"Hikal Limited Q3 FY2022 Earnings Conference Call"

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Mr. Manoj Mehrotra –President - Pharmaceuticals Business - Hikal Limited -
Mr. Kuldeep Jain - Chief Finance Officer – Hikal Limited
Mr. Vimal Kulshrestha –President – Crop Protection Business – Hikal Limited

Moderator

Ladies and gentlemen, good day and welcome to the Q3 FY22 Earnings Conference Call of Hikal Limited. This conference call may contain forward looking statements about the company which are based on the beliefs, opinions and expectations of the company as on date of this call. These statements are not the guarantees of future performance and involves 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. Anish Swadi, Senior President – Animal Health and Business Transformation from Hikal Limited. Thank you and over to you Mr. Anish.

Anish Swadi

Thank you very much. Good afternoon and a very warm welcome to everyone present on this call. I am Anish Swadi, Senior President of Business Transformation and Animal Health. With me, I have Mr. Kuldeep Jain, our Chief Financial Officer; Mr. Manoj Mehrotra, our President, Pharmaceuticals Business; Mr. Vimal Kulshrestha, our President, Crop protection business 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 Q3 FY22 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 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 employees across the company are now 100% vaccinated for both doses.

I'm going to start off the call with a comment on the incident at Surat.

I would at this point of time like to update you all on the Surat matter, where, as you are all aware three of our employees have been cooperating in the investigation and since have been remanded in judicial custody. The matter is still currently under investigation and Hikal is cooperating completely with the authorities in this regard. We have appointed leading law firms and counsel to represent us in this matter.

The main issue is that the tanker reported as allegedly disposing chemicals into the stream was not the same tanker that left the Company's promises in Taloja. The company has provided all documentary evidence to this effect. We strongly believe that we have no culpability in regard to the incident that happened in Surat on 6th January 2022. The matter currently is sub-judice and hence, we would not be able to answer any additional questions in this regard. Whenever there are any further material updates, we shall intimate the stock exchanges.

Moving on to business.

<u>Credit Rating upgrade</u>

Before we go into the details of the Financial Performance for the quarter and nine months ended on 31st December 2021, we are pleased to share with you all that our credit rating agency, ICRA, has upgraded our long-term rating on 15th December 2021 to A+ on the back of healthy growth in operating income, operational efficiencies, and a healthy pipeline of new products.

Let me now take you through the financial results.

Talking about our Q3 Financial performance, revenue for the quarter was at Rs. 515 Crore, registering a YoY growth of 11% and a QoQ growth of 10%. Our EBITDA came in at Rs. 93 Crore which is a growth of about 2% on YoY basis as well as on QoQ basis. EBITDA margins for Q3 stood at 18.1%. Lastly, our PAT for the quarter stood at Rs. 45 Crore which translates to a growth of 12% when compared to the same period last year. The growth in the bottom line is due to a combination of factors, namely, higher profits from our operations, reduced interest cost through successful negotiations with our bankers and opting for the new tax regime. We are confident that this trend will continue to improve our bottom line further and generate strong cash flows in the coming quarters and years.

Further, the nine months performance for this financial year projects an even better picture, with our revenue standing at Rs. 1,440 Crore for 9M FY22, as compared to Rs. 1,188 Crore for 9M FY21, and this a robust growth of 21%. On the EBIDTA front, the growth stood at 31%, rising from Rs. 214 Crore to Rs. 281 Crore for the corresponding periods. This, coupled with improved financing costs and lower tax rates due to opting for the new tax regime, saw our PAT rising from Rs. 82 Crore in 9MFY21 to Rs. 140 Crore in 9MFY22, which translates into a remarkable growth of 70%. In fact, we have surpassed the annual PAT number of last financial year (i.e., Rs. 133 Cr.) in the first 9 months of this financial year.

Our Balance Sheet and return ratios

In addition to growing the top line and bottom line, we have also been making focused efforts to strengthen our balance sheet and to improve the return ratios of the Company. As a result, our debt-to-equity ratio now stands at 0.57x as compared to 0.61x at the end of previous financial year and 0.73x in the year before that. We have also negotiated with our bankers to bring down our average borrowing cost from 6.99% in March 2021 to blended rate of 6.11% in December 2021.

On the Trailing Twelve Months (TTM) basis, our Return on Capital Employed (ROCE) has now reached 18.5%, which is a consistent improvement from 16.1% in FY21 and 12.5% in FY20. The Return on Equity (ROE) has also improved to 19% from 15.2% in FY21 and 10.7% in the year preceding that. These numbers indicate a healthy condition of the business, considering the nature of operations along with the ongoing and planned capacity expansions.

Dividend

The Company has declared an interim dividend of 60% for the financial year 2021-22.

