"Asian Paints Q2 FY 2018 Earning Results Conference Call"

October 24, 2017

ASIAN PAINTS MANAGEMENT

MR. K.B.S. ANAND	: MD & CEO
MR. MANISH CHOKSI	: PRESIDENT – SUPPLY CHAIN, INTERNATIONAL & IT
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

ANALYST

MR. RANJIT CIRUMALLA – BATLIVALA & KARANI SECURITIES LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the Asian Paints 2Q FY2018 Earnings Conference Call, hosted by Batlivala & Karani Securities India Private Limited. 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. Ranjit Cirumalla from B&K Securities. Thank you and over to you Sir!

Ranjit Cirumalla: Thank you, fellows. On behalf of B&K Securities, we welcome all the participants on Q2 FY2018 results conference call. We thank the management of Asian Paints for giving us the opportunity to host this call today. We have with us Mr. K.B.S. Anand, MD & CEO of Asian Paints. May I now hand over the call to Mr. Arun Nair, Corporate Communications to take the call forward.

Arun Nair: Good evening, friends. We have Mr. K.B.S. Anand, MD & CEO; Mr. Jayesh Merchant, CFO & Company Secretary; President - Industrial JVs; Mr. Manish Choksi, President - International, Supply Chain, IT and Chemicals; Mr. R.J. Jeyamurugan, VP- Finance and Mr. Parag Rane, Chief Manager - Finance. May I now request Mr. Anand to take it forward.

K.B.S. Anand: Good evening everyone and thank you for participating in the Q2 FY2018 conference call for Asian Paints.

Starting with **Economic Environment**. It has been a challenging year for the Indian economy facing disruptions on account of demonetisation and the rollout of GST within a span of seven months. GDP growth has been on a downward trajectory with the Q1 growth rate falling to a low of 5.7%. The monsoon however has been largely good across regions.

We did see some pickup in the current quarter on the back of a challenging first quarter. The early festive season also helped in demand revival.

On the global front, there are signs of strength especially in the U.S. economy giving rise to heightened expectations of tightening by the U.S. Fed. However, the global economy, at large, continues to face challenges around subdued inflation, low potential growth and an uneven recovery.

In our international markets, key units in Egypt and Ethiopia continued to face challenges around foreign exchange and raw material availability. The overall international performance was also impacted by adverse exchange rate fluctuations.

Financials : Consequent to the introduction of Goods and Services tax (GST) with effect from July 1, 2017; Central Excise, VAT, etc., had been subsumed into GST. In accordance with the Indian Accounting Standard - 18 on Revenue and Scheduled III of the Companies Act 2013, Excise Duties, levies like GST, VAT etc. are not part of Revenue. The figures and growth percentages have been suitably adjusted to make the revenue from operations for the periods upto June 30, 2017 comparable.

Decorative Business: The Decorative paint business registered high single-digit volume growth in the current quarter. There was a recovery from Q1, which was affected by the impact of destocking due to GST. However, the impact of GST continued through July and the recovery of sorts was seen only in September.

On a sequential basis, material prices were stable, helped to an extent by the strong currency. There was no price revision in the second quarter. We had effected one price increase in the month of May of 2.68% on the back of an earlier price increase effected in March 2017 of 3%.

The company has discontinued the production of Phthalic Anhydride at its Ankleshwar plant since August 2017 and plans to augment its manufacturing capacity for paints, synthetic resins and emulsions at that location.

Industrial Business:. The Automotive coatings joint venture (PPG-AP) witnessed subdued demand in the Auto OEM and General Industrial business segments. Even the Auto Refinish segment continued to witness challenging conditions in the market. However, the performance of the Industrial coatings JV (AP-PPG) was fairly satisfactory.

International Business:. Financials of the current quarter include the financials of Causeway Paints, Sri Lanka, which was acquired on April 3, 2017. Hence, the numbers are not comparable with the financials of the previous year.

Units in Nepal, Bangladesh, Oman and Bahrain witnessed good topline growth. However, the currency devaluation in Egypt and the forex unavailability in Ethiopia affected the overall performance of international operations. The company inaugurated its first paint plant in Indonesia in the month of September 2017, with an initial capacity of 5000 MT/year on a single-shift basis. The company also completed divestment of its stake in the Caribbean region effective 24th July 2017.

Home Improvement Business. Both the segments within the Home Improvement business i.e kitchen business under Sleek and the bath business under Ess Ess performed considerably better than the first quarter.

Capex: The capex plan for the year FY2018 at the standalone company level is about Rs.1200 Crores, which includes Rs.1000 Crores on the two upcoming new paint manufacturing facilities at Mysuru and Vizag in South India. We are on track to commission the first phase of both the plants in FY2018-19.

