

Akzo Nobel India

On a colorful growth trajectory

Akzo Nobel India Ltd (Akzo) is one of the leading paint manufacturers in India under the brand name 'Dulux'. Akzo has ~11% share by revenue among the top 5 players. It manufactures and markets a wide range of coatings (contributes ~90%) and specialty chemicals & others (~10%). Akzo has six manufacturing facilities in Hyderabad, Bengaluru, Gwalior, Mohali, Raigad & Navi Mumbai.

Akzo gaining market share: Paint industry has grown at CAGR of ~12% over FY2011-16, and most of the players have reflected the same growth trend, however, Akzo stands out as a front runner, as it has grown at a pace of 20% CAGR over the same period. This implies that the company is steadily increasing its share in the pie and is expected to continue the growth momentum going ahead.

Affordable Housing recovery provides a perfect blend for growth: Real Estate industry had been underperforming since the last few years, however, considering that the government has relaxed the norms to push affordable housing under the scheme 'Housing For All' and given benefits to the first home buyers, we expect a recovery in the Real Estate sector going ahead. We believe Akzo is strongly placed to ride on this wave, as its brand 'Dulux' is well positioned in the premium decorative paints segment (2nd largest after Asian Paints) and the company also has a well planned and instrumental strategy to increase its presence in tier II & III cities through its 8,800 dealer & distributor network, where pricing provides a competitive advantage to 'Dulux' over peers.

New facility in Noida, JV with Atul Ltd & Powder Coating plant in Mumbai: Considering the potential of Indian markets, Akzo is expanding its base and aggressively setting up new facilities. Recently it has commissioned specialty coatings facility and colour laboratory in Noida 600 kl.p.a capacity to service customers from consumer electronics, automobile and cosmetic industries. Secondly, it has entered in JV with Atul Ltd. to produce MCA (monochloroacetic acid) with its latest technology at Atul's existing infrastructure in Gujarat. Finally, to encash the incremental double digit demand in powder coating segment, Akzo is setting up a facility in Mumbai to serve its customers in the Northern and Western parts of India.

Outlook & Valuation: We expect Akzo to report revenue at 11% CAGR to ₹3,773cr and Adj. PAT at 25% CAGR to ₹375cr over FY2016-19E on the back of recovery in the real estate sector, reduced repainting cycle, strong brand and expansion in specialty chemical. Notably, at present, Akzo is at lower valuations as compared to its peers in the industry. EV/Sales for Akzo is at 1.9x FY2019E, whereas all the peers (Asian Paints, Berger Paints & Kansai Nerolac) are above 3x, and the company's EV/EBITDA is in lower teens (11.8x FY2019E), whereas peers are in 20x category. Moreover, Akzo is currently trading at 18.6x P/E on FY2019E EPS, which is below its peers. We believe that the stock provides opportunity at these levels with attractive and relatively cheaper valuations to the peers. **At CMP of ₹1,496, stock trading at 21.6x/18.6x of FY2018E/FY2019E EPS respectively, which we believe is attractive. We Initiate Coverage on the stock, with a 'BUY' recommendation, and a Target Price of ₹1,720 (23x on Avg FY2018 & FY2019 EPS).**

Key Financials

Y/E March (₹ cr)	FY16	FY17E	FY18E	FY19E
Net Sales	2,740	2,955	3,309	3,773
% chg	8.4	7.8	12.0	14.0
Net Profit	192.2	266.7	323.4	375.3
% chg	4.7	38.8	21.3	16.0
EBITDA (%)	11.1	13.3	13.7	13.6
EPS (₹)	41.2	57.2	69.3	80.4
P/E (x)	36.3	26.2	21.6	18.6
P/BV (x)	9.6	8.5	7.2	5.9
RoE (%)	26.4	32.7	33.3	31.8
RoCE (%)	10.3	12.9	14.5	14.9
EV/Sales (x)	2.6	2.4	2.1	1.9
EV/EBITDA (x)	19.9	15.8	13.5	11.9

Source: Company, Angel Research; Note : CMP as of February 27, 2017

BUY

CMP	₹1,496
Target Price	₹1,720

Investment Period	12 Months
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Stock Info

