FIRST LIGHT

13 August 2021

RESEARCH

BOB Economics Research | Inflation and IIP

Industrial activity slows, inflation eases

Pidilite Industries | Target: Rs 1,525 | –31% | SELL

Raw material pressure hurts gross margin

Eicher Motors | Target: Rs 2,200 | –19% | SELL

Dull quarter as volumes trend down; maintain SELL

Daily macro indicators

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.33	(2bps)	(3bps)	66bps
India 10Y yield (%)	6.24	0bps	5bps	39bps
USD/INR	74.44	0.0	0.3	0.5
Brent Crude (US$/bbl)	71.44	1.1	(5.4)	57.3
Dow	35,485	0.6	1.8	26.8
Shanghai	3,533	0.1	0.2	6.4
Sensex	54,526	(0.1)	4.1	42.1
India FII (US$ mn)	**10-Aug**	**MTD**	**CYTD**	**FYTD**
FII-D	(43.6)	(28.7)	(3,281.9)	(1,254.6)
FII-E	(10.8)	547.2	6,925.4	(401.0)

Source: Bank of Baroda Economics Research

SUMMARY

India Economics: Inflation and IIP

India's IIP eased to 13.6% in Jun'21 led by base effect. Notably, over a 2-year horizon, output is down by 5.2% led by capital goods and durables. FMCG has expanded. CPI inflation has cooled off to 5.6% in Jul'21 (6.3% in Jun'21) led by food inflation at 4% (110bps MoM decline). Core too softened to 6% (6.2% in Jun'21). We expect inflation at 5.5% and growth to pick up to 9.7% in FY22. This should give RBI room to normalize policy in Q4FY22 by changing its liquidity stance and raising reverse repo rate.

Click here for the full report.

Pidilite Industries

- Consolidated Q1 revenue grew 121% YoY, rebounding from a tepid base
- Gross margin contracted 435bps YoY but lower employee cost aided operating margin expansion of 10ppt
- We maintain estimates and roll over to a new Jun'22 TP of Rs 1,525 (vs. Rs 1,365); retain SELL

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Eicher Motors

- Q1 revenue declined 35% QoQ on weak volumes (-40%). Lower operating efficiency further pulled down profitability
- Monthly sales run-rate at ~42k vs. ~70k required to meet our FY22 volume estimate
- Maintain Mar'22 TP of Rs 2,200 based on 24x FY23E EPS; reiterate SELL

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INFLATION AND IIP

12 August 2021

Industrial activity slows, inflation eases

India's IIP eased to 13.6% in Jun'21 led by base effect. Notably, over a 2-year horizon, output is down by 5.2% led by capital goods and durables. FMCG has expanded. CPI inflation has cooled off to 5.6% in Jul'21 (6.3% in Jun'21) led by food inflation at 4% (110bps MoM decline). Core too softened to 6% (6.2% in Jun'21). We expect inflation at 5.5% and growth to pick up to 9.7% in FY22. This should give RBI room to normalize policy in Q4FY22 by changing its liquidity stance and raising reverse repo rate.

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IIP growth eases: Industrial output moderated to 13.6% in Jun'21 from 29.3% in May'21. Base effect explains this. Consumer durables, capital and intermediate goods seem to be driving growth. It is more useful to look at growth from a 2-year horizon. On that count, Industrial output is 5.2% lower (-14.3% in May'21) led by 6.2% decline in manufacturing and 2.6% dip in electricity output. Capital goods (-21% over Jun'19) and consumer durables (-15% over Jun'19) have declined the most—pandemic impact. Infra, primary goods and intermediate goods have contracted only marginally. Only FMCG (essential goods) output has expanded.

Food inflation cools down: CPI inflation moderated significantly to 5.6% in Jul'21 from 6.3% in Jun'21 led by decline in food inflation to 4% from 5.1%. Within food, vegetable prices fell by 7.7% (-0.7% in Jun'21), while that of fruits rose by 8.9% as against 11.8% in Jun'21 and that of pulses increased by 9% as against 10% in Jun'21. Oils and fats too decelerated to 32.5% from 34.8%. Perhaps reduction in custom duty on edible oils worked. Inflation in egg, meat and fish and milk products accelerated. Perishables are likely to pull down food inflation in the coming months on the back of a high base (vegetables inflation was 12.7% in H1FY21).

