

Company

27 July 2010 | 10 pages

Asian Paints (ASPN.BO)

 Equity
 Target price change
 Estimate change

Demand Buoyancy Continues; Raising TP to Rs2,772

- 1QFY11 moderate PAT beat** — Reported PAT at Rs2.22bn was ahead of our estimates (Rs2.1bn). EBITDA was c10% ahead of our estimates – driven by both a revenue beat of ~8% and EBITDA margin beat, which at 19% exceeded estimates by 20bps. Higher depreciation coupled with lower financial income resulted in PAT beat of ~5%.
- Underlying business remains strong** — We estimate domestic volume growth at ~18-20%, among the strongest in the consumer space. There could be some element of stocking (given ~4% price hike in May, followed by ~2.8% in July). Mix also appears to have improved, which should enable ASPN to mitigate margin pressures over the next 2 years. We expect discretionary spends and strong pricing power to drive revenue growth of ~19% CAGR over FY10-12E.
- Margins to trend down, given cost pressures** — Gross margins at parent and consolidated level contracted ~120 and ~210bps Y/Y respectively – a combination of costs + higher excise duties. We believe gross margins have peaked – forecast ~140bps GM contraction over FY10-12E. In future, pricing power should remain strong, enabling ASPN to manage cost pressures.
- Increasing earnings estimates, New target price Rs2,772** — We raise EPS estimates by 5-9% over FY11-12E driven by 4-7% increase in EBITDA forecasts on the back of: a) ~2% increase in revenues, b) 100bps expansion in gross margins (stronger pricing + better mix). Our TP is based on 25x Dec11E EPS (earlier 23x Mar11E). We hike our multiple in line with other FMCG companies. At our target price, ASPN's relative multiple (vs. broad market) is ~1.67x.
- Reiterate Buy** — a) Improving mix (in favor of emulsions, we estimate ~40% of revenues) should support mix improvement/margins; b) Directionally, an appreciating rupee should also help profit growth (~25% of inputs are imported); c) We expect ASPN's profits to grow at ~20% CAGR over FY10-12E.

Buy/Low Risk	1L
Price (27 Jul 10)	Rs2,437.75
Target price	Rs2,772.00
	<i>from Rs2,092.00</i>
Expected share price return	13.7%
Expected dividend yield	1.6%
Expected total return	15.3%
Market Cap	Rs233,828M
	US\$4,969M

Price Performance (RIC: ASPN.BO, BB: APNT IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2009A	4,014	41.84	-3.9	58.3	19.4	36.7	0.7
2010A	7,720	80.48	92.3	30.3	13.7	53.0	1.1
2011E	9,128	95.17	18.2	25.6	10.6	46.7	1.6
2012E	11,136	116.10	22.0	21.0	8.4	44.7	1.9
2013E	13,022	135.76	16.9	18.0	6.7	41.5	2.2

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	58.3	30.3	25.6	21.0	18.0
EV/EBITDA adjusted (x)	35.2	19.1	16.2	13.3	11.3
P/BV (x)	19.4	13.7	10.6	8.4	6.7
Dividend yield (%)	0.7	1.1	1.6	1.9	2.2
Per Share Data (Rs)					
EPS adjusted	41.84	80.48	95.17	116.10	135.76
EPS reported	41.48	87.12	95.17	116.10	135.76
BVPS	125.43	178.27	229.01	290.92	363.30
DPS	17.50	27.00	38.07	46.44	54.30
Profit & Loss (RsM)					
Net sales	54,639	66,809	79,588	94,536	108,629
Operating expenses	-48,682	-55,369	-66,185	-78,316	-89,767
EBIT	5,957	11,441	13,403	16,221	18,862
Net interest expense	-263	-285	-205	-175	-170
Non-operating/exceptionals	510	778	862	1,015	1,198
Pre-tax profit	6,204	11,934	14,060	17,060	19,890
Tax	-1,974	-3,731	-4,401	-5,340	-6,225
Extraord./Min.Int./Pref.div.	-252	154	-531	-584	-642
Reported net income	3,978	8,356	9,128	11,136	13,022
Adjusted earnings	4,014	7,720	9,128	11,136	13,022
Adjusted EBITDA	6,701	12,276	14,327	17,256	19,956
Growth Rates (%)					
Sales	24.0	22.3	19.1	18.8	14.9
EBIT adjusted	-1.0	92.1	17.2	21.0	16.3
EBITDA adjusted	1.4	83.2	16.7	20.4	15.6
EPS adjusted	-3.9	92.3	18.2	22.0	16.9
Cash Flow (RsM)					
Operating cash flow	3,363	12,442	9,928	11,606	13,961
Depreciation/amortization	744	836	924	1,036	1,094
Net working capital	-1,656	3,530	-656	-1,150	-797
Investing cash flow	-895	-10,042	-5,075	-5,000	-7,500
Capital expenditure	-2,878	-4,585	-3,000	-2,000	-2,500
Acquisitions/disposals	1,983	-5,457	-2,075	-3,000	-5,000
Financing cash flow	-1,436	-4,082	-4,750	-5,298	-6,079
Borrowings	334	-794	-489	-100	0
Dividends paid	-1,967	-3,023	-4,261	-5,198	-6,079
Change in cash	997	-1,045	103	1,308	383
Balance Sheet (RsM)					
Total assets	28,328	37,846	44,219	53,299	63,801
Cash & cash equivalent	2,104	1,058	1,161	2,469	2,852
Accounts receivable	5,719	5,425	6,541	7,770	8,928
Net fixed assets	9,051	12,801	14,876	15,841	17,247
Total liabilities	15,541	19,802	20,776	23,334	26,251
Accounts payable	5,542	7,183	8,225	9,528	10,932
Total Debt	3,086	2,292	1,804	1,704	1,704
Shareholders' funds	12,787	18,044	23,442	29,964	37,550
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	12.3	18.4	18.0	18.3	18.4
ROE adjusted	36.7	53.0	46.7	44.7	41.5
ROIC adjusted	29.8	48.1	49.5	52.0	53.5
Net debt to equity	7.7	6.8	2.7	-2.6	-3.1
Total debt to capital	19.4	11.3	7.1	5.4	4.3