Going Forward: There are signs of some recovery towards the latter half of Q2. Coupled with good monsoon and settling down of the trade channel from the initial hiccups of the GST rollout, we are hopeful of a better demand condition in the second half of the year. However, raw material prices continue to be higher and we will need to monitor this trend carefully and take necessary action to protect margins. In the International markets, the forex situation in the markets of Egypt and Ethiopia is a key cause of concern. Thank you everyone. We are happy to take any questions you may have.

Moderator: Sure. Thank you very much. We will now begin with the question and answer session. We have the first question from the line of Avi Mehta from India Infoline. Please go ahead.

Avi Mehta: Congratulations on the performance. Sir I just wanted to kind of understand a little bit on the gross margin front. So if we see versus first quarter of FY2018, the gross margin has moderated on a sequential basis despite what you highlighted about input cost being flattish and the price increase of May now flowing through for the entire quarter. Why has that happened? Is there a transition stock impact that is there and if it is, could you kind of quantify it?

Management: The material cost impact, what was there in the first quarter, to some extent, it also extended in the next few months, July and August. And to some extent, GST credit impact is also there, but it is not that significant. Main impact is material prices whatever that it was, the stable environment continued in last 1.5 months of the second quarter. So we had the first few months impacted to some extent by the higher material prices in the second quarter.

Avi Mehta: Of the second quarter. So you are essentially saying that this number is what we should kind of assume going forward. There is no one-off over here?.

Management: There is no one-off item in this.

Avi Mehta: This Rs.67.5 Crores that you have indicated discontinued operations. Does this include also some sale proceeds because last quarter was only Rs.2.5 Crores?

Management: It is profit on the sale proceeds… Sale proceeds minus our cost of investment. This is one off item

Avi Mehta: Lastly, I am sorry, I did not understand your comment about the demand environment. You said that there has been a pickup that is coming in or that you are witnessing the festive season or what exactly was the case, if you could just clarify that again, Sir?

Management: What we tried to say was that in Q1, the demand was definitely subdued largely on account of destocking and due to GST. The channel continued to face pressures through the month of July. We did see revival in demand conditions in the month of September. Whether it was purely due to an early festive season or due to real demand revival on an ongoing basis, we cannot comment.

Avi Mehta: I will come back in the queue for any other questions. Thank you very much Sir!

Moderator: Thank you. We have the next question from the line of Vivek Maheshwari from CLSA. Please go ahead.

Vivek Maheshwari: Good evening everyone. Few questions. First on the dealer side, are all your dealers have they migrated to GST now as we speak, as much as you know?

Management: Yes. They have given their GST numbers and we are able to bill them.

Vivek Maheshwari: Sure. But 100% of your dealers have migrated or is there a tail, which is remaining?

Management: We are not really billing to dealers who do not have GST number?

Vivek Maheshwari: No that is what I am saying for. Earlier let us say if you have 100 dealers, are all of those 100 dealers back are into GST net?

Management: I would say 99 out of 100, if you want to put it to be really on the safe side, but as far as I am aware, all significant dealers are into GST.

Vivek Maheshwari: I know these are very early days, but have you seen let us say unorganized sector coming under pressure because of GST? Anecdotally, if not I am sure you do not have the data at this point of time, but anecdotally have you seen that trend?

Management: I cannot really comment. I think it is too early days to say that because a lot of the unorganized sector is also getting organized. Some of the very small players you might say struggled through the month of July, August, but they are all coming on track gradually.

Vivek Maheshwari: Which means that they are paying taxes, etc., etc., that is what you mean?

Management: Yes.

Vivek Maheshwari: On the gross margin. So in the past you had given indication about operating margins, but how should we think about, I know this question Avi had asked, but how should we think about gross margin, so 41.5%, is it the new norm, at what level do you take product prices, what is a comfortable band for your GMs?

Management: Sorry, we donot give this detail.

Vivek Maheshwari: No, I appreciate that you cannot give forward looking, but there has to be comfort. You have answered about operating margins in the past, so I see no reason why you...

Management: What we have said earlier that we will be always take a look at our margins based on input cost and cost of goods, look at the competitive environment, look at forward looking what we expect the material scenarios and then we take appropriate pricing decisions. This margin position is something that we would not like to answer.

Vivek Maheshwari: The reason of asking you is obviously simple. You are running with let us say 44%, 44.5% last year, it is down to 41% in this quarter. You did speak about a price hike, so the point is that there must be a band in which you would want to operate.

Management: We would not say that we want to operate in a band. We would just say that depending on market conditions we would take a call.

