

Pidilite Industries

BSE SENSEX 17,622	S&P CNX 5,335	CMP: INR143	TP: INR181	Buy								
Bloomberg	PIDI IN	Year	Net Sales	Adj.PAT	EPS	EPS	P/E	P/BV	RoE	RoCE	EV/	EV/
Equity Shares (m)	506.1	End	(INR m)	(INR m)	(INR)	Gr. (%)	(X)	(X)	(%)	(%)	Sales	EBITDA
52-Week Range (INR)	183/123	3/11A	23,799	3,289	6.5	12.1	22.0	6.4	28.9	30.6	3.0	14.7
1,6,12 Rel. Perf. (%)	-11/-20/17	3/12E	28,421	3,299	6.5	0.0	22.0	5.4	24.4	27.3	2.4	14.2
M.Cap. (INR b)	72.4	3/13E	33,820	4,329	8.3	27.1	17.3	4.2	24.3	30.7	2.0	10.8
M.Cap. (USD b)	1.5	3/14E	40,398	5,305	10.1	22.5	14.1	3.5	24.9	32.7	1.6	8.7

- **3QFY12 results below expectations:** Pidilite Industries (PIDID) 3QFY12 results were disappointing with adjusted PAT declining 7% YoY to INR790m (vs our estimate of INR920m). Sales grew 16.5% YoY to INR6.9b led by ~14-15% volume growth in consumer and bazaar product segments.
- **INR depreciation impacts gross margins:** Gross margins declined 330bp to 43.2% due to steep INR depreciation and higher VAM (Vinyl Acetate Monomer) prices on a YoY basis. Industrial products segment reported 2% decline in sales and 43% decline in profits due to poor export demand and inventory de-stocking.
- **Estimates lowered:** We have lowered our FY12 EPS estimates by 5% and FY13 EPS estimates by 2.6% to factor in lower margins in the consumer business due to high input costs and declining sales in industrial chemicals. However, going forward, we believe the company would gain from appreciating INR as VAM prices have eased to USD1,000/MT.
- **Positive on volume growth in consumer and Bazaar products:** We remain positive on volume growth in the consumer and Bazaar segments despite the management's cautious outlook. We also believe margins in the consumer and Bazaar segments would start expanding from 1QFY13; however, the industrial chemicals segment's margins would take time to recover.
- **Valuations and View:** We introduce our FY14 EPS estimate at INR10.1/share and forecast 25% PAT CAGR over FY12-14. The stock price has reacted from INR190 levels due to concerns over falling margins and growth outlook. It trades at 17.3x FY13E EPS of INR8.3 and 14.1x FY14E EPS of INR10.1. Maintain **Buy** with target price of INR181, 27% upside from the current level.

Quarterly Performance

Y/E March	(INR Million)									
	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Sales	6,322	5,896	5,936	5,639	7,699	7,103	6,918	6,701	23,806	28,421
Change (%)	21.6	15.4	27.2	26.2	21.8	20.5	16.5	18.8	21.8	19.4
Gross Profit	3,052	2,811	2,758	2,699	3,438	3,093	2,989	3,043	11,327	12,563
Gross Margin %	48.3	47.7	46.5	47.9	44.7	43.5	43.2	45.4	47.6	44.2
Operating Expenses	1,497	1,569	1,573	1,885	1,905	1,791	1,782	2,193	6,546	7,671
% of sales	23.7	26.6	26.5	33.4	24.7	25.2	25.8	32.7	27.5	27.0
EBITDA	1,556	1,242	1,185	813	1,533	1,302	1,207	850	4,796	4,892
EBITDA Margin %	24.6	21.1	20.0	14.4	19.9	18.3	17.4	12.7	20.1	17.2
Change (%)	28.4	1.6	27.1	17.5	-1.5	4.8	1.9	4.5	20.4	2.0
Depreciation	108	111	111	114	116	118	121	135	444	490
Interest	82	87	52	48	40	59	73	32	268	204
Other Income	13	47	55	34	51	29	45	75	150	201
PBT	1,378	1,092	1,078	686	1,429	1,153	1,058	759	4,234	4,399
Tax	300	246	233	158	350	289	268	193	936	1,100
Effective Tax Rate (%)	21.8	22.5	21.6	23.0	24.5	25.1	24.8	25.4	22.1	25.0
Adj PAT	1,078	846	844	529	1,079	864	790	566	3,297	3,299
Change (%)	18.4	-3.6	30.6	-2.8	0.1	2.2	-6.5	7.1	12.3	0.1

