

## Company Focus

22 October 2007 | 7 pages

# Asian Paints (ASPN.BO)

 Target price change   
 Estimate change 

## Buy: Strong 2QFY08, Raising Target Price to Rs1102

- Another strong quarter** – While Asian Paints reported 49% increase in 2QFY08 profit (pre exceptionals), domestic growth (13% YoY) seems to be slowing down. On the positive side, margins expanded 258bps.
- Slowdown in domestic growth** – Domestic growth slowed to 13% against 15-20% growth seen in last few quarters. Management has indicated that there is a slowdown in domestic construction activity which has impacted paint sales. Asian Paints has recently lowered its prices by 2-3% which may arrest domestic volume slowdown.
- Appreciating rupee aiding margins** – Despite rising crude prices, EBITDA margins expanded 258bps aided by an appreciating rupee and improving margins in international businesses. Management has cautioned that such strong margin expansion trend may not be sustainable.
- International business performing well**– While international business growth was only 7.85%, adversely impacted by an appreciating rupee, EBIT margins have been improving sharply, especially for key areas such as Middle East and South Asia. We believe Asian Paints is on track to deliver 3-4% net margin on its international business in FY08E.
- Raising target price to Rs1102** — We are moving our earnings basis to consolidated from standalone. Our price target of Rs1102 is based on 25x FY09E consolidated EPS (formerly mid-FY09E). Maintain Buy (1L).

<b>Buy/Low Risk</b>	<b>1L</b>
Price (19 Oct 07)	Rs930.35
Target price	Rs1,102.00
	<i>from Rs1,028.00</i>
Expected share price return	18.5%
Expected dividend yield	2.1%
<b>Expected total return</b>	<b>20.5%</b>
Market Cap	Rs89,239M
	US\$2,258M

### 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)	(%)	(%)
2006A	2,208	23.02	26.5	40.4	13.8	36.4	1.3
2007A	2,861	29.84	29.6	31.2	11.5	40.2	1.4
2008E	3,512	36.62	22.7	25.4	10.0	42.0	2.1
2009E	4,227	44.08	20.4	21.1	8.8	44.3	2.4
2010E	5,036	52.51	19.1	17.7	7.9	47.0	2.8

