

# Management Discussion and Analysis

## Global Economic Overview

2018 was a challenging year for the global economy. As a result, the global economic growth in 2019 is likely to further slip to 3.3%. However, the economy is expected to start rebounding from the latter part of 2019 and pick up growth to 3.6% in 2020.

Source: IMF's World Economic Outlook Report - April 2019

## Indian Economic Overview

India continues to remain one of the fastest growing major economies in the world despite moderation in real GDP growth to 6.8% in FY 2018-19 from 7.2% in FY 2017-18.

Source: Economic Survey Report FY 2018-19

The fundamentals of Indian economy has substantially improved supported by on-going structural reforms and progressive policy measures.

## Industry Overview

The global specialty chemical market is expected to grow at a CAGR of 5.47% from USD 743.80 billion in 2017 to USD 970.55 billion in 2022. Agrochemicals segment dominated the global specialty chemical industry followed by polymers and plastic additives segments.

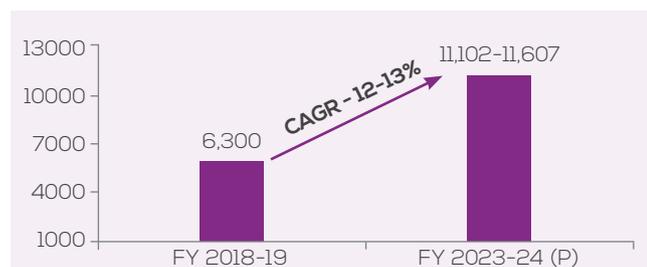
Asia-Pacific especially, China and India, are likely to be the major revenue contributors to the specialty chemicals market throughout the forecast period.

Source: CRISIL Research

## Indian Specialty Chemical Industry

The size of Indian Chemical Industry after registering a growth of 7-8% CAGR during FY 2013-14 to FY 2018-19, stood at Rs. 6,300 billion in FY 2018-19. Specialty chemicals accounts for 20-25% of the overall chemicals industry and is expected to grow significantly at a CAGR of 12-13% over the next five years. The industry serves both domestic and global market.

### Indian specialty chemicals industry - Market size (Rs. billion)



Source: CRISIL Research Report; P: Projected

## Overview of key end-user industries for specialty chemicals in India

### Pharmaceutical Intermediates market

Specialty chemicals are used by pharmaceutical manufacturers as intermediates in making drugs. India has emerged as a key manufacturing hub of Active Pharmaceutical Ingredients (APIs) and generic formulations. The pharmaceutical intermediates market which stood at Rs. 553 billion in FY 2017-18 is expected to reach Rs. 677-716 billion in FY 2020-21, exhibiting a CAGR of 7-9% over the forecasted period.

Source: CRISIL Research

### Agrochemicals

Specialty chemicals are used as intermediates in agrochemical industry. With strong growth drivers in place, the agrochemical consumption is expected to grow at a CAGR of 8-10% in the next 5 years

### Domestic crop protection market size (Rs. billion)



Source: CRISIL Research; P: Projected

### Heating, ventilation and air conditioning (HVAC) / Electronic Chemicals

The domestic HVAC market is expected to grow at a CAGR of 11-12% from Rs. 240-246 billion in FY 2017-18 to reach Rs. 330-345 billion in FY 2020-21. Growth is expected to be driven by higher demand for commercial spaces, development of smart cities, on-going and upcoming airport and metro infrastructure.

Source: CRISIL Research

### Polymer, Paints, Coatings and Construction Chemicals

As per IBEF Infrastructure Report, May 2019, India is expected to become the third largest construction market globally by 2022. CRISIL Research expects construction

industry in India to grow at a CAGR of 8-10% led by an increase in housing and infrastructure investments.

## Company Overview

Neogen Chemicals Ltd. (hereinafter referred to as NCL / the Company) is one of India's leading manufacturers of bromine and lithium-based specialty chemicals.

