Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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. 2,439**	
Price Target: **Rs. 2,605**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

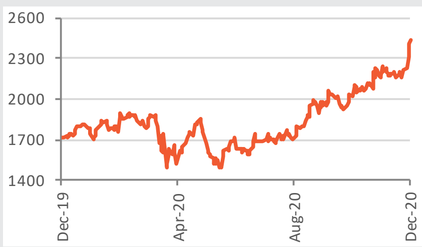
Company details

Market cap:	Rs. 233,924 cr
52-week high/low:	Rs. 2,443 / 1,432
NSE volume: (No of shares)	25.1 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	11.9	21.9	40.5	38.8
Relative to Sensex	1.0	7.4	9.6	29.1

Sharekhan Research, Bloomberg

Asian Paints Limited

Colour won't wear off soon

Consumer Goods | Sharekhan code: ASIANPAINT | Company Update

Stock Update

Summary

- We retain a Buy on Asian Paints Ltd (APL) with revise price target to Rs. 2,605. Its leadership position in domestic decorative paints business, focus on become complete home decor player and sturdy balance sheet will keep valuations at a premium (~56x FY2023E EPS) versus large FMCG companies.
- Volume growth to be steady on strong demand from tier 3/4 towns and recovery in metros/tier 1 towns. Domestic decorative paint volumes grew by 11% in Q2.
- Recent foray in home lighting and furniture space and scale-up of bathroom and kitchen fittings business will help APL become a complete home decor play from just a paints company in the long run.
- Market share gains from unorganised players, gradual recovery in painting activities in metros and tier-1 towns and a pick-up in institutional/industrial business would be key revenue growth drivers in the near term.

Asian Paints Ltd's (APL's) volumes grew by 11% in Q2FY2021 with a strong recovery in painting activities in tier-3 and 4 towns. Upgrades in emulsions, undercoats and waterproofing products performing well and good traction to the bottom-of-pyramid products helped APL clock a strong recovery in volume growth after a dismal Q1FY21 that was largely affected by lockdown. Our channel checks suggest that home decor/re-painting activities have started recovering in metros/tier 1 towns (especially in cities such as Mumbai) which was badly affected by the spread of the COVID-19 virus. The company's institutional business (fetching ~10% of revenues) has also seen a recovery as stalled projects have begun activities and a lot of enquiries are flowing in for newer projects. Unorganised players are finding it difficult to re-enter the market due to liquidity concerns, which provides APL an opportunity to gain market share. With its focus on becoming a complete home decor play the company has introduced products in home lightings, furnishings and furniture. APL's bathroom and kitchen fitting business grew in low single digits in Q2 and growth is expected to improve in the coming quarters as most of the home decor projects have regained momentum. Thus, overall we expect APL's domestic paint volume growth to sustain at around high single digits to low double digits in the near term. International business is expected to post low-double digit growth in Q3FY21 as industrial/painting activities have resumed in Nepal (earlier impacted by a lockdown) in October and November. Overall, the international business grew by ~8% in Q2. A better product mix and benign input prices would continue to help operating margins to remain high on y-o-y basis in the coming quarters.

Our Call

View - Retain Buy with revised PT of Rs. 2,605: Market share gains from unorganised players, a gradual recovery in painting activities of metros / tier-1 towns and pick-up in the institutional/industrial business would be key revenue growth drivers along with increasing traction to home decor products in the near term. APL's leadership position in domestic decorative paints industry, focus on becoming a complete home décor segment and sturdy balance sheet justifies premium valuations of ~56x its FY2023E EPS. We maintain our Buy recommendation on the stock with a revised price target of Rs. 2,605 (60x its FY2023E EPS).

Key Risks

Any disturbance caused by localised lockdown due to sudden spike in Covid-19 cases or sharp increase in the key input prices would act as a key risk to our earnings estimates in the near to medium term.

