Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Indigo Paints Ltd

Good Quarter; Change in strategy to improve growth prospects

Consumer Goods	Sharekhan code: INDIGOPNTS
Reco/View: Buy ↔	CMP: Rs. 1,697 / Price Target: Rs. 2,250 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 34.82

Updated Feb 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 8,070 cr
52-week high/low:	Rs. 2,736 / 1,376
NSE volume: (No of shares)	0.5 lakh
BSE code:	543258
NSE code:	INDIGOPNTS
Free float: (No of shares)	2.2 cr

Shareholding (%)

Promoters	54.0
FII	37.6
DII	3.6
Others	4.80

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	9.0	-3.7	-26.9	-32.9
Relative to Sensex	14.1	1.6	-19.7	-40.3

Sharekhan Research, Bloomberg

Summary

- Indigo Paints Limited (IPL) posted good performance in an inflationary environment. Revenue grew 13% y-o-y (largely a price led growth) and OPM improved 176 bps y-o-y to 18.6%. PAT grew 39% y-o-y to Rs. 34.6 crore.
- IPL has shifted focus on improving reach/output per dealer in Tier 1 and Tier 2 towns. The company targets to grow 2x the industry in the medium term with revamped focus on large towns and steady growth in smaller towns.
- Revamped strategy is unlikely to impact profitability. Margins will gradually improve post correction in input prices and because of better operating leverage in the medium term.
- IPL's stock price has corrected by 38% from its high and is currently trading at 52.3x and 37.7x its FY2023E and FY2024E earnings. We maintain Buy with a revised PT of Rs. 2,250.

Indigo Paints Limited (IPL) posted yet another quarter of good performance in a tough environment of raw-material inflation and slowdown in consumer demand. Revenue grew by 13.4% y-o-y to Rs. 288.4 crore, largely driven by price increases undertaken in the paint portfolio to mitigate raw-material inflation. Sales volume remained muted as sales remained subdued during January and February due to channel over stocking caused by a steep price increase in Q3FY2022. Most key markets registered double-digit growth ahead of Kerala, which has higher contribution to overall revenue. Gross margin dropped by 305 bps y-o-y to 43.6%, while OPM improved by just 176 bps to 18.6%. Operating profit grew by 25.2% y-o-y to Rs. 53.8 crore and PAT grew by 39.1% y-o-y to Rs. 34.6 crore. For FY2022, revenue and PAT grew by 25.2% and 18.6%, respectively (with OPM declining by 190 bps y-o-y to 15%).

Key positives

- Second consecutive quarter of sequential improvement in gross margins (improved by 72 bps q-o-q to 43.6%).
- OPM expanded by 176 bps y-o-y to 18.6% in Q4 despite input cost inflation and higher advertisement spends.
- Dealer count increased by 545 to 15,787 dealers; Tinting machine count has improved to 7,101 from 5,472 in March 2021.

Key negatives

- Trade channel over bought position during the start of the quarter due to steep price hikes, which led to muted offtake in January and February affecting overall sales volume in Q4.

Management Commentary

- IPL has shifted its strategy by focusing more on expanding its reach and output per dealer in tier 1 and tier 2 cities in the urban market. The company has identified 750 such cities of focus, which are large in India. IPL is focused on intensive engagement with influencers (painters' community) in these towns to improve sales. Benefits of revamped focus and plan initiatives would start flowing from H2FY2023.
- Demand environment remains resilient. The industry witnessed good recovery in demand in April 2022 with good pick-up in volume growth (lower than pre-COVID level sales). Good growth momentum is expected to continue in the coming months because of strong demand from urban markets.
- Price increases of some of the key inputs have gone up significantly in March and have been relatively stable in April-May (but at higher levels). The company has undertaken price increase of 20-22%, in-line with the industry's price hike in FY2022. It has further increased prices by 0.5% in May 2022 and would go for another round of price increase of 0.6-0.7% in June 2022.
- We expect gross margins to be lower in Q1FY2023 due to raw-material price increase at the fag-end of the quarter. However, if raw-material prices stabilise in the coming months, gross margins would sequentially improve in the quarters ahead. Better revenue mix and higher sales volume would help margins to consistently improve in the medium term.

Revision in estimates – We have revised downwards our estimates for FY2023 and FY2024 to factor in lower-than-earlier expected gross margin due to inflated raw-material and lower sales growth.

