

Asian Paints

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Valuations are now fair

We recently met Asian Paints' management to get a sense of the company's international business as well as the raw material scenario. We maintain our earnings estimates and the price target. However, we downgrade the stock to **Neutral** and drop it for the first time from our top pick list.

Investment Rationale

- The company expects improved performance in the international business and some improvement in the raw material scenario. We maintain our estimates, but downgrade the stock to Neutral, based solely on the upside from the current levels. We maintain our price target of Rs 900.
- International business performance is expected to continue improving on the back of improvements in the ME, South Asian and Caribbean. South East Asia shows little signs of improvement.
- Raw material inflation seems under control. Some of the raw materials have seen some decline in prices in the recent past. However, we see crude holding higher in the last few weeks with some upward pressure.
- Domestic demand seems still quite robust. The entry of some new players is unlikely to impact the incumbents any time soon, particularly in the decoratives segment.

Downgrade to Neutral

- We downgrade the stock to Neutral from Outperformer purely on the upside from the current levels. We continue to see a robust business performance. We like the excellent management of the tough environment in which the company is operating. The stock is currently trading at 23x FY08E and 19x FY09E EPS. We maintain our price target of Rs 900.

Downgrade Neutral/Rs 855
Target Rs 900 (+5%)

Sector (Relative to market)

OW	N	UW
	N	

Stock (Relative to market)

B	OP	N	UP	S
		N		
> 10%	5% to 10%	5% to -5%	-5% to -10%	< -10%

This note should be read for

- *Company Visit*
- *Downgrade and drop from top pick list*

Bloomberg code : APNT IN
 Reuters code : ASPN.BO
 www.asianpaints.com

BSE Sensex : 14064
 NSE Nifty : 4145

Company data

O/S shares :	96mn
Market cap (Rs) :	81bn
Market cap (USD) :	2bn
52 - wk Hi/Lo (Rs) :	899 / 500
Avg. daily vol. (3mth) :	52,435
Face Value (Rs) :	10

Share holding pattern, %

Promoters :	47.8
FII / NRI :	22.4
FI / MF :	11.1
Non Promoter Corp. Holdings :	2.9
Public & Others :	15.8

Price performance, %

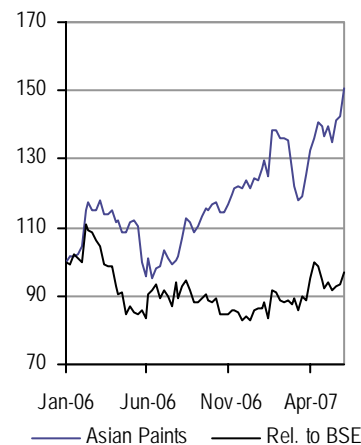
	1mth	3mth	1yr
Abs	6.8	22.2	47.9
Rel to BSE	2.8	9.7	9.2

Valuation summary

Y/E Mar, Rs mn	FY05	FY06	FY07E	FY08E	FY09E
Total Income	25,739	30,210	36,709	43,176	50,356
Total income Growth, %	16.0	17.4	21.5	17.6	16.6
Core EBIDTA	3,351	3,917	4,779	5,859	7,029
EBIDTA margins, %	13.0	13.0	13.0	13.6	14.0
Net profit	1,744	2,132	2,846	3,547	4,330
PAT margins, %	6.8	7.1	7.8	8.2	8.6
EPS, Rs	18.2	22.2	29.7	37.0	45.1
EPS Growth, %	20.5	22.2	33.5	24.6	22.1
PER, x	46.7	38.2	28.6	23.0	18.8
EV/EBIDTA, x	25.0	21.3	17.3	14.1	11.5
EV/Net Sales, x	3.3	2.8	2.3	1.9	1.6
Price/Book Value, x	12.9	11.5	9.6	8.3	7.2
ROIC, %	24.0	25.6	34.3	38.5	42.7
ROE, %	28.4	31.9	36.6	38.8	41.0
Dividend Yield, %	1.1	1.5	1.5	2.4	3.0

Source: Company, Man Financial Research Estimates

Price vs. Sensex



Source: Bloomberg, Man Financial Research

We met Asian Paints' management recently in a bid to understand the likelihood of better international business performance as well as developments on the raw material front. We sensed that the management is positive on the likelihood of an improved international business compared with last year. On the raw material front, it looked comfortable with the current price table.

