

Stock Update

Akzo Nobel India Ltd.

February 21, 2022





Akzo Nobel India Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Paints	Rs. 1939	Buy in Rs 1929-1950 band and add on dips in Rs. 1757-1775 band	Rs. 2120	Rs. 2315	2 quarters

HDFC Scrip Code	AKZNOBEQNR
BSE Code	500710
NSE Code	AKZOINDIA
Bloomberg	AKZO IN
CMP (Feb 18, 2022)	1939
Equity Capital (RsCr)	46
Face Value (Rs)	10
Equity Share O/S (Cr)	4.6
Market Cap (RsCr)	8822
Book Value (Rs)	283
Avg. 52 Wk Volumes	18848
52 Week High	2475
52 Week Low	1862

Share holding Pattern % (Dec, 2021)	
Promoters	74.76
Institutions	12.27
Non Institutions	12.97
Total	100.0



**HDFCsec Retail research
stock rating meter**

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

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 Ltd. (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. Industrial paints contribute to a little more than one third of sales for Akzo.

Valuation & Recommendation:

Despite Covid-19 pandemic and subsequent lockdowns, paint sector re-bounded strongly reporting sequential recovery since Q2FY21. As in-home became the central theme, home improvement categories picked up and policy support for residential real estate aided the faster recovery for paints vs other discretionary categories. We expect, the demand momentum for decorative paints to remain robust over medium term led by multitude of tailwinds (demographic led housing growth, shortening of repainting cycle, premiumisation, etc). Besides decorative paints, on industrial paints front, Akzo, with its exhaustive and superior portfolio (Akzo Nobel NV is the world's largest coatings company) is expected to be the biggest beneficiary of the upturn in the capex cycle.

The management's 'growth in a healthy way' philosophy rejects margin dilutive aggressive growth in favour of better profitability by tweaking product mix, revising pricing structures, aptly choosing target markets and developing robust internal systems and processes. Acting as a further tailwind to its momentum is the strong balance sheet and emphasis on constantly introducing new quality products to stay ahead of the general marketplace.

We expect the company to report ~20% earnings CAGR over FY21-24E driven by ~16% revenue CAGR and improving margins. Paints industry is amongst the worst affected sectors in recent times due to raw material inflation. However, ahead of the market price hikes and cost optimisation have aided a sequential improvement in margins for Akzo. With RM inflation likely to have peaked, we expect margins to remain stable going ahead. Akzo is trading at lowest valuation among its peers in paint sector providing ample margin of safety.



We think the base case fair value of the stock is Rs 2120 (27X FY24E EPS) and the bull case fair value of is Rs 2315 (29.5X FY24E EPS). Investors can buy the in stock Rs 1929-1950 band (24.5X Sept'23E EPS) and add more is Rs 1757-1775 band (22.5X FY24E EPS).

Financial Summary

Particulars (Rs Cr)	Q3FY22	Q3FY21	YoY-%	Q2FY22	QoQ-%	FY20	FY21	FY22E	FY23E	FY24E
Operating Income	914	775	18%	741	23%	2,661.8	2,421	3,078	3,465	3,815
EBITDA	128	135	-5%	95	35%	379.1	341	419	502	553
APAT	84	87	-4%	56	50%	237.4	208	264	323	358
Diluted EPS (Rs)	18.4	19.2	-4%	12.2	50%	52.2	45.6	57.9	71.0	78.6
RoE-%						20.0	16.4	20.5	24.8	26.1
P/E (X)						37.2	42.5	33.5	27.3	24.7
EV/EBITDA (X)						21.6	23.7	19.7	16.2	14.5

(Source: Company, HDFC sec)

Q3FY22 Result Highlights

Akzo registered its highest ever quarterly revenue of Rs 914 Cr (18% YoY growth) in Q3FY22 with strong contribution coming from both segments i.e. decorative and industrial paints. In decorative paints, growth was aided by the healthy festive season and projects segment. It reported strong double-digit growth across both Premium and Mass categories, reflecting a generally conducive economic environment. A continued uptick across infrastructure, power, marine and real estate segments propelled growth in coatings business.

Inflationary trend in RM prices: Sky-high raw material prices have understandably taken the sheen off profit margins. Gross margins of top 5 paint companies have contracted by 632-832 bps for Q3FY22. For Akzo, the gross margin fall was lowest due to ahead of the market price hikes. As of December-end, Akzo had implemented ~17% price increase with another hike of ~5% in January 2022. Pricing revision in Coatings is slower to translate given the long-term nature of B2B projects.

Growth in a healthy way: As acknowledged by AkzoNobel Group Global CEO, Thierry Vanlancker, it is an ongoing growth story in India, where it wants to keep the middle part between growing but growing in a very healthy way. Last year, Akzo had unveiled a new mid-term strategy 'Grow & Deliver' for balancing growth with profitability. Company doesn't want to aggressively expand at the cost of lower profitability as it focuses on building a sustainable business for long term value creation.

Under the "Grow" umbrella, it aims to reinforce its portfolio with new innovative and sustainable solutions in paints and coatings – across both existing and adjacent categories supported by Distribution 2.0 strategy that catapulted it closer to customers in 4,000 towns pan-India. Akzo was first large company in paint industry to start distribution route (like consumer staples companies) compared to direct distribution



network which has now been adopted by other large peers. It plans to reach 8,500 towns from 5,000 currently in two years and add another 4000- 5000 retail outlets in next two years.

Towards the “Deliver” aspect, Akzo has prioritized commercial excellence via strong margin management and value engineering. This dual approach powered it to provide the right products to the right customers at the right time, and most importantly, without diluting its profitability.

The importance of this strategy is clear from the fact that Akzo has fared the best in terms of EBITDA margin expansion over two years with a significant gap to its peers and it has fared the worst in terms of revenue growth over two years compared to its peers. However its revenue trajectory is steadily improving over past three quarters YoY vs peers due to benefits of investments in distribution and new products and relatively favorable base vs peers.

Continued focus on innovation: Backed by strong parent with renowned R&D capabilities, Akzo Nobel India has launched innovative products with remarkable consistency. It introduced Interpon coatings in Q1FY21, Dulux Promise SmartChoice in the economy emulsion segment and relaunch of Dulux SuperClean, premium interior emulsion in Q2FY21 followed by Dulux professional Weathershield Anti-carb in Q3FY21 and Dulux Assurance in Q4FY21. Further, in Q1FY22 it introduced bio-based super premium interior emulsion and Super premium wood coating Sadolin Luxurio PU in Q2FY22. Going ahead, the management has guided of have a slew of launches and some game-changing innovations in the pipeline.

PAT likely to grow at 20% CAGR over FY21-24E: We expect Akzo to report 16% CAGR revenue growth over FY21-24E with continued strong momentum in decorative paints and turnaround in industrial paints.

The performance of industrial paints segment had been volatile over past few quarters due to Covid-19 pandemic and the impact of semiconductor shortage (end use in appliances and automotive). However, Indian economy being on a firm path of infrastructure-fuelled growth augurs well for Akzo’s coating business. According to the management, in MPY (Marine, Protective and Yacht) coatings, Akzo had strong project gains in Infrastructure, Power, Mining, Coastal & Navy Segments and in Industrial Coatings business, which caters to Steel and Packaging industries it had wins from both domestic and export orders. Though, semiconductor shortage had impact on Automotive OEM sales, with play in aftersales market, the company sustained its growth run in Premium and Value Brand businesses.

The inflation across input costs has been abnormal and the risk from inflationary trend is likely to carry through in the near term. Akzo, though, has been fairly agile in pricing actions which has safeguarded its profitability to a large extent. With expectations of raw material



costs peaking this quarter, we expect margins to remain stable going ahead. We expect the company's PAT to grow at 20% CAGR over FY21-24E.

