11 November 2022

2QFY23 Results Update | Sector: Specialty Chemicals

Deepak Nitrite

Estimate changes	↓
TP change	↔
Rating change	↔

Bloomberg	DN IN
Equity Shares (m)	136
M.Cap.(INRb)/(USDb)	283.7 / 3.5
52-Week Range (INR)	2690 / 1682
1, 6, 12 Rel. Per (%)	-10/-4/-12
12M Avg Val (INR M)	1879

Financials & Valuations (INR b)

Y/E March	FY22	FY23E	FY24E
Sales	68.0	79.9	79.7
EBITDA	16.0	15.1	17.7
PAT	10.7	10.0	11.7
EPS (INR)	78.2	73.4	85.9
EPS Gr. (%)	37.5	(6.2)	17.1
BV/Sh.(INR)	245	307	380
Ratios			
Net D:E	0.1	0.0	(0.1)
RoE (%)	37.5	26.6	25.0
RoCE (%)	32.1	24.5	23.7
Payout (%)	9.0	15.0	15.0
Valuations			
P/E (x)	26.6	28.4	24.2
P/BV (x)	8.5	6.8	5.5
EV/EBITDA (x)	17.9	18.9	15.8
Div. Yield (%)	0.3	0.5	0.6
FCF Yield (%)	2.2	1.0	2.4

Shareholding pattern (%)

As On	Sep-22	Jun-22	Sep-21
Promoter	45.7	45.7	45.7
DII	12.0	10.7	10.6
FII	8.5	9.1	10.9
Others	33.8	34.5	32.9

FII Includes depository receipts

CMP: INR2080 **TP: INR1,890 (-9%)** **Neutral**

Contraction in Phenol margin, but recovery expected

- Deepak Nitrite (DN) reported a miss on our estimate. EBITDA came in 9% lower than our estimate at INR2.7b, while EBITDA margin – at 13.8% – was also below our estimate of 16.3%, the lowest since 1QFY19. **The miss was largely due to the Phenolic segment. EBIT margin contracted to 8% in Deepak Phenolics, the lowest since 4QFY20.**
- Management announced that it has commissioned a project (for an agrochemical product) in Oct'22 for which the entire volumes are tied up for the next five years – it expects another project to be commissioned in Nov'22, which would be margin accretive.
- A product for the EU market (developed in-house) was also launched and DN is only the second manufacturer of the same globally. This would be replacing a product recently banned for being carcinogenic. The performance of DN was also adversely affected by the fire incident in its Nandesari site but the plant is running at full capacity since Oct'22.
- We raise our FY23/24 revenue estimates by 8%/7% primarily due to the commissioning of new products, Nandesari plant running at full capacity and the company being successful in passing on the cost increases with demand remaining robust. However, given the contraction in Phenol margins in 2QFY23 and the underperformance of the Phenolic segment in 1HFY23 v/s last year, we cut our EBITDA/EPS estimates by 8%/9% for FY23E, respectively.
- The stock trades at 24x/23x FY23E/FY24E EPS. With pricing environment remaining volatile and limited earnings growth opportunities until the time Greenfield expansions get commissioned (phenol downstream products would result in captive phenol consumption of 35-40%), we maintain our **Neutral** rating. **We value the stock at 22x FY24E EPS, to arrive at our TP of INR1,890.**

Miss on EBITDA as margin remains suppressed

- DN's revenue was above our estimate at INR19.6b, up 17% YoY, but down 5% QoQ. EBITDA declined 30% YoY and 24% QoQ to INR2.7b (est. INR3b). **EBITDAM stood at 13.8% (v/s 17.3% in 1QFY23) – the lowest since 1QFY19**. Gross margin contracted 370bp QoQ to 30.2%. PAT dipped 31% YoY and 26% QoQ to INR1.7b (est. INR1.9b,), **translating into an EPS of INR12.8.**
- The **EBIT margin in Phenolics stood at 8%** (the lowest since 4QFY20), with EBIT at INR1b. The **EBIT margin in Advanced Intermediates stood at 20%** (v/s 18% in 1QFY23), with EBIT at INR1.4b. Revenue mix in Phenolics/Advanced Intermediates stood at 65%/35% in 2QFY23, respectively. EBIT mix in Advanced Intermediates/ Phenolics stood at 57%/43% v/s 41%/59% in 1QFY23, respectively.
- The Nandesari plant, which was adversely impacted by a fire incident in Jun'22, turned fully operational in Oct'22.
- DN has incorporated a company in the Sultanate of Oman – Deepak Oman Industries FZC – to set up a chemical manufacturing plant.

