

## Company Flash

10 May 2006 | 6 pages

# Asian Paints (ASPN.BO)

## Lower Base Aids Growth. Expensive Valuations, Sell.

- 4Q beats expectations** - Asian Paints' 4QFY06 performance was ahead of our expectations - consolidated EBITDA profits grew 30.3% yoy, driven by 21.3% sales growth. Net profits grew 27% yoy, 10% ahead of our estimates. Improving product mix and stability in some key raw material costs aided margins. However, overall raw material costs still remain under pressure.
- Domestic sales surprise**- Key element of surprise in 4Q was 25% domestic paints sales growth, driven by a 30% volume growth. We believe that volumes were aided by a low base of last year, when sales were delayed on account of VAT-related uncertainties. Management has guided at 12-13% domestic paints industry volume growth. We expect Asian Paints to grow in-line with the market
- International business mixed**- Middle East and Caribbean are the profitable locations for Asian Paint, with ROCE of 21% and 13%, respectively. However, South East Asia and South Asia are the trouble areas, where the company has sub-scale operations and lacks pricing power. Management indicated that it would either exit these locations or look for acquisitions to gain scale.
- Maintain Sell**- We maintain our Sell (3L) rating with price target of Rs623 based on 20x 1-year forward P/E. The stock currently trades at 24.4x FY07E P/E, pricing in growth prospects, and we do not see near-term re-rating triggers.

<b>Sell/Low Risk</b>	<b>3L</b>
Price (10 May 06)	Rs662.60
Target price	Rs623.00
Expected share price return	-6.0%
Expected dividend yield	1.7%
<b>Expected total return</b>	<b>-4.3%</b>
Market Cap	Rs63,556M US\$1,417M

Figure 1. Statistical Abstract

Year to 31-Mar	Net Profit (Rs Mils.)	FD EPS (Rs)	EPS Growth (%)	P/E (x)	DPS (Rs)	Yield (%)	RoE (%)
2004	1,478	15.4	-	43.2	8.5	1.3	29.3
2005	1,735	18.0	17.3	36.8	9.5	1.4	31.4
2006E	2,215	23.0	27.7	28.8	12.0	1.8	35.8
2007E	2,617	27.2	18.2	24.4	15.0	2.3	36.6
2008E	3,096	32.1	18.2	20.6	18.0	2.7	37.7

Source: Company Reports and Citigroup Investment Research

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See page 4 for Analyst Certification and important disclosures.

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## Asian Paints -4Q06 and FY06 Results

Figure 2. Asian Paints -4Q06 and FY06 Result Summary (Rupees in Millions, Percent)