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
<b>Valuation Ratios</b>					
P/E adjusted (x)	40.4	31.2	25.4	21.1	17.7
EV/EBITDA adjusted (x)	23.4	19.0	15.8	13.4	11.3
P/BV (x)	13.8	11.5	10.0	8.8	7.9
Dividend yield (%)	1.3	1.4	2.1	2.4	2.8
<b>Per Share Data (Rs)</b>					
EPS adjusted	23.02	29.84	36.62	44.08	52.51
EPS reported	22.12	29.30	36.62	44.08	52.51
BVPS	67.39	81.10	93.27	105.55	117.82
DPS	12.50	13.00	19.08	22.18	25.64
<b>Profit &amp; Loss (RsM)</b>					
Net sales	30,210	36,700	43,454	50,932	59,240
Operating expenses	-26,900	-32,530	-38,385	-44,834	-51,974
<b>EBIT</b>	<b>3,311</b>	<b>4,169</b>	<b>5,069</b>	<b>6,098</b>	<b>7,266</b>
Net interest expense	-114	-189	-202	-198	-198
Non-operating/exceptionals	311	368	414	457	505
<b>Pre-tax profit</b>	<b>3,507</b>	<b>4,349</b>	<b>5,282</b>	<b>6,357</b>	<b>7,573</b>
Tax	-1,323	-1,467	-1,769	-2,129	-2,537
Extraord./Min.Int./Pref.div.	-63	-72	0	0	0
<b>Reported net income</b>	<b>2,121</b>	<b>2,810</b>	<b>3,512</b>	<b>4,227</b>	<b>5,036</b>
Adjusted earnings	2,208	2,861	3,512	4,227	5,036
Adjusted EBITDA	3,917	4,781	5,748	6,827	8,030
<b>Growth Rates (%)</b>					
Sales	18.0	21.5	18.4	17.2	16.3
EBIT adjusted	24.4	25.9	21.6	20.3	19.1
EBITDA adjusted	16.9	22.1	20.2	18.8	17.6
EPS adjusted	26.5	29.6	22.7	20.4	19.1
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>2,448</b>	<b>2,791</b>	<b>3,616</b>	<b>4,311</b>	<b>4,980</b>
Depreciation/amortization	606	611	678	729	765
Net working capital	-205	-579	-756	-645	-821
<b>Investing cash flow</b>	<b>-1,233</b>	<b>-1,405</b>	<b>-548</b>	<b>-956</b>	<b>-669</b>
Capital expenditure	-755	-1,025	-1,028	-956	-669
Acquisitions/disposals	-239	-190	240	0	0
<b>Financing cash flow</b>	<b>-1,199</b>	<b>-1,097</b>	<b>-2,446</b>	<b>-3,050</b>	<b>-3,859</b>
Borrowings	218	449	-101	0	0
Dividends paid	-1,370	-1,428	-1,829	-2,127	-2,459
<b>Change in cash</b>	<b>16</b>	<b>289</b>	<b>621</b>	<b>305</b>	<b>452</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>17,062</b>	<b>20,241</b>	<b>23,443</b>	<b>26,157</b>	<b>28,831</b>
Cash & cash equivalent	734	1,054	1,675	1,980	2,432
Accounts receivable	3,475	4,206	4,941	5,721	6,492
Net fixed assets	4,518	4,932	5,281	5,509	5,413
<b>Total liabilities</b>	<b>9,999</b>	<b>11,862</b>	<b>13,798</b>	<b>15,335</b>	<b>16,832</b>
Accounts payable	5,787	7,870	8,731	10,091	11,600
Total Debt	2,613	3,062	2,961	2,961	2,961
<b>Shareholders' funds</b>	<b>7,063</b>	<b>8,378</b>	<b>9,645</b>	<b>10,822</b>	<b>11,999</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	13.0	13.0	13.2	13.4	13.6
ROE adjusted	36.4	40.2	42.0	44.3	47.0
ROIC adjusted	22.9	29.6	31.8	33.5	37.1
Net debt to equity	26.6	24.0	13.3	9.1	4.4
Total debt to capital	27.0	26.8	23.5	21.5	19.8

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## 2QFY08 Results Review

Figure 1. Asian Paints (Consolidated): 2QFY08 Results Summary (Rupees in Millions, Percent)

	2QFY07	2QFY08	%Change, YoY
<b>Net Sales</b>	<b>9,980.8</b>	<b>11,331.6</b>	<b>13.5</b>
Expenditure	-8,638.7	-9,515.9	10.2
<b>EBITDA</b>	<b>1,342.1</b>	<b>1,815.7</b>	<b>35.3</b>
<i>EBITDA Margin (%)</i>	<i>13.4</i>	<i>16.0</i>	<i>258 bps</i>
Interest	-49.8	-68.9	38.5
Depreciation & Amortisation	-148.9	-145.6	(2.2)
Other Income	97.8	264.6	170.6
<b>PBT</b>	<b>1,241.3</b>	<b>1,865.8</b>	<b>50.3</b>
Tax	-387.7	-596.9	54.0
<i>Tax Rate (%)</i>	<i>31.2</i>	<i>32.0</i>	<i>76 bps</i>
<b>PAT</b>	<b>853.6</b>	<b>1,268.9</b>	<b>48.7</b>
Exceptional items	-26.2	-130.3	397.3
<b>PAT after Exceptionals</b>	<b>827.4</b>	<b>1,138.6</b>	<b>37.6</b>
No of shares	95.9	95.9	
<b>EPS</b>	<b>8.9</b>	<b>13.2</b>	<b>48.7</b>
<b>Cost Details</b>			
Total Raw Material Cost	6,014.3	6,654.4	10.6
<i>% of Sales</i>	<i>60.3</i>	<i>58.7</i>	<i>-153 bps</i>
Employee/Staff Cost	686.3	750.2	9.3
<i>% of Sales</i>	<i>6.9</i>	<i>6.6</i>	<i>-26 bps</i>
Other Expenditure	1,938.1	2,111.3	8.9
<i>% of Sales</i>	<i>19.4</i>	<i>18.6</i>	<i>-79 bps</i>

