

# Indian Chemical Sector

## The silver lining

The first half of CY20 was an unanticipated turning point for the chemical industry. The dual effects of the COVID-related economic downturn and disruption in chemical supply chain impacted the industry adversely. However, this sector was amongst the first few that returned to normalcy. We have assessed the current situation of the industry and our analysis compels us to uphold our positive stance on our specialty chemicals universe.

The chemicals consumed by end user industries like pharmaceuticals, agrochemicals, home and personal care showed strong resilience during the lockdown and the robust demand continued, post the unlock. During the lockdown, the chemicals consumed by certain industries like automotive, construction, textile, FMCG, and dyes experienced a fall in demand owing to a cut in discretionary spending by consumers. But post lockdown, the demand from end user industries has picked up.

Additionally, chemical sector companies saved on costs like travelling, marketing and sales due to restricted movement. Besides, they invested in IT infrastructure, which helped them save operating and administration costs.

We maintain BUY on AIL, Galaxy Surfactants, Sudarshan Chemical; ADD on NFIL, Balaji Amines, Alkyl Amines, SRF; while maintaining SELL on Vinati Organics. We are also initiating coverage on Fine Organic and NOCIL with a BUY and Deepak Nitrite with an ADD recommendation.

### Bounce-back in revenue and jump in margins

Our specialty chemical universe witnessed a smart recovery in manufacturing operations, post the COVID-led disruptions and attained normalcy. As the end-user industries for the chemical sector witnessed demand recovery, aggregate revenues inched up 31/10% QoQ/YoY to INR 70bn in 2QFY21. Companies catering to pharma and agrochemical industries showed a higher resilience. Alkyl Amines' revenue grew 19/24% QoQ/YoY to INR 2.9bn, owing to 18% YoY volume growth and better realisations in 2Q, courtesy robust pharma and agro demand. Similarly, Balaji Amines' revenue grew 33/22% QoQ/YoY to INR 2.8bn in 2Q. Aarti Industries, which derives ~60% of its revenues from pharma, agro and FMCG industries, also demonstrated revenue growth of 25/9% QoQ/YoY to INR 11.7bn in 2Q.

Gross margins remained protected for most companies in our universe despite the pandemic, mainly due to benign raw material prices and better realisations. While per unit raw material prices fell, realisations did not fall correspondingly. Companies benefited from a cut in administrative expenses, travel and exhibition expenses and delivered higher operating leverages. This has resulted in 194bps QoQ jump in aggregate EBITDA margin to 25% in 2QFY21.

### Capex spending in full swing

Companies in our chemical universe continue to assign importance to investing in Capex to milk future opportunities. All of them have maintained their pre-COVID Capex plans, while a few have deferred them due to the disturbances caused by the pandemic, although, none have announced a cut in them. The managements are more positive and have announced additional projects in the past six months to seize the import substitution opportunity.

Company	Reco	TP	Upside (%)
AIL	BUY	1,440	16.3
Alkyl Amines	ADD	5,450	6.8
Balaji Amines	ADD	1,540	6.4
Deepak Nitrite	ADD	1,130	8.5
Fine Organic	BUY	2,905	23.1
Galaxy Surfactants	BUY	2,750	23.6
NFIL	ADD	2,720	7.3
NOCIL	BUY	185	21.8
SRF	ADD	6,080	9.7
Sudarshan Chemical	BUY	605	20.8
Vinati Organics	SELL	1,015	-19.4

FY23E	PER (x)	P/B (x)
AIL	34.5	4.9
Alkyl Amines	35.0	8.2
Balaji Amines	20.3	3.6
Deepak Nitrite	17.2	4.2
Fine Organic	30.1	7.1
Galaxy Surfactants	19.8	4.1
NFIL	33.5	5.9
NOCIL	18.0	1.9
SRF	30.4	4.3
Sudarshan Chemical	19.8	4.3
Vinati Organics	34.7	6.2

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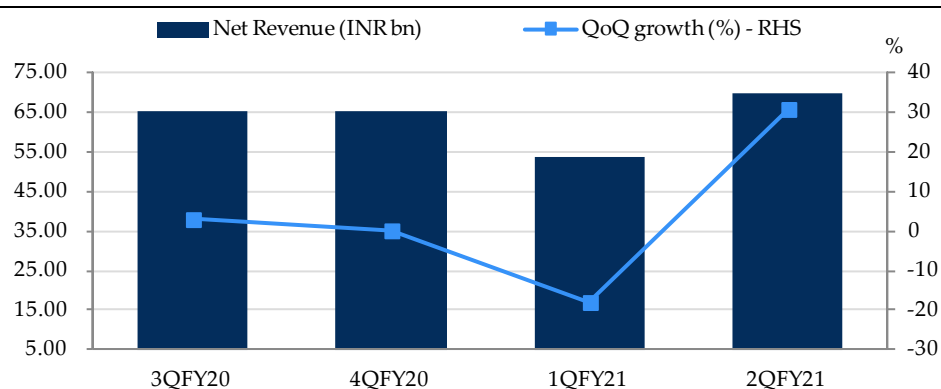
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## Impact of COVID-19 on the chemical sector

### Revenue

Aggregate revenue of our chemical universe demonstrated a flattish QoQ growth in 4QFY20 and came to INR 65.4bn. However, in 1QFY21, struck by COVID-19 pandemic-led disruption, aggregate revenue fell 18% QoQ to INR 53.6bn. As demand recovery was witnessed in the end-user industries catered by our chemical companies, aggregate revenue inched up 31/10% QoQ/YoY to INR 70bn in 2QFY21. Companies catering to pharma and agrochemical industries showed a resilient performance in 2QFY21. Alkyl Amines' revenue grew 19/24% QoQ/YoY to INR 2.9bn owing to 18% YoY volume growth and better realisations in 2Q, courtesy robust pharma and agro demand. Similarly, Balaji Amines' revenue grew 33/22% QoQ/YoY to INR 2.8bn in 2Q. AIL that derives ~60% of its revenue from pharma, agro and FMCG industries also demonstrated a revenue growth of 25/9% QoQ/YoY to INR 11.7bn in 2Q. SRF's revenue grew 36/21% QoQ/YoY to INR 21bn, owing to an outstanding performance in the Speciality Chemicals and Packaging Films businesses.

#### Exhibit-1: Revenue trend

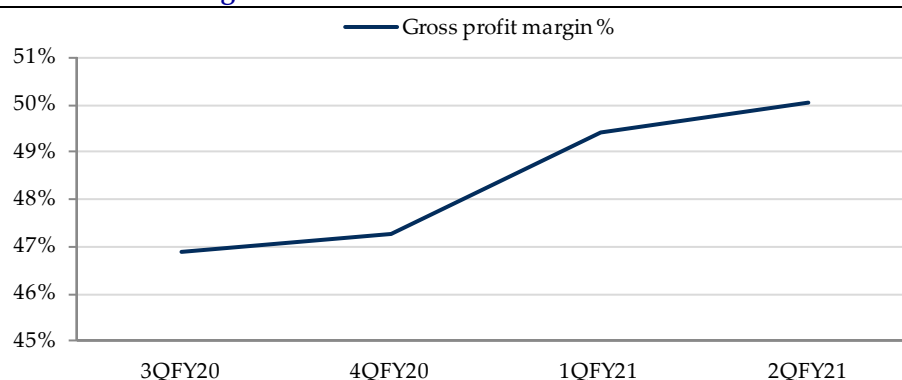


Source: Company, HSIE Research | We have considered data of our chemical coverage companies for this chart

### Margins

While the pandemic impacted the aggregate revenue of our chemical universe in 1QFY21, gross margin actually grew from 47% in 4QFY20 to 49% in 1QFY21, and further to 50% in 2QFY21. Gross margins remained protected for most of the companies in our universe (even through the pandemic) mainly due to benign raw material prices and better realisations. While the per unit raw material prices fell, there wasn't a similar fall in the realisations. This can be witnessed in Galaxy Surfactants' 2QFY21 results. Raw material cost per ton fell by 6% QoQ in 2Q, whereas the fall in revenue per ton was only 2%.

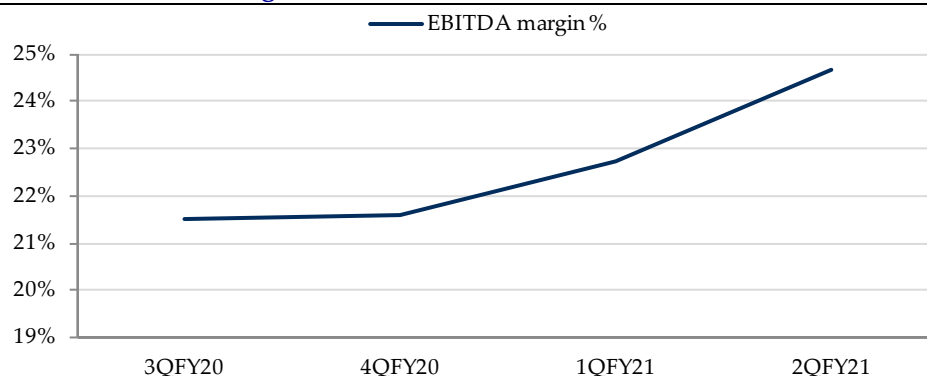
#### Exhibit-2: Gross margin trend



Source: Company, HSIE Research | We have considered data of our chemical coverage companies for this chart

EBITDA margin of our chemical universe grew from 22% in 4QFY20 to 23% in 1QFY21, and further to 25% in 2QFY21. Companies benefited from a cut in administrative expenses, travel and exhibition expenses and delivered higher operating leverages. NFIL clocked in the highest-ever reported EBITDA margin in the past five years at 30% (+476/494 bps YoY/QoQ) in 2Q on the back of strong momentum in high-value business' performance. Backed by operating leverage and the high margin Acetonitrile, EBITDA margin of Alkyl Amines in 2Q grew to 33% (+114/730bps QoQ/YoY). For Galaxy Surfactants, EBITDA margin grew 201/334bps QoQ/YoY to 17%, owing to lower opex as a result of curtailed travel, fair and exhibition expenses.

**Exhibit-3: EBITDA margin trend**

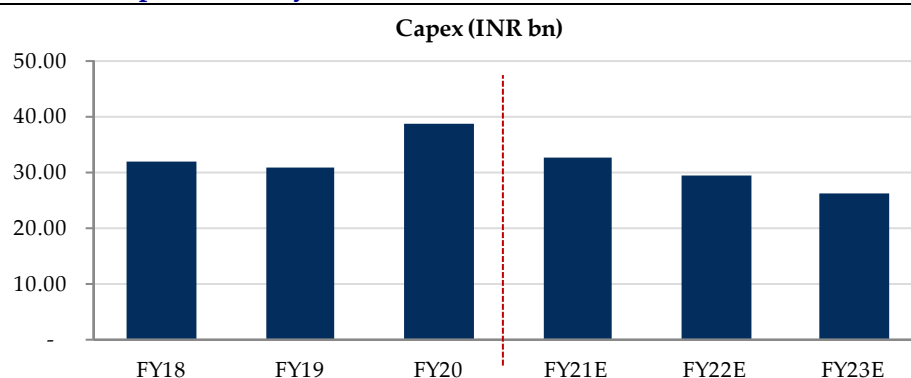


Source: Company, HSIE Research | We have considered data of our chemical coverage companies for this chart

### Capex

Companies under our chemical universe continue to assign importance to investing in Capex to milk future opportunities. All of them have maintained their pre-COVID Capex plans, while a few have only deferred those due to the disturbances caused by the pandemic, although none have announced a cut in them.

**Exhibit-4: Capex over the years**



Source: Company, HSIE Research | We have considered data of our chemical coverage companies for this chart

## Fine Organic

### R&D is the key to success

(TP INR 2,905; BUY)

We initiate coverage on Fine Organic Industries Ltd (FOIL) with a BUY recommendation. Our DCF-based target price of INR 2,905/share (WACC of 10% and terminal growth rate 3.5%) implies an upside of 23% from the current level. We expect FOIL's PAT to grow at a 32% CAGR over FY21-23E, led by a 20% CAGR in revenue. In the absence of major Capex over the next two years, the RoCE would expand from 18% in FY21E to 24% in FY23E. The constant focus on R&D and availability of capacity will enable the company to remain competitive and expand its customer base. Given the capacity expansion -led growth, its capability to generate 20%+ returns on reinvested profits, and unique business model with high entry barriers FOIL's current PER of 38.0/30.1x FY22/23E looks contextually low.

### R&D is the key for success

- The business of FOIL is highly knowledge-intensive unlike other chemical companies. The products are largely customised; thus, continuous R&D and innovation are the pillars of growth for the company. The company has a team of 18 scientists and technicians in R&D. The focus of the team is always on developing inhouse technologies and processes with a strategic customer centric research and development.
- These Oleo-chemical based additives are specially designed to impart specific functionality in the end product. The manufacturing technology is not easily available unlike commodity product manufacturing. Therefore, they have to develop it inhouse. Over the years, FOIL has developed proprietary technology and process development capabilities. This has resulted in strengthening its customer base besides enabling them to become competitive.
- Additionally, FOIL's R&D team has developed inhouse process design expertise to construct production facilities. This helps them to effectively cater to the market needs and significantly reduces capital expenditure costs for expansions vis-à-vis other players.
- In order to extract more value from its raw material, the company has developed a variety of products in its R&D center, which has helped them reduce waste significantly and boost margins.

### Diversified Product Portfolio

- FOIL is the largest manufacturer of Oleo-chemical based additives in India and is a key producer globally. The company produces the additives, which are at par with the global standards. The company produces over 400 specialty additives to cater to the demand of Foods, Plastics and other industries. The chemical ingredients used for these products could be the same, but specifications are different. With the minor change in specifications, a new product is created to cater to a different end user. Thus, FOIL enjoys the flexibility to cater to the changing market demands.
- The company has pioneered the art of manufacturing and marketing of food emulsifiers in India. Over the years, their product range expanded to anti-fungal agents, bread improvers and beverage clouding agents. The company develops Oleo-chemistry based additives for PVC, Polyolefins, Styrenic, Polyamides and other engineering polymers, rubbers and elastomers.

