

Asian Paints

BSE SENSEX
18,759

S&P CNX
5,705

CMP: INR3,898

TP: INR3,900

Neutral

Bloomberg APNT IN
Equity Shares (m) 95.9
52-Week Range (INR) 4,170/2,551
1,6,12 Rel. Perf. (%) -1/2/18
M.Cap. (INR b) 373.9
M.Cap. (USD b) 7.0

| Year End | Net Sales (INR m) | Adj.PAT (INR m) | EPS (INR) | EPS Gr. (%) | P/E (X) | P/BV (X) | RoE (%) | RoCE (%) | EV/Sales | EV/EBITDA |
|----------|-------------------|-----------------|-----------|-------------|---------|----------|---------|----------|----------|-----------|
| 3/11A | 77,223 | 8,432 | 87.9 | 1.0 | - | - | 38.5 | 50.7 | - | - |
| 3/12A | 96,322 | 9,887 | 103.1 | 17.3 | 37.8 | 13.6 | 36.0 | 47.8 | 3.8 | 24.2 |
| 3/13E | 110,400 | 11,652 | 121.5 | 17.8 | 32.1 | 11.1 | 34.7 | 46.6 | 3.3 | 20.2 |
| 3/14E | 129,785 | 13,707 | 142.9 | 17.6 | 27.3 | 9.2 | 33.8 | 45.5 | 2.8 | 16.7 |

- Asian Paints (APNT) posted in-line results for 2QFY13, with consolidated PAT up 15% YoY to INR2.4b (v/s our estimate of INR2.4b). Revenue grew 16.5% YoY, 2.5% ahead of our estimate. Consolidated EBITDA margin declined 50bp YoY to 13.8% (v/s our estimate of 15%), despite flat gross margin. Higher staff costs (up 10bp YoY) and overheads (up 30bp YoY) led to the EBITDA margin decline.
- Standalone sales grew ~16.2% YoY. Gross margin was flat YoY but contracted 265bp QoQ. EBITDA margin expanded 20bp YoY to 15.2%, led by operating leverage.
- We estimate that APNT's domestic decorative paints volumes (part of the standalone entity) increased ~6% YoY. Though modest, this is a good recovery after 2% YoY volume decline in 1QFY13, more so given the higher base (15% YoY volume growth in 2QFY12) and shift in festive season (Diwali) to November. We expect volume growth to accelerate going forward led by festive demand.
- Sales of international and industrial subsidiaries/JVs (imputed as difference between consolidated and standalone entities) were up 18% YoY. However, operating margin declined 270bp YoY to 7.4%.
- We maintain our revenue and earnings estimates for FY13 and FY14. Festive season demand has begun on a good note and we expect Asian Paints to benefit from softening in Tio2 and currency appreciation in 2HFY13. The stock trades at 32.1x FY13E and 27.3x FY14E EPS, respectively. We maintain **Neutral** rating on APNT given the rich valuations.

Quarterly Performance (Consolidated)