Vivek Maheshwari: That is very helpful. Third, on other expenses despite let us say high single-digit volume that number I presume that other overheads will be a mix of variable plus fixed, why is that number flat on a y-o-y basis, anything specific one-off, which is helping it?

Management: So there is no one-off, especially in that. It is a general sort of control in terms of various overheads that we have done this year.

Vivek Maheshwari: This is what should be sustainable, right?

Management: I think we are doing some belt tightening. We looked at some uncertain and volatile situation in the past. We feel that it is better to be conservative than go overboard in that.

Vivek Maheshwari: Last bit on one-off Rs.67.5 Crores that number is pre-tax, is there a tax implication of that, if so how much will that be?

Management: This is the gain on sale of our Caribbean investment, and this is issuable by Singapore, which is the holding company for Caribbean operations. So there is no tax impact. There is no capital gain tax in Singapore.

Vivek Maheshwari: Got it. Understood. Thank you very much and all the best.

Moderator: Thank you. The next question is from the line of Amnish Aggarwal from Prabhudas Lilladher. Please go ahead.

Amnish Aggarwal: My question is regarding the numbers, for the purpose of comparison, you have given on one place that the excise duty of Rs.420 Crores needed to be adjusted for the GST purpose, whereas in the results table in your September 2016 quarter, the excise duty is actually Rs.469 Crores, not Rs.420 Crores, so where is this gap of Rs.50 Crores?

Management: That number, what you are referring to in the results, is excise duty on production. What we have given very clearly we have indicated that this is excise duty on sale, which has to be reduced from the sale amount.

Amnish Aggarwal: But in the results table...

Management: Yes, the results table will have excise duty on production, which gets adjusted in the changes in inventory, opening stock and closing stock.

Amnish Aggarwal: So the rest of the amount is adjusted?

Management: Yes.. The rest of the amount is adjusted.

Amnish Aggarwal: Sir my second question is if you look at say the previous quarters you have not taken any incremental price increase post May, but how has the sales mix been moving because your topline growth say high single-digit, so the realization seems to be now going ahead than the price increase, which has been undertaken relative to what it was last year and due to higher putty sales and all the realization growth was less in comparison to the price changes?

Management: So we have had a price increase of about 5.7%, so your realization is actually slightly lower than that.

Amnish Aggarwal: So there is no mix improvement, which is happening as of now?

Management: In the two quarters, no.

Amnish Aggarwal: Sir my final question is that there was an increase in GST by say a couple of percentage points on paints means overall rate of taxation, so given that the raw material scenario is not very favourable as yet gross margins stayed under pressure, so do you feel the need to take any price increase in the medium term, particularly...

Management: Sorry, we will not be able to comment on that as we do not discuss future pricing decisions.

Amnish Aggarwal: But Sir is there some increase in the taxes overall on you?

Management: They are about the same.

Amnish Aggarwal: There is no increase in overall taxation?

Management: No.

Amnish Aggarwal: Thanks a lot.

Moderator: Thank you. We have the next question from the line of Anshuman Atri from Haitong Securities. Please go ahead.

Anshuman Atri: Thank you for the opportunity and congratulation on performance. My question is regarding Smartcare solutions, so what kind of performance has it done in the first half and how do you see in the next one to two year as to what kind of overall revenue shares you kind of get and has it been extended to Pan India dealership?

Management: It is more or less Pan India today for most of the products we have already launched. It is doing extremely well, but we are a very small player at this point of time. Frankly we require a little more time to be on par with the other leaders in the marketplace.

Anshuman Atri: Is it safer to assume that this segment would be easier to scale than the other home improvement solutions?

Management: Yes.

Anshuman Atri: And in the home improvement, this is the last question, how do we see it going forward, and whether it will be restricted to the current set of products and how do you want to build a physical presence in terms of the concept stores, which we have launched and the revenue share, which this particular segment can have in next two, three years?

Management: So Q1 was disappointing for both these home improvement segments of Ess Ess and Sleek. The impact of GST was felt much more by them than the paint segment. We have seen a strong recovery or a significant recovery in both these segments in Q2. There might be some change in pattern; different pattern of GST on their various products on readymade kitchen, etc. We will have to relook at it probably a quarter down the line on how well they are faring. We are fairly optimistic on their growth, but we would want to stabilize in businesses before really branching off into other businesses.

Anshuman Atri: Thank you for answering.

Moderator: Thank you. The next question is from the line of Abneesh Roy from Edelweiss. Please go ahead.

Abneesh Roy: Sir my question is on Indonesia. The new plant is, so in terms of distribution and initial response could you update how are things?

