

Chemcon Specialty Chemicals Ltd

Recommendation		SUBSCRIBE		BACKGROUND	
Price Band		Rs 338-340		Company Overview Chemcon Specialty Chemicals Ltd (Chemcon) is a manufacturer of specialised chemicals, such as HMDS (hexamethyldisilazane amine) and CMIC ((chloromethyl isopropyl carbonate), which are predominantly used in the pharmaceuticals industry, and inorganic bromides, namely Calcium Bromide, Zinc Bromide and Sodium Bromide, which are predominantly used as completion fluids in the oilfields industry (the “Oilwell Completion Chemicals”). Objects of the Issue The issue of Rs 318 cr (at upper band) comprised of Rs 165 cr fresh issue and Rs 153 cr Offer for Sale. The company intends to fund capex and working capital from the fresh issue. Investment Rationale <ul style="list-style-type: none">Benefit of capacity expansion of FY20 in near term - The company has tripled its CMIC capacity from 600 MT to 1800 MT in last 3 years in addition to doubling of oil well completion chemical’s capacity. Chemcon has also more than doubled its HMDS capacity in FY20. With higher capacity being available now, the company’s HMDS revenues are likely to grow by 15-20% over CY19-23.Further Increase in capacity by around 60% mainly in pharma division – Chemcon has total volumetric reactor capacity of 374.85 KL, as on July 31, 2020. With the IPO money, it plans to build two additional plants with a total volumetric reactor capacity of 251 KL.High ROE profile – The company enjoys high return ratios due to constant EBIDTA/ton and high Asset turnover (2.8x in FY20). However, it has moderated in last couple of years due to recent capex, which is likely to improve once the capacity utilisation improves. Valuation and Recommendation Between FY18-20 Chemcon’s revenues have grown at CAGR of 29% while PAT grew at higher rate of 36% CAGR. The management believes the company can grow at 15-18% CAGR for next 2-3 years. EBIDTA/ton is expected to remain steady although volumes are likely to improve on the back of (a) strong demand outlook (b) expanded capacity. The issue price commands P/E of 25.5x (FY20) at the upper price of band of Rs 338-340, which is well within the industry range. We recommend “Subscribe” on the issue for listing gains.	
Bidding Date		21-23 Sept			
Book Running Lead Manager		Intensive Fiscal Services, Ambit			
Registrar		Link In-time			
Sector		Specialty Chemicals			
Minimum Retail Application – Details At Cut off Price					
Number of Shares		44			
Application Money		14960			
Discount to retail		NIL			
Payment Mode		ASBA, UPI			
Financials (Rs Cr)		FY19	FY20		
Total Income		303	262		
EBITDA		66	70		
PAT		43	49		
Valuations*		Lower Band	Upper Band		
Market Cap (Rs cr)		1238	1245		
EPS		13.3	13.3		
BV/share		40	40		
P/BV		8.5	8.5		
P/E		25.3	25.5		
*diluted equity					
Post Issue Shareholding Pattern					
Promoters		74.5%			
Public		25.5%			
Offer structure for different categories					
QIB (Including Mutual Fund)		50%			
Non-Institutional		15%			
Retail		35%			
Post Issue Equity Capital (Rs cr)		36.6			
Issue Size (Rs cr)		317-318			
Face Value (Rs)		10			
Runjhun Jain Assitant Vice President (+91 22 6273 8177) runjhun.jain@nirmalbang.com					

Financial Snapshot	FY18	FY19	FY20
Revenues	157	303	262
%growth*	79%	93%	-14%
EBIDTA	45	66	70
% margins	28.7%	21.8%	26.8%
Adj. PAT	26	43	49
EV/EBIDTA @ Rs340			18.0
P/E @ Rs 340			25.5
P/BV @ Rs 340			12.8

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Company Overview

Chemcon Specialty Chemicals Ltd (Chemcon) is a manufacturer of specialised chemicals, such as HMDS (hexamethyldisilazane amine) and CMIC (chloromethyl isopropyl carbonate), which are predominantly used in the pharmaceuticals industry, and inorganic bromides, namely Calcium Bromide, Zinc Bromide and Sodium Bromide, which are predominantly used as completion fluids in the oilfields industry (the “Oilwell Completion Chemicals”).

