SINCE 1986
DALAL STREET INVESTMENT JOURNAL
DEMOCRATIZING WEALTH CREATION

VALUE PICK
CHASING VALUE, NOT PRICES

January 2017

Company Name	:	**ASIAN PAINTS**
BSE Code	:	**500820**
Time Duration	:	**1 year**
CMP	:	**₹934 (as on 11 January, 2017)**
Target Price	:	**₹1250**

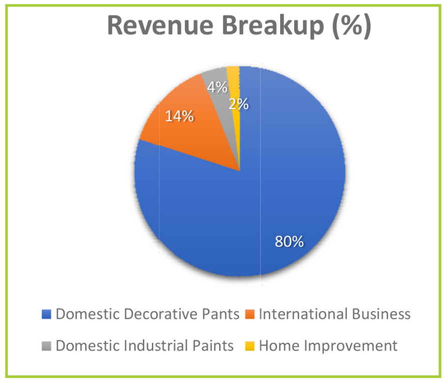
Our Value Pick for the month of January 2017 is Asian Paints. Asian Paints is India's largest paint company with an installed capacity of ~1.2 million kilolitres per annum. It is a dominant leader with ~50% market share in the domestic market. The company's decorative paint segment (80% of revenue) has ~53% market share. The company is the second largest supplier to automotive industrial coating segment with 20% market share under JV with PPG Industries, USA, which is a global leader in paints. The company has grown at a CAGR of 15% over the last five years led by portfolio expansion (added home improvement business, automotive industrial coating segment, adhesives), improved demand from overseas markets and non-tier-I cities in India and ramp-up in newly expanded plants. The company has chemical manufacturing segment, the products of which are consumed 50%-plus internally. Also, it has entered into the adhesive category by late FY16 and expanded its product portfolio.

The company is expanding its paints manufacturing capacity at Vizag and Mysore by 11,00,000 KL with a total capex of Rs 4,085 cr. We expect the company to post strong earnings growth, capitalizing on strong volumes from budding demand and capacity additions, combined with momentum in overseas and non-core operations. Its revenues are expected to grow at a CAGR of 12.33% over FY16-18E, which combined with a ~97 bps expansion in EBITDA margin, is seen improving consolidated profit numbers for the same period by 22.71% CAGR. Considering the growth prospects led by the rise in demand, product mix, capex and GST benefits; we see 30%-plus upside in the stock from the current level.

Growth Drivers

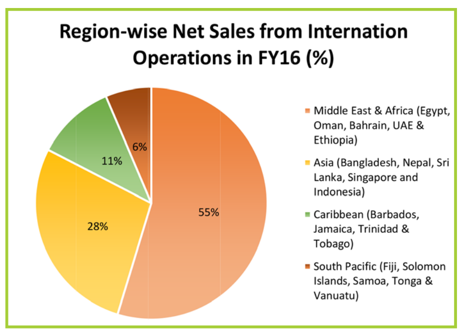
Product mix and leadership position to aid growth

The company's revenues are attributable to domestic decorative paints, domestic industrial paints, home improvement business and international business which contributed approximately 80%, 4%, 2% and 14%, respectively, in FY16. The company has strong presence in domestic market with a network of 40,000-plus dealers, supported by 26 plants across India. The company focuses on product portfolio expansion by adding innovative products/solutions (textured paints, waterproofing etc.) and ramping up in Home Improvement Business (HIB). We expect non-core business (HIB) i.e. modular kitchen (Sleek) and bathroom fitting (Ess Ess) ranges to continue their current growth rate of 10% using pan-India network.



The company is foraying into adhesives in the retail segment by entering a distribution arrangement with Henkel Adhesives Technologies, Germany, to sell the 'Loctite' brand of adhesives. It has seen adding value to the company through higher revenues and diversification. The company is also expected to do well in automotive industrial coating segment under the JV with PPG Industries.

Overseas Operations



The company's operations are spread over 18 countries in the Middle East, Asia, Caribbean and South Pacific, besides India. Its greenfield expansion in Indonesia is expected to be completed by the end of Q4FY17E. Additionally, the pressure in overseas markets (particularly Middle-East) due to the steep decline in oil prices last fiscal is also expected to abate, thereby improving demand. We expect the higher demand to improve all round utilisations, particularly at the 21,000 KL plant at Sohar in Oman inaugurated last fiscal.

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Benefits of GST

The company currently faces an effective tax rate of ~23% and will benefit from a lower tax burden under GST assuming it is implemented with an effective rate of 18%. Additionally, the implementation of GST will bring many unorganized players under the tax umbrella, squeezing their earnings and forcing them to raise prices in order to continue sustainable operations. The consequent narrowing of the price gap is expected to result in an increase in migration of customers towards branded producers like Asian Paints.

