Volume No. XII Issue No. 06 **July 3, 2020**

Hikal

Rs 124

Higher growth trajectory from FY22

Sensex: 36,021 Nifty: 10,607

FINANCIALS SUMMARY

	SALES	OPM (%)	OP	OTHER INC.	PBIDT	INTEREST	PBDT	DEP.	PBT BEFORE EO	EO	PBT AFTER EO	TOTAL TAX	PAT	EPS* (RS)
1803 (12)	1296.1	18.7	241.75	4.46	246.21	49.12	197.09	85.59	111.5	0	111.5	34.27	77.23	6.3
1903 (12)	1589.61	18.8	298.13	2.26	300.39	58.43	241.96	92.88	149.08	0	149.08	46.01	103.07	8.4
2003(12)	1507.26	18.1	273.15	3.7	276.85	52.42	224.43	82.46	141.97	15.4	126.57	42.14	84.43	7.7
2103(12P)	1478.49	16.7	246.59	3.91	250.49	56.41	194.09	88.35	105.73	0	105.73	34.89	70.84	5.7
2203(12P)	1803.73	18.8	339.1	4.3	343.4	62.05	281.35	101.61	179.74	0	179.74	59.31	120.43	9.8

*On post bonus equity of Rs 24.66 crore: Face value of Rs 2 each. EO: Extraordinary items. EPS excludes EO and relevant tax. (P): Projections. Figures in crore.
Source Capitaline Database

Hikal Limited was incorporated on July 8, 1988 as a private limited company with the name Hikal Chemicals Industries Private limited, by the Hiremath family and Surajmukhi Investments & Finance Limited, a wholly-owned subsidiary of Kalyani Steels Limited as the shareholders. Subsequently in 2000, the name was changed to Hikal Limited, while the company got listed in 1995. The company is engaged in the manufacturing of various chemical intermediates, specialty chemicals, active pharma ingredients and contract research activities.

Hikal owns five manufacturing facilities: Taloja, Mahad (Maharashtra), Panoli (Gujarat) Jigani (Karnataka) and an R&D centre at Pune. The company started commercial production in 1991 at Mahad (Maharashtra) facility for manufacturing intermediates for dyes, pharmaceuticals and agrochemicals.

The plant at Taloja (Maharashtra) was built in technical collaboration with Merck and is the only fully-integrated plant to produce Thiabendazole in the world.

The facility at Panoli (Gujarat) was acquired from Novartis in 2000 and produces key intermediates and regulatory starting materials for the pharmaceutical industry and is US FDA certified for advanced intermediates.

The Jigani (Karnataka) facility manufactures key APIs for the pharmaceutical industry and has been approved by the US FDA, PMDA (Japan) and the European Union authorities.

The company has a research and development centre in Pune, which provides end-to-end services from custom synthesis, analytical development and scale up from development to commercial manufacturing.

Hikal is a B2B player, which provides active ingredients, intermediates and R&D services to global pharmaceuticals, animal health, crop protection and specialty chemicals companies. For FY20, pharma and crop protection accounted for 59% and 41%, respectively, of operating revenues.

The pharma business is currently divided almost equally between generic active pharma ingredients (APIs) and contract development and manufacturing organisation (CDMO) businesses.

Animal health business accounts for 20-25% of CDMO business. In crop protection, 70% of revenues are derived from CDMO with the remaining from proprietary products, specialty chemicals and specialty biocides.

STOCK DATA

BSE Code	:	524735
BSE Group	:	B
NSE Code	:	HIKAL
Bloomberg	:	HKCI.IN
Reuters	:	HIKA.NS
Par Value	:	Rs 2
52-week High/Low	:	Rs 178 / Rs 57
Sector	:	Pharmaceuticals

SHAREHOLDING PATTERN*

Category		% of equity
Foreign	:	5.96
Institutions	:	2.25
Govt Holding	:	0
Corporate Holding	:	1.69
Promoters	:	68.77
Public & Others	:	21.34

* as on 31/03/2020
Source: Capitaline Databases

Hikal aspires to be a global cost leader in key APIs

Hikal is creating a mixed portfolio of APIs, both niche and therapeutic which shall enable it to get into a deep strategic relationship with customers. The company is significantly investing in capacity to cater to the increased demand from customers while mitigating the risk of supply-chain disruptions in china.

Hikal aspires to be a global cost leader in key APIs with a strong product development pipeline and a focus on continuous improvement in operations and costs. It plans to commercialize 3-4 APIs every year with economies of scale and a good cost position. The company is in the midst of increasing manufacturing capacities at both Bengaluru and Panoli site. This new flexible capacity will address the future market demands of generic API molecules.

