

March 25, 2013

BSE Code: 503806 NSE Code: SRF Reuters Code: SRFL.BO Bloomberg Code: SRF:IN

SRF Ltd (SRF), with presence in manufacturing chemical based industrial intermediates. The company was established in 1970. The company operates mainly in three business segments, namely, Technical Textiles Business (TTB), Chemicals and Polymers Business (CPB) and Packaging Films Business (PFB). SRF has also presence in the international market with operations spread across four countries - India, UAE, Thailand and South Africa. With a leading edge in-house R&D technology for Chemicals Business and Technical Textiles Business, the company continues to focus towards new product development to stay competitive in the market.

Investor's Rationale

SRF continues to enjoy dominant position in most of its segments of operation with market share of 36%, 40% and 60% in NTCF, chloromethane and refrigerant gases and belting fabrics respectively. SRF has successfully commissioned three projects at Dahej, Gujarat that includes flexible multipurpose plant for production of fluorochemicals, intermediate specialty plant; and first phase of captive power plant with a capacity of 4 MW with an investment worth ₹2,500 mn. The company is expected to derive value from new products manufactured at its Dahej facility from FY'13 onwards.

In order to de-risk its business portfolio, SRF is expanding capacities in the speciality chemicals, packaging films, laminated plastics and coated fabrics, which is likely to reduce its dependence on the Technical Textiles Business. and to achieve US\$ 1 bn revenue target by FY'14.

SRF has a superior in-house R&D, for process innovations and product development that placed the company at par with the global peers in fluorides business which requires a high level of expertise and experience. The company is actively engaged in development of many new molecules at its Bhiwadi and Chennai R&D centers.

SRF'S 9MFY'13 performance remains bleak due to sluggish demand and lower realisations in NTCF and PFB segment. Low CER monetisation during 9MFY'13 has also contributed to the decline in the net profits. We expect the company's performance to pick up from FY'14 due to the contribution from new chemical facilities at Dahej stabilised realisations in PFB segment and better demand for tyre cord business.

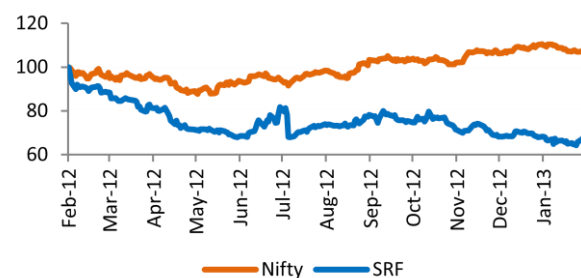
Market Data

Rating	BUY
CMP (₹)	166.05
Target (₹)	199
Potential Upside	~20.0%
Duration	Long Term
52 week H/L (₹)	264.9/164.4
All time High (₹)	444
Decline from 52WH (%)	37.3
Rise from 52WL (%)	1.0
Beta	0.9
Mkt. Cap (₹ bn)	9.8
Enterprise Value (₹ bn)	15.6

Fiscal Year Ended

Y/E	FY11A	FY12A	FY13E	FY14E
Revenue (₹bn)	34.7	40.0	36.8	40.5
Net Profit(₹bn)	4.8	3.8	2.4	3.2
Share Capital (₹bn)	0.6	0.6	0.6	0.6
EPS (₹)	80.0	64.1	41.5	54.1
P/E (x)	2.1	2.6	4.0	3.1
P/BV (x)	0.6	0.5	0.5	0.4
EV/EBITDA (x)	1.6	1.9	2.3	1.9
ROCE (%)	31.1	24.2	16.7	19.5
ROE (%)	28.5	20.5	12.0	13.9

One year Price Chart



Shareholding Pattern	Dec'12	Sep'12	Diff.
Promoters	50.7	50.7	-
FII	7.8	8.1	(0.3)
DII	12.7	12.8	(0.1)
Others	28.8	28.4	0.4

TTB continues to be SRF's largest business segment, contributing over 47.0% to the total sales of the company.

