INSTITUTIONAL RESEARCH

Clean Science and Technology

HALS expansion: CSTL's strategic leap

We maintain SELL on Clean Science and Technology (CSTL) with a price target of INR 1,037 (WACC 11%, terminal growth 6%), owing to (1) slower-than-expected ramp-up in hindered amine light stabilizers (HALS) and (2) entry of domestic competitors in mono methyl ether of hydroquinone (MEHQ) manufacturing. We believe CSTL has an import substitution opportunity in HALS. However, the upcoming capacity augmentation in HALS by competitors and muted demand growth shall remain challenges to growth in HALS revenue. Therefore, HALS revenue growth could be slower than we had anticipated earlier. We have lower revenue estimates from HALS in FY25 and FY26. EBITDA and PAT shall grow at a 23/23% CAGR over FY24E-27E. The RoE is expected to improve from 21.6% in FY24E to 22.2% in FY27E. We believe the valuation is contextually high at 41/34/31x FY25E/26E/27E EPS.

New HALS products will be launched in FY25

CSTL has inaugurated a new manufacturing facility of Clean Fino-Chem Limited (CFCL), a wholly owned subsidiary of CSTL within a stipulated timeframe. The company has invested INR3.35bn in CFCL for building capacities for new HALS and utilities. It is planning to launch these products in phases over the next six to eight months.

The successful launch of intermediates for HALS and HALS products is testimony to the company's deep understanding of complex chemistries. HALS products find application in end-user industries like automobiles, industrials, construction, powder coating, solvent-borne paints, adhesives, etc. The previously launched HALS 770 by CSTL predominantly focused on the domestic market while the upcoming HALS shall target both domestic and export market opportunities.

CSTL has started receiving orders from Europe and Middle East for HALS 770 and has had an encouraging response in the domestic market as well. The company has received approvals from multinationals in Europe for HALS 701. The company aims to increase overall HALS production to 200 tons per month (tpm) by March 2025 from the current production rate of 50 tpm.

In order to protect their market share, competitors have lowered HALS prices, post the entry of CSTL last year. The prices have also dropped further due to subdued demand. Blended realisation for imported HALS products fell ~40% from peak realisation in Q1FY23 *(Refer Exhibit 06).*

BASF is augmenting the HALS production capacity at its sites in Lampertheim, Germany and Pontecchio Marconi, Italy. It aims to serve the growing demand for light stabilizers used in durable plastics applications and increase supply security for customers worldwide. Its plant is expected to come on stream in CY2024.

We believe the capacity expansion by competitors, fall in realisation, and lower demand can threaten CSTL's HALS ramp-up. The growth in HALS revenue should be slower than we had anticipated earlier. We have lower revenue estimates from HALS in FY25 and FY26.

In our estimates, share of revenue from higher-margin products for FY25 and FY26 increased from 88% and 85% to 92% and 86%, which leads to EBITDA margins for the two years increasing by 128bps and 197bps respectively.

SELL

CMP *(as on 15 Mar 2024)*	INR1,299
Target Price	INR 1,037
NIFTY	22,023

KEY CHANGES	OLD	NEW
Rating	SELL	SELL
Price Target	INR 980	INR 1,037
EPS %	FY24E	FY25E
	-1.8%	-2.3%

KEY STOCK DATA	
Bloomberg code	CLEAN IN
No. of Shares (mn)	106
MCap (INR bn) / ($ mn)	138/1,688
6m avg traded value (INR mn)	210
52 Week high / low	INR 1,622/1,227

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	(12.2)	(10.8)	(6.7)
Relative (%)	(13.8)	(17.9)	(32.9)

SHAREHOLDING PATTERN (%)

	Sep-23	Dec-23
Promoters	74.98	74.98
FIs & Local MFs	5.23	5.14
FPIs	6.00	5.92
Public & Others	13.79	13.97
Pledged Shares	0.00	0.00

