

July 6, 2021

Incorporated in 2003, Clean Science and Technology manufactures critical specialty chemicals such as performance chemicals (MEHQ, BHA, AP), pharmaceutical intermediates (Guaiacol, DCC), and FMCG chemicals (4-MAP and Anisole). The company's products are used as key starting level materials, as inhibitors, or as additives, by customers, for products sold in regulated markets. Key customers include Bayer AG, SRF Ltd, Gennex Laboratories, Nutriad International NV and Vinati Organics. It has two certified production facilities with a combined installed capacity of 29,900 MTPA in India strategically in Kurkumbh (Maharashtra), in close proximity to the JNPT port.

Increase in capacity for existing/newer products bode well for future growth

The differentiation in the process manufacturing between Clean science and peers assisted company to offer products at competitive price and thereby helped it gain meaningful market share across its product portfolio. Going ahead, it plans to expand overall capacity of existing products, which should translate into improvement in the market share further. Moreover, it also plans to set up a fourth unit, which could have asset turn in the similar range of present business segments with decent OPM visibility. The management has not outlined any capex details yet. Thus, any announcement can improve revenue visibility further.

Healthy financial performance likely to sustain ahead

The company recorded revenue growth of 14% CAGR in FY19-21 supported by higher volume growth across the segments. With changes in the anisole manufacturing technology, it was able to improve gross margins, to a certain extent, and thereby OPM. Going ahead, with sustainability in gross margins along with better working capital management and operating leverage likely to play out, it can aid FCF considerably. In turn, this would help the company to incur capex from internal accruals. Since newer businesses should have better/similar RoCE, incremental cash can sustain group RoCE and thereby help it to demand better valuations ahead.

Key risk & concerns

- Lower growth visibility for MEHQ to impede overall growth
- Significant portion of revenues from limited market remains the key business risk
- Loss of customer would impede financial performance

Priced at FY21 P/E of 48.2x on upper band

At ₹ 900, the stock is available at 48.2x FY21. We assign a **SUBSCRIBE** rating to the issue.

Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	CAGR FY19-21
Net Revenue	393.3	419.3	512.4	14.1%
EBITDA	136.3	185.3	259.0	37.8%
EBITDA Margins (%)	34.7%	44.2%	50.5%	
Adj. PAT	97.7	139.6	198.4	42.5%
Adj. EPS (₹)	9.2	13.1	18.7	
EV/EBITDA	70.0x	51.5x	36.9x	
P/E	97.9x	68.5x	48.2x	
ROE (%)	35.9	40.8	36.8	
ROCE (%)	47.7	51.3	47.9	

Source: RHP, ICICI Direct Research.



Particulars

Issue Details	Amount
Issue Opens	July 7, 2021
Issue Closes	July 9, 2021
Issue Size (₹ Crore)	1,547
Price Band (₹)	880-900
No of Shares on Offer (Crore)	1.72
Minimum lot size	16
Face Value (₹)	1

Shareholding Pattern (%)

	Pre IPO	Post IPO
Promoter	94.7%	78.5%
Public	5.3%	21.5%
Total	100.0%	100.0%

Objective of issue

OFS worth ₹ 1547 crore

To achieve the benefits of listing the equity shares on the stock exchanges and for the offer for sale

