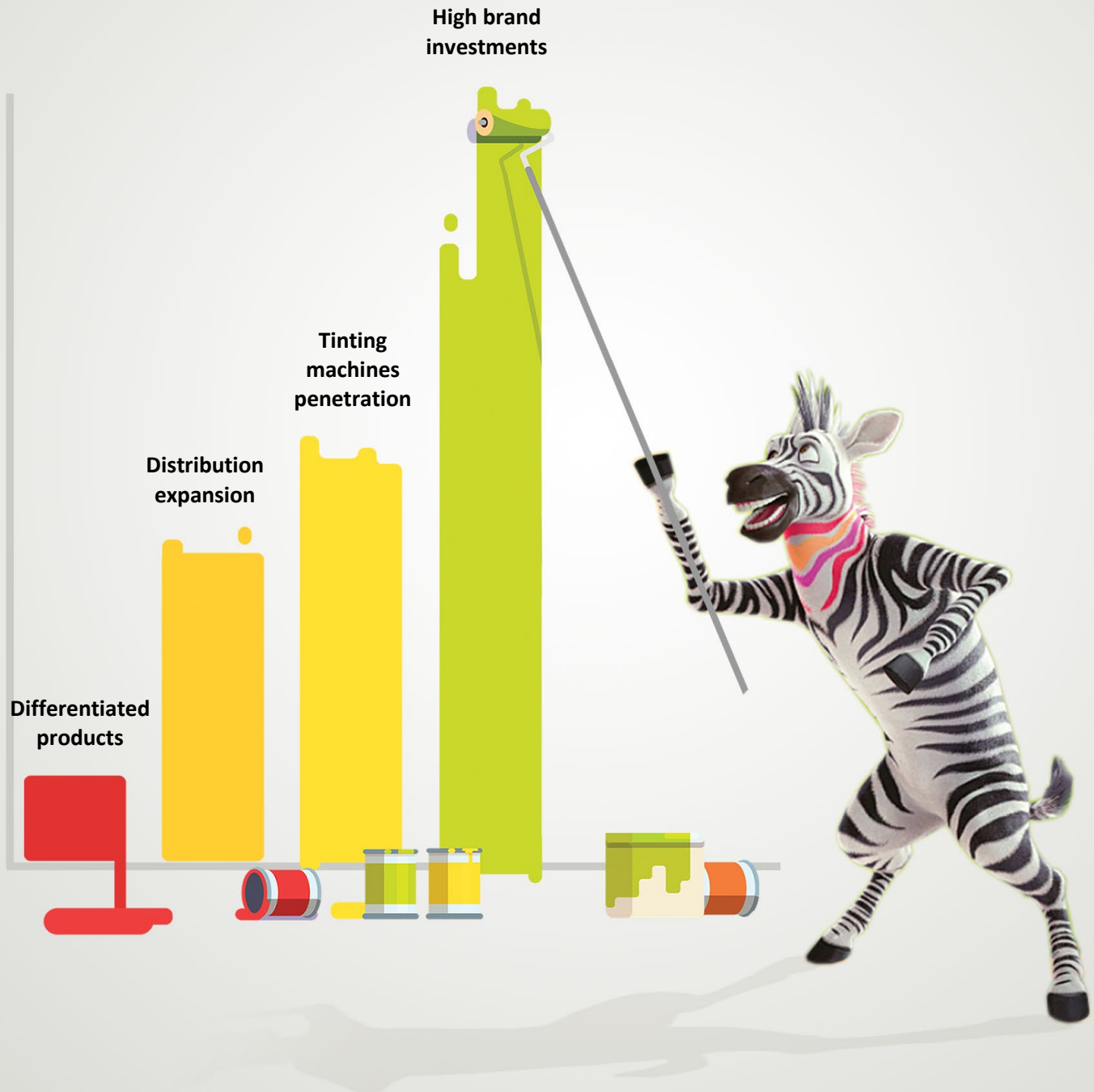


Indigo Paints



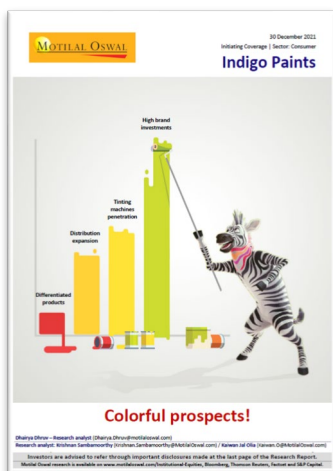
Colorful prospects!

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

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Indigo Paints: Colorful prospects!

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Financials and valuations

Indigo Paints

BSE SENSEX

57,794

S&P CNX

17,204


INDIGO

Be surprised!

Stock Info

Bloomberg	INDIGOPN IN
Equity Shares (m)	47.6
M.Cap.(INRb)/(USDb)	90.9 / 1.2
52-Week Range (INR)	3348 / 1906
1, 6, 12 Rel. Per (%)	12/123/-
12M Avg Val (INR M)	380
Free float (%)	46.0

Financials Snapshot (INR b)

Y/E Dec	2022E	2023E	2024E
Sales	9.0	12.0	15.0
Sales Gr. (%)	25.0	33.0	25.0
EBITDA	1.3	2.1	3.0
Margins (%)	14.3	17.3	20.0
Adj. PAT	0.8	1.3	2.0
Adj. EPS (INR)	16.7	27.5	41.0
EPS Gr. (%)	14.5	64.9	49.1
BV/Sh.(INR)	135.1	162.7	203.7

Ratios

RoE (%)	13.2	18.5	22.4
RoCE (%)	13.0	18.2	22.1

Valuations

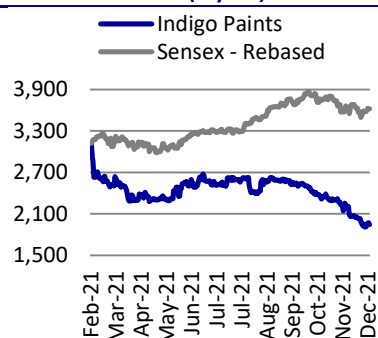
P/E (x)	116.5	70.6	47.4
P/BV (x)	14.4	12.0	9.5
EV/EBITDA (x)	69.7	43.3	29.3

Shareholding pattern (%)

As On	Sep-21	Jun-21	Mar-21
Promoter	54.0	54.0	54.0
DII	2.6	2.6	3.2
FII	11.6	11.8	10.7
Others	31.9	31.7	32.2

FII Includes depository receipts

Stock Performance (1-year)


CMP: INR1,942 TP: INR2,270 (+17%)
Buy

Colorful prospects!

Established in the year 2000, Indigo Paints (INDIGOPN) is the fifth largest company operating in the INR542b (USD7.2b) Paints industry in India. Its product portfolio includes emulsions, enamels, wood coatings, distempers, primers, putties, and cement paint. Despite being a late entrant to this industry with high entry barriers, INDIGOPN has been able to create its presence in the market through its multi-pronged strategy of introducing differentiated products, high ad spends (as a percentage of sales), focusing on the rural markets, and increasing the penetration of tinting machines. The company has a presence in 27 States and 7 Union Territories with its distribution network of more than 14,700 dealers.

Key highlights:

- INDIGOPN has successfully surpassed the high entry barriers of the Indian Paints industry through its patient and multi-pronged strategy comprising a) introducing differentiated products, b) purposefully building a distribution network via the rural markets, c) creating brand equity through high investments in ads, d) rapidly driving the penetration of tinting machines, and e) engaging with influencers (painters/contractors) to build trust.
- The INR545b Indian Paints industry is expected to post a robust ~12% CAGR over FY19–24E, driven by urbanization, the shortening of the repainting cycle, growth in branded players, and the robust pricing power of the branded players. In addition, the oligopolistic nature of the industry means that the incumbents have a considerable growth opportunity.
- We expect INDIGOPN to continue with its robust strategy and thereby deliver a sales/EBITDA/PAT CAGR of ~28%/35%/41% over FY21–24E. The recent sharp price hikes across the industry would further support sales growth and margin recovery in 2HFY22/FY23E.
- We initiate coverage with a Buy rating, with TP of INR2,270 (55x FY24E EPS).

Indigo Paints – the only successful new player in the last 20 years

- The Indian Paints industry is an oligopolistic industry dominated so far by four large players. The industry has high entry barriers for newcomers as the incumbents have strong moats such as a) robust distribution networks, b) strong brand equity, and c) the significant penetration of tinting machines.
- INDIGOPN is the only new entrant in the last two decades to have successfully overcome these high barriers with its patient and multi-pronged strategy, which comprises:
 - a) **Introducing differentiated products to distinguish itself in the market: It focuses on niche and differentiated products** (~30% of sales in FY21, with the first-mover advantage in many cases), which helps it to distinguish itself in a competitive market and get access to dealer shelf space. These products are also margin accretive.

- b) **Purposefully building a distribution network via rural markets:** INDIGOPN initially focused on Tier II to Tier IV towns and villages instead of metros and Tier I cities – where the large incumbents have a strong presence in distribution and penetration of tinting machines. This made it easier to onboard dealers. This approach of first building a foothold in the smaller markets and thereafter progressing to the larger cities requires considerable patience. It currently has a dealer network of 14,700+ dealers and is rapidly adding new dealers.
- c) **Creating brand equity through high investments in ads:** The Top 4 companies have created strong brand equity over the years by spending 3–6% of sales on A&P. INDIGOPN is also investing significantly (11–13% of sales) towards building its brand. This should help in creating brand trust and recall in the mind of the consumer.
- d) **Rapidly driving the penetration of tinting machines within its dealer network:** It aims to become the preferred brand among dealers and improve the throughput per outlet. It has added ~6,400 tinting machines, penetrating ~43% of its dealer network. While it still trails to larger peers, the IPO proceeds would support this effort.
- e) **Engaging with influencers (painters/contractors) to build trust:** Along with offering financial incentives, INDIGOPN also conducts blind tests with influencers to gain their trust.

Robust industry growth prospects

- The INR545b (USD7.2b) Paints industry in India is expected to post a 12.2% CAGR over FY19–24E, led by a ~10% volume CAGR. With the recent sharp price hikes, industry sales are expected to grow further in the coming years.
- Decorative Paints (74% of the Indian Paints market) is expected to grow at a faster pace (~13% CAGR), from INR403b (USD5.4b) in FY19. At 4.1kg, India has one of the lowest per capita consumption numbers, even compared with emerging markets offering long growth runways.
- Industry growth drivers comprise a) urbanization, b) the shortening of the repainting cycle, c) growth in branded players, and d) the robust pricing power of the branded players. Additionally, the oligopolistic nature of the industry means that the incumbents would see considerable growth opportunity.

Slated to deliver strong growth

- Over FY18–21, INDIGOPN delivered a sales/EBITDA/PAT CAGR of ~22%/68%/70%, driven by a) its efforts on distribution expansion, b) the proliferation of tinting machines, c) brand investments, and d) an improving product mix through differentiated products. We expect these initiatives to continue in the coming years as well. In addition, the company has taken 18–20% price hikes in recent months (in line with that of the industry) amid sharp commodity inflation. Accordingly, we expect it to deliver a sales/EBITDA/PAT CAGR of ~28%/ 35%/41% over FY21–24E.
- INDIGOPN has grown faster than peers in recent years, and we expect it to continue to do so in the coming years as well.
- Post the IPO, the company has turned into a net cash company after repaying its debt. It is expected to generate strong OCF, led by sales growth and EBITDA

margin expansion. INDIGOPN is currently expanding capacity at its Tamil Nadu facility with capex of INR2.25b spread over FY22 and FY23. This should lead to negative FCF for FY22E, which is expected to turn positive in subsequent years.

- Although the cash infusion from the IPO led to a drop in INDIGOPN's ROCE in FY21, we expect it to improve gradually in the coming years.

