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Asian Paints Limited

Wrapping up Q3 with flying colours

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. 2,715**	
Price Target: **Rs. 3,000**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

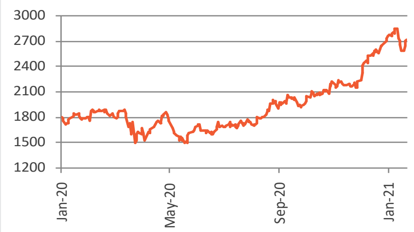
Company details

Market cap:	Rs. 260,422 cr
52-week high/low:	Rs. 2871 / 1432
NSE volume: (No of shares)	24.0 lakh
BSE code:	500820
NSE code:	ASIANPAINT
Free float: (No of shares)	45.3 cr

Shareholding (%)

Promoters*	52.8
FII	19.8
DII	8.1
Others	19.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.3	28.4	57.5	50.0
Relative to Sensex	-2.7	6.8	26.7	30.1

Sharekhan Research, Bloomberg

Summary

- Asian Paints Limited (APL) registered healthy performance in Q3FY2021 with revenue growing by 25%; OPM improving by 439 bps to 26.3%; PAT growth stood at 62%.
- Volume growth in the domestic decorative business stood at 33% in Q3, well ahead of 11% volume growth in Q2.
- Sustained demand for decorative paints in tier III/IV towns and strong uptick in demand for premium paint products in metros coupled with scale-up in home improvement business would help maintain double-digit growth in the coming years.
- We maintain our Buy recommendation on the stock with a revised PT Rs. 3,000. Leadership positioning in the domestic decorative paints business, focus on becoming a complete play in the home decor space, sturdy balance sheet, and expected higher dividend payout will keep valuations at premium levels.

Asian Paints Limited (APL) registered healthy all-round performance in Q3FY2021. Revenue grew by 25.2%, operating profit margin (OPM) expanded by 439 bps to 26.3% (led by higher gross margin and lower fixed cost), and PAT grew by 62%. APL's domestic decorative paints business registered robust volume growth of 33% compared to 11% volume growth in Q2FY2021. This was aided by strong pent-up demand, led by deferment of re-panting activities coupled with strong festive and occasional demand. Growth momentum in tier 3 and 4 towns continued due to sustained upgrade from unorganised to organised players. The highlight of the quarter was strong recovery in tier 1 and metro towns, which registered robust double-digit volume growth. Recovery in re-painting activities and increase in institutional due to revival in the real estate and construction sectors led to strong growth in tier 1 cities/metros. Strong uptick in passenger vehicles (PV) led to original equipment manufacturer (OEM) business report good growth in Q3 and industrial paints business witnessed recovery in Q3. Home improvement business posted 23% growth during the quarter. International business grew by 20%+. Benign input prices and cost-saving initiatives aided strong 439 bps improvement in OPM to 26.3%. Sustained upgrades to better brands in tier3/4 towns (50% of overall paints market), upgrades to premium/luxury paints in metros, and revival in the real estate market will be key growth levers in the near to medium term. The company is focusing on becoming a complete home decor play and launched 16 stores providing end-to-end home decor solutions to customers. The company is planning to double its store count over the next two years. Though raw-material prices have gone up, stringent cost measures, better mix, and improved operating leverage would help OPM to sustain on a y-o-y basis in FY2022 and would improve in FY2023. Capacity utilisation currently stands at 60%; and hence, there are no major capital expenditure plans in the coming years.

Key positives

- Volume growth of the decorative paints business stood at more than 30%+
- Auto paints business continues to see an uptick; industrial paints sales recovering
- Paints business margins expanded by 508 bps; home improvement business almost witnessed breakeven at EBIDTA level.

Key negatives

- Raw materials started moving up with increase in crude oil prices, which will put some pressure on gross margins.

Our Call

View: Maintain Buy with a revised PT of Rs. 3,000: We have revised upwards our earnings estimates for FY2021/FY2022/FY2023 to factor in much better-than-expected volume growth in Q3FY2021 and higher-than-expected margin expansion. The structural growth story of the domestic paint industry is intact and is expected to grow in double digits over the next four to five years. Market share gains, upgradation to premium products, and improving penetration in tier 3/4 cities will enable APL to deliver growth ahead of industry growth. With no major capex programme, we expect the company to reward shareholders with higher dividend payout. Thus, leadership position in the domestic decorative paints business, focus on becoming a complete play in the home decor space, sturdy balance sheet, and expected higher dividend payout will keep valuations at premium levels. The stock is currently trading at 59x its FY2023E EPS. We maintain our Buy recommendation on the stock with a revised PT of Rs. 3,000 (valuing the stock at 65x its FY2023E EPS).

