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Date: 20.11.2024
Bangalore

To,

M/s. Bombay Stock Exchange Limited
Phiroze Jeejeebhoy Towers
Dalal Street,
Mumbai-400001

Security Code: 524654

Subject: Disclosure under Regulation 30 of SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015

Dear Sir/Madam,

Pursuant to Regulation 30 of SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015, we wish to inform you that the Company participated in the Investors Conference Call on Monday, 18th November, 2024, enclosed herewith please find transcript of earnings conference call on unaudited financial results for the quarter and half year ended 30th September 2024. No unpublished price sensitive information was shared/discussed in the meeting.

Kindly take the same on your records.

Yours Faithfully,

For Natural Capsules Limited

SHILPA BURMAN
Digitally signed by SHILPA BURMAN
Date: 2024.11.20 16:00:39 +05'30'

Shilpa Burman
Company Secretary & Compliance Officer

NATURAL CAPSULES LIMITED

"**Natural Capsules Limited**
Q2 & H1 FY'25 Earnings Conference Call"
November 18, 2024

MANAGEMENT: **MR. SUNIL MUNDRA**
MANAGING DIRECTOR
NATURAL CAPSULES LIMITED

MR. RAJ KISHORE PRASAD
CHIEF FINANCIAL OFFICER
NATURAL CAPSULES LIMITED

Moderator: Ladies and gentlemen. Good day and welcome to Q2 and H1 FY'25 Earnings Conference Call of Natural Capsules Limited.

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 opening remark concludes. Should you need assistance during this conference call please signal the 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. Abhishek Mehra from TIL advisors. Please go ahead.

Abhishek Mehra: Thank you, Ryan. Welcome, everyone and good evening. Thank you for joining this Q2 and H1 FY'25 Earning Conference Call of Natural Capsules Limited.

The "Results" and "Investor Presentation" have been emailed to you and are also available on the stock exchanges.

In case anyone does not have a copy of the same, please do write to us and we will be happy to send it over to you.

To take us through the Results for the "Quarter" and the "Financial Year" and answer your questions, we have with us today, Mr. Sunil Mundra – Managing Director, and Mr. Raj Kishore Prasad – Chief Financial Officer.

We will be starting with a brief overview of the quarter from Mr. Mundra, which will be followed by the Q&A session.

I would like to remind you all that everything said in this call that reflects any outlook for the future, which can be construed as a forward-looking statement, must be viewed in conjunction with the uncertainties and risks that the company faces. These uncertainties and risks have been included but are not limited to what has been mentioned in our annual report.

With that said, I will now hand over the call to Mr. Mundra. Thank you and over to you Sir.

Sunil Mundra: Good afternoon, everyone. Thank you for joining us today for Natural Capsules Limited's Earnings call for the 2nd Quarter of FY25. I am Sunil Mundra, Managing Director of Natural Capsules, and I am delighted to present our "Financial Results" and insight into our performance during this quarter.

As we previously communicated, we have been focusing on enhancing our performance in the capsule segment, and I am pleased to report that our efforts are indeed yielding positive results, as evidenced by the improvement in our gross margins.

For Q2 FY'25, we have achieved revenue from the operation of Rs. 41.22 crores, reflecting a year-on-year increase of 5.21%. Our gross margins have expanded due to a favorable product mix and increased demand for our vegetarian capsules. However, it is important to note that while our gross margins have improved, this has not yet translated into profitability due to a rise in other expenses.

We are currently facing increased freight costs on our export shipments and higher power charges at our Pondicherry plant that have impacted our bottom line. Specifically, our profit after tax for this quarter stands at a loss of Rs. 0.6 crores, which is mainly due to additional provision of deferred tax, which reflects a decline compared to the previous year.

We expect the additional freight charges to normalize in the current quarter and going forward, and we hope to further streamline our operations and enhance efficiencies moving forward. Despite these challenges, our EBITDA for the quarter was Rs. 4.5 crores, with an EBITDA margin of 10.93%. We remain optimistic about stabilizing profitability in the coming quarters as we implement measures to mitigate these expenses.

Looking ahead, we are excited about the new HPMC production line that we had ordered earlier, which is expected to be operational by February next year. This new capacity will enable us to meet the growing demand for HPMC capsules, particularly as we see lead times extending up to 90 days among leading players in the industry. Additionally, we anticipate a price increase of about 2% to 3% in the current quarter, which should further support our bottom line.

In our API segment, we are nearing our final approval from the Pollution Control Board for our production facility in Bangalore. Although there have been delays in this process, we expect to secure the final clearances within this quarter. We have submitted samples to 23 pharmaceutical companies and supplied trial batches to several firms, laying the groundwork for larger orders once operations commence.

In summary, while we are currently facing some short-term challenges with expenses impacting our profitability, the underlying strength of our capsules business is clear to improve gross margins and strategic investments aimed at future growth. We remain committed to stabilizing profitability while capitalizing on the strong demand within the industry. Thank you for your attention today.

I look forward to addressing your questions during the Q&A session following this presentation.

Moderator: The first question comes from the line of Yug Jhaveri from Molecule Ventures. Please go ahead.

