Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Asian Paints

Results beat expectations on all fronts

Consumer Goods	Sharekhan code: ASIANPAINT	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,711**	
Price Target: **Rs. 1,987**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

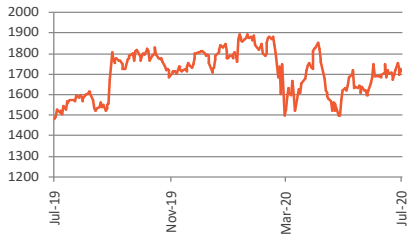
Company details

Market cap:	Rs. 164,114 cr
52-week high/low:	Rs. 1916/1432
NSE volume: (No of shares)	14.2 lakh
BSE code:	500820
NSE code:	ASIANPAINT
Free float: (No of shares)	45.3 cr

Shareholding (%)

Promoters*	52.8
FII	18.2
DII	9.0
Others	20.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.0	-6.3	-4.2	15.3
Relative to Sensex	-11.4	-28.1	4.2	14.6

Sharekhan Research, Bloomberg

Summary

- Though Q1 saw the impact of the April lockdown that hit around 30-40 days of business,sales improved post Unlocking 1.0, and June saw double-digit volume growth for Asian Paints (APL) in decorative paints segment.
- Sharp recovery in June helped APL post better-than-expected performance in Q1FY2021 with revenues declining by 43% y-o-y (against street expectation of 55-60%) and OPM standing at 16.6% (as against our as well street expectation of 9.5%).
- We maintain that FY2022 would see strong recovery on back of pent-up demand for painting activities, shift to trusted brands and higher construction activities.
- We have increased our earnings estimates by 6% and 4% for FY2021 and FY2022, respectively. We maintain our Buy recommendation on the stock with a PT of Rs. 1,987.

APL's consolidated revenue decreased by ~43% to Rs. 2,922.7crore (ahead of our expectation of Rs. 2054.1crore). April was a washout for decorative paints business but a recovery was seen from May (volume recovery to 80% of base quarter) and strong pick-up in demand was seen for decorative paints in June which led to double-digit volume growth of 14% during the month. Benign crude oil prices led gross margins to jump by 110 bps to 44.7%. Lower operating leverage led to operating margins (OPM) declining by 611 bpsto 16.6%, which is better than our expectation due to cost-saving initiatives and stringent management of ad-spends.With fear of virus receding among consumers, repainting activities gaining momentum (tier-III/IV towns recovered to pre-COVID levels). Further the company's safe-painting initiative will help gain more customers and achieve market share gains in the coming quarters. If the Coronavirus scare recedes significantly, H2FY2021 will be much better than H1. Considering the strong traction for its products, the waterproofing segment can be a revenue contributor in the near to medium term.

Key positives

- Decorative paints segment registered 14% volume growth in the month of June.
- OPM at 16.6% is much better than ours as well as the street's expectation of 9.5%.

Key negatives

- April was a washout month on account of no sales during lockdown, resulting in a 43% decline in revenue.
- Metros and some Tier-1 towns are yet to see significant recovery in business environment.

Our Call

Valuation: Maintain Buy with a PT of Rs. 1,987: We have increased our earnings estimates by 6% and 4% for FY2021 and FY2022, respectively to factor in better than expected performance in Q1. The company has sturdy balance sheet and strong liquidity position which will help APL to recover faster than small players and gain market share. The stock is currently trading at 48.3x its FY2022E earnings. Strong positioning in decorative paints business and a sturdy balance sheet would help in maintaining the premium valuation. We maintain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 1,987.

Key Risks

Any late recovery in demand or substantial increase in crude prices and crude derivative prices would act as a key risk to our earnings estimates.