| Y/E March | FY12 | | | | FY13 | | | | FY12 | FY13E | FY13 | Var. (%) |
|------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|--------|----------|
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3QE | 4QE | | | | |
| Net Sales | 22,571 | 22,447 | 25,605 | 25,387 | 25,393 | 26,160 | 30,100 | 28,748 | 96,010 | 110,400 | 25,500 | 2.6% |
| Change (%) | 23.3 | 24.0 | 22.0 | 29.5 | 12.5 | 16.5 | 17.6 | 13.2 | 24.3 | 15.0 | 13.3 | |
| Raw Material/PM | 13,537 | 13,507 | 15,514 | 15,213 | 14,838 | 15,714 | 17,910 | 16,736 | 57,770 | 65,198 | 15,045 | 4.4% |
| Gross Profit | 9,035 | 8,940 | 10,092 | 10,174 | 10,554 | 10,445 | 12,191 | 12,012 | 38,240 | 45,202 | 10,455 | -0.1% |
| Gross Margin (%) | 40.0 | 39.8 | 39.4 | 40.1 | 41.6 | 39.9 | 40.5 | 41.8 | 39.8 | 40.9 | 41.0 | |
| Operating Expenses | 5,149 | 5,772 | 6,118 | 6,420 | 6,176 | 6,834 | 7,314 | 6,725 | 23,459 | 27,049 | 6,630 | 3.1% |
| % of Sales | 22.8 | 25.7 | 23.9 | 25.3 | 24.3 | 26.1 | 24.3 | 23.4 | 24.4 | 24.5 | 26.0 | |
| EBITDA | 3,886 | 3,168 | 3,974 | 3,754 | 4,379 | 3,612 | 4,876 | 5,287 | 14,781 | 18,154 | 3,825 | |
| Margin (%) | 17.2 | 14.1 | 15.5 | 14.8 | 17.2 | 13.8 | 16.2 | 18.4 | 15.4 | 16.4 | 15.0 | (119) |
| Change (%) | 11.9 | -4.4 | 15.2 | 31.8 | 12.7 | 14.0 | 22.7 | 40.9 | 179.6 | 22.8 | 18.5 | |
| Interest | 65 | 88 | 90 | 166 | 109 | 122 | 130 | 144 | 410 | 504 | 130 | |
| Depreciation | 291 | 300 | 307 | 314 | 334 | 357 | 400 | 455 | 1,211 | 1,546 | 365 | |
| Other Income | 338 | 353 | 225 | 470 | 326 | 422 | 300 | 158 | 1,387 | 1,207 | 300 | 40.8% |
| PBT | 3,868 | 3,133 | 3,802 | 3,744 | 4,262 | 3,555 | 4,646 | 4,847 | 14,547 | 17,310 | 3,630 | |
| Tax | 1,155 | 955 | 1,138 | 1,097 | 1,273 | 1,041 | 1,417 | 1,549 | 4,344 | 5,280 | 1,107 | |
| Effective Tax Rate (%) | 29.9 | 30.5 | 29.9 | 29.3 | 29.9 | 29.3 | 30.5 | 32.0 | 29.9 | 30.5 | 30.5 | |
| PAT before Minority | 2,713 | 2,179 | 2,664 | 2,647 | 2,989 | 2,514 | 3,229 | 3,298 | 10,203 | 12,031 | 2,523 | |
| Minority Interest | 79 | 91 | 96 | 52 | 106 | 122 | 95 | 56 | 319 | 379 | 95 | |
| Adjusted PAT | 2,634 | 2,087 | 2,569 | 2,595 | 2,884 | 2,392 | 3,134 | 3,242 | 9,884 | 11,652 | 2,428 | -1.5% |
| Change (%) | 18.5 | -2.8 | 16.6 | 39.5 | 9.5 | 14.6 | 22.0 | 24.9 | 17.2 | 17.9 | 16.3 | |

E: MOSL Estimates

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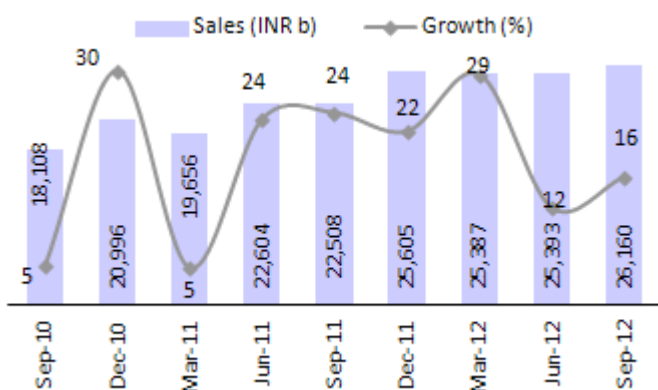
Analyst meet highlights

