

Industry	CMP	Recommendation	Add on dips to	Target	Time Horizon
Chemicals	Rs. 273	Buy at CMP and Add on Dips	Rs. 273-255	Rs. 302-348	4 Quarters

Headquartered in Gujarat, Deepak Nitrite was founded in 1970 by Mr. C. K. Mehta and managed now by his son Mr. Deepak Mehta. Instituted as a fully indigenous sodium nitrite and sodium nitrate plant, Deepak Nitrite has today grown into a \$700 mn global group.

Deepak Nitrite is a multi- product company ranging across 3 major categories of: Basic Chemicals, Fine & Speciality Chemicals and Performance Products. Distribution network of the company spans over 30 countries, while the ISO certified manufacturing facilities are located at Nandesari and Dahej in Gujarat, Roha and Taloja in Maharashtra, and at Hyderabad in Telangana. Recently, company has undergone large Greenfield project at Dahej for manufacturing of phenol and acetone at a project cost of Rs. 1,400 Cr.

Currently, the stock is trading at 15.7x of FY20 which we think is quite an attractive level given the bright future prospects. We initiate Deepak Nitrite a BUY at CMP of Rs. 273 and add on decline of Rs. 255 for the successive Targets of Rs. 302 and Rs. 348 in the time frame of 1 Year.

Investment Rationale:

- **Diversified Product Portfolio and Leading market position in most of them**
- **Fine and Speciality Chemical Segment holds strong potential**
- **Mega Expansion story**
- **Dahej Plant will be Import Substitute**
- **Phenol/acetone plant to boost topline and margins from FY19 onwards**

Risk & Concerns:

- **High Volatility in Raw Materials Prices**
- **Significant Currency Appreciation**
- **Regulatory issues in India and abroad**
- **Delay in ramping up Dahej Plant**

HDFC Scrip Code	DEENIT
BSE Code	506401
NSE Code	DEEPAKNTR
Bloomberg	DN IN
CMP as on 24 Apr18	273
Equity Capital (Rs Cr)	27.28
Face Value (Rs)	2
Equity O/S (Cr)	13.6
Market Cap (Rs Cr)	3,628
Book Value (Rs)	57.3
Avg. 52 Week Vol	423883
52 Week High	298
52 Week Low	132

Shareholding Pattern (%)	
Promoters	44.7
Institutions	25.1
Non Institutions	30.2

PCG Risk Rating*	Yellow
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* Refer Rating explanation

FUNDAMENTAL ANALYST

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KEY HIGHLIGHTS

- ***Deepak Nitrite, founded in 1970, is a multi-product chemical company with distribution network of the company spans over 30 countries.***
- ***DNL has implemented a Greenfield project with capex of Rs. 1400 Cr to manufacture Phenol and Acetone at Dahej. This plant will be having huge capacity to fill the demand supply gap in the country.***
- ***Dahej plant is expected to start commissioning in Q4FY18 and likely to boost topline and margins from FY19 onwards.***
- ***Stock is trading at 15.7x of FY20 which we think is quite an attractive level given the bright future prospects. We initiate Deepak Nitrite a BUY at CMP of Rs. 273 and add on decline of Rs. 255 for the successive Targets of Rs. 302 and Rs. 348 in the time frame of 1 Year.***

Diversified Product Portfolio and Leading market position in most of them

DNL manufactures a range of intermediates for use in several industries, including Colourants, Petrochemicals, Agrochemicals, Rubber, Pharmaceuticals, Paper, Textile, Detergents, Fine & Speciality Chemicals, etc. Company has also developed expertise in multiple chemical processes, including Nitration, Alkylation, Nitrogen Oxides Absorption, Hydrogenation/ Reduction, Sulphonation, Condensation, Diazotisation and Oxidation.

The company is a preferred supplier to some of the leading global chemical companies like BASF, CIBA, Monsanto, Bayer Crop Science etc. DNL has fostered long term relationships across a wide range of industries and is a preferred supplier to some of the leading companies both in India and Internationally.

Over the years company have built enduring relationships with leading global companies and have made presence in over 30 countries including USA, the European and East European nations, South Korea, South America and the ASEAN countries.

