“Hikal Limited
Q2 FY2022 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Hikal Limited Q2 FY2022 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 the 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 "*" and "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sameer Hiremath - Managing Director. Thank you and over to you, Sir!

Sameer Hiremath: Good afternoon and a very warm welcome. I am Sameer Hiremath, Managing Director, and along with me, I have Mr. Anish Swadi, Senior President Business Transformation, Mr. Kuldeep Jain, our Chief Financial Officer and Strategic Growth Advisors, our Investor Relations Advisors.

We hope you and your family members are safe and healthy. I am pleased to interact with all of you on our Q2 FY2022 earnings call. 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 our website too.

As part of our continuous efforts to fight the pandemic, our employees across the company are 100% vaccinated for their first dose and over 75% have been vaccinated for their second dose. We expect to have all our employees fully vaccinated over the next few months.

From an industry perspective, outsourcing for both pharma and crop protection industries continues to evolve from a largely cost arbitrage strategy to strategic supply chain security and reliability. Post COVID-19, innovator and generic companies are looking to further diversify their supply chain, internal supplier and geographical concentration. Due to these factors, Indian companies like Hikal that offer an attractive blend of a strong quality and regulatory track record, capability of handling complex chemistry, excellent customer support and cost competitiveness will have an opportunity to capitalize on a greater share on the outsourcing.

Hikal's existing own product portfolio has also seen volume growth over the last few quarters, which is expected to continue going forward.

In terms of new products, we have a healthy pipeline and continue to see a strong traction for our customers in both our businesses to support the future growth plans.

Now let me take you through the financial performance. Revenue for the quarter was Rs. 469 Crores registering a year-on-year growth of 26%. Our EBITDA came at Rs. 91 Crores which is a growth of 30%. EBITDA margins saw an improvement of 62 basis points to 19.4% as compared to 18.8% in Q2 of last year. Lastly our PAT for the quarter stood at Rs. 44 Crores which is a marked improvement of 63% from Rs. 27 Crores for the same period last year.

Similarly, the corresponding figures for H1 FY2022 have shown immense promise, with our revenue standing at Rs. 926 Crores for the first half as compared to Rs. 725 Crores for H1 of last year, registering a growth of 28%. On the EBITDA front, the growth stood at 53% rising from Rs. 122 Crores to Rs. 187 Crores for the corresponding period. While the improved tax rate due to opting for the new tax regime and improving finance costs led to substantial increase in profit after tax with a growth of 125% rising from Rs. 42 Crores in H1 FY2021 to Rs. 95 Crores in H1 FY2022.

The company's cost of financing has also reduced as a result of efficient working capital utilization and successful renegotiation of lower rates of interest, which augurs well for our company and the benefits will continue to accrue going forward.

Our Pharmaceutical division maintains similar revenue levels for the quarter as last year. At Rs. 280 Crores the Q2 revenue for the division was flat as compared to the same period last year. The EBIT for the division came at Rs. 37 Crores, which translates to an EBIT margin of 13.4%.

For H1 FY2022 with the revenue of Rs. 554 Crores the division registered a growth of 12% year on year. In terms of EBIT the growth was at 20% rising to Rs. 86 Crores on a year-on-year basis which translates to an EBIT margin of 15.5%.

Last quarter i.e. Q2, we received the manufacturing license for production of APIs at a Panoli site. This is in line with our strategy to diversify our manufacturing footprint by having two independent sites to manufacture APIs. Over the next several months we'll be validating several APIs for launch in the next financial year from our Panoli site.

Our Crop Protection revenue for Q2 was Rs. 190 Crores which is a year-on-year growth of 105%. The EBIT for the division was Rs. 34 Crores compared to Rs. 8 Crores in Q2 FY2021 which is a growth of 335% year-on-year. The EBIT margin is 18% in Q2 FY2022 compared to 8.5% in Q2 FY2021.

In H1 FY2022, Rs. 372 Crores revenues were recorded, registering a 61% growth on a year-on-year basis. The EBIT stood at Rs. 66 Crores, an increase of 167% on a year-on-year basis with margins of 17.7%.

During the last quarter, i.e. Q2, historic rainfall in the Raigad district region had a severe impact on Mahad operations, leading to the shutdown of our Mahad facility for almost a month. This led to a loss in sales and profitability for the division. Relentless efforts by our team from all our sites helped restarting our operations in a staggered manner and we were able to return to normal operations in due course. Despite the challenges faced by the flooding our crop protection division did well to recover last quarter.

Global supply chain challenges coupled with steep increase in input raw material prices continue to pose a challenge for our industry going forward. We were hit by the disruption in logistics in the past few months and more recently, are experiencing an unprecedented increase and non-availability of input raw materials.

