Neogen Chemicals Ltd.
Q3 & 9M FY20 Earnings Conference Call
February 10, 2020

Moderator: Ladies and gentlemen, good day and welcome to the Neogen Chemicals' Q3 & 9M FY20 Earnings Conference Call. 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. Shiv Muttoo of CDR India. Thank you and over to you, sir.

Shiv Muttoo: Good afternoon, everyone and welcome to Neogen Chemicals Limited's Q3 & 9M FY20 Earnings Conference Call for Investors and Analysts. The call has been hosted to discuss the third quarter financial performance and share 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 and Mr. Mahesh Tanna - Chief Financial Officer.

We will commence the call with comments from the Management Team, post which we shall open the call for Q&A Session where the management will be glad to respond to any queries that you may have.

At this point, I would like to highlight that some of the statements made in today's call maybe forward-looking in nature. The actual results may vary from the forward looking statements made. Detailed statement in this regard is available in the 'Neogen Chemicals Q3 & 9M FY20 Earnings Presentation' which has been shared with all of you earlier.

I would now like to invite Dr. Harin Kanani to commence by sharing his thoughts on the Q3 FY20 Financial Performance of Neogen Chemicals, strategic progress made by the Company thus far and Management's long-term vision.

Dr. Harin Kanani: Good afternoon, everybody, and I thank you all for taking out time to join us for the Q3 & 9M FY20 Earnings Conference Call. I am sure all of you would have gone through the Results Documents which we have shared earlier on our website and on BSE and NSE.

Q3 FY20 was another quarter of strong performance for Neogen Chemicals that was driven by volume growth on the back of higher utilization of existing capacities. Here, I would like to highlight that in Q3 last year, we had seen an expansion of production after the maintenance work was carried out at the Vadodara facility and overall plant efficiency has been ramping up in that quarter from lower levels in H1 of last year. The encouraging performance demonstrated during the quarter was as per plan based on sustained demand from a range of clients in India and internationally from a wide range of Bromine and Lithium-based derivatives products manufactured by us.

Overall, in the first nine months of this financial year, revenue was up 40%, and profit after tax was up 74%, signifying strong momentum from a range of corporate initiatives.

Now, I would like to share with you an update on the Greenfield expansion project at Dahej SEZ. I am happy to report that the inorganic lithium facility at Dahej SEZ, Gujarat has now come fully online and regular commercial production has been initiated on schedule. As indicated previously, our inorganic production capacity has now doubled, and we have also created space that in future if we need we can further expand in the same manufacturing block subject to continuing international demand from customers. We recently had our first international Japanese customer visit to the plant, and I am happy to share that they have provisionally approved the facility and already placed PO for the first consignment. We look forward to seeing the first billing from Dahej SEZ in this quarter which is a new location for Neogen Chemicals and further diversifies our manufacturing base. Our organic product facility expansion is also coming up at the same location in Dahej SEZ, construction activities have already started and it is expected to be commissioned towards the end of FY21 which will once again double the organic production capacity.

Now, I would like to briefly provide you with an overview of Q3 FY20 financial performance. During the quarter under review, we delivered another healthy top line growth performance of 30% to Rs. 82.3 crore which was driven by higher utilization levels. This was supported by 23% revenue growth in Organic Chemicals at Rs. 70 crore while revenue from Inorganic Chemicals almost doubled at Rs. 12 crore. EBITDA expanded by 54% to Rs. 16 crore, translating to EBITDA margin of 19.4%, higher by 290 bps in the same period last year and slightly higher than previous quarter. Our margins have been expanding on a Y-o-Y basis on the back of revenue growth, higher capacity utilization, better efficiencies on economies of scale as well as tighter control over operating expenses. As a result, profit after tax came in at Rs. 8.2 crore, higher by 91%.

As we look ahead, Neogen Chemicals is best placed to capture the ongoing growth opportunities present in the end user industries, given our expertise as well as wide portfolio of products. This will also be bolstered by our focus on Advanced Specialty Intermediates as well as increasing the contribution from Custom Synthesis and Manufacturing portfolio. We remain on track to deliver better performance in the next year, backed by revenues from the expanding inorganic facility at Dahej SEZ as well as de-bottlenecking initiatives at the existing plants. Our performance will be further enabled by upcoming organic expansion which will come in towards the end of the next financial year which will be the main driver for FY22. All in all, we are excited with the business momentum and remain confident on executing the growth opportunities.

That concludes my opening comments on our performance and outlook. I would now request the moderator to open the forum for questions from our 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 Nav Bhardwaj from Anand Rathi. Please go ahead.

