

**SELL**

TP: Rs 1,215 | ▼ 10%

**PIDILITE INDUSTRIES**

Construction Materials

14 November 2019

## Volumes and margins disappoint

**Pidilite Industries (PIDI) reported below-expected consolidated Q2FY20 revenue growth of 2.8% YoY as CBP volumes dipped 0.9%, offsetting industrial volume growth of 12.6%. Operating margins fell 50bps YoY to 20.4%, resulting in flat EBITDA growth. Management expects margins to remain steady in light of benign RM prices, but indicated that demand conditions are challenging. We cut FY20-FY22 PAT estimates by 5-6% due to a soft H1. On rolling valuations over, we move to a Sep'20 TP of Rs 1,215 (earlier Rs 1,240).**

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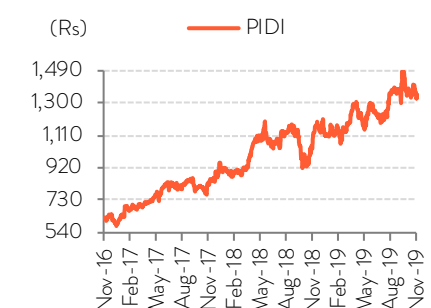
**Revenue growth below estimates:** PIDI's consolidated Q2 revenue grew 2.8% YoY to Rs 18.1bn, with 13.7% YoY constant currency growth in overseas subsidiaries. Standalone revenue increased 3.6% YoY to Rs 15.7bn, as volumes grew just 0.6% YoY (-0.9% in the consumer & bazaar (CBP) segment and +12.6% in the industrial segment). Management indicated that the continued demand slump has hit CBP volumes, but expects some recovery in FY21.

Ticker/Price	PIDI IN/Rs 1,344
Market cap	US\$ 9.5bn
Shares o/s	508mn
3M ADV	US\$ 11.3mn
52wk high/low	Rs 1,494/Rs 1,046
Promoter/FPI/DII	70%/11%/19%

Source: NSE

**Operating margins decline:** Although gross margins expanded 400bps YoY, consolidated operating margins dipped 48bps to 20.4% due to higher other expenses (+305bps) and employee expenses (+140bps) – consequently, EBITDA was flat and PBT growth soft at 5.3% for the quarter. Gross margins increased as raw material prices softened, whereas other expenses moved up due to higher A&P spends (+240bps YoY in Q2, +150bps in H1). Management expects margins to hold at current levels as RM prices remain benign in Q3.

## STOCK PERFORMANCE



Source: NSE

**Maintain SELL on expensive valuations:** We prune our PAT estimates for FY20-FY22 by 5-6% to build in the H1FY20 underperformance. While we like PIDI for its strong franchise and broad portfolio, valuations at 47.9x FY21E P/E look rich, especially against the backdrop of weakening demand.

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	60,324	70,787	76,847	88,275	1,00,879
EBITDA (Rs mn)	13,412	13,682	16,753	19,332	22,193
Adj. net profit (Rs mn)	9,159	8,901	12,097	14,266	16,523
Adj. EPS (Rs)	18.0	17.5	23.8	28.1	32.5
Adj. EPS growth (%)	7.5	(2.9)	35.9	17.9	15.8
Adj. ROAE (%)	26.0	23.1	27.0	27.4	27.3
Adj. P/E (x)	74.5	76.7	56.5	47.9	41.3
EV/EBITDA (x)	50.9	49.9	40.7	35.1	30.6

Source: Company, BOBCAPS Research

**BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda**

Important disclosures, including any required research certifications, are provided at the end of this report.