Yug Jhaveri: So, my first question is on the capsule segment. So, it's been a few quarters that we have installed our first HPMC line. However, we have not seen any significant contribution or growth in the top line. So, can you please let us know how the HPMC lines are performing and what sort of additional growth can we anticipate when the additional 2 lines will be installed? Also, please let me know the planned timeline for the installation of the additional 2 lines.

Sunil Mundra: So, to answer your first question that no significant growth was seen after the addition of the first line, yes, you are right to an extent that initial first quarter, it took some time for getting the samples approved from various customers. Our major customers are in foreign countries, in Brazil, in Canada, US. So, we have sent samples, and those samples are cleared and in Q2, we saw some movement, but now in Q3, we are seeing some improvement in the volume business. Though production has stabilized, the dispatches were delayed because of the approval process. Now, each of the individual HPMC lines is carrying certain particular specific size. So, currently, we have established our size zero line. Now the next size double zero line is under the process of getting implemented. We expect it to come online by February next year. We are trying to get an optimum design of the capsule, which runs on all types of machines in the international market. So, we expect that once all the 3 lines which we have now planned are full on board. On an annualize basis, they should contribute roughly around 35 to 40 crores of top line.

Yug Jhaveri: Okay. So, my second question is on the recent fundraise. So, can you help us understand the need of the recent fundraise, the planned utilization of those funds and can we use those funds to fast track the ordering of the new HPMC lines to accelerate the growth or we have been very behind. So, initial planned timeline for the HPMC CAPEX right now. That's why.

Sunil Mundra: The recent fundraise was as informed to the stock exchange was mainly for two purposes. One was to contribute to the subsidiary company because of the increase in the project outlay there and delay in implementation. There was some cost implications, which the company has taken care of. Second is, of course, to beef up our working capital requirement and that would help us to meet the higher top line revenue because the working capital requirement is also there. Another question was whether this funding would help us to expedite the implementation of HPMC line. To an extent, yes. But the funding for the HPMC line was never a concern area. It was basically from the point of view of getting the clarity of the customer approval for our capsules from the machine trial point of view and also now the design optimization for the next 2 machines that what capsules we manufacture should be suitable for all types of machines across all the continents.

So, those are the reasons that we are going a little slow on the HPMC line or else there is no constraint about the funds of that account.

Yug Jhaveri: Okay. In the last conference call, you had mentioned about 180 to 190 crores of top line in the capsule business this fiscal year. So, just because of the increase in realization and then incremental revenues coming from HPMC line, do you think that we are on track to meet those guidance this year?

Sunil Mundra: Of course, there is an incremental revenue coming from an increase in our selling price to an extent of about 2% to 3%. So, that would add up. The HPMC line implementation of line number 2 and 3 has been delayed because of some delay in getting the customer approval. So, we still anticipate that we should touch about 175 to 180 crores, if not 180 to 190. 175 to 180 is achievable.

Yug Jhaveri: This year, okay. For the capsule business, what would be your guidance for FY'26 both in terms of top line as well as the margin profile and how do you plan to achieve it?

Sunil Mundra: We already mentioned that top line revenue could be in the range of 175 to 180 crores.

Yug Jhaveri: So, for this fiscal year, I am asking about FY'26.

Sunil Mundra: FY26, yes, probably we expect it to be in the range of 210 plus 20, 210 to 220 crores with the full operation of HPMC 3 lines and improvement in the margins. We expect it to go to about 210 to 220 crores. Now, how do we hope to get there? One, of course, is in this year the contribution of HPMC could be maybe not more than 10 to 15 crores, but we expect another 20 or 30 crores coming from the HPMC line in full year of operation next financial year.

The bottom-line projections for the current year could be in the range of 14 to 15%. This is likely on a higher side as compared to what we have achieved in the first half. We are hopeful of this because on the basis of improvement in our realization rates as well as some better contribution from HPMC. HPMC capsules definitely give better EBITDA margins. So, in FY'26, we hope to get this to a higher level of back to around 17 to 18%, by which time our HPMC contribution in the overall revenue would be much higher than compared to the current year.

Yug Jhaveri: Okay. So, for FY26, you are guarding about 210 to 220 crores of revenue. HPMC would contribute nearly 30 to 40 odd crores with EBITDA margin between 17 to 18%, right?

Sunil Mundra: Right.

Yug Jhaveri: Okay. Now, the next 2 questions are on the API side of the business. So, it is extremely disheartening to see that we have not yet started commercial production in our plant. For the last 3 quarters, we have just been saying that for sure the plant will start in this quarter, but somehow it just doesn't happen. So, can you please explain the length which has caused the delays from the start where we are today and in the most conservative estimate, by when will this plant actually start?

Sunil Mundra: Actually, I agree with you that it is a bit disheartening to note that there was a delay, which was some of the reasons were beyond our control, like the statutory approval from the

Pollution Control Board. In fact, we got approval for our small volume lab sometime in the month of March. But unfortunately, the larger facility was still not approved because of frequent changes in the Pollution Control Board level, the top management. The chairman got removed by the government, went to court, got reinstated. Now, finally, he is being retired. This happened twice in last nine to ten months and this gentleman was appointed by the previous government and due to this political tussle, he kept on all the projects on hold. More than 1,600 files were kept on hold by this gentleman who was retired last week. Now, we are hoping that the new... In fact, in the last 6 months, we could get 2 steps out of the 3 steps that were required to be done by us to achieve this final approval for the total plant concerned for the operation. One was the changes in the dimension, size, and the scope of the project. Second one was, of course, our ZLD inspection, which was done in last 3 months and now the file is with the Pollution Control Board, and we expect the committee to take it up very soon and next few weeks, we are expecting it to happen. Meanwhile, a plant has been made ready and we have been operating the plant with the sterility batches in fermentation and trial batches or dummy batches on our synthesis plant just to make sure that the plant is ready. The moment we get the license, we are able to start. So, in the anticipation that our pollution license is expected in the next few weeks, we have already started the procurement of our all-main raw material, key raw material and we hope that probably sometime in December, we should be able to start both the segments in large-scale facility.

