Neogen Chemicals Limited
Q3 & 9M FY21 Earnings Conference Call: February 15, 2021
Edited Transcript

Moderator: Ladies and gentlemen. Good day and welcome to the Neogen Chemicals' Q3 & 9M FY21 earnings conference call. As a reminder, all participant lines will be in the listening only mode. And there will be an opportunity for you to ask questions after the presentation concludes. 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.

Mr. Shiv Muttoo: Good evening everyone and welcome to Neogen Chemicals' earnings conference call for analysts and investors, to discuss the third quarter and nine-months financial performance and share operating highlights of the Company. Joining us on the call today 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, we shall open this session for Q&A, during which the management will be glad to respond to any queries that you may have.

At this point, I would like to add that some of the statements made or discussed on the conference call today may be forward-looking statements. The actual results may vary from these forward-looking statements. A detailed disclaimer in this regard is available in the Neogen Chemicals' Q3 & 9M FY21 earnings presentation, which has been shared earlier.

I would now like to invite Dr. Harin Kanani to commence by sharing his thoughts on the strategic progress made by the Company. Over to you.

Dr. Harin Kanani: Thank you, Shiv. Good evening, and a warm welcome to everyone on the Neogen Chemicals' Q3 & 9M FY21 earnings conference call. I hope all of you are safe and in good health.

We had shared our earnings presentation earlier. I hope you would have got a chance to go through it. Let me begin by summarising the key developments during the quarter.

We demonstrated steady momentum in our performance during the quarter with stable accretion to our earnings, which was in line with our expectations. This was supported by our efforts of running the plants at high utilisation levels based on better demand visibility across key product categories. Positive demand was partly driven by healthy recovery trends in economic activity in India, and across the globe following several unlock phases.

In Q3 FY21, we delivered the highest ever revenues of Rs. 85 crore, which was driven by 36% growth in inorganic lithium-based chemicals and better product mix. Strong growth in the inorganic segment was achieved despite lower prices of lithium in 2020, which is a key raw material. Just to give you some perspective, we have estimated this impact to be close to Rs. 12 crore for the nine-month period in FY21, which means, excluding this impact of lower raw material prices, our inorganic chemicals revenue during the nine-months period would have been higher at Rs. 54 crore versus Rs. 42 crore as reported today.

I am pleased to share that based on significant pickup in economic activity in India and global markets, the demand for most of our key products has been expanding and getting restored back to normalised levels. As you may have seen, our organic chemical business is operating at optimal utilisation levels, and we look forward to further business expansion in this segment based on the upcoming capacity enhancement that will be completed soon.

In the inorganic chemical division, we are capitalising on the positive demand trajectory backed by newly commissioned capacities now available to us.

On the first phase of brownfield expansion at Dahej SEZ, I am happy to state that we are now in the final stages of project completion of organic chemicals and are targetting to commercialise this facility by the end Q4 FY21 or early Q1 FY22. This is more or less in line with our original estimates, in spite of delays due to COVID related closure earlier in the year. The project completion is subject to receiving customary final approvals from relevant authorities. Following this enhancement, we reiterate our revenue target of Rs. 450 crore in FY22 based on the demand pipeline and the new capacities coming online. This will further cement our position as a leading manufacturer of bromine-based Specialty Chemicals, and a trusted partner for custom synthesis and contract manufacturing.

To close, we believe, that Neogen Chemicals has, over the last few years, built enhanced capabilities around multiple components of its business. Our product portfolio has delivered on the potential to innovate at every stage of scale up. We have expanded capacities and organisational capabilities to enhance our competitive position globally. Incremental Capex execution expected in FY22 is further proof of the growing strength of our business engagement, that is finding strong support from rapidly expanding visibility for India as a key component for global supply chains.

With that, I conclude my opening remarks, and would now request Mr. Ketan Vyas, our CFO, to share his views on the Q3 FY21 financial performance.

Mr. Ketan Vyas: Thank you. Good evening everyone. I will take you through the financial performance of the Company for the third quarter ended December 31, 2020.

In Q3 FY21, our revenues improved by 4% year-on-year and quarter-on-quarter to Rs. 85 crore. EBITDA came in at Rs. 17 crore, higher by 5% year-on-year, translating to EBITDA margins of 19.8%, an expansion of 40 bps Y-on-Y. EBITDA improvement was achieved despite the initial impact of COVID-19 as well as higher employee cost, as organisational competencies are being enhanced across functions. Favourable product mix also aided the operational performance.

Profit after tax marginally improved by 4% year-on-year to Rs. 9 crore, which was in line with higher finance cost and depreciation due to capex undertaken at Mahape, Vadodara and Dahej facilities. In Q3 FY21, our domestic and export mix stood at 55% and 45%, respectively.

That concludes my opening remarks. I would now request the moderator to open the session for questions from the participants.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Swarnabha Mukherjee from Edelweiss.

Mr. S. Mukherjee: A couple of questions from my side. First one is, in your organic business, I understand that the kind of performance we have seen this quarter is more a function of constraints on the capacity side that you have right now. So, if you could throw some light on how otherwise the demand side of the scenario you were looking at? And also, in terms of your product mix within organic, because of the capacity constraints, how are you prioritising your customer demand? And has that impacted the margin in any way?