Source: Company Reports, Citi Investment Research

Figure 2. Asian Paints (Consolidated): 2QFY08 Sales Break-up (Rupees in Millions, Percent)

Rs Mn	2QFY07	2QFY08	% yoy
APL Paints	7638.2	8644.8	13.2
Chemicals	198.5	252.9	27.4
APPG+APICL	483	642.4	33.0
International	1661.1	1791.6	7.9
<b>Total Sales</b>	<b>9980.8</b>	<b>11331.7</b>	<b>13.5</b>

Source: Company Reports

We are moving our earnings basis to consolidated from standalone. Our model now is on a consolidated basis. Our new price target of Rs1102 is based on 25x FY09E consolidated EPS.

## 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 Indian paints industry.

### **Investment strategy**

The rise in urbanization, higher disposable incomes, cheaper housing loans and a shift from semi-permanent to permanent housing structures are driving the paints market at over 1.5x GDP growth. Asian Paints enjoys competitive advantages that should help it outpace the market — 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. The Berger acquisition in 2002 increased the share of revenues from the overseas ventures to more than 20% of group sales, from 5%. Over the past 10 years, Asian Paints' profit CAGR has been 15%; we expect this to pick up over the next three years.

### **Valuation**

We prefer P/E as our primary valuation tool because the company operates in a non-cyclical industry. Being the market leader, the company also has reasonable pricing power. Historically, the stock has traded at an average of 16x one-year rolling forward EPS for the standalone entity. However, we believe the stock is a re-rating candidate (especially with international operations turning around and local growth accelerating) and could trade at over 20x-25x P/E, the higher end of its historical trading band. Our target price of Rs1102 is based on 25x FY09E consolidated EPS. Our target multiple reflects the pickup in the growth profile of Asian Paints' domestic paints business and increasing profitability of the international and industrial coatings businesses. Our 25x target multiple is in line with what we attribute to other mid-cap consumer stocks in our universe that have similar growth and ROE characteristics.

### **Risks**

We rate Asian Paints as Low Risk based on our quantitative risk-rating system. The main downside risks that could impede the stock from reaching our target price include: (1) 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) If economic growth slows, it would affect demand for paints; (4) If Asian Paints is unable to aggressively respond to recent moves from the competition, it could lose market share; and (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.

# Appendix A-1

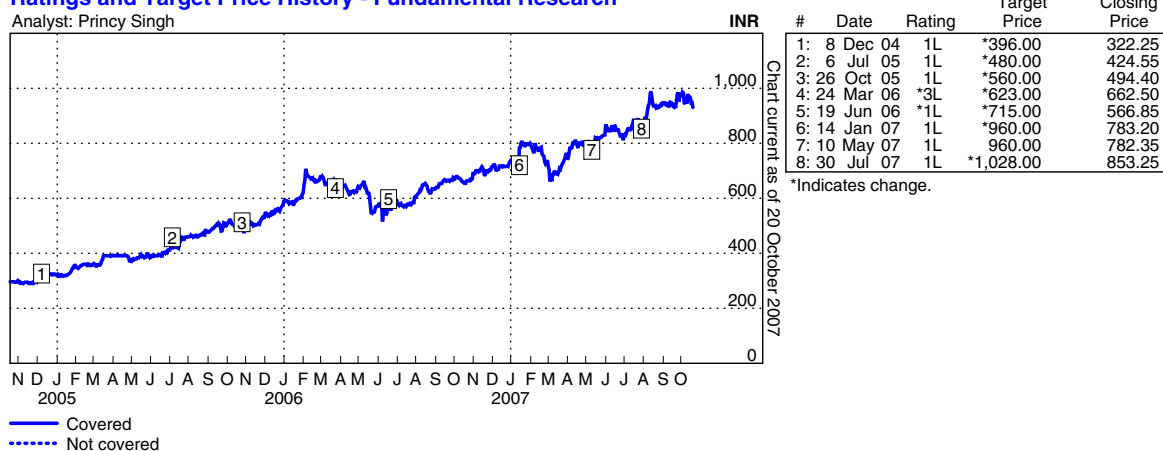
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Analyst: Princy Singh



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