



Pidilite Industries Limited

Strong quarter, Araldite acquisition strengthens the product basket

Building Materials

Sharekhan code: PIDILITIND

Result Update

3R MATRIX

	+	=	-
Right Sector (RS)	✓	✗	✗
Right Quality (RQ)	✓	✗	✗
Right Valuation (RV)	✓	✓	✗

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	✗	↔	✓
RQ	✗	↔	✓
RV	✗	↔	✗

Reco/View	Change
Reco: Buy	↔
CMP: Rs. 1,596	
Price Target: Rs. 1,875	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

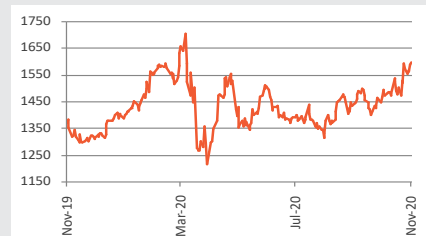
Company details

Market cap:	Rs. 81,075 cr
52-week high/low:	Rs. 1,710/1,186
NSE volume: (No of shares)	9.4 lakh
BSE code:	500331
NSE code:	PIDILITIND
Free float: (No of shares)	15.1 cr

Shareholding (%)

Promoters	70.2
FII	10.9
DII	8.7
Others	10.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.5	19.8	11.5	16.4
Relative to Sensex	2.7	9.6	-20.7	12.9

Sharekhan Research, Bloomberg

Summary

- Pidilite Industries' (Pidilite's) Q2FY2021 performance was boosted by a strong recovery in the domestic consumer bazaar business (up 7.3%) and OPM expansion of 603 bps to 22.6%.
- Consolidated revenues and PBT grew by 4% and 27% beating ours as well as the street's expectations.
- With intensity of the COVID-19 virus receding, the domestic consumer business is expected to post better growth in the coming quarters, while the B2B business is expected to reach pre-COVID levels in H2. International markets such as America, Middle East, Africa and Asia posted a recovery.
- Acquisition of Araldite brand strengthens commanding position in domestic adhesives space. We maintain a Buy on the stock with a revised PT of Rs. 1,875.

Consolidated revenue grew by 4.1% y-o-y to Rs. 1,880.3 crore (driven by a sales and volume mix of 3.6%), ahead of our expectation of Rs. 1,842.9 crore. The consumer bazaar business registered volume and mix growth of 7.2%, while B2B (largely industrial products) business declined by 8.4% in Q2FY2021 (but recovered from 53% decline in Q1). Improved growth in the consumer business is attributable to double-digit growth in the rural markets and tier-IV towns. Globally, the American region registered a strong growth of ~52% in revenues and EBIDTA margins improved to 26% (excluding one-time tax gain of Rs. 9.5 crore). Benign input prices (largely those of VAM) aided in gross margins to remain high by 256 bps to 55.9%. OPM improved by 603 bps y-o-y to 27.3% ahead of our expectation of 22.6%. Operating profit grew by 39.2% and PBT grew by 27.2% to Rs. 477.8 crore (ahead of our expectation of Rs. 386.8 crore). Despite washed out Q1, the company's cash flow from operating activities stood stable at Rs. 662.7 crore in H1FY2021 compared to Rs. 751.9 crore in H1FY2020. With construction activities gaining momentum in the rural and semi-urban markets, the consumer bazaar business is expected to post better performance in the coming quarters. International markets such as America, Middle East & Africa and Asia clocked a recovery. Further, Pidilite acquired an iconic adhesive brand, Araldite, by wholly acquiring Huntsman Advanced Materials Solutions Private Limited (HAMSPL), a subsidiary of Huntsman Group, US). The acquisition is done at a cash consideration of ~Rs. 2,100 crore, which is largely done through internal accruals. The acquisition will expand Pidilite's adhesive portfolio with iconic brands such as Araldite (market leader in the epoxy adhesives), which will help to further strengthen its commanding positioning in the domestic adhesives market.

Key positives

- Consolidated OPM expanded by 603 bps to 27.2% driven by lower input prices and operating efficiencies.
- American region's revenues grew by 52% to Rs. 81.3 crore and EBIDTA stood at Rs. 20 crore (highest in the past several quarters).
- Acquisition of HAMSPL includes the trademark license for Middle East, Africa and ASEAN countries.

