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HIKAL

August 19, 2022

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

The Manager, Listing Department
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 June 30, 2022

In continuation of our letters dated August 09, 2022 and August 11, 2022 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 August 11, 2022 for your information and records.

Kindly take the information on record.

Thanking you,

Yours Sincerely,
for **HIKAL LIMITED**

RAJASEKHAR REDDY CHINTAKINDI
Digitally signed by RAJASEKHAR REDDY CHINTAKINDI
Date: 2022.08.19 11:08:01 +05'30'

Rajasekhar Reddy
Company Secretary & Compliance Officer

Encl.: As above

"Hikal Limited Q1FY23 Earnings Conference Call"

August 11, 2022

Disclaimer: E&OE. This transcript is edited for factual errors. In case of discrepancy, the audio recordings uploaded on the stock exchange on 11th August 2022 will prevail.

MANAGEMENT	**MR. SAMEER HIREMATH -- MANAGING DIRECTOR, HIKAL LIMITED** **MR. ANISH SWADI -- SENIOR PRESIDENT OF BUSINESS TRANSFORMATION AND ANIMAL HEALTH, HIKAL LIMITED** **MR. KULDEEP JAIN -- CHIEF FINANCIAL OFFICER, HIKAL LIMITED** **MR. MANOJ MEHROTRA -- PRESIDENT, PHARMACEUTICAL BUSINESS, HIKAL LIMITED** **MR. VIMAL KULSHRESTHA -- PRESIDENT, CROP PROTECTION BUSINESS, HIKAL LIMITED**

Moderator: Ladies and gentlemen, good day, and welcome to Hikal Limited Q1 FY '23 Earnings Conference Call. This conference call may contain forward-looking statements about the company, which are based on the beliefs, opinions and expectations of the company as on the date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict. As a reminder, all participant lines will be in the listen only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded.

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

Sameer Hiremath: Thank you. Ladies and gentlemen, a very good afternoon to all of you, and thank you very much for joining us today for our Q1 FY '23 Earnings Call. I am Sameer Hiremath – Managing Director, Hikal Limited. Alongside me, I have Anish Swadi – Senior President of Business Transformation and Animal Health; Kuldeep Jain – our Chief Financial Officer; Manoj Mehrotra – our President, Pharmaceutical Business; Vimal Kulshrestha – our President, Crop Protection Business; and Strategic Growth Advisors, our Investor Relations advisors.

We trust that you and your family are safe and well. I hope you had the chance to go through our earnings release presentation and the financial figures for the quarter. These are available on our website and the stock exchanges.

I would like to start this call with an update on the unfortunate incident which occurred at Surat's Sachin GIDC on 6th January 2022. This legal case is still sub-judice and as things stands, Hikal is in a very strong legal position. As a result of the Sachin GIDC incident, the MPCB had given a closure notice to the Taloja factory. We had filed a writ petition and the Hon'ble Bombay High Court has decided in company's favor to resume operations at our Taloja site. As on date, the company operations are normalized and all plants are fully operational.

I would like to highlight that we faced several challenges in both of our businesses during the difficult quarter. We had an impact Rs. 50 crore in revenue and Rs. 20 crore in terms of contribution due to the disruption in operation to our Taloja plant during the quarter. In our Pharma business, we witnessed a demand slowdown on account of channel inventory reduction by our key customers. As indicated in our previous call, there will be a step wise recovery over the next three quarters.

Some of the key points for this quarter gone by: Supply chain is still an ongoing challenge for the sector owing to the geopolitical situations – ongoing Russia and Ukraine conflict and a lockdown in China. These factors have impacted the margins as expected and as outlined in the previous calls, resulting in steep increase in the cost of raw materials, solvent, utilities and energy. Also, the rise in crude oil prices have significantly impacted freight and logistics costs.

We are now seeing the prices of some of our key raw materials softening and we expect this trend to continue in the following months. We expect this reduction of raw material prices to partly benefit in Q2. However, the majority benefit should accrue from Q3 onwards. We continue to create alternative local supplier base to minimize supply chain disruptions in the market. We are also investing in our R&T capabilities in order to handle increase in inquiries in both our businesses.

Talking about the financial numbers for this quarter – The top line stood at Rs. 379 crore against Rs. 457 crore in the same period last year, recording a decrease of 17% year-on-year, predominantly due to inventory correction by our pharma customers and a disruption in operations for the Crop Protection business. The margin pressure highlighted earlier, led to a contraction EBITDA to Rs. 23 crore, primarily due to lower sales and product mix, increased input cost of raw materials, energy and solvents. Further, under-absorption of fixed costs during the quarter also reduced the EBITDA.