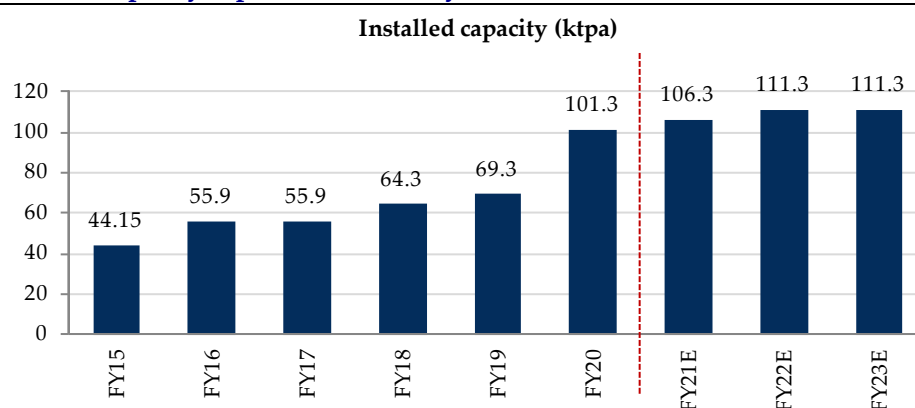
## Fragmented and loyal customer base

- FOIL has more than 700 direct customers and more than 160 distributors (~50% of business comes from distributors) who sell products to more than 5,000 end users. Japanese customers of the company prefer supply through distributors. The company has a fragmented customer base, with the share of the largest customer in revenue being less than 3%.
- Additives manufactured by the company impart specific characteristic to the end products. Thus, the volume required of these chemicals in end products is very small, ranging from 0.1% to 0.5% of the total volume of final product. However, the reliability, trust and consistency in quality are the key traits to acquire customer.
- Oleo-chemical based products are more consumer and environmentally friendly. The customers are quality conscious. The customer approval process is very lengthy. Generally, it takes 3-5 years for approval. In case, if additives are being used in foods or beverages, it takes 8-10 years. The cost of approval process is also very high. Therefore, customers prefer and stick to approved suppliers.
- Out of these 400 products, most of the products are based on customer specification. The company works closely with the customer to develop those additives/products. This lengthy, costlier and time-consuming approval process requires patience and restricts entry of new players.

## With no major Capex, FOIL to generate free cash flows of INR 5bn over FY21-23E

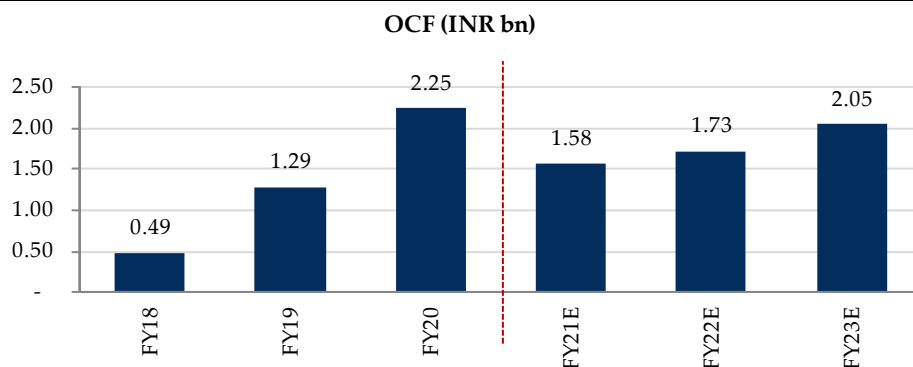
- FOIL plans to expand production capacity by 42ktpa (~60%) from 69.3ktpa in FY19 to 111.3ktpa by FY22E. In Aug-19, the company has commissioned 32ktpa of capacity in FY20 at Ambarnath facility. In Nov-20, the company commissioned partial capacity of 10ktpa plant at Patalganga. In FY22, the remaining capacity will be commissioned.
- Post this expansion, the production capacity will be 111.3ktpa by FY22 end. We believe that this capacity will be adequate to take care of volume growth until FY24. Thus, we foresee no major Capex to augment the capacity being undertaken by the company over, at least, the next three years.
- In FY20, the company has generated an OCF of INR 2.2bn and FCF of INR 1.5bn. We expect, despite slowdown in demand in FY21, the company to generate FCF of INR 5bn over FY21-23E.

**Exhibit-5: Capacity expansion over the years**



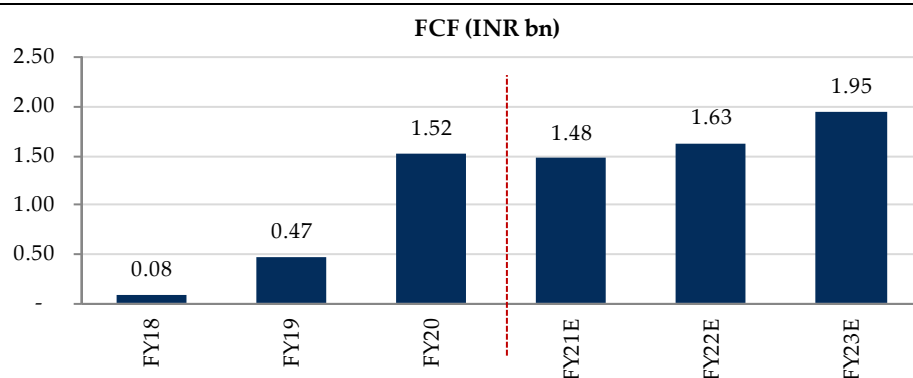
Source: Company, HSIE Research

Exhibit-6: Operating cash flows trend



Source: Company, HSIE Research

Exhibit-7: Free cash flows trend

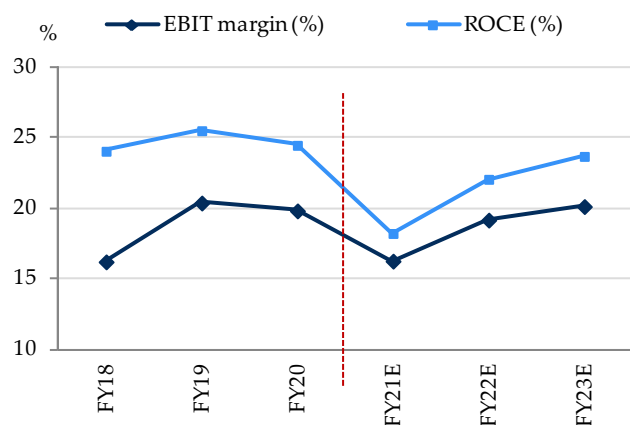


Source: Company, HSIE Research

**EBIT margin to improve by 387bps to 20% in FY23E, while RoCE by 546bps to 24%**

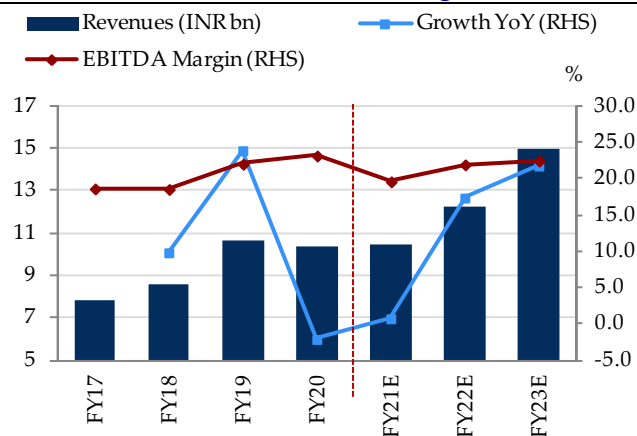
- The company has been able to earn a healthy return on its capital in the midst of the Capex that it has incurred. The RoCE was in the range of 24-25% over FY18-20. We expect it to fall in FY21E to 18% due to fall in absolute EBIT. However, in the absence of major Capex in the coming years and expected increase in utilisation of the recently-commissioned capacity, we expect RoCE to increase to 24% by FY23E with increase in EBIT margin from 16% in FY21 to 20% in FY23E.

Exhibit-8: EBIT margin and RoCE (%)



Source: Company, HSIE Research

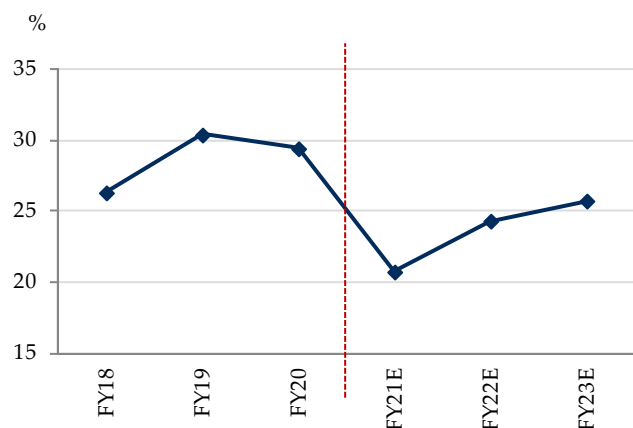
Exhibit-9: Revenue and EBITDA margin



Source: Company, HSIE Research

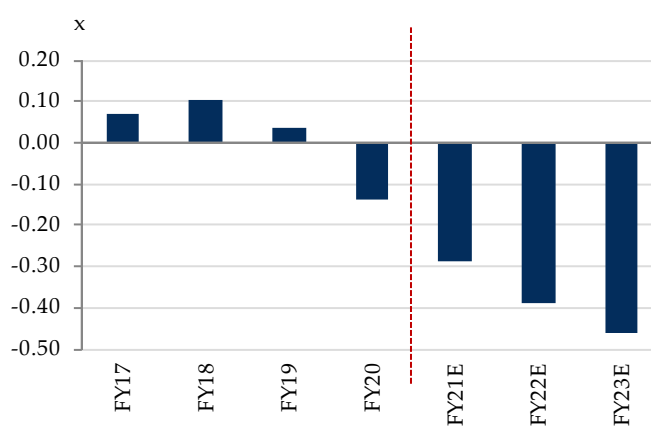


Exhibit-10: RoE (%)



Source: Company, HSIE Research

Exhibit-11: Net debt to equity (x)



Source: Company, HSIE Research

## About the company

- Founded in 1970, Fine Organic Industries Ltd (FOIL) is the brainchild of Mr. Ramesh Shah, a Mumbai-based businessman with experience in chemical trading and Mr. Prakash Kamat, a skilled technocrat from Institution of Chemical Technology. FOIL is the largest manufacturer of oleochemical-based additives in India and a strong player globally. FOIL is one of the six global players in the specialty food emulsifiers industry, and one of the five global players in the polymer additives industry. It produces over 400 types of speciality plant derived oleochemical-based additives used in food, plastic, cosmetics, paint, ink, coatings and other specialty application in various industries.
- FOIL has over 700 direct customers and over 160 distributors (who sold its products to more than 5,000 customers) from 70 countries. Its products include Datem, Acetem and Lactem. It manufactures three types of food additives: anti-fungal agents/preservatives, emulsifiers and other specialty additives. It manufactures a range of plastic additives: polyolefins additives; styrenics/elastomer/thermoplastic elastomer compound additives; engineering plastic processing additives; foamed plastic product additives; polyvinyl chloride processing additives and thermosets/composite product additives. It also manufactures cosmetic, pharmaceutical and rubber additives. It produces anti-settling agents, thickening/anti-sagging agents, wetting and dispersing agents, defoamers, biocides and anti-mar waxes. FOIL currently has three state-of-art-manufacturing facilities in Maharashtra at Ambernath, Badlapur and Dombivli. It has two subsidiaries, namely Fine Organics (USA) Inc. and Fine Organics Europe BV, along with two JV entities FineADD Ingredients GmbH and Fine Zeelandia Private Ltd. Exports formed 55% of its revenues in FY20.



