

July 21st, 2011

ASIAN PAINTS

HOLD

Asian Paints is India's leading paint manufacturing company (also ranked amongst the top 10 decorative coating companies in the world) with a market share of ~50% in the organized paint market offering a wide array of products across price points.

- Robust demand witnessed in the Indian paint market:** Despite rising inflation and slowing GDP, the volume growth in the paint market has sustained in the range of 14%-18% yoy since the last 5 years. This is backed by buoyant demand from the decorative segment led by expansion in housing (witnessing growing rural demand) and construction sectors.
- Asian Paints benefits from its leadership position:** Leveraging on its brand equity and operational efficiency, it is able to maintain its EBITDA margins. In spite of constant price increases in FY11 (~15%) to set off the high inflation in key raw materials, the company saw a steady volume growth of ~18% in FY11.
- Massive capacity expansion plan:** To keep pace with the increasing demand for decorative coatings given the double digit volume growth, the Company has continually focused on augmenting its manufacturing capabilities
- Wide array of products and extensive network reach:** Asian Paints offers a wide array of products across all price points catering to different income groups. Its extensive distribution network of 27,000 dealers (~65% of total dealers), it will be able to tap the rising rural demand
- Valuations:** Although, fundamentally the stock seems attractive, there is limited upside from these levels.

Based on FY13 P/E multiple of 30, the fair value for the company works out to be Rs 3,496

Particulars (Rs. Mn)	FY08A	FY09A	FY10A	FY11A	FY12E	FY13E
Net Sales	44,072.3	54,639.0	66,809.4	77,062.0	93,626.0	112,351.2
Y-o-Y Growth (%)		24.0%	22.3%	15.3%	21.5%	20.0%
EBITDA	6,606.3	6,701.0	12,275.4	13,129.0	15,448.3	17,976.2
Y-o-Y Growth (%)		1.4%	83.2%	7.0%	17.7%	16.4%
PAT	4,092.0	3,978.5	8,355.2	8,432.0	9,578.7	11,176.6
Y-o-Y Growth (%)		-2.8%	110.0%	0.9%	13.6%	16.7%
EPS (Rs.)	42.7	41.5	87.1	87.9	99.9	116.5
BVPS (Rs.)	102.4	125.4	178.3	228.0	288.9	363.4
EBITDA margin (%)	15.0%	12.3%	18.4%	17.0%	16.5%	16.0%
PAT Margin (%)	9.3%	7.3%	12.5%	10.9%	10.2%	9.9%
ROE (%)	41.7%	33.1%	48.9%	38.5%	34.6%	32.1%
P/E	73.2	75.3	35.9	35.5	31.3	26.8
P/B	30.5	24.9	17.5	13.7	10.8	8.6

Recommendations	<= 1 year	1 - 2 yrs	2 - 5 yrs
Strong Buy			
Buy			
Hold			
Reduce			
Sell			

Strong Buy - Expected Returns > 20% p.a.

Buy - Expected Returns from 10 to 20% p.a.

Hold - Expected Returns from 0 % to 10% p.a.

Reduce - Expected Returns from 0 % to 10% p.a. with possible downside

Sell - Returns < 0 %



STOCK DATA

BSE / NSE Code	500820/ASIANPAINT
Bloomberg Code	APNT:IN
No. of Shares (Mn)	95.92
Sensex/Nifty	18503/5562

PRICE DATA

CMP Rs (20th Jul '11)	3123.5
Beta	0.637
Market Cap (Rs mn)	299,200
52 Week High-Low	3,387/2,364
2 Week Avg Volume (L)	5,456

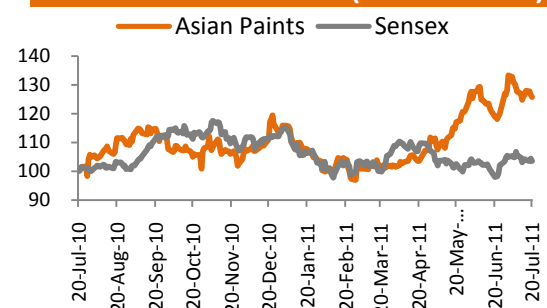
STOCK RETURN (%)

	30D	3M	6M	1Y
Asian Paints	6%	21%	17%	26%
Sensex	6%	-6%	-3%	3%
Nifty	6%	-5%	-3%	4%

