"SRF Limited
Q1 FY24 Earnings Conference Call"

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MANAGEMENT: **MR. RAHUL JAIN** – PRESIDENT AND CHIEF FINANCIAL OFFICER – SRF LIMITED
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MODERATOR: **MR. ANSHUMAN GUPTA** – INVESTEC CAPITAL SERVICES

Moderator: Ladies and gentlemen, good day, and welcome to SRF Limited Q1 FY24 Earnings Conference Call hosted by Investec Capital Services. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Please note that this conference is being recorded.

I now hand the conference over to Mr. Anshuman Gupta, Lead Analyst – Chemicals, Pharma and Healthcare.

Anshuman Gupta: Good afternoon, everyone and thank you for joining us today. We at Investec are pleased to host SRF Limited's Q1 FY24 Results Conference Call. We have with us today Mr. Rahul Jain, President and CFO of SRF Limited. Now I would like to invite Ms. Nitika Dhawan, Head of Corporate Communications at SRF, to initiate the proceedings for the results call. Thank you.

Nitika Dhawan: Good afternoon, everyone and thank you for joining us on SRF Limited's Q1 FY24 Results Conference Call. We will begin this call with brief opening remarks from our President and CFO, Mr. Rahul Jain, following which, we will open the forum for an interactive question-and-answer session. Before we begin this call, I would like to point out that some statements made in this call may be forward-looking, and a disclaimer to this effect has been included in the earnings presentation shared with you earlier. I would now like to invite Mr. Jain to make his opening remarks.

Rahul Jain: Thank you, Nitika. Good afternoon, everyone. I extend a warm welcome to you all and thank you for joining us today on SRF's Q1 FY24 Earnings Conference Call. I trust all of you had the opportunity to go through our financial results and the presentation shared with you earlier. I will begin the call by briefly taking you through the key financial and operational highlights for the period under review, following which we will open the forum for a Q&A session.

We reported a decline in our profitability during the quarter, primarily due to the expected down cycle witnessed in the Packaging Films business. Additionally, the Chemicals business saw lower sales within the Fluorochemicals business. Nevertheless, amidst the challenges of global macroeconomic scenario, our core Specialty Chemicals business delivered a commendable performance reporting healthy growth over last year. In Q1 FY24, gross operating revenue declined by 14% Y-o-Y to INR3,338 crores. EBIT stood at INR595 crores, translating to an EBIT margin of 18%. Profit after tax came in at INR359 crores, down by 41% Y-o-Y. During the quarter, the Board has approved an interim dividend amounting to INR3.6 per share, which will lead to a cash payout amounting to INR106.72 crores.

Coming to our segmental performance. The Chemicals business reported revenues of INR 1,660 crores, down 3.6%. Despite a weak environment and inventory unwinding with agro customers globally, the Specialty Chemicals business delivered healthy growth in margin and sales over the corresponding period last year. We continue to expand our new product portfolio and launched 2 new products each in agro and pharma space in Q1. Moreover, in the past few quarters, we have commissioned some flexible and dedicated facilities which are expected to augment the overall performance going forward as we ramp up utilization levels in the second half of the year. There is significant global inventory unwinding taking place, which is visible from the commentary of global leaders, and we have also experienced some of the same. The business also witnessed customers engaging in some inventory rationalization, along with rescheduling of some orders. However, we believe this trend is transitory and is expected to continue only for a few quarters. In a sense, some temporary hiccups are being witnessed and countermeasures are being implemented. Fundamentally, India's momentum as an alternate specialty chemicals manufacturing base remains intact, and the China Plus One theme remains strong.

Our capex momentum also remains strong. Multiple ongoing projects are on track and are anticipated to be operational in the upcoming quarters, further enhancing the prospects of the Specialty Chemicals business. SRF remains committed to growing strong collaboration with innovators, especially for developing complex and downstream products and active intermediates. With the introduction of new products, the business will continue to expand its customer base, strengthen market presence, and enhance growth potential.

During this quarter, our Fluorochemicals business was impacted both in terms of volume and price of HFCs. Volume growth was primarily due to a weak domestic summer, and the Chinese dumping witnessed across key geographies post reopening of their economy lead to price reduction. Further, the demand for chloromethanes remains sluggish in both domestic and international markets, owing to overall weakness in agrochemicals and pharma industries. Despite the near-term impact on ref gases, the underlying potential for global and domestic HFCs remains strong with significant traction from the U.S. market, which should play out over the next few quarters. We expect our performance to improve in H2 FY24 and are confident of the long-term growth prospects of the Fluorochemicals business. In line with our continued expansion endeavours, ongoing projects valued at nearly INR 1,100 crores are expected to be capitalized in FY24. We have initiated some trial runs in the new PTFE facility and expect to commission the facility soon. The Board has also approved a project aiming at expanding the capacity of Anhydrous Hydrogen Chloride (AHCL) at Dahej. The expansion is intended to cater to the growing demand for AHCL in pharmaceutical intermediates.

