



Asian Paints

Date: 05/05/2020

OVERVIEW

Recommendation: Accumulate for a target of ₹2254

Valuation: Over valued

Current Market Price: ₹1650

Time Horizon: 4-5 years

ECONOMIC MOAT

Company History: Founded: 1942

Company Management

MD & CEO: K.B.S Anand

Chairman: Ashwin Dani



ABOUT THE COMPANY:

Asian Paints Limited (BSE: 500820, NSE: ASIANPAINT) is an Indian multinational paint company headquartered in Mumbai, Maharashtra. The company is engaged in the business of manufacturing, selling and distribution of paints, coatings, products related to home decor, bath fittings and providing of related services. Asian Paints is India's largest and Asia's third largest paints corporation. As of 2015, it has the largest market share with 54.1% in the Indian paint industry. Asian Paints is the holding company of Berger International.

Asian Paints:

- Largest Paint Company In India
- 3rd Largest Paint Company In Asia
- 9th Largest Paint Company In The World
- 50+ Years Of Market Leadership In India
- 27 Paint Manufacturing Facilities Globally
- 65+ Countries Where Products Are Sold
- 16 Countries Of Operation

Brands

- Asian Paints
- Causeway Paints
- Asian Paints Berger
- Kadisco By Asian Paints
- Scib Paints
- Taubmans
- Apco
- Berger Paints



Pros:

- Largest Paint Company In India With More Than 50 Years Of Leadership.
- Company Has Maintained A Return Of Capital Employed Of 38%.
- Company Is Virtually Debt Free.
- Asian Paints Foray Into Hand, Surface Sanitizer Segment.
- Asian Paints Have The Largest Network Of Distribution In The Paint Industry And Have The Largest Market Share In The Paint Industry.
- Excise Duty Expense Has Fallen 98.8% From 437.8 Crores To 8.32 Crores In The Year 2019.

Cons:

- Valuation At A 59.6X P/E Indicates A Valuation Bubble Within The Company.
- Promoter Stake Is Pledged.
- Business Nature Shows Positive Correlation With Economic Growth And Income Of Individual And Current Situation Concludes Numbers Against The Economic Growth.
- With Increasing Revenues Company Is Not Able To Maintain Return On Capital Employed And Return On Net Worth And Both The Ratios Are In Decline.



COMPETITIVE MOAT OF ASIAN PAINTS:

- Asian paints leadership in various segments of paints business in India act as its biggest competitive advantage over other paints companies in India and its reach in more than 65 countries with 16 countries where operations are carried along with well established brands of paints as such that consumer become brand loyal towards Asian paints.
- Company's strong hold on scalability as it has revenue growth at 12.54% CAGR from 2010 to 2019 and on the bottom line with a growth of 11.14% CAGR. Thus, the correlation between revenue growth and profit growth is 0.88 which is very near to 1, it also is a moat of the company as there are many businesses listed on the stock market which have a double-digit growth in revenues but their profit growth is stagnant.
- Asian paints have their product portfolio which is been used in various segments such as home paints, automobile paint for cars and automotive, and oil paints and many more. With a market share of more than 50% in the industry, the quarters to come can be tough for the businesses which has a positive correlation with economic growth of the nation and are cyclical in nature and paints businesses enjoys the same privilege but the depth of the business of Asian paints will help it survive the adverse effect on the business due to the corona and Asian paints will be first in its industry to observe good numbers once corona pandemic and its effects get vanished.
- In the nearer future even the business with a great competitive moat will face a plunge in both revenues as well as bottom line and thus no business is inevitable to the effects of corona, the question of survive will emerge among investor for businesses to invest. Thus, finding the bottom seems like a funny joke to discuss and investor should be cautious enough to invest in companies with price to earnings multiple of more than 50X and Asian paints is one among them. To end up with successful investment great business with adequate growth potential must come along at a fair valuation.