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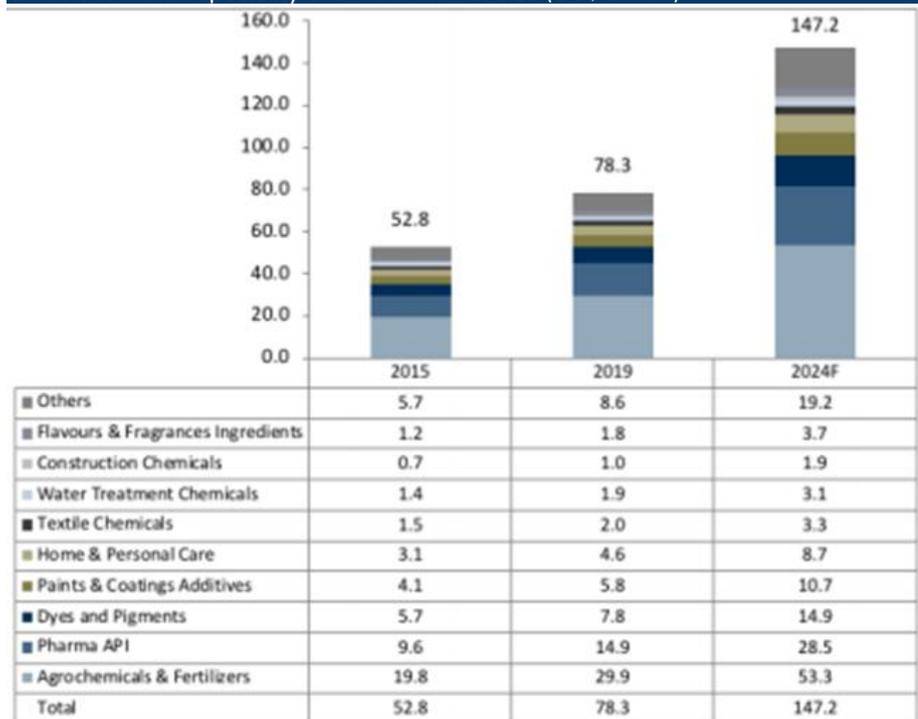
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Industry Overview

Green chemistry is an emerging focus among manufacturing industries that minimises pollution at a molecular level. The idea is that companies can adopt new scientific processes to minimise the toll their products take on the environment. Green chemistry is the design of chemical products and processes that reduce or eliminate the use or generation of hazardous substances. Green chemistry applies across the life cycle of a chemical product, including its design, manufacture, use, and ultimate disposal. Companies are actively designing novel concept to reduce emission of hazardous substances. The changes can be as large as changing the entire chemistry or even as small as changing certain catalyst to reduce carbon footprints. Companies are actively switching their production process to green chemistry.

Exhibit 1: Indian speciality chemical market size (US\$ billion)



Source: RHP, ICICI Direct Research

4-MAP

The 4-Methoxy-Acetophenone is an important spice, medicine, and makeup intermediate. The 4-MAP is an aromatic chemical compound with an aroma described as sweet, fruity, nutty and similar to vanilla. The 4-MAP occasionally also has the aroma of butter or caramel. It is used as a cigarette additive, a fragrance, ingredient to manufacture UV filter and in food flavouring. It is also used as a chemical intermediate in manufacturing cosmetic additives like Avobenzone. It is one of the most common UVA-filters in sunscreens and is able to absorb the full spectrum of UVA rays. UV filters account for 9% of the global active ingredients market. The 4-MAP falls under the UV filter product segment of personal care active ingredient. The UV filter market was valued at US\$373 million in 2019.

Exhibit 2: Global 4-Methoxy Acetophenone (4-MAP) market (US\$ mn)



Source: RHP, ICICI Direct Research

Ascorbyl Palmitate

Ascorbyl Palmitate is produced from ascorbic acid, or vitamin C. Ascorbyl Palmitate has vitamin C activity approximately equal to that of Ascorbic Acid (L-form). Ascorbic acid in form of sodium ascorbate or Ascorbyl Palmitate is extensively used as an ingredient in anti-aging cosmetic products. AP is part of Vitamin C derivatives of anti-aging active ingredients. Ascorbyl Palmitate (AP) and Butylated hydroxyl anisole (BHA) have applications as antioxidants in the personal care industry. In cosmetic preparations, antioxidants have two functions, as active ingredients and as protectors of other ingredients against oxidation. Currently, the application of antioxidants in cosmetics is increasing.

Exhibit 3: Global Ascorbyl Palmitate market (US\$ mn)



Source: RHP, ICICI Direct Research

Guaiacol

The global Guaiacol market is currently pegged at US\$309 million and is expected to grow at a CAGR of 1.3% from 2019 to 2025. Guaiacol is a naturally occurring organic compound with the formula C₇H₈O₂. It is used as a precursor in the manufacture of vanillin and is also used in the synthesis of pharmaceuticals. Guaiacol is majorly used as a reducing co-substrate for COX reactions. It is mainly used as expectorant and antiseptic. Guaiacol is a chemical intermediate used for manufacturing of active pharmaceutical intermediate (APIs). It is also used in synthesis of food materials and perfumery products. The unique aromatic odour of Guaiacol makes it suitable for acting as perfumery as well as flavouring agents. Guaiacol also finds applications in the agriculture sector as it protects the crop from

damage and improves crop yield. Guaiacol serves as a reducing agent for bio catalytic reactions also.