## Financials (Consolidated)

### INCOME STATEMENT

INR mn	FY18	FY19	FY20	FY21E	FY22E	FY23E
<b>Revenues</b>	<b>8,558</b>	<b>10,603</b>	<b>10,381</b>	<b>10,459</b>	<b>12,276</b>	<b>14,950</b>
<i>Growth %</i>	<i>9.8</i>	<i>23.9</i>	<i>(2.1)</i>	<i>0.7</i>	<i>17.4</i>	<i>21.8</i>
Raw Material	5,578	6,552	6,093	6,396	7,374	9,200
Employee Cost	516	628	725	799	876	961
Other Expenses	876	1,088	1,158	1,213	1,332	1,431
<b>EBITDA</b>	<b>1,588</b>	<b>2,336</b>	<b>2,405</b>	<b>2,051</b>	<b>2,694</b>	<b>3,359</b>
<i>EBITDA Margin (%)</i>	<i>18.6</i>	<i>22.0</i>	<i>23.2</i>	<i>19.6</i>	<i>21.9</i>	<i>22.5</i>
<i>EBITDA Growth %</i>	<i>9.4</i>	<i>47.1</i>	<i>2.9</i>	<i>(14.7)</i>	<i>31.3</i>	<i>24.7</i>
Depreciation	200	175	347	350	340	349
<b>EBIT</b>	<b>1,388</b>	<b>2,161</b>	<b>2,058</b>	<b>1,701</b>	<b>2,354</b>	<b>3,010</b>
Other Income (Including EO Items)	160	198	202	212	223	234
Interest	32	18	48	42	35	35
<b>PBT</b>	<b>1,516</b>	<b>2,341</b>	<b>2,212</b>	<b>1,872</b>	<b>2,541</b>	<b>3,209</b>
Tax	559	945	513	487	637	805
<b>PAT</b>	<b>957</b>	<b>1,396</b>	<b>1,699</b>	<b>1,385</b>	<b>1,905</b>	<b>2,404</b>
EO (Loss) / Profit (Net of Tax)	-	-	-	-	-	-
<b>APAT</b>	<b>957</b>	<b>1,396</b>	<b>1,699</b>	<b>1,385</b>	<b>1,905</b>	<b>2,404</b>
Share from associates	(4)	(34)	(51)	-	-	-
Minority Interest	-	-	-	-	-	-
<b>Consolidated APAT</b>	<b>953</b>	<b>1,363</b>	<b>1,648</b>	<b>1,385</b>	<b>1,905</b>	<b>2,404</b>
<i>Consolidated APAT Growth (%)</i>	<i>22.4</i>	<i>42.9</i>	<i>20.9</i>	<i>(16.0)</i>	<i>37.5</i>	<i>26.2</i>
<b>AEPS</b>	<b>31.1</b>	<b>44.4</b>	<b>53.7</b>	<b>45.2</b>	<b>62.1</b>	<b>78.4</b>
<i>AEPS Growth %</i>	<i>22.4</i>	<i>42.9</i>	<i>21.0</i>	<i>(16.0)</i>	<i>37.5</i>	<i>26.2</i>

Source: Company, HSIE Research

### BALANCE SHEET

INR mn	FY18	FY19	FY20	FY21E	FY22E	FY23E
<b>SOURCES OF FUNDS</b>						
Share Capital	153	153	153	153	153	153
Reserves and Surplus	3,803	4,849	6,036	7,005	8,338	10,021
<b>Total Equity</b>	<b>3,956</b>	<b>5,002</b>	<b>6,189</b>	<b>7,158</b>	<b>8,491</b>	<b>10,174</b>
Minority Interest	-	-	-	-	-	-
Long-term Debt	-	928	915	915	915	915
Short-term Debt	536	354	333	-	-	-
<b>Total Debt</b>	<b>536</b>	<b>1,283</b>	<b>1,247</b>	<b>915</b>	<b>915</b>	<b>915</b>
Deferred Tax Liability	(48)	(2)	(67)	(68)	(70)	(71)
Long-term Provision and others	-	39	76	77	79	80
<b>TOTAL SOURCES OF FUNDS</b>	<b>4,443</b>	<b>6,322</b>	<b>7,445</b>	<b>8,082</b>	<b>9,415</b>	<b>11,098</b>
<b>APPLICATION OF FUNDS</b>						
Net Block	883	782	2,168	1,932	1,699	1,454
Capital WIP	317	1,063	58	44	37	34
Other non-current assets	611	736	657	677	699	721
Non-current Investments	106	100	328	328	328	328
<b>Total Non-current assets</b>	<b>1,917</b>	<b>2,680</b>	<b>3,211</b>	<b>2,982</b>	<b>2,763</b>	<b>2,536</b>
Inventories	891	893	1,317	1,327	1,557	1,896
Debtors	1,465	1,556	1,323	1,300	1,538	1,918
Cash and Cash Equivalents	124	1,092	2,104	2,983	4,209	5,614
Other Current Assets	852	801	498	508	519	529
<b>Total Current Assets</b>	<b>3,332</b>	<b>4,342</b>	<b>5,243</b>	<b>6,118</b>	<b>7,824</b>	<b>9,958</b>
Creditors	699	534	858	864	1,014	1,235
Other Current Liabilities & Provns	107	166	151	154	157	161
<b>Total Current Liabilities</b>	<b>806</b>	<b>700</b>	<b>1,009</b>	<b>1,018</b>	<b>1,172</b>	<b>1,396</b>
<b>Net Current Assets</b>	<b>2,526</b>	<b>3,642</b>	<b>4,234</b>	<b>5,100</b>	<b>6,652</b>	<b>8,562</b>
<b>TOTAL APPLICATION OF FUNDS</b>	<b>4,443</b>	<b>6,322</b>	<b>7,445</b>	<b>8,082</b>	<b>9,415</b>	<b>11,098</b>

Source: Company, HSIE Research

## CASH FLOW STATEMENT

INR mn	FY18	FY19	FY20	FY21E	FY22E	FY23E
Reported PBT	1,520	2,375	2,262	1,872	2,541	3,209
Non-operating & EO Items	(164)	(232)	(252)	(212)	(223)	(234)
Interest Expenses	32	18	48	42	35	35
Depreciation	200	175	347	350	340	349
Working Capital Change	(534)	(148)	420	13	(326)	(505)
Tax Paid	(568)	(899)	(578)	(488)	(638)	(807)
<b>OPERATING CASH FLOW (a)</b>	<b>486</b>	<b>1,290</b>	<b>2,247</b>	<b>1,575</b>	<b>1,730</b>	<b>2,047</b>
Capex	(403)	(819)	(728)	(100)	(100)	(100)
Free Cash Flow (FCF)	84	471	1,519	1,475	1,630	1,947
Investments	4	6	(228)	-	-	-
Non-operating Income	160	198	202	212	223	234
Others	(120)	(125)	79	(21)	(21)	(22)
<b>INVESTING CASH FLOW (b)</b>	<b>(359)</b>	<b>(739)</b>	<b>(675)</b>	<b>91</b>	<b>101</b>	<b>112</b>
Debt Issuance/(Repaid)	133	747	(36)	(332)	-	-
Interest Expenses	(32)	(18)	(48)	(42)	(35)	(35)
FCFE	185	1,199	1,435	1,102	1,595	1,912
Share Capital Issuance	105	-	-	-	-	-
Dividend	(277)	(258)	(407)	(415)	(571)	(721)
Others	(113)	(52)	(69)	2	2	2
<b>FINANCING CASH FLOW (c)</b>	<b>(183)</b>	<b>418</b>	<b>(559)</b>	<b>(788)</b>	<b>(605)</b>	<b>(755)</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>(55)</b>	<b>968</b>	<b>1,012</b>	<b>879</b>	<b>1,226</b>	<b>1,404</b>
EO Items, Others						
<b>Closing Cash &amp; Equivalents</b>	<b>124</b>	<b>1,092</b>	<b>2,104</b>	<b>2,983</b>	<b>4,209</b>	<b>5,614</b>

Source: Company, HSIE Research

## KEY RATIOS

	FY18	FY19	FY20	FY21E	FY22E	FY23E
<b>PROFITABILITY %</b>						
Gross Margin	34.8	38.2	41.3	38.8	39.9	38.5
EBITDA Margin	18.6	22.0	23.2	19.6	21.9	22.5
EBIT Margin	16.2	20.4	19.8	16.3	19.2	20.1
APAT Margin	11.1	12.9	15.9	13.2	15.5	16.1
RoE	26.3	30.4	29.5	20.7	24.3	25.8
RoIC	24.2	31.9	34.2	26.0	36.9	45.3
RoCE	24.1	25.5	24.5	18.2	22.1	23.7
<b>EFFICIENCY</b>						
Tax Rate %	36.9	40.4	23.2	26.0	25.1	25.1
Fixed Asset Turnover (x)	3.6	4.4	3.1	2.5	2.8	3.3
Inventory (days)	38	31	46	46	46	46
Debtors (days)	62	54	47	45	46	47
Other Current Assets (days)	36	28	18	18	15	13
Payables (days)	46	30	51	49	50	49
Other Current Liab & Provns (days)	5	6	5	5	5	4
Cash Conversion Cycle (days)	87	76	54	55	53	53
Net Debt/EBITDA (x)	0.3	0.1	(0.4)	(1.0)	(1.2)	(1.4)
Net D/E	0.1	0.0	(0.1)	(0.3)	(0.4)	(0.5)
Interest Coverage	44.0	117.5	42.7	40.9	66.9	85.6
<b>PER SHARE DATA (Rs)</b>						
EPS	31.1	44.4	53.7	45.2	62.1	78.4
CEPS	37.6	50.1	65.0	56.6	73.2	89.8
Dividend	-	7.0	11.0	11.3	15.5	19.6
Book Value	129.0	163.2	201.9	233.5	277.0	331.8
<b>VALUATION</b>						
P/E (x)	75.9	53.1	43.9	52.2	38.0	30.1
P/Cash EPS (x)	62.7	47.1	36.3	41.7	32.2	26.3
P/BV (x)	18.3	14.5	11.7	10.1	8.5	7.1
EV/EBITDA (x)	45.8	31.0	29.7	34.3	25.6	20.1
EV/Revenue (x)	8.5	6.8	6.9	6.7	5.6	4.5
Dividend Yield (%)	-	0.3	0.5	0.5	0.7	0.8
OCF/EV (%)	0.7	1.8	3.1	2.2	2.5	3.0
FCFF/EV (%)	0.1	0.6	2.1	2.1	2.4	2.9
FCFE/M Cap (%)	0.3	1.7	2.0	1.5	2.2	2.6

Source: Company, HSIE Research

## NOCIL

### Banking on opportunities

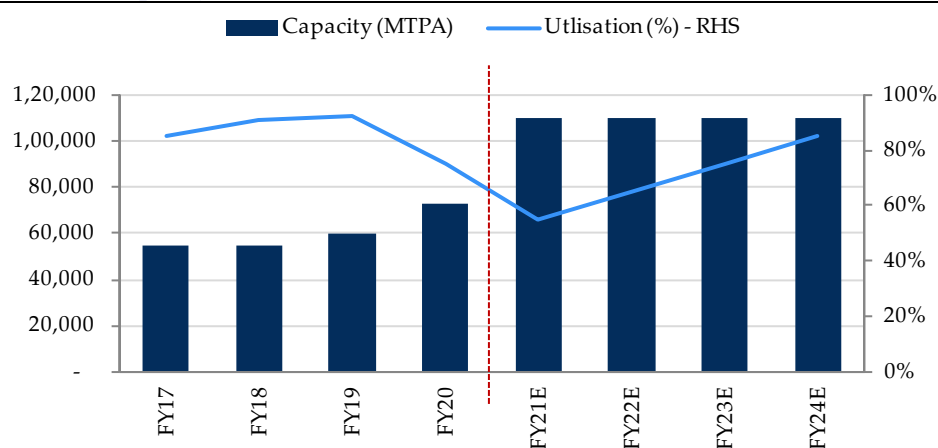
(TP INR 185; BUY)

We initiate coverage on NOCIL with a DCF-based target price of INR 185/share (WACC of 10% and terminal growth rate 3.5%), implying an upside of 22% from the current level. Our BUY recommendation on the stock is premised on (1) doubling of capacity, (2) robust volume growth on the back of pick-up in demand of the tyre industry, and (3) expansion of margin with focus on specialised rubber chemicals. We expect NOCIL's PAT to grow at a 38% CAGR over FY21-23E, led by a 14% CAGR in revenue. In the absence of major Capex over the next two years, the RoCE shall expand from 6% in FY21E to 10% in FY23E and generate a FCF of INR 2bn over FY21-23E.

### Volume growth of a 16% CAGR over FY21-24E

- The ongoing Capex plan of doubling the capacity from 55,000MTPA to 1,10,000 MTPA was started in FY18. In a phase-wise manner, the company has expanded its capacity gradually. Post commissioning of Phase II A of the Capex plan in 2QFY21, the installed capacity of NOCIL (including intermediates) stood at 85,000MTPA. Additionally, 25,000 MTPA of capacity will be added by the end of FY21 to reach the total of 1,10,000 MTPA.
- The average plant utilisation was ~75% of the available capacity (85,000 MTPA) in 2QFY21. Currently, NOCIL's share in domestic market is ~40-45%, while Chinese rubber chemical manufacturers cater to another 45-50%. The capacity expansion should allow it to increase domestic market share further and consolidate its position in the domestic market. Post expansion, we factor in utilisation of around 65% for FY22E, 75% in FY23E and 85% in FY24E. Capacity utilisation should reach the optimum level by FY25. Hence, we expect the volume CAGR to remain robust around 16% during FY21-24E.

#### Exhibit-12: Capacity and utilization trend



Source: Company, HSIE Research

## Positive outlook on the tyre industry

- Rubber chemicals constitute ~3.5-4% of rubber consumption. Thus, the rubber chemical industry essentially follows the trend of global rubber consumption. The tyre industry is the largest consumer of rubber and, hence, rubber chemicals. 60% of NOCIL's volumes go to tyre companies and domestic sales is ~70%. Thus, the growth of the company is highly sensitive to growth of the domestic tyre industry.
- The Indian tyre industry has witnessed a strong recovery post COVID-19 lockdown, with tyre manufacturers registering strong performance. The automotive industry, which had been going through a tough time since mid of FY19, has witnessed strong demand growth momentum after the un-lockdown. The automotive production is picking up, driven by personal mobility trend and improving demand outlook. Besides, the replacement market has shown strong demand, driven by multiple factors like pent-up demand, increasing vehicle utilisation trends, and positive rural economy.
- Apart from these fundamental factors, the policy initiatives will support the current growth momentum for tyre industry. Considering the dumping of tyres in the domestic market by Chinese and South-East Asian tyre manufacturers, the government has taken several steps in the last three years to restrict the import of tyres. India had imposed anti-dumping duty on import of truck and bus radial tyres from China in 2017.
- In Jun-20, the government imposed a restriction on import of tyres across segment and geographies. This should result in growth of the domestic tyre industry. NOCIL, with ~45% of domestic market share, has expanded its capacity; with availability of rubber chemicals across the entire value chain, the company is in a sweet spot to capitalise this opportunity.

