Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy



# Pidilite Industries Ltd

## Strong Q1; rich valuation limit upside

| Building materials | Sharekhan code: PIDILITIND | |
|---|---|---|
| Reco/View: Hold ↓ | CMP: Rs. 2,639 | Price Target: Rs. 2,850 ↑ |

↑ Upgrade ↔ Maintain ↓ Downgrade


**Summary**

- Pidilite Industries' (Pidilite's) Q1FY2023 performance beat ours as well the street's expectation with strong revenue and PAT growth of 60% and 64%, with robust demand across key markets. OPM fell by 87 bps y-o-y to 17.1% due to higher input prices.
- VAM prices has corrected to $1600-1800 per tonne from highs of $2500 per tonne (consumption prices in Q2 will be higher at $2300-2500 per tonne. Thus, OPM would recover substantially from Q3FY2023. Management targets OPM of 22-24% in medium term.
- Strong urban demand (especially in projects, home improvement and real estate segments) has led to strong volume growth. Rural demand (one-third of domestic revenues) is witnessing pressure but expected to recover from H2FY2023.
- Stock has good run-up of 24% in last three months and is currently trading at 85.9x/65.2x its FY2023/24E earnings. With unfavourable risk-reward, we downgrade our rating on stock to Hold from Buy earlier with a revised PT of Rs. 2,850.


**Pidilite Industries (Pidilite) put up a strong show in Q1FY2023 led by pent-up demand in home improvement segment and recovery in the art & crafts business due to opening up of schools. Revenue rose 60% y-o-y (three-year CAGR at 15.4%) to Rs. . 3,101 crore. Domestic consumer segment registered a growth of 64% y-o-y (three-year CAGR at 15.7%) to Rs. . 2,436 crore and business-to-business (industrial) segment grew by 50% y-o-y (three-year CAGR at 16.3%) to Rs. . 722 crore. Volume growth in domestic consumer bazaar business stood at 49%, while in B2B business it was at 29%. VAM consumption prices stood at $2,230/tonne as compared to $1,608/tonne in Q1FY2022 Higher VAM prices led to a 741 bps y-o-y decline in gross margins to 41.7% (same was lower by 181 bps on QoQ basis). EBITDA margins declined by 87 bps y-o-y to 17.1% as price hikes and higher sales volumes helped company to arrest a plunge in margins. Reported PAT grew by 64%y-o-y to Rs. 357.5 crore.**

**Key positives**

- B2B business saw yet another quarter of strong y-o-y volume growth of 49% on led by recovery in real estate segment and strong demand from projects and construction activities.
- International business grew robustly with a 29% and 22% rise in revenues and EBIDTA.
- Consolidated OPM improved by 108 bps q-o-q on back of prices undertaken and strong sales volume.

**Key negatives**

- Increase in VAM prices dragged down gross margins by 741 bps y-o-y to 41.7%.

**Management Commentary**

- Good demand from housing and home improvement space in the urban market (two-thirds of domestic business) will help Pidilite to maintain the good volume growth momentum in the coming quarters. Rural demand is expected to pick up from Q3FY2023 boosted by good monsoons. The company is targeting to achieve profitable volume growth in the coming quarters.
- Pidilite's Vinyl acetate monomer (VAM) consumption prices stood at $2230/tonne in Q1FY2023 vs. $1608/tonne in Q1FY2022. Consumption in Q2 is expected to remain at $2300-2500 per tonne. Prices have seen good correction in last few months and are currently trading at $1600-1800 per tonne. With some of the global facilities starting operations and muted demand in the international markets, the VAM prices are expected to correct further in the coming quarters. The company expects margins to remain flat in Q2 and would improve from Q3.
- Pidilite expects broad based-growth across categories with the core portfolio expected to grow by 1-1.5x of GDP, while growth portfolio would grow by 2-4x of GDP. The pioneer portfolio is expected to cross revenues of over Rs. 100 crore in the next three years.

**Revision in estimates –** We have fine-tuned our earnings estimates for FY2023 and FY2024 to factor in the higher than expected operating performance in Q1FY2023. We will keenly monitor movement of VAM prices before making any further revisions in earnings estimates.