Improvement in international business

International business, which showed a strong growth (9x) in EBIT, is expected to perform better in FY08E. The Middle East market, which was largely responsible for the EBIT jump in FY07, continues to benefit from the robust growth in the construction industry. Expanding the product portfolio and adding DTS machines is helping the company. In the South Asian markets, both Bangladesh and Sri Lanka are expected to move towards improved profitability as volumes increase. However, the political uncertainty in these markets can have its own fallout, which could temporarily upset demand. The Egypt market continues to do well consistently after a strong performance over the last three years. The company's Caribbean business, which had a poor Q4FY07 due to cement shortage in the market, has started the year well and is expected to do better. EBIT had declined almost 60% in FY07 due to gross margin pressure and poor top-line growth (12%). We expect some improvement in both the top line as well as bottom line in the Caribbean.

Positive- ME, Egypt, South East Asia
Negative- South Asia

We are, however, concerned with the South East Asian markets, which pulled down the overall profitability quite sharply. The company is working primarily to cut losses in these markets. **Overall, we believe that profitability will move up further from FY07 levels.**

International Performance Summary

Value Sales (Rs mn)	FY07	FY06	YoY chng, %
Caribbean	1523	1359	12.1
ME	2606	1981	31.5
South Asia	621	471	31.8
SE Asia	843	766	10.1
South Pacific	725	660	9.8
	6318	5237	20.6
EBIT (Rs mn)			
Caribbean	28	68	-58.8
ME	253	93	172.0
South Asia	10	-19	-152.6
SE Asia	-127	-154	-17.5
South Pacific	23	32	-28.1
	187	20	835.0
EBIT Margin (%)			bps chng
Caribbean	1.8	5.0	-317
ME	9.7	4.7	501
South Asia	1.6	-4.0	564
SE Asia	-15.1	-20.1	504
South Pacific	3.2	4.8	-168
Total	3.0	0.4	258