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1QFY11 Results Summary

EBITDA margins remained flat Y/Y on last year's high base of 19%; sequential improvement of 240bps positively surprised as mgmt managed staff and other SG&A costs; Pricing benefits also would be visible going forward

We estimate that domestic volumes would have risen 18-20% Y/Y; Standalone entity revenues grew a robust 28% Y/Y

Reported PAT grew 26% Y/Y to Rs2.2bn buoyed by strong operating performance (EBITDA growth of 26% Y/Y to Rs3.5bn)

Figure 1. Asian Paints Consolidated Results (Rupees in Millions, Percent)

	1QFY10	1QFY11	% yoy
Net Sales	14,602	18,302	25.3
Expenditure	-11,844	-14,831	25.2
EBITDA	2,758	3,471	25.8
<i>EBITDA Margin (%)</i>	<i>18.9</i>	<i>19.0</i>	<i>8 bps</i>
Interest	-72	-42	-41.1
Depreciation & Amortisation	-198	-269	35.9
Other Income	156	184	17.9
PBT	2,645	3,344	26.4
Tax	-844	-1,013	20.0
<i>Tax Rate (%)</i>	<i>31.9</i>	<i>30.3</i>	<i>-162 bps</i>
PAT	1,801	2,331	29.5
Exceptional items & Minority interest	-40	-109	173.9
PAT after Exceptionals/MI	1,761	2,222	26.2
No of shares	96	96	
EPS	18.8	24.3	29.5
Cost Details	1QFY10	1QFY11	% yoy
Total Raw Material Cost	8,191	10,487	28.0
<i>% of Sales</i>	<i>56.1</i>	<i>57.3</i>	<i>121 bps</i>
Employee/Staff Cost	1,044	1,189	13.9
<i>% of Sales</i>	<i>7.1</i>	<i>6.5</i>	<i>-65 bps</i>
Other Expenditure	2,610	3,155	20.9
<i>% of Sales</i>	<i>17.9</i>	<i>17.2</i>	<i>-63 bps</i>

Source: Company Reports

Figure 2. Asian Paints Parent Results (Rupees in Millions, Percent)

Standalone	1QFY10	1QFY11	% yoy
Net Sales	11,648	14,911	28.0
Expenditure	-9,207	-11,905	29.3
EBITDA	2,441	3,007	23.1
<i>EBITDA Margin (%)</i>	<i>21.0</i>	<i>20.2</i>	<i>-80 bps</i>
Interest	-29	-20	-30.2
Depreciation & Amortisation	-150	-225	50.7
Other Income	162	174	7.3
PBT	2,426	2,935	21.0
Tax	-781	-926	18.6
<i>Tax Rate (%)</i>	<i>32.2</i>	<i>31.5</i>	<i>-65 bps</i>
PAT	1,645	2,010	22.2
Cost Details			
Total Raw Material Cost	6,338	8,428	33.0
<i>% of Sales</i>	<i>54.4</i>	<i>56.5</i>	<i>211 bps</i>
Employee/Staff Cost	691	826	19.6
<i>% of Sales</i>	<i>5.9</i>	<i>5.5</i>	<i>-39 bps</i>
Other Expenditure	2,178	2,652	21.7
<i>% of Sales</i>	<i>18.7</i>	<i>17.8</i>	<i>-92 bps</i>