Dr. Harin Kanani: When it comes to organic capacity, normal optimal utilisation level is considered as 80%. So almost since last four to five quarters, barring the COVID period, we have been working beyond the 80% - 80%, 85%, 90%, in that range. We are working at a very high utilisation level because of the capacity constraint and very strong demand of our molecules. In terms of prioritisation of molecules, basically our idea was to serve our existing customers, and on top of that, take care of the newer customers, especially the two contracts that we have signed. So we have given priority to these customers because the long-term view and benefit we will have of these once we have the additional capacity. And we selected these customers' requirements against some customers who tend to give us a monthly or quarterly kind of volume requirement. So, that has been the product mix change to some extent.

I would say, margin wise, especially the molecule which we are doing for international customer, we are doing it for the first time under the CSM. So at present, the margins are more or less similar. But yes, there is some impact that the raw material contribution is slightly lesser, and also there is a slightly higher manufacturing cost attached to that. So, if you see, gross margins have improved slightly. But I would say, the margin would remain more or less similar to our organic production at present.

Mr. S. Mukherjee: Okay. So, just to clarify, as you commission the new capacity, like you have earlier alluded to the strategy that is to move to better product mix which should be more innovation-driven, so more complex kind of products. How do you see the margin trajectory because of that? Because right now what I understand is that despite picking up some complex product, at least at the gross margin level, things have broadly remained at the same kind of percentages. So, if you could throw some light on that.

Dr. Harin Kanani: We have more and more percentage contributed by advanced intermediates, where there is multi-step reaction beyond bromination and other chemistries combined. As you have said, that gives us a chance for more innovation. And going forward, let us say by FY23/FY24, once we have done these molecules for quite a bit of time, we hope that we are able to do the innovation and with those innovations, we are able to improve our margins. At present, as I mentioned, overall, there might be some shift or swings between gross margin and manufacturing costs. But at an EBITDA level, as I have mentioned earlier, because we are setting up a new capacity which will take some time to ramp up and get fully utilised, at present, we have maintained what we maintained earlier, that our margins, at least for the next financial year, would be more or less in the range of 18.5%, plus or minus 1%. This has been our steady margins. And as more molecules come from this new business and as we are able to stabilise the Dahej facility, we hope to improve the margins.

Mr. S. Mukherjee: Okay, that is very helpful. Harin, another question on the inorganic side. If I understand correctly, what you mentioned on growth, if we look at a constant pricing basis, it probably means that you had around 28% volume growth in nine months over a corresponding period. So, what is the outcome in terms of EBITDA impact? Did lower realisation impact the unit volume EBITDA also or at EBITDA level, things have more or less remained the same?

Dr. Harin Kanani: Whenever there are large variations in lithium and RM prices, we of course want to do higher of the two. I mean, either we try to have higher EBITDA percentage or higher absolute. Whichever number is higher, we try to maintain that. And the customer wants the lower of the two. So, there is always a give and take with the customer. And the truth lies somewhere in between. So, it goes both sides. When the prices suddenly increase, you do not get the same absolute number, you try to maintain the percentage and you try to get something more. Similarly, when prices go down. So somewhere in between we try to maintain our percentage margins to a slightly higher level. Beyond that, I would not like to communicate too much in detail, because it is specific strategy that we take with each individual customer, and reality is different with each individual customer.

Moderator: The next question is from the line of Bobby Jairam from Falcon Investment.

Mr. Bobby Jairam: I have a few questions. The first one is, the new molecule that you are developing, is this based on your research or based on customer demands? As in, is the customer requesting for it or are you coming up yourself?

Dr. Harin Kanani: Majority of our business comes when customer requests for it. So, most of the molecules which Neogen develops, are on customer request. The difference is that there are some molecules where the customer just gives you the name and sometimes they give us the quality and the impurity that they would want. And then we have to decide the best possible route of manufacturing, the chemistry and then the commercial manufacturing system. Sometimes, in custom synthesis and manufacturing, especially when it is an innovator customer who has already done some work, we get some partial technology from the customer, and then we build on that and develop a commercial manufacturing technology. So, I think, to answer your question, the molecules are always requested by the customer, we develop for a specific customer. The technology sometimes is partially given by the customer, sometimes we develop it from scratch, which is what differentiates our own products and CSM molecules.

Mr. Bobby Jairam: Okay. And the new capacity that is coming on board, is there some sort of order book for that?

Dr. Harin Kanani: The new capacity that we have is also a multi-product facility. And in this facility, as we have said earlier, we have two customers who have signed a multi-year agreement with us, which will give us visibility. From both these customers, we have an order book of around Rs. 30 crore to Rs. 50 crore each on the lower side, and around Rs. 60 crore to Rs. 70 crore each on the higher side. So there is a contract but the actual POs or the orders are received on a yearly basis because the prices keep fluctuating, and there is usually a range. So the customer, depending on that particular year's demand, gives us the PO.

Some of our existing customers are five years old. Almost 50% to 60% of the business comes from customers who are more than 10 years old, and almost 75% of business currently is coming from those existing customers. So the assumption is that the existing business will continue with the existing products and existing clients. And on top of that, these new customers' demand will come. That is what will give us the visibility of being able to utilise majority of the Rs. 450 crore that we are targeting for next year, or when we set up our Phase I capacity. And looking at these and other customers in pipeline is what helped us decide our Phase II capacity.