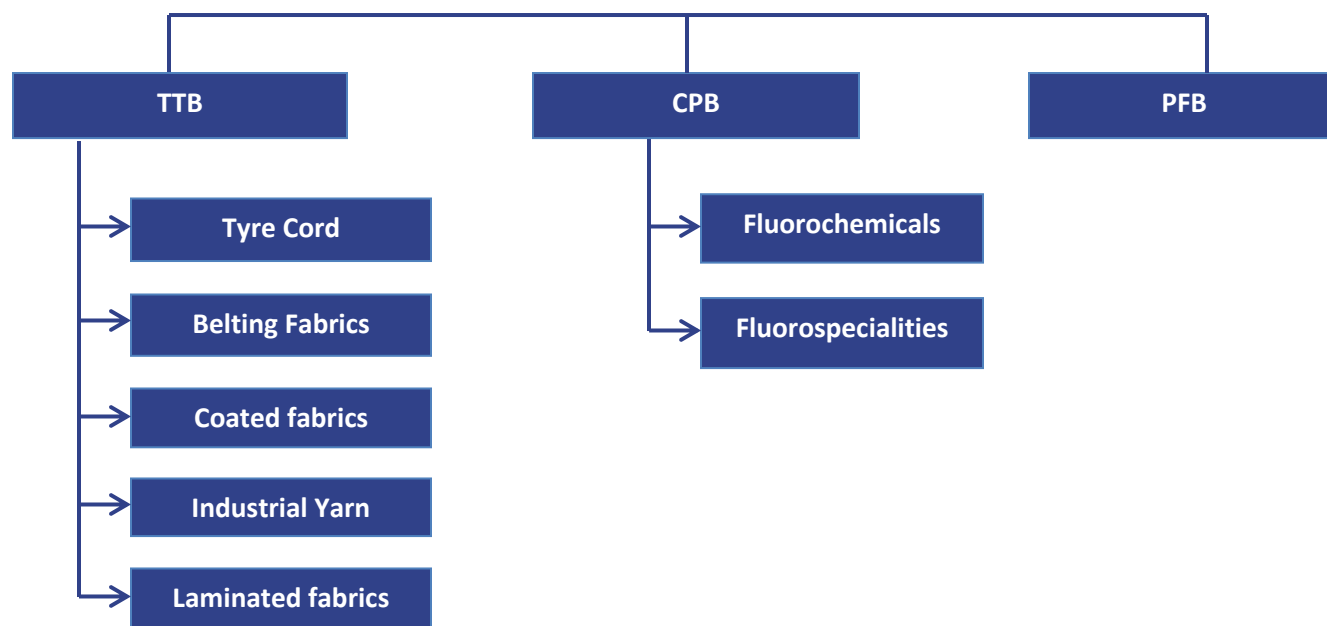
SRF ~ India's largest chemical based industrial intermediate manufacturer

SRF was established in 1970 as Shri Ram Fibres Ltd, by DCM group. It has a well-diversified business model, operating majorly in three business segments, namely, Technical Textile Business (TTB), Chemical and Polymers Business (CPB) and Packaging Film Business (PFB). The company's TTB enjoys a global leadership position, and also enriched as the domestic leader in Refrigerants, Engineering Plastics and Industrial Yarns. Reflecting 15.2% YoY growth at ₹16,652 mn in FY'12, TTB continues to be SRF's largest business segment, contributing over 47.0% to the total sales of the company. It includes three sub-segments, namely Nylon Tyre Cord Fabric (NTCF), Belting Fabric (BF) and Coated Fabric (CF). The NTCF segment of Technical Textiles Business, the largest business of SRF, and used as a reinforcement material in all categories of cross-ply tyres ranging from bicycle to heavy commercial vehicles and even airplanes. BF is used mainly in manufacturing industrial conveyor belts and other mechanical rubber equipment. CF is the nylon/polyester fabric coated with PVC. The CPB segment comprises of two sub-segments, namely, Fluoro-chemicals and Fluorospeciality business, engaged in manufacturing refrigerant gases, chloromethane and in manufacturing advanced intermediates required to manufacture Active Pharmaceutical Ingredients (API).

