



Neogen Chemicals Limited  
Q1 FY20 Earnings Conference Call Transcript  
August 13, 2019

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**Moderator:** Ladies and gentlemen, good day and welcome to the Neogen Chemicals' Q1 FY20 Earnings Conference Call. As a reminder, all participants' lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '\*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Shiv Muttoo of CDR India. Thank you and over to you, sir.

**Shiv Muttoo:** Thanks, Karuna. Thank you everyone and good morning. Welcome to the Neogen Chemicals Limited's First Conference Call for Investors and Analysts. The call has been hosted to discuss the Q1 FY20 Financial Performance and to share the operating highlights of the company with you. Joining us on the call are senior members of the management team including Dr. Harin Kanani – Joint Managing Director, Mr. Anurag Surana – Director and Mr. Mahesh Tanna – Chief Financial Officer.

We will commence the call with comments from the management team post which we will open the call for a Q&A session where the management will be glad to respond to all the queries that you may have. At this point, I would like to highlight that some of the statements made today during the call may be forward looking statements. The actual results may vary from the forward looking statements made by the management. A detailed statement in this regard is available in Neogen Chemicals' Q1 FY20 Earnings Presentation that has been shared earlier with all of you.

I would now like to invite Dr. Harin Kanani to commence this call by sharing his thoughts on the Q1 financial performance of Neogen Chemicals, strategic progress made by the company and the management's long-term vision. Over to you.

**Harin Kanani** Thank you, Shiv. Good morning everybody and thank you for taking out the time to join us for our very first conference call post the listing in May 2019. We have had an encouraging start to our journey as a listed entity and I, on behalf of the board of directors and the management team of Neogen Chemicals, would like to express our gratitude to the investor community for their continued belief in our story and the participation.

Through its initial public offering, Neogen Chemicals raised a total of Rs. 132 crore including Rs. 70 crore issued as a fresh equity shares by the

company. The proceeds of the issue, net of IPO expenses have already been utilized fully towards retiring long-term borrowings of over Rs. 22 crore, repayment of preferential shares of Rs. 12 crore and the rest for the working capital. As a result, our debt to equity ratio now stands at 0.59 as on 30th June, 2019 as compared to 1.7 in the previous financial year. Now we are investing in our next phase of capacity expansion on this robust balance sheet platform.

Today, I am delighted to have an opportunity to interact with the community of analysts and investors and look forward to partnering with all the stakeholders who are supporting and participating in our growth opportunities. As mentioned earlier, we believe Neogen is a family and we are very happy to now also include investors and other stakeholders in this largely fast growing family.

Given that this may be our first interaction with many of you, I would like to give you a quick overview of the business and some thoughts on our corporate journey till date and our thoughts on the business.

We are one of India's leading manufacturers of bromine-based and lithium-based speciality chemicals with product offerings comprising of organic as well as inorganic chemicals. These products are used in pharma, agro as intermediates, engineering liquids, electronic chemicals, aroma chemicals, flavours and fragrance, speciality polymers and as a cooling media in eco-friendly vapour absorption machines (VFM). Over the years, Neogen has expanded its product range and presently manufactures an extensive range of speciality chemicals that form the part of several global supply chain and see demand from the range of longstanding customers, both in India as well as in international markets. We have a large range of organic and inorganic chemical compounds developed based on the outstanding contribution from our internal R&D team and resources.

While Neogen commenced its business operations in 1991, my father, Mr. H. T. Kanani, who is the Chairman and Managing Director of the company, has been associated with bromine almost from 1970s. He set up one of India's first bromine plant using indigenous technology in Navlakhi near Morbi in Gujarat in the 70s. Later in 1985, he started a small manufacturing plant for making bromine derivatives from a 600 square feet plant in Thane which was a proprietary company with limited about 100 litres reactor capacity. These are the origins of Neogen Chemicals and we have the learning of almost 50 years of domain experience that today allow us to stand tall as a leading global manufacturer in our chosen chemistries. Now, we have come a long way and following multiple capacity expansions at our Mahape facility as well as acquisition of Solaris ChemTech Industries' Bromine derivatives plant at Vadodara in 2016, we are developing third location at Dahej in Gujarat that enjoys SEZ benefits.

So since we expanded beyond single location operations in Mahape, our sales turnover has expanded from Rs. 100 crore in FY16 to Rs. 239 crore in FY19. In this 3-year period, profits have expanded almost 4 times to Rs. 21 crore. Our 5-year revenue CAGR stands at almost 26% while the PAT CAGR is at robust 40%. I am also glad to share with you that we have



consistently delivered profits in each of the 28 years of our operations at Neogen Chemicals with positive growth in 26 of those years.

R&D has been an integral part of our growth and we have established 2 in-house R&D units with an endeavour to develop new processes and improve existing process. Our 20-member dedicated R&D team which is roughly 10% of our overall employee strength are constantly evaluating opportunities in bromine and lithium-based chemistries.

Lastly, we have also developed our expertise in custom synthesis and contract manufacturing of the products for specific customers which has been scaling up nicely over last 3 years.

Now, let me move on to our Q1 FY20 Financial Performance:

During the quarter under review, we have delivered strong earnings performance driven by promising demand environment across our key product offerings and higher capacity utilizations at our plants as compared to the same period previous year. Our revenue and profits after tax on a year-on-year basis grew by 66% and 92% respectively. Revenue growth of 66% to Rs. 64.4 crore was on a low base last year as we undertook a major overhaul in the Vadodara unit in the corresponding quarter last year, which resulted in lower production at the Vadodara facility. Revenue from organic chemicals stood at Rs. 48.4 crore, a growth of almost 83% while revenue performance of the inorganic chemicals improved by 32% to Rs. 16.1 crore. EBITDA expanded by 70% to Rs. 11.5 crore led by higher capacity utilization at both of our plants as well as better efficiencies on larger scale of operations. Profit after tax came in at Rs. 5.5 crore, which was higher by 92%.

