India

REDUCE *(no change)*

Consensus ratings*:	Buy 10	Hold 3	Sell 4

Current price:	Rs2,054
Target price: ▲	Rs1,514
Previous target:	Rs1,460
Up/downside:	-26.3%
InCred Research / Consensus:	-27.8%
Reuters:	DPNT.NS
Bloomberg:	DN IN
Market cap:	US$3,858m
	Rs280,151m
Average daily turnover:	US$12.4m
	Rs898.2m
Current shares o/s:	136.4m
Free float:	49.9%

**Source: Bloomberg*

Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	5.7	6.3	0.0
Relative (%)	6.7	1.3	(9.1)

Major shareholders	% held
Promoter & Promoter Group	50.1
Franklin Resources Inc	2.6
Motilal Oswal AMC	2.4

Deepak Nitrite Ltd

EPS cut for FY24F, FY25F & FY26F

- The tepid demand environment has led to DNL's earnings missing estimates in the past quarters. Going ahead, raw material inflation will also hit earnings.
- Consensus EPS estimates need to be cut. In our view, Deepak Nitrite or DNL is unlikely to achieve its FY22 EPS in the next two years.
- DNL may need to raise equity in the near term if it wants to finish its expansion projects over the next three years to drive future growth. Retain REDUCE.

Profitability of phenol business is in doubt

Phenol demand has experienced a significant decline, leading to a drop in Deepak Nitrite or DNL's overall spreads per tonne and a sharp decrease in gross profits, reminiscent of 2QFY21. Deepak Nitrite's historically high P/E ratio was justified by three factors: 1) Anticipated sustainability of the phenol cycle and this resulting in higher cash flows. 2) Plan to invest these cash flows in value-added products, transitioning the company's commodity character. 3) Projected remarkable EPS growth. However, with the foundational premise of the phenol supercycle and the China+1 strategy for phenol-like bulk commodities crumbling, EPS reductions are on the horizon. The decline in phenol's profitability will curtail cash flows, thereby limiting the company's capacity for fresh investments. As a result, the company's ambitious Rs70bn capex plan could strain its balance sheet, potentially necessitating raising equity capital from the investors.

Cyclical products to weigh on profitability

The decline in acetone prices post-Covid pandemic is impacting the profitability of the phenolic segment. The weakness is evident in DASDA (diamino stilbene disulfonic acid) and methoxylamine hydrochloride. The robustness of 3-trifluoromethyl acetophenone, used in fungicide Trifloxystrobin, remains, but it's expected to weaken with the decline in agrochemicals. Our analysis of gross spreads over raw materials shows the cyclic nature of MIBK (methyl isobutyl ketone), MIBC (methyl isobutyl carbinol), para tertiary butyl phenol (PTBP), iso propyl alcohol (IPA), 2,4 DTBP (2,4 di tertiary butyl phenol), salicylic acid, PF (phenol formaldehyde) resin, polycarbonates, bisphenol-A and S, benzaldehyde, benzyl alcohol, benzo trifluoride, and cyclohexanone oxime. Please click: IN: Deepak Nitrite Ltd - Commodity capex doesn't guarantee profits (REDUCE - Maintained)

We cut EPS for FY24F-26F; retain REDUCE rating

We maintain our REDUCE rating on the stock with a target price of Rs1,514. Our assessment indicates that consensus valuation is overly optimistic, and we have adjusted our EPS estimates downwards by 25% for FY24F & FY25F. This adjustment is primarily because of declining product spreads, including those of phenol, leaving little room for positive prospects. Upside risk: A recovery in phenol prices.