The company has also established its international presence in countries like UAE, Thailand and South Africa and also enjoys global leadership in some of its businesses

The company has reputed set of clients across business segments. TTB segment's clients includes major auto tyre OEM's like Apollo Tyres, CEAT, JK, Tyres, MRF Tyres. In white goods segment the company provides to LG, Electrolux, Whirlpool, Videocon and in pharmaceuticals key customers include Dr. Reddy's Laboratories, Ranbaxy and Morepen. PFB segment supplies to FMCG players like HUL, P&G and several regional players.

A well-diversified business entity



SRF continues to enjoy dominant position in most of its segments of operation with market share of 36%, 40% and 60% in NTCF, chloromethane and refrigerant gases and belting fabrics respectively.

SRF has successfully commissioned and capitalized three projects at Dahej in Gujarat during Q2FY'13 with an investment worth ₹2,500 mn.

SRF has invested heavily on other businesses like speciality chemicals, packaging films, laminated plastics and coated fabrics to de-risk its business portfolio.

Business strengths

Focused towards expansion: SRF has garnered the reputation of being the market leader in most of its segments of operation with market share of 36%, 40% and 60% in NTCF, chloromethane and refrigerant gases and belting fabrics respectively. In line with the strategy towards expanding beyond existing products, the company has diversified its presence and has marked its entry into PTCF business and is expected to further deepen its presence in this segment ahead. Besides, the company is developing fluorospecialty chemical pipeline to cash-in the burgeoning demand in the segment.

Superior in-house R&D: SRF has a superior in-house R&D, for process innovations and product development that placed the company at par with the global peers like DuPont, Bayer as it operates in fluorides business which requires a high level of expertise and experience. Its technical dominance has provided a level playing field to match up across other major tyre OEM players in the high specification NTCF market. Its chemical R&D division is actively engaged in development of many new molecules at its Bhiwadi and Chennai R&D centres. SRF has filed 8 new process patents as intellectual property during FY'12 taking the total number of patents to 20.

SRF's chemical business benefiting from the capacity expansion at Dahej plant

SRF has augmented its capacity at Dahej in Gujarat for Fluoro specialty chemicals and HFC-134A. The capacity expansion will augment growth for chemical business that will boost the revenue contribution from this segment in future. In July 2012, SRF has commissioned and capitalized three projects at Dahej, Gujarat that includes flexible multipurpose plant for production of fluorochemicals, intermediate specialty plant; and first phase of captive power plant with a capacity of 4 MW. The company has made a capex of ₹2,500 mn towards these projects. The company is expected to derive value from new products manufactured at its Dahej facility from FY'13 onwards. In addition, the investment in a new R-134a/125 plant in Dahej will come up at the end of FY'14.

