Neogen Chemicals Limited
Q2 & H1 FY21 Earnings Conference Call
November 9, 2020

Moderator: Ladies and gentlemen, good day and welcome to Neogen Chemicals Earnings Conference Call. As a reminder, all participants' lines will be in 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 to an operator by pressing '*' and '0' on your touchtone phone. Please note this conference is being recorded. I now hand the conference over to Mr. Nishid Solanki of CDR India. Thank you. And over to you, sir.

Nishid Solanki: Thank you. Good afternoon everyone, and welcome to Neogen Chemicals' Earning Conference Call for Analysts and Investors. The call has been hosted to discuss the Second Quarter and First Half Financial Performance of the Company and share the Operating Highlights. Joining us today on the call are senior members of the management team, including Dr. Harin Kanani - Managing Director, Mr. Anurag Surana - Director and Mr. Ketan Vyas - Chief Financial Officer.

We will commence the call with opening thoughts from the management team, post which the session will be open for Questions-and-Answers.

At this point, I would like to add that some of the statements that may be made or discussed on the conference call today may be forward looking in nature. The actual results may vary from these forward looking statements. A detail disclaimer in this regard is available in "Neogen Chemicals' Q2 & H1 FY21 Investor Presentation" which has been shared earlier.

I would now like to invite Dr. Harin Kanani to share his Perspectives. Thank you and over to you, sir.

Dr. Harin Kanani: Thank you, Nishid. Good afternoon everyone and a warm welcome to you on Neogen Chemicals' Q2 & H1 FY21 Earnings Conference Call. I hope all of you are safe and in good health amid the ongoing COVID-19 pandemic situation.

I will commence today by sharing my views on the Financial Performance and covering Key Developments in Neogen Chemicals Ltd., during the quarter under review. I am sure all of you would have gone through the Results Documents shared earlier and also uploaded on the stock exchanges.

Before proceeding further, I would like to take this opportunity to introduce to you Mr. Ketan Vyas who joined us last month as Chief Financial Officer and is on the call with us today. Ketan is a Fellow Member of Indian Institute of Chartered Accountants of India and MBA and has a professional certification in Project Management from PMI, USA. Before joining Neogen, he has had a cumulative 22 years of diverse experience in Finance and Accounts as well as Indian and international taxation.

Most recently, he was Group CFO at Batliboi Ltd and has previously worked with leading companies, such as, Arcelor Mittal Projects India, SGS India, Dow Corning India and Rhodia Chemicals India. He will be interacting with many of you as part of the Neogen management team in future. Along with Ketan, we have made several senior level appointments over the last few quarters to expand our management bandwidth in support of our growth objectives.

Now, continuing with the financial results discussion, in Q2 of financial year 2021, we reported a positive topline performance, driven by favorable product mix and supported by better demand for new products from customers. This came in spite of impact of COVID-19 and some capacity constraints in Specialty Organic Chemical segment. I am pleased to share that we have demonstrated sustained organizational resilience with the dedicated support of the growing Neogen family. Our operations have continued to function efficiently in compliant manner within the framework of the altered work environment. Promising demand visibility across key and user industries has given us the confidence to operate our plants at high utilization levels in a sustained manner.

Revenue for Q2 FY21 demonstrated a growth of 6.3% to Rs. 82 crore. This was supported by 6% growth in Organic Chemical segment to Rs. 67 crore, while 10% growth came in from Inorganic Chemical Segment at Rs. 15 crore. For Q2 FY21, our domestic and export mix stood at 44% and 56%, respectively, which is higher as compared to some of our previous quarters.

EBITDA in Q2 FY21 increased by 5% to Rs. 15 crore, translating to EBITDA margin of 18.8%. Focused initiatives on cost management steered the EBITDA performance which was delivered despite higher costs incurred during the quarter to provide an additional layer of safety for the employees during the pandemic. This is reflected in higher employee cost and other expenses to the tune of Rs. 1.41 crore in the first half of FY21. Profit after tax moderated to Rs. 7 crore in Q2 FY21 primarily on account of higher depreciation in line with the new capacities added and increased finance costs related to Capex done last year. Apart from this, we also had a one-time impact of Rs. 55 lakhs in Q2 FY21 related to IND AS adjustments towards processing fees towards earlier financial loans. Our performance would have shown year-on-year improvement, but for this factor.

As on today, all our manufacturing units are functioning at near to peak utilization level in line with the improved demand scenario other than some downtime related to COVID and some shut down taken for modifications for adjusting new molecules. This is barring the recently added inorganic plant which is also scaling up as expected.

Our organic expansion at Dahej SEZ where we are doubling our reactor capacity is progressing well and is scheduled to be operated by the end of Q4 of FY21 despite the disruption in normal activity over the last few months.