Yug Jhaveri: So, you are saying that by December or by max January, you will start commercial production after receiving approvals?

Sunil Mundra: Yes.

Yug Jhaveri: If the plant starts contributing to the revenue from next year or from this quarter, so what is the sort of incremental top line that can be expected for last quarter also and from full next fiscal year?

Sunil Mundra: For the Q4 of the current year, probably we are going to do not more than 10 to 15, 20 crores. Maybe because right now, we are targeting only the customers in the domestic market with a generic product line. Because right now, the plant is approved under Schedule M by the Government of India. Whereas now, the WHO GMP is the next stage that we have to achieve for getting entry into some of the bigger companies, which is already in the process is on that we have to put our 3 products on stability and once the stability batches achieve 6 months of stability, we need to call the drug controller team for inspection and we get the WHO GMP. So, till that stage is achieved, we will not be able to get entry into some of the larger companies. But keeping in mind that we are catering to the generic companies, we should be able to achieve about 10 to 15 crores of top line revenue in Q4.

Yug Jhaveri: And for FY'26?

Sunil Mundra: FY'26, we are keeping, say, I have a conservative base about 80 crores. 80 to 90 crores.

Yug Jhaveri: 80 to 90 crores of top line?

Sunil Mundra: Yes. We do expect some export business also to materialize. We are in advanced discussion with some of the regulated market player, but they cannot take directly. So, they are buying it through some other country operation where they have their own factory. So, those discussions are also on and there are online evaluation of the facilities going on. So, we are hoping that that may also materialize.

Yug Jhaveri: So, in FY'26, we are guiding 80 to 90 crores. So, this will be from generic companies only or you will try to get approval from those companies also?

Sunil Mundra: So, at the moment, what we have forecasted is that even if we get the Schedule M GMP license by middle of next year, say July or so, it might still take another 3 months for us to get approval from some of these Schedule M requirement companies like the bigger Indian corporates and all. So, we have anticipated 50% of the revenue coming from exports to some countries where we are hopeful that after this current evaluation, the online audit process which is going on that will materialize and balance will come from the domestic market.

Yug Jhaveri: And so, this year, we will spend our time to get approvals from the government bodies. So, are they putting in a case forward to extend our PLI benefit by one additional year as this year has been almost delayed at the government's end?

Sunil Mundra: We have taken up this issue with the Department of Pharmaceuticals. In fact, with the Commerce Minister's Open Session which was there in the last week of September in Delhi, I attended that and there we have taken up this issue. But the government is non-committed at this point of time. But we can expect a positive reply in the coming year or so.

Yug Jhaveri: Okay. Last quarter, you spoke about increasing the price of APIs. But I think in this quarter, again, the prices have started inching down. So, what is the actual situation? Can you please help us to understand that?

Sunil Mundra: Yes. In fact, the API prices across the board have been facing reduction and this is mainly due to dumping or probably selling at cheaper rates from China. So, this is bothering across the API industry and pharma industry at large. The matter is before the government. The government is seriously considering putting anti-dumping duty in few cases wherever possible and also imposing minimum import price in several cases where the data is made available to the government. So, in our case also, we have represented the government along with our cost statement. Government has said that we must start production first and again approach them. They will help us in imposing a minimum import price. So, that would help us to get our reasonable recovery of our cost and reasonable margin.

Yug Jhaveri: And the realizations?

Sunil Mundra: Yes.

Yug Jhaveri: Okay and last question is finally on the consolidated level. So, where do you see Natural Capsules as a company 5 years down the line both in terms of capsule top line and margins as well as API top line and margins down the line 5 years?

Sunil Mundra: Five years? Yes. Our vision on capsules and API is clear. Capsules at this moment of time, we are on consolidation mode whatever the capacities that we are putting up for HPMC. We want to consolidate that and start. Our vision is to increase our exports and reach out to better quality customers so that our sales to the generic place goes down and margin improvement. Five years down the line without any addition of capacity, with the current capacity whatever as in plan, we see at least the top line revenue going to 250 to 270 crores with EBITDA margin of upwards of around 20%. Whereas in API business, definitely there will be significant changes. Our aim is to get the facility approved by USFPA, EU GMP and maybe by fourth year by the PMDA Japan. Our aim is to get 75% of the revenue coming out of these regulated markets with EBITDA margins of not less than 25% on a weighted average basis and I expect top line revenue in the range of 250 crores to 270 crores in the year.

Yug Jhaveri: From API? Next five years?

Sunil Mundra: Yes.

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

Ankit Gupta: So, my question was on the API division. So, like you have already started supplying samples to the big pharma companies in the domestic market. So, any indications from them how is the product because in this the quality and all becomes very important since it's a fermentation product. So, if you can talk about that what has been their response towards our product?

Sunil Mundra: The response has been good, and we have so far submitted samples to about 23 customers out of which 9 to 10 companies we have made commercial sales also. So, the response has been good so far. So, general companies do put these samples on stability studies within their company. They convert into their finished product and then put into stability for seeing those products. So, the results will be generally known by accelerated stability in 3 months, 6 months. So, a few companies have achieved that, and they have started buying from us and few are in the process of getting that accelerated stability study reports. Once they get that, probably we will be able to start supplying.

Ankit Gupta: Sure, and then once we start commercial operations, what we, from my limited understanding of the fermentation business from lab scale to commercial stage is something which is very difficult to achieve in a fermentation product. So, like, how confident are we of achieving that?

Sunil Mundra: So, in our case, we are having a team of scientists who have worked on these products at the similar size at which we propose to do. Right now, though we did all our R&D batches at a very small level of a 300-liter pilot fermenter, but we are scaling up to 60-kilo fermenter where our working volume would be about 42 kilo, 70% of the vessel volume. So, we are confident that we will be able to scale it up quickly because the persons who are in charge and running this fermentation facility are guys who have worked for about 7 to 8 years on this 60-kilo fermenter.

Ankit Gupta: So, let's assume by end of Q3, we get approval from the Pollution Control Board and, like, we start commercial operations from Q4. So, what will be our depreciation interest cost per quarter for the API plant?

Sunil Mundra: I think we are anticipating a total annual basis depreciation of about 7.5 crores. So, on a quarterly basis it will be about 1.85 crores.

Ankit Gupta: And interest cost?

Sunil Mundra: Interest cost is about roughly 80 lakhs per quarter.

Ankit Gupta: So, not much, like, interest cost is not that increased compared to what we have currently.

Sunil Mundra: Yes. So, we have not considered working capital cost on this. So, this is 80 lakhs towards the loans.

Ankit Gupta: CAPEX only.

Sunil Mundra: Yes, the term loans and all.

Ankit Gupta: Yes. Okay and then the plant has been delayed quite a bit. So, we have seen CWIP increasing even for the first half of this year as well. So, how much has been the preoperative expenses which have been capitalized in, let's say, in our CWIP till date?

Sunil Mundra: So, right now, since our only small volume Kilolab was ready, and we have calculated that the capacity in proportion was not more than 10% of the overall capacity, we have capitalized only preoperative expense of 2. So, about 25 lakhs has been capitalized, and I think the rest of the preoperative expenses are still under the work CWIP. So, once the final operation starts, we will be capitalizing the total preoperative expenses.

Ankit Gupta: Okay. Any amount that you can give me if you have that handy?

Sunil Mundra: Yes, originally preoperative expense was anticipated about 8 to 9 crores. This is going to be somewhere around 18 to 20 crores.

Ankit Gupta: Okay and then, like, let's assume if we start our operations from Q4, like, when do we expect to break even on EBITDA level, and how much will be our fixed cost per quarter for plant operations?

Sunil Mundra: See, as I mentioned, it is depending on the kind of margins that we are able to derive next year. Next year, first year of full operation, little bit of uncertainty in terms of kind of customers that we will cater to in case we are able to get some of the good export orders at which we hope to get. In that case, our blended margin could be about 10% EBITDA. If we get that, then we will be able to break even in the next year itself.

Ankit Gupta: And I think once you start operation, at least few quarters it will take to stabilize also the plant.

Sunil Mundra: Yes, I think about it, one quarter should be enough to stabilize the operation.

Ankit Gupta: Sure. Okay and let's say, you know, once, like, in FY'27 onwards is what we can see significant improvement in our profitability in our API plant.

Sunil Mundra: That's exactly right. FY'27 is the year in which we anticipate approvals from EU GMP and maybe going forward US FDA and we see a much better quality of customer and our exports going up significantly and that is where we see the significant improvement in EBITDA.

Moderator: Thank you. The next question comes from the line of Madhur Rathi from Counter Cyclical Investments. Please go ahead.

Madhur Rathi: Sir, I am trying to understand whether in the 4th quarter we can expect losses from the API plant.

Sunil Mundra: Yes. I think API plant's 1st quarter will be the 4th quarter of the current financial year. Obviously, there will be losses and on consolidated basis, losses will be there. Yes, you are right.

Madhur Rathi: Sir, so and in the answer to the previous question about capitalizing the preoperative expenses, sir, did I hear you correctly that 18 to 20 crores of preoperative expenses will be capitalized under fixed assets?

Sunil Mundra: Yes.

Madhur Rathi: So, ideally, sir, is it not better to book them to P&L and take advantage of the losses to set off the taxes?

Sunil Mundra: See, these are preoperative expenses before starting production. So, obviously, we would like to capitalize them. Those which are directly identifiable with the current running production capacity, we are directly debiting to P&L.

Madhur Rathi: And, sir, since our new API plant is quite small, I understand from the investor presentation. So, how does our cost of production compare with the landed cost of imports? And, sir, because I am assuming the Chinese and other locations, the plants might be really big, so they must be enjoying economies of scale. So, in that, so what's your thought about our cost of production versus the competition?