Key Risks

Increased competitive pressures from large players, slowdown in the demand environment, or spike in key input 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	20,434	24,086	27,459
OPM (%)	19.6	20.6	23.1	23.0	23.4
Adjusted PAT	2,214	2,779	3,183	3,747	4,410
% YoY growth	9.2	25.5	14.5	17.7	17.7
Adjusted EPS (Rs.)	23.1	29.0	33.2	39.1	46.0
P/E (x)	117.6	93.7	81.8	69.5	59.0
P/B (x)	27.5	25.7	21.6	18.4	15.3
EV/EBIDTA (x)	65.1	58.3	51.8	44.4	37.9
RoNW (%)	24.8	28.4	28.7	28.6	28.3
RoCE (%)	22.1	22.2	22.7	22.8	23.0

Source: Company; Sharekhan estimates

Consolidated revenue grew by ~25.2% y-o-y, 33% volume growth in decorative paints business: Consolidated revenue grew by 25.2% y-o-y to Rs. 6,788.5 crore, which was ahead of our expectation of Rs. 5,947 crore, driven by 30% volume growth in the decorative paints business led by strong performance in the premium and luxury portfolio, which was better than our and street's expectation of 11%-19%. Home improvement and industrial paints also witnessed strong recovery during the quarter with 20%+ growth. Revenue of the international business grew by 20%, with double-digit volume growth in markets such as Middle East and Asia. Benignraw-material prices caused gross margins to expand by 207 bps to 45%. This, along with cost optimisation and other efficiencies, resulted in a 439 bps expansion in OPM to 26.3%. Operating profit grew by strong 50.3% y-o-y to Rs. 1,787.9 crore. Profit before tax (PBT) grew by 61% y-o-y to Rs. 1,671.5 crore, far better than our expectations. Adjusted PAT grew by 62.3% y-o-y to Rs. 1,265 crore due to strong operating performance.

Standalone revenue grew by 26.1%; Efficiencies drove up margins: Standalone revenue grew by 26.1% y-o-y to Rs. 5,872.8 crore. Domestic decorative business registered double-digit volume growth. Lower input costs and improved product mix resulted in gross margins to expand by 219 bps to 46.1%. Operating efficiencies led OPM to increase by 416 bps to 28.2%. Operating profit rose by 48% y-o-y to Rs. 1,654.2 crore. PBT grew by 56% y-o-y to Rs. 1,589.8 crore, led by better operating margin. PAT grew by 57% y-o-y to Rs. 1,187.9 crore.

Key conference and business highlights

- **Domestic decorative business registered strong growth:** Volumes of APL's domestic decorative paints business grew by 33% in Q3 compared to 11% in Q2FY2021. The highlight of the quarter was that all months witnessed strong sales. Strong demand in tier 3 and 4 cities sustained, while strong recovery was seen in metros and large cities due to significant reduction in virus scare. Key factors that led to strong demand growth were pent-up demand due to deferment of painting activities supported by the festive and marriage season. This, along with strong resurgence in real estate and construction activities, aided faster recovery in metros and tier 1 cities during the quarter. Though the growth momentum is expected to sustain, it is likely to moderate in Q4 as festive sales and intensity of pent-up demand would lower off in the coming months.
- **Home improvement business posted strong recovery:** The home improvement business registered strong growth of 22%, with the kitchen business growing by 20.3% to Rs. 81 crore and bath business growing by 23.1% to Rs. 73 crore. Kitchen business witnessed double-digit growth for components as well as full kitchen products. The bath business division also saw strong sequential growth across product segments. Project business grew on a sequential basis, led by demand from institutional and from real estate players because of demand for new homes. Kitchen business reported breakeven at the EBIDTA level, while bath business registered profit of Rs. 1 crore at PBT (after breakingeven in Q2). Thus, overall home improvement business was close to breakeven at EBIDTA level in Q3FY2021. Further, revival in the real estate market would help in posting good demand in the near term. Overall, the home improvement business is expected to post good growth in the coming quarters.
- **International business grew by 20%:** Revenue of the international business grew by 22.4% y-o-y to Rs. 700 crore and PBT grew by 2.7x to Rs. 74 crore. Major geographies including Africa, Asia, and Middle East registered strong double-digit growth during the quarter. The company has expanded its range of waterproofing products in markets such as Middle East, Asia, and other key geographies. The company also launched bath business in South Asian markets such as Nepal and Bangladesh.
- **Focus on becoming a complete home decor play:** APL wants to become a complete home decor play in India. The company has opened 16 home decor stores of ~6,000 square feet, which will give visualised experience of a complete home to customers. The focus is on providing the best experience, quality products, and prompt services to its customers. The company already has a strong grip in the bathing and kitchen space. Recently, APL entered the furniture and lighting space. This, along with its leadership position in painting, will help APL become a large home decor play. The company is planning to add another 16 stores over the next two years.

