



“Asian Paints Q3 FY17 Results Investor Conference Call”

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ASIAN PAINTS MANAGEMENT:

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Moderator: Ladies and gentlemen, good day and welcome to the Asian Paints Q3 FY17 Results Investor Conference Call. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. In case need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Arun Nair - Corporate Communications, Asian Paints. Thank you and over to you, sir.

Arun Nair: Thank you and good afternoon ladies and gentlemen. Welcome to Asian Paints Investor Conference Call for Q3 FY17 results. We have with us Mr. K.B.S. Anand – MD & CEO, Mr. Jayesh Merchant – CFO & Company Secretary as well as the President of Industrial JVs, Mr. R.J. Jeyamurugan – VP (Finance), Mr. Parag Rane – Chief Manager (Finance) and Mr. Jalaj Dani will be joining us, who is the President – HR Supply Chain & Chemicals. Now I hand over the call to Mr. K.B.S. Anand for the opening remarks.

K.B.S. Anand: Good morning everyone and welcome to the Asian Paints Q3 FY17 conference call. I will start with economic environment.

The 3rd quarter has been a challenging period on the macro front both domestic as well as international. It has been more than 2 months since the radical demonetization decision was implemented and the environment still remains uncertain. Most of the external agencies have revised the growth forecast downwards but in our assessment, it is too early to have a fair picture of the impact.

Even on the international front the unexpected outcome of the US presidential election has raised a lot of uncertainty in the market and this was reflected in the financial markets as well. Coupled with the sudden shock of demonetization, Rupee saw depreciation of almost 2% during the quarter.

Reviewing the Decorative business,

The decorative business registered low single digit volume growth in Q3. The quarter began on a good note due to the festival season of Diwali. However, the demand was impacted to a certain extent in the month of November on the back of demonetization, particularly in North and Central India. Sales in South India especially Tamil Nadu were affected due to the cyclone Vardah in the month of December. On a sequential basis, material prices continued to witness an upward trend in the quarter, thereby squeezing margins.

Reviewing the Industrial business,

The automotive coating JV, (PPG-AP) registered decent growth in the quarter due to a good pickup in the auto OEM segment. However, the general industrial segment servicing mainly the 2-wheeler OEMs was affected due to the fallout of demonetization.

The industrial coating JV, (AP-PPG), saw good growth in the quarter in both liquid industrial paints and powder coating segments.

Lower raw material prices aided profitability of both these industrial businesses significantly.

Reviewing the international business,

The international business reported good numbers specifically aided by contributions from Nepal, Fiji and certain units in the Middle East. Egypt one of our key markets, saw a decent growth but was impacted by the sharp devaluation of the Egyptian pound. Egypt implemented a flexible exchange rate regime effective 3rd November 2016, following which the Egyptian pound experienced significant depreciation. This has led to a recognition of a loss on translation of the company's receivables from SCIB-Egypt reducing the Other Income in the current quarter and the year by Rs. 16.4 crores. Shortage of foreign exchange continue to effect operations in Ethiopia.

Reviewing the home improvement business,

The pace of growth of the kitchen business – Sleek and bath business – Ess Ess for the quarter was much slower than the earlier part of the year due to the effect of delayed sales as a result of demonetization. We continue to enhance our distribution reach and drive operational efficiencies in both the businesses.

CAPEX,

The total CAPEX plan for FY17 is about Rs. 600 crores. This includes some spends for the two new paint manufacturing facilities being set up at Mysuru (Karnataka) and Vizag (Aandhra Pradesh). Civil construction for the Mysuru facility has commenced and the land levelling work at the Vizag facility will be completed shortly. Both the plants will be set up in phases, depending on future demand condition.

Going forward

As mentioned earlier, the demand outlook for the domestic market remains uncertain, at least over the short term. However, we expect improvement in conditions as we move forward. Good growth in the agricultural sector coupled with reduced interest rates in the economy should provide impetus for growth. Over the long term, a “less-cash” economy and implementation of GST, despite some expected initial hiccups, would push the demand to the formal sector and thus augurs well for us.

Raw-material prices have seen an upward trend in the last couple of quarters. We will need to monitor this carefully and take the necessary action at an opportune time.

In the international markets, some of the units like Ethiopia, Egypt and Trinidad continued to face challenges around currency devaluation, foreign exchange availability and demand conditions.

Thank you everyone, we are happy to take any questions you may have.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin with the question and answer session. It is first question from the line of Avi Mehta from IIFL. Please go ahead.

Avi Mehta: Just wanted to understand this demonetization bid, would you be able to share some kind of demand trend post the announcement of demonetization and whether December has seen any signs of uptick or how if you could give us any sense on how the demand behavior has been on the ground?

Management: Like I mentioned, it is very difficult to go from month to month. I think we will have to take it over a slightly longer period because in different parts of the country old notes went on for some time and some people's move to a less cash system was much faster. So, the South recovered very fast, frankly speaking the South and West was much better. North and Central India were affected much more and much longer.