As highlighted in our earning presentation, I would urge all the investors and analysts to compare our financial performance only with that of the corresponding quarter of previous year to evaluate business progress on a like-to-like basis, as our business has some seasonal factors, due to which the company tends to deliver stronger financial performance in the second half of the financial year.

Going forward, we expect to continue to drive production at our existing facility at optimal capacity utilization. We have also planned Greenfield expansion at Dahej SEZ that will double our capacity, both on organic and inorganic product line. We have already started construction activities of the inorganic facility and remain confident of commissioning the plant as per the targeted timeline. Based on the pipeline of products and the current export enquiries from our customers in Japan and Europe, we are also installing a multi-product plant to manufacture organic derivatives along with advanced intermediates at our Dahej facility. This was earlier planned to be installed in Vadodara. Overall, I believe that based on demand and visibility and encouraging business landscape, we are favourably positioned to realize our growth opportunities over the next few years.

That concludes my initial comments on our business. I would now request the moderator to open the forum for questions from participants.

**Moderator:** Thank you very much sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Sudarshan Padmanabhan from Sundaram Mutual Fund. Please go ahead.

**S. Padmanabhan:** My question is on the presentation which says that the second half is much stronger than the first half, since we do not have the exact numbers of the first, second and third quarter of last year, what would approximately be the build-up, I mean between the first half on the sales and the EBITDA side?

**Harin Kanani:** If you look at our last year performance, we had around Rs. 95 crore which came in the first half and almost Rs. 150 crore came in the second half, so many times, historically speaking, almost 40 to 45% is in first half and about 55 to 60% is in the second half in terms of sales.

**S. Padmanabhan:** And in terms of EBITDA because there would also be an element of operating leverage, right?

**Harin Kanani:** If you also see our last year Q4 numbers, the EBITDA percentage was almost higher at 20% because when the sales are higher, the profits also get booked in-line with sales, so that is the reason it was almost 20% when the average was 18.5%, but if you want the exact number, we have last year's DRHP, so we can tell you how much was 6 month's EBITDA and how much for the whole year, so we will share that in this call at a later point.

**S. Padmanabhan:** And, second is on growth, can you give some colour on how much is it primarily driven by volumes or whether there is a pricing element to it because if I actually look at the EBITDA margins which has expanded, the EBITDA margin expansion is just about 40 bps despite of a huge jump in the topline and part where we had kind of missed up a little bit is on the gross margin side, so is there any kind of situation where the raw material prices have fallen and we have been having some higher cost of raw material or whether there has been some change in the prices that we are supposed to do?

**Harin Kanani:** I think in terms of the sales increase, the growth that we have got in, this has largely come from organic and this has been driven by the volume growth because as we mentioned earlier, in last year, we had taken a major overhaul of the Vadodara facility, so June, July and bit of August the Vadodara facility worked at a very low utilization level, whereas this time it was available fully, so we were able to utilize it much higher and as you will see, majority of growth has also come from the organic side which is the higher utilization that we had, so it has come through volumes. In terms of your question with respect to the percentage margins, so I agree that our percentage has increased quite a bit in terms of the revenue and the EBITDA percentage has moved just a bit, mainly this was also a quarter in which whatever additional production, so we have done some additional production which was not sold as yet, hence profit is also not booked, so

that is the reason that you are seeing this and also one of the things that we have done is that for example, if you see our employee cost also has risen significantly because we increased our team over last one year as compared to the same quarter, so as a result of that overall, you don't see a very large increase in terms of percentage. Specifically in case of raw materials, because of product mix changes, what we always feel that there is almost 1 to 1.5% kind of variance from quarter to quarter or from year to year, these are largely driven by product mix rather than any specific trend or anything like that.

**S. Padmanabhan:** One final question from my side is, until the new capacities at Dahej comes in, I mean would we be because you are already running at around Rs. 60 crore in the first quarter and you mentioned that the salience is 40% and 60% for the second half, until the new capacities come in, do we have enough capacities to drive the growth specifically in the second half as the growth will optically look much larger in the second half due to the demand in lithium and the organic side itself?

**Harin Kanani:** In terms of the percentage growth, we won't be able to deliver a percentage growth like this in the second half and you are right that the second half will, compared to the same period last year, there may not be a very big increase because the plants were already at high utilization in the second half of the last financial year. So first and second quarters, we will of course have the benefit of a lower base. We have also shared earlier that our existing capacity with the right product mix is more or less enough for Rs. 300 crore kind of revenues, so depending on the exact product mix and the utilization levels we can get, we can be anywhere between Rs. 280 to 320 crore which is, let us say, somewhere between like 18% to 30% kind of a growth depending on or if you take kind of average at Rs. 300 crore somewhere around 22 to 25% growth over last year. This is without utilizing any of the new capacities which are likely to come in this and next financial year.

**S. Padmanabhan:** And the new capacities would come in towards the fourth quarter or the third quarter?

**Harin Kanani:** Yes, the inorganic capacity is likely for fourth quarter this year and the organic capacity is expected for next financial year, towards third or fourth quarter in the next financial year.