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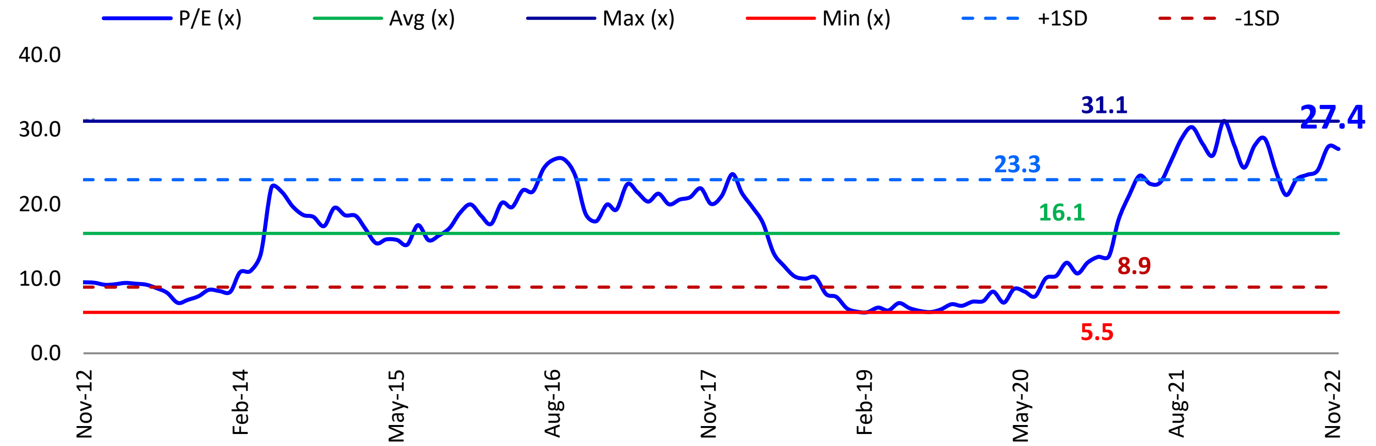
Valuation and view

- The management aims to become the largest player in Solvents, with a play on import substitution. It has already announced its foray into MIBK (40ktpa), MIBC (8ktpa) and Polycarbonate. Note that MIBC is a forward integration of MIBK.
- Despite a capex of INR15b over the next two years, DN is likely to turn net cash positive by FY24, with an FCF generation of INR9.6b over FY23-24. Return ratios are forecasted to be at 4-27%, significantly lower than that of FY22.
- However, the management's focus remains on commodities, rather than specialty products or complex commodities, as of now. **We maintain our Neutral rating, valuing DN at 22x FY24E EPS to arrive at our TP of INR1,890.**

Consolidated - Quarterly Snapshot (INR m)

Y/E March	FY22				FY23				FY22	FY23E	FY23
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			2QE
Gross Sales	**15,262**	**16,814**	**17,223**	**18,724**	**20,580**	**19,617**	**19,825**	**19,920**	**68,022**	**79,941**	**18,304**
YoY Change (%)	*126.3*	*70.3*	*39.5*	*28.0*	*34.8*	*16.7*	*15.1*	*6.4*	*56.0*	*17.5*	*8.9*
Gross Margin (%)	46.3%	37.4%	37.0%	38.2%	33.9%	30.2%	33.2%	37.8%	39.5%	33.8%	31.6%
EBITDA	**4,515**	**3,865**	**3,519**	**4,103**	**3,560**	**2,709**	**3,547**	**5,319**	**16,002**	**15,134**	**2,975**
Margin (%)	29.6	23.0	20.4	21.9	17.3	13.8	17.9	26.7	23.5	18.9	16.3
Depreciation	436	441	455	446	419	424	562	737	1,777	2,143	549
Interest	109	92	68	71	86	59	51	8	340	204	56
Other Income	83	84	258	35	96	120	219	148	460	584	128
PBT	**4,053**	**3,417**	**3,253**	**3,622**	**3,151**	**2,346**	**3,152**	**4,722**	**14,345**	**13,371**	**2,498**
Tax	1,026	873	829	950	805	601	1,014	945	3,678	3,365	628
Rate (%)	*25.3*	*25.6*	*25.5*	*26.2*	*25.5*	*25.6*	*32.2*	*20.0*	*25.6*	*25.2*	*25.2*
Reported PAT	**3,026**	**2,543**	**2,425**	**2,672**	**2,346**	**1,745**	**2,138**	**3,777**	**10,666**	**10,005**	**1,870**
YoY Change (%)	*205.8*	*49.4*	*12.0*	*-7.9*	*-22.5*	*-31.4*	*-11.8*	*41.3*	*37.5*	*-6.2*	*-26.5*
Margin (%)	*19.8*	*15.1*	*14.1*	*14.3*	*11.4*	*8.9*	*10.8*	*19.0*	*15.7*	*12.5*	*10.2*
Segmental Revenue (INR m)											
Advanced Intermediates	5,491	5,697	7,224	7,953	7,300	6,853	7,450	8,338	26,365	29,941	7,485
Phenolics	9,990	11,370	10,331	11,221	13,349	12,841	12,375	11,435	42,912	50,000	10,819
Segmental EBIT (INR m)											
Advanced Intermediates	1,546	1,322	1,690	2,131	1,327	1,384	1,765	2,584	6,688	7,059	1,782
Phenolics	2,873	2,204	1,836	1,759	1,877	1,027	1,500	1,596	8,671	6,000	1,619
Segmental EBIT Margins (%)											
Advanced Intermediates	28%	23%	23%	27%	18%	20%	24%	31%	25%	24%	24%
Phenolics	29%	19%	18%	16%	14%	8%	12%	14%	20%	12%	15%

