



Pidilite Industries Limited

Eyeing strong post-pandemic recovery

Consumer Goods

Sharekhan code: PIDILITIND

Company 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

Reco/View	Change
Reco: Buy	↔
CMP: Rs. 2,065	
Price Target: Rs. 2,315	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

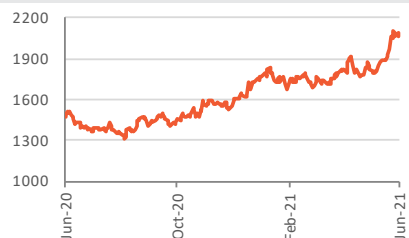
Company details

Market cap:	Rs. 1,04,929 cr
52-week high/low:	Rs. 2,124 / 1,307
NSE volume: (No of shares)	7.4 lakh
BSE code:	500331
NSE code:	PIDILITIND
Free float: (No of shares)	15.2 cr

Shareholding (%)

Promoters	70.2
FII	11.9
DII	7.6
Others	10.37

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	14.0	19.6	29.1	36.7
Relative to Sensex	7.6	16.7	13.0	-15.5

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy recommendation on Pidilite Industries Limited (Pidilite), with a revised PT of Rs. 2,315. Pidilite's dominance in the construction chemical and adhesive space and strong balance sheet will keep valuations at premium levels.
- With 50% drop in COVID-19 cases from its peak of 3.9 lakh cases in the second wave, India is gearing up for unlock. Gradual unlock in respective states would result in recovery in construction chemical products due to pent-up demand.
- Low penetration for waterproofing products, improved demand for construction chemicals in rural areas, and market share gains from small players are key growth drivers in the medium term.
- Spike in VAM prices and uncertain demand in the current environment are key headwinds in the near term. The company is targeting to maintain OPM of 20%-24% in the medium term.

Pidilite Industries Limited (Pidilite) reported flat sales at Rs. 7,293 crore in FY2021. Sales declined by ~28% in H1FY2021, but the company posted strong recovery in H2FY2021 with a 29% revenue growth. Robust growth was seen across categories – adhesives, construction chemicals, and do-it-yourself (DIY) categories, driven by continued demand momentum in both rural and urban areas in the second half of year. With a recovery in the macroeconomic environment and a consequential improvement in industrial/construction activities, the B2B business clocked strong double-digit growth. The second wave of COVID-19 will affect the company's performance in the near-term performance, as the spread is deeper in rural India. With a 50% drop in COVID-19 cases from its peak of 3.9 lakh cases in the second wave, India is gearing up for easing of lockdowns again. Our interaction with various small construction companies and dealers suggest that full recovery is expected by August 2021/September 2021 with easing of restrictions and consumers allowing plumbers/workers to perform internal plumbing/waterproofing activities/home improvement activities. This is in line with the trend seen during the first wave when a recovery was visible from Q2FY2021. Two key differentials in the first wave and second wave were 1) government projects/ construction activities continued in the some of the less affected states in the second wave, resulting in a steady demand for B2B industrial products; and 2) international markets such as America, Middle East, and Africa are expected to perform well as most markets have opened up after significant drop in cases and massive vaccination drive. PIL's management expects strong recovery post the normalisation of the pandemic due to improving penetration of waterproofing products in urban and rural markets, shift to branded products in the rural market, and market share gains from small players in the current environment of rising input prices and liquidity concerns. The sharp increase in VAM prices will put margins under pressure in the near term. Management believes a sharp increase in VAM prices is due to supply disruption as demand remains stable. Hence, from July 2021 the company expects prices to correct once supply normalises. The company has hiked prices by 5-6%, which covers 75% of raw-material inflation. Further price hikes will be undertaken if input prices continue to surge from current levels. The newly-acquired Huntsman Advanced Material Solutions Pvt. Ltd. (HAMSPL) is expected to contribute revenue of ~Rs. 500 crore annually, which is achieving an operating profit margin (OPM) of about 35%. Thus, the company is focusing on maintaining OPM of 20-24% in the medium term. The working capital cycle stood stable at 62 days and cash & cash equivalents on books stood at Rs. 625 crore.

Our Call

View: Retain Buy with a revised PT of Rs. 2,315: Low penetration of water-proofing activities as compared to other countries, shift to branded products (especially in rural markets), and introduction of new products augur well for the company from a long-term perspective. With a strong brand portfolio, Pidilite has a monopoly in the domestic adhesives market and acquisition of the Araldite brand further strengthens its position in this space. The stock currently trades at 64.8x its FY2023E earnings. A monopoly in the adhesives market, consistently strong cash-generation ability, and robust growth prospects will continue to keep valuations at a premium. We maintain a Buy recommendation on the stock with a revised price target (PT) of Rs. 2,315.

