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FIRST LIGHT

11 November 2022

RESEARCH

PIDILITE INDUSTRIES | TARGET: Rs 2,380 | –10% | SELL

Margin expansion ahead but valuations lofty; reiterate SELL

SOMANY CERAMICS | TARGET: Rs 710 | +35% | BUY

Gas prices continue to weigh on margins

ZYDUS WELLNESS | TARGET: Rs 2,185 | +33% | BUY

High commodity prices play spoilsport

METALS & MINING

Aluminium price floor emerging – Alcoa

Daily macro indicators

Indicator	08-Nov	09-Nov	Chg (%)
US 10Y yield (%)	4.12	4.09	(3bps)
India 10Y yield (%)	7.44	7.39	(5bps)
USD/INR	81.91	81.43	0.6
Brent Crude (US$/bbl)	95.4	92.7	(2.8)
Dow	33,161	32,514	(2.0)
Hang Seng	16,557	16,359	(1.2)
Sensex	61,185	61,034	(0.2)
India FII (US$ mn)	**04-Nov**	**07-Nov**	**Chg ($ mn)**
FII-D	(9.2)	(45.6)	(36.4)
FII-E	193.7	236.2	42.5

Source: Bank of Baroda Economics Research

SUMMARY

PIDILITE INDUSTRIES

- Consolidated Q2 net revenue increased 15% YoY to Rs 30bn as the C&B/B2B segments grew 14%/17%
- Gross margin contracted 440bps YoY to 41% due to a spike in VAM prices to US$ 2,491/mt from US$ 2,071/mt in Q2FY22
- We raise FY23/FY24 PAT by 10%/23% and revise our TP to Rs 2,380 (vs. Rs 1,870) based on a higher 64x P/E; retain SELL

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SOMANY CERAMICS

- Q2 revenue growth at 9% YoY due to 24.5% increase in blended realisation (+13% QoQ); however, tile volumes declined 2% YoY
- EBITDA margin contracted 420bps YoY to 5.9% owing to lower gross margin (-350bps) and absence of price hikes
- We cut FY23/FY24 PAT by 11%/10% and revise our TP to Rs 710 (vs. Rs 830). Maintain BUY

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ZYDUS WELLNESS

- Q2 revenue grew 12% YoY (-38% QoQ) to Rs 4.3bn aided by 5% volume growth
- Gross/EBITDA margins fell 490bps/420bps YoY to 43%/3.8% due to higher input and other costs
- Retain BUY on product innovation, distribution expansion and improving product category penetration; TP unchanged at Rs 2,185

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METALS & MINING

- Aluminium price floor building up with a tighter physical market, but near-term upside capped by high demand uncertainty
- Triggers for price breakout include visibility on economic recovery, end to the Russia-Ukraine war, and sanctions on Russian aluminium
- Key monitorables are automotive build rates and length of maintenance shutdowns at US plants plus billet premium in Europe

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SELL

TP: Rs 2,380 | ▼ 10%

PIDILITE INDUSTRIES | Construction Materials | 10 November 2022

Margin expansion ahead but valuations lofty; reiterate SELL

- **Consolidated Q2 net revenue increased 15% YoY to Rs 30bn as the C&B/B2B segments grew 14%/17%**
- **Gross margin contracted 440bps YoY to 41% due to a spike in VAM prices to US$ 2,491/mt from US$ 2,071/mt in Q2FY22**
- **We raise FY23/FY24 PAT by 10%/23% and revise our TP to Rs 2,380 (vs. Rs 1,870) based on a higher 64x P/E; retain SELL**

Ruchitaa Maheshwari
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Steady revenue growth: PIDI's consolidated Q2FY23 net revenue grew 15% YoY to Rs 30bn led by a combination of product mix, distribution expansion, product innovation, digital initiative and measured price hikes. Consumer & Bazaar (C&B) segment revenue increased 14% YoY to Rs 24.3bn, but segmental EBIT margin contracted 570bps to 21.7%. The B2B segment grew 17% YoY to Rs 6.2bn with EBIT margin expanding 300bps to 7.9%.