Exhibit 1: DN currently trades at 27.4x, at a 70% premium to its long-term average P/E



Source: Company, MOSL

CONFERENCE CALL

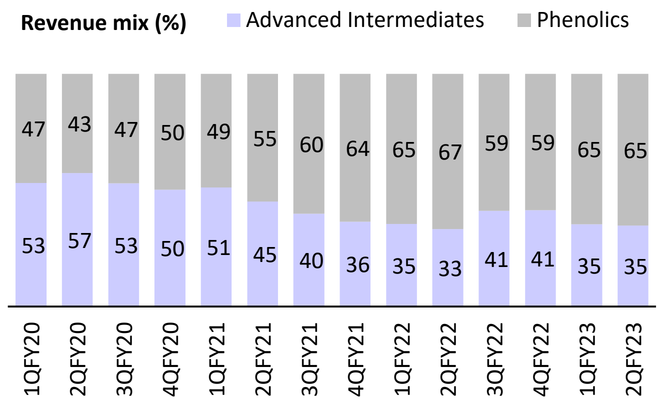
Management commentary – Key highlights:

- Full production capacity achieved in Oct’22 in the Nandesari plant
  - In Jul’22, operations resumed using natural gas and not coal. P&L impact was to the tune of INR40m.
- Volatile global environment, sustainable inflationary pressure and higher freight rates were seen in 2QFY23
- Wallet share has either remained stable or increased in 2QFY23 despite challenges
- RM movement was not in line with finished goods movement
  - China saw moderation in demand due to elections
  - Cost of key RMs including utilities was volatile and higher in 2QFY23
- DN was successful in passing on the cost increases with demand remaining robust
- DPL achieved high average plant utilization during 1HFY23, for 2Q it was similar to 1QFY23
  - Expect DPL margins to be better in the coming quarters as prices normalize
- All projects are on track to be commissioned in phases as announced earlier
  - Commissioned a project in Oct’22 and the entire volume for the next five years is tied up for an agrochemical product
    - DN has leadership position and it is the 2nd or the 3rd largest player in the world
  - Expect another project to be commissioned in Nov’22, which is margin accretive
  - DN also commissioned an unnamed product for the EU market which was recently banned for its carcinogenic properties; it is only the second manufacturer of this product in the world
    - Targeted globally but prioritizing in Europe right now, would be replacing the banned product
    - DN has developed the product in-house
- It has also announced a chemical manufacturing unit in the Sultanate of Oman for products that use energy as an input since cost of energy is much lesser in the Middle East
  - 51% of equity being invested with DN having deep customer connect and market insight
- In DN, there was no volume growth and in DPL 10% volume growth was observed

Management plans to expand Hydrogenation and Nitration capacities including getting into new chemistries such as fluorination and photo chlorination (as announced earlier).

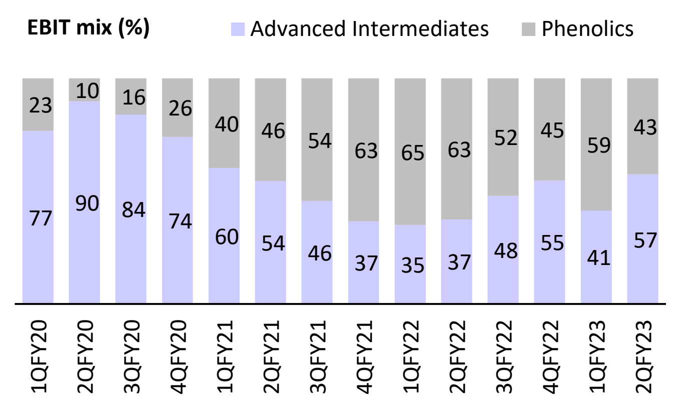
Story in charts – 2QFY23

Exhibit 2: Contribution of Phenolics in total revenue remained stable at 65% in 2QFY23 QoQ…



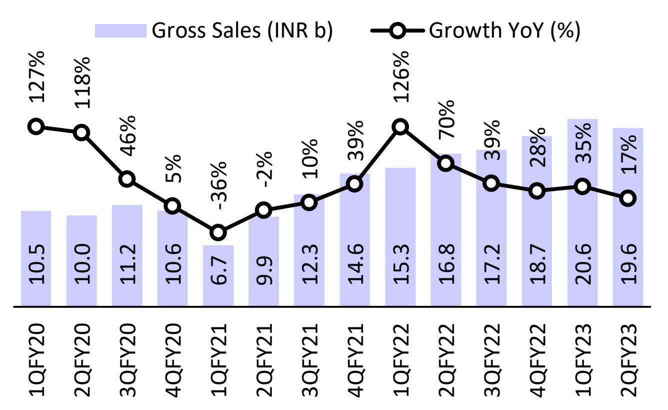
Source: Company, MOFSL

Exhibit 3: …with Phenolics' contribution to EBIT mix declining to 43% QoQ from 59% in 1QFY23



