We initiate coverage on the Pidilite Industries Ltd (PIL) stock with an 'ACCUMULATE' rating and a target price of Rs 323 based on 27x FY15E earnings. We believe that PIL can command a premium over the peer group considering 1) relatively higher growth in company’s estimated consolidated revenues through FY13-15E 2) company’s healthy balance sheet 3) strong brand perception with virtual absence of significant competition in the domestic market and 4) potential case of turnaround in the overseas business.

PIL is India’s leading player in consumer and specialties chemicals space. The company enjoys 60% market share in India and its 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. PIL’s Fevicol has become synonymous with adhesives in India and has been ranked as largest selling adhesive brand in Asia. Pidilite, on back of strong R&D base has strategized to grow its international presence through acquisitions and by setting up its manufacturing facilities/sales offices in important regions including USA, UK, Singapore, Brazil, UAE, Egypt and South Africa.

We project revenue growth at 17.6% CAGR between FY13-15E in consolidated revenues from Rs. 36.5 bn in FY13 to Rs 50.6 bn in FY15E on back of 1) resilient domestic demand across sectors for adhesives and sealants 2) strong brand perception in domestic adhesive market leading to higher retail sales 3) robust distribution network offering pan India presence and 4) reduction in losses at international subsidiaries. At current price of Rs 290, PIL stock is trading at 23.8 x P/E and 16.9 x EV/EBITDA on FY15E earnings.

Key Investment Rationale

- **Leadership position in the domestic adhesives market; strong brand recall differentiates PIL from competition.** PIL is a prominent player which enjoys leadership position (over 60%) in Indian adhesive market on back of 1) strong brand acceptance in adhesive space 2) robust distribution network offering pan India presence 3) efficient cost controls providing price advantage to the end user. The domestic adhesives market has grown at 20% CAGR between FY10-13.

- **International presence offers geographical diversification; turnaround in key overseas subsidiaries could potentially add to future cash flow generation.** PIL, through its subsidiaries is present in over 55 countries including USA, Brazil, Thailand, Singapore, Bangladesh, Egypt and Dubai. Currently Pidilite derives 13% of revenues from its international operations. PIL’s overseas subsidiaries revenues have been growing at a reasonable pace (10% CAGR between FY10-13) with the exception of those in Brazil and Egypt. In our projection, we build margin improvement in FY14E and FY15E on back of 1) measures taken by the management with respect to HR restructuring to improve profitability in Americas and 2) continued momentum in South Asia. We believe that these factors should help accelerate consolidated cash flow generation for the company.

- **Extensive Distribution Network.** PIL has a robust network of over 4000 distributors spread across India including tier I, tier II and tier III cities. Company enjoys wide reach and would continue to focus on interior locations as significant growth is expected to come from these areas.
Sustained emphasis on research & development initiatives provides competitive edge to the company. PIL manufacturers its products in house and pays considerable emphasis on the research and development capabilities. It constantly ventures into new initiative related to technological advancement. Company consistently deploys resources for adding and modifying current product specifications making it valuable to the end users. Company currently has 22 products in the category of Synthetic Resins, Adhesives, Sealants and construction chemicals. Most of the products are developed in house by the company.

Company to maintain high growth in financials; higher operating margins and shorter cash conversion cycle likely to aid to free cash flow generation. We project 17.6% CAGR between FY13-15E in consolidated revenues from Rs.36.5 bn in FY13 to Rs.50.6 bn in FY15E on back of 1) resilient domestic demand across sectors for adhesives and sealants and 2) pick up in international business.

Within the revenue streams, we expect domestic sales to grow at 19% CAGR between FY13-15 on back of 1) strong brand perception in adhesive space leading to higher retail sales 2) robust distribution network offering pan India presence and 3) growth in real estate sector strengthening construction chemicals division.

We project slight increase in the EBITDA margins over FY14E due to operating leverage. We do not build major increase in VAM (company’s key raw material) in constant currency terms. We project consolidated EBITDA margins at 17% and 17.1% in FY14E and FY15E respectively. We believe that the company is likely to post improvement in operating cash flow from Rs 3.8 bn in FY13 to Rs 6.3 bn in FY15E.

Current valuations appear reasonable vis-à-vis the potential growth in profits. At current price of Rs 290, PIL stock is trading at 23.8 x P/E and 16.9 x EV/EBITDA on FY15E earnings. We note that the company has higher return on employed capital and shorter working capital cycle than most of the companies in the peer group. We believe that recent run up in the stock price/expected further rerating would capture company’s healthy balance sheet, strong brand perception with virtually absence of significant competition in the domestic market and probable case of turnaround in the overseas business. We value PIL stock at 27x FY15E (16.9x EV/EBITDA) earnings and arrive at a target price of Rs 323 per share. In view of limited upside to our target price we recommend ‘AC-CUMULATE’ rating on company’s stock.

Key Concerns

- Sharp increase in raw material prices. Sharp increase in the raw material prices especially VAM (Vinyl Acetate monomer) which the key raw material for the company would negatively affect company’s profitability. In our estimates, we build a moderate increase in key raw material prices going ahead.

- Slowdown in domestic industrial activity. Specialty Industrial Chemicals (SIC) segment growth is highly correlated with the overall economic activity in the country. Any slowdown in the industrial spending would imply lower off take of company’s products.

- Forex related risk. PIL primarily imports its key raw material VAM from overseas markets. Sharp depreciation in INR could likely pose negative risks to our estimated financials.

- Delays in commissioning of elastomer project. Company has been making investments in Elastomer project through past few years. Any delays in revenue generation in elastomer project could depress company’s financials.