

***Innovation led growth to intensify***

Incorporated in 1959, Pidilite Industries Ltd. is a pioneer in consumer and speciality chemicals in India, with a diversified product portfolio including adhesives and sealants, construction chemicals, hobby colours and polymer emulsions, among others.

**Investment Rationale**

**Strong brand equity & unmatched distribution reach:** Pidilite enjoys a dominant position in the adhesive and sealants business in India with a market share of ~70%. The company has a strong legacy of reputed brands in the adhesives and sealants category in India viz; Fevicol and M-Seal. Pidilite has a well-entrenched distribution network of more than 4,000 distributors servicing more than 400,000 dealers/retailers and 4,000 industrial customers. To further enhance its distribution reach, the company is increasing its penetration into the tier 2/3 cities and rural areas.

**Core consumer segment (82% of sales) to drive growth backed by strong R&D:** The company over the years has created well-known brands such as Fevicol, Fevi Kwik, M-Seal, Dr. Fixit and Fevi Stik in this category, has led to sustainable growth of the segment (CAGR of 17% over FY12-15). As a result of strong product mix (led by niche products), Pidilite enjoys a superior pricing power in the branded product category, which is predominantly propelling the growth of the segment. Given revival in economic activity coupled with recovery in urban discretionary spending and deeper penetration into tier 2/3 cities, we expect revenue CAGR of 11% in FY15-17E for this segment.

**Uptick in industrial investment augurs well for industrial product segment:** Industrial product segment (contributed ~18% to overall revenues in FY15) has grown at CAGR of ~11% over FY12-15 on steady demand from industries such as textiles, packaging, leather, etc. We expect segment revenue to grow at CAGR of ~2% for FY15-17E led by recovery in industrial investment.

**Strong balance sheet with healthy operating cashflow:** Pidilite has a strong balance sheet with high cash flow from operations and negligible debt levels. Driven by its effective control on working capital requirements, the company has managed to generate healthy operating and free cash flows (~Rs. 600 Crores free cashflows in FY16E). We expect the cashflows to strengthen going ahead led by uptick in profitability and absence of major capex. Further, we expect ROE & ROCE to improve to 28.3% and 40.1% respectively in FY17E.

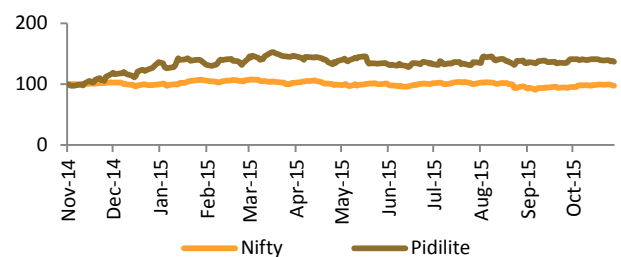
**Valuation:** With strong brand recall, superior pricing power and distribution reach, we believe Pidilite is a strong play in the recovery in discretionary spending. Further, subdued crude and VAM prices will be margin accretive going ahead. We expect revenue and PAT to grow at a CAGR of 11% and 30% over FY15-FY17E. We initiate coverage on the stock with a BUY rating with a target price of Rs. 646 (FY17E P/E of 38x), implies a potential upside of 13% for the coming 12 months.

**Market Data**

|                          |            |
|--------------------------|------------|
| <b>Rating</b>            | <b>BUY</b> |
| <b>CMP (Rs.)</b>         | 574        |
| <b>Target (Rs.)</b>      | <b>646</b> |
| <b>Potential Upside</b>  | 13%        |
| <b>Duration</b>          | Long Term  |
| Face Value (Rs.)         | 1.0        |
| 52 week H/L (Rs.)        | 638/396    |
| Adj. all time High (Rs.) | 638        |
| Decline from 52WH (%)    | 10.0       |
| Rise from 52WL (%)       | 44.9       |
| Beta                     | 0.4        |
| Mkt. Cap (Rs.Cr)         | 29,427     |

