath:** On an annualized basis.

**Aditya Khemka:** On an annualized basis, right, so that is clarified and then earlier you have made on capex so that was Rs.125 Crores for 2023 and 2024, therefore Rs.250 Crores two year put together, is that right?

**Sameer Hiremath:** That is right. Apart from the current capex which we are doing in the last two years, yes.

**Aditya Khemka:** Yes, so just wanted to clarify those two things. Okay, so my first question is on the run rate, the revenue run rate that we have been doing in pharma and the EBIT margin, so we have been in that Rs.270 Crores – Rs.290 Crores of quarter with about 16%-17% EBIT margins for the past four quarters, what is it that you seek in now help us to go to the next leg, I know you are introducing three to four new products this year, you said that on this call but what is the market opportunity of these products, what is the stickiness of the revenue that you expect from these products and what will drive your operating leverage because 17% EBIT margins in CDMO of business in pharma seem suboptimal to me?

**Sameer Hiremath:** As we get operating leverage and we get scale and I know we get volume increases which is going to be happening in this year when our new capacity starts coming on stream in the second half of this year, we expect the revenues to go in the high teens as I have given guidance earlier, that will obviously improve our EBIT margins also even faster than the growth in revenues going forward.

**Aditya Khemka:** Understood and sir you made a comment on the gross margin where you said you expect the gross margin to remain where it is this quarter 51% or 50% in that region given that in your product has higher margin but then, your full year FY2021 EBITDA was 19%, this quarter you have done 21%, yet you are guiding for 100 basis points expansion for the full year for their coming few years including this year, does that imply that in the coming three quarters of this year you expect some escalation in cost and therefore some suppression of EBITDA margin from this 21% towards 20%?

**Sameer Hiremath:** There has been lot of uncertainty happening and in this COVID year, there are freight issues, there are shortage of raw material, there is flooding happening at site, there is oxygen shutdown, there is so much uncertainty in the business. We will rather be a little bit conservative and give you some guidance rather than the obvious idea will be to do better than that. We expect that it will be better than what we guide but in view of the uncertainty this is what we believe, and we like to stick to the guidance we gave post Q4 for numbers, but we aim of trying to do better that that.

**Aditya Khemka:** Understood and I appreciate that so just one last clarification on the oxygen supply shortage that you had this quarter, the past quarter Q1 of FY2022 could you quantify what impact that had on our revenue and margins or just revenue if you can because I am sure you will not be able to produce a few products because you did not get the industrial oxygen?

**Sameer Hiremath:** The site was shut for about three weeks because of oxygen supply and we used that time to do annual maintenance shutdown so that to reduce the impact on production because that is way we have to be taken in end of Q1 and on Q2 which we normally do, so the revenue impact was about Rs.5 Crores for the quarter.

**Aditya Khemka:** Around Rs.5 Crores of the quarter, okay. Thank you and all the very best.

**Moderator:** Thank you. The next question is from the line of Aejas Lakhani from Unifi Capital. Please go ahead.

**Aejas Lakhani:** Congratulation on the fantastic set of numbers. I wanted to learn more about Gabapentin, I like to learn more about our installed capacity, how do you see demand panning out, do you see any price realization pressures, any input price pressures and how the shift is taking place from Gabapentin to Pregabalin? Thanks

**Sameer Hiremath:** First of all, the capacity is well in excess of a 1,000 tonne significant in excess of a 1,000 tonne and the global market for Gabapentin is growing even now even during the COVID year and Pregablin also is growing and we supply both to the markets, so we are not seen cannibalization of Gabapentin because the Pregablin, they are both different therapies and different segments of patients and population that they cater to, it is a different price point and both are growing, so initially when Pregablin was launched generally there was a feeling that it may cannibalize Gabapentin volume but Pregablin already impacted over the last several years and we do not see that happening, so both continue to grow. Regarding the pricing pressure, I think as prices are stabilizing in Gabapentin and margins are stable, raw material prices also have stabilized and so we do not see any significant impact on margins on Gabapentin going forward.

**Aejas Lakhani:** I just wanted to understand that could you give some quantitative color of what kind of growth you expect from Gabapentin going forward?

**Sameer Hiremath:** Gabapentin is a very old product. We launched in 2005, so about mid to high single digits.

**Aejas Lakhani:** Got it. Thank you, Sir.

**Moderator:** Thank you. The next question is from the line of Anish Moonka from JST Investments. Please go ahead.

**Anish Moonka:** Thank you for the opportunity Sir. My first question is on the emerging business vertical of biocides. Like we have already mentioned in our FY2020 annual report that we have commercially launched one biocide and how we also have a pipeline of products at various stages of development, so could you please share about the current developments in this vertical, the opportunities that you foresee and the competitive advantages that we bring to the table? Thank you.