Analyst(s)

Satish KUMAR
T (91) 22 4161 1562
E satish.kumar@incredcapital.com

Abbas PUNJANI
T (91) 22 4161 1598
E abbas.punjani@incredcapital.com

Financial Summary	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Revenue (Rsm)	68,022	79,721	75,755	76,682	82,608
Operating EBITDA (Rsm)	16,036	12,894	12,219	12,366	13,121
Net Profit (Rsm)	10,666	8,520	7,839	7,602	8,088
Core EPS (Rs)	78.2	62.5	57.5	55.7	59.3
Core EPS Growth	37.5%	(20.1%)	(8.0%)	(3.0%)	6.4%
FD Core P/E (x)	26.27	32.88	35.74	36.85	34.64
DPS (Rs)	7.0	4.9	4.9	4.9	4.9
Dividend Yield	0.41%	0.29%	0.29%	0.29%	0.29%
EV/EBITDA (x)	17.36	21.45	23.23	22.98	21.66
P/FCFE (x)	236.19	354.92	153.50	1,406.33	412.91
Net Gearing	(5.3%)	(8.9%)	7.6%	7.4%	6.4%
P/BV (x)	8.39	6.85	5.84	5.08	4.46
ROE	37.5%	22.9%	17.6%	14.8%	13.7%
% Change In Core EPS Estimates					
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Capex = higher leverage or equity infusion

Deepak Nitrite used to trade at a high P/E ratio because of these three reasons: 1) Phenol cycle will sustain and hence, higher cash flows. 2) These cash flows will be deployed in value-added products and hence, the company's commodity character will change. 3) Projected EPS growth is mind boggling. However, as the base premise of the phenol supercycle and China+1 prospects in a phenol-like bulk commodity has come down crashing, EPS cuts will commence. Cash flows will be constrained and Rs70bn capex will result in balance sheet leverage, or the company can come to the investors for raising equity capital.

The cyclical nature of phenol is before us

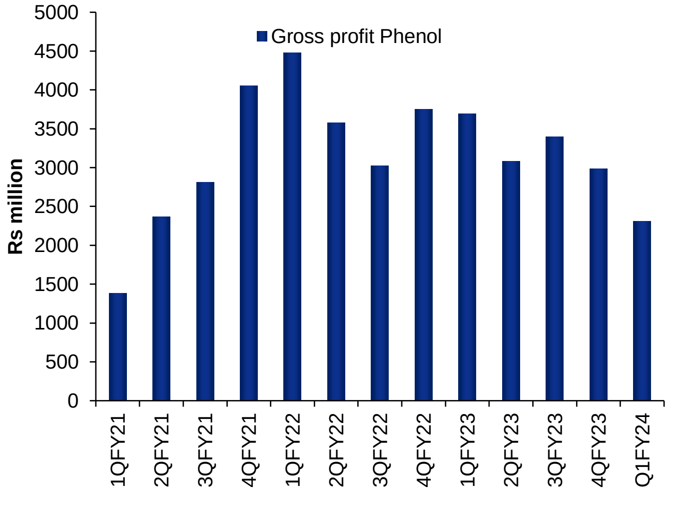
Phenol demand appears to have collapsed as its spreads and overall gross profits have collapsed. Falling acetone prices (as the Covid-19 pandemic is way behind us) are showing on the phenolic segment's profits. DASDA and methoxylamine hydrochloride are showing signs of weakness. 3-trifluoromethyl acetophenone (it is used to make the fungicide, Trifloxystrobin) is still strong, but as agrochemical prices weaken, its spreads will also fall.

Consensus earnings estimates are too high (FY24F and FY25F EPS estimates need to be cut by 25% each). Probably, DNL may not repeat its FY22 earnings performance even in FY25F. The folly of asset-turn analysis (revenue = N* capex) has manifested this quarter as it is clear with DNL we are dealing with a highly cyclical company.

