

We recently met the management Akzo Nobel India to understand the key business drivers and margin levers. Our key takeaways from the meeting are as follows:

Demand scenario: The demand scenario has improved significantly as compared to same time a year back. Enquires have increased significantly and pick up in volume growth seems likely in the forthcoming quarters. Akzo Nobel has significant exposure to industrial category and pick up in industrial activity will be helpful for Akzo Nobel's performance coatings portfolio.

Market positioning and performance: Akzo being smaller organized player is a price taker but the company has a very strong premium portfolio. Akzo's products are more skewed towards the premium category but the presence in Tier 3 & 4 cities and rural regions is limited. This has impacted their volume growth in the recent past as growth in the Tier 3 & 4 cities, rural regions and mass market categories have been the drivers for the paints category. In FY14, the company's volume growth was around 2-3% and price growth was around 5-6%. This was lower than industry growth rate on account of limited product portfolio and market reach. It is addressing this issue by launching around 4 products each year and expanding distribution network to new towns.

Gross margins could trend downwards on portfolio expansion: Akzo's gross margins are similar (Slightly better) to industry leader's gross margins on account of its premium product portfolio. Akzo Nobel is now launching more products in the mass market category to expand its distribution network gain volume market share. Directionally, the gross margins are likely to trend downwards as the company's product profile changes towards mass market products but the company will continually work towards cost saving measures to maintain margins.

EBIDTA margin and possible operating leverage gains: In FY14, the company's EBIDTA margins at 8% were significantly lower than industry leader Asian Paints' EBIDTA margins at 15%. The lower EBIDTA margins are on account of royalty charges which are currently at 2% of revenues and will increase to 3% from Q3FY15. Apart from the higher Royalty charges the employee expenses as a % of revenues at 8% (FY14) are significantly higher than industry average of around 5%. This is because the organization is ahead of time and employee count may not increase significantly over the next 2-3 years. The management also indicated that their advertising and promotion expenses are around 6% of revenues (FY14 advertising and publicity expense at 5% and promotional activities accounted for around 1% of revenues) compared to industry average of 5% notwithstanding significant industrials portfolio where advertising spends are significantly lower than consumer facing businesses. All these ahead of time investments present significant opportunities for operating leverage gains as the existing cost structure is capable of absorbing 30-40% growth in revenues without significant increase in the cost structure.

Capacity utilisation another key trigger: Akzo Nobel commissioned 50mn Litres Per Annum (LPA) plant in Gwalior taking the total capacity to 200mn LPA. The Gwalior plant capacity utilisation is around 30% and presents immense scope for operating leverage gains based on volume growth which is dependent on recovery in industrial category and strategic initiatives in the decorative paints category.

Overall: Akzo should be a key beneficiary of revival in industrial demand in the performance coating category which is driven by infrastructure, white goods, marine and others. Akzo Nobel's strategy of launching new products and distribution expansion will benefit the company with a lag as product and channel acceptability will take time. The scope for margin expansion continues to remain significant. However, it will depend on growth led by operating leverage gains.

Not Rated

AKZO IN | CMP RS 1132

Company Data

| | |
|------------------------|------------|
| O/S SHARES (MN) : | 48 |
| MARKET CAP (RSBN) : | 55 |
| MARKET CAP (USDBN) : | 0.9 |
| 52 - WK HI/LO (RS) : | 1155 / 710 |
| LIQUIDITY 3M (USDMN) : | 0.5 |
| FACE VALUE (RS) : | 1 |

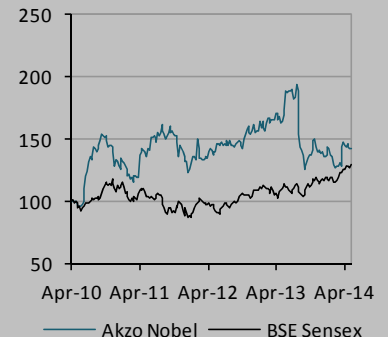
Share Holding Pattern, %

| | |
|-------------------------------|------|
| PROMOTERS : | 73.0 |
| FII / NRI : | 3.2 |
| FI / MF : | 9.0 |
| NON PROMOTER CORP. HOLDINGS : | 6.7 |
| PUBLIC & OTHERS : | 8.2 |

