

DEEPAK FERT. & PETROCHEM.

INR 102

*Execution delays continue*

BUY

Deepak Fertilizer and Petrochemicals Corporation Limited (DFPCL) Q3FY07 results were in line with expectations. Net revenues registered growth of 69.7% Y-o-Y at INR 2.4 bn and net profits grew by healthy 54.7% Y-o-Y to INR 247 mn. This was on account of strong performance of both its chemicals and fertilizers businesses, which grew by 63.3% and 67.5% Y-o-Y, respectively. EBITDA, at INR 406 mn, was 47% higher Y-o-Y and EBITDA margins improved by 470bps sequentially. This is due to higher contribution of traded segments and subsequently lower raw material costs.

DFPCL's iso propyl alcohol (IPA) plant has already commenced operations and has registered revenues of INR 149 mn for this quarter. For 9MFY07, the plant has, however, registered sales of only INR 233.4 mn as against our estimate of INR 840 mn for the year. This is due to delay in the start of the project and disruption of supply of raw material from the supplier. Adjusted for the contribution of IPA plant, DFPCL's chemical business grew by 48.6% Y-o-Y.

Delay in start of ammonium nitrate project at Paradip continues with management revising its guidance for completion of the project by June 2009. We estimated revenues of INR 1.5 bn in FY08E and 2.9 bn in FY09E, which is unlikely to come through. The phased opening of real estate project is also slated to be in April 2007 as against the earlier expectation of December 2006. Based on the aforesaid factors and robust growth in the fertilizer and chemical divisions, we are revising our revenue forecast upwards in FY07E and FY08E by 25.9% and 5.4% respectively. Our EPS forecast is revised downwards by 5.1% and 13.3% for FY07E and FY08E respectively.

Our sum of parts value is INR 125.9 for FY08E and INR 145.2 for FY09E. This has come down from our earlier estimate of INR 162 and INR 218 due to delay in gas availability and more importantly due to delay of the higher marginal and secular ammonium nitrate business. On our revised EPS of INR 10.7 and INR 12.2 the stock trades at a PE of 9.5x and 8.4x our FY07E and FY08E estimates, respectively. We maintain our 'Buy' recommendation.

Result Highlights

- DFPCL registered net revenues of INR 2.4 bn, a growth of 69.7% Y-o-Y, driven by strong sales growth in fertilizer and industrial chemicals.

Fertilizer sales increased by 67.5% Y-o-Y, led by 145% Y-o-Y growth in traded business.

Financials

Year to March	Q3FY07	Q3FY06	% change	Q2FY07	% change	FY07E	FY08E
Sales (INR mn)	2,433	1,434	69.7	2,126	14.5	8,890	9,823
EBITDA (INR mn)	406	276	47.3	256	58.8	1,491	2,192
Net profit (INR mn)	247	160	54.7	157	57.6	941	1,075
EPS (INR)	2.8	1.8	54.7	1.8	57.6	10.7	12.2
P/E (x)						9.5	8.4
EV/ EBITDA						6.1	4.1
ROE (%)						15.5	15.8

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Market Data

52-week range (INR) : 115 / 63
Share in issue (mn) : 88.2
M cap (INR bn/USD mn) : 9.0 / 203.8
Avg. Daily Vol. BSE/NSE ('000) : 286.3

Share Holding Pattern (%)

Promoters : 41.0
MFs, Fls & Banks : 19.2
Fls : 1.1
Others : 38.7

Chemical business grew 63.3% Y-o-Y, driven by strong growth in manufactured division (59.1% Y-o-Y growth) and traded division (82.45 Y-o-Y growth).

- ◆ EBITDA, at INR 406 mn, grew 47.3% Y-o-Y and 58.5% sequentially. Prices of naphtha, a key input for manufacturing chemicals, have risen 72% Y-o-Y in 9MFY07.
- ◆ Segmental profit for the chemical and fertilizer businesses grew 49.4% and 81% Y-o-Y.
- ◆ Depreciation cost grew 40.6% Y-o-Y and is higher on account of depreciation charges of its IPA plant. Net profit increased 54.7% to INR 247 mn and 57.6% sequentially, whereas net profit margins improved by 180bps to 9.9%.

