Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

SRF Limited

In-line Q3; focus on specialty to drive growth

Specaility Chem	Sharekhan code: SRF	Result 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. 5,406**	
Price Target: **Rs. 6,760**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

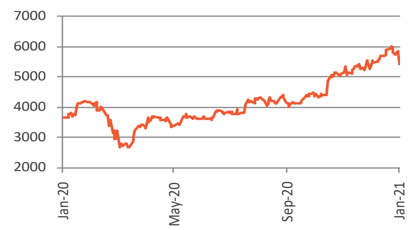
Company details

Market cap:	Rs. 32,030 cr
52-week high/low:	Rs. 6075/2492
NSE volume: (No of shares)	2.7 lakh
BSE code:	503806
NSE code:	SRF
Free float: (No of shares)	2.92 cr

Shareholding (%)

Promoters	51
DII	19
FII	11
Others	19

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.2	22.3	40.6	48.7
Relative to Sensex	-7.5	2.2	12.5	30.6

Sharekhan Research, Bloomberg

Summary

- Revenue grew by 16% y-o-y to Rs. 2,146 crore, while margins expanded 429 bps y-o-y to 25.4%, which was largely in-line with street estimates. However, adjusted PAT at Rs. 303 crore (up 60% y-o-y) marginally lagged estimates due to a higher tax rate.
- Chemical/packaging film/technical textiles businesses reported strong revenue growth of 11.6%/25.7%/9.3% y-o-y to Rs. 906 crore/Rs. 802 crore/Rs. 367 crore. EBIT margin from these businesses increased by 334/307/764 bps y-o-y to 21%/26.5%/18.5%.
- Management is upbeat on sustained high growth for specialty chemicals business especially from agri-space and expects earnings recovery in Fluorochemicals over Q4FY21-Q1FY22 led by improvement in refrigerant gas prices.
- High capex intensity in specialty chemical business would drive superior long-term earnings growth and could further aid re-rating. Hence, we maintain a Buy on SRF with an unchanged PT of Rs. 6,760.

SRF Limited's Q3FY2021 operational performance was largely in-line with expectations with 16% y-o-y growth in revenues to Rs. 2,146 crore (versus our estimate of Rs. 2,156 crore) and strong margin expansion of 429 bps y-o-y to 25.4% (largely in line with street estimates but slightly lagging our estimate of 26.1%). Revenue growth was led by good performance across three businesses with the chemical/packaging film/technical textile segments reported a revenue growth of 11.6%/25.7%/9.3% y-o-y to Rs. 906 crore/Rs. 802 crore/Rs. 367 crore. Growth in the chemicals segment was led by strong demand for specialty chemicals, especially from overseas and a higher capacity utilization while packaging segment benefited from new capacities in Thailand and Hungary. The technical textiles segment benefited from improved demand from tyre sector. Gross margins increased by 295bps y-o-y to 52.5% led by margin improvement across chemical, packaging and technical textiles segments. Consequently, reported OPM also increased by 429 bps y-o-y to 25.4%. Resultantly, reported operating increased by 39.6% y-o-y to Rs. 545 crore (slightly below our estimate of Rs. 562 crore). EBIT margin from chemical/packaging/technical textiles increased by 334/307/764 bps y-o-y to 21%/26.5%/18.5%. However, EBIT margin in packaging segment declined by 307 bps q-o-q due to contraction in spreads. Adjusted PAT, at Rs. 303 crore (up 60.3% y-o-y; down 6.9% q-o-q) was 4.5% below our estimate of Rs. 317 crore primarily due to higher-than-expected effective tax rate at 26.8% (versus an assumption of 25.2%). The management is optimistic of sustained high strong growth in specialty chemical business over next 3-4 years primarily led by strong demand from agri-space (both existing and new molecules) and improved earnings from fluorochemicals in Q4FY2021-Q1FY2022 led by improving pricing environment and better volumes (higher demand from the auto replacement market). However, the packaging business is expected to see margin contraction as two new lines has got commissioned globally. SRF's high capex intensity towards the specialty chemical business (50-60% of the planned capex of Rs. 1,500-2,000 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 a Buy on SRF with an unchanged PT of Rs. 6,760.