- APNT's new brand identity is aimed at deeper connect with the customers by widening their imagination and scope of creativity towards new possibilities.
- Management indicated that demand for decorative paints in 2QFY13 was lower than expectation. However, the onset of festive season has been good in terms of demand and premium products have shown a promise in offtake.
- Rural market demand was also below expectations; however, offtake in Tier 1 and Tier 2 cities were reasonable.
- Demand from auto and industrial business was subdued due to a weak macro economic environment; however, auto refinish demand has shown a recovery.
- APNT's RM index increased by 7% during 2QFY13. While TiO2 prices have stabilized, currency volatility remains a concern.
- Capacity expansion plans at the Khandala plant are on track. Company has so far invested INR4b for its Khandala plant. Phase 1 will have a capacity of 300,000 KL and is set to be commissioned by 4QFY13. Total capex for FY13 is expected to be INR7.5b.
- Royalty to APNT from its international operations stood at INR94m.
- Company witnessed pressure in its international business in the South Asian markets due to weak economic environment. Sales growth in Caribbean, Middle East and South Pacific was healthy, though ~16-17% growth was led by favorable currency. Egypt business still remains under pressure.

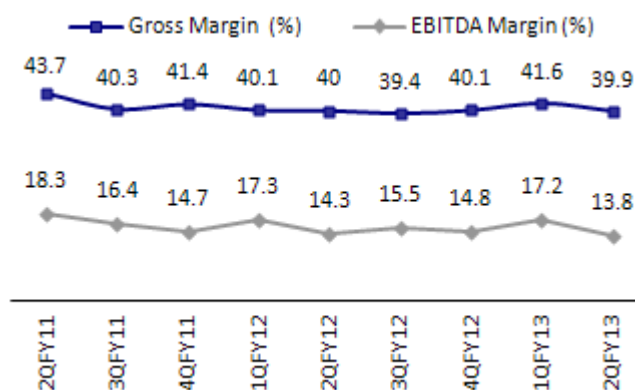
Consolidated sales up 16.5% YoY; subsidiaries' sales up 19% YoY

- Consolidated net sales grew 16.5% YoY to INR26.1b, marginally higher than our estimate of INR25.5b.
- Gross margin remained flat YoY but contracted 170bp QoQ to 39.9%.
- EBITDA margin contracted 30bp YoY to 13.8%, lower than our estimate of 15%. EBITDA grew ~11.9% YoY to INR3.6b v/s our estimate of INR3.8b.
- We expect operating margins to improve in 3QFY13, as input cost (TiO2) has corrected from the peak and the INR has appreciated from the lows.
- Other income grew 19.6% YoY to INR422m and tax rate declined 120bp YoY to 29.3%; consequently, adjusted PAT grew 14.6% YoY to INR2.4b.
- Despite lower than expected EBITDA margin, adjusted PAT was in line with our estimate due to higher other income (INR422m v/s our estimate of INR300m) and lower tax rate (29.3% v/s our estimate of 30.5%).

Consolidated sales up 16% YoY



Gross margin flat YoY

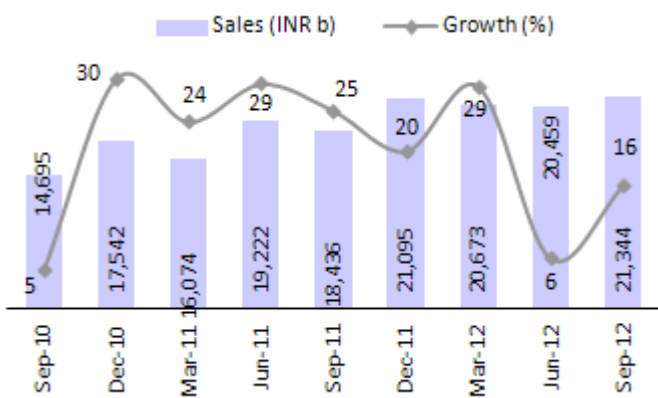


Source: Company/MOSL

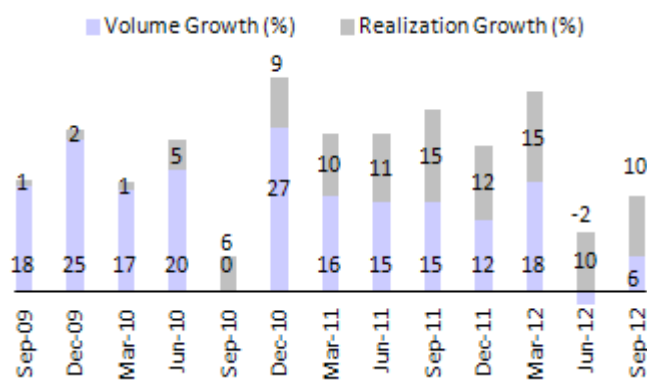
Domestic volumes up ~6% YoY; gross margin contracts 260bp YoY

