Deepak Nitrite Ltd (DNL)	
No. of shares (m)	116.3
Mkt cap (Rs crs/$m)	1450/217.0
Current price (Rs/$)	125/1.9
Price target (Rs/$)	153/2.3
52 W H/L (Rs.)	130/54
Book Value (Rs/$)	47/0.7
Beta	0.7
Daily volume (avg. monthly)	331300
P/BV (FY17e/18e)	2.2/2.0
EV/EBITDA (FY17e/18e)	10.0/8.6
P/E (FY17e/18e)	18.4/16.3
EPS growth (FY16/17e/18e)	14.0/12.7
OPM (FY16/17e/18e)	12.3/13.2/13.8
ROE (FY16/17e/18e)	15.6/13.6/12.9
ROCE(FY16/17e/18e)	9.7/8.4/7.1
D/E ratio (FY16/17e/18e)	1.1/1.1/1.7
BSE Code	506401
NSE Code	DEEPAKNTR
Bloomberg	DN IN
Reuters	DPNT.BO

Shareholding pattern	%
Promoters	52.0
MFs / Banks / FIs	7.0
Foreign	7.1
Govt. Holding	0.0
Public & others	34.0
Total	**100.0**

As on Jun 30, 2016

Recommendation

BUY

Analyst

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Company brief

Sorted into basic chemicals, fine & specialty chemicals and performance products, Deepak Nitrite's product portfolio consists of organic, inorganic and fine chemicals - for use in detergents, colorants, paper, agro chemicals, rubber etc.

Highlights

- Mammoth capacities (relative to size of DNL) of phenol and acetone are being erected to satiate India's rising demand for chemicals which find varied use - phenol in laminates, paints and automobile lining; acetone in pharmaceuticals, paints, adhesives & thinners etc. By developing marketing and distribution channels across India, DNL plans not only to replace imports but spur local demand. It reckons that over four-fifths of India's demand of acetone and phenol is imported – nearly 100% of their derivatives are imported, necessitating local supply base.
- Post commissioning of the hydrogenation plant at Dahej - facilitating development of various product lines - resource mobilization has now gathered pace for the coveted Rs 1200 crs ($179.5m) phenol and acetone project - expected to start by early 2018 - one of its kind in India. Debt amassment for the project (Rs 720 crs/$107.7m) leaves little scope of margin of error for misjudgment of any kind - be it product demand -supply appraisal or project costs - can have deleterious effects, despite the project being handled by global majors.
- Pacing up newly launched intermediates of personal care and pharmaceuticals and OBA - in export markets - would fasten mobilization of internal accruals for the phenol project. EBIT margin for FSC segment is estimated to rise by 270 bps in current fiscal, supporting two-thirds of allocable EBIT. DNL's overseas endeavors for OBA (Optical Brightening Agent) products would boost capacity utilization at its FWA (Fluorescent Whitening Agent) facility in Dahej.
- The stock currently trades at 18.4x FY17e EPS of Rs 6.78 and 16.4x FY18e EPS of Rs 7.64. Ramification of adverse fx movement, project delays and subtlety of FWA business - Rs 8.7 crs deficit last fiscal - could somewhat annul forbearance of entrenched FSC (Fine & Specialty Chemicals) and BCC (Bulk Chemicals & Commodities) segments. Yet high entry barriers for the phenol business - multitude of government approvals being one of the many - are nauseating for new entrants. Ample scope exists to launch key derivatives of phenol and acetone at a later stage. We assign buy rating with target of Rs 153 based on 20x FY18e earnings (peg ratio: 0.9) over a period of 6-9 months.

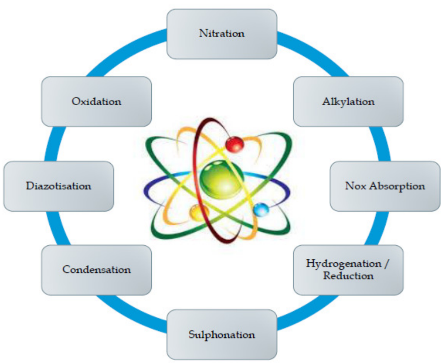
Consolidated (Rs crs)	FY15	FY16	FY17e	FY18e
Income from operations	1327.16	1372.93	1414.02	1588.50
Other Income	2.07	1.59	72.29	1.02
EBITDA (other income included)	141.31	168.39	258.80	219.68
Profit after associate profit	52.98	63.89	80.52	96.47
EPS(Rs)	5.07	5.94	6.78	7.64
EPS growth (%)	-	17.3	14.0	12.7

Company Profile

Deepak Nitrite, a leading supplier of organic, inorganic and fine chemicals, specializes in hydrogenation, nitration, customized molecule development, hazardous reactions and toluene derivatives. Its products - manufactured at its plants in Nandesari & Dahej in Gujarat, Roha and Taloja in Maharashtra, and at Hyderabad in Andhra Pradesh - finds end use in agro-chemicals, dyestuffs, pigments, inks, whiteners, pharmaceuticals, fuel additives, textiles and paper. For few products like sodium nitrite, sodium nitrate and nitro toluenes it has market supremacy in India, while for some like xylidines, cumidines and oximes it is amongst top global suppliers.

Its subsidiary, Deepak Phenolics, is setting up a plant for manufacturing phenol and acetone. In 2013, it commissioned optical brightening agents (OBA) facility (port supported) at Dahej and also undertook brownfield expansion for inorganic salts at Nandesari (Gujarat). Its Hyderabad plant - acquired from Vasant Chemicals - supplies DASDA (zero discharge toluene derivative), which is used in production of OBA.

Source: Deepak Nitrite



Plant location	Products	remarks
Dahej (Gujarat)	OBA for paper, detergent, textiles	200 lb production capacity
Nandesari(Gujarat)	bulk & commodities and fine & specialty chemicals	equipped with ETPs
Taloja (Mah.)	Hydrogenation and noble metal catalysis specialty	products mainly exported
Roha (Mah.)	Multispecialty site	intermediates for agro-chemicals
Hyderabad (A.P)	DASDA	20% world share

Source: Deepak Nitrite

Product Profile

Deepak Nitrite classifies its product portfolio into three segments namely basic chemicals, fine & specialty chemicals and performance products.

