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On a strong footing, but expectations higher

CHEMICAL REACTION. With sufficient growth levers, risk-reward is balanced at the current juncture for SRF

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We had recommended investors to accumulate SRF in June 2023 when the outlook was tough, but valuations appeared to factor some of the headwinds. While the stock has returned a modest 15 per cent in this period, the company has weathered the headwinds, and is now on a stronger footing. But the stock is now trading at 44/34 times one-/two-year forward earnings. This premium multiple is on earnings, which are expected to grow 57/29 per cent year-on-year in FY26/FY27.

While the company has sufficient growth levers, the weight of expectations, which appear to have factored optimistic growth prospects, imply risk-reward is balanced at the current juncture. Investors with a long-term perspective can continue to hold, while new investors need to wait for better entry points.

The company is recovering from an elongated inventory destocking that lasted from FY25 in its chemicals segment. Chemicals segment is composed of speciality chemicals (58 per cent in FY25) and fluorochemicals (42 per cent).

The speciality chemicals segment, which manufactures agro-chemical intermediaries – primarily for patented molecules in export markets – faced destocking but it is gradually easing. The segment has launched five new agro-chem intermediates and three new pharma intermediates in FY25, which is supplementing the ongoing recovery.

Along with a few more approvals received in Q1FY26 and the ramp-up of products launched last year, the sector is expected to fare strongly in FY26. The company has invested in capacity building earlier for the segment, and continues the same with ₹250-crore agrochem facility announced in Dahej.

The fluorochemicals segment is composed of refrigerant gases and fluoropolymers. In the US market, refrigerant gases are now under a quota regime to limit the impact of these gases on the environment. The company has a stable position even in the current quota regime, and the outlook is balanced for the company.

Domestically, the current season has seen RAC (room air conditioners) sales slowing, which could be a headwind. The demand from West Asia and other markets aided the company to overcome the domestic slowdown in Q1FY26. The company has built a strong refrigerant gases capacity and supplemented it by adding capacity for AHF (critical intermediate for refrigerant gases), which witnessed commercialisation of a third line. This should allow for higher volume sales of these gases in FY26.

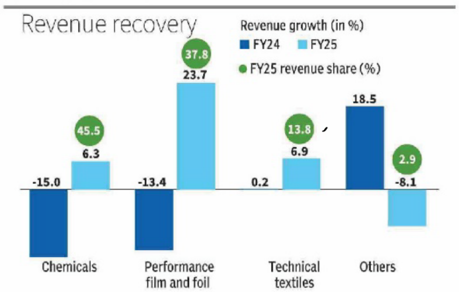
SRF has developed and launched R467A refrigerant gas, which has received American certification, and has a low global warming potential.

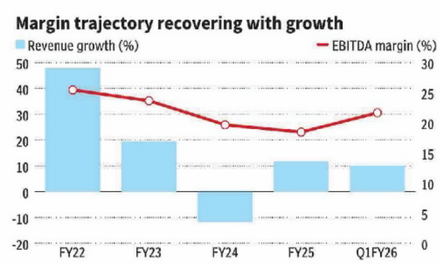
The ramp-up of the same will also support sales in the segment. The company has also commissioned a ₹1,100-crore facility to develop next generation of refrigerant gases to be operational in the long run.

Fluoropolymers or PTFE (Polytetrafluoroethylene) is the other growth avenue for SRF. Commodity-grade and speciality-grade sales have started domestically. And for the export segment – which will be the main driver – the speciality grade is under client approval process. The company expects significant traction from FY26. In a strong boost last week, SRF and NYSE-listed chemical player Chemours announced a strategic partnership, under which SRF will supply fluoropolymers and fluoroelastomers from its Dahej plant starting next year.

While the quantum, grade (advanced or commodity) and capex needed are unknown, SRF has started a supply line with an international major, which is a strong start to the fluoropolymer segment.

Overall, the company is aiming for a 20 per cent year-on-year growth in the chemicals segment, aided by new products and better pricing scenario.





◉ HOLD

SRF ₹2,916.10

WHY

- Chemicals and Performance films on growth path
- Strong expansion in margins
- Premium valuations factor optimistic growth prospects

PERFORMANCE FILM

Performance film and foil business (PFFB) faced cyclical overcapacity and slower growth. The cycle seems to be turning to the benefit of the company. Domestically, a recent fire accident at the facility of another film company will keep supplies tight, weeding out over-capacity. The company has initiated a ₹490-crore capex in the value-added segment to drive further growth. SRF has also added an aluminium line. Introduction of anti-dumping duty against cheaper Chinese imports should aid the segment.

Technical textiles are facing weak demand in belting fabrics and increasing competition from China, which is adding to the pricing pressure. While the other two segments have overcome cyclical downturn, technical textiles still seems to be under pressure.

FINANCIALS, VALUATION

With the recovery in leading segments — chemicals and PFFB, along with better pricing and better input material costs, EBITDA margins are expected to recover strongly in FY26. The first quarter of FY26 reported a 430-bps EBITDA margin improvement year on year. Both chemicals and PFFB reported an average 500-bps improvement in EBIT margins in the quarter, even as technical textiles margin were subdued.

The company has a modest debt position of 1.2 times net debt to trailing 12-month EBITDA. On the capex front, the company is eyeing a capex of ₹2,500 crore in FY26.

As mentioned, estimates are factoring high growth in earnings. A mid-teens revenue growth is likely over the next two years – powered by growth in chemicals and PFFB, partially offset by technicals. Margin expansion of 200 bps can power 18-20 per cent earnings growth for the next two years.

For the high 40 per cent earnings growth expected by the consensus, besides benefits from strong capacity expansion and favourable pricing in domestic and international markets, business growth has to be a high de-leveraging exercise (lower interest costs) as well. Existing investors must monitor these variables.

While growth prospects are good, execution risks in meeting the expectations are high. The valuations at 44 times FY26 earnings factor the high expectations.