



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		38.67
Updated Aug 08, 2023		
High Risk		
NEGL	LOW	MED
0-10	10-20	20-30
		HIGH
		30-40
		SEVERE
		40+

Source: Morningstar

Company details

Market cap:	Rs. 71,067 cr
52-week high/low:	Rs. 2,864 / 2,050
NSE volume:	5.5 lakh (No of shares)
BSE code:	503806
NSE code:	SRF
Free float:	14.66 cr (No of shares)

Shareholding (%)

Promoters	51
FII	20
DII	14
Others	16

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.2	1.2	5.6	-15.0
Relative to Sensex	1.2	-6.1	-11.8	-27.7

Sharekhan Research, Bloomberg

Specaility Chem		Sharekhan code: SRF		
Reco/View: Buy	↔	CMP: Rs. 2,398	Price Target: Rs. 2,745	↔
↑ Upgrade	↔ Maintain	↓ Downgrade		

Summary

- ◆ Bayer (SRF's key customer) has recently hinted toward some easing of channel inventory in the agrochem space and provided a healthy growth outlook of 5-7% for its core CPC (ex-Glyphosate) portfolio. This bodes well for SRF's fluorospecialty growth in the coming quarters.
- ◆ The upcoming 30% HFCs production cut in the U.S. from January 2024 would mean tight HFC market and the U.S. is likely to remain net importer of HFCs. This situation would play out well for SRF as it would have twin benefit of volume and better ref-gas pricing environment in H2FY2024.
- ◆ SRF's massive capex plan of Rs. 15,000 crore for the next five years with majority focused on the chemical business would drive sustained high double-digit growth for its chemical business. The ramp-up of the new pharma intermediates plant, MPP-4, chloromethane and commissioning of new plants (PTFE and R-32 expected to come on-stream over Q2-Q3 of FY2024) would be key monitorable in FY2024.
- ◆ SRF is a quality player and its investment in specialty chemicals and China plus one opportunity provides strong long-term earnings growth prospects. A valuation of 25x its FY2025E EPS seems reasonable. We maintain a Buy rating on SRF with an unchanged PT of Rs. 2,745.

SRF in its recent earnings call indicated that inventory destocking in the agrochemical space seems temporary in nature and does not have any impact on demand despite some order delays by customers. This assumption is supported by Q2CY2023 earnings conference call of Bayer (SRF key client) in which it stated that they "don't have issues regarding inventory in the channel and have a very healthy level of products in any region that they operate". Moreover, we expect the HFC market to become tight by Q4FY2024 with planned 30% production cut in the U.S. This would create a supply shortage for various high GWP ref-gases as well as improve ref-gas price and the same bodes well for a strong recovery in SRF's fluorochemical business (ref-gas) in H2FY2024. Potential normalisation of ref-gas demand/pricing and likely easing of inventory reduction concern in the agrochem side would significantly improve earnings outlook for SRF in H2FY2024 and drive re-rating of the stock as its capex commitment towards the chemical segment provides strong medium to long-term revenue/earnings growth visibility. Hence, we maintain our Buy rating on SRF with an unchanged price target (PT) of Rs. 2,745. At the CMP, the stock trades at a reasonable valuation of 25x FY2025E EPS.