Results (Consolidated) Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Total Revenue	6788.5	5420.3	25.2	5350.2	26.9
Raw-Material Cost	3728.5	3089.0	20.7	2974.5	25.3
Employee Cost	388.3	343.0	13.2	378.9	2.5
Other Expenses	883.9	798.9	10.6	731.7	20.8
Total Operating Cost	5000.6	4230.9	18.2	4085.0	22.4
Operating Profit	1787.9	1189.4	50.3	1265.2	41.3
Other Income	97.9	69.8	40.2	82.6	18.5
Interest & Other Financial Cost	21.1	24.1	-12.2	20.5	3.0
Depreciation	193.2	197.1	-2.0	193.6	-0.2
Profit Before Tax	1671.5	1038.1	61.0	1133.7	47.4
Tax Expense	431.4	277.6	55.4	293.6	46.9
Adjusted PAT before MI	1240.1	760.5	63.1	840.1	47.6
Minority Interest (MI)	25.3	19.2	31.4	11.8	114.3
Reported PAT	1265.4	779.7	62.3	851.9	48.5
Adj. EPS (Rs.)	13.2	8.1	62.3	8.9	48.5
			bps		**bps**
GPM (%)	45.1	43.0	207	44.4	67
OPM (%)	26.3	21.9	439	23.6	269

Source: Company; Sharekhan Research

Standalone snapshot Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Total Revenue	5872.8	4656.9	26.1	4526.7	29.7
Operating Profit	1654.2	1117.9	48.0	1149.6	43.9
Profit Before Tax	1589.8	1017.4	56.3	1060.1	50.0
Tax Expense	401.9	258.5	55.4	267.0	50.5
Reported PAT	1187.9	758.9	56.5	793.1	49.8
Adj. EPS (Rs.)	12.4	7.9	56.5	8.3	49.8
			bps		**bps**
GPM (%)	46.1	44.0	219	45.4	74
OPM (%)	28.2	24.0	416	25.4	277

Source: Company; Sharekhan Research

Result snapshot (International and other subsidiaries) Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Revenue	915.7	763.4	19.9	823.5	11.2
Operating profit	133.7	71.5	87.1	115.6	15.7
OPM(%)	14.6	9.4		14.0	
PBT	81.7	20.7	-	73.6	10.9
PAT	77.4	20.8	-	58.8	31.7

** Difference between consolidated and standalone figures*

Outlook and Valuation

■ Sector view - Structural growth of the paint industry is intact

The Indian paint industry reported an 11% CAGR over FY2011-FY2019 and stood at Rs. 545 billion. The decorative paint segment constitutes around 74% of total paint sales, resulting in the paint sector growing at a robust rate even at the time of an industrial slowdown. April and May (constitute ~25% of total per annum sales) are two of the key months for re-painting activities in the domestic market. FY2021 was affected by the pandemic, led by lockdown, resulting in almost no business in Q1FY2021. However, robust recovery was witnessed in subsequent quarters due to strong improvement in demand in tier 3/4 towns. Faster recovery would be seen in FY2022, with recovery in re-painting activities and new construction activities. The decorative paint industry is expected to post a 13% CAGR over FY2019-FY2024, led by reduction in the repainting cycle to 4-5 years (from earlier 8-10 years), acceptance for better paint products in smaller towns, and upgradation of premium brands in cities and large towns.

