

Asian Paints (APNT IN)

The Sergey Bubka of paints

INDIA | FMCG | Company Update

21 August 2019

Sergey Bubka is a Ukrainian pole-vaulter who broke the world record 35 times and in the process, beat his own record 14 times. He just kept on raising the bar (literally), truly living up to the motto of the Olympic games – Citius, Altius, Fortius (faster, higher, stronger).

We believe Asian Paints is pulling a Sergey Bubka in the paints industry. The company is likely to tighten its grip on leveraging its existing moats – strong brand equity, an extensive distribution network, and a well-diversified product portfolio. In the process, it will set up new benchmarks every year. Its healthy volume growth is likely to continue in the medium term based on: (1) aggression in gaining market share across its product categories after its recent c.50% capacity addition, (2) **launch of products in the paint category (Tractor Sparc) at disruptive price points**, (3) foray into adjacent categories (waterproofing, construction chemicals, and **very recently – sandpaper**), leveraging the strength of its existing distribution network, and (4) **intense push into low-margin and high-working-capital-intensive institutional orders**. We have increased our EPS estimates for FY20/21 by 2% each to incorporate a benign RM outlook. Simultaneously, we have raised our target multiple to 50x from 45x because it is one of the few companies within the discretionary space that has high earnings visibility. **We have also raised our target to Rs 1,785 (50x Sep-21 EPS) vs. Rs 1,580 (45x Sept-21 EPS) earlier.**

Distemper segment disrupted; emulsion to follow: We believe APNT’s volume growth is likely to remain strong for the balance three quarters of FY20 based on: (1) GST rate reduction to 18% from 28%, which is likely to benefit APNT the most in its distemper segment where the share of the unorganized segment is higher. This is because its pricing premium vs. the unorganized sector has now reduced to 10% from 20-25% pre-GST; (2) a **gradual roll-out of its newly launched economy emulsion (Tractor Sparc) at a disruptive price point on a pan-India basis. It launched Tractor Sparc at Rs 75 per litre to gain market share from the unorganized sector whose emulsion prices are in the range of Rs 70-75/ltr. Before the launch of Tractor Sparc, APNT’s emulsion products started from Rs 95-100 per litre;** (3) its renewed aggression in matching the competition’s price, which is generally at a 3-5% discount. Also, increased awareness among rural households about applying lower-coat (putty and primer) before applying final coat (distempers) has aided demand of low-end products. In addition, structural tailwinds such as shorter repainting cycles, APNT’s express/professional painting services ensuring timely completion, and higher discretionary spending – will aid longer term growth.

Softer RM prices will be a cherry on the cake: APNT has already cut prices by 0.4% in 1QFY20 (on a weighted average basis) mainly in enamels. **We believe it is unlikely to cut prices until the festival / wedding season (mid 3QFY20), despite softer RM prices, as it wouldn’t want to disturb the market’s equilibrium. Our channel checks suggest that volume growth trends for the paints industry have remained healthy for July. Moreover, our recent interaction with Kansai’s management reiterated our contention that decorative paints are yet to see any slowdown.**

Key RM	Q1FY20	Q2FY20e	Q3FY20e	Q4FY20e
Tio2	6%	(2)%	(6)%	(6)%
Crude	-5%	(21)%	(14)%	(6)%

** Assuming current crude and Tio2 price hold for balance part of year

Foray into adjacent categories, leveraging existing distribution network: We like the management’s strategy of being present in the entire value chain (painting cycle) so that it can fully leverage its distribution network. **It has made rapid strides in waterproofing (despite the presence of a strong incumbent) based on an increased warranty period, creating awareness among painters about the application of waterproofing material, high dealer margins, and increased A&P spends. Also, it has recently forayed into sandpaper, where the market remains fragmented (higher prevalence of the unorganized sector).**

BUY (Maintain)

CMP RS 1,595
TARGET RS 1,785 (12%)

COMPANY DATA

O/S SHARES (MN) :	959
MARKET CAP (RSBN) :	1505
MARKET CAP (USDBN) :	21.1
52 - WK HI/LO (RS) :	1594 / 1120
LIQUIDITY 3M (USDMN) :	30.
PAR VALUE (RS) :	1

