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Initiating Coverage AkzoNobel India Ltd.

30-March-2021





Industry	LTP	Base Case Fair Value	Bull Case Fair Value	Recommendation	Time Horizon
Paints	2224	2515	2720	Buy at CMP and add on dips to 1990-2010 band	2 quarters

HDFC Scrip Code	AKZNOBEQNR
BSE Code	500710
NSE Code	AKZOINDIA
Bloomberg	AKZO IN
CMP Mar 26, 2021	2224
Equity Capital (cr)	46
Face Value (Rs)	10
Eq- Share O/S(cr)	4.6
Market Cap (Rscr)	10032
Book Value (Rs)	272
Avg.52 Wk Volume	20487
52 Week High	2510
52 Week Low	1760

Share holding Pattern % (Dec 31, 2020)	
Promoters	74.76
Institutions	12.25
Non Institutions	12.99
Total	100.0

Fundamental Research Analyst

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About the Company:

Akzo Nobel NV, the world's third largest paint company with leading market positions and brands in countries around the globe, operates in India through its subsidiary Akzo Nobel India (Akzo). Akzo has been an integrated player, covering all segments and coating all surfaces while having a strong presence in the premium/niche segments. With access to global R&D technology, it continues to focus on innovations by bringing best in class differentiated products to the Indian consumer and focusing on key brands. Over the years it has expanded footprint into adjacent categories of waterproofing, woodcare, putty and adhesives. It has strengthened its distributor footprint (20,000 dealers and 52 sales depots) with the much-needed reach into the under-served districts of India as tier 2/3/4 cities are likely to drive the high growth. Akzo in India is amongst the top 4 paint companies with market share of 6% operating in the decorative paint segment primarily through its well-known brand "Dulux" and in the areas of coating through leading brands such as Interpon, International, Sikkens and more.

Valuations & Recommendation:

The demand across India for paints is at 5 year high, a portion of this can be attributed to pent up demand as result of lockdown impositions. The fundamentals of the paint business continue to be buoyant and strong and the industry should see strong growth. In the premium segment which was affected by lockdown where Akzo commands a strong position has also seen a good growth with demand reviving across cities. On industrial paints front (39% of revenues), auto has made a strong comeback. Additionally with strong order book for infrastructure companies, industrial paints segment is also on the cusp of double-digit growth. Huge untapped market, new properties for paintings and repainting, will continue to be key drivers for growth in India. Akzo's emphasis to produce quality, innovate and standardize products, strategy to constantly introducing new products to stay ahead of the general marketplace, operational and internal efficiencies and aggressive advertisement campaigns are the core capabilities of the firm, driving its growth. Akzo is trading at lowest valuation amongst its peers. We feel investors could look to buy at CMP and add on dips to Rs. 1990-2010 band for base case fair value of Rs. 2,515 (37X FY23E EPS) and bull case fair value of Rs. 2720 (40X FY23E EPS) in the next two quarters.



Financial Summary (Rs Cr)

Particulars (Rs cr)	Q3FY21	Q3FY20	YoY-%	Q2FY21	QoQ-%	FY20	FY21E	FY22E	FY23E
Net Revenues	775	727	6.5%	607	27.6%	2662	2355	2829	3148
EBITDA	135	116	16.4%	105	29.2%	379	325	405	455
APAT	87	74	18.9%	66	31.8%	243	207	267	310
Diluted EPS (Rs)	19.18	16.91	13.4%	14.56	31.7%	52.1	45.5	58.5	68.0
P/E (x)						41.7	48.8	38.0	32.7
EV/EBITDA						25.4	30.2	23.5	20.3
RoE-%						20.4	15.9	18.3	18.8

(Source: Company, HDFC sec)

Long term Triggers

The Big 4 in Indian paints industry:

