

India

**Underweight** (no change)

**Highlighted Companies**

**Aarti Industries**

**REDUCE, TP Rs625, Rs855 close**

Lack of pricing power makes it vulnerable to input price shocks while high valuation makes its stock price susceptible to a steep correction.

**Clean Science and Technology**

**REDUCE, TP Rs847, Rs1852 close**

Clean Science and Technology is one of the costliest chemical stocks in India, trading at 82x FY22 EPS and forecasted EPS CAGR of 14%.

**Meghmani Finechem Ltd**

**ADD, TP Rs2151, Rs1587 close**

Riding on the back of expansion in niche products that can substitute imports (ECH, chloro toluene), EPS is likely to grow at a 30% CAGR over FY22-25F.

**Summary Valuation Metrics**

P/E (x)	Mar22-A	Mar23-F	Mar24-F
Aarti Industries	30.22	48.41	33.6
Clean Science and Technology	86.14	74.08	65.54
Meghmani Finechem Ltd	26.08	18.32	14.76

P/BV (x)	Mar22-A	Mar23-F	Mar24-F
Aarti Industries	7.18	6.43	5.58
Clean Science and Technology	25.61	20.87	17.31
Meghmani Finechem Ltd	9.08	5.08	3.78

Dividend Yield	Mar22-A	Mar23-F	Mar24-F
Aarti Industries	0.69%	0.43%	0.62%
Clean Science and Technology	0%	0%	0%
Meghmani Finechem Ltd	0%	0%	0%

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# Chemicals - Others

## Margins of commodity chemicals are falling

- Margins of almost all commodity chemicals have stopped rising and now they have started declining as well.
- We advise caution on phenol, ethyl acetate, DASDA, LiPF6, MEHQ, 4-MAP, acetonitrile, ATBS, PDCB, MMA, and epoxy resins as they will do well in 3QFY23F but don't extrapolate from this for other quarters.
- The only bright spot is HFC. However, remember this bull phase is driven by shortsightedness of the US administration and will die down soon.

### Commodity chemicals' margins are on the decline

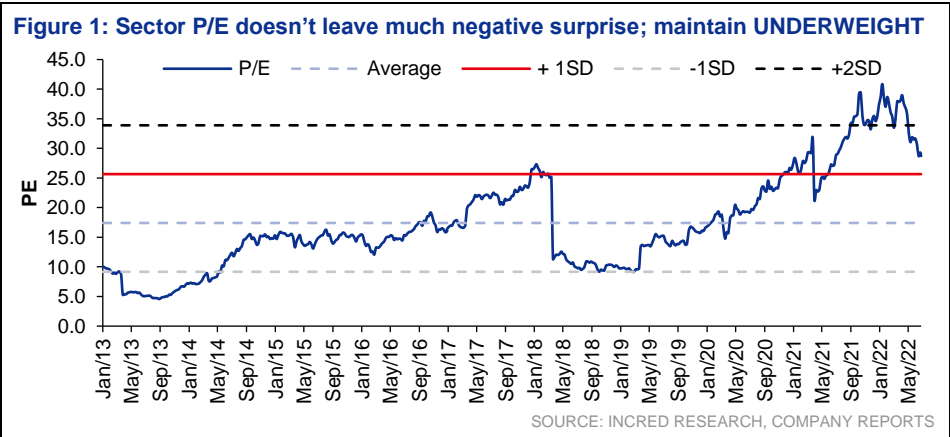
Commodity chemicals' margins are on the downswing. As it always happens, the decline is never linear and hence, one will see volatility during the downtrend in coming quarters. All these chemicals were beneficiaries of post-Covid supply chain crisis and demand surge (overstocking). However, as things normalize, margins are returning to their long-term mean. The most interesting things in the Indian market currently are lithium-ion battery electrolytes and additives. Any company that produces, or claims it can produce these things, or is in the process of installing the plant (or even a pilot plant) is getting an astronomical valuation (please see the valuations of Neogene and Gujarat Fluorochemicals or GFL). However, LiPF6 itself is getting replaced in global markets by LiFSi, and its additives like vinylene carbonate (VC) and fluoroethylene carbonate (FEC) are also fast becoming outdated (negative for Ami Organics – NOT RATED).