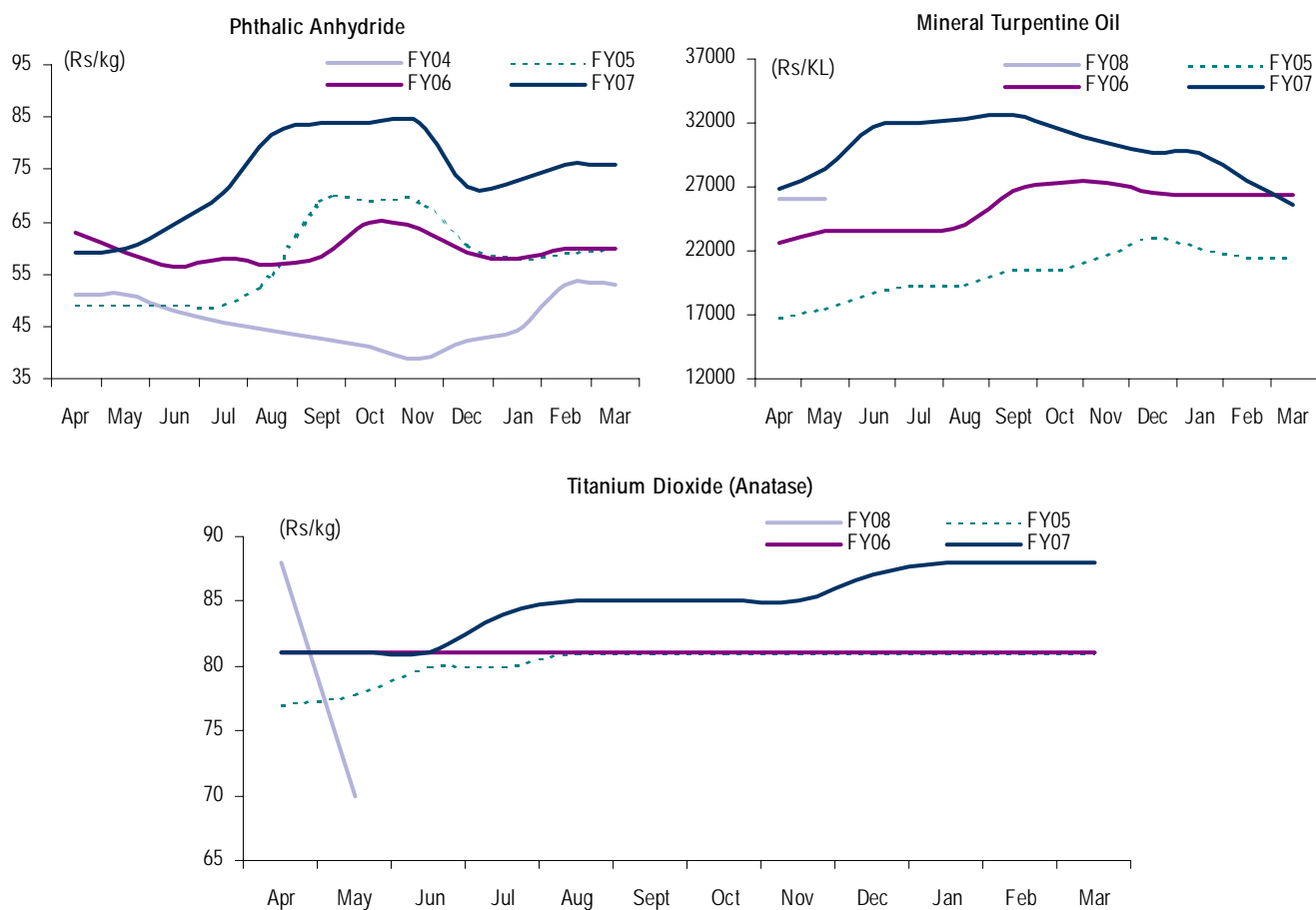
Source: Company, Man Financial Research

Raw material scenario looking better

We have seen some of the key raw material prices slide in the last couple of months. Prices of titanium dioxide (TiO₂) have declined as a result of lower customs duty (down 2.5%) and the strengthening rupee. However, recently titanium dioxide prices have been raised by DuPont Titanium Technologies (the largest TiO₂ producer globally) and a few other players in all markets by around 5c/lb. We have also seen Mineral Turpentine Oil (MTO) prices decline on a YoY basis since March'07. Phthalic Anhydride (PAN) has also seen a similar declining trend. While crude price still remains a risk, we do not see the raw material inflationary pressure remaining similar in FY08.

Key raw material prices are lower in the last couple of months. However, sustainability through the year is still doubtful

Raw materials- In a benevolent mode



Source: Company, Capitaline, Man Financial Research

Downgrade to Neutral; remove from our top picks

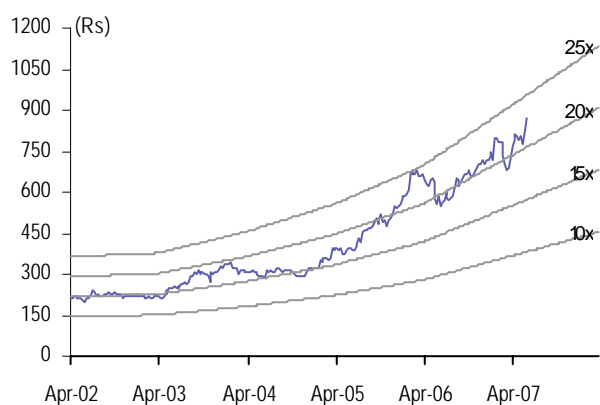
We downgrade the stock to **Neutral** from Outperformer purely on the upside from the current levels. We continue to see a robust business performance and like the excellent management of the tough environment in which the company is operating. The stock has been one of the best performers in the sector and has delivered these returns with lower price volatility as well. However, we believe that the valuations currently cap the upside. We do not see a high probability of any likely upgrade of our estimates for the year. We also replace the stock with Godrej Consumer Products Limited in our top pick list. We had maintained the stock as our top pick for over a year now.

