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		⇔	

ESG Disclosure Score NEW

ESG RISK RATING 30.39

Updated Nov 08, 2021

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

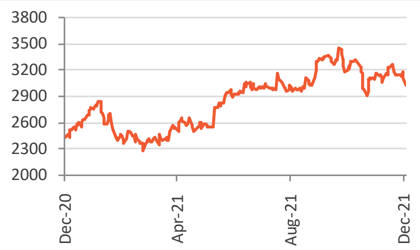
Company details

Market cap:	Rs. 291,404 cr
52-week high/low:	Rs. 3,504/2,261
NSE volume: (No of shares)	12.1 lakh
BSE code:	500820
NSE code:	ASIANPAINT
Free float: (No of shares)	45.3 cr

Shareholding (%)

Promoters	52.8
FII	22.2
DII	6.8
Others	18.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.8	-8.9	3.6	24.6
Relative to Sensex	1.7	-6.3	-4.9	-1.3

Sharekhan Research, Bloomberg

Asian Paints Ltd

Demand buoyant; correction offers investment opportunity

Consumer Goods	Sharekhan code: ASIANPAINT
Reco/View: Buy ⇔	CMP: Rs. 3,038
Price Target: Rs. 3,550 ⇔	

↑ Upgrade ⇔ Maintain ↓ Downgrade

Summary

- Asian Paints Ltd's (APL's) decorative paints' sales volumes clocked a two-year CAGR of 22% in Q2 (and 17.5% in H1FY22). Buoyant urban demand and gradual pick-up in rural demand would help maintain growth momentum in H2.
- APL has cumulatively hiked prices by ~16% and is planning to take another price increase of 5%, which will address raw material inflation (that stood at 20% in Q2FY2022). If raw material prices remain stable at current level, OPM would normalise by Q4FY2022.
- New businesses (including kitchen and bath) are scaling up well with strong demand in the home improvement sector. New ventures are expected to post good improvement in profits ahead.
- We maintain a Buy on the stock with an unchanged price target of Rs. 3550. Stock has corrected by ~13% from its high and is trading at 68x/54x its FY2023/24E EPS.

Asian Paints Ltd's (APL's) decorative paint volumes grew by ~18% in H1FY2022 (two-year CAGR stood at 22%) with strong growth in Tier 1/Tier 2 cities, which was higher than growth in Tier-3/Tier-4 towns. Double-digit volume growth is expected to sustain in H2FY2022 with sustained buoyancy in urban demand (led by sustained repainting activities and uptick in real estate sector especially in affordable housing space) and a gradual pick-up in the rural demand. Further, in line with its aggressive pricing strategy, APL hiked prices by ~9% in November,21 (cumulative price increase of 16%) and is planning to take additional hike of 5% to mitigate the impact of a sharp surge in input costs. As input costs stabilise, margins would return to 18-20% by Q4FY2022.

- **Buoyant urban demand to drive growth in H2:** APL registered a strong volume growth of 34% (two-year volume CAGR of 22%) in Q2FY2022 with strong growth in tier-1/tier-2 towns, which stood ahead of rural demand. We expect the strong double digit volume growth momentum to sustain in H2 as the company is witnessing good demand in project business with deep inroads across segments – building construction, speedy completion of real estate projects due to strong demand in affordable housing segment, government infra projects and co-operative housing societies. This along with sustained demand from home improvement space (in wake of festive / wedding season) would help the double-digit volume growth to sustain in H2FY2022.
- **Capacity expansion to meet increased demand:** Upgradation at bottom-of-the pyramid, scale-up in sales of waterproofing category, uptick in real estate cycle, increasing demand for premium products and expansion in dealers' network remains key volume growth drivers in the near term. Sensing this as an opportunity and maintain the leadership position in a strong demand environment, the company has planned to expand Ankleshwar, Gujarat paint capacity to 2,50,000 kilolitre (KL) from 1,30,000 KL earlier.
- **Aggressive pricing strategy to mitigate input cost pressure:** A significant increase in the crude oil and crude derivatives prices led to APL's consolidated gross margins were down by 828 bps to 36.2% in H1FY22 (down by 965 bps in Q2). Raw material inflation in Q2 stood at 20%. The company decided to undertake an aggressive price increase to mitigate the raw material inflation and took a price hike of ~9% in November 2021 and has planned for further price hike of 5% in the first week of December. This will help reduce stress on profitability and OPM is expected to normalise to 18-20% by Q4 (with raw material prices remaining at current levels).