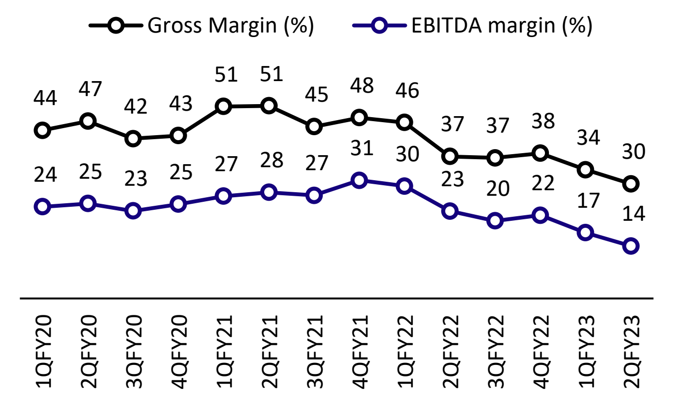
Source: Company, MOFSL

Exhibit 1: Sales rose 17% QoQ, -5% YoY



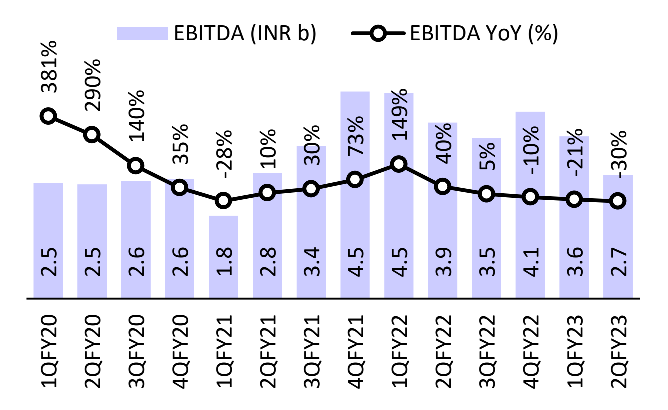
Source: Company, MOFSL

Exhibit 2: Margins continued to decline



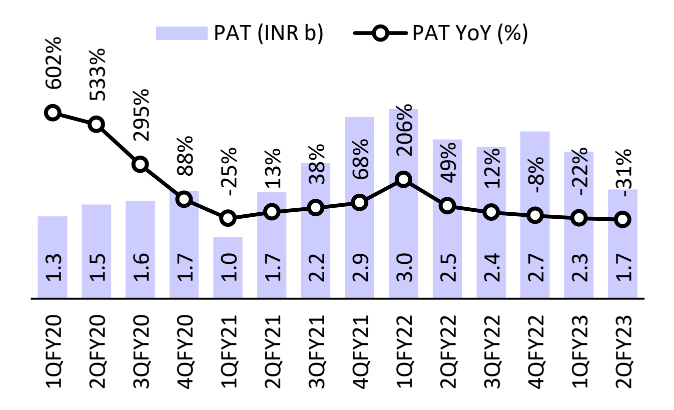
Source: Company, MOFSL

Exhibit 3: EBITDA declined 24% QoQ (margin at 13.8%)



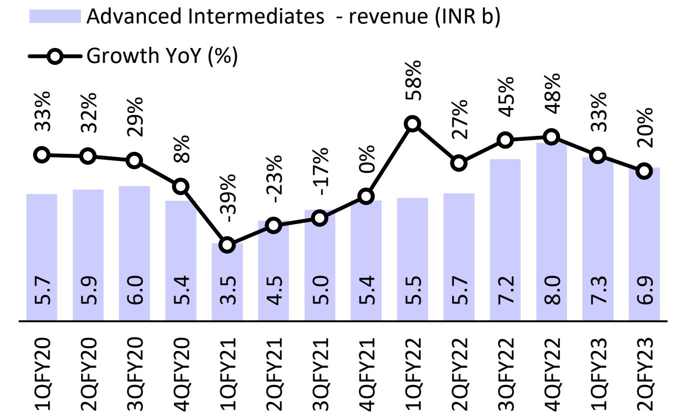
Source: Company, MOFSL

Exhibit 4: PAT declined 26% QoQ (margin at 8.9%)