Key negatives

- The business in metros is yet to recover to pre-COVID levels.
- VAM prices have started hardening, which will affect gross margins in the coming quarters.

Our Call

View -Retain Buy with revised PT of Rs. 1,875: We have broadly maintained our earnings estimates despite strong performance to factor in the impact of an increase in raw material prices in H2FY2021. With a strong portfolio of brands, Pidilite has a monopoly in the domestic adhesives market. The acquisition of Araldite brand further strengthens its position in the domestic adhesives space. The stock is currently trading at 51x its FY2023E EPS. A portfolio of strong brands, consistent cash generation and good return profile makes it a quality investment bet from a long-term perspective. We maintain our Buy recommendation on the stock with a revised price target of Rs. 1,875.

Key Risks

If COVID-19 global pandemic takes time to get under control, the recovery will be gradual (with possibility of frequent lockdowns), which will continue to affect the financial performance of Pidilite in the near term.

Valuation (Consolidated)

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	7,078	7,294	6,598	8,241	9,122
OPM (%)	19.3	21.6	22.1	23.1	23.8
Adjusted PAT	946	1,177	996	1,365	1,588
% YoY growth	-2.0	24.4	-15.4	37.1	16.3
Adjusted EPS (Rs.)	18.6	23.2	19.6	26.9	31.3
P/E (x)	85.6	68.9	81.4	59.4	51.0
P/B (x)	19.5	18.2	15.9	13.3	11.1
EV/EBIDTA (x)	52.7	46.3	50.3	37.7	32.3
RoNW (%)	24.5	27.4	20.9	24.4	23.7
RoCE (%)	22.6	22.7	17.9	20.7	20.2

Source: Company; Sharekhan estimates

Revenue grew by 4% y-o-y, benign input prices and efficiencies drive margin expansion: Consolidated revenues grew by 4.1% y-o-y to Rs. 1,880.3 crore as sales volumes and mix grew by 3.6%, ahead of our expectation of Rs. 1,842.8 crore. Gross margins improved by 256 bps to 55.9% mainly on account of lower raw material prices (largely those of VAM). This, along with lower other expenses led to sharp rise in OPM by 688 bps to 7.6% (slightly ahead of our and street expectation of 6%). Standalone (~87% of overall business) OPM stood at 27.3%. Consolidated operating profit grew by 39.2% y-o-y to Rs. 512.6 crore. Considerably lower other income and higher depreciation charges resulted in profit before tax to grow slightly lower by 27.2% y-o-y to Rs. 477.8 crore. Adjusted PAT grew by just 4.9% y-o-y to Rs. 356.4 crore, mainly on account of a one-time tax gain in the base quarter due to reduction in the corporate tax rate, but stood ahead of our expectation of Rs. 317.7 crore. Reported PAT grew by 9.7% y-o-y to Rs. 356.4 crore in Q2FY2021 as against Rs. 325 crore in Q2FY2020.

Standalone revenue grew by 3.7% y-o-y: Standalone revenue grew by 3.7% y-o-y to Rs. 1,630.2 crore from Rs. 1,571.7 crore in Q2FY2020. Comparable standalone net sales of the consumer & bazaar business grew by 7.2% y-o-y while the B2B business (largely industrial products) declined by 8.4% y-o-y in Q2FY2021 (but recovered from 53% decline in Q1). Lower input prices drove up gross margins by 281 bps to 56.5%. OPM improved significantly by 661 bps to 28.9% driven by operating efficiencies. Operating profit was up by 34.4% y-o-y to Rs. 471.9 crore, whereas PBT rose by 21.7% y-o-y to Rs. 455.4 crore. A higher tax incidence caused adjusted PAT to decline by 2.1% y-o-y to Rs. 339.2 crore. Reported PAT came in at Rs. 338.8 crore.

Araldite acquisition strengthens position in epoxy adhesive category

Pidilite entered into definitive agreement with Huntsman Group (US) for wholly acquiring in one of their subsidiaries in India namely, Huntsman Advanced Materials Solutions Private Limited (HAMSPL). HAMSPL manufactures and sells Adhesives, Sealants and other products under well-known brands such as Araldite, Araldite Karpenter and Araseal in India. Araldite is a leading brand in the domestic epoxy adhesive category with a share of more than one-third of the market. The epoxy adhesives are largely used in the non-wood construction activities. The acquisition will help Pidilite have a leadership positioning in the space. It can use its strong distribution reach to penetrate the brand in the other markets. The brand has operating margins in line with Pidilite's operating margins. Pidilite's current focus would be to increase the growth prospects of the brand in the near to medium term.