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	19,248	20,211	19,700	23,785	27,379
OPM (%)	19.6	20.6	20.4	21.5	22.0
Adjusted PAT	2,214	2,779	2,586	3,400	4,105
% YoY growth	9.2	25.5	-6.9	31.5	20.7
Adjusted EPS (Rs.)	23.1	29.0	27.0	35.5	42.8
P/E (x)	74.1	59.1	63.5	48.3	40.0
P/B (x)	17.3	16.2	14.3	12.4	10.4
EV/EBIDTA (x)	41.0	36.7	38.2	30.2	25.4
RoNW (%)	24.8	28.4	24.0	27.6	28.4
RoCE (%)	22.1	22.2	19.1	22.0	22.8

Source: Company; Sharekhan estimates

Consolidated revenue declined by ~43% y-o-y, strong double-digit volume growth in June: Consolidated revenue declined by 42.7% y-o-y to Rs. 2,922.7 crore, which was ahead of our expectation of Rs. 2,054 crore, affected by sudden stoppage of business activities in the initial part of the quarter due to a nationwide lockdown. April was a complete washout for the decorative paints business. Recovery was seen from May when the business registered double-digit volume growth in June. Home improvement and industrial paints also witnessed some improvement in June. International business was a mixed bag, with some markets performing better, while others were affected by lockdown. Geographies such as Africa and Middle East performed better than South Asia which was impacted by lockdowns. Soft raw material prices caused gross margins to expand by 110 bps to 44.7%. However, higher employee costs and lower operating leverage resulted in OPM to decline by 611 bps. Operating profit declined by 58.2% y-o-y to Rs. 484.3 crore. Lower other income and lower revenue resulted in profit before tax (PBT) to fall by 68.4% y-o-y to Rs. 320 crore. A lower tax incidence led adjusted PAT to decline by 64.7% y-o-y to Rs. 233.9 crore. Reported PAT came in at Rs. 219.6 crore in Q1FY2021 as against Rs. 674.2 crore in Q1FY2020.

Standalone revenue fell by 44%; margins affected by lower operating leverage: Standalone revenue declined by 44.1% y-o-y to Rs. 2,446.6 crore, affected by lower sales in April and May due to a nationwide lockdown. Domestic decorative business registered strong double-digit volume growth in June. Lower input costs resulted in gross margins to expand by 154 bps to 46.3%. However, lower operating leverage led OPM to decline by 579 bps to 19.1%. Operating profit fell by 57.2% y-o-y to Rs. 467 crore. A fall in other income and revenue resulted in PBT to decline by 65.8% y-o-y to Rs. 337 crore. However, a lower tax incidence led reported PAT to decline by 61.4% y-o-y to Rs. 251.9 crore.

Other conference call highlights:

- **Rural/Tier-II, III and IV towns recovering faster than urban:** April was a complete washout month for domestic decorative paints business. Recovery was witnessed in May with volumes getting back to 80% of pre-COVID levels and the business registered a strong 14% volume growth in June. Overall, the business got back to 62% in volume terms and 56% in value terms of pre-COVID levels. Tier-II, III and IV towns recovered faster than metros and tier-I cities and the demand is back to pre-COVID levels. The western region is severely impacted as against the rest of India, which will take some time to recover. The company witnessed higher demand for health/hygiene products such as the Royale Health Shield Anti-bacterial paint. The safe painting campaign undertaken by the company has given consumers the confidence to carry on repainting activities with lesser fear of the pandemic. This will help the company add new consumers. This, along with improving recovery rate of COVID-19 will help the demand get back on track earlier than expected. If the Coronavirus scare increases, it will halt sales. However, if the pandemic situation is controlled by September, a faster recovery in demand could be seen prior to the festive season leading to better performance in H2FY2021.
- **Soft raw material prices and efficiencies to help margins to improve:** Raw material prices were sequentially lower, which helped gross margins to expand. The company will continue to benefit from lower raw material prices unless there is a significant rise in crude oil prices, which will help margins to improve sequentially. As the recovery is faster in tier-II, III and IV towns, sales for emulsions/value added products have been higher as compared to premium/super-premium products. This has led to the gap between value and volume growth to sustain. Once we see recovery in metros and tier-I cities, gradually the gap is expected to reduce. The company has undertaken certain cost-saving initiatives such as relooking at rentals, freight control, prudent advertising spends and reduction in discretionary expenditure. This, along with soft raw material prices will help the company post better margins in the coming quarters.
- **Underpenetrated waterproofing market provides huge headroom for growth:** The Indian waterproofing market is underutilised and stands at Rs. 6,000 crore, which is much lower compared to developed countries such as China. The per-capita consumption is very low in India. This provides a huge scope for growth for the company. With increasing awareness among consumers on the requirement of waterproofing of houses/terraces, there will be higher traction for such products,in turn driving growth in the waterproofing segment. With an increase in the size of the waterproofing market, APL will also see considerable growth in its waterproofing segment in the coming quarters.