Avi Mehta: And sir, you are saying that month on month, month wise it will be difficult, which means that it is kind of moving all over the places that what is giving you the reason for this calling it out uncertain still or ...?

Management: Because both November and December there were various differences in how the old notes vanished from the scene and the approach taken by various traders and manufactures in that environment. It is only from January that there is some level of stability in operations. You will have to give us a month or two to really assess effectively what is happening all over the country.

Avi Mehta: So, if I kind of consider that with kind of demand environment being uncertain and input pricing pressure you highlighted is sustaining. How would you kind of look at EBITDA growth levers? Would you look at price increases lever when would you look at that or deal, is there any lever in terms of growing EBITDA for marketing spends which could be kind of look that should demand remain weak, I just wanted to understand that part sir?

Management: We really do not give guidance on EBITDA. But we have certain plans and objectives, which we will try and achieve through whatever mechanisms are available to us.

Avi Mehta: Is there an ability to kind of reduce marketing spends at from the current levels where we are or would price increases be an alternative that we will have to only look at now, is what I wanted to understand?

Management: Anything is feasible but what approach we are going to take I will not be able to share now.

- Avi Mehta:** And sir, lastly if I look at the difference between the standalone consolidated financials, so just a very sharp margin expansion in that segment which is the international plus the industrial segment, what has been the reasons for that sir and specifically because last quarter to this quarter is being a sharp movement of almost 300 bps in EBITDA on that part of the business. What has driven that if you could kind of urge one-off would?
- Management:** I think the top-line growth for one has been much better in all the other businesses rather than the decorative business and some of the home improvement businesses in India. The top line growth in international has been good in Q3. Fortunately, there was no demonetization in their markets, so they were not really affected to that extend and surprisingly the industrial business other than the two-wheeler segment has done well in Q3.
- Avi Mehta:** So, is that segment seeing a margin, because if I see the revenue growth prospect, I mean revenue growth difference that is not a material change its 10 to 13 but the margin is kind of move very sharply. So, is it more the industrial that has seen a pick up or is it across the board in international as well sir?
- Management:** In both.
- Moderator:** Thank you. We have the next question from the line of Anshuman Atri from Haitong Securities. Please go ahead.
- Anshuman Atri:** My question is regarding cost. So, how is the cost index moved in this quarter and what kind of inventory we are maintaining and how do we see it in Q4 and next year going forward?
- Management:** So, material cost we have seen a 1.5% increase on actual consumption average in Q3 over Q2. However, our expected consumption average for Q4 is substantially higher.
- Anshuman Atri:** Exhausted most of the inventory low cost inventory?
- Management:** It varies from product to product. So, in some cases average raw material inventory we carry is about 30 days, so it balances out frankly speaking but we also place orders. For imports, will it takes time to reach you in a sense. So, there is a little bit of that always there.
- Anshuman Atri:** Overall any general sense as to how much you are expecting next year as cost to increase as compared to the Q3 or Q2?
- Management:** There too many variables involved in it.
- Anshuman Atri:** The second question is regarding SmartCare and adhesives. We have seen also few like the partner the Loctite we have seen, we are getting aggressive in the retail segment also launching instant adhesives and other products. So, what kind of collaboration do we have with Loctite and how is Asian Paint going to expand its product portfolio and SmartCare adhesives?

- Management:** In SmartCare adhesives, we have an arrangement with Loctite for certain products we sell through the dealer networks so to speak which is essentially towards non-industrial consumer across the country. We are also selling some of our own adhesives outside the Henkel range under the SmartCare brand, so the combination of these two. Henkel has the right for the industrial end usage. We are looking more towards the consumer and the very small industry usage which goes through the retail network.
- Anshuman Atri:** Because I saw a Loctite 495 instant adhesives, so I was had some confusion as to in retail segment whether it is a competing product?
- Management:** It is not exactly a competing product maybe similar to what we are giving but it is not exactly a competing product as far as I understand. I will also cross check, thank for the info.
- Moderator:** Thank you. We have the next question from the line of Amit Sachdeva from HSBC. Please go ahead.
- Amit Sachdeva:** Sir, one question on the Demonetization and how did you handle it? Looks like it was still a very good performance given the November was looking in the way things were very volatile in the quarter. So, what exactly you did to set off was it do you some extended credit term or was some additional discounts were offered and how this channel was managed so smoothly if I may say especially in the decorative side?
- Management:** Frankly we did not do anything. Our customers behaved well and looked after our interest.
- Amit Sachdeva:** But sir, it might be because what we were hearing on the ground was that sales were quite down and it was as if the half the sales were disappeared across dealership but this looks like completely took us little by surprise how the numbers have been and what that trade was talking about. So, this seems to be ...
- Management:** It varies across geographies.
- Amit Sachdeva:** No, that is obviously the case but, so it seems like a very good performance
- Management:** Not a very good performance, sorry basically it is a bad quarter.
- Amit Sachdeva:** But I think considering the noise at least it seems to as is the still a decent performance.
- Management:** Thank you. But we are not too happy about it.
- Amit Sachdeva:** No, I am sure sir, but I think sir how are you looking like January are you sort of looking some uptick in January which was not there in December or how is the, your own feeling is in terms of?
- Management:** We really do not give this sort of guidance's and I personally feel it is too early. For example, the North region was affected the most. January is not the ideal month for North India because

it is extremely cold there and there been through a cold spell too. So, if you could do this month to month analysis, you can tend to get it all wrong like the dealers you visited in November and December. So, Amit, the short-term analysis sometimes gets us off.