We have put in significant efforts over the past few years on developing alternate sourcing partners and backward integration of certain raw materials. While this will help us in the medium term, we do expect certain disruptions in the short and near term. Over the next several months, we do expect the situation to normalize.

We have commissioned new capacities for our pharma CDMO business in our Unit-2 facility in Bengaluru. This is primarily for our development pipeline in our CDMO business. Capex investments for multipurpose facilities are on track across both our businesses for new products to be launched in a staggered manner over the next several quarters. We expect to complete several ongoing revenue and infrastructure projects by the second half of this year and going into next financial year.

We are undergoing a transformation of our business from ‘good to great’ while continuing to drive profitable growth. As I informed you on our last quarterly call, we have on-boarded a global consultant to help us identify the right strategic direction for choosing suitable products, partners and technologies for the future while bolstering our R&D and manufacturing capabilities.

In addition, to this our business excellence initiatives continue to benefit the organization by increasing operational efficiencies. Our transformation exercise is underway and we expect to reap the benefits over the next several quarters.

We are receiving traction in our animal health business post the signing of a long-term contract several months ago. We believe firmly that the journey forward will entail further accelerated growth for existing as well as emerging businesses. While the number of products in the pipeline and the customer inquiries have increased a healthy list of leads and enquiries for new businesses, the company is well positioned to capitalize on the opportunities at hand and those which will come going forward.

This growth hinges on multiple drivers starting with our ability to convert numerous enquiries which are increasing quarter-on-quarter from the top global players into concrete businesses backed by a global shift in strategy of creating an alternative to China. By focusing on our core strength of developing our own processes and technology, and delivering the best-in-class products, thereby becoming a partner of choice for our customers.

In terms of an outlook for the year, we stand by our initial projected growth in topline at a CAGR of high teens along with a 50 to 100 basis points improvements in EBITDA margins per annum over the next two to three years going forward.

The growth trajectory along with new opportunities, strong customer relationships and new technologies will catalyze our progress towards our bold aspirations.

With this, we will now open the floor to question and answer. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Rohit Nagraj from Emkay Global. Please go ahead.

Rohit Nagraj: Thanks for the opportunity and congrats on decent set of numbers despite challenging environment during the quarter. So the first question is that we lost revenues because of a Mahad plant shutdown. Is there any possibility of recovering them in subsequent quarters? And because of the non-availability of some of the raw materials, do we further expect that the revenues for the next Q3 and Q4 may get impacted? Thank you.

Sameer Hiremath: Thanks for your question. The first question was regarding the Mahad facility impact and whether we will be able to make it up. Well, the efforts are underway to ramp up capacity. We are trying to make up to the best extent possible but there is going to be some impact because the shut down as you know was almost for a month. So, we will try to minimize the impact for the remaining two quarters.

And the second question I think you asked was regarding what is the impact on raw materials on the future prospect of the business? Well, raw material prices are going up, input prices have risen and they have risen quite dramatically. We are trying to pass on the price increases to our customers. Obviously, there is a lag effect in many cases, but these are efforts underway. There are a lot of uncertainties in the market today, not only in pricing but also in terms of availability, but we are quite hopeful that with the mitigation plan that we have put in place over the last several years, we will be able to ride the storm and be able to minimize the negative impact of the increases. But it is a challenging time and raw material shortages, energy costs are all increasing and input prices are increasing.

Rohit Nagraj: Thanks. The second question is on Hikal 2.0. So last time you had indicated about the initiative so any tangible and material benefits that have accrued over the last one year and how are we seeing the benefits accruing maybe over the next one year or two years timeframe? Thank you.

Sameer Hiremath: I will hand it over to our transformation head, Anish Swadi. Anish, could you take that?

Anish Swadi: As you know we just started this exercise a few months ago. It has not been on for a full year. It has only been a few months since we started and we are starting with the strategies of both the business to redefine and to validate what our current strategies are in place. I think the tangible benefits will happen over a period of time as we implement some of the initiatives that have been recommended by the teams. So that will happen over the next several quarters starting off slowly and then ramping up as we implement it. As you know our business takes a long time to implement several changes whether it is regulatory, whether it is manufacturing but certainly the initial impact has been positive and we do expect these benefits to accrue over a period of time.

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

Moderator: Thank you. The next question is from the line of Dhruv Bhimrajka from Monarch AIF. Please go ahead.

Dhruv Bhimrajka: Sir my question is that in your 4Q FY2021 press release you had mentioned about the new long long-term contract of a fungicide with a US-based crop protection company, so any update on that long-term contract Sir?

Sameer Hiremath: That is under execution. It is on track. There is no change since the last board meeting. It is underway.