### Refrigerants are propelling SRF and GFL, but not for long

The US, via implementation of The AIM Act, which was included in the Consolidated Appropriations Act, 2021 (passed in late 2021), directed the Environmental Protection Agency or EPA to phase down production and consumption of hydrofluorocarbons or HFCs in the US by 85 per cent over the next 15 years. This Act proposed a dramatic reduction in production and consumption of HFCs. While production is easy to monitor but to comply with 2023 guidelines, companies may have started to reduce production since the beginning of 2022. HFC-125 has the highest MMTVe and hence, to comply with 2023 guidelines, American producers may have started cutting production of HFC-125 aggressively which has led to the biggest surge in HFC-125 prices. This anomaly will correct soon and more so, given the slowdown in the western world. Beware of extrapolating from 2QFY23F numbers of SRF (REDUCE) and Gujarat Fluorochemicals (REDUCE). Deepak Nitrite will have another soft quarter. DASDA never took off and phenol spreads are falling.

### Astronomical valuations leave no scope for further rise

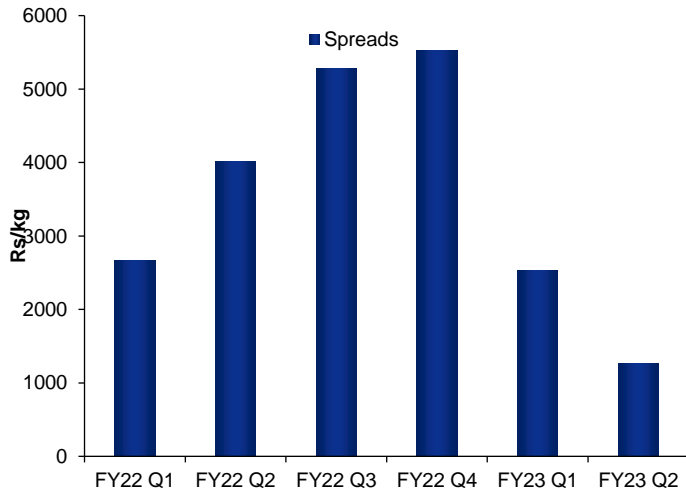
Trailing earnings multiple is the right way to look at the chemical sector as no one knows the growth trajectory. Trusting management commentary on commodity chemicals has never been a wise strategy (see steel prices peaking in May 2021). Like the capital goods sector in 2007-08, we believe the chemical sector has already touched its multi-year peak. We retain our underweight rating on the sector.



## Margins of commodity chemicals are falling

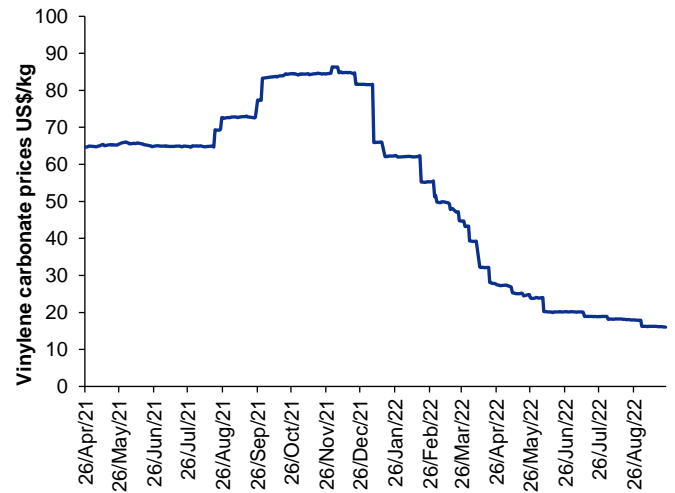
### All commodity chemicals' margins are on the decline

**Figure 2: LiPF6's (most-hyped electrolyte in Indian stock market) margins are falling - negative for Gujarat Fluorochemicals (REDUCE)**



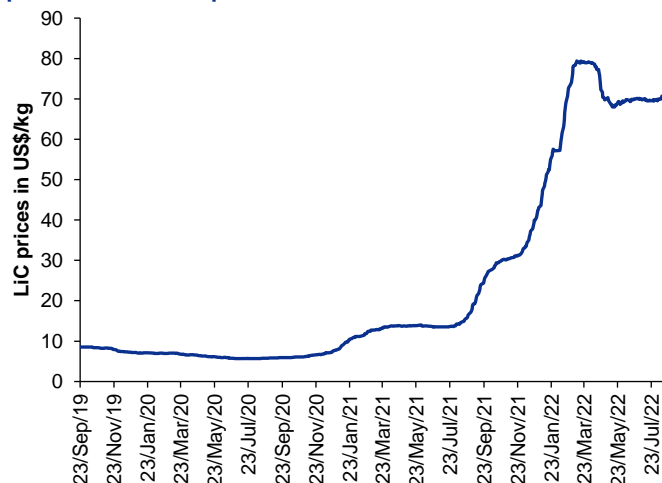
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 3: Prices of lithium-ion battery electrolyte additives are also declining - negative for Ami Organics (NOT RATED)**



