Sharekhan by BNP PARIBAS

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Asian Paints Limited

Rural India brings recovery cheer

Consumer Goods	Sharekhan code: ASIANPAINT	Company 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. 1,956**	
Price Target: **Rs. 2,275**	↑

↑ Upgrade ⟺ Maintain ↓ Downgrade

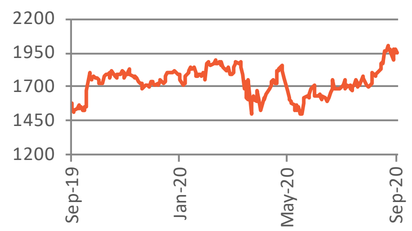
Company details

Market cap:	Rs. 187,619 cr
52-week high/low:	Rs. 2,016/1,432
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	14.1	19.8	5.7	27.4
Relative to Sensex	12.3	6.9	5.9	23.0

Sharekhan Research, Bloomberg

Summary

- Construction and painting activities have re-gained momentum especially in the tier III/IV towns. Further there is an emerging trend of consumer shifting to better quality paints (including puttys, distempers and emulsions) in the rural market.
- Asian Paints (APL), a leading player in the decorative paints segment, will benefit from the rural recovery and its volumes are likely to grow in double digits in the near term. In metros, a gradual recovery is likely from Q3FY2021.
- Benign input prices would continue to support margins; cost savings would help OPM improve q-o-q and stabilise in Q3FY2021.
- A sturdy balance sheet, consistent dividend payouts and focus on becoming a complete home improvement player makes APL a better pick in consumer goods space. We maintain Buy with revised PT of Rs. 2,275.

Q1FY2021 was lull for all the paint companies' earnings as the COVID-19 lockdown affected sales of decorative paints across India. Asian Paints Limited's (APL's) revenues declined ~43% y-o-y. April was a wash-out month, while volumes recovered to 80% of pre-COVID levels in May. In June, volume growth returned to double digits at 14%. Our channel checks suggest that as construction and painting activities regain momentum, sales growth have kept up their pace in July-August,20 (despite temporary hiccups of local lockdowns). Demand was strong in tier-III and tier-IV towns, which were less affected by the Coronavirus spread. Metros (including New Delhi and Mumbai) are yet to see a significant recovery. However, some green shoots are visible as the virus' scare has reduced and internal mobility in cities has improved. Activities such as electrical/air conditioner services have resumed gradually. Stalled home renovations have resumed with the easing of lockdowns in most cities (barring containment zones). This gives us an indication that the re-painting activities will resume in top urban markets from Q3FY2021. We expect realisations to be lower y-o-y but high demand is expected to be seen for the bottom-of-the pyramid products. Hence, revenue growth is expected to lag volume growth in the near term. On the other hand, benign input prices will continue to support profitability in the near term. This coupled with an agile distribution and supply chain would help in fulfilling customer needs and simultaneously reduce costs.

Our Call

Valuation: Maintain Buy with revised price target of Rs. 2,275: A shorter re-painting cycle of 3-5 years, shift to trusted brands, rapid urbanisation and resurgence in the industrial/construction activities remain key long-term growth drivers for the paint companies. Strong product portfolio (straddling the pyramid), agile supply chain and strong distribution reach (over 65,000 dealers) would help APL stand tall among peers and help it achieve double-digit earnings growth in the near to medium term. Stable working capital management and strong cash flows will continue to support its growth prospects. Thus, stable earnings visibility in the medium term and consistent dividend payout of 50%+ will keep valuation at premium. We therefore continue to prefer APL as it is a safe bet from a long-term perspective. We maintain our Buy recommendation on the stock with a revised price target of Rs. 2,275.

Key Risks

Any disturbance caused by frequent localised lockdowns or a sharp increase in the key input prices would act as a key risk to our earnings estimates in the near to medium term.

Valuations (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	19,248	20,211	19,746	23,841	27,443
OPM (%)	19.6	20.6	20.4	21.5	22.0
Adjusted PAT	2,214	2,779	2,596	3,413	4,119
% YoY growth	9.2	25.5	-6.6	31.5	20.7
Adjusted EPS (Rs.)	23.1	29.0	27.1	35.6	42.9
P/E (x)	84.7	67.5	72.3	55.0	45.5
P/B (x)	19.8	18.5	16.4	14.2	11.9
EV/EBIDTA (x)	46.8	42.0	43.6	34.4	29.0
RoNW (%)	24.8	28.4	24.1	27.6	28.4
RoCE (%)	22.1	22.2	19.2	22.1	22.8

