ANANDRATHI

India I Equities

Consumer

Result Update

Change in Estimates ☑ Target ☑ Reco ☑

28 October 2010

Asian Paints

Rating: **Buy**
Target Price: ₹2975
Share Price: ₹2503

Weak quarter, growth momentum intact; upgrade to Buy

- **Growth momentum intact.** Despite Asian Paints reporting a dismal 2QFY11, we raise our FY12e earnings 5% to factor in the improved margin owing to recent price hikes. We see the revenue growth momentum intact in spite of the weak quarter. We upgrade the stock to Buy from Hold, with revised price target of ₹2,975 (₹2,520 earlier).

- **Revenue growth at 5%.** The company reported a mere 5% yoy revenue growth. Prolonged monsoons and inventory build-up with dealers in 1QFY11 resulted in lower revenue growth. In '10, as Diwali is almost 20 days later than in '09, some of the revenues would accrue in 3QFY11. Despite registering lower growth in 2QFY11, we see the company's long-term growth trend intact.

- **Margins maintained despite higher raw material cost.** In the quarter, the margin was only 40bp lower yoy. Despite rising raw material prices, select price hikes and 'uptrading' helped pass on higher costs. Net profit was up 4%, on lower income tax.

- **Outlook.** As per-capita paint consumption in India is far lower than in other countries, opportunities abound as also from the 'uptrading' expected from a rising middle class. We expect market leader Asian Paints to register healthy growth rates in a booming segment.

- **Valuation.** We value the stock at revised target price of ₹2,975, which is at a PE of 25x FY12e earnings. Our target PE is at 50% premium to the 12-month forward Nifty PE; average premium of the past 10 years was 25%. With the strong earnings growth momentum and better return ratios, we expect the premium to expand. Key risks are higher raw material prices and competition.

Key data	APNT IN /APNT.BO
52-week high/low	₹2920/1575
Sensex/Nifty	19941/5988
3-m average volume	US$8.1m
Market cap	₹255bn/US$5.6m
Shares outstanding	96m
Free float	48.0%
Promoters	52.0%
Foreign Institutions	14.9%
Domestic Institutions	10.9%
Public	22.2%

Consolidated quarterly results

Year end 31 Mar	2QFY10	2QFY11	% yoy	1HFY10	1HFY11	% yoy
Sales (₹m)	17,239	18,108	5.0	31,842	36,410	14.3
EBITDA (₹m)	3,228	3,315	2.7	5,986	6,786	13.4
EBITDA margin (%)	18.7	18.3	(40) bps	18.8	18.6	(20) bps
Interest (₹m)	64	46	(29.2)	136	88	(35.5)
Depreciation (₹m)	200	284	42.2	398	553	39.1
Other income (₹m)	247	249	0.7	403	433	7.4
PBT (₹m)	3,211	3,234	0.7	5,855	6,578	12.3
Tax (₹m)	1,065	984	(7.6)	1,909	1,997	4.6
Tax rate (%)	33.2	30.4	273 bps	32.6	30.4	224 bps
PAT (₹m)*	2,057	2,147	4.4	3,818	4,369	14.4

*Source: Company, Anand Rathi Research *Adjusted for extraordinary items*

Consolidated Financials

Year end 31 Mar	FY11e	FY12e
Sales (₹m)	76,041	91,256
Net profit (₹m)	8,874	11,332
EPS (₹)	92.5	118.1
Growth (%)	14.9	27.7
PE (x)	27.1	21.2
PBV (x)	10.4	7.9
RoE (%)	43.5	42.2
RoCE (%)	52.7	52.8
Dividend yield (%)	1.2	1.4
Net gearing (%)	(17.8)	(31.5)