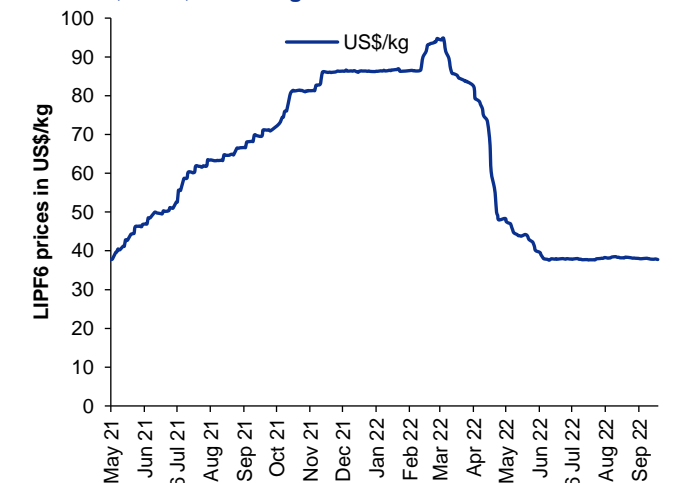
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 4: Rising lithium carbonate prices will exert further pressure on LiPF6 prices**



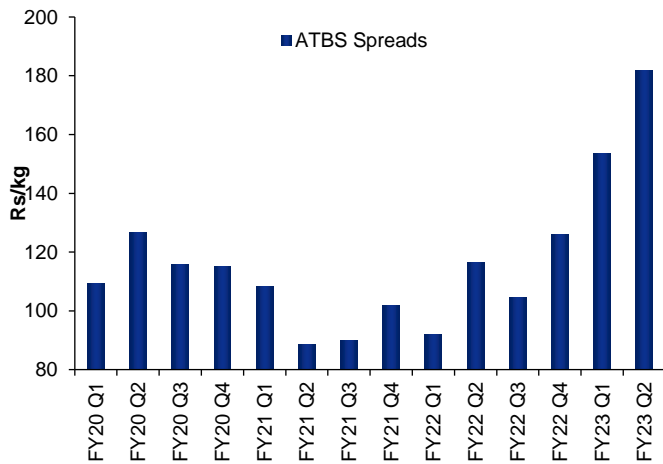
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 5: LiPF6 prices are also collapsing as a better alternative, LiFSi, is coming to the market**



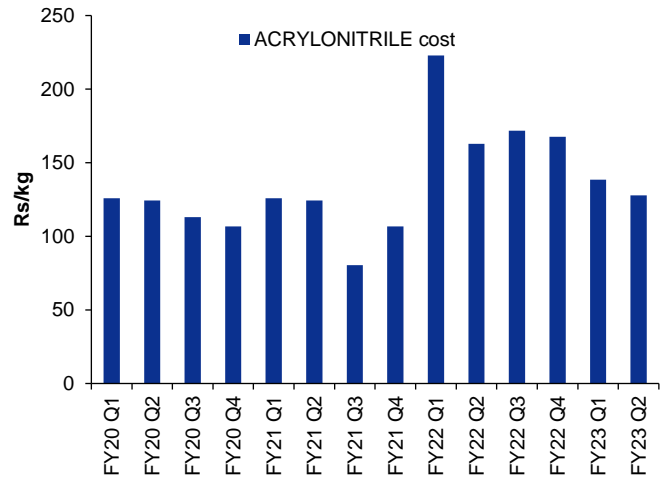
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 6: ATBS does well, but may not last long...