Source: BSE

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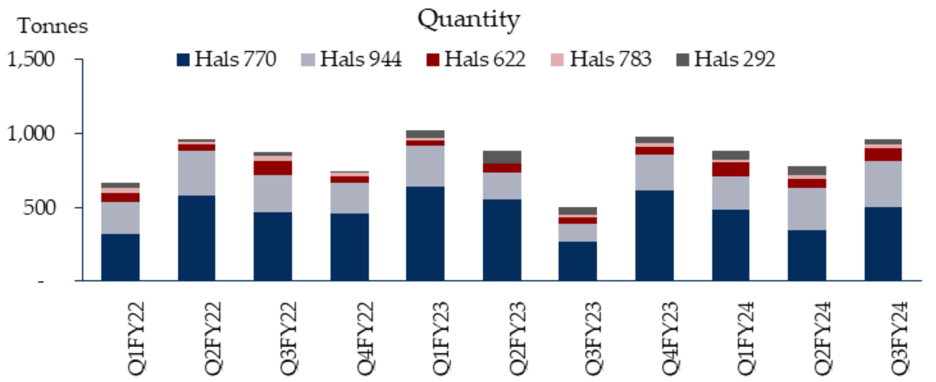
Exhibit-1: Applications of HALS

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

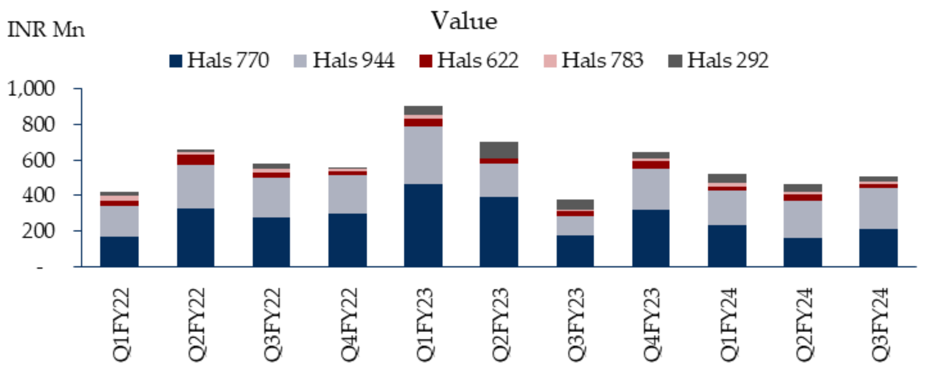
Exhibit-2: HALS 770 is the largest imported HALS in India



Source: Volza.com, HSIE Research

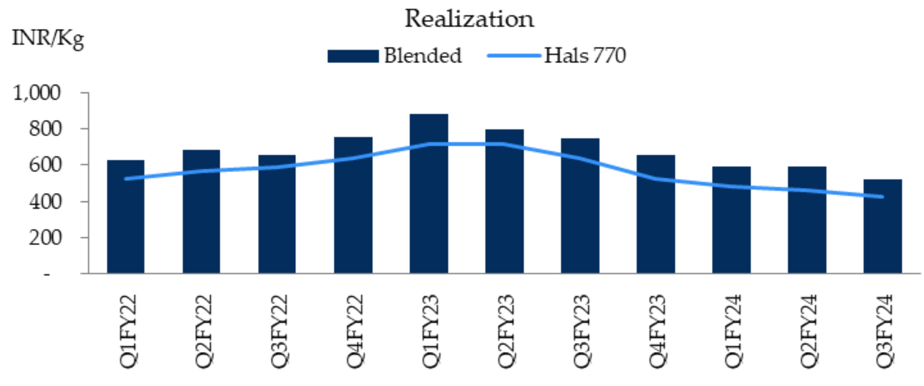
Over the last three years, the average quarterly imports of HALS are ~850 tonnes. During Q1FY22, total HALS imports were ~670 tonnes while it has reached ~970 tonnes by Q3FY24; HALS 770 is the largest imported HALS with a quarterly average of ~480 tonnes, followed by HALS 944 with an average quarterly import of ~240 tonnes.

Exhibit-3: Quarterly HALS* import trend in INR mn



Source: HSIE Research, Volza.com
*For HALS 770, 944, 622, 783, and 292

Exhibit-4: Realisations of imported HALS* have fallen 15%-51% in YTD FY24 vs FY23



Source: Volza.com, HSIE Research,
*For HALS 770, 944, 622, 783, and 292

The average blended realisation of majorly imported HALS remained in the range of INR 500 to 800 INR/kg. The average realisation of HALS 770 (which is the largest imported HALS) remained at ~570 INR/kg. CSTL is currently focused on products shown in Exhibit 1, which are majorly imported into India.

