Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Indigo Paints Ltd

Muted Q3; Long-term growth prospects intact

Consumer Goods	Sharekhan code: INDIGOPNTS
Reco/View: Buy ↔	CMP: **Rs. 1,115**
	Price Target: **Rs. 1,400** ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Stock Update

Result Update

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 Dec 08, 2022

High Risk

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

Source: Morningstar

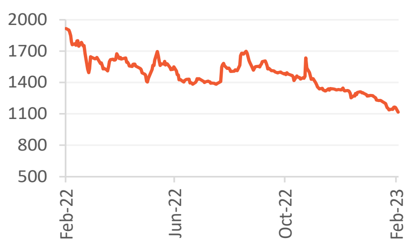
Company details

Market cap:	Rs. 5,303 cr
52-week high/low:	Rs. 1,950 / 1,107
NSE volume: (No of shares)	0.7 lakh
BSE code:	543258
NSE code:	INDIGOPNTS
Free float: (No of shares)	2.2 cr

Shareholding (%)

Promoters	54.0
FII	35.7
DII	3.3
Others	7.01

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-12.7	-18.9	-26.0	-41.4
Relative to Sensex	-13.0	-16.6	-27.0	-48.5

Sharekhan Research, Bloomberg

Summary

- Indigo Paints Limited's (IPL) Q3FY2023 performance was affected by delayed withdrawal of monsoon, resulting in 6% y-o-y revenue growth to Rs. 281.3 crore. OPM stood flat at 14.4%; PAT grew by 8% y-o-y to Rs. 26 crore.
- Q4 is seasonally a strong quarter. Sales volume improved substantially in November/December 2022 and momentum continued in January 2023. The strategy of expanding base in a larger city is working well.
- The company is planning to enter into a highly growing waterproofing and construction chemical category in India in FY2024. Stabilising input prices augurs well for the company to focus on improving sales volume in the near future.
- The stock has corrected by 41% in the past one year and is trading at a reasonable valuation of 31.8x/24x its FY2024E/FY2025E earnings. We maintain Buy with a revised PT of Rs. 1,400.

Indigo Paints Limited's (IPL) performance was largely in-line with other paints companies. The company reported muted revenue growth, which was affected by delayed withdrawal of monsoon and early festive season in October 2022. Revenue grew by 6% y-o-y to Rs. 281.3 crore. Revenue growth was driven by a mix of volume and value (with price-led growth staying ahead of volume growth). Price hikes and correction in input prices aided gross margins to improve by 94 bps to 43.8% (improved by 210 bps q-o-q). OPM stood almost flat to 14.4% during the quarter. Operating profit grew by 5% y-o-y to Rs. 40.6 crore and PAT grew by 8.1% y-o-y to Rs. 26.8 crore. For 9MFY2023, revenue grew by 21.1% y-o-y to Rs. 747.9 crore. OPM improved by 134 bps y-o-y to 14.7% and PAT grew by 18% y-o-y to Rs. 67 crore.

Key positives

- Volume growth in the cement and putty stood strong at 35% in Q3FY2023.
- Tinting machine count increased by 232 to 7,978 from 7,716 in September 2022.

Key negatives

- Emulsions sales volume decreased by 4.3% y-o-y in Q3.

Management Commentary

- Q4 is normally the strongest business quarter for IPL. The company witnessed good sales performance in January 2023, in line with the recovery witnessed in November-December 2022 after soft October 2022. The company expects momentum to continue in the quarters ahead.
- The company witnessed higher sales traction in 750 identified cities, while growth in focus areas is almost double the growth in upcountry areas. The company will be offering higher trade discount to push primary sales in the backdrop correcting input prices.
- A few of the key input prices have stabilised from their high, the company has not taken any price hike in the recent past.
- The upcoming plant in Tamil Nadu is in the final stage of completion and is expected to be commissioned in Q4. This will take care of rising demand in the southern market. The company is also planning to set up an additional line of solvent base paints in Jodhpur. This facility would help to provide better efficiencies.

Revision in estimates – We have revised downwards our earnings estimates to factor in the soft performance in Q3. We have also lowered OPM compared with earlier estimates, as the company has decided to spend higher raw-material savings in providing trade discounts to dealers in the quarters ahead to push sales in key markets.