Our Call

View: Maintain Buy with an unchanged price target of Rs. 3,550: APL's dominant positioning in the domestic decorative paints business and focus on becoming complete home décor play in the long run gives us a visibility of better earnings growth in the medium term. We expect APL's revenues and PAT to grow at CAGR of 20% over FY2021-24E. The company's stock price has corrected by 13% from its high and is trading at 68x/54x its FY2023/24E EPS. Recent correction provides a good opportunity to accumulate a quality consumer play with monopoly in the domestic paint industry. We maintain our Buy recommendation on the stock with an unchanged price target of Rs. 3,550.

Key Risks

Increased competitive pressures from large players or sustained increase in the key input prices would act as a key risk to our earnings estimates.

Valuation (consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	21,713	28,321	32,150	36,336
OPM (%)	22.4	17.3	19.5	21.1
Adjusted PAT	3,207	3,300	4,322	5,391
% YoY growth	15.4	2.9	31.0	24.7
Adjusted EPS (Rs.)	33.4	34.4	45.1	56.2
P/E (x)	90.9	88.4	67.5	54.1
P/B (x)	22.8	20.6	18.1	15.3
EV/EBIDTA (x)	56.0	55.0	43.1	35.1
RoNW (%)	28.0	24.4	28.5	30.6
RoCE (%)	22.4	19.8	23.3	25.0

Source: Company; Sharekhan estimates

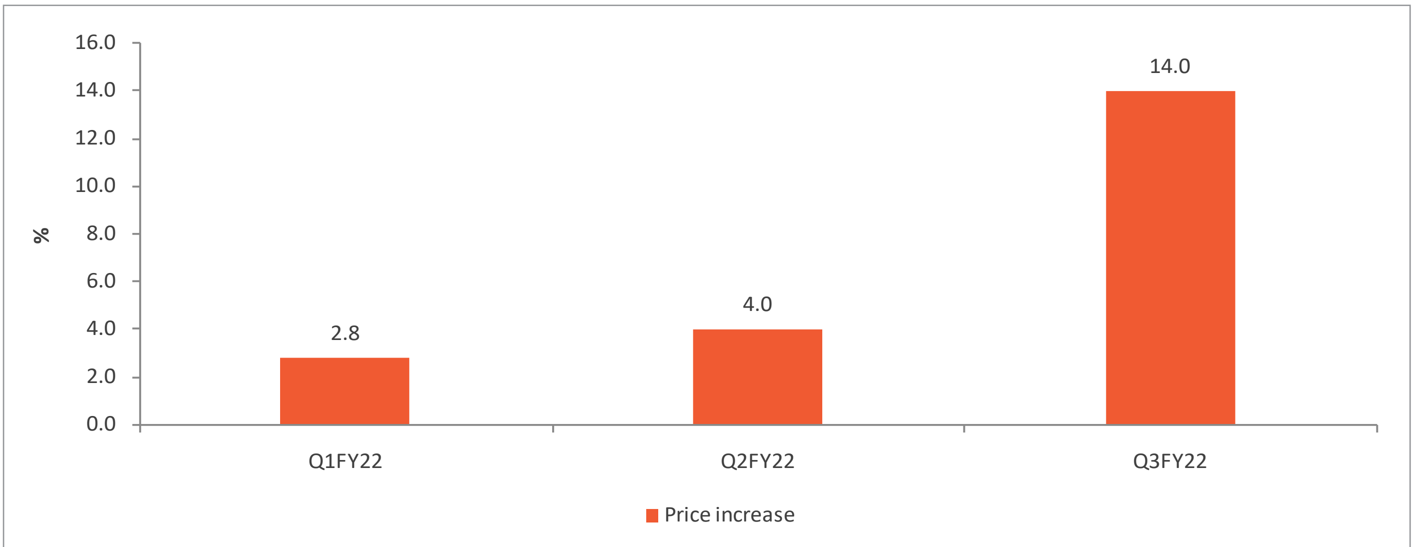
Double digit volume growth sustain led by strong urban demand

APL registered a strong volume growth of 34% (two-year volume CAGR of 22%) in Q2FY2022 with strong growth in the tier1/tier2 towns which stood ahead of rural demand. The company continues to gain market share in the decorative paints segment, which is currently at ~60%. The economy and the luxury range of products grew strongly supported by uptick from new launches in the luxury and premium space. We expect the strong double-digit volume growth momentum to sustain in H2 as the company is witnessing good demand in project business with deep inroads across segments – building construction, speedy completion of real estate projects due strong demand in affordable housing segment, government infrastructure projects and co-operative housing societies. This along with sustained demand from home improvement space (in wake of festive / wedding season) would help the double digit volume growth to sustain in H2FY2022.