SHARE HOLDER PATTERN (%)

Promoter	52.3%
Foreign	16.2%
Institution	11.6%
Corporate Holdings	6.2%
Public & Others	13.7%
Total	100.0%

1 Year Price Performance (Rel. to Sensex)



Call us at
39400800



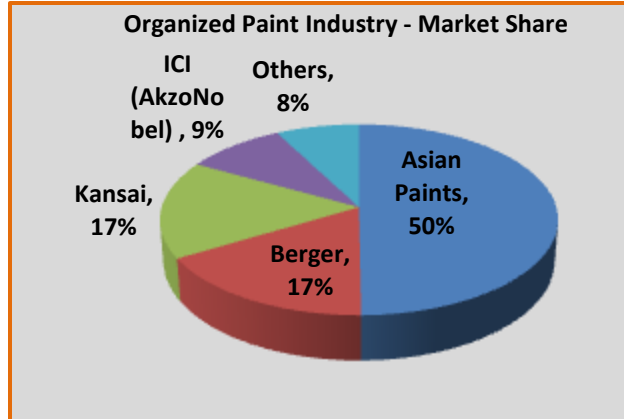
BUSINESS PROFILE

Asian Paints is India's leading paint manufacturing company with a market share of ~50% in the organized paint market offering a wide array of products across price points. It is also ranked amongst the top 10 decorative coating companies in the world. Its business is majorly dominated by the Decorative paints segment (house paints) which accounts for ~70% of Asian Paints revenue. The company operates through an extensive distribution network of 27,000 dealers (~65% of the complete dealer network) and 90 depots.

Given the market dominance stance and strong brand equity, Asian Paints enjoys strong pricing power in the industry which is reflected in FY11 wherein it increased the prices five times aggregating to ~14% due to price rise in raw materials. This substantial increase in prices did not affect demand which continued to be robust.

The company believes in adding innovation to its offerings with services like

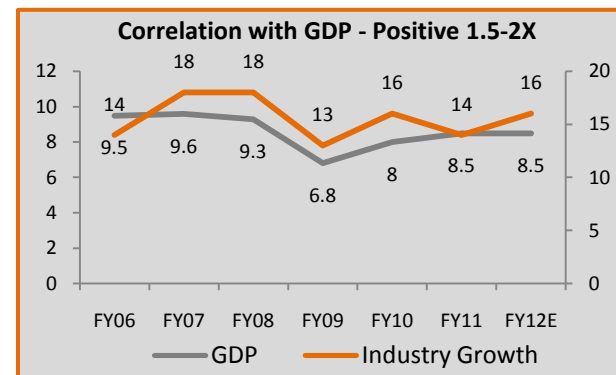
- **Colour Ideas** where the consumer is provided with an environment wherein he can experience what colour can do to his home along with Colour Consultancy Services.
- **Tinting machines** which enables a dealer to have the inventory for the base paint and can create different shades by adding pigments. This helps the dealer to save the inventory and packaging cost while improving margins.
- **Trial Paint kits** to enable the customer to try the paint at a lower cost instead of buying the whole tin.



INDUSTRY

The Indian paint industry estimated at ~Rs 19,000cr has shown a volume growth of ~14-18% y-o-y since FY06. The growth in the paint industry is highly correlated to the GDP growth by (~1.5-2x). Given the 8.5% growth rate for the Indian economy for FY12, the Indian paint industry is expected to show a volume growth of 15-16% led by robust demand

65% of the industry is organized of which the major market share owners are Asian Paints, Kansai Nerolac, Berger and ICI (AkzoNobel). The paints are largely classified into two segments - industrial and decorative.



Decorative paints constitute ~75% of the Indian paint market which are broadly house paints (emulsions, enamels, distempers etc). Change in consumption pattern from distempers to enamels has led to an uptrading in this segment. The growth in this segment is led by repainting (which off lately has witnessed shorter cycles) and growth in real estate.

Automotive and white goods paints mainly contribute to the industrial segment which is driven by growth in infrastructure spending (roads, rails, ports etc) and automotive sector.

Paints are distributed majorly through dealers instead of having their own shops. There are approximately 40,000 dealers in the country which is expected to grow in the range 5-7% annually.