We have written multiple notes on the capex plan of DNL and how it won't help in reducing cyclicality even slightly. IN: Deepak Nitrite Ltd - Commodity capex doesn't guarantee profits (REDUCE - Maintained) and IN: Deepak Nitrite Ltd - Analyzing its probable polycarbonate project (REDUCE - Maintained)

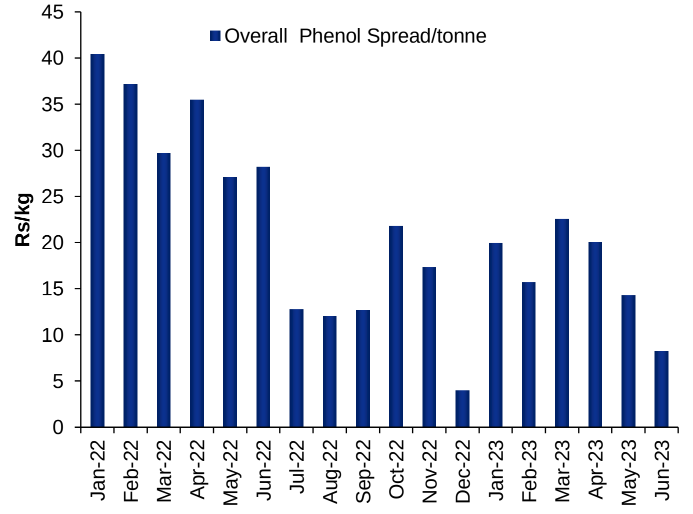
Gross profits from the phenolic division have fallen

Figure 1: Gross profits of the phenolic division have fallen…



SOURCE: INCRED RESEARCH, COMPANY REPORTS

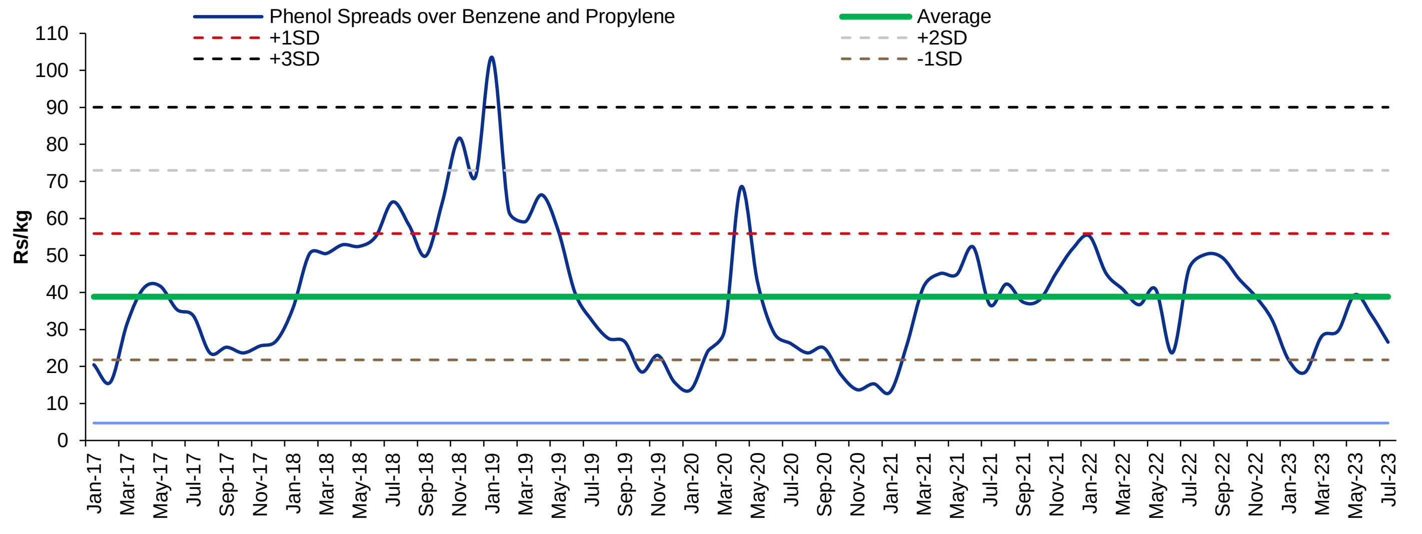
Figure 2: ….in line with the decline in phenol spreads



SOURCE: INCRED RESEARCH, COMPANY REPORTS

As of now, benzene spreads are depressed but phenol demand weakness is still leading to sub-par spreads ➤

