

Recommendation	HOLD
CMP as of 10th May 2018 (Rs)	253.85
Target Price (Rs)	257
Potential Return	1%

Stock Details	
Sector	Chemicals
Bloomberg Code	DN IN
Reuters Code	DPNT BO
52 week high/low	298/133
No of shares (O/S) mn	136.4
Market Cap (Rs mn)	34,623
Daily Average Volume (BSE+NSE) - 1 year	4,31,510
Sensex/Nifty	35,319/10,741

Shareholding Pattern (%)			
	Mar-18	Dec-17	Sep-17
Promoters	44.7	46.6	46.5
MFs	12.5	10.7	11.0
FPIs	11.1	12.8	14.1
FIs/Banks	0.5	0.6	0.6
Others	31.2	29.3	27.8



Data Source: ACE Equity
Rebased to a scale of 100

Deepak Nitrite Ltd

Valuations fragile to phenol execution

Key highlights of 4QFY18 results:

- DNL reported standalone sales of Rs 3,929.5, growth of 19.4% YoY. Domestic business contributed 62% (up +23% YoY) while exports was 38% (up +16% YoY). Overall volume growth across all segments was up by 5% YoY in Q4FY18.
- Segment wise growth is as follows; Basic Chemicals (BC) 7.5% YoY, Fine & Specialty Chemicals (FSC) 22.6% YoY, Performance Products (PP) 21% YoY.
- EBITDA growth stood at 22% YoY to Rs 489.5 mn, leading to EBITDA margins of 12.5% vs 12.2% (+30 bps YoY). This was due to better utilization in the FSC division, which registered EBIT margins to the tune of 24.8% (+1000 bps YoY).
- Normalized PAT (adjusted for exceptional income) showed an increase of 21% YoY to Rs 203.2 mn, though the tax rate was higher at 34.2% compared to last year.
- The Phenol project is in the pre-commissioning phase now and is expected to start trial production soon.
- Company announced a backward integration capex of Rs 600 mn for FSC division in order to expand the capacity by 15-20%.
- Adjusted EPS (before exceptional items and after QIP) was Rs 1.61 against Rs 1.5.

Result highlights and investment rationale

Domestic demand propels growth: Q4FY18 topline growth of 19.4% was slightly higher than our expectations. FSC division demonstrated a sales growth of 22.6% YoY, followed by +9.2%/7.3% YoY in PP division and BC division (higher base of 25% growth in Q4FY17) respectively. Company witnessed a volume growth of 5% across all segments as a result of sturdy demand by established performance products. Improvement in topline growth was marked by heavy demand from domestic players especially in the FSC segment. Roha facility is operating at its full potential now (which was partly shutdown in Q4FY17), while the PP division is still at 40-45% levels. Subdued utilizations in past few quarters for OBA & DASDA are expected to improve owing to healthy pickup from key industry segments. Keeping in view the robust domestic industry consumption, company has laid out a de-bottlenecking capex of Rs 600 mn to augment the existing capacity by 15-20%. In light of the above factors, we marginally revise our consolidated topline estimates upward by 1-1.5% for FY20.

FSC maintain consistent outperformance: Despite of increase in raw material costs (on the back of surging commodity prices) EBITDA grew by 21.7% YoY, with margins expanding to 12.5% vs 12.2% i.e. +30 bps. Primarily, the improvement in margins was driven through FSC division (EBIT margins of 24.8% vs 14.7% YoY) up nearly 1000 bps, more than compensated for the dip in BC division (14.4% vs 15.5%) and continued operational losses in PP division. Production constraints globally have led to supply shortage, thus fetching substantially higher realizations for key performance products, as well as China's focus on producing more downstream products is playing out favorably. Going forward as the phenol project progresses into commissioning phase, initially margins would tend to get impacted (factoring in conservative utilization of 50%-55%) however, development in established products & utilizations in PP division will offset this to a certain. We believe phenol expansion at 70-75% utilization (assuming no delays) by FY20 should elevate the margin trajectory. We estimate the consolidated margins to further lever up by 200bps in next 2 years.

Phenol project execution: The project has entered into the pre-commissioning stage (as per the latest update). So far it has nearly spent Rs 11.5 bn and set aside Rs 2 bn for working capital requirements. Our channel check suggests the domestic demand is growing well and suppliers are not able to keep up with huge inquiries. Our interactions suggest CRACK spread currently stands at US\$650/675 per MT (surged 30%-40% YTD) owing to few US based benzene & cumene producers closed their plant, who catered to

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China's downstream product manufacturers resulting in a supply crunch. Management continues to remain focused on catering the soaring domestic demand for the phenol, interactions during seed marketing is also progressing well & are confident of ramping up the project in phases expecting to deliver breakeven by FY19 and generating profitable growth after that (provided no delays). Factoring these aspects we stick to earlier topline estimates to FY20E for phenol division.

Actual versus estimates table							
Particulars (Rs mn)	Q4FY17	Q3FY18	Q4FY18	YoY	QoQ	Q4FY18E	Variance
Net Sales	3,291.6	3,711.4	3,929.5	19.4%	5.9%	3,747.5	4.9%
Expenditure	2,889.2	3,190.7	3,440.0	19.1%	7.8%	3,219.1	6.9%
EBITDA	402.4	520.7	489.5	21.7%	-6.0%	528.4	-7.4%
EBITDA Margin	12.2%	14.0%	12.5%	20 bps	(150) bps	14.1%	(164) bps
Depreciation	117.0	129.7	133.8	14.3%	3.1%	131.2	2.0%
EBIT	285.4	391.0	355.8	24.7%	-9.0%	397.2	-10.4%
EBIT Margin	8.7%	10.5%	9.1%	40 bps	(140) bps	10.6%	(155) bps
Interest	83.0	90.2	111.3	34.1%	23.4%	82.4	35.0%
Other income	8.6	6.3	64.5	652.9%	921.7%	6.2	943.5%
PBT	211.0	307.2	309.0	46.5%	0.6%	321.0	-3.7%
Exceptional items	42.0	-	-	NM	NM	-	NM
Tax	42.0	103.7	105.8	152.2%	2.0%	106.9	-1.0%
Tax Rate	16.6%	33.8%	34.2%	1760 bps	40 bps	33.3%	(94) bps
Other comprehensive income	(7.5)	(4.0)	15.9	NM	NM	-	NM
PAT	203.5	199.5	219.1	7.7%	9.9%	214.1	2.4%
PAT Margin	6.2%	5.4%	5.6%	20 bps	(60) bps	5.7%	(10) bps
EPS (Rs)*	1.5	1.5	1.6	7.7%	9.9%	1.6	2.3%
Data Source: ACMIIL Institutional Research, Company							
*No of share adjusted for QIP Allotment in January 2018							

Outlook & valuation:

On a trailing basis, stock trades at exorbitant valuation of 44x (FY18 EPS Rs 6), implying a greater emphasis on phenol/acetone growth trajectory. DNL management did a remarkable job in completing the project within timeline, suffering no delays either in terms of funding or clearances. Management has indicated an expected growth in market demand for phenol of 10-12% vs 8% earlier, further strengthens the industry prospects. This vertical would add equivalent sales of Rs 15bn by FY20 (based on our estimate optimal utilizations) generating margins to the tune of 15-16% (EBITDA) & 4% PAT, in addition to the existing commodity business (expected to grow by 10%-12%). Although rich valuations have stayed for some time now, here onwards the movement would be fragile to execution & timeline. However, we remain slightly cautious on the execution timeline to pan out till Q2FY19E, while the phenol sales is highly dependent on movement of import prices from here (as spread has rallied in past few months). Since the valuation seems to factor in most of the expectations (phenol project) on the higher side, we estimate 16x on FY20E EPS of Rs 16, implying TP of Rs 256. We recommend **HOLD**.

FINANCIAL STATEMENTS

Income Statement (Consolidated)

Particulars (Rs mn)	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Net Sales	10,194	12,696	13,272	13,357	13,707	16,515	29,595	36,028
YoY Growth	29.1%	24.5%	4.5%	0.6%	2.6%	20.5%	79.2%	21.7%
EBITDA	722	1,140	1,397	1,683	1,355	1,962	3,788	5,008
EBITDA Margin	7.1%	9.0%	10.5%	12.6%	9.9%	11.9%	12.8%	13.9%
Depreciation	189	296	360	395	480	526	1,036	1,081
EBIT	532	844	1,037	1,289	874	1,436	2,752	3,927
Interest	114	280	380	391	341	451	592	721
Other income	107	18	21	15	109	124	118	72
Exceptional items	-	-	-	-	703	-	-	-
PBT	526	582	677	913	642	1,109	2,279	3,279
Tax	148	198	143	262	382	318	775	1,115
Tax Rate	28.1%	34.1%	21.1%	28.7%	28.4%	28.7%	34.0%	34.0%
PAT	378	383	534	651	939	799	1,504	2,164
PAT Margin	3.7%	3.0%	4.0%	4.9%	6.9%	4.8%	5.1%	6.0%
EPS (Rs)	3.6	3.7	5.1	6.1	7.2	5.9	11.0	15.9
Adjusted EPS*	2.8	2.8	3.9	4.8	3.2	5.9	11.0	15.9

Data Source: ACMIL Institutional Research, Company

*No of share adjusted for QIP Allotment in January 2018

Balance Sheet (Consolidated)

Particulars (Rs mn)	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Share capital	105	105	209	233	261	273	273	273
Reserves & Surplus	2,701	2,971	3,259	4,496	6,887	8,949	10,262	12,221
Net worth	2,806	3,075	3,468	4,729	7,149	9,221	10,534	12,494
Long term debt	2,393	2,713	2,386	1,589	2,184	5,505	5,155	4,455
Short term debt	707	1,907	2,310	2,685	3,766	3,316	3,833	3,633
Total Debt	3,101	4,620	4,696	4,274	5,951	8,820	8,988	8,088
Current liabilities & Provisions	2,689	2,457	2,529	3,295	4,307	7,160	9,102	11,785
Others	291	414	543	644	469	704	1,172	1,436
Total Liabilities	8,887	10,566	11,236	12,941	17,875	25,906	29,796	33,802
Net Block	4,430	5,324	5,867	6,297	9,351	15,421	14,985	14,054
Non- current investments	13	31	172	28	37	23	18	13
Cash	95	64	27	65	145	482	409	1,573
Inventories	1,044	1,300	1,050	1,210	1,671	3,254	4,865	6,416
Debtors	2,423	2,922	3,110	3,132	3,603	4,118	6,892	8,884
Other current assets	28	13	76	28	804	1,594	1,628	1,801
Short term loans & advances	634	660	520	538	139	187	237	360
Current investments	-	-	-	838	1,143	294	194	94
Current assets	4,223	4,959	4,784	5,812	7,506	9,929	14,224	19,129
Others	221	251	413	805	980	533	568	600
Total Assets	8,887	10,566	11,236	12,941	17,875	25,906	29,796	33,802

Data Source: ACMIL Institutional Research, Company

Q4FY18 Update

Institutional Equities

Cash Flow (Consolidated)

Particulars (Rs mn)	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
PAT	378	383	534	651	939	799	1,504	2,164
Depreciation	189	296	360	395	480	526	1,036	1,081
Inc/Dec in working capital	(364)	(1,205)	(214)	171	(737)	(76)	(2,602)	(1,222)
Others	39	383	372	455	(192)	49	458	236
CF from Operating activity	243	(142)	1,052	1,673	491	1,298	395	2,258
Inc/Dec in Fixed assets & CWIP	(1,578)	(965)	(832)	(865)	(2,412)	(6,595)	(600)	(150)
Inc/Dec in investments	-	-	-	(838)	(296)	863	100	100
Others	22	(6)	(34)	9	(817)	448	5	5
CF from Investment activity	(1,556)	(971)	(866)	(1,694)	(3,526)	(5,284)	(495)	(50)
Inc/Dec in share capital	-	-	-	807	1,464	1,283	-	-
Inc/Dec in debt	647	1,432	274	(254)	2,160	2,870	167	(900)
Dividends paid	(63)	(83)	(104)	(104)	(139)	-	(191)	(205)
Others	(112)	(267)	(393)	(406)	(439)	172	50	61
CF from Financing activity	473	1,082	(223)	43	3,046	4,324	27	(1,044)
Inc/Dec in cash	(840)	(31)	(37)	22	11	337	(73)	1,165
Opening balance	935	95	64	31	53	145	482	409
Closing balance	95	64	27	65	145	482	409	1,573

Data Source: ACMIL Institutional Research, Company

Q4FY18 Update

Institutional Equities

Ratios (Consolidated)								
Particulars	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Profitability Ratios								
RoE	13.5%	12.5%	15.4%	13.8%	13.1%	8.7%	14.3%	17.3%
RoCE	8.6%	10.3%	11.6%	12.9%	6.1%	7.5%	13.5%	18.3%
RoA	4.3%	3.6%	4.8%	5.0%	5.3%	3.1%	5.0%	6.4%
Valuation Ratios								
P/E	7.3	11.7	13.4	11.2	15.7	44	23	16
P/BV	1.0	1.5	2.1	1.7	2.4	3.8	3.3	2.8
EV/EBITDA	8.3	8.1	8.9	7.1	15.9	22.8	11.9	8.5
EV/Sales	0.6	0.8	1.0	0.9	1.6	2.7	1.5	1.2
Per Share								
EPS (Rs)	3.6	3.7	5.1	6.1	7.2	5.9	11.0	15.9
DPS (Rs)	0.8	1.0	1.0	1.2	1.2	1.3	1.4	1.5
Book value (Rs)	26.8	29.4	33.2	40.7	54.7	67.6	77.2	91.6
Capital structure ratios								
D/E (x)	1.2	1.7	1.6	1.1	1.0	1.1	0.9	0.7
Current ratio (x)	1.6	2.0	1.9	1.8	1.7	1.4	1.6	1.6
Quick ratio (x)	1.2	1.5	1.5	1.4	1.4	0.9	1.0	1.1
Turnover ratios								
Fixed asset turnover (x)	2.3	2.4	2.3	2.1	1.5	1.1	2.0	2.6
Debtor days	87	84	86	86	96	91	85	90
Inventory days	37	37	29	33	45	72	60	65
Payable days	79	45	34	42	63	121	90	95
Data Source: ACMIIL Institutional Research, Company								

Notes:

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Our Rating Scale

Buy: Expected return greater than 20% within the next 12-18 months.

Accumulate: Expected return greater than 10% but less than 20% within the next 12-18 months.

Hold: Expected return of upto 10% within the next 12-18 months.

Reduce: Expected return of upto (-) 10% within the next 12-18 months.

Sell: Expected return of over (-) 10% within the next 12-18 months.

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