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 38.14

Updated Mar 08, 2023

High Risk

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

Source: Morningstar

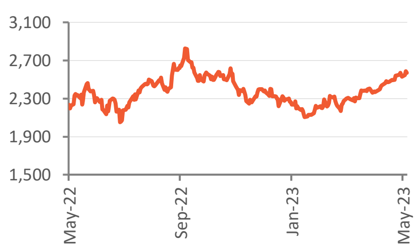
Company details

Market cap:	Rs. 76,232 cr
52-week high/low:	Rs. 2,864 / 2,003
NSE volume: (No of shares)	5.2 lakh
BSE code:	503806
NSE code:	SRF
Free float: (No of shares)	14.66 cr

Shareholding (%)

Promoters	51
FII	19
DII	15
Others	16

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.2	12.3	7.7	15.1
Relative to Sensex	4.3	10.2	7.4	0.6

Sharekhan Research, Bloomberg

SRF Ltd

Chem biz brightens Q4; upbeat guidance & pharma foray key catalyst

Speciality Chem	Sharekhan code: SRF		
Reco/View: Buy ↔	CMP: Rs. 2,572	Price Target: Rs. 2,960 ↔	

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q4FY23 numbers show strength in chemical segment, which helped deliver strong 10% q-o-q growth in consolidated PAT to Rs. 562 crore (5% above our estimate) despite demand/margin headwinds for packaging film/technical textile businesses.
- Chemical segment EBIT grew by 47% y-o-y/31% q-o-q and was well significantly above our expectation, led by beat of 16%/700 bps in revenues/margins, given phenomenal performance by both fluorochemical and specialty chemical businesses. Packaging film's EBIT declined by 85%/65% y-o-y/q-o-q to Rs. 41 crore as margins plunged by 1,629/631 bps y-o-y/q-o-q to just 3.6% amid soft BOPET/BOPP spreads. Technical textile segment's EBIT improved q-o-q but still remains well below normal level given weak NTCF demand.
- Management was confident with its 20%+ revenue guidance and sustained high margin guidance for chemical segment despite a high base (revenue/EBIT growth of 41%/68% in FY23). Pharma CDMO foray plan and commercialization of 7-8 new AIs over next two years could be key catalyst for growth going forward.
- Stock price has run-up sharply by 18% from March lows but is still 10% below 52-week high of Rs. 2,864 and thus risk-reward seems favourable given expectations of a 20% PAT CAGR over FY23-25E, efficient capital allocation (high capex intensity for chemical business) and a reasonable valuation of 25x its FY2025E EPS. Hence, we maintain a Buy on SRF with an unchanged PT of Rs. 2,960. SRF remains our top pick in the specialty chemical sector.

Q4FY23 was yet another strong quarter for SRF Limited with a 4%/5% beat in operating profit/PAT at Rs. 932 crore/Rs. 562 crore, up 12%/10% q-o-q, led by continued outperformance from its chemical segment (revenue/EBIT growth of 20%/31% q-o-q) offsetting subdued earnings from packing films/technical textiles. Overall, OPM expanded by 63 bps q-o-q to 24.7% and was 105 bps above our estimates of 23.6% reflecting strength in chemical segment's margins, while revenues were in line at Rs. 3,778 crore (up 6.4% y-o-y; up 8.9% q-o-q) as a robust growth in chemical segment was offset by subdued packing films/technical revenue of Rs. 1,153 crore/Rs. 431 crore, down/up by 4.1%/1.1% q-o-q. Chemicals segment continued with its phenomenal growth with 20% q-o-q increase in revenues to Rs. 2,102 crore and very strong EBIT margin of 35.2% (up 310 bps y-o-y; up 307 bps q-o-q) and thus chemical EBIT grew by 47%/31% y-o-y/q-o-q to Rs. 739 crore (accounted for 88% of overall EBIT in Q4FY23). Chemical business' stellar show was led by exceptional performance by fluorochemicals business (strong volumes for refrigerants, blends, Dymel® HFA 134a/P propellants, ramp-up of CMS plant and strong pricing for HFCs) and strong growth from specialty chemical (robust demand for flagship products and downstream derivatives and contribution from new products commercialized in FY23). The packaging film segment faced challenges, which is reflected in steep 65% q-o-q decline in EBIT to Rs. 41 crore given a very sharp contraction in EBIT margin to just 3.6% (down 1629 bps y-o-y; down 631 bps q-o-q) owing to several new BOPET/BOPP lines coming onstream in a weak demand environment. Technical textiles segment witnessed recovery on a sequential basis with EBIT growth of 41.5% q-o-q to Rs. 48 crore but remained way below-normal level as demand concern continues for Nylon Tyre Cord Fabrics (NTCF), which offsets improvement in volume for nylon and polyester industrial yarn.