Basic Chemicals

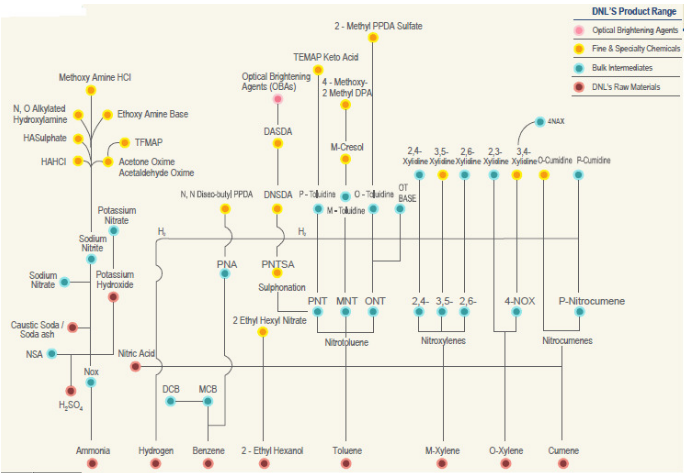
Includes low to moderate margin - high volume - commodity chemicals such as nitro toluene, sodium nitrite and sodium nitrate. User industries for nitro-toluene include colorants, specialty chemicals, rubber chemicals, pharmaceuticals, dyes and agro-chemicals. Sodium nitrite finds use in dyes/pigments, food colors, pharma intermediates, electroplating etc.

Fine & specialty chemicals

In stark contrast to basic chemicals, this segment handles low volume - high margin customized products- specialty chemicals, xylidines, oximes, cumidines, nitro oxylene amongst others. Focused on B2B supply model, this segment supplies to a whole host of unrelated industries - agro chemicals, pharmaceuticals, paper, pigments etc.

Performance products

It supplies OBA and its intermediate DASDA. Deepak brags about being the world's sole fully integrated OBA manufacturer (Toluene - PNT - DASDA - OBA). OBA finds extensive use in paper, detergents and textile industries.



Source: Deepak Nitrite

Bulk intermediates	Fine & Specialty chemicals	Fluorescent Whitening Agents
• Nitro Tolunes colourants; pharma; dyes; rubber chemicals; explosives • Fuel additives refinery • Sodium nitrite dyes/pigments; food colours; colourants; specialty chemicals	• Specialty colourants • Xylidines pigment; pharma intermediates; agro chemicals • Oximes agro chemicals • Cumidines agro chemicals	• DASDA/FWA paper; textiles; detergents

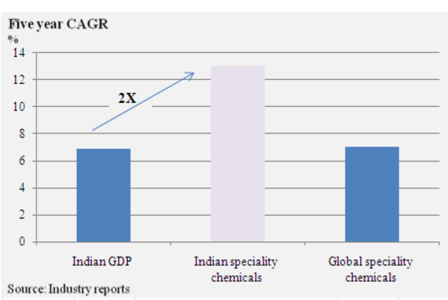
Source: Deepak Nitrite

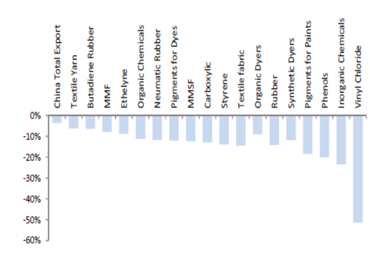
Investment Thesis

Specialty chemicals industry

Changing dynamics of global specialty chemicals industry in past year or so has reinvigorated fortunes of Indian specialty chemical manufacturers. Tellingly, strict implementation of environment control regulations in China has led to shutdown of plants across the country, benefitting Indian players the most. Industry reports suggest that China chemical exports could fall for second year in a row which could open up huge export opportunities for Indian manufacturers, particularly producers of polymers, dyes & pigments, textile chemicals and agro chemicals. Reports also indicate that India's share in global specialty chemical industry is estimated to grow 6-7% in 2023 from 2.8% in 2013 with market size in excess of $80 bn.

Reports further presage that the Indian specialty chemicals industry - worth $25 bn and growing at 12%- could be worth $33.2bn by 2019. Apart from factors such as low cost labour and raw material availability, increasing sophistication of Indian players in product innovation, branding and innovation would help matters too. Further low per capita consumption of chemicals in India, strong GDP growth and rapid progress in key user industries domestically would stimulate industry growth.



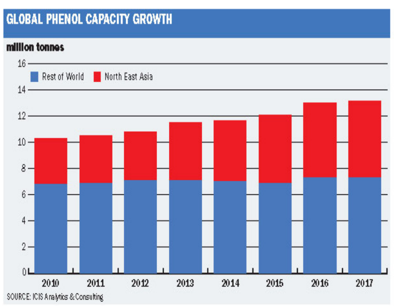


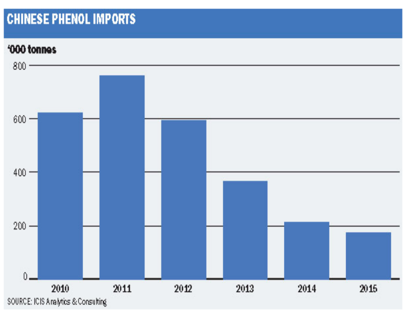
Yet product innovation and robust R&D processes holds key, reckons Deepak Bhimani, president of Indian Speciality Chemical Manufacturers' Association (ISCMA), and CMD, Navdeep Chemicals. He also posits that Indian companies have to adopt inter-disciplinary approach to research. Collaboration with global firms to jointly manufacture specialty chemicals should not be overlooked. Sensing growing state intervention favoring state owned firms in China and rising labor costs, MNCs are de-risking their sourcing arrangements by adding other developing economies - that bodes well for India.