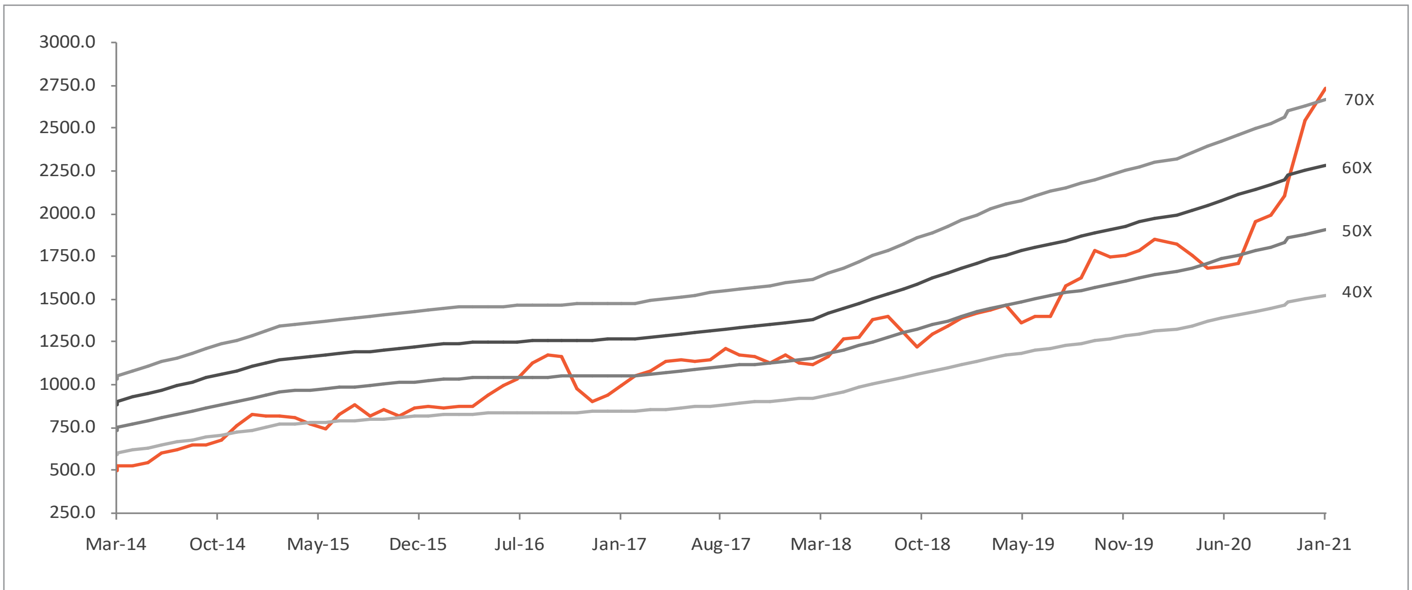
■ Company outlook - FY2022 will be strong due to resurgence of painting activities

APL delivered one of the strongest performances in Q3, with volume growth in decorative paints business standing at robust 30%. Though we expect some moderation in volume growth, we expect it to remain in healthy double digits in the coming quarters. Thus, overall, we expect FY2021 to remain flat in terms of revenue and strong margin expansion led by benign input cost and prudent cost-saving measures. PAT is expected to grow by 14% in FY2021. We expect strong double-digit revenue growth in FY2022, as the resurgence in paint activities would lead to strong paints demand (especially in April-May, which saw no sales in FY2021 due to stringent lockdown). However, increasing crude prices might put some pressure on gross margins. The better operating leverage and price hikes undertaken by the company would help in maintaining margins on y-o-y basis. Further, high demand for home decor products would help performance of the home improvement business to scale up in the coming years.

■ Valuation - Buy with a revised PT of Rs. 3,000

We have revised upwards our earnings estimates for FY2021/FY2022/FY2023 to factor in much better-than-expected volume growth in Q3FY2021 and higher-than-expected margin expansion. The structural growth story of the domestic paint industry is intact, which is expected to grow in double digits over the next four to five years. Market share gains, upgradation to premium products, and improving penetration in the tier 3/4 cities will enable APL to deliver growth ahead of industry growth. With no major capex programme, we expect the company to reward shareholders with higher dividend payout. Thus, leadership position in domestic decorative paints business, focus on becoming a complete play in the home decor space, sturdy balance sheet, and expected higher dividend payout will keep valuations at premium levels. The stock is currently trading at 59x its FY2023E EPS. We maintain our Buy recommendation on the stock with a revised PT of Rs. 3,000 (valuing the stock at 65x its FY2023E EPS).

One-year forward P/E band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Berger Paints	117.9	89.3	74.9	71.7	57.2	48.6	21.6	19.8	24.8
Kansai Nerolac	74.4	55.3	48.8	39.4	28.1	23.7	18.3	17.3	20.8
Asian Paints	81.8	69.5	59.0	51.8	44.4	37.9	22.7	22.8	23.0

Source: Company, Sharekhan estimates

About company

APL is the largest paint company in India with 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 the 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

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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