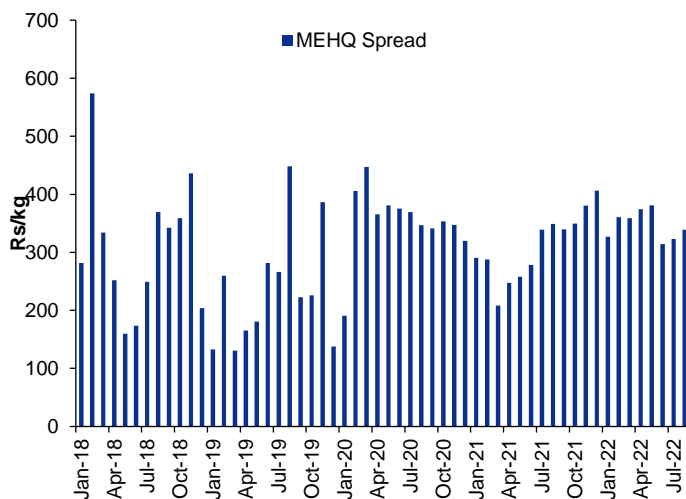
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 7: ...as falling acrylonitrile prices will recover in some time



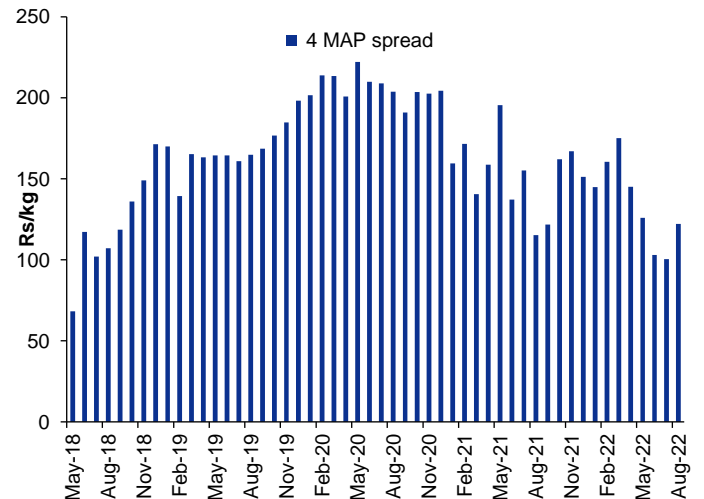
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Figure 8: MEHQ (hydroquinone monomethyl ether) is still doing fine, but Vinati Organics' entry will destroy this small market - negative for Clean Science (REDUCE)



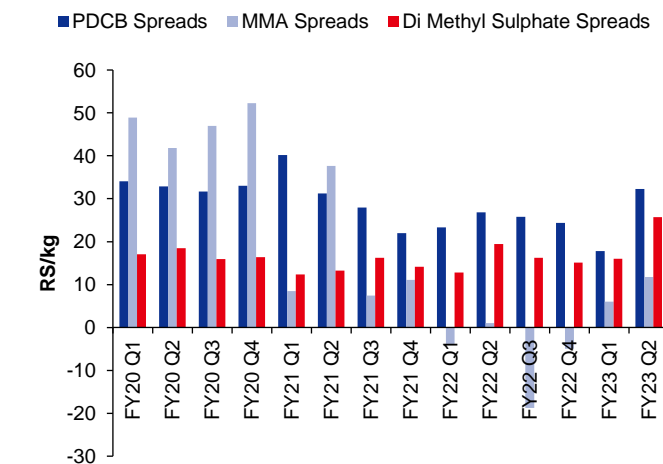
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 9: 4-methoxy acetophenone is also on the decline mode - negative for Clean Science (REDUCE)



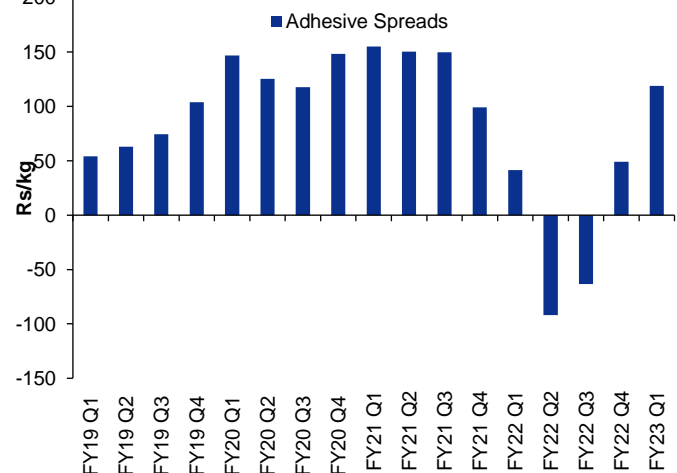
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 10: Aarti Industries may get repriced in 2QFY23F as it is taking advantage of falling raw material prices, but eventually it will lead to a fall in product prices as well



