

## Company Flash

30 October 2006 | 6 pages

# Asian Paints (ASPN.BO)

## Strong 2QFY07: India Construction Story Playing Out

- Strong 2QFY07** – Domestic and international businesses recorded solid top-line growth of 27% and 25%, respectively. Domestic growth remained strong driven by good growth in the Paints (27%) and Industrial (21%) segments. The strong growth was on account of advancement of sales due to an early festive season and price increase taken by Asian Paints from Oct, which again led to the pushing of sales ahead into September. Consolidated profit grew 44% despite slight decline in operating margins.
- Margins hold up despite cost pressures** – Asian Paints was able to pass on cost increases through price hikes in the range of 0.7% to 1.7% in this quarter. Prices of inputs such as oils, monomers and solvent have risen significantly on a sequential basis. Asian Paints has taken another price hike effective October 1; however, it expects raw material prices to remain stable at the current levels.
- Industry fundamentals remain strong** – Domestic paints industry is expected to grow by c.15% in FY07 on the back of a strong 8%+GDP growth. Demand growth in the second half, though strong, could be lower due to the early festive season this year, which advanced sales into the Sep quarter. Demand for automotive paints and auto-protective coating is expected to remain strong on strong growth in the passenger vehicles and the ongoing infrastructure projects, respectively.
- We remain positive** – At 18.8x FY08E *consolidated* earnings, we continue to remain positive. Maintain Buy/Low Risk (1L) with target price of Rs715.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (30 Oct 06)	Rs667.75
Target price	Rs715.00
Expected share price return	7.1%
Expected dividend yield	2.2%
<b>Expected total return</b>	<b>9.3%</b>
Market Cap	Rs64,050M US\$1,422M

Figure 1. Statistical Abstract

Year to 31-Mar	Net Profit (Rs Mils.)	FD EPS (Rs)	EPS Growth (%)	P/E (x)	DPS (Rs)	Yield (%)	RoE (%)
2005	1,734.8	18.0	17.4	37.1	9.5	1.42	31.4
2006	1,878.1	19.5	8.3	34.2	12.5	1.87	31.4
2007E	2,778.2	28.8	47.9	23.1	15.0	2.25	40.7
2008E	3,127.1	32.5	12.6	20.6	18.0	2.70	39.1
2009E	3,712.9	38.6	18.7	17.3	4.7	0.70	36.5

Source: Company Reports and Citigroup Investment Research

See page 4 for Analyst Certification and important disclosures.

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## Asian Paints: 2QFY07 Results

Figure 2. Asian Paints: 2QFY07 Consolidated Results Summary (Rupees in Millions, Percent)

	2QFY06	2QFY07	% Change
<b>Net Sales</b>	<b>7,907.2</b>	<b>9,980.8</b>	<b>26.2</b>
Expenditure	-6,818.5	-8,638.8	26.7
<b>EBITDA</b>	<b>1,088.7</b>	<b>1,342.1</b>	<b>23.3</b>
<i>EBITDA Margin (%)</i>	<i>13.8</i>	<i>13.4</i>	<i>-32bps</i>
Interest	-29.3	-49.8	69.9
Depreciation & Amortization	-159.5	-148.9	-6.7
Other Income	68.2	97.8	43.4
Profit from associate co.	-5.2	-1.9	-64.0
PBT	962.9	1,239.4	28.7
Tax	-369.4	-387.7	5.0
<i>Tax Rate (%)</i>	<i>38.4</i>	<i>31.3</i>	<i>-708bps</i>
<b>PAT</b>	<b>593.6</b>	<b>851.7</b>	<b>43.5</b>
Exceptional Items	-17.5	-1.7	nm
<b>Profit after Exceptionals</b>	<b>576.1</b>	<b>849.9</b>	<b>47.5</b>
Minority interest	-15.5	22.6	nm
<b>Profit after Exceptionals &amp; Minority Interest</b>	<b>591.6</b>	<b>827.3</b>	<b>39.8</b>
<b>Cost Details</b>			
Raw Materials	4,641.5	6,014.4	29.6
<i>% of Sales</i>	<i>58.7</i>	<i>60.3</i>	<i>156bps</i>
Employee Cost	580.5	686.3	18.2
<i>% of Sales</i>	<i>7.3</i>	<i>6.9</i>	<i>-47bps</i>
Other Expenditure	1,596.5	1,938.1	21.4
<i>% of Sales</i>	<i>20.2</i>	<i>19.4</i>	<i>-77bps</i>

Source: Company Reports

## Asian Paints Company Description

Asian Paints is the market leader in India's decorative paints industry, accounting for 47% of the total revenues of the top six companies in the organized segment. Asian Paints also caters to the industrial paints segment, and has a presence in 22 countries, including South Asian countries, China, Australia, the Caribbean and the Middle East. Asian Paints has strong brands, a wide range of offerings across all product categories, and the most extensive distribution network in the paints industry.

