Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Asian Paints Limited

Colourful Q2, complete home decor play in making

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. 2,100**	
Price Target: **Rs. 2,475**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

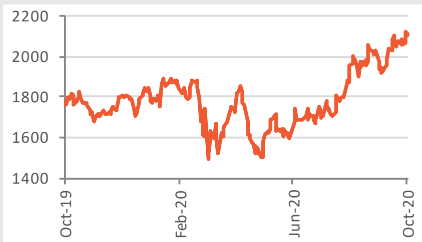
Company details

Market cap:	Rs. 201,456 cr
52-week high/low:	Rs. 2,143 / 1,432
NSE volume: (No of shares)	26.4 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	8.5	23.7	15.9	18.0
Relative to Sensex	1.0	16.6	-13.4	13.9

Sharekhan Research, Bloomberg

Summary

- Asian Paints Limited (APL) registered healthy performance. Revenue grew by 6%; OPM improving by 474 bps to 23.6% and strong growth of 36% at PBT level.
- Volume growth in the domestic decorative business stood at 11%, ahead of our and street expectation of 7%-8%.
- The stock is currently trading at 59.2x/49.3x its FY2022/23E EPS. Leadership position in the domestic decorative paint industry, sturdy balance sheet, and good dividend pay-out will keep valuations at premium level.
- We have fine-tuned our earnings estimates to factor better-than-expected performance. We retain our Buy recommendation with a revised PT of Rs. 2,475.

Asian Paints Limited (APL) registered strong all-round performance in Q2FY2021. The company's revenue grew by 6%, OPM expanded by 474 bps to 23.6% (led by higher gross margins and lower fixed cost), and PBT grew by 35%. The company maintained the momentum of double-digit volume growth achieved in June 2020 and registered volume growth of 11% in the domestic decorative paints business. This was aided by upgrades in emulsion, undercoats performing well, water proofing doing well, and some luxury emulsion products gaining good traction. International business registered ~8% growth, with double-digit volume growth in Sri Lanka and Bangladesh. Strong uptick in passenger vehicles (PV) was aided by OEM business reporting good growth in Q2 and industrial paints recovering gradually. Home improvement business has recovered to 97% of pre-COVID levels, with the bath business registering mid-single digit growth. With focus on becoming a complete home decor play, the company has introduced products in home lightings, furnishings, and furniture. Sanitising service business 'San Assure' is getting good response and is helping the company to promote its paint business. Tier-II and tier-III cities continue to perform well, while metros have recovered to 70%-80% of pre-COVID levels. If the virus continues to recede further, management is confident of improvement in the decorative paints volume growth trajectory. The company has worked upon reducing its fixed costs by cutting down on several costs such as rentals, which will provide support to margins in the near term. Raw-material prices have remained benign, which will help gross margins to sustain despite reduction in realisations in the coming quarters.

Key positives

- Volume growth of the decorative paints business stood at 11%.
- Losses in the home improvement business reduced to Rs. 4 crore in Q2FY2021 from ~Rs. 15 crore in Q2FY2020.
- Auto paints business saw an uptick; Industrial paints expected to recover.

Key negatives

- Metros are yet to be fully recovered; currently recovered to 70%-80% of pre-COVID levels

Our Call

View: Maintain Buy with a revised PT of Rs. 2,475: We have fine-tuned our earnings estimates to factor in better-than-expected performance in Q2FY2021. Sustained recovery in volume growth and margin expansion would be key earnings growth drivers in the near to medium term. The stock is currently trading at 59.2x/49.3x its FY2022/23E EPS. Leadership position in the domestic decorative paints business, focus on becoming a complete play in the home decor space, sturdy balance sheet, and good dividend payout will keep valuations at the premium level. We maintain our Buy recommendation on the stock with a revised PT of Rs. 2,475.

Key Risks

Any disturbance caused by localised lockdown due to the sudden spike in COVID-19 cases or a sharp increase in 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	19,428	23,477	27,030
OPM (%)	19.6	20.6	21.3	21.8	22.5
Adjusted PAT	2,214	2,779	2,690	3,403	4,090
% YoY growth	*9.2*	*25.5*	*-3.2*	*26.5*	*20.2*
Adjusted EPS (Rs.)	23.1	29.0	28.04	35.47	42.6
P/E (x)	91.0	72.5	74.9	59.2	49.3
P/B (x)	21.3	19.9	17.4	15.1	12.7
EV/EBIDTA (x)	50.3	45.1	45.6	37.0	31.0
RoNW (%)	24.8	28.4	24.8	27.3	28.1
RoCE (%)	22.1	22.2	19.7	21.8	22.5