**Fiscal Year Ended**

| Y/E                | FY14A | FY15A | FY16E | FY17E |
|--------------------|-------|-------|-------|-------|
| Revenue (Rs.Cr)    | 4,283 | 4,844 | 5,269 | 5,948 |
| Net profit (Rs.Cr) | 450   | 513   | 749   | 875   |
| EPS (Rs.)          | 8.8   | 10.0  | 14.6  | 17.1  |
| P/E (x)            | 35.0  | 60.0  | 41.0  | 35.2  |
| P/BV (x)           | 8.0   | 13.5  | 11.0  | 9.1   |
| ROE (%)            | 24.9  | 24.2  | 29.6  | 28.3  |

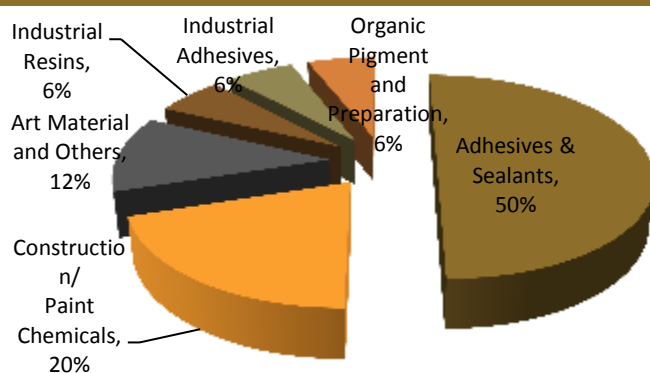
**One year Price Chart**

**Shareholding Pattern**

|           | Sep 15 | Jun 15 | Chg.  |
|-----------|--------|--------|-------|
| Promoters | 69.7   | 69.7   | 0.0   |
| FII       | 14.5   | 5.8    | 8.7   |
| DII       | 5.2    | 14.0   | (8.8) |
| Others    | 10.6   | 10.5   | 0.1   |

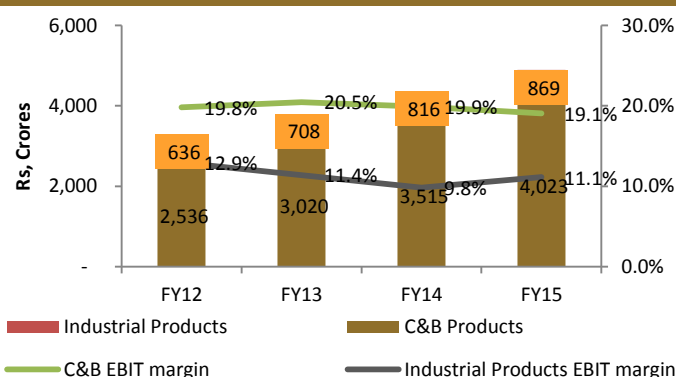
## Pidilite Industries: 'A Household Name'

Incorporated in 1959, Pidilite Industries Ltd. enjoys dominant position in adhesives and sealants, construction chemicals, hobby colours and polymer emulsions in the domestic market. The company's iconic brand Fevicol is currently the largest selling adhesives brand in Asia. It operates in three segments viz; Branded Consumer & Bazaar Products, Industrial Products and Others. Branded Consumer and Bazaar Products segment is engaged in manufacturing of Adhesives, Sealants, Art Materials, Construction and Paint Chemicals. It alone contributes 82% to the company's overall revenue and has grown at CAGR of ~17% and EBIT CAGR of ~15% over FY12-15 with EBIT margin of 19.1% in FY15. Industrial segment include products such as Industrial Adhesives, Synthetic Resins, Organic Pigments and Pigment Preparations. It accounts for 18% of the company's total revenue and has grown at CAGR of ~11% over FY12-15. EBIT CAGR remains muted at ~5% with EBIT margin of 11.1% in FY15.

Product-wise Revenue breakup in FY15



Segment-wise revenue & EBIT margin breakup



**Pidilite's iconic brands like Fevicol and M-Seal garnered market share of ~70% each in the domestic market**

## Robust product portfolio; differentiated offerings

Pidilite is leveraging its dominant position in the adhesives market to bring new and differentiated product and build strong brand preference among consumers. It has managed to create a strong brand image with well-known brands (Fevicol, Fevi Kwik, M-Seal, Dr. Fixit and Fevi Stik) in adhesives and sealants category, leading to sustainable growth of the segment that has grown at a CAGR of 17% over FY12-FY15. The company's iconic brands like Fevicol and M-Seal garnered market share of ~70% each in the domestic market. Further, the company continued to invest in brand building through various ad campaigns that helped the company fortifying its position as the market leader and stay ahead of its peers. The company has managed to contain its marketing and selling expenses below 5% of sales, despite its aggressive ad campaigns. The company's pricing power in the branded product category coupled with strong product mix (niche products) is predominantly propelling the growth of the segment. Given the uptick in economic activity coupled with recovery in urban discretionary spending and deeper penetration into tier 2/3 cities, we expect the C&B segment to record revenue CAGR of 11% in FY15-17E.

