

DEEPAK FERT. & PETROCHEM.

INR 119



Upcoming projects to drive growth

BUY

Deepak Fertilizer and Petrochemicals Corporation's (DFPCL) Q3FY08 results were in line with our expectations, with revenues registering 12.5% Y-o-Y and 26.3% Q-O-Q (at INR 2.7 bn) driven by growth in the chemicals business. EBITDA of INR 451 mn registered growth of 11% Y-o-Y and 40% Q-o-Q driven by better realisations from the chemicals business. Net profit of INR 245 mn remained flat Y-o-Y on account of lower other income and higher interest cost.

The chemicals segment registered growth of 27.6% Y-o-Y driven by strong growth in both manufacturing and trading goods. Trading revenues grew by 16% Y-o-Y and 153% Q-o-Q on account of increased prices of methanol, which improved from INR 11,000/tonne in the previous quarter to INR 22,000/tonne in Q3FY08. The company expects methanol prices to stabilize at these levels. The fertilizer segment's revenues declined by 19% Y-o-Y on account of low availability of phosphoric acid in international markets.

DFPCL's Dahej Uran gas pipeline was commissioned in the quarter. The company is in the process of entering into a long term contract for supply of gas which will help considerably reduce its cost of raw materials, thereby contributing to better margins. Its retail venture *Ishanya, the specialty mall*, has begun operations; it has already opened up 2 lakh square feet space housing over 1,000 brands and is expected to open 50,000 square feet in the next quarter, when it is expected to break even. Further, the ammonium nitrate plant at Paradip is on track and targeted for completion in FY10E.

We expect DFPCL to register revenues of INR 9.8 bn in FY08E and INR 10.9 bn in FY09E. Our FY10 revenue estimate stands at INR 14.7 bn due to contribution from the ammonia nitrate plant, IPA, and the retail venture. On our EPS estimate of INR 13.7 and INR 17.3, the stock is trading at a PE of 8.6x and 6.8x our FY09 and FY10 estimates, respectively. We maintain our 'BUY' recommendation on the stock.

Key highlights

- Net revenues, at INR 2.7 bn, registered 12% Y-o-Y growth and 26.3% Q-o-Q growth, on account of higher growth in the chemicals business.
- Sales in the industrial chemicals segment increased 27.6% Y-o-Y and chemical manufacturing grew 30.5%. Trading revenues improved by 16.4% Y-o-Y on account of increased methanol prices, which have stabilized at INR 22,000/tonne in Q3FY08.

Financials

Year to March	Q3FY08	Q3FY07	% change	Q2FY08	% change	FY07	FY08E
Sales (INR mn)	2,740	2,433	12.6	2,169	26.3	8,331	9,823
EBITDA (INR mn)	451	406	11.0	322	40.0	1,442	2,192
Net profit (INR mn)	245	247	(1.1)	218	12.0	929	1,076
EPS (INR)	2.8	2.8	(1.1)	2.5	12.0	9.0	12.2
P/E (x)						17.7	13.1
EV/ EBITDA						11.6	6.5
ROE (%)						14.5	15.8

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Reuters : DPFE.BO

Bloomberg : DFPC IN

Market Data

52-week range (INR) : 178 / 75

Share in issue (mn) : 88.2

M cap (INR bn/USD mn) : 10.5 / 267.5

Avg. Daily Vol. BSE/NSE ('000) : 363.1

Share Holding Pattern (%)

Promoters : 41.9

MFs, Fls & Banks : 18.3

Fls : 1.9

Others : 37.9

- Growth in the chemicals manufacturing segment was also driven by a higher contribution from IPA (INR 641 mn) in the quarter.
- Fertilizer sales declined 19% for the quarter, as revenues from both the manufacturing and trading segments reduced 7% and 23% Y-o-Y, respectively. Lower manufacturing in the company's fertilizer segment was on account of reduced availability of phosphoric acid in the international market and lower availability of material for trading.
- Raw material costs have increased by 74.8% Y-o-Y on account of 11% drop in APM gas supply during the nine months ended December 2007. Further, the price of naphtha is also higher compared to the previous year.
- EBITDA margins have shown low growth of 11% Y-o-Y; this is on account of higher raw material and employee costs. Employee costs have increased by 16.7% Y-o-Y. This is on account of increased salaries to reduce attrition as well as increased employment in the IPA segment.
- Interest cost stood at INR 38 mn, up 54.7% Y-o-Y. This is on account of working capital loan taken during the quarter.
- Net profit for the year of INR 245 mn remained flat Y-o-Y on account of lower other income. Other Income was INR 64 mn compared to INR 73 mn in Q3FY07 and INR 139 mn in Q2FY08. Lower other income was on account of surplus cash being deployed for expansion and no income being realized from services rendered.