- ◆ **Better commentary from SRF clients in the agrochemical space:** In a recent earnings concall, one of the key clients (Bayer) gave an optimistic commentary for the agrochemical space. Bayer is anticipating pick up in the sales of the insecticides and fungicides segment, while its herbicide portfolio is expected to maintain growth momentum. Bayer expects LATAM market to witness robust growth as it is expected to recover from adverse weather conditions related to double-digit sales decline in Q4FY2022. Bayer expects a healthy growth outlook of 5-7% for its core CPC (ex-Glyphosate) portfolio. Moreover, Bayer don't have issues of inventory in the channel and have a very healthy level of its products in any region that they operate. A likely easing of inventory reduction concern in the agrochem side and SRF's strong collaboration with agrochem innovators would significantly improve the growth outlook for its fluorospecialty business in H2FY2024.
- ◆ **Demand for HFC products expected to improve from Q4FY2024:** The U.S. plans to cut production and consumption of high global warming potential (GWP) HFC including R134a, R404A, and R410A from January 2024 onwards. However, demand for high GWP HFC will remain in the secondary market, which will support ref-gas pricing apart from supply shortages in the U.S. market. This situation would play out well for SRF as it would have twin benefits of volume and better ref-gas pricing environment in H2FY2024. Moreover, demand for R-32 is increasing in the U.S. and India, Japan, and South Korea are moving towards R-32 for room air conditioners. To fulfill this demand, SRF will be commissioning additional capacity (~15,000MT) for R-32 in Q2FY2024. Over the long term, Hydrofluorolefins (HFOs) is going to be a major product within the fluorochemicals business mainly due to zero-ozone depletion potential and low global warming potential of the product.
- ◆ **Massive chemical capex plan to drive growth in specialty chemicals:** SRF has planned for a massive capex plan of Rs. 15,000 crore over the next five years with a majority of capex aligned towards the chemical business (for specialty chemical and fluorochemicals). SRF Pharma Intermediates Plant (PIP) was commissioned in May 2023 and is expected to ramp up production in the next two quarters. We believe that the capex would provide sustainable strong growth and healthy RoE for specialty chemicals. Commissioning of new Pharma Intermediates plant (PIP) and new product launches (two new products launched each in the agrochemical and pharma space in Q1FY2024) will increase the company's engagement with customers, strengthen its market presence, and enhance growth potential.

Our Call

Valuation – Maintain Buy on SRF with an unchanged PT of Rs. 2,745: SRF is a quality player (strong collaboration with innovators and dedicated customer contracts) and holds strong long-term earnings growth prospects, given the support of China plus one strategy by global players. SRF's stock price has seen a decent recovery, but it is still 16% below its 52-week high of Rs. 2,864, which provides a good opportunity for the investor to accumulate the stock. Investment in the right areas of specialty chemicals would drive a 15% PAT CAGR over FY2023-FY2025E along with healthy RoE/RoCE of 20%/21%. At the CMP, the stock trades at a reasonable valuation of 28x/25x its FY2024E/FY2025E EPS. Hence, we maintain our Buy rating on SRF with an unchanged price target (PT) of Rs. 2,745.

Key Risks

- 1) Slower offtake from user industries and concerns about the correction in product prices can affect revenue growth,
- 2) slower-than-expected capex in the chemical segment, and 3) input cost price volatility might affect margins.

Valuation (Consolidated)

Particulars	FY22	FY23	FY24E	FY25E
Revenue	12,434	14,870	16,440	18,842
OPM (%)	25.5	23.7	25.3	24.8
Adjusted PAT	1,872	2,113	2,530	2,805
y-o-y growth (%)	56.3	12.9	19.7	10.9
EPS (Rs.)	63.1	71.3	85.3	94.6
P/E (x)	37.8	33.0	28.2	25.4
EV/EBITDA (x)	23.3	21.1	17.5	15.3
P/BV (x)	8.3	6.9	5.6	4.6
RoCE (%)	23.0	20.9	21.9	21.3
RoE (%)	24.5	22.9	21.9	19.8

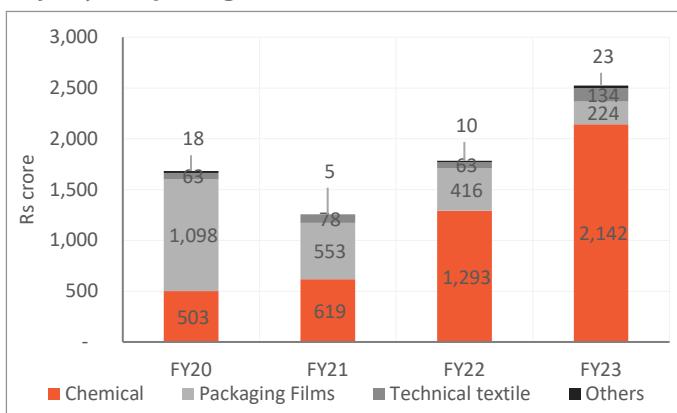
Source: Company; Sharekhan estimates

Key projects of SRF – largely for chemical business

Date of Commissioning	Business segment	Expansion project
Q1FY2024	Chemicals	New Pharma Intermediates plant (PIP) plant
Q1FY2024	Textile	New capacity for solid woven fabric (part of the belting fabrics portfolio)
Q2FY2024	Chemicals	New R32 plant (HFC variant with lower GWP)
Q3FY2024	Packaging films	New aluminium foil capacity
Q2FY2024-Q3FY2024	Chemicals	New polytetrafluoroethylene (PTFE) capacity