Higher growth potential for Hikal in the CDMO industry

The global pharmaceutical contract manufacturing market size was estimated to be valued at USD 120 billion in 2018. It is expected to witness a CAGR of 9.3% till 2026. The share of the API contract manufacturing (merchant) market is roughly USD 50 billion which is still less than 40% of the global synthetic APIs market, comprising of advanced intermediates and chemically synthesized APIs.

At a time when large pharmaceutical companies are focusing on reducing their operational expenses and prioritizing capital investments on their most innovative products, this in-house capacity represents a large reservoir adding to the growth potential for Hikal in the CDMO industry.

Indian companies are increasingly getting better in terms of environmental and statutory compliances with issues of warning letters getting resolved. CDMOs are now also engaging with smaller innovator companies besides big Pharma companies and are offering solutions across the entire value chain. Well executed projects by CDMOs will lead to further opportunities and will build better relationships with innovator companies.

Positive about the future prospects of animal health business

Hikal continues its efforts to grow the animal health business. Hikal develops animal health APIs and intermediates focused on the companion animal segment. It develops products in-house as well as provide contract manufacturing services from GMP-compliant facilities. Apart from synthetic products, Hikal also has a High Potency Products Development Lab based at its Research and Technology (R&T) Center. It continues to establish relationships with global animal health companies in the world and is positive about the future prospects of this business.

Stable performance in Crop Protection business

Crop protection business is split between Contract manufacturing for global innovators (CRAMs) which makes up around 70% of the revenue and the Proprietary segment which accounts for the remaining 30%. This segment is dominated only by a few large companies resulting in high concentration. Along with building its own portfolio of products, Hikal also enjoys global and exclusive supplier status for some molecules. Competition in this segment is lower than in pharma, largely due to fewer players and consolidation among large players. The company sees a lot of new market

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opportunities and is optimistic about the future demand for its existing product base as well as for new products in the pipeline. While demand in the crop protection business is cyclical based on the current market forecast for commercial and under development products, the company expect the outlook to remain positive over the next few years.

FY 20 performance affected by many headwinds

For year ended Mar20, net sales fell 5% to Rs 1507.26 crore. The company operating margins decreased 700 bps to 18.1%. As a result operating profits fell 8% to Rs 273.15 crore.

Other income rose 64% to Rs 3.7 crore. Interest cost was down 10% to Rs 52.42 crore. Finance cost for the year ended Mar20 includes exchange loss on foreign currency working capital/term loans of Rs. 3.07 crore compared to loss of Rs 7.35 crore in year ended Mar19. Depreciation fell 11% to Rs 82.46 crore.

PBT before EO was down 5% to Rs 141.97 crore. The company had EO expense of Rs 15.4 crore compared to nil in the corresponding previous year period. Exceptional item during the current period comprises customs duty Rs. 13.39 crore on past imports of raw materials at an Export Oriented Unit of the Holding Company and interest of Rs. 2.01 crore thereon, paid during the quarter on directions of the Customs authority. PBT after EO was down 15% to Rs 126.57 crore. Effective tax rate was up 200 bps to 33%. PAT reported was down 18% to Rs 84.43 crore.

For the 12 months, sales from the Pharmaceutical segment stood at Rs 886.87 crore and accounted for 59% of sales. PBIT from the same was down by 1% to Rs 127.53 crore and accounted for 56% of total with PBIT margin at 14.4%. Sales from the Crop Protection segment stood at Rs 620.39 crore and accounted for 41% of sales. PBIT from the same was down by 11% to Rs 99.65 crore and accounted for 44% of total with PBIT margin at 16.1%.

In FY 20 Hikal faced several headwinds in business. During the year, the business operations in both divisions were impacted due to several reasons. In Q2 its Crop Division business was affected by severe flooding at Mahad (Maharashtra) facility and water cuts at Taloja (Maharashtra) facility.

Also, in Q2 Pharmaceutical division took a plant shutdown to increase capacities, which resulted in a loss of revenues and profits. Crop protection business reported a flattish growth for the year because there was some inventory correction from some of major customers. The nationwide lockdown imposed by Government of India to contain the COVID-19 pandemic further disrupted the operations resulting in loss of revenue towards the end of Q4.

Adverse impact of Covid-19 in short term

The company had shut down its operations on 21st March 2020 post lockdown announcement by government of India. Being a part of the essential services industry it was able to restart its operations on 5th April 2020 after getting permission from the respective government authorities. It took around 10-15 days to normalize the operations and start producing in holistic manner.

During the COVID-19 lockdown the company had implemented several cost rationalization and efficiency improvement measures across the company

On the contract manufacturing side it has several products in various stages of development which will fuel its growth for several years

The capacity utilization for the month of April was low. However, the utilization improved to 60% in May. Currently in June it is operating around 80% utilization across its manufacturing planta. The company currently has approximately 75 to 80% of manpower working at its manufacturing plant units.

On the raw material supply side the company faced initially several logistical issues due to restriction and movement of goods, which are resolved to a large extent. However the company is still facing few instances of delay and non availability of some raw materials and it is taking necessary action to mitigate this risk.

During the COVID-19 lockdown the company had implemented several cost rationalization and efficiency improvement measures across the company. These include increasing its domestic sourcing of the raw materials as well as the increasing automation, mechanization and implementing industry 4.0 initiative which will lead to improvement in operational efficiency going forward.

Business continues to be robust with no major impact on demand for its products. The company stated that there has been no cancellation of any orders. And it continues to be optimistic for the long term prospects of both its divisions.

Covid will improve the medium-to-long term prospects

The pandemic has led to additional inquiries from customers who are looking to de-risk their current supply chains. Management is confident that it will be able to capitalise on these opportunities for future growth. The company's long time good relations and solid track record with many leading MNCs in pharma and crop protection field will give it an edge in capitalizing on these new opportunities. However conversion of opportunities in to real business takes time due to various negotiations and regulatory procedures.

Besides export opportunities in both its businesses (pharma and crop protection), the company is also focusing on improving business in domestic market to capitalize on opportunities to replace imported materials as domestic players are increasingly looking at sourcing materials locally, rather than import from China.

During FY20, the company has filed three new drug master files in generic business. On the contract manufacturing side it has several products in various stages of development which will fuel its growth for several years. It expects major revenues to flow from FY22-23

The company has successfully developed the API for Favipiravir at pilot scale and is currently supplying test quantities to clients. Favipiravir is currently in medical trials for the treatment of COVID-19.

And clinical trials are currently running all across the world. The company is currently scaling up the product and expect to commercialize the product by September October of this year. There is still a regulatory process involved and it is still early to gauge the demand and the revenue potential.

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Building capacities to capitalize on opportunities

The company is continuing its capex plan in both of its segments. During the COVID-19 lockdown, the construction activity was completely stopped. However, with the relaxation in lockdown the company expects to resume construction activities shortly. Currently, the availability of skilled manpower has been a challenge in the ongoing pandemic and it is discussing with various contractors to provide skilled manpower for the long term basis. The company expects to complete the capex by end of FY21.

Out of the total capex of Rs 300 crore the company has already spent Rs 158 crore and the balance will be spent in FY21. The capex plan is equally split between both the division in pharmaceutical and crop protection with a majority of which is being incurred in Panoli site. The asset turnover on the total capex is expected to be about 1.5 times

Capex to be completed by end of FY21 should start rolling in revenues from FY22 while major contribution is expected to start from FY23. The company expects revenue of Rs 2500 crore by FY23

The capex plan is equally split between both the division in pharmaceutical and crop protection with a majority of which is being incurred in Panoli site. The asset turnover on the total capex is expected to be about 1.5 times

Valuation

Hikal had a difficult FY20 in which flooding, pollution issues, planned shutdown besides Covid related disturbances created significant headwinds in an otherwise steady business model. FY21 performance too is expected to be tepid due to lack of visibility led by ongoing Covid 19 related issues. However going ahead as the capex gets completed in FY21, and new products revenues go on stream and new opportunities are won, prospects are looking promising for FY22 and beyond.

In FY 2021 and FY 2022 we expect Hikal to register EPS of Rs 5.7 and Rs 9.8 respectively. The scrip trades around Rs 124. P/E on FY22 projected EPS works out to around 13

HIKAL: RESULTS

	2003(03)	1903 (03)	VAR %	2003 (12)	1903 (12)	VAR. (%)
Sales	378.99	457.50	-17	1507.26	1589.61	-5
OPM (%)	18.6	18.4		18.1	18.8	
OP	70.63	83.98	-16	273.15	298.12	-8
Other inc.	1.73	0.05	999	3.70	2.26	64
PBIDT	72.36	84.03	-14	276.85	300.38	-8
Interest	13.70	12.64	8	52.42	58.43	-10
PBDT	58.66	71.39	-18	224.43	241.95	-7
Dep.	20.94	23.23	-10	82.46	92.88	-11
PBT before EO	37.72	48.16	-22	141.97	149.07	-5
EO	0.00	0.00	0	15.40	0.00	0
PBT after EO	37.72	48.16	-22	126.57	149.07	-15
Total Tax(including MAT)	13.25	14.82	-11	42.14	46.01	-8
PAT	24.47	33.34	-27	84.43	103.06	-18
EPS (Rs) *	#	#		7.7	8.4	

*Annualised on current equity of Rs 24.66 crore: Face value of Rs 2 each. EO: Extraordinary items. EPS excludes EO and relevant tax. Figures in crore. *Source Capitaline Database*