Mr. Bobby Jairam: Understand. And in the inorganic chemicals, just based on what you said, it looks like there is quite a bit of uncertainty as to how much money you would actually make, given there is no raw material pass through. So why don't you have some sort of a pass-through mechanism if you have good relationships with your customers?

Dr. Harin Kanani: There is a pass-through mechanism. What happens is, traditionally the pass-through works in a sense that, let us say for making x kg of a particular product I am allowed to charge, y dollars per kg. Now, that's the normal standard understanding between me and my customer with whom we have been working for last 20/25 years. Now, what happens is that, let us say the lithium prices have become 2x. One argument is that you still get y dollars per kg because this is what we have agreed upon. But then what it does is that the percentage realisation kind of goes down, because now I am selling worth 2x with the same margin of y. So my percentage would go down. So what I was trying to say is that, if I was getting y dollars per kg, when the x price goes to 2x, I also try to get 2y as my contribution to maintain the EBITDA percentage, which I normally used to get. But, of course, the customer knows that my manufacturing cost and my profits are usually y, so we settle somewhere in-between y and 2y. And now when the price comes back from 2x to, let's say, 1.5x or something like that, we are again in that same range between our y. Thus, our y is always protected and so we will never make a loss but we will make that minimum absolute margins. What I wanted to clarify was that the additional ones that you get, some times that is what varies. So it varies between this y and 2y kind of a number.

Mr. Bobby Jairam: If I understand you correctly, you are saying there is an absolute EBITDA per kilogram which is more or less guaranteed? And the percentage really does not matter?

Dr. Harin Kanani: Right. So, the absolute is more or less guaranteed, and then you try to get more because you are investing more money when you are buying a higher priced raw material, your inventory holding cost is higher and things like that. So you try to get something additional, which you can get away sometimes and sometimes depending on the demand-supply scenarios you can get away with few customers. But few customers will insist on giving you only y. So usually it is always in between. But the minimum is always guaranteed.

Moderator: The next question is from line of Karthik Bhatt, an individual investor.

Mr. Karthik Bhatt: A couple of questions. On the contract manufacturing front, are there any new contracts visibility that is there? And how is the revenue pie likely to change over the next one or two years? Do you see the pie from contract manufacturing likely to increase? That's one. And also, I see a slightly higher proportion of R&D workforce in the investor presentation. Any light on that as

	to in which division or which business are we looking to have a larger R&D team?
Dr. Harin Kanani:	In terms of business break up - what we have given so far before our new expansion or if we take last year's base - more or less 50% of the revenue is coming from bromine derivatives, 30% is coming from advanced intermediates, of which 10% is custom synthesis and then around 20% is coming from lithium. That was our normal kind of steady average case. Once the new capacity comes online, we are hoping that we may get 40% still from our bromine derivatives and 40% to come from advanced intermediate. This is what we hope to achieve, let us say, by FY22 or FY23. And we want custom synthesis ideally to be about 20% of the 40%. So, the additional 10% that we are trying to gain in the advanced intermediate, mostly we are looking to come from custom synthesis and then lithium would remain more or less stable at 20%. So I think that's the breakdown or the target we have set. And doing this, while almost increasing our revenue to Rs. 500 crore plus by FY23/FY24. So over the next two/three years we are increasing the top-line, as well as trying to achieve a higher percentage from advanced intermediates. And within that, higher percentage from contract manufacturing. About your second question, about increase in the R&D, there are two parts. So yes, we are spending more amount of our R&D resources for the contract manufacturing projects, and these advanced intermediates. So they are right now taking up majority of our share, because in the bromine derivatives we have an opportunity to increase volumes just by taking higher market share. The number of new molecules is relatively limited because we now have a very vast range of molecules. There are still some which we keep working on, but majority is coming from this advanced intermediates. And within that, contract manufacturing. And we are now also focussing not only on new chemistry, but also more efficient manufacturing techniques. So it is not just the chemistry, but also R&D on some better processes to optimise the way we produce products. So I think that is the mix that we have increased upon.
Mr. Karthik Bhatt:	I think in the last call you mentioned certain initiatives being taken on working capital management, working with creditors, debtors. So how well are we progressing further on that? Can we expect more improved numbers on the working capital management front?
Dr. Harin Kanani:	I will ask Ketan to reply to this question, because he is behind all this.
Mr. Ketan Vyas:	As we grow, because of the increased capacity, we expect that the working capital cycle would improve and working capital requirements would slightly increase, but not in the same proportion to the turnover that we expect. That is what we want to achieve.
Dr. Harin Kanani:	So just to add. As we said, we will do some work this year and more work we are expecting next year, when we have a significant increase in the turnover.
Mr. Ketan Vyas:	So, not trying to put too much pressure on the working capital requirements but manage it within what best we can do in case of better inventory, better receivables and everything.
Moderator:	Next question is from the line of Rohit Nagaraj from Sunidhi Securities.
Mr. Rohit Nagaraj:	Just on the outlook. I understand that the last quarter we had indicated FY22 revenue guidance of about Rs. 500 crore, but here we are saying Rs. 450

crore. So, is there any change or is it a broader range of Rs. 450 crore to Rs. 500 crore?

