

Chemcon Speciality Chemicals Ltd (Chemcon)

Sensex	38,034
Nifty	11,251

ISSUE DETAILS

Offer Price Band	₹338-340
Face Value	₹10
Issue Size (in mn)	₹3170-3180
Pre-issue shares (in mn)	31.78
Post-issue shares (in mn)	36.63
Market Cap (in mn. post issue)	12,390-12,450
Type	Fresh Issue and Offer for Sale
Fresh Issue (nos mn)	4.85
OFS (nos mn)	4.50
Listing (Stock Exchange)	BSE, NSE
Retail Allocation	35%
QIB Allocation	50%
Non-Insti Investors	15%
Minimum Bid	44 shares and in multiple
Offer Open Date	21 st September, 2020
Offer Close Date	23 rd September, 2020

Website: www.cscpl.com

Shareholding Pattern (%)	Pre-Offer	Post Offer
Promoter Holding	100.0	74.5
Public Shareholding	-	25.5
Total	100.00	100.00

Investors should read the risk factors and more detailed information in the Prospectus and the application form before investing in the issue.

(₹ mn)

Particulars	FY18	FY19	FY20
Revenue	1,576	3,033	2,621
Growth%		92.4%	-13.6%
EBITDA	450.9	660.8	702.6
EBIDTA Margins %	28.6%	21.8%	26.8%
Reported PAT	263.8	430.4	488.5
PAT Margins %	16.7%	14.2%	18.6%
Reported EPS (₹)	8.3	13.5	15.4
Return on Net Worth	49.2%	44.9%	34.2%

Source: Chemcon Speciality Chemicals Ltd. RHP

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Company Background

Incorporated on December 15, 1988, Chemcon Speciality Chemicals Ltd (Chemcon) is a manufacturer of specialised chemicals, such as Hexamethyldisilazane / Hexamethyldisilane (HMDS) and Chloromethyl Isopropyl Carbonate (CMIC) which are predominantly used in the pharmaceuticals industry (Pharmaceutical Chemicals), and inorganic bromides, namely Calcium Bromide, Zinc Bromide and Sodium Bromide, which are predominantly used as completion fluids in the oilfields industry (Oilwell Completion Chemical).

The company's has 7 manufacturing plants at a single location – Manjusar in Gujarat, having volumetric reactor capacity of 374kl as of July 2020.

Business Overview

Company has an experience of over two decades in manufacturing and export of different types of specialised chemicals. As on the date, company is engaged in the manufacture of following products:

A. Pharmaceutical Chemicals – These comprise of the chemicals which are utilised in the process of producing anti-viral and anti-bacterial drugs and a drug for treatment of tuberculosis. Currently Chemcon principally manufactures three products, namely:

- 1. HMDS and ancillary products (including hi-purity HMDS)** – Company is the only manufacturer of HMDS in India and the third largest manufacturer of HMDS worldwide, in terms of production in CY19 (source: Frost & Sullivan Report). HMDS is widely used in the pharmaceutical industry as a silylating agent in the process of manufacture of pharmaceutical drugs of the Penicillin group (such as Amikacin, Penicillin, Cephalosporins and other kinds of Penicillin derivatives), hydroxyl protectants, preparation of 5-azacytidine, an antineoplastic drug, preparation of β 3-AR agonists used in anti-stress formulations and the manufacture of antibiotics such as Cefprozil and Cefadroxil and anti-viral drugs such as Sofosbuvir, Lamivudine and Emtricitabine. HMDS may also be used in the semiconductor electronics industry and in vinyl silicone rubber to improve their tearing strength.

It also manufactures hi-purity HMDS, which finds application in the pharmaceuticals, semiconductors and rubber industries, however is yet to commence the commercial sale of hi-purity HMDS.

- 2. CMIC** – Company is the largest manufacturer of CMIC in India and the second largest manufacturer of CMIC worldwide, in terms of production and capacity in CY19 according to Frost & Sullivan Report. 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 and by the European Medicine Authority for the treatment of Hepatitis B. Tenofovir and its combination preparations have witnessed the largest sales for anti-AIDS drug. CMIC is also used in the synthesis of other anti-viral drugs.

- 3. 4 CBC** – It 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 a herbicide for weed control in maize and sugarcane. Company executed its first sale of 4 CBC in July 2020.

B. Oil well Completion Chemicals – These comprises of inorganic bromides which are utilised inter alia as completion fluids in the oil and gas exploration process. Currently company manufactures a range of inorganic bromides, namely, Calcium Bromide (solution and powder), Zinc Bromide (solution) and Sodium Bromide (solution and powder).

Company is engaged in the manufacturing of Oilwell Completion Chemicals, which are predominantly utilised in the oil and gas exploration process as completion chemicals. Completion chemicals act as demulsifying agents for crude oil in offshore operations and are used to control wellbore pressures in upstream oil and gas operations. Company manufactures the following types of bromides - Calcium Bromide (solution and powder), Sodium Bromide (solution and powder) and Zinc Bromide (solution).

Company is the only manufacturer of Zinc Bromide and the largest manufacturer of Calcium Bromide in India, in terms of production in CY19.

Additionally, the company is in the process of commencing the commercial production of 2,5 DHT which is predominately used in the pharmaceutical industry in the preparation of and synthesis of substituted tetrahydrothiophene derivatives 2-amino-3-(arylsulfonyl) thiophenes, potential antiviral and antitumor agents.

Product Category	Products Manufactured	Installed Capacity (MTPA)	Volumetric Reactor Capacity (KI)
Pharmaceutical Chemicals	HMDS and ancillary products	4200	177.8
Pharmaceutical Chemicals	HMDS (hi-purity)	600	13.0
Pharmaceutical Chemicals	CMIC	1800	121.75
Oilwell Completion Chemicals	Calcium Bromide (solution), Zinc Bromide (solution) and Sodium Bromide (solution)	14400	57.3
Oilwell Completion Chemicals	Calcium Bromide (powder)	600	5.0

Key Customers

Pharmaceutical Chemicals	Oilwell Completion Chemicals
Hetero Labs Ltd	Shree Radha Overseas
Laurus Labs Ltd	Wtaer Systems Specialty Chemical
Ind-Swift Laboratories Ltd	DMMC
Aurbindo Pharma Ltd	Universal Drillinfg fluids
Sanjay Chemicals Pvt Ltd	CC Gran Ltd Liability
Lantech Pharmaceuticals	
Macleod Pharmaceuticals	
Vivin Drugs Phrmaceuticals Ltd	

Objects Of The Issue

Objects	Amount (₹ mn)
Capital expenditure towards expansion of the Manufacturing Facility (i.e. to set up 2 new plants and 1 laboratory, at the existing Manufacturing Facility at Manjusar, Vadodara	410.33
To meet working capital requirements	900.00
General Corporate Purpose	-
Net Proceeds	-

Competitive Strengths

- **Leading manufacturer globally of the Pharmaceutical Chemicals and leading manufacturer in India of the Oilwell Completion Chemicals** – India is currently a net importer of HMDS, with about 40% of India's current domestic demand being catered by imports majorly from China and Germany. India is expected to witness a demand growth for HMDS of 10.6% CAGR between CY19 and CY23 according to Frost & Sullivan Report. Chemcon is the only manufacturer of HMDS in India and well positioned to capitalise on the potential growth of the HMDS market.

India and China are the only countries that produce CMIC. Company's share in the global CMIC manufacturing capacity has increased from 7.07% in CY14 to 26.16% in CY19. India is a net importer of CMIC, with about 62% of India's current domestic demand 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% between CY19 and CY23. Frost & Sullivan further estimates that Chemcon is well positioned to substitute the imports from China and hence, has an opportunity to grow at a CAGR of more than 25% between CY19 and CY23.

Further, while they commenced the sales of their Oilwell Completion Chemicals in CY14, their share in the global production of the Oilwell Completion Chemicals has grown to 2.65% in CY19 according to Frost & Sullivan Report.

- **Diversified customer base coupled with long standing relationships** – Chemcon supplies their products to customers in India and also exports its products to countries including United States of America, Germany, Italy, South Korea, China, Japan, United Arab Emirates, Serbia, Russia, Spain, Thailand and Malaysia. In FY20, FY19 and FY18, their exports contributed 39.78%, 31.99% and 47.84% respectively of their total revenue from operations.

Chemcon is expanding its customer base, which has resulted in a decrease in their customer concentration, year on year. Their top 5 customers and their top 10 customers contributed 59.35% and 72.26%, respectively of their total revenue from operations in FY20, as compared to 60.01% and 75.67%, respectively of the total revenue from operations in FY18.

Company's top 6 customers for FY20 have been their customers for over 4 years which shows customer stickiness.

- **The specialty chemicals industry has high entry barriers** – The specialty chemicals industry in which Chemcon operates has high entry barriers (highly knowledge intensive) due to the involvement of complex chemistry in the manufacture of their products, which is difficult to commercialize on a large scale and; long gestation period to be enlisted as a supplier with the customers, particularly with the customers of their Pharmaceutical Chemicals.

The specialty chemicals industry is highly knowledge intensive. Their products have application in the pharmaceutical, oil-well drilling, semi-conductor and electronic-chemical industries where they are used to manufacture high value proprietary and specialised products. Given the nature of the application of company's products, their processes and products are subject to, and measured against, high quality standards and stringent impurity specifications. Further, end products manufactured by the customers, where company's products are used, and where such use has been formally recognised in filings with regulatory agencies, any change in the vendor of the product may require significant time and cost for the customer. Hence, customer acquisition involves a long gestation period, resulting in a very few players being involved in manufacturing of the products.

- **Experienced senior management** – Chemcon has a strong and experienced management team which has positioned their business well for continued growth and development. The management team has significant experience in the areas of finance, manufacturing, quality control, strategy, raw material sourcing, process re-engineering and business development. Two of their Whole time Directors (who are not members of the Promoter Group) have been associated with Chemcon for over 20 years and have played a key role in developing their business and Chemcon benefited from their significant experience in their respective areas of expertise. The knowledge and experience of their management team provides Chemcon with a significant competitive advantage as they seek to grow in their existing markets and enter new segments and geographies.

Competitive Strengths

- **Expansion of the total installed production capacity** – Chemcon aims to expand their manufacturing operations and production capacity. They have 7 operational individual plants for the production of their products, within the manufacturing facility. The total volumetric reactor capacity as on July 31, 2020 was 374.85 KL. The Company intends to build 2 additional plants with a total volumetric reactor capacity of 251 KL. These additional plants shall be utilised for the manufacturing of chemicals which are principally used pharmaceutical industry. With completion of expansion, total volumetric reactor capacity at facility shall increase to 625.9kl from 375 kl which will enable to improve profitability going ahead.
- **Augmenting growth in the current geographic markets and expanding into new geographic markets** – Chemcon, the only manufacturer of HMDS in India and the largest manufacturer of CMIC in India in terms of production in CY19, aims to capitalise on the potential growth of the HMDS and CMIC market in India by expanding their manufacturing and sales of HMDS and CMIC. India is a net importer of CMIC and HMDS (source: Frost & Sullivan Report) and Chemcon aims to expand their manufacturing and sales operations of CMIC and HMDS to substitute such imports. The trade dispute between USA and China may indirectly help India boost its exports and to take advantage of it, Chemcon has started supply of HMDS to customers in the USA.

Chemcon currently supplies the Oilwell Completion Chemicals largely to customers in India, the Middle East, Serbia and Russia. They aim to expand the sales of the Oilwell Completion Chemicals in existing and new geographies including Nigeria, Malaysia, China and Ghana.

Exploring newer applications of the existing products as well as focusing on new products that are in synergy with the current operations – Chemcon currently supplies HMDS largely to the pharmaceuticals industry and aims to market their products for end-use applications in other industries including the rubber and semiconductor manufacturing industry. Company recently commissioned plant with capacity to manufacture 600MTPA of high purity HMDS which find application in pharmaceuticals, silicon/rubber as well as semiconductor industries. They aim to undertake the development and manufacture of newer products, largely focusing on chemicals used in the pharmaceuticals, semiconductors and rubber industries.

- **Continue to strive for cost efficiency** – Chemcon intends to continue to be cost efficient in the production of their products. This efficiency is achieved through strategies like having a large single location manufacturing facility, dedicated plants for each product, process reengineering for efficient raw material consumption and being a sizeable player in the industry in each of their products. Economies of scale will also enable them to continuously improve their operational efficiencies.

Key Concerns/Risks

- Promoter and certain promoter group had filed application for settlement with Sebi wrt certain non compliances wrt holding in listed company, which was a member of Promoter group, which if determined adversely may negatively impact operations, reputation and prospects of company.
- Mr Naresh Goyal, member of Promoter group has filed appeal in relation to criminal proceeding filed against him which if determined adversely may negatively impact operations, reputation and prospects of the company.
- A significant portion of its revenue comes from a few customers and the loss of one or more such customers or a reduction in their demand for products may adversely affect its business and financials.
- The commercial success of Oilwell Completion Chemicals is dependent on the level of oil and gas exploration, development and production activities. Factors affecting the level of oil and gas exploration, development and production activities, could have a material adverse effect on business operations and financials.

Our View

Company has reported ~28.9% topline CAGR, ~24.5% EBITDA CAGR & 36.1% PAT CAGR over FY18-FY20. Since there are no listed companies with the same business model, we have considered other listed entities in the specialty chemical business such as Fine Organics Ltd, Galaxy Surfactants, Aarti Industries etc. which trade at FY20 P/E multiplies of ~25x-31x. At the offer price band of ₹338-₹340/- Chemcon Specialty Chemicals is commanding a ~22.2x P/E on FY20 EPS which is inline with peers mentioned. We believe company's specialised product offerings, increasing demand for the products, superior return ratios and stable asset quality justifies its valuation. **We thus advise investors with a long-term investment horizon to SUBSCRIBE to the issue.**

Consolidated Financials

	(₹ mn)		
Balance Sheet	FY20	FY19	FY18
I. ASSETS			
Non-current assets			
a. Property, plant and equipment	474.20	395.42	296.41
b. Capital work-in-progress	37.42	6.70	-
c. Right-Of-Use Asset	13.32	-	-
d. Intangible assets	0.20	0.26	-
e. Financial assets			
(i) Other financial assets	4.78	5.15	2.33
f. Other non-current assets	2.40	11.89	17.11
Total non-current assets	532.32	419.42	315.84
Current assets			
a. Inventories	480.75	459.14	210.36
b. Financial assets			
(i) Trade receivables	889.47	641.18	295.56
(ii) Cash and cash equivalents	10.74	6.84	9.28
(iii) Bank Balances Other than (ii) above	130.28	109.06	5.62
(iv) Other financial assets	14.01	14.41	14.79
c. Other current assets	200.34	80.27	119.20
Total current assets	1,725.60	1,310.91	654.81
Total assets	2,257.92	1,730.33	970.65
II. EQUITY AND LIABILITIES			
Equity			
a) Equity share capital	317.78	317.78	79.44
b) Other equity	1,145.92	652.52	456.78
Total equity	1,463.69	970.30	536.22
Liabilities			
Non-current liabilities			
a. Financial liabilities			
(i) Borrowings	145.99	24.66	24.95
(ii) Lease Liabilities	8.22	-	-
b. Non-current provisions	0.56	4.92	7.21
c. Deferred tax liabilities (net)	22.57	24.34	16.20
Total non-current liabilities	177.34	53.92	48.36
Current liabilities			
a. Financial liabilities			
(i) Borrowings	286.75	297.38	136.12
(ii) Trade payables			
- Total outstanding dues of micro enterprises and small enterprises	38.72	25.28	34.09
- Total outstanding dues of creditors other than micro enterprises and small enterprises	218.50	263.44	138.68
(iii) Other financial liabilities	45.01	112.03	27.20
(iv) Lease liabilities	4.11	-	-
b. Other current liabilities	23.77	6.71	11.68
c. Short Term Provisions	0.03	1.29	38.29
Total current liabilities	616.89	706.12	386.06
Total equity and liabilities	2,257.92	1,730.33	970.65