Nav Bhardwaj: My first question would be regarding Dahej SEZ unit which is coming on stream, what would be the effective tax rate going ahead in the coming quarter and the years ahead?

Dr. Harin Kanani: In the next financial year, we will mainly see revenue coming from Inorganic Chemicals segment which is going to come from Dahej SEZ and even if we take 50% utilization it will be around Rs. 20 – Rs. 30 crore, so roughly close to around 8% or 10% of revenue which will be coming in from Dahej SEZ in the next financial year. So, by next year, there will not be a very significant change in the tax rate, but in FY22 and FY23 when we also get the organic revenues coming in from there, the tax rate may become lower than what it is currently existing.

Nav Bhardwaj: What would be the current debt in our books?

Dr. Harin Kanani: In terms of long-term debt, it is about Rs. 30 to Rs. 32 crore which is basically what we have used for upgrading capacities in Vadodara and in Dahej SEZ for setting up the inorganic plant., Working capital utilization is about Rs. 84 to 85 crore. That is around Rs. 114 crore total debt.

Nav Bhardwaj: Any plans of repaying this in the near future?

Dr. Harin Kanani: So, in the next year, for our organic capacity expansion, the term loan will increase, so long term debt will increase in the last quarter as well next finance year. In terms of working capital, depending on the improvement we see, because the business is likely to increase over next two years, working capital requirements also will increase and depending on final working capital cycle, I think previously also we had given in one of the conference calls a range between Rs. 150 crore to Rs. 200 crore by FY22. So, this is where we are currently looking at. Of course, the existing term loans we will start repayment. So, that we will keep repaying starting June of next year which was taken for Dahej SEZ and Vadodara CAPEX. Hence, that repayment will start and that portion will decrease. But overall I think there will be an increase.

Nav Bhardwaj: Also, in terms of volume growth, can we share a split between organic and inorganic, how did we do this quarter?

Dr. Harin Kanani: So, I think we have given a revenue-wise break-up between organic and inorganic. In terms of rates, as we had already shared in the last quarter, the lithium prices are softening a bit. But wherever we do not have a contract or any new contract, that we are getting into, the realization per Kg are going down in line with the lithium prices globally going down. In case of organic, because these are more long-term pricing and there has been no specific movement. For the same product, there has been no specific, very significant trend in realization in organic. It is more or less the same in terms of per unit or per Kg rates.

Moderator: Thank you. The next question is from the line of Sudarshan Padmanabhan from Sundaram Mutual Fund. Please go ahead.

S Padmanabhan: My question is on the capacity utilization in the Organic Chemicals. One is if you can tell us where are we running at, I mean, Rs. 70 crore is something that is chock-a-block, where is the headroom for growth and even as a business, is it a possibility that you can actually utilize the capacity better in terms of focusing more on higher value, lower volume products so that the realization improves and hence the growth can be seen in the Organic business?

Dr. Harin Kanani: We basically consider anything above 80% utilization in organic as over utilization or peak utilization. So, we have been basically running at above 80% ever since Q4 of the last financial year, this is almost like four quarters in running where the utilization levels in organic are above 80%. From a quarter-to-quarter or month-to-month, it ranges from 80% to 85% and we sometimes are able to get months with even 90% kind of utilization. So, it is broadly in that range. Yes, this is more or less like peak utilization levels. We do have within this option where we try to do one molecule which is having better per reactor revenue potential. So, we do take that into account, however, for us, supporting customers who have been with us for many years and those relationships and the new customers which are going to be key molecules for our Dahej SEZ organic plant are priority. So supporting their requirement, that is slightly more important and we give priority to that as opposed to just saying how we can get the maximum turnover from the existing site.

So, there is some optimization and we keep doing that internally. Actually the improvement that we expect still is mainly from trying to de-bottleneck or increase our efficiency of production. Of course, some of the molecules which we feel have better margin potential in future or better turnover potential for a given capacity, these R&D products they are coming online, because again these are seeds, this is like a growing a plant and you need to support the plant when it is growing. So, similarly, these businesses will be given priority and based on that sometimes you may see some molecules which have ultimately large potential but not so efficient, require higher capacity for making the same turnover. We may even do that. So, this is the range what we currently have. So, around Rs. 70-odd crore turnover that you see is more or less plus or minus few crore you will keep seeing till we see a very big increase which will come in organic in Dahej SEZ.

S Padmanabhan: If I look at the working capital across both the businesses, with the inorganic moving up next year, how does that change the working capital cycle, do you think with the new Dahej coming up there would be some kind of release as far as the working capital cycle is concerned, so, how was it?

