Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

SRF Ltd

Recovery expected from Q4; growth capex intact

Speciality Chem	Sharekhan code: SRF
Reco/View: Buy ↔	CMP: Rs. 2,368 · Price Target: Rs. 2,745 ↔

↑ 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 38.67
Updated Aug 08, 2023

High Risk

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

Source: Morningstar

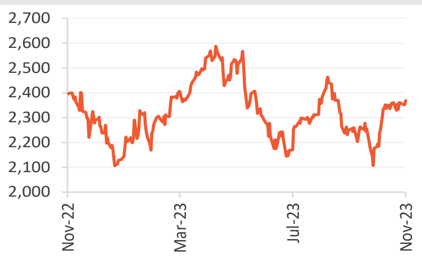
Company details

Market cap:	Rs. 70,205 cr
52-week high/low:	Rs. 2,637/2,050
NSE volume: (No of shares)	5.1 lakh
BSE code:	503806
NSE code:	SRF
Free float: (No of shares)	14.66 cr

Shareholding (%)

Promoters	51
FII	20
DII	14
Others	16

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.9	0.5	-6.3	-1.1
Relative to Sensex	3.0	-2.9	-13.3	-7.0

Sharekhan Research, Bloomberg

Summary

- The management indicated that worst seems to be behind in terms of global destocking in agrochem space and expect normalcy to resume soon with signs of recovery from Q4FY24. It sounded optimistic of strong medium -to-long term growth in fluorospecialty; 6-7 AIs under pipeline; Pharma revenue share target at 15-20%.
- HFC phase outs in developed countries would firm up HFC prices, which bodes well for recovery in ref-gas. Next leg of growth would be driven by capacity addition for HFOs and expect capex to start by 2025-26 as the patents would start expiring from 2026-2027.
- Packaging film business would continue to see pricing/margin pressure given demand-supply imbalances. Focus on VAP and thus recently announced capex to set-up capacitor-grade BOPP film line.
- SRF remains focused on its growth and is committed on its capex plan of Rs15000 crore (announced earlier). We maintain our Buy rating on SRF with an unchanged PT of Rs. 2,745. At the CMP, the stock trades at a reasonable valuation of 23x its FY2026E EPS.

We met the senior management of SRF Limited to understand the business outlook and growth plans. The management sounded optimistic about a recovery from Q4FY24 and is committed to its earlier announced medium-term capex plan of Rs. 15000 crore. SRF's focus on fluoropolymers space, HFOs and new AIs (6-7 for agrochemical), ramp-up of pharma business and introduction of VAP in packaging film would provide platform for sustainable strong growth over medium-to-long term. China+1 and Europe+1 theme provides ample long-term growth opportunities. We maintain our Buy rating on SRF.

- **Ref-gas and new Fluoropolymers (FP) – phase outs of HFCs bode well for price; focus on PTFE ramp-up and new FPs:** Phase-outs of HFCs in the developed market with production and consumption cut for high GWP HFCs from January 2024 would mean huge production cut from China and the US. On the other hand, replacement demand for HFCs would remain and thus overall global HFCs demand to largely remain flat, while production is anticipated to be lower. Management highlighted that phase outs (CFCs and HCFC) had an inverse co-relation to prices historically and thus HFCs price would gradually start firming up due to supply shortages with implementation of production cuts. The situation would play out well for SRF by HFCs sales in India, ME, Thailand and the US. HFCs quota for India will be determined during CY24-26 and thus production cuts would be seen from CY2027. SRF expects next capex cycle to be for Hydrofluoroolefins (HFOs) as the developed countries would transition towards the same and plans to announce HFO capacity capex from FY25-26 as the patents would start expiring from 2026-2027. SRF has recently commissioned PTFE plant and initially would focus on commodity grade PTFE and plans to soon move to produce value added products (already made some investment in VAP assets). The company expects huge growth opportunities in fluoropolymers given large import substitution opportunity (India imports 60% of its PTFE requirement). SRF is on track to move to a new range of fluoropolymers like PVDF, FKM and FEP post stablisation of PTFE plant.
- **Fluorospecialty – Expect recovery from Q4FY24; pharma revenue share target of 15-20%:** SRF believes that the industry seems to be largely behind the worst phase of global destocking (was due to higher supplies and rationalisation of purchase decision given high global interest rate) in the agrochemical space and expects normalcy to resume soon although it seems difficult to provide exact timeline for the same. SRF expects a recovery in the segment from Q4FY24 onwards and is optimistic of sustaining strong growth. SRF is working on 6-7 AIs for agrochemicals which has global market opportunity of >Rs. 4000 crore and the company plans to set-up either dedicated plants or MPPs if things work out as per its plan. SRF targets to take pharma revenue to 15-20% in next five years versus 8-9% currently.
- **Packaging film – Margins to stay weak; announced new investment on Capacitor Grade BOPP Film line:** BOPET segment will continue to see pricing/margin pressure given weak demand amid excess global supply. SRF is focused to manufacture VAP products and in line with that the company has recently announced investment of Rs. 275 crore at Indore for establishing a dedicated Capacitor Grade BOPP Film line, which will cater to the demand emerging from manufacture of electronics and EV sector in India.

