

January 24, 2018

# Asian Paints (ASIPAI)

₹ 1167

## Muted volume growth; margins expand...

- Asian Paints (APL) witnessed 10.5% growth in net sales to ₹ 4260.5 crore (I-direct estimate - ₹ 4460.4 crore) mainly led by a mix of volume growth and price hikes. We believe volume growth has been to the tune of 5% during the quarter. Decorative paints demand remained muted for the company due to lower demand in south India that was impacted by extended monsoons and continued GST related disruptive environment, in general
- Operating margin improved 120 bps to 20.9% (I-direct estimate: 19.0%) due to 6.4% decline in overhead expenses as investment in renewable energy resulted in savings in power cost. Simultaneously, lower marketing expenses have also helped in margin expansion. We believe input tax credits in many overhead expenses also resulted in margin expansion
- Led by higher operating profit and 19.8% growth in other income, net profit increased 16.1% YoY to ₹ 567.2 crore (vs. I-direct estimate: ~₹ 545.5 crore)

### Leader in paint segment, economic recovery to drive volume growth

APL is the industry leader in the decorative paint segment with 53% market share and a dealer network of over 40,000 across India. It derives 89% of its topline from the decorative segment while the rest comes from the industrial segment. We believe paint companies will be key beneficiaries of the government's key reforms like implementation of GST along with thrust to increase rural income levels. Normal monsoon and additional government expenditure in rural schemes is likely to boost the rural disposable income and, in turn, their consumption. GST would reduce tax arbitrage for unorganised segment (25-30% of total industry). This will provide additional benefit to organised players in the long run (shift in demand of branded product category). With the expansion in paints capacity in Andhra Pradesh and Karnataka, APL is best placed to capture this additional demand, in future. We model revenue CAGR of 13.4% in FY17-20E led by 9.3% CAGR volume growth for decorative paints from tier II, tier III cities and a shorter repainting cycle.

### APL to maintain profitability in near term amid rising input prices

To avoid inflationary pressure, APL has successfully passed on the price hike (~6-7%) to its customers previously. However, the EBITDA margin tapered off in FY12-13 as raw material prices moved up sharply (~40% of raw material are imported) hit by an elevated dollar value against the rupee (up 19% in FY11, FY13) and bottoming out titanium dioxide (TiO<sub>2</sub>) prices. With stabilisation of crude oil prices in FY15-17, operating margins rose sharply (from 16% to 20%) during this period. We believe operating margins at the current elevated levels would not sustain while increasing pressure from crude related derivatives would result in a slight contraction (to 18% in FY20E), going forward.

### Fairly valued; recommend HOLD

We expect the company to record sales CAGR of 13.4% in FY17-20E led by estimated volume CAGR of 9.3%. We believe that being a market leader in the decorative paint segment, any price hike in raw material would be easily passed on to its customers. The company would maintain EBITDA margin at ~18% despite higher raw material prices. As a result, PAT is likely to record a CAGR of 13.8% for FY17-20E. Also, high cash on books could lead to an increase in dividend payout & improvement in RoEs. The stock is discounting all near term positives at the CMP. Hence we maintain **HOLD** recommendation with a target price of ₹ 1240/share.

Rating matrix		
Rating	:	Hold
Target	:	₹ 1240
Target Period	:	12 months
Potential Upside	:	6%

What's Changed?		
Target		Unchanged
EPS FY19E	Changed from ₹ 27.6 to ₹ 26.9	
EPS FY20E	Introduced at ₹ 31.0	
Rating		Unchanged

Quarterly Performance					
	Q3FY18	Q3FY17	YoY (%)	Q2FY18	QoQ (%)
Revenue	4,260.5	3,857.1	10.5	4,274.2	-0.3
EBITDA	891.2	757.0	17.7	801.1	11.2
EBITDA (%)	20.9	19.6	129bps	18.7	217bps
PAT	567.0	489.3	15.9	593.7	-4.5

Key Financials				
₹ Crore	FY17E	FY18E	FY19E	FY20E
Revenue	15,290	17,872	21,083	24,944
EBITDA	3,021.4	3,361.5	3,804.4	4,515.9
Net Profit	2,016.2	2,195.3	2,576.6	2,973.6
EPS (₹)	21.0	22.9	26.9	31.0