The key raw materials used to manufacture Vanillin products are Guaiacol and Guethol. Synthetic Vanillin has been further segmented into Lignin Vanillin, Guaiacol Vanillin and Ethyl Vanillin. Guaiacol Vanillin currently represents the biggest segment. Given the favourable growth of Global Vanillin market in coming years, the Guaiacol market is expected to witness consistent demand in future. Guaiacol is used as a key starting material to produce APIs like Guaifenesin, Carvedilol, Ranolazine and Methocarbamol.

The Guaiacol market is estimated to be ~60,000 MT per annum. Solvay is the largest producer of Guaiacol globally. The company is the third largest producer of Guaiacol in the world and the second largest producer in India (in terms of manufacturing capacities). Camlin Fine Sciences is the largest producer of Guaiacol in India.

Exhibit 4: Guaiacol usage in few APIs...

API	Drug Class	Application	2019 Sales (USD million)	2019 Sales (MT)	Value Growth (CAGR) (%)
Guaifenesin	Expectorant	Guaifenesin is used to reduce chest congestion caused by the common cold, infections, or allergies.	1,713	22,58	3.8%
Carvedilol	Beta-blocker	Carvedilol is a medication used to treat high blood pressure, hypertension, congestive heart failure, and left ventricular dysfunction in people who are otherwise stable.	638	96	-11.2%
Ranolazine	Anti-anginal	Ranolazine is used to treat chronic angina (chest pain). This medicine is usually used together with other medicines, such as ACE inhibitors, angiotensin receptor blockers, calcium channel blockers, beta-blockers, or nitrates.	3,276	280	9.6%
Methocarbamol	Muscle Relaxants	Methocarbamol is used with rest, physical therapy, and other measures to relax muscles and relieve pain and discomfort caused by strains, sprains, and other muscle injuries.	110	851	-8.4%
Codeine	Cough suppressant	Codeine is one of a group of medicines called anti-tussives (help to prevent coughing).	320	52	-22.1%

Source: RHP, ICICI Direct Research

Monomethyl ether of hydroquinone (MEHQ)

Mono methyl ether of hydroquinone (MEHQ) is an organic compound and synthetic derivative of hydroquinone. MEHQ is commercially manufactured by the hydroxylation of anisole or by free radical reaction between p-benzoquinone and methanol. The global MEHQ market was valued at US\$121.9 million in 2019 and expected to record growth of 5.8% between 2019 and 2025. On a volume basis, the demand of MEHQ was ~12.5 KT growing at a CAGR of 5.2%.

Application of MEHQ

Dermatology: MEHQ is widely used in dermatology as the main ingredient in topical drugs, which are used for skin depigmentation. The drug is generally prescribed by dermatologists for the treatment of solar liver spots, age spots, or solar lentigines.

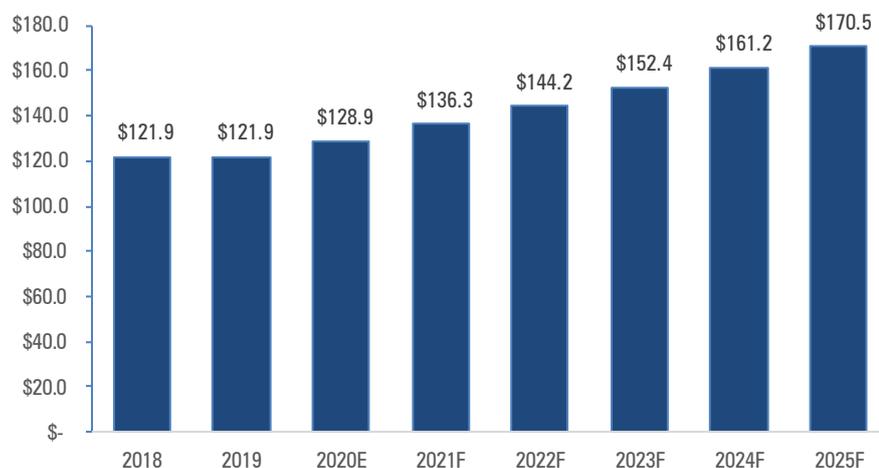
Polymers & Monomers: MEHQ is also widely used as a polymerisation inhibitor in manufacturing various monomers such as acrylics, methacrylics and other acrylates, vinyl acetate monomers, etc, along with unsaturated polyesters. MEHQ is also used as a stabiliser for cosmetics, liquid detergents and cellulose materials. Polymers are finding new applications, due to which, their demand is increasing day by day.

