

14 March 2023

Asian Paints

Steady value creator offering entry opportunity; upgrading to a Buy

On industry interaction and channel checks, we expect Asian Paints' demand to rise, vs. weak Q3 volumes. Lower input prices would help margins expand from Q4. While we lower our FY23e/24e/FY25e 8%/6%/6% to factor in weak Q3 volumes and higher capex, we are optimistic of its earnings (~17% CAGR) over FY23-25. The recent stock-price fall provides an entry, driving our upgrade to a Buy at TP of Rs3,260 (55x FY25e EPS) vs. Rs3,570 (60x Sep'24e EPS) earlier.

Pricing discipline unlikely to be broken with new entrant. Despite new entries (JSW Paints), no price wars have been seen, a concern among the investor community. With the Grasim entry, we don't expect this to change as demand is expected to be steady and industry distribution is unlikely to accept price cut, which could curb all-round profitability.

Demand to improve post Q3 blip; channel check suggest upswing. The prolonged monsoon and early festivities curtailed Q3 volume growth, which rebounded in Dec and is expected to be healthy, per management. Our channel checks suggest some upswing in demand, post-Nov. But certain pockets saw keen competition from new dealers.

Margins could surprise. Past management guidance had been conservative. It suggested a lower 17-18% optimal EBITDA margin over FY16-FY17 but delivered ~20%. Thus, the current 17-20% margin guidance could be overshoot, given lower input prices and cost-efficiencies.

Rich valuations a constraint; stock-price drop offers entry. We acknowledge the rich valuations (53x FY24e EPS), but forecast 17% earnings CAGR over FY23-25 aided by margin gain. Paints companies have been the most consistent value creators over the last 3/5/10 years. This would continue, aided by steady earnings growth. **Risks:** Sharp rise in input costs; entrants disrupting the industry, capturing considerable market share.

Rating: Buy

Target Price: Rs.3,260

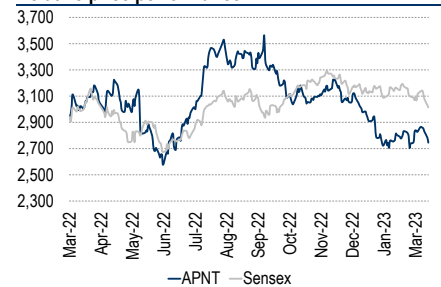
Share Price: Rs.2,783

Key data	APNT IN / ASPN.BO
52-week high / low	Rs3590 / 2560
Sensex / Nifty	57900 / 17043
3-m average volume	\$36.9m
Market cap	Rs2634bn / \$31925.5m
Shares outstanding	959m

Shareholding pattern (%)	Dec'22	Sep'22	June'22
Promoters	52.6	52.6	52.6
- of which, Pledged	7.6	10.6	11.0
Free Float	47.4	47.4	47.4
- Foreign Institutions	18.5	18.6	18.5
- Domestic Institutions	8.5	8.8	8.5
- Public	20.4	20.0	20.4

Estimates revision (%)	FY23e	FY24e	FY25e
Sales	-4	-4	-5
EBITDA	-8	-5	-5
PAT	-8	-6	-6

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY21	FY22	FY23e	FY24e	FY25e
Sales (Rs m)	2,17,128	2,91,013	3,44,420	3,85,061	4,27,033
Net profit (Rs m)	31,393	31,463	41,663	50,714	56,851
EPS (Rs)	32.7	32.8	43.4	52.9	59.3
P/E (x)	85.0	84.8	64.1	52.6	47.0
EV / EBITDA (x)	54.3	55.1	42.2	34.5	29.9
P/BV (x)	20.8	19.3	16.9	14.5	12.6
RoE (%)	24.5	22.8	26.3	27.6	26.8
RoCE (%)	25.7	22.1	26.3	28.0	27.3
Dividend yield (%)	0.6	0.7	0.8	0.9	1.1
Net debt / equity (x)	-0.0	-0.0	-0.0	0.0	-0.0

Source: Company, Anand Rathi Research * price as of 13th MarAjay Thakur
Research Analyst