Valuation and view

- The Indian Paints industry offers an attractive opportunity on account of the low per capita consumption of paints, urbanization, and the shortening of the repainting cycle. Coupled with the oligopolistic nature of the industry, this means that the incumbents have strong growth runways.
- INDIGOPN has gradually, but successfully, managed to breach the barriers to gain entry into the Paints industry on the back of its patient, multi-pronged strategy. It has grown faster v/s peers and has been chipping away an increasing share of the industry profit pool.
- At just ~2% market share, INDIGOPN has immense opportunity to grow by increasing its distribution reach as well as the throughput per dealer. We expect it to deliver a sales/EBITDA/PAT CAGR of 28%/35%/42% over FY21–24E.
- While we expect INDIGOPN to continue to outperform larger peers in the industry, aggression by larger players in the rural markets could put the brakes on INDIGOPN's growth aspirations. At the same time, greater acceptability in the urban markets would be crucial to INDIGOPN's ambitions of achieving scale. Therefore, it would be necessary to watch out for INDIGOPN's performance in both these markets.
- On account of its strong topline and earnings growth outlook, we believe INDIGOPN deserves higher multiples in line with large peers trading at 55–60x. We initiate coverage with a **Buy** rating, and TP of INR2,270 (55x FY24E EPS).

Exhibit 1: Comparative valuations

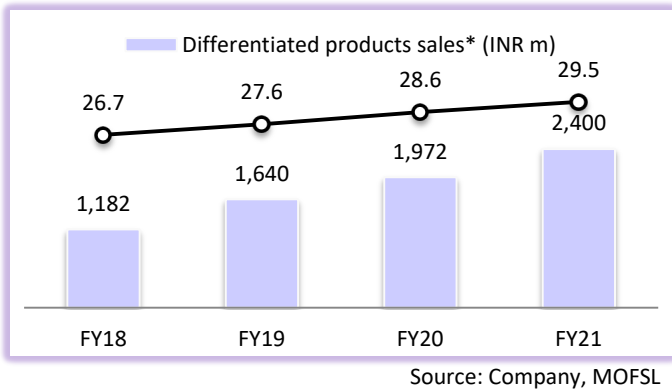
Company	Reco	CMP (INR)	Target Price		Mkt Cap (INR b)	CAGR FY20-24E (%)		P/E (x)			ROE (%)
			(INR)	Upside (%)		Sales	EBITDA	FY22E	FY23E	FY24E	FY24E
APNT	Neutral	3,364	3,540	5	3,227	17.8	18.0	86.1	65.5	57.0	34.5
BRGR	-	760	-	-	738	14.1	16.3	85.7	66.6	56.2	26.9
KNPL	-	582	-	-	314	9.5	15.0	63.2	43.7	35.6	17.4
AKZO	-	2,025	-	-	92	7.7	8.2	35.8	32.1	28.8	17.6
INDIGOPN	Buy	1,944	2,270	17	92	24.5	34.7	116.5	70.6	47.4	22.4

Source: Company, MOFSL, Bloomberg

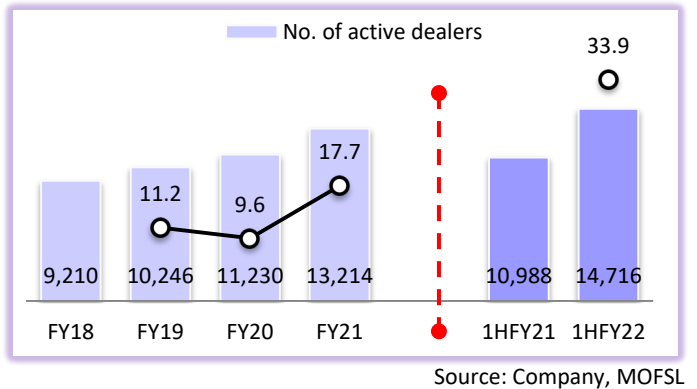
Story in charts

Poised for strong growth

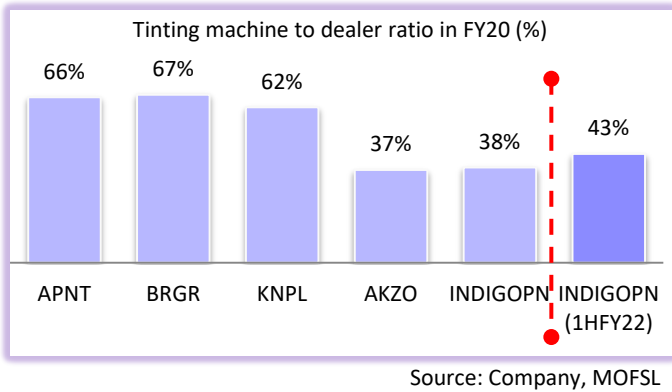
Increasing contribution of differentiated products



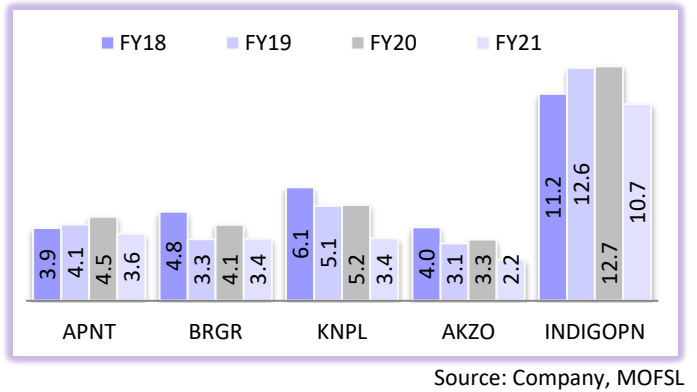
Rapidly adding dealers and...



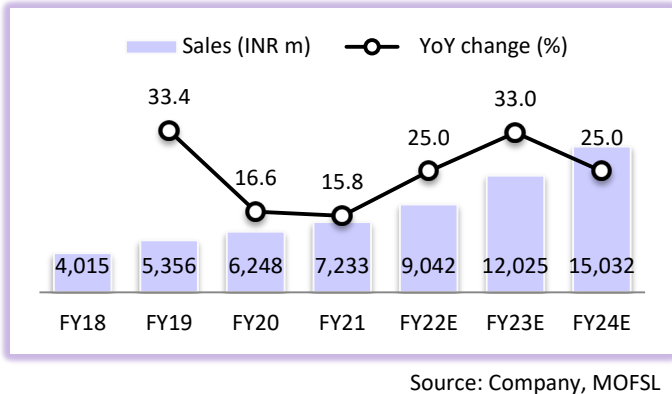
...penetrating the network with tinting machines



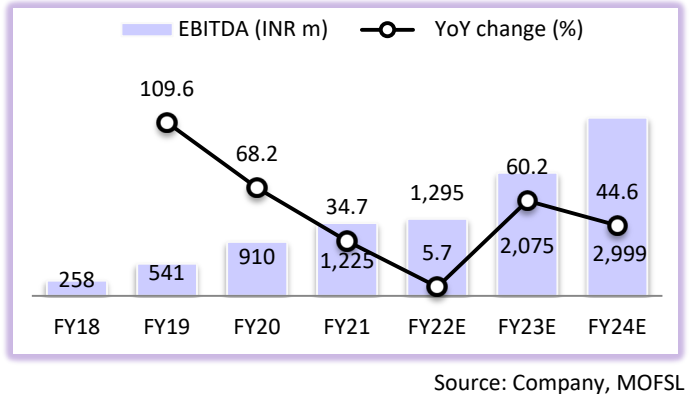
INDIGOPN incurs significantly higher A&P spends



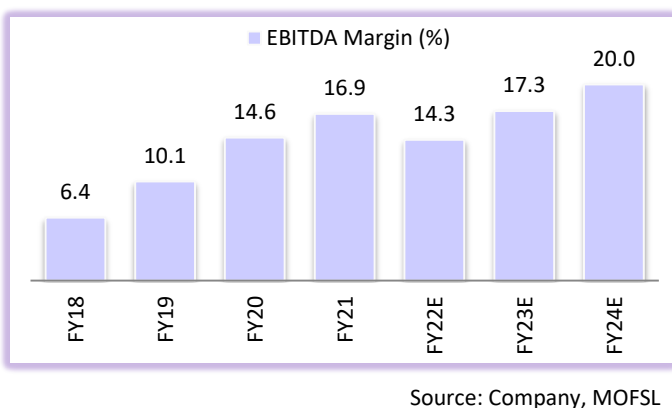
Sales to grow at 28% CAGR over FY21-FY24E



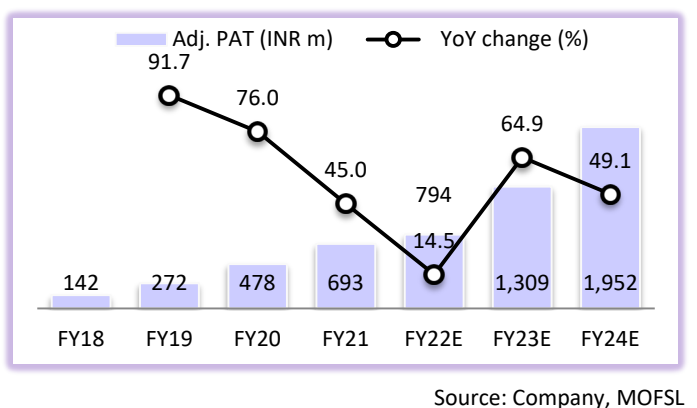
EBITDA to grow at ~35% CAGR over FY21-24E



EBITDA margin to expand 300bp over FY21-24E



PAT to grow at 41% CAGR over FY21-24E



About INDIGOPN: Making a mark in an industry of giants

- Founded in 2000 by Mr Hemant Jalan, Indigo Paints (INDIGOPN) is the fifth largest company in India's Decorative Paints industry with ~2% market share.
- Its product portfolio comprises emulsions, enamels, wood coatings, distempers, primers, putties, and cement paints.
- INDIGOPN is backed by PE investor Sequoia Capital, which invested INR300m in FY15 and a further INR1.1b in FY16. Post the IPO, Sequoia holds 28.5% of the company's shares.
- In FY16, INDIGOPN acquired Kerala-based Hi-Build Coatings (HBC) for INR900m. HBC's promoter Mr K Narayanan Kutty now serves as an Executive Director on the INDIGOPN board.
- INDIGOPN is present in 27 (of 28) states and 7 (of 8) union territories in India through a dealer network of more than 14,700 dealers. Its three manufacturing plants are located in Jodhpur (Rajasthan), Kochi (Kerala), and Pudukkottai (Tamil Nadu).
- It is the only successful new entrant in the last two decades to make a mark in an industry dominated by age-old giants.

Surmounting industry moats

Differentiated products



Other niche products

Cement paint



1kg pouch distemper



- The Paints industry has some high entry barriers that offer strong moats to the incumbents. These barriers include a) a strong distribution network, b) strong brand equity, and c) significant penetration of tinting machines.
- To surmount these moats, INDIGOPN has employed the following strategies:
 - Introducing differentiated products to distinguish itself in the market
 - Building a distribution network via the rural markets in a patient way
 - Creating brand equity through high investments in ads
 - Rapidly driving the penetration of tinting machines
 - Engaging with influencers (painters/contractors) to build trust

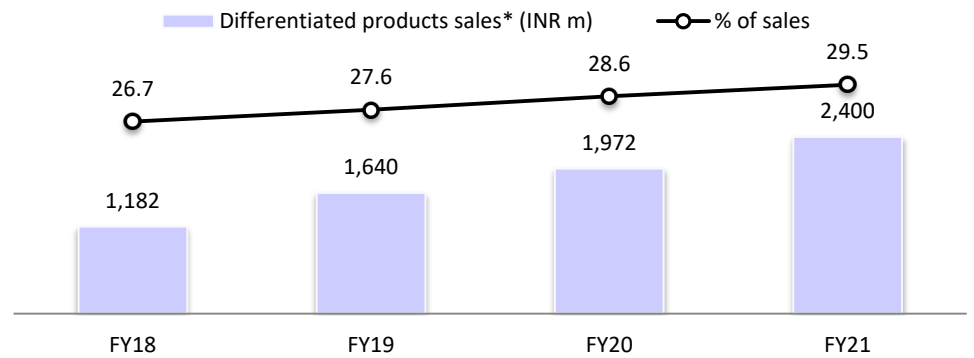
A) Introducing differentiated products to distinguish itself in the market

- INDIGOPN has identified several niche categories within the Paints industry and introduced specialized products in these markets.
- This has led to several advantages:
 - i) These products create brand differentiation and recognition in the market.
 - ii) This makes it easier to generate demand and thereby get access to shelf space as dealers may be reluctant to stock products with low demand. In other words, these products help get the company's foot in the door.
 - iii) They offer the first-mover advantage, making it easier to scale up.
 - iv) Finally, these products are gross margin-accretive as the company has a better pricing power compared to other products.
- INDIGOPN's differentiated products may be classified into two buckets:
 - i) Category-creator products are considered a distinct category of products.
 - ii) Value-added products offer certain value additions in existing categories.
- Differentiated products posted strong growth of 38.7%, 20.3%, and 21.7% in FY19, FY20, and FY21, respectively. As a percentage of sales, their share increased to 29.5% in FY21 from 26.7% in FY18.
- Besides differentiated products, INDIGOPN has a niche presence in certain other categories too, wherein it has a higher pricing power due to low competitive intensity. For example, it enjoys low competition in low-value cement paints and the 1kg pouch distemper SKU.
- Historically, the company used to advertise only these differentiated products to stand out among its peers and that gave drove the demand for these products.