Now, I'd like to handover to our President - Pharmaceuticals, Mr. Manoj Mehrotra, to take us through the performance of the pharmaceuticals division

Manoj Mehrotra

Thank you, Anish. Our Pharmaceutical business recorded a flat revenue at Rs. 268 Crores in Q3 FY22 due to a lower offtake by several customers. The EBIT for the division came in at Rs. 36 Crore. This translates to an EBIT margin of 13.3% in Q3FY22. This was primarily due to an increase in input costs. We are in dialogue with our customers to pass on the rise in the input prices. This process generally has a lag of a few months which can be seen in the muted segmental profitability for the business.

For 9MFY22, with a revenue of Rs 822 Crore the division registered a growth of 8% YoY basis. In terms of EBIT, the growth was at 2%, rising to Rs 121 Crore on YoY basis. This translates to an EBIT margin of 14.7%.

On the CDMO front, we continued to receive several new enquiries from global innovator companies regarding collaborations in our CDMO business segment. We have also won an order for manufacturing two key starting materials for a new drug from a global innovator. Additionally, we have commenced process development for several active ingredients which are part of the multi-year Animal health project with a global innovator.

Our Own Products business also added new customers and new geographies for some of the key molecules in this past quarter. Our Anti diabetic portfolio of APIs for the future is also receiving healthy traction from customers. We expect the demand to stay buoyant on our own products business in the coming quarters.

Now, I'd like to handover to our President - Crop Protection, Mr. Vimal Kulshrestha, to take us though the performance of the Crop Protection division

Vimal Kulshrestha

Thank you, Manoj. Good afternoon, all participants of the call. Our Crop Protection revenue for Q3 was Rs. 246 Crore which is a YoY growth of 27% and 30% growth on QoQ basis. The EBIT for the division was Rs. 38 Crore compared to Rs. 31 Crore in Q3FY21, which is a growth of 22% YoY basis. The EBIT margin is at 15.2% in Q3FY22.

In 9MFY22, Rs 619 Crore revenue was recorded, registering a 45% growth on YoY basis. The EBIT stood at Rs 104 Crore, an increase of 86% on YoY basis with margin of 16.8%.

The Crop Protection business witnessed a growth on the back of higher demand from our leading CDMO customers. Several new enquiries for potential partnerships in our CDMO business segment were received. We expect this momentum to continue in the next several quarters. Sales of our own products faced challenges of raw material availability; however, we expect the supply to normalize in the coming months, providing a further boost to our Crop protection business.

Now, I'd like to handover to Anish, to take us though further updates.

Anish Swadi

Thank you, Vimal. I would like to talk about the supply chain. In the current environment global supply chain challenges coupled with an unprecedented non-availability and increase of input raw material as well as utility prices will continue to create an obstacle for our industry going forward. Our strategy to integrate backwards and develop alternate sourcing partners is yielding results in terms of sustainability of operations.

<u>Our Business Transformation Program</u>

Pinnacle, our business transformation initiative, is on track to create a roadmap across business verticals to drive aggressive yet profitable and sustainable growth over the next five years through a newly strategic direction. We are already starting to see some of the positive impact of the Pinnacle initiatives on our business operations. We will continue to invest in developing new products, capabilities, technologies and building new capacities considering both of our businesses are seeing strong tailwinds on account of the prevailing China-plus-one sentiment.

Outlook

With the world returning to a near-normal state on the COVID front. There could be some short-term impact on the operations of our Crop Protection business due to the recent receipt of MPCB notice. However, we are taking appropriate legal measures as advised by counsels in the Courts to remedy the situation swiftly.

We have a robust growth outlook for both of our businesses owing to the number of products in the pipeline and a healthy list of enquiries for new business. The rethinking of the supply chains across the globe has come at the most opportune time for us and is in line with our growth ambitions. By focusing on our core strengths of creating our own processes and delivering the best in-class products, we are ready to take on complex chemistries, provide the right infrastructure, expertise, and support, thereby increasing our share of wallet with existing and new customers.

During these difficult times, I would like to thank our customers, suppliers, bankers as well as investors and other stakeholders for their continued support. With this, we will now open the floor for Q&A.

Moderator

Thank you very much. We will now begin the question-and-answer session. Anyone who wishes to ask the question may press "*" and "1" on the touchtone telephone. If you wish to remove yourself from the question queue, you may press "*" and "2". Participants are requested to limit their questions to two per participant and use handset while asking a question. Ladies and gentlemen, we will wait for a moment while the question queue assembles.

The first question is from the line of Rahul Jain from Credence Wealth. Please go ahead.

Rahul Jain
Hello. Thanks for the opportunity and good to see the divisional heads also being there on the call and we hope that we continue with this practice. So good to see both the pharma and Crop Protection division heads being there on the call.