Source: Anand Rathi Research

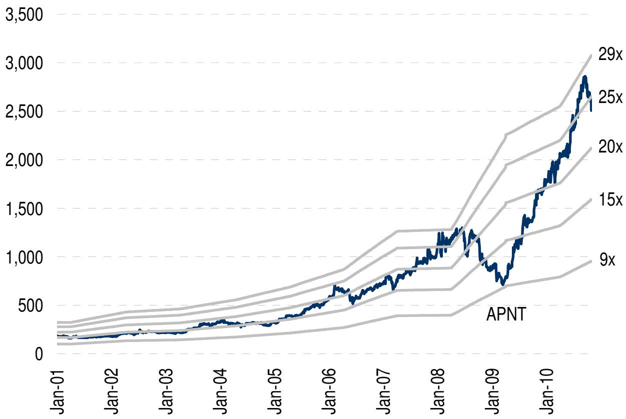
Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year end 31 Mar	FY09	FY10	FY11e	FY12e	FY13e
Net sales	54,632	66,809	76,041	91,256	109,523
Sales growth (%)	24.0	22.3	13.8	20.0	20.0
- Op. expenses	47,716	54,533	62,652	74,484	89,295
EBIDTA	6,916	12,276	13,390	16,772	20,228
EBITDA margins (%)	12.7	18.4	17.6	18.4	18.5
- Interest	263	285	204	154	104
- Depreciation	744	836	1,061	1,262	1,414
+ Other income	517	778	1,022	1,309	2,010
- Tax	1,974	3,731	4,273	5,333	6,631
PAT	4,452	8,203	8,874	11,332	14,090
PAT growth (%)	2.0	84.2	8.2	27.7	24.3
Consolidated PAT	4,236	7,720	8,874	11,332	14,090
FDEPS (₹/share)	44.2	80.5	92.5	118.1	146.9
CEPS (₹/share)	51.9	89.2	103.6	131.3	161.6
DPS (₹/share)	17.5	27.0	30.0	35.0	36.0

Source: Company, Anand Rathi Research

Fig 4 – PE Band



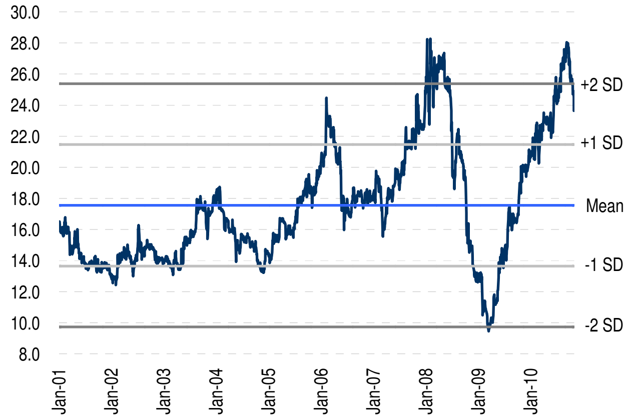
Source: Bloomberg, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year end 31 Mar	FY09	FY10	FY11e	FY12e	FY13e
Share capital	959	959	959	959	959
Reserves & surplus	11,606	16,703	22,210	29,614	39,664
Shareholders' fund	12,565	17,662	23,169	30,574	40,623
Debt	3,086	2,292	1,792	1,292	792
Minority interests	756	945	945	945	945
Capital employed	16,407	20,899	25,906	32,810	42,360
Fixed assets	9,557	13,168	14,607	16,095	17,431
Investments	784	6,241	6,241	11,241	16,241
Working capital	3,957	430	4,446	4,856	5,350
Cash	2,109	1,060	612	618	3,338
Capital deployed	16,407	20,899	25,906	32,810	42,360
No. of shares (m)	95.9	95.9	95.9	95.9	95.9
Net Debt/Equity (%)	7.6	(23.0)	(17.8)	(31.5)	(43.9)
W C turn (%)	7.2	0.6	5.8	5.3	4.9