## Investment Thesis

The rise in urbanization, higher disposable incomes, cheaper housing loans and a shift from semi-permanent to permanent housing structures are driving the paints market at over 1.5x GDP growth. Asian Paints enjoys competitive advantages that should help it outpace the market's growth — strong brands, a wide range of offerings across all product categories, and the most extensive distribution network in the paints industry. The company is leveraging off its local expertise to improve the performance of the assets acquired abroad. The Berger acquisition in 2002 increased the share of revenues from the overseas ventures to more than 20% of group sales, from 5%. Over the past 10 years, Asian Paints' profit CAGR has been 15%; we expect this to pick up over the next three years. The stock has historically traded at a 20-100% premium to the Sensex P/E. With earnings growth likely to pick up, we expect the stock's valuation premium to increase to the historical average premium.

Figure 3. Relative price performance

(%)	3M	6M	12M
<b>Absolute</b>	15.0	4.8	42.2
<b>Rel. to .BSESN</b>	(4.9)	(2.2)	(15.3)

Source: Company Reports

## Valuation

We prefer P/E as our primary valuation tool because the company operates in a non-cyclical industry with a fairly predictable earnings stream. Being the market leader, the company also has reasonable pricing power, allowing it to protect earnings in the event of cost shocks. Historically, the stock has traded at an average of 16x one-year rolling forward EPS for the standalone entity. However, we believe the stock is a re-rating candidate (especially with international operations turning around and local growth accelerating) and could trade at 17-22x P/E, the higher end of its historical trading band. Our target price of Rs715 is based on 20x FY08E consolidated EPS. Our DCF model gives a target price of Rs685. Our key DCF assumptions include a WACC of 13.5%, a growth rate to perpetuity of 6% and beta of 0.63. Our growth rate to perpetuity builds in 1.5% population growth, with residual growth coming from migration from unorganized housing to organized housing.

## Risks

We rate Asian Paints Low Risk based on our quantitative risk-rating system. The main downside risks that could impede the stock from reaching our target price include: (1) Asian Paints is in the process of integrating companies acquired overseas and in India. Integration risks include streamlining of operations and integrating employees; (2) Asian Paints has operations in 22 countries outside India, therefore any wild currency fluctuation could hurt profitability; (3) The domestic paint market's growth hinges on economic activity and growth. If economic growth slows, it would affect demand for paints; (4) If Asian Paints is unable to aggressively respond to recent moves from the competition, it could lose market share; and (5) Raw materials constitute almost 57% of Asian Paints' total operational costs. A major part of raw-material prices is linked to global oil and petrochemical prices. Upside risks to our target price include faster than expected domestic paints growth and any domestic acquisitions made by Asian Paints.

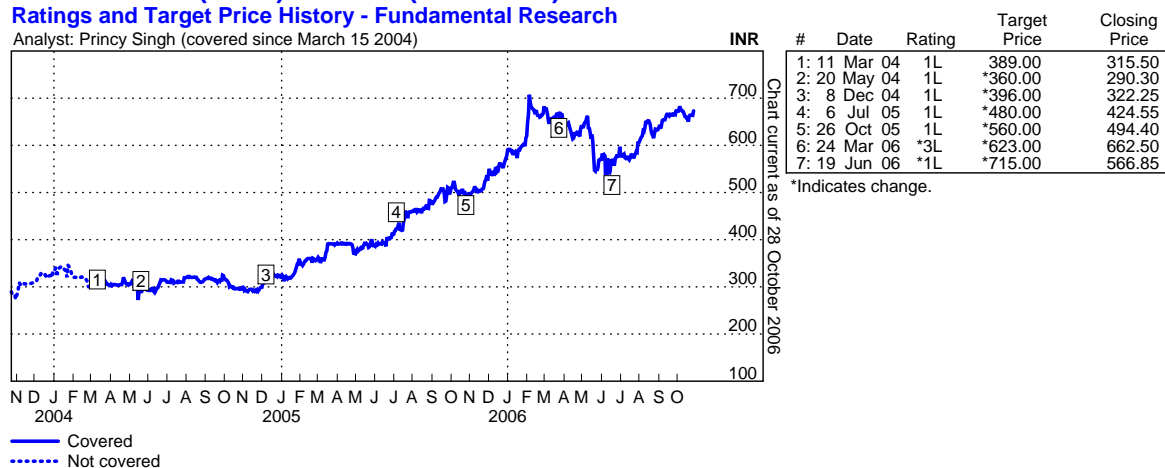
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Analyst: Princy Singh (covered since March 15 2004)



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