

# Pidilite Industries – BUY



PIDI IN

Rs120

Mid-caps

20 May 2010

Result review

## Healthy growth but operating costs weigh on margins

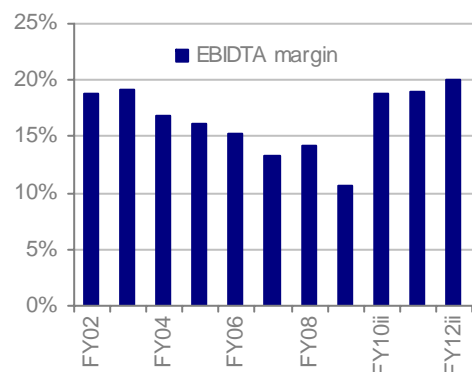
**Adjusted for extraordinary** (on account of an AS11-driven write-back in 4QFY09), Pidilite's net profit grew 92% YoY in 4QFY10, although reported PAT was down 18%. Revenue growth was relatively modest at 16% YoY, but operating profit grew 29% YoY, owing to low profitability in the year-ago period. QoQ EBIDTA margin erosion was largely due to increased operating costs in the standalone business rather than gross margin erosion (thereby vindicating our faith in pricing power). In our view, the surge in costs could mean a ramp-up in pursuit of high growth in the construction chemicals business. We retain BUY.

**YoY comparison looks favourable, adjusted for extraordinary:** Pidilite's adjusted PAT, at Rs466m, actually registered 92% YoY growth in 4QFY10. In spite of a 368bps QoQ drop in EBIDTA margin (13.8%), a lacklustre 4QFY09 (driven by inventory markdowns) aids YoY comparisons.

**Standalone business margins pushed down by operating costs:** Most of the erosion in EBIDTA margin is due to the mainstay standalone business. In spite of a slight QoQ improvement in gross margin to 49.7%, EBIDTA margin dropped 416bps to 16.2%, mainly because of a rise of 10.8% QoQ in staff costs and 14.1% QoQ in other operating expenses.

**Subsidiaries remain a pressure point:** Subsidiaries cumulatively lost the company Rs165m in FY10. Although efforts to control costs remain apparent in a 15.6% YoY salary cost reduction, non-employee operating expenses rose 34% QoQ. The subsidiaries have been making losses even at EBIDTA level for the last two quarters. With YoY sales growth of 10% reflecting increased business traction, we expect operating leverage to play through and deliver a breakeven in FY11.

### We expect margins to improve



Source: IIFL Research

### Financial Summary

Y/e 31 Mar	FY08A	FY09A	FY10ii/A	FY11ii	FY12ii
Revenues (Rs m)	17,082	19,863	22,133	26,268	30,209
EBITDA Margins (%)	14.1	10.6	18.5	18.9	20.0
Pre-Exceptional PAT (Rs m)	1,713	1,313	2,802	3,562	4,342
Reported PAT (Rs m)	1,726	1,119	2,770	3,562	4,342
EPS (Rs)	3.0	1.1	5.5	6.8	8.3
Growth (%)	37.9	-64.2	147.5	27.1	21.9
<b>PER (x)</b>	<b>39.3</b>	<b>109.9</b>	<b>21.7</b>	<b>17.5</b>	<b>14.3</b>
Price/Book (x)	10.9	17.4	6.9	5.0	4.1
ROE (%)	31.1	16.7	38.3	33.4	31.3
Debt/Equity (x)	0.8	0.9	0.7	0.3	0.2
<b>EV/EBITDA (x)</b>	<b>45.6</b>	<b>93.0</b>	<b>23.5</b>	<b>20.3</b>	<b>16.6</b>

Price as at close of business on 19 May 2010

12-mth TP (Rs) 125 (5%)

Market cap (US\$ m) 1,305

52Wk High/Low (Rs) 129/48

Diluted o/s shares (m) 506

Daily volume (US\$ m) 1

Dividend yield FY10ii (%) 1.7

Free float (%) 29.4

### Shareholding pattern (%)

Promoters 70.6

FII's 9.3

DII's 8.6

Others 11.5

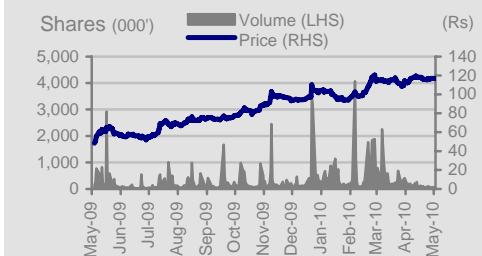
### Price performance (%)

