

Asian Paints | HOLD

Unfathomable mix change

Asian Paints' 2QFY19 report was a clear disappointment – more from a mix/margin angle, even as volume growth of 'low double-digit' turned out to be tad higher vs our forecast of c.8%. What is not clear, though, is how a double-digit volume growth translated into a mere 8.5% growth in revenue, considering the cumulative price-hike of 3.5% effected thus far (1.5% in Mar'18 plus 2% in May'18; the pricing action in Jul'18 was realisation-neutral, i.e. price-cut was effected to entirely pass on the 10ppt cut in GST rate). This apparent deterioration in mix further pressured margin which seems to have compressed much more than warranted by the inflation in RM prices. One possible explanation could be additional trade payouts to re-imburse for value-loss on transition stocks due to the tax cut but considering the lean trade inventory, we reckon the impact of the same would be no more than 1-1.5ppt. The stock could trade down on the back of this result; we await management's view on the mix-related issue. The stock is nearly flat vs 12M ago level, and the current result could provide a good entry opportunity into what we still view as a very attractive long-term business franchise.

- **Steady volume growth but lower realisation adversely impacted value-growth (and possibly, margin):** Asian Paints' 2QFY19 consolidated revenue grew 8.5% to INR46.4bn but EBITDA and adjusted net profit declined 2.1% and 3.1% to INR7.8bn and INR4.9bn respectively. Revenue was 3% below our estimates while the consequent EBITDA and net profit miss were significantly higher – in part due to some possible one-off costs as explained earlier. As per management, the domestic decorative business sustained a low double-digit volume growth, despite the delayed festive season this year. This, however, implies that sales-realisation was down 1-2% vs year-ago level despite an effective 3.5% price-hike taken during the year (excluding the GST-cut related pricing in Jul'18 which was passed-through to customers in entirety).
- **GPM compressed much more than we expected:** Asian Paints' consolidated GPM witnessed a sharp 139bps compression YoY and was down 334bps QoQ. Our proprietary Paints RM Index reflects a sequential increase of 7%, on a one-quarter lag basis. GPM pressure plus higher fixed costs (SG&A growth, though broadly inline with volume growth, turned out to be higher vs value-growth given the adverse mix change) led to a 184bps compression in EBITDA margin and resulted in a 2% decline in EBITDA. We note that a part of the GPM pressure was also on account of delay in taking further price-hikes for fear of attracting anti-profiteering provisions ([see earlier note](#)), post the GST Council's unexpected rate reduction (28% to 18%) during the quarter. The company has since hiked prices by 2.3% (Oct 1st), which would help ease margin pressure to some extent.
- **Industrials grew well but International operations performance remained subdued:** Asian Paints' Industrial and International revenue growth trajectory decelerated to 7% vs 11% seen in 1Q. As per the company, both the industrial JVs witnessed good growth but challenging conditions persisted in International operations due to issue of forex unavailability, high inflation and difficult economic conditions in some of the geos. Home Improvement posted a healthy 20% growth with good growth in both Kitchens (+22%) and Bathware (+18%); Home Improvement losses, however, rose 27-28% YoY and QoQ.

Financial Summary					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Sales	148,254	165,257	191,149	222,915	259,784
Sales growth (%)	5.5%	11.5%	15.7%	16.6%	16.5%
EBITDA	29,864	31,976	36,426	43,698	51,771
EBITDA Margin (%)	19.8%	19.0%	18.7%	19.3%	19.6%
Adjusted net profit	19,171	19,683	22,649	27,277	32,694
EPS (Rs)	20.0	20.5	23.6	28.4	34.1
EPS growth (%)	6.9%	2.7%	15.1%	20.4%	19.9%
ROIC (%)	24.9%	22.5%	23.5%	25.1%	0.0%
ROE (%)	27.1%	24.6%	25.4%	27.0%	28.2%
PE (x)	60.0	58.5	50.8	42.2	35.2
Price/Book Value (x)	15.1	13.7	12.2	10.6	9.3
EV/EBITDA (x)	38.3	35.5	31.2	25.9	21.8
Dividend Yield (%)	0.9%	0.7%	0.8%	1.1%	1.4%

