



“Asian Paints Q3 & Nine Months FY’19 Investor Conference
Call”

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MANAGEMENT:

MR. K.B.S. ANAND : MD & CEO
**MR. JAYESH MERCHANT : CFO & COMPANY SECRETARY, PRESIDENT – INDUSTRIAL
JVs**
MR. R.J. JEYAMURUGAN : VP - FINANCE
MR. PARAG RANE : CHIEF MANAGER - FINANCE
MR. ARUN NAIR – MANAGER - CORPORATE COMMUNICATIONS

Moderator: Ladies and gentlemen, good day and welcome to the Asian Paints Q3 & Nine Months FY'19 Investor Conference Call. As a reminder, all participants' 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 from Asian Paints, Corporate Communications. Thank you and over to you, sir.

Arun Nair: Good evening and welcome to Asian Paints Investor Call for Q3 FY19 Results. On the call we have Mr. K.B.S. Anand – MD and CEO; Mr. Jayesh Merchant -- CFO and Company Secretary and also the President of Industrial JVs; Mr. R.J. Jeyamurugan -- VP, Finance; Mr. Parag Rane – Chief Manager, Finance and myself Arun Nair from Corporate Communications.

May I now request Mr. K.B.S. Anand to take the call forward?

K.B.S. Anand: Good Evening, everyone.

Increased volatility and challenging business conditions marked the quarter gone by.. On the domestic macro front, growth trends still remain uncertain and the volatility in crude prices and exchange rates have only added to the uncertainty. After witnessing a significant increase in crude prices and a sharp fall in the rupee till the middle of the quarter, the later part of the quarter saw respite in terms of declining crude prices and rupee appreciation.

In the consolidated financials: Revenue from operations has increased by 24.1% to ₹ 5,294 crores in Q3 and by 16% to ₹ 14,331.6 crores in nine months. PBDIT increased by 15.3% to ₹ 1,103.6 crores in Q3 and increased by 12.7% to ₹ 2,906.7 crores in nine months. PBT increased by 13.4% to ₹ 973.5 crores in Q3 and increased by 12.5% to ₹ 2,570.4 crores in nine months. Net profit from continuing operations increased by 14.1% to ₹ 647.2 crores, and increased by 12.6% to ₹ 1,724.5 crores in nine months.

For the standalone financials: Revenue from operations has increased by 26.4% to ₹ 4,536.1 crores in Q3 and by 17.1% to ₹ 12,156.5 crores in nine months. PBDIT increased by 18.7% to ₹ 1,052 crores in Q3 and increased by 16.6% to ₹ 2,744.8 crores in nine months. PBT increased by 17.1% to ₹ 940.2 crores in Q3 and increased by 16.7% to ₹ 2,459.7 crores in nine months. Net profit increased by 19.3% to ₹ 631 in Q3 and increase by 17.9% to ₹ 1,655.1 crores in nine months.

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 business registered high double-digit volume growth in the third quarter and delivered strong performance across regions. Post reduction of GST rate from 28% to 18%

effective 27th July, we immediately passed off the entire GST benefit to consumers and decided not to pass on the raw material inflation, to be in compliance with the anti-profiteering provisions. However, with continued input cost prices due to the fall in rupee as well as increase in raw material prices, we have taken two price increases in the third quarter; 2.35% from October 2018 and another 1.7% from December 2018 to recover gross margins to an extent.

Business Review – INDUSTRIAL:

In the industrial business, the Automotive coatings JV (PPG-AP), witnessed good growth in the General Industrial segment. However, the Auto OEM segment witnessed subdued growth on back of fall in production across auto OEMs. The Industrial Coatings JV (AP-PPG) continued to grow well led by good performance in Protective coatings and the Powder coating segment. Both the businesses continued to face pressure from rising raw material prices and the price increases implemented in the market have not been enough to recover the margins fully.

Business Review – INTERNATIONAL:

In the international portfolio major units like Egypt, Bangladesh and Sri Lanka continued to face challenging business conditions. In Ethiopia, the third quarter saw a bit of pick-up as the unit was able to secure forex for its raw material imports. The greenfield operations in Indonesia continued to progress on its planned trajectory.

Business Review – HOME IMPROVEMENT:

Both the businesses in the Home Improvement space, continue to scale up at the planned levels with expansion in network and enhancement in the product portfolio. Both these businesses have done reasonably well.

CAPEX:

As informed in the last quarter, the first phase of the plant at Mysuru, Karnataka was commissioned as per plan in the month of September 2018 and the plant is progressing well on its stabilization. The first phase of the plant at Vizag, Andhra Pradesh is also set to be commissioned this quarter. The total Capex plan for the standalone operations for the current year is about ₹ 1,000 crores including spends of about ₹ 800 crores on the two new plants.