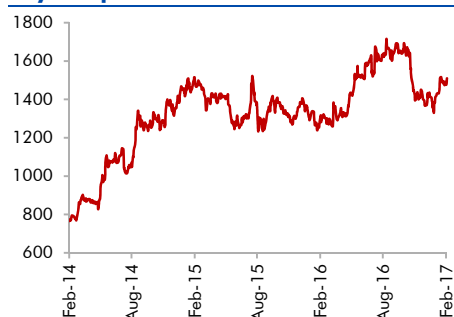
Sector	Paints
Market Cap (₹ cr)	6,999
Net Debt (₹ cr)	(322)
Beta	0.5
52 Week High / Low	1,745/1,204
Avg. Daily Volume	266
Face Value (₹)	10
BSE Sensex	28,817
Nifty	8,899
Reuters Code	AKZO.BO
Bloomberg Code	AKZO@IN

Shareholding Pattern (%)

Promoters	73.0
MF / Banks / Indian Fls	8.4
FII / NRIs / OCBs	1.8
Indian Public / Others	16.8

Abs.(%)	3m	1yr	3yr
Sensex	10.9	23.4	39.6
Akzo Nobel India	7.3	17.7	97.1

3-year price chart



Source: Company, Angel Research

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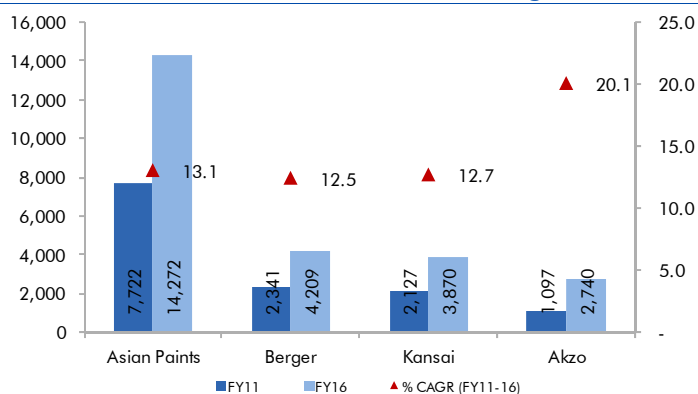
Key investment arguments

Akzo gaining market share

Industry has grown at ~12% CAGR over FY2011-16, while Akzo stands out as front runner with 20% CAGR

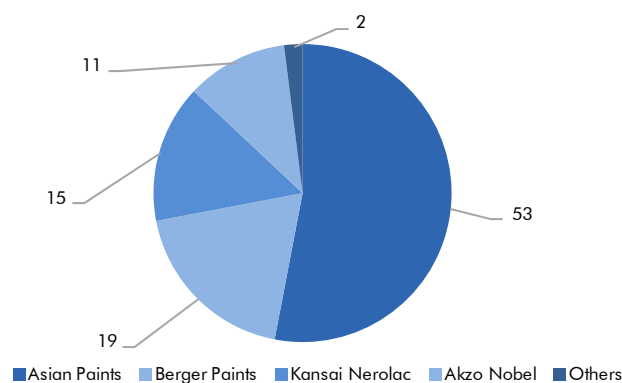
Paints industry is proxy to growth and consumption in the economy. The Indian Paints industry was around ₹40,300cr in FY2014-15 and is expected to reach ₹70,875cr by FY2019-20, according to India Paint Association (IPA). The industry is divided into Decorative & Industrial Paints. The split of the Decorative Paints market to Industrial Paints market is around 75-25 (Decorative Paints market size in India was ₹30,385cr and the Industrial Paints was ₹9,915cr in FY2014-15). Decorative Paints industry is mainly divided into organized players (~65%), whereas remaining is constituted by the unorganized players. Unorganized players predominantly serve the rural part of India where affordability is a bigger criterion than quality & brand. Organized side of the industry is dominated by the 4-5 major players like Asian Paints, Berger Paints, Kansai Nerolac, Akzo Nobel (Dulux) & Shalimar Paints. Asian Paints is the leader in industry with ~53% market share, while Berger Paints 19%, Kansai Nerolac 15% and Akzo Nobel clocks 11% and remaining is shared by other organized players. Paints industry has grown at a CAGR of ~12% over FY2011-16 and most of the players have reflected the same trend, however, Akzo stands out as front runner, as it has grown at the pace of 20% CAGR over same period, which implies it is steadily increasing its share in the pie. We believe Akzo will maintain its historical growth trajectory and will continue to grow at a steady pace. We expect Akzo's revenue to grow at 11.2% CAGR to ₹3,773cr over FY2016-19E, on the back of incremental volumes and price hikes.