Source: Company data, JM Financial. Note: Valuations as of 22/Oct/2018



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Recommendation and Price Target

Current Reco.	HOLD
Previous Reco.	HOLD
Current Price Target (12M)	1,410
Upside/(Downside)	17.2%
Previous Price Target	1,415
Change	-0.4%

Key Data – APNT IN

Current Market Price	INR1,200
Market cap (bn)	INR1,151.4/US\$15.7
Free Float	62%
Shares in issue (mn)	959.2
Diluted share (mn)	959.2
3-mon avg daily val (mn)	INR1,739.6/US\$23.7
52-week range	1,491/1,082
Sensex/Nifty	34,316/10,304
INR/US\$	73.3

Price Performance

%	1M	6M	12M
Absolute	-8.0	3.5	1.9
Relative*	-0.7	4.4	-3.3

* To the BSE Sensex

JM Financial Research is also available on:
Bloomberg - JMFR <GO>,
Thomson Publisher & Reuters
S&P Capital IQ and FactSet

Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Exhibit 1. 2QFY19 results snapshot

(INR mn)

	CONSOLIDATED					PARENT		
	2QFY19	2QFY18	YoY growth	2QFY19E	% var	2QFY19	2QFY18	YoY growth
Net Revenue (excl all taxes)	46,391	42,742	8.5%	47,715	-2.8%	39,142	36,022	8.7%
Cost of Goods Sold	27,924	25,132	11.1%	28,247	-1.1%	23,169	20,809	11.3%
Gross Profit	18,467	17,610	4.9%	19,468	-5.1%	15,973	15,213	5.0%
Gross Profit Margin - % of Net Sales	39.8%	41.2%	-139 bps	40.8%	-99 bps	40.8%	42.2%	-142 bps
Staff Cost	3,073	2,822	8.9%	3,101	-0.9%	2,155	2,020	6.7%
Other Expenses	7,553	6,777	11.4%	7,276	3.8%	6,545	5,992	9.2%
EBITDA	7,842	8,011	-2.1%	9,090	-13.7%	7,273	7,201	1.0%
EBITDA margin - % of Net Sales	16.9%	18.7%	-184 bps	19.1%	-215 bps	18.6%	20.0%	-141 bps
Depreciation	947	889	6.6%	954	-0.7%	828	772	7.3%
EBIT	6,894	7,122	-3.2%	8,135	-15.3%	6,445	6,429	0.3%
Interest Expense	121	88	38.2%	91	33.7%	66	50	33.4%
Other Income	633	534	18.6%	571	10.8%	717	638	12.2%
PBT Before Exceptional Items	7,406	7,569	-2.1%	8,616	-14.0%	7,096	7,018	1.1%
PBT After Exceptional Items	7,406	7,569	-2.1%	8,616	-14.0%	7,096	7,018	1.1%
Reported Net Profit	4,928	5,759	-14.4%	5,775	-14.7%	4,815	4,734	1.7%
Adjusted Net Profit	4,928	5,084	-3.1%	5,775	-14.7%	4,815	4,734	1.7%

Source: Company, JM Financial

Exhibit 2. Costs breakdown

% of sales	CONSOLIDATED			PARENT	
	2QFY19	2QFY18	2QFY19E	2QFY19	2QFY18
Cost of Goods Sold	60.2%	58.8%	59.2%	59.2%	57.8%
Staff Cost	6.6%	6.6%	6.5%	5.5%	5.6%
Other Expenses	16.3%	15.9%	15.3%	16.7%	16.6%
Depreciation	2.0%	2.1%	2.0%	2.1%	2.1%

Source: Company, JM Financial

Exhibit 3. 2QFY19 segment-wise financials (consolidated)

(INR mn)