It is the only manufacturer of HMDS in India and was the third largest manufacturer of HMDS worldwide in terms of production in CY19. It is also the largest manufacturer of CMIC in India and the second largest manufacturer of CMIC worldwide, in terms of production and capacity in CY19. Further, it is the only manufacturer of Zinc Bromide and the largest manufacturer of Calcium Bromide in India.

HMDS is widely used in manufacturing of antibiotics such as penicillin, cephalosporins and other types of penicillin derivatives.

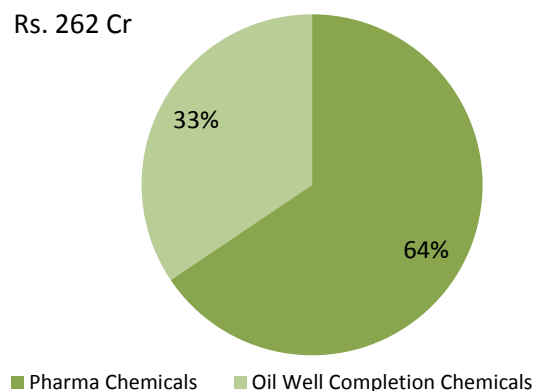
The CMIC belongs to the product category of chemicals used as pharma intermediates. Chloromethyl isopropyl carbonate (CMIC) is an antiviral drug intermediate product, which is a key intermediate for anti- AIDS and anti-hepatitis B drug Tenofovir.

Zinc bromide can be used with other bromides and chlorides to prepare non-damaging Liquids and Calcium bromide Used as a completion and work-over fluid to control wellbore pressures in upstream oil & gas operations

Revenue Breakup

FY20 Revenues

Rs. 262 Cr



The key customers of company’s Pharmaceutical Chemicals include Hetero Labs Limited, Laurus Labs Limited, Aurobindo Pharma Ltd etc and the key customers of our Oilwell Completion Chemicals include Shree Radha Overseas, Water Systems Specialty Chemical DMCC and CC Gran Limited Liability Company.

Chemcon, currently has seven operational plants of which two plants are dedicated to the manufacturing of HMDS and ancillary products (including one plant dedicated to the manufacturing of hi-purity HMDS), one multipurpose plant, currently being used for manufacturing of HMDS and other pharmaceutical chemicals, two plants are dedicated to the manufacturing of CMIC and two plants dedicated to the manufacturing of its Oilwell Completion Chemicals, along with three warehouses for the storage of the products and raw materials etc

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Investment Rationale

Benefit of capacity expansion of FY20 in near term

The company has tripled its CMIC capacity from 600 MT to 1800 MT in last 3 years in addition to doubling of oil well completion chemical's capacity. Chemcon has also more than doubled its HMDS capacity in FY20.

HMDS	Installed Capacity (MT)	Available Capacity	Actual Prdn	Capacity Utilisation (%)	Revenues (Rs cr)
Till 31-July 20	4200	1400	696	49.7%	
FY20	4200	2475	2915	117.8%	114.7
FY19	1800	1800	1674	93.0%	122.4
FY18	1800	2300	1588	69.0%	60.6

The additional capacity of 2400 MT in HMDS was commissioned in March'20 hence the company couldn't get the benefit of the same in FY20. Due to increased demand, it has utilised the one of the CMIC's plant for HMDS production which is a reason for decline in actual production of CMIC in FY20.

Though revenues for the segment have decline in FY20 over FY19 despite increase in the volumes, the management reiterated that its EBITDA/ton, which is fixed in nature, has remained constant and the decline is only due to decline in raw material prices which affected the end product prices too.