	(₹ mn)		
Profit and Loss	FY20	FY19	FY18
Income			
Revenue from operations	2,620.52	3,033.41	1,576.42
Other income	39.65	19.86	7.49
Total income (I+II)	2,660.17	3,053.26	1,583.91
Expenses			
Cost of Materials Consumed	1,533.71	1,947.39	793.82
Changes in inventories of finished goods and work-in-progress	(44.64)	(98.23)	(20.67)
Excise Duty	0.00	-	4.86
Employee Benefit expenses	140.50	241.12	188.04
Finance costs	46.84	40.02	30.36
Depreciation and Amortisation expenses	46.20	28.64	22.59
Other expenses	288.33	282.29	159.40
Total expenses (IV)	2,010.94	2,441.23	1,178.40
Profit before tax (III-IV)	649.22	612.03	405.51
Tax expense:			
a) Current tax			
- Current tax	163.80	174.60	141.64
- Taxes for earlier years	0.31	0.69	0.87
b) Deferred tax charge/(credit)	(3.41)	6.33	(0.81)
Total Tax Expenses	160.70	181.62	141.70
Profit/(Loss) after tax (V-VI)	488.53	430.41	263.81
Other comprehensive income			
Items that will not be reclassified subsequently to Profit and Loss			
Remeasurement of Gains/(Losses) on defined benefit Plans	6.50	5.48	2.71
Deferred tax	(1.64)	(1.81)	(0.90)
Other Comprehensive Income (expense)/ income, Net of Tax (VIII)	4.87	3.67	1.81
Total Comprehensive Income for the Year/Period (VII+VIII)	493.40	434.08	265.62
Earnings per equity share			
Basic [in ₹]	15.37	13.54	8.30
Diluted [in ₹]	15.37	13.54	8.30

(₹ mn)

Cash Flow	FY20	FY19	FY18
Cash flow from Operating Activities			
Net Profit Before Tax	649.22	612.03	405.51
Adjustment for:			
Depreciation and Amortization expense	42.93	28.64	22.59
Depreciation on Right of use assets	3.26		
(Profit)/ Loss on assets sold	0.56	0.51	(0.55)
Finance Cost	46.84	40.02	30.36
Interest received from Banks/ Others	(7.98)	(1.48)	(1.10)
Operating Profit before Working Capital Changes	734.84	679.72	456.81
Adjustment for:			
Change in Trade receivables	(248.28)	(345.63)	(71.68)
Change in Other Non-current financial assets	0.38	(2.83)	(0.08)
Change in Other current financial assets	0.40	0.37	(8.63)
Change in Other assets	(104.66)	58.86	(81.06)
Change in Inventories	(21.61)	(248.78)	(119.95)
Change in Trade payables	(31.50)	115.95	85.09
Change in Other financial liabilities	(70.33)	83.62	(22.20)
Change in Other current liabilities and provisions	17.95	(2.18)	17.32
Cash generated from Operations	277.17	339.12	255.62
Less : Income tax paid/ (Refund) (net)	172.15	228.54	114.29
Net Cash generated from Operating Activities (A)	105.02	110.58	141.33
Cash flow from Investing Activities			
Purchase of Property, Plant & Equipment, Investment Property & Intangibles, including Right-of-use assets	(165.62)	(142.73)	(80.68)
Term deposits with maturity 3 to 12 months	(21.22)	(103.44)	(0.40)
Sale proceeds of Property, Plant & Equipment	12.69	7.60	1.66
Interest received from Banks/ Others	7.98	1.48	1.10
Net Cash used in Investing Activities (B)	(166.17)	(237.09)	(78.33)
Cashflow from Financing Activities			
Finance cost	(43.83)	(38.10)	(24.14)
Proceeds/(Repayment) of Short term Borrowings	(10.63)	161.26	(35.09)
Proceeds of Long term Borrowings	139.59	9.83	12.45
(Repayment) of Long term Borrowings	(14.94)	(8.92)	(10.31)
Payments of interest portion of lease liabilities	(0.89)	-	-
Payments of principal portion of lease liabilities	(4.26)	-	-
Net Cash used in Financing Activities (C)	65.05	124.07	(57.08)
Net (Decrease)/ Increase in Cash & Cash Equivalents (A) + (B) + (C)	3.90	(2.44)	5.92
Cash & Cash Equivalents at the beginning of the period/ year	6.84	9.28	3.35
Cash & Cash Equivalents at the end of the period/year	10.74	6.84	9.28

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Disclosure of Interest Statement in Chemcon Speciality Chemicals Ltd (Chemcon) as on September 21, 2020

Name of the Security	Chemcon Speciality Chemicals Ltd (Chemcon)
Name of the analyst	Yogita Desai
Analysts' ownership of any stock related to the information contained	NIL
Financial Interest	
Analyst:	No
Analyst's Relative: Yes / No	No
Analyst's Associate/Firm: Yes/No	No
Conflict of Interest	No
Receipt of Compensation	No
Way2Wealth ownership of any stock related to the information contained	NIL
Broking relationship with company covered	NIL
Investment Banking relationship with company covered	NIL

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