Sir, with regards to Pharma you have mentioned in the initial remark as well as in the presentation about the slowing offtake by several of our customers. And also, at the same time you have mentioned that there are good enquiries. The demand continues to be good as mentioned in your presentation also. So just to understand what exactly is happening. Why this offtake has been low? Is this a temporary situation? Because of what factors it could be? And also, another observation has been that for last several quarters, we have been around this 250 to 270 crores of top line. Leave aside one or two abnormal quarters where you know because of rainfalls were there, we had some issues a year back, but in general we have been around this range. Going forward, how do you expect the division to do in terms of, you know, picking up the offtake on the sales growth? That is my first question. Shall I also put forth my other questions?

Anish Swadi
Yes, please go ahead.

Rahul Jain

With regards to Agro, we have done very well in this quarter, and we have been doing reasonably well for past few quarters on the other side. So, what was the volume growth in this quarter? Was there any because in the previous quarter due to excessive rainfall in Mahad, we add some impact on this division. So, is it because of some spillover or this is related to a good growth on the demand side and how sustainable this is?
You have spoken about a long-term contract in your fourth quarter last year with regards to a new fungicide, for a Japanese customer. So, what's the progress on that? How big that molecule could be, and you know, typically have you already had some large shipments to this customer? These are my 3 questions.

Anish Swadi
So, on the Pharma I would like to ask Manoj Mehrotra to take the question and, on the crop, Vimal will take on the question.

Manoj Mehrotra
Yeah, so I'll answer the first question on the Pharma business. So just to give you a little perspective on the Pharma business and the previous year's volume and value growth. So, in the year 2021 we had a robust growth of 21% revenue wise. In this year, the growth has been subdued. We have clocked around 8% growth in on YTD basis. So, the number of 250 to 260 Crores has to be really seen in the context of last year. And this year, the growth will definitely be muted and will not reach the number of 21%, what we saw in the previous fiscal year. The reasons have primarily been the inventory correction with many of our customers. They have overstocked earlier, and we have generally witnessed a slowdown in demand by the generics customers who are selling to the United States of America. I do not expect that this slowdown will continue beyond two quarters, and we will be back to the growing ways from the first quarter of next year.

Where we are seeing definitely more robust enquiries and customer interest is on the CDMO business. The China-plus-one strategy we can really see it playing around. We are getting a lot of inquiries and we have converted a few of them. But as we all know, the CDMO business takes time to build up, and even if you get an order now, it'll take at least six months to a year till at least some revenue start trickling in. But once they come in, they are there for good and we are very confident that the CDMO of business will be profitable and grow much faster for Hikal Pharma business.

Vimal Kulshrestha

Yeah, on the crop protection, the growth is mainly on account of better product mix. On nine-month basis, the volume growth is 10%, so main growth is coming based on the product mix.

Rahul Jain
And this quarter was quite good. Was it due to some spillover of the previous quarter, because previous quarter had some impact at Mahad?

Vimal Kulshrestha

No, there was no such impact, and the quarter growth is mainly because of the product mix change as compared to FY21.

Rahul Jain
That's helpful. And sir, with regards to this long-term contract which you had spoken about in your Q4 FY21 call, whereby you had mentioned about a new fungicide and also along with that, if you could share some more details on new product introductions, which we have done in last six to nine months, and which further we expect to launch in next one year or so?

Vimal Kulshrestha

Yeah, so currently we have 3-4 new CDMO enquiries. We are also going to have as you are aware, 2 new fungicides – our own fungicide – for which capex is already on. We continue to see momentum of enquiries coming on CDMO part and we will be working continuously on new products to fill our multipurpose plant capacity.

Rahul Jain
Could you share some details about the size of these products? If that could be possible.

Vimal Kulshrestha

These products, initially, this would be around 100 crores and full potential of these products would be close to 400 to 500 crores.

Rahul Jain
Oh, that's quite helpful Sir. Thank you so much. And wish you all the best.

Moderator
Thank you. The next question is from the line of Dhaval Shah, from Svan Investment. Please go ahead. Mr. Dhaval, please go ahead with your question. Your line is unmuted.

Dhaval Shah
You know on the background of the ongoing, the plant closure, and the Surat episode, do we see any sort of impact hitting our business in the way about dealing with the customers were going on? And also, for the plant closure notice, if we go for a stay against the order, do we really have to shut down our plant or we can get to stay on it and then continue with the business operation? Yeah, these are my two questions.

Anish Swadi
Right, so Dhaval, with regards to your first question, we've been very transparent with all our customers from day one. As soon as this incident unfolded, we reached out to all our key customers, and we've talked them through it and they've had some questions which we've answered and we update them on a regular basis. Our customers have been very supportive of us and they're standing by us, and they said any help or support that you need from our side we are more than happy and willing to provide. So, customers have been very supportive and transparent, and we've been very transparent with them.

