

INDEPENDENT EQUITY RESEARCH: DEEPAK NITRITE LTD (DEEPAK.NS)

Rating: NEUTRAL / HOLD | Target Price: Rs.780 – Rs.850 | Implied Downside: 50-55% | Current Price: Rs.1,694

Methodology: Discounted Cash Flow (DCF) Valuation

1. Background & Objective

This project was undertaken to understand how valuation changes across different phases of an industrial cycle, using Deepak Nitrite Ltd as a case study. The objective was not short-term stock prediction, but to **build a full bottom-up DCF model**, test assumptions, and compare intrinsic value with market expectations.

Deepak Nitrite is a good case for this study because:

- It operates in a **highly cyclical chemical segment**
 - It recently experienced **peak margins followed by sharp normalization**
 - It is currently executing a **large, capital-intensive expansion**
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2. Business Overview

Deepak Nitrite is one of India's leading manufacturers of chemical intermediates, with a strong position in the **Phenol–Acetone value chain**, where it commands nearly **50% market share** domestically.

Historically, the company benefited from global supply disruptions and favourable pricing, especially during FY20–FY22. However, as global capacity normalized, profitability declined, highlighting the cyclical nature of the business.

3. Core Investment Observation

Mismatch Between Market Price and Cycle Position

During FY21, the company reported EBITDA margins of nearly **28%**, driven by unusually high spreads. By FY24–FY25, margins had corrected to **11–14%**, closer to long-term averages.

Despite this, the stock continues to trade at a valuation that implies:

- A **quick return to peak margins**
- Sustained high profitability through the cycle

Given increasing global Phenol supply (especially from China), I believe this assumption is optimistic.

4. Polycarbonate Expansion – Opportunity with Execution Risk

The company has announced a **Rs.5,000 Cr investment** to enter the Polycarbonate segment. Strategically, this is positive, as it moves the firm towards higher value-added products.

However, from a valuation perspective:

- Cash flows will remain under pressure during the construction phase

- Capital will be locked in CWIP for multiple years
- Return ratios may weaken before improving

This makes near-term valuation sensitive to execution timelines.

5. Valuation Methodology (DCF Model)

A **5-year DCF model** was constructed using conservative operating assumptions to reflect mid-cycle conditions rather than peak performance. The DCF is anchored on trailing twelve-month (TTM) operating performance to reflect current cycle conditions. The valuation is based on Free Cash Flow to the Firm (FCFF), discounted at WACC.

Key Assumptions

- **Revenue Growth:** 12% CAGR
- **EBIT Margins:** 14% (below historical peak, closer to normalized levels)
- **WACC:** 12%
- **Terminal Growth:** 5%

The model projects revenues growing from **Rs.8,300 Cr (FY25E)** to approximately **Rs.14,500 Cr (FY30E)**.

Based on these assumptions, the **intrinsic value works out to ~Rs.735 per share**.

6. Sensitivity & Market Expectations

A sensitivity analysis was conducted across WACC and terminal growth assumptions.

To justify the current market price (~Rs.1,700), the company would need:

- Revenue growth above **18% CAGR**, and
- EBIT margins exceeding **20%**, like peak-cycle conditions

This suggests that the market is pricing in a near-perfect recovery scenario.

7. Key Learnings from the Project

- Cyclical businesses should not be valued using peak margins
 - Capital allocation decisions significantly impact short-term ROIC
 - DCF outcomes are highly sensitive to margin assumptions in commodity-linked sectors
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8. Conclusion

This project reinforced the importance of aligning valuation assumptions with industry cycle dynamics. While Deepak Nitrite remains a strong business structurally, my analysis suggests that current market prices reflect overly optimistic expectations.

The study concludes that the stock offers **limited margin of safety at current levels**, making it a useful example of valuation risk during cyclical downturns.