Further, in its Q2 meeting, Neogen board has approved additional Capex of Rs. 55 crore at our Dahej SEZ plant to be executed in FY22. This new round of Capex will expand the company’s organic chemical production capacity to 3,90,000 liters and has the potential to further expand our revenues by Rs. 150 to Rs. 175 crore which will be utilized over FY23 and FY24. The board’s decision to commit to the next round of capacity expansion is based on few long-term contracts signed with two leading innovator companies apart from advanced stages of discussion for long-term engagement with several other companies, which are also slowly progressing towards a stage where we sign a long-term agreement. We expect that the current round of Capex which is likely to come online in Q4 will majorly be captured by these new long-term contracts, which are signed and which are expected to sign in near future. Looking at that, the board has decided for further expansion to set up capacity in FY22 so that in FY23 and FY24 we do not have a capacity constraint. This expansion, we believe, will further elevate our position as a leading manufacturer of bromine-based specialty chemicals, and a reliable partner for contract manufacturing.

Let me conclude by saying that we are well placed to take advantage of the structural position enjoyed by India as a leading supplier of chemical products to global innovators. Our world-class cost-efficient manufacturing backed by focus on innovative process and product development along with our resource readiness, has allowed us to build strong relationships with a growing number of longstanding customers and will translate into ongoing value enhancement for all our stakeholders.

That concludes my opening remarks. 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. We have a first question from the line of Rohit Nagraj from Sunidhi Securities. Please go ahead.

Rohit Nagraj: The first question is on the long-term contracts that you just talked about. What are the salient features of the contracts in terms of the timelines in terms of any visibility on margins. May be the input cost prices go up, and whether we will be sufficiently compensated for the same, and are these facilities going to be dedicated for the long-term contracts or are they fungible?

Dr. Harin Kanani: Thank you. So far, as we have discussed in last few quarters conference calls, Neogen has been working with several innovator companies in Japan, Europe and USA. And as we had mentioned in our earlier calls that these are progressing stage-by-stage. So, from the various companies that we had worked with two, we have signed a five year and a six year contract. In these in some sense, the pricing will fluctuate on a yearly basis depending on the changes in the input costs. So, the understanding is that more or less our margins will get protected, of course, subject to the right utilizations and right operating performance from our side, and the changes in the raw materials will get adjusted on a yearly basis. These agreements also have a minimum requirement, sort of commitment from the customer that they will buy some XYZ minimum quantity over a five year period or over a six year period. And in some cases, there is a more concrete requirement given for the next two years, and beyond that, there is a projection given by the customer.

So, to answer your third point, whether this facilities would be fungible, yes, I mean, when some of these are large multi-stage molecules, so they would have a dedicated facility when the molecule is running, but the configuration is such that we can modify it for other products if it is needed.

Rohit Nagraj: Any value to the contract like five year there will be a revenue potential of some tangible value?

Dr. Harin Kanani: I would like to say that each molecule can be in the range of let us say Rs. 30 crore to Rs. 50 crore or slightly more per year kind of requirement, because, as I said, there is total volume in one case, which is committed and in the other case, they have committed for two years and beyond that, they have just given us a projection, so we have to go with that.

Rohit Nagraj: The Rs. 30 crore to Rs. 50 crore is for both the contracts?

Dr. Harin Kanani: No, individual contracts.

Rohit Nagraj: So, around Rs. 60 crore to Rs. 100 crore for both the contracts on a yearly basis?

Dr. Harin Kanani: Correct. Again, this is a minimum volume, and they can take more than that, but this is the minimum that they need to take.

Rohit Nagraj: And this will start from FY22 onwards?

Dr. Harin Kanani: Yes. I always mentioned that we have R&D, then we have a Kilo Lab, then we have a pilot and then we have the first commercial run. So, the first commercial run, we have already started in this year, which is like a trial and then based on that the multi-year contract, will start from next year onwards. So, we already are doing that and the increase in the export is partly contributed by these two contracts as well, just the first commercial run.

Rohit Nagraj: And the second question is on the incremental Capex that is being announced after COVID at Dahej. So, here we are doing it for the existing molecules or for the newly developed molecules, because you mentioned that the potential of Rs. 150 crore to Rs. 175 crore will be over a period of maybe FY23-24. So, what gives us the visibility that we will be able to achieve those revenues?