Price hikes to mitigate impact of raw material inflation

A significant increase in the crude oil and crude derivatives prices led to APL's consolidated gross margins were down by 82 bps to 36.2% in H1FY22 (down by 965 bps in Q2). Raw material inflation in Q2 stood at 20%. The company decided for aggressive price increase to mitigate the raw material inflation and took a price hike of ~9% in November 2021 and planned for further price hike of 5% in first week of December. Price hike is unlikely to have any significant on sales volumes with demand environment remaining buoyant. We might see some disruption due to inventory de-stocking at distributors level, which might be a short term phenomenon. On the other hand, a cumulative price increase of 20-21% will help in reducing stress on profitability and OPM is expected to normalise to 18-20% by Q4 (with raw material prices remaining at current levels). APL is also focusing on formula efficiencies, which largely emphasises on substituting some of the inflated raw materials with low price raw materials to derive cost benefits. Also with improving demand for premium products such as super luxury products in the urban market and upgradation to emulsions in the tier-3 / tier-4 towns would help APL improve product mix in the medium term. Thus, we are confident of APL posting sustained higher margins post the easing of raw material prices in the quarters ahead.

Aggressive price increase in H2FY2022



Source: Company, Sharekhan Research

Capacity expansion on the cards

In November, the company commenced the expansion of manufacturing capacity in Ankleshwar, Gujarat of paint from 130,000 KL to 250,000 KL and resins and emulsions from 32,000 MT to 85,000 MT to be completed over 2-3 years at a total investment of ~Rs. 960 crore on plant and machinery. This expansion will be carried out on the existing land owned by the company. The company's existing units are located in various parts of the country as mentioned below -

APL's capacities at various location in India

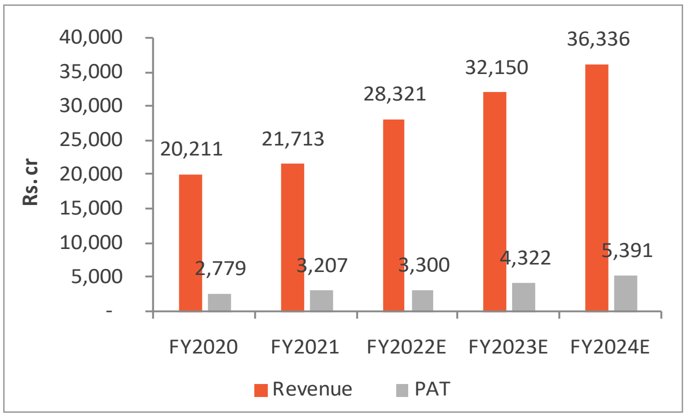
Location	Capacity	Type
Rohtak, Haryana	4,00,000 KL	Decorative coating
Kasna, Uttar Pradesh	80,000 KL	Decorative coating
Ankleshwar, Gujarat	1,30,000 KL	Decorative coating
Khandala, Maharashtra	3,00,000 KL	Decorative coating
Patancheru, Telangana	80,000 KL	Decorative coating
Vishakhapatnam, Andhra Pradesh	3,00,000 KL	Decorative coating
Mysuru, Karnataka	3,00,000 KL	Decorative coating
Sriperumbudur, Tamil Nadu	1,40,000 KL	Decorative coating
Cuddalore, Tamil Nadu	8,760 MT	Chemical
Sarigam, Gujarat (Facility of Subsidiary company)	7,200 MT	Industrial coating
Taloja, Maharashtra	14,000 KL	Industrial coating

Source: Company; Sharekhan Research

The capacity expansion will help the company to meet the increasing demand for decorative paints and recovery in demand in the industrial/automotive paints and aid the company to strengthen its leadership position in the paints business.