With a dedicated workforce of over 400-plus professionals, R&D plays a pivotal role in driving the development of cutting-edge products and process technologies, catering to both specialty chemicals and the fluorochemicals businesses. Bolstered by deep domain expertise, our company excels in handling some of the most complex chemistries in the world, firmly positioning us as frontrunners in managing challenging projects. The strength of our R&D

capabilities is further exemplified by our intensive patent portfolio. An impressive total of 139 patents granted and 408 processed patents filed to date highlight our commitment to breaking new grounds in our chosen areas of operations. Sustainable efficiency improvements through technology interventions remains one of the four pillars of our R&D. Moving forward, R&D will remain the driving force behind SRF's journey towards excellence, empowering us with the capabilities of process development, scale ups and successful commercialization of new chemistries. This includes new AIs as well as next-generation, environmentally responsible refrigerants.

Coming to our Packaging Films business. This vertical continues to face significant headwinds due to the cyclical downturn, driven by huge capacity additions in India and overseas and the global economic slowdown. SRF value-added product portfolio, long-term customer contracts and our 'Easy to do Business With' strategy collectively contributes to a distinct performance advantage over competitors. However, considering the uncertain environment, we anticipate that this may still take some time before the demand supply situation normalizes, especially in BOPET. This is a down cycle that the business is witnessing, which is probably one of the worst that has been seen over the past few years. Only passage of time will correct the situation as demand continues to grow and announced expansions get deferred or delayed. Having said that, the business will continue to focus on profitability enhancement through growth value-added products in both BOPET and BOPP segments and contractual sales and continue to outperform the competition. We will also focus on sustainability initiatives driven by the 3R approach: Reduce, reuse and recycle.

The progress on the aluminum foil project remains on track and is expected to be commissioned in Q3 FY24. With this, SRF will be among the select players offering customers all 3 major packaging products, including BOPET, BOPP and aluminum foil.

Moving to our Technical Textiles business segment. The business witnessed pressure on margins and volume in our flagship Nylon Tyre Cord Fabric segment when compared to corresponding period last year. In addition, the decline in caprolactam prices impacted revenues. We have spoken about this earlier, of the nature of the business where caprolactam prices are a pass-through. The other segment of the Technical Textiles business, namely Belting Fabrics and Polyester Industrial Yarn, witnessed growth during the quarter, with greater emphasis on high-end value-added product sales. During the quarter, the solid woven fabric, a crucial product for the Belting Fabrics portfolio has been successfully commissioned. This milestone marks a significant step in meeting the growing demand for high-quality belting fabrics in the market. Overall, post the margin correction witnessed last year, this remains a stable business. Going forward, growth will be driven by the belting fabric subsegment as capacity expansions get commissioned next year. Additionally, the business will continue to focus on higher operating leverage and cost optimization through various interventions across our facilities.

Lastly, in our other segment, we witnessed significant growth in both Coated and Laminated Fabrics segment. In the Coated Fabrics segment, SRF maintains its prominent leadership position in the domestic market, achieving highest ever domestic sales and EBITDA. We witnessed a surge in demand across all categories with notable emphasis on value-added products. In the Laminated Fabrics segment, SRF sustained its pricing and volume leadership, operating the plant at full capacity and achieving its best ever sales in Q1 FY24. In the future, we expect demand to remain stable.

Additionally, we also witnessed an increased interest outgo during the quarter from INR32 crores corresponding period last year to INR66 crores during Q1 FY24. This is due to the current interest rate scenario prevailing both globally and locally as well as slightly higher borrowings.

During the quarter, SRF Foundation, the social arm of SRF was honoured with the Bronze Award for its exemplary CSR Preventive Health Project (Rural) at the 7th CSR Health Impact Awards organized by IHW Council. The project has made significant strides in enhancing preventive health care services in rural areas, positively impacting the community.

In conclusion, SRFs remarkable success over the years stands testament to our well-established diversified business model and commitment to innovation and technology leadership. This, along with our unparalleled R&D capabilities, should enable us to navigate uncertain times. While certain sectors may continue to face short-term headwinds, we are confident that our core chemical segment driven by advancements from our R&D efforts will drive healthy growth and create sustainable value for all stakeholders over the long-term.

On that note, I conclude my remarks and would be glad to discuss any questions, comments or suggestions that you may have. I would now like to ask the moderator to open the line for Q&A session. Thank you so much.

Moderator: The first question is from the line of Sumant Kumar from Motilal Oswal.

Sumant Kumar: So sir, can you talk about the capitalization in FY24 because we have mentioned in the PPT, we are going to capitalize INR 1,100 crores. So apart from this, is there any more capitalization in FY24?

Rahul Jain: In FY24, the INR 1,100 crores number is essentially on the Fluorochemicals business. In addition to this, there are about INR1,400 - INR1,500 crores of projects that will take place as capitalization in the Specialty Chemicals business as well. If we aggregate all of the capitalization that should take place during this financial year, we believe the number could be in the range of about INR 2,800 crores – INR 2,900 crores. Also, this does not include Altech. If you include Altech, it could be another INR450 crores - INR500 crores of capitalization on the aluminum foil project that are not included here.

Sumant Kumar: So apart from INR2,900 crores you are talking about INR400 crores more.

Rahul Jain: It will be higher than INR400 crores, but yes, that's the number.