Price Performance, %

| | 1mth | 3mth | 1yr |
|------------|------|------|------|
| ABS | 5.7 | 19.8 | 54.8 |
| REL TO BSE | 3.2 | 11.3 | 6.8 |

Price Vs. Sensex (Rebased values)



Source: PhillipCapital India Research

Other Key Ratios

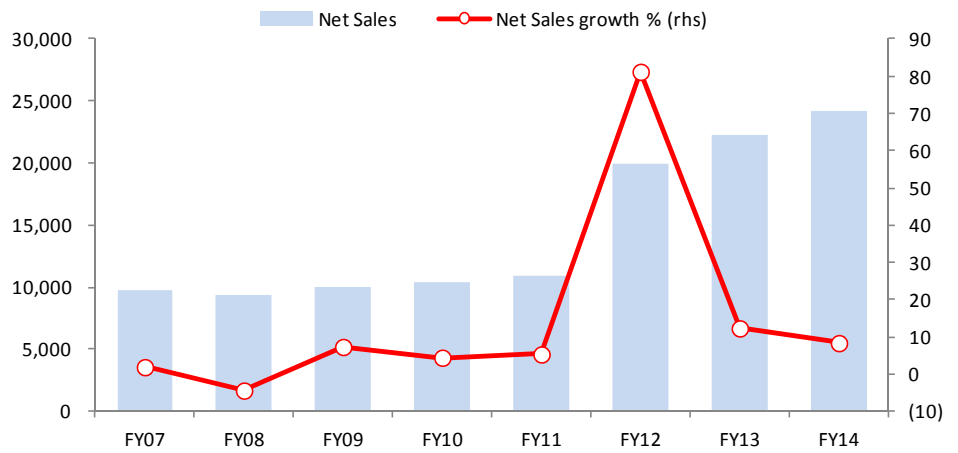
| Rs mn | FY12 | FY13 | FY14 |
|-----------------|--------|--------|--------|
| Net Sales | 19,878 | 22,320 | 24,179 |
| Ebidta | 1,746 | 1,885 | 1,919 |
| Net Profit | 2,018 | 2,188 | 1,502 |
| EPS, Rs | 54.8 | 46.9 | 32.2 |
| PER, X | 11.0 | 12.9 | 18.7 |
| EV/EBIDTA, x | 12.6 | 14.8 | 14.6 |
| EV/Net Sales, x | 1.1 | 1.3 | 1.2 |
| ROE, % | 23.2 | 39.8 | 28.5 |

Source: PhillipCapital India Research Est.

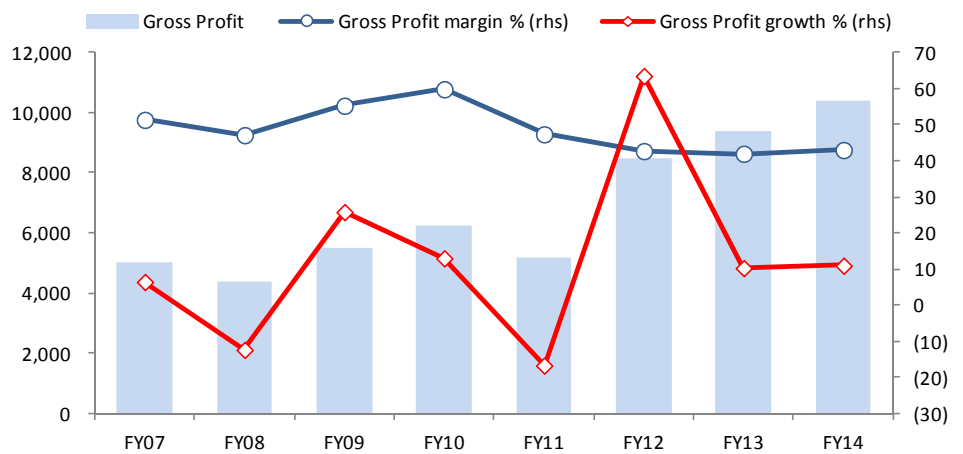
Naveen Kulkarni, CFA, FRM
 (+ 9122 66679947)
 nkulkarni@phillipcapital.in

