

Asian Paints

CMP: INR729
TP: INR840 (+15%)
Upgrade to Buy

Valuations no longer euphoric; upgrade to Buy

No immediate demand revival; multiple growth drivers in place

BSE SENSEX	S&P CNX
27,116	8,175
Bloomberg	APNT IN
Equity Shares (m)	959.2
M.Cap. (INR b) / (USD b)	699.3/11.0
52-Week Range (INR)	923/551
1, 6, 12 Rel. Per (%)	-3/-5/24
Avg Val(INRm)/Vol'000	1081/1464
Free float (%)	47.2

Financials & Valuation (INR b)

Y/E MAR	2015	2016E	2017E
Sales	140.1	158.0	182.3
EBITDA	20.6	27.0	33.2
Adj. PAT	14.2	18.7	23.1
Adj. EPS(INR)	14.8	19.5	24.0
EPS Gr. (%)	15.8	31.4	23.4
BV/Sh.(INR)	49.4	58.6	70.7
RoE (%)	32.4	36.1	37.2
RoCE (%)	34.6	39.2	41.3
Payout (%)	41.1	42.3	42.4
Valuations			
P/E (x)	49.1	37.4	30.3
P/BV (x)	14.7	12.4	10.3
EV/EBITDA(x)	33.3	25.2	20.2
Div. Yld (%)	1.0	1.3	1.6

- Recent correction provides good entry opportunity; upgrade to Buy: Our primary concern on APNT, despite our long-standing preference for its business model, has been expensive valuations. The stock witnessed euphoric re-rating post the crude price correction, backed by the expectations (unrealistic, in our view) that APNT's EBITDA margins will cross the 20% barrier. After the recent correction of ~20%, we believe valuations now allow for a decent entry opportunity in what is essentially a play on long-term discretionary consumption story of India (backed by demographics and urbanization). Thus, we **upgrade to Buy** with an unchanged target price (INR 840) and unchanged target P/E (35x FY17 EPS)
- No immediate relief in decorative paints volume growth: Despite the improvement in consumer sentiments in India post the general elections, recovery on the ground for discretionary consumption was slow and volume growth of APNT's decorative paints business decelerated in 2HFY15 (from ~11% volume growth in 1Q15 to ~4% in 4Q15). We expect the demand to remain subdued in the near term (per our dealer checks) and pick up gradually in 2HFY16. Despite the noise around monsoon and its consequent impact on demand for consumer goods, we believe relevance of monsoons has declined for consumer companies over the years—owing to better distribution reach, higher incomes and targeted rural specific initiatives by companies. Thus, barring a severe draught, we don't expect demand to deteriorate. We note that the management in the recent analyst meet pointed to rural growth being higher than urban growth, but highlighted that the gap is narrowing. We model in mid-single digit volume growth for the next two quarters, but forecast a double-digit growth in 2HFY16—aided by pick-up in demand and benign base (volume growth in 2HFY15 was 3.5%).
- Medium-term story robust: Notwithstanding the near-term demand concerns, APNT's medium-term volume growth outlook remains robust—given the lower consumption (per capita consumption of only ~2.5kg vs. global average of 7kg; shift in consumer preference toward branded players, given higher discretionary income) and APNT's market leadership (~55% market share and stable/gaining despite rising competition). Demand revival will also drive operating leverage in 2HFY16 and FY17E. The government's focus on housing (the Cabinet on Wednesday cleared the '*Housing for All by 2022*' scheme, which is aimed at providing housing for urban poor) and *Smart Cities* could also be an incremental driver of volume growth going forward. However, APNT would not receive material benefits out of these projects as it is not focused on project customers (lower-margin business).

