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### Company update and earnings revision

## Mid-cap

Target price: Rs1,615

### Earnings revision

(%)	FY21E	FY22E
Sales	↑ 2.0	↑ 0.7
EBITDA	↑ 6.5	↑ 0.7
EPS	↑ 7.8	↓ 2.5

### Target price revision

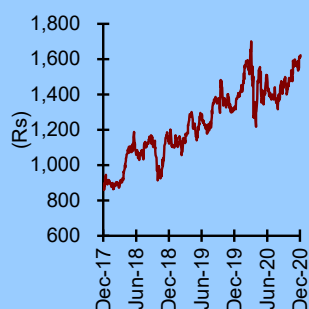
Rs1,615 from Rs1,520

### Shareholding pattern

	Mar '20	Jun '20	Sep '20
Promoters	69.9	70.2	70.2
Institutional investors	19.4	19.2	19.6
MFs and other	3.4	3.9	4.4
Insurance	4.1	3.8	3.9
FII	11.9	11.5	11.2
Others	10.7	10.6	10.2

Source: BSE, NSE

### Price chart



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INDIA

**ICICI Securities**

# Pidilite Industries

**HOLD**

**Maintain**

## Strategically covering gaps in portfolio and distribution

**Rs1,639**

Last week, we hosted Pidilite Industries (PIDI) CFO Mr. Pradip Menon for interacting with a small group of investors. The key takeaways are: 1) while growth momentum seems to have sustained, PIDI remains cautiously optimistic post Q2FY21 due to renewed Covid cases across the globe; 2) input costs have started hardening post Q2 and have increased faster in the past 3-4 weeks; 3) the company may keep an eye on M&A opportunities (e.g. arts and crafts material segment), but believes it has managed to cover gaps in a large part of its C&B portfolio; 4) PIDI has been expanding distribution to rural areas over the past few years and the intent now is to directly serve villages with sub-0.2mn population; 5) established and organised players are able to compete in all major categories more comfortably than the smaller players who have actually suffered in the wake of Covid breakout. Retain HOLD.

► **Rolling over to Sep'22E earnings:** Factoring-in the faster than expected economic recovery and recent hardening of input costs, we now expect PIDI to report revenue and adjusted PAT CAGRs of 9.9% and 15.4% respectively, over FY20-FY23E. We revise our target price to Rs1,615 (earlier: Rs1,520) based on 50x Sep'22E earnings and maintain our **HOLD** rating on the stock. Key downside risks: further increase in VAM prices, and higher competitive intensity in the construction chemical segment.

### Key takeaways:

- **Q2FY21 performance:** a) Company performed well (above its own expectations) with sequential improvement in demand conditions with rural and semi-urban areas reporting double-digit growth; b) metros and tier-1 cities however have not been able to grow at pre-Covid levels. Consumer & Bazaar (C&B) segment revenues though were back at pre-Covid levels in most geographies (with construction chemicals and DIY products in particular growing impressively) while B2B segment revenues faced demand headwinds, which however gave way to growth in the latter part of the quarter; d) benign input costs, lower A&P spend and cost rationalisation helped the company report record EBITDA margin in Q2FY21; d) international subsidiaries reported double-digit growth while domestic subsidiaries faced demand headwinds due to lower growth in waterproofing subsidiary Nina-Percept and CIPY (flooring solutions) on account of its higher exposure to the automobile sector. However, both these subsidiaries returned to growth in the latter part of Q2.
- **Current performance:** a) Company sees some green shoots in the real estate sector in emerging markets. The larger part of real estate construction is happening in tier-2 and above cities and towns, and activities sustained during the Covid period too. Metros however are returning to growth only gradually. b) Growth momentum has thus sustained into Q3FY21-TD with Oct'20 and Nov'20 together registering YoY growth. c) Input prices have hardened post Q2 and have increased faster in past 3-4 weeks.