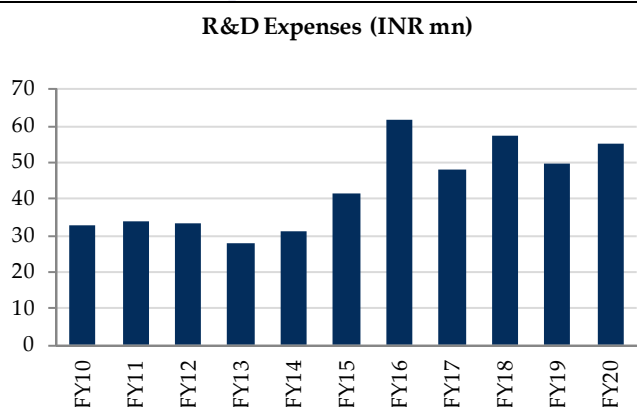
## The market leader in rubber chemicals

- NOCIL is the largest manufacturer of rubber chemicals in India. The company has presence across the entire range of rubber chemicals with 22 products. Its brands PILFLEX anti-degradants, PILNOX anti-oxidants, PILCURE accelerators, post vulcanisation stabiliser and PILGARD pre vulcanisation inhibitor are well recognised in both domestic and international markets.
- NOCIL's involvement in the rubber chemical business spans over four decades. It is one of the few players in this business to offer a wide range of rubber chemicals to suit customer needs. Due to rich experience and being able to offer a one-stop shop to customers, NOCIL is acknowledged as a dependable supplier of rubber chemicals. Globally, it is recognised for its technical capabilities.
- The company enjoys 40-45% of the domestic market share and commands ~5% share globally, which will increase to ~7% post completion of the Phase II B. The company is committed to customer-focused, innovative organisation in the field of rubber chemicals and is considered a partner of choice for customers across globe. Its longstanding relationship with customers allows it to serve higher demand and grab bigger opportunities.

### High entry barriers ensure healthy return

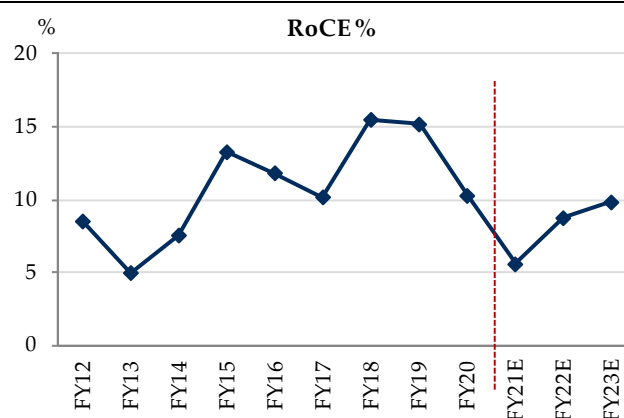
- Setting up a rubber chemical manufacturing unit requires massive investment and technical expertise. The rubber chemical companies have to meet and comply with stringent environmental pollution standards. Therefore, in spite of robust demand for rubber chemicals, there are not many producers in India.
- Tyre companies are becoming extremely stringent on the quality of raw material like rubber chemicals as they are constantly adhering to latest technology and upgrading their standards in terms of tyre quality to match international standards. In order to stay ahead of the curve, continuous investment in R&D is a must. We believe NOCIL is the only Indian player to have developed strong expertise in this area. The company has in-house R&D that focusses on continuous development of niche products and novel technologies.
- Its presence across the entire product basket of rubber chemicals gives strong visibility amongst its clients as it gives the rubber chemical manufacturer first-hand advantage to supply diversified product to varied end users.
- The gestation period is relatively higher as compared to other chemicals due to technology and customer approval process. It takes about 4-5 years for a new chemical manufacturer from setting up the plant to actual product delivery to the customer after approval. These entry barriers help maintain reasonably healthy returns for the company.

Exhibit-13: R&D expenses trend



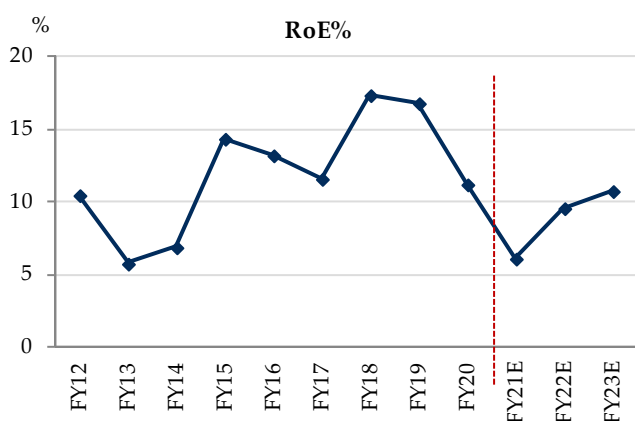
Source: Company, HSIE Research

Exhibit-14: RoCE %



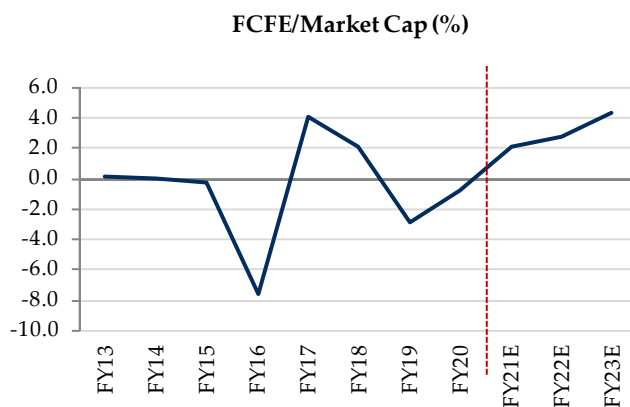
Source: Company, HSIE Research

Exhibit-15: RoE%



Source: Company, HSIE Research

Exhibit-16: FCFE/ Market Cap (%)

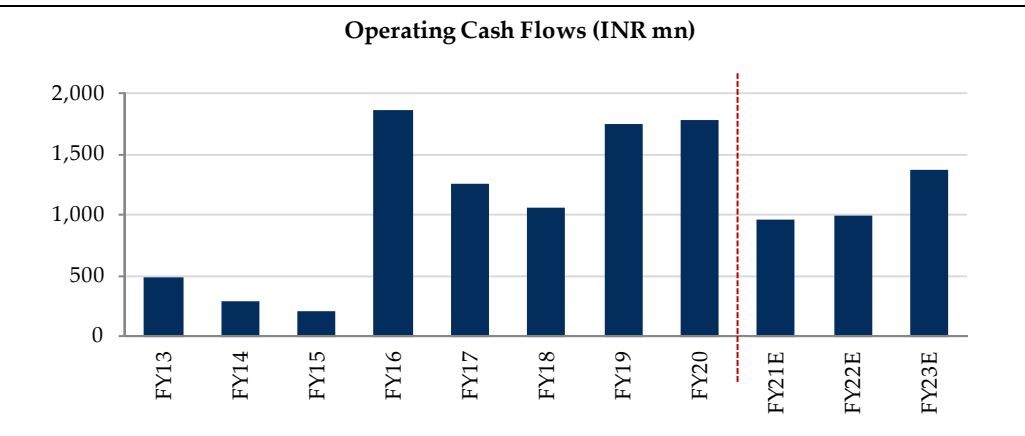


Source: Company, HSIE Research

### No major Capex required in near term; thus, will generate healthy FCF

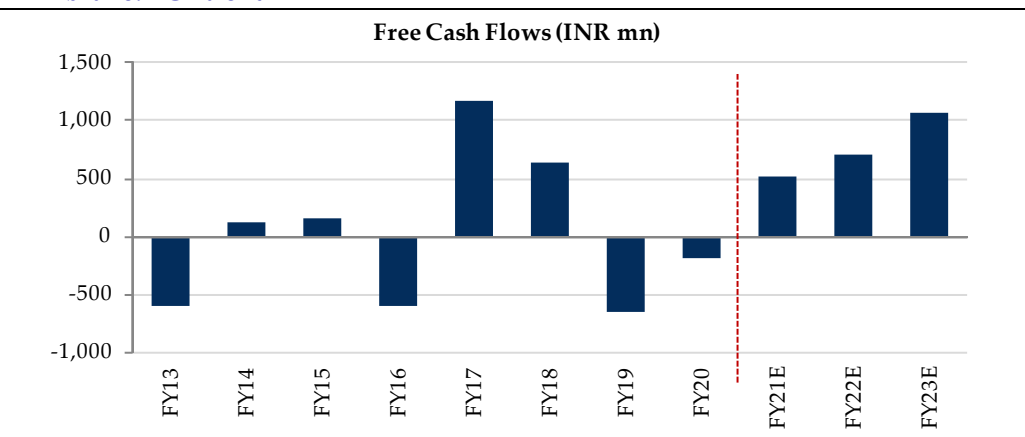
- The company is about to complete INR 4.25bn of Capex plan to expand its capacity to 1,10,000MTPA. It has already commissioned the first phase of INR 1.7bn Capex in Jun-18 and Jan-19. Further, it has capitalised 50% of phase-II Capex of INR1.4bn in 2QFY21. It will capitalise the remaining INR1.4bn of phase-II Capex by Q4FY21. We believe the incremental capacity will be fully utilised by FY25E. The company has financed this Capex through internal accruals.
- The company has adequate capacity in place to meet the growing demands, considering the large Capex investments made in the recent past. Thus, we do not see major expansion plans being undertaken by the company at least over the next three years.
- The company has witnessed negative free cash flows in FY19 and FY20, owing to Capex spends for expansion. With major Capex having been completed, the company is expected to generate positive FCF. Over FY21-23E, we expect the company to generate an FCF of INR 2bn.

Exhibit-17: OCF trend



Source: Company, HSIE Research

Exhibit-18: FCF trend

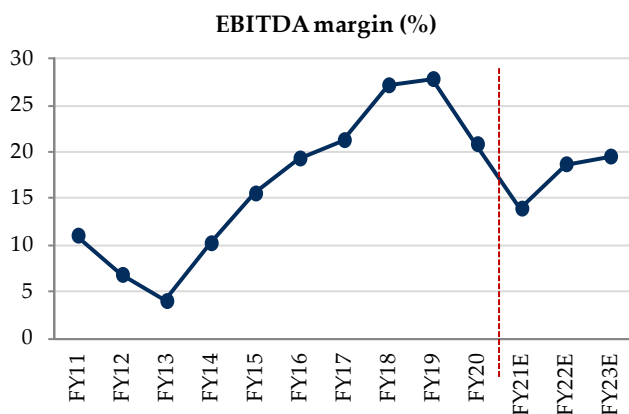


Source: Company, HSIE Research

### EBITDA margin to expand with increasing utilisation and better product mix

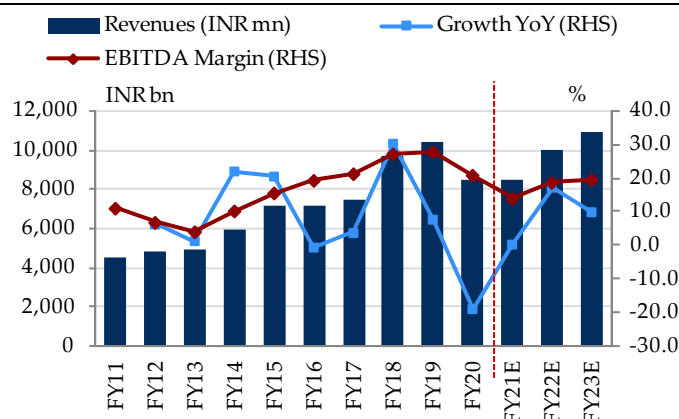
- Lower prices and lower capacity utilisation had resulted in operating de-leverage. This had resulted in EBITDA margin declining to 12% in 1HFY21 as against 21% in FY20. As capacity is becoming available and demand is picking up, utilisation will increase. We expect 85% of plant utilisation on total expanded capacity by FY24.
- As per management, the focus is to increase contribution of specialty products, which is currently contributing 25% of revenue and 65% of total exports. These are relatively a specialised technical application, where the competition is relatively minimal. Thus, company enjoys a cost-plus scenario.
- The benefit of operating leverage and better product mix towards relatively higher margin specialised products will result in expansion in EBITDA margin to 20% in FY23E from 12% in 1HFY21.

Exhibit-19: EBITDA margin



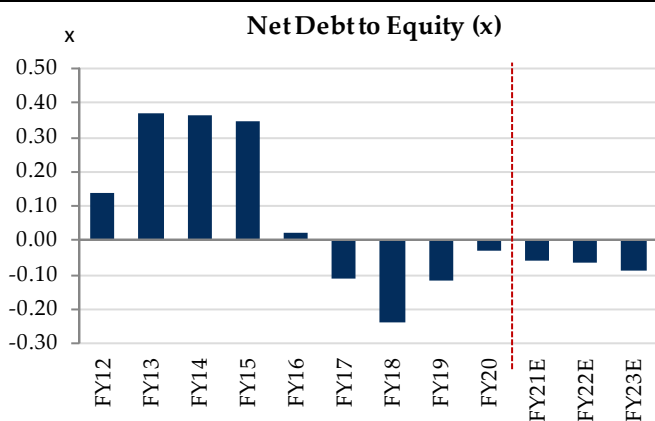
Source: Company, HSIE Research

Exhibit-20: Revenue and EBITDA trend



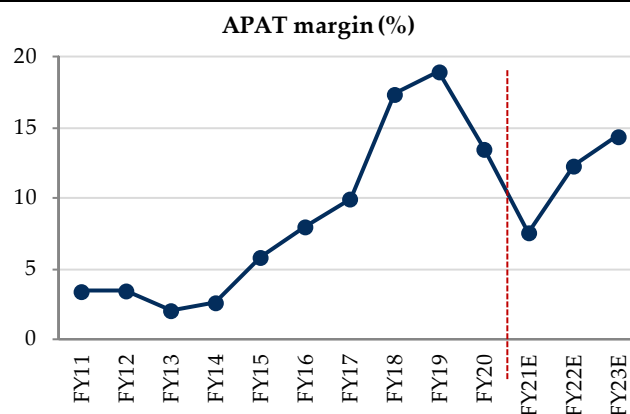
Source: Company, HSIE Research

Exhibit-21: Net debt to equity ratio (x)



Source: Company, HSIE Research

Exhibit-22: APAT margin



Source: Company, HSIE Research



## About the company

- NOCIL Ltd is the largest domestic manufacturer and supplier of rubber chemicals. The company, formed in May 1961, belongs to the Arvind Mafatlal Group of Industries. It has two state-of-the-art manufacturing facilities at Navi Mumbai, Maharashtra, and at Dahej, Gujarat. Its product portfolio consists of anti-degradants, antioxidants, accelerators and other application products. The brands of rubber chemicals produced by the company are PILFLex (rubber anti-degradant), PILnox (rubber antioxidant), PILcure (rubber accelerator), and PILGarD (rubber pre-vulcanisation inhibitor). These are well-recognised in both domestic as well as international markets. The products manufactured by the company are used by the tire industry and other rubber processing industries. NOCIL has a wholly owned subsidiary named PIL Chemicals Ltd, which is engaged in the processing of rubber chemical products. Exports consisted 34% of the total revenues in FY20.