Acquisition funded by internal accruals

The Araldite acquisition has been done for a cash consideration of ~Rs. 2,100 crore, excluding customary working capital and other adjustments. The acquisition was funded by internal accruals with an upfront payment of 90% of the transaction value (remaining 10% will be paid after meeting some of the performance parameters). In addition to the Indian subcontinent business, the acquisition includes a trademark license for Middle East, Africa and ASEAN countries.

Other conference call highlights

- ♦ Demand for consumer & bazaar products remains high in rural and tier-IV towns due to commencement of construction activities (largely one storey/two storey houses were waterproofing and other adhesive products are used). Hence, rural and semi-urban markets recorded double-digit growth with strong demand for construction chemical products. Metros are yet to see demand reach pre-COVID levels but have started seeing a sequential improvement. Once real estate/construction gain some pace in the metros and large cities demand for the construction chemicals products will improve in the coming quarters.
- ♦ Among categories, construction chemicals and do-it-yourself products are seeing strong traction and driving the growth for the company. Woodwork adhesives have gained momentum and got into positive growth trajectory. Tile adhesives/joinery adhesives are doing well. Floor coating is also seeing good demand in the semi-urban markets.
- ♦ Nina Percept (domestic subsidiary) largely caters to premium real estate projects (multi-storey buildings/large projects) constructed in metros. Since most these projects are operating at very slow pace or halted, Nina Percept's revenue has been impacted. So the company is focusing on divert the business into large construction projects such building of tunnels/airports, etc.
- ♦ VAM prices have moved up to \$900 in recent times. Consumption cost in Q2FY2021 stood at \$765/tonne as against \$901/tonne in Q2FY2020. It stood at \$822/tonne in Q1FY2021. The hardening of VAM prices are expect to affect margins in the coming quarters (likely to be sequentially lower on quarter-on-quarter basis. Though input prices are going up, cost efficiencies would help margins to remain flat or marginally high in H2FY2021.
- ♦ Pidilite's capacity utilisation currently stands at 90%. So the company plans to undertake capital expenditure which will be 4-5% of revenues in the coming years to enhance the capacity.

Results (Consolidated)				Rs cr	
Particulars	Q2FY21	Q2FY20	y-o-y (%)	Q1FY21	q-o-q (%)
Total Revenue	1880.3	1806.6	4.1	877.8	-
Raw Material Cost	828.4	842.2	-1.6	408.5	102.8
Employee Cost	242.1	234.5	3.3	215.7	12.3
Other Expenses	297.2	361.7	-17.8	187.3	58.7
Total Operating Cost	1367.7	1438.3	-4.9	811.5	68.5
Operating Profit	512.6	368.2	39.2	66.4	-
Other Income	21.7	55.8	-61.1	20.0	8.5
Interest & Other Financial Cost	8.7	8.3	4.5	9.1	-4.6
Depreciation	47.9	40.2	19.0	46.1	3.9
Profit Before Tax	477.8	375.5	27.2	31.2	-
Tax Expense	122.0	36.6	-	15.9	-
Adjusted PAT before MI	355.8	338.9	5.0	15.4	-
Minority Interest (MI)	0.6	1.1	-42.5	0.5	29.8
Adjusted PAT after MI	356.4	339.9	4.9	15.8	-
Exceptional Items	0.0	14.9	-	0.0	-
Reported PAT	356.4	325.0	9.7	15.8	-
Adj. EPS (Rs)	7.0	6.7	4.9	0.3	-
			bps		bps
GPM (%)	55.9	53.4	256	53.5	248
OPM (%)	27.3	20.4	688	7.6	-

Source: Company; Sharekhan Research

Result Snapshot (Standalone)				Rs cr	
Particulars	Q2FY21	Q2FY20	y-o-y (%)	Q1FY21	q-o-q (%)
Total Revenue	1630.2	1571.7	3.7	772.4	-
Operating Profit	471.9	351.0	34.4	95.4	-
Profit Before Tax	455.4	374.3	21.7	76.9	-
Tax Expense	116.2	28.0	-	20.2	-
Adjusted PAT before MI	339.2	346.3	-2.1	56.7	-
Exceptional Items	0.5	22.2	-	0.0	-
Reported PAT	338.8	324.1	4.5	56.7	-
Adj. EPS (Rs)	6.7	6.8	-2.1	1.1	-
			bps		bps
GPM (%)	56.5	53.7	281	54.5	201
OPM (%)	28.9	22.3	661	12.4	-