Dr. Harin Kanani: So, we may have some improvements. Mainly as we had mentioned, once Dahej organic comes up, this is where we will see the working capital cycle and especially the inventory days improve, because then we have some relief from capacity constraints. And the other point being that if we are able to fill the Dahej facility with larger molecules each molecule having let us say Rs. 25 crore, Rs. 30 crore, Rs. 50 crore kind of business wherein we can then have dedicated reactors, this is what we expect. So, I think again because of several feedback that we have received, we are trying to improve the working capital cycles, but structurally we will get help in FY22 once the organic capacity comes online in Dahej SEZ.

S Padmanabhan: With this inorganic capacity coming in and a little bit of a chock-a-block on the organic side, what can be the kind of growth which one can look at in FY21 because I think until FY21 fourth quarter, you might not see the organic business coming in and lending in the kind of volumes that is required.

Dr. Harin Kanani: So, I think basically the driver for growth next year will be one, how much we are able to use the inorganic and this will be new customers that will be coming in, so, one is how much will be that. The second will be within our organic either doing de-bottlenecking or some product optimization or some of the new molecules which we feel have better efficiencies or productivity coming online, so, that will be the second driver of growth. We have some number in mind because we preliminary froze our budget, but internally we decided that we will have a better clarity by May. So, maybe during next conference call, we can give you a better guidance for what can be the number which we can hit in the next financial year.

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

Manish Gupta: Dr. Harin, could you talk about how the opportunity or how customers are looking at Neogen, has it changed from the last 24-months or so because compared to the last 24-months, you have more facilities now, your balance sheet is far stronger. So, can you give some flavor about how customers are seeing you today vis-à-vis how they did 24-months ago?

Dr. Harin Kanani: The 2-3 trends which I have seen with the customers and this is a combination of what you mentioned, also overall the dynamics that, the international customers are looking to have, more presence from Indian suppliers, and also the team that we are building, that has had their previous customer connect. So, combination of all of these is that we are working now more with innovators both in agro as well as pharma space, we are getting opportunities for molecules, which are very new, just about to register or in case of pharma about to get launched after phase-IV. So, either at the key starting material level as well as at under CSM, Custom Manufacturing of Advanced Intermediates. Also, they are more willing to try with us with higher value molecules. So, I have shared most of the molecules are between $7 to $20, $25 range, and the new ones can go as high as $100, so we are working on several molecules which have a value more of $100, $200, so these kinds of higher value products. More new customers come in that range. I have seen them giving us more opportunities to get involved in this project and also more confident to give us multi-stage higher value molecules. Everything that you mentioned and a few additional points, which I added are the ones which are the factors behind that.

Manish Gupta: So, can you also talk a little bit about how pricing works in your business? Some of the stuff that you are doing is still in early stage, I guess, it might be a bit sensitive. So all of these, what return on equity or return on capital do you think the business that could evolve to say five years down the line?

Dr. Harin Kanani: So far, we had mainly focused on where EBITDA percentage should evolve too. I have not yet made ROE or ROC kind of calculations, 5 years down the line. So I will not be able to comment on that. But basically as we have shared earlier, our operational efficiencies will improve as we do scale and many other ability to negotiate, ability to purchase, these are the things which will improve as we scale up and as more and more production comes out of the Vadodara and Dahej, where we have the bulk bromine handling kind of facility. Ultimately, how much in these 5 years we are able to innovate. I again keep stressing that, finally, it is our ability to innovate which will drive because there would be many people who can make the same molecule or who have organic production facility. But when we do some innovation, we do some improvements over our existing customer demand, that is what basically gives us a better EBITDA and which in turn will be giving better revenue.

Also, the only other thing which I would like to mention is which we have highlighted earlier that currently roughly Rs. 20 to 30 crore worth of CAPEX is in the form of land because we have a 40-acres land in Vadodara and we have 13-acres land in Dahej SEZ. So, this is the one which is currently non-productive, only land does not produce any revenue. So, as the productive CAPEX increases and the ratio of this productive to non-productive land improves, and as we have targeted with additional capacity available, we are able to also improve our working capital cycle, I am sure the ROE and ROCs both will improve significantly.

Manish Gupta: Do you have any aspirational targets for say 5 years down the line, say fiscal year 2024, what do you think is a realistic number that Neogen Chemicals could deliver on revenue and EBITDA?

Dr. Harin Kanani: I do not have a specific number for 5 years that this is what we want to achieve because I feel that sometimes when you put that number, of course, you are driven by that and then you try to do, but you may also take some decisions just to achieve that revenue which ideally you should not have. So, the way we work in Neogen, our principle is our next step is very clear. And I have also shared earlier that once we are very close to getting this existing CAPEX and organic close to completion where we know and we have all the majority of customer tie-up, we will immediately view the situation and the board and our advisors will together come and we will take a decision of the next CAPEX. So it is very clear that as long as we keep seeing enough opportunities, we will keep doing each CAPEX. I think for us most of the current thought process is, each CAPEX will be one block of Rs. 150 crore to Rs. 200 crore. So, currently we have visibility of up to Rs. 450, crore Rs. 500 crore kind of turnover, whenever we do next block, it will add another Rs. 150 crore to Rs. 200 crore and the block after. Now, will we be able to do two blocks, three blocks, one block? There is no need for us to take that decision now. And every block we will keep evaluating the opportunities in front of us, the risks and the rewards and based on that we will keep taking that decision one at a time.

Moderator: Thank you. The next question is from the line of Kaushal Shah from Dhanki Securities. Please go ahead.

Kaushal Shah: Three questions: One, is our organic capacity delayed by a few months because the last time if I remember correctly, we indicated Q3 or Q4, now we indicating Q1 FY20? The second is you mentioned initially about this new Japanese customer. So, are we kind of actively scooping, because we will have significant capacity addition in one year's time, so what is our scoping with new customers for ensuring that the higher capacity gets utilized? And the third was if you can maybe share some more thoughts on the Advanced Intermediates and the Custom Synthesis and Manufacturing business?

Dr. Harin Kanani: So first question about the CAPEX. So, we had indicated earlier that we expect the organic CAPEX to come somewhere around December 2020 and I think what we have now indicated is that will come towards the end of the year. So basically it will come in Q4 of next financial year. Again, exactly when it will come? We will be able to give you a better guidance once we are closer to let us say maybe the first quarter conference call which will be like around August, so, around August we will have a better clarity on that. But the way currently it looks like, just like our inorganic lithium where we said somewhere between Jan and March the plant will start, and we were able to start early February. So similarly, organic also currently more or less looks like similar timeline but let us say just for the sake of our planning, we have said worst case scenario by March, the organic plant has to start. This is still a bit of a question mark and being a first organic plant that we were setting up we will have a better clarity somewhere around July, August. So, this is on the CAPEX.

About your new customers scooping, two parts; one is the inorganic plant, and the second is the organic plant. So yes, we have been actively talking to potential customers whom we had in mind with which we want to fill this capacity. As I mentioned, this clarity is much higher for the organic because the number of products and number of customers existing as well as potential I have for organic, that is very clear for us and it is much larger. So, this is where we have a much higher capacity and we expect faster utilization in that space. In case of inorganic, earlier also I have mentioned that there are relatively limited products and limited customers, and it also depends on some growth projections of my existing customers. So, this will take some time for us to reach full utilization in the inorganic, but yes, we are already in touch with several of these customers, they will come one-by-one and approve the facility and once they approve, then the business will follow. Also, in lithium currently overall worldwide, the demand has reduced and in some sense a bit of oversupply situation. So, we are watching how this lithium is developing. So, right now the lithium prices are almost half of what they were almost two years ago. So, overall what is the revenue which we can get? So, our original estimate was around Rs. 45 crore to Rs. 50 crore at peak utilization. So, we were trying to target at least 50% to 60% in the first year itself. So, about Rs. 20 crore to Rs. 30 crore coming in from Dahej SEZ with the new customers in SEZ.

Last point was Advanced Intermediates and Custom Synthesis Manufacturing. So, both of these continue to remain, like I have shared with you earlier, more or less around 50% (+/-5%) is organic products, Advanced Intermediates are 30% (+/-5%), and Inorganic, already that number has been shared, is around 18% to 19%. The discussions with customer as I just shared in my previous answer to question that there are more and more customers asking us to do Advanced and Custom Synthesis projects. And in my R&D again, this is what is taking majority of the space, almost 60%- 70% of R&D is dedicated to the Advanced and Custom Synthesis manufacturing space.

Kaushal Shah: Just one directional question, I think earlier in one of the calls, you had mentioned that potentially we can do 30% of the total revenue from this segment. So that is kind of looks likely now or maybe we want to revise downwards or upwards?

Dr. Harin Kanani: So what we had said is that broadly I am saying on an average, we said 50%, Organic, 30% for Advanced and Custom Synthesis Manufacturing together and 20% for Lithium, the Inorganic business, and we said at least a worst case scenario we would like it to be 50%, 30%, 20% and our efforts are to see if we can make more like between the 50% and 30%, if the 30% can increase, so the new addition that we are doing, can we do more of the Advanced Intermediates. So, we are in the same kind of a boat now, that to us 50%, 30%, 20% seems achievable and there are many molecules and customer discussions where the 30% can improve, but this will be basically impacting mostly in FY22 in the business.

