



“Deepak Nitrite Limited’s Q3 & 9M FY21 Earnings Conference Call”

February 16, 2021



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*Deepak Nitrite Limited
February 16, 2021*

Moderator: Ladies and gentlemen, good day, and welcome to Deepak Nitrite Limited's Q3 & 9M FY21 Earnings Conference Call, hosted by Antique Stockbroking Limited. As a reminder, all participant lines will be in the listen only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touch tone phone. Please note that this conference is being recorded.

I now hand the confidence over to Mr. Anubhav Adlakha from Antique Stock Broking. Thank you and over to you, sir.

Anubhav Adlakha: Good afternoon, everyone. On behalf of Antique Stock Broking and iCare Capital, we thank you for joining us on Deepak Nitrite's Q3 & 9M FY21 earnings call. Today, we have with us Mr. Maulik Mehta – Executive Director & CEO and Mr. Somsekhar Nanda – Deputy CFO.

We will begin the call with opening remarks from the management, followed by an interactive question and answer session. At the outset, I would like to clarify that certain statements made or discussed on the call today may be forward-looking in nature. And a disclaimer to this effect has been included in the investor's communication shared with you earlier. To begin with, Mr. Mehta will share with us the operating performance and the growth plans of the Company, followed by Mr. Nanda who shall be taking us through the financial and segmental performance.

I will hand over the call to Mr. Mehta for his opening comments. Thank you and over to you, sir.

Maulik Mehta: Good day, everybody and welcome to Deepak Nitrite's Q3 & 9M FY21 earnings conference call. I trust that you and your families are safe and in good health. I hear both positive and negative news all the time about COVID and the vaccine drive. And I really pray that all of us stay careful and at the same time optimistic. I hope you would all have had the opportunity to go through the results document, which was distributed earlier. I would also like to share that Mr. Sanjay Upadhyay is not available today, that is because of a happy reason that he has taken a personal leave for the week and Mr. Somsekhar Nanda will be proxying on his behalf.

As we have shared, Deepak Nitrite is in its 50th year of operation, and over these last five decades, we have and will continue to uphold high standards of operational and corporate governance. The diverse product offerings developed and the process knowledge ingrained over 50 years remain exemplars toward solutions to global challenges. Our focus on 'People First' has enabled us to win the dedication of all employees, fostering cross functional teamwork that is positioned to navigate uncertainty of business and economic cycles. This dedication from our teams has allowed us to rapidly overcome the impact of the lockdown which caused severe disruption and loss of over one month of production in quarter one. The lingering effects of the pandemic still persist in some of the end user segments like paper, textiles and oil. But we are pleased to have delivered a standout performance upon resuming operations to lift our YTD performance back to a year-on-year growth trajectory.

Operational excellence at all plants and customer stickiness has led to consolidated revenues of Rs. 1,240 crore in Q3 FY21, higher by 9% compared to last year. Growth has been led by the segments of Phenolics and Fine & Speciality Chemicals. While Basic Chemicals was affected by temporary raw material unavailability, it is now seeing a steady progression towards pre-COVID levels of demand. Our performance products segment is clearly impacted by a sharp drop in prices, which were unusually elevated last year. Although product prices in performance products segment have not yet normalized, on a general basis, we witnessed demand and plant capacity utilization returning to pre-COVID levels, and we hope to see the same trajectory moving into Q4. The improved performance of the Fine & Speciality Chemical segment and the Phenolics segment, including the accretive accumulation of contribution from IPA have guided a significant improvement in consolidated EBITDA, which stood at Rs. 340 crore and was higher by 25% year-on-year. PBT for Q3 was Rs. 290 crore, higher by 38% on year-on-year basis, lifted by the operating performance and reduced financial costs of the Company. As a result, profit after tax grew by 38% from Rs. 157 crore in Q3 last year to Rs. 217 crore in Q3 this year.

What I would like to highlight here is how we have progressively scaled our operation during the year. After the disruption in end of March and a substantial part of Q1, we have steadily rebuilt our momentum over Q2 and now in Q3. In fact, as we had also mentioned in Q2, you would have seen that we have grown our PBT, both standalone and consolidated, in each successive quarter of this financial year.

Operationally, domestic revenues stood at Rs. 864 crore in Q3 FY21 as against Rs. 659 crore in Q2 FY21, growing at 31% quarter-on-quarter. There has also been a fairly sharp recovery in domestic economic activity and we have moved quickly to capture greater wallet share across key customer segments. Export revenues rose to Rs. 368 crore in Q3 FY21 as compared to Rs. 326 crore in Q2 FY21 despite challenges on international shipping, due to container and ship unavailability. The emphasis was on the key geographies that were recovering faster, resulting in better movement of goods and smoother international trade. This has helped us grow export revenues even when some of our markets are faced with challenges of a second wave, and also mutations in the virus is resulting in additional rounds of lockdown and restrictions.

Moving to our segmental performance. The Basic Chemical segment reported revenues of Rs. 196 crore, up 14% on a sequential basis, despite short-term challenges. This was in line with strong recovery in the economic activity across the country, backed by planned initiatives undertaken by the Company. Fine & Speciality chemicals delivered a consistent performance with revenues of Rs. 211 crore. Performance was also supported by stable realization for key products with positive demand landscape across the portfolio. Performance products segment delivered a robust sequential performance with revenues of Rs. 90 crore in Q3 FY21, delivering a gain of 34% quarter-on-quarter. Both capacity utilization and customer demand have started to return to pre-COVID levels towards the end of Q3 and are expected to further improve moving forward. Deepak Phenolics witnessed revenue increases of 37% quarter-on-quarter with EBITDA growing by similar numbers of 36%. EBITDA margin stayed firm at 25.5% as the



*Deepak Nitrite Limited
February 16, 2021*

pressure from rising input prices was offset by operating leverage gains. Initiatives to elevate plant performance have resulted in utilization of over 115% consistently. Forward integration into value added derivatives like IPA have resulted in improved contribution in both Q2 and Q3.

