



Asian Paints

| | |
|--------------------|--------------|
| STOCK INFO. | BLOOMBERG |
| BSE SENSEX: 13,024 | APNT IN |
| | REUTERS CODE |
| S&P CNX: 3,769 | ASPN.BO |

30 October 2006

Buy

Previous Recommendation: Buy

Rs668

| | |
|-----------------------|-----------|
| Equity Shares (m) | 95.9 |
| 52-Week Range | 790/465 |
| 1,6,12 Rel. Perf. (%) | -6/-4/-27 |
| M.Cap. (Rs b) | 64.1 |
| M.Cap. (US\$ b) | 1.4 |

| YEAR | NET SALES | Adj.PAT | EPS | EPS | P/E | P/BV | ROE | ROCE | EV/ | EV/ |
|-------|-----------|---------|------|------------|------|------|------|------|-------|--------|
| END | (RS M) | (RS M) | (RS) | GROWTH (%) | (X) | (X) | (%) | (%) | SALES | EBITDA |
| 3/06A | 23,192 | 2,214 | 23.1 | 25.6 | 28.9 | 10.1 | 35.0 | 44.5 | 2.7 | 17.5 |
| 3/07E | 26,902 | 2,647 | 27.6 | 19.6 | 24.2 | 8.5 | 35.3 | 50.0 | 2.2 | 14.5 |
| 3/08E | 30,938 | 3,179 | 33.1 | 20.1 | 20.1 | 7.0 | 34.7 | 49.7 | 1.9 | 11.9 |

- Standalone 2QFY07 results were in line with our expectations, largely due to strong revenue growth driven by boom in the construction sector and dealers stocking up on paints due to the early Diwali season and price increases from 1 October 2006, even as raw material prices continued to depress margins.
- Standalone net sales grew 26.8% YoY to Rs7.8b. Volume growth was around 24% for the entire portfolio, while industrial paints grew by over 20%. Exterior paints and emulsions continue to lead growth in decorative segments.
- EBITDA margins declined by 90bp during the quarter on a YoY basis to 15.3% mainly due to 5.75% YoY increase in solvent prices due to high crude oil prices.
- Asian Paints has opted to raise the price for solvent-based paints by 1.7% from 1 September 2006 and has announced a 0.5% price increase in emulsions from 1 October 2006.
- Management has given positive volume growth guidance of more than 14% for FY07, with stable raw material prices currently, as crude prices have come off by 25%. Demand is expected to remain strong in industrial paints also due to the boom in infrastructure activity, although the forthcoming quarter will reflect the impact of an early Diwali.
- We expect the company to maintain valuation premium due to healthy growth prospects, strong brands and excellent track record in rewarding shareholders. The stock is trading at 24.2x FY07E EPS and 20.1x FY08E EPS. We maintain **Buy**.

| QUARTERLY PERFORMANCE | | | | | | | | | | (Rs Million) |
|------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
| Y/E MARCH | FY06 | | | | FY07 | | | | FY06 | FY07E |
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3QE | 4QE | | |
| Net Sales | 5,106 | 6,192 | 6,406 | 5,645 | 6,034 | 7,849 | 7,050 | 5,969 | 23,192 | 26,902 |
| Change (%) | 27.1 | 19.6 | 10.5 | 27.7 | 18.2 | 26.8 | 10.0 | 5.7 | 19.5 | 16 |
| Total Expenditure | 4,378 | 5,186 | 5,433 | 4,832 | 5,095 | 6,646 | 5,950 | 4,832 | 19,672 | 22,724 |
| EBITDA | 728 | 1,006 | 973 | 812 | 939 | 1,203 | 1,100 | 936 | 3,519 | 4,178 |
| Margin (%) | 14.3 | 16.2 | 15.2 | 14.4 | 15.6 | 15.3 | 15.6 | 15.7 | 15.2 | 15.5 |
| Change (%) | 18.1 | 24.2 | 7.8 | 33.4 | 29.0 | 19.6 | 13.1 | 15.2 | 19.8 | 19 |
| Interest | 5.5 | 9 | 17 | 7 | 13.0 | 18 | 16 | -7 | 38 | 40 |
| Depreciation | 111 | 113 | 112 | 120 | 110 | 115 | 135 | 176 | 455 | 535 |
| Other Income | 60 | 71 | 83 | 145 | 64 | 101 | 85 | 151 | 359 | 401 |
| Operational PBT | 672 | 956 | 927 | 830 | 880 | 1,171 | 1,034 | 918 | 3,385 | 4,004 |
| Non Recurring Items | 0 | -17 | 3 | -334 | 0 | -2 | 0 | 0 | -346 | 0 |
| PBT | 672 | 938 | 930 | 496 | 881 | 1,170 | 1,034 | 918 | 3,039 | 4,004 |
| Tax | 229 | 326 | 327 | 310 | 299 | 401 | 370 | 330 | 1,192 | 1,401 |
| Deferred Tax | 1 | 0 | -6 | -16 | 1 | -7 | -12 | -27 | -21 | -45.0 |
| Effective Tax Rate (%) | 34 | 34.8 | 34.4 | 59.1 | 34 | 33.7 | 34.6 | 33.1 | 38.5 | 34 |
| PAT | 441.7 | 612 | 610 | 203 | 580.2 | 776 | 676 | 614 | 1,868 | 2,648 |
| Adjusted PAT | 442 | 629 | 606 | 537 | 580 | 777 | 676 | 614 | 2,214 | 2,648 |
| Change (%) | 32 | 27.9 | 11.4 | 31.3 | 31 | 23.6 | 11 | 14 | 24.5 | 19.6 |

