November 17, 2017 | RE-INITIATING REPORT | VOL-3, NO-20

Hikal Limited

BUY

CMP: Rs.235 | **TARGET PRICE: Rs.325** | **TIME : 12 months**

REINITIATION REPORT

We had initiated coverage on Hikal Limited on April 20, 2016 (Vol-2 No-7) at the price of Rs143 and target of Rs200. Post our coverage, the stock has breached our initial as well as revised target of Rs250 to hit a new high of Rs265. With the recent developments in the company, the conviction in the recommendation stands strong post the analysis. We thereby re-initiate a BUY call on the stock at CMP of Rs235 and target of Rs325 over a horizon of 12 months.

About the Company:

Hikal Limited (Hikal) was incorporated in 1988 as a private limited company by the Hiremath family and Surajmukhi Investments & Finance Limited, a wholly owned subsidiary of Kalyani Steels Limited as the shareholders. Hikal being the preferred partner of choice of leading pharmaceutical and agrochemical companies is engaged in R&D, manufacturing and marketing of fine chemicals for different customers across the above industries. It collaborates with innovator companies and offers solutions in Contract Research, Custom Synthesis and Custom Manufacturing. It has the edge of being one of the few companies globally that have a hybrid model catering to diversified industries.

INVESTMENT RATIONALE

(A) The catalyst for change:

The crux of the company has always been robust R&D, knowing this; one should also be aware of the fact that these are slow and time consuming processes. There are lot of changes taking place in Hikal's approach towards consistent growth which will bear fruits only in the long term. The team that Hikal has built appears to be energetic and aims to further propel the growth story.

The company has a twin play in Pharma and crop protection. They maintain a beautiful balance between the two segments and provide customised solutions as per the market demand. This hybrid model helps cater to the diverse industry. The company has been a slow compounder; they grow at their own pace, however steadily. Moreover, they appear to be at the brink of a transformational change, which will be backed by the already existing product as well as new additions which will come in the long term. All these efforts will benefit the company becoming a stronger player in both the segments of crop protection as well as Pharma API. The company has one of its plant at Panoli. This plant will be dedicated towards API manufacturing going forward and probable de-bottlenecking can be seen here in times to come.

The company has adopted the three pronged strategy for manufacturing API for Human health, Generic API and Animal Health. This so called three pronged strategy would be applied for the crop protection as well. The company is working towards niche technologies like steroid and peptide chemistry. The company has indicated the animal health division to be a small segment, however highly profitable. It further intends to launch new variants in times to come. The company is working on addition of new molecules to its offerings. In terms of diversification in biocides and speciality chemicals; last year the company has already launched biocides and is focusing on neighbouring countries for better prospects and customers for the same.

The management has indicated growth opportunities in the markets of NAFTA, LATAM. With the GOI looking at indigenous producers of insecticides, Make in India should benefit the company going forward. Moreover, the environmental issues in China should also lead to opportunities for Indian bourses. The commercialization of two new insecticides and fungicides is under radar of the company. The company is in the process of filing new DMFs for anti diabetic products that it is developing. It has added four DMF and two certificates of suitability. The company is continuing its focus on contract development and contract manufacturing.

Please Turn Over

SNAPSHOT	
52 week H / L	Mcap (INR mn)
265 / 191	19,317
Face value: 2	
BSE Code	NSE CODE
524735	HIKAL

Annual Performance

(Rs mn)	FY15	FY16	FY17	FY18E
Sales (Net)	8719	9256	10139	11357
EBITDA	1825	1809	1985	2158
EBITDA (%)	20.9	19.5	19.6	19.0
Other Income	16	18	34	38
Interest	600	622	498	479
Depreciation	642	673	691	739
PBT	193	120	161	264
PAT	405	413	668	714
Equity	164	164	164	164
EPS (INR)	5	5	8	9

Quarterly Performance

Parameters (Rs mn)	Dec-16	Mar-17	Jun-17	Sept-17
Sales (Net)	2,508	3,096	2,627	2,923
EBITDA	489	570	497	538
EBITDA (%)	19	18	19	18
Other Income	5	12	16	4
Interest	131	91	117	131
Depreciation	171	171	213	215
PAT	132	274	133	153
Equity (Rs mn)	164	164	164	164

Ratio Analysis

Parameters (Rs mn)	FY15	FY16	FY17	FY18E
EV/EBITDA (x)	12.9	13.2	12.0	11.0
EV/Net Sales (x)	2.7	2.6	2.3	2.1
M Cap/Sales (x)	2.2	2.1	1.9	1.7
M Cap/EBITDA (x)	10.6	10.7	9.7	9.0
Debt/Equity (x)	0.9	0.9	0.8	0.7
ROCE (%)	15	14	14	14
Price/Book Value (x)	3.6	3.4	3.1	2.9
P/E (x)	47.7	46.8	28.9	27.1

Share Holding Pattern as on 30th September 2017

Parameters	No of Shares	%
Promoters	5,65,28,510	68.77
Institutions	99,87,517	12.27
Public	1,51,06,413	18.96
TOTAL	8,16,22,440	100.00

Note: All the data is calculated as per Market Price on 16th Nov 2017.

