November 8, 2023

BSE Ltd.,
P J Towers,
Dalal Street,
Mumbai - 400 001.
Scrip Code: 524735

National Stock Exchange of India Ltd.,
Exchange Plaza,
Bandra-Kurla Complex, Bandra,
Mumbai - 400 051.
Symbol: HIKAL

Dear Sir/Madam,

Subject: Transcript of Earnings call for quarter ended September 30, 2023

In continuation of our letters dated October 30, 2023 and November 2, 2023 and pursuant to Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, please find enclosed the transcript of the earnings call held on November 2, 2023, for quarter ended September 30, 2023.

Kindly take the information on record.

Thanking you,

Yours Sincerely,
for **HIKAL LIMITED**

Rajasekhar Reddy Chintakindi
Digitally signed by Rajasekhar Reddy Chintakindi
Date: 2023.11.08 15:09:21 +05'30'

Rajasekhar Reddy
Company Secretary & Compliance Officer

Encl.: As above

Hikal Ltd.

Admin. Office: Great Eastern Chambers, 6th Floor, Sector 11, CBD Belapur, Navi Mumbai - 400 614, India. Tel. + 91–22–6277 0299, + 91–22–6866 0300

Regd. Office: 717, Maker Chambers - 5, Nariman Point, Mumbai - 400 021, India. Tel. +91-22 6277 0477. Fax: + 91-22 6277 0500

www.hikal.com info@hikal.com CIN: L24200MH1988PTC048028

Hikal Limited

Q2 FY24 Earnings Conference Call

November 02, 2023

Disclaimer: E&OE - This transcript is edited for factual errors. In case of discrepancy, the audio recordings uploaded on the stock exchange on 2nd November 2023 will prevail.

MANAGEMENT: **MR. SAMEER HIREMATH – MANAGING DIRECTOR – HIKAL LIMITED**
MR. ANISH SWADI – SENIOR PRESIDENT, BUSINESS TRANSFORMATION – HIKAL LIMITED
MR. KULDEEP JAIN – CHIEF FINANCIAL OFFICER – HIKAL LIMITED
MR. MANOJ MEHROTRA – HEAD, PHARMACEUTICAL BUSINESS – HIKAL LIMITED

Moderator: Ladies and gentlemen, good day, and welcome to Q2 FY '24 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 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 star then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Sameer Hiremath, Managing Director from Hikal Limited. Thank you, and over to you, sir.

Sameer Hiremath: Thank you very much. Ladies and gentlemen, good evening, and a warm welcome to all of you. We extend our gratitude to all of you for participating in our Q2 and H1 FY '24 Results Conference Call. I am Sameer Hiremath, Managing Director, Hikal Limited, and I will be leading the discussion and presenting the financial results.

On this call, I have with me Mr. Anish Swadi, Senior President, Business Transformation; Mr. Kuldeep Jain, our Chief Financial Officer; Mr. Manoj Mehrotra, our President, Pharmaceuticals business; and Strategic Growth Advisors, our Investor Relations Advisors.

I hope you have had the chance to go through our earnings release, investor presentation and the financial statement for the quarter and half year ended 30th September 2023. These are available on Hikal's official website and the stock exchanges' website.

The global chemical industry continues to experience a challenging period with prices declining across product segments, coupled with the high channel inventory levels and intense price competition. Customers are focusing on lower prices to bring down the average inventory cost while selectively making new purchases. We expect prices to bottom out, elevated inventory levels to subside and demand likely to pick up at the end of this financial year, resulting in improvement in operational profitability quarter-on-quarter going forward.

China's economic woes have created depressed market conditions, specifically for the Crop Protection market. However, though we are witnessing price stabilization in certain segments, we expect demand to improve by end of this financial year.

For Q2 FY '24, our revenue stood at INR 435 crores, EBITDA stood at INR 57 crores, with EBITDA margins at 13.2%, an increase of 73 basis points on a year-on-year basis. On a sequential basis, our revenue and EBITDA grew by 12% and 14%, respectively.

For H1 FY '24, our revenue stood at INR 823 crores, EBITDA stood at INR 108 crores, with EBITDA margins at 13.1%, an increase of 323 basis points on a year-on-year basis. We were able to navigate through market headwinds on back of cost improvement program and softening in prices of certain raw materials.

