

Pidilite Industries Ltd

Buy
(High Risk-High Return)

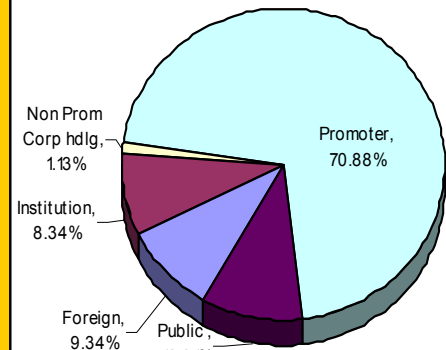
CMP: - Rs 145



Key Data

| | |
|------------------------|------------|
| Face Value: | 1 |
| 52 week High: | 158 |
| 52 Week Low: | 75 |
| NSE Code: | PIDILITIND |
| Average Vol. (Monthly) | 34675 |

Shareholding Pattern



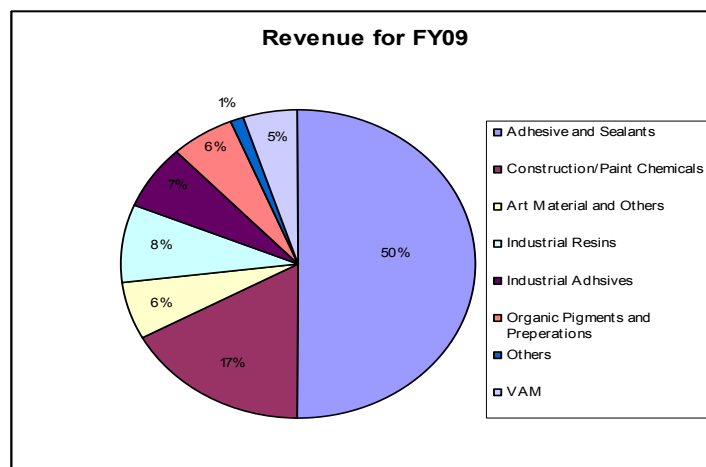
Company Background

Pidilite is consumer and specialty chemical company. Pidilite is a leader in adhesive and sealants. The Company's product range includes Adhesives and Sealants, Construction and Paint Chemicals, Automotive Chemicals, Art Materials, Industrial Adhesives, Industrial and Textile Resins and Organic Pigments and Preparations. Its brand name Fevicol has become synonymous with adhesives to millions in India and is ranked amongst the most trusted brands in India. The Company operates under two major business segments:

1. **Branded Consumer & Bazaar Products:** - Products such as Adhesives, Sealants, Art Materials, Construction and Paint Chemicals are covered under branded Consumer & Bazaar Products segment. These products are widely used by carpenters, painters, plumbers, mechanics, households, students, offices, etc
2. **Speciality Industrial Chemicals:** - Speciality Industrial Chemicals segment covers products such as Industrial Adhesives, Synthetic Resins, Organic Pigments, Pigment Preparations, Surfactants, etc. and caters to various industries like packaging, textiles, paints, printing inks, paper, leather, etc.
3. Company's other business includes manufacturing and Sale of **Vinyl Acetate Monomer (VAM)**. The company has an installed capacity of 30,000 MT per annum.

Investment Rationale

- Strong Brand Presence in Indian Market:** - The Company has dominant position in the domestic sealants and adhesive market in India with its brand Fevicol. The company has been ranked amongst top 25 brands recognized in India. Its other brand i.e. Dr Fixit has also been well received in the sealant and Adhesive Industry. The company enjoys a 30 per cent market share in the Rs 3,000-crore adhesive market in India (retail as well as industrial adhesives). Going forward we expect the company to maintain its leadership position in domestic adhesive and sealant market.
- Sales growing at CAGR of more than 26% and PAT at 13.5%:-** Pidilite Industries has reported a topline CAGR of more than 26% in the past seven years. The company's net sales grew from 493 Cr in FY02 to Rs 1986 Cr in FY09. The company sales have increased on the back of strong brand building efforts, introduction of new products and various acquisitions. With dominant market share for its products we expect the company to continue to grow in the coming years. Although raw material prices for the company's were up steeply resulting in lower profits in FY09, the company has managed to report a CAGR of 13.5% in PATM over the past seven years. With raw material prices expected to remain steady at current price we expect the company to report better PATM in the coming quarters.
- Expanding presence in various segments for adhesive and sealants market:** - The Company has started expanding its range of adhesives and sealants used for building construction and interior decoration. The range which was so far mostly focused on making furniture has now been expanded to include adhesives for fixing tiles, marble, granite, etc. on various surfaces, adhesives for fixing wall papers and adhesive for laying wooden floors. More such adhesives and sealants will be introduced in the coming years to cater to the expanding building construction and interior decoration market. Going forward we expect significant increase in revenues from these new brands.



