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### Company Update

## Consumer Staples & Discretionary

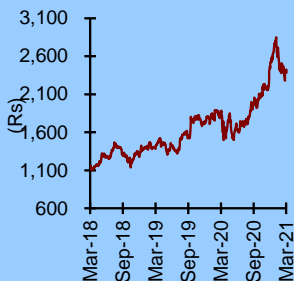
Target price: Rs2,600

### Shareholding pattern

	Jun '20	Sep '20	Dec '20
Promoters	52.8	52.8	52.8
Institutional investors	27.2	28.0	28.2
MFs and other	3.9	3.2	2.8
Banks, FI's, Insurance co	4.5	3.8	3.1
FIs	18.8	20.4	21.7
Pension Fund	-	0.6	0.6
Others	20.0	19.2	19.0

Source: BSE

### Price chart



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# INDIA

## Asian Paints

**ADD**  
**Maintained**

We like the diversification strategy – ‘risk-reward’ in tiles appears to be attractive

**Rs2,401**

Asian Paints is test-marketing / introduced designer tiles maintaining the template of entering at least one new business each year in last seven years. In our view, designer tiles can open up additional revenue opportunity of ~Rs30,000 per household. APNT can leverage (1) its existing brands and (2) relationships with real estate developers (initially to achieve critical size). It can also offer better value to consumers via (1) matching tiles with paints and (2) protection against damp walls. However, APNT may need to invest in distribution as there is limited overlap in paint and tile retail outlets. The skill sets, labour charges/hour of painter and mason are also different. Considering APNT’s new product template of lower investments in capex and branding, we believe success can create (potentially huge) value with negligible downside in case of failure. **ADD retained.**

- ▶ **Launch of designer tiles:** After entering waterproofing, putty, adhesives, kitchen, bath and Home Decor and strengthening presence in primers, Asian Paints has now entered designer wall tiles under the brand ‘royale with Asian Paints’. We believe it is entering multiple businesses considering (1) large opportunity in adjacent categories, (2) better utilization of existing distribution and brands and (3) rising competitive pressures in core business of paints.
- ▶ **Analyzing ‘right to win’ in tiles:** The entry in designer tiles opens up revenue opportunity of ~Rs30,000 per household. We believe Asian Paints has tailwinds in tiles business as (1) better service to the consumers via offering tiles matching with their paints, (2) solution to the damp walls, (3) better utilization of relationships with real estate developers (Projects business) and (4) higher revenues of tile adhesives. It will also be able to benefit from umbrella advertising. Similar to other new businesses of APNT, we expect limited investments (initially) in fixed assets.
- ▶ **Likely headwinds in tiles business:** There is hardly any overlap between distribution of paints and tiles and it may force Asian Paints to invest more in distribution. Also, the skill sets of a painter and mason are different. As a painter is paid more labour charges/ hour, he might be reluctant to work as a mason.
- ▶ **Tiles - A growth industry with strong RoCE for incumbents:** Our Building Material analyst team, Nehal Shah and Jigar Shah opines that tiles industry has grown at a CAGR of 11.1% over FY10-20. Considering the 50% share of unorganized/ smaller players and the premiumization potential, the organized players are likely to sustain healthy revenue growth in low-mid teens over FY20-30. Incumbents also generate RoCE of 15%+ (> Cost of capital) across business cycles.
- ▶ **Maintain ADD:** We model sales and earnings CAGR of 12.5% and 17.3% respectively, for FY20-FY23E. Maintain ADD with a DCF-based TP of Rs2,600. Lower-than-expected urban recovery and potential execution challenges in new categories are key risks.

Market Cap	Rs2303bn/US\$31.5bn	Year to March (Cons)	FY20	FY21E	FY22E	FY23E
Reuters/Bloomberg	ASPN.BO/APNT IN	Net Revenue (Rs mn)	202,113	208,361	255,772	288,078
Shares Outstanding (mn)	959.2	Net Profit (Rs mn)	27,556	29,858	37,858	43,598
52-week Range (Rs)	2871/1431	Dil. EPS (Rs)	28.2	31.1	39.5	45.5
Free Float (%)	47.2	% Chg YoY	25.1	10.5	26.8	15.2
FII (%)	21.7	P/E (x)	85.2	77.1	60.8	52.8
Daily Volume (US\$'000)	83,192	CEPS (Rs)	36.6	39.6	49.0	56.1
Absolute Return 3m (%)	(4.7)	EV/EBITDA (x)	55.4	49.2	39.8	34.9
Absolute Return 12m (%)	30.3	Dividend Yield (%)	0.5	0.5	0.6	0.6
Sensex Return 3m (%)	10.2	RoCE (%)	24.3	24.3	26.6	26.0
Sensex Return 12m (%)	42.3	RoE (%)	27.8	27.7	29.9	28.6

Please refer to important disclosures at the end of this report

## Analyzing right to win in designer tiles

Asian Paints has introduced designer tiles. We analyse the opportunity in designer tiles and the 'right to win' of Asian Paints in designer tiles. We also believe a large unorganised market in tiles and limited capital investments may allow Asian Paints generate healthy growth as well as return ratios.

**Chart 1: Designer tiles introduced by Asian Paints**



Source: Company, I-Sec research

### Sizing up the opportunity

**Revenue opportunity of at-least Rs30,000 per household:** Most consumers in India prefer tiles instead of paints in kitchens and bathrooms. It is easier to clean tiles than paints. Also, paint is likely to get more impacted in kitchen due to constant heat, oil, steam etc. In case of bathroom constant usage of water, soap and detergents may impact the paint.

We believe entry in designer tiles will allow Asian Paints to better service the consumers and gain additional revenues. Assuming that each household has two bathrooms and one kitchen, the total expenditure on wall tiles is ~Rs30,000.

**Table 1: Likely revenue potential of Rs30,000 per household**

Particulars	Details	Comments
Surface area in bathroom - 1	200	Two walls of 8X10 Sq. feet, Two walls of 5X10 Sq.
Surface area in bathroom - 2	200	feet minus Bathroom door & window
Surface area in kitchen	250	Four Walls minus (cupboards + cooking area + kitchen door + window)
<b>Total surface area covered by tiles</b>	<b>650</b>	
Designer tile price per Sq. foot (Rs)	50	
<b>Total revenue potential (Rs)</b>	<b>32,500</b>	

Source: Company, I-Sec research

**Tiles can be useful for damp walls:** Many consumers also use tiles to protect the damp walls instead of paints / waterproofing. As of now Asian Paints is not able to cater to these consumers and we believe entry in designer tiles will allow Asian Paints to cater to these consumers too.