Core inflation eases further: Core inflation softened to 6.0% in Jul'21 from 6.2% in Jun'21. What eased? Transport and communication at 10.5% (11.6% in Jun'21), education at 3% (3.4% in Jun'21), personal care and effects at 3.8% (4.7% in Jun'21) and household goods and services at 4.9% (5.7% in Jun'21). Health care inflation remained elevated and recreation and amusement too inched up as restrictions are relaxed. Cost push inflation is likely to be visible in coming months as full pass-through of higher commodity prices is yet to happen. While global commodity prices have eased a little in the last few weeks on the back of rising Covid-19 cases, a rebound when cases decline cannot be ruled out.

We expect retail inflation at 5.5% in FY22 led by core inflation at 6.1%. Monsoon is improving and bodes well for food inflation. Growth outlook is also improving. This should give RBI room to normalize monetary policy in Q4FY22 by reducing wedge between reverse repo and repo rate and changing its liquidity stance.

Key highlights

- CPI inflation edged down to 5.6% in Jul'21 from 6.3% in Jun'21.
- Food inflation fell to 4%. Core inflation moderated to 6%.
- IIP moderates to 13.6% from 29.3% in May'21. It has fallen by 5.2% over a 2-year horizon.

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SELL

TP: Rs 1,525 | ∨ 31%

PIDILITE INDUSTRIES | Construction Materials | 12 August 2021

Raw material pressure hurts gross margin

- **Consolidated Q1 revenue grew 121% YoY, rebounding from a tepid base**
- **Gross margin contracted 435bps YoY but lower employee cost aided operating margin expansion of 10ppt**
- **We maintain estimates and roll over to a new Jun'22 TP of Rs 1,525 (vs. Rs 1,365); retain SELL**

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Revenue growth rebounds off a weak base: PIDI's consolidated Q1FY22 revenue grew 121% YoY (112.5% ex-Hunstman) to Rs 19.4bn, with 79.5% YoY constant currency growth in overseas subsidiaries due to a low pandemic-hit base quarter. Standalone revenue increased 111% YoY to Rs 16.3bn with volume growth of ~105% (+103% in the consumer & bazaar segment and 113% in B2B). Per management, sales were adversely affected from mid-April to mid-June due to the pandemic but have improved thereafter.

Demand trends looking up: Demand has seen sustained recovery in July and early August post unlocking. Recovery has been broad-based across product categories and geographies and should sustain in the absence of further Covid restrictions. As per management, domestic subsidiaries such as Nina Percept will do well going ahead as the housing market is seeing better traction.

Gross margin declines on higher RM cost: Gross margin contracted 435bps YoY (–170bps QoQ) as prices for key material VAM increased to an average of US$ 1,610/mt vs. US$ 890/mt in Q1FY21 ($1,200/mt in Q4). However, consolidated operating margin rose 1,040bps YoY to 17.9% due to lower employee cost (-1,008bps) and other expenses (-466bps) – this yielded EBITDA/PBT growth of 424%/821% YoY.

Margin pressures ahead: VAM prices peaked in April at ~US$ 2,000/mt and are currently at US$ 1,400-1,500/mt. Management expects a further gradual decline post Q2. The company has taken a price hike of 4-6% across products in Q1 which should cover ~75% of the increased RM cost. However, Q2 margins may be affected by high-cost inventory carried over from Q1.

Maintain SELL on expensive valuations: Though we like PIDI's business model, current valuations look rich at 68.2x FY23E EPS, especially in light of increased margin stress from higher input prices. We roll forward to a revised Jun'22 TP of Rs 1,525, based on a 45x one-year forward P/E multiple (42x earlier), in line with the stock's 10-year average.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	PIDI IN/Rs 2,221
Market cap	US$ 15.2bn
Free float	30%
3M ADV	US$ 16.0mn
52wk high/low	Rs 2,334/Rs 1,357
Promoter/FPI/DII	70%/12%/18%