Dhruv Bhimrajka: So as and when it happens that will be announced, so it is under the agreement stage right now is what we can assume?

Sameer Hiremath: It is already signed. The execution is underway right now.

Dhruv Bhimrajka: Execution is underway. That is great to hear. Also in your in your 1Q 2022 press release, you had mentioned about emerging business verticals such as animal health and biocides so can you please explain what is this biocides because I am new for this company so just wanted to understand the biocides business?

Anish Swadi: This is Anish. So, the biocide business lies under the specialty chemicals umbrella. The beauty of the biocide business is that basically we utilize our own crop protection assets to manufacture these products. So, we have several biocides that go into various aspects. So, for example we have biocides that go into the paints industry that can also be used as crop protection products so there are multipurpose use products. We have been in the biocide business for several years; however, now we have got a strategic plan to accelerate the growth of that biocide business. There are supply chain constraints coming out from China and we think this is a good place for us to take advantage of and utilize our chemistry skills as well as our customer outreach to grow this type of business.

Dhruv Bhimrajka: Thank you so much. I will come back in the queue.

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

Ranveer Singh: Thanks for taking my question. On capex side what capex we have spent in first half and what is plan for second half for next year also if you could give?

Sameer Hiremath: I will hand over to my CFO, Kuldeep if you can take that question, please.

Kuldeep Jain: Thank you. So far in the first half we have capitalized almost Rs. 127 Crore expenditure and we expect almost Rs. 175 Crores in the next H2.

Ranveer Singh: And for FY2023 Sir?

Kuldeep Jain: FY2023 we are spending close to Rs. 300 Crores.

Ranveer Singh: Any target for debt reduction for next two or three years?

Kuldeep Jain: No, we are into the capex expenditure mode. So, we cannot really look at that as a target but we will just like to maintain our debt equity on the same ratio. And you would have observed that our interest costs as well as debt-to-equity has been reducing continuously.

Ranveer Singh: I missed your comment on status of Mahad facility, so this has resumed operations now?

Sameer Hiremath: Yes. It did resume. It was shut for almost a month but resumed operations.

Ranveer Singh: Thank you. That is it from my side.

Moderator: Thank you. The next question is from the line of Ashish Thavkar from Motilal Oswal AMC. Please go ahead.

Ashish Thavkar: Thanks for the opportunity. Sir, can you quantify the impact of logistics and higher energy consumption, what was the cost impact in this quarter?

Sameer Hiremath: Logistics impact on this quarter was around Rs. 2 Crores for this quarter and energy consumption was around close to Rs. 4.5 Crores to Rs. 5 Crores.

Ashish Thavkar: Okay, you feel this energy consumption which could get addressed for the next two quarters because some of the companies were mentioning that this cost could normalize over the next two quarters?

Sameer Hiremath: Yes, we are hoping but let us see it is a wait and watch. Again, many of our contracts as I mentioned earlier, has a pass through clause to our customers, but there could be a lag effect to normalize the pricing as well.

Ashish Thavkar: So, but on this pass through contracts, are the customers willing to take the full impact in one go or you are passing it on in a staggered manner?

Sameer Hiremath: It depends more on or less it is staggered manner everybody's input costs are going up, so we have to share the pain sometimes with our customers and share the benefits also. It is partnership model.

Ashish Thavkar: One last question on this capex around Rs.400 Crores to Rs.500 Crores that we have lined up over the next two years or so, any asset-turn you are working on what in your mind?

Sameer Hiremath: Sorry, can you repeat that I could not hear you, what is that?

Ashish Thavkar: So, around Rs.300 Crores to Rs.400 Crores in capex that you will be spending over the next 24 months, is there any asset-turn guidance that is likely to be to be invested?

Sameer Hiremath: Yes, we have been maintaining an asset turn ratio about 1.5:1 and we still maintain that.

Ashish Thavkar: I have some more questions. I will get back in the queue. Thanks.

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

Sandeep: I have two questions. The first question is more medium-term if you look at your pharmaceutical CDMO business, it is about $60 million so given the opportunity, given the pipeline you see, what is the potential for this business? The largest player like Divis is at about $370-$380 million today, so from $60 million where can we be in three to four years and what are the requirements for us to really scale this business?

Sameer Hiremath: You are right, there is a lot of potential to grow the CDMO business and we are seeing lot of new enquiries coming in the CDMO business. So, we are quite confident of growing this aggressively. It takes time as you know to acquire a customer and customer tries you out for that one project and it takes time to ramp up, you mentioned a company in your question, they also have taken about ten-fifteen years for their inflection point to reach. We are on that journey, we expect the business to grow over two – three times over the next few years as we go ahead.