Valuation summary				
	FY17E	FY18E	FY19E	FY20E
P/E	55.3	50.8	43.3	37.5
Target P/E	59.0	54.2	46.2	40.0
EV / EBITDA	36.4	32.8	28.9	24.4
P/BV	14.7	12.9	11.2	9.7
RoNW (%)	29.8	26.3	27.0	27.1
RoCE (%)	42.1	38.1	36.2	36.5

Stock data	
Particular	Amount
Market Capitalization (₹ Crore)	111,459.0
Total Debt (FY17) (₹ Crore)	545.5
Cash and Investments (FY17) (₹ Crore)	1,933.4
EV (₹ Crore)	110,071.1
52 week H/L (₹)	1262/851
Equity capital (₹ Crore)	95.9
Face value (₹)	1.0

Price performance (%)				
	1M	3M	6M	12M
Asian Paints	1.1	4.7	13.2	7.3
Berger Paints	13.4	10.0	12.1	7.8
Kansai Nerolac	6.7	11.1	29.8	31.8
Akzo Noble	1.5	4.2	(9.0)	10.9

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## Variance analysis

	Q3FY18	Q3FY18E	Q3FY17	YoY (%)	Q2FY18	QoQ (%)	Comments
Revenue	4,260.5	4,460.4	3,857.1	10.5	4,274.2	-0.3	Net sales witnessed a growth of 10.5% led by the ~5% volume growth in decorative paints
Other Income	49.7	49.2	41.3	20.3	53.4	-7.0	
Raw Material Exp	2,461.0	2,564.2	2,169.1	13.5	2,504.2	-1.7	Gross margins contracted by 160 bps mainly due to the increasing Titanium di-oxide prices and increasing trend of Crude based derivatives
Employee Exp	271.1	310.7	250.4	8.3	282.2	-3.9	
Manufacturing & Other exp	637.3	739.7	680.6	-6.4	686.7	-7.2	Overhead expenses declined by 6.4% mainly due to the lower power cost on the back of company's investment in renewable energy and simultaneously lower marketing expenses. We believe company would have got benefits on Input tax credits
EBITDA	891.2	845.8	757.0	17.7	801.1	11.2	
EBITDA Margin (%)	20.9	19.0	19.6	129 bps	18.7	217 bps	Improvement in operating margins on the back of lower overhead exp to sales
Depreciation	89.6	93.7	84.5	6.0	88.9	0.8	
Interest	9.2	9.9	9.0	1.9	8.8	5.0	
Exceptional items	0.0	0.0	14.9		67.5	-100.0	
PBT	841.9	791.5	719.7	17.0	824.3	2.1	
Total Tax	291.3	261.2	243.0	19.9	245.9	18.5	
PAT	567.0	545.5	489.3	15.9	593.7	-4.5	Led by higher EBITDA, net profit increased by 15.9% to ₹ 567 crore

## Key Metrics

Volume growth (%)	5.0	12.0	4.0		9.0		Volume growth has been muted as South India witnessed an extended monsoon. Simultaneously, Trade has not still fully recovered from GST related woes
Realisation growth (%)	5.0	1.3	-1.4		5.0		The company has taken price hike in March & May 2017

Source: Company, ICICIdirect.com Research

## Change in estimates

(₹ Crore)	FY18E			FY19E			FY20E New	Comment
	Old	New	% Change	Old	New	% Change		
Revenue	18,864.7	17,871.9	-5.3	22,821.5	21,082.6	-7.6	24,943.6	We have changed our FY18E & FY19E revenue estimates downwards mainly due to lower than expected volume growth in FY18
EBITDA	3,214.4	3,361.5	4.6	3,899.3	3,804.4	-2.4	4,515.9	
EBITDA Margin (%)	17.0	18.8	177bps	17.1	18.0	96bps	18.1	We have changed our operating margins estimates upward mainly due to expected lower overhead expenditure in FY18E & FY19E
PAT	2264.3	2195.3	-3.0	2645.4	2576.6	-2.6	2973.6	
EPS (₹)	23.6	22.9	-3.0	27.6	26.9	-2.6	31.0	