Exhibit 1: Revenue FY11-FY16 and CAGR growth



Source: Company, Angel Research

Exhibit 2: Market Share by Revenue



Source: Company, Angel Research

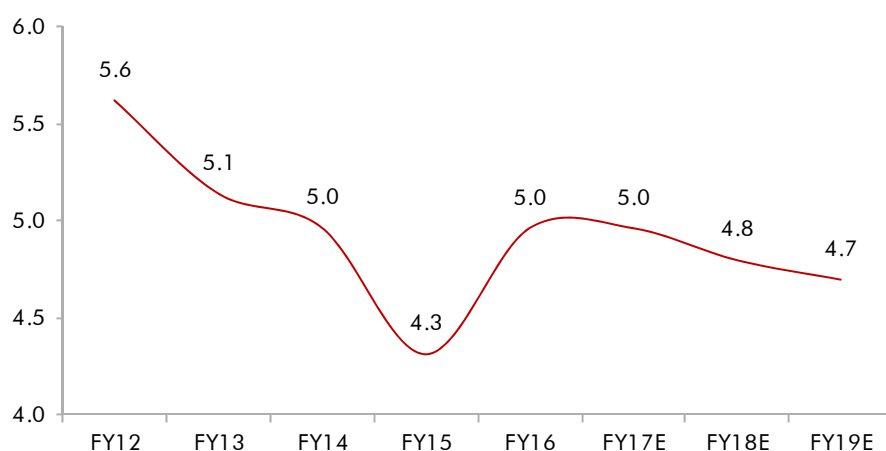
Government's push for Affordable Housing & benefits given to the first home buyer to generate demand for Decorative Paints

Affordable Housing recovery provides a perfect blend for growth

The demand for Decorative Paints is derived from B2B & B2C segments; where B2B part of business serves the real estate developers and B2C business comes either from painting the new house or repainting of the existing house. Repainting of house creates more than 65% of demand and remaining comes from the new property and B2B business. Repainting cycle has shrunk to 4-5years from 7-8years, which has helped the industry volumes to grow with steady pace, but as real estate industry has been underperforming from the last few years, B2B business has witnessed sharp decline. New launches and absorption rates have dropped drastically in the country, which has led to the drop in the B2B business.

However, we are expecting recovery going ahead, as the government has relaxed the norms to push affordable housing under the scheme 'Housing For All' and given benefits to the first home buyers. We believe Akzo is strongly placed to ride on this wave, as its brand 'Dulux' is well positioned in the premium decorative paints segment (2nd largest after Asian Paints) and the company also has a well planned and instrumental strategy to increase its presence in tier II & III cities through its 8,800 dealer & distributor network, where pricing provides a competitive advantage to 'Dulux' over peers. Further, the company spends ~5% of its total revenue towards advertising & promotion in order to increase its brand visibility and penetration, which is a positive for the company. Currently Shraddha Kapoor and Farhan Akhtar are the brand ambassadors for 'Dulux'.

Exhibit 3: Advertising spend (%) of Revenue



Source: Company, Angel Research

New facility in Noida, JV with Atul Ltd & Powder Coating plant in Mumbai

Considering the potential of Indian markets, Akzo is expanding its base and aggressively setting up new facilities. Recently, it has commissioned specialty coatings facility and colour laboratory in Noida 600 kl.p.a capacity to service customers from consumer electronics, automobile and cosmetic industries. Company has invested ₹3cr of investment towards its Noida plant, thus catering to the localization drive undertaken by many large players. Akzo has already commissioned its first phase and is likely to complete its second phase by the end of FY2017, which would provide further scope for expansion. According to the Indian Brand Equity Foundation (IBEF), India is expected to be the fifth largest market for consumer durables by 2025 and is also expected to reach at US\$400bn by 2020, and notably north India is the hub for this sector. The company's rationale behind expanding in Noida is to serve this market better and benefit from the incremental demand. Secondly, the size of the beauty, cosmetic and grooming market is growing fast as well, and is expected to reach US\$20bn, which can be a further demand booster for the company's product line.