We believe consumers staying in old buildings (> 20 year), on ground floor and near water bodies such as rivers, lakes are likely to use wall tiles instead of paints/waterproofing to protect the walls.

**Matching tiles to the paints:** While renovating / repainting the house, the consumers may prefer to use matching tiles to the paint used. In such cases Asian Paints will be able to better service the customers than its peers.

**Benefit of umbrella advertising:** The designer tiles are introduced under the 'royale' brand of Asian Paints. We believe Asian Paints will have advantage of umbrella advertising and the investments in brand building for tiles will be limited.

**Chart 2: Benefit of umbrella advertising of paint brands....**      **Chart 3: ...in designer tiles**



Source: Company, I-Sec research

**Limited investments (at-least initially):** Asian Paints has entered multiple new categories in past decade. These include waterproofing, putty, adhesives, bath and kitchen. It has also strengthened its presence in primers. Asian Paints has also introduced some Home Décor products. We note Asian Paints has preferred to outsource the production of new products which reduces the investments in the business.

Asian Paints has focussed on core strength of marketing, branding and distribution. We expect similar strategy in tiles too. We do not expect any investments in fixed assets, at-least initially.

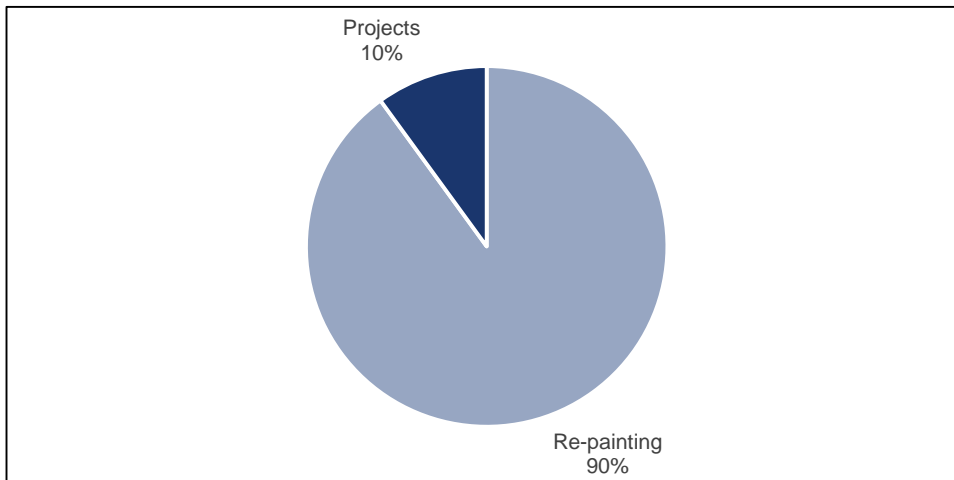
**Table 2: Manufacturing strategy in case of new products by Asian Paints**

Segment	Manufacturing strategy
Putty	Outsourced
Primer	Own as well as outsourced
Adhesives	Outsourced to Henkel
Waterproofing	Own as well as outsourced
Home Décor	Outsourced
Tiles	Likely to be outsourced
Kitchen	In house manufacturing
Bath	Largely outsourced

Source: Company, I-Sec research

**Leveraging relationships with real estate developers:** Asian Paints will be able to leverage the existing relationships with the real estate developers to sell designer tiles too. The projects business accounts for ~10% of decorative segment.

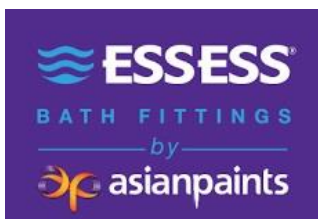
**Chart 4: Revenue share of Projects as % of Decorative segment**



Source: Company, I-Sec research

**Leveraging distribution of Bath Segment:** Asian Paints has three brands in Bath segment as (1) Ess Ess, (2) bathsense asianpaints and (3) royale Bathrooms. We believe the company can leverage the distribution networks of Bath segments to roll out designer tiles. Our channel checks suggest the company has healthy presence in Bath business in North India.

**Chart 5: Key brands in Bath segment**



Source: Company, I-Sec research

### Headwinds and/or challenges

**Paint and tiles distribution structure is different:** There are ~100,000 paint outlets in India and Asian Paints is present in ~70,000 outlets. The company sells paints to the dealers who sell these paints to end consumers. The trade margin/schemes are ~15%. These paint outlets also sell putty, primer, adhesives and waterproofing products. We also note some paint outlets sell electrical and plumbing products.

There are ~30,000 retail outlets selling tiles in India. The trade margins in tiles is ~8-10%. Some of these outlets also sell sanitary ware and faucets.

However, we believe there is very little overlap between tiles and paint shops. Hence, Asian paints will need additional investments to develop distribution in tiles business.

**Table 3: Distribution structure in paints vs tiles**

Particulars	Paints	Tiles
Number of outlets pan India (No.)	1,00,000	30,000
Trade margin / schemes (%)	~15%	8-10%
Ancillary products sold	Putty, primer, waterproofing, adhesives	Sanitary ware, Faucets
Other products sold	Electrical, hardware, plumbing products	Other Building materials

Source: Company, I-Sec research

**Skill set of painters and tile masons are different:** The skill sets of painters and tile masons are totally different. The labour rates per hour are also different in painting vs tile applications. A painter may not like to invest time and efforts in a work which pays lower rate per hour.

Asian paints have also entered waterproofing and the skill sets in waterproofing are also different. It is difficult to assume one person (painter) to learn three different skill sets such as painter, plumber and mason.

**Table 4: Skillsets required in multiple businesses**

Particulars	Skill set	Rate per hour (Rs)
Painting	Painter	100
Waterproofing	Plumber	200
Tiles	Mason	80

Source: Company, I-Sec research

While we believe the painters may lack the skill sets, they can be trained to use the tile adhesives which is extremely efficient and cost effective method for tiles. Usage of tile adhesives can open up another revenue stream for Asian Paints.