TAKE ON ASIAN PAINTS

We believe that Asian paints is a wonderful business with a strong depth in operation it carries out. The demand of paints depends on the demand of other industries such as reality, automotive etc. and currently the Indian economy will not be able to created the demand usually expected at a normal rate due to the outbreak of corona virus. Thus, in the nearer term things can get really tough and especially till the term the lockdown is been applied. Currently Asian paints is trading at 58.60X its earning for the fiscal year and amid that high valuation Asian paints is trading at a discount of 22% to its industry P/E of 72.5. which in itself is not enough for an investor to decide whether its fairly valued or over-valued. But we also believe that due to its market leadership and depth hold over scalability investor today are willing to buy it at 58X its earnings but according to us investor should wait for the last leg fall to come and the entry price for Asian paints will be very crucial as nobody can truly predict the condition or the situation in times to come and the old saying stand true that “Too Big Too Fail Is A Myth”.

Talking about the past performance of the stock Asian paints have a revenue growth of 12.54 CAGR and a profit growth of 11.14% CAGR but with the increase in volume of revenues the return on capital employed and return on net-worth has been falling and 34% and 24.1%.

The company’s business is of the manufacturing nature and requires more of capital expenditure resulting in less amount of free cashflows. Different businesses are valued using different parameters and if we start valuing manufacturing business in the same way we do for IT businesses using free cash-flows thus, in this case we will have to ignore free cash flows.

In the years to come we believe the efficiency in the bottom line will improve with growing revenues and once the economy starts pacing up Asian paints will emerge as the one among the various company to reap the fruit of economic growth as due to which people’s income will increase , personal disposable income will increase resulting in increase in the spending at the root levels of the Indian economy.



FUTURE OUTLOOK OF ASIAN PAINTS

Asian paints	2018	2019	2020E	2021E	2022E	2023E	2024E
Revenues	17483Cr	19577Cr	20360Cr	22396Cr	24636Cr	27099Cr	29809Cr
Net Profit	2098Cr	2212Cr	2689Cr	3087Cr	3532Cr	3923Cr	4465Cr
Free Cash-Flows	705Cr	1081Cr	1124Cr	1259Cr	1410Cr	1579Cr	1769Cr

We Believe That Mr. Market Will Continue To Favor Asian Paints For Its Business Leadership And Brand And In Future We Are Also Optimistic On Increasing Efficiency Levels.

Thus, Here Is How We Are Valuing or Forecasting Asian Paints In The Years To Come

- Currently Asian paints trades at 5.56 times its revenue and 58X its earnings
- But for the year 2024 as per our forecast which is the value in the most risk associated environment, we value Asian paints 8 times its revenue

That is 29809 crores *8 = 238,472 crores which values per share price at ₹2486

- Consideration in the efficiency of the earnings we believe Asian paints will continue its trend to be in high PE stock and thus we value it at 50X its earnings of 2024

That is 4465 crores*50 = 223,250 crores

- Taking a margin of safety of 8% we believe that Asian paints shares will be valued at **₹2254 per share.**

WHY WE THINK ASIAN PAINT WILL BE NOT PREFERRED BY A VALUE INVESTOR?

Asian paints trades at 58X its earnings currently and its profit should grow at double digit growth to bring its P/E DOWN. competition from subsidiaries of global players and declining rural as well as urban demand can make Asian paints see some its toughest year to come specially for next few years. With increasing revenues company is not able



to maintain return on capital employed and return on net worth and both the ratios are in decline.