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

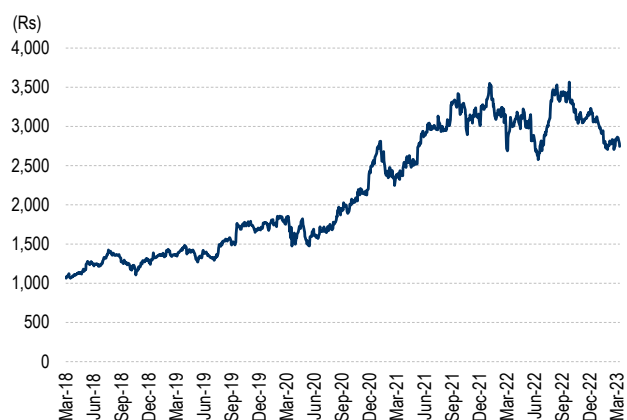
Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Net revenues (Rs m)	2,17,128	2,91,013	3,44,420	3,85,061	4,27,033
Growth (%)	7	34	18	12	11
Direct costs	1,20,972	1,83,008	2,11,806	2,29,167	2,50,337
Gross profit	96,156	1,08,005	1,32,613	1,55,894	1,76,696
Gross margins, %	44.3	37.1	38.5	40.5	41.4
Other expenses	47,600	59,969	70,147	79,283	88,560
EBITDA	48,556	48,036	62,467	76,612	88,136
EBITDA margins, %	22.4	16.5	18.1	19.9	20.6
- Depreciation	7,913	8,164	8,563	9,663	13,111
Other income	3,031	3,800	3,700	3,000	3,300
Interest expenses	916	954	1,357	1,445	1,489
PBT	42,758	42,719	56,246	68,504	76,837
Effective tax rates, %	25.7	25.8	25.8	25.8	25.8
+ Associates / (Minorities)	389	227	100	150	200
Net Income	31,393	31,463	41,663	50,714	56,851
WANS	959	959	959	959	959
FDEPS (Rs / sh)	32.7	32.8	43.4	52.9	59.3

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
PBT	43,044	41,877	56,246	68,504	76,837
+ Non-cash items	-6,652	-7,697	-6,221	-8,108	-11,300
Oper. prof. before WC	49,695	49,574	62,467	76,612	88,136
- Incr./ (decr.) in WC	-2,065	-27,952	-6,449	-4,252	-4,094
Others incl. taxes	10,797	11,757	14,483	17,640	19,785
Operating cash-flow	36,834	9,865	41,534	54,720	64,256
- Capex (tang. + intang.)	-2,611	-5,111	-15,736	-37,500	-34,500
Free cash-flow	34,223	4,754	25,799	17,220	29,756
Acquisitions					
- Div. (incl. buyback & taxes)	4,994	17,628	21,582	24,939	28,776
+ Equity raised	-	-750	-	-	-
+ Debt raised	257	3,247	-	1,000	-
- Fin investments	3,679	-973	-	-	-
- Misc. (CFI + CFF)	956	2,024	-1,013	-1,555	-1,811
Net cash-flow	24,852	-11,428	5,230	-5,164	2,792

Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 2 – Balance sheet (Rs m)

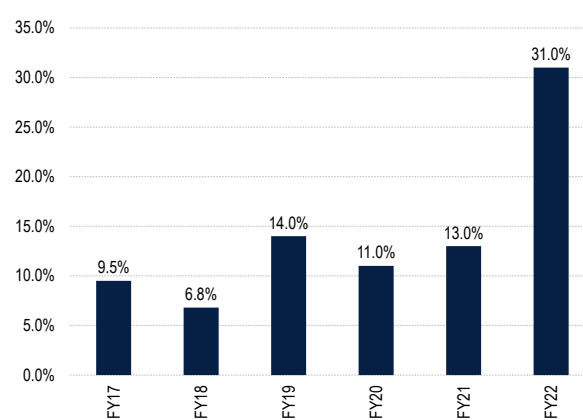
Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Share capital	959	959	959	959	959
Net worth	1,28,063	1,38,116	1,58,196	1,83,971	2,12,046
Debt	3,486	7,757	7,757	8,757	8,757
Minority interest	4,229	3,875	3,975	4,125	4,325
TL / (Assets)	4,013	3,228	1,899	1,899	1,899
	-	-	-	-	-
Capital employed	1,39,790	1,52,976	1,71,827	1,98,752	2,27,027
Net tangible assets	53,877	51,329	57,766	83,103	1,04,992
Net Intangible assets	1,682	1,433	1,433	1,433	1,433
Goodwill	3,026	2,429	2,429	2,429	2,429
CWIP (tang. & intang.)	1,830	4,264	5,000	7,500	7,000
Investments (strategic)	14,697	10,668	5,155	5,155	5,155
Investments (financial)	32,671	21,807	27,321	27,321	27,321
Current assets (excl. cash)	89,663	1,29,011	1,49,624	1,63,735	1,79,057
Cash	6,108	8,643	13,874	8,710	11,502
Current liabilities	63,763	76,609	90,773	1,00,632	1,11,860
Working capital	25,900	52,402	58,851	63,103	67,197
Capital deployed	1,39,790	1,52,976	1,71,827	1,98,752	2,27,027

Fig 4 – Ratio analysis

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
P/E (x)	85.0	84.8	64.1	52.6	47.0
EV / EBITDA (x)	54.3	55.1	42.2	34.5	29.9
EV / Sales (x)	12.1	9.1	7.7	6.9	6.2
P/B (x)	20.8	19.3	16.9	14.5	12.6
RoE (%)	24.5	22.8	26.3	27.6	26.8
RoCE (%) - after tax	25.7	22.1	26.3	28.0	27.3
RoIC (%) - after tax	32.4	29.0	33.8	35.4	33.1
DPS (Rs / sh)	17.9	19.2	22.5	26.0	30.0
Dividend yield (%)	0.6	0.7	0.8	0.9	1.1
Dividend payout (%) - incl. DDT	54.5	58.4	51.8	49.2	50.6
Net debt / equity (x)	-0.0	-0.0	-0.0	0.0	-0.0
Receivables (days)	43.7	48.6	48.2	47.9	47.6
Inventory (days)	63.9	77.2	74.2	71.1	69.3
Payables (days)	56.8	52.2	51.3	50.7	51.0
CFO : PAT %	117.3	31.4	99.7	107.9	113.0

Source: Company, Anand Rathi Research

Fig 6 – Volume-growth trend



Source: Company

Channel checks key takeaways

- Most dealerships indicated uptick in demand in Q4 vs. Q3
- Soft demand in certain pockets owing to rural weakness; rise in new dealership-based competition; steep price increases (of ~25% in the last 1-2 years); weakness in the real-estate market.
- Southern markets have a high share of emulsions, while the North and East have a mix of emulsion and distempers. **Exterior emulsions constitute 30-50% of the emulsion range for many larger dealers.**
- No material market share erosion for Asian Paints due to entrants (JSW Paints), though competition has turned keener in a few towns.
- Many regional or local brands such as Edisun (Gujarat) and Brightstar (Punjab) are priced 20-25% lower than brand names. Nippon Paints is active in certain pockets of the south.
- Counterfeits product eroding brands in certain pockets.
- Margins & trade discounts to dealers have remained steady over the last 2 years
- Many dealers/distributors are averse to stocking newer brands owing to limited shelf space and achieving sales targets.

Fig 7 – Local brand Edisun retails in Gujarat



Source: Anand Rathi Research

Q3 and concall highlights

Early Diwali dampens Q3 volumes; healthy double-digit growth in Dec. A protracted monsoon and early Diwali led to muted Q3 volume growth (flat y/y). Standalone sales rose 0.4% y/y (three-year volume/value CAGRs: 16%/17.6%). Growth was tepid but similar across T3/T4 towns and T1/T2 cities. The Q3 sales mix was led by the economy, with some down-trading in the premium and luxury category due to the steep price hikes. Asian Paints added 10,000 retail points in 9M, which widened its retail reach to over 150,000 outlets (~3x those of the nearest competitor).

Gross margin expands 180bps on lower input costs. In Q3, input costs fell 7% vs. an 8% rise in H1 (when prices were hiked 3%). Management said further softening input costs should expand the Q4 gross margin. We expect gross and EBITDA margins to improve 250-300bps each over FY23-25.

Rs87.5bn capex over the next three years. The company announced additional water-based manufacturing capacity of 0.4m kilo-litres at an outlay of Rs20bn. The earlier announced brownfield and backward integration initiatives are expected to be ready over the next three years.

Fig 8 – Capex details

Plant/expansion	Investment	Capacity
Existing capacity		1.74m kilo-litres
Greenfield plant	Rs20bn	0.4m kilo-litre
Brownfield plant	Rs67.5bn (incl. Rs21bn on the VAE and VAM units)	0.5m kilo-litre
Vinyl acetate ethylene emulsion		150,000 tpa
Vinyl acetate monomer		100,000 tpa
Total	Rs87.5bn	2.67m kilo-litres

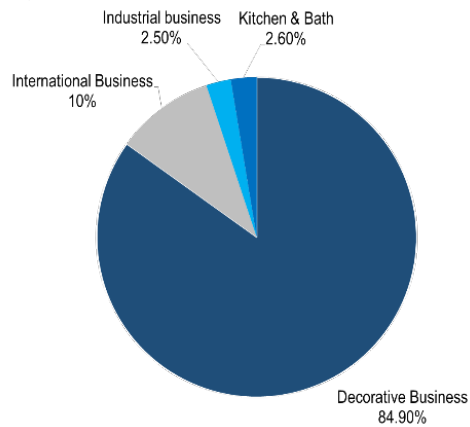
Source: Company, Anand Rathi Research

Key takeaways from Q3 earnings concall

- Overall volume growth was muted at ~1% y/y owing to the high base and price increases in the base quarter.
- Last year the company raised prices of paints: ~10% on 10th Nov'22, ~5 % on 1st Dec'22.
- Larger stock build-up in Q3 FY22 ahead of price increases impacted volumes for the quarter
- On the heavy base and prolonged monsoon in Oct, volumes were impacted, recovering in Nov and to good double-digit growth in Dec.
- Growth has been tepid across markets (T1/T2 and T3/T4) in Q3 and only a 1% difference in growth rate was seen between the two groups.
- Down-trading in premium and luxury paints was witnessed.
- Asian Paints had acquired White Teak, which generated Rs290m revenue in Q3, Rs730m in 9M and Rs580m last year. Weatherseal, acquired earlier, generated Rs70m revenue in Q3. Both the businesses benefitted from integration with the Beautiful Home store network.
- The company has done fairly well despite muted international markets with mixed results. Asian Paints Global generated about ~2% revenue growth; excl. SriLanka growth is ~13%.

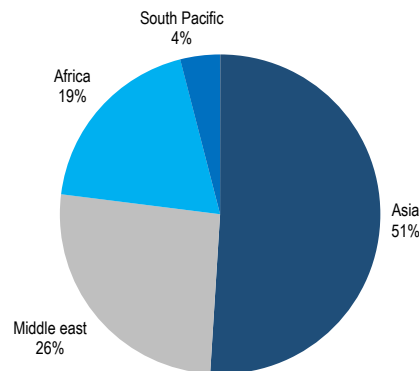
- The company expects to maintain a broad 17-20% EBITDA margin.
- It announced investment of Rs87.5bn incl. new investments in a greenfield plant at ~Rs20bn for 0.4m kilo-litre capacity.
- Backward integration (announced earlier) would be ready in another two years.
- The company undertook Rs90bn capex in the last two years and is currently operating at 70-75% capacity.
- Management expects to maintain a 38-40% gross margin even if raw-material prices soften
- The company has increased its in-house capacity in wood finishing and water-proof products by almost 50%
- It currently outsources 1.5m-1.6m kilo-litres, which is unlikely to change.