Pidilite's key brands



**Leveraging its R&D capabilities, Pidilite has continuously driven product innovation and has succeeded in introducing various successful products over the years.**

**Pidilite has acquired smaller companies and successfully integrated target company's operations with itself, which gives us comfort on its future acquisition strategy.**

### Distribution reach provides competitive edge

Pidilite has a well-entrenched distribution network of more than 4,000 distributors servicing more than 400,000 dealers/retailers and 4,000 industrial customers. Pidilite has created strong relations with the intermediaries like contractors, carpenters, plumbers, painters, ensuring customer stickiness. Its strong distribution reach give a competitive edge to Pidilite. Pidilite enjoys strong pricing power due to its diversified product mix, prominent brands and extensive distribution network. To further enhance its distribution reach, the company is increasing its penetration into the tier 2/3 cities and rural areas.

### Innovative product offerings to fortify brand positioning

Pidilite persistent focus towards R&D has paid off (R&D expenses on consolidated basis has increased by ~10% YoY in FY15) as most of the company's products have been developed in-house. Leveraging its R&D capabilities, Pidilite has continuously driven product innovation and has succeeded in introducing various successful products over the years like Fevicol Marine, Fevicol Wood grip, Fevicol All Fix, Fevistik Super, Blue & Purple, and M-Seal (black & white), among others. To further increase its operating strength, Pidilite in FY15 launched Fevicol Hi-per with an anti-bubble formula, Dr. Fixit Blueseal – a water proofing spray, M-seal PV Seal, a new range of solvent cement and Motomax Insta Shine - an easy-to-use disposable polishing sponge. This enables Pidilite to stay ahead of peers and facilitates its brand equity. Robust spending on R&D and marketing have created a moat for the company that is unlikely to be breached in the near term.

#### New product launches in FY15



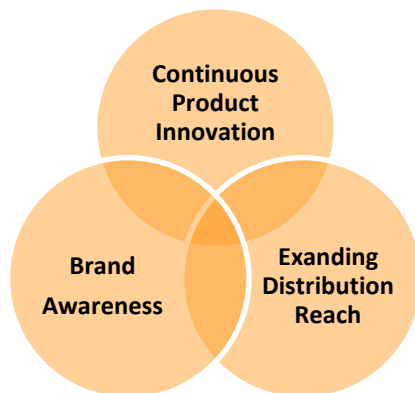
### Growing through inorganic route

Over the years, Pidilite Industries has made several acquisitions that have helped the company expand its product offerings. It has acquired smaller companies and successfully integrated target company's operations with itself, which gives us comfort on the future acquisition strategy of Pidilite. Among its latest endeavors is the acquisition of the waterproofing business of Nina Concrete Systems Private Ltd. (NCS) by Nina Waterproofing Systems Private Ltd (NWSP), a subsidiary of Pidilite Industries, on a slump sale basis. Pidilite holds 70% of the paid up capital in NWSP. The acquisition brings water proofing products (hydrophilic swellable water bars, hdro flex, hycrete and extruded polystyrene insulation) into its portfolio. In FY15, the company has also acquired Blue Coat's adhesive business on a slump sale basis for a cash consideration of Rs 263.6 Crores. The acquisition of Blue Coat's adhesive business complemented existing product portfolio of the company as Blue Coat is largely into white glue and furniture-making adhesive and also helped Pidilite in leveraging its existing strong brand.