Dr. Harin Kanani: As you know, the current organic expansion capacity which is coming in Q4 will increase our capacity from Rs. 350 crore to Rs. 500 crore. So, we are having an incremental capacity of let us say Rs. 150 crore. Now, if I just take these two customers and another five customers, for whom we have completed the R&D phase and now we have either entered the pilot or we are about to start the first commercial run. So, when I just add this, the expectation is over next two years, these customers themselves will together take away the Rs. 150 crore additional capacity that we are taking. So, there would not be any additional capacity available for other new products or for our own products additional business. Most of these which I mentioned - what we are working with innovators in agro and pharma space - they are mostly new molecules and new requirements. So, that is the reason the board felt that come FY23.There was always a question asked even in earlier conference calls, that if you try to achieve Rs. 450 crore in FY22, what is the plan for in FY23? So, there was visibility and we had promised somewhere around November/ December, that is, when either in this meeting or the earlier meeting, we were to decide on our FY23 requirements and hence the Capex to be done in FY22. So, based on these positive developments of the long-term contracts and the interest shown or the projections given by other customers where we have not yet reached the contract signing stage, but the things are moving in a positive direction, we felt that there is a clear visibility for the first Rs. 150 crore. So, we should start creating additional capacity for FY23 and in FY24 it should be available to us.

Rohit Nagraj: How are the bromine prices behaving in recent times, and what is our immediate outlook in terms of the pricing, any demand/ supply disruptions or any other factors which are affecting the pricing?

Dr. Harin Kanani: As a policy, because bromine is a key raw material for us, we get into annual contract for bromine. But this we got into, in the month of let us say April or May, and at that time, there was a slight, I would say around 10% or 15% increase in bromine as compared to the previous financial year. So, that was something which was on predicted lines, because the Chinese bromine capacities keep going down, so the bromine prices are still increasing, and that was the trend which we have seen in the last three to four years. Of course, if it increases too much, at some point of time, the bulk bromine derivatives start pushing it back and the demand goes down. So, there is also a situation where if overall economy of the world goes down, the bulk bromine demand goes down, and again more bromine becomes available and the prices soften. But we do not expect very positive or negative movement on a year-on-year basis in bromine. It will be in that 10% to 15% range depending on the demand/ supply scenario in a given year. Specifically within India, last couple of months, bromine prices have been very volatile and has even increased to 30% to 40%, but that is only for people who are buying spot. Companies like Neogen which have an annual contract, the impact this year was around 10% to 15%.

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

Kaushal Shah: Just wanted a little more clarity on this particular point. We had indicated that the runway was kind of clear for us till FY22. Now that we have got these new customers, what is the kind of visibility that we can see over, let us say, slightly medium-term future, may be three years or so? Also, in addition to this Rs. 55 crore Capex, do you anticipate that we will need more Capex because to the earlier question you mentioned that we will probably not have enough capacity available in case we get new customers? So if you can just highlight on that?

Dr. Harin Kanani: Sure. I think what we have done is we have now decided to add Rs. 150 crore to Rs. 175 crore capacity for FY22. And if this gets fully installed in FY22, you know that in FY23, you have Rs.650 crore capacity available, so, we feel that is a significant capacity available for growth. There is enough headroom for growth for FY23 available to us. Then, in FY22, around the same time, we can go and ask the same question to ourselves. As I mentioned, the optimal time to decide is somewhere around December. So we can take a decision either in November or February. So by November 2021 or February 2022, we will decide, depending on the way the business is developing, if we should further invest in creating more capacity in FY23 to take it beyond Rs. 650 crore. So, that will depend as we go forward. And again, as we said earlier, there is a possibility to increase capacity at both the sites. So, we can keep reviewing these businesses every year and take a decision going forward what additional capacity is needed.

Kaushal Shah: And on margin front, the upcoming orders that we have got or we will start servicing, they are coming at roughly the same margin level or they are coming at a better or a lower level?

Dr. Harin Kanani: At present, I would say they are at the same margin levels. But what happens is these are new molecules for us. So generally, the practice is that as we start working with them commercially over one or two years or three years, we look for improvement. And then when you do that improvement, you share with your customers the benefits of that. So some customer gets benefited. But as I said earlier that especially in these advanced intermediates innovator molecules, there is always a room for improvement because they are very, very new. So, as we will do this improvement, let us say, over FY22, FY23. Once we have done this, two/three years that is where there is a potential for us to make a higher margin.

Kaushal Shah: So, in the earlier quarters, we have guided for Rs. 450 to Rs. 500 odd crore revenue number for FY22. So, I believe now given the fairly clear visibility, we should not have any issues in achieving that number?

Dr. Harin Kanani: These contracts help us get a better visibility of the Rs. 450 crore number. So, I always said, we will have a Rs. 500 crore capacity, but the target was to at least reach Rs. 450 crore in FY22, and yes, these contracts will work towards that guidance as we have a stronger belief at least from a business or the demand side of it to be able to achieve that number.

Kaushal Shah: And one final question on the funding part. Will we be using internal accruals for this Capex or we will be taking on some debt?

Dr. Harin Kanani: The existing enhancement which is currently happening is happening with debt and even for the additional Rs. 55 crore that we have planned, our belief is to go and have a long-term debt for that because we feel that when a company which is growing very fast, it is always good to have long-term investments funded by long-term loans rather than use working capital. If our cash generation is enough, we will have a lower working capital utilization. So, we will be going for a long-term debt for this additional expansion.