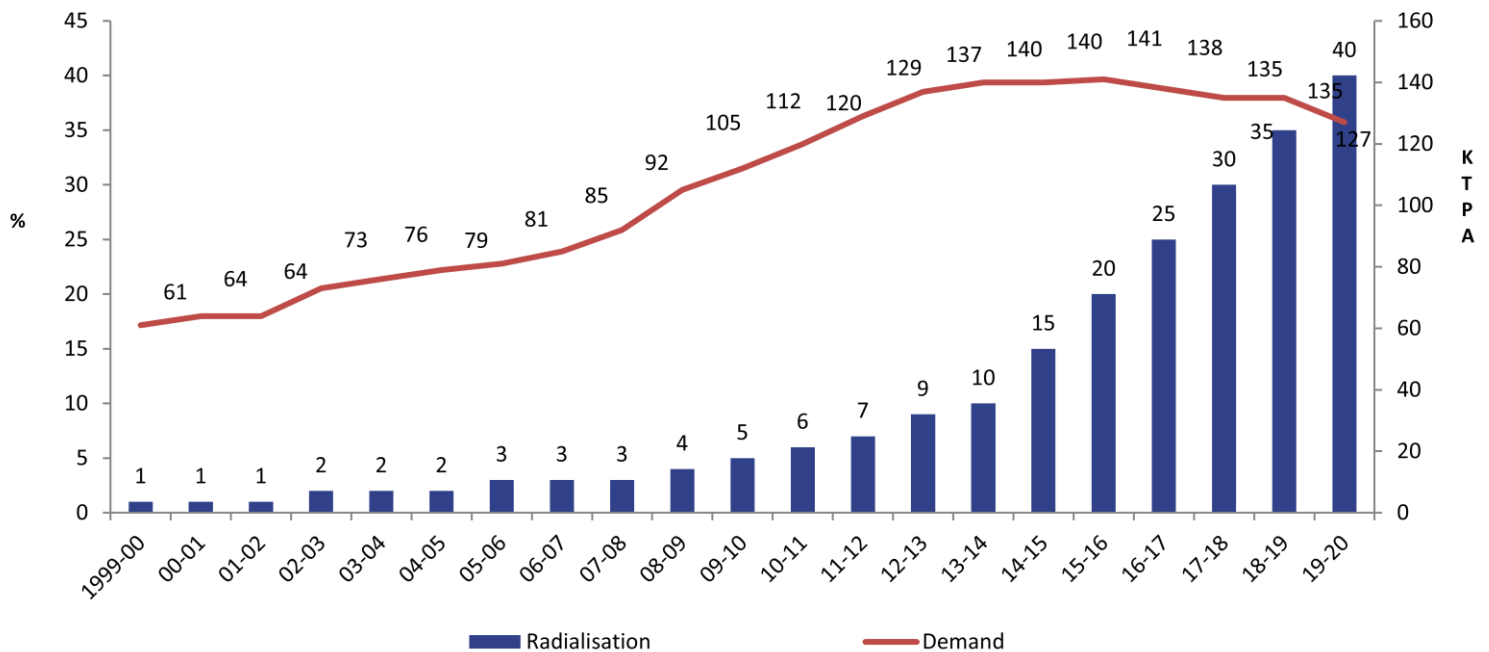
The investment in new plant reflects the company's strategy towards increasing its existing product basket for its R&D and knowledge-based fluorospecialties business. The products from the new plant will mainly find usage in the fields of agrochemicals, pharmaceuticals and performance products.

Remains focused towards diversification to de-risk its business

In a move towards de-risk its business portfolio, SRF is expanding capacities in the speciality chemicals, packaging films, laminated plastics and coated fabrics, which is likely to reduce its dependence on the Technical Textiles Business. The NTCF segment of Technical Textiles Business, the largest business of SRF, is witnessing slowdown in demand and margin pressure on account of significantly higher commodity prices, particularly for chemicals and energy costs and has primarily become a buyer's market. The diversification is a part of the company's strategy towards achieving US\$ 1 bn revenue target by FY'14 end by deepening its focus on the high growth potential businesses.

SRF is setting up two green field overseas plants for packaging films. One plant is being set up in South Africa with a capacity of 25,500 TPA to manufacture Biaxially Oriented Polyethylene Terephthalate film. While the other is coming up in Thailand with a capacity of 28,500 TPA to manufacture Biaxially Oriented Polypropylene film. Both the projects are expected to commence commercial production during FY'14. The plant in South Africa will mark its maiden entry into BOPP films and will also help it expand its portfolio geographically for packaging films. In addition, the company is also ramping up its new Coated Fabric plant that will help the Technical Textiles Business to reduce its dependence in Nylon Tyre Cord.

Tyre Radialisation vs. NTCF Demand



Slow demand and subdued price realisations hampered the Q3FY'13 performance. Lower EBITDA and forex losses impacted the net profit.

Q3FY'13 performance hampered by slowdown in demand and subdued pricing

SRF witnessed a moderate decline in its revenues by 6.3% YoY to ₹8,889 mn in Q3FY'13 on lower segmental revenue due to slowdown in demand. The revenue from TTB segment fell 7.0% YoY to ₹3,972 mn while the CPB segment revenues declined 5.0% YoY to ₹3,516 mn and the PFB segment sales declined 10.1% YoY to ₹1,410 mn.