Key positives

- Robust chemical segment's performance with 20% q-o-q revenue growth and 307 bps q-o-q improvement in EBIT margin to 35%.

Key negatives

- Steep revenue decline/margin contraction of 17%/1629 bps y-o-y for the packing film segment.

Management Commentary

- **Chemicals –** Revenue growth guidance for FY24 was strong at over 20%. Margin outlook was positive too although there may be some moderation from Q4FY23 level. Specialty chem grew by 35% in FY23 and management guided for an over 20% growth for FY24. Chemical segment's RoCE may moderate from current level of 32% as some new products would take time to be RoCE accretive.
- **Packaging films –** Margins would remain under pressure as new capacities for BOPET/BOPP expected to become operational. SRF's volume expected to improve in FY24 with recovery in Hungary plant and 10-15% higher capacity at South Africa plant.
- **Technical textiles –** A slight demand improvement visible for NTCF. SRF focus would to be ramp-up capacity utilisation from 75% currently.
- **Project updates –** 1) PTFE plant is to be commissioned by end-May or mid-June 2023 and guided for 30-40% utilisation in FY24, 2) PX-1/PX-2 progressing as per plan, 3) R-32 capacity expected by June/July 2023 and production to start from August/September 2023 and 4) Aluminium foil project progressing with some cost increase to Rs. 530 crore (versus earlier estimate of Rs. 425 crore) but IRR expected to remain healthy.
- SRF is planning to foray into pharma CDMO and looking at both organic and inorganic opportunities. Focus to be large pharma CDMO player.
- SRF expects 7-8 active intermediates (for agrochemicals) to commercialise over next two years apart from regular product launches.
- SRF is not concerned from rise in generic product supply from China given ~85% of business is focused on innovators.
- SRF have over Rs. 2,000 crore of CWIP as of now with seven plants coming up for specialty chemical and three plants for fluorochemical in FY24. Capex intensity to remain strong and guided for capex of Rs. 2,500 crore for FY24.

Revision in estimates – We have increased our FY24 earnings estimate by 7% to factor management guidance and have fine-tuned our FY25 earnings estimates.

Our Call

Valuation – Maintain Buy on SRF with an unchanged PT of Rs. 2,960: High growth in the chemical business supported by increased capex intensity would drive strong revenue/EBITDA/PAT CAGR of 15%/19%/20% over FY2023-FY2025E and a healthy RoE/RoCE of 21%/22%. Investment in right areas of the specialty chemical business would improve earnings quality and safeguard from cyclical packaging film margins. SRF's stock price has recovered strongly from March lows but is still 10% below its 52-week high level of Rs. 2,864 and thus the valuation of 27x/25x its FY2024E/FY2025E EPS seems reasonable given strong growth outlook for its key chemical segment. Hence, we maintain a Buy rating on SRF with an unchanged price target (PT) of Rs. 2,960.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	12,434	14,870	17,013	19,530
OPM (%)	25.5	23.7	26.7	25.6
Adjusted PAT	1,872	2,113	2,828	3,043
% y-o-y growth	56.3	12.9	33.9	7.6
EPS (Rs.)	63.1	71.3	95.4	102.7
P/E (x)	40.7	36.1	27.0	25.1
EV/EBITDA (x)	24.9	22.5	17.0	15.2
P/BV (x)	8.9	7.4	5.8	4.8
RoCE (%)	23.0	20.9	24.1	22.5
RoE (%)	24.5	22.9	24.2	20.9

Source: Company; Sharekhan estimates

Robust chemical biz. performance led to Q4 earnings beat

Q4FY23 consolidated revenues at Rs. 3,778 crore (up 6.4% y-o-y; up 8.9% q-o-q) were in line with our estimate of Rs. 3778 crore. Chemical business revenues grew strongly by 34%/20% y-o-y/q-o-q to Rs. 2102 crore while that of the packaging film/technical textile remain subdued at Rs. 1153 crore/Rs. 431 crore, down/up by 4.1%/1.1% q-o-q. OPM at 24.7% (up 63 bps q-o-q) was 105 bps above our estimate due to stronger-than-expected EBIT margin for chemical at 35.2% (up 310 bps/307 bps y-o-y/q-o-q). However, packaging film EBIT margin disappointed with contraction of 631 bps q-o-q to just 3.6% while that of technical textiles, improved by 321 bps q-o-q to 11.2%. Consequently, operating profit at Rs. 932 crore (down 1.7% y-o-y; up 11.8% q-o-q) was 4.5% above our estimate of Rs. 892 crore. Consolidated PAT at Rs. 562 crore (down 7.1% y-o-y; up 10% q-o-q) was also 4.5% above our estimate reflecting strong performance from the chemicals segment.

Q4FY2023 conference call highlights

Specialty chemicals business – Strong demand to persist, FY24 revenue growth guidance of 20%+

- Specialty chemical business grew strongly in Q4 led by commissioning/commercialization of new plants/products in FY23 and robust y-o-y growth of key products.
- Company is seeing increased downstream demand for advanced products and multiple AIs are under discussion with various customers. Rising usage of fungicides and herbicides will support demand going forward.
- Company will continue to focus on launch of new products and on expanding its portfolio of raw material suppliers.
- The management expects strong ramp up of recently capitalised PIP plant and is focused on improving efficiency through optimum utilisation of resources.

Fluorochemicals – Strong performance led by Ref gas demand, HFCs demand to be subdued in Q1FY24

- Fluorochemicals business delivered a healthy performance led by robust demand for Ref gas and strong NPR's of major HFCs. The company achieved highest sales for Dymel® HFA 134a/P with an expanded geographical presence across over 20 countries.
- Weakness for HFCs in Q1FY24 due to low temperatures is likely to be transitory. The demand in the refrigerants segment is expected to remain healthy in the near to medium term. Management is focused on building the export portfolio and product offerings to offset the oversupply and weakness in the domestic market.
- Company commissioned CMS2, CPP, and CaCl2 plants during the year and is focused on ramping up the operations in FY24.
- Company will commission the PTFE capacity in the next quarter and the PX-1/PX-2 capacity is progressing well as per plan. Management will prioritise getting product approvals at the earliest.
- Q1FY24 may see some impact on HFCs due to weak summer season and likely to be transitory. Management expects ramp-up in Middle East and US volumes over Q2/Q3 of FY24.

Packaging films – Weak demand with headwinds to persist in FY24; Aluminium Foil project on track

- Q4 performance faced several headwinds like margin pressure due to weak global demand, oversupply and steep energy cost in Europe. The company will focus on VAP sales and expand its customer base to navigate through uncertain times.
- Margin pressures will continue in FY24 though energy costs are moderating in Europe. Hungary is expected to improve its performance going forward and volume gains from de-bottlenecked South African unit capacity is likely to aid operational efficiencies.
- Aluminium foil project progressing as per plan, although with some cost increases. SRF will now become a solution provider of the three major substrates—BOPET, BOPP and aluminium foil. Company will focus on VAP in both BOPP and BOPET.

Technical textiles – Continued weakness in Nylon Tyre Cord Fabric demand; Focus on cost optimization

- Q4 was subdued due to weak demand for Nylon Tyre Cord Fabric (NTCF) but Belting Fabric delivered higher y-o-y sales.
- Management is witnessing revival in demand or NTCF and Belting Fabric that is expected to remain healthy due to increased focus on infrastructure development. Increased demand for geo-textiles and seat belts will support the demand for Polyester industrial yarn.
- Company will focus on cost optimization across various plants and emphasis high-end VAP sales.

Capex guidance

- Company guided for a capex of Rs. 2500 crore for FY24, of which Rs. 1200-1300 crore will be spent for projects already on ground.

Results (Consolidated) Rs cr

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Revenue	**3,778**	**3,549**	**6.4**	**3,470**	**8.9**
Total Expenditure	2,846	2,601	9.4	2,636	8.0
Operating profit	**932**	**948**	**(1.7)**	**834**	**11.8**
Other Income	22	7	208.9	10	123.1
Depreciation	155	132	17.5	151	2.6
Interest	66	36	84.6	62	6.4
PBT	733	788	(6.9)	631	16.2
Tax	171	182	(6.2)	120	42.4
Reported PAT	**562**	**606**	**(7.1)**	**511**	**10.1**
Reported EPS (Rs.)	19.0	20.4	(7.1)	17.2	10.1
Margin (%)			**BPS**		**BPS**
OPM	24.7	26.7	(205)	24.0	63
NPM	14.9	17.1	(218)	14.7	16
Tax rate	23.3	23.1	17.3	19.0	428.4

Source: Company; Sharekhan Research

Segmental performance (Consolidated) Rs cr

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Segmental revenue					
Technical Textiles	431	497	(13.3)	426	1.1
Chemical	2,102	1,572	33.7	1,757	19.6
Packaging Film	1,153	1,390	(17.1)	1,203	(4.1)
Others	94	93	1.0	92	2.1
Total Revenue	**3,780**	**3,553**	**6.4**	**3,478**	**8.7**
Inter Segment	2	3	(50.5)	8	(79.5)
Net Revenue	**3,778**	**3,549**	**6.4**	**3,470**	**8.9**
Segmental EBIT					
Technical Textiles	48	91	(47.1)	34	41.5
Chemical	739	504	46.6	564	31.1
Packaging Film	41	276	(85.2)	119	(65.5)
Others	11	4	177.0	9	24.0
Total EBIT	**840**	**876**	**(4.1)**	**726**	**15.7**
EBIT Margin (%)			**BPS**		**BPS**
Technical Textiles	11.2	18.4	(717)	8.0	321
Chemical	35.2	32.1	310	32.1	307
Packaging Film	3.6	19.8	(1,629)	9.9	(631)
Others	12.0	4.4	764	9.9	212
Overall EBIT margin	**22.2**	**24.7**	**(244)**	**20.9**	**131**

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector View – Structural growth drivers to propel sustained growth for the 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 rise in exports given China Plus One strategy followed by global customers, and favourable government policies (such as tax incentives and production-linked incentive scheme similar to that of the pharmaceutical sector). We believe conducive government policies, product innovation, massive export opportunities, and low input prices would help the sector report a high double-digit earnings growth trajectory on a sustained basis in the next 2-3 years.

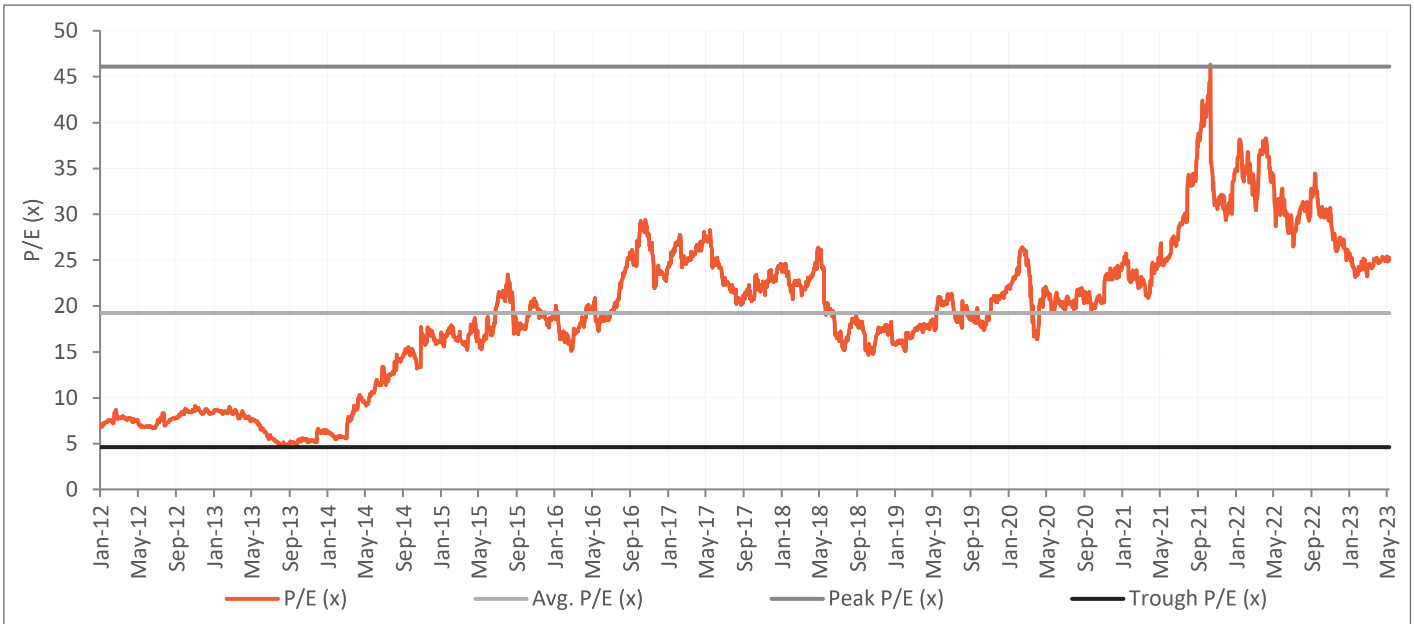
■ **Company Outlook – Long-term story intact, capex momentum to continue**

The management sees significant growth opportunities in the agro-chemicals and active pharmaceutical ingredients (API) segments (developing two pharmaceutical molecules in collaboration with innovators). Moreover, in the fluorochemicals space, SRF is focusing on ramping up its utilisation levels at recently commissioned HFC facilities and it sees demand traction to be strong. Specialty chemicals are likely to continue growing at a healthy pace, while volumes/margins for fluorochemicals would improve as demand is expected to improve. Higher volumes from expanded capacities would drive packaging films volume although margins are expected to contract amid oversupply. The company generates healthy operating cash flows and, hence, largely relies on internal accruals to fund its capex. This strengthens balance sheet further and helps improve return ratios.

■ **Valuation – Maintain Buy on SRF with an unchanged PT of Rs. 2,960**

High growth in the chemical business supported by increased capex intensity would drive strong revenue/EBITDA/PAT CAGR of 15%/19%/20% over FY2023-FY2025E and a healthy RoE/RoCE of 21%/22%. Investment in right areas of the specialty chemical business would improve earnings quality and safeguard from cyclical packaging film margins. SRF's stock price has recovered strongly from March lows but is still 10% below its 52-week high level of Rs. 2,864 and thus the valuation of 27x/25x its FY2024E/FY2025E EPS seems reasonable given strong growth outlook for its key chemical segment. Hence, we maintain a Buy rating on SRF with an unchanged price target (PT) of Rs. 2,960.

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 API (developing two pharma molecules in collaboration with innovators). Continued high capex to expand capacities in high-growth areas of the specialty chemical business is likely to drive sustained high earnings growth. Moreover, the structural high-growth cycle for the 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 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	4.14
2	Amansa Holdings Pvt Ltd	3.55
3	Vanguard Group Inc/The	1.86
4	BlackRock Inc	1.58
5	FundRock Management Co SA	1.15
6	SBI Life Insurance Co Ltd	1.06
7	SBI Funds Management Ltd	0.87
8	FMR LLC	0.69
9	Norges Bank	0.58
10	SBI Pension Funds Pvt Ltd	0.54

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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Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

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