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FIRST LIGHT

14 May 2021

RESEARCH

BOB Economics Research | Inflation and IIP

Industrial activity rebounds, inflation eases

Pidilite Industries | Target: Rs 1,365 | –27% | SELL

Higher RM cost to crimp margins; maintain SELL

Apollo Tyres | Target: Rs 140 | –37% | SELL

Margin headwinds ahead; maintain SELL

SUMMARY

India Economics: Inflation and IIP

India's industrial output rose by a stellar 22.4% in Mar'21, even after adjusting for a low base. CPI inflation eased to 4.3% in Apr'21 from 5.5% in Mar'21 led by moderation in food inflation to 2% in Apr'21 (4.9% in Mar'21). Core inflation too edged down to 5.5% in Apr'21 from 6.1% in Mar'21. While industrial activity has lost momentum on the back of lockdowns, inflationary pressure is building up due to rising international commodity prices. Inflation trajectory is contingent on monsoon rainfall (projected to be normal).

Click here **for the full report.**

Pidilite Industries

Pidilite Industries (PIDI) reported consolidated Q4FY21 revenue growth of 45% YoY on a tepid base, with a 45%/26% rise in standalone C&B/B2B volumes. Operating margin expanded 115bps YoY to 20.6% due to lower employee and other expense-to-sales, aiding EBITDA/PBT growth of 53%/62% YoY. Management expects margins to remain under pressure due to higher RM cost. Retain SELL with an unchanged Mar'22 TP of Rs 1,365 given the downside risk to earnings from RM cost inflation plus rich valuations of 58x FY23E P/E.

Click here **for the full report.**

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	1,000
TCS	Buy	3,780
Tech Mahindra	Buy	1,190

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	3,750
Greenply Industries	Buy	195
Laurus Labs	Buy	540
Transport Corp	Buy	320

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.62	2bps	(4bps)	96bps
India 10Y yield (%)	6.01	0bps	(1bps)	(16bps)
USD/INR	73.34	0	1.9	2.9
Brent Crude (US$/bbl)	68.55	0.3	8.9	128.7
Dow	34,269	(1.4)	1.4	44.2
Shanghai	3,442	0.4	(0.3)	19.0
Sensex	49,162	(0.7)	(0.9)	56.7
India FII (US$ mn)	**10 May**	**MTD**	**CYTD**	**FYTD**
FII-D	(2.4)	201.3	(2,191.0)	(163.7)
FII-E	159.2	(380.0)	5,457.2	(1,869.1)

Source: Bank of Baroda Economics Research

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Apollo Tyres

Apollo Tyres (APTY) delivered an operational beat in Q4FY21 led by better margins in European operation. Consolidated revenue dipped 3% QoQ to Rs 50bn, EBITDA margin dropped 300bps to 16.2% (–500bps est.), and adj. PAT fell 36% QoQ to Rs 2.9bn. We expect consolidated margins to remain stressed given steep RM cost inflation, higher share of the lower-margin India business, and an adverse product mix as OEM demand returns in FY22. Current valuations at 25x FY23E EPS look rich – retain SELL with an unchanged Mar'22 TP of Rs 140.

Click here for the full report.

INFLATION AND IIP

12 May 2021

Industrial activity rebounds, inflation eases

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India's industrial output rose by a stellar 22.4% in Mar'21, even after adjusting for a low base. CPI inflation eased to 4.3% in Apr'21 from 5.5% in Mar'21 led by moderation in food inflation to 2% in Apr'21 (4.9% in Mar'21). Core inflation too edged down to 5.5% in Apr'21 from 6.1% in Mar'21. While industrial activity has lost momentum on the back of lockdowns, inflationary pressure is building up due to rising international commodity prices. Inflation trajectory is contingent on monsoon rainfall (projected to be normal).

KEY HIGHLIGHTS

- CPI inflation edged down to 4.3% in Apr'21 from 5.5% in Mar'21.
- Food inflation fell to 2%. Core inflation moderated to 5.5%.
- Industrial activity saw a strong rebound in Mar'21 at 22.4%. For FY21, IIP fell by 8.6%.

