Deepak Nitrite

Strong YoY growth in 3QFY19; phenol biz at 80%+ utilization

Deepak Nitrite (DN IN, Mkt Cap $435m, CMP Rs228)

Result summary:
Revenues: Rs4,523m (+22% YoY; 1% above IIFLe)
Ebitda: Rs662m (+27% YoY; 9% below IIFLe)
Net profit: Rs316m (+55% YoY; 1% above IIFLe)

Highlights:

- Deepak Nitrite (DNL) reported strong YoY growth in both topline and bottomline in its standalone financials (ex-phenol) for 3QFY19, as expected. However, while standalone revenues were 1% above IIFLe, Ebitda missed by 9% due to lower-than-expected gross margins, which fell 360 bps QoQ. Standalone net profit was shored up by higher-than-expected other income and lower-than-expected interest expense.
- The company has not yet started reporting consolidated quarterly financials including the phenol subsidiary (Deepak Phenolics). We expect it to begin doing so from next quarter onwards (4QFY19). However, for 3QFY19, the company has announced that the phenol business generated revenues of Rs3.2b along with positive Ebitda and PBT for the quarter (exact Ebitda and PBT figures have not been disclosed). The phenol project was reportedly commissioned on November 1, 2018, so it contributed to financials for only two months of the quarter. Thanks to the commencement of revenues from phenol, consolidated revenues from manufacturing grew 110% YoY to Rs7.8b. Consolidated profits have not been disclosed. Management also announced that the phenol facility consistently operated at >80% utilization during 3Q.
- Coming back to discussing the standalone results, revenues were modestly higher than our estimates across all three segments: Basic Chemicals, Fine & Speciality Chemicals, and Performance Products. However, in terms of segmental Ebit, the Basic Chemicals segment missed our estimate by 6%, while the Fine & Speciality Chemicals segment was in line, and Performance Products topped our estimate by a sizeable 27%. Please note that segmental Ebit includes other income. Unallocable expenses were 11% higher than our estimate, leading to in-line PBT and PAT. The Performance Products segment, which includes the two products OBA and DASDA, reported a turnaround to positive PBT, probably for the first time in its history going back nearly six years. Key reasons for the performance improvement in this segment are the restructuring in OBA and the firmness in prices of DASDA.
- Management commentary in the earnings press release indicates that the strength in revenues and margins was driven primarily by improved product realizations. Volume growth seems to have been a prominent contributor only in the Fine & Speciality Chemicals segment. Management has also pointed out that the company was able to adjust its product mix based on timely assessment of market demand, thereby capitalizing on higher realizations in its key products. Cost optimization efforts also contributed to Ebitda growth. Price realizations appear to have been particularly strong in the domestic market: domestic revenues grew 29% YoY, whereas exports grew 10% YoY. Management said demand from end-user industries in the domestic market was healthy.
- Management has provided a bullish outlook in the press release. Chairman Deepak Mehta has said that "the several exciting opportunities in downstream intermediates (of phenol) will assist us in further elevating our performance in times ahead." The company expects the increase in availability of locally-produced phenol and acetone to boost the production of downstream intermediates in India, thereby further diversifying end-use applications and expanding the size of the overall market. The standalone business is also reportedly benefiting from the "positive demand environment backed by firm realizations." However, we would caution that any correction in chemical prices and/or phenol spreads is a risk.

Abhijit R. Akella, CFA
abhijit.akella@iiflcap.com
91 22 4646 4654

Mohit Surana
mohit.surana@iiflcap.com
91 22 4646 4657

- Standalone debt is nearly flat QoQ at Rs4.7b, and standalone debt-to-equity is 0.47x (while debt-to-Ebitda is ~1.7x). Net capital employed in the standalone business at the end of 3QFY19 was Rs9.5b, implying that the annualized pre-tax ROCE for 3QFY19 was ~22%. The company has said in the notes to its financial statements that the Income Tax Department conducted search operations during the quarter at the premises of the company, and that the company believes that the search operations will not have any adverse material impact on its performance.

The post-results conference call is scheduled for 3.00 pm IST on Wednesday, 6th February (dial-in # +91 22 6280 1401). We'll revert with revised estimates thereafter. The summarized results are presented below.

Figure 1: 3QFY19 results summary

Deepak Nitrite (Standalone, Rs m)	3QFY18	2QFY19	3QFY19	YoY %
Total income from operations	**3,711**	**4,327**	**4,523**	**22%**
Cost of goods sold	(2,187)	(2,255)	(2,519)	15%
Gross margin %	41.1%	47.9%	44.3%	325 bps
Employee benefits expense	(346)	(403)	(417)	21%
% of income	-9.3%	-9.3%	-9.2%	10 bps
Other expenses	(656)	(983)	(925)	41%
% of income	-17.7%	-22.7%	-20.5%	-279 bps
Ebitda	**522**	**686***	**662**	**27%**
Ebitda margin %	14.1%	15.9%	14.6%	57 bps
Depreciation and amortization	(130)	(132)	(133)	3%
% of income	-3.5%	-3.0%	-2.9%	55 bps
Operating income	393	554	529	35%
Operating margin %	10.6%	12.8%	11.7%	112 bps
Other income	5	3	55	1081%
Finance costs	(90)	(117)	(103)	15%
Exceptional items	0	0	0	NM
Profit before tax	307	441	480	56%
PBT margin %	8.3%	10.2%	10.6%	235 bps
Tax expense	(104)	(160)	(164)	58%
Effective tax rate %	-33.8%	-36.3%	-34.2%	-42 bps
Net profit	**203**	**281**	**316**	**55%**
Net margin %	5.5%	6.5%	7.0%	151 bps
Adjusted net profit	203	258	316	55%
Adjusted EPS	**1.56**	**1.90**	**2.32**	**49%**

Source: Company, IIFL Research

* Includes Rs34.8m one-off gain on insurance claim settlement. Adjusted for this gain, 2QFY19 Ebitda would be Rs651m.

Figure 2: 3QFY19 segmental information

Standalone (Rs m)	3QFY18	2QFY19	3QFY19	YoY %
Revenues:				
Basic Chemicals	1,933	2,017	2,194	13%
Fine & Specialty Chemicals	1,224	1,438	1,484	21%
Performance Products	674	968	995	48%
Others/Unallocable	0	0	0	NM
Total revenues	3,831	4,423	4,673	22%
Less: Inter-segment revenue	(119)	(96)	(150)	25%
Net Sales/Income from Operations	**3,711**	**4,327**	**4,523**	**22%**
EBIT:				
Basic Chemicals	283	361	339	19%
EBIT margin %	14.7%	17.9%	15.4%	78 bps
Fine & Specialty Chemicals	271	372*	342	26%
EBIT margin %	22.1%	25.9%	23.1%	94 bps
Performance Products	(13)	142	181	NM
EBIT margin %	-1.9%	14.6%	18.2%	2,011 bps
Total EBIT	**541**	**874**	**862**	**59%**
Less: Interest	(90)	(117)	(103)	15%
Less: Other unallocable	(144)	(317)	(278)	93%
PBT	**307**	**441**	**480**	**56%**

Source: Company, IIFL Research

* Includes Rs34.8m one-off gain on insurance claim settlement. Adjusted for this gain, Fine & Specialty Chemicals 2QFY19 Ebit would be Rs337m.