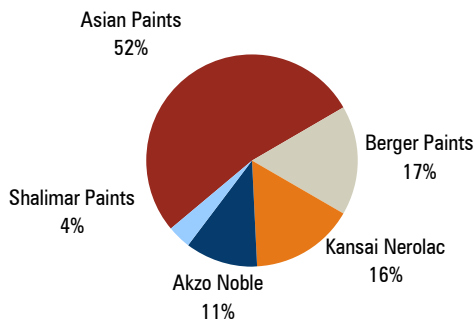
Source: Company, ICICIdirect.com Research

## Assumptions

	Current			Introduced	Earlier		Comments
	FY17E	FY18E	FY19E	FY20E	FY18E	FY19E	
Volume Growth (%)	13.1	5.6	12.4	10.0	8.3	15.8	We have changed our volume estimates downwards
Realisation Growth (%)	(2.6)	2.4	3.0	3.0	3.5	3.0	

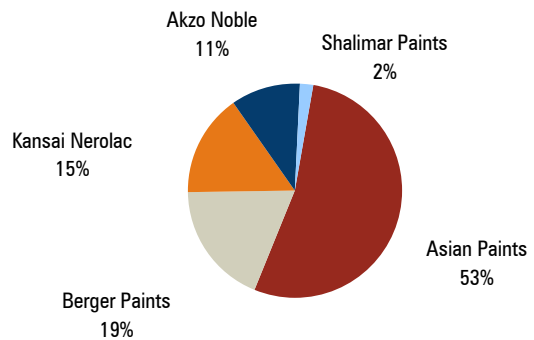
Source: Company, ICICIdirect.com Research

**Exhibit 1: Market share of leading paint companies (2008)**



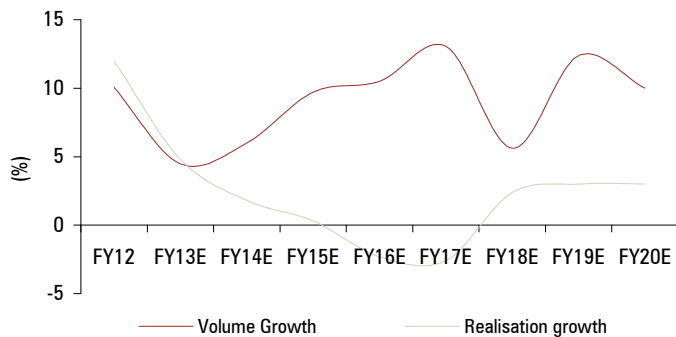
Source: Company, ICICIdirect.com Research

**Exhibit 2: Market share of leading paint companies (2016)**



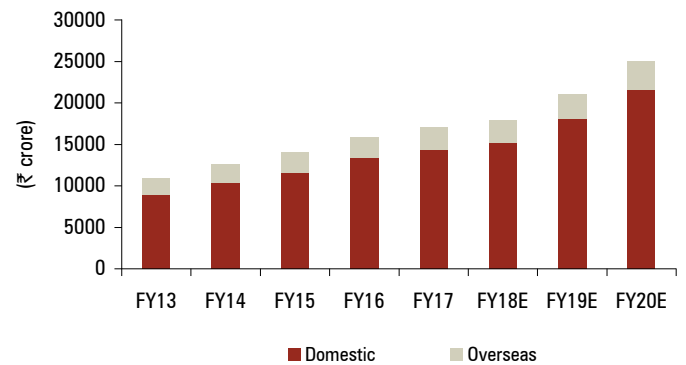
Source: Company, ICICIdirect.com Research