GOING FORWARD:

As mentioned earlier, fall in crude prices and appreciation in rupee towards the later part of the third quarter has provided some respite on the raw material cost front. However, we will need to monitor the demand conditions which would continue to remain uncertain given the upcoming busy election season. In the international markets, difficult business conditions in some of the key units continue to be a cause of concern.

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

- Moderator:** Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Abneesh Roy from Edelweiss. Please go ahead.
- Abneesh Roy:** In Q2 Distemper had done quite well because of the GST rate cut. Now in Q3 normally Emulsion does well because of the festive-related seasonality. So, if I take off the festive-related impact, has the buoyancy in Distemper been maintained or it has slowed down?
- Management:** We maintained to an extent. You got to remember that there is a later Diwali this year compared to previous year. So, comparing quarter-on-quarter is not perfectly okay in our business.
- Abneesh Roy:** In terms of the region-specific you have been saying East India is growing the fastest while South India was a laggard. So, obviously in this quarter Kerala would have benefited you a lot. So, my question is, has Kerala seen in terms of percent of revenue double digit kind of contribution?
- Management:** All the regions have done well and I do not think Kerala has done exceptionally better than any other region.
- Abneesh Roy:** But in terms of growth it will be quite high right because lot of reconstruction, repainting would have happened. So, on YoY basis would not Kerala have outperformed the overall reported volume growth?
- Management:** No.
- Abneesh Roy:** Lastly on the Home Improvement side, I am seeing ESS ESS in the last four quarters has been in that ₹.46, 49 crore and quarter-on-quarter there is a dip. So, earlier what used to happen, Ess Ess used to grow faster than Sleek, now last two quarters Sleek is growing faster and quarter-on-quarter dip in Ess Ess, in spite of festive and other home improvement companies which have come out with numbers, they have seen a very strong volume growth. So, what is happening in Ess Ess, what is the issue.
- Management:** There is no real issue. The growth is reasonably good, marginally lower than what we expected in this quarter, but we are reasonably confident that the trajectory continue.
- Abneesh Roy:** Could you update on the distribution expansion there? Has the competitive intensity gone up because the competition seems to have done slightly better and you said versus expectation is a bit lower in Ess Ess?
- Management:** I do not think there is any real difference.
- Abneesh Roy:** Rural acceleration, any data point you can share -- has the rural grown faster than Q2 on YoY basis taking all those?
- Management:** Prior to Diwali rural always grows faster; Diwali was later in November, rural growth has been good.

- Moderator:** Thank you. The next question is from the line of Avi Mehta from IIFL. Please go ahead.
- Avi Mehta:** Sir, I was just referring to your comment towards the end about demand environment remains uncertain. This despite very good quarterly performance that you have seen. Would it suggest that there are more one-off factors like festive season timing, price increase announcements, Kerala flood, etc., which have driven this improvement in this quarter because I am just trying to understand why those two contrasting data points -- one is your data point and one is your commentary, just if you could explain that please?
- Management:** There is definitely a factor of a delayed Diwali helping this quarter. We are little uncertain about the future quarters because of elections and other things, uncertain raw material prices, rupee volatility, etc., all these play a role in overall demand situation.
- Avi Mehta:** So, would this be a more medium termish kind of commentary that you are trying to indicate or elections would happen okay, so you are saying that is the reason why you are not willing to call it out despite strong growth?
- Management:** Yes.
- Avi Mehta:** Sir, the second bit was if you could help clarify how was the growth across different categories; Distempers growth versus, has there been any divergence in the growth rates that you have seen specifically?
- Management:** I think growth has been good across all categories in this quarter.
- Avi Mehta:** So, there is no salience of distempers rising the way you had called out in the last quarter right sir?
- Management:** Compared to previous year, yes, compared to the last quarter, no.
- Avi Mehta:** Okay, but sir is that previous year because of the festive timing only you think or is there an underlying shift what I am trying to get is do you feel there is a shift on market shares on the back of GST rate reduction or would you be willing to call that out or no?
- Management:** Give me another year and I will tell you.
- Avi Mehta:** Sir lastly, there was the other comment about despite the two rounds of price increases we are able to recover gross margins to an extent. Does that imply that in the current level of input cost, does need another round of price increase is that what you mean or what exactly?
- Management:** When we did the price increases, we did not do what we really wanted to do to the full extent. Since the raw material prices have fallen a little bit, the rupee has strengthened a little bit. So, the situation is volatile and uncertain. It is quite fluid. We really need to see how it goes in the months coming by.

