

# DEEPAK FERTILIZER

## Dry patch; high-risk high-return opportunity

India Equity Research | Fertilisers

Deepak Fertilisers (DFPCL) reaped a disappointing Q3FY19 suffering from raw material shortage, inventory losses and water-availability issues. That said, we attribute its underperformance to its high gearing with debt/EBITDA at 6x and large ongoing capex. At the same time, we believe the company's strong operating cash flow of ~INR6bn and leadership in concentrated chemical products offers deep long-term value. All in all, we are cutting FY19/20E EBITDA by 24%/13%. Valuing the stock at EV/EBITDA of 6.5x yields our new target price of INR175 (versus INR243 earlier). Though the spectre of debt/capex continues to overhang, we maintain 'BUY' based on our high-risk high-return conviction given the stock's susceptibility to the direction of leverage/capex.

### Multiple one-offs afflict Q3FY19...

Consolidated revenue slid 11% YoY to INR14.5bn impacted by de-growth across the chemical segment (down 21% YoY) overshadowing the 12% YoY growth in the fertiliser segment. Lack of water hurt IPA and acids production in chemicals. In the fertilizer segment lower phosphoric acid availability and higher prices of phosphoric acid and ammonia affected profitability with an EBIT loss of INR137mn. PAT tanked 59% YoY to INR185mn affected by a fall-off in EBITDA and spike in interest cost.

### ...but leveraged balance sheet and huge capex key concerns

We believe DFPCL's high gearing (debt/EBITDA at 6x) and large ongoing capex (topping INR55bn on aggregate across ammonia, TAN and IPA) clouds near-term performance. Though management continues to evaluate options for strengthening the balance sheet (including divestment of non-core assets) and funding the capex along with some strategic investors, we believe the stock would continue to be under pressure given absence of any concrete plans.

### Outlook and valuation: A risky bet; maintain 'BUY'

Factoring in the aforementioned challenges, we cut FY19/20E EBITDA by 24%/13%, not to mention the high risk to bottom line due to the steep interest cost. We are trimming the FY20E EV/EBITDA to 6.5x (from 7x) based on a 15% discount to last five-years' average, which yields a new TP of INR175 (versus INR243 earlier). Though we acknowledge the high-risk nature of this investment opportunity, we do believe management has the ability to face these rough times and deliver long-term value.

#### Financials

(INR mn)

Year to March	Q3FY19	Q3FY18	% Chg	Q2FY19	% Chg	FY18	FY19E	FY20E
Net revenues	14,534	16,449	(11.6)	17,687	(17.8)	59,949	65,073	53,600
EBITDA	1,078	1,490	(27.7)	1,151	(6.3)	5,452	5,092	6,679
Adjusted Profit	125	570	(78.1)	185	(32.6)	1,641	940	2,245
Adjusted Diluted EPS	1.4	6.5	(78.3)	2.1	(33.3)	18.6	10.7	25.5
Diluted P/E (x)						6.5	11.3	4.7
EV/EBITDA (x)						7.5	8.0	5.8
ROAE (%)						8.1	4.5	10.2

#### EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

#### MARKET DATA (R: DPFE.BO, B: DFPC IN)

CMP	: INR 119
Target Price	: INR 175
52-week range (INR)	: 397 / 104
Share in issue (mn)	: 88.2
M cap (INR bn/USD mn)	: 11 / 144
Avg. Daily Vol. BSE/NSE ('000)	: 294.6

#### SHARE HOLDING PATTERN (%)

	Current	Q2FY19	Q1FY19
Promoters *	51.2	51.2	51.2
MF's, FI's & BKs	3.2	4.3	4.5
FII's	4.0	6.0	6.2
Others	41.6	38.5	38.1
* Promoters pledged shares (% of share in issue)	:	NIL	

#### PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	(5.7)	(21.3)	(15.6)
3 months	(0.4)	(40.6)	(40.2)
12 months	(16.1)	(70.6)	(54.5)

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### Q3FY19: Conference call highlights

#### Q3FY19:

- Performance was affected by rare circumstances. There were headwinds in all the three business segments—Pharma Chem, Mining Chemicals and Fertiliser.
- Phosphoric acid prices shot up 46% YoY, propylene prices 25% YoY and ammonia price 25% YoY. The company faced severe issues in procuring phosphoric acid. Unprecedented water shortage issues affected the fertiliser segment.