**FIG 1 – CONSOLIDATED QUARTERLY PERFORMANCE**

Particulars (Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
<b>Net revenues</b>	<b>18,066</b>	<b>17,572</b>	<b>2.8</b>	<b>20,168</b>	<b>(10.4)</b>
Raw Material Cost	8,422	8,892	(5.3)	9,805	(14.1)
Employee cost	2,345	2,037	15.1	2,436	(3.8)
Other expenses	3,617	2,978	21.5	3,617	0.0
<b>EBITDA</b>	<b>3,682</b>	<b>3,666</b>	<b>0.5</b>	<b>4,437</b>	<b>(17.0)</b>
EBITDA margin (%)	20.4	20.9	(48bps)	22.0	(162bps)
Depreciation and amortization	402	316	27.4	377	6.6
<b>EBIT</b>	<b>3,280</b>	<b>3,350</b>	<b>(2.1)</b>	<b>4,060</b>	<b>(19.2)</b>
EBIT Margin (%)	18.2	19.1	(91bps)	20.1	(197bps)
Net interest expenses	83	60	37.5	73	12.8
Other income	558	276	101.9	399	39.9
EBT and Except. Items	3,755	3,566	5.3	4,385	(14.4)
Exceptional items	(222)	(17)	NM	0	NM
Earnings before tax	3,533	3,549	(0.5)	4,385	(19.4)
Income taxes	293	1,230	(76.2)	1,444	(79.7)
Income tax as % of PBT	8.3	34.7	(2,638bps)	32.9	(2,464bps)
<b>Earnings after tax</b>	<b>3,240</b>	<b>2,318</b>	<b>39.7</b>	<b>2,941</b>	<b>10.2</b>
Profit in associate company	11	(7)	(263.1)	3	265.5
Minority interest (expense) income	(8)	5	NM	(15)	NM
Net income (loss) adjusted	3,465	2,334	48.5	2,929	18.3
<b>Net income (loss), reported</b>	<b>3,242</b>	<b>2,316</b>	<b>40.0</b>	<b>2,929</b>	<b>10.7</b>

Source: Company, BOBCAPS Research

**FIG 2 – CONSOLIDATED SEGMENTAL PERFORMANCE**

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
<b>Revenue</b>					
Consumer & Bazaar Products	15,350	15,114	1.6	17,364	(11.6)
Industrial Products	2,899	2,537	14.3	2,935	(1.2)
Others	152	206	(26.1)	225	(32.5)
Total	18,401	17,856	3.1	20,524	(10.3)
Less: Inter Segment revenue	(335)	(284)	17.9	(356)	(6.0)
<b>Net revenues</b>	<b>18,066</b>	<b>17,572</b>	<b>2.8</b>	<b>20,168</b>	<b>(10.4)</b>
<b>EBIT</b>					
Consumer & Bazaar Products	3,889	3,661	6.2	4,625	(15.9)
Industrial Products	525	420	24.9	453	16.0
Others	(27)	(17)	NM	(14)	100.7
<b>Total</b>	<b>4,386</b>	<b>4,064</b>	<b>7.9</b>	<b>5,064</b>	<b>(13.4)</b>
<b>EBIT Margin (%)</b>					
Consumer & Bazaar Products	25.3	24.2	111bps	26.6	(130bps)
Industrial Products	18.1	16.6	154bps	15.4	270bps
<b>Total</b>	<b>24.3</b>	<b>23.1</b>	<b>115bps</b>	<b>25.1</b>	<b>(83bps)</b>

Source: Company, BOBCAPS Research

**FIG 3 – STANDALONE QUARTERLY PERFORMANCE**

Particulars (Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
<b>Net revenues</b>	<b>15,717</b>	<b>15,177</b>	<b>3.6</b>	<b>17,791</b>	<b>(11.7)</b>
Raw material exp	7,277	7,644	(4.8)	8,616	(15.5)
Employee exp	1,866	1,620	15.2	1,987	(6.1)
Other exp	3,065	2,449	25.2	3,008	1.9
<b>EBITDA</b>	<b>3,510</b>	<b>3,465</b>	<b>1.3</b>	<b>4,180</b>	<b>(16.0)</b>
EBITDA margin (%)	22.3	22.8	(50bps)	23.5	(116bps)
Depreciation and amortization	303	237	28.2	281	8.1
<b>EBIT</b>	<b>3,207</b>	<b>3,229</b>	<b>(0.7)</b>	<b>3,899</b>	<b>(17.7)</b>
EBIT Margin (%)	20.4	21.3	(87bps)	21.9	(151bps)
Net Interest expenses	36	17	117.5	27	33.2
Other income	572	435	31.4	390	46.8
<b>PBT</b>	<b>3,743</b>	<b>3,648</b>	<b>2.6</b>	<b>4,262</b>	<b>(12.2)</b>
Income taxes	280	1,201	(76.7)	1,387	(79.8)
Income tax as % of PBT	7.5	32.9	(2,546bps)	32.5	(2,505bps)
<b>Earnings after tax, adjusted</b>	<b>3,463</b>	<b>2,446</b>	<b>41.6</b>	<b>2,876</b>	<b>20.4</b>
Extraordinary	(222)	0	NM	0	NM
<b>Net income (loss), reported</b>	<b>3,241</b>	<b>2,446</b>	<b>32.5</b>	<b>2,876</b>	<b>12.7</b>

