

SELL

TP: Rs 1,525 | ▼ 31%

PIDILITE INDUSTRIES

Construction Materials

12 August 2021

Raw material pressure hurts gross margin

- Consolidated Q1 revenue grew 121% YoY, rebounding from a tepid base
- Gross margin contracted 435bps YoY but lower employee cost aided operating margin expansion of 10ppt
- We maintain estimates and roll over to a new Jun'22 TP of Rs 1,525 (vs. Rs 1,365); retain SELL

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Revenue growth rebounds off a weak base: PIDI's consolidated Q1FY22 revenue grew 121% YoY (112.5% ex-Hunstman) to Rs 19.4bn, with 79.5% YoY constant currency growth in overseas subsidiaries due to a low pandemic-hit base quarter. Standalone revenue increased 111% YoY to Rs 16.3bn with volume growth of ~105% (+103% in the consumer & bazaar segment and 113% in B2B). Per management, sales were adversely affected from mid-April to mid-June due to the pandemic but have improved thereafter.

Demand trends looking up: Demand has seen sustained recovery in July and early August post unlocking. Recovery has been broad-based across product categories and geographies and should sustain in the absence of further Covid restrictions. As per management, domestic subsidiaries such as Nina Percept will do well going ahead as the housing market is seeing better traction.

Gross margin declines on higher RM cost: Gross margin contracted 435bps YoY (-170bps QoQ) as prices for key material VAM increased to an average of US\$ 1,610/mt vs. US\$ 890/mt in Q1FY21 (\$1,200/mt in Q4). However, consolidated operating margin rose 1,040bps YoY to 17.9% due to lower employee cost (-1,008bps) and other expenses (-466bps) – this yielded EBITDA/PBT growth of 424%/821% YoY.

Margin pressures ahead: VAM prices peaked in April at ~US\$ 2,000/mt and are currently at US\$ 1,400-1,500/mt. Management expects a further gradual decline post Q2. The company has taken a price hike of 4-6% across products in Q1 which should cover ~75% of the increased RM cost. However, Q2 margins may be affected by high-cost inventory carried over from Q1.

Maintain SELL on expensive valuations: Though we like PIDI's business model, current valuations look rich at 68.2x FY23E EPS, especially in light of increased margin stress from higher input prices. We roll forward to a revised Jun'22 TP of Rs 1,525, based on a 45x one-year forward P/E multiple (42x earlier), in line with the stock's 10-year average.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	PIDI IN/Rs 2,221
Market cap	US\$ 15.2bn
Free float	30%
3M ADV	US\$ 16.0mn
52wk high/low	Rs 2,334/Rs 1,357
Promoter/FPI/DII	70%/12%/18%

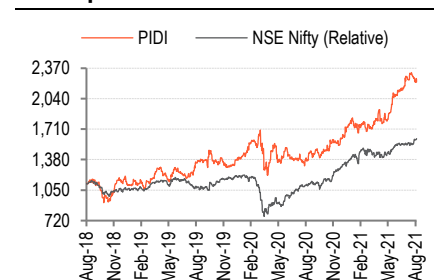
Source: NSE | Price as of 12 Aug 2021

Key financials

Y/E 31 Mar	FY21P	FY22E	FY23E
Total revenue (Rs mn)	72,927	89,662	1,03,920
EBITDA (Rs mn)	16,806	20,891	24,213
Adj. net profit (Rs mn)	11,339	14,160	16,547
Adj. EPS (Rs)	22.3	27.9	32.6
Consensus EPS (Rs)	22.3	26.4	32.7
Adj. ROAE (%)	22.6	24.1	25.4
Adj. P/E (x)	99.5	79.7	68.2
EV/EBITDA (x)	67.0	53.8	46.4
Adj. EPS growth (%)	(2.2)	24.9	16.9

