

Asian Paints

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,612	APNT IN
	REUTERS CODE
S&P CNX: 3,754	ASPN.BO

10 May 2006

Buy

Previous Recommendation: Buy

Rs663

		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
Equity Shares (m)	95.9	3/06A	23,192	2,214	23.1	25.6	28.7	10.0	35.0	44.5	2.6	17.4
52-Week Range	790/375	3/07E	26,902	2,647	27.6	19.6	24.0	8.5	35.3	50.0	2.2	14.4
1,6,12 Rel. Perf. (%)	-6/-22/-21	3/08E	30,938	3,179	33.1	20.1	20.0	6.9	34.7	49.7	1.9	11.8
M.Cap. (Rs b)	63.6											
M.Cap. (US\$ b)	1.4											

- Standalone 4QFY06 results (excl. extraordinary expenses) were better v/s our expectations, largely due to strong revenue growth driven by boom in the construction sector, competitive pricing, innovative marketing and new products.
- Standalone net sales grew 27.7% YoY and 19.5% for FY06. Decorative paint volumes grew 29.5%, partly aided by the low base due to impending VAT implementation in April 2005. Exterior paint continued to lead the growth momentum whilst all segments, except enamel, posted encouraging growth.
- EBITDA margins expanded 60bp YoY to 14.4% mainly due to lower YoY prices of raw materials despite small price reduction adopted at end-3QFY06. Stable titanium dioxide and lower vegetable oil and additive prices helped balance sharp increase in solvent prices.
- International operations recorded 12.7% sales growth in 4QFY06 and 11% in FY06. Stiff competition in SE Asian countries and natural calamities in the Caribbean were responsible for sub par performance even as the Middle East continued to report robust numbers. We expect the company to exit operations in SE Asian countries where it currently does not have more than 2%-3% share.
- We are increasing our standalone EPS estimates by 5.7% to Rs27.6 for FY07 and by 7.6% to Rs33.1 for FY08 respectively. We expect strong growth prospects ahead owing to the construction boom and buoyant economy. The stock is currently trading at 24x FY07E EPS and 20x FY08E EPS. We maintain **Buy**.

QUARTERLY PERFORMANCE									(Rs Million)	
Y/E MARCH	FY05				FY06				FY05	FY06
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net Sales	4,018	5,179	5,797	4,421	5,106	6,025	6,406	5,645	19,415	23,192
Change (%)	6.0	4.8	28.7	8.7	27.1	16.3	10.5	27.7	14.4	19.5
Total Expenditure	3,401	4,369	4,895	3,812	4,378	5,019	5,433	4,832	16,477	19,672
EBITDA	616	810	902	609	728	1,006	973	812	2,938	3,519
Margin (%)	15.3	15.6	15.6	13.8	14.3	16.7	15.2	14.4	15.1	15.2
Change (%)	15.6	0.2	23.0	3.9	18.1	24.2	7.8	33.4	9.0	19.8
Interest	7	6	8	6	5	9	17	7	28	38
Depreciation	120	122	122	112	111	113	112	120	476	455
Other Income	41	95	88	91	60	71	83	145	316	359
Operational PBT	530	777	861	582	672	956	927	830	2,749	3,385
Non Recurring Items	0	0	-43	0	0	-17	3	-334	-43	-346
PBT	530	777	818	582	672	938	930	496	2,706	3,039
Tax	194	285	296	215	229	326	327	310	988	1,192
Deferred Tax	2	0	20	-42	1	0	-6	-16	-18	-21
Effective Tax Rate (%)	36.9	36.7	38.7	29.7	34.3	34.8	34.4	59.1	35.9	38.5
PAT	334	492	501	409	442	612	610	203	1,736	1,868
Adjusted PAT	334	492	544	409	442	629	606	537	1,779	2,214
Change (%)	16.2	5.2	31.2	17.0	32.1	27.9	11.4	31.3	17.1	24.5