Our Call

View: Maintain Buy with a revised PT of Rs. 1,400: IPL is focusing on gaining share in tier-1 and tier-2 cities where it has a better dealer presence. The company's revamped strategy is showing good results and will help the company to achieve growth ahead of the industry over the next two to three years. Further, the company is planning to enter the construction chemical and waterproofing segment, which has seen good demand in the recent past. Focused strategies will help IPL to achieve consistent revenue growth of 24% over FY2022-FY2025. This along with OPM expansion will enable PAT to post a 38% CAGR over FY2022-FY2025. The stock has corrected by 41% in the past one year and is currently trading at 31.8x/24x its FY2024/FY2025E EPS. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 1,400.

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	1,104	1,445	1,737
OPM (%)	16.9	15.0	15.7	17.8	19.0
Adjusted PAT	71	84	112	167	221
% Y-o-Y growth	48.2	18.6	33.6	48.4	32.6
Adjusted EPS (Rs.)	14.9	17.7	23.6	35.0	46.4
P/E (x)	74.8	63.1	47.2	31.8	24.0
P/B (x)	9.4	8.2	8.2	7.7	6.7
EV/EBIDTA (x)	40.9	37.1	29.3	19.5	15.0
RoNW (%)	18.6	13.9	17.4	25.0	29.8
RoCE (%)	23.3	18.1	22.5	32.3	38.7

Source: Company; Sharekhan estimates

Soft Q3; Margins improved sequentially

IPL's revenue grew by modest 6% y-o-y to Rs. 281.3 crore due to delayed withdrawal of monsoon and early onset of the festive season in October 2022. IPL continued to witness strong sales growth in Tier-1 and Tier-2 cities. Gross margin improved by 94 bps y-o-y to 43.8%, while OPM stood flat y-o-y at 14.4% (OPM was impacted by a sharp 39% y-o-y increase in employee cost). Operating profit grew by 4.9% y-o-y to Rs. 40.6 crore and PAT grew by 8.1% y-o-y to Rs. 26.3 crore. The company witnessed sequential improvement in performance, with revenue growth at 16%; while adjusted PAT grew by 26.5%. Despite the higher trade discounts offered by the company, gross margin and OPM improved by 210 bps and 50 bps q-o-q, respectively, aided by correction in raw-material prices. IPL added 262 tinted machines during the quarter. The company's new plant in Tamil Nadu is expected to be commissioned in March 2023.

Key conference call highlights

- **Soft quarter impacted by multiple factors; Q4 outlook intact:** The company witnessed muted growth in Q3 mainly due to the delayed withdrawal of monsoon coupled with early Diwali and prolonged festive holidays, which dented sales in October 2022. However, sales growth rebounded in November 2022 and December 2022. Traditionally, Q4 is the strongest quarter for the company and management is confident that the trend will continue this year with better operating performance expected in Q4FY2023.

- **Strategy 2.0 on track:** The company witnessed higher sales traction in the 750 identified cities, while growth in focus areas is almost double the growth in upcountry areas. Management has indicated that IPL's strategy of increasing presence in Tier-1 and Tier-2 cities is showing good results and the company will continue to strengthen the team to engage with influencers.

- **Value growth ahead of volume growth across categories:** Due to several rounds of price increases undertaken in a span of one year, y-o-y value growth in each category is higher than volume growth in Q3FY2023 and 9MFY2023. The company did not take any price hike in Q3FY2023 as inflation in raw-material costs has been largely absorbed. Going forward, both value and volume growth are expected to be in tandem with a normalised base. The emulsions category's volume declined by 4.3% y-o-y in Q3FY2023; however, on a cumulative basis (9MFY2023), volume grew by 6.2% y-o-y. The company's calibrated approach to gain market share delivered good results with 42% and 35% y-o-y increase in value and volume growth of cement paint and putty segment, respectively. The enamels segment continued to grow in double digits in 9MFY2023.

- **Continued A&P spends for brand building:** Management has guided that IPL will continue to focus on brand building through investments in advertisement and promotions (A&P). In line with this brand-building strategy, the company continued to spend on A&P in Q3FY2023. As per management, A&P spends in 9MFY2023 have been marginally higher on a y-o-y basis.

- **Network expansion continued:** IPL increased its tinting machine to 7,978 from 7,716 in Q3FY2023. Management has indicated the company will continue to increase active dealer count and tinting machine population, especially in larger towns. As a result, the percentage of tinting machines in 750 cities has risen to 25.8% from 24.5% at FY2022-end.

- **Tamil Nadu plant to be commissioned in Q4:** The company is making good progress in the expansion of the Tamil Nadu plant and it is expected to be commissioned in March 2023.

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Net revenue	**281.3**	**265.5**	**6.0**	**242.6**	**15.9**
Material cost	158.0	151.6	4.2	141.4	11.7
Employee cost	20.2	14.6	39.0	17.5	15.5
Other expenses	62.5	60.6	3.0	49.9	25.1
Total expenditure	240.7	226.8	6.1	208.8	15.3
Operating profit	**40.6**	**38.7**	**4.9**	**33.8**	**20.1**
Other income	3.8	2.3	63.2	3.2	18.4
Interest expenses	0.3	0.3	3.3	0.3	11.9
Depreciation	8.7	7.9	10.7	8.5	2.6
Profit Before Tax	**35.3**	**32.8**	**7.6**	**28.2**	**25.2**
Tax	9.1	8.5	6.3	7.4	21.7
Adjusted PAT	**26.3**	**24.3**	**8.1**	**20.8**	**26.5**
Extra-ordinary gain / loss	0.0	0.0	-	16.3	-
Reported PAT	**26.3**	**24.3**	**8.1**	**37.1**	**-29.2**
EPS (Rs.)	5.5	5.1	8.1	4.4	26.5
			bps		**bps**
GPM (%)	43.8	42.9	94	41.7	210
OPM (%)	14.4	14.6	-15	13.9	50
NPM (%)	9.3	9.2	18	8.6	78
Tax rate (%)	25.7	26.0	-32	26.4	-75

Source: Company, Sharekhan Research

Category-wise volume/Value growth in Q3FY2023

Product Category	Q3FY2023		9MFY2023	
	Value growth (%)	Volume growth (%)	Value growth (%)	Volume growth (%)
Cement paints + Putty	42.3	34.8	28.1	18.9
Emulsions	3.3	-4.3	22.8	6.2
Enamels + Wood Coatings	14.6	4.7	31.6	16.0
Primers + Distempers + Others	5.5	1.3	17.2	6.3

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Structural growth of the paint industry is intact

In Q3FY2023, paint companies witnessed demand slowdown impacted by consumer inflation, extended monsoons, shorter festival season, and normalisation of pent-up demand, which would lead to lower volume growth during the quarter. Volatile input prices and a slowdown in rural India are near-term headwinds for the paint industry. However, 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 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 21% y-o-y, while OPM expanded by 134 bps y-o-y and PAT grew by 8% y-o-y in 9MFY2023. Growth was supported by a better mix coupled with price hikes undertaken to mitigate the impact of inflated raw-material prices and, to some extent, by correction in key raw-material prices in Q3FY2023. 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 Tier-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 19% in FY2025.

■ Valuation - Maintain Buy with a revised PT of Rs1,400

IPL is focusing on gaining share in tier-1 and tier-2 cities where it has a better dealer presence. The company's revamped strategy is showing good results and will help the company to achieve growth ahead of the industry over the next two to three years. Further, the company is planning to enter the construction chemical and waterproofing segment, which has seen good demand in the recent past. Focused strategies will help IPL to achieve consistent revenue growth of 24% over FY2022-FY2025. This along with OPM expansion will enable PAT to post a 38% CAGR over FY2022-FY2025. The stock has corrected by 41% in the past one year and is currently trading at 31.8x/24x its FY2024/FY2025E EPS. We maintain our Buy rating on the stock with a revised PT of Rs. 1,400.

Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Asian Paints	84.4	69.1	51.5	51.4	43.7	34.0	19.5	21.2	24.7
Indigo paints	63.1	47.2	31.8	37.1	29.3	19.5	18.1	22.5	32.3

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 16,500+ 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 plans 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	Sequoia Cap India Inv Hldg	12.15
2	Small Cap World Fund Inc.	2.32
3	Capital Group Cos Inc.	2.32
4	Carne Global Fund Managers	1.46
5	ICICI Prudential Life Insurance Co.	1.42
6	Emirate of Abu Dhabi United Arab Emirates	1.35
7	Nomura Holdings Inc.	0.87
8	Caisse de Depot et Placement du Quebec	0.37
9	First State Investment ICVC	0.21
10	SBI Funds Management Ltd.	0.19

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Ms. Binkle Oza; Tel: 022-61150000; email id: complianceofficer@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com.

Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O/ CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.