*** Sum of the parts valuation**

Given the various businesses DFPCL has and the new annuity businesses, ones with secular credentials, we have tried to look at Deepak's valuations using sum of the parts as well as by attaching some value to the current land that it has and which will be used in the next 1 year. Based on this, we arrive at a one-year expected value of INR 125.9/share and a 2-year expected value of INR 145.2/share.

Table 1: Some of the parts valuation

(INR mn)	Base case		Optimistic case		Pessimistic case	
	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E
- Current business EBITDA	1,216		1,216		1,216	
- Less: AN	503		503		503	
Commodity business EBITDA	712	712	712	712	712	712
Target EV/EBITDA (x)	4.0	4.0	5.0	5.0	3.0	3.0
EV	2,850	2,850	3,562	3,562	2,137	2,137
Retail mall						
Revenues	225		225		225	
Yield (%)	10.0		10.0		12.0	
EV	2,250	2,250	2,250	2,250	1,875	1,875
IPA project						
EBITDA	708	817	708	817	708	817
Target EV/EBITDA (avg of commodity and secular valuation)	5.5	5.5	6.5	6.5	4.5	4.5
EV	3,892	4,496	4,599	5,313	3,184	3,678
AN EBITDA						
- Existing	503	503	503	503	503	503
- New	0	0	0	0	0	0
Target EV/EBITDA (x)	7.0	7.0	8.0	8.0	6.0	6.0
EV	3,521	3,521	4,024	4,024	3,018	3,018
Incremental commodity business EBITDA on gas upside						
- Power & fuel saving	125	250	250	250	250	250
- Utilisation upside to fertiliser & methanol	175	350	350	350	350	350
Less: Methanol down cycle	250	250	250	250	250	250
Target EV/EBITDA (x)	4.0	4.0	5.0	5.0	3.0	3.0
EV	200	1,400	1,750	1,750	1,050	1,050
Value of existing 10 acre plot	1,000	1,000	1,000	2,000	500	500
Total EV	13,713	15,517	17,186	18,900	11,765	12,259
Add: Net cash	(2,610)	(2,712)	(2,610)	(2,712)	(2,610)	(2,712)
Equity value	11,103	12,805	14,576	16,187	9,155	9,547
No of shares (mn)	88.2					
Sum-of-parts value (INR/share)	125.9	145.2	165.3	183.5	103.8	108.2
Current stock price (INR)	102					
	1-year	2-year	1-year	2-year	1-year	2-year
Upside (%)	23.5	42.5	62.2	80.1	1.9	6.2
CAGR (%)	2,353.8	19.4	6,218.1	34.2	186.3	3.1

Source: Edelweiss research

Segmental results - Q3FY07

	Q3FY07	Q3FY06	% change	Q2FY07	% change
Segment revenue	2,457	1,458	<i>68.5</i>	2,249	<i>0.1</i>
Chemicals	1,658	1,015	<i>63.3</i>	1,205	<i>0.4</i>
- Manufactured	1,321	830	<i>59.1</i>	1,040	<i>0.3</i>
- Traded	337	185	<i>82.4</i>	164	<i>1.0</i>
Bulk fertilizers	845	505	<i>67.5</i>	1,044	<i>(0.2)</i>
- Manufactured	197	240	<i>(18.0)</i>	207	<i>(0.0)</i>
- Traded	649	265	<i>145.2</i>	838	<i>(0.2)</i>
PBIT	395	277	<i>42.6</i>	302	<i>0.3</i>
Chemicals	532	356	<i>49.4</i>	374	<i>0.4</i>
Bulk fertilizers	(135)	(75)	<i>81.0</i>	(66)	<i>1.0</i>
Less: Interest	24	16	<i>53.8</i>	28	<i>(0.1)</i>
Less: Net unallocable exp	28	26	<i>5.8</i>	54	<i>(0.5)</i>
PBT	343	235	<i>45.9</i>	220	<i>0.6</i>
Profitability (%)	16.1	19.0		13.4	
Chemicals	32.1	35.1		31.1	
Bulk fertilizers	(16.0)	(14.8)		(6.3)	