Source: Company; Sharekhan estimates

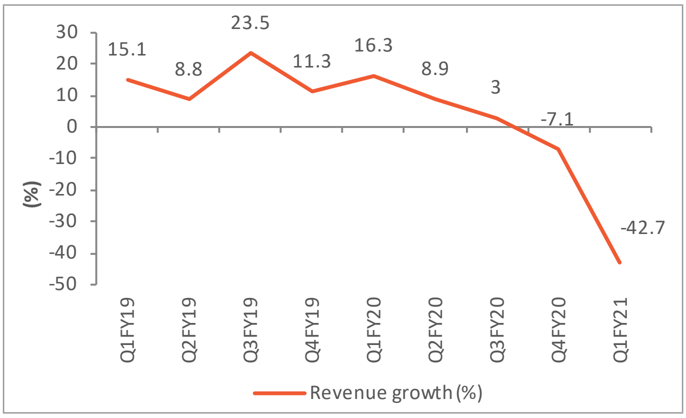
Focus on building agile supply chain: APL is focusing on building agile supply chain to fulfil customer needs and simultaneously reduce costs. In tier-I cities, the company offers day zero promise for the dealers, which means if an order is placed around 10-11 AM, products will be delivered the same day. The company also uses connected IoT and visibility systems so that a complete tracking and tracing could be done right from when the products leave the factories and land at the dealers' shops.

Painters and customers safety was given high importance: APL has steadily taken care of its stakeholders. The threat of infection is a serious cause of concern for painters, their families and consumers and hence the company devised the safe painting service to safeguard their needs. This digital campaign echoes the provision and safety-standards the company is putting into place to ensure the well-being and safety of all stakeholders. APL has provided safety kits, insurance support to painters and educated them about hygiene levels to re-start operations. APL started getting more and more enquiries from customers for painting activities and other services. The company started providing such leads to painters to re-start operations. Its safe painting campaign got encouraging response on account of its hygiene services (sanitises the house after completion of painting activities.

Channel-checks suggest recovery in demand in large metros by Q3: Q1FY2021 was lull quarter for the paint companies' earnings as the COVID-19 lockdown affected sales of decorative paints across India. Asian Paints Limited's (APL's) revenues declined ~43% y-o-y. April was a wash-out month, while volumes recovered to 80% in May. In June, volume growth returned to double digits at 14%. Our channel checks suggest that as construction and painting activities regain momentum, sales growth have kept up their pace in July-August,20 (despite temporary hiccups of local lockdowns). Strong demand is witnessed in tier-III and tier-IV towns, which were less affected by the pandemic. Demand in metros (especially in Mumbai) is expected to come back on track in Q3FY2021 with re-painting activities expected to come back on track from November-December according to dealers and larger contractors. At present nominal services such as electrical/air-conditioner/ water purifier servicing have started regaining momentum. Renovations/home improvement activities which were put on halt during the lockdown period, have resumed from August-September in metros.