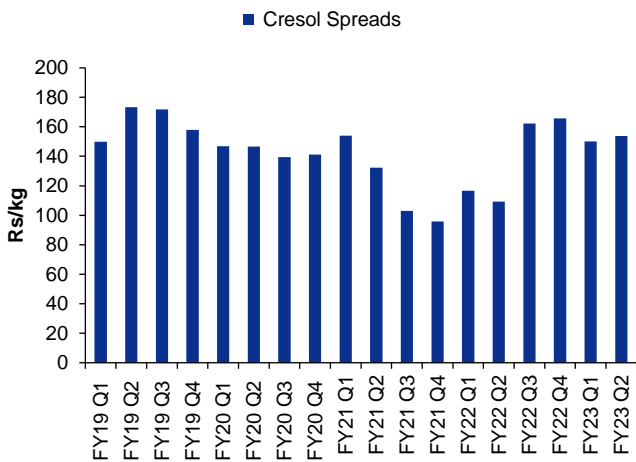
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 11: Falling bisphenol-A spreads will help Atul to regain a part of its margin in the Lapox product series (but we reckon it will be temporary)



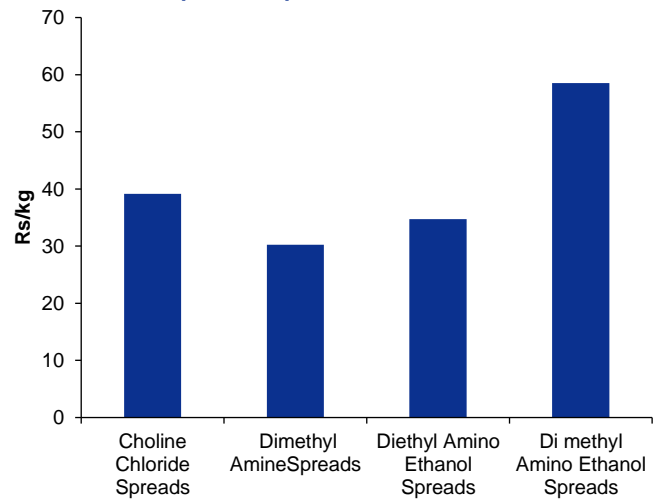
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 12: Cresols are still doing fine and hence, one can expect flattish YoY EBITDA for Atul in 2QFY23F**



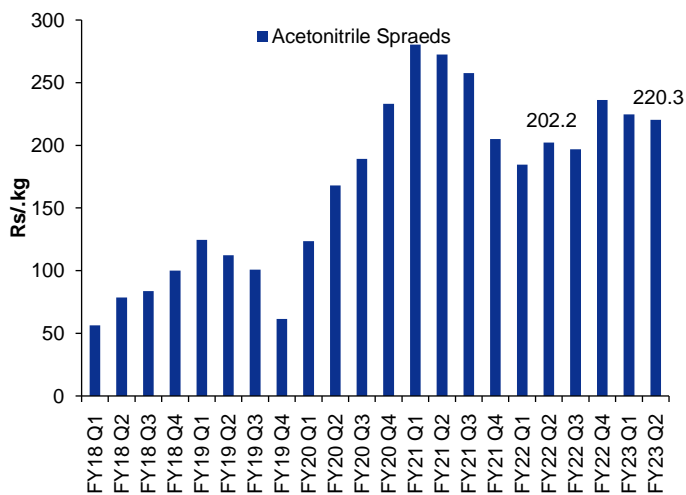
SOURCE: COMPANY REPORTS, INCRED RESEARCH