Margins contract: Gross margin contracted 440bps YoY to 41% owing to raw material inflation, weaker currency and high-priced inventory. However, selective pricing action along with mix enrichment helped to maintain gross margins sequentially (-70bps). Key raw material VAM soared to US$ 2,491/mt from US$ 2,071/mt in Q2FY22 (US$ 2,231/mt in Q1FY23) vs. current orders at US$ 1,200-1,400/mt. Hence, EBITDA margin contracted by 435bps YoY to 16.6%.

Solid standalone performance: PIDI's standalone sales grew 23% YoY to Rs 27.2bn. C&B segment revenue grew 22% YoY to Rs 22bn. Segment EBIT margin declined 520bps YoY to 23.3%. B2B segment revenue grew 26% YoY to Rs 5.5bn with EBIT margin declining 140bps YoY to 8.3%. Gross/EBITDA margins contracted 525bps/455bps YoY to 40.3%/17.1%.

Margin expansion ahead: PIDI saw broad-based demand across product categories during the quarter and expects H2FY23 to be driven by good monsoons and continued pickup in the housing market. Per management, VAM prices have currently softened to US$1,200-1,400/mt vs. US$ 2,491/mt in Q2, which will benefit margins from Q3FY23.

We raise FY23/FY24 PAT estimates by 10%/23% and have increased our target FY24E P/E multiple to 64x (vs. 62x) to incorporate better H1 numbers and the margin expansion. While the earnings outlook is healthy, valuations are rich at ~72x FY24E EPS (5Y median P/E of ~70x). Despite factoring the better H2FY23, our estimates are below consensus. We maintain SELL with a revised TP of Rs 2,380 (earlier Rs 1,870).

Key changes

Target	Rating
▲	◄ ►

Ticker/Price	PIDI IN/Rs 2,656
Market cap	US$ 16.5bn
Free float	30%
3M ADV	US$ 13.5mn
52wk high/low	Rs 2,919/Rs 1,989
Promoter/FPI/DII	70%/11%/19%

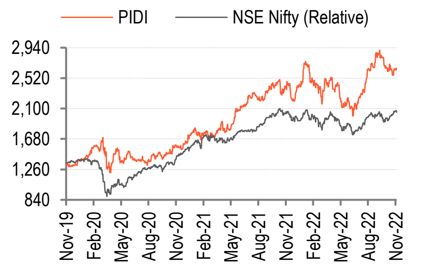
Source: NSE | Price as of 10 Nov 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	99,210	1,10,824	1,34,820
EBITDA (Rs mn)	18,473	21,611	28,312
Adj. net profit (Rs mn)	11,965	14,179	18,883
Adj. EPS (Rs)	23.5	27.9	37.2
Consensus EPS (Rs)	23.5	33.1	38.9
Adj. ROAE (%)	19.9	21.2	25.6
Adj. P/E (x)	112.8	95.2	71.5
EV/EBITDA (x)	72.9	62.4	47.6
Adj. EPS growth (%)	5.5	18.5	33.2

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

BUY
TP: Rs 710 | ⮝ 35%

SOMANY CERAMICS | Construction Materials | 10 November 2022

Gas prices continue to weigh on margins

- **Q2 revenue growth at 9% YoY due to 24.5% increase in blended realisation (+13% QoQ); however, tile volumes declined 2% YoY**
- **EBITDA margin contracted 420bps YoY to 5.9% owing to lower gross margin (-350bps) and absence of price hikes**
- **We cut FY23/FY24 PAT by 11%/10% and revise our TP to Rs 710 (vs. Rs 830). Maintain BUY**

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Margins contract: SOMC's Q2FY23 revenue grew 9% YoY (+12% QoQ) to Rs 6.1bn aided by a 24.5% rise in blended realisation. However, volumes declined by 2% YoY. Due to an increase in gas cost and input cost inflation, gross margin contracted 350bps YoY. Hence, EBITDA margin declined 420bps to 5.9%, with EBITDA down 36% YoY. Consolidated revenue grew 10% YoY to Rs 6.2bn while EBITDA margin fell 535bps to 6.8% on a lower gross margin (-485bps) of 29.4%. The company has not taken any price hikes during the quarter, impacting margins.