Economy and Industry Analysis

- The paint industry at an aggregate level is cyclical in nature in all of its dimension. The demand of paints as a product comes from various industries such as real estate for housing but again its cyclical, in automobile for coloring the body of automobile but automobile industry in itself is cyclical. Thus, any industry which cyclical is nature depends directly on the economic condition of the country as whether individuals will buy the product or not depends on their income levels, employment levels etc.
- Thus, all the economic indicators suggest that the economy in the nearer term of 1-2 years will face a muted or sluggish demand for the paint industry as consumer in the times of dark cloud caused due to corona pandemic will be too cautious and tight while spending money and during this time, people will only spent on necessary items .
- The corona pandemic will have its effect at a minimal of 1.5 to 2 years and during this time period people will not build houses, but a car , thus there can be decrease in the degree of the demand of paints and in the times of lockdown the companies producing paints will also face difficulty in utilizing its capacity to the normal level.
- ***Crude oil in terms of paint industry***, oil is considered as a raw material for the production of paints and recently the prices of oil had made history by trading at a negative value and has been trading at decades low, which makes a small compensating level of good news during covid-19 for the paints producing companies but low demands will hunt the hurt .
- The economy will face a muted or maybe a negative growth for the current fiscal year and maybe few of the quarters of the FY22. The country has been in lockdown for the last 40 days and more, with no commercial trade within country, inter states of India just the necessities and businesses in the FMCG as well as pharma space are operating ahead of other sectors of the economy due to their nature of product falling under the necessities.
- The economy will have to pass through the tough times of corona with a cautious hand with spending, stimulus to boost business but in our views some things are just unavoidable



and can't be just overcome with unilateral transfers. The country will have to face the corona pandemic to overcome it.

FINANCIAL HIGHLIGHT

Profit and loss Account with Forecast

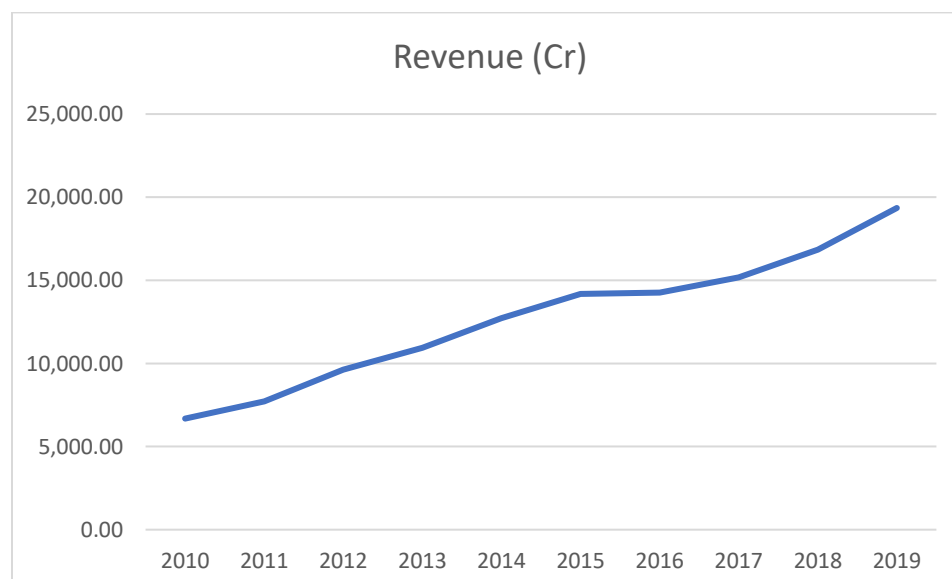
Asian paints								
Rs. crores's		2018A	2019A	2020E	2021E	2022E	2023E	2024E
Income Statement Rs. crores's								
Revenue		17,482.85	19,576.89	20,359.97	22,395.96	24,635.56	27,099.11	29,809.03
COGS		11,244.32	12,620.68	12,928.58	14,221.44	15,643.58	17,343.43	19,077.78
Gross Profit		6,238.53	6,956.21	7,431.39	8,174.53	8,991.98	9,755.68	10,731.25
other expenses		2,820.30	3,204.63	3,364.86	3,533.10	3,709.76	3,895.25	4,090.01
EBITDA		3,418.23	3,751.58	4,066.53	4,641.42	5,282.22	5,860.43	6,641.24
Depreciation		360.47	430.67	509.00	559.90	615.89	677.48	745.23
Interest		35.07	51.00	56.10	61.71	67.88	74.67	82.14
EBT		3,022.69	3,269.91	3,501.43	4,019.81	4,598.45	5,108.29	5,813.88
Taxes		925.17	1,058.02	812.33	932.60	1,066.84	1,185.12	1,348.82
Net Income		2,097.52	2,211.89	2,689.10	3,087.22	3,531.61	3,923.16	4,465.06
Assumptions								
Revenue growth			12.0%	4.0%	10.0%	10.0%	10.0%	10.0%
COGS % of revenue		64.3%	64.5%	63.5%	63.5%	63.5%	64.0%	64.0%
other expenses		2,820.3	3,204.6	5.0%	5.0%	5.0%	5.0%	5.0%
Depreciation % of revenue		2.1%	2.2%	2.5%	2.5%	2.5%	2.5%	2.5%
Interest		35.1	51.0	500.0	500.0	500.0	500.0	500.0
Tax rate		30.6%	32.4%	23.2%	23.2%	23.2%	23.2%	23.2%
free cashflows		704.66	1080.72	1124	1259	1410	1579	1769



