

Asian Paints

Growth rate set to moderate

We estimate EPS CAGR will moderate at 19.7% over FY09-11 (vs 32.4% CAGR over FY06-08), as we see limited potential for margin expansion. The outlook for decorative paints remains positive. Buy, with an increased target price of Rs1,410.

Key forecasts

	FY07A	FY08A	FY09F	FY10F	FY11F
Revenue (Rsm)	28212.9	34161.6	40997.1	48908.3	58426.9
EBITDA (Rsm)	4217.6	5540.1	6674.8	8108.4	9863.7
Reported net profit (Rsm)	2744.0	3838.5	4647.3▲	5520.1	6745.4
Normalised net profit (Rsm) ¹	2720.3	3932.3	4647.3	5520.1	6745.4
Normalised EPS (Rs)	28.4	41.0	48.4▲	57.5	70.3
Dividend per share (Rs)	13.0	17.0	20.0▲	25.0▲	30.0
Dividend yield (%)	1.03	1.35	1.59	1.99	2.39
Normalised PE (x)	44.3	30.7	25.9▼	21.8	17.9
EV/EBITDA (x)	28.8	21.9	18.2	15.0	12.2
Price/book value (x)	16.2	13.0	10.3	8.37	6.78
ROIC (%)	35.0	39.9	40.2	38.0	38.8

1. Post-goodwill amortisation and pre-exceptional items
Accounting Standard: Local GAAP
Source: Company data, ABN AMRO forecasts

year to Mar, fully diluted

Earnings growth should moderate, while margins should stabilise

AP's EBITDA margins have expanded 100bp over the past three years, accelerating EPS growth to 32.4% vs sales growth of only 21%. Looking ahead, we see a couple of factors that may constrain margin expansion: 1) rising prices of crude-oil-linked raw materials (35% of total raw material cost); and, 2) a depreciating rupee (6.9% since 4Q08) will add to the cost inflation, as most raw materials are linked to the import parity pricing. Besides, AP is focused on growing volumes (rightly so, we believe), so it may try to keep price hikes to the minimum. AP raised prices by 1.2% in February 2008 and another 2.9% in June.

Market leadership remains intact

AP continues to strengthen its brand equity via innovative initiatives, such as: 1) introducing crack fillers, a product that has received good consumer response; 2) giving three to five-year warranties to large real-estate developers, driving growth in the institutional decorative paints segment; and, 3) providing company-certified contractors for home-painting jobs in 15 Indian cities, a business which is fast gaining traction. AP has maintained a market share of 42% in the domestic market.

International business sustains the turnaround

In FY08, AP's international sales grew by 12% yoy in rupee terms, while recording a PAT of Rs408.6m (Rs98m in FY07). The Middle East continued to report a strong performance, with real growth of 28% yoy (23% in rupee terms). Given the current volatility and lower scale of operations spread across 23 countries, we value the international business at a lower (than the domestic business) PER of 11x on FY09F earnings.

Buy maintained with a new target price of Rs1,410

We introduce our FY11 EPS estimates, and raise FY09-10 numbers by 2-4%. Correspondingly, our DCF-based target price rises to Rs1,410 (from Rs1,296). At our target price, the stock would trade at 23.6x FY10F earnings, adjusting for the value of international operations of Rs52.5/share. We believe AP's premium valuation (25%) to the Sensex is justified given the company's secular earnings growth and superior ROE (44% in FY09F).

Priced at close of business 10 June 2008. Use of ▲ ▼ indicates that the line item has changed by at least 5%.

Mafatlal Chambers – C Wing, Ground Floor, N.M. Joshi Marg, Lower Parel (E), Mumbai 400 013, India. Tel : +91 022 6754 8411 Fax : +91 022 6754 8420

Buy

Absolute performance

n/a

Short term (0-60 days)

Overweight

Market relative to region

Materials

India

Price

Rs1256.65

Target price

Rs1410.00 (from Rs1296.00)

Market capitalisation

Rs120.54bn (US\$2.81bn)

Avg (12mth) daily turnover

Rs34.97m (US\$0.87m)

Reuters

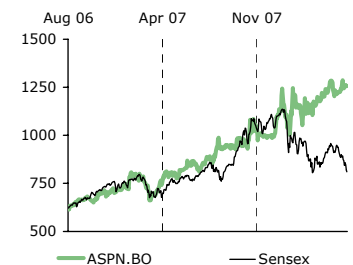
ASP.N.BO

Bloomberg

APNT IN

Price performance (1M) (3M) (12M)

