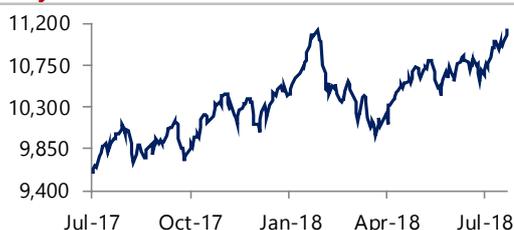


JULY 25, 2018

Equity	% Chg				
	24-Jul	1 Day	1 Mth	3 Mths	
Indian Indices					
SENSEX Index	36,825	0.3	3.2	6.4	
NIFTY Index	11,134	0.4	2.9	4.9	
NSEBANK Index	26,974	(0.1)	0.8	7.7	
NIFTY 500 Index	9,451	0.9	1.7	0.6	
CNXMcap Index	18,497	1.3	(0.5)	(7.5)	
BSESMCAP Index	16,219	2.2	(1.9)	(11.1)	
World Indices					
Dow Jones	25,242	0.8	4.1	4.8	
Nasdaq	7,841	(0.0)	4.1	12.0	
FTSE	7,709	0.7	2.7	4.5	
NIKKEI	22,510	0.5	1.3	1.9	
Hangseng	22,510	0.5	1.3	1.9	
Shanghai	28,663	1.4	(0.3)	(4.8)	
Value traded (Rs cr)		24-Jul	% Chg Day		
Cash BSE		3,390	31.3		
Cash NSE		34,563	9.5		
Derivatives		874,238	27.5		
Net inflows (Rs cr)		23-Jul	MTD	YTD	
FII		167	(2,095)	(6,935)	
Mutual Fund		(199)	5,512	74,115	
Nifty Gainers & Losers		Price	Chg	Vol	
24-Jul		(Rs)	(%)	(mn)	
Gainers					
Grasim Industries	1,000	8.5	3.3		
Hindalco Ind	208	5.8	18.5		
Indiabulls Housing	1,258	5.1	2.0		
Losers					
Kotak Mahindra Bank	1,312	(1.9)	3.1		
Heo MotoCorp	3,108	(1.8)	1.6		
Bajaj Finance	2,713	(1.5)	2.8		
Advances / Declines (BSE)					
24-Jul	A	B	T	Total	% total
Advances	314	913	68	1,295	100
Declines	75	191	43	309	24
Unchanged	-	19	9	28	2
Commodity		% Chg			
	24-Jul	1 Day	1 Mth	3 Mths	
Crude (US\$/BBL)	73.9	0.7	(1.1)	(0.1)	
Gold (US\$/OZ)	1,225	0.0	(3.2)	(7.4)	
Silver (US\$/OZ)	15.5	0.6	(5.2)	(6.5)	
Debt / forex market		24-Jul	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	7.8	7.8	7.8	7.7	
Re/US\$	68.9	68.9	68.1	66.4	

Nifty



Source: Bloomberg

News Highlights

- ▶ India's largest exchange plans to start extended trading subject to approval from the regulator sometime in October, it said in an email to clients. It shared a "skeletal framework" for trading till 11.55 p.m.—nearly seven hours more than now. According to the framework: There shall be two trading sessions with a break of about 60-90 minutes. The first session would be between 9:15 a.m. and 3:30 p.m. (Bloomberg)
- ▶ The GST Council's decision to reduce taxes on decorative paints from 28 percent to 18 percent is a "welcome move", and should help improve demand from small consumers, Managing Director and Chief Executive Officer KBS Anand said in a press release. (Bloomberg)
- ▶ Asia's largest private healthcare provider, Malaysia headquartered IHH Healthcare, which was recently picked as the winning bidder in the hotly contested race for a controlling interest in **Fortis Healthcare** is gearing up for round two of its consolidation strategy in its fourth home market, India, multiple individuals familiar with the company's plans told media on condition of anonymity (ET).
- ▶ **Punj Lloyd** files plea challenging maintainability of **ICICI Bank's** application before NCLT. (Bloomberg)
- ▶ **Andhra Bank** gets capital infusion of Rs 20.19 bn from the central government (Bloomberg)
- ▶ **HDFC** to consider raising up to \$1.5 billion via foreign currency loan. (Bloomberg)
- ▶ The government is planning to sell its 73 per cent stake in hydro-power producer **NHPC** to its state-run peer **NTPC** for around Rs 182 bn. (ET)
- ▶ **Maruti**, the country's largest carmaker says it is on track to meet BS VI emission norms, which will come into effect from April 2020. (ET)
- ▶ **GAIL**, the state-run firm will not be split but will have to hive off its transportation business into a subsidiary to reduce the conflict of interest, oil ministry sources said. (ET)
- ▶ **JSW Steel** will merge recently-acquired distressed asset Monnet Ispat & Energy with the company, chairman Sajjan Jindal said on Tuesday. (ET)
- ▶ The Cabinet is expected to soon consider **IDBI Bank's** proposal to issue fresh equity to the Life Insurance Corporation of India (LIC), offering the insurer a controlling 51 per cent stake in the lender as the government pushes for the deal to be completed by September (ET)
- ▶ **Idea Cellular Ltd** and Vodafone India Ltd have made a joint payment of Rs 72.5 bn under protest to the department of telecom for merger of their mobile business. (Mint)
- ▶ **Alkem Laboratories** has received an Establishment Inspection Report from the US Food and Drug Administration for its manufacturing facility at Amaliya, Daman. (BL)

What's Inside

- ▶ **Initiating Coverage:** Persistent Systems Ltd.
- ▶ **Result Update:** Kajaria Ceramics Ltd, Asian Paints Ltd.
- ▶ **Forthcoming events**

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, IE = Indian Express, BL = Business Line, ToI: Times of India, BSE = Bombay Stock Exchange, MC = Moneycontrol

Initiating Coverage

PERSISTENT SYSTEMS LTD

Stock Details

Market cap (Rs mn)	:	67720
52-wk Hi/Lo (Rs)	:	880 / 590
Face Value (Rs)	:	10
3M Avg. daily vol	:	231,473
Shares o/s (m)	:	80

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	30,337	36,028	40,723
Growth (%)	5.4	18.8	13.0
EBITDA	4,687	6,037	7,222
EBITDA margin (%)	15.5	16.8	17.7
PAT	3,230	4,180	5,205
EPS	40.4	52.2	65.1
EPS Growth (%)	7.2	29.4	24.5
BV (Rs/share)	266	302	349
Dividend/share (Rs)	10.0	13.0	15.1
ROE (%)	16.0	18.4	20.0
ROCE (%)	18.4	21.9	23.8
P/E (x)	21.0	16.2	13.0
EV/EBITDA (x)	14.0	10.4	8.1
P/BV (x)	3.2	2.8	2.4

Source: Kotak Securities - PCG; Company

Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	30.4	30.5	30.6
FII	26.2	26.5	24.0
DII	15.8	14.1	14.5
Others	24.2	28.9	30.9

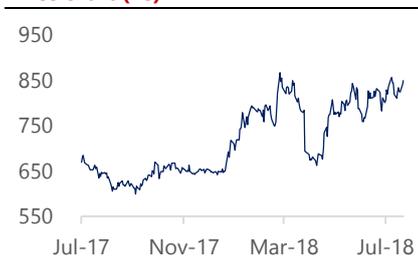
Source: Company

Price Performance (%)

(%)	1M	3M	6M
Persistent Systems	2.2	17.0	7.6
Nifty	2.7	4.7	0.3

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

PRICE RS. 848

TARGET RS. 1025

BUY

Persistent specializes in software product development and technology services. It helps enterprises to **transform their business to software-driven business** in North America, Europe, and Asia. The company has moved away from effort-based business (low growth prospects) to value-based business (high growth prospects and better margins). Our confidence on quality improvement of earnings and long-term margin sustainability, going forward is supported by company's strategy of aggressively focusing on digital business, increasing its efforts on IP and non-linear revenue through the IBM partnership along with allied deal wins and reducing its focus on linear revenue.

Persistent expects to outperform industry-growth rate and report overall double-digit revenue growth for FY19E supported by healthy traction in digital business. We expect Persistent's revenue to grow by 19% yoy to Rs. 36 bn in FY19 and to grow by 13% yoy to Rs. 41 bn in FY20E as against Rs.30 bn in FY18 (5.4% yoy). Additionally, it is aggressively focusing on newer technologies such as machine learning, block chain, IoT, data and digital which should elevate its growth trajectory, we opine.

We initiate coverage on Persistent with a BUY rating and a multiple based price target of Rs.1,025/share. Management has pointed to a stronger pipeline with significant deals wins particularly in the field of Neuro sciences. Margin improvement and strong revenue visibility makes us positive on its growth prospects. Additionally, cash rich balance sheet, strong free cash flow and healthy return ratios (ROE 16+% and ROCE 18+%) also provide high comfort. At CMP, the stock is valued at 8.1x EV/EBITDA and 13x P/E on FY20E basis. We have valued the stock at 15.7x PE multiple which is at a 30% discount to TCS.

Key Investment Rationale

- ❑ **Persistent to beat Nasscom's growth guidance:** Nasscom has guided for IT services exports growth of 7-9% in c/c (constant currency) for FY19 as against 7 % in FY18. Persistent is optimistic in beating Nasscom's growth forecast backed by growth in new businesses.
- ❑ **Strong pipeline:** It has made significant wins in the field of neurosciences which has helped in building strong pipeline. Parx has good growth potential and has built a healthy pipeline.
- ❑ **Digital solutions will accelerate top-line growth:** Digital is an important part of Persistent's future growth journey and revenue from digital business is continuously growing. Persistent is seeing strong traction and winning projects, where customers are looking at custom built development on newer technology. Just to highlight, Digital revenue contribution has grown meaningfully from 14% of the total revenue in Q1FY17 to ~21% of the total revenue by the end of FY18.
- ❑ **New product launches:** Persistent's strategy is to focus on collaborative innovation/co-creation model to build new business models and revenue streams. It has already successfully created a new digital solution in collaboration with its existing clients. We expect co-creation model to start showing meaningful results from H1FY19 and onwards.

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- **Revenue growth and margin improvement to drive earnings:** Persistent's management is aggressively focusing on digital business and expects overall double-digit revenue growth for FY19E supported by healthy traction in digital business-Healthcare and BFSI. According to NASCCOM, social, mobility, cloud, analytics and IoT are estimated to comprise ~20% of IT revenue in 2020.
- Persistent has indicated that profit margin improvement will happen due to couple of factors such as 1) Better business mix, 2) Improvement in utilization levels, 3) Higher IP deals and 4) Higher onsite utilization. The company has indicated that new deals are generating better revenues and hence higher margins are long-term sustainable. Further, it is focusing more on IP and digital business which enjoys better margins than traditional business. We expect Persistent to report an EBITDA margin of 16.8%/17.7% in FY19E and FY20E, respectively vs. 15.5% in FY18.
- **Focus on sales and marketing:** The Company believes it has strong portfolio (IBM and IP) to cater and hence is aggressively investing in sales and marketing (v/s reduced re-engineering spends) which will boost its topline. Further, with the inclusion in the IBM reseller list and expansion of its sales team should help it to reach out to IBM clients in Europe, directly boosting the company's revenue growth prospects.
- **Healthy Financials:** Over FY14-18, Persistent has posted revenue growth of 16% CAGR, generated healthy RoCE/ROE of above 18%/16%, respectively and maintained 23% plus dividend payout. We expect EPS to grow at 26% CAGR over the next two years (FY18-FY20E), driven by higher revenue growth and improvement in EBITDA margins. Lot of headwinds such as volatility in profitability and delay in revenue generation from IBM IoT deal during FY18 seems to be over.