Exhibit 2: Differentiated products introduced by INDIGOPN

Classification	Product	Series	Applications	Solvent-/Water-based
Category-creator products	❖ Floor Coat Emulsion	Platinum	❖ Concrete, cement tiles, terrace floor tiles, paver blocks	Water-based
	❖ Bright Ceiling Coat	Platinum, Gold	❖ Concrete and plastered ceilings	
	❖ Metallic Emulsion	Platinum	❖ Wood, metal, and masonry	
	❖ Tile Coat	Platinum	❖ Concrete and roof tiles	
Value-added products	❖ PU Super Gloss Enamel	Platinum	❖ Wood and metal	Solvent-based
	❖ Dirtproof and Waterproof Exterior Laminate	Platinum	❖ Cement plaster, concrete, and other masonry	Water-based
	❖ Exterior and Interior Acrylic Laminate	Platinum		

Source: Company, MOFSL

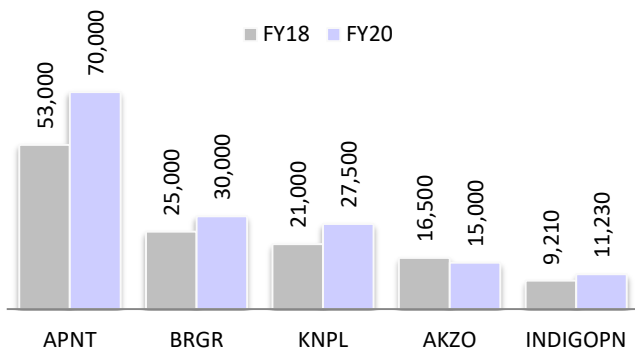
Exhibit 3: Differentiated products contribute 29.5% of sales in FY21

*invoicing as per contracted price

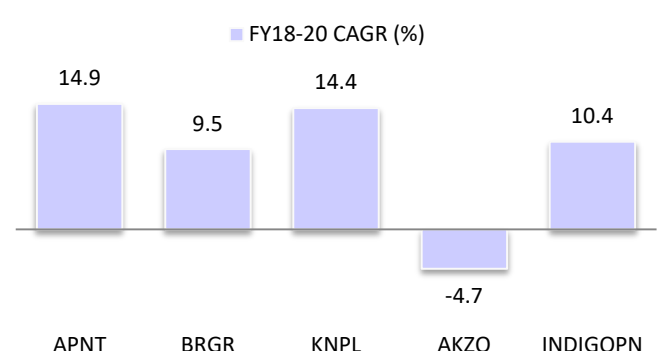
Source: Company, MOFSL

B) Building distribution network via the rural markets in a patient way

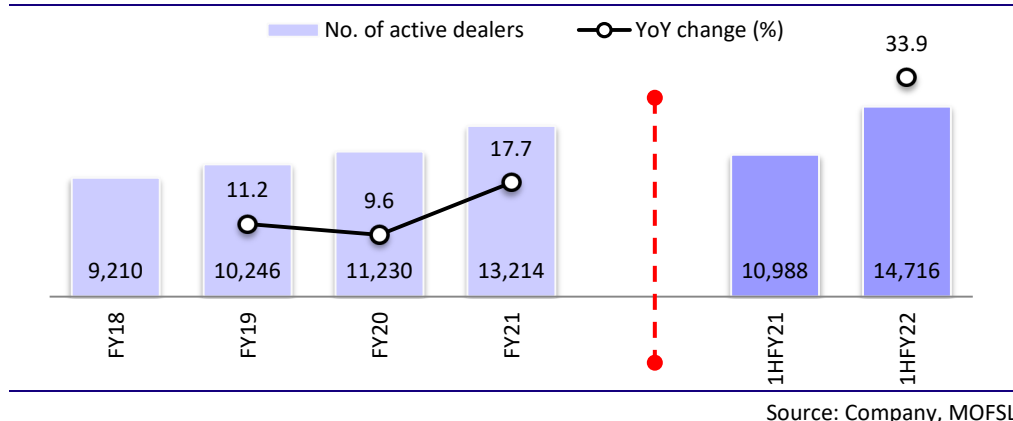
- The top 4 players have a strong presence in the urban markets, rendering it practically impossible for smaller players to compete in these markets. With this realization, INDIGOPN instead focused on the rural markets (tier II–IV towns and villages) wherein it was easier to onboard dealers. The dealers in this market also have a higher convincing ability to influence customer decisions.
- Thus, differentiated products, coupled with the rural focus, have made it easier to build a dealer network. Thereafter, INDIGOPN leveraged this relationship to distribute a wider range of products.
- It eventually also expanded to relatively larger cities and metros. This approach of entering cities after rural areas requires considerable patience as it entails gaining a foothold in the smaller markets first.
- With 14,700+ dealers, INDIGOPN has a footprint in 27 of 28 states and 7 of 8 UTs in India. The management believes there is vast scope for network expansion in new as well fast-growing existing markets (wherein it already has a presence). With the market leader, Asian Paints (APNT), having a dealer network of 70,000+ dealers, INDIGOPN has a long way to go.

Exhibit 4: INDIGOPN has a large network of dealers...

Source: INDIGOPN, MOFSL

Exhibit 5: ...which is expanding at decent rate

Source: INDIGOPN, MOFSL

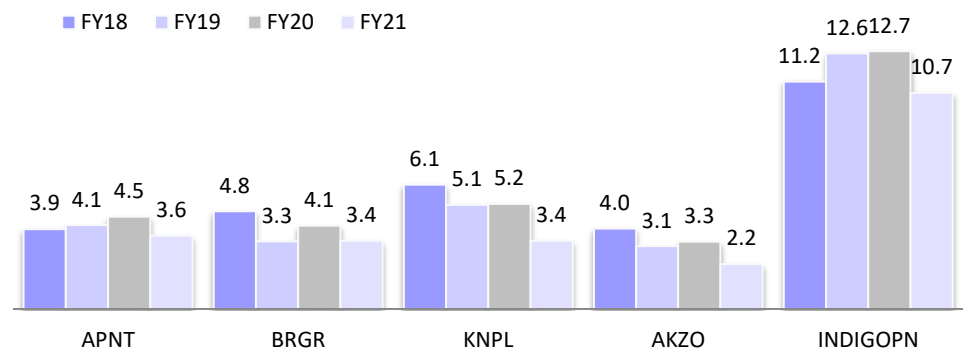
Exhibit 6: INDIGOPN has seen a large increase in active dealers in the last one year

INDIGOPN ads featuring popular cricketer M. S. Dhoni



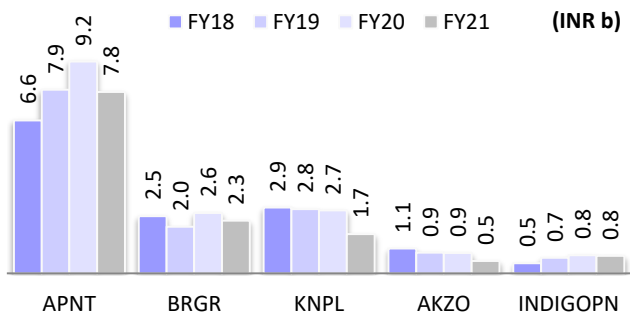
C) Creating brand equity through high investments in ads

- The top 4 paint companies have been spending 3–6% of their sales on A&P over the years to fortify their brands. These massive spends have meant that they have a strong brand recall among consumers.
- To compete with these large brands, INDIGOPN has been investing significantly in A&P as well. As a percentage of sales, INDIGOPN's A&P spends have been in the ~11–13% range in FY18–21. This is significantly higher than peers. However, on an absolute basis, INDIGOPN's ad spends are comparable with those of AKZO, but are still far lower than the rest.
- Creating brand equity and awareness is critical in the market as consumers have less trust in lesser known brands and thus avoid them. In this context, INDIGOPN has been doing well with high ad spends. Its ad spends in FY20 were higher than those of Kansai Nerolac Paints Ltd (KNPL) and AkzoNobel India (AKZO). It was also not far behind BRGR in this regard.
- Two of its branding strategies are notable:
 - a) Having a single brand name "Indigo" for all the categories and segments has helped consolidate brand recall. This is unlike peers with several sub-brands that require branding efforts on all the sub-brands.
 - b) INDIGOPN has historically only advertised differentiated products, which has helped the company carve a niche for itself in a competitive market. While this has boosted the sales of its differentiated products, awareness regarding emulsions has been low. It has recently started advertising wall emulsions along with its differentiated products (e.g., [ceiling coats](#), [floor coats](#), and [enamels](#)). Instead of having separate ads for emulsions, it is using combined ads, aimed at building brand recall, while signaling to consumers to try its wall emulsions as well.
- The management has indicated that going forward A&P spends as a percentage of sales should decline as these shall not rise as fast as the sales growth achieved.

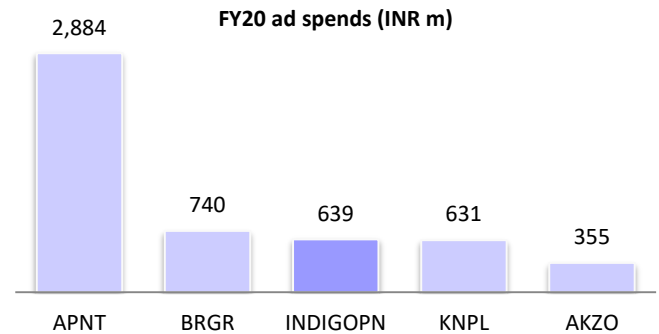
Exhibit 7: As % of sales, INDIGOPN spends significantly higher than peers on A&P...

*all players cut down A&P spends in FY21 due to COVID impact

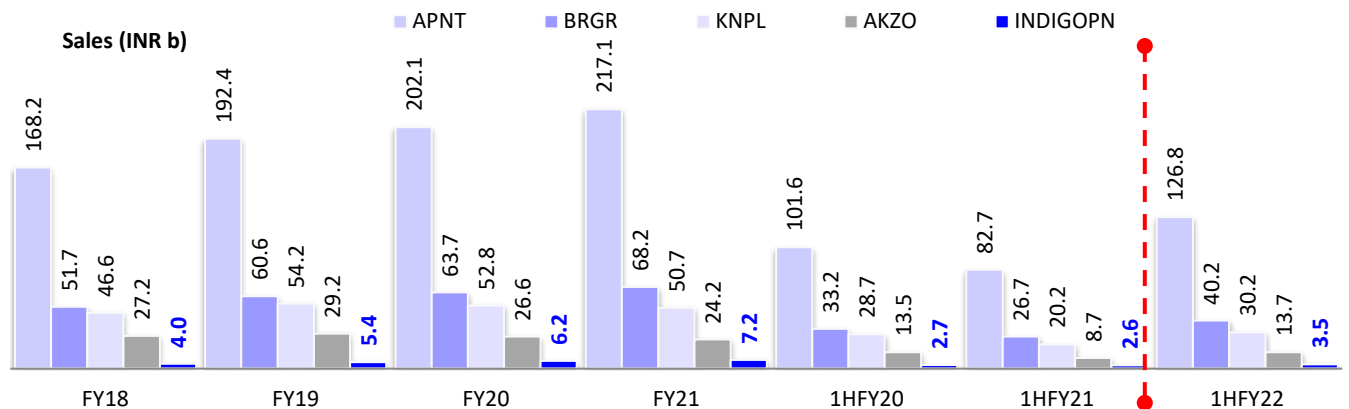
Source: Companies, MOFSL

Exhibit 8: ...however, on absolute basis, it is still far behind most peers in terms of A&P...