	1M	3M	12M
Price (Rs)	1223	1157	855.0
Absolute %	2.8	8.6	47.0
Rel market %	15.6	16.1	38.8
Rel sector %	6.6	11.0	46.8



Stock borrowing: Difficult

Volatility (30-day): 19.81%

Volatility (6-month trend): ↓

52-week range: 1334.00-800.00

Sensex: 14889.25

BBG AP Chemicals: 248.74

Source: ABN AMRO, Bloomberg

Researched by

ABN AMRO Institutional
Equities Team

www.abnamrobroking.co.in

Table 1 : EPS revisions

EPS change table (Rs)	Old	New	Change
FY09F	45.8	48.4	5.7%
FY10F	56.3	57.5	2.3%
FY11F		70.3	

Source: ABN AMRO forecasts

Table 2 : Interim results summary

Rs m	1Q08	2Q08	3Q08	4Q08
Net Sales	7,402.08	8,912.00	9,162.40	8,685.10
% Change	23%	13.5%	30%	19%
Expenditure	6,239.62	7,400.40	7,621.00	7,360.60
% Change	22%	11%	26%	19%
- +/- in stock	-405.35	-214.80	442.00	-208.10
- Raw material	4,649.45	5,357.50	4,820.10	5,120.50
- Employee remuneration	461.77	490.10	494.10	500.80
- Other overheads	1,533.75	1,767.60	1,864.80	1,947.40
EBITDA	1,162.46	1,511.60	1,541.40	1,324.50
Operating margin (%)	15.7%	17.0%	16.8%	15.3%
Interest	-17.52	-25.50	-26.90	-12.80
Depreciation	-104.27	-107.50	-111.90	-114.00
Other Income	87.78	257.10	168.90	112.00
Profit before Tax	1,128.45	1,635.70	1,571.50	1,309.70
Tax	386.17	555.30	494.10	443.90
Net Profit pre-extra-ord	742.28	1,080.40	1,077.40	865.80
Extraordinary	0.01	4.00	-0.50	-17.40
Net Profit post extra-ord	742.29	1,084.40	1,076.90	848.40
PAT after minority interest				
Tax/ PBT	-34%	33.9%	31.4%	33.9%
Raw material to sales	57.3%	57.7%	57.4%	56.6%
Empl cost/sales	6.2%	5.5%	5.4%	5.8%
Other OH	20.7%	19.8%	20.4%	22.4%

Source: Company data

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ASIAN PAINTS: KEY FINANCIAL DATA

Income statement

Rsm	FY07A	FY08A	FY09F	FY10F	FY11F
Revenue	28212.9	34161.6	40997.1	48908.3	58426.9
Cost of sales	-16607	-19561	-23860	-28465	-34004
Operating costs	-7388.2	-9060.2	-10462	-12335	-14559
EBITDA	4217.6	5540.1	6674.8	8108.4	9863.7
DDA & Impairment (ex gw)	-454.1	-437.7	-546.3	-660.2	-720.4
EBITA	3763.5	5102.4	6128.5	7448.2	9143.3
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
EBIT	3763.5	5102.4	6128.5	7448.2	9143.3
Net interest	-68.7	-82.7	-94.4	-110.1	-64.3
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	404.5	625.8	662.2	615.9	640.5
Reported PTP	4099.3	5645.5	6696.3	7954.0	9719.5
Taxation	-1379.0	-1713.2	-2049.1	-2433.9	-2974.2
Minority interests	n/a	n/a	n/a	n/a	n/a
Exceptionals (post-tax)	23.7	-93.8	0.00	0.00	0.00
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	2744.0	3838.5	4647.3	5520.1	6745.4
Normalised Items Excl. GW	23.7	-93.8	0.00	0.00	0.00
Normalised net profit	2720.3	3932.3	4647.3	5520.1	6745.4

Source: Company data, ABN AMRO forecasts

year to Mar

Balance sheet

Rsm	FY07A	FY08A	FY09F	FY10F	FY11F
Cash & market secs (1)	424.9	413.5	413.5	413.5	413.5
Other current assets	8167.1	10028.7	11105.7	12839.6	14925.9
Tangible fixed assets	3465.3	5392.2	7305.7	7623.6	7779.6
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	3343.9	4228.8	4500.0	5500.0	6000.0
Total assets	15401.2	20063.2	23324.9	26376.8	29119.0
Short term debt (2)	n/a	n/a	n/a	n/a	n/a
Trade & oth current liab	6482.3	9516.0	9908.6	10320.7	10753.5
Long term debt (3)	1256.7	947.0	1413.5	1338.7	269.6
Oth non-current liab	221.5	315.2	315.2	315.2	315.2
Total liabilities	7960.4	10778.2	11637.2	11974.7	11338.4
Total equity (incl min)	7440.8	9285.0	11687.7	14402.1	17780.7
Total liab & sh equity	15401.2	20063.2	23324.9	26376.8	29119.0
Net debt (2+3-1)	831.7	533.5	1000.0	925.2	-143.9