Akzo has entered in JV with Atul Ltd. to install a world scale monochloroacetic acid (MCA) plant at Atul's facility in Gujarat. It will use chlorine and hydrogen manufactured by Atul to produce MCA (taking advantage of the Atul's existing

infrastructure) and utilize Akzo Nobel’s latest eco friendly hydrogenation technology for best results. Noida facility will serve the Indian MCA market along with the captive requirement of Atul Ltd.

Finally, in order to encash the incremental double digit demand in powder coating segment, Akzo has broken ground on its new powder coatings plant in Mumbai, India. The investment of ₹63.5cr will allow the company to increase capacity in the region, which forms an important part of its organic growth plans. The new facility will complement Akzo’s existing plant in Bangalore, which is focused on supplying to the Southern and Eastern parts of the country, whereas upcoming facility will focus on the customers in the Northern and Western regions. The Mumbai facility will also produce several new product lines for the Indian market, including bonded metallic powders and localized products for markets such as pipe and re-bar coatings. Revenue from new Mumbai facility will start contributing to the top-line from the 2HFY2018.

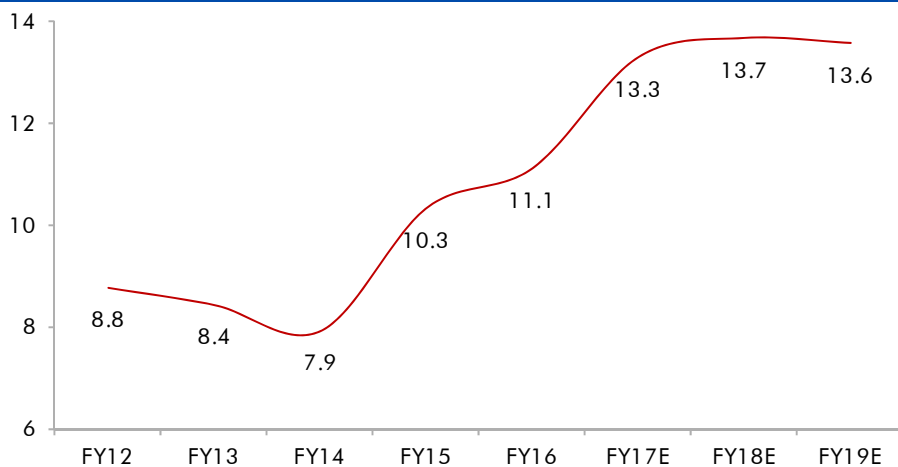
Along with the Greenfield expansion Akzo also took a Brownfield route to further boost the top-line. Akzo India acquired Indian industrial coatings business at ~₹11cr comprising of Functional Materials & Solutions segment which caters to wind energy segment & construction industry. Addition of BASF’s folio will strengthen its position in the industrial coating and deepen its product offering to the present clientele, which will reflect in the top-line going forward.

We believe these new facilities and recent acquisition will certainly contribute to the company’s revenue in coming years.