Source: Companies, MOFSL

Exhibit 9: ...although its ad spends are higher v/s KNPL and AKZO...

Source: INDIGOPN, MOFSL

Exhibit 10: ...despite its sales being significantly lower v/s large peers

Source: Companies, MOFSL

D) Rapidly driving the penetration of tinting machines

- The company has developed a tinting machine with a built-in computer. This helps in saving space and offers a sleek look.
- In line with its network expansion strategy, INDIGOPN also started adding tinting machines in FY15 at its dealers in tier III and IV towns and villages wherein the penetration of tinting machines by large players was lower. It is now gradually adding the machines at its dealers in larger cities and metros.

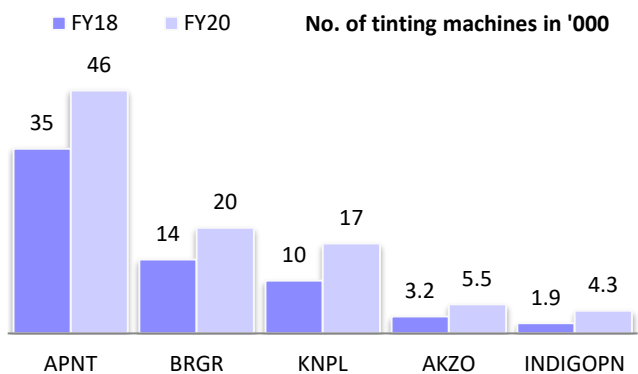
Indigo tinting machine with built-in computer



Source: YouTube

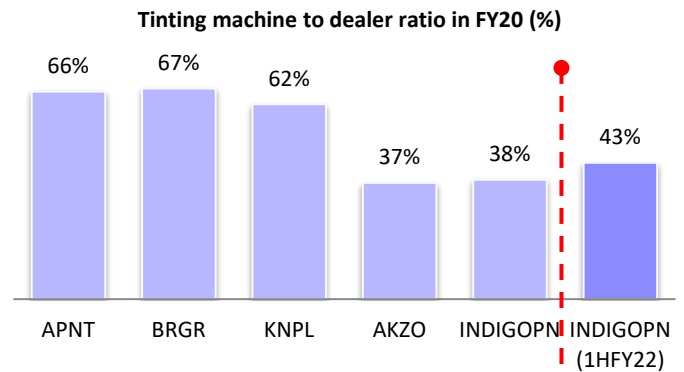
- Adding tinting machines is crucial to increasing the throughput per outlet as dealers prefer brands that have already provided their tinting machines.
- Furthermore, while peers charge the full amount (INR0.13–0.15m) to the dealers to install the machine, INDIGOPN has been offering these for 20% of the cost.
- With growing brand equity, it has been successful in adding tinting machines at the retailers' premises. The company has been adding ~1,250 tinting machines annually over FY18–20. It had ~6,400 tinting machines as of Sep'21, which formed ~43% of its network (up from ~4,300 machines in FY20, which formed 38% of the network). However, the penetration of tinting machines is still significantly lower v/s most large peers on both an absolute as well as percentage-of-sales basis.
- The management believes there is vast potential to take the count of tinting machines up to 17–20k dealers in the medium term.
- To further expand the distribution of the machines, INDIGOPN would have to make further investments. Of the fresh issue of INR3b at the IPO, the company has earmarked INR500m for the purchase of tinting machines and gyroshakers. This would accelerate the proliferation of the machines.

Exhibit 11: Paint companies are rapidly adding tinting machines to their networks



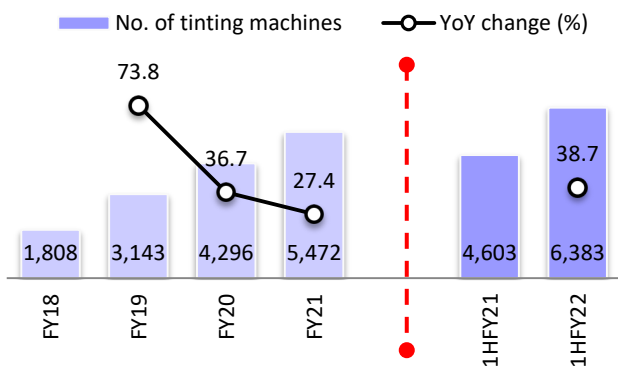
Source: INDIGOPN, MOFSL

Exhibit 12: INDIGOPN has proliferated 42% of its network with tinting machines, but needs to accelerate the pace



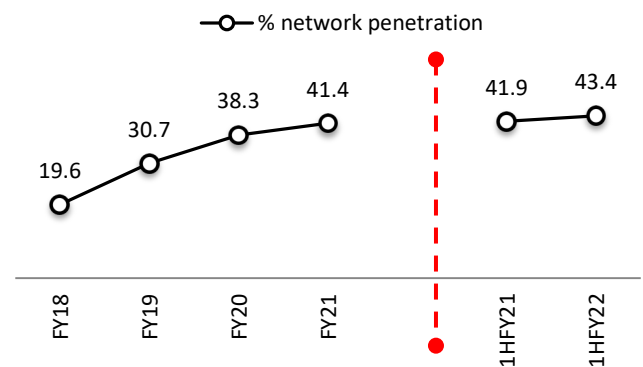
Source: INDIGOPN, MOFSL

Exhibit 13: INDIGOPN is rapidly adding tinting machines...



Source: Company, MOFSL

Exhibit 14: ...and increasing their penetration in its network



Source: Company, MOFSL

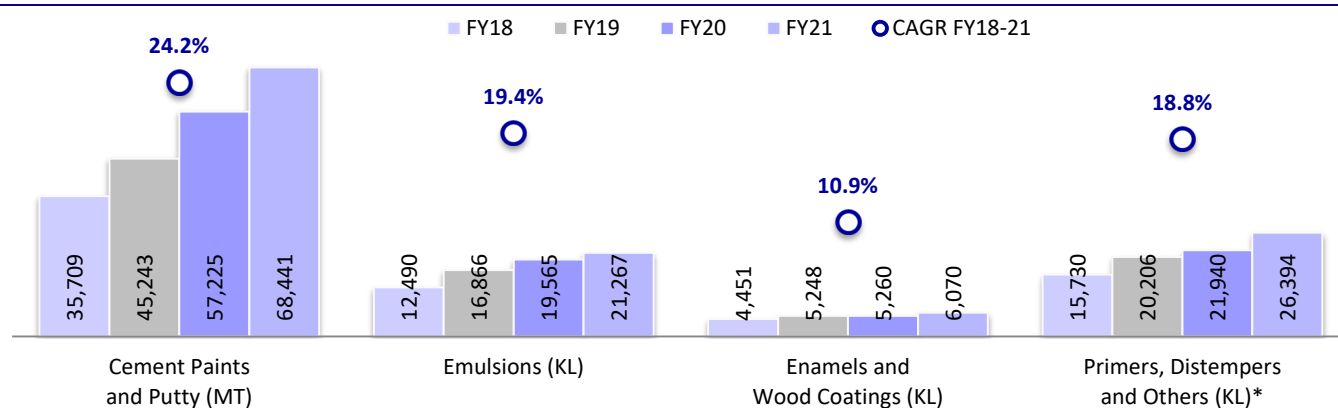
E) Engaging with influencers (painters/contractors) to build trust

- Painters and contractors are important influencers in the Paints industry. Paint players engage with them to shore up their brand equity. APNT has been training them for several years now. Since 2007, APNT's [Colour Academy](#) has offered vocational training to painters across 17 locations in India.
- Along with offering financial incentives through redeemable coupons, INDIGOPN has also been conducting painter meets at which it carries out the blind testing of the company's products against peer products. It also offers company-branded merchandise to the painters.
- It is necessary to gain the trust of these influencers in the quality of the company's products as they carry reputational risk in recommending the paint brand. Should any customer be dissatisfied with the products used, the painters/contractors stand to lose their reputation in the market, which would hamper prospects. In this context, INDIGOPN's blind testing initiative is a step in the right direction.

Improving product mix

- In volume terms, cement paints and putties/emulsions posted a CAGR of 24.2%/19.4% over FY18–21. The fast growth in emulsions is encouraging as this indicates increased acceptance of key products in the market. We believe that the growth in emulsions is led by its differentiated products.
- Gaining acceptance for its emulsions is crucial for future growth as these products form the bulk of the market. Increasing the salience of emulsions is thus a positive for future growth and scalability. Growth in the Emulsions business would further aid margin expansion.
- While emulsions posted the fastest sales CAGR of ~30% over FY18–20, these products saw slower growth in FY21. All segments have posted double-digit sales CAGR over FY18–21. The fast growth seen in emulsions was led by differentiated products (refer to page 9). While the contribution of emulsions to the sales mix increased to 45.3% in FY20 (from 41.9% in FY18), it has declined to 42.8% in FY21 due to relatively slower growth vis-à-vis other segments.

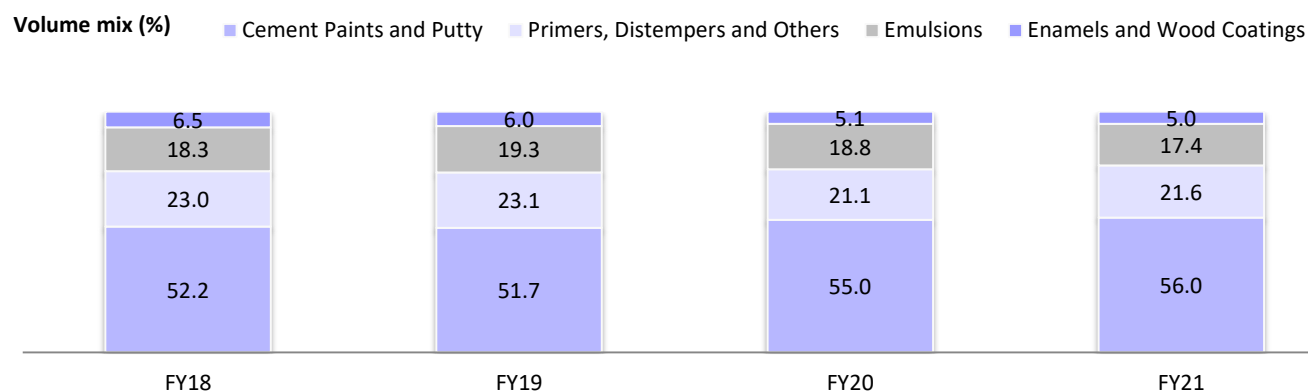
Exhibit 15: INDIGOPN sees strong volume growth, led by cement paints, putties, and emulsions...