Sumant Kumar: Okay. And now talking about the Chemicals segment. Particularly in Specialty Chemicals side, you were talking about the inventory rationalisation. So can you talk about how the Specialty Chemical segment growth in this quarter? And how is the mix of the advanced intermediate we are supplying to patented molecule customer or in generic market? And also, how is the margin trajectory of overall Chemicals business?

Rahul Jain: Okay. So when you talk about the overall position of the Specialty Chemicals business, when we compare it to corresponding period last year, we believe that it has still grown by about 10%. Again, we don't give a number breakup here. That's been the position that we've taken on it for a long time. So that's how it will remain. In terms of the overall Chemicals business margin, if you compare it with corresponding period last year, roughly, the margin was about 30% and this year, the number is about 28%. So not a very significant decrease, but yes, some decrease. I would really say that a majority of this decrease is attributable to both volume and price reductions that have happened in HFCs. Specialty Chemicals business, even the EBIT margin would have actually grown here. For Intermediate AIs, as of now, we do one AI; P32, that's the one that is continuing. There are a couple of other small ones that we've done. As we go out in time, some of these AIs will become more consistent products that we will start to sell.

Moderator: The next question is from the line of Rohit Nagraj from Centrum Broking.

Rohit Nagraj: Sir, first question is again on Specialty Chemicals. So we have said that the inventory destocking probably will have its impact in subsequent couple of quarters. Did we see the same during Q1 as well? And was it purely volume-driven or there was price reduction as well?

Rahul Jain: So Rohit, to be very frank about it, if I look at it, my margins in the Specialty Chemicals business has improved. Now to a certain extent, and we've said this earlier also, these are largely contracted business in nature. What we have now seen is that some of the key raw material prices have started to come down. And therefore, there will be some of the debate in terms of passing on some of those changes in the commodity price cycle to some of the customers as well. As of now, in Q1, I have not seen any significant price pressure. But yes, there are certain reschedulings that are happening. Again, we don't believe it is a demand burn that has happened; still remains a positive from an overall, let's say, annual growth perspective that we have.

Rohit Nagraj: Right. And second question is on PTFE. So do we expect any material revenues during this FY24 given that we are at the end of commercializing the facility?

Rahul Jain: We are only at the end of Q1. We believe that the batch processes are now starting to take shape. There will be some of the customer approvals, some of the products have to kind of get through, from customer approval perspective. My sense is that end of September, early October, is when the project will get capitalized. And subsequently, there should be revenue that should come in. I can't give you an exact number in terms of what, but our overall thought process is that, let's say, between 1,000 to 1,500 MT of sales should come through this financial year.

Moderator: The next question is from the line of Arjun Khanna from Kotak Mahindra Asset Management.

Arjun Khanna: Just in terms of our thought process. So you've mentioned that our longer-term projects remain on track, and we expect to keep capex momentum intact. So in the environment of a slowing economic cycle, what gives us this confidence of continuing the investments that we have already planned?

Rahul Jain: To be very frank about it, if you look at it from a historical perspective also, and to a certain extent, when you look at the projects that are currently going on, I think the confidence is the amount of products or things that we are currently working on in our R&D, in terms of what can get capitalized or what opportunities can come through, which only does give us the confidence that we should be able to continue the capex position that we've created. Obviously, Arjun, both projects that are currently on, it is not really appropriate to kind of shelf them out at this point in time. A majority of the amount in terms of the capex has already been spent. So I mean, even on those, the confidence is that we should be able to scale these up very, very fast.

Arjun Khanna: Sure. In the last quarter call, the MD did talk about the new active intermediates. We are looking at 7-8 coming through in the next few years. Given our conversations on the spec chem side, have you seen delays in terms of those projects coming through or any R&D-related delays on the spec chem side?

Rahul Jain: Arjun, again, you correctly pointed this out. We had talked about the fact that it will take 6-7 AIs about 2 years to materialize completely. Again, it's only 1 quarter that has passed. And I don't see a significant reduction in the inquiry on that side. It's only 3 months, Arjun. I think we are in fairly good shape in terms of some of these AIs also coming through at a faster pace.

Moderator: The next question is from the line of Ankur Periwal from Axis Capital.

Ankur Periwal: First one on the ref gas side. You did mention that lower pricing as well as some bit of China dumping impacting the global international demand, primarily U.S. Any thoughts there in terms of action taken by the government? Or how do you see the pricing as well as volume growth specifically in the U.S. market for this financial year?

Rahul Jain: So 2 things, Ankur, on the volume growth or the overall volume that we can sell, we have also said that during Q1, what we've faced is the fact that volume was lower because of the weak summer that we've seen in the domestic market. Again historically also, when you look at it, this is probably the best quarter that happens for the Fluorochemicals or HFC, from a domestic market perspective. When we look at it from an export market perspective, we believe there is significant traction from the U.S. market going forward, and H2, therefore, should be much better than H1, is the view that we are having. Again, contracts will get executed over this quarter and the next quarter, with sales being affected probably more in Q3 and Q4.

Ankur Periwal: Sure. Sir, just a clarification. So on a volume growth basis for the full year, we still believe a positive number there on an overall company basis.