Dr. Harin Kanani: Just to clarify. What we have informed is that the capacity which is coming in Phase - I is going to be Rs. 500 crore capacity; of which, the original target was to achieve Rs. 450 crore in FY22. So, I think I have always maintained that FY22 target, which is the first full utilisation of our Phase - I capacity increase, we will be targetting a turnover of at least Rs. 450 crore. So, when I mentioned Rs. 450 crore in my opening statement, it is just reiterating the same.

And the Phase - II work will also start almost in parallel. So, we have said, over three years, by FY24, we can utilise this capacity fully, which is likely to give us somewhere around Rs. 675 crore revenue. Now, how much of that Rs. 675 crore will come by FY23 and how much in FY24, we would be able to give an update sometime in the next financial year. But our target or our guidance always was Rs. 450 crore for FY22. And we are just saying that we are now confident of achieving that, because more or less the capacity is coming online soon.

Mr. Rohit Nagaraj: The second question is in terms of the EBITDA per kg on lithium business. Is there any inventory loss because of the decline in lithium prices during the first nine months, as we have indicated the top line has got impacted? Is there any inventory loss or does it usually get adjusted with our ongoing contracts?

Dr. Harin Kanani: Most of the time it gets adjusted with the contracts ongoing, and there is no inventory loss that we have suffered on the lithium side. Basically what we tend to do is, when we have, for example, x quantity of expected POs from a customer at a particular price, we book our lithium in the same proportion to basically cover that. Sometimes we only keep about one container worth extra, which is used as the basis for any next level of commitment we are giving. So the impact of that is very marginal.

Mr. Rohit Nagaraj: In terms of the international marketing, how are we currently placed? And given that we are increasing the capacity, we have tapped two long-term contracts, what is the strategy in terms of getting the incremental business from international customers?

Dr. Harin Kanani: Yes. These long-term contracts that we have signed have been with our international customers. We work very closely with both, international as well as domestic customers. The reason why the incremental business is coming from international customers is that our focus has been to work on a larger number of newer molecules. These are innovative molecules which we first start working on with our international customers; and sometimes when they are our own molecules, we have developed them for international customers, we are way ahead of time. The demand comes to India, when the molecule is going to become generic. So this way, by working with international customers, we can work better. We also have, in our team, some advisors who are based out of Japan, as well as in our business development team who have worked with international customers based out of Japan, Europe, U.S., etc. So I think between them, Mr. Surana and Neogen's own track record in pharma, we have a very good ability to connect with international customers in Japan and Europe, both in pharma as well as in agro. And we do take part in international exhibitions to keep adding new customers every year. That is something which this year we have not been able to do. But just based on our other visibility efforts, we still keep getting new product enquiries - from our existing customers, as well as some potentially new customers whom we identify on a strategic basis. And then we go and try to make connections with them.

Mr. Rohit Nagaraj: That's really helpful. Just one last clarification. The international business during this quarter has come down. Is it because of the container availability and freight issue? And is it a spillover to Q4?

Dr. Harin Kanani: If you see our presentation, the international business has actually increased. Our exports were 45% this year, which was about Rs. 38.59 crore. This was about Rs. 9 crore higher than the same period in the previous year. But maybe you are comparing with Q2?

Mr. Rohit Nagaraj: Right, sequentially I was comparing. I think last quarter it was 65% if I am not wrong.

Dr. Harin Kanani: Okay. I need to check that. But it would just be specific customer requirements in that particular quarter and things like that. There is some delay because of the container congestion, no doubt. But I would not say that it was the main determining factor between the two. It was just that who had more requirement this year. But overall, I think when we are looking at the whole year, we are doing much higher international business as compared to the last year.

Moderator: The next question is from the line of Bharat Shah from ASK Investment Managers.

Mr. Bharat Shah: Basically, I wanted to understand as to how do you see the overall size of the opportunity? How do you see it shaping up over a period of next three to five years? What are we doing that will make our growth rate different than that of the overall opportunity shaping up? And some kind of evidential form of tangibility. You outlined that next year we are well on course to do about Rs. 450 crore turnover, but let's say two more years thereafter - FY24 and two more years, which is FY26 - so roughly over three to five years - where do we see the journey for Neogen? So A, the size of opportunity; B, what are we doing differently to get a better traction for ourselves; and C, some kind of tangible evidence of that - in your opinion as to how it will shape up for Neogen.

Dr. Harin Kanani: Bharatbhai, we have discussed this earlier. I would request Mr. Surana if he can take this question and give his thoughts on that, and then I will add my comments.

Mr. Anurag Surana: Sure. Bharat bhai, there are three opportunities we now look at as Neogen. One is the bromine compound opportunity. That we have explained over several calls. The existing bromine compound opportunity stands at about Rs. 5,000 crore to Rs. 7,000 crore, and that does not include the new molecules which are being discovered around the bromo chemistry. That is one opportunity which we sort of target and work towards. The other is the advanced intermediates, which is then bromo+++. So, may be starting from a bromine compound and then going more downstream, finding application into the pharmaceutical or agro-chemical space. That is the second opportunity. And the third opportunity which we address is the custom synthesis and contract manufacturing opportunity. Now, for these two opportunities, it is kind of very difficult to give the size, because as agrochemical is about $50 billion market size, and then if we do a back calculation on how much is the value of the active ingredient and intermediate, and then how much of that is outsourced, so that is a $5 billion to $7 billion addressable market. And the pharma space for key starting material, like advanced intermediate, that is a much, much larger opportunity. So, that is an answer to the first question which you asked. I mean, as far as Neogen Chemicals is concerned, we are addressing all these three opportunities with our plant in Vadodara and the new plant which will start soon in Dahej, we have now more than adequate infrastructure and width and bandwidth also to address the multi-step chemistry opportunity. So, that really opens up a lot of space for us.