Superior balance sheet and return ratios: Akzo has one of the strongest balance sheet in the sector with zero debt and cash of ~Rs 460 Cr as on 30th Sept, 2021. Going ahead, with tightly managed working capital cycle and improved profitability, we expect it to generate ~Rs 1200 Cr operating cashflows. It has good history of dividend payout and has already paid an interim dividend of Rs 40/sh for FY22. Lower working capital requirements and high fixed asset turnover has resulted in Akzo generating highest Return on Capital (RoC) in the industry.

Key Risks

Volatility in 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. However faster shift to water based paints in future (due to their advantages like high gloss, corrosion protection and ease of cleaning walls) could result in better margin trajectory over the medium term.

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 including Indigo Paints, Shalimar Paints, Nippon Paints, Kamdhenu Paints, Esdee Paints, etc. have also been eyeing on fast growing paint sector. The entry of large groups - JSW and Grasim and unnecessary price wars by smaller players or new entrants to make inroad in the industry can affect the margins.

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



Peer Comparison:

Company	MCap (in Rs Cr)	Revenue (in Rs Cr)			EBITDA Margin			APAT (in Rs Cr)			P/E (X)		
		FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Asian Paints	312871	27693	30816	34545	16.9%	19.2%	19.7%	3011	3897	4589	104	80	68
Berger Paints	71639	8627	9706	10980	15.8%	17.9%	18.5%	824	1074	1303	87	66	55
Kansai Nerolac	26625	6141	6947	7920	13.7%	16.4%	17.0%	499	690	831	53	39	32
Akzo	8822	3078	3465	3815	13.6%	14.5%	14.5%	264	323	358	34	27	25

(Source: HDFC sec estimates)

Financials

Income Statement

Particulars (Rs cr)	FY19	FY20	FY21	FY22E	FY23E	FY24E
Net Revenues	2918	2662	2421	3078	3465	3815
Growth (%)	7.3	-8.8	-9.0	27.1	12.6	10.1
Operating Expenses	2576	2283	2081	2659	2963	3262
EBITDA	342.4	379.1	340.8	418.6	502.5	553.2
Growth (%)	14.7	10.7	-10.1	22.8	20.1	10.1
EBITDA Margin (%)	11.7	14.2	14.1	13.6	14.5	14.5
Depreciation	65	79	76	79	85	91
Other Income	42	38	23	25	28	31
EBIT	319	338	289	364	445	493
Interest expenses	5	9	10	11	12	13
PBT	316	323	278	354	433	480
Tax	105	86	71	90	111	122
PAT	211	237	208	264	323	358
Share of Asso./Minority Int.	0	0	0	0	0	0
Adj. PAT	211	237	208	264	323	358
Growth (%)	2.8	12.5	-12.6	27.0	22.5	10.7
EPS	46.3	52.2	45.6	57.9	71.0	78.6

Balance Sheet

As at March	FY19	FY20	FY21	FY22E	FY23E	FY24E
SOURCE OF FUNDS						
Share Capital	46	46	46	46	46	46
Reserves	1091	1193	1243	1233	1283	1368
Shareholders' Funds	1136	1238	1288	1279	1329	1413
Total Debt	3	0	0	0	0	0
Total Sources of Funds	1139	1238	1288	1279	1329	1413
APPLICATION OF FUNDS						
Net Block & Goodwill	530	574	543	539	539	548
CWIP	17	16	17	17	17	17
Investments	377	84	1	1	1	1
Other Non-Curr. Assets	63	186	222	188	257	289
Total Non-Current Assets	987	859	782	745	813	854
Inventories	392	424	488	590	636	679
Debtors	444	396	413	506	570	627
Cash & Equivalents	63	553	733	562	701	820
Other Current Assets	212	94	113	159	154	182
Total Current Assets	1111	1467	1748	1817	2061	2309
Creditors	606	676	798	812	979	1114
Other Current Liab & Provisions	352	412	443	470	567	635
Total Current Liabilities	959	1088	1242	1282	1546	1749
Net Current Assets	152	379	506	534	515	559
Total Application of Funds	1139	1238	1288	1279	1329	1413