Source: Company; Sharekhan Research

Segmental performance snapshot (Standalone)				Rs cr	
Particulars	Q2FY21	Q2FY20	y-o-y (%)	Q1FY21	q-o-q (%)
Consumer & Bazaar	1527.7	1396.9	9.4	702.0	-
Business to Business	377.1	433.3	-13.0	188.2	100.3
Others	7.2	16.4	-56.5	1.8	-
Total revenue	1911.9	1846.7	3.5	892.1	-
Consumer & Bazaar	532.4	378.2	40.7	132.0	-
Business to Business	29.0	62.9	-53.9	-22.7	-
Others	0.8	-2.5	-	-3.5	-
Total PBIT	562.1	438.6	28.2	105.9	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Long-term growth prospects of construction chemicals intact

India's construction chemicals industry is at a nascent stage with a market size of ~Rs. 6,500-7000 crore, which is just 4-5% of the global construction chemicals market. An increase in construction and infrastructure activities with a strong adherence to quality will drive demand for construction chemicals in the near to medium term. Further, growing adoption of green-building concept and increasing government regulations pertaining to the use of high-quality waterproofing systems with low volatile organic compounds (VOC) and insulation would result in shift to products with brand recognition in the medium to long term. With government focusing on improving the growth prospects of furniture sector and converting it into one of the major exporting hubs, demand for adhesives is expected to increase in the coming years.

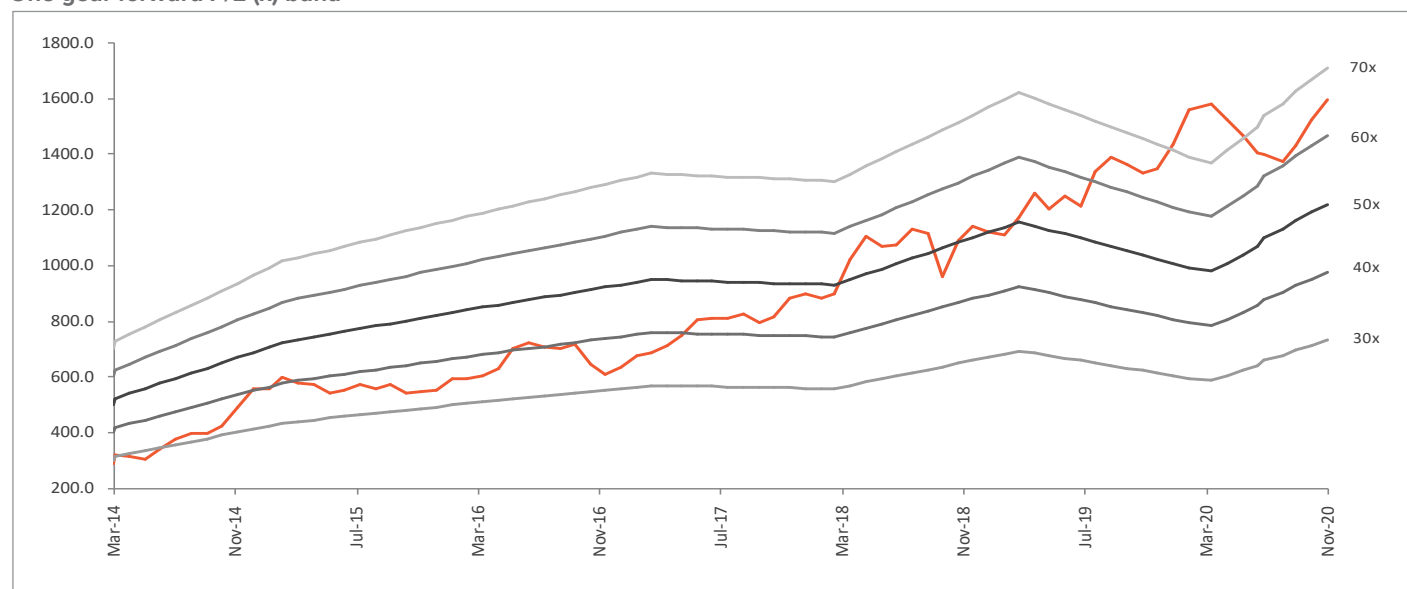
■ Company outlook - Strong growth expected in FY2022