**S. Padmanabhan:** And what would be the absolute debt on the books?

**Harin Kanani:** The absolute debt on the books as on 30<sup>th</sup> June, 2019 is now standing at around Rs. 83 crore.

**Moderator:** Thank you. We move to the next question from the line of Kaushal Shah from Dhanki Securities. Please go ahead.

**Kaushal Shah:** Two questions, one is the impact that could come in our input cost because of these recent INR depreciation and also some thoughts on the Vadodara plant, have we been impacted by the rains that we witnessed in the last

fortnight or so and because of that, are we likely to see any delay or any postponement of revenues or the expansion?

**Harin Kanani:**

Vadodara site was not affected by the rains. Only thing was the entire city was flooded and hence some of the employee's homes were also flooded, so for few days, some of the employees located in Vadodara could not travel. This was just 1 to 1-1/2 days, but we also had some other local employees and other people in the plant, so we ensured that the plant was running even during those rains so there is no significant impact of the Vadodara rains. Also, as I mentioned earlier in my opening remarks, we have decided to take further expansion in Dahej Special Economic Zone (SEZ). This was largely driven by the demand scenario which is coming from lot of export based customers and we thought like doing this Dahej Special Economic Zone will give us the benefits of the exports business that we have, so anyways this is now also planned in Dahej and there is again no impact on the expansion because of the rain. Can you repeat the first question again?

**Kaushal Shah:**

The impact of recent rupee depreciation and to what extend are we hedged?

**Harin Kanani:**

So, majority of our business is, either we are exporting, so as you can see, almost 49% of this quarter and even last year revenue came from exports and even on the domestic front, majority of time we are basically doing import substitution, so for majority of this, whenever it depreciates this will not have any negative impact on Neogen's operations. Some of the local domestic business also that we have, there is a price reset clause in our contract that as soon as dollar changes by more than Re. 1, the price on the monthly basis resets, so I don't think we will have negative impact in terms of our hedging, more or less I think majority of our exports as well as existing imports and import commitments are hedged except for few portion which are contract based hedging, so this is something which we will not hedge because the rate resets on the market situation.

**Moderator:**

Thank you. The next question is from the line of Dhaval Shah from Girik Capital. Please go ahead.

**Dhaval Shah:**

Just one question. So after the expansion what sort of topline can we do at 85% capital utilization?

**Harin Kanani:**

Once both organic and inorganic capacities come into place, technically if the product mix was exactly the same, we can do Rs. 500 crore plus because both the expansions will double the capacity, but on the safer note and because we want to do more advanced intermediates where there is more processing involved, we are also upgrading our plants and the new plants that we are making to higher specification because this will be made from scratch whereas the Mahape site is relatively an old site and the Vadodara site also was an acquired site, so there will be a bit of a CAPEX, so considering that we are looking at least Rs. 500 crore topline once both these expansions are in place.

**Dhaval Shah:** So this would be achieved by FY22?

**Harin Kanani:** Yes, this will be achieved by FY22.

**Dhaval Shah:** And with 18% EBITDA?

**Harin Kanani:** Yes, we basically say that we have in the last couple of years reported close to 18.5%, so we would say (+/-1%), so anywhere between 17.5% to 19.5% would be our target.

**Dhaval Shah:** What is our plan over next 2 to 3 years with regards to working capital, so we had discussed that we want to get down our inventory plus receivables, so how are we progressing on that? What initiatives are we taking?

**Harin Kanani:** I think couple of initiatives that we are basically taking.

**Dhaval Shah:** Can you quantify these initiatives on inventory side?

**Harin Kanani:** So I think basically what we are trying to do is, the need for the inventory and the debtors was based upon the requirements of the business to meet the customer needs in terms of the timelines, etc., so these will change partly with the right kind of product mix, customer mix and strategy with the new customers, so as we said that we have more new capacity coming in and we have more and more products where we have dedicated our reactors. I think with some of you when I have interacted, I have mentioned that 3 years ago, we had only one product which contributed more than Rs. 10 crore, now we already have 7 or 8 molecules which contribute more than Rs. 10 crore, so once we have these kind of products, we can dedicate the reactors for them and then the need to change over and these kind of things go down. Also, once we start getting into larger long-term contracts or more customers with annual contracts, we have a better visibility on the business, so these are the things that we are currently working and when we are now making new contracts with our customers, we are also trying to negotiate the payment terms a bit better where if the customer requires very long term, we are trying to insist on LC, so slowly or gradually what we feel is to basically improve on our working capital requirement, so we would target, let us say, at least first target would be to reduce down by 10 days and then slowly going forward, improve upon that.

**Dhaval Shah:** So you said we are more on the contract manufacturing side, correct?

**Harin Kanani:** When I said contract, I meant like just the annual contract with my product, contract manufacturing as well as for my product, I mean what I mentioned is applicable for both.

**Dhaval Shah:** So what would be our order book size and what is the timeline to deliver those orders? Do we have one year of kind of deliverable or it is over a span of 2 years, 3 years, so how do you plan your expansion? How do you plan your Rs. 500 crore projection what you said, you must be having some, so how do we understand that?

**Harin Kanani:** First one, if you look at existing POs that I had so far, they are basically annual, 6 monthly or quarterly or even just a PO to PO, execute this PO and get that. So these are the kind of contracts that we have. We so far don't have like a 5-year PO or something or 2 year or 3 year kind of.

