SRF
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Twin engines of demand, pricing propel SRF stock

Gains in chemicals business from exports and expanding product portfolio

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CHEMICALS SEGMENT MAJOR GAINER

Q3FY22 segment performance	Revenue (₹ crore)	change % Y-o-Y	Margins* (%)	change Y-o-Y bps
Technical textile	538	47	21	200
Chemicals and polymer	1,428	58	29	839
Packaging films	1,276	59	20	-600
Others	107	45	8	-300
Total	**3,349**	**56**	**24**	**400**

bps: basis points; * Segment or earnings before interest and tax margins
Source: JM Financial

The country's largest specialty chemicals company SRF is benefiting from the twin triggers of increased demand and higher pricing. This was reflected in the October-December quarter performance which beat estimates across all parameters. Led by 58 per cent rise each in sales of chemicals and polymer and packaging segments, consolidated revenue grew 56 per cent year-on-year (YoY).

The incremental gains from the chemicals business, which accounts for 43 per cent of revenue, came from the domestic market, exports, and an expanding product portfolio. Growth in the business was led by refrigerants, specialty chemicals, and chloromethane, with refrigerants benefiting from higher volumes and realisations.

Ritesh Gupta and Prasenjit Bhuiya of Kotak Institutional Equities believe that growth in refrigerants will be led by volumes from higher domestic air conditioner manufacturing, with a strong season expected after two consecutive years of lockdowns and entry into geographies like the US.

Realisations are expected to improve due to imposition of the anti-dumping duty by India and the US (Chinese imports) and higher product demand in export markets. The beat on the operating performance was also led by the chemicals business, which accounted for half of the operating profit. Segment margins for the chemicals business were up 839 basis points (bps) YoY and 706 bps quarter-on-quarter to 29.4 per cent. Higher prices in refrigerant gases and chloromethane boosted overall margins in the chemicals business, according to analysts at Edelweiss Securities.

In the packaging business (38 per cent contribution to revenue), volume growth was led by additional capacities in Hungary and Thailand, which came on stream. Strong demand for biaxially oriented polypropylene films helped expand margins in the segment on a sequential basis by 317 bps to 19.9 per cent. However, on a YoY basis, profitability was down due to additional supply in the international market.

Technical textile business, too, posted good growth, led by belting fabrics and polyester industrial yarn, although the nylon tyre cord fabric segment disappointed. The company indicated that demand from automakers continues to be weak due to degrowth in the automotive industry. Margins for this business fell on a sequential basis.

Given the third-quarter performance and strong near-term outlook for key segments, most brokerages have raised their 2021-22 earnings by up to 13 per cent. Analysts at JM Financial have a 'Buy' rating and believe that higher contribution from the chemicals business is likely to improve overall earnings growth.

Moreover, the addition of pharmaceutical products in the specialty chemicals division should help offset the cyclicality of agrochemicals, they add.

Axis Securities analysts, led by Ankur Periwal, also say that SRF's operating profit mix is undergoing a significant change on the back of expected strong growth in the chemicals business, coupled with normalisation in the packaging film business, which will drive significant shift in its profit contribution over 2020-21 through to 2023-24 and drive stock rerating.