SRF Limited

Creating niche chemistry

Specaility Chem	Sharekhan code: SRF	Company Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 5,894**	
Price Target: **Rs. 6,760**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

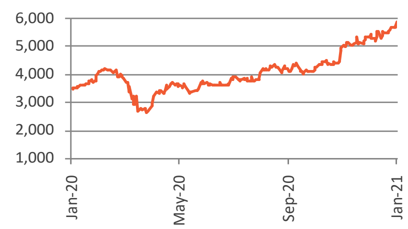
Company details

Market cap:	Rs. 34,916 cr
52-week high/low:	Rs. 5,958/2,492
NSE volume: (No of shares)	2.6 lakh
BSE code:	503806
NSE code:	SRF
Free float: (No of shares)	2.74 cr

Shareholding (%)

Promoters	52
DII	17
FII	11
Others	19

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.7	38.1	51.4	68.6
Relative to Sensex	2.9	17.7	18.6	50.9

Sharekhan Research, Bloomberg

Summary

- SRF Limited (SRF) is poised for a strong earnings cycle, led by continuous capex in specialty chemical (expected to grow at 20% for the next couple of years), cyclical recovery in refrigerants, and strong momentum in the packaging films segment.
- We believe calibrated expansion in the right space (chemicals) provides strong capacities for sustainable high growth (even beyond FY2023) and would drive further valuation re-rating for SRF.
- Higher margins in the packaging business and steady double-digit growth in specialty chemical would help SRF to post strong 68% y-o-y growth in PAT to Rs. 317 crore in Q3FY2021.
- We maintain our Buy rating on SRF with a revised PT of Rs. 6,760 (to reflect higher valuation multiple given our expectation of superior earnings growth and strong balance sheet. SRF is our top pick in the specialty chemical space.

SRF Limited (SRF) is poised for a strong earnings growth cycle over the next couple of years, led by upcoming opportunities in the specialty chemical space created by China Plus One strategy adopted by global players coupled with government's thrust on Aatma Nirbhar Bharat initiative to reduce import dependence. High double-digit growth in the specialty chemicals business, potential cyclical recovery in refrigerants, and traction in the packaging films segment would likely drive 23% PAT CAGR over FY2021E-FY2023E for SRF. Moreover, the company's plan to set up a new BOPP line with 60ktpa capacity at Indore with capex of Rs. 424 crore and high capex intensity towards the specialty chemical business (50%-60% of the planned capex of Rs. 1,500 crore-1,800 crore over the next three years) would drive sustainable high earnings growth even beyond FY2023. We believe calibrated expansion in the right space (chemicals) would drive further re-rating for SRF. Thus, we maintain our Buy rating on SRF with a revised PT of Rs. 6,760 (valued at 25.5x its FY2023E EPS). At the CMP, the stock is trading at 27.2x its FY2022E EPS and 22.2x its FY2023E EPS.

Our Call

Valuation – Maintain Buy on SRF with a revised PT of Rs. 6,760: SRF's capex intensity focuses on the specialty chemical business, which would drive sustainable double-digit earnings growth and re-rating as share of high-growth specialty chemical business would increase over next few years. Robust earnings growth outlook (expect 23% PAT CAGR over FY2021E-FY202E), strong return ratio (RoE/RoCE of 20%/21%), and robust cash flows (to support the growth plan) keep us constructive on medium to long-term growth prospects of SRF. Hence, we maintain our Buy on SRF with a revised PT of Rs. 6,760. At the CMP, the stock is trading at 27.2x its FY2022E EPS and 22.2x its FY2023E EPS.

Key Risks

- Slowdown in offtake from user industries and concerns over product price correction can impact revenue growth.
- Input cost price volatility might impact margins.

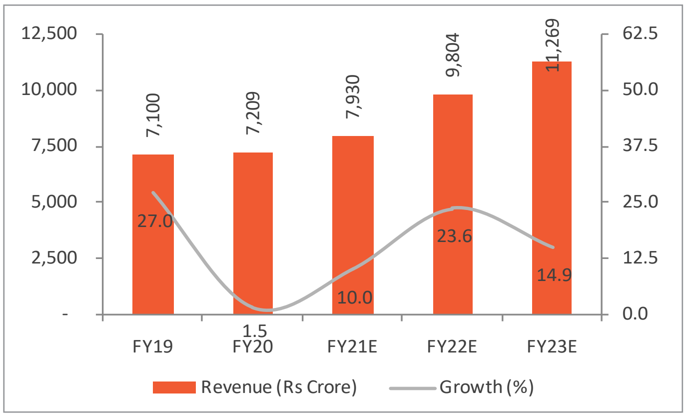
Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	7,100	7,209	7,930	9,804	11,269
OPM (%)	18.3	20.2	23.2	22.9	23.1
Adjusted PAT	642	1,019	1,017	1,267	1,550
% y-o-y growth	39.1	58.8	(0.1)	24.5	22.4
Adjusted EPS (Rs.)	105.0	138.8	173.9	216.5	265.0
P/E (x)	56.1	42.5	33.9	27.2	22.2
P/BV (x)	8.3	7.0	5.9	4.9	4.0
EV/EBITDA (x)	28.9	25.7	20.2	16.4	14.1
RoCE (%)	13.3	13.7	16.5	19.3	20.8
RoE (%)	16.0	17.9	18.8	19.6	19.9

Source: Company; Sharekhan estimates

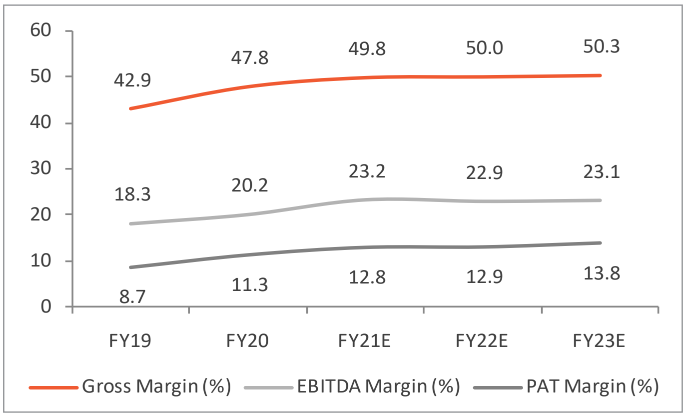
Financials in charts

Scalable and sustainable revenue growth



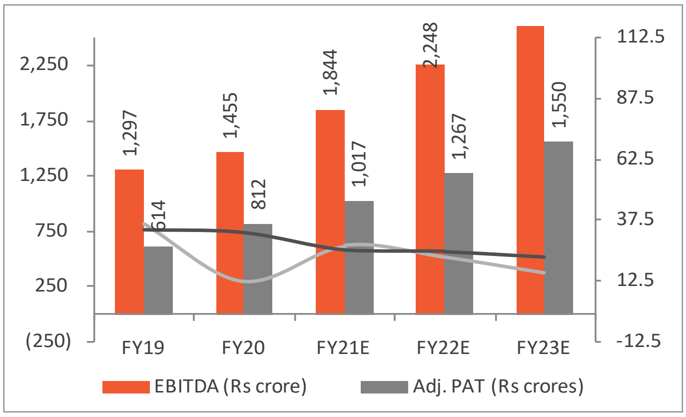
Source: Company, Sharekhan Research

Consistent strong margin profile



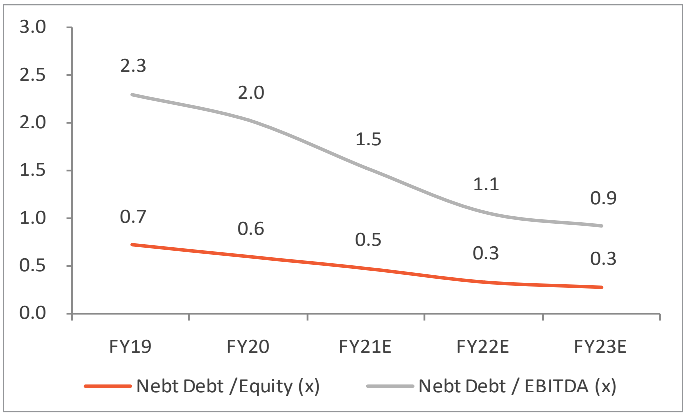
Source: Company, Sharekhan Research

EBITDA/PAT CAGR of 19%/23% over FY21E-FY23



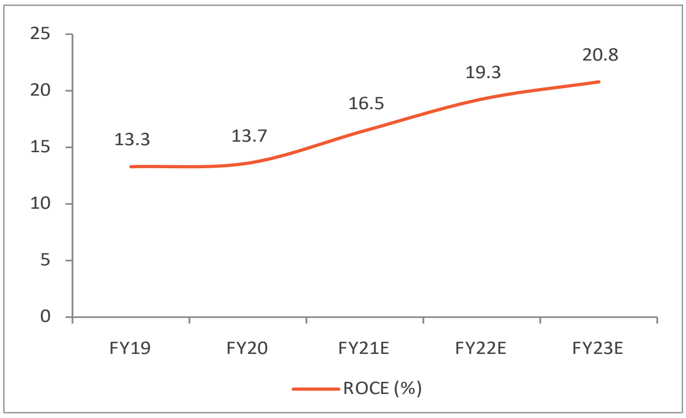
Source: Company, Sharekhan Research

Lean balance sheet to support expansion



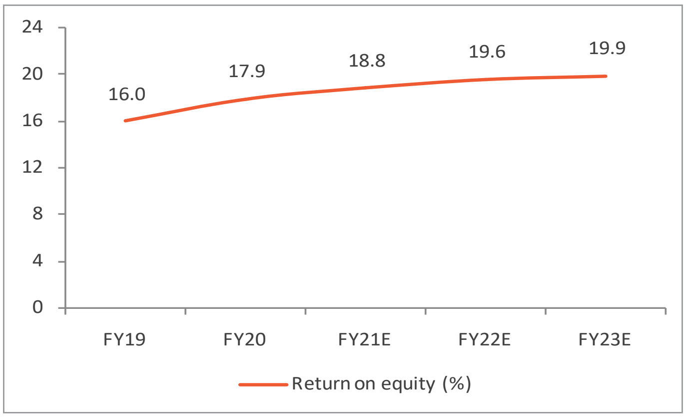
Source: Company, Sharekhan Research

RoCE to inch up



Source: Company, Sharekhan Research

RoE on an improving trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector view - Structural growth drivers to propel sustained growth for the specialty chemical sector over the medium to long term**

We remain bullish on the medium to long-term growth prospects of the specialty chemical sector, given massive revenue opportunity from the perspective of import substitution (India's total specialty chemical imports are estimated at $56 billion), potential increase in exports given China Plus One strategy by global customers, and favourable government policies (such as tax incentive and production-linked incentive scheme similar to the pharma sector). In our view, conducive government policies, product innovation, massive export opportunity, and low input prices would help the sector witness high double-digit earnings growth trajectory on sustained basis over the next 2-3 years.

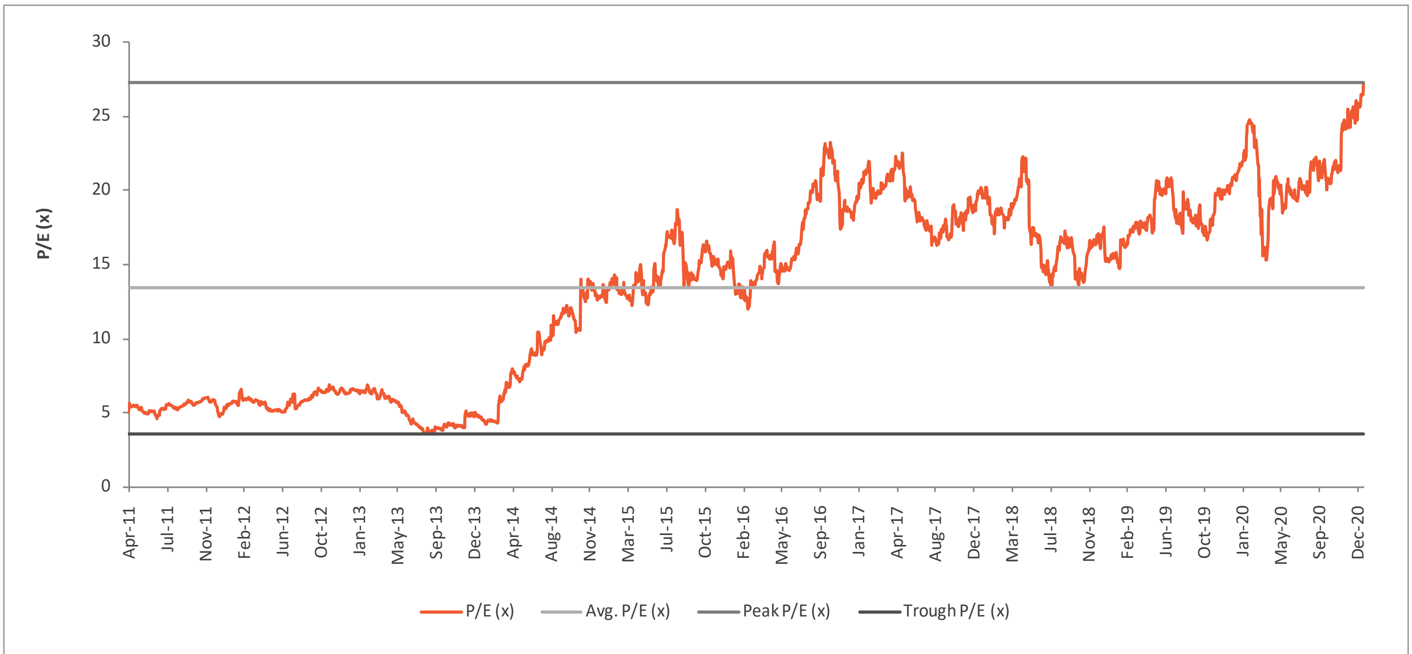
■ **Company outlook - Long-term story remains intact, capex momentum to continue**

Management sees significant growth opportunities in agro chemicals and active pharma ingredients (developing two pharmaceutical molecules in collaboration with innovators). Moreover, in the flurochemicals space, the company is focusing on ramping up utilisation levels at the recently commissioned HFC facilities and it sees demand traction to be strong from international markets during H2FY2021E. Speciality chemicals are likely to continue performing at a healthy pace, while demand for fluorochemicals would improve in H2FY2021. Increased volumes from expanded capacities to drive packaging films. The company generates a healthy operating cash flow and, hence, largely relies on internal accruals to fund its capex. This strengthens the balance sheet further and helps in improving return ratios.

■ **Valuation - Maintain Buy on SRF with a revised PT of Rs. 6,760**

SRF's capex intensity focuses on the specialty chemical business, which would drive sustainable double-digit earnings growth and re-rating as share of high-growth specialty chemical business would increase over next few years. Robust earnings growth outlook (expect 23% PAT CAGR over FY2021E-FY202E), strong return ratio (RoE/RoCE of 20%/21%), and robust cash flows (to support the growth plan) keep us constructive on medium to long-term growth prospects of SRF. Hence, we maintain our Buy on SRF with a revised PT of Rs. 6,760. At the CMP, the stock is trading at 27.2x its FY2022E EPS and 22.2x its FY2023E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Established in 1970, the company is a chemical-based multi-business entity engaged in the manufacturing of industrial and specialty intermediates. The company's diversified business portfolio covers technical textiles, chemicals (flurochemicals and specialty chemicals), and packaging films. The company has 11 manufacturing plants in India, two in Thailand, one in South Africa, and an upcoming facility in Hungary. The company exports to more than 75 countries.

Investment theme

Favourable growth prospects across the segment, led by speciality chemicals and fluorochemicals. Management sees significant growth opportunities in agro chemicals and active pharma ingredients (developing two pharma molecules in collaboration with innovators). The company generates a healthy operating cash flow and, hence, largely relies on internal accruals to fund its capex programme, which strengthens the balance sheet further. Improved utilisation levels would help in higher assets turnover as well as debt reduction. This augurs well for improved margin profile, higher return ratio and would drive further re-rating of SRF.

Key Risks

- Slowdown in demand offtake from user industries and concerns over product price correction can impact revenue growth.
- Adverse input cost price volatility might impact the margin profile.

Additional Data

Key management personnel

Arun Bharat Ram	Executive Chairperson
Ashish Bharat Ram	Executive Director
Kartik Bharat Ram	Executive Director
Pramod Gopaldas Gujarathi	Executive Director
Meenakshi Gopinath	Non-Executive – Non-Independent Director
Sanjay Chatrath	President and CEO (TTB)
Rahul Jain	Chief Financial Officer
Rajat Lakhanpal	Company Secretary and Compliance Officer

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Amansa Holdings Pvt Ltd	6.2
2	Kotak Mahindra Asset Management Co	4.7
3	Nippon Life India Asset Management Ltd	1.2
4	NIPPON LIFE INDIA	1.1
5	Stichting Depositary Apg Emerging	1.1
6	ICICI Prudential Life Insurance Company	1.1
7	STITCHING DEPOSITORY APG	1.1
8	SBI Life Insurance Co Ltd	1.0
9	Mirae Asset Global Investments Co	1.0
10	DSP Investment Managers Pvt Ltd	0.9

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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