E: MOST Estimates

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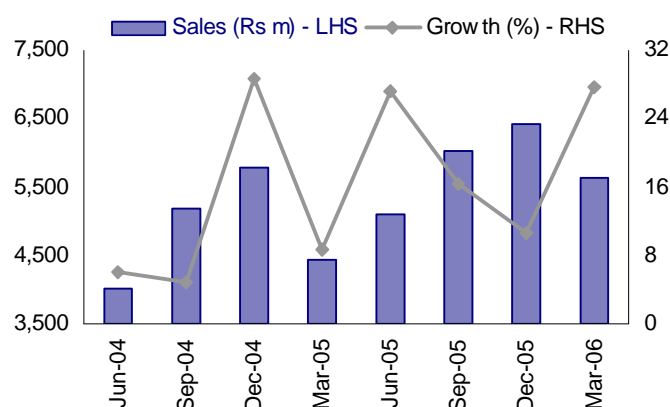
Asian Paints 4QFY06 results were better than expectations driven by strong revenue growth. The boom in the construction sector has led to increased demand for decorative paint across segments. Success of Apex Ultima in the high-growth exterior emulsion segment contributed significantly to the buoyant growth. Industrial business, comprising protective coatings, floor coatings and road marking segments, grew by over 20%. Operating margins for the standalone business expanded 60bp YoY for the quarter to 14.4%. Stable titanium dioxide prices and lower prices for vegetable oils and additives enabled the company to improve margins despite a sharp increase in the prices of solvents. The company wrote off Rs336m as diminution in the value of investments in Asian Paints International, which resulted in 4QFY06 reported profits being 50% lower than 4QFY05.

SEGMENTAL REVENUE: 4QFY06V/S 4QFY05

	4QFY05	4QFY06	CHG (%)
Segment Revenue			
Paints	4,247.2	5,503.9	29.6
Others	360.8	386.4	7.1
Total	4,608.0	5,890.3	27.8
Less: Inter-segment Revenue	138.3	166.5	
Net Sales	4,469.7	5,723.7	28.1
Segment PBIT			
Paints	691.2	843.6	22.0
Others	9.1	26.7	195.0
Total	700.2	870.3	24.3

Source: Company/Motilal Oswal Securities

SALES GROWTH MOVEMENT (YOY)



Source: Company/Motilal Oswal Securities

Raw material pricing pressure to sustain

Management expects the paints industry to record volumewise growth of 12%-13% on a conservative basis. Exterior paints are expected to lead the growth rates. Sales mix continues to be favorable due to launch of higher value items under the Utsav range as also rising sales of higher value exterior emulsions.

Raw material pricing pressure is likely to sustain in the coming years primarily due to high solvent prices, which are linked to crude oil prices. We expect the company to opt for selective price increases to sustain margins.

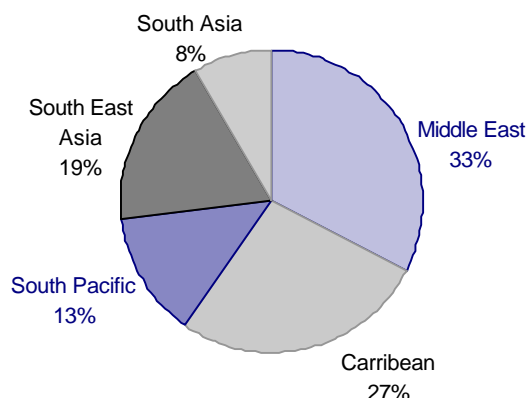
Restructuring of global business could improve profitability

The international business continued to be a drag on consolidated profits over FY06, primarily due to poor performance in South Asian and South-East Asian markets. Increase in raw material prices along with lack of scale in key markets, were the main reasons for losses in these regions. The Middle East continued to be an attractive market while the Caribbean markets were impacted due to natural calamities (storms) during CY05. The company reported a cumulative operating loss of US\$3.5m in FY06 compared with profit of US\$0.936m in FY05 in South Asia and South-East Asia.

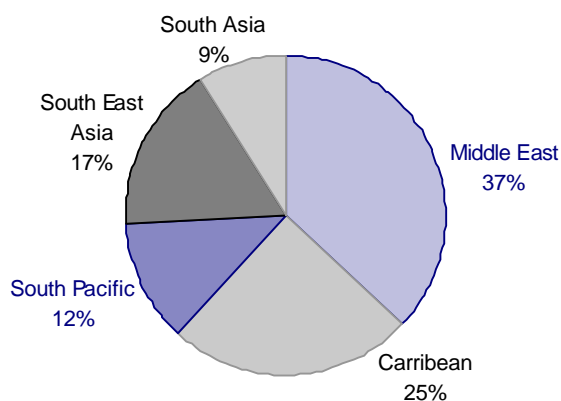
Management said that they were considering rationalizing some of these businesses either by consolidation with other players or exiting some of them. As the company has merely 2%-3% market share in certain territories such as China, Thailand and Malaysia, we cannot rule out the exit option in these regions.

