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Stock Update

Result Update

Pidilite Industries Ltd

Soft Q2; lofty valuation restrict upside

Building materials	Sharekhan code: PIDILITIND

Reco/View: Hold	↔	CMP: Rs. 2,656	Price Target: Rs. 2,850	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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	Negative	↔	Negative

ESG Disclosure Score

ESG RISK RATING 32.38

Updated Oct 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. 134,991 cr
52-week high/low:	Rs. 2,917/1,989
NSE volume: (No of shares)	4.1 lakh
BSE code:	500331
NSE code:	PIDILITIND
Free float: (No of shares)	15.3 cr

Shareholding (%)

Promoters	69.9
FII	11.7
DII	7.8
Others	10.6

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	1.7	1.3	25.6	12.2
Relative to Sensex	-4.4	-0.7	11.1	11.8

Sharekhan Research, Bloomberg

Summary

- Pidilite Industries Limited's (Pidilite) Q2FY2023 performance was soft with 15% y-o-y revenue growth, driven by pricing and mix (sales volume remained flat), while EBITDA margin fell by 433 bps y-o-y to 16.6% due to higher input prices, weaker currency, and high-cost inventory. PAT declined by 10% y-o-y.
- VAM prices have corrected to $1,200-1,400 per tonne from highs of $2,500 per tonne (consumption price was at $2,491 per tonne in Q2). Thus, EBITDA margin would start recovery from Q3FY2023 and is expected to reach 20% by Q4FY2024.
- Demand was soft in Q2 as rural and semi-urban regions witnessed higher impact of inflation. Management is cautiously optimistic for improved demand in H2, led by better monsoon, pick-up in construction activities, and stable input inflation. Management is targeting double double-digit volume growth in FY2023.
- The stock has good run-up of 20% in the last six months and is currently trading at 95x/67x its FY2023/FY2024E earnings. We retain Hold with an unchanged PT of Rs. 2,850.

Pidilite Industries Limited's (Pidilite) Q2FY2023 performance was a mixed bag. Revenue grew in double digits, while margins declined sharply on a y-o-y basis. Revenue rose by 14.7% y-o-y to Rs. 3,011 crore, aided by growth across categories and geographies. Domestic consumer bazaar (C&B) business registered growth of 14% y-o-y and B2B business grew by 18.4% y-o-y. Volume growth in the domestic consumer bazaar business stood at 1%, while it remained almost flat for the B2B business. In the international market, Asia and Middle East and Africa delivered strong performance, registering y-o-y revenue growth of 38% and 20%, respectively. VAM consumption prices stood at $2,491/tonne as compared to $2,071/tonne in Q2FY2022 (consumption rate in Q1 was $2,231/tonne). Higher VAM prices and weaker currency led to a 441-bps y-o-y decline in gross margin to 41%. The decline in EBITDA margin was restricted to 433 bps y-o-y to 16.6%, aided by better operating efficiencies. Reported PAT fell by 10% y-o-y to Rs. 337.8 crore. For H1FY2023, revenue grew by 33.9% y-o-y to Rs. 6,112.3 crore and PAT grew by 17% y-o-y to Rs. 695.3 crore, while EBITDA margin declined by 282 bps y-o-y to 16.8% in H1FY2023.

Key positives

- Asia and Middle East and Africa grew by 38% and 20% y-o-y, respectively.
- EBITDA margin of Asia and Middle East and Africa improved by 189 bps and 344 bps y-o-y, respectively.

Key negatives

- America registered a decline of 7% y-o-y.
- Gross margin declined by 441 bps y-o-y to 41% due to higher VAM prices, weaker currency, and high-priced inventory.
- PBIT of domestic C&B/B2B business declined by 341/88 bps y-o-y.

Management Commentary

- Good demand from new construction (one-third of sales) and home improvement space in the urban market (two-thirds of the domestic business) will help Pidilite to maintain strong growth in the urban market. Rural demand is expected to pick up from Q3FY2023 boosted by good monsoon season. Overall, the company is targeting to achieve double-digit volume growth in FY2023.
- Pidilite is focusing on achieving consistent double-digit growth in its domestic consumer bazaar business, driven by sustained new addition (one-third overall growth), distribution expansion (especially in the rural market), and responsive supply chain in the coming years.
- Pidilite's vinyl acetate monomer (VAM) consumption prices stood at $2,491/tonne in Q2 ($2,230/tonne in Q1FY2023) vs. $2,071/tonne in Q2FY2022. Prices have seen good correction in the past few months and are currently trading at $1200-1400 per tonne. The company will start seeing sequential margin improvement from Q3 as some of the other input prices are yet to see significant correction. Thus, EBITDA margin in Q3 will be better than Q2, while it will reach 20% by Q4FY2023 (if prices remain stable at the current level).
- The company is unlikely to take any significant price cuts in the domestic consumer bazaar portfolio while it has reduced prices in the B2B portfolio.