Phenol & Acetone markets

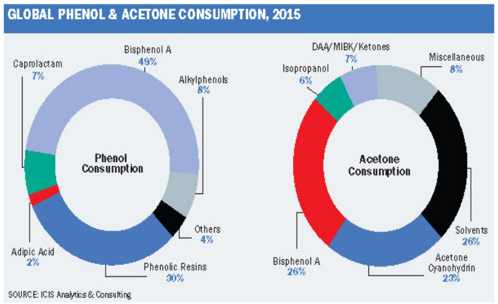
The global phenol and acetone markets have seen a sharp increase in capacities in the last five years with more than 2.1m tonnes phenol capacity being added between 2010 and 2016 , of which over 2m tonnes has been added in Asia, led by China. In 2015, three new plants with a combined annual capacity of 8 lakh tonnes were commissioned in China, which along with earlier expansions has seen threefold increase in its phenol capacity since 2010. More capacity additions have come or is expected to come on stream in Asia in 2016 - Thailand's PTT Phenol 2.5 lakh tonne per annum (tpa) plant and South Korea's Kumho P&B 3 lakh tpa plant.

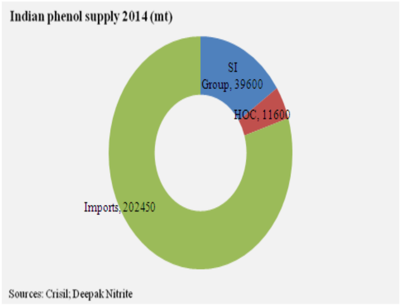
Other projects in pipeline include Petro Rabigh's 2.75 lakh tpa plant in Saudi Arabia and 4 lakh tpa plant of YPC Phenol (JV between INEOS Phenol and Sinopec YPC) in Nanjing. At a time when new capacities have come up, global demand growth for phenol, acetone and their derivatives has slowed down. Pertinently, its derivatives like bisphenol-A (BPA), polycarbonate, epoxy resins, phenolic resins and methyl methacrylate (MMA) have also seen increased investment in new capacities in last few years. Despite new capacities of downstream products, actual demand for derivatives has not moved in tandem with construction demand, pushing down average operating rates for phenol. Main factors precipitating this decline include fall in optical media usage for polycarbonate and slowdown in BRIC economies.

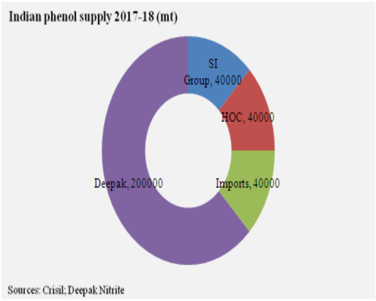




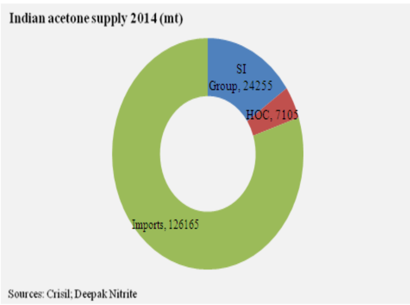
ICIS Consulting expects operating rates to remain in low to mid 80% range until 2020 and phenol demand to rise by 3% per year during this period - lead by Asia and South America. For acetone, new capacity additions in Asia have far less impact on global markets. Despite over 1m tonnes of capacity addition in past five years, global operating rates for acetone have neared 85%. ICIS projects sub 3% annual growth for acetone for the next ten years - more or less in line with half decade growth of 3%.

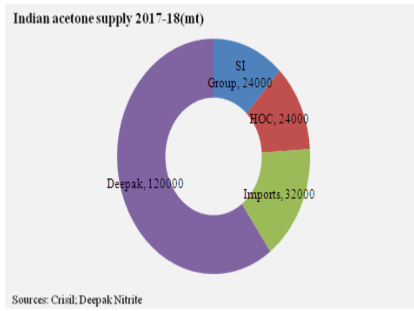






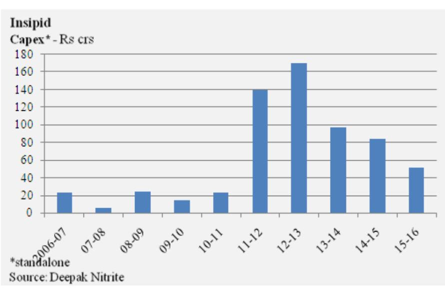
But with dwindling Chinese imports - a fall of 5 lakh tonnes in 2015 compared with 2011- phenol exports of Europe and USA have been hit hard. India, which imported 2.45 lakh tonnes of phenol in 2015, overtook China as Asia's largest buyer. With lackluster Chinese imports and lack of alternative markets in Asia, most of the surplus Asian phenol production is now expected to be dumped in India, where domestic supplies cover just one-fifth of the total demand. To protect its local producers, India has time and again slapped prohibitive duties on phenol.

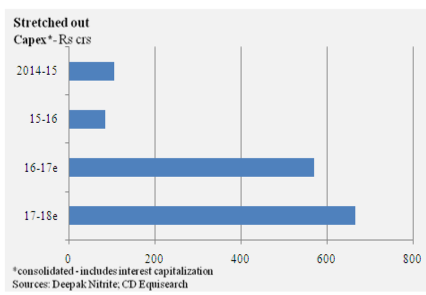




Capex

A capex program of monstrous proportions is being undertaken at Dahej (Gujarat) which on completion in 2018 would have magnifying effect on its assets & turnover- fixed assets 1.3x over; total assets 1.6x over; turnover to treble at least. Pegged at Rs 1200 crs ($179.5m), this asset splurge vastly belittles the combined fixed asset accretion of last ten years (Rs 632 crs/$94.6m), undermining hidden risks of cost over runs, project delays and crippling impact of random government policies. Funded majorly by debt (debt/equity: 60/40), the program entails setting up 2 lakh tpa capacity of phenol and 1.2 lakh tpa of co-product acetone in technical assistance with Kellogg, Brown & Root International, Inc., while ThyssenKrupp Industrial Solutions would handle the EPC services. The project also includes 2.6 lakh tpa capacity of cumene - feedstock for phenol and acetone - to be manufactured with technical support of UOP Honeywell.

