

Asian Paints

BSE Code : **500820**

Time Duration : **18 months**

CMP : **₹1362.00 (as on 27 June, 2019)**

Target Price : **₹1600**



Large Rhino

Swiftest Performers
Among Heavy Weights

Our Large Rhino pick for the month of June is Asian Paints (APL), which is India's top paints company with market share of around 55 per cent in the decorative paints. Further, it is the tenth largest coatings company in the world. The company generates nearly 85 per cent of its sales from the decorative paints segment. The company also operates in the industrial paint segment. In addition to this, it operates in the home improvement segments with its brands Ess Ess and Sleenk. Apart from India, the company has manufacturing facilities in 15 different countries.

Key beneficiary of shift in demand to organised players : The domestic paint industry is estimated to be worth around Rs 50,000 crore and, out of this, 75 per cent can be attributed to the decorative paints category, which consists of categories like surface-like exterior wall paints, interior wall paints, wood finishes, enamels as well as ancillary products like primers, putties, etc. The remaining 25 per cent belongs to the industrial paint category, which constitutes automotive coatings, marine coatings, packaging coatings, powder coatings, protective coatings and other general industrial coatings. The unorganised players still command a sizeable 30-35 per cent market share and predominantly cater to the low end of the product basket. We believe post-GST, there will be erosion of cost benefit that small players used to enjoy due to the lower tax, which would result in shift of demand from unorganised to organised players. Also, the reduction in GST rate from 28 per cent to 18 per cent is benefiting the organised players as tax compliance is likely to hit the unorganised players. Thus, being a market leader, Asian Paints would be the key beneficiary of this shift in demand.

Strong return ratios despite capex and headwinds: The company during FY19 completed expansion of Mysuru plant situated in Karnataka, with an initial capacity of 3 (three) lakh KL p.a., having ultimate capacity of 6 (six) lakh KL p.a. and Vishakhapatnam plant situated in Andhra Pradesh, with an initial capacity of 3 (three) lakh KL p.a., having ultimate capacity of 5 (five) lakh KL p.a. Despite the capacity expansions, the company's cash balance improved due to strong operating cash flows and as return ratios too remained stable (38.4 per cent ROCE in FY19 vs 40.9 per cent in FY17). This additional production capacity would help the company to grow in the foreseeable future. Also, during this period, the input cost, mainly crude oil, was volatile and despite this, the company managed to record strong performance in terms of profitability and return ratios.

Strong demand for paints augurs well for the APL : The reduction in repainting cycle would aid in demand, which would lead to stronger demand for the paints. Also, higher construction activity in the country bodes well for the paint industry. Repainting segment dominates the demand for decorative paints (accounts for ~75 per cent of demand) owing to good demand in rural and small towns. As most of the repainting demand comes from rural areas, monsoon plays an important role for this demand. Thus, any monsoon deficiency may restrict further growth. Additionally, the government's impetus for construction sector would create enormous opportunity for the paint industry. The changing consumer preference for decorative paints, trendy colours, protective features also bodes well for the paint industry. Notably, the per capita consumption of paints in India is far lower at 3.75 kgs as against the global average of 12-15 kgs, thus providing huge headroom for growth. We believe Asian Paints is well-poised to reap the benefits from this opportunity due to its market leadership position, unique pricing strategy at the lower end, higher growth in premium products coupled with brand equity and distribution strength. But slowdown in the automobile sector may restrict further growth.

Focus on home improvement and revival in exports key things to watch : The kitchen market in India is estimated to be worth more than Rs 15,000 crore and only around 7-8 per cent of this market is controlled by the organised players, which provides a huge potential for growth. The management is focusing on increasing its distribution network and improving operational efficiency for SLEEK and ESS ESS business. The challenging business conditions affected operations in some of the key markets in the international business portfolio, especially Egypt, Ethiopia, Bangladesh and Sri Lanka. The stabilisation of the Indian currency, along with any revival in the key export markets, would help APL to boost its exports revenue (12% of revenue).

Financial : In the fourth quarter of FY19, the company's net sales improved 11.71 per cent yoy to Rs. 5018.2 crore. EBITDA for the quarter largely remained flat at Rs. 823 crore, with a corresponding margin contraction of 230 bps. EBITDA margin for Q4FY19 stood

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at 16.4 per cent. Higher material prices and media spends adversely impacted EBITDA. Net profit for the quarter remained flat at Rs. 481.6 crore. The depreciation was higher due to commencement of two new plants. In the fiscal year 2018-19, the company's revenue was up by nearly 15 per cent yoy to Rs. 19349.8 crore. EBITDA for full year was at Rs. 3756.9 crore, up by 7.5 per cent. EBITDA margin for the period was at 19.41 per cent. PAT for FY19 was up by 5.8 per cent yoy to Rs. 2171.10 crore.

Valuation & outlook : Despite capacity expansion and volatile input prices, the company has maintained its return ratios. Its ROE, ROA and ROCE remained robust at 25.6 per cent, 17.3 per cent and 38.4 per cent, respectively. In terms of valuation, the stock of Asian Paints is currently available at 60.4x P/E on TTM earnings. The low per capita consumption of paints in India and the traction in construction activity, the company's dominant position will help it to paint a remarkable future. However, volatility in crude oil and currency may impact company's profitability negatively as crude forms a major raw material for paints. Owing to all these factors, we recommend a **BUY** on the stock and expect stock to deliver around 18 per cent return.

Inc/Exp Statement(Consolidated) (Rs in Crore)

| Description | 201903 | 201803 | 201703 | 201603 | 201503 |
|-------------------|----------|----------|----------|----------|----------|
| Net Sales | 19349.84 | 16887.19 | 15396.56 | 14271.49 | 14182.81 |
| Total Income | 19576.89 | 17175.28 | 15658.99 | 14484.88 | 14352.52 |
| Total Expenditure | 15820.00 | 13680.06 | 12372.25 | 11494.00 | 11939.92 |
| PBIDT | 3756.89 | 3495.22 | 3286.74 | 2990.88 | 2412.60 |
| PAT | 2171.09 | 2051.73 | 1966.64 | 1769.36 | 1427.33 |
| Dividend % | 1050.00 | 870.00 | 1030.00 | 750.00 | 610.00 |
| Adj. EPS(Rs) | 22.51 | 21.26 | 20.22 | 18.19 | 14.54 |

Quarter On Quarter (Consolidated) (Rs in Crore)

| Particulars | 201903 | 201812 | Q on Q Var% | 201803 | Y on Y Var% |
|-------------------|---------|---------|-------------|---------|-------------|
| Net Sales | 5018.21 | 5293.99 | -5.21 | 4492.30 | 11.71 |
| Total Expenditure | 4195.25 | 4251.01 | -1.31 | 3652.37 | 14.86 |
| PBIDT (Excl OI) | 822.96 | 1042.98 | -21.10 | 839.93 | -2.02 |
| PAT | 481.57 | 631.73 | -23.77 | 490.88 | -1.90 |
| PBIDTM% (Excl OI) | 16.40 | 19.70 | -16.75 | 18.70 | -12.30 |
| PBIDTM% | 17.53 | 20.56 | -14.74 | 19.57 | -10.42 |
| PATM% | 9.60 | 11.93 | -19.53 | 10.93 | -12.17 |
| Adj. EPS(Rs) | 4.93 | 6.63 | -25.64 | 5.01 | -1.60 |



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