

28 September 2017

Akzo Nobel India – BUY

CMP : 1,811
Target Price : 2,269
Upside : 25%+
Stop Loss : 1,605 (closing basis)

Investment Thesis

Recently, the stock price of Akzo Nobel India Ltd. (Akzo Nobel) corrected by ~18% from 52-week high of Rs.2,089 as the company reported lower than expected results due to increase in cost of materials consumed and adverse movements in inventories in the last quarter.

With 11.1% market share by revenue, Akzo Nobel is 4th largest player in the paint industries in India. It manufactures and markets a wide range of coatings and specialty chemicals. Akzo Nobel has ~9,000 strong dealer/partners network aggressively pushes sales while the strong MNC backing of Akzo Nobel NV ensures quality products and technical expertise. Over the last six years, the company's net sales and EBITDA grew at a CAGR of around ~17% and ~18%, respectively, with the help of innovations and diversified portfolio of brands. While demand for decorative and industrial paints in the recent past has been sluggish, we expect the industry to pick up well with revival in the domestic economy in the medium to long term. We expect Akzo Nobel to achieve double digit revenue growth over next two years on account of retaining leadership in premium decorative segment and gaining market share in mid-tier segment.

With recent correction in crude oil prices, Akzo Nobel is direct beneficiary as nearly 45-50% of cost of goods sold being crude/derivatives related. Raw materials like vinyl acetate monomer, accounts for 15-18% of the total purchase basket of a paint company, are also derivatives of crude oil. Crude oil prices have gone down from high of ~US\$120 per bbl levels and trading nearly US\$50-55 per bbl levels in the past two years. Price of another key raw material of Akzo Nobel, Titanium Dioxide (~7% of sales) has also been benign. Though there may be some price cuts in future, Akzo Nobel may keep a portion of this benefit to itself. With demand quite strong for Akzo Nobel's product portfolio, it may be able to maintain high margins for the coming quarters.

Financials

- During the past 5 years, revenue of Akzo Nobel grew at a CAGR of 7.3% while PAT grew at a CAGR of 4.1% in the same period.

Standal. (Rs.Mn.)	FY15	FY16	FY17	FY18E	FY19E
Revenue	25,270	27,401	28,249	32,486	37,359
EBITDA	2,614	3,049	3,488	4,011	4,613
% growth	36.2	16.6	14.4	15.0	15.0
PAT	1,863	2,021	2,470	2,841	3,261
EPS (INR)	39.9	43.3	52.9	60.8	69.8
P/E (x)	46.7	43.0	35.2	30.6	26.7
RoE (%)	20.3%	27.7%	24.5%	25.7%	26.9%

- Akzo Nobel has reported standalone revenue for Q1FY18 at Rs.7,913mn, a growth of 1.6% YoY primarily led by 2.5% YoY increase in revenue from coatings segment.

Stock Data

Market Cap (INR MN)	84,515
Market Cap (\$ MN)	1,286
Shares O/S (in MN)	46.7
Avg. Volume (3 month)	22,000
52-Week Range (Rs.)	2,089 / 1,328

Shareholding Pattern

Promoters	72.96%
FIIIs	1.98%
Institutions	8.33%
Others (incl. body corporate)	16.73%

Performance (%)	1M	6M	1Yr
Absolute	6.5%	13.1%	12.6%
BSE 500	2.8%	11.9%	15.6%

Key Ratios

Div Yield	1.2%
TTM PE	38.8x
ROE	23.8%
TTM EPS (INR)	48.0/-

- EBITDA of Akzo Nobel has declined by 31.9% YoY to Rs.665mn due to 3.4% YoY increase in cost of materials consumed and adverse movements in inventories. As a result, EBITDA margin has also contracted by 413bps YoY to 8.4% in Q1FY18.
- Consequently, net profit of Akzo Nobel also declined by 35.8% YoY to Rs.413mn due to slow sales growth and higher input prices.

Key Business Highlights

- Akzo Nobel is engaged in manufacturing of paints, varnishes, enamels or lacquers, organic and inorganic chemical compounds.
- Akzo Nobel manufactures and markets a range of coatings covering decorative paints, performance coatings, marine coatings, protective coatings, metal coatings, powder coatings, specialty coatings, vehicle refinishes and specialty chemicals. It provides solutions to the industries like, oil and gas, infrastructure, such as airports and stadium, power, construction, mining and minerals.
- Akzo Nobel It employs ~1,800 people across its six production facilities at Bangalore, Hyderabad, Mohali, Thane, Raigad and Gwalior along with two research laboratories and 88 warehouses across India.