| Revenue (In Rs Cr) | Q1FY09 | Q1FY10 | Var (%) |
|---------------------------|--------|--------|---------|
| Consumer & Bazar Products | 367.3 | 410.5 | 11.76 |
| Industrial Products | 108.9 | 114.5 | 5.14 |
| Others(VAM) | 44.4 | 2.5 | |

| Segment PBIT | Q1FY09 | Q1FY10 | Var (%) |
|---------------------------|--------|--------|---------|
| Consumer & Bazar Products | 90.6 | 121.7 | 34.33 |
| Industrial Products | 14.1 | 19.7 | 39.72 |
| Others(VAM) | 4 | -2.8 | |

- Increase In consumer bazaar product sales:** - Consumer & Bazar product sales, which contributes nearly 70% of the sales, reported an increase in sales by more than 11%. The company also plans to launch more products in this segment in the coming months. We expect the company to report better topline from this segment.
- Raw material cost down by more than 8.5% at the end of Q1FY10:-** The Company reported better operating profit margins at the end of Q1FY10, mainly due to a reduction in prices of raw material. The overall effect of reduction in raw material cost resulted in Pidilite reporting better PATM. PAT for the company was up by more than 51% QoQ. The chief raw material for the company is Polyvinyl

Acetate produced from Ethylene produced from gas/crude. With crude/Gas prices less than what they were last year, we expect that company would be able to report better OPM and PATM in the coming quarters too. OPM for the consumer & bazaar products improved by nearly 500 Bps, Industrial Paints OPM improved by over 425 Bps. Although, the company has been reporting higher OPM in Q1FY10, but we expect the OPM to decline as raw material costs pick up in the coming quarters.

| OPM (%) | Q1FY09 | Q1FY10 |
|----------------------------|--------|---------|
| Consumer & Bazaar Products | 24.67 | 29.65 |
| Industrial Products | 12.95 | 17.21 |
| Others(VAM) | 9.01 | -112.00 |

- **Growing the inorganic and organic way:** - Pidilite Industries is also growing its international presence through acquisitions and setting up manufacturing and marketing facilities abroad. The company has 13 overseas subsidiaries (four direct and nine step-down) including those with manufacturing and marketing operations in the US, Brazil, Thailand, Singapore and Dubai. Manufacturing facilities in India are located in Gujarat, Maharashtra, Himachal Pradesh and Daman.
 - The Bangladesh facility is expected to begin commercial production in September, while the one in Egypt would be commissioned by December
 - The company is setting up an Elastomer plant in Dahej (Sez). The company in its annual report has said that the dismantled plant has reached plant site and is undergoing refurbishment. The total capex cost for the project is pegged at Rs 530 Cr.
 - In FY09, one new facility for manufacture of Construction Chemicals was set up at Kala-amb, Himachal Pradesh. The company plans to further expand its Kala-Amb facility by 10000 tonnes.
- **Halts production of VAM:** - Since the pricing of bought-out VAM was more advantageous, the Company opted to purchase VAM available in the market rather than operating the plant in Q1FY10. This aided the company in reporting higher operating profit. Once raw material cost i.e Crude and Gas prices stabilize the company would commence the VAM plant operations.
- **Consistent dividend history and dividend payout:** - The Company has been consistently paying dividend since 1992. In FY09, despite a bad year for the company in which it reported lower profits, the company gave a dividend of Rs 1.75 per share, which was same as in FY08. The dividend pay out for the company was at nearly 40% on consolidated basis and 30% on standalone basis. We expect the company to post good results in FY10 and a higher dividend can be expected from the company.
- **FCCB bought back on discount:** - The company had raised FCCB worth USD 40 Mn , amounting to Rs 159.4 Cr, in Dec 2007 at a conversion price of Rs 257 Per share. The company had bought back USD 2.8 Mn worth of FCCB discount.
- The company has close to Rs 160 Cr cash on its books that translate to Rs 6 per share.

Risk and Concerns

- The company has exposure to forex and currency fluctuation would result in fluctuation in bottom-line.
- The company's chief raw material is Poly Vinyl Acetate which is derived from Ethylene. Any Increase in price in Ethylene would erode Pidilite's Bottom-line.
- The company has been expanding abroad and opening manufacturing facilities. The company had to close one of its plants in UAE as it was found un-viable. More Such closure can result in lower ROCE for the company.
- The subsidiaries faced adverse market conditions due to economic slowdown and steep increase in input cost in H1 of FY 2009 and was negatively impacted by forex fluctuations. Company reported lower consolidated profits due to factors .Steps have been initiated to rationalize the product mix and other cost efficiencies.