Manish Pushkar, CFA
 (+ 9122 6667 9764)
 mpushkar@phillipcapital.in

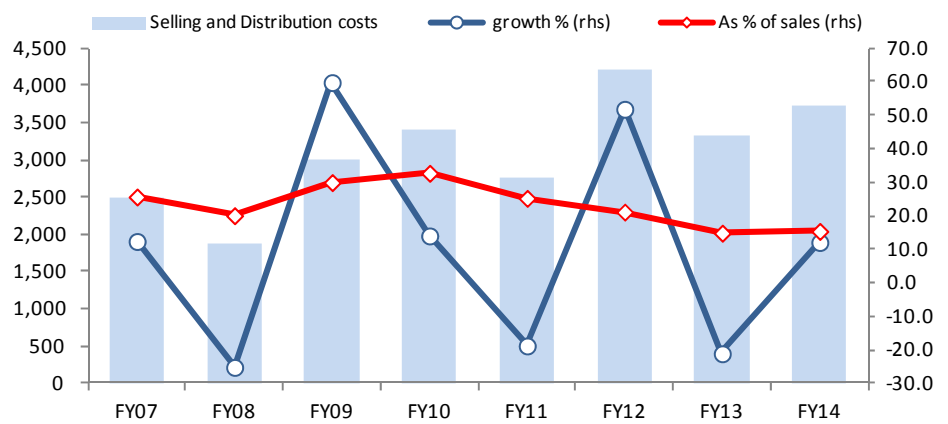
Key performance charts



Source: Company, PhillipCapital India Research

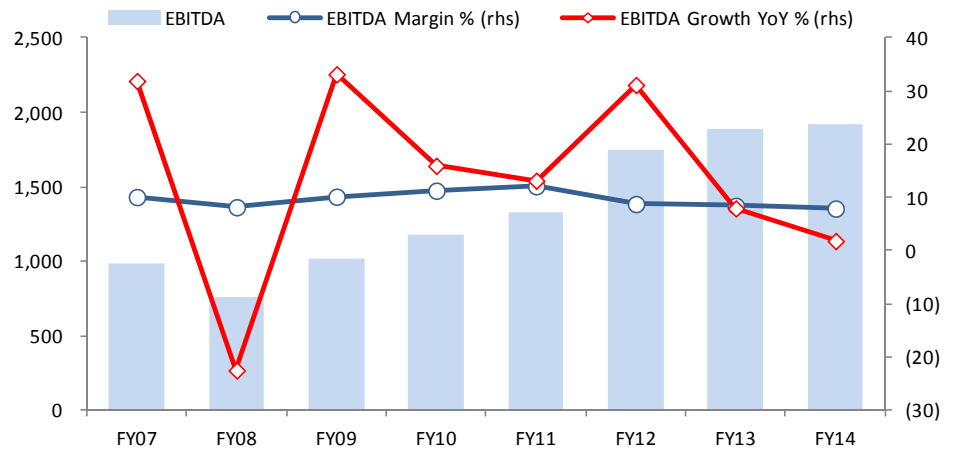


Source: Company, PhillipCapital India Research

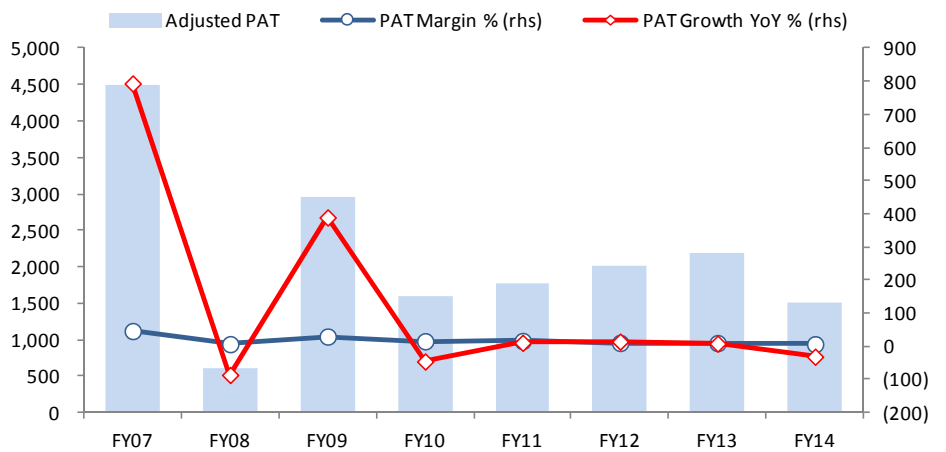


Source: Source: Company, PhillipCapital India Research

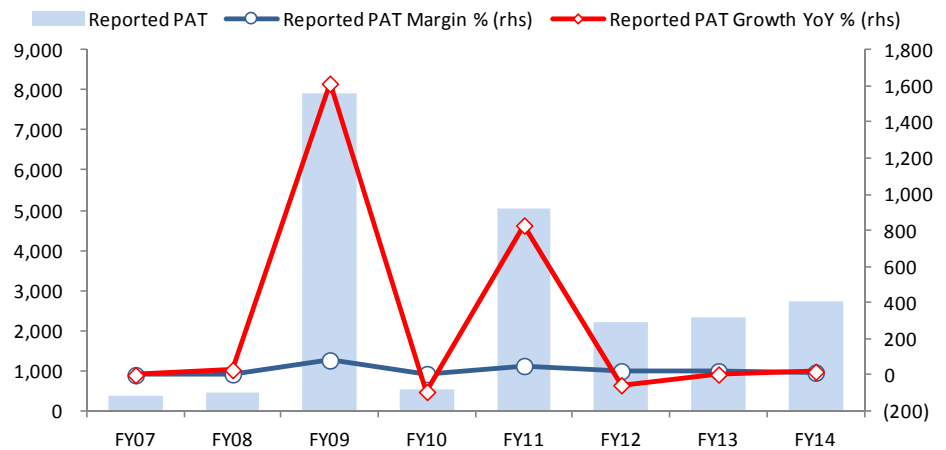
Key Operating performance charts



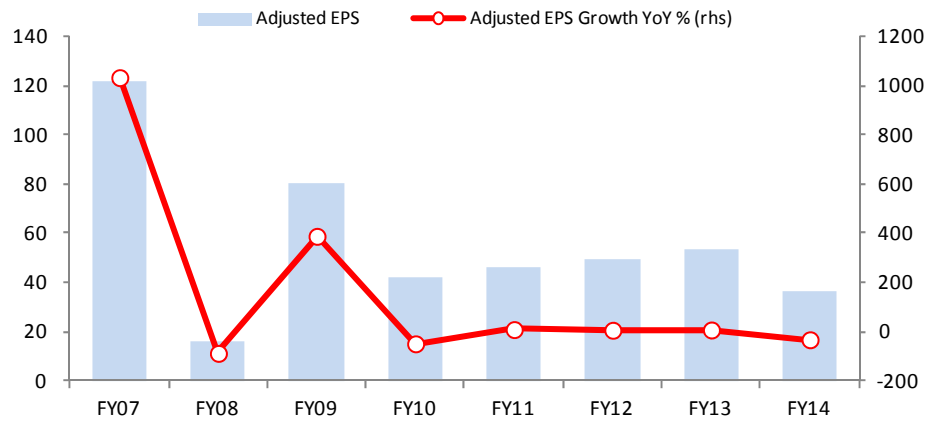
Source: Company, PhillipCapital India Research



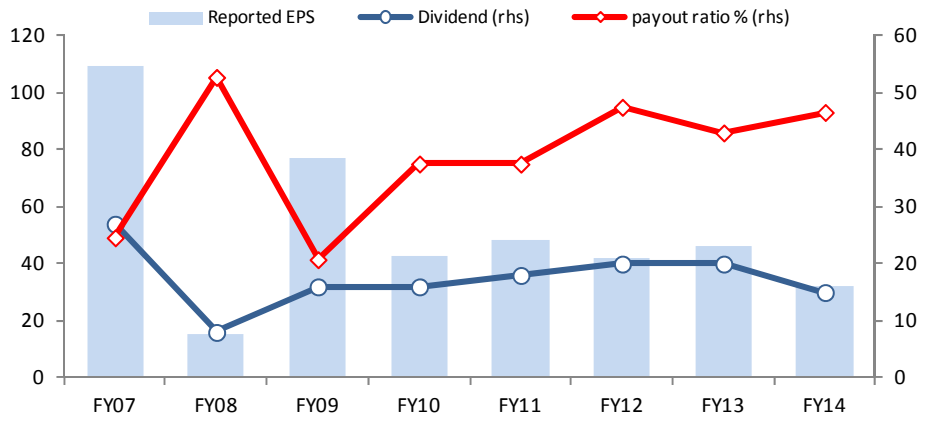
Source: Company, PhillipCapital India Research



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Financials

Income Statement

| Y/E Mar, Rs mn | FY11 | FY12 | FY13 | FY14 |
|---------------------------------|---------------|---------------|---------------|---------------|
| Net sales | 10,968 | 19,878 | 22,320 | 24,179 |
| Growth, % | 5 | 81 | 12 | 8 |
| Other income | 0 | 0 | 0 | 0 |
| Total income | 10,968 | 19,878 | 22,320 | 24,179 |
| Raw material expenses | -5,775 | -11,390 | -12,955 | -13,784 |
| Employee expenses | -696 | -1,473 | -1,753 | -1,939 |
| Other Operating expenses | -9,637 | -5,269 | -5,727 | -6,537 |
| EBITDA (Core) | 1,331 | 1,746 | 1,885 | 1,919 |
| Growth, % | 13.2 | 31.2 | 8.0 | 1.8 |
| Margin, % | 12.1 | 8.8 | 8.4 | 7.9 |
| Depreciation | -217 | -366 | -386 | -437 |
| EBIT | 1,114 | 1,380 | 1,499 | 1,482 |
| Growth, % | 13.2 | 31.2 | 8.0 | 1.8 |
| Margin, % | 12.1 | 8.8 | 8.4 | 7.9 |
| Interest paid | -15 | -39 | -89 | -15 |
| Other Non-Operating Income | 1,100 | 1,123 | 1,381 | 567 |
| Pre-tax profit | 2,749 | 3,182 | 3,823 | 2,538 |
| Tax provided | -433 | -446 | -603 | -532 |
| Profit after tax | 2,316 | 2,736 | 3,220 | 2,006 |
| Others (Minorities, Associates) | 0 | 0 | 0 | 0 |
| Net Profit | 2,316 | 2,736 | 3,220 | 2,006 |
| Growth, % | 11.3 | 14.3 | 8.4 | (31.4) |
| Net Profit (adjusted) | 1,766 | 2,018 | 2,188 | 1,502 |
| Unadj. shares (m) | 37 | 37 | 47 | 47 |
| Wtd avg shares (m) | 37 | 37 | 47 | 47 |

Balance Sheet

| Y/E Mar, Rs mn | FY11 | FY12 | FY13 | FY14 |
|---------------------------------------|---------------|---------------|--------------|--------------|
| Cash & bank | 167 | 139 | 158 | 221 |
| Debtors | 1,045 | 1,647 | 1,121 | 1,234 |
| Inventory | 1,240 | 1,322 | 1,217 | 1,296 |
| Loans & advances | 744 | 445 | 467 | 411 |
| Other current assets | 0 | 0 | 0 | 0 |
| Total current assets | 3,196 | 3,552 | 2,963 | 3,160 |
| Investments | 6,926 | 8,257 | 4,357 | 4,136 |
| Gross fixed assets | 3,116 | 2,857 | 3,115 | 3,737 |
| Less: Depreciation | -1,783 | -1,559 | -1,662 | -2,251 |
| Add: Capital WIP | 105 | 35 | 49 | 27 |
| Net fixed assets | 1,437 | 1,333 | 1,502 | 1,512 |
| Non-current assets | 0 | 0 | 0 | 0 |
| Total assets | 11,465 | 13,061 | 8,691 | 8,710 |
| Current liabilities | 3,835 | 4,364 | 3,190 | 3,284 |
| Total current liabilities | 3,835 | 4,364 | 3,190 | 3,284 |
| Non-current liabilities | 0 | 0 | 0 | 160 |
| Total liabilities | 3,835 | 4,364 | 3,190 | 3,444 |
| Paid-up capital | 384 | 409 | 409 | 409 |
| Reserves & surplus | 7,246 | 8,288 | 5,105 | 4,883 |
| Shareholders' equity | 7,630 | 8,697 | 5,501 | 5,266 |
| Total equity & liabilities | 11,465 | 13,061 | 8,691 | 8,710 |

Source: Company, PhillipCapital India Research Estimates

Cash Flow

| Y/E Mar, Rs mn | FY11 | FY12 | FY13 | FY14 |
|--|---------------|---------------|---------------|---------------|
| Pre-tax profit | 2,749 | 3,182 | 3,823 | 2,538 |
| Depreciation | 217 | 366 | 386 | 437 |
| Chg in working capital | -71 | 146 | -567 | -41 |
| Total tax paid | -396 | -460 | -554 | -564 |
| Other operating activities | 1,522 | 2,773 | 2,493 | 354 |
| Cash flow from operating activities | 4,021 | 6,007 | 5,582 | 2,724 |
| Capital expenditure | -307 | -262 | -555 | -448 |
| Chg in investments | 2,226 | -1,331 | 3,901 | 220 |
| Cash flow from investing activities | 1,919 | -1,593 | 3,346 | -227 |
| Free cash flow | 5,939 | 4,414 | 8,928 | 2,497 |
| Equity raised/(repaid) | -2,081 | 1,067 | -3,195 | -235 |
| Debt raised/(repaid) | 0 | 0 | 0 | 160 |
| Dividend (incl. tax) | -771 | -1,115 | -4,367 | -4,094 |
| Cash flow from financing activities | -2,852 | -48 | -7,562 | -4,169 |
| Net chg in cash | 3,087 | 4,366 | 1,365 | -1,672 |

Valuation Ratios & Per Share Data

| | FY11 | FY12 | FY13 | FY14 |
|--------------------------------|--------|--------|--------|--------|
| Per Share data | | | | |
| EPS (INR) | 48.0 | 54.8 | 46.9 | 32.19 |
| Growth, % | 11.3 | 14.3 | (14.4) | (31.4) |
| Book NAV/share (INR) | 207.2 | 236.1 | 117.9 | 112.9 |
| FDEPS (INR) | 48.0 | 54.8 | 46.9 | 32.2 |
| CEPS (INR) | 38.9 | 45.2 | 33.0 | 30.8 |
| CFPS (INR) | 38.0 | 57.3 | 36.6 | 38.7 |
| DPS (INR) | 18.0 | 26.0 | 80.0 | 75.0 |
| Return ratios | | | | |
| Return on assets (%) | 18.8 | 22.5 | 30.1 | 23.2 |
| Return on equity (%) | 23.1 | 23.2 | 39.8 | 28.5 |
| Return on capital employed (%) | 26.8 | 33.8 | 46.2 | 36.9 |
| Turnover ratios | | | | |
| Asset turnover (x) | 19.9 | 39.3 | 29.8 | 21.2 |
| Sales/Total assets (x) | 0.9 | 1.6 | 2.1 | 2.8 |
| Sales/Net FA (x) | 7.9 | 14.4 | 15.7 | 16.0 |
| Working capital/Sales (x) | (0.1) | (0.0) | (0.0) | (0.0) |
| Working capital days | (26.8) | (17.5) | (6.3) | (5.2) |
| Liquidity ratios | | | | |
| Current ratio (x) | 0.8 | 0.8 | 0.9 | 1.0 |
| Quick ratio (x) | 0.5 | 0.5 | 0.5 | 0.6 |
| Interest cover (x) | 74.3 | 35.4 | 16.8 | 98.8 |
| Dividend cover (x) | 2.7 | 2.1 | 0.6 | 0.4 |
| Total debt/Equity (%) | - | - | - | 3.0 |
| Net debt/Equity (%) | (2.2) | (1.6) | (2.9) | (1.1) |
| Valuation | | | | |
| PER (x) | 12.6 | 11.0 | 12.9 | 18.7 |
| Price/Book (x) | 2.9 | 2.6 | 5.1 | 5.3 |
| Yield (%) | 3.0 | 4.3 | 13.3 | 12.4 |
| EV/Net sales (x) | 2.0 | 1.1 | 1.3 | 1.2 |
| EV/EBITDA (x) | 16.6 | 12.6 | 14.8 | 14.6 |
| EV/EBIT (x) | 16.6 | 12.6 | 14.8 | 14.6 |

Management

| | |
|--|-------------------|
| Vineet Bhatnagar (Managing Director) | (91 22) 2300 2999 |
| Jignesh Shah (Head – Equity Derivatives) | (91 22) 6667 9735 |

Research

Automobiles

| | |
|--------------|------------------|
| Dhawal Doshi | (9122) 6667 9769 |
| Priya Ranjan | (9122) 6667 9965 |

Banking, NBFCs

| | |
|------------------|------------------|
| Manish Agarwalla | (9122) 6667 9962 |
| Paresh Jain | (9122) 6667 9948 |

Consumer, Media, Telecom

| | |
|---------------------------|------------------|
| Naveen Kulkarni, CFA, FRM | (9122) 6667 9947 |
| Vivekanand Subbaraman | (9122) 6667 9766 |
| Manish Pushkar, CFA | (9122) 6667 9764 |

Cement

| | |
|-----------------|------------------|
| Vaibhav Agarwal | (9122) 6667 9967 |
|-----------------|------------------|

Economics

| | |
|--------------|------------------|
| Anjali Verma | (9122) 6667 9969 |
|--------------|------------------|

Engineering, Capital Goods

| | |
|-------------------|------------------|
| Ankur Sharma | (9122) 6667 9759 |
| Hrishikesh Bhagat | (9122) 6667 9986 |

Infrastructure & IT Services

| | |
|----------------|------------------|
| Vibhor Singhal | (9122) 6667 9949 |
| Varun Vijayan | (9122) 6667 9992 |

Midcap

| | |
|--------------------|------------------|
| Vikram Suryavanshi | (9122) 6667 9951 |
|--------------------|------------------|

Metals

| | |
|--------------|------------------|
| Dhawal Doshi | (9122) 6667 9769 |
|--------------|------------------|

Oil&Gas, Agri Inputs

| | |
|---------------|------------------|
| Gauri Anand | (9122) 6667 9943 |
| Deepak Pareek | (9122) 6667 9950 |

Pharma

| | |
|-------------|------------------|
| Surya Patra | (9122) 6667 9768 |
|-------------|------------------|

Retail, Real Estate

| | |
|---------------------------|------------------|
| Abhishek Ranganathan, CFA | (9122) 6667 9952 |
| Neha Garg | (9122) 6667 9996 |

Technicals

| | |
|-------------------|------------------|
| Subodh Gupta, CMT | (9122) 6667 9762 |
|-------------------|------------------|

Production Manager

| | |
|-------------------|------------------|
| Ganesh Deorukhkar | (9122) 6667 9966 |
|-------------------|------------------|

Database Manager

| | |
|----------------|------------------|
| Vishal Randive | (9122) 6667 9944 |
|----------------|------------------|

Sr. Manager – Equities Support

| | |
|-------------|------------------|
| Rosie Ferns | (9122) 6667 9971 |
|-------------|------------------|

Sales & Distribution

| | |
|-----------------------|------------------|
| Kinshuk Bharti Tiwari | (9122) 6667 9946 |
| Ashvin Patil | (9122) 6667 9991 |
| Shubhangi Agrawal | (9122) 6667 9964 |
| Kishor Binwal | (9122) 6667 9989 |
| Sidharth Agrawal | (9122) 6667 9934 |
| Bhavini Shah | (9122) 6667 9974 |

| | |
|---------------------|------------------|
| Dipesh Sohani | (9122) 6667 9756 |
| Sales Trader | |
| Dilesh Doshi | (9122) 6667 9747 |
| Sunil Pandit | (9122) 6667 9745 |
| Execution | |
| Mayur Shah | (9122) 6667 9945 |

Corporate Communications

| | |
|----------------|------------------|
| Zarine Damania | (9122) 6667 9976 |
|----------------|------------------|

Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd

250 North Bridge Road, #06-00 Raffles City Tower,
Singapore 179101

Tel : (65) 6533 6001 Fax: (65) 6535 3834

www.phillip.com.sg

JAPAN

Phillip Securities Japan, Ltd

4-2 Nihonbashi Kabutocho, Chuo-ku
Tokyo 103-0026

Tel: (81) 3 3666 2101 Fax: (81) 3 3664 0141

www.phillip.co.jp

THAILAND

Phillip Securities (Thailand) Public Co. Ltd.

15th Floor, Vorawat Building, 849 Silom Road,
Silom, Bangrak, Bangkok 10500 Thailand

Tel (66) 2 2268 0999 Fax: (66) 2 2268 0921

www.phillip.co.th

UNITED STATES

Phillip Futures Inc.

141 W Jackson Blvd Ste 3050

The Chicago Board of Trade Building

Chicago, IL 60604 USA

Tel (1) 312 356 9000 Fax: (1) 312 356 9005

MALAYSIA

Phillip Capital Management Sdn Bhd

B-3-6 Block B Level 3, Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450 Kuala Lumpur

Tel (60) 3 2162 8841 Fax (60) 3 2166 5099

www.poems.com.my

INDONESIA

PT Phillip Securities Indonesia

ANZ Tower Level 23B, Jl Jend Sudirman Kav 33A,
Jakarta 10220, Indonesia

Tel (62) 21 5790 0800 Fax: (62) 21 5790 0809

www.phillip.co.id

FRANCE

King & Shaxson Capital Ltd.

3rd Floor, 35 Rue de la Bienfaisance
75008 Paris France

Tel (33) 1 4563 3100 Fax : (33) 1 4563 6017

www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia

Level 37, 530 Collins Street

Melbourne, Victoria 3000, Australia

Tel: (61) 3 9629 8380 Fax: (61) 3 9614 8309

www.phillipcapital.com.au

INDIA

PhillipCapital (India) Private Limited

No. 1, 18th Floor, Urmi Estate, 95 Ganpatrao Kadam Marg, Lower Parel West, Mumbai 400013

Tel: (9122) 2300 2999 Fax: (9122) 6667 9955 www.phillipcapital.in

HONG KONG

Phillip Securities (HK) Ltd

11/F United Centre 95 Queensway Hong Kong
Tel (852) 2277 6600 Fax: (852) 2868 5307

www.phillip.com.hk

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd.

No 550 Yan An East Road, Ocean Tower Unit 2318
Shanghai 200 001

Tel (86) 21 5169 9200 Fax: (86) 21 6351 2940

www.phillip.com.cn

UNITED KINGDOM

King & Shaxson Ltd.

6th Floor, Candlewick House, 120 Cannon Street
London, EC4N 6AS

Tel (44) 20 7929 5300 Fax: (44) 20 7283 6835

www.kingandshaxson.com

SRI LANKA

Asha Phillip Securities Limited

Level 4, Millennium House, 46/58 Navam Mawatha,
Colombo 2, Sri Lanka

Tel: (94) 11 2429 100 Fax: (94) 11 2429 199

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Registered office: No. 1, 18th Floor, Urmi Estate, 95 Ganpatrao Kadam Marg, Lower Parel West, Mumbai 400013