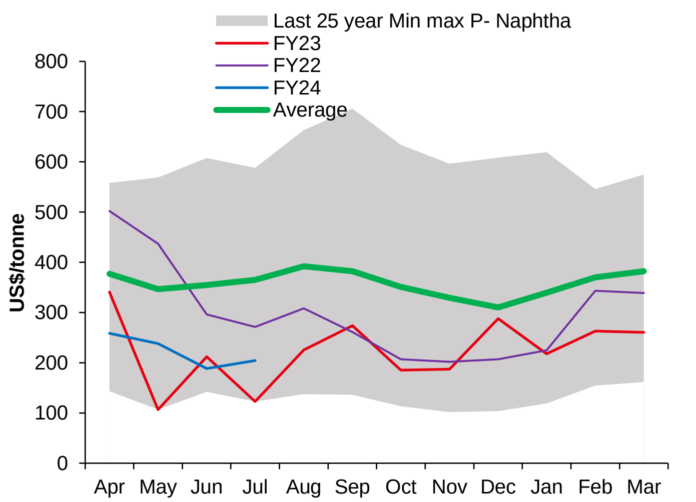
Figure 3: Phenol demand weakness is leading to sub-par spreads over its raw materials



SOURCE: INCRED RESEARCH, COMPANY REPORTS

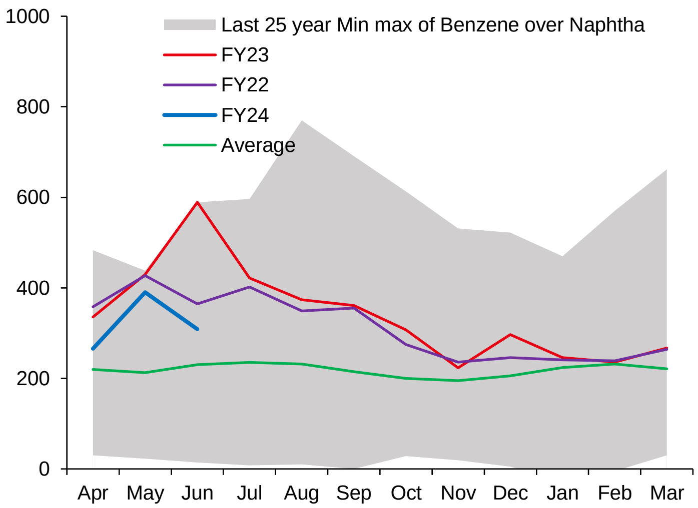
Deepak Nitrite is enjoying the benefit of extremely low spreads of propylene, although in the case of benzene it is higher vis-à-vis historical average ➤

Figure 4: Mean reversion in propylene will mean that its spreads over naphtha will increase by US$150/t



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 5: On the other hand, benzene spreads over naphtha can come down by US$70-75/t



SOURCE: INCRED RESEARCH, COMPANY REPORTS

All else remaining the same means a reversion in spreads can bring down DNL's phenol spreads by 12% ➤

So, while benzene has the potential to come down by US$70-75/mt vis-à-vis naphtha, propylene prices can go up US$150/t. Normally, 1t of benzene needs 0.91t of benzene and 0.71t of propylene. Hence, everything else remaining the same, just based on mean reversion, spreads of benzene can further compress by = 0.71*150-0.91*75 = US$40/t or Rs3.2/kg or around 12% on spot basis.

We have analyzed the expansion projects of Deepak Nitrite as well and have shown their commodity nature ➤

Please click the links to our earlier reports: IN: Deepak Nitrite Ltd - Analysing its probable polycarbonate project (REDUCE - Maintained) and IN: Deepak Nitrite Ltd - Commodity capex doesn't guarantee profits (REDUCE - Maintained)

