



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

Updated Jan 08, 2022

31.27

High Risk

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

Source: Morningstar

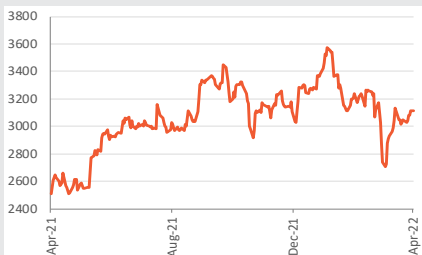
Company details

Market cap:	Rs. 2,98,900 cr
52-week high/low:	Rs. 3,588 / 2,484
NSE volume: (No of shares)	13.4 lakh
BSE code:	500820
NSE code:	ASIANPAINT
Free float: (No of shares)	45.4 cr

Shareholding (%) as on 31-12-2021

Promoters*	52.6
FII	21.7
DII	7.2
Others	18.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	13.8	-9.9	-2.7	24.1
Relative to Sensex	2.3	-11.2	-4.9	0.8

Sharekhan Research, Bloomberg

Asian Paints Ltd

Strategic acquisitions to transform into home décor play

Consumer Goods

Sharekhan code: ASIANPAINT

Reco/View: Buy



Upgrade



Maintain



Downgrade

CMP: Rs. 3,116

Price Target: Rs. 3,689

Summary

- Asian Paints Limited (APL) acquires 49% stake in White Teak (present in decorative lighting products & fans) for Rs. 180 crore and 51% stake in Weatherseal (present in uPVC windows and doors) for Rs. 19 crore.
- Both acquisitions are in line with APL's focus of transforming itself from 'share of surface' to 'share of space' in the long run. APL expects revenue contribution from the home décor business to increase to 10% over the next two-three years from current single digit.
- APL plans to utilise its network of strong distribution points and institutional clients to grow both businesses. In the near term, both the businesses are unlikely to add materially to its earnings.
- The stock is currently trading at 70.8x and 54.9x its FY2023E and FY2024E earnings, respectively. We maintain Buy with an unchanged PT of Rs. 3,689.

Asian Paints Limited (APL) acquires 49% stake in White Teak for Rs. 180 crore and 51% stake in Weatherseal for Rs. 19 crore. APL's acquisition of both brands is in line with the company's strategy of taking forward its transition from a 'share of surface' within the home to 'share of space'. APL plans to utilise its network of strong distribution points and institutional clients to grow both businesses. APL looks at taking leadership and provide value addition to its customers through these acquisitions. The company will be acquiring 100% stake in both the companies by FY2026 in a phased manner. Though both the acquisitions are unlikely to add to earnings in the near term, they are in strategic relevance to APL from its long-term growth prospects.

- About the acquisition:** APL entered into a definitive agreement to acquire 49% stake in Obgenix Software Private Limited (known by the brand name 'White Teak') for a consideration of approximately Rs. 180 crore, along with earn out up to maximum of Rs. 114 crore, payable after a year, subject to achievement of mutually agreed financial milestones. It also agreed to acquire the remaining 51% stake in White Teak in two phases for a consideration of Rs. 426 crore based on achievement of financial milestones. Further, the company entered into a definitive agreement with the promoters of Weatherseal Fenestration Private Limited for infusion of Rs. 19 crore for 51% stake. It also agreed to acquire additional 23.9% stake in Weatherseal Fenestration from its promoters, in a staggered manner, over the next three years.
- About acquired companies and presence of categories:** White Teak is engaged in the business of decorative lighting products and fans. Decorative lighting market in India (largely dominated by unorganised players) is about Rs. 1,200 crore presently and is growing at 18-20% annually. White Teak has strong design and innovation capabilities with the company being able to sense the choice of the Indian customers, providing it an edge over the Chinese products. APL has acquired White Teak at 20x its FY2021 revenue. EBITDA margin of White Teak is comparable to the paint business. Weatherseal (incorporated in March 2022) is engaged in the business of interior decoration/furnishing, including manufacturing uPVC Windows and door systems. The company is an established brand in South India and its pricing is competitive to regional brands in that market. Size of the current market is more than Rs. 11,000 crore and market share of organised players is about 40%.
- Focus on scaling up the home décor business:** APL's acquisition of both brands is in-line with the company's strategy of taking forward its transition from a 'share of surface' within the home to 'share of space'. The company can leverage on its strong dealership reach and is expanding home décor outlets. The company has 29 home stores in 25 towns and plans to increase them to 70-75 stores across the country by year end. The company is also looking to widen its portfolio in its existing 500 premium stores present in over 200 towns by putting up space for lighting in these stores. APL targets the home décor business to contribute ~10% to India's decorative business in the next 2-3 years.