**Chart 6: Tile adhesives by APNT**



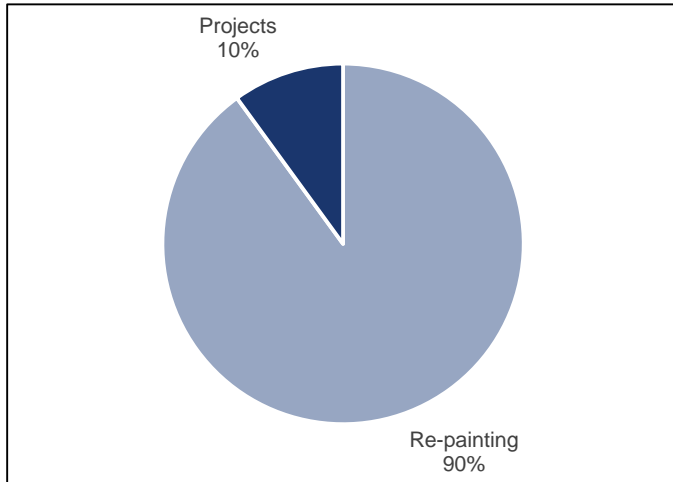
Source: Company, I-Sec research

**Chart 7: Tile on Tile adhesive by APNT**



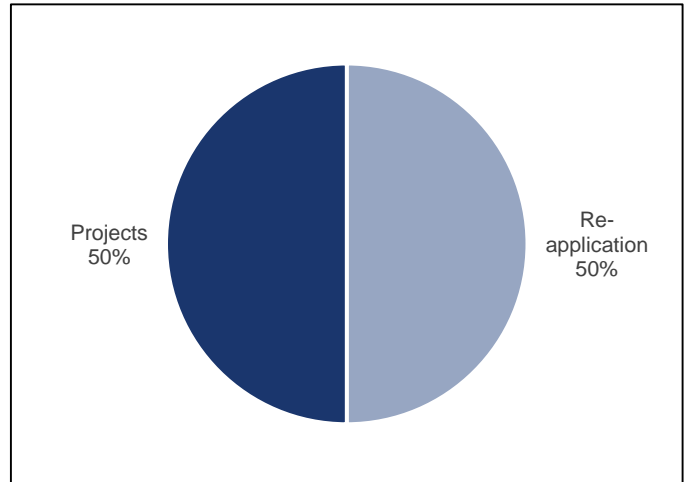
**Tiles has relatively higher B2B revenue share than paints:** The revenue share of B2B (Projects) is ~10% in paints. We believe the revenue share on B2B customers is relatively higher in tiles. Hence, business model of tiles is slightly different than paints.

**Chart 8: Projects business is lower in paints...**



Source: Company, I-Sec research

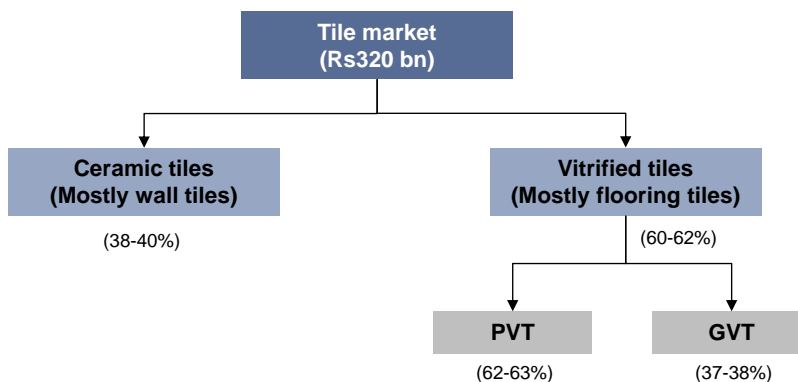
**Chart 9: ... than in tiles segment**



## Analyzing opportunity in tiles business

Tiles industry size is pegged at Rs320bn including Rs80bn of exports in FY20. The industry has grown at a CAGR of 11% over last decade (16.5% over FY10-15). The tiles are categorised mainly into ceramics and vitrified tiles. Vitrified tiles are further classified into Polished vitrified tiles (PVT) and Glazed vitrified tiles (GVT). Ceramic tiles are mostly wall tiles while vitrified tiles are mostly flooring tiles. Ceramic tiles represent 38-40% of the overall market while Vitrified tiles represents rest. Morbi in Gujarat is the major unorganised cluster in Indian tiles market. Players venturing into tiles market start with outsourcing/JV model and then gradually venture into value added tiles market manufacturing. Even branded players like Kajaria and Somany ceramics have outsourcing/JV revenue mix of more than 40-50%.

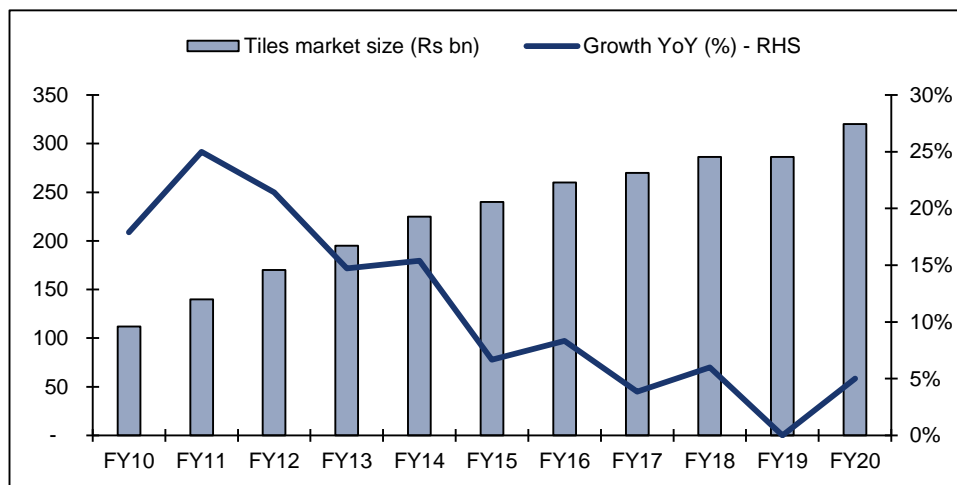
**Chart 10: Structure of tiles industry**



Source: Company, I-Sec research

**Tiles have grown at CAGR of 11.1% over FY10-20:** Tiles sector have grown at a CAGR of 11.1% over last decade. However, between FY10-15 it has grown at a CAGR of 16.5% led by robust real estate sales. While post FY16-17 real estate sales have gradually declined along with overall economy also started declining impacting tiles demand.

