Sharekhan by BNP PARIBAS

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Pidilite Industries Ltd

Q3 was miss on margins; medium term growth path intact

Building materials	Sharekhan code: PIDILITIND
Reco/View: Buy ↔	CMP: Rs. 2,461	Price Target: Rs. 2,792 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- In Q3FY2022, margins missed the mark, dragged down by a rise in prices of inputs (largely VAM).
- VAM prices topped at $2,500/tonne in December 2021 (Q3 consumption cost was $2,200/tonne) compared to $2,071/tonne in Q2FY2022. If supply situation improves, VAM prices are expected to correct in next 4-6 months. The company will try to maintain OPM at ~20% in the near term.
- Domestic consumer & bazaar (C&B) business grew by 21% with a 10% rise in volumes. The management is confident of maintaining good volume growth momentum in the medium term.
- Stock price has corrected by 11% from its recent high and risk-reward favourable to enter into quality building material play with medium growth outlook intact. We maintain a Buy recommendation on the stock with an unchanged PT of Rs. 2,792.

Pidilite Industries (Pidilite) Q3FY2022 performance was affected by a sharp decline in OPM affected by a significant increase in the VAM prices. Its consolidated revenues grew by 24% y-o-y to Rs. 2,850.7 crore driven 21% growth in the domestic C&B business and 35% growth in the B2B business. Gross margins decreased by 1,117 bps y-o-y, led by a sharp increase in the VAM prices. VAM consumption price stood at $2,200/tonne as compared to $1,000/tonne in Q3FY2021 thus dragging down OPM by 861 bps to 19.3% (lagging ours as well as the street's expectation of 21-22% for the quarter). The company is confident of medium term growth outlook in view of strong demand from home improvement segment and improved demand from real estate and construction segments. Margins are expected to remain under pressure in the near term but will improve as input prices ease.

Key positives

- Domestic C&B business grew by 21% y-o-y led by 10% volume growth.
- B2B business registered a strong y-oy growth of 31% on account of recovery in the real estate and construction activities.
- New acquired Araldite business posted revenues of ~Rs. 150 crore and EBIDTA of Rs. 48 crore.

Key negatives

- Sharp increase in VAM prices dragged down gross margins by 1,117 bps y-o-y to 43.6% and OPM by 861 bps y-o-y to 19.3%.
- American subsidiary registered decline in revenues by 24% due to high base of Q3FY21.

Management Commentary

- C&B Business witnessed steady demand conditions during the quarter. Urban markets performed better than tier-2/-3 towns, which witnessed softening in demand during the quarter. The company expects near demand environment to be challenging considering the emergence of third wave and inflationary pressures. However, the company is confident of medium term growth outlook.
- Vinyl acetate monomer (VAM) prices topped $2,500 per tonne in December 2021 (consumption price stood at $2,200/tonne) higher than Q2 consumption cost of $2,071 per tonne. Prices marginally corrected in January 2022 and stood at $1,900-1,950/tonne and are expected to correct further if supply is sorted out in the coming months. The company has passed on 70-75% of input cost inflation through price hikes.
- With strong cost saving measures, the management is targeting OPM of ~20%, which is at the lower end of the target margin band of 20-24%. The decline in the key input prices would help margins to improve to upper end of the targeted band.

Revision in estimates – We have reduced our earnings estimates for FY2022 by 7% to factor in lower than expected gross margins and the management's near term bleak outlook on demand and profitability. We have maintained estimates for FY2023 and FY2024.

Our Call

View – Maintain Buy with an unchanged PT of Rs. 2,792: Pidilite's management is confident improving growth prospects in the medium to long run led by higher demand from the home improvement segment and improving demand from real estate and construction activities. The company continued to gain market share in the construction chemical segment (especially in the waterproofing space) from unorganised players. The stock has corrected by 11% from its recent high and any further correction can be considered as a good entry point in the quality building material play. The stock is trading at 74.0x and 61.8x its FY2023E and FY2024E EPS. We maintain a Buy on the stock with an unchanged price target of Rs. 2,792.

Key Risks

If impact of third COVID-19 wave remains for a while along with sustained high consumer inflation, the demand in tier 2/3 towns is expected to remain muted. Further, inflated VAM prices remain key risk to profitability.