Operating margins recovering from the bottom

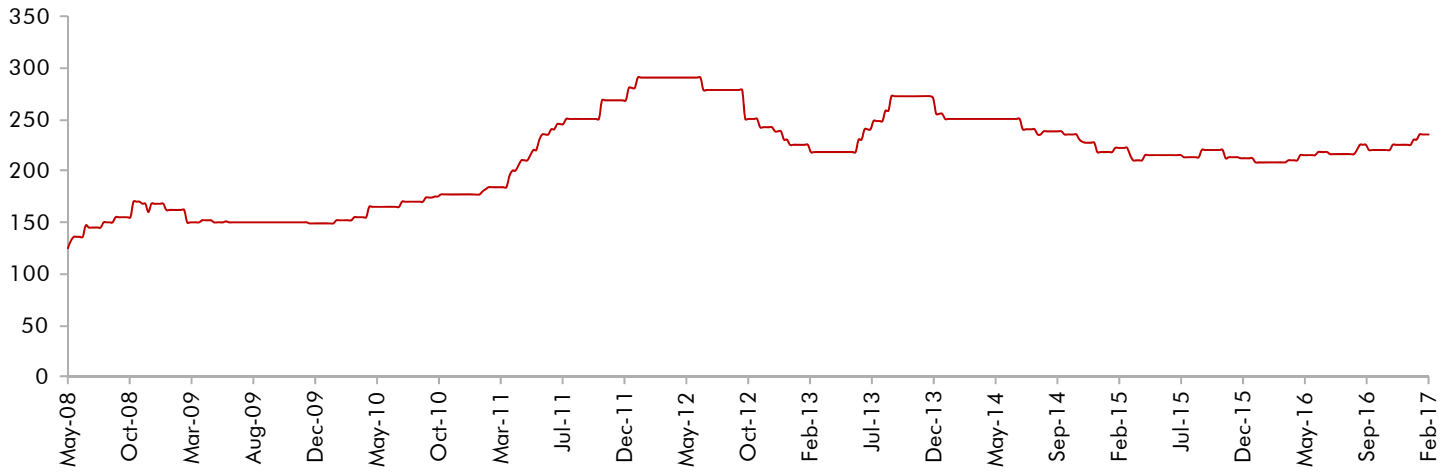
Akzo’s operating margin had taken a dip in FY2012 and remained in the range of 7.8%-8.8% until FY2014 due to the amalgamation of 3 fellow subsidiaries with Akzo operating in the country. Secondly Crude & Titanium dioxide prices were at their highest levels during the same period. Margins witnessed decent recovery of 240bps from the bottom (FY2014) in FY2015 and will continue to inch up as input cost is fairly stable.

Exhibit 4: EBITDA Margin (%)



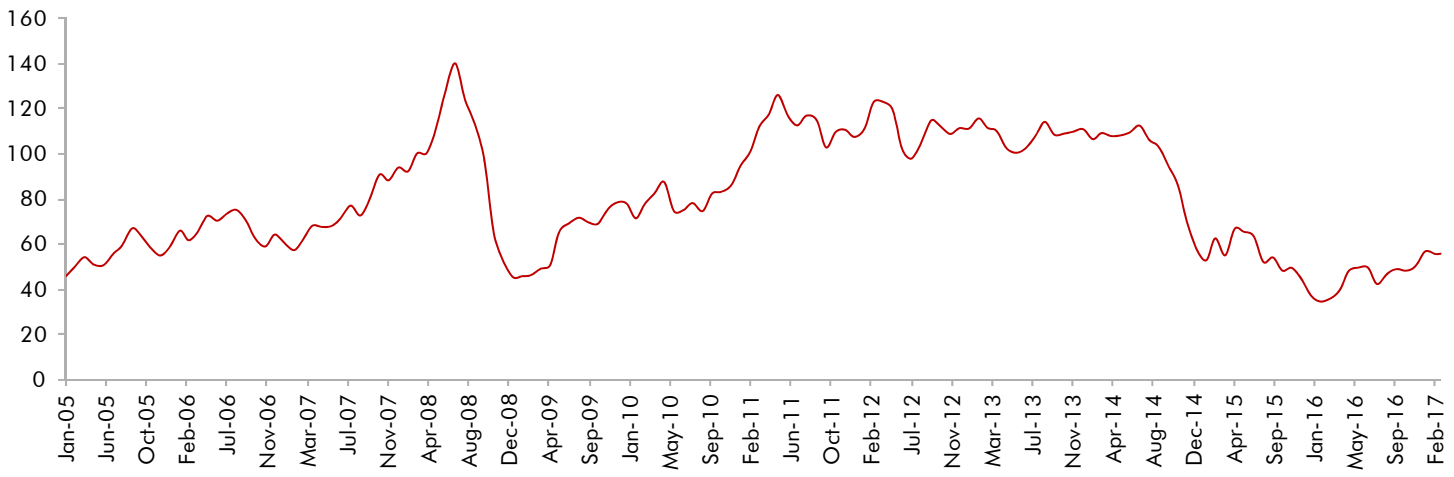
Source: Company, Angel Research

Exhibit 5: Titanium Dioxide Price (₹/kg)