Import substitution opportunity

Globally, during FY22, the international market for UV absorbers and light stabilizers remained at INR 102 bn. The major growth comes from the demand for various types of plastic, packaging material, automotive plastics, and agricultural films. The growth is also driven by the coating industry, primarily industrial coating. Emerging markets are major growth opportunities. Total HALS imported during FY23 were ~3,400 tonnes holding a value of INR2.6bn. There are multiple challenges in importing HALS as (i) orders have to be placed in bulk in ISO containers; (ii) product degradation is likely as products are procured in bulk and used over a period; (iii) there could be a forex risk; (iv) working capital cycle is stretched; and (v) freight and other costs. CSTL has the technology to produce key intermediates, TAA (Triacetone amine) and TMP (Tetramethylpiperidine), which are important for producing HALS. We believe CSTL has an import substitution opportunity of ~ INR 2.5 bn.

Entry of a domestic competitor in MEHQ could erode margins

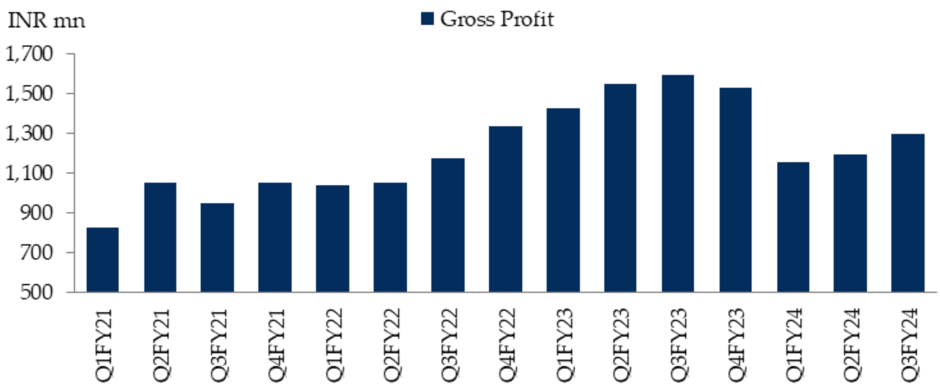
The current global demand for MEHQ stands at -15ktpa. CSTL holds the largest share of the MEHQ market globally, boasting over 50% market share; this is due to its eco-friendly and cost-effective manufacturing process using the anisole route, unlike competitors who use the hydroquinone route.

Vinati Organics (VO) is one of CSTL's largest customers, their relationship spanning over a decade. VO is setting up a 5ktpa anisole capacity and a 3ktpa MEHO/Guaiacol plant using the anisole route. We believe the MEHQ produced will be predominantly marketed rather than consumed internally as an inhibitor for the polymerisation reaction.

The MEHQ-Guaiacol plant is expected to be operational by March 2024. With a similar technology for MEHQ production, VO aims to challenge CSTL's dominance, aspiring to capture 25% to 30% of the global market share.

Commodity nature of MEHQ and Guaiacol will force new players to offer discount to prevailing prices to gain market share. Product validation and approval is a tedious and time-consuming process. Therefore, customers will ensure ability of new suppliers to offer prices on sustainable basis during headwinds of market as well. Therefore, VO's entry into the MEHQ/Guaiacol market is anticipated to intensify competition and exert pressure on pricing and profitability of CSTL' s business. MEHQ and Guaiacol contribute ~60% in CSTL's revenue with very high gross profit margin.