E: MOST Estimates

Revenues record robust growth

2QFY07 results were in line with expectations driven by strong revenue growth. Sales growth at 26.8% was higher than our estimates due to dealers stocking up in anticipation of an early Diwali and adoption of price increases effective 1 October 2006, preponing sales to 2QFY07. In addition, favorable consumer demand due to heightened construction and infrastructure activity boosted demand. Industrial business which comprises protective coatings, floor coatings and road-marking segments grew by over 20%. Powder coating business grew by 30% while automotive paints business (Asian PPG) grew by 19%. Operating margins for the standalone business declined by 90bp on YoY basis as solvent prices increased by 5.75% YoY and 10% QoQ.

SEGMENT REVENUE

| | 2QFY06 | 2QFY07 | CH. (%) |
|---------|--------|--------|---------|
| -Paints | 6,039 | 7,687 | 27.3 |
| -Others | 378 | 448 | 0.8 |

Segment PBIT

| | | | |
|---------|-------|--------|------|
| -Paints | 997.9 | 1162.4 | 29.9 |
| -Others | 26.5 | 84.5 | 79.6 |

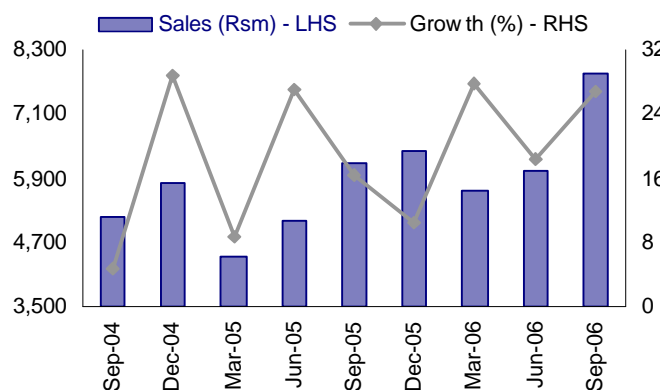
Margins

| | | |
|---------|------|------|
| -Paints | 16.5 | 15.1 |
| -Others | 7.0 | 18.8 |

Source: Company/ Motilal Oswal Securities

Segmental results show margin decline in paints but margin expansion in phthalic anhydride. Segmental paint revenues grew by 27.3% with 140bp margin decline while phthalic anhydride reported 18.6% sales growth and 1,180bp margin expansion.