- Avi Mehta:** So, comment to an extent is more because of the uncertainty of raw materials rather than the current level of raw materials right sir?
- Management:** At the point we did price increases we should have done a higher price increase. We decided not to do so because we were uncertain on how the raw material prices are going to vary. Fortunately, they dipped a little bit, that helped us. If they rise again, we would probably have to do a price increase.
- Moderator:** Thank you. The next question is from the line of Aditya Soman from Goldman Sachs. Please go ahead.
- Aditya Soman:** Has there some meaningful contribution from your new products such as Waterproofing, so we have seen the number of SKUs that go up meaningfully in the last year?
- Management:** Yes, but it is probably not that significant in the overall value of business.
- Aditya Soman:** With these new products, is this also generating higher volumes for your Decorative business or it is a big competitive edge in a sense it is not very meaningful from revenue perspective?
- Management:** We expected to become meaningful from a revenue perspective and yes, it definitely lends an edge to our overall paint business.
- Aditya Soman:** Secondly, in terms of depreciation this quarter we saw significant increase. Is this just a function of the commissioning of the Mysuru plant and should we expect that to be even higher in 4Q given that Vizag will also come on board?
- Management:** Absolutely right.
- Aditya Soman:** So, a number little bit higher than what we saw this quarter would be fair to assume for Q1 and thereafter?
- Management:** Yes.
- Aditya Soman:** And for next year, we are done with the Capex right now largely in terms of the big hump of CAPEX, so ₹ 800 crores on this plant and ₹ 1,000 crores overall. So, should we expect a lower level for next year or...?
- Management:** Much lower number.
- Moderator:** Thank you. The next question is from the line of Arnab Mitra from Credit Suisse. Please go ahead.
- Arnab Mitra:** I just had one question that despite very high revenue growth, there does not seem to be any major operating leverage that has played out on staff and other expenses. So, what is the reason

for that sharp step up and would you expect leverage to play out if growth rates remain reasonably high?

Management: No, staff cost in this quarter you see a slight increase because of our new plant which has come up, that cost of employees included in this quarter. As far as the retiral benefits are concerned, you see the increase because of the falling yield on the gratuity and leave liability. As far as operating leverage is concerned in this quarter, you cannot compare this quarter with the previous quarter because this quarter definitely growth in top line has contributed for some increase in variable cost. The percentage to sales if you look at it, it is still lower than the previous quarter.

Arnab Mitra: So, partially to do with the new factory cost basically?

Management: Yes.

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

Richard: Hi, this is Richard here. I have got two questions: One is has this price cut due to the GST rate cut, anyway helped in lifting your demand condition and your volume growth. In a sort of higher price activity like painting know did something like 10% price cut actually helped lift demand significantly considering the labor cost would not have fallen?

Management: Let us put it this way; definitively helped to the extent that when we increase prices, the burden on people did not increase, and may be it helped to some extent with the unorganized sector in balancing out the price differences.

Richard: Would you attribute that to be a key reason for this high double-digit volume growth because I do not remember seeing such a positive description of volume growth from you in recent times?

Management: Give me another year like I said, I would not like to jump the gun based on one quarter.

Richard: My second question is on margin. If I ex out this the beating impact that you had in Q2 because you wanted to avoid stickering new prices, etc., the gross margin compression in Q2 was probably 80 bps or so as per my workings even though the reported number showed 140 bps compression. Now versus that 80 - 90 bps whatever that may be, the gross margin compression that we saw this quarter is about 120 bps and you took two rounds of price increases in Q3. I am just wondering why you did not take the two opportunities of the two price increase to fully correct the gross margin pressure that you faced and Q3 margin compression actually turned out to be sharper than Q2?

Management: So, you have to understand there is always a little bit of lag when we purchase raw materials since the fair quantity is also imported and dependent on crude and crude derivative, so there is always a lag between international prices and actual consumption average as we call it, that is

one aspect. Two, we were reasonably clear given the slowdown that everybody talked of in China, etc., that the raw material prices are going to be volatile for some time to be, and we would be in a very vulnerable position if we took the entire price rise that we required. We have always tended to pump for growth over absolute profitability quarter-to-quarter.

Richard: Are you as optimistic about growth post Q3 or you think that was just a period of very good activity that happened?

Management: So, if there were no elections due around in the first quarter of next financial year, I would say YES; but elections are always a factor of uncertainty, let us see what happens.

Moderator: Thank you. The next question is from the line of Manoj Menon from ICICI Securities. Please go ahead.

Manoj Menon: Sir just a couple of questions actually: The first actually on the Sleek business. If you can give just some comments about Sleek it would be very helpful. Is it for about a per cent of revenue, 2% of revenue, how it is growing, what is the business plan there?

Management: It is about 1.5% of revenue.