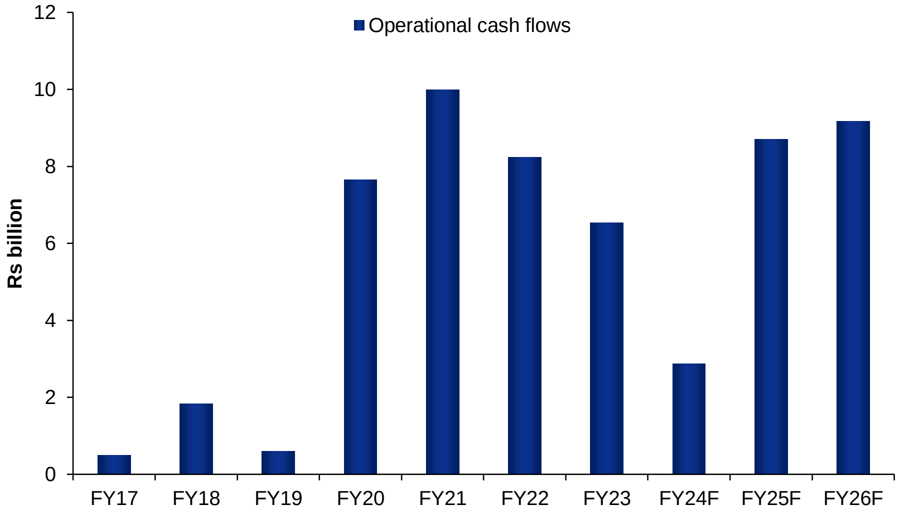
Please note that these projects need a significant capex

While the company has yet not come out with its detailed capex plan for all the above-mentioned expansion projects, we estimate that the overall capex for these projects will be ~Rs70bn.

However, the fall in phenol profitablity will limit cash flows and thereby the company's ability to invest

Assuming a 1:2 debt-equity ratio for new projects, DNL needs around Rs30bn in operational cash flow. It seems unlikely that DNL will be able to garner the same in the next three years.

Figure 6: Operational cash flow in the next three years will not be enough to finance new projects



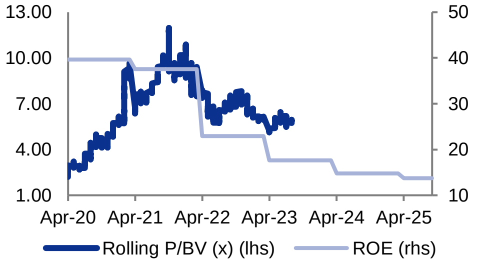
SOURCE: INCRED RESEARCH, COMPANY REPORTS

DNL needs to raise equity capital to finance new projects

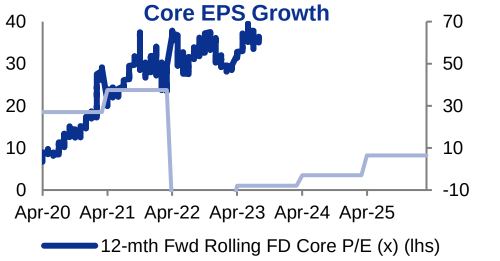
In our view, the company needs to raise at least Rs10bn in equity capital ASAP to finance new projects.

BY THE NUMBERS

P/BV vs ROE



12-mth Fwd FD Core P/E vs FD Core EPS Growth



Profit & Loss

(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Total Net Revenues	**68,022**	**79,721**	**75,755**	**76,682**	**82,608**
Gross Profit	**26,878**	**26,246**	**22,726**	**24,538**	**27,261**
Operating EBITDA	**16,036**	**12,894**	**12,219**	**12,366**	**13,121**
Depreciation And Amortisation	(1,777)	(1,663)	(1,896)	(2,038)	(2,144)
Operating EBIT	**14,259**	**11,231**	**10,323**	**10,328**	**10,977**
Financial Income/(Expense)	(340)	(248)	(319)	(640)	(640)
Pretax Income/(Loss) from Assoc.					
Non-Operating Income/(Expense)	426	476	476	476	476
Profit Before Tax (pre-EI)	**14,345**	**11,459**	**10,480**	**10,163**	**10,812**
Exceptional Items					
Pre-tax Profit	**14,345**	**11,459**	**10,480**	**10,163**	**10,812**
Taxation	(3,678)	(2,939)	(2,641)	(2,561)	(2,725)
Exceptional Income - post-tax					
Profit After Tax	**10,666**	**8,520**	**7,839**	**7,602**	**8,088**
Minority Interests					
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	**10,666**	**8,520**	**7,839**	**7,602**	**8,088**
Recurring Net Profit	10,666	8,520	7,839	7,602	8,088
Fully Diluted Recurring Net Profit	**10,666**	**8,520**	**7,839**	**7,602**	**8,088**