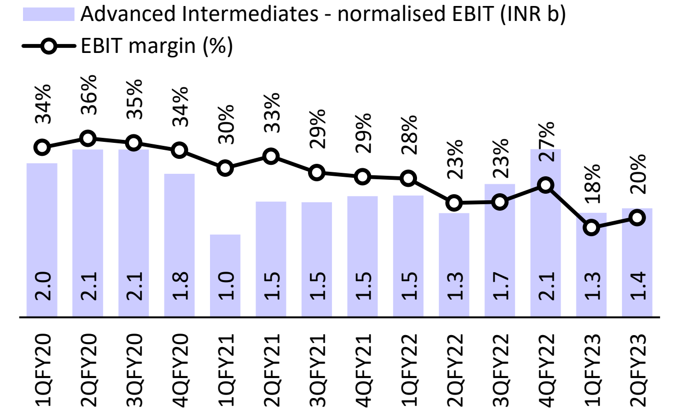
Source: Company, MOFSL

Exhibit 5: Revenue from Advanced Intermediates declined 6% QoQ…



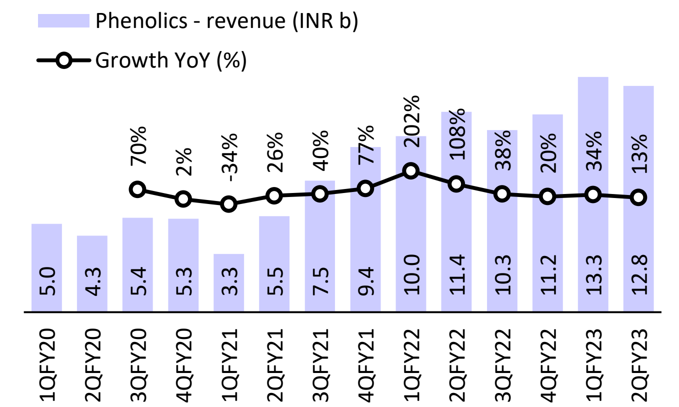
Source: Company, MOFSL

Exhibit 6: …with a decline (+200bp) in EBIT margin



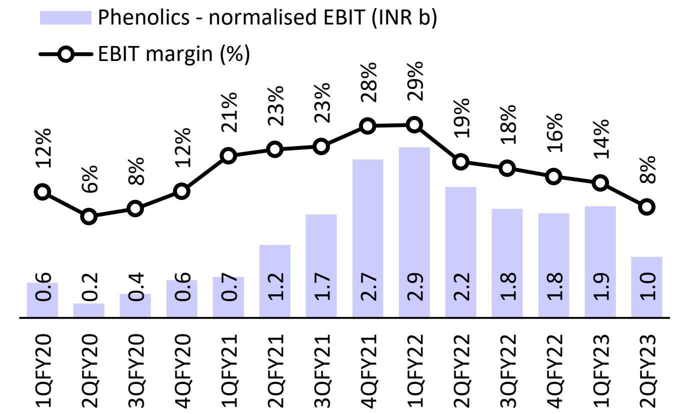
Source: Company, MOFSL

Exhibit 7: Revenue for Deepak Phenolics declined 4% QoQ…



Source: Company, MOFSL

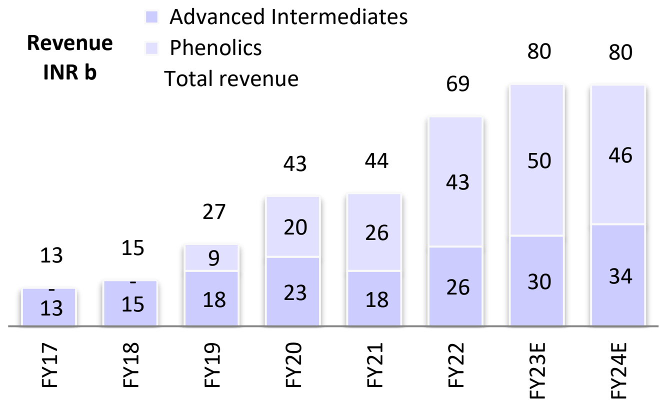
Exhibit 8: …with EBIT margin at 8%



Source: Company, MOFSL

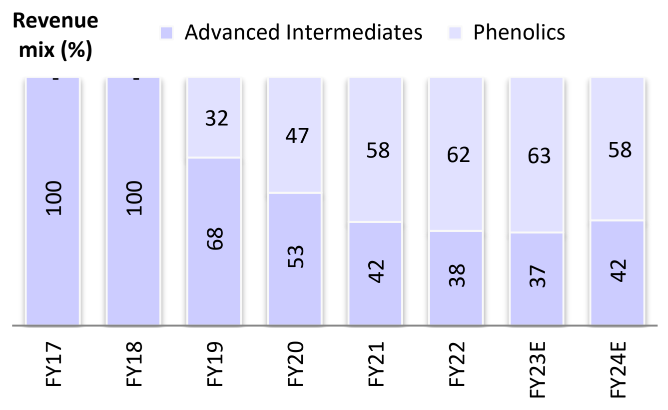
Financial story in charts

Exhibit 9: Revenue growth peaked as product prices in DPL normalizes going forward…