Source: Company Reports

Figure 3. Imputed Subsidiaries Results (Rupees in Millions, Percent)

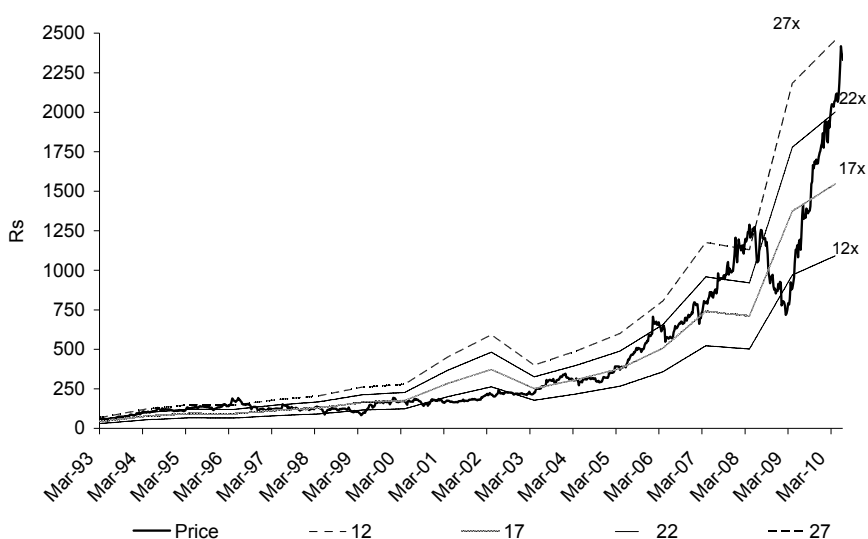
Imputed subsidiaries	1QFY10	1QFY11	% yoy
Net Sales	2,954	3,391	14.8
Expenditure	-2,637	-2,926	11.0
EBITDA	317	465	46.7
EBITDA Margin (%)	10.7	13.7	298 bps
Interest	-43	-22	-48.4
Depreciation & Amortisation	-49	-44	-9.7
Other Income	-6	10	-263.9
PBT	219	409	86.5
Tax	-63	-87	37.8
Tax Rate (%)	(29)	(21)	753 bps
PAT	156	322	106.3
Exceptional items & Minority interest	-40	-109	nm
PAT after Exceptionals	116	213	82.8
Total Raw Material Cost	1,853	2,060	11.2
% of Sales	63%	61%	-2 bps

Source: Company Reports, CIRA

Maintain Buy: Increasing Target Price to Rs2,772

We reiterate our Buy/Low Risk (1L) recommendation on Asian Paints, increasing our TP to Rs2,772 (from Rs2092), at 25x Dec11E EPS (23x Mar11E earlier). Our target multiple is at c30% premium to ASPN's average trailing multiple of the past 3 years. We are comfortable ascribing this premium given that the revenue growth trajectory should be very strong (~19% CAGR over FY10-12E), and we expect strong earnings growth, despite a contraction in gross margins going forward.

Figure 4. Asian Paints: One Year Forward P/E Band Chart



Source: DataStream, Company Reports and Citi Investment Research and Analysis

At our target price, ASPN's relative multiple (vs. broad market) is ~1.67x.

We expect EPS to grow at a healthy 20% CAGR over FY10-12E, driven by growth in volumes of the domestic decorative paints business. ASPN's recent price hikes and improving mix in favor of emulsions (~40% of revenues) should further support revenue growth. Moreover, we expect the rupee to appreciate against the US\$ over FY11/12E, which should beneficially affect ASPN's margins (~25% of inputs are imported).

Earnings Revision Summary

Figure 5. Asian Paints (Consolidated): Earnings Revision Summary

Year to 31-Mar	2011E			2012E		
	Old	New	% Chg	Old	New	% Chg
Sales (Rs Mils.)	78,407	79,588	2%	92,375	94,536	2%
EBITDA (Rs Mils.)	13,832	14,327	4%	16,112	17,256	7%
EBITDA Margin (%)	17.6%	18.0%		17.4%	18.3%	
Net Profit (Rs Mils.)	8,726	9,128	5%	10,194	11,136	9%
Diluted EPS (Rs)	91.0	95.2	5%	106.3	116.1	9%
Dividend Per Share (Rs)	36.4	38.1	5%	42.5	46.4	9%

Source: Citi Investment Research and Analysis estimates

Positive earnings revision of ~5-9% over FY10-12E is driven by both a) 2% increase in revenues assumptions over FY11-12E as we factor in the benefits of the recent price hikes and b) tweaking our gross margin forecasts.

