

Clean Science and Technology

Margin to decline, valuation expensive

We maintain SELL on Clean Science and Technology (CSTL) with a price target of INR 1,026 (WACC 11%, terminal growth 6%), owing to (1) slower-than-expected ramp-up in hindered amine light stabilisers (HALS); (2) entry of domestic competitor in mono methyl ether of hydroquinone (MEHQ) manufacturing; and (3) lower offtake of performance chemicals. Gross profit margin and EBITDA margin are expected to fall by 520/340 bps by FY26 from 65/43% in FY23. Global giants are augmenting the capacities of HALS and intermediates of HALS. Vinati Organics (VO) plant to manufacture MEHQ is expected to commence production by FY24-end. VO is using a process similar to the process being used by CSTL, which has given CSTL a competitive advantage. EBITDA and PAT shall grow at a 13/11% CAGR over FY23-26E. The RoE is expected to decline from 33.2% in FY23 to 23.9% in FY26E, owing to a reduction in margin and asset turnover. Valuations are contextually high at 41/36x FY25E/26E EPS.

Slower-than-expected ramp-up of HALS portfolio

CSTL's current capacity utilisation of the 2ktpa HALS 701 and 770 plant at its unit-3 facility in Kurkumbh is ~50%. This is mainly owing to the subdued global demand from the masterbatches producers. The company is also incurring a Capex of INR 3bn at its unit-4 facility to set up a plant to launch value-added HALS products (HALS 622, HALS 944 HALS 119 and various blends) with higher realisations that will take up the total HALS capacity to 15ktpa. The plant is expected to be commissioned by Jan-24.

The current market demand for HALS globally is ~100ktpa and CSTL plans to capture an 8-10% market share in the coming years. CSTL expects to run its HALS plants at a 50% capacity utilisation in Q4FY24 and to reach a 75% capacity utilisation in FY25. The company aims to achieve peak revenue for its HALS business in the next three years.

Global giants such as Solvay, BASF and UniteChem who have been HALS players for a long time have recently augmented their HALS and intermediates capacities (Exhibit 2). We believe that a fast ramp-up of the HALS portfolio is a key monitorable for the growth of CSTL in the coming quarters. The company's legacy products are mature, and hence the success of the HALS portfolio is integral for growth. However, capacity expansion by competitors and lower demand can pose a threat to CSTL's HALS ramp-up.

Entry of a domestic competitor in MEHQ, a key threat, going ahead

The current global demand for MEHQ is ~15ktpa. CSTL is the largest player globally of MEHQ and it has more than 50% market share in the product. CSTL enjoyed the leadership position as their process to manufacture MEHQ is eco-friendly and economical. The company uses an anisole route to manufacture MEHQ compared to the hydroquinone route by competitors.

Vinati Organics (VO) is setting up a 5ktpa anisole capacity and 3ktpa MEHQ/Guaiacol plant using an anisole route. By using the same technology to produce MEHQ, VO can challenge CSTL's leadership position. VO plans to attain a 25% to 30% global market share in the coming years. In order to gain market share, VO may lower the price of MEHQ, in our opinion. Thus, the entry of VO in the MEHQ market will put pressure on realisations and margins.

SELL

CMP (as on 20 Oct 2023)	INR 1,356
Target Price	INR 1,026
NIFTY	19,543

KEY CHANGES	OLD	NEW
Rating	SELL	SELL
Price Target	INR 1,165	INR 1,026
EPS %	FY24E -11.5%	FY25E -10.7%

KEY STOCK DATA

Bloomberg code	CLEAN IN
No. of Shares (mn)	106
MCap (INR bn) / (\$ mn)	144/1,761
6m avg traded value (INR mn)	259
52 Week high / low	INR 1,700/1,227

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	2.9	(2.8)	(16.0)
Relative (%)	6.1	(12.5)	(26.5)

SHAREHOLDING PATTERN (%)

	Jun-23	Sep-23
Promoters	74.99	74.98
FIs & Local MFs	6.40	5.23
FPIs	5.84	6.00
Public & Others	12.77	13.79
Pledged Shares	0.00	0.00

Source: BSE

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Introduction of new pharma intermediates

CSTL plans to launch 2-3 new pharma intermediates in the coming two years for which it plans to incur a total Capex of INR 2bn. Each product has an opportunity size of INR 1-3bn. These pharma intermediates are import substitutes and at the same time also hold significant export opportunities.