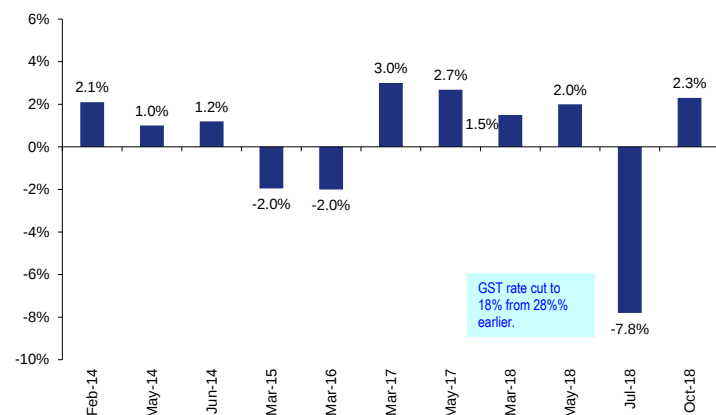
	2QFY19	2QFY18	YoY chg	1HFY19	1HFY18	YoY chg
Segment Revenue						
Paints - Domestic Decorative	38,649	35,604	8.6%	75,252	67,232	11.9%
Paints - Industrial + International	6,722	6,289	6.9%	13,195	12,128	8.8%
Sleek (Modular Kitchens)	527	431	22.4%	977	803	21.7%
Ess-Ess (Bathroom Fittings)	493	418	17.9%	952	678	40.5%
Total Segment Revenue	46,391	42,742	8.5%	90,376	80,840	11.8%
Segment EBIT						
Paints - Domestic Decorative	7,882	7,439	6.0%	16,559	13,806	19.9%
Paints - Industrial + International	421	723	-41.7%	846	1,283	-34.0%
Sleek (Modular Kitchens)	-30	-21	NM	-72	-69	4.0%
Ess-Ess (Bathroom Fittings)	-95	-78	NM	-151	-143	5.3%
Total Segment EBIT (before unallocable)	8,178	8,064	1.4%	17,183	14,877	15.5%
Segment Margin %						
Paints - Domestic Decorative	20.4%	20.9%	-50 bps	22.0%	20.5%	147 bps
Paints - Industrial + International	6.3%	11.5%	-523 bps	6.4%	10.6%	-416 bps
Sleek (Modular Kitchens)	-5.7%	-4.8%	NM	-7.4%	-8.6%	NM
Ess-Ess (Bathroom Fittings)	-19.2%	-18.6%	NM	-15.8%	-21.1%	NM
Total Segment Margin %	17.6%	18.9%	-124 bps	19.0%	18.4%	61 bps

Source: Company, JM Financial..

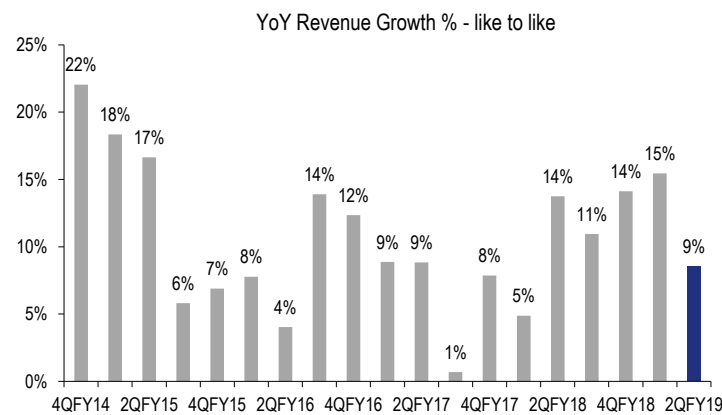
Exhibit 4. Asian Paints revenue growth could be higher at 9.4%, on our workings, adjusting for one-off costs relating to distributor reimbursements for transition stocks