In key developments, I am happy to share that we have commenced land development operations at our newly procured site in Dahej 2, which is of 127 acres. This site will house the capacity augmentation of the standalone business. Again, this site will see development in phases. The Brownfield expansion of the IPA business is also on track and will be commissioned towards the end of Q4 or early Q1. Brownfield expansions in Deepak Nitrite were completed at the tail end of Q3, and we look forward to maintaining wallet share to customers who are witnessing demand growth.

In the second week of October, we had set up a new subsidiary called Deepak Clean Tech that would house some of our upcoming new products. Thus, we are optimistic that the consolidated entity will witness encouraging improvements along the length and breadth of group verticals.

To conclude, I would like to add that Deepak is well-poised for growth through various initiatives. Even as we return to pre-COVID levels, there is a visible demand uptick from global customers who placed strong emphasis for Deepak's products and quality over most competition. Early initiatives to de-risk our supply chain from China have also resulted in mitigating most of the impact of supply chain challenges faced in the Indian industry. We believe that with a proven capability and track record and a high degree of forward and backward integration, in such a challenging environment, we are well equipped, globally, and nationally. That, together with contributions from our forthcoming brownfield expansion and the large greenfield expansions, housing value-added forward integration will serve to strengthen our competitiveness position, and help us expand market share, creating value for all of our shareholders.

Thank you. And I would now like to hand over the call to our Deputy CFO, Mr. Somsekhar Nanda, to address this forum and briefly take you through the financial performance during this period under review.

Somsekhar Nanda:

Thank you, Maulik bhai. Good afternoon, everybody. And a warm welcome to Deepak Nitrite's earnings call. I will take you through the financial highlights for the quarter ended December 31, 2020.

During the third quarter, many high frequency indicators such as demand for power, volume of railway freight, number of e-Way Bills being generated, monthly vehicle sales, collections in GST and highway toll collections have demonstrated a V-shaped recovery, pointing towards a fairly comprehensive economic rebound. Leveraging this rebound in economic activity, supported by internal initiatives to restore operations, Deepak Nitrite has delivered a resilient performance.

Looking at the Q3 performance, standalone revenues improved by 10% to Rs. 491 crore compared to Rs. 448 crore in the previous quarter. This rise in standalone revenues has come from positive contribution from all three strategic business units.

In the third quarter of current financial year, EBITDA was Rs. 149 crore compared to Rs. 139 crore reported in the immediately preceding quarter, registering 7% growth on a standalone basis. The EBITDA margin declined by 72 basis points from 31.1% in Q2 FY21 to 30.4% in Q3 FY21, owing to limited availability of certain raw materials despite long-term contracts in place, which resulted in stoppage of plant and spot purchases at higher cost for a temporary period.

The PBT of the Company has been steadily increasing in each successive quarter of this fiscal year, with standalone PBT increasing from Rs. 85 crore in the first quarter, going up to Rs. 125 crore in the second quarter, followed by Rs. 132 crore in the third quarter, and we expect a similar trajectory in the last quarter as well. Firm EBITDA performance, supported by lower finance cost, resulted in accretive PBT growth in Q3. Profit after tax for the third quarter was Rs. 98 crore as against Rs. 92 crore, growing by 6% on a Q-o-Q basis.

On a consolidated basis, turnover stood at Rs. 1,240 crore in the third quarter compared to Rs. 991 crore in the preceding quarter, which is higher by 25%. The growth in volumes in the Phenolics business was due to enhanced capacity utilization above 100%, which has given us robust traction in revenues. Consolidated EBITDA stood at Rs. 340 crore in third quarter compared to Rs. 280 crores in Q3 FY20, higher by 22%. Consolidated PBT and PAT have both increased 27% on Q-o-Q basis, as high turnover has been supported by a lower finance cost.

Basic Chemicals revenue grew by 14% Rs. 196 crore in the third quarter against Rs. 172 crore in the preceding quarter. EBIT improved by 15% to Rs. 47 crore in Basic Chemicals business unit, with EBIT margin of 24%.

Fine & Speciality Chemicals revenue came in at Rs. 211 crore in the third quarter, growing by 0.5% Q-o-Q and expanded 22% Y-o-Y basis. The segment reported an EBIT of Rs. 91 crore, which is about 43% EBIT margin.

Performance products segment revenues stood at Rs. 90 crore in the third quarter, recording a growth of 34% over the previous quarter. This segment contributed EBIT of Rs. 8.2 crore. As shared by Maulik bhai, this segment had witnessed the normalization of customer demand and volumes, and any recovery in realization will drive the performance moving ahead.

Deepak Phenolics witnessed an encouraging performance in the third quarter as revenues increased by 37% Q-o-Q to Rs. 747 crore against Rs. 545 crore in the preceding quarter. The segment reported an EBIT of Rs. 174 crore, resulting in an EBIT margin of 23.3% in third quarter compared to 22.5% in second quarter. The Company has focused on operational efficiency at this facility and has driven utilization beyond 115% of stated capacity during this quarter. Our teams have also displayed impressive agility in seamlessly coordinating the material



*Deepak Nitrite Limited
February 16, 2021*

movement, considering ongoing constraints, logistically in terms of raw materials and finished product.

On the balance sheet front, the financial position of the Company is stable. It is using its cash flows to steadily reduce debt. On a standalone basis, Deepak Nitrite as a Company is debt free, while Deepak Phenolics' gearing ratio is around 0.7x, which brings a consolidated net debt to equity ratio at 0.28x. The Company enjoys a robust liquidity position with cash and liquid investments amounting to nearly Rs. 83 crore on a consolidated basis.

With that, I would now request the moderator to open the forum for question-and-answer session.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Karan Rathod from AUM Advisors.

Karan Rathod: My question is directed towards Maulik. If you can outline for us the medium to long-term growth CAPEX initiatives, it will be very helpful to figure out how the Company will grow going forward. Whether this will be a combination of your base Phenolics business capacity expansion, now that you are running at record capacity utilization over there or downstream products into phenol and acetone derivatives. And some sort of dual sourcing strategies that you discussed on earlier calls where India could be a good sort of sourcing destination on the China-plus-one theme. So, if you can just outline how you have thought about your growth CAPEX initiatives over the next three to four years, would be helpful.