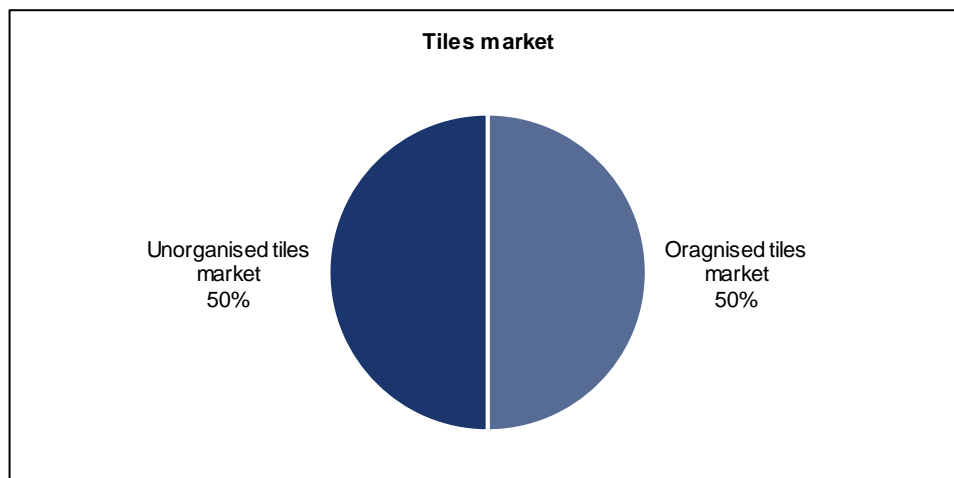
**Chart 11: Revenue growth of tiles industry**



Source: Company, I-Sec research

**Market structure of tiles industry:** Tiles market in India is equally divided between organised vs unorganised. Unorganised cluster like Morbi in Gujarat have advantages in terms of scale and raw material availability at reasonable rates. Also, branded players outsource lower category tiles to Morbi and hence overall mix of Morbi tiles mix would be higher than 50% to around 65-68%. Hence, branded players have a decent opportunity to gain market share from unorganised market.

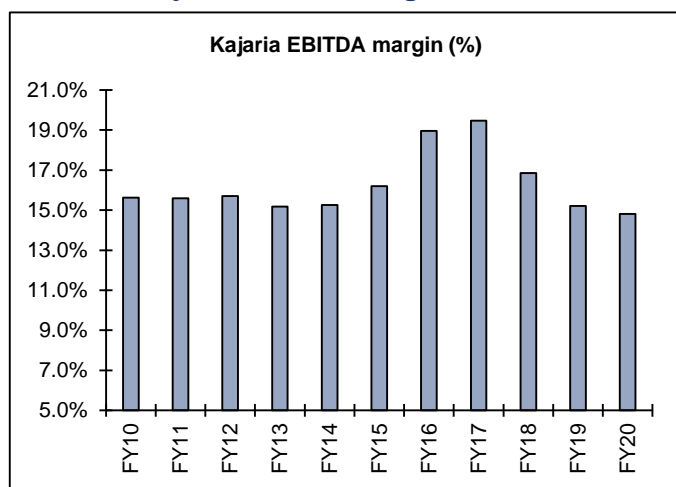
**Chart 12: Unorganised vs Organised market**



Source: Company, I-Sec research

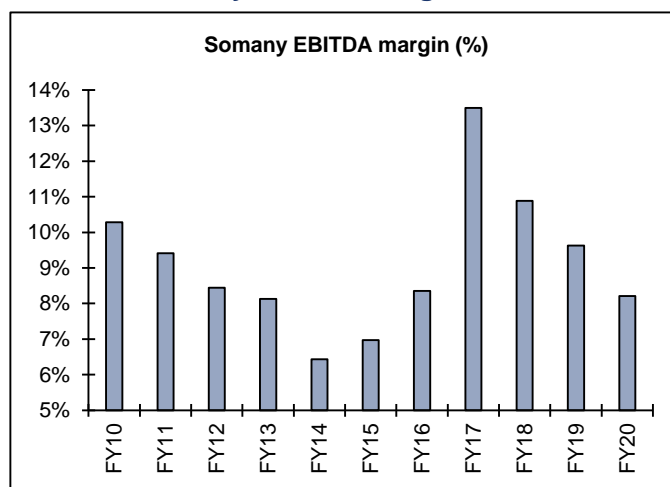
**EBITDA margin in tiles:** Ceramics tiles has an EBITDA margin of 8-10% while vitrified tiles have an EBITDA margin of 15-20%.

**Chart 13: Kajaria EBITDA margin**



Source: Company, I-Sec research

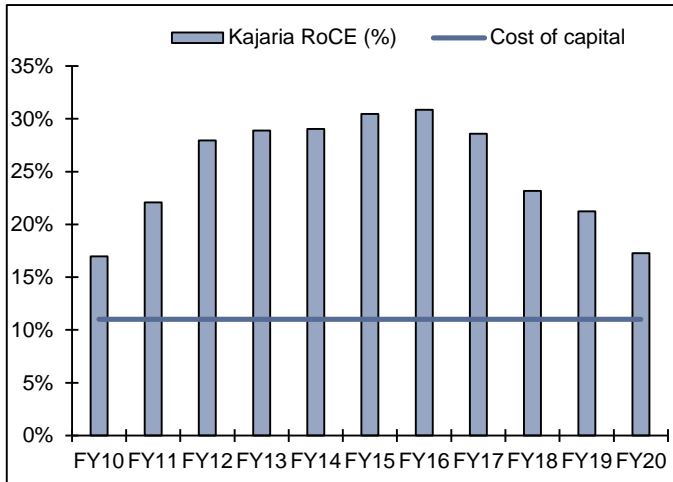
**Chart 14: Somany EBITDA margin**





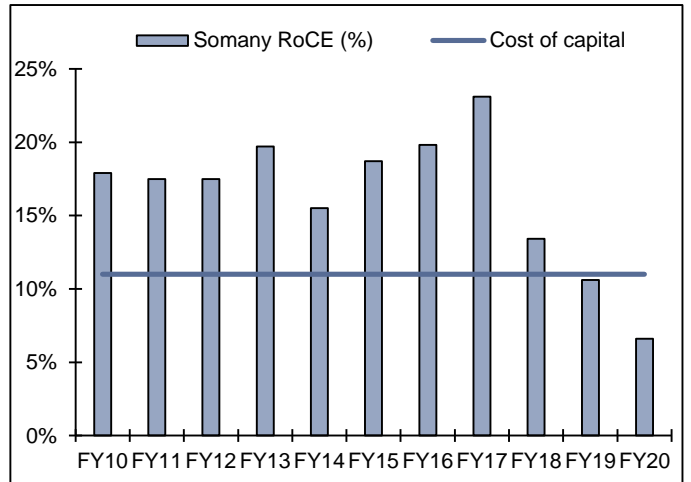
**RoCE in tiles:** Branded tiles players generate average RoCE upwards of 15% (> higher than cost of capital).

