

Deepak Nitrite Ltd. (DNL)

No. of shares (m)	136.4
Mkt cap (Rs crs/\$m)	27087/3271.6
Current price (Rs/\$)	1986/24.0
Price target (Rs/\$)	2504/30.2
52 W H/L (Rs.)	2690/1682
Book Value (Rs/\$)	268/3.2
Beta	1.2
Daily volume NSE (avg. monthly)	340450
P/BV (FY23e/24e)	6.7/5.2
EV/EBITDA (FY23e/24e)	18.6/14.4
P/E (FY23e/24e)	29.5/2.2
EPS growth (FY22/23e/24e)	37.3/-14.1/33.0
OPM (FY22/23e/24e)	23.6/18.0/21.2
ROE (FY22/23e/24e)	38.7/25.1/26.5
ROCE(FY22/23e/24e)	34.1/23.8/25.6
D/E ratio (FY22/23e/24e)	0.1/0.1/0.0
BSE Code	506401
NSE Code	DEEPAKNT
Bloomberg	DN IN
Reuters	DPNT.NS

Shareholding pattern

	%
Promoters	45.7
MFs / Banks / FIs	12.0
Foreign Portfolio Investors	8.5
Govt. Holding	-
Public & others	33.8
Total	100.0

As on Sep 30, 2022

Recommendation

BUY

Analyst

KISHAN GUPTA, CFA, FRM

Phone: + 91 (33) 4488 0043

E- mail: kishan.gupta@cdequi.com

Company brief

Sorted into advanced intermediates and phenolics, DNL's product portfolio comprises organic, inorganic and fine chemicals - for use in detergents, colorants, paper, agro chemicals, rubber etc.

Highlights

- Despite fire around the warehouse section of Deepak's Nandesari plant in Q1 which led to damage of certain property, plant and equipment and inventory, Deepak managed to report all but 26% growth in revenues of its advanced intermediates business though on little growth in its EBIT. EBIT margin thus declined to 20.2% from 23.6% in the same quarter a year ago as overall volumes dipped 15% when compared to that in same period a year ago.
- Accentuated by energy crisis in Europe, Deepak's phenolics business - despite decent volume growth in Q2, was badly impacted by fall in phenol prices. Margins, thence, declined to 8% from 19.3% in Q2 of previous year (14.1% in Q1), thus precipitating 53.4% drop in EBIT of phenolics segment. Rising benzene prices also spoilsport last quarter.
- Overall operating profit though declined by a back breaking 29.9% not least due to elevated cost of utilities, fall in volumes and costs incurred in restarting the Nandesari (Gujarat) plant in a phased manner. Flat lining of interest and depreciation barely help arrest the fall in earnings - PAT descended by 31.4% to Rs 174.47 crs compared with Rs 254.34 crs in the same period a year ago. Higher power & fuel costs impacted profits too: surged to Rs 145.23 crs in Q2 from Rs 101.57 crs, partly due to use of high cost natural gas; though its earnings impact was just Rs 4 crs in Q2.
- The stock currently trades at 29.5 x FY23e EPS of Rs 67.22 and 22.2x FY24e EPS of Rs 89.43. Thanks to fire at its Nandesari plant and gut-wrenching meltdown in margins of phenolics business - precipitated by fall in phenol prices globally - earning estimates for the current fiscal has been cut by quarter. Yet launch of new products post gradual commissioning of new integrated projects would doubtlessly support earnings next fiscal - estimated to grow by a third, though on a low base. Balancing odds, we believe that the stock merits a buy rating with revised target of Rs 2504 (previous target: Rs 2723) based on 28x FY24e earnings, over a period of 6-9 months.

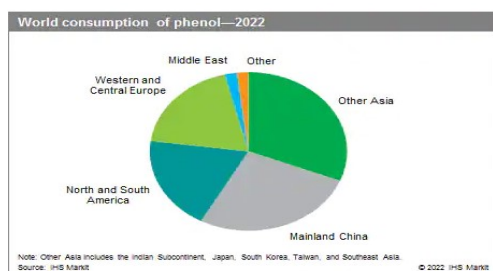
Consolidated (Rs crs)	FY20	FY21	FY22	FY23e	FY24e
Income from operations	4229.71	4359.75	6802.19	7825.67	8538.45
Other Income	35.20	21.52	42.61	40.11	57.65
EBITDA (other income included)	1064.10	1271.68	1648.52	1445.01	1870.48
Profit after associate profit (adjusted for EO)	615.83	777.20	1067.21	916.84	1219.83
EPS (Rs)	45.15	56.98	78.24	67.22	89.43
EPS growth (%)	253.8	26.2	37.3	-14.1	33.0