#### Debt

- The company repaid INR2.50bn of capital market borrowing in January. From September through December, DFPC paid back INR 1.50bn in debt.
- Peak debt figure: INR20.4bn (INR7.5bn drawn so far; the rest can be drawn over the next 32 months).
- Repayment to start after two years of commissioning of the ammonia project. Interest cost to be capitalised.
- All debt in Indian rupees.

#### Capex

- Dahej: FY19 -> INR55bn
- FY20 -> INR80bn (ammonia plant)

#### Trading

- Chemical trading likely to reduce. The company plans to reduce the contribution from traded chemicals to INR1.8bn

#### Raw materials

- Ammonia: 80% is imported. After the start of plant, the Talaja facility will be 100% catered by the plant.
- Phosphoric acid: Diversified sources of procurement.
- Propylene: Situation normal after a rare incident that took place at a BPCL facility.
- GAS: Consumption to double up after the new ammonia facility gets commissioned. However, ample LNG facility.

#### Fertiliser

- The company is focused on the value-added specialty segment. Growth seen in the differentiated and specialty segments.
- Phosphoric acid: Price reduction of USD15/ton seen in Q3FY19.
- NP/NPK market share for DFPC is 19%.

#### Chemical

- Inventory loss of INR63mn written off. Methanol price dropped due to the America-Iran trade issue, which dragged methanol price 30–40%.

#### Regulatory approval

- Ammonia: Approval likely by August–September.
- TAN: Approval expected by August–September.
- IPA: Expected by March–April this year.
- NPK: Expected by March–April this year.

#### Outlook

- IPA: Volumes likely to improve. Raw material cost has started easing. Therefore, margin and volumes are expected to improve.
- Nitric acid: Demand outlook is good. The Dahej facility would add a capacity of 1,50,000 tons. Overall, we expect margins to improve.
- TAN: Operating at 100% utilisation. Strong demand remains. Softening of ammonia prices will improve operating margins.
- NPK: Phosphoric acid supply situation improved. Shift from the bulk fertiliser to specialty fertiliser to derive improvement in margins.
- Chemical segment: Recovery is expected in immediate terms.

## Fertilisers

**Table 1: Operational performance**

(INR mn)

Segment revenue	Q3FY19	Q3FY18	% YoY	Q2FY19	% QoQ
a) Chemicals					
Manufactured	6,445	5,986	7.7	6,702	(3.8)
Traded	3,024	5,930	(49.0)	4,094	(26.1)
Total	9,469	11,916	(20.5)	10,795	(12.3)
b) Fertilisers					
Manufactured	3,096	3,829	(19.2)	3,548	(12.7)
Traded	1,914	661	189.6	3,249	(41.1)
Total	5,010	4,490	11.6	6,797	(26.3)
c) Realty	52	40	29.1	60	(14.7)
d) Others	4	3	20.7	34	(89.8)
<b>Total</b>	<b>14,534</b>	<b>16,449</b>	<b>(11.6)</b>	<b>17,687</b>	<b>(17.8)</b>
Less: Inter segmental revenue	0	0		0	#DIV/0!
<b>Net revenue from operations</b>	<b>14,534</b>	<b>16,449</b>	<b>(11.6)</b>	<b>17,687</b>	<b>(17.8)</b>
<b>Net profit before interest and tax</b>					
a) Chemicals	919	1,607	(42.8)	1,291	(28.8)
b) Fertilisers	-133	99	(234.5)	-45	193.0
c) Realty	-25	-33	NA	-38	NA
d) Others	-6	-7	(11.1)	25	
Total	755	1,665	(54.7)	1,232	(38.7)
Less: Interest	572	353	62.1	575	(0.5)
Less: Other unallocable expenditure	22	541	(96.0)	371	(94.1)
<b>Total profit before tax</b>	<b>162</b>	<b>771</b>	<b>(79.1)</b>	<b>287</b>	<b>(43.7)</b>
<b>PBIT (%)</b>					
a) Chemicals	9.7	13.5		12.0	
b) Fertilisers	(2.7)	2.2		(0.7)	
c) Realty	(48.5)	(83.2)		(62.1)	
d) Others	(182.9)	(248.3)		71.8	
<b>Capital employed</b>					
a) Chemicals	16,266	16,881		20,064	
b) Fertilisers	11,023	8,114		8,569	
c) Realty	2,059	2,236		2,367	
d) Others	221	280		328	
e) Unallocated	-8,202	-8,956		-10,546	
<b>Total</b>	<b>21,366</b>	<b>18,555</b>		<b>20,780</b>	