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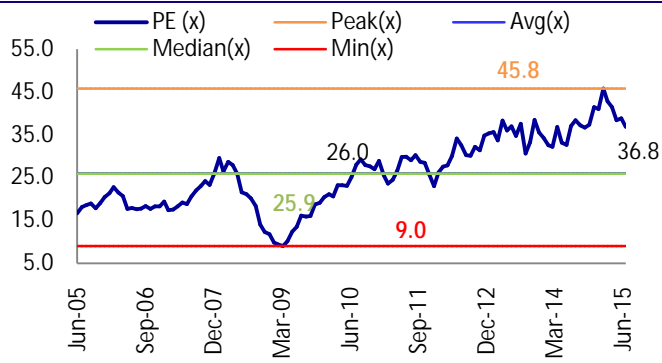
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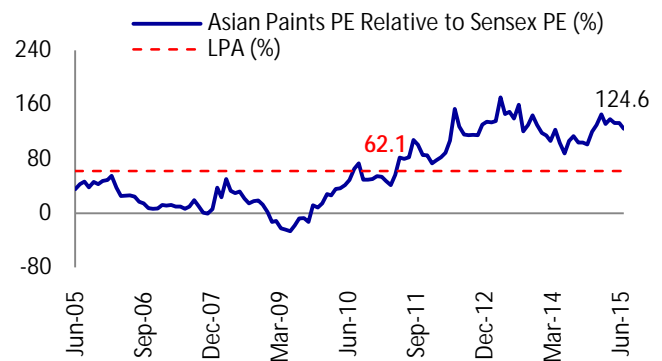
- n **Raw material scenario benign, but may not result in supernormal margin gains:** Benefits of lower input cost (crude and crude derivatives) have kicked in for APNT beginning 3QFY15 (APNT gross margin expanded 280bp and 320bp in 3Q and 4Q, respectively). We note that in the previous cycle in FY09-10, when crude prices corrected by 18%, gross margin for APNT and Berger Paints expanded by ~300-500bp for sequential quarters. APNT's FY10 PAT doubled YoY; however, it also benefited in FY10 from reduction in excise duty. Our discussion with the management of various paint companies does not point toward any supernormal margin expansion (expectations of which drove valuations to euphoric levels in 3Q15, in our view). Most of the paint companies will look to pass on gains from input cost correction to revive volume growth, in our view. We model in 360bp gross margin expansion over FY15-17.
- n **Additional drivers for medium-term growth:** a) **Industrial paints business (6% of revenues):** Revival of growth in industrial paints as both auto as well as non-auto segments are increasingly witnessing good demand, and soft base should benefit segment growth. b) **International operations (13% of revenues):** Stabilization and expansion of international operations should aid overall profitability, in our view. We note APNT has expanded its operations in Ethiopia (acquired Kadisco Paints) and recently got approval to set up facility in Indonesia. c) **Scaling up of home improvement business:** We believe APNT's transition from being a paint company to a complete provider of home décor solutions via its acquisition of Sleek and Ess Ess could provide it with incremental levers of growth in the medium term. Both these brands were regional in nature, with predominant presence in Western and Southern geographies. APNT is now planning to take these brands to a national level and also bringing the service levels to APNT standards (both these businesses have now been co-branded with APNT).
- n **Valuation and view:** Near-term concerns notwithstanding, we are positive on the long-term prospect of the decorative paints industry. Improving macros and consumer sentiment should drive volume growth going ahead; we estimate 27.3% EPS CAGR over FY15-17, with underlying gross and EBITDA margin expansion of 360bps and 350bps, respectively. APNT offers a strong franchise with robust distribution network (second Paints player has distribution reach ~50% of APNT), strong logistic management (key competitive advantage in the Indian paints industry), unmatched trade servicing standards and by being the thought leader in the space. Recent correction pertaining to concerns around slow pick-up in demand provides a good medium-term entry point, in our view. **Upgrade to Buy** with a target price of INR840 (35x FY17E, three-year average P/E).