Margins will be under pressure

CSTL enjoyed healthy margins owing to efficient processes and a market leadership position in its major products. Gross profit and EBITDA margin were 53-65% and 31-43% during FY18 to FY23 (Exhibit 3). HALS products are low-margin products compared to the margins of CSTL's existing product portfolio (Exhibit 4). Besides, the entry of VO into MEHQ manufacturing will put pressure on the margins of existing products. We expect gross profit margin and EBITDA margin to fall from 65/43% in FY23 to 60/39% in FY26.

Exhibit-1: Applications of HALS

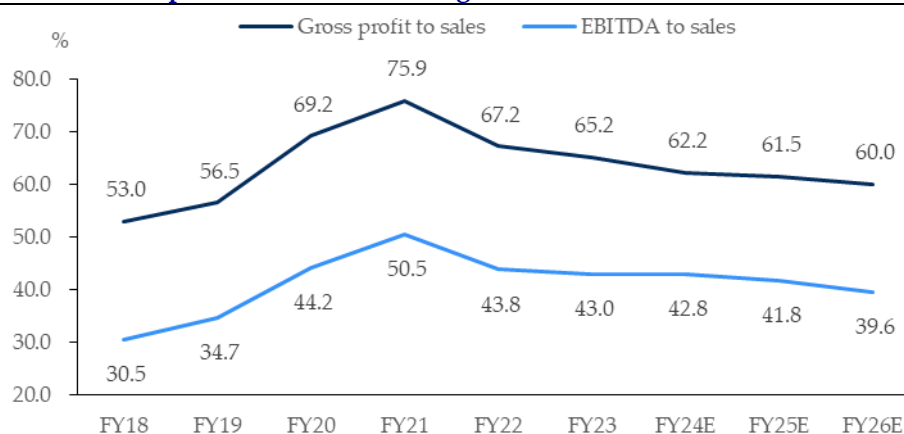
HALS Name	End-user industries
HALS 770	Industrial, solvent borne, adhesive and sealant
HALS 944	Automotive, industrial, solvent borne, adhesive, sealant, powder coating
HALS 622	Industrial, solvent borne, adhesive, sealant, powder coating
HALS 119	Automotive, industrial, solvent borne, powder coating
HALS 783	Industrial, powder coating
HALS 292	Automotive, industrial, printing & packaging, solvent borne, wood industry, construction industry
HALS 111	Automotive, industrial, solvent borne, powder coating
HALS 2020	Adhesive, sealant
HALS 791	Automotive
HALS 123	Automotive, industrial, printing & packaging, solvent borne, wood industry, construction industry

Source: Company, HSIE Research

Exhibit-2: Global giants augmenting their HALS and intermediates capacities

Name of the company	Capacity augmentation announced	Date
UniteChem	One of the important strengths of UniteChem is its solid backward integration, providing extensive production flexibility, high reliability and maximum quality control. The Group's current 80,000-ton capacity for intermediates is being ramped up to more than 300,000 tons with an expansion of its existing Suqian (Jiansu) facilities. In addition, three new plants are scheduled to come on stream in 2022/2024 at Nanchong (Sichuan), Shengjin and Shengrui (both Jiangsu). These significant investments will also allow UniteChem to integrate further intermediates in its production and support the availability of new additive solutions. Capacity in finished products will be more than doubled by an increase of 50,000 tons to meet growing customer demands for both existing and new products, such as UV absorbers—produced in a novel environmentally friendly process—as well as nucleating agents and other stabilizers.	June 17, 2022
BASF	BASF will increase production capacity for its hindered amine light stabilizers (HALS) at sites located in Pontecchio Marconi, Italy and Lampertheim, Germany. As part of a multi-step investment plan, BASF aims to support the growing demand for light stabilizers used in durable plastics applications and provide enhanced security of supply to global customers.	February 24, 2023
Solvay	Solvay's new high molecular weight (HMW) hindered amine light stabilizer (HALS) capacity is now online, complementing existing HALS production at the Willow Island, West Virginia, USA, site. "We decided to expand our capacity to better meet the needs of our customers," explained Ning Chen, Vice President of Polymer Additives for Solvay's Technology Solutions' global business unit. "This investment provides peace of mind to our clients, ensuring security of supply and a faster response from Solvay, a technology leader and industry reference in light stabilization. With it, we are well-positioned to continue delivering innovative solutions and growing with our customers."	January 15, 2020