**Figure 13: YoY performance of amine companies is looking good - in terms of product spreads**



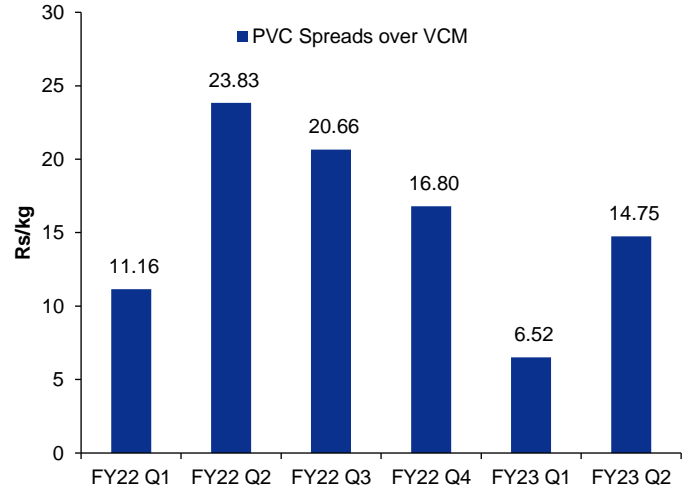
SOURCE: COMPANY REPORTS, INCRED RESEARCH

**Figure 14: However, flattish acetonitrile spreads don't look good for Alkyl Amine's (NOT RATED) prospects in 2QFY23F**



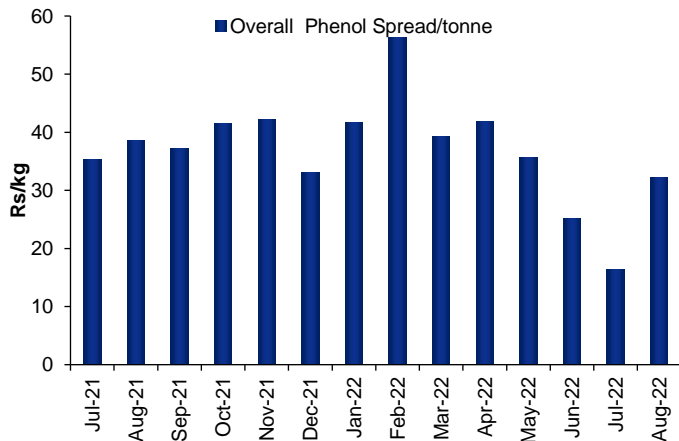
SOURCE: COMPANY REPORTS, INCRED RESEARCH

**Figure 15: Chemplast (NOT RATED) may do better QoQ in 2QFY23F, but way behind its performance in 2QFY22**



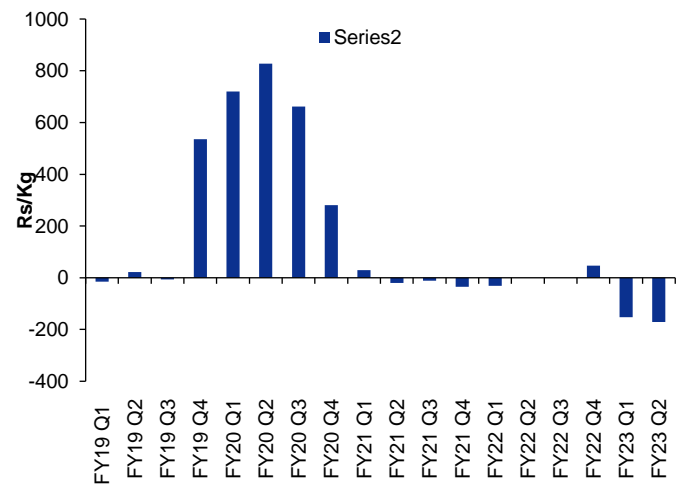
SOURCE: COMPANY REPORTS, INCRED RESEARCH

**Figure 16: Phenol will have no joy, but may have some respite QoQ**



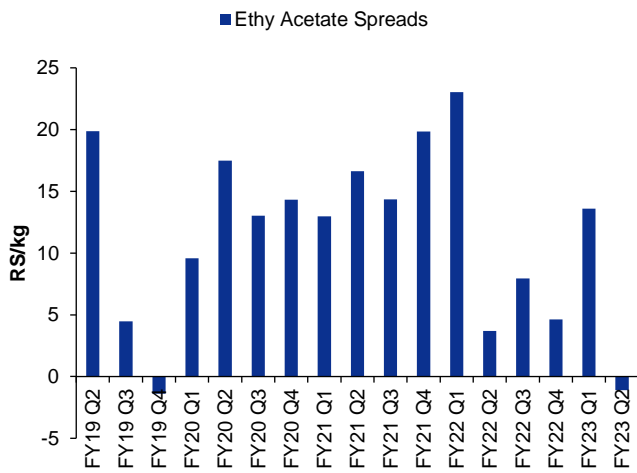
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 17: DASDA's prospects remains negative**