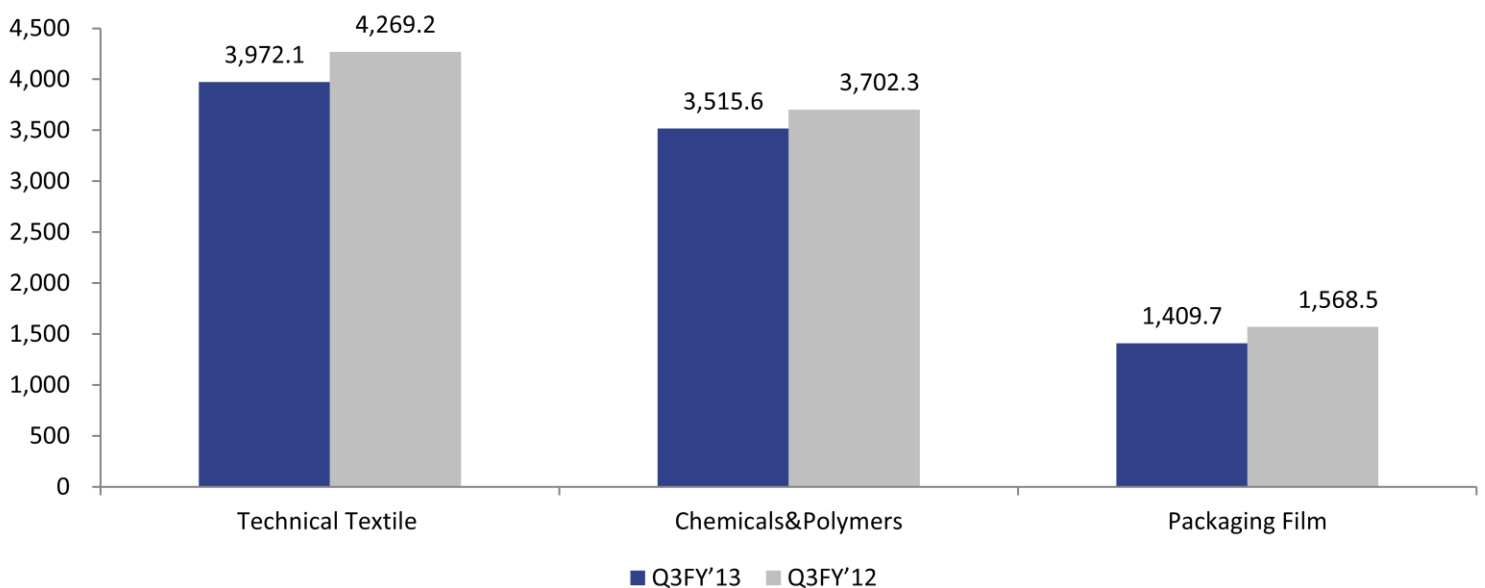
On the EBITDA front, lower sales dragged EBITDA to ₹2,154 mn in Q3FY'13 with the EBITDA Margin contracted 380bps YoY to 24.2% impacted by due to higher power and fuel and other expenses YoY. TTB segment margins remained under pressure down by 180 bps YoY. The CPB segment margins fell considerably on account of low CER monetisation and also the recently commissioned plants might aggravate overhead expenses. PFB segment's operating loss deepened further to ₹49 mn compared to loss of ₹38 mn a year earlier.

As a result, the net profit of the company declined 19.3% YoY to ₹892 mn. The foreign exchange loss amounting to ₹203 mn during the quarter also impacted the net profit.

In the first nine month of FY'13, the company's performance also remained under pressure with revenue declined by 7% YoY to ₹25,049 mn, while the net profit fell significantly by 38% YoY to ₹1,866 mn.