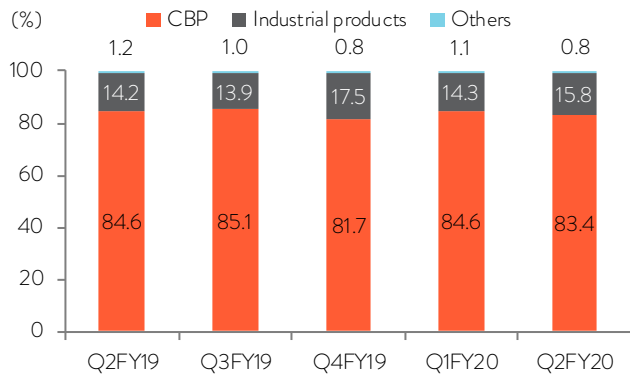
Source: Company, BOBCAPS Research

**FIG 4 – STANDALONE SEGMENTAL PERFORMANCE**

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
<b>Revenue</b>					
Consumer & Bazaar Products	13,001	12,719	2.2	14,987	(13.2)
Industrial Products	2,899	2,537	14.3	2,935	(1.2)
Others	152	206	(26.1)	225	(32.5)
Total	16,052	15,461	3.8	18,147	(11.5)
Less: Inter Segment revenue	(335)	(284)	17.9	(356)	(6.0)
<b>Net revenues</b>	<b>15,717</b>	<b>15,177</b>	<b>3.6</b>	<b>17,791</b>	<b>(11.7)</b>
<b>Profit before interest &amp; tax</b>					
Consumer & Bazaar Products	3,848	3,744	2.8	4,493	(14.4)
Industrial Products	525	420	24.9	453	16.0
Others	(27)	(18)	NM	(14)	100.7
<b>Total</b>	<b>4,346</b>	<b>4,147</b>	<b>4.8</b>	<b>4,932</b>	<b>(11.9)</b>
<b>Margin (%)</b>					
Consumer & Bazaar Products	29.6	29.4	16bps	30.0	(38bps)
Industrial Products	18.1	16.6	154bps	15.4	270bps
Others	(18.0)	(8.6)	(931bps)	(6.0)	(1,192bps)
<b>Total</b>	<b>27.6</b>	<b>27.3</b>	<b>33bps</b>	<b>27.7</b>	<b>(7bps)</b>

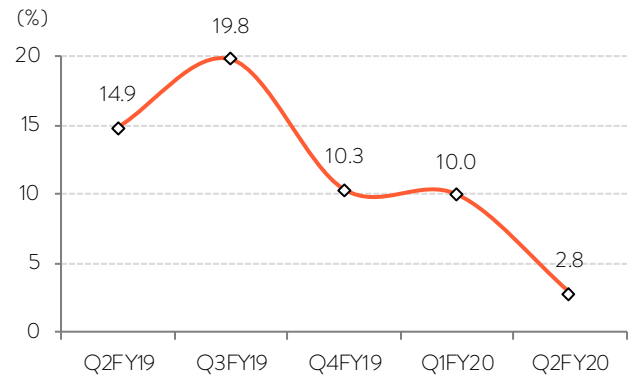
Source: Company, BOBCAPS Research

**FIG 5 – CONSOLIDATED REVENUE BREAKUP**



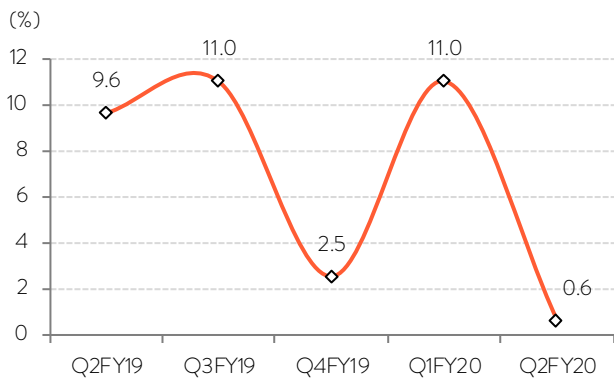
Source: Company, BOBCAPS Research

**FIG 6 – CONSOLIDATED REVENUE GROWTH**



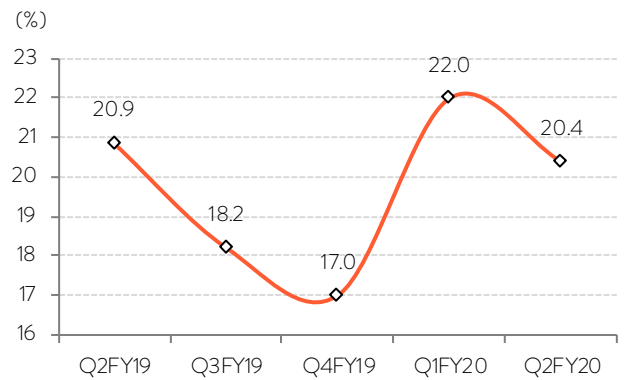
Source: Company, BOBCAPS Research

**FIG 7 – TOTAL VOLUME GROWTH**



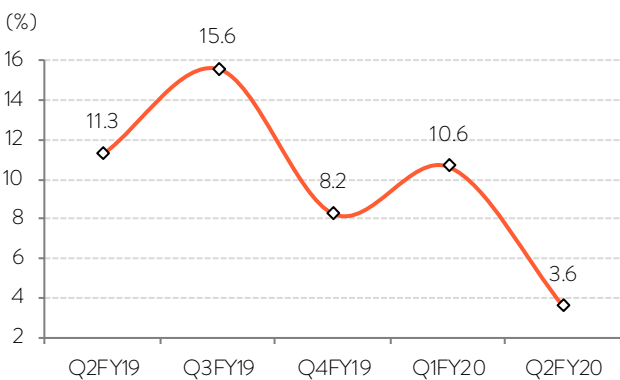
Source: Company, BOBCAPS Research

**FIG 8 – CONSOLIDATED EBITDA MARGIN**



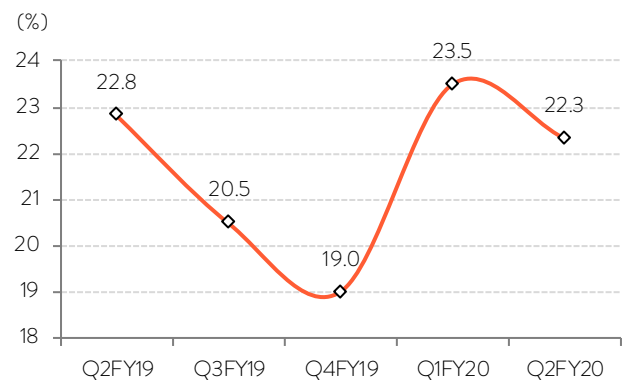
Source: Company, BOBCAPS Research

**FIG 9 – STANDALONE REVENUE GROWTH**



Source: Company, BOBCAPS Research

**FIG 10 – STANDALONE EBITDA MARGIN**



Source: Company, BOBCAPS Research

## Earnings call highlights

- An anaemic demand climate, tight liquidity among dealers and the extended monsoons exerted a toll on PIDI's Q2 performance.
- Management cited the weak market conditions as the reason behind lower CBP volumes and does not believe it has lost market share. Demand recovery is expected in FY21.
- The industrial segment performed well owing to strong pigment demand. Closure of several plants in China has led to an uptick in growth, both in export & domestic markets.
- Competition has increased in the waterproofing segment but not in adhesives & sealants, as per management.
- RM cost was benign during Q2. VAM prices averaged ~US\$ 901/t for the quarter and are currently at US\$ 890/t. PIDI normally has 45 days of VAM inventory.
- The company is comfortable on the margin front due to the continuing soft RM price trend.
- A&P spend is guided to normalise over FY20 to 3.7-3.8% of sales.