Revision in estimates – We have reduced our earnings estimates for FY2023 and FY2024 to factor in lower operating margins than earlier expected as Q2 saw VAM consumption price reaching its top. VAM prices are expected to correct in the coming quarters. We will keenly monitor the movement of VAM prices before making any further revisions in our earnings estimates.

Our Call

View – Retain Hold with an unchanged PT of Rs. 2,850: Management is confident of improving growth prospects in the medium to long run, led by higher demand from the 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 20% in the past six months and it is trading at 94.6x and 67.3x its FY2023E and FY2024E earnings, respectively. With limited upside from current levels, we maintain our Hold rating on the stock with an unchanged PT of Rs. 2,850.

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	FY25E
Revenue	7,293	9,921	11,904	14,048	16,095
OPM (%)	23.0	18.6	18.1	20.9	21.5
Adjusted PAT	1,130	1,207	1,426	2,005	2,384
Adjusted EPS (Rs.)	22.2	23.8	28.1	39.5	46.9
P/E (x)	-	-	94.6	67.3	56.6
P/B (x)	24.1	21.1	18.4	15.3	12.6
EV/EBIDTA (x)	77.1	72.0	61.8	44.9	37.8
RoNW (%)	22.5	20.1	20.8	24.8	24.4
RoCE (%)	16.7	14.8	16.3	20.1	20.2

Source: Company; Sharekhan estimates

Mixed Q2 – Revenue growth at 15% y-o-y; EBITDA margin down by 433 bps y-o-y

Pidilite's revenue grew by 14.7% y-o-y to Rs. 3,011.2 crore in Q2FY2023, driven by growth across categories and geographies. Consumer Bazaar (C&B) business grew by 14.1% y-o-y to Rs. 2,431.5 crore (standalone business grew by 14.1% y-o-y) and B2B business grew by 17.2% y-o-y to Rs. 623.7 crore (domestic B2B grew by 18.4% y-o-y). Growth in both the categories was aided by distribution expansion, innovation, responsive supply chain, and digital initiatives. In the domestic market, urban market grew faster than the rural region. In the international market, Asia and Middle East grew by 38% and 20% y-o-y, respectively, while America registered a decline of 7% y-o-y. Higher VAM prices, weaker currency, and high-priced inventory led to a 441-bps y-o-y decline in gross margins to 41%. Calibrated pricing action aided gross margins to remain flat on a sequential basis. Despite the 441-bps decline in gross margin, EBITDA margin decline was limited to 433 bps y-o-y to 16.6%, aided by better operating efficiencies. PBIT of the domestic C&B business declined by 341 bps y-o-y, while that of the B2B business contracted by 88 bps y-o-y. Operating profit decreased by 9% y-o-y to Rs. 499.9 crore and reported PAT decreased by 10.1% to Rs. 337.8 crore. For H1FY2023, revenue grew by 33.9% y-o-y to Rs. 6,112.3 crore, aided by double-digit volume growth in both C&B and B2B businesses. PAT grew by 17% y-o-y to Rs. 695.3 crore, while EBITDA margin declined by 282 bps y-o-y to 16.8% in H1FY2023.

Domestic C&B business grew by 14.1% y-o-y

Consumer and bazaar products (C&B) business reported standalone revenue of Rs. 2,196.4 crore in Q2FY2023, registering 14.1% y-o-y growth. The strong growth was driven by modest volume growth and better mix. The business's PBIT margin decreased by 341 bps y-o-y to 23.3% in Q2FY2023 due to higher input prices. PBIT stood flat at Rs. 512 crore.

Domestic B2B segment grew by 18.4% y-o-y

Standalone revenue of the B2B segment grew by 18.4% y-o-y to Rs. 551.7 crore. PBIT margin decreased by 88 bps to 8.3%. The segment's PBIT grew by 7% y-o-y to Rs. 45.6 crore.