Rahul Jain: Yes. From a refrigerant gas HFC perspective, from a year as a whole, when we compare it to last year, there should be some growth that we should witness.

Ankur Periwal: Sure. Sir, second question on the 2 big plants that are coming up, PTFE as well as aluminum foil. When should we start seeing the ramp up here, both in terms of revenues and the margin front?

Rahul Jain: On PTFE?

Ankur Periwal: On PTFE and aluminum foil, on the revenue as well as on the margins front, for the respective business segment. Will these margins be accretive to the current margins?

Rahul Jain: So Ankur, the PTFE, like I answered to the last question, we believe should be capitalized somewhere in the end of Q2 or early Q3 / early H2. Again, volumes will be very difficult to be able to predict, but let's say, between 1,000 to 1,500 tonne revenue should come through is our current projection on this. On the aluminum foil, I think the timeline is similar in terms of the product approval cycle; it should take some time. Let's say, the full value of the revenues from the aluminum foil, we will start to see in FY25 only.

Moderator: The next question is from the line of Surya Patra from Philip Capital.

Surya Patra: My question is on the inventory rationalization by customers or the rescheduling of the orders by customers in the Specialty Chemicals side. So you have seen some of that impact in the first quarter. But in the light of that development as well as the 4 scheduled specialty projects, which is likely to be commissioned throughout the current financial year, do you see any challenge to your guidance number for 20% plus growth in the Specialty Chemicals?

Rahul Jain: So Surya, again, given where Q1 is, and I see where you are coming from in terms of the overall revenue growth potential that we had talked about. I think it's not to be looked at from a linear perspective. There is an inventory destocking that is happening. There is a position that the customers are starting to take. There is a certain position Chinese companies are starting to take around this. Again, that's the negative side of it.

On the positive side, there are new projects that are getting commissioned. FCB is witnessing more traction on the U.S. market. So I would really say that if there are some hiccups that we experienced in Q1, I think we will have to kind of wait out Q2 to be able to give you a better picture in terms of where growth positions are. And I think it will be better to talk about it at that point in time rather than today. Again, if I start to talk about it today, it will probably come out as a bit of a negative. I think given where the macroeconomic environment is, we will have to wait out and see what happens in Q2 to be able to give you a better picture.

Surya Patra: Okay. Just an extension to this. So this is about, obviously, the Specialty Chemicals projects. But given the kind of general demand scenario that is prevailing currently globally, and we also know that many of our projects are generally precontracted with customers. So knowing all those things, is it better to say that even those 8-odd projects are likely to be commissioned this year, but the realistic ramp-up benefit will be seen in the subsequent financial year?

Rahul Jain: I think we've said this in the past as well that when you look at specialty chemicals or even any chemical plant, it takes some time to stabilize it. We will commercialize it. Our intent is to be able to ramp this up at a very fast pace. We will certainly look at doing that. I would really say that our intention to achieve growth is certainly there. The only challenge that has been posed today is the global economic scenario that is prevailing out. I think it's not a negative from our side. We still believe growth is possible, and that's how we are looking at it Surya. You are absolutely right when you say that there are contracted positions that we have created. And those should be the positive trait, that should help us out in order to be able to achieve this.

Surya Patra: Okay. Sir, my second question is on two clarifications. What was the kind of inventory loss that you have witnessed in the Packaging Films business this quarter? This is one. And secondly, on the ref gas also, you have mentioned in your presentation that there is a destocking scenario in the HFCs. So what is the level? Do you think that there was a kind of a large inventory that was lying for HFCs in the, let's say, U.S. market? Or what is the length of the inventory stocking generally that happens in the ref gas in the U.S. market? If you can give some clarity there.

Rahul Jain: Here, in budget, one on the inventory loss in the packaging film business. I don't see a very large number of an inventory loss, given where PTA prices are; because it's to be calibrated from let's say, Q4 closure. While when we are talking about inventory prices or raw material pricing, we are comparing corresponding period last year versus this year. So that's the difference here. So no major losses that are embedded in these numbers.

In terms of overall stocking and overall inventory positioning, what's happened over time

Surya, is that when we look at the positions that some of the customers are creating, the need for product was very high given uncertainty around supplies. Now as China has opened up, supplies have come in. The delivery schedules or the willingness to keep a larger inventory has come down a bit. And that's what kind of creating a position where customers are happy to keep a lower inventory. So that's the shift that is happening today. I don't think they will come to a situation where everything will become zero before they will start to weaken it. It's a dynamic situation that is playing out.

Moderator: The next question is from the line of Abhijit Akella from Kotak Securities.

Abhijit Akella: I just have 2, sir. First on the refrigerants business. There are multiple dynamics playing out in that business in the near future. I mean, right now, we are seeing this aggressive competition from China, plus we have the Indian companies, including yourself, setting up new capacities during the course of this year. But then at the same time, there is going to be a production cut in the U.S.A. in early 2024, and later on in next year, maybe the additional demand coming in from the trucks segment where the Indian government has mandated ACs. So I mean in your assessment, if you could please just share your perspective on how you expect this business to sort of shape up over the next few quarters or several quarters, that would be very helpful.