Source: Company data, ABN AMRO forecasts

year ended Mar

Cash flow statement

Rsm	FY07A	FY08A	FY09F	FY10F	FY11F
EBITDA	4217.6	5540.1	6674.8	8108.4	9863.7
Change in working capital	128.5	479.2	-684.4	-1321.8	-1653.5
Net interest (pd) / rec	-94.7	-237.3	567.8	505.8	576.2
Taxes paid	-1485.9	-1752.2	-2049.1	-2433.9	-2974.2
Other oper cash items	n/a	n/a	n/a	n/a	n/a
Cash flow from ops (1)	2765.6	4029.8	4509.1	4858.5	5812.3
Capex (2)	656.4	2567.1	-2459.8	-978.2	-876.4
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	-594.7	-875.3	-271.2	-1000.0	-500.0
Cash flow from invest (3)	61.7	1691.8	-2731.0	-1978.2	-1376.4
Incr / (decr) in equity	0.00	0.00	0.00	0.00	0.00
Incr / (decr) in debt	345.6	-309.7	466.5	-74.7	-1069.1
Ordinary dividend paid	-2148.8	-872.7	-2244.5	-2805.7	-3366.8
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	-883.0	-4550.6	-0.04	n/a	n/a
Cash flow from fin (5)	-2686.2	-5733.0	-1778.1	-2880.4	-4435.9
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Incr/(decr) cash (1+3+5+6)	141.1	-11.4	0.00	0.00	0.00
Equity FCF (1+2+4)	3422.0	6596.9	2049.3	3880.4	4935.9

Lines in bold can be derived from the immediately preceding lines.