Market Cap	Rs833bn/US\$11.3bn			
Reuters/Bloomberg	PIDI.BO / PIDI IN			
Shares Outstanding (mn)	508.1			
52-week Range (Rs)	1709/1186			
Free Float (%)	29.8			
FII (%)	11.2			
Daily Volume (US\$'000)	20,036			
Absolute Return 3m (%)	10.1			
Absolute Return 12m (%)	23.2			
Sensex Return 3m (%)	18.7			
Sensex Return 12m (%)	14.1			
<b>Year to Mar (Cons)</b>	<b>FY20</b>	<b>FY21E</b>	<b>FY22E</b>	<b>FY23E</b>
Revenue (Rs mn)	72,945	68,801	85,960	96,886
Rec. Net Income (Rs mn)	11,515	10,687	14,939	17,746
Rec. EPS (Rs)	22.8	21.1	29.5	35.1
% Chg YoY	22.9	(7.4)	39.7	18.8
P/E (x)	71.9	77.6	55.6	46.8
CEPS (Rs)	25.3	25.2	34.1	40.1
EV/E (x)	52.5	52.1	38.5	33.3
Dividend Yield (%)	0.5	0.4	0.6	0.7
RoCE (%)	32.7	27.4	33.1	33.5
RoE (%)	25.7	21.4	25.9	26.4

Please refer to important disclosures at the end of this report

- PIDI expects **Q4FY21 performance** also to be strong but remains cautiously optimistic on growth because of the recent return of second/third Covid wave across geographies globally and in some cities of India.
- **Araldite acquisition:** It is a strategic acquisition with PIDI acquiring a market leader in the epoxy adhesive segment (where it had limited presence). With the acquisition of HAMSPL, PIDI is now in the midst of actively looking at its portfolio, gaps in distribution and working out a strategy to accelerate business.
- **PIDI's strategy on HAMSPL:** Company is still developing a strategy to scale up Araldite brand, hence refrained from commenting on the same. Fevitite is PIDI's existing mid-priced brand in the epoxy adhesive category and the company is planning to push both the brands in parallel post the HAMSPL acquisition.
- **Key criteria for acquisitions:** a) Whether the category or adjacency or the target company has sufficient gross margins that can justify investment behind the brand and leaves enough on the table to give a return to the shareholder and the investor; b) not to do acquisitions merely to bulk up the revenues; and c) ideally, look at the growth or pioneer category for getting into any acquisition or a JV or any other arrangement (HAMSPL acquisition however was an exception to the rule as it was in the core/established category of epoxy adhesives where PIDI's presence was limited); and d) drive profitable growth.
- As a strategy, PIDI looks at its business in three categories:
  - **Core category:** Where there is a certain established market or maturity in that market, and which grows at a certain pace.
  - **Growth category:** Where there is significant potential for market growth or share gains and the growth levels are much faster.
  - **Pioneer or nascent category:** Where there is huge market creation opportunity.
- **Likely M&A opportunities:** PIDI may keep eye on M&A opportunities, but believes it has managed to cover gaps in a large part of its C&B portfolio. It may however keep looking at adjacencies in categories in the form of JVs or other arrangements.
- **May however look at an M&A opportunity in the arts and craft material segment:** After filling the gap in epoxy adhesive category through the acquisition of HAMSPL, the only category in the C&B portfolio where company sees an opportunity is in the arts and crafts material segment, where it does not have a complete portfolio.
- **Focus likely to intensify on SRA and solvent cement categories:** Company has a fair amount of catching-up to do in categories like solvent cements and synthetic rubber adhesives (SRA) segments. It has laid out plans/strategies to scale up both the categories starting FY22.
- **Waterproofing:** The waterproofing market in India is broadly one third the size of the developed markets. The key rationale is the propensity to use waterproofing has been less in India. Thus the opportunity to grow is enormous in this segment. While competition is increasing, the fast-growing market of waterproofing would enable all the players to grow in the segment.

**Retail-Institutional mix in waterproofing in India:** Waterproofing industry's retail-institutional mix is 2/3<sup>rd</sup>-1/3<sup>rd</sup>, which the company expects to reverse over medium to long term (as seen in the developed countries). Company is present in both retail and institutional segments, but none of the competition is. Players like Sika, Fosroc and BASF are into the institutional segment while paints and cement companies are focusing on retail.