Management: I think it is early days. We launched our products somewhere in the beginning of this fiscal, and have been marketing and distributing the products there with the help of a manufacturer who made the products for us. Since starting the plant, we have now started manufacturing a range of products in our own facilities and distributing the products. We have been able to appoint distributors in key markets, who are able to sort of reach out to the smaller dealers in that market, that is the model we are pursuing, at this point of time. I think we have done groundwork in the market to look at where we can position our products and what are our lead products into the market. I think at least the first response I would not say is pretty ok. I think they are sort of being able to gain access to the dealer channel. Anything to say more than at this point of time will be too early in the game. So I think with the organized product mix we have got, we have been able to establish the distribution mechanism. Now we have to see what happens in terms of the sale mechanism ticking in. So maybe I would wait till the end of this fiscal before we can actually give you a full colour on what really is happening with our products.

Abneesh Roy: As a followup to this, in India, for example, any new paint company finds it very difficult to access the dealer and in India total around 50000 dealers are there. In Indonesia, how does it work, is it easier for a new player to access the dealer or is it similarly difficult just like India? Your brand is slightly known in those markets anywhere right? Before the launch itself Berger was known because of the adjacent markets Berger was present. So is that helping in some way to get access?

Management: Let me answer it in the reverse order. In Indonesia, we have launched the Asian Paint brand of products, the name of the company there is Asian Paints. We are not using the Berger brand in Indonesia. We do not have the rights for the Berger brands in Indonesia either, so the brands are part of Asian Paints. That is first point. Second point it is not easy to get access to the network. In fact, it is even more difficult to distribute products in Indonesia because it is not a single landmark country. It is made up of two very large islands, very populated and very large islands, Java and Sumatra and then there are some 1000 other islands in aggregate. So the supply chain is far more complex than that of India, so it is definitely not easy, but we are encouraged by the fact that we have been able to enlist distributors who are interested in our products, so it is early days. That is why I mentioned that we will wait till the end of the fiscal before I can give you something.

Abneesh Roy: Sir my second question is on the other new business or additions how is the response there? There the GST rate also fell from 26% to 18%, so how has that changed the dynamics, is the shift from unorganized to organized happening faster?

Management: We have just entered adhesives. We are too small really, so the response has been good, we are growing, but it is very, very early days.

Abneesh Roy: My final question on the decor volume growth in India. First quarter was low single digit. This time it is high single, so the average for the first half has been around 5% on a quarterly run rate. So in terms of market share, do you think Asian Paint is slipping? Why I am asking this is one, 5% volume growth seems low from a correlation to GDP perspective. 1.5x to 1.7x GDP. If I take 5% as a lower number, I understand GST-related impact. If I see Kansai Nerolac's commentary they have said 18% volume growth in Q2, how do you see that volume growth versus your own volume growth, any comment on why they should be growing much faster than the industry?

Management: I am sorry, as a policy we do not talk about competition. We do not think we have lost market share in the markets in which we are present, but let us see at the end of the year how things are. Things have evened out. As you see the topline is not drastically different between the two companies, but let us see at the end of the year how it goes.

Abneesh Roy: That is all from my side. Thank you.

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

Richard Liu: This is Richard here. Thanks for taking my question. Sir on home improvement, these two numbers that we are seeing, which is about I think 6% growth in the standalone home improvement business and 7.5% growth in I think that would be basically the Sleek. Are these numbers like-to-like or is there some sort of an excise adjustment we require for these also?

Management: For Sleek, it is a very marginal adjustment, but in Ess Ess, it is already done in these standalone operations.

Richard Liu: So what would be the like-to-like growth for Ess Ess?

Management: For Q2, it is a significant double-digit kind of a number in terms of revenues

Richard Liu: And Sleek, you are saying, it is more or less representative.

Management: Yes, representative.

Richard Liu: Is there any sort of beneficial impact on either the COGs line or the other expenditure line because of input tax credit on GST versus how it was represented in the other scenario?

Management: It is hardly two months, If you really talk about GST completely all the expenses and all. There is no main impact. Maybe some credits and all, which was available, but overall scenario it is not impactful.

Richard Liu: If I may just extend this into, let us say, something more general. So we have heard a lot of businesses say that you will now start getting input tax credit on many of the expenses. If I would analyze your own expenditure line, you know, be it COGs or be it any of the items, which falls into what you call other expenditure. Are there any items of significance where you will probably get input tax credit now and which where you were not getting input tax credit earlier?

Management: Nothing major.

Richard Liu: There is not much change in that regard. That is very helpful. Thank you, wish you all the best.

Moderator: Thank you. The next question is from the line of Ashutosh Joytiraditya from Crisil. Please go ahead.

Manoj Menon: This is Manoj Menon from Deutsche Bank here. Ashutosh is my colleague. So a couple of questions actually. One on the price increases. The question is actually regarding the past. I heard you were reiterating that you will not comment about the future. What I am trying to understand is the reason for not taking a price increase in the last let us say three months to mitigate the gross margin impact?