Our Call

Valuation – Retain Buy with an unchanged PT of Rs. 3,689 - APL is focusing on transforming itself from a paint company to a complete home décor company in the long run. Strategic stake buy in White Teak and Weatherseal is unlikely to add significantly to the company's earnings. It is open for more such inorganic and organic acquisitions, which will help in widening its home décor portfolio. Scale-up in the company's operations and revenue would help in adding to the company's earnings in the medium to long term. The stock is currently trading at 70.8x/54.9x its FY2023E/FY2024E EPS. Near-term headwinds of volatility in crude prices and slowdown in demand environment will keep toll valuations in the near term. Long-term growth prospects in the core paint business and focus on becoming a complete home décor play augur well in the long run. We maintain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 3,689.

Key Risks

If crude prices continue to remain volatile for the long run, the decline in margins will be higher than anticipated and will act as a risk to our earnings estimates for FY2023/FY2024.

Valuation (consolidated)

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	21,713	29,231	34,034	38,741
OPM (%)	22.4	16.6	18.0	20.0
Adjusted PAT	3,207	3,273	4,221	5,443
% YoY growth	15.4	2.0	29.0	28.9
Adjusted EPS (Rs.)	33.4	34.1	44.0	56.7
P/E (x)	93.2	91.3	70.8	54.9
P/B (x)	23.3	21.1	18.7	15.7
EV/EBIDTA (x)	57.4	56.7	45.0	35.7
RoNW (%)	28.0	24.3	28.0	31.1
RoCE (%)	22.4	19.7	22.9	25.3

Source: Company; Sharekhan estimates

Details of strategic two stake buys

1. Acquisition of 49% stake in White Teak

APL entered into a share purchase agreement with the shareholders of Obgenix Software Private Limited (popularly known by the brand name of 'White Teak') for the acquisition of 100% of its equity share capital in a staggered manner over the period of next three years, subject to certain conditions.

According to the terms of the agreement:

- a. APL would be acquiring 49% of its equity share capital for a consideration of ~Rs. 180 crore along with an earnout of up to maximum of Rs. 114 crore, payable after a year, subject to achievement of mutually agreed financial milestones.
- b. The remaining 51% of the equity share capital would be acquired in a staggered manner, the consideration for which would be based on achievement of defined financial milestones for the business:
 - I. 11% of the equity share capital would be acquired for a maximum consideration of Rs. 66 crore during FY2024; and
 - II. 40% of the equity share capital would be acquired for a maximum consideration of Rs. 360 crore during FY2026.

2. Acquisition of 51% stake in Weatherseal

APL also entered into a shareholders' agreement and share subscription agreement with the promoters of Weatherseal, Mr. Harish Munireddy and Ms. Pratibha SB and Weatherseal, for infusion of ~Rs. 19 crore for 51% stake by subscription to equity share capital of Weatherseal, subject to customary closing adjustments and conditions precedent.

According to the agreement, the company has agreed to acquire further stake of 23.9% in Weatherseal from its promoter shareholders, in a staggered manner, over the next three years. It is also informed that out of 23.9% stake to be acquired in Weatherseal:

- a. 13.9% stake would be acquired during FY2025; and
- b. 10% stake would be acquired during FY2026.

The enterprise value that would be used to compute the consideration for acquisition would be derived at a multiple of 1.5x of Weatherseal's net revenue or 15x its EBITDA, whichever is lower. Revenue and EBITDA will be based on the financial year prior to the year of acquisition.

Key conference call highlights

- ◆ **Purpose of acquisition:** APL's acquisition of both brands is in-line with the company's strategy of taking forward its transition from a 'share of surface' within the home to 'share of space'. The home décor business will add to its core business. APL plans to utilise its network of strong distribution points and institutional clients to grow both businesses. APL looks at taking leadership and provide value addition to its customers through these acquisitions. The company aims to capture customers throughout the lifecycle of new home buying and home renovation. APL expects the home décor business to contribute ~10% to India's decorative business in the next 2-3 years.
- ◆ **Leverage APL's network:** APL currently has 29 home stores in 25 towns, which the company plans to increase to 70-75 stores across the country by year end. The company is also looking to widen its portfolio in its existing 500 premium stores present in over 200 towns by putting up space for lighting in these stores. The company also plans to add these products to its home service facility, which is a mid-premium facility for its customers.
- ◆ **Structure of organisation:** APL's kitchen business is part of a subsidiary, bath business is part of the company, while the two new acquisitions will be part of subsidiaries. The business will be run under a single management through a combination of direct and matrix reporting.