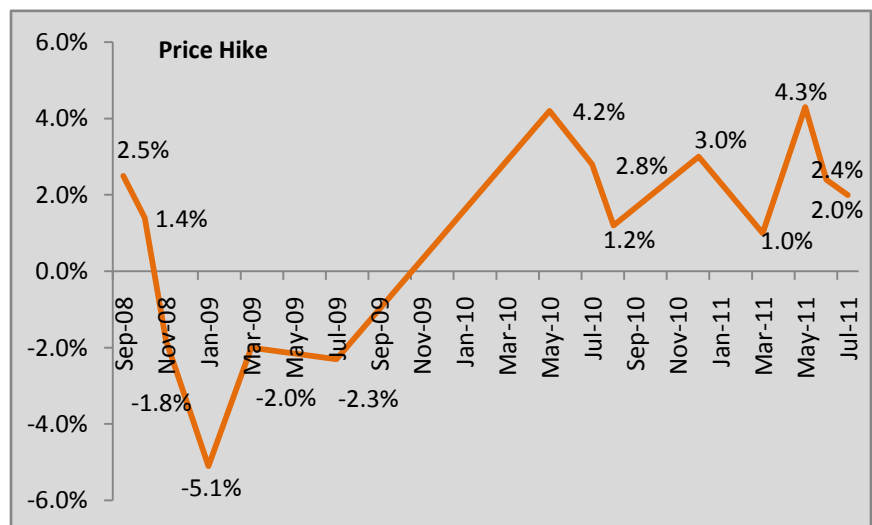
KEY TRIGGERS

Robust demand witnessed in the Indian paint market

Despite rising inflation and slowing GDP, the volume growth in the paint market has sustained in the range of 14%-18% yoy since the last 5 years. This is backed by buoyant demand from the decorative segment led by expansion in housing and construction sectors. The company reported that demand from rural and smaller towns (which account for ~40%-50% of sales) were significantly better than the metros/large cities of the country (growth was ~150-200 bps higher). Paints also experienced a change in consumption pattern which is a shift from distemper to enamels and emulsions (products with higher margins) and shorter repainting cycles (repainting accounts for ~75% of sales in decorative segment).

Asian Paints benefits from its leadership position

Asian Paints is well positioned as the leader in Indian decorative paints segment. It leverages on its brand equity and operational efficiency built over the years to maintain its EBITDA margins. In spite of constant price increases in FY11 (~15%) and in the beginning of FY12 (~9%) to set off the high inflation in key raw materials, the company saw a steady volume growth of ~18% in FY11. Please refer the price chart below that states the price hike done by the company at different time intervals. In spite of spiraling raw material costs, it has achieved a revenue growth of 23.4%. This makes it a 5 year CAGR of 22.2% in revenue and 32.9% in net profits.



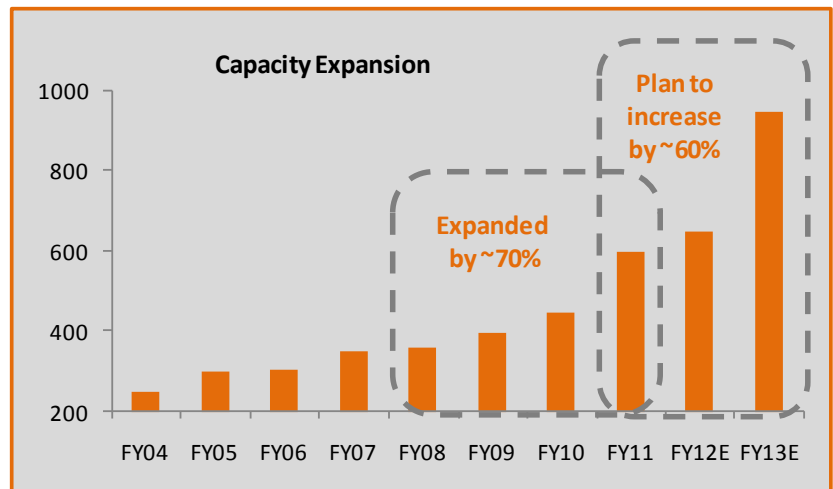
We have found that due to operational efficiency and effective management of advertising & promotional expenses (as a % of sales has reduced from 30 to 25), the company has been able to increase the realization per liter by ~40% despite same incremental effect in raw material costs since FY2004.

The company was able to maintain the margins also due to a shift in consumption pattern from distemper to emulsions and enamels (which provide better realizations and higher margins comparatively)

Massive capacity expansion plan

To keep pace with the increasing demand for decorative coatings given the double digit volume growth, the Company has continually focused on augmenting its manufacturing capabilities (refer graph on the side).

In April 2010, the manufacturing facility at Rohtak, Haryana was commissioned with an initial capacity of 150,000 KL per annum. The Company has plans to increase the installed capacity at this plant to 200,000 KL per annum by Q4FY12 while it can be scaled up to 400,000 KL per annum. Along with this, the construction work of the seventh decorative paint plant in Khandala, Maharashtra has also commenced which is expected to



commission by end of FY13 with an initial capacity of 300,000 KL per annum. Apart from these, the company also plans to set up manufacturing unit in Andhra Pradesh and expand its existing unit in Hyderabad.

The Company has plans to form a new 50:50 joint venture with PPG Industries (with whom it already has a JV to cater the industrial paint segment which forms a small part of its sales ~16-17%) for servicing the protective, powder coatings, industrial containers and light industrial coatings markets. This new joint venture will leverage PPG's technology and global customer relationships while continuing to build on Asian Paints' customer base, manufacturing footprint, distribution channels and local relationships. However, the growth in automotive and industrial paint seems challenging given the current interest rate tightening scenario.

Wide array of products and extensive network reach

Asian Paints offers a wide array of products across all price points catering to different income groups. During FY11, it launched water based wood finishes in North which would be launched across in a phased manner. New textured finishes for



the exteriors – Duracast Pebbletex and Crosstex were launched and met with good response from builders/ contractors for large projects. Along with new products, it brings a lot of innovative offering (color ideas, tinting machines, trial kits etc) through its extensive distribution network of 27,000 dealers (~65% of total dealers). Given the rising rural demand for paints, it is likely to benefit the most with its extensive network reach.

KEY CHALLENGES

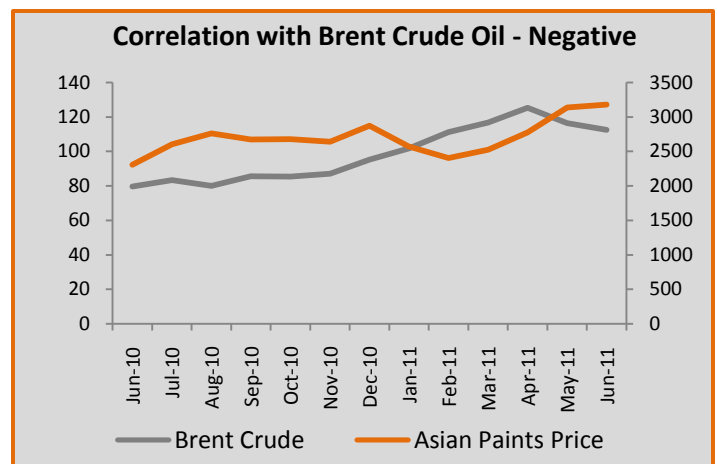
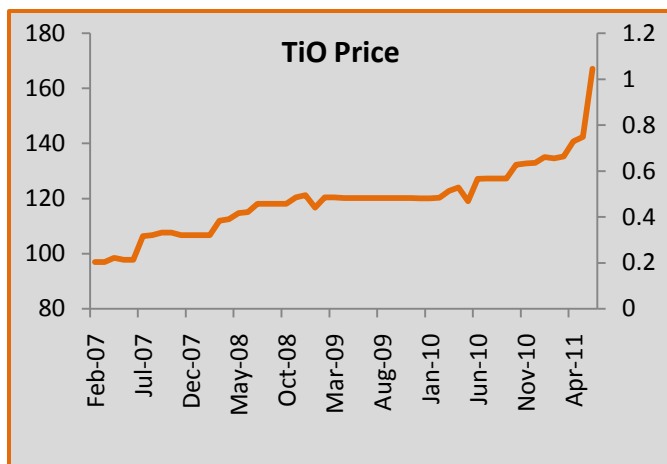
Demand likely to see a slowdown in short term due to slack in Real Estate projects

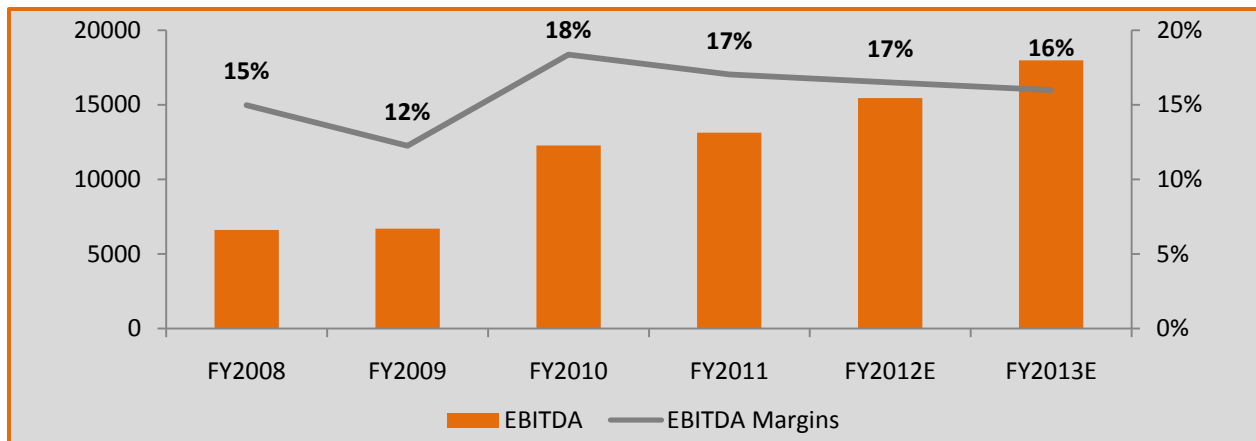
Amidst rising interest rates and high inflation, we are witnessing a slack in volumes in the real estate projects which will affect the demand for decorative paints. Consumers might postpone the repainting of their existing houses due to rising costs and also due to monsoons.

High inflation in input cost

Sharp rise in input costs of key items like titanium dioxide and crude based derivatives remains a key challenge for the company (raw materials account for ~60% of sales). As can be seen in the chart below, the EBITDA margins have declined in FY11 and are expected to decline further in FY2012-13. Margins were affected due to weak global demand on the back of unrest in caribbean regions and increasing raw materials.

Considering the ~15% price rise in FY11, the company has limited scope to increase the price further. Also, due to intense competition in the Indian paint market (with new foreign entrants like Jotun Paints, Nippon and Sherwin Williams) the company would find it difficult to cut down on advertising and promotional expenses. Also, price hikes in non decorative paints have been minimal and is likely to affect the margins in this segment.





PEER COMPARISON

Company Name	Net Sales (Rs. mn)	PAT (Rs. mn)	EBITDA Margin (%)	PAT Margin (%)	ROE (%)	P/E (TTM)
Asian Paints	77,062	8,432	17%	11%	39%	35
Kansai Nerolac	22,587	2,060	11%	9%	22%	23
Berger Paints	23,281	1,501	12%	6%	23%	24
Akzo Nobel (ICI India)	12,110	1,766	9%	14%	16%	19

**FY11 figures

Asian Paints is the market leader in the paints industry and has the strongest network reach. It also has a wide array of products across price points with innovative offerings. Because of these factors, Asian Paints has the highest EBITDA Margin and ROE in the industry. Akzo Nobel is strong in premium products while Berger is focused on lower end paints. Kansai is a leader in industrial paints mainly driven by auto paints which is going through a slowdown. However, considering the fact that Asian Paints is trading at a higher P/E, the stock must have priced in all the positives and hence the upside from these levels may be limited unless we witness a better-than-expected volume growth.



VALUATIONS

The overall economic outlook for 2011-12 appears to be positive but challenging. The market for Industrial products is expected to slowdown given the fall in auto sales and sluggish infrastructure development and industrial growth.

While demand for decorative paints has been steady with a double-digit growth and the overall environment for Asian Paints looks positive, risks like input cost inflation, global slowdown and rising interest rate (affecting the housing sector) may have a short term negative impact. We believe the stock has factored most of the positive as it is currently trading at ~17% premium to its average historical P/E and has outperformed the index by ~30% post its listing on the MSCI Index.

