October 23, 2018

Asian Paints (ASIPAI)

₹ 1140

Higher raw material cost weighs on margin...

Rating matrix

Rating	:	Hold
Target	:	₹ 1180
Target Period	:	12 months
Potential Upside	:	3%

What's Changed?

Target	Changed from ₹ 1575 to ₹ 1180
EPS FY19E	Changed from ₹ 24.7 to ₹ 22.8
EPS FY20E	Changed from ₹ 31.5 to ₹ 28.1
Rating	Unchanged

Quarterly Performance

	Q2FY19	Q2FY18	YoY (%)	Q1FY19	QoQ (%)
Revenue	4,639.1	4,265.2	8.8	4,390.3	5.7
EBITDA	784.2	801.1	-2.1	874.4	-10.3
EBITDA (%)	16.9	18.8	-188bps	19.9	-301bps
PAT	506.0	593.7	-14.8	571.3	-11.4

Key Financials

₹ Crore	FY17	FY18	FY19E	FY20E
Revenue	15,062	16,825	19,209	22,627
EBITDA	2,986.4	3,197.6	3,449.9	4,185.0
Net Profit	2,016.3	2,097.5	2,183.7	2,696.6
EPS (₹)	21.0	21.9	22.8	28.1

Valuation summary

	FY17	FY18	FY19E	FY20E
P/E	54.2	52.1	50.1	40.5
Target P/E	56.1	53.9	51.8	42.0
EV / EBITDA	36.1	33.9	31.4	25.7
P/BV	14.4	13.0	11.8	10.1
RoNW (%)	32.8	31.6	30.0	32.2
RoCE (%)	26.3	24.4	23.5	25.0

Stock data

Particular	Amount
Market Capitalization (₹ Crore)	109,326.0
Total Debt (FY18) (₹ Crore)	520.8
Cash and Investments (FY18) (₹ Crore)	2,140.7
EV (₹ Crore)	107,706.1
52 week H/L (₹)	1489/1082
Equity capital (₹ Crore)	95.9
Face value (₹)	1.0

Price performance (%)

	1M	3M	6M	12M
Asian Paints	(4.3)	(11.8)	5.8	4.6
Berger Paints	(5.1)	(7.8)	5.5	8.4
Kansai Nerolac	(12.1)	(15.5)	(17.6)	(16.9)
Akzo Noble	(3.5)	(14.1)	(18.1)	(13.5)

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- Asian Paints' (APL) Q2FY19 performance was operationally weak in EBITDA margin terms. We believe paint volume growth at ~10% YoY was achieved through a change in product mix while APL refrained from taking a price hike in an inflationary scenario looking at festive demand around the corner. It has instead passed on the GST rate cut to its dealers with immediate effect to fast liquidate the inventory. APL has taken a price hike of 2.35% effective from October 1, 2018 and guided at a few more price hikes in upcoming quarters to negate the impact of higher crude related raw material prices and adverse currency movements. However, demand being more skewed towards lower end products like distemper, we believe margin pressure would remain in near future
- We believe the volume CAGR of ~13% in FY18-20E would be largely supported by a shorter repainting cycle and increasing presence in the southern region through two news facilities (with capacity of 3 lakhs/KL each) in Andhra Pradesh and Karnataka. We also believe the company would gradually take a price hike to maintain EBITDA margin in the range of ~18-19%

Capacity expansion in untapped markets to drive volume growth

APL is the industry leader in the decorative paint segment with 53% market share and a dealer network of over 55,000 across India. It derives 89% of its topline from the decorative segment while the rest comes from the industrial segment. Further, a reduction in the GST rate from 28% to 18% would benefit organised players in the long run while rising tax compliance would hit the unorganised segment commanding ~25% of the total industry. With the expansion in paints capacity in Andhra Pradesh and Karnataka, APL is best placed to capture this additional demand, going ahead. We model revenue CAGR of ~16% in FY18-20E led by volume CAGR ~13% supported by sustained demand of decorative paints from tier II, tier III cities and a shorter repainting cycle.

