

Term Project

On

*“Akzo Nobel India Ltd. An attractive target for
Acquisition by Asian Paints”*

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DECLARATION

I, Harish Kumar student of EMBA 2014-2016 batch of Delhi School of Management, Delhi Technological University, Bawana road, Delhi-42 declare that term project on “**Akzo Nobel India Ltd. An attractive target for acquisition by Asian paints**” submitted in partial fulfilment of Executive MBA programme is the original work conducted by me.

The information and data given in the report is authentic to the best of my knowledge.

This Report is not being submitted to any other University for award of any other Degree, Award and Fellowship.

Harish Kumar

Place: New Delhi

Date: 25 May 2016.

CERTIFICATE

This is to certify that Minor Project Report titled “**Akzo Nobel India Ltd. An attractive target for acquisition by Asian paints**” is a bonafide work carried out by Ragesh Ramachandran of our Delhi School of Management, Delhi Technological University, Delhi for fulfilment of Executive – Master of Business Administration (E–MBA) degree.

He has worked under my guidance and supervision.

Dr. Archana Singh

Assistant Professor – DTU

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Delhi School of Management

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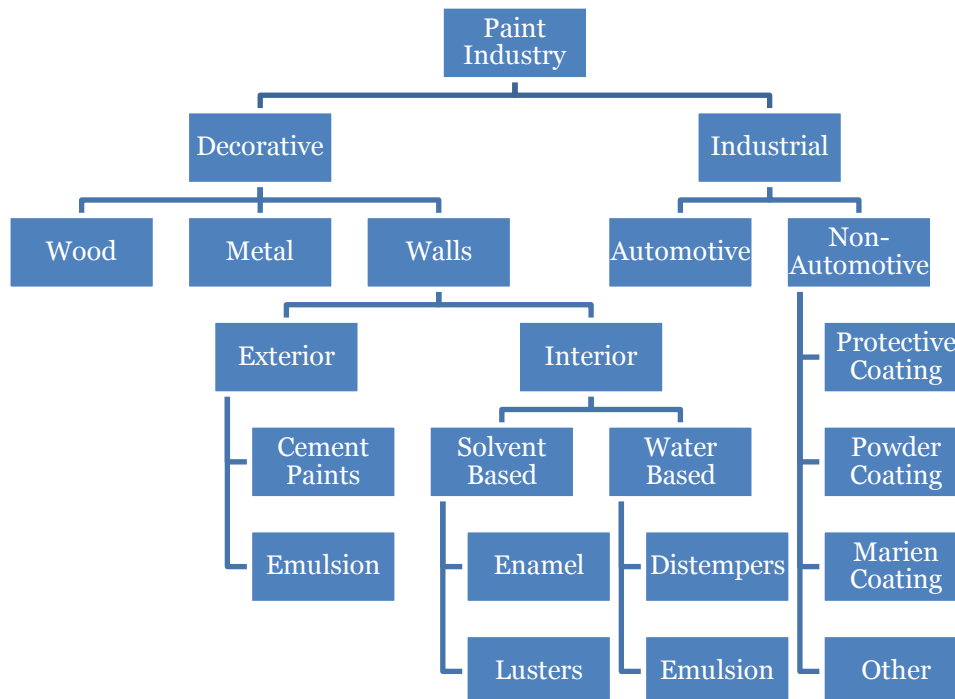
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1: A Perspective on the Indian Paints Industry

The Indian Paints and Coatings industry is valued at \$3.5 billion in terms of sales. Volume output of the industry is estimated to be 2 million metric tons. India's per capita consumption is estimated to be 1.5 Kg much lower than its global and Asian counterparts. The industry is expected to grow at 15% CAGR. Indian paint industry growth is found correlated with GDP of the country and grows on an average of 1.7-2.1X GDP.



Current state

- The Indian paint and coatings industry is riding high on the growth in the Indian automobile industry, new construction in the housing segment and improving infrastructure throughout the country. Thirty percent of the paint business is comprised of new construction projects. GDP growth projections of six to 6.5% in the current year mean a growth of nine to ten percent in Indian paint business. The growth will be 12-13% in the industrial segment and eight to nine percent for decorative paint.
- As for the future, the industry has predicted a CAGR of eight to nine percent for the next five years compared to last year's growth levels of 27.4% for cars and 8.9% for two wheelers. The Indian housing industry is likely to do well in the current year as well, recording a growth rate of 35% last year. As a result of the overall health of India's economy, it is safe to predict a nine to ten percent growth rate for the Indian paint industry in the next five years.
- The major players are Asian Paints, Goodlass Nerolac, Berger, ICI and Shalimar. Recently, world leaders like Akzo Nobel, PPG, DuPont and BASF have set up base in India with product ranges such as auto refinishes, powder coatings and industrial coatings. Kansai Paints of Japan, which entered into collaboration with Goodlass Nerolac in 1984, is now the holding company for Goodlass Nerolac with 64.52% equity holding. PPG has a joint venture with Asian

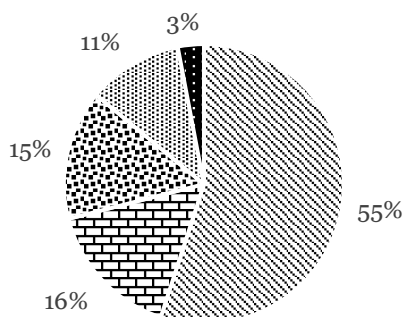
Paints to manufacture industrial coatings. Jenson & Nicholson and Snowcem India are no longer active players because of dwindling sales in recent years.

- The industry is not capital intensive and depreciation charges are not significant. Working capital requirements are moderate. However, most companies in the lower rungs are unaware about the realization of debtors. Added to this has been the problem related to collection of installments on color dispensing machines, which are mostly purchased on lease

Sector Composition – Major Players

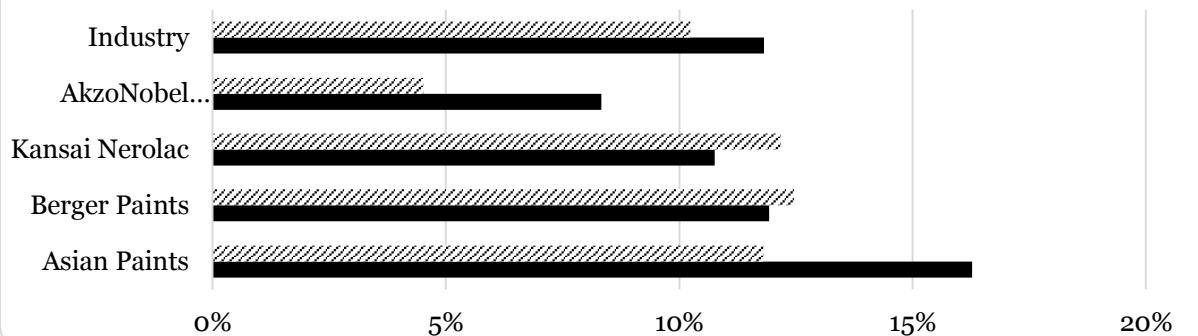
Company	Collaborations	Areas of Collaboration
Asian Paints	PPG Ind Inc Sigma Coatings Nippon Paints PPG International , USA	Electro Deposition Primers High Performance Coatings Powder Coatings Performance Coatings & Finishes
Kansai Nerolac	Kansai Paint Co. Ltd., Japan (Kansai) Oshima Kogyo Co. Ltd., Japan PPG International , USA	Process Design, Quality Improvement Manufacturing Heat Resistance Coatings Performance Coatings & Finishes
Berger Paints	Herbertsons Gmbh Valspar Corp Inc Teodur BV	Auto Coatings Heavy Duty Coatings Powder Coatings
Akzo Nobel India	Imperial Chemical Inds Plc	Powder Coatings

Market Share



\ Asian Paints - Berger Paints · Kansai Nerolac
 * Akzo Nobel ■ Shalimar Paints

Sales Growth %



Key Growth Drivers

- Growth in Real-estate Construction
- Growth in Automotive Industry
- Increase in Disposable Income
- 100% FDI in construction
- Easy financing for Home loans at affordable rates
- Increased Government Expenditure on Infrastructure
- Growth in Industrial Sector
- Decreasing raw material prices
- GDP growth

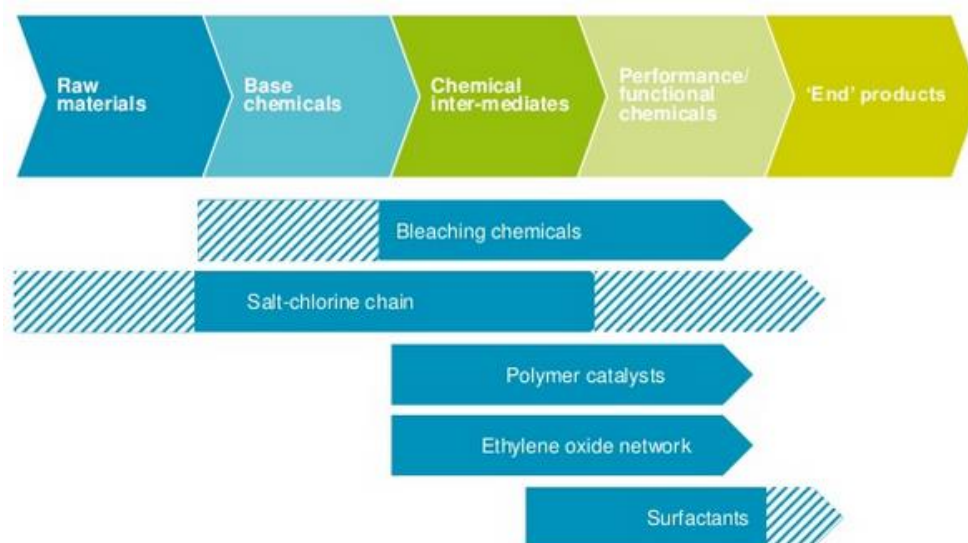
2: Overview of AkzoNobel Ltd.