Source: Angel Research, Bloomberg

Exhibit 6: Brent Crude Prices (US\$/b)



Source: Angel Research, Bloomberg

We believe there is further scope for Akzo’s operating margin to improve by 200-250bps from here, on the back of stable input price and the tight cost control by the management on expenditures.

Outlook & Valuation

Considering the recovery in the affordable housing segment, reduced repainting cycle and expansion plan of the Akzo, we believe that the company's revenue would grow at 11% CAGR to ₹3,773cr over the period of FY2016-19E and will steadily increase its market share in the Premium Decorative Paints segment. As Akzo's operating margin is improving, we expect that profitability would also simultaneously witness an upward trend and Adj. PAT will grow at 25% CAGR to ₹375cr over the period of FY2016-19E.

Notably, at present, Akzo is at lower valuations compared to its peers in the industry. EV/Sales for Akzo is at 1.9x FY19E, whereas all the peers (Asian Paints, Berger Paints & Kansai Nerolac) are above 3x, and the company's EV/EBITDA is in lower teens (11.8x FY19E), whereas peers is in 20x category. Moreover, Akzo is currently trading at 18.6x P/E on FY19E EPS, which is below its peers. We believe the stock provides opportunity at these levels with attractive and relatively cheaper valuations to the peers. At CMP of ₹1,496, stock trading at 21.6x/18.6x of FY18E/FY19E EPS respectively which we believe is attractive. We Initiate Coverage on the stock, with a 'BUY' recommendation and Target Price of ₹1,720 (23x on Avg FY18&FY19 EPS).

Peer Analysis

Exhibit 7: Peer Analysis

	Market Cap	EPS			P/E			EV/EBITDA			EV/Sales			ROE (%)		
	(₹ Cr.)	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E
Akzo Nobel	6,980	57.2	69.3	80.4	26.2	21.6	18.6	15.8	13.5	11.9	2.4	2.1	1.9	32.7	33.3	31.8
Asian Paints	96,375	21.8	25.9	27.9	46.2	38.9	36.1	33.5	28.4	23.8	6.7	5.7	4.5	34.4	34.9	35.6
Berger Paints	22,512	4.7	5.6	6.3	49.7	41.2	36.5	25.5	21.3	22.5	3.7	3.1	3.4	27.9	28.4	32.9
Kansai Nerolac	19,269	8.6	10.4	11.4	42.7	35.3	32.2	26.9	22.5	20.57	4.4	3.8	3.5	17.0	17.6	23.3

Source: Angel Research, Bloomberg

Downside risks to our estimates

- Sharp increase in Crude and Titanium dioxide poses a risk to the operating margins, even though some of its incremental input cost will be passed on to the consumers.
- Prolonged pain in the housing segment is a risk to the company's incremental revenue, as it contributes nearly 30-35% of top-line.

Company Background

Akzo Nobel India Ltd (Akzo) is a leading paint manufacturer in India with ~11% market share by revenue among the top 5 players. It manufactures and markets a wide range of coatings and specialty chemicals. It has been present in India for over 100 years and is the fourth largest player in the Paints industry. Over 1,900 people work at Akzo Nobel India in its six production facilities, two state-of-the-art research laboratories and 88 warehouses. Akzo's 8,800 strong dealer/partners network aggressively pushes sales, while the strong MNC backing of Akzo Nobel NV ensures quality products and technical expertise. Akzo has plants at Bangalore, Hyderabad, Mohali, Thane, Gwalior and Raigad. It is broadly into 9 different coating segments including the decorative and the performance (Industrial coatings). Some of the other important verticals include powder coatings, coil coatings, protective coatings, wood coatings, etc. Coating business contributes ~90% of Akzo's revenue, while the remaining 10% comes from specialty chemical & others. The company's decorative segment portfolio is skewed towards premium priced products ('Dulux' brand). In the premium Decorative Paints segment, the company enjoys a market share of around ~22% as compared to its overall market share of ~11%.

