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India Ratings Affirms SRF’s Debt at ‘IND AA+’/Stable and its CP at ‘IND A1+’; Rates Proposed Bank Loans

Mar 20, 2024 | Specialty Chemicals

India Ratings and Research (Ind-Ra) has affirmed SRF Limited’s bank loan ratings as follows:

Details of Instruments

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (billion)	Rating assigned along with Outlook/ Watch	Rating Action
Commercial paper	-	-	Up to 90 days	INR6.0	IND A1+	Affirmed
Term loans	-	-	FY24-FY28	INR1.88	IND AA+/Stable	Affirmed
Term loans	-	-	FY24-FY28	INR5.3	IND AA+/Stable	Assigned
Fund-based and non-fund-based working capital limits	-	-	-	INR27.8	IND AA+/Stable/IND A1+	Affirmed
Proposed fund-based and non-fund-based working capital limits	-	-	-	INR0.86	IND AA+/Stable/IND A1+	Affirmed
Fund-based and non-fund-based working capital limits	-	-	-	INR13	IND AA+/Stable/IND A1+	Assigned

Analytical Approach

The agency continues to take consolidated view of SRF and its subsidiaries to arrive at the ratings, given the strong linkages among the entities.

Detailed Rationale of the Rating Action

The affirmation reflects SRF’s continued robust business profile due to its strong market position and vertical integratiaon especially within the chemical business (CB) segment, diversified business verticals, multiple end-use applications of its products coupled with a healthy financial profile reflected in its strong margins and comfortable credit metrics.

Ind-Ra expects the FY25 EBITDA margin to stabilise after moderating in FY24 as realisations moderated across various operating segments, even as the scale continues to grow from the full benefit of the past capex on ramping-up of the existing facilities and the commissioning of new facilities. Also, Ind-Ra expects the FY25 net leverage to remain steady and closer to the FY24’s band of 1.5x to 1.75x, which has inched up due due to the company’s lower operating margins amid high capex spends. Ind-Ra derives confidence from the management’s ability to execute new capex to deliver growth while maintaining prudent credit metrics.

List of Key Rating Drivers

Strengths

Diversified business profile

CB margins drive overall profitability

Continued investments in CB segment to drive revenue growth in FY24-FY25

Continued strong credit metrics

Healthy standalone performance

Weaknesses

PFB margins continue to be weak in FY24

Free cash flows to remain negative amid large capex planned

Detailed Description of Key Rating Drivers

Diversified Business Profile: SRF is well diversified within its product mix, manufacturing, infrastructure and end-user industries. The company's diverse product mix enables it to cater to diverse end-use industries including automobile, pharmaceuticals, air conditioning and refrigeration, food and agro, chemicals, mining, among others. It operates in four diverse segments i) chemicals business (CB) with 46.8% contribution to the total revenue in 9MFY24 (9MFY23: 47.8%, FY23: 49.8%, FY22: 42.1%), ii) PFB at 34.5% (36.3% ,34.8%, 38.4%), iii) technical textiles business (TTB) at 14.9% (13.2%, 12.7%, 16.8%), and iv) others at 3.8% (2.7%, 2.7%, 2.7%).

The CB segment product mix comprises refrigerants, pharma propellants, industrial chemicals, agrochemicals and pharma intermediates chemicals. The PFB segment product mix comprises biaxially oriented polypropylene films (BOPP), biaxially oriented polyethylene terephthalate (BOPET) films under the PFB division. The TTB segment product mix comprises tyre cord fabrics, belting fabrics and polyester industrial yarn. Furthermore, in its newly formed subsidiary SRF Altech Limited, the company has entered into manufacturing of aluminium foil post completion of capex beginning 4QFY24.

CB Drives Overall Profitability: SRF has been strategically making high investments in CB, which has higher entry barriers and higher margin levels than its other business segments. Accordingly, this provides some safeguard against the weak performance within PFB. CB's contribution to the total EBIT increased to 71.3% in 9MFY24 (9MFY23: 68%, FY23: 73.3%, FY22: 49.3%), resulting in a lower EBIT share across the other business segments (PFB: 9MFY24: 10.9%, 9MFY23: 21.9%, FY23: 17.4%; FY22: 33.4%; TTB: 12.9%, 9.1%, 8.2%, 16.6%). Ind-Ra expects SRF's business profile to strengthen further with the commercialisation of new capacities and addition of product chemistries and products.