Sandeep: Understood. The second question is that if you look at your margins for pharmaceuticals and which is like 50:50 CDMO and own products at this point in time. Again, margins are subpar when we compare you to some of the more skilled players. What could be the reason for that and how do we see the margin trajectory going forward, I understand the current quarter because of logistics raw material etc., and if we take aside what are the right margins for this business, is it that you have to take the technology from your MNC partners and that is why the margins are lower or some of the products like, Gabapentin we have 35% market share but not reflected in margin. So, just how to think about margins in the medium-term?

Sameer Hiremath: We are refreshing our product portfolio by launching new products over the next few years, every year we are launching new molecules that have much higher margin ratio. So, while some of the current historical margins are lower due to the older products and due to the competition. But going forward, as we take on the new molecule and we launch them, the margin profile will be very different. It is well in excess of what we have today. So, the margins will start improving year-on-year. I think this H1, a lot of impact due to the input prices going up and the logistics cost also. Otherwise, once things stabilize, we are quite optimistic that margins will start going up on the pharma business.

Sandeep: Last question. Is the crop protection margin generally lower than pharma margin or nothing like that it is product to product?

Sameer Hiremath: Depends on what product you choose and what profile it has. Generally pharma is higher than crop but if crop was to be high in certain cases, it is a case-to-case basis. I do not think I can generalize. If you do niche products in crop, which we are doing as a lot of our molecules are on our niche side, we have a good margin on that. We are not doing commodity, bulk and all, and that is why our margins are quite reasonable in the crop business.

Sandeep: Fair enough. Thank you so much.

Moderator: Thank you. The next question is from the line of Ankur Periwal from Axis Capital. Please go ahead.

Ankur Periwal: Sir, thanks for the opportunity. Sir, first question on the global consultant and wherein we are trying to identify growth opportunities, so two parts to the question. One, are we or is this consultancy arrangement largely to restructure or improve the efficiency of the current business segment or (two), it is also expanding into adjacencies and a newer segment from a growth perspective?

Anish Swadi: So, the strategic exercise or the transformation exercise that we are taking is across the company. It is looking at ESG which is the core strategy of ours, we are looking at key account management; we are looking at how to be the best in class when it comes to manufacturing, R&D and also looking at new diversified strategic areas for our business. So, it is across various aspects of the company. It is not only focusing on a particular segment of business. We are evaluating new areas based on new technologies that we can incorporate or inculcate within the company and how to pivot from there and build on those new verticals. So, it is not a restructuring, but it is a transformation because we already have a very strong base built now how do we pivot from the current base into the next orbit.

Ankur Periwal: Sure, and if I look at our pharma revenues or even the crop protection revenues over the last two to three years, more or less we have been in a tight band so, just wanted your thoughts on the product ramp up or the revenue ramp up for the product. Whether the growth will be largely led by the new product launches as well as the CDMO opportunity or is there a like-to-like growth delta in the products as well and if you may add on to the overall growth potential that we are looking at in these two segments?

Anish Swadi: On the product side we have an existing large-base volume business and this business is going as well. The key to this business we are finding is that over a period of time, that we have established ourselves a global leader in most of the products that we manufacture, and we are margin accretive. I think the incremental or the delta margin will come from new products that we have got in the pipeline under both the businesses. We are launching several products in the next several quarters. We have a strategy to launch at least two to three new products in the crop protection business and three to four products in the pharma business and we also have a healthy pipeline of CDMO projects in both our businesses.

So, with these new products coming on stream the margin profile will increase. We will see a delta there and that is why we give our future guidance of increasing our EBITDA margins over 50 to 100 basis points.

I'd also like to say, in addition to that it is just because we do have an old base of products we are also increasing the margin efficiency wherever possible. We work on processes continuously, we have cost improvement programs across the company for some of the larger, older, high volume products that we do have and since we have established ourselves, we are keen to maintain that leadership position and we will maintain that leadership position in those older molecules which are actually coming back and still increasing in terms of volume.

Ankur Periwal: Sure, that is helpful and if I may just squeeze in one more, with this growth opportunity across CDMO as well as the new product segments, will it also change the working capital profile of the company historically we have been having slightly higher inventory days, we saw some reduction last year but is that reduction sustainable or we will probably bounce back to the same 150 days – 160 days odd on the inventory side?

Kuldeep Jain: Yes, like in terms of number of days it does remain same but in terms of the absolute value it will increase in the proportion of the business.

Ankur Periwal: Sir, when you say same it is 150 days or 110 days odd in the last year?

Kuldeep Jain: It is 110 days currently which we will try to maintain at 110 days.

Ankur Periwal: Okay, that is helpful. That is it from my side. Thank you and all the best.