2.1 Business Overview

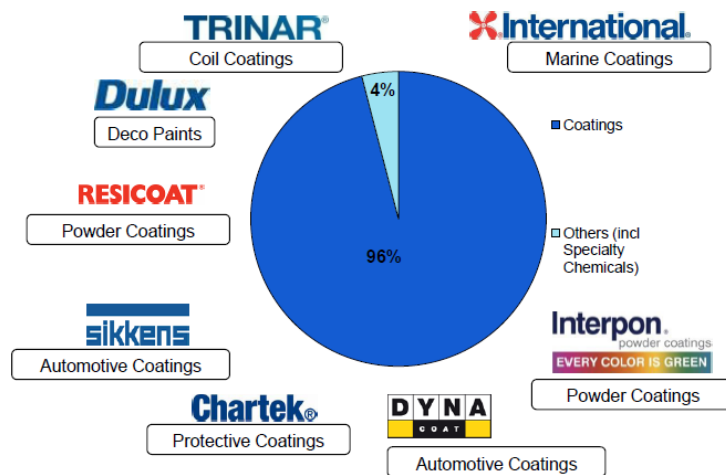
Akzo Nobel India Ltd. (ANIL) manufactures and markets a wide range of coatings covering decorative paints, performance coatings and specialty chemicals, having its registered office in Kolkata, India. The company's product portfolio includes marquee brands such as Dulux, Sikkens, International and Interpon.

On 2 January 2008, the day Akzo Nobel NV became owner of the entire equity share capital of Imperial Chemical Industries Ltd., the holding company of ICI India Limited, through a scheme of arrangement under section 425 of the UK Companies Act 1985. The name of the Company was changed to its present name, Akzo Nobel India Limited, in February 2010. The businesses currently in its portfolio are Coatings and Specialty. In 2012, under the scheme of amalgamation sanctioned by the High Courts of Karnataka, Mumbai and Kolkata, Akzo Nobel Car Refinishes India Private Limited, Akzo Nobel Coatings India Private Limited and Akzo Nobel Chemicals (India) Limited were amalgamated with the Company, with effect from 18 May.

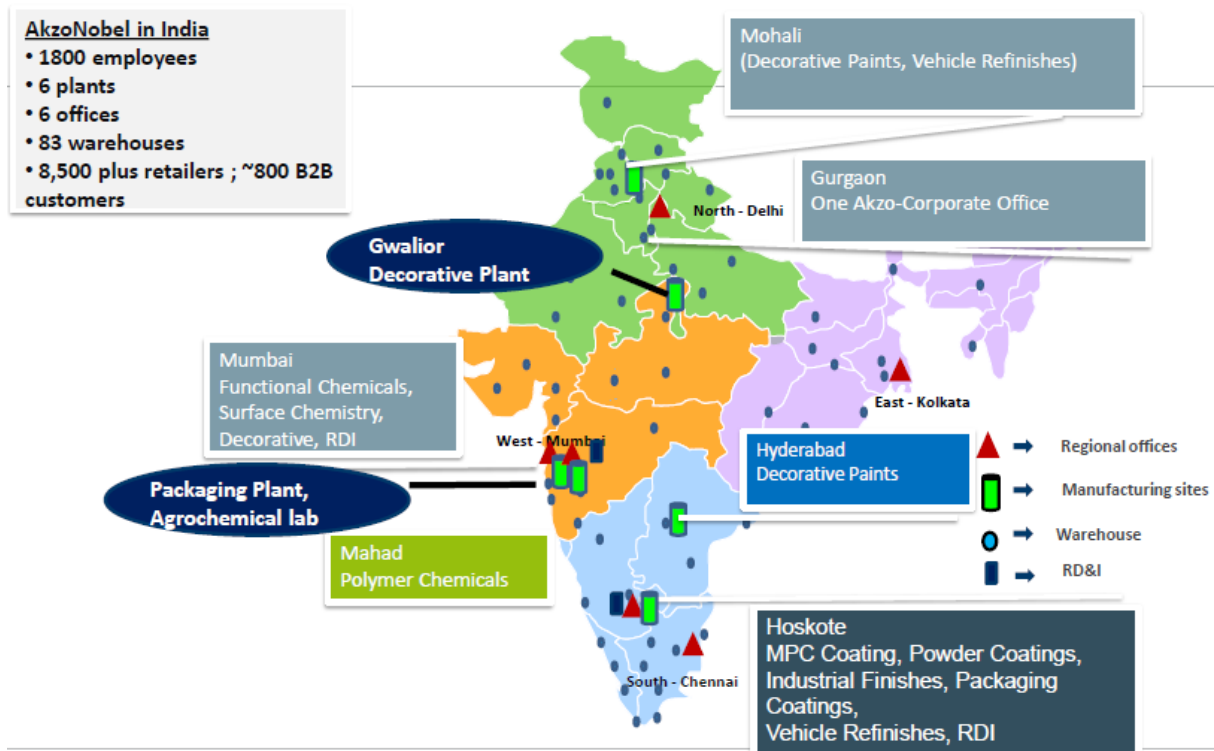
With an employee strength of more than 1700, AkzoNobel India's manufacturing sites, business & sales offices and distribution network across the country.



Segments:



AkzoNobel's Presence in India:



Raw Materials:

Raw materials are divided into three major groups, namely, pigments (titanium dioxide, zinc oxide etc.), solvents (mineral turpentine) and resins and additives. Amongst the vital pigments used in the process of paint manufacture is Titanium dioxide (TiO₂) and the industry consumes around 60% of TiO₂. India has abundant raw materials for the manufacture of TiO₂, especially ilmenite of which it has 12% of the world's deposits. It is ironical that the paint industry presently imports TiO₂ in excess of Rs.1 bn - a figure that may touch Rs 2 bn by the turn of the century. TiO₂ is responsible for the demand-supply gap. If the strong demand growth boosts domestic production of TiO₂, there will be an increased usage in various sectors.

If the raw materials are properly utilized, India has the potential to emerge as a net exporter of TiO₂ in the next five years.

The table below shows the foreign exchange exposure. The company is net long on foreign exchange and the reason for this is the high reliance on imported raw materials, but it is currently importing less raw material as compared to the industry average.

	Industry			Akzo Nobel India Ltd.		
	2013	2014	2015	2013	2014	2015
Imported RM as % of total RM	33.13%	32.58%	32.48%	27.57%	25.38%	27.47%

Marketing Channels:

Being both Business-to-business and business – to – consumer firm, AkzoNobel India Ltd. has a strong retail presence. It has a strong presence all over India with over 8500 retailers and 800 B2B customers.

2.2 Shareholding pattern/ Investor Profile

The chart below shows the shareholding pattern and the one following gives the distribution of shareholders, i.e. how many shareholders are in different segments of no. of shares held and the total value held by the group.

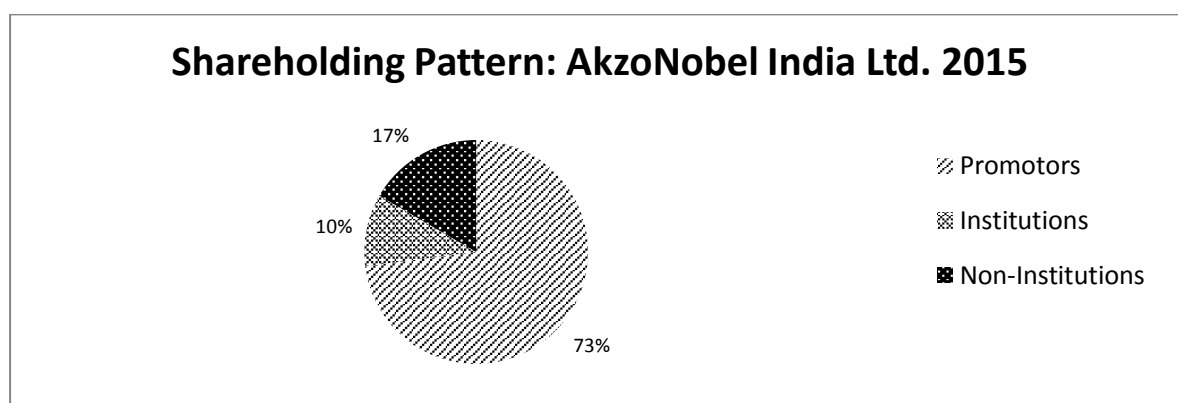
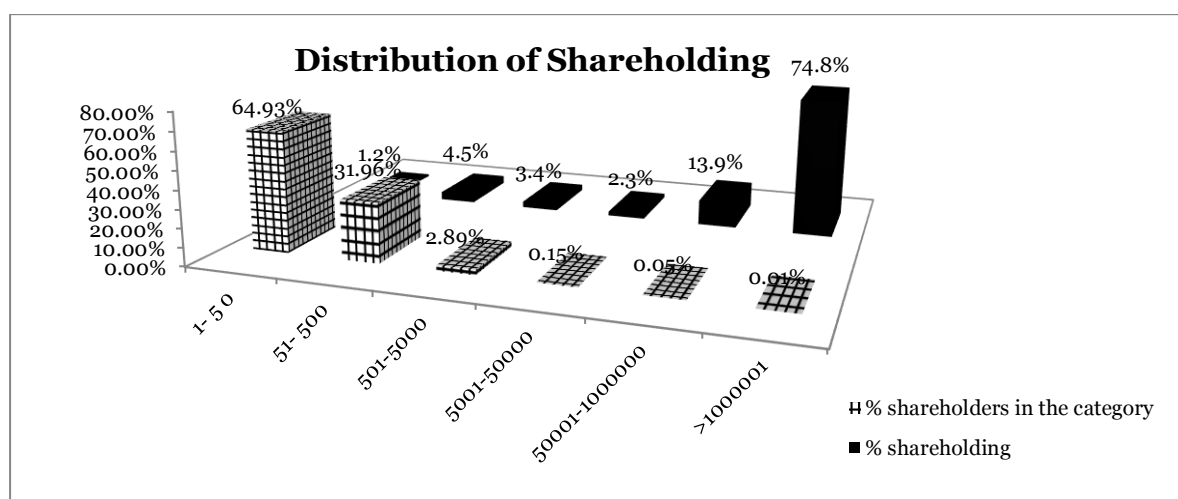


Figure 1



Figure

The total number of outstanding shares with Akzo Nobel India at present is 46,660,314 shares.

2.3 Market Behaviour

The tables that follow highlight some observations about the performance of Akzo Nobel India Ltd. in the stock markets compared to the other players in the industry.