The stock is currently trading at 23x FY08E and 19x FY09E EPS. While these multiples are lower than their recent highs, these are fair and in line with the likely slower growth in earnings. We maintain our price target of Rs 900, implying an upside of 5% from CMP.

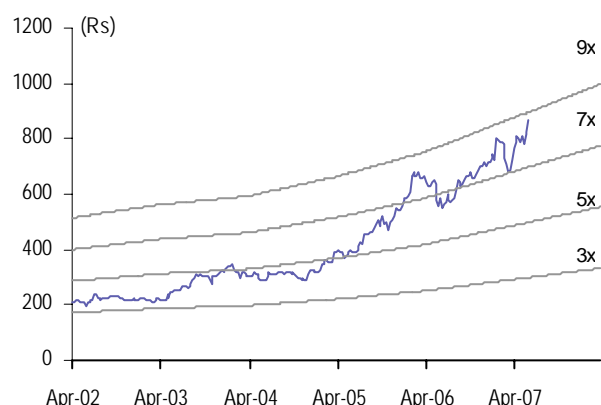
Valuations fair. Maintain our target and earnings estimates.

ABSOLUTE ROLLING VALUATION BAND CHARTS

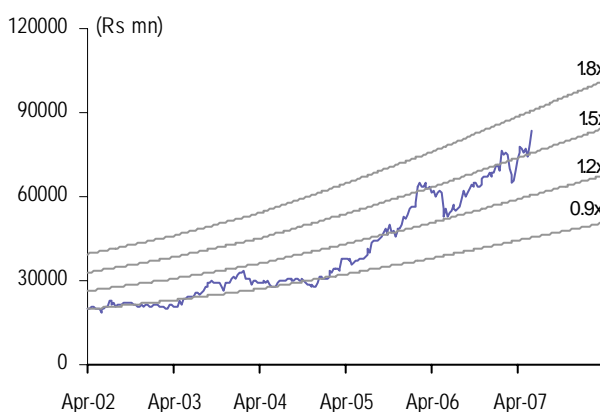
PE band



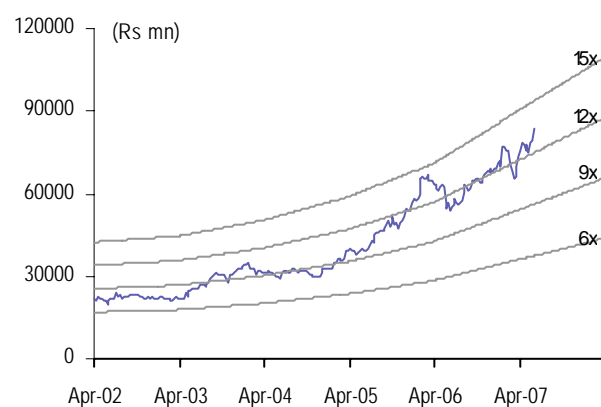
PBV band



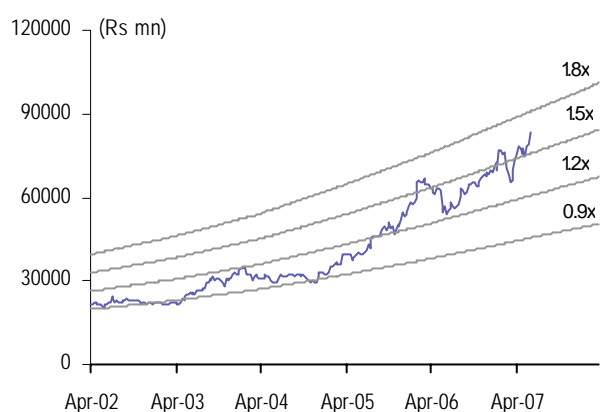