Source: Company, Edelweiss research

**Financial snapshot**
**(INR mn)**

Year to March	Q3FY19	Q3FY18	% change	Q2FY19	% change	YTD19	FY19E	FY20E
Net revenues	14,534	16,449	(11.6)	17,687	(17.8)	54,483	65,073	53,600
Raw material	11,422	12,556	(9.0)	14,025	(18.6)	43,546	48,805	36,448
Staff costs	685	656	4.5	629	8.9	2,040	2,827	3,109
Other expenses	1,349	1,748	(22.8)	1,883	(28.4)	5,188	8,350	7,364
Total expenditure	13,456	14,959	(10.0)	16,537	(18.6)	50,774	59,981	46,921
EBITDA	1,078	1,490	(27.7)	1,151	(6.3)	3,709	5,092	6,679
Depreciation	436	433	0.7	426	2.3	1,281	1,743	2,103
EBIT	642	1,057	(39.3)	724	(11.4)	2,428	3,349	4,576
Interest	572	353	62.1	575	(0.5)	1,720	2,296	1,782
Other income	92	67	37.6	137	(33.3)	305	200	200
Add: Prior period items								
Profit before tax	162	771	(79.1)	287	(43.7)	1,013	1,253	2,994
Provision for taxes	28	195	(85.7)	92	(69.6)	312	313	748
Minority interest								
Associate profit share								
Profit- Discontinued Ops								
Exceptional Items								
Reported net profit	134	576	(76.8)	195	(31.6)	701	940	2,245
Adjusted Profit	125	570	(78.1)	185	(32.6)	682	940	2,245
Diluted shares (mn)	89	88		88		89	88	88
Adjusted Diluted EPS	1.4	6.5	(78.3)	2.1	(33.3)	7.6	10.7	25.5
Diluted P/E (x)	-	-		-		-	11.3	4.7
EV/EBITDA (x)	-	-		-		-	8.0	5.8
ROAE (%)	-	-		-		-	4.5	10.2
<b>As % of net revenues</b>								
Raw material	78.6	76.3		79.3		79.9	75.0	68.0
Employee cost	4.7	4.0		3.6		3.7	4.3	5.8
Other expenses	9.3	10.6		10.6		9.5	12.8	13.7
EBITDA	7.4	9.1		6.5		6.8	7.8	12.5
Reported net profit	0.9	3.5		1.0		1.3	1.4	4.2

**Change in Estimates**

	FY19E			FY20E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	65,073	69,677	(6.6)	53,600	60,315	(11.1)	
EBITDA	5,092	6,665	(23.6)	6,678	7,656	(12.8)	
EBITDA Margin	7.8	9.6		12.5	12.7		
Adjusted Profit	940	2,352	(60.0)	2,245	3,224	(30.4)	
After Tax							
Net Profit Margin	1.4	3.4		4.2	5.3		
Capex	6,962	6,462	7.7	8,500	5,000	70.0	

### Company Description

DFPCL was incorporated in 1979 by Mr. C.K. Mehta as a private limited company. It is currently one of the leading manufacturers of industrial chemicals and fertilisers in India. The company operates in three business segments—chemicals, agribusiness, and specialty retailing. It has emerged as an integrated multi-product company manufacturing ammonia, iso propyl alcohol, methanol, nitric acid, low-density prilled ammonium nitrate, and nitro-phosphate fertilisers in its state-of-the-art plants operating with world class technology.

### Investment Theme

Deepak Fertiliser (DFPCL) management is confident about strong growth in its chemical business comprises of TAN, IPA and Nitric Acids on back of its aggressive capex plans.

Company has committed capex of INR8bn in IPA to increase its capacity by 1,00,000mtpa to 170,000 mtpa. This plant is likely to get completed over next 3 years and is likely to enjoy higher margins driven by efficiency as against current margins of 25-30%. In Nitric Acid, they plan to invest INR 5.5-6bn which is likely to be completed in 2 years and expected to contribute INR1bn to EBITDA.

DFPCL enjoys leadership in TAN (Technical Ammonium Nitrate) in India and controls 2/3rd of India's market. The product enjoys margins of 25% and company has plans for further capex however the same is not yet finalized.