With intensity of the Coronavirus receding in India, domestic consumer business is expected to post better growth in the coming quarter while B2B business has recovered to 92% of pre-COVID levels. International markets such as America, Middle East & Africa and Asia posted a recovery in performance. Thus, H2FY2021 is expected to be much better than H1FY2021 in terms of revenues. However, hardening of raw material prices would put pressure on the margins in the second half. Consistent cash flow generation and a strong portfolio of brands would help the company to stay ahead of competition in tough times. FY2022 is expected to see strong double-digit revenue growth driven by strong pent-up demand in categories. We expect revenues and PAT to grow at a CAGR of 8% and 12% over FY2020-23E (likely to grow at a CAGR of 18% and 26% over FY2021-23E).

■ Valuation - Retain Buy with revised PT of Rs. 1,875

We have broadly maintained our earnings estimates despite strong performance to factor in the impact of an increase in raw material prices in H2FY2021. With a strong portfolio of brands, Pidilite has a monopoly in the domestic adhesives market. The acquisition of Araldite brand further strengthens its position in the domestic adhesives space. The stock is currently trading at 51x its FY2023E EPS. A portfolio of strong brands, consistent cash generation and good return profile makes it a quality investment bet from a long-term perspective. We maintain our Buy recommendation on the stock with a revised price target of Rs. 1,875.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Asian Paints	76.2	78.8	62.3	47.4	48.0	38.9	22.2	19.7	21.8
Astral Poly Technik	70.9	68.3	50.2	39.7	38.8	30.0	21.4	19.1	22.3
Pidilite Industries	68.7	81.3	59.3	46.2	50.2	37.7	22.7	17.9	20.7

Source: Company, Sharekhan Research

About company

Pidilite is a leading manufacturer of adhesives and sealants, construction chemicals, crafts products, DIY (Do-It-Yourself) products and polymer emulsions in India. Pidilite has divided its business into two segments; Consumer & Bazaar Product segment (C&B; includes adhesives, sealants, art and craft material and others, construction and paint chemicals) and Industrial Product segment (IP; includes industrial adhesives, synthetic resins, organic pigments, pigment preparations and surfactants). C&B accounts for ~84% of Pidilite's standalone revenue while balance is contributed by IP segment. The company's brand name Fevicol has become synonymous with adhesives to millions in India and is ranked amongst the most trusted brands in the country. Some of the other major brands are M-Seal, Fevikwik, Fevistik, Roff, Dr. Fixit and Fevicryl.

Investment theme

Pidilite has monopoly in the domestic adhesive market on account of its strong product portfolio. Over the years it has transformed itself from B2B to B2C players by consistently introducing consumer centric product in the domestic market. Though FY2021 will be affected by the pandemic situation, its long term growth prospects are intact as the company is continuously launching new products under core brands, entering into new categories, expanding into neighbouring countries and enhancing the domestic distribution reach. Strong cash flows, lean balance sheet and decent payout makes it safest better in the volatile market environment.

Key Risks

- ♦ **Sustenance of pandemic situation:** If global pandemic situation takes time to get under control, the recovery in the business environment will take more time, which will continue affect the financial performance of Pidilite in the near term.
- ♦ **Increase in competition:** Any increase in competition from established players would act as a key risk to the earnings estimates in the near to medium.

Additional Data

Key management personnel

Madhukar Parekh	Chairman
Bharat Tilakraj Puri	Managing Director
Pradip Menon	Chief Financial Officer
Puneet Bansal	Company Secretary

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Genesis Indian Investment Co Ltd	5.0
2	Life Insurance Corporation Of India	3.4
3	Axis Asset Management Co Ltd	2.5
4	Axis Equity Advantage Fund	2.3
5	Vanguard Group	0.9
6	Blackrock Inc	0.7
7	Norges Bank	0.7
8	UTI Asset Management Company	0.4
9	Capital Group Cos Inc	0.3
10	Principal Financial Group Inc	0.3

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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