In our Pharma business, while we had a challenging quarter from a margin perspective, we have started to see improvements in volume and expect the trend to continue in the second half of the financial year. Deeper penetration in Japan, Latin America and MENA geographies have started yielding positive traction in the API segment. We have started receiving regulatory approvals across geographies for our newer product portfolio. Our new multipurpose plant for Animal Health is completed at Panoli, Gujarat and commissioning is underway.

On the Crop Protection side, the industry is facing challenges owing to a steep price erosion globally followed by stagnant demand globally on account of disruptive destocking in the market. Demand is likely to show signs of picking up towards the end of this financial year, which is expected to result in favourable operating leverage resulting in improved margin profile sequentially.

To navigate the impact of market headwinds, we've implemented a range of strategic initiatives aimed at cost improvement, optimizing our supply chain, streamlining procurement, digitization and enhancing productivity through automation. These steps have contributed to improving operational efficiency.

In summary, we are well positioned for sustainable growth in the medium to long term. While we acknowledge the presence of short-term challenges due to the current global situation, we remain confident in the company's long-term prospects for growth and profitability.

For the Crop Protection business in the Q2 FY '24, we reported a revenue of INR 165 crores, EBIT of INR 22 crores and EBIT margin of 13.3%. For the H1 FY '24, the Crop Protection business reported revenues of INR 328 crores, EBIT of INR 39 crores and EBIT margin of 11.9%. On a sequential basis, EBIT grew by almost 28%.

The global Crop Protection industry continues to go through a challenging phase on account of disruptive destocking situation coupled with aggressive pricing from Chinese companies. We are at the advanced stages of discussions with various customers for new projects which are expected to yield positive results in the medium to long term. Our strategic vendor development, diversification of our supplier base and backward integration program is helping us to mitigate supply chain risks. Our new multipurpose plant at Panoli is under commissioning.

In the own product segment, we continue to witness higher-than-normal inventory levels in the end market, which is expected to improve towards the end of this financial year and the beginning of next year. However, the medium- to long-term outlook for these products remain positive and end-user consumption is stable. Additionally, we are actively exploring new product and service opportunities with newer customers to further diversify and expand our business.

Our CDMO business continued to receive inquiries from both current and new clients. This demonstrates the continued demand for our contract manufacturing and development services. We are focused on capitalizing on these opportunities and enhancing our position among global innovator companies.

Now I would like to hand over to Manoj Mehrotra, head of our Pharmaceutical business, who will provide an overview of the pharmaceutical division's performance. Over to you, Manoj.

Manoj Mehrotra: Thank you, Sameer, and good evening, ladies, and gentlemen. I'll start with the financials for Q2 FY '24. Pharma business reported revenue of INR 270 crores, EBIT of INR 12 crores and EBIT margin of 4.3%. For H1 FY '24 Pharma business reported revenue of INR 495 crores, EBIT of INR 22 crores and EBIT margin of 4.4%.

On a sequential basis for Q2, there is revival in both revenues and EBIT, which is up 20% and 22%, respectively. We are witnessing good traction in Pharma business aided by revival of API segment. On a year-on-year basis, certain raw material prices have decreased. This, along with the implementation of a variety of measures to enhance cost optimization and operational efficiencies, has led to better profitability.

In the API segment, we are witnessing a sequential revival in our API business. We have been able to successfully maintain our market share in legacy products despite competition. Our efforts to penetrate new regions like Japan, Middle East, Latin America are yielding positive results, leading to increased interest and visibility in these markets.

We have started receiving regulatory approval across geographies for new product portfolio. During the quarter, we received Taiwanese approval for our API Dapagliflozin. This strengthens our position as a pure play API manufacturer and commitment towards the portfolio in the anti-diabetes therapeutic category.

We have a robust pipeline with 8 to 10 products under development and have targeted to launch 3 to 4 products during FY '24. Going forward, we prioritize maximizing API sales by increasing our customer share of wallet, investing in new markets, and expanding our market share in specific APIs, where we have advantages in terms of backward integrations, scale, and technology.

In the CDMO segment, in Q2 FY '24, witnessed a muted performance for CDMO business on the back of destocking situation. However, looking ahead, we anticipate the normalization of the CDMO industry towards end of FY '24. We maintain a robust pipeline of project in the CDMO space and actively pursue additional opportunities that have arisen in recent quarters. We have two opportunities in Phase III of clinical trials which are likely to get commercial in the coming years.

As we have mentioned before, CDMO's a long-term business that requires time, commitment, and patience to establish strong relationships. We are pleased to report that despite the destocking situation, we have observed increased traction among our existing innovator customers, allowing us to expand our share of the business driven by newer set of molecules.