Sunil Mundra: So, our production size of the fermenter at 60 KL is more or less comparable with the Chinese major players of steroids. Even though lately there are a few people who have entered at a little higher capacity of the fermenter, 80 KL to 100 KL. But cost of production is more or less that what we are currently seeing, the information that we have, that we are at par with the Chinese yield levels. But the challenge that we currently face is the significant amount of dumping that is happening from China, not only in our steroidal API segment, but all segments. That is because I think the government there is probably offering them some sort of incentive to export, or there is overcapacity there, or the players there are also facing some significant losses. So, I would say that if the Chinese prices come back to normal, or our government imposes from MIP, minimum import price, which is basically based on a fair costing, we should be at par with Chinese, and we will not be at any disadvantage in terms of cost competition. Having said that, probably PLI benefit will help us to meet that competition much better.

Madhur Rathi: Sir, as per the current landed price of Chinese imports, how does our cost of production compare with the current import parity price?

Sunil Mundra: At this moment, I think the difference is there to the extent of about 30-35%. The cost of production that we have, and what is the current landed cost from China, there is a gap of about 30-35%. And this is what we have brought to the notice of the government and this drop is also noticed in the last 6 quarters. We have given the import data of the last 6 years to the government, and we have proven that the prices even pre-COVID, at least 3 years pre-COVID, during COVID, have all at a particular level, with the plus minus band of 15%, 20%. But these are the historically lowest prices at the current moment, and the prices are much lower as compared to the last 6 years' average trend. So, the government is also aware of the matter, and hopefully they will take some action.

Madhur Rathi: Sir, do we have some kind of timeline before which we can see some kind of anti-dumping or tariffs on these Chinese imports?

Sunil Mundra: So, in this regard, we had several rounds of discussion with the Department of Pharmaceuticals, Ministry of Commerce. The government has given assurance that they will take it up. But the only thing is, in my last meeting with the Deputy Secretary of the Department of

Pharmaceuticals, they made it that once you start production of all the 3 PLI products, they will come and inspect and probably they will announce or they will consider our case.

Madhur Rathi: So, in that case, if we start next year, I would expect, because in Q4 I would expect it to be the operational aspect of it. But full-fledged production if we start in FY'26, I would expect another year. Sir, can we expect that there will be losses if there is no anti-dumping duty by the government, which takes around 6 to 9 months to get into the final order. Till that time, there could be some kind of losses in the EPI segment.

Sunil Mundra: So, we don't foresee losses because we are also trying to push ourselves on the export front. With the technical-grade API, we are able to find nearly 50% market for exposures. Where the margins are better and they will see that whatever the kind of negative margin that we have in domestic sales, probably will be compensated.

Madhur Rathi: Sir, if API prices are down everywhere, is that not the case with the technical API exports that we are speaking about?

Sunil Mundra: Yes, this is a technical-grade API being exported to some regulated market player. So, there the price levels are altogether different. Their price levels are not impacted this much.

Madhur Rathi: Okay. Sir, that was from my side. Thank you so much and all the best.

Moderator: Thank you. The next question comes from the line of Chirag Fialoke from Ratnatraya Capital. Please go ahead.

Chirag Fialoke: Thank you so much. Could you share the volume for this quarter and last quarter on the capsule side?

Sunil Mundra: Volume for the current quarter on the terms of sales, the sales what we did in Q2 of FY'25 as well as compared to this, not significant change. We did about 4.04 billion in Q2 of FY'24 and in the current quarter, we did about 4.17 billion for the Q2 of FY'25. More or less same.

Chirag Fialoke: Got it and in Q1?

Sunil Mundra: Q1 we did almost again 4.1 billion. Our quantities have been more or less stagnant and they are almost as we are running our plants at 96-97% of the capacity. The volume quantities are more or less being achieved in the same level.

Chirag Fialoke: Understood. That's clear. In the current P&L, are there any costs that are sitting for the API plant as well?

Sunil Mundra: Yes, part of it because as we have said already, we announced small volume production in small volume Kilolab before March this year. So, a small part of the API plant is being charged to P&L.

The expenses are being debited to revenue. The rest are getting capitalized. That's roughly around 10% or so.

Chirag Fialoke: 10% of cost? You are saying of the 16.9-17 crores? 1.5 crores to do for the API plant?

Sunil Mundra: In the last quarter, 52 lakhs is the expenses charged to the consolidated P&L.

Chirag Fialoke: So, this quarter's EBITDA would have been higher by 52 lakhs had it not been for the API plant.

Sunil Mundra: So, stand-alone basis, our EBITDA will be in the range of about 12% as compared to 10.95%.

Chirag Fialoke: Standalone difference is the entirety of that difference. Is that correct?

Sunil Mundra: Yes, that's the difference.

Chirag Fialoke: So, standalone will be a very accurate representation of just the capital. Okay, perfect. On the gross margin side, if I look at a more long-term average, the gross margins are more in the 54-55% range. I know you were talking about a potential price increase in November-December of 2%. I guess that will get you to the 54-55% gross margin range for the capital-only business? Is that how you see it?

Sunil Mundra: Actually, the gross margin has dropped last year to about 48-49%. Fortunately, in the last 2 or 3 quarters, we have seen a very small, but baby steps kind of a growth. 4%, 3% gradually we have seen in the last 3 quarters. So, we are back to around, say, 51% of a gross margin at the moment. But we hope to achieve 53-54% maybe in the next 3 quarters or so when our HPMC line is back, because that has got a little better gross margin.