Source: Company data, ABN AMRO forecasts

year to Mar

ASIAN PAINTS: PERFORMANCE AND VALUATION

Standard ratios	Asian Paints					Hindustan Unilever			Nestle India		
Performance	FY07A	FY08A	FY09F	FY10F	FY11F	FY08F	FY09F	FY10F	FY08F	FY09F	FY10F
Sales growth (%)	21.7	21.1	20.0	19.3	19.5	15.3	14.2	14.2	18.1	17.6	18.4
EBITDA growth (%)	19.8	31.4	20.5	21.5	21.6	18.7	19.0	15.8	20.6	17.6	17.1
EBIT growth (%)	22.8	35.6	20.1	21.5	22.8	18.7	20.1	16.5	21.9	18.1	17.7
Normalised EPS growth (%)	21.2	44.6	18.2	18.8	22.2	16.8	16.9	16.3	23.0	18.3	17.1
EBITDA margin (%)	14.9	16.2	16.3	16.6	16.9	14.2	14.8	15.0	21.1	21.1	20.9
EBIT margin (%)	13.3	14.9	14.9	15.2	15.6	13.1	13.8	14.1	19.3	19.4	19.3
Net profit margin (%)	9.64	11.5	11.3	11.3	11.5	13.1	13.4	13.6	13.4	13.5	13.3
Return on avg assets (%)	19.6	22.5	21.7	22.5	24.5	29.8	30.7	32.6	41.4	45.6	46.9
Return on avg equity (%)	39.8	47.0	44.3	42.3	41.9	129.0	118.1	104.1	116.8	118.1	124.4
ROIC (%)	35.0	39.9	40.2	38.0	38.8	186.1	155.4	199.6	132.9	161.9	170.7
ROIC - WACC (%)	24.6	29.4	29.7	27.6	28.4	174.6	143.9	188.1	121.5	150.5	159.3
				<i>year to Mar</i>			<i>year to Dec</i>			<i>year to Dec</i>	
Valuation											
EV/sales (x)	4.30	3.54	2.96	2.48	2.06	3.27	2.82	2.43	3.84	3.26	2.75
EV/EBITDA (x)	28.8	21.9	18.2	15.0	12.2	23.1	19.1	16.2	18.2	15.4	13.2
EV/EBITDA @ tgt price (x)	32.3	24.5	20.4	16.8	13.7	25.7	21.3	18.1	20.7	17.6	15.0
EV/EBIT (x)	32.2	23.7	19.8	16.3	13.2	24.9	20.5	17.2	19.9	16.8	14.3
EV/invested capital (x)	14.3	11.9	9.35	7.76	6.71	32.2	35.0	39.3	41.4	37.0	34.4
Price/book value (x)	16.2	13.0	10.3	8.37	6.78	28.9	21.9	16.6	30.9	27.1	24.9
Equity FCF yield (%)	2.84	5.47	1.70	3.22	4.09	3.49	5.02	5.86	3.59	3.81	4.58
Normalised PE (x)	44.3	30.7	25.9	21.8	17.9	24.7	21.1	18.2	28.9	24.5	20.9
Norm PE @tgt price (x)	49.7	34.4	29.1	24.5	20.1	27.5	23.5	20.2	32.9	27.8	23.7
Dividend yield (%)	1.03	1.35	1.59	1.99	2.39	3.41	3.63	4.05	2.43	3.06	3.76
				<i>year to Mar</i>			<i>year to Dec</i>			<i>year to Dec</i>	
Per share data	FY07A	FY08A	FY09F	FY10F	FY11F	Solvency	FY07A	FY08A	FY09F	FY10F	FY11F
Tot adj dil sh, ave (m)	95.9	95.9	95.9	95.9	95.9	Net debt to equity (%)	11.2	5.75	8.56	6.42	-0.81
Reported EPS (INR)	28.6	40.0	48.4	57.5	70.3	Net debt to tot ass (%)	5.40	2.66	4.29	3.51	-0.49
Normalised EPS (INR)	28.4	41.0	48.4	57.5	70.3	Net debt to EBITDA	0.20	0.10	0.15	0.11	-0.01
Dividend per share (INR)	13.0	17.0	20.0	25.0	30.0	Current ratio (x)	1.33	1.10	1.16	1.28	1.43
Equity FCF per share (INR)	35.7	68.8	21.4	40.5	51.5	Operating CF int cov (x)	45.9	25.4	-10.6	-13.4	-14.2
Book value per sh (INR)	77.6	96.8	121.8	150.1	185.4	Dividend cover (x)	1.91	2.06	2.07	1.97	2.00
				<i>year to Mar</i>						<i>year to Mar</i>	

Priced as follows: ASPN.BO - Rs1256.65; HLL.BO - Rs234.35; NEST.BO - Rs1729.95
Source: Company data, ABN AMRO forecasts

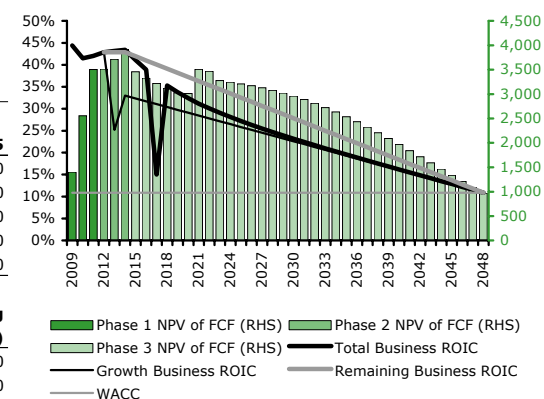
ASIAN PAINTS: VALUATION METHODOLOGY

Economic Profit Valuation			Discounted Cash Flow Valuation		
	Rs m	%		Rs m	%
Adjusted Opening Invested Capital	11676.7	9	Value of Phase 1: Explicit (2009 to 2011)	7459.0	6
NPV of Economic Profit During Explicit Period	10267.8	8	Value of Phase 2: Value Driver (2012 to 2014)	11150.6	8
NPV of Econ Profit of Remaining Business (1, 2)	33586.8	26	Value of Phase 3: Fade (2015 to 2048)	87074.2	66
NPV of Econ Profit of Net Inv (Grth Business) (1, 3)	74640.9	57	Terminal Value	26271.8	20
Enterprise Value	130172.2	100	Enterprise Value	131955.6	100
Plus: Other Assets	5040.0	4	FCF Grth Rate at end of Phs 1 implied by DCF Valuation		7.8
Less: Minorities	0.0	0	FCF Grth Rate at end of Phs 1 implied by Current Price		7.4
Less: Net Debt (as at 11 Jun 2008)	0.0	0			
Equity Value	135212.2	104			
No. Shares (millions)	95.9				
Per Share Equity Value	1,410.00				
Current Share Price	1,256.65				
Sensitivity Table	No of Years in Fade Period				
	15	18	20	23	25
WACC					
8.9%	1065.00	1223.00	1333.00	1506.00	1627.00
9.9%	908.00	1027.00	1109.00	1236.00	1324.00
10.9%	788.00	879.00	942.00	1037.00	1103.00
11.9%	694.00	765.00	814.00	887.00	936.00
12.9%	618.00	675.00	713.00	771.00	809.00
Performance Summary				Phase 2 Avg (2012 - 2014)	
	2009	2010	2011		
Invested Capital Growth (%)	27.2	19.7	14.4	16.0	
Operating Margin (%)	16.3	16.6	16.9	16.0	
Capital Turnover (x)	3.9	3.9	4.0	4.0	