Maulik Mehta: Yes. So on Deepak Nitrite and in Deepak Phenolics, both the companies have opportunities that are in line now for announcements over the next few months, which will be on growth. Deepak Nitrite is looking at both downstream and upstream products, the upstream products will lead to better resilience and the downstream products will lead to expansions of the value chains in competencies which Deepak already possesses, as well as a couple of new platforms that will allow us to manufacture new value-added products in new vertical. Deepak Phenolics will be looking at increasing the market share in its current products, as well as prioritizing downstream products which come from phenol and acetone as raw materials.

So if you ask about priority, I would say that Deepak Nitrite's priority has always been the same to occupy as large a space in the value chain that it is present in, as well as systematically add new verticals that it has a great degree of confidence about being a global player in. In Deepak Phenolics, the priority will be first to ensure that it has the right downstream products. And as in where the opportunity presents itself, to be able to expand the base product manufacturing. But we also do feel like the current plant has some further gas in its tank in order to increase productivity.

Karan Rathod: So, is there any indication you could provide from a size perspective, what sort of CAPEX are we looking at over the next two, three years?

Maulik Mehta: So, I think it would be safe to say that over the next year, we are looking at something along the lines of about Rs. 400 crore or so, in Deepak Nitrite and about Rs. 200 crore to Rs. 300 crore in Deepak Phenolics, plus/ minus.

Moderator: The next question is from the line of Rohit Nagaraj from Sunidhi Securities.

Rohit Nagaraj: The first question is just extension of the earlier one. So, in terms of our R&D strategy for new product development, where are we more inclined towards? So, I understand that in nitrite the performance products segment is not where probably there would be incremental opportunities, while the Basic Chemicals is relatively high-volume decent margin business. So how it is focused in terms of our strategy? And which are the major segments that we are trying to bank on, is it really only the pharma segments or agro segment or any other emerging segment?

Maulik Mehta: As I have highlighted, even in the last concall, we do not look at products based on which segment they are in. So, if you see our Basic Chemical segment, we look at contribution and EBITDA numbers that a lot of other companies might consider as part of the course for the Speciality segment, and similarly even with phenol and acetone. Now, we look at our segments as just a marketing direction, so it is either push or pull. But when we invest in R&D, we invest based on process capabilities. So for example, if you are talking about unique nitration or hydrogenation, now these are processes that can be equally applicant in Basic Chemical products, Fine & Speciality products, and phenol and acetone. So, at the end of the day, what we look at is R&D for improving a particular process chemistry. And once that improved process chemistry is there, we are able to launch new products which may have required a very unique setup of competency that we either have or we have been working on developing.

It is coincidental that many of the products that we are coming into are focused on the agrochemical and pharma segments. But rest assured that the process innovation is one that will also take us into improved realization of existing basic products and new value-added basic products. One very simple example is when we manufacture food grade sodium nitrite. At the end of the day, while the product is sodium nitrite, the product that we started our journey 50 years ago, it's a very niche market, it is very demanding set of customers and the kind of product that is given to them, while it shares characteristics with the basic product, it has a unique manufacturing process. So I would hesitate to classify our R&D investments into business segments, because that is not the intention of the R&D. The R&D is to ensure that we are able to get good products, which at the end of the day, may have an anchor customer in one segment, but at various stages, either upstream downstream or as an intermediary stream can also be attractive to other segments.

Rohit Nagaraj: Thanks, that was pretty elaborated. Now the second question is on the Phenolics segment. So we have operated at 115% utilization this quarter, so how are we seeing the utilization rate going in the future quarters? And an allied question to that, when are we having our maintenance shutdown? And then what would be the frequency of maintenance shut down thereafter?

Maulik Mehta: So we got lucky and unlucky because of the pandemic. And in Q1 we were able to tie in the maintenance shutdown along with the national shutdown. And if you ask where we are going in Q4 compared to Q3 where we already had a high operating performance, as I mentioned earlier, we still believe that there is gas left in the tank. The plant has been put up in an extremely robust manner. And as the team gains more and more confidence about its nuances, it's able to further improve productivity. So now, while we say that it is 115% of design capacity, our internal confidence, it just means that this is a new benchmark that we have to ensure that we cross. So 115% for us now becomes a baseline number internally.

Rohit Nagaraj: Right. And the next on maintenance shutdown?

Maulik Mehta: We will announce it, but we won't be expecting any impact in quarter four.

Moderator: The next question is from the line of Sudarshan Padmanabhan from Sundaram Mutual Fund.

Sudarshan Padmanabhan: If you look at the last two years, we have done a commendable job as far as debt reduction and cash flow is concerned on a consolidated basis, as well as on the Deepak Phenolics side. If I look at the opportunities in hand because a fair amount of phenol goes into medicine. You are typically talking about anti-infectives, I also believe that it is used in vaccine preservation as well. And in light with this kind of an opportunity and the Government talking about PLI scheme, several companies are talking about investing, I mean, where do you think that our investment should be in the next three years? And where do you think the growth should be as far as the Deepak Phenolics is concerned?

Maulik Mehta: Okay, that is a very nuanced question. So, Deepak Phenolics is in a position where it's able to look at a good mix of smaller volume, higher value downstream, and higher volume but medium value downstream as well. In short, the answer will be a mix of the two. So, we are well aware of the short-term opportunities offered by PLI. And we are also well aware that at the end of the day, the opportunity must be one that is sustainable with or without PLI. So, whether it is PLI or tariff and non-tariff barriers and these things, at the end of the day, we pick and choose our products based on whether there is sustainability without using these temporary crutches. And luckily, we are seeing good set of opportunities to be able to go downstream in smaller volume and in higher volume for both phenol and acetone. I think a series of announcements over the next several months will give a good indication of how we are going about prioritizing these.

Sudarshan Padmanabhan: Would we be also targeting phenol derivatives. I mean, have we developed capabilities internally to the point where we can commercially look at some kind of phenol derivatives in the next couple of years?

Maulik Mehta: Yes, of course, this is our first priority in the Deepak Phenolics segment. Also, I must highlight that the goal of Deepak moving forward is not to always look at something which is only a phenol derivative or acetone derivative, there are a lot of opportunities that present themselves which require phenol or cumene or acetone as raw materials, but also use process competencies

that are there in Deepak Nitrite. So, there will be a lot of mix and match, this is one of the key reasons why we considered a new subsidiary called Deepak Clean Tech which is able to use both Deepak Nitrite and Deepak Phenolics advantages to create a very clear right-to-win in the new products that we go into. So you will see products that will have a lot of synergy from both the parent companies, and therefore we believe that this will be a good reason why Deepak, with its process-first process before product, way of thinking, has a good reason to succeed regardless of global market conditions, regardless of potential competition from international players. Because here we have harnessed the last 50 years of good, steady improvement in competencies.

Sudarshan Padmanabhan: With respect to our investment, I mean, we are currently having a net debt of about Rs. 570 crore and the Rs. 350 crore kind of EBITDA which we are doing, translating to about anywhere between Rs. 280 crore to Rs. 300 crore of cash, I mean, I would assume that largely in the next two to three quarters we should be more or less debt free. From the business side, I mean, where do you think our comfort will be as far as, say, net debt-to-EBITDA is concerned, both on the consolidated side, standalone as well as on the subsidiary side?

Maulik Mehta: I am not comfortable right now.

Sudarshan Padmanabhan: Okay. But is there any number that we have, I mean, in terms of where the net debt-to-EBITDA would be at comfort

Maulik Mehta: Mr. Nanda can answer this question, but I can tell you that while we have robust plans for growth, and Mr. Nanda and the finance team is extremely tight on corporate governance, I think he will give you a more balanced view.

Somsekhar Nanda: See, our objective is to have a balance of both growth as well as good capital structure. Now, traditionally, if you see and if you have joined our calls, you would have seen that never ever we have said that we would like to be zero debt Company or a low levered Company. We would like to grow, and which means you will have to infuse capital in form of debt or equity. And for that matter, if we have to increase our debt levels, that is fine, as long as the capital structure is healthy and that gives the momentum to the Company. And this is what we have been reiterating and this philosophy will also obey in the years to come. While Maulik bhai just enunciated or delineated the growth plans of the group, we will be having very healthy cash flow coming in from the operations, we may not shy ourselves away from borrowing also, because borrowing terms are very, very good for us these days.

Moderator: The next question is from the line of Naresh Vaswani from Sameeksha Capital.

Naresh Vaswani: My first question is, our Company has been focusing on operational efficiencies, last time also you had mentioned that in Phenolics, most of the increase in margin is broadly due to operational efficiency; and right now, as you mentioned, despite the gross margins going down, we are able to utilize the plant at a higher capacity and thereby maintaining the margin. So, can you illustrate a bit more in detail on how do you achieve these efficiencies, that would help.

And the second is on this incremental revenue which has come in the Phenolics segment, how much is due to this 15% additional capacity which we are able to utilize and how much of it is due to the higher phenol in this quarter?

Maulik Mehta:

I think higher prices of finished goods should always be seen in the light of higher prices of raw materials. But with regards to improvement in productivity and operational excellence, it is not a single point answer that we can give you. What we can tell you is that the Company invests in good manufacturing practices across, and in Phenolics and in a couple of other locations we aggressively use both software and sensor based IoT in order to ensure that there is minimal wastage of material, time, and manpower. So across the board, what we are seeing is that there is opportunities for improvement, and incremental improvement. But when you are talking about volumes as high as we are talking about lakhs of tonnes, these incremental improvements result in good, significant, and sustainable bottom-line gains. But rest assured, what we can tell you is that this is the result of looking at the same boring set of numbers and processes and looking very hard at any and every point of improvement. A lot of these opportunities are thrown up by the kind of sensors that we have deployed, and the software that we use for modelling.

Naresh Vaswani:

Sure. And my next question is, in the Basic Chemicals and Fine & Speciality Chemicals, what would be the current capacity utilization and how much scope do we have in terms of expansion, considering the ECs which we have got recently? And how much capacity we are planning to add in these two segments in next two years?

Maulik Mehta:

So, we keep on adding capacity as and when we feel it is necessary. Like I mentioned earlier, some brownfield CAPEX was completed in Q3, as earlier intimated, and we will continue to do this. So on an average, you can say that Q3 was about 85% capacity utilization in these two segments. A lot of it was because of temporary unavailability of raw materials. And some of it was because the end customers in a few of our products are in the MSME segment. So, they were still in the process of reopening. They had their own internal challenges. But in Q4, we find that most if not all of the MSME customers have reopened and are looking at robust demand for their end products. So moving forward, it will be interesting to see how capacity utilization moves up from its current stage, because we are expecting at least a reduction in the challenges of raw material availability, and definitely a good demand uptick from customers across the board.

Moderator:

The next question is from the line of Sabyasachi Mukerji from Centrum PMS.

Sabyasachi Mukerji:

My first question is on broad medium to long term perspective. You have kind of guided that for the few months we will be coming up with a series of announcements on the growth plans. But qualitatively if you can throw some colour on the next three to five years kind of plan in terms of CAPEX, if you can quantify that CAPEX and expected assets, expected turns you will be likely to generate out of that. So that is my first question.

Maulik Mehta:

I don't think it is correct for us to be able to vacillate on the CAPEX number. What I can tell you is that the way that we choose products is with a very rigorous set of conditions which we call Deepak's right-to-win, where we say that any new product that we get into, it must have a payback of three years, it must have a good reason whether it is an upstream or downstream integration, process competency, customer synergy, all of these things, five or six points that are mentioned in that, and it goes through a rigorous set of conditions. Now, all I can say, giving you an indication today is that we have quintupled the expenditure on R&D in the last two years. And we would not have done this unless, we had a very aggressive and a robust set of opportunities in front of us. So today, I am unfortunately not able to give you the kind of details and colour that you would want to have in this call. But I can tell you that our growth trajectory, at least the one that we are considering internally, is aggressive. And at the same time, one where we are able to back it with a good reason why Deepak should be the Company to win in this kind of a product. So we are very confident about the opportunities that are there in front of us. We are very confident in the long-term viability and the long-term contracts that we will have with anchor customers. And we have already clarified that these products will not be specifically in one segment or another, but there will be definitely a bias towards agrochemical and pharma. That does not preclude other segments as well.

Sabyasachi Mukerji:

That is helpful. My second question is on the Phenolics part. You have clocked almost Rs. 750 crore kind of a quarterly revenue in this quarter. And you mentioned that this is kind of a benchmark that you are setting for the next quarter or so. So my question is that comes to almost Rs. 3,000 crore of annual revenue, if I just analyze the number. And going ahead, we will also add some of the downstream products and the ICFA's to CAPEX will also come. So, do we expect this number to move north of this Rs. 3,000 crore annual? And how will the margin trajectory be, keeping into consideration that we will be adding the downstream product also, so if you can give some colour on that.

Somsekhar Nanda:

The top line in Deepak Phenolics depends on the crude price and hence the prices of propylene, benzene and hence phenol and acetone. It may not be always be true for us to say that we will be achieving at least this. What Maulik bhai had stated was that we are setting a benchmark for us about the volume and hence the capacity utilization, not on the top line. Top line depends on many extraneous factors over which you have no control. Now having said that, it will depend on the international market, what is happening elsewhere in the globe, say, in the U.S. or in Singapore or in Thailand, depending on that the top line will keep on moving. We are concerned with the profitability and the volumes and the operational efficiency of our plants.

Maulik Mehta:

Also, I would like to correct my earlier comment and replace the word benchmark with baseline. What I intended to say is that the performance that has been demonstrated in a sustainable manner becomes the new baseline for us. Because we are not only confident about ensuring that these volumes are sustainable, but we also always look at seeing how we can identify opportunities to increase volumes and reduce the per kilo cost. So margin over materials and volumes are our two key drivers.

- Moderator:** The next question is from the line of Tejas Seth from Nippon India Asset Management.
- Tejas Seth:** Just dwelling more on the CAPEX side. I mean, that's where I think everyone of us needs clarity. You said Rs. 400 crore of CAPEX in Deepak Nitrite. And I think on the gross block of FY20, which was broadly Rs. 1,000 crore for only Deepak Nitrite, I think that would be 40% kind of CAPEX addition in just one year. Secondly, if we look at the EC, environmental clearance which the Company got in Deepak Nitrite and Deepak Phenolics, one, in Deepak Phenolics there was a lot of capacity addition which is at the proposed level, both for phenol and acetone and even cumene I think you have asked for doubling the capacity. And there are a lot of new products which you have asked for approval, where we have got the approval in Deepak Nitrate as well. So, again, just some elaboration on that, is the understanding right that the 40% capacity addition we are doing in Deepak Nitrite? And the 30% to 40% expansion is what we are looking at in Deepak Phenolics?
- Maulik Mehta:** No, I will correct certain assumptions there. We don't really look at gross block as a way to quantify our growth opportunities. So I really cannot elaborate on that point. However, Rs. 400 crore is a mix of new products and upstream. So these are products where we believe that there is a good reason why they will bolster Deepak's profitability in some cases; and in other cases bolster Deepak's top-line growth. So, it is not just a significant volume of new products that we are adding. There is some of that and there is some of improving the fortification of Deepak Nitrite's profitability. And on Deepak Phenolics, announcements will be, as I mentioned, shortly. But IPA is anyways coming up, we have another internal project for improving our bottom-line by ensuring that we have good sustainable clean power and that is also ongoing. So, both of these things are expected to be seeing the light of day as scheduled, and they will further add to both top-line and bottom-line, similarly with Deepak Nitrite. So, I will not consider a comparison to the gross block, it is inaccurate and it will lead to a lot of confusion.
- Tejas Seth:** Okay. On the proposed capacity addition in Deepak Phenolics where you have asked for 6,500 tonnes over 21,000 tonnes on the monthly basis; and on the acetone again it is 5,200 tonnes on 12,800 tonnes on monthly basis. There is nearly 30% volume addition, and cumene, we are looking at doubling the capacity. So, is this part of the Dahej Unit 2 plant, or is it the debottlenecking at Unit 1, the brownfield expansion?
- Maulik Mehta:** Yes. So, one of it is because of what you see right now in terms of the volumes that we are able to manufacture. You see, some of that's consumed within and some of this is what we are looking forward to from the existing site in the forthcoming quarters.
- Tejas Seth:** At Dahej 2 unit, you will be looking at predominantly for Deepak Nitrite only, all the new products or even for the expansion of the existing products?
- Maulik Mehta:** No, let me reiterate that the new site will have products that have both raw material and process competency coming in from both companies. And we will be seeing a significant set of products,

some of which will be higher value, some of which will be higher volume. And I would not say that these products are definitely linked to one or the other. And that's also the rationale behind why we have taken certain administrative steps.

Moderator: The next question is from the line of Hasmukh Gala from Finvest Advisors.

Hasmukh Gala: Just two questions from my side. How do you see the pricing trend per se in different businesses, like in performance products you said that last year was very high and now it has drastically come down? So, for the major products that we have, going ahead with the robust demand which you are expecting, what kind of pricing trends we will see in general?

Maulik Mehta: Right. So in general, in my commentary in the previous investor call after Q2 results, we said that in a lot of segments we are seeing that there is a revival in volume demand. We are expecting that there will be a revival in prices, perhaps one step after the demand increase. And we remain taking that position. We have seen across the board in, I think, pretty much all of our products an increase in prices. Now, unfortunately, in some of our segments in Q3, for a part of Q3 we also saw unavailability of raw materials, which led to some sort of a margin compression. But as I mentioned earlier, we have seen these challenges being moderating in scope and impact now. So we are expecting not only that the volume increase, which was already creeping in at some part of Q3, continuing robustly in Q4, but also we are seeing a price increase.