- ◆ **Kitchen and bath business:** Combined contribution from both businesses is currently at Rs. 500 crore. APL targets Rs. 2,500 from these businesses (combined) in the next 3-4 years.
- ◆ **Outlook:** APL is open for more such inorganic and organic acquisitions, which will help the company to widen its product portfolio.

Acquisition of White Teak to increase presence in the home lighting space

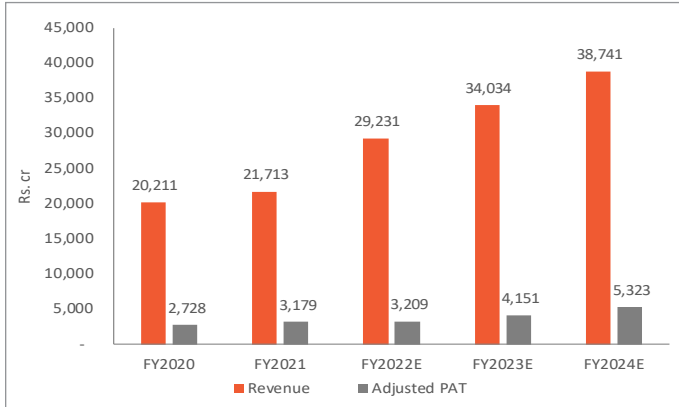
- ◆ **About White Teak:** White Teak is a private limited company established in 2016 by Silicon Valley tech entrepreneurs, Mr. Pawan Mehta and Mr. Gagan Mehta. White Teak is engaged in the business of decorative lighting products and fans. The company has a very strong tech-enabled platform and 70-80% of the company's revenue is through online sales. APL acquired White Teak at 20x its FY2021 revenue. EBITDA margin of White Teak is comparable to the paint business. APL expects White Teak's revenue to double every year for the next few years.
- ◆ **Purpose of acquiring White Teak:**
 - White Teak has strong design and innovation capabilities with the company being able to sense the choice of the Indian customers, providing it an edge over Chinese products.
 - It has a strong e-commerce platform with majority of the company's revenue coming from online sales.
 - The pricing of the company's products is competitive to Chinese products available in the market.
 - It has an established supply chain.
 - The company has strong manufacturing capabilities (Currently APL outsourced lighting products from multiple sources and it would have taken APL two-three years to build the manufacturing capabilities. Acquisition of the business saved the company's time and efforts).
- ◆ **About the decorative lighting market:** The decorative lighting market in India is about Rs. 1,200 crore presently and is growing at 18-20% annually. It is currently dominated by the unorganised sector, mostly through imports from China.

Acquisition of Weatherseal to expand the home décor portfolio

- ◆ **About Weatherseal:** Weatherseal is a company incorporated in March 2022. The company is engaged in the business of interior decoration/furnishing, including manufacturing uPVC Windows and door systems. The existing promoters of Weatherseal have been in the same line of business for the past seven years. Weatherseal is predominantly present in South India.
- ◆ **Purpose of acquiring Weatherseal:**
 - The company is an established brand in South India and its pricing is competitive to regional brands in that market.
 - The company's products are comparable to the products of regional players, but with value addition of better design, quality finishing, and superior service.
 - The company has expertise of engineering technology required for the business.
 - The doors and windows category involves a complex supply chain of various categories such as design, over coating, material for doors/windows, and selection of glass. Weatherseal has established supply chain, which APL can benefit from.
 - APL can leverage the manufacturing capabilities of Weatherseal, thereby saving the company's resources of time and efforts (similar to the lighting business).
- ◆ **About windows and doors market:** The size of the current market is more than Rs. 11,000 crore and the market share of organised players is about 40%.