**Dhaval Shah:** We are a small company, so our volumes are also small.

**Harin Kanani:** Yes and also it is spread across a lot of customers. Having said that, some of the contract manufacturing businesses that we are currently discussing with, we may have the potential of a multi-year kind of a scenario, but as of now majority of business is PO to PO but we also have a lot of repeat customers, so basically when we do the planning, like for example, I have customers who have been with me for 20 years, 25 years and we have not been able to have a multi-year arrangement, only because the customer does not have the visibility or the raw material cycles are not to the same extent like there is a lot of repeat business which comes. So we had for example, worked out at the time of our DRHP that our 9-month numbers, I mean I know the exact percentage, so I am sharing. 50% of the business came from customers more than 10 years old and 75% came with customers more than 5 years old, so this is about our everyday planning.

Coming back to your question for Rs. 500 crore kind of a topline and the visibility on that what we have done internally is we have looked at each of our products and each of the customer with whom we are either doing business or we have at least had some interaction to make internal data base of what is the total product potential of this business of the existing molecules as well as we have looked at the molecules which are currently in the pipeline and when I add that up, the number is almost more than 10 times higher the demand that we can make against the Rs. 500 crore, so that is why we are reasonably confident. Majority of the Rs. 500 crore will come from molecules which are already existing. It is only a question of having the capacity.

**Dhaval Shah:** From the existing portfolio, we will have Rs. 500 crore?

**Harin Kanani:** Yes, of course there are things in pipeline and if we get molecules which are better than the existing in terms of either the future potential or in terms of profitability, we would of course give preference to that but like a worst case scenario would be just my existing molecules also can continue and can give us Rs. 500 crore.

**Dhaval Shah:** Basically, you have to just grab the customer's wallet share in terms of that molecule?

**Harin Kanani:** Yes, that is right.

**Dhaval Shah:** And what would be our total debt profile on the balance sheet including acceptances, LC, so what would be the draft number over next 2 years when you achieve Rs. 500 crore topline?

- Harin Kanani:** For a Rs. 500 crore kind of topline, our expected debt as of now based on our internal models will be let's say somewhere around, Rs. 150 to 200 crore, in that range.
- Dhaval Shah:** And any sort of pay out you have in mind. I don't think you may have made a policy but any payout or you said it will be very low because you will need lot of money for that CAPEX?
- Harin Kanani:** Yes, so historically also Neogen being a profitable company, we always pay dividend and it will not be a very large payout as you very rightly said, but I think we have been in the range of 15 to 20% and unless business really requires it, we would like to continue, so even this year also we have done similar payout and we would expect to continue more or less in that line.
- Dhaval Shah:** And next year, any fresh equity raising plan in your model?
- Harin Kanani:** As of now no, because I think we have sufficient and if our normal business pans out up to FY22 also, we have very comfortable debt equity ratios in spite of the working capital requirements and the investments that we need to make, so we won't need any special investment.
- Moderator:** Thank you. The next question is from the line of Dhavan Shah from ICICI Securities. Please go ahead.
- Dhavan Shah:** I have few questions. Firstly about the second half that you mentioned that around 60% of the revenue comes in the second half, so can you please share is that coming from the organic chemical side or the inorganic chemical side and which geographies do you see more traction towards the second half if you can share these two details?
- Harin Kanani:** In the second half, of course both organic and inorganic but generally what we have seen is especially for inorganic, the second half and that too even in the last quarter is more lopsided. So one of the reason behind this is that we make one of the products, lithium bromide which is used in vapour absorption cooling and this being environmentally friendly, they have 100% depreciation and these are basically industrial cooling machines and some of the machines have 3 month, 4 months or even 6 to 7 months manufacturing time, so what tends to happen is that our customers and our customer's customers tend to buy this at least in the last quarter, so they can get the maximum benefit of the depreciation due to which Q4 is the one where we have the maximum lithium bromide business, so this is one of the factors.
- In terms of organic production, what we have seen is specially customers from Europe, in the second half of the calendar year, there are two months where there are lot of holidays, so August is the month where Europe is semi-closed for summer vacation and December is when they have Christmas and other holidays, so they also tend to start and also they want minimum inventory at the end of December, so they start buying in August, November when they have their new year budget and the shipments for that start from December-January, so that is why the December to March



period and initially they want more inventory, so that is the other reason why we see slightly higher demand from our European geography during that time.

**Dhavan Shah:** And you also mentioned that the order inquiries are really very good and may be you are witnessing around 10 times more than your budgeted Rs. 500 crore topline, so is that safe to assume that you may reach to the optimum utilization at Dahej capacity in the next year itself?

**Harin Kanani:** No, the Dahej capacity will come online itself in the next year, so the organic capacity will come online in either Q3 or Q4 of FY21, so that is why we are saying that the first full year of operation in FY22. Because of this demand, we will ensure that it reaches full utilization.

**Dhavan Shah:** And if you can share the realization differentiation between this organic and inorganic chemicals and what is the operating margin of these two segments if you can share these two details that would be helpful?

**Harin Kanani:** We don't share individual organic, inorganic operating margin side for various reasons, but in terms of the main difference, the organic chemicals are mostly used as intermediates, so they are used as building blocks, whereas the inorganic ones, they generally have some property and for us majority of inorganic ones are lithium based molecules, so molecules like lithium bromide, chloride, nitrate, sulphate that we make, they all have some property, so they had uses in these engineering, construction chemicals or as a catalyst in pharma, so that is the major distinguishing between them. Also the competitor profile, so the set of competitors which do the organobromides and the set of competitors which do inorganic lithium are quite separate, so we have very few other companies which do both internationally, so that is why they both behave differently.