## Financials (Standalone)

### INCOME STATEMENT

INR mn	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
<b>Net Revenues</b>	<b>7,152</b>	<b>7,422</b>	<b>9,676</b>	<b>10,429</b>	<b>8,463</b>	<b>8,494</b>	<b>9,963</b>	<b>10,960</b>
<i>Growth (%)</i>	<i>(0.5)</i>	<i>3.8</i>	<i>30.4</i>	<i>7.8</i>	<i>(18.9)</i>	<i>0.4</i>	<i>17.3</i>	<i>10.0</i>
Material Expenses	3,156	3,334	4,471	4,979	3,698	4,222	4,983	5,420
Change in Inventories	439	262	(65)	(310)	181	297	-	-
Employee Expenses	578	609	674	681	741	685	727	770
Other Operating Expenses	1,597	1,638	1,968	2,177	2,079	2,105	2,391	2,630
<b>EBITDA</b>	<b>1,381</b>	<b>1,580</b>	<b>2,629</b>	<b>2,903</b>	<b>1,765</b>	<b>1,184</b>	<b>1,862</b>	<b>2,140</b>
<i>EBITDA Margin (%)</i>	<i>19.3</i>	<i>21.3</i>	<i>27.2</i>	<i>27.8</i>	<i>20.8</i>	<i>13.9</i>	<i>18.7</i>	<i>19.5</i>
<i>EBITDA Growth (%)</i>	<i>23.5</i>	<i>14.3</i>	<i>66.4</i>	<i>10.4</i>	<i>(39.2)</i>	<i>(32.9)</i>	<i>57.3</i>	<i>14.9</i>
Depreciation	137	187	229	230	324	353	388	401
<b>EBIT</b>	<b>1,275</b>	<b>1,484</b>	<b>2,543</b>	<b>2,773</b>	<b>1,537</b>	<b>992</b>	<b>1,594</b>	<b>1,863</b>
Other Income (Including EO Items)	30	91	143	100	97	161	120	125
Interest	93	22	12	6	13	-	-	-
<b>PBT</b>	<b>1,181</b>	<b>1,462</b>	<b>2,531</b>	<b>2,767</b>	<b>1,524</b>	<b>992</b>	<b>1,594</b>	<b>1,863</b>
Tax	404	494	845	926	214	255	400	467
<b>RPAT</b>	<b>777</b>	<b>968</b>	<b>1,686</b>	<b>1,841</b>	<b>1,309</b>	<b>737</b>	<b>1,194</b>	<b>1,396</b>
Minority Interest								
EO (Loss) / Profit (Net of Tax)	-	-	-	-	-	-	-	-
<b>APAT</b>	<b>777</b>	<b>968</b>	<b>1,686</b>	<b>1,841</b>	<b>1,309</b>	<b>737</b>	<b>1,194</b>	<b>1,396</b>
<i>APAT Growth (%)</i>	<i>37.0</i>	<i>24.6</i>	<i>74.1</i>	<i>9.2</i>	<i>(28.9)</i>	<i>(43.7)</i>	<i>62.1</i>	<i>16.9</i>
<b>AEPS</b>	<b>4.7</b>	<b>5.8</b>	<b>10.2</b>	<b>11.1</b>	<b>7.9</b>	<b>4.4</b>	<b>7.2</b>	<b>8.4</b>
<i>EPS Growth (%)</i>	<i>37.0</i>	<i>24.6</i>	<i>74.1</i>	<i>9.2</i>	<i>(28.9)</i>	<i>(43.7)</i>	<i>62.1</i>	<i>16.9</i>

Source: Company, HSIE Research

### BALANCE SHEET

INR mn	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
<b>SOURCES OF FUNDS</b>								
Share Capital	1,608	1,636	1,645	1,654	1,656	1,656	1,656	1,656
Reserves	6,007	7,415	8,730	9,876	10,104	10,531	11,009	11,567
<b>Total Shareholders' Funds</b>	<b>7,615</b>	<b>9,050</b>	<b>10,374</b>	<b>11,531</b>	<b>11,760</b>	<b>12,187</b>	<b>12,665</b>	<b>13,224</b>
Long-term Debt	150	50	-	-	-	-	-	-
Short-term Debt	109	100	50	-	-	-	-	-
<b>Total Debt</b>	<b>259</b>	<b>150</b>	<b>50</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Minority Interest								
Long-term Provisions & Others	182	165	153	147	233	240	247	254
Net Deferred Tax Liability	1,004	1,025	1,003	1,054	887	913	940	969
<b>TOTAL SOURCES OF FUNDS</b>	<b>9,060</b>	<b>10,391</b>	<b>11,580</b>	<b>12,731</b>	<b>12,879</b>	<b>13,340</b>	<b>13,853</b>	<b>14,447</b>
<b>APPLICATION OF FUNDS</b>								
<b>Net Block</b>	<b>5,244</b>	<b>5,179</b>	<b>5,021</b>	<b>6,286</b>	<b>7,690</b>	<b>9,082</b>	<b>9,113</b>	<b>9,071</b>
CWIP	60	31	392	1,305	1,563	269	149	90
Goodwill								
Investments	1,372	2,014	775	519	494	494	494	494
LT Loans & Advances	127	127	294	402	201	207	213	220
Other Non-Current Assets	183	56	35	46	162	167	172	177
<b>Total Non-current Assets</b>	<b>6,986</b>	<b>7,407</b>	<b>6,517</b>	<b>8,559</b>	<b>10,110</b>	<b>10,218</b>	<b>10,141</b>	<b>10,052</b>
Inventories	1,324	1,143	1,550	1,704	1,361	1,366	1,603	1,763
Debtors	1,508	1,665	2,434	2,322	2,032	2,039	2,392	2,632
Cash & Equivalents	71	1,135	2,521	1,357	360	728	828	1,186
ST Loans & Advances	5	12	2	3	10	-	-	-
Other Current Assets	137	119	298	334	405	406	477	524
<b>Total Current Assets</b>	<b>3,045</b>	<b>4,074</b>	<b>6,804</b>	<b>5,720</b>	<b>4,168</b>	<b>4,540</b>	<b>5,300</b>	<b>6,104</b>
Creditors	704	810	1,139	988	892	896	1,051	1,156
Other Current Liabilities	267	280	603	559	507	522	538	554
<b>Total Current Liabilities</b>	<b>971</b>	<b>1,090</b>	<b>1,741</b>	<b>1,547</b>	<b>1,399</b>	<b>1,418</b>	<b>1,588</b>	<b>1,710</b>
<b>Net Current Assets</b>	<b>2,073</b>	<b>2,984</b>	<b>5,063</b>	<b>4,173</b>	<b>2,769</b>	<b>3,122</b>	<b>3,711</b>	<b>4,395</b>
<b>TOTAL APPLICATION OF FUNDS</b>	<b>9,060</b>	<b>10,391</b>	<b>11,580</b>	<b>12,731</b>	<b>12,879</b>	<b>13,340</b>	<b>13,853</b>	<b>14,447</b>

Source: Company, HSIE Research

## CASH FLOW STATEMENT

INR Mn	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Reported PBT	1,181	1,462	2,531	2,767	1,524	992	1,594	1,863
Non-operating & EO Items	-30	-91	-143	-100	-97	-161	-120	-125
Interest Expenses	93	22	12	6	13	-	-	-
Depreciation	137	187	229	230	324	353	388	401
Working Capital Change	303	154	-693	-274	407	15	-489	-326
Tax Paid	187	-472	-867	-875	-381	-229	-372	-439
<b>OPERATING CASH FLOW ( a )</b>	<b>1,871</b>	<b>1,261</b>	<b>1,068</b>	<b>1,754</b>	<b>1,790</b>	<b>970</b>	<b>1,001</b>	<b>1,375</b>
Capex	-2,476	-93	-432	-2,408	-1,986	-450	-300	-300
Free Cash Flow (FCF)	-604	1,168	636	-654	-196	520	701	1,075
Investments	-899	-642	1,239	256	25	-	-	-
Non-operating Income	30	91	143	100	97	161	120	125
Others	52	127	-147	-119	85	-11	-11	-12
<b>INVESTING CASH FLOW ( b )</b>	<b>-3,292</b>	<b>-517</b>	<b>804</b>	<b>-2,171</b>	<b>-1,780</b>	<b>-300</b>	<b>-191</b>	<b>-187</b>
Debt Issuance/(Repaid)	-1,214	-109	-100	-50	-	-	-	-
Interest Expenses	-93	-22	-12	-6	-13	-	-	-
FCFE	-1,912	1,038	524	-710	-209	520	701	1,075
Share Capital Issuance	0	28	9	9	2	-	-	-
Dividend	-192	-230	-350	-490	-980	-309	-717	-838
<b>FINANCING CASH FLOW ( c )</b>	<b>-1,500</b>	<b>-333</b>	<b>-453</b>	<b>-537</b>	<b>-992</b>	<b>-309</b>	<b>-717</b>	<b>-838</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>-2,920</b>	<b>411</b>	<b>1,419</b>	<b>-954</b>	<b>-981</b>	<b>361</b>	<b>93</b>	<b>350</b>
EO Items, Others	2,944	653	-33	-210	-16	7	7	7
<b>Closing Cash &amp; Equivalents</b>	<b>71</b>	<b>1,135</b>	<b>2,521</b>	<b>1,357</b>	<b>360</b>	<b>728</b>	<b>828</b>	<b>1,186</b>

Source: Company, HSIE Research

## KEY RATIOS

	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
<b>PROFITABILITY (%)</b>								
GPM	49.7	51.6	54.5	55.2	54.2	46.8	50.0	50.5
EBITDA Margin	19.3	21.3	27.2	27.8	20.8	13.9	18.7	19.5
EBIT Margin	17.8	20.0	26.3	26.6	18.2	11.7	16.0	17.0
APAT Margin	8.0	10.0	17.4	19.0	13.5	7.6	12.3	14.4
RoE	13.2	11.6	17.4	16.8	11.2	6.2	9.6	10.8
Core RoCE	10.8	11.7	18.9	17.8	11.5	5.9	8.8	9.8
RoCE	11.9	10.2	15.5	15.2	10.3	5.6	8.8	9.9
<b>EFFICIENCY</b>								
Tax Rate (%)	34.2	33.8	33.4	33.5	14.1	25.7	25.1	25.1
Asset Turnover (x)	1.8	1.4	1.9	1.9	1.2	1.0	1.1	1.2
Inventory (days)	68	56	58	60	59	59	59	59
Debtors (days)	77	82	92	81	88	88	88	88
Other Current Assets (days)	7	6	11	12	18	17	17	17
Payables (days)	36	40	43	35	38	38	38	38
Other Current Liab & Prov (days)	18	17	22	17	19	20	17	16
Cash Conversion Cycle (days)	98	88	97	101	107	106	108	109
Net Debt/EBITDA (x)	0.1	(0.6)	(0.9)	(0.5)	(0.2)	(0.6)	(0.4)	(0.6)
Net D/E	0.0	(0.1)	(0.2)	(0.1)	(0.0)	(0.1)	(0.1)	(0.1)
Interest Coverage	13.6	66.8	208.4	440.2	116.4	-	-	-
<b>PER SHARE DATA</b>								
EPS (Rs/sh)	4.7	5.8	10.2	11.1	7.9	4.4	7.2	8.4
CEPS (Rs/sh)	5.5	7.0	11.6	12.5	9.9	6.6	9.6	10.9
DPS (Rs/sh)	1.2	1.8	2.5	2.5	2.5	1.6	3.6	4.2
BV (Rs/sh)	46.0	54.7	62.6	69.6	71.0	73.6	76.5	79.8
<b>VALUATION</b>								
P/E	32.4	26.0	14.9	13.7	19.2	34.2	21.1	18.0
P/BV	3.3	2.8	2.4	2.2	2.1	2.1	2.0	1.9
EV/EBITDA	18.4	15.3	8.6	8.2	14.1	20.6	13.1	11.2
OCF/EV (%)	7.4	5.2	4.7	7.4	7.2	4.0	4.1	5.7
FCF/EV (%)	(2.4)	4.8	2.8	(2.7)	(0.8)	2.1	2.9	4.5
FCFE/MCAP (%)	(7.6)	4.1	2.1	(2.8)	(0.8)	2.1	2.8	4.3
Dividend Yield (%)	0.8	1.2	1.6	1.6	1.6	1.0	2.4	2.8

Source: Company, HSIE Research

## Deepak Nitrite

### Market leader in most segments

(TP INR 1,130; ADD)

We initiate coverage on Deepak Nitrite Ltd (DNL) with an ADD recommendation. Our DCF-based target price of INR 1,130/share (WACC of 10% and terminal growth rate 3.5%) implies an upside of 9% from the current level. The company has market leadership across most of its product segments. The diversified revenue stream helps protect against a downswing in any one business and keeps operating margin steady. Impending Iso Propyl Alcohol (IPA) expansion and robust demand for its products will drive growth for Deepak Phenolics Ltd (DPL). We expect improvement in gearing ratio and net debt to EBITDA from 0.7x and 1.0x in FY20 to 0.0x and 0.1x by FY23, owing to lower Capex intensity and expected increase in cash.