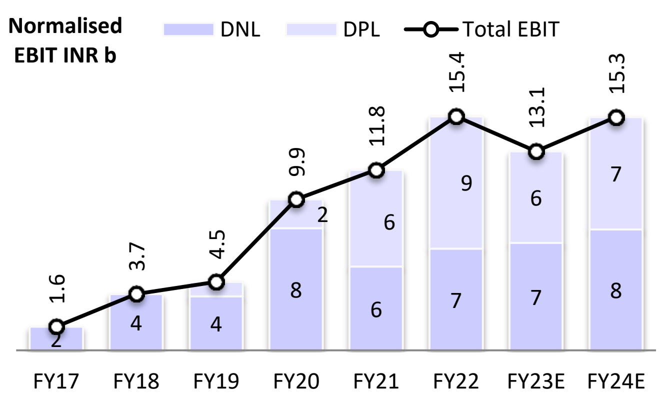
Source: MOFSL

Exhibit 10: …resulting in a lower contribution from DPL in the total revenue mix



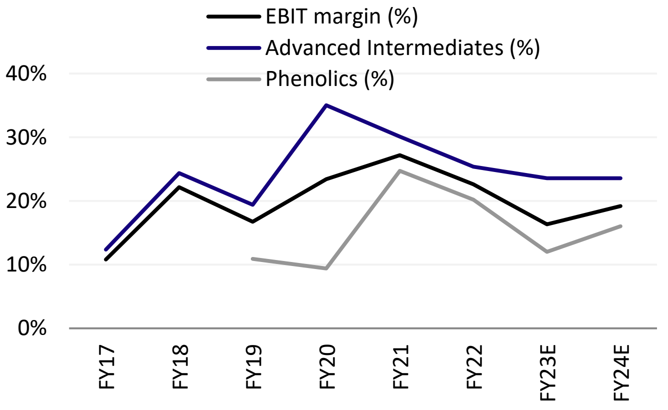
Source: Company, MOFSL

Exhibit 11: Expect normalized EBIT margin to stabilize at ~15%



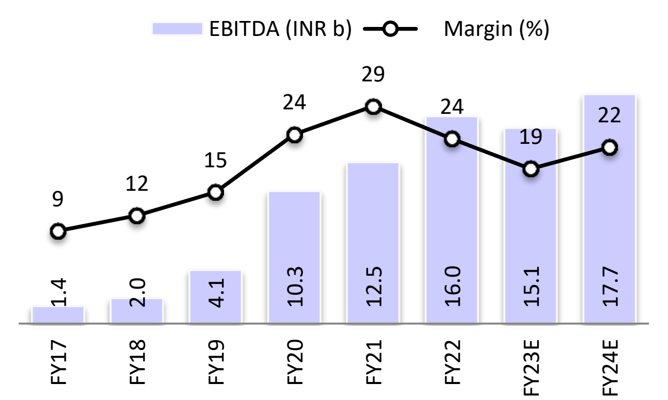
Source: Company, MOFSL

Exhibit 12: …with Advanced Intermediates still enjoying a higher EBIT margin (estimate ~24%)