IIP sees a rebound in Mar'21: Industrial output contracted by 8.6% in FY21 compared with a dip of 0.8% in FY20 led by 7.8% decline in mining and 9.8% decline in manufacturing. Electricity output was stable. However, in Mar'21, IIP increased by 22.4%. A low base (-18.7% in Mar'20) explain this. Electricity output was resilient at 22.5% even after adjusting for a decline of 8.2% in Mar'20. Manufacturing output saw an increase of 25.8% in Mar'21 on the back of a low base of (-) 22.8% in Mar'20. The uptick in IIP was broad based led by capital and consumer durable goods at 41.9% (-38.8% in Mar'20) and 54.9% (-36.8% in Mar'20) respectively. Infra and FMCG goods output also rose by 31.2% (-24.3% in Mar'20) and 27.5% (-22.3% in Mar'20) in Mar'21.

Food inflation moderates: CPI inflation softened to 4.3% in Apr'21 from 5.5% in Mar'21. A favourable base explains this. Food inflation moderated to 2% in Apr'21 from 4.9% in Mar'21 led by vegetables index which fell by 14.2% in Apr'21 compared with a dip of 5% in Mar'21. Cereal prices fell by 3% after a 0.7% contraction in Mar'21. Prices of pulses rose by 7.5% in Apr'21 (13.3% in Mar'21). Price pressure was visible in meat and fish (16.7% versus 15.1%), eggs (10.6%), oil and fats (25.9% versus 24.9%) and fruits (9.8% versus 7.9%). While surplus cereal stocks are a positive, food inflation depends on monsoon. A below normal monsoon when global food prices are rising will be inflationary.

Core inflation tapers off: Core inflation edged down to 5.5% (6.1% in Mar'21). This was led by decline in transport and communication (11% versus 12.5%). The dip in core was broad based as seen in household goods and services (2% versus 3.3%), recreation and amusement (4.6% versus 6.2%), education (0.9% versus 2.6%) and personal care and effects (5.4% versus 5.9%). Clothing and footwear prices rose by 3.5% from 4.4%. Given muted demand outlook, core is expected to gravitate lower in coming months. Higher oil prices are a risk.

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SELL
TP: Rs 1,365 | ⋎ 27%

PIDILITE INDUSTRIES | Construction Materials | 13 May 2021

Higher RM cost to crimp margins; maintain SELL

Pidilite Industries (PIDI) reported consolidated Q4FY21 revenue growth of 45% YoY on a tepid base, with a 45%/26% rise in standalone C&B/B2B volumes. Operating margin expanded 115bps YoY to 20.6% due to lower employee and other expense-to-sales, aiding EBITDA/PBT growth of 53%/62% YoY. Management expects margins to remain under pressure due to higher RM cost. Retain SELL with an unchanged Mar'22 TP of Rs 1,365 given the downside risk to earnings from RM cost inflation plus rich valuations of 58x FY23E P/E.

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Healthy revenue growth: PIDI's consolidated Q4 revenue grew 45% YoY (38.2% ex-Hunstman) to Rs 22.4bn, with 29% constant currency growth in overseas subsidiaries. Standalone revenue increased 41% YoY to Rs 18.6bn aided by a tepid base of last year and volume growth of 40% YoY (+45% in the consumer & bazaar (C&B) segment and 26% in B2B). Management stated that the demand outlook was difficult to assess due to the resurgent pandemic.

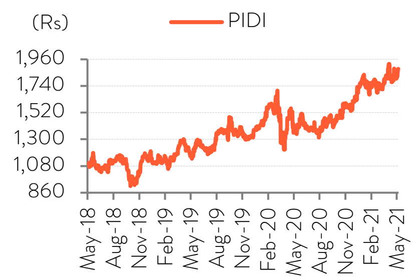
Gross margin declines: Despite a 455bps YoY (–110bps QoQ) contraction in gross margin, consolidated operating margin rose 115bps YoY to 20.6% due to lower employee cost (–205bps) and other expenses (–365bps) – this yielded EBITDA/PBT growth of 53%/62% YoY. Gross margin declined as RM prices for key material VAM increased to an average of US$ 1,200/mt in Q4 vs. US$ 925/mt in the year-ago quarter. Management expects sustained near-term margin pressure due to RM inflation (VAM prices now at US$ 2,000/mt) and is targeting an EBITDA margin range of 20-24% over the medium term.

Valuations expensive; SELL: Though we like PIDI's business model, current valuations look rich at 58x FY23E EPS, especially in light of increased margin stress from higher input prices. Maintain SELL with an unchanged Mar'22 TP of Rs 1,365, set at a P/E multiple of 42x FY23E.