**Our Call**

**View – Downgrade to Hold with PT of Rs. 2,850:** The management is confident of improving growth prospects in the medium to long run led by higher demand from home improvement segment and rising demand from real estate and construction activities. Strong brand portfolio and wider reach will help to gain market share in the construction chemical segment (especially in the waterproofing space) from unorganised players. The stock has seen a good run-up of 24% in last three months and it is trading at 85.9x and 65.2x its FY2023E and FY2024E earnings. With limited upside from the current levels, we have downgraded our rating to Hold and Buy with a revised price target of Rs. 2,850. We shall wait for better opportunity to enter in the quality consumer and building material stock.

**Key Risks**

Sustained inflation in the raw material prices (including VAM) and a slowdown in the consumer demand will act as risk to our earnings estimate.

**Valuation (consolidated)** Rs cr

| Particulars | FY21 | FY22 | FY23E | FY24E |
|---|---|---|---|---|
| Revenue | 7,293 | 9,921 | 11,721 | 13,822 |
| OPM (%) | 23.0 | 18.6 | 19.9 | 21.8 |
| Adjusted PAT | 1,130 | 1,207 | 1,561 | 2,056 |
| Adjusted EPS (Rs.) | 22.2 | 23.8 | 30.7 | 40.5 |
| P/E (x) | - | - | 85.9 | 65.2 |
| P/B (x) | 24.0 | 20.9 | 18.0 | 14.9 |
| EV/EBIDTA (x) | 76.6 | 71.6 | 56.6 | 43.6 |
| RoNW (%) | 22.5 | 20.1 | 22.5 | 25.0 |
| RoCE (%) | 16.7 | 14.8 | 17.7 | 20.2 |

*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 | Positive | ↔ | Positive |
| RQ | Positive | ↔ | Positive |
| RV | Neutral | ↓ | Negative |

**ESG Disclosure Score** NEW

ESG RISK RATING 32.38

Updated July 08, 2022

High Risk

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

*Source: Morningstar*

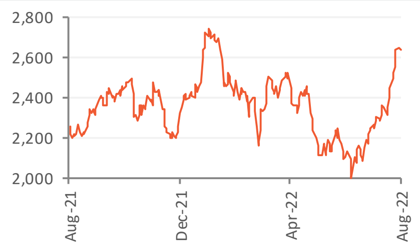
**Company details**

| | |
|---|---|
| Market cap: | Rs. 1,34,127 cr |
| 52-week high/low: | Rs. 2,765/1,989 |
| NSE volume: (No of shares) | 4.2 lakh |
| BSE code: | 500331 |
| NSE code: | PIDILITIND |
| Free float: (No of shares) | 15.3 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 69.9 |
| FII | 11.5 |
| DII | 7.5 |
| Others | 11.06 |

**Price chart**




**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 17.2 | 24.4 | 6.0 | 16.7 |
| Relative to Sensex | 7.1 | 12.0 | 5.3 | 7.9 |

*Sharekhan Research, Bloomberg*

### Q1FY2023 – Strong performance with sequential improvement in the OPM

Revenues grew by 60% y-o-y (3-year CAGR at 15.4%) to Rs. 3,101 crore ahead of our expectation of Rs. 2,772 crore and average street expectation of Rs. 2,503crore. Domestic consumer segment registered a growth of 64% y-o-y (3-year CAGR at 15.7%) to Rs. 2,436 crore and business-to-business (industrial) segment grew by 50% y-o-y (3-year CAGR at 16.3%) Rs. 722 crore. Volumes of the domestic consumer bazaar business grew by 49%. Higher VAM prices led to 741 bps y-o-y decline in the gross margins to 41.7% (same was lower by 181 bps q-o-q). EBITDA margin declined by 87 bps y-o-y to 17.1% higher than our as well as average street expectation of 16.2-16.5%. EBIDTA margins improved by 108 bps on QoQ basis. EBITDA increased by 52.3% y-o-y to Rs. 529.5 crore. Adjusted PAT grew by 64.3% y-o-y to Rs. 357.5 crore, ahead of our as well as average street expectation of Rs. 263-286 crore.

### C&B business grew by 66.6% y-o-y

Consumer and bazaar products (C&B) business reported standalone revenue of Rs. 2,192.0 crore in Q1FY2023, registering 66.6% y-o-y growth (three-year CAGR of 15%). The strong growth was driven by 49% growth in volume & mix. The business' PBIT margins decreased by 331 bps to 23.2% in Q1FY2023 due to higher input prices. PBIT grew by 46.7%y-o-y to Rs74.9crore. The management is confident of maintaining good volume growth momentum in the medium term.