Rahul Jain: Abhijit, thank you for your question. I think I pointed this out in the base commentary also that while there are certain short-term pressures that we are witnessing, there is a near-term impact that we are seeing, the underlying potential of the global and domestic HFC space, given the things that you've pointed out in terms of production cuts happening in the U.S., in terms of inventory positions in China that got created because of their base year for last year and huge inventories that were created. We also are seeing some of the U.S. manufacturers looking at cutting their production out. I think both globally and locally also, the traction on HFCs will remain strong going forward as well. The inventory positioning should play out over probably next quarter, maybe Q3 as well. But when we look at it from a longer-term perspective, we are fairly confident that this is a business that gives us advantage. Now you also talked about some of the new capacities that are coming in India. Again, I think we've talked about this earlier as well. That while there will be some new capacities that will play out, we believe that our position in terms of the overall HFC capacities that we've created and the backward integration that we've talked about from an HFC perspective, puts us in a fairly strong position when you look at HFC domestic market. So that's how we would look at it. There is a short-term position that has got played out. But in the long-term, we're fairly confident that our technological play, our backward integration, our market penetration, our relationships in the U.S. market should keep us in very, very good state here.

Abhijit Akella: That is helpful. And then just the other thing I just had was on the PTFE and aluminum foil projects. At current prices or in the current market scenario, if you could please just share your perspective on what might be a sort of economics we should be looking at full utilization for these projects from a revenue and margin perspective.

Rahul Jain: So Abhijit, again, I think I have answered that twice already. PTFE should get commercialized end of September, early October. It is a complex product. It's the first time that we are doing a fluoropolymer. It has given us ability to do future fluoropolymers as well. We will have to go to the market and, let's say, do the selling out there. So it's very difficult to be able to give you a number here. Like I said, in an answer to a previous question also, is that we believe between 1,000 to 1,500 tonnes we should be able to manage. Again, aluminum foil will have to go through some of the ramp-up in terms of the product approval as well. Hopefully that should come through more in FY25 than in FY24 from a revenue and margin perspective. So that's how we would look at it, Abhijit.

Abhijit Akella: Yes. But I was just hoping to understand is whether there's any sort of significant change from the original expectations you might have had in terms of the economics of these projects, like full utilization compared to your initial expectations.

Rahul Jain: I don't think there is a significant change in terms of initial expectation when you look at it from a longer-term perspective. Shorter-term, we've seen prices of certain products go up very significantly, PTFE specifically, and therefore, it should give us larger economic value than smaller ones.

Moderator: The next question is from the line of Krishan Parwani from JM Financial.

Krishan Parwani: Yes. Two questions from my side. First is, going forward, how will your mix change between dedicated and multipurpose capacities? As in the incremental capex would be more towards contracted business, Or how would it be?

Rahul Jain: So dedicated plants today would probably be, let's say, around 15-16. Revenue from dedicated plant would probably be in the range of about 80%-85%. So that's how we would look at it. Again, as we go out and commercialize more dedicated plants, the revenue shift towards dedicated should be higher. Most of the new plants that we are capitalizing today or looking to capitalize in H2 are largely dedicated in nature. So as a concept, as those ramp up, revenue from dedicated ones should go up.

Krishan Parwani: Perfect. That's helpful. And just one small clarification. So did you mention that you would try to achieve 20% kind of growth, but things would be more clearer in Q2. Is that correct understanding?

Rahul Jain: I mean, yes, to a certain extent. I'm saying that being able to give you a better guidance on growth, we will have to probably wait out a bit.

Moderator: The next question is from the line of Rohan Gupta from Nuvama Wealth Management.

Rohan Gupta: Sir, first question is on refrigerant gases, we have seen the current quarter see significant price drop. Though you mentioned that you've been seeing much inventory-led losses in the current quarter, which are there. But do you see that...

Rahul Jain: No, no, just to clarify. I have said that there are no inventory losses. So it's not an inventory markdown that has happened. What I said is that price has gone down because of a certain extent of Chinese dumping happening. That's what I said.

Rohan Gupta: I meant inventory markdown only. So there is no inventory markdown. Right. So with the falling prices and now prices have stabilized, do you see that the current quarter Q1, the worst is over? Or do you see that a further pain in terms of further volume decline or margin pressure in ref gases business going forward?

Rahul Jain: So Rohan, when you look at ref gases, overall, I don't want to say the worst is over. But what I can tell you is that we are seeing significant traction. We believe Q2 should be better than Q1 and H2 should be certainly better than H1 in total. So that's how we would look at it. Again, I would only tend to think that the U.S. market is giving a good traction. And given, let's say, some delays, some domestic position that are also getting created here.

Rohan Gupta: But sir, Q2 are not the season for the ref gases as far as the domestic market are concerned.

Rahul Jain: There was mildish April, May in terms of the heat in the country, but we are seeing sustained heat coming in. So maybe there is a delayed season that we are seeing here. We don't know today.

Rohan Gupta: Okay. So you are seeing some kind of volume recovery at least in Q2, and definitely much better in H2 also coming from the U.S. market and all?

Rahul Jain: Correct. Absolutely. Bang on.