**Anish Swadi:** Thanks for the question. Biocide is certainly an interesting vertical for us. We see a significant growth potential over the next three years to five years primarily coming from imports coming in from China and demand in Europe as well as the US market, we have a portfolio of biocide that we have identified which are currently under development, we have initiated some customers in terms of sending samples and we are receiving some positive response. It is part of our overall strategy to diversify the crop protection vertical into creating another vertical under biocides and specialty chemicals, so we do see this potentially as growing over the next several years just as we talked about the animal health division, in terms of quantification, it is a little difficult to say today what we expect but we definitely think that this could be a Rs.100+ Crores potential over the next four years to five years as we go forward.

**Anish Moonka:** Thank you. My next question is what we hear from like every CDMO, API, chemicals or pharmaceutical Company is that they are all augmenting their R&D capabilities, so have we seen any increased attrition or salary inflation in our R&D division also in addition to that, I wanted to understand the boards thought process behind ESOP given that we are already a billion dollar Company? Thank you.

**Sameer Hiremath:** Well, you are right I mean every Company is looking at R&D but we have not seen any significant attrition increase in the last year I mean we have got very good policy for our employees, Hikal has won the great place to work and best employer brand for several years in the country and we have lots of employees friendly policies in the Company taking care of employees and their family members through we have a very manageable attrition levels in our Company. So we do not see any issue there, we are below industry average on the attrition level. The second question is regarding ESOP, we do not have any ESOP plan in the Company. We have an incentive program for our employees based on performance and with Hikal 2.0 and a next five-year vision we have got long term plan for our employees based on that.

**Anish Moonka:** Thank you and all the best.

**Moderator:** Thank you. The next question is from the line of Raghunath, an individual investor. Please go ahead.

**Raghunath:** This flooding issue is occurring too often, last time also we have suffered because of floods, is there any long term fix for this so that this will not be repeated?

**Sameer Hiremath:** It is a long-term fix? what is the question, is it a long term fix for what you are saying?

**Raghunath:** Yes, so that we can avoid this kind of situations in the future, is there any plan for that?

**Sameer Hiremath:** We are looking at a new facility and putting in place all the anti-flooding measures, but you know if it rains 840 mm in 24 hours, I mean no system can avoid that, this is the worst rain in the last 50 years which is absolutely peak. Last year flooding was minimal compared to this, this year was very severe flooding situation but whatever new plants that we are building a new site we are doing is we will ensure that we take care of these measures to the maximum extent possible. We are working with the Mahad MIDC to help us with desilting of the river and improving the width of the river which was the flooding which took place, so there is lot of measures have been taken, so hopefully, if this happens then they can minimize the impact on operations and this is where our multi site strategy really comes into play where we can have production moved around from one site to the other even though we have had an impact in Q2 because our production capacity of some of our products are on the higher side we can make up the volumes in remaining two quarters of the year. It is a issue, which has repeated in the last three years, but we will do our best, there are some global warming issues which is beyond our control.

**Raghunath:** Okay. Thank you, Sir.

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

**Dhaval Shah:** When we lose revenue because of this flooding or some other issue like the oxygen supply, so being a process industry can we recoup this revenue, or it is lost?

**Sameer Hiremath:** Well, As I mentioned to you earlier person for the product that we have in our Mahad site we have some spare capacity so the plan is to make up the lost revenue in the course of the next seven months or so and there is a impact probably in one quarter, but we will make it up in the following two quarters.

**Dhaval Shah:** Okay, so the client would use it like next batch they will be using the product?

**Sameer Hiremath:** No customer orders have been deferred or canceled because of this, we informed to all our customers, and they said no problem, it happens in Europe as well. As you know there was severe flooding in Germany and in Belgium last month and China as well. It is happening all over the world and customer understand and they have reaffirmed their commitment for volumes for this year, it has got deferred from one quarter to the other.

**Dhaval Shah:** Okay and second is Q2 should we around Rs.20 Crores of revenue should be deferred because of the flooding?

**Sameer Hiremath:** We are assessing the impact currently, and all efforts are being taken to restart the operations as soon as possible and safety of the operations are very important as you know, we want to start the chemical plant, we want to start operations in a very safe manner without having any incident in any of our sites. We would have a good clarity probably by next month, by end of this month we will hopefully restart operations.