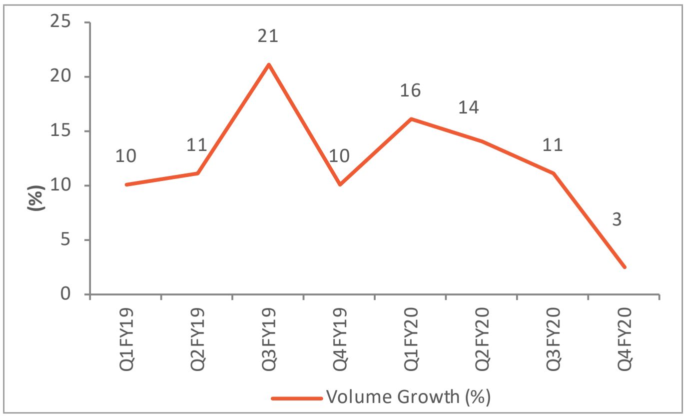
Financials in charts

Negligible sales in April affected revenue growth in Q1FY21



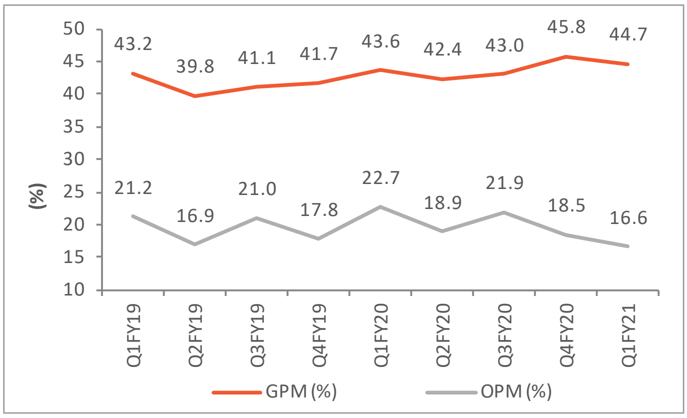
Source: Company, Sharekhan Research

Volume growth was consistent till Q3FY20



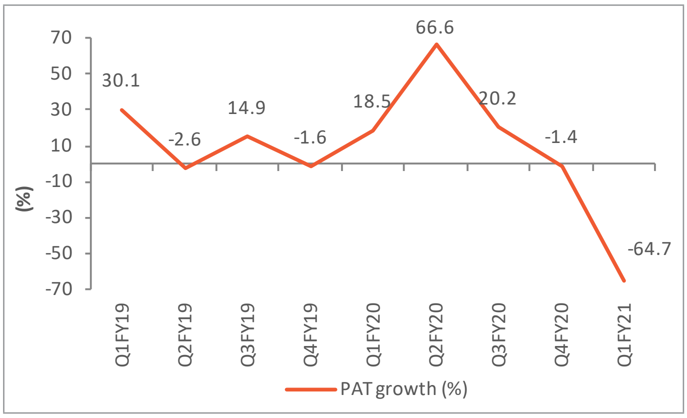
Source: Company, Sharekhan Research

GPM improved y-o-y in Q1, low operating leverage hit OPM



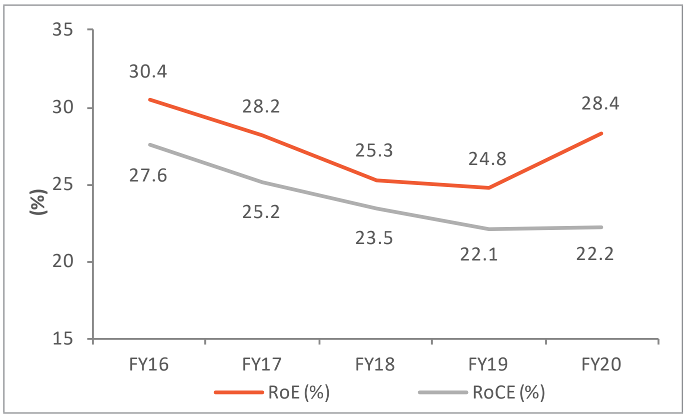
Source: Company, Sharekhan Research

Profitability affected by lockdown



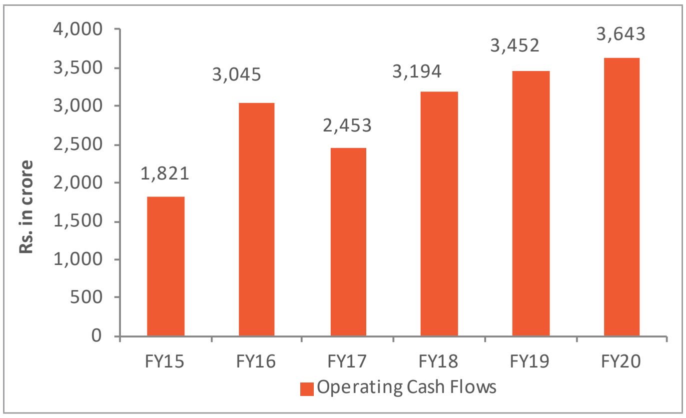
Source: Company, Sharekhan Research

Return ratios on an improving trend



Source: Company, Sharekhan Research

Strong operating cash flows



Source: Company, Sharekhan Research

Outlook and Valuation

Sector outlook - Recovery in repainting activities to drive growth in FY2022

April and May (constitute ~25% of annual sales) are the key months for re-painting activities in India. The lockdown affected the sales in April, which was a wash-out month for most paints companies. However, strong recovery was seen in May, largely in tier-III and -IV towns and June saw a recovery in sales to pre-COVID levels. The virus' scare is receding in metros (such as Mumbai and New Delhi) as mobility resumes. Home improvement and renovation activities are expected to regain pace in November-December 2020. However, loss of two major months of business (April-May) would be a drag on FY2021 industry performance along with a lower demand for automotive paints. Faster recovery would be seen in FY2022 with a recovery in re-painting activities and new construction activities.