Financial snapshot

(INR mn)

Year to March	Q3FY07	Q3FY06	% change	Q2FY07	% change	FY06	FY07E	FY08E
Net sales	2432.9	1,434	<i>69.7</i>	2,126	<i>14.5</i>	5,629	8,890	9,823
Total expenditure	2026.9	1,158	<i>75.0</i>	1,870	<i>8.4</i>	4,593	7,400	7,630
EBITDA	406	276	<i>47.3</i>	256	<i>58.8</i>	1,036	1,491	2,192
Other income	72.7	55	<i>31.2</i>	106	<i>(31.7)</i>	326	317	128
Depreciation	110.2	78	<i>40.6</i>	90	<i>22.7</i>	316	378	599
EBIT	368.5	253	<i>45.8</i>	272	<i>35.3</i>	1,046	1,112	1,593
Interest (Net)	24.3	16	<i>53.8</i>	28	<i>(14.4)</i>	57	104	207
PBT	344.2	237	<i>45.3</i>	244	<i>41.1</i>	990	1,326	1,514
Taxes	95.7	77	<i>24.3</i>	63	<i>52.4</i>	319	384	439
PAT	249	160	<i>55.4</i>	181	<i>37.2</i>	670	941	1,075
Extra-ordinary items	1	-		24	<i>(95.4)</i>	(129)	-	-
Adjusted PAT	247	160	<i>54.7</i>	157	<i>57.6</i>	799	941	1,075
Tax rate (%)	27	31		25		<i>31.4</i>	<i>29.0</i>	<i>29.0</i>
% of sales								
Raw material	21	32		28		23	21	22
Staff cost	5	7		5		7	5	5
Other expenditure	58	42		54		50	51	48
EBITDA	17	19		12		18	17	22
Net profit	10	11		8		11.3	10.6	10.9

Company Description

Incorporated in 1979, DFPCL started commercial production of ammonia in 1983 with natural gas as a 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-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 a cyclical business. 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. Thus, in late 90's 70% of its sales came from fertilizers (at a time when chemicals was in a down cycle), while over 70% of its sales come from chemicals currently. DFPCL is also venturing into three big projects that provide growth impetus for the company in the coming years.

Risks and Concerns

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 to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	4,782	5,629	8,890	9,823	10,048
Manufacturing expenses	2,838	3,740	6,515	6,592	6,544
Employee expenses	405	415	465	535	589
S G & A expenses	291	437	420	504	554
Total expenditure	3,534	4,592	7,400	7,630	7,687
EBITDA	1,247	1,036	1,491	2,192	2,362
Depreciation	311	316	378	599	693
EBIT	936	721	1,112	1,593	1,668
Interest expenditure	87	57	104	207	227
Other income	228	326	317	128	122
Profit before tax	1,078	991	1,326	1,514	1,563
Provision for taxation	327	372	384	439	453
Profit after tax	750	619	941	1,075	1,110
Recurring net profit	750	619	941	1,075	1,110
Extraordinary items	47	-	-	-	-
Reported profit	797	619	941	1,075	1,110
EPS (INR) fully diluted	9.0	9.0	10.7	12.2	12.6
CEPS (INR) fully diluted	12.6	12.6	15.0	19.0	20.4
Dividend per share (INR)	1.9	1.9	3.0	3.0	3.2
Dividend payout ratio (%)	0.3	0.3	0.3	0.3	0.3

