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3R MATRIX			
	+	=	-
Right Sector (RS)	✓	■	■
Right Quality (RQ)	✓	■	■
Right Valuation (RV)	✓	■	■
+ Positive	= Neutral	- Negative	

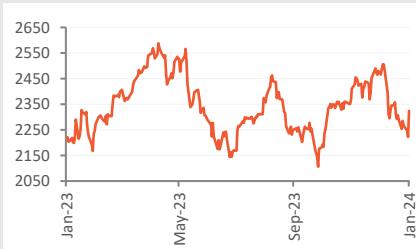
What has changed in 3R MATRIX		
	Old	New
RS	■	↔
RQ	■	↔
RV	■	↔

Company details

Market cap:	Rs. 68,888 cr
52-week high/low:	Rs. 2,637/2,050
NSE volume: (No of shares)	4.4 lakh
BSE code:	503806
NSE code:	SRF
Free float: (No of shares)	14.66 cr

Shareholding (%)

Promoters	51
FII	20
DII	15
Others	15

Price chart**Price performance**

(%)	1m	3m	6m	12m
Absolute	-5.8	3.0	3.2	4.6
Relative to Sensex	-5.1	-6.5	-4.7	-15.6

Sharekhan Research, Bloomberg

SRF Ltd**Weak Q3; recovery expected from Q4 onwards**

Specaility Chem		Sharekhan code: SRF		
Reco/View: Buy	↔	CMP: Rs. 2,324	Price Target: Rs. 2,745	↔
↑ Upgrade	↔ Maintain	↓ Downgrade		

Summary

- Q3 result was weak with a 12% miss in the consolidated PAT at Rs. 253 crore (down 16% q-o-q) due to continued headwinds of inventory rationalization for specialty chemical, pricing led margin pressure for ref-gas and challenging environment for packaging films.
- Chemical/packaging film/technical textile EBIT declined by 7%/42%/8% q-o-q to Rs. 322 crore/Rs. 45 crore/Rs. 69 crore in Q3FY24.
- Management indicated that Q4FY24 to be better as it has witnessed significant recovery in specialty chemical, expect ref-gas price to be more rational and sees traction in new molecules. SRF commissioned PTFE, HFC expansion, Aluminium foil facility and guided for capex of Rs. 2,000-2,200 crore for FY25.
- We maintain our Buy on SRF with an unchanged PT of Rs. 2,745. SRF is a quality player and its investment in specialty chemicals provides strong long-term earnings growth prospects. Valuation seems reasonable at 24x its FY2026E EPS.

SRF Limited's (SRF) Q3FY2024 results were weak with a miss of 7%/9%/12% in consolidated revenue/operating profit/PAT at Rs. 3,053 crore/Rs. 566 crore/Rs. 253 crore, down 4%/10%/16% q-o-q, due to subdued performance of the chemical and packaging film segment. Chemical segment's revenue/EBIT margins fell 2%/130 bps q-o-q reflecting headwinds for specialty chemical business due to continued inventory rationalization and lower realization for ref-gas in seasonally weak quarter. Packaging films segment continued to see margin pressure given oversupply of BOPET and thus its EBIT margin shrunk by 277 bps q-o-q to just 4.1% while revenues were muted with 3% q-o-q de-growth. Technical textile performance was decent despite impact on Manali plant operations due to cycle led by improved domestic demand for NTCF.

Key positives

- Commissioned PTFE, HFC expansion and Aluminium foil facility.

Key negatives

- Subdued revenues and margin contraction for chemical/packaging film segments.

Management Commentary

- Specialty chemical business experienced improvement in the later part of the Q3FY24 which management expects to continue in coming months. In 9MFY24, the company has incurred around Rs. 1100 crore in capex with plan to capitalize an additional INR 700 crore in capex in Q4FY24.
- In fluorochemical space, despite weak performance, underlying demand for HFC remained strong and with significant traction coming from India, the Middle East and Southeast Asia. Management expects healthy demand coming from domestic passenger vehicle and Room AC market in CY2024.
- In packaging film space, the management expects demand-supply imbalance and margin pressure to continue in medium term.
- In technical textile segment, The management expects stable demand for NTCF, while domestic demand expected to remain strong for belting fabrics.
- For FY25, company plans to incur a capex of ~Rs. 2000-2200 crores with 80% expected to be spent on chemical business.

Revision in estimates – We have lowered our FY2024-26 earnings estimate to factor in 9MFY24.

Our Call

Valuation – Maintain Buy on SRF with an unchanged PT of Rs. 2,745: Although there are short-term concerns on HFCs and inventory rationalisation in the agrochemicals 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 (corrected sharply by 12% from its 52-week high of Rs. 2,637) is a good opportunity for the investment to accumulate the stock. Investment in the right areas of specialty chemicals would drive an 11% PAT CAGR over FY2023-FY2026E along with healthy RoE/RoCE of 18.9%/19%. At the CMP, the stock trades at a reasonable valuation of 24x 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 correction in product prices can affect revenue growth.
- Input cost price volatility might affect margins.

Valuation (Consolidated)

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Revenue	12,434	14,870	13,852	16,563	19,284
OPM (%)	25.5	23.7	19.7	24.4	25.5
Adjusted PAT	1,872	2,113	1,419	2,187	2,858
% y-o-y growth	56.3	12.9	(32.8)	54.1	30.7
Adjusted EPS (Rs.)	63.1	71.3	47.9	73.8	96.4
P/E (x)	36.6	32.0	48.7	31.6	24.2
P/BV (x)	8.1	6.7	5.9	5.0	4.2
EV/EBITDA (x)	22.6	20.5	26.8	18.3	14.6
RoCE (%)	23.0	20.9	13.1	17.0	19.0
RoE (%)	24.5	22.9	12.9	17.2	18.9

Source: Company; Sharekhan estimates

Key Conference call takeaways

Specialty chemicals business – Expect significant recovery in Q4FY24

- ◆ Specialty chemical business continuing to witness a tough environment due to ongoing inventory rationalization by certain key customers, though demand outlook remains strong in the medium to long term.
- ◆ Specialty chemical business experienced improvement in the later part of the Q3FY24 which management expects to continue in coming months.
- ◆ Company has Launched 3 new products in the Agro-vertical and has robust pipeline for new and complex products.
- ◆ The company has further diversified its raw material supply base.
- ◆ In 9MFY24, the company has incurred around Rs. 1100 crore in capex with plan to capitalize an additional Rs. 700 crore in capex in Q4FY24.

Fluorochemicals – Margin pressure; long-term growth intact

- ◆ In fluorochemicals business witnessed sluggish demand and pressure on margin mainly due to lower volumes and realizations, particularly in key global markets.
- ◆ Despite pressure weak performance, the underlying demand for HFC remained strong and with significant traction coming from India, the Middle East and Southeast Asia
- ◆ Management expects healthy demand coming from domestic passenger vehicle and Room AC market in CY2024.
- ◆ Focus on ramp-up of newly commissioned PTFE and R32 plants.

Packaging films – Margin pressure to continue

- ◆ Packaging business continued to face supply overhang which resulted in pressure on margins. Going ahead, management expects demand-supply imbalance and margin pressure to continue in medium term.
- ◆ Company is facing persistent competition from Chinese players Southeast Asia which is expected to continue going forward.
- ◆ Recent conflict in Red Sea crisis has led to longer shipping cycles, which can potentially create demand for local new suppliers.
- ◆ Company has successfully commenced operation in phase 1 of its Aluminium foil facility on January 1, 2024. The company incurred capex of around Rs. 536 crore in building this facility. This facility has a high precision drilling mill which will enable company to produce premium products in thinner gauges and wider widths.

Technical textiles – Stable demand for NTCF

- ◆ Manali plant operations got impacted in December 2023 due to Cyclone Michaung, however operations largely resumed by the end of January.
- ◆ Despite the impact on Manali operations, technical textiles business reported a healthy performance in Q3FY24 driven by an uptick in domestic demand for NTCs.
- ◆ Management expects stable demand for NTCF, while domestic demand expected to remain strong for belting fabrics.

Other Businesses

- ♦ In Coated fabrics segment witnessed strong demand which is expected to remain stable going forward.
- ♦ Laminated fabrics segment continue to witnessed oversupplied market, however management expects steady sales in the upcoming quarter

Others

- ♦ For FY25, the company plans to incur capex of ~Rs. 2000 – 2200 crores with 80% expected to be spent on chemical business and rest on others.

Results (Consolidated)

Particulars (Rs. Cr)	Q3FY24	Q3FY23	YoY (%)	Q2FY24	Rs cr QoQ (%)
Revenue	3,053	3,470	(12.0)	3,177	(3.9)
Total Expenditure	2,487	2,636	(5.6)	2,551	(2.5)
Operating profit	566	834	(32.1)	626	(9.6)
Other Income	19	10	87.3	29	(35.6)
Depreciation	169	151	12.1	161	4.8
Interest	67	62	8.7	79	(15.0)
PBT	348	631	(44.8)	415	(16.0)
Tax	95	120	(20.9)	114	(16.8)
Reported PAT	253	511	(50.4)	301	(15.7)
Reported EPS (Rs.)	8.5	17.2	(50.4)	10.1	(15.7)
Margin (%)			YoY (BPS)		QoQ (BPS)
OPM	18.5	24.0	(549)	19.7	(118)
NPM	8.3	14.7	(642)	9.5	(117)
Tax rate	27.2	19.0	822	27.5	(25)

Source: Company, Sharekhan Research

Segmental performance (Consolidated)

Particulars	Q3FY24	Q3FY23	YoY (%)	Q2FY24	Rs cr QoQ (%)
Segmental revenue					
Technical Textiles	458	426	7.6	506	(9.4)
Chemical	1,394	1,757	(20.6)	1,426	(2.3)
Packaging Film	1,091	1,203	(9.3)	1,122	(2.8)
Others	114	92	23.0	127	(10.5)
Total	3,057	3,478	(12.1)	3,181	(3.9)
Inter Segment	4	8	(53.7)	3	6.1
Net Revenue	3,053	3,470	(12.0)	3,177	(3.9)
Segmental EBIT					
Technical Textiles	69	34	101.2	75	(8)
Chemical	322	564	(42.9)	348	(7)
Packaging Film	45	119	(62.2)	77	(42)
Others	21	9	132.1	33	(35.9)
Total EBIT	457	726	(37.1)	533	(14.3)
EBIT Margin (%)					
Technical Textiles	15.0	8.0	698	14.8	20
Chemical	23.1	32.1	(902)	24.4	(130)
Packaging Film	4.1	9.9	(575)	6.9	(277)
Others	18.7	9.9	878	26.1	(741)
Overall EBIT margin	15.0	20.9	(596)	16.8	(182)

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 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 rise in exports given China Plus One strategy followed by global customers and a favourable government policies (such as tax incentives 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 report a high double-digit earnings growth trajectory on a sustained basis in the next 2-3 years.

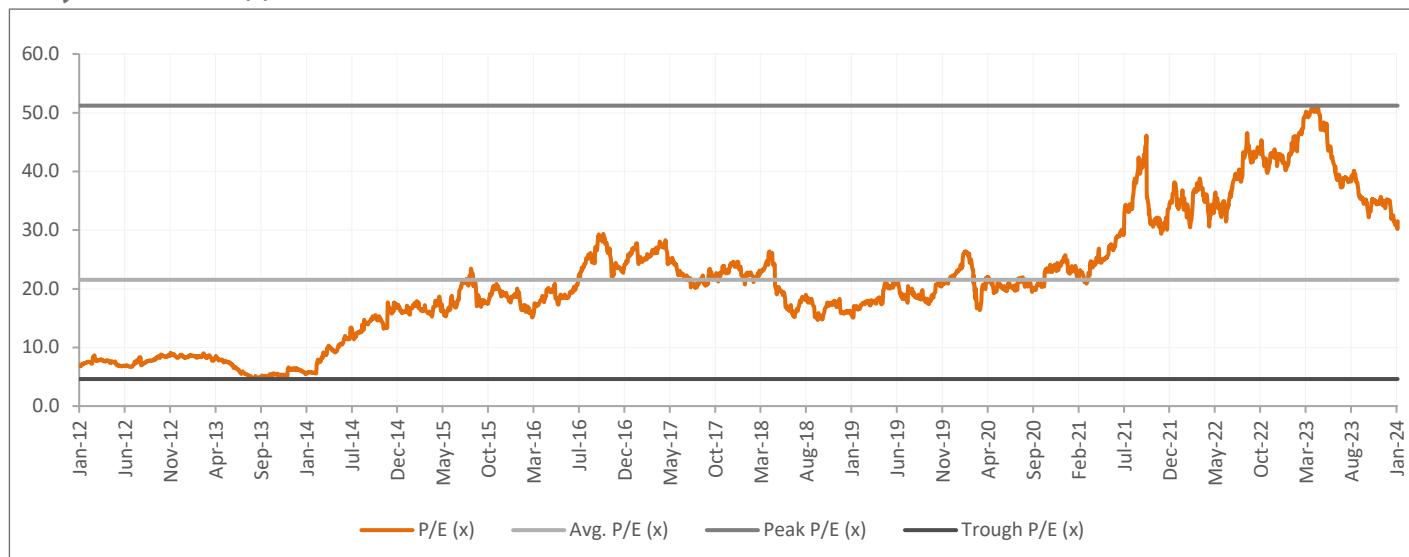
■ Company Outlook – Near-term concerns seem transitional; capex-led growth story intact

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, the management sees strong global demand (especially in the U.S.) for HFCs. High capital intensity toward specialty chemicals makes us confident about the long-term revenue/earnings growth of SRF. Moreover, investment in the right areas of the specialty chemicals 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

Although there are short-term concerns on HFCs and inventory rationalisation in the agrochemicals 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 (corrected sharply by 12% from its 52-week high of Rs. 2,637) is a good opportunity for the investment to accumulate the stock. Investment in the right areas of specialty chemicals would drive an 11% PAT CAGR over FY2023-FY2026E along with healthy RoE/RoCE of 18.9%/19%. At the CMP, the stock trades at a reasonable valuation of 24x 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
Prashant Yadav	President and CEO, Fluorochemicals Business & Technical Textiles
Anurag Jain	President and CEO, Specialty Chemicals Business & Chemicals Technology Group
Prashant Mehra	President & CEO, Packaging Films Business, Coated & Laminated Fabrics Business
Rahul Jain	Chief Financial Officer
Rajat Lakhpal	Company Secretary and Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Kotak Mahindra Asset Management Co	3.92
2	Life Insurance Corp of India	2.18
3	FMR LLC	1.97
4	Vanguard Group Inc/The	1.91
5	BlackRock Inc	1.69
6	Mirae Asset Global Investments Co	1.3
7	FIL Ltd	1.12
8	SBI Pension Funds Pvt Ltd	0.75
9	HDFC Asset Management Co Ltd	0.72
10	FundRock Management Co SA	0.65

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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