

Benign RM to support Margin performance

Q4FY20 performance was dragged by COVID-19, we were positively surprised by the Margin performance that came in ahead of our estimates while, bottomline was more or less in line with our expectation. For Q4FY20, Asian Paints (ANPT) reported Revenue/Core EBITDA/PAT de-growth of -8%/-3%/-2% YoY at Rs. 4,636cr/ Rs. 860cr/Rs. 480cr respectively. Core EBITDA Margins expanded by 93bps YoY to 18.5% vs our estimate of 16.7% and 17.6% in Q4FY19 largely driven by 428bps Gross Margin expansion aided by benign RM costs. GM for Q4FY20 stood at 45.8% (43.5% our estimates) However, GM gains were partially offset by 2%/7% YoY rise in Staff Costs and Other Expenses on account of lower absorption of overall costs impacted by lockdown. Recurring PAT of Rs. 480cr declined by a meagre 0.9% YoY (Rs. 497cr our estimates) aided by corporate tax rate cuts. Near term volume pressures are likely to sustain as Metros and Tier1 cities (40-50% of volumes) remain under severe pressure due to COVID-19 impact. To factor in near term demand challenges and benign RM outlook we revise our FY21E/22E Revenue/PAT estimates downwards by 26%/19% and 28%/12% respectively. **Retain HOLD rating but revise our TP to Rs. 1,796/share (earlier Rs. 1,890/share) on the back of downward revision in FY21/22E earnings. Key risks to our estimates – COVID-19 led demand disruption, uncertainty over second wave of the pandemic in India.**

Key concall takeaways

- **Decorative volumes growth of double digits in Jan-Feb** period was encouraging. But owing to COVID-19 impact ANPT ended Q4FY20 with just 3% volume growth. However, for FY20, ANPT reported an 11.2% volume growth with value growth being lower 5.5% due to inferior mix (company's strategy to focus on bottom of pyramid products to drive volumes).
- **Production levels improving:** As per management, company witnessed pent up demand in May; June demand has likely normalized as operations are now running at 60-70% of pre-COVID levels and also receiving good leads from safe paintain services campaign launched.
- **Demand driven by smaller towns/cities:** With smaller towns and cities not being severely impacted by COVID-19, have been reported to drive demand. Meanwhile, metros/Tie-1 cities forming 45-50% of revenues continue to be impacted by COVID.
- **Q1FY21, RM basket is expected to be deflationary** despite INR depreciation and thus could support Gross Margins and thereby Operating Margins in Q1FY21 despite a lower volume growth outlook.
- **On Product mix:** Management mentioned that gap between volume/value growth will continue for some more time as it continues to focus on value for money / bottom of the pyramid products. Also, GM of several low-value products is similar to premium products.

Our Take

While we remain fairly optimistic about the long term growth prospects of Asian Paints a leader in the domestic paints industry, we remain cautious on the near term demand conditions given discretionary nature of paints and adherence to social distancing norms. Although the company has launched safety painting services we believe it would take a while for shift in consumers mindset towards painting in these difficult times. As a result, we revise our Revenue/EBITDA/PAT estimates for FY21/FY22 by -26%/-29%/-28% and 19%/14%/12% respectively with gradual recovery expected in FY22E. **At CMP, stock trades at 53x its FY22E EPS which we believe is pricey in the given growth context. We retain HOLD rating and target P/E multiple of 50x with a revised TP of Rs. 1,796 (earlier Rs. 1,890/share).**

Key Financials (Consolidated)

(Rs. Cr)	FY19	FY20	FY21E	FY22E
Net Sales	19,240	20,211	18,028	22,151
EBITDA	3,766	4,162	3,601	5,014
Net Profit	2,214	2,779	2,397	3,447
EPS (Rs.)	23.0	28.9	25.0	35.9
PER (x)	75.7	60.3	79.1	53.3
EV/EBITDA (x)	42.0	37.4	45.1	32.1
P/BV (x)	8.7	8.3	9.2	7.4
ROE (%)	23.8	27.9	19.8	25.7

Source: Company, Axis Research

(CMP as of June 24, 2020)

CMP (Rs)	1,748
Upside /Downside (%)	3%
High/Low (Rs)	1,915/1,291
Market cap (Cr)	1,61,495
Avg. daily vol. (6m) Shrs.	8,87,865
No. of shares (Cr)	92.9

Shareholding (%)