Valuation

- Akzo Nobel's high market share is attributable to a wide range of high quality products and a gradually developing a strong dealer network. Akzo Nobel has a pan-India presence with 6 manufacturing facilities, ~83 warehouses, several regional & area offices and a distribution network of ~9,000 plus dealers. Eastern and Northern India account for majority of the company's sales, reflecting possible growth in Western and Southern markets. Demand for paints in South and West India is among the highest in the country (about 60% share) but Akzo Nobel's presence in these regions is limited. To improve presence in these regions, Akzo Nobel is continuously adding dealers in South and West India.
- Akzo Nobel has seen a pick-up in urban demand recently largely driven by improved consumer sentiment in urban markets. While revival in urban demand applies to the entire paints industry, Akzo Nobel is benefiting more due to higher salience of urban markets in its revenues. Though consumer inflation has been on higher side, the company believes that paints demand cannot be postponed indefinitely. According to AC Nielsen's report, decorative paints' revenue is growing at a higher rate compared to industrial paints. Lower growth rate of industrial paints is due to slowdown in OEM segment, lower spending in infrastructure segment and lack of pricing power. We expect, with revival in economy, good monsoon in the past two years and shifting consumer preference towards premium products, revenue from decorative paints of Akzo Nobel will grow at much higher rate in the years to come.
- With 4th largest player in the paint industries in India, maintaining high margins due to lower raw material cost, strong dealer/partners network, plans to grow in Western and Southern markets and benefiting more due to higher salience of urban markets, we value Akzo Nobel at 32.50x FY19E EPS of Rs.69.80 to arrive at target price of Rs.2,269.00, an upside of ~25%.

Risk & Concern

- Revival in paints industry depends on economic growth and any downward trend in economy may hamper Akzo Nobel's revenue.
- Stiff competition as the industry players are adding capacity across the board, may pose threat to Akzo Nobel's growth.
- Akzo Nobel is a major supplier of paints to the steel sector and any cheap Chinese imports may impact steel industry in India thereby affecting overall paint consumption.

Graphs & Charts

Figure 1: Net Sales Trend

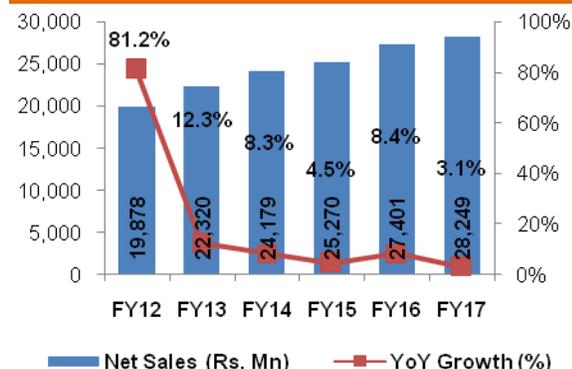


Figure 2: EBITDA & EBITDA Margin Trend

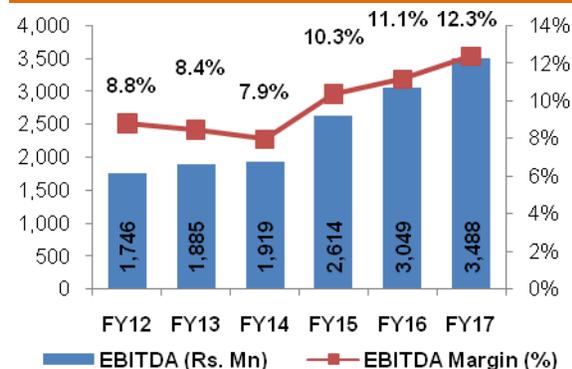
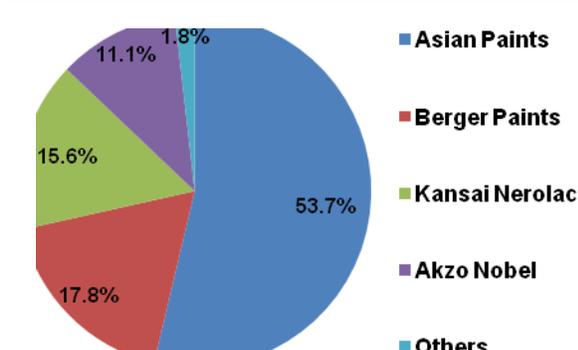


Figure 3: PAT Trend



Figure 4: Market-share of Indian Paint Industry



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