### Product Portfolio

NCL's product portfolio includes specialty organic bromine-based compounds, other specialty organic chemical compounds and specialty inorganic lithium-based chemical compounds.

**Organic Chemicals:** Product offerings in this segment include bromine compounds and other organic compounds containing chlorine, fluorine and iodine-based and combinations thereof along with niche products such as Grignard reagents. This segment also offers Advanced Intermediates manufactured by combining bromination with other chemistries to create forward-integrated value-added products. The major end-users in this segment include pharmaceutical, agrochemical, flavour and fragrance and electronic-chemical. This segment contributed 82% to FY 2018-19 total revenues.

**Inorganic Chemicals:** The products in this segment includes specialty, inorganic lithium-based chemical compounds which are used in eco-friendly Vapor Absorption Machines (VAM) for cooling air/water/process equipment. These products find application in industries such as heating ventilation and air-conditioning (HVAC) and refrigeration, construction chemicals, pharmaceutical and specialty polymer. This segment contributed 17% to FY 2018-19 total revenues.

The Company is further expanding its organic chemical segment by undertaking custom synthesis and contract manufacturing.

## Business Development and Strategies

### Enhancing the production capacities

NCL is focussed on increasing its production capacities. Presently, the Company is developing a greenfield manufacturing unit at Dahej SEZ, in Gujarat and is also proposing to expand its organic chemical operations in Dahej SEZ. The proposed Dahej SEZ facility is expected to cater to the anticipated increase in demand for inorganic chemicals and will almost double the Company's total inorganic specialty chemical manufacturing capacity to 24,00,000 kg production per annum. Looking at the pipeline and the growing number of enquiries for advanced intermediates and Contract Manufacturing from the

clients in Europe and Japan, the Company further proposes to expand its Organic Chemical manufacturing capacity by setting up a Multi-Product Plant at Dahej.

### Increasing the share of contract manufacturing portfolio

The Company has entered into contract manufacturing arrangements with a few international pharmaceutical, agrochemical, aroma and specialty polymer companies. Going forward, NCL aims to increase the size and scale of contract manufacturing business to be able to enter into long term contracts with assured margins and product off-take thereby strengthening the continuous flow of business. The Company has several projects in the R&D which are enquiries from Innovator and Generic companies. The Management has a clear strategy to focus on development of the Custom Synthesis and Contract Manufacturing business.

### Expanding growth in domestic and global markets

There is a strong demand potential for bromine and lithium-based products in India and overseas, owing to growing demand in their final application industries. The Company targets to increase its exports share by leveraging its strong manufacturing capabilities, long-standing customer relationships, strong R&D competencies and robust product portfolio.

### Focus on higher value addition advanced specialty intermediates

Over the last few years, the Company has done forward integration by focussing on combining bromination with other chemistries to make advanced intermediates that are traditionally manufactured by customers. This value addition will reduce a processing stage for customers and free-up their specialised capacity for making final molecules such as APIs, specialty polymers, electronic chemicals etc. This also benefits the NCL with higher margin and increased profitability. The Company intends to enhance its presence in the segment to strengthen business sustainability and cater to the increasing demand for such advanced intermediates, for which it is proposing capacity expansion programme.

## Financial Performance

### Standalone financial performance for FY 2018-19 vs. FY 2017-18

Standalone revenue including other income for FY 2018-19 increased by 45% and stood at Rs. 23,975.78 Lakhs as compared to Rs. 16,481.66 Lakhs in FY 2017-18. Revenues from organic chemicals segment increased 82% to Rs. 19,300 Lakhs led by better capacity utilisation and efficiency in operations. Revenues from inorganic chemicals segment declined