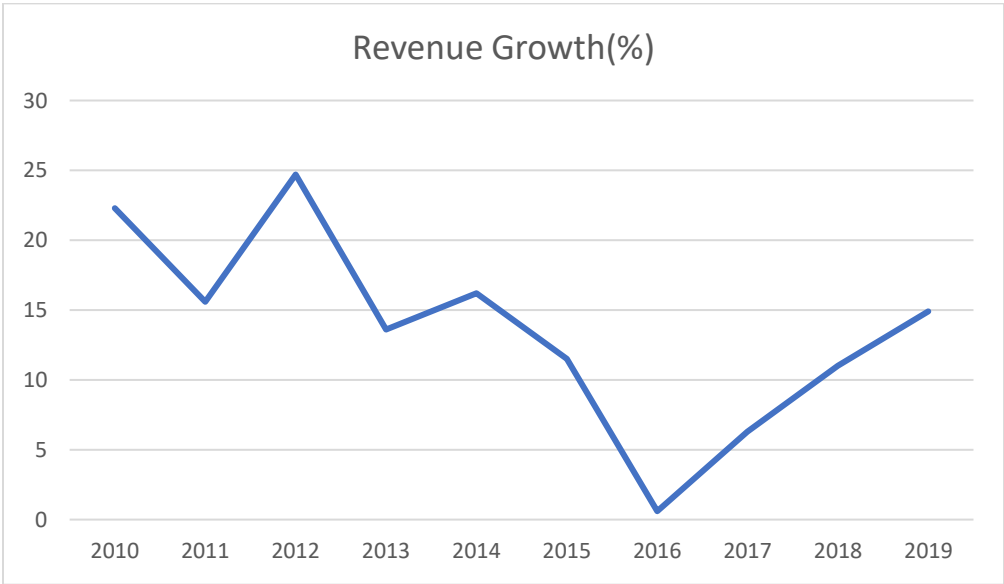
COMMON SIZE STATEMENT

Analysis		2018A	2019A	2020A	2021E	2022E	2023E	2024E
Common size income statement								
Revenue		100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
employee benefit expenses		64.3%	64.5%	63.5%	63.5%	63.5%	64.0%	64.0%
Gross Profit		35.7%	35.5%	36.5%	36.5%	36.5%	36.0%	36.0%
other expenses		16.1%	16.4%	16.5%	15.8%	15.1%	14.4%	13.7%
EBITDA		19.6%	19.2%	20.0%	20.7%	21.4%	21.6%	22.3%
Depreciation		2.1%	2.2%	2.5%	2.5%	2.5%	2.5%	2.5%
Interest		0.2%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
EBT		17.3%	16.7%	17.2%	17.9%	18.7%	18.9%	19.5%
Taxes		5.3%	5.4%	4.0%	4.2%	4.3%	4.4%	4.5%
Net Income		12.0%	11.3%	13.2%	13.8%	14.3%	14.5%	15.0%
free cashflows as % of net profit		34%	49%	42%	41%	40%	40%	40%

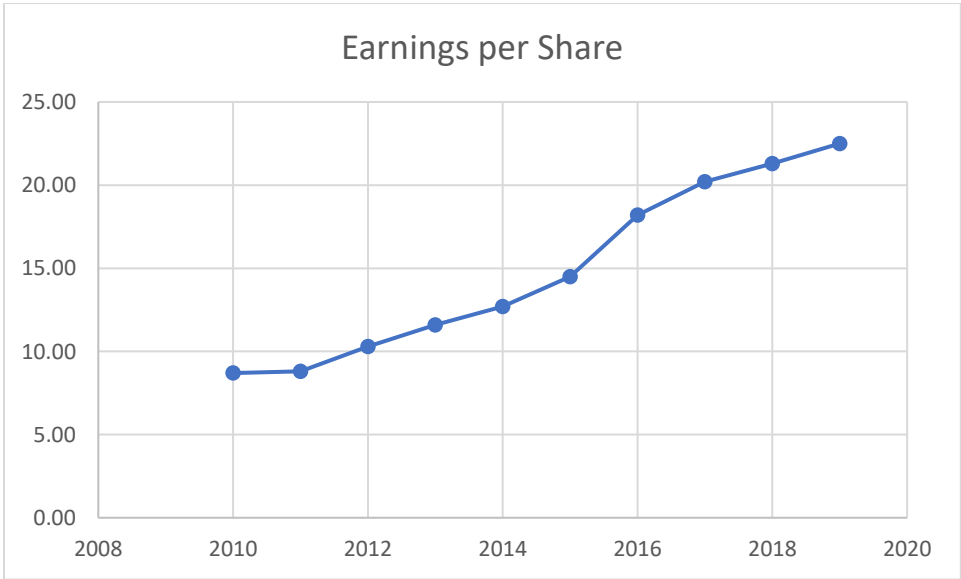
REVENUE IN CRORES



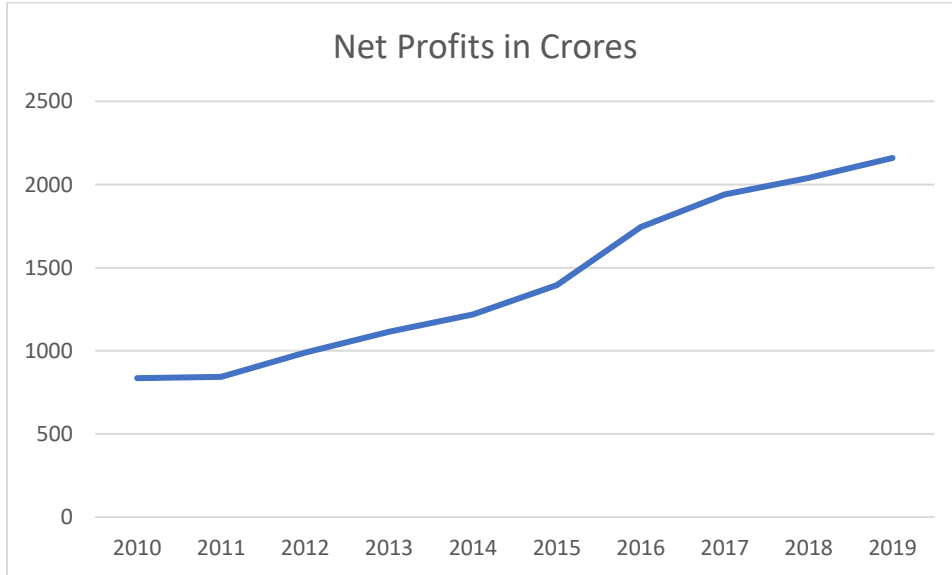
REVENUE GROWTH IN %



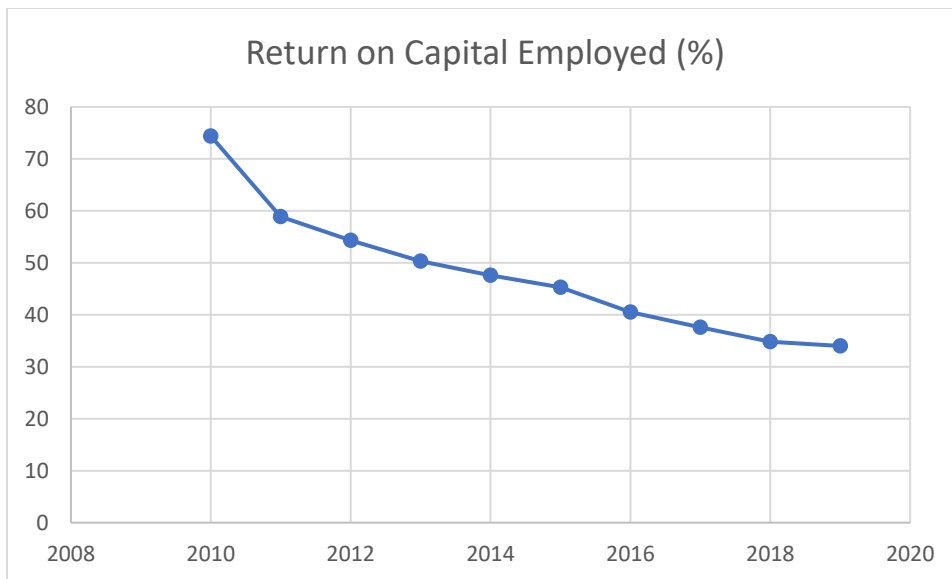
EARNINGS PER SHARE



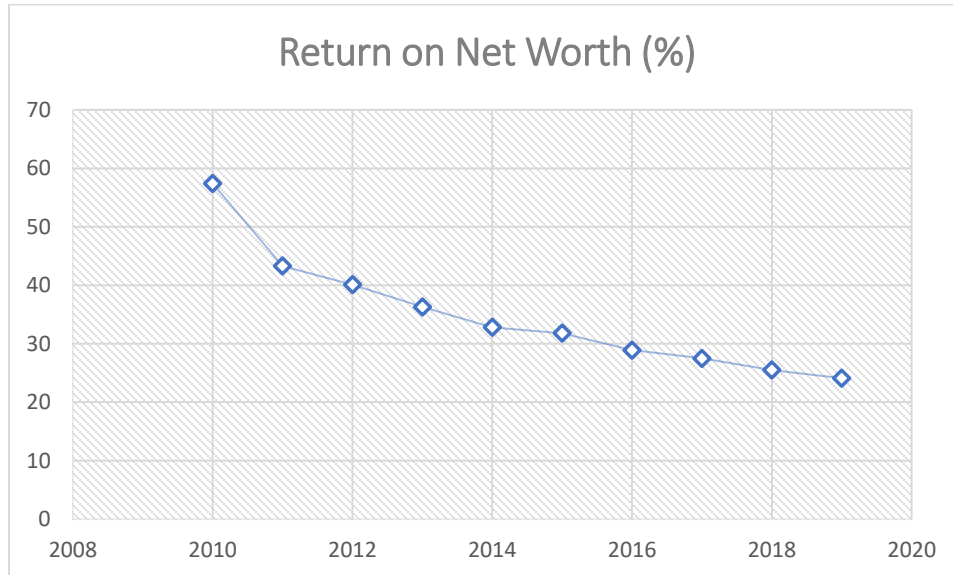
NET PROFITS IN CRORES



RETURN ON CAPITAL EMPLOYED



RETURN ON NET WORTH



Dividend Policy:

- The company's dividend yield is less than 1% and currently stands at 0.63%.
- The company has formed an image of a growth stock thus investor doesn't bother themselves with less dividend payout and the stock stands for its image as investor are willing to own shares of the company at a P/E of 59.5X.



COMPETITOR ANALYSIS

Asian Paints

Asian Paints	FOR THE YEAR 2019			FOR THE YEAR 2018			
Segments	Revenue (Cr)	Profits (Cr)	Margin s	Revenue (Cr)	profits (Cr)	Margin s	Margin s YOY
Paints	18,933.36	3,567.19	18.84%	16,927.18	3,260.51	19.26%	-2.19%
Home Improvements	416.48	-53.18	-12.77%	335.05	-31.95	-9.54%	33.90%
TOTAL	19349.84	3514.01	18.16%	17262.23	3228.56	18.70%	-2.90%

Berger Paints

Berger Paints	FOR THE YEAR 2019			FOR THE YEAR 2018			
Segments	Revenue (Cr)	profits (Cr)	Margin s	revenue (Cr)	profits (Cr)	Margin s	margin s YOY
Paints	6121.89	497.45	8.13%	5327.99	460.83	8.65%	-6.05%
TOTAL	6121.89	497.45	8.13%	5327.99	460.83	8.65%	-6.05%

Note: Berger paints is only involved in production and sell of paints so only margins are taken into consideration as there is no segment reporting reported by the company itself

Kansai Nerolac

Kansai Nerolac	FOR THE YEAR 2019			FOR THE YEAR 2018			
Divisions	Revenue (Cr)	Profits (Cr)	Margin s	revenue (Cr)	Profits (Cr)	Margin s	margins YOY
Paints	5484.84	447.66	8.16%	4879.43	513.75	10.53%	-22.48%



TOTAL	5484.84	447.66	8.16%	4879.43	513.75	10.53%	-22.48%
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Note: Kansai Nerolac is only involved in production and sell of paints so only margins are taken into consideration as there is no segment reporting reported by the company itself

CONCLUSION:

If we were to observe and compare the margins of the three paints companies, it can be concluded that margins have fallen for the three of the companies in 2019 as compared to 2018. But it can be noted that margins of Asian paints have fallen by just 2.9% whereas margins for kansai Nerolac plunged by 22.48% and for Berger paints margins plunged by 6.5%.

Thus, it shows the moat of Asian paints that instead of year 2019 being a tough year for the bottom-line growth in the paint industry, the company margins plunged by a muted magnitude.

Regarding the loss of 53 crores in the home improvement segment for Asian paints we believe that the company motive here is to gain market share in the home improvement space that is majorly bathroom fittings and a loss margin of 12% on sales for initial level is nothing much to worry about and is a good to go thing.

VALUATIONS

Current Situation:

- Share Price: ₹1650 (as on 05/05/2020)
- Market Cap: **158,268** Crore (as on 05/05/2020)
- Total Shares Outstanding: 95.92 Crores
- Dividend Yield: 0.63% (for year ended 31st march 2020)
- Eps: ₹28.32



- Book Value: ₹103.03
- PE Ratio (TTM):58.71
- 1 Year Returns: **13.64%**

- **Per Share Valuations:**

- Dividend Per Share: ₹18.15
- Free-Cashflow Per Share: ₹11.26 (31ST march 2019)
- Operating Cashflow Per Share: ₹23.08 (31ST march 2019)
- Price/Free-Cashflow Ratio: 146 times
- Operating Revenue Per Share: ₹ 199.78
- Operating Profit Per Share: ₹34.09
- Current Investment Per Share: ₹12.24
- Non-Current Investment Per Share: ₹14.54

Other Valuation Parameters:

- PBIDT Margin: 19.39%
- PBIT Margin: 17.16%
- PBT Margin: 16.90%
- Net Profit Margin: 11.09%
- Return on Equity: 22.68%
- Return on Assets: 13.78%
- Return on Capital Employed: 31.23%



VALUATION MATRIX:

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Interest		35.1	51.0	500.0	500.0	500.0	500.0	500.0
Tax rate		30.6%	32.4%	23.2%	23.2%	23.2%	23.2%	23.2%
free cashflows		704.66	1080.72	1124	1259	1410	1579	1769

How are we valuing Asian paints at current valuation?

- Asian paints currently valued at **5.56 times** its forward **revenue of the FY 2024**
- Asian paints is currently trading at a forward **P/E ratio of 35.84X (FY2024)**
- Asian paints is currently trading at **90.40** times its free cashflows of FY2024



TARGETS

Recommendation buy on dips for a target of ₹2254

Valuation: target valuation of 216,203 crores

Current Market Price ₹1650

Time Horizon: 4-5 years



Disclaimer: This report is just an analysis of a listed company and I hereby confirm everything mentioned above to be true to my knowledge. Please contact your financial advisor before acting on the recommendation. The author or the website or anyone associated with it is not responsible for any loss incurred.

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