	1M	3M	1Y
Pidilite	5.9	16.6	142.9

Industries

Rel. to Sensex	11.6	15.2	128.1
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### Stock movement



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## 4QFY10 – a mixed bag

Figure 1: Consolidated quarterly numbers – strong YoY growth

(Rs m)	4QFY09	3QFY10	4QFY10	% YoY	% QoQ
<b>Net Sales</b>	<b>4,439</b>	<b>5,274</b>	<b>5,148</b>	<b>16.0</b>	<b>-2.4</b>
COGS	2,427	2,711	2,594	6.9	-4.3
Employee expenses	572	602	627	9.5	4.1
Employee expenses / sales (%)	12.9%	11.4%	12.2%	-73 bps	75 bps
Other expenses	891	1,041	1,219	36.8	17.1
Other expenses / sales (%)	20.1%	19.7%	23.7%	361 bps	393 bps
<b>Total cost</b>	<b>3,890</b>	<b>4,354</b>	<b>4,439</b>	<b>14.1</b>	<b>2.0</b>
Gross Profit	2,013	2,563	2,554	26.9	-0.3
Gross Margin (%)	45.3%	48.6%	49.6%	428 bps	102 bps
<b>Op Ebitda</b>	<b>550</b>	<b>920</b>	<b>709</b>	<b>29.0</b>	<b>-23.0</b>
Ebitda Margin	12.4%	17.4%	13.8%	139 bps	-368 bps
Depreciation	158	173	177	12.6	2.5
<b>Op Ebit</b>	<b>392</b>	<b>747</b>	<b>532</b>	<b>35.6</b>	<b>-28.8</b>
Op Ebit Margin	8.8%	14.2%	10.3%	149 bps	-385 bps
Other income	23	70	8	-66.4	-88.8
Interest expense	114	78	69	-39.7	-11.9
<b>PBT</b>	<b>301</b>	<b>738</b>	<b>471</b>	<b>56.2</b>	<b>-36.3</b>
Tax	64	81	17	-73.1	-78.5
FBT					
Deferred tax	1	36	-14	-2400.0	-138.2
Tax rate	22%	16%	1%	-2081 bps	-1505 bps
<b>APAT before minority interest</b>	<b>236</b>	<b>622</b>	<b>467</b>	<b>97.7</b>	<b>-24.9</b>
Minority interest	-7	-1	1		
<b>APAT after minority interest</b>	<b>243</b>	<b>623</b>	<b>466</b>	<b>91.7</b>	<b>-25.2</b>
Extraordinary Items	-337	-21	-10		
<b>Reported PAT</b>	<b>580</b>	<b>644</b>	<b>476</b>	<b>-17.9</b>	<b>-26.1</b>

Source: IIFL Research, Company

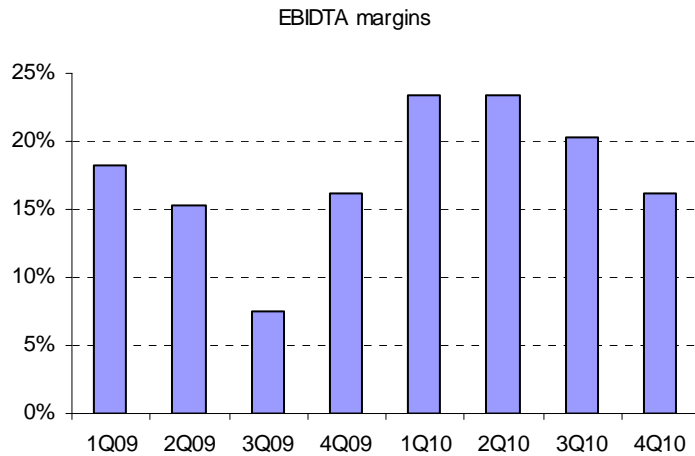
Consolidated gross margin remained robust at 49.6%, reassuring us that the business retains enough pricing power to translate its revenue growth opportunity into strong earnings growth.