Source: Company; Sharekhan estimates

Consolidated revenue grew by ~6% y-o-y, double-digit volume growth in decorative paints business: Consolidated revenue grew by 5.9% y-o-y to Rs. 5,350.2 crore, which was ahead of our expectation of Rs. 5,201 crore, driven by 11% volume growth in the decorative paints business, which was better than our and street's expectation of 7%-8%. Value growth stood at 6%. Home improvement and industrial paints also witnessed some improvement during the quarter. The international business portfolio did well, supported by favourable market conditions in the Middle East, Africa, and Asia, with the exception of Nepal, which continued to witness challenging business conditions due to the pandemic. Favourable raw-material prices and better product mix caused gross margins to expand by 197 bps to 44.4%. This, along with cost optimisation and other efficiencies, resulted in a 474 bps expansion in OPM to 23.6%. Operating profit grew by 32.5% y-o-y to Rs. 1,265.2 crore. Despite lower other income, reduced interest costs resulted in profit before tax (PBT) to rise by 35.5% y-o-y to Rs. 1,133.7 crore. There was a one-time tax gain in the corresponding quarter last year due to reduction in corporate tax rate by the government. Thus, a higher tax incidence led to adjusted PAT stand flat at Rs. 851.9 crore. On a like-to-like basis, adjusted PAT grew in-line with PBT.

Standalone revenue grew by 5.8%; Efficiencies drove up margins: Standalone revenue grew by 5.8% y-o-y to Rs. 4,526.7 crore. Domestic decorative business registered double-digit volume growth. Lower input costs and improved product mix resulted in gross margin to expand by 203 bps to 45.4%. Operating efficiencies led OPM to increase by 498 bps to 25.4%. Operating profit rose by 31.6% 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. 1,149.6 crore. However, a higher tax incidence led reported PAT to stand flat at Rs. 793.1 crore.

Other conference call highlights:

- **Recovery led by tier-II/III/IV markets:** The decorative paint industry in India has started recovering from June, led by strong recovery in tier-II, III, and IV markets. The domestic decorative paint business' volume growth improved to 11% in Q2FY2021 from a 38% decline in Q1, improving m-o-m. Festive demand was witnessed across markets (especially in east). However, though metros have witnessed sequential recovery, they are still at 70%-80%, not back to pre-COVID levels. North and the east have shown better recovery than other regions. Mumbai, Bangalore, and Chennai markets are yet to see recovery due to higher COVID-19 cases.
- **New launches gaining good traction:** Emulsions and undercoats continue to perform well, whereas the waterproofing portfolio is expanding. Luxury emulsions in certain categories are doing well. New launches including anti-bacterial paints and a range of sanitisers and surface disinfectants are gaining good traction. APL continued to gain strong response to safe painting and sanitising services.
- **Healthy volume growth achieved in the international business:** The international business registered close to double-digit volume growth, driven by strong recovery in Africa, Middle East, Sri Lanka, and Bangladesh (reported double-digit volume growth). Nepal is still under pressure due to COVID-related restrictions. The company launched new products in premium and luxury emulsions in the international market to fill in product gaps. The waterproofing segment is also performing well across markets. Overall, international business reported revenue of Rs. 660 crore in Q2FY2021 and Rs. 1,056 crore in H1FY2021. PBT stood at Rs. 69 crore for Q2FY2021, registering growth of 44.3% y-o-y, driven by lower raw-material prices and sourcing and formulation efficiency.
- **Better mix improved gross margins:** Gross margin saw an expansion of 197 bps, largely led by soft input prices and better product mix. Demand recovery was witnessed across the range of products from economy to premium as well as some luxury range of products. Gross margins are good at the lower end of the paints portfolio. The improved mix along with favourable raw-material prices will help gross margins to remain high in the coming quarters.
- **Cost optimisation drove up OPM:** OPM expanded by 474 bps to 23.6% in Q2FY2021, much ahead of expectations, largely because of rental savings as a result of negotiations, reduction in travel expenses, and savings in marketing spends. Some of these savings are sustainable, however, as markets open up some of the variable expenses will go up again.

- **Expansion into furniture and lightings to become a complete home decor play:** The home improvement business (contributes ~2% to total revenue) has also seen recovery in both the kitchen and bath segments. Components and full kitchen segment saw good recovery, whereas institutional business picked up sequentially. The bath segment also witnessed good recovery led by economy range of products. To transform into a complete home decor solutions company, APL entered into lightings, furnishings, and furniture. The company has tapped all channels including retail, one-stop premium decor stores of APL, institutions, as well as architects and interior designers. Since the sector is largely unorganised, APL has a huge scope for growth.
- **Focus on dealer's health:** The company was able to support retailers very well, both in terms of demand and margins that they are making. The company supported them on multiple fronts, such as sorting out liquidity issues, providing health insurance, sanitising their shops, and providing new credit layers.
- **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 dealers, which means if an order is placed at around 10-11 AM, the products will be delivered the same day. The company also uses connected IoT and visibility systems so that complete tracking and tracing could be done, right from when the products leave the factories to when they land at the dealers' shops.

Result Snapshot (Consolidated) Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y (%)	Q1FY21	q-o-q (%)
Total Revenue	5350.2	5050.7	5.9	2922.7	83.1
Raw Material Cost	2974.5	2907.2	2.3	1615.0	84.2
Employee Cost	378.9	347.6	9.0	361.5	4.8
Other Expenses	731.7	841.1	-13.0	461.9	58.4
Total Operating Cost	4085.0	4095.8	-0.3	2438.4	67.5
Operating Profit	1265.2	954.8	32.5	484.3	-
Other Income	82.6	105.2	-21.4	47.1	75.5
Interest & Other Financial Cost	20.5	25.9	-20.9	20.1	1.9
Depreciation	193.6	197.2	-1.8	191.2	1.3
Profit Before Tax	1133.7	836.9	35.5	320.0	-
Tax Expense	293.6	7.2	-	86.2	-
Adjusted PAT	840.1	829.6	1.3	233.9	-
Minority Interest	11.8	15.4	-23.4	-14.3	-
Reported PAT	851.9	845.0	0.8	219.6	-
Adj. EPS (Rs.)	8.9	8.8	0.8	2.3	-
			BPS		BPS
GPM (%)	44.4	42.4	197	44.7	-34
OPM (%)	23.6	18.9	474	16.6	708

Source: Company; Sharekhan Research

Result Snapshot (Standalone) Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y (%)	Q1FY21	q-o-q (%)
Total Revenue	4526.7	4278.0	5.8	2446.6	85.0
Operating Profit	1149.6	873.5	31.6	467.0	146.2
Profit Before Tax	1060.1	793.0	33.7	337.0	-
Tax Expense	267.0	2.5	-	85.1	-
Reported PAT	793.1	790.5	0.3	251.9	-
Adj. EPS (Rs.)	8.3	8.2	0.3	2.6	-
			BPS		BPS
GPM (%)	45.4	43.4	203	46.3	-93
OPM (%)	25.4	20.4	498	19.1	631

Source: Company; Sharekhan Research

Performance of the Home improvement segment Rs cr

Particulars	Q2FY21
Kitchen business	
Revenue	61
Profit before tax	-4.4
Bath business	
Revenue	55
Profit before tax	0

Source: Company; Sharekhan Research

Result Snapshot (Standalone) Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y (%)	H2FY21	H1FY20	y-o-y (%)
Revenue	660	612	7.8	1059	1164	-9.0
Profit before tax	69	48	44.3	73	77	-4.9

Source: Company; Sharekhan Research

Outlook and Valuation

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

April and May (constitute ~25% of total per annum sales) are one of the key months for re-painting activities in the domestic market. The lockdown affected April sales, which was a wash-out month for most paint companies. However, strong recovery was seen in May/June, largely in tier-III and IV towns and continued in the subsequent months. Virus scare is receding in metros (such as Mumbai and Delhi) as mobility has resumed and business has recovered to 75% of pre-COVID levels. 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 lesser demand for industrial paints. Faster recovery would be seen in FY2022, with recovery in re-painting activities and new construction activities.

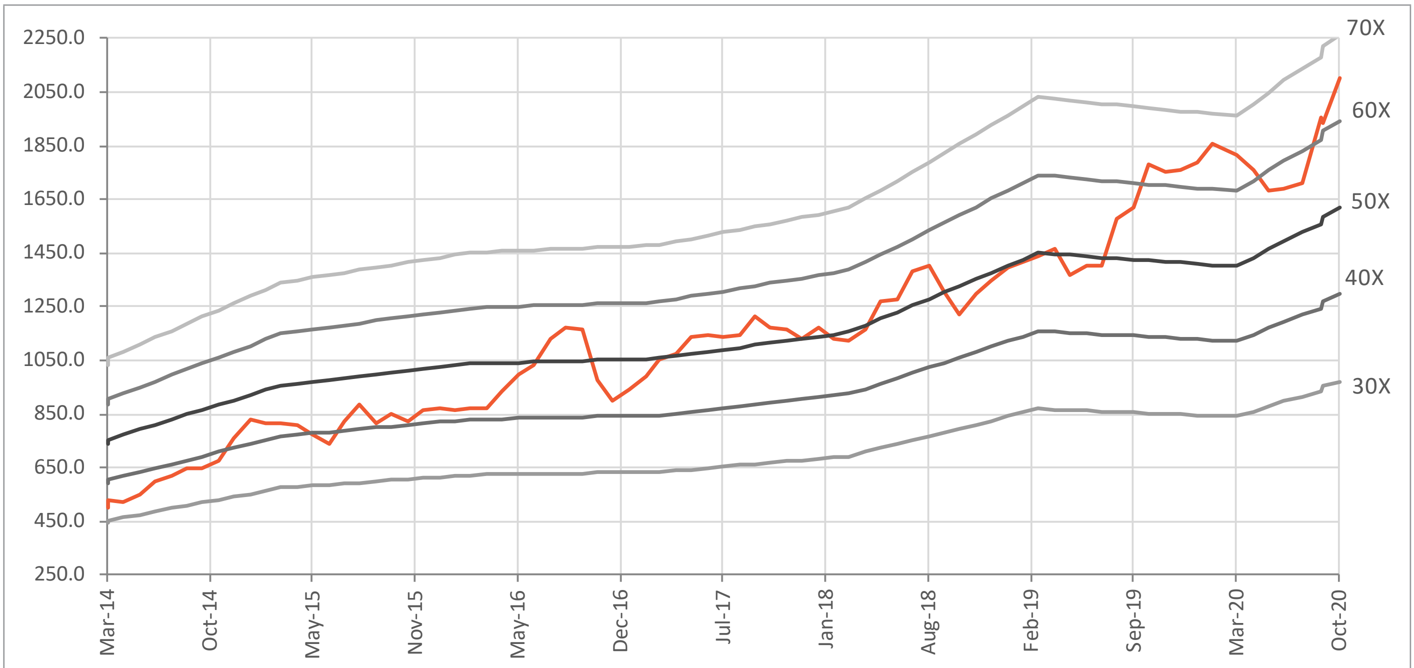
■ Company outlook - Near-term growth levers intact

APL has maintained the double-digit volume growth momentum and achieved volume growth of 11% in Q2FY2021, led by sustained demand in tier-II/III/IV towns. Metros and tier-I (constitute ~40% of sales) would see recovery in demand post significant reduction in virus threat. Initiatives such as safe painting/'San Assure' are gaining good traction and helping the company to get new customers for its core paint business. Further, high demand is seen in value-for-money paints, as shift is happening to quality products in the rural market. Other businesses including home improvement and auto paints have regained momentum, while it will take some time for industrial paints to revive. Benign input prices and cost-cutting measures will continue to provide support to profitability. Shortening of re-painting cycle (3-5 years), shift to trusted brands, rapid urbanisation, and resurgence in industrial/construction activities remain key long-term growth drivers for APL.

■ Valuation - Premium valuations to sustain

We have fine-tuned our earnings estimates to factor in better-than-expected performance in Q2FY2021. Sustained recovery in volume growth and margin expansion would be key earnings growth drivers in the near to medium term. The stock is currently trading at 59.2x/49.3x its FY2022/23E EPS. Leadership position in the domestic decorative paints business, focus on becoming a complete play in the home decor space, sturdy balance sheet, and good dividend payout will keep valuations at the premium level. We maintain our Buy recommendation on the stock with a revised PT of Rs. 2,475.

One-year forward P/E (x) band



Source: Company, Sharekhan Estimates

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Berger Paints	90.0	92.8	69.0	58.2	40.9	35.2	34.1	24.3	27.8
Kansai Nerolac	52.3	59.0	43.0	33.5	35.4	27.5	18.5	13.5	17.1
Asian Paints	72.5	74.9	59.2	45.1	45.6	37.0	22.2	19.7	21.8

Source: Sharekhan Research

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 26 paint manufacturing plants in 15 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 84% to the company's total revenue, whereas the industrial coatings space including automotive and non-automotive constitutes only 2%, 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 and CEO
Ashwin Dani	Chairman
R J Jeyamurugan	CFO and Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Teesta Retail Private Limited	4.9
2	Life Insurance Corporation of India	2.8
3	Capital Group Cos Inc	1.2
4	Vanguard Group Inc	1.1
5	SBI Funds Management Pvt Ltd	1.1
6	BlackRock Inc	1.1
7	JP Morgan Chase & Co	0.6
8	Axis Asset Management Co Ltd	0.6
9	UTI Asset Management Co Ltd	0.4
10	Standard Life Aberdeen PLC	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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;