by 17% to Rs. 4,800 Lakhs due to decline in prices of lithium and softer demand. The revenue growth was majorly on account of higher capacity utilisation, favourable product mix and increased productivity in Vadodara facility. Consequently, EBIDTA for FY 2018-19 increased to Rs. 4,341.90 Lakhs as compared to Rs. 2,899.23 Lakhs in FY 2017-18, exhibiting a growth of 50%. Net Profit for FY 2018-19 increased two-fold to Rs. 2,103.67 Lakhs as compared to Rs. 1,069.05 Lakhs in FY 2017-18 as the higher EBIDTA was supported by lower finance cost due to higher export and improved rating and reduction in tax rate. The Earnings per Share (EPS) for FY 2018-19 grew to Rs. 10.48 as compared to Rs. 5.35 in FY 2017-18, a growth of 96%.

### Consolidated Financial Performance for FY 2018-19 vs. FY 2017-18

Consolidated revenue including other income for FY 2018-19 increased by 45% and stood at Rs. 23,966.82 Lakhs as compared to Rs. 16,471.36 Lakhs in FY 2017-18. The higher capacity utilisation with economies of scale resulted in EBIDTA increasing from Rs. 2,899.23 Lakhs in FY 2017-18 to Rs. 4,341.90 Lakhs in FY 2018-19. Net Profit for FY 2018-19 increased by 91% to Rs. 2,094.69 Lakhs as compared to Rs. 1,098.45 Lakhs in FY 2017-18. The Earnings per Share (EPS) for FY 2018-19 grew to Rs. 10.43 as compared to Rs. 5.49 in FY 2017-18.

The Company recorded a Networth of Rs. 7,020.07 Lakhs as on March 31, 2019 as against Rs. 5,041.50 Lakhs as on March 31, 2018. Total Debt increased to Rs. 11,998.64 Lakhs as on March 31, 2019 from Rs. 8,221.39 Lakhs as on March 31, 2018. During the same period, the Net Fixed Assets increased to Rs. 8,271.19 Lakhs as against Rs. 6,699.92 Lakhs, while Cash and Cash Equivalents stood at Rs. 116.64 Lakhs as against Rs. 31.73 Lakhs.

Ratio	2017-18	2018-19
Operating Profit	₹ 2,899.22 Lakhs	₹ 4,341.90 Lakhs
Operating Profit Margin	17.68%	18.16%
PAT	₹ 1,069.05 Lakhs	₹ 2,103.67 Lakhs
PAT Margin	6.52%	8.80%
Current Ratio	1.28	1.37
Inventory Turnover	3.64	3.91
Net Debt to Equity level	1.63	1.70
Interest Coverage ratio	2.61	3.40
Debtors Turnover ratio	4.98	5.01
Return on Networth	21.13%	29.86%

### Corporate Social Responsibility (CSR)

NCL undertakes strong and continuous efforts in framing its CSR policies and participation in social welfare measures where it can provide maximum benefits to the society at large. The Company has constituted

a CSR Committee and also formulated a CSR policy to govern such initiatives. The Committee decides / recommends to the Board on details of CSR activities to be undertaken.

### Human Resources

Human resources are vital in the successful growth of a Company. NCL strives to maintain a balance between business needs and individual aspirations by adoption of new technology and progressive employee centric policies and practices. The Company remains focussed on attracting the best talent in the industry and nurturing them through robust learning and development mechanisms. The Company has a strong employee retention mechanism where it motivates them through regular engagement and undertakes fair and transparent performance appraisal. NCL ensures a safe, conducive and productive work environment for its talented pool of employees who continue to play key roles in enhancing business efficiency, devising strategies and evolving business as per industry requirements.

### Environment, Health and Safety (EHS)

NCL has implemented an effective audit and verification approach across all operations to track all the products and processes and ensure they comply with its EHS policies, procedures and practices. The Company strictly adheres to the laws, regulations and contractual commitments concerning air emissions, wastewater discharges, solid and hazardous waste material handling, worker health and safety, and the investigation and remediation of contamination or other environmental restoration.