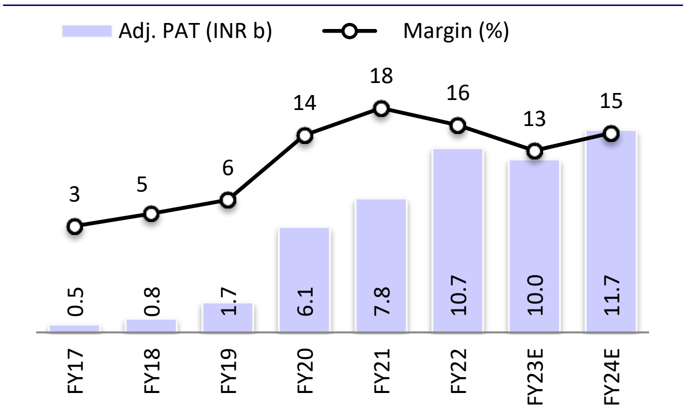
Source: Company, MOFSL

Exhibit 13: EBITDA margin to normalize from FY21 levels



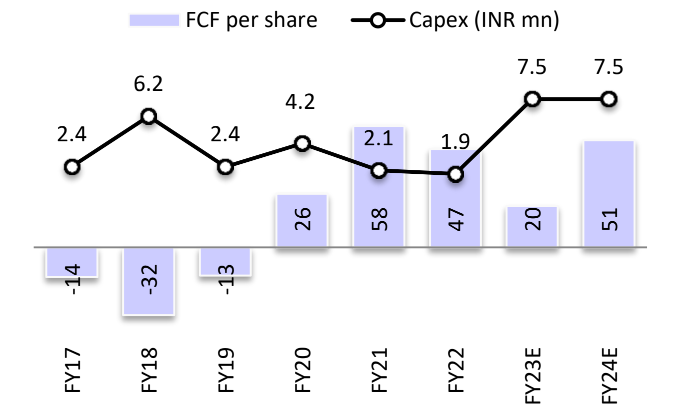
Source: Company, MOFSL

Exhibit 14: Expect ~5% PAT CAGR over FY22-24



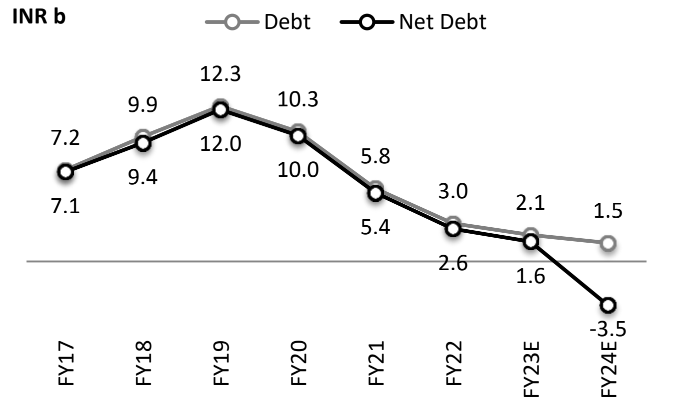
Source: Company, MOFSL

Exhibit 15: DN to incur ~INR15b on capex over FY23-24E…



Source: Company, MOFSL

Exhibit 16: …but is likely to turn net cash positive in FY24E



Source: Company, MOFSL

Financials and valuations

Consolidated - Income Statement								(INR m)
Y/E March	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23E**	**FY24E**
Total Income from Operations	**14,547**	**16,762**	**26,999**	**42,297**	**43,598**	**68,022**	**79,941**	**79,726**
Change (%)	-0.2	15.2	61.1	56.7	3.1	56.0	17.5	-0.3
Gross Margin (%)	41.9	38.0	39.0	43.9	48.1	39.5	33.8	37.6
EBITDA	**1,355**	**1,963**	**4,139**	**10,258**	**12,470**	**16,036**	**15,134**	**17,742**
Margin (%)	9.3	11.7	15.3	24.3	28.6	23.6	18.9	22.3
Depreciation	480	526	778	1,397	1,526	1,777	2,143	2,508
EBIT	**874**	**1,437**	**3,361**	**8,861**	**10,944**	**14,259**	**12,992**	**15,234**
Int. and Finance Charges	341	451	832	1,149	742	340	204	143
Other Income	109	123	151	352	215	426	584	566
PBT bef. EO Exp.	**642**	**1,109**	**2,680**	**8,064**	**10,417**	**14,345**	**13,371**	**15,657**
EO Items	705	0	0	0	0	0	0	0
PBT after EO Exp.	**1,347**	**1,109**	**2,680**	**8,064**	**10,417**	**14,345**	**13,371**	**15,657**
Total Tax	382	318	943	1,954	2,659	3,678	3,365	3,941
Tax Rate (%)	28.4	28.7	35.2	24.2	25.5	25.6	25.2	25.2
Reported PAT	**963**	**790**	**1,737**	**6,110**	**7,758**	**10,666**	**10,005**	**11,716**
Adjusted PAT	**458**	**790**	**1,737**	**6,110**	**7,758**	**10,666**	**10,005**	**11,716**
Change (%)	-26.9	72.4	119.8	251.9	27.0	37.5	-6.2	17.1
Margin (%)	3.2	4.7	6.4	14.4	17.8	15.7	12.5	14.7

Consolidated - Balance Sheet								(INR m)
Y/E March	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23E**	**FY24E**
Equity Share Capital	261	273	273	273	273	273	273	273
Total Reserves	6,887	8,949	10,443	15,446	23,194	33,112	41,616	51,575
Net Worth	**7,149**	**9,221**	**10,716**	**15,719**	**23,467**	**33,384**	**41,889**	**51,848**
Total Loans	7,239	9,866	12,286	10,279	5,775	3,007	2,105	1,473
Deferred Tax Liabilities	391	454	775	796	1,078	1,229	1,229	1,229
Capital Employed	**14,778**	**19,541**	**23,776**	**26,794**	**30,320**	**37,620**	**45,222**	**54,550**
Gross Block	6,106	6,403	17,749	20,460	22,441	25,263	32,763	40,263
Less: Accum. Deprn.	306	528	743	2,140	3,666	5,443	7,586	10,094
Net Fixed Assets	**5,801**	**5,875**	**17,006**	**18,320**	**18,774**	**19,820**	**25,177**	**30,169**
Capital WIP	3,492	9,545	339	1,723	2,068	1,037	1,037	1,037
Total Investments	**1,181**	**318**	**24**	**24**	**1,893**	**4,390**	**4,390**	**4,390**
Curr. Assets, Loans, and Adv.	**7,402**	**10,167**	**11,910**	**12,019**	**12,868**	**19,057**	**22,839**	**26,892**
Inventory	1,671	3,272	4,107	3,945	3,827	5,846	7,287	6,970
Account Receivables	3,603	4,118	5,750	6,127	7,563	11,291	13,269	13,233
Cash and Bank Balance	145	482	258	314	334	418	517	4,927
Cash	58	94	30	21	89	229	327	4,737
Bank Balance	87	388	228	293	245	189	189	189
Loans and Advances	1,982	2,296	1,795	1,633	1,144	1,503	1,766	1,762
Curr. Liability and Prov.	**3,097**	**6,364**	**5,502**	**5,292**	**5,283**	**6,684**	**8,221**	**7,938**
Account Payables	2,146	5,953	4,724	3,643	4,367	5,117	6,379	6,101
Other Current Liabilities	832	280	587	1,385	640	1,272	1,494	1,490
Provisions	119	132	191	264	276	296	347	346
Net Current Assets	**4,305**	**3,803**	**6,408**	**6,727**	**7,585**	**12,373**	**14,618**	**18,954**
Appl. of Funds	**14,779**	**19,541**	**23,776**	**26,794**	**30,320**	**37,620**	**45,222**	**54,550**