Valuations (consolidated)

Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	7,293	9,616	10,958	12,341
OPM (%)	23.0	19.5	21.5	23.5
Adjusted PAT	1,130	1,258	1,608	2,024
Adjusted EPS (Rs.)	22.2	24.8	31.6	39.9
P/E (x)	110.7	96.6	74.0	61.8
P/B (x)	22.4	19.6	16.5	13.8
EV/EBIDTA (x)	71.4	62.9	49.1	41.2
RoNW (%)	22.5	21.6	24.2	24.3
RoCE (%)	16.7	16.8	20.2	20.8

Source: Company; Sharekhan estimates

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	=	↔	=

ESG Disclosure Score NEW

ESG RISK RATING 33.86

Updated Jan 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

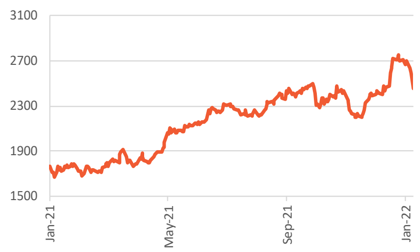
Company details

Market cap:	Rs. 1,25,063 cr
52-week high/low:	Rs. 2,765 / 1,663
NSE volume: (No of shares)	5.2 lakh
BSE code:	500331
NSE code:	PIDILITIND
Free float: (No of shares)	15.3 cr

Shareholding (%)

Promoters	70.0
FII	12.0
DII	7.5
Others	10.53

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.5	6.4	7.2	43.8
Relative to Sensex	0.6	9.8	-1.6	22.9

Sharekhan Research, Bloomberg

Revenue growth momentum sustained; miss on margins with OPM declining by 861 bps y-o-y

Revenues grew by 24% y-o-y to Rs. 2,850.7 crore. Sequentially, revenue grew by 8.5%. Domestic consumer business registered a growth of 21% y-o-y driven by 10% growth in the sales and volume mix. Growth in the urban market outpaced the rural market. Business-2-Business (industrial) business grew by 35% y-o-y to Rs. 511.7 crore led by a 13% volume and mix growth. Domestic subsidiaries in C&B reported good sales growth. Performance of domestic subsidiaries in the B2B improved sequentially on account of recovery in real estate and construction related activities. In International business, Asia & Middle East delivered double-digit revenue growth while Americas witnessed decline in revenue on a high base of last year. Overall, overseas subsidiaries reported 2.7% y-o-y growth to Rs. 178.3 crore. A sharp increase in the VAM prices led to 1,117 bps y-o-y decline in the gross margins to 43.6% (down 182 bps q-o-q). This led to sharp 861 bps y-o-y and 167 bps q-o-q decline in the OPM to 19.3%. Operating profit declined by 14.3% y-o-y to Rs. 549 crore. Sharp decline in the margins led to 19.5% y-o-y decrease in PAT to Rs. 359.2 crore.

Double-digit revenue growth by Consumer and bazaar products (C&B) business sustains: The C&B business reported standalone revenue of Rs. 1,925.1 crore during the quarter, registering 21% y-o-y growth. Revenue growth was due to y-o-y volume and mix growth of 10%. Growth was broad based across all categories such as adhesives, construction chemicals and DIY portfolio. The urban market performed much better than the rural market. The business PBIT decreased by 15% y-o-y led by sharp increase in the input prices.

Business to Business (B2B) grew by 39.5% y-o-y: Standalone revenue of the B2B grew by 39.5% y-o-y to Rs. 511.7 crore supported by volume and mix led growth of 13%. Strong demand from real estate and construction sector led to strong growth for B2B products in the domestic market. PBIT of the B2B declined by 13% y-o-y to Rs. 50.1 crore. Subsidiaries in the B2B business improved sequentially on account of recovery in real estate and construction related activities.

Muted performance by international subsidiaries: Overseas subsidiaries delivered muted performance during the quarter registering 3.0% y-o-y revenue growth to Rs. 187.4 crore. Within the regions, Asia grew by 18.8% y-o-y while Middle East & Africa grew by 23.5% y-o-y. Modest revenue growth in Asia was on the back of lockdown restrictions in many countries. The Americas witnessed decline in revenue by ~25% y-o-y on a high base of last year on account of pent-up demand and benefits passed by the Government to consumers during COVID. Profitability was affected on account of input cost inflation.