Mr. Bharat Shah: But to discuss that further, as far as the existing business of bromine compounds is concerned, about $800 - 1 billion kind of an opportunity, and that will be a bit of a slow-moving trend. Because overall growth opportunity on that is somewhat limited. Am I right in understanding that?

Mr. Anurag Surana: I would not say that. Because the process of discovery is such that when an R&D scientist working in an innovator company works on a particular molecule, his target is more towards the application of that molecule - in pharma it is towards the therapeutic segment, in agrochemical it is towards either a fungicide or herbicide. Once the biological activity of the molecule is determined, then he decides which route to follow. And then that route might as well be a fluorine or chlorine or bromine kind of a building block. So, I don't think it is fair for anybody to hazard a guess that in the next ten years, more molecules would be floro based or bromo based. But we do feel that in the present scenario, the bromo space, as you mentioned, seems to be about $1 billion. And looking at the limited existing bromo space, we have already started work few years back in the advanced intermediates and custom synthesis space, that is gaining traction. We already pointed out in the last call that we have a couple of contracts signed which are getting commercialised. There are several, at least half a dozen, molecules in the R&D and some in the pilot stage, which are, again, custom synthesis contract manufacturing, and these are for innovator companies. And these are multi-step chemistry molecules. Some of them have bromo, some of them do not even have bromo, either in the beginning or at the end. There is no bromo involved in that. I think you also touched upon what strategy Neogen adopts. Our strategy clearly is to find innovative processes of doing work for the customers. We add value by innovating. So, that is our key strength. Whenever a customer feels that Neogen has the capabilities to innovate, he gives us the project, irrespective of whether it has bromine or not.

Mr. Bharat Shah: Basically what we are saying is, from the bromine compound whatever it is, our strengths are well established, clients are aware that opportunity will take its own course and we have a strong position there. And either we defend our share or we get it better. And how the path will evolve, time will tell. As far as the second and the third opportunities are concerned - advanced intermediates and custom synthesis and contract manufacturing, - that is a new path we are developing. And that is also for different kinds of manufacturing, involvement of different chemistries, as well as greater innovation line. These are two areas: One, it is hard but if we have to hazard some kind of a guess, what kind of overall opportunity may exist in this kind of work?

Mr. Anurag Surana: Clearly there have been several discussions around the custom synthesis and contract manufacturing opportunities in agrochemical space. That has been, as I said, derivatised to an opportunity size of, when innovator companies outsource, that part is estimated to be about $5 billion to $7 billion, growing at a CAGR of at least 15%. This growth is coming partly because of the growth of the agrochemical business, and partly because the innovators are outsourcing more. So, these two things are driving that 15% growth. And the other is molecules moving from geographies like Europe or Japan or now even China to India. So, the growth in India, as per experts' opinions, in the agrochemical space, is around 20%, the CAGR in the agrochemical advanced intermediates and AI outsourcing. As far as pharma is concerned, I mean, the opportunity size is much, much, much bigger. They say the total pharma business is anywhere between $500 - $700 billion to almost reaching $1 trillion dollars. In terms of API, it is very low. But again, there is not too much of custom synthesis and contract manufacturing happening in that space in India. So, that again becomes an opportunity for Neogen. Plus there is also the historic business that Neogen has with good generic companies in India. We have named them several times. These guys are also interested in getting Neogen to do advanced intermediates for them.

Mr. Bharat Shah: So, if I were to summarise and please correct me if I am wrong. Basically, bromine is our bread and butter and strength. We have evolved over a period of time, and we have evolved along with our customers. And there are many parts, many technologies, we have confidence in and clarity and even customers seem to repose confidence in that. Using that, along with the new capacities that we are setting up, more advanced capacities, plus our growing confidence in other branches of chemistry and ability to handle more complex and multiple branch chemistry, it would allow us to make some meaningful forays into custom synthesis and contract manufacturing and advanced intermediates. While it is difficult to estimate the overall size and immediacy of it, these two areas should spend bigger and larger space for growth over a period of time. Is that a fair understanding?

Mr. Anurag Surana: Yes, that is very well summarised. Just a couple of things I would like to add here. One is that even in the bromo space we are not that big. We are at about, when you say $1 billion opportunity, we are at kind of a 10% or less market share. So, there is enough opportunity for us to grow. And that is a space where we have a lot of credibility, both domestic as well as international. Now, as far as the other spaces, the advanced intermediates and custom synthesis and contract manufacturing are concerned, we are extremely sure and we are very confident on our capabilities. Because our promoters are technocrats - they are both chemical engineers - Dr. Harin has also done his Ph. D. And, ultimately, synthetic organic chemistry is synthetic organic chemistry. Nobody in school or college or at IIT or in Ph. D., teaches you to do only bromination, or only florination, or only chlorination. It is taught as synthetic organic chemistry. So, we are confident of our capabilities. What we are trying to do now for the last three, four years, is to establish our credibility with the customers. So, as the customer confidence grows in our abilities to do other chemistries or multiple step molecules, we will continue to gain traction and, hopefully business will grow in this space also. And this, as we discussed, is a much larger space.