Chirag Fialoke: Understood. My next question was on exports. One, could you share what percentage of revenue was from exports in the first half? And second, obviously, you know, a lot of this pricing we have talked about in the previous call, you can offset a lot of the pricing pressure by having larger, more regulated clients. Where are we in that process? What proportion of sales do you think now come from clients where market movement of capital prices will not impact us?

Sunil Mundra: To answer your first question, what percentage of sales are from exports, I would say roughly one-third. So, out of 40 crores of top-line revenue, 40-41 crores, we have done 13.5 crores of exports. Now, you are talking about your second question, are we selling the sales to those kind of clients where the prices will not get impacted by the market fluctuations? Yes. Our efforts are on to increase the share of those kind of clients and at this moment, we sell roughly, apart from the exports, out of the domestic business, roughly around 20%-25% business comes from such clients. The rest of the clients are either Indian mid-corporates or MSME industry. So, therefore, our aim is to increase sales to these kind of clients or the kind of clients who would use them for the ultimate finished product which goes to their regulated market supply.

So, there those kind of challenges are not seen. So, probably in next 2 years, we will see that this percentage of sales to such clients will be going up.

Chirag Fialoke: Got it and is it fair to assume that almost all exports are to such clients? So, almost 50% of sales are now to more clients where the requirement is such that the pricing is more fixed than anything else.

Sunil Mundra: No, even export price also are sensitive to market conditions. There are different areas. We export to US now, we export to Canada, we are exporting in Southern America to Brazil, various countries in Far East and Russia also we have started again. So, the client depends on some of the African countries like Kenya, Uganda. There some of them are price sensitive but some of those in Latin America, in Central America, they are not that sensitive. So, we can't say that 100% of the exports are non-sensitive to price variation but those 2 African markets, yes, they are little bit price sensitive.

Chirag Fialoke: Understood. Just the last question on the CAPEX side. The first one, the receivable days have sort of seen a significant uptick and have further increased this quarter to more like 140 odd days. Would you talk about that and what is your CAPEX estimate for the year for the consol companies? Thank you.

Sunil Mundra: Actually, this is the area of concern for us as well because actually what is happening in pharma industry, there is a government deadline for 31st December to upgrade their plants. So, many of our clients are holding payments, diverting all their funds towards facility improvement. There are many such cases. Secondly, another reason I told is that the preference to MSME industry which the government has pushed all the industry players to give, so that has caused a stretch in the payment to non-MSME companies. So, in this quarter also we have seen there is an increase in the number of days effectively. But if you look at the gross sales, which would mean that from the revenue number you have to add GST part of it, probably this would go down to about 112 days or so, which is around 120 days. So, still we would consider that is high because as compared to FY'23 when we have touched this is about 70-75 days. So, our aim will be to bring it down. We are working on it. We hope that next year it will improve.

Chirag Fialoke: Understood. One follow-up here and then just your CAPEX estimate of the year. Last couple of years there have been a few provisions for credit losses. What is the quantum of that in H1? Is that also a concern now with days going up? Is there also a possibility of some of them turning bad and your CAPEX estimate for the year?

Sunil Mundra: I think on the credit loss side we are fully covered. We have provided for that and we have a certain policy in which we are covering all those losses. We do not foresee any major amount of P&L getting impacted out of that and in this first half also I think we have provided additional, probably in about 35 lakhs odd as additional provision. On the CAPEX side, your question was on the CAPEX, right?

Chirag Fialoke: Yes, for the year, for the console, what will be the CAPEX?

Sunil Mundra: CAPEX for the console, of course, we have already done with the CAPEX in our API plant on the subsidiary side. On the capsule side, we have already incurred cost for the project which is ongoing. The amount is sitting in working progress accounts. So, probably we will end up the year where we will be capitalizing about something around 8 to 10 crores of assets in the parent company and in subsidiary company, probably we will be, once the total production starts, we will be capitalizing the whole CWIPs.

Chirag Fialoke: Under H2, there is no real CAPEX outflow and for the year, probably the estimate is closer to 21 crores. That's my estimate. Is that correct?

Sunil Mundra: In H2, in capsule division, we have done very minor this thing, but we expect this HPMC line to come. So, there will be about 7 to 8 crores of additional investment related to that line.

Chirag Fialoke: Okay. So, on a cash flow basis, probably 35 odd crores on CAPEX. Is that right?

Sunil Mundra: Yes, that's right. You are right.

Moderator: Thank you. The next question comes from the line of A.S. Basra, an investor. Please go ahead.

A.S. Basra: My question is related to the API segment. So, we have 4 patents already granted and some of them are under approval and under filing. I just wanted to understand. So, these patents are into which geography? Are these patents specific to India or what geography?

Sunil Mundra: These are purely Indian patents as of now.

A.S. Basra: So, these are Indian patents. Alright. So, do these patents are on the chemistry side, I mean fermentation.

Sunil Mundra: So, we have so far filed 4 and 5th one is in pipeline. So, we have 2 on fermentation and 3 on chemistry.

A.S. Basra: Two on fermentation and 3 on chemistry. Alright. I just wanted to understand. So, are Chinese counterparts, more or less, are they also using the fermentation for specifically the kind of APIs we are going to produce?