Although, fundamentally the stock seems attractive, there is limited upside from these levels. **Based on an average FY13 P/E multiple of 30, the fair value for the company works out to be Rs 3,496**

Key Assumptions	FY08A	FY09A	FY10A	FY11A	FY12E	FY13E
Paints growth (% YoY)	18%	13%	16%	14%	14%	16%
Raw Materials (% of net sales)		58.5%	61.7%	56.2%	58.1%	59.0%
Overheads (% of net sales)		26.0%	25.4%	24.9%	25.0%	25.0%
Capex (Rs mn)		2,196	3,611	2,500	9,000	5,000
Tax Rate (% of PBT)		31.8%	31.3%	30.1%	31.0%	31.0%
Depreciation		5.09%	5.57%	5.69%	5.70%	5.70%

**It plans to spend Rs 9000mn in FY12 on account of its expansion in Rohtak Plant by 50,000 KL along with its new 300,000 KL green field plants in Khandala. The JV with PPG industries in the industrial paint segment is expected to be operational by Dec 2011.*

Income Statement (RsM)	2008A	2009A	2010A	2011A	2012E	2013E
Gross Sales	49,385.6	60,438.4	71,065.6	83,614.7	101,591.9	121,910.2
Net sales	44,072.3	54,639.0	66,809.4	77,062.0	93,626.0	112,351.2
Growth	20.1%	24.0%	22.3%	15.3%	21.5%	20.0%
Materials Cost	(25,776.0)	(33,706.0)	(37,580.0)	(44,746.0)	(54,771.2)	(66,287.2)
% of Net Sales	58.5%	61.7%	56.2%	58.1%	58.5%	59.0%
Overheads	(11,690.0)	(14,232.0)	(16,954.0)	(19,187.0)	(23,406.5)	(28,087.8)
% of Net Sales	26.5%	26.0%	25.4%	24.9%	25.0%	25.0%
Research & development	0.0	0.0	0.0	0.0	0.0	0.0
Other operating items	0.0	0.0	0.0	0.0	0.0	0.0
EBITDA	6,606.3	6,701.0	12,275.4	13,129.0	15,448.3	17,976.2
Depreciation	(592.0)	(744.0)	(836.0)	(1,131.0)	(1,646.0)	(1,931.0)
EBIT	6,014.3	5,957.0	11,439.4	11,998.0	13,802.3	16,045.2
Total other non-operating income	596.0	510.1	777.8	826.0	850.0	900.0
Net interest income/expense	(211.6)	(263.2)	(284.7)	(222.0)	(218.0)	(195.0)
Exceptional items	0.0	0.0	0.0	0.0	0.0	0.0
Pretax profit	6,398.7	6,203.9	11,932.5	12,602.0	14,434.3	16,750.2
Taxation	(2,033.7)	(1,973.9)	(3,731.1)	(3,789.0)	(4,474.6)	(5,192.6)
Minority interest	(188.7)	(216.4)	(482.7)	(381.0)	(381.0)	(381.0)
Preferred dividends	0.0	0.0	0.0	0.0	0.0	0.0
Net extraordinary items	(84.3)	(35.1)	636.5	0.0	0.0	0.0
Reported net income	4,092.0	3,978.5	8,355.2	8,432.0	9,578.7	11,176.6
Dividend Paid	1,907.8	1,967.4	3,023.1	3,570.5	3,740.9	4,028.6
Retained Earnings	2,184.2	2,011.1	5,332.1	4,861.5	5,837.8	7,148.0