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE



Fig 1 – Consolidated quarterly performance

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Net revenues	19,368	8,778	120.6	22,355	(13.4)
Raw Material Cost	9,857	4,085	141.3	10,996	(10.4)
Employee cost	2,806	2,157	30.1	2,627.1	6.8
Other expenses	3,229	1,873	72.4	4,124	(21.7)
EBITDA	3,476	664	423.7	4,608	(24.6)
EBITDA margin (%)	17.9	7.6	1,039bps	20.6	(267bps)
Depreciation and amortization	566	461	22.8	572	(1.0)
EBIT	2,910	203	1,335.4	4,036	(27.9)
EBIT Margin (%)	15.0	2.3	1,271bps	18.1	(303bps)
Net Interest expenses	96	91	6.1	74	29.3
Foreign exchange gain (loss), net	0	0	n.m.	0	n.m.
Other income	61	200	(69.4)	173	(64.7)
EBT and except. Items	2,875	312	821.3	4,135	(30.5)
Exceptional items	0	0	n.m.	(36)	(100.0)
Earnings before tax	2,875	312	821.3	4,099	(29.9)
Income taxes	721	159	354.9	1,038	(30.5)
Income tax as % of PBT	25.1	50.8	(2,572bps)	25.3	(23bps)
Earnings after tax	2,154	154	1,303.0	3,061	(29.6)
Profit in associate company	23	5	385.1	13	72.7
Minority interest (expense) income	24	110	n.m.	(13)	n.m.
Net income (loss), reported	2,201	268	721.8	3,062	(28.1)

Source: Company, BOBCAPS Research

Fig 2 – Consolidated segmental performance

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Revenue					
Consumer & Bazaar Products	14,862	7,020	111.7	17,303	(14.1)
Business to Business	4,820	1,882	156.1	5,350	(9.9)
Others	99	18	446.4	174	(43.1)
Total	19,782	8,921	121.8	22,827	(13.3)
Less: Inter Segment revenue	(414)	(142)	190.9	(472)	(12.3)
Net revenues	19,368	8,778	120.6	22,355	(13.4)
EBIT					
Consumer & Bazaar Products	3,704	1,305	183.8	4,692	(21.1)
Business to Business	420	(220)	(290.6)	524	(19.8)
Others	6	(35)	n.m.	14	(57.1)
Total	4,131	1,050	293.5	5,230	(21.0)
EBIT Margin (%)					
Consumer & Bazaar Products	24.9	18.6	633bps	27.1	(219bps)
Business to Business	8.7	(11.7)	2042bps	9.8	(108bps)
Total	21.3	12.0	937bps	23.4	(207bps)

Source: Company, BOBCAPS Research

Fig 3 – Standalone quarterly performance

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Net revenues	16,261	7,724	110.5	18,570	(12.4)
Raw material exp	8,256	3,514	135.0	8,944	(7.7)
Employee exp	2,293	1,717	33.6	2,157	6.3
Other exp	2,716	1,539	76.5	3,393	(19.9)
EBITDA	2,995	954	213.9	4,077	(26.5)
EBITDA margin (%)	18.4	12.4	607bps	22.0	(354bps)
Depreciation and amortization	405	348	16.3	393	2.9
EBIT	2,590	606	327.3	3,684	(29.7)
EBIT Margin (%)	15.9	7.8	808bps	19.8	(391bps)
Net Interest expenses	63	34	86.6	44	42.4
Other income	1,020	197	419.0	119	760.4
PBT	3,548	769	361.2	3,759	(5.6)
Income taxes	663	202	228.1	994	(33.3)
Income tax as % of PBT	18.7	26.3	(759bps)	26.4	(775bps)
Net income (loss), reported	2,885	567	408.7	2,765	4.3