**Exhibit 3: Expect volume CAGR of 9.3% in FY17-20E**



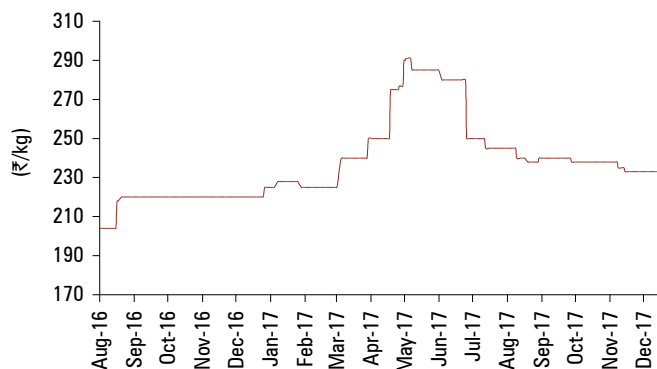
Source: Company, ICICIdirect.com Research

**Exhibit 4: Sales growth at 13.4% CAGR in FY17-20E**



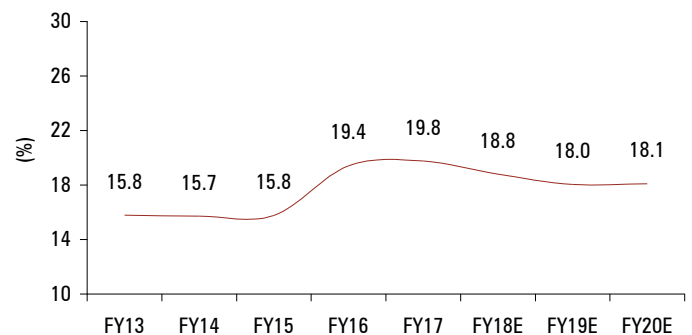
Source: Company, ICICIdirect.com Research

**Exhibit 5: Stabilising raw material cost (Tio2 prices)**



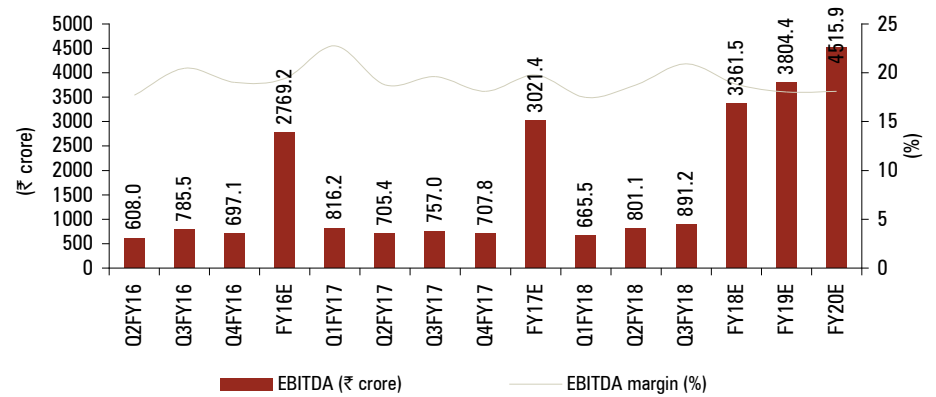
Source: Company, ICICIdirect.com Research

**Exhibit 6: Regular price hike to help in margin expansion**



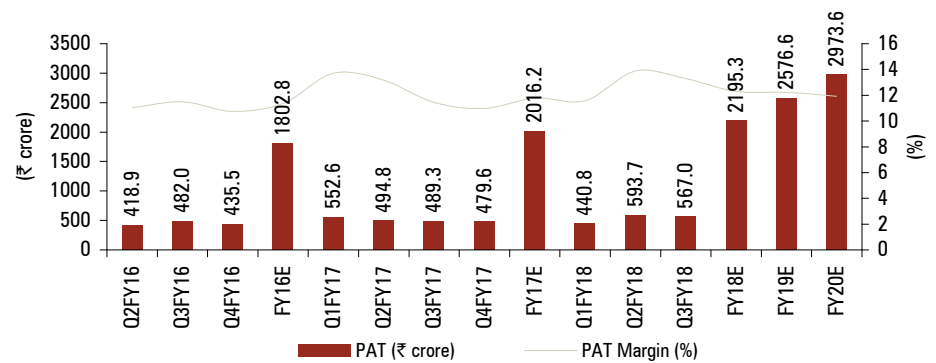
Source: Company, ICICIdirect.com Research