The Indian paint industry has grown at a CAGR of 10.4 percent from FY08 when the market was valued at Rs. 15900 Cr (USD 2.1 Bn) to FY20 when the market size reached Rs. 57000 Cr (USD7.75 billion). The industry can be bifurcated into decorative paints and industrial paints. The decorative paint category constitutes almost 75% of the overall market. The decorative paint market includes multiple categories, including exterior wall paints, interior wall paints, wood finishes and enamels, as well as ancillary products like primers, putties, etc. The industrial paint category constitutes the balance 25% of the paint market and includes a broad array of segments like automotive, marine, packaging, powder, protective and other general industrial coatings. The Big 4 (Asian Paints, Berger Paints, Kansai Nerolac and AkzoNobel India) accounts for ~65% of the market with higher consolidation in the decorative paints segment of ~75%. The industrial paints segment is slightly fragmented with the Big 4 accounting for 51% of the market. There exists a high correlation between the paint industry's growth and GDP. The paint industry volume growth has a GDP multiplier of 1.5-2X. Some of the reasons the industry has done well are increasing urbanization, increasing disposable income and shortening repainting cycles. Repainting cycles have reduced to 4-5 years versus 8-10 years earlier for interior paints and 7-8 years versus 12-16 years for exterior paints. There has been a strong uptrend in the demand from Tier 2 and Tier 3 cities and rural India which is likely to continue and cushion the volume growth. The per capita consumption of paints in India is ~ 4 kgs (vs. global average of 15 Kgs), much lower in comparison to the other countries in the world. This will be one of the important drivers of paint companies in India. The implementation of GST in 2017 and reduction in tax rate from 28% to 18% as well as focus on low end emulsion by the top companies have led to shrinking of unorganized industry. The industry is expected to post volume growth of 10% in the near future led by strong repainting demand, construction activities and industrial and infrastructure development.



Strong Product Portfolio and continued innovations:

Decorative Paints

In the decorative paints segment - Dulux brand has strong positioning in both, interior and exterior paints specifically in premium and mid-range segment. Akzo having a market share of 20% in the premium decorative segment is likely to benefit as a result of up trading from economy and mid-range to premium segment. The management has also guided to enhance the focus on economy segment with the products which has reasonable margins as it provides huge opportunity for rapid growth. Over the years the company has also forayed in woodcare, putty, adhesives and waterproofing segment, however, at present the contribution remains low.

Category	Range	Brand
Interior Paint	Premium	Dulux Velvet
	Mid-market	Dulux Superclean
		Dulux Promise
Exterior Paint	Premium	Dulux Weathershield Powerflexx
		Dulux Weathershield Maxx
	Mid-market	Dulux Weathershield Flash
		Economy

Ancillary Products:

Category	Brand
Waterproofing	Dulux Aquatech
Primer	Dulux Smoothover
	Dulux Promise Primer
	Dulux Exterior Acrylic Primer
	Dulux Quick Drying Primer
Putty	Dulux Weathershield Putty
	Dulux WoodGuard Wood Putty (Wood)
Metal	Dulux Satin



Woodcare	Dulux Gloss
	Duco NC Lacquer
	Duco 1K PU
	Dulux Super Glossy

Industrial Paints

In India, Akzo is perhaps the only player which can claim to ‘coat any surface’. With a strong parent company in Akzo Nobel N.V. (Global leader in industrial paints) it has the access to world class R&D which it has leveraged to come up with innovative products and this helps it to have an edge over its domestic peers. The company has also setup a R&D center in Bengaluru which leverages global and local resources to provide analytical services to fulfill the needs of all coatings businesses in India and also has the process capability to evaluate and certify raw materials, intermediates and products in India.

Category	Brand	Application
Marine and Protective Coating	International	High performance coating solutions for all kind of shipping vessels
	Coatln	Coating solutions for all types of building, component, and surface
Automotive and Specialty Coating	Sikkens	Automotive Interiors & Exteriors – OEMs, Tiers and Applicators producing parts for new cars
	Lesonal	Commercial Vehicles – Original equipment builders, repairers and refurbishers of light and heavy commercial vehicles such as truck, bus, train and trailer
	Wanda	Vehicle Refinishes – Dealer networks, body shops, distributors & fleet owners
	Duco	Vehicle Refinishes – Dealer networks, body shops, distributors & fleet owners
Powder Coatings	Interpon	Coatings solutions to an extensive range of industry sectors which include; automotive, architectural, appliances, agricultural and construction (ACE), general industrial, functional, furniture, and IT.
	Resicoat	
Industrial Coatings	TRINAR	Architectural features such as metal roofing, wall panels, curtain walls and canopies.
	Vitalure	Coatings and inks for the protection and decoration of beverage, food, aerosol and general line cans, metal closures and collapsible tubes
	Aqualure	
	Vitalac	



Higher scope in industrial paints:

The industrial paints account for ~25% of overall paints industry which is way lower when compared to the developed economies (52% - USA, 52% - Europe, 60% - China, 70% - South Korea). Automobile industry is the largest component of industrial paints industry accounting for 40%. Non-automobile paints include protective coatings (used in infrastructure, oil and gas, construction etc.), marine coating (used in ships, trawlers, supply vessels, etc.) and powder coatings (used in appliances, pharmaceuticals etc.). The industrial coatings segment in India has not been able to match the growth figures of decorative coating. Over the years, the decorative paint segment has grown at a CAGR of 11.4% against the industrial segment, which has grown at a CAGR of 7.9%. Industrial paint's lower contribution in India's overall paint market is due to lower industrial and infrastructure development compared to other matured countries and developing countries like China, and higher technical know-how required in the industrial paint segment, which in turn leads to negligible involvement of unorganized players. The industrial paint segment is highly dependent on business cycles and economic conditions. The automotive coatings segment - the biggest contributor to the overall volumes in the industrial paints segment has been facing challenging times due to the slowdown faced by the auto industry over the last two years period and this has affected overall industrial paints volume. Amongst the top 4, Akzo has the highest contribution from industrial paints to the revenues at 39%, (9% - Asian Paints, 17% - Berger and 36% - Kansai Nerolac). However, as per the recent trends the auto sector has seen decent revival. The budgetary allocations for capex by the government in addition to path breaking PLI scheme will give a big boost to construction activities and drive the capex across industries. Akzo being a leading supplier and preferred partner for lot of OEMs is likely to be one of the biggest beneficiaries in mid to long term.

Divesting speciality chemicals business:

In 2018 Akzo divested its specialty chemicals business as a going concern to an affiliate of the Akzo Nobel Group for net consideration of Rs. 309 Cr. The management's intention behind the sale was to focus on the core decorative and industrial painting business and strive for best efficiency and performance.

Short term Triggers

Strong Gross and EBITDA margins:

Akzo enjoys the highest gross margin amongst the top 4 despite highest contribution to the revenues from industrial paints. This is because, it has high contribution from premium category paints to the topline. Lower input costs and focus on premiumisation have helped the Akzo to improve its gross margins. However, despite having highest gross margins the company has the lowest EBITDA margins among the top 4 on the account of royalty payments and higher employee expense. AkzoNobel India Limited pays royalty of ~3% on net sales to its parent



AkzoNobel N.V. in accordance to agreement. Employee expense for Akzo stood at 9.6% of net sales in FY20 against the top 3 average of 6.5%. The company has a higher employee expense perhaps due to higher pay scales. However, if it succeeds at increasing volumes in the mass and economy segments, incremental employee expense will reduce. The management has sacrificed aggressive growth in favour of better profitability by tweaking its product mix, revising pricing structures, aptly choosing target markets and developing robust internal systems and processes. Besides Akzo is also working on multiple cost saving initiatives including exiting from very low margin economy segments, judicious advertisement spends, etc. which should drive the profitability.

Strong Balance Sheet:

Akzo generates one of the highest Return on Capital (RoC) in the industry. This is due to lower working capital requirements and high fixed asset turnover. The company has the lowest working capital requirements amongst its peer group because of fairly high payable days. Amongst the top 4, Akzo has incurred the lowest capex since FY15 with last greenfield expansion in FY14 leading to higher asset turnover. Low working capital requirements and high asset turnover has led to high FCF generation (>90%) for Akzo. The company has strong balance sheet and history of good dividend payouts.

Premium vs Economy

Akzo has a stronger presence in premium category with (>20% market share). Customers chose premium category paints for better quality and greater aesthetics. Having a legacy of 80 years and portfolio of innovative products makes Dulux a preferred choice in premium category paints. Higher share of premium category paints has also resulted in the company generating industry leading gross margins. In the past, company has benefitted from up trading from mid-range to premium category paints. However, in recent years it has marked its entry in economy emulsions as it provides huge opportunity for rapid growth. Unorganized sector primarily has a presence in economy category paints and this provides an opportunity for Akzo to increase its market share as customers will opt for branded paints at similar price points. Sensing the opportunity for high volume growth and increasing market share, the management has been proactive in launching products in economy segment. For instance, in August, Akzo launched Dulux Promise SmartChoice, water based emulsion providing good coverage, opacity, long lasting smooth finish, available in 1000+ shades making it most viable option in comparison to distemper and cement based paints. Growth in volumes here will enhance the margins on account of positive operating leverage.