- During the quarter, PIDI provided for a Rs 222mn impairment charge on the synthetic elastomer project.
- Q2 revenues at subsidiary Nina-Percept declined 24.7% YoY as pressure mounted on the real estate sector. PIDI also saw a slowdown in areas linked to the construction and home interior markets.
- Subsidiaries in Bangladesh (where the company will start an additional factory in Q2) and Sri Lanka are seeing good traction.
- The tax rate going ahead will be ~25.2%.

### Valuation methodology

PIDI is the leader in India’s adhesive market with a strong brand, extensive distribution reach and large product portfolio. The company has a unique distribution framework, with products available in both building material as well as FMCG channels. While we like PIDI for its strong franchise and broad portfolio, current valuations at 47.9x FY21E P/E appear rich, especially against the backdrop of weakening demand.

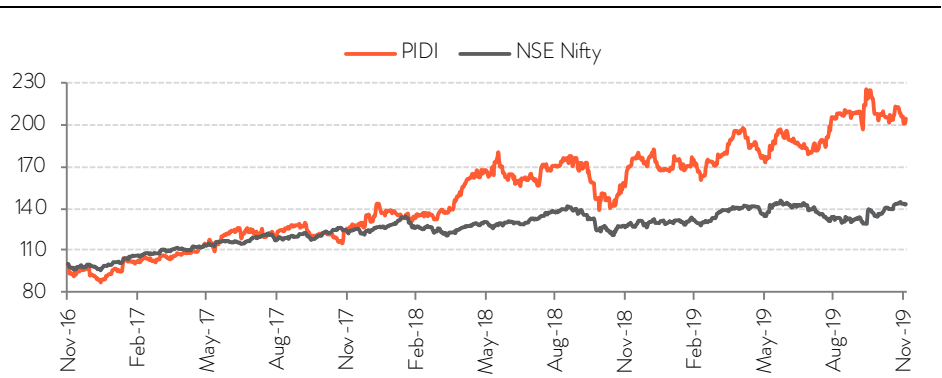
We prune our PAT estimates for FY20-FY22 by 5-6% to build in the H1FY20 underperformance. On rolling valuations over, we move to a Sep’20 target price of Rs 1,215 (earlier Rs 1,240), based on an unchanged one-year forward P/E multiple of 40x. Maintain SELL due to rich valuations.

**FIG 11 – REVISED ESTIMATES**

(Rs mn)	FY20E			FY21E			FY22E		
	New	Old	Change (%)	New	Old	Change (%)	New	Old	Change (%)
Revenue	76,847	81,970	(6.2)	88,275	94,596	(6.7)	1,00,879	1,08,262	(6.8)
EBITDA	16,753	17,869	(6.2)	19,332	20,717	(6.7)	22,193	23,818	(6.8)
PAT	12,097	12,750	(5.1)	14,266	15,137	(5.8)	16,523	17,576	(6.0)

Source: BOBCAPS Research

**FIG 12 – RELATIVE STOCK PERFORMANCE**



Source: NSE

### Key risks

- **Sharp decline in raw material prices:** Any sudden, steep fall in RM prices, especially for crude-linked products, could drive above-expected margins.
- **Above-expected pick-up in housing activity:** A stronger revival in the housing market than anticipated can take growth ahead of estimates.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Total revenue</b>	<b>60,324</b>	<b>70,787</b>	<b>76,847</b>	<b>88,275</b>	<b>1,00,879</b>
EBITDA	13,412	13,682	16,753	19,332	22,193
Depreciation	(1,199)	(1,327)	(1,537)	(1,766)	(2,018)
EBIT	12,213	12,355	15,216	17,567	20,176
Net interest income/(expenses)	(155)	(261)	(289)	(124)	(114)
Other income/(expenses)	560	586	1,257	1,646	2,050
Exceptional items	0	0	0	0	0
EBT	13,542	13,560	16,183	19,089	22,112
Income taxes	(4,392)	(4,661)	(4,078)	(4,810)	(5,572)
Extraordinary items	465	349	0	0	0
Min. int./Inc. from associates	9	1	(8)	(12)	(17)
<b>Reported net profit</b>	<b>9,623</b>	<b>9,249</b>	<b>12,097</b>	<b>14,266</b>	<b>16,523</b>
Adjustments	(465)	(349)	0	0	0
<b>Adjusted net profit</b>	<b>9,159</b>	<b>8,901</b>	<b>12,097</b>	<b>14,266</b>	<b>16,523</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	5,438	5,806	5,593	6,425	7,342
Other current liabilities	5,353	6,837	6,337	5,837	5,337
Provisions	1,431	637	5,444	6,420	7,435
Debt funds	1,226	1,111	335	285	285
Other liabilities	1,107	1,201	1,201	1,201	1,201
Equity capital	508	508	508	508	508
Reserves & surplus	35,233	40,973	47,626	55,472	64,560
Shareholders' fund	35,740	41,481	48,134	55,981	65,068
<b>Total liabilities and equities</b>	<b>52,045</b>	<b>59,145</b>	<b>69,164</b>	<b>78,323</b>	<b>88,908</b>
Cash and cash eq.	1,636	1,904	3,973	3,430	4,129
Accounts receivables	9,381	10,560	10,738	12,334	14,095
Inventories	8,043	9,345	9,356	11,097	12,682
Other current assets	4,767	8,818	9,270	9,709	10,193
Investments	12,459	11,514	18,054	23,097	28,145
Net fixed assets	15,699	16,897	17,666	18,549	19,557
CWIP	0	0	0	0	0
Intangible assets	0	0	0	0	0
Deferred tax assets, net	59	107	107	107	107
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>52,045</b>	<b>59,145</b>	<b>69,163</b>	<b>78,323</b>	<b>88,908</b>

Source: Company, BOBCAPS Research

### Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	14,741	14,888	17,720	20,854	24,129
Interest expenses	155	261	289	124	114
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,795)	(5,472)	3,452	(2,470)	(2,397)
Other operating cash flows	(4,517)	(4,671)	(4,039)	(4,767)	(5,524)
<b>Cash flow from operations</b>	<b>8,584</b>	<b>5,006</b>	<b>17,423</b>	<b>13,742</b>	<b>16,322</b>
Capital expenditures	(1,768)	(1,327)	(2,305)	(2,648)	(3,026)
Change in investments	1,972	945	(6,540)	(5,044)	(5,048)
Other investing cash flows	(319)	(247)	(1,482)	(976)	(1,015)
<b>Cash flow from investing</b>	<b>(116)</b>	<b>(628)</b>	<b>(10,327)</b>	<b>(8,668)</b>	<b>(9,090)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	250	(115)	(775)	(50)	0
Interest expenses	(155)	(261)	(289)	(124)	(114)
Dividends paid	(7,927)	(3,733)	(3,962)	(5,444)	(6,420)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(7,832)</b>	<b>(4,109)</b>	<b>(5,027)</b>	<b>(5,618)</b>	<b>(6,534)</b>
<b>Changes in cash and cash eq.</b>	<b>636</b>	<b>268</b>	<b>2,069</b>	<b>(544)</b>	<b>699</b>
<b>Closing cash and cash eq.</b>	<b>1,636</b>	<b>1,904</b>	<b>3,973</b>	<b>3,430</b>	<b>4,129</b>

### Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	19.0	18.2	23.8	28.1	32.5
Adjusted EPS	18.0	17.5	23.8	28.1	32.5
Dividend per share	6.0	6.5	8.5	10.1	11.7
Book value per share	70.4	81.7	94.8	110.2	128.1

### Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	11.3	9.6	8.9	7.7	6.7
EV/EBITDA	50.9	49.9	40.7	35.1	30.6
Adjusted P/E	74.5	76.7	56.5	47.9	41.3
P/BV	19.1	16.5	14.2	12.2	10.5

### DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	67.6	65.6	74.8	74.7	74.7
Interest burden (PBT/EBIT)	110.9	109.8	106.4	108.7	109.6
EBIT margin (EBIT/Revenue)	20.2	17.5	19.8	19.9	20.0
Asset turnover (Revenue/Avg TA)	120.9	127.3	119.8	119.7	120.6
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.4	1.4	1.4
Adjusted ROAE	26.0	23.1	27.0	27.4	27.3

Source: Company, BOBCAPS Research | Note: TA = Total Assets



**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	8.0	17.3	8.6	14.9	14.3
EBITDA	6.5	2.0	22.4	15.4	14.8
Adjusted EPS	7.5	(2.9)	35.9	17.9	15.8
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	22.2	19.3	21.8	21.9	22.0
EBIT margin	20.2	17.5	19.8	19.9	20.0
Adjusted profit margin	15.2	12.6	15.7	16.2	16.4
Adjusted ROAE	26.0	23.1	27.0	27.4	27.3
ROCE	21.8	19.4	23.9	24.1	23.9
<b>Working capital days (days)</b>					
Receivables	52	51	51	48	48
Inventory	96	88	92	88	89
Payables	36	36	35	32	32
<b>Ratios (x)</b>					
Gross asset turnover	2.3	2.4	2.4	2.6	2.7
Current ratio	1.8	2.1	1.9	1.9	2.0
Net interest coverage ratio	78.6	47.4	52.6	141.6	176.9
Adjusted debt/equity	0.0	0.0	(0.1)	(0.1)	(0.1)

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

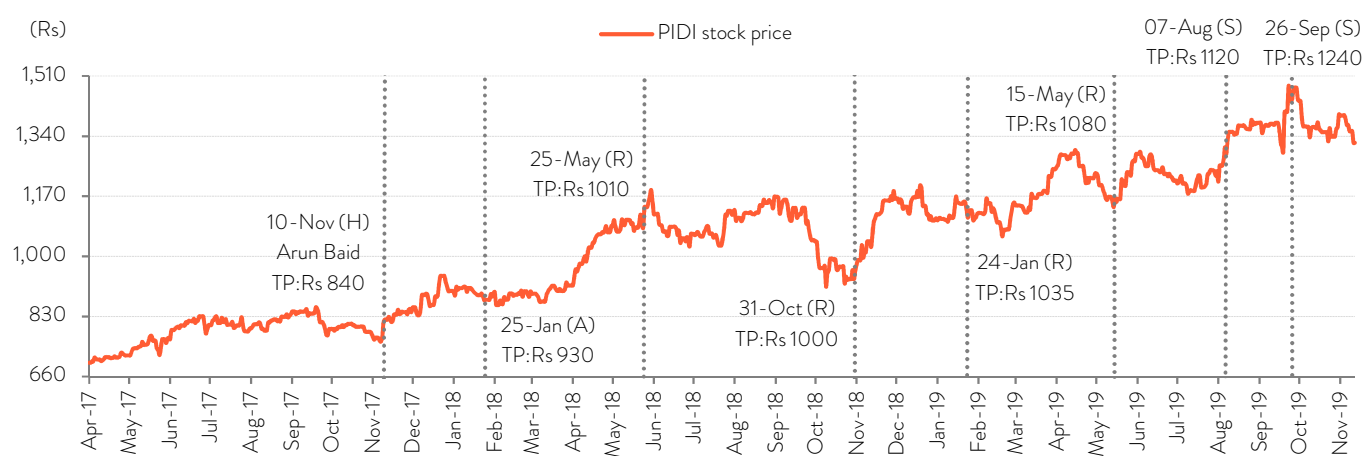
**ADD** – Expected return from >+5% to +15%

**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)

### HISTORICAL RATINGS AND TARGET PRICE: PIDILITE INDUSTRIES (PIDI IN)



B – Buy, A – Add, R – Reduce, S – Sell, H – Hold

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