Decent performance by international subsidiaries

Overseas subsidiaries witnessed good sales growth, but EBITDA remained under pressure due to higher input costs. International business revenue grew by 25.1% y-o-y to Rs. 205.3 crore. Within regions, Asia grew by 38% y-o-y to Rs. 77.3 crore and Middle East and Africa grew by 20.3% y-o-y to Rs. 63.4 crore, while Americas declined by 7.3% y-o-y to Rs. 64.6 crore. Asia's EBITDA grew by 56% y-o-y to Rs. 12.5 crore (EBITDA margin up by 189 bps y-o-y to 16.2%). Middle East and Africa reported EBITDA of Rs. 2.3 crore in Q2FY2023, up from Rs. 0.1 crore in Q2FY2022 (EBITDA margin improved by 344 bps y-o-y to 3.6%). Americas registered loss of Rs. 0.9 crore against profit of Rs. 6.4 crore in Q2FY2022.

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	y-o-y (%)	Q1FY23	q-o-q (%)
Revenue	**3,011.2**	**2,626.4**	**14.7**	**3,101.1**	**-2.9**
Raw-Material Cost	1,776.9	1,433.9	23.9	1,808.0	-1.7
Employee Cost	303.2	273.1	11.0	315.7	-4.0
Other Expenses	431.1	369.7	16.6	447.9	-3.8
Total Operating Cost	2,511.3	2,076.8	20.9	2,571.6	-2.3
Operating Profit	**499.9**	**549.6**	**-9.0**	**529.5**	**-5.6**
Other Income	11.0	13.9	-20.9	10.7	3.0
Interest & Other Financial Cost	11.7	12.4	-5.5	9.0	29.3
Depreciation	63.6	60.3	5.5	61.3	3.8
Profit Before Tax	**435.6**	**490.8**	**-11.3**	**469.8**	**-7.3**
Tax Expense	100.9	115.9	-13.0	115.7	-12.8
Adjusted PAT before MI	334.7	374.9	-10.7	354.1	-5.5
Minority Interest (MI)	3.1	0.7	-	3.4	-9.9
Reported PAT	**337.8**	**375.5**	**-10.1**	**357.5**	**-5.5**
EPS (Rs.)	6.6	7.4	-10.1	7.0	-5.5
			bps		**bps**
GPM (%)	41.0	45.4	-441	41.7	-71
EBITDA MARGIN (%)	16.6	20.9	-433	17.1	-47
NPM (%)	11.2	14.3	-308	11.5	-31
Tax rate (%)	23.2	23.6	-46	24.6	-147

Source: Company, Sharekhan Research

Domestic segmental performance Rs cr

Particulars	Q2FY23	Q2FY22	y-o-y (%)	Q1FY23	q-o-q (%)
Consumer & Bazaar	2,196.4	1,802.6	21.8	2,198.3	-0.1
Business to Business	551.7	439.4	25.5	632.9	-12.8
Others	22.4	14.6	53.6	25.8	-13.1
(-) Inter-segment	55.3	43.2	27.8	67.2	-17.8
Total revenue	**2,715.2**	**2,213.4**	**22.7**	**2,789.7**	**-2.7**
Consumer and Bazaar	511.8	514.3	-0.5	510.4	0.3
Business to Business	45.6	42.6	7.0	74.9	-39.1
Others	-0.3	-0.8	-57.7	1.4	-
Total PBIT	**557.1**	**556.1**	**0.2**	**586.7**	**-5.1**

Source: Company, Sharekhan Research

International business performance Rs cr

Particulars	Q2FY23	Q2FY22	y-o-y (%)	Q1FY23	q-o-q (%)
Asia	77.3	56	38.0	83.8	-7.8
Middle East and Africa	63.4	52.7	20.3	61.4	3.3
Americas	64.6	69.7	-7.3	70.9	-8.9
Total revenue	**205.3**	**178.4**	**15.1**	**216.1**	**-5.0**
Asia	12.5	8	56.3	15.9	-21
Middle East and Africa	2.3	0.1	-	1	-
Americas	-0.9	6.4	-	4.3	-
EBIDTA	**13.9**	**14.5**	**-4.1**	**21.2**	**-34.4**

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 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 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.