**Exhibit 7: Price hike at regular interval to support EBITDA margin (FY17-20E)**



Source: Company, ICICIdirect.com Research

**Exhibit 8: PAT likely to grow at 13.8% CAGR in FY17-20E**



Source: Company, ICICIdirect.com Research

#### Key conference call takeaways...

- Asian Paints reported 10.5% sales growth on the back of ~5% estimated volume growth and ~5% realisation growth. The company took 2% and 3% price hike in March and May 2017, respectively
- The muted volume growth can be attributed to extended monsoons in south India. The management also said sales volumes have not reached pre-GST levels indicating the GST related trade disruption is still not settled in some regions
- Gross margins declined 160 bps mainly due to increasing crude based derivatives and inching up of titanium di-oxide prices. However, a favourable product mix to emulsions has neutralised the impact of a sharp increase in raw material
- The company witnessed operating margins expansion of 130 bps mainly due to 100 bps savings overhead expenses. The company has invested in renewable energy that resulted in saving of power cost during the quarter. Simultaneously, marketing expenses also declined during the quarter as festive season sales were preponed to Q2 this year
- APL witnessed moderate growth in auto OEMs, auto refinish and general industrial business segment. Simultaneously, industrial coating JV AP-PPG also saw healthy growth during the quarter
- International sales were adversely impacted by exchange rate fluctuation in some key markets
- The home improvement segment, which includes Ess Ess bath fittings and Sleek, witnessed 21% growth in sales to ₹ 84.7 crore
- The company is expected to incur a capex of ₹ 1200 crore in FY19, which would largely be spent on new facilities in Mysuru, Karnataka and Vizag, Andhra Pradesh

## Outlook and valuation

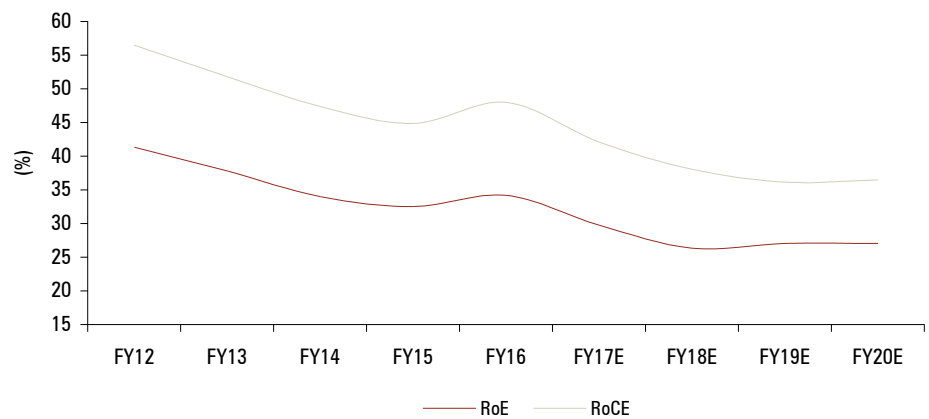
We believe the company will record sales CAGR of 13.4% in FY17-20E led by estimated volume CAGR of 9.3%. We believe that being a market leader in the decorative paint segment, any price hike in raw material would easily be passed on to its customers. The company is expected to maintain EBITDA margin at ~18% despite higher raw material prices. As a result, PAT is likely to record 13.8% CAGR for FY17-20E. Also, high cash on books could lead to an increase in dividend payout & improvement in RoEs. The stock is discounting all near term positives at CMP. Hence, we maintain **HOLD** recommendation with a target price of ₹ 1240/share.

**Exhibit 9: Valuation**

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY17	15290.2		21.0		55.3	36.4	29.8	42.1
FY18E	17871.9	16.9	22.9	8.9	50.8	32.8	26.3	38.1
FY19E	21082.6	18.0	26.9	17.4	43.3	28.9	27.0	36.2
FY20E	24943.6	18.3	31.0	15.4	37.5	24.4	27.1	36.5

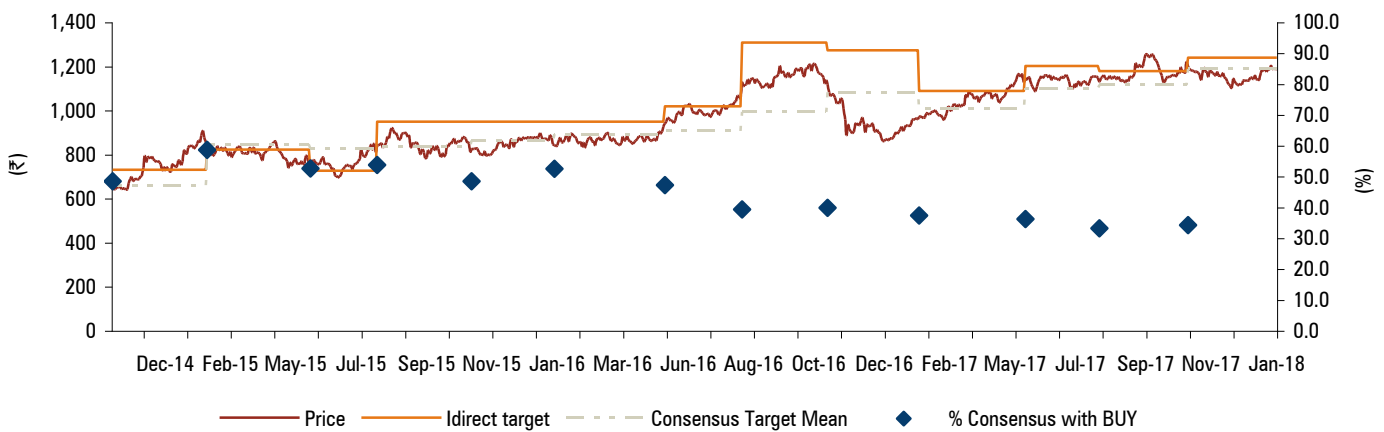
Source: Company, ICICIdirect.com Research

**Exhibit 10: Lighter balance sheet to help drive return ratios**



Source: Company, ICICIdirect.com Research

## Recommendation history vs. consensus



Source: Bloomberg, Company, ICICIdirect.com Research

## Key events

Date	Event
Mar-10	Robust volume growth along with substantial improvement in operating margins ~18% (best in last six seven years) results in a rally in the stock
May-10	Commences operations in its new manufacturing facility at Rohtak, Haryana with a capacity of 1,50,000 kl at an investment of ₹ 275 crore
Jan-11	Margin decline due to slow & steady inch up of key crude based raw material prices
Oct-11	Aggressive price hike to mitigate raw material pressure a respite to the stock price
May-12	Starts building a decorative paints plant in Khandala (Maharashtra) with a capacity of ~3,00,000 kl (scalable capacity of 4,00,000 kl)
Jan-13	Sustained volumes along with ~20% decline in Titanium dioxide lead to positive movement in the stock
Jul-13	Stock witnesses a steep decline in anticipation of adverse impact on results due to a volatile currency movement
Nov-13	With sustained volumes and strong margins in Q2FY14 contrary to expectation, the stock recovers and makes new high in November
Nov-13	Company closes down operation of its powder coating plant at Baddi (HP) for two years due to a significant decline in the processing volume
Feb-14	Unconditional cash offer for shares of Berger International (BIL), Singapore by Asian Paints (International) Ltd (APIL), Mauritius, to make BIL a wholly-owned subsidiary and delist from Singapore Exchange Securities Trading (SGX-ST)
Apr-14	Asian Paints (International) Ltd, Mauritius, subsidiary of Asian Paints acquires 51% stake in Kadisco Chemical Industry PLC, Ethiopia
May-14	Asian Paints acquires entire stake of Ess Ess Bathroom Products Pvt Ltd, a prominent player in the bath and wash business segment in India

Source: Company, ICICIdirect.com Research

## Top 10 Shareholders

Rank	Name	Last filing date	%O/S	Position (m)	Change (m)
1	Life Insurance Corporation of India	30-Sep-17	6.5	62.1	8.8
2	Smiti Holding & Trading Company Pvt. Ltd.	30-Sep-17	5.6	54.1	0.0
3	Isis Holding & Trading Company Pvt. Ltd.	30-Sep-17	5.5	52.9	0.0
4	Geetanjali Trading & Investments Pvt. Ltd.	30-Sep-17	5.1	49.3	0.0
5	Teesta Retail Pvt. Ltd.	30-Sep-17	4.9	47.0	0.0
6	Elcid Investments, Ltd.	30-Sep-17	3.0	28.3	0.0
7	Vakil (Abhay Arvind)	30-Sep-17	2.4	23.3	0.0
8	Gujarat Organics Ltd	30-Sep-17	2.4	22.8	0.0
9	Sudhanava Investments & Trading Company Pvt. Ltd.	30-Sep-17	2.0	19.0	0.0
10	Rupen Investment & Industries Pvt. Ltd.	30-Sep-17	2.0	18.8	0.0

Source: Reuters, ICICIdirect.com Research

## Shareholding Pattern

(in %)	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Promoter	52.8	52.8	52.8	52.8	52.8
Institutions	25.6	25.7	25.9	26.1	26.1
Others	21.6	21.5	21.3	21.1	21.1

## Recent Activity

Buys			Sells		
Investor name	Value(m)	Shares(m)	Investor name	Value(m)	Shares(m)
Life Insurance Corporation of India	152.8	8.8	Grantham Mayo Van Otterloo & Co LLC	-21.1	-1.2
ICICI Prudential Asset Management Co. Ltd.	12.6	0.7	Nomura Asset Management Co., Ltd.	-20.8	-1.1
FIL Investment Management (Hong Kong) Limited	3.6	0.2	Handelsbanken Asset Management	-14.8	-0.9
Tredje AP Fonden	3.5	0.2	Bessemer Trust Company, N.A. (US)	-8.2	-0.5
SBI Funds Management Pvt. Ltd.	3.3	0.2	UTI Asset Management Co. Ltd.	-3.7	-0.2

Source: Reuters, ICICIdirect.com Research

## Financial summary

Profit and loss statement ₹ Crore				
(Year-end March)	FY17	FY18E	FY19E	FY20E
Total Operating Revenue	15,290.2	17,871.9	21,082.6	24,943.6
Growth (%)		16.9	18.0	18.3
Raw Material Expenses	8,430.6	10,274.7	12,387.1	14,640.7
Employee Expenses	1,086.3	1,161.7	1,370.4	1,646.3
Marketing Expenses	1,542.8	625.5	737.9	947.9
Administrative Expenses	341.7	393.2	590.3	848.1
Other expenses	867.3	2,055.3	2,192.6	2,344.7
Total Operating Expenditure	12,268.8	14,510.3	17,278.2	20,427.6
EBITDA	3,021.4	3,361.5	3,804.4	4,515.9
Growth (%)		11.3	13.2	18.7
Depreciation	338.8	376.1	441.1	576.5
Interest	30.6	54.7	45.8	59.6
Other Income	262.6	197.0	153.6	130.6
PBT	2,914.6	3,127.6	3,471.1	4,010.4
Total Tax	948.0	1,054.4	954.5	1,102.9
PAT	2,016.2	2,195.3	2,576.6	2,973.6
Growth (%)		8.9	17.4	15.4
EPS (₹)	21.0	22.9	26.9	31.0

Source: Company, ICICIdirect.com Research

Cash flow statement ₹ Crore				
(Year-end March)	FY17	FY18E	FY19E	FY20E
Profit before Tax	2,914.6	3,195.1	3,471.1	4,010.4
Add: Depreciation	338.8	376.1	441.1	576.5
(Inc)/dec in Current Assets	-602.8	-516.6	-872.7	-1,243.1
Inc/(dec) in CL and Provisions	0.0	496.2	644.9	401.2
Others	-210.7	143.1	125.8	145.7
Tax Paid	-925.4	-1,054.4	-954.5	-1,102.9
CF from operating activities	1,527.3	2,263.3	2,414.6	2,211.3
(Inc)/dec in Investments	-94.8	-185.0	-90.0	-90.0
(Inc)/dec in Fixed Assets	-667.2	-1,073.9	-808.9	-673.5
Others	105.9	0.0	0.0	0.0
CF from investing activities	-656.1	-1,258.9	-898.9	-763.5
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	226.6	-29.7	-20.8	-34.6
Dividend paid & dividend tax	-947.3	-1,151.0	-1,247.0	-1,438.8
Inc/(dec) in Sec. premium	0.0	0.0	0.0	1.0
CF from financing activities	-756.4	-1,180.8	-1,267.8	-1,473.4
Net Cash flow	114.8	-176.4	247.9	-25.7
Opening Cash	1,577.7	582.1	405.7	653.6
Closing Cash	2,742.4	405.7	653.6	628.0