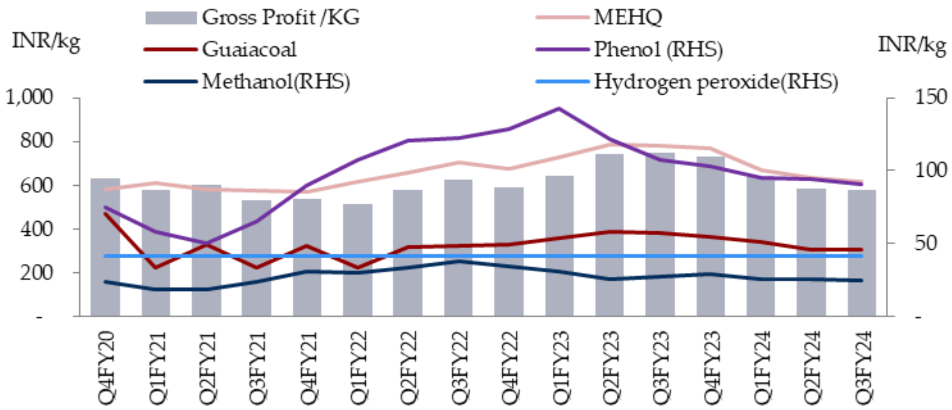
Exhibit-5: Gross profit trend



Source: Company, HSIE Research

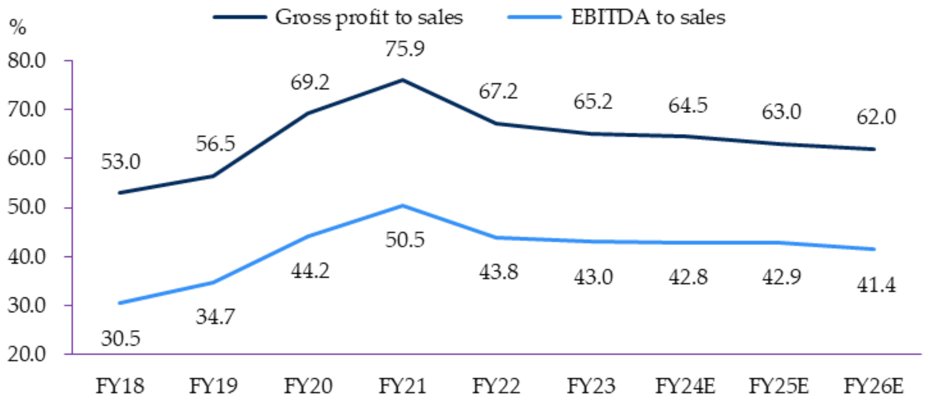
In FY23, estimated gross profit/kg for MEHQ and Guaiacol increased owing to increase in realisation of finished products while raw material prices remain flattish compared to FY22. During 9MFY24, raw material prices and product prices corrected as compared to prices in FY23. On per kg basis, correction in finish product prices is much sharper than correction in raw material prices, resulting in a fall in gross profit per kg.

Exhibit-6: Estimated product prices correlating with estimated gross profit per unit



Source: Company, HSIE Research, Chemical Weekly, Volza.com

Exhibit-7: Gross profit and EBITDA margin trend



Source: Company, HSIE Research

Financial summary (consolidated)

INR mn	3Q FY24	2Q FY24	QoQ (%)	3Q FY23	YoY (%)	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	1,947	1,811	7.5	2,374	(18.0)	6,849	9,358	7,814	10,922	13,937
EBITDA	866	748	15.7	1,082	(20.0)	2,999	4,021	3,345	4,686	5,771
APAT	626	522	20.0	838	(25.3)	2,285	2,952	2,396	3,330	4,090
AEPS (INR)	5.9	4.9	20.0	7.9	(25.3)	21.5	27.8	22.6	31.3	38.5
P/E (x)						60.5	46.9	57.7	41.5	33.8
EV/EBITDA(x)						45.9	34.4	41.3	29.4	23.5
RoE (%)						34.9	33.2	21.6	24.8	24.8

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)	3,353	3,345	(0.2)	4,753	4,686	(1.4)	5,537	5,771	4.2
Adj. EPS (INR/sh)	23.0	22.6	(1.8)	32.1	31.3	(2.3)	37.1	38.5	3.8

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**	**7,814**	**10,922**	**13,937**
Growth %	*63.1*	*6.6*	*22.2*	*33.7*	*36.6*	*(16.5)*	*39.8*	*27.6*
Raw Material	1,712	1,292	1,236	2,247	3,260	2,774	4,041	5,296
Employee Cost	249	310	436	345	452	484	556	640
Other Expenses	609	738	863	1,258	1,625	1,211	1,638	2,230
EBITDA	**1,363**	**1,853**	**2,590**	**2,999**	**4,021**	**3,345**	**4,686**	**5,771**
EBIDTA Margin (%)	*34.7*	*44.2*	*50.5*	*43.8*	*43.0*	*42.8*	*42.9*	*41.4*
EBITDA Growth %	*85.7*	*35.9*	*39.8*	*15.8*	*34.1*	*(16.8)*	*40.1*	*23.2*
Depreciation	110	137	172	249	361	508	612	691
EBIT	**1,253**	**1,716**	**2,417**	**2,750**	**3,660**	**2,837**	**4,075**	**5,080**
Other Income (Including EO Items)	113	109	256	300	298	358	365	372
Interest	0	1	1	1	2	0	0	0
PBT	**1,365**	**1,823**	**2,673**	**3,048**	**3,956**	**3,195**	**4,440**	**5,453**
Tax	389	427	689	763	1,005	799	1,110	1,363
PAT	**977**	**1,396**	**1,984**	**2,285**	**2,952**	**2,396**	**3,330**	**4,090**
EO (Loss) / Profit (Net Of Tax)	-	-	-	-	-	-	-	-
APAT	**977**	**1,396**	**1,984**	**2,285**	**2,952**	**2,396**	**3,330**	**4,090**
Share from associates	-	-	-	-	-	-	-	-
Minority Interest	-	-	-	-	-	-	-	-
Consolidated APAT	**977**	**1,396**	**1,984**	**2,285**	**2,952**	**2,396**	**3,330**	**4,090**
Consolidated APAT Growth (%)	*99.7*	*43.0*	*42.1*	*15.2*	*29.2*	*(18.8)*	*38.9*	*22.8*
AEPS	**9.2**	**13.1**	**18.7**	**21.5**	**27.8**	**22.6**	**31.3**	**38.5**
AEPS Growth %	*99.7*	*43.0*	*42.1*	*15.2*	*29.2*	*(18.8)*	*38.9*	*22.8*