Dulux Assurance Program:

In February 2021, Akzo has rolled out a new ad campaign for Dulux Assurance™ Program assuring perfect colour, uniform finish and coverage stated else the paint will be replaced. Dulux Assurance™ has been launched basis the insight that consumers find quality of Dulux products ahead of the industry. Here Akzo is making promise like no other paint company in the industry. Consumers can get in touch with AkzoNobel via either WhatsApp or its website, provide invoice, Dulux Assurance™ Card and photographs of the surface showing the problem areas. Upon validation of the claim, a voucher for the replacement product will be sent through email within 14 working days by the company. We believe this unique strategy can further solidify people’s perception of the company’s products and increase the product offtake.

Grasim’s entry in Paints:

In January, Grasim Industries Limited announced its foray into the paints sector. Grasim is said to invest Rs. 5,000 Cr over next 3 years with an aim to become the second largest player in paints industry. We feel that Grasim’s entry will help in increasing the size of pie rather than just redistribution of pie and drive the formalization of sector. As Grasim plans to generate 20% IRR, there shouldn’t be any ungainly price wars. Paints like FMCG sector is tough sector to enter into and over the years top 4 players have more or less maintained their market share due investment in brands, distribution and, innovations. The notable point is that Grasim only plans to enter decorative paints, industrial paints segment is likely to remain unaffected. Akzo being one of the biggest players in industrial paints (39% of revenues, FY20) should not face any material impact.

Key Risks:

Raw material prices

Solvents, pigments, resins, latex, monomers and titanium dioxide are the key raw materials for Akzo. Titanium dioxide is one of the key raw materials in paints. Titanium Dioxide is a pigment used to impart whiteness, brightness, opacity (elimination of transparency), and UV protection and is largely imported. ~60-65% of raw materials have their prices driven by crude oil price. While the company can pass-forward most such price volatilities to customers (more so in case of decorative paints) through occasional price hikes, they could be with a lag and could distort margins in certain quarters.

Stiff competition



Akzo operates in a highly competitive industry. Currently it's oligopolistic in nature where top 4 players (Asian Paints, Berger Paints, Kansai Nerolac and AkzoNobel India) account for 75% of country's market. Other smaller players in organized segment include Indigo Paints, Shalimar Paints, Nippon Paints, Kamdhenu Paints, Esdee Paints, etc. have also been eyeing on fast growing paint sector. The entry of JSW and Grasim and unnecessary price wars by smaller players or new entrants to make inroad in the industry can affect the margins.

Forex risk

Akzo is exposed to forex risk as some of its raw materials (such as Titanium Dioxide) are imported and some are quoted in USD.

Possible reduction in margins in case of successful increase in mass and economy paints sales

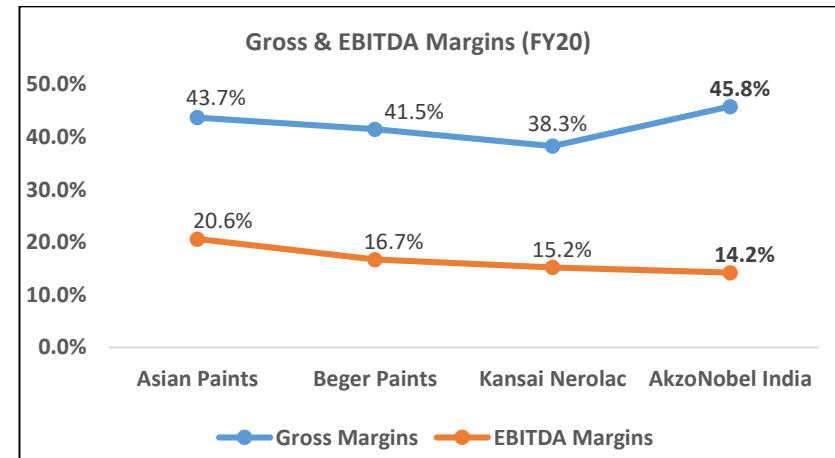
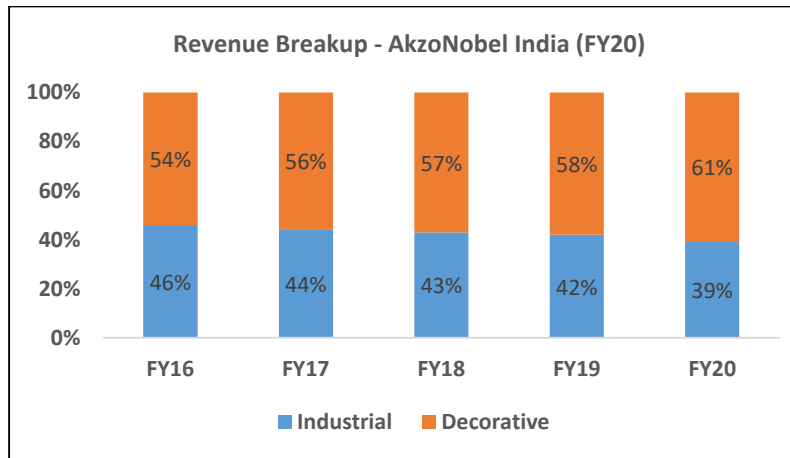
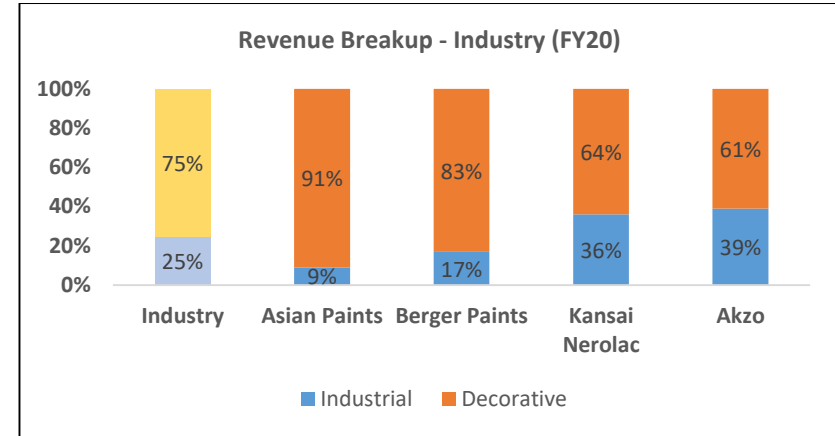
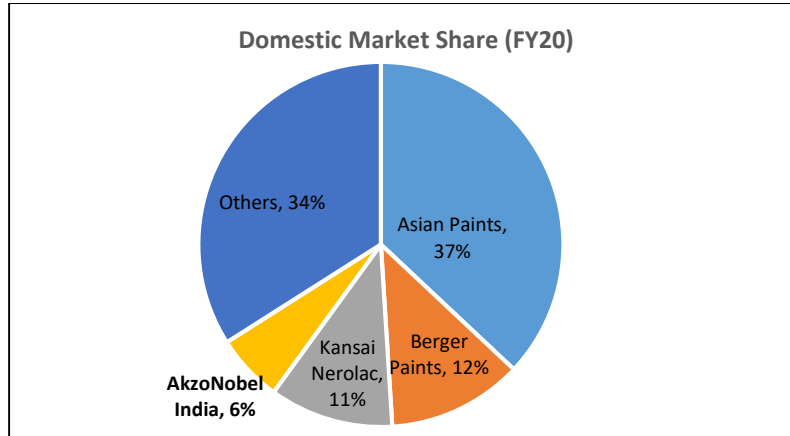
Akzo has largely been luxury paints player and has the highest market share (after Asian Paints) in luxury paints. However, the demand for mass and economy paints is far higher in India and management has guided that it would increase its focus on mass and economy paints. While this could lead to substantial volume and value growth, it could have a negative impact on margins.

Growth linked to GDP

The volume growth rate of paint industry has been a multiplier of GDP growth and so, any slowdown in GDP growth will impact the sector's growth

About Company

AkzoNobel is a leading paints and coatings company. Headquartered in Amsterdam, the Netherlands, the Company is active in over 150 countries with around 33,000 employees. It operates in India through its subsidiary Akzo Nobel India (Akzo). Akzo Nobel India Limited formerly ICI India Ltd is into Coatings business. The Coatings business has two main components: Decorative Paints and Performance Coatings. The company sells decorative paint under the well-known brand Dulux and performance coatings under multiple brands such as Interpon, Sikkens, etc. Akzo employs ~1,500 people across its five production facilities (at Bengaluru, Hyderabad, Mohali, Thane and Gwalior) and a research laboratory (Bengaluru). It services its customers through a strong distribution network of ~20,000 dealers and 52 sales depots across India. Over the years, Akzo also entered into new segments like Woodcare, Putty, Adhesives and Waterproofing.