Valuation and recommendation

Pidilite Industries is a dominant player in the adhesive and sealant market in India. The company cleared all the high-cost inventory of raw materials, the low-cost inventory of raw materials together with price increases boosted OPM 510 bps to 23.3% in Q1 of FY 2010. Thus, strong brands enable the company to generate better sales and margin, barring short-term aberration. Going ahead with crude derivative still priced lower, we expect the company to post better OPM for FY10. The company is about to start off its manufacturing operations at Bangladesh and African plants by later this. We have projected sales from these facilities with a lag effect of six months. We have projected that the company would post an EPS of 9.93, which is a conservative estimate in view of Q1FY10 EPS of 3.3. At this EPS the company is trading at an earning multiple of 14.1x. We recommend investors to buy the counter in 135-145range with a target of Rs 195 in medium term.

| Earnings Table | | | | |
|-----------------------|----------------|-------------|--------------|--------------|
| | (Rs Cr) | | | |
| Particulars | FY08 | FY09 | FY10E | FY11E |
| Net Sales | 1708.24 | 1986.32 | 2107 | 2338 |
| Change % | | 16.28 | 6 | 11 |
| Total Income | 1740.60 | 2015.39 | 2137 | 2384 |
| Total Expenditure | 1467.10 | 1792.62 | 1723 | 1931 |
| PBDIT | 273.50 | 222.77 | 415 | 453 |
| Depreciation | 45.88 | 58.82 | 80 | 89 |
| PBIT | 227.62 | 163.95 | 335 | 364 |
| Interest | 19.00 | 36.09 | 32 | 30 |
| PBT | 208.62 | 127.86 | 303 | 334 |
| Tax | 35.80 | 16.67 | 51 | 60 |
| Reported PAT | 172.82 | 111.19 | 251 | 274 |
| Adjusted PAT | 173.00 | 111.19 | 251 | 274 |
| Change % | | -35.73 | 126 | 9 |
| Cash Profit | 218.88 | 170.70 | 331 | 363 |

| Key Ratios | | | | |
|--------------------|-------------|-------------|--------------|--------------|
| Particulars | FY08 | FY09 | FY10E | FY11E |
| EBDIT (%) | 15.71 | 11.05 | 19.40 | 19.00 |
| PBIT (%) | 13.08 | 8.13 | 15.66 | 15.27 |
| PAT (%) | 9.94 | 5.55 | 11.75 | 11.49 |
| RoCE (%) | 19.84 | 12.58 | 22.08 | 20.99 |
| RoE (%) | 27.91 | 16.12 | 28.56 | 25.35 |
| Debt-Equity | 0.85 | 0.88 | 0.72 | 0.61 |

| Balance Sheet | | | | |
|----------------------|----------------|-------------|--------------|--------------|
| | (Rs Cr) | | | |
| Particulars | FY08 | FY09 | FY10E | FY11E |
| Share Capital | 28.18* | 25.31 | 25.31 | 25.31 |
| Reserves | 591.58 | 668.79 | 854 | 1055 |
| Shareholder's Fund | 619.76 | 694.10 | 880 | 1080 |
| Loan Funds | 527.62 | 609.52 | 692 | 654 |
| Total Liabilities | 1147.38 | 1303.62 | 1572 | 1734 |
| Net Fixed Assets | 666.81 | 833.13 | 1034 | 1094 |
| Investments | 3.24 | 25.37 | 41 | 72 |
| Net Current Assets | 477.33 | 445.12 | 496 | 568 |
| Total Assets | 1147.38 | 1303.62 | 1572 | 1734 |

*Equity capital reduction due to preferred stock redemption

| Valuations | | | | |
|--------------------|-------------|-------------|--------------|--------------|
| Particulars | FY08 | FY09 | FY10E | FY11E |
| Adjusted EPS (Rs) | 6.14 | 4.42 | 9.93 | 10.82 |
| Cash EPS (Rs) | 7.77 | 6.74 | 13.09 | 14.34 |
| BV Per Share | 21.99 | 27.42 | 34.75 | 42.69 |
| Dividend per share | 1.75 | 1.75 | 2.25 | 2.50 |
| P/E | 22.80 | 31.67 | 14.10 | 12.94 |
| P/BV | 6.37 | 5.11 | 4.03 | 3.28 |
| M-Cap/Sales | 2.31 | 1.78 | 1.68 | 1.52 |

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