Item	BSE	NSE
Market Capitalisation (In Rs. Crore)	6099.90	6099.9
Adjusted Share Price (In Rs)	1308.50	1309
Beta	0.6	0.6
No. of shares	46,660,314	

Parameter	AkzoNobel India Ltd.	Industry
Price as on 31/3/2015	1410	410.07
Book Value per share	10	1
Dividend Per Share	20	1.417
Dividend Yield (%)	1.53	4.12
EPS	38.93	8.71
P/E	33.58	20.77

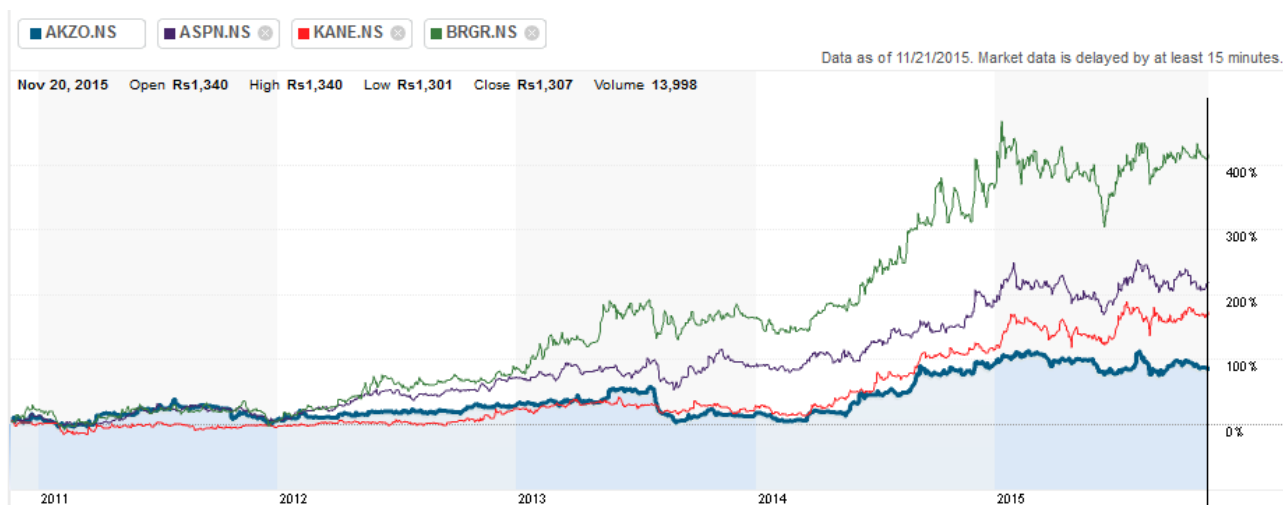
From the above table, we can see that Akzo Nobel India has higher Dividend per share, EPS and P/E as compared to the paints industry and hence demands a stock premium.

Stock price movement compared to CNX Nifty Fifty



As is evident from the graph above, compared to NIFTY index, AkzoNobel India Ltd. stock has performed better in most periods.

Stock price movement compared to Peers:



The chart above shows the price movement of AkzoNobel India Ltd., Asian Paints Ltd., Kansai Nerolac and Berger Paints Ltd. For the period from 2011 to 2012, Akzo Nobel stock has performed better than its peers. From 2012 to 2013, however, both Asian Paints Ltd. and Berger Paints Ltd outperformed Akzo Nobe stock. A reason could be the lack of initiatives by the management regarding any major expansion plans and extra overhead costs incurred. From 2014, Akzo Nobel is placed at the last when compared with its peers in stock performance.

2.4 Financial Analysis of Raymond Ltd.

Ratios

Liquidity Ratios

Ratios	2015	2014	2013
Current Ratio	1.41	1.23	1.33
Days of Payable Outstanding (DPO)	61.11	68.16	72.14
Days of Inventory Outstanding (DIO)	89.40	84.62	91.33
Days of Sales Outstanding (DSO)	37.06	42.56	37.93
Cash Conversion Cycle (CCC)	65.35	59.02	57.12

Current Ratio has shown improvement in the last year. Change in DPO, DIO and DSO seems to explain the change in current ratio. Debtor collection standards and credit extension have been raised which seems to explain lower debtors despite 4% increase in sales. A 3% increase in inventory to support 4% increase in sales seems to have pushed the DIO up.

Debt and Coverage Ratios

Debt Ratios for this company were irrelevant as they do not have any debt in their books. The closest they come to long term borrowings is deposit from customers. Even in Cash Flow Statements they show meagre interest payments termed as bank charges. However, given the low beta (0.78) of the business, the company may consider leveraging the firm to increase its EPS and hence market capitalization.

It is also imperative to note that there is no short term debt either and the business is run primarily by equity financed capital. This debt free capital structure seems to be industry norm where the debt equity ratio of the competitors is either less than 0.01 or there is no long term and short debt in their books. Thus, we can say that paints industry in general works on 100% equity financed model.

It is also imperative to observe that the firms in general do not seem to be in need of funds and investment as the dividend payout ratio is high.

Profitability Ratios

Profitability ratios	2015	2014	2013
Gross margin	35%	33%	31%
NPM	8%	6%	10%
ROA	43%	42%	41%
ROE	2.84%	3.59%	4.61%
Asset turnover	1.42	1.21	0.98
ROCE	43%	42%	41%
Dividend Payout	1.88	2.49	0.43

Annual report states that the company has taken significant effort to improve the efficiency of the firm. This can be clearly seen in the 400 basis point increase in the gross margin over the course of two years. However, it is important to note that only 200 basis points were able to water down to net profit margin which has increased in by 2% in the past two years. The increase in margin also is driven by reduction in cash discounts given on sales which make a major portion of other expenses in the P&L account.

There has been also an improvement in the ROA and Asset turnover. This has been mainly achieved by the reduction of fixed assets and current assets by the firm. In 2012, under the scheme of amalgamation sanctioned by the High Courts of Karnataka, Mumbai and Kolkata, Akzo Nobel Car Refinishes India Private Limited, Akzo Nobel Coatings India Private Limited and Akzo Nobel Chemicals (India) Limited were amalgamated with the Company, with effect from 18 May. The merger has created a strong entity and has led to efficiencies as the firm was able to achieve an increase in sales of about 4% even the fixed assets were reduced by 17% and current assets by about 25%. However, there is a doubt as to how much more of these efficiencies can be achieved in the coming years.

Another interesting aspect about the business is the fluctuation in the ROE and changes in the dividend payout ratio. The firm has an ROE ranging from 5% to 3% over the years but the cost of equity as estimated by us stands at 13.35% which led to a 20% decrease in stock price between FY 13 and FY 14. By increasing the dividend payout ratio by 200%, the firm was able to achieve 56% increase in the stock price between FY14 and FY15. The cash for these dividends seem to be partly funded by the cash realised by the sales of fixed assets and the cash released in the form of free working capital. The increase in share price is line with Dividend Discount model of valuing a share. As the ROE is less than cost of equity, therefore the firm can increase its value by declaring larger dividend.

This also seems to explain the lack of debt in the books. They are hardly in need of funds and actually cutting back on their asset base. Thus the firm has no debt and is in no need of debt.

Leverage Ratios

Leverage Ratios	2015	2014	2013
Business Leverage	8.93	-3.24	1.33
Operating leverage	8.88	-3.22	1.29
Financial leverage	1.01	1.01	1.03

As already mentioned, there is hardly any financial leverage in the firm. If we calculate the Operating Leverage of the firm, we get very variable figures, which explain the volatility of the firm as the NPM are wafer thin and variable. Also the other income often contribute 50 to 100% of the profit for the firm. Thus any change in firm's other income, which mostly constitutes of redemption of its investments in mutual funds and other securities significantly affects its profits. However, theoretically speaking, with decrease in the fixed asset base, the operating leverage of the firm at any level of sale is bound to decline.

DuPont Analysis

DuPont for RONW

Parameter	2015	2014	2013
Current Assets(CA)	1,112.80	1,350.80	1,483.00
Fixed Assets (FA)	686.30	688.10	822.20
Total Assets (TA)	1,799.10	2,038.90	2,305.20
Net worth	920.00	847.80	1,105.30
Net Sales	2,469.80	2,371.70	2,179.70
PAT	186.30	150.20	218.80
TA/NW	1.96	2.40	2.09
Net Sales / TA (asset turnover)	1.37	1.16	0.95
PAT/ Sales (net margin)	8%	6%	10%
RONW	20%	18%	20%
<u>PAT/ Sales (net margin) (ADJUSTED)</u>	<u>6%</u>	<u>4%</u>	<u>4%</u>
<u>RONW (ADJUSTED)</u>	<u>16%</u>	<u>11%</u>	<u>8%</u>

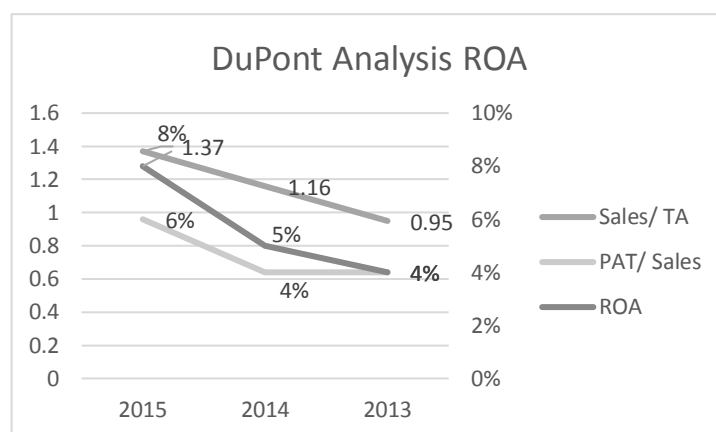
As per our analysis, there is a clear year on year increase in RONW driven by

- Increase in TA/NW –**
 - Which is driven up by reduction in fixed assets
 - Also the declaration of 250% dividend which reduced the net worth on the books of account
 - In FY 15 the reduction in TA/NW was driven by further reduction of assets.
- Asset turnover has increased**
 - As combined entity uses the firm's efficiently and effectively.
- Although net margin here is in contradiction to the calculation above is affected by variation in other income which are not related to the business and vary a lot causing the margins to move. If we adjust the ratios for same. **The new figures show a clear improvement in the ratio vis-à-vis the previous years.**
 - Net margins have been driven up by reduction in cost of goods sold which has decreased from 60% of net revenue to 56% in two years
 - There has been a decrease in other expenses by 2% in two years from 28% of net revenue to 26% of net revenue—mainly driven by reduction in cash discount on sales

DuPont for ROA

Parameter	2015	2014	2013
PAT/ Sales	6%	4%	4%
Sales/ TA	1.37	1.16	0.95
ROA	8%	5%	4%

ROA seems to confirm the fact the return on the assets has increased significantly on the basis of improvement in cost structure and also reduction in total assets which has made the firm asset light and improved the profitability of the firm.



Altman z-score

Component	2015	2014	2013
WC	320.9	253.5	368.6
TA	1799.1	2038.9	2305.2
EBIT	274	205	288
MV of equity	6,556.24	6,556.24	4,708.03
Sales	2,470	2,372	2,180
BV of liability	879.1	1191.1	1199.9
Cumulative Retained earnings	873.3	801.1	1058.6
WC/ TA	0.178367	0.124332	0.159899
Cumulative Retained earnings/ TA	0.485409	0.392908	0.459223
EBIT/ TA	0.152187	0.100495	0.124935
MV of equity/ BV of liabilities	7.457901	5.504358	3.923682
Sales/ TA	1.372798	1.163225	0.945558
z- score	7.24	5.50	4.55

A Z-score below 1.8 means the company is probably headed for bankruptcy, while companies with scores above 3.0 are not likely to go bankrupt. The lower/higher the score, the lower/higher the likelihood of bankruptcy.