On the overall Pharma business, our CDMO revenue has been subdued, and our API to CDMO ratio is close to 70% to 30% in H1 as compared to a historical average of closer to 60-40 ratio. We expect comparatively better second half of the year, more so in Q4 as CDMO demand revives.

As informed earlier, our API facility in Panoli has received an no action indicated compliance status with “Zero 483” observations from the U.S. FDA. This achievement reflects our unwavering commitment to maintaining the highest standards of quality, compliance, and regulatory adherence across all our manufacturing sites. These developments further reinforce our position as a leading player in the industry known for our strict adherence to quality and regulatory governance.

Now I would like to hand over to Anish Swadi, Senior President, Business Transformation, who will provide an overview of our Animal Health and Business Transformation initiatives.

Anish Swadi: Thank you, Manoj. I'll start off with an update to the Animal Health business. So, the development of multiple APIs under a long-term contract with an innovator Animal Health company is on track. We have completed the construction of our multipurpose Animal Health facility at Panoli, and the commissioning of the asset is currently underway.

We are on track to provide validation batches of several new products under development to our customer over a period of the next 4 to 6 quarters. These validation batches will act as a first step towards registration and then towards commercialization of the products. We are currently in discussions with several additional innovator customers to provide a variety of services, ranging from R&D to manufacturing, for their current and future portfolio needs.

Our extensive manufacturing networks and deep engagements with global innovators, along with niche customers, positions us as the partner of choice in this field. By offering end-to-end support and process development and complex molecule synthesis, we have and are providing an end-to-end solution for our customers.

To summarize, the long-term prospects will continue to outweigh the short-term challenges that we face currently. Project Pinnacle, our business transformation initiative, has already started to bear fruits. Several initiatives are underway for building new capabilities in terms of technology, resources, digitization, and infrastructure. We expect the momentum to continue positively into the future.

I would now like to open the floor to Q&A.

Moderator: Our first question is from the line of Sajal Kapoor, who is an investor.

Sajal Kapoor: Has the number of CDMO customer audits changed meaningfully over the last 3 years? And can you share some numbers, like how many annual audits Hikal was getting 3 years ago versus today, please?

Sameer Hiremath: Manoj, you want to take that?

Manoj Mehrotra: Yes. So in our CDMO business, we are regularly audited and visited by various customers. I don't have an exact number at this point of time, but we have seen several new customers who have come in the last one year. There was a gap during the COVID period. But in 2023, several new customers have come and visited us and audited us. But as we mentioned, the CDMO business is a long-term business, and it takes time to scale up.

Sajal Kapoor: Yes, Manoj, I was interested in, let's say, 2019, before COVID, you were getting x number of audits annually. Where is that number today, ballpark? I mean, as a percentage, not the absolute number?

Manoj Mehrotra: 1.5x.

Sajal Kapoor: So 50% jump, right? Okay. So that's helpful. And is this across Agro as well? Or is it predominantly more traction on Pharma, including Animal Health?

Sameer Hiremath: No, I think it's for Agro as well because we're increasing our customer base and our market penetration, the number of customers that we onboarded in the last few years has increased dramatically in both divisions. So, there is a similar type of uptick of visits and audits from Agro and chemical companies.

Sajal Kapoor: That's helpful, Sameer. So 50% increase over the last 4 years. Does that also translate into a 50% increase in the number of scientists that we have over the last 4 years, so 2019 versus today? Is that a fair assessment? Or is that number on the scientific capability sort of side less than 50%?

Sameer Hiremath: I think the scientific community has more to do with the type of project that we've got. Some of the projects that we've got with our innovator companies involved R&D development contracts. So that's why we strengthened our R&D significantly in the last couple of years.

Plus, the number of inquiries which are under development. Manoj also mentioned a few NCEs that are currently developing with our clients. So, that all adds up to the reason why we have more R&D strength as we built up our capabilities in the last 3 to 4 years.

Sajal Kapoor: Yes, sure, Sameer. So I was just trying to get a better understanding on -- I'll give you an example. So if those 50% increase in customer audits have actually translated into a near 50% increase in the workload, then I think it's obvious to assume that you would need roughly 50% more scientists, assuming that in 2019, every person was occupied, busy. Or is that not the case? I mean, there is some increase, but the feeling I'm getting is it's not as high as 50% over the last 4 years.

Sameer Hiremath: Yes the audits -- sorry Manoj, take that, yes.