Key Risks

Any sustained slowdown in domestic business performance due to frequent lockdowns or increase in VAM prices would act as key risks to our earnings estimates in the near to medium term.

Valuation (Consolidated)

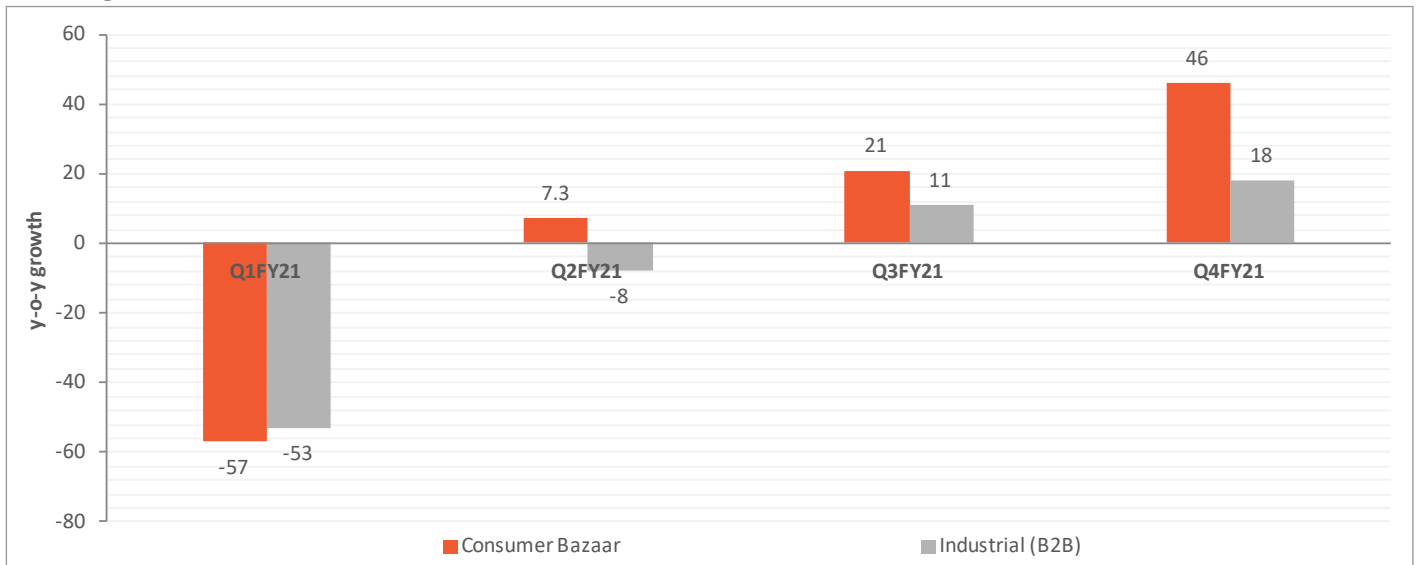
Particulars	Rs cr				
	FY19	FY20	FY21	FY22E	FY23E
Revenue	7,078	7,294	7,293	8,204	9,926
OPM (%)	19.3	21.6	23.0	22.7	23.8
Adjusted PAT	946	1,177	1,130	1,247	1,619
Adjusted EPS (Rs.)	18.6	23.2	22.2	24.6	31.9
P/E (x)	110.8	89.1	92.9	84.1	64.8
P/B (x)	25.3	23.5	18.8	16.6	14.1
EV/EBIDTA (x)	68.4	60.1	60.0	54.4	42.8
RoNW (%)	24.5	27.4	22.5	20.9	23.5
RoCE (%)	22.6	22.7	16.7	16.3	19.6

Source: Company; Sharekhan estimates

H2FY2022 is expected to see strong recovery

GST implementation, deepening roots in rural India, and adding more consumer-centric products aided Pidilite to post strong recovery in H2FY2021 after dismal H1 was affected by surge in COVID-19 cases and subsequent lockdowns. Consumer bazaar business, which registered a decline of 57% in revenue in Q1, saw a sharp recovery of 7% in Q2 and grew in strong double digits in H2FY2021. Industrial product business saw little late recovery but posted double-digit growth in H2Y2021. Resurgence in industrial and manufacturing activities and resumption of real estate and construction led to improvement in the industrial (B2B) business. Average COVID-19 cases have corrected by ~50% from its peak of 3,91,263 cases and are expected to further recede in the coming days. Some states have already started working on easing lockdown norms. However, in the second wave, states will be gradually opening the lockdown. Hence, recovery, which was anticipated in Q2, might be seen from Q3FY2022.