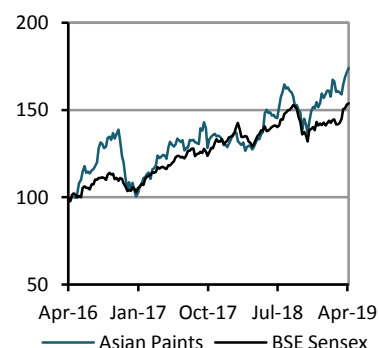
SHARE HOLDING PATTERN, %

	Jun 19	Mar 19	Dec 18
PROMOTERS :	52.8	52.8	52.8
FII / NRI :	16.7	16.0	15.0
FI / MF :	9.2	10.2	11.2
NON PRO :	2.9	2.9	2.9
PUBLIC & OTHERS :	18.4	18.1	18.2

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	15.3	19.0	12.4
REL TO BSE	19.0	19.0	13.9

PRICE VS. SENSEX



KEY FINANCIALS

Rs mn	FY20E	FY21E	FY22E
Net Sales	2,23,355	2,55,518	2,92,493
EBIDTA	45,629	53,374	62,448
Net Profit	26,165	31,171	37,206
EPS, Rs	27.3	32.5	38.8
PER, x	58.2	48.8	40.9
EV/EBIDTA, x	33.2	28.2	23.8
P/BV, x	14.0	12.2	10.5
ROE, %	24.1	25.0	25.7
Debt/Equity (%)	5.7	5.0	4.3

Source: Phillip Capital India Research

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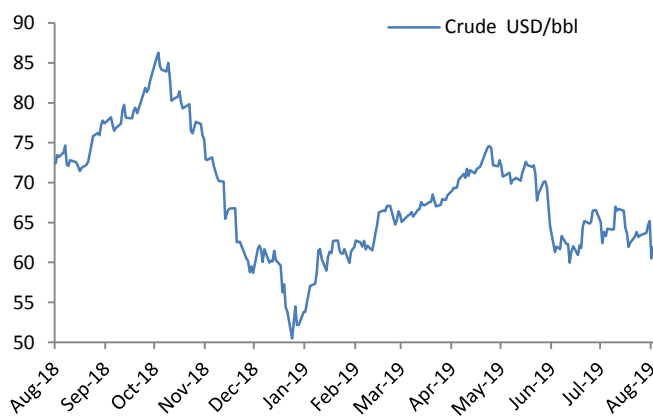
Why are paint companies not materially affected by the real-estate slowdown?

- Fresh painting constitutes 25% of paint demand in India. Majority of the builders in India apply low-quality distempers (mostly purchased from unorganized players) anticipating that home buyers will repaint using better-quality paints (most emulsions).
- Not surprisingly, the real-estate slowdown has not hurt organized players to a material extent – because paints used on new buildings were not purchased from them in a meaningful way in any case.
- With pricing premium between organized and unorganized players reducing to 10% from 20-25%, branded paint companies are catching the tailwinds from both sides of the business – B2B (real-estate developers / institutional clients) and B2C (residential households).

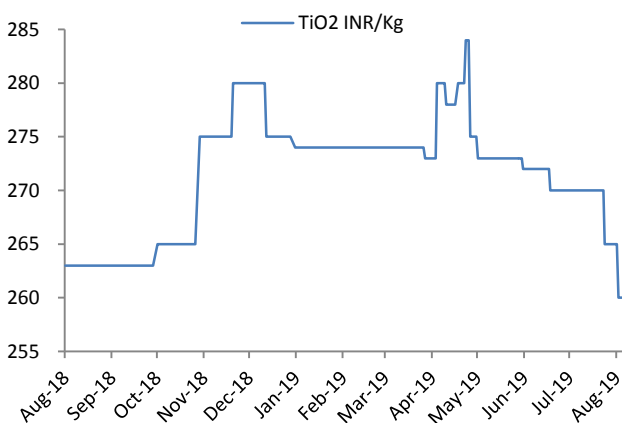


Tractor Sparc was launched at Rs 75 per litre to gain market share from the unorganized sector, whose emulsion prices are at Rs 70-75. Before the launch of Tractor Sparc, APNT’s range of emulsions started from Rs 95-100 per litre

Outlook on crude prices remains benign, given global uncertainties



TiO2 in a downward spiral



Source: Bloomberg

Discussion on strategy deployed by the management to garner market share in the ancillary product portfolio

Have ancillary products helped volume growth at the aggregate level?

