**NGL Finechem Management Q&A – 26 Feb 2018**  
– Ayush Mittal  
– Donald Francis

**Human APIs/Veterinary APIs**  
Kindly educate us a little on NGLs addressable domain. Any plans for addressing adjacent domains?

We are into Veterinary and Human APIs. If we look at the Industry 80% of Veterinary products are also used for Humans. Exclusively veterinary products would be about 20% of the market.

Anthelmintics – De-wormers – is one major category of products we operate in. Animals have to take de-worming once a month due to raw food and conditions they ingest in. There is a huge number of worms that need to be routinely expelled from their bodies. Similarly Blood Parasites is another big category– Animals get bitten a lot by different types of ticks and fleas.

New product introductions is a continual process. We added one new Analgesic product. We are adding one product in muscle growth category. Till now we had been only addressing API requirements for mammals. Now we are looking to introduce five new Poultry products.

**Business Evolution/Product Opportunity Choices**  
NGL Finechem enjoys a profitable niche today. Kindly elaborate on business/product choice philosophy/process.

The kind of product selection you see today started off by chance. In 1981 we were making pharmaceutical APIs like Erythromycin. Till the late 90’s we were into Human APIs. These were primarily 2-step, 3-step process chemistry with low/vanishing margins. The business evolved gradually. In 1997 a Dutch company asked us if we could manufacture a 8-stage-synthesised complex chemistry product. It was our first veterinary product that we delivered and it was very successful.

This was totally different to what we were doing till 1997 – dependent on bulk traders – a different customer set. We started to develop new set of client and product profiles – exploring synergies around customer needs. It took a long time. Gradually customers started asking us for new products – most of which were earlier manufactured in European Union.

In 1997 we had 1 product and by 2007 we could offer 6-7 such products. By 2017 we are now offering 22 products.

What will be the share of complex chemistry products in the 22?  
Most are 7-8 stage synthesis complex chemistry products (higher scope for value-addition). Some are 3-4 step products. We have developed the process chemistry for all products in-house.

You enjoy high profitability margins. How do you go about choosing product niches?   
Whenever you start a new product, you are never the best at it. You become better, more efficient (process chemistry), with time. We don’t go by margins to start with. We have never chosen a product from market size/profitability analysis. Volume products usually see high competitive intensity. We have consciously chosen a low-volume niche game – products which we can make well and sell well. Every year while working on new products we need to also focus on improving process efficiency for existing products.

**Markets/Customer Segments/Evolution**  
Can you please elaborate on the sell-well philosophy?  
First we need to be able to make the product efficiently. Then we need to treat our customers well. No false promises. Be able to fulfill in the quickest possible time. Be transparent in pricing – we have actually passed-on price discounts to our customers on occasions where there is a big benefit. We have done this on 3 occasions till now. We always strive towards developing long-term relationships with our customers.

Could you give us a sense of how Customer Segments has evolved?  
15-20 years back we were 100% dependent on traders. Today contribution from traders will be less than 10%. Traders are bulk customers and would order in Tons. Today we serve about 350 customers directly. Ultimate customer requirements would be in 50Kg to 100 Kg lots – but with higher profitability. We serve 4 of the Top 10 global customers. All customers from 1997 are still with us.

How easy or difficult is it to access/address top global customer requirements?  
To address a top customer it can take anything between 2-4 years for first sale to happen. It took us 4 years with our largest customer. The requirements have become stiffer and takes longer with Customers now asking for 3 commercial batches versus lab sampling earlier. One now needs to provide stability data also. Most common requirement is 6 months accelerated study. And Customers will then perform their own checks. Our facilities are audited every 2 years. 40% of our Sales are to EU customers – but for Sales in other un-regulated markets.

You seem to be focusing only on un-regulated markets? The rationale?  
At this stage of our business size we are content to play in un-regulated markets. We find there is enough scope in the medium-term for our product range to scale efficiently, and profitably in these markets. You see the cost-structures for a regulated market entry is much higher. It is not only the registration/filing costs; one cannot serve both regulated and un-regulated markets from the same factory – cost-efficiently. The investments in manpower, equipment, testing also are of a higher order.

If regulated markets are growing at 6-7%, how are unregulated markets doing?  
Un-regulated Markets are growing at a much faster rate. What happened in India in the 80s is getting replicated in many countries. Every country/government is encouraging and providing incentives for local manufacture. To give some examples – In 2004 when we first went to Columbia, there were only 10-12 companies, today there are 300-350 companies. Bangladesh had 20-25 pharma companies, today there are 500 pharma companies, 20-25 are veterinary companies. Most of these companies are making formulations – they need APIs from quality and efficient suppliers like NGL.

What would be the addressable market for NGL’s current 22 products in unregulated Markets?  
Difficult to put a proper figure here without published data. But should be around ~1000 Crores.

Nature of Customer Contracts. Proportion of long-term contracts versus SPOT orders?  
Typically Customer relationships are all long term in nature. As mentioned before all our customers from 1997 are still with us. However most orders are on SPOT basis. There are couple of products for which we do contract manufacturing for which contracts are long term in nature.