Financials

Income Statement

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Net Revenues	2918	2662	2355	2829	3148
Growth (%)	7.3%	(8.8)%	(11.5)%	20.1%	11.3%
Operating Expenses	2576	2283	2030	2424	2693
EBITDA	342	379	325	405	455
Growth (%)	14.6%	10.8%	(14.2)%	24.4%	12.5%
EBITDA Margin (%)	11.7%	14.2%	13.8%	14.3%	14.5%
Depreciation	65	79	75	84	85
EBIT	277	300	250	321	370
Other Income	42	38	35	42	48
Interest expenses	5	9	8	6	4
PBT	315	328	277	356	414
Tax	105	86	70	90	104
APAT	210	243	207	267	310
Growth (%)		1.2%	(14.8)%	29.0%	16.1%
EPS	46.3	52.1	45.5	58.5	68.0

Balance Sheet

As at March	FY19	FY20	FY21E	FY22E	FY23E
SOURCE OF FUNDS					
Share Capital	46	46	46	46	46
Reserves	1091	1192	1323	1498	1708
Shareholders' Funds	1136	1238	1368	1544	1753
Long Term Debt	3	53	40	30	10
Short Term Debt	-	11	11	11	11
Net Deferred Taxes	-3	-12	-12	-12	-12
Non Current Liabilities	74	87	63	63	63
Total Source of Funds	1210	1378	1471	1637	1826
APPLICATION OF FUNDS					
Net Block	530	574	628	648	688
CWIP	17	16	16	16	16
Goodwill	-	-	-	-	-
Other Non-Current Assets	437	157	353	279	163
Right of Use Assets	0	100	100	100	100
Total Non Current Assets	984	847	1097	1043	967
Inventories	392	424	355	387	431
Trade Receivables	444	396	374	426	466
Cash & Equivalents	62	553	373	657	898
Other Current Assets	209	92	81	98	109
Total Current Assets	1107	1465	1183	1568	1904
Trade Payables	606	671	581	697	776
Other Current Liab & Provisions	278	231	230	277	308
Total Current Liabilities	884	902	811	974	1084
Net Current Assets	226	530	374	594	819
Total Application of Funds	1210	1378	1471	1637	1826

Cash Flow Statement

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Reported PBT	316	323	277	356	414
Non-operating & EO items	-15	-17	-35	-42	-48
Interest Expenses	5	9	8	6	4
Depreciation	65	79	75	84	85
Working Capital Change	-107	91	-24	64	16
Tax Paid	-124	-111	-70	-90	-104
OPERATING CASH FLOW (a)	139	374	232	379	367
Capex	-42	-48	-36	-20	-40
Free Cash Flow	97	326	195	359	327
Non-operating income	6	252	35	42	48
INVESTING CASH FLOW (b)	185	4	-1	22	8
Interest Expenses	-2	-9	-8	-6	-4
FCFE	96	317	174	342	305
Share Capital Issuance	-238	0	0	0	0
Dividend	-121	-132	-91	-100	-109
Others	0	-16	0	0	0
FINANCING CASH FLOW (c)	-360	-157	-112	-117	-134
NET CASH FLOW (a+b+c)	-35	221	118	284	241

Key Ratios

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
EBITDA Margin	11.7	14.2	13.8	14.3	14.5
EBIT Margin	9.5	11.3	10.6	11.3	11.8
APAT Margin	7.2	9.1	8.8	9.4	9.8
RoE	17.3	20.4	15.9	18.3	18.8
RoCE	15.3	22.5	19.5	23.1	29.0
Solvency Ratio					
Net Debt/EBITDA (x)	(1.05)	(1.51)	(1.25)	(1.73)	(2.11)
Net D/E	(0.05)	(0.39)	(0.23)	(0.40)	(0.50)
PER SHARE DATA					
CEPS	60.5	70.6	62.0	77.0	86.7
BV	249.5	271.8	300.5	339.0	385.0
Cash Conversion (days)	20	-3	0	-8	-9
Debtor days	56	54	58	55	54
Inventory days	49	58	55	50	50
Creditors days	135	159	160	160	160
VALUATION					
P/E	48.2	41.7	48.8	38.0	32.7
P/BV	8.9	8.2	7.4	6.6	5.8
EV/EBITDA	29.4	25.4	30.2	23.5	20.3
EV / Revenues	3.5	3.6	4.2	3.4	2.9
Dividend Yield (%)	1.1	0.6	0.9	1.0	1.1

(Source: Company, HDFC sec)



One Year Price Chart



(Source: Company, HDFC sec)



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