### Quality

NCL's products and manufacturing processes are subject to stringent quality standards and specifications. The Company has strict quality control processes and systems to recheck and monitor the operations to ensure that they meet production standards and compliance with regulatory requirements at every stage of its operations. Further, the Company's customers regularly carry out audits of its products, facilities and manufacturing processes to ascertain quality.

### Internal Control System

NCL has laid down internal control policies, guidelines and procedures in accordance with the nature, size and complexity of business operations. The management looks after designing, implementing and maintaining adequate internal control relevant to the accuracy in preparation and presentation of the financial information. The Company's

internal team and Audit Committee closely supervise the business operations. The committees also ensure adherence and adequacy to Company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information. Any irregularity, failure or deviation of internal control systems are reported to the management so that timely and adequate measures are undertaken to ensure uninterrupted functioning of the business.

## Risk and Mitigation

The Company has developed and implemented the Risk Management Policy which is reviewed periodically by the Board of Directors. The below risks which are under the purview of the Company's control are managed through a robust risk management process of risk identification and mitigation, through risk reduction strategies and plans. NCL constantly monitors the success of the risk mitigation measures to control them.

- **Regulatory Risk:** NCL operates in a number of global markets and is exposed to the risk of changing regulations.

**Mitigation:** The Company has strong policies for quality and Safety, Health and Environment (SH&E), which it continues to upgrade on an on-going basis to remain compliant to local norms in various international markets. The Company's manufacturing facilities are certified with ISO 9001:2015 for quality, ISO 14001:2015 for environmental standards and BS OHSAS 18001:2007 for operational health and safety by Bureau Veritas Certification Holding SAS-UK branch. The Company works closely with various international customers to understand their specific requirement and local regulatory requirement and adheres to the same.

- **Innovation Risks:** NCL has inculcated the culture of innovation in product and processes to ensure sustainable growth. Inappropriate investment in processes and technology and poor R&D could adversely impact the Company's business integrity along with its reputation.

**Mitigation:** NCL has two R&D facilities, one each in Vadodara and Mahape manufacturing units. The Company has a dedicated 22-member R&D team which comprises ~10% of total workforce.. The team includes 5 senior personnel with doctorates in science (Ph.D.) from reputed institutions. All R&D initiatives are led by the Senior Leadership. Since

inception, the Company's product portfolio has grown from around 20 products to 198 products. At present, the Company is committed to strengthen its R&D capabilities on a continuous basis.

- **Forex risks:** NCL derives approximately 50% of its revenues from outside India including 16% deemed exports (where the Company supplies products to its EOU, SEZ customers who eventually export their end products). Being exposed to a significant number of geographies, any unfavourable movement in currency will lead to financial losses.

**Mitigation:** The risk is minimised with a natural hedge as the Company procures about 40-60% of its raw materials from domestic sources. The Company keeps track of currency movements on an ongoing basis and enters into forward contracts to hedge the foreign currency exposure. Further, the Company has pass-through mechanism with its customers for price reset on monthly basis for foreign exchange movement.

- **Raw Material Risk:** The Company is exposed to the risk of availability of raw materials and fluctuation in raw material prices.

**Mitigation:** NCL has built a long-standing relationship with its suppliers to ensure steady availability of raw materials at competitive prices. Further, the Company enters into short-term supply contract for a period of around one year and manages the inventory of raw materials and finished products in response to changing market scenario. Large volume annual contract also provides the Company significant rate negotiation power. Further, the Company follows the back to back contracts with suppliers and customers for large volume.

## Cautionary Statement

Certain statements in the management discussion and analysis may be forward looking within the meaning of applicable securities law and regulations and actual results may differ materially from those expressed or implied. These statements are likely to address the Company's growth strategy, financial results, product potential and development programmes based on certain assumptions and expectation of future event, actual results could differ materially from those expressed or implied. The Company assumes no responsibility to publicly amend, modify or revise any forward looking statements on the basis of subsequent developments, information of events.