The firm's Z- score is way above the threshold values signifying the safety of the stock and it has improved over time giving a little indication about the improving health of the business. Thus, as of now we can say the business is a going concern and the basic accounting principles hold true for the firm.

Economic Value Added:

$$\text{EVA} = \text{OIC} * (\text{ROIC} - \text{WACC}) = \text{NOPAT} - \text{OIC} * \text{WACC}$$

Component	2015	2014	2013
Operating Income	1,121	1,040	937
WACC	13.35%	13.35%	13.35%
OIC	1689	1916.7	1949.5
OIC*WACC	225	255	260
NOPAT	240	195	266
EVA	15	-60	6

The firm has clearly gone under a turnaround. The firm was destroying value to the tune of Rs. 60 crores in FY 14 and through significant step it has turned itself around and now EVA stands at Rs. 15 crores. It also reflects in the firm's stock price that rose approx. 56% signifying the confidence the investors have shown in the firm's ability to survive.

The change has been brought about by the change in the operating invested capital and increase in NOPAT driven by efficiencies. Hence the firm is EVA positive.

The WACC of the firm is equal to cost of equity as there is no debt in the books of the firm.

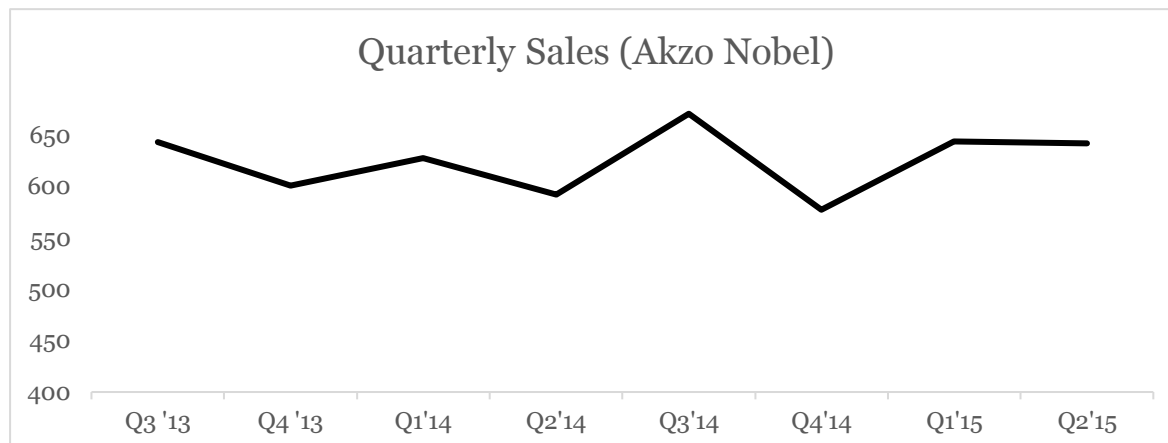
Positive Aspects

1. The material cost as a percentage of sales for Akzo Nobel India Ltd. stands at 27% compared to the industry figure of 33%.
2. Very high P/E, dividend per share, EPS as compared to the industry
3. The company has a better cash conversion cycle as compared to the industry primarily due to the abnormally high trade payable payment period. Compared to the industry (81 days), creditor's period (145 days) is longer due to strong bargaining power. They also give longer credit period (43 days) to the buyers, however, higher creditors repayment period over the industry compensates for higher debtors period. Also, the CCC is lower both due to lower days for holding raw material inventory (32 days) , lower WIP inventories (3 days) and lower finished goods inventory too (59 days)
4. Less import dependence on raw materials compared to industry: as has been pointed out before, the imports are almost 27.48% of the raw materials consumed, while for the industry, the figures is 32.48%.
5. From the EVA analysis, it is evident that the firm was destroying value to the tune of Rs. 60 crores in FY 14 and through significant step it has turned itself around and now EVA stands at Rs. 15 crores.
6. Over the past three years, asset turnover has increased.

Risks/ Negative aspects

1. The firm has an ROE ranging from 5% to 3% over the years but the cost of equity as estimated by us stands at 13.35% which led to a 20% decrease in stock price between FY 13 and FY 14.
2. By increasing the dividend payout ratio by 200%, the firm was able to achieve 56% increase in the stock price between FY14 and FY15. The cash for these dividends seem to be partly funded by the cash realised by the sales of fixed assets and the cash released in the form of free working capital.

3. Very high share of employee expenses as percentage of sales- 7.94% compared to the industry average of 4.82 %
4. Seasonal sales unlike industry. The industry allows for uniform sales throughout the year as the demand for paints, both in decorative as well as industrial coatings are too high to bring under control



This shows that the sales are the highest in the third quarter, i.e. from September to December, primarily because of the festive season (Diwali) which increases the sale of decorative paints and industrial paints to be used for automobiles

5. Extremely volatile nature of raw material prices which have the potential to erode the profits of the firm
6. Much lower profit margin (8% against 15% of the industry) due to higher operating expenses (employee benefit costs and overheads) as compared to the industry and also lower Return on Net Worth (16% against 43% of industry)

3. Target Identification Exercise

INDIAN PAINTS INDUSTRY – A BRIGHT FUTURE AHEAD

The Indian paint industry is estimated to touch Rs. 62,000-crore in the next two years, largely helped by the increasing demand across the country, especially in the hinterlands, states a new report released by the Associated Chambers of Commerce and Industry of India (Assocham). 'Indian paint industry is likely to surge from the current level of about Rs. 40,600-crore to about Rs. 62,000-crore by 2016, witnessing a double-digit compound annual growth rate (CAGR) of about 20%.

This has caught the attention of a lot of international players. Also the incumbent players have been trying to expand capacity to meet the expected surge in demand. In fact, Asian Paints, the largest player in the market is negotiating with South Indian states for land to set up a 6,00,000 kilo litre decorative paints plant with an investment of Rs2,500 crore.

3.1 Growth drivers identified

Decorative Paints

- 100% FDI in construction
- Change in culture tending towards nuclear families
- Reduced duration of repainting cycles

- Simultaneous upgradation of major cities, satellite towns and rural areas
- Easy availability of home loans at affordable rates
- Thrust on non-residential sector as well – Government-driven housing schemes
- Premium-isation and shift to home décor solutions for urban customers leading to higher margins
- Shift to emulsions and water based paints from solvent based paints leading to lower raw material costs and higher margins

Industrial Paints

- Increase in domestic production of automobiles due to local demand and financing options, and utilisation of India as an export hub by global auto majors
- Growth in auto refinish business
- Higher economic growth rate sparking FDI in multiple industries
- Growth in protective coatings, powder coatings and coil coatings due to thrust on infrastructure, consumer durables and high end construction segments

3.2 Reasons for acquiring Akzo Noble India

We consider Akzo Noble to be a target which is performing poorly in some areas but has good potential.

I. Poor performance as compared to the sector in specific areas

The company is not performing well in certain parameters, which can be improved by involvement of Asian Paints through its expertise in the sector leading to creation of value for the acquiring company.

1. Profitability Ratios

Profitability ratios	Sector Average			Akzo Noble		
	2013	2014	2015	2013	2014	2015
Gross margin	45%	44%	45%	31%	33%	35%
NPM	17%	16%	17%	10%	6%	8%
ROA	43%	44%	45%	41%	42%	43%
ROE	25.7%	26.1%	26.5%	4.61%	3.59%	2.84%
Asset turnover	1.65	1.59	1.72	0.98	1.21	1.42
ROCE	43%	44%	45%	41%	42%	43%
Dividend Payout	20%	31%	31%	43%	249%	188%

Though Akzo Noble India enjoys access to cheaper raw materials as compared to the sector, which is primarily due to the company's product portfolio and low material costs, this has not resulted in a higher net profit margin for the company. ROA, ROE and Asset Turnover are increasing but are still much lower than the industry average. We expect these low number to be primarily due the merger of Akzo Nobel Coatings India Private Ltd., Akzo Nobel Car Refinishes India Private Ltd. and Akzo Nobel Chemicals (India) Ltd. with Akzo Nobel India Limited in 2012. Going forward, it would not be wrong to expect the ROA, ROE and Asset Turnover numbers to converge to the sector average as the merger completes. This points to the fact that there are company specific factors for Akzo Noble's poor performance in certain areas and value can be created by the acquiring company by focusing on these areas while leveraging on Akzo Noble's strengths.

2. Employee expenses are high

Employee Benefit Expenses	Sector			Akzo Noble					
	2013	2014	2015	2013	2014	2015	Q1'16	Q2	Q3
	4.4	4.5	4.82	7.4	7.8	7.94	8.8	8.5	7.8

The employee expenses as a percentage of sales have consistently stayed high for the company as compared to the sector. No other company in the sector has employee benefits expenses higher than 5% with Kansai Nerolac having the lowest expenses at 4%. Though the company had a rejig of the organisation in Q1 of FY 2016 to the extent of completely removing 2 layers of management, the reorganization is yet to show results as seen from the numbers for the first three quarters of FY 2016. We expect the current management to face some difficulty in decreasing these expenses.

3. 'Purchase of Stock in trade' expenses are high

Purchase of trading goods	Sector			Akzo Noble		
	2013	2014	2015	2013	2014	2015
	3.4	4.0	4.49	8.4	8.9	8.56

A large part of benefit accrued by the company because of lower raw material expenses is being eaten up by the purchases of stock in trade. This number for the company is nearly twice as high as compared to the sector. Bringing this within the sector average limits can make the company as profitable as Asian Paints, which has the highest NPM in the sector. The share of 'purchase of trading goods' is high even considering the fact that Akzo Noble gets nearly 40% of its revenue from the industrial paints sector as Kansai Nerolac which is the industry leader in industrial coatings in India has a much lower expense in this item. (4.4%)

4. Liquidity ratios

DETAILS	Sector Average	AkzoNobel India
	(No. of Days)	(No. of Days)
Raw Material Inventory	34	32
WIP Inventory	8	3
Finished Goods Inventory	62	59
Inventory Conversion Cycle	103	94
Receivables Conversion Period	37	43
(Trade Payables Payment Period)	81	145
Cash Conversion Cycle (CCC)	59	-8
Inventory of Trading Goods	45	65

The company has a better cash conversion cycle primarily due to the abnormally high trade payable payment period. At the same time, the company has the lowest raw material expense in the sector, so the long payment period may be due to the influence of either the parent company Akzo Noble or the promoters ICI. So, it is doubtful whether this CCC can be sustained after acquisition by a third party. The payment period can be reduced for further discounts on

raw material which should add to the NPM. As mentioned earlier, the company is maintaining a very high inventory of trading goods which is eating into the NPM and thus needs to be reduced.