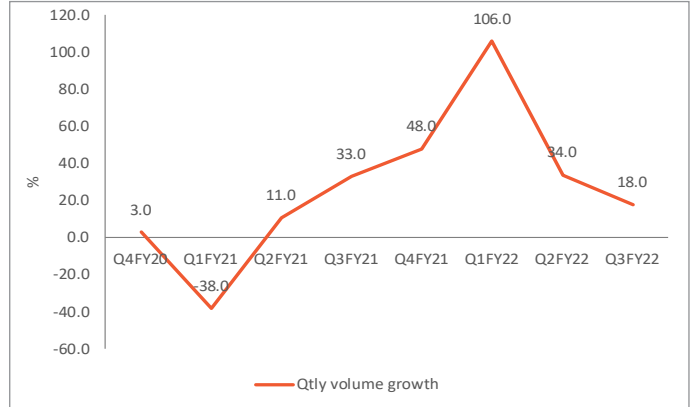
Financials in charts

Strong growth in revenue and PAT



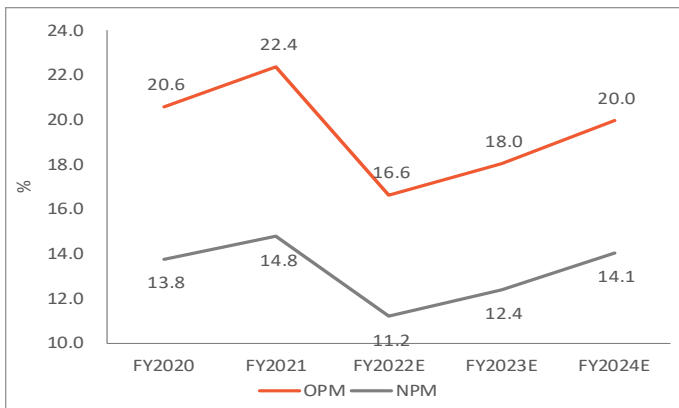
Source: Company, Sharekhan Research

Trend in quarterly volume growth



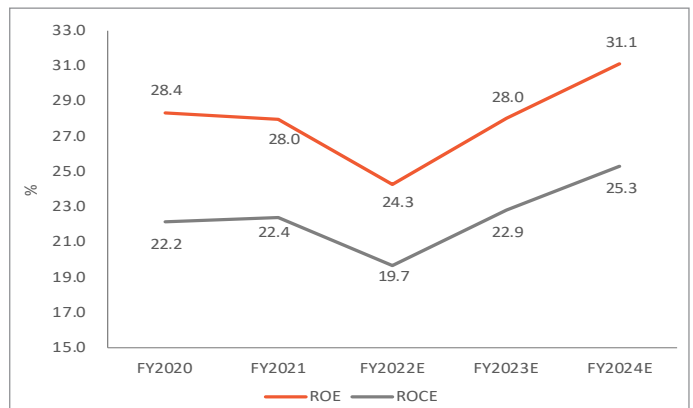
Source: Company, Sharekhan Research

OPM and NPM to recover by FY2024



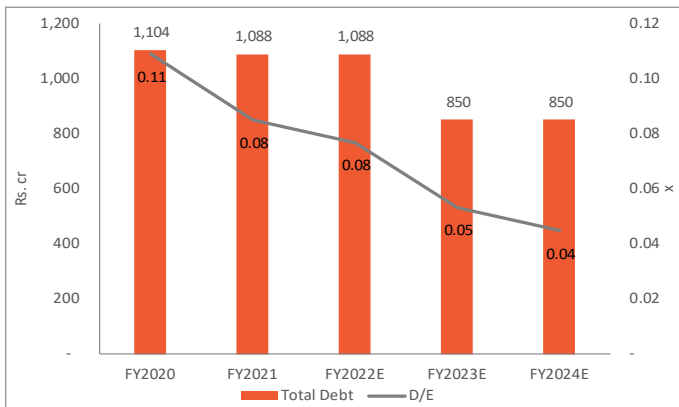
Source: Company, Sharekhan Research

Return ratios to improve



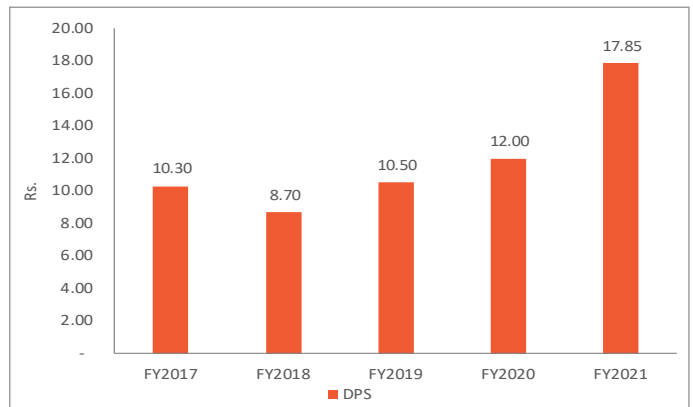
Source: Company, Sharekhan Research

Debt to decline from current levels



Source: Company, Sharekhan Research

Dividend payout trends



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. 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 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. Volatile input prices and slowdown in rural India are near-term headwinds for the paint industry. 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 paint companies in the near term.