**Dhavan Shah:** But normally I think inorganic should have better margins compared to organic or vice versa?

**Harin Kanani:** So my one line for any better margins is wherever we have done innovation or wherever we have done something very unique, either in terms of quality or registrations or in terms of process, that is the place which has good margin, so I don't want to say broadly inorganic is better or organic is better.

**Dhavan Shah:** And roughly around 65% of the overall revenue comes from organic side, so what is your medium-term target, I mean this revenue mix will remain the same over the period of next 4 to 5 years?

**Harin Kanani:** Actually at present, it is slightly more than 65% and the exact breakup is, organic is almost 78% and 22% was the lithium for this particular quarter, but what will happen is after the doubling, even lithium will double capacity first, then you will have organic capacity coming online, so depending on when these capacities come online, you may see some fluctuations of lithium increasing and decreasing, but as of now the way we see it, it is more like 80% organic and 20% inorganic.

- Dhavan Shah:** And can you share some CRAMS opportunity, what could be the revenue size of this CRAMS in the long run, it should be around less than 10% right now, but what is your overall target for this segment?
- Harin Kanani:** Overall, we currently have advanced intermediates and CRAMS, so for me more important is the advanced chemistry, so advanced intermediates and CRAMS together is roughly at around 30% contribution. Our base case scenario is that even when we touch Rs. 500 crore, 30% is still this advanced and CRAMS. Again, our criteria for selection would be where we have better margins, sometimes like I said even the product business, if we have done some innovation have better margin, so in our model or in our projection, we keep it at 30% numbers, of course if CRAMS kind of improve or if we have good opportunities either there, we will look to improve it. In my R&D as of now, lot of products that we are doing are more like advanced intermediates and CRAMS, so in my new product pipeline, there is a higher weightage on advanced intermediates and CRAMS. If that gets translated within 3 years into real products and business then it may increase, but otherwise the present mix at least should continue even at the Rs. 500 crore level.
- Moderator:** Thank you. The next question is from the line of Nav Bhardwaj from Anand Rathi. Please go ahead.
- Nav Bhardwaj:** First question is on the inventory number that we have shared around Rs. 14 crore, can you give the split of how much of that is in finished goods stock?
- Harin Kanani:** From the Rs. 14 crore, the finished good stock has actually decreased by around Rs. 2.3 crore and the majority increase has come from the work in progress and now basically for us, majority of what we call as work in progress is also very close to finished good stage. What we like to do is that for our products where we have multiple customers, we like to keep the inventory close to different customers by different specifications, so we will try to keep it at WIP level where it is purified but only the final blending is remaining so based on that.
- Nav Bhardwaj:** Next question would be in the variation in gross margins, is there predictable pattern to it because of the product mix change as you pointed out that in Q4 we wanted to be more towards inorganic and Q3 it also changes, so is there a predictable pattern to it or?
- Harin Kanani:** Do you mean on a quarter to quarter basis?
- Nav Bhardwaj:** Right and for the full year as well.
- Harin Kanani:** So for the whole year, what we have seen is, historically if I look at Neogen's balance sheet, it has been in the range of 57 to 61%. I am giving you a very broad range here, over 5 or 10 year kind of a period. I have not tracked quarter to quarter honestly previously, but as a whole, for the whole year, it has been in the range of 57 to 61%, most of the years being between 58 to 60%, so there have been times and I think the number of

products that we do, so we do almost like, though we have 198 products, we have almost 50 products which are at a significant level which we are doing and each one has its own dynamics, so for example, lithium prices in between had increased a lot, so our gross margin there had reduced because while our margin was protected and slightly improved but the gross contribution was more. Similarly, when we moved from our Mahape to Vadodara facility, while we started doing more advanced intermediates, in the bromine derivative, we started doing more of slightly higher volume molecules which we could do once we had the Vadodara capacities, so it is the combination of all these things which is causing this fluctuation, but we have more or less seen that it has stayed within this range so far.

**Nav Bhardwaj:** Also, a follow-up on the same lines is that the pass-through mechanism that we have is it on the percentage basis or is it on absolute per ton basis with the customers?

**Harin Kanani:** Honestly, a fully formula driven pass-through mechanism what we have is on the lithium business and that is where it is on an absolute basis. Of course, there are some part of it which are also linked like, for example, if you are giving credit or inventory cost there that we keep in our model, in our formulas they are again driven on the value basis, but our manufacturing cost and our, let us say, our PBT level margin is on an absolute basis. Having said that we try our best to see how this can be improved. Most of the others is like upward negotiation, so it is not like a formula, it is more like on an yearly basis we discuss with our customers and what we have seen is of course, we get what is the absolute increase of the raw material we are able to pass on and we also try our best to see if we can maintain the percentage, so it is the combination of both.

**Nav Bhardwaj:** Last question being, you almost shared that the last quarter for the reasons you stated we should see uptake in the sales volumes, also will there be an uptake in the EBITDA margins like it happened in Q4 FY19?

**Harin Kanani:** So the EBITDA margins to some extent increased because lot of profit, you know the way the inventory booking goes, the inventory is booked only at cost and that is only at manufacturing cost, so when we sell this inventory and generally in Q4, large amount of this inventory also, Q3, Q4 when this get sold, so when we sell more that gets booked, so that is the reason why you see it higher in Q4.