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	19,248	20,211	19,476	23,530	27,090
OPM (%)	19.6	20.6	21.3	21.8	22.7
Adjusted PAT	2,214	2,779	2,700	3,414	4,162
% YoY growth	9.2	25.5	-2.8	26.4	21.9
Adjusted EPS (Rs.)	23.1	29.0	28.15	35.60	43.4
P/E (x)	105.7	84.2	86.6	68.5	56.2
P/B (x)	24.7	23.1	20.2	17.5	14.7
EV/EBIDTA (x)	58.4	52.3	52.8	42.9	35.6
RoNW (%)	24.8	28.4	24.9	27.4	28.4
RoCE (%)	22.1	22.2	19.8	21.9	23.0

Source: Company; Sharekhan estimates

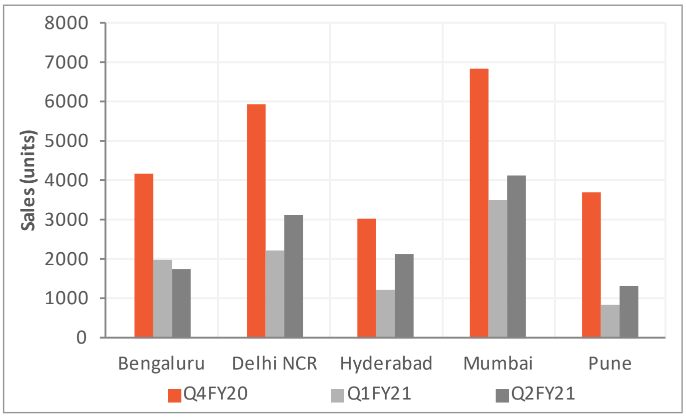
India's residential real-estate market is getting out of woods; improving real estate sales also augurs well for paint demand: The housing market was grappling with policy changes, regulatory reforms, a liquidity crisis and changing consumer preferences. The pandemic further worsened the wounds. Q1FY2021 saw significant dip in the home-buying. However, the situation has improved since June 2020. A combination of favourable factors such as low mortgage rates, stable prices, and flexible payment plans of developers make this an appropriate time for probable homebuyers to enter the market and strike lucrative deals. Further some state governments also supported the sector by reducing stamp duty/easing development process / providing some concession to developers. The lockdown has also reinforced the importance of owning a home. Furthermore, demand has also emerged from Non Resident Indians (NRIs) impacted by economic uncertainties in Europe and the Middle East. This created a pent-up demand in the residential sector and Q2 (July-September,20) witness strong uptick in demand. Most of the top cities have seen uptick in the home purchase in Q2 (on Q-O-Q basis). This will be positive for APL as new houses/ residential projects constitute ~30% of domestic demand for decorative paints. Further increase in residential sales will create demand for home decor products such as light, furniture products and kitchen fittings.

Residential sales Q2 vs. Q1FY21

Cities	Q4FY20	Q1FY21	Q2FY21	qoq%
Bengaluru	4186	1977	1742	-11.9
Delhi NCR	5941	2250	3112	38.3
Hyderabad	3027	1207	2122	75.8
Mumbai	6857	3527	4135	17.2
Pune	3728	851	1344	57.9

Source: Industry reports; Sharekhan Research

Domestic resident sales seen pick-up in Q2FY21 (July-September)



Source: Industry reports; Sharekhan Research

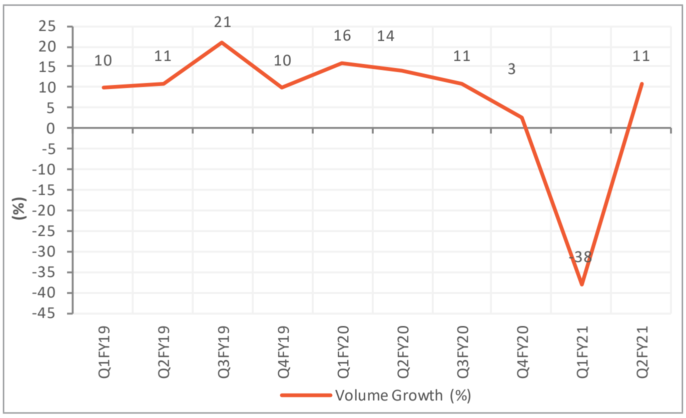
Paint demand momentum sustains in tier 3/4 towns; recovery visible in metros/tier 1 towns: The decorative paint industry in India has started recovering from June, led by strong recovery in tier-II, III, and IV markets. The domestic decorative paint business' volume growth improved to 11% in Q2FY2021 from a 38% decline in Q1, improving m-o-m. Demand improved amid the festive season across markets. Emulsion and undercoat products continued to gain good traction (especially in rural markets). Home decor/painting activities in the metros have recovered as the COVID-19 virus scare is receding. While the festive season was good, we expect the momentum to continue as events such as weddings/socialising for homes would induce people to renovate their homes. Also, with the tendency of work from home has increased in metros and towns, the people are looking to refurbish their respective houses. This will further create demand for paints and home decor products in the metros and top towns in the coming quarters. The company's institutional business (~10% of revenues) has also seen a recovery with stalled projects have begun activities and lot of enquiries are getting for newer projects. Unorganised players are finding it difficult to re-enter the market due to liquidity concerns, which provides opportunity for large player like APL to gain market share.