Key positives

- Strong revenue growth of 11.6%/25.7%/9.3% y-o-y for Chemical/Packaging Film/Technical textiles segments
- EBIT margin from chemical/packaging/technical textiles expanded by 334/307/764 bps y-o-y to 21%/26.5%/18.5%.

Key negatives

- Revenues from Fluorochemicals remained flat y-o-y despite better volume and thus indicated lower prices.

Our Call

Valuation – Maintain Buy on SRF with an unchanged PT of Rs. 6,760: We maintain our FY2021-FY2023 earnings estimates given largely inline Q3FY2021 operating performance. SRF's capex intensity focuses on the specialty chemical business, which would drive a sustainable double-digit rise in earnings and re-rating as share of high-growth specialty chemical business would increase over next few years. A robust growth 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 a Buy rating on SRF with an unchanged PT of Rs. 6,760. At CMP, the stock is trading at 25x its FY2022E EPS and 20.4x its FY2023E EPS.

Key Risks

- Slower 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)	51.5	39.0	31.1	25.0	20.4
P/BV (x)	7.7	6.4	5.4	4.5	3.7
EV/EBITDA (x)	26.7	23.8	18.7	15.1	13.1
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

Largely in-line Q3FY2021 results

Consolidated revenues of Rs. 2,146 crore (up 16% y-o-y; up 2.2% q-o-q) were largely in line with our estimate of Rs. 2,156 crore. Strong revenue growth was supported by 11.6% y-o-y, 25.7% y-o-y and 9.3% y-o-y revenue increase from chemical, packaging segment and technical textiles respectively to Rs. 906 crore/Rs. 802 crore/ Rs. 367 crore. Growth in the chemical segment was led by strong demand for specialty chemical especially from overseas market and higher capacity utilization while packaging segment benefited from new capacities in Thailand and Hungary. Gross margins increased by 295 bps y-o-y to 52.5% led by margin improvement across chemical, packaging and technical textiles segment. Consequently, reported OPM also increased by 429 bps y-o-y to 25.4% (in line with street expectation but marginally below our estimate 26.1% due to rise in power & fuel and employee cost). Resultantly, reported operating increased by 39.6% y-o-y to Rs. 545 crore (slightly below our estimate of Rs562 crore). EBIT margin from chemical/packaging/technical textiles increased by 334/307/764 bps y-o-y to 21%/26.5%/18.5%. However, EBIT margin in packaging segment declined by 307 bps q-o-q. Adjusted PAT at Rs. 303 crore (up 60.3% y-o-y; down 6.9% q-o-q) was 4.5% below our estimate of Rs. 317 crore primarily due to higher-than-expected effective tax rate at 26.8% (versus assumption of 25.2%).

Q3FY2021 conference call highlights

- **Specialty chemicals business** – The segment delivered strong growth led by higher volumes (especially from agro-chemical customers), which led to higher capacity utilization of dedicated/multipurpose plants (MPP). The management expects strong growth momentum to continue over 3-4 years for both exiting products and new molecules. Focus is to develop complex molecules which would help drive margins. Large portion of the capex for specialty chemical would be dedicated to agri-opportunities.
- **Fluorochemicals** – Performance of the segment has improved led by enhanced sales volume of refrigerants in domestic and export markets and healthy contribution from the chloromethanes. Refrigerants demand from automobile and air conditioning segment is witnessing a strong rival. With the automobile segment, demand from OEMs is good and replacement demand is also expected to pick-up in Q1FY2022. The management expects better earnings led by both volume and margin improvement in Q4FY2021-Q1FY2022 due to improving Refrigerant gas prices and seasonally strong demand. The management indicated that HFCs capacity stand at ~35 ktpa (excluding R22) are at close to full utilisation. Capacity (including R22) is at ~45ktpa and is expected to reach full utilisation in the next 12-18 months.
- **Packaging films** – Strong packaging demand and new capacities in Thailand and Hungary resulted in healthy volume growth but margins declined q-o-q. The management guided for contraction in margins for Packaging Films segment in the coming quarters as supply is expected to increase given addition of one BOPET in Nigeria and one BOPP line in Colombia. However, ramp-up of utilisation at Hungary plant would provide some support to margin given benefit of operating leverage. The upcoming BOPP line at Thailand would come onstream by June-2022 while the Indore line is expected to get commissioned by June 2023.
- **Technical textiles** – The segment witnessed strong performance backed by a faster-than-expected recovery in the tyre industry with Belting Fabrics contributing significantly to the overall performance. Also, lower imports led to ramp-up of production capacity for technical textiles. The company is focused to increase capacity to debottlenecking (400tonne/month capacity already done) across various plants, which would mean higher production and benefit of operating leverage.
- **Capex plans** – The company's capex plan is on track and has maintained guidance of Rs. 1,500-2,000 crore in the next 2-3 years. Out of this, 50-60% would be spent on the specialty chemicals business, 20-30% on packaging films and remaining on maintenance. The company expects Rs. 1,200-1,300 crore of capex spending over FY2021-FY2022.
- The company is re-examining at capex plan for the proposed PTFE plant (which has been delayed by more than a year owing to the challenging business environment).

Results | Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Net Sales	**2,146**	**1,850**	**16.0**	**2,101**	**2.2**
Operating profit	**545**	**390**	**39.6**	**582**	**(6.4)**
Other Income	22	6	289.9	10	122.4
Depreciation	117	102	14.4	114	2.2
Interest	28	48	(40.1)	36	(21.2)
PBT	421	246	71.0	442	(4.6)
Tax	119	(86)	NA	116	1.8
Profit from discontinuing operations (net of tax)	0	(2)	NA	(0)	NA
Reported PAT	325	343	(5.3)	315	3.0
Adjusted PAT	**303**	**189**	**60.3**	**325**	**(6.9)**
Adjusted EPS (Rs)	52.7	32.9	60.3	56.6	(6.9)
Margins			**YoY (BPS)**		**QoQ (BPS)**
Operating profit margin (%)	25.4	21.1	429	27.7	(233)
Adjusted NPM (%)	14.1	10.2	390	15.5	(138)

Source: Company; Sharekhan Research

Segmental performance | Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Segmental revenue					
Technical Textiles	367	336	9.3	332	10.5
Chemical	906	812	11.6	881	2.8
Packaging Film	802	638	25.7	833	(3.7)
Others	74	69	6.9	57	29.8
Total Revenue	**2,149**	**1,855**	**15.8**	**2,103**	**2.2**
Inter Segment	**2**	**4**	**(48.0)**	**2**	**1.8**
Net Revenue	**2,146**	**1,850**	**16.0**	**2,101**	**2.2**
Segmental EBIT					
Technical Textiles	68	37	86.1	50	35
Chemical	190	143	32.8	174	9
Packaging Film	212	149	42	246	(14)
Others	8	8	(0)	9	(7)
Total EBIT	**479**	**337**	**42**	**480**	**(0)**
EBIT Margin (%)			**BPS**		**BPS**
Technical Textiles	18.5	10.9	764	15.1	340
Chemical	21.0	17.6	334	19.8	117
Packaging Film	26.5	23.4	307	29.6	(307)
Others	11.2	12.0	(78)	15.5	(435)
Overall EBIT margin	**22.3**	**18.2**	**407**	**22.8**	**(54)**

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 medium to long-term growth prospects of the specialty chemical sector, given a 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 clock high double-digit earnings growth trajectory on sustained basis in the next 2-3 years.

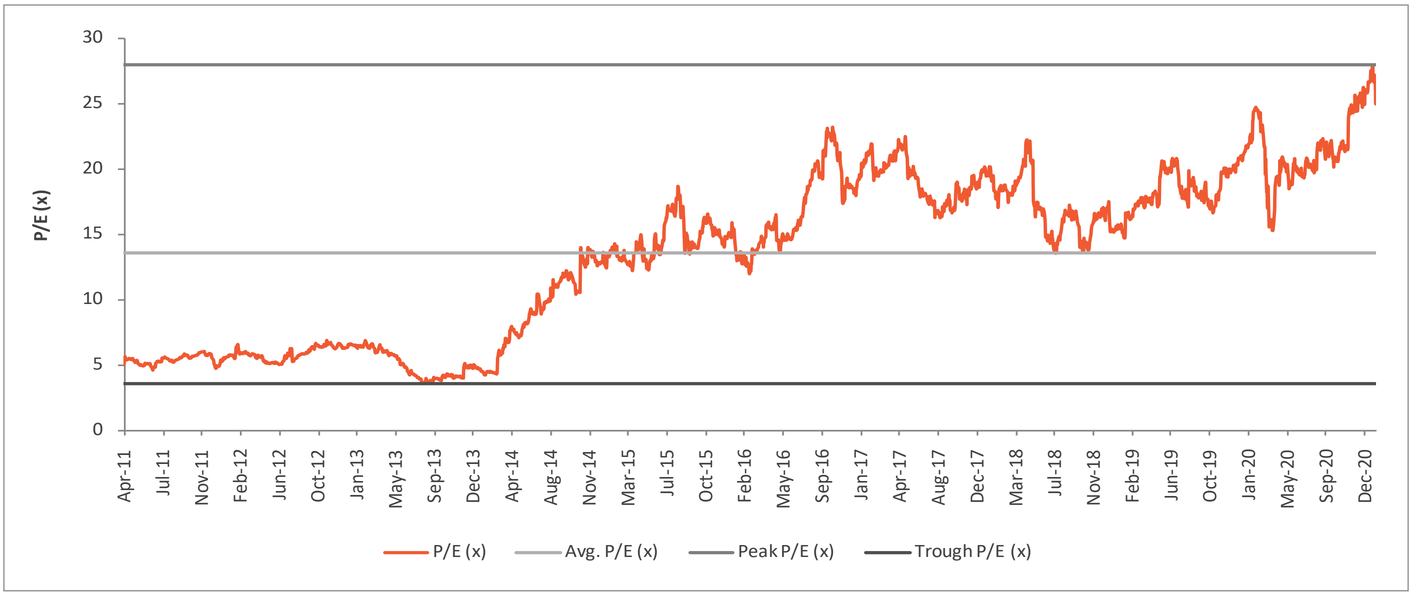
■ Company outlook - Long-term story remains intact, capex momentum to continue

The management sees significant growth opportunities in agro chemicals and active pharma ingredients (developing two pharmaceutical molecules in collaboration with innovators). Moreover, in the fluorochemicals space, the company is focusing on ramping up utilisation levels at the recently commissioned HFC facilities and it sees demand traction to be strong during Q4FY2021E-Q1FY2022E. Specialty chemicals are likely to continue performing at a healthy pace, while volume/margin for fluorochemicals would improve in Q4FY2021. Increased volumes from expanded capacities to drive packaging films. The company generates healthy operating cash flows 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 an unchanged PT of Rs. 6,760

We maintain our FY2021-FY2023 earnings estimates given largely inline Q3FY2021 operating performance. SRF's capex intensity focuses on the specialty chemical business, which would drive a sustainable double-digit rise in earnings and re-rating as share of high-growth specialty chemical business would increase over next few years. A robust growth 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 a Buy rating on SRF with an unchanged PT of Rs. 6,760. At CMP, the stock is trading at 25x its FY2022E EPS and 20.4x 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 (fluorochemicals 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 and higher return ratio. With the stock trading at a reasonable valuation and strong growth prospects over the next 2-3 years, we expect a further re-rating.

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; Note: Shareholding as on January 08, 2021

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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