### B2B segment grew 52%

Standalone revenue of B2B segment grew by 52% y-o-y to Rs. 632.9 crore (grew by 21% q-o-q), driven by a 29% volume growth. PBIT margins decreased by 137 bps to 11.8%. The segment's PBIT grew by 36% y-o-y to Rs. 74.9 crore.

### Decent performance by international subsidiaries

Overseas subsidiaries delivered strong numbers with broad-based growth across key international countries. International business revenues grew by 29%y-o-y to Rs. 216.1 crore. Within regions, Asia grew by 32.2% y-o-y, Americas grew by 28.3% and Middle East & Africa grew by 25% y-o-y. Americas saw decline in the EBIDTA by 23.0%y-o-y to Rs. 4.3 crore while all other regions (including Asia and Middle East) saw good improvement in EBIDTA on y-o-y basis.

## Key Conference call takeaways

- **Demand momentum to sustain:** Good demand from the housing and home improvement space in the urban market (two-thirds of domestic business) will help the company to maintain the good volume growth momentum in the coming quarters. Rural demand is expected to see a pickup from Q3FY2023 boosted by good monsoons. The company is targeting to achieve profitable volume growth in the coming quarters. With real estate and construction activities picking up, strong demand is anticipated for construction chemical products in the medium term.
- **VAM prices correcting; benefits to flow from H2FY2023:** Pidilite's vinyl acetate monomer (VAM) consumption prices stood at \$2230/tonne in Q1FY2023 versus \$1608/tonne in Q1FY2022. Consumption in Q2 is expected to remain at \$2300-2500 per tonne. Prices have seen good correction in last few months and are currently trading at \$1600-1800 per tonne. With some of the global facilities starting operations and muted demand in the international markets, the VAM prices are expected to correct further in the coming quarters. The company expects margins to remain flat in Q2 and would improve from Q3.

- **Calibrated price hikes undertaken to mitigate cost pressure:** The company undertook calibrated price hikes to the extent of 10-15% across categories over the past 12 months to mitigate the impact of input cost inflation. With VAM prices correcting from its high, the company is not expecting any further price increase in the product portfolio in the near term.
- **OPM to be maintained at 20-24% in in the medium term:** The management indicated that its focus would be on growing volumes rather than margins. The pressure on margin is expected to soften from H2FY2023 onwards as input costs stabilise. Standalone margins are expected to be between 20-24% in the medium term.
- **Waterproofing biz picking up –** The waterproofing market is consolidating and growing at a faster rate than the other products. As a result, larger players are becoming larger and consequently gaining market share. Paint companies have largely entered into coating waterproofing products and are largely competing with unorganised players in the is space. Thus the company is not expecting competition from paint companies to have any impact on the near term performance.
- **Focus remains on expanding reach in the rural markets:** The company has 7,500 Pidilite Ki Duniya stores in several villages of population of 5000-10,000. Further the company 17,000 villages of 5,000-8,000 villages under its distribution to improve the penetration of its products. Further the company has tied-up with HUL's Shakti Amma to distribute products in the villages and small towns.
- **Broad-based growth across categories –** The company expects its growth to be broad based across its categories. The core portfolio is expected to grow by 1-1.5x of GDP, growth portfolio is expected to grow by 2-4x of GDP, while the company targets revenue of over Rs. 100 crore in the next three years in the pioneer portfolio.