Gross margins expansion to sustain: APL's consolidated gross margins improved ~150 bps y-o-y basis to 44.5% in H1FY2021 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 similar to company level margins at the lower end of the paints portfolio. An improved product mix along with favourable raw material prices will help gross margins remain high in the coming quarters. The crude prices have seen uptick in the recent past. However the impact of increasing crude prices on crude derivatives prices comes with a lag. Thus we expect FY2021 gross margins to remain higher on y-o-y basis. However if surge in the crude prices continues, the gross margins will come under stress in FY2023.

OPM to expand but lower than Q2: Benign input prices, savings in the marketing spends and cut on discretionary spends helped APL's operating margin to improve by ~475 bps to 23.6% in Q2FY2021. We expect OPM expansion to sustain but at a lower level compared to Q2 as some of the cost elements such as marketing spends/media spends might go up with a resumption of painting activities.

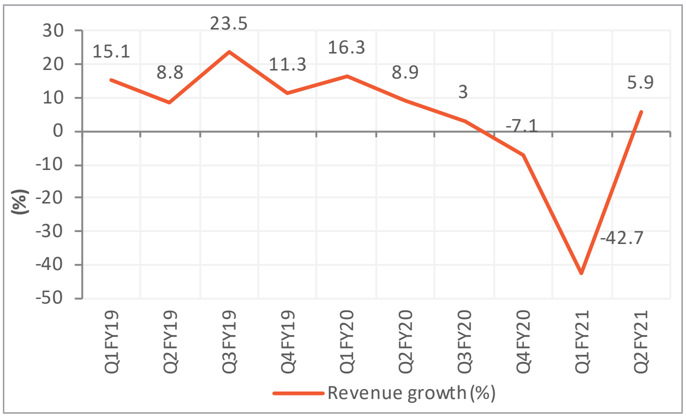
Financials in charts

Volume growth recovered in Q2



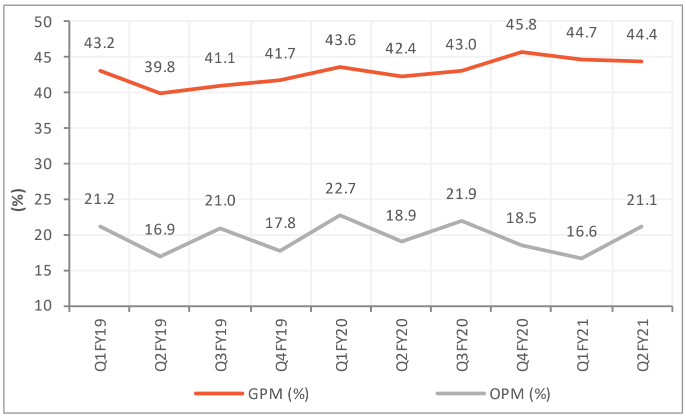
Source: Company, Sharekhan Research

Revenue growth recovered along with volume growth



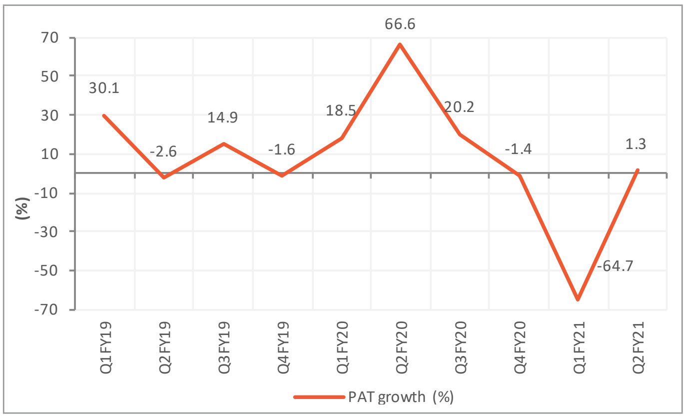
Source: Company, Sharekhan Research

Gross margins and OPM improved on y-o-y basis



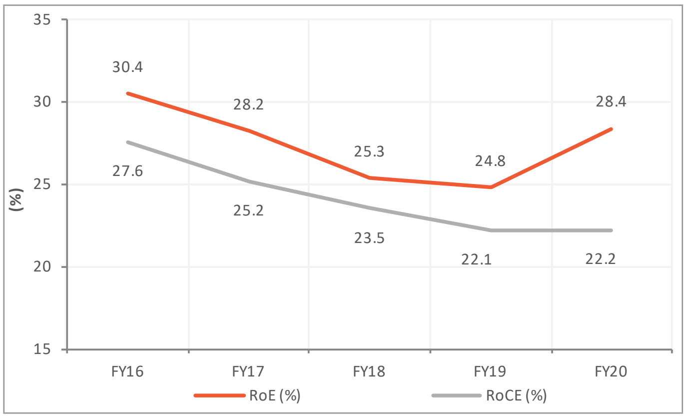
Source: Company, Sharekhan Research

Trend in PAT growth



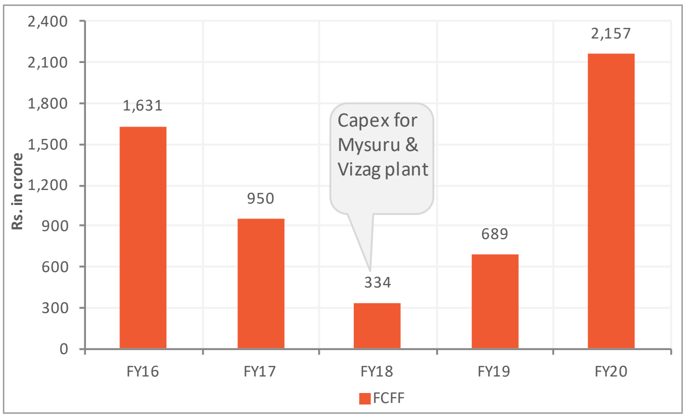
Source: Company, Sharekhan Research

Strong return ratios



Source: Company, Sharekhan Research

Robust FCF



Source: Company, Sharekhan Research

Outlook and Valuation

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

April and May (that constitute ~25% of total per annum sales) are among the key months for re-painting activities in India. The COVID-led lockdown affected April sales, which was a wash-out month for most paint companies. However, a strong recovery was seen in May-June, largely in tier-3 and -4 towns and it continued in the subsequent months. The scare of the COVID-19 virus is receding in metros (such as Mumbai and Delhi) as mobility has resumed and business has recovered to of pre-COVID levels. Home improvement and renovation activities regained pace in October-November2020. However, loss of business in two major months (April-May) and lesser demand for industrial paints would be a drag on FY2021 industry performance. Faster recovery would be seen in FY2022, with recovery in re-painting activities and new construction activities.

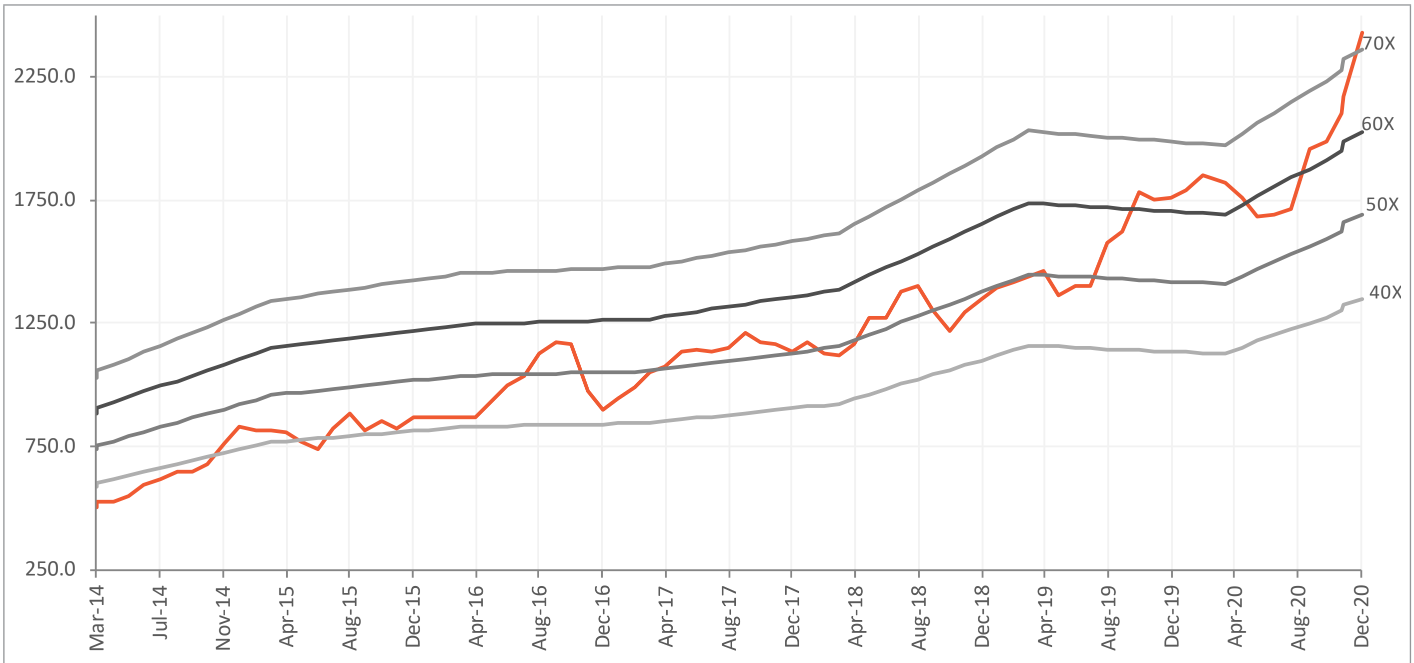
■ Company outlook - Near-term growth levers intact

India's decorative paints industry has started recovering from June, led by a strong growth 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. Our channel checks suggest that the home decor/re-painting activities have started seeing a recovery in metros/tier 1 towns (especially in city like Mumbai) which was badly affected by spread of COVID-19 virus. The company's institutional business (~10% of revenues) has also seen a recovery with stalled projects have begun activities and lot of enquiries are getting for newer projects. Thus, overall, we expect APL's domestic paint volume growth to sustain at around high single digit to low double digit in the near term. Teh international business is expected to post low double digit growth in Q3FY21 as Nepal which was affected by a lockdown in Q2 has seen resumption in industrial/painting activities in October and November (international business grew by ~8% in Q2). A better product mix and benign input prices would continue to help operating margins to remain high on y-o-y basis in the coming quarters.

■ Valuation - retained Buy with revised TP of Rs. 2605

Market share gains from unorganised players, a gradual recovery in painting activities of metros / tier-1 towns and pick-up in the institutional/industrial business would be key revenue growth drivers along with increasing traction to home decor products in the near term. APL's leadership position in domestic decorative paints industry, focus on becoming a complete home décor segment and sturdy balance sheet justifies premium valuations of ~56x its FY2023E EPS. We maintain our Buy recommendation on the stock with a revised price target of Rs. 2,605 (60x its FY2023E EPS).

One-year forward P/E (x) band



Source: Company, Sharekhan Estimates

Peer comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Berger Paints	97.4	73.6	61.7	58.9	46.6	39.9	21.6	19.8	24.8
Kansai Nerolac	64.0	47.1	41.4	37.4	29.7	26.0	18.3	17.3	20.8
Asian Paints	86.6	68.5	56.2	52.8	42.9	35.6	19.8	21.9	23.0

Source: 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 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 andCEO
Ashwin Dani	Chairman
R J Jeyamurugan	CFO andCompany 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

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