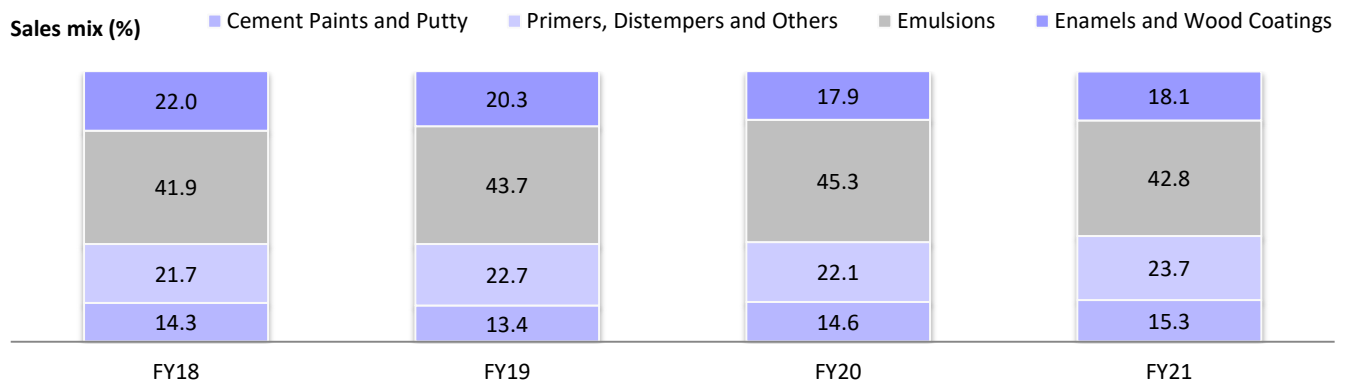
* Distempers are manufactured in MT

Source: Company, MOFSL

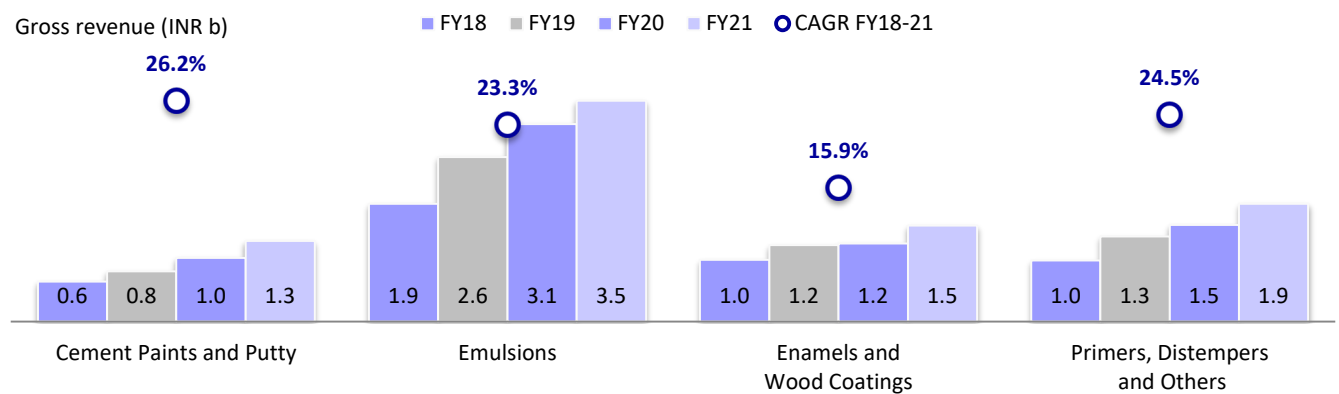
Exhibit 16: Cement paints and putties form the bulk of volumes...



Source: Company, MOFSL

Exhibit 17: ...but contribute less to sales; emulsions have the highest contribution to sales

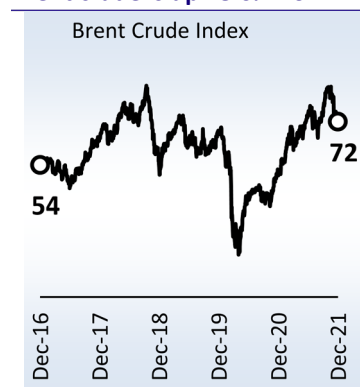
Source: Company, MOFSL

Exhibit 18: While emulsions posted the fastest sales CAGR over FY18–20, they saw slower growth in FY21

Source: Company, MOFSL

Ground checks: rural positive, but urban a monitorable

- **Strong presence in Kerala:** Kerala contributed ~35% to sales for INDIGOPN in FY20; however, this declined to 30% in FY21, with other regions growing at a faster pace. Channel checks indicate INDIGOPN is among the top brands for dealers in Kerala with a meaningful contribution to overall sales. The dealers largely expressed an optimistic outlook for the brand.
- **Dealers largely sell differentiated or adjacent products:** Most of the dealers we talked to indicated that for INDIGOPN, they largely sell one or more floor paints, ceiling paints, enamels, wood coatings, or primers. There is no particular product favored in any particular geography. We believe this higher salience of differentiated and adjacent products is owing to the company's focused advertisements for the products. Consequently, we expect wall emulsion sales to pick up now that the company has begun to advertise these as well.
- **Low brand awareness hinders offtake, but dealers can convince customers to switch:** In a market with well-entrenched large players, INDIGOPN is still a very small brand. Compared with the larger brands, there is much lower awareness for INDIGOPN, preventing customers from trying out its products. However, the dealers are able to convince the customers about the superior quality of several of INDIGOPN's products, especially when the customers trust the dealers.
- **Smaller dealer network prevents inter-dealer competition:** An unintended consequence of a vast dealer network of large brands is that within a geography, there are usually multiple dealers of the same brand. This leads to high inter-dealer competitive intensity, thereby eating into dealers' margins as they have to offer higher discounts to drive sales. While this does not affect the company's margins, it disincentivizes the dealers to sell the brands. In such a scenario, they prefer to focus on smaller brands with a smaller distribution footprint and, therefore, lower competition. This phenomenon especially benefits smaller brands such as INDIGOPN.
- **INDIGOPN's fulfillment slower v/s bigger players:** Due to its smaller size, INDIGOPN has fewer depots and a lower frequency of servicing dealers. In the case of an urgent order of any depleted product, the dealer can get the order fulfilled in a matter of hours from APNT, but order fulfillment may take 1–2 days for INDIGOPN. This does affect the dealer sentiment to some extent. However, we believe that as the company scales up, these issues should get resolved.
- **Good traction in rural, but urban markets to be monitored:** INDIGOPN has scaled up its presence well in rural and small-town markets. However, the top 4 players dominate in the urban and metro areas. Our channel checks in Mumbai, for example, indicate a very low presence of INDIGOPN in the dealer's brand mix. Again, the challenge to scale up here is threefold: a) low brand recognition and visibility lead to lower trust among consumers, b) large players have already penetrated their tinting machines in the market making them the preferred brands of the dealers, and c) the fast rate of fulfillment by larger players makes it easier for dealers to close orders faster for larger brands. Thus, INDIGOPN's performance in urban markets will have to be monitored.

Brent crude is up 78.6% YoY

Source: Bloomberg, MOFSL

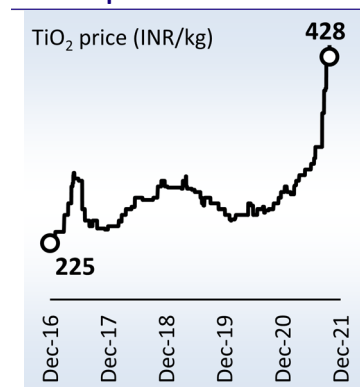
Price hikes to mitigate commodity inflation impact

- In the past 12 months, paint companies have seen unprecedented inflation in key RMs, such as crude-linked derivatives, titanium dioxide (TiO₂), vegetable oils, phthalic anhydride, monomers, and solvents.
- This is driven by commodity inflation and disruptions in the supply chain during COVID.
- As of 3QFY22, Brent crude / TiO₂ was up 78.6%/61.2% YoY.
- To mitigate this impact, different players employed various means, such as RM substitution, overhead cost cuts, and some limited price hikes. However, as the market leader APNT resisted increasing prices in 1HFY22 to gain market share, other players could take price hikes only to a limited extent then.
- This resulted in sharp pressure on the gross margins of paint companies across the industry in 1HFY22 (especially in 2QFY22), as shown in the chart below.

Exhibit 19: Industry players saw gross margin erosion of 400-1,000bps in 2QFY22

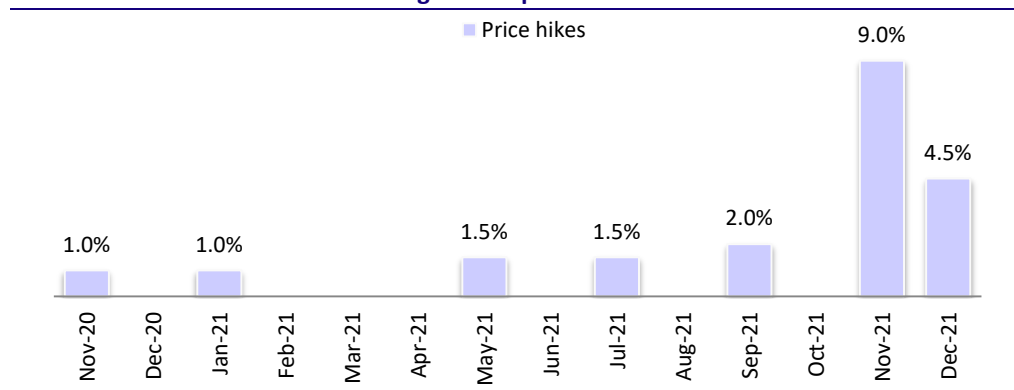
	Gross margins (%)								YoY change (bps)			
	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	1QFY22	2QFY22
APNT	43.6	42.4	43.0	45.8	44.7	44.4	45.1	43.2	38.4	34.7	-631	-966
BRGR	40.8	41.0	40.8	43.6	41.0	42.8	44.2	43.7	38.6	38.3	-238	-449
KNPL	38.3	38.4	37.5	38.5	41.6	39.3	38.4	34.4	34.3	28.9	-732	-1,043
AKZO	45.2	47.2	45.8	45.0	44.8	48.7	45.5	42.8	42.4	40.2	-241	-849
INDIGOPN				52.4	44.5	50.2	49.6	46.7	45.5	41.7	106	-846

Source: Company, MOFSL

TiO₂ is up 61.2% YoY

Source: Bloomberg, MOFSL

- As the commodity inflation continued to rage on in 3QFY22, players across the industry took price hikes of 15–20%. These sharp price hikes across the industry imply a) strong price-led growth in 2HFY22/FY23E, b) recovery in gross margins 3QFY22 onwards, and c) the slight cooling off of competitive intensity due to pricing over the near term.
- INDIGOPN has also cumulatively taken price hikes in the range of 18–20%. It has been hiking prices since Nov'20 in select parts of its product portfolio, while the recent hikes in Nov/Dec'21 were taken across the majority of its portfolio.

Exhibit 20: INDIGOPN has been taking several price hikes since Nov'20

Source: Company, MOFSL

Financial analysis: Slated to deliver strong growth

- Over FY18–21, INDIGOPN delivered a sales/EBITDA/PAT CAGR of ~22%/68%/70%, driven by a) its efforts on distribution expansion, b) the proliferation of tinting machines, c) brand investments, and d) an improving product mix through differentiated products. We expect these initiatives to continue in the coming years as well.
- In addition, the company has taken 18–20% price hikes in recent months (in line with that of the industry) amid sharp commodity inflation. Accordingly, we expect it to deliver a sales/EBITDA/PAT CAGR of ~28%/ 35%/41% over FY21–24E.
- Due to the ongoing commodity inflation, the gross margins of paint companies across the board came under pressure in 1HFY22. This led to players across the industry taking sharp price hikes of 15–20%. While gross margins are expected to compress in FY22E due to the impact seen in 1HFY22, they are expected to improve 2HFY22 onwards as the impact of the price hikes flows in.
- While the company would continue to incur high A&P spends towards building its brand equity, these would not rise as fast as the sales. Accordingly, A&P spends as a percentage of sales would decline going ahead. While the management has guided for annual decline of 150bp in A&P spends, we are building in slower annual decline.
- Consequently, EBITDA / adj. PAT would likely post a CAGR of 35%/41% over FY21–24E.

