

## Deepak Fertilisers and Petrochemicals

 BSE code: 500645  
 NSE code: DEEPAKFERT

**CMP: Rs 101**
**Target: Rs 158**
**BUY**
**Sudeep Anand**

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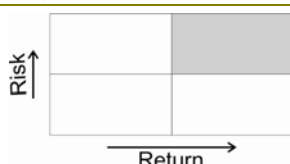
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**Company data**

Particulars	
Market cap (Rs bn / US\$ mn)	8.9/224.4
Outstanding equity shares (mn)	88.2
52-week high/low (Rs)	127 / 73
3-month average daily volume	214,292

**Financial snapshot**

Particulars	FY07	FY08E	FY09E
Sales (Rs mn)	8,729.3	11,151.4	14,010.2
Growth (%)	43.4	27.7	25.6
Adj net profit (Rs mn)	920.1	1,226.4	1,640.6
Growth (%)	19.6	33.3	33.8
FDEPS (Rs)	10.4	13.9	18.6
Growth (%)	19.6	33.3	33.8
P/E (x)	9.7	7.3	5.4
ROE (%)	15.0	17.7	20.4

**Risk-return profile**

**Shareholding pattern**

(%)	Sep-07	Jun-07
Promoters	41.9	41.9
FIs	2.6	2.0
Banks & FIs	18.9	18.0
Public	36.6	38.1

**Stock performance**

Returns (%)	CMP	1-mth	3-mth	6-mth
Deepak Fert	101	(10.3)	0.1	19.2
Sensex	18,513	9.5	17.9	30.2

**Company website** [www.dfpci.com](http://www.dfpci.com)
**IPA sales fuel performance**

Deepak Fertilisers and Petrochemicals' (DFPCL) net sales increased 5.4% YoY to Rs 2.2bn in Q2FY08, slightly below our expectations due to slower growth in the agri-services division. However, the company witnessed strong growth in the industrial chemical business, driven by higher IPA and propane sale volumes. Further, the increased capacity utilisation at the IPA plant led a considerable 560bps expansion in EBITDA margin to 17.6% and propelled operating profit growth to 54% YoY. Net profit increased at a slower rate of 21% YoY due to higher depreciation, interest and tax expenses and lower other income.

We expect rising IPA sales to underpin future growth. Also, the company's new 15,000tpa ammonia storage tank is on schedule for completion by early FY09, which will reduce dependency on gas as a feedstock. Branching and connecting links for GAIL's Dahej-Uran pipeline are also nearing completion and DFPCL expects to finalise a gas supplier soon. We expect these developments to improve the company's utilisation level significantly. DFPCL's retail foray is also progressing smoothly with close to 80% (440,000sq ft) of the area at its specialty mall leased out so far and the first store recently opening its doors. We expect robust revenue streams from this foray, and maintain our Buy call on the stock with a one-year target price of Rs 158.

**Actual vs estimated performance**

(Rs mn)	Actual	Estimated	% Variance
Net sales	2,240.5	2,362.7	(5.2)
EBITDA	393.8	432.3	(8.9)
PAT	219.9	249.9	(12.0)
EPS (Rs)	2.5	2.8	(12.1)

Source: Company, Religare Research

**Quarterly results**

(Rs mn)	Q2FY08	Q2FY07	% Chg YoY	Q1FY08	% Chg QoQ
Net sales	2,240.5	2,125.6	5.4	2,197.9	1.9
Total expenditure	1,846.7	1,869.9	(1.2)	1,811.2	2.0
EBITDA	393.8	255.7	54.0	386.7	1.8
EBITDA margin (%)	17.6	12.0	-	17.6	-
Depreciation	108.4	89.8	20.7	106.1	2.2
Interest	30.5	28.4	7.4	50.0	(39.0)
EBIT	254.9	137.5	85.4	230.6	10.5
Other income	67.9	106.4	(36.2)	115.6	(41.3)
Tax expenses	102.9	62.8	63.9	119.3	(13.7)
PAT	219.9	181.1	21.4	226.9	(3.1)
Net profit margin (%)	9.8	8.5	-	10.3	-
EPS (Rs)	2.5	1.8	39.9	2.6	(2.7)

Source: Company, Religare Research

## Result highlights

**IPA and propane sales rose 13% YoY to Rs 720mn; higher plant utilisation boosts margins**

### Higher IPA volumes expand sales

DFPCL's net sales grew 5.4% YoY to Rs 2.2bn in Q2FY08, led by strong growth in the industrial chemical business arising from higher iso-propyl alcohol (IPA) sales. Increased production volumes of this product resulted in a 12.5% rise in revenues from IPA and propane to Rs 720mn as compared to Rs 640mn in Q1FY08. Revenues from the agri-services division, however, slowed down due to reduced availability of phosphoric acid and lower availability of material for trading.

### Steep rise in EBITDA margin

DFPCL's EBITDA margin increased 560bps YoY to 17.6%, in line with our expectations. The company has increased its utilisation level at the IPA plant to almost 70% from 30% in FY07, which greatly improved cost efficiency. Consequently, EBITDA increased 54% YoY to Rs 393.8mn during the quarter.