E: MOSL Estimates

Key takeaways from the concall

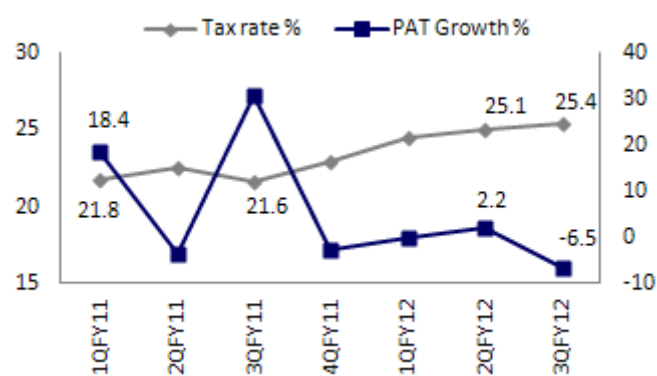
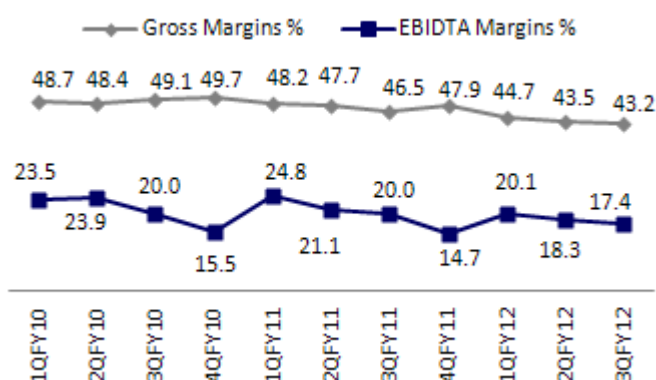
- Consumer and Bazaar products has seen 22.6% sales growth in 3Q, growth is higher in domestic market as the exports have grown at only 14%. Construction chemicals sales have increased by 30% YoY. Although some headwinds are visible in volume growth, it is too early to assume any definitive trend emerging.
- Industrial chemicals sales have declined due to decline in exports by 15%, primarily in USA and Europe. Sales have been impacted in industrial resins and pigments; there has been inventory de-stocking at the customer level in anticipation of lower prices.
- Interest cost in 3Q includes MTM restatement of liability in respect of USD33m FCCB.
- VAM prices have declined to USD1000/MT from USD1100MT in the beginning of 3Q; INR appreciation will reduce the cost of inputs and help increase margins. PIDI keeps inventory of 40 days of raw material, so 1QFY13 will show gains from lower input costs for full quarter.
- International business has reported strong growth in Middle East and Africa, and South East Asia, South America has been adversely impacted due to poor performance in Brazil. PIDI has taken a write off of INR96.9m in its investments in Brazil.
- Synthetic elastomer s project still hangs in balance as the board has directed to consultant to look into a few more issues. PIDI has so far spent INR3.5b on the project. Some outcome is likely by the end of March2012.

Standalone sales up 16.5%; Margins decline 260bp on input cost pressure

- Pidilite Inds 3QFY12 results are below estimates with Adj PAT declining by 7% to INR790m (est 920m) as INR depreciation impacted gross margins and industrial chemicals reported decline in sales led by sluggish exports.
- The company has reported sales of INR6.9b (est Rs7.1b), a growth of 16.5% led by 14-15% volume growth in Consumer and bazaar.
- Gross margins declined by 330bp to 43.2% due to steep INR depreciation and higher VAM prices on a YoY basis. However, VAM prices (currently at USD100/ton) have steadily declined and are now lower by 25-30% from their peak. Management expects that with VAM prices remaining at lower levels and INR appreciating, margins are expected to improve from 4QFY12.
- Stable employee costs and 70bp decline in other expenditure restricted EBITDA margin decline to 260bp at 17.4%. Other income was higher by 120% due to INR75m onetime gain on relinquishment of tenancy rights. Diminution in value of investment in the Brazilian subsidiary (INR 96.9m) and forex loss (INR24.9m) were other exceptional losses, adjusting for these PAT was down by 7% to INR790m.
- PIDI has incurred a capex of INR900m for the year thus far and expects to incur capex of INR1.25b. We note that this includes INR400m towards the elastomer project.