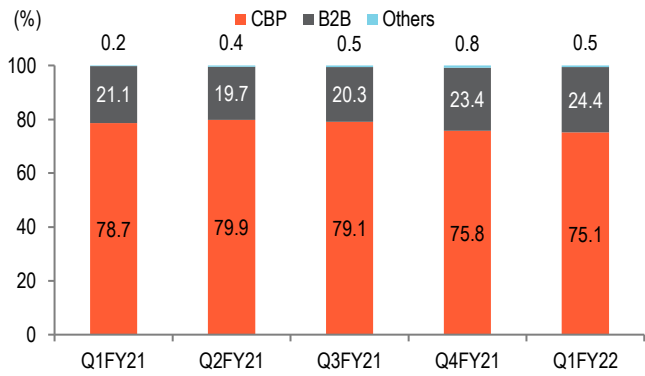
Source: Company, BOBCAPS Research

Fig 4 – Standalone segmental performance

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Revenue					
Consumer & Bazaar Products	12,522	6,145	103.8	14,510	(13.7)
Business to Business	3,961	1,683	135.3	4,207	(5.8)
Others	99	18	446.4	174	(43.2)
Total	16,583	7,846	111.4	18,891	(12.2)
Less: Inter Segment revenue	(322)	(122)	163.9	(321)	0.3
Net revenues	16,261	7,724	110.5	18,570	(12.4)
EBIT					
Consumer & Bazaar Products	3,295	1,470	124.1	4,295	(23.3)
Business to Business	541	55	878.1	606	(10.8)
Others	6	(35)	n.m.	14	(57.4)
Total	3,842	1,491	157.7	4,915	(21.8)
EBIT Margin (%)					
Consumer & Bazaar Products	26.3	23.9	238bps	29.6	(329bps)
Business to Business	13.7	3.3	1,037bps	14.4	(75bps)
Others	6.1	(193.4)	19,944bps	8.1	(204bps)
Total	23.6	19.3	432bps	26.5	(284bps)