- APNT aspires to become the #1 player in waterproofing and has come out with specific schemes in the peak season (1Q is an important season for waterproofing) with a focus on specific territories. Within construction chemicals, it focussed on 2-3 large products in south India. It does not want to miss out on covering any raw material or equipment that is used in the painting process.
- Brush and roller categories do not contribute meaningfully to its revenue pool, but earn fairly decent margins because it is able to procure them economically.
- Sandpaper: To increase its presence in the value chain, APNT launched sand paper, which is used to remove old paint. India's sand-paper market is fragmented with a heavy presence of the unorganised players. APNT's sandpaper is priced at par with other branded players at Rs 12-15 while those of unorganised players are available at about Rs 10. Dealers said that although APNT's product is slightly costlier, it could gradually start gaining market share because its product quality is superior.



APNT's sandpaper is available at par with other branded players at Rs 12-15 while that of unorganised players is at about Rs 10

Waterproofing products did very well in 1QFY20. What can keep driving their growth?

- Generally, there are two types of waterproofing – one is for external walls, so that water does not enter the house through external cracks, and the other is for internal walls where waterproofing chemicals are mixed with putty and primer, so that no dampness or moisture is visible on internal wall. Contractors told us that one form of waterproofing is enough (either external or internal), but it has to be done properly.
- While Asian Paints is a rather recent entrant in waterproofing solutions, Pidilite has been a strong player in this segment with stronger brand equity. APNT has been able to gain meaningful market share in internal waterproofing, based on its strong distribution network and because its product are at a substantial discount to market leader Pidilite's. The latter continues to be a leader in external waterproofing (way ahead), but Asian Paints has been making gradual gains here too, as civil contractors have started buying APNT waterproofing material along with exterior paints, realising that its quality is at par with Pidilite's and price is cheaper. Civil contractors operate at low margins and would like to save every penny possible while maintaining quality.
- APNT has gained market share over Pidilite recently in other ways as well – it offers a warranty of 7 years vs. the 5-year warranty that it offered earlier. In response, Pidilite, which wasn't offering any warranty earlier, has begun matching APNT's revised warranty. These warranties and improved product formulations (that deliver better results) are spurring customers into bundling waterproofing with their painting jobs.
- For APNT, waterproofing margins are 7-8% while it earns 4-5% margin in paints. APNT has started training centres across India for construction workers / painters about how to apply waterproofing products and construction chemicals. Higher margin and training for painters has resulted in strong growth in waterproofing. It has been very aggressive in government contracts (it has already big 3-4 government contracts in hand).

Yet to find a fix for adhesives

- Asian Paints has not been able to make much headway in the adhesives market due to lower product shelf-life and low sales velocity.
- Due to lower sales velocity, effectiveness reduces significantly (due to lower shelf life) – thereby creating quality issues, which in turn leads to a poor customer experience.

- Asian Paints' current distribution network consists of mainly paint stores. In metro and tier-1 cities, these stores tend to sell only paint-related materials. As its adhesives portfolio has to be sold through hardware stores in these areas, getting a foothold against a strong incumbent will be challenging here.
- In tier 2/3 cities, paint stores stock up many adjacent products (are multi-purpose), so it may be able to make some gains.
- The key decision influencer remains the carpenter – a segment with whom Pidilite has significant influence.