Gross margins decline 330bp; EBITDA margins down 260bp

QoQ tax rate remains stable



Source: Company/MOSL

Consumer and Bazaar sales up 22.6%; Industrial sales fall 2% due to decline in exports

- Consumer and Bazaar sales are up 22.6% led by strong momentum in volume growth which is higher by 14-15% for the quarter. Though margins are lower by 180bp YoY, they are up 70bp QoQ due to QoQ decline in VAM prices; however full benefit was not visible due to steep INR depreciation making VAM imports costlier.
- Appreciation of INR in 4Q is likely to provide support to margins as USD VAM prices are ruling at USD1000/MT down from a peak of USD1250/ton. We believe margins for Pidilite have bottomed out; margins improvement will be witnessed from 1QFY13.
- The continued robust growth in consumer and bazaar segment in spite of 5-6% price hike in Fevicol towards end of 1Q indicates strong consumer demand. Though management has indicated that operating environment is challenging, momentum in growth is likely to continue.
- Industrial product sales are down 2.1% while EBIT is down 43%, margins have declined 770bp. The decline in sales is due to a 15% decline in exports (uncertainty in US and Europe markets) and 5% decline in domestic sales. Domestic sales which are linked to exports have seen a slowdown. Domestic and overseas customers

Segmental: Industrial segment drags down overall performance

Segmental	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12	3QFY12
Consumer and Bazaar							
Sales (INRm)	4,974	4,558	4,499	4,098	6,127	5,604	5,521
Sales Growth (%)	21.2	15.9	26.5	27.1	22.8	23.2	22.6
EBIT (INRm)	1,505	1,186	1,144	791	1,586	1,281	1,303
% Contribution	87.6	86.1	83.9	77.1	87.7	85.5	90.9
EBIT Growth %	23.7	6.4	28.2	26.6	5.4	9.7	15.5
EBIT margin %	30.2	26.0	25.4	19.3	25.9	22.9	23.6
Industrial Products							
Sales (INRm)	1,394	1,400	1,425	1,575	1,662	1,646	1,400
Sales Growth (%)	21.7	9.8	33.1	24.4	22.8	17.6	-2.1
EBIT (INRm)	245	223	261	272	259	243	148
% Contribution	14.3	16.2	19.1	26.5	14.3	16.2	10.3
EBIT Growth %	24.3	-16.4	27.8	10.3	5.7	8.4	-43.2
EBIT margin %	17.6	15.9	18.3	17.3	15.6	14.8	10.6

Source: Company/MOSL

are also delaying purchases and not keeping inventory in anticipation of price decline; however there have not been any significant orders cancelled. We believe recovery in export market will be gradual.

Brazil performance drags international business; Elastomer project still on hold, decision expected by March end

- International sales increased 15.9% for the quarter at INR862m; however in constant currency basis sales declined by 0.8%. South America (40% of international sales) reported a 16.5% revenue decline; steep input cost pressure resulted in continued losses. Sales in North America improved, with constant currency growth of 9%; cash profits increased by 30% in the geography. Middle East and Africa and South Asia performed well with 62% and 17% sales growth respectively, with margins improving.
- Elastomer project continues to be on hold with a decision expected by end of 4QFY12. The company has thus far invested INR3.54b in the project; INR400m has been invested in the current year. We note that this is the second time that the project has been stalled which raises doubts on its long term visibility. The selling price of the product has remained steady at USD5.5-5.4/kg. PIDI has asked for incremental details on the project by the consultant and is likely to take a final call on the project in the month of March2012.

Reducing estimates by 3-5%; stock looks attractive post correction

We are cutting FY12 EPS estimates by 5% and FY13 EPS estimates by 2.6% due to lower margins in the consumer business due to high input costs and sales decline in Industrial chemicals. We believe that PDID will gain from appreciating INR as VAM (Vinyl Acetate Monomer) prices have also softened to USD1,000/MT. We believe consumer and Bazaar margins to start expanding by 1QFY13 while industrial chemicals will take some time to recover. We remain positive on the volume growth scenario in the consumer and Bazaar products despite cautious outlook by the management.