Source: ABN AMRO forecasts

- In periods following the Explicit Period i.e. Phase 2 and Phase 3
- Remaining Business is defined as Capital as at the end of Phase 1 and capex = depreciation thereafter
- Net Investment is defined as capex over and above depreciation after Phase 1

Returns, WACC and NPV of Free Cash Flow

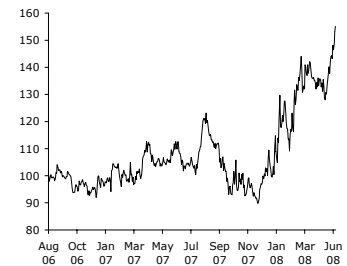


Asian Paints

Company description

Asian Paints is India's largest paints company and is ranked among the top 10 decoratives-coating companies worldwide, with group sales of US\$700m. AP has strengthened its dominance in its core business with a 42% market share in the decoratives segment. The decorative paints business accounts for 90% of AP's sales, and AP dominates the category with presence in all price points. Its recent foray into exterior paints has been successful and it has already become the largest player in the category in terms of sales value. AP's global operations have achieved scale with its Berger International acquisition.

Buy Price relative to country



Strategic analysis

Average SWOT company score: 3

Mkt share of key players, 07

Strengths 4

Dominates the Indian decorative paints market with a strong franchise and excellent brand equity. It continues to innovate to maintain its leadership position with over 19,000 retail outlets vs 11,000 for the closest competitor.

Weaknesses 2

About 35% of the domestic paints market is unorganised, which exerts pricing pressure on organised players like AP.

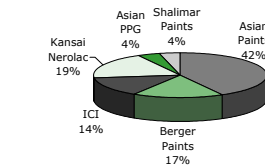
Opportunities 3

The exterior paints market offers significant opportunity for AP. In decoratives paints, the unorganised segment holds 35% market share, which has been reducing over the years.

Threats 3

New foreign competition can steal market share over time.

Scoring range is 1-5 (high score is good)



Source: Company data

Market data

Headquarters
Nirmal, 5th floor, Nariman point, Mumbai-21.

Website
www.apaints.com

Shares in issue
95.9m

Freefloat
45%

Majority shareholders
Promoters (43%), FIIs (19%), Fis (11%)

India

Country view

Overweight

Country rel to Asia Pacific

We expect Indian growth to remain robust in 2008, driven by domestic demand due to the rise in wages and farm incomes. We see a structural growth story emerging in real estate and agriculture, in line with the government's 11th five-year development plan of redistributing income beyond the city centres. We remain selective buyers of consumer discretionary and consumer staples, especially in upstream industries such as cold chain, agri-businesses and organised retail. We think the IT sector is also worth a fresh look as valuations look increasingly undemanding at present levels and major players have demonstrated an ability to protect their margins.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.



Competitive position

Average competitive score: 3+

Broker recommendations

Supplier power 3+

AP is the largest domestic player in the paints industry and hence has the benefit of scale while negotiating prices for raw materials.

Barriers to entry 3+

Distribution reach and brand equity are the key entry barriers in the paint industry. AP possesses one of the strongest distribution networks in the paints sector.

Customer power 3+

AP enjoys strong customer loyalty, given its strong market positioning and innovation.

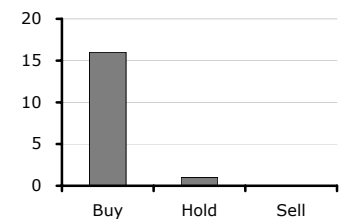
Substitute products 3+

The unorganised sector offers cheaper painting options, but these are clearly inferior in quality.

Rivalry 3+

In the organised sector, Berger Paints, Goodlass Nerolac and ICI are the key competitors. Besides, 35% of the paint market is in the unorganised sector.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg