Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Indigo Paints Ltd

Strong Q1; eyeing better growth ahead

Consumer Goods	Sharekhan code: INDIGOPNTS

Reco/View: Buy	↔	CMP: Rs. 1,562	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 July 08, 2022

Medium Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 7,430 cr
52-week high/low:	Rs. 2,689 / 1,375
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	37.7
DII	3.4
Others	4.86

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	8.7	4.8	-21.0	-40.1
Relative to Sensex	0.1	-1.7	-20.6	-47.2

Sharekhan Research, Bloomberg

Summary

- Indigo Paints Limited (IPL) posted strong numbers amid high input cost inflation. Revenue grew 44% y-o-y (3-years CAGR stood at 17%) and OPM improved 283 bps y-o-y to 15.7%. PAT grew 72% y-o-y to Rs. 20 crore.
- Change in strategy of improving reach/output per dealer in Tier 1 and Tier 2 towns is seeing some green shoots. Incremental revenues from strategy changes would start flowing in from Q3FY2023.
- Key input prices (including emulsion monomers, titanium oxide & packaging material) have corrected from highs and company will continue to see sequential improvement in the gross margins in the coming quarters.
- Stock trades at 48.1x and 34.7x its FY2023E and FY2024E earnings. We maintain Buy with an unchanged PT of Rs. 2,250.

Indigo Paints Limited (IPL) posted sturdy numbers in a tough environment of raw material inflation and slowdown in consumer demand. Revenue grew by 43.6% y-o-y to Rs. 224.0 crore on a low base of Q1FY2022 (3 years CAGR revenue growth stood at 17%). Revenue growth was driven by mix of volume and value. However, price-led growth stood at ~30% while volume growth stood in mid-teens. The company witnessed good sales growth in both Kerala and Rest of India. Better product mix, lower trade spends and price hikes in the portfolio helped in corrected sharp y-o-y fall in gross margins to 33 bps (improved by 158 bps on q-o-q). The OPM improved by 283 bps y-o-y to 15.7%. Operating profit grew by 75% y-o-y to Rs. 35.3 crore and PAT grew by 71.5% y-o-y to Rs. 20 crore.

Key positives

- Third consecutive quarter of sequential improvement in gross margins; improved by 158 bps q-o-q to 45.2% highest as compared to peers.
- Emulsions (highest value contributor to revenues) registered 65.7% value growth and 34.4% volume growth.
- Dealer count increased by 739 to 16,526 dealers; tinting machine count improved to 7,435 from 5,800 in March 2021.

Key negatives

- Primers & distemper volumes grew by just 2.4%.

Management Commentary

- IPL has shifted its strategy by focusing more on expanding its reach and output per dealer in tier-1 and tier-2 urban cities. It is focused on intensive engagement with influencers (painters' community) in these towns to improve sales. The strategy is already showing some green shoots. The incremental revenues from same would start flowing from Q3FY2023.
- Indigo has launched a range of budget exterior emulsions and more economical variants of distempers. The company is planning to enter the industrial paints segment by entering into strategic tie-up with formidable international player in the coming years.
- Prices of some of the key inputs such as emulsion monomers, titanium dioxide and packaging material has corrected from its high in last six months. If prices continued to decline or remain stable in the coming months, the company will see y-o-y substantial improvement in the margins from Q3FY2023.
- Advertisement spends will increase by 5-10% on an absolute basis and hence advertisement spends as percentage to sales will continue decline in the coming years. FY2023 advertisement spends to sales will be 8-8.5%.

Revision in estimates – We broadly maintain our earnings estimates for FY2023 and FY2024 and will keenly monitor the performance in the coming quarters.

Our Call

View: Maintain Buy with an unchanged 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 beat industry growth in the medium term (IPL targets growth at twice 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 from its high and is currently trading at 48.1x/34.7x 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)	-	88.4	48.1	34.7
P/B (x)	13.2	11.4	10.8	9.5
EV/EBIDTA (x)	58.3	52.7	32.1	22.8
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 43.6% y-o-y; OPM improved by 283 bps on y-o-y basis

Revenues grew by 43.6% y-o-y to Rs. 224 crore, ahead of our and average street expectation of Rs. 180 crore and Rs. 203 crore, respectively. Revenue growth was driven by mix of volume and value with price hikes taking lead over volume. Better product mix, lower trade spends and price hikes in the portfolio helped in corrected sharp y-o-y fall in gross margins to 33 bps (improved by 158 bps on QoQ). The OPM improved by 283 bps y-o-y to 15.7%. Operating profit grew by 74.9% y-o-y to Rs. 35.3 crore and 71.5%y-o-y increase in the PAT to Rs. 19.9 crore (ahead of our and average street expectation of Rs. 10-17 crore). The company has achieved price-led growth in most of its categories. Emulsions (contributing over 50% to overall revenues) registered a value growth of 66% and volume growth of 34%. Primers & distempers registered a value growth of 28% with volume growth of 2.4%.