Cash Flow

(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
EBITDA	16,036	12,894	12,219	12,366	13,121
Cash Flow from Invt. & Assoc.					
Change In Working Capital	(11,712)	(3,418)	757	(1,106)	(1,218)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	(89)		(7,466)		
Other Operating Cashflow	810	248	319	640	640
Net Interest (Paid)/Received	(340)	(248)	(319)	(640)	(640)
Tax Paid	3,535	(2,939)	(2,641)	(2,561)	(2,725)
Cashflow From Operations	**8,238**	**6,537**	**2,870**	**8,699**	**9,178**
Capex	(1,868)	(3,286)	(8,500)	(8,500)	(8,500)
Disposals Of FAs/subsidiaries	7				
Acq. Of Subsidiaries/investments	(2,401)				
Other Investing Cashflow	22				
Cash Flow From Investing	**(4,241)**	**(3,286)**	**(8,500)**	**(8,500)**	**(8,500)**
Debt Raised/(repaid)	(2,812)	(2,462)	7,455		
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	(750)	(800)	(800)	(800)	(800)
Preferred Dividends					
Other Financing Cashflow	(296)				
Cash Flow From Financing	**(3,858)**	**(3,262)**	**6,655**	**(800)**	**(800)**
Total Cash Generated	140	(11)	1,025	(601)	(121)
Free Cashflow To Equity	**1,186**	**789**	**1,825**	**199**	**679**
Free Cashflow To Firm	**4,338**	**3,499**	**(5,311)**	**839**	**1,319**

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS…cont'd

Balance Sheet

(Rs mn)	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Total Cash And Equivalents	4,786	4,168	4,344	3,940	4,015
Total Debtors	11,291	13,095	12,453	12,605	13,579
Inventories	5,846	8,931	8,486	9,454	10,185
Total Other Current Assets	1,183	1,197	1,197	1,197	1,197
Total Current Assets	**23,105**	**27,391**	**26,480**	**27,196**	**28,975**
Fixed Assets	20,857	22,425	36,730	43,192	49,548
Total Investments	22	25	25	25	25
Intangible Assets					
Total Other Non-Current Assets	321	1,448	1,448	1,448	1,448
Total Non-current Assets	**21,200**	**23,897**	**38,203**	**44,665**	**51,021**
Short-term Debt	1,132	115	7,000	7,000	7,000
Current Portion of Long-Term Debt					
Total Creditors	5,117	6,618	6,288	6,303	6,790
Other Current Liabilities	1,220	1,205	1,205	1,205	1,205
Total Current Liabilities	**7,469**	**7,938**	**14,494**	**14,508**	**14,995**
Total Long-term Debt	1,875	430	1,000	1,000	1,000
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	129	154	154	154	154
Total Non-current Liabilities	**2,004**	**584**	**1,154**	**1,154**	**1,154**
Total Provisions	1,447	1,866	1,096	1,096	1,096
Total Liabilities	**10,920**	**10,388**	**16,744**	**16,758**	**17,245**
Shareholders Equity	33,384	40,900	47,939	55,103	62,751
Minority Interests					
Total Equity	**33,384**	**40,900**	**47,939**	**55,103**	**62,751**