Our Call

View: Maintain Buy with a revised PT of Rs. 2,250: IPL is focusing on gaining share in tier 1 and tier 2 cities where it has relatively good dealer presence. Revamped strategy will help the company to grow ahead of the industry's growth in the medium term (IPL targets growth of 2.0x the industry's growth). This will help the company to achieve consistent revenue growth of 30% over FY2022-FY2024. This along with OPM expansion will enable PAT to post a 60% CAGR over FY2022-FY2024. The stock has corrected by ~38% from its high and is currently trading at 52.3x/37.7x its FY2023/FY2024E EPS. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 2,250.

Key Risks

Increased competitive pressures from large players or a sustained rise in key input prices would act as a key risk to our earnings estimates.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	723	906	1,202	1,523
OPM (%)	16.9	15.0	18.6	20.4
Adjusted PAT	71	84	154	214
% Y-o-Y growth	*48.2*	*18.6*	*83.8*	*38.6*
Adjusted EPS (Rs.)	14.9	17.7	32.5	45.0
P/E (x)	-	96.0	52.3	37.7
P/B (x)	14.3	12.4	11.8	10.3
EV/EBITDA (x)	63.5	57.4	35.0	24.8
RoNW (%)	18.6	13.9	23.1	29.2
RoCE (%)	23.3	18.1	29.5	37.3

Source: Company; Sharekhan estimates

Revenue grew by 13.4% y-o-y; OPM improved by 176 bps q-o-q aided by price hikes

IPL's revenue grew by 13.4% y-o-y to Rs. 288.4 crore in Q4FY2022, largely driven by price increases, with muted volume growth. Gross margin decreased by 305 bps y-o-y to 43.6%. However, the same improved by 72 bps q-o-q mainly on account of price hikes and better revenue mix. OPM improved by 176 bps y-o-y to 18.6%, aided by lower media spends during the quarter. Operating profit grew by 25.2% y-o-y to Rs. 53.8 crore and reported PAT grew by 39.1% y-o-y to Rs. 34.6 crore. For full year FY2022, IPL's revenue grew by 25.3% y-o-y to Rs. 906 crore. Growth was largely price led as the company undertook multiple price hikes to the extent of 20-22% in FY2022. Gross margin decreased by 463 bps y-o-y to 43.3%, impacted by high raw-material prices. Advertisement and promotional spends at Rs. 87.9 crore were higher by 13.5% y-o-y. Higher advertisement spends and higher raw-material prices led to a 193-bps y-o-y decline in OPM to 15%, partially mitigated by price hikes undertaken during the year. Operating profit grew by 11% y-o-y to Rs. 136 crore. Higher other income and lower interest expense led to 18.6% y-o-y growth in reported PAT to Rs. 84 crore. The board declared a dividend of Rs. 3 per equity share of face value of Rs. 10 per share for FY2022.

Key Conference call takeaways

- **Shift in focus to tier 1/tier 2 towns –** After attaining certain scale in tier 3 and tier 4 towns, IPL has shifted its focus on tier 1 and tier 2 towns to achieve strong growth in the coming years. Tier 3/4 towns currently contribute 25% to overall sales of IPL. The company has identified 750 large cities (excluding top metros), where it is planning to increase its sales. The company has good active dealer network in these towns, but output per dealer is very low. Thus, the company is focusing on increasing output per dealer by focusing on intensive engagement with influencers' (painters) community in these cities. This will not result in incremental cost and, hence, will not materially affect margins. Benefits of these initiatives will start flowing in from second half of the year. Overall, management expects the shift strategy would help in achieving strong double-digit revenue growth ahead of the industry.

- **Subdued demand growth in Q4; Expected to recover –** Sales were impacted in January and February due to channel over stocking caused by steep price hikes in Q3FY2022, leading to muted sales volumes during these months. However, volumes recovered in March and have witnessed good traction over April/May. IPL reported good sales traction in Kerala and strong double-digit growth momentum continued. The company aims to maintain a balance between volume growth and margin protection and will not opt for volume growth against losing margins.

- **FY2022 growth was a mix of value and volume growth –** Most categories registered good volume and value growth during the year. Emulsions category reported the highest volume/value growth of 21.7%/39.8%, respectively, in FY2022. Cement paints and putty reported volume growth of 3.9% and value growth of 7.9% during the year. Enamels and wood coatings category's volume grew by 2.9%, while value growth stood at 16%. Primers, distempers, and other categories registered volume and value growth of 5.4% and 21.4%, respectively.