### Market leadership across most product segments to drive business profile

- DNL has more than 30 products, spread across four segments (including subsidiary): Basic Chemicals (BC), Fine & Specialty chemicals (FSC), Performance Products (PP) and Phenolics. The company's operation is highly backwardly integrated. The company is among the top three global players for xylidines, cumidines and oximes, which are widely used in agrochemicals and pigments industries.
- In the Basic Chemical business, the group is the largest player in India for supplying sodium nitrite/nitrate (market share of 80%), fuel additives (75%) and nitro-toluene (50%). Its market position in the PP business (market share of 75% in optical brightening agents) is supported by a large capacity, integrated operations (backward integration to Diamino Stilbene Disulfonic Acid - DASDA) and receipt of customer approvals.
- Deepak Phenolics Ltd (DPL), the company's 100 per cent subsidiary, is a new platform for products based on phenol, acetone and isopropyl alcohol (IPA). It produces 200ktpa of phenol and 120ktpa of its co-product acetone and 2,600ktpa of cumene. This plant is eight times larger than all existing facilities in India. DPL is doubling its IPA capacity to 60ktpa from 30ktpa.

#### Exhibit-23: Diversified product portfolio

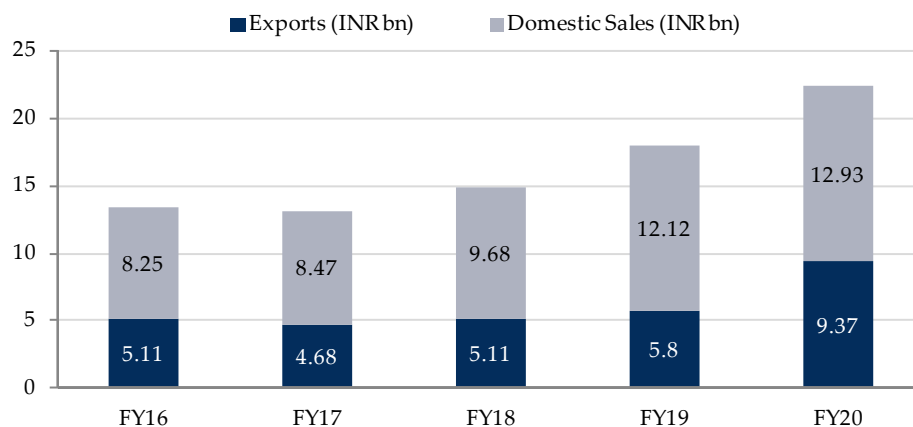
Business Segment	Basic Chemicals	Fine & Speciality Chemicals	Performance Products	Phenolics
Products	Sodium Nitrite	Xylidines	Optical Brightening Agent (OBA)	Phenol
	Sodium Nitrate	Oximes	DASDA	Acetone
	Nitro Toluidines	Cumidines		Cumene
	Fuel Additives	Speciality agrochemicals		Isopropyl alcohol
	Nitrosyl Sulphuric Acid			
Application Diversity	Colourants	Agrochemicals	Paper	Laminate & Plywood
	Petrochemicals	Colours & Pigments	Detergents	Pharmaceuticals
	Rubber	Paper	Textiles	Adhesives
		Personal Care	Coating Applications in Printing & Photographic Paper	Sanitizers
		Pharmaceuticals		Rubber
				Chemicals
			Paints	

Source: Company, HSIE Research

### Diversified customer base ensures steady operating margins

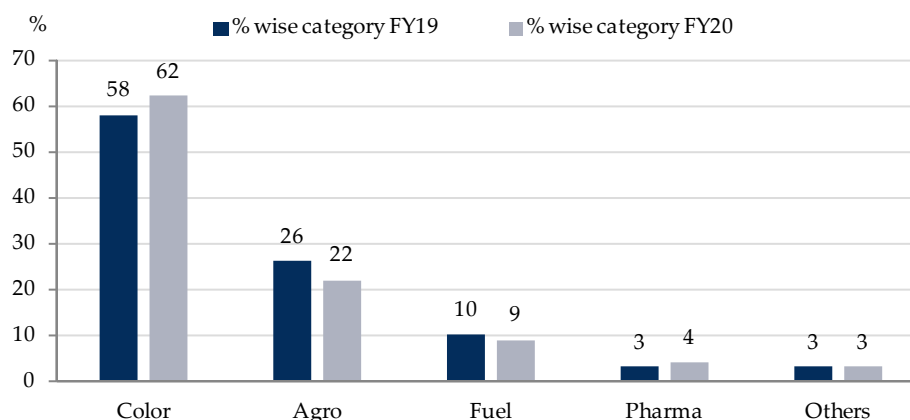
- The company is well-diversified in terms of end-user industries. The products manufactured by DNL has applications in petrochemicals, rubber, paper, colorants, pigments, agrochemicals, pharmaceuticals, personal care, detergents, paints, sanitizers and adhesives. It has more than 700 customers spread across 6 continents. Furthermore, no customer contributes more than 7% to total revenues, indicating a diversified customer profile. DNL has multi-year and multi-layer relationship with its customers. Its vast portfolio offerings ensure customer stickiness.
- The management has successfully diversified geographical presence through investments in the FSC business. The diversified revenue stream protects against downswing in any one business and keeps operating margin steady. Furthermore, cost efficiency measures in the FSC and PP businesses, strong R&D capability, and market leadership across its product segments have kept operating profitability healthy. Improving operating performance, diversity in revenue, integrated operations enable DNL to sustain improved operating efficiency.

**Exhibit-24: Geographical sales mix**



Source: Company, HSIE Research

**Exhibit-25: Revenue mix by application**

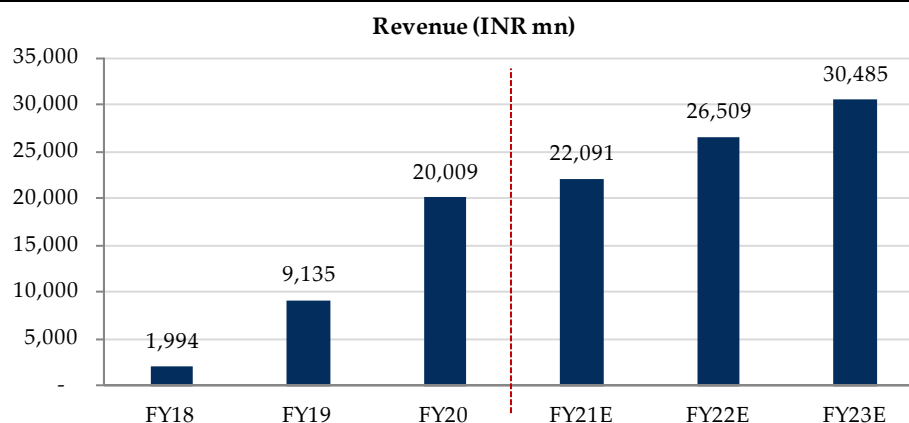


Source: Company, HSIE Research

## Deepak Phenolics will be a growth engine

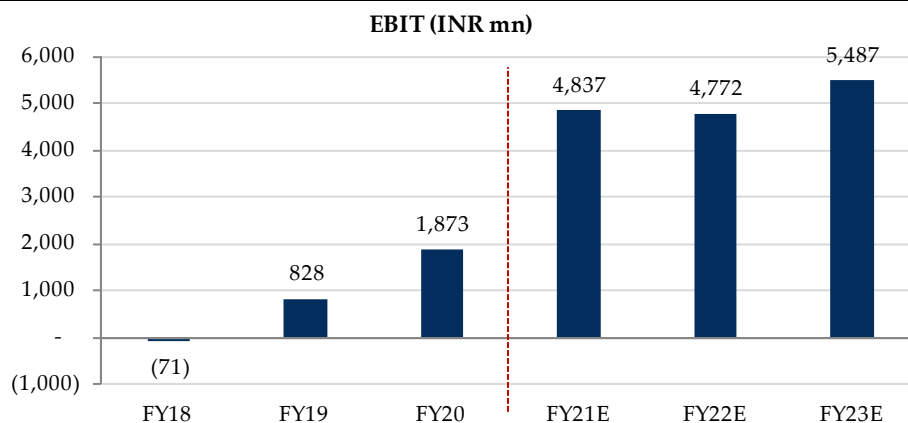
- Deepak Phenolics, the company's 100% subsidiary, produces products based on phenol, acetone and isopropyl alcohol (IPA). These are basic chemicals, which have wide application. Phenols are used for making glue, household products and as intermediates for industrial synthesis. Acetone is a universal, organic solvent used in manufacturing of pharma products, plastics, cosmetics and personal care products. IPA is also a key component in the manufacture of cleaning, disinfectants, inks, agro-chem formulations, resins, acrylic emulsions and pharmaceutical products.
- DPL invested more than INR 14bn over two years to create a manufacturing capacity of 200ktpa of phenol and 120ktpa of its co-product acetone and is supported by a captive capacity for 2600ktpa of cumene. The plant was commissioned and started operation in Nov-18. FY20 was its first full year of operation, wherein its Phenol plant capacity utilisation ramped up to more than 90%.
- In 1QFY21, DPL commenced commercial production of IPA from Acetone at its Dahej facility. It is a solvent primarily used by Pharmaceutical companies and is also used for manufacturing sanitizers. The plant has a production capacity of 30ktpa which is being utilised at near full capacity. The company substituted majority of the local market imports of Phenol and Acetone, reportedly attaining a market share of ~65% in the country.
- Deepak Fertilisers and Petrochemicals Corporation was the only manufacturer of IPA in India with an installed capacity of 70ktpa. The country's total demand for IPA is around 200ktpa since it is the most commonly used disinfectant for sanitizers. The demand for IPA is robust. DPL has announced a brown field expansion of IPA plant to double it by 1QFY22 in order to cater to rising demand and for import substitution. DPL already contribute ~52% (1HFY21) to the group's business.
- We believe that the company plans to enter into a variety of downstream derivatives of Phenol and Acetone, the production of IPA being the first step in that direction. DNL acquired several land parcels as a part of its capacity expansion and growth plan. This comprises a big parcel of land acquired at Dahej, followed by smaller parcels of land acquired in Hyderabad and Roha. The company has acquired land of INR 1.4bn in aggregate for those land parcels in FY20.

### Exhibit-26: Revenue trend of Deepak Phenolics



Source: Company, HSIE Research

Exhibit-27: EBIT trend of Deepak Phenolics

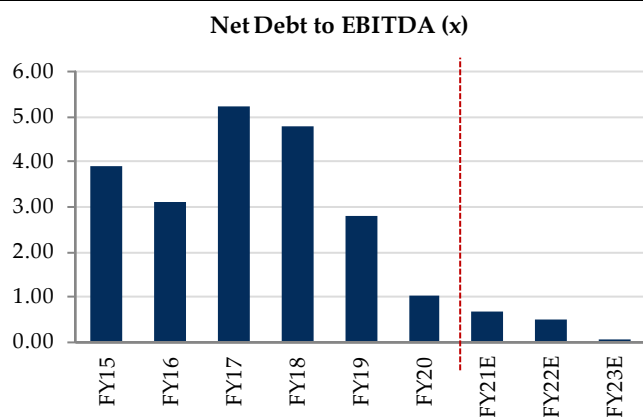


Source: Company, HSIE Research

### Strengthening balance sheet

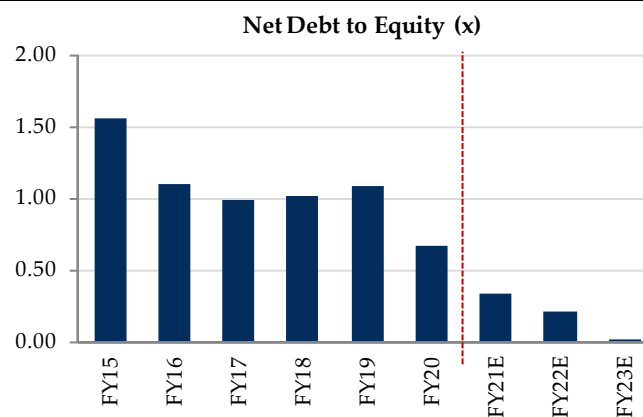
- During FY17-19, the company incurred one of its largest Capex ever through DPL, with 60% debt. This Capex was primarily towards setting up plant for the phenol and acetone. Thus, net debt to EBITDA ratio increased to 4.8x and net debt to equity to 1.0x as on Mar-18. The plant was commissioned in FY19 and is currently operating at close to its full utilisation. The expected increase in cash accruals and lower Capex intensity will result in sustained improvement in gearing and debt to EBITDA to 0.0x and 0.1x for FY23E. The interest coverage ratio would improve from 7.7x in FY20 to 29.4x in FY23E.