Chart of growth/decline in various business



Source: Company; Sharekhan Research

Waterproofing segment to be the company's key growth driver

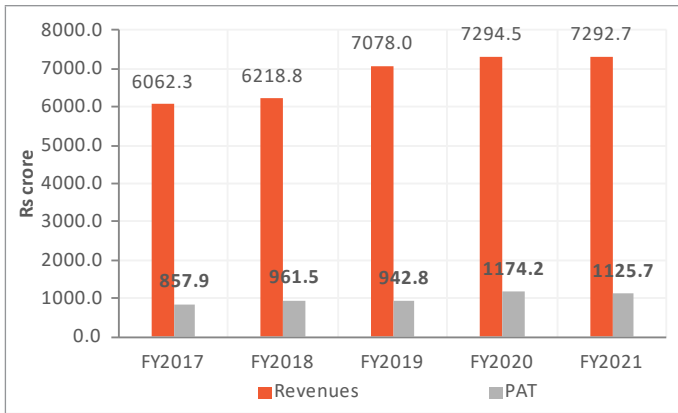
Penetration of waterproofing products in India is very low with only 4 out of 10 households using waterproofing while constructing new house, which is much lesser compared to other countries. It was the first segment that saw early recovery post the easing of first wave of COVID-19 in India. With consumers now focusing on the quality of the constructions and government standards improving, demand for waterproofing products will improve in the coming years. Moreover, top companies coming into the space will help in improving awareness about various waterproofing products. The traction for waterproofing products is also improving in rural markets. Thus, the company expects this segment to be one of the key growth drivers in the long run. Nina Percept Private Limited business got significantly impacted during the lockdown, but it saw strong improvement in H2FY2021. In Q4, the business registered low single-digit growth due to strong resurgence in construction/infrastructure activities. The company expects the business to strongly recover post normalisation of the second wave.

Sustained focus on expanding rural penetration; Alternate channels to improve penetration

Pidilite's products are available in 4 million outlets. Projects such as 'Housing for All' and rapid urbanisation have improved demand for construction chemicals and waterproofing in rural markets. The company has maintained its focus on expanding its reach in rural markets. The company has added 700 sub-stockists, covering 7,000 villages in India. Further, the company is banking on alternate channels to increase awareness and improve penetration of construction chemical products. *Pidilite Ki Duniya* (PKD) merchandise outlets are available in sub 12,000 population villages, which are set up to create awareness and provide training to end-users. At present, there are 60 such outlets. PKD's sales grew by 1.3x in FY2021. E-commerce and modern trade channels are also performing well, which grew by 4x and 1.3x in FY2021.