**Results (consolidated)** Rs cr

| Particulars | Q1FY23 | Q1FY22 | y-o-y (%) | Q4FY22 | q-o-q (%) |
|---|---|---|---|---|---|
| **Revenues** | **3,101.1** | **1,936.8** | **60.1** | **2,507.1** | **23.7** |
| Raw Material costs | 1,808.0 | 985.7 | 83.4 | 1,416.3 | 27.7 |
| Employee costs | 315.7 | 280.6 | 12.5 | 278.6 | 13.3 |
| Other Expenses | 447.9 | 322.9 | 38.7 | 411.1 | 8.9 |
| Total Operating Cost | 2,571.6 | 1,589.2 | 61.8 | 2,106.0 | 22.1 |
| **Operating Profit** | **529.5** | **347.6** | **52.3** | **401.1** | **32.0** |
| Other Income | 10.7 | 6.1 | 74.5 | 11.1 | -3.9 |
| Interest & Other Financial Cost | 9.0 | 9.6 | -6.1 | 9.4 | -3.4 |
| Depreciation | 61.3 | 56.6 | 8.3 | 62.2 | -1.4 |
| **Profit Before Tax** | **469.8** | **287.5** | **63.4** | **340.7** | **37.9** |
| Tax Expense | 115.7 | 72.1 | 60.5 | 91.5 | 26.4 |
| Adjusted PAT before MI | 354.1 | 215.4 | 64.4 | 249.1 | 42.1 |
| Minority Interest (MI) | 3.4 | 2.3 | 50.0 | 5.2 | -34.5 |
| **Reported PAT** | **357.5** | **217.6** | **64.3** | **254.4** | **40.6** |
| EPS (Rs) | 7.0 | 4.3 | 64.2 | 5.0 | 40.5 |
| | | | **bps** | | **bps** |
| GPM (%) | 41.7 | 49.1 | -741 | 43.5 | -181 |
| OPM (%) | 17.1 | 17.9 | -87 | 16.0 | 108 |
| NPM (%) | 11.5 | 11.2 | 29 | 10.1 | 138 |
| Tax rate (%) | 24.6 | 25.1 | | 26.9 | |

*Source: Company, Sharekhan Research*

**Domestic segmental performance** Rs cr

| Particulars | Q1FY23 | Q1FY22 | y-o-y (%) | Q4FY22 | q-o-q (%) |
|---|---|---|---|---|---|
| Consumer & Bazaar | 2,198.3 | 1,315.3 | 67.1 | 1,599.2 | 37.5 |
| Business to Business | 632.9 | 417.1 | 51.7 | 523.4 | 20.9 |
| Others | 25.8 | 9.9 | 160.7 | 18.8 | 37.3 |
| (-)Inter-segment | 67.2 | 32.2 | 108.7 | 57.0 | 17.9 |
| **Total revenue** | **2,789.7** | **1,710.1** | **63.1** | **2,084.4** | **33.8** |
| | | | | | |
| Consumer & Bazaar | 510.4 | 348.9 | 46.3 | 373.5 | 36.6 |
| Business to Business | 74.9 | 55.1 | 36.0 | 46.7 | 60.4 |
| Others | 1.4 | 0.6 | 136.7 | -0.8 | - |
| **Total PBIT** | **586.7** | **404.6** | **45.0** | **419.4** | **39.9** |

*Source: Company, Sharekhan Research*

**International business performance** Rs cr

| Particulars | Q1FY23 | Q1FY22 | y-o-y (%) | Q4FY22 | q-o-q (%) |
|---|---|---|---|---|---|
| Asia | 83.8 | 63.4 | 32.2 | 82.5 | 1.6 |
| Middle East &Africa | 61.4 | 49.1 | 25.1 | 55.4 | 10.8 |
| Americas | 70.9 | 55.3 | 28.2 | 53.6 | 32.3 |
| **Total revenue** | **216.1** | **167.8** | **28.8** | **191.5** | **12.8** |
| | | | | | |
| Asia | 15.9 | 12.5 | 27.2 | 9.1 | 75 |
| Middle East &Africa | 1 | -0.6 | - | -1.4 | - |
| Americas | 4.3 | 5.5 | -21.8 | -2.4 | - |
| **EBIDTA** | **21.2** | **17.4** | **21.8** | **5.3** | **300.0** |

*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. 6,500-7,000 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 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.