	At 28% GST	At 18% GST
Manufacturer's price	1,000	1,000
GST	280	180
Price to Dealer	1,280	1,180
Incremental GST	78	32
Final Selling Price	1,358	1,212
Annual Domestic Revenue		141,679
10 days inventory		3,882
Reimbursement @ 10% thereon		388
Reported Revenue 2QFY18		42,742
Reported Revenue 2QFY19		46,391
Adjusted Revenue 2QFY19		46,779
Reported Revenue Growth		8.5%
Adjusted Revenue Growth		9.4%

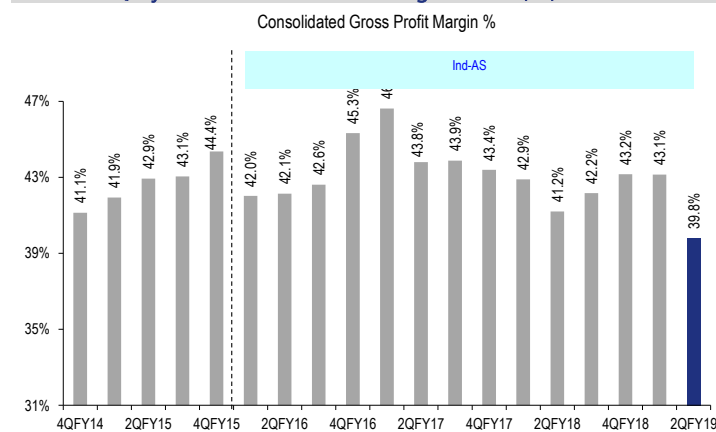
Source: Company, JM Financial

Exhibit 5. Selling price changes in recent past


Source: Company, JM Financial

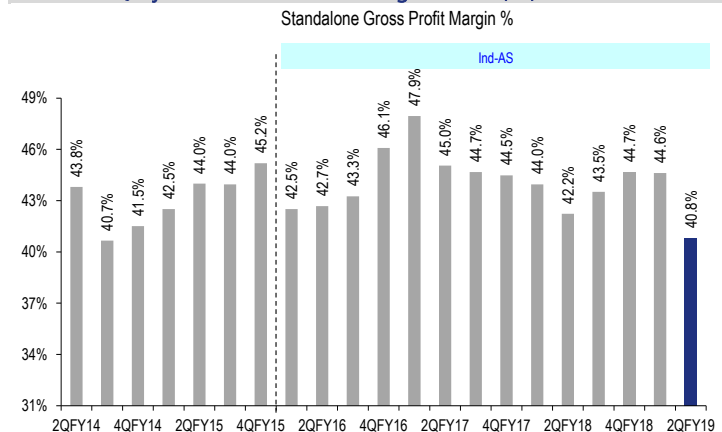
Exhibit 6. YoY revenue growth trend (consolidated)


Source: Company, JM Financial

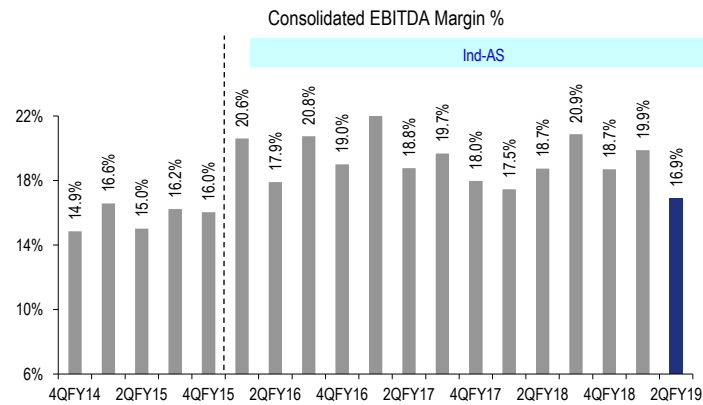
Exhibit 7. Qtrly Consolidated Gross Margin Trend (%)


Source: Company, JM Financial.