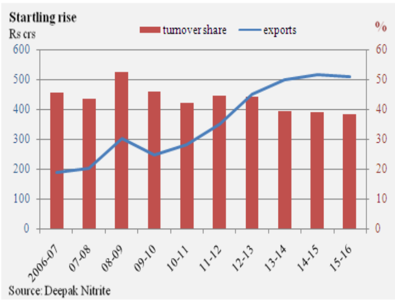


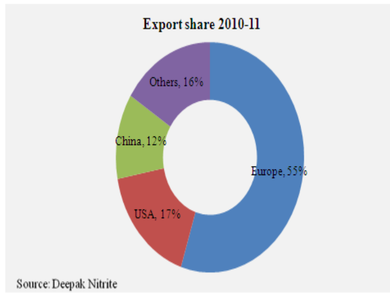


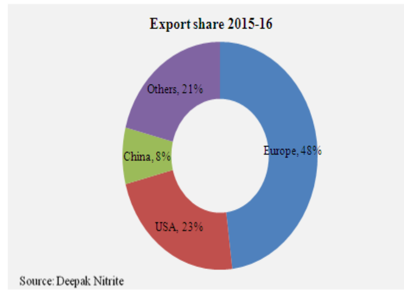
Equity funding for the project would follow a motley of initiatives - QIP funding; internal accruals; land sale. Nearly Rs 80 crs ($12m) was raised through a QIP last fiscal (11.75m shares at Rs 70.90 per share) and Rs 120 crs ($18m) fund raising (board resolution for Rs 150 crs/$22.4m) is planned in the current fiscal. Land sale garnered some Rs 71 crs ($10.6m) in the first quarter with internal accruals expected to imbue the gap. Startlingly, DNL's all recent expansions pale to the phenol project - be it the OBA project at Dahej (fully commissioned in 2014) or salts facility at Nandesari (started in 2013). The former emboldened its forward integration pursuits by using nitro toluene for DASDA production, which further produces OBA.

Exports

Despite much hyperbole of Indian chemical export possibility, DNL's exports have grown just one-seventh in last three years. Stung by miserable off take of fuel additives - low crude oil prices to be blamed for - exports rose by a disconcerting 3.2% in fiscal 2014-15, undoing vitality of the past. Peppiness in FSC segment failed to preclude a marginal decline in sales last fiscal. Sclerosis in European economies of late has not been less deleterious, pummeling DNL's European market export share by six percentage points in last three years. In contrast, economic healthiness of Germany and Switzerland helped its exports advance by 24.3% in fiscal 2011-12, the year it completed the CLP notification under REACH for all its EU exports. Yet the fledgling OBA business holds promise - bagged large orders from MNCs in paper and detergent industry. Distribution network and dilution facility for OBA in US would also help to tap local resources.



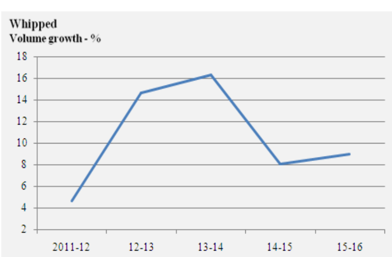


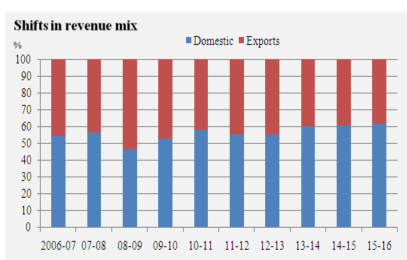


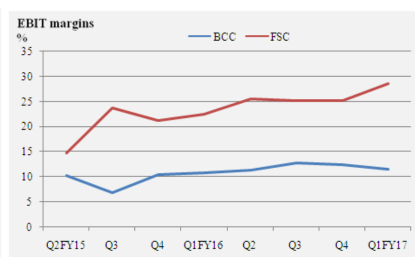
Financials & Valuation

Ambiguity of sorts permeates for DNL's phenol project risks scuppering its existing set up not least due to project's gargantuan investments, shrouding hidden risks - debt equity ratio to climb to 1.7 by FY18 before the commencement of the project; return on capital would deplorably fall. Handling of the project by global majors - ThyssenKrupp Industrial; Kellogg, Brown & Root International; UOP Honeywell - would barely help to circumvent pernicious import centric government policy and cost over runs - consequently constricts funding options. Estimates of project payback period mostly avoid considering stress in product demand - here phenol and acetone, the annual demand growth for whom is projected at 7-8%.

Yet financing risks have withered somewhat for debt portion has been fully tied up and nearly half of required equity raised. Pending project commissioning, exports of OBA and recently launched high margin pharma and personal care intermediates would lever business growth, whose pace stalled in last couple of years thanks to tumult in crude oil markets. Volumes too failed to remain impervious to abject uncertainty as its growth dwindled to 9% last fiscal from 16.4% in FY14 - crude oil prices topped out in 2014. Yet value addition stays obliquely paramount, particularly in FSC segment, for it obliterated much of the stress in other segments by recording 24% volume growth and 574 bps expansion in margins - 57% growth in EBIT - last fiscal.