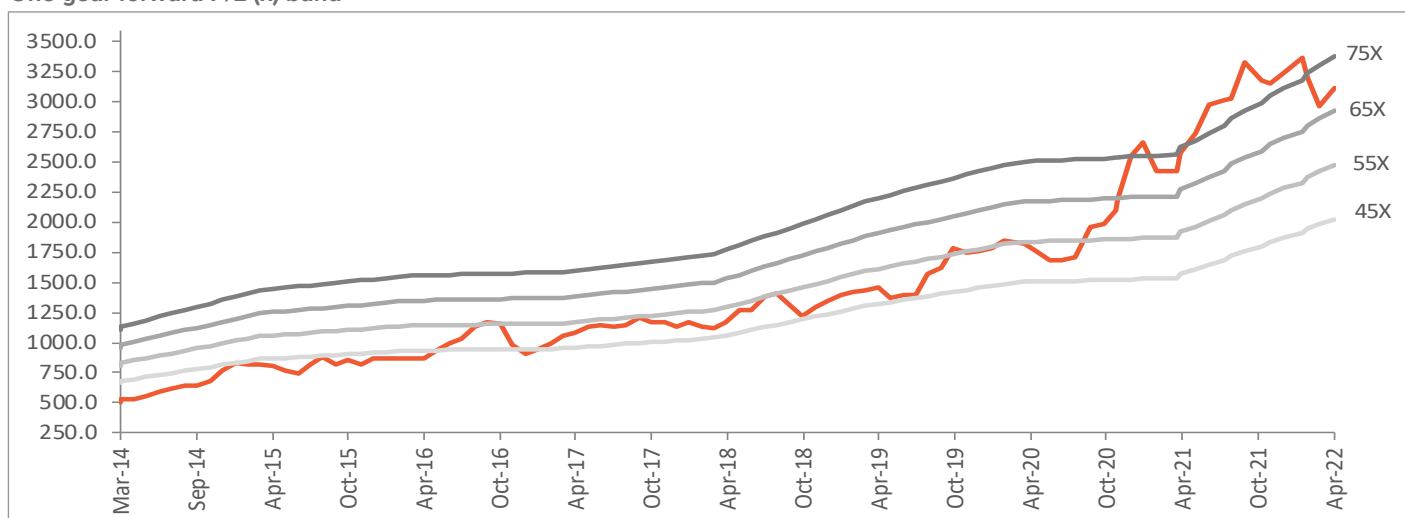
■ Company Outlook – Look beyond near-term headwinds

APL's revenue grew by 40% in 9MFY2022 with volume growth at 40% in the decorative paints business (two-year CAGR of 20%). OPM stood almost flat at 24.5%. Late December and January witnessed impact on retail sales due to emergence of third COVID-19 wave. Management expects demand to recover from mid-February and will be better in Tier 1-2 towns. However, slowdown in rural India and price hikes in the portfolio will impact sales volume in the near term. Water proofing products, construction chemicals, and the project business will continue to witness strong traction from the real-estate sector, government projects, and housing society projects in the medium term. Volatile crude prices will keep margins under pressure in the near term. The company has undertaken 20% price hike in the portfolio and might increase it further with 5-6% price hike in Q1FY2023.

■ Valuation – Re-iterate Buy with an unchanged price target of Rs. 3,689:

APL is focusing on transforming itself from a paint company to a complete home décor company in the long run. Strategic stake buy in White Teak and Weatherseal is unlikely to add significantly to the company's earnings. It is open for more such inorganic and organic acquisitions, which will help in widening its home décor portfolio. Scale-up in the company's operations and revenue would help in adding to the company's earnings in the medium to long term. The stock is currently trading at 70.8x/54.9x its FY2023E/FY2024E EPS. Near-term headwinds of volatility in crude prices and slowdown in demand environment will keep toll valuations in the near term. Long-term growth prospects in the core paint business and focus on becoming a complete home décor play augur well in the long run. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 3,689.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Berger Paints	97.6	80.3	63.9	62.7	50.4	42.1	24.0	25.8	28.1
Indigo Paints	-	77.7	45.2	60.6	52.0	30.1	23.3	20.7	29.4
Asian Paints	93.2	91.3	70.8	57.4	56.7	45.0	22.4	19.7	22.9

Source: Company, Sharekhan estimates

About the 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, waterproofing, 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. However, demand slowdown in rural India and volatile input prices will keep toll on the company's operating performance in the near term.

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

Deepak Satwalekar	Chairman
Amit Syngle	Managing Director and CEO
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	LIC of India	1.9
3	BlackRock Inc.	1.7
4	Vanguard Group Inc.	1.6
5	SBI Funds Management Pvt. Ltd.	1.3
6	Capital Group Cos Inc	1.2
7	JP Morgan Chase & Co	0.7
8	UTI Asset Management Co. Ltd.	0.5
9	Axis Asset management	0.4
10	Standard Life Aberdeen PLC	0.4

Source: Bloomberg

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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 deteriorating 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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