Mr. Bharat Shah: And one last thing. While we are looking at materially increasing the output in the next financial year, in 2022, do we have some kind of a goalpost for the period ahead - over three to five years? Any indication of where do we think we will be? And how much of that is currently and confidently envisaged and how much of that will be work in progress to be evolved over a period of time?

Dr. Harin Kanani: Yes. We do have goalposts internally. But we have not shared those in public forum as of yet. Give us some time to discuss internally if we should give three-year or five-year vision for where Neogen can be. What we would like to say is that, when we bought the Vadodara site and Dahej site, they both were relatively quite a large area. So as against one acre, which we had in Mahape, Vadodara has 40 acres, Dahej is 12 acres. And these large areas were taken with the view that we should be able to continuously grow and land and permission should not come in our way. So, between the two sites that we currently have, we have a land for manufacturing more than Rs. 2,000 crore - Rs. 3,000 crore, at least. Now, our internal view is that we should always take one step at a time, and while we know where we want to be, let us say, three year to five years to seven years from now, our focus should be on what we want to do immediately. And that decision mainly comes when we are committing additional capital or additional investment.

So for example, the investment work which we did, we said, okay, this will allow us to reach somewhere close to Rs. 675 crore - Rs. 700 crore over the next two to three years. So let us do that investment. And that is something which we shared with everyone that, yes, by FY24 this existing capacity, if we do not do any additional investment, we will reach Rs. 700 crore. So, every year we will review this number and every year we will be kind of giving a two-or three-year guidance. Now, should we give a longer guidance? We have some numbers in our mind, but let me discuss internally if we should start sharing them publicly. Because what we feel is sometimes it biases your decision, and then you are not remaining impartial, because you tend to make it happen at any cost. Whereas we think we should be a bit more prudent when we are doing the investment. So that is the reason we give a two-year/three-year number, based on the investment which we have committed to so far. So I hope I can give you this answer and try to get away with that.

One more point I would like to add to what Mr. Surana said. One of the long-term contracts that we have signed is for a slightly improved version of my existing bromine derivative, because there is a new API which required that particular use of the drug and the potential for that is significantly higher. In fact, it is more than the use of that molecule for all my existing applications combined. So, there will be new opportunities in the bromine space as well. And the other thing, which is happening, is that as we are proving ourselves and our capacities are increasing, our consumption of bromine is increasing. We are getting more and more competitive as compared to our European and Chinese counterparts. So there is an option to basically go for the bromine derivatives also. However, our focus currently is to get inroads into advanced intermediates and contract manufacturing. So that remains the core focus. At the same time, we can keep looking for opportunities in bromine space. And if at all, we have some delay in getting advanced intermediate or contract, we always have the unmet requirement of bromine derivatives as a backup. Fortunately for us, the capacities are fungible, so it kind of gives us the additional options to make either this or that and hedge our risks.

Mr. Bharat Shah: That is a very fair answer. So will it be fair to say that beyond 2022, at least the growth thereafter, will be superior to the growth that we have experienced in the past? And given the fact that the business funnel and the opportunities are broadening now, our capacities and approach, and all of that is also broadening. That's one. And second, growth and opportunity going ahead will be limited by our ambition, capabilities and fire in the belly or will it be limited more by externalities?

Dr. Harin Kanani: If we just look at the last three to four years' performance, you can see that we have done significantly better as compared to what we had done earlier - in terms of absolute growth or growth percentage. This was because some of the constraints like land which we were facing were removed; and post IPO, to some extent, the capital that we had and the ability to raise debt at competitive rates. These things improved. So yeah, we also feel that, especially once Dahej unit comes up…this is a plant which one has designed from scratch; we have been able to make that site completely the way we wanted, as much as we wanted…So I think that also will open up more opportunities for us because it is made at a higher standard. So, I think, yes, our efforts will be to enlarge this funnel and have better growth rates overall over a three-year/five-year period as compared to what we had earlier.

To answer your second question, there is no issue of fire in the belly. I mean, for us, we would want to work with as many good international clients, and you do your bit of serving the pharma and the agro industry as to the highest extent as possible. I think the main constraint is we need to be really pragmatic about the opportunities in front of us. It should not be growth because we are supposed to grow. And it should not be at the cost of existential risk. It has to be a balanced kind of growth and sustainable. So for us - what my father also has always insisted upon - it is always that before we take one step forward, we have to make sure that the first one is on firm ground. So as long as we are confident of the existing capacity getting utilised by the existing customers, we have enough options there, we would definitely then go ahead and do further expansion. So, it will be a mix. Mainly ensuring what is the external demand we are getting and based on our size at any given point of time, what is the pragmatic expansion that we should do. And not create an existential risk for Neogen by overexpansion. It is a question which you had asked me that, are you biting more than what you can chew. And I think that is the question we keep asking ourselves every time we take a decision to expand.

Mr. Bharat Shah: Sure. That is an extremely fair answer and I am thankful to you for that. And thank you Suranaji as well. So, nobody can dispute the quality of growth, and the prudence of that is any time any day more important than just the brutal growth. So cannot at all disagree with you there, 100% in agreement with you.

Moderator: The next question is from the line of Sabyasachi Mukherjee from Centrum.