TREND IN SALES AND GROWTH

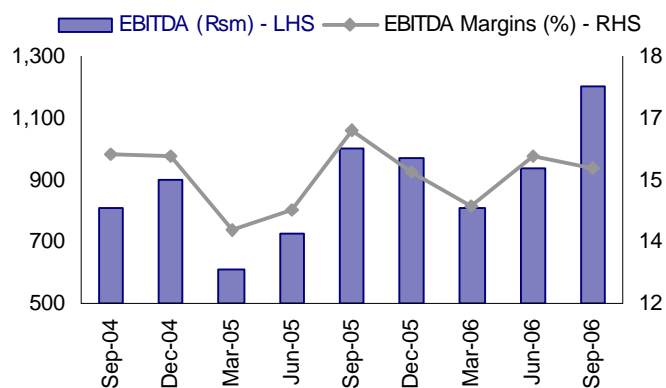


Source: Company/ Motilal Oswal Securities

Price increases to maintain margins

Asian Paints has undertaken three price increases this year. Prices of solvent-based paints were increased by 0.7% from 1 June and by 1.7% from 1 September 2006, which is reflected in the current performance. The company hiked the prices of emulsions from 1 October 2006 by 0.5%. Management has indicated that the current raw material prices are stable as crude prices have softened. The company has also experienced increase in freight costs due to the ban on overloading in trucks. We expect margins to improve in the coming quarters as the benefits of soft raw material prices and price increases for finished products get reflected. Demand growth is expected to be strong due to rising disposable income (4th year of 7%+ GDP growth) and construction boom.

TREND IN EBITDA MARGIN



Source: Company/ Motilal Oswal Securities

Valuation and view

We are bullish on the company in the coming quarters due to the boom in construction activity. We expect the company to maintain valuation premium due to strong growth prospects, strong brands and excellent track record in rewarding shareholders. The stock is trading at, 24.2x FY07E EPS and 20.1x FY08E EPS. We maintain **Buy**.

Asian Paints: an investment profile

Company description

Asian Paints is the largest paint manufacturer and marketer in India with 45% share in the decorative paints. The company has a presence in automotive segment via a JV with PPG of the US. Asian Paints acquired Berger International of Singapore to enter the league of top ten paint companies in the world.

Key investment arguments

- Growing investment in housing and construction will likely drive demand for decorative paints by 12%-13% over the next 3-5 years.
- New powder coating unit will boost income and profits for the high-growth industrial segment.

Key investment risks

- High spread and geographical diversification increases execution risk.
- Raw material prices can impact profit margins due to limited pricing power as a result of presence of the unorganized sector and intense competition.

Recent developments

- Asian Paints Coatings, a wholly-owned subsidiary commenced commercial production at its new powder coatings unit at Baddi. The unit will enjoy excise and income tax benefits.

Valuation and view

- We have an EPS forecast upwards of Rs27.6 for FY07E and Rs33.1 for FY08E on a standalone basis.
- The stock is trading at, 24.2x FY07E EPS and 20.1x FY08E EPS. We maintain **Buy**.

Sector view

- We are Positive on the sector. Volume growth remains strong although input cost pressure continues.
- Companies with product innovations and strong marketing will be gainers in the long term.
- Longer term prospects bright, given rising incomes, low penetration and booming construction and infrastructure development.

COMPARATIVE VALUATIONS

| | | ASIAN PAINTS | ITC | HLL |
|---------------|-------|--------------|------|------|
| P/E (x) | FY07E | 24.2 | 25.6 | 31.9 |
| | FY08E | 20.1 | 21.4 | 25.3 |
| EV/EBITDA (x) | FY07E | 14.5 | 16.7 | 27.5 |
| | FY08E | 11.9 | 13.9 | 21.3 |
| EV/Sales (x) | FY07E | 2.2 | 5.4 | 4.2 |
| | FY08E | 1.9 | 4.5 | 3.6 |
| P/BV (x) | FY07E | 8.5 | 6.8 | 23.1 |
| | FY08E | 7.0 | 5.8 | 20.0 |

SHAREHOLDING PATTERN (%)

| | SEP.06 | JUN.06 | SEP.05 |
|---------------|--------|--------|--------|
| Promoter | 47.8 | 47.8 | 42.8 |
| Domestic Inst | 12.6 | 12.5 | 14.2 |
| Foreign | 21.0 | 19.2 | 24.4 |
| Others | 18.6 | 20.6 | 18.6 |

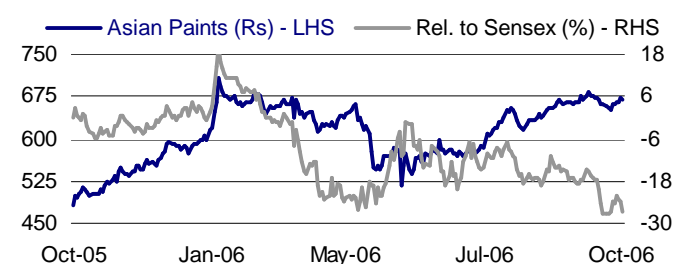
EPS: MOST FORECAST VS CONSENSUS (RS)

| | MOST FORECAST | CONSENSUS FORECAST | VARIATION (%) |
|------|---------------|--------------------|---------------|
| FY07 | 27.6 | 27.1 | 2.0 |
| FY08 | 33.1 | 31.8 | 4.1 |