Fig 9 – Revenue Mix, FY22



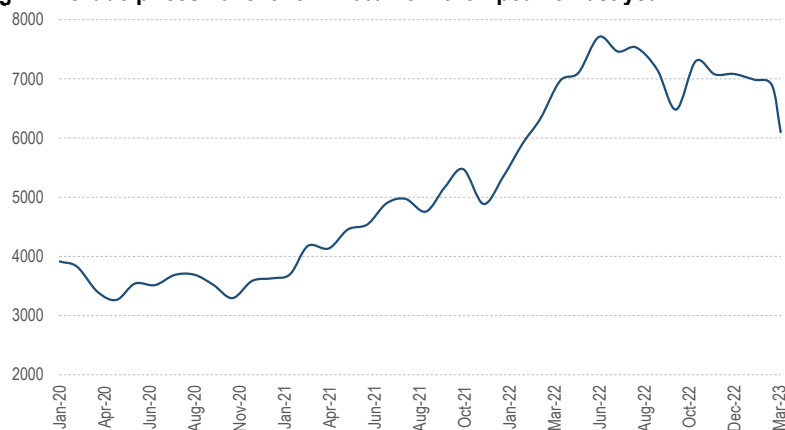
Source: Company, Anand Rathi Research

Fig 10 – International business mix (FY22)



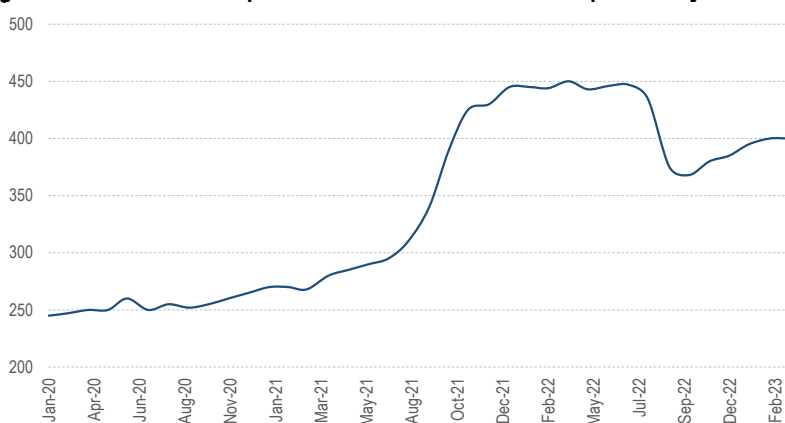
Source: Company, Anand Rathi Research

Fig 11 – Crude prices have fallen ~20% from their peak of last year



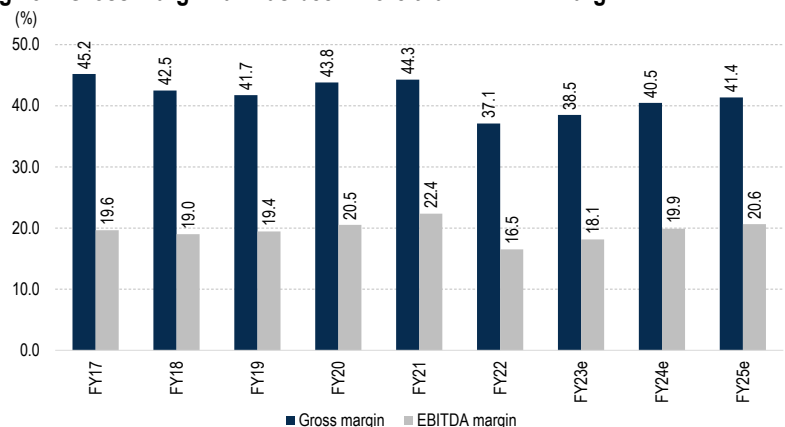
Source: Bloomberg, Anand Rathi Research

Fig 12 – Titanium dioxide prices are down ~11% from their peak last year



Source: Bloomberg, Anand Rathi Research

Fig 13 – Gross margin fall has been more than EBITDA margin in FY22



Source: Company, Anand Rathi Research

Result highlights

Fig 14 – Quarterly results (standalone)

(Rs m)	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23
Volume growth (%)	10.0	-	-38.0	11.0	33.0	48.0	106.0	34.0	18.0	8.0	37.0	10.0	1.0
Net sales	46,569	38,790	24,466	45,267	58,728	56,708	47,859	61,519	74,911	67,596	75,862	73,443	75,218
Y/Y (%)	3	-8	-44	6	26	46	96	36	28	19	59	19	0
Gross profit	20,470	18,230	11,337	20,554	27,100	25,352	18,934	21,935	28,087	26,840	28,917	26,352	29,276
Gross margins (%)	44.0	47.0	46.3	45.4	46.1	44.7	39.6	35.7	37.5	39.7	38.1	35.9	38.9
Staff costs	2,475	2,372	2,719	2,767	2,809	2,992	3,161	3,229	3,378	3,333	3,636	3,857	3,792
Other expenses	6,816	8,100	3,949	6,291	7,749	10,136	6,953	9,956	10,027	9,880	10,656	11,340	10,536
EBITDA	11,179	7,758	4,670	11,496	16,542	12,224	8,820	8,749	14,682	13,627	14,626	11,156	14,948
Y/Y (%)	8	-5	-57	32	48	58	89	-24	-11	11	66	28	2
EBITDA margins (%)	24.0	20.0	19.1	25.4	28.2	21.6	18.4	14.2	19.6	20.2	19.3	15.2	19.9
PBT	10,174	6,495	3,370	10,601	15,898	11,035	7,949	8,295	13,674	12,563	13,724	10,202	14,430
Y/Y (%)	8	-9	-66	34	56	70	136	-22	-14	14	73	23	6
PAT	7,589	4,521	2,519	7,931	11,879	8,196	5,961	6,186	10,203	9,000	10,173	7,633	10,859
Y/Y (%)	20	-5	-61	0	57	81	137	-22	-14	10	71	23	6
Staff cost (% of sales)	5.3	6.1	11.1	6.1	4.8	5.3	6.6	5.2	4.5	4.9	4.8	5.3	5.0
Other expenses (% of sales)	14.6	20.9	16.1	13.9	13.2	17.9	14.5	16.2	13.4	14.6	14.0	15.4	14.0

Source: Company

Fig 15 – Quarterly results (consolidated)

(Rs m)	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23
Net sales	54,203	46,356	29,227	53,502	67,885	66,514	55,854	70,960	85,272	78,927	86,069	84,576	86,367
Y/Y (%)	3	-8	-43	6	25	43	91	33	26	19	54	19	1
Gross profit	23,313	21,250	13,077	23,758	30,600	28,721	21,464	24,656	31,339	30,546	32,450	30,219	33,310
Gross margins (%)	43.0	45.8	44.7	44.4	45.1	43.2	38.4	34.7	36.8	38.7	37.7	35.7	38.6
Staff cost	3,430	3,356	3,615	3,789	3,883	4,121	4,321	4,415	4,557	4,574	4,896	5,126	5,038
Other expenses	7,989	9,298	4,619	7,317	8,839	11,417	8,008	11,196	11,359	11,540	11,995	12,816	12,158
EBITDA	11,894	8,596	4,843	12,652	17,879	13,183	9,136	9,045	15,423	14,433	15,560	12,277	16,114
Y/Y (%)	8	-3	-58	33	50	53	89	-29	-14	9.5	70.3	35.7	4.5
EBITDA margins (%)	21.9	18.5	16.6	23.6	26.3	19.8	16.4	12.7	18.1	18.3	18.1	14.5	18.7
PBT	10,381	6,953	3,200	11,337	16,715	11,505	7,811	8,160	13,788	12,960	14,181	10,721	14,426
Y/Y (%)	8	-5	-68	35	61	65	144	-28	-18	13	82	31	5
PAT	7,797	4,803	2,196	8,519	12,654	8,699	5,685	5,960	10,157	8,504	10,169	7,827	10,770
Y/Y (%)	20	-1	-67	1	62	81	162	-29	-18	-2	79	31	6
Staff cost (% of sales)	6.3	7.2	12.4	7.1	5.7	6.2	7.7	6.2	5.3	5.8	5.7	6.1	5.8
Other expenses (% of sales)	14.7	20.1	15.8	13.7	13.0	17.2	14.3	15.8	13.3	14.6	13.9	15.2	14.1

Source: Company

Valuation

Based on industry interaction and channel checks, we expect demand to rise vs. weak Q3 volumes. Also, lower input prices would expand margins from Q4. We lower our FY23e/24e/FY25e 8%/6%/6% to factor in the weak Q3 volumes and higher capex.

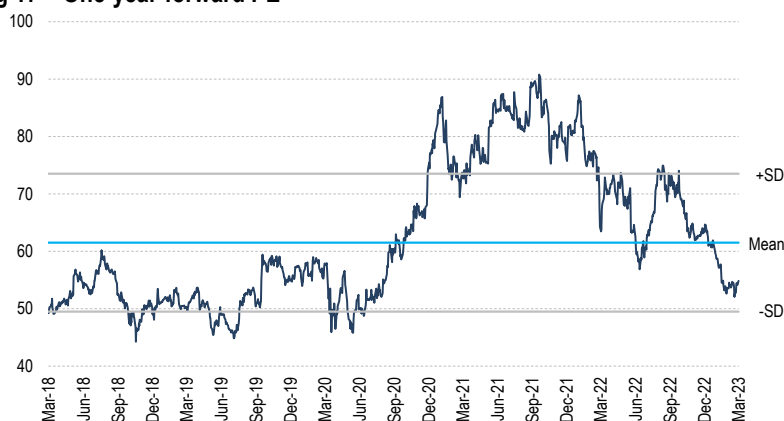
We acknowledge the rich valuations of Asian Paints (53x FY24e EPS). However, we forecast 17% earnings CAGR over FY23-25e EPS, aided by margin gains. Paints companies have been most consistent value-creators over the last 3/5/10 years with 15%/20%/20% CAGR returns. We believe this would continue, aided by steady earnings growth providing an entry opportunity. Thus, we upgrade Asian Paints to a Buy, with a TP of Rs3,260 (55x FY25e EPS) vs. Rs3,570 (60x Sep'24e EPS).

Fig 16 – Change in estimates

(Rsm)	Old			New			Change (%)		
	FY23e	FY24e	FY25e	FY23e	FY24e	FY25e	FY23e	FY24e	FY25e
Sales	3,58,092	4,01,779	4,47,582	3,44,420	3,85,061	4,27,033	-4	-4	-5
EBITDA	68,140	80,933	93,265	62,467	76,612	88,136	-8	-5	-5
PAT	45,458	53,758	60,669	41,663	50,714	56,851	-8	-6	-6

Source: Anand Rathi Research

Fig 17 – One-year-forward PE



Source: BSE, Bloomberg, Anand Rathi Research

Key risks

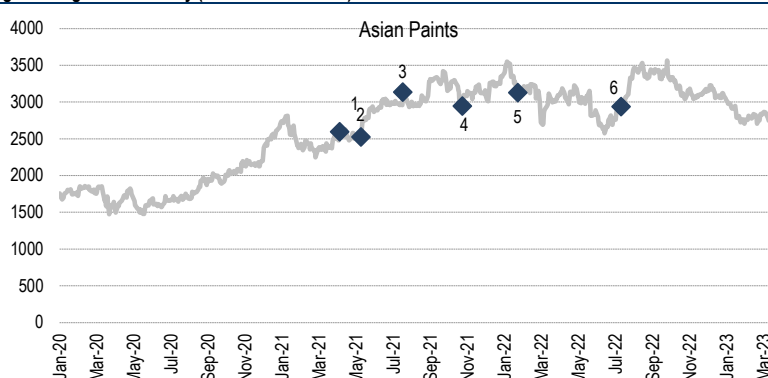
- Sharp rise in input costs, and
- Newer entrants disrupting the industry and capturing considerable market share.

Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

Important Disclosures on subject companies Rating and Target Price History (as of 14 March 2023)



	Date	Rating	TP (Rs)	Share Price (Rs)
1	06-Apr-21	Sell	2,542	2,510
2	13-May-21	Sell	2,643	2,556
3	21-Jul-21	Sell	2,748	3,159
4	21-Oct-21	Sell	3,102	3,004
5	20-Jan-22	Sell	3,359	3,287
6	26-Jul-22	Hold	3,570	3,108

Anand Rathi Ratings Definitions

Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US\$1bn) and Mid/Small Caps (<US\$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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