**Chart 15: Kajaria RoCE**



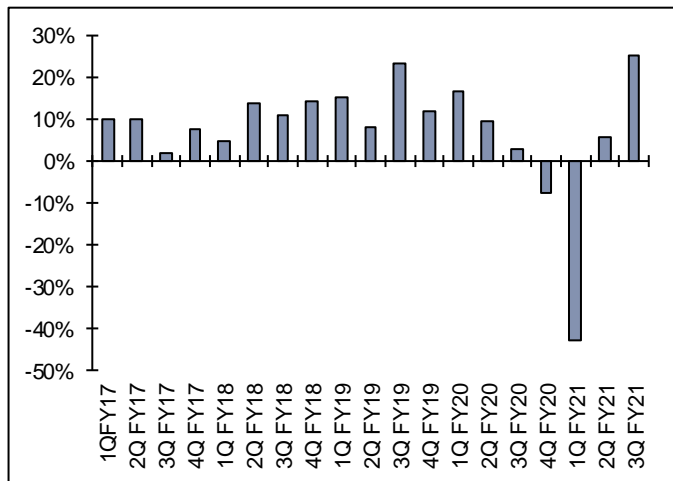
Source: Company, I-Sec research

**Chart 16: Somany RoCE**



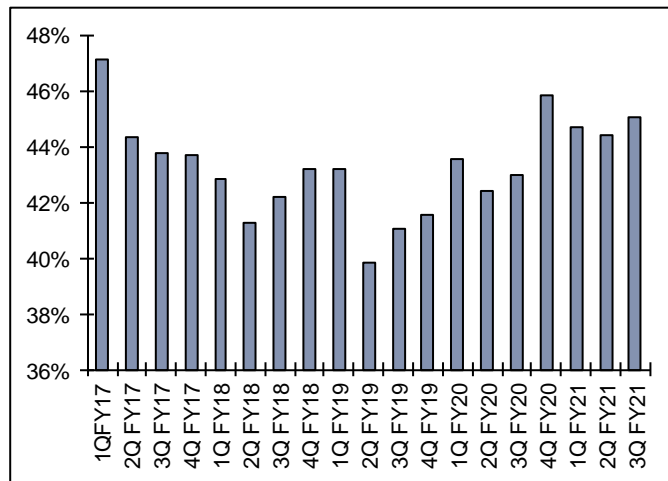
**Operational highlights – Quarterly (Consolidated)**