MCap/Sales band



EV/EBIDTA band



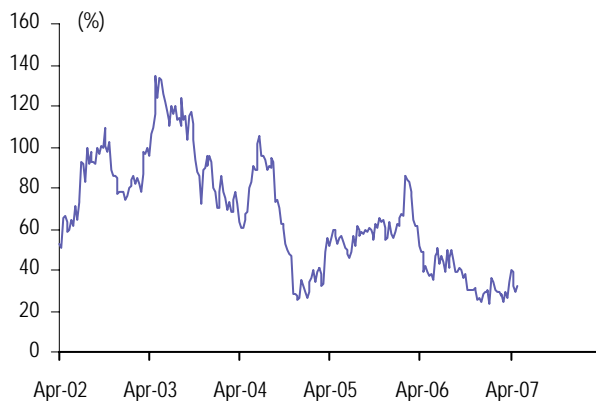
EV/Sales band



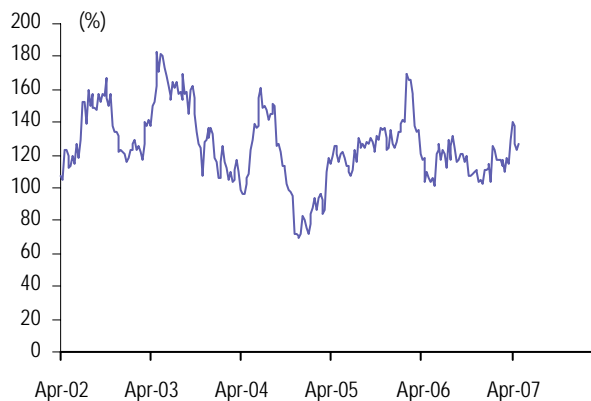
Source: Man Financial Research

PREMIUM / DISCOUNT TO SENSEX

PE



PBV

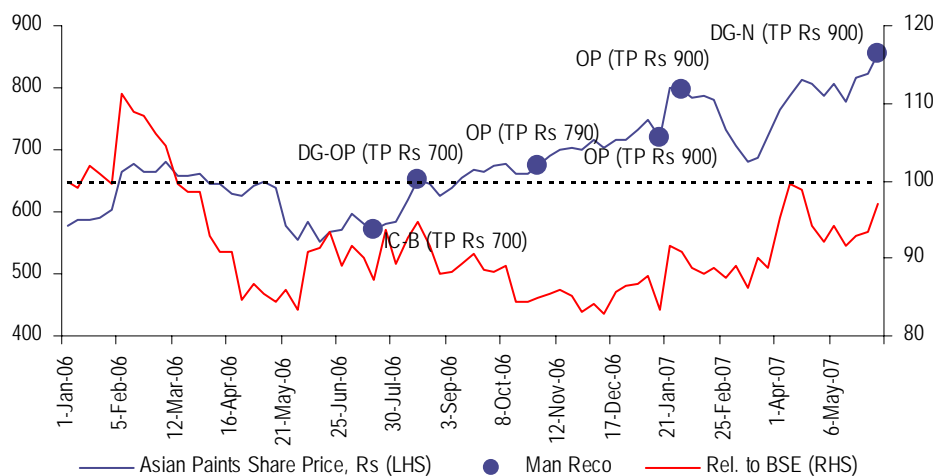


MCap/Sales



Source: Man Financial Research

Recommendation performance



IC = Initiating Coverage; DG = Downgrade; UG = Upgrade; TP = Target Price;
 OP = Outperformer; UP = Underperformer; N = Neutral; S = Sell, B = Buy
 Source: Bloomberg, Man Financial Research