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	11,959	14,689	18,043
Total Equity	**2,721**	**3,421**	**5,397**	**7,684**	**10,100**	**12,065**	**14,796**	**18,149**
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**	**12,329**	**15,059**	**18,413**
APPLICATION OF FUNDS								
Net Block	1,270	1,656	1,858	2,957	4,601	6,748	7,899	8,549
Capital WIP	39	34	550	441	205	50	588	447
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**	**7,207**	**8,895**	**9,405**
Inventories	370	346	529	881	1,088	909	1,270	1,620
Debtors	598	698	742	1,535	1,462	1,221	1,706	2,177
Cash and Cash Equivalents	94	93	157	747	125	287	649	2,827
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**	**6,154**	**7,475**	**10,589**
Creditors	223	357	610	1,021	805	672	940	1,199
Other Current Liabilities & Provns	163	389	410	327	349	360	371	382
Total Current Liabilities	**386**	**746**	**1,020**	**1,348**	**1,155**	**1,032**	**1,310**	**1,581**
Net Current Assets	**1,539**	**1,825**	**2,932**	**4,355**	**5,149**	**5,122**	**6,164**	**9,009**
TOTAL APPLICATION OF FUNDS	**2,888**	**3,553**	**5,579**	**7,898**	**10,364**	**12,329**	**15,059**	**18,413**

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	3,195	4,440	5,453
Non-operating & EO Items	(113)	(109)	(256)	(300)	(298)	(358)	(365)	(372)
Interest Expenses	0	1	1	1	2	0	0	0
Depreciation	110	137	172	249	361	508	612	691
Working Capital Change	(863)	(287)	(1,043)	(833)	(1,416)	190	(681)	(667)
Tax Paid	(352)	(464)	(616)	(729)	(980)	(799)	(1,110)	(1,363)
OPERATING CASH FLOW (a)	**148**	**1,102**	**931**	**1,436**	**1,625**	**2,736**	**2,896**	**3,742**
Capex	(381)	(518)	(891)	(1,239)	(1,768)	(2,500)	(2,300)	(1,200)
Free Cash Flow (FCF)	(233)	584	40	197	(143)	236	596	2,542
Investments	-	-	-	-	(255)	-	-	-
Non-operating Income	113	109	256	300	298	358	365	372
Others	33	1	(201)	95	(9)	-	-	-
INVESTING CASH FLOW (b)	**(235)**	**(408)**	**(835)**	**(845)**	**(1,734)**	**(2,142)**	**(1,935)**	**(828)**
Debt Issuance/(Repaid)	20	1	(24)	-	(3)	0	-	-
Interest Expenses	(0)	(1)	(1)	(1)	(2)	(0)	(0)	(0)
FCFE	(212)	584	16	195	(148)	236	595	2,541
Share Capital Issuance	-	(1)	93	-	0	-	-	-
Dividend	(128)	(153)	(33)	-	(531)	(431)	(599)	(736)
Others	(6)	(541)	(67)	0	23	(0)	(0)	(0)
FINANCING CASH FLOW (c)	**(114)**	**(696)**	**(32)**	**(1)**	**(513)**	**(431)**	**(599)**	**(736)**
NET CASH FLOW (a+b+c)	**(201)**	**(2)**	**64**	**590**	**(622)**	**163**	**361**	**2,178**
EO Items, Others								
Closing Cash & Equivalents	**95**	**93**	**157**	**747**	**125**	**287**	**649**	**2,827**

