MOTILAL OSWAL

23 January 2012

3QFY12 Results Update | Sector: Consumer-Paints

Asian Paints

BSE SENSEX	S&P CNX
16,739	5,049

CMP: INR2,722 TP: INR3,161 Buy

Bloomberg	APNT IN
Equity Shares (m)	95.9
52-Week Range (INR)	3,366/2,395
1,6,12 Rel. Perf. (%)	-5/-3/14
M.Cap. (INR b)	261.1
M.Cap. (USD b)	4.9

Year End	Net Sales (INR M)	Adj.PAT (INR M)	EPS (INR)	EPS Gr. (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ Sales	EV/ EBITDA
3/10A	66,809	8,345	87.0	107.9	-	-	48.8	61.5	-	-
3/11E	77,062	8,432	87.9	1.0	31.0	11.9	38.5	49.0	3.3	19.3
3/12E	94,960	9,599	100.1	13.8	27.2	9.6	35.3	45.5	2.7	17.7
3/13E	110,941	11,582	120.7	20.7	22.5	7.9	34.9	46.1	2.3	14.3

- Asian Paints (APNT) posted in-line results for 3QFY12. Consolidated PAT was INR 2.56b (our estimate: INR2.6b).
- Domestic volume growth, remained healthy at 12%, we believe concerns of severe slowdown in domestic volumes is unwarranted; expect double-digit volume growth to sustain. Continued price hikes, stabilizing input costs and strengthening of the rupee will aid margin recovery in the coming quarters.
- APNT should continue to enjoy premium valuations due to strong growth visibility, high entry barriers and pricing power. The stock trades at 27x FY12E and 22.5x FY13E EPS. **Buy**.

Conference call highlights

- Demand for the decorative business remains healthy; the lower rate of volume growth is on account of a high base in 3QFY11 (37% growth in domestic business).
- The company has taken a 2.2% price increase in 3Q; cumulative price increase in 9MFY12 has been 10.53%.
- The raw material (RM) index was up 21.59% in 3QFY11 and 17.44% in 9MFY12 v/s FY11 levels; we estimate 20% YoY increase in RM index for 3Q. Titanium-dioxide prices have stabilized on easing availability.
- APNT has booked INR150m (60bp) in other expenditure as MTM impact of INR depreciation; we note that 25% of the company's RM requirement is imported.
- International business has reported 20% increase in sales in 3Q, led by strong growth in South Asia and INR depreciation; growth in Egypt, Caribbean and Middle East remains under pressure.
- The industrial business transferred to AP Coatings from the standalone entity is 2-3% of group sales (INR2b). The restructuring is expected to be completed by June2012.

QUARTERLY PERFORMANCE (Consolidated) (INR Million)

Y/E MARCH	FY11				FY12E				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Volume Growth % *	24.0	0.0	27.0	16.0	15.0	15.0	12.0	14.0	16.8	14.5
Tio2 Price Index	154	166	173	178	192	236	264	280	168	243
Net Sales	18,302	18,108	20,996	19,656	22,604	22,508	25,605	24,243	77,062	94,960
Change (%)	25.3	5.0	29.6	4.7	23.5	24.3	22.0	23.3	15.3	23.2
Raw Material/PM	10,487	10,197	12,535	11,526	13,537	13,507	15,514	14,396	44,746	56,953
Gross Profit	7,815	7,911	8,461	8,130	9,067	9,001	10,092	9,847	32,317	38,007
Gross Margin (%)	42.7	43.7	40.3	41.4	40.1	40.0	39.4	40.6	41.9	40.0
Operating Expenses	4,344	4,596	5,012	5,236	5,146	5,772	6,118	6,455	19,187	23,490
% of Sales	23.7	25.4	23.9	26.6	22.8	25.6	23.9	26.6	24.9	24.7
EBITDA	3,471	3,315	3,449	2,894	3,922	3,229	3,974	3,392	13,130	14,516
Margin (%)	19.0	18.3	16.4	14.7	17.3	14.3	15.5	14.0	17.0	15.3
Change (%)	25.8	2.7	8.4	-6.9	13.0	-2.6	15.2	17.2	7.0	10.6
Interest	42	46	59	76	65	88	90	-39	222	205
Depreciation	269	284	286	292	291	300	307	334	1,131	1,232
Other Income	184	249	194	200	305	292	225	382	826	1,205
PBT	3,344	3,234	3,298	2,726	3,871	3,133	3,802	3,479	12,602	14,285
Tax	1,013	984	974	818	1,155	955	1,138	1,081	3,789	4,328
Effective Tax Rate (%)	30.3	30.4	29.5	30.0	29.8	30.5	29.9	31.1	30.1	30.3
PAT before Minority	2,331	2,250	2,324	1,909	2,716	2,179	2,664	2,398	8,814	9,957
Minority Interest	109	103	120	49	79	91	96	91	381	358
Adjusted PAT	2,222	2,147	2,203	1,860	2,637	2,087	2,569	2,306	8,432	9,599
Change (%)	26.2	4.4	11.0	-2.9	18.7	-2.8	16.6	24.0	1.0	13.8