Management: So we think we have a reasonably healthy gross margin as we stand.

Manoj Menon: No, the reason is that you are recently saying that a 300 bps decline in gross margins is what has been as per the plan?

Management: Yes.

Manoj Menon: If I heard Mr. Choksi correctly a little earlier, there is also a comment about a belt tightening, etc., on the cost side. Now contextually, when I think about it, if there is expectation of a demand recovery, of course, belt tightening is something to be done at every point in time, but it did appear to me, my interpretation of what if I heard you guys correctly it is actually saying that there has been a further focus on cost, etc. Would it be correct to say that the outlook on demand is probably a little muted because if I heard Mr. Anand also earlier about that the demand outlook was not necessarily great compared to at least what you used to talk about 3 or 6 months back?

Management: So it is like this, we are very clear the demand in Q1 was not great and has started to recover now. We are reasonably cautiously optimistic, as I put it in the past, about the future, but we really cannot say 100% how demand will go, so because of a bad Q1 we tightened a little bit and if things recover I presume we will change a little bit.

Manoj Menon: Understood and sir just a followup on this. If I just simply add up the 1Q volumes and the 2Q volumes, it does appear that the 1H, which is April to September volume growth, is around 5%, which is definitely significantly lower in terms of trajectory compared to what at least some of the competition has reported and if I heard you a little earlier talking about wait for the full year, but does that six months make such a big difference that is one question and second one is are there any significant differences in the industry growth rates region wise because that is the only thing probably that will explain such a wide divergence between player X and player Y.

Management: There is a whole difference. There are some differences in regional growth rates. I have to submit all the regions are not growing identically. There are also differences in product growth rates across categories. This also plays a role, so it is probably a combination of various things. So we do not think the value growth rate or topline growth rate of the two companies are drastically different while there is a great difference in the volume growth rates.

Manoj Menon: Understood. Thank you guys. All the best.

Moderator: Thank you. The next question is from the line of Tejash Shah of Spark Capital. Please go ahead.

Tejash Shah: Thanks for the opportunity. Sir I just wanted to know has the dealer level inventory restored to pre-GST level?

Management: It is very tough to say exactly. I will say, in some dealers, yes, in some dealers, no. So it is a mixture. We probably have not got fully there, but partially there, yes.

Tejash Shah: So on an average, we are below the level which we were there earlier?

Management: Possibly, yes. It is very tough to exactly say that, but, yes.

Tejas Shah: Second, this being GST quarter and the consequent disruption, was there any dealer addition at industry level or at company level this quarter?

Management: There was, but may not be that significant as earlier, but there was.

Tejash Shah: Since in FMCG we are seeing some early signs of wholesaler consolidation, is there any such reading you are picking up in paints distribution network happening?

Management: In India, we operate essentially through retailers and do not operate too much through wholesalers, so our focus is on the retail network rather than the wholesale network.

Tejash Shah: The question was whether small retailers are still finding GST compliance cost high, are you seeing that they are complaining or actually there are signs of somebody surrendering and that market being picked up by larger dealers in the same area?

Management: Not really.

Tejash Shah: Lastly, some of the commentary, which we are picking up from competitors, is that though price hikes were taken in the first quarter, but the actual price realizations were not that aggressive or that those are not reflected in the numbers and in fact some competitors are also indicating that there were some price cuts also taken in some of their products, so was there any price benefit or price cuts passed on in some of our products to consumers or that was not the case in our numbers?

Management: There was very marginal. GST rationalization led to some changes in a few products, but at the overall level if I say percentage impact that will not be more than 0.1%.

Tejas Shah: Lastly on bookkeeping, was there any one-off in other income this quarter or in the base quarter?

Management: There is no one off. In Q2FY17, Akzo dividend was higher as compared to the amount received this year.

Tejas Shah: That is it from my side and all the best Sir!

Moderator: Thank you. We have the next question from the line of Chinmay Gandre of Future Generali. Please go ahead.

Chinmay Gandre: Thank you for taking my question Sir! Sir with respect to the raw material cost, you mentioned that starting of the quarter, the raw material cost was on the higher side and essentially we see the average for the quarter, which is around 58% odd, but you also mentioned that towards the second half of the current quarter basically the raw material prices for you were on the lower side, is that the right understanding? My question for you is basically for the current quarter you mentioned that initial sale in July, your raw material was on higher side and basically whatever you produced in say August and or maybe September throughout the month your raw material that went in were on the lower side, right? That understanding is right.

Management: So when we ended the quarter, definitely, those prices were lower than that at the beginning of the quarter.