*The company has guided that VAM prices to stabilize around USD 900/ton.*

*We believe the segment revenue to grow at a CAGR of ~2% for FY15-17E led by an uptick in industrial investments.*

**Growth strategies**

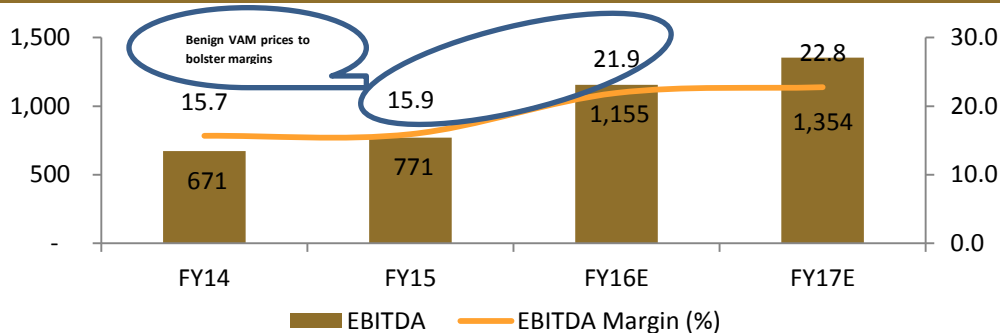


*Pidilite adopted three pronged strategy for growth viz; strong and innovative product portfolio, augmenting distribution reach and create brand awareness among customers. We believe the aforementioned drivers provide the company a distinct advantage.*

**Strong pricing power and benign raw material prices to support margins**

With well established brands coupled with vast distribution network, Pidilite enjoys strong pricing power in most of the categories it operates. The company over the years has managed to pass-on the rise in raw material costs to the end consumers, which has helped the company in sustaining margins. The standalone gross margin has been maintained at 45%, while EBITDA margin has stayed in the range of 17-18%. Owing to the weakness in the global economy, the average price of the company’s key raw material - vinyl acetate monomer (VAM), a crude derivative, has witnessed a sharp correction in the recent past. The price of VAM slipped below USD 950/ton in Q2FY16 as compared to USD 1350-1400/ton in Q1FY15. The company has guided that VAM prices to stabilize around USD 900/ton. Hence, we estimate consolidated EBITDA margin of 21.9% and 22.8% in FY16E and FY17E.

**EBITDA to grow at a CAGR of ~33% over FY15-17E led by subdued VAM prices**



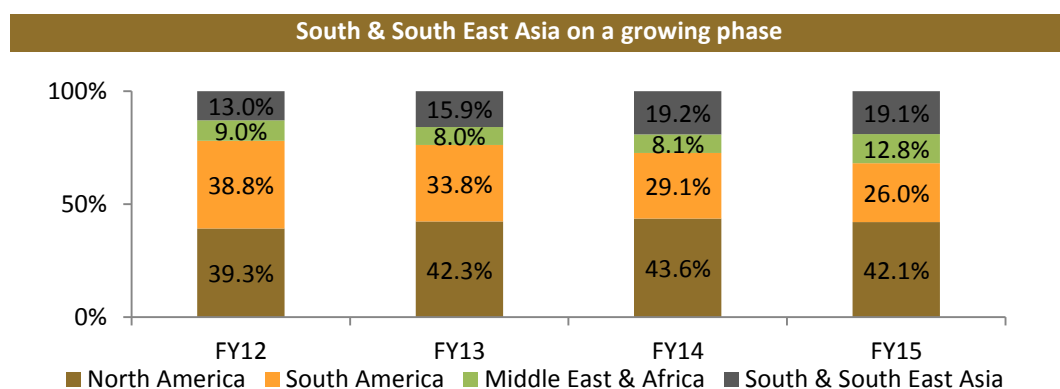
**Recovery in industrial investments would give leg-up to growth**

With the economy showing signs of revival, we expect the industrial segment to gather momentum going ahead. The segment offers diverse range of product includes; industrial adhesives, industrial resins, leather & textile chemicals and pigments powders, which cater to various industries like packaging, footwear, stickers, cigarettes, leather, among others. Further, export is also the driving force behind growth for industrial products as large amount of its industrial products is exported (generates more than 40% of revenue from exports). We believe the segment revenue to grow at a CAGR of ~2% for FY15-17E led by an uptick in industrial investments.