Financials and valuations

Ratios

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Basic (INR)								
EPS	**3.4**	**5.8**	**12.7**	**44.8**	**56.9**	**78.2**	**73.4**	**85.9**
EPS Growth (%)	**-27%**	**72%**	**120%**	**252%**	**27%**	**37%**	**-6%**	**17%**
Cash EPS	6.9	9.6	18.4	55.0	68.1	91.2	89.1	104.3
BV/Share	52.4	67.6	78.6	115.2	172.0	244.8	307.1	380.1
DPS	1.1	1.3	6.5	4.5	5.5	7.0	11.0	12.9
Payout (%)	19.6	27.0	61.6	12.1	9.7	9.0	15.0	15.0
Valuation (x)								
P/E	618.9	359.1	163.4	46.4	36.6	26.6	28.4	24.2
Cash P/E	302.2	215.6	112.8	37.8	30.6	22.8	23.4	19.9
P/BV	39.7	30.8	26.5	18.0	12.1	8.5	6.8	5.5
EV/Sales	20.0	17.5	11.0	6.9	6.6	4.2	3.6	3.5
EV/EBITDA	214.7	149.3	71.5	28.6	23.2	17.9	18.9	15.8
Dividend Yield (%)	0.1	0.1	0.3	0.2	0.3	0.3	0.5	0.6
FCF per share	-14.1	-32.1	-13.3	25.6	57.8	46.8	19.8	50.9
Return Ratios (%)								
RoE	7.7	9.7	17.4	46.2	39.6	37.5	26.6	25.0
RoCE	5.6	6.5	10.5	27.6	29.1	32.1	24.5	23.7
RoIC	6.5	10.7	13.5	28.0	32.1	36.7	27.4	27.3
Working Capital Ratios								
Fixed Asset Turnover (x)	2.5	2.9	2.4	2.4	2.4	3.5	3.6	2.9
Asset Turnover (x)	1.0	0.9	1.1	1.6	1.4	1.8	1.8	1.5
Inventory (Days)	42	71	56	34	32	31	33	32
Debtor (Days)	90	90	78	53	63	61	61	61
Creditor (Days)	54	130	64	31	37	27	29	28
Leverage Ratio (x)								
Current Ratio	2.4	1.6	2.2	2.3	2.4	2.9	2.8	3.4
Interest Coverage Ratio	2.6	3.2	4.0	7.7	14.7	41.9	63.5	106.4
Net Debt/Equity ratio	1.0	1.0	1.1	0.6	0.2	0.1	0.0	-0.1

Consolidated - Cash Flow Statement **(INR m)**

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
OP/(Loss) before Tax	1,347	1,109	2,680	8,064	10,417	14,345	13,371	15,657
Depreciation	480	528	778	1,397	1,526	1,777	2,143	2,508
Others	-403	481	829	1,262	852	295	204	143
Direct Taxes Paid	-162	-279	-561	-1,985	-2,365	-3,535	-3,365	-3,941
(Inc.)/Dec. in WC	-772	-9	-3,123	-1,092	-412	-4,643	-2,147	75
CF from Operations	**490**	**1,830**	**603**	**7,647**	**10,019**	**8,239**	**10,206**	**14,442**
(Inc.)/Dec. in FA	-2,412	-6,206	-2,410	-4,160	-2,140	-1,862	-7,500	-7,500
Free Cash Flow	**-1,922**	**-4,376**	**-1,808**	**3,487**	**7,879**	**6,377**	**2,706**	**6,942**
Change in Investments	-296	906	299	3	-1,854	-2,401	0	0
Others	-817	53	486	-122	33	22	0	0
CF from Investments	**-3,526**	**-5,247**	**-1,626**	**-4,279**	**-3,961**	**-4,241**	**-7,500**	**-7,500**
Issue of Shares	1,464	1,463	0	0	0	0	0	0
Inc./(Dec.) in Debt	2,160	2,626	2,033	-1,088	-5,246	-2,812	-902	-631
Interest Paid	-342	-450	-841	-1,134	-736	-320	-204	-143
Dividend Paid	-167	-188	-213	-1,060	-4	-750	-1,501	-1,757
Others	-69	2	-20	-94	-5	24	0	0
CF from Fin. Activity	**3,046**	**3,453**	**958**	**-3,376**	**-5,990**	**-3,858**	**-2,607**	**-2,532**
Inc./Dec. in Cash	**10**	**36**	**-64**	**-8**	**68**	**139**	**98**	**4,410**
Opening Balance	47	58	94	30	22	90	229	328
Closing Balance	**58**	**94**	**30**	**22**	**90**	**229**	**328**	**4,738**

N O T E sS

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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