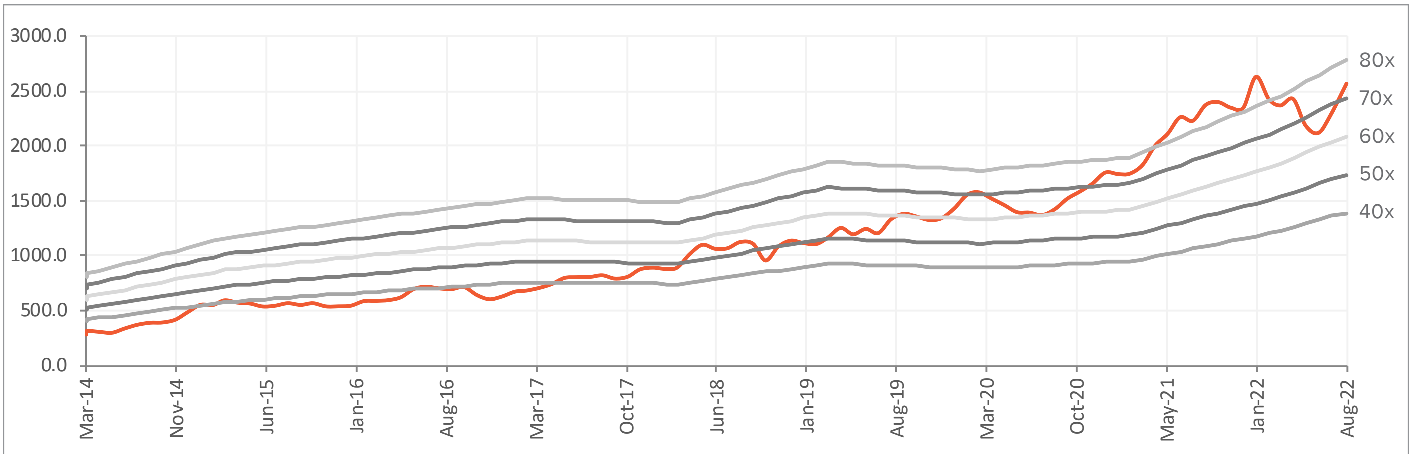
### Company Outlook – Medium-term growth prospects intact

Pidilite delivered strong numbers in FY2022 registering revenue growth of 36% y-o-y aided by strong volume growth of over 20% across categories and geographies. Margins were impacted as input prices remained elevated during the year. Urban markets outperformed rural/semi-urban markets, which witnessed softening in demand. In H2FY2023, demand is expected to be good aided by better monsoon, higher government spending, improving outlook in the real estate/construction sector and increasing demand for home improvement products. The company expects broad based growth across categories and targets one-third of growth to come from innovation. VAM prices are at high levels and are expected to cool off in H2FY2023. The company endeavours to maintain OPM at 20-24% in the medium term.

### Valuation – Downgrade to Hold with revised PT of Rs. 2,850

The management is confident of improving growth prospects in the medium to long run led by higher demand from home improvement segment and rising demand from real estate and construction activities. Strong brand portfolio and reach will help to gain market share in the construction chemical segment (especially in the waterproofing space) from unorganised players. The stock has seen a good run-up of 24% in last three months and it is trading at 85.9x and 65.2x its FY2023E and FY2024E earnings. With limited upside from the current levels, we have downgraded our rating to Hold and Buy with a revised price target of Rs. 2,850. We shall wait for better opportunity to enter in the quality consumer and building material stock.

**One-year forward P/E (x) band**




*Source: Sharekhan Research*

**Peer Comparison**

| Companies | P/E (x) | | | EV/EBITDA (x) | | | RoCE (%) | | |
|---|---|---|---|---|---|---|---|---|---|
| | FY22 | FY23E | FY24E | FY22 | FY23E | FY24E | FY22 | FY23E | FY24E |
| Asian Paints | - | 77.1 | 60.1 | 62.7 | 49.3 | 39.4 | 19.5 | 23.0 | 25.2 |
| Pidilite Industries | - | 85.9 | 65.2 | 71.6 | 56.6 | 43.6 | 14.8 | 17.7 | 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 ~80% 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 a B2B to B2C player by consistently introducing consumer-centric product in the domestic market. Though FY2022 was affected by the pandemic situation, Pidilite's 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 bet 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**

| | |
|---|---|
| Madhukar Balvantray Parekh | Chairman |
| Bharat Puri | Managing Director |
| Pradip Menon | Chief Financial Officer |
| Manisha Shetty | Company Secretary |

*Source: Company Website*

**Top 8 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Axis AMC | 3.07 |
| 2 | Life Insurance Corp of India | 2.7 |
| 3 | Capital Group Cos Inc | 1.36 |
| 4 | BlackRock Inc | 1.21 |
| 5 | Vanguard Group Inc | 1.17 |
| 6 | First State Investments ICVC | 0.85 |
| 7 | Norges Bank | 0.71 |
| 8 | Mathews International Capital Mgmt LLC | 0.66 |

*Source: Bloomberg*

## 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*

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