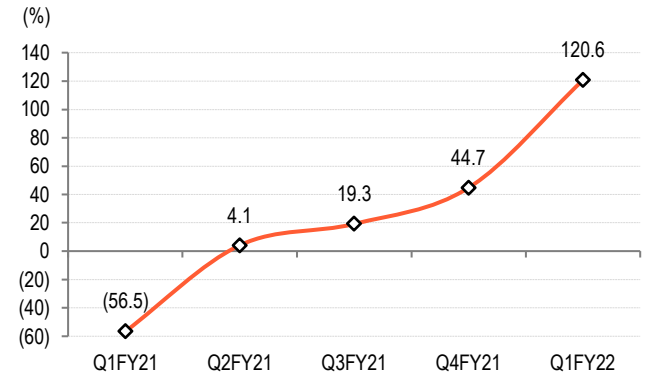
Source: Company, BOBCAPS Research

Fig 5 – Consolidated revenue breakup



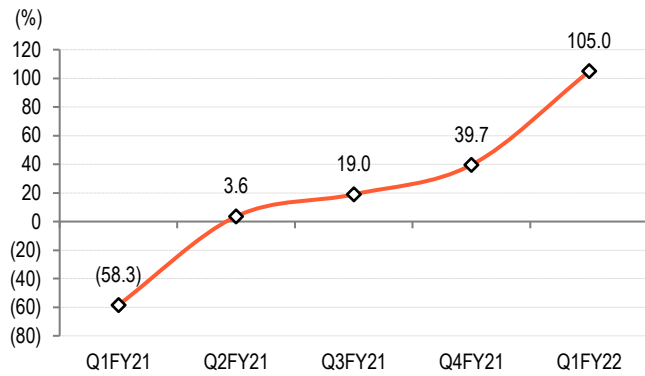
Source: Company, BOBCAPS Research

Fig 6 – Consolidated revenue growth



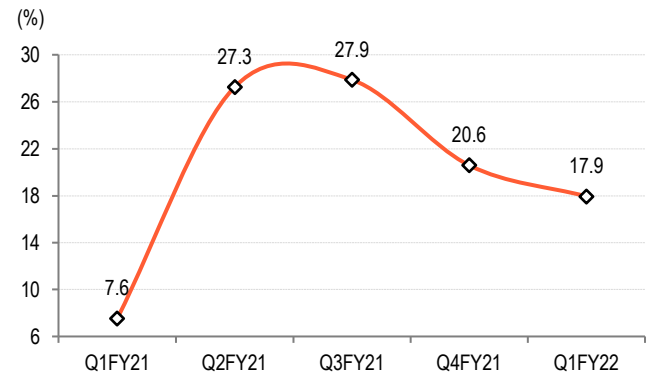
Source: Company, BOBCAPS Research

Fig 7 – Total volume growth



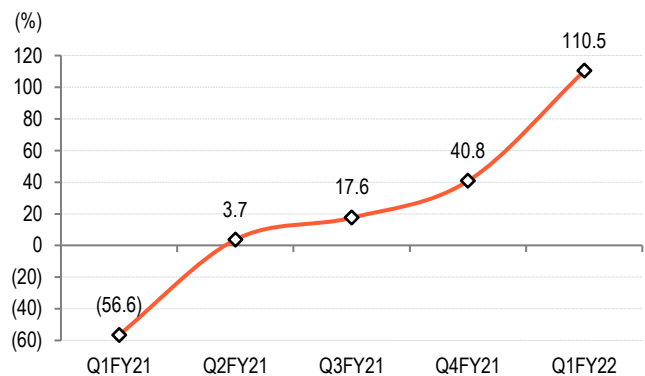
Source: Company, BOBCAPS Research

Fig 8 – Consolidated EBITDA margin



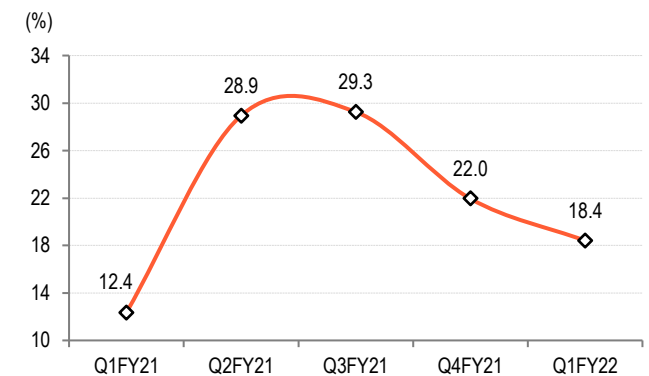
Source: Company, BOBCAPS Research

Fig 9 – Standalone revenue growth



Source: Company, BOBCAPS Research

Fig 10 – Standalone EBITDA margin



Source: Company, BOBCAPS Research

Earnings call highlights

- Demand in Q1FY22 was dampened by the second Covid wave but has begun to recover from mid-June. The consumer & bazaar business saw traction in the DIY, construction chemical and adhesive segments during the quarter.
- Hunstman, acquired in Nov'20, posted revenue of ~Rs 717mn and EBITDA of Rs 223mn in Q1. Management believes operating margins in this business will always be higher than PIDI's overall margins.
- Prices of key input VAM have hardened from US\$ 890/mt in Q1FY21 to US\$ 1,610/mt in Q1FY22. They peaked at US\$ 2,000/mt in April before correcting to current levels of US\$ 1,400-1,500/mt.
- The company has taken a price increase of 4-6% in Q1 which will cover 75% of the input cost inflation.
- Q2 margins may be impacted as PIDI carries high-cost inventory of Q1 but should improve thereafter as RM prices are falling.
- The company continues to focus on rural/semi-urban markets for deeper product penetration.
- In the international business, the Americas grew 37% YoY in Q1, the Middle East and Africa grew 84%, and Asia 129%.
- Per management, the revamp of its international strategy initiated 3.5-4 years ago is working.
- The company will incur capex at 4-6% of sales.
- Gross margins in adhesives and construction chemicals are similar. However, the construction chemicals business earns lower operating margins as the company spends heavily in this category.
- The arts & crafts business has suffered heavily due to the lockdown but should revive once schools reopen. Management sees this as a high focus area and plans to launch innovative products going ahead.

Valuation methodology

PIDI is the leader in India's adhesive market with a strong brand, extensive distribution reach and large product portfolio. The company has a unique distribution framework, with products available in both building material as well as FMCG channels.

While we like PIDI's business model, current valuations at 68.2x FY23E EPS appear rich against the backdrop of earnings risk from higher raw material prices. We maintain our estimates and roll over to a Jun'22 TP of Rs 1,525 (vs. Rs 1,365), based on a 45x one-year forward P/E multiple (42x earlier), in line with the stock's 10-year average. Retain SELL.

Fig 11 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
Consumer & Bazaar Products (Rs mn)	58,089	69,707	80,163	91,386
Growth (%)	4.2	20.0	15.0	14.0
Business to Business (Rs mn)	15,754	19,377	23,093	27,576
Growth (%)	(12.3)	23.0	19.2	19.4