₹ mn	Q3FY'13	Q3FY'12	YoY (%)	9MFY'13	9MFY'12	YoY (%)
Net Revenue	8,889	9,491	(6.3)	25,049	27,018	(7.3)
EBITDA	2,154	2,664	(19.1)	4,614	6,784	(32.0)
EBITDA Margin (%)	24.2	28.1	-	18.4	25.1	-
Other Income	28	72	(60.9)	141	202	(30.0)
Depreciation	478	418	14.4	1,363	1,194	14.2
Interest	208.3	257	(18.9)	694.5	768.4	(9.6)
PBT	1,293	1,613	(19.9)	2,452	5,023	(51.2)
Tax	400	507	(21.1)	586	1,369	(57.2)
PAT	892.5	1,106	(19.3)	1,866	3,004	(37.9)
PAT Margin %	10.0	11.6	-	7.4	11.0	-
EPS (₹)	15.5	18.8	(17.4)	32.5	50.4	(35.5)

SRF's segmental performance (₹ in mn)

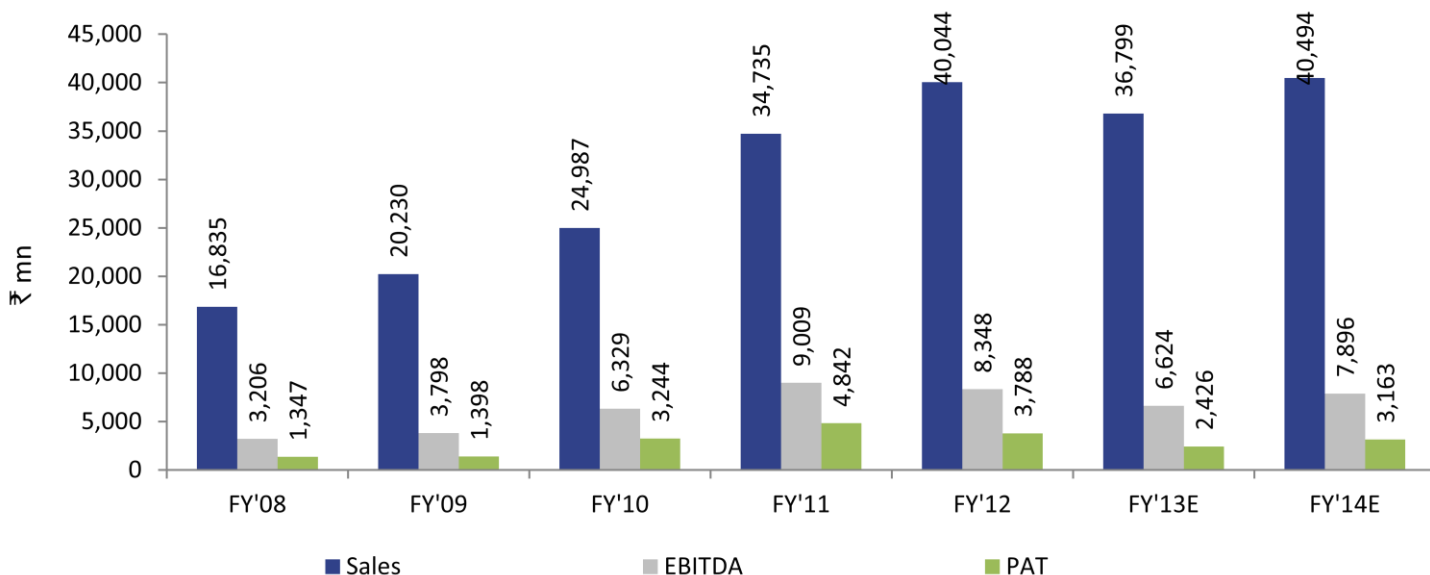


Stiff competition from Chinese imports, volatility in crude oil prices, growing tyres radialisation and high power cost – are the key challenges confronted by the company.

