Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Indigo Paints Ltd

Q2 retains colour in seasonally weak quarter

Consumer Goods	Sharekhan code: INDIGOPNTS
Reco/View: **Buy** ⇔	CMP: **Rs. 1,496**
	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 Oct 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. 7,118 cr
52-week high/low:	Rs. 2,398 / 1,375
NSE volume: (No of shares)	0.6 lakh
BSE code:	543258
NSE code:	INDIGOPNTS
Free float: (No of shares)	2.2 cr

Shareholding (%)

Promoters	54.0
FII	37.5
DII	3.1
Others	5.43

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-0.1	-2.3	1.0	-37.4
Relative to Sensex	-5.2	-6.3	-11.3	-38.4

Sharekhan Research, Bloomberg

Summary

- Indigo Paints Limited (IPL) posted strong performance in a seasonally weak quarter. Revenues grew 24% y-o-y (largely a price-led growth) and OPM improved 200 bps y-o-y to 13.9%. PAT grew 53% y-o-y to Rs. 20.8 crore.
- A change in strategy of improving reach/output per dealer in Tier-1 and Tier-2 towns is seeing some green shoots. Dealers' revenue contribution from tier 1 towns is 2-3 times higher as compared to dealer revenue contribution from tier 3/4 towns.
- Key input prices have corrected from highs and are currently stable that will help margins improve in H2FY2023. Management expects a good recovery in sales in Q3/Q4 unless there is any volatility in the commodity prices.
- Stock has corrected from highs and is trading at reasonable valuation of 33.3x its FY2024E earnings. We maintain Buy with an unchanged PT of Rs. 2,250.

Indigo Paints Limited (IPL) clocked strong numbers in a seasonally weak quarter, which was impacted by extended monsoon. Revenue grew by 23.7% y-o-y to Rs. 242.6 crore on a low base of Q2FY2022. Revenue growth was driven by mix of volume and value (with price led growth staying ahead of volume growth). The company witnessed good sales growth in state of Kerala and other large towns. Price hikes aided the gross margins to remain flat on y-o-y basis. OPM improved by 200 bps y-o-y to 13.9% led by better efficiencies. Operating profit grew by 45% y-o-y to Rs. 33.8 crore and PAT grew by 53.2% y-o-y to Rs. 20.8 crore. An excess tax provision of Rs. 16.33 crore pertaining to earlier years has been reversed. Reported PAT stood at Rs. 37.1 crore.

Key positives

- Volume growth in the enamels + woodcoating stood strong at 29%.
- OPM improved by 200 bps y-o-y to 13.9%.
- Dealer count increased by 232 to 16,758 dealers; tinting machine count improved to 7,716 from 6,383 in September 2021.

Key negatives

- Emulsions sales volume decreased by 4.2% y-o-y in Q2.

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 yielding good results for the company. Dealer output in tier 1 and tier 2 towns is 2-3x higher as compared to tier 3-4 towns. The increase in contribution from tier 1 and tier 2 with helps revenues to grow strongly in the coming years.
- With some of the key input prices have stabilised from its high, the company will see y-o-y substantial improvement in the margins in the coming quarters.
- 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%.
- The upcoming plant in Tamil Nadu is in the final stage of completion and is expected to be commissioned in Q4 (earlier expected to be commissioned by Q3FY23).

Revision in estimates – We broadly maintain our earnings estimates for FY2023 and FY2024 and will keenly monitor performance in the coming quarters. We have introduced FY2025E earnings through this note.

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 IPL to achieve consistent revenue growth of 26.5% over FY2022-FY2025. This along with OPM expansion will enable PAT to post a 48% CAGR over FY2022-FY2025. Stock has corrected from its high and is currently trading at 46.1x/33.3x its FY2023/FY2024E EPS. We maintain a Buy on the stock with an unchanged 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	FY25E
Revenue	723	906	1,202	1,523	1,832
OPM (%)	16.9	15.0	18.6	20.4	21.0
Adjusted PAT	71	84	154	214	272
% Y-o-Y growth	48.2	18.6	83.8	38.6	27.0
Adjusted EPS (Rs.)	14.9	17.7	32.5	45.0	57.2
P/E (x)	-	84.7	46.1	33.3	26.2
P/B (x)	12.6	11.0	10.4	9.1	7.6
EV/EBIDTA (x)	55.7	50.4	30.7	21.8	17.3
RoNW (%)	18.6	13.9	23.1	29.2	31.7
RoCE (%)	23.3	18.1	29.5	37.3	40.8

Source: Company; Sharekhan estimates

Strong Q2 despite seasonally weak quarter

IPL reported a strong 23.7% y-o-y revenue growth to Rs. 242.6 crore despite extended monsoons during the quarter. Revenue growth is largely price-led growth with price hikes undertaken across categories. Emulsions (contributing over 50% to overall revenues) registered a value growth of 17.4% and volume decline of 4.2%. Primers & distempers registered a value growth of 22.4% with volume growth of 13.1%. Despite a change in the product mix due to extended monsoons, gross margins remained flat y-o-y while OPM increased by 200 bps y-o-y to 13.9%. Operating profit grew by 44.5% y-o-y to Rs. 33.8 crore. The company reversed an excess tax provision of Rs. 16.33 crore pertaining to earlier years (exceptional items), resulting in 53.2% y-o-y growth in the adjusted PAT to Rs. 20.8 crore. Reported PAT came in at Rs. 37.1 crore. For H1FY2023, revenue came in at Rs. 466.6 crore, registering a y-o-y growth of 32.5%, while adjusted Pat came in at Rs. 40.7 crore, up by 25.1% y-o-y and OPM expanded by 243 bps y-o-y to 14.8%.