Financial snapshot

(INR mn)

Year to March	Q3FY08	Q3FY07	% change	Q2FY08	% change	FY07	FY08E	FY09E
Net sales	2,740	2,433	12.6	2,169	26.3	8,331	9,823	10,893
Total expenditure	2,289	2,027	12.9	1,847	24.0	6,889	7,630	8,399
EBITDA	451	406	11.0	322	40.0	1,442	2,192	2,494
Other income	64	73	(12.2)	139	(54.2)	363	130	123
Depreciation	114	110	3.0	108	4.7	391	599	693
EBIT	401	369	8.8	353	13.7	1,052	1,593	1,801
Interest (Net)	38	24	54.7	31	23.3	115	207	227
PBT	364	344	5.6	322	12.7	1,300	1,516	1,697
Taxes	118	96	23.0	103	14.4	355	440	492
PAT	246	249	(1.1)	220	12.0	945	1,076	1,205
Extra-ordinary items	1	1	0.0	1	0.0	16	0	0
Adjusted PAT	245	247	(1.1)	218	12.0	929	1,076	1,205
Tax rate (%)	31.8	27.3		31.2		27.3	29.0	29.0
% of sales								
Raw material	32.1	20.7		37.7		24.9	22.0	23.0
Staff cost	4.8	4.6		6.5		5.7	5.6	5.5
Other expenditure	46.6	58.0		41.0		52.1	43.8	43.4
EBITDA	16.5	16.7		14.8		17.3	22.3	22.9
Net profit	8.8	9.9		9.5		10.9	11.0	11.1

Company Description

Incorporated in 1979, DFPCL started commercial production of ammonia in 1983 with natural gas as feedstock. Since then, the company has emerged as an integrated multi-product company manufacturing ammonia, methanol, nitric acid, low-density prilled ammonium nitrate, and nitro-phosphate fertilizers in its state-of-the-art plants operating with world class technology.

Investment Theme

DFPCL, with its current business of fertilizers and chemicals, has been generating steady EBITDA of INR 1-1.2 bn over the last five years, despite the chemical business being cyclical in nature. This is due to the fact that it can deploy natural gas (key ingredient for its fertilizers and chemicals business) to make high-margin products. In the late 90s, 70% of its sales came from fertilizers (at a time when chemicals were undergoing a down cycle), whereas currently, over 70% of its sales come from chemicals. DFPCL is also venturing into three big projects that are likely to provide it growth impetus going forward.

Key Risks

One of the key risks that DFPCL faces is fluctuations in prices of ammonia, its key input. It uses ammonia to manufacture ammonium nitrate and its acids. Most of the expansion that DFPCL is undergoing is on the basis of imported ammonia that comes at a higher price. However, large global sized merchant ammonia capacities are coming up in Iran, Saudi Arabia, and Australia in the next six months, which will help the company get ammonia at relatively lower rates.

Financial Statements

Income statement					(INR mn)
Year ended 31 March	FY06	FY07	FY08E	FY09E	FY10E
Net revenues	5,629	8,331	9,823	10,893	14,705
Manufacturing expenses	3,740	5,860	6,419	7,066	10,080
Employee expenses	415	478	549	604	725
S G & A expenses	437	551	662	728	910
Total expenditure	4,592	6,889	7,630	8,399	11,715
EBITDA	1,036	1,442	2,192	2,494	2,990
Depreciation	316	391	599	693	741
EBIT	721	1,052	1,593	1,801	2,249
Interest expenditure	57	115	207	227	266
Other income	326	363	130	123	162
Profit before tax	991	1,300	1,516	1,697	2,146
Provision for taxation	372	355	440	492	622
Profit after tax	619	945	1,076	1,205	1,524
Recurring net profit	619	945	1,076	1,205	1,524
Extraordinary items	0	16	0	0	0
Reported profit	619	929	1,076	1,205	1,524
EPS (INR) fully diluted	9.0	10.5	12.2	13.7	17.3
CEPS (INR) fully diluted	12.6	15.0	19.0	21.5	25.7
Dividend per share (INR)	1.9	3.0	3.0	3.2	3.7
Dividend payout ratio	0.3	0.3	0.3	0.3	0.3

Common size metrics- as % of net revenues

Year ended 31 March	FY06	FY07E	FY08E	FY09E	FY10E
Manufacturing expenses	66.4	70.3	65.3	64.9	68.5
Employee expenses	7.4	5.7	5.6	5.5	4.9
S G & A expenses	7.8	6.6	6.7	6.7	6.2
Depreciation	5.6	4.7	6.1	6.4	5.0
Interest expenditure	1.0	1.4	2.1	2.1	1.8
EBITDA margin	18.4	17.3	22.3	22.9	20.3
EBIT margin	12.8	12.6	16.2	16.5	15.3
Net profit margin	11.0	11.3	11.0	11.1	10.4

Growth metrics (%)

Year ended 31 March	FY06	FY07E	FY08E	FY09E	FY10E
Net revenues	17.7	48.0	17.9	10.9	35.0
EBITDA	(16.9)	39.2	52.0	13.8	19.9
EBIT	(23.0)	45.9	51.5	13.0	24.9
Net profit	(22.4)	50.2	15.8	11.9	26.5
EPS	0.0	16.5	15.8	11.9	26.4