	Mar-20	Dec-19	Sep-19
Promoter	52.8	52.8	52.8
FIs	17.2	17.2	17.0
MFs / UTI	4.5	5.0	5.2
Banks / FIs	0.1	0.0	0.0
Others	25.5	25.0	25.0

Financial & Valuations

Y/E Mar (Rs. bn)	2020	2021E	2022E
Net Sales	202	180	222
EBITDA	42	36	50
Net Profit	28	24	34
EPS (Rs.)	28.9	25.0	35.9
PER (x)	60.3	79.1	53.3
EV/EBITDA (x)	37.4	45.1	32.1
P/BV (x)	16.8	15.6	13.7
ROE (%)	27.9	19.8	25.7

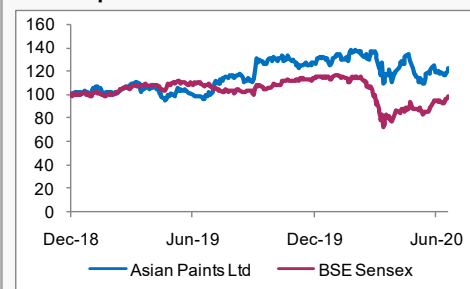
Change in Estimates (%)

Y/E Mar	FY21E	FY22E
Sales	-25.5	-19.1
EBITDA	-28.5	-14.1
PAT	-27.8	-12.5

Axis vs Consensus

EPS Estimates	2021E	2022E
Axis	25.0	35.9
Consensus	31.4	37.8
Mean Consensus TP (12M)	1,759	

Relative performance



Source: Capitaline, Axis Securities

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Q4FY20 Financial (Consolidated)

(Rs cr)	Q4FY20	Axis Sec Est	Axis Sec Var (%)	Q3FY20	QoQ Growth %	Q4FY19	YoY Growth %
Domestic Volume growth est. (% YoY)	3	2	100 bps	10	-700 bps	10	-700 bps
Domestic Value growth est. (% YoY)	-11	-3	-830 bps	-8	-340 bps	1.9	-1290 bps
Gross Sales	4,636	4,863	-5%	5,420	-14%	5,018	-8%
Gross Profits	2,125	2,115	0%	2,331	-9%	2,086	2%
Gross Margin (%)	45.8	43.5	235 bps	43.0	283 bps	41.6	428 bps
Staff costs	336	-	-	343	-2%	330	2%
Other operating expenses	930	-	-	799	16%	871	7%
EBITDA	860	810	6%	1,189	-28%	884	-3%
EBITDA margin (%)	18.5	16.7	189 bps	21.9	-340 bps	17.6	93 bps
Depreciation	195	-	-	197	-1%	179	8%
Interest	26	-	-	24	7%	30	-14%
Other Income	56	-	-	70	-20%	57	-2%
PBT	699	664	5%	1,057	-34%	738	-5%
Tax rate (%)	31.3	25.2	612 bps	26.3	506 bps	34.3	-296 bps
Reported PAT	480	497	-3.4%	779	-38%	484	-0.9%

Source: Company; Axis Securities

Change in Estimates

(Rs Cr)

	Revised		Old		% Change	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Revenue	18,028	22,151	24,213	27,386	(25.5)	(19.1)
EBITDA	3,601	5,014	5,039	5,839	(28.5)	(14.1)
EBITDA %	20.0	22.6	20.8	21.3	-84bps	132bps
PAT	2,397	3,447	3,320	3,938	(27.8)	(12.5)
EPS	25.0	35.9	34.5	40.8	(27.6)	(11.9)

Source: Company, Axis Research

Other Key Concall Takeaways

- 1) **Demand scenario:** Management mentioned, while a large portion of demand can be deferred, some part of it will be forgone due to COVID-19 as typically consumers prefer to paint houses pre-monsoon and with COVID hitting the country from March until end May with severe lockdown implemented, sales linked to this was lost. However, general replacement demand (rental flats) continues and is highly recoverable. Wedding driven painting demand is expected to decline given deferment / cancellation of marriages (in some cases).
- 2) **Value-volume differential to continue in near term:** For FY20, management highlighted that volumes grew at ~11%, but value growth remained at ~5%; this leads to ~6% differential, which is consistent with standard 6-8% differential maintained by company (largely due to up-gradation push in emulsions). Management indicated that lower-end push is more strategic – looking at market demand and potential to grow (focus on growing market v/s taking share); hence, the volume-value differential is likely to sustain in the near term.
- 3) **Paints project business under pressure:** The projects business, construction chemicals and infrastructure coatings (c10% of sales) segment is in doldrums as developers face dual challenges of labor shortage and liquidity constraints apart from weak consumer demand.
- 4) **Consumer confidence:** Asian Paints is offering safe painting service to customers at no additional cost except for a minor Rs. 1,000-1,500 per customer per painting project. This is to allay customer's paranoia towards allowing any third person from entering the house.
- 5) **International business:** Demand situation is similar to India for most of South Asian geographies (Sri-lanka, Bangladesh, Nepal, and Indonesia); however situation in Middle East and Africa (Egypt, Ethiopia) is relatively better as impact of lockdown is minimal.
- 6) **Home improvement business:** Sleek and Ess Ess continued to be impacted due to weak real estate scenario and implementation of lockdown from second fortnight of March 2020. Company impaired investment in Sleek for an amount of Rs. 29.7cr.
- 7) **RM tailwinds augur well for near term margins:** Gross margin improvement has come due to lower RM prices (QoQ decline reported despite INR depreciation), and through efficiencies in sourcing/formulations. No fresh price cuts have been taken so far (barring the 1% portfolio level cut in last December), but the company has plans to pass on price benefits once the demand situation normalizes. Currently, import of RM is 8-10% of total requirements from China. But it already has back up plans in place (tie-up with alternate vendors) in case of any import duties levied on goods coming from China in wake of the border issue escalation.
- 8) **Hygiene segment:** Company has added sanitizers and is looking to capitalize on existing Royal Health Shield brand. It is also investing in parallel distribution system to reach normal FMCG shops to take sanitizers to them.
- 9) **Other takeaways:**
 - ✓ Migrant labor to come back by August end as there are not enough income generating avenues for them in rural areas
 - ✓ DIY (Do it yourself) concept is difficult to take off in India compared to western world because of poor construction quality. However, for small projects (single wall) it is quite possible.
 - ✓ Capex is restricted to only the necessary investments
 - ✓ Inventory levels have now normalized after having seen a surge in March impacted by the lockdown
 - ✓ No liability provided for CCI case as there is no update on the case due to shutdown effected by COVID
 - ✓ Category wise, company focused on pushing premium emulsions as well as growing waterproofing/coatings business in Q4FY20. Management stated that currently even as premium categories are doing better, lower end is growing faster and 'Value for Money' products are expected to do well (benefit seen for putty and emulsion segment) in the interim with increased down-trading and reduction in customer wallet share.

Valuation & Outlook

We continue to believe Asian Paints is well positioned from a long term perspective given some of the structural growth drivers like diverse product portfolio straddling across price points, 2) significant opportunity to grow in entry levels paints driven by distribution and success of its new products which are launched at 15-20% lower prices. Further, we expect the company to focus on cash conservation and thus low capex guidance in FY21 and also a likely lower dividend payout. Despite the long term growth drivers, we remain cautious on the near term demand conditions given discretionary nature of paints and adherence to social distancing norms and utmost importance given to health and hygiene by customers (company may stand to gain but too early to assess success of safe painting services). As a result, we revise our Revenue/EBITDA/PAT estimates for FY21/FY22 by -26%/-29%/-28% and 19%/14%/12% respectively with gradual recovery expected in FY22E. At CMP, stock trades at 53x its FY22E EPS which we believe is pricey in the given context of growth. We retain HOLD rating and target P/E multiple of 50x with a revised TP of Rs. 1,796 (earlier Rs. 1,890/share).

Financials (consolidated)
Profit & Loss

(Rs Cr)

Y/E Mar, Rs. Cr	FY19	FY20	FY21E	FY22E
Net sales	19,240	20,211	18,028	22,151
Growth, %	15.9	5.04	-10.8	22.8
Other income	233	304	341	375
Total income	19,473	20,516	18,369	22,526
Raw material expenses	-11,265	-11,383	-10,131	-12,380
Employee expenses	-1,237	-1,366	-1,373	-1,414
Other Operating expenses	-2,973	-3,300	-3,200	-3,642
EBITDA (Core)	3,766	4,162	3,601	5,014
Growth, %	25.2	11.7	(17.9)	38.9
Margin, %	20.8	22.1	20.3	23.0
Depreciation	-622	780	766	811
EBIT	3,376	3,686	2,899	4,279
Growth, %	19.1	9.2	(21.3)	47.6
Margin, %	17.5	18.2	16.1	19.3
Interest paid	(105.3)	(102.3)	(27.2)	(24.8)
Pre-tax profit	3,312	3,634	2,929	4,318
Tax provided	-1,098	-855	-809	-1,170
Profit after tax	2,214	2,779	2,119	3,148
Adj. Net Profit	2,215	2,779	2,397	3,447

Source: Company, Axis Securities

Balance Sheet

(Rs Cr)

As at 31st Mar, Rs. Cr	FY19	FY20	FY21E	FY22E
Cash & bank	445	783	2,752	4,535
Debtors	1,913	1,799	1,877	2,124
Inventory	3,150	3,390	4,939	5,765
Loans & advances	94	87	87	87
Other current assets	1,213	1,395	1,395	1,395
Total current assets	6,815	7,453	11,049	13,906
Investments	2,569	2,019	2,019	2,019
Gross fixed assets	7,308	8,008	8,508	9,008
Less: Depreciation	-1,683	-2,656	-3,422	-4,233
Add: Capital WIP	210	140	140	140
Net fixed assets	5,835	5,492	5,227	4,916
Total assets	14,717	14,611	17,941	20,487
Current liabilities	4,448	3,893	6,470	7,529
Total current liabilities	4,448	3,893	6,470	7,529
Non-current liabilities	616	340	340	310
Total liabilities	5,064	4,233	6,810	7,839
Paid-up capital	96	96	96	96
Reserves & surplus	9,375	10,034	10,845	12,425
Shareholders' equity	9,654	10,377	11,131	12,648
Total equity & liabilities	14,717	14,611	17,941	20,487

Source: Company, Axis Securities

Cash Flow

(Rs Cr)

Y/E Mar (Rs. Cr)	FY19	FY20	FY21E	FY22E
Pre-tax profit	3,312	3,634	2,929	4,318
Depreciation	622	781	766	811
Chg in working capital	78	-855	949	-14
Total tax paid	-1,021	-1,003	-809	-1,170
Other operating activities	0	0	0	0
Cash flow from operating activities	2,991	2,557	3,834	3,944
Capital expenditure	-1,320	-438	-500	-500
Chg in investments	-428	550	0	0
Cash flow from investing activities	-1,707	163	-443	-436
Free cash flow	1,284	2,720	3,391	3,508
Equity raised/(repaid)	882	681	754	1,517
Dividend (incl. tax)	-1,027	-1,385	-1,586	-1,866
Cash flow from financing activities	-17	-937	-832	-379
Net Change in cash	1,268	1,782	2,559	3,128

Source: Company, Axis Securities

Ratio Analysis

(%)

Y/E Mar	FY19	FY20	FY21E	FY22E
Per Share data				
EPS (INR)	23.1	28.9	25.0	35.9
Growth, %	9.4	25.3	(13.6)	43.8
Book NAV/share (INR)	96.9	104.0	111.8	127.7
FDEPS (INR)	23.1	29.0	22.1	32.8
CEPS (INR)	29.6	37.1	30.1	41.3
DPS (INR)	8.9	12.0	13.7	16.2
Return ratios				
Return on assets (%)	16.3	19.4	13.1	16.5
Return on equity (%)	23.8	27.9	19.8	25.7
Return on capital employed (%)	23.3	27.1	19.2	25.9
Turnover ratios				
Asset turnover (x)	2.6	2.5	2.4	3.2
Sales/Total assets (x)	1.4	1.4	1.1	1.2
Sales/Net FA (x)	3.5	3.6	3.4	4.4
Working capital/Sales (x)	0.1	0.1	0.1	0.1
Working capital days	36.5	50.2	37.0	30.4
Liquidity ratios				
Current ratio (x)	1.5	1.9	1.7	1.8
Quick ratio (x)	0.8	1.0	0.9	1.1
Dividend cover (x)	2.6	2.4	1.6	2.0
Total debt/Equity (%)	6.6	3.4	3.2	2.5
Net debt/Equity (%)	1.8	(4.4)	(22.5)	(34.5)
Valuation				
PER (x)	75.7	60.3	79.1	53.3
Price/Book (x)	18.0	16.8	15.6	13.7
Yield (%)	0.5	0.7	0.8	0.9
EV/Net sales (x)	8.7	8.3	9.2	7.4
EV/EBITDA (x)	42.0	37.4	45.1	32.1
EV/EBIT (x)	49.7	45.4	57.0	38.2

Source: Company, Axis Securities

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