**Dhaval Shah:** Okay, last question given the inflation in steel and lot of other raw material, our project IRR must have got disturbed because of the capital equipment cost increasing, so the same is getting adjusted in our contracts what we do with our customers?

**Sameer Hiremath:** Wherever we have new projects coming in if there is an increase due to input cost increases, we are having discussion with our customers and adjusting accordingly.

**Dhaval Shah:** And they are happy to ot they are asking us to share, or they are taking it up majority have we are able to pass it?

**Sameer Hiremath:** Well, nobody is happy to take a price increase while there is a discussion and we are quite successful on most occasions and sometime it is sharing sometimes they take most of it, so we have to improve our efficiency, that is one of our business excellence in our HIBEX program by increasing our efficiencies, if to improve capacity utilization, improve capacities and throughput, the combination of several other things.

**Moderator:** Thank you. The next question is from the line of Rohit Nagraj from Emkay Global Financial Services. Please go ahead.

**Rohit Nagraj:** Thanks for the follow up, just one question in terms of CDMO project, so generally what is threshold revenue size that you look at when we are looking at any project and what has been the enquiries flow, are these coming from particular geography or particular set of chemistry segment, how has it changed over the last two years to three years? Thank you.

**Sameer Hiremath:** CDMO project because the NCEs and clinical trials, phase-1, phase-2, phase-3 they start off small but then they get ramped up by the product moves from one phase to the other, we look at a product from obviously with deep revenue potential, but we also look at the relationship value that we have with the customer. We have key account management concepts in the Company where we identify our key customers and we build a basket of products with them, some may be large revenue products, some may be smaller revenue products in higher margins, it is a combination approach.

**Rohit Nagraj:** Right, thanks a lot and any geographical split up that we have seeing more enquiries from any particular geography?

**Sameer Hiremath:** Historically, we were getting maximum enquiries from US and Europe but now we also seeing a lot of new enquiries coming in from Japan, so that being a change in the last two years to three years I would say and has got even more intensified in the COVID era.

**Rohit Nagraj:** Thanks a lot, and best of luck.

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

**Pranay Dhelia:** Just a follow up, at what percentage capacity are we operating currently?

**Sameer Hiremath:** Around 85% to 90% currently.

**Pranay Dhelia:** That is optimal at the moment?

**Sameer Hiremath:** Yes, that assumes down time for maintenance, this is after taking everything into account.

**Pranay Dhelia:** We can only improve on this once we have new capacities added from next quarter onwards?

**Sameer Hiremath:** Yes, we can do. That is true a slight improvement may be in operational efficiency, but the new capex is coming on stream.

**Pranay Dhelia:** Directly, 1.5x assets turnover that will add further to the revenue, so this is basically the top revenue we can do with the current asset size?

**Sameer Hiremath:** Depend on product mix, if you look at a quarter-to-quarter, there is variation in revenue because of product mix, so product mix changes then you get little bit more than what we are doing?

**Pranay Dhelia:** In that case can you also guide us little bit on the current volume growth you had, not only on value growth, the volume growth in terms of sales you had?

**Sameer Hiremath:** The volume growth for the Company for this quarter was 28%.

**Pranay Dhelia:** That is just volume growth, not value growth?

**Sameer Hiremath:** Value was 29.5% and volume was 28.1%.

**Pranay Dhelia:** Okay, that is fantastic Sir. Thank you so much.

**Moderator:** Thank you. The next question is from the line of Aditya Nahar from Alpna Enterprises. Please go ahead.

**Aditya Nahar:** Thank you for taking my question. Just wanted to check with you, three years back what was the percentage of revenue coming in from newer products and what is it in 2021?

**Sameer Hiremath:** Three years or four years if I go back, it was probably about 5%, today it is around 10% we expect in the last year and we expect that we have sustainable ratio track and marginal increase year-on-year.

**Aditya Nahar:** Alright, so are there any target in terms of next four years or five years, x-percentage would be from newer products?

**Sameer Hiremath:** Yes, by the next five years our transformational journey we want to get a 20% of our revenue every year they give products for the next five years.

**Aditya Nahar:** Great. Thank you so much and best of luck.

**Moderator:** Thank you. Ladies and gentlemen, this was the last question for today. I would now like to hand the conference over to Mr. Sameer Hiremath for closing comments.

**Sameer Hiremath:** Thank you, 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 Advisor, our Investor Relation Advisor. Thank you once again and stay safe. Goodbye and have a very good evening. Thank you.

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