Figure 2: Standalone business – the key growth driver

(in Rs m)	4QFY09	3QFY10	4QFY10	% YoY	% QoQ
<b>Net Sales</b>	<b>3,874</b>	<b>4,668</b>	<b>4,524</b>	<b>16.8</b>	<b>-3.1</b>
COGS	2,080	2,377	2,276	9.4	-4.2
Employee expenses	432	458	508	17.6	10.8
Employee expenses / sales (%)	11.1%	9.8%	11.2%	8 bps	140 bps
Other expenses	737	885	1,010	37.0	14.1
Other expenses / sales (%)	19.0%	19.0%	22.3%	328 bps	335 bps
<b>Total cost</b>	<b>3,249</b>	<b>3,720</b>	<b>3,794</b>	<b>16.8</b>	<b>2.0</b>
Gross Profit	1,794	2,291	2,248	25.3	-1.9
Gross Margin (%)	46.3%	49.1%	49.7%	338 bps	61 bps
<b>Op Ebitda</b>	<b>625</b>	<b>948</b>	<b>731</b>	<b>16.9</b>	<b>-22.9</b>
Ebitda Margin	16.1%	20.3%	16.2%	1 bps	-416 bps
Depreciation	126	108	115	-8.6	6.6
<b>Op Ebit</b>	<b>499</b>	<b>840</b>	<b>615</b>	<b>23.4</b>	<b>-26.7</b>
Op Ebit Margin	12.9%	18.0%	13.6%	72 bps	-439 bps
Other income	6	13	18	185.7	39.5
Interest expense	96	74	58	-39.5	-21.5
<b>PBT</b>	<b>409</b>	<b>778</b>	<b>575</b>	<b>40.6</b>	<b>-26.1</b>
Tax	64	81	16	-75.7	-80.6
FBT	0	0			
Deferred tax	3	36	-23	-976.9	-163.2
Tax rate	16%	15%	-1%	-1759 bps	-1624 bps
<b>APAT</b>	<b>342</b>	<b>662</b>	<b>582</b>	<b>70.2</b>	<b>-12.0</b>
Extraordinary Items	-334	-20	33		
<b>PAT</b>	<b>676</b>	<b>682</b>	<b>550</b>	<b>-18.6</b>	<b>-19.3</b>

Source: IIFL Research, Company

With the standalone (India consumer) business facing growth opportunities in most of its sub-segments (especially in construction chemicals), we believe this ramp-up of operating costs represents an investment in distribution and marketing, to pursue a high growth trajectory. The construction chemicals business will continue to be the significant upside risk to our 15% revenue growth assumption.

**Figure 3: Sharp drop in standalone EBIDTA margins in 4QFY10**


Source: IIFL Research, Company

**Figure 4: Operating expenses climbed in 4Q at standalone level**


Source: IIFL Research, Company

**Figure 5: Subsidiaries continue to make losses**

(Rs m)	4QFY09	3QFY10	4QFY10	% YoY	% QoQ
<b>Net Sales</b>	<b>565</b>	<b>606</b>	<b>624</b>	<b>10.3</b>	<b>2.9</b>
COGS	347	334	318	-8.4	-4.9
Employee expenses	141	144	119	-15.6	-17.3
Employee expenses / sales (%)	24.9%	23.7%	19.0%	-584 bps	-465 bps
Other expenses	154	156	209	36.2	34.1
Other expenses / sales (%)	27.1%	25.7%	33.5%	636 bps	778 bps
<b>Total cost</b>	<b>641</b>	<b>634</b>	<b>646</b>	<b>0.7</b>	<b>1.9</b>
Gross Profit	219	272	306	39.9	12.5
Gross Margin (%)	38.7%	44.9%	49.1%	1038 bps	419 bps
<b>Op Ebitda</b>	<b>-75</b>	<b>-28</b>	<b>-22</b>		
Ebitda Margin	-13.4%	-4.6%	-3.5%	985 bps	105 bps
Depreciation	31	65	62	97.8	-4.3
<b>Op Ebit</b>	<b>-107</b>	<b>-92</b>	<b>-84</b>		
Op Ebit Margin	-18.9%	-15.3%	-13.5%	545 bps	181 bps
Other income	17	57	-10		
Interest expense	18	4	11	-41.0	169.2
<b>PBT</b>	<b>-108</b>	<b>-40</b>	<b>-105</b>		
Tax	0	0	2		
FBT	0	0	0		
Deferred tax	-2	0	9		
Tax rate	N/A	N/A	N/A		
<b>APAT</b>	<b>-106</b>	<b>-40</b>	<b>-115</b>		
Extraordinary Items	-4	-1	-43		
<b>PAT</b>	<b>-96</b>	<b>-38</b>	<b>-74</b>		