Key conference call highlights

- **Weak quarter for exterior application products:** Q2 which is generally a seasonally low demand quarter characterized by inferior product mix was further accentuated by excessive rains in select states and extended monsoons across the country which impacted the sales of products for exterior applications in general.
- **Value growth ahead of volume growth across categories:** Due to several rounds of price increases undertaken in the span of one year, the y-o-y value growth in each category is higher than volume growth in Q2FY2023. Emulsions registered a value growth of 17.4% and volume decline of 4.2%. Primers & distempers registered a value growth of 22.4% with volume growth of 13.1%. Cement paints and putty delivered value/volume growth of 16.3%/6.2%, respectively. Enamels and wood coatings delivered value growth of 46.9% and volume growth of 28.8%.
- **Continued A&P spends for brand building** – The management has guided that IPL will continue to focus on brand building through investments in advertisement & promotions. In line with this brand building strategy, the company continued to spend on A&P in Q2FY2023. The A&P expense for the quarter was down by 7.13% y-o-y on a high base of last year due to higher investments in Q2FY2022 as IPL schedule was split between April and September in 2022. However, in H1FY2023, overall A&P increased by 13.56% y-o-y. The company launched a new marketing campaign to promote differentiated products in Kerala with Mr. Mohan Lal as Brand Ambassador.
- **Network expansion continued** – IPL increased its active dealer count from 16,526 in Q1FY2023 to 16,758 in Q2FY2023, while the tinting machine count rose to 7,716 from 7,435 in Q1FY2023. The management has indicated that the company will continue to increase active dealer count and tinting machine population, especially in larger towns.
- **Tamil Nadu plant to be commissioned by Q4** – The company is making good progress in expansion of the Tamil Nadu plant and it is expected to be commissioned by Q4FY2023 (Q3FY2023 earlier).

Results (Standalone) **Rs cr**

Particulars	Q2FY23	Q2FY22	Y-o-Y %	Q1FY23	Q-o-Q %
Net revenue	**242.6**	**196.1**	**23.7**	**224.0**	**8.3**
Material cost	141.4	114.3	23.7	122.8	15.2
Employee cost	17.5	13.8	26.5	16.6	5.6
Other expenses	49.9	44.6	11.9	49.3	1.2
Total expenditure	208.8	172.7	20.9	188.7	10.7
Operating profit	**33.8**	**23.4**	**44.5**	**35.3**	**-4.3**
Other income	3.2	3.0	4.6	0.5	555.7
Interest expenses	0.3	0.3	3.4	0.4	-37.5
Depreciation	8.5	7.7	10.2	8.4	0.7
Profit Before Tax	**28.2**	**18.5**	**52.8**	**26.9**	**4.8**
Tax	7.4	4.9	51.5	7.0	6.4
Adjusted PAT	**20.8**	**13.5**	**53.2**	**19.9**	**4.3**
Extra-ordinary gain/loss	16.3	0.0	-	0.0	-
Reported PAT	**37.1**	**13.5**	**173.7**	**19.9**	**86.3**
EPS (Rs.)	0.4	0.3	53.2	0.4	4.3
			bps		**bps**
GPM (%)	41.7	41.7	-1	45.2	-347
OPM (%)	13.9	11.9	200	15.7	-183
NPM (%)	8.6	6.9	165	8.9	-33
Tax rate (%)	26.4	26.6	-22	26.0	40

Source: Company, Sharekhan Research

Category-wise volume/Value growth in Q2FY2023

Product Category	Value growth (%)	Volume growth (%)
Cement paints + Putty	16.3	6.2
Emulsions	17.4	-4.2
Enamels + Wood Coatings	46.9	28.8
Primers + Distempers + Others	22.4	13.1

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 paints sector growing at a robust rate even at the time of an industrial slowdown. Demand was hit in Q2FY2023 due to heavy rains in South India, while margins are expected to recover, aided by easing inflationary pressure and price hikes undertaken by the companies. Paint companies are likely to report robust performance with strong revenue growth on sustained momentum in decorative paints and recovery in industrial paints with margin improvement due to a drop in crude oil prices. Volatile input prices and a slowdown in rural India are near-term headwinds for the paints industry. The decorative paints industry is expected to post a 13% CAGR over FY2019-FY2024, led by a reduction in the repainting cycle to 4-5 years (from 8-10 years earlier), acceptance of 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 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 IPL to achieve consistent revenue growth of 26.5% over FY2022-FY2025. This along with OPM expansion will1 enable PAT to post a 48% CAGR over FY2022-FY2025. Stock has corrected from its high and is currently trading at 46.1x/33.3x its FY2023/FY2024E EPS. We maintain a Buy on the stock with an unchanged price target (PT) of Rs. 2,250.

Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Asian Paints	94.0	75.7	54.9	57.2	48.0	36.5	19.5	21.4	25.5
Berger Paints	72.3	58.5	50.8	45.0	36.3	31.5	22.7	24.3	24.6
Kansai Nerolac	61.3	39.4	32.4	36.6	23.7	20.0	12.3	18.6	20.0
Indigo paints	84.7	46.1	33.3	50.4	30.7	21.8	18.1	29.5	37.3

Source: Company; Sharekhan Research

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

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	Carne Global Fund Managers	1.46
8	Emirate of Abu Dhabi United Arab Emirates	1.35
9	Nomura Holdings Inc	0.87
10	Caisse de Depot et Placement du Quebec	0.37

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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