**Nav Bhardwaj:** A similar repetition can be seen in this coming Q4 as well?

**Harin Kanani:** Yes, so again we would expect like you know if we are able to repeat like last year higher sales in Q4 that will result in slightly better EBITDA margins and again my request would be that what we have done so far at 18.5% of last few years, I would say for whole year also, I would keep a range between 17.5% to 19.5% is what we would like internally to be in.

**Moderator:** Thank you. The next question is from the line of Manish Gupta from Solidarity Investments. Please go ahead.

**Manish Gupta:**

I have three questions, the first one is, you mentioned in your opening comments that the demand environment is very favourable, can you talk a little bit about how much of this you think is structural vis-à-vis your short-term tailwind and how much of this improvement in demand environment is caused by issues in China?

**Harin Kanani:**

I think when we said that better environment, we were saying as compared to the same quarter last year, we have already seen the improvement that we did in third and fourth quarter and also this was partly driven by the fact that we had capacity and we had enough customers for that, so it is the same continuation, so let us say if you are comparing to previous quarter, there is nothing new which has happened. This is the continuation of the demand. We still believe that our business is driven by capacity availability, so even in this quarter all my plants were at 80% or above utilization which is like the best utilization for our kind of multi-product batch-manufacturing corrosive chemistry, so I think that is the major driver.

To answer your question, of course it has helped us that some of the competition has had issues, but I think majority of this demand was mapped, it was latent, it was always present as we also have let us say for example, for our Rs. 500 crore, only of course with the issues with China was having, it became that much easier for us to capture it in a very short time without compromising on our margin. That is the only benefit. The other thing which I would like to say that while there is some specific only for now kind of opportunities available, for example there is very large inquiries that we get from China, but we are not even considering that because our goal and our focus is what is sustainable, what over a period of time can give us margins on a consistent basis and this is what we are choosing when we are doing business specially when our capacities are limited.

**Manish Gupta:**

Second question, is that you mentioned that overtime, the share of your business which is downstream is increasing, but if we look at financials over the last couple of years, one is not seeing any noticeable uptake in gross margin, so if the business is increasing, more share of your business is coming from downstream, should we not see some incremental gross margin improvement overtime?

**Harin Kanani:**

So three points in this. As I answered earlier to Nav's question, we have I would say broadly three segments, one is the lithium, second is the organobromide derivatives and third is what I called as this advanced intermediates, CRAMS also included as part of that. So like you know while you have more advanced intermediates coming in, you also had lithium prices which had gone to historical highs. Also, within the bromide derivative business which also has increased significantly, when we were in Mahape, we were doing organobromide where the worldwide demand was, let us say, 100 to 200 metric tonnes and in the new site, we had gone to some molecules which have a worldwide demand of 1,000 to 1,500 metric tonnes, so they also have slightly different gross margin ratio, so it is a combination of these that while this is coming in, the others are also happening. Having said that, not all advanced intermediates mean that they have a lower GC, so I mean it again varies from molecule to molecule and

my actual take which I keep repeating is wherever we have done innovation, we see the gross margins are significantly higher and the raw material cost is lower, so it is more the innovation which drives this and the better product mix which drives this.

**Manish Gupta:** This brings me to the next question that you know you are guiding for an EBITDA range which is plus, minus 1% from where you are, I am not interested in next quarter or the next year, but as long term investors, we are looking at where the business is going, right, so if overtime your business is becoming more downstream, you are investing more in innovation, overtime shouldn't these margins be creeping up?

**Harin Kanani:** Manish, our target and desire would be to improve the margins, I mean one of the reasons why we like advanced intermediates is it will give us the opportunities to innovate more because when we are doing a single organobromide it is just a one step, two step kind of chemistry whereas as opposed to that if we are doing a 4 or 5 steps phase chemistry or let us say molecules which are ranging from \$20 to \$100 kind of range as opposed to \$7 to \$15 range, this gives us more opportunities for innovation, so this is what is basically our desire that through this innovation, how our next 3 years. As I mentioned, even for Rs. 500 crore, our target is to at least maintain the existing 30%. We may do better than that. You know if you are able to transcend and make this innovations where we have higher opportunities and then increase this business to advance with innovation and make sure that we get better returns, so while our target would be to cross 20%, so far I have not yet reached that kind of a change where I can ask you or tell you to have a guidance like that. So I would still keep my guidance between this 17.5% to 19.5% range, yet there is a potential for changing it, there is a potential for increasing but so far we have not done that or till the time I have the exact final product mix which I will have in FY22. It is kind of too early for me to tell very confidently that yes, this will be a 20% plus kind of business.

**Manish Gupta:** And my last question is, can you talk a little bit about your philosophy on how you think about capacity creation because clearly you are seeing a strong demand environment, one can see the confidence in your statements, but you are also, I guess looking at or you think about your debt, so how do you think about incremental capacity creation because I don't want to put words in your mouth, but it would appear to me that you will sell out your capacity that you are creating right now by FY22, so will you be in constant capacity creation mode and how do you think about the balance between seizing the opportunity in front of you but managing risks?

**Harin Kanani:** Yes, so this is kind of what we are currently doing in Dahej, it is going to be our first kind of Greenfield tailor made as per our desire kind of a plant because as I mentioned earlier, Mahape started in 1991 and the Vadodara site also we acquired from somebody, so there were already some restrictions that we had to do. Also as you have seen that we are growing very fast, so when I am thinking of capacity increase, I am not only thinking of the additional capacity but also ensuring that we have the right set of system and right set of manpower and people to basically support this capacity. Both our Dahej as well as Vadodara site have a lot of land

available for further growth. Each one can do at least Rs. 1,000 crore kind of business individually, so as soon as we are confident that for example, now once our capacity of what we need for FY22 business has already come online or is like close to coming online, we have a very firm commitment, I mean we can start talking to customer closer to that and once we have very firm commitment or very clear visibility, we will definitely consider our next capacity expansion also simultaneously, so as soon as we are 100% confident when the capacity is coming online and we have good commitments also from our customers for that. That time we will continue to grow and yes, we will keep continuing adding capacity as we go forward.