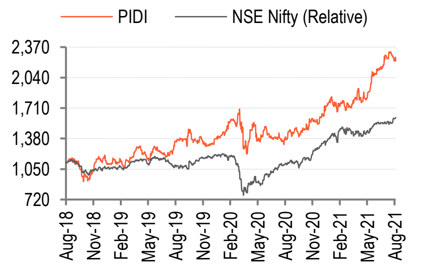
Source: NSE | Price as of 12 Aug 2021

Key financials

Y/E 31 Mar	FY21P	FY22E	FY23E
Total revenue (Rs mn)	72,927	89,662	1,03,920
EBITDA (Rs mn)	16,806	20,891	24,213
Adj. net profit (Rs mn)	11,339	14,160	16,547
Adj. EPS (Rs)	22.3	27.9	32.6
Consensus EPS (Rs)	22.3	26.4	32.7
Adj. ROAE (%)	22.6	24.1	25.4
Adj. P/E (x)	99.5	79.7	68.2
EV/EBITDA (x)	67.0	53.8	46.4
Adj. EPS growth (%)	(2.2)	24.9	16.9

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE

RESULT REVIEW

SELL

TP: Rs 2,200 | ⩔ 19%

EICHER MOTORS | Auto Components | 12 August 2021

Dull quarter as volumes trend down; maintain SELL

- **Q1 revenue declined 35% QoQ on weak volumes (-40%). Lower operating efficiency further pulled down profitability**
- **Monthly sales run-rate at ~42k vs. ~70k required to meet our FY22 volume estimate**
- **Maintain Mar'22 TP of Rs 2,200 based on 24x FY23E EPS; reiterate SELL**

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Weak quarter: EIM's standalone Q1FY22 revenue was in line with our projections, with a 35% QoQ decline to Rs 19.1bn on the back of a 40% QoQ drop in quarterly volumes and a 4% increase in ASP stemming from pricing action. Gross margin improved 30bps QoQ but lower volumes impacted operating efficiencies. EBITDA thus fell 48% QoQ to Rs 3.3bn and margins shrank 450bps to 17.5% (21.1% est.). Adj. PAT was down 43% QoQ to Rs 2.7bn.

Near-term volume and cost headwinds: During H2FY21, EIM clocked a quarterly sales run-rate of ~200k units (~66k monthly rate) and reported a 23% EBITDA margin. In contrast, it posted total sales of ~168k vehicles (~42k monthly rate) over the past four months, including exports. Here on, the company will have to achieve a monthly run-rate of ~70k vehicles to achieve our projections for FY22. Though we pencil in a healthy 14% volume CAGR for Royal Enfield over FY21-FY24 supported by launches and pent-up demand, we believe higher raw material costs, an erratic supply chain and inability to take further price hikes will exact a toll on earnings.

Leadership change: EIM in its press release mentioned that Vinod Dasari, CEO of Royal Enfield and whole-time director of the company, has resigned. The board has approved appointment of current Royal Enfield COO B Govindrajan, an industry veteran with 32 years of experience, as executive director.

Maintain SELL: We expect EIM to clock a revenue, EBITDA and PAT CAGR of 17%, 21% and 27% respectively over FY21-FY24. Our FY22/FY23 revenue forecasts are ~10% below consensus due to lower volume assumptions and our EBITDA margins are 200bps below at ~22%. We are ~29% short on EPS. We believe consensus revenue and margin assumptions could be at risk considering the huge ask on volumes as well as rising raw material costs.

We continue to value the stock at 24x FY23E EPS (in line with its long-term average) and also assign Rs 150/sh (consensus value) to its VECV business. Retain SELL with an unchanged Mar'22 TP of Rs 2,200.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	EIM IN/Rs 2,718
Market cap	US$ 10.0bn
Free float	51%
3M ADV	US$ 24.4mn
52wk high/low	Rs 3,037/Rs 2,007
Promoter/FPI/DII	49%/32%/7%

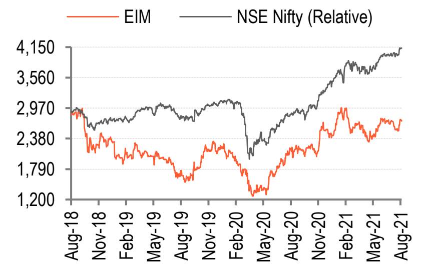
Source: NSE | Price as of 11 Aug 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	86,190	105,998	125,493
EBITDA (Rs mn)	17,865	22,320	27,846
Adj. net profit (Rs mn)	13,608	18,382	24,107
Adj. EPS (Rs)	48.7	66.1	87.0
Consensus EPS (Rs)	48.7	84.0	107.5
Adj. ROAE (%)	14.0	16.8	19.1
Adj. P/E (x)	55.8	41.1	31.2
EV/EBITDA (x)	39.4	30.7	25.2
Adj. EPS growth (%)	(30.2)	35.7	31.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

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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