Moderator: Thank you. The next question is from the line of Dhaval Shah from GIRIK Wealth Advisors Pvt. Ltd. Please go ahead.

Dhaval Shah: Over a next two year period, your share of business from innovator customers, how would that pan out, currently, how much is it from pharma and agro, and over next two years, once your new facility becomes online by FY22, how would that look?

Dr. Harin Kanani: When we say business is for innovator, what happens is most of the innovators work through Custom Synthesis producers worldwide, I mean, for APIs, especially in the pharma segment. So even now, several of these businesses are happening through the Custom Synthesis producers for the APIs. Now, some of these companies are directly engaging with us and saying, okay, I will get the API made at any place, but I will approve you and you are the guy who will supply at all the places. So, this is what has been changing and some of these people are coming and saying instead of just supplying a starting material, can you give us a more Advanced Intermediates? As I mentioned, if this remains 30%, I think even within the 30%, Advanced Intermediates business also, my expectation is looking at current things, the innovator share will increase, but unfortunately, I have not broken down the business that way. So, maybe we will work that out in our future projections, but we expect the share to increase. I do not have a specific number for you, unfortunately, sorry.

Dhaval Shah: The bromine derivative segment, so, what is the customer profile, just want to understand?

Dr. Harin Kanani: It is both pharma and agro, but when it comes to innovators, it is mostly not directly to the innovators, it would be to the contract manufacturer of the innovator. So let us say Merck or Pfizer would use either Divis or Hikal or some other international companies like them for their API production, so we would be supplying it to them. In Bromine also, there are innovators, but like I said, one level remote from the innovators.

Dhaval Shah: Advanced Intermediates is somewhere where you would be largely indirect to the innovators and bromine would be a mix of generic and the innovator.

Dr. Harin Kanani: That is correct. Even in Advanced Intermediates, there are some generic molecules as well where the Indian pharma industry, we have gone one stage ahead of ours and they prefer it that way. Or that is how we had lost that business sometime in the past, because the customer moved to buying more advanced which we have since developed once we had capacity. So even in advanced, we have both generic and innovator as well as in our bromine derivatives also we have generic and innovator.

Dhaval Shah: On the Agro side, if some innovator molecule is getting launched, so you would have a visibility till next 3-4 years on the customer side that which all molecules are getting launched and when and what we have to supply, is that the case?

Dr. Harin Kanani: So, for some of the new projects that we are working on, we are working with agro innovators, and yes, in that case, they do give us 3-5 years kind of projection. For that matter, even some of the pharma innovators, sometimes even for the starting raw material are directly engaging with us. They are also giving us 3-5 years kind of a visibility of the requirements. But again these are some of the new businesses which we are currently working on, which are more relevant for Dahej expansion.

Dhaval Shah: In the last three years, on the pharma side a molecule which has gone commercial and you were supplying the intermediate, now you are a part of the commercial launch as well. Do you have any molecule in your basket or going forward you are expecting something to do commercial?

Dr. Harin Kanani: Every year we are doing new products, right. So, there are two kinds of major changes which happens, one is when a product becomes generic. So for my generic business, when particular molecules become off-patent and there is a date kind of set for that. So few months before that, the customers stop buying the small trial quantities for approvals and then they start buying the big volumes. So even in my last three years, I have had three or four such molecules which have shifted from just buying for this to buying commercial volumes now. And yes, going forward there are a few lined up which we have targeted for our Dahej where the launches have just happened or expected to happen and the ramp up is likely to happen where the customer is requesting us to basically supply them.

Dhaval Shah: So when a molecule goes commercial, from a lab scale quantities here, say milligram or gram scale, what is the conversion to the commercial quantity demanded by the customer?

Dr. Harin Kanani: So it varies from molecule to molecule and it is always not just from gram scale. So what happens generally our experience says that it starts from gram level as you mentioned, but most of them for their FDA filing at least purchase a few hundred Kgs to few MTs. So, what we see is that already you made that a few hundred Kgs and a few metric tons. In case of generic, most likely once we make for one, there are other customers also who want to file. So we make this few hundred Kg or few metric tonns for several customers and we have seen the range can be from few years, I mean, the shortest can be 2-3 years before launch, sometime I have done molecules

7-8 years at a few metric ton levels before the actual launch happens. So that depends on how big the molecule is and how much in advance the API people want to do the filing.

Dhaval Shah: So the largest batch for you could be 5-tons, 10-tons?

Dr. Harin Kanani: Largest single batch would be 5-tons.