5. Other expenses are high

	Akzo Noble	Sector
<i>Freight and transport</i>	18.12%	24.67%
<i>Advertisement and publicity</i>	16.31%	24.35%
<i>Royalty</i>	8.58%	0.00%
<i>Cash discount on sales</i>	12.95%	18.75%
<i>Consultancy charges</i>	5.59%	
<i>Loss on foreign exchange (net)</i>	0.02%	0.07%
<i>Miscellaneous expenses</i>	17.43%	14.09%

As mentioned before, due to insufficient control on overheads Akzo Noble's gross margins are getting eaten up. We see that even in the cases of distribution and advertisement and promotion expenses, Akzo Noble is spending much less than the sector. But a major chunk of the expenses is due to high royalty being paid to the parent company and other smaller overheads (<10% of Other Expenses item) that are leading to higher other expenses for the company (25.2% of Sales as compared to 21.4% for the sector). This again points to a company specific problem.

II. Management Quality can be questioned

The management has not been able to rein in the overhead expenses consistently. Akzo Noble has the highest overhead expenses in the sector. Though, it would be too early to assume poor management since the company has gone through structural changes in 2012 and more recently in early 2015, a management change can be a possible option if they fail to perform consistently.

III. Good potential and possibilities of synergies with Asian Paints

1. Access to technology and customer base

The industrial paints sector is dominated by foreign players primarily due to technological advantage of these players and their long-term relationship developed with OEMs across geographies. Though, Asian Paints has a working JV with PPG for the industrial coatings segment, an acquisition of Akzo Noble can lead to higher penetration of the industrial coatings market, especially in the auto refinishing segment in which Akzo Noble is a leader in India.

2. Premium portfolio

The industrial coatings sector is defined by lower margins as compared to the decorative paints due to the absence of branding and the additional expenses accrued in providing customised services for the OEM partners. This has been balanced by Akzo Noble by focusing heavily on the premium segment in decorative paints. Dulux as a brand has firmly entrenched itself as a premium brand and thus achieves higher margins.

3. Synergies identified in the section on Valuation, a lot of changes can be made to create value which have been listed down in the recommendations

Considering these factors – poor performance of the company in specific areas, good potential and questionable quality of management, we think that Akzo Noble India is a good target for acquisition by Asian Paints.

4. Acquisition Proposal

For 72.96% stake, Asian Paints needs a total of 34,044,335 (3.4 crore) shares. With the prevailing price (as on 22nd Nov, 2015) of Rs 1310/ share, we arrived at a premium of 30% based on the calculated synergies which gives us a total investment figure of Rs.5797.75 Crores. The premium has been discussed in detail in the section related to calculation of synergies for valuation. Asian Paints should buy the entire promoter stake from ICI Ltd (49.24%), Akzo Noble Coatings International BV (18.49%) and Akzo Noble Chemicals International BV (5.23%).

Valuation of the Target before Acquisition

Projection Period

The business cycle for industrial paints is non-seasonal while that for decorative paints is highly seasonal. We have forecasted the financials for a period of 3 years from 2016 to 2018.

WACC Computation

The following are details for the WACC calculation¹:

Item	Method of calculation	Value
Cost of Debt (K_d)	Akzo Nobel has been rated BBB by CRISIL which gives spread of 2.63%	10.43%
Market Value of debt (D)	No debt in books	0
Risk- free return	10 year Government Bond Yield	7.79%
Beta	Obtained from Bloomberg	0.67
Market risk premium	Geometric Mean of historical Sensex data(Buisness analysis and valuation by Pitabas Mohanty Book)	7.13%
Cost of equity (K_e)	$K_e = R_f + \beta(R_m - R_f)$	11.76%
Market Value of equity (E)	Known (no. of shares times the market price)	6105.5 Crores
WACC	$\frac{E}{D+E} K_e + \frac{D}{D+E} K_d (1-t)$	11.76%

Assumptions

Refer Assumption Sheet attached

¹All computations as on 21/11/2015

Balance Sheet of Akzo Nobel before Acquisition

EQUITY AND LIABILITIES	As at 31 March 2013	As at 31 March 2014	As at 31 March 2015	As at 31 March 2016	As at 31 March 2017	As at 31 March 2018
Shareholders' funds						
(a) Share capital	47	47	47	47	47	47
(b) Reserves and surplus	1059	801	873	1212	1687	2343
Non-current liabilities						
(a) Deferred tax liabilities (net)	5	12	11	11	11	11
(b) Other long-term liabilities	19	14	16	22	27	34
(c) Long term liabilities						
(d) Long term provisions	62	67	60	82	103	128
Current liabilities						
(a) Trade payables	479	493	459	622	777	970
(b) Other current liabilities	117	118	115	115	115	115
(c) Short-term provisions	519	487	218	55	14	3
	2305	2039	1799	2165	2780	3650
ASSETS						
Non-current assets						
(a) Fixed assets						
(i) Tangible assets	355	503	516	499	566	644
(ii) Capital work-in-progress	106	31	12	30	0	0
(b) Non-current investments	270	50	50	50	50	50
(c) Long term loans and advances	90	103	108	130	163	203
(d) Other non-current assets	2	2	1	1	1	1
Current assets						
(a) Current investments	677	579	344	172	86	43
(b) Inventories	315	324	365	519	782	1191
(c) Trade receivables	252	308	278	363	454	566
(d) Cash and bank balances	86	72	60	329	594	848
(e) Short-term loans and advances	129	51	52	66	82	102
(f) Other current assets	25	17	14	7	3	2
	2305	2039	1799	2165	2780	3650

Profit & Loss Statement of Akzo Nobel before Acquisition

Revenue From Operations		For the year ended 31 March 2013	For the year ended 31 March 2014	For the year ended 31 March 2015	For the year ended 31 March 2016	For the year ended 31 March 2017	For the year ended 31 March 2018
Sale Of Products (Gross)		2,420.9	2,637.8	2,741.6	3,381.4	4,223.9	5,271.5
Less: Excise Duty		-241.2	-266.1	-271.8	-337.7	-421.9	-526.5
Net Sales		2179.7	2,371.7	2,469.8	3,043.7	3,802.0	4,745.0
Service Income		33.2	27.9	33.7	41.2	51.5	64.3
Other Operating Income		19.1	18.3	23.5	26.4	32.9	41.1
		2232	2,417.9	2,527.0	3,111.3	3,886.5	4,850.4
		0					
Other Income		138.1	56.7	65.0	115.2	144.0	179.7
	<i>Accrued interest on long term investments (bonds)</i>		3.9	4.3	3.37	3.37	3.37
	<i>Gains on redemption of long term investments (fixed maturity plan mutual fund schemes)</i>		35.3	30.5	9.45	11.81	14.73
	<i>Gains on redemption of other investments (short term liquid mutual fund schemes)</i>		15.1	22.6	35.38	44.20	55.16
	<i>Interest income on income tax refunds</i>			1.2	1.06	1.33	1.66
	<i>Surplus in pension fund written back</i>		0.5	0.7	1.13	1.41	1.76
	<i>Provision/liabilities no</i>		0.6	3	3.27	4.08	5.10

	<i>longer required written back</i>						
	<i>Profit on disposal of fixed assets (net)</i>			2.5	2.22	2.77	3.46
	<i>Miscellaneous</i>		1.3	0.2	1.50	1.87	2.34
Total Revenue		2370.1	2,474.6	2,592.0	3,226.5	4,030.5	5,030.1
Expenses							
Cost Of Materials Consumed		1084.5	1,172.6	1,197.0	1,398.7	1,687.2	2,022.9
		<i>For the year ended 31/03/2013</i>	<i>For the year ended 31/03/2014</i>	<i>For the year ended 31/03/2015</i>	<i>For the year ended 31/03/2016</i>	<i>For the year ended 31/03/2017</i>	<i>For the year ended 31/03/2018</i>
	<i>Opening stock</i>						
	<i>Raw materials</i>	109.1	101.9	94.2	117.8	220.3	408.3
	<i>Add: Purchases</i>						
	<i>Raw materials</i>	1,077.3	1,164.9	1,220.6	1,501.2	1,875.2	2,340.3
	<i>Less: Closing stock</i>						
	<i>Raw materials</i>	-101.9	-94.2	-117.8	-220.3	-408.3	-725.6
	<i>Materials consumed</i>	1,084.5	1,172.6	1,197.0	1,398.7	1,687.2	2,022.9
	<i>Details of raw materials consumed</i>						
	<i>Titanium Dioxide</i>	165.1	162.0	152.1	199.7	239.4	286.5
	<i>Pigments / Extenders / Tinters</i>	130.6	153.9	180.1	192.0	230.2	275.5
	<i>Resins</i>	262.5	261.0	255.0	300.8	370.4	446.2
	<i>Latex, Monomers</i>	104.3	147.3	153.0	154.9	186.3	223.8
	<i>Solvents</i>	134.8	146.0	137.6	173.9	208.5	249.6
	<i>Packing materials</i>	110.8	128.3	134.7	154.9	185.7	222.2
	<i>Others*</i>	176.4	174.1	184.5	222.4	266.7	319.2

Purchase Of Stock-In-Trade		199	220.4	221.9	278.1	347.3	433.5
Changes In Inventories Of Finished Products, Work-In-Progress And Stock-In-Trade		12	-14.6	-12.6	-48.8	-70.5	-87.6
	<i>Inventories at the beginning of the year</i>						
	<i>Finished products</i>	180	164.7	183	196.3	235.8	294.5
	<i>Stock in trade</i>	37.5	38.3	39.7	39.8	51.2	63.9
	<i>Work-in-progress</i>	6.5	9.7	6.7	10.6	11.7	14.7
		224	212.7	230	246.7	298.6	373.1
	<i>Less: Inventories at the end of the year</i>						
	<i>Finished products</i>	165	183.4	196	235.8	294.5	367.5
	<i>Stock in trade</i>	38.3	39.7	39.8	51.2	63.9	79.8
	<i>Work-in-progress</i>	9.7	6.7	10.6	11.7	14.7	18.3
		213	229.8	247	298.6	373.1	465.6
	<i>Movement in excise duty on finished products</i>	0.7	2.5	4.3	3.2	3.9	4.9
		12	-14.6	-12.6	-48.8	-70.5	-87.6
Employee Benefits Expense		175.3	193.9	205.8	249.1	311.1	388.3
Finance Costs		8.9	1.5	1.5	1.5	1.5	1.5
	<i>Interest expense / Bank charges</i>	8.9	1.5	1.5	1.5	1.5	1.5