- **Price hikes help to mitigate input cost inflation –** The entire paint industry took sharp price hikes in Q3FY2022. In Q4FY2022, raw-material prices remained stable in January and February but surged in March. Consequently, marginal price increases were undertaken in May and one more round of marginal price hike (0.6-0.7%) is expected to be announced in the first week of June. Prices are stable for now, but there is uncertainty regarding prices in the medium to long term. At FY2022-end, prices were higher by 20-22% y-o-y for most products. In terms of category of products, putty prices were higher by 4-5%, while price hikes in emulsion were higher to the extent of ~20%.

- **Distribution network expansion continued –** IPL opened two new depots in Q4FY2022, one at Himachal Pradesh and the other at Delhi. The company also increased its active dealer count from 15,242 in FY2021 to 15,787 in FY2022, while the tinting machine count has gone up to 7,101 in FY2022 from 6,749 in FY2021.

- **Focus on engagement with the painter community –** Management indicated that IPL has strong dealer engagement in Tier 3 and 4 cities (currently 25% revenue comes from these cities) and now the company plans to shift focus to Tier 1 and 2 cities. The company plans to arrange for campaigns, which will concentrate on engaging with the painter community in these cities. As per management, IPL's dealer network in these cities is strong but now the company aims to improve output per dealer in these cities. Output/dealer is 5x in Tier 3 and 4 cities as compared to Tier 1 and 2 cities.

- **Stable gross margin from Q2/Q3 FY2023 –** As indicated by the management, supply chain issues have eased out and raw material availability has improved. With stabilising raw-material prices, gross margins are expected to gradually improve from Q2FY2023.
- **Continued focus on advertisement expenses –** Advertisement expenses continued to grow in FY2022. IPL will continue to focus on brand building through investing in build brand equity. In FY2023 as well, the company has planned to incur good investment on advertisement. However, total advertisement spends as a percentage of revenue are expected to decline.
- **Capacity expansion on track –** Construction of Tamil Nadu plant has delayed a bit and the plant is now expected to be commissioned by Q3FY2023 (Q2FY2023 earlier). The company added two product lines in Q4FY2022. Management indicated that peak capacity utilisation is a better measure to access the performance of paint companies rather than average capacity utilisation. Most paint companies witness two peaks during a year – one in November and the other in March/April. The company plans for capacity expansion 1-1.5 years ahead of peak capacity utilisation.

Results (Standalone) Rs cr

Particulars	Q4FY22	Q4FY21	Y-o-Y %	Q3FY22	Q-o-Q %
Net revenue	**288.4**	**254.3**	**13.4**	**265.5**	**8.6**
Material cost	162.6	135.6	19.9	151.6	7.3
Employee cost	14.3	13.7	4.9	14.6	-1.5
Other expenses	57.6	62.0	-7.1	60.6	-4.9
Total expenditure	234.6	211.3	11.0	226.8	3.5
Operating profit	**53.8**	**42.9**	**25.2**	**38.7**	**39.0**
Other income	2.5	1.6	59.0	2.3	8.3
Interest expenses	0.5	0.4	21.8	0.3	85.8
Depreciation	8.3	7.0	19.4	7.9	5.8
Profit Before Tax	**47.4**	**37.1**	**27.8**	**32.8**	**44.4**
Tax	12.8	12.2	4.8	8.5	50.4
Adjusted PAT	**34.6**	**24.9**	**39.1**	**24.3**	**42.3**
EPS (Rs.)	0.7	0.5	39.1	0.5	42.3
			bps		**bps**
GPM (%)	43.6	46.7	-305	42.9	72
OPM (%)	18.6	16.9	176	14.6	408
NPM (%)	12.0	9.8	222	9.2	284
Tax rate (%)	27.1	33.0	-595	26.0	108

Source: Company, Sharekhan Research

Category-wise volume/Value growth in FY2022

Product Category	Value growth (y-o-y %)	Volume growth (y-o-y %)
Cement Paints + Putty	7.9	3.9
Emulsions	39.8	21.7
Enamels + Wood Coatings	16	2.9
Primers + Distempers + Others	21.4	5.4

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Structural growth of the paint industry is intact

The Indian paints industry reported an 11% CAGR over FY2011-FY2019 and stood at Rs. 545 billion. The decorative paint segment constitutes around 74% of total paint sales, resulting in the paint sector growing at a robust rate even at the time of an industrial slowdown. April and May (that constitute ~25% of total per annum sales) are two key months for re-painting activities in the domestic market. FY2021 was affected by the pandemic, led by lockdown, resulting in almost no business in Q1FY2021. Volatile input prices and slowdown in rural India are near-term headwinds for the paint industry. The decorative paint industry is expected to post a 13% CAGR over FY2019-FY2024, led by reduction in the repainting cycle to 4-5 years (from 8-10 years earlier), acceptance for better paint products in smaller towns, and upgradation of premium brands in cities and large towns. Higher input prices will keep a toll on margins of paint companies in the near term.

■ Company Outlook – Growth momentum to sustain

Revenue grew by 25.3%, while operating profit grew by 11% in FY2022. Growth was supported by better mix coupled with price hikes undertaken to mitigate the impact of inflated raw-material prices. The company expects strong sales volume growth (2x of industry) in the coming quarters because of its renewed focus on increasing the output per dealer in tier 1 and 2 cities. Rising urbanisation, willingness to spend on home improvement, strong traction to differentiate products, distribution expansion, and market share gains would help IPL to grow faster than the industry in the coming years. Scale-up in the business will help OPM improve further and reach ~20% in FY2024.

■ Valuation – Maintain Buy with a revised PT of Rs. 2,250

IPL is focusing on gaining share in tier 1 and tier 2 cities where it has relatively good dealer presence. Revamped strategy will help the company to grow ahead of the industry's growth in the medium term (IPL targets growth of 2.0x the industry's growth). This will help the company to achieve consistent revenue growth of 30% over FY2022-FY2024. This along with OPM expansion will enable PAT to post a 60% CAGR over FY2022-FY2024. The stock has corrected by ~38% from its high and is currently trading at 52.3x/37.7x its FY2023/FY2024E EPS. We maintain our Buy recommendation on the stock with a revised PT of Rs. 2,250.

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Asian Paints	96.0	73.9	56.5	58.5	47.0	36.9	19.5	22.5	25.2
Berger Paints	69.6	55.4	45.7	40.2	33.6	20.8	25.8	28.1	28.9
Indigo paints	96.0	52.3	37.7	57.4	35.0	24.8	18.1	29.5	37.3

Source: Company, Sharekhan estimates

About company

Incorporated in 2000, IPL is the fifth largest paint company in India. The company started its operations by manufacturing lower-end cement products and gradually expanded its range to cover most segments of water-based paints such as exterior emulsions, interior emulsions, distempers, and primers. The company kept churning out bright new ideas for painting solutions, with alarming regularity. IPL introduced India's first metallic paint, first floor coat paint, unique ceiling coat paint, and first-of-its-kind paint for roofs. Differentiated products contribute ~30% to the company's revenue. The company has a growing dealership base of 15,500+ dealers covering 27 states.

Investment theme

IPL is the fastest growing paints companies in India, which has carved a niche for itself by developing and marketing differentiated products to establish its position in the high entry barrier paint industry. The company has the highest gross margin of 48% among paint companies. The differentiated business model aided the company to achieve strong top and earnings growth of 19% and 46% over FY2019-FY2022, respectively, with the highest gross margin of ~43% among peers. Though near-term pandemic-led uncertainties would impact growth, rising urbanisation, willingness to spend on home improvement, strong traction to differentiate products, and market share gains would help IPL to achieve faster recovery in the coming years.

Key Risks

- Increased raw-material prices: Any significant increase in crude prices and other input costs will affect the company's profitability.
- Delay in capacity expansion: Delay in capacity expansion plan due to any regulatory hurdle or any other reason would affect the company's future growth prospects.
- Company does not enter into long-term arrangements with dealers: IPL presently does not have any long-term or exclusive arrangements with any of the dealers and cannot assure that it will be able to sell the same quantities as it supplied historically to such dealers.

Additional Data

Key management personnel

Hemant Jalan	MD and Chairman
Thundiyil Surendra Suresh Babu	COO
Chetan Bhalchandra Humane	CFO
Sujoy Bose	Company Secretary and Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SCII V	14.81
2	Sequoia Cap India Inv Hldg	13.73
3	Small Cap World Fund Inc.	2.07
4	Capital Group Cos Inc.	2.07
5	ICICI Prudential Life Insurance Co.	1.89
6	Ashoka India OPP FD	1.86
7	Emirate of Abu Dhabi United Arab Emirates	1.35
8	Nomura Holdings Inc.	0.69
9	Invesco Asset Management India Pvt. Ltd.	0.24
10	Ashoka India Equity Investments	0.23

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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