Ticker/Price	PIDI IN/Rs 1,880
Market cap	US$ 13.0bn
Shares o/s	508mn
3M ADV	US$ 14.1mn
52wk high/low	Rs 1,929/Rs 1,307
Promoter/FPI/DII	70%/12%/18%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
Total revenue (Rs mn)	70,787	72,945	72,927	89,678	1,03,628
EBITDA (Rs mn)	13,682	15,760	16,806	20,895	24,145
Adj. net profit (Rs mn)	8,901	11,590	11,339	14,162	16,501
Adj. EPS (Rs)	17.5	22.8	22.3	27.9	32.5
Adj. EPS growth (%)	(2.9)	30.2	(2.2)	24.9	16.5
Adj. ROAE (%)	23.1	26.9	22.6	24.1	25.4
Adj. P/E (x)	107.3	82.4	84.2	67.5	57.9
EV/EBITDA (x)	69.8	60.6	56.7	45.5	39.4

Source: Company, BOBCAPS Research | P – Provisional

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SELL
TP: Rs 140 | ∀ 37%

APOLLO TYRES | Auto Components | 13 May 2021

Margin headwinds ahead; maintain SELL

Apollo Tyres (APTY) delivered an operational beat in Q4FY21 led by better margins in European operation. Consolidated revenue dipped 3% QoQ to Rs 50bn, EBITDA margin dropped 300bps to 16.2% (–500bps est.), and adj. PAT fell 36% QoQ to Rs 2.9bn. We expect consolidated margins to remain stressed given steep RM cost inflation, higher share of the lower-margin India business, and an adverse product mix as OEM demand returns in FY22. Current valuations at 25x FY23E EPS look rich – retain SELL with an unchanged Mar'22 TP of Rs 140.

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European operations cushion margin: APTY's consolidated Q4FY21 revenue totalled Rs 50bn (-3% QoQ) on higher volume growth across segments. Though India operations reported a below-expected 38.6% gross margin, outperformance in Europe cushioned the decline in consolidated EBITDA margin to 300bps QoQ (vs. a 500bps contraction expected). Adj. PAT decreased 36% QoQ to Rs 2.9bn.

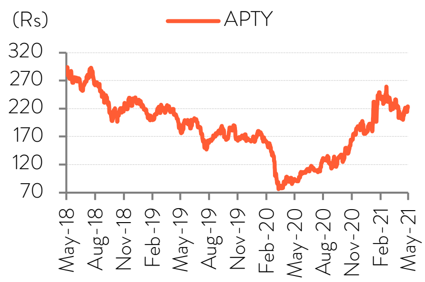
Margin headwinds ahead: With a 12% QoQ cost rise in the raw material basket in Q4, a further expected increase of ~10% QoQ in Q1FY22 and the inability of tyre companies to fully pass on the burden, we anticipate further margin erosion. Also, our FY21-FY23 revenue forecast at 14% CAGR for Indian operations vs. 8% for Europe implies an adverse margin mix, given better profitability in APTY's European business. Lastly, with Indian OEMs expected to clock healthy growth (vs. replacement demand), the sales mix could turn unfavourable, hurting margins.

Valuations full – maintain SELL: Our FY22/FY23 revenue estimates are in line with consensus, but we are ~35% lower on EPS given weaker operating margin expectations. We pencil in a revenue/EBITDA/adj. PAT CAGR of +11%/–2%/–23% for the company over FY21-FY23. The stock is trading at an expensive 25x FY23E EPS. Maintain SELL with a Mar'22 TP of Rs 140 (16x FY23E EPS).

Ticker/Price	APTY IN/Rs 221
Market cap	US$ 1.7bn
Shares o/s	572mn
3M ADV	US$ 25.3mn
52wk high/low	Rs 261/Rs 89
Promoter/FPI/DII	41%/23%/17%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
Total revenue (Rs mn)	175,488	163,270	173,970	194,362	215,347
EBITDA (Rs mn)	17,762	19,155	27,975	24,288	26,917
Adj. net profit (Rs mn)	6,798	4,764	9,579	4,803	5,665
Adj. EPS (Rs)	15.4	8.3	5.5	7.6	8.9
Adj. EPS growth (%)	(6.1)	(29.9)	81.2	(49.9)	17.9
Adj. ROAE (%)	6.8	4.8	8.1	4.0	4.6
Adj. P/E (x)	14.4	26.6	40.2	29.3	24.8
EV/EBITDA (x)	9.1	8.8	6.4	7.0	6.1

Source: Company, BOBCAPS Research | P – Provisional

Disclaimer

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

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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