Exhibit 1: Asian Paints P/E (x)



Source: Company, MOSL

Exhibit 2: Asian Paints P/E relative to sensex (%)



Source: Company, MOSL

Exhibit 3: Gross margin performance during previous crude correction cycle (FY09-10)

	4QFY09	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11
GDP YoY growth (%) at constant prices (old series)	3.5	5.9	9.3	7.7	11.4	9.1	8.2	8.7
Average Crude Prices (USD/bbl)	46	60	69	76	77	79	77	87
Change in Crude Prices (%)	(52.5)	(51.2)	(41.2)	31.4	69.2	32.6	11.7	15.8
Net Sales (INR m)								
Asian Paints	14,249	14,602	17,239	16,200	18,768	18,302	18,108	20,996
Change (%)	25.8	17.6	16.9	22.6	31.7	25.3	5.0	29.6
Berger Paints	3,507	3,715	4,528	4,251	4,347	4,909	5,172	5,492
Change (%)	(2.1)	5.9	21.9	(6.1)	2.3	12.9	5.4	6.2
Gross Profit (INR m)								
Asian Paints	5,511	6,411	7,441	7,073	8,304	7,815	7,911	8,461
Berger Paints	1,242	1,395	1,626	1,486	1,560	1,768	1,894	1,957
Gross margin (%)								
Asian Paints	38.7	43.9	43.2	43.7	44.2	42.7	43.7	40.3
Berger Paints	35.4	37.5	35.9	34.9	35.9	36.0	36.6	35.6
Gross margin expansion (bps)								
Asian Paints	(3.1)	4.4	4.3	7.5	5.6	(1.2)	0.5	(3.4)
Berger Paints	0.6	5.4	3.6	1.3	0.5	(1.5)	0.7	0.7
EBITDA Profit (INR m)								
Asian Paints	1,791	2,758	3,228	3,181	3,108	3,471	3,315	3,449
Berger Paints	307	422	507	420	414	537	539	553
EBITDA margin (%)								
Asian Paints	12.6	18.9	18.7	19.6	16.6	19.0	18.3	16.4
Berger Paints	8.8	11.4	11.2	9.9	9.5	10.9	10.4	10.1
EBITDA margin expansion (bps)								
Asian Paints	(1.2)	5.0	4.6	11.4	4.0	0.1	(0.4)	(3.2)
Berger Paints	(1.8)	3.0	1.9	2.4	0.8	(0.4)	(0.8)	0.2

Source: Company, MOSL

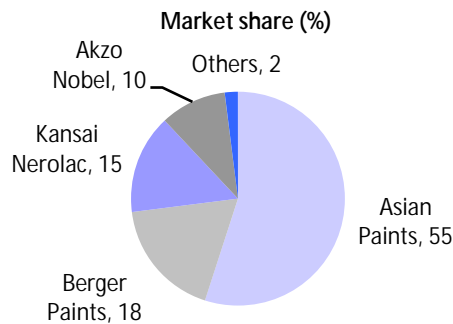
Exhibit 4: Innovations leader in Paints industry; growth across various distribution formats

Format	Remark
Colour World	APNT broadened its Color World network by adding 3000 stores, taking the total count to 30,000 in FY15. During FY14 APNT added 3,200 Colour World stores
EzyColour Retailer Program	In FY15, APNT implemented 'Ezycolour Retailer' program (Self Help Colour and Product Consultancy Kiosk) in more than 2,000 dealerships across the country. During FY14 this facility was available at 150 retailers
Colour Ideas Stores	APNT added 70 new Colour Idea stores taking the total count to more than 200 . The stores provided in-store colour consultancy to more than 125,000 customers during FY15 (80,000 customers in FY14).
Colour Stores	APNT provided colour consultancy to more than 9,000 customers at its signature experience stores (5,000 customers in FY14)
Ezycolour Store	The company initiated Ezycolour store format at Kolkata (previously present in Mumbai and Delhi), which provided colour consultation to 2,000 customers
Colour Consultancy at Home	Coour Consultancy at Home was extended to 24 cities with more than 16,000 customers having availed this service in FY15. During FY14, this service was available to 13 cities with more than 10,000 customers availing this service.