**Competition**  
Peer comparison: (Hester is not a relevant peer)

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| --- | --- | --- | --- | --- |
| **Particulars (in %)** | **2017** | | | |
| **Sequent** | **Hester** | **NGL** | **Lasa** |
| **RM Cost** | 48.7% | 23.3% | 37.7% | 65.5% |
| **Employee Cost** | 14.3% | 15.0% | 13.9% | 4.9% |
| **Other Exp** | 26.1% | 28.2% | 22.6% | 6.9% |
| **OPM** | **11%** | **33%** | **26%** | **23%** |
| **Dep.** | 6.8% | 5.7% | 3.0% | 4.3% |
| **Finance Cost** | 4.0% | 2.8% | 0.7% | 4.7% |
| **PBT** | **0.1%** | **25.0%** | **22.0%** | **13.8%** |

Players like Sequent (with lot of common products) are focusing on addressing the larger market opportunity in regulated markets?  
Yes. Sequent has set themselves a much bigger goal. They have taken a conscious decision to move away completely from un-regulated to regulated markets. In the initial transition/consolidation period efficiency/profitability may suffer. They should do very well post the transition.

Someone like LASA (with some common products) seems have much higher RM costs, yet operating at similar 20%+ margins? Any comments  
Not sure why that should be so. One aspect could be that they might have a higher proportion of volume products. Typically lower step process products have lower gross margins (less scope for value-addition).

Please give us a sense of competitive intensity for NGL product segments  
As mentioned before we consciously choose low volume niche product segments that are difficult to make well and attract low competition. For most of our products typically there would be 5-6 suppliers in our markets

**R&D Investments/DMF Investments/Capacity**

Kindly update us on your in-house R&D capabilities?  
We have a full-fledged analytical lab set-up in-house since 2005. There are 22 people in R&D – 3 PHDs, 10-11 MSCs.

You have also filed for 2 DMFs. Kindly elaborate on that?  
Yes we have filed 2 DMFs in 18 Countries in EU. We now have in-house capabilities to create product dossiers and file DMFs – with 6months Accelerated Study data, Real-Time data, Impurity Profiles, Pilot and then Stability Data. We seeded this in a small way to build-up our in-house capabilities.

Capacity creation has lagged behind? Kindly comment.  
It’s very easy to create capacity!  
We were caught on the wrong foot during last expansion. We thought of consolidating in 2012 for a couple of years. We wanted to start work in Nov 2014 but it took about 21 months to get EC approval – which we had not anticipated. By 2015 we ended up utilizing full capacity and could start expansion work only in 2016.

We are being proactive for future expansions. We have taken land in Tarapur. One EC approval we have got. Hopefully we should get the other approval soon. Will kick start next expansion once we hit about 50% utilization at the current capacity.

What kind of Asset Turns will be achievable at full capacity?  
We should be able to meet our usual 2.5 Asset Turns norms

We see NGL setting a fine record in all round process efficiency. For example the energy and water usage drastic improvements. How are these targets set?  
As they say sometimes necessity is the mother if invention. For example in one of our plants the Water Authority suddenly reduced the water pressure – with the result that where we used to get 55 Cu meters/day, we started getting only 35 Cu meters/day. We had to adapt and adapt fast.

Having said that we set ourselves yearly goals in the first month every year. We set a sort of wishlist and work towards that during the year. We set wishlists on how to make some things better, how to sell better, how to achieve better chemistry, how to improve our employee skills, how to reduce wastages. It’s a wishlist – a process for continuous improvement. Cumulatively the results show up. If we stop thinking, we stop growing.

**Risks**  
You enjoy pretty stable operating margins. Yet, if most of your Sales are SPOT basis, aren’t there risks on price realisations being volatile? What has been the experience?

Today all pricing is Global and Open in nature. We haven’t experienced much volatility as we operate in low-volume niche markets, competition is low. Yes risks always exist for a new player to come in and under-cut. This is more common in bigger volume pharma product markets. But sometimes we do experience some level of dumping at quarter end.

What about risks on Environment regulations/Tightening Norms?  
Regulatory Norms are getting tighter. In 2017 plants in Tarapore subjected to weekly monitoring by NGT. 8 plants have come under scanner in last 3 years. Cost of compliance is climbing up. For example Effluent Plant investment needed has gone up from 1 Cr to 5 Cr today. Our new plant is completely Zero Liquid Discharge compliant.

Fire Risks?  
We had two instances of fires breaking out in 2003 and 2009. We have a full-fledged Fire Safety Team.

High Debtor Days (90-120 days)?  
High Debtor days are a norm in most of our markets. In LatAm markets they require additional 40days of credit after receipt. But correspondingly we get higher realisations – say a $40/Kg product we would realise $44

Any other Risks?  
In our business we always carry risks of new products doing well.

Risks of China Intermediates supply suddenly stopping?  
Most of our intermediates are available locally. However it can happen in one or two products e.g. in Vitamin B12 and Amitraz – China supply for key intermediate suddenly got squeezed with some factories closing. RM costs shot up 8-10x. Market reaction was for substitute products getting prescribed/used.

**Disclosures:**  
Ayush Mittal – Invested; No transactions in last 30 days  
Donald Francis – Tracking; Not Invested