Key Conference call takeaways

- **Shift in focus to tier 1/tier 2 towns:** IPL has identified 750 large cities, 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. The company is focusing on increasing output per dealer by focusing on intensive engagement with influencers' (painters) community in these cities. Strategy on increasing the presence in the Tier-1 and Tier-2 cities are showing early indications of traction and are expected to yield rich results in the next 2-3 quarters. Overall, management expects the shift strategy would help in achieving strong double-digit revenue growth, ahead of the industry.
- **Distribution network continued to expand –** IPL increased its active dealer count from 15,787 in Q4FY2022 to 16,526 in Q1FY2023, while the tinting machine count rose to 7,435 from 7,101 in Q4FY2022.
- **Product launches and likely entry into industrial paints:** IPL has launched a range of budget exterior emulsions and more economical variants of distempers. The company is planning to enter the industrial paints segment by entering into strategic tie-up with formidable international player in the coming years.
- **New brand ambassador for Kerala –** IPL has strong presence in Kerala with more than 30% of revenues coming from the state. To improve its position further the market, the company is planning for regional advertising. To this end the company has signed on Mr. Mohan Lal as Brand Ambassador.
- **Profitability to improve in the quarters ahead:** A rise in prices of some of the key inputs such as emulsion monomers, titanium dioxide (down by 20%) and packaging material has corrected from its high in last six months. If prices continue to decline or remain stable in the coming months, the company will see y-o-y substantial improvement in margins from Q3FY2023.
- **Continued focus on advertisement expenses –** IPL will continue to focus on brand building through investments on building 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 –** The company is making good progress in expansion of the Tamil Nadu plant and the plant is expected to be commissioned by Q3FY2023 (Q2FY2023 earlier).

Results (Standalone) Rs cr

Particulars	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Net revenue	**224.0**	**156.0**	**43.6**	**288.4**	**-22.3**
Material cost	122.8	85.0	44.4	162.6	-24.5
Employee cost	16.6	13.6	22.1	14.3	15.8
Other expenses	49.3	37.3	32.4	57.6	-14.4
Total expenditure	188.7	135.9	38.9	234.6	-19.6
Operating profit	**35.3**	**20.2**	**74.9**	**53.8**	**-34.4**
Other income	0.5	3.0	-83.9	2.5	-80.6
Interest expenses	0.4	0.3	68.1	0.5	-20.4
Depreciation	8.4	7.4	14.6	8.3	1.3
Profit Before Tax	**26.9**	**15.6**	**72.7**	**47.4**	**-43.2**
Tax	7.0	4.0	76.2	12.8	-45.4
Reported PAT	**19.9**	**11.6**	**71.5**	**34.6**	**-42.4**
EPS (Rs.)	0.4	0.2	71.5	0.7	-42.4
			bps		**bps**
GPM (%)	45.2	45.5	-33	43.6	158
OPM (%)	15.7	12.9	283	18.6	-290
NPM (%)	8.9	7.4	145	12.0	-310
Tax rate (%)	26.0	25.5	51	27.1	-105

Source: Company, Sharekhan Research

Category-wise volume/Value growth in Q1FY2023

Product Category	Value growth (%)	Volume growth (%)
Cement paints + Putty	22.7	12.7
Emulsions	65.7	34.4
Enamels + Wood Coatings	38.1	15.8
Primers + Distempers + Others	28.0	2.4

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 paints 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. The industry is expected to post strong growth in Q1FY2023 on back of low base of Q1FY2022 (affected by the pandemic) and price hikes of over 20% (implemented to mitigate pricing pressures). Volatile input prices and slowdown in the rural India are near-term headwinds for paint industry. The decorative paints 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. Better product mix and efficiencies would help paint companies to post higher margins in the long run.

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 an unchanged 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 beat industry growth in the medium term (IPL targets growth at twice 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 from its high and is currently trading at 48.1x/34.7x its FY2023/FY2024E EPS. We maintain our Buy recommendation on the stock with a revised price target (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	-	78.7	61.3	64.0	50.3	40.2	19.5	23.0	25.2
Berger Paints	68.3	56.7	46.9	44.3	36.0	29.7	19.4	20.0	21.5
Indigo paints	88.4	48.1	34.7	52.7	32.1	22.8	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	2.32
4	Capital Group Cos Inc	2.32
5	Ashoka India OPP FD	1.86
6	ICICI Prudential Life Insurance Co.	1.76
7	Emirate of Abu Dhabi United Arab Emirates	1.35
8	Nomura Holdings Inc	0.43
9	Caisse de Depot et Placement du Quebec	0.37
10	Invesco AMC	0.22

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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