Exhibit 21: Strong growth potential; to lead to sales / EBITDA / adj. PAT CAGR of 28%/35%/41% over FY21–24E

	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Sales	4,015	5,356	6,248	7,233	9,042	12,025	15,032
Change (%)	-	33.4	16.6	15.8	25.0	33.0	25.0
Gross Profit	1,638	2,371	3,028	3,468	4,005	5,532	7,215
Margin (%)	40.8	44.3	48.5	47.9	44.3	46.0	48.0
A&P spends	451	677	791	774	916	1,082	1,263
% of sales	11.2	12.6	12.7	10.7	10.1	9.0	8.4
EBITDA	258	541	910	1,225	1,295	2,075	2,999
Change (%)	-	109.6	68.2	34.7	5.7	60.2	44.6
Margin (%)	6.4	10.1	14.6	16.9	14.3	17.3	20.0
Adj. PAT	142	272	478	693	794	1,309	1,952
Change (%)	-	91.7	76.0	45.0	14.5	64.9	49.1
Margin (%)	3.5	5.1	7.7	9.6	8.8	10.9	13.0

Source: Company, MOFSL

- Of the IPO proceeds of INR3b, the company has earmarked INR250m for debt repayment. The company has fully [repaid its term loans](#) post the IPO. INDIGOPN is now a net cash company.

Exhibit 22: Company turns net cash owing to IPO proceeds

	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Debt	316	516	392	0	0	0	0
Cash	46	140	57	2,583	1,426	1,496	2,795
Investments	184	197	208	497	797	1,197	1,697
Net Cash	85	179	127	-3,080	-2,223	-2,693	-4,491

Source: Company, MOFSL

- INDIGOPN's working capital days improved to 15 days in FY21 from 40 days in FY18 on a reduction in both inventory and debtor, days (but partially offset by a decrease in creditor days as well).
- We assume the cash conversion cycle would stay at current levels in the years ahead.

Exhibit 23: INDIGOPN's cash conversion cycle improves drastically to 15 days in FY21 from 40 days in FY18

	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Inventory	552	693	768	947	1,183	1,574	1,967
Account Receivables	968	1,038	1,045	1,212	1,515	2,015	2,519
Account Payables	1,085	1,362	1,386	1,856	2,229	2,965	3,706
Days (year-end basis)							
Inventory days	50	47	45	48	48	48	48
Debtor days	88	71	61	61	61	61	61
Creditor days	99	93	81	94	90	90	90
Cash conversion cycle	40	25	25	15	19	19	19
Days (average basis)							
Inventory days		42	43	43	43	42	43
Debtor days		68	61	57	55	54	55
Creditor days		83	80	82	82	79	81
Cash conversion cycle		27	23	18	16	17	17

Source: Company, MOFSL

- With the inflow of IPO proceeds, INDIGOPN's return ratios deteriorated in FY21. However, as the sales growth momentum continues, return ratios should improve from FY23E.

Exhibit 24: Cash inflow from IPO proceeds to affect return ratios in FY21 and FY22E, but improve thereafter

	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
RoE (%)	11.1	19.8	27.8	18.2	13.2	18.5	22.4
RoCE (%)	11.3	16.4	22.5	17.4	13.0	18.2	22.1

Source: Company, MOFSL

- With robust sales growth and margin expansion, INDIGOPN is expected to deliver strong OCF in the coming years.
- The company is currently undergoing major capacity expansion at its Tamil Nadu facility, which would require capex of INR2.25b spread over FY22 and FY23. INDIGOPN is utilizing the INR1.5b in proceeds from the IPO for this purpose. This facility is expected to be operationalized by Jul–Aug'22.
- This high capex would lead to negative FCF in FY22E, which is expected to turn positive in subsequent years.

Exhibit 25: INDIGOPN to deliver CFO/FCF CAGR of ~20%/48% over FY21–24E

	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
OCF	238	516	723	1,214	792	1,395	2,085
Capex	181	633	613	660	1,700	950	300
FCF	57	-117	110	553	-908	445	1,785

Source: Company, MOFSL

INDIGOPN growing faster than the industry

- INDIGOPN delivered the highest sales growth among peers over FY19–21. However, this was on a much smaller base.
- INDIGOPN's peers saw sharper decline in 1HFY21 and, thus, a sharper rebound in 1HFY22. On a two-year CAGR basis, INDIGOPN grew faster than peers in 1HFY22.

Exhibit 26: INDIGOPN is considerably smaller than peers...

Sales (INR b)	FY18	FY19	FY20	FY21	1HFY20	1HFY21	1HFY22
APNT	168.2	192.4	202.1	217.1	101.6	82.7	126.8
BRGR	51.7	60.6	63.7	68.2	33.2	26.7	40.2
KNPL	46.6	54.2	52.8	50.7	28.7	20.2	30.2
AKZO	27.2	29.2	26.6	24.2	13.5	8.7	13.7
INDIGOPN	4.0	5.4	6.2	7.2	2.7	2.6	3.5

Source: Companies, MOFSL

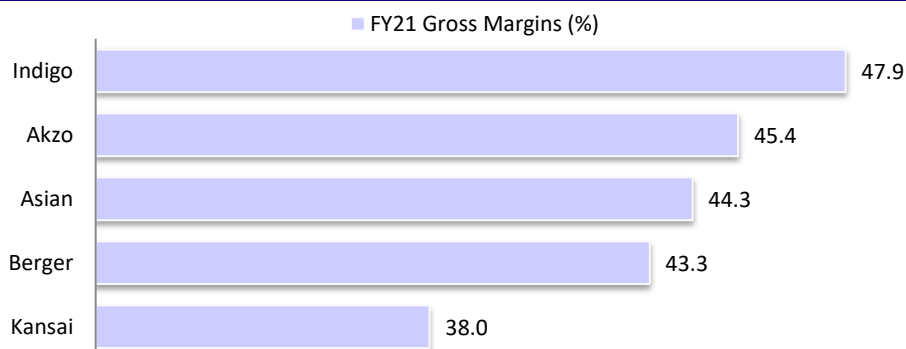
Exhibit 27: ...but grew faster than the peers in FY19-21 and on a two-year CAGR basis in 1HFY22

Sales growth (%)	FY18	FY19	FY20	FY21	2Y CAGR FY19-21	1HFY21	1HFY22	2Y CAGR 1HFY20-22
APNT	11.7	14.4	5.0	7.4	6.2	(18.5)	53.3	11.7
BRGR	13.5	17.3	5.0	7.1	6.1	(19.4)	50.5	10.2
KNPL	14.9	16.4	(2.7)	(3.9)	-3.3	(29.5)	49.5	2.7
AKZO	5.7	7.3	(8.8)	(9.0)	-8.9	(36.1)	58.0	0.5
INDIGOPN	-	33.4	16.6	15.8	16.2	(4.8)	35.7	13.7

Source: Companies, MOFSL

- INDIGOPN has the highest gross margins among peers. This is attributable to two factors:
 - Differentiated products have higher margins.
 - INDIGOPN's manufacturing facilities are closer to RM sources, leading to lower inward logistic costs. However, outward logistic costs would be higher v/s peers, effectively offsetting EBITDA margins.
- While 1HFY22 saw the substantial erosion of gross margins across the Paints industry – amid unprecedented commodity inflation in the last 12 months – the sharp price hikes taken in 2Q and 3QFY22 would mitigate this impact. The gross margins of all the players are expected to improve in 2HFY22.

Exhibit 28: INDIGOPN posted highest gross margins among peers in FY21



Source: Companies, MOFSL

- INDIGOPN delivered sharper EBITDA growth vis-à-vis its sales growth over FY19-FY21. Consequently, INDIGOPN saw a sharp margin expansion over FY18–20, led by sharp expansion in gross margins and reduction in A&P spends (as a percentage of sales).
- In 1HFY22, INDIGOPN's EBITDA was affected by a) gross margin compression due to commodity inflation and b) significantly higher A&P spends in 1QFY22 amid the Indian Premier League (IPL) season. While A&P spends are high on a quarterly basis, they are expected to be in line with its past trajectory for FY22E.
- INDIGOPN reported margin levels near those of peers in FY20 and FY21 despite having higher A&P spends as a percentage of sales. Its A&P spends (as a percentage of sales) are expected to decline in the coming years, leading to further margin expansion.

Exhibit 29: INDIGOPN has the smallest size of EBITDA...

EBITDA (INR b)	FY18	FY19	FY20	FY21	1HFY22
APNT	32.0	37.7	41.6	48.6	18.2
BRGR	8.1	9.4	10.6	11.9	5.9
KNPL	7.9	7.5	8.0	8.6	3.5
AKZO	3.0	3.4	3.8	3.4	1.9
INDIGOPN	0.3	0.5	0.9	1.2	0.4

Source: Companies, MOFSL

Exhibit 30: ...but grew faster v/s peers over FY19–21

EBITDA growth (%)	FY18	FY19	FY20	FY21	1HFY22
APNT	7.1	17.8	10.5	16.7	3.9
BRGR	12.3	15.9	13.4	12.0	38.7
KNPL	7.6	(5.2)	6.9	7.3	2.3
AKZO	(9.1)	14.7	10.7	(10.1)	101.7
INDIGOPN		109.6	68.2	34.6	(9.5)

Source: Companies, MOFSL

Exhibit 31: INDIGOPN has EBITDA margins comparable with peers, which would expand further with ad spends decreasing as % of sales

EBITDA Margin (%)	FY18	FY19	FY20	FY21	1HFY22
APNT	19.0	19.6	20.6	22.4	14.3
BRGR	15.6	15.4	16.7	17.4	14.7
KNPL	17.0	13.9	15.2	17.0	11.7
AKZO	11.0	11.7	14.2	14.1	13.6
INDIGOPN	6.4	10.1	14.6	16.9	12.4

Source: Companies, MOFSL

- INDIGOPN's PAT too grew ahead of peers over FY19-21.
- However, 1HFY22 PAT was affected by the compression in EBITDA margins.
- With the sharp growth seen in recent years, INDIGOPN's share has gradually increased in the industry profit pool.

Exhibit 32: INDIGOPN's PAT grew sharply ahead of peers...

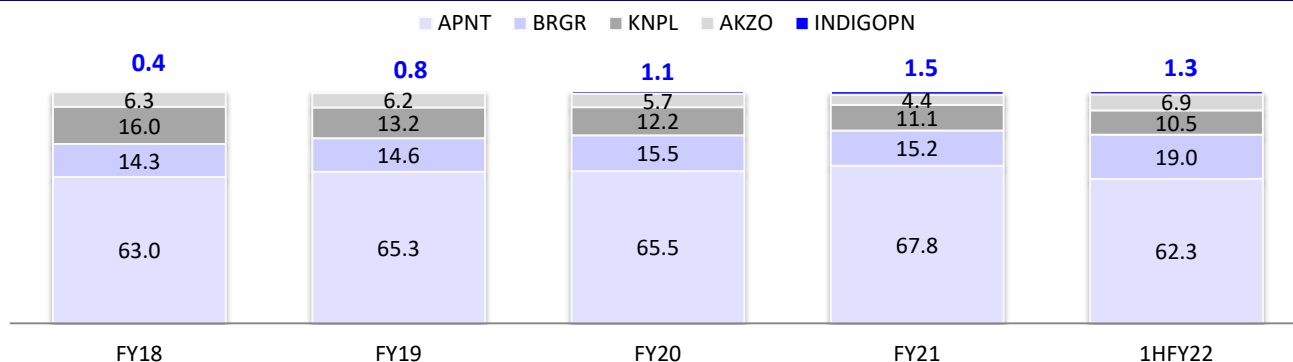
Adj. PAT (INR b)	FY18	FY19	FY20	FY21	1HFY22
APNT	20.3	22.1	27.8	32.1	11.8
BRGR	4.6	4.9	6.6	7.2	3.6
KNPL	5.1	4.5	5.2	5.3	2.0
AKZO	2.0	2.1	2.4	2.1	1.3
INDIGOPN	0.1	0.3	0.5	0.7	0.3