### Higher tax and depreciation limits PAT growth

Despite the strong operating profit, the company's net profit increased 21.4% YoY to Rs 219.9mn in Q2FY08. DFPCL's depreciation, interest and tax expenses grew 20.7%, 7.4% and 63.9% YoY during the quarter, partially offsetting the higher operating gain. Further, other income declined 36.2% YoY to Rs 67.9mn in Q2FY08 owing to the lower return on its investments.

## Future outlook

### Ammonia storage tank on schedule for early FY09

DFPCL uses natural gas and propylene as feedstock to manufacture its products. However, the gas supply is limited and meets only 65–70% of its total requirement, leading to under-utilisation of its plants for products like methanol, nitro phosphate and diluted nitric acid. The company is building a 15,000tpa ammonia storage tank at Jawaharlal Nehru Port Trust (JNPT) to supplement its feedstock requirements. The tank is on schedule to come online by early FY09, which will help the company to reduce dependency on gas as a feedstock.

### Dahej-Uran pipeline nearing completion

GAIL commissioned the 489km Dahej-Uran gas pipeline in June 2007, while branching and connecting pipelines with its Taloja plant are nearing completion. This will provide the company with a regular supply of LNG. DFPCL is also in the final stage of negotiations for tie-ups for additional gas supplies. Once it is able to procure additional gas, capacity utilisation will increase dramatically. In FY07, methanol, ammonium nitrate, and diluted nitric acid production ran at very low utilisation levels of 68%, 29% and 78% respectively.

### First store at retail mall 'Ishanya' opened recently

DFPCL has set up a design centre and specialty mall called Ishanya in Pune focusing exclusively on interior and exterior designing. The first store at the mall, Croma from the Tata Group, has recently opened doors to customers. The company expects a large number of stores to be opened during this festival season. Once the mall is fully operational, Ishanya will have over 100 outlets and nearly 5,000 brands. The company has already leased out nearly 80% of the 550,000sq ft of leasable area, which will generate strong revenue streams going forward.

**550,000sq ft is being leased out to over 100 retail outlets at the Ishanya mall in Pune**

## Valuation

### Buy with a target price of Rs 158

At the current market price the company is trading at a P/E multiple of 7.3x on FY08E and 5.4x on FY09E. We have used a sum-of-the-parts (SOTP) valuation which assesses DFPCL's commodity business and the Ishanya project separately. We reiterate our Buy recommendation on the stock with a one-year target price of Rs 158.

#### DCF assumptions – Commodities

Particulars	Assumptions
Risk free rate of return (%)	8.0
Beta	1.2
Market risk premium (%)	7.0
Cost of equity (%)	16.4
Cost of debt (%)	11.0
Debt-to-equity ratio (FY08) (%)	0.5
Cost of capital (%)	13.5
Terminal growth rate (%)	2.0
Total enterprise value (Rs mn)	13,961.3
Value of equity (Rs mn)	10,960.6
Fully diluted no. of shares (mn)	88.2
Fair value per share (Rs)	124
Target price per share (Rs)	141

Source: Religare Research

#### Ishanya project assumptions

Particulars	Assumptions
Revenue in FY08 (Rs mn)	120
Revenue in FY09 onwards (Rs mn)	400
Capitalisation rate (%)	8.5
Initial investment (Rs mn)	1,500
Cost of capital	13.6%
Total value of the project (Rs mn)	1,248
Fair value per share (Rs/share)	14
Target price per share (Rs/share)	17

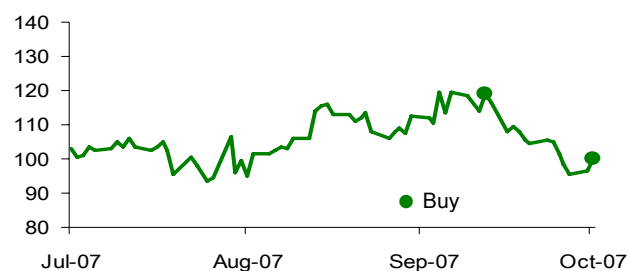
Source: Religare Research

#### Recommendation history

Date	Event	Reco price	Tgt price	Reco
04-Oct-07	Initiating Coverage	114	158	Buy
25-Oct-07	Results Update	101	158	Buy

Source: Religare Research

#### Stock performance



Source: Religare Research

## Consolidated financials

### Profit and Loss statement

(Rs mn)	FY06	FY07	FY08E	FY09E
Revenues	6,086.1	8,729.3	11,151.4	14,010.2
Growth (%)	15.6	43.4	27.7	25.6
EBITDA	1,085.0	1,511.3	2,061.6	2,809.1
Growth (%)	(18.6)	39.3	36.4	36.3
Depreciation	(397.4)	(472.8)	(522.5)	(579.5)
EBIT	1,032.1	1,422.0	1,940.9	2,650.9
Growth (%)	(13.1)	37.8	36.5	36.6
Interest	(59.1)	(116.3)	(192.7)	(312.2)
Other income	330.8	369.7	388.2	407.6
EBT	1,099.3	1,295.8	1,748.3	2,338.7
Growth (%)	(3.9)	17.9	34.9	33.8
Tax	(330.2)	(375.7)	(521.9)	(698.2)
Effective tax rate	30.0	29.0	29.9	29.9
Adj net income	769.0	920.1	1,226.4	1,640.6
Growth (%)	(3.2)	19.6	33.3	33.8
Shares outstanding (mn)	88.2	88.2	88.2	88.2
FDEPS (Rs)	8.7	10.4	13.9	18.6
DPS (Rs)	3.0	3.0	3.0	3.0
CEPS (Rs)	13.3	15.9	19.8	25.2