In the case of the notice on the Taloja plant, we are currently evaluating all the legal options. As you are probably well aware of, chemical plant cannot be shut down in a short amount of period of time.
So, we're going through all the motions and we're weighing our options legally. And we have already initiated some of those legal actions from our side.

Dhaval Shah
OK, so just for my understanding. So, once they give you a notice you have to first shut down and then if you can get a stay and then you can restart the plan. How does it work?

Anish Swadi
It happens parallelly. We're doing it both ways so you basically have you establish your legal options and then you can initiate a safe shutdown.

Dhaval Shah
Okay. Thank you very much.

Moderator
The next question is from the line of Shravan Vora from Premier Capital. Please go ahead.

Shravan Vora
Hi, thanks for the opportunity. So, my question was a little similar to the previous one that post these issues in the last one, one and a half month. Are we seeing any change in our interaction for future contracts with customers or any issues on the customer pipeline side?

Anish Swadi
Yeah, so Shravan, we haven't seen anything as I mentioned earlier. We've informed all our customers very transparently in the last four to five weeks. We've had an ongoing dialogue with the customers. Any and every question that they've had to the best of our ability, we've answered that. Again, they've been extremely supportive. In fact, many of our customers said that our relationships with you and your company have been for over 15 to 20 years. We know the standards that you keep, and this is unfortunate and please keep us aware of any developments that do happen.
So, we're in consistent dialogue with our customers. No customer has retracted or cancelled any orders as of now.

Shravan Vora
My second question is on the pharma business side. So, we've spoken about this in the last quarter also. That we have a pass-through clause, and we are trying to negotiate with a lag. So, any timeline on how much time will it take for that to reflect in margins or how that will work?

Manoj
Yeah, I'll answer this question. Yes, it takes around six months to kind of implement the pass-through costs because we can't be doing this kind of discussion with customers every month. So, you will definitely see some improvement next quarter onwards, i.e. January onwards, where these pass-through costs will be implemented based on the historical buying price which prevailed in the previous six months.

Shravan Vora
The next question is on the plant closure notice that we received. We've been talking that most of our sites are fungible, like we can produce products at other sites also. So, is there any way we can cover-up, like not the entire production loss, but to some extent if we are able to cover-up?

Anish Swadi
So, while most of our plants are fungible, currently we are running full, which is why we're putting capex on the ground. So that's a good problem to have. On the flip side, we are looking at how we can potentially if we do have some kind of shutdown, we mitigate those losses from a business perspective. Obviously, it doesn't happen overnight, but we do have contingency plans in which you know, we will also consider taking our annual maintenance shutdown earlier rather than later, which we usually do in the month of April. That would then allow us to run our plants through, so we're looking at various contingency factors to best serve the business.

Shravan Vora
Right. So, on capex you mentioned we are raising some capital from IFC. Any update on that capital raise?

Anish Swadi
We are getting a loan NCD from IFC, and this is something that's been in process for several months. Right now, we have provided to IFC all the documentation and they are now undergoing their internal processes. And this is for the Capex plans of the company both Pharma and crop divisions and this is long term sustainable capex. So, this is a very long-term loan. It is not equity.

Shravan Vora
Thank you so much for this call and all the very best.

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

Sameer Dosani
Thank you for the opportunity. Just a question that I had around the Taloja plant. I just want to understand whether they are zero liquid discharge or not? And you know, if not, then you know what you think about that. Is that something which is required? And I mean overall thoughts around that. And also do we have zero liquid discharge in our pharma plants?

Vimal Kulshrestha

Our Taloja plant is basically it is not zero liquid discharge, so we are allowed to discharge which goes to CETP (common effluent treatment plant). And we are well within (our limits), so we are complying as per the condition.
Now this particular closure is due to the Surat incident because of which it has been given to us, and since the Surat incident it is sub judice, we would like not to divulge more detail around it.

Sameer Dosani

No, but is that allowed not to have it zero liquid discharge and what is the industry practice around it. Do we something like that in pharma plants as well due to mandate for US FDA approvals.

Manoj Mehrotra
Yeah, the Pharma plants in Bangalore zero liquid discharge and there are no effluents which goes out so. We have the necessary equipment to treat all the effluents inside.
But again, having said that it varies from state to state and the historical and whether it is in approved industrial area. There are, provincial or state level laws which govern it. In case of Taloja it happens to be we have the necessary permission. But in Bangalore, we have always set up like zero liquid discharge plant for Pharma.