Chinmay Gandre: Yes, and that would be primarily because of, say, TiO2 prices coming down?

Management: Not really, TiO2 prices actually have gone up.

Chinmay Gandre: On a sequential basis, they have come off, right?

Management: No, they are going up.

Chinmay Gandre: I also wanted to get understanding with respect to basically we normally have around 3 months inventory, which is there, which is like reflected in your balance sheet number also. So my question is basically maybe in the Q3 that benefit we would get because of....

Management: I do not know where you got these numbers from. We certainly do not have 3 months inventory.

Chinmay Gandre: How many months of inventory all, normally?

Management: About 2 months; RM + FG put together.

Chinmay Gandre: Basically raw material prices for you moved correspondingly to crude prices going up from $50 average to say now $55 plus?

Management: Sorry, We cannot comment on that.

Chinmay Gandre: But essentially, you would carry some benefit of, say, 2 months odd because crude say went up from September starting right?

Management: See, crude only goes into solvent-based products, which are 15% of our production. All the others are indirect petroleum products, which are governed more by supply-demand situation across the world and any supply constraints. It did cause a problem for certain products and you will have various things happening all across the world, which will affect.

The demand-supply position across the world for these raw materials affects the price of these raw materials rather than just the price of crude.

Chinmay Gandre: Coming back to TiO2, now it is around say $240, $230 per tonne, around that level versus it had reached to around $280.

Management: Different grades have different prices from different regions. So it is impossible to give you a basket. It depends on the mix that we have got and we would not be able to disclose that procurement mix.

Chinmay Gandre: Thank you for taking my questions Sir!

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

Avi Mehta: Essentially, I wanted to understand the one simple point competitive intensity. Has there been moderation in that, which is possibly resulting in the moderation of marketing spends?

Management: Yes, at times of low demand generally competitive intensity increases.

Avi Mehta: Because I was just trying to correlate. So the other expense decline, I did not get that, was it across the board is what you said or was it largely a fixed cost, was there any kind of qualitative breakup that you could share with us?

Management: There are various heads..For example, to name a few, renewables which gives you savings on power, fuel processing cost, all those are there. We have not really sort of watered down in terms of our marketing expense. Those continue to grow.

Avi Mehta: So that has not been there and secondly on the working capital the increase in debtors', is it more a one-off or is there anything that has changed in terms of because of GST that is kind of coming through?

Management: The numbers are not really comparable. Because last year the debtors were with excise,, this year we are showing it with the full GST plus the sales number that you can use without tax this year, but last year it will be with tax.

Avi Mehta: I understood that in the sales number. You are saying that GST is kind of impact and this is why there will be a difference also that you have undertaken. That is all from my side. Thank you very much Sir!

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

Amit Sachdeva: Good evening and thank you for taking my questions although many of them have been answered. Just a stretch on the festive season demand, which K.B.S. was mentioning that, obviously September picked up, but just in order to understand when you look at a festive sort of season from your point of view when does it really start and when does it really end? Basically pre Dussehra or post Diwali how the revenue or at least the revenue split between these two periods for you?

Management: We operate through a large retail channel and since we have plants that are manned at a fixed level we are trying to produce constantly, so we try and fill the channel earlier. So our festive demand starts in July.

Amit Sachdeva: Basically, you would perhaps would have, if not July, which was still impacted by GST, you start start in August and maybe it sort of there was a throughput and hence it picked up, so has that sort of momentum continued in October as well that the kind of channel...

Management: Issue has been that a part of the demand has got dampened by the extended monsoon into the middle of October. Normally the monsoon sort of collapses by middle of September. So exterior painting you can understand, if it is raining people are not going to paint outside the building. It has been affected across many parts of the country.

Amit Sachdeva: So am I hearing correctly that because of the delayed kind of monsoon, October has sort of seen good pickup as well?

Management: There has been festive demand in October, but we are not really totally happy with the performance because we expected it to be significantly better.

Amit Sachdeva: Sure. Understood Sir! Second one if I may stretch a little bit on margins because I hear KBS making comment that we will monitor the situation and we will look to protect margins when we see input prices summing up. I am using a very loose statement, but given the construct of your gross margins slipping and other expenses being clinically flat y-o-y, which led to obviously EBITDA growth pretty decent, even though the gross margin was obviously falling. So is this like a template that you would like to follow? Let us try and keep margins broadly stable with whatever price increases or not increases have to be taken, but broadly the operating construct is like that or is it something we are reading correctly or it is too much?

Management: We calculate gross margin on the basis of our annual sales; In terms of what we expect to sell and what gross margin we would like to maintain annually to deliver the topline and bottomline the board ask us to. The monthly fluctuations or quarterly fluctuations vary due to a wide variety of factors including the product mix, including the demand scenario, including the raw material fluctuations that we anticipate and occur or do not occur. So we try and balance this over a period. So if you find a quarter-to-quarter variation I frankly would not like to comment on that.

Amit Sachdeva: No fair enough. Understood Sir! Thank you so much and have a great evening.

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

Harit Kapoor: Just two questions. Firstly, on the dealer addition part so you said that first half was relatively weaker because of the GST transition. So just wanted to know whether you will still be on track to do that 4000 to 5000 number for the full year and will that be more back-ended now because first half has been a bit weaker?

Management: See the first quarter was fairly decent. I will not say the first quarter was bad. The first quarter was fairly good. The second quarter has been uncertain. While we do target increase in dealer network I am not sure how this year will go because of the GST implications for the dealers all across the country. Because you have to understand that dealers where we are opening are generally the smaller dealers in smaller locations. We look at Sales and profitability not necessarily only dealers.

Harit Kapoor: The reason I asked was probably one of the reasons that the volume growth vis-à-vis the competition would have been a little different could also be in terms of network expansion for the first half vis-à-vis competition, so just my question was related to that would you see a slightly more back-ended growth for this year on dealer expansion per se?

Management: I do not think the factor would be dealer expansion.

Harit Kapoor: The second thing was on the tax rates. So with the new plants in South India that you are investing, are there any tax breaks there? Any benefits on taxation?

Management: No, we will come back later because we are yet to sign the agreement with the government. Once we formulate, then we will announce that.

Harit Kapoor: That is it from me. Thanks.

Moderator: Thank you. We have the next question from the line of Sabyasachi Mukherjee from India Nivesh Securities. Please go ahead.

S Mukherjee: Sir with the appreciation in rupee has the company face the trading cost a bit initially this year. So how do you look at input cost going forward?

Management: We donot know as to how the rupee will behave in the second half plus there is a bigger factor of how the raw material prices themselves will be, so we will have to see that.

S Mukherjee: The second question is, can we expect the capacity extension of.3 lakhs as was proposed in phase one to be operational by FY2019 and is it going as per plan?

Management: Yes. Mysuru and Vizag expansion is as per plan.

S Mukherjee: If you could give some more guidance from the sale of Caribbean operations?

Management: We already completed the sale in July third week, We have divested the entire Caribbean operation on July 24, 2017.

S Mukherjee: Like how does the company strategically looks in that because for the company acquiring Causeway Paints in Sri Lanka and there has been a shuffle.

Management: Essentially, that the Caribbean operation was acquired as a part of a larger acquisition of Berger Paints, Singapore, which has a whole series of subsidiaries spread across many countries. The Caribbean although highly profitable did not really fit into our long-term strategy and we decided to divest it. Operations in Africa and Asia are our focus of attention and we will be continually looking at acquisitions in these markets.

S Mukherjee: Thank you Sir! That is all from my side.

Moderator: Thank you. The next question is from the line of Manish Poddar from Renaissance Investments. Please go ahead.

Manish Poddar: I just wanted to get your thoughts on, can we explore our FMCG like distribution structure when you go down to let us say Tier 3 and 4 markets?

Management: We do not plan to do so. We have a significant penetration in smaller Tier 2, Tier 3, even Tier 4 towns; we do not think we are going to change strategy on that.

Manish Poddar: So incrementally, would the freight cost let us say on an annual basis would it keep growing at the rate, which has been growing in the past?

Management: Freight cost would have grown not only on account of network expansion, but it would have gone on account of the changes that we have been seeing in the freight cost itself, so there are rates and taxes and inflation and obviously, the diesel prices that have impacted freight. I do not think the impact of expansion of network is significant enough at this point in time.

Manish Poddar: Got it. Thanks.

Moderator: Thank you. The next question is from the line of Bobby Jayram from Falcon Investments. Please go ahead.

Bobby Jayram: Regarding the lower income affordable housing. How do you see them purchasing paint? Would they be using paints like Asian Paints, Berger or would they be going for the lower-cost ones? What is your view? I am talking about the less than Rs.25 lakhs in Tier 2 and 3?

Management: See, there are two parts to paint consumption in housing. One is what is provided by the builder. We are not very sure what quality of paint, for example if it is whitewash and cement paint we would not be supplying it. These are the cheapest products possible in new construction in India. So we are not very sure what is going to be specified in affordable housing. If it improves to distemper and emulsion, there is a possibility we may be a provider, but there is a large segment of this affordable housing and all happening in India, it goes for repainting almost immediately upon purchase where we would target consumers through the dealer network that we have.

Bobby Jayram: What is the split between the labour cost and the cost of paint in Tier 2 and 3?