Rohan Gupta: Okay. Sir, second question is on the packaging film. We have been talking about our packaging film business and how robust we had made it over a period of time with moving more towards value-added products and all. It's the second quarter in a row when we are working on such a wafer thin margin of 3.5% to 4.5%. I understand it's a slightly commoditized basis, and you have always mentioned that the fall in commodity prices will also have impact on your margins also. But probably current quarter and last quarter margins look extraordinary. Do you see this scenario, as you have mentioned in your presentation also, the scenario looks quite grimy going forward also, maybe it will only improve gradually? So do you see that the recovery in this business will take another 1 year or 2 years? Because with this kind of margin and if you have a higher set of value-added, then probably the competitor should be bleeding and making losses, isn't it, if we have a high share of value added?

Rahul Jain: So Rohan, that's a comment. What's the question?

Rohan Gupta: Sir, my question is that if we are working on 4.5%-5% kind of EBIT margin, first of all, is the competition losing money? Or we are also aligned? I mean, there is no part of the value added and our margins are also as good as a commodity margin. That's what question is number 1. Second, when do we see that the recovery panning out in the Packaging Film business?

Rahul Jain: Okay. Got it. Rohan, you're right that, let's say, business proposition here is 'Easy to do Business With', contracted sales, value-added products. And that's something that's helping us out in being able to even get to that 4.7% EBIT margin that you are talking about, which is visible from the numbers. Now when you look at it, and I'm sure you will do the comparison of the peers' number, my sense is you will find us to be slightly differentiated here. We should be doing better than some of our competition, when we look at any metric on this side, be it EBIT margin, EBITDA margin or for that matter by the return on capital employed, I think we should be doing better, given the traits that I just talked about. In terms of recovery, I think BOPET will take some more time to recover. But BOPP, I think, is doing all right. Hopefully, it won't go through an extended cycle, and we should do slightly better off. Again, Rohan, please understand that this is probably one of the worst cycles this business has seen. To a certain extent, also driven by the super normal profit that were being made in FY21, FY22, because of new capacities that have got added. Demand is still growing, albeit at a small or at a lower pace, which should take this up going forward. And therefore, we believe that's the way BOPET will, let's say, pan out over time.

Moderator: The next question is from the line of Vivek Rajamani from Morgan Stanley.

Vivek Rajamani: Just one clarification and one question on Specialty Chemicals. You mentioned the inventory rationalization that you're seeing. I presume that's predominantly on agrochemicals, correct? Or is this happening a bit more broad-based across a few other sectors? And if it's possible, could you give us a sense of how much of your portfolio is exposed to this? And the second question was, you mentioned that because of these inventory rationalization, deal rescheduling, you guys are already taking some remedial measures. I just wanted to understand if you could give some colour on what kind of measures can you take given that it's a very global situation, right?

Rahul Jain: So 2 questions, Vivek. Let me just try and answer both. You are aware of this, and we've talked about this in the past. Majority of our revenues depend on largely agrochemical. Now the inventory rationalization that we are seeing is also majority in the agrochemical space. When we look at it from a futuristic perspective, there are some customers that have talked about order management, some delays. But luckily, we have not seen any demand burn happening here. There are no cancellations that we have witnessed. So that's a positive. You are right when you say that this is a global scenario. How will we implement countermeasures; I think, we've also created our inventory positions in terms of being able to supply the customer on a contracted basis. The countermeasures being implemented are, let's say, faster depletion of those inventories as well. So we are taking various measures. We're also looking to let's say, advance some of the products which were probably scheduled slightly later for sales, in order to manage the margins and revenues of this side. So those are probably some of the countermeasures that we have taken.

Moderator: The next question is from the line of Vishnu Kumar from Spark Capital Advisors.

Vishnu Kumar: On 1Q Specialty Chemicals, based on commentary, is it right to conclude that ref gas had a big negative or rather had a bigger negative and agrochemical was still mildly positive? Or how should we read the growth at least?

Rahul Jain: The overall revenue negative is roughly about 3.6% when you look at it, from corresponding period last year.

Vishnu Kumar: Correct.

Rahul Jain: Again, like I said, Specialty Chemicals has grown. And by corollary that means flouro-chemicals has degrown. I can't give you the exact numbers because we don't disclose a quarterly breakup of these numbers.

Vishnu Kumar: Got it, sir. Sir, in this commentary, I mean, if this is the approach, I mean we have not seen the bigger negative? Or when you say the inventory rationalization, it means that we still probably did not get the growth we've targeted. Is that the right approach, because if it's still kind of positive?

Rahul Jain: Distinguish between the 2 businesses. Specialty Chemicals, we've seen both, growth in revenues and margins. Fluorochemicals, it's a negative in terms of volume and, therefore, margin as well because price has come down. When you look at inventory rationalization for the future, we are kind of talking about some space that is getting created and what we have seen in the spec chem business. For the Fluorochemicals business, we've also said in the previous answers that we are seeing traction in the U.S. market, we believe H2 is going to be much better than H1. So that's the way we should look at it, Vishnu.

Vishnu Kumar: Got it, sir. On the Specialty Chemicals, especially the agro side, you did mention that some RM is coming down and we may look into passing through some. Generally, in terms of pricing some of these products, we look at a percentage margins or on a per tonne basis, how do you look about it?