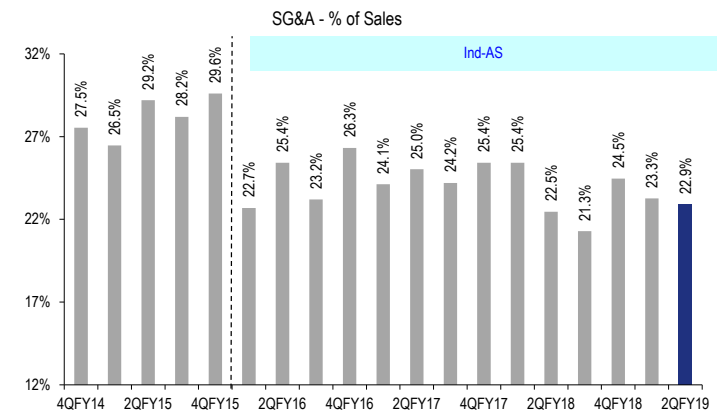
Note: Under Ind-AS, Revenue from 1QFY16 onwards are net of Sales Promotion Spends, which were accounted as part of 'Other Expenses' earlier.

Exhibit 8. Qtrly Standalone Gross Margin Trend (%)


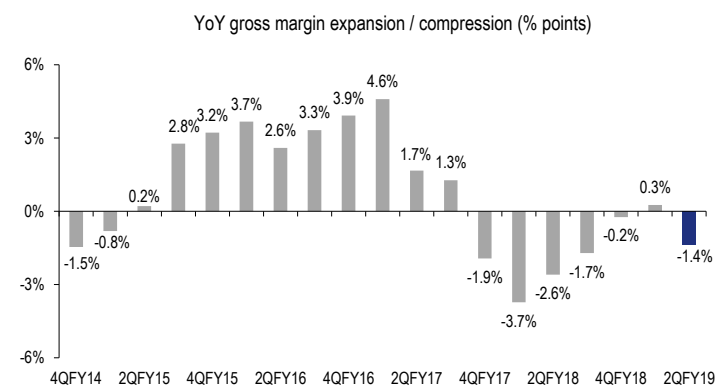
Source: Company, JM Financial

Exhibit 9. Qtrly consolidated EBITDA margin trend (%)

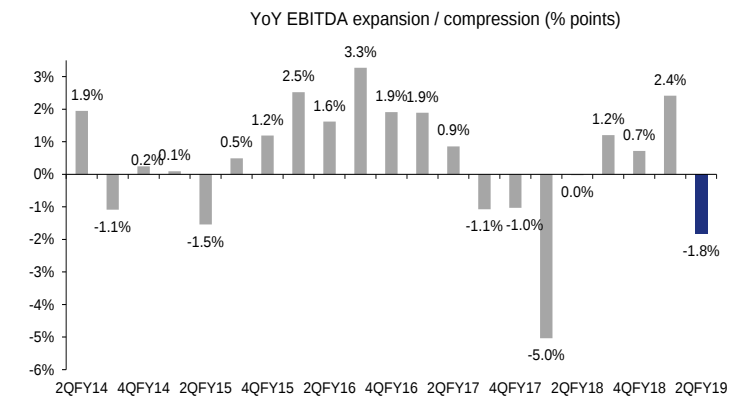
Source: Company, JM Financial. Note: Under Ind-AS, Revenue from 1QFY16 onwards are net of Sales Promotion Spends, which were accounted as part of 'Other Expenses' earlier.