**Chart 17: Revenue growth (YoY)**



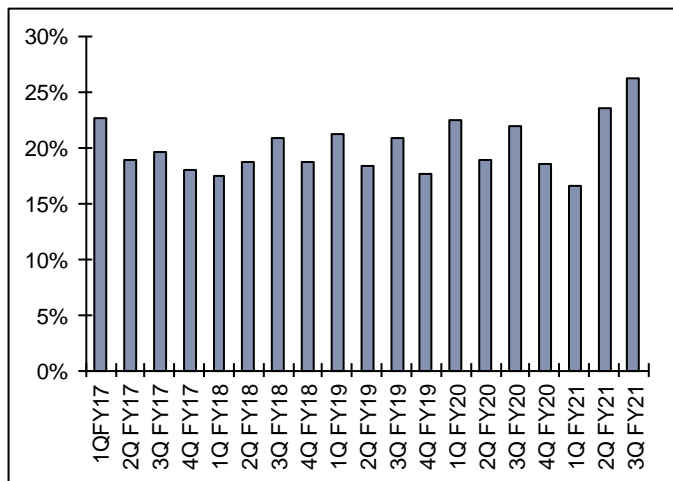
Source: Company data, I-Sec research

**Chart 18: Gross margin**



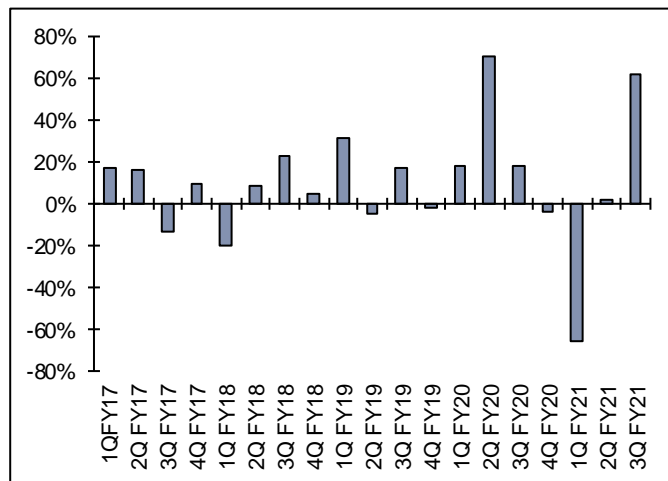
Source: Company data, I-Sec research

**Chart 19: EBITDA margin**



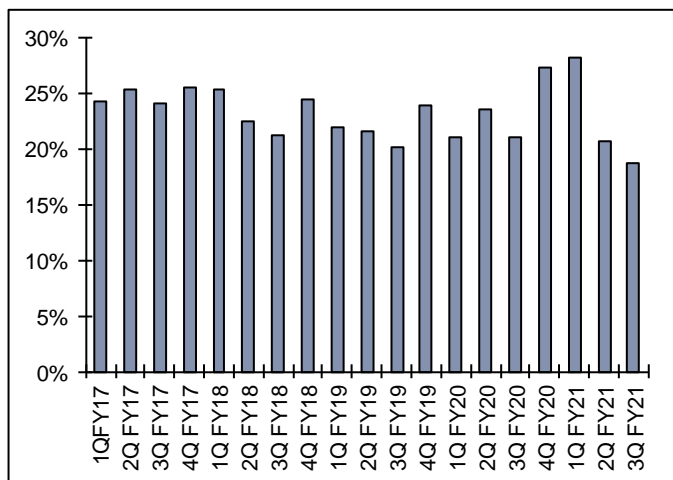
Source: Company data, I-Sec research

**Chart 20: PAT growth (YoY)**



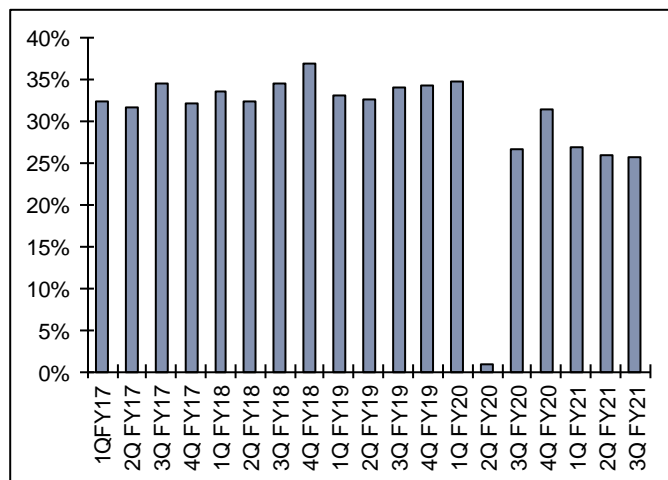
Source: Company data, I-Sec research

**Chart 21: Staff cost and other expenditure as % of net sales**



Source: Company data, I-Sec research

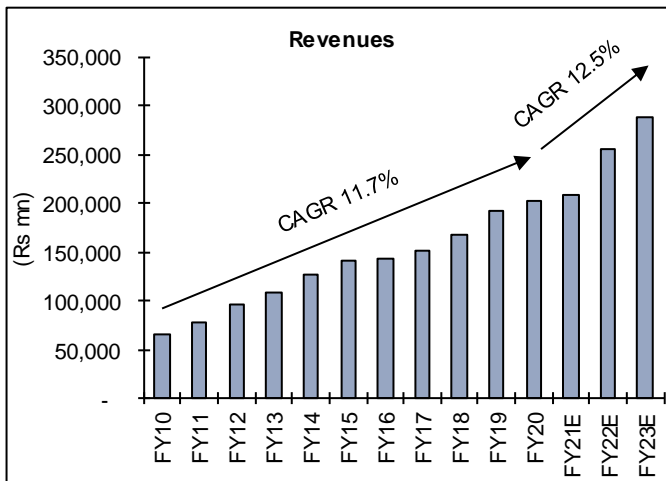
**Chart 22: Effective tax rate**



Source: Company data, I-Sec research

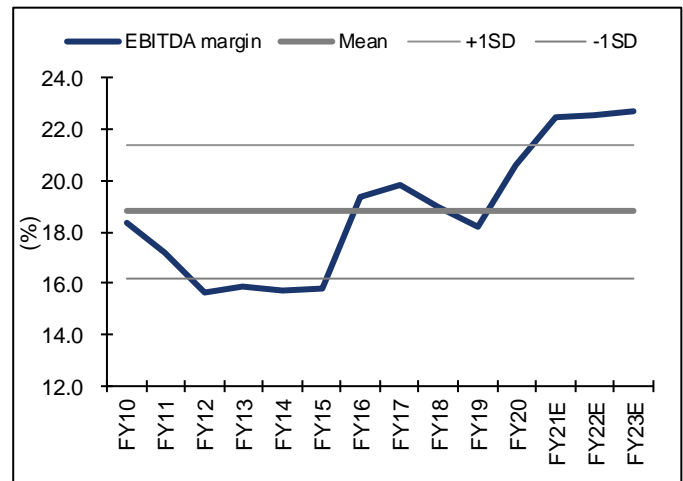
**Operational highlights - Annual**

**Chart 23: Revenues and growth rates**



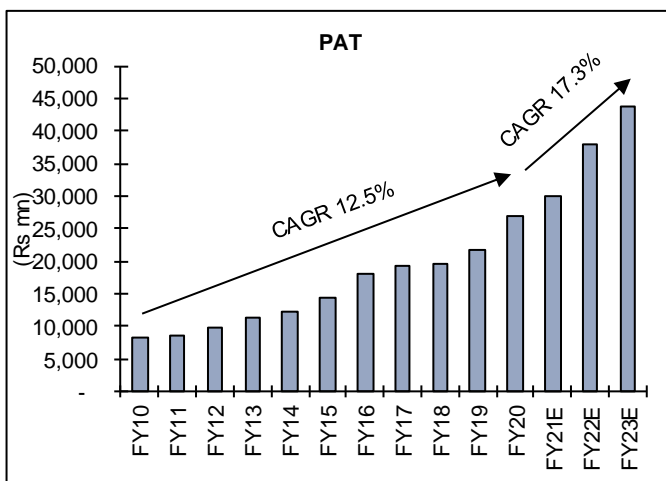
Source: Company data, I-Sec research

**Chart 24: EBITDA margin**



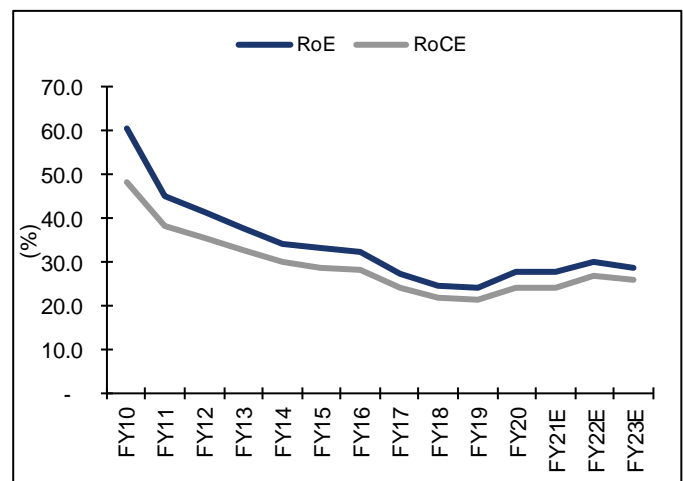
Source: Company data, I-Sec research

**Chart 25: PAT and growth rates**



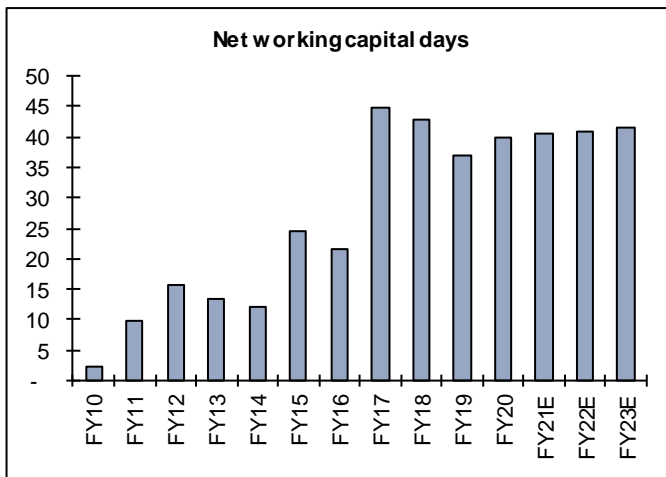
Source: Company data, I-Sec research

**Chart 26: RoE & RoCE**



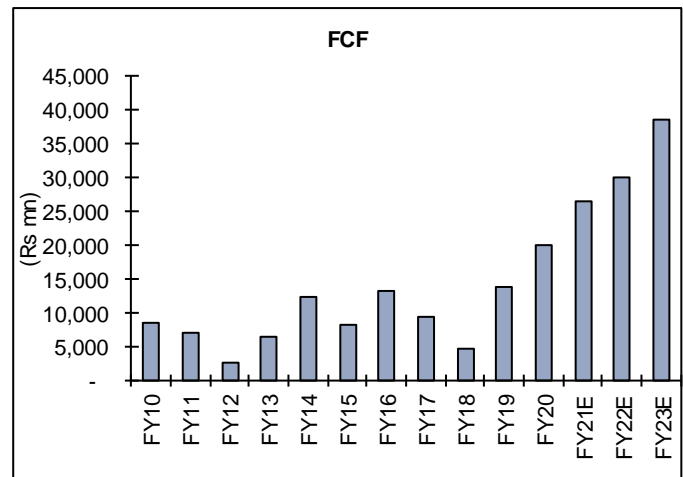
Source: Company data, I-Sec research

**Chart 27: Net working capital days**



Source: Company data, I-Sec research

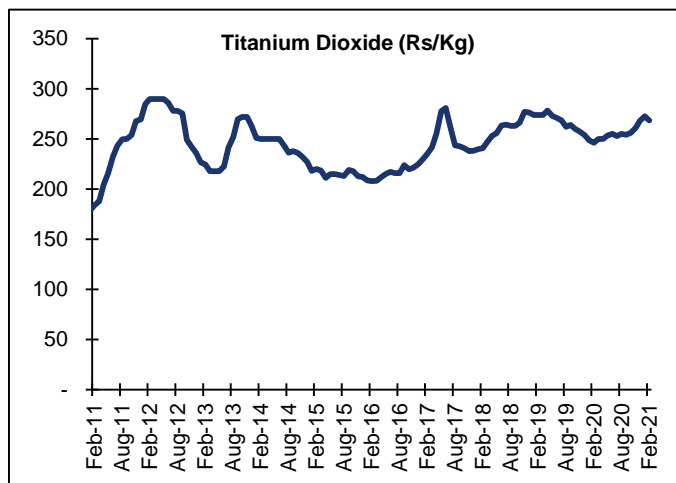
**Chart 28: Free cash-flow**



Source: Company data, I-Sec research

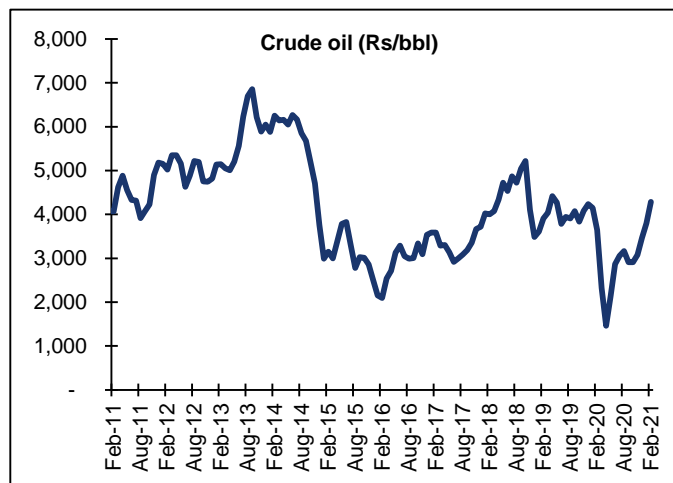
**Key raw material prices**

**Chart 29: Titanium di-oxide**



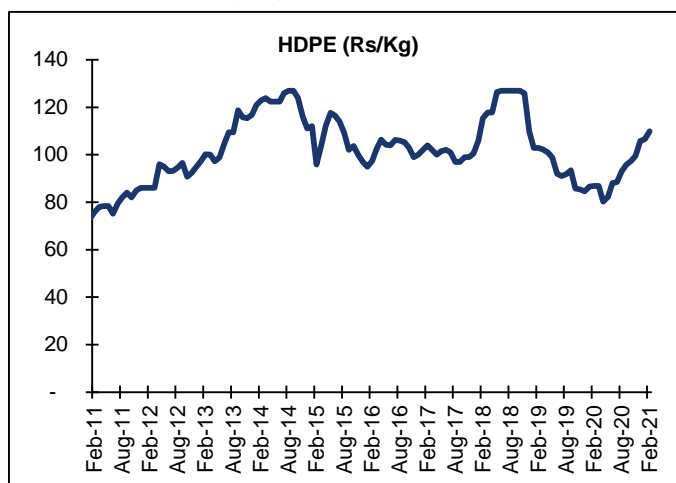
Source: Company data, I-Sec research

**Chart 30: Crude oil**



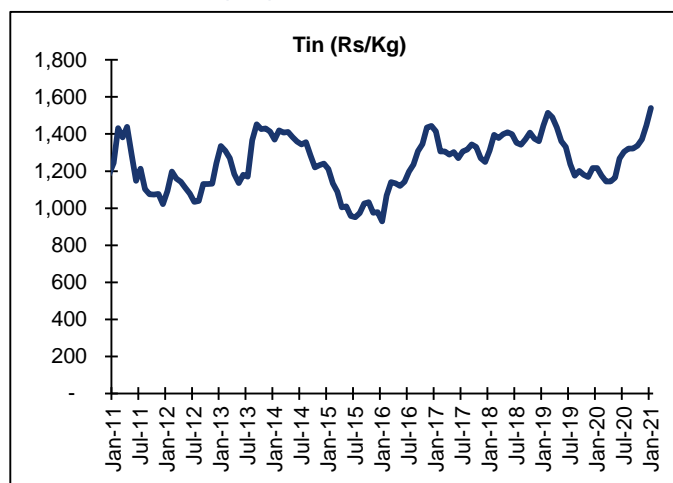
Source: Company data, I-Sec research

**Chart 31: Packaging material - HPDE**

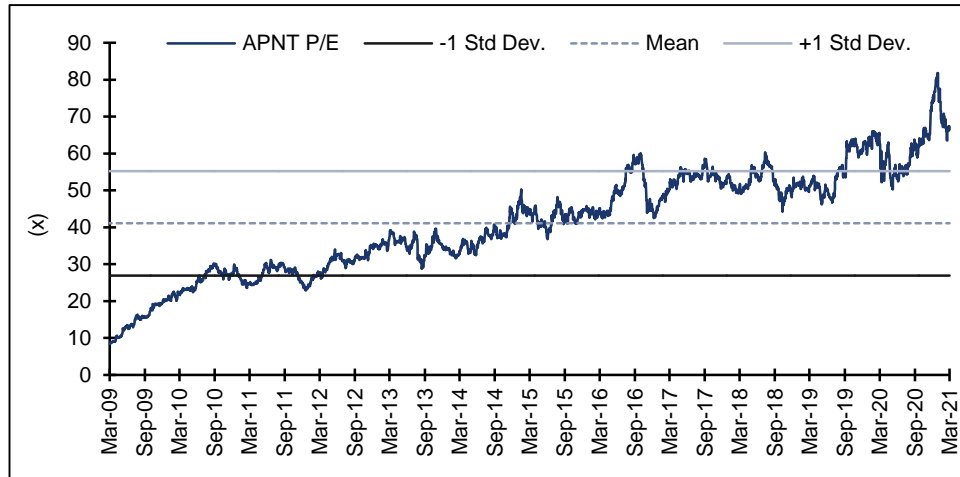


Source: Company data, I-Sec research

**Chart 32: Packaging material - Tin**



Source: Company data, I-Sec research

**Chart 33: Mean PE and Standard deviations**

Source: Bloomberg and I-Sec research

## Risks

- Volatility in raw material prices is a major risk to our estimates. Input cost increases led by high crude prices and a weak INR could put pressure on the margins in the short term due to lag in price action
- Significant increase in competitive pressures
- Lower-than-expected urban recovery
- Potential execution challenges in new categories

## Financial summary (consolidated)

Table 5: Profit &amp; loss statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
<b>Net Revenues</b>	<b>202,113</b>	<b>208,361</b>	<b>255,772</b>	<b>288,078</b>
<b>Operating Expenses</b>	<b>160,495</b>	<b>161,560</b>	<b>198,075</b>	<b>222,761</b>
<b>EBITDA</b>	<b>41,618</b>	<b>46,800</b>	<b>57,697</b>	<b>65,317</b>
% margins	20.6%	22.5%	22.6%	22.7%
Depreciation & Amortisation	7,805	7,855	8,892	9,926
Gross Interest	1,023	1,342	1,342	1,342
Other Income	3,043	2,843	3,740	4,878
<b>Recurring PBT</b>	<b>35,833</b>	<b>40,447</b>	<b>51,203</b>	<b>58,927</b>
Less: Taxes	8,549	10,314	13,057	15,026
Less: Minority Interest	262	275	288	303
<b>Net Income (Reported)</b>	<b>27,023</b>	<b>29,858</b>	<b>37,858</b>	<b>43,598</b>
Extraordinaries (Net)	(534)	-	-	-
<b>Recurring Net Income</b>	<b>27,556</b>	<b>29,858</b>	<b>37,858</b>	<b>43,598</b>

Source: Company data, I-Sec research

Table 6: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
<b>Assets</b>				
Total Current Assets	70,676	77,084	98,997	124,563
of which cash & cash eqv.	7,828	12,293	19,463	34,984
Total Current Liabilities & Provisions	40,589	41,247	50,374	56,380
<b>Net Current Assets</b>	<b>30,087</b>	<b>35,837</b>	<b>48,623</b>	<b>68,184</b>
Investments	26,578	33,578	41,578	49,578
Net Fixed Assets	59,523	61,669	63,777	64,851
Capital Work-in-Progress	1,402	1,402	1,402	1,402
Goodwill	3,200	3,200	3,200	3,200
<b>Total Assets</b>	<b>120,791</b>	<b>135,685</b>	<b>158,580</b>	<b>187,214</b>
<b>Liabilities</b>				
<b>Borrowings</b>	11,184	11,184	11,184	11,184
Deferred Tax Liability	4,270	4,270	4,270	4,270
Minority Interest	4,035	4,035	4,035	4,035
Equity Share Capital	959	959	959	959
Face Value per share (Rs)	1	1	1	1
Reserves & Surplus*	100,342	115,237	138,132	166,766
Less: Misc. Exp. n.w.o.	-	-	-	-
<b>Net Worth</b>	<b>101,302</b>	<b>116,196</b>	<b>139,091</b>	<b>167,725</b>
<b>Total Liabilities</b>	<b>120,791</b>	<b>135,685</b>	<b>158,580</b>	<b>187,214</b>

Source: Company data, I-Sec research

Table 7: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
<b>Operating Cashflow</b>	<b>35,089</b>	<b>37,713</b>	<b>46,750</b>	<b>53,524</b>
Working Capital	(2,629)	(1,285)	(5,616)	(4,040)
Changes				
Capital Commitments	(11,335)	(10,000)	(11,000)	(11,000)
<b>Free Cashflow</b>	<b>21,125</b>	<b>26,428</b>	<b>30,134</b>	<b>38,484</b>
<b>Cashflow from Investing Activities</b>	<b>(868)</b>	<b>(7,000)</b>	<b>(8,000)</b>	<b>(8,000)</b>
Issue of Share Capital	-	-	-	-
Inc (Dec) in Borrowings	5,024	-	-	-
Dividend paid	(13,554)	(14,964)	(14,964)	(14,964)
<b>Change in Deferred Tax Liability</b>	<b>(1,127)</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Chg. in Cash &amp; Bank balances</b>	<b>3,379</b>	<b>4,464</b>	<b>7,171</b>	<b>15,521</b>

Source: Company data, I-Sec research

Table 8: Key ratios

(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
<b>Per Share Data (Rs)</b>				
EPS	28.2	31.1	39.5	45.5
Cash EPS	36.6	39.6	49.0	56.1
Dividend per share (DPS)	12.0	12.0	14.0	15.0
Book Value per share (BV)	105.6	121.1	145.0	174.9
<b>Growth (%)</b>				
Net Sales	4.5	3.1	22.8	12.6
EBITDA	18.1	12.5	23.3	13.2
PAT	25.1	10.5	26.8	15.2
Cash EPS	34.9	8.3	23.8	14.4
<b>Valuation Ratios (x)</b>				
P/E	85.2	77.1	60.8	52.8
P/CEPS	65.6	60.6	49.0	42.8
P/BV	22.7	19.8	16.6	13.7
EV / EBITDA	55.4	49.2	39.8	34.9
EV / Sales	11.4	11.0	9.0	7.9
<b>Operating Ratios</b>				
Raw Material / Sales (%)	56.3	54.8	54.3	53.6
Employee cost / Sales (%)	6.8	6.9	6.8	7.3
SG&A / Sales (%)	16.3	15.9	16.4	16.4
Other Income / PBT (%)	8.5	7.0	7.3	8.3
Effective Tax Rate (%)	23.9	25.5	25.5	25.5
Working Capital (days)	40.0	40.7	41.0	41.5
Inventory Turnover (days)	60.4	60.4	60.4	60.4
Receivables (days)	32.0	32.0	32.0	32.0
Payables (days)	67.6	67.6	67.6	67.6
Net D/E Ratio (x)	0.1	0.1	0.1	0.1
<b>Profitability Ratios (%)</b>				
Net Income Margins	13.5	14.5	14.9	15.2
RoACE	24.3	24.3	26.6	26.0
RoAE	27.8	27.7	29.9	28.6
Dividend Payout	42.2	41.4	32.7	28.4
Dividend Yield	0.5	0.5	0.6	0.6
EBITDA Margins	20.6	22.5	22.6	22.7

Source: Company data, I-Sec research

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