* 4QFY10 Numbers include 6months consolidation of International operations

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- Asian Paints 3QFY12 results are in line with estimates with Cons PAT of INR 2.56b (est INR 2.6b).
- Domestic volume growth at ~12% though marginally lower than expectation was still healthy given the demand slack in consumer discretionaries.
- Consolidated EBITDA margin at 15.5% (est 15.2%) was higher 120bp QoQ, driven by 60bp savings in employee costs and 120bp in other expenses.
- Subsidiary sales were up 30% YoY with margins contracting by 480bp to 7.7% (not comparable due to transfer of APNT's industrial paints and powder coating business). International sales were up 20% led by South Asia.
- Domestic volume growth though healthy at 12% is unlikely to increase to 16%+ volume CAGR of last five years in the near term. We believe concerns of severe slowdown in domestic volumes is unwarranted; expect double digit volume growth to sustain.
- Continued price hikes, stabilizing input costs and strengthening of the rupee will aid margin recovery in the coming quarters.
- We believe APNT will continue to enjoy premium valuations due to strong growth visibility, high entry barriers and pricing power. The stock trades at 27x FY12E and 22.5x FY13E EPS. **Buy**.

Conference call highlights

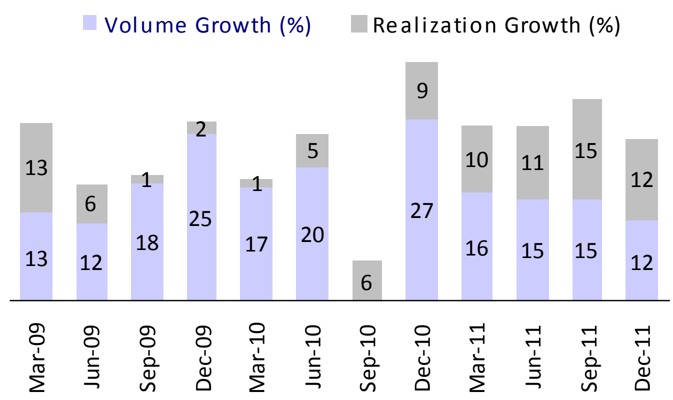
- Demand for the decorative business remains healthy; the lower rate of volume growth is on account of a high base in 3QFY11 (37% growth in domestic business).
- The company has taken a 2.2% price increase in 1st December; cumulative price increase in 9MFY12 has been 10.53%.
- RM Index is up 21.59% in 3QFY11 and 17.44% in 9MFY12 vs FY11 levels; we estimate a 20% YoY increase in RM index for 3Q. TiO2 prices have stabilized on easing availability; however there has been non moderation yet.
- The company has booked INR150m (60bp) in other expenditure as MTM impact of INR depreciation; we note that 25% of the company's RM requirement is imported and will be susceptible to currency fluctuations.
- International business has reported 20% increase in sales in 3Q led by strong growth in South Asia and INR depreciation; growth in Egypt, Caribbean and Middle East remains under pressure.
- The industrial business that has been transferred to AP Coatings from the standalone entity would constitute 2-3% of group sales (INR2b). The management expects to complete the transformation of the industrial business into the JV with PPG by May-June 2012.