If I look at, say, performance products, we are seeing a price increase of about 10% to 12%. And in Basic Chemicals, also, we are seeing an increase in prices of about the same. Of course, at the same time, we are also seeing some increase in raw material prices. But our primary goal right now is, (a) we should be able to pass on pretty much all of it forward. And (b) that our first goal must be volume availability should not be challenged. So, we have worked extremely hard with the supply chain teams in the last two months to ensure that regardless of raw material prices, we need to be well covered; and we need to have these discussions constantly with our customers that this is the market environment. Customers have also been appreciative of that. And it is demonstrated by the increase in stickiness of key customers. So actually, even though prices are increasing, in some cases, increasing more than competitor prices, we are seeing no letup in customer stickiness, we have actually increased customer stickiness, if I may say so over the last two months.

Hasmukh Gala: My second question in Deepak Phenolics, the average EBITDA margin in last two years, if you see FY20 full year, we had 11.5%. As still there is not much of the downstream products in Phenolics, so now they are all going to come in, what would be the ideal level of margin we will be looking at?

Maulik Mehta: Okay, so basically, it will depend a lot on which products we are choosing to priorities. And the thing is that this will change within a financial year, as we start to introduce new products, if the product is more of a bulk product it will continue along this trajectory of between 22% to 24%

EBITDA. And if it is, Speciality product, it will tend a little bit higher. But let's keep in mind that the volume of phenol and acetone has a significant gravity to it. So when we add new products, our goal is to ensure that we are by and large in the same EBITDA band. Adding two or three products which are at significantly higher EBITDA margin, but very little volume will not even make a material change to the overall EBITDA. So, we should expect that moving forward something between 22% to 27% should be a reasonable expectation, given the sheer volume of this material that is involved.

Hasmukh Gala: And this clean technology subsidiary we have floated, what is our plan, which products we will be launching in that?

Maulik Mehta: Yes, those are the products which we will have the opportunity to share with you over the next couple of months. Unfortunately, there is a diplomatic answer to this and then there is the honest answer to this. The diplomatic answer is that we are waiting for steel prices to moderate again, which we are expecting while announcing new products. But the real answer is very simple, that we have a special committee of the board that is convened in order to look at new product proposals and new capital investment proposals. This body has not had the opportunity to meet and it is looking forward to meeting in the next month. So once the committee clears out, we will be able to announce it over the next month or two. And if it has some subsequent questions which we work on answering, accordingly, plus month or so. So basically, over the next three months we will be able to give some clarity to the new products that we are looking at introducing. And I would also suggest, do not look at the name Clean Tech as an indicator of what products we will be making.

Hasmukh Gala: Right. So I thought it maybe something to do with some environmentally friendly products or something like that.

Maulik Mehta: I can say that is Deepak Nitrite's position across the board anyways, we are responsible credited, we have very high sustainability scores. In fact, one of our plants right now, very recently, it was in the top 25% quartile in terms of sustainability, and it recently got related to being in the top 0.1% for sustainability. So our goal with even existing plants and new plants is always to ensure that we are sustainable, from energy, water, thermal, everything, by product management, everywhere. And that is, in fact, we say that this is something that we are doing for the environment. But if I am being honest, this is also one of the key channels through which we are able to improve our profitability.

Moderator: The next question is from the line of Kishan Gupta from CD Equisearch.

Kishan Gupta: So basically want to understand what is your competitive advantage in the phenol business?

Maulik Mehta: Okay. I can start off by telling you what our competitive disadvantage is. Our competitive disadvantage primarily, if I am comparing to global marquee players in the same segment, is that they manufacture phenol and acetone right next to their raw material sources. So normally they

do it attached to a refinery. And in many cases, that allows them huge kind of latitude in the way that they plan their raw material availability. Our greatest advantage was also the greatest disadvantage that we started out with. We did not have a lot of capital that we could deploy and we did not have a lot of land that we could put this plant into. So, we took the Theory of Constraints in a strong way and we said, okay, we have not as much money as global giants, and we have not as much land as global giants, and we have no easy access to putting the plant up in the same premises as refiners. But we do have is the value of a domestic industry, which is not only a large importer, but also can grow substantially if the right support is there from a domestic supplier of phenol and acetone. This was a challenge that we took. And therefore, we deployed our limited capital in an extremely conservative way, where, for us, literally every paisa was important, every square foot was important. And what we were able to therefore put up is a plant that we are very proud of now saying that it has the lowest thermal footprint, the lowest water footprint, the maximum amount of phenol and acetone produced per square foot of land. But the reality of this is that this is the success that came out of the challenge.

I believe that if we did not have such challenges, we may have been less efficient. But because of these challenges, we focused entirely from day one of conceiving the project on seeing how efficiently we could put the plant up, both in time and in budget, and ensure that across the board we were able to measure every single step where we would potentially be able to improve efficiency. What we did not expect is the significant support that we got from all of our employees and cross functional teams in being able to identify various opportunities. What we have also mentioned earlier is that we consider value from waste to be a keystone initiative that we use across all of our sites. Finally, we are seeing that there is a faster than originally projected growth in terms of phenol and acetone demand in the country. And net, net, our customers are always comfortable using Deepak's products, which are world-class anyways, acetone is in any way manufactured at a pharmaceutical grade. And therefore, I would say that it is the sum total of our constraints earlier, which have now turned into our advantages, and also the customer stickiness. So if I look at our plant to any other plant worldwide, I can tell you that we would not be left embarrassed whether it is in terms of productivity or quality of product, even though many of these, if not all of these global giants are far better capitalized than us and have a far more robust upstream integration with refineries, we have been able to overcome those challenges with better planning, just nose to ground working on improving productivity.