Commissioning of fertilizer plant have already started contributing to revenues and company is expecting achieving 0.5mn MT of NPK fertilizer sales in FY18 and 0.8mn MT in FY19.

### Key Risks

Though the company has tied up with Middle East suppliers for ammonia and for natural gas with multiple sources in India, any issues on this front may pose a risk for DFPCL.

High volatility in crude prices could adversely impact the company's raw material costs and, hence, its profitability.

Any delay in the payment of subsidies by GoI or payment of the same by means of fertiliser bonds, could strain the company's working capital cycle. The Indian finance minister has, however, assured that the entire subsidy amount will be paid in cash and not bonds.

INR volatility may impact the operating margin of the chemicals segment of DFPCL.

## Financial Statements

### Key Assumptions

Year to March	FY18	FY19E	FY20E	FY21E
<b>Macro</b>				
GDP(Y-o-Y %)	6.5	7.1	7.6	7.6
Inflation (Avg)	3.6	4.5	5.0	5.0
Repo rate (exit rate)	6.0	6.0	6.5	6.5
USD/INR (Avg)	64.5	66.0	66.0	66.0
<b>Company</b>				
Raw Material (% net rev)	76.0	75.0	68.0	70.0
Chemicals EBITDA margin (%)	24.9	24.6	24.4	24.4
Fertiliser EBITDA margin (%)	2.0	(1.0)	4.5	5.5
Other exp (% net rev)	10.8	12.8	13.7	10.8
<b>Cost assumptions</b>				
<b>Financial assumptions</b>				
Employee cost (% of rev)	4.1	4.3	5.8	6.1
Tax rate as % of PBT	28.5	25.0	25.0	-
Capex (INR mn)	9,456	6,962	8,500	5,000
Debtor days	100	114	126	116
Inventory days	51	58	70	60
Payable days	54	77	111	87
Cash conversion cycle	97	95	85	89
Interest Exp (% of Debt)	6.7	7.0	5.5	4.8
Dep. (% gross block)	6.8	6.0	6.0	6.5

### Income statement

(INR mn)

Year to March	FY18	FY19E	FY20E	FY21E
Net revenue	59,949	65,073	53,600	55,999
Materials costs	45,549	48,805	36,448	39,200
Gross profit	14,399	16,268	17,152	16,800
Employee costs	2,458	2,827	3,109	3,420
Other Expenses	6,489	8,350	7,364	6,058
EBITDA	5,452	5,092	6,679	7,322
Depreciation	1,632	1,743	2,103	2,440
EBIT	3,820	3,349	4,576	4,882
Less: Interest Expense	1,732	2,296	1,782	1,784
Add: Other income	240.9	200.00	200.00	200.00
Profit Before Tax	2,329	1,253	2,994	3,298
Less: Provision for Tax	664	313	748	824
Less: Minority Interest	24	-	-	-
Reported Profit	1,641	940	2,245	2,473
Adjusted Profit	1,641	940	2,245	2,473
Shares o/s (mn)	88	88	88	88
Adjusted Basic EPS	18.6	10.7	25.5	28.0
Diluted shares o/s (mn)	88	88	88	88
Adjusted Diluted EPS	18.6	10.7	25.5	28.0
Adjusted Cash EPS	42.0	30.4	49.3	55.7
Dividend per share (DPS)	7.0	5.0	8.0	-
Dividend Payout Ratio(%)	44.0	54.9	36.8	-

### Common size metrics

Year to March	FY18	FY19E	FY20E	FY21E
Gross margin	24.0	25.0	32.0	30.0
EBITDA margins	9.1	7.8	12.5	13.1
EBIT margins	6.4	5.1	8.5	8.7
Net Profit margins	2.8	1.4	4.2	4.4

### Growth ratios (%)

Year to March	FY18	FY19E	FY20E	FY21E
Revenues	44.5	8.5	(17.6)	4.5
EBITDA	15.2	(6.6)	31.2	9.6
Adjusted Profit	6.1	(42.7)	139.0	10.2
EPS	6.1	(42.7)	139.0	10.2