**Manish Gupta:**

And is there a lead time we should think about like after you set up Rs. 500 crore to go from, say Rs. 500 crore to the next incremental, what is the lead time it takes to set that up?

**Harin Kanani:**

Any incremental manufacturing block would roughly take 18 months from the time you break grounds, so let us say between 12 to 18 months depending on how efficiently you can get it done and the complexities involved in that project. Now, let us say, for example, by the time we are in FY21 and again it is too early to say, but once we are confident we can make the decision for the next CAPEX. From that time, it will take about 18 months.

**Moderator:**

Thank you. The next question is from the line of Ashish U from InvesQ. Please go ahead.

**Ashish U:**

Just wanted to hear from Mr. Surana as to the progress on the CRAMS part and how does he see the opportunity unfolding over the next few years, so just wanted to have a feel of whether this is a big enough growth driver for the company and how are plans for this?

**Anurag Surana:**

As Dr. Kanani has been mentioning, CRAMS is a focus area for Neogen. The overall opportunity in the CRAMS segment has been growing. There are more and more innovator companies in Europe and Japan which are looking to outsource and India seems to be one of the preferred destination for molecules which are innovation and knowledge and technology driven, so in that sense Neogen fits right into the scheme. We are a company which focuses on innovation and knowledge chemistry, so we do see lot of opportunities coming in our way in the CRAMS segment, the advantage in the CRAMS segment being better visibility of business, stable margins by pass-through of costs and so on, so it will form a kind of a large base for Neogen and being multistep chemistry will give us more opportunities to innovate and improve our margins.

**Ashish U:**

What is the level of connection that you would have got with your customers over the last few years that you have developed this business? Can we say that this is kind of at advanced stage as to picking up from here to make a material difference to the overall business for the next 5 years? I mean any qualitative or quantitative comments would help, just trying to understand whether it can be big enough in the next 5 years?



**Anurag Surana:**

We have already made a beginning, in CRAMS business always there is a long gestation period, so we have kind of lived through that gestation period. There are couple of projects which are already commercialized. We have few projects in the pipeline, I mean few of them are in the advanced stages of R&D, one or two are getting into the R&D stage where we are doing the quality validations and process validations with our customers, so we believe that over a 5-year horizon, the CRAMS business could form a reasonable percentage of our business. I mean clearly that is one of our strategies and objectives to make CRAMS as a reasonable percentage of our business, but we are in an initial stage and I won't hazard a guess on how much percentage would it become, but certainly it would be a noticeable percentage in our business.

**Ashish U:**

Mr. Kanani, just wanted to understand because your comments have been pretty confident in terms of the business that if we would garner, any risk that you would point out as to the story entirely as you see playing out anything that might create a problem which would be visible to you, may be, what can go wrong basically?

**Harin Kanani:**

I think we spend a lot of time in ensuring that as I mentioned earlier, when we are growing, we are growing with the right support and infrastructure in terms of people, IT, etc., so this is one thing that we need to make sure that we do it right, that the organization runs smoothly and as efficiently as it had before.

The second thing that we want to basically ensure is a very good compliance on EHS levels within Neogen; however, as we have seen in China, sometimes we have seen that even if you are doing okay sometimes what your neighbour does can be a challenge, but this is something true for all specialty chemical companies, so this is what is the regulatory standpoint or what is the people's view standpoint with regards to handling these chemicals, so this is two and third is while we believe that China there is a major correction now and most of the time, even if some of the capacities which were polluting or not good have been shut down, even if they come back online, they will not be allowed to cheat and they will be at the same level or cost and compliance as us. There are always times where China has come back and surprised people. We have had cases where sometimes they are just not rational and they would do business even at loss, so something like that happening, so these are the 2 to 3 things which I think of in terms of the potential risks or potential things I would worry about.

**Moderator:**

Thank you. The next question is from the line of C Shrihari from PCS Securities. Please go ahead.

**C Shrihari:**

Firstly, to understand your business a little better, I would like to know what is the composition of unique products in a total basket in the sense, products which don't have any competition from other lines like chlorine may be and secondly in your pipeline are you targeting any products which would basically try to target, let us say these chlorine lines or whatever which are suffering from toxicology related issues and on the number's front, basically you have mentioned that CRAMS and allied accounts for



30% of revenue, so is the profitability profile significantly different from the other business?

**Harin Kanani:** Just to clarify, you asked something related to chlorine based molecules?

**C Shrihari:** Yes, I said I mean let us say if you have a bromine product, so I presume may be you may have a chlorine competitor, so any such, I want to know what is the share of totally unique products, I mean you don't have any substitutes at all?