PIDI's synthetic elastomer project continues to remain in balance. We believe that any final decision regarding the project including sale or induction of a partner can be a big positive for the company. We remain confident of growth momentum in core business of consumer and Bazaar due to differentiated product offerings and strong brand strength of the company. We are introducing FY14 EPS at INR10.1/share and estimate 25% PAT CAGR over FY12-14. PIDI has reacted from INR190 levels due to concerns on falling margins and growth outlook and trades at 17.3x FY13 EPS of INR8.3 and 14.1x FY14 EPS of INR10.1. Maintain **Buy** with target price of INR181, a 27% upside.

Pidilite Industries: an investment profile

Company description

Pidilite is the largest branded adhesives player in India, having an iconic brand like Fevicol. Apart from having a strong presence in adhesives, the company has expanded its presence in emerging segments like mechanized joinery, modular furniture, flooring, automotive care and waterproofing through Dr Fixit and Roff.

Key investment arguments

- We expect strong consumer driven demand to continue and drive 15%+ volume growth for the company in the future.
- Strong brand leadership and pricing power will assist margin expansion in the future.
- Successful completion of the synthetic elastomer project (est. cost Rs5.5m; INR3.4b already spent) can provide earnings upside post FY12.

Key investment risks

- Continued increase in VAM prices which could impact margins in the near term as price increases will be with a lag.
- Delay in commissioning elastomer project and longer than expected payback period which could strain cash flows.

Comparative valuations

		Pidilite	Asian Paints
P/E (x)	FY12E	22.0	29.8
	FY13E	17.3	24.7
EV/EBITDA (x)	FY12E	15.9	19.5
	FY13E	12.2	15.7
EV/Sales (x)	FY12E	2.7	3.0
	FY13E	2.3	2.5
P/BV (x)	FY12E	6.0	10.5
	FY13E	4.7	8.6

Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	70.8	70.5	70.6
Domestic Inst	6.3	6.8	8.0
Foreign	12.4	11.9	10.3
Others	10.6	10.9	11.2

Recent developments

- 25% decline in VAM prices are likely to provide some respite to margins in 4QFY12

Valuation and view

- We are reducing FY12 and FY13 EPS estimates by 3-5% and to factor in higher input costs and sales decline in industrial chemicals.
- The stock trades at 22x FY12E EPS of INR6.5 and 17.3x FY13E EPS of INR8.3. Maintain **Buy** with SOTP-based target price of INR181.

Sector view

- We have a cautious view on the sector given the slower income growth in the economy which might impact volumes as well as profit margins of companies.
- Companies with low competitive pressures and broad product portfolios will be able to better withstand any slowdown in a particular segment.
- Longer term prospects appear bright, given rising incomes and low penetration.

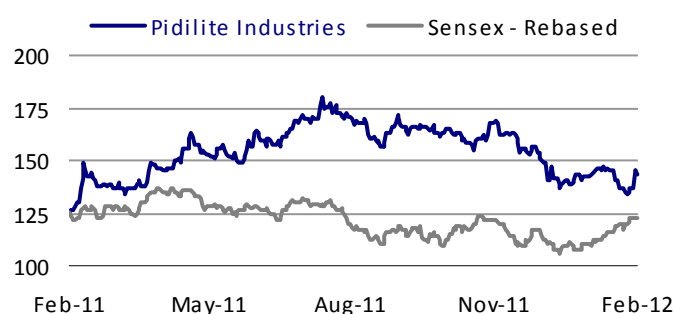
EPS: MOST forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	6.5	6.5	0.3
FY13	8.3	8.1	2.8

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
143	181	26.6	Buy

Stock performance (1 year)



Financials and Valuation

Income Statement		(INR Million)			
Y/E March	FY11	FY12E	FY13E	FY14E	
Net Sales	23,799	28,421	33,820	40,398	
Change (%)	21.8	19.4	19.0	19.4	
Raw Materials	12472	15858	18457	22153	
Gross Profit	11327	12563	15363	18245	
Margin (%)	47.6	44.2	45.4	45.2	
Operating Expenses	6546	7671	9011	10568	
EBITDA	4,780	4,892	6,353	7,677	
Change (%)	20.0	2.3	29.9	20.8	
Margin (%)	20.1	17.2	18.8	19.0	
Depreciation	444	490	548	612	
Int. and Fin. Charges	268	204	149	112	
Other Income	157	201	235	313	
Profit before Taxes	4,225	4,399	5,890	7,267	
Change (%)	28.5	4.1	33.9	23.4	
Margin (%)	17.8	15.5	17.4	18.0	
Tax	936	1,100	1,561	1,962	
Tax Rate (%)	22.2	25.0	26.5	27.0	
Adj PAT	3289	3299	4329	5305	
Change (%)	12.1	0.3	31.2	22.5	
Margin (%)	13.8	11.6	12.8	13.1	
Exceptional/Prior Peric	250	151	0	0	
Reported PAT	3,039	3,149	4,329	5,305	