Source: Company, HSIE Research

Exhibit-3: Gross profit and EBITDA margin trend

Source: Company, HSIE Research

Exhibit-4 Realisation and gross margin for HALS products for Suqian Unitech corp

Particulars	Realisation (INR/kg)			Gross margin (%)		
	CY19	CY20	CY21	CY19	CY20	CY21
Light Stabilizer 944	754	747	907	31.5	28.4	31.5
Light Stabilizer 770	483	474	569	26.2	25.5	30.6
Light Stabilizer 622	379	377	519	36.6	33.1	46.9
Light Stabilizer 119	964	851	918	—	48.8	33.0
Polymerization Inhibitor 701	386	506	519	36.7	44.9	43.3

Source: Unitech, Bloomberg

Financial summary (consolidated)

INR mn	1QFY24	4QFY23	QoQ(%)	1QFY23	YoY(%)	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	1,881	2,169	(13.3)	2,341	(19.6)	6,849	9,358	9,002	11,799	14,489
EBITDA	761	1,051	(27.6)	913	(16.6)	2,999	4,021	3,856	4,930	5,736
APAT	589	805	(26.8)	629	(6.3)	2,285	2,952	2,767	3,489	4,034
AEPS (INR)	5.5	7.6	(26.8)	5.9	(6.3)	21.5	27.8	26.0	32.8	38.0
P/E (x)						63.0	48.8	52.1	41.3	35.7
EV/EBITDA(x)						47.8	35.8	37.2	28.9	24.5
RoE (%)						34.9	33.2	24.6	25.3	23.9

Source: Company, HSIE Research

Change in estimates (consolidated)

Y/E Mar	FY24E Old	FY24E New	% Ch	FY25E Old	FY25E New	% Ch	FY26E Old	FY26E New	% Ch
EBITDA (INR mn)	4,337	3,856	(11.1)	5,488	4,930	(10.2)	6,556	5,736	(12.5)
Adj. EPS (INR/sh)	29.4	26.0	(11.5)	36.8	32.8	(10.7)	43.8	38.0	(13.2)

Source: Company, HSIE Research

Financials (Consolidated)

INCOME STATEMENT

INR mn	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Revenues	3,933	4,193	5,124	6,849	9,358	9,002	11,799	14,489
<i>Growth %</i>	<i>63.1</i>	<i>6.6</i>	<i>22.2</i>	<i>33.7</i>	<i>36.6</i>	<i>(3.8)</i>	<i>31.1</i>	<i>22.8</i>
Raw Material	1,712	1,292	1,236	2,247	3,260	3,403	4,542	5,796
Employee Cost	249	310	436	345	452	484	556	640
Other Expenses	609	738	863	1,258	1,625	1,260	1,770	2,318
EBITDA	1,363	1,853	2,590	2,999	4,021	3,856	4,930	5,736
<i>EBITDA Margin (%)</i>	<i>34.7</i>	<i>44.2</i>	<i>50.5</i>	<i>43.8</i>	<i>43.0</i>	<i>42.8</i>	<i>41.8</i>	<i>39.6</i>
<i>EBITDA Growth %</i>	<i>85.7</i>	<i>35.9</i>	<i>39.8</i>	<i>15.8</i>	<i>34.1</i>	<i>(4.1)</i>	<i>27.9</i>	<i>16.3</i>
Depreciation	110	137	172	249	361	470	589	673
EBIT	1,253	1,716	2,417	2,750	3,660	3,385	4,342	5,063
Other Income (Including EO Items)	113	109	256	300	298	304	310	317
Interest	0	1	1	1	2	0	0	0
PBT	1,365	1,823	2,673	3,048	3,956	3,689	4,652	5,379
Tax	389	427	689	763	1,005	922	1,163	1,345
PAT	977	1,396	1,984	2,285	2,952	2,767	3,489	4,034
EO (Loss) / Profit (Net Of Tax)	-	-	-	-	-	-	-	-
APAT	977	1,396	1,984	2,285	2,952	2,767	3,489	4,034
Share from associates	-	-	-	-	-	-	-	-
Minority Interest	-	-	-	-	-	-	-	-
Consolidated APAT	977	1,396	1,984	2,285	2,952	2,767	3,489	4,034
<i>Consolidated APAT Growth (%)</i>	<i>99.7</i>	<i>43.0</i>	<i>42.1</i>	<i>15.2</i>	<i>29.2</i>	<i>(6.3)</i>	<i>26.1</i>	<i>15.6</i>
AEPS	9.2	13.1	18.7	21.5	27.8	26.0	32.8	38.0
<i>AEPS Growth %</i>	<i>99.7</i>	<i>43.0</i>	<i>42.1</i>	<i>15.2</i>	<i>29.2</i>	<i>(6.3)</i>	<i>26.1</i>	<i>15.6</i>