Common size metrics- as % of net revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Manufacturing expenses	59.4	66.4	73.3	67.1	65.1
Employee expenses	8.5	7.4	5.2	5.4	5.9
S G & A expenses	6.1	7.8	4.7	5.1	5.5
Depreciation	6.5	5.6	4.3	6.1	6.9
Interest expenditure	1.8	1.0	1.2	2.1	2.3
EBITDA margin	26.1	18.4	16.8	22.3	23.5
EBIT margin	19.6	12.8	12.5	16.2	16.6
Net profit margin	15.7	11.0	10.6	10.9	11.0

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net revenues	1.4	17.7	57.9	10.5	2.3
EBITDA	1.1	(16.9)	43.8	47.1	7.7
EBIT	(0.1)	(23.0)	54.3	43.2	4.7
Net profit	14.4	(22.4)	52.1	14.2	3.2
EPS	14.4	0.0	18.0	14.2	3.2

Balance sheet					(INR mn)
As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Share capital	882	882	882	882	882
Reserves	4361	4855	5549	6301	7078
Shareholders funds	5,243	5,737	6,431	7,183	7,960
Secured loans	909	1,761	2,409	2,909	2,909
Deferred tax liability	511	483	483	483	483
Sources of funds	6,662	7,981	9,322	10,575	11,352
Gross assets	6,784	6,774	9,168	11,668	13,168
Less Depreciation	3,820	4,079	4,525	5,124	5,817
Net fixed assets	2,965	2,695	4,644	6,545	7,351
CWIP	811	2,257	2,257	2,257	2,257
Investments	883	882	882	882	882
<i>Current assets</i>	<i>3,192</i>	<i>3,729</i>	<i>3,691</i>	<i>3,282</i>	<i>3,371</i>
Debtors	548	906.0	1,188	1,312	1,342
Cash & bank balance	1,833	1,713.5	937	299	196
Inventory	384	609.1	840	794	806
Advances	427	499.9	727	877	1,027
<i>Current liabilities</i>	<i>1,189</i>	<i>1,606</i>	<i>2,186</i>	<i>2,425</i>	<i>2,544</i>
Creditors	138	522	710	784	802
Other liabilities	587	632	695	765	841
Provisions	464	453	781	876	901
Working capital	2,003	2,122	1,505	857	827
Misc expenditure		25	25	25	25
Uses of funds	6,662	7,981	9,313	10,565	11,342
BV (INR)	59.4	65.0	72.9	81.4	90.3

Cash flow statement					(INR Mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net profit	753	798	941	1,075	1,110
Add: Depreciation	311	316	378	599	693
Add: Deferred tax	(78)	53	-	-	-
Gross cash flow	986	1,141	1,320	1,674	1,803
Less: Dividends	265	265	282	323	333
Less: Changes in W. C.	(377)	239	169	(11)	73
Operating cash flow	1,098	638	868	1,362	1,397
Less: Change in investments	54	(1)	-	-	-
Less: Capex	703	1,436	2,394	2,500	1,500
Free cash flow	341	(797)	(1,526)	(1,138)	(103)

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE (%)	16.0	14.5	15.5	15.8	14.7
ROCE (%)	19.9	18.0	17.5	18.2	17.1
Debtor days	41.8	58.8	48.8	48.8	48.8
Inventory days	29.3	39.5	34.5	29.5	29.3
Fixed assets T/o (x)	1.3	1.3	1.5	1.3	1.1
Debt/Equity (x)	0.2	0.3	0.4	0.4	0.4
Interest coverage (x)	14.0	21.7	13.7	8.3	7.9

Valuation parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (diluted) (INR)	9.0	9.0	10.7	12.2	12.6
<i>Y-o-Y growth (%)</i>	<i>14.4</i>	<i>0.0</i>	<i>18.0</i>	<i>14.2</i>	<i>3.2</i>
CEPS	12.6	12.6	15.0	19.0	20.4
PE (x)	11.3	11.3	9.5	8.4	8.1
Price/BV (x)	1.7	1.6	1.4	1.3	1.1
EV/Sales (x)	1.7	1.6	1.0	0.9	0.9
EV/EBITDA (x)	6.5	7.4	6.1	4.1	3.8

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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