Source: Company, MOSL

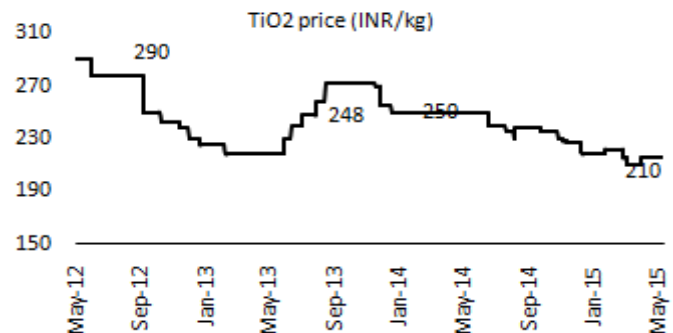
Story in charts

Exhibit 5: APNT dominates with 55% market share



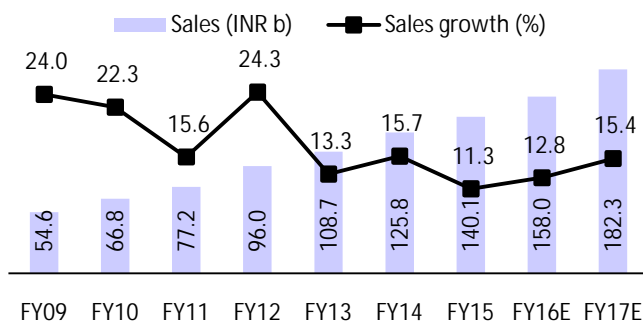
Source: Industry, Company, MOSL

Exhibit 6: Tio2 prices down 14% YoY



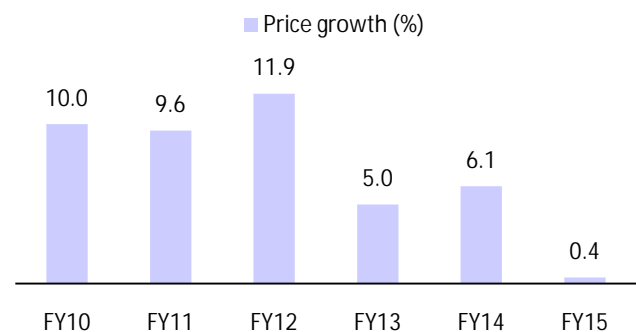
Source: Industry, Company, MOSL

Exhibit 7: Revenues to post 14.1% CAGR over FY15-17E



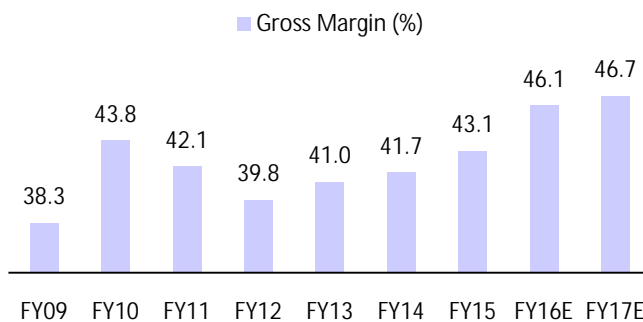
Source: Company, MOSL

Exhibit 8: Weighted average price increase of 0.4% in FY15



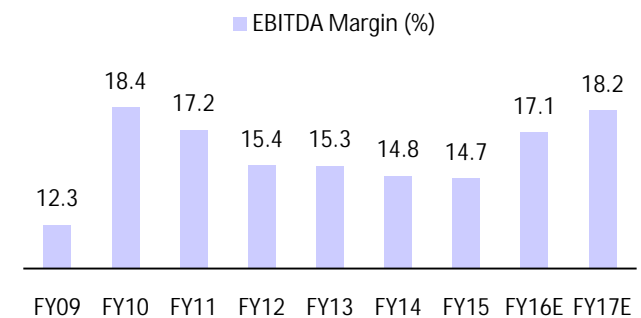
Source: Company, MOSL

Exhibit 9: Gross margin to expand 360bp over FY15-17E



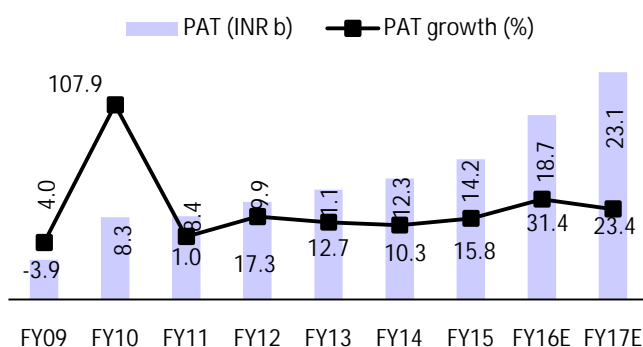
Source: Company, MOSL

Exhibit 10: EBITDA margin expand 350bp over FY15-17E



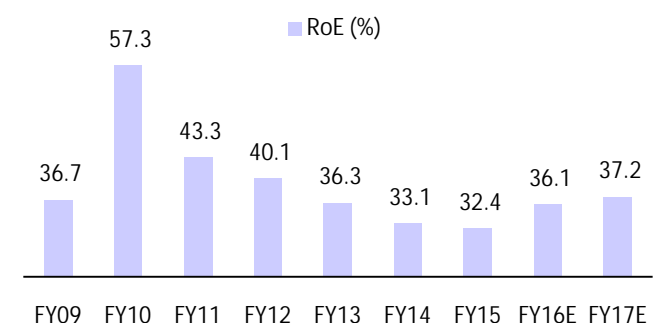
Source: Company, MOSL

Exhibit 11: Expect 27.3% PAT CAGR over FY15-FY17E



Source: Company, MOSL

Exhibit 12: Return Ratios (x): RoE remained in a band



Source: Company, MOSL

Financials and valuations

Income Statement						(INR Million)	
Y/E March	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E
Net Sales	77,223	95,983	108,744	125,816	140,053	157,990	182,278
Change (%)	15.6	24.3	13.3	15.7	11.3	12.8	15.4
Raw Materials	44,746	57,770	64,130	73,407	79,715	85,162	97,150
Gross Profit	32,477	38,213	44,614	52,409	60,339	72,828	85,128
Margin (%)	42.1	39.8	41.0	41.7	43.1	46.1	46.7
Operating Expenses	19,196	23,465	27,936	33,762	39,759	45,846	51,901
EBITDA	13,281	14,749	16,677	18,647	20,579	26,981	33,227
Change (%)	8.2	11.1	13.1	11.8	10.4	31.1	23.1
Margin (%)	17.2	15.4	15.3	14.8	14.7	17.1	18.2
Depreciation	1,131	1,211	1,546	2,457	2,659	3,078	3,516
Int. and Fin. Charges	232	410	367	422	348	368	368
Other Income	680	1,413	1,788	2,674	3,472	3,981	4,563
Profit before Taxes	12,597	14,541	16,552	18,442	21,045	27,516	33,907
Margin (%)	16.3	15.1	15.2	14.7	15.0	17.4	18.6
Tax	3,502	4,274	4,364	5,378	6,576	8,117	10,002
Deferred Tax	282	61	593	338	-81	413	509
Tax Rate (%)	30.0	29.8	29.9	31.0	30.9	31.0	31.0
PBT Before Minority	8813	10206	11595	12727	14549	18987	23397
Minority Interest	381	319	456	440	322	292	329
Adjusted PAT	8,432	9,887	11,139	12,288	14,227	18,695	23,068
Change (%)	1.0	17.3	12.7	10.3	15.8	31.4	23.4
Margin (%)	10.9	10.3	10.2	9.8	10.2	11.8	12.7
Exceptional/Prior Period inc	0	0	0	-100	-276	0	0
Reported PAT	8,432	9,887	11,139	12,188	13,952	18,695	23,068

Balance Sheet						(INR Million)	
Y/E March	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E
Share Capital	959	959	959	959	959	959	959
Reserves	20,915	26,526	32,884	39,433	46,465	55,240	66,858
Net Worth	21,874	27,485	33,843	40,392	47,424	56,199	67,817
Loans	2,334	3,411	2,510	2,492	4,182	4,182	4,182
Other Liability	979	1,063	1,638	1,970	1,911	2,340	2,868
Minority Interest	1,099	1,367	1,608	2,460	2,637	2,929	3,257
Capital Employed	26,287	33,326	39,598	47,314	56,153	65,650	78,124
Gross Block	19,878	21,043	33,851	36,621	38,664	45,664	50,664
Less: Accum. Depn.	7,151	8,453	9,884	12,419	14,522	17,600	21,116
Net Fixed Assets	12,727	12,590	23,967	24,202	24,142	28,064	29,548
Capital WIP	433	6,171	592	716	1,960	1,960	1,960
Investments	4,290	3,547	2,957	14,236	15,878	17,231	26,723
Curr. Assets, L&A	28,284	34,398	39,887	40,187	44,685	54,742	62,298
Inventory	13,054	15,989	18,303	20,699	22,585	24,672	28,965
Account Receivables	5,731	7,813	9,809	11,103	11,799	13,418	15,981
Cash and Bank Balance	6,262	6,243	7,367	2,290	2,044	7,299	6,754
Others	3,237	4,354	4,408	6,095	8,257	9,353	10,599
Curr. Liab. and Prov.	19,819	23,796	28,247	33,441	32,970	38,806	44,864
Account Payables	10,874	12,625	14,416	17,457	15,488	18,666	21,293
Other Liabilities	5,277	6,722	8,438	9,298	9,892	10,892	11,994
Provisions	3,668	4,449	5,394	6,686	7,591	9,249	11,576
Net Current Assets	8,465	10,602	11,639	6,746	11,714	15,936	17,434
Goodwill on Cons.	372	415	442	1,414	2,458	2,458	2,458
Application of Funds	26,287	33,326	39,598	47,313	56,153	65,650	78,124

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E
Basic (INR)							
EPS	8.8	10.3	11.6	12.8	14.8	19.5	24.0
Cash EPS	10.0	11.6	13.2	15.4	17.6	22.7	27.7
BV/Share	22.8	28.7	35.3	42.1	49.4	58.6	70.7
DPS	3.7	4.6	5.4	6.2	7.3	9.7	11.9
Payout %	36.4	38.8	39.6	41.4	41.1	42.3	42.4

Valuation (x)

P/E				56.9	49.1	37.4	30.3
Cash P/E				47.4	41.4	32.1	26.3
EV/Sales				5.4	4.9	4.3	3.7
EV/EBITDA				36.7	33.3	25.2	20.2
P/BV				17.3	14.7	12.4	10.3
Dividend Yield (%)				0.8	1.0	1.3	1.6

Return Ratios (%)

RoE	43.3	40.1	36.3	33.1	32.4	36.1	37.2
RoCE	51.5	45.4	41.5	37.3	34.6	39.2	41.3

Working Capital Ratios

Debtor (Days)	27	30	33	32	31	31	32
Asset Turnover (x)	3.6	4.1	3.1	4.1	3.9	3.6	3.9

Leverage Ratio

Debt/Equity (x)	0.1	0.1	0.1	0.1	0.1	0.1	0.1
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Cash Flow Statement

(INR Million)