Manoj Mehrotra: Yes. See, audit is one thing, and then the customer approves your capabilities and the site. So there's always a lag. So audit has clearly improved by 50%. But scientific community, the number of people have not increased to that proportion. And we increased scientists as and when the real business comes in. So we always have some bench strength. But as and when we see visibility of business, then we add the scientists.

Sajal Kapoor: Sure, sure. That's helpful. And maybe if, Sameer, you could answer. So today if I look at the whole business, the consolidated entity, we work across 3 different segments. So, we have human, we have Animal Health and Crop Protection capabilities. Does this not dilute our focus as you're trying to cook too many recipes at the same time will spoil the dinner? Is that not possible?

Or you think that, because you are working across different domains, there is a cross-fertilization, and it may actually be beneficial over the medium to long term to have 3 distinct capabilities. I mean, how do you see that? Is that a hindrance? Or is that an advantage?

Sameer Hiremath: Actually, I think that is an advantage because there's a lot of cross-fertilization of ideas. You get economies of scale. Some of the sites are shared sites, like the Panoli site does Crop, Pharma and Animal Health, it does all the 3, so has economies of scale. R&D is a shared site. And some customers also have both sides of the segments, they do both Animal Health and Pharma or Crop and Pharma. So, there are some innovator companies that are looking at that.

And if you look at it, there's a lot of healthy competition that we have within our 3 divisions to vie for high value or utilization of common resources to build good competition within the company.

And if you look at some of our competitors, they are trying to do this. Many of our competitors in the Pharma or on the Crop side, have announced foray into either of the 2 segments. So this is a good, balanced approach. One industry is kind of going through a tough time, the second segment can kind of balance it out. It also helps in de-risking from business cycle as well.

Sajal Kapoor: Yes. No, that's a fair comment, Sameer. And I think PI Industries is one example. They were predominantly into Agro; they are now moving into Pharmaceuticals. And Laurus Labs is another example where they were always in Pharmaceuticals, but now they are increasing exposure into Animal Health and Crop Protection. So, I take that.

I've got more questions, and I'll fall back in the queue.

Moderator: Our next question is from the line of Pranay Dhelia from Panchatantra Advisors LLP.

Pranay Dhelia: Just a couple of observations on the numbers. This quarter, ROE has been even below the cost of capital, whereas our margins on the Crop Protection as well as on the API are well below the industry average. Now being long-term investors, we've been expecting the margins to improve, and that's what the commentary has been in the past. But they just refuse to tick away. At this time, I would say as a long-term investor, at least some way or the other, we need some answers, how do we expect improvement on these counts?

Sameer Hiremath: So, I think the sales have been depressed on the Crop side. If you look at, the sales have come down quite considerably. And the product mix on the Pharma side has been predominantly on the generics versus the CDMO. So that was the reason why the margins have been subdued.

We expect H2 and the new products which are kicking in and all the CDMO part to come back from Q3-Q4. And as I have been saying, we expect quarter-on-quarter improvement. And towards the end of the year, we'll get back towards steady state. Product mix change will bring in a significant change in the margins going forward.

And the new capex that comes on stream, which as Anish mentioned, the Animal Health plant commissioning is underway. The Crop Protection asset is also -- will start very soon. So that should have a better margin profile and to the overall margins on both the divisions.

Pranay Dhelia: Do we expect the ROE to go northwards soon enough because this is the first quarter I've seen ROEs below cost of capital.

Sameer Hiremath: Yes, it will start going up. I mean, this is -- I think this is a one-off on the quarter. It will start improving.

Pranay Dhelia: And a couple of questions on the debt front. If you could just tell us what is the debt composition we currently have and the cost of debt at the moment?

Sameer Hiremath: Kuldeep, can you take this?

Kuldeep Jain: Yes, sure. Our current total debts are almost INR 778 crores, which is absolutely in line with the corresponding half year last year, which was INR 779 crores. Our cost of fund is 8.7% currently, which was 6.7%. As you know that MCLR rate has increased in the past last 6 months, 9 months. And therefore, we are also impacted with that.

Pranay Dhelia: This INR 770 crores is entirely term loan? Or you have a breakup of it?

Kuldeep Jain: No. We have INR 250 crores as a short-term loan and INR 535 crores as a long-term loan.

Pranay Dhelia: Okay. And further expansion capex, we don't need to raise any debt? I believe internal cash flows would suffice for it?

Kuldeep Jain: No, we'll have to do some funding from the next quarter, maybe H2 because we have to complete the project which is unfinished. We'll need some money for this.