Moderator: Thank you. The next question is from the line of Aditya Khemka from InCred AMC. Please go ahead.

Aditya Khemka: Thanks for the opportunity. I had a question on other expenses, so you mentioned that power and fuel costs are going up and it is impacting cost of operations, but if I look at the other expenses for the first quarter and the second quarter the numbers seem to have gone up year-over-year by 30% to 35% between the three quarters and generally power and fuel is half of our other expenses, broadly speaking. So, assuming that power has gone up by 30% -35% year-over-year how much of this is driven by volume in terms of volume of production and how much is the tariff increase that you are paying?

Kuldeep Jain: Of our total expenditure 60% is towards the volume and because since last year, we were having a pandemic, these are not really comparable.

Aditya Khemka: Sir, I understand volumes cannot be comparable but in terms of tariffs?

Kuldeep Jain: In terms of?

Aditya Khemka: Cost of power?

Kuldeep Jain: Yes, cost of power has certainly gone up so which is where 60% towards the volume and 40% towards the cost.

Aditya Khemka: Okay, and if I look at your crop protection business, in that business we saw a very rough patch in previous years and now for the last three to four years we have been in the Rs.600 Crores to Rs. 700 Crores of our topline range and I understand you are launching new products, but I want to understand the base business better. So whatever growth is we have seen this first half of FY2022, how much is it driven by pricing and how much it is driven by volume, any colour on that?

Sameer Hiremath: Well, if you look at our revenues for the first half, crop business revenues grew by over 60% in terms of value terms compared to last year because the last year's second quarter was actually not a comparable quarter, there was pandemic, and we had some other issues on our side. This year in spite of having the Mahad flood issue we have been able to increase volumes by 29% compared to the last half year. So, value is growing faster than volume. We have launched higher value, higher margin products and we are very cognizant of the fact on pricing and margins. So, our value is overtaking our volume increase.

Aditya Khemka: Got it. Sir, one more question on this. What is the nature of the business here you may launched higher value products but are these products where you have limited competition or no competitors and if more competitors were to emerge, could there be pricing pressure on these high value products?

Sameer Hiremath: Almost 70% - 75% of the crop protection business is in custom manufacturing compared to 50% on the pharma side so the custom manufacturing space on the crop side, we have long-term contract for on-patent molecules. Now in the on-patent molecules, there is no competition. Even if it goes off-patent, 80% of the crop protection industry, 80% to 85% of crop protection industry is on-patent or proprietary off-patent that means there is no competition even when it goes generic because our customers have innovative formulations which they have patented. So the competition is very limited, if competition do come in, we see the big five or big six agro companies that we work with are able to retain maximum market share unlike the pharma industry where the generics make a very big dent. In the crop industry, generics contribute to less than 20% of the total crop segment and that is expected to remain so, as the innovator companies in the crop business will defend their market share of their product even when they go off-patent.

Aditya Khemka: This less than 20% you are saying is in terms of volume?

Sameer Hiremath: In terms of value, volume is much higher, generic volume is much higher. I am talking in terms of value.

Aditya Khemka: Okay, understood. So, your generic launches products after goes off-patent, what is the kind of the price discount they offer?

Sameer Hiremath: It depends on case-to-case. We have a very few generic products that we compete on the crop side. We are mostly on the innovator side, on-patent side or the proprietary, but there is some pricing pressure, but it is not as steep as a pharma business where there is a drastic fall. Crop is far more gradual because there is less competition of the generic side and there are only two-three large players on the global scale that participate in any generic portfolio.

Aditya Khemka: I would part with one more question, Mahad has seen several bouts and episodes of flooding and several "black swan events" and our crop protection business seems to be heavily reliant on that site. How do we manage this risk of natural disaster as a company?

Sameer Hiremath: I don't think there have been several black swan events, there is one event that impacted once in 50 years so I would not like to put that down to anything towards only our site, it has impacted the entire region. That being said our Mahad business contributes to approximately 20% of our total crop protection business. We are de-risking through our other sites. We are expanding capacity of Panoli site, so Mahad will remain an important part of the crop business, but we will have options at Taloja and in Panoli and we are also putting in measures in case such an incident does take place in the future we have safety measures in place to prevent any such disaster taking place on our sites.

Aditya Khemka: Thank you for the answer, Sir. All the best.

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

Pranay Dhelia: Hello Sameer, many congratulations on the great set of number we continue to stay invested and hope the company continues to grow as well. Sir, just two quick questions. One is on the capacity utilization and second is on the debt, if you can give me details of the debt outstanding?

Sameer Hiremath: Sure, on the capacity I will take it and debt I will hand over to my CFO. Capacity we have around 85% utilization on capacity and debt, Kuldeep if you can please answer the question related to debt.