APL to maintain profitability in near term amid rising input prices

APL has witnessed a significant expansion in EBTIDA margin (by ~400 bps in FY15-17) owing to lower raw material prices and rising proportion of premium products in the portfolio. However, a reversal was witnessed from FY18 onwards owing to inability to pass on a sudden rise in crude based raw material prices. We believe APL will absorb some inflationary pressure by taking hit in the gross margin for the near term (as the gross margin declined ~330 bps in H1FY19 from its peak in FY17). Though the management has guided for a price hike at regular interval, we believe a continued rise in raw material prices would keep EBITDA margins of the company under check.

Raw material led headwinds to weigh on valuations

We expect APL to record revenue, earnings CAGR of ~16%, ~12%, respectively, in FY18-20E led by volume CAGR of 13% in the domestic segment. With a slow pick-up in volume growth in H1FY19, APL has been cautious on the demand outlook for FY19E. Simultaneously, a change in product mix coupled with raw material cost pressures would keep gross margin under pressure in coming quarters. We believe the current phase of slowing volumes is temporary while demand for paints is structurally growing considering the lower per capita paint consumption in India. However, at the current price the stock is richly valued. We maintain our **HOLD** rating on the stock with a revised target price of ₹ 1180/share.

Variance analysis

	Q2FY19	Q2FY19E	Q2FY18	YoY (%)	Q1FY19	QoQ (%)	Comments
Revenue	4,639.1	4,389.9	4,265.2	8.8	4,390.3	5.7	Sales largely driven by ~10% YoY growth in decorative sales volume
Other Income	63.3	57.1	53.4	18.6	61.7	2.7	Higher treasure income translated into increase in other income
Raw Material Exp	2,792.4	2,626.9	2,504.2	11.5	2,492.3	12.0	Gross margins declined ~130 bps YoY mainly due to the change in product mix and higher inflation in raw material during Q2FY19
Employee Exp	307.3	308.2	282.2	8.9	306.4	0.3	
Manufacturing & Oth exp	755.3	697.5	677.7	11.4	717.1	5.3	
EBITDA	3,854.9	3,632.6	3,464.1	11.3	3,515.8	9.6	
EBITDA Margin (%)	16.9	17.3	18.8	-188 bps	19.9	-301 bps	Lower gross margin coupled with lower opearating leverage (at new plant at Mysuru commenced operation in Q2FY19) had impacted margin
Depreciation	94.7	94.1	88.9	6.6	90.5	4.7	
Interest	12.1	9.4	8.8	38.2	8.8	38.2	
Exceptional items							
PBT	740.6	710.9	824.3	-10.2	836.8	-11.5	
Total Tax	242.7	234.6	245.9	-1.3	277.0	-12.4	
PAT	506.0	486.2	593.7	-14.8	571.3	-11.4	PAT adjusted with one-time gain in base period declined ~4% YoY
Key Metrics							
Volume growth (%)	10.3	8.0	9.0		12.0		Double digit volume growth was mainly due to a change in product mix and support to its dealers in terms of liquidating old inventories by giving higher rebate (in order to adjust GST related price reduction)
Realisation growth (%)	-1.4	-4.6	5.0		1.9		Change in product mix (skewed more towards lower end products), rebates and absence of sufficient price hike has translated into lower realisation

Source: Company, ICICI Direct Research

Change in estimates

(₹ Crore)	FY19E			FY20E			Comment
	Old	New	% Change	Old	New	% Change	
Revenue	19,435.0	19,208.9	-1.2	23,105.3	22,627.0	-2.1	We model revenue CAGR of ~16% led by volume CAGR of ~13% in FY18-20E. The volume growth would largely be driven by repainting demand and upcoming manufacturing facilities in Mysuru and Vizag
EBITDA	3,695.8	3,449.9	-6.7	4,554.8	4,185.0	-8.1	
EBITDA Margin (%)	19.0	18.0	-106bps	19.7	18.5	-122bps	We tweak our EBITDA margin estimate downward considering adverse currency movement and high inflationary pressure in crude relative derivatives
PAT	2366.1	2183.7	-7.7	3026.2	2,696.6	-10.9	
EPS (₹)	24.7	22.8	-7.7	31.5	28.1	-10.9	