**Harin Kanani:** First of all, we are specialized in bromine chemistry and while making few molecules along with bromination, there is also need for chlorination, so we do this bromine or chlorine kind of molecules but we are not as a company focused or specialized only for making chlorine based molecules or we don't have a strategy where we say that we want to make bromine or chlorine in case of a replacement or something like that. I think when you said may be in terms of the usage, the product that we are making can that be used either as chlorine or as bromine, so most of the time the decision whether chlorine derivative gets used or the bromine derivative gets used, gets done at R&D stages when my customers are making their synthesis strategy. It is very rare that once it has come into commercial and once it has been made on a regular basis, not that it doesn't happen, but very rare for a customer to switch completely from bromine to chlorine, so in our strategy we are not looking at chlorine based molecules. In terms of unique products, I don't understand exactly the definition of unique products. I mean majority of the molecules we make are made also by others, at least one person, but there are few molecules where we have done innovation, where we have let us say may be 18 to 19% of the market share of the world (1.02.22). Again these are specialities, so each molecule is not very big, but there are few products but I am unable to quantify how much percentage of business comes from that.

**C Shrihari:** And your pipeline, do you have any products which can be a substitute for an existing product?

**Harin Kanani:** No, I think majority of our pipeline is driven by either new patented molecules which are going to be commercialized which are going to require this brominated derivative or some advanced intermediate of that or we have some molecules which are going to become generic, so we had not made for the innovators but the generic customer have requested us to make the molecules. This is majorly our pipeline, this is not more like substitution of the product A with the product B, but more like new things which my customers are doing for which they require.

**C Shrihari:** Then the second part of it, what will be the difference in percentage, the profitability profile for advanced intermediates and CRAMS and the rest of the business?

**Harin Kanani:** First of all, we don't give segment-wise margins due to confidentiality purpose, but as I mentioned earlier also in my call, we believe that majority of the times the better margin comes from product where we have done

innovation or we have done something unique in terms of either a good process or a good quality or a very early registration with lot of customers and being in the DMFs long before, so these are the things which ensure like better margins as opposed to a lithium or a bromine or advanced intermediates as a category as a whole.

**C Shrihari:** And any specific therapies that this bromine compounds find application?

**Harin Kanani:** It is wide ranging, so it gets used in antibiotics, it gets used in anti-heart drug, BP control, it gets used in cholesterol control, it gets used in urinary tract control, it gets used in asthma based, it gets used in epilepsy drug, so there is a very broad range because these are the building blocks and once my customer has used my bromine derivative, the bromine is actually out of it and what the bromine is attached to is what gets delivered in the final molecule, so that is why they are more like facilitators to make the APIs and therefore they don't have a very specific therapeutic class to which they will apply.

**C Shrihari:** Just to take this forward, I mean the pipeline that you mentioned about 5 therapies, so which will be the key one?

**Harin Kanani:** No, these are the therapies which I said all my existing molecules, the pipeline also includes agro intermediates for new innovator molecules or pharma intermediates for again different therapies, so there is no therapy-based selection or a criteria. We look at each individual molecule, we look at that particular molecule's potential and we take a judgement based on that.

**C Shrihari:** Any big opportunity? I am basically trying to get some lead, so?

**Harin Kanani:** All are big opportunities which we are trying to pursue in our view of things, so as I mentioned you, we had 4 years ago only one molecule which was more than Rs. 10 crore which was a lithium bromide. Now we already have more than 6 or 7 molecules and now we are also trying to look at molecules which are even bigger business potential than this as we go forward.

**C Shrihari:** Rather from your sales point of view, I mean to say, let us say so called blockbuster products, would any of those be requiring your products in the pipeline?

**Harin Kanani:** I am not sure exactly, I have not mapped that way because the pipeline whether the final molecule is going to be, many of them are innovator molecules so whether they will be blockbuster or not will come to know only once they are launched in the market.

**C Shrihari:** The ones going generic?

**Harin Kanani:** No, nothing that stands out.

**Moderator:** Thank you. The next question is from the line of Dhavan Shah from ICICI Securities. Please go ahead.



- Dhavan Shah:** I mean you mentioned that in the second half, one of the major factors which is driving sales is the accelerated depreciation, so I just wanted to understand one of the growth drivers for the second half is the AD benefits which is driving the lithium in the inorganic chemical sales, so do you foresee any risks, I mean the AD benefits can be reduced over the period of time and if that happens then is there any risks to the realizations because I think the issue was there in the wind sector, the AD benefits was reduced from 80% to 40%, so I mean wind sector has some other concerns as well, but do you foresee anything in your sector and what is the AD rate right now?
- Harin Kanani:** This depreciation rates which are additional depreciation benefit of almost 100% is given to my customer's customer when they buy and install these machines, so when they make a choice, so now we are discussing basically what is the drivers for my customer's business in this vapour absorption machine, so there are 2 or 3 drivers, one is that they are basically non-polluting, so there is no gas which goes and there is no greenhouse effect to them whereas these are liquid based cooling machines, so these are the machines which are made by companies like Thermax, Voltas, Kirloskar, etc., so they are the ones where there is benefit. This is one of the benefits of this machine.
- Second is they can recover the waste heat, so if somebody has a waste heat available, their energy bills can go down by 40 to 50% by recovering the waste heat recovery for cooling purpose and the third is the depreciation benefit that they get, so I don't understand, actually my customer's business or my customer's customer prioritization well enough to tell you that how much significant portion is the depreciation benefit.
- Moderator:** Thank you. Ladies and gentlemen, this was the last question for today. I now hand the conference over to the management for their closing comments. Over to you, sir.
- Harin Kanani:** Thank you for taking time to join our call, I hope we were able to answer all your questions. Should you have any further queries, please feel free to contact our investor relations team – CDR India and we look forward to connecting with all of you again in next quarter.
- Modérateur:** Thank you very much members of the management. Ladies and gentlemen, on behalf of Neogen Chemicals Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

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