Source: Company, ICICIdirect.com Research

Balance sheet ₹ Crore				
(Year-end March)	FY17	FY18E	FY19E	FY20E
Liabilities				
Share Capital	95.9	95.9	95.9	95.9
Reserve and Surplus	7,506.3	8,550.5	9,880.1	11,414.9
Total Shareholders funds	7,602.2	8,646.5	9,976.1	11,510.9
Long term loans	41.1	41.1	41.1	41.1
Long Term Provisions	146.0	166.0	186.0	206.0
Minority Interest/Other LT liab	745.5	770.5	795.5	820.5
Current Liabilities				
Creditors	1,922.8	2,234.0	2,693.9	2,910.1
Other CL	1,962.0	2,147.0	2,332.0	2,517.0
Total Liabilities	12,419.7	14,005.1	16,024.6	18,005.6
Assets				
Gross Block	5,236.2	6,336.2	7,236.2	8,136.2
Less: Acc Depreciation	2,125.9	2,502.0	2,943.1	3,519.5
Net Block	3,110.3	3,834.2	4,293.1	4,616.7
Capital WIP	257.5	607.5	957.5	1,307.5
Non- Current Investments	1,300.7	1,450.7	1,505.7	1,560.7
LT loans & advances	72.6	97.6	122.6	147.6
Deferred Tax Assets	16.16	2.4	2.4	2.4
Other Non-current Assets	696.9	706.9	716.9	726.9
Current Assets				
Inventory	2,626.9	2,730.4	3,221.0	3,880.1
Debtors	1,446.6	1,489.3	1,756.9	2,217.2
Cash & Bank	582.1	405.7	653.6	628.0
Loans & Advances	17.8	248.2	292.8	346.4
Other Current Assets	2,292.2	2,432.2	2,502.2	2,572.2
Total Assets	12,419.7	14,005.1	16,024.7	18,005.6

Source: Company, ICICIdirect.com Research

Key ratios				
(Year-end March)	FY17	FY18E	FY19E	FY20E
Per share data (₹)				
EPS	21.0	22.9	26.9	31.0
Cash EPS	24.0	26.2	30.8	36.3
BV	79.3	90.1	104.0	120.0
DPS	10.3	12.0	13.0	15.0
Cash Per Share	60.7	42.3	68.1	65.5
Operating Ratios (%)				
EBITDA Margin	19.8	18.8	18.0	18.1
PBT / Total Operating income	17.1	17.9	16.5	16.1
PAT Margin	11.8	12.3	12.2	11.9
Inventory days	55.4	55.0	55.0	56.0
Debtor days	30.5	30.0	30.0	32.0
Creditor days	40.5	45.0	46.0	42.0
Return Ratios (%)				
RoE	29.8	26.3	27.0	27.1
RoCE	42.1	38.1	36.2	36.5
RoIC	29.4	27.3	29.5	29.9
Valuation Ratios (x)				
P/E	55.3	50.8	43.3	37.5
EV / EBITDA	36.4	32.8	28.9	24.4
EV / Net Sales	7.2	6.2	5.2	4.4
Market Cap / Sales	7.3	6.2	5.3	4.5
Price to Book Value	14.7	12.9	11.2	9.7
Solvency Ratios				
Debt/EBITDA	0.2	0.2	0.2	0.2
Debt / Equity	0.1	0.1	0.1	0.1
Current Ratio	1.5	1.4	1.4	1.6
Quick Ratio	0.7	0.7	0.7	0.8

Source: Company, ICICIdirect.com Research

## **RATING RATIONALE**

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