Moderator: Thank you. We have next question from the line of Nav Bhardwaj from Anand Rathi. Please go ahead.

Nav Bhardwaj: A quick question. Would the long-term contracts that we are getting right now, you also mentioned that we are post the R&D stage for about four to five more such kind of commitments. Is that a correct understanding?

Dr. Harin Kanani: That is right. So let us say totally we have worked with around six, seven innovator companies, out of which two of them have now already resulted into contracts. And with remaining four to five companies, the R&D stage is over. The R&D samples have been approved by the customer. And at the end of R&D, we feel we are able to meet the cost targets which the customers have given to us. So, we are in a situation where either we are proceeding for a pilot trial and in some cases even pilot is completed and post pilot, the customer is in the process of taking a decision for the first commercial order. So, generally after you do the first commercial trial, where you demonstrate that you can make that molecule at a commercial level with certain efficiencies and can achieve the quality, that is when the customer thinks of getting into a multi-year significant commitment.

Nav Bhardwaj: Great. That throws a lot of light on our earnings visibility, but then leads to a question about our cash conversion cycle and our working capital, because we had earlier mentioned in our call that because of greater capacity coming in Dahej, probably working capital is going to limber down to smaller numbers, because we will have higher capacity for current products. But if the capacity is going to be utilized for other products, which are going to be having dedicated molecules, how are we planning to bring down our working capital cycle in the future?

Dr. Harin Kanani: There are two or three ways to improve. One is, as we start doing these molecules, the single molecule business itself is now more. So our average per molecule increases and while they are multi-use reactors, we can have dedicated reactors running there. And there is a better visibility that we can get from our international customers. As more and more business gets done through these kind of customers and these kind of molecules that help you plan better and improve your working capital cycle. Also, this is the first time, for example, where let us say next year we said, we have a capacity available for Rs. 500 crore, but we are going to try and achieve Rs. 450 crore. So, we have kept a 10% headroom. Similarly, in FY22 itself, we are setting up a Rs. 650 crore, so, let us say going into FY23 and FY24 we will have a Rs. 650 crore capacity against which whatever is the utilization in that given year. So, we will always have that extra room available where we can then have some kind of a comfort on that.

The second area which we worked on and partly you have seen the result that there are three parts. I mean, debtors, creditors and your stock. So, this capacity constraint is with regard to the stock part of it. But when it comes to debtors, again, when we are getting into these contracts also, we are mindful to try to see to have terms where our debtor cycle can improve as we do more business with them. So, that will help us improve the debtors. And what we have done is that since Neogen is into a business which requires longer working capital cycle, we also started working with our key vendors. And these key vendors we have requested if they can give us a longer credit term. So, some of these vendors have responded positively and with Neogen's strengths and now also better visibility in the financial market, and better financial strength as compared to two or three years ago, slowly, they are also giving us a longer credit term, and some of them are able to also get it discounted from their bankers and get the money still faster. So, it is a kind of win-win situation based on Neogen's credibility. So that way the creditors are also increasing. So, higher creditors, higher debtors and then the last part is the stock for which we are trying to take these decisions early on. We have that exact capacity and we are currently not running neck-to-neck. I mean, just imagine my current scenario where we already are onboarding these customers and accommodating their commercial trial production, at the same time, we all know that for last four quarters or five quarters Neogen has been running at already full utilization. So we are already at full utilization level, on top of that, we are doing modifications sometimes to make this new customer molecule, and at the same time we also have some challenges related to COVID and still we are satisfying our regular customers. So, these are the challenges which we currently are facing. And one of the advantages of taking this decision little bit in advance is that we have sufficient time to get this capacity in our next financial year. And then we always have some extra capacity available that if an opportunity were to come, we can quickly grab it. So that is the whole idea.

I had promised in my earlier call that somewhere around December, we will take a call, but luckily, this customer commitment came in, so we were able to convince the board and started a bit earlier. So, we will always keep some headroom available for either additional growth or at least to ensure that we have comfortable operation and we are not always running at full utilization level.

Nav Bhardwaj: Also, the entire R&D has been done by our team in-house, for all these products, right?

Dr. Harin Kanani: R&D, of course, has been done. But like I said, in some of the contract manufacturing projects, the customer's team has done the initial R&D at the ground level, then it has been transferred to us, and then we have done the Kg level and the scale up and now at the commercial plants.

Nav Bhardwaj: Last question on this would be, which areas are we targeting in terms of either agro chemical products or the pharmaceutical products or anything else, if you could comment on that?

Dr. Harin Kanani: If I take this total six, seven innovators with whom we are working, we have agro, we have pharma and the third category I would just say non-agro, non-pharma, so it is different. I will not name the industry, but I would say it is non-agro, non-pharma. So, it spreads across three different industries. Even the first two which I would say as a percentage, agro is on a higher side. So, even the export increase that you see in this particular quarter has been for one of the agro molecules and we have also seen the agro as industry cross 10% and move into 15% in this quarter for the first time.