Source: Company, HSIE Research

BALANCE SHEET

INR mn	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
SOURCES OF FUNDS								
Share Capital	14	13	106	106	106	106	106	106
Reserves And Surplus	2,706	3,408	5,290	7,578	9,994	12,263	15,124	18,432
Total Equity	2,721	3,421	5,397	7,684	10,100	12,369	15,230	18,538
Minority Interest	-	-	-	-	-	-	-	-
Long-term Debt	1	3	3	3	-	-	-	-
Short-term Debt	25	24	-	1	1	1	1	1
Total Debt	26	27	3	3	1	1	1	1
Deferred Tax Liability	139	102	176	209	234	234	234	234
Long-term Provision and others	3	3	4	1	29	29	29	29
TOTAL SOURCES OF FUNDS	2,888	3,553	5,579	7,898	10,364	12,633	15,494	18,802
APPLICATION OF FUNDS								
Net Block	1,270	1,656	1,858	2,957	4,601	5,934	7,297	8,012
Capital WIP	39	34	550	441	205	601	650	463
Other non current assets	40	39	239	145	154	154	154	154
Non-current Investments	-	-	-	-	255	255	255	255
Total Non-current assets	1,349	1,729	2,648	3,544	5,215	6,945	8,356	8,883
Inventories	370	346	529	881	1,088	1,047	1,372	1,685
Debtors	598	698	742	1,535	1,462	1,406	1,843	2,264
Cash and Cash Equivalents	94	93	157	747	125	632	1,459	3,634
Other Current Assets	863	1,433	2,523	2,540	3,629	3,738	3,850	3,965
Total Current Assets	1,926	2,570	3,951	5,703	6,303	6,823	8,524	11,548
Creditors	223	357	610	1,021	805	775	1,015	1,247
Other Current Liabilities & Provns	163	389	410	327	349	360	371	382
Total Current Liabilities	386	746	1,020	1,348	1,155	1,135	1,386	1,628
Net Current Assets	1,539	1,825	2,932	4,355	5,149	5,688	7,138	9,919
TOTAL APPLICATION OF FUNDS	2,888	3,553	5,579	7,898	10,364	12,633	15,494	18,802

Source: Company, HSIE Research

CASH FLOW STATEMENT

INR mn	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Reported PBT	1,365	1,823	2,673	3,048	3,956	3,689	4,652	5,379
Non-operating & EO Items	(113)	(109)	(256)	(300)	(298)	(304)	(310)	(317)
Interest Expenses	0	1	1	1	2	0	0	0
Depreciation	110	137	172	249	361	470	589	673
Working Capital Change	(863)	(287)	(1,043)	(833)	(1,416)	(32)	(623)	(606)
Tax Paid	(352)	(464)	(616)	(729)	(980)	(922)	(1,163)	(1,345)
OPERATING CASH FLOW (a)	148	1,102	931	1,436	1,625	2,901	3,144	3,785
Capex	(381)	(518)	(891)	(1,239)	(1,768)	(2,200)	(2,000)	(1,200)
Free Cash Flow (FCF)	(233)	584	40	197	(143)	701	1,144	2,585
Investments	-	-	-	-	(255)	-	-	-
Non-operating Income	113	109	256	300	298	304	310	317
Others	33	1	(201)	95	(9)	-	-	-
INVESTING CASH FLOW (b)	(235)	(408)	(835)	(845)	(1,734)	(1,896)	(1,690)	(883)
Debt Issuance/(Repaid)	20	1	(24)	-	(3)	0	-	-
Interest Expenses	(0)	(1)	(1)	(1)	(2)	(0)	(0)	(0)
FCFE	(212)	584	16	195	(148)	701	1,144	2,585
Share Capital Issuance	-	(1)	93	-	0	-	-	-
Dividend	(128)	(153)	(33)	-	(531)	(498)	(628)	(726)
Others	(6)	(541)	(67)	0	23	(0)	(0)	0
FINANCING CASH FLOW (c)	(114)	(696)	(32)	(1)	(513)	(498)	(628)	(726)
NET CASH FLOW (a+b+c)	(201)	(2)	64	590	(622)	507	827	2,175
EO Items, Others								
Closing Cash & Equivalents	95	93	157	747	125	632	1,459	3,634