Depreciation And Amortization Expense (Net Of Transfer From Revaluation Reserve)		38.6	43.7	52.6	49.5	56.2	63.9
Other Expenses		572.7	653.7	653.5	814.64	1,017.62	1,270.00
Total Expenses		2091	2,271.2	2,319.7	2,742.6	3,350.5	4,092.6
Profit Before Tax Exceptional item (income)		279.1	203.4	272.3	483.9	679.9	937.5
Exceptional item (income)				2.7			
Profit Before Tax		279.1	203.4	275.0	483.9	679.9	937.5
Tax Expense:							
Current Tax		57.2	43.5	85.7	145.17	203.98	281.25
Deferred Tax Charge/(Credit)		2.1	7.4	-0.1			
Provision For Earlier Years		1	2.3	3.1	0.39	0.55	0.75
Total Tax Expenses		60.3	53.2	88.7	145.56	204.53	282.00
Profit For The Year		218.8	150.2	186.3	338.3	475.4	655.5

Cash Flow of Akzo Nobel before Acquisition

	For the year ended 31 March 2013	For the year ended 31 March 2014	For the year ended 31 March 2015	For the year ended 31 March 2016	For the year ended 31 March 2017	For the year ended 31 March 2018
(A) Cash flow from operating activities						
Profit before exceptional items and tax	279.1	203	275	484	680	937
Adjusted for :						
Depreciation and amortisation	38.6	43.7	52.60	49.47	56.19	63.93
Loss on write off of fixed assets			0.10			
Provisions/liabilities no longer required written back	-1.2	-1.1	-3.70	-3.27	-4.08	-5.10
Profit on deposit of fixed assets (net)			-2.50	-2.22	-2.77	-3.46
Provision for doubtful debts and advances	2.3	1.8	1.20			
Accrued interest on long term investments (bonds)	-3.6	-3.9	-4.30	-3.37	-3.37	-3.37
Gains on redemption of long term investments	-88.1	-35.3	-30.50	-9.45	-11.81	-14.73
Gains on redemption of other investments	-15.1	-15.1	-22.60	-35.38	-44.20	-55.16
Exceptional Item - Income	-0.3		-2.70	0	0	0
Interest income on Income tax refund	-27.9		-1.20	-1.06	-1.33	-1.66
Interest expense	8.9	1.5	1.50	1.5	1.5	1.5
	-86.4	-8.4	-12.10	-3.78	-9.86	-18.04
Operating profit before working capital changes	192.7	195	262.90	480.13	670.08	919.45
Changes in :						
(Decrease) / increase in current and non current liabilities and provisions	73.3	19.5	-21.20	-1	114	182
Decrease / (increase) in inventories	18.5	-9.3	-40.50	-154	-262	-410
Decrease / (increase) in trade receivables	-26.9	-58.1	28.00	-85	-90	-112
(Increase) / decrease in loans and advances and other current and non current assets	-13.5	17.3	-0.90	-14	-16	-20
	51.4	-30.6	-34.60	-254	-255	-360
Cash generated from operations	244.1	164.4	228.30	226.48	414.95	559.27

Income tax paid (net)	-36.1	6.4	-72.90	-145.56	- 204.53	-282.00
Net cash flow from operating activities (A)	208	170.8	155.40	80.92	210.42	277.26
(B) Cash flow from investing activities						
Purchase of fixed assets (net of sale)	-126.1	-120.3	-51.20	49.47	18.05	-14.07
Sale of fixed assets		0.4	2.50	0	0	0
Payments relating to divested businesses	-1	0	0.00	0	0	0
Investments in long term investments	-520	-115		-23	-32	-40
Investment in other investments	-342.2	-1791.5	- 1,832.00	0	0	0
Redemption of long term investments	933.1	356.6	364.70	0	0	0
Proceeds from sale of other current investments	88.9	1918.9	1,754.60	172	86	43
Fixed deposits held as margin money	-0.5	1.4	0.10	0	0	0
Net cash flow from investing activities (B)	33.1	250.5	238.70	198.93	71.70	-11.37
(C) Cash flow from financing activities						
Buyback of shares	-120.9					
Dividend paid	-93.3	-373	-350	0	0	0
Tax on dividend	-15.2	-63.4	-59.5	0	0	0
Interest paid	-1.5	-1.50	-1.5	-1.5	-1.5	-1.5
Interest income on income tax refund			1.2	1.06	1.33	1.66
Net cash flow from financing activities (C)	-230.9	-438	-410	-0.44	-0.17	0.16
Net changes in cash and cash equivalents (A+B+C)	10.2	-16.9	-15.6	279.41	281.94	266.06
Cash and cash equivalents - opening balance	68.5	79	61.8	60	329	594
Cash and cash equivalents - closing balance	78.7	62	46.2	339.51	610.70	859.90

FCF Valuation of Akzo Nobel before Acquisition

	2015A	2016E	2017E	2018E
Net Sales	2469.8	3043.670875	3802.044	4744.986
EBITDA	326.4	534.8816232	737.6387	1002.924
EBIT	273.8	485.4099178	681.4438	938.9914
NOPAT	187.35	339.3972764	476.4631	656.539
Add: Depreciation	52.6	49.47170543	56.19491	63.93295
Gross Cash Flow	239.95	388.8689819	532.658	720.472
Capex				
Increase in Op. Wkg Cap		75	166	315
Gross Investment		75	166	315
FCF	239.95	314.23	367.03	405.04

Terminal Value	7,451.02
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WACC-t(for each time period)	11.76%	11.76%	11.76%	11.76%
Discount Factor	1.00	0.89	0.80	0.72
PV of FCF & TV		281.16	293.84	5,627.56
Enterprise Value		6,202.55		
Add: Cash		60.10		
Less: Secured Loan		0.00		
Less: Unsecured Loan		0.00		
Equity		6,262.65		
		Rs.		
Intrinsic Value per share		1,341.04		

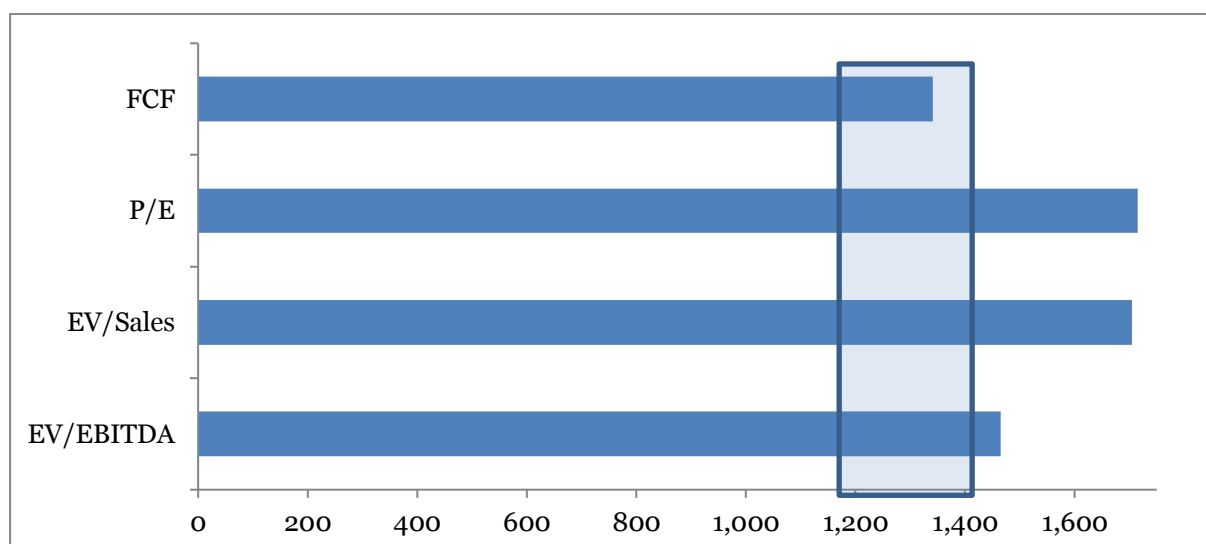
Sensitivity of Share Price

Sensitivity analysis of Terminal growth rate V/s Cost of capital						
		Terminal growth rate				
		3%	4%	5%	6%	7%
Cost of capital	8.76%	1,001.09	1,111.87	1,255.42	1,448.79	1,723.38
	9.76%	976.03	1,083.82	1,223.48	1,411.61	1,678.76
	10.76%	951.85	1,056.74	1,192.65	1,375.74	1,635.71
	11.76%	928.51	1,030.60	1,162.90	1,341.11	1,594.17
	12.76%	905.96	1,005.37	1,134.18	1,307.69	1,554.08
	13.76%	884.19	980.99	1,106.43	1,275.41	1,515.36
	14.76%	863.14	957.44	1,079.63	1,244.23	1,477.96

Relative Valuation

	Total Debt	Cash	Net Debt	Equity	ND/E	Raw Beta	Adjusted Beta	Beta Unlevered	Beta Levered
Asian Paints	32.09	61.81	(29.72)	95.92	(0.31)	0.81	0.87	1.09	0.87
Berger Paints	288.49	141.15	147.34	69.33	2.13	0.73	0.82	0.34	2.62
Kansai Nerolac	41.50	34.05	7.45	53.89	0.14	0.72	0.81	0.74	1.19
Akzo Nobel	0.00	53.61	(53.61)	46.70	(1.15)	0.67	0.78	3.22	0.26
Shalimar Paints	109.94	4.46	105.48	3.79	27.83	1.04	1.02	0.05	21.11

The companies have been chosen by considering companies which are similar in terms of beta, risk, product cycle and market capitalization.



