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SRF seeks chemicals biz revival as earnings visibility dims

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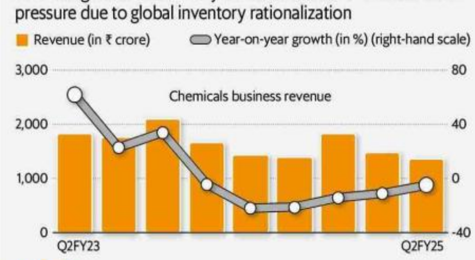
SRF Ltd's September quarter (Q2FY25) results drew a lukewarm response from the Street, with the underperformance in its core chemicals segment and muted growth in the packaging films business hurting investor sentiment. Consolidated Ebitda stood at ₹538 crore, down 13% year-on-year (y-o-y), and short of the consensus estimate of ₹631 crore.

SRF's chemicals segment, which contributed nearly half of revenue and three-fourths of Ebit in FY24, remains a drag on its earnings outlook. Segment revenue fell around 5%, compounding the 11% decline in Q1FY25. The fall was driven by inventory rationalization across consumer industries.

The global agrochemical industry has been under pressure due to elevated inventories and pricing challenges, exacerbated by surplus supply from China. While SRF's specialty chemicals saw some traction from new products, overall volumes were constrained by inventory issues. Thus, Ebit for this segment plunged nearly 30%, with margins shrinking sharply.



A drag

Revenue growth of SRF's key chemicals business remains under pressure due to global inventory rationalization

Source: Company, Motilal Oswal Financial Services

The management expects specialty chemicals business to slowly pick up in H2FY25 aided by a strong order book. Yet, it has not provided revenue and margin guidance for FY25.

According to JM Financial Institutional Securities, with prices bottoming out and chemicals Ebit margin similar to that in FY17-19, chemicals margin should improve.

Sales from packaging film business rose 27%, but Ebit grew just 7% as margin pressure persisted due to oversupply in some sub-segments. Technical textiles revenue grew 6% while Ebit fell 5%.

As a result, some brokerages cut earnings expectations. Nuvama Research cut its FY25/26/27 earnings per share estimates by 23%/11%/11%.

On the bright side, SRF continues to focus on capital investment and has a comfortable net debt-to-equity ratio of 0.4x. Its board has approved ₹1,100 crore to build a fourth-generation refrigerant plant, aimed at reducing greenhouse gas emissions. For FY25, SRF has outlined capex of ₹1,600-1,800 crore.

But for now, negatives overshadow these potential long-term positives. SRF's stock has declined about 8.5% so far in 2024, versus a 17% gain in Nifty500. *Bloomberg* data shows SRF's valuations are stretched at 43x FY25 earnings estimates. A turnaround in the chemicals business will be essential for reversing the stock's fortunes.