TARGET PRICE AND RECOMMENDATION

| CURRENT PRICE (RS) | TARGET PRICE (RS) | UPSIDE (%) | RECO. |
|--------------------|-------------------|------------|-------|
| 668 | 729 | 9.1 | Buy |

STOCK PERFORMANCE (1 YEAR)



| INCOME STATEMENT (UNCONSOLIDATED) | | | | | |
|-----------------------------------|---------------|---------------|---------------|---------------|---------------|
| (Rs Million) | | | | | |
| Y/E MARCH | 2005 | 2006 | 2007E | 2008E | 2009E |
| Net Sales | 19,415 | 23,192 | 26,902 | 30,938 | 35,578 |
| Change (%) | 14.4 | 19.5 | 16.0 | 15.0 | 15.0 |
| Raw Materials | 11,154 | 13,517 | 15,684 | 17,975 | 20,635 |
| Staff Cost | 1,179 | 1,290 | 1,445 | 1,632 | 1,845 |
| Admin. & Other Exp. | 4,144 | 4,865 | 5,596 | 6,373 | 7,294 |
| EBITDA | 2,938 | 3,519 | 4,178 | 4,957 | 5,805 |
| % of Net Sales | 15.1 | 15.2 | 15.5 | 16.0 | 16.3 |
| Depreciation | 476 | 455 | 535 | 580 | 610 |
| EBIT | 2,732 | 3,077 | 4,044 | 4,840 | 5,719 |
| Interest | 28 | 38 | 40 | 40 | 40 |
| Other Income | 316 | 359 | 401 | 462 | 524 |
| Non Recurring Exp. | 46 | 346 | 0 | 0 | 0 |
| PBT | 2,705 | 3,039 | 4,004 | 4,800 | 5,679 |
| Tax | 988 | 1,192 | 1,401 | 1,680 | 1,874 |
| Deferred Tax | -18 | -21 | -45 | -60 | -60 |
| Rate (%) | 36.5 | 39.2 | 35.0 | 35.0 | 33.0 |
| PAT | 1,735 | 1,868 | 2,648 | 3,180 | 3,865 |
| Adjusted PAT | 1,763 | 2,214 | 2,647 | 3,179 | 3,864 |
| Change (%) | 16.1 | 25.6 | 19.6 | 20.1 | 21.5 |

| BALANCE SHEET (UNCONSOLIDATED) | | | | | |
|--------------------------------|--------------|--------------|--------------|--------------|---------------|
| (Rs Million) | | | | | |
| Y/E MARCH | 2005 | 2006 | 2007E | 2008E | 2009E |
| Share Capital | 959 | 959 | 959 | 959 | 959 |
| Reserves | 4,763 | 5,373 | 6,544 | 8,192 | 10,416 |
| Net Worth | 5,722 | 6,332 | 7,503 | 9,152 | 11,376 |
| Loans | 840 | 671 | 670 | 670 | 670 |
| Capital Employed | 6,561 | 7,002 | 8,173 | 9,821 | 12,045 |
| Gross Fixed Assets | 7,127 | 8,327 | 8,827 | 9,327 | 9,827 |
| Less: Depreciation | 4,015 | 4,470 | 5,005 | 5,585 | 6,195 |
| Net Fixed Assets | 3,112 | 3,857 | 3,822 | 3,742 | 3,632 |
| Capital WIP | 83 | 83 | 83 | 83 | 83 |
| Investments | 2,584 | 2,953 | 3,987 | 5,527 | 7,067 |
| Curr. Assets | 5,925 | 5,111 | 5,749 | 6,442 | 7,812 |
| Inventory | 3,308 | 2,345 | 2,720 | 3,128 | 3,597 |
| Debtors | 1,490 | 1,639 | 1,901 | 2,186 | 2,514 |
| Cash & Bank Balance | 210 | 210 | 210 | 210 | 783 |
| Loans & Advances | 727 | 727 | 727 | 727 | 727 |
| Other Current Assets | 190 | 190 | 190 | 190 | 190 |
| Curr. Liabilities | 4,838 | 4,676 | 5,097 | 5,541 | 6,058 |
| Creditors | 2,787 | 2,625 | 3,045 | 3,490 | 4,007 |
| Other Liabilities | 934 | 934 | 934 | 934 | 934 |
| Provisions | 1,117 | 1,117 | 1,117 | 1,117 | 1,117 |
| Net Curr. Assets | 1,087 | 436 | 652 | 901 | 1,754 |
| Deferred Tax Liability | -305 | -326 | -370 | -431 | -491 |
| Appl. of Funds | 6,561 | 7,003 | 8,174 | 9,822 | 12,045 |