Source: Companies, MOFSL

Exhibit 33: ...over FY19-21 but was affected in 1HFY22

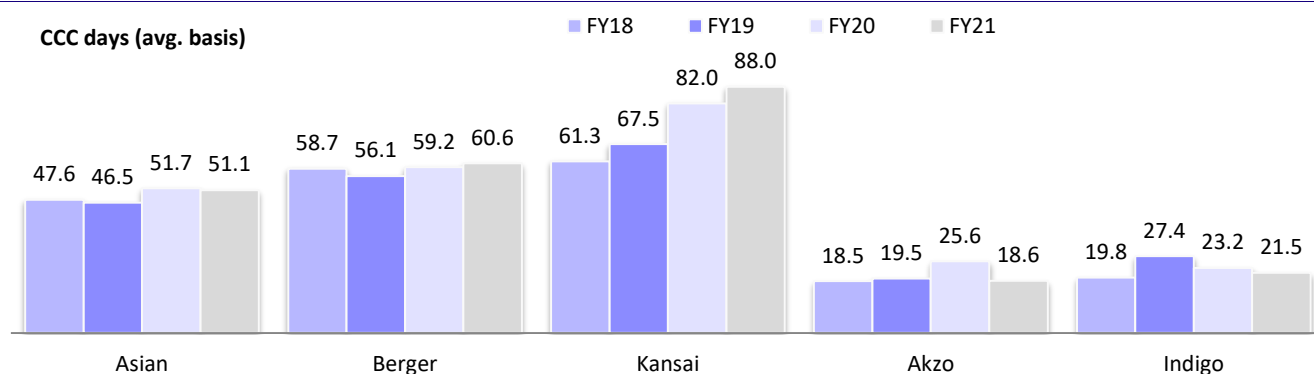
PAT Growth (%)	FY18	FY19	FY20	FY21	1HFY22
APNT	1.9	9.2	25.5	15.4	10.1
BRGR	(2.7)	7.2	32.8	9.7	52.3
KNPL	0.7	(12.9)	15.2	1.9	0.5
AKZO	(11.8)	3.5	15.4	(14.4)	186.0
INDIGOPN		91.7	76.0	44.9	(7.5)

Source: Companies, MOFSL

Exhibit 34: INDIGOPN gradually chipping at industry profit pool

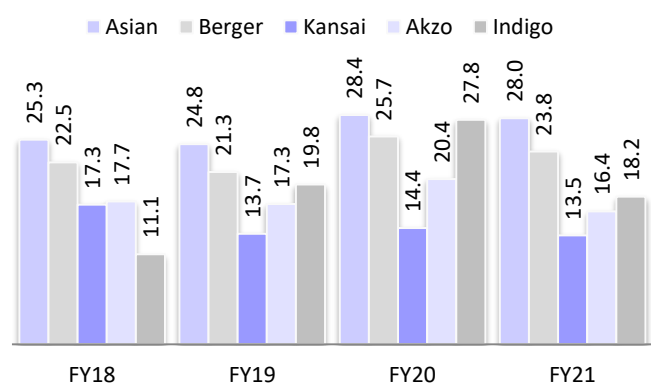
Source: Companies, MOFSL

- Overall cash conversion cycle (CCC) days: INDIGOPN has low CCC days due to having high payable days. INDIGOPN outsources the manufacturing of some emulsions, unlike peers, resulting in high creditor days for these products. This shrinks its CCC days significantly.

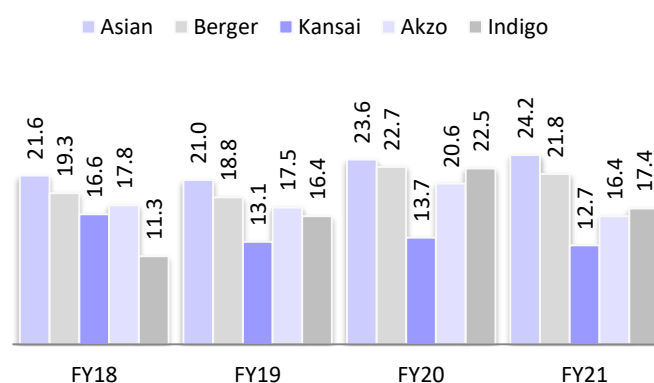
Exhibit 35: INDIGOPN has considerably lower CCC days v/s larger peers

Source: Companies, MOFSL

- INDIGOPN has return ratios comparable with APNT and BRGR, while KNPL and AKZO have weaker ratios. INDIGOPN's return ratios declined in FY21 due to large fund infusion from IPO proceeds.

Exhibit 36: INDIGOPN has ROEs (%)...

Source: INDIGOPN, MOFSL

Exhibit 37: ...and ROCEs comparable with APNT/BRGR (%)

Source: INDIGOPN, MOFSL

Valuation and view

- The Indian Paints industry offers an attractive opportunity on account of the low per capita consumption of paints, urbanization, and the shortening of the repainting cycle. Coupled with the oligopolistic nature of the industry, this means that the incumbents have strong growth runways.
- INDIGOPN has gradually, but successfully, managed to breach the barriers to gain entry into the Paints industry on the back of its patient, multi-pronged strategy to a) build up its distribution from the rural areas to urban, b) introduce differentiated products, c) invest heavily in brand building, and d) rapidly penetrate store networks with tinting machines. It has grown faster v/s peers and has been chipping away an increasing share of the industry profit pool.
- At just ~2% market share, INDIGOPN has immense opportunity to grow by increasing its distribution reach as well as the throughput per dealer. We expect it to deliver a sales/EBITDA/PAT CAGR of 28%/35%/42% over FY21–24E.
- While we expect INDIGOPN to continue to outperform larger peers in the industry, aggression by larger players in the rural markets could put the brakes on INDIGOPN's growth aspirations. At the same time, greater acceptability in the urban markets would be crucial to INDIGOPN's ambitions of achieving scale. Therefore, it would be necessary to watch out for INDIGOPN's performance in both these markets.
- On account of its strong growth outlook, we believe the company deserves higher multiples in line with large peers trading at 55–60x. We initiate coverage with a **Buy** rating, and TP of INR2,270 (55x FY24E EPS).

Exhibit 38: Comparative valuations

Company	Reco	CMP (INR)	Target Price		Mkt Cap (INR b)	CAGR FY20-24E (%)		P/E (x)			ROE (%)
			(INR)	Upside (%)		Sales	EBITDA	FY22E	FY23E	FY24E	
APNT	Neutral	3,364	3,540	5	3,227	17.8	18.0	86.1	65.5	57.0	34.5
BRGR	-	760	-	-	738	14.1	16.3	85.7	66.6	56.2	26.9
KNPL	-	582	-	-	314	9.5	15.0	63.2	43.7	35.6	17.4
AKZO	-	2,025	-	-	92	7.7	8.2	35.8	32.1	28.8	17.6
INDIGOPN	Buy	1,944	2,270	17	92	24.5	34.7	116.5	70.6	47.4	22.4

Source: Company, MOFSL, Bloomberg

Key risks

- **Continued commodity inflation** could lead to gross margin and EPS pressure. Alternatively, if the industry player takes price hikes, it could have an impact on the demand and therefore affect the EPS.
- **Aggression by leaders in rural markets** could weaken INDIGOPN's stronghold in those markets and materially affect its growth prospects.
- **Leadership succession** is a concern as currently there is no replacement for Mr. Hemant Jalan who is aged 64. The company's patient strategy to build the business from rural markets could be at risk if a new leader steps in.
- **New entrants**, while prima facie do not seem to be a threat to INDIGOPN, need to be watched out for as INDIGOPN is considerably smaller in size than its peers.

Management profile



Mr Hemant Jalan

Managing Director and Chairman

Mr Hemant Jalan, Managing Director and Chairman

Mr Jalan founded INDIGOPN in 2000 and currently serves as the MD and Chairman of the company. He has over 20 years of experience in the Paints industry. Previously, he was associated with AF Ferguson & Co. as a consultant. Presently, he is also associated with Halogen Chemicals as Director. He holds a B. Tech. in Chemical Engineering from IIT Kanpur, a Master's in Science (M.S.) from Stanford University, and an MBA from the University of Chicago.

Mr K Narayanan Kutty, Executive Director

Mr Kutty is Executive Director of INDIGOPN since Feb'16. He previously served as MD of HBC. He holds a B.Sc. in Mechanical Engineering from the University of Kerala and a PGDM from IIM Calcutta.

Mr Chetan Humane, Chief Financial Officer

Mr Humane has been working with INDIGOPN since Sep'01 and was appointed CFO in Mar'20. He has over 19 years of experience in accounting and finance. Previously, he was associated with Jenson & Nicholson as a commercial assistant. He holds Bachelor's and Master's degrees in Commerce from the University of Pune.

Mr T S Suresh Babu, Chief Operating Officer

Mr Babu serves as COO of INDIGOPN and has over 16 years of experience in marketing and sales. He joined INDIGOPN post its acquisition of HBC. Previously, he was associated with Berger Paints Limited, Idea Cellular, Etisalat DB Telecom, and HBC. He holds a B.E. in Mechanical Engineering from Sambalpur University and a PGDM from Xavier Institute of Management, Bhubaneswar.

Mr Varghese Idicula, Vice President – Technical

Mr Idicula has over 35 years of experience in R&D and production and joined INDIGOPN post its acquisition of HBC. Previously, he was associated with Asian Paints, Pidilite, Sherwin Williams Saudi Arabia, and HBC. He holds a B.Sc. and an MBA from the University of Bombay. He has also received a diploma in paint technology from the Colour Society and the Indian Paint Association.



Bull and bear case

(INR b)	FY21	FY22E	FY23E	FY24E	Comments
Total Sales (INR m)	7,233	9,403	12,694	16,503	❖ Faster sales growth aided by price hikes
YoY growth (%)	15.8	30.0	35.0	30.0	
EBITDA (INR m)	1,225	1,413	2,254	3,458	❖ Faster margin expansion led by gross margin recovery, lower A&P spends as % of sales and operational leverage
Margin (%)	16.9	15.0	17.8	21.0	
EPS (INR)	14.6	18.5	30.3	48.2	
EPS growth (%)	45.0	27.2	63.6	59.0	
P/E multiple				60x	❖ Assuming higher multiple
TP (INR)				2,900	

(INR b)	FY21	FY22E	FY23E	FY24E	Comments
Total Sales (INR m)	7,233	8,680	10,850	13,020	❖ Slower sales growth affected by increasing competition
YoY growth (%)	15.8	20.0	25.0	20.0	
EBITDA (INR m)	1,225	1,176	1,709	2,324	❖ Slower margin expansion led by slower recovery in gross margins and slower reduction in A&P spends as % of sales
Margin (%)	16.9	15.0	17.8	21.0	
EPS (INR)	14.6	14.8	21.6	30.1	
EPS growth (%)	45.0	1.7	45.8	39.1	
P/E multiple				50x	❖ Assuming lower multiple
TP (INR)				1,500	

SWOT analysis



Strength

- The company is rapidly expanding distribution network and adding tinting machines. This is further aided by IPO proceeds.
- Differentiated products have created a niche for the brand in the market. These also offer higher pricing power and margins.
- The management's patient approach has helped scale up the business from the rural markets.

Weaknesses

- INDIGOPN has lower brand equity v/s peers as it is a relatively newer brand, while peers have been investing in brand-building for decades.
- It has a weaker presence in the urban markets due to stiff competition from larger players.
- There is currently no succession planning to Mr. Hemant Jalan who is aged 64.

Opportunities

- INDIGOPN has lower brand equity v/s peers as it is a relatively newer brand, while peers have been investing in brand-building for decades.
- It has a weaker presence in the urban markets due to stiff competition from larger players.
- There is currently no succession planning to Mr. Hemant Jalan who is aged 64.

Threats

- Higher aggression by larger players could threaten INDIGOPN as it is a much smaller player and may not have the means to counter them.
- Continued commodity inflation could necessitate further sharp price hikes affecting consumer demand.