Dhaval Shah: Historically it has been the largest batch?

Dr. Harin Kanani: Yes, my biggest reactor today at present what we had given even in DRHP, is 8,000 liter reactor, and the biggest batch size I am getting is maybe not 5 tons the biggest is 6-7 tons in Vadodara.

Dhaval Shah: In terms of procurement of the machinery for your expansion projects, are you facing any delay, trouble on that side given there is a massive expansion happening by many companies in the domestic market?

Dr. Harin Kanani: So far, we have worked with several of our established equipment suppliers with whom we have been in touch for last many-many years. So, so far we have not had them not giving committed volumes. So, whatever they commit more or less, on time they are delivering the equipments.

Moderator: Thank you. The next question is from the line of Rohit Nagraj from Sunidhi Securities. Please go ahead.

Rohit Nagraj: On the lithium front, you mentioned that the prices have gone down. So, is there any possibility of inventory losses that customers want their product prices to be lower and do we have a per Kg kind of EBITDA or is it a fixed percentage?

Dr. Harin Kanani: So what happened is when these prices were going down, I think a significant thing happened in the quarter in which we just reported our results. But more or less, we had a customer coverage, in the sense we had done back-to-back customer contracts. And even though customer requested a bit that, please adjust for some price. So, we had some cushion, so wherever we had a cushion, we kind of supported the customer like some quantities old, some quantities new. But more or less I think our per Kg profit margin was protected in this particular case which was last quarter.

Going forward, because the speed at which this lithium prices have been changing, we basically advise the customer to go Q-o-Q basis, and we are also trying to cover on Q-o-Q basis, and we will keep some extra for new customers coming in, but nothing which will have a very big impact on the balance sheet.

Rohit Nagraj: On the new molecule front, so normally our organic derivatives or advanced derivatives would form how much part of the final formulations of the molecule, is it a substantial part or is it a relatively smaller part? As you said that you will be supplying to maybe Hikal and Hikal will be further supplying to the innovator who will formulate the product and sell it in the market.

Dr. Harin Kanani: If you look at the market price which is sold or bought to the consumer, our contribution is very-very negligible. At the API level, I think the industry averages around 40% to 50% can be or some cases maybe 60% can be RM prices at the API level. And in that, ours would be one of the raw materials. So, they will have also other raw materials, etc., So, now, depending on the molecule, my guess is, it may be as low as just 1% or 2% of the selling price of the API and as high as maybe 20% or 30% of the selling price, and that changes from molecule-to-molecule, which stage our molecule is, what are the other raw materials, so there is a lot of variability for each product, for each final API application.

Rohit Nagraj: One last question on the R&D front. If could just give us a color on what is the normal spend on R&D? What is the team size? And what have been the products that we have come out in the last few years? What is the kind of product pipeline that we are working on?

Dr. Harin Kanani: So I think as of now, we have about 24-25 people working on R&D. And in our presentation also, we mentioned about 10% is R&D team size. In this quarter, post-December, we also further enhanced this and we also have plans to recruit more in our R&D. So R&D spend in terms of percentage has been in the range of around 0.7%-0.8%. However, I have to say that so far as a company, what actually has also been advised and pointed out by others that we are actually taking only the salaries paid for the R&D team and at the ground level, whatever they purchase the raw material of that. So, we are not apportioning the common utilities or common raw materials or even the initial trials that we do in the plant are not currently considered at the R&D expense. So, I think if we were to kind of consider that, we may be about 1.25% or 1.5%. So, we are also trying to see what is the industry norm in terms of recognizing R&D revenues and then over next year our target is to kind of adjust to that. So, this is in terms of how much percentage we are spending, number of employees.

As compared to what is the pipeline, what are the new molecules which are coming. So what you would have seen in last three years when we have gone from Rs. 100 crore to let us say this year, we had projected around Rs. 280 crore to Rs. 300 crore which more or less we are on track to achieve. So, when we have gone from Rs. 100 crore to Rs. 300 crore, I can remember at least three or four important molecules which have come in the last two years, and, of course, the bulk of the R&D which is done in last two years, will mainly gear towards Dahej SEZ and you will see that come in, in FY22. Just to also give an example of how quickly we can respond. So, we had one customer who came in and who says, look, I am going to have a big launch which is going to come up in FY23 and for FY23 launch, I want some small 20-30 MT to be produced within this financial year. So, we got the inquiry in the month of April, we already did R&D, we already did scale up, and before March, we will also deliver the final molecule contributing 2%-2.5% of our annual turnover. So, sometimes you have to respond to customer needs, and they work like this and sometimes they take longer time.