Araldite continues to perform well: Araldite registered revenues of Rs. 150 crore in Q3FY2022 compared to Rs. 135 crore achieved in Q2FY2022. Araldite is expected to report revenue of Rs. 130 crore-150 crore per quarter in the near term. Margins are anticipated to sustain. With expansion in the reach of the product, contribution will further improve in the medium term. It will remain a margin-accretive product. The brand posted EBIDTA margins of 32% which is lesser compared with 44% in Q3FY2021 affected by higher input prices.

Key conference call highlights

- **Third COVID-19 wave may cause some disturbance; but medium-term growth prospects are intact:** Business witnessed steady demand conditions during the quarter. Urban markets performed better than tier-2/3 towns, which witnessed softening in demand. The company expects near term demand environment to be challenging considering the emergence of third wave and inflationary pressures. However, the company is confident of medium term growth outlook. With real estate and construction activities picking up, strong demand is anticipated for construction chemical products in the medium term. In the work from home culture, more and more urban population are focus on improving the look of their houses and hence demand for C&B products are expected to sustain in the medium term.

- **Strong prospects in rural India:** Rural India registered double-digit growth in Q3FY2022. Softening in demand for home improvement products is less compared with consumer staples and hence expected to quickly rebound once inflationary environment ease out. The management expects some incentives for boosting rural economy to come up in the upcoming Union Budget. With government projects such as housing for all and rapid urbanisation, the demand for construction chemical products will improve in the coming years. The penetration level for construction chemical and waterproofing products in rural is much less compared to urban market which provides huge scope to grow. Further the company is focusing on increasing its presence in 5,000-10,000 population villages in the medium to long term. Currently it has 7,000 outlets spread in rural India.

- **Large runway for growth in waterproofing segment:** The waterproofing market in India is widely under penetrated and consumers lack awareness about product. Around 4 out 10 houses in India are currently using waterproofing products. Hence there is a wide scope for growth in this segment and Pidilite is undertaking the right steps to capture this opportunity by creating awareness about the products. With improved penetration, the company will also be benefitted in the long term. The paint companies that have entered the market are selling only one or two conventional products and hence will not have any serious competitive threat for the company. Pidilite's strong product portfolio in the water proofing segment and enhancing reach will help the segment to achieve strong growth in the coming years.

- **VAM prices have peaked; likely to correct in early FY2023:** VAM prices were hovering at $2,300-2,400 per tonne at beginning of Q3 and topped $2,500 per tonne in December,21. The company's average procurement price stood at close to $2,200 per tonne in Q3FY2022, which is higher than procurement price $2,071/tonne in Q2FY2022 and much higher as compared to $1,000 per tonne in Q3FY2021. The prices corrected in January 2022 to $1,950 per tonne and are expected to correct further once supply situation improves in the global markets. The company expects supply situation to improve post the completion of winter Olympics in China.
- **Calibrated price hikes undertaken:** The company undertook calibrated price hikes to the extent of 70-75% to mitigate the impact of input cost inflation. In view of volatility in the global VAM prices, the company would maintain its calibrated pricing strategy. Any further price hike will depend on volatility in raw-material prices.
- **OPM to remain at 20% in Q4; to improve as input costs inflation eases:** Despite sharp jump in the input prices on y-o-y and q-o-q basis, the company managed to maintain its OPM at ~20% in Q3FY2022. This was on back of stringent cost saving measures and operating efficiencies, which helped the company to achieve margins close to lower end of its trajectory. The company expects to maintain OPM at lower end of the trajectory in Q4 and expects to improve from Q1FY2023 with expected fall in the input prices.
- **Capex to remain at 4-6% of turnover:** The company targets its capex spends to be at 4-6% of its annual turnover. As stated by management recently, capex could have been at a higher end as the company is setting up 12 new facilities in the country, which include both greenfield and brownfield expansions. The company is setting up facilities for new products such as grouting and marble adhesives in western part of India. New facilities will spread out all over India. Capacity utilisation is expected to reduce to 60-70% from current level of 70-80% once all the new facilities are operational at optimum utilisation. The company aims to improve its supply chain through increasing its production and warehousing capacity. This will help the company to achieve significant growth in FY2022.