Outlook & Recommendation

Global Phenol Update

By some industry report, the demand for phenols is projected to grow by a CAGR of 4.9% in the decade ending FY32 not least due to increasing use of phenol in everyday products such as mouthwash, disinfectants, inks, liquid detergents, and floor cleaners. Further rising construction activities in both residential and commercial spaces has propelled production of plywood, laminated beams and flooring panels - where phenol resins find use.

No small factor for the rapid growth of phenol and phenol derivatives during the forecast period is increasing of take from chemical and pharmaceutical sector. Moreover, increasing use of phenol as feedstock for wide range of compounds and derivatives shall boost market growth. The report reckons that the increasing usage of phenols as an industrial cleaner for electronic devices and machinery parts may drive market growth over the analysis period. Adoption of phenol in the pharmaceutical industry for manufacture of various drugs is another demand supporting factor.



Source: HIS Markit



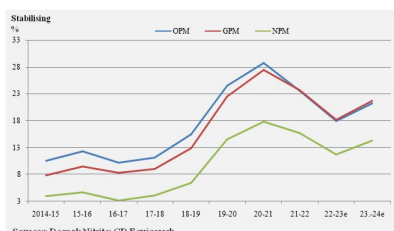
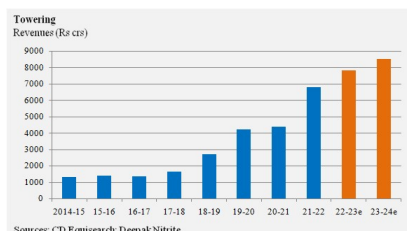
Source: Persistence Research

Varied uses of phenol ranging from industrial cleaners for machinery parts and electronic devices to making coloured dyes to starting material for plastics and explosives such as picric acid to basic material in wood preservatives such as creosote would do barely do little to galvanize the phenol industry globally in the following decade. Some other uses include use of phenol resin in manufacture of thermosetting plastics; paper phenolics employed for manufacturing household laminates and paper composite panels.

Yet challenges for growth of phenol industry abound. Strict government and environment regulations in the countries in North America and Europe are projected to restrain market growth. Moreover, a ban on BPA in the United States and Europe may hinder the growth of the market during the forecast period.

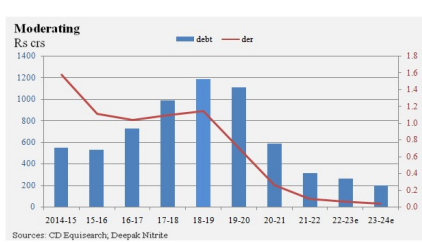
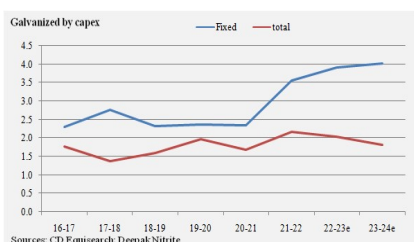
Financials & Valuation

Recovering from after effects of fire at its Nandesari plant sometime in Q1 this year, Deepak Nitrite is expected to show improved throughput over the course of the current fiscal. With an unflinching focus on import substitution and launch of derivatives of phenol and acetone, new products (mainly advanced solvents) are expected to be unveiled in the next few quarters, though scaling such products would barely be a small feat not least due to operational challenges therewith.

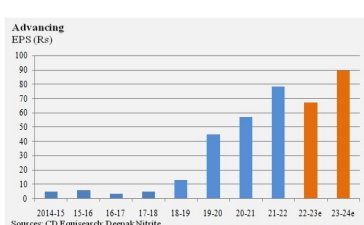
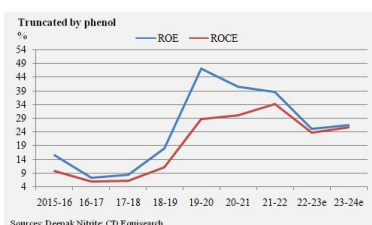


Post commissioning of second IPA plant in Q4, plans have been drawn to commission projects worth some Rs 1500 crs, including value added products of phenol and acetone; new chemistries such as photo chlorination and fluorination; upstream and downstream integration projects. Much of these investments would be channelized through its wholly owned subsidiary, Deepak Chem Tech Ltd. Phenol and acetone related upstream and downstream projects - which would increase value addition - would gobble some Rs 700 crs of the tally.

Despite growth catalysts seemingly in place, Deepak is little untouched by heightened volatility in phenol and acetone prices, leading to no miniscule fluctuations in earnings. Though higher capacity utilization of phenol plant has helped circumvent some of the external stress, yet risks associated with entrenched energy crisis in Europe and operational challenges in ramping up capacities of newer products cannot be undermined. Further, phenol and acetone being commodities have little pricing power, more so when the manufacturer does not have world-beating capacities.



The stock currently trades at 29.5 x FY23e EPS of Rs 67.22 and 22.2x FY24e EPS of Rs 89.43. Squashed by volatility in energy prices and decline in commodity prices, post tax earnings this fiscal would barely look up. Boosted by recovery in phenol prices and increased of take of value added derivatives of phenol and acetone, earnings are projected to rise by a third next fiscal on back of improving margins. Earnings would be hardly suppressed by improving outlook of Deepak's performance products business - now part of advanced intermediates. Weighing odds, we assign buy rating on the stock with revised target of Rs 2504 (previous target: Rs 2723) based on 28x FY24e earnings, over a period of 6-9 months. For more info, refer to our February report.



Cross Sectional Analysis

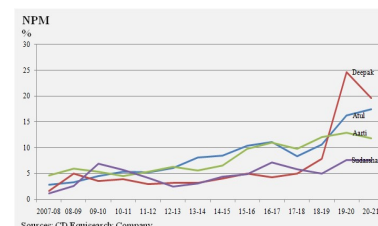
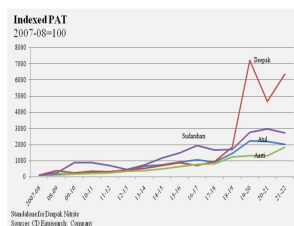
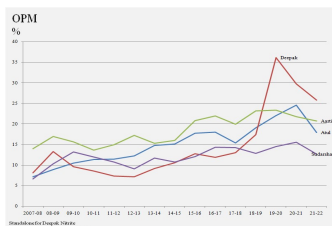
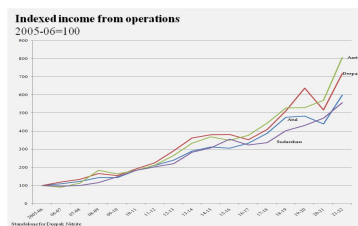
Company	Equity (Rs crs)	CMP (Rs crs)	Mcap (Rs crs)	Inc. from ops. (Rs crs)	Profit (Rs crs)	OPM (%)	NPM (%)	Int. cov.	ROE (%)	Mcap / IO	P/BV	P/E
Atul Ltd	30	7918	23368	5715	634	16.5	10.9	96.6	14.5	4.1	5.2	36.9
Deepak Nitrite	27	1986	27087	7614	919	18.3	12.1	41.4	28.4	3.6	7.4	29.5
Sudarshan Chem	14	390	2697	2311	93	10.7	4.0	5.3	12.1	1.2	3.4	29.1

calculations on ttm basis

Companies not truly comparable due to product dissimilarities

Mixed fortunes awaited Atul last quarter for its hardly weak performance in life science chemicals business was somewhat offset by weakish outcome in performance and other chemicals business. Driven by higher price realization in crop protection, its life science chemicals business reported 65.1% growth in revenues and 331% growth in EBIT, though on a small base. Performance and other chemicals business, however, bore the brunt of falling realizations and high energy cost for it reported 2.4% growth in sales and 49.2% drop in EBIT - EBIT margin thus plunged to 8.1% VS 16.2% in the same quarter a year ago. Overall operating profit though flat lined and post tax earnings advanced by a barely amusing 2.9% to Rs 150.91 crs as compared to Rs 146.63 crs in the same period a year ago.

Crushed by high raw material inflation (mainly coal) and subdued product pricing (largely due to weak product demand), Sudarshan's pigment business reported modest growth in topline (6.2% rise) and dramatic fall in EBIT (53.3% drop) last quarter, thus resulting in EBIT margin of 2.9% when compared with 6.7% in the same quarter a year ago. Sudarshan's pigments revenues suffered not least due to weak domestic demand for plastics and barely robust export demand due to grave geo-political uncertainty. No small volatility in product prices has led to deferment of buying decisions by domestic customers. It, however, expects sales ramp in coming quarters not least due to new project commencements.



Financials

Income Statement - Consolidated

Figures in Rs crs

	Q2FY23	Q2FY22	% chg.	H1FY23	H1FY22	% chg.
Income from operations	1961.65	1681.35	16.7	4019.64	3207.57	25.3
Other Income	12.04	8.43	42.8	21.65	16.68	29.8
Total Income	1973.69	1689.78	16.8	4041.29	3224.25	25.3
Total Expenditure	1690.80	1294.81	30.6	3392.81	2369.53	43.2
PBIDT (other income included)	282.89	394.97	-28.4	648.48	854.72	-24.1
Interest	5.90	9.24	-36.1	14.49	20.18	-28.2
Depreciation	42.40	44.05	-3.7	84.28	87.61	-3.8
PBT	234.59	341.68	-31.3	549.71	746.93	-26.4
Tax	60.12	87.34	-31.2	140.62	189.96	-26.0
PAT	174.47	254.34	-31.4	409.09	556.97	-26.6
MI	-	-	-	-	-	-
Net profit after MI	174.47	254.34	-31.4	409.09	556.97	-26.6
Extraordinary Item	-	-	-	-	-	-
Adjusted Net Profit	174.47	254.34	-31.4	409.09	556.97	-26.6
EPS (F.V. 2)	12.79	18.65	-31.4	29.99	40.83	-26.6

Segment Results

Figures in Rs crs

	Q2FY23	Q2FY22	% chg.	H1FY23	H1FY22	% chg.
Segment Revenue						
Advanced Intermediates	685.30	544.40	25.9	1415.28	1071.65	32.1
Phenolics	1284.08	1139.22	12.7	2619.01	2138.30	22.5
Total	1969.38	1683.62	17.0	4034.29	3209.95	25.7
Inter segment revenue	7.73	2.27	240.5	14.65	2.38	515.5
Income from operations	1961.65	1681.35	16.7	4019.64	3207.57	25.3
Segment EBIT						
Advanced Intermediates	138.35	128.38	7.8	271.05	255.92	5.9
Phenolics	102.66	220.39	-53.4	290.40	507.65	-42.8
Total	241.01	348.77	-30.9	561.45	763.57	-26.5
Interest	5.90	9.24	-36.1	14.49	20.18	-28.2
Other Unallocable Exp. (net of income)	0.51	-2.15	-123.7	-2.76	-3.54	-22.0
PBT	234.59	341.68	-31.3	549.71	746.93	-26.4

Financials

Income Statement - Consolidated

Figures in Rs crs

	FY20	FY21	FY22	FY23e	FY24e
Income from operations	4229.71	4359.75	6802.19	7825.67	8538.45
<i>Growth (%)</i>	56.9	3.1	56.0	15.0	9.1
Other Income	35.20	21.52	42.61	40.11	57.65
Total Income	4264.91	4381.27	6844.80	7865.79	8596.10
Total Expenditure	3200.81	3109.59	5196.28	6420.77	6725.63
EBITDA (other income included)	1064.10	1271.68	1648.52	1445.01	1870.48
Interest	117.97	77.33	36.37	25.96	21.43
EBDT	946.13	1194.35	1612.15	1419.06	1849.05
Depreciation	139.73	152.63	177.70	186.74	209.49
Tax	195.37	265.91	367.81	315.47	419.73
Net profit after MI	611.03	775.81	1066.64	916.84	1219.83
Extraordinary item	-4.80	-1.39	-0.57	-	-
Adjusted Net Profit	615.83	777.20	1067.21	916.84	1219.83
EPS (Rs.)	45.15	56.98	78.24	67.22	89.43

Segment Results

Figures in Rs crs

	FY22	FY23e	FY24e
Segment Revenue			
Advanced Intermediates	2511.05	2925.33	3304.29
Phenolics	4303.42	4929.60	5267.20
Total	6814.47	7854.93	8571.49
Inter segment revenue	12.28	29.25	33.04
Income from operations	6802.19	7825.67	8538.45
Segment EBIT			
Advanced Intermediates	595.73	666.51	754.87
Phenolics	867.11	590.78	895.42
Sub Total	1462.84	1257.29	1650.29
Interest	34.05	25.96	21.43
Other Unallocable Exp. (net of income)	-5.66	-0.99	-10.69
PBT	1434.45	1232.31	1639.55

Consolidated Balance Sheet

Figures in Rs crs

	FY20	FY21	FY22	FY23e	FY24e
SOURCES OF FUNDS					
Share Capital	27.28	27.28	27.28	27.28	27.28
Reserves	1544.63	2319.37	3311.16	4132.53	5243.24
Total Shareholders Funds	1571.91	2346.65	3338.44	4159.81	5270.52
Long term debt	792.89	534.80	200.37	140.37	80.37
Total Liabilities	2364.80	2881.45	3538.81	4300.18	5350.89
APPLICATION OF FUNDS					
Gross Block	2109.89	2292.53	2566.85	2816.84	3216.84
Less: Accumulated Depreciation	277.90	428.80	603.43	790.17	999.66
Net Block	1831.99	1863.73	1963.42	2026.67	2217.18
Capital Work in Progress	172.27	220.44	122.23	380.00	420.00
Investments	2.38	189.29	439.02	652.23	1352.23
Current Assets, Loans & Advances					
Inventory	394.50	382.69	584.55	704.31	768.46
Sundry Debtors	612.72	756.30	1129.06	1330.36	1451.54
Cash and Bank	31.40	33.43	41.79	37.62	27.25
Other Assets	117.68	92.97	92.55	97.74	103.17
Total CA & LA	1156.30	1265.39	1847.95	2170.03	2350.42
Current liabilities	736.91	543.10	739.22	841.18	901.55
Provisions	12.04	10.38	7.70	9.50	9.50
Total Current Liabilities	748.95	553.48	746.92	850.68	911.05
Net Current Assets	407.35	711.91	1101.03	1319.35	1439.37
Net Deferred Tax (net of liability)	-79.61	-107.81	-122.87	-128.00	-135.00
Other Assets (Net of liabilities)	30.43	3.88	35.98	49.93	57.12
Total Assets	2364.80	2881.45	3538.81	4300.18	5350.89

Key Financial Ratios

	FY20	FY21	FY22	FY23e	FY24e
Growth Ratios					
Revenue (%)	56.9	3.1	56.0	15.0	9.1
EBIDTA (%)	147.3	19.0	29.5	-12.4	29.4
Net Profit (%)	253.8	26.2	37.3	-14.1	33.0
EPS (%)	253.8	26.2	37.3	-14.1	33.0
Margins					
Operating Profit Margin (%)	24.5	28.7	23.6	18.0	21.2
Gross Profit Margin (%)	22.5	27.4	23.7	18.1	21.7
Net Profit Margin (%)	14.6	17.8	15.7	11.7	14.3
Return					
ROCE (%)	28.8	30.2	34.1	23.8	25.6
ROE (%)	47.2	40.4	38.7	25.1	26.5
Valuations					
Market Cap / Sales	1.2	5.2	4.5	3.5	3.2
EV/EBIDTA	5.9	18.0	18.5	18.6	14.4
P/E	8.5	29.1	28.7	29.5	22.2
P/BV	3.3	9.9	9.4	6.7	5.2
Other Ratios					
Interest Coverage	7.9	14.5	40.5	48.5	77.5
Debt-Equity Ratio	0.7	0.3	0.1	0.1	0.0
Current Ratio	1.5	2.3	2.7	2.9	3.6
Turnover Ratios					
Fixed Asset Turnover	2.4	2.4	3.6	3.9	4.0
Total Asset Turnover	2.0	1.7	2.2	2.1	1.8
Debtors Turnover	7.1	6.4	7.2	6.4	6.1
Inventory Turnover	7.9	8.0	10.7	10.0	9.1
Creditors Turnover	7.6	7.8	11.0	11.3	10.3
WC Ratios					
Debtor Days	51.2	57.3	50.6	57.4	59.5
Inventory Days	46.0	45.6	34.0	36.6	40.0
Creditor Days	47.8	47.0	33.3	32.3	35.5
Cash Conversion Cycle	49.4	55.9	51.2	61.7	63.9

Cumulative Financial Data

Figures in Rs crs	FY19-21	FY22-24e
Income from operations	11286	23166
Operating profit	2705	4824
EBIT	2407	4391
PBT	2123	4307
PAT	1567	3204
Dividends	182	314
OPM (%)	24.0	20.8
NPM (%)	13.9	13.8
Interest coverage	8.5	52.4
ROE (%)	32.9	28.7
ROCE (%)	24.9	26.5
Debt-equity ratio*	0.3	0.0
Fixed asset turnover	3.1	3.8
Debtors turnover	6.4	7.0
Inventory turnover	8.1	10.6
Creditors turnover	6.2	10.9
Debtors days	56.7	52.2
Inventory days	45.2	34.4
Creditor days	59.1	33.4
Cash conversion cycle	42.7	53.1
Dividend payout ratio (%)	11.7	9.8

FY19-21 implies three years ending fiscal 21; *as on terminal year; consolidated data

Moderation in margins in most of its businesses, most starkly in phenolics, in last few quarters has decelerated much of the momentum built in specialty chemicals industry during Covid -19, thus hurting earnings. Though Deepak's cumulative operating profit during FY22-24e period is estimated to grow in no weakish terms (78% over FY19-21 period), but margins is projected to decline to 20.8% from 24% in the preceding three year period. Though cranking of its phenol plant at full speed would somewhat help matters, but energy crisis in Europe due to Russia-Ukraine war has hit phenol demand and thus impacted its prices.

Though enhancement of IPA facility and phenol and acetone derivatives would barely suppress value addition, yet heightened volatility in raw materials (benzene case in point) would scarcely lend steadiness to margins. No weakish growth in post tax earnings in FY22 would somewhat temper growth in cumulative post tax earnings during FY22-24e period, thus barely elevating return on capital/equity - ROE estimated at 28.7% for FY22-24e period compared with 32.9% for preceding three year period. Discernible rebound in its performance products business would somewhat help circumvent the adverse impact of pricing lag in its basic intermediates and fine & speciality chemicals businesses.

Financial Summary – US dollar denominated

million \$	FY20	FY21	FY22	FY23e	FY24e
Equity capital	3.6	3.7	3.6	3.3	3.3
Shareholders funds	208.5	309.0	427.8	489.3	623.4
Total debt	146.6	80.0	41.4	31.4	24.2
Net fixed assets (incl CWIP)	265.9	283.5	275.1	290.7	318.5
Investments	0.3	25.8	57.9	78.8	163.3
Net current assets	54.0	86.6	132.6	146.2	160.7
Total assets	313.7	381.8	454.2	506.2	633.1
Revenues	596.8	587.6	912.9	945.2	1031.3
EBITDA	151.0	171.6	221.3	174.5	225.9
EBDT	134.4	161.2	216.5	171.4	223.3
PBT	114.7	140.4	192.6	148.8	198.0
Profit after associate profit	86.9	104.7	143.2	110.7	147.3
EPS(\$)	0.64	0.77	1.05	0.81	1.08
Book value (\$)	1.53	2.27	3.14	3.59	4.57

income statement figures translated at average rates; balance sheet and cash flow at year end rates; projections at current rates (Rs 82.79/\$). All dollar denominated figures adjusted for extraordinary items.

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Registered Office: 37, Shakespeare Sarani, 3rd Floor, Kolkata – 700 017; Phone: +91(33) 4488 0000; Fax: +91(33) 2289 2557 Corporate Office: 10, Vasawani Mansion, 5th Floor, DinshawWachha Road, Churchgate, Mumbai – 400 020. Phone: +91(22) 2283 0652/0653; Fax: +91(22) 2283, 2276 Website: www.cdequi.com; Email: research@cdequi.com

buy: >20% accumulate: >10% to ≤20% hold: ≥-10% to ≤10% reduce: ≥-20% to <-10% sell: <-20%

Exchange Rates Used- Indicative

Rs/\$	FY18	FY19	FY20	FY21	FY22
Average	64.45	69.89	70.88	74.20	74.51
Year end	65.04	69.17	75.39	73.50	75.81

All \$ values mentioned in the write-up translated at the average rate of the respective quarter/ year as applicable. Projections converted at current exchange rate. Cumulative dollar figure is the sum of respective yearly dollar value.