- Standalone sales grew 16.2% YoY to INR21.3b. We expect domestic decorative paints volumes to grow ~6% YoY.
- Gross margin was flat YoY but declined 260bp QoQ to 40.6%. We believe this is due to lack of price hikes post May 2012 and higher carrying cost of raw material inventory. APNT took its last price hike in May (3.2%). However, TiO2 prices have come off 5% QoQ from the peak and we expect the benefits from the same to reflect in 3QFY13.
- EBITDA margin expanded 20bp YoY to 15.2%, led by 30bp savings due to operating leverage. EBITDA grew ~18.1% YoY to INR3.2b.
- PAT grew just 5% YoY, as other income declined 37% YoY (base quarter had dividend income of INR158.3m from Mauritius subsidiary) and tax rate was 125bp YoY higher at 30.3%.

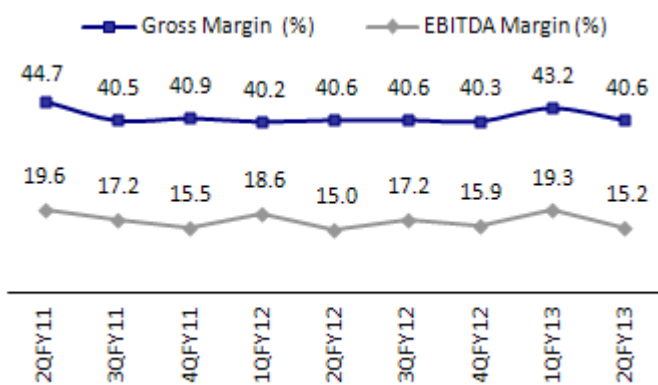
Domestic decorative paints sales up 16% YoY, led by ~6% YoY volume growth



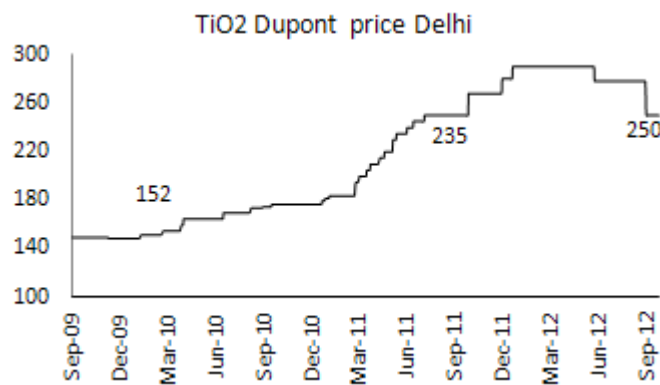
Domestic decorative volumes recover QoQ; up 6% YoY



Gross margin flat; EBITDA margin up 20bp YoY



Correction in TiO2 prices should reflect in 3QFY13 gross margin



Source: Company/MOSL

Performance of international division + industrial subsidiaries/JVs (imputed as difference between standalone and consolidated numbers)

The international business and industrial JVs posted 18% YoY revenue growth. EBITDA margin declined 268bp YoY to 7.4%. However, due to lower tax rate and higher other income, PAT was INR153.4m as against a loss of INR41.7m in 2QFY13.

Valuation and view: Festive season started on good note; levers for margin expansion ahead

- Decorative paints demand has improved post 2QFY13 and October has begun on a good note according to our channel checks. We expect good festive demand in 3QFY13, as Diwali has shifted to November this year from October in FY12.
- Correction in input costs and currency appreciation augurs well for APNT's gross margin.
- We maintain our revenue and earnings estimates for FY13 and FY14, factoring in 7-8% volume growth for FY13 and 12-13% volume growth for FY14.
- The stock trades at 32.1x FY13E and 27.3x FY14E EPS. Maintain **Neutral** with a target price of INR3,900.

