"Asian Paints Q1 FY 2019 Results Conference Call"

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Moderator: Ladies and gentlemen good day and welcome to the Asian Paints Q1 FY2019 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. Should you 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. Thank you and over to you sir.

Arun Nair: Good evening and welcome to Asian Paints Investor Conference for Q1 FY19 Results. With me we have Mr. K.B.S. Anand – MD & CEO; Mr. Jayesh Merchant, CFO & Company Secretary and also the President of Industrial JVs; Mr. Manish Choksi, President – International, IT, HR and Chemicals; Mr. R.J. Jeyamurugan, VP - Finance and Mr. Parag Rane, Chief Manager - Finance.

Now may I ask Mr. K.B.S. Anand to take the call forward.

K.B.S. Anand: Good evening everyone and welcome to the Q1 FY 19 Conference Call for Asian Paints.

ECONOMIC ENVIRONMENT

The recovery trend in the domestic economy witnessed over the last couple of quarters, continued to extend to the first quarter of this financial year. However, while the recovery continues to gather pace, demand conditions for the paint industry still remain challenging. At the global level, while major economies continue to show resilience, there are lingering uncertainties over the horizon. Hardening inflation and the resulting tighter monetary conditions, elevated crude oil prices, heightened trade barriers are dampening the business confidence across.

CONSOLIDATED FINANCIALS : Q1 FY19 RESULTS

Revenue from operations increased by 15.5% to Rs. 4398.6 crores from Rs. 3809.8 crores. PBDIT increased by 25.9% to Rs. 936.1 crores from Rs. 743.7 crores. PBT increased by 29.7% to Rs. 848.3 crores from Rs. 654.3 crores. Net profit after non-controlling interest increased by 30.6% to Rs. 558 crores from Rs. 427.4 crores.

STANDALONE FINANCIALS : Q1FY 19 RESULTS

Revenue from operations increased by 16.2% to Rs. 3706.2 crores from Rs. 3188.73 crores. PBDIT for the quarter increased by 30.8% to Rs. 893.7 crores from Rs. 683.2 crores. PBT increased by 34.3% to Rs. 810 crores from Rs. 603.1 crores. Net profit increased by 35.3% to Rs. 542.6 crores from Rs. 400.9 crores.

Please note that the figures for the previous year have been suitably adjusted to bring them in line with post GST financials.

BUSINESS REVIEW - DECORATIVE

The Decorative paint business registered a good double-digit growth in the current quarter helped to an extent by the low base in the first quarter of the previous year. On a sequential basis, material prices have been moving up and we took a price increase of 1.9% in the month of May 2018 to negate the input cost pressures to an extent. This is on the back of a 1.4% price increase affected in the month of March 2018.

BUSINESS REVIEW - INDUSTRIAL

The Automotive coatings joint ventures (PPG-AP) witnessed good growth in the General Industrial segment on the back of strong performance in the two-wheeler and commercial vehicle industry. The Auto Refinish segment which took a beating last year due to the GST rollout related issues saw a good off-take in the current year.

The Industrial Coatings JV (AP-PPG) registered good growth in the quarter led by strong performance across business segments. Profitability in both the businesses was however impacted due to rising material cost pressures which could not be passed through completely.

BUSINESS REVIEW - INTERNATIONAL

Overall, the international portfolio faced challenging business conditions across major units. The high inflationary situation continued to effect demand condition in Egypt. Forex unavailability continued to hurt operations in Ethiopia. Incessant rains affected sales in current quarter in the key units of Bangladesh and Sri Lanka. The fledgling operations in Indonesia continue to gather pace and the unit has done well to expand its retail network and market presence.

BUSINESS REVIEW – HOME IMPROVEMENT

Both the segments within the home-improvement business - the Kitchen business under Sleek and the Bath business under Ess Ess, have registered strong growth in the current year. Both the businesses continue to expand their network to increase scale of business.

CAPEX

The CAPEX plan for the standalone company for the current year it is around Rs. 1000 crores. This includes spend of around Rs. 800 crores on the two new paint manufacturing facilities being set up in Mysuru (Karnataka) and Vizag (Andhra Pradesh) in South India. The first phase of both these plans will be commissioned in this financial year.

GOING FORWARD

As mentioned earlier, growth in the current year was to some extent helped by the low base of the previous year. We are hopeful of a further recovery in demand conditions as we enter the festival season. The GST rate reduction from 28% to 18% on paints should also help demand from the small consumers and the company is taking steps to pass on the benefits of this rate reduction to the consumers. However, we are continuous increase in raw material prices and expect an inflation of almost 10% in the second quarter on the average of last years, raw material cost. We have passed on only a part of this through the cumulative 3.3% price increases taken in March '18 and May '18 and should have ideally looked at a further price increase. However, we may need to defer it due to the GST rate reduction.

In the international markets, continuing difficulties in sourcing the required Forex for business operations in Ethiopia continues to be a key concern.

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

Moderator: Thank you very much. We will now begin the question and answer session. We have the first question from the line of Abneesh Roy from Edelweiss. Please go ahead.

Abneesh Roy: My first question is on your statement, ideally should have taken price hike but deferred due to GST rate cut. So does it mean you will pass on the entire 10% and because of the clauses of anti-profiteering, etc., you may not take price hike which is warranted, so there could be a margin compression in the coming quarter?

Management: If we take a price hike immediately, we will come under the lens of the anti-profiteering Bureau so to speak. So, we would have to defer it and recover cost over the rest of the year.

Abneesh Roy: Second is you had pointed out Tamil Nadu slowdown in the previous quarters and competitive intensity being high, on these two parameters what is the status?

Management: The competitive intensity continues to be high but there is a recovery.

Abneesh Roy: There is a recovery because of any particular reason?

Management: No I think the market has improved itself.

Abneesh Roy: The other spends is seeing a very low inflation which means the ad spend also would have seen a very low single-digit growth, does it point towards lesser competitive intensity or its just your phasing of the ad-spends is.?

Management: We haven't phased out ad-spends.

Abneesh Roy: But it has seen only 2% to 3% growth in other cost.

Management: That was not marketing spends, they actually see a good double-digit growth specific in terms of marketing spends. But some of our other costs especially the larger cost like freight, rent etc are seeing a slightly lower inflation as compared to the previous years in Q1 for the current year. But the way, the fuel prices and retail prices of fuel are behaving, maybe Q2 onwards, we might see a higher impact. But in Q1 we had a lower inflation on this key cost.

Abneesh Roy: On your smaller businesses Sleek and Ess, the Ess continues to grow much faster than Sleek this quarter also 56% versus 17% for Sleek. So what's the thought of reviving and taking Sleek to the next level, last 7-8 quarters is broadly in the 35 crores to 50 crores quarterly run rate, so if you could talk about why such a big difference in terms of growth rate? Is GST impacting Sleek, is there a reverse shift in Sleek?

Management: You are looking at the numbers which are of previous year. In the notes to the account, we have given the right numbers, comparable numbers.

Abneesh Roy: But any comments?

Management: Sleek has also grown at 22% in this quarter.

Moderator: The next question is from the line of Avi Mehta from India Infoline. Please go ahead.

Avi Mehta: I just wanted to clarify the statement that demand from small customers is likely to benefit from the GST rate reduction, are these self-painting guys that's why you are expecting that or if you could just explain?

Management: There is very little DIY in India, so there is not really self-painting. But the gap between the organized sector and the unorganized sector was much higher, that would reduce.

Avi Mehta: So you mean it essentially has got to do with market share gains in that category is why you are saying is that what you're referring to when you say demand from small customers?

Management: Partly yes and when the cost of paint and painting itself sort of reduces, we anticipate demand to improve.

Avi Mehta: So there would be some—you are saying some—impact from the price reduction on the general demand plus market share gain, is that a fair understanding?

Management: Yes.

Avi Mehta: Just on the GST rate reduction being passed through, just wanted to clarify and confirm you have the ability to pass it on differentially across different categories, higher premium products might see higher production, is that something that you….?

Management: It will be a 10% reduction in the GST rate per se, so we operate with a certain dealer price list to our entire dealer network. That continues to be the same. The GST is simply reducing from 28 to 18, so there is a straight of 10% reduction in the effected cost to the dealer network and consumer across products on the maximum retail price. But most of our products do not sell on the maximum retail price, so the differential may vary to some extent.

Avi Mehta: On the dealer margin itself because of this reduction in GST rate, would you be able to weigh or work on those numbers reduce it to some extent or you would want to let the margin be enjoyed by the supply chain because you would have increased it when the slight increase in tax rates, right?

Management: No, we really can't control dealer margins because we have an open network policy with a large number of dealers in each city and except in the very small villages and towns where there are monopolistic dealer networks. We really don't control dealer margins at all.

Avi Mehta: So that I think is something that the market force will decide.

Management: Yes.

Moderator: The next question is from the line of Utsav Shah from Capgrow Capital. Please go ahead.

Utsav Shah: I wanted to know when the two plants are expected to begin production that you mentioned in your CAPEX expenditure for this year.

Management: Mysuru is expected in September and Visakhapatnam in January.

Utsav Shah: Could you comment on your capital utilization at the moment?

Management: Around 75% - 80% currently.

Moderator: The next question is from the line of Amit Sachdeva from HSBC. Please go ahead.

Amit Sachdeva: My question is on GST, as you note in your release that it will be difficult to take price increases since GST has reduced and even though the input prices tend to have moved up quite significantly. My question is why it is difficult for someone to understand that GST is applied on the invoice value and then your price increases linked to input price increases that you face in industry. Why you have to have such a dilemma that why input prices cannot be passed on to product which specially has a higher oil linkage versus some which have lower oil linkage and why it would be such seen as a profiteering move, especially in your industry when it is a known fact that input prices have been so high; why you would sort of make such an assertion?

Management: It's partially anti-profiteering plus confusion of pricing among the entire vast dealer network. We have more than 52,000 dealers across the country, so varying rates and getting them settled takes a little time. So it take atleast a month for the new GST to really get implemented effectively post which we can consider. But since time would have elapsed, it would have an impact.

Amit Sachdeva: Second question Mr. Anand would be that obviously time to time you would run separate schemes also based on various product lines and this obviously would mean that price increases in reality would vary at your will anyways. So would it not be fair to say that if for example if the input price inflation is low or high you could use this leverage to push a certain volume more than others and hence which somebody also asked that realized price for various goods can actually quite substantially vary when GST rate is being implemented.

Management: The level of inputting we do is considerably low compared to the price increases we are talking about. In addition, a lot of input is directed towards the end consumer or painters etc. so it's a mixture. You really can't totally cut one out from the other.

Moderator: The next question is from the line of Vicky Punjabi from JM Financial. Please go ahead.

Richard: Hi, this is Richard Liu here. I just wanted to understand more on the profitability of the non-domestic Decorative business. And the way I'm looking at this really the difference between the paint segment in consol and the paints segment in standalone which I guess represents industrial and international together. So if I look at this steady-state margin here used to be about in the range of about 10%-12%-14% and that has come down significantly to about something like mid-single-digit. How has this happened and what will trigger a reverse move on this?

Management: In Decorative in India, we are market leaders and we have the ability to transfer from material prices immediately or in advance so to speak; and hence take care of inflationary environment much more successfully then we can do in either the industrial market or in international markets where we are not the market leader. There it is incumbent, we are in some extent dependent on how the rest of the market reacts to increasing raw material prices. Due to relatively subdued demand in many markets for example Egypt, Middle East etc. many of our competitors have not taken to increasing prices. And we have not been able to take the price increases we so desired or at least to the extent we desired across markets. So, the lag effect is definitely there in an inflationary scenario. The previous couple of years you had a sort of deflationary scenario where the advantages were obvious and you could maintain a higher margin much more easily. Plus you have a situation in Ethiopia where our ability to source Forex has in absolute terms reduced the business and obviously also in the absolute terms impacted the total profit contribution and Ethiopia was a reasonable profit contributor. So all these three factors had sort of impacted this which is slower demand, our ability to raise prices as well as a one-off situation in Ethiopia where we are unable to source Forex and plus absolute returns were down.

Richard: So if I suffice to say that this impact was more from the overseas business line from the industrial business.

Management: Industrial business also but you are right. The impact that we are witnessing in overseas business is much larger than the industrial business; the impact is going to be much more significant there.

Richard: Is there in the trigger for a reverse movement other than raw material prices itself pulling back?

Management: No, gradually we expect competition too and we have started the process of increasing prices across markets. So it will come back but you are in inflationary scenario. As you are increasing prices you are finding raw material prices are continuing to increase further. It's not a status quo situation where you can really play catch-up so easily. It's a fluid market where there are varying dynamics.

Moderator: The next question is from the line of Vivek Maheshwari from CLSA. Please go ahead.

Vivek Maheshwari: My first question is the 3.3% price hike that you took until May, did that pass on all the cost inflation?

Management: So it passed on the cost inflation till Q1, not what has risen in Q2 since.

Vivek Maheshwari: Which is what you have quantified as 10%, so 10% is something that is incremental.

Management: 10% is what I said is over last year average for the full-year. Now we have taken 3.3% or 3.4% over that, already out of that. The balance we would like to have taken. We have to determine when to take it.

Vivek Maheshwari: Which means that until May-June all the cost inflation has been passed on?

Management: Yes.

Vivek Maheshwari: I know you don't give these numbers but can you just qualitatively indicate the premium part of the portfolio growing faster or in line with the base portfolio?

Management: Sorry, we do not comment.

Vivek Maheshwari: Could you quantify when you say you gave an example of 1980s excise duty reduction, so today what will be the size in terms of percentage of the unorganized market at the moment?

Management: Nielsen's study which the IPA published talks about around 30% of the market being the unorganized sector.

Vivek Maheshwari: And that 30% number is volume or value?

Management: Value.

Vivek Maheshwari: Because of let's say a 10 percentage points price reduction would you also expect uptrading in the category as in premium products being more affordable and therefore customers going for that?

Management: Very difficult to anticipate that. There could be some uptrading but it is very difficult to talk about that as yet.

Moderator: The next question is from the line of Shrinivas Seshadri from Mirabilis. Please go ahead.

Shrinivas Seshadri: I had a couple of questions with respect to the new capacity coming in Mysuru and Vizag. I believe that the first place itself will add around 50% to the current capacity if I'm not mistaken. So typically, when you ramp-up these capacities and obviously the market is growing at a pace. And if I understand correctly, you would kind of try to utilize capacity in an optimal manner from day one. So how do we think about the overall capacities getting balance through the existing plants and also do you also so something from outside in terms of manufacturing or how does this kind of overall thing work, that's one? And secondly as a result of that would there be any kind of meaningful savings in terms of logistic cost or any other cost for you as a company?

Management: The second part is easier. There would be logistic savings since these plants are closer to the markets where we have inadequate capacity currently. Setting up a plant is fairly long process from the point of searching for land, getting permission, setting up the plant etc. so we really can't set-up plants every day. And given our volumes, these plant's erstwhile capacity will last us only 4-5 years, it's not going to last us much longer. Secondly paint manufacturing is more of a batch process, not a continuous process. So we will manufacture according to where it is most optimally beneficial in the economic terms for the company. And even if you look at the fastest ramp-ups, we will not be able to ramp-up to full capacity. We can only do it in about 2.5 to 3 years period of time even if we went on the most accelerated pace and did everything that we have to do and got everything right for time around.

Shrinivas Seshadri: If I understand correctly, you don't use any outsourced capacity at all, right as a company?

Management: We do for certain products. Some of the putty, primers we make outside, some of the solvent-based paints we make outside. But that's more because of you can say economic reasons rather than anything else. Wherever we think the technology is important to us, we manufacture it inside the factories.

Shrinivas Seshadri: This capacity doesn't really address that portion?

Management: No.

Shrinivas Seshadri: Any possibility of quantification of the logistics and other savings because of this?

Management: No. while we have done it I don't have the figures in front of me.

Moderator: The next question is from the line of Anand Shah from Axis Capital. Please go ahead.

Anand Shah: One question was essentially; would there be any fiscal savings from commercialization of these two plants?

Management: There are certain tax benefits given by these governments, both in Karnataka and Andhra Pradesh.

Anand Shah: And this would be like state specific benefits like….

Management: Yes, state specific benefits, its relating to the sales made locally, manufactured from the same plant.

Anand Shah: So sales essentially only in those specific states.

Management: Specifically in the respective states.

Anand Shah: Which will have benefits?

Management: Yes.

Anand Shah: The inflation that you called out in Q2 that 10% is essentially you are expecting is on YOY basis?

Management: YOY, average base of last year, 10% on that. It's not quarter-to-quarter but it is on the average of last year.

Anand Shah: And is there any significant mix improvement that would have happened this quarter because if I look at the standalone numbers and compare just the growth in cost of materials and let's say just for a volume growth; I know you don't share volume growth, but if I assume a certain mix and volume a division let's say 13%-14% volume growth and 2%-3% pricing that way and do it, it seems your cost of materials have for volume adjusted were largely flat. It looks like this trajectory for example was much higher earlier which has actually come down. So this you are expecting sort of to again move up significantly, so was there any mix improvement or any procurement benefit that would have kicked in this quarter?

Management: Nothing undue.

Moderator: The next question is from Kunal Bhatia from Dalal & Broacha from. Please go ahead.

Kunal Bhatia: Just wanted to know currently what is our mix of solvent and water-base and how have they moved? I believe in the last analyst meet you mentioned around 40%, so how has it moved over the past few years if you could give?

Management: I don't think I mentioned 40% anywhere?

Kunal Bhatia: Water-based.

Management: We don't give the mix but definitely over the last two decades, water base is growing much faster than solvent base. Our new plans are entirely water-based.

Moderator: The next question is from the line of Lakshmi Naryanan from Catamaran. Please go ahead.

Lakshmi Naryanan: My first question is regarding the GST change. You mentioned that there is some part of the price will be passed on to the customer. And for the end customer what is the range of price reduction he can actually expect?

Management: The entire tax benefit will be passed on to the customer. So the MRP decreases will reflect the entire GST reduction. And our bill to the customer based on our DPL, there will be new rate. But how the dealer sort of passes it on to the customer is up to the channel on a case to case basis.

Lakshmi Naryanan: I am sure dealer can actually enhance his margin also.

Management: That possibility exists but it is a competitive environment so while that might occur for very small customers, in most markets it is difficult for the dealer to really increase his margin significantly.

Lakshmi Naryanan: And you mentioned 30% is the unorganized broadly, so I believe it will be more on the enamels or which segment it will be more unorganized?

Management: Enamels and distempers definitely larger but it is also there in emulsions.

Lakshmi Naryanan: Another question is that from the capacity you are setting up, you are almost setting up equal to your existing capacity which means that you're thinking about a particular volume growth for the industry. When I look at all the other players including your top competitors are also setting up capacities, so if you can just step back and help me understand in terms of what is the volume growth you are expecting for the industry? And some time it happened earlier also that all the players are setting up extra capacity or this happens quite continuously every cycle?

Management: We do not give projections. The Indian Paint Association is the best organization to give projections for growth for the paint industry. But given the past decade what we are doing like I said, Phase-I will take care of at best 4-5 years increase in production in sales.

Lakshmi Naryanan: You said you have around 52,000 touch points, what kind of growth that actually, I mean how much that end point grows for us if you look at five years back what was that number and some direction there?

Management: We are increasing about 3000 end points every year in the last 4-5 years.

Lakshmi Naryanan: So you have 52,000 of some x so that x also increasing more?

Management: As urbanization is increasing as cities are expanding, x is also increasing, so frankly that figure is anybody's guess.

Moderator: The next question is from Avi Mehta from India Infoline. Please go ahead.

Avi Mehta: Just a clarification the deferring that you have seen exactly what is the time period for this anti-profiteering because if you have any time period in mind.

Management: I wish I had clarity on that I would have told you.

Avi Mehta: The second thing was the industrial segment. You have indicated that margins have come under pressure because of the input cost situation, the inability to pass it on. Does this reduction in any way help us in that or no?

Management: No, because the industrial segment was getting full GST benefit as a user.

Avi Mehta: So there would be no impact on that?

Management: There is no impact of that. It takes a little time to negotiate with each OEM customer or each contract for increase in prices, there is always a lag effect. And in an inflationary scenario what you negotiate you find you have already negotiated less, so it's an ongoing process throughout the year.

Avi Mehta: So that is where the divergence kind of creeps in. Okay.

Moderator: The next question is from PV Bhattad from Aditya Investments. Please go ahead.

PV Bhattad: My question is regarding the new upcoming plants. What I wanted to understand is will there be any manufacturing cost reduction due to the new technology which we will be using in the new plants?

Management: May not be significant from the other newer plants but on an overall basis the average might drop.

Moderator: The next question is from Tejas Shah from Spark Capital. Please go ahead.

Tejas Shah: The sharp cut in GST rates, does it create any disruption at inventory level, at dealer level?

Management: The disruption is in terms of that stickering, etc., is to be done for the new MRP across packs. And given that the range that we have small packs, big packs and we sell such a large volume, it's quite a labor-intensive exercise which has to be done very rapidly.

Tejas Shah: So, do you need to change the price tag for the inventory at dealer level as well or it is from the fresh stock that you send from here on?

Management: We really can't do it at the dealer level but we will instruct the dealer to do it at his level.

Tejas Shah: For last two years we are picking up from various real estate sources that new real estate projects are under tremendous pressure. But volume growth for paint industry has remained robust, so are we witnessing any significant change in that historic mix in favor of re-painting demand versus fresh painting?

Management: Re-painting has always been a major chunk of our business as a matter of fact. So project sales. new construction was a very small element in our overall business and was more with the unorganized sector really speaking.

Tejas Shah: But do you believe that small portion has become more smaller for us in industry as well?

Management: No I don't think so.

Tejas Shah: Lastly, you mentioned standalone CAPEX of 1000 crores, what will be the number at consolidated level?

Management: Around 200 crores at a consol level additional.

Moderator: The next question is from Abhijeet Kundu from Antique Stock Broking. Please go ahead.

Abhijeet Kundu: There has been a decline in other income during the quarter, any key reason, what should be building for the year?

Management: Because of the CAPEXs that we are undertaking since last year on the two new plants, our investible surplus has come down to an extent. And the other reason is last year you had a rupee appreciation benefit going through the entire quarter so we had an exchange gain versus this year you have an exchange loss, so that's the reason.

Abhijeet Kundu: With regards to new plant, so one is that there would be a 1000 crores CAPEX for the year for FY19 the total CAPEX should be about 1200-1300 crores.

Management: So 1000 crores is at the standalone level.

Abhijeet Kundu: And 1200-1300 at the consolidated level?

Management: Yes, around 1200, for this year.

Abhijeet Kundu: The increase in depreciation should happen as the plants come in September and then in January, there should be an increase in depreciation as well.

Management: Yes.

Moderator: The next question is from Manish Ostwal from Nirmal Bang. Please go ahead.

Manish Ostwal: My question on your comment on the international markets have because of the currency issues you're facing challenges in terms of growth, so how is the situation, whether it is remained similar or we can expect some improvement in the business going ahead?

Management: We have only one market where we have currency challenges which is currently Ethiopia. And we have to hold our plans for that particular market, so there we don't know the outlook. But we should be able to do maybe a little less than significantly lesser number in Ethiopia than what we did last year. Other markets are not impacted by availability of FOREX, they may be impacted by sort of depreciation in their currencies and they are impacted by demand conditions that remained weak in the markets that we spoke of.

Manish Ostwal: In terms of GST rate cut, how do you see the impact of the demand of like-to-like basis?

Management: As we said, demand should increase in the medium-term.

Manish Ostwal: This home improvement business segment in terms of growth and the profitability, what is your outlook?

Management: The growth has been extremely good in this quarter. We are continuing to drive for growth in the balance portion of the year.

Moderator: Thank you very much. That was the last question in the queue as there are no further questions. I would now like to hand the conference over to Mr. K.B.S. Anand – MD & CEO for closing comments.

K.B.S. Anand: Everyone thank you very much for participating in our Conference Call and look forward to seeing you next quarter. Thank you.

Moderator: Thank you very much. On behalf of Asian Paints that concludes this conference. Thank you for joining us ladies and gentlemen, you may now disconnect your lines.