Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

SRF Ltd

Robust growth outlook across businesses

Speciality Chem	Sharekhan code: SRF
Reco/View: Buy ⇔	CMP: Rs. 2,161 / Price Target: Rs. 2,430 ⇔

↑ Upgrade ⇔ Maintain ↓ Downgrade

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		⇔	

ESG Disclosure Score NEW

ESG RISK RATING	19.0
Updated Nov 08, 2021	
Low Risk	

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

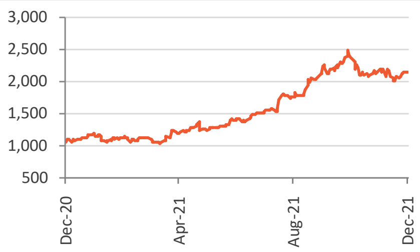
Company details

Market cap:	Rs. 64,060 cr
52-week high/low:	Rs. 2544/1021
NSE volume: (No of shares)	7.0 lakh
BSE code:	503806
NSE code:	SRF
Free float: (No of shares)	14.6 cr

Shareholding (%)

Promoters	51
FII	19
DII	10
Others	20

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.4	-4.8	51.3	102.3
Relative to Sensex	2.8	-2.5	41.2	78.4

Sharekhan Research, Bloomberg

Summary

- SRF's management expects specialty chemical business to grow steadily by 15-20% p.a. in 3-5 years, while the fluorochemicals business would benefit from higher refrigerant prices and huge demand from the US. Earnings momentum of technical textiles to stay strong, while rise in BOPET spreads bodes well for near-term margin of packaging film business.
- Capex intensity would stay high with a cumulative spending plan of Rs. 3,500-3,600 crore over FY22-23 of which ~60% would be in chemicals segment. Large projects include fourth MPP, fluorocarbon refrigerant facility, PTFE plant with R-22 and BOPP line at Indore.
- Management is confident of growth across segments and focused to invest in high-growth specialty chemicals and thus we expect strong revenue/PAT CAGR of 19%/23% over FY21-24E along with RoE/RoCE of 20.4%/22.2%. A likely ADD by India on R-125 imports from China would further add to profitability while logistic issues (although limited impact currently) could be a near-term concern.
- A 15% correction in stock price from 52-week high provides a good entry opportunity given superior earnings growth outlook while strong FCF and robust balance sheet provides scope for capex led growth. Favourable dynamics of Indian specialty chemicals space would support premium valuations. Hence, we maintain a Buy on SRF with an unchanged PT of Rs. 2,430.

We interacted with the management of SRF Limited, and the commentary was positive across business segments. Within chemical segment, the management expects specialty chemical business to sustain 15-20% revenue growth annually over next 3-5 years and the outlook for fluorochemicals business on margin/volume front has improved considerably with recent increase in HFC refrigerant price (especially of R-125 and R-32) given anti-dumping duty (ADD) by the US on imports from China and large demand from the US market. Technical textile business (TTB) is likely to sustain strong earnings momentum over next 3-4 quarters as margins stay robust amid renewed pricing contracts and domestic price is at discount of Rs. 75-85/kg versus import parity price. Packaging film margin also expected to improve in near term as BOPET price/ spreads rise given good demand traction.

- **Chemicals segment – Robust double digit revenue growth to sustain; margin to improve as ref-gas price improves:** The performance of HFC refrigerants business is expected to improve considerably in H2FY22 and over FY23E-24E on volume and margin front. Volume growth is expected to be driven by higher capacity utilisation (operating at full utilisation for most products) as demand improves and expansion (R-32 capacity expansion by 2,500 mt by January 2022, chloromethane capacity expansion by March'22 and new swing capacity of 15,000mt by FY24E). Anti-dumping duty by the US on imports of HFCs from China has led to better realisation and improved margin outlook for refrigerants business in near to medium term. Any potential duty imposed by India on imports of R-125 from China would further improve margins. Specialty chemical business is expected to sustain 15-20% annual revenue growth as capex intensity to remain high and benefit of ramp-up of new projects.
- **Packaging films – Near term margin to recovery as higher demand absorbs incremental capacities:** BOPET spreads are expected to recover in Q3FY22 as demand environment has improved and BOPP margin continue to remain strong. Ramp-up at new BOPET capacities at Thailand and Hungary and commissioning of new BOPP line at Indore would aid volume in the near to medium term.
- **Technical textile – Structural margin improvement led by renewed pricing contracts:** Recent improvement in TTB segment's realisation/margin (given shut down of capacities in China) is expected to sustain and has room for further improvement as realisation remains below import parity prices. The management is confident to sustain higher utilisation as demand environment is buoyant from the nylon tyre cord fabrics, belting fabrics and polyester industrial yarn segments.

Our Call

Valuation – Maintain Buy on SRF with an unchanged PT of Rs. 2,430: High growth in the chemical business supported by high capex intensity, sustained strong margin for the technical textiles business and focus on value-added products (VAP) in the packaging film business would drive strong revenue/EBITDA/PAT CAGR of 19%/19%/23% over FY2021-FY2024E along with good RoE/RoCE of 20.4%/22.2%. Investment in right areas of specialty chemical business would improve earnings quality and safeguard from cyclical packaging film margins. A superior earnings growth outlook, strong FCF generation and robust balance sheet keep us constructive on SRF and justified premium valuation. Hence, we maintain a Buy on SRF with an unchanged PT of Rs. 2,430. At CMP, the stock is trading at 36x its FY2023E EPS and 28.6x its FY2024E EPS.

Key Risks

- Slower offtake from user industries and a likely correction in product prices can impact revenue growth.
- Input cost price volatility might impact margins.

Valuation (consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	8,400	10,266	12,064	14,135
OPM (%)	25.5	24.5	24.8	25.3
Adjusted PAT	1,197	1,438	1,780	2,236
% YoY growth	17.5	20.1	23.7	25.6
Adjusted EPS (Rs.)	40.4	48.6	60.1	75.5
P/E (x)	53.5	44.5	36.0	28.6
EV/EBITDA (x)	30.9	26.5	22.0	17.7
RoCE (%)	18.5	19.1	20.4	22.2
RoE (%)	20.3	19.1	19.6	20.4

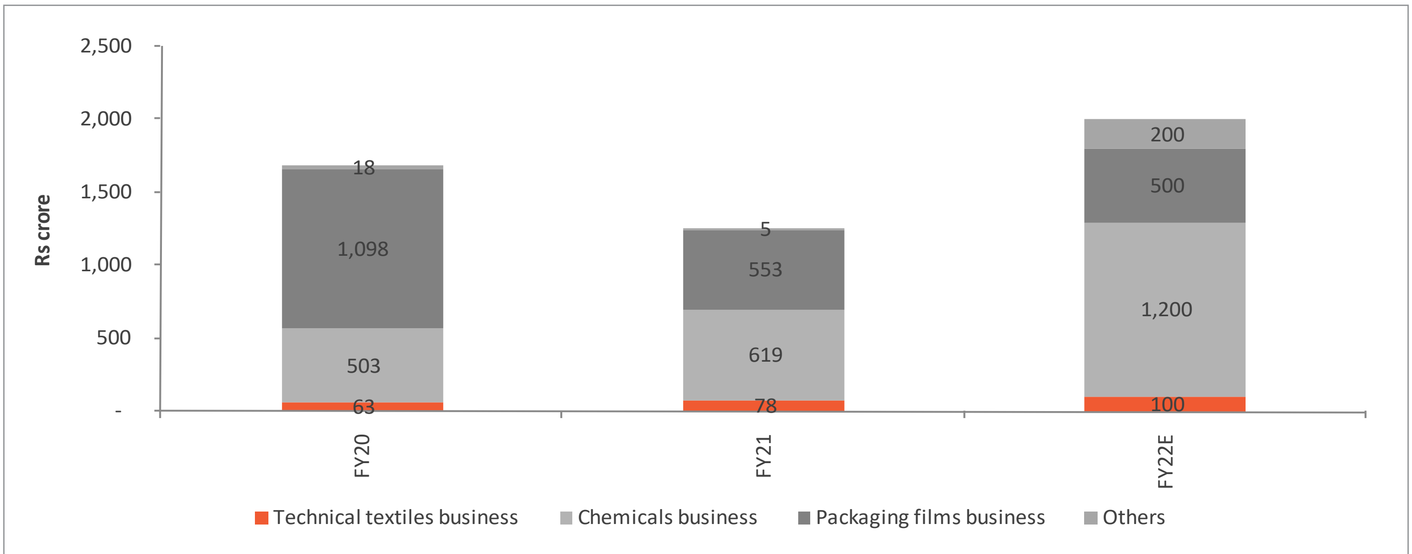
Source: Company; Sharekhan estimates

Key project of SRF – largely towards chemical and packaging film segment

Date of announcement	Business segment	Expansion project	Capex plan (Rs. crore)	Commissioning timeline
Aug-19	Chemicals	Project for setting up of an integrated facility for development of PTFE	424	Oct-22
Feb-20	Chemicals	Project for setting-up of a range of dedicated plants to produce specialty chemicals	238	Commissioned in September 2021
Jul-20	Chemicals	Chloromethane capacity expansion	315	Mar'22
Nov-20	Packaging films	New BOPP line at Indore with capacity of 60,000 TPA	424	Jun-22
Nov-20	Chemicals	Dedicated facility to produce 200 mtpa of P16	17.5	
Nov-20	Utilities	Future water security and thermal oxidation projects	220	
May-21	Chemicals	MPP4 plant at Dahej	375	Jul-22
Jul-21	Chemicals	15,000 MTPA of fluorocarbon refrigerants and certain key raw materials at Dahej	550	Jul-23
Oct-21	Chemicals	Debottlenecking of project at Dahej for creating agrochemical products	27.5	

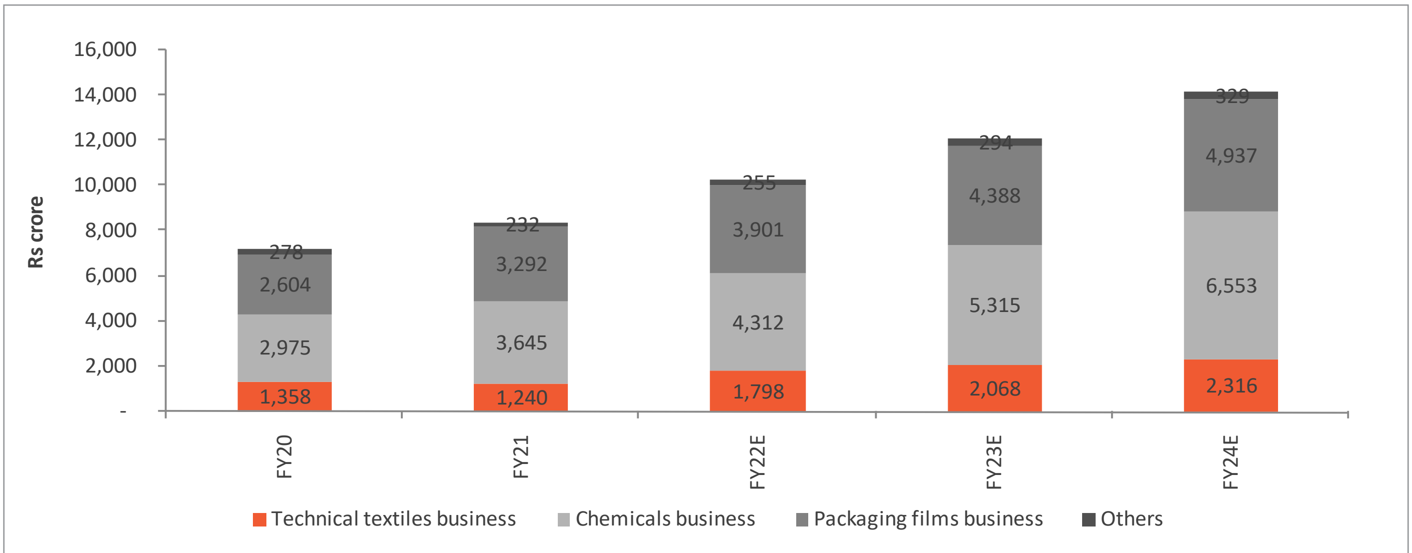
Source: Company; Sharekhan Research

Capex plan to be focused on chemical segment



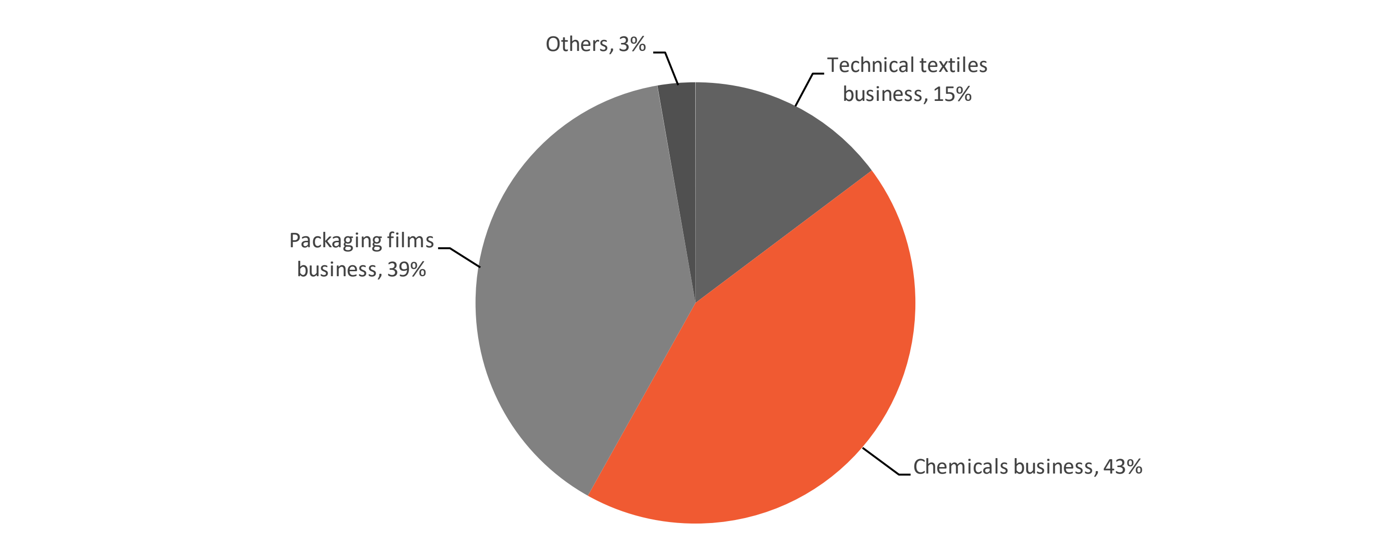
Source: Company, Sharekhan Research

Revenue growth to driven by chemical segment



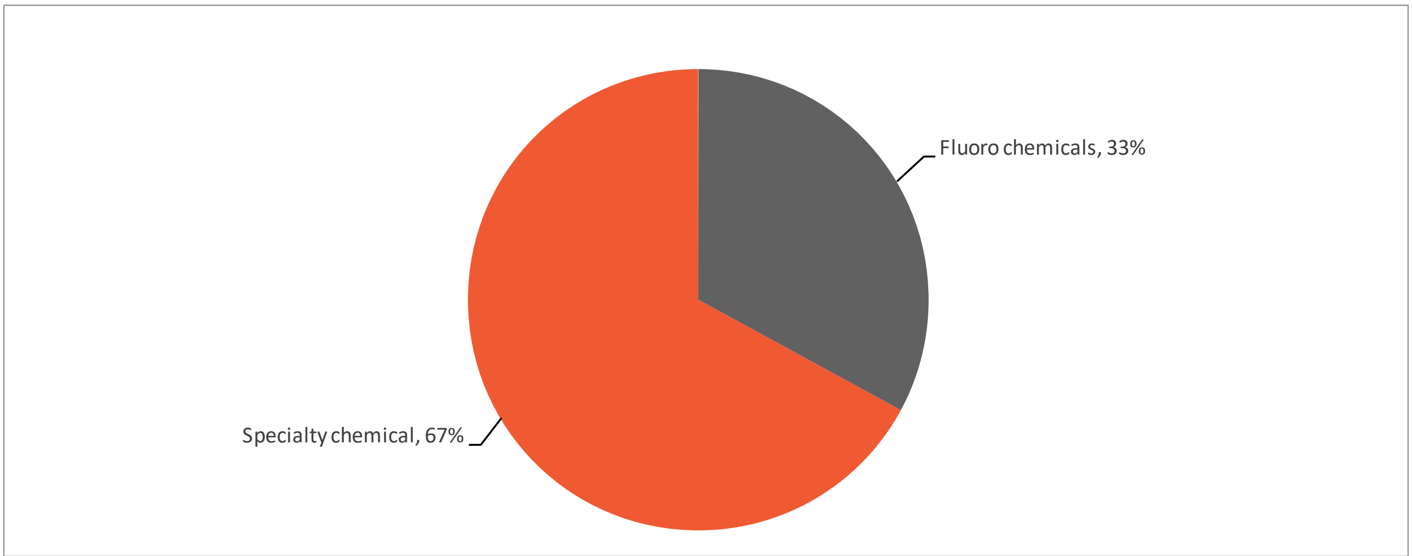
Source: Company, Sharekhan Research

FY21 revenue mix



Source: Company, Sharekhan Research

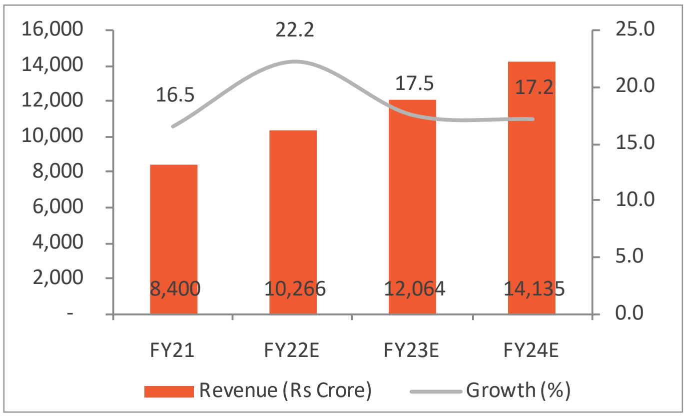
Chemical segment revenue break-up for FY21



Source: Company, Sharekhan Research

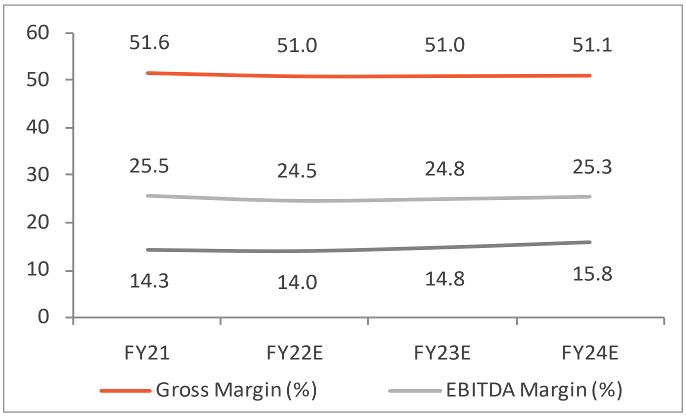
Financials in charts

Scalable and sustainable revenue growth



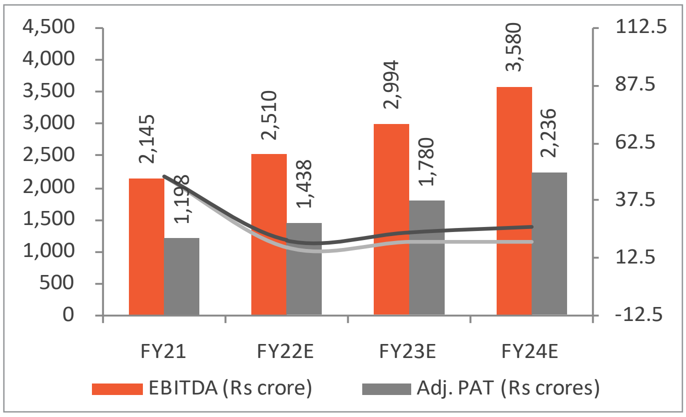
Source: Company, Sharekhan Research

Consistent strong margin profile



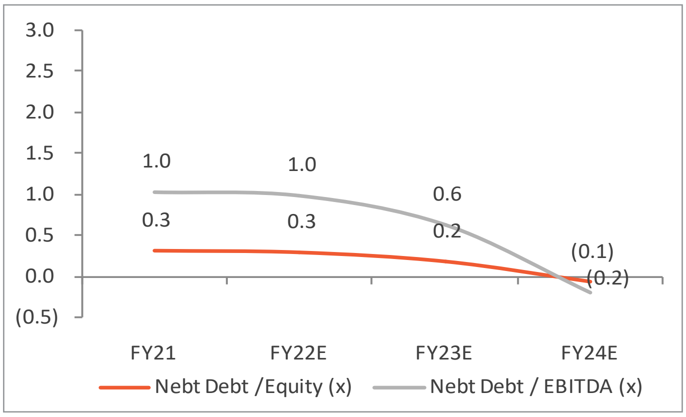
Source: Company, Sharekhan Research

EBITDA/PAT CAGR of 19%/23% over FY21-FY24E



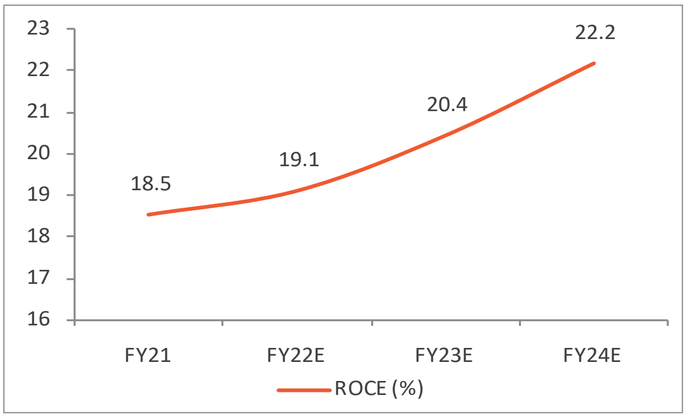
Source: Company, Sharekhan Research

Lean balance sheet to support expansion



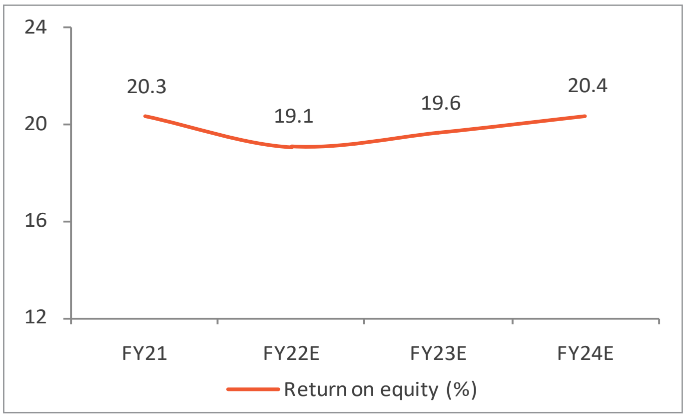
Source: Company, Sharekhan Research

RoCE on an improving trend



Source: Company, Sharekhan Research

Steady RoE trend



Source: Company, Sharekhan Research

Outlook and Valuation

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

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

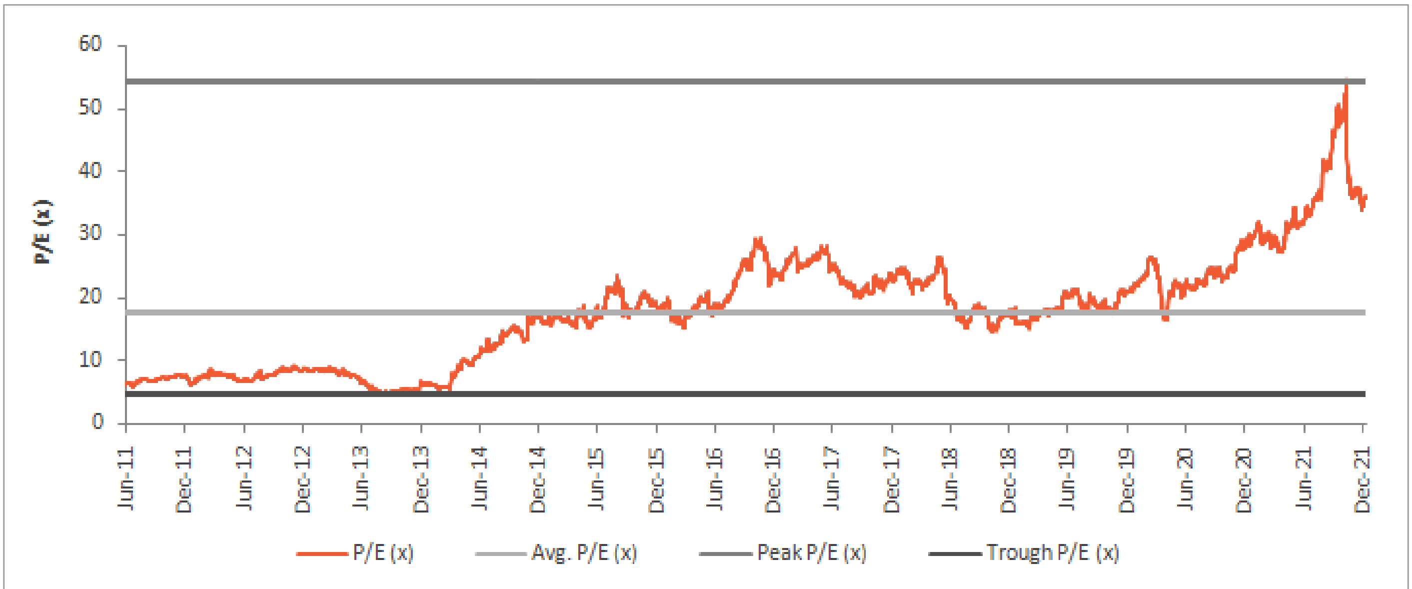
■ Company outlook - Long-term story stays intact, capex momentum to continue

The management sees significant growth opportunities in the agro-chemicals and active pharmaceutical ingredients (developing two pharmaceutical molecules in collaboration with innovators). Moreover, in the fluorochemicals space, SRF is focusing on ramping up utilisation levels at the recently commissioned HFC facilities and it sees demand traction to be strong. Specialty chemicals are likely to continue performing at a healthy pace, while volumes/margins for fluorochemicals would improve as demand is expected to improve. Increased volumes from expanded capacities to drive packaging films volumes although margin expected to contract given over supply situation. 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 improve return ratios.

■ Valuation - Maintain Buy on SRF with an unchanged PT of Rs. 2,430

High growth in the chemical business supported by high capex intensity, sustained strong margin for the technical textiles business and focus on value-added products (VAP) in the packaging film business would drive strong revenue/EBITDA/PAT CAGR of 19%/19%/23% over FY2021-FY2024E along with good RoE/RoCE of 20.4%/22.2%. Investment in right areas of specialty chemical business would improve earnings quality and safeguard from cyclical packaging film margins. A superior earnings growth outlook, strong FCF generation and robust balance sheet keep us constructive on SRF and justified premium valuation. Hence, we maintain a Buy on SRF with an unchanged PT of Rs. 2,430. At CMP, the stock is trading at 36x its FY2023E EPS and 28.6x its FY2024E 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). Continued high capex to expand capacities in high growth areas of specialty chemical business is likely to drive sustained high earnings growth. Moreover, structural high growth cycle for Indian specialty chemicals sector given favourable dynamics (China plus One strategy by global companies) to support premium valuation for quality players like 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: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Amansa Holdings Pvt Ltd	5.0
2	Kotak Mahindra Asset Management Co Ltd/India	4.1
3	Vanguard Group Inc./ The	1.6
4	BlackRock Inc.	1.4
5	SBI Funds Management Pvt. Ltd	1.3
6	HDFC Life Insurance Co. Ltd	1.2
7	SBI Life Insurance Co Ltd	1.0
8	NGUYEN THI HONG	0.9
9	ICICI Prudential Life Insurance Co. Ltd	0.9
10	William Blair & Co. LLC	0.8

Source: Bloomberg

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

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

Sharekhan

by BNP PARIBAS

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