Moderator: Thank you. We have next question from the line of Bharat Shah from ASK Investment Managers. Please go ahead.

Bharat Shah: Just to capture all that you said in terms of the expanded capacity or plan to expand incremental turnover potential. So, what we are saying is, in the current year, by the time our expansion is through, for FY2022 we would have potentially Rs. 450 crore to Rs. 500 crore capacity. By the time FY2022 is through with the additional CAPEX plan for the next year, the Rs. 55 crore, would have a turnover potential of Rs. 650 crore in the following year. And then what needs to be committed to FY2023, the call will be taken some time towards the end of the next calendar year. Am I right in that understanding?

Dr. Harin Kanani: Yes, you are right.

Moderator: Thank you. We have next question from the line of Dhruv Bhatia from BOI AXA Mutual Fund. Please go ahead.

Dhruv Bhatia: A couple of questions on the contract. The two contracts that you have won, are these contracts for advanced intermediates, are these contracts for CSM or could you just clarify that?

Dr. Harin Kanani: CSM mostly is advanced intermediates. Advanced intermediates we basically break down as our own advanced intermediate or CSM. So in this particular case, this one of the contracts that we have already signed is an advanced intermediate under CSM and another one which we have is our own bromine molecule and one another bromine derivative which we exclusively developed for that customer. And majority of the other four or five additional which are in the pipeline, they are all under CSM and under advanced intermediate side.

Dhruv Bhatia: Okay. And when you say that these are for innovator companies, are these products which you are going to service, are they generic products, patented products, can you spell out?

Dr. Harin Kanani: To the best of my knowledge, most of these are for the innovative molecules which are just launched. So they are still not yet generic, these are still under patent molecules.

Dhruv Bhatia: And is the customer himself doing these molecules which is getting outsourced to Neogen or is it that you are replacing an outsourced vendor?

Dr. Harin Kanani: In some cases, we are the first vendor and in some cases the customer had originally planned with somebody in China, but the Chinese company fell through because of what happened last year. So, they approached Neogen as the main vendor for them now. And in some cases the customer has, may be one vendor in China or somewhere else, but they were looking at a second vendor. So, we are the second vendor in that case.

Dhruv Bhatia: And you mentioned that for the first year, you are looking at Rs. 35 crore to Rs. 60 crore revenue per contract, and then advance up to between Rs. 75 crore to Rs. 90 crore from FY2023 onwards, is that correct?

Dr. Harin Kanani: No. What we said is, in each of these contracts so far we have signed, there is a potential of Rs. 30 crore to Rs. 50 crore on a yearly basis. That range depends upon the exact volume and the exact price which we work out on a year-to-year basis based on the demand projection from the customer. And they have a potential, so this is a minimum volume, and then the customer has an option to take even more. So that again will depend on a yearly basis.

Dhruv Bhatia: So, are you putting up this Rs. 150 crore to Rs. 175 crore revenue potential capacity based on the ramp up that is expected from the customers or are you putting up this incremental capacity for the new customers also which we think are going to get converted into customers for you?

Dr. Harin Kanani: As we said earlier, internally we always want to be very conservative when we are taking any CAPEX decision. As I have shared earlier also in my conference call, that we had one option that the entire Rs. 150 crore we have a commitment from just my new customers. And there is another option where let us say none of these new were to work out, we would just use our own molecule for our existing customers and do more of that. So we had these two ends of a spectrum, and then we said, the actual will be somewhere in between. So, this is what I have been sharing over last two, three conference calls. Now basically what is happening is that some of these new have become clear, and we still have an unmet demand over existing molecules. So with that and looking at now more clearer projection from the innovator, customers or the new customer and the new product that we are working with. So based on that, we can now go ahead and take a call that, okay, there is a very good certainty now that the Rs. 150 crore which we have added will get filled with these as well as my existing molecules, additional demands. So let's go ahead and create additional Rs. 150 crore capacity. Because to satisfy all these, we will require more capacity than Rs. 150 crore over two to three years' period.

Dhruv Bhatia: Sure. And just last question from my side, when you said that you are working with six to seven innovator companies, and these are the two contracts which are converted from these innovative companies, how long have you been working on the product development with the customer? And is it like you are working on one product and the hit ratio has been 100% or are you working with multiple products?

Dr. Harin Kanani: Usually when we start work with any customer, it depends on the customer needs. Sometimes there can be a single molecule and sometimes there can be two or three molecules. So, we have seen three molecules. Again, the dynamics of which one comes first, which is higher priority. In one case which I told you we are supplying two bromine derivatives, one is our own and one we custom developed for the customer. So the number of molecules per customer is different. But usually, once we start with one they also give others. But the first one which you started with is leading and there could be others also behind them, or sometimes it depends on customer priority, that this one is launching first so you focus on this first then you move on to the other. So that is to answer your question on number of molecules.