Ink: MEHQ is also used in the ink industry as a polymerisation inhibitor.

Agrochemicals: MEHQ is the building block for agrochemical and organic chemical manufacturing industries. Increasing consumption of agrochemicals and organic chemicals is boosting the MEHQ market. The agrochemical industry is showing good growth, which makes it a prominent market for MEHQ. It forms a part of active agrochemical ingredients.

Intermediate: MEHQ is used as an intermediate to manufacture BHA. There are certain regulations on the exposure limit for MEHQ. According to the National Institute for Occupational Safety and Health, the recommended exposure limit for MEHQ is 5 mg/m³ for an eight-hour workday. There are many regulations pertaining to Hydroquinone as it is classified as a drug and is banned for the use in cosmetic products in Europe and in many countries such as Japan, Australia and several African states.

Exhibit 5: Global MEHQ market (US\$ mn)



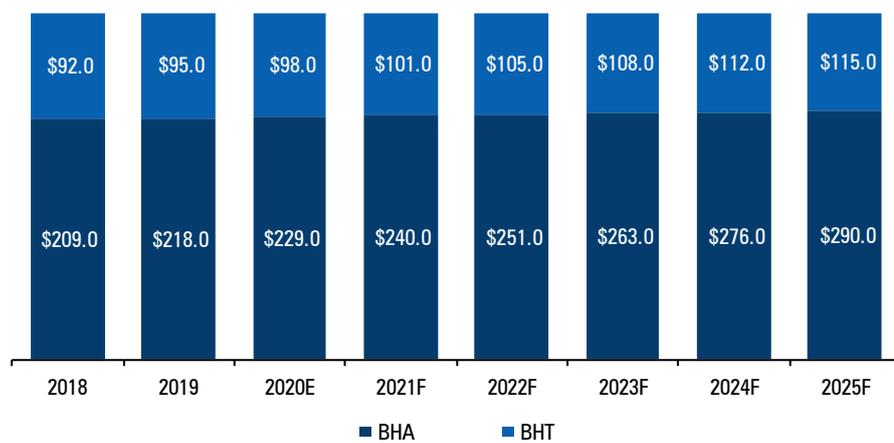
Source: RHP, ICICI Direct Research

Global BHT, BHA anti-oxidants market

BHA and butylated hydroxytoluene (BHT) are two structurally related lipophilic compounds generally used as antioxidants. Antioxidants such as BHA or BHT have been widely used for many years to preserve freshness, flavour and colour of foods and animal feeds as well as to improve the stability of pharmaceuticals and cosmetics. The third compound, EQ, is one of the best known feed antioxidants for domestic animal and fish. Its unquestionable advantage is its high antioxidant capacity and low production costs.

BHA is intended to be used as an antioxidant in feeding stuffs for all animal species and categories except dogs with a maximum content of 150 mg/kg (FEEDAP) complete feeding stuffs (alone or together with BHT (E 321) and/or ethoxyquin (E 324)) and for dogs with a maximum content of 150 mg/kg complete feeding stuffs (alone or together with BHT (E 321)).

Exhibit 5: Global BHT & BHA market (US\$ mn)



Source: RHP, ICICI Direct Research

Company background

Incorporated in 2003, Clean Science and Technology manufactures functionally critical specialty chemicals such as performance chemicals (MEHQ, BHA, AP), pharmaceutical intermediates (Guaiacol, DCC) and FMCG chemicals (4-MAP, Anisole). Within 17 years of incorporation, the company has grown to be the largest manufacturer globally of MEHQ, BHA, Anisole and 4-MAP, in terms of installed manufacturing capacities as of March 31, 2021.