Fine and Speciality Chemical Segment holds strong potential

The Fine and Speciality Chemicals segment comprises of niche products that require more value addition. Under Fine and Speciality Chemicals segment, the Company manufactures Speciality Chemicals, Xylidines (useful for Pigment, Fuel, Agrochemicals, Pharma), Oximes and Cumidines (both useful for Agro Chemicals). These products brings much better margin for the company compared to others.

For further growth in this segment, DNL is now focusing on increasing product basket for pharma and personal care where the company sees large potential and strong domestic as well as international demand. Revenues from Fine and Speciality Chemicals stood at Rs 359.3 Cr for FY17 compared to Rs 393.4 Cr for FY16. This segment contributed 30% to the total revenues during the year.

Mega Expansion story

DNL has implemented a Greenfield project to manufacture Phenol and Acetone at Dahej in the State of Gujarat. This project is being implemented through Deepak Phenolics Limited (DPL), a wholly owned subsidiary of the Company. The capacity of the Phenol Plant will be 200,000 MTPA and that of co-product Acetone will be 120,000 MTPA. DPL would also be manufacturing 260,000 MTPA of Cumene, which is one of the raw material in manufacturing Phenol and Acetone. This project is expected to be commissioned in the second half of FY17-18.

The total capex for the project is around Rs 1400 Cr which will be funded through combination of debt and equity. The project is expected to be commissioned by April 2018. Company has already tied up the entire debt portion of 840 Cr and remaining 560 Cr are raised partly by QIP, Sale of land and internal Accruals. DNL has guided that its debt repayments will start from June 2020.

Dahej Plant will be Import Substitute

Phenol: It is also referred to as Carboic acid or monohydroxy benzene, is a versatile industrial organic chemical. It is used to produce a wide variety of chemical intermediates, including bisphenol-A, phenolic resins, cyclohexanone and aniline. It is consumed in laminates, automobile, foundry, paints, rubber, surfactants, pharma, agro-chemicals, etc.

Phenol consumption in India has increased at CAGR of about 7%, from nearly 200,000 MT in FY 2010-11 to 280,000 MT in FY 2015-16. While this consumption was largely driven by the phenolic resins industry, which accounts for 76% of Phenol consumed in India.

Indian phenol market is expected to reach Rs 28bn in 2020 from Rs 17bn in 2012, expected to grow at 6.5%.

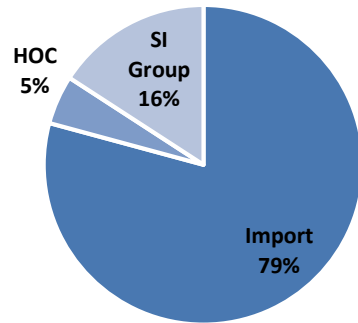
Acetone: Acetone is predominantly used in the production of pharmaceuticals, paints, adhesives and thinners, etc. The consumption of acetone has increased at a CAGR of about 4% from around 125,500 MT in FY2010-11 to 152,425 MT in FY 2015-16. Acetone is a by-product of phenol manufacturing process, as a result, stronger demand for phenol has resulted in oversupply of acetone globally.

Indian acetone market is expected to reach Rs 19bn in 2020 from Rs 9bn in 2012, growing at 10%.

Over the past many years the demand of the phenol and acetone was largely supported by Imports as there were no major producers in the domestic market. HOC and SI Group were the only players in the industry and they could meet domestic demand up to only 20%, so the rest has be imported. This demand supply gap has been understood by Deepak Nitrite and they has established plant for the same at Dahej with huge capex. This will make DNL a market leader once this plant starts commissioning business. Management has guided that production is expected to start from FY18.

Market Opportunity in India:

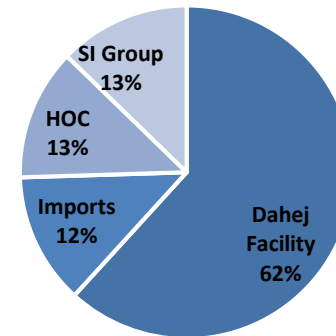
Phenol Demand - 2014 (250,100 MT)



Source: Company, HDFC sec Research

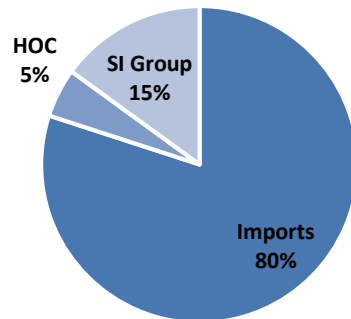
DNL's facility (200,000MT) will start Operations in FY18