How long we have been working? Few of these customers we have worked with for two, two and a half years. Some of these customers we have worked with, let's say, about a year, year and a half at least.

Moderator: Thank you. We have next question from the line of Manish Gupta from Solidarity Advisors. Please go ahead.

Manish Gupta: Dr. Harin, what is the useful life of plant that you set up?

Dr. Harin Kanani: Let us say, generally the building that we set up has a life of 25 years, 30 years or longer with modification and strengthening and things like that. So, for example, even if you take my Mahape plant, we started using it in 1991 and we are still using it. But yes, inside, the reactors keep changing from time to time. Generally, the reactors range from 8 or 10 years to even 15 years, 17 years, unless something wrong happens to them specifically. So, I would say, that's individual component wise the life of a plant.

Manish Gupta: Do you take any maintenance CAPEX through your balance sheet or is all the maintenance CAPEX expense through the P&L?

Dr. Harin Kanani: The maintenance CAPEX, again, we follow the normal accounting rule that some significant maintenance which is supposed to increase the life of the machinery significantly is considered as CAPEX, but the remaining major is taken as P&L.

Manish Gupta: So, when we are talking about the Rs. 55 crore CAPEX that is for the new plant. But will there be some other CAPEX other than the Rs. 55 crore which goes for maintenance CAPEX?

Dr. Harin Kanani: Yes, there will be. We estimate around Rs. 10 odd crore of maintenance CAPEX across our other sites. There are two parts of this, one is for debottlenecking. Second is to increasing the life, which is a pure maintenance purpose. And third is modification of a new molecule. For example, my Mahape and Karakhadi are the ones where we have our R&D. So, when we want to do a new molecule, sometimes they require some change in configuration or different reactors, so basically those kind of modifications. So, debottlenecking, sometimes new technology. So, for example, if you have a vacuum pump, we find a better vacuum pump which is more energy efficient or better operational performance. So, then we may also do because of that. So, all that goes into the maintenance CAPEX bracket.

Manish Gupta: Okay. My second question is that over time, I guess, since the share of value add in your overall business mix is improving, and you will get some operating leverage with scale, and you will have longer runs as the size of molecule increases, can we expect some EBITDA margin expansion gradually over time?

Dr. Harin Kanani: Yes, I think internally Neogen as a team is aware that many of our peers have EBITDA margins which are much higher. Of course, many of them also have a much higher scale of operation. So, we also strive to achieve that as our scale of operations improve, as our molecule mix improves, and one of the choices behind trying to work more on advanced intermediates or with innovators kind of is to see if we can improve our margins and EBITDA and other operating parameters. So, that is something we are striving to achieve. But again, we are rapidly growing. So, for that, many a time you take some decisions now, which for today are not very good, but for tomorrow and day after it optimizes your two years down the line growth or something like that. So that's the reason where, for example, for Dahej site we already have some employees already appointed and some more will be appointed in the next quarter, but the capacity may come online, let's say, in Q4. So you have sometimes these mismatches. But overall, yes, I mean, once this stabilizes and also, we are adding new molecules. So once we run with these molecules for a while we can do some innovations and improve. So together that should help us improve the EBITDA. But I am not able to put a finger or a time that yes from this year onwards or from this point in time we can give you the kind of prediction. So, I think earlier also, what I have said that up to FY22, our target is that, when we are doing another significant jump, from Rs. 300 crore to Rs. 450 crore. And we are operationalizing for organic Dahej side. So that's the major issue. After that, there will be incremental increases at the same site. So, we said, till FY22, at least from a guidance point of view, similar range of 18.5% plus/minus 1%, and during COVID they requested 1.5% range. So, that's the range. And then beyond FY22 we will let you know once we are already running at that level, and you have kind of felt that run rate. And then we have a better idea of the cost structure at that run rate.

Moderator: Thank you, sir. We have next question from the line of Sabyasachi Mukerji from Centrum PMS. Please go ahead.

Sabyasachi Mukerji: Good to hear about the new CAPEX announcement. A few questions from my side. First of all, what is your net debt-to-EBITDA or net debt-to-equity number that you have sought out?

Dr. Harin Kanani: The debt-to-equity is around 0.82.

Sabyasachi Mukerji: And what would be the peak, I mean, after having this Rs. 55 crore of funding through long-term debt, what is the peak number that you don't want to cross beyond which number?

Dr. Harin Kanani: I think we have kept for ourselves, even post IPO in my first or second call itself what I had given, a target of below 1 most of the time. And certain quarters where the capacity is fully utilized and then, the profits will come next year, we can go up to 1.25. So, on an average, over a long period of time, 1 and not to try and cross 1.25. So, even current projections show we will be comfortably within that range, even in the peak period in basically FY21 and FY22. And then beyond that, we should again reduce below 1.