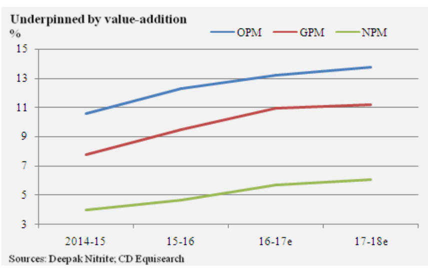


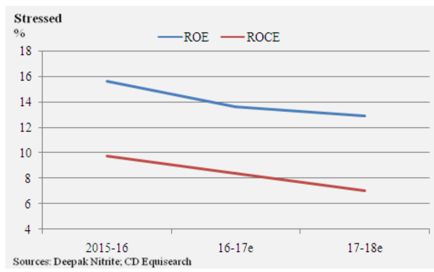




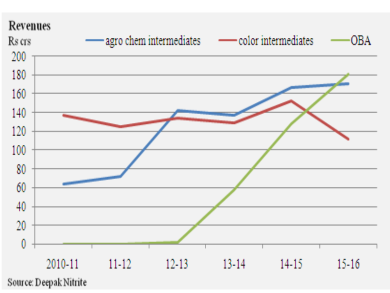
The quarter gone by portends further increase in FSC segment margins, while the BCC segment grinds to prevent margin erosion resulting from intense competition. DNL's prophecy of FSC segment portfolio diversification gained prominence with its launch of new drug intermediates for anti-biotics and decongestant therapeutic segments and securing long term supply contract for personal care intermediates; not to count large supply contract for agro intermediates from Bayer CropScience. Resurgence of exports rests on establishing local presence in USA for OBA business.

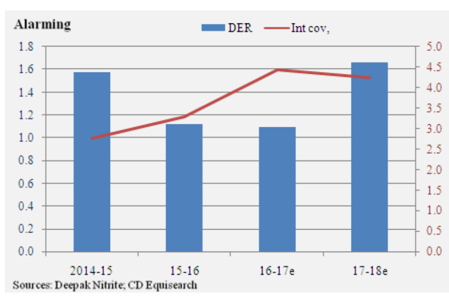
Though capitalization of interest expense - related to Phenol project debt - would shield earning deterioration over the next two years, operating cash flows and return on capital can hardly avoid being buffeted - ROE to drop to 7.1% by FY18, shaving off 260 bps from the current reading. Temporary setbacks to earnings growth, turnover and leverage ratios cannot be obscurely undermined for randomness emanating from external events incite tail risks. Steady accretion of operating cash flows would deter thwarting funding plans (read: internal accruals) of the phenol and acetone project, bypassing funding risks.





The stock currently trades at 18.4x FY17e EPS of Rs 6.78 and 16.4x FY18e EPS of Rs 7.64. Average EPS growth of 12.9% (over the next two years) masks underlying buoyancy in earnings (22.8% annual growth) for the benefits of the funds raised (or to be raised) from the QIP issue will not accrue till the commencement of the phenol project. Notwithstanding humungous opportunities in newly laid projects, frailties to hidden risks - such as deferment of project, Chinese competition et al - is doubtless worthy of evaluation, Investors' could abstain from denigrating the amassment of debt not least because of its fleeting effect. On balance we recommend buying the stock with target of Rs 153 based on 20x FY18e earnings (peg ratio: 0.9) over a period of 6-9 months.





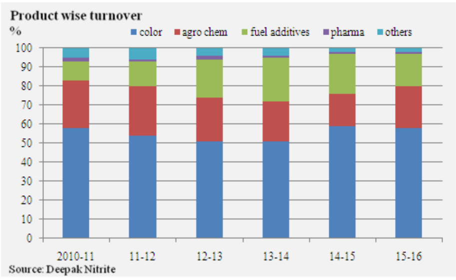
Risks & Concerns

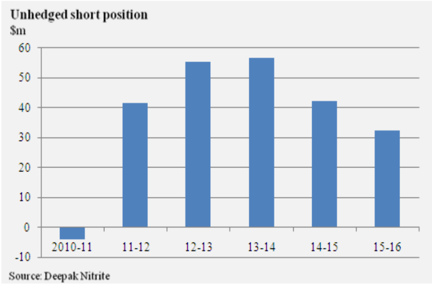
Business risks

DNL's various businesses - agro chemicals; colorants; fuel additives - suffer from uncertainties of different kinds - agro chemicals from vagaries of monsoons; colorants from fragility of demand from end user industries; fuel additives from vicious regulatory issues concerning fuel pricing. Weak environmental control activities and intense competitive intensity - more evident in bulk chemicals intermediates - pose noteworthy risks.

Currency risks

Given its net long dollar position arising out of exports, appreciation of rupee impacts its competitiveness. So it has consistently held large unhedged short dollar positions over the last five years, to counter foreign exchange volatility.

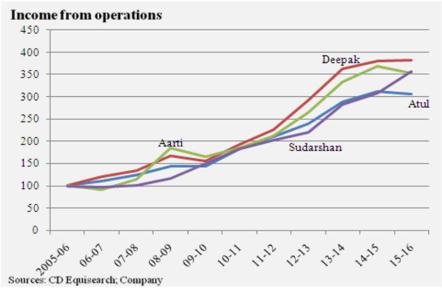


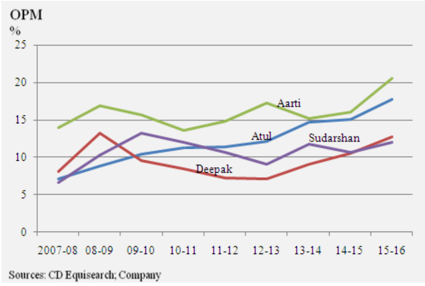


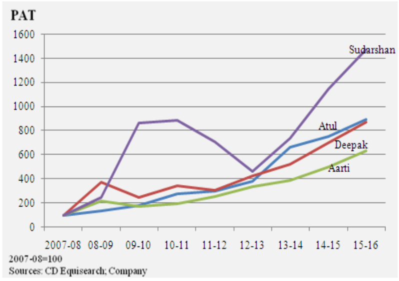
Cross Sectional Analysis

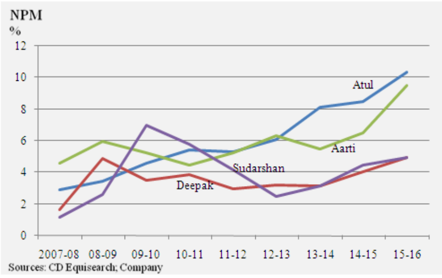
Company	Equity*	CMP	Mcap*	IO	Profit*	OPM	NPM	Int. coverage	ROE	Mcap / IO	P/BV	P/E
Aarti Inds.	42	617	5142	2705	274	20.4	10.1	4.1	25.5	1.9	4.5	18.8
Atul Ltd	30	2190	6495	2508	285	18.0	11.4	15.3	23.4	2.6	4.9	22.8
Deepak Nitrite	23	125	1450	1311	66	13.1	5.0	3.6	16.2	1.1	2.7	22.1
Sudarshan Chem	14	412	2849	1250	85	13.7	6.8	5.5	23.6	2.3	8.0	33.5