Gas price on the rise: Rising gas cost is putting pressure on margins. Total gas cost increased by Rs 5/scm QoQ in Q2FY23 to Rs 64/scm (+100% YoY). Per management, the Q3 margin will improve owing to reduction in gas cost and LPG coming into system. Prices in the northern region have risen from Rs 58/scm in Q1FY23 to Rs 65/scm in Q2FY23, and in the south to Rs 75/scm in Q2 (Rs 60-62/scm currently). In Morbi, prices are stable at Rs 65/scm QoQ.

Alternate fuel to improve margins: Compared to gas cost which hovers at Rs 65/scm, LPG trades at Rs 50/scm. As per management, 50% of its units have been moved to alternate fuel, LPG. By the end of Nov'22, the company expects 60-62% of the units to run on LPG. Per management, switching to alternatives such as LPG and propane coupled with softening of gas prices should result in improvement in operating margins going forward. For Q3, management expects fuel cost at ~Rs 60/scm.

Near-term demand headwinds: Gas price uncertainty continues and there remains a risk of further global gas price spikes amid winter (H2) and prolonged geopolitical tensions. However, the switch to alternative fuel will provide much needed respite to financials. Due to the sharp spike in gas prices in European countries, Morbi's tiles competitiveness has improved and exports are expected to pick up. We lower our PAT estimates by 11% for FY23 and 10% for FY24 to incorporate the H1FY23 performance and a reduction in FY23 volume growth guidance to low double digits (earlier 15-20%). The stock is trading at 17.2x FY24E EPS vs. its 5Y median of 26.3x. Post estimate revision, we have a new TP of Rs 710 (vs. Rs 835), set at an unchanged 22x FY24E P/E multiple – retain BUY.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	SOMC IN/Rs 527
Market cap	US$ 273.0mn
Free float	45%
3M ADV	US$ 0.2mn
52wk high/low	Rs 970/Rs 511
Promoter/FPI/DII	55%/2%/43%

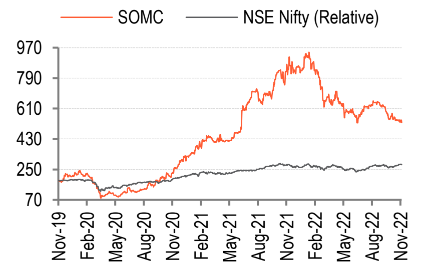
Source: NSE | Price as of 10 Nov 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	20,945	23,167	27,140
EBITDA (Rs mn)	2,065	2,187	2,873
Adj. net profit (Rs mn)	888	893	1,370
Adj. EPS (Rs)	21.0	21.1	32.3
Consensus EPS (Rs)	21.0	26.2	38.7
Adj. ROAE (%)	13.0	11.6	15.7
Adj. P/E (x)	25.1	25.0	16.3
EV/EBITDA (x)	12.3	11.5	8.9
Adj. EPS growth (%)	24.8	0.6	53.4

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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BUY
TP: Rs 2,185 | ⮝ 33%

ZYDUS WELLNESS | Consumer Staples | 10 November 2022

High commodity prices play spoilsport

- **Q2 revenue grew 12% YoY (-38% QoQ) to Rs 4.3bn aided by 5% volume growth**
- **Gross/EBITDA margins fell 490bps/420bps YoY to 43%/3.8% due to higher input and other costs**
- **Retain BUY on product innovation, distribution expansion and improving product category penetration; TP unchanged at Rs 2,185**

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Revenue up 12% YoY: ZYWL's consolidated Q2FY23 revenue grew 12% YoY to Rs 4.3bn led by 5% volume growth and marketing efforts across the portfolio. The company witnessed downtrading by rural consumers (25% of the topline), which led to sequentially lower volume growth.

EBITDA margin contracts: Higher input cost inflation, mainly in milk (+25% YoY), aspartame (+65% YoY) and dextrose monohydrate (+65% YoY), along with weakening of the rupee and higher crude prices exerted pressure on margins. Gross margin contracted 490ps YoY to 43.3% and EBITDA margin fell 420bps to 3.8%. To mitigate cost inflation, the company plans to take calibrated price hikes in the coming months (+2% hike taken now), the full benefit of which is expected in Q4.

Key growth triggers: (a) Per management, raw material inflation is likely to soften in H2FY23, which will not only aid gross margin expansion but will also provide flexibility for aggressive brand investments. We believe this will bolster volume growth. (b) Management is looking at filling white spaces and has been offering brand extensions and new launches, which we expect will aid revenue growth.