Balance Sheet (RsM)	2006A	2007A	2008A	2009A	2010A	2011A	2012E	2013E
Cash and marketable securities	734.1	1,053.9	1,107.1	2,103.7	1,058.3	1,330.4	2,518.9	4,218.1
Accounts receivable	3,475.2	4,206.1	4,603.3	5,719.2	5,425.2	5,855.3	7,182.3	8,618.7
Inventory	4,888.7	5,980.1	7,140.1	7,689.5	9,558.8	13,054.3	12,825.5	15,390.6
Other Current Assets			560.5	496.7	648.4	895.1	895.1	895.1
Loans & Advances			1,525.2	1,978.0	1,746.2	2,054.4	2,054.4	2,054.4
Total Current assets	10,454.4	12,913.0	14,936.2	17,987.1	18,436.9	23,189.5	25,476.1	31,176.9
Net tangible fixed assets	4,518.3	4,931.7	6,917.4	9,051.4	12,800.5	13,160.0	20,514.0	23,583.0
Investments	1,640.6	1,927.2	2,766.5	784.0	6,241.1	9,219.5	7,241.1	7,241.1
Net goodwill	448.7	468.7	443.5	505.5	367.3	371.9	367.3	367.3
Total assets	17,061.9	20,240.6	25,063.6	28,328.0	37,845.8	45,940.9	53,598.5	62,368.4
Accounts payable	3,296.3	4,485.4	5,719.6	5,541.5	7,183.2	8,913.8	10,928.9	13,240.4
Total other current liabilities	2,491.1	3,385.0	4,139.7	4,569.9	6,613.3	7,489.9	7,489.9	7,489.9
Total provisions	1,258.5	662.1	1,664.0	1,810.0	3,150.4	3,365.3	3,365.3	3,365.3
Current liabilities	5,787.4	7,870.4	11,523.3	11,921.4	16,946.9	19,769.0	21,784.1	24,095.6
Long-term debt	2,612.8	3,061.8	2,752.1	3,086.2	2,292.3	2,347.0	1,703.6	500.0
Deferred Tax	340.7	267.9	390.8	533.1	562.3	851.8	562.3	562.3
Total liabilities	9,999.4	11,862.1	14,666.2	15,540.7	19,801.5	22,967.8	24,050.0	25,157.9
Minority interest - accumulated	600.3	600.8	573.7	755.7	944.5	1,098.9	1,836.5	2,350.5
Shareholders' Equity	6,462.5	7,778.0	9,823.8	12,031.7	17,099.8	21,874.2	27,712.0	34,860.0
Shareholders' funds	7,062.8	8,378.8	10,397.5	12,787.4	18,044.3	22,973.1	29,548.5	37,210.5
Liabilities and shareholders' funds	17,062.1	20,240.8	25,063.7	28,328.1	37,845.8	45,940.9	53,598.5	62,368.4

EBITDA Calculation (RsM)	2008A	2009A	2010A	2011A	2012E	2013E
EBIT	6,014.3	5,957.0	11,439.4	11,998.0	13,802.3	16,045.2
Depreciation & amortization	(592.0)	(744.0)	(836.0)	(1,131.0)	(1,646.0)	(1,931.0)
EBITDA	6,606.3	6,701.0	12,275.4	13,129.0	15,448.3	17,976.2

Share Data (M)	2008A	2009A	2010A	2011A	2012E	2013E
Period-end ordinary shares -	95.9	95.9	95.9	95.9	95.9	95.9
Market Cap	305,505.2	305,505.2	305,505.2	305,505.2	305,505.2	305,505.2
EV	307,150.2	306,487.7	306,739.2	306,521.8	304,689.9	301,787.1
Shareholders' Equity	9,823.8	12,031.7	17,099.8	21,874.2	27,712.0	34,860.0

Per Share Data (Rs)	2008A	2009A	2010A	2011A	2012E	2013E
EPS	42.66	41.48	87.11	87.91	99.86	116.52
DPS	19.89	20.51	31.52	37.22	39.00	42.00
P/E	73.22	75.31	35.86	35.53	31.28	26.81
BVPS	102.42	125.43	178.27	228.05	288.91	363.43
P/B	30.50	24.90	17.52	13.70	10.81	8.59

Cash Flow (RsM)	2009A	2010A	2011A	2012E	2013E
PAT	3,979	8,355	8,432	9,579	11,177
Depreciation	744	836	1,131	1,646	1,931
change in WC	(1,656)	3,530	(1,658)	917	(1,690)
Operating cash flow	3,066	12,722	7,905	12,142	11,418
Capex	(2,878)	(4,585)	(1,491)	(9,000)	(5,000)
free Cash Flow	188	8,136	6,414	3,142	6,418
Change in debt	334	(794)	55	(643)	(1,204)
Change in equity	197	(264)	(87)	0	0
Dividend paid	(1,967)	(3,023)	(3,571)	(3,741)	(4,029)
Change in investment	1,983	(5,457)	(2,978)	1,978	0
Others	262	356	439	453	514
	997	(1,046)	272	1,188	1,699