Capacity Expansion

The expansion of Rohtak plant to double its capacity to 4,00,000 KL/annum was successfully completed last fiscal. Also, the modernisation was undertaken at the company's older plants in Ankleshwar and Kasna. The ramp-up and stabilisation of operations is expected to boost volumes and improve operational leverage. Building of two new facilities have also been started at Mysore and Vizag with capacities of 6,00,000 KL and 5,00,000 KL, respectively. These plants are going to be built up in a phased manner in response to increasing demand.

Industry Tailwind

Increasing urbanisation, higher income levels shortening repainting cycles and a rapid shift away from distemper to higher value emulsions are expected to aid revenue numbers. The favourable monsoons and implementation of 7th Pay commission will increase disposable incomes, leading to higher repainting demand. The growth momentum is expected to continue to be higher from tier-II and tier-III cities after passing demonetisation impact.

Financial Performance

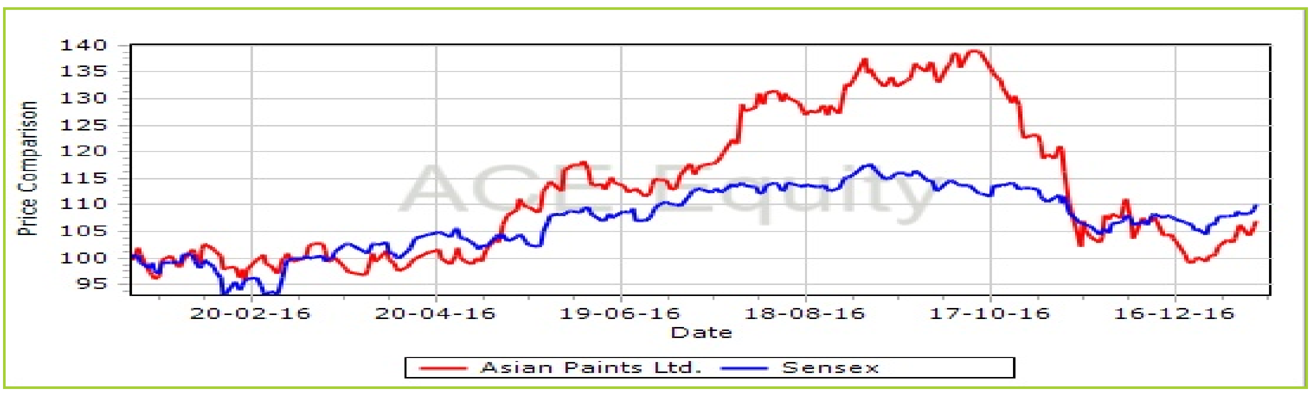
Asian Paints posted a strong set of consolidated numbers in Q2FY17 as compared to Q2FY16. Its consolidated net profit for Q2FY17 grew 17.9% YoY to Rs 475.90 cr on the back of volume growth and robust operational performance.

The strong volume growth of ~10% in both decorative and industrial paints particularly from tier-I and tier-II cities helped the company achieve an operating revenue growth of 10.2% YoY to Rs 4,232.46 cr in Q2FY17. The growth in volumes was achieved despite extended monsoons putting a dampener on demand in certain regions in central and western India.

The EBITDA for the period came in at Rs 712.98 cr, a YoY growth of 17.3%, led by a 100 bps expansion in EBITDA margin to 16.8%. The margin expansion was primarily due to the impact of stable raw material prices.

Valuation

The stock is trading at FY18E P/E of 33.64x on FY18E EPS of Rs 27.09, which looks attractive at the current level as compared to its peers. The company delivers healthy ROE of 33.36% in FY16. We expect Q3 to be subdued due to demonetion impact. We see stock price to correct further on this note, so we recommend investors to **BUY** this scrip in the range of Rs 875-950 (CMP- 934) with a target price of Rs 1250.



Quarter On Quarter (Consolidated) (Rs in Crore)					
Particulars	201609	201606	Q on Q Var%	201509	Y on Y Var%
Net Sales	3720.51	3590.16	3.63	3394.35	9.61
Total Expenditure	3050.34	2817.15	8.28	2826.91	7.90
PBIDT (Excl OI)	712.98	820.25	-13.08	608.01	17.26
PAT	480.99	540.01	-10.93	409.64	17.42
PBIDTM% (Excl OI)	16.85	20.09	-16.13	15.83	6.44
PBIDTM%	18.72	21.86	-14.36	17.47	7.16
PATM%	11.36	13.23	-14.13	10.67	6.47
Adj. EPS(Rs)	4.96	5.58	-11.11	4.21	17.81