**Sizeable international operations**

Pidilite has considerable presence in the global markets with 15 overseas subsidiaries (4 direct and 11 step-down) including those having manufacturing and selling operations in USA, Brazil,

Thailand, Dubai, Egypt and Bangladesh. The company generates around 10% of consolidated revenue from international operations and it has grown at a CAGR of ~15% over FY12-FY15, driven by South & South East Asia, North America and Middle East & Africa with revenue CAGR of 17%, 29% and 30% respectively. South & South East Asia region (the fastest-growing) continues to witness robust growth led by decent growth in Bangladesh and Thailand. On the EBITDA front, the growth was predominantly led by South & South East Asia and North America, grew at a CAGR of 54% and 17% respectively. While, the company's South American and Middle East & Africa region continues to witness loss at the EBITDA level. Pidilite's Brazil operations continue to remain under pressure impacted by adverse economic conditions, depreciating currency and demand slowdown. The company is looking to curtail operational costs in order to minimize losses. However, we do not expect these regions to turn profitable in the near term.



### Decent revenue growth in H1FY16

The consolidated revenue growth stood at 7.4% in H1FY16 at Rs. 2,789.5 Crores largely supported by improved performance from Consumer & Bazaar Products segment, wherein revenue rose by 8.8% to Rs. 2,371.9 Crores in H1FY16 from Rs. 2180.4 Crores in H2FY15. However, performance of industrial segment continues to be impacted by slowing demand. The net profit rose 35.7% to Rs. 417.2 Crores as against Rs. 307.4 Crores in the corresponding period last fiscal due to sharp growth in EBITDA.

### Revenue and PAT to grow at CAGR of 11% and 30% over FY15-17E

Led by sustained demand from tier 2/3 cities, increased focus on new product offering, coupled with recovery in industrial investments, we believe Pidilite is an ideal play. We estimate consolidated revenue CAGR of 11% over FY15-17E driven by C&B revenue CAGR of 11%. The tax rate will be higher in FY16 due to end of the tax holidays in its 3 units in Himachal Pradesh. Notwithstanding the fact, we expect the net profit to grow at a CAGR of ~30% over FY15-17E and ROE & ROCE to improve to 28.3% and 40.1% by FY17E.

### Key Risks:

- Adverse movement in VAM prices to impact margins.
- Challenging economic environment in Brazil with the construction and real estate sector witnessing slowdown.
- Synthetic Elastomer project a drag as the company has invested a huge amount of money in the plant in Dahej, Gujarat.
- Steep depreciation in the rupee could create margin tailwinds as input prices are dollar linked.

## Profit & Loss Account (Consolidated)

| Y/E (Rs.Cr)                     | FY14         | FY15         | FY16E        | FY17E        |
|---------------------------------|--------------|--------------|--------------|--------------|
| <b>Total operating Income</b>   | <b>4,283</b> | <b>4,844</b> | <b>5,269</b> | <b>5,948</b> |
| Raw Material cost               | 2,361        | 2,681        | 2,600        | 2,900        |
| Employee cost                   | 442          | 497          | 541          | 611          |
| Other operating expenses        | 808          | 895          | 973          | 1,084        |
| <b>Total operating expenses</b> | <b>3,612</b> | <b>4,073</b> | <b>4,114</b> | <b>4,595</b> |
| <b>EBITDA</b>                   | <b>671</b>   | <b>771</b>   | <b>1,155</b> | <b>1,354</b> |
| Depreciation                    | 81           | 118          | 131          | 147          |
| Other Income                    | 38           | 41           | 45           | 55           |
| <b>EBIT</b>                     | <b>629</b>   | <b>694</b>   | <b>1,069</b> | <b>1,262</b> |
| Interest cost                   | 16           | 16           | 15           | 15           |
| <b>Profit before tax</b>        | <b>612</b>   | <b>678</b>   | <b>1,054</b> | <b>1,247</b> |
| Tax                             | 165          | 169          | 306          | 374          |
| Profit after tax                | 447          | 509          | 748          | 873          |
| Minority Interests              | 0            | 1            | 1            | 1            |
| P/L from Associates             | 3            | 5            | 2            | 3            |
| <b>Net Profit</b>               | <b>450</b>   | <b>513</b>   | <b>749</b>   | <b>875</b>   |

## Balance Sheet (Consolidated)

| Y/E (Rs.Cr)                   | FY14         | FY15         | FY16E        | FY17E        |
|-------------------------------|--------------|--------------|--------------|--------------|
| Paid up capital               | 51           | 51           | 51           | 51           |
| Reserves and Surplus          | 1,901        | 2,219        | 2,734        | 3,326        |
| <b>Net worth</b>              | <b>1,953</b> | <b>2,271</b> | <b>2,785</b> | <b>3,378</b> |
| Minority Interest             | 4            | 5            | 6            | 7            |
| Total Debt                    | 46           | 58           | 60           | 60           |
| Other non-current liabilities | 86           | 81           | 93           | 105          |
| <b>Total Liabilities</b>      | <b>2,088</b> | <b>2,415</b> | <b>2,944</b> | <b>3,550</b> |
| Total fixed assets            | 1,164        | 1,419        | 1,458        | 1,481        |
| Investments                   | 260          | 360          | 540          | 690          |
| Net Current assets            | 567          | 501          | 801          | 1,220        |
| Other non-current assets      | 96           | 135          | 146          | 158          |
| <b>Total Assets</b>           | <b>2,088</b> | <b>2,415</b> | <b>2,944</b> | <b>3,550</b> |

## Cash Flow Statement (Consolidated)

| Y/E (Rs.Cr)                                | FY14         | FY15         | FY16E        | FY17E        |
|--|--------------|--------------|--------------|--------------|
| Pre tax profit                             | 612          | 678          | 1,054        | 1,247        |
| Depreciation                               | 81           | 118          | 131          | 147          |
| Chg in Working Capital                     | (151)        | (59)         | (80)         | (53)         |
| Tax paid                                   | (167)        | (175)        | (296)        | (364)        |
| <b>Cash flow from operating activities</b> | <b>375</b>   | <b>561</b>   | <b>810</b>   | <b>977</b>   |
| Capital expenditure                        | (190)        | (410)        | (170)        | (170)        |
| Chg in investments                         | 49           | (81)         | (180)        | (150)        |
| <b>Cash flow from investing activities</b> | <b>(141)</b> | <b>(491)</b> | <b>(350)</b> | <b>(320)</b> |
| Equity raised/(repaid)                     | 0            | 0            | 0            | 0            |
| Debt raised/(repaid)                       | (65)         | 12           | 2            | 0            |
| Dividend paid                              | (156)        | (162)        | (233)        | (279)        |
| <b>Cash flow from financing activities</b> | <b>(221)</b> | <b>(149)</b> | <b>(231)</b> | <b>(279)</b> |
| Net chg in cash                            | <b>13</b>    | <b>(79)</b>  | <b>229</b>   | <b>377</b>   |

## Key Ratios (Consolidated)

| Y/E                        | FY14 | FY15 | FY16E | FY17E |
|----------------------------|------|------|-------|-------|
| <b>Growth (%)</b>          |      |      |       |       |
| Net Sales                  | 16.5 | 13.1 | 8.8   | 12.9  |
| EBITDA                     | 13.2 | 14.8 | 49.8  | 17.2  |
| Net profit                 | 6.1  | 14.0 | 45.8  | 16.6  |
| <b>Margin (%)</b>          |      |      |       |       |
| EBITDA                     | 15.7 | 15.9 | 21.9  | 22.8  |
| EBIT                       | 13.8 | 13.5 | 19.4  | 20.3  |
| NPM                        | 10.5 | 10.6 | 14.2  | 14.7  |
| <b>Return Ratios (%)</b>   |      |      |       |       |
| RoE                        | 24.9 | 24.2 | 29.6  | 28.3  |
| RoCE                       | 33.9 | 32.0 | 41.2  | 40.1  |
| <b>Per share data</b>      |      |      |       |       |
| EPS                        | 8.8  | 10.0 | 14.6  | 17.1  |
| DPS                        | 2.7  | 2.9  | 3.8   | 4.5   |
| <b>Valuation(x)</b>        |      |      |       |       |
| P/E                        | 35.0 | 60.0 | 41.0  | 35.2  |
| EV/EBITDA                  | 23.3 | 39.9 | 26.4  | 22.3  |
| EV/Net Sales               | 26.5 | 47.1 | 29.8  | 25.0  |
| P/B                        | 8.0  | 13.5 | 11.0  | 9.1   |
| <b>Turnover Ratios (x)</b> |      |      |       |       |
| Net Sales/GFA              | 3.2  | 3.0  | 2.8   | 2.9   |
| Sales/Total Assets         | 1.5  | 1.6  | 1.5   | 1.4   |

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