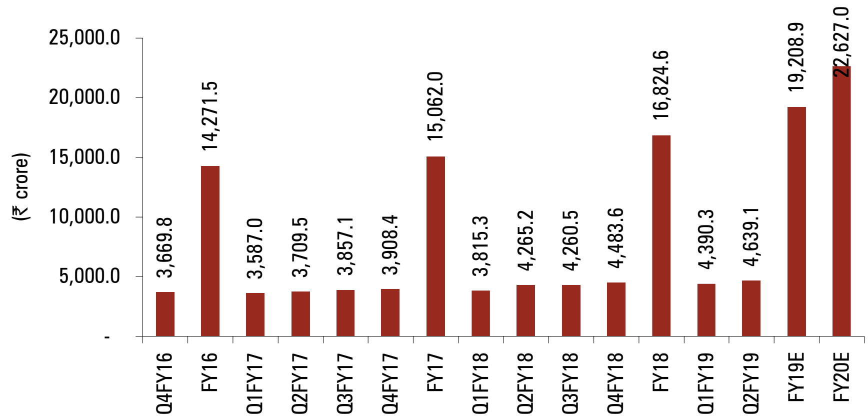
Source: Company, ICICI Direct Research

Assumptions

	Current				Earlier		Comments
	FY17	FY18	FY19E	FY20E	FY19E	FY20E	
Volume Growth (%)	13.2	11.0	12.0	14.3	11.0	14.8	We slightly change our volume estimates owing to commencement of new capacity in Mysuru during Q2FY19
Realisation Growth (%)	(2.6)	2.4	1.7	2.9	2.2	5.0	Change in realisation would largely be driven by price hike at different intervals to offset higher raw material prices

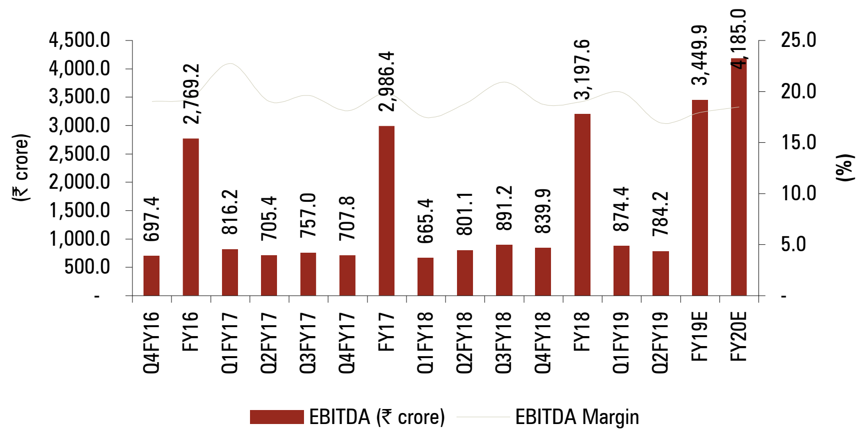
Source: Company, ICICI Direct Research

Exhibit 1: Demand from tier I, tier II to help drive sales growth, going forward



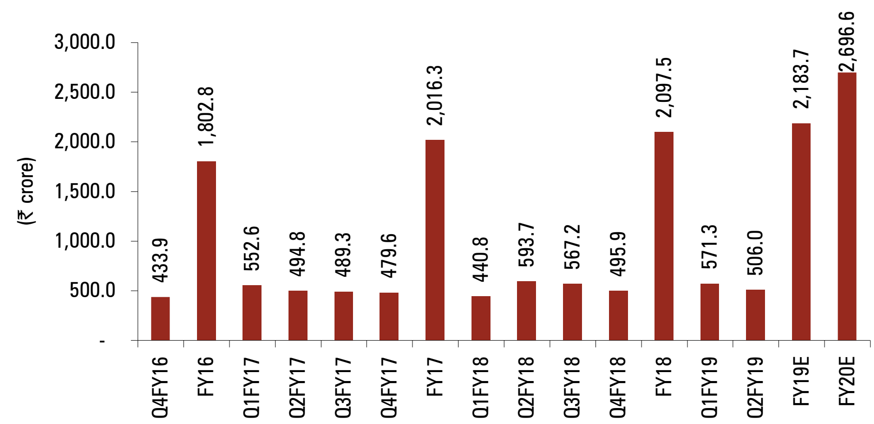
Source: Company, ICICI Direct Research

Exhibit 2: Price hike at regular interval to support EBITDA margin (FY18-20E)