EV/EBITDA	EV/Sales	P/E	FCF	52 week low	52 week high
1,465.24	1,705.24	1,714.87	1,341.04	1,201.00	1,550.00

Balance Sheet of Asian Paints before Acquisition

EQUITY AND LIABILITIES	As at 31 March 2013	As at 31 March 2014	As at 31 March 2015	As at 31 March 2016	As at 31 March 2017	As at 31 March 2018
Shareholders' funds						
(a) Share capital	95.92	95.92	95.92	95.92	95.92	95.92
(b) Reserves and surplus	2,926.34	3,505.01	4,134.34	5,690.61	7,622.06	10,030.71
	3,022.26	3,600.93	4,230.26	5,786.53	7,717.98	10,126.63
Non-current liabilities						
(a) Long Term Borrowings	46.26	39.51	32.09	28.56	25.42	22.62

(b) Deferred tax liabilities (net)	143.33	177.07	167.78	202.93	183.56	199.19
(c) Other long-term liabilities	0.5	0.12	0	3.20	3.20	3.20
(d) Long term provisions	76.58	67.12	85.25	89.51	93.99	98.69
	266.67	283.82	285.12	324.20	306.16	323.70
CURRENT LIABILITIES						
(a) Trade payables	1,214.12	1,498.84	1,313.08	1,938.75	2,440.37	3,075.30
(b) Other current liabilities	719.38	785.68	832.71	1,130.94	1,423.55	1,793.93
(c) Short-term provisions	423.74	550.6	612.03	646.25	813.46	1,025.10
	2,357.24	2,835.12	2,757.82	3,715.94	4,677.37	5,894.33
TOTAL	5,646.17	6,719.87	7,273.20	9,826.66	12,701.52	16,344.66
ASSETS						
NON CURRENT ASSETS						
Fixed Assets						
(a) Fixed assets						
(i) Tangible assets	2,074.91	1,973.21	1,886.42	2,812.21	3,003.89	3,161.68
(ii) Intangible Assets	26.98	38.99	79.07	71.23	59.73	45.12
(ii) Capital work-in-progress	52.55	37.95	139.54	139.54	139.54	139.54
	2,154.44	2,050.15	2,105.03	3,022.98	3,203.16	3,346.34
(b) Non-current investments	359.7	727.19	775.72	775.72	775.72	775.72
(c) Long term loans and advances	91.06	94.64	209.54	98.43	102.36	114.17
(d) Other non-current assets	0.03	6.6	13.64	13.64	13.64	13.64
CURRENT ASSETS						
(a) Current investments	105	943.96	1,118.06	1,130.94	1,423.55	1,793.93
(b) Inventories	1,480.79	1,665.05	1,802.18	2,423.44	3,050.46	3,844.13
(c) Trade receivables	633.88	712.36	728.87	969.37	1,220.18	1,537.65
(d) Cash and bank balances	551.57	104.12	61.81	907.46	2,302.36	4,150.25
(e) Short-term loans and advances	162.72	239.7	205.43	323.12	406.73	512.55
(f) Other current assets	106.98	176.1	252.92	161.56	203.36	256.28
	3,040.94	3,841.29	4,169.27	5,915.90	8,606.64	12,094.78
Total	5,646.17	6719.87	7273.2	9,826.66	12,701.52	16,344.66

Profit & Loss Statement of Asian Paints before Acquisition

Revenue From Operations	For the year ended 31 March 2013	For the year ended 31 March 2014	For the year ended 31 March 2015	For the year ended 31 March 2016	For the year ended 31 March 2017	For the year ended 31 March 2018
Sale Of Products (Gross)	9,978.88	11,542.02	12,878.80	16,156.25	20,336.40	25,627.52
Less: Excise Duty	1,068.91	1,241.80	1,393.13	1,615.62	2,033.64	2,562.75
Revenue from sale of goods and services (Net of discounts and excise duty)	8,909.9	10,300.2	11,485.6	14,540.62	18,302.76	23,064.77
Other Operating Revenue	50.1	118.56	163.16	179.48	197.42	217.17
Other Income	126.12	173.66	186.82	205.50	226.05	248.66
Total Revenue	9,086.19	10,592.44	11,835.65	14,925.60	18,726.23	23,530.59
Expenses						
Cost of Materials Consumed	5,125.48	5,758.71	6,191.72	8,078.12	10,168.20	12,813.76
Purchases of Stock-in-Trade	174.11	256.58	380.56	323.12	406.73	512.55
Changes in inventories of finished goods, work-in-progress and stock-in-trade	-136.17	-75.34	-132.43	-117.06	-117.06	-117.06
Employee Benefits Expense	404.59	482.43	606.94	807.81	1,016.82	1,281.38
Other Expenses	1,844.76	2,219.13	2,591.52	3,069.69	3,863.92	4,869.23
TOTAL Expense(II)	7,412.77	8,641.51	9,638.31	12,161.69	15,338.60	19,359.86
EARNINGS BEFORE INTEREST, TAX, DEPRECIATION AND AMORTISATION (EBITDA) (I) - (II)	1,673.42	1,950.93	2,197.34	2,763.91	3,387.63	4,170.74
Depreciation and Amortisation Expense	126.98	212.32	223.11	304.41	340.86	377.30
Finance Costs	30.56	26.08	27.13	28.22	29.34	30.52
PROFIT BEFORE EXCEPTIONAL ITEMS AND TAX	1,515.88	1,712.53	1,947.10	2,431.29	3,017.43	3,762.92
Exceptional Items	0	9.96	13.53	0.00	0.00	0.00
PROFIT BEFORE TAX	1,515.88	1,702.57	1,933.57	2,431.29	3,017.43	3,762.92
Less : Tax Expense						
Current Tax	406.03	498.63	616.42	826.39	1,025.63	1,279.02

(Excess)/Short tax provision for earlier years	-2.74	1.14	-0.96	0	0	0
Deferred Tax (benefit)/expense	62.59	33.74	-9.29	48.63	60.35	75.26
Total Tax Expenses	465.88	533.51	606.17	875.02	1,085.97	1,354.28
PROFIT AFTER TAX	1,050.00	1,169.06	1,327.40	1,556.27	1,931.46	2,408.65

5. ACQUISITION STRATEGY & SYNERGIES

Keeping Kansai Nerolac away from your turf

This acquisition is important for Asian Paints from a strategic perspective also. Kansai Nerolac is a distant third in the overall paints market but a market leader in the industrial paints market. It has also started investing into branding and distribution to grow its share and increase its foothold in the decorative paints segment. This company with the backing of its Japanese parent company has the wherewithal and the will to enter into Asian Paints' territory. With minimal presence in the industrial paints market, Asian Paints is putting in strong efforts into the entering the market with investment in R&D. By acquiring Akzo Nobel, Asian Paints will get a strong foothold in the industrial paints market and will be able to give a credible threat to Kansai Nerolac that its attempts to enter the decorative paints market will be met by aggressive attack on its foothold in the industrial paints market.

Akzo Nobel is a good target for Asian Paints to acquire. It has extremely high sales potential which is being reflected in the current market price. However, the acquisition shall need some detailing to ensure that Asian Paints will be able to ensure desired synergies and benefits to itself.

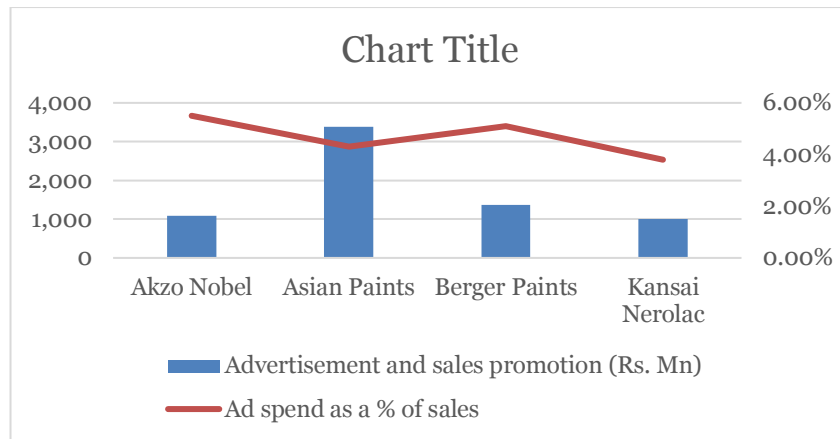
1. It has to make sure that proper technology transfer agreements are in place to assure the transfer of the desired technology for manufacturing of industrial paints which Akzo Nobel is known for.
2. Convert promoters into lenders with convertible debentures. This is to ensure that while the ownership shifts the parent company continues to be vested in the firm.

Synergies

Advertising synergies

The total expenditure of the combined firm will be around Rs. 4,478 million which is a large sum of money. Some synergies in terms of bargaining power with the advertisers while booking bulk slots for the season can be achieved. However, since we shall make a small percentage of the aggregate revenue of the TV channels not much synergies are expected here.

However, promotional activities such as price discounts, dealer discounts will be aggressively cut because more often than not they are given to fight competition. Since a major competition is not being acquired, we can easily coordinate our activities to maintain the status quo.



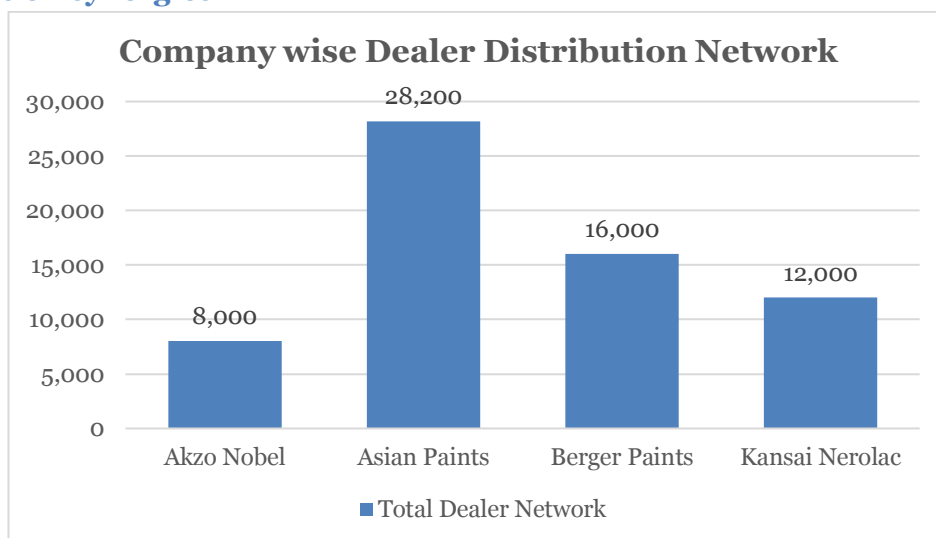
Also, since usually in price discounts the market leader loses the most, here that will not be the case. Since, from marketing perspective, Akzo Nobel brands and Asian Paints brands will be kept separate, in case of price competition, Asian paints can simply offer a price discount on Akzo Nobel products to undercut the competitor and still maintain both market share and profitability since he will be losing margin on a lower sales base compared to if he had done it on the total sales base.