The consolidated revenue from operations stood at INR95.7 billion in 9MFY24 (9MFY23: INR111 billion; FY23: INR149 billion, FY22: INR124 billion) and consolidated EBIDTA margins reduced to 21.7% (24.8%, 23.7%, 25%). RoCE remained strong at around 22.1% in FY23 (FY22: 23.1%). CB business revenue declined around 16% yoy in 9MFY24 to INR44.8 billion after having growing 41% yoy in FY23 to INR74.1 billion. The fall in revenue over 9MFY24 can be primarily attributed to the Chinese inventory destocking and dumping and working capital pressures at customers' end within the specialty chemicals business (SCB) amid the peak global interest rate resulting in limited offtake from agrochemical and pharmaceutical industries, along with lower realisation within the refrigerants segment. Accordingly, the EBIT margins declined to 25.2% in 9MFY24 (9MFY23: 30.2%; FY23: 31.6% ; FY22: 26.7%). Previously in FY23, both revenue and margins improved due to the commercialisation of new products (from MPP-4) and healthy demand for key products and their downstream derivatives in SCB and higher refrigerant volumes in the fluorochemicals business.

Ind-Ra expects the CB segment's profitability to moderate in FY24 and receive some support over FY25 with a gradual improvement in the customer offtake, rebound in the prices, new product scale-up and customers placing larger orders, given supply-chain disruptions. Furthermore, SRF commissioned its polytetrafluoroethylene plant in October 2023, which is expected to gradually ramp over FY25 as it obtains various product approvals.

Continued Investments in CB Segment to Drive Revenue Growth in FY24-FY25: SRF has a strong market position in SCB and refrigerant gas business. The SCB segment manufactures intermediates for the agrochemical and pharmaceutical sectors. SRF's competitive advantage in the SCB segment stems from its increasing presence and expertise across multiple chemistries, flexible manufacturing setups, strong research and development processes (research and development spend: FY23: INR1,293 million, FY22: INR1,169.9 million, FY21: INR1,105 million, FY20: INR1,328 million, global patents applied: 430, granted: 146) and integrated business operations. SRF also has a strong position in the fluorochemicals business (Ind-Ra estimates 30%-40% of CB revenue), particularly in refrigerants and propellants, driven by integrated capacities and a wide range of refrigerants and their blends in the portfolio. Ind-Ra expects the margins to improve in the next couple of quarters with increased volumes expected on account of deferred purchases in SCB and likely ramp-up in the high-margin PTFE segment in the next couple of quarters.

SRF's incurred capex of around INR28.7 billion in FY23 (FY22: INR18.3 billion, INR12.1 billion) with 75%-80% of capex towards the CB segment. In 9MFY24, the company had already incurred capex of around INR11 billion towards the CB segment and about INR7 billion is expected by management in 4QFY24 . Over the medium term, Ind-Ra believes SRF will incur capex of INR25 billion-30 billion each year, out of which 75%-80% is expected towards the CB segment, driving its segmental share and EBITDA margins higher. The company is subject to environment-related risks and given the major capex will be in the CB segment, a timely execution of the projects remains a key monitorable. Ind-Ra expects continuous revenue growth in FY25 with the company continuously launching new products and commissioning new plants in agrochemicals.

Continued Strong Credit Metrics: SRF's gross debt increased to INR48.57 billion in 1HFY24 (1HFY23: INR37.15 billion, FY23: INR43.54 billion, FY22: INR35.39 billion), driven by continued capex in the PFB and CB segments, offsetting some scheduled repayments that were not refinanced. Ind-Ra expects the gross debt to increase further over FY24-FY25 on account of the further capex being executed. The net leverage was 1.27x in 1HFY24 (1HFY23: 0.85x, FY23: 0.92x, FY22: 0.87x) and the net leverage including acceptances was about 1.1x in FY23 (FY22: 1x, FY21: 1.43x). Ind-Ra expects the net leverage (both including and excluding acceptances) to elevate yoy in FY24 with continued capex and lower profitability yoy. Ind-Ra expects the EBITDA interest coverage (operating EBITDA to gross interest expense) to remain comfortable over the near-to-medium term (FY23: 17x, FY22: 27.0x). While the company will continue to incur growth capex, the operating performance will be supported by the ramp-up of past capex investments, which has started to contribute to the operating earnings and expected improvement in demand scenario post 3QFY24 in CB segment. Ind-Ra derives confidence from the management's ability to execute new capex to deliver growth while maintaining a prudent financial policy and adequate liquidity. However, ramp-up of new capacities will remain a key monitorable.

Healthy Standalone Performance: On a standalone basis and adjusted for discontinued operations, SRF's revenue declined 12% yoy to INR78.7 billion for 9MFY24 (FY23: INR120.7 billion, FY22: INR99.5 billion, FY21: INR69.9 billion), and its EBITDA margin stood at 22.1% (26.4%, 25.7%, 25.5%, 24.9%). On a standalone basis and adjusted for discontinued operations, SRF's interest coverage was 10.4x in 9MFY24 (FY23: 18.1x, FY22: 27x, FY21: 15.7x).