Source: Company, BOBCAPS Research

Fig 12 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
					FY22E	FY23E	FY22E	FY23E	
Kajaria Ceramics	KJC IN	HOLD	995	19.5	24.2	29.8	20.1	23.4	32
Somany Ceramics	SOMC IN	BUY	820	17.5	22.8	33.9	13.8	17.6	22
Greenply Industries	MTLM IN	HOLD	210	18.0	8.9	10.5	22.4	21.5	20
Century Plyboard	CPBI IN	HOLD	395	19.5	12.0	14.8	19.2	19.7	25
Greenpanel Industries	GREENP IN	BUY	315	25.1	12.2	16.4	14.3	18.6	18
Cera Sanitaryware	CRS IN	HOLD	4,375	16.1	115.4	138.1	16.2	17.1	30
Astral	ASTRA IN	SELL	1,400	19.1	21.3	26.4	26.0	29.4	50
Finolex Industries	FNXP IN	HOLD	185	4.2	7.3	7.5	13.9	13.2	24
Supreme Industries	SI IN	HOLD	1,990	11.2	56.2	63.4	22.6	21.5	30
Pidilite industries	PIDI IN	SELL	1,525	19.4	27.9	32.6	24.1	25.4	45
Asian Paints*	APNT IN	NR	NA	12.9	38.5	47.3	27.1	29.4	NA

Source: BOBCAPS Research | *Bloomberg consensus, NR – Not Rated

Key risks

Key upside risks to our estimates are:

- **Sharp decline in raw material prices:** Any sudden, steep fall in RM prices, especially for crude-linked products, could drive above-expected margins.
- **Above-expected pickup in housing activity:** A stronger revival in the housing market than anticipated can take growth ahead of estimates

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21P	FY22E	FY23E	FY24E
Total revenue	72,945	72,927	89,662	1,03,920	1,19,726
EBITDA	15,760	16,806	20,891	24,213	28,016
Depreciation	(1,699)	(2,007)	(2,242)	(2,598)	(2,993)
EBIT	14,061	14,800	18,650	21,615	25,023
Net interest inc./(exp.)	(336)	(372)	(180)	(135)	(60)
Other inc./(exp.)	396	794	699	921	989
Exceptional items	0	0	0	0	0
EBT	15,219	15,221	19,169	22,401	25,952
Income taxes	(3,477)	(3,964)	(4,984)	(5,824)	(6,748)
Extraordinary items	(552)	(36)	0	0	0
Min. int./Inc. from assoc.	(26)	91	(25)	(30)	(35)
Reported net profit	11,164	11,312	14,160	16,547	19,169
Adjustments	426	27	0	0	0
Adjusted net profit	11,590	11,339	14,160	16,547	19,169

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21P	FY22E	FY23E	FY24E
Accounts payables	6,210	10,067	9,217	10,705	12,333
Other current liabilities	9,185	12,958	12,458	11,958	11,458
Provisions	735	829	959	1,109	1,259
Debt funds	1,691	2,139	3,000	850	850
Other liabilities	823	3,980	3,980	3,980	3,980
Equity capital	508	508	508	508	508
Reserves & surplus	44,048	55,421	61,201	67,956	75,781
Shareholders' fund	44,556	55,930	61,710	68,464	76,289
Total liab. and equities	65,357	88,304	93,796	99,621	1,08,821
Cash and cash eq.	7,033	4,515	9,052	10,689	13,985
Accounts receivables	10,885	13,210	13,511	15,659	18,041
Inventories	9,295	12,342	11,521	12,043	13,875
Other current assets	10,157	9,190	10,170	11,115	12,146
Investments	7,197	1,765	1,810	1,863	1,924
Net fixed assets	12,890	14,428	39,450	39,969	40,568
CWIP	2,593	2,939	2,939	2,939	2,939
Intangible assets	5,178	29,751	5,178	5,178	5,178
Deferred tax assets, net	130	166	166	166	166
Other assets	0	0	0	0	0
Total assets	65,357	88,304	93,796	99,621	1,08,821

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21P	FY22E	FY23E	FY24E
Cash flow from operations	13,474	14,866	14,971	16,884	18,352
Capital expenditures	(4,687)	(24,088)	(2,690)	(3,118)	(3,592)
Change in investments	4,317	5,433	(46)	(53)	(61)
Other investing cash flows	33	1,203	0	0	0
Cash flow from investing	(337)	(17,452)	(2,736)	(3,170)	(3,652)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	581	448	861	(2,150)	0
Interest expenses	(336)	(372)	(180)	(135)	(60)
Dividends paid	(8,254)	(7)	(8,380)	(9,792)	(11,344)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(8,009)	69	(7,698)	(12,077)	(11,403)
Chg in cash & cash eq.	5,128	(2,517)	4,537	1,637	3,296
Closing cash & cash eq.	7,032	4,515	9,052	10,689	13,985