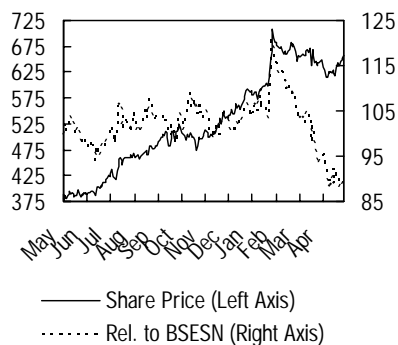
	Standalone			Consolidated			Standalone			Consolidated		
	4QFY05	4QFY06	% YoY	4QFY05	4QFY06	% YoY	FY05	FY06	% YoY	FY05	FY06	% YoY
<b>Net Sales</b>	<b>4,510.0</b>	<b>5,644.8</b>	<b>25.2</b>	<b>6,307.3</b>	<b>7,650.1</b>	<b>21.3</b>	<b>19,545.6</b>	<b>23,191.6</b>	<b>18.7</b>	<b>25,738.6</b>	<b>30,210.4</b>	<b>17.4</b>
Expenditure	(3,900.9)	(4,832.4)	23.9	(5,600.4)	(6,729.1)	20.2	(16,607.8)	(19,672.4)	18.5	(22,387.3)	(26,293.8)	17.4
<b>EBITDA</b>	<b>609.1</b>	<b>812.5</b>	<b>33.4</b>	<b>707.0</b>	<b>921.0</b>	<b>30.3</b>	<b>2,937.8</b>	<b>3,519.2</b>	<b>19.8</b>	<b>3,351.3</b>	<b>3,916.6</b>	<b>16.9</b>
<i>Margin (%)</i>	<i>13.51</i>	<i>14.39</i>	<i>89 bps</i>	<i>11.2</i>	<i>12.0</i>	<i>83 bps</i>	<i>15.03</i>	<i>15.17</i>	<i>14 bps</i>	<i>13.0</i>	<i>13.0</i>	<i>-6 bps</i>
Interest	(6.4)	(6.5)	2.7	(16.8)	(22.7)	35.1	(27.5)	(38.3)	39.1	(108.2)	(114.3)	5.7
Depreciation & Amortisation	(112.1)	(120.1)	7.1	(169.7)	(203.4)	19.9	(476.1)	(455.3)	(4.4)	(690.7)	(682.2)	(1.2)
Other Income	91.4	144.5	58.1	57.6	117.3	103.5	316.1	359.3	13.6	323.7	320.3	(1.1)
PBT	582.0	830.4	42.7	578.1	812.2	40.5	2,750.3	3,384.9	23.1	2,876.2	3,440.4	19.6
Tax	(171.9)	(293.6)	70.8	(182.5)	(353.3)	93.6	(969.8)	(1,170.8)	20.7	(1,060.8)	(1,322.9)	24.7
<i>Tax Rate (%)</i>	<i>29.53</i>	<i>35.35</i>	<i>582 bps</i>	<i>31.6</i>	<i>43.5</i>	<i>1194 bps</i>	<i>35.26</i>	<i>34.59</i>	<i>-67 bps</i>	<i>36.9</i>	<i>38.5</i>	<i>157 bps</i>
<b>PAT and before exceptionals</b>	<b>410.2</b>	<b>536.9</b>	<b>30.9</b>	<b>395.6</b>	<b>458.9</b>	<b>16.0</b>	<b>1,780.5</b>	<b>2,214.1</b>	<b>24.4</b>	<b>1,815.3</b>	<b>2,117.5</b>	<b>16.6</b>
Exceptional Items	0.8	(336.0)	nm	-	-	nm	(42.3)	(336.0)	694.1	-	-	nm
Prior period items	1.1	2.0	80.2	(0.5)	2.0	(469.8)	(3.3)	(10.3)	206.9	(5.0)	(10.3)	106.6
<b>Profit after exceptionals</b>	<b>412.0</b>	<b>202.9</b>	<b>(50.8)</b>	<b>395.1</b>	<b>460.9</b>	<b>16.6</b>	<b>1,734.8</b>	<b>1,867.8</b>	<b>7.7</b>	<b>1,810.4</b>	<b>2,107.2</b>	<b>16.4</b>
Minority Interest	-	-	na	(28.7)	9.0	na	-	-	na	(71.6)	23.3	na
Profit from associate co.	-	-	na	0.4	(4.1)	na	-	-	na	2.2	(9.3)	na
<b>Net Profit</b>	<b>412.0</b>	<b>202.9</b>	<b>(50.8)</b>	<b>366.8</b>	<b>465.8</b>	<b>27.0</b>	<b>1,734.8</b>	<b>1,867.8</b>	<b>7.7</b>	<b>1,740.9</b>	<b>2,121.2</b>	<b>21.8</b>
<b>Key Costs</b>												
<b>Sales</b>	<b>4,510.0</b>	<b>5,644.8</b>	<b>25.2</b>	<b>6,307.3</b>	<b>7,650.1</b>	<b>21.3</b>	<b>19,545.6</b>	<b>23,191.6</b>	<b>18.7</b>	<b>25,738.6</b>	<b>30,210.4</b>	<b>17.4</b>
Raw Materials	2,588.2	3,260.1	26.0	3,787.4	4,515.9	19.2	11,284.5	13,517.4	19.8	15,026.3	17,921.0	19.3
<i>% of Sales</i>	<i>57.4</i>	<i>57.8</i>	<i>37 bps</i>	<i>60.0</i>	<i>59.0</i>	<i>-102 bps</i>	<i>57.7</i>	<i>58.3</i>	<i>55 bps</i>	<i>58.4</i>	<i>59.3</i>	<i>94 bps</i>
Employee Cost	320.9	299.2	(6.8)	517.4	520.1	0.5	1,179.3	1,289.8	9.4	2,015.5	2,233.6	10.8
<i>% of Sales</i>	<i>7.1</i>	<i>5.3</i>	<i>-182 bps</i>	<i>8.2</i>	<i>6.8</i>	<i>-140 bps</i>	<i>6.0</i>	<i>5.6</i>	<i>-47 bps</i>	<i>7.8</i>	<i>7.4</i>	<i>-44 bps</i>
Other Expenditure	991.8	1,273.2	28.4	1,295.6	1,693.2	30.7	4,144.1	4,865.2	17.4	5,345.5	6,139.2	14.8
<i>% of Sales</i>	<i>22.0</i>	<i>22.6</i>	<i>56 bps</i>	<i>20.5</i>	<i>22.1</i>	<i>159 bps</i>	<i>21.2</i>	<i>21.0</i>	<i>-22 bps</i>	<i>20.8</i>	<i>20.3</i>	<i>-45 bps</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.