Kuldeep Jain: Sure, about debt as on September 30, remains Rs. 629 Crores it was Rs.616 Crores as of March this includes primarily Rs. 225 Crores for the working capital and Rs. 400 Crores for the long-term loans.

Pranay Dhelia: Can you give me a break-up of the capacity utilization in terms of pharma and crop protection both please?

Sameer Hiremath: Both in the 80% to 90% range. That is the reason we are going for new capex because we are running out of capacity installed, so we are running between 80% and 90%.

Pranay Dhelia: Okay, and the domestic and export break up of our sales?

Sameer Hiremath: Domestic and export is about 70:30, 70% is export and 30% is domestic. But most of the domestic business will also be in the deemed export.

Pranay Dhelia: Pharma and crop both?

Sameer Hiremath: Crop is slightly lower in terms of domestic it is about less than 20%, pharma is slightly higher because lot of the customers are in India which formulate but those are taken as deemed export sales.

Pranay Dhelia: That would be from my side. Thank you once again and many congratulations. We will definitely be much better in the quarters to come.

Moderator: Thank you. Our next question is from the line of Anubhav Sahu from MC Research. Please go ahead.

Anubhav Sahu: Thanks for the opportunity. My question is with respect to mega capex cycle, you mentioned around Rs. 180 Crores you would be spending in H2, and I think Rs. 300 Crores – in next year. So, my first question is like how long and how big is this capex cycle going to be and if you can elaborate various milestones for that?

Sameer Hiremath: You are right we are spending about Rs. 175 Crores in the remaining part of this year and as mentioned we are spending around Rs. 300 Crores next financial year. Now, it takes typically 12 months to 18 months post-launch on the pharma side to start realizing the potential of the capex. On the crop side, you can start realizing this faster. So, if you are doing the capex, let us say by the end of this year, we start realizing by the end of next year, and then gradually ramp up over the next year or so. So, the benefits will start coming in from FY2024 onwards, the big benefits which are coming in.

Anubhav Sahu: Okay, and if you could categorize in terms of both pharma and crop protection how is the incremental capacity would be after the end of this capex cycle?

Sameer Hiremath: By the end of this year the pharma and crop protection will be around 60:40, 60% pharma and 40% crop and we expect them to move towards 50:50 split by the end of FY2023. In 2023 we expect to put in more capex on the crop side as we are acquiring new crop protection projects. The pharma will be more or less completed this cycle by the end of this financial year and then next year we will be investing more on the crop side, so if you take a two years' average it will move towards the 50:50 split this year and next year.

Anubhav Sahu: Okay, that is on the sales side, so what I meant is because of your investment including this year, for two years Rs.600 Crores kind of investment you are looking at. So, what is the incremental capacity which we will be having for both the segments?

Sameer Hiremath: These are multipurpose large plants we have put in; we will have asset turns of typically of 1.5:1 so if you put in Rs. 300 crores every year so multiply that by 1.5 that is the revenue generation potential on this capex at peak which should take a few years post commissioning of the plant to realize.

Anubhav Sahu: My last question is that for our next fiscal though I understand that for fiscal 2024 all the major benefits will accrue to us but for fiscal 2023 how do we see the incremental capacity addition for us?

Sameer Hiremath: Most of the capex is underway, half has been done till now, half will be done by the end of this year. So, FY2023 will be the year where we will be validating the products we are launching the molecules, it takes time to do the filings. So, there will be some impact on FY2023, but the bigger impact will come in FY2024 onwards, and then the capacity will go up considerably.

Anubhav Sahu: Got it. Thanks a lot for this.

Moderator: Thank you. The next question is from the line of Nilesh Doshi from Green Lantern Capital. Please go ahead.

Nilesh Doshi: Sameer, thank you for taking my question. One of the questions on CDMO business, which is currently as you said about $60 million, you said that you would like to grow this business by two times to three times over next two years is that correct understanding?

Sameer Hiremath: It will grow by two times to three times in the next four year to five years I do not think it will be three years it will grow rapidly but it will take about four years to five years to get there.

Nilesh Doshi: Okay, and that do we have enough capacity in place for that?

Sameer Hiremath: We are investing, this is part of the capacity, we are investing towards the CDMO business in Q2 the capex that we have capitalized was the new CDMO plant that we had built and the balance capex that we are also doing lot of it is towards the CDMO business that we are putting in place. These are all multipurpose assets so we can do CDMO and then use in through.

Nilesh Doshi: Could that commence by next year?

Sameer Hiremath: Some of it will be coming towards the end of next year but the benefits will start accruing from FY2024 onwards. Takes about 12 months to start, post filing, validation batches, putting them on the filing, it takes about 12 months after the commissioning of the plant.