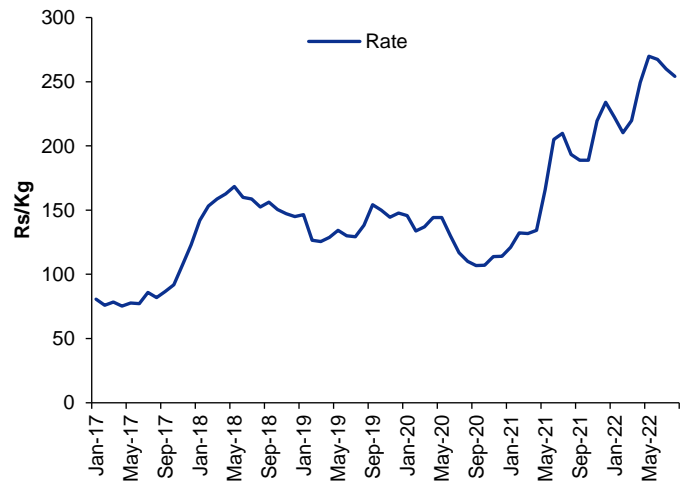
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 18: Laxmi Organics can register a very bad performance in 2QFY23F**



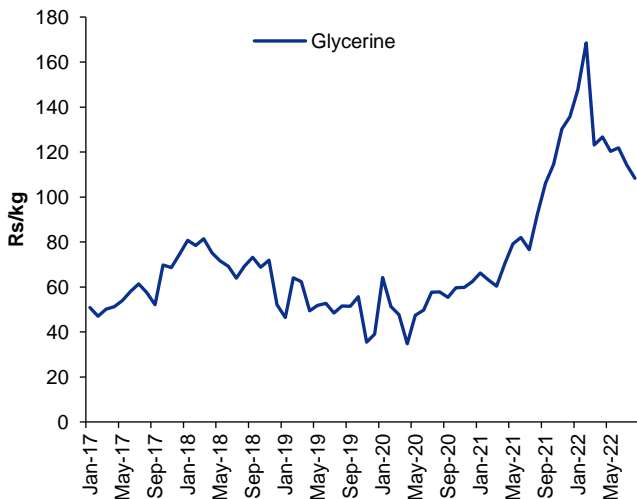
SOURCE: COMPANY REPORTS, INCRED RESEARCH

**Figure 19: ECH import prices are rising as Chinese supply bottlenecks have not eased**



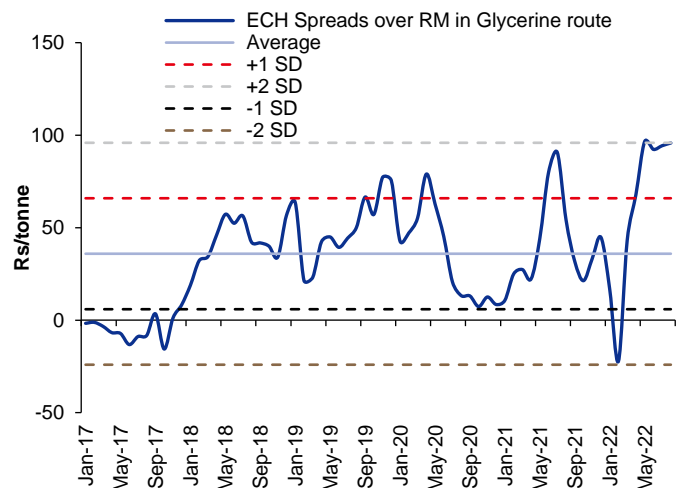
SOURCE: COMPANY REPORTS, INCRED RESEARCH

**Figure 20: However, import prices of glycerin are falling...**



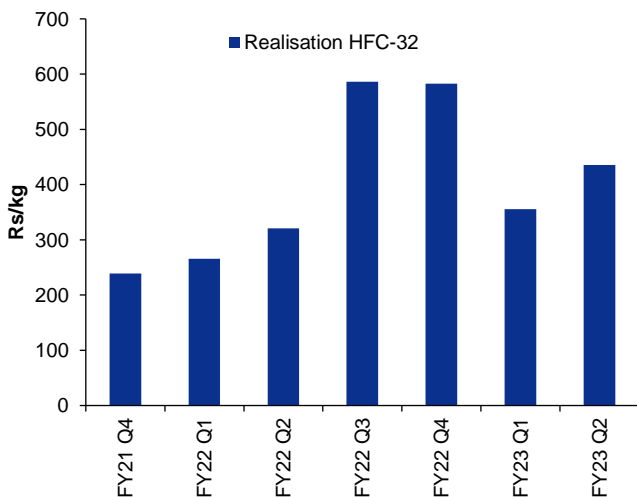
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 21: ...leading to a rapid increase in ECH spreads, which is positive for Meghmani Finechem (ADD)**



