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Journalist: Ram Prasad Sahu
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THE COMPASS

Demand drivers remain strong for SRF's chemicals business

Firm has increased capex to tap into new opportunities

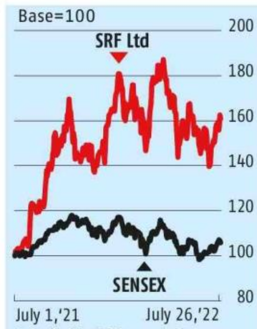
RAM PRASAD SAHU

Even as the benchmark indices traded in the negative territory — going down close to 1.5 per cent over two days — specialty chemicals major SRF gained over 4 per cent in trade and was the top gainer in the BSE 100 basket, on Monday. On Tuesday the stock was relatively flat at ₹2,364.

The gains came on the back of a better-than-expected June quarter (Q1) show of the 2022-23 financial year (FY23), led by the chemicals and packaging segments. While some brokerages have marginally cut their estimates due to margin pressures in the packaging segment for FY23, the robust demand trends in the chemicals business and expansions are expected to be positive for the stock in the medium term.

The management's bullishness on the chemicals business is reflected in the enhanced capital expenditure (capex) programme for FY23. The company is guiding for a capex of ₹3,100-₹ 3,300-crore, 75 per cent of this is allocated to the chemicals business. The earlier guidance for the company was of ₹2,500-2,700 crore and about 70 per cent was meant for the chemical space.

Abhijit Akella and Prasenjit Bhuiya of Kotak Institutional Equities believe these investments are consistent with management's belief that fluorospecialty revenues will more than double (over the next couple of years) as compared to the FY22 base of ₹3,100 crore. This is on the back of a positive traction in discussions with customers and any disruptions in the industry's operations in Europe may give rise to new opportunities, they add.



Compiled by BS Research Bureau

The chemicals segment, which accounted for 44 per cent of consolidated revenues, posted a 55 per cent growth in Q1FY23 to higher prices and volumes of refrigerant gases and steady performance in the specialty business.

Segment operating profit was up 2.3 times while margins expanded by 10 percentage points to 30.2 per cent as compared to Q1FY22. The company expects FY23 segment margins to be better than 27 per cent reported last year. Given the strong demand trends, the company expects refrigerant prices to be at elevated levels.

Motilal Oswal Research expects specialty chemicals to maintain its growth momentum with robust demand for the flagship product as well as new product additions. The brokerage has raised their FY23 earnings estimates by 10 per cent, given the higher than estimated segment profits across businesses.

The packaging films business, the second-largest by revenue, too saw strong growth with sales rising 45 per cent year-on-year (YoY). This was led by the ramp up in its Thailand plant and higher prices due to the increased raw material costs. While segment profits in the business were up 25 per cent YoY, the company expects fresh capacity additions to put pressure on spreads and there could be an inventory loss in the September quarter (Q2FY23) due to sharp drop in raw material prices.

While the medium term outlook remains strong, there could be revenue/margin pressures in the near term, given seasonal weakness, production-related issues and higher raw material costs.

Most brokerages have a 'buy' on the stock price, given the structural growth story in the fluorochemicals space. The price targets are in the ₹2,500-3,000 per share range, which, from the current levels, offers a return of 25 per cent at the upper end of the target band. Investors can consider the stock for the long term on corrections.