Balance sheet					(INR mn)
Year ended 31 March	FY06	FY07E	FY08E	FY09E	FY10E
Share capital	882	882	882	882	882
Reserves	4,855	5,556	6,309	7,153	8,219
Shareholders funds	5,737	6,438	7,191	8,035	9,101
Secured loans	1,761	2,409	2,909	2,909	3,909
Deferred tax liability	483	483	483	483	483
Sources of funds	7,981	9,330	10,583	11,426	13,492
Gross assets	6,774	9,168	11,668	13,168	13,668
Less Depreciation	4,079	4,537	5,136	5,829	6,570
Net fixed assets	2,695	4,631	6,532	7,339	7,098
CWIP	2,257	2,257	2,257	2,257	2,257
Investments	882	882	882	882	882
<i>Current assets</i>	<i>3,729</i>	<i>3,633</i>	<i>3,303</i>	<i>3,592</i>	<i>6,513</i>
Debtors	906	1,113	1,312	1,455	1,964
Cash & bank balance	1,713	1,006	320	237	2,152
Inventory	609	787	794	874	1,220
Advances	500	727	877	1,027	1,177
<i>Current liabilities</i>	<i>1,606</i>	<i>2,108</i>	<i>2,426</i>	<i>2,679</i>	<i>3,292</i>
Creditors	522	665	784	870	1,174
Other liabilities	632	695	765	841	925
Provisions	453	748	877	968	1,193
Working capital	2,122	1,525	877	914	3,221
Misc expenditure	25	25	25	25	25
Uses of funds	7,981	9,320	10,573	11,417	13,483

Cash flow statement					(INR mn)
Year to March	FY06	FY07E	FY08E	FY09E	FY10E
Net profit	798	929	1,076	1,205	1,524
Add: Depreciation	316	391	599	693	741
Add: Deferred tax	53	0	0	0	0
Gross cash flow	1,141	1,320	1,675	1,898	2,264
Less: Dividends	265	279	323	361	457
Less: Changes in W. C.	239	120	38	120	391
Operating cash flow	638	921	1,314	1,417	1,416
Less: Change in investments	(1)	0	0	0	0
Less: Capex	1,436	2,394	2,500	1,500	500
Free cash flow	(797)	(1,473)	(1,186)	(83)	916

Ratios

Year ended 31 March	FY06	FY07E	FY08E	FY09E	FY10E
ROE (%)	14.5	15.3	15.8	15.8	17.8
ROCE (%)	18.0	17.3	18.2	18.3	20.1
Debtor days	59	49	49	49	49
Inventory days	39	34	29	29	30
Fixed assets T/o (x)	1.3	1.4	1.3	1.2	1.6
Debt/Equity (x)	0.3	0.4	0.4	0.4	0.4
Interest coverage (x)	21.7	12.3	8.3	8.5	9.1

Valuation parameters

Year ended 31 March	FY06	FY07E	FY08E	FY09E	FY10E
EPS (diluted) (INR)	9.0	10.5	12.2	13.7	17.3
<i>Y-o-Y growth (%)</i>	<i>0.0</i>	<i>16.5</i>	<i>15.8</i>	<i>11.9</i>	<i>26.4</i>
CEPS	12.6	15.0	19.0	21.5	25.7
P/E (x)	17.7	15.2	13.1	11.7	9.3
Price/BV (x)	2.5	2.2	2.0	1.8	1.6
EV/Sales (x)	2.5	1.7	1.4	1.3	1.0
EV/EBITDA (x)	11.6	9.8	6.5	5.7	4.7

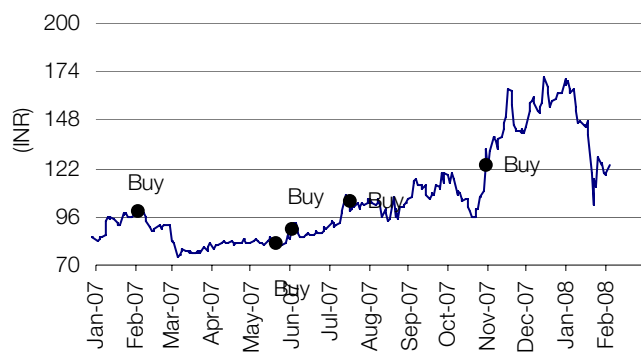
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Coverage group(s) of stocks by primary analyst(s): Miscellaneous

Deepak Fertilizer, Essel Propack, Moser Baer, Opto Circuits India and Sintex Industries

Deepak Fertilisers & Petrochemicals



Recent Research

Date	Company	Title	Price (INR)	Recos
30-Jan-08	Adani Enterprises	Momentum continues; <i>Result Update</i>	889	Buy
29-Jan-08	Havell's India	On track; <i>Result Update</i>	560	Buy
25-Jan-08	TIL	Margins continue to Impress; <i>Result Update</i>	610	Buy
21-Jan-08	TRF	Dismal growth, but record margins; <i>Result Update</i>	1,531	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	110	43	15	2	188

* 12 stocks under review / 6rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	88	74	26

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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