Amit Sachdeva: So, sir basically the idea is to atleast fathom that how we should make an assumption about growth and obviously, how things can normalize from your point of view, you obviously said that it is still uncertain. But given the wedding days are longer or given that basically some pick up inventory has already happened. Do you see some early signs where you really through put is set off X percentage of what used to be and are you getting some sense out of it, so how do you make sense of the quarter in the next six months?

Management: I think we are in a more of a VUCA (volatility, uncertainty, complexity and ambiguity) world and we have to learn to live with these fluctuations in demand and the environment. Hopefully things will improve and get back to earlier criteria and do even better if less cash society is going to drive growth of the economy in the long run and more of the organized sector. We stand to benefit but how it plays off in a month to month basis is very difficult to predict.

Amit Sachdeva: I know you do not give us guidance on price increases, etc. but given the input prices are firmed up, have you set off initiated some of these talks or at least can you give us some reflection of how the industry pricing environment might ...?

Management Sorry, We do not give any guidance.

Moderator: Thank you. We have the next question from the line of Nakul Manaktala from Samaira Investment. Please go ahead.

Nakul Manaktala: Just want a gauge in terms of what type of inventory levels that you are seeing at the distributor as a dealer levels right now and given that your sales are probably were soft based on your expectations in pre-November 8th. Can you see slowdown in sales to the distributors going forward given that they might be some inventory pile up?

Management: We do not have distributors. We sell directly to about 45,000 retailers in the country and I do not think their stock in trade has gone up. If anything, it may have marginally gone down.

Nakul Manaktala: So, you are not seeing much of our impact that and in terms of institutional selling how is that business progressing?

Management: That has continued to be reasonably good but again we do not sell directly, we sell through our retail channel, you have to remember that.

Nakul Manaktala: No, but in terms of institutional selling from the retailers to the institutional buyers.

Management: So, that has been reasonably good.

- Moderator:** Thank you. We have the next question from the line of Latika Chopra from JP Morgan. Please go ahead.
- Latika Chopra:** You commented about a less cash economy helping the formal players, I understand the time frame is too short but did you see any initial signs in the months of December or January about, if there are share gains from the informal channels in the paints industry?
- Management:** We have very little data on the informal sector to able to really make that analysis like this. But there are parts of the country that at least initially have moved into a less cash transaction basis, especially in South India. That is all I can say at this time.
- Latika Chopra:** The second one is a broader question. In some of the past instances you have mentioned that 17% to 18% is more like an optimal level for margins for this industry over the medium to long term. Currently we are running close to about 20 odd percent and I did hear that you mention about various levers, whether it will be on pricing or on cost savings to mitigate the pressures on the gross margin front. How do you look at it? Are you okay to sort of let go of certain margins to ensure that volume recovery is faster, any thoughts here?
- Management:** Given our size, I do not think we can grow too much faster than the market will really grow. So, we are definitely engaged in not losing market share and would like to gain a little if possible. So depending on how the market grows, we do not think volume growth can be significantly higher than that.
- Latika Chopra:** And on margin?
- Management:** Irrespective of the margin we make or do not make.
- Latika Chopra:** So, sustaining the current level of margins using pricing or cost or those levers is a possibility?
- Management:** Like I said, We do not give guidance on margins.
- Latika Chopra:** Right, but do you still maintain that 17%-18% is more optimal levels for this industry
- Management:** Yes 17 is a more optimal level.
- Moderator:** Thank you. We have the next question from the line of Manoj Menon from Deutsche Bank. Please go ahead.
- Manoj Menon:** Couple of questions here, one on the sales of the ancillary products outside of paints which you book under the decorative head and report as such when you talk about the decorative volumes. Just trying to understand what is happening to those, I am not really talking about this last quarter because that could have been a one-off, generally how that trending over the last year and how do you see this opportunity into the medium term, is this more of a tactical sort of an approach or is it a more strategic approach here?

- Management:** The growth has been fairly good across water proofing, adhesives, wall papers, etc. So, it is not as if the growth has continued to be reasonably good. Over the year and even in the quarters so to speak. It is an advantage both strategically or otherwise.
- Manoj Menon:** But I would reckon that the proportion of these products which you have just mentioned would be very small. It would be more of these putty and the old products which probably would be a larger component, is that assumption right?
- Management:** That is absolutely true. These fit in to what we call our home décor or our home improvement range and would facilitate us strategically our expansion in terms of providing of complete solution to consumers in the area of decor and home improvement.
- Manoj Menon:** Now, the reason I am asking this about the growth rates in general in ancillaries because given that you had a great tailwind for gross margins in the last couple of years. Higher growth in ancillaries which is inherently mix negative was probably not an issue but given the environment of probably gross margins tapering off very it is now. Just trying to understand would you still focus on out these products really out performing versus your paints going to the medium term because it is an added headwind for gross margins otherwise?
- Management:** See, like you yourself said they represent a very small percentage of our sales. They are not going to affect overall gross margins significantly and they add strategically in terms of what we are offering the consumer as a whole. Both from the consumer angle as well as the trade angle we find an advantage in focusing on these businesses.
- Manoj Menon:** And secondly on GST. The last available data from government commentary was sometime in October, November when the government basically specified that all the polluting industries would be at 28% and into that one data point. The second data point is that in my understanding some of the paints at an industrial level are classified as polluting industry or as a polluting products by the ministry of environment. Any update or any light which you can throw on GST?
- Management:** We have received no information from the government or any of the authorities regarding this.
- Manoj Menon:** Anything at an industry association level, if you could talk any about that?
- Management:** Nothing has come at any level.
- Moderator:** Thank you. We have the next question from the line of Chitrangda Kapur from Sameeksha Capital. Please go ahead.
- Chitrangda Kapur:** You alluded to the fact, so that the domestic demand in the short term may remain weak. So, in that context will our utilizations of a manufacturing capacity come down a little bit or are you planning to maintain at the current levels?
- Management:** If demand drops, our capacity utilization will drop. We are hopeful demand will not stay down for so long.

Chitrangda Kapur: Continuing to that you also mentioned that with the improvement in the agri economy going forward it will hopefully improve the demand from the rural sector. So, in that context how relevant and how significant contributor is mid-economic range of paints to a rural portfolio?

Management: It is fairly significant because the rural sector or the, what we call the non-urban town represents a big chunk of assets.

Chitrangda Kapur: Can you quantify that?

Management: Frankly we do not give this data out.

Chitrangda Kapur: Also, if you could highlight the incentives that we would have given to our retail channels in this months, difficult months of November if I could say that?

Management: Nothing significant to be honest. No additional incentive that we normally would not give.

Chitrangda Kapur: Usually what is the finished good inventory that is kept in our retail channel partners?

Management: It depends from market to market. I would say the average is somewhere between 15 to 30 days.

Chitrangda Kapur: And you, is my understanding is correct you mentioned that probably the stock in trade has actually marginally gone down instead of increasing at the retail channel.

Management: Yes.

Chitrangda Kapur: So, that was PAN India or there was pocket specific geographies which because you mentioned that South has recovered fast but North and Central India were impacted much?

Management: Yes. So, North and Central India has impacted more and the rest are impacted less.

Chitrangda Kapur: So, when you are saying that your finished goods inventories have actually marginally gone down. So, you were talking about the PAN India or?

Management: My finished goods inventories have not gone down, we are talking of the dealer channels.

Chitrangda Kapur: Dealer channels, I am sorry. But yes.

Management: So, it is very difficult for me to actually track. I have 45,000 dealers and they do not give me their inventories. I know this on what my salesmen visit them they get an idea of the stock they are carrying. It is impossible for me to track so accurately, I can only give you a general feel or a general idea.

Chitrangda Kapur: That would also be helpful, if you could.

- Management:** So, giving you a general feel idea I do not think they have increased; if anything they have marginally dropped is the best indication I can give.
- Chitragda Kapur:** And is that consistent urban versus rural?
- Management:** So, I try to say this these probably not true, South and West would have probably maintained at the current levels. If they have dropped, they have dropped in the North and East.
- Moderator:** Thank you. We have the next question from the line of Vivek Maheshwari from CLSA. Please go ahead.
- Vivek Maheshwari:** First on the raw material did I hear correctly you said 1.5% quarter-on-quarter increase?
- Management:** Yes.
- Vivek Maheshwari:** And could you give us sense how were the spot or the exit would be say December versus the quarter average?
- Management:** we talk about actual consumption averages not the price prevailing in the market when we are tracking costs. We are talking of the cost as we allocate in terms of consumption. So, the variation is not significant. If you are talking about purchase price, it will be a higher but I do not have the data of hand.
- Vivek Maheshwari:** Because you said fourth quarter will see a fair bit of rise from third quarter levels, so ...?
- Management:** Because if you do a combination of things you are having a Rupee devaluation that is occurred in the quarter by about 2%-3%, then you crude gone up a little bit, some of the monomer prices going up, rutile prices going up, so you are seeing trends. So, by these trends we do anticipate that there will be an increase. It is still too early to say how much.
- Vivek Maheshwari:** Just in a conceptual I am not interested really in knowing your pricing strategy but given that the inputs are moving up what is it that you are waiting for if you have to take a pricing decision number one and number two is it just that when you were enjoying this 19%-20% margins you always knew that these were not for real and that is why there is no hurry to take-up prices?
- Management:** It is a combination of both. We were never sure of how low raw material prices would stay and we do not like the idea of changing prices on a monthly basis because the trade gets very adversely affected even if we go up or down. It gives certain advantages to people with greater financial power, etc., which we do not like to encourage in the trade. So, we try and limit price increases or decreases to one or two in a year as far as possible and try to see pricing over at least a 6 months' time frame when we look at raw material and finished good prices. Now we are not while we may be the market leaders, we are not in a dominant position from our context and we will have to see the environment, the demand conditions, and how our competitors behave both in terms of pricing as well as the current discounts they are giving in the market on