Key Ratios

	Mar-22A	Mar-23A	Mar-24F	Mar-25F	Mar-26F
Revenue Growth	56.0%	17.2%	(5.0%)	1.2%	7.7%
Operating EBITDA Growth	28.6%	(19.6%)	(5.2%)	1.2%	6.1%
Operating EBITDA Margin	23.6%	16.2%	16.1%	16.1%	15.9%
Net Cash Per Share (Rs)	13.04	26.56	(26.80)	(29.76)	(29.22)
BVPS (Rs)	244.75	299.85	351.46	403.98	460.05
Gross Interest Cover	41.89	45.32	32.39	16.14	17.15
Effective Tax Rate	25.6%	25.6%	25.2%	25.2%	25.2%
Net Dividend Payout Ratio	10.7%	9.4%	10.2%	10.5%	9.9%
Accounts Receivables Days	50.58	55.83	61.55	59.64	57.85
Inventory Days	42.90	50.43	59.94	62.79	64.76
Accounts Payables Days	42.07	40.05	44.42	44.07	43.17
ROIC (%)	38.0%	25.2%	19.7%	14.6%	13.6%
ROCE (%)	42.3%	27.9%	20.7%	17.1%	16.2%
Return On Average Assets	27.3%	18.2%	13.9%	11.8%	11.3%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

DISCLAIMER

This report (including the views and opinions expressed therein, and the information comprised therein) has been prepared by Incred Research Services Private Ltd.(formerly known as Earnest Innovation Partners Private Limited) (hereinafter referred to as "IRSPL"). IRSPL is registered with SEBI as a Research Analyst vide Registration No. INH000007793. Pursuant to a trademark agreement, IRSPL has adopted "Incred Equities" as its trademark for use in this report.

The term "IRSPL" shall, unless the context otherwise requires, mean IRSPL and its affiliates, subsidiaries and related companies. This report is not directed or intended for distribution to or use by any person or entity resident in a state, country or any jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject IRSPL and its affiliates/group companies to registration or licensing requirements within such jurisdictions.

This report is being supplied to you strictly on the basis that it will remain confidential. No part of this report may be (i) copied, photocopied, duplicated, stored or reproduced in any form by any means; or (ii) redistributed or passed on, directly or indirectly, to any other person in whole or in part, for any purpose without the prior written consent of IRSPL.

The information contained in this report is prepared from data believed to be correct and reliable at the time of issue of this report.

IRSPL is not required to issue regular reports on the subject matter of this report at any frequency and it may cease to do so or change the periodicity of reports at any time. IRSPL is not under any obligation to update this report in the event of a material change to the information contained in this report. IRSPL has not any and will not accept any, obligation to (i) check or ensure that the contents of this report remain current, reliable or relevant; (ii) ensure that the content of this report constitutes all the information a prospective investor may require; (iii) ensure the adequacy, accuracy, completeness, reliability or fairness of any views, opinions and information, and accordingly, IRSPL and its affiliates/group companies (and their respective directors, associates, connected persons and/or employees) shall not be liable in any manner whatsoever for any consequences (including but not limited to any direct, indirect or consequential losses, loss of profits and damages) of any reliance thereon or usage thereof.

Unless otherwise specified, this report is based upon reasonable sources. Such sources will, unless otherwise specified, for market data, be market data and prices available from the main stock exchange or market where the relevant security is listed, or, where appropriate, any other market. Information on the accounts and business of company(ies) will generally be based on published statements of the company(ies), information disseminated by regulatory information services, other publicly available information and information resulting from our research. Whilst every effort is made to ensure that statements of facts made in this report are accurate, all estimates, projections, forecasts, expressions of opinion and other subjective judgments contained in this report are based on assumptions considered to be reasonable as of the date of the document in which they are contained and must not be construed as a representation that the matters referred to therein will occur. Past performance is not a reliable indicator of future performance. The value of investments may go down as well as up and those investing may, depending on the investments in question, lose more than the initial investment. No report shall constitute an offer or an invitation by or on behalf of IRSPL and its affiliates/group companies to any person to buy or sell any investments.