Rohit Nagraj: In terms of product concentration, say top-5 or top-10 products contribute to how much of our revenues - is it a substantial part of our revenues?

Dr. Harin Kanani: Similar to before, about 50% to 60% for the top-10. But let me see if my team has a more accurate number. Before the end of this call, I will try to share.

Moderator: Thank you. The next question is from the line of Tanush Mehta from Dalal & Broacha. Please go ahead.

Tanush Mehta: I have a few questions. One is, can you throw light on inventory levels overall because as we are planning for a big CAPEX as well, so what are inventory levels as of now? Secondly, the traction and the order that we are getting in organic as well as inorganic business is from agro chemical vertical or the pharma vertical? And I wanted to know how many new clients have we added post the IPO?

Dr. Harin Kanani: So you mentioned inventory levels, then the new industry in which we are targeting and the third is post IPO clients. So, in terms of inventory levels, at present, our inventory levels are overall last year it was around 110-days based on net sales value and at six months and even in this quarter, it is slightly higher at around 112, 113 that days, but by end of the year, we expect again to be closer to 110-days. So, this is the inventory levels we worked at. And I think debtor levels were slightly around 86 days at the end of March 2019, and both at six months and nine months, they have improved and they are a bit lower. And again, depending on how the final quarter goes, we expect to improve on that in this year itself. Inventory days major improvement, of course, efforts are on to build in some efficiencies where we were inefficient, but I think some of the design-based constraints that we have, those we expect to solve by FY22.

Third thing which you mentioned was industry. One of the things which has happened is that the pharma concentration in our business has increased. So up to 2016, pharma was between 50% to 60%, at present, it is around 75%. So, we are trying to give a little bit more push to agro. Of course, the choices on the molecule-to-molecule and what value Neogen can add. But at present in our pipeline, we have several agro projects so that hopefully we can increase the share of agro which is currently around 7% to 8% to about 15% to 20% in that range. This is our desire and target and we will see the results in FY22, how close to that we can get. We keep adding several customers, but unfortunately I have not kept a track of that. So post-IPO exactly how many customers we have added, I do not have the number with me. I am sorry about that.

Tanush Mehta: At the time of the IPO, you mentioned revenue contribution from top 10-20 clients. Is that number possible as of Q3 FY20?

Dr. Harin Kanani: For the top-10 customers for the nine months, the percentage was 46.5%. Top-10 products also have contributed around 60% to 65% in that range for the nine months.

Moderator: Thank you. The next question is from the line of Pallavi from Sameeksha Capital. Please go ahead.

Pallavi: Just regarding the R&D budget, if you could say, which are we focusing more, on organic or inorganic?

Dr. Harin Kanani: Around 90% of that so far is organic.

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

Dhavan Shah: I just wanted to understand about the peak revenue visibility from this new Japanese customer. So you mentioned somewhere around Rs. 20 to 30-odd crore could be incremental revenue from Dahej which also includes these new customer revenue. So can you please share some more thoughts on that?

Dr. Harin Kanani: I will not be able to specifically share the number from a specific Japanese customer because the products that we are into, there are only 2-3 Japanese customers for the lack of confidentiality. But as I mentioned to you, based on the capacity that we have, and based on the discussions we have had with the customer, our target is to add this inorganic around Rs. 20 crore to Rs. 30 crore in that range in organic business in the next financial year because we have now the capacity available.

Dhavan Shah: So, if you do not share the number, that is okay, but what is the overall opportunity size do you foresee if you can share that number?

Dr. Harin Kanani: Totally what we had mapped out is overall around Rs. 1,000 crore or Rs. 1,200 crore were the lithium-based derivative opportunities which we had mapped out. Again, in this industry also there are six or seven overall players. So, how much of that we can get is the question we have to answer. So, the refrigeration industry where we have been the major player in India accounting for almost all of the domestic purchase of lithium bromide by the OEMs, we are trying to now be a second source for companies in Japan, China, Korea, where other OEM manufacturers are present. And these relationships take a bit of time because it is a very key product for them in both in terms of value as well as the performance of the machine. So these customers who approved had already approved our product from our domestic site. Now they also approved SEZ, whereas the other customers we have to start from scratch and we will try to get majority of the approvals in the current year.

Dhavan Shah: Second question is you mentioned that some unused land is available at Dahej, Vadodara too. So, can you share some Brownfield CAPEX per ton number for both inorganic as well as organic segment?