Balance Sheet		(INR Million)			
Y/E March	FY11	FY12E	FY13E	FY14E	
Share Capital	506	508	524	524	
Reserves	10,889	13,000	17,309	20,773	
Net Worth	11,395	13,507	17,833	21,298	
Loans	2,867	2,918	1,405	806	
Deferred Liability	410	435	461	486	
Capital Employed	14,672	16,860	19,699	22,590	
Gross Block	8,720	9,420	10,520	11,720	
Less: Accum. Deprn.	4,310	4,800	5,348	5,960	
Net Fixed Assets	4,410	4,620	5,172	5,760	
Capital WIP	3,331	3,600	3,700	3,850	
Investments	4,656	5,841	7,259	8,661	
Curr. Assets, L&A	7,596	9,367	11,287	13,416	
Inventory	3,544	4,472	5,506	6,579	
Account Receivables	2,866	3,469	4,130	4,934	
Cash and Bank Balance	273	405	489	587	
Others	913	1,020	1,162	1,315	
Curr. Liab. and Prov.	5,321	6,568	7,719	9,096	
Account Payables	4,137	5,199	5,975	7,013	
Provisions	1,184	1,369	1,744	2,083	
Net Current Assets	2,275	2,799	3,568	4,319	
Miscellaneous	0	0	0	0	
Application of Funds	14,672	16,860	19,699	22,590	

E: MOSL Estimates

Ratios					
Y/E March	FY11	FY12E	FY13E	FY14E	
Basic (INR)					
EPS	6.5	6.5	8.3	10.1	
Cash EPS	10.3	10.6	13.2	15.8	
BV/Share	22.5	26.6	34.0	40.6	
DPS	1.8	2.0	2.5	3.0	
Payout %	31.3	36.0	35.4	34.7	
Valuation (x)					
P/E	22.0	22.0	17.3	14.1	
Cash P/E	13.9	13.5	10.9	9.0	
EV/Sales	3.0	2.4	2.0	1.6	
EV/EBITDA	14.7	14.2	10.8	8.7	
P/BV	6.4	5.4	4.2	3.5	
Dividend Yield (%)	1.2	1.4	1.7	2.1	
Return Ratios (%)					
RoE	28.9	24.4	24.3	24.9	
RoCE	30.6	27.3	30.7	32.7	
Working Capital Ratios					
Debtor (Days)	44	45	45	45	
Creditor (Days)	79	81	79	78	
Asset Turnover (x)	3.6	3.8	3.9	4.0	
Leverage Ratio					
Debt/Equity (x)	0.3	0.2	0.1	0.0	

Cash Flow Statement		(INR Million)			
Y/E March	FY11	FY12E	FY13E	FY14E	
PBT before Extra Ord	4,225	4,399	5,890	7,267	
Add: Depreciation	444	490	548	612	
Interest Paid	268	204	149	112	
Less: Taxes Paid	936	1,100	1,561	1,962	
(Incr)/Decr in WC	-372	-392	-685	-653	
CF from Operations	3,629	3,601	4,342	5,375	
Extra ordinary items	-250	-151	0	0	
CFO after extraordinary	3,379	3,450	4,342	5,375	
Incr in FA	-1,236	-969	-1,200	-1,350	
Pur of Investments	452	-1,185	-1,419	-1,402	
CF from Invest.	-784	-2,154	-2,619	-2,752	
Change in Networth	-2,065	-2,195	-1,507	-3,649	
Incr in Debt	-1,347	50	-1,512	-599	
Dividend Paid	1,029	1,184	1,529	1,834	
Interest Paid	-268	-204	-149	-112	
CF from Fin. Activity	-2,650	-1,164	-1,640	-2,525	
Incr/Decr of Cash	-55	132	83	99	
Add: Opening Balance	328	273	405	489	
Closing Balance	273	405	489	587	

N O T E S

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Pidilite Industries

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