Management: Labour cost would be about 60% to 70% of the cost of painting.

Bobby Jayram: So would that mean that the actual decision to buy a higher quality paint would matter much, it makes sense to buy higher quality paints, right, since labour cost is so much?

Management: Yes.

Bobby Jayram: Thanks.

Moderator: Thank you. The next question is from the line of Prasad Deshmukh from Bank of America. Please go ahead.

Prasad Deshmukh: Good evening to all of you. Two questions… firstly, as part of your advertising, are you increasingly using digital advertising, per se and how is the trend in terms of spend for digital?

Management: So definitely, we have increased the spend on digital, but it is yet a small portion of our total media cost, but we have been increasing it substantially every year.

Prasad Deshmukh: Any pointer towards how much of your total advertising budget goes towards digital?

Management: No. We cannot share that.

Prasad Deshmukh: Second question is, there have been a lot of media articles, and in fact some statements that government authority also, there is a discussion going on about moving products in the 28% bracket in GST to 18%, so is there any lobbying effort going on from paint industry as well to get this done?

Management: I think the Indian Paint Association is trying to do something, We have left it to the Association to fight out the matter.

Prasad Deshmukh: Thanks a lot Sir!

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

Vivek Maheshwari: Sir, two things. First, other income in this quarter is down quite a bit Y-o-Y, anything specific over there?

Management: We are spending heavily on the large new plants, which is recommended to the cash flow generation, which is resulting in lower sort of investment income. That is one of the key.

Vivek Maheshwari: Second thing, you mentioned to an earlier question by Manoj, I think you mentioned about growth rate between you and Kansai. I just want to know how much is volume market share important to you or is it that you focus more on the value market share because the comment that you have about value growth being similar for both the companies whereas Kansai growing more in volume. Does that mean volume is less relevant?

Management: No, both are relevant.

Vivek Maheshwari: So if there is I mean, volume-wise, there is a market share loss, is that then correct? At the value level, it does not look like, but in terms of volume there is a share loss, you would admit?

Management: In this quarter, I have to admit, if they have grown at 20% and I have grown in high single-digit, I have to say, there is a loss. I cannot deny it.

Vivek Maheshwari: But both are equally important to you in that context.

Management: Yes.

Vivek Maheshwari: Got it thanks. All the best.

Moderator: Thank you. The next question is from Sayali Gandhi from Torero Capital. Please go ahead.

Sayali Gandhi: I just have one question unanswered. Can you just repeat what you said about capex in the beginning of the call?

Management: So we have a capex of about Rs.1200 Crores for the year of which Rs.1000 Crores is towards the two new plants we are setting up in Mysuru and Vizag.

Sayali Gandhi: That is it. Thank you.

Moderator: Thank you. The next question is from the line of Krishnan Sambamoorthy from Motilal Oswal Securities. Please go ahead.

K Sambamoorthy: Just looking at the balance sheet, apart from the fact that there has been an increase in capex, there is an increase in the noncurrent asset as well or even over March, which is about Rs.200 Crores, and another Rs.110 Crores increase in other current assets. A, what is driving this and will this increase going forward as well?

Management: So part of this increase is because of the advances on our capital procurements for these projects.

K Sambamoorthy: That will be on the other noncurrent assets part, but there is also Rs.110 Crores increase in the other current assets, which is government tax receivables?

Management: Yes. These are the receivables from the government for taxes on GST and other things. At the month end it is receivable, then it gets adjusted when the payment is made.

K Sambamoorthy: The high impact towards the end of the year as well because I am just looking at September, March, and again, September there has been a very sharp increase in both of these both other noncurrent assets as well as other current assets.

Management: The noncurrent assets would typically continue till we commission the plant. On the government tax credit assets, those would also be because of the GST changes, those would be sort of permanent in that balance sheet.

K Sambamoorthy: Got it. Thanks a lot.

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

Abhijeet Kundu: I just had one question on the raw material cost. You said that the raw material cost had stabilized in September after the increase in July, August. So ideally, going ahead, the impact of raw material cost on your financials should be lower as compared to Q2 if the current scenario continues?

Management: The raw material in the past situation is a dynamic situation. We will have to wait and monitor this pricing. Ist is too early to comment anything at the moment.

Abhijeet Kundu: Thanks.

Moderator: Due to time constraints, we will take that as the last question. I would now like to hand the conference back to the management for any closing comments.

Management: Thank you very much for participating in the Asian Paints Q2fy18 conference call. Look forward to hearing from you again at the next conference call. Thank you.

Moderator: Thank you very much. On behalf of Batlivala & Karani Securities that concludes this conference. Thank you for joining us. You may now disconnect the lines.