Our Call

Valuation – Maintain Buy on SRF with an unchanged PT of Rs. 2,745: Although there are short-term concerns on inventory rationalisation in the agrochemical space, SRF is a quality player (strong collaboration with innovators and dedicated customer contracts) and hold strong long-term earnings growth prospects, given the support of China plus one strategy by global players. We believe the recent weakness in SRF's stock price is a good opportunity for the investment to accumulate the stock. Investment in the right areas of specialty chemicals would drive a 14% PAT CAGR over FY2023-FY2026E along with healthy RoE/RoCE of 19.6%/19.8%. At CMP, the stock trades at a reasonable valuation of 23x its FY2026E EPS. Hence, we maintain our Buy rating on SRF with an unchanged price target (PT) of Rs. 2,745.

Key Risks

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

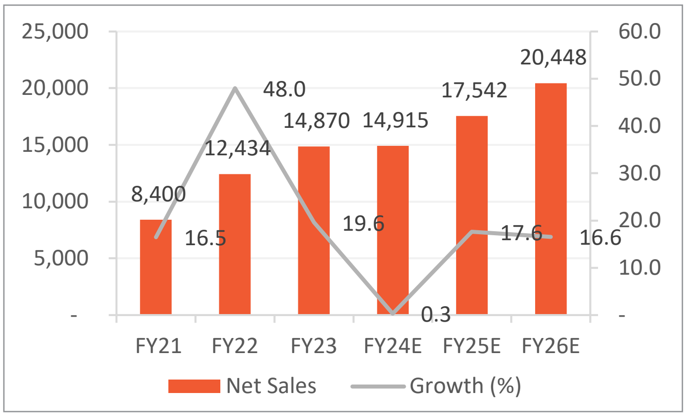
Valuation (Consolidated) Rs cr

Particulars	FY23	FY24E	FY25E	FY26E
Revenues	14,870	14,915	17,542	20,448
OPM (%)	23.7	21.4	24.3	25.6
Adjusted PAT	2,113	1,773	2,346	3,093
% y-o-y growth	12.9	(16.1)	32.3	31.9
Adjusted EPS (Rs.)	71.3	59.8	79.1	104.4
P/E (x)	32.6	39.7	30.0	22.8
P/BV (x)	6.8	5.9	4.9	4.1
EV/EBITDA (x)	20.9	23.2	17.6	13.8
RoCE (%)	20.9	15.7	17.7	19.8
RoE (%)	22.9	15.9	17.8	19.6

Source: Company; Sharekhan estimates

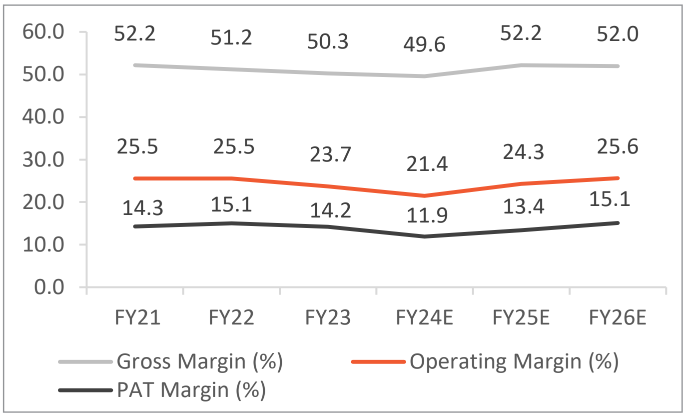
Financials in charts

Scalable and sustainable revenue growth



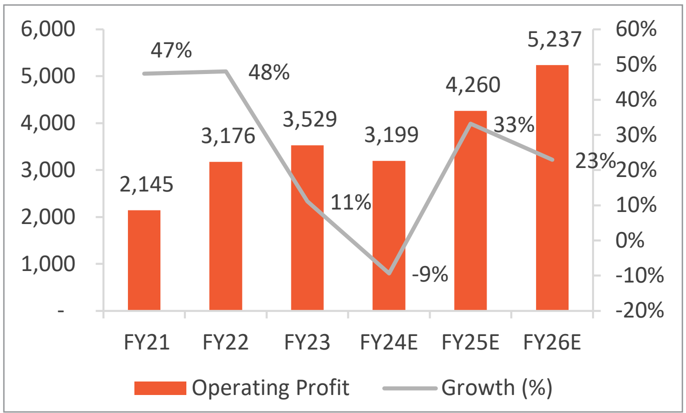
Source: Company, Sharekhan Research

Consistent strong margin profile



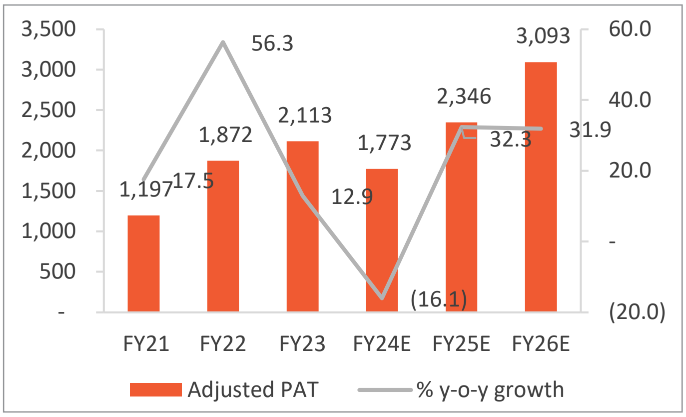
Source: Company, Sharekhan Research

EBITDA to clock 14% CAGR over FY23-26E



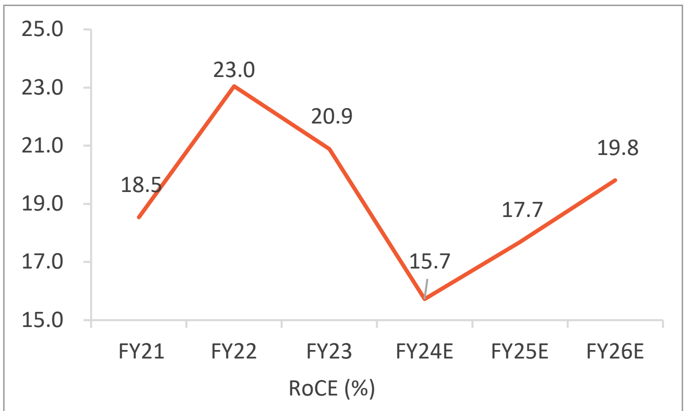
Source: Company, Sharekhan Research

PAT to clock 14% CAGR over FY23-26E



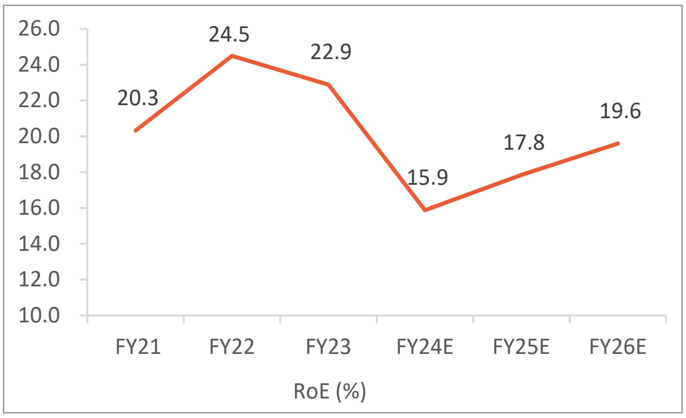
Source: Company, Sharekhan Research

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 the 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.

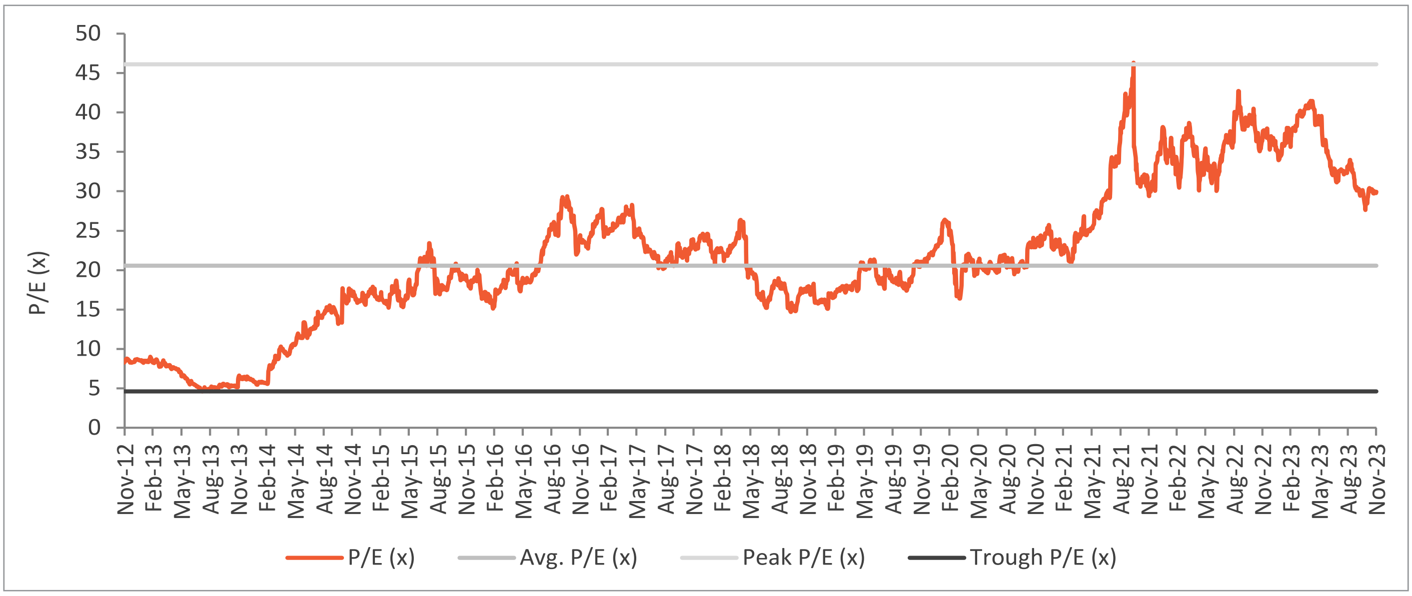
■ Company outlook - Near-term concerns transitionary; capex-led growth story intact

Management indicated near-term concern 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 US) 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 would improve earnings quality and safeguard from cyclical packaging film margins.

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

Although there are short-term concerns on inventory rationalisation in the agrochemical space, SRF is a quality player (strong collaboration with innovators and dedicated customer contracts) and hold strong long-term earnings growth prospects, given the support of China plus one strategy by global players. We believe the recent weakness in SRF's stock price is a good opportunity for the investment to accumulate the stock. Investment in the right areas of specialty chemicals would drive a 14% PAT CAGR over FY2023-FY2026E along with healthy RoE/RoCE of 19.6%/19.8%. At CMP, the stock trades at a reasonable valuation of 23x its FY2026E 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) 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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Kotak Mahindra Asset Management Co	3.99
2	Amansa Holdings Pvt Ltd	3.54
3	FMR LLC	2.2
4	Vanguard Group Inc/The	1.93
5	BlackRock Inc	1.6
6	Life Insurance Corp of India	1.13
7	SBI Life Insurance Co Ltd	1.06
8	FIL Ltd	0.99
9	ICICI Prudential Life Insurance Co	0.77
10	HDFC Asset Management Co Ltd	0.72

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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