Vimal Kulshrestha

Just to add what Manoj has mentioned, Taloja plant is in MIDC area and there they have the common effluent treatment plant (CETP). So there the industries are allowed to give effluent to common effluent treatment plant after doing the pretreatment.

Sameer Dosani
Understood.

Moderator
Thank you, the next question is from the line of Siddhant Maheshwari from Multi Act. Please go ahead.

Siddhant Maheshwari
Thanks for the opportunity. My question is somewhat similar to previous question. I know it might be a little early to comment. Assuming that you know company will be able to shift production from Taloja to a different unit, need not entirely be a part of the amount in case. In that case, will there be any decline in sales, or can we expect you know more or less same level of sales and earnings estimates considering next two years down the line?

Vimal Kulshrestha

I'll take this question. There could be some short-term impact because of this closure notice. Now Taloja unit has revenue of around 260 Crores on annualized basis. And based on that, the impact will come. Suppose if it is for 15 days closure, accordingly, impact will come.

Siddhant Maheshwari
OK, and Sir, could you please confirm what are the current capacity utilizations in different units?

Anish Swadi
Across the company I would say the current capacity utilization is anywhere between 80-85%. So yeah, it's almost full, which is why we're also going into capex.

Siddhant Maheshwari

OK, so sir, when we say 80-85% capacity utilization then I mean do you really think you know we will be able to shift, you know Taloja requirement to other units like when we are already operating at high-capacity utilization?

Anish Swadi
So that's what I had said earlier in my in the comment that while evaluating options that we can, maybe we can make an intermediate in another plant, so far, we're still continuing as we are, to reduce the impact from the MPCB closure. We're tackling that right now and we are confident that we should be able to solve that process legally.

Siddhant Maheshwari
OK. Sir, I just have one last question. If you can give us some idea that what has been the thought process behind borrowing money from IFC compared to let's say bank funding or any other domestic funding? Is there any specific interest cost benefit and how difficult it has been to get from funding from IFC?

Anish Swadi
Well, look. As most of you know, IFC is part of the World Bank, and it's a premier funding financial institution, the funding that we're going for, and that we've discussed is part of our sustainability initiatives across Company. So it's been a very rigorous process. I would say it's far more challenging than going to a regular financial institution because you have to present to them your project plans based on sustainability, the initiatives that you're undertaking and where you see yourself as a company nearly three to five years from now. Plus, the benefit one gets from funding through IFC, number one is the sustainability or the ESG angle to it. So as a company ESG is our one of our main strategy objectives, and IFC is funding some of the green energy initiatives that we also have to become a fully sustainable company. So definitely, going to IFC is more challenging than going to a regular financial institution, but they also provide finer rates as well and long-term funding for some of the programs that we have in place which match well with us. So, it's been quite a rigorous six-month process and we're almost at the end right now.

Siddhant Maheshwari
OK Sir, just one small question. What actions company has already taken so far to resolve the issues in Taloja plant? I know, I mean it might be a little early to say, but this is the last question.

Anish Swadi
Yeah, so again like we said, it's a little early to tell that, but we've initiated appropriate legal measures as advised by our legal counsel for the matter. And again, we're going to the courts to help remedy these situations with. We can't comment any further since the matter is sub judice right now.

Siddhant Maheshwari
OK, Thank you.

Moderator
Thank you, the next question is from the line of Rahul from Raj Finance. Please go ahead.

Rahul
Hello, I'm audible? Yeah, I just have one question. Is there a way that we can process the waste in our facility? Or is the management planning to do that going forward?

Vimal Kulshrestha

Yeah, so we have various processes where waste is either it is processed inside, or it is given to the outside processor. It depends on product to product and the kind of waste produced. But yes, just to tell you that we are doing lot of improvement internally to improve on efficiencies of the product and reducing the waste.

Rahul
OK, but is there a way where we can process the entire waste like 100% going forward?

Vimal Kulshrestha

So as of now we do not have any such plan. So as I mentioned in my answer to previous question, that as of now, we are connected with MIDC's CETP and there the discharges as per the approved (limits) by MPCB.

Rahul
OK, Cool, that's a good.

Moderator
The next question is from the line of Rohan Bajaj from UMG Securities. Please go ahead.

Rohan Bajaj
Hi, thank you the opportunity. So again, on the same line, so is it possible to share the MPCB order? I believe it's a public document, so if you could share that document.

Anish Swadi
Yeah, so we can't share the MPCB document. So, unless you can get it directly from the MPCB that can be shared, and again, the matter is sub judice, so we can't share the document at this period of time.

Rohan Bajaj
OK, so also one more thing, just wanted to understand what the procedural documentation is required so we believe the time of the receipt of the notice and the clarification that is given to the exchange, there was some sort of delay, so just wanted to understand if we can expect a better level of clarity on such front?

Anish Swadi
We gave it within 24 hours of receiving it.

Moderator

Thank you, the next question is from the line of Rohit Nagraj from Emkay Global. Please go ahead.

Rohit Nagraj
Yeah, thanks for the opportunity. So, first question is on the Pinnacle initiative. So given that it's a growth initiative and probably, it could also have an element of maybe increasing the operating efficiency, digitalization, etc. What is the kind of benefit in terms of margin that we expect over the next, maybe two to five years? I think that's a five-year project. So, what are the tangible benefits we are expecting from this initiative?

Anish Swadi
So, Rohit, you are actually right. Pinnacle is a growth initiative and one of the main reasons for undertaking Pinnacle was to get operational efficiency. So, we definitely expect several benefits to arise not only from operations but also from supply chain and business development. So, all combined we expect at least 50 to 75 basis point increase on an annual basis when it comes to EBITDA margin and this would be spread across various segments of the business so it will be through supply chain, long term contracts, business development, increasing efficiencies on the operations side, so all that combined would yield to some of these benefits.

Rohit Nagraj
Right, so got it and we expect these benefits coming from FY22 or FY23?

Anish Swadi
So, you know those initiatives are ongoing. The first objective of Pinnacle is to identify some of those benefits within the verticals that we have. So, we've identified some of the key products, the key supply chain issues, how to streamline them, how to get better pricing, whether it comes to buying in bulk, where it comes to signing long term contracts, or whether it's finding also alternative vendors, so a lot of these initiatives have been identified and it takes anywhere between 6 to 9 months given the regulatory situation in order to capitalize on these initiatives. We also have instituted a key account management system which is also yielding benefits in terms of the business side. We are getting additional inquiries from most of our customers. The product pipeline of both our businesses are quite healthy at this period of time and we're also investing in capital expenditure at this time to meet those new product pipeline deliveries.

Rohit Nagraj
Second question, pardon me for harping on the Taloja shutdown issue. Now in terms of maintenance shut down, normally what is the number of days we take maintenance shut down if we are able to coincide it with the current issue? And second question to that, in terms of whether the customers again will need any validation, certifications or audits now before we start applying through this facility?

Vimal Kulshrestha

Yeah, so to answer your first question, the normal shutdown requirement is 3 to 4 weeks. So that we'll be taking, and we'll be doing all shut down activities and maintenance activities. And to answer your second question, that since these products have been old, so we do not think any re-validation would be required by the customers. So as and when we start, we will again start supplying it immediately.

Rohit Nagraj
Right. That's very helpful. One more question on the long term or contract arrangement on both the businesses. So generally, how much percentage of our revenue is coming from long term contracts on an annual basis from both for pharma and the Crop protection?

Manoj Mehrotra
For Pharma it is close to 50% which is on long term contract with global customers.

Vimal Kulshrestha

And for crop it is around 65 to 70%.

Rohit Nagraj
Got it, that's very helpful. Thanks a lot.

Moderator
The next question is from the line of Anubhav Sahu from M3 research. Please go ahead.

Anubhav Sahu
Hello, yeah, thanks for this opportunity. Thanks for keeping this call, really helpful. So, a couple of questions from my end. One, if you could, talk about environment compliance in general, post this incident and any sector wise or industry wide steps being taken by the regulatory authorities like GPCB or MPCB on which you can comment upon?

Anish Swadi
I'm sorry, could you repeat that question please?

Anubhav Sahu
Yeah, so I'm interested in, is there any major steps being taken by the GPCB or MPCB post this incident, which has an implication for the chemical sector in general maybe in terms of implementation. For example, I mean we are getting news flow that you know the waste disposal of material that is getting stricter or vetted a lot. And then they have some strict audit or compliance being done. So I mean with that context in mind, is there any industry-wide development you're seeing?

Anish Swadi
So as of now, as a company we are not seeing that you know any wide industry changes right now.
But you know, whenever there is an incident, whether it's related to this or prior incidents, there's always the industry associations, they always do get together and, see what changes can be made it, if at all. Again, we are not at this point in time seeing any industry wide changes or regulation changes in this case.

Anubhav Sahu
OK. Also, are there any specific steps we want, or we are planning to take from the compliance point of view? I'm not sure we, for example, if we already have it in place, but let's say for example, some

companies would like to do GPS tracking of vendor vehicles. In such kind of supply chain. What are your thoughts on that or any steps in that direction?

Anish Swadi
We have quite robust systems in place. Obviously post this incident each of the businesses, each of the divisions have gone through each of their SOPs to ensure that there are no gaps in the system. Again, as a company, where we have, I would say close to 75% of our customers being global, we are audited very frequently by all our customers. You know that's a secondary nature of also checking all compliances as well, and we also have internal audits that we do so. Again, but nonetheless, we have robust processes in place, and we are looking at areas in which there potentially could be gaps and revisiting them. You know, so for example, we have a doer and a checker system. Now we have a doer, checker, and a final checker system as well that we've implemented just to be on the safe side. And we continuously do that. You know, wherever recommendations are given by either our customers and/ or all regulatory authorities we always take that into account and effect those changes.

Anubhav Sahu
Okay, and one last question, more generic in nature. Just wanted to understand what is our backup plan for fulfilling the pending orders from Taloja? And Why I'm calling this is generic because, you know, incident could be of different nature. There could be some plant level accident or so, and in those kinds of eventualities how do company plans to fulfill those orders. And do such orders, have any penalty clause or something if you are not fulfilling that order?

Vimal Kulshrestha

Yeah, so as as we mentioned earlier in our speech that we would be utilizing this time to take the maintenance of the plant which we normally take in in the month of April. So that after that we are able to continuously service our customer and do the business. And what was your second question. Can you repeat again?

Anubhav Sahu
Is there any penalty?

Vimal Kulshrestha

No, penalty from the customers.

Anubhav Sahu
And this is the general nature of contracts which we have? Or it is specific orders where we have some penalty?

Vimal Kulshrestha

There's no penalty.

Anish Swadi

Also, as a general principle, just to add what Vimal said, most customers do have some safety stock as do we, right, which is on the high sea, or which is at the customers' warehouse. So, we work very closely with our customers to ensure that there is some safety stock buildup. We've also been extremely transparent with our customers since the notice we have received at Taloja. We have informed all of them so they can also plan their supply chains as well.

Anubhav Sahu
OK, understood. Thanks a lot.

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

Nitin
Yeah, thank you for the opportunity. So, I have two questions. The first question is when we had this con call in Q4 FY19, you mentioned that the capacity utilization was around 75-80%. Now it is 80-85% utilization, which is not highly distinct. You had mentioned at the time also about the Capex of 350 Crore with the gear upto 1.5 to two in next two years. So what is the status of that capex? It has been, you know, three years now and looks like the thinking line remains the same. Can you please comment on this?

Anish Swadi
So, look in FY19, we have grown right. Our revenues have grown, our capacities have grown. A lot of the Capex has come on stream and significant amount of that capex is still CWIP which is our capex that we're doing in Panoli. In terms of capacity utilization, it also depends on product mix. Some products require additional steps, but could give you the same amount of revenue, but have maybe a higher gross margin. The capacity utilization depends on the kind of products in the product mix that you have.
However, if you look at our numbers from FY19 to where we are now, we've grown considerably. We've seen that our profit after taxes also surpassed what we did in the full financial year last year in the first nine months of this year. So, the company has been growing.

Nitin
OK. My second question is, I don't want to argue or discuss about that, but my second question is Hikal had an impeccable record with five USFDA inspections in last 15 years and it cleared all the successfully. But suddenly you know in the last two years we noticed that there is a constant deterioration in the operational practices, first the flood issue at the plant not notified to the exchanges. Then recently a serious Sachin GIDC gas leaked incidents happened and now this pollution notice. So, what is wrong with Hikal? Are we taking too many shortcuts these days and what is the thinking of the management and are we sensitive about the repercussions of this issues with respect to our client relationships? Many of them are, of course, global MNC companies and they may have zero tolerance policy.

Anish Swadi
Yeah, so to answer your question, corporate compliance has always been and continues to be at the top of our mind. It is a priority for us. To will give you an example, we start every management committee with a EHS briefing or environment, health and safety briefing. We have always been at the peak of having the best corporate compliance and operational compliance from that perspective. The flood issue was yes

was beyond our control in terms of the floods that we had and yes did it take us longer to report to the Stock Exchange. However, we corrected that shortly thereafter, and you can see from the incident post that we reported all well within the stipulated corporate or the time periods.

In terms of, our customers, our customers are who pay our bills, and our customers are absolutely supportive and we have always been transparent with our customers and they always come to audit us well. USFDA might come once in three years, each of our assets get audited at least several times in 12-month period. So, we are very close in terms of operational working with our customers, and we continue to do that. The Sachin GIDC incident is an unfortunate incident that in which we can grow and again as per my opening statement, you know we are sure that we will be working towards clearing our name from the incident. That's all I can say at this period of time.

Nitin
OK, thank you all the best.

Moderator
The next question is from the line of Pranay Dhelia from Panchatantra Advisors. Please go ahead.

Pranay Dhelia
First of all, many congratulations on a good set of numbers I doubt anybody done that in this call yet. We continue to grow, which is very good as a stakeholder. I've been part of this company for five years and I hope that we continue to be part for another five years. We are doing all the right things and I'm sure these are unfortunate incident will also pass away.