Rahul Jain: Generally speaking, it depends on contract, what's the contract that you have with the customer. Generally speaking, it's a dollarized margin that you have generally, it's also, therefore, the most difficult part here, to price the product.

Vishnu Kumar: Got it. So my question would be in the case of pricing comes down, would we still be able to maintain on a per tonne basis or it is going to be a percent margin? At least broadly, if you could just say that at least the majority of contracts would be on a dollarized per tonne or on a percentage.

Rahul Jain: I would like to check that out and give you an appropriate answer on it, Vishnu. I don't have a singular answer to it on whether most contracts are dollarized or on a percentage margin basis. Because please understand, it is not like technical textiles business where key raw materials are pass-throughs. It's a product-based contract that gets entered into here. So pretty much difficult to give any answer to that question, Vishnu.

Moderator: The next question is from the line of Archit Joshi from B&K Securities.

Archit Joshi: Just one question. Can you speak a bit about the new avenue that has opened up for us in ref gases, which is through the mandatory installation of AC systems? And supplementarily if we can also speak about what kind of gas, I'm actually assuming there will be R134a, and since our current capacity expansion is happening in R32, does that change any of our plans at all?

Rahul Jain: So Archit, this is a very, very recent development that has happened through the announcement that came in very, very recently by the Minister of Transport in terms of installing certain air conditioning systems in trucks as well. You're absolutely right that this is a positive for the R134a, which is used for mobile air conditioning. The only point that I would make is that this is still something that will probably result in additional domestic volumes in the next 18 months to 24 months, when we will start to see some of the manufacturers install air conditioning systems in the trucks. So FY25 is when we will start to see some traction on that side. Again, I think the ability here, is to see how much we can manufacture. You know that we have flexible plants in our Bhiwadi plant, and therefore, our ability to manufacture 134a both for domestic use and global use, depends on how the market demand shapes up. And I don't think there is any other manufacturer of 134a. So it should be an overall benefit to SRF, Archit.

Moderator: The next question is from the line of Tarang Agrawal from Old Bridge Capital.

Tarang Agrawal: Three questions from my side. Sir, given that almost 85% of your spec chem business is from dedicated facilities, would it therefore mean that as and when eventually when the product goes generic, you will also try to play into that market?

Rahul Jain: The agrochemical market is not like the pharma market, Tarang. The point is that our intent is to continue to supply to innovator. Now whether innovator is doing a pure innovator product, which is only being done by him, or when he starts to do branded generics also, we are happy to supply to the innovator. So that's how it works for us. And dedicated plants will continue to grow as we keep growing the position on various products and more complexity gets added.

Tarang Agrawal: Got it. And sir, I mean, how much would your market share be in these intermediates that you're supplying in these dedicated plants?

Rahul Jain: Very difficult to comment. But on a more generic basis, I think the way we look at it in di- and trifluoroalkyl intermediates, we are probably one of the largest in the world.

Tarang Agrawal: Would it entail more than 45% market share?

Rahul Jain: I will have to come back to you, Tarang, on it in terms of what's the percentage market share. My sense is, it should be in that range.

Tarang Agrawal: Got it. And sir, last question. Packaging Films over cycles, do you generally work with a 15% return on capital employed as a thumb rule?

Rahul Jain: In the past, when you look at the average return on capital employed from the Packaging Film business, because we've always said that this is to a certain extent cyclical, we've seen return on capital employed average over the 5 to 7 years in excess of about 16%-18%. We have always also said that we are happy with the 15% to 16% return on capital employed on the Packaging Film business overall. And I think that's the story that should continue.

Moderator: The next question is from the line of Lavanya Tottala from UBS Group.

Lavanya Tottala: Most of my questions are answered. I just wanted to understand your take on overall global agrochem business, like pricing and demand environment. So from your commentary, I understand that Specialty Chem is still doing well, but in general how the environment is it?

Rahul Jain: This is something that we've heard from our customers. We understand from the ground level and the needs of the final farmer or the customer as agrochemicals, that those needs remain pretty much in good shape. We've also got feedback as customer input, and demand seems pretty much all right and in good shape. It's not that there is lowering of demand for products on the agrochemical side. So that's something that's good news for us. Like we said, there is some inventory positioning that has got created, some due to overall COVID, some due to nonavailability of product. And this has also led to much higher inventory levels with some of the customers, which is kind of getting rationalized now. So that's the position that's playing out.

Lavanya Tottala: Okay, got it. And on anything on the pricing, sir, is there any decline?

Rahul Jain: Like I said, Lavanya, the pricing of majority of my Specialty Chemicals products is contracted. While there will be some renegotiation, given where commodity prices are, our intent would be to hold it out as much.

Lavanya Tottala: Got it, got it. Just on packaging business. So if I understand right, you expect it to be more gradual recovery, and it might take a few more quarters. Is the understanding right?

Rahul Jain: That's correct.

Lavanya Tottala: And any inventory loss that we have taken in packaging business?

Rahul Jain: I said nothing here.

Lavanya Tottala: No inventory loss, right. Okay.

Moderator: The next question is from the line of Madhav Marda from Fidelity International.