Domestic volume growth at ~12%, EBITDA margins stable due to strong operating leverage

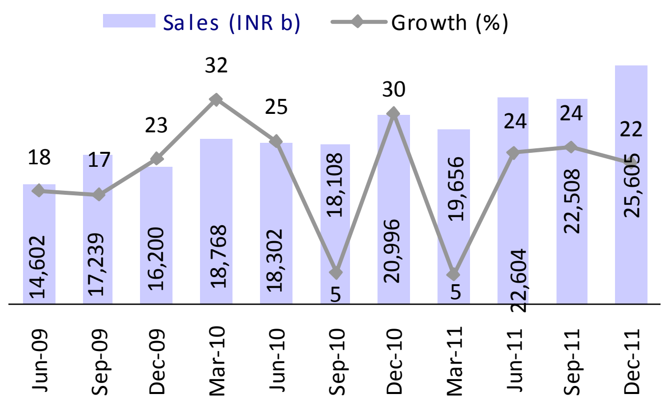
- Standalone sales grew 20.3% to INR 21.1b; we estimate volume growth at ~12%. Excluding the transfer of its powder coatings business to AP Coatings, sales growth would be ~24%. Volume growth is marginally below estimates but remains encouraging given the slackening consumer demand scenario in discretionary product categories like durables and apparel.

- Gross margins expanded 10bp YoY, but contracted 20bp QoQ to 40.6% due to (1) 49% YoY increase in Titanium Dioxide prices, and (2) rupee depreciation.
- Standalone EBITDA margin at 17.2% was flat YoY due to operating leverage benefits in employee costs (down 30bp) and healthy gross margins. EBITDA grew 20.3% to INR3.6b.
- 23% increase in other income helped 21% PAT growth to INR2.5b.
- Price increases continued; APNT took a 0.4% price hike in November and a 2.2% price increase in December to pass on a part of the input cost pressure and INR depreciation. We believe continued double digit volume growth in an environment of price increases and weak consumer demand is evidence of APNT's strong pricing power.
- The management has stated that demand is good for decorative coatings business across the country; however industrial business, including auto, continues to face challenges.

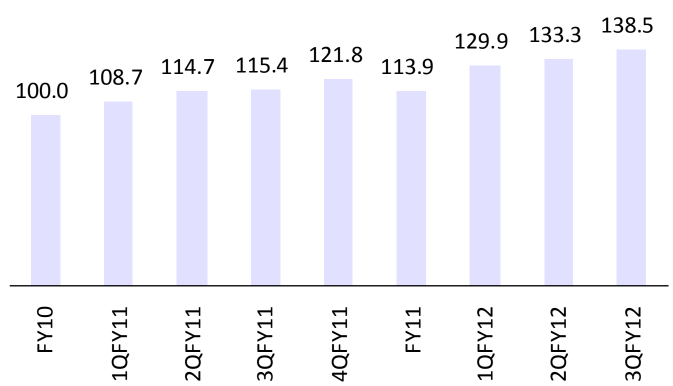
Double digit volume growth continues...



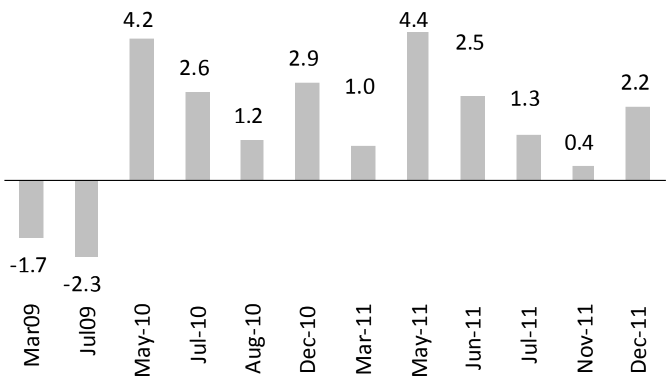
Consol sales growth in line with expectations



Input cost index up 20% YoY



Two price increases taken in 3QFY12



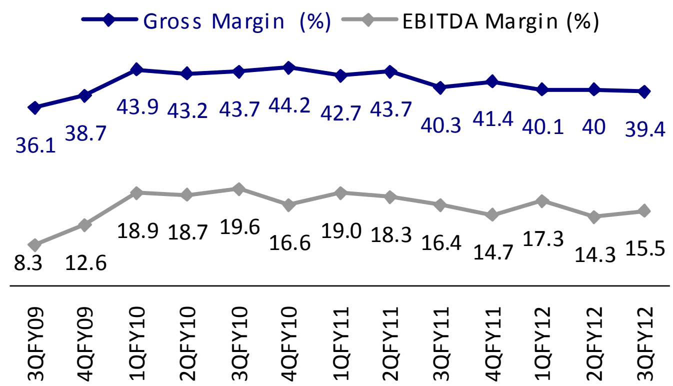
Source: Company/MOSL

Consolidated sales up 22%; subsidiaries sales up 30%; sequential sales pickup in international business positive

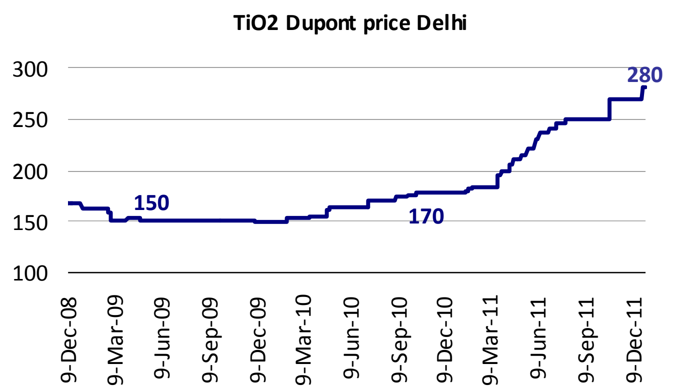
- Consolidated sales increased 22% to INR25.6b (est INR25.8b). Gross margins were down 90bp YoY to 39.4%, employee costs were down 20bp which restricted EBITDA margin contraction to 90bp to 15.5%. PAT increased by 16.6% to INR 2.6b (est INR2.6b).

- Subsidiaries including international business reported 30.6% increase in sales; however, the same is not comparable as this industrial business was part of the standalone entity in FY11, but is now part of the recently formed AP Coatings.
- International sales were up 20% owing to strong growth posted in South Asia.
- EBITDA margin declined 480bp (220bp QoQ) to 7.7% as gross margins contracted 560bp (240bp QoQ) to 33.9%; indicative of margin pressures in the industrial and international business.
- We estimate LTL sales growth of 15% in 3Q as against 5% in 2Q; pick-up in sales growth is positive in our view.
- The management has indicated that political and macro economic conditions in some countries continue to impact international performance, though performance in South Asia has been strong. We believe margins in the international business will continue to improve sequentially as the economic situation in markets such as Middle East and Egypt gradually improves. We note that Egypt is the most profitable market for APNT across geographies; an early recovery in Egypt can accelerate profit growth and expand margins.

Consolidated EBITDA margin down 90bp YoY



Tio2 prices continue to rule firm



Source: Company/MOSL

Margins near bottom levels, Domestic volume growth key monitorable over next few quarters; Maintain Buy

- In spite of consumer demand slowdown in discretionary categories, APNT has shown ~12% volume growth in the domestic decorative business. Though growth may not mirror the 16%+ volume CAGR of last five years in the near term, we believe concerns of severe slowdown in volume growth are unwarranted. Expect APNT to sustain double digit volume growth in coming periods.
- Though margin pressures continue, improving performance in the international business, continued price hikes, stabilizing input costs and appreciation in the rupee will aid margins in the coming quarters. We believe our FY13 margin estimate of 15.9% could see upsides.
- We believe APNT will continue to enjoy premium valuations due to strong growth visibility, high entry barriers and pricing power. The stock trades at 27.2x FY12E and 22.5x FY13E EPS. **Buy**.

Asian Paints: an investment profile

Company description

Asian Paints is India's largest paint manufacturer and marketer, with a dominant share in the decoratives segment. For the industrials and automotive segment, it has a JV with PPG of the US. Asian Paints acquired Berger International of Singapore to expand its operations in other markets in Asia, the Middle East and the Caribbean.

Key investment arguments

- Expansion in housing and construction will drive demand for decorative paints over the next 3-5 years.
- International operations, are likely to gradually improve from FY13.

Key investment risks

- Demand for decorative paints would be highly dependent on the normalcy of monsoons.
- Input cost are on an uptrend; Higher than expected increase in input cost would be a key risk to our EPS estimates.

Recent developments

- Asian Paints has taken a price increase of 10.5% YTD to pass on the input costs pressure
- Asian paints has purchased land at Kesurdi for construction of Greenfield capacity of 1,50,000 KL. The plant is likely to be commissioned in 4QFY13.

Valuation and view

- The stock trades at 27x FY12E EPS of INR 100.1 and 23x FY13E EPS of INR 120.7. Maintain **Buy**.

Sector view

- We are positive on the long-term demand potential in the sector, near-term concerns due to the monsoon notwithstanding, APNT continues to be the best play on the structural growth story in decorative paints.
- Longer term prospects are bright, given rising incomes and low penetration and a booming construction and infrastructure development.

Comparative valuations

		Asian Paints	ITC	HLL
P/E (x)	FY12E	27.2	25.5	33.6
	FY13E	22.5	21.6	29.0
EV/EBITDA (x)	FY12E	17.7	16.2	25.1
	FY13E	14.3	13.5	21.3
EV/Sales (x)	FY12E	2.7	5.8	3.6
	FY13E	2.3	4.9	3.2
P/BV (x)	FY12E	9.6	8.2	25.7
	FY13E	7.9	6.9	20.8

EPS: MOST forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	100.07	100.04	0.03
FY13	120.74	122.09	-1.10

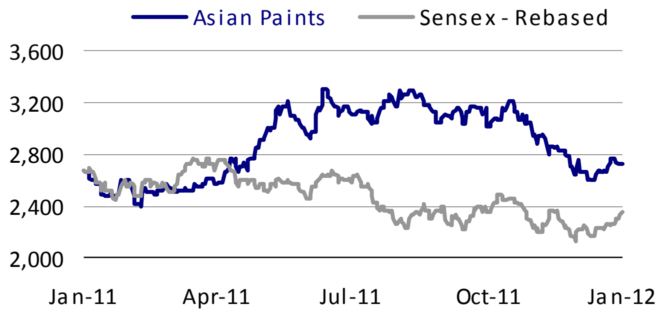
Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
2,722	3,161	16.1	Buy

Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	52.8	52.8	52.3
Domestic Inst	8.6	8.9	11.4
Foreign	19.5	19.3	16.4
Others	19.0	19.1	19.9

Stock performance (1 year)



Financials and Valuation

Income Statement					(INR M)
Y/E March	FY09	FY10	FY11	FY12E	FY13E
Net Sales	54,639	66,809	77,062	94,960	110,941
Change (%)	24.0	22.3	15.3	23.2	16.8
Raw Materials	33706	37580	44746	56953	66073
Gross Profit	20933	29230	32317	38007	44868
Margin (%)	38.3	43.8	41.9	40.0	40.4
Operating Expenses	14232	16956	19187	23490	27178
EBITDA	6,701	12,274	13,130	14,516	17,690
Change (%)	1.4	83.2	7.0	10.6	21.9
Margin (%)	12.3	18.4	17.0	15.3	15.9
Depreciation	744	836	1,131	1,232	1,523
Int. and Fin. Charges	263	285	222	205	124
Other Income	510	1,405	826	1,205	1,299
Profit before Taxes	6,204	12,559	12,602	14,285	17,343
Change (%)	-3.0	102.4	0.3	13.4	21.4
Margin (%)	11.4	18.8	16.4	15.0	15.6
Tax	1,811	3,676	3,507	4,043	4,943
Deferred Tax	163	55	282	286	347
Tax Rate (%)	31.8	29.7	30.1	30.3	30.5
PBT Before Minority	4230	8828	8814	9957	12053
Minority Interest	216	483	381	358	472
Adjusted PAT	4,014	8,345	8,432	9,599	11,582
Change (%)	-3.9	107.9	1.0	13.8	20.7
Margin (%)	7.3	12.5	10.9	10.1	10.4
Exceptional/Prior Pe	-35	12	0	0	0
Reported PAT	3,978	8,356	8,432	9,599	11,582

Ratios					
Y/E March	FY09	FY10	FY11	FY12E	FY13E
Basic (INR)					
EPS	41.8	87.0	87.9	100.1	120.7
Cash EPS	49.6	95.7	99.7	112.9	136.6
BV/Share	125.4	178.3	228.0	283.8	346.1
DPS	20.5	31.5	37.2	46.8	58.5
Payout %	41.8	31.0	36.4	40.0	41.4
Valuation (x)					
P/E	65.1	31.3	31.0	27.2	22.5
Cash P/E	54.9	28.4	27.3	24.1	19.9
EV/Sales	4.8	3.8	3.3	2.7	2.3
EV/EBITDA	39.0	20.9	19.3	17.7	14.3
P/BV	21.7	15.3	11.9	9.6	7.9
Dividend Yield (%)	0.8	1.2	1.4	1.7	2.1
Return Ratios (%)					
RoE	33.4	48.8	38.5	35.3	34.9
RoCE	39.4	61.5	49.0	45.5	46.1
Working Capital Ratios					
Debtor (Days)	10	8	8	8	8
Asset Turnover (x)	3.8	6.5	4.8	5.2	4.0
Leverage Ratio					
Debt/Equity (x)	0.3	0.1	0.1	0.1	0.0

Balance Sheet					(INR M)
Y/E March	FY09	FY10	FY11	FY12E	FY13E
Share Capital	959	959	959	959	959
Reserves	11,073	16,141	20,915	26,267	32,238
Net Worth	12,032	17,100	21,874	27,226	33,197
Loans	3,086	2,292	2,347	2,050	1,300
Deferred Liability	533	562	852	1,137	1,484
Minority Interest	756	945	1,099	1,456	1,928
Capital Employed	16,407	20,899	26,172	31,870	37,910
Gross Block	14,614	15,004	19,878	21,878	32,500
Less: Accum. Depn.	6,484	6,276	7,151	8,382	9,905
Net Fixed Assets	8,130	8,728	12,727	13,495	22,595
Capital WIP	921	4,072	433	9,000	1,750
Investments	784	6,241	9,220	4,219	8,100
Curr. Assets, L&A	17,987	18,437	23,190	27,428	31,675
Inventory	7,690	9,559	13,054	14,569	16,717
Account Receivables	5,719	5,425	5,855	7,805	9,118
Cash and Bank Balaı	2,104	1,058	1,330	1,662	1,939
Others	2,475	2,395	2,950	3,392	3,900
Curr. Liab. and Prov.	11,921	16,947	19,769	22,644	26,582
Account Payables	5,542	7,183	8,914	10,298	11,947
Other Liabilities	4,605	6,613	7,490	8,460	9,561
Provisions	1,775	3,150	3,365	3,886	5,074
Net Current Assets	6,066	1,490	3,421	4,784	5,093
Godwill on Cons.	506	367	372	372	372
Application of Funds	16,407	20,899	26,172	31,870	37,910

E: MOSL Estimates

Cach Flow Statement					(INR M)
Y/E March	FY09	FY10	FY11	FY12E	FY13E
OP/(loss) before Tax	6,701	12,274	13,130	14,516	17,690
Int./Div. Received	510	1,405	826	1,205	1,299
Interest Paid	-263	-285	-222	-205	-124
Direct Taxes Paid	-1,811	-3,676	-3,507	-4,043	-4,943
(Incr)/Decr in WC	-1,656	3,530	-1,658	-1,031	-33
CF from Operations	3,481	13,249	8,568	10,443	13,890
Incr in FA	-2,281	-3,541	-1,235	-10,567	-3,373
Pur of Investments	1,983	-5,457	-2,978	5,001	-3,881
CF from Invest.	-299	-8,998	-4,213	-5,566	-7,254
Issue of Shares	0	0	0	0	0
Incr in Debt	334	-794	55	-297	-750
Dividend Paid	-1,967	-3,023	-3,571	-4,489	-5,611
Min Int/ Dt					
Others	-552	-799	173	26	-54
CF from Fin. Activity	-2,185	-4,616	-3,343	-4,760	-6,415
Incr/Decr of Cash	997	-365	1,012	117	221
Add: Opening Balan	1,107	2,104	1,058	1,330	1,662
Closing Balance	2,104	1,739	2,070	1,447	1,884

N O T E S

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3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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