Kishan Gupta:

So how does it fructify into your cost per tonne or something compared to their manufacturing cost?

Maulik Mehta:

I will not comment on that. But I can tell you that, historically, what many analysts have considered to be the margin that Deepak makes as per the spread that they calculate. I can say Mr. Nanda can correct me if I am wrong, I don't think there has been a single time in the last four quarters at least that we have not exceeded that expectation of gross margin.

Moderator:

The next question is from the line of Saurabh Kapadia from Asian Market Securities

Saurabh Kapadia: On the raw materials shortage, was it only to one segment or it was across the segments? And also, is it related to an imported material that led to this shortage? And are we looking at increasing the inventory levels going ahead?

Maulik Mehta: So the raw material shortages were locally sourced. The raw material shortages were also because of unexpected issues at our suppliers ends. And we had contracts in place and we were supposed to have received those raw materials without any hitch. But unfortunately, because of operational issues at our supplier end, we were unable to get the volumes that we needed. And in some cases that led to lower plant utilization or even stoppage, in other cases it led to us needing to go out into the market and mop up raw materials at exorbitant prices in order to ensure that we were able to meet the contracted customer demand. So at no point did we raise any force majeure clause on raw material. And we saw that unfortunately, in Q3, our performance in many of the products was affected because of this availability, but we were able to retain customer stickiness. Now as the availability of these key raw materials has become normalized, we are seeing that we will run all of our plants as per their expected utilization and continue to service the wallet share of customers.

Somsekhar Nanda: Further to this I must add that, these are all temporary phenomenon which keeps on happening. In our life, it doesn't happen so frequently. But since it's happened, we thought of letting our investors know and we have been able to correct the situation by whatever we could do to supply to our customers, retain them and enhance the customer relationship going forward.

Saurabh Kapadia: My second question on Fine & Speciality Chemicals. So our margins are in line with what we have guided, 40% plus kind of margins. But looking at three to five years' time horizon, what could be the sustainable range for the margins in the Fine & Speciality Chemical, given that we are already expanding the capacity for new products which will come on-stream from next year?

Maulik Mehta: So we continued with the same margin guidance, I think between 42% and 45%, 46% is the right number. In Q2, you did see a number which was slightly above that, because we had our challenges because of COVID, we had Nisarg Cyclone also that affected us. And therefore, we cherry picked the products which would have the highest impact on our profitability. But the right number to expect, generally speaking, if we have all of our engines firing is between 42% to 46%.

Somsekhar Nanda: Saurabh, what Maulik bhai has just said rightly, your question is, what is our guidance or profitability on Fine & Specialty products over three to five years' time.

Saurabh Kapadia: Yes, I am looking for sustainable margins that we can look at in the Fine & Speciality.

Somsekhar Nanda: Sustainable margins should be around this level, 40%, 45%. But again, last year, we were around 35%, this year Q2 we were at 48%, 49%. So, it was a pleasant surprise within these constraints and with these good and bad factors, the way we are working and as Mr. Maulik Mehta has mentioned, we are working on several fronts. So this sustainability is around 40%, 45% level.

But let us see, the situation keeps revolving and we will be coming every quarter to you giving whatever guidance we get to the best possible manner and to the best ability of our Company.

Maulik Mehta:

What I can add to what Mr. Nanda has said is that an important consideration for us is regardless of whether the margin is 40%, 45% or 50%, we must not lose customer wallet share, that is key and that is very important. And in fact, I can assure investors on this that Deepak's focus remains on maintaining wallet share and maintaining the kind of relationship that it has with a customer, which goes back in some cases to about a decade or so 15 years. In other cases, it is new, but it is fast developing into a very solid relationship which will then take us through the next several years in some cases formal and in some cases informal contracts. So it's important for us to point that out that when we talk about margins, we must never do it at the expense of wallet share.

Somsekhar Nanda:

With all due respect to this question and the answer that we have, the most important thing what Maulik bhai has mentioned is to return wallet share. He has been modest, he tries to increase the wallet share also, by which we ensure the stickiness of the customers. Margins are a fallout of all these various elements. So while we act on margins, we also actively act on this increasing customer relationship stickiness, wallet share, so other things are automatic fall out.

Maulik Mehta:

Like most of the products that we are into, in the Fine & Speciality Chemicals segment, I think it would be safe to say that we are number one in the customers' wallet share. I don't think that there is a single product that we make in this segment where we are number two or three or four in the wallet share of the key customers.

Moderator:

The next question is from the line of Vimal Shah from Oneup Financial.

Vimal Shah:

Two or three quick questions. On the Performance Products segment, when do you think the normal run rate will be back, both in terms of utilization and the margins coming back? That is question number one.

Question number two, and oddly a participant had asked on Clean Tech, is this specifically floated for green kind of products? And would it be fair to assume that these products would have a far better trajectory of operating margins than the current overall margins that the Company is enjoying?

And lastly, can you allude to the fact that how would we, you said Rs. 400 crore CAPEX in Nitrite and Rs. 300 crore CAPEX in Phenolics. Would it go to enhance the capacities on the Phenolics side also? I mean, is that part also covered since you are very much attuned to having more downstream products, which possibly are more profitable.

Maulik Mehta:

Okay, I think that there are a few misunderstandings here that I will look forward to clearing. One, with regards to Performance Products segment, we are already seeing a significant increase in volume demand, which we are able to cater to. And as I mentioned earlier, we will see price and margin improvement. But let me also be very clear that in no way should this imply that we

will go back to last year's abnormal margins in Performance Products. That was a unique situation led by externalities, which were Chinese. And if this situation should arise again, it will be fortuitous, but it cannot be something that we can give any sort of a guidance towards. So, this is not to be expected and this is not to be accounted for. Let me be very clear about that. But in general, while we are seeing something like about 12% to 14% margin in Performance Products, the right number to target would be something close to an 18% to 20%. So between quarter four and quarter one, as end user segments like paper and textile recover to pre-COVID levels, we hope to see this target as we have indicated after the Q2 numbers as well.