(c) The average penetration of ZYWL's portfolio brands stands at ~20% (12-24% across categories), signifying higher growth headroom vs. its FMCG peers. In our view, an increase in market penetration from modest levels is one of the levers for sustained long-term category growth. To improve penetration, ZYWL aims to widen direct distribution coverage from 0.6mn to ~1mn by FY25. Growth in modern trade, chemist channel sales and e-commerce channels is likely to further boost sales.

Revival underway; retain BUY: ZYWL is trading at 23.6x FY24E EPS. We retain BUY and our TP of Rs 2,185, set at 38x FY24E EPS (in line with the stock's 5Y median), on the back of new launches, increasing distribution strength, a broader presence through existing brands, its ability to cater to white spaces, and a strong gross margin which gives the company the leeway to spend more on brand building. We are also positive on ZYWL's debt reduction measures, quick free cash flow generation and superior execution.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	ZYWL IN/Rs 1,642
Market cap	US$ 1.3bn
Free float	35%
3M ADV	US$ 1.2mn
52wk high/low	Rs 2,090/Rs 1,430
Promoter/FPI/DII	65%/3%/25%

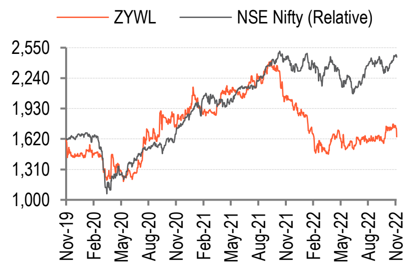
Source: NSE | Price as of 10 Nov 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	20,091	22,045	24,534
EBITDA (Rs mn)	3,448	4,056	4,711
Adj. net profit (Rs mn)	3,098	3,657	4,442
Adj. EPS (Rs)	48.4	57.4	69.5
Consensus EPS (Rs)	48.4	56.1	69.3
Adj. ROAE (%)	5.9	6.9	7.8
Adj. P/E (x)	33.9	28.6	23.6
EV/EBITDA (x)	33.0	26.4	22.2
Adj. EPS growth (%)	(19.3)	18.0	21.2

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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METALS & MINING

10 November 2022

Aluminium price floor emerging: Alcoa

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- **Triggers for price breakout include visibility on economic recovery, end to the Russia-Ukraine war, and sanctions on Russian aluminium**
- **Key monitorables are automotive build rates and length of maintenance shutdowns at US plants plus billet premium in Europe**

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We summarise key takeaways from our interaction with Jim Dwyer, VP – Investor Relations and Pension Investments, Alcoa (AA US, Not Rated).

Aluminium price floor emerging: While aluminium prices have been range-bound at US$ 2,100-2,400/t over the past two months, Alcoa's discussions with western investors suggest that a price floor is building up. This is being supported by aluminium smelters operating nearly halfway into the cost curve and significant margin compression from high energy and raw material costs. Even if raw material inflation starts to ease, it will take one or two quarters for prices to hit the cost base and support margin improvement.

Near-term upside capped by demand uncertainty: Aluminium physical markets are relatively tight with low inventory levels and a reduced demand-supply imbalance post smelter closures, but near-term upsides appear capped by the hazy outlook on demand. Signs of slowdown in Europe, patchy recovery in China and destocking/ purchase deferrals by US buyers all make for a volatile demand climate.

Triggers for price breakout: We believe tightness in the aluminium market will start getting priced in once there emerges a strong probability of no major recession in the US, a manageable recession in Europe and sustained recovery in China. An end to the Russia-Ukraine war would also aid economic recovery by way of lowering energy costs and boosting demand. Alternatively, sanctions on Russian aluminium could also be a trigger if they are restrictive enough to block global trades outside the developing world (e.g. curbs on global traders).

Read-across for Indian aluminium players: Although it is difficult to put a timeline to price and margin recovery, we believe that revival may take at least six months considering prevailing demand uncertainty as well as the typical lag in pass-along of raw material costs. For further insights from our discussions with other major global producers, please refer to our report of 20 October, **Aluminium market in need of supply rebalancing**.

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HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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