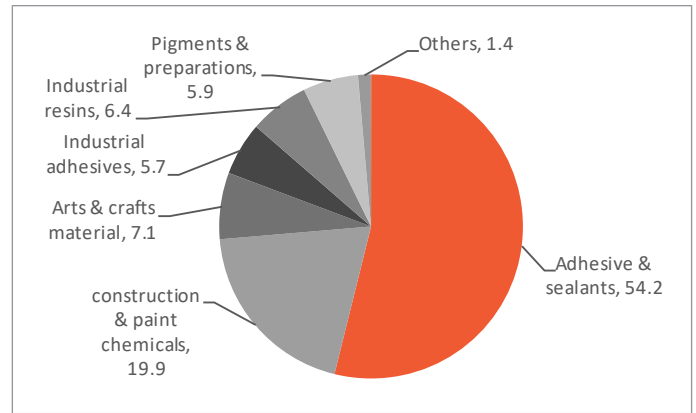
Financials in charts

Trend in revenues and PAT



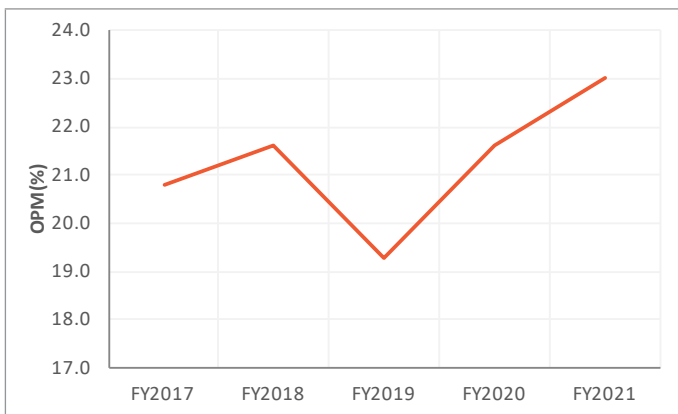
Source: Company, Sharekhan Research

Revenue break in various segments



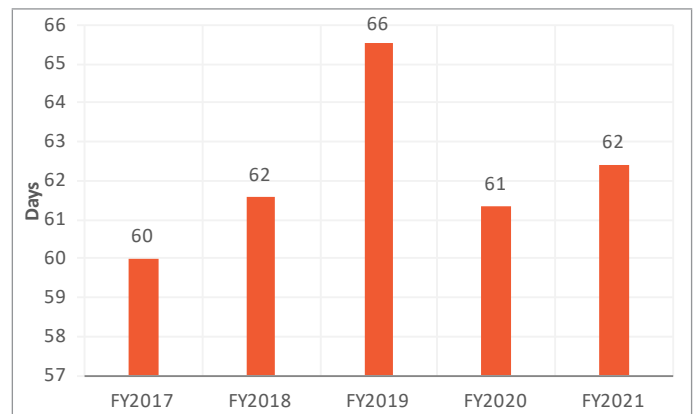
Source: Company, Sharekhan Research

Trend in OPM



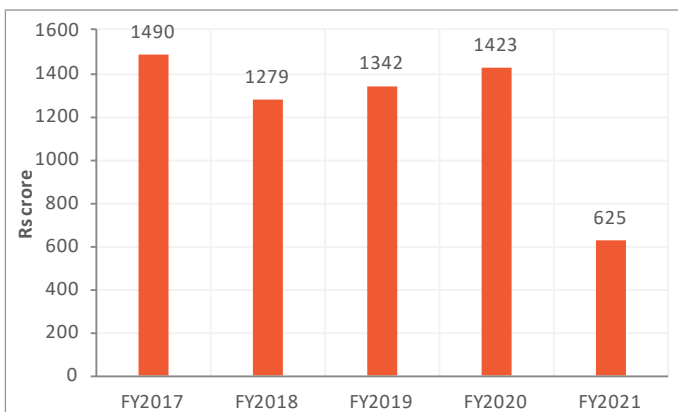
Source: Company, Sharekhan Research

Working capital remained stable



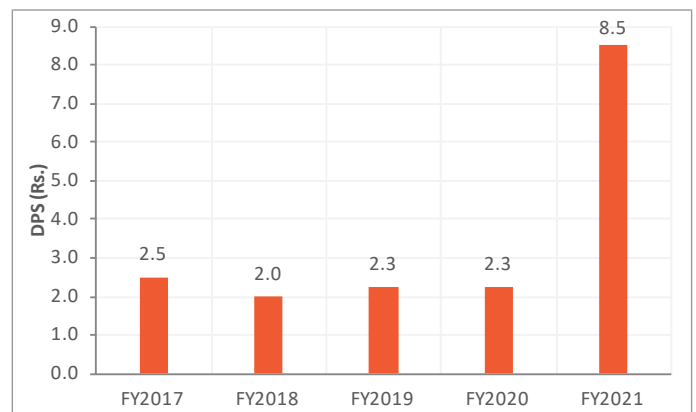
Source: Company, Sharekhan Research

Liquidity position remained strong



Source: Company, Sharekhan Research

Dividend payout remained high in FY2021



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector outlook - 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 crore- Rs. 7,000 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 a shift to branded products in the medium to long term. With the government focusing on improving the growth prospects of the furniture segment and converting it into one of the major exporting hubs, demand for adhesives is expected to increase in the coming years.