Source: Company, ICICIdirect.com Research

Exhibit 3: PAT likely to grow at 12% CAGR in FY18-20E

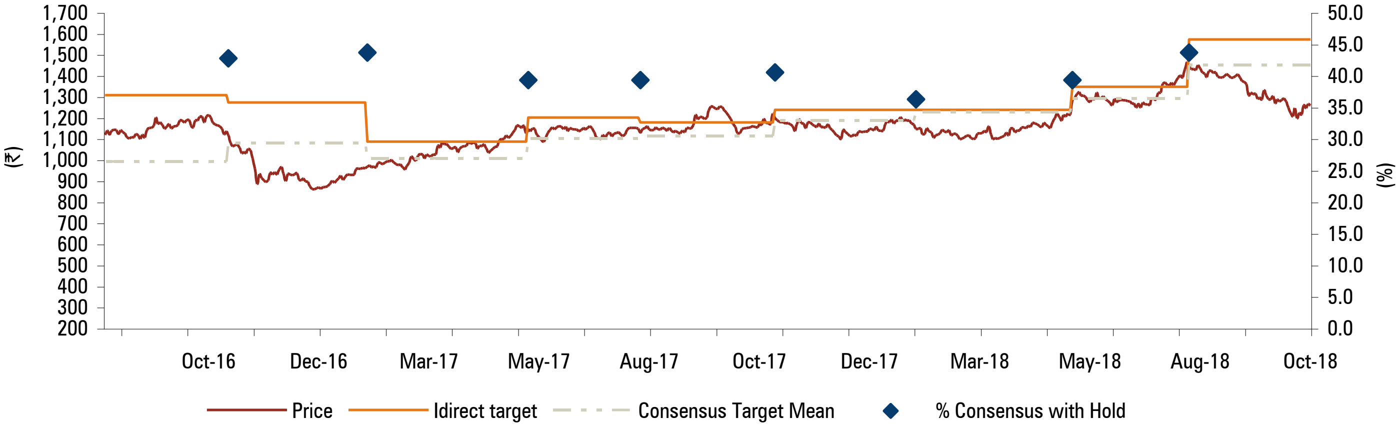


Source: Company, ICICI Direct Research

Key takeaways of conference call …

- The domestic paint demand scenario remained challenging during Q2FY19. In addition to this, rising crude prices, a tightening monetary policy and adverse currency movement impacted overall paint industry
- Despite higher inflationary pressure and adverse currency movement, the company has not passed on raw material price hikes. APL had taken a price hike of ~2.35% in October 2018. It expects a further rise in raw material prices, going forward
- In order to liquidate the stock (held prior to GST rate reduction), the company has provided significant discount/rebate to dealers, which has impacted topline and profitability of the company
- Volume growth of ~10% YoY was on account of higher sales of distempers and putty. Historical distemper and putty contribution to total sales increases during the festive season. Unorganised segment contribution in the distemper and putty segment is higher of ~40% vs. ~30% unorganised pie in the total paint industry
- In international operations, business conditions continued to remain challenging with issues like forex unavailability, high inflation and difficult economic conditions
- There was no significant impact of tsunami on the business of Indonesian operations
- The first phase of new capacity at Mysuru commenced operation during September 2018. The company is on track to commence the first phase of its second plant in Vizag by the end of Q4FY19

Recommendation history vs. consensus



Source: Bloomberg, Company, ICICI Direct 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	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
Dec-17	Acquires entire paid up share capital of Reno Chemicals Pharmaceuticals and Cosmetics Ltd for the consideration of ₹ 160 crore
Dec-17	Acquires balance stake (49% of share capital) in Sleek from Ahuja family for consideration of ₹ 50 crore