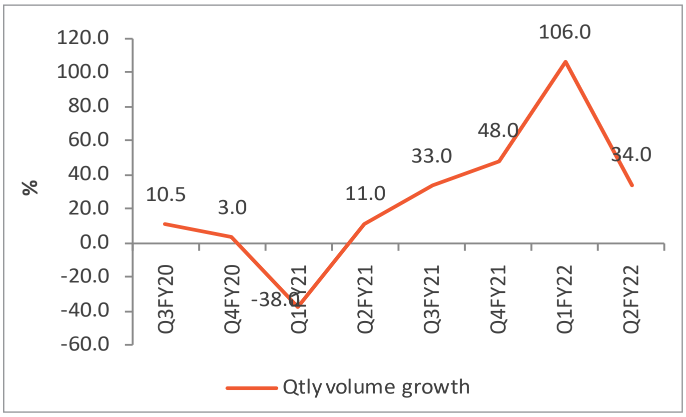
Financials in charts

Strong growth in revenue and PAT



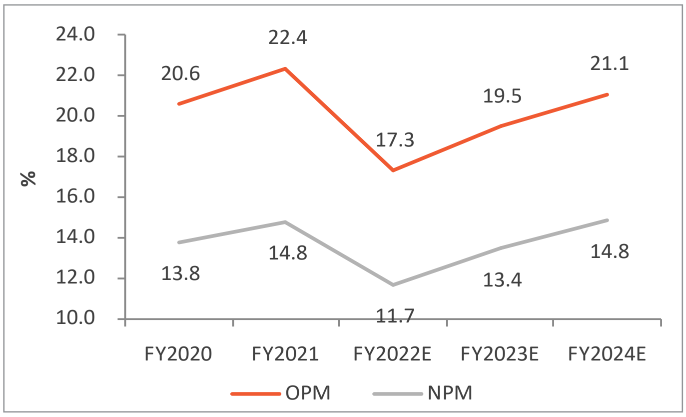
Source: Company, Sharekhan Research

Trend in quarterly volume growth



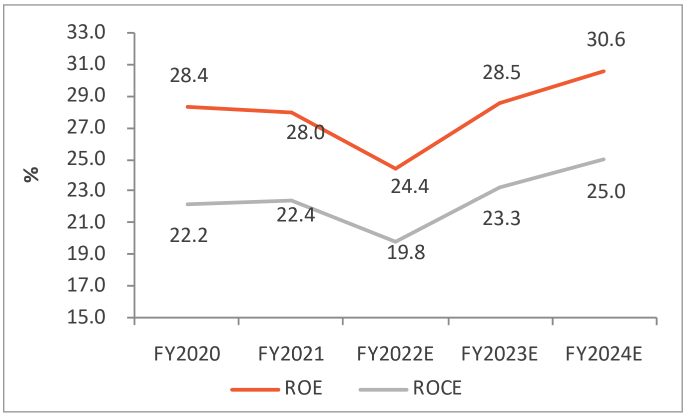
Source: Company, Sharekhan Research

OPM and NPM to recover by FY2024



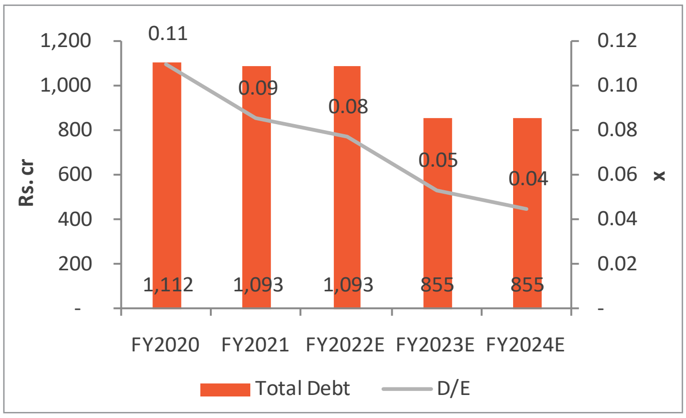
Source: Company, Sharekhan Research

Return ratios to improve



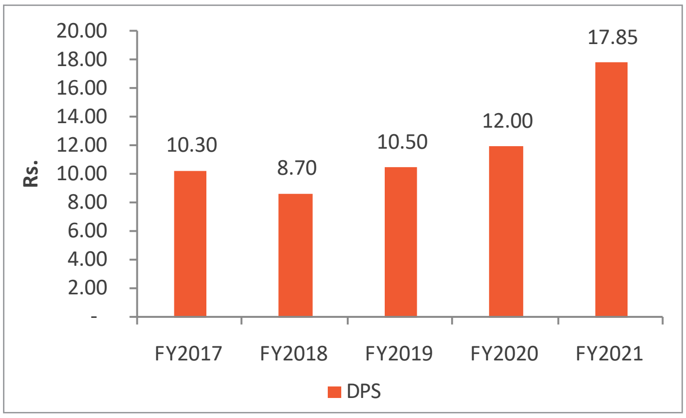
Source: Company, Sharekhan Research

Debt to decline from current level



Source: Company, Sharekhan Research

Dividend payout history



Source: Company, Sharekhan Research

Outlook and Valuation

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

The Indian paints industry reported an 11% CAGR over FY2011-FY2019 and stood at Rs. 545billion. 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. Second wave affected the momentum in Q1FY2022, but faster recovery seen from Q2FY2022. 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 8-10 years earlier), acceptance for better paint products in smaller towns, and upgradation of premium brands in cities and large towns. Higher input prices will keep toll margins of the paint companies in the near term.