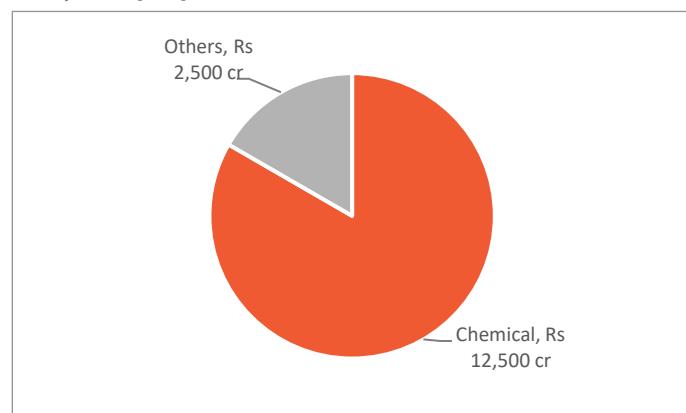
Source: Company; Sharekhan Research

Majority of capex aligned towards the chemical business



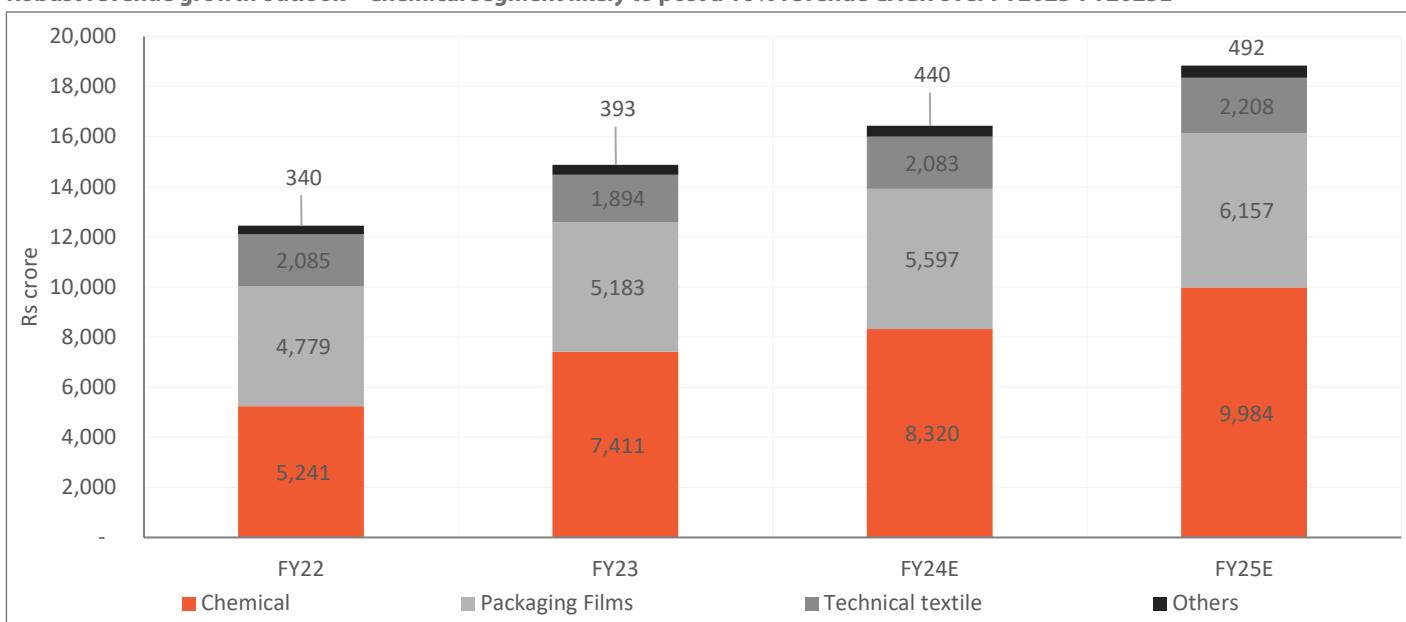
Source: Company, Sharekhan Research

Five-year capex plan of Rs. 15,000 crore (83% towards chemical)