We think that current margins are near peak levels and forecast gross margins to dip 140bps over FY10-12E.

We have reduced our tax rate assumptions to 31.3% in line with the FY10 results.

Asian Paints

Company description

Asian Paints is the market leader in India's decorative paints industry, accounting for around 40-50% 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 over 20 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 Indian paints industry.

Investment strategy

We rate Asian Paints Buy/Low Risk (1L). Growth momentum in the business remains strong – we expect overall profits to grow at a solid ~20% CAGR over FY10-12E driven by a healthy growth in volumes of the domestic decorative paints business (~77% of ASPN's consolidated revenues). ASPN's improving mix in favor of emulsions (~40% of revenues) should further support revenue growth. Moreover, we expect the rupee to appreciate against the US\$ over

FY11/12E, which should beneficially affect ASPN's margins (~25% of inputs are imported).

Over the long term, we remain positive as rise in urbanization, higher disposable incomes, and a shift from semi-permanent to permanent housing structures should continue to drive the paints market at around 1.5x GDP growth. Asian Paints enjoys competitive advantages that should help it outpace the market. These include 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. International diversification continues at a healthy pace, with the share of revenues from the overseas ventures accounting for 18% of group revenues.

Valuation

We prefer P/E as our primary valuation methodology as the company operates in a relatively non-cyclical industry. As the market leader, the company also has reasonable pricing power. Over the last year, the stock re-rated as the domestic paints demand increased at a healthy pace, after a sharp decline in FY09. The stock now trades at ~24x one-year forward P/E, higher than the last 5-year mean of ~19x, however, far lower than its peak forward P/E of around 30x. Strong ~20% EPS growth over the next 2 years with relatively stable operating margins (on a high base of FY10) supports our positive stance.

Our target price of Rs2,772 is based on 25x Dec11E consolidated EPS - a c30% premium to its average multiple of the past 3 years. We are comfortable ascribing this premium. ASPN's revenue growth trajectory should be very strong (~19% CAGR over FY10-12E), and we expect strong earnings growth, despite a contraction in gross margins going forward. At our target price, ASPN's relative multiple (vs. broad market) is ~1.67x.

Risks

We rate Asian Paints shares as Low Risk based on our quantitative risk-rating system, which tracks historical share price volatility. The main downside risks to our target price include: (1) If economic growth decelerates further, it would affect demand for paints; (2) If Asian Paints is unable to aggressively respond to competition, it could lose market share to either organised or unorganized segments; and (3) Input cost pressures, as these are primarily linked to global petrochemical prices, (4) Asian Paints has operations in more than 20 countries outside India, therefore any adverse currency fluctuations could impact profitability.

Appendix A-1

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Asian Paints (ASPN.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Jamshed Dadabhoy
Covered since May 6 2008

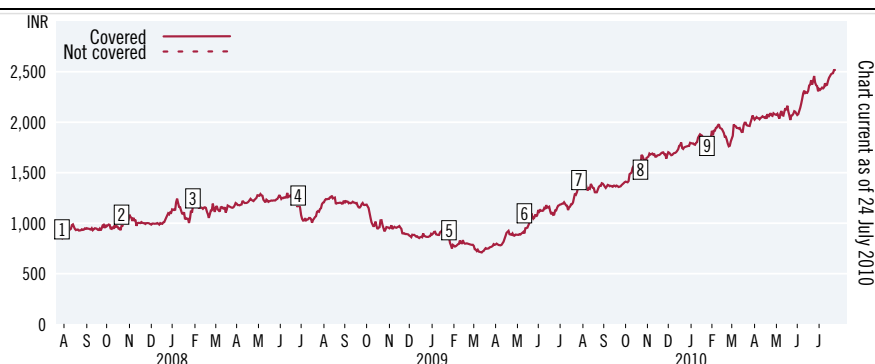


Chart current as of 24 July 2010

Date	Rating	Target Price	Closing Price
1 30-Jul-07	1L	*1,028.00	853.25
2 21-Oct-07	1L	*1,102.00	930.35
3 30-Jan-08	1L	*1,335.00	1,172.40
4 26-Jun-08	*3L	*1,098.00	1,179.90
5 26-Jan-09	3L	*801.00	922.60
6 12-May-09	*1L	*1,090.00	898.40
7 28-Jul-09	1L	*1,562.00	1,385.90
8 22-Oct-09	1L	*1,762.00	1,530.20
9 24-Jan-10	1L	*2,092.00	1,766.90

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2010

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