Nilesh Doshi: Okay, the second question is on that Animal Healthcare which we signed a JV agreement. What is the status if you can share some more details on it?

Sameer Hiremath: On the Animal Healthcare part, the project is in two parts, first is the R&D development of the molecule which is currently underway, and it is progressing very nicely on track and now we are moving into the second phase of the project where we are beginning to design the plant and we will be starting to construct the plant in the next financial year.

Nilesh Doshi: So, it would come in operation in FY2024?

Sameer Hiremath: That is correct. This is a long-term project; it is a long-term contract as you know we have signed. The first phase we develop the molecules and develop the technology from scratch which we are doing, and the second phase is to build and start manufacturing on a commercial scale.

Nilesh Doshi: Okay, our understanding was that these molecules are already existing, and the JV partner would have provided the processes to manufacture it?

Sameer Hiremath: Only for few they have done that but majority of them have to be developed by us. It is a large basket of products.

Nilesh Doshi: This will come under not CDMO, but it will be something similar to CRAMS, right?

Sameer Hiremath: Yes exactly, CRAMS. You are right.

Nilesh Doshi: Okay, third is on the Mahad that one month loss of production, can you quantify what kind of expenditure we would have incurred to restart the operations and has it been gone through P&L in Q2 or it will come under Q3?

Sameer Hiremath: The expenditure being, we are putting an insurance claim and that is under discussion with the insurance agencies. So, we are well covered for the insurance and as and when we accrue the insurance then we will account it in our results.

Nilesh Doshi: But will you be able to quantify how much that could have been approximately?

Sameer Hiremath: We are under discussions with the insurance companies so I do not think I will be in a position to talk about that right now.

Nilesh Doshi: The last is on the other expenses since it has gone up substantially in Q2 over Q1, any cost towards commissioning of this CDMO would have been accounted in this quarter Q2?

Sameer Hiremath: Mostly due to the energy and logistics increases that is the main reason.

Nilesh Doshi: So, that you said we should start recovering from Q3 with a lag effect?

Sameer Hiremath: No, a part of it, logistics and energy there is a lag effect, but you cannot recover all of it, we recover part of it.

Nilesh Doshi: Thanks. That is all from my side.

Moderator: Thank you. The next question is from the line of Mohit Arora from SOIC LLP. Please go ahead.

Mohit Arora: Congratulations on a great set of numbers. Sir, I had a question in terms of a capex plan, just trying to get my own understanding. So, this year we had capex plan of Rs.300 Crores and even next year we have a capex plan of Rs.300 Crores and in FY2024 we will also have the ten-year contract for the Animal CDMO kicking in, is the understanding correct?

Sameer Hiremath: That is correct.

Mohit Arora: Sir, second question was with the long-term guidance for growing the pharma business is at two times to three times and even the Animal CDMO business is basically a topline of Rs.500 Crores and in Agro as well we had mentioned that we grow the revenues by almost 2X to 3X, so over next four year to five years are we looking at Hikal basically doubling or tripling at topline?

Sameer Hiremath: We are looking at growing the business substantially and it is as part of our transformation strategy.

Mohit Arora: That is heartening to know and Sir one last question. In first half of the year we did a gross margin of close to 51% so the impact of input cost raw material is not that visible so, do we expect to maintain our gross margins in the second half of the year?

Sameer Hiremath: Input costs are definitely a concern and that is why we still remain by our guidance of 50 to 100 basis points improvement in EBITDA Margin for the full year compared to the last financial year. So, there could be some marginal ups and downs on the margin for the Q3 and Q4 because of margins of six months was 20.2% EBITDA Margin and 100 basis points over or 50 basis points over last year is 19.3% to 19.8% so we remain in that range of guidance.

Mohit Arora: Right, thank you so much, Sir and wishing you all the best.

Moderator: Thank you. The next question is from the line of Sameer Dosani from Carnelian Capital. Please go ahead.

Sameer Dosani: Just to clarify one thing, we have capex of Rs. 175 Crores in H2 and Rs. 300 Crores of capex in FY2023, we also have Rs. 250 Crores of capital work-in-progress sitting in the balance sheet. So, do we expect Rs. 475 Crores plus Rs. 250 Crores to commission in FY2023 and benefit of this would accrue in FY2024 is that what we are saying?

Kuldeep Jain: Part of the CWIP as on September 30 will be capitalized in the second half that is what we are talking about Rs. 175 Crores and this Rs. 300 Crores for the next year will be capitalized somewhere in 2023 – 2024.

Sameer Dosani: Okay, this Rs. 475 Crores is including the CWIP that is already in the balance sheet, right?

Kuldeep Jain: Right, you are right.

Sameer Dosani: And this excludes our Animal Healthcare contract, right?

Kuldeep Jain: Yes, you are right.

Sameer Dosani: Second clarification. When we say 2X to 3X in our CDMO business does this includes our Animal Healthcare contract, or it does not?

Kuldeep Jain: Yes.

Sameer Dosani: So, included already included in this?

Kuldeep Jain: Yes, it is included.

Sameer Dosani: Okay, thanks. That is it from my side.

Moderator: Thank you. The next question is from the line of Manish Jain from Money Life Advisory Services. Please go ahead.

Manish Jain: Thanks for the opportunity. My first question is what kind of new opportunities are we seeing from China-plus-one strategy?

Sameer Hiremath: We see new opportunities in both our business divisions. Even in some of our generic products where there were the Chinese suppliers, we have seen market share moving towards suppliers in India including Hikal. On the CDMO side, many of the Innovator companies who were focused on China they have decided to now focus on India for outsourcing, so we are seeing opportunities there. On the Biocide side which Anish spoke about and which is part of our Specialty Chemicals business in an allied business of our Crop business, there are a lot of opportunities to shift volumes to India. On the Animal Health side there are lot of the active ingredients manufacturers who are primarily based in China, again one of the reasons why this contract we signed with the large multinational company was to de-risk their supply chain out of China. And we have seen many more Animal Health companies also talking to us to further de-risk and we had discussions with them for similar type of contracts going forward. So, it is not only specific to one business. It applies to all our division, all of them stand to gain from the China shift.

Manish Jain: What can we expect the contribution of new products to the overall revenue in the future?

Sameer Hiremath: It is around 10% currently and we are looking accelerating that to about 15% and overall, it can even go to 20% over the next four year to five year medium-term.

Manish Jain: Thank you and all the best.

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

Ranveer Singh: Thanks for the followup. Just on the capacity we have commissioned for CDMO business at Bengaluru after this commissioning of capacity, how much total CDMO capacity has increased?

Sameer Hiremath: This is a new development and launch plant that we have done, so the capacity has gone up by between 15% and 20% on a CDMO side, but it is all multipurpose capacity.

Ranveer Singh: Okay, so is it dedicated capacity?

Sameer Hiremath: Sorry?

Ranveer Singh: Is it dedicated capacity?

Sameer Hiremath: No, it is not dedicated, we have lot of flexibility in our capacities. All our plants are flexible and multipurpose.

Ranveer Singh: If you could give some quantitative factors like in terms of number of projects currently, we have in CDMO or number of clients or order book if you could give some indication that would give more visibility in this period?

Sameer Hiremath: In the pharma space we typically have about ten to twelve products that are already commercialized, seven to eight products are in the pipeline at various stages as they are currently in scale up or in this active discussion mode where we are launching the molecules.

Ranveer Singh: And is it possible to assign the value to pipeline projects?

Sameer Hiremath: These are all under clinical phase-2, phase-3 trials, so very difficult to give you a value potential all depends on how the molecule does in the market and what is the success rate, so it is very difficult to give a number to this.

Ranveer Singh: Okay, and on anti-diabetic side whether we will be manufacturing Gliptins for API?

Sameer Hiremath: We are making Gliptins and the Gliflozins and we are very strong on the Anti-diabetes portfolio and that will be our next wave of products that we are launching. They go off patent in the next four to five years and we are getting a lot of traction with our customers on these molecules.

Ranveer Singh: Okay, fine and similarly for crop protection CDMO also if you could give some pipeline projects details?

Sameer Hiremath: In the crop side we currently have about four products in the CRAM side and two proprietary products under development and this list is increasing as the number of enquiries are increasing but this is as of today if you take today's numbers, we have four products in the development on the CRAM which is CDMO and two on the own development.

Ranveer Sing: So, growth would be coming through addition of new projects, or is this pipeline or this product itself is a high-volume products and will grow in volume?

Sameer Hiremath: In crop these are already launched products or to be launched and the ramp up is pretty fast unlike pharma, in crop launches are much faster. So, we expect them to ramp up within a few years to get to large volumes.

Ranveer Singh: Okay, thanks a lot. That is it from my side.

Moderator: Thank you. Ladies and gentlemen, that could be our last question for today. I now hand the conference over to Mr. Sameer Hiremath, for closing comments. Thank you and over to you, Sir!

Sameer Hiremath: I would like to take this opportunity to thank everybody for joining the call. Hope we have been able to address all your queries. For any further information kindly get in touch with the Strategic Growth Advisors, our Investor Relations advisors. Thank you once again, stay safe, goodbye.

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