PFB Margins Continue to be Weak in FY24: The PFB segment's EBIT declined 66% yoy and EBIT margins remained weak at 5.2% in 9MFY24 (9MFY23: 12.8%, FY23:10.7%, FY22: 19.8%, FY21: 27.3%), on account of demand-supply mismatches in the global market leading to lower realisations. In 9MFY24, PFB revenues reduced to INR33.1 billion (9MFY23: INR40.3 billion; FY23: INR51.8 billion; FY22: INR47.8 billon) resulting in a EBIT of INR1.7 billion (INR5.1 billion, INR 5.5 billion, INR9.4 billion). While SRF has a global presence in the PFB segment, offering value-added products in proximity to customer locations, Ind-Ra expects the global demand-supply dynamics to keep the segment margins range bound at the existing levels over the near term. To mitigate this, SRF is continuously focusing on operational efficiency initiatives, expansion of value-added products in both BOPET and BOPP, implementation of cost-saving strategies and securing additional contractual sales.

Free Cash Flows to Remain Negative amid Large Capex Planned: Given the large capex plans to be executed each year, Ind-Ra expects the free cash flows to be negative over the near term. They have remained negative in the past five years, given the large capex and dividend payments. However, the operational cash flows are expected to be positive led by the operational EBTIDA generation. The cash flow from operations remained positive in FY23 at INR27.3 billion (FY22: INR20.2 billion, FY21: INR16.1 billion). However, Ind-Ra draws comfort from the likelihood of capex plans being funded by a mix of debt and internal accruals.

Liquidity

Adequate: SRF's liquidity is supported by cash balances (including current investments) of INR9.4 billion at end-1HFY24 (FYE23: INR10.9 billion, FYE22: INR7.67 billion, FYE21: INR5.5 billion), a robust operating performance, and a strong access to capital markets and the banking system. SRF's cash flow from operations was INR27.3 billion in FY23 (FY22: INR20.2 billion, FY21: INR16.1 billion, FY20: INR11.2 billion). For the 12 months ended January 2024, the standalone fund-based limit utilisation based on the company's drawing power was around 50%, while the non-fund-based limit utilisation was around 70%. SRF has debt repayments of around INR4.9 billion and INR10.1 billion over FY24 and FY25, respectively. Ind-Ra expects SRF to comfortably service its debt repayment obligations serviced through internal accruals. Its working capital cycle stood at 84 days in FY23 (FY22: 85 days).

Rating Sensitivities

Positive: A significant improvement in the scale, market position and ROCE, and increased share of high-margin and high-entry barrier segments in the overall business profile while maintaining the credit metrics on a sustained and consolidated basis, will be positive for the ratings.

Negative: A lower-than-expected ROCE and/or lower-than-expected margins on a sustained basis, and/or larger-than-expected debt-funded capex and/or elongation in the working capital cycle, leading to the net leverage (including acceptances) exceeding 2.5x, on a sustained and consolidated basis, will be negative for the ratings.

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on the company, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

About the Company

Incorporated in 1973, SRF is a diversified manufacturing company with production facilities across India, Hungary, Thailand and South Africa. Its business interests span technical textiles, refrigerants, fluoro specialty chemicals, specialty chemicals and packaging films.

FINANCIAL SUMMARY - CONSOLIDATED

Particulars	FY23	FY22
Net revenue (INR billion)	148.7	124.3
EBITDA (INR billion)	35.3	31.0
Operating EBITDA margin (%)	23.7	25.0
Gross interest cover (x)	17.3	26.8
Net leverage (x)	0.92	1.03
Source: SRF, Ind-Ra		

Status of Non-Cooperation with previous rating agency

Not applicable

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook				
	Rating Type	Rated Limits (billion)	Rating	20 October 2023	18 April 2023	19 April 2022	20 April 2021	21 April 2020
Issuer rating	Long-term		-	WD	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable
Term loans	Long-term	INR7.18	IND AA+/Stable	-	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable
Fund-based and non-fund-based working capital limits	Long-term/Short-term	INR41.66	IND AA+/Stable/IND A1+	-	IND AA+/Stable/IND A1+	IND AA+/Stable/IND A1+	IND AA+/Stable/IND A1+	IND AA+/Stable/IND A1+
Commercial paper	Short-term	INR6	IND A1+	-	IND A1+	IND A1+	IND A1+	IND A1+

Bank wise Facilities Details

Click here to see the details

Complexity Level of the Instruments

Instrument Type	Complexity Indicator
Term loans	Low
Fund-based working capital facilities	Low
Commercial paper	Low

For details on complexity level of the instruments please visit https://www.indiaratings.co.in/complexity-indicators.

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Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

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APPLICABLE CRITERIA

Evaluating Corporate Governance

Short-Term Ratings Criteria for Non-Financial Corporates

Corporate Rating Methodology

The Rating Process