- **Africa and Middle East recovering faster, South Asia will take time to recover:** APL's international business witnessed good growth in June driven by double-digit volume growth in Africa and Middle East as the lockdown began to be lifted in April/early May in the UAE and certain parts of Africa. Faster recovery was witnessed in both the Middle East and Africa. South Asia had a higher impact with Nepal being impacted severely. Bangladesh and Sri Lanka have witnessed recovery in June, whereas Nepal will take some to recover.
- **Capex to sustain at current levels:** APL has completed a major part of its capex cycle in FY2018-19 as two major plants have been commissioned. The capex for FY2020 stood at about Rs. 350 crore. Going ahead, we expect the capex to be slightly lower in FY2021 and to be around the same range of Rs. 300-400 crore in FY2022 and FY2023. The company's cash position is strong and thus, we do not expect any major cuts in capex.

Results (Consolidated) **Rs cr**

Particulars	Q1FY21	Q1FY20	y-o-y (%)	Q4FY20	q-o-q (%)
Total Revenue	2922.7	5104.7	-42.7	4635.6	-37.0
Raw Material Cost	1615.0	2876.7	-43.9	2510.6	-35.7
Employee Cost	361.5	339.9	6.4	335.6	7.7
Other Expenses	461.9	730.2	-36.7	929.8	-50.3
Total Operating Cost	2438.4	3946.8	-38.2	3776.0	-35.4
Operating Profit	484.3	1157.9	-58.2	859.6	-43.7
Other Income	47.1	73.5	-35.9	55.8	-15.6
Interest & Other Financial Cost	20.1	26.7	-24.5	25.7	-21.6
Depreciation	191.2	191.8	-0.3	194.5	-1.7
Profit Before Tax	320.0	1013.1	-68.4	695.3	-54.0
Tax Expense	86.2	351.1	-75.5	219.0	-60.7
Adjusted PAT before MI	233.9	662.0	-64.7	476.3	-50.9
Minority Interest (MI)	-14.3	12.2	-	4.0	-
Reported PAT	219.6	674.2	-67.4	480.2	-54.3
Adj. EPS (Rs)	2.3	7.0	-67.4	5.0	-54.3
			bps		bps
GPM (%)	44.7	43.6	110	45.8	-110
OPM (%)	16.6	22.7	-611	18.5	-197

Source: Company; Sharekhan Research

Results (Standalone) **Rs cr**

Particulars	Q1FY21	Q1FY20	y-o-y (%)	Q4FY20	q-o-q (%)
Total Revenue	2446.6	4380.2	-44.1	3879.0	-36.9
Raw Material Cost	1312.8	2418.0	-45.7	2056.0	-36.1
Employee Cost	271.9	247.5	9.8	237.2	14.6
Other Expenses	394.9	624.8	-36.8	810.0	-51.3
Total Operating Cost	1979.6	3290.3	-39.8	3103.2	-36.2
Operating Profit	467.0	1089.9	-57.2	775.8	-39.8
Other Income	51.8	85.5	-39.4	65.1	-20.4
Interest & Other Financial Cost	14.9	19.3	-22.5	19.3	-22.9
Depreciation	166.9	169.8	-1.7	172.2	-3.0
Profit Before Tax	337.0	986.3	-65.8	649.5	-48.1
Tax Expense	85.1	333.9	-74.5	164.2	-48.2
Adjusted PAT before MI	251.9	652.5	-61.4	485.3	-48.1
Exceptional Items	0.0	0.0	-	33.2	-
Reported PAT	251.9	652.5	-61.4	452.1	-44.3
Adj. EPS (Rs)	2.6	6.8	-61.4	5.1	-48.1
			bps		bps
GPM (%)	46.3	44.8	154	47.0	-66
OPM (%)	19.1	24.9	-579	20.0	-91

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Recovery in repainting activities to drive growth in FY2022

April and May (constitutes ~25% of total per annum sales) are the key months for re-painting activities in the domestic market. The lockdown affected the sales in April, which was a washout month for most paint companies. However, strong recovery was seen in May, largely in tier-III and tier-IV towns and June witnessed recovery in sales to pre-COVID levels. If the Coronavirus scare reduces in the coming months, a strong recovery could be seen prior to festive season and recovery could be much better than anticipated for H2FY2021. However, the loss of two major months of business would be a drag on FY2021 industry performance along with lower demand for automotive paints. Faster recovery would be seen in FY2022 with recovery in re-painting activities and new construction activities.

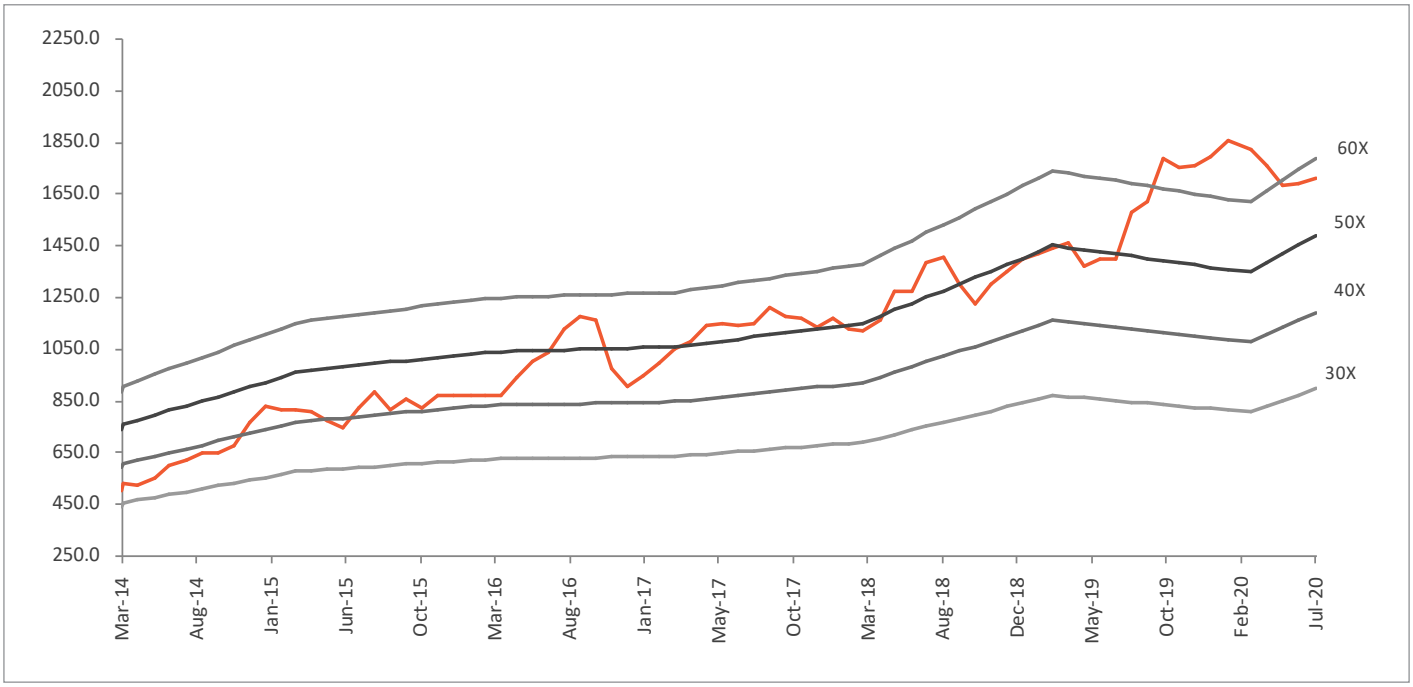
■ Company outlook - Near term growth levers intact

APL's management has indicated that demand in tier-IIIand tier-IVcities has reached to pre-COVID level and is expected to improve further. Metros and tier-Icities (that constitute ~40% of sales) would see recovery in demand post significant reduction in virus threat. Initiatives such as safe painting and higher demand for value for money products would help in maintaining growth momentum. Lower input prices would provide support toprofitability. Domestic market share gains, product additions and strong traction to adjacent segments such as waterproofing would be medium-term growth drivers.

■ Valuation - Premium valuation to sustain

We have increased our earnings estimates by 6% and 4% for FY2021 and FY2022, respectively to factor in better than expected performance in Q1. The company has sturdy balance sheet and strong liquidity position which will help APL to recover faster than small players and gain market share. The stock is currently trading at 48.3x its FY2022E earnings. Strong positioning in decorative paints business and a sturdy balance sheet would help in maintaining the premium valuation. We maintain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 1,987.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Berger Paints	77.5	77.7	59.1	48.1	47.4	37.8	33.8	24.1	28.3
Kansai Nerolac	44.9	50.9	35.9	28.8	31.8	24.5	18.5	13.1	17.5
Asian Paints	59.1	63.5	48.3	36.7	38.2	30.2	22.2	19.1	22.0

Source: Company, Sharekhan estimates

About company

APL is the largest paint company in India with a market leadership of over 50 years and stands among the top 10 paint companies in the world. The company has 27 paint manufacturing plants in 16 countries, serving customers in over 65 countries globally. The company offers paints – decorative and industrial, wall coverings and waterproofing along with kitchen and bath fittings, adhesives and services. Deco India, including decorative paints, water proofing, wall coverings and adhesives, constitutes almost 83% to the company's total revenue, whereas the industrial coatings space including automotive and non-automotive constitutes only 3%, through two 50:50 joint ventures with PPG industries Inc., USA (AP-PPG). The international business contributes ~12% to the total revenue mainly dominated by Nepal, Sri Lanka and Bahrain. A small portion is contributed by kitchen and bath fittings through its subsidiary Sleek International Pvt. Ltd. (Sleek Kitchens) and EssEss Bath Fittings.

Investment theme

The rising middle-income group, fast urbanisation, shift from unorganised to organised space; and improving penetration in rural markets are some of the key revenue drivers for paint companies in the near to medium term. APL, with a leadership position in the decorative paint business and strong brand portfolio, will continue to deliver good earnings growth in the near term. APL is expected to benefit from its recent capacity expansion, vast distribution network, product innovation, and growth in its premium products.

Key Risks

- **Increased raw-material prices:** Any significant increase in crude prices and other input costs will affect the company's profitability.
- **Slowdown in economic growth:** Any slowdown in economic growth will affect repainting demand, which constitutes almost 70% of the total paint demand.
- **Slowdown in the auto industry:** Further sluggishness in demand in the auto industry or slowdown in infrastructure development will affect the industrial coatings segment.

Additional Data

Key management personnel

Amit Syngle	Managing Director & CEO
Ashwin Dani	Chairman
R J Jeyamurugan	CFO & Company Secretary

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Teesta Retail Private Limited	4.9
2	Life Insurance Corporation of India	2.8
3	Vanguard Group Inc	1.1
4	SBI Funds Management Pvt Ltd	1.1
5	BlackRock Inc	1.1
6	Capital Group Cos Inc	1.1
7	Axis Asset Management Co Ltd	0.7
8	JP Morgan Chase & Co	0.6
9	ICICI Prudential Asset Management	0.5
10	UTI Asset Management Co Ltd	0.4

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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