The opinions expressed are based on information which are believed to be accurate and complete and obtained through reliable public or other non-confidential sources at the time made. (Information barriers and other arrangements may be established where necessary to prevent conflicts of interests arising. However, the analyst(s) may receive compensation that is based on his/their coverage of company(ies) in the performance of his/their duties or the performance of his/their recommendations. In reviewing this report, an investor should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additional information is, subject to the duties of confidentiality, available on request.

The report is not a "prospectus" as defined under Indian Law, including the Companies Act, 2013, and is not, and shall not be, approved by, or filed or registered with, any Indian regulator, including any Registrar of Companies in India, SEBI, any Indian stock exchange, or the Reserve Bank of India. No offer, or invitation to offer, or solicitation of subscription with respect to any such securities listed or proposed to be listed in India is being made, or intended to be made, to the public, or to any member or section of the public in India, through or pursuant to this report.

The research analysts, strategists or economists principally responsible for the preparation of this research report are segregated from the other activities of IRSPL. Information barriers and other arrangements have been established, as required, to prevent any conflicts of interests.

The research analysts, strategists or economists principally responsible for the preparation of this research report are segregated from the other activities of IRSPL. Information barriers and other arrangements have been established, as required, to prevent any conflicts of interests.

IRSPL may have issued other reports (based on technical analysis, event specific, short term views etc.) that are inconsistent with and reach different conclusion from the information presented in this report.

Holding of Analysts/Relatives of Analysts, IRSPL and Associates of IRSPL in the covered securities, as on the date of publishing of this report

	Analyst/ Relative	Entity/ Associates
any financial interests in the company covered in this report (subject company) and nature of such financial interest	NO	NO
actual/beneficial ownership of 1% or more in securities of the subject company at the end of the month immediately preceding the date of publication of the research report or date of the public appearance;	NO	NO
any other material conflict of interest at the time of publication of the research report or at the time of public appearance	NO	NO
received any compensation from the subject company in the past twelve months for investment banking or merchant banking or brokerage services or investment advisory or depository or distribution from the subject company in the last twelve months for products/services other than investment banking or merchant banking or broker- age services or investment advisory or depository or distribution from the subject company in the last twelve months	NO	NO
managed or co-managed public offering of securities for the subject company in the last twelve months	NO	NO
received any compensation or other benefits from the subject company or third party in connection with the research report	NO	NO
served as an officer, director or employee of the subject company	NO	NO
been engaged in market making activity for the subject company	NO	NO

Analyst declaration

- The analyst responsible for the production of this report hereby certifies that the views expressed herein accurately and exclusively reflect his or her personal views and opinions about any and all of the issuers or securities analysed in this report and were prepared independently and autonomously in an unbiased manner.
- No part of the compensation of the analyst(s) was, is, or will be directly or indirectly related to the inclusion of specific recommendations(s) or view(s) in this report or based any specific investment banking transaction.
- The analyst(s) has(have) not had any serious disciplinary action taken against him/her(them).
- The analyst, strategist, or economist does not have any material conflict of interest at the time of publication of this report.
- The analyst(s) has(have) received compensation based upon various factors, including quality, accuracy and value of research, overall firm performance, client feedback and competitive factors.

IRSPL and/or its affiliates and/or its Directors/employees may own or have positions in securities of the company(ies) covered in this report or any securities related thereto and may from time to time add to or dispose of, or may be materially interested in, any such securities.

IRSPL and/or its affiliates and/or its Directors/employees may do and seek to do business with the company(ies) covered in this research report and may from time to time (a) buy/sell the securities covered in this report, from time to time and/or (b) act as market maker or have assumed an underwriting commitment in securities of such company(ies), and/or (c) may sell them to or buy them from customers on a principal basis and/or (d) may also perform or seek to perform significant investment banking, advisory, underwriting or placement services for or relating to such company(ies) and/or (e) solicit such investment, advisory or other services from any entity mentioned in thisreport and/or (f) act as a lender/borrower to such company and may earn brokerage or other compensation. However, Analysts are forbidden to acquire, on their own account or hold securities (physical or uncertificated, including derivatives) of companies in respect of which they are compiling and producing financial recommendations or in the result of which they play a key part.