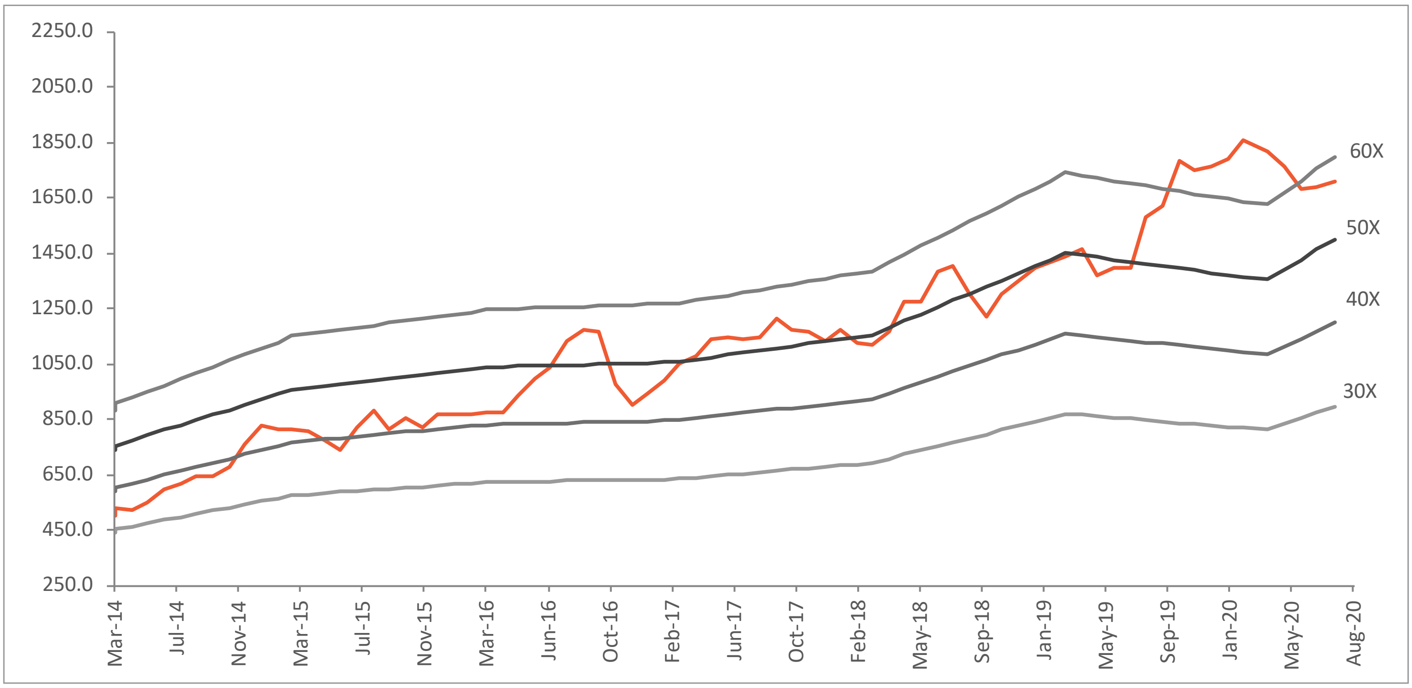
Company outlook - Near-term growth levers intact

APL's Management has indicated that the demand in tier-III and tier-IV towns has reached pre-COVID levels and is expected to improve further. Metros and tier-I (constitutes ~40% of total sales) would see recovery in demand post significant reduction in virus threat. Initiatives such as safe painting is gaining good traction. Further, higher demand is seen in value-for-money paints as shift is happening to quality products in the rural market. Benign input prices would continue to support the profitability. Shortening of re-painting cycle to 3-5 years, shift to trusted brands, rapid urbanisation and resurgence in the industrial/construction activities remains key long-term growth drivers for APL.

Valuation - Premium valuation to sustain

Strong product portfolio (straddling the pyramid), agile supply chain and strong distribution reach (over 65,000 dealers) would help APL stand tall among peers and help it achieve double-digit earnings growth in the near to medium term. Stable working capital management and strong cash flows will continue to support its growth prospects. Thus, stable earnings visibility in the medium term and consistent dividend payout of 50%+ will keep valuation at premium. We therefore continue to prefer APL as it is a safe bet from a long-term perspective. We maintain our Buy recommendation on the stock with a revised price target of Rs. 2,275.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Berger Paints	81.6	73.0	57.2	51.7	46.7	38.2	20.7	21.0	23.7
Kansai Nerolac	49.1	43.8	37.4	33.6	29.1	25.2	13.8	14.5	15.4
Asian Paints	67.5	72.3	55.0	42.0	43.6	34.4	22.2	19.2	22.1

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 Ess Ess 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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