Pranay Dhelia: So will our debt equity ratio further deteriorate because of that?

Kuldeep Jain: Not really because we will have the equity also coming into the next H2. We'll have a -- we're estimating good profits in the H2.

Pranay Dhelia: So the current debt-to-equity ratios, if I'm not mistaken, was 0.61. That would stay the same?

Kuldeep Jain: Maybe 0.1, 0.2 here and there.

Pranay Dhelia: And what is the kind of capex we are looking at in this current year and next year there?

Kuldeep Jain: Sameer, you can answer about the next year.

Sameer Hiremath: Yes. So I mean, historically, we are doing -- the idea is -- the focus is now to complete the ongoing capex. And so the plan for this year is to complete the balance capex. So we said, on an average, we were historically doing about INR 300 crores per year. And this year, we're planning about INR 200 crores of capex. And the next year will be slightly lower than that as well because the idea is to fill up the current assets.

Pranay Dhelia; So how much of INR 200 crores is left this year?

Kuldeep Jain: INR 100 crores is already completed.

Sameer Hiremath: INR100 crores, yes. 50% is left.

Pranay Dhelia: Okay. So INR 100 crores left. And next year, you plan similar, INR 200 crores.

Sameer Hiremath: Maybe slightly lower than that because that focus is on completing and filling up the plants, and they're two big assets that are to fill up for next year.

Pranay Dhelia: Yes. And we've been speaking of good expansion in the past. So all of this will be commissioned by H1 of FY '25? Like Panoli is already under commissioning, as we just said. And the other capex that you are doing, all that will also come into production, mainstream production, by January or soon enough?

Sameer Hiremath: I would say, towards April -- March to April of next year.

Pranay Dhelia: So FY '25, we should expect substantial jump in top line?

Sameer Hiremath: It takes time. You're ramping up takes 1 or 2 to 3 years. So first year -- second year -- the crop business would be 2 years, the pharma business takes about 18 to 24 months because the validation itself takes 12 months to validate these products, and then you get approval.

Pranay Dhelia: So last quarter, Sameer, as you mentioned, someone had asked it with a 5 year, which is the company, you said hopefully, by '26, '27, we'll be seeing top line of INR3,500 cores to INR4,000 crores. Do you still stick by it, that, that should be doable easily?

Sameer Hiremath: Yes. We have a lot of expansion, and we have a target to grow our business quite substantially in next 3 to 4 years.

Moderator: Our next question is from the line of Viraj Mehta from Equirus PMS.

Viraj Mehta: Sameer, one question that we as investors are not able to understand is, if you look at last commentary of last year, 1.5 years -- 1 year actually, of not only you but multiple players across the segment talking about inventory destocking and prices going down. But the point is that most of those players also saw significant uptick when the prices went up, and also the growth was higher in volume and inventory stocking was happening, right?

Like almost all-on an average, agrochemical exporters or API exporters, revenue went up between 50% and 70%. But our revenues also didn't grow. Like our revenues were hovering between like INR1,600 crores to INR1,900 crores, INR2,000 crores. But now when the reverse is happening, we are nearing the brunt. So how is this cyclicality only hurting us on the downside but did not have any impact on us on the upside?

Sameer Hiremath: No. Actually, if you look at our crop revenue from FY '22 to FY '23, there was a significant upside. So we had benefited from that upside between FY '22 and FY '23. If you look at our sales in FY '22, our crop sales grew from INR660 crores in FY '22 to INR900 crores between FY '21 to FY '23. So we grew almost INR300 crores on the top line in those 2 years. So there was a significant uptick, as you said, during the good years of the crop business. We did benefit significantly from that.

Viraj Mehta: No, no, I meant as an overall company. Our revenues, Sameer, went up by like INR400 crores in 3 years. And if I look at the overall number, we are roughly at the same revenue we were like 3 years back, which is actually not the case for most of the players, even after the downtick that we are seeing right now. And on top of that, we have done large capex. So, like this has happened when also we have cumulatively done like INR 500 crores of total capex, INR 550 crores.

Sameer Hiremath: Actually, 3 years ago, we were INR 1,500 crores. And now last year, we ended at INR 2,000 crores. So, we actually added INR 500 crores on the top line. If you look at the 3- to 4-year horizon. So we've not gone back to this number. FY '22, FY '23 was flat. But if you go back 3 years, it's going to be INR 500 crores on the top line.

Viraj Mehta: Sure. sure. So post this all capex, Sameer, we just need 1 final thing. What the total revenue like you will be able to do with the current capacities and the current capex completion happens?