So, my questions are primarily on the business front. How much has the dependence on China reduced for raw materials over the past year? Because you see China as such, the supply from there has been very volatile, so want to know the continuity of our Pharma operations and other raw material sources from China.

Anish Swadi
As a company, we are still about 30-35% dependent on Chinese supplies. Because, as you know, the major feedstock come from China, but we've had a program in place to de-risk our supply chain, and in the next two to three years, we definitely want to bring down by about 5-10%. So that's where we are right now. Yes, it's unfortunate that the that the dependence on China still continues, but they do manufacture several products or several key starting materials which are not manufactured anywhere else in the world. But you know the flip side of that is the positivity in terms of the China plus one strategy that is being followed by our customers which are leading to additional inquiries and additional business opportunities for us. So while we are still dependent on China, albeit, far lower than where we were, probably four to five years ago, which that number would have been probably closer to 50-55%. We have consistently brought it down, and we do have an action plan which we're implementing to bring it down even further.

Pranay Dhelia

Next would be, Sameer had mentioned in the previous two calls that freight cost is really hitting the bottom line. So, has the freight costs come down this quarter or have we entered into some long-term contracts with our transporters to ensure some smooth objectivity impact?

Anish Swadi
The freight cost unfortunately has not come down yet. In fact, freight costs have actually gone up since the last quarter when we had the conference call.

Pranay Dhelia
So, have you been able to pass it on to our customers or we have to bear it in our bottom line?

Anish Swadi
Most of our customers, we passed it on, but there are several like input freight costs in which we had to bear some of those increase and there are certain customers in which we have to pay for the shipping as well.

Pranay Dhelia
The last question would be, we've been doing continuously the Capex over the past two and half years and that is reflected in the top line. For FY23 now there's just one quarter left for FY22, so for FY23, how much of new capacity do we see being added and how much of a top line growth will be expect from this capacity, assuming here you know what I can recall from two quarters ago or three quarters ago we were told that the assets turnover ratio would be 1.75?

Anish Swadi
Right, so as you know that basically, as you correctly said, a lot of capex is being added. We expect the capex to come on stream majorly in second half of next financial year.

Pranay Dhelia
That’s H2 FY23.

Anish Swadi
That's correct, and the reason being is that there were some minor delays because of the third wave of COVID due to some personnel not being available for the construction of the plants. But that seems to have eased to a certain extent now. We still do have some delays, but we're definitely going ahead with all our capex plans across both the divisions. And once we validate the products, as you know, in our business it takes time. You have to spend about three to six months to validate the product, but we do expect that some of the Capex will yield benefits in the following financial year.

Pranay Dhelia
So going by the numbers, what I can recollect from my past notes we're expecting a capex of 180 Crores this year. So, do we expect about say 300-350 Crores to be added to the top line?

Anish Swadi

Oh well, you know to look at the guidance. We've always said that we grow in the high teens, mid to high teens. We will continue that once the capex comes up on stream. We also have additional opportunities that we're putting within the capex that we have currently, like more profitable products as well. So we'll stand what we look at. And also, just to reiterate, we had always indicated that the asset turnover ratio would be somewhere around 1.5 times.

Pranay Dhelia
OK, and what is the volume growth in the pharma as well as the Crop Protection division for this year and next year projection?

Anish Swadi
This year projections I'll hand over to Vimal and Manoj. Next year we are still working through what our budgeting process, so we can't give you an idea, but this year we can surely tell.

Vimal Kulshrestha

This year for Crop protection, it has been 10% volume growth and for Pharma Manoj can inform.

Manoj Mehrotra
Yeah, similar 10% or so. The revenues have grown by 8%, but that is more on.

Pranay Dhelia
I'm concerned about the volume growth, not revenues.

Manoj
The volumes are similar, I'll say around 10%.

Pranay Dhelia
OK, that would be it. Thank you so much. Wish you all the best and I'm sure that will come out of it stronger.

Moderator
Thank you. Ladies and gentlemen, due to time constraints, that was the last question for today. I would now like to hand the conference over to Mr. Anish Swadi for closing comments.

Anish Swadi

I would like to take this opportunity to thank everybody for joining the call. With the growth opportunities on offer and sheer quantity of inquiries that are coming in, we are very optimistic that we will end this financial year on a positive note, and we will continue the growth momentum even post that in the years to come. I hope we have been able to address all your queries. Again, I would like to reiterate my appreciation and thanks to all our customers, our suppliers, our bankers, as well as all the investors and other stakeholders for their continued support during this period.

If you have any further questions, please do kindly get in touch with Strategic Growth Advisors, our Investor Relations team. Thank you once again.

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