

Stellar Q3 Sets the Stage for SRF's Rerating

Shares surge 11% after the company reported 40% increase in revenue and 36% in PAT

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Mumbai: SRF is poised for a significant re-rating after the December quarter performance that points to a turnaround in the specialty chemicals business.

The management is confident that volumes in some of its businesses, such as fluoro-specialties and packaging films, will pick up from the current quarter and that the recently commissioned plant would aid the chemical business.

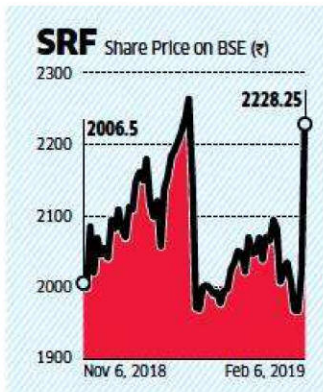
Shares of SRF surged 11% to ₹2,239 on Wednesday. SRF's revenue increased 40.6% to ₹1,964 crore. EBITDA grew 43% while PAT increased 36.5% to ₹157 crore. EBITDA margin expanded 30 bps YoY to 16.9% even as the gross margin contracted 480 bps YoY to 42.6%.

The consensus forecast from 15

analysts is extremely bullish, and EPS is estimated to rise to ₹139 over the next year from the current level of ₹107.

"We like SRF's ability to grow its earnings by aggressively re-investing its healthy operating cash flows along with a judicious mix of debt," said Ritesh Gupta, analyst, Ambit Capital. "The turnaround of the specialty chemicals business from the March quarter after a gap of three years is a key catalyst for the return ratios. While ROCEs will always be lower than peers, growth clearly will outperform."

The chemical division posted robust top-line growth of 46% as the chloromethane plant reached optimal utilisation along with volume and price-led growth in the specialty chemicals business. The management is confident of passing on input costs and of strong growth in the specialty chemical business, paced



by improved order visibility.

"The specialty chemicals segment – the only dampener in FY 2018 – has shown strong signs of revival," said Gautam Duggad, head of research,

Motilal Oswal Securities. "We value SRF with implied EV/EBITDA of 9.4x and implied PE of 15x and set a target price of ₹2,636."

Contrary to investor apprehensions, SRF has quadrupled its earnings over FY 2014-19 while improving ROEs to 18%. Aggressive investments into the existing businesses have led to lower ROE/ROCEs.

"R&D investments, the cornerstone of SRF's commendable success in the high entry-barrier specialty chemicals, have yielded handsome dividends. It filed 145 patents so far for R&D and technology, of which 19 have been granted," said Rohan Gupta, analyst, Edelweiss Securities. "With a strong products pipeline and focused capex of ₹2,500 crore to be incurred over the next three-four years, we expect the division to post strong revenue CAGR of 20% over FY18-20E, and catapult its revenue/EBITDA share."