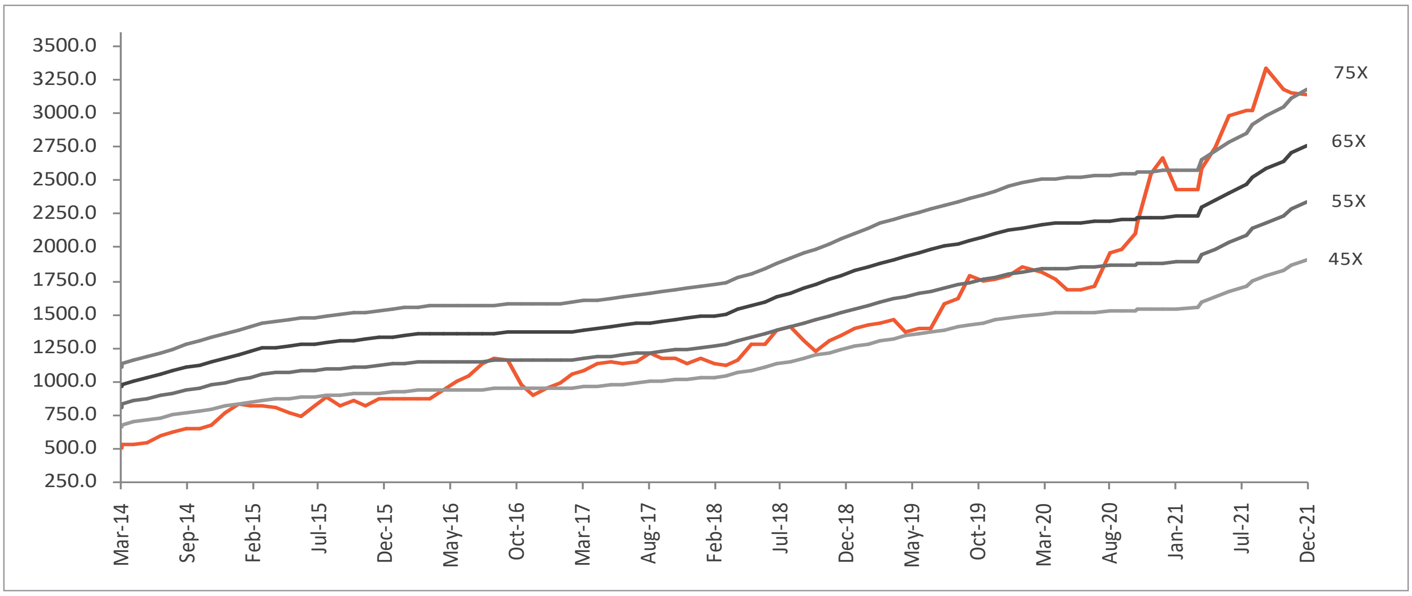
■ Company outlook - Volume growth to sustain; focus on regaining loss margins

With resilient demand for decorative paints and expected recovery in the industrial/automotive paints, the management expects double-digit volume growth to sustain in the near term. This will be well-supported by the home improvement business, which is focusing largely on complete home décor play. In addition, industrial/automotive paints are expected to see a strong recovery in the demand in the coming quarters. The company has implemented cumulative price increase of 16% (and planned for additional price hike of 5%), which along with formulation and supply efficiencies would help in recovery in the profitability (targeting OPM to reach to 18-20% by Q4).

■ Valuation - Maintain Buy with an unchanged price target of Rs. 3,550

APL's dominant positioning in the domestic decorative paints business and focus on becoming complete home décor play in the long run gives us a visibility of better earnings growth in the medium term. We expect APL's revenues and PAT to grow at CAGR of 20% over FY2021-24E. The company's stock price has corrected by 13% from its high and is trading at 68x/54x its FY2023/24E EPS. Recent correction provides a good opportunity to accumulate a quality consumer play with monopoly in the domestic paint industry. We maintain our Buy recommendation on the stock with an unchanged price target of Rs. 3,550.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Berger Paints	98.1	71.1	59.5	77.2	61.6	52.4	30.5	35.7	36.1
Asian Paints	90.9	88.4	67.5	56.0	55.0	43.1	22.4	19.8	23.3

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 60 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 EssEss 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	Vanguard Group Inc.	1.73
3	BlackRock Inc.	1.59
4	LIC of India	1.49
5	Capital Group Cos Inc	1.23
6	SBI Funds Management Pvt. Ltd.	1.2
7	JP Morgan Chase & Co	0.75
8	UTI Asset Management Co. Ltd.	0.47
9	Axis Asset management	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

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