Y/E March	FY11	FY12	FY13	FY14	FY15	FY16E	FY17E
OP/(loss) before Tax	12,597	14,541	16,552	18,442	21,045	27,516	33,907
Depreciation	1,131	1,211	1,546	2,457	2,659	3,078	3,516
Net interest	-448	-1,004	-1,421	-2,252	-3,124	-3,613	-4,195
Direct Taxes Paid	-3,502	-4,274	-4,364	-5,378	-6,576	-8,117	-10,002
(Incr)/Decr in WC	-1,771	-2,156	87	-184	-5,215	1,033	-2,043
CF from Operations	8,007	8,318	12,400	13,086	8,789	19,897	21,183
Incr in FA	-1,235	-6,903	-7,230	-2,894	-3,287	-7,000	-5,000
Free Cash Flow	6,773	1,415	5,170	10,192	5,502	12,897	16,183
Pur of Investments	1,951	742	591	-11,279	-1,642	-1,353	-9,492
CF from Invest.	717	-6,161	-6,639	-14,173	-4,930	-8,353	-14,492
Issue of Shares	0	0	0	0	0	0	0
Incr in Debt	42	1,077	-902	-18	1,690	0	0
Dividend Paid	-3,571	-4,459	-5,155	-5,904	-6,981	-9,259	-11,447
Int./Div. Received	680	1,413	1,788	2,674	3,472	3,981	4,563
Interest Paid	-232	-410	-367	-422	-348	-368	-368
Others	-440	202	-2	-320	-1,940	-644	16
CF from Fin. Activity	-3,521	-2,177	-4,638	-3,990	-4,106	-6,290	-7,236
Incr/Decr of Cash	5,204	-19	1,123	-5,077	-247	5,255	-545
Add: Opening Balance	1,058	6,262	6,243	7,367	2,290	2,044	7,299
Closing Balance	6,262	6,243	7,367	2,290	2,043	7,298	6,754

E: MOSL Estimates

Corporate profile: Asian Paints

Company description

Asian Paints is India's largest paint manufacturer and marketer, with a dominant share in the decorative segment. For the industrials and automotive segment, it has a JV with PPG of the US. Asian Paints acquired Berger International of Singapore to expand its operations in other markets in Asia, the *Middle East and the Caribbean*.

Exhibit 13: Sensex rebased

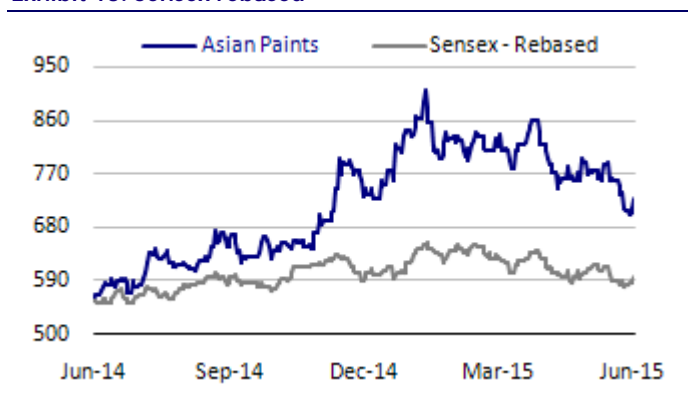


Exhibit 14: Shareholding pattern (%)

	Mar-15	Dec-14	Mar-14
Promoter	52.8	52.8	52.8
DII	8.8	9.9	9.4
FII	18.1	17.3	18.0
Others	20.3	20.1	19.9

Note: FII Includes depository receipts

Exhibit 15: Top holders

Holder Name	% Holding
Ojasvi Trading Private Limited	4.9
Life Insurance Corpn.Of India	4.9
Aberdeen Global Indian Equity (Mauritius) Ltd	1.1

Exhibit 16: Top management

Name	Designation
Ashwin Choksi	Chairman
Ashwin Dani	Vice Chairman
K B S Anand	Managing Director & CEO
Jayesh Merchant	CFO & Company Secretary

Exhibit 17: Directors

Name	Name
Ashwin Choksi	Mahendra Shah*
Ashwin Dani	Deepak Satwalekar*
K B S Anand	Malav Dani
Amar Vakil	M K Sharma*
Mahendra Choksi	Abhay Vakil
S Sivaram*	Vibha Paul Rishi*
S Ramadorai*	Amrita Vakil
Dipankar Basu*	

*Independent

Exhibit 18: Auditors

Name	Type
BSR & Co LLP	Statutory
Shah & Co	Statutory
RA & Co	Cost Auditor

Exhibit 19: MOSL forecast v/s consensus

EPS (INR)	MOSL forecast	Consensus forecast	Variation (%)
FY16	19.5	19.7	-0.8
FY17	24.0	23.8	0.9

NOTES

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