Higher sales investment of US\$ 4-5 mn will be supported by reduced spending on engineering/R&D

Result Update

KAJARIA CERAMICS LTD

Stock Details

Market cap (Rs mn)	:	68905
52-wk Hi/Lo (Rs)	:	768 / 414
Face Value (Rs)	:	2
3M Avg. daily vol (mn)	:	495,295
Shares o/s (m)	:	159

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Sales	27,106	31,102	33,824
Growth (%)	6%	15%	9%
EBITDA	4,564	4,976	5,750
EBITDA margin (%)	16.8%	16.0%	17.0%
Net profit	2,344	2,646	3,131
EPS(Rs)	14.7	16.6	19.7
Growth (%)	9%	13%	18%
BVPS (Rs)	85.0	98.0	114.1
DPS (Rs)	3.0	3.0	3.0
ROE (%)	18.6	18.2	18.6
ROCE (%)	22.0	22.2	24.0
P/E (x)	29.4	26.0	22.0
EV/EBITDA (x)	15.5	14.0	12.0
P/BV (x)	5.1	4.4	3.8

Source: Company

Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	47.6	47.6	47.6
FII	26.1	28.1	28.7
DII	9.6	9.2	7.4
Others	16.4	15.1	16.3

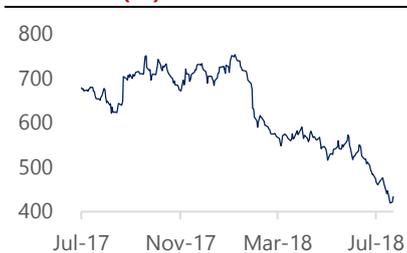
Source: Company

Price Performance (%)

(%)	1M	3M	6M
Kajaria Ceramics	(15.2)	(23.6)	(38.9)
Nifty	2.9	4.9	0.4

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

PRICE Rs.433

TARGET Rs.551

BUY

Kajaria Ceramics revenues were in line with our estimates but lower than expected margins led to net profits coming below our estimates. Results were impacted by higher gas prices resulting in higher power and fuel cost along with pressure on realizations. Volumes are likely to pick up and we believe that further cost pressures are likely to ease out going forward. Loss making JVs are expected to make profits going forward. Company has also decided to offload its stake in its subsidiary Soriso Ceramics for Rs 110 mn.

Key highlights

Revenue growth of 4.7% YoY was led by volume growth as realizations remained largely under pressure. Operating margins stood at 14.7% vs 16.5% same period last year due to higher gas prices. Net profit performance on YoY basis was impacted by fall in margins and stood below our estimates.

Consolidated financial highlights

(Rs mn)	Q1FY19	Q1FY18	YoY (%)	Q4FY18	QoQ (%)
Net Sales	6,570.2	6,275.8	4.7	7,500.4	(12.4)
Total Expenditure	5,601.9	5,238.6	6.9	6,299.7	(11.1)
(Increase) / Decrease In Stocks	(354.3)	(460.8)		39.5	
Cost of Services & Raw Materials	1,937.1	1,892.4		1,894.9	
As % of sales	29.5	30.2		25.3	
Purchase of Finished Goods	689.0	786.2		976.1	
As % of sales	10.5	12.5		13.0	
Operating & Manufacturing Exp	921.5	989.4		1,060.9	
As % of sales	14.0	15.8		14.1	
Electricity, Power & Fuel Cost	1,539.7	1,265.7		1,521.3	
As % of sales	23.4	20.2		20.3	
Employee Cost	868.9	765.7		807.0	
As % of sales	13.2	12.2		10.8	
EBITDA	968.3	1,037.2	(6.6)	1,200.7	(19.4)
EBITDA (%)	14.7	16.5		16.0	
Depreciation	226.7	218.4		228.6	
EBIT	741.6	818.8	(9.4)	972.1	(23.7)
Interest	41.7	78.0		46.9	
EBT (exc other income)	699.9	740.8	(5.5)	925.2	(24.4)
Other Income	23.8	41.4		51.4	
PBT	723.7	782.2	(7.5)	976.6	(25.9)
Tax	269.8	293.1		280.3	
Tax (%)	37.3	37.5		28.7	
PAT	453.9	489.1	(7.2)	696.3	(34.8)
Minority Interest	(1.6)	(15.9)		36.6	
Consolidated Net Profit	455.5	505.0	(9.8)	659.7	(31.0)
NPM (%)	6.9	8.0		8.8	
Equity Capital	158.9	158.9		159.0	
Face Value (In Rs)	1.00	1.00		1.00	
Basic EPS before Extraordinary Items	2.87	3.18	(9.8)	4.15	(30.9)

Source: Company

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Valuation and outlook

Stock is currently trading at valuations of 26x and 22x on FY19 and FY20 estimates respectively. We revise our estimates to factor in slightly lower realizations and higher costs while keeping the volume growth intact. We reduce our forward valuation multiples downwards to 28x vs 30x earlier to factor in delays in percolation of GST and e-way bill implementation benefits for the organized players. The competition has increased in the value added products too which is impacting realizations of these players. We expect the sector to witness these challenges further for 1-2 quarters more and once complete compliance begins towards e-way bill, then organized players will start witnessing increased volumes and improved realizations.

We arrive at a revised price target of Rs 551 based on 28x FY20 estimated earnings (Rs 648 earlier). We believe that organized players like Kajaria Ceramics are likely to benefit from demand improvement with market leading position and wide offering of products. We remain positive on the company and maintain BUY.

Revenue growth led by volume improvement

Revenue for Q1FY19 were in line with our estimates but volume gains were offset to some extent by pricing pressure. Growth was largely led by 9.5% YoY volume improvement but average realizations were down by 4.5% YoY. Average realization for Q1FY19 stood at Rs 367 per sq m as realizations from own manufactured products and JV products were impacted by increased competition and excess capacities in GVT category. We believe that prices have also largely bottomed out with most players operating at break-even level in the GVT category.

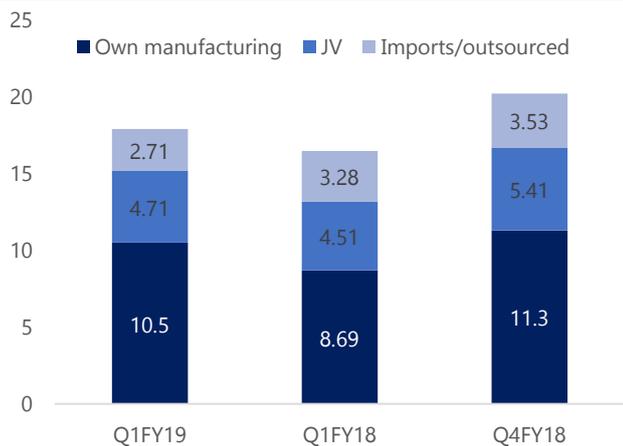
Realization details - Average realizations for Q1FY19 were down by 4.5% YoY and 1.1% QoQ and stood at Rs 367 per sq m.

- Realizations declined by 5.4% YoY from own manufacturing plants on yearly basis and declined quite sharply by 16.5% YoY from JV plants due to pressure on GVT realizations. Realizations from own production stood at Rs 370 per sq m while realizations from JV plants stood at Rs 326 per sq m, down by 16.5% YoY;
- Realizations from imported products stood at Rs 278 per sq m, up by 2.9% YoY.

Volume details - Volumes were up by 9.5% YoY largely led by volume improvement from owned plants and partly from JV plants.

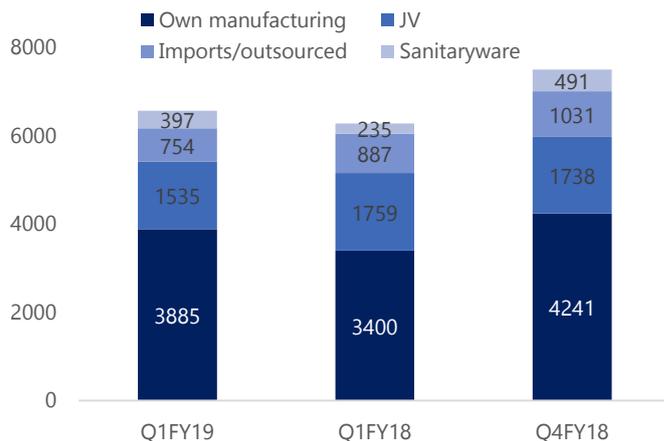
- Revenues from own production improved by 14.2% YoY and was led by volume gains of 20.8% YoY.
- Revenues from JVs declined by 12.8% YoY due to pricing pressures as volumes have grown by 4.4% YoY from JV plants. Utilization levels are improving from the JV plants now.
- Sales from imports has gone down by 15% YoY due to relatively lower realization as compared to own plants.
- Sanitaryware and faucets division has reported 69% YoY improvement in revenues. Volumes are likely to improve going forward with improved demand.

Sales volume break up (mn sq mtr)



Source: Company

Revenues (Rs mn)



Source: Company

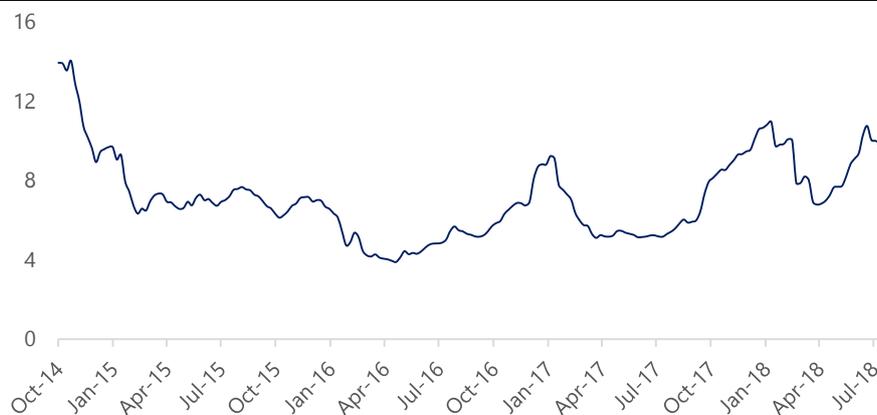
Company has also decided to offload its stake in its subsidiary Soriso Ceramics for Rs 110 mn. Soriso Ceramics had turnover of Rs 568 mn (2.1% of consolidated turnover) and net worth of Rs 205.8 mn.

We tweak our estimates to factor in slightly lower realizations as delays in e-way bill implementation compliance may continue to impact the realizations for organized players. We expect revenues to grow at a CAGR of 11.7% between FY18-20 led by a volume growth at a CAGR of 12.5% between FY18-20.

Margins impacted by higher gas prices and pressure on realization

Operating margins for the quarter stood at 14.7% vs 16.5% for Q1FY18. Margins were impacted due to higher gas prices as well as pressure on realizations. Spot LNG prices have started correcting since June last week and if the trend continues then it might result in margin improvement from H2FY19 onwards. We revise our estimates downwards to factor in Q1FY19 performance, though we have witnessed minor correction in gas prices since beginning of FY19. We expect margins of 16%/17% in FY19/FY20 respectively. (17.7%/17.7% estimated earlier for FY19/20 respectively) taking into account higher costs. Improved product mix and reduction in gas prices is likely to aid margins from current levels.