Exhibit 10. SG&A - % of sales

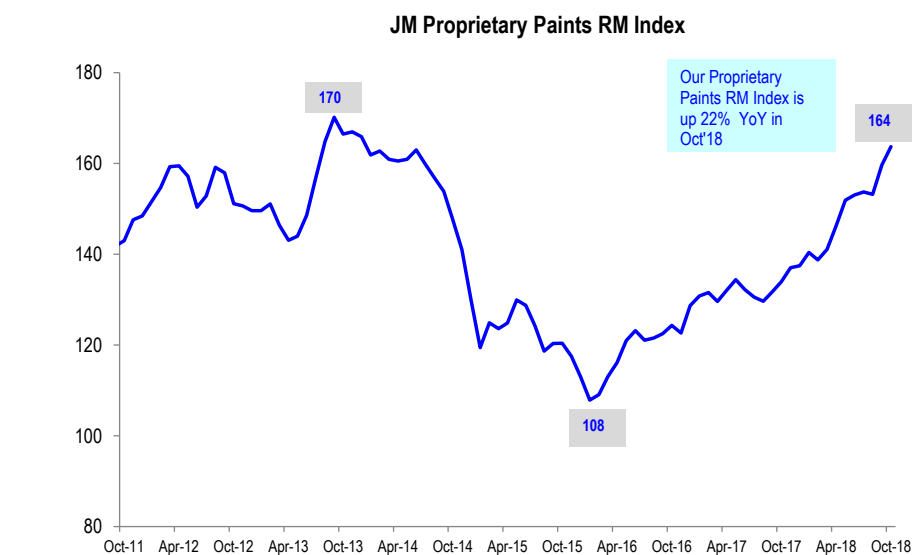
Source: Company, JM Financial. Note: Sales Promotion Spends, earlier accounted as part of 'Other Expenses', are now deducted from Revenue from 1QFY16 onwards under Ind-AS.

Exhibit 11. Gross margin change (consolidated) (%)

Source: Company, JM Financial

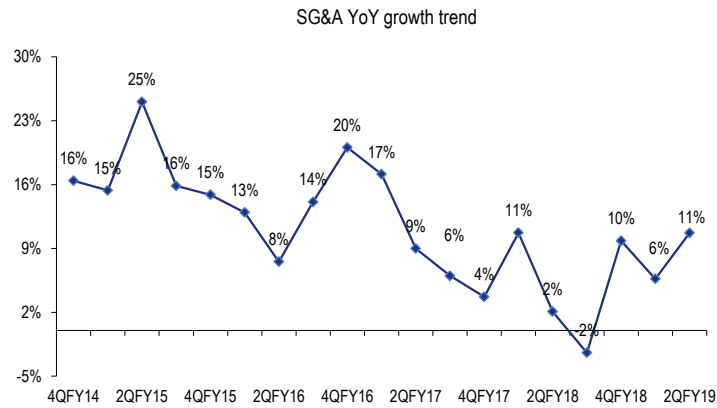
Exhibit 12. EBITDA margin change (consolidated) (%)

Source: Company, JM Financial

Exhibit 13. Our proprietary RM index is 22% higher YoY in Oct'18

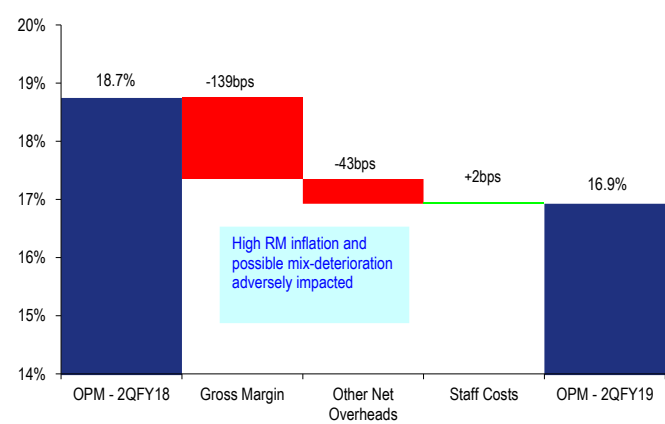
Source: Company, JM Financial

Exhibit 14. SG&A growth trend



Source: Company, JM Financial

Exhibit 15. Operating margin movement – 2QFY19



Source: Company, JM Financial

Exhibit 16. Asian Paints one-year forward PE band



Source: Company, JM Financial

Financial Tables (Consolidated)