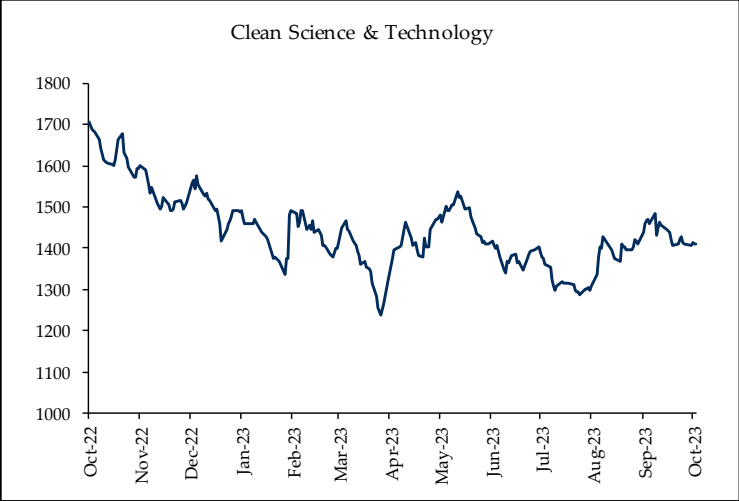
Source: Company, HSIE Research

KEY RATIOS

	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
PROFITABILITY %								
Gross Margin	56.5	69.2	75.9	67.2	65.2	62.2	61.5	60.0
EBITDA Margin	34.7	44.2	50.5	43.8	43.0	42.8	41.8	39.6
EBIT Margin	31.9	40.9	47.2	40.1	39.1	37.6	36.8	34.9
APAT Margin	24.8	33.3	38.7	33.4	31.5	30.7	29.6	27.8
RoE	42.5	45.5	45.0	34.9	33.2	24.6	25.3	23.9
RoIC	40.4	42.5	43.2	35.6	33.1	24.3	26.8	27.5
RoCE	40.1	43.4	43.5	33.9	32.3	24.1	24.8	23.5
EFFICIENCY								
Tax Rate %	28.5	23.4	25.8	25.0	25.4	25.0	25.0	25.0
Fixed Asset Turnover (x)	2.5	2.1	2.1	2.1	1.9	1.3	1.4	1.4
Inventory (days)	34	30	38	47	42	42	42	42
Debtors (days)	55	61	53	82	57	57	57	57
Other Current Assets (days)	80	125	180	135	142	152	119	100
Payables (days)	48	101	180	166	90	83	82	79
Other Current Liab & Provns (days)	15	34	29	17	14	15	11	10
Cash Conversion Cycle (days)	107	81	61	81	137	153	126	111
Net Debt/EBITDA (x)	(0.1)	(0.0)	(0.1)	(0.2)	(0.0)	(0.2)	(0.3)	(0.6)
Net D/E	(0.0)	(0.0)	(0.0)	(0.1)	(0.0)	(0.1)	(0.1)	(0.2)
Interest Coverage	3,796.2	1,418.0	2,656.6	1,870.5	1,876.9	63,157.2	80,998.8	94,454.9
PER SHARE DATA (INR)								
EPS	9.2	13.1	18.7	21.5	27.8	26.0	32.8	38.0
CEPS	10.2	14.4	20.3	23.9	31.2	30.5	38.4	44.3
Dividend	N/A	N/A	N/A	3.3	5.0	4.7	5.9	6.8
Book Value	25.6	32.2	50.8	72.3	95.1	116.4	143.4	174.5
VALUATION								
P/E (x)	147.5	103.2	72.6	63.0	48.8	52.1	41.3	35.7
P/Cash EPS (x)	132.5	93.9	66.8	56.8	43.5	44.5	35.3	30.6
P/BV (x)	53.0	42.1	26.7	18.7	14.3	11.6	9.5	7.8
EV/EBITDA (x)	105.6	77.7	55.6	47.8	35.8	37.2	28.9	24.5
EV/Revenue (x)	36.6	34.3	28.1	20.9	15.4	15.9	12.1	9.7
Dividend Yield (%)	N/A	N/A	N/A	0.2	0.4	0.3	0.4	0.5
OCF/EV (%)	0.1	0.8	0.6	1.0	1.1	2.0	2.2	2.7
FCFE/EV (%)	(0.2)	0.4	0.0	0.1	(0.1)	0.5	0.8	1.8
FCFE/M Cap (%)	(0.1)	0.4	0.0	0.1	(0.1)	0.5	0.8	1.8

Source: Company, HSIE Research

1 Yr Price movement



Rating Criteria
BUY: >+15% return potential
ADD: +5% to +15% return potential
REDUCE: -10% to +5% return potential
SELL: > 10% Downside return potential

Disclosure:

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