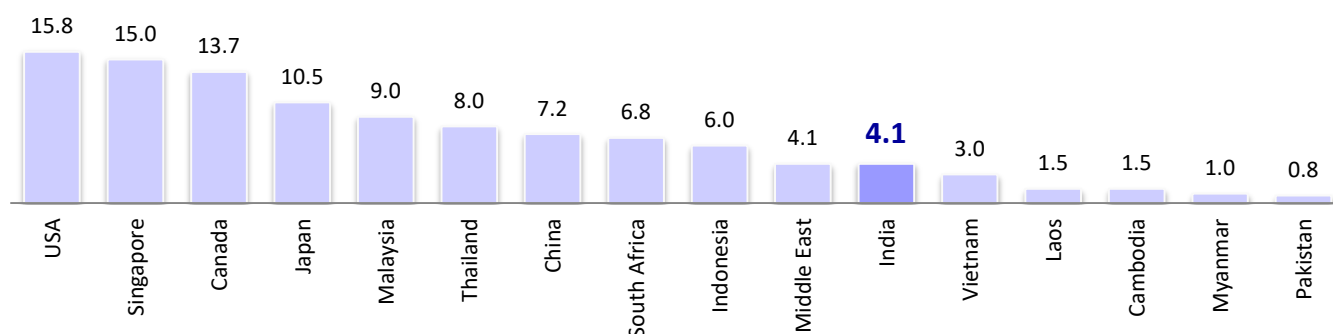
Annexure

Paints industry presents large opportunity

At 4.1kg, the per capita consumption of paints is low in India v/s other comparable countries

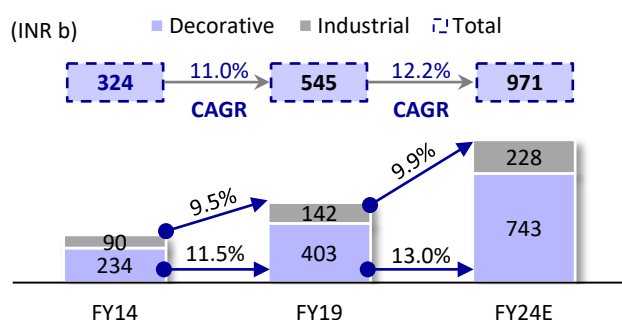
- The Indian Paints industry was INR545b in size in FY19 and is expected to grow to INR971b in FY24E (12.2% CAGR). In volume terms, it stood at 6.3mmt in FY19 and is expected to grow to 10.1mmt in FY24E (9.9% CAGR). Since these estimates were made pre-COVID, they do not factor in the sharp price hikes undertaken by paints companies in recent months to offset the high RM inflation. Hence, the industry sales growth is likely to be higher going forward.
- The per capita basis consumption of paints has expanded at a 6.8% CAGR to 4.1kg in 2019 from 2.6kg in 2012. This is still lower than other global economies.
- Industry growth drivers are: a) urbanization, b) rise in the popularity of branded paints, c) the shortening of the repainting cycle, and d) robust pricing power.
- The Decorative Paints segment, INR545b in size, constituted 74% of the industry (in value terms) in FY19. It is expected to post a strong 13% CAGR to INR743b over FY19–24E. The Industrial Paints segment (incl. Auto), INR142b in size, constituted the remaining 26% of the industry. It is expected to post a 9.9% CAGR over FY19–24E. Owing to its robust growth, the share of Decorative Paints is expected to increase to 77% in FY24E from 72% in FY14.
- The organized segment constitutes 67% of the Paints industry and its share has increased since FY15 (from 65%). This shift has been aided by demonetization and GST implementation, which severely affected the smaller players.
- As the rural market is growing at a faster pace than urban, paint companies have been expanding their dealer networks in these areas.

Exhibit 39: Low per capita consumption of paints and coatings in India v/s key global economies



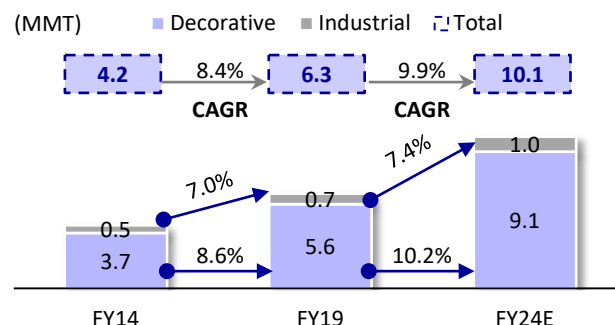
Source: Bloomberg, Frost & Sullivan, MOFSL

Exhibit 40: Paints industry to post 12.2% CAGR...



Source: Company websites, Coatings World, New Articles, Frost & Sullivan, MOFSL

Exhibit 41: ...with 9.9% volume CAGR over FY19–24E



Source: Company websites, Coatings World, New Articles, Frost & Sullivan, MOFSL

Decorative Paints to register strong growth

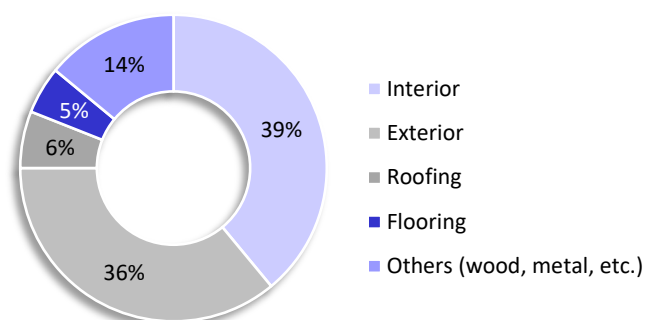
- Products in the Decorative Paints category include emulsions (wall finishes) for interior and exterior use, enamels, wood finishes, and ancillary products (such as primers and putties). Interior and exterior applications together constitute ~75% of the total demand.
- The Decorative Paints industry stood at INR403b in FY19 and is set to post a CAGR of 13% over FY19–24E. It constitutes 74% of the overall Paints market. The industry has benefited from a reduction in GST rates on paints, varnishes, and putties from 28% to 18% in Jul'18.
- Repainting constitutes ~80% of paint demand. The repainting cycle has shortened to 4–5 years presently from 7–8 years a decade ago. The share of unorganized players in fresh paint demand is high as many builders apply low-cost paints/distempers to lower the cost of construction.
- The market has seen a shift from distempers to emulsions owing to the availability of affordable emulsions. Consumers are also uptrading to emulsions on account of the products' higher durability, better aesthetics, and wide color range. Emulsions are gaining popularity over oil-based paints as they are less toxic in comparison, release fewer volatile organic compounds (VOCs), and are devoid of any strong odor.
- Water-based paints (58% of Decorative Paints market) are emerging as the preferred choice for consumers for both interior and exterior applications. The major players are focusing on building their capacities in this segment – over oil-based and powder-based paints, which contribute 34% and 8% to decorative demand, respectively.
- For decorative paints, the share of rural (tier II–IV towns and villages) stands at 50%.

Exhibit 42: Emulsions/enamels to grow in low teens

(INR b)	FY14	FY19	FY24E	CAGR FY14-19 (%)	CAGR FY19-24E (%)
Emulsions	95.7	163.9	309.5	11.4	13.6
Enamels	54.7	103.4	201.0	13.6	14.2
Primers	22.6	39.5	70.4	11.8	12.3
Distempers	24.5	39.2	65.9	9.9	10.9
Putties	19.5	31.4	54.6	10.0	11.7
Wood Coatings	10.0	15.1	23.9	8.6	9.6
Others	7.0	10.5	17.7	8.4	11.0
Total	234.0	403.0	743.0	11.5	13.0

Source: INDIGOPN, MOFSL

Exhibit 43: Interior/Exterior paints together constitute ~75% of decorative paints

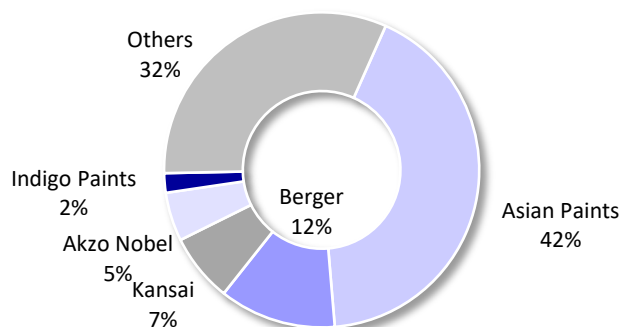


Source: INDIGOPN, MOFSL

High entry barriers lead to oligopoly

- The top four players in the Decorative Paints industry have ~66% market share, resulting in an oligopoly. While there are several small players (organized as well as unorganized), their shares are quite small.
- The Paints industry has some high entry barriers that offer strong moats to the incumbents. These barriers include a) a strong distribution network, b) strong brand equity, and c) the significant penetration of tinting machines

Exhibit 44: Top 4 players with ~66% market share in 2019



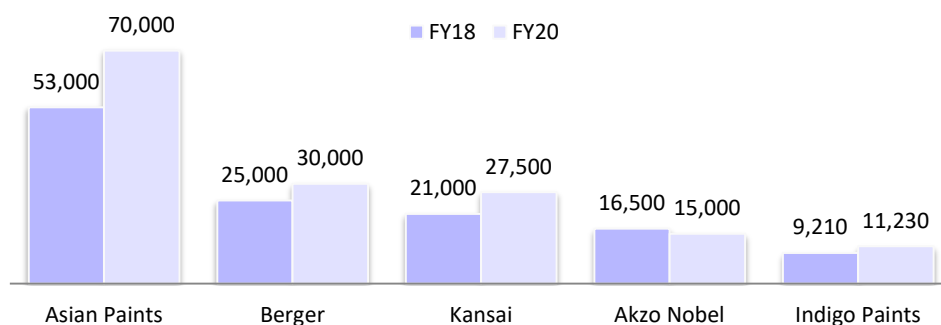
Source: INDIGOPN, MOFSL

Indigo Paints has set up a dealer network of more than 14,700 dealers over two decades

A) Wide distribution network

- The top 4 players have established a strong and wide dealer network across the country, including in rural markets, over past several decades.
- Additionally, unlike the FMCG industry, the Paints industry has a large direct distribution network that eliminates the need for distributors. Pioneered and perfected by APNT, other players are following suit in order to stay competitive.
- Furthermore, the Top 4 players dominate the urban markets; it is extremely difficult for a new player to compete in this environment as (i) awareness of new brands is low among end consumers and (ii) the leading players have a stronghold on dealers and influencers (painters/contractors).
- As a solution, a new entrant could begin by establishing itself in the rural markets and scale up to larger towns gradually. Even in rural, a new entrant has to strive to be the second or third important brand for the dealer as one or more of the Top 4 brands may already be delivering strong performances for the dealer. This strategy, thus, requires patience to scale up sustainably.

Exhibit 45: Paint companies have extensive dealer networks

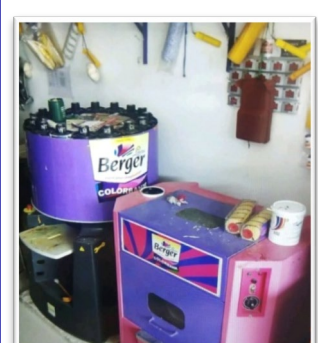


Source: INDIGOPN, MOFSL

Asian Paints and Nerolac ads featuring celebrities



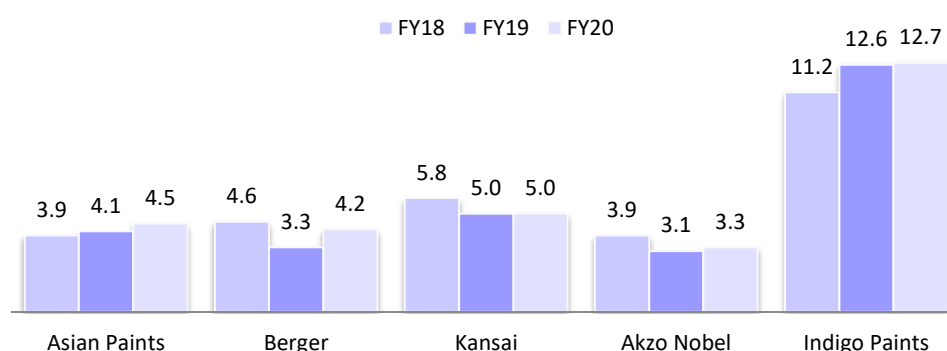
Berger tinting machine



B) Strong brand equity

- The Top 4 players have been present in the market for decades and have invested heavily in brand building over the years. These companies typically spend 3–6% of their sales on ad spends and promotions.
- Using celebrities and catchy jingles, these companies have successfully created a strong brand recall and have thereby become household names.
- To compete with these brands, a new entrant must also invest significantly in creating comparