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Journalist: Ram Prasad Sahu

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SRF earnings likely to remain robust

But gains from multiple triggers are factored in the valuation

RAM PRASAD SAHU
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The stock of SRF, the country's largest specialty chemicals maker, rose 4.6 per cent intraday on Tuesday after the management indicated expectations of a strong second half of financial year 2021-22 (H2FY22) for each of its key segments of chemicals, packaging films, and technical textiles.

This comes after strong September quarter (Q2) results — the company reported a consolidated revenue growth of 35.1 per cent with growth broad-based across segments.

Though the stock gave up some gains on Wednesday, most brokerages remain positive about its earnings trajectory over the next two years. The other trigger for the stock is its inclusion in the MSCI India Index from December 1, which should lead to higher inflows in the stock.

Among key segments, the chemicals business is the largest, accounting for 40 per cent of its revenues. Within the segment, the refrigerant business has benefited from higher volumes and improved realisations. The company had recorded higher sales from the international segment in Q2. Given its expertise in newer generation refrigerants, the backward integration to chloromethanes gives it a cost advantage that will be difficult to match, according to IIFL Research.

As a result, volumes are expected to be higher in H2 compared with H1. This coupled with capacity additions would lead to higher growth over the next 2-3 years. Half of the ₹2,000 crore capital expenditure in FY22 is expected to be deployed in the refrigerant business.

In the specialty chemicals business (agrochemicals and pharmaceutical intermediates) the company expects growth to be in the 15-20 per cent range over next few years, with a rise in the share of the pharma business. The overall chemical business saw revenue grow 28 per cent in Q2, with margins expanding 250 basis points (bps) year-on-year.

Though the packaging business (37 per cent of revenues) saw strong growth in Q2 with revenues rising by 28.7 per cent, margins came under pressure declining by a sharp 1,290 bps YoY. This was due to capacity additions and weak demand in BOPET (polyester) films, which are used in printing and coating applications.

While demand has picked up in Q3, given significant capacity additions, the Street will keep an eye on the impact of the same on growth.

In technical textiles, the smallest of the key segments, increased demand from the tyre sector and reopening of the mining sector led to higher sales of products like nylon tyre cord and belting fabrics. The segment saw 68 per cent growth YoY in Q2. Closure of capacities in China and lower prices offer the company legroom to hike prices and boost realisations.

Analysts at Sharekhan Research, who have maintained their FY22-24 earnings estimates, expect earnings growth to be driven by chemicals and technical textiles, while volume growth in packaging film is expected to offset lower margins. Earnings growth is expected to be strong at over 30 per each for FY22 and FY23, but the 67 per cent rise in the stock over the last six months factors in these gains. Investors can look at the stock on dips.

STEADY MARGIN

	Net sales (₹ crore)	Change YoY (%)	Ebitda margin (%)	Net margin (%)
FY20	7,418.7	-3.6	18.5	13.7
FY21	8,402.3	13.3	25.3	14.3
FY22E	10,501.2	25.0	24.0	14.4
FY23E	12,416.6	18.2	25.0	15.4

E: Estimates

Source: Company, Anand Rathi Research

SUM-OF-THE-PARTS VALUATION (Figures in ₹)

Segment	EV/share
Chemical and polymer	1,917
Technical textile	112
Packaging film	318
others	8
Total EV/share	2,355
Target price per share	2,265
Current market price	2,167
Upside (%)	4.5

EV: Enterprise value
Source: IIFL Research