Profit & Loss Statement					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Sales (excluding taxes)	148,254	165,257	191,149	222,915	259,784
Sales Growth	5.5%	11.5%	15.7%	16.6%	16.5%
Other Operating Income	2,366	2,989	3,368	3,928	4,577
Total Revenue	150,620	168,246	194,516	226,843	264,361
Cost of Goods Sold/Op. Exp.	83,289	96,912	114,601	133,387	155,851
Personnel cost	10,336	11,155	12,402	14,236	16,326
Other expenses	27,131	28,203	31,087	35,522	40,412
EBITDA	29,864	31,976	36,426	43,698	51,771
EBITDA (%)	19.8%	19.0%	18.7%	19.3%	19.6%
EBITDA Growth (%)	7.8%	7.1%	13.9%	20.0%	18.5%
Depn & Amort	3,348	3,605	3,953	4,658	5,205
EBIT	26,516	28,371	32,473	39,040	46,566
Other Income	2,624	2,206	2,247	2,714	3,470
Finance Cost	300	351	334	317	301
PBT before Excep & Forex	28,841	30,227	34,386	41,437	49,736
Excep & forex Inc/Loss(-)	0	0	0	0	0
PBT	28,841	30,227	34,386	41,437	49,736
Taxes	9,433	10,410	11,599	13,977	16,776
Extraordinary Inc/Loss(-)	259	700	0	0	0
Assoc. Profit/Min. Int.(-)	272	128	138	183	265
Reported Net profit	19,394	20,389	22,649	27,277	32,694
Adjusted Net Profit	19,171	19,683	22,649	27,277	32,694
Net Margin (%)	12.7%	11.7%	11.6%	12.0%	12.4%
Diluted share capital (mn)	959	959	959	959	959
Diluted EPS (Rs)	20.0	20.5	23.6	28.4	34.1
Diluted EPS Growth	6.9%	2.7%	15.1%	20.4%	19.9%
Total Dividend + Tax	11,875	10,053	11,325	15,003	19,617
Dividend Per Share (Rs)	10	9	10	13	17

Source: Company, JM Financial

Balance Sheet					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Shareholders' Fund	76,039	84,102	94,098	108,212	123,597
Share capital	959	959	959	959	959
Reserves & Surplus	75,080	83,143	93,139	107,253	122,638
Preference Share Capital	0	0	0	0	0
Minority Interest	3,755	3,277	3,927	4,684	5,593
Total Loans	5,603	5,334	5,068	4,814	4,573
Def. Tax Liab / Assets (-)	3,430	3,975	3,969	3,961	3,951
Total - Equity & Liab	88,827	96,688	107,062	121,671	137,714
Net Fixed Assets	35,613	51,374	58,686	60,389	62,492
Gross Fixed Assets	37,203	43,781	55,047	61,408	68,716
Intangible Assets	1,935	3,273	3,273	3,273	3,273
Less: Depn. & Amort.	6,100	9,731	13,685	18,343	23,548
Capital WIP	2,575	14,051	14,051	14,051	14,051
Investments	26,670	21,557	24,236	29,083	34,900
Current Assets	61,769	64,704	70,682	86,611	104,044
Inventories	26,269	26,583	31,422	36,644	42,704
Sundry Debtors	14,466	17,306	18,853	21,986	25,623
Cash & Bank Balances	9,709	6,276	4,163	9,259	13,899
Loans & Advances	6,259	6,781	7,643	8,691	10,128
Other Current Assets	5,066	7,758	8,602	10,031	11,690
Current Liab. & Prov.	35,225	40,947	46,542	54,412	63,722
Current Liabilities	31,858	38,025	43,313	50,678	59,409
Provisions & Others	3,367	2,922	3,230	3,733	4,313
Net Current Assets	26,545	23,758	24,140	32,199	40,322
Application of Funds	88,827	96,688	107,062	121,671	137,714