We believe that rationalization would result in the company exiting several regions in South Asia and South East Asia, which should cut down the losses. Further, rationalization would enable focus on high-growth regions — India and the Middle East.

GEOGRAPHICAL SALES MIX (2005)



GEOGRAPHICAL SALES MIX (2006)



Source: Company/Motilal Oswal Securities

REGIONWISE EBITDA (US\$ '000)

	2005	2004
Middle East	3,273	2,267
Carribean	2,493	2,487
South Pacific	1,218	1,256
South East Asia	-3,209	18
South Asia	-304	918

Source: Company/ Motilal Oswal Securities

Industrial paints record encouraging show; new units to boost profits

Asian PPG (automotive coatings) and Asian Paints' industrial coatings grew 17.7% and 36.4% respectively during FY06. Automotive segment reported smart growth in both original equipment (OE) and refinish segments.

Asian Paints has commissioned a new powder coating facility at Baddi through its wholly owned subsidiary, Asian Paints Coatings Ltd. The new unit, with 1400 MT capacity, will provide the excise and income tax benefits. The powder coatings business has high growth prospects but lower margins versus decorative paints. The company plans to double capacity of the unit during the forthcoming year at a marginal cost of Rs20m. Long term however, the company plans to increase capacity to 4 times the initial installed capacity. Currently this unit has powder coating capacity of 1,400 ton whilst Asian Paints Coatings' total capacity for this product is 3,900ton.

Asian Paints sells floor coatings, road marking paints and protective coatings as part of the standalone entity. Currently the company completely outsources the paints for this high-growth segment. The new unit at Taloja is expected to start production in 3QFY07, and should boost profitability in the coming years.

Valuation and view

We are increasing our standalone EPS estimates by 5.7% to Rs27.6 for FY07 and by 7.6% to Rs33.1 for FY08 respectively. We expect strong growth prospects ahead owing to the construction boom and buoyant economy. The estimated 20% PAT CAGR over FY06-FY08 and excellent track record of rewarding shareholders will enable the company to maintain premium valuations. The stock is currently trading at, 24x FY07E EPS and 20x 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 currently trading at, 24x FY07E EPS and 20x 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	24.0	27.7	36.9
	FY08E	20.0	24.4	29.3
EV/EBITDA (x)	FY07E	14.4	17.1	31.9
	FY08E	11.8	14.5	24.9
EV/Sales (x)	FY07E	2.2	6.3	4.8
	FY08E	1.9	5.4	4.2
P/BV (x)	FY07E	8.5	7.0	26.6
	FY08E	6.9	6.0	23.2

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	47.2	46.8	42.9
Domestic Institutions	12.2	13.4	15.4
FII's/FDIs	22.2	21.7	23.4
Others	18.4	18.1	18.3

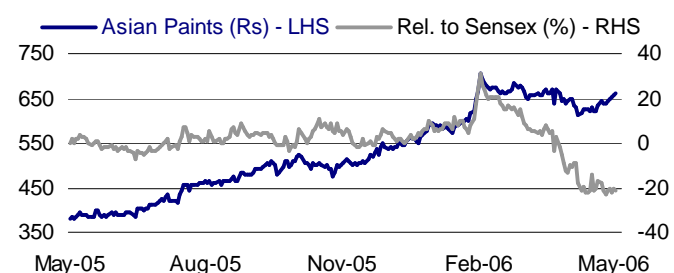
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	27.6	26.8	3.0
FY08	33.1	31.9	3.9

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
663	729	10.0	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (UNCONSOLIDATED)					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
Net Sales	16,967	19,415	23,192	26,902	30,938
Change (%)	7.8	14.4	19.5	16.0	15.0
Raw Materials	9,442	11,154	13,517	15,684	17,975
Staff Cost	1,016	1,179	1,290	1,445	1,632
Admin. & Other Exp.	3,814	4,144	4,865	5,596	6,373
EBITDA	2,695	2,938	3,519	4,178	4,957
% of Net Sales	15.9	15.1	15.2	15.5	16.0
Depreciation	480	476	455	535	580
EBIT	2,366	2,732	3,077	4,044	4,840
Interest	53	28	38	40	40
Other Income	217	316	359	401	462
Non Recurring Exp.	68	46	346	0	0
PBT	2,313	2,705	3,039	4,004	4,800
Tax	880	988	1,192	1,401	1,680
Deferred Tax	-44	-18	-21	-45	-60
Rate (%)	38.0	36.5	39.2	35.0	35.0
PAT	1,478	1,735	1,868	2,648	3,180
Adjusted PAT	1,518	1,763	2,214	2,647	3,179
Change (%)	5.9	16.1	25.6	19.6	20.1