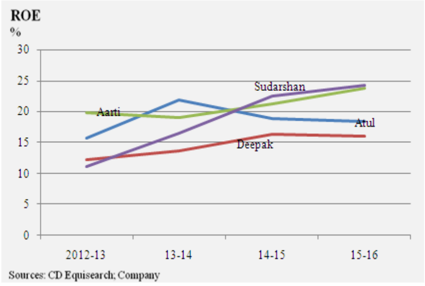
*figures in crores; calculations on ttm basis
Companies not truly comparable due to product dissimilarity











Financials

Quarterly Results -Standalone

Figures in Rs crs

	Q1FY17	Q1FY16	% chg.	FY16	FY15	% chg.
Income from operations	**313.70**	**338.32**	**-7.3**	**1335.73**	**1327.16**	**0.6**
Other Income	73.06	0.20	36394.2	1.54	2.05	-24.9
Total Income	**386.76**	**338.52**	**14.2**	**1337.27**	**1329.22**	**0.6**
Total Expenditure	274.65	300.35	-8.6	1167.39	1187.46	-1.7
PBIDT (other income included)	**112.10**	**38.18**	**193.7**	**169.88**	**141.76**	**19.8**
Interest	8.37	10.02	-16.4	39.10	37.99	2.9
Depreciation	10.51	9.49	10.8	39.45	36.02	9.5
PBT	**93.22**	**18.67**	**399.3**	**91.33**	**67.74**	**34.8**
Tax	25.36	5.31	377.5	26.18	14.30	83.1
PAT	**67.86**	**13.36**	**408.0**	**65.15**	**53.44**	**21.9**
Extraordinary Item	55.20	-	-	-1.16	-0.08	1299.2
Adjusted Net Profit	**12.66**	**13.36**	**-5.2**	**66.32**	**53.52**	**23.9**
EPS (F.V. 2)	5.84	1.28	356.7	6.17	5.12	20.5

Segment Results

Figures in Rs crs

	Q1FY17	Q1FY16	% chg.	FY16	FY15	% chg.
Segment Revenue						
Basic Chemicals	155.01	181.89	-14.8	674.56	749.59	-10.0
Fine & Specialty Chemicals	98.77	95.25	3.7	393.37	326.20	20.6
Performance Products	61.72	62.14	-0.7	273.68	266.18	2.8
Others - unallocable	1.54	0.93	65.4	5.78	5.42	6.7
Total	**317.05**	**340.22**	**-6.8**	**1347.39**	**1347.39**	**0.0**
Inter segment revenue	3.35	1.89	76.9	11.67	20.23	-42.3
Net sales / Income from operations	**313.70**	**338.32**	**-7.3**	**1335.73**	**1327.16**	**0.6**
Segment EBIT						
Basic Chemicals	17.79	19.84	-10.3	79.59	73.54	8.2
Fine & Specialty Chemicals	28.34	21.51	31.7	97.19	61.88	57.1
Performance Products	-2.84	-2.14	32.5	-8.71	0.66	-1425.9
Total	**43.29**	**39.21**	**10.4**	**168.07**	**136.08**	**23.5**
Interest	8.37	10.02	-16.4	37.45	36.41	2.9
Other Unallocable Exp. (net of income)	-58.30	10.53	-653.8	39.30	31.93	23.1
PBT	**93.22**	**18.67**	**399.3**	**91.33**	**67.74**	**34.8**

Financials

Income Statement - Consolidated

Figures in Rs crs

	FY15	FY16	FY17e	FY18e
Income from operations	**1327.16**	**1372.93**	**1414.02**	**1588.50**
Growth (%)	-	3.4	3.0	12.3
Other Income	2.07	1.59	72.29	1.02
Total Income	**1329.23**	**1374.52**	**1486.31**	**1589.51**
Total Expenditure	1187.92	1206.13	1227.51	1369.84
EBITDA (other income included)	**141.31**	**168.39**	**258.80**	**219.68**
Interest	37.99	39.71	33.15	42.12
EBDT	**103.31**	**128.68**	**225.66**	**177.56**
Depreciation	36.02	39.54	41.27	41.48
Tax	14.30	26.23	48.52	39.46
Net profit	**52.99**	**62.91**	**135.87**	**96.62**
Profit/(loss) of associate	-0.09	-0.17	-0.15	-0.15
Net profit after associate profit	**52.90**	**62.74**	**135.72**	**96.47**
Extraordinary item	-0.08	-1.15	55.20	-
Adjusted Net Profit	**52.98**	**63.89**	**80.52**	**96.47**
EPS (Rs.)	5.07	5.94	6.78	7.64

Segment Results

Figures in Rs crs

	FY15	FY16	FY17e	FY18e
Segment Revenue				
Basic Chemicals	749.59	674.56	607.10	667.81
Fine & Speciality Chemicals	326.20	393.37	464.70	532.67
Performance Products	266.18	273.68	309.21	352.05
Others - unallocable	5.42	42.99	47.29	52.02
Total	**1347.39**	**1384.60**	**1428.31**	**1604.54**
Inter segment revenue	20.23	11.67	14.28	16.05
Net sales / Income from operations	**1327.16**	**1372.93**	**1414.02**	**1588.50**
Segment EBIT				
Basic Chemicals	73.54	79.59	70.42	78.47
Fine & Speciality Chemicals	61.88	97.19	125.47	146.48
Performance Products	0.66	-8.71	-12.37	-7.04
Sub Total	**136.08**	**168.07**	**183.53**	**217.91**
Interest	36.41	37.65	31.02	39.74
Other Unallocable Exp. (net of income)	32.38	41.29	-31.89	42.10
PBT	**67.29**	**89.13**	**184.39**	**136.08**