Mr. S. Mukherjee: My first question is about your organic business. If I look at the quarterly run rate, you have been clocking almost Rs. 67 crore/Rs. 68 crore, roughly Rs. 70 crore of quarterly run rate over the last four or five quarters. Now, once this Phase - I capex organic plant that comes up in Dahej, probably at the end of this quarter or early next quarter. What would this number look like, any color on that?

Dr. Harin Kanani: In next year, we are targetting a Rs. 450 crore revenue, of which our estimate would be, depending on the price of lithium, the lithium contribution would be somewhere around Rs. 60 crore to Rs. 70 crore at least, and on a higher side, Rs. 60 crore to Rs. 80 crore, in that range. So, our estimate is around Rs. 360 crore to Rs. 370 crore will come from organic. On an average we expect around Rs. 80 crore to Rs. 90 crore kind of revenue in organic once the Dahej site starts coming online. Of course, it will be a bit phase-wise managed. In the sense that you will see a gradual ramp up because this is a new plant right from the beginning. So, our capacity utilisation will also increase gradually. Some of the molecules we already have the customer approval to start at that site, because they are completely new sites and they were already registered with the new site. Some of the customers would have to audit and approve the site. So, therefore, it will be slightly more in the second half as compared to the first half. But yes, I mean, we would, let us say, by FY23 just based on this capacity, we would go on run rate of around Rs. 80 crore to Rs. 100 crore, ultimately. But we will gradually increase to that.

Mr. S. Mukherjee: So, the peak quarterly revenue run rate would be somewhere around Rs. 100 crore, is that a correct understanding?

Dr. Harin Kanani: For the organic, yes.

Mr. S. Mukherjee: Next question is on Phase - II capex. That would probably be undertaken somewhere in H2 FY22. So, is this Phase - II capex, a dedicated plant only for the two contracts or is it something like MPP, multi-purpose kind of a plant? How do we look at it?

Dr. Harin Kanani: Phase - II is mainly multipurpose. It is in the same manufacturing block actually. So, the same manufacturing block we are putting additional reactors. When we had planned Phase - I, we had kept some space for future expansion. Now, based on the visibility of the contract, we said okay, now, there is a fair bit of clarity on Phase - I reactors. So, we said okay, we can put some more reactors and, again, it will be multipurpose. Phase - II is not specifically for these contracts. Actually, majority of Phase - I will now be used for the existing contracts. And to shift some of our molecules from Mahape and Vadodara to Dahej site, which is exports because Dahej is a SEZ. So we are trying to take maximum international customers' permission to do the international business of existing molecules from Dahej for exports.

Mr. S. Mukherjee: These two contracts, when the revenues will start flowing in?

Dr. Harin Kanani: Partly they have started flowing in from this year itself. But in this year what has happened is because the capacity is limited, we have reduced some of the non-standard/non-regular customers' requirements, and we are using that to serve the international customers. And this is a first year, so the requirements are a bit lower. And the increase in the nine months that you have seen in exports is partly responsible because of the new contracts and the revenue that they are already contributing. Going forward, of course, there will be additional revenue which will come as per what I have discussed earlier.

Mr. S. Mukherjee: Two bookkeeping questions. One is, if you can highlight the working capital position, especially the inventory days by December end, that would be helpful.

Dr. Harin Kanani: I think you can see, it has been steady in the last six months as well as nine months. Like I said, because of COVID there was a higher capacity, higher stock which was built up. That over the last three quarters has slowly been reducing. And more or less, we are targetting to achieve between 110, 120 days on net sales, as it was in the pre-COVID days for the revised revenue target.

Mr. S. Mukherjee: And the cash flow number for the nine months and the net debt figure as of December 2020?

Dr. Harin Kanani: Again, I think if you saw in six months also, our operating cash flow was positive. And it is remaining positive and improved in nine months. Actually, we do not have the exact number for net debt at present.

Mr. S. Mukherjee: I mean, it has remained in the similar ballpark range or has it increased, just a directional sense.

Dr. Harin Kanani: There is an increase in debt because of the capex we are doing. So the term debt is also increasing.

Mr. Ketan Vyas: Mainly the debt increased on the long-term side because of the higher capex in the upcoming Dahej plant.

Dr. Harin Kanani: And the working capital keeps fluctuating, but more or less in the same levels.

Moderator: The next question is from the line of Rohit Sinha from Emkay Global.

Mr. Rohit Sinha: In the last three/four years what kind of growth have we seen in the incremental customers and in what segment, like agro and pharma? Just wanted to understand what kind of new customer addition has provided growth or is it a penetration in existing customers?

Dr. Harin Kanani: Mostly we have been adding 50 to 70 customers almost every year, which has been the track record even earlier. Of course, what has happened is that especially in agro and to some extent in pharma, the innovator customers with whom we are working, not that they have become part of the business, but it has increased. So, if we were working with, for example, seven or eight customers, I think in DRHP also we had given number of contracts, eight or nine contract manufacturing customers with whom we were working. So, that number has now significantly increased. So, yes, the number of customers we have been adding every year. And what has changed in the last three/four years is, now we are working more and more with either innovator customers, or in case of pharma, the contract manufacturer of innovator customers, and sometimes directly with the innovator customers as well.

Mr. Rohit Sinha: Okay. And this is a mix of both, I mean, domestic as well as exports?