BALANCE SHEET (UNCONSOLIDATED)					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
Share Capital	959	959	959	959	959
Reserves	4,356	4,763	5,373	6,544	8,192
Net Worth	5,315	5,722	6,332	7,503	9,152
Loans	705	840	671	670	670
Capital Employed	6,020	6,561	7,002	8,173	9,821
Gross Fixed Assets	6,512	7,127	8,327	8,827	9,327
Less: Depreciation	3,106	4,015	4,470	5,005	5,585
Net Fixed Assets	3,405	3,112	3,857	3,822	3,742
Capital WIP	39	83	83	83	83
Investments	2,425	2,584	2,953	3,987	5,527
Curr. Assets	4,610	5,925	5,111	5,749	6,442
Inventory	2,115	3,308	2,345	2,720	3,128
Debtors	1,379	1,490	1,639	1,901	2,186
Cash & Bank Balance	246	210	210	210	210
Loans & Advances	788	727	727	727	727
Other Current Assets	82	190	190	190	190
Curr. Liabilities	3,972	4,838	4,676	5,097	5,541
Creditors	2,187	2,787	2,625	3,045	3,490
Other Liabilities	507	934	934	934	934
Provisions	1,278	1,117	1,117	1,117	1,117
Net Curr. Assets	638	1,087	436	652	901
Deferred Tax Liability	-487	-305	-326	-370	-431
Appl. of Funds	6,020	6,561	7,003	8,174	9,822

E: MOf Estimates

RATIOS (UNCONSOLIDATED)					
Y/E MARCH	2004	2005	2006	2007E	2008E
Basic (Rs)					
EPS	15.8	18.4	23.1	27.6	33.1
Cash EPS	31.1	34.9	416	49.6	58.6
Book Value	55.4	59.7	66.0	78.2	95.4
DPS	8.5	9.5	11.5	13.5	14.0
Payout (incl. Div. Tax.)	55.2	52.5	59.1	48.9	42.2
Valuation (x)					
P/E		36.0	28.7	24.0	20.0
Cash P/E		19.0	15.9	13.4	11.3
EV/EBITDA		21.0	17.4	14.4	11.8
EV/Sales		3.2	2.6	2.2	1.9
Price/Book Value		11.1	10.0	8.5	6.9
Dividend Yield (%)		14	17	2.0	2.1
Profit. Ratios (%)					
RoE	28.6	30.8	35.0	35.3	34.7
RoCE	39.5	42.2	44.5	50.0	49.7
Turnover Ratios					
Debtors (Days)	30	28	26	26	26
Inventory (Days)	45	62	37	37	37
Creditors (Days)	46	52	41	41	41
Asset Turnover (x)	2.8	3.0	3.3	3.3	3.1
Leverage Ratio					
Debt/Equity (x)	0.1	0.1	0.1	0.1	0.1

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
OP/(loss) before Tax	2,215	2,462	3,064	3,643	4,377
Int./Div. Received	217	316	359	401	462
Depreciation and Amort.	480	476	455	535	580
Interest Paid	-53	-28	-38	-40	-40
Direct Taxes Paid	-880	-988	-1,192	-1,401	-1,680
(Incr)/Decr in WC	581	-485	651	-217	-248
CF from Operations	2,560	1,754	3,300	2,921	3,452
Extraordinary Items	-68	-46	-346	0	0
(Incr)/Decr in FA	-357	-659	-1,200	-500	-500
(Pur)/Sale of Investments	-948	-159	-369	-1,034	-1,540
CF from Invest.	-1,373	-864	-1,915	-1,534	-2,040
(Incr)/Decr in Debt	-331	135	-169	-1	0
Dividend Paid	-920	-1,037	-1,258	-1,476	-1,531
Others	38	-24	41	90	119
CF from Fin. Activity	-1,213	-926	-1,386	-1,387	-1,412
Incr/Decr of Cash	-26	-36	-1	0	0
Add: Opening Balance	272	246	210	210	210
Closing Balance	246	210	210	210	210



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Asian Paints

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| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |

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