- PIDI is the only company providing **end-to-end solutions (with product and services) in the waterproofing segment** through its subsidiary Nina-Percept.
- In terms of **customer mix**, PIDI caters to five sub-segments: individual dwelling units, multi-storey units, commercial real estate, infrastructure, and industry. The first two form part of retail while the last three are part of the institutional segment.
- **Focus on premiumisation:** In Fevicol category, premium variants currently have a dominant share and the focus on premiumisation will continue. This remains a common theme across all other categories as well.
- **Distribution expansion:** PIDI has been expanding distribution to rural areas over the past few years and the intent now is to directly serve villages with sub-0.2mn population (currently it has presence through indirect coverage only). Now it is also targeting villages with population less than 0.05mn through direct coverage. The opportunity is likely to last for some more years as the company was a late entrant in rural areas.
- **Emerging India business is currently growing at 1.5x** the average growth in the C&B segment and is likely to last through the near to medium term.
- **Acquisition of Pepperfry stake (2%)** was to increase knowledge on of e-commerce and to understand any change in consumer preferences, besides increasing PIDI's ability to sell products to institutional consumers like Pepperfry.
- PIDI has almost tripled its **R&D spend** (albeit on a lower base) over the past five years.
- **Change in competitive landscape, particularly post Covid:** More established and organised players with multiple factories, strong supply chain and strong back-end are able to compete in all major categories more comfortably than the smaller players (who have actually suffered post the Covid breakout). This helps players like PIDI though the advantage may not be permanent.
- **Cost savings post Covid:** With more establishments opting for work from home, less travel and higher use of digital platforms, PIDI's travel cost may remain under check in the near to medium term. However, it is not likely to aid margins materially.

**Table 1: Change in estimates**

(Rs mn)

Estimates	Old		New		Change (%)	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Revenue	67,462	85,334	68,801	85,960	2.0%	0.7%
EBITDA	15,049	21,482	16,029	21,639	6.5%	0.7%
EBIDTA margins	22.3%	25.2%	23.3%	25.2%	100bps	0bps
Reported PAT	9,950	15,381	10,728	14,989	7.8%	-2.5%
Reported EPS	19.6	30.3	21.1	29.5	7.8%	-2.5%

Source: Company data, I-Sec research

## Financial summary (consolidated)

**Table 2: Profit & Loss statement**
*(Rs mn, year ending March 31)*

	FY20	FY21E	FY22E	FY23E
<b>Net Revenues</b>	<b>72,945</b>	<b>68,801</b>	<b>85,960</b>	<b>96,886</b>
<b>Operating Expenses</b>	<b>57,185</b>	<b>52,772</b>	<b>64,320</b>	<b>71,974</b>
<b>EBITDA</b>	<b>15,760</b>	<b>16,029</b>	<b>21,639</b>	<b>24,911</b>
% margins	21.6%	23.3%	25.2%	25.7%
Depreciation & Amortisation	1,699	2,090	2,332	2,547
Gross Interest	336	463	419	363
Other Income	942	667	1,117	1,453
<b>Recurring PBT</b>	<b>14,667</b>	<b>14,143</b>	<b>20,006</b>	<b>23,455</b>
Less: Taxes	3,477	3,521	5,001	5,629
Less: Minority Interest	56	(65)	65	80
<b>Net Income (Reported)</b>	<b>11,134</b>	<b>10,687</b>	<b>14,939</b>	<b>17,746</b>
Extraordinaries (Net)	(381)	-	-	-
<b>Recurring Net Income</b>	<b>11,515</b>	<b>10,687</b>	<b>14,939</b>	<b>17,746</b>

Source: Company data, I-Sec research

**Table 3: Balance sheet**
*(Rs mn, year ending March 31)*

	FY20	FY21E	FY22E	FY23E
<b>Assets</b>				
Total Current Assets	32,705	26,225	33,521	40,109
of which cash & cash eqv.	7,033	651	3,281	6,086
Total Current Liabilities & Provisions	16,130	14,343	15,801	16,729
<b>Net Current Assets</b>	<b>16,574</b>	<b>11,882</b>	<b>17,720</b>	<b>23,380</b>
<b>Investments</b>				
of which	11,862	5,362	7,862	11,362
Strategic/Group	20,660	25,071	25,239	26,192
Others	-	-	-	-
<b>Net Fixed Assets</b>	<b>-</b>	<b>15,000</b>	<b>15,000</b>	<b>15,000</b>
Goodwill	<b>49,097</b>	<b>57,314</b>	<b>65,821</b>	<b>75,934</b>
<b>Total Assets</b>				
<b>Liabilities</b>	1,691	3,191	2,791	2,391
<b>Borrowings</b>	693	743	743	743
<b>Deferred Tax Liability</b>	2,157	2,092	2,157	2,237
Minority Interest	508	508	508	508
Equity Share Capital	1	1	1	1
Face Value per share (Rs)	44,048	50,780	59,622	70,055
Reserves & Surplus				
<b>Net Worth</b>	<b>44,556</b>	<b>51,288</b>	<b>60,130</b>	<b>70,563</b>
<b>Total Liabilities</b>	<b>49,097</b>	<b>57,314</b>	<b>65,821</b>	<b>75,934</b>