The company's specialty chemicals have a wide range of applications that cater to a diverse base of customers across industries. Its customers include manufacturers and distributors in India as well as other regulated international markets including China, Europe, the US, Taiwan, Korea and Japan. In FY21, revenue from operations for sales outside India represented 67.86% of total revenue from operations, respectively. The table below sets forth certain information on key products, their applications and the industries such products are used in:

Exhibit 5: Key products and its applications towards different industry...

Product	Application	Industry	Category as per F&S Reports
MEHQ	Polymerization inhibitor in the manufacturing of various monomers such as acrylics, methacrylics and other acrylates, vinyl acetate monomers, along with unsaturated polyesters. Also used as a stabilizer for cosmetics, liquid detergents, and cellulose materials.	Acrylic fibers, inks, agrochemicals, cosmetics, topical drugs.	Agrochemicals and fertilizers, home and personal care, paints and coatings additives, and textile chemicals
Guaiacol	Pre-cursor for vanillin production, and in the synthesis of pharmaceuticals. Majorly used as a reducing co-substance for COX reactions, as an expectorant and antiseptic.	Pharmaceuticals, flavours and fragrances, and agriculture.	Pharma API, flavours and fragrances ingredients
BHA	Used as a synthetic antioxidant	Food packaging, animal feed, rubber, cosmetics and petroleum products.	Home and personal care, others
4-MAP	Spice, medicine and make-up intermediate, ingredient for UV filters, cigarette additive and flavouring in food	Personal care (cosmetics), flavors and fragrance industry	Home and personal care, flavours and fragrances ingredients
DCC	Powerful dehydrating agent commonly used for the preparation of amides, esters, and anhydrides. Also used as a reagent in anti-retroviral drugs	Pharmaceuticals	Pharma API
Ascorbyl Palmitate	Anti-oxidant properties for anti-aging products	Personal care, topical drugs in dermatology to prevent hyperpigmentation and photo-aging	Home and personal care, pharma API
Anisole	Precursor to perfumes, insect pheromones, and pharmaceuticals.	Cosmetics, pharmaceutical and agrochemicals	Home and personal care, agrochemicals and fertilizers, pharma API

Source: RHP, ICICI Direct Research

The company's products are used as key starting level materials, as inhibitors, or as additives, by customers, for products sold in regulated markets. Key customers include Bayer AG, SRF, Gennex Laboratories, Nutriad International NV and Vinati Organics. The customer relationships have been strengthened over a long period, based on the company's ability to consistently deliver quality products at competitive prices. Some of its customers have also been associated with it for over 10 years as of May 31, 2021.

It has two certified production facilities in India strategically located at Kurkumbh (Maharashtra), in close proximity to the JNPT port from where it exports majority of products. Each facility has an on-site R&D unit, quality control department, warehouse, and effluent treatment system that treats effluent, to make facilities zero liquid discharge facilities. The facilities have dedicated production lines, with a combined installed capacity of 29,900 MTPA as of March 31, 2021, and capacity utilisation rates of 71.94% for FY21. It has also recently set-up a unit at the third facility adjacent to existing facilities at Kurkumbh (Maharashtra), and have recently been allotted land for the construction of a fourth facility at Kurkumbh (Maharashtra).

Investment Rationale

Leverage R&D capabilities and understanding of catalysis to develop new product portfolio

The company aims to continue to refine existing processes in terms of improving yields and efficiencies, and enhancing backward integration, by leveraging its expertise on complex chemistries such as halogenation, hydrogenation, oxidation, Grignard chemistry, and coupling reactions, that it has generated over time. It intends to develop eco-friendly, cost effective processes through biphasic or triphasic reactions, in the form of either vapour-phase reactions, liquid-solid reactions, or liquid-liquid solid reactions. It is also in the process of expanding R&D infrastructure by setting-up an additional R&D unit at Facility III at Kurkumbh (Maharashtra), where it proposes to install R&D equipment for synthesising new products and certain catalysts under development.