Manoj Menon: What stage of evolution it is in that you have completely understood the business, one-offs are over, it is ready for an expansion, some color on what is the thoughts on that market per se?

Management: This year we have been growing consistently well. So, I would say we understood the business better than we did in the previous year, but it has also been offset by relatively slowdown in a construction boom and lot of the kitchen business also goes to fresh construction. So, it is a combination of things. I think we should be able to grow in both the Home Improvement business consistently for the next few years.

Manoj Menon: Then the second question is the overall Decorative business or may be very specifically on the Paints business. Would it be fair to say that the top players outperforming materially in the bottom end of the market versus the unorganized peers?

Management: Let us see how all the top players do. There is a little bit of that, but it is very difficult to judge because the unorganized sector is not very easily measurable.

Manoj Menon: On the third one, if I look at the capacity expansion plan that you have which is quite steep actually. So, would it be fair to say that the next three-year outlook that the management has is materially different than let us say what it was for the last three years of actual performance?

Management: The whole process of setting up a plant, getting approval and constructing it is; if you start from acquisition of land is actually a three to five year process. So, when we plan for expansion, we look at a little longer-term; yes, to safeguard our bets, we generally do not construct the entire plant at one shot, but we still like to try it and make it an economic size so that we will get the full benefits of efficiency and automation from the factory. As a result, we set these factories for

I would say five to seven year time frame on how we are going to expand and this was done almost four or five years back so to speak. So, I do not think we will take year-to-year phenomena in terms of determining our capacity expansion.

Manoj Menon: No, the only reason I ask this because it is almost like half a million KL capacity coming up which is quite. I understood the timing factor, but just the question actually came how the genesis was more to do with the absolute numbers being very high in terms of the percentage increase on your current capacity?

Management: I agree.

Moderator: Thank you. The next question is from the line of Harit Kapoor from IDFC Securities. Please go ahead.

Harit Kapoor: I have two questions: First is on the subsidiary part. So, if we look at the subsidiaries which include the international business and PPG-AP the margins in the subsidiary business over the last two to three quarters have been stable at about 7.5-8% If you could just give some outlook on how the international cost structure and margins are panning out and have they kind of bottomed out in the first nine months of the year?

Management: In most of the international markets we are not really the market leader. And in an inflationary scenario, especially where currencies are depreciating and raw material prices increasing, if you are a market laggard or of a much smaller market share, it is extremely difficult to pass on the entire raw material price increases to consumers and that has adversely affected us. Simultaneously, two markets; one, Ethiopia we have we had a severe foreign exchange crisis where frankly selling the material is not a problem, but getting the raw material is the severe problem because you do not have foreign exchange, and Egypt where the economy has stuttered a little bit and that has continued for some time. Whether it is bottomed out or not, it is not very easy to say.

Harit Kapoor: Is there any incremental pressure you have seen in any of these markets in the last one or two quarters or so that makes you believe that there is still uncertainty there?

Management: I do not think there is any incremental pressure per se or more competition or any other factors. Only the incremental pressure that came in the beginning of Q3 was the raw material inflation that spiked up.

Harit Kapoor: On the PPG-AP part which kind of reflect in your associate profit, there has been a fairly good jump up from Q2 to Q3. So, would that be a reflection of certain price pass-through that you have been able to get where the profitability has improved in that business?

Management: A little bit, but the auto OEM sector the pass-throughs are much more difficult, there is a big lag between negotiating prices with the big auto players, not all of them are doing too well and are

reluctant for price increases at this point of time. So, that takes a little bit of time. The other businesses have been able to recover some element of the raw material price increases.

Harit Kapoor: Last question is on the capacity expansion. Any tax benefits on this and in which line item are we to see this whether it is in the form of refund or it will be just in the form of lower tax rate on either Mysuru or Vizag if you could just help us with that?

Management: Mysuru, there is industry loan benefit, but we are yet to get the entire process and documentation executed with the government. So, it may not impact the financials per se, it will come as a balance sheet item. As far as the Vizag is concerned, yes, we have a tax benefit similar to what we have in Maharashtra, but that will accrue when we start hitting the market may be later part of the year or next year.

Harit Kapoor: Okay, it is a similar kind of thing; zero percent for first five years and stuff like that?

Management: No, it is a refund subsidy; whatever the tax you collect, then government pays it to you later.

Harit Kapoor: Which would be reflected in our other operating income.

Management: Yes.

Moderator: Thank you. The next question is from the line of Pulkit Singhal from Motilal Oswal Asset Management. Please go ahead.

Pulkit Singhal: My question is nothing to do with the quarter but I was just looking at your revenue growth for the last 10-12 years in the standalone business. Now we had a phase of around six to seven years of 20-25% kind of growth rates till FY'12, in the last six years till FY'18 it has been in the 10-15% kind of growth rate range. I just wanted to understand, what in your view were the reasons for the, there is a clear step down in terms of the growth rate by 10%-odd from those high levels?

Management: A) I do not think it was exactly 10%, may be 7-8% but you are not far off. There were two essential reasons: The first was in the earlier period you are in a high inflationary scenario, prices were increasing by 3-5% every year. While most of the period you are talking of the last five periods except for this year primarily, has been a deflationary period where prices have actually dropped in the middle. The second is the GDP growth was definitely seen to be higher with the much higher growing middle class in India in that decade and higher GDP growth or higher number of earning people where households and good construction business definitely has spurred growth to a greater extent.

Pulkit Singhal: Is there an element also of new real estate construction, we know that real estate scenario has not been particularly great for the last five to six years, does that sentiment impact repainting cycles as well?

Management: It does not impact repainting cycles, but it definitely impacts the quantum of repainting feasible. If we have less houses, less of them are going to be repainted, in the sense you had a

growth because the construction was heavy in the decade and you had a lot of houses that are repainted, lot of the fresh houses actually go for rentals and the great thing about rentals is houses get painted every three years.

Pulkit Singhal: Just another question is on the pricing strategy. Given that in this new phase of growth, 10-15% versus the 20-25%, I believe we were probably more of volume growth driven focus back then. Is it based now on volume, gross margin or EBITDA margin targets, how do you look at how much to take price hike because now we see more of premiumization happening in the last five, six years?

Management: I think premiumization was happening even then to a big extent. So, I do not think there is any real difference on that end. If anything in the last five years, there has been more sale of lower value products like puttys and this year distempers, which has had an impact at a lower end.

Pulkit Singhal: The question was how do you decide on how much pricing hike to take – is there a margin target on gross level, EBITDA level or how do you...?

Management: Something at EBITDA level, gross level and net profit.. distributors, shareholders, all that.

Moderator: Thank you. The next question is from the line of Rahul Maheshwari from TCG AMC. Please go ahead.

Rahul Maheshwari: Two questions: One, the new factor which would be adding the capacity, so currently before the factory even have not started, what was the outsourcing percentage which you used to give to the third-party contract in-house, what was the percentage and now once the new factory has come into play, how much the percentage of outsource contracting would be reduced and that how it will be impact on the financials that in terms of the margins, how the cost savings or the margin accretion would be taking place? Second, what is your current distribution number of dealers which is taking place and as compared to the percentage increase which you are planning out on a yearly basis, I am not talking of quarterly, would it be in line with the industry growth rate not in terms of their absolute amount but as compared to industry what the distribution dealers are growing for your company?

Management: Between 25-30% of my volume is outsourced, but these tend to be lower value products where we look for a freight advantage in terms of sourcing all over the country. Actually the products we make in our factory are a little different from the products we outsource. So, the percentage outsourcing may not change significantly if the growth rates of both the categories are similar. So, hence it will not directly affect cost. Yes, the factory in South India will increase cost because you have very additional plant operating but it will decrease cost because of the freight the South India demand will reduce. The second question was, we add roughly around 3000 dealers a year. We have about 60,000-65,000 dealers. I have no idea about the competition numbers. So, I would rather not comment on that.

- Rahul Maheshwari:** Sir, when you said the new factory which is building, purely towards the water based solvents which is the high margin product. So, what kind of differential between your base value segment is there and that definitely it will take time to increase the capacity in that new factory. Any quantum or color or idea on what the pricing differential in terms of number of x times, can you?
- Management:** We are a raw material intensive industry and actual manufacturing cost is a very small element of our selling price. Actually, the difference in freight cost, etc., will probably be more substantial than the difference in manufacturing cost.
- Rahul Maheshwari:** Any range what freight cost savings would be taking?
- Management:** Sorry, We would not like to give that at this point of time.
- Moderator:** Thank you. The next question is from the line of Abneesh Roy from Edelweiss. Please go ahead.
- Abneesh Roy:** A few follow up questions: One is Indonesia we saw in Q2 also nature cause of worry, floods, etc., Q3 also some bit. So, could you update on the demand side? And Emulsion launch what is the update and distribution expansion how much has been done in Q3?
- Management:** We are still such a small player that we are not really hit by the calamities, etc., that occur to some extent but in some of these places where the islands in this world of global warming, we can expect this to happen any time. The growth has been good and we have expanded the network. If I go roughly by the key emulsion selling edge we have, we had about 175 color infinity as we call them in Indonesia, we have added a little more than 100 this year and expanded the network across many islands. We have added three more distributors this year and increase the network they are catering to. But yet we are very small.
- Abneesh Roy:** To understand the total universe what is the rate of expansion both distributors and color thing which you said?
- Management:** It is not entirely comparable because every company is adopting a different policy. There are two large companies that operate directly through their own distribution centers and through the dealer network, that is Avia Avian and Nippon and two that operate through distributors -- Mobilac and Akzo. So, you have to remember, we are also new, we are understanding the market to a great extent and there are 1,000 islands there, it is a highly dispersed market. I do not think I am in a position to give you very accurate data on this.
- Abneesh Roy:** But it continues to meet the internal target, right?
- Management:** Yes.
- Abneesh Roy:** Tamil Nadu market share, has it come back for you, any comment on Nippon because I am seeing them again becoming very aggressive on the media spend?
- Management:** Yes, they are, but I think we have held our own this year.

- Abneesh Roy:** Sir, when I see the pricing, you have taken four rounds of price hikes in the calendar year, the last one in December, so total hike of around 7-8%. So, in the premium end and lower end, will the hike be similar – 7-8% or fair to expect that at the higher end it will be more and lower end will be subsidized?
- Management:** It will be similar, it would not be grossly different; but there could be marginal differences here and there. I do not think we take rarest policy that premium has to get more premiumized, we try and maintain a certain minimum gross margin across categories and we are trying to maintain that.
- Abneesh Roy:** We have seen discretionary slowdown definitely in a lot of the categories. So, my question is in the metro cities, has the growth tapered down now, again do not see Q3 because Q3 is abnormal quarter because of one or two reasons, but are you seeing pockets of slowdown in Mumbai, Delhi, some of the bigger markets?
- Management:** Not really.
- Moderator:** Thank you. The next question is from the line of Pratim Roy from Stewart & Mackertich. Please go ahead.
- Pratim Roy:** I have already two to three questions. First of all, how much volume is coming from the real estate segment top line? What is the view, is there any significant demand picking up because after GST and RERA there is a lot of issue in real estate segment, so if you can give me some idea, what is the contribution – has it gone up from a real estate segment demand?
- Management:** I would say our market share in the real estate segment is little lower than the normal painting segment. So, it has been consistently growing up every year and I would say it has gone up although I think the real estate segment has not done that well. I do not think GST has had that much of an impact on the real estate segment.
- Pratim Roy:** Demon effect also there, right, that impacted the real estate segment in a large way. But my question is that is the real estate demand going up, there is an opportunity, so that the paint demand is also going up, I just want to match these things?
- Management:** I think the real estate segment would be maybe about 20-25% of the paint demand and repainting could be about 75% of the real demand. The fact of real estate going up or down does not that grossly affect the overall paint demand.
- Pratim Roy:** The recent capital expansion, what is the capacity utilization that you are expecting in the next two to three years?
- Management:** Capacity utilization will be entirely on how much we can sell. So, I can come back to you once we firm up our plans.

- Pratim Roy:** The volume growth, if you can give me the exact number on year-on-year basis, sequential quarter, quarter-on-quarter last year same quarter?
- Management:** Sorry, We do not give exact numbers on volume growth. We will give you exact value growth.
- Moderator:** Thank you. The next question is from the line of Pratik Poddar from Narnolia Financial. Please go ahead.
- Pratik Poddar:** What is the current capacity utilization that you are working on?
- Management:** Around 80%.
- Pratik Poddar:** As in the last question, you said that you do not give exact volume figure, but if you could just help us with if it was in high teens or in the low 20s?
- Management:** I said high double- digit volume growth.
- Pratik Poddar:** The other way around, I just wanted to actually understand in Q2 we faced lower realization due to rebates given because of the stickering cost, just wanted to clarify is that reversed in this quarter?
- Management:** It was not just the stickering cost, it was the fact that we did not want to appear to take benefit of the GST reduction by not passing on the full benefit to the consumers. So, as a result, in spite of steep rise in raw material prices, we took a conscious decision not to increase prices by about two months. There was a very sharp increase in raw material prices and we did not increase prices for more than two months and hence we suffered.
- Pratik Poddar:** Agreed sir. Sir, what I intended to ask is actually apart from the price hike that we have taken, is there any reversal of better realization that we have found already in the products which we have lesser of distemper share and that is how the realization was much higher than the price hike we have taken?
- Management:** As a matter of fact, when we took the price hike, we were not able to recover the entire impact of the raw material cost increases. Fortunately, after that raw material prices have fallen a little bit and we are in a little more comfortable position. Otherwise, we probably would have had another price hike by now.
- Pratik Poddar:** Over the last four quarters, we are facing a lot of margin pressure in the international business. So, do you think the situation will improve going ahead in the next year not in the Q4 immediately?
- Management:** It should because we tend to face margin pressure in the international business as well as an industrial JVs because in most of these businesses, we are not the dominant market leaders and whenever there is a sharp inflationary pressure we are not immediately able to pass on the raw material price hikes to consumers, there is always a lag. And in period where inflation continues

over a period of time, you have a price increase, but there is a further inflation you are playing a catch up game for some time. Secondly, some of the markets, Egypt and Ethiopia over the last couple of years have definitely had high extent of inflation, foreign exchange crisis, currency, all, etc., which has compounded the problem.

Moderator: Thank you. The next question is from the line of Akshat Chandak from FMP Global. Please go ahead.

Akshat Chandak: Just wanted to understand your mix regarding the water-based and solvent-based products? So, are we at 50:50 or are we getting better off that mark since you had earlier highlighted that the water based is growing at much higher pace, want your comments on that?

Management: Water-based is much more than 50.

Akshat Chandak: How is the traction that you are seeing in the home improvement business, is the traction present or you are actually making losses there, right?

Management: We are making losses at the moment, but that losses are essentially because of the expansion of the distribution system and set up. We are seeing good growth. So, in a few years, we should become profitable.

Moderator: Thank you. The next question is from the line of Abhijeet Kundu from Antique Stock Broking. Please go ahead.

Abhijeet Kundu: My first question was you said that for FY'19 YTD we have seen higher sales of distemper. So, for this quarter also the same would apply that there was inferior product mix as compared to the previous year quarter?

Management: Compared to the previous year quarter, yes.

Abhijeet Kundu: So, the actual realization growth would be lower than the price hikes that you have taken?

Management: On a portfolio level, yes.

Abhijeet Kundu: Sir, you have been increasing your distribution in newer geographies. How much of your growth would be coming from this new distribution expansion? On a consistent basis even if we see 11-12% is the volume growth. So, how much of it would be driven by your new distribution initiative? I do not want to be quantified but ...

Management: It is very small. We have 60,000 outlets and we have opened 3,000 that is 5% and these tend to be smaller because they are fresher, the impact is very insignificant in the short-term; in the longer-term this multiplies and becomes fairly significant as the years go by.

Abhijeet Kundu: Sorry, I should have put it in this way that how much of this would have been contributed by the distribution that you would have done for the last three, four years because as you rightly said that contribution improves and becomes sizeable over a period of time?

Management: Frankly, I will have to calculate, I cannot give you a rough answer, but if you are increasing 5% networth over the last three, four years, probably it might have 5% impact at the overall level.

Abhijeet Kundu: Sir, we have seen close to 20% increase in staff cost and about 25% increase in other expenditure, majority of that would be primarily due to your new capacity addition during the quarter. Now, post Q4, when the other capacity also comes in, on overall basis we should see higher increase in your staff cost as well as in your other expenditure, right?

Management: You are right, it was partially due to the commissioning of the Mysuru plant but probably higher factor was the drop in interest cost of gratuity and unpaid leave. So, there are number of variables that come into employee cost. It is a combination of both the factors, but you are right, when the next plant comes, that plant employees will also come into manpower cost.

Abhijeet Kundu: So, primarily why I am asking that is your other expenditure has gone up by close to 25%?

Management: I think quarter-to-quarter is not a right way to look at other expenditure because you will always have say for example this quarter we had higher marketing spend because of the specific ad that we ran this quarter. So, maybe at YTD level is the right sense to get around the overheads.

Moderator: Thank you. The next question is from the line of Abhishek Bhandari from Macquarie. Please go ahead.

Abhishek Bhandari: I have two questions: First is I remember in one of the calls earlier you had said that you do not want to cross a certain threshold margin as it might attract too much of competition. So, do you think if I look at the trailing nine months margin at 20.7%-odd, I do not know the number, but do you think are we around that number, there is still some more scope before we can hit that threshold?

Management: I really cannot answer that question because the raw material pricing is so volatile at the moment. It changes month-to-month at the moment what is my margin and I do not like changing prices every month. So, I take a little bit of gamble and try and look at the next quarter before I decide on pricing.

Abhishek Bhandari: My second question is around your huge capacities which are coming up both in Mysuru and Vizag this quarter. You might have some internal plans to sweat out your assets with certain threshold utilization. So, beyond the usual ramp up in our steady fashion are there any incremental distribution plans or extra marketing efforts you are trying to do especially for South India where these capacities are coming up?

- Management:** I wish it was so easy to sell more just by putting up capacity. We are on a competitive scenario where all our competitors are also putting up capacity. But you got to take it while these plants look huge, the current capacity we are putting up probably will be fulfilled in the next four years or five years. Given the timeframe we have to set up plants and the difficulty we get in setting plants, we are comfortable with this.
- Abhishek Bhandari:** The reason for asking this, do you think the initial cost of employees and the other expenses will be covered by the sales plan what you have internally for those at least for next one year?
- Management:** If you include depreciation then it is little difficult, I agree.
- Moderator:** Thank you. The next question is from the line of Rahul Maheshwari from TCG AMC. Please go ahead.
- Rahul Maheshwari:** Just wanted, what is the progress on AP Homes and how well it has been trended during the quarter and what is your plan going forward for AP Homes because you had planned that once it starts progressing, you would be opening other branches too?
- Management:** The four we have are operating fairly effectively as well, selling paints and other categories quite consistently. We are planning to open up four more by the middle of say July next year.
- Rahul Maheshwari:** What percentage it would be contributing?
- Management:** Very small yet.
- Rahul Maheshwari:** Second thing, I know it would be difficult because you have current capacity at 1.1 million KL and you have added 0.6 million KL which is 58% of the current entire peers. So, just wanted, what kind of demand is on the overall outlook would be there or whether there is sufficient demand whether one would be grabbing the market share from the other peers and the next phase would be coming more 0.6 KL, and you have told just now that your entire full capacity would be taking this in four years. So, how big is the market so that the entire industry can grow because quite capacity as a percentage is almost combining all the peers, it is very high sir.
- Management:** I agree, we are reasonably optimistic about the future.
- Rahul Maheshwari:** But the same kind of trend can be maintained sir, do you think you would be gaining the market share from others by being more aggressive right now from what you were facing from last two years?
- Management:** Let me put it this way. If you do not have the capacity, you definitely cannot gain market share. If you have the capacity, you have potential to gain market share.
- Rahul Maheshwari:** But sir, just to squeeze a little bit, once you are now with the capacity ready and demand is there and if to gain the market share would you play on a volume front more little bit compromising

on margins or you would intact the margins in the place even though the capacity does not ramp up in the way what you want?

Management: Sorry, We will not be able to answer that.

Moderator: Thank you. The next question is from the line of Pulkit Singhal from Motilal Oswal Asset Management. Please go ahead.

Pulkit Singhal: The last five to six years that you mentioned was a deflationary cycle. To that extent, obviously the labour cost has gone up and that probably firms a larger chunk of the overall painting cost at this point, maybe around 60%-odd. To that extent, do you think your ability to take price hikes is lot better than it was say six years back and therefore to manage the raw material price volatility because the overall paint cost to the consumer will not change as much as it would have earlier?

Management: Yes, you are right, absolutely, but there is also a channel in between and for example Mumbai the painting contractor determines the rate that is being charged, etc., with the consumer. To them, the actual price makes a significant difference. For the small household, you are absolutely right, it is much easier to pass on but in larger projects that the painting contractors is much more difficult to pass on price hikes.

Pulkit Singhal: Sir, what would be your sense in terms of the price inflation over the last five, six years like a combination of these two, how much would a consumer be facing, overall the painting for the same like-to-like?

Management: GST reduction has definitely helped the consumer because it is reduced by about 10% but still about 10-15% increase in painting cost would be there for the household.

Pulkit Singhal: This Home Solutions business, I think you started at some point, labour cost, I mean, I do not know whether India would ever go to do-it-yourself kind of painting because you are so used to servicing. Do you think this Home Solutions business could be a big one for you even say 10-years down the line or is that an area we are getting into because you start competing with your own?

Management: We are never competing with our own shopkeepers because we were always sourcing the material through the shopkeepers, but the model is a higher cost model because when it is being done through company, you end up paying all the taxes, etc., So, we have launched a new model about two years ago which is doing exceptionally well which we call "Paint Total" which is through a dealer network. We train the painters and painting contractors and the supervisors to carry out a job very similar to the home solutions but at a much lower price. So, this model is doing very well as a matter of fact and we plan to propagate and extend this extensively all over the country. It is already operating in more than 150-cities and towns in the country.

Pulkit Singhal: That model is allowing you to keep a tab on the painting cost to the consumer in a better way?

- Management:** Yes.
- Moderator:** Thank you. Ladies and gentlemen, we will take the last question from the line of Indira Badrinarayan from Morgan Stanley. Please go ahead.
- Indira Badrinarayan:** Just one book-keeping question please. Any guidance on the overall tax rate for the next full two years?
- Management:** We are in the highest marginal rate. First, you will get some benefit but it is not very significant if you look at the overall tax what we pay to the government.
- Moderator:** Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. K.B.S. Anand -- M.D. and CEO, Asian Paints for closing comments.
- K.B.S. Anand:** Thank you, everyone for participating in our conference call. Thanks a lot and meet you next quarter.
- Moderator:** Thank you very much. Ladies and gentlemen, on behalf of Asian Paints Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.