Lower operating profits and increased depreciation on account of asset additions and marginal increase in finance cost in view of interest rate hike resulted in a profit after tax loss of Rs. 8.9 crore. Hikal's long term credit rating is maintained at A+ by ICRA.

With a strong pipeline of inquiries in both our businesses and resumption of operations at our Taloja site, we expect a step wise recovery in each of the coming quarters.

Now I would like to hand over to our President, Pharmaceuticals, Manoj Mehrotra, to take us through the performance of the Pharmaceutical division.

Manoj Mehrotra: Thank you, Sameer, and good afternoon, ladies and gentlemen. I'll start with the financial update. The pharma business experienced degrowth in revenue of 18% with Rs. 224 crore total revenue in Q1 FY '23 versus Rs. 274 crore of revenue in Q1 FY '22. This degrowth is due to the temporary demand softening for key products and channel inventory correction by customers, which will, by natural progression, correct in the upcoming quarters. The EBIT of the division stood at a negative Rs. 8 crore. Fall in EBIT is attributed to lower sales, significant increase in input costs coupled with lag in passing the increased costs to the customers, and lower absorption of fixed costs.

On the positive side, our business excellence initiatives have resulted in reduction of costs, which has helped in partially absorbing the impact of higher input prices. On the business vertical update, on the API side, we continue to add several new customers and strengthen our presence in new geographies of LATAM and Middle East. Our new product launches in antidiabetic therapy areas have witnessed increased customer traction over last few quarters. With the softening of raw material and solvent prices, we expect sales and profitability to improve in upcoming quarters. We have about 10 products in the pipeline at various pages of development and plan to launch three to four products in FY '23.

Our CDMO business continues to witness increased number of inquiries. We aim to increase the win rate percentage to fuel the profitable growth. We have received an order for validation quantities for two intermediates for a COVID drug from a global innovator company. We have also received order from a global innovator for an intermediate for a new chemical entity, which is in Phase 2b of its clinical trial. Our future pipeline for CDMO business remains robust with several new opportunities.

On Animal Health, we work with several of the leading animal health companies and these relationships have been strengthened over time. We have commenced process development for a number of active ingredients that are part of the multi-year animal health project with a leading global innovator. As guided in the previous call, we intend to complete the animal health plant commissioning by the end of FY '23 and start validating products in the following year.

On future outlook, we have a healthy pipeline of CDMO projects, which will add to the profitable growth and change in business mix in the near future. We are focusing on enhancing customer engagement through further intensifying our key account management, which will also lead to increased share of customers' wallet. We continue to work on cost improvement programs to lower production costs and improve overall profitability. We have also started experiencing softening of prices for some of our key raw materials, which would reflect in improved profitability in the coming quarters. Our focus remains on executing our pipeline, which will result in profitable growth. We maintain that FY '23 will be a year of consolidation where we would rebuild our business despite market pressure persisting and would deliver improved results in the second half of the year.

Now I will hand over to Vimal for the Crop Protection business update.

Vimal Kulshrestha: Thank you, Manoj, and good afternoon, all the participants of this earnings call. The Crop business has recorded revenue degrowth of 15% year-on-year with Rs. 155 crore total revenue in Q1 FY '23 versus Rs. 183 crore in Q1 FY '22. Decrease in sales was on account of disruption in operations, which we tried to minimize by undertaking the annual preventive maintenance at the Taloja facility. The EBIT for the division was Rs. 10 crore in Q1 FY '23, primarily on the back of lower sales, higher input cost of raw material, solvents and energy as well as due to lower absorption of fixed costs.

Demand continues to remain strong in the domestic market, and there are also indications from our existing global customers for a higher forecast next financial year. We are also witnessing rise in inquiries from existing as well as new customers for potential collaborations. Construction of our new multipurpose plant is on track at Panoli. We expect to commission it in second half of FY '23.

In own product business, demand of existing products remains intact from our key customers, and demand supply scenario remains favorable in the domestic market. We are getting good traction of new fungicides in the pipeline from customers. We are in a process of strengthening our presence in Europe and Latin America. We also continue to explore new product opportunities in the business. Presently, we are working on five-six products and are at different stages of development.

Our CDMO business continues to receive new inquiries from new and existing customers. We are intensifying our efforts to strengthen the relationship with customers in Europe, U.S. and Japan by further integrating key account management. On future plans, as our Taloja operations has resumed, efforts are focused towards covering the production loss of first quarter to best extent over the next three quarters. To ensure stable availability and better pricing of key RM, we embarked upon the strategic supplier base development, derisking the supply chain from China through backward integration.