Expansion of manufacturing capacity for existing products

The company's product portfolio is aligned to the changing global and Indian trend of environmentally friendly chemicals, and it intends to leverage on the aggressive growth rates of present product portfolio. For instance, the global market for MEHQ, Anisole and AP is expected to grow at ~5-6% over the next five years, and for BHA, 4-MAP and DCC is expected to grow by ~4% over the same period (Source: F&S Reports). To cater to the growing demand from existing customers and to meet requirements of new customers, it intends to and is in the process of expanding the manufacturing capacities for few of existing products. It also intends to add manufacturing capacities for certain new products that will form part of stabiliser/ additive product portfolio, that the company is in the process of developing, for application in paints and coatings, pharmaceutical, flavours and fragrance, and agriculture industries. The markets for paints and coatings, pharmaceutical chemicals, flavours and fragrance and agrochemical industries are expected to grow at CAGR of 5.1%, 6.1%, 5.2% and 5.8% in 2019-2025E, respectively (Source: F&S Reports). To achieve capacity expansion, it has recently set-up a unit third manufacturing facility that is being constructed adjacent to existing facilities at Kurkumbh (Maharashtra), and have recently been allotted land for the construction of a fourth facility in Kurkumbh (Maharashtra).

Strong and long-standing relationships with key customers

The company's customers comprise direct end-use manufacturers as well as institutional distributors. A majority of revenues is generated from direct sales to customers. Certain key customers include Bayer AG and SRF for agro-chemical products, Gennex Laboratories for pharmaceutical intermediates, and Vinati Organics for specialty monomer products, Nutriad International NV for animal nutrition. Some of customers have also been associated with the company for over 10 years as of May 31, 2021. Its products are used as key starting level materials, as inhibitors, or additives by customers for their finished products, for sale in regulated markets. The customer engagements are therefore dependent on delivering quality products consistently. It could take potential customers a few years to approve as suppliers, based on quality control systems and product approvals across jurisdictions by multiple regulators. Due to the resources involved in engaging with new suppliers, customers are less inclined to pursue alternate supply sources. This provides it with an advantage over new entrants who would need to make significant investments and endure a long gestation period with potential customers in order to effectively compete.

Key risks & concerns

- **Lower growth visibility for MEHQ to impede overall growth:** MEHQ constitutes ~50% of overall revenue, which finds application in polymerisation inhibitor in acrylic acids, primarily involved in the manufacturing acrylic fibre, paints and inks, adhesives and super absorbent polymers. The segmental growth remained at 12% CAGR in FY19-21. Any slowdown in the end user industry demand or increase in competition can hurt the overall growth of the business.
- **Significant portion of revenues from limited market remains key business risk–** Historically, it derived a significant portion of revenues from a limited number of markets, viz. China, India, Europe and the Americas. Revenue contribution from sale of products to China, India, Europe, and the Americas remained at 37.12%, 31.41%, 13.82% and 11.47%, respectively. Since there are few competitors from the same business stream present in China, hence, any technological developments there can lower the growth outlook and impact the business performance.
- **Loss of customer to impede performance** – Top 10 customers contribute 48% to overall revenue while top client constitutes ~13% of the topline. Loss of customer or lower business growth from large customers owing to intense competition can impede the growth of the business

Financial summary

Exhibit 6: Profit and loss statement		₹ crore		
Year end March	FY19	FY20	FY21	
Total Operating Income	393.3	419.3	512.4	
Growth (%)	-	6.6	22.2	
Raw Material Expenses	171.2	129.2	123.6	
Gross Profit	222.1	290.1	388.8	
Employee Cost	24.9	31.0	43.6	
Other Operating Expenses	60.9	73.8	86.3	
EBITDA	136.3	185.3	259.0	
Growth (%)	-	35.9	39.8	
Other Income	11.3	10.9	25.6	
EBITDA, including OI	147.6	196.2	284.6	
Depreciation	11.0	13.7	17.2	
Net Interest Exp.	0.0	0.1	0.1	
Other exceptional items	0.0	0.0	0.0	
PBT	136.5	182.3	267.3	
Total Tax	38.9	42.7	68.9	
Tax Rate	28.5%	23.4%	25.8%	
PAT	97.7	139.6	198.4	
Adj. PAT after Minority interest	97.7	139.6	198.4	
Adj. EPS (₹)	9.2	13.1	18.7	
Shares Outstanding	10.6	10.6	10.6	