Key challenges confronted by the company:

- Any adverse movement in the crude oil prices is a major concern for the company as its key raw material – Caprolactam, a derivative of crude oil accounts for ~ 40.0% of the total raw material cost. Caprolactam is a major element used for the production of NTCF.
- Medium and heavy commercial vehicle accounts for majority of the company’s tyre segment. The current radialisation level of Truck & Bus in India is in the range of 20.0-22.0%. The tyre majors like Apollo, JK, CEAT and MRF are on the phase of expanding capacities, which may reduce the dependence on NTCF reinforcement and may cause a major concern for the company. In the global market the demand for NTCF witnessed slowdown only when bus and trucks tyre radialisation reaches 30.0-35.0%.
- Efficient and low cost power accounts for 11% of the total operating expenses for the company. Any disruption in the availability of the power may hamper the NTCF business of the company.
- The company may not able to derive the benefit of CER from this year under Kyoto protocol norms, due to the non-trading of CER’s generated from industrial gases in Europe, the world’s largest carbon market, which might impact the financial performance of the company as most of the capex done has yet to achieve the peak utilisation level.

Net sales, EBITDA and PAT trend



Balance Sheet (Consolidated)

Y/E (₹million)	FY11A	FY12A	FY13E	FY14E
Share Capital	615	584	584	584
Reserve and surplus	16,365	17,931	19,661	22,128
Net Worth	16,980	18,515	20,245	22,713
Long term debt	5,695	7,171	6,921	6,771
Deferred tax liability	2,161	2,269	2,269	2,269
Long term provisions	106	106	101	111
Current Liabilities	10,697	11,761	10,554	11,279
Capital Employed	35,638	39,822	40,091	43,143
Fixed Assets	21,459	24,925	24,791	26,632
Goodwill	30	30	30	30
Investment	1,162	1,405	1,405	1,405
Loans & Advances	626	1,245	1,159	1,276
Other Non-current Assets	14	32	32	32
Deferred tax assets	154	141	141	141
Current Assets	12,195	12,044	12,532	13,626
Capital Deployed	35,638	39,822	40,091	43,143

Key Ratios (Consolidated)

Y/E	FY11A	FY12A	FY13E	FY14E
EBITDA Margin (%)	25.9	20.8	18.0	19.5
EBIT Margin (%)	22.4	17.0	13.4	15.4
NPM (%)	13.9	9.5	6.6	7.8
ROCE (%)	31.1	24.2	16.7	19.5
ROE (%)	28.5	20.5	12.0	13.9
EPS (₹)	80.0	64.1	41.5	54.1
P/E (x)	2.1	2.6	4.0	3.1
BVPS(₹)	280.6	313.3	346.5	388.7
P/BVPS (x)	0.6	0.5	0.5	0.4
EV/Operating Income (x)	1.5	1.8	2.2	1.9
EV/EBITDA (x)	1.6	1.9	2.3	1.9

Profit & Loss Account (Consolidated)

Y/E (₹million)	FY11A	FY12A	FY13E	FY14E
Net Sales	34,735	40,044	36,799	40,494
Expenses	25,726	31,696	30,175	32,598
EBITDA	9,009	8,348	6,624	7,896
EBITDA margin (%)	25.9	20.8	18.0	19.5
Other Income	459	278	280	280
Depreciation	1,701	1,837	1,959	1,959
EBIT	7,767	6,789	4,945	6,217
Interest	897	1,172	1,324	1,496
Profit Before Tax	6,870	5,617	3,621	4,721
Tax	2,027	1,829	1,195	1,558
Net Profit	4,842.4	3,788	2,426	3,163
NPM (%)	13.9	9.5	6.6	7.8

Valuation and view

We expect the company's performance to gain momentum from FY'14 due to the contribution from new chemical facilities at Dahej stabilised realisations in PFB segment and better demand for tyre cord business. SRF is invested heavily on other businesses with high growth potential to achieve US\$ 1 bn revenue target by FY'14 end. We believe even in absence of CER's the CPB segment is expected to deliver ~20-25% EBITDA margin and the contribution in the overall revenues will also increase in future.

Considering the above aspects, we rate the stock as 'BUY' at the current market price of ₹166, which implies a P/E of ~4.0x FY'13E EPS of ₹41.5 and 3.1x on FY'14E EPS of ₹54.1 respectively.



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