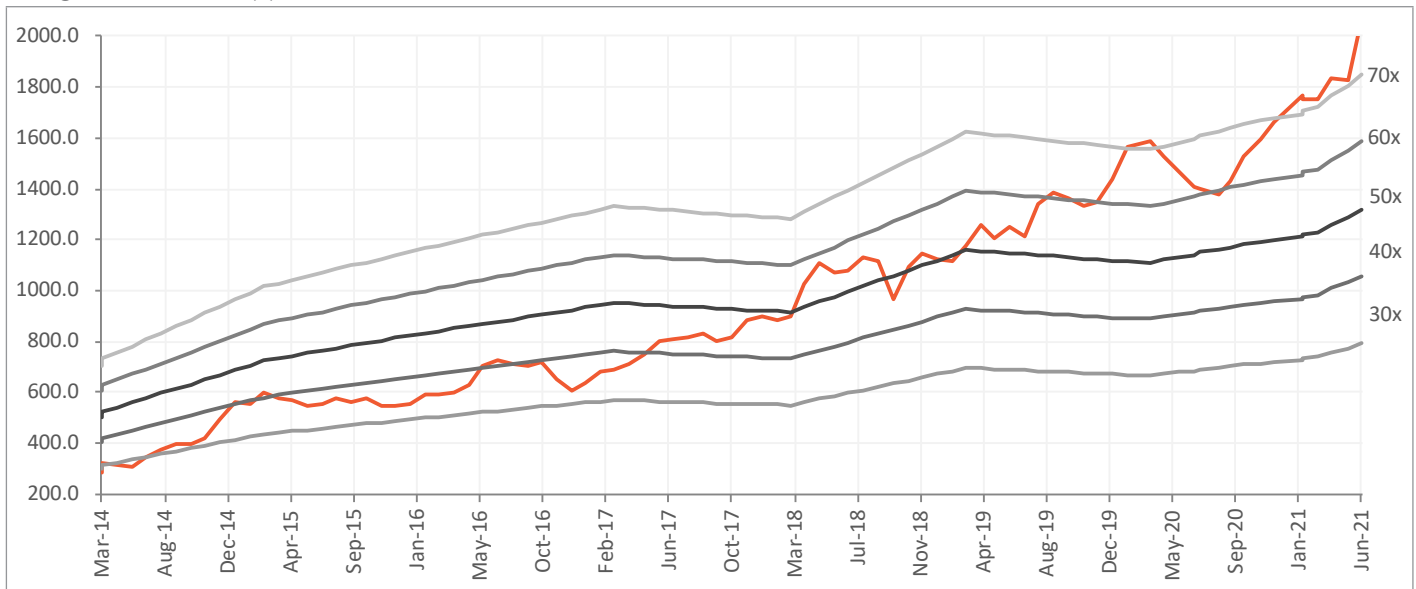
■ Company outlook - Strong growth expected in FY2023

Despite a disrupted Q1FY2021 quarter, PIL ended FY2021 on a good note with flat revenue y-o-y and OPM improving by 140 bps to 23%. Management expects strong recovery post normalisation of the pandemic environment due to improving penetration of water-proofing products in urban and rural markets, shift to branded products in the rural market, and market share gains from small players in the current scenario of rising input prices and liquidity concerns. Further, recovery in international markets will give a boost to export revenue and performance of international subsidiaries. The company endeavours to maintain its OPM at 21%-24% in the medium term.

■ Valuation - Retain Buy with a revised PT of Rs. 2,315

Low penetration of water proofing activities compared to other countries, shift to branded products (especially in rural markets), and introduction of new products augur well for the company from a long-term perspective. With a strong brand portfolio, Pidilite has a monopoly in the domestic adhesives market and acquisition of Araldite brand further strengthens its position in the domestic adhesive space. The stock currently trades at 64.8x its FY2023E earnings. A monopoly in the adhesives market, consistently strong cash-generation ability, and robust growth prospects will continue to keep valuations at premium. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 2,315.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Asian Paints	86.9	75.8	62.2	53.8	48.0	40.1	20.7	19.7	22.7
Pidilite Industries	92.9	84.1	64.8	60.0	54.4	42.8	16.7	16.3	19.6

Source: Company, Sharekhan estimates

About company

Pidilite is a leading manufacturer of adhesives and sealants, construction chemicals, crafts products, DIY products, and polymer emulsions in India. Pidilite has divided its business into two segments: consumer and bazaar products 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 the balance is contributed by the 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 a monopoly in the domestic adhesive market on account of its strong product portfolio. Over the years, the company has transformed itself from B2B to B2C players by consistently introducing consumer-centric products in the domestic market. Though FY2021 and FY2022 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 make it the safest better in the volatile market environment.

Key Risks

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

Additional Data

Key management personnel

Bharat Puri	Executive Director – MD
Apurva Parekh	Executive Director
Pradip Menon	Chief Financial Officer
Puneet Bansal	Company Secretary

Source: Company Website

Top 7 shareholders

Sr. No.	Holder Name	Holding (%)
1	Genesis Indian Investment Co. Ltd.	5.0
2	Life Insurance Corporation of India	3.0
3	Axis Asset Management Co. Ltd.	2.3
4	Vanguard Group	0.9
5	Blackrock Inc.	0.8
6	Norges Bank	0.7
7	UTI Asset Management Company	0.4

Source: Bloomberg (old data)

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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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