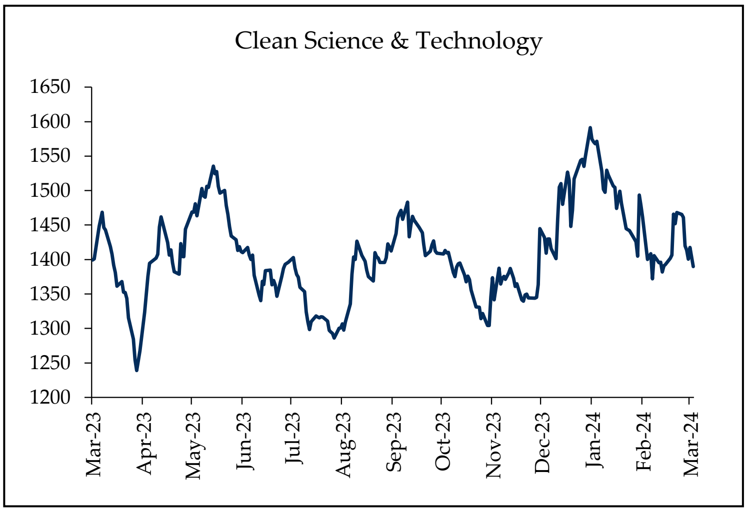
Source: Company, HSIE Research

KEY RATIOS

	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
PROFITABILITY %								
Gross Margin	56.5	69.2	75.9	67.2	65.2	64.5	63.0	62.0
EBITDA Margin	34.7	44.2	50.5	43.8	43.0	42.8	42.9	41.4
EBIT Margin	31.9	40.9	47.2	40.1	39.1	36.3	37.3	36.5
APAT Margin	24.8	33.3	38.7	33.4	31.5	30.7	30	29
RoE	42.5	45.5	45.0	34.9	33.2	21.6	25	25
RoIC	40.4	42.5	43.2	35.6	33.1	19.8	24	27
RoCE	40.1	43.4	43.5	33.9	32.3	21.1	24	24
EFFICIENCY								
Tax Rate %	28.5	23.4	25.8	25.0	25.4	25.0	25	25
Fixed Asset Turnover (x)	2.5	2.1	2.1	2.1	1.9	1.1	1	1
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	175	129	104
Payables (days)	48	101	180	166	90	88	85	83
Other Current Liab & Provns (days)	15	34	29	17	14	17	12	10
Cash Conversion Cycle (days)	107	81	61	81	137	169	131	111
Net Debt/EBITDA (x)	(0.1)	(0.0)	(0.1)	(0.2)	(0.0)	(0.1)	(0)	(0)
Net D/E	(0.0)	(0.0)	(0.0)	(0.1)	(0.0)	(0.0)	(0)	(0)
Interest Coverage	-	-	-	-	-	-	-	-
PER SHARE DATA (INR)								
EPS	9.2	13.1	18.7	21.5	27.8	22.6	31	38
CEPS	10.2	14.4	20.3	23.9	31.2	27.3	37	45
Dividend	N/A	N/A	N/A	3.3	5.0	4.1	6	7
Book Value	25.6	32.2	50.8	72.3	95.1	113.6	139	171
VALUATION								
P/E (x)	147.5	103.2	72.6	63.0	46.9	57.7	42	34
P/Cash EPS (x)	132.5	93.9	66.8	56.8	41.8	47.6	35	29
P/BV (x)	53.0	42.1	26.7	18.7	13.7	11.5	9	8
EV/EBITDA (x)	105.6	77.7	55.6	47.8	34.4	41.3	29	23
EV/Revenue (x)	36.6	34.3	28.1	20.9	14.8	17.7	12.6	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	1.2	2.0	2.1	2.8
FCFF/EV (%)	(0.2)	0.4	0.0	0.1	(0.1)	0.2	0.4	1.9
FCFE/M Cap (%)	(0.1)	0.4	0.0	0.1	(0.1)	0.2	0.4	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:

We, **Nilesh Ghuge, MMS, Harshad Katkar, MBA, Prasad Vadnere, MSc & Akshay Mane, PGDM,** authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. SEBI conducted the inspection and based on their observations have issued advise/warning. The said observations have been complied with. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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