E: MOST Estimates

| RATIOS (UNCONSOLIDATED) | | | | | |
|---------------------------|-------------|-------------|-------------|-------------|-------------|
| Y/E MARCH | 2005 | 2006 | 2007E | 2008E | 2009E |
| Basic (Rs) | | | | | |
| EPS | 18.4 | 23.1 | 27.6 | 33.1 | 40.3 |
| Cash EPS | 34.9 | 416 | 49.6 | 58.6 | 69.7 |
| Book Value | 59.7 | 66.0 | 78.2 | 95.4 | 118.6 |
| DPS | 9.5 | 11.5 | 13.5 | 14.0 | 15.0 |
| Payout (incl. Div. Tax.) | 52.5 | 59.1 | 48.9 | 42.2 | 37.2 |
| Valuation (x) | | | | | |
| P/E | 36.3 | 28.9 | 24.2 | 20.1 | 16.6 |
| Cash P/E | 19.1 | 16.1 | 13.5 | 11.4 | 9.6 |
| EV/EBITDA | 21.1 | 17.5 | 14.5 | 11.9 | 9.8 |
| EV/Sales | 3.2 | 2.7 | 2.2 | 1.9 | 1.6 |
| Price/Book Value | 11.2 | 10.1 | 8.5 | 7.0 | 5.6 |
| Dividend Yield (%) | 14 | 17 | 2.0 | 2.1 | 2.2 |
| Profit. Ratios (%) | | | | | |
| RoE | 30.8 | 35.0 | 35.3 | 34.7 | 34.0 |
| RoCE | 42.2 | 44.5 | 50.0 | 49.7 | 47.8 |
| Turnover Ratios | | | | | |
| Debtors (Days) | 28 | 26 | 26 | 26 | 26 |
| Inventory (Days) | 62 | 37 | 37 | 37 | 37 |
| Creditors (Days) | 52 | 41 | 41 | 41 | 41 |
| Asset Turnover (x) | 3.0 | 3.3 | 3.3 | 3.1 | 3.0 |
| Leverage Ratio | | | | | |
| Debt/Equity (x) | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |

| CASH FLOW STATEMENT | | | | | |
|------------------------------|--------------|---------------|---------------|---------------|---------------|
| (Rs Million) | | | | | |
| Y/E MARCH | 2005 | 2006 | 2007E | 2008E | 2009E |
| OP/(loss) before Tax | 2,462 | 3,064 | 3,643 | 4,377 | 5,195 |
| Int./Div. Received | 316 | 359 | 401 | 462 | 524 |
| Depreciation and Amort. | 476 | 455 | 535 | 580 | 610 |
| Interest Paid | -28 | -38 | -40 | -40 | -40 |
| Direct Taxes Paid | -988 | -1,192 | -1,401 | -1,680 | -1,874 |
| (Incr)/Decr in WC | -485 | 651 | -217 | -248 | -281 |
| CF from Operations | 1,754 | 3,300 | 2,921 | 3,452 | 4,134 |
| Extraordinary Items | -46 | -346 | 0 | 0 | 0 |
| (Incr)/Decr in FA | -659 | -1,200 | -500 | -500 | -500 |
| (Pur)/Sale of Investments | -159 | -369 | -1,034 | -1,540 | -1,540 |
| CF from Invest. | -864 | -1,915 | -1,534 | -2,040 | -2,040 |
| (Incr)/Decr in Debt | 135 | -169 | -1 | 0 | 0 |
| Dividend Paid | -1,037 | -1,258 | -1,476 | -1,531 | -1,640 |
| Others | -24 | 41 | 90 | 119 | 118 |
| CF from Fin. Activity | -926 | -1,386 | -1,387 | -1,412 | -1,522 |
| Incr/Decr of Cash | -36 | -1 | 0 | 0 | 572 |
| Add: Opening Balance | 246 | 210 | 210 | 210 | 210 |
| Closing Balance | 210 | 210 | 210 | 210 | 783 |

N O T E S

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| Disclosure of Interest Statement | Asian Paints |
|---|---------------------|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | Yes |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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