Figure 3. Relative price performance



Source: Datacentral

Figure 4. Price performance

(%)	3M	6M	12M
Absolute	(3.4)	28.4	73.2
Rel. to .BSESN	(22.5)	(14.7)	(10.3)

Source: Datacentral

## Investment Thesis

We rate Asian Paints a Sell (3L). Although we like the growth story at Asian Paints, we believe valuations have become rich and we do not see much re-rating potential. Asian Paints has outperformed the Sensex by as much as 5% over the past six months and trades at 24x FY07E P/E.

Asian Paints is the market leader in India's decorative paints industry, accounting for 47% of the total revenues of the top six players in the organized segment. Rise in urbanization, higher disposable incomes, cheaper housing loans and a shift from semi-permanent to permanent housing structures are driving longer term paints market growth at over 1.5x GDP growth. Asian Paints enjoys competitive advantages that should help it outpace the market growth — strong brands, a wide range of offerings across all product categories, and the most extensive distribution network in the paints industry.

Asian Paints is benefiting from the strong growth in the housing sector in India. However, we believe that competitive activity would limit the scope for further margin expansion. Though we have modeled a steady margin expansion from FY06E-FY078E, we believe there is a downside risk to our assumptions.

## 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 that the stock could trade at the higher end of its trading band of 17-22xP/E owing to expectations of its international operations turning around. We value Asian Paints at a multiple of 20x which is line with the premium that Asian Paints has traded historically to the Sensex. Our price target of Rs623 is based on 20x FY07 consolidated EPS.

Our DCF model gives a target price of Rs600, providing support to our P/E-based target price. We use a two-stage FCFF model, with a base case discount rate of 10.5% (WACC) and a beta of 0.54. We have done explicit forecast till FY10. We assume growth rate to perpetuity of 6%.

## Risks

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) Domestic paint market growth hinges on economic activity and growth. If economic growth slows, it would affect demand for paint and Asian Paints' sales growth may slow. (4) If Asian Paints is unable to aggressively respond to recent moves from the competition, it could lose market share. (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. If these prices rise, it would impact margins. Upside risks to our stock price target could arise from 1) Faster than expected domestic paints growth, that could translate into higher growth for Asian Paints 2) Any domestic acquisitions made by Asian Paints that could increase its market dominance are likely to be viewed positively and could trigger a stock re-rating

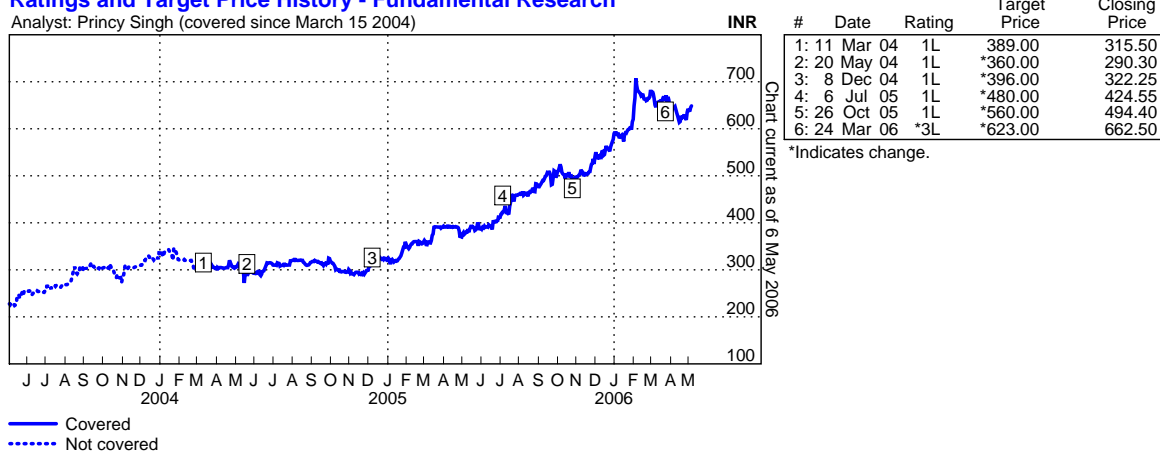
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#### Asian Paints (India) Limited (ASPN.BO) Ratings and Target Price History - Fundamental Research

Analyst: Princy Singh (covered since March 15 2004)



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Data current as of 5 May 2006

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India -- Asia Pacific (110)	47%	21%	32%
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