Results (consolidated) Rs cr

Particulars	Q3FY22	Q3FY21	Y-o-Y %	Q2FY22	Q-o-Q %
Revenues	**2,850.7**	**2,299.0**	**24.0**	**2,626.4**	**8.5**
Raw Material Cost	1,608.3	1,040.2	54.6	1,433.9	12.2
Employee Cost	280.0	260.3	7.6	273.1	2.5
Other Expenses	413.4	357.7	15.6	369.7	11.8
Total Operating Cost	2,301.7	1,658.2	38.8	2,076.8	10.8
Operating Profit	**549.0**	**640.8**	**-14.3**	**549.6**	**-0.1**
Other Income	5.2	20.4	-74.6	13.9	-62.8
Interest & Other Financial Cost	10.8	12.1	-10.9	12.4	-13.0
Depreciation	60.5	49.5	22.2	60.3	0.2
Profit Before Tax	**483.0**	**599.7**	**-19.5**	**490.8**	**-1.6**
Tax Expense	127.5	154.8	-17.6	115.9	10.0
Adjusted PAT before MI	355.5	444.9	-20.1	374.9	-5.2
Minority Interest (MI)	3.7	1.6	136.1	0.7	473.8
Adjusted PAT after MI	359.2	446.4	-19.5	375.5	-4.3
Exceptional Items	0.0	0.0	-	0.0	-
Reported PAT	**359.2**	**446.4**	**-19.5**	**375.5**	**-4.3**
EPS (Rs.)	7.1	8.8	-19.5	7.4	-4.3
			bps		**bps**
GPM (%)	43.6	54.8	-1117	45.4	-182
OPM (%)	19.3	27.9	-861	20.9	-167
NPM (%)	12.6	19.4	-682	14.3	-170
Tax rate (%)	26.4	25.8		23.6	

Source: Company; Sharekhan Research

Standalone segmental performance Rs cr

Particulars	Q3FY22	Q3FY21	Y-o-Y %	Q2FY22	Q-o-Q %
Consumer & Bazaar	1925.1	1597.5	20.5	1802.6	6.8
Business to Business	511.7	378.6	35.2	439.4	16.5
Others	20.5	12.2	68.1	14.6	40.3
(-)Inter-segment	41.0	31.6	29.6	43.2	-5.2
Total revenue	**2416.3**	**1956.7**	**23.5**	**2213.4**	**9.2**
PBIT					
Consumer & Bazaar	501.9	591.1	-15.1	514.3	-2.4
Business to Business	50.1	57.6	-13.0	42.6	17.5
Others	-1.2	-0.5	125.0	-0.8	50.0
Total PBIT	**550.8**	**648.2**	**-15.0**	**556.1**	**-1.0**

Source: Company; Sharekhan Research

International business performance Rs cr

Particulars	Q3FY22	Q3FY21	Y-o-Y %	Q2FY22	Q-o-Q %
Asia	80.9	68.1	18.8	62.8	28.8
Middle East &Africa	53.1	43	23.5	50.8	4.5
Americas	53.4	70.8	-24.6	64.7	-17.5
Total revenue	**187.4**	**181.9**	**3.0**	**178.3**	**5.1**
EBIDTA					
Asia	15.1	13.8	9.4	8.6	75.6
Middle East &Africa	-1.2	-0.2	500.0	-0.1	1100.0
Americas	0.7	10.2	-93.1	6	-88.3
EBIDTA	**14.6**	**23.8**	**-38.7**	**14.5**	**0.7**

Source: Company; Sharekhan Research

Domestic subsidiaries performance Rs cr

Particulars	Q3FY22	Q3FY21	Y-o-Y %	Q2FY22	Q-o-Q %
Nina Percept Pvt. Ltd	62.8	61.2	2.6	54.3	15.7
ICA Pidilite Pvt Ltd	80.1	58.6	36.7	73.7	8.7
Cipy Polyurethene	38.8	30.2	28.5	29.8	30.2
Others	9.1	10.2	-10.8	12.1	-24.8
Total revenue (excld. HAMSPL)	**190.8**	**160.2**	**19.1**	**169.9**	**12.3**
Pidilite Adhesives (HAMSPL)	149.4	59.1		135.5	10.3
Total revenue	**340.2**	**219.3**	**55.1**	**305.4**	**11.4**
EBIDTA					
Nina Percept Pvt. Ltd	-5.9	-1.7	247.1	-9.6	-38.5
ICA Pidilite Pvt Ltd	9.7	14.5	-33.1	14	-30.7
Cipy Polyurethene	4.7	3.8	23.7	2.6	80.8
Others	0.1	1.7	-94.1	1.4	-92.9
Total EBIDTA (excld. HAMSPL)	**8.6**	**18.3**	**-53.0**	**8.4**	**2.4**
Pidilite Adhesives (HAMSPL)	48	25.8		47.3	1.5
Total EBIDTA	**56.6**	**44.1**	**28.3**	**55.7**	**1.6**

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-7,000 crore, which is just 4-5% of the global construction chemicals market. Increased 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.