Source: Company, ICICI Direct Research

Top 10 Shareholders

Rank	Name	Last filing date	%O/S	Position (m)	Change (m)
1	Life Insurance Corporation of India	30-Jun-18	7.7	73.9	0.3
2	Smiti Holding & Trading Company Pvt. Ltd.	30-Jun-18	5.6	54.1	0.0
3	Sattva Holding And Trading Pvt. Ltd.	30-Jun-18	5.5	52.9	52.9
4	Geetanjali Trading & Investments Pvt. Ltd.	30-Jun-18	5.1	49.3	0.0
5	Teesta Retail Pvt. Ltd.	30-Jun-18	4.9	47.0	0.0
6	Elcid Investments, Ltd.	30-Jun-18	3.0	28.3	0.0
7	Vakil (Abhay Arvind)	30-Jun-18	2.4	23.3	0.0
8	Gujarat Organics Ltd	30-Jun-18	2.4	23.2	0.0
9	Sudhanava Investments & Trading Company Pvt. Ltd.	30-Jun-18	2.0	19.0	0.0
10	Rupen Investment & Industries Pvt. Ltd.	30-Jun-18	2.0	18.8	0.0

Source: Reuters, ICICI Direct Research

Shareholding Pattern

(in %)	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
Promoter	52.8	52.8	52.79	52.8	52.8
FII	16.7	16.4	15.08	14.7	14.9
DII	9.4	10.0	11.75	11.9	10.0
Others	21.1	20.9	20.4	20.6	22.3

Recent Activity

Buys			Sells		
Investor name	Value(m)	Shares(m)	Investor name	Value(m)	Shares(m)
Sattva Holding And Trading Pvt. Ltd.	976.9	52.9	Fidelity Management & Research (Hong Kong) Limited	-11.0	-0.6
SBI Funds Management Pvt. Ltd.	41.0	2.3	Matthews International Capital Management, L.L.C.	-11.2	-0.6
Veritas Asset Management LLP	16.4	0.8	ICICI Prudential Asset Management Co. Ltd.	-10.5	-0.5
Amundi Hong Kong Limited	12.2	0.6	Franklin Advisers, Inc.	-6.8	-0.4
Kotak Mahindra Asset Management Company Ltd.	8.6	0.4	Axis Asset Management Company Limited	-6.8	-0.4

Source: Reuters, ICICI Direct Research

Financial summary

Profit and loss statement				₹ Crore
(Year-end March)	FY17	FY18	FY19E	FY20E
Total Operating Revenue	15,062.0	16,824.6	19,208.9	22,627.0
Growth (%)		11.7	14.2	17.8
Raw Material Expenses	8,328.9	9,691.2	11,430.2	13,068.3
Employee Expenses	1,033.6	1,115.5	1,279.0	1,544.1
Other expenses	2,713.1	2,820.3	3,049.8	3,829.6
Total Operating Expenditure	12,075.6	13,626.9	15,759.0	18,442.0
Growth (%)		12.8	15.6	17.0
EBITDA	2,986.4	3,197.6	3,449.9	4,185.0
Growth (%)		7.1	7.9	21.3
Depreciation	334.8	360.5	499.4	588.3
Interest	30.0	35.1	46.0	53.1
Other Income	262.4	220.6	230.5	271.5
PBT	2,909.9	3,092.7	3,135.0	3,815.1
Total Tax	943.3	1,041.0	994.1	1,177.2
Profit from Associates	49.6	45.8	42.7	58.6
PAT	2,016.3	2,097.5	2,183.7	2,696.6
Growth (%)		4.0	4.1	23.5
EPS (₹)	21.0	21.9	22.8	28.1