various products. Taking all these factors into account as well as our objectives of the margins or the profits we want to make, we decide on our pricing strategies.

Vivek Maheshwari: Sorry to be persistent but since you said about 6 months, so if look at from first quarter to second quarter to third quarter your gross margins have been steadily coming down in domestic business, so isn't that itself enough reason you have to take up pricing.

Management: We were very clear in the first quarter they were unsustainable margins. They were at record high level and we had predicted margins would fall and we had built the same to our radar or compass or the way we were going to proceed. So, certain amount of the margin dip was unpredicted. So, we did not think it is feasible to operate at such a high margin. The rate of increase of raw material prices, when they would increase, how much they would increase was impossible to anticipate on 1st of April. If we were very clear what is going to happen at that point of time, we may have taken a price decrease or an increase depending on the circumstances.

Vivek Maheshwari: And you mentioned about again this raw material on spot basis do you have any idea how higher it is from the third quarter average? Let say we do not want know your fourth quarter consumption because it is a mix of several commodities and inputs that we would be unable to find out but were the spot would be from third quarter average, any idea on that?

Management: We have told you from 2nd to 3rd quarter it is about 1.5%.

Vivek Maheshwari: And in 3rd quarter to current spot.

Management: Sorry we will not be able to share the number. It is not readily available with us.

Vivek Maheshwari: I think this question was also asked but on the subsidiary when I look at consol minus standalone there is a 300-basis point gross margin expansion and there is a 350-basis point EBITDA margin expansion. So much so that I think this is like 15.5% on EBITDA, in case of subsidiaries highest ever that we have seen and so is the case with gross margins. What is pulling it up so much if assuming that all the inputs have been moving up? Your revenues are up like 13%, your gross profit.

Management: See material costs across various countries or various locations differ differently. Different currencies have devalued or appreciated in different cycles, all these factors come into being. So, since we operate in 18 other countries, it becomes very difficult to give you a country-to-country assessment. Industrial margins have definitely seen a good gain. It also depends on the mix of products you sell in where you get a higher margin, it is a combination of whole factor of things, not just raw material prices. So, the products being sold in different countries, their products being sold in industrials quite often have different material mix compared to the decorative products we sell. So, it is not apples-to-apples comparison totally.

Vivek Maheshwari: And lastly a small thing, your standalone tax rate is almost 34% as against let say 31.5% in the first half. What should we be building in for FY17 entire year and FY18 please?

- Management:** It is the same thing, we are at the marginal rate. We do not really get income tax exemptions or anything.
- Moderator:** Thank you. We have the next question from the line of Tejas Shah from Spark Capital. Please go ahead.
- Tejas Shah:** Sir, I am not sure if you measure it formally but if you can give some sense on how was the gap between primary sales and retail offtake in decorative business. Did it expand considerably in the quarter or there were some hard level of inventory at dealer level?
- Management:** I like to mention there is no increase in inventory at the dealer level. 70%-odd of our sales is done on cash payment. So, dealers do not stock unnecessarily unless he sees a great advantage in terms of price increase coming up or great demand situation where sales would be loss if they do not have inventory. In the scenario where the demand situation is being uncertain, it will not make sense for the channel to stock up is my perception.
- Tejas Shah:** Sir, secondly you mention that Auto JV did well, so was it growth from the same client or there was some addition of new clients there as well?
- Management:** It was the same client maybe they expanded into another plant of that client, etc., and that client also did well.
- Tejas Shah:** And sir, lastly, I know you do not give guidance but you were recently quoted in media on margins that maintaining high level of margins may no longer be possible, so just wanted to know where you were coming from?
- Management:** I just said consistently over 5 years.
- Moderator:** Thank you. We have the next question from the line of Abhay Moghe from Bajaj Allianz Life Insurance. Please go ahead.
- Abhay Moghe:** I just had one question; can you share year-on-year change in Q3 and 9 months for cash flow from operations?
- Management:** We don't have exact number on hand but I think the data provided gives you the idea. From operating cash flow perspective, this year we will have a slightly higher CAPEX outflows. It is not any significant kind of impact on the cash flow to the extent of may be 200 crores to 300 crores this year.
- Abhay Moghe:** So, why I am asking this is because when we see EBITDA obviously there has been lot of changes in IndAS?
- Management:** We are talking about the cash flow, we do not think there is any significant difference between this year and last year, the CAPEX expenditure may be 200 crores – 300 crores more than the previous year. But otherwise the cash flow position is very similar.

- Abhay Moghe:** No, what I was asking was because EBITDA is like there is a change in IndAS like-to-like whatever you have restated number or what you reported last numbers. So, there is lot of different numbers one can see. But I do not think that in the cash flow statement there should be any change. So, that is why I am specifically asking sir.
- Management:** There is no really change.
- Abhay Moghe:** No, year-over-year change the cash flow from operations after working capital and taxes paid would have increased or decreased so what is that percentage change? It has increased by say 2%-3% decline by 1% for the Q3 number?
- Management:** If you remove the CAPEX position out, purely basis the revenue generation and the working capital, they would be broadly similar in terms of what they were last year given the growth of roughly around 8% that we have seen this year. Cash flows on the CAPEX side they are around 300 crores higher in this year versus the last year.
- Abhay Moghe:** So, excluding the CAPEX, the only cash flow from operations would have grown by something like 3% to 4% that is what you are saying?
- Management:** Probably the revenue growth that you see, we have certain increase in the working capital which is evident in the numbers that we have.
- Abhay Moghe:** So, like-to-like IndAS, EBITDA whatever growth is come in, that is translating into the cash flow from operation.
- Management:** More or less it will translate.
- Moderator:** Thank you. We have the next question from the line of Rahul Maheshwari from IDBI Mutual Fund. Please go ahead.
- Rahul Maheshwari:** I have just two questions, first of all can you give a light on what was the performance of AP Homes, pre-demonetization and post-demonetization period and going forward is the track which we were highlighted that till next one or two years, this is the target for the AP Homes to be inaugurated in the different parts? And the second question is regarding the what is the current utilization rate for the manufacturing capacity of the company because as we find that for next 12 years you have earlier also said that in Karnataka and Andhra Pradesh there would be in phased manner the manufacturing capacity would be added depending on the demand conditions and plus yesterday also there was a release regarding manufacturing capacity expansion at Ankleshwar capacity. So, if we take all things going on same as the demand is coming, so what kind of growth rate do you expect for next 5 years if all the manufacturing capacities are installed in the phased manner?
- Management:** First one is easiest to answer. We do not track impact of demonetization in AP Homes because it is not our business. He is a retailer handling the operations independently. All we can say is

his sales of paints and other products has continued reasonably well, on lines what it was prior to demonetization but it is very difficult for me to tell you anything more than that.

Rahul Maheshwari: Any target in FY18, apart from the one AP Home, you might be targeting in any parts of the country?

Management: We are opening 3 more, they should come up in the next 2 quarters.

Rahul Maheshwari: And what is the current capacity utilization for the company?

Management: It is about 75% and we will try and maintain it. See, it is very difficult to predict long-term what is the growth rate, if you take our volume growth rate in the period 2000 to 2012 it was around 15% volume growth rate and in the last 5 years it is been about 10%-11%, roughly in that region.

Rahul Maheshwari: But just a sense on a broader picture that for next 10 years, if at all, it is good that there is a capacity addition in different parts of the country but any sense or any target in terms of the things go well, not 10%-11% but going forward even if it is 8% kind of growth rate. So, how it would pan out, can you give some color on that?

Management: Our objective is to have capacity to plan for growth we expect to get and if the economy revives, we should expect higher volume growth rates and since the process of getting land and permission and setting up a plant is anyway between 3 to 5 years, we have to plan for these contingencies. If growths are a little slower we are not necessarily upset about it because we will get the capacity in the following year.

Rahul Maheshwari: And is there any company apart from manufacturing is there some outsourcing being done?

Management: There is about 25%-30% of our capacity that is outsourced but it is generally not emulsion, it is the putties and primers and some enamels and distempers that we manufacture.

Rahul Maheshwari: And going forward it would remain the same percentage range or you have finding that it may increase the percentage?

Management: New capacities we are setting up other than in Ankleshwar will be only emulsion capacities depending on how the growth of these products pan out in the future years, capacities may be added or otherwise.

Rahul Maheshwari: And can you just give us sense that the 25%-30% of manufacturing is being outsourced, so what kind of cost benefit analysis being say if you are going for own production and if you are doing for outsourcing, so what EBITDA margin, any color?

Management: The essential advantage we would go is it because of logistics and freight advantage we get for the cheaper products, if they are manufactured close to the point of sale.

Moderator: Thank you. We have the next question from the line of Sanjay Singh from Axis Capital. Please go ahead.

Sanjay Singh: Just wanted to know, would it be possible for you to share if your December sales were better than what we had in November?

Management: Yes.

Sanjay Singh: So, you mentioned the fact that they could have been old note ...

Management: They were higher last year also and the year before last also.

Sanjay Singh: No, only the sense is, reason with asking is, there was any spike in November because the old note sales?

Management: See, India is not one city. India is more than a continent. What happens in Bombay is different from Delhi, Calcutta, Chennai, Bangalore, every part of the company behaves differently and many different things happen everywhere. There is no uniformity.

Moderator: Thank you. We have the next question from the line of Jubil Jain from Phillip Capital. Please go ahead.

Jubil Jain: Sir, can you throw some light on the premiumization trend for the decorative segment for the last few years some metrics like growth in average ticket size or some other indicators?

Management: See, the basic trend we track is the growth of premium of products. The premium products have been growing at may be at least 5% higher than the other products.

Jubil Jain: What would be the split-up premium versus the mass products?

Management: Sorry, we don't share this information.

Jubil Jain: Sir and secondly what would be the inventory had in hand in the trade channel, rough cut rates?

Management: It varies in parts of the country. 15-30 days is the general inventory that the trade carries. Places like Bombay stock even less than 15 days because of the cost of space and the fact that we supply them even twice a day.

Jubil Jain: Sir and lastly would it be correct to assume that there was a realization declining of around 2% for Q3. Did you take any price cuts in Q3?

Management: The last price cut was February 2016.

Jubil Jain: There was 2%. So, what Q3 the realization declines would will be around 2% or because of some change in mix, the number would be different?

- Management:** Probably some mix marginally, when you look quarter-to-quarter it becomes very difficult to access reasons like that because depending on the Diwali date the mix of product sold in different parts of the country varies.
- Jubil Jain:** Sir, my question is the price cut similar to the decline in realization or is that very different if you look at Y-o-Y basis, basically from the 1st March, 2016 price cut till today. Basically, Q3 versus Q3, right so there is only the 2% price cut which comes into the play. So, will the realization decline be also 2% or will be significantly lower than that say 4%-5% because of the some change in mix.
- Management:** I think it will be slightly higher because we have a higher mix of the low price products coming in.
- Jubil Jain:** So, what would be the ballpark range for realization next time?
- Management:** That is the number which we are not sharing but it would be slightly higher than the 2% price cut that we took.
- Jubil Jain:** Sir lastly, actually can you give some light on the average ticket size, basically has that been a huge change in the average ticket size in the last few years or has it been constant?
- Management:** There has been that inflationary change, I do not think there has been any significant. We have all sort of buyers; people who have one room houses and you have builders who have constructing multi storied houses. It was majorly about premiumization. So no major change.
- Moderator:** Thank you. We have the next question from the line of Bobby Jairam from Falcon Investment. Please go ahead.
- Bobby Jairam:** Do you see any fundamental disruption for the paint sector?
- Management:** We are too insignificant for anybody to be worried about our sector. Technologically worldwide other than the change in exteriors where lot of commercial buildings have shifted to glass and aluminum and hence the coatings have shifted from architectural coatings to industrial coatings for coating aluminum and glass. We have not seen any significant change over the last few decades and similarly in distribution; but anything is possible in today's world because you have seeing massive disruptions in many industries, I agree; but we are probably too small for people to really focus on something that drastic.
- Moderator:** Thank you. We have the next question from the line of Nitin Mathur from Jefferies. Please go ahead.
- Nitin Mathur:** I just wanted to understand the share of unorganized players in the paints business, so would 30%-35% be a good estimate of that?
- Management:** Yes.

- Nitin Mathur:** And I think you mentioned that something around GST and the disruptions that would follow post the implementation of GST. So, just wanted to understand what would that disruptions be?
- Management:** See, there are 2-3 types of disruptions that may occur. They would be a short-term disruptions because how stock in trade in the channels would get the credit for the various taxes, taxes already imposed. In the case when VAT was implemented there were some disruptions in the channel and the trade is not confident that these disruptions would not arise again. So, they might be some level of destocking for a month prior to GST implementation but over a period of 6 months it should easily be evened out. The second change can occur depending upon the GST rate that comes into implementation whether it significantly increases the prices or decreases the prices of paint, can affect demand of the organized sector versus the unorganized sector.
- Nitin Mathur:** And what is the effective indirect tax rate that you are paying today?
- Management:** We have an excise duty of 11%-12% and sales taxes of 14% on an average.
- Moderator:** Thank you. We have the next question from the line of Nillai Shah from Morgan Stanley. Please go ahead.
- Nillai Shah:** Just one question on the margins. If I go back to 3 to 4 years when your margins and the vicinity under all accounting standards of about 17%-18% you are very consistent about your fact that did not want the margins to go higher because you would attract unnecessary competition. Then when the input cost benefit starts coming through over the last 4 to 6 quarters you consistently mentioned that margins have to be viewed in context of volume growth, etc., and that how you would manage the business. Given that the volumes have not really picked up over the longish term, how do you see your strategy as far as margins evolving?
- Management:** So, like I mentioned it is very difficult to talk of volume growth significantly higher than the real market volume growth. So, when we talk of volume growth, we are talking of volume growth higher or lower than the market volumes. If the market volume does not increase for a variety of factors related to the economic growth or construction or a variety of factors, it is very difficult for us to grow significantly higher than that unless we really hurt margins tremendously. So, we would like to grow marginally above the market growth rate and gain a little share consistently and we price accordingly in that manner.
- Nilay Shah:** Pricing or margins is the second derivative of it. What you have focused on is volumes, if volumes come through then pricing is not the primary lever or margins is not the primary lever that you would look at in terms of judging the business performance?
- Management:** Correct. But both are levers. So, we need to protect the interest of all shareholders.
- Moderator:** Thank you. We have the next question from the line of Nimit Shah from ICICI Securities. Please go ahead.

- Nimit Shah:** Just a small question on the excise rate like sequentially we have seen some reduction in the excise rate, any specific reason for that?
- Management:** There may be some mix and see the excise you will see is related to the production and the sale is not related to production. So, it causes a little bit of variation from your perspective.
- Nimit Shah:** But are there any facilities which are enjoying tax benefits.
- Management:** No.
- Moderator:** Thank you. We have the next question from the line of Chanchal Khandelwal from Birla Sun Life Mutual Fund. Please go ahead.
- Chanchal Khandelwal:** From the GST rate assume the rate of GST is 28% current rate as you defined is 26% is assumption to that you need to take 2% price hike to manage that, is that difference 2% assuming the GST rate is 2?
- Management:** We will have to get the exact rate and all the understanding there. You have to take it as it is not an adding of rates it is the multiplication of rates, so you take 1.12 into 1.14 you get a different thing from 26 if you look at it in that sense. That will be very close to 28.
- Chanchal Khandelwal:** The reason I am asking this is, are we waiting for the clarity in GST rate and then will decide whether we need to take a price hike?
- Management:** No.
- Chanchal Khandelwal:** Sir, secondly on the margin front, lots of questions have been asked but if I look at margin for last 6 years. So, FY10 you had 18.5% margin and then the margin went down and last 2 years in fact you have seen margin increase. Is 17%-18% margin is new normal can we assume that?
- Management:** We do not give margin guidance. We would like to optimize profits as well as gain share in the market place.
- Chanchal Khandelwal:** So, is the margin improvement some part must also have happened because of water based paint doing well. So, that mix improvement will sustain, so I am assuming that the new margin can be the new normal margin.. is that assumption right?
- Management:** No but wherever mix improvement occurs more players come in. So, it is not what is the scenario at one point of time is not a permanent scenario. So, you have a lot of unorganized sector also come into emulsions today.
- Chanchal Khandelwal:** But given that 4 players are strong and they hold the market shares, so and the price increase is not difficult to take. Isn't 18% margin sustainable for a little longer term?
- Management:** If it is not difficult to take, everybody would have taken it long ago.

- Chanchal Khandelwal:** But you are still maintaining that margin, sir. We have seen that margin. Lastly on the home improvement business, now you have multiple categories you are looking at, you are doing Sleek kitchen, Ess Ess bathroom fittings and now you also have the Adhesives. So, where will the focus be and can we assume that 3%-4% extra growth over the next 4-5 years can come from this home improvement business?
- Management:** They are still too small and insignificant to have a 3%-4% impact but we would like that to happen in due course.
- Chanchal Khandelwal:** But why are we doing multiple categories here instead of taking up one category and trying to scale that up?
- Management:** Because we are looking at the home improvement category as a whole and we have really gone into two categories only kitchens and bathrooms. Adhesives is more of an add-on business which is supporting some of our paint business; we came in through wallpaper, came into adhesives and then came into light things in our channel more than anything else. It is not totally home improvement per se.
- Moderator:** Thank you. Ladies and gentlemen, we will take our last question that is from the line of Akash Vora from Raj Finance. Please go ahead.
- Akash Vora:** I just wanted to know if we are painting a house of 800 to 1000 square feet, labor cost and material cost would be around in percentage terms more or less same or what it would be? Because I just wanted to know does automation play a good role currently in or painting a house and what it would be in near future like it would change significantly because labor cost have increased over the years significantly?
- Management:** So, non-paint cost tends to be 65% of the cost of painting a home. And automation does not play a significant role in reducing the cost. It tends to play a role in expediting the time or reducing the pain of painting; that is the dust, etc., in the environment.
- Akash Vora:** But in near future do you see that might change role significantly and the labor cost might be saturated at some point of time?
- Management:** Well, I am told in the West, labor cost is about 95% of the cost of painting.
- Moderator:** Thank you. Ladies and gentlemen that was last question. I would now like to hand the conference over to Mr. K.B.S. Anand – MD & CEO, Asian Paints for closing comments. Thank you and over to you sir.
- K.B.S. Anand:** Thank you all of you for the interest you have shown in Asian Paints and in our conference calls. I wish we could give more clarity on demonetization, but we are willing to learn from all of you or exposed to all corporates all over the country. Thank you.

Moderator: Thank you very much members of the management. Ladies and gentlemen on behalf of Asian Paints, that concludes this conference. Thank you for joining us and you may now disconnect your lines.