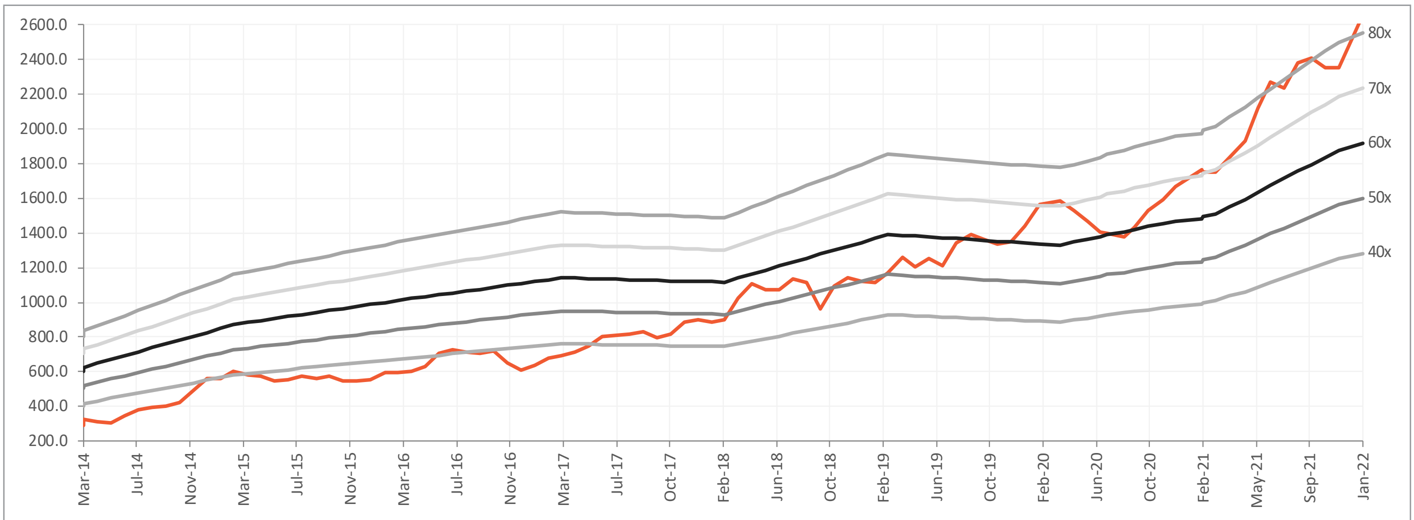
■ Company outlook – Medium term growth prospects intact

Business witnessed steady demand in Q3FY22. Urban markets performed better than tier 2/3 towns, which witnessed softening in demand during the quarter. The company expects near demand environment to be challenging considering the emergence of third wave and inflationary pressures. However, the company is confident of medium term growth outlook with improving outlook in the real estate/construction sector and increasing demand for home improvement products. VAM prices have corrected from its high and are expected to further correct from Q1FY2023 led by expected improvement in supply in global markets. The company endeavours to maintain OPM at 20-24% in the medium term.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 2,792

Pidilite's management is confident of improving growth prospects in the medium to long run led by higher demand from the home improvement segment and improving demand from real estate and construction activities. The company continued to gain market share in the construction chemical segment (especially in the waterproofing space) from unorganised players. The stock has corrected by 11% from its recent high and any further correction can be considered as a good entry point in the quality building material play. The stock is trading at 74.0x and 61.8x its FY2023E and FY2024E EPS. We maintain a Buy on the stock with an unchanged price target of Rs. 2,792.

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	FY22E
Asian Paints	93.2	89.3	65.9	57.4	55.7	42.3	22.4	20.0	24.1
Pidilite Industries	110.7	96.6	74.0	71.4	62.9	49.1	16.7	16.8	20.2

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; C&B 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 ~82% 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 among the most trusted brands in the country. Some of the other major brands are M-Seal, Fevikwik, Fevistik, Roff, Dr. Fixit Fevicryl, Motomax, Hobby Ideas, and Araldite.

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 FY2022 will be affected the 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 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

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)

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 detoriating 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

Sharekhan

by BNP PARIBAS

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