Source: Company, ICICI Direct Research

Exhibit 7: Cash flow statement		₹ crore		
Year end March	FY19	FY20	FY21	
PBT & Extraordinary	136.5	182.3	267.3	
Depreciation	11.0	13.7	17.2	
After other adjustments				
(Inc) / Dec in Working Capital	-20.9	13.1	-14.9	
Taxes	-35.5	-42.4	-65.9	
Others	-6.4	-6.6	-10.8	
CF from operating activities	84.7	160.1	192.8	
Purchase of Fixed Assets	-38.8	-50.3	-84.4	
Others	-56.1	-56.0	-102.3	
CF from investing activities	-95.0	-106.3	-186.8	
Proceeds from issue of shares	0.0	-40.1	0.0	
Borrowings (Net)	2.0	0.1	-2.4	
Others	-12.8	-15.5	-3.5	
CF from financing activities	-10.8	-55.4	-5.9	
Net cash flow	-21.1	-1.6	0.2	
Effects of foreign currency translation	1.0	1.4	0.0	
Opening Cash & Bank	29.5	9.4	9.3	
Closing Cash & Bank	9.4	9.3	15.7	

Source: Company, ICICI Direct Research

Exhibit 8: Balance sheet		₹ crore		
Year end March	FY19	FY20	FY21	
Liabilities				
Share Capital	1.4	1.3	10.6	
Reserves	270.6	340.8	529.0	
Total Shareholders Funds	272.1	342.1	539.7	
Minority Interest	0.0	0.0	0.0	
Long Term Borrowings	0.1	0.3	0.3	
Net Deferred Tax liability	13.9	13.2	17.6	
Other long term liabilities	0.0	0.0	0.0	
Long-term provisions	0.3	0.3	0.4	
Current Liabilities and Provisions				
Short term borrowings	2.5	2.4	0.0	
Trade Payables	22.3	35.7	61.0	
Other Current Liabilities	16.2	35.7	40.8	
Short Term Provisions	0.1	0.1	0.2	
Total Current Liabilities	41.1	74.0	102.0	
Total Liabilities	327.5	429.9	659.9	
Assets				
Net Block	125.1	162.9	182.9	
Capital Work in Progress	3.9	3.4	55.0	
Non-current investments	0.0	0.0	0.0	
Other Non Current Assets	5.9	6.6	26.9	
Current Assets, Loans & Advances				
Current Investments	75.2	133.0	232.1	
Inventories	37.0	34.6	52.9	
Sundry Debtors	59.8	69.8	74.2	
Cash and Bank	9.4	9.3	15.7	
Loans and Advances	0.0	0.2	0.2	
Other Current assets	11.1	10.1	20.0	
Current Assets	192.6	257.0	395.1	
Total Assets	327.5	429.9	659.9	

Source: Company, ICICI Direct Research

Exhibit 9: Key ratios				
Year end March	FY19	FY20	FY21	
Per share data (₹)				
Adj. EPS	9.2	13.1	18.7	
Adj. Cash EPS	10.2	14.4	20.3	
BV	25.6	41.6	60.2	
DPS	7.5	9.0	2.5	
Operating Ratios (%)				
Gross Margin (%)	56.5	69.2	75.9	
EBITDA Margin (%)	34.7	44.2	50.5	
PAT Margin (%)	24.8	33.3	38.7	
Debtor Days	55	61	53	
Inventory Days	34	30	38	
Creditor Days	21	31	43	
Cash Conversion Cycle	69	60	47	
Return Ratios (%)				
Return on Assets (%)	29.8	32.5	30.1	
RoCE (%)	47.7	51.3	47.9	
Core RoIC (%)	65.9	84.7	82.7	
RoE (%)	35.9	40.8	36.8	
Solvency Ratios				
Total Debt / Equity	0.0	0.0	0.0	
Interest Coverage	NM	NM	NM	
Current Ratio	4.7	3.5	3.9	
Quick Ratio	3.8	3.0	3.4	
Valuation Ratios (x)				
EV/EBITDA	70.0	51.5	36.9	
P/E	97.9	68.5	48.2	
P/B	35.1	21.6	14.9	
EV/Sales	24.3	22.8	18.6	

Source: Company, ICICI Direct Research

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