Cash Flow Statement

Particulars (Rs Cr)	FY19	FY20	FY21	FY22E	FY23E	FY24E
Reported PBT	315.6	323.2	278.2	353.8	433.5	480.0
Non-operating & EO items	0.3	13.6	0.2	22.3	-36.6	-22.4
Interest Expenses	-11.0	-21.3	-9.6	10.6	11.7	12.9
Depreciation	65.2	79.0	75.5	78.8	85.0	90.8
Working Capital Change	-107.0	90.9	20.9	-188.2	125.9	66.2
Tax Paid	-123.9	-111.3	-82.0	-90.2	-110.5	-122.4
OPERATING CASH FLOW (a)	139.2	374.1	283.2	187.0	509.0	505.1
Capex	-41.8	-47.8	-28.1	-75.0	-85.0	-100.0
Free Cash Flow	97.4	326.3	255.1	112.0	424.0	405.1
Investments	220.9	304.6	83.5	0.0	0.0	0.0
Non-operating income	6.1	-252.4	-280.3	0.0	0.0	0.0
INVESTING CASH FLOW (b)	185.2	4.4	-224.9	-75.0	-85.0	-100.0
Debt Issuance / (Repaid)	0.0	0.0	0.0	0.0	0.0	0.0
Interest Expenses	-1.5	-8.9	-7.7	-10.6	-11.7	-12.9
FCFE	322.9	369.6	50.6	101.4	412.3	392.2
Share Capital Issuance	0.0	0.0	0.0	0.0	0.0	0.0
Dividend	-100.2	-109.8	-154.8	-273.0	-273.0	-273.0
FINANCING CASH FLOW (c)	-101.7	-118.7	-162.5	-283.6	-284.7	-285.9
NET CASH FLOW (a+b+c)	222.7	259.8	-104.2	-171.6	139.3	119.2
Opening balance of cash	62.5	285.2	545.0	440.8	269.2	408.5
Closing balance of cash	285.2	545.0	440.8	269.2	408.5	527.7

Key Ratios

Particulars	FY19	FY20	FY21	FY22E	FY23E	FY24E
Profitability Ratios (%)						
EBITDA Margin	11.7	14.2	14.1	13.6	14.5	14.5
EBIT Margin	10.9	12.7	11.9	11.8	12.8	12.9
APAT Margin	7.2	8.9	8.6	8.6	9.3	9.4
RoE	17.4	20.0	16.4	20.5	24.8	26.1
RoCE	26.3	28.4	22.8	28.4	34.1	36.0
Solvency Ratio (x)						
Net Debt/EBITDA	-0.2	-1.5	-2.2	-1.3	-1.4	-1.5
Net D/E	-0.1	-0.4	-0.6	-0.4	-0.5	-0.6
Per Share Data (Rs)						
EPS	46.3	52.2	45.6	57.9	71.0	78.6
CEPS	60.6	69.5	62.2	75.2	89.7	98.6
BV	249.2	272.1	283.1	281.1	292.0	310.6
Dividend	24.0	14.0	50.0	60.0	60.0	60.0
Turnover Ratios (days)						
Debtor days	52	57	61	54.5	56	57
Inventory days	46	55	68	63.9	64	62
Creditors days	79	87	111	95	94	94
Valuation						
P/E	42	37	42	33	27	25
P/BV	8	7	7	7	7	6
EV/EBITDA	25	22	24	20	16	14
EV / Revenues	3	3	3	3	2	2
Dividend Yield (%)	1.2	0.7	2.6	3.1	3.1	3.1

(Source: Company, HDFC sec)



Akzo Nobel India Ltd.

Share Price Chart:



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. These stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicity of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.



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Disclosure:

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