Sameer Hiremath: All the new capex that we're putting in is an asset turnover between 1.2 to 1.4, in that range. And that's what we're targeting for the new capexes.

Viraj Mehta: But so that guidance has also been revised downwards from what it was earlier, right?

Sameer Hiremath: No, it was always at in that range, was probably maybe 1.3 to 1.5, in that range. So because of the product mix, we actually are focusing more on the margin profiling. And it's close to 1.2 to 1.4. You can take an average of 1.2 to 1.4, yes, 1.3.

Moderator: Our next question is from the line of Rajvi Shah from Bright Securities.

Rajvi Shah: I have 2 questions. The first is how is a new business acquisition happening? Are you winning any new contracts?

Sameer Hiremath: Sorry, can you repeat that question? I couldn't hear you. What was it?

Rajvi Shah: Yes, sure. How is the new business acquisition happening? Are you winning any new contracts?

Sameer Hiremath: Yes. I think the number of new inquiries have increased tremendously. We have several new inquiries and resulting in a large number of projects which are under development. And the customer traction has increased, the number of audits, as Manoj mentioned, has gone up at 50%. Same thing on the crop side.

A lot of that is resulting in new inquiries coming in, but also onboarding new customers from new geographies. So we're spreading our business and the customer reliance is going down, and we're managing our risk with the reliance of products and customers coming down.

Rajvi Shah: Okay. And the next one is on Pharma side. Are you winning new CDMO businesses?

Sameer Hiremath: Yes, we have. Manoj?

Manoj Mehrotra: Definitely. On the Pharma side, as we mentioned in my opening speech, that we have got 2 projects on Phase III which are under commercialization now. It takes maybe 1 or 2 years, depending on the customer approvals. And after -- apart from that, there are a few others which are under active discussion and close to finalization.

Moderator: Our next question is from the line of Aditya Sen from Robo Capital.

Aditya Sen: Sir, to the previous participant, you answered that will be -- you should expect significant uptick in the margins. Can you please give us a ballpark number where we should expect the EBITDA margin for H2 and obviously for FY '25 also.

Sameer Hiremath: Actually, because of the volatility, we are not giving any forward-looking statements right now. I'm not giving any estimates. Sorry, I won't be able give to give you any numbers right now.

Aditya Sen: Okay. If we like keep the volatility part, volatility thing aside for a while and depend on the -- as you said that the CDMO proportion would increase in H2. So accordingly, that should add like 2-3% of EBITDA? Can we go by that figure?

Sameer Hiremath: I'm not going to give you numbers per se. I'm not giving any forward statements. It's a very volatile environment.

Moderator: Our next question is Yug Mehta from AB Capital.

Yug Mehta: Are you seeing any traction from European, U.S. companies' vis-a-vis Chinese political situation?

Sameer Hiremath: Yes. I think the American companies are moving faster away from China than the European companies and because there's a political decision taken to get out of China and move away as much as possible. Europeans are doing it, but not as fast as the Americans. And the company will start to benefit in both segment, Crop, and Pharma. There is a lot of customer interest and customer inquiries and a lot of delegations of companies coming and visiting Indian suppliers for new businesses and new opportunities.

Moderator: Our next question is from the line of Dhwanil Desai from Turtle Capital.

Dhwanil Desai: Sir, my first question is on the Pharma CDMO side. So, if you can talk a bit more about what kind of product pipeline we have, how many molecules, split between generic and NCE. And NCE, what stage? Some granularity and that would be very helpful.

Sameer Hiremath: Manoj, can you answer that?

Manoj Mehrotra: Yes. Yes. So we had mentioned in my opening statement that we have 2 molecules which are the Phase III, which are very promising. We have supplied some quantities in FY '23 and will supply in FY '24 also.

Going forward, because they are in clinical stage it's very difficult to predict how will be the scale up. But we are -- our customers are very confident that they will make it to the market and they will definitely be big products for us.

There are several others which are in Phase I, Phase II, but that is a little too early for us to predict. And so it is better that we kind of hold on until they move to Phase III. Although we get fee for service kind of revenue for Phase I, Phase II also. But once it goes to Phase III, we are more certain, and that is the time customer also kind of start getting into contractual discussions. This is on the CDMO side.

On the API side, we have -- we filed around 2 to 3 DMFs every year. And that's the launch plan, which we have for various other APIs. But the API business is not contractual in nature, that is more on the spot business with various generic companies. And it is good that we have a large portfolio, first, we have built in the CNS segment. Now we have built a portfolio in the antidiabetic segment also.

Dhwanil Desai: Right. Manoj, on the CDMO side, whatever is the current CDMO business, is it safe to assume that a large part of that CDMO is coming from non-NCE part? And going forward, the NCE part will kick in?

Manoj Mehrotra: Yes. That's a good way to look at it, yes. Because the non-NCE part remains as a kind of a base business, it's already launched, products are life cycle management products. But the NCEs will add future and they give you a sudden bump up in revenue, which may happen in FY '25 or FY '26.

Dhwanil Desai: Okay. Also, can you talk a bit about how does the length of the agreement in CDMO business for non-NCE part? How long they are, how the price regulation happens? Some -- again, some color on that.

Manoj Mehrotra: See, usually, if the CDMO contracts are 5 years, I'll say, and they have a price variation clause. And the raw material prices are mostly pass through cost because there's various volatility in the raw material cost, but there's always a lag effect.

Dhwanil Desai: Okay. Okay. Sir the reason I'm asking this is that our -- on the pharma side, we are at a very low margin. So is there any inventory loss which is factoring into this margin?

Manoj Mehrotra: No. At this point of time, we have inventories, but not to that extent, but on the CDMO unless we had a customer firm forecast, or from -- we don't really manufacture in advance. The margins are down, as I mentioned earlier that, because the CDMO segment, which is always of a higher margin, has shrunk due to customer inventory corrections. But we are confident of getting it back from 2024 or Q4 of this financial year. That is the time when customers will kind of relook at the inventory level and start taking orders.

Dhwanil Desai: Okay. Got it. On the Animal Health side, I think Anish talked about kind of validation batches and taking validation orders for a number of products. So at this juncture, can you talk about how many molecules are at that stage where we can start taking validation batches? What's the portfolio? How many will get commercialized in next year, FY '25? And then how many into FY '26? If you can give some sense on that.

Anish Swadi: Yes, sure. So as we said that we are -- currently, the plant has been built and it's commissioned. We are currently undergoing validation of several products. So in the next, I would say, 18 months, we would have probably gone through validation of 6 to 8 products where we supply the customers with the quantities they required to register the products, post which, once the registration comes through, the commercialization starts.

Dhwanil Desai: As a process, is it safe to assume that the chemistry part of it is out of the way? That has been -- the development has been complete to the satisfaction of the customer. And then now the validation, the manufacturing part will come into play. And thereafter, the regulatory part will take its own time. That's how it will work, right?

Anish Swadi: Yes. So in principle, yes. However, it happens concurrently. So you don't finish all the development all at once and then go into validation. So it's a concurrence. So as you finish development of 2 to 3 products, then you put it in the commercial cycle for validation. Then the remaining products in the pipeline gets developed and then you push it through. So it's concurrently happening at the same time.

Dhwanil Desai: Okay. Sir, the reason I'm asking is that if you are taking that next 12 months, we'll do the validation part, typical registration takes a couple of years, right, in some of the major geographies. So how do we expect ramp-up from the Animal Health in next 2 years then? Because validation will take FY '25, and then regulation, regulatory approval will take another year, 1.5 years. So essentially, everything should start falling in place from FY '26 second half onwards?

Anish Swadi: Yes. So as I mentioned again, so we're submitting validation batches this year to -- for some of the products that we'll -- that we have currently already developed, that will start getting registered. But all registration doesn't take 24 months. There are certain registrations in certain countries in which it takes 12 to 14 months as well.

So we expect that commercial revenues will start probably sometime in '26, but in the early part of '26. It depends on geographies as well because these are global registrations. It's not a single country registration.

Dhwanil Desai: Right. – Got it and out of the CWIP of INR 500 crores, INR 550 crores, how many will get capitalized this year?

Sameer Hiremath: Kuldeep, please answer that.

Kuldeep Jain: Yes, we are estimating almost INR 480 crores, INR 490 crores capitalized in this year.

Dhwanil Desai: And you capitalized asset on the point of commercialization, right? When do we take first commercial batch?

Anish Swadi: So there are 2 aspects. One is the completion of the project in terms of the ready-to-use and then commercial productions.

Dhwanil Desai: So when do you capitalize?

Anish Swadi: We capitalize on the completion of the project.

Dhwanil Desai: Completion. Okay. Got it. And last question from my side. So, I think we have -- in our commentary, we have talked about if you see some revival on Agchem side from the last quarter of FY '24. Sir, is this more of our estimation? Or is this something which is the feedback that we are getting from customers?

Because this timeline, not for us, but for everybody, has been -- keeps on changing. I mean, it was first in the second half. Now everybody talks about Q4. Some of the global players are now talking about first half FY '25. So is this more of a guesstimate kind of work? Or is it based on some concrete feedback from our customers?

Sameer Hiremath: No, I think it's not guesstimate. I think it's based on the market data and the consumption patterns of the end products. We track that very closely. It depends on product to product. The inventory levels are different for different products. They're different for fungicide, insecticide, herbicides. Different geographies, depending on if you're selling in Latin America, the cycle is different. European and North America cycle is different. So you need to track it down and drill it down.

Again, we track it based on market information market and consumer data, discussions with our customers. And this is -- there's always the best estimate or best guess, but this is what we work with. And we are looking at the exports out of China, the manufacturing situation in China. There are a lot of data that has been used to come to this decision.

But you're right. I mean, it's largely -- it is data driven, but there is some level of estimation as well. But mostly data driven. Yes.

Dhwanil Desai: Okay. And one more question on the margin, not like 1 or 2 quarters. But I think in the past also, we've been saying that the products have higher gross margin upward of 50%. We are in the 48-50% range. And so eventually, when the new product mix changes, the gross margin will improve.

So let's say, when it goes above 50-52%. Whatever cost structure that we have created today, is it fair to assume that we will be significantly above our historical margins of 19-20%? You can eliminate the timeline part of it, of when it happens. But is that the right way to look at the overall business model?

Sameer Hiremath: Yes, it will go. I mean as I've always said, the newer products have much better margin profile than our historical portfolio. And with our investments already being put in place by end of this year and our fixed cost being there for a large extent, there will be a significant uptick in margin due to the operational leverage also that we will get based on higher volumes and higher-margin products that are being launched in the coming years.

Moderator: Our next question is from the line of Ankeet Pandya from Infinite Asset Management.

Ankeet Pandya: Sir, first question on the gross margin front. So in the current quarter, we have reported of 51% of our gross margin versus 56.1% in Q1 FY '24. And historically, for the last around 5, 6 quarters, you have been at the range of 36% to 48% gross margin. So just wanted to get some clarity on that front. Did Q1 had so many one-offs item in the numbers? And how should we look at for the second half and on a steady-state business on the gross margin?

Sameer Hiremath: The numbers don't seem to be accurate, what you mentioned, on the gross margin side.

Ankeet Pandya: Sorry. I didn't get you, sir.

Sameer Hiremath: You said the number that you mentioned, don't seem to be the correct numbers that you mentioned on the gross margin. Our overall contribution margin was about 46% as a company and not 51%, what you mentioned.

Ankeet Pandya: I guess I'll check on that. So on the next second question on the volume front, volume side, how has been the growth on volume front for both the Pharma and Crop Protection?

Sameer Hiremath: If you look at the volume front for H1, if you look at for the Crop Protection business, the volumes have actually degrown by 26%, but for Pharma, they've grown by 4%. So the company has a degrowth of 16%, primarily driven by the Crop Protection volume reduction.

Ankeet Pandya: And sir, in the Crop Protection, given that it's been a year-over-year basis almost 39%, 40% decline. So sequentially, going forward, can we assume some improvement on the Crop Protection business, given that by Q4, all the channel inventory issues will get normalized? So sequentially, should we assume growth in the Crop Protection business?

Sameer Hiremath: So, I think while the normalization starts from Q4, the improvement will start from Q4 for the Crop business.

Moderator: Thank you. Ladies and gentlemen, that was the last question of our question-and-answer session. As there are no further questions, I would like to hand the conference over to Mr. Sameer Hiremath for closing comments.

Sameer Hiremath: Thank you, everyone, for joining our quarterly earnings call and for your continued interest in our company. We appreciate your support as we navigate through the global business environment. Our vision is to become a sustainable company that prioritizes technology, remains dedicated to effective execution, and maintains a strong customer-centric approach, ensuring best-in-class service in all our business sectors. We are strategically positioned to leverage the substantial opportunities presented by the ongoing global shift of supply chains to India.

As we conclude this call, we want to assure you that we are here to address any further questions or concerns. Please feel free to reach out to us or to our investor relations partner, Strategic Growth Advisors.

Once again, thank you for your participation, and wishing everyone a happy festive season. Wish you a very happy Diwali. Good evening and have a good day. Bye.

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