HMDS industry is expected to grow at CAGR of 11% over FY19-23. Chemcon being the only manufacturer in India and well poised to cash on the growth opportunities by substituting imports. **With higher capacity being available now, the company's HMDS revenues are likely to grow by 15-20% over CY19-23.**

In addition, Chemcon commissioned its Hi-Purity HMDS plant (Plant P "2") in July 20 with 600 MT capacity. Hi-Purity HMDS finds application in semiconductor and rubber/silicone industries. Besides Hi-Purity HMDS, this plant can also be used for manufacture of normal HMDS (used in pharmaceutical industry

CMIC	Installed Capacity (MT)	Available Capacity	Actual Prdn	Capacity Utilisation (%)	Revenues (Rs cr)
Till 31-July 20	1800	600	451	75.2%	
FY20	1800	1800	808	44.9%	33.9
FY19	1800	1250	1196	95.7%	47.5
FY18	1200	1200	1076	89.7%	32.7

CMIC is a key intermediate for the manufacture of Tenofovir, a nucleotide antiviral anti-AIDS and anti-Hepatitis B drug. Tenofovir has been approved by the US FDA for the treatment of HIV infections and Hepatitis B

India is a net importer of CMIC, with about 62% of India's domestic demand in CY19 being catered to by imports from China. India, a major CMIC consumer market, is expected to witness a demand growth at a CAGR of 11.0% over FY19-23.

Chemcon was the largest manufacturer of CMIC in India and the second largest manufacturer of CMIC worldwide, and is well positioned to substitute the imports from China and hence, has an opportunity to grow at a CAGR of more than 25% over CY19-23

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Oil Well Completion Chemicals	Installed Capacity (MT)	Available Capacity	Actual Prdn	Capacity Utilisation (%)	Revenues (Rs cr)
Till 31-July 20	14400	4800	88	1.8%	
FY20	14400	14400	6039	41.9%	87.7
FY19	14400	14400	8248	57.3%	107.1
FY18	14400	14400	5847	40.6%	56.2

The Company is engaged in the manufacturing of Oilwell Completion Chemicals, which are predominantly utilised in the oil and gas exploration process as completion chemicals. It had doubled the capacity in FY18 to 14400 MT from 7200 MT, however, due to decline in crude oil prices resulting in lower capex in oil wells, the company is not able to fully utilise its capacity.

It has also launched two new products – 4CBC and 2,5 DHT

4 CBC - 4 CBC is widely used in the pharmaceutical and agrochemical industry in the preparation of Pyrazinamide, a medication used to treat tuberculosis. 4 CBC is also used in the agrochemical industry in the preparation of a 4-hydroxyphenylpyruvate dioxygenase inhibitor which is used as an herbicide for weed control in maize and sugarcane.

The company executed its first sale of the product in FY21.

2,5 DHT - 2,5 DHT is predominately used in the pharmaceutical industry in the preparation of and synthesis of substituted tetrahydrothiophenederivatives 2-amino-3-(arylsulfonyl) thiophenes, potential antiviral and antitumor agents. The company is in the process of commencing the manufacturing of 2,5 DHT

Further Increase in capacity by around 60% mainly in pharma division

The company is looking to further expand its manufacturing operations and production capacity. Chemcon has total volumetric reactor capacity of 374.85 KL, as on July 31, 2020. With the IPO money, it plans to build two additional plants with a total volumetric reactor capacity of 251.00 KL. These additional plants shall be utilised for the manufacturing of chemicals which are principally used pharmaceutical industry. With the completion of such expansion, the total volumetric reactor capacity shall increase from the volumetric reactor capacity of 374.85 KL to 625.85 KL and will enable the company to significantly benefit from economies of scale.

Positive Industry outlook

Pharmaceutical intermediates are the chemical compounds that form the building blocks used in production of active pharmaceutical ingredient (API). Over the years, the share of imports in domestic consumption has dropped from ~65% in FY13 to ~58% in fiscal FY19. Further, the overall market of chemicals used as pharma intermediates is anticipated to grow at 7-9% CAGR over the 5 yrs.

In addition, the specialty chemicals industry has high entry barriers due to (a) the involvement of complex chemistry in the manufacture of the Products, which is difficult to commercialize on a large scale and; (b) a long gestation period to be enlisted as a supplier with the customers, particularly with the customers of the Pharmaceutical Chemicals.