Consolidated Balance Sheet

Figures in Rs crs

	FY15	FY16	FY17e	FY18e
SOURCES OF FUNDS				
Share Capital	20.91	23.26	25.26	25.26
Reserves	325.31	449.61	685.08	760.27
Total Shareholders Funds	**346.22**	**472.87**	**710.34**	**785.53**
Long term debt	238.60	158.93	416.53	880.00
Total Liabilities	**584.82**	**631.80**	**1126.88**	**1665.53**
APPLICATION OF FUNDS				
Gross Block	817.38	899.03	905.31	915.40
Less: Accumulated Depreciation	268.65	301.31	332.92	374.40
Net Block	**548.73**	**597.72**	**572.38**	**541.01**
Capital Work in Progress	43.96	31.93	584.76	1241.05
Investments	2.98	86.60	32.66	2.51
Current Assets, Loans & Advances				
Inventory	105.04	121.02	129.49	138.56
Sundry Debtors	310.99	313.19	328.85	353.51
Cash and Bank	3.06	6.49	5.85	8.89
Other Assets	54.14	56.67	55.70	58.45
Total CA & LA	**473.23**	**497.37**	**519.89**	**559.42**
Current liabilities	469.73	577.73	567.39	649.74
Provisions	14.32	20.25	22.62	26.66
Total Current Liabilities	**484.05**	**597.98**	**590.01**	**676.41**
Net Current Assets	-10.82	-100.61	-70.12	-116.99
Net Deferred Tax (net of liability)	-46.32	-56.65	-66.65	-76.65
Other Assets (Net of liabilities)	46.29	72.81	73.85	74.60
Total Assets	**584.82**	**631.80**	**1126.88**	**1665.53**

Cash Flow Statement

Figures in Rs crs

	FY15	FY16	FY17e	FY18e
Net Income **(a)**	52.99	62.91	135.87	96.62
Non cash exp. & others (b)	**47.85**	**52.60**	**-20.68**	**50.80**
Depreciation	36.02	39.54	41.27	41.48
Profit / loss on sale of assets	0.34	1.63	-70.77	-
Dividend income	-0.03	-0.51	-0.70	-0.20
Interest income	-0.62	-0.54	-0.48	-0.48
Deferred tax & others	11.55	10.33	10.00	10.00
Others	0.60	2.15	-	-
(Increase) / decrease in NWC (c)	**-30.33**	**13.37**	**-8.66**	**-15.33**
Inventory	24.91	-15.98	-8.47	-9.06
Debtors	-18.75	-4.35	-15.66	-24.66
Trade payables	-31.64	23.55	15.97	14.91
Loans & Advances	12.34	-8.76	2.29	-4.06
Others	-13.63	-2.83	-	-
Current liabilities	-3.56	21.74	-2.79	7.56
Operating cash flow - CFO (a+b+c)	**70.51**	**128.88**	**106.52**	**132.09**
Capex	-106.09	-85.55	-570.24	-666.70
Sale of fixed assets	1.25	0.22	70.77	-
Others	15.00	0.00	-15.00	-
Current investments	-	-83.79	53.79	30.00
Subsidiary investment	-0.05	-	-	-
Dividend income	0.03	0.51	0.70	0.20
Interest received	0.74	0.40	0.48	0.48
Investing cash flow - CFI (d)	**-89.12**	**-168.20**	**-459.50**	**-636.02**
Net borrowings	27.37	-25.43	249.13	525.22
Dividends & others	-12.17	-12.53	-16.80	-18.24
Dividends paid	-10.39	-10.40	-13.95	-15.16
CDT	-1.78	-2.13	-2.84	-3.09
Equity issuance	-	80.71	120.00	-
Financing cash flow - CFF (e)	**15.21**	**42.75**	**352.34**	**506.98**
Net change (a+b+c+d+e)	-3.40	3.43	-0.64	3.04

Key Financial Ratios

	FY15	FY16	FY17e	FY18e
Growth Ratios				
Revenue (%)	-	3.4	3.0	12.3
EBIDTA (%)	-	20.2	10.6	16.8
Net Profit (%)	-	20.6	26.0	19.8
EPS (%)	-	17.3	14.0	12.7
Margins				
Operating Profit Margin (%)	10.6	12.3	13.2	13.8
Gross Profit Margin (%)	7.8	9.5	11.0	11.2
Net Profit Margin (%)	4.0	4.7	5.7	6.1
Return				
ROCE (%)	-	9.7	8.4	7.1
RONW (%)	-	15.6	13.6	12.9
Valuations				
Market Cap / Sales	0.5	0.6	1.0	0.9
EV/EBIDTA	8.9	7.2	10.0	8.6
P/E	13.5	11.4	18.4	16.3
P/BV	2.1	1.7	2.2	2.0
Other Ratios				
Interest Coverage	2.8	3.3	4.4	4.2
Debt-Equity Ratio	1.6	1.1	1.1	1.7
Current Ratio	1.0	1.0	0.9	0.8
Turnover Ratios				
Fixed Asset Turnover	-	2.4	2.4	2.9
Total Asset Turnover	-	2.3	1.6	1.1
Debtors Turnover	-	4.4	4.4	4.7
Inventory Turnover	-	10.7	9.8	10.2
Creditors Turnover	-	9.9	8.7	8.8
WC Ratios				
Debtor Days	-	83.0	82.9	78.4
Inventory Days	-	34.3	37.2	35.7
Creditor Days	-	36.8	42.0	41.7
Cash Conversion Cycle	-	80.5	78.2	72.4
Cash Flows				
CFO /EBITDA	0.5	0.8	0.6	0.6
FCFF (Rs crs)	11.3	72.5	-328.5	-474.0
FCFE (Rs crs)	8.8	19.0	-103.8	21.3