Source: Company, Religare Research

### Cash flow statement

(Rs mn)	FY06	FY07	FY08E	FY09E
Net income	769.0	920.1	1,226.4	1,640.6
Depreciation	397.4	472.8	522.5	579.5
Other adjustments	(158.2)	316.4	(13.7)	(13.7)
Changes in WC	(427.0)	(939.7)	(456.3)	(374.0)
Operating cash flow	581.3	769.6	1,279.0	1,832.4
Capital expenditure	(1,480.9)	(1,730.8)	(1,000.0)	(4,000.0)
Investments	264.5	49.7	0.0	0.0
Other investing inc/(exp)	148.1	33.4	0.0	0.0
Investing cash flow	(1,068.3)	(1,647.8)	(1,000.0)	(4,000.0)
Free cash flow	(487.1)	(878.2)	279.0	(2,167.6)
Issue of equity	0.0	0.0	0.0	0.0
Issue/repay debt	834.7	1,492.3	400.0	2,500.0
Dividends paid	(302.2)	(309.9)	(309.9)	(309.9)
Others	(57.4)	(183.1)	18.7	0.0
Financing cash flow	475.1	999.3	108.8	2,190.1
Beg. cash & cash eq	250.7	238.8	359.9	747.6
Chg in cash & cash eq	(12.0)	121.1	387.7	22.5
Closing cash & cash eq	238.8	359.9	747.6	770.1

Source: Company, Religare Research

### Balance sheet

(Rs mn)	FY06	FY07	FY08E	FY09E
Cash and cash eq	238.8	359.9	747.6	770.1
Accounts receivable	1,019.7	1,288.4	1,631.7	2,036.1
Inventories	669.0	1,205.6	1,383.0	1,737.5
Others current assets	653.1	952.1	1,044.4	1,298.1
Current assets	2,580.6	3,805.9	4,806.7	5,841.7
LT investments	1,457.4	1,407.8	1,407.8	1,407.8
Net fixed assets	3,511.7	5,131.3	5,608.8	9,029.3
CWIP	2,242.3	1,880.7	1,880.7	1,880.7
Total assets	9,792.0	12,225.7	13,703.9	18,159.5
Payables	545.4	895.0	1,071.4	1,360.1
Others	1,068.8	890.4	889.4	1,239.3
Current liabilities	1,614.2	1,785.4	1,960.8	2,599.4
LT debt	1,760.8	3,253.1	3,653.1	6,153.1
Other liabilities	532.3	705.1	705.1	705.1
Equity capital	882.0	882.0	882.0	882.0
Reserves	5,002.7	5,600.0	6,502.8	7,819.8
Net worth	5,884.7	6,482.1	7,384.9	8,701.9
Total liabilities	9,792.0	12,225.7	13,703.9	18,159.5
BVPS (Rs)	66.7	73.5	83.7	98.7

Source: Company, Religare Research

### Financial ratios

	FY06	FY07	FY08E	FY09E
EBITDA margin (%)	17.8	17.3	18.5	20.1
EBIT margin (%)	17.0	16.3	17.4	18.9
Net profit margin (%)	10.6	10.7	11.0	11.7
FDEPS growth (%)	(3.2)	19.6	33.3	33.8
Receivables (days)	61.2	53.9	53.4	53.0
Inventory (days)	40.1	50.4	45.3	45.3
Payables (days)	32.7	37.4	35.1	35.4
Current ratio (x)	1.6	2.1	2.5	2.2
Interest coverage (x)	17.5	12.2	10.1	8.5
Debt/equity ratio (x)	0.3	0.5	0.5	0.7
ROE (%)	11.4	15.0	17.7	20.4
ROCE (%)	10.3	11.6	13.1	14.4
ROAE (%)	7.2	8.4	9.5	10.3
EV/Sales (x)	1.9	1.4	1.1	0.8
EV/EBITDA (x)	10.9	7.8	5.7	4.2
P/E (x)	11.6	9.7	7.3	5.4
P/BV (x)	1.5	1.4	1.2	1.0
P/CEPS (x)	7.6	6.4	5.1	4.0

Source: Company, Religare Research

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### Recommendation parameters

			Returns	Absolute
Large-caps*	> 10%	< - 5%		
	BUY	SELL		
Mid-caps**	> 25%	< 10%		

\*Market cap over US\$ 1bn \*\*Market cap less than US\$ 1bn

### Religare Securities

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