Madhav Marda: A couple of questions on the capex. So one was on the pharma intermediate plant where we put up a fairly large gross block. Just any updates on the ramp-up there? And secondly, on the HFO where you indicated that the plant sort of is in the works. So just any timelines on that as well, please.

Rahul Jain: Too early to say. PIP has got commissioned only I think in May this year, which is probably only a month. I think we had also said that we expect ramp-up of the PIP plant to happen over the next 3 to 6 months. Again, the mix here is very important. We will see a good mix of products from the PIP plant coming through, probably some at the end of FY24, and therefore, some large revenues in FY25. HFO, I don't think it can change in 3 months. We've told you that we are working on the HFO piece. There is significant groundwork that is happening. I don't think it can update in 3 months. So that's the same thing that we had updated you when we talked to you last.

Moderator: The next question is from the line of Vishal Biraia from Bandhan Asset Management.

Vishal Biraia: So a lot of material we are hearing is getting imported into the U.S. And this could be largely Chinese materials that has been circumvented via some other countries. So are you seeing something of this sort happening? And these are slightly different blends, which can be made into the main consumption blends, like 34a and 410a. So I mean, how bad is this scenario of circumvented imports?

Rahul Jain: You're right to a certain extent, Vishal, that we've also heard some of the stories in terms of various types of blends being imported and circumventing duties. We've made appropriate representations on these. But again, Vishal, while these were some small positions that are getting created, we have to look at it from a longer-term perspective and probably more medium-term perspective from our side, where we still believe customer demand is there. We believe U.S. traction will build out during FY24; there is contracting that is happening probably currently, and hopefully, that should play out in our favor, Vishal. While these things will keep happening, you can only represent to the authorities on those.

Vishal Biraia: Okay. So would it be fair to assume that these circumvented imports via Turkey or via Vietnam are very small in quantity? Or have these become meaningful in the last few months?

Rahul Jain: Vishal, you can look at that import data and take a call. I have not been able to look at that import data and think through this. But maybe I can ask someone on the team to do that and then give us some better clarity on this. But you are right, we've also heard some news around it.

Moderator: The next question is from the line of Sanjesh Jain from ICICI Securities.

Sanjesh Jain: One on the guidance cut by our customer, it's in the range of 15% to 25%. And when they say inventory destocking, is that inventory at the innovator level? Or are they talking about the inventory at the distributor and retailer level? Where is the inventory pile-up happening in the entire ecosystem?

Rahul Jain: Largely at distributor level, Sanjesh, is what we hear.

Sanjesh Jain: Okay. It's largely distributor level. And then underlying demand, you are telling that it is intact. So we don't have to worry once this inventory is normalized. Is that the right understanding?

Rahul Jain: This is what we hear from the ground Sanjesh, from customers directly.

Sanjesh Jain: Got it, got it. Second, on the refrigerant gas side, how do you see domestic market prices recovering? Is it purely because of the demand slowdown? Or you think the quota determination period will have a slightly heightened competition? And where is this excess inventory coming? Is it coming from China to India?

Rahul Jain: To a certain extent, 32, I would say, yes, but not for 134 or blends. Again, there will be competition as some of the peers in the industry will come up with capacity. I think I answered this question in one of the previous questions that look at our capacity there, look at our marketing ability there in terms of our channel partners, look at our backward integration on each of the products. I think we should be in fairly good shape even with the competition coming in. Now whether there will be a price fall or not, I'm unable to say anything about it. We will only see once they are able to come up with the product and let's say, start to supply in the market.

Sanjesh Jain: Got it. But have you seen increased import coming from China? Is that happening?

Rahul Jain: 32, yes to a certain extent. It's actually very large, which has also therefore led to some price reduction on 32 in domestic market.

Sanjesh Jain: Okay. Not for 134a or the 125?

Rahul Jain: India is not a direct 125 consumer, Sanjesh.

Sanjesh Jain: But we have the 410a, right?

Rahul Jain: As I said, 125 is probably the smallest element of the HFCs.

Sanjesh Jain: Got it. And if you can give us some color, what is the price drop in 32 for India?

Rahul Jain: By product, we don't give that, Sanjesh. You have to do distributor checks, to come to know about it.

Sanjesh Jain: Ok It's not a problem. Just one last bit on the margin guidance. We said that in the last quarter that we will do better than FY23. How do you see margins for FY24 in the Chemicals business?

Rahul Jain: Closing Q4 margins were on the higher side. There will be some, tapering of the margin that should happen. I think that's the story that will play out. Even then we had not factored in the amount of inventory run down that we have seen. So to that extent, let's see what pans out. It's a dynamic situation that is playing out. And we will probably give you more colour on this as we go out in time.

Moderator: Thank you very much. We'll take that as last question. I now hand the conference over to the management for closing comments.

Rahul Jain: Thanks, everyone. I hope we've been able to answer all of your questions. If you have any further questions, we would be happy to be of assistance. We hope to have your valuable support on a continued basis as we move ahead. On behalf of the management, I once again, thank you for taking the time to join us on this call. Thank you.

Moderator: Thank you very much. On behalf of Investec Capital Services, that concludes this conference. Thank you for joining us. You may now disconnect your lines. Thank you.

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