Dr. Harin Kanani: So, I think one manufacturing block of organic which I mentioned earlier, let us say around 125 to 150 meter cube, let us say glass lined reactor volume. So for us that number is somewhere around Rs. 75-odd crore for each one, and that basically can give you a turnover let us say between Rs. 150 crore to Rs. 200 crore. For inorganic, like the manufacturing block that we have invested is Rs. 15 crore, but within this we have a space that with the incremental CAPEX, we can further double So, this Rs. 15 crore is not only to double the capacity, but also create infrastructure that if we wanted to do further double, we can do that in the inorganic plant itself, and that would again be a limited CAPEX of around Rs. 5 to Rs.10 crore

Dhavan Shah: This also can give you two-time asset turn?

Dr. Harin Kanani: Yes, I mean, because the existing Rs. 15 crore is also giving us, like this is not including the land, okay, so the Rs. 15 crore that we currently invested also is likely to give us between Rs. 40 crore to Rs. 50 crore. So, in inorganic the asset turns are usually better, for organic because it requires more reaction time and more controls, etc., the asset turns are a bit lower.

Dhavan Shah: But given that you mentioned that the lithium prices are going down, so still do you foresee that kind of asset turn?

Dr. Harin Kanani: Yes, so we still can see Rs. 40 crore kind of asset turn.

Dhavan Shah: Because of Corona Virus, have you seen some positive or negative impact on your business if you can share?

Dr. Harin Kanani: When I think of Corona Virus, the first thing I really think is that, the world as a whole can resolve this problem quickly, because it is major a health-hazard, not only for China, but the whole world. As of now, I think several of other chemical companies also have mentioned that most of the customers because of the Chinese New Year have already covered or taken care of their supplies up to March or April, and we all are basically watching very closely, all customers to understand what is the impact. We hope that the situation improves significantly very quickly. So, as of now, we do not have any significant positive or negative effect because of the current health problem in China. And majority of our raw materials come outside of China. A little bit also comes out of China except for one product, we have alternate supplier for that. So I do not think there will be any negative impact because of that. And currently I have not budgeted or I am actually not even hoping for a positive impact out of that because my hope is that the problem gets solved very quickly.

Moderator: Thank you. The next question is from the line of Siddharth Mehta, an individual investor. Please go ahead.

Siddharth Mehta: My only question is the comment in your investor presentation about the capacity that was down for maintenance in the first half of FY19 and there is a comment that the numbers for FY20 look better because it was a lower base and that will probably not continue in FY21 because now we are at full capacity. So, could you explain a little bit about what was the growth that was there due to the maintenance having impaired the plant and then what could be the growth going forward now for FY21 with full capacity?

Dr. Harin Kanani: In the last financial year, from June-to-July and mid of August, we had undertaken a major overhaul of our Vadodara unit. As you may recall, the Vadodara unit was acquired by us at the end of December 2016. So, in 2017-18, we ran the plant the way it was, we upgraded the capacity, etc. But the major upgrade what was not allowing us to achieve full utilization was done in this June, July and early August period. So, as you can see, I think the first and the second quarter of that financial year, we had done I think only about Rs. 90 crore, Rs. 95 crore which was roughly Rs. 45 crore per quarter on an average, and in the third quarter we improved and we went up to around Rs. 65-odd crore, the last quarter of the last financial year we did around Rs. 80-odd crore. So, from them except for Q1 which is seasonally a little week, we have been doing more or less close to Rs. 80 crore per quarter, so, the Q4 was about Rs. 80 crore, then even last Q2 was also Rs. 78 crore, and this time we did around Rs. 83 crore. So, this is the capacity that we currently have at peak utilization in organic. As I mentioned in one of my earlier calls, now that we have got the inorganic capacity, even though we know it takes a bit longer for us to get customer approvals and ramp this up, but we are still trying to see how this can be most efficiently utilized so that it can be the driver of growth and internally we are discussing on product optimization a bit and some additional debottlenecking which we can do, which will allow us to give us some growth. While we have a very clear view of FY22 which we have said that we will have a capacity for Rs. 500 crore and we are targeting almost close to Rs. 450 crore in FY22. We do not have very specific guidance for FY21 yet. The big question mark is exactly when the organic capacity will come online. So, as I explained to one of the previous participant, that most likely we will give you a guidance on that after the year is over in our May call. So this is what our internal decision is currently.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to the management for closing comments. Sir, over to you.

Dr. Harin Kanani: Thank you once again for taking time out to join our call. I hope we have satisfactorily answered all your questions. Should you have any further questions, please feel free to contact our Investor Relations team – CDR India. We look forward to connecting with all of you again in the next quarter. Thank you.

Moderator: Thank you very much, sir. Ladies and gentlemen on behalf of Neogen Chemicals Ltd., that concludes this conference call. Thank you for joining with us and you may now disconnect your lines.

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