Estimated Demand for Phenol in 2017-18 (320,000 MT)



Source: Company, HDFC sec Research

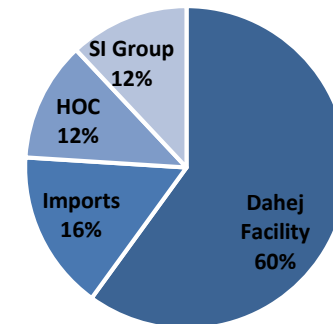
Acetone Demand - 2014 (156,734 MT)



Source: Company, HDFC sec Research

DNL's facility (120,000MT) will start Operations in FY18

Estimated Demand for Acetone in 2017-18 (200,000 MT)



Source: Company, HDFC sec Research

Phenol/acetone plant to boost topline and margins from FY19 onwards

Management has guided that Dahej plant is progressing well on track and expected to start commissioning in Q4FY18. Capacity utilization is estimated at 70% and 85% in FY18 and FY19 respectively.

Although company will not be having major price difference in comparison to the imported one, the factors like lower logistic cost, currency fluctuation, inventory management (helpful in maintain Working capital cycle) etc will attract the local suppliers. Furthermore DNL has started maintaining working relations with the potential customers like Century ply boards, Aurobindo Pharma, Atul, Alembic Pharma, etc.

We expect company to post CAGR of ~36% in sales and ~34% in Net Profit over FY17-20E. While EBITDA Margin is estimated to rise ~500bps over the same time frame. Our estimates has risk of delay in the project commissioning on time.

View & Valuation:

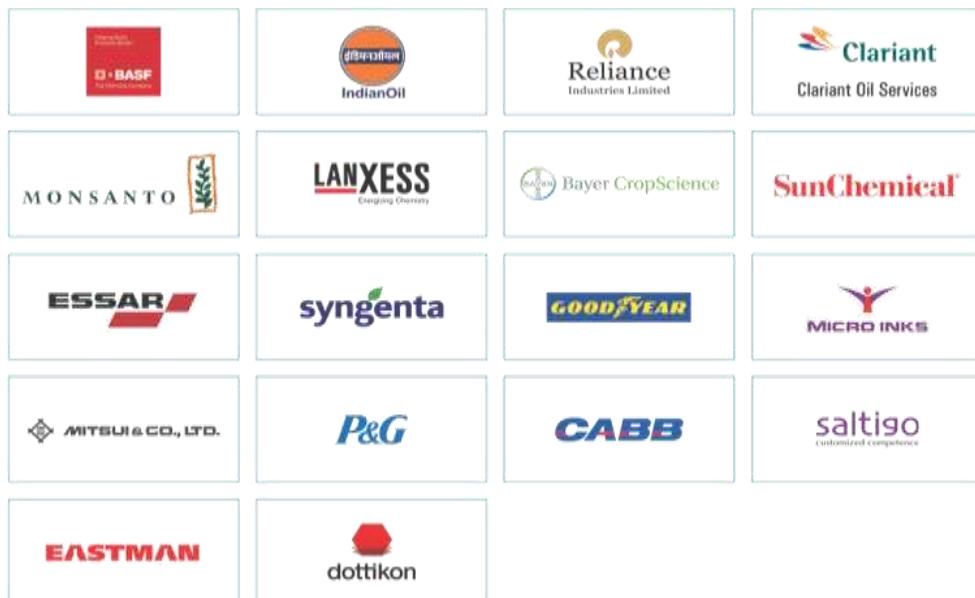
Deepak Nitrite, with diversified product portfolio and huge distribution network, is favourably positioned to capture opportunities emerging across the chemicals & speciality chemicals landscape. Commissioning of Phenol and Acetone at Dahej, strong potential of Fine and Speciality Chemical segment, new product launches etc. will drive sharp rise in earning of DNL.

Currently, the stock is trading at 15.7x of FY20 which we think is quite an attractive level given the bright future prospects. We initiate Deepak Nitrite a BUY at CMP of Rs. 273 and add on decline of Rs. 255 for the successive Targets of Rs. 302 and Rs. 348 in the time frame of 1 Year.

Risk & Concerns:

- **High Volatility in Raw Materials Prices:** Raw material forms a major component in the chemical processes. Volatility in the raw material prices is one of the main challenges faced by the industry.
- **Significant Currency Appreciation:** With almost 39% of the revenue coming from the exports, high currency fluctuation will definitely hurt the profitability of the company. Appreciation of Rupee will hurt the growth of the company as the competitive advantage against China will be reduced then.
- **Regulatory issues in India and abroad:** Chemical companies always have inherent problem of regulatory hindrance. Any change in regulatory norms can have significant impact on the company's future. They also require number of approvals and have to maintain quality standards.
- Any delay in ramping up the Phenol & Acetone Manufacturing Project at Dahej.

MAJOR CUSTOMERS



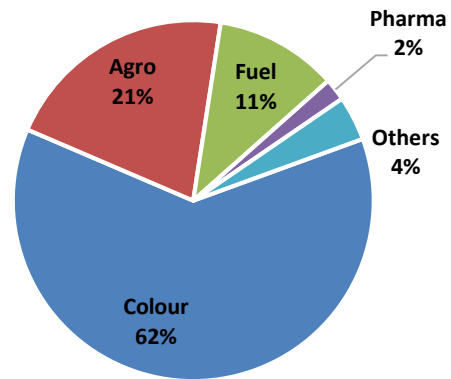
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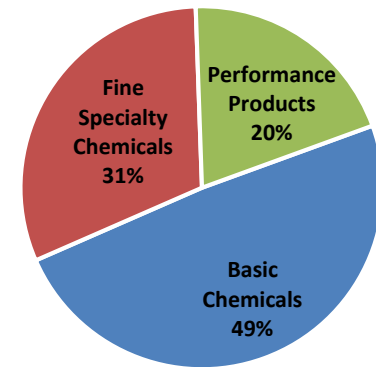
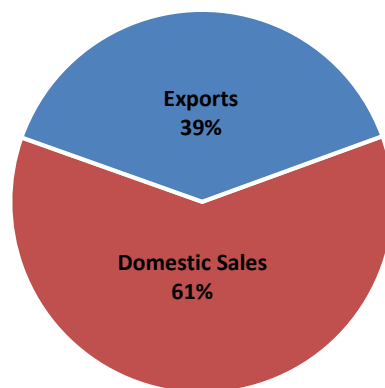
Manufacturing Facilities

Place	State	Engagement
NANDESARI	Gujarat	Bulk and commodity product manufacturing
DAHEJ	Gujarat	Full spectrum stilbenic Optical Brightening Agents production
DAHEJ	Gujarat	Phenol & Acetone Manufacturing Project
TALOJA	Maharashtra	Hydrogenation & noble metal catalysis specialty
ROHA	Maharashtra	Multispecialty site specialising in pilot plants
HYDERABAD	Telangana	Manufactures DASDA for captive use in commercial sales

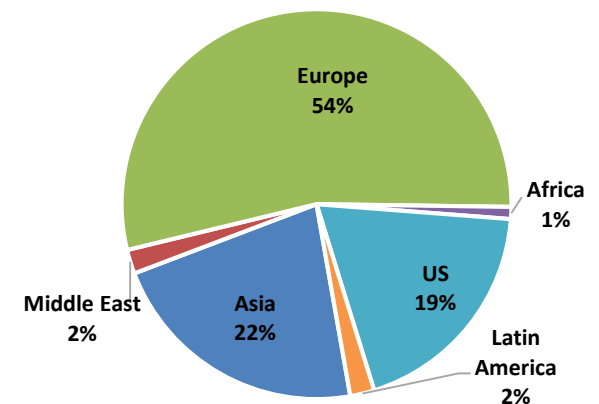
Source: Company, HDFC sec Research

Revenue Contribution by Industry (FY17)


Source: Company, HDFC sec Research

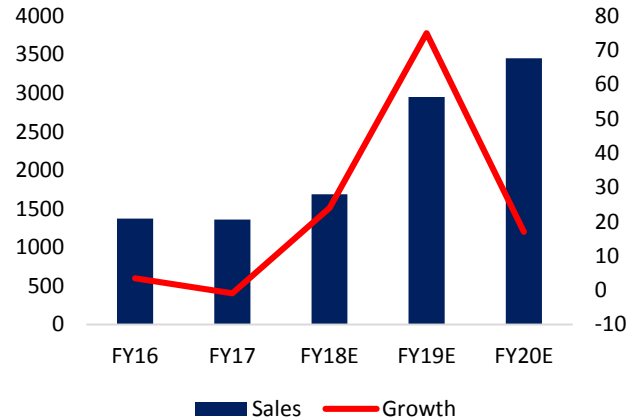
Product Mix (9M FY18)

Export vs. Domestic Sales (FY17)


Source: Company, HDFC sec Research

Key Export Markets (FY17)


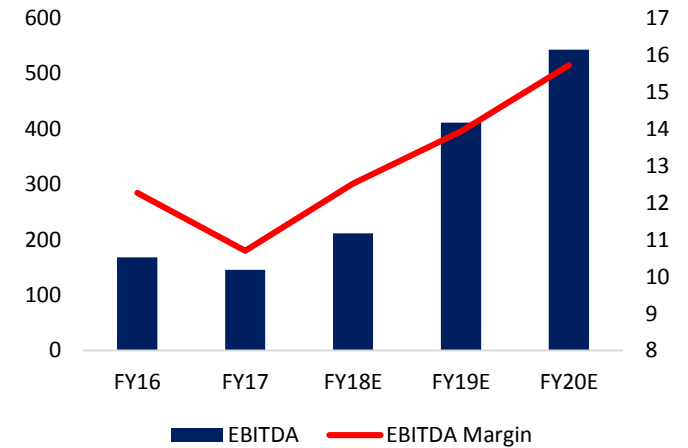
Source: Company, HDFC sec Research

Revenue may see ~ 36% CAGR over FY17-20E



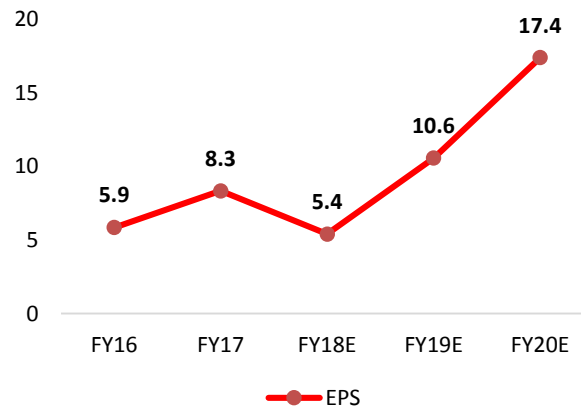
Source: Company, HDFC sec Research

EBITDA and EBITDA Margin set to rise from FY19E



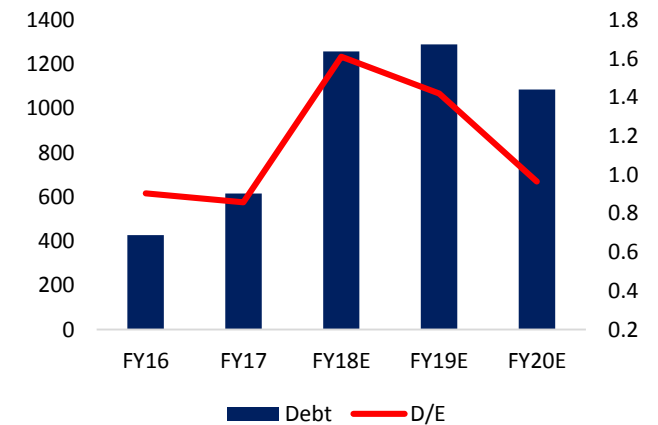
Source: Company, HDFC sec Research

Earning Per Share of DNL



Source: Company, HDFC sec Research

Greenfield Expansion has led to high D/E ratio



Source: Company, HDFC sec Research

Income Statement (Consolidated)

(Rs Cr)	FY16	FY17	FY18E	FY19E	FY20E
Net Revenue	1373	1360	1687	2952	3454
Other Income	1.6	4.9	10.0	15.0	20.0
Total Income	1375	1365	1697	2967	3474
Growth (%)	3.4	-0.7	24.3	74.9	17.1
Operating Expenses	1206.1	1219.8	1485.7	2556.1	2931.1
EBITDA	168.4	145.6	211.2	411.1	542.9
Growth (%)	19.2	-13.6	45.1	94.6	32.1
EBITDA Margin (%)	12.3	10.7	12.5	13.9	15.7
Depreciation	39.5	42.7	58.4	100.3	101.3
EBIT	129	103	153	311	442
Interest	39.7	36.5	50.5	101.8	96.1
Exceptional Items	0.0	70.5	0.0	0.0	0.0
PBT	89	137	102	209	346
Tax	26.2	38.8	28.6	64.8	108.2
RPAT	63	98	74	144	237
Growth (%)	18.7	55.7	-24.8	95.7	64.6
EPS	5.9	8.3	5.4	10.6	17.4

Source: Company, HDFC sec Research

Balance Sheet (Consolidated)

As at March (Rs Cr)	FY16	FY17	FY18E	FY19E	FY20E
SOURCE OF FUNDS					
Share Capital	23.3	26.1	27.3	27.3	27.3
Reserves	450	691	754	880	1097
Shareholders' Funds	472.9	717.1	781.0	907.4	1124.3
Long Term Debt	158.9	238.3	786.4	747.1	597.7
Net Deferred Taxes	56.7	65.7	80.0	100.0	50.0
Long Term Provisions & Others	7.7	10.5	10.5	10.5	10.5
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total Source of Funds	696	1032	1658	1765	1782
APPLICATION OF FUNDS					
Net Block	630	940	1681	1605	1524
Long Term Loans & Advances	83.3	172.7	156.0	143.8	136.7
Total Non Current Assets	713	1113	1837	1749	1661
Current Investments	83.8	114.0	30.0	40.0	75.0
Inventories	121.0	135.8	157.1	307.3	350.1
Trade Receivables	313.2	360.3	425.2	727.9	870.6
Short term Loans & Advances	53.8	61.5	55.4	51.0	48.4
Cash & Equivalents	6.5	14.5	87.0	113.6	99.3
Other Current Assets	2.9	6.2	6.8	7.6	8.7
Total Current Assets	581	692	762	1247	1452
Short-Term Borrowings	268.5	376.6	470.8	541.4	487.3
Trade Payables	133.1	150.2	175.0	336.1	401.5
Other Current Liab & Provisions	176.1	242.2	290.6	348.7	435.9
Short-Term Provisions	20.3	4.1	4.5	4.9	5.4
Total Current Liabilities	598.0	773.1	940.9	1231.2	1330.1
Net Current Assets	-16.8	-80.7	-179.4	16.3	122.1
Total Application of Funds	696	1032	1658	1765	1783

Source: Company, HDFC sec Research

Cash Flow Statement (Consolidated)

(Rs Cr)	FY16	FY17	FY18E	FY19E	FY20E
Reported PBT	89.2	136.8	102.3	209.0	345.5
Non-operating & EO items	66.9	137.9	-10.0	-15.0	-20.0
Interest Expenses	39.7	36.5	50.5	101.8	96.1
Depreciation	39.5	42.7	58.4	100.3	101.3
Working Capital Change	9.4	71.9	171.2	-169.0	-120.1
Tax Paid	-26.2	-38.8	-28.6	-64.8	-108.2
OPERATING CASH FLOW (a)	218.5	387.0	343.7	162.3	294.6
Capex	-69.6	-336.4	-800.0	-24.0	-20.0
Free Cash Flow	148.8	50.6	-456.3	138.3	274.6
Investments	-26.1	-89.4	16.7	12.2	7.0
Non-operating income	1.6	4.9	10.0	15.0	20.0
INVESTING CASH FLOW (b)	-94.2	-420.9	-773.3	3.2	7.0
Debt Issuance / (Repaid)	-69.6	91.2	562.4	-19.3	-199.4
Interest Expenses	-39.7	-36.5	-50.5	-101.8	-96.1
FCFE	39.6	105.3	55.6	17.1	-20.9
Share Capital Issuance	2.4	2.9	1.1	0.0	0.0
Dividend	-14.0	-15.7	-10.9	-17.7	-20.5
FINANCING CASH FLOW (c)	-120.9	41.9	502.1	-138.9	-316.0
NET CASH FLOW (a+b+c)	3.4	8.0	72.5	26.6	-14.3
Closing Cash	6.5	14.5	87.0	113.6	99.3

Source: Company, HDFC sec Research

Key Ratios

	FY16	FY17	FY18E	FY19E	FY20E
EBITDA Margin	12.3	10.7	12.5	13.9	15.7
EBIT Margin	9.4	7.6	9.1	10.5	12.8
APAT Margin	4.6	7.2	4.4	4.9	6.9
RoE	15.4	16.5	9.8	17.1	23.4
RoCE	18.5	10.0	9.2	17.6	24.8
Solvency Ratio					
Net Debt/EBITDA (x)	2.0	3.3	5.4	2.8	1.7
D/E	0.9	0.9	1.6	1.4	1.0
Net D/E	0.7	0.7	1.5	1.3	0.8
Interest Coverage	3.2	2.8	3.0	3.1	4.6
PER SHARE DATA					
EPS	5.9	8.3	5.4	10.6	17.4
CEPS	8.8	10.8	9.7	17.9	24.8
BV	40.6	55.0	57.3	66.5	82.4
Dividend	1.2	1.2	0.8	1.3	1.5
Turnover Ratios (days)					
Debtor days	83.3	96.7	92.0	90.0	92.0
Inventory days	30.0	34.5	34.0	38.0	37.0
Creditors days	40.3	44.9	43.0	48.0	50.0
VALUATION					
P/E	46.3	32.9	50.6	25.8	15.7
P/BV	6.7	5.0	4.8	4.1	3.3
EV/EBITDA	24.0	27.7	19.1	9.8	7.4
EV / Revenues	2.9	3.0	2.4	1.4	1.2

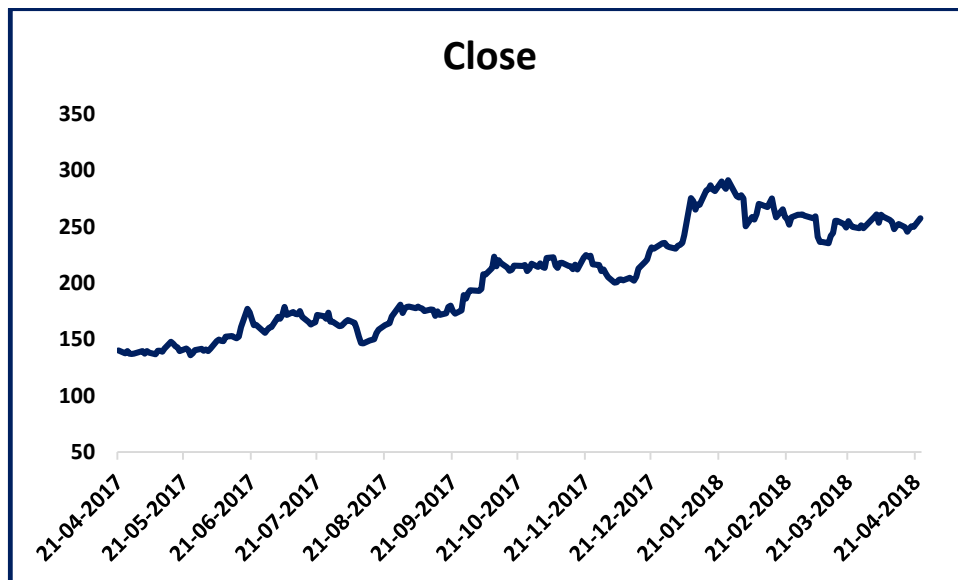
Source: Company, HDFC sec Research

Rating Chart

R E T U R N	HIGH			
	MEDIUM			
	LOW			
		LOW	MEDIUM	HIGH
RISK				

Ratings Explanation:

RATING	Risk - Return	BEAR CASE	BASE CASE	BULL CASE
BLUE	LOW RISK - LOW RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 20% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 15% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 15%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 20% OR MORE
YELLOW	MEDIUM RISK - HIGH RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 35% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 20% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 30%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 35% OR MORE
RED	HIGH RISK - HIGH RETURN STOCKS	IF RISKS MANIFEST PRICE CAN FALL 50% OR MORE	IF RISKS MANIFEST PRICE CAN FALL 30% & IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 30%	IF INVESTMENT RATIONALE FRUCTFIES PRICE CAN RISE BY 50% OR MORE

**Rating Definition:**

Buy: Stock is expected to gain by 10% or more in the next 1 Year.

Sell: Stock is expected to decline by 10% or more in the next 1 Year.

Disclosure:

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