Balance sheet		(INR mn)			
As on 31st March	FY18	FY19E	FY20E	FY21E	
Share capital	882	882	882	882	
Reserves & Surplus	19,580	19,988	21,384	23,008	
Shareholders' funds	20,462	20,870	22,266	23,890	
Minority Interest	403	400	400	400	
Long term borrowings	6,255	6,255	6,300	6,300	
Short term borrowings	28,392	25,000	27,000	35,000	
Total Borrowings	34,647	31,255	33,300	41,300	
Def. Tax Liability (net)	(785)	(785)	(785)	(785)	
<b>Sources of funds</b>	<b>54,728</b>	<b>51,741</b>	<b>55,181</b>	<b>64,805</b>	
Gross Block	25,542	32,542	37,542	37,542	
Net Block	21,489	26,747	29,644	27,204	
Capital work in progress	6,538	6,500	10,000	-	
Total Fixed Assets	399	399	399	399	
Total net fixed assets	28,427	33,646	40,043	27,603	
Non current investments	100	100	100	100	
Cash and Equivalents	4,780	1,644	5,311	5,477	
Inventories	7,685	7,809	6,196	6,664	
Sundry Debtors	19,654	20,823	16,080	19,600	
Loans & Advances	399	400	400	400	
Other Current Assets	8,085	5,206	4,288	4,480	
Current Assets (ex cash)	35,823	34,238	26,964	31,144	
Trade payable	9,090	11,387	10,737	8,018	
Other Current Liab	5,312	6,500	6,500	6,500	
Total Current Liab	14,402	17,887	17,237	14,518	
Net Curr Assets-ex cash	21,421	16,351	9,727	16,625	
<b>Uses of funds</b>	<b>54,728</b>	<b>51,741</b>	<b>55,181</b>	<b>64,805</b>	
BVPS (INR)	232.0	236.6	252.4	270.8	

Free cash flow		(INR mn)			
Year to March	FY18	FY19E	FY20E	FY21E	
Reported Profit	1,641	940	2,245	2,473	
Add: Depreciation	1,632	1,743	2,103	-	
Interest (Net of Tax)	1,160	1,539	1,194	1,195	
Others	1,780	558	388	2,829	
Less: Changes in WC	6,348	(5,070)	(6,624)	6,898	
Operating cash flow	(1,295)	9,848	12,554	(401)	
Less: Capex	9,456	6,962	8,500	5,000	
<b>Free Cash Flow</b>	<b>(10,751)</b>	<b>2,887</b>	<b>4,054</b>	<b>(5,401)</b>	

## Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Deepak Fertilizer Ltd	144	11.2	4.7	8.0	5.8	4.5	10.2
Coromandel International	1,839	16.9	14.4	10.9	9.5	22.7	22.5
Zuari Agro Chemicals	103	5.7	5.0	10.4	10.3	8.5	8.9
Median	-	11.2	5.0	10.4	9.5	8.5	10.2
AVERAGE	-	11.3	8.0	9.8	8.6	11.9	13.9

Source: Edelweiss research

Cash flow metrics		FY18	FY19E	FY20E	FY21E
Year to March					
Operating cash flow	(1,295)	9,848	12,554	(401)	
Financing cash flow	12,692	(6,020)	(387)	5,566	
Investing cash flow	(11,407)	(4,188)	(8,500)	(5,000)	
Net cash Flow	(10)	(359)	3,667	166	
Capex	(9,456)	(6,962)	(8,500)	(5,000)	
Dividend paid	(725)	(531)	(850)	(850)	

## Profitability and efficiency ratios

Year to March	FY18	FY19E	FY20E	FY21E
ROAE (%)	8.1	4.5	10.2	10.5
ROACE (%)	8.8	6.6	8.8	8.4
Inventory Days	51	58	70	60
ROA	3.7	1.8	4.2	4.1
Debtors Days	100	114	126	116
Payable Days	54	77	111	87
Cash Conversion Cycle	97	95	85	89
Current Ratio	2.5	1.9	1.6	2.1
Gross Debt/EBITDA	6.4	6.1	5.0	5.6
Gross Debt/Equity	1.7	1.5	1.5	1.7
Adjusted Debt/Equity	1.7	1.5	1.5	1.7

## Operating ratios

Year to March	FY18	FY19E	FY20E	FY21E
Total Asset Turnover	1.3	1.2	1.0	0.9
Fixed Asset Turnover	2.8	2.7	1.9	1.9
Equity Turnover	2.9	3.1	2.4	2.4