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21P	FY22E	FY23E	FY24E
Reported EPS	22.0	22.3	27.9	32.6	37.7
Adjusted EPS	22.8	22.3	27.9	32.6	37.7
Dividend per share	13.5	8.5	13.1	15.3	17.8
Book value per share	87.7	110.1	121.4	134.7	150.1

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21P	FY22E	FY23E	FY24E
EV/Sales	15.5	15.4	12.5	10.8	9.4
EV/EBITDA	71.6	67.0	53.8	46.4	40.0
Adjusted P/E	97.4	99.5	79.7	68.2	58.9
P/BV	25.3	20.2	18.3	16.5	14.8

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21P	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	76.2	74.5	73.9	73.9	73.9
Interest burden (PBT/EBIT)	108.2	102.8	102.8	103.6	103.7
EBIT margin (EBIT/Revenue)	19.3	20.3	20.8	20.8	20.9
Asset turnover (Rev./Avg TA)	117.2	94.9	98.5	107.5	114.9
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.5	1.4
Adjusted ROAE	26.9	22.6	24.1	25.4	26.5

Ratio Analysis

Y/E 31 Mar	FY20A	FY21P	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	3.0	0.0	22.9	15.9	15.2
EBITDA	15.2	6.6	24.3	15.9	15.7
Adjusted EPS	30.2	(2.2)	24.9	16.9	15.8
Profitability & Return ratios (%)					
EBITDA margin	21.6	23.0	23.3	23.3	23.4
EBIT margin	19.3	20.3	20.8	20.8	20.9
Adjusted profit margin	15.9	15.5	15.8	15.9	16.0
Adjusted ROAE	26.9	22.6	24.1	25.4	26.5
ROCE	23.3	20.1	21.6	23.0	24.4
Working capital days (days)					
Receivables	54	60	54	51	51
Inventory	100	117	104	88	84
Payables	38	53	51	46	46
Ratios (x)					
Gross asset turnover	2.9	2.5	2.0	1.7	1.9
Current ratio	2.1	1.5	1.9	2.1	2.3
Net interest coverage ratio	41.8	39.8	103.7	160.4	420.6
Adjusted debt/equity	(0.1)	0.0	(0.1)	(0.1)	(0.2)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

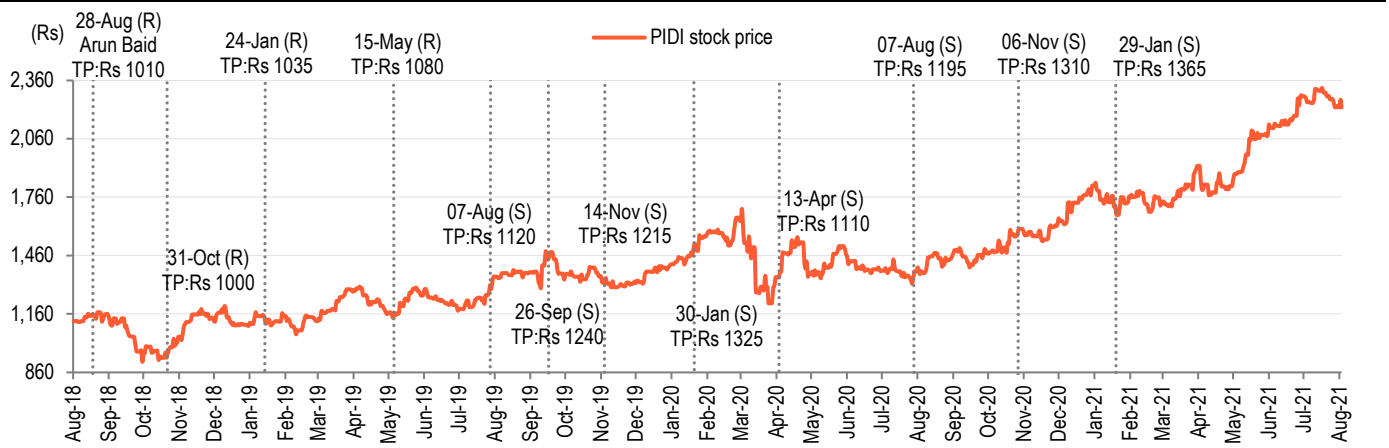
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): PIDILITE INDUSTRIES (PIDI IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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