Source: Company, JM Financial

Cash Flow Statement					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Profit before Tax	28,841	30,227	34,386	41,437	49,736
Depn. & Amort.	3,388	3,605	3,953	4,658	5,205
Net Interest Exp. / Inc. (-)	-1,448	-965	-910	-1,227	-1,806
Inc (-) / Dec in WCap.	-6,028	-797	-2,605	-3,181	-3,740
Others	-225	-128	-1,148	-1,361	-1,638
Taxes Paid	-9,254	-10,807	-11,489	-13,759	-16,520
Operating Cash Flow	15,273	21,134	22,187	26,568	31,237
Capex	-6,672	-14,088	-11,265	-6,361	-7,308
Free Cash Flow	8,601	7,047	10,921	20,206	23,929
-Inc/dec in investments	-948	-3,417	-2,679	-4,847	-5,817
Other current assets	1,059	1,512	1,914	2,397	3,169
Investing Cash Flow	-6,561	-15,993	-12,031	-8,811	-9,956
Inc/dec in capital	0	0	0	0	0
Dividend+Tax Thereon	-9,473	-12,178	-12,653	-13,164	-17,310
Inc/dec in loans	2,266	-1,262	384	504	668
Other assets	-357	-352	0	0	0
Financing Cash Flow	-7,564	-13,791	-12,269	-12,660	-16,642
Inc / Dec (-) in Cash	1,148	-8,650	-2,113	5,096	4,640
Opening cash balance	8,561	14,926	6,276	4,163	9,259
Closing cash balance	9,709	6,276	4,163	9,259	13,899

Source: Company, JM Financial

Dupont Analysis					
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Margin	12.7%	11.7%	11.6%	12.0%	12.4%
Asset Turnover (x)	1.8	1.8	1.9	2.0	2.0
Leverage Factor (x)	1.2	1.2	1.1	1.1	1.1
RoE	27.1%	24.6%	25.4%	27.0%	28.2%
Key ratios					
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
BV/Share (Rs)	79.3	87.7	98.1	112.8	128.9
ROIC (%)	24.9%	22.5%	23.5%	25.1%	0.0%
ROE (%)	27.1%	24.6%	25.4%	27.0%	28.2%
Net Debt-equity ratio (x)	-0.2	-0.1	-0.1	-0.2	0.0
PER	60.0	58.5	50.8	42.2	35.2
PBV	15.1	13.7	12.2	10.6	9.3
EV/EBITDA	38.3	35.5	31.2	25.9	21.8
EV/Net Sales	7.7	6.9	5.9	5.1	4.3
Debtor days	36	38	36	36	36
Inventory days	65	59	60	60	60
Creditor days	96	102	100	101	102

Source: Company, JM Financial

History of Earnings Estimate and Target Price

Date	Recommendation	Target Price	% Chg.
26-Oct-15	Hold	805	
19-Jan-16	Hold	845	5.0
12-May-16	Hold	865	2.4
28-Jul-16	Hold	915	5.8
25-Oct-16	Hold	960	4.9
24-Jan-17	Hold	960	0.0
12-May-17	Hold	995	3.6
25-Jul-17	Hold	1,135	14.1
22-Jan-18	Hold	1,135	0.0
11-May-18	Hold	1,190	4.8
5-Jun-18	Hold	1,310	10.1
24-Jul-18	Hold	1,415	8.0

Recommendation History



APPENDIX I

JM Financial Institutional Securities Limited

(formerly known as JM Financial Securities Limited)

Corporate Identity Number: U67100MH2017PLC296081

Member of BSE Ltd., National Stock Exchange of India Ltd. and Metropolitan Stock Exchange of India Ltd.

SEBI Registration Nos.: Stock Broker - INZ000163434, Research Analyst – INH000000610

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Definition of ratings	
Rating	Meaning
Buy	Total expected returns of more than 15%. Total expected return includes dividend yields.
Hold	Price expected to move in the range of 10% downside to 15% upside from the current market price.
Sell	Price expected to move downwards by more than 10%

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