SLNG spot (\$/MMBTU)



Source: Bloomberg

Net profit performance lower than our estimates

Net profit performance on YoY basis was impacted by fall in margins but boosted by lower interest expense. Loss making JVs had achieved break-even during FY18 and company expects to make profits in these JV's going forward. We revise our profit estimates downwards by 14%/8% for FY19/20 respectively and expect net profits to grow at a CAGR of 11.4% between FY18-20.

Valuation and recommendation

Stock is currently trading at valuations of 26x and 22x on FY19 and FY20 estimates respectively. We revise our estimates to factor in slightly lower realizations and higher costs while keeping the volume growth intact. We reduce our forward valuation multiples downwards to 28x vs 30x earlier to factor in delays in percolation of GST and e-way bill implementation benefits for the organized players. The competition has increased in the value added products too which is impacting realizations of these players. We expect the sector to witness these challenges further for 1-2 quarters more and once complete compliance begins towards e-way bill, then organized players will start witnessing increased volumes and improved realizations.

We arrive at a revised price target of Rs 551 based on 28x FY20 estimated earnings (Rs 648 earlier). We believe that organized players like Kajaria Ceramics are likely to benefit from demand improvement with market leading position and wide offering of products. We remain positive on the company and maintain BUY.

Company background

Kajaria Ceramics is the largest manufacturer of ceramic/vitrified tiles in India and the 9th largest in the world. It has an annual capacity of 68.37 mn. sq. meters presently, distributed across eight plants - one in Sikandrabad (UP), one in Gailpur (Rajasthan), One in Malutana (Rajasthan), four in Morbi (Gujarat) and one in Vijaywada (AP).

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Revenues	25,496	27,106	31,102	33,824
% change YoY	6.0	6.3	14.7	8.7
EBITDA	4,963	4,564	4,976	5,750
% change YoY	8.0	(8.1)	9.0	15.5
Other Income	154	116	100	100
Depreciation	814	885	964	1,088
EBIT	4,303	3,794	4,112	4,762
% change YoY	9.0	(11.8)	8.4	15.8
Net interest	340	241	191	105
Profit before tax	3,963	3,553	3,922	4,657
% change YoY	10.0	(10.3)	10.4	18.7
Tax	1,425	1,267	1,333	1,583
as % of PBT	36.0	35.7	34.0	34.0
Profit after tax	2,538	2,286	2,588	3,073
Minority interest and other CI	17	(58)	(58)	(58)
Net income	2,521	2,344	2,646	3,131
% change YoY	9.0	(7.0)	12.9	18.3
Shares outstanding (m)	158.9	159.0	159.0	159.0
EPS (reported) (Rs)	15.9	14.7	16.6	19.7
CEPS (Rs)	21.0	20.3	22.7	26.5
DPS (Rs)	3.0	3.0	3.0	3.0

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Cash and cash equivalents	520	824	667	287
Accounts receivable	3,389	4,507	4,530	4,926
Inventories	3,720	3,785	4,306	4,682
Loans and Adv & Others	795	574	626	655
Current assets	8,424	9,689	10,129	10,551
Other non-current assets	121	82	82	82
LT investments	1	4	4	4
Net fixed assets	11,856	11,627	13,163	14,575
Total assets	20,401	21,403	23,378	25,213
Payables	2,921	2,578	3,155	3,431
Others	655	580	580	580
Current liabilities	3,576	3,158	3,735	4,011
Provisions	308	248	572	572
LT debt	2,900	2,728	1,728	728
Min. int and def tax liabilities	1,866	1,759	1,759	1,759
Equity	159	159	159	159
Reserves	11,592	13,351	15,425	17,983
Total liabilities	20,401	21,403	23,378	25,213
BVPS (Rs)	74.0	85.0	98.0	114.1

Source: Company, Kotak Securities – Private Client Research;

Cash flow Statement

(Year-end March)	FY17	FY18	FY19E	FY20E
EBIT	4,286	3,852	4,170	4,819
Depreciation	814	885	964	1,088
Change in working capital	(303)	(1,305)	(19)	(527)
Chg in other assets/liabilities	39	(207)	325	-
Operating cash flow	4,836	3,226	5,440	5,381
Interest	(340)	(241)	(191)	(105)
Tax	(1,425)	(1,267)	(1,333)	(1,583)
Cash flow from operations	3,071	1,718	3,916	3,692
Capex	(1,386)	(657)	(2,500)	(2,500)
(Inc)/dec in investments	-	-	-	-
Cash flow from investments (1,386)	(657)	(2,500)	(2,500)	(2,500)
Proceeds from issue of equity	-	0	-	-
Inc/(dec) in debt	(991)	(173)	(1,000)	(1,000)
Proceeds from share premium	-	(12)	-	-
Dividends	(381.4)	(572.0)	(572.4)	(572.4)
Cash flow from financing (1,372)	(757)	(1,572)	(1,572)	(1,572)
Opening cash	199	520	824	667
Closing cash	512	824	667	287

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end March)	FY17	FY18	FY19E	FY20E
EBITDA margin (%)	19.5	16.8	16.0	17.0
EBIT margin (%)	16.9	14.0	13.2	14.1
Net profit margin (%)	9.9	8.6	8.5	9.3
Receivables (days)	43.9	53.2	53.2	53.2
Inventory (days)	54.1	50.5	50.5	50.5
Sales/assets (x)	2.2	2.3	2.4	2.3
Interest coverage (x)	12.7	15.7	21.6	45.3
Debt/equity ratio(x)	0.3	0.2	0.2	0.1
ROE (%)	23.6	18.6	18.2	18.6
ROCE (%)	27.0	22.0	22.2	24.0
EV/ Sales (x)	2.8	2.6	2.2	2.0
EV/EBITDA (x)	14.3	15.5	14.0	12.0
Price to earnings (x)	27.3	29.4	26.0	22.0
Price to book value (x)	5.9	5.1	4.4	3.8
Price to Cash Earnings (x)	20.6	21.3	19.1	16.3

Source: Company, Kotak Securities – Private Client Research

Result Update

ASIAN PAINTS LTD (APNT)

Stock Details

Market cap (Rs mn)	:	1407863
52-wk Hi/Lo (Rs)	:	1476 / 1082
Face Value (Rs)	:	1
3M Avg. daily volume	:	1,024,562
Shares o/s (m)	:	959

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	168,244	187,598	210,250
Growth (%)	10.0	11.5	12.1
EBITDA	31,975	36,725	41,649
EBITDA margin (%)	19.0	19.6	19.8
PAT	20,271	25,490	28,946
EPS	21.1	26.6	30.2
EPS Growth (%)	0.5	25.7	13.6
BV (Rs/share)	99.5	115.8	135.2
Dividend/share (Rs)	8.7	9.5	10.0
ROE (%)	22.6	24.7	24.0
ROCE (%)	32.7	33.5	32.9
P/E (x)	69.4	55.2	48.6
EV/EBITDA (x)	40.0	34.9	30.8
P/BV (x)	14.7	12.7	10.8

Source: Company

Shareholding Pattern (%)

(%)	Jun-18	Mar-18	Dec-17
Promoters	52.8	52.8	52.8
FII	14.7	14.7	16.4
DII	11.9	11.9	9.8
Others	20.5	20.5	21.0

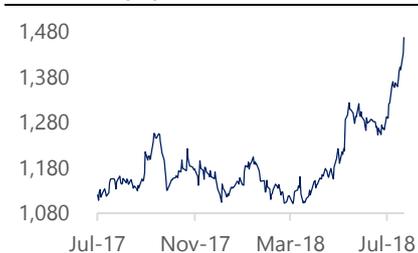
Source: Company

Price Performance (%)

(%)	1M	3M	6M
Asian Paints Ltd	15.8	25.4	27.5
Nifty	2.9	4.9	0.4

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

PRICE RS.1467

TARGET RS.1420

SELL

Strong double digit volume growth in the decorative segment, good demand in the industrial coating and automotive coating and raw material price inflation and volatile INR were the highlights of the results for APNT during the quarter.

Key Highlights

- ❑ As per management commentary, APNT experienced healthy double digit YoY volume growth in the decorative segment. Healthy automotive demand and improved demand in the industrial segment lead to strong performance of the entire industrial segment.
- ❑ International operations faced challenging conditions with issues like forex unavailability, difficult weather conditions impacting overall business performance.
- ❑ Both the businesses in the home improvement category viz. the Kitchen (Sleek) and Bath (Ess Ess) business registered strong growth in the quarter
- ❑ Management also indicated that the raw material prices remained at higher levels for the company during the quarter at +10% YoY which impacted operational performance. APNT has taken a price hike of 3.3% in May to counter the increase in raw material prices. Post that the company has faced further increase in raw material prices. However, the company doesn't intend to further increase product prices post reduction in GST rates from July 2018.
- ❑ Revenue was reported at Rs 43.9 bn (+15.1% YoY) with EBIDTA margin of 19.9% and PAT of Rs 5.71 bn vs. our expectation of Rs 5.05 bn. We interpret the results as healthy.

Valuation and Outlook

We estimate that branded paint demand will remain robust in a country like India where per capita consumption is very low and 30% paint market is still unorganised. Management of APNT also indicated that the volume trends remain strong for the company and expect the trend to continue in medium term. We believe that the favorable GST changes should help paint companies and APNT. In light of this positive GST development, we have increased our earnings estimate by 3% each for FY19 and FY20. For APNT, we estimate 11% volume CAGR over FY18 – FY20E with stable margins and ROE of ~24% and ROCE of ~32.9% for FY20E.

The stock has run-up by more than 25% since our last update in May 2018 and is trading at a very stretched valuation of 48.6x FY20 earnings, which we believe is not commensurate to its performance and involves risk like raw material price inflation, demand slowdown and competition. Recommend SELL with an increased TP of Rs 1420 (from Rs 1320) at 46x FY20E earnings which is at a small premium for the market leader to valuation commanded by peers.

Amit Agarwal

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Quarterly consolidated Performance

(Rs mn)	Q1FY18	Q4FY18	Q1FY19	YoY (%)	QoQ (%)
Net Sales	38,152	44,836	43,902	15.1	(2.1)
QoQ (%)	-3.5	5.2	-2.1		
YoY (%)	4.9	13.4	15.1		
Raw Material	21,811	25,447	24,923	14.3	(2.1)
Employee	2,862	2,761	3,064	7.1	11.0
Other expenses	6,824	8,229	7,171	5.1	(12.9)
Total operating expenses	31,497	36,437	35,158	11.6	(3.5)
EBIDTA	6,655	8,399	8,744	31.4	4.1
EBIDTA margin	17.4	18.7	19.9	14.2	6.3
Depreciation	905	914	905	0.0	(1.0)
EBIT	5,750	7,485	7,839	36.3	4.7
Interest	80	91	88	10.0	(3.3)
Other income	783	392	617	(21.2)	57.4
Exceptional	0	0	0		
PBT	6,453	7,786	8,368	29.7	7.5
Taxes	2,160	2,877	2,769	28.2	(3.8)
PAT	4,293	4,909	5,599	30.4	14.1
JV /Associate	90	50	115		
Reported PAT	4,383	4,959	5,714	30.4	15.2
Equity	959	959	959		
EPS (Rs)	4.6	5.2	6.0	30.4	15.2

Source: Company

Management indicated the sales performance of Q1FY19 could be attributed to:

- Healthy double digit volume growth in the decorative segment on a favourable base of Q1FY18 pre GST immediate quarter
- Strong automotive demand with large number of new launches
- Improved capex cycle in the economy (primarily government projects) leading to healthy demand in the industrial segment
- Improved quarterly performance of Home improvement business including Kitchen (Sleek) and bathroom (EssEss)

Inexhaustive list of growth drivers for APNT

Decorative	Industrial
Favorable demographics	New auto launches
Rising disposable income	Government infra capex
Shift from unorganized industry	Thrust on real estate sector
Shortening repainting cycle	Strong demand for consumer durables
Increased per capita consumption	Improving transportation industry
50000 + dealer base	Volume CAGR of 10% over FY18 to 20E
Huge product portfolio across segments	
Expectation of normal monsoon	
Volume CAGR of 11% over FY18 to 20E	

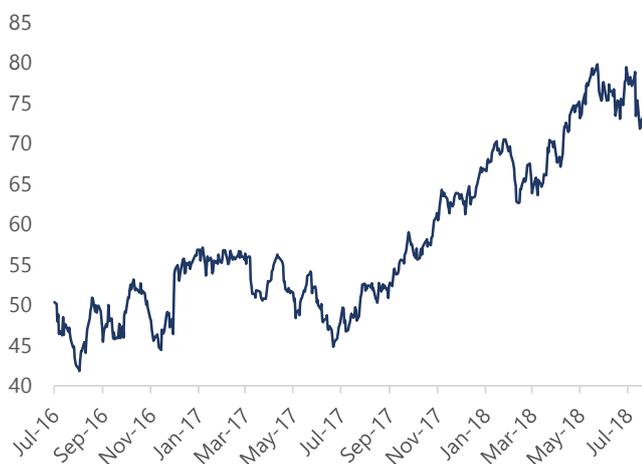
Source: Kotak Securities – Private Client Research

Raw Material Prices

Paint Industry uses two key raw material including crude derivatives and Titanium Dioxide. The Paint industry is experiencing increase in prices of raw material since the last 3 quarters. Almost ~60% of the raw material are crude derivatives and with crude at \$73/barrel (+30% YoY), prices of crude derivatives have also increased. Even prices of pigments like Titanium Dioxide, Iron oxide and Zinc oxide have increased. Even INR volatility has contributed to cost inflation for the company. To counter this, the management of paint companies including APNT have resorted to price increase and cost optimization.

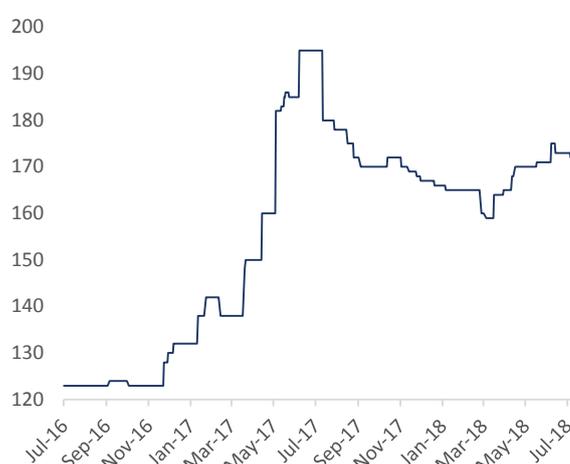
Management of APNT indicated that the raw material prices remained at higher levels for the company during the quarter at +10% YoY which impacted operational performance. APNT has taken a price hike of 3.3% in May to counter the increase in raw material prices. The company has faced further increase in raw material prices post May 2018. However, the company doesn't intend to further increase product prices post reduction in GST rates from July 2018.

Brent crude (US\$/barrel)



Source: Bloomberg

Titanium dioxide imported from China (US\$/MT)



Source: Bloomberg

Current capacities and capex

APNT is currently set up paint manufacturing facilities in Mysore and Vizag. The capacities at both these manufacturing facilities is getting built in a phased manner by APNT (over the next 3 to 4 years), to cater to the future demand. Plus, APNT is also upgrading and expanding its capacity at Ankleshwar Gujarat involving an investment of Rs 6.5 bn over the next 4 years. Apart from these fixed capital investments we estimate the company to spend Rs 3 bn per annum towards maintenance capex, translating to an approximate total capex of Rs 10 bn per annum. Plants at Vizag and Mysore are expected to start commercial operations by H2FY19.

Investment in new facilities by APNT

Area	Vizag	Mysore	Ankleshwar
Capacity (lakh Kilo Litre)	400000	600000	200,000
Investment (Rs bn)	17.5	23.0	6.5
Estimated over FY18 to FY22E			

Source: Company

Latest development – reduction in GST a big positive for the company

Paint industry was paying excise of 12.5% and 15% VAT under the old regime. So introduction of GST rate of 28% in July 2017 did not change the price at the consumer end with some adjustment happening only at the dealer end.

Post the current reduction of GST rate from 28% to 18%, we expect paint companies (they had shown intent earlier also) to reduce the prices and pass on the benefit partially to consumers which is estimated to boost the volumes for paint industry. Partially the benefit of lower GST would be retained by the paint companies as a cushion against rising raw material prices. Both the reactive steps by the industry would aid the margins and bottom line of paint companies going forward. In light of this, we have increased our earnings estimate for APNT by 3% for each FY19 and FY20.

Company Background

Asian Paints has come a long way since its small beginnings in 1942. It was set up as a partnership firm by four friends who were willing to take on the world's biggest, most famous paint companies operating in India at that time. Over the course of 25 years, Asian Paints became a corporate force and India's leading paints company. Driven by its strong consumer-focus and innovative spirit, the company has been the market leader in paints since 1967. Today, it is double the size of any other paint company in India. Asian Paints manufactures a wide range of paints for decorative and industrial use.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Revenues	152,903	168,244	187,598	210,250
% change YoY	-1.6	10.0	11.5	12.1
RawMaterial	84,653	94,026	103,867	116,072
Employee cost	7,361	8,176	9,098	10,167
Other expenses	30,672	34,067	37,908	42,362
Total Operating expd	122,686	136,269	150,873	168,601
EBITDA	30,217	31,975	36,725	41,649
Depreciation	3,388	3,604	3,550	3,850
EBIT	26,829	28,371	33,175	37,799
Other income	2,625	2,206	2,500	2,800
Interest expense	306	351	300	325
Profit before tax	29,148	30,226	35,375	40,274
Tax	9,479	10,408	10,385	11,828
ETR (%)	32.5	34.4	29.4	29.4
Profit after tax	19,669	19,818	24,990	28,446
JV & Associates	500	453	500	500
Net income	20,169	20,271	25,490	28,946
% change YoY	7.0	0.5	25.7	13.6
Shares outstanding (m)	959	959	959	959
EPS	21.0	21.1	26.6	30.2

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement

(Year-end March)	FY17	FY18	FY19E	FY20E
PAT	20,169	20,271	25,490	28,946
Depreciation +DTL	4,336	4,645	4,589	5,033
Change in working capital	207	(1,304)	(1,645)	(1,925)
Cash flow from operations	24,712	23,612	28,433	32,054
Capex	(3,766)	(10,000)	(10,000)	(10,000)
Investments	788	(480)	-	-
Cash flow from investments (2,978)	(10,480)	(10,000)	(10,000)	(10,000)
Equity issuance	-	-	-	-
Debt raised	684	(385)	(346)	(312)
Dividend Paid	(11,852)	(10,012)	(10,933)	(11,508)
Miscellaneous items	-	-	-	-
Cash flow from financing (11,169)	(10,397)	(11,279)	(11,279)	(11,820)
Net cash flow	10,565	2,735	7,155	10,234
Opening cash	4,242	14,807	17,542	24,697
Closing cash	14,807	17,542	24,697	34,931

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end March)	FY17	FY18	FY19E	FY20E
Cash	14,807	17,542	24,697	34,931
Debtors	13,761	15,142	16,884	18,923
Inventory	27,523	30,284	33,768	37,845
Loans & advances	5,352	5,889	6,566	7,359
Other current assets	3,058	3,365	3,752	4,205
Total current assets	49,693	54,679	60,969	68,331
LT investments	26,520	27,000	27,000	27,000
Net fixed assets	33,678	40,074	46,524	52,674
Total assets	124,699	139,297	159,192	182,937
Creditors	18,348	20,189	22,512	25,230
Provisions	7,645	8,412	9,380	10,513
Other current liabilities	10,703	11,777	13,132	14,718
Total current liabilities	36,697	40,379	45,024	50,460
LT debt	3,849	3,464	3,117	2,806
Minority Interest	0	0	0	0
Equity Capital	9,590	9,590	9,590	9,590
Reserves	74,564	85,864	101,460	120,081
Networth	84,154	95,454	111,050	129,671
Total liabilities	124,699	139,297	159,192	182,937

Source: Company, Kotak Securities – Private Client Research;

Ratio Analysis

(Year-end March)	FY17	FY18	FY19E	FY20E
EBITDA margin (%)	19.8	19.0	19.6	19.8
EBIT margin (%)	17.5	16.9	17.7	18.0
Net profit margin (%)	13.2	12.0	13.6	13.8
ROE (%)	25.4	22.6	24.7	24.0
ROCE (%)	35.5	32.7	33.5	32.9
DPS	10.3	8.7	9.5	10.0
Dividend payout (%)	58.8	25.1	27.0	24.9
Book Value (Rs/share)	87.8	99.5	115.8	135.2
Working capital turnover (days)	31.3	43.0	43.7	43.7
Debt Equity (x)	0.0	0.4	0.2	0.0
PER (x)	69.7	69.4	55.2	48.6
P/C (x)	57.4	56.4	46.7	41.4
Dividend yield (%)	0.7	0.6	0.6	0.7
P/B (x)	16.7	14.7	12.7	10.8
EV/Sales (x)	8.9	8.1	7.3	6.5
EV/ EBITDA (x)	41.7	40.0	34.9	30.8

Source: Company, Kotak Securities – Private Client Research

Forthcoming Events

Forthcoming events

Date	Event
25-Jul	Crompton Greaves, Hero MotoCorp, JSW Steel, KPIT, L&T earnings expected
26-Jul	Biocon, Colgate Palmolive, Concor, Dr. Reddy's, Eveready Ind, ITC, Jindal Stainless (Hisar), Maruti Suzuki India, Petronet LNG, Tata Power earnings expected
27-Jul	Bank of Baroda, Genus Power, HCL Tech, ICICI Bank earnings expected
28-Jul	Balmer Lawrie, JK Cement, Persistent earnings expected
30-Jul	Axis Bank, GSPL, HDFC, IDFC, IDFC Bank, Shree Cement, Tech Mahindra earnings expected
31-Jul	BEL, Bludart, Castrol India, Dabur, MGL, Redington, Supreme Ind, Tata Motors, Tech Mahindra, Vedanta,

Source: www.bseindia.com

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- ACCUMULATE** – We expect the stock to deliver 5% - 12% returns over the next 12 months
- REDUCE** – We expect the stock to deliver 0% - 5% returns over the next 12 months
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- NM** – **Not Meaningful.** The information is not meaningful and is therefore excluded.
- NOTE** – Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

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