FINANCIALS

Income Statement

(Rs mn)	FY05	FY06	FY07E	FY08E	FY09E
Net sales	25,497	29,982	36,448	42,884	50,027
<i>Growth, %</i>	<i>16.4</i>	<i>17.6</i>	<i>21.6</i>	<i>17.7</i>	<i>16.7</i>
Other operating income	242	228	261	292	328
Total income	25,739	30,210	36,709	43,176	50,356
Operating expenses	-22,387	-26,293	-31,929	-37,317	-43,327
EBITDA	3,351	3,917	4,779	5,859	7,029
<i>Growth, %</i>	<i>12.8</i>	<i>16.9</i>	<i>22.0</i>	<i>22.6</i>	<i>20.0</i>
<i>Margin, %</i>	<i>13.0</i>	<i>13.0</i>	<i>13.0</i>	<i>13.6</i>	<i>14.0</i>
Depreciation	-691	-682	-610	-699	-744
EBIT	2,661	3,235	4,170	5,161	6,285
<i>Growth, %</i>	<i>17.5</i>	<i>21.6</i>	<i>28.9</i>	<i>23.8</i>	<i>21.8</i>
<i>Margin, %</i>	<i>10.3</i>	<i>10.7</i>	<i>11.4</i>	<i>12.0</i>	<i>12.5</i>
Interest received/(paid)	-108	-114	-189	-142	-89
Other Income	324	320	368	371	377
Income from Associates	2	-9	-4	0	0
Pre-tax profit	2,878	3,431	4,344	5,389	6,573
Tax provided	-1,061	-1,323	-1,461	-1,818	-2,213
Profit after tax before MI	1,818	2,109	2,883	3,572	4,360
Minority Interest/Associates	-72	23	-21	-25	-30
PAT after MI & Extra-ordinary Items	1,741	2,121	2,808	3,547	4,330
MAN Net profit	1,744	2,132	2,846	3,547	4,330
<i>Growth, %</i>	<i>20.5</i>	<i>22.2</i>	<i>33.5</i>	<i>24.6</i>	<i>22.1</i>
Extraordinary items: Gains/(Losses)	-5	-10	-54	0	0
Unadj. shares (m)	96	96	96	96	96
Wtd avg shares (m)	96	96	96	96	96

Cash Flow

(Rs mn)	FY05	FY06	FY07E	FY08E	FY09E
Pre-tax profit	2,878	3,431	4,344	5,390	6,573
Depreciation	917	493	560	649	694
Chg in working capital	-1,407	-433	277	194	280
Total tax paid	-1,061	-1,323	-1,461	-1,817	-2,233
Other operating activities	-5	-10	-54	0	0
Cash flow from operating activities	1,322	2,159	3,666	4,415	5,313
Capital expenditure	-546	-642	-900	-2,350	-1,100
Chg in investments	0	-276	0	0	0
Chg in associates	0	0	0	0	0
Chg in marketable securities	-120	-227	-500	0	0
Chg in proceeds from sale of assets	0	0	0	0	0
Chg in acquisition/disposal of assets	0	0	0	0	0
Other investing activities	0	0	0	0	0
Cash flow from investing activities	-667	-1,145	-1,400	-2,350	-1,100
Free cash flow	655	1,014	2,266	2,065	4,213
Equity raised/(repaid)	-323	39	0	0	0
Chg in minorities	-131	-15	9	7	3
Debt raised/(repaid)	702	218	-263	-250	-1,500
Dividend (incl. tax)	-993	-1,130	-1,752	-2,028	-2,660
Other financing activities	0	0	0	0	0
Cash flow from financing activities	-745	-889	-2,006	-2,271	-4,157
Net chg in cash	-90	125	259	-206	56