Sabyasachi Mukerji: Sure. I also see a CWIP, capital work in progress in the balance sheet of Rs. 24 crore as on September. Is this something you are doing as part of this Rs. 55 crore of CAPEX we have already started?

Dr. Harin Kanani: No, this is part of the Rs. 75 crore CAPEX which we are currently doing for Dahej. This is where our turnover goes from Rs. 350 crore to Rs. 500 crore. So, what is going to come online in March, this CWIP is towards that.

Sabyasachi Mukerji: Okay. So, basically, if I were to look at the gross block number of FY20 March end, and the gross block number that will come in March 2021, so there is basically a Rs. 75 crore to Rs. 80 crore of addition that will be in March 2021 number, is that a correct understanding?

Dr. Harin Kanani: Yes. And there will be some CAPEX which we are doing also in Mahape and Baroda. So around, I would say, closer to Rs. 80 crore to Rs. 85 crore. And then the Rs. 55 crore plus another maintenance CAPEX of Rs. 10 crore, so another Rs. 65 crore in FY22, based on whatever we have planned up till now.

Sabyasachi Mukerji: Got it. One more clarification. I was seeing the cash flow from operations number in your results document and the presentation. If I look at the cash flow from operations of last year, I mean, half year ended September 2019, it was a negative number, right? Around, I think Rs. 17 crore or Rs. 17.5 crore of negative cash flow from operation in the result document. But if I look at the presentation, it is a positive number. Can you help out over here?

Dr. Harin Kanani: There is a small typo in our earnings presentation. Last year it was negative and now it is positive 44. So, we will get that changed and have a revised one uploaded on our website and exchanges. Thank you for pointing it out.

Moderator: Thank you, sir. We have next question from the line of Ayaz Motiwala from Nivalis Partners. Please go ahead.

Ayaz Motiwala: My question was related to bromine chemistry and the way you have explained in our interactions in the past. From this agro and pharmaceutical opportunity with international customers, it doesn't sound that it is so niche as such. It may be versus benzene, but it doesn't sound so small as an opportunity. So what we would like to learn is, as you approach more customers with R&D work, with yours and you move from the pilot quantities to kilo and bigger commercial scale. So what is the kind of opportunity that you are seeing in your strength of organic, inorganic chemistry on what you have on the ground, people and resources?

Dr. Harin Kanani: My belief is, yes, that bromine chemistry can be utilized across industries and for several molecules. And historically, also, what we have seen is that the bromine derivatives get used in multiple products, multiple end uses, and multiple customers. The difference is that when you take a $3.5 or $4 bromine, then do you just make a single bromine derivative which is, let's say, $10 or $15, or maybe with one more step around $20? Or you then also build on that and do other chemistries and you are able to reach up to, let's say, like $100 or $150 or $200, in that range. Now, it's the same bromine, right? But what you do with that bromine differs on what is the additional chemistries that you are ready to do. So that's what currently we are doing, that we are trying to basically go and move forward. And I think one of the things which is important is that, are you able to, first, adopt to these other chemistries along with bromine? And what happens is, when we do that over a long period of time, sometimes. So for example, one of the chemistry which comes after bromination is Grignard reagent. So this Grignard reagent, we have been doing now almost for 20 years. And over a period of time we get expertise in that. So that's how we are looking at this, that we can keep adding to our expertise, we can try taking a higher value number and take bigger challenges. And that too now, who do you do it for? I mean, do you do it for a generic company for a molecule where your competition is China or you do it with an innovator company, where you are one of the first or the second company in the world to do that. So then there is a value attached to be able to be the first and the second. So I think that's where we are looking at the potential. And I think here the question is, when we work with bromine, we are also used to handling hazardous chemicals. So your approach and attitude to manage hazardous chemicals, handle tough chemistry like bromine, and also we saw pharma industry, so doing it with a high amount of quality assurance and quality control systems in place. So I think that's the combination which becomes our key strength and makes us a winner or a challenger in this area. I hope I answered your question.

Ayaz Motiwala: That's helpful and we can build on this. Just in the context of a quick follow-up question before time runs out. The second one is related to the expansion plan, which has the revenue growth potential of Rs. 150 crore to Rs. 200 crore, and the new Rs. 55 crore plan that you are announcing. What should we be thinking in terms of working capital? So you announced long-term debt would be taken. If you can call out on these two new long-term signed up projects, in the context of, as you said, there will be an uptake in tonnage and one side there will be a level of margin assurance, and some amount of sort of working capital and other parts which you may have to manage at the back end. So, could you talk a bit about that in terms of the composite capital employed? Will your working capital be a large portion and will you look at your same payback norms of three and a half, four years, and five years? How should we look at that lumpy big investment that you plan to do?

Dr. Harin Kanani: Over a period of time, we feel we should not be looking at one molecule or one business at a time. Overall, as a company, what we have acknowledged is that we need to improve our working capital cycles. Because when we want to grow faster, by having better working capital cycle the need for dependence on debt reduces. And also, you are better protected in case somethings were to go wrong. So that's what we have been doing. And we have to do that at each business, we have to do slightly better as compared to earlier. So, that's what we have discussed earlier. One of the constraints for us was not having capacity. Having capacity improves that you can make closer to just in time. But if you are capacity constrained, you cannot make just in time. So, that is one aspect which we are changing.

And the second aspect is that, single molecule contributing more on an average. So again, there is a trade-off. If you have, let's say, only 10 molecules giving you 10%

each turnover, one of them goes down and you have a challenge. So, having more molecules is allowing us to grow very fast, because we are in touch with more customers and we have more opportunities. At the same time, it is also making us inefficient. So, you have to strike a balance. And we are trying to see that by doing these contracts, we take the balance more towards slightly higher per average turnover of molecule, if I were to say that, which will help us improve, like have dedicated reactors and reduce the changeover and be efficient. So, these are the things which we are working on. And what we have said, overall, as a business, our effort will be to improve the working capital cycle going forward in FY22 and FY23. And there are three aspects which I detailed in my earlier answer to one of the questions asked.

Ayaz Motiwala: Yes, I think the revenue per molecule part is very helpful. Thank you for that.

Moderator: Thank you. We have next question from the line of Shanti Patel from Shanti Patel Investment Advisors. Please go ahead.

Shanti Patel: I have got one simple question. Today, what is our return on capital employed and return on equity? And what will be the situation after our turnover will reach at Rs. 500 crore?

Dr. Harin Kanani: Historically, our return on equity used to range around 18%, 19%, and return on capital, if you are taking post tax, used to be around 16%, 17%. At present, the return on equity is about 16%. And return on capital employed post tax is around 13.3%, pre-tax is around 17%. This is also because we are right now doing the new investment. And earlier we have also invested into lot of land which is for next 20, 25 years. So as long as our margins remain the same and we improve working capital, if we go by historical, we were somewhere around 18%, 19% ROE and, let's say, 16% or 17% post-tax ROCE or 20% pre-tax ROCE. So, we will at least try to reach there. And then, as I answered earlier, if your margins improve, if you are able to increase the efficiency and working capital cycle, then they can go beyond the 20% range.

Moderator: Thank you. We have the last question from the line of Bharat Shah from ASK Investment Managers. Please go ahead.

Bharat Shah: When we think of our current size of the business, it is still rather small size of the business. And in light of the kind of capital expenditures in expansion, we are talking about leveraging that CAPEX. I hope we are not trying to bite off more than we can chew or can afford.

Dr. Harin Kanani: Bharat Bhai, we have, at least internally been very conservative about it. And we have looked at different scenarios and kept different options in mind when we have taken this decision. As you pointed out, yes, as compared to some of my peers, our size is small. But at the same time, we want to definitely grow our business, because there is a lot of demand coming in from our customers. But of course, we never want to do it at a risk, as you said, trying to bite more than what you can chew. So that's a question we keep asking ourselves always. And at least we believe we are not doing that. Of course, time is the only final prover of whether we are right or wrong. But we have kind of thought of that. And this is really mainly to make sure that we are not in a situation where we have to say no to our customers. And there is a good opportunity for Neogen, as is for many specialty chemicals in India. And when we see a good visibility, only after that we have taken this decision.

Bharat Shah: Incremental CAPEX typically, what is the cutoff, minimum return on capital employed that we believe would be there?

Dr. Harin Kanani: Bharat bhai, sorry, I don't have that number on an incremental basis. What we have looked at is, our incremental investment giving us, let's say, additional revenue. So, for example, the Dahej incremental investment of Rs. 75 crore we did, was giving us a visibility of around Rs. 150 crore, because this was a Greenfield site and we were doing it for the first time in Dahej. Whereas this incremental Rs. 55 crore is already giving us a visibility of Rs. 150 crore to Rs. 175 crore. So, unfortunately, we don't look from that ROI point of view and I don't have the exact number. But whatever it is, it is much higher as compared to what we did for the first Rs. 75 crore.

Bharat Shah: Thank you. But it will be useful if you could have some benchmark on investment because otherwise CAPEX staying is a certainty, outcome in terms of profit in top-line is a matter of conjecture.

Dr. Harin Kanani: Sure. We will have those kinds of numbers ready next time on our investments.

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

Dr. Harin Kanani: I thank everyone for taking time out to join Neogen Chemicals' conference call. I would also like to thank CDR team for arranging the same. If you have any further questions, please feel free to contact our Investor Relations team, CDR India. I hope, I satisfactorily answered all your questions. With that, I would like to end and wish you and your family a very Happy Diwali.

Moderator: Thank you very much, sir. 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.