Source: Company, Anand Rathi Research

Fig 5 – Mean PE(x) and standard deviations



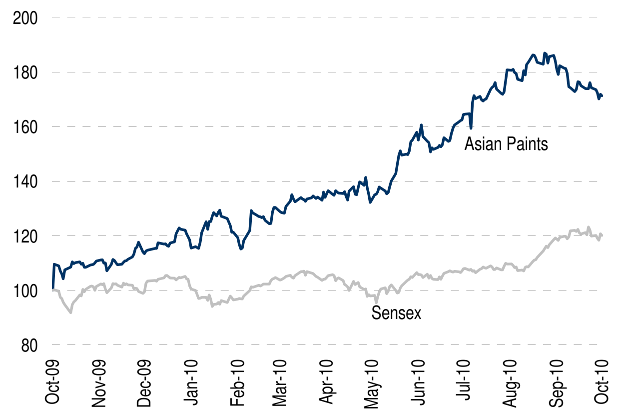
Source: Bloomberg, Anand Rathi Research

Fig 3 – Cash flow statement (₹m)

Year end 31 Mar	FY09	FY10e	FY11e	FY12e	FY13e
Consolidated PAT	4,236	7,720	8,874	11,332	14,090
+ Depreciation	744	836	1,061	1,262	1,414
Cash profit	4,980	8,556	9,935	12,594	15,504
- Incr/(Decr) in WC	(1,431)	1,338	(4,016)	(411)	(493)
Operating cash flow	3,824	10,687	5,919	12,184	15,010
- Capex	(2,896)	(3,773)	(2,500)	(2,750)	(2,750)
Free cash flow	928	6,914	3,419	9,434	12,260
- Dividend	(1,999)	(2,359)	(3,367)	(3,928)	(4,040)
+ Equity raised	-	-	-	-	-
+ Debt raised	(41)	(675)	(500)	(500)	(500)
- Investments	1,984	443	-	(5,000)	(5,000)
- Misc. items	125	(52)	-	-	-
Net cash flow	997	4,271	(448)	6	2,720
+ Opening cash	1,107	2,104	1,060	612	618
Closing cash	2,104	6,375	612	618	3,338

Source: Company, Anand Rathi Research

Fig 6 – Asian Paints vs. Sensex



Source: Bloomberg

Results Review

The prolonged monsoons and a delayed Diwali resulted in Asian Paints reporting lower revenue growth, a mere 5%. The EBITDA margin was steady despite higher raw material prices. Net profit was up 4% as income tax came lower.

Revenue growth stunted by a prolonged monsoon

Prolonged monsoon and a delayed Diwali resulted in lower revenue growth

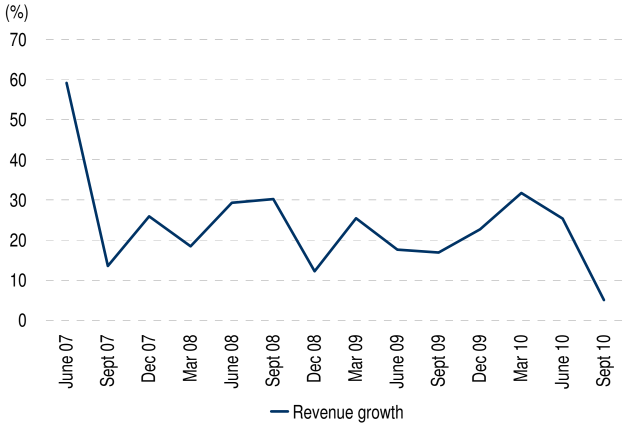
The company reported revenue growth of a mere 5% in 2QFY11. It had earlier hiked prices – 4.2% on 1 May '10, 2.6% on 1 Jul '10 and 1.2% on 1 Aug '10. We reckon that volume growth in the quarter was flat owing to the hiked prices.

The lower revenue growth, though, could be attributed to the prolonged monsoons (leading to lower offtake, mostly affecting sales of exterior paints). Price hikes at the start of the quarter led to inventory build-up in 1QFY11 itself. Diwali in '10 being almost 20 days later than in '09, some revenue would only come in 3QFY11.

Nevertheless, with no major impact on the long-term growth trend in paints in India, we do not consider the lower 2QFY11 results to be a concern.

EBITDA margin held steady despite rising raw material prices, by way of select price hikes and 'uptrading' by consumers

Fig 7 – Revenue growth (yoy)



Source: Company

Event and impact on revenue growth

Fig 8 – Event and impact on revenue growth

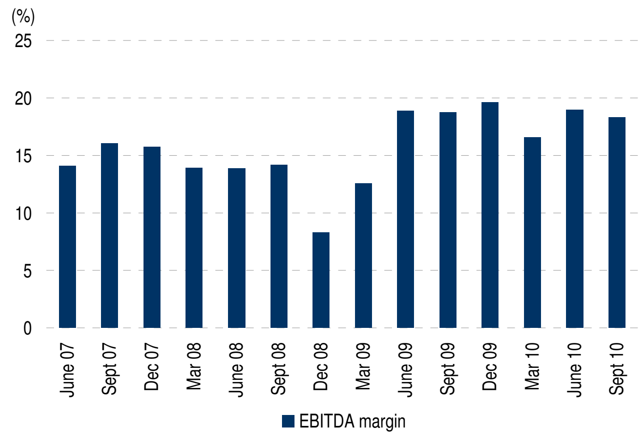
Event	Impact on revenue growth
Prolonged monsoon	Revenue growth to be spread over the next 2-3 quarters
Inventory build-up	Higher revenues were seen in 1QFY11
Late Diwali	Revenue growth will be seen in 3QFY11

Source: Company, Anand Rathi Research

Steady EBITDA margin

The EBITDA margin corrected just 40bp in 2QFY11. Despite mounting raw material prices, the company has been able to hold on to its margins. The price hikes have helped pass on higher raw material prices. And the trend in 'uptrading' has also helped expand margins.

Fig 9 – EBITDA margin



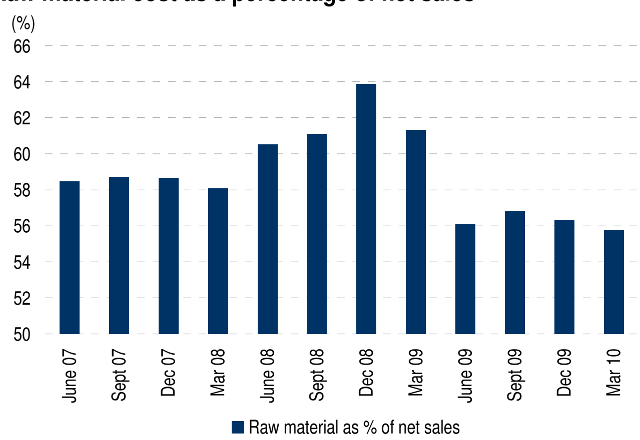
Source: Company

Raw material costs rising

Though raw material prices are rising, the company has managed to report a lower raw-material-cost-to-sales in 2QFY11. Raw material cost (as a percentage of net sales) inched down to 56.3% in 2QFY11 from 56.8% in 2QFY10. The major raw material, titanium dioxide, and packaging material were up by more than 20% each in 2QFY11 vs. 2QFY10.

We reckon that, though most raw material prices are moving up, rupee appreciation would help partly reduce cost pressures.

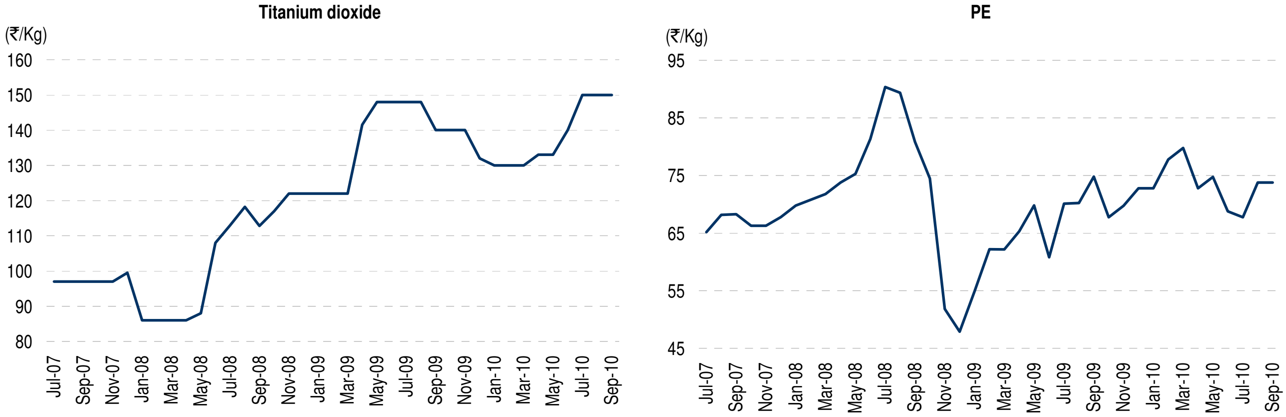
Fig 10 – Raw material cost as a percentage of net sales



Source: Company

Major raw material prices

Fig 11 – Major raw material prices

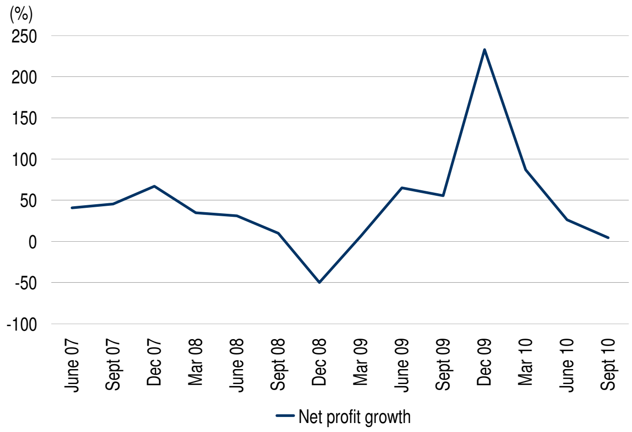


Source: Bloomberg, RIL PE=Packaging material

Lower net profit growth

The net profit was up 4% yoy. The lower revenue growth and margin have resulted in lower earnings growth. The income tax rate has, however, slipped 270bp yoy.

Fig 12 – Net profit growth



Source: Company

Long term growth potential intact

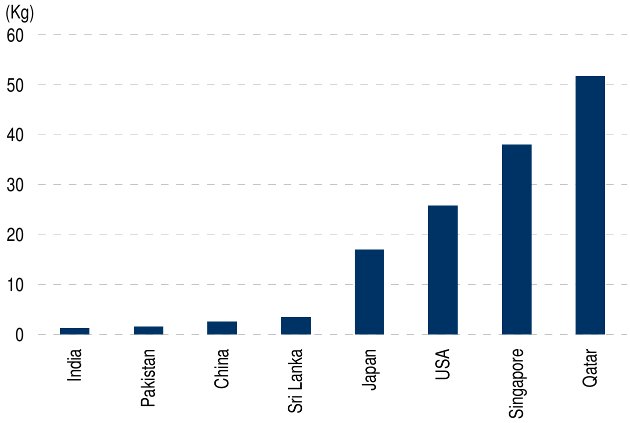
With lower per-capita consumption of paints, we expect the growth in the paint industry to remain healthy in the medium-to-long term. We expect uptrading, from distempers to emulsions and enamels, which will drive revenues and margins.

Long-term growth potential intact

We reckon that, with the long-term growth trend of paints in India intact, the paints sector and market leader Asian Paints could see revenue growth of ~15% in the medium-to-long term. As the paint sector revenue is closely correlated with the GDP, we expect the sector to continue doing well, since GDP is growing at ~8%.

Low per capita consumption indicates a long-term growth story

Fig 13 – Lower per-capita consumption

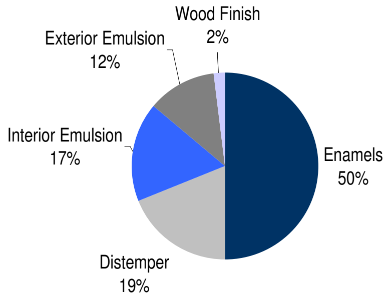


Source: Company

Significant growth through uptrading

We reckon that significant opportunities would arise from 'uptrading'. At present, distempers still command 19% of the paints market. On the rising consumption of enamels and emulsions, the company can look forward to better realizations and higher margins.

Fig 14 – Paint industry: Revenue breakdown (FY10)



Source: Company

Change in estimates and valuation

We raise FY12e revenue and net profit respectively 1% and 5% to factor in the price hikes. We also raise the target price, from ₹2,520 to ₹2,975. We value the stock at a target PE of 25x FY12e earnings.

Change in estimates

We maintain our estimates for FY11. However, to factor in the price hikes, we raise our FY12e revenue 1% and net profit 5%. We reckon that, with rupee appreciation, the company would be able to counter raw material cost pressures and expand margins. We introduce FY13 estimates; we expect revenue and net profit growth of 20% and 24% respectively in FY13e.

Fig 15 – Change in estimates

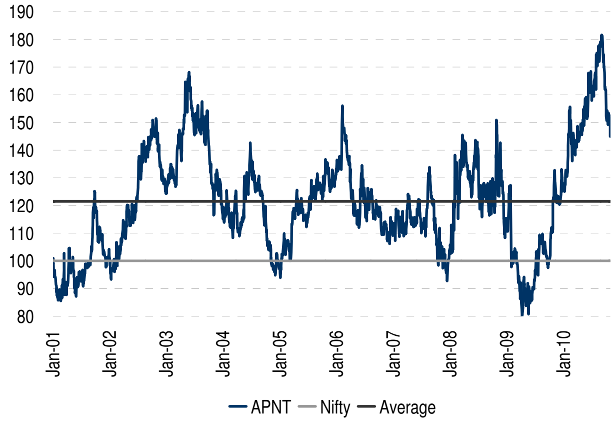
	FY11e			FY12e		
₹m	Previous	Revised	Change (%)	Previous	Revised	Change (%)
Revenues	76,041	76,041	0.0	90,526	91,256	0.8
Net profit	8,874	8,874	-	10,833	11,332	4.6

Source: Anand Rathi Research.

Valuation

We raise the target price to ₹2,975/share from ₹2,520 at a PE of 25x FY12e earnings. With the increase in estimates for FY12 and a higher earnings CAGR of 21% over FY10-12e, we raise the target PE to 25x (from 22x) FY12e earnings. We expect PEG to be 1x. In the past 10 years, the stock has traded at a 25% premium to the 12-month forward Nifty PE. Owing to the higher earnings growth and better return ratios, we expect the premium to expand to 50%.

Fig 16 – Premium/Discount to 12M forward Nifty PE



Source: Bloomberg, Anand Rathi Research.

Key risks and concerns

- Higher raw material prices
- More intense competition

Appendix 1

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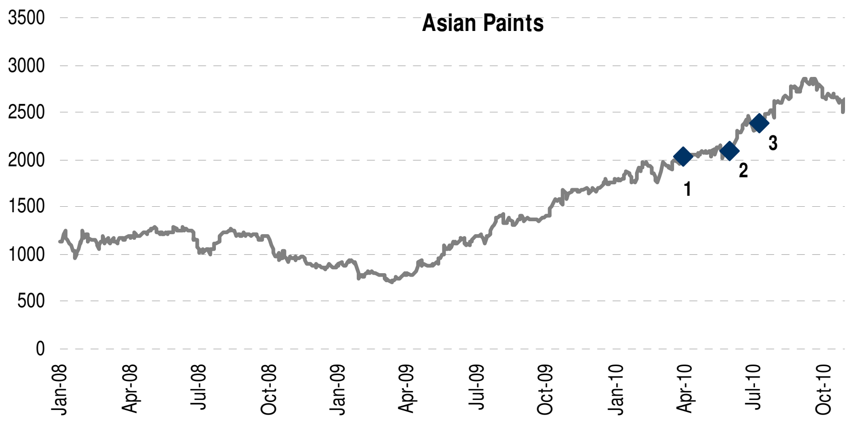

	Date	Rating	TP (₹)	Share Price
1	31-Mar-10	**Buy**	2,400	2,039
2	31-May-10	**Buy**	2,520	2,104
3	9-Jul-10	**Hold**	2,520	2,335

Source: Bloomberg

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