Source: Company, Sharekhan Research

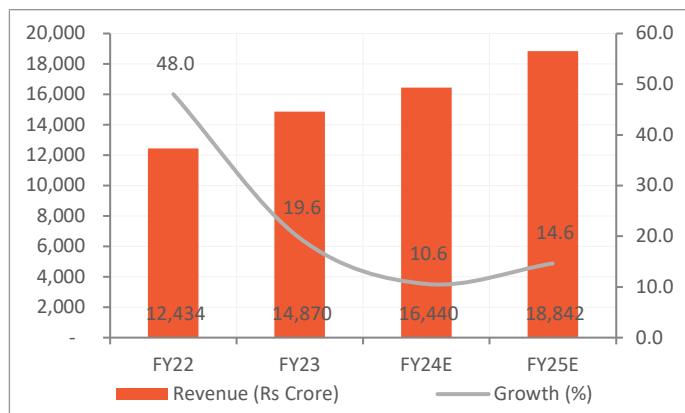
Robust revenue growth outlook – Chemical segment likely to post a 16% revenue CAGR over FY2023-FY2025E



Source: Sharekhan Research

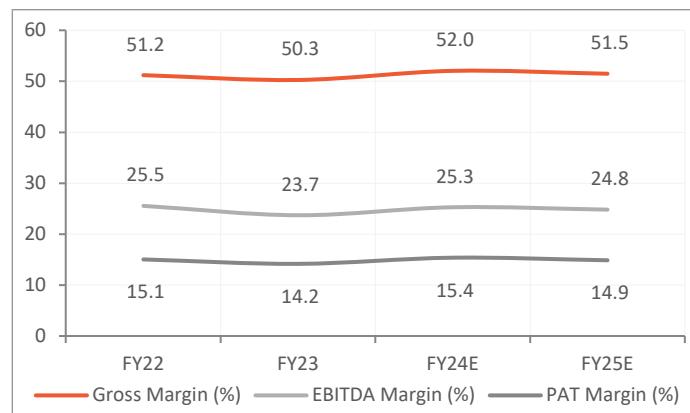
Financials in charts

Scalable and sustainable revenue growth



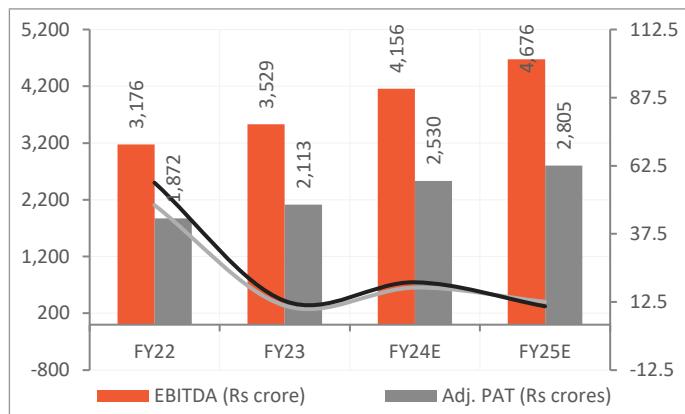
Source: Company, Sharekhan Research

Consistent strong margin profile



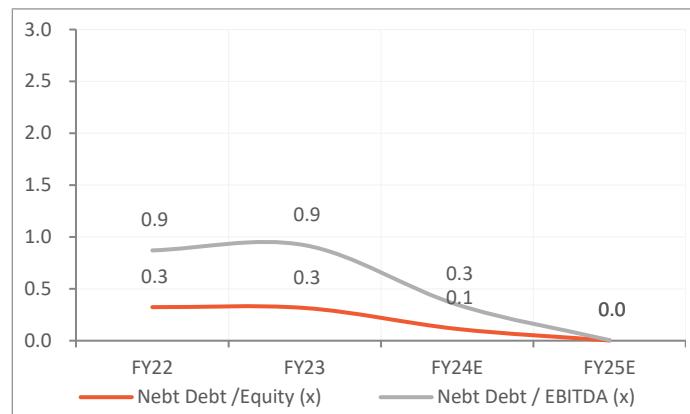
Source: Company, Sharekhan Research

EBITDA to post a 15% CAGR over FY2023-FY2025E



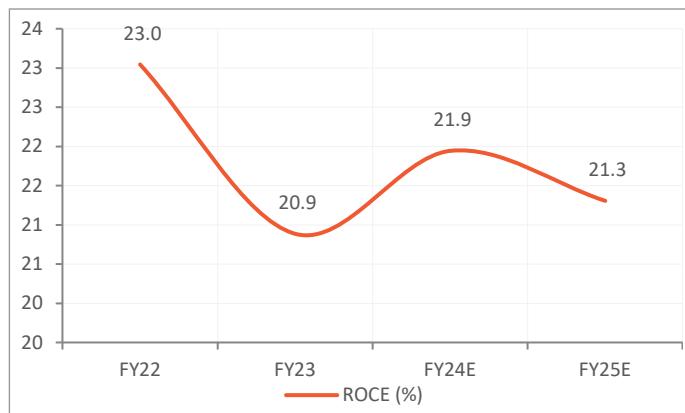
Source: Company, Sharekhan Research

Lean balance sheet to support expansion



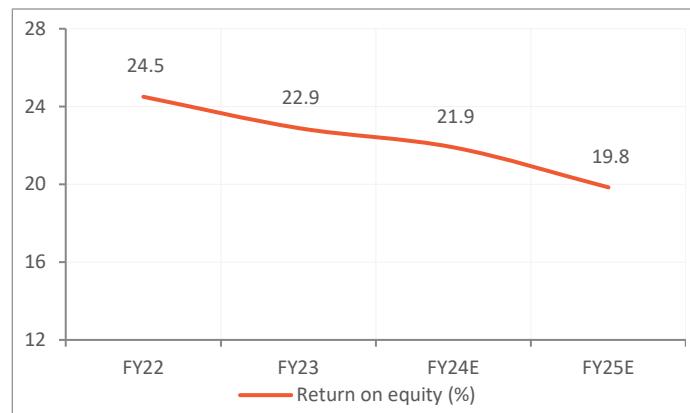
Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

RoE trend



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.

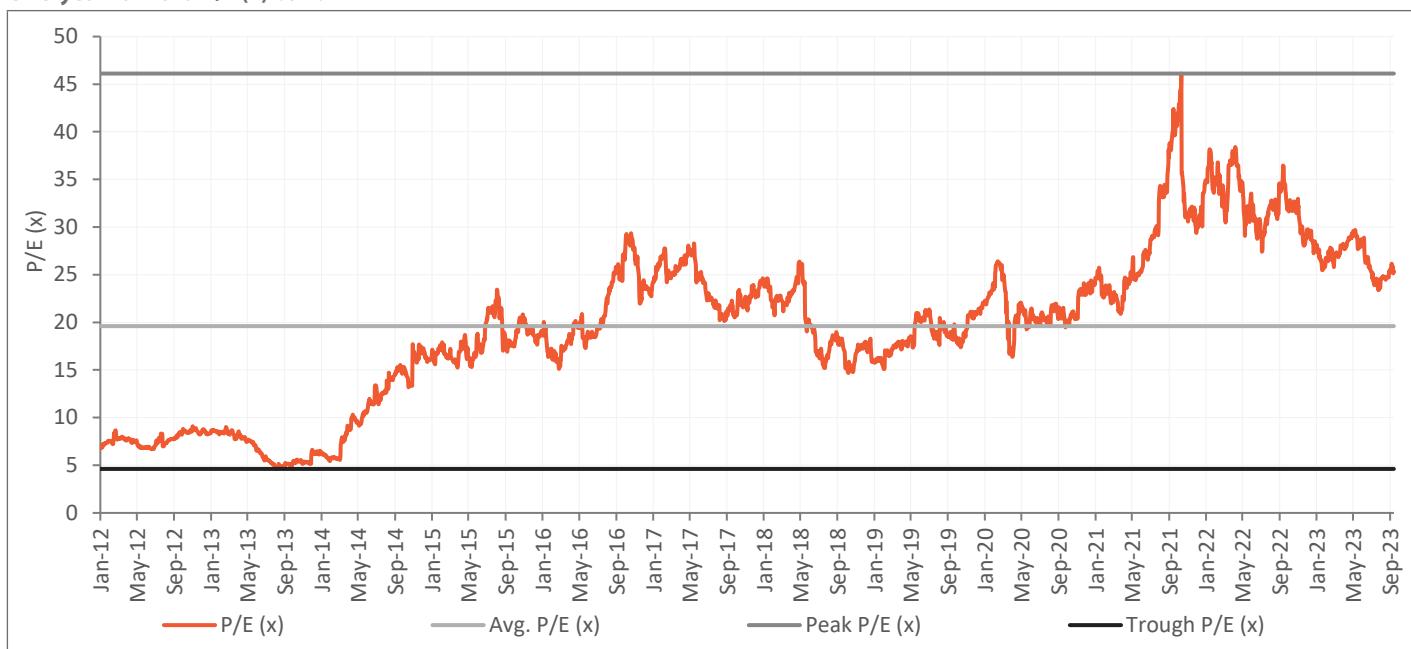
■ Company Outlook – Near-term concerns seem transitionary; capex-led growth story intact

Management indicated near-term concerns for the company, given temporary ref-gas pricing pressure and inventory rationalisation along with order delays by customers in agrochemical. The above-mentioned challenges seem short-term in nature and significant growth opportunities are expected in the agro-chemicals as well as active pharmaceutical ingredients (API) segments. Moreover, management sees strong global demand (especially in the U.S.) for HFCs. High capital intensity toward specialty chemical makes us confident about the long-term revenue/earnings growth of SRF. Moreover, investment in the right areas of the specialty chemical business would improve earnings quality and safeguard from cyclical packaging film margins.

■ Valuation – Maintain Buy on SRF with an unchanged PT of Rs. 2,745

SRF is a quality player (strong collaboration with innovators and dedicated customer contracts) and holds strong long-term earnings growth prospects, given the support of China plus one strategy by global players. SRF's stock price has seen a decent recovery, but it is still 16% below its 52-week high of Rs. 2,864, which provides a good opportunity for the investor to accumulate the stock. Investment in the right areas of specialty chemicals would drive a 15% PAT CAGR over FY2023-FY2025E along with healthy RoE/RoCE of 20%/21%. At the CMP, the stock trades at a reasonable valuation of 28x/25x its FY2024E/FY2025E EPS. Hence, we maintain our Buy rating on SRF with an unchanged price target (PT) of Rs. 2,745.

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), is expected 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
Prashant Yadav	President and CEO, Fluorochemicals Business and Technical Textiles Business
Anurag Jain	President and CEO, Specialty Chemicals Business and Chemicals Technology Group
Prashant Mehra	President and CEO, Packaging Films Business, Coated and Laminated Fabrics Business
Rahul Jain	Chief Financial Officer
Ajay Chowdhury	President and CHRO
Sanjay Rao	President and CIO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Kotak Mahindra Asset Management Co	4.14
2	Amansa Holdings Pvt Ltd	3.54
3	FMR LLC	1.94
4	Vanguard Group Inc/The	1.88
5	BlackRock Inc	1.61
6	Life Insurance Corp of India	1.13
7	SBI Life Insurance Co Ltd	1.06
8	FIL Ltd	0.86
9	ICICI Prudential Life Insurance Co	0.86
10	HDFC Asset Management Co Ltd	0.84

Source: Bloomberg

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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 external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/ weak realisation environment resulting in margin pressure and deteriorating 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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