Asian Paints: an investment profile

Company description

Asian Paints (APNT) is India's largest paint manufacturer and marketer, with a dominant share in the decorative segment. For the industrials and automotive segment, it has a JV with PPG of the US. APNT acquired Berger International of Singapore to expand its operations in other markets in Asia, the Middle East and the Caribbean.

Key investment arguments

- Expansion in housing and construction will drive demand for decorative paints over the next 3-5 years.
- International operations, which have turned around, will contribute to the company's earnings.

Key investment risks

- High spread and geographical diversification increases risk of execution.
- Other players in the decorative segment are becoming more aggressive.

Recent developments

- APNT took a 2% price increase from April and another 3% from May to mitigate the impact of increase in excise duty from 10% to 12%, increase in prices of TiO₂ and INR depreciation.
- APNT expects its Khandala plant to be commissioned in 4QFY13, with a capacity of 300,000KL.

Valuation and view

- We maintain our revenue and earnings estimates for FY13 and FY14.
- The stock trades at 32.1x FY13E and 27.3x FY14E EPS. Maintain **Neutral** with a target price of INR3,900.

Sector view

- We are positive on the long-term demand potential in the sector. Near-term concerns notwithstanding, APNT has displayed strong resilience in volume growth.
- Longer-term prospects bright, given rising incomes and low penetration.

Comparative valuations

| | | Asian Paints | ITC | HLL |
|---------------|-------|--------------|------|------|
| P/E (x) | FY13E | 32.1 | 31.5 | 36.5 |
| | FY14E | 27.3 | 22.9 | 31.4 |
| EV/EBITDA (x) | FY13E | 20.2 | 17.5 | 28.4 |
| | FY14E | 16.7 | 14.6 | 24.3 |
| EV/Sales (x) | FY13E | 3.3 | 6.4 | 4.5 |
| | FY14E | 2.8 | 5.4 | 4.0 |
| P/BV (x) | FY13E | 11.1 | 8.7 | 26.3 |
| | FY14E | 9.2 | 7.4 | 19.9 |

Shareholding pattern (%)

| | Sep-12 | Jun-12 | Sep-11 |
|---------------|--------|--------|--------|
| Promoter | 52.8 | 52.8 | 52.8 |
| Domestic Inst | 8.8 | 8.7 | 8.9 |
| Foreign | 19.6 | 19.6 | 19.3 |
| Others | 18.8 | 18.9 | 19.1 |

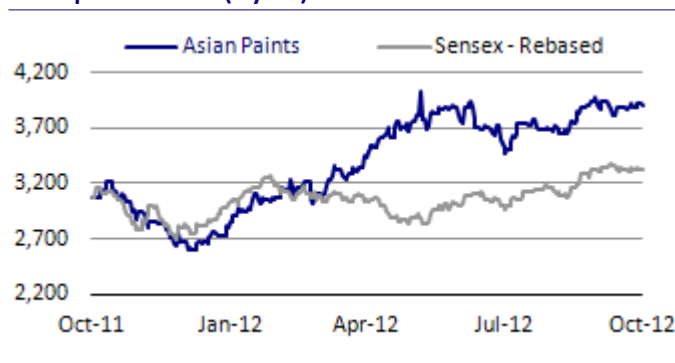
EPS: MOST forecast v/s consensus (INR)

| | MOSL Forecast | Consensus Forecast | Variation (%) |
|------|---------------|--------------------|---------------|
| FY13 | 121.5 | 121.2 | 0.3 |
| FY14 | 142.9 | 145.7 | -1.9 |

Target price and recommendation

| Current Price (INR) | Target Price (INR) | Upside (%) | Reco. |
|---------------------|--------------------|------------|---------|
| 3,898 | 3,900 | 0.1 | Neutral |

Stock performance (1 year)



Financials and Valuation

| Income Statement | | | | | | Ratios | | | | | |
|----------------------------|---------------|---------------|---------------|----------------|----------------|-------------------------------|-------|-------|-------|-------|-------|
| (INR Million) | | | | | | | | | | | |
| Y/E March | FY10 | FY11 | FY12 | FY13E | FY14E | Y/E March | FY10 | FY11 | FY12 | FY13E | FY14E |
| Net Sales | 66,809 | 77,223 | 96,322 | 110,400 | 129,785 | Basic (INR) | | | | | |
| Change (%) | 22.3 | 15.6 | 24.7 | 14.6 | 17.6 | EPS | 87.0 | 87.9 | 103.1 | 121.5 | 142.9 |
| Raw Materials | 37580 | 44746 | 57770 | 65198 | 76327 | Cash EPS | 95.7 | 99.7 | 115.7 | 137.6 | 163.0 |
| Gross Profit | 29230 | 32477 | 38552 | 45202 | 53458 | BV/Share | 178.3 | 228.0 | 286.5 | 350.1 | 422.8 |
| Margin (%) | 43.8 | 42.1 | 40.0 | 40.9 | 41.2 | DPS | 31.5 | 37.2 | 46.5 | 58.5 | 70.2 |
| Operating Expenses | 16956 | 19196 | 23465 | 27049 | 31492 | Payout % | 31.0 | 36.4 | 38.8 | 41.2 | 42.0 |
| EBITDA | 12,274 | 13,281 | 15,088 | 18,154 | 21,966 | Valuation (x) | | | | | |
| Change (%) | 83.2 | 8.2 | 13.6 | 20.3 | 21.0 | P/E | | | 37.8 | 32.1 | 27.3 |
| Margin (%) | 18.4 | 17.2 | 15.7 | 16.4 | 16.9 | Cash P/E | | | 33.7 | 28.3 | 23.9 |
| Depreciation | 836 | 1,131 | 1,211 | 1,546 | 1,928 | EV/Sales | | | 3.8 | 3.3 | 2.8 |
| Int. and Fin. Charges | 285 | 232 | 410 | 504 | 576 | EV/EBITDA | | | 24.2 | 20.2 | 16.7 |
| Other Income | 1,405 | 680 | 1,074 | 1,207 | 1,058 | P/BV | | | 13.6 | 11.1 | 9.2 |
| Profit before Taxes | 12,559 | 12,597 | 14,541 | 17,310 | 20,520 | Dividend Yield (%) | | | 1.2 | 1.5 | 1.8 |
| Change (%) | 102.4 | 0.3 | 15.4 | 19.0 | 18.5 | Return Ratios (%) | | | | | |
| Margin (%) | 18.8 | 16.3 | 15.1 | 15.7 | 15.8 | RoE | 48.8 | 38.5 | 36.0 | 34.7 | 33.8 |
| Tax | 3,676 | 3,502 | 4,274 | 4,933 | 5,848 | RoCE | 61.5 | 50.7 | 47.8 | 46.6 | 45.5 |
| Deferred Tax | 55 | 282 | 61 | 346 | 410 | Working Capital Ratios | | | | | |
| Tax Rate (%) | 29.7 | 30.0 | 29.8 | 30.5 | 30.5 | Debtor (Days) | 8 | 7 | 8 | 8 | 8 |
| PBT Before Minority | 8828 | 8813 | 10206 | 12031 | 14261 | Asset Turnover (x) | 6.5 | 3.8 | 4.5 | 3.5 | 3.2 |
| Minority Interest | 483 | 381 | 319 | 379 | 554 | Leverage Ratio | | | | | |
| Adjusted PAT | 8,345 | 8,432 | 9,887 | 11,652 | 13,707 | Debt/Equity (x) | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Change (%) | 107.9 | 1.0 | 17.3 | 17.8 | 17.6 | | | | | | |
| Margin (%) | 12.5 | 10.9 | 10.3 | 10.6 | 10.6 | | | | | | |
| Exceptional/Prior Perio | 12 | 0 | 0 | 0 | 0 | | | | | | |
| Reported PAT | 8,356 | 8,432 | 9,887 | 11,652 | 13,707 | | | | | | |

| Balance Sheet | | | | | | Cash Flow Statement | | | | | |
|------------------------------|---------------|---------------|---------------|---------------|---------------|------------------------------|---------------|---------------|---------------|---------------|---------------|
| (INR Million) | | | | | | (INR Million) | | | | | |
| Y/E March | FY10 | FY11 | FY12 | FY13E | FY14E | Y/E March | FY10 | FY11 | FY12 | FY13E | FY14E |
| Share Capital | 959 | 959 | 959 | 959 | 959 | OP/(loss) before Tax | 12,274 | 13,281 | 15,088 | 18,154 | 21,966 |
| Reserves | 16,141 | 20,915 | 26,526 | 32,626 | 39,600 | Int./Div. Received | 1,405 | 680 | 1,074 | 1,207 | 1,058 |
| Net Worth | 17,100 | 21,874 | 27,485 | 33,585 | 40,560 | Interest Paid | -285 | -232 | -410 | -504 | -576 |
| Loans | 2,292 | 581 | 559 | 700 | 800 | Direct Taxes Paid | -3,676 | -3,502 | -4,274 | -4,933 | -5,848 |
| Other Liability | 562 | 1,745 | 1,847 | 2,205 | 2,665 | (Incr)/Decr in WC | 3,530 | -784 | -1,075 | -740 | -7,890 |
| Minority Interest | 945 | 1,099 | 1,367 | 1,746 | 2,300 | CF from Operations | 13,249 | 9,443 | 10,404 | 13,183 | 8,710 |
| Capital Employed | 20,899 | 25,299 | 31,257 | 38,236 | 46,325 | Incr in FA | -3,541 | -1,606 | -6,946 | -10,163 | -1,078 |
| Gross Block | 15,004 | 20,249 | 21,458 | 32,792 | 34,870 | Pur of Investments | -5,457 | 1,951 | 742 | 1,655 | -81 |
| Less: Accum. Deprn. | 6,276 | 7,151 | 8,453 | 9,999 | 11,927 | CF from Invest. | -8,998 | 345 | -6,204 | -8,508 | -1,159 |
| Net Fixed Assets | 8,728 | 13,099 | 13,006 | 22,793 | 22,943 | Issue of Shares | 0 | 0 | 0 | 0 | 0 |
| Capital WIP | 4,072 | 433 | 6,171 | 5,000 | 4,000 | Incr in Debt | -794 | -1,711 | -23 | 142 | 100 |
| Investments | 6,241 | 4,290 | 3,547 | 1,892 | 1,973 | Dividend Paid | -3,023 | -3,571 | -4,459 | -5,611 | -6,734 |
| Curr. Assets, L&A | 18,437 | 28,284 | 36,238 | 37,997 | 51,798 | Min Int/ Dt | | | | | |
| Inventory | 9,559 | 13,054 | 15,989 | 16,636 | 19,557 | Others | -1,479 | 698 | 263 | 71 | 52 |
| Account Receivables | 5,425 | 5,731 | 7,813 | 9,074 | 10,667 | CF from Fin. Activity | -5,296 | -4,584 | -4,219 | -5,399 | -6,582 |
| Cash and Bank Balance | 1,058 | 6,262 | 6,243 | 5,520 | 6,489 | Incr/Decr of Cash | -1,045 | 5,204 | -19 | -724 | 970 |
| Others | 2,395 | 3,237 | 6,194 | 6,768 | 15,085 | Add: Opening Balance | 2,104 | 1,058 | 6,262 | 6,243 | 5,520 |
| Curr. Liab. and Prov. | 16,947 | 20,807 | 27,705 | 29,447 | 34,389 | Closing Balance | 1,059 | 6,262 | 6,243 | 5,520 | 6,490 |
| Account Payables | 7,183 | 10,874 | 12,968 | 11,789 | 13,802 | | | | | | |
| Other Liabilities | 6,613 | 4,606 | 8,462 | 9,594 | 10,883 | | | | | | |
| Provisions | 3,150 | 5,327 | 6,275 | 8,064 | 9,705 | | | | | | |
| Net Current Assets | 1,490 | 7,478 | 8,533 | 8,550 | 17,409 | | | | | | |
| Godwill on Cons. | 367 | 0 | 0 | 0 | 0 | | | | | | |
| Application of Funds | 20,899 | 25,299 | 31,257 | 38,235 | 46,325 | | | | | | |

E: MOSL Estimates

N O T E S

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Asian Paints

- | | |
|---|----|
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| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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