Dr. Harin Kanani: It is more on the export side. When I talked about the innovator customers and in domestic, especially in pharma, we already had a very wide coverage. And in agro also, majority of customers are already very old for us. We have been working with them almost since 1991. And many of them are now consolidating, so there are fewer of them, yes, in terms of number of customers. And I think businesswise, we are seeing our exports have also increased.

Mr. Rohit Sinha: So, the last one bookkeeping question. Can you just give some number on what is the overall capex for FY2021 and FY2022? And with the split of expansionary capex and maintenance capex?

Dr. Harin Kanani: The Dahej MPP capex number was Rs. 75 crore and Rs. 55 crore was specifically to add the existing capacity. So, that is roughly around Rs. 130 crore. On top of that, in our Mahape and Vadodara unit, there is maintenance capex as well as to take care of modifications to make some of the new molecules and new chemistry. So we are spending around Rs. 20 crore/Rs.

25 crore this year. And next year also we expect to spend around that much, in addition to the Rs. 130 crore capex that we already announced, specifically for the increase in capacity and setting up organic in Dahej.

Mr. Rohit Sinha: So this Rs. 130 crore is spread between FY2021 to FY2022, right? And another Rs. 20 crore/Rs. 25 crore for the FY2021 and FY2022 each year?

Dr. Harin Kanani: Correct.

Moderator: The next question is from the line of Vineet Kumar, an individual investor.

Mr. Vineet Kumar: My question is, since we are into exports, how does the container shortage affect our business? Was there some effect in the last quarter and in the ongoing quarter?

Dr. Harin Kanani: What has happened so far is that some of our consignments are getting delayed in terms of shipping. So normally the case is, if it leaves from my factory, within one or two weeks we are able to clear the cargo and put it on the sea. Now, may be it is taking a week longer. And some of the imports also we are trying to get in, are getting delayed. More or less we have been able to manage with the inventories that we have. But yes, I mean, that is something which is an area of worry and the problem has gotten a little more aggravated in this quarter. So we are trying to use our inventories of raw materials. As I have explained earlier also, we have tried to keep higher inventory of raw material ever since COVID issues had started, to ensure that our capacity which was currently at a very precious commodity, especially in organic, does not remain idle. And we are very happy that the chances of our plant remaining closed because of non-availability of RM are less than 0.2% or 0.3%, which is really good, for such a complex product and number of products that we run. It is a good achievement in spite of the challenges. But yes, we are watching that in Q4 and we will see how overall it impacts.

Mr. Vineet Kumar: Just to follow up on that question. Since you said you had a good stock of raw materials after COVID, have we got the benefit of lower raw material costs? Because we had a very good stockpile of the raw material when the costs were down.

Dr. Harin Kanani: No, there was no specific benefit. I mean, when I said higher raw material, it is may be by say 20% or 25%, not like I have bought 5x or something like that. Or 2x or 3x, which will give me some price benefit. So, I do not think there was any specific price benefit to the best of my knowledge, because we maintain more inventory.

Mr. Vineet Kumar: In the last earnings call, you mentioned, apart from the two long-term customers or innovator company, we were in discussion with three or four more customers. Any update on that discussion?

Dr. Harin Kanani: That is progressing. As I mentioned, there are several stages. May be one or two customers, we have done the first small trial production, sent the materials for approval. As I mentioned, we have R&D, we have pilot, we have then what I call as a first commercial campaign, and then more of a long-term view. So, things have moved in molecules, where for some we have completed the R&D and submitted samples to customer for evaluations and things like that. So, they are progressing in spite of COVID and other challenges.

Mr. Vineet Kumar: So, as I assume, by stage 4 when we go through the final MOUs, are we in stage 3 with any of those companies?

Dr. Harin Kanani: Not yet. We are still at stage 0, 1 and 2 with them. I mean, in some cases we have done stage 2. So now we are hoping to get into stage 3 early next year or something like that.

Mr. Vineet Kumar: My final question would be, since we are working with the innovator companies, do they have some patented duration where they have the rights to manufacture? How many are those molecules on which we are currently working where the process is getting unpatented or coming off the patents?

Dr. Harin Kanani: Majority of the contract manufacturing that we are doing, those are with molecules which are just registered or likely to get registration very soon. So we are actually towards the beginning of the patented molecule cycle, rather than towards the end of it when it comes to contract manufacturing and the agro business side. On the pharma side, it is a very regular thing. Every year there are a couple of molecules which become generic. And especially most of these molecules are our own molecules. So we are supplying simultaneously sometimes to the innovators, CMOs also and we are also supplying it to generic producers. And specifically, to answer the two contracts that we have signed, these molecules were just registered, so we are at the beginning cycle.

Mr. Vineet Kumar: So basically, we have a runway of like 7 to 10 years with those molecules?

Dr. Harin Kanani: Yes, it is kind of sometimes difficult to hazard a guess on how long the patent will work, because there are so many patent complexities. But yes, currently the customers have given us the visibility for at least five years, and I would stick to that.

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

Dr. Harin Kanani: Thank you all the participants for joining the call and your questions. I hope we were able to appropriately respond to your questions. If you still have any more questions, please feel free to contact our Investor Relations team, CDR India and we will try to address them. Thank you again and we look forward to connecting with all of you in the next call.

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

The transcript has been edited for clarity. Although an effort has been made to ensure high level of accuracy, some transcription errors may have remained. The Company takes no responsibility of such errors.