## Valuation parameters

Year to March	FY18	FY19E	FY20E	FY21E
Adj. Diluted EPS (INR)	18.6	10.7	25.5	28.0
Y-o-Y growth (%)	6.1	(42.7)	139.0	10.2
Adjusted Cash EPS (INR)	42.0	30.4	49.3	55.7
Diluted P/E (x)	6.4	11.2	4.7	4.3
P/B (x)	0.5	0.5	0.5	0.4
EV / Sales (x)	0.7	0.6	0.7	0.8
EV / EBITDA (x)	7.5	8.0	5.8	6.4
Dividend Yield (%)	5.9	4.2	6.7	-



## Additional Data

### Directors Data

S.C. Mehta	Chairman & Managing Director	Partha Bhattacharyya	Director
R. A. Shah	Director	M. P. Shinde	Director
U. P. Jhaveri	Director	S. R. Wadhwa	Director
Smt. Parul S. Mehta	Director	Anil Sachdev	Director
Pranay Vakil	Director	Anil Singhvi	Director
Mahesh Chhabria	Director	Ashok Kumar Purwaha	Director
Berjis Desai	Director		

Auditors - B.K.Khare & Co.

*\*as per last available data*

### Holding Top -10

	Perc. Holding		Perc. Holding
ICICI Prudential Life Insurance	4.35	VAN ECK ASSOCIATES CORPORATION	0.18
Fidelity Management and Research	1.83	New Zeleand Super Annuation Fund	0.14
Dimensional Fund Advisor	1.55	ROBUST MARK SER PVT LTD	0.13
Aditya Birla Sun Life	0.43	Manulife Financial Corp	0.03
UTI Asset Mgmt	0.28	Alaska Permanent Fund Corp	0.02

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
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No Data Available

*\*as per last available data*

### Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
31 Jan 2019	Robust Marketing Services Pvt Ltd	Buy	100000.00
20 Apr 2018	Nova Synthetic Limited	Buy	22100.00
10 Apr 2018	Nova Synthetic Limited	Buy	20000.00

*\*as per last available data*

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## Coverage group(s) of stocks by primary analyst(s): Fertilisers

Chambal Fertilisers and Chemicals, Coromandel International, Deepak Fertilizer Ltd, Zuari Agro Chemicals

### Recent Research

Date	Company	Title	Price (INR)	Recos
22-Jan-19	<b>Coromandel International</b>	Macros impact; outlook stable; <i>Result Update</i>	436	Buy
21-Nov-18	<b>Deepak Fertiliser</b>	Gearing, capex funding daunting; <i>Result Update</i>	164	Buy
19-Nov-18	<b>Zuari Agrochemicals</b>	Mixed bag; gearing remains high; <i>Result Update</i>	234	Buy

### Distribution of Ratings / Market Cap

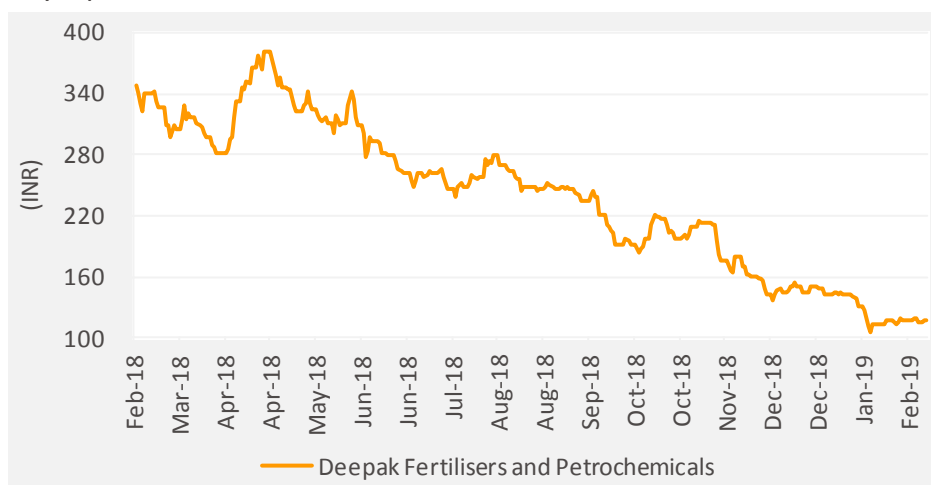
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

### Rating Interpretation

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

### One year price chart



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