Exhibit-28: Net debt to EBITDA (x)



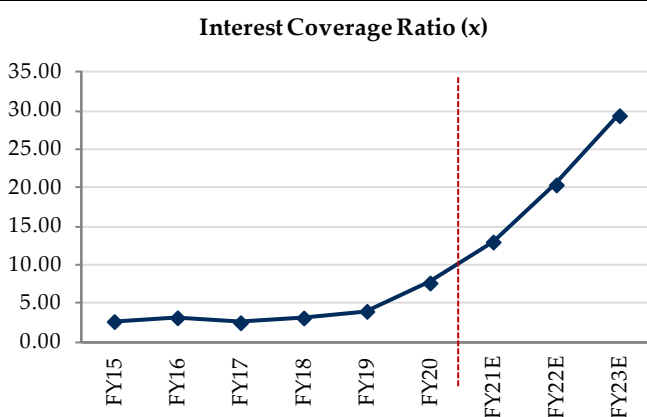
Source: Company, HSIE Research

Exhibit-29: Net debt to equity (x)



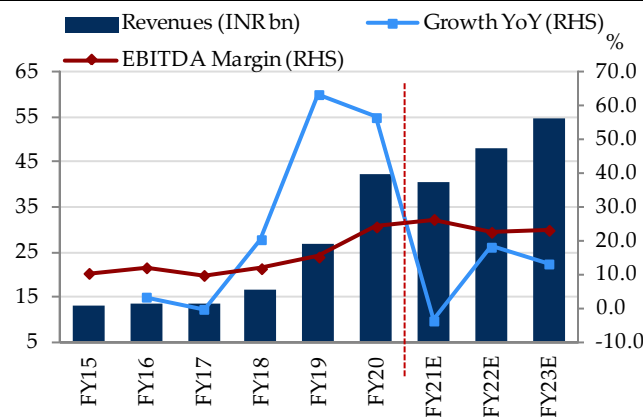
Source: Company, HSIE Research

Exhibit-30: Interest Coverage Ratio (x)



Source: Company, HSIE Research

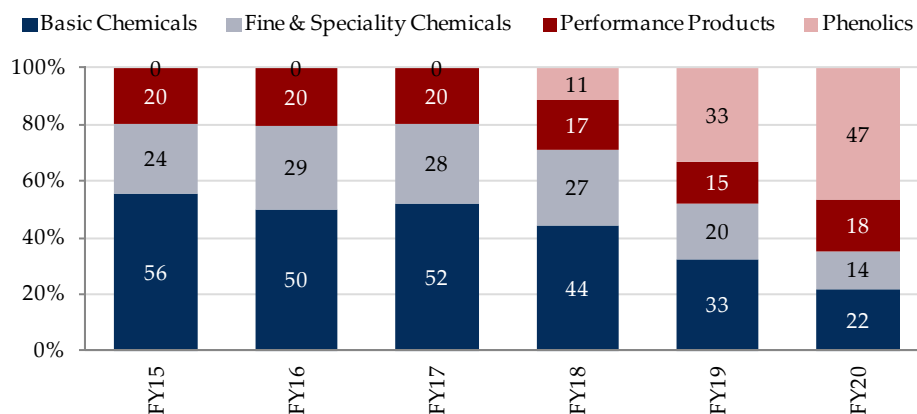
Exhibit-31: Revenue and EBITDA margin



Source: Company, HSIE Research

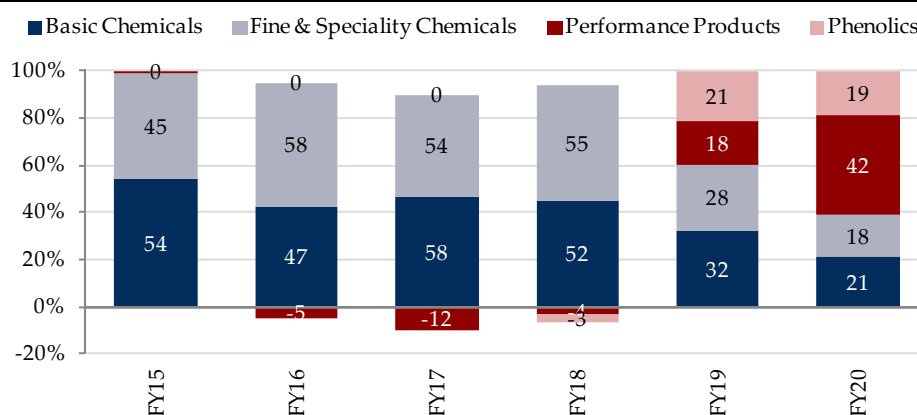


**Exhibit-32: Segmental Revenue Split**



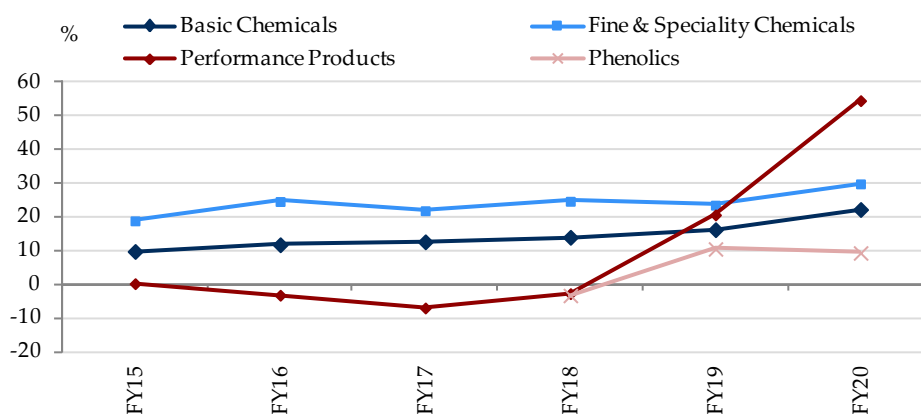
Source: Company, HSIE Research

**Exhibit-33: Segmental EBIT Split**



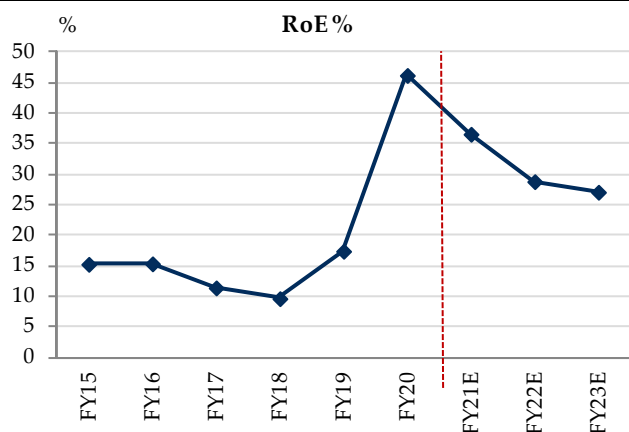
Source: Company, HSIE Research

**Exhibit-34: Segmental EBIT margins**



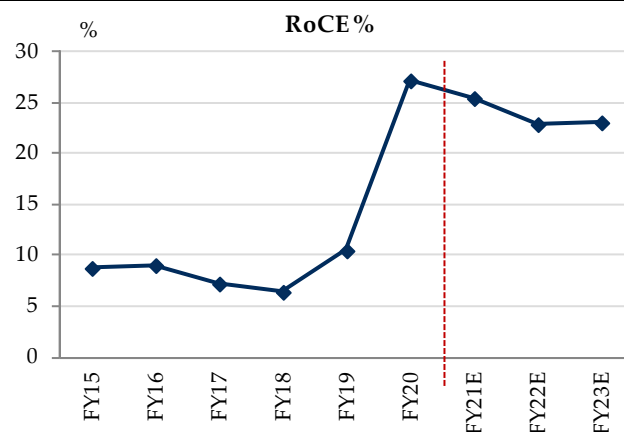
Source: Company, HSIE Research

Exhibit-35: RoE (%)



Source: Company, HSIE Research

Exhibit-36: RoCE (%)



Source: Company, HSIE Research

## About the company

- Deepak Nitrite was incorporated in 1970 by Mr C.K. Mehta and is now a leading player in the Indian chemical intermediates industry. It is the largest producer of phenol and acetone in India and a leading global producer of sodium nitrite and sodium nitrate. The company operates in four segments: (1) Basic Chemicals (22% of total revenues in FY20), (2) Fine and Speciality chemicals (14%), (3) Performance Products (18%), and (4) Phenolics (47%). The Basic Chemicals segment offers nitrites, nitro toluidines and fuel additives. The Fine and Speciality chemicals segment offers specialty chemicals, xylydines, oximes and cumidines. The performance products segment offers diamino stilbene disulfonic acid (DASDA) and optical brightening agent (OBA). The phenolics segment offers acetone, cumene, IPA and phenol operated completely by the company's subsidiary Deepak Phenolics Ltd. The company's products are used in several industries such as dyes and pigments, petrochemicals, agrochemicals, rubber, water treatment, glass, pharmaceuticals, personal care, paper, industrial explosives, textile and detergents. It has a very strong base of global customers such as Bayer, Henkel, BASF, L'Oréal, Indian Oil, Essar, HPCL, BPCL, Clariant, Eastman, Reliance and Sudarshan.
- The company's manufacturing facilities are located at Nandesari, Dahej (Gujarat), Roha, Talaja (Maharashtra) and Hyderabad (Telangana), and its research and development facility is located at Nandesari (Gujarat). The company has two wholly owned subsidiaries - Deepak Phenolics Ltd and Deepak Nitrite Corporation Inc. Exports formed 25% of the total revenues in FY20.

## Financials (Consolidated)

### INCOME STATEMENT

INR mn	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
<b>Revenues</b>	<b>13,729</b>	<b>13,707</b>	<b>16,515</b>	<b>26,999</b>	<b>42,297</b>	<b>40,767</b>	<b>48,206</b>	<b>54,607</b>
<i>Growth %</i>	3.4	(0.2)	20.5	63.5	56.7	(3.6)	18.2	13.3
Raw Material	8,255	8,459	10,388	16,467	23,735	21,010	26,789	30,053
Employee Cost	1,191	1,223	1,362	1,798	2,185	2,485	2,783	3,117
Other Expenses	2,616	2,671	2,802	4,596	6,119	6,479	7,713	8,737
<b>EBITDA</b>	<b>1,668</b>	<b>1,355</b>	<b>1,963</b>	<b>4,139</b>	<b>10,258</b>	<b>10,793</b>	<b>10,922</b>	<b>12,700</b>
<i>EBITDA Margin (%)</i>	12.1	9.9	11.9	15.3	24.3	26.5	22.7	23.3
<i>EBITDA Growth %</i>	19.8	(18.8)	44.9	110.8	147.8	5.2	1.2	16.3
Depreciation	395	480	526	778	1,397	1,272	1,392	1,543
<b>EBIT</b>	<b>1,273</b>	<b>874</b>	<b>1,437</b>	<b>3,361</b>	<b>8,861</b>	<b>9,521</b>	<b>9,530</b>	<b>11,157</b>
Other Income (Including EO Items)	16	814	123	151	352	279	287	296
Interest	397	341	451	832	1,149	731	466	379
<b>PBT</b>	<b>891</b>	<b>1,347</b>	<b>1,109</b>	<b>2,680</b>	<b>8,064</b>	<b>9,069</b>	<b>9,351</b>	<b>11,074</b>
Tax	262	382	318	943	1,954	2,305	2,396	2,838
<b>PAT</b>	<b>629</b>	<b>965</b>	<b>790</b>	<b>1,737</b>	<b>6,110</b>	<b>6,764</b>	<b>6,954</b>	<b>8,236</b>
EO (Loss) / Profit (Net of Tax)	-	285	-	-	-	-	-	-
<b>APAT</b>	<b>629</b>	<b>680</b>	<b>790</b>	<b>1,737</b>	<b>6,110</b>	<b>6,764</b>	<b>6,954</b>	<b>8,236</b>
Share from associates	-	(1)	-	-	-	-	-	-
Minority Interest	-	-	-	-	-	-	-	-
<b>Consolidated APAT</b>	<b>629</b>	<b>678</b>	<b>790</b>	<b>1,737</b>	<b>6,110</b>	<b>6,764</b>	<b>6,954</b>	<b>8,236</b>
<i>Consolidated APAT Growth (%)</i>	18.9	7.8	16.5	119.8	251.9	10.7	2.8	18.4
<b>AEPS</b>	<b>4.6</b>	<b>5.0</b>	<b>5.8</b>	<b>12.7</b>	<b>44.8</b>	<b>49.1</b>	<b>51.0</b>	<b>60.4</b>
<i>AEPS Growth %</i>	18.9	7.8	16.5	119.8	251.9	9.7	3.8	18.4