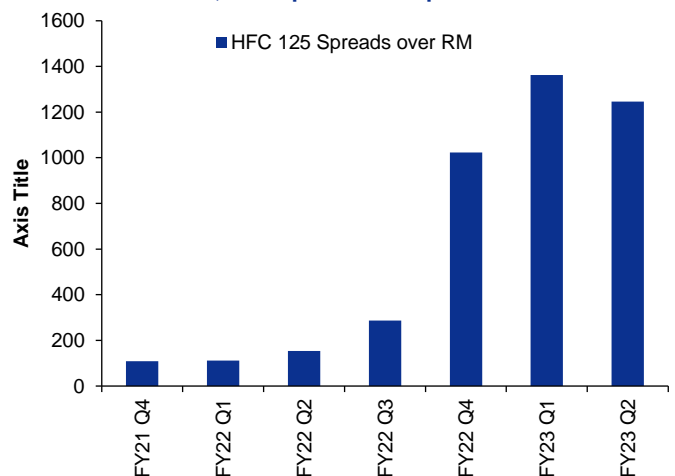
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 22: HFC-32 prices are higher QoQ but lower YoY**



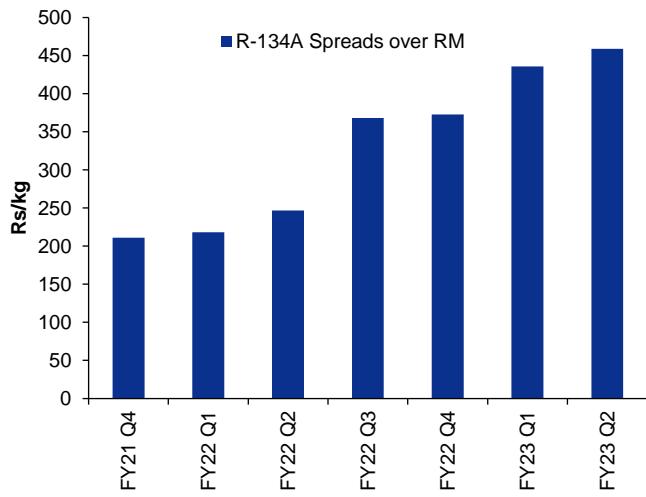
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 23: HFC-125 performance has been stellar, and it continues to do well; YoY spreads are up 12x**



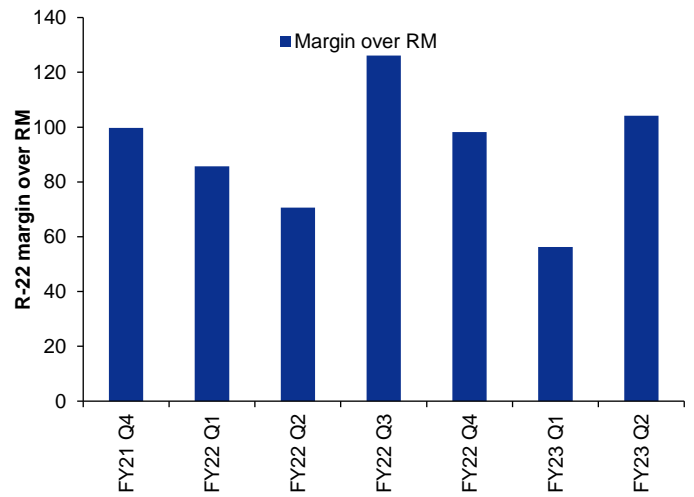
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 24: Even R-134A's spreads over raw material are higher YoY**



SOURCE: COMPANY REPORTS, INCRED RESEARCH

**Figure 25: Same is the case with R-22, as its margins are rising over raw material**



SOURCE: COMPANY REPORTS, INCRED RESEARCH

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