Financials

Income Statement

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Net sales	1,93,415	2,23,355	2,55,518	2,92,493
Growth, %	15	15	14	14
Total income	1,93,415	2,23,355	2,55,518	2,92,493
Raw material expenses	-1,13,423	-1,29,303	-1,47,082	-1,67,526
Employee expenses	-12,572	-14,457	-16,192	-18,135
Other Operating expenses	-29,799	-33,965	-38,870	-44,384
EBITDA (Core)	37,621	45,629	53,374	62,448
Growth, %	17.7	21.3	17.0	17.0
Margin, %	19.5	20.4	20.9	21.4
Depreciation	-6,256	-7,835	-8,685	-9,485
EBIT	31,365	37,795	44,689	52,963
Growth, %	10.5	20.5	18.2	18.5
Margin, %	16.2	16.9	17.5	18.1
Interest paid	-1,057	-1,162	-1,278	-1,406
Other Income	2,331	2,913	3,641	4,552
Non-recurring Items	0	0	0	0
Pre-tax profit	33,046	39,974	47,502	56,580
Tax provided	-10,966	-13,287	-15,810	-18,852
Profit after tax	22,080	26,686	31,692	37,728
Others (Minorities, Associates)	-521	-521	-521	-521
Net Profit	21,559	26,165	31,171	37,206
Growth, %	9.5	21.4	19.1	19.4
Net Profit (adjusted)	21,559	26,165	31,171	37,206
Unadj. shares (m)	959	959	959	959
Wtd avg shares (m)	959	959	959	959

Balance Sheet

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Cash & bank	4,449	12,952	24,985	41,366
Debtors	19,134	22,029	25,202	28,849
Inventory	31,499	36,104	41,303	47,280
Loans & advances	942	942	942	942
Other current assets	14,004	14,004	14,004	14,004
Total current assets	70,028	86,031	1,06,436	1,32,441
Investments	25,697	26,125	26,574	27,045
Gross fixed assets	72,558	81,558	90,058	98,058
Less: Depreciation	-14,046	-21,881	-30,565	-40,050
Add: Capital WIP	2,097	2,097	2,097	2,097
Net fixed assets	60,609	61,774	61,590	60,105
Total assets	1,56,333	1,73,931	1,94,599	2,19,591
Current liabilities	45,909	49,503	53,468	58,027
Total current liabilities	45,909	49,503	53,468	58,027
Non-current liabilities	11,632	11,632	11,632	11,632
Total liabilities	57,542	61,135	65,100	69,659
Paid-up capital	959	959	959	959
Reserves & surplus	94,202	1,07,684	1,23,867	1,43,779
Shareholders' equity	98,792	1,12,795	1,29,499	1,49,932
Total equity & liabilities	1,56,333	1,73,931	1,94,599	2,19,591

Source: Company, PhillipCapital India Research Estimates

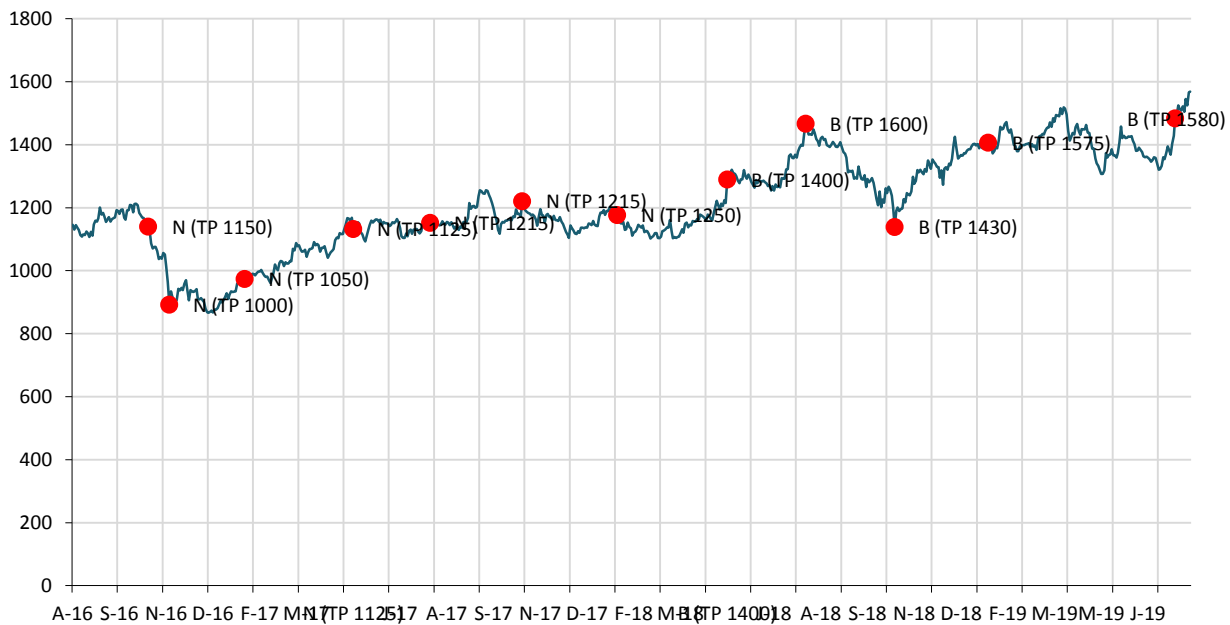
Cash Flow

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Pre-tax profit	33,046	39,974	47,502	56,580
Depreciation	6,256	7,835	8,685	9,485
Chg in working capital	151	-3,907	-4,406	-5,065
Total tax paid	-9,544	-13,287	-15,810	-18,852
Cash flow from operating activities	29,909	30,614	35,970	42,147
Capital expenditure	-15,491	-9,000	-8,500	-8,000
Chg in investments	-4,290	-428	-449	-472
Cash flow from investing activities	-19,374	-9,000	-8,500	-8,000
Free cash flow	10,535	21,614	27,470	34,147
Equity raised/(repaid)	36	0	0	0
Debt raised/(repaid)	942	0	0	0
Dividend (incl. tax)	-12,106	-12,683	-14,988	-17,294
Cash flow from financing activities	-11,295	-12,683	-14,988	-17,294
Net chg in cash	-760	8,931	12,482	16,853
Opening cash balance	4,047	4,449	12,952	24,985
Closing cash balance	4,449	12,952	24,985	41,366

Valuation Ratios

	FY19	FY20E	FY21E	FY22E
Per Share data				
EPS (INR)	22.5	27.3	32.5	38.8
Growth, %	9.5	21.4	19.1	19.4
Book NAV/share (INR)	99.2	113.3	130.1	150.9
FDEPS (INR)	22.5	27.3	32.5	38.8
CEPS (INR)	29.0	35.4	41.6	48.7
CFPS (INR)	28.3	28.4	33.2	38.7
DPS (INR)	10.5	11.0	13.0	15.0
Return ratios				
Return on assets (%)	15.7	16.9	17.9	18.9
Return on equity (%)	22.7	24.1	25.0	25.7
Return on capital employed (%)	22.3	23.7	24.8	25.9
Turnover ratios				
Asset turnover (x)	2.6	2.7	2.9	3.2
Sales/Total assets (x)	1.3	1.4	1.4	1.4
Sales/Net FA (x)	3.5	3.7	4.1	4.8
Working capital/Sales (x)	0.1	0.1	0.1	0.1
Receivable days	36.1	36.0	36.0	36.0
Inventory days	59.4	59.0	59.0	59.0
Payable days	102.1	96.9	92.4	88.4
Working capital days	37.1	38.5	40.0	41.2
Liquidity ratios				
Current ratio (x)	1.5	1.7	2.0	2.3
Quick ratio (x)	0.8	1.0	1.2	1.5
Interest cover (x)	29.7	32.5	35.0	37.7
Total debt/Equity (%)	6.5	5.7	5.0	4.3
Net debt/Equity (%)	1.8	(6.2)	(15.0)	(24.3)
Valuation				
PER (x)	70.6	58.2	48.8	40.9
PEG (x) - y-o-y growth	7.4	2.7	2.6	2.1
Price/Book (x)	16.0	14.0	12.2	10.5
EV/Net sales (x)	7.9	6.8	5.9	5.1
EV/EBITDA (x)	40.5	33.2	28.2	23.8
EV/EBIT (x)	48.6	40.1	33.6	28.1

Stock Price, Price Target and Rating History



Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	$\geq +15\%$	Target price is equal to or more than 15% of current market price
NEUTRAL	$-15\% > \text{to} < +15\%$	Target price is less than +15% but more than -15%
SELL	$\leq -15\%$	Target price is less than or equal to -15%.

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