Akzo's Decorative Paints business-line manufactures the 'Dulux' brand of paints for interior and exterior decoration and protection as well as products for surface preparation and wood care. The emphasis is on quality, aesthetics and high performance in terms of longevity, washability and stain resistance, anti-colour fading, water proofing, quicker & easier applicability, faster drying time, low VOC and odour, and so on.

Akzo Nobel India's Performance Coatings business-line provides some of the most advanced packaging coatings and inks in the market, protecting everything from food and drinks cans to aerosols and metal closures. Performance coatings have diverse functions and have four applications viz. Industrial Coatings, Powder Coatings, Automotive & Aerospace Coatings, Marine & Protective Coatings.

The Specialty Chemicals business in India deals in more than 30 products grouped under organic peroxides, metal alkyls and polymer additives to pharmaceutical companies, polymer producers, composite and rubber industry.

As a part of its growth strategy, in May 2012, Akzo merged three Indian subsidiaries of Akzo Nobel NV – Akzo Nobel Coatings India, Akzo Nobel Car Refinishes India, and Akzo Nobel Chemicals (India) – by issuing additional share of 11.1mn in accordance with the share swap ratio of the scheme. The merger brought the company's operations in India under a single umbrella. Before merger, Akzo operated in two segments of coating industry – decorative and auto refinish, but after the merger, its operation has increased to 11 segments.

Exhibit 8: Akzo's Product Portfolio

Premium Range	Mid - Range	Economy	Exterior
DSS Colour Bright	Dulux Promise	Maxilite Acrylic Distemper,	Weathershield Max
Dulux Guardian	ICI Magik	ICI Acrylic Distemper	Weathershield
Velvet Touch 'Pearl Glo'	Maxilite	Plastic super smooth	Promise
Velvet Touch 'Trends'	Rainbow Emulsion		WeatherShield Ultra Clean
Dulux satin Finish			WeatherShield Tex
Dulux super Gloss			

Source: Company, Angel Research

Profit & Loss Statement

Y/E March (₹ cr)	FY15	FY16	FY17E	FY18E	FY19E
Total operating income	2,527	2,740	2,955	3,309	3,773
% chg	4.5	8.4	7.8	12.0	14.0
Total Expenditure	2,266	2,435	2,562	2,857	3,261
Raw Material	1,406	1,469	1,545	1,731	1,992
Personnel	206	231	243	261	290
Others Expenses	654	736	774	865	978
EBITDA	261	305	393	453	512
% chg	36.2	16.6	28.9	15.1	13.2
(% of Net Sales)	11.5	12.5	15.3	15.8	15.7
Depreciation & Amortisation	53	53	54	57	63
EBIT	209	251	339	395	449
% chg	40.9	20.4	34.9	16.6	13.5
(% of Net Sales)	9.2	10.3	13.2	13.8	13.8
Interest & other Charges	2	1	1	2	2
Other Income	65	40	43	65	74
(% of PBT)	23.9	13.8	11.4	14.2	14.3
Recurring PBT	272	290	381	459	521
% chg	33.9	6.5	31.4	20.4	13.6
Tax	89	98	114	135	146
(% of PBT)	32.6	33.7	30.0	29.5	28.0
PAT (reported)	184	192	267	323	375
Extraordinary Items	3	10	-	-	-
PAT after MI (reported)	186	202	266	323	375
ADJ. PAT	183	192	266	323	375
% chg	22.3	4.7	38.8	21.3	16.0
(% of Net Sales)	7.3	7.0	9.0	9.8	9.9
Fully Diluted EPS (₹)	39.3	41.2	57.2	69.3	80.4
% chg	(5.3)	4.7	38.8	21.3	16.0