Source: IIFL Research, Company

The most heartening development in the subsidiaries business remains revenue growth and a reduction in salary costs. We expect a breakeven by end-FY11.

## Financial summary

### Income statement summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Revenue	17,082	19,863	22,842	26,268	30,209
EBITDA	2,412	2,104	4,281	4,974	6,050
EBIT	1,954	1,516	3,596	4,195	5,171
Interest expense	-190	-361	-289	-212	-170
Others items	314	119	250	288	331
Profit before tax	2,077	1,275	3,557	4,270	5,332
Tax expense	-363	-167	-533	-683	-960
Extraordinary items	13	4	-25	0	0
Net Profit	1,726	1,105	2,978	3,562	4,342

### Cashflow summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Profit before tax	1,954	1,516	3,596	4,195	5,171
Depreciation & Amortization	459	588	685	780	880
Tax paid	-363	-167	-533	-683	-960
Working capital change	-1,277	186	-470	-563	-648
Other operating items	-2	-7	-20	-25	-30
Operating Cash-flow	771	2,117	3,257	3,703	4,413
Capital expenditure	-3,258	-2,251	-1,600	-1,900	-2,000
Free cash flow	-2,487	-135	1,657	1,803	2,413
Equity raised	106	76	-134	1,538	-228
Investments	127	-221	-913	0	0
Debt financing/disposal	3,814	825	-195	-1,769	-426
Dividends paid	-443	-443	-1,051	-1,247	-1,520
Other items	81	18	100	100	100
Net change in Cash & cash equivalents	1,322	-122	-576	500	500

Source: Company data, IIFL Research

### Balance-sheet summary (Rs m)

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Cash & cash equivalents	1,718	1,601	1,000	1,500	2,000
Sundry debtors	2,656	2,876	3,129	3,598	4,138
Trade Inventories	2,988	2,798	3,442	3,958	4,552
Other current assets	928	1,011	1,100	1,350	1,600
Fixed assets	6,668	8,331	9,247	10,367	11,487
Other assets	32	254	1,167	1,167	1,167
Total assets	14,992	16,871	19,085	21,941	24,945
Sundry creditors	3,102	3,401	3,916	4,589	5,324
Long-term debt/Convertibles	5,264	6,089	5,894	4,125	3,699
Other long-term liabilities	416	434	534	634	734
Minorities/other Equity	13	7	27	52	82
Networth	6,198	6,941	8,714	12,542	15,106
Total liabilities & equity	14,992	16,871	19,085	21,941	24,945

### Ratio Analysis

Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Sales growth (%)	36.9	16.3	15.0	15.0	15.0
Core EBITDA growth (%)	45.2	-12.8	103.4	16.2	21.6
Core EBIT growth (%)	46.5	-22.4	137.2	16.6	23.3
Core EBITDA margin (%)	14.1	10.6	18.7	18.9	20.0
Core EBIT margin (%)	11.4	7.6	15.7	16.0	17.1
Net profit margin (%)	10.0	5.5	13.1	13.6	14.4
Dividend payout ratio (%)	25.9	40.2	35.0	35.0	35.0
Tax rate (%)	17.5	13.1	15.0	16.0	18.0
Net Debt/Equity (%)	57.2	64.7	56.2	20.9	11.2
Return on Equity (%)	31.1	16.7	38.3	33.4	31.3
Return on Assets (%)	14.4	6.9	16.7	17.4	18.5

Source: Company data, IIFL Research



#### Key to our recommendation structure

**BUY** - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

**SELL** - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

**Add** - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.

**Reduce** - Stock expected to return less than the hurdle rate, ie return of less than 10%.

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