India Midcaps

RESULT UPDATE

SRF

Margin pressure offsets revenue gain

India Equity Research| Miscellaneous

Edelweiss
Ideas create, values protect

SRF's Q4FY17 top line surpassed estimate, but INR2.2bn EBITDA came 12% below estimate due to margin pressure across segments. PAT, at INR1.3bn, surpassed the INR1.2bn forecast led by forex gain. Chemical segment's FY17 margin plummeted 470bps YoY to 19% due to weak global agrochem market. However, SRF is going ahead with capex as the segment's long-term growth remains intact. In our view, earlier-than-anticipated recovery in specialty chemical segment can trigger earnings growth. But, sustained weak demand could jeopardise earnings due to margin pressure. We revise down FY18E EPS 7% due to weak margin, but revise up FY19E EPS 7% due to commissioning of packaging plant. We will monitor the global agrochemical scenario for any sign of improvement or wait for stock price correction to review our recommendation. Maintain 'HOLD' with revised TP of INR1,786 (INR1,738 earlier), based on our SOTP-based valuation.

Refrigerants boost chemical revenue; margin under pressure

Chemical revenue, at INR5.1bn, grew 12% YoY led by strong growth in refrigerants business. Global slowdown in agrochemicals remained a drag on specialty chemical as EBIT margin remained muted at 16.6% (down 660bps YoY). Management continues to focus on this segment and has committed INR7bn capex (INR2bn announced in Q4FY17) in the past 1 year. We expect chemical revenue to pick up (FY17-19E CAGR of 18.4%) and EBIT margin to rise to 23% by FY19 (19% in FY17), leading to 30% CAGR in EBIT (FY17-19). We expect a strong refrigerants segment to also support margin.

Technical textile, packaging films margins flounder

Technical textile sustained strong revenue growth of 23% YoY to INR5.3bn albeit, on a low base. Segment's margin, however, tumbled 110bps YoY to 10%. Packaging films' revenue jumped 26% YoY to INR3.8bn led by commissioning of BOPET plant in Q4FY17. However, its margin reeled under pressure due to significant capacity addition in the industry. We have modeled the same in our FY18/19E numbers. We believe, upcoming capacities in packaging films is likely to keep margins under pressure.

Outlook and valuations: recovery awaited; maintain 'HOLD'

Pick up in global agrochemical market is a key trigger for SRF. We revise down FY18E EPS 7% due to current weak margin, but revise up FY19E EPS 7% due to commissioning of the packaging film plant. Our SOTP-based valuation yields target price of INR1,786. We maintain '**HOLD**' recommendation.

Financials (Consolidated) (INR mn)

Year to March	Q4FY17	Q4FY16	*YoY (%)*	Q3FY17	*QoQ (%)*	FY17	FY18E	FY19E
Net Revenues	13,258	11,130	*19.1*	11,330	*17.0*	48,218	57,097	65,228
EBITDA	2,157	2,248	*(4.0)*	2,312	*(6.7)*	9,694	10,855	13,004
Adj. Profit	1,147	1,072	*7.0*	1,119	*2.4*	4,874	5,197	6,505
Dil. EPS (INR)	20.0	18.7	*7.0*	19.5	*2.4*	84.9	90.5	113.3
Dil. P/E (x)						19.1	17.9	14.3
EV/EBITDA (x)						11.3	10.1	8.2
ROAE (%)						16.7	15.3	16.9

EDELWEISS RATINGS

Absolute Rating	**HOLD**
Investment Characteristics	Growth

MARKET DATA *(R: SRFL.BO, B: SRF IN)*

CMP	: INR 1,617
Target Price	: INR 1,786
52-week range (INR)	: 1,970 / 1,197
Share in issue (mn)	: 57.4
M cap (INR bn/USD mn)	: 93 / 1,436
Avg. Daily Vol. BSE/NSE ('000)	: 243.9

SHARE HOLDING PATTERN (%)