Source: Company data, I-Sec research

**Table 4: Quarterly trends**
*(Rs mn, year ending March 31)*

	Dec-19	Mar-20	Jun-20	Sep-20
Total Income	19,266	15,447	8,778	18,803
% growth (YoY)	4.3%	-5.8%	-56.5%	4.1%
EBITDA	4,632	3,009	664	5,126
Margin (%)	24.0	19.5	7.6	27.3
Other income	398	140	200	217
Add: Extraordinaries	-	(330)	-	-
<b>Net profit</b>	<b>3,418</b>	<b>1,575</b>	<b>268</b>	<b>3,564</b>

Source: Company data, I-Sec research

**Table 5: Cashflow statement**
*(Rs mn, year ending March 31)*

	FY20	FY21E	FY22E	FY23E
<b>Operating Cashflow</b>	<b>9,295</b>	<b>12,818</b>	<b>17,321</b>	<b>20,358</b>
Working Capital Changes	1,914	(16,719)	(3,258)	(2,905)
Capital Commitments	(5,372)	(6,500)	(2,500)	(3,500)
<b>Free Cashflow</b>	<b>5,837</b>	<b>(10,401)</b>	<b>11,564</b>	<b>13,952</b>
<b>Cashflow from Investing Activities</b>	<b>3,615</b>	<b>6,500</b>	<b>(2,500)</b>	<b>(3,500)</b>
Issue of Share Capital	-	-	-	-
Inc (Dec) in Borrowings	581	1,500	(400)	(400)
Dividend paid	(4,526)	(4,061)	(6,083)	(7,298)
<b>Change in Deferred Tax Liability</b>	<b>(379)</b>	<b>80</b>	<b>50</b>	<b>50</b>
<b>Chg. in Cash &amp; Bank balance</b>	<b>5,128</b>	<b>(6,382)</b>	<b>2,631</b>	<b>2,805</b>

Source: Company data, I-Sec research

**Table 6: Key ratios**
*(Year ending March 31)*

	FY20	FY21E	FY22E	FY23E
<b>Per Share Data (in Rs.)</b>				
EPS(Basic Recurring)	22.8	21.1	29.5	35.1
Diluted Recurring EPS	25.3	25.2	34.1	40.1
Recurring Cash EPS	7.5	6.5	10.0	12.0
Dividend per share (DPS)	91.9	105.1	122.6	143.3
Book Value per share (BV)				
<b>Growth Ratios (%)</b>	3.1	-5.7	24.9	12.7
Operating Income	15.2	1.7	35.0	15.1
EBITDA	22.9	-7.4	39.7	18.8
Recurring Net Income	21.6	-0.4	35.1	17.5
Diluted Recurring EPS				
Diluted Recurring CEPS	71.9	77.6	55.6	46.8
<b>Valuation Ratios</b>	64.7	65.0	48.1	40.9
P/E	17.8	15.6	13.4	11.4
P/CEPS	52.5	52.1	38.5	33.3
P/BV	11.3	12.1	9.7	8.6
EV / EBITDA				
EV / Operating Income	46.6	43.1	43.7	43.7
EV / Op. FCF (pre -Capex)	12.7	13.3	11.8	11.8
<b>Operating Ratios</b>	11.0	12.2	11.8	11.3
COGS/Sales (%)	0.1	0.0	0.1	0.1
Employee/Sales (%)	23.7	24.9	25.0	24.0
SG&A/Sales (%)	79.0	74.0	72.0	72.0
Other Income / PBT (%)	52.0	52.0	52.0	52.0
Effective Tax Rate (%)	58.0	53.0	51.0	51.0
Receivables (days)	31.0	31.0	31.0	31.0
Payables (days)	-0.1	0.0	0.0	-0.1
<b>Profitability Ratios (%)</b>				
Recurring Net Income				
Margins	15.9	15.6	17.4	18.4
RoCE	32.7	27.4	33.1	33.5
RoNW	25.7	21.4	25.9	26.4
Dividend Payout Ratio	41.3	37.2	41.0	41.4
Dividend Yield	0.5	0.4	0.6	0.7
EBITDA Margins	21.6	23.3	25.2	25.7

Source: Company data, I-Sec research

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