Cumulative Financial Data

Figures in Rs crs	FY08-10	FY11-13	FY14-16
Income from operations	1592	2482	3933
Operating profit	168	189	427
EBIT	124	144	326
PBT	79	114	221
PAT	55	82	160
Dividends	16	24	42
OPM (%)	10.5	7.6	10.9
NPM (%)	3.5	3.3	4.1
Interest coverage	2.8	4.9	3.1
ROE (%)	9.7	11.0	14.1
ROCE (%)	9.4	7.4	9.9
Debt-equity ratio*	0.3	1.2	0.9
Fixed asset turnover	3.2	3.5	2.9
Debtors turnover	5.0	4.8	4.9
Inventory turnover	7.4	9.1	10.4
Creditors turnover	7.1	5.5	7.0
Debtors days	73.0	76.0	75.0
Inventory days	49.6	40.0	35.2
Creditor days	51.4	66.2	52.2
Cash conversion cycle	71.2	49.7	57.9
Dividend payout ratio (%)	28.1	28.1	26.5

FY07-09 implies three years ending fiscal 09; *as on terminal year; standalone data

Dramatic change in fortunes resulting both from sharp rise in revenues and higher margins vitalized profits in three years ending fiscal 2016 - Rs 160 crs ($23.9m) vs Rs 82 crs($12.2m) in FY11-13 period. Higher off take of inorganic salts (+81%), nitro aromatic (+84%), agro chem intermediates (+70%) and OBA buttressed sales, redressing sketchy trends in operating profit (Rs 427 crs ($63.9m) vs Rs 189 crs($28.2m)). Contrary to expectations, domestic sales (+72%) outpaced export revenues (+41%) in last three years, flinging export revenue contribution into an unremitting decline - 48.2% in FY08-10 to 43.6% in FY11-13 to 38.9% in FY14-16.

Changes in product mix and moderation in crude oil prices helped expansion in OPMs to 10.9% compared to 7.6% in FY11-13 period, demonstrated in 559 bps fall in raw material / sales ratio; power cost / sales ratio too slid by 60 bps. That stoked inexorable gains in return on capital - ROE has decidedly risen in last five years - despite woeful asset turnover ratios. Yet cash conversion cycle has lengthened to 58 days from some 50 days largely due to withering creditor days.

Financial Summary – US dollar denominated

million $	FY15	FY16	FY17e	FY18e
Equity capital	3.3	3.5	3.8	3.8
Shareholders funds	55.2	71.2	106.2	117.4
Total debt	87.0	79.7	116.5	195.12
Net fixed assets (incl CWIP)	94.6	94.8	173.0	266.5
Investments	0.5	13.1	4.9	0.4
Net current assets	-1.7	-15.2	-10.5	-17.5
Total assets	93.3	95.1	168.5	249.1
Revenues	217.0	209.7	211.6	237.7
EBITDA	23.1	26.0	28.1	32.9
EBDT	16.9	19.9	23.2	26.6
PBT	11.0	13.9	17.0	20.4
Profit after associate profit	8.7	9.8	12.0	14.4
EPS($)	0.08	0.09	0.10	0.11
Book value ($)	0.53	0.61	0.84	0.93
Operating cash flow	11.3	19.4	15.9	19.8
Investing cash flow	-14.2	-25.4	-68.7	-95.2
Financing cash flow	2.4	6.4	52.7	75.8

income statement figures translated at average rates; balance sheet and cash flow at year end rates; projections at current rates
All dollar denominated figures are adjusted for extraordinary items.

Recommendation

Emergence of new global capacities of phenol and acetone in the last few years, most notably in China, have reset trade flows, with India transpiring as one of the world's most lucrative markets for phenol - market potential: 2.75 lakh tonnes. Alarmed by China's self sufficiency in phenol most Asian phenol exporters look to India as the most lucrative market, precipitating threats of brutal dumping.

To safeguard domestic manufacturers, Indian government imposed anti-dumping duty, ranging from $47.29-$196.24 a tonne, on US and Chinese Taipei imports of phenol in 2014. Earlier this year, Directorate General of Anti-dumping and Allied Duties (DGAD) of Indian Commerce Ministry recommended imposing anti-dumping duty in the range of USD 77.19 per tonne and USD 253.06 per tonne on import of phenol from EU, Korea and Singapore for these countries were exporting to India 'below its associated normal value'.

However, opportune it may look - India's large import dependent market for phenol and acetone with 7-8% annual growth - ever-changing global trade flows would test the resolve of DNL's blood-curdling size of capital investments in phenol and acetone project - nearly twice the size of its existing fixed asset base. Unruly market dynamics of phenol / acetone in 2018, if it were to arise, would render DNL's mammoth debt servicing nearly insurmountable, provoking near term liquidity crunch.

Yet DNL has resorted to lessen project ambivalence by starting seed marketing of phenol with major clients and establishing marketing and distribution channels across India. To begin with, DNL would focus on obliterating imports - some 80% of total Indian market size - of both phenol and acetone, followed by foray in other neighboring countries. Production of key derivatives of phenol and acetone would be taken up at a later stage.

DNL's resliced revenue base reflects its ravenous quench for value addition - EBIT of FSC segment has soared over 3x in last three years - symptomatic of India's rising share of global specialty market. Beside unveiling new intermediates of pharmaceuticals and personal care last fiscal - a scalable business with potential revenues of over Rs 300 crs($44.9m), currently a puny Rs 30 crs($4.5m), new intermediates of agro chemicals are being developed for launches over the next few quarters to foster business metamorphosis; it also flogged special grade of sodium nitrite to secure its market share of inorganic salts.

The stock currently trades at 18.4x FY17e EPS of Rs 6.78 and 16.4x FY18e EPS of Rs 7.64. DNL's phenol project, though imposing in size, would struggle to escape uncertainty of the external environment; no matter how benign it's casted. Yet resilience of its FSC business to upheavals in global crude oil markets deserve review for its profit would more than double that of other segments combined by FY18. Equity funding for the phenol project has masked much of the vivacity in earnings (22.8% vs 12.9% average annual growth in EPS) over the next two years. We recommend buying the stock with target of Rs 153 based on 20x FY18e earnings (peg ratio: 0.9) over a period of 6-9 months.

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