	Current	Q2FY17	Q1FY17
Promoters *	52.4	52.4	52.4
MF's, FI's & BKs	10.8	10.8	11.2
FII's	18.1	18.6	18.0
Others	18.7	18.2	18.5

** Promoters pledged shares (% of share in issue) : NIL*

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	(3.7)	(6.7)	(2.9)
3 months	5.1	4.2	(1.0)
12 months	28.4	30.9	2.5

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Q4FY17 conference call: Key highlights

SRF expects near term challenges which includes:

- Slowdown in agrochemical sector
- Strengthening INR
- Higher tax - 30% (23-24% last year)

Chemicals

- In FY17, revenue mix was 50:50 for refrigerants: specialty chemicals, similar to FY16.
- For specialty chemicals segment, revenue remained flat YoY at INR7.5bn.
- Margin for specialty chemicals are better than refrigerants.
- Overall margin will only improve once share of specialty chemicals picks up.
- In the specialty chemicals segment, share of agri : pharma stands at 75: 25 (similar to last year).

Specialty Chemicals

Capex

- **In FY17, SRF incurred capex of INR7bn,** of which INR3bn was expended towards BOPET plant (packaging films segment) and balance for chemicals division.
- **For FY18, the company is planning capex of INR10bn** to be largely incurred on chemical division, except INR2.5bn on packaging films segment for BOPP plant.
- By FY18 year end, the company targets to maintain debt at current levels.
- During the quarter, SRF announced capex of INR2bn for chemicals segment to create production capability to produce new agrochemical with peak production capacity of 250MT and carry out modifications in the P 11/12 plant to improve capacities to meet R 134a production requirements, both at Dahej.
- The new dedicated agrochemicals plant will be JV with customer where SRF will be manufacturing active ingredient trying for the first time in agrochemicals sector. SRF and customer have worked together for 6-7 years to bring this project to reality. There will be long term lock-in with the customer for supply of this product and will take 12-18 months for commissioning of this plant

Packaging Films

- In Feb 2017, BOPET unit at Indore was commissioned.
- In FY17, 4 lines of BOPET got commissioned in including SRF's line which is adding to margin pressure.
- Margins are likely to remain under pressure.

Refrigerants

- Volume of R134 increased ~30% to 9,000 tonnes in FY17 (versus 7,000 tonnes in FY16).
- SRF continues to enjoy more than 50% market share with improving volumes and better product offerings.
- It is the first company to launch FLORON 22 cans in India this will prevent pilferage

- In next couple of weeks, SRF will be ready with its Dymel brand and it will take ~1 year for the company to switch customers from Dymel to SRF

Chart 1: C&P share stood higher at 36% in Q4FY17 from 32% in Q3FY17…

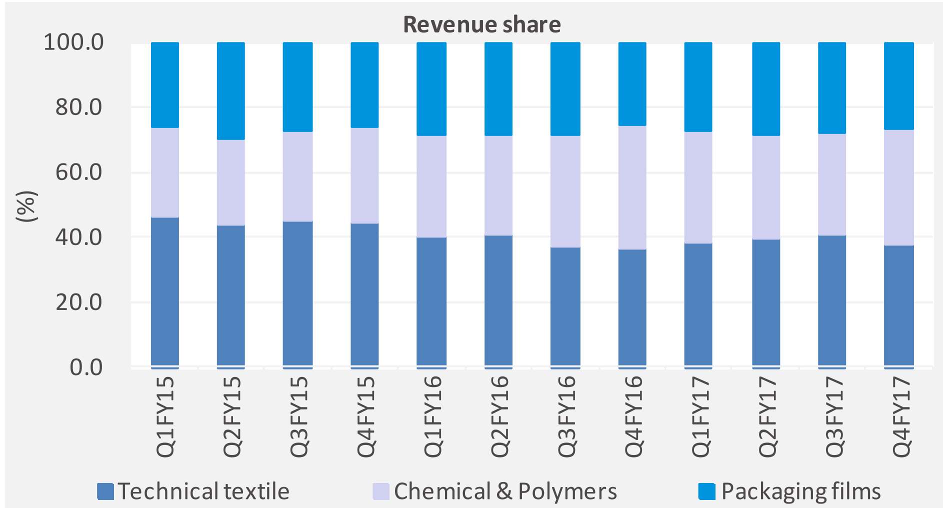
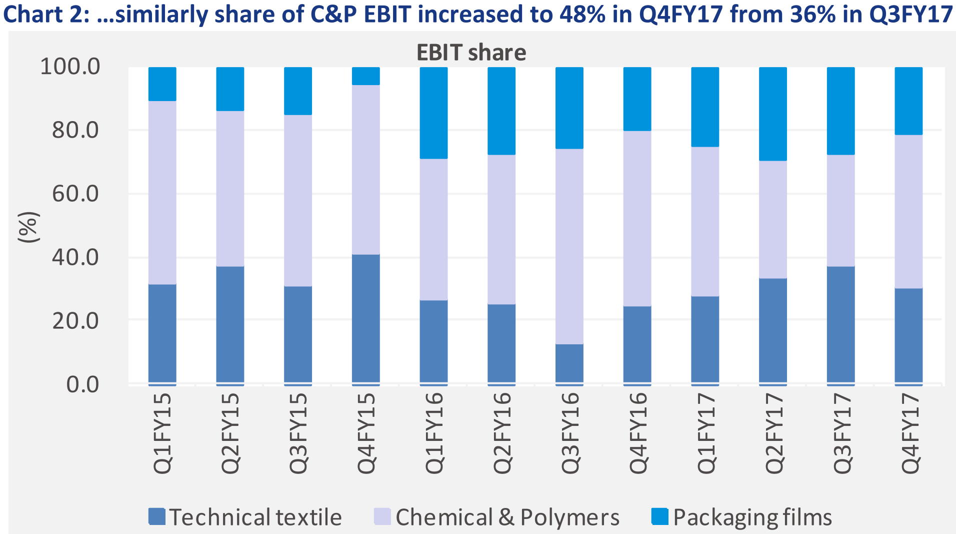
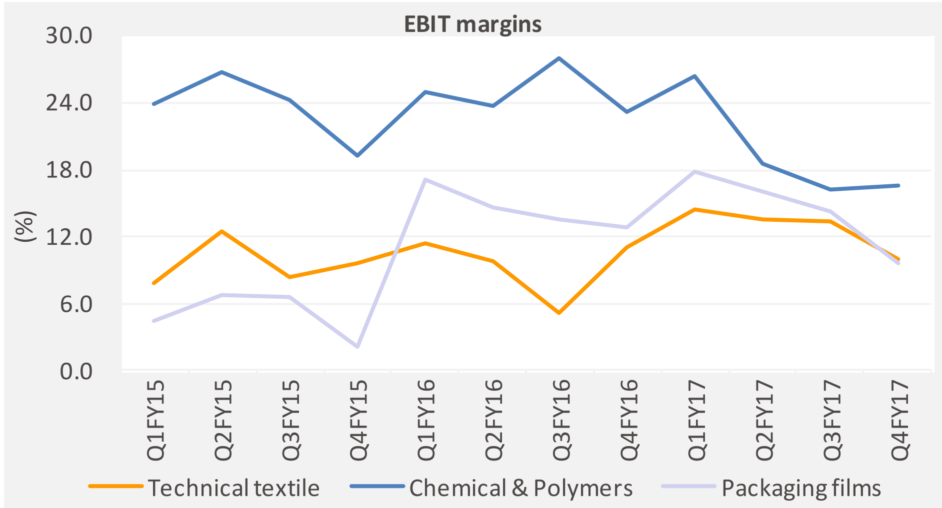


Chart 2: …similarly share of C&P EBIT increased to 48% in Q4FY17 from 36% in Q3FY17



Source: Company, Edelweiss research

Chart 3: C&P margins fell by 660bps YoY, stable QoQ



Source: Company, Edelweiss research

Financial snapshot (INR mn)

Year to March	Q4FY17	Q4FY16	*% change*	Q3FY17	*% change*	FY17	FY18E	FY19E
Net revenues	13,258	11,130	*19.1*	11,330	*17.0*	48,218	57,097	65,228
Staff costs	1,212	1,121	*8.1*	1,075	*12.8*	4,338	4,772	5,249
Direct costs	6,995	5,400	*29.5*	5,559	*25.8*	24,184	28,606	33,006
Other expenses	2,893	2,360	*22.6*	2,384	*21.4*	10,002	12,864	13,968
EBITDA	2,157	2,248	*(4.0)*	2,312	*(6.7)*	9,694	10,855	13,004
Depreciation	730	695	*5.1*	709	*3.0*	2,834	3,248	3,565
EBIT	1,428	1,554	*(8.1)*	1,604	*(11.0)*	6,860	7,607	9,439
Other income	259	114	*128.3*	64	*303.3*	455	500	500
Interest	228	320	*(28.7)*	269	*(15.1)*	1,018	889	777
Add: Exceptional items	185	57	*225.9*	(45)	*(516.0)*	-	-	-
Profit before tax	1,644	1,404	*17.1*	1,355	*21.3*	6,296	7,218	9,162
Provision for taxes	352	287	*22.5*	271	*29.7*	1,422	2,021	2,657
Minority interest								
Associate profit share								
Profit- Discontinued Ops								
Reported net profit	1,292	1,117	*15.7*	1,084	*19.2*	4,874	5,197	6,505
Adjusted Profit	1,147	1,072	*7.0*	1,119	*2.4*	4,874	5,197	6,505
Diluted shares (mn)	57	57		57		57	57	57
Adjusted Diluted EPS	20.0	18.7	*7.0*	19.5	*2.4*	84.9	90.5	113.3
As % of net revenues								
Direct costs	52.8	48.5		49.1		50.2	50.1	50.6
Employee cost	9.1	10.1		9.5		9.0	8.4	8.0
Other expenses	21.8	21.2		21.0		20.7	22.5	21.4
EBITDA	16.3	20.2		20.4		20.1	19.0	19.9
Reported net profit	8.6	9.6		9.9		10.1	9.1	10.0
Tax rate	21.4	20.4		20.0		22.6	28.0	29.0

Change in Estimates

	FY18E			FY19E			
	New	**Old**	***% change***	**New**	**Old**	***% change***	**Comments**
Net Revenue	57,097	52,191	*9.4*	65,228	58,116	*12.2*	Higher growth from Packaging films and Chemicals division
EBITDA	10,855	11,080	*(2.0)*	13,004	12,580	*3.4*	Revenue partially offset by cautious margin assumption in packaging and technical textiles segment
EBITDA Margin	*19.0*	*21.2*		*19.9*	*21.6*		
Adjusted Profit After Tax	5,197	5,362	*(3.1)*	6,505	6,033	*7.8*	
Net Profit Margin	*9.1*	*10.3*		*10.0*	*10.4*		
Capex	10,000	7,690	*30.0*	4,500	7,759	*(42.0)*	

Company Description

SRF is a multi-business entity manufacturing chemical-based industrial intermediates. It commenced operations as Shri Ram Fibres in 1970 when its parent company DCM decided to set up a separate entity to manufacture nylon tyre cord fibres. Its business portfolio covers technical textiles, fluorochemicals, chloromethanes, specialty chemicals, engineering plastics and packaging films. SRF does business with 75 countries and has 9 facilities in India and 2 each in Thailand and South Africa. The company's business is divided into 3 divisions: (1) technical textiles, (2) chemical & polymers; and (3) packaging films.

Investment Theme

Car/refrigerator sales to spur fluorochems; R&D to drive specialty: Capacity utilisation in SRF's fluorochemicals business is anticipated to surge riding spurt in sales of refrigerators & cars and import substitution. Moreover, R&D investments, cornerstone of SRF's commendable success in high entry barriers specialty chemicals, have yielded handsome dividends—filed 30 process patents in FY17, taking the tally to 111 patents filed till date and commercialised more than 40 products—leading to 18% revenue CAGR over FY12-17. With a strong products pipeline and focused capex (INR25bn to be incurred over 3-4 years), we expect the division to post strong revenue growth, and catapult its revenue/EBITDA share going forward.

Technical textiles: Cash cow; Packaging: **Consumption growth play -** SRF has been channelising technical textiles' ~INR2.2bn/year FCF to finance incremental capex in other divisions. We estimate packaging films to clock 20% revenue CAGR over FY17-19, led by capacity addition.

Key Risks

Limited product life cycle: There is a risk of early phase out of the molecule due to availability of a substitute or development of some other molecule in the other market.

Pace of launch of new molecules: SRF faces inventory risk as the timing of launch of a molecule is determined by client campaign. Also, this leads to volatility risk on quarterly basis as when a molecule is launched profitability shoots up significantly.

Financial Statements

Key assumption

Year to March	FY16	FY17	FY18E	FY19E
Macro Assumptions				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.8	5.0	5.2
Repo rate (exit rate)	6.8	6.3	6.3	6.3
USD/INR (Avg)	65.0	67.5	67.0	67.0
Financial Assumptions				
Revenue Growth				
Technical Textile	(7)	6	2	2
Chemicals & Polymers	29.8	5.0	15.0	22.0
Packaging Films	9.2	3.6	20.0	20.0
EBIT margin (%)				
Technical Textile	9.1	12.6	11.0	11.0
Chemicals & Polymers	23.7	19.0	21.0	23.0
Packaging Films	14.2	14.0	11.5	11.5
Balance Sheet Assumptions				
Capex (INR mn)	5,876	7,014	10,000	4,500
Inventory (days)	115	116	105	95
Receivables (days)	45	44	41	38
Payable (days)	101	115	103	95

Income statement (INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Net revenue	45,927	48,218	57,097	65,228
Materials costs	23,306	24,184	28,606	33,006
Employee costs	3,863	4,338	4,772	5,249
Other Expenses	9,030	10,002	12,864	13,968
Total operating expenses	36,199	38,524	46,242	52,223
EBITDA	9,728	9,694	10,855	13,004
Depreciation	2,750	2,834	3,248	3,565
EBIT	6,979	6,860	7,607	9,439
Add: Other income	278.3	454.6	500.00	500.00
Less: Interest Expense	1,305	1,018	889	777
Profit Before Tax	5,952	6,296	7,218	9,162
Less: Provision for Tax	1,551	1,422	2,021	2,657
Reported Profit	4,402	4,874	5,197	6,505
Adjusted Profit	4,402	4,874	5,197	6,505
Shares o /s (mn)	57	57	57	57
Adjusted Basic EPS	76.7	84.9	90.5	113.3
Diluted shares o/s (mn)	57	57	57	57
Adjusted Diluted EPS	76.7	84.9	90.5	113.3
Adjusted Cash EPS	124.5	134.3	147.1	175.4
Dividend per share (DPS)	10.0	12.0	15.0	20.0
Dividend Payout Ratio(%)	15.7	17.0	19.9	20.7

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Materials costs	50.7	50.2	50.1	50.6
Staff costs	8.4	9.0	8.4	8.0
S G & A expenses	19.7	20.7	22.5	21.4
Depreciation	6.0	5.9	5.7	5.5
Interest Expense	2.8	2.1	1.6	1.2
EBITDA margins	21.2	20.1	19.0	19.9
Net Profit margins	9.6	10.1	9.1	10.0

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	1.2	5.0	18.4	14.2
EBITDA	35.6	(0.4)	12.0	19.8
PBT	49.0	5.8	14.6	26.9
Adj. net profit	45.4	10.7	6.6	25.2
EPS	45.4	10.7	6.6	25.2

Miscellaneous

Balance sheet				(INR mn)
As on 31st March	**FY16**	**FY17**	**FY18E**	**FY19E**
Share capital	584	584	584	584
Reserves & Surplus	26,110	31,242	35,406	40,567
Shareholders' funds	26,695	31,827	35,990	41,152
Short term borrowings	5,781	5,456	6,198	6,511
Long term borrowings	19,120	14,319	11,586	9,023
Total Borrowings	24,901	19,774	17,784	15,534
Long Term Liabilities	583	596	856	978
Deferred tax (net)	3,997	2,840	2,840	2,840
Sources of funds	**56,176**	**55,037**	**57,471**	**60,505**
Gross Block	69,625	75,500	86,886	91,386
Net Block	40,151	43,193	51,331	52,265
Capital work in progress	1,174	2,586	1,200	1,200
Intangible Assets	988	857	857	857
Total Fixed Assets	42,313	46,635	53,387	54,322
Non current investments	43	251	251	251
Cash and Equivalents	5,468	2,669	631	2,275
Inventories	7,050	8,381	8,010	9,242
Sundry Debtors	5,145	6,569	6,281	7,175
Loans & Advances	4,538	566	4,355	4,975
Other Current Assets	140	4,513	213	243
Current Assets (ex cash)	16,873	20,029	18,858	21,635
Trade payable	7,146	8,089	8,010	9,242
Other Current Liab	1,376	6,458	7,647	8,736
Total Current Liab	8,521	14,547	15,657	17,978
Net Curr Assets-ex cash	8,351	5,482	3,201	3,657
Uses of funds	**56,176**	**55,037**	**57,471**	**60,505**
BVPS (INR)	464.9	554.3	626.8	716.7

Free cash flow				(INR mn)
Year to March	**FY16**	**FY17**	**FY18E**	**FY19E**
Reported Profit	4,402	4,874	5,197	6,505
Add: Depreciation	2,750	2,834	3,248	3,565
Interest (Net of Tax)	965	788	640	551
Others	552	(788)	(640)	(551)
Less: Changes in WC	(2,232)	(2,882)	(2,541)	334
Operating cash flow	10,900	10,591	10,986	9,737
Less: Capex	5,876	7,014	10,000	4,500
Free Cash Flow	**5,024**	**3,577**	**986**	**5,237**

Cash flow metrics

Year to March	FY16	FY17	FY18E	FY19E
Cash flow from ops	10,900	10,591	10,986	9,737
Investing cash flow	(6,667)	(7,222)	(10,000)	(4,500)
Financing cash flow	(1,825)	(5,953)	(3,023)	(3,594)
Net cash Flow	2,408	(2,584)	(2,037)	1,643
Capex	(5,876)	(7,014)	(10,000)	(4,500)
Dividend paid	(692)	(827)	(1,034)	(1,344)

Profitability and efficiency ratios

Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	17.7	16.7	15.3	16.9
ROACE (%)	14.7	14.2	15.4	18.0
Inventory Days	115	116	105	95
Debtors Days	45	44	41	38
Payable Days	101	115	103	95
Cash Conversion Cycle	58	46	43	38
Current Ratio	2.6	1.6	1.2	1.3
Gross Debt/EBITDA	2.6	2.0	1.6	1.2
Gross Debt/Equity	0.9	0.6	0.5	0.4
Adjusted Debt/Equity	1.0	0.7	0.6	0.4
Net Debt/Equity	0.7	0.5	0.5	0.3
Interest Coverage Ratio	5.3	6.7	8.6	12.2

Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	0.9	0.9	1.0	1.1
Fixed Asset Turnover	1.1	1.1	1.2	1.2
Equity Turnover	1.8	1.6	1.7	1.7

Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	76.7	84.9	90.5	113.3
Y-o-Y growth (%)	*45.4*	*10.7*	*6.6*	*25.2*
Adjusted Cash EPS (INR)	124.5	134.3	147.1	175.4
Diluted P/E (x)	21.1	19.0	17.9	14.3
P/B (x)	3.5	2.9	2.6	2.3
EV / Sales (x)	2.4	2.3	1.9	1.6
EV / EBITDA (x)	11.5	11.3	10.1	8.2
Dividend Yield (%)	0.6	0.7	0.9	1.2

Additional Data

Directors Data

Arun Bharat Ram	Chairman	Ashish Bharat Ram	Managing Director
Kartik Bharat Ram	Dy Managing Director	K. Ravichandra	Director
Vellayan Subbiah	Non-Executive Director	Vinayak Chatterjee	Non-Executive Director
Pramod Bhasin	Non-Executive Director	Tejpreet S. Chopra	Non-Executive Director
L. Lakshman	Non-Executive Director	Meenakshi Gopinath	Non-Executive Director

Auditors - Deloitte Haskins & Sells

**as per last available data*

Holding – Top10

	Perc. Holding		Perc. Holding
Amansa Capital	6.50	UTI Unit & Charitable & Religion	1.61
DSP Blackrock	4.07	Dimensional Fund Advisors	1.53
Stiching Dep Apq	2.01	UTI Asset Mgmt	1.24
Max New York Life Emrg Eq	1.25	Max New York Life Insurance Co	1.07
Sundaram Asset Mgmt	1.90	Kotak Mahindra	0.54

**as per latest available data*

Bulk Deals

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

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
27 May 2016	Arun Bharat Ram	Buy	27500.00
27 May 2016	Karmav Real Estate Holding LLP	Sell	27500.00

**as per last available data*

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ADITYA NARAIN

Coverage group(s) of stocks by primary analyst(s): ***Miscellaneous***

AIA Engineering, Apar Industries Ltd, Aarti Industries, Agro Tech Foods, Balkrishna Industries, CCL Products India, Essel Propack, Orient Refactories, Supreme Industries, Solar Industries, SRF, Vesuvius India, VIP Industries

Recent Research

Date	Company	Title	Price (INR)	Recos
24-May-17	**CCL Products India**	Constrained by capacity; moving up the value chain; *Result Update*	288	Buy
22-May-17	**Aarti Industries**	Specialty chemicals on a high; margin pressure anticipated; *Result Update*	859	Buy
28-Apr-17	**Supreme Industries**	Demonetisation dents volume; product mix change drive margin; *Result Update*	1,088	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

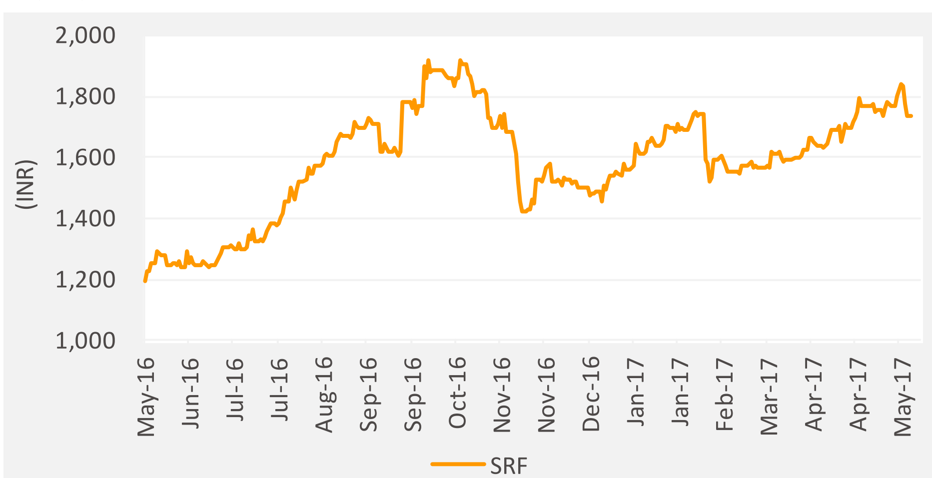
	Buy	Hold	Reduce	Total
Rating Distribution* * 1stocks under review	161	67	11	240

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	156	62	11

Rating Interpretation

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

One year price chart



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