Source: Company, HSIE Research

### BALANCE SHEET

INR mn	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
<b>SOURCES OF FUNDS</b>								
Share Capital	233	261	273	273	273	273	273	273
Reserves and Surplus	4,496	6,887	8,949	10,443	15,446	20,980	26,723	33,525
<b>Total Equity</b>	<b>4,729</b>	<b>7,149</b>	<b>9,221</b>	<b>10,716</b>	<b>15,719</b>	<b>21,253</b>	<b>26,996</b>	<b>33,798</b>
Minority Interest	-	-	-	-	-	-	-	-
Long-term Debt	1,589	2,184	5,505	8,699	7,794	6,900	5,520	4,416
Short-term Debt	3,699	5,055	4,361	3,167	3,120	451	451	451
<b>Total Debt</b>	<b>5,288</b>	<b>7,239</b>	<b>9,865</b>	<b>11,865</b>	<b>10,915</b>	<b>7,351</b>	<b>5,971</b>	<b>4,867</b>
Deferred Tax Liability	566	391	454	775	796	796	796	796
Long-term Provision and others	77	78	250	252	287	293	299	305
<b>TOTAL SOURCES OF FUNDS</b>	<b>10,660</b>	<b>14,856</b>	<b>19,791</b>	<b>23,608</b>	<b>27,717</b>	<b>29,693</b>	<b>34,062</b>	<b>39,766</b>
<b>APPLICATION OF FUNDS</b>								
Net Block	5,977	5,859	5,876	17,158	18,320	18,909	20,448	21,995
Capital WIP	319	3,492	9,545	339	1,723	3,861	4,931	4,340
Other non-current assets	805	980	533	140	457	471	485	499
Non-current Investments	28	37	23	24	24	24	24	24
<b>Total Non-current assets</b>	<b>7,130</b>	<b>10,369</b>	<b>15,977</b>	<b>17,661</b>	<b>20,523</b>	<b>23,265</b>	<b>25,887</b>	<b>26,859</b>
Inventories	1,210	1,671	3,254	4,107	3,945	3,802	4,496	5,093
Debtors	3,132	3,603	4,118	5,750	6,127	5,596	7,069	7,921
Cash and Cash Equivalents	65	145	482	258	314	89	308	4,141
Other Current Assets	1,405	2,086	2,075	1,503	1,177	1,200	1,224	1,249
<b>Total Current Assets</b>	<b>5,812</b>	<b>7,505</b>	<b>9,929</b>	<b>11,617</b>	<b>11,563</b>	<b>10,688</b>	<b>13,098</b>	<b>18,404</b>
Creditors	1,331	2,146	4,900	4,724	3,643	3,511	4,151	4,703
Other Current Liabilities & Provns	950	873	1,215	945	727	749	771	794
<b>Total Current Liabilities</b>	<b>2,281</b>	<b>3,018</b>	<b>6,115</b>	<b>5,670</b>	<b>4,369</b>	<b>4,259</b>	<b>4,922</b>	<b>5,497</b>
<b>Net Current Assets</b>	<b>3,530</b>	<b>4,487</b>	<b>3,814</b>	<b>5,948</b>	<b>7,194</b>	<b>6,428</b>	<b>8,175</b>	<b>12,907</b>
<b>TOTAL APPLICATION OF FUNDS</b>	<b>10,660</b>	<b>14,856</b>	<b>19,791</b>	<b>23,608</b>	<b>27,717</b>	<b>29,693</b>	<b>34,062</b>	<b>39,766</b>

Source: Company, HSIE Research

## CASH FLOW STATEMENT

INR mn	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Reported PBT	891	1,348	1,109	2,680	8,064	9,069	9,351	11,074
Non-operating & EO Items	(16)	(815)	(123)	(151)	(352)	(279)	(287)	(296)
Interest Expenses	397	341	451	832	1,149	731	466	379
Depreciation	395	480	526	778	1,397	1,272	1,392	1,543
Working Capital Change	(545)	(877)	1,011	(2,358)	(1,190)	541	(1,528)	(899)
Tax Paid	(159)	(558)	(255)	(623)	(1,932)	(2,305)	(2,396)	(2,838)
<b>OPERATING CASH FLOW ( a )</b>	<b>964</b>	<b>(80)</b>	<b>2,719</b>	<b>1,158</b>	<b>7,136</b>	<b>9,029</b>	<b>6,997</b>	<b>8,962</b>
Capex	(765)	(3,535)	(6,595)	(2,854)	(3,943)	(4,000)	(4,000)	(2,500)
Free Cash Flow (FCF)	199	(3,615)	(3,877)	(1,696)	3,193	5,029	2,997	6,462
Investments	2	(9)	14	(0)	0	-	-	-
Non-operating Income	16	814	123	151	352	279	287	296
Others	(263)	(175)	448	393	(317)	(14)	(14)	(15)
<b>INVESTING CASH FLOW ( b )</b>	<b>(1,011)</b>	<b>(2,906)</b>	<b>(6,011)</b>	<b>(2,310)</b>	<b>(3,908)</b>	<b>(3,735)</b>	<b>(3,727)</b>	<b>(2,219)</b>
Debt Issuance/(Repaid)	(157)	1,951	2,627	2,000	(951)	(3,563)	(1,380)	(1,104)
Interest Expenses	(397)	(341)	(451)	(832)	(1,149)	(731)	(466)	(379)
FCFE	(356)	(2,006)	(1,702)	(529)	1,094	735	1,151	4,979
Share Capital Issuance	24	29	11	0	-	-	-	-
Dividend	(125)	(167)	(188)	(213)	(1,060)	(1,167)	(1,211)	(1,434)
Others	737	1,595	1,631	(26)	(12)	(58)	6	6
<b>FINANCING CASH FLOW ( c )</b>	<b>81</b>	<b>3,066</b>	<b>3,629</b>	<b>928</b>	<b>(3,172)</b>	<b>(5,519)</b>	<b>(3,051)</b>	<b>(2,911)</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>34</b>	<b>80</b>	<b>337</b>	<b>(224)</b>	<b>56</b>	<b>(225)</b>	<b>219</b>	<b>3,833</b>
EO Items, Others								
<b>Closing Cash &amp; Equivalents</b>	<b>65</b>	<b>145</b>	<b>482</b>	<b>258</b>	<b>314</b>	<b>89</b>	<b>308</b>	<b>4,141</b>

Source: Company, HSIE Research

## KEY RATIOS

Ratios	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
<b>PROFITABILITY %</b>								
Gross Margin	39.9	38.3	37.1	39.0	43.9	48.5	44.4	45.0
EBITDA Margin	12.1	9.9	11.9	15.3	24.3	26.5	22.7	23.3
EBIT Margin	9.3	6.4	8.7	12.4	20.9	23.4	19.8	20.4
APAT Margin	4.6	4.9	4.8	6.4	14.4	16.6	14.4	15.1
RoE	15.4	11.4	9.7	17.4	46.2	36.6	28.8	27.1
RoIC	9.4	3.9	9.8	13.3	27.6	27.6	26.0	27.6
RoCE	9.0	7.2	6.4	10.5	27.2	25.5	22.9	23.1
<b>EFFICIENCY</b>								
Tax Rate %	29.4	28.4	28.7	35.2	24.2	25.4	25.6	25.6
Fixed Asset Turnover (x)	1.6	1.5	1.7	1.7	1.8	1.6	1.7	1.8
Inventory (days)	32	45	72	56	34	34	34	34
Debtors (days)	83	96	91	78	53	50	54	53
Other Current Assets (days)	37	56	46	20	10	11	9	8
Payables (days)	59	93	172	105	56	61	57	57
Other Current Liab & Provns (days)	25	23	27	13	6	7	6	5
Cash Conversion Cycle (days)	69	80	10	36	35	27	34	33
Net Debt/EBITDA (x)	3.1	5.2	4.8	2.8	1.0	0.7	0.5	0.1
Net D/E	1.1	1.0	1.0	1.1	0.7	0.3	0.2	0.0
Interest Coverage	3.2	2.6	3.2	4.0	7.7	13.0	20.4	29.4
<b>PER SHARE DATA (Rs)</b>								
EPS	4.6	5.0	5.8	12.7	44.8	49.1	51.0	60.4
CEPS	7.5	8.5	9.6	18.4	55.0	58.5	61.2	71.7
Dividend	1.0	1.2	1.2	1.3	6.5	7.1	7.4	8.8
Book Value	34.7	52.4	67.6	78.6	115.2	155.8	197.9	247.8
<b>VALUATION</b>								
P/E (x)	225.7	209.4	179.7	81.8	23.2	21.2	20.4	17.2
P/Cash EPS (x)	138.6	122.6	107.9	56.5	18.9	17.8	17.0	14.5
P/BV (x)	30.0	19.9	15.4	13.2	9.0	6.7	5.3	4.2
EV/EBITDA (x)	88.3	110.0	77.1	37.1	14.9	13.8	13.5	11.2
EV/Revenue (x)	10.7	10.9	9.2	5.7	3.6	3.7	3.1	2.6
Dividend Yield (%)	0.1	0.1	0.1	0.1	0.6	0.7	0.7	0.8
OCF/EV (%)	0.7	(0.1)	1.8	0.8	4.7	6.0	4.7	6.3
FCFF/EV (%)	0.1	(2.4)	(2.6)	(1.1)	2.1	3.4	2.0	4.5
FCFE/M Cap (%)	(0.3)	(1.4)	(1.2)	(0.4)	0.8	0.5	0.8	3.5

Source: Company, HSIE Research

## Exhibit-37: Peer valuation table

Company	CMP (INR)	RECO	TP (INR)	P/E (x)			RoE (%)			EV/EBITDA (x)			Dividend yield (%)			FCFF yield (%)		
				FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
AIL	1,238	BUY	1,440	45.9	45.2	34.5	14.7	13.2	15.2	25.5	23.7	19.3	0.2	0.2	0.3	(1.4)	0.5	1.5
Alkyl Amines	5,105	ADD	5,450	43.2	38.9	35.0	37.3	30.5	26.3	28.9	27.0	23.7	0.2	0.2	0.2	1.0	1.0	1.4
Balaji Amines	1,448	ADD	1,540	23.5	23.0	20.3	23.1	19.1	17.8	15.8	14.8	12.9	0.0	0.1	0.1	1.4	1.7	1.8
Deepak Nitrite	1,041	ADD	1,130	21.2	20.4	17.2	36.6	28.8	27.1	13.8	13.5	11.2	0.7	0.7	0.8	3.4	2.0	4.5
Fine Organic	2,359	BUY	2,905	52.2	38.0	30.1	20.7	24.3	25.8	34.3	25.6	20.1	0.5	0.7	0.8	2.1	2.4	2.9
Galaxy Surfactants	2,225	BUY	2,750	25.4	21.9	19.8	26.1	24.8	23.3	16.7	14.8	13.5	0.8	1.0	1.1	3.1	2.2	3.2
NFIL	2,535	ADD	2,720	58.7	41.9	33.5	14.0	17.1	18.9	36.7	26.3	20.5	0.4	0.6	0.7	0.4	0.2	1.7
NOCIL	152	BUY	185	34.2	21.1	18.0	6.2	9.6	10.8	20.6	13.1	11.2	1.0	2.4	2.8	2.1	2.9	4.5
SRF	5,544	ADD	6,080	33.5	33.1	30.4	18.3	15.9	15.1	18.9	18.1	16.5	0.3	0.3	0.3	1.4	1.4	2.1
Sudarshan Chemical	501	BUY	605	27.3	25.2	19.8	20.1	19.7	22.6	15.1	13.7	11.6	1.5	1.6	2.3	0.5	1.3	2.4
Vinati Organics	1,260	SELL	1,015	48.5	38.1	34.7	19.4	20.9	19.3	37.3	28.7	25.4	0.4	0.4	0.5	(1.2)	(0.7)	(0.7)

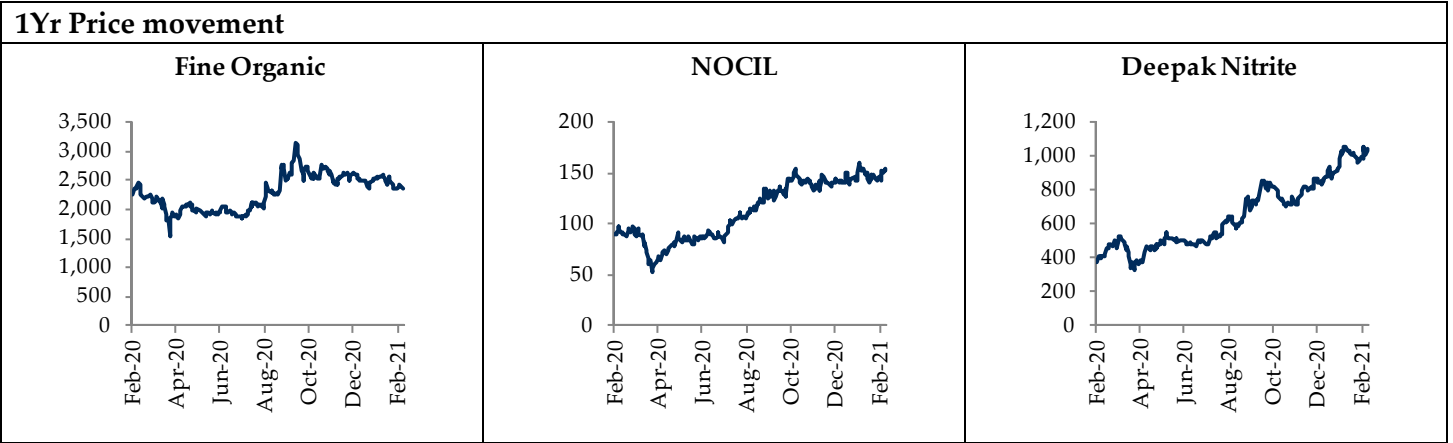
Source: Company, HSIE Research

## Exhibit-38: Change in estimates, TP and rating

Company	CMP (INR)	Rating		TP		Old EPS			New EPS			Est Change (%)		
		Old	New	Old	New	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
AIL	1,238	BUY	BUY	1,400	1,440	27.0	27.4	35.8	27.0	27.4	35.8	-	-	-
Alkyl Amines	5,105	ADD	ADD	5,310	5,450	118.2	131.1	146.0	118.2	131.1	146.0	-	-	-
Balaji Amines	1,448	ADD	ADD	1,280	1,540	42.5	52.5	59.5	61.6	63.0	71.2	44.9	20.0	19.7
Galaxy Surfactants	2,225	BUY	BUY	2,750	2,750	87.8	101.7	112.3	87.8	101.7	112.3	-	-	-
NFIL	2,535	ADD	ADD	2,720	2,720	43.2	60.5	75.7	43.2	60.5	75.7	-	-	-
SRF	5,544	ADD	ADD	6,080	6,080	165.4	167.5	182.1	165.4	167.5	182.1	-	-	-
Sudarshan Chemical	501	BUY	BUY	605	605	18.4	19.8	25.3	18.4	19.8	25.3	-	-	-
Vinati Organics	1,260	SELL	SELL	1,015	1,015	26.0	33.1	36.3	26.0	33.1	36.3	-	-	-

Source: Company, HSIE Research

# Chemical: Sector Update



**Rating Criteria**

- BUY: >+15% return potential
- ADD: +5% to +15% return potential
- REDUCE: -10% to +5% return potential
- SELL: > 10% Downside return potential

## Chemical: Sector Update

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