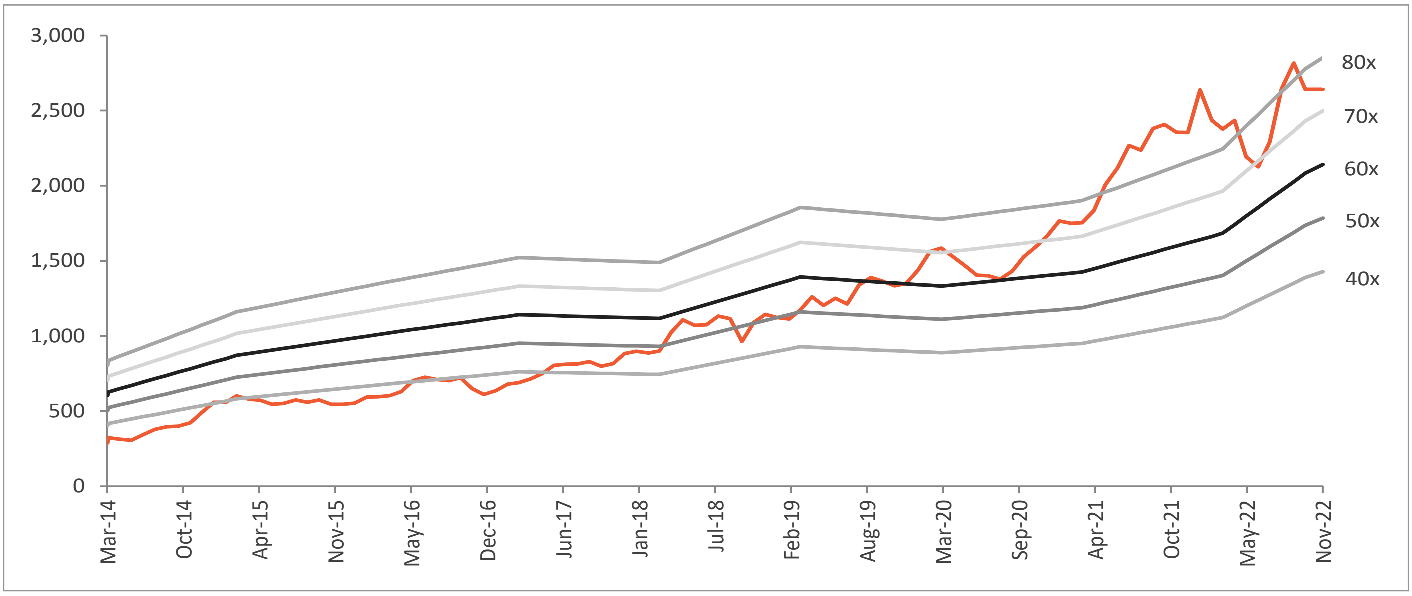
■ Company outlook - Medium-term growth forecast intact

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 from innovation. VAM prices are at high levels and are expected to cool off in H2FY2023. The company endeavours to maintain EBITDA margin at around 20% in the medium term.

■ Valuation - Retain Hold with an unchanged PT of Rs. 2,850

Management is confident of improving growth prospects in the medium to long run, led by higher demand from the 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 20% in the past six months and it is trading at 94.6x and 67.3x its FY2023E and FY2024E earnings, respectively. With limited upside from current levels, we maintain our Hold rating on the stock with an unchanged PT of Rs. 2,850.

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	92.2	74.3	53.9	56.1	47.1	35.8	19.5	21.4	25.5
Pidilite Industries	-	94.6	67.3	72.0	61.8	44.9	14.8	16.3	20.1

Source: Company; Sharekhan Research

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 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 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, the company has transformed itself from a B2B to B2C player by consistently introducing consumer-centric products 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 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

- **Raw-material inflation:** Sustained inflation in key raw-material prices (including VAM) would act as a risk to our earnings estimates.
- **Slowdown in consumer demand:** Any slowdown in consumption would impact demand and negatively impact revenue growth.
- **Increased competition:** Any increase in competition from established players would act as a key risk to our earnings estimate in the near to medium term.

Additional Data

Key management personnel

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

Source: Company

Top 09 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis AMC	3.08
2	Life Insurance Corp of India	2.70
3	BlackRock Inc.	1.29
4	New World Fund	1.22
5	Capital Group Cos Inc.	1.19
6	Vanguard Group Inc.	1.03
7	Norges Bank	0.71
8	First State Investments ICVC	0.65
9	Mathews International Capital Mgmt. LLC	0.64

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 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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