



# 5 MINUTE STOCK IDEA

BY SMART SYNC INVESTMENT ADVISORY SERVICES

## CHEMCON SPECIALITY CHEMICALS LTD

### WHAT WE LIKE

#### STRONG MARKET POSITIONING

The company is the leading producer of intermediate drugs like HMDS (for the Penicillin group), CMIC (for Anti-aid drugs) & bromides. It has long-term relationships with Marquee clients like Laurus Labs & Aurobindo Pharma among others. Further, the company's partial backward integration in the HMDS intermediate also strengthens its positioning.

#### ENTRY BARRIERS

Owing to complex chemistry, high gestation period, & stringent regulatory norms among others, the company is shielded from any new competition.

#### BUYING THE PESSIMISM PLAY?

The company has witnessed tough 3 years wherein the growth in sales has primarily come from Bromides while the pharma intermediates division- volumes have decreased.

However, post-H2FY24, the demand is expected to come back, & the company's new capacity is also expected to come online by FY24. Given the company's strong import substitution & exports opportunity, potential supplies to the semiconductor industry (through its new high-purity HMDS plant) & long-term goal of touching INR 1000 Crs revenues in the coming 4-5 years, it can be an interesting company to track as the Pharmaceutical industry might have almost bottomed out.

#### TRANSITION FROM A COMMODITY TO A SPECIALTY CHEMICALS PLAYER

The company owing to the addition of new products has been able to pivot from a commodity player with low margins to a specialty chemical producer with high margins which has also boosted its revenues.

Business	FY15 Revenue Rs 64 Crs	FY23 Revenue Rs 303 Crs
CMIC	Rs 10 Crs	Rs 46 Crs
HMDS	Rs 36 Crs	Rs 130 Crs
Bromides	Rs 13 Crs	Rs 107 Crs
Others	Rs 5 Crs	Rs 20 Crs

#### OPERATIONAL LEVERAGE OPPORTUNITY

Although the current average capacity utilization is between 30-50% for all its products, this might be due to the high initial gestation period. Thus any recovery in demand is expected to directly boost the bottom line owing to operational leverage.

#### STRONG BALANCE SHEET

Despite having low capacity utilisations & high capex in recent periods, the company is net debt free where Cash (131 Crs) is higher than the long-term borrowings (64 Crs), thus ensuring limited financial risk.

### WHAT WE DON'T LIKE

#### GEOGRAPHICAL CONCENTRATION RISK

All of the company's plants (9) are located in Manjusrar, Vadodara which exposes it to unforeseen risks like natural calamity, labor strikes, or any other event in the city.

#### REGULATORY RISKS

The company owing to the hazardous nature of its chemicals is susceptible to any orders by the regulatory bodies regarding closure of its operations. (In fact, the company did receive an order from GPCB in FY22.. which was later revoked)

#### ELONGATED WORKING CAPITAL CYCLE

While the company's payable days have been reduced, its average inventory & debtor days have increased massively in the last 5 years which has led to poor PAT-CFO conversion due to money being stuck in working capital as well as lower Returns on capital employed (ROCE).

	Mar 2012	Mar 2013	Mar 2014	Mar 2015	Mar 2016	Mar 2017	Mar 2018	Mar 2019	Mar 2020	Mar 2021	Mar 2022	Mar 2023
Debtor Days	62	51	40	52	51	93	88	77	124	142	146	81
Inventory Days	132	107	146	74	45	56	99	91	118	175	102	164
Days Payable	110	46	97	79	39	81	82	57	63	67	70	44
Cash Conversion Cycle	84	112	89	47	57	70	86	111	179	250	177	201
Working Capital Days	91	118	85	64	59	79	93	95	175	188	155	164
ROCE %	15%	17%	17%	17%	22%	18%	74%	85%	43%	29%	21%	16%

#### STAGNANT HISTORICAL GROWTH

The company has faced tough 5 years where despite fixed assets increased by 3.5X from 40 Crs to 141 Crs, the revenue, volumes & profit growth have been stagnant while margins have eroded drastically to 18% in the recent quarters due to soft demand for CMIC & HMDS, & an increased share of bromides in total revenues which are used in oil well completion chemicals (a very cyclical source of revenue).



#### QUESTIONABLE PROMOTER BACKGROUND

One of the company's promoters was previously convicted by the CBI of an alleged criminal conspiracy. This coupled with other instances like another promoter group entity filing a suit with SEBI against one promoter for mismanagement of its operations does not bode well for the company's reputation.

Pursuant to a criminal complaint ("Complaint") filed by the Central Bureau of Investigation (Jaipur) ("CBI"), the CBI Special Court, Jaipur ("CBI Court"), vide an order dated December 24, 2018 ("CBI Court Order"), has convicted and sentenced *inter alia* a member of our Promoter Group, **Naresh Vijaykumar Goyal** (in his capacity as a director of Super Scientific Works Private Limited) to (i) rigorous imprisonment for two years with a fine of ₹10,000 for commission of offences under Section 120-B of the Indian Penal Code, 1860; and (ii) rigorous imprisonment for three years and fine of ₹ 20,000 each for commission of offences under Section 13(1)(d)(ii) of the Prevention of Corruption Act, 1988.

The said Complaint was filed by CBI in relation to an alleged criminal conspiracy entered into by certain officers of Hindustan Salts Limited ("HSL"), Hemant K. Goel (as a director of Goel Scientific Glass Works Limited, "GSGWL"), and Naresh Vijaykumar Goyal (as a director of SSWPL) to (i) illegally award a tender and work order ("Tender") for the installation of a bromine plant at Kharaghoda to GSGWL and (ii) GSGWL illegally sub-contracting its obligations under the Tender to SSWPL.

#### HIGH CLIENT CONCENTRATION & FOREX RISK

Top 5 & 10 clients contribute 40% & 59% of the total revenues. The company also derived 59% of its revenues in FY23 from exports which expose it to forex volatility risks (which are mitigated to some extent owing to the import of raw materials).