Sunil Mundra: Absolutely, yes. They also use the same fermentation. Most of the route of synthesis is common because we have also been doing R&D after 5-6 years. We also realized that and fermentation is the basis. I mean, we have people who worked in Chinese industries and have good connects there. So, we know what is the route of synthesis is there. So, it is fermentation and synthesis combined. It is a sandwich process.

A.S. Basra: Okay. I just wanted to understand. So, for example, this fermentation route is, as per my knowledge, difficult to synthesize and now we are doing that. So, does this give us some pricing power to the customers that they will prefer the product which has been produced through fermentation route?

Sunil Mundra: So, worldwide, the idea is that these Steroidal APIs are now concentrated only in China. No other country manufactures it. No other country manufactures this. Though the original innovator of this product was Pfizer in US, the Pfizer facility in Europe as well, they were doing that. They stopped long years back. They transferred technology to China. Chinese companies have been doing it. India also never did it. It is the first time that we are trying to do it here. Now, for the last 15 years, since 2010 onwards, most of the steroidal API manufacturing has shifted to fermentation. Prior to 2010, a large amount of it was being done through chemical synthesis route or plant extraction route. But since 2010, maybe one or two companies in China which moved around 2014. Otherwise, the rest of the industry moved in 2010 towards fermentation.

A.S. Basra: Alright. Very beautifully explained. I just wanted to know one more information. So, as we can see that the people in R&D for our company has increased to 52. I just wanted to know the approximate amount per quarter we are spending on R&D.

Sunil Mundra: I think in terms of subsidiary company alone, these numbers are subsidiary company where the API is getting manufactured. The amount of revenue expenses that we spend on R&D per quarter could be about 120 lakhs.

A.S. Basra: Alright. One more question on the capsule side. Sir, I just wanted to know, maybe just a gross picture of this scenario. What are the actual margin differences, what we earn and what our largest competitor in India, the largest manufacturer in India earns? So, what's the gross margin difference approximately between us and them?

Sunil Mundra: So, the largest competitor for us is a company called ACG in Mumbai and to answer your question, I would say that the cost of the production is more or less the same. But it is the difference in the revenue, the sales realization per unit of production. That brings out the difference. So, the gross margin what we claim around 50-52% at this moment, probably in case of ACG could be another 8-10% higher, maybe 60%. Because a significant part of their business comes from clients, which are supplying to regulated markets. And they have almost about 40% of their revenue coming from exports.

A.S. Basra: Alright and in the future, when all these three HPMC lines are commercialized, so, do we envisage to gradually shift all our lines to HPMC and get done with the previously manufactured capsules, the old ones, which doesn't fetch us much margin?

Sunil Mundra: Yes, our focus is on that because gelatin capsules have been the major manufacturing volume at the moment. HPMC is a product which is getting more attention in almost all the other regulated markets, especially in North America and Europe. So, we feel that HPMC will have a much better, significant advantage over gelatin in the future. So, our aim also would be to replace the gelatin machines with HPMC machines over a period of time. Maybe annually we take a target to replace 2-3 machines. That kind of plan we may take up in the future.

A.S. Basra: Alright. Sir, one last question on the API front. In your previous one of the interviews a long time back, probably a year and a half back, you discussed regarding that initially we will be producing with one API, which maybe hydrocortisone. We will be producing that and subsequently we will be coming on to prednisolone, beta and delta. In that interview you mentioned that initially we will not be self-sufficient in all the raw materials. One of the key materials we will be importing from China. So, since we are behind the schedule probably by 7-8 months and we have gotten that time with others, have we worked on that chemistry so that we can backward integrate and start? Have we utilized that 7-8 month or the whole process is behind schedule now?

Sunil Mundra: No. So, I am happy to inform that we have utilized these last 7-8 months to overcome the challenges, especially in the hydrocortisone prednisolone line. Now we are confident that as soon as we start our fermentation plant, probably in about 6-8 weeks or maybe 10 weeks, we should be able to produce our completely internally produced prednisolone. So, that will be our first aim. There are 2 more products, dexamethasone and betamethasone. There we are working on some of the steps where we probably are confident that once we are done with prednisolone manufacturing, dexa and beta also will be coming online. At this moment, to meet the requirement of the customers and all that, we had imported some intermediates from China, which is maybe N-4, N-5 kind of thing, or dexamethasone, betamethasone and those products we manufactured and supplied the samples and put into our stability, which was for getting the licenses and regulatory approvals. So, I think going forward, our aim would be to completely integrate it domestically.

A.S. Basra: All right and since you have been in the industry for more than 20 years and so, I just wanted to know with your experience, what is the current scenario? For example, as per me, since last 5-6 years, US FDA was very critical in their inspections and giving a lot of objections, coming out to inspect the specific plants in India and has the scenario changed with the view as to they want to have one more option rather than China? Basically, my question is on China plus one. On ground, is it happening? Is it US FDA and maybe EU GMP a bit relaxed on giving the inspections to Indian companies or more or less the environment is the same, they are heavily critical?

Sunil Mundra: My understanding is the regulatory requirements will not be relaxed just because the government there wants to give preference to China plus one story. But what might happen is the companies there in those countries like North America or Europe probably will give preference to Indian companies and will consider them as an alternative supply chain in addition to China. So, that is the kind of understanding I have.