Hikal Limited — BUY

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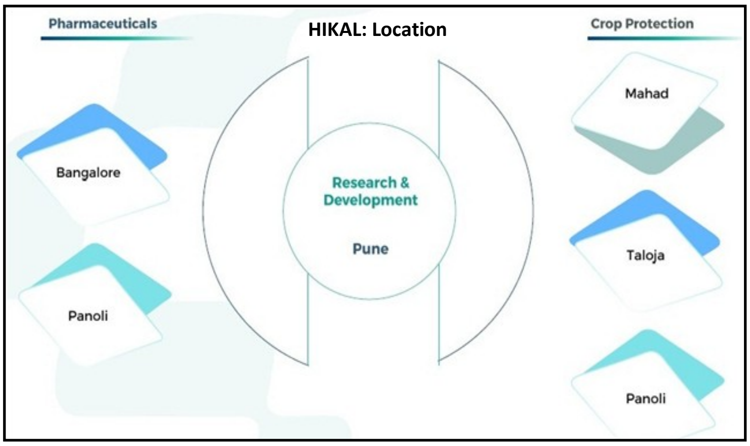
INVESTMENT RATIONALE (contd.)

(A) The catalyst for change:

Some of the key strategies for growth chalked by the company would include:
(a) Aggressive growth in the segments of Pharma, animal health and crop protection.
(b) Develop their own portfolio of products as a strategy for growth.
(c) Maintaining the positive track record with existing customers.

(B) Hybrid business model:



Source :Company presentation Sept 2017

Hikal is engaged in the manufacturing of various agrochemical intermediates, specialty chemicals, active pharmaceutical ingredients and contract research activities. Hikal is amongst the few global companies to offer customised, cost effective and sustainable solution which ranges right from R&D to commercial manufacturing. Hikal was the first Indian company to be a member of Rx-360, a global Pharma supply chain consortium. This indicates the world class quality standards maintained the company. The company has established it repute as a preferred supplier to large global customers across the regulated markets. The company continues to maintain strong relation with its clients who may be innovators, mid size Pharma, Biotech and generic companies, thus making Hikal one of the preferred suppliers to some of the top crop protection companies across the globe.
The company has the capability of developing and scaling up services to innovator companies. At the same time, the company offer right combination for growth via its potential and quality products with cost arbitrage. Hikal aims to be a leading, reliable and high quality CDMO player on a global level. The company stands strong with the edge of catering to different industries, helping it avoid dependency on a single sector.

Future Strategies

- European Innovator Client:

Hikal has a long-term contract manufacturing agreement with a European innovator client to commercially manufacture molecules gaining momentum. There have been several other projects which the company is evaluating for commercial manufacturing.

- USA –Based Food Ingredient Client

The company has been doing well with a specialized product with a US based client for food ingredients. Hikal expects several approvals with other new clients using the product.

- Business in Japan

Hikal has developed all the skills to meet all quality requirements in the Japanese markets. The company is in discussion for different opportunities across intermediates and advanced intermediates manufacturing contracts. The company is taking all the necessary initiatives to expand its business in Japan. It has a strong presence in the Japanese markets. The company has been working on multiple research projects for Japanese crop protection companies that are expected to fructify going forward.

Financials:

The company has crossed the significant milestone of Rs10bn in sales. For the full year (FY17-18), there was a 9.5% growth in the net sales at Rs10,139mn as against Rs9,257mn last year. The full year Ebidta (FY17-18) stood at 19% as compared to 20% last year. The net profits (FY17-18) however clocked a good growth of 61.6% at Rs668mn as against Rs413mn. The EPS for FY17-18 stood at Rs8.13. On the segmental front, the Pharma segment grew by 24% while the crop protection division clocked a growth of 23%. For the full year, the growth was 6% and 15% respectively. The quarter ending September 2017, too has shown strong set of numbers, which marks consistent growth in the turnover as well as maintenance of margins of 18-19%.

Risks and concerns:

Unfavorable currency movements could impact the bottom line, as a substantial part comes from exports. Also with the CDMO business there is no visibility regarding the products and clientele due to confidentiality maintained.

Outlook and valuations:

The company is at the transformational stage. It is backed by the existing products as well as the new additions in immediate and long term which will benefit going forward. We maintain our positive outlook on the company with a target price of Rs325.

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