China currently accounts for 50% of Global HMDS capacity. However, India is expected to rise as a new exporter in the global HMDS market following challenging situation faced by China leading to India becoming a new preferred origin for the products. This could be a potential success factor for Chemcon. India is expected to witness a demand growth of 10.6% (2019-23) CAGR fuelled by increase of end use customers and growing population base who can afford quality healthcare. In addition, the

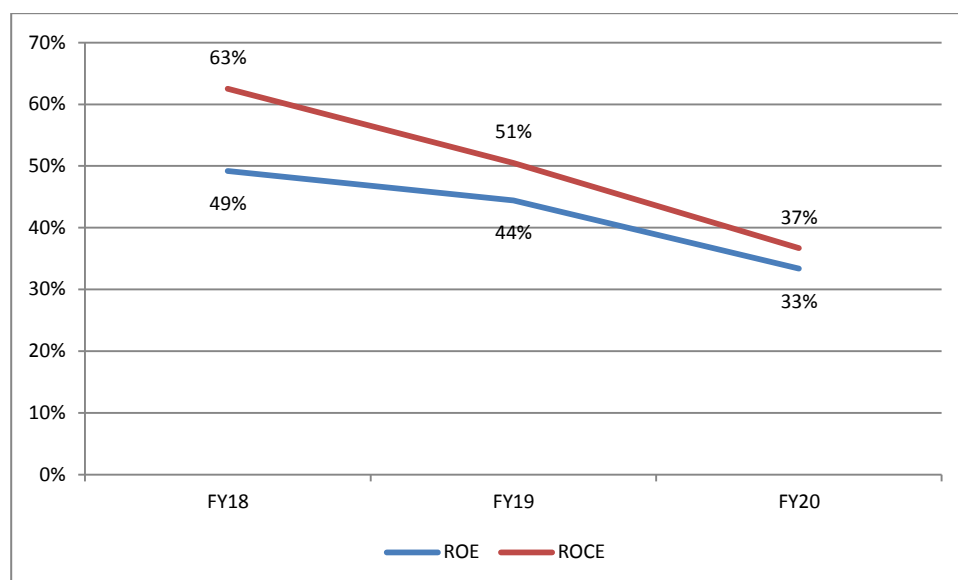
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US-China dispute may influence China's HMDS exports to the US and may indirectly help India boost its exports. Chemcon has already started supplies to US based on opportunity created due to US-China disputes.

India and China are the only countries that produce CMIC. In 2019, India and China accounted for 36% and 64% of the global production share respectively. India, the largest consumer of CMIC in the world, accounts for ~65% of the global CMIC demand. Chemcon is one of the leading players in the market of CMIC industry. The CMIC Global Demand is expected to grow at a CAGR of 10.8% through the projected 4 year period. Currently, India is a net importer of CMIC. Chemcon well positioned to substitute the imports from China and hence, has an opportunity to grow at a CAGR of more than 25% between 2019 and 2023.

High ROE Profile

The company enjoys high return ratios due to constant EBIDTA/ton and high Asset turnover (2.8x in FY20). However, it has moderated in last couple of years due to recent capex, which is likely to improve once the capacity utilisation improves.



Risks and Concerns

- Price takers** – Though Chemcon is a leading player in HMDS and CMIC products, however being an import dominant industry, prices of the products and raw materials are determined by the Import parity prices and the company has no control over it. However, as the EBITDA/ton are generally steady, the company is able to grow profits in tandem with its volumes.
- Product and Customer Concentration** – HMDS (including ancillary products) contributed ~50% of FY20 revenues, likewise in Oilwell completion chemicals (33% of revenues), one single customer contributed ~26% of revenues. Any reduction in the demand of these products can affect the revenues and profitability of the company
- High working capital** - The company has high working capital on the back of increased debtors day which has moved to 122 days in FY20 from 76 days in FY19.

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Valuation and Recommendation

Between FY18-20 Chemcon's revenues have grown at CAGR of 29% while PAT grew at higher rate of 36% CAGR. The management believes the company can grow at 15-18% CAGR for next 2-3 years. EBITDA/ton is expected to remain steady although volumes are likely to improve on the back of (a) strong demand outlook (b) expanded capacity

We have compared Chemcon Specialty Chemicals with the leading specialty chemicals companies with Paushak and Neogen (due to common products and technology) and with IOL chemicals (due to single product company)

	Sales	Sales CAGR FY18-20	EBITDA CAGR FY18-20	D/E	Total Asset Turns	EBITDA Margins	ROE	PE	EV/EBITDA
<i>FY20 figures in Rs. Cr.</i>									
Paushak Ltd.	138	15%	21%	0.0	0.6	31.0%	15.4%	37.5	30.6
Neogen Chemicals	306	38%	42%	0.8	1.1	19.0%	18.4%	57.0	30.5
IOL Chemicals	1895	39%	119%	-0.1	2.7	30.3%	44.4%	13.5	8.3
Chemcon Sp.Chemicals	262	29%	25%	0.2	1.5	26.8%	33.4%	25.5	18.0

The issue price commands P/E of 25.5x (FY20) at the upper price of band of Rs 338-340, which is well within the industry range. **We recommend "Subscribe" on the issue for listing gains.**

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FINANCIALS

P&L (Rs. Cr)	FY18	FY19	FY20	Balance Sheet (Rs. Cr)	FY18	FY19	FY20
Net Revenue	157	303	262	Share Capital	8	32	32
% Growth	79%	93%	-14%	Reserve & Surplus	46	65	115
COGS	77	185	149	Non Controlling Int	-	-	(0)
% of Revenues	49.2%	60.9%	56.8%	Networth	54	97	146
Employee Cost	19	24	14	Total Loans	16	32	43
% of Revenues	12.0%	7.9%	5.4%	Deff Tax Liab	2	2	2
Other expenses	16	28	29	Other non-curr liab.	-	-	-
% of Revenues	10.1%	9.3%	11.0%	Trade payable	17	29	26
EBITDA	45	66	70	Other Current Liab	4	12	8
EBITDA Margin	28.7%	21.8%	26.8%	Total provisions	5	1	0
Depreciation	2	3	5	Total Current Liab.	26	41	34
Other Income	1	2	4	Total Equity & Liab.	97	173	226
Interest	3	4	5	Fixed Assets & CWIP	30	40	53
Share of PAT (Invst)				Goodwill			
Exceptional gain				Investments			
PBT	41	61	65	Deff Tax Assets			
Tax	14	18	16	Other non Curr. assets	0	2	1
Tax rate	35%	30%	25%	Cash	1	12	14
PAT	26	43	49	Inventories	21	46	48
% Growth	834%	63%	13%	Debtors	30	64	89
EPS (Post Issue)	7.2	11.8	13.3	Other Current assets	15	9	21
Performance Ratios	FY18	FY19	FY20	Total Assets	97	173	226
EBITDA Margin (%)	28.7%	21.8%	26.8%	Cash Flow (Rs. Cr)	FY18	FY19	FY20
PAT Margin (%)	16.8%	14.2%	18.6%	EBITDA	45	66	70
ROE (%)	49.2%	44.4%	33.4%	Provisions & Others	1	2	3
ROCE (%)	62.5%	50.5%	36.7%	Op. profit before WC	46	68	73
Net D/E (x)	0.3	0.2	0.2	Change in WC	(20)	(34)	(46)
Turnover Ratios	FY16	FY17	FY20	Less: Tax	(11)	(23)	(17)
Debtors Days	68	76	122	CF from operations	14	11	11
Inventory Days	48	54	66	Addition to assets			
Creditor Days	40	34	35	(Purchase)/Sale of invst.	(8)	(24)	(17)
Asset Turnover (x)	2.3	2.3	1.4	Div/Int Received	0	0	1
Valuation Ratios	FY18	FY19	FY20	CF from Investing	(8)	(24)	(17)
Price/Earnings (x)			25.5	Loans	(3)	16	11
EV/EBITDA (x)			18.0	Dividend Paid			
Price/BV (x)			12.8	Interest paid	(3)	(4)	(5)
Mkt cap/Sales (x)			4.8	Others	1	0	(0)
EV/Sales (x)			4.8	CF from Financing	(6)	12	7
Source: Company Data, NBRR				Net Change in cash	1	(0)	0
				Cash at beginning	0	1	1
				Exchange difference			
				Cash at end	0.9	0.7	1.1

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