SRF
We always find a better way

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Scaling up on complexity

SPECIALITY CHEMICALS. Strong momentum in chemicals outweighs headwinds for SRF

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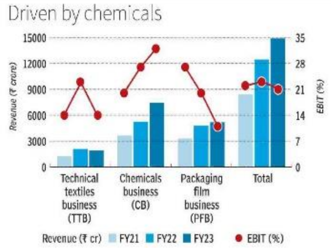
SRF is the largest speciality chemicals company in India. In line with 'high growth phase' of the segment, the company reported revenue/EPS growth of 22/35 per cent CAGR in the last five years. Strong domestic demand, increased traction from export clients and India becoming an alternate supplier to China have supported the segment, and the company.

With new products from a larger manufacturing base and higher traction from existing and new clients, the company should sustain high growth in its largest segment (chemicals) while retaining margins. The other two segments have faced structural headwinds with contraction in revenue base, and are expected to fare comparatively better in the medium term. We
1 recommend that investors accumulate the stock, currently trading at 30/25 times FY24/FY25 earnings.

SRF operates three main segments, led by chemicals business (CB 50 per cent of FY23 revenues). This has the speciality chemicals business supplying active ingredients and complex molecules to innovator agrochemical clients (80-85 per cent from innovators) and fluorochemicals segment.

Packaging films business (PFB 35 per cent) and Technical textiles business (TTB 13 per cent) are the other two segments.

Driven by chemicals



ACCUMULATE

SRF ₹2,512.00

WHY

- Strong momentum in chemicals business
- Two other segments facing structural headwinds
- Moderately higher valuations

CHEMICAL BUSINESS

The speciality chemicals business accounted for 57 per cent of CB in FY23. The division is gaining from increased traction from clients, who are expanding to further downstream and complex products. SRF has been able to put dedicated plants for such products. The future capex plans include seven plants for speciality chemicals, mainly in agrochemicals, which should be operational in FY24-FY25 (should add 10 per cent to the segment).

The existing base, with recently introduced products from a multi purpose plant, is also expected to ramp up and add to growth. SRF is expanding into pharma intermediates with a dedicated plant and is looking to expand into the pharma CDMO (contract development and manufacturing) space with high-value contracts by way of organic or inorganic additions.

Fluorochemicals business is mainly driven by refrigerant gases, which have gained from higher prices following anti-dumping duty in the US on Chinese supplies. Domestic sales have also gained from increased demand from ACs and automobiles.

The US market will face a 30 per cent cut in utilisation of these gases in view of an environmental phasedown. But the company expects the cut extending to production as well, should sustain its export potential. SRF will be adding a new facility by July-2023 for R-32 refrigerant gas.

SRF's pharma propellant Dymel and chloromethanes have also witnessed strong uptake with ramp-up expected in the latter's new dedicated plant. SRF entry into fluoropolymers is expected by H2FY24 with the commercialisation of PTFE. SRF intends to start with commodity grade product and later expand to higher grades. The company is also eyeing complex downstream fluoropolymers, including a plant under development at ₹595 crore, which should imply 10-12 per cent revenue contribution in FY25-26 to fluorochemicals.

SRF delivered 42 per cent revenue CAGR in FY21-23 in CB and expects to drive 20 per cent growth in FY24 as well. The segment's EBIT margin has expanded from 20 per cent to 31 per cent in the period, and SRF expects to maintain the elevated margins as it scales up in complexity and product mix.

PFB AND TTB

The two segments are facing structural headwinds, more so for PFB. Owing to higher installed capacity in PFB segment, domestically and internationally, the prices of packing films have declined significantly. The lower pricing should impact sales in the medium term, not only for SRF but for industry itself. With a low margin environment, closure of excess capacity is expected to aid SRF in the longer term.

SRF has also initialised aluminium packaging line (ramp-up in Q2FY24), which completes a full product range in packaging along with international presence for SRF which already operates a value added segments. The industry leading portfolio and support from other business should help SRF last longer in the industry when margin profile improves (EBIT margins declined 16.2 percentage points to 3.2 per cent in Q4FY23 for SRF).

The other segment, TTB, is facing lower demand for nylon tyre fabric which is expected to reverse in FY24 while belting fabric is doing well. SRF aims to focus on value-added products for growth.

FINANCIALS, VALUATION

Assuming an arrest in margin decline in the two segments with flat revenue growth in FY24, SRF should be able to drive low double-digit growth in FY24 EBIT profit, driven by chemicals business alone.

The industry-wide weakness should lead to reversals in the two segments in the longer run as well. The company intends to spend ₹2,500 crore in FY24 after a similar outlay in FY23 and expects to sustain such intensity in the medium term for chemicals segment.

The new venture into fluropolymers and pharma intermediates should aid the ongoing growth in chemicals base business (gases and speciality active ingredients) in the longer term. The company has a low leverage ratio of 0.93 times net debt to EBITDA and is expected to maintain the same even in expansion.