Balance Sheet

Y/E March (₹ cr)	FY15	FY16	FY17E	FY18E	FY19E
SOURCES OF FUNDS					
Equity Share Capital	47	47	47	47	47
Reserves & Surplus	873	682	770	925	1,133
Shareholders Funds	920	729	816	972	1,179
Deferred Tax Liability	11	14	14	14	13
Total Liabilities	931	743	831	986	1,192
APPLICATION OF FUNDS					
Gross Block	581	583	630	626	618
Less: Acc. Depreciation	53	53	54	57	63
Net Block	528	530	576	568	555
Investments	394	546	569	630	726
Current Assets	876	943	989	1,160	1,430
Inventories	365	359	381	432	519
Sundry Debtors	278	318	329	388	474
Cash	60	55	59	96	159
Loans & Advances	159	186	192	213	243
Other Assets	14	25	27	31	35
Current liabilities	868	1,276	1,302	1,373	1,518
Net Current Assets	8	(333)	(314)	(213)	(88)
Total Assets	931	743	831	986	1,192

Cashflow Statement

Y/E March (₹ cr)	FY15	FY16	FY17E	FY18E	FY19E
Profit before tax	275	300	381	459	521
Depreciation	53	54	54	57	63
Change in Working Capital	(35)	65	(14)	(65)	(63)
Interest / Dividend (Net)	2	1	1	2	2
Direct taxes paid	(73)	(113)	(114)	(135)	(146)
Others	(66)	(42)	(11)	0	0
Cash Flow from Operations	155	264	297	318	378
(Inc.)/ Dec. in Fixed Assets	(51)	(39)	(100)	(50)	(50)
(Inc.)/ Dec. in Investments	287	(128)	(23)	(61)	(96)
Others	3	11	0	0	0
Cash Flow from Investing	239	(157)	(123)	(111)	(146)
Issue of Equity	0	0	0	0	0
Dividend Paid (Incl. Tax)	(409)	(112)	(168)	(168)	(168)
Interest / Dividend (Net)	(2)	(1)	(1)	(2)	(2)
Cash Flow from Financing	(406)	(113)	(169)	(170)	(170)
Inc./(Dec.) in Cash	(12)	(5)	4	37	62
Opening Cash balances	72	60	55	59	96
Closing Cash balances	60	55	59	96	159

Key Ratios

Y/E March	FY15	FY16	FY17E	FY18E	FY19E
Valuation Ratio (x)					
P/E (on FDEPS)	38.0	36.3	26.2	21.6	18.6
P/CEPS	29.2	27.3	21.8	18.3	15.9
P/BV	7.6	9.6	8.5	7.2	5.9
Dividend yield (%)	2.7	9.4	4.0	4.0	4.0
EV/Sales	2.8	2.6	2.4	2.1	1.9
EV/EBITDA	21.4	19.9	15.8	13.5	11.9
EV / Total Assets	3.6	3.6	3.3	3.1	2.8
Per Share Data (₹)					
EPS (Basic)	39.3	41.2	57.2	69.3	80.4
EPS (fully diluted)	39.3	41.2	57.2	69.3	80.4
Cash EPS	51.2	54.8	68.7	81.6	94.0
DPS	20.0	70.0	30.0	30.0	30.0
Book Value	197.0	156.2	175.0	208.3	252.7
Dupont Analysis					
EBIT margin	9.2	10.3	13.2	13.8	13.8
Tax retention ratio	0.7	0.7	0.7	0.7	0.7
Asset turnover (x)	1.3	1.4	1.4	1.5	1.5
Operating ROE	20.0	26.4	32.7	33.3	31.8
Returns (%)					
ROCE	9.7	10.3	12.9	14.5	14.9
ROE	20.0	26.4	32.7	33.3	31.8
Turnover ratios (x)					
Asset Turnover (Gross Block)	1.3	1.4	1.4	1.5	1.5
Inventory / Sales (days)	47	45	45	46	48
Receivables (days)	20	21	20	21	23
Payables (days)	60	74	70	65	65
WC cycle (ex-cash) (days)	8	(8)	(4)	2	5
Solvency ratios (x)					
Net debt to equity	-	-	-	-	-
Interest Coverage (EBIT / Int.)	139.2	199.5	240.8	249.4	248.4

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Disclosure of Interest Statement

Akzo Nobel India

1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)