Now I would like to hand over to Anish for overall business outlook.

Anish Swadi: Thank you, Vimal. As Sameer, Manoj and Vimal have talked about our business and performance over the previous quarter and upcoming business pipeline for each of the businesses, which continues to be robust, I would like to reiterate the same message and conviction. FY '23 is going to be a year of consolidation to prepare for accelerated growth of the company. We have taken some major headwinds over the past two quarters; however, we have been resilient through it all. During these challenging times, we remain committed and maintain transparency with all our stakeholders, which has helped us tide over these challenging times.

I would like to reiterate that we have not lost a single customer or contract in any of our businesses during this period. While we have seen a dip in performance this quarter, we expect a step wise quarter-on-quarter sales improvement with expectation of a normalized sales quarter from Q3 onwards. We are observing softening of raw material prices over time with greater strategic planning and execution, we are ensuring higher throughput and improved costs. Pressure in Q1 was expected to be high, as indicated, but we are confident of achieving an improvement in profitability quarter-on-quarter, starting Q2.

Our transformation journey Pinnacle is witnessing good momentum across both businesses. With the help of our consulting partner, we have taken various initiatives across the company to make Hikal grow from ‘Good to Great’. Over the last several quarters, we have focused our efforts on cost improvement programs to absorb some of the impacts of higher input costs. At the same time, we continue the initiatives of the strategic builds for each of our businesses for future growth. This will help reach our bold aspirations of driving profitable as well as sustainable growth as our long-term vision remains intact.

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

Moderator: Thank you very much. We will now begin the question-and-answer session. Our first question is from the line of Ankit Gupta from Bamboo Capital. Please go ahead.

Ankit Gupta: First of all, given how the kind of degrowth we have seen in the first quarter, do you think we'll be able to at least match the revenue that we had reported in FY '22 of around Rs. 1,900 crore?

Sameer Hiremath: Yes, I don't see that as an issue. I think the next three quarters, we'll make up the lost revenue from Q1, which should be well above last year's numbers.

Ankit Gupta: And Sameer, given the kind of consolidation that we've seen in our revenues in FY '23, what kind of growth aspirations do we have for FY '24 and '25, given the kind of base we've set now and the kind of CAPEX we have had and with the animal health supplies will also start from FY '25 onwards? So, what kind of growth are we aspiring for FY '24 and '25?

Sameer Hiremath: So, we're expecting going forward in the high teens, growth will accelerate into the high teens.

Ankit Gupta: But given we had zero growth during FY '23, don't you think the growth should have been higher because we have been aspiring for high-teen growth for past so many years and the kind of CAPEX that we have taken is almost double than what we had already been doing prior to FY '20, and we have been doing quite a bit of CAPEX. So, don't you think that growth should be higher for '24 and '25?

Sameer Hiremath: See, the plant should be ready by end of this year, right, by end of FY '22, two big CAPEX that we're doing. So, next step will be the ramp-up of these two plants. Full utilization of plants will start from FY '24 or '24-'25. So, next year, there will be growth, and the big jump will come in FY '25 when the full utilization of these plants will start.

Ankit Gupta: And on the Taloja plant, is the plant operating now at normal capacity? Or how are things on that plant?

Sameer Hiremath: It is operating at absolutely normal capacity. This entire quarter will have the benefit of Taloja plant full operations.

Ankit Gupta: And, Sameer, given how things are shaping up on both pharma and agro side, if you can talk about the kind of product launches that we have planned for FY '23, '24 and '25 on both the segments?

Sameer Hiremath: So, I'll hand it over to the businesses, I think they have the details. Manoj, if you can talk through.

Manoj Mehrotra: On the Pharma side, we have around 10 products in development in the pipeline in various stages. We will launch three to four API products every year going forward, starting in FY '23. But as you know that you start a little slow, it takes two to three years for the revenues to peak. But the run rate of three to four products, APIs every year will continue.

Ankit Gupta: Sir, but out of these ten products, how many will be CDMO and how many will be under our own products?

Manoj Mehrotra: When I say products, I imply own products, which are own APIs or Hikal-owned DMFs. On the CDMO side, we talk in terms of projects. So, we will definitely have 2 to 3 projects going commercial every year. Like in the case of the Animal Health multiyear contract, what we have signed, that has ten products and every year we'll do four to five out of those. And going forward, those will actually have ten products in FY '25.

Ankit Gupta: And on agro side?

Vimal Kulshrestha: In the agro side, we'll be adding in our own products, three to four new products. And the CDMO side, we expect at least five to six new projects by FY '25.

Ankit Gupta: And one last question is on the margin front. This year has been exception for us. So, prior to the kind of disruptions, we have seen over the past two quarters, we have maintained that we are aspiring to improve our EBITDA margins by 1% to 1.5%-2% every year from what our base was in FY '22 or around 19%-19.5%. So, on the margin front, how do you see things panning out for us for FY '24 and '25, let's forget about '23, given the kind of disruptions we are seeing?

Sameer Hiremath: Considering FY '22 as a base, forget FY '23 as it's a year consolidation. Base for FY '22, we expect 50 to 100 basis points improvement year-on-year on the margins from FY '24 onwards.

Ankit Gupta: So, let's say, in FY '25, can we aspire to touch 22%-23% kind of EBITDA margins or it will be lower?

Sameer Hiremath: Yes. I mean if you add 50 to 100 basis points over two-three years, it should work out to approximately the same number, yes.

Moderator: We have the next question from the line of Siddhartha Grover from Equirus PMS. Please go ahead.

Viraj Mehta: This is Viraj here. Just a couple of questions from my side. The COVID drug that you talked about, I mean, is the size of the drug in the range of 50 million to 100 million? Because I mean, essentially, the talk was that the Merck drug has been kind of slowed down in terms of production for all the Indian producers. Is this the same drug we are talking about?

Manoj Mehrotra: No, we are not authorized to disclose the COVID drug which is there because we have confidentiality agreement. So, at this point, our objective is to get into the supply chain of the innovator. And going forward, I'm sure this will have other indications as well. And once we start a relationship, things may change for COVID also and things may change for other indications, we have to really wait and watch.

Viraj Mehta: Absolutely. Thanks a lot. And for the large CAPEX that we have done, Sameer, what's the kind of top line? Earlier we were talking about close to Rs. 3,000 crore post the whole CAPEX is over. Is that still the same number that we think we can do on the current capacity that we have?

Sameer Hiremath: Currently, I mean, we're investing about Rs. 300 crore to Rs. 400 crore of CAPEX every year, right? So, asset turn of about 1.5 for the new CAPEX. If our baseline last year is Rs. 2,000 crore and you do our asset turn of 1.5 of the new CAPEX, it adds up to about Rs. 3,000 crore-plus.

Viraj Mehta: So, is the current capacity base revenue only Rs. 2,000 crore, that's the max we can do? Because I thought we were running at a slightly lower utilization.

Sameer Hiremath: Maybe little bit of tweaking and little bit operational excellence improvements, 10%-15% we can do. So, debottleneck exercises, 10% to 15%, but the CAPEX that will start kicking in from end of this year will give us the benefits from next year and FY '25 and FY '26 will be the peak realization.

Viraj Mehta: And if we look at the commentary of some of the other large agrochemical players, at least they are indicating that the amount of inquiries that they are seeing is close to 1.5 to 2x of last year and last year itself was a 2x over the year before. So, is that the kind of traction we are also seeing?

Vimal Kulshrestha: Yes. So, we are also seeing the same traction, and we are also getting good inquiries from our existing customers as well as from new customers.

Viraj Mehta: And with the energy prices in the West being significantly higher, do you think some of these large MNC companies who have plants in Europe might look at shifting some of the lower-end products because we are now just far more cost competitive even in conversion costs compared to them? Earlier we were competitive in terms of manpower cost, but now even conversion cost seems to be far lower for us compared to Europeans.

Vimal Kulshrestha: Absolutely, we expect so. We expect that some of this capacity will shift to India.

Moderator: Thank you. Our next question is from the line of Ranvir Singh from Edelweiss. Please go ahead.

Ranvir Singh: Sir, just on Taloja facility, last month, we received that court's order and things are now operational. But we say customer demand is intact, then why that will take three quarters to normalize revenue level?

Vimal Kulshrestha: See, that is on the basis of capacity available in the plant. So, you can increase, I mean, some production in one quarter. So, you cannot make up all the loss in one quarter. I hope this clarifies your question.

Ranvir Singh: So, the past loss would be covered in subsequent quarter, and then we will have additional sales, that's what you are saying.

Vimal Kulshrestha: Yes.

Ranvir Singh: And like the guidance you are giving, for FY '23, we are expecting to end up at flattish revenue, right?

Sameer Hiremath: Compared to last year, yes. It's a year of consolidation.

Ranvir Singh: So, for Rs. 1,900 crore kind of revenue, the rest of three quarters should have above Rs. 500 crore kind of sales. So, additional Rs. 100 crore and maybe because this year is staggered, so the last quarter should have some higher run rate than historically we have been receiving. So, what will drive that?