Moderator: The next question is from the line of Devarsh Shah from SPL Investment. Please go ahead.

Devarsh Shah: So, most of the questions were asked by the earlier participants. Now, I just have 2 questions. So, you mentioned you have a higher gross profit margin due to higher freight cost and power cost. The probability of this quarter is impacted. So, can you share what is the usual percentage of revenue of these plan items? So, higher freight cost and power cost impact the probability of this quarter, right? So, what is the usual percentage of revenue?

Sunil Mundra: Okay. So, What has happened is in this quarter, we suddenly got a rising power increase in our Pondicherry plant where the power increase was on hold for last 3 years. Suddenly, they took not only power revision but also trying to recover the old gap. The last 2-3 years, they have not raised. So, there, I think our incremental bit is on an annualized basis roughly around 1 crore kind of an additional hit to the bottom line for the additional power cost that we are having. So, that is one. The percentage-wise, if you say, earlier, we used to spend something like about 9 to 10%, probably it will go up by another 1% much. That is what I think. Now, coming to the freight cost, what will be meant? Freight cost, I meant was export freight cost. So, as you are aware, the recent significant changes in the geopolitical situation as well as in some months prior to the September ending, suddenly the export freight container cost suddenly went up. And this has come down to a bit to some extent but it has not yet fully come back to the original position. For our export shipments, we used to have export freight almost around 14% to 16%. Now, in this last quarter, it went up to 18% to 20%.

Devarsh Shah: Okay. So, what are you seeing for the next quarter as well or we see some improvement over this area?

Sunil Mundra: We will see improvement in terms of freight in the current quarter. It may not go back to the same 16% but maybe a couple of notches going down and next quarter, it should normalize.

Devarsh Shah: Okay, fantastic and I have just a second question. So, in your investor presentation, you said about, you will get financial incentive around 67 crores from PLI. Can you share some lights on that?

Sunil Mundra: So, this 67 crores is calculation based on our total 6 years of revenue that we generate against these 3 products. 20% incentive on all our sales once we achieve the conditions that has been prescribed under PLI. One is to achieve the committed capacity, 90% domestic value addition and of course, the incentives to be given on the agreed amount which we have quoted at that point of time. So, based on these 3 conditions on the prices that we had committed, those prices are still lower than the market prices or more or less, now they have become almost coming to the level of market prices. Earlier, those market prices were higher and we had quoted less. So, based on these 67 crores, the incentive that we hope to get over the 6 years.

Moderator: Thank you. The next question comes from the line of from the line of Chirag Fialoke from Ratnatraya Capital. Please go ahead.

Chirag Fialoke: It is just a follow-up on one of the questions from one of the participants, the one previous to me. You said on a cost basis, we are similar to the Indian largest competitor as well as Chinese competitor. Is that right? I thought my understanding was that, especially for our 4 million plus capsules per day line and even our 2.5 million capsules per day line, we will probably be the lowest in the world and probably lower by 10-15% to the competition. Is that not correct?

Sunil Mundra: Mr. Chirag, you are right to an extent that our capsules produced on those 4.8 million capsule capacity machines, the cost is less. At this point of time, our 50% capacity still comes out of the older generation machines. On a weighted average basis, our cost will be more or less similar to what ACG produces. If I take a standalone basis, the high-speed machine, my cost, apple-to-apple comparison, they are cheaper than what ACG produces.

Chirag Fialoke: Got it and the older machines would be similar, right? Because our older machines are also 2.5, if I am not wrong.

Sunil Mundra: Not all older machines are 2.5. There are only 2 lines of 2.5. Rest we have 4 lines of 1.5 million and 6 lines of 1 million capsules. The older lines, their efficiency levels are low, cost of production is higher, mainly because of the lower output and higher power consumption.

Chirag Fialoke: And on a global average, not just the Indian competitor, but on a global average, if I take the top 3-4 global suppliers, their lines are more in the 1.5 range or the 2.5 range?

Sunil Mundra: In China, most of the companies have about 2.5 million kind of a thing. Only the companies like Capsugel, which is the world's largest producer, they have a capacity of about 4 million. ACG has about 4.2 million. I think across China, the companies have between 2 to 2.5 million.

Chirag Fialoke: Sorry, so ACG also would be 4 million capsules per day?

Sunil Mundra: 4 million, 4.2 million per day capacity in the machines.

Chirag Fialoke: Machine lines, not the overall capacity, but individual lines.

Sunil Mundra: I am talking about the capacity per day.

Chirag Fialoke: Not the overall, but per line, you are saying the 4 million faster lines?

Sunil Mundra: 4.2 million capsules per day capacity of the machine.

Chirag Fialoke: Correct. Those lines are available with ACG as well as some of the Chinese players.

Sunil Mundra: Capsugel, which is now part of Lonza, a Swiss company called Lonza.

Moderator: Thank you. As there are no further questions, I would now hand the conference over to Mr. Sunil Mundra for his closing comments.

Moderator: Thank you all for joining us today for our Earnings Call. We appreciate your time and interest in Natural Capsules Limited. Should you have any further questions or require additional information, please do not hesitate to reach out to our Investor Relations Advisors, TIL Advisors. We look forward to continuing our conversation and updating you on our progress in the future.

Thank you once again and have a great day ahead. Thank you all.

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