Source: Company, Man Financial Research Estimates

Balance Sheet

(Rs mn)	FY05	FY06	FY07E	FY08E	FY09E
Cash & bank	608	734	994	787	845
Marketable securities at cost	264	490	990	990	990
Debtors	2,959	3,475	4,023	4,481	4,996
Inventory	4,545	4,889	4,779	4,792	4,820
Loans & advances	800	745	796	856	914
Other current assets	316	611	598	630	663
Total current assets	9,492	10,945	12,181	12,537	13,229
Investments	875	1,150	1,150	1,150	1,150
Gross fixed assets	9,355	9,766	10,666	13,016	14,116
Less: Depreciation	5,091	5,584	6,144	6,793	7,487
Add: Capital WIP	106	337	337	337	337
Net fixed assets	4,370	4,519	4,859	6,560	6,966
Other non-current assets	500	449	399	349	299
Total assets	15,237	17,062	18,589	20,596	21,644
Current liabilities	4,087	4,524	5,080	5,570	6,117
Tax payable	177	52	65	70	75
Dividends payable	528	767	436	679	846
Provisions	1,386	1,703	1,852	2,083	2,402
Total current liabilities	6,178	7,046	7,434	8,403	9,440
Non-current liabilities	2,748	2,953	2,676	2,406	881
Total liabilities	8,926	9,999	10,109	10,808	10,321
Paid-up capital	959	959	959	959	959
Reserves & surplus	4,713	5,503	6,889	8,166	9,669
Shareholders' equity	5,672	6,462	7,849	9,125	10,628
Minorities	639	600	630	662	695
Total equity & liabilities	15,237	17,062	18,588	20,595	21,644

Ratios Fundamentals

	FY05	FY06	FY07E	FY08E	FY09E
Performance Ratios					
Return on assets (%)	13.0	13.5	16.9	18.7	20.9
Return on equity (%)	28.4	31.9	36.6	38.8	41.0
Return on Invested capital (%)	24.0	25.6	34.3	38.5	42.7
RoC/Cost of capital (x)	2.3	2.3	2.8	3.1	3.3
RoC - Cost of capital (%)	13.6	14.4	22.2	26.2	29.9
Return on capital employed (%)	21.9	22.9	28.4	31.4	36.2
Cost of capital (%)	10.5	11.2	12.1	12.2	12.8
RoCE - Cost of capital (%)	11.4	11.7	16.4	19.2	23.4
Efficiency Ratios					
Asset turnover (x)	3.6	3.9	4.5	4.8	5.1
Sales/Total assets (x)	1.7	1.9	2.0	2.2	2.4
Sales/Net FA (x)	5.6	6.7	7.8	7.5	7.4
Working capital/Sales (x)	0.10	0.09	0.08	0.05	0.04
Fixed capital/Sales (x)	0.39	0.34	0.30	0.31	0.29
Receivable days	42.4	42.3	40.3	38.1	36.5
Inventory days	65.1	59.5	47.9	40.8	35.2
Payable days	66.6	62.8	58.1	54.5	51.5
Current ratio (x)	1.5	1.6	1.6	1.5	1.4
Quick ratio (x)	0.8	0.9	1.0	0.9	0.9
Interest cover (x)	24.6	28.3	22.1	36.2	70.4
Dividend cover (x)	1.9	1.8	2.3	1.8	1.8
Ratios: Valuations					
PER (x)	46.7	38.2	28.6	23.0	18.8
PEG (x) - y-o-y growth	2.3	1.7	0.9	0.9	0.9
Price/Book (x)	12.9	11.5	9.6	8.3	7.2
Yield (%)	1.1	1.5	1.5	2.4	3.0
EV/Net sales (x)	3.3	2.8	2.3	1.9	1.6
EV/EBITDA (x)	25.0	21.3	17.3	14.1	11.5
EV/EBIT (x)	31.4	25.8	19.8	16.0	12.9
EV/NOPLAT (x)	49.8	42.0	29.8	24.1	19.4
EV/CE	9.2	8.3	7.4	6.8	6.6

Source: Company, Man Financial Research Estimates

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