Sameer Hiremath: Your first question was whether we're going to achieve last year's number, right? Is that your first question?

Ranvir Singh: Yes, that is the question.

Sameer Hiremath: We'll achieve it in a staggard manner back on regular run rate by Q3 and Q4. So, step wise, Q2 is better than Q1, Q3 is better than Q2, and so on and so forth. Also, one is that we're only talking about the crops business. So, the pharma also has witnessed a slowdown in Q1, and that slowdown is now reducing. The channel inventory has already been eaten up. So, we expect sales to start normalizing by end of Q2 itself and the full benefit will come from Q3 and Q4. So, put these two together and the Taloja plant and agro operations running at full steam, we see the plant back on track, this is back on track from next quarter onwards. So, we will see huge improvement this quarter as well.

Ranvir Singh: And the contribution of Panoli will start from first quarter FY '24 moving forward?

Sameer Hiremath: Yes, FY '24 first quarter, that's right.

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

Pranay Dhelia: Good to hear you, Mr. Sameer. Great to see you back and I hope that these obstacles are only temporary for Hikal and for the shareholder family. A couple of quick questions. How much of current debt do we carry on our books?

Sameer Hiremath: Yes, Kuldeep, our CFO can answer that.

Kuldeep Jain: We have Rs. 680 crore net debt today, I mean by 30 June.

Pranay Dhelia: That's all term loan?

Kuldeep Jain: No. Say, 50% is term loan and 50% is the working capital loans. So, Rs. 400 crore, Rs. 300 crore net debt.

Pranay Dhelia: Secondly, we've seen a sharp increase in interest costs. What I can make out is from the last call, you had guided that your debt equity ratio was 0.59 and cost of funds was 6.15%. How much has that changed?

Kuldeep Jain: It has changed in the first quarter, it has changed minutely, just 18 basis points, but we expect to increase by Q2, Q3 more.

Pranay Dhelia: By only 18 basis points change and your interest cost has gone up substantially by almost 50%. So, if your cost of funds has not increased so much, how can your interest cost grow so much?

Kuldeep Jain: It includes some re-evaluation loss of the notional re-evaluation loss of the loans which we have taken in the foreign currencies.

Pranay Dhelia: But that is not mentioned in your notes to accounts. It would have been prudent to mention it so that we can judge. It's sending very wrong signal to shareholders. We're thinking that your cost of funds has shot up all of a sudden in spite of your credit rating being maintained.

Mr. Sameer, on the second question, looking at the steep fall in share price, can we expect the promoters to do some creeping or the company to announce some buyback to rest the concern amongst the shareholders?

Sameer Hiremath: I can’t give any comment on that.

Pranay Dhelia: Best of luck for the future and I hope that whatever has transpired has transpired and you do achieve whatever you set out on.

Sameer Hiremath: Thank you very much.

Moderator: The next question is from the line of Hiten Boricha from Joindre Capital. Please go ahead.

Hiten Boricha: So, my first question is, can you quantify the production loss which has happened in Taloja plant in revenue and in EBITDA, which happened in this quarter? What would be the quantification for that?

Sameer Hiremath: The revenue loss was around Rs. 50 crore for the quarter, and that has impacted the contribution by close to Rs. 20 crore.

Hiten Boricha: Rs. 50 crore in revenue and Rs. 20 crore in EBITDA, right?

Sameer Hiremath: That's right, EBIT.

Hiten Boricha: Sir, my next question is on this revenue guidance you have given that we will definitely do Rs. 1,900-1,950 crore kind of revenue in this year itself. So, we are expecting like Rs. 500 crore kind of normal revenue from next quarter itself, from Q2 itself. So, just wanted to understand this on the margin perspective, are we expecting double-digit kind of margin from next quarter itself, let's say, around 10%?

Sameer Hiremath: From the margin perspective, definitely double-digit margin, and there's a step wise increase in revenues to get towards the run rate of Rs. 500 crore plus per quarter. Average for 3 quarters will be above Rs. 500 crore.

Hiten Boricha: So, we will do 10% kind of margin from next quarter itself, right?

Sameer Hiremath: The idea is to do better than that, yes.

Hiten Boricha: And sir, my last question is on the Taloja plant which is going to start you mentioned it will be starting in second half, right?

Sameer Hiremath: No, it's already started from early July.

Hiten Boricha: Early July? My question is on the MPP plant, sorry, Panoli plant.

Sameer Hiremath: Panoli plant is starting by end of this year.

Hiten Boricha: End of this year. And what kind of revenue we are expecting from that plant, sir?

Sameer Hiremath: When at peak, it will be about Rs. 200-300 crore, about Rs. 300 crore at peak after 3 years of commissioning.

Hiten Boricha: So, the peak revenue number will come in FY '25, if I'm not wrong, right?

Sameer Hiremath: FY '26.

Hiten Boricha: FY '26.

Sameer Hiremath: Because it takes time to have some revalidation, approvals. It's a multi-purpose plant, there's multiple products in that plant.

Hiten Boricha: So, the margins for these products will be similar to the company's current margin? Or it will be lower as funding of the CAPEX is also done by the partner itself so?

Sameer Hiremath: See, as I've been mentioning on all the previous calls, any new project that we take, the margin profile is significantly higher than our historical margins. Historical EBITDA margin is about 18% to 19%. All the new projects and new product selection is done with a higher margin profile, well in excess of 20%. The asset turnover itself also, for the new projects, are closer towards 1.5. These are the basis of selection of new molecules and new projects.

Moderator: The next question is from the line of Jayesh Parekh from JMP Capital. Please go ahead.

Jayesh Parekh: My question is for Sameer bhai. Sameer bhai, kindly take my question in the right spirit. If you see last nine to ten years block of Hikal, in terms of revenue, we have just grown from Rs. 700 crore, Rs. 800 crore to Rs. 1,900 crore. And in terms of operating margin, we have never crossed 20% operating margin in last five-six years. Only in 2012, '13, we were 26%, 28% and then we have never seen those kind of margin. And my second point was that cash from our operation has just gone up from Rs. 150 crore to about Rs. 290 crore for March 2022. So, my humble request is that at least, if not last 10 years, but in last 5 years, the chemical sector in India has performed very well, when you see our peers into crop science business as well as pharmaceutical business. So, can we find out what exactly is wrong with our beautiful organization with such a beautiful plant, that we are not able to grow in line with what is happening in the industry?

Sameer Hiremath: Well, it's a very valid question. And we are even more concerned than you are about this point. So, we've done several things. We relooked at our entire operating model. We've got a transformation program that we started last year called Pinnacle. We are looking at growing our business faster in line with our peers to improve our margins, also in line with our peers. So, all the new projects that I mentioned to the earlier speakers is for a much higher margin profile and winning the larger contracts. We're putting in significant steel in the ground and investing. So, I think, yes, in the last 5 years, maybe we have not grown as fast as our competitors, but you will see, in the next 5 years, we are going to catch up and we'll be playing in the same level as the top two-three in each of our fields. So, the idea is to grow and accelerate growth in the next three to five years, significantly and the historical growth will be a thing of the past. And there are a lot of opportunities today.

Moderator: Our next question is from the line of Aditya Khemka from InCred Asset Management. Please go ahead.

Aditya Khemka: Sir, if I look at your Taloja plant closure, so just I'm a bit confused, does the Taloja plant only contribute to Crop Protection business or does it contribute to the Pharmaceutical business as well?

Sameer Hiremath: Only the Crop Protection business.

Aditya Khemka: And previously, you had said that Taloja contributes 15% of revenue. So, was that 15% of total revenue or 15% from the Crop Protection revenue?

Sameer Hiremath: 15% of total company Hikal revenue.

Aditya Khemka: 15% of Hikal revenue. So, that would be roughly 30% of Crop Protection revenue.

Sameer Hiremath: Yes.

Aditya Khemka: Yes. I mean, given the broadness of the crop revenue.

Sameer Hiremath: Yes, 30%-35%.

Aditya Khemka: And now on the Taloja plant itself, so given that we have not been able to supply our customers for one entire quarter, and obviously, they must have consumed the inventory that would have been lying with them, I would have thought that in the second quarter, we would run the plant double shift and sort of fill up their inventory as well as provide them enough material to continue supply this quarter. But from your statements, what I understand is, we are going to restock the inventory not immediately in one quarter, but over the next two-three quarters in a slowish manner. Could you sort of help me understand why that is the path we have taken?

Vimal Kulshrestha: I'm Vimal Kulshrestha. So, this plant is a continuous plant, it as such, runs in three shifts. And based on the capacity available in each quarter, we will make up the loss of Q1. So, it is not possible to be done in one quarter.

Aditya Khemka: It is a continuous plant, I was not aware of it.

Vimal Kulshrestha: It's a continuous plant.

Aditya Khemka: So, yes, in that case, it will just totally make sense. Second question on the pharma side. So, we understand the decline in the Crop Protection business is largely now due to the Taloja closure and therefore, should normalize when Taloja normalizes, which you are saying this happened. But on the pharma side, you're basically saying that the customers have some inventory and that inventory is basically getting depleted as they are not taking up fresh stock and then with the depletion of inventory, get more orders. Could you help us with the product concentration on the pharma side? Our largest product, what percentage of revenue does it account for? And this question is for FY '22. And then for that product, what is the situation in Q1 FY '23?

Manoj Mehrotra: So, our largest product is around 30% of Pharma business. And we have seen that overall, not only this product, but other products, including the CDMO products, had excess inventory with customers, which were corrected in Q1. By the very definition of inventory, long-term demand is going to come back, and we've already started seeing positive outlook from the month of July, August. And we will get back to normal sales in the next three quarters. That's what Sameer also mentioned in the past.

Aditya Khemka: Yes, I get that. So, this product, which was 30% of the pharma revenue in FY '22, in Q1 '23, did it maintain 30% contribution to top line? Or was it significantly lower?

Manoj Mehrotra: See, our intention is to, long term, bring it down to 20%. And this year, we'll have to see whether from 30% will it go to 25% to 28% in that range. The long-term prospect is getting down to 20% and launch new products with higher margins, which will improve the profitability trajectory of the pharma business.

Aditya Khemka: And this is your own product, not a CDMO product, right, the 30% contribution product?

Manoj Mehrotra: That is our own product.

Aditya Khemka: It is an own product. And why do you see contribution coming down? I mean, obviously, one reason would be the growth of other products and launch of new products. But in absolute terms, it seems that this product is declining, right? I mean, again, inventory being one part, but is there an element of market share loss or competitor positioning in terms of better cost or pricing? Could you help us with that?

Manoj Mehrotra: No. See, the long-term prospect of the product is good. We will maintain our market share. But since this is a mature product, the newer products will grow faster, and this product will have a slower growth. So, on absolute terms, this product will continue to grow. Maybe it will grow at 5%-7%, but others will grow at greater than 15%. So, by the arithmetic itself weightage will come down.

Aditya Khemka: Just one last question from my side. When we say CDMO, does it mean that our customers are innovators, and they have patented products or innovative products which have just gone off patent or maybe off patent already? Or do we mean it's products which may be innovator or generic, but we are developing the product?

Manoj Mehrotra: No. When we say CDMO, it means we supply to innovators. They may be patented, KSM to patented or new chemical entities, which are molecules or all also part of life cycle management for the innovator company. And either they can be APIs or they can be key starting materials. We also are into custom development, where they work on Phase 1, Phase 2 kind of molecules, which will get launched in FY '25 or '26 onwards. And we have a healthy pipeline of these Phase 1, Phase 2 kind of molecules also. In fact, we have said that we have signed the contracts for

Phase 2b launch of a global innovator company. In the next three to four years, it should get commercially launched.

Aditya Khemka: Sir, just an observation on that. So, when we look at other CDMO companies, right, which are majority CDMO contribution, their gross margin tends to be closer to 70% and EBITDA tends to be closer to 30%, at least for the CDMO segment of the business, and then they do the generic or the own product division, where, obviously, numbers are lower and therefore, what we get to see is the consol number, which is sort of the average between the CDMO and the generic. In your situation, if I assume similar numbers for CDMO, 70-30, which really doesn't seem to be the case, maybe it's even lower than that, is the generic or our own product segment in both Crop Protection and Pharma really like below 10% EBIT or EBITDA margin business that we are running?

Manoj Mehrotra: No. What I will say that in our CDMO business, we have some life cycle management products, which may not generate this kind of high contribution margins of 70%. But the NCEs or the new development which is happening, those will definitely have higher margins. So, as of now, definitely if the CDMO gets higher margin, going forward, our attempt is to get more CDMO customers, invest more out there. From a level of 50-50, we would like CDMO to contribute 60% of our revenue and margins will be higher than 60%.

Moderator: The next question is from the line of Rohit Nagraj from Centrum Broking. Please go ahead.

Rohit Nagraj: Apologies for asking the question again on the historical performance. But in the last four to five years, we have seen that there could be an external event and it takes some of the quarterly performance for a toss. I mean we have seen that when the Mahad flood issue, after that COVID, then last quarter was hyperinflation in cost, this quarter, inventory destocking. So, what has the management taken steps in terms of not such an aggravated impact on a particular quarter on the business? And an allied question to that is that during such cases of cost inflation, don't we have any mechanism to pass it on to the customers instead of taking the entire brunt ourselves over a period of time?

Sameer Hiremath: Yes, I think your question is in two parts. One is again, we've had some external events, some of them are force majeure related, I mean, the Mahad flood was. COVID was definitely force majeure, I mean it's not of our doing and Taloja also unfortunate event that took place. But we've learned a lot from these events. First, we are de-risking our portfolio and our plant to a large extent. So, percentage contribution from a single site or a single building on that side will come down. We're making alternative arrangements to move products around from one site to the other if and when such unfortunate events do take place in the future. So, that one is expected to ensure that the impact on any external events could be minimized to a larger extent than what it is today.

Rohit Nagraj: Right. And the second part of the question in terms of the contracts with our customers from a pricing perspective?

Sameer Hiremath: The contract with the customers, many of them have pass through clauses, and we are already in discussions with them, and there's a lag effect of one to two quarters to get the benefit because discussions have already begun, and we expect the benefit to accrue in the remaining three quarters of this year.

Rohit Nagraj: But do we get compensated for the loss of opportunity or loss of margins for previous quarters? Or is that only for the subsequent quarter that the pricing gets suggested?

Sameer Hiremath: It depends on a customer to customer. It's an ongoing basis. So, it will be plus, minus, but overall is positive for the company.

Rohit Nagraj: And second question is, I understand that from FY '20 to '22, we have invested close to about, say, Rs. 600 crore in CAPEX. How much of that is reflected in our revenues of FY '22? Just wanted to gauge in terms of how much potential opportunity that we are looking at to capitalize over the next two-three years from the Rs. 600 crore CAPEX?

Sameer Hiremath: Rs. 600 crore will be the investment by end of this year. And between last year and this year, will be the Rs. 600 crore investment. So, the benefits will partially come in this year, but most of the benefit will come in from next year onwards.

Rohit Nagraj: So, just clarification, in FY ’21 also we had combined spent close to about Rs. 250 - 300 crore. The entire benefit being captured in FY '22 numbers ?

Sameer Hiremath: It takes about two to three years depending on the type of product to get the full benefit. There’s a ramp-up period.

Rohit Nagraj: And just one last clarification. You indicated about the revenue guidance for FY '23, in terms of margins, given that we had additional margins for Q1, what would be our margin expectation even if we are able to catch up in the next three quarters and averaging for FY '23?

Sameer Hiremath: So, we'll be in a position to give guidance after Q2 numbers.

Moderator: The next question is a follow-up question from the line of Aditya Khemka from InCred Asset Management. Please go ahead.

Aditya Khemka: On the CDMO part of the business, again, this raw material cost pressure, again, if I follow the trends from larger companies, Lonza, Catalent and some of our local competitors, it seems relatively easy, when they talk at least, they say it's relatively easy to pass on the raw material cost pressure to CDMO customers because as in our product is a very small part or a very small component of their overall product and economics. But looking at our gross margin for the last two-three quarters, it seems that our CDMO customers don't see it the same way. So, what I want to understand is, is it just a contractual bit there, because of the contract, we have not been able to renew the price of our outputs? Or is it because our customers don't really want to entertain thoughts of price increases, that we have not been able to pass it on?

Vimal Kulshrestha: So, to answer your question, CDMO customers, we are able to pass on the cost impact, but with a lag effect. And that lag can be one to two quarters.

Aditya Khemka: And for the generic customers, as in, our own product customers?

Manoj Mehrotra: No, the generic customer, it's the market which dictates the competitive pressures. In the pharma API or the own product business, unfortunately, we have not been able to pass on the cost increases because everyone has not increased the prices. So, there, we have to kind of absorb. But going forward, in the raw material and solvent prices, we are seeing a softening trend. Things will get better in the next three quarters.

Aditya Khemka: Yes. So, I'm saying how much raw material inventory do we carry, KSM do we carry because the spot prices of these raw materials is correcting? And if we have still got high-priced inventory, we'll have to consume the higher-priced inventory first, right?

Manoj Mehrotra: No, you're right. You're right on that. But when we know that raw material price is softening, we really don't keep much inventory.

Aditya Khemka: All right. So, these KSMs would start to reflect from the second and third quarter itself, right?

Manoj Mehrotra: I said only towards the third quarter because many of the raw materials are imported. In case of imported, they are already in the high seas and the one to two months inventory will be there for imported raw materials. But the full impact of the softening of raw material prices will be shown in Q3 onwards.

Moderator: Ladies and gentlemen, that would be our last question for today. I now hand the conference back to the management for their closing remarks. Thank you, and over to you.

Sameer Hiremath: Thank you for joining the call. And I would personally like to thank all of you for your continued support to the company through these challenging times. I'm confident that the future is bright and Hikal will continue to grow sustainably in the coming years. If there is any further questions, please feel free to reach out to us or to our Investor Relations partner, Strategic Growth Advisors. Stay safe and take care. Thank you very much. Have a very good afternoon. Goodbye.

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