Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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 19.61

Updated Apr 08, 2022

Low Risk

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

Source: Morningstar

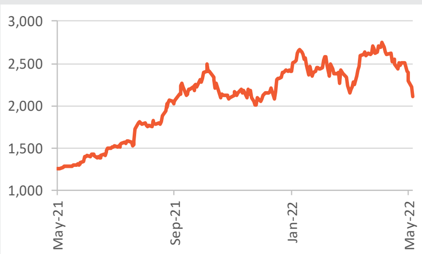
Company details

Market cap:	Rs. 62,601 cr
52-week high/low:	Rs. 2,773 / 1,240
NSE volume: (No of shares)	10.0 lakh
BSE code:	503806
NSE code:	SRF
Free float: (No of shares)	14.6 cr

Shareholding (%)

Promoters	51
FII	20
DII	9
Others	21

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-21.8	-14.7	-0.5	67.3
Relative to Sensex	-14.0	-8.2	8.7	56.7

Sharekhan Research, Bloomberg

SRF Ltd

Chemical biz catalyses Q4; guidance bright

Specaility Chem	Sharekhan code: SRF
Reco/View: Buy ↔	CMP: Rs. 2,112 / Price Target: Rs. 2,800 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q4FY22 operating profit/PAT of Rs. 948 crore/Rs. 606 crore, up 47%/59% y-o-y beat ours/street's estimates led by stronger-than-expected growth in chemicals (EBIT up 83%/20% y-o-y/q-o-q) and lower tax rate.
- Chemical business performed robustly, clocking a revenue growth of 36% y-o-y and EBIT margin expansion of 819 bps y-o-y to 32% led by higher margins in ref-gas and strong demand for specialty chemicals. Packaging film saw decent EBIT growth of 8.5% q-o-q and resilient margin of 19.8% (flat q-o-q). Technical textiles' EBIT declined 20% q-o-q due to revenue de-growth and margin contraction.
- Specialty chemical segment's revenue growth guidance of 20% for FY23 and ref-gas pricing to remain strong given favourable demand-supply. Chemical segment would sustain EBIT margin of 31%. FY23 capex target of Rs. 2,500-2,700 crore (~44% on high growth chemicals).
- A 24% fall in stock price from 52-week high provides a good entry opportunity given capex-led strong earnings growth outlook. Hence, we maintain a Buy on SRF with an unchanged PT of Rs. 2,800. At CMP, the stock trades at 28.3x/23.7x its FY23E/24E EPS.

SRF Limited's Q4FY22 results were above our estimates with 2.2%/8.3%/10.5% beat in revenue/operating profit/PAT at Rs. 3,549 crore/Rs. 948 crore/Rs. 606 crore, up 36.1%/47.4%/59% y-o-y primarily driven by a stronger-than-expected growth in chemical business and lower tax rate. Chemical segment posted robust performance with revenue/EBIT margin/EBIT growth of 36%/819 bps/83% y-o-y to Rs. 1,572 crore/32.1%/ Rs.504 crore in Q4FY22 as fluorochemicals performed very well on account of higher volumes/realisations from the refrigerants and chloromethanes segments in both the domestic and exports markets and strong demand for specialty chemicals. Performance of the packaging film segment was decent with a revenue/ EBIT growth of 9%/8.5% q-o-q to Rs. 1,390 crore/Rs 276 crore primarily led by volume growth given ramp-up facilities at Hungary/Thailand while margin remain largely stable q-o-q at 19.8%. However, the technical textiles missed estimate with EBIT de-growth of 19.5% q-o-q to Rs. 91 crore due to weak revenue (down 7.6% q-o-q) and EBIT margin (down 270 bps q-o-q) reflecting weak demand for Nylon Tyre Cord Fabrics (NTCF).

Key positives

- Robust revenue growth of 36.4%/41.9% y-o-y in chemical/packaging film segments.
- Chemical EBIT margin increased by 819 bps/272 bps y-o-y/q-o-q to 32.1%.

Key negatives

- Decline in revenue/EBIT margin by 7.6%/270 bps q-o-q in technical textiles.

Management Commentary

- Management guided for a 20% y-o-y revenue growth for specialty chemical in FY23 on high growth of 30% in FY22. Pricing environment for HFCs to remain strong given favourable demand environment. Chemical segment margin to sustain at H2FY22 level of 31% EBIT margin on pass-through of costs.
- Management expects BOPET margins to come under pressure as new lines are expected to become operational.
- Technical textiles segment's margins would improve on pricing revision in FY23 and guided for sustainable quarterly EBIT of Rs. 100-120 crore.
- Capex guidance of Rs. 2,500-2,700 crore for FY23 versus Rs. 2,000 crore in FY22. Rs. 1700-1800 crore to be spent on chemical business.
- **Other updates –** 1) Incorporated SRF Altech Limited for foray into aluminium foil, 2) launched 6 new products in specialty chemical segment in FY22 and targets similar product pipeline for FY23, 3) PTFE project on track and expected to get commissioned by October 2022, 4) new specialty product plant at Dahej at capex of Rs. 115 crore.

Revision in estimates – We have increased our FY23-24 earnings estimates to factor higher revenue growth in the chemicals business.

Our Call

Valuation – Maintain Buy on SRF with an unchanged PT of Rs. 2,800: High growth in 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 16%/16%/19% over FY2022-FY2024E and a healthy RoE/RoCE of 22%/23%. 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 justify its premium valuations. Hence, we maintain a Buy on SRF with an unchanged PT of Rs. 2,800. At CMP, the stock is trading at 28.3x its FY2023E EPS and 23.7x its FY2024E EPS.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	8,400	12,434	14,562	16,848
OPM (%)	25.5	25.5	25.0	25.3
Adjusted PAT	1,197	1,872	2,212	2,642
% y-o-y growth	*17.5*	*56.3*	*18.2*	*19.4*
EPS (Rs.)	40.4	63.1	74.6	89.1
P/E (x)	52.3	33.4	28.3	23.7
EV/EBITDA (x)	30.2	20.6	17.9	14.9
P/BV (x)	9.1	7.3	5.9	4.7
RoCE (%)	18.5	23.0	22.5	23.0
RoE (%)	20.3	24.5	23.0	22.1

Source: Company; Sharekhan estimates

Q4 beat led strong performance by chemical business: Consolidated revenues at Rs. 3,549 crore (up 36.1% y-o-y; up 6.1% q-o-q) was 2% above our estimates of Rs. 3,473 crore. The slight beat in revenues was led by better-than-expected revenue growth of 36%/42% y-o-y from chemical/packaging film segments offsetting a miss in revenue from technical textiles at Rs. 497 crore (down 7.6% q-o-q). OPM at 26.7% (up 204 bps y-o-y; up 37 bps q-o-q) was 150 bps above our estimate. Chemical EBIT margin witnessed robust improvement of 819bps/272bps y-o-y/q-o-q to 32.1% and that of packaging film remained largely stable q-o-q at 19.8%. However, technical textiles EBIT margin declined by 270 bps q-o-q to 18.4%. Consequently, operation profit at Rs. 948 crore (up 47.4% y-o-y; up 7.6% q-o-q) was 8% above our estimate of Rs. 876 crore. PAT at Rs. 606 crore (up 59% y-o-y; up 19.8% q-o-q) was 11% above our estimate of Rs. 548 crore as led by beat in chemical and packaging film EBIT and lower-than-expected tax rate at 23.1% (versus assumption of 25%).

Q4FY2022 conference call highlights

Specialty chemicals business – Management guided 20% revenue growth for FY23

- SRF achieved Rs. 3,100 crore revenues in specialty chemicals which was up 30% y-o-y in FY22. It was much higher than the management's guidance given of 15-20% growth for the fiscal. This was driven by strong demand for existing and more complex molecules and ramp up of new products.
- Announced capex of Rs. 115 crore at MPP4 to produce specialty products. This would help strengthen agro and pharmaceutical portfolio.
- Management is optimistic that growth will sustain and guided for revenue growth of 20% for FY22 on high base of FY22 and is hopeful it will beat the guidance as done in past years. Strong growth will be driven by robust order book position, ramp up of new products in 12-18 months and commission of MPP4. The company has planned to launch 6 new products in FY23 (similar to FY22 product launches).

Fluorochemicals – Ref gas pricing environment to remain strong

- Segment benefited from volume growth and strong realization across all HFCs in both domestic and international markets and better realization from chloromethane segment.
- In FY22 Capacity utilization across HFC plants was 72-75% and running at full capacity utilization currently. HFC contributed to about 30% of revenues for overall chemical segment.
- Strong demand for Dymel® HFA 134a/P sales. The company is expanding presence of fluorochemicals business across India, Bangladesh, Argentina, and Thailand. In addition, it has entered new markets such as Greece and Taiwan.
- Pricing outlook for Ref-gas to remain strong as no new capacity will be added in the near term and demand remain strong.

Packaging films – BOPET margins to come under pressure as new line to be to come on-stream

- New lines will be added in BOPET, therefore there will be margin pressure and thus company wants to expand its value-added products. BOPP demand growth to sustain.
- SRF Altech Limited is incorporated as a wholly owned subsidiary of SRF Ltd., to engage in the manufacturing of aluminum foil. Civil work will start shortly and company expects tax benefits through this incorporation of the subsidiary.

Technical textiles – Quarterly EBIT guidance of Rs. 100-120 crore

- Nylon tyre cord fabric volumes were subdued but margins remained strong.
- Company is in talks with customers for price revision in FY23 and has guided for quarterly EBIT run rate of Rs. 100-120 crore. Price negotiations with customer in FY23 will help sustain margins.

Capex guidance

- Company guided for a capex of Rs. 2,500-2700 crore in FY23 as against a capex of Rs. 2,000 crore in FY22.
- Company will spend Rs. 1,700-1,800 crore in Chemical business and within that Rs. 1,100 crore for fluorochemical business.
- Commodity price inflation could result in 8-15% rise in capex.

Results (Consolidated) Rs cr

Particulars	Q4FY22	Q4FY21	Y-o-Y %	Q3FY22	Q-o-Q %
Revenue	**3,549**	**2,608**	**36.1**	**3,346**	**6.1**
Total Expenditure	2,601	1,964	32.4	2,464	5.6
Operating profit	**948**	**643**	**47.4**	**881**	**7.6**
Other Income	7	13	(44.2)	11	(32.2)
Depreciation	132	118	11.1	132	(0.6)
Interest	36	26	36.5	29	21.4
PBT	788	512	54.0	730	7.9
Tax	182	130	40.0	225	(18.9)
Profit from discontinuing operations (net of tax)	-	(1)	NA	-	NA
Reported PAT	**606**	**381**	**59.0**	**506**	**19.8**
EPS (Rs.)	20.4	12.9	59.0	17.1	19.8
Margin (%)			**BPS**		**BPS**
OPM	26.7	24.7	204	26.3	37
NPM	17.1	14.6	246	15.1	195
Tax rate	23.1	25.4	-231.3	30.8	-763.9

Source: Company; Sharekhan Research

Segmental performance (consolidated) Rs cr

Particulars	Q4FY22	Q4FY21	Y-o-Y %	Q3FY22	Q-o-Q %
Segmental revenue					
Technical Textiles	497	401	24.0	538	(7.6)
Chemical	1,572	1,153	36.4	1,428	10.1
Packaging Film	1,390	980	41.9	1,276	9.0
Others	93	78	20.2	107	(12.8)
Total Revenue	**3,553**	**2,610**	**36.1**	**3,349**	**6.1**
Inter Segment	3	3	20.2	3	0.9
Net Revenue	**3,549**	**2,608**	**36.1**	**3,346**	**6.1**
Segmental EBIT					
Technical Textiles	91	73	25.6	114	(19.5)
Chemical	504	275	83.3	419	20.3
Packaging Film	276	219	26.2	254	8.5
Others	4	9	(53.4)	9	(52.3)
Total EBIT	**876**	**575**	**52.2**	**796**	**10**
EBIT Margin (%)			**bps**		**bps**
Technical Textiles	18.4	18.2	24	21.1	(270)
Chemical	32.1	23.9	819	29.4	272
Packaging Film	19.8	22.3	(247)	19.9	(8)
Others	4.4	11.3	(691)	8.0	(362)
Overall EBIT margin	**24.7**	**22.1**	**261**	**23.8**	**89**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Structural growth drivers to propel sustained growth for specialty chemical sector

We remain bullish on 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 sector clock high double-digit earnings growth trajectory on sustained basis in the next 2-3 years.

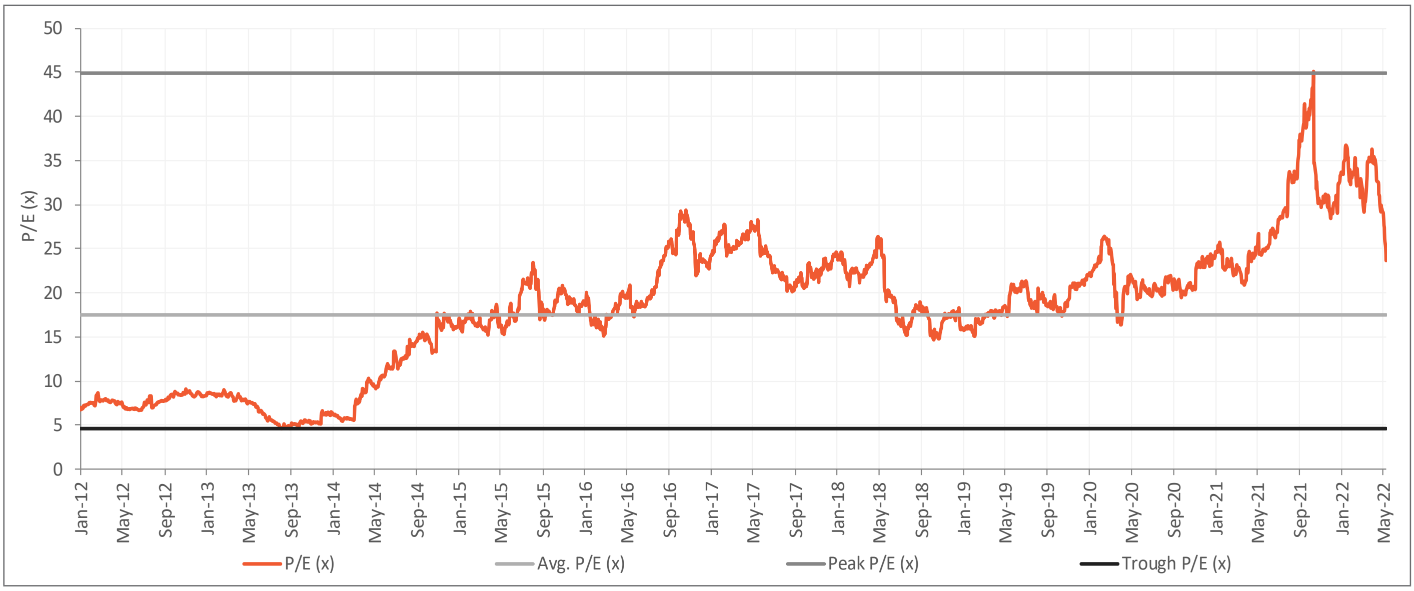
■ Company outlook – Long-term story stays intact, capex momentum to continue

The management sees significant growth opportunities in the agro-chemicals and active pharmaceutical ingredients segments (developing two pharmaceutical molecules in collaboration with innovators). Moreover, in the fluorochemicals space, SRF is focusing on ramping up utilisation levels at 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. Higher volumes from expanded capacities to drive packaging films volume although margin expected to contract given an oversupply 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. 2,800

High growth in 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 16%/16%/19% over FY2022-FY2024E and a healthy RoE/RoCE of 22%/23%. 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 justify its premium valuations. Hence, we maintain a Buy on SRF with an unchanged PT of Rs. 2,800. At CMP, the stock is trading at 28.3x its FY2023E EPS and 23.7x 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Kotak Mahindra Asset Management Co Ltd/ India	4.04
2	Amansa Holdings Pvt Ltd	3.83
3	Blackrock Inc	1.58
4	Vanguard Group	1.56
5	SBI Funds Management Ltd	1.15
6	ICICI Prudential Life Insurance Co Ltd	1.10
7	NGUYEN THI HONG	0.90
8	Nippon Life India Asset Management	0.71
9	Morgan Stanley	0.56
10	Dimensional Fund Advisors LP	0.51

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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by BNP PARIBAS

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