Now with regards to the capital investment, I mentioned Deepak Nitrite's number, but Deepak Phenolics number that you have assumed Rs. 300 crore is wrong, it will be perhaps a little bit lower, closer to Rs. 200 crore. What is important also is to point out that we are not going to start splitting hairs about how much of this is for capacity enhancement and how much of this is towards a new product development. At the end of the day, what both of these end up doing is make your Company more sustainable, more robust. The profitability in either cases is something that the management knows how to gain.

And let me also lastly mention that I had already highlighted that Deepak Clean Tech, the named Clean Tech is not indicative of the kind of products that we will manufacture. So we will manufacture value-added chemical intermediates that cater to the fast-growing end user segments, we are very clear about that. We are clear that there are opportunities for import substitution, and we are clear that there are opportunities in agro, pharma, dye intermediates where there is an increase in demand of the kind of products that Deepak manufactures, and the competencies that Deepak has.

If you are asking about margins that are way above worth the margins that the Company currently employs and enjoys, I would say that I do not know which Company you are comparing to, because I believe that Deepak Nitrite and Phenolics are able to enjoy reasonably good margin across most of their products. And looking for some sort of quantum improvement over that, I would say, even if it is possible, it is unreasonable to expect. As and when that happens, we take the best advantage of that. But we have a good and diverse range of products that are able to span between 20% margin all the way to 50% and 60%, maybe even more. But what is important, I will restate is that the products that we are looking at getting into and the investments that we are making are ones where we expect the margin guidance to remain. And these will lead to significant improvements, both in top-line and bottom-line, and also strengthening of the core businesses that we are already into. So, please don't go into assuming that this is going to be a group of products which will give us 100% margin, no. But I think that we are in a very enviable position. Our goal is to continue to remain in that enviable position. The management has set for itself very stiff ambitions over the next three or four years and is working very hard to achieve those numbers. We have the right team, the right set of products, the right competencies, and the right market interest, both internationally and domestically. So I believe that along with that, and our balance sheet, you should expect to see more of the same,

perhaps in some quarters faster, and perhaps in some quarters a more normalized growth trajectory. But the growth trajectory is what we should be considering.

Vimal Shah: What are the kind of investments you are targeting in Clean Tech?

Maulik Mehta: I have already made these comments, let's not split hairs about Clean Tech and Nitrite and Phenolics. What we should be focused on is the numbers that I have already mentioned. And whether they are in Clean Tech or Nitrite or Phenolics, at the end of the day, the investor, the shareholders are the ones to benefit, because all of these are part of the same group Company.

Somsekhar Nanda: See, what Maulik bhai has rightly mentioned several times on this call that our target event for a CAPEX project is about three years, regardless of steel prices all these projects will come whenever they are approved by the approving committee, and they will be announced gradually to you.

Moderator: The next question is from the line of Shanti Patel from Shanti Patel Investments.

Shanti Patel: I just wanted to know whether we are facing any competition from China in respect of our existing products? And number two, what is our market share in respect of various products that we are manufacturing in India?

Maulik Mehta: I think we manufacture more than 50 products. So very difficult to give you a consolidated answer. Of course, we face significant competition from China, of course, our processes that we employ across multiple products, in many of these cases, Chinese companies also do the same. This has always been a feature for the chemical intermediate segment, and is not expected to change. However, I can also reaffirm that we are able to maintain our margins despite stiff competition from China. And we expect to continue to do so. Just because China is a competition does not mean that your Company is any less able to match global best players. So when we put in an investment, and when we manufacture a product, our goal must be not to consider a single country as a competition, but whether it is Europe or the US or China, or anywhere else in the world, our product quality should be world-class, and our operating cost and margin over material should be based on having that right kind of expertise. We don't get into products where we are manufacturing, just for a domestic best-case scenario. Our operating expenditure is equivalent, if not better, in some cases, to global players.

Shanti Patel: And with all these expansions, what will be the approximate turnover for the year 2021-2022? If can you give some guidance?

Maulik Mehta: I think this is not yet an answer that we can give. A lot of this is going to be based on how quickly our committee approves of the product. And then based on that, how well we are able to negotiate with equipment fabricators to be able to put the plants up. So it's very difficult for us to give you this answer right now. Hopefully, we should be able to give more light on this in the forthcoming months.



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- Shanti Patel:** With reference to the first question only, now there is some competition from China. But with respect to the market share of China and our market share, where do we stand in India?
- Maulik Mehta:** We stand well. Most of our products that we are into, are having a commanding position domestically, and also a commanding position with key customers internationally. That is the strength of Deepak, that's what we look at continuing, even with the new products that we are looking at getting into.
- Moderator:** The next question is from the line of Ashish Shah from CJ Shah & Company.
- Ashish Shah:** Just wanted to know, when you mentioned the three-year payback period, what kind of ROCE are you looking at in the new projects? And would this include the expansions on the current capacity as well as the new projects or it is just for the new projects?
- Maulik Mehta:** I don't think it matters. At the end of the day, a three-year free cash flow payback is a three-year free cash flow payback.
- Somsekhar Nanda:** You would be able to arrive at ROCE based on this information easily.
- Ashish Shah:** But just wanted to know, is it only for the new projects or also for the brownfield expansions?
- Somsekhar Nanda:** Almost all the projects.
- Moderator:** Thank you very much. Ladies and gentlemen, that will be the last question for today. I will now hand the conference over to the management for closing comments.
- Maulik Mehta:** Thank you, everybody, for taking time out to join us on this call. I am happy that we were able to answer some of your questions. And unfortunately, we were not able to answer some of the questions which were pertaining to the new products. But we look forward to being able to share more light on that in the subsequent few months. Other than that, I hope we have adequately answered all your questions. Should you have any further questions, please feel free to contact our Investor Relations team or CDR India. We look forward to connecting with all of you again in the near next quarter. And hopefully, face to face with many of you as soon as possible. Thank you, everybody. Please stay safe.
- Somsekhar Nanda:** Thank you very much everybody for joining this call.

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