Source: Company, ICICI Direct Research

Cash flow statement				₹ Crore
(Year-end March)	FY17	FY18	FY19E	FY20E
Profit before Tax	1,964.8	2,047.5	2,183.7	2,696.6
Add: Depreciation	334.8	360.5	499.4	588.3
(Inc)/dec in Current Assets	-1,082.8	-639.6	-772.9	-1,107.2
Inc/(dec) in CL and Provisions	487.1	572.3	580.9	707.0
Others	30.0	35.1	46.0	53.1
CF from operating activities	1,733.9	2,375.7	2,537.0	2,937.7
(Inc)/dec in Investments	511.3	150.0	150.0	150.0
(Inc)/dec in Fixed Assets	-1,802.8	-1,200.0	-1,000.0	-1,000.0
Others	608.8	-421.9	-272.7	-110.4
CF from investing activities	-682.7	-1,471.9	-1,122.7	-960.4
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	241.8	-24.8	50.0	-130.0
Dividend paid & dividend tax	-916.9	-1,187.4	-1,187.4	-1,187.4
Inc/(dec) in Sec. premium	1.3	-88.9	-176.3	-53.1
CF from financing activities	-673.8	-1,301.1	-1,313.7	-1,370.5
Net Cash flow	377.4	-397.2	100.7	606.8
Opening Cash	424.2	801.5	404.3	505.0
Closing Cash	801.5	404.3	505.0	1,111.8

Source: Company, ICICI Direct Research

Balance sheet				₹ Crore
(Year-end March)	FY17	FY18	FY19E	FY20E
Liabilities				
Share Capital	95.9	95.9	95.9	95.9
Reserve and Surplus	7,508.0	8,314.3	9,180.2	10,689.4
Total Shareholders funds	7,603.9	8,410.2	9,276.1	10,785.3
Total Debt	545.5	520.8	570.8	440.8
Deferred Tax Liability	359.2	417.1	417.1	417.1
Minority Interest	375.5	327.7	344.0	361.2
Total Liabilities	8,894.9	9,684.2	10,616.6	12,013.0
Gross Block	3,720.3	4,378.1	6,183.2	7,333.2
Less: Acc Depreciation	610.0	973.1	1,472.6	2,060.9
Capital WIP	257.5	1,405.1	800.0	650.0
Total Fixed Assets	3,367.8	4,810.1	5,510.7	5,922.4
Other Investments	1,300.7	1,084.0	984.0	884.0
Liquid Investments	1,351.3	1,056.7	1,006.7	956.7
Goodwill on Consolidation	193.2	327.3	327.3	327.3
Current Assets				
Inventory	2,626.9	2,658.3	3,035.0	3,575.1
Debtors	1,446.6	1,730.6	1,975.9	2,327.5
Loans and Advances	17.9	12.8	14.8	16.8
Other Current Assets	721.7	1,051.0	1,200.0	1,413.5
Cash	801.5	404.3	505.0	1,111.8
Total Current Assets	5,614.7	5,857.1	6,730.7	8,444.7
›ilities				
Creditors	1,922.8	2,160.0	2,466.1	2,789.6
Provisions	195.2	196.7	224.6	254.1
Other current liabilities	1,408.5	1,742.1	1,989.0	2,342.9
Total Current Liabilities	3,526.5	4,098.8	4,679.6	5,386.6
Net Current Assets	2,088.2	1,758.3	2,051.1	3,058.1
Other Non Current Assests Total	593.7	647.9	736.9	864.6
Total Assets	8,894.9	9,684.3	10,616.6	12,013.0

Source: Company, ICICI Direct Research

Key ratios				
(Year-end March)	FY17	FY18	FY19E	FY20E
Per share data (₹)				
EPS	21.0	21.9	22.8	28.1
Cash EPS	24.5	25.6	28.0	34.3
BV	79.3	87.7	96.7	112.5
DPS	9.6	12.4	12.4	12.4
Cash Per Share	6.4	10.1	15.4	21.5
Operating Ratios (%)				
EBITDA Margin	19.8	19.0	18.0	18.5
EBIT Margin	17.6	16.9	15.4	15.9
PAT Margin	13.3	12.2	11.4	11.9
Activity Ratios				
Inventory days	63.7	57.7	57.7	57.7
Debtor days	35.1	37.5	37.5	37.5
Creditor days	46.6	46.9	46.9	45.0
Return Ratios (%)				
RoE	32.8	31.6	30.0	32.2
RoCE	26.3	24.4	23.5	25.0
RoIC	46.5	48.6	40.7	44.4
Valuation Ratios (x)				
P/E	54.2	52.1	50.1	40.5
EV / EBITDA	36.1	33.9	31.4	25.7
EV / Net Sales	7.2	6.4	5.6	4.8
Market Cap / Sales	7.3	6.5	5.7	4.8
Price to Book Value	14.4	13.0	11.8	10.1
Solvency Ratios				
Debt/EBITDA	0.2	0.2	0.2	0.1
Debt / Equity	0.1	0.1	0.1	0.0
Current Ratio	1.4	1.3	1.3	1.4
Quick Ratio	0.6	0.7	0.7	0.7

Source: Company, ICICI Direct Research

ICICI Direct Research coverage universe (Consumable)

Sector / Company	CMP (₹)	TP(₹)	Rating	M Cap (₹ Cr)	EPS (₹) FY18	FY19E	FY20E	P/E (x) FY18	FY19E	FY20E	EV/EBITDA (x) FY18	FY19E	FY20E	RoCE (%) FY18	FY19E	FY20E	RoE (%) FY18	FY19E	FY20E
Asian Paints (ASIPAI)	1,140	1,180	Hold	109,326	21.9	22.8	28.1	52.1	50.1	40.5	33.9	31.4	25.7	31.6	30.0	32.2	24.4	23.5	25.0
Astral Polytecnik (ASTPOL)	866	1,180	Hold	10,370	14.7	20.1	26.6	59.0	43.1	32.6	41.6	30.3	24.1	22.9	25.0	26.6	17.2	18.2	19.6
Bajaj Electricals (BAJELE)	490	650	Hold	5,000	8.2	20.3	22.3	59.8	24.1	21.9	23.4	17.5	15.0	18.1	17.9	18.1	13.7	19.8	18.4
Havells India (HAVIND)	589	650	Buy	36,748	11.4	13.3	17.1	51.6	44.2	34.4	34.7	29.4	22.7	25.2	28.6	30.7	18.8	21.3	22.7
Kansai Nerolac (KANNER)	360	390	Hold	19,401	9.6	10.1	11.1	37.6	35.7	32.4	24.5	22.9	18.7	24.5	24.4	26.1	16.5	16.6	16.3
Pidilite Industries (PIDIND)	924	1,200	Hold	47,368	18.8	19.5	24.4	49.0	47.3	37.9	41.8	36.4	30.0	33.6	30.9	33.6	27.0	22.6	24.4
Essel Propack (ESSPRO)	88	115	Hold	2,765	5.5	5.9	7.7	15.9	15.0	11.5	8.4	8.1	6.8	18.0	19.0	21.2	15.2	14.8	17.5
Supreme Indus (SUPIND)	964	1,320	Hold	12,245	33.9	40.8	44.8	28.4	23.6	21.5	19.2	17.3	14.7	27.9	28.5	29.7	22.7	22.9	23.0
Symphony (SYMLIM)	958	1,350	Buy	6,702	27.5	23.1	33.1	34.8	41.4	29.0	34.4	38.1	25.2	41.3	29.9	39.1	31.5	26.4	33.8
V-Guard Ind (VGUARD)	167	220	Hold	7,109	3.1	4.2	5.5	53.3	40.0	30.4	48.0	36.6	27.6	23.7	28.8	30.9	17.7	21.8	23.5
Voltas Ltd (VOLTAS)	506	650	Hold	16,735	17.5	21.3	24.5	29.0	23.8	20.7	30.0	24.7	20.6	19.8	25.0	25.0	14.8	19.0	18.8
Time Techno (TIMTEC)	114	175	Buy	2,578	8.0	10.0	12.5	14.3	11.4	9.1	8.5	7.2	6.1	14.9	16.5	18.0	12.2	13.7	14.7

Source: Company, ICICI Direct Research

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Buy: >10%/15% for large caps/midcaps, respectively;
Hold: Up to +/-10%;
Sell: -10% or more;

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