Technological synergies

“The next phase of growth will be embarked by the industrial paints segment. The firm [Asian Paints] has been heavily investing to develop a strong industrial paint product portfolio to bet on India’s rampant industrialization.” – BP Wealth Paint Sector Overview

Industrial paints segment of the market is dominated by the most technologically advanced player. By acquiring Akzo Nobel, Asian Paints would get access to this technology and will be able to grow further in the market. However, it is imperative to understand that the technology access that Akzo Nobel has is because of being a subsidiary of a global paints giant, Akzo Nobel. Therefore, Asian Paints needs to ensure that proper technology transfer agreements are in place otherwise we are going to lose out on a lot of value.

Distribution synergies



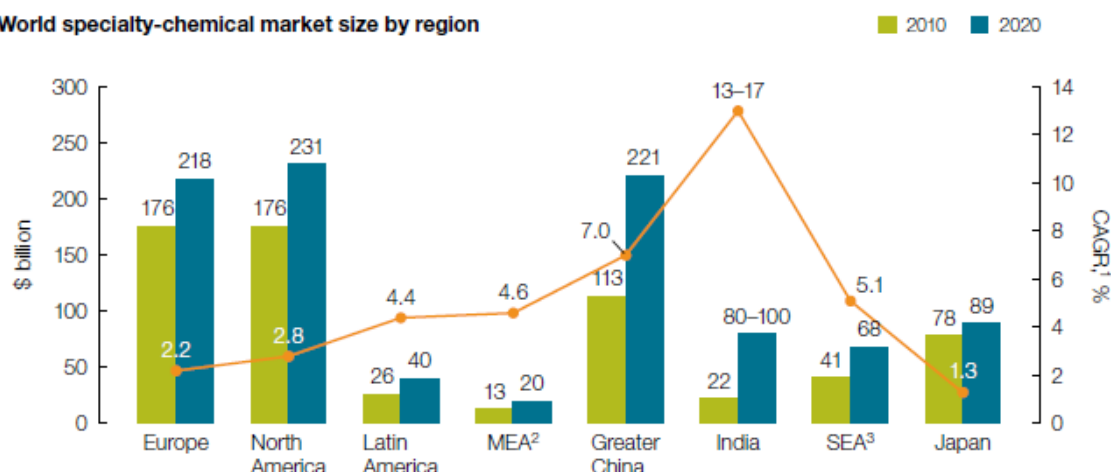
Both the companies had heavily invested in the creation of a sizable distribution network to achieve the desired sales. After the acquisition significant synergies are going to be achieved

in this area. Firstly, a simple combination of the dealer will lead to major cutting down of costs. While not all Akzo Nobel dealers will be axed but the under-performing dealers in both the companies can be shown the door as the companies consolidate.

It will be a win-win situation as the dealers will now be able to offer both the major brands under that same roof and also due to reduction in the competition will be able to service customers at a higher price.

Opportunity- Speciality Chemicals

World speciality-chemical market size by region



¹Compound annual growth rate.

²Middle East and Africa.

³Southeast Asia.

Source: SRI; McKinsey estimates

Speciality chemicals (also called specialties or effect chemicals) are particular chemical products which provide wide variety of effects on which many other industry sectors rely. Some of the categories of speciality chemicals are adhesives, agrichemicals, cleaning materials, cosmetic additives, construction chemicals, elastomers, flavours, food additives, fragrances, Industrial gases, lubricants, polymers, surfactants, and textile auxiliaries. Other industrial sectors such as automobile, aerospace, food, cosmetics, agriculture, manufacturing, textile industries are highly dependent on such products.


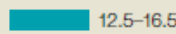



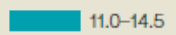

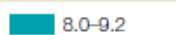

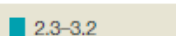

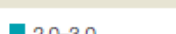



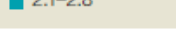

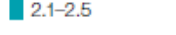

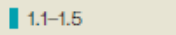

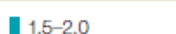

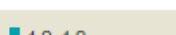



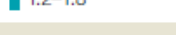

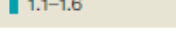

Akzo Nobel Worldwide has a large portfolio strong brands in speciality chemicals under these five main business segments:

- Industrial Chemicals
- Polymer Chemistry
- Surface Chemistry
- Ethylene and Sulfur Derivatives
- Pulp and Performance Chemicals

This gives Akzo Nobel a strong foothold in this market. It's Indian subsidiary matches its global prowess and has created a niche for itself in the speciality chemicals market. Given this opportunity, Asain Paints stands to gain immensely from this acquisition. By acquiring their speciality chemicals division and investing in it along with their existing JV, PPG-AP with PPG Industries Inc. it will can experience immense growth in the market.

Factors driving specialties growth potential will vary by segment.


 Less than 25% 25-50% 50-75% 75-100%

Growth drivers evaluated					
Segment	India 2010, \$ billion	Key end markets	Adoption level ¹	Impact of consumer standards	India 2020 potential, \$ billion
1 Paints and coatings	3.1	Construction, automotive		High	 12.5-16.5
2 Dyes and pigments	3.5	Textiles, exports		Low	 10.0-14.5
3 Agrochemicals	3.4	Agriculture, exports		High	 11.0-14.5
4 Specialty polymers	2.0	Packaging, automotive		High	 8.0-9.2
5 Plastic additives	0.8	Pipes, automotive		Medium	 2.3-3.2
6 Construction chemicals	0.5	Infrastructure, real estate		High	 2.0-3.0
7 Home-care surfactants	1.0	Laundry care, dishwashing		Low	 2.1-2.8
8 Textile chemicals	0.7	Apparel, technical textiles		Medium	 2.1-2.5
9 Flavor and fragrances	0.4	Food processing, personal care		Medium	 1.1-1.5
10 Water chemicals	0.5	Industrial water, municipal water		High	 1.5-2.0
11 Cosmetic chemicals	0.4	Bath and shower, hair care		Medium	 1.3-1.8
12 Paper chemicals	0.4	Printing, packaging		Low	 1.2-1.8
13 Printing inks	0.4	Publication, packaging		Low	 1.1-1.6
14 I&I ² cleaners	0.2	Food processing, hotels		High	 0.8-1.2
15 Rubber chemicals	0.2	Tires and tubes		Medium	 0.5-0.7
16 Others ³	5.0				 20.0-30.0
Total: ~22.5		CAGR:⁴ 13-17%		Total: ~80-100	

McKinsey report analysis shows that there is expectation

Synergy Assumptions

Item	Company	Changes	Reasoning
Revenue	Asian paint, Akzo Nobel	5% Decrease	This is due to expected cannibalisation from the similar product among companies.
Cost of Material Consumed	Asian paint, Akzo Nobel	3% Decrease	Due to economies of scale and optimisation in procurement
Employee cost	Asian paint, Akzo Nobel	5% Decrease	Optimisation of workforce
Tangible Assets	Akzo Nobel	20% Decrease	Reduction due to optimisation in capex

We see the increase in Akzonobel intrinsic value rise from Rs 1688 per share to Rs 1951 per share. Opportunity in speciality chemicals will be above the value calculated.

The current value of share price is Rs 1310 per share and hence we have enough margin to gain from acquisition while offering a 30% premium of share price Rs 1703.

6. Changes to be introduced

To acquire the firm we have taken a debt of Rs. 5797.5 crores to acquire the firm. We have plan to service this debt with our excess cash. It is also imperative to note that given the high value of equity and also the absence of debt in the books of both the firms before the acquisition allows us to go for this high leverage strategy. We intend to pay off 10% of the debt every year and slowly unlever the firm over the period of 10 years. The huge cash flows of the firm will help the organization finance such paying off of debt.

It is also imperative to know that Asian Paints will require access to the Akzo Nobel's technology. Therefore, to ensure that such technology is transferred through proper technology transfer agreements will be in place.

7. Consolidated Balance Sheet of Asian Paints After Acquisition

EQUITY AND LIABILITIES	As at 31 March 2015	As at 31 March 2016	As at 31 March 2017	As at 31 March 2018
Shareholders' funds				
(a) Share capital	96	96	96	96
(b) Reserves and surplus	4134	7894	13687	19829
	4,230.26	7,989.68	13,783.28	19,924.75
Non-current liabilities				
(a) Long Term Borrowings	5840	5237	4634	4031
(b) Deferred tax liabilities (net)	184	223	209	231
(c) Other long-term liabilities	0	3	3	3
(d) Long term provisions	145	164	187	215
(e)Minority Stake	199	279	310	349
	6368	5906	5343	4829
CURRENT LIABILITIES				
(a) Trade payables	1,772.08	2,432.71	3,056.47	3,842.72
(b) Other current liabilities	947.61	1,189.29	1,467.27	1,819.13
(c) Short-term provisions	830.03	668.44	786.41	977.25
	3,549.72	4,290.43	5,310.15	6,639.11
TOTAL	14,148.30	18,186.41	24,436.60	31,392.53
ASSETS				
NON CURRENT ASSETS				
Fixed Assets				
(a) Fixed assets				
(i) Tangible assets	2,402.82	3,211.15	3,457.04	3,677.24
(ii) Intangible Assets	79.07	71.23083333	59.72966667	45.1185
(ii) Capital work-in-progress	138.56	268.90	139.54	139.54
	2,620.45	3,551.28	3,656.31	3,861.90
(b) Non-current investments	826	826	826	826
(c) Long term loans and advances	317	222	257	307
(d) Other non-current assets	14	14	14	14
CURRENT ASSETS				
(a) Current investments	1462	1247	1438	1747
(b) Inventories	2167	2731	3492	4534
(c) Trade receivables	1007	1266	1590	1998
(d) Cash and bank balances	122	3313	7641	12975
(e) Short-term loans and advances	257	369	464	584
(f) Other current assets	267	160	197	245
(g) Goodwill	5089	4487	4259	3469
Total	14,148.30	18,186.41	23,834.34	30,562.28

8. Calculation of Minority Stake & Goodwill

Akzo Nobel	Year	Amount	asian paints	(in Rs. Cr.) minority stake
Shareholding pattern			77.27%	22.73%
pre acquisition profit		873	674.80	198.50
post acquisition profit	2015			
	2016	307	236.95	69.70
	2017	444	343.25	100.97
	2018	614	474.42	139.56
equity share	2015			
	2016	47	36.09	10.61
	2017	47	36.09	10.61
	2018	47	36.09	10.61
Valuation of Stake	2015		674.80	198.50
	2016		947.84	278.82
	2017		1,054.14	310.09
	2018		1,185.30	348.67

Investment by Asian Paints into the shares

Akzo Nobel India Ltd. 41.3

Final Value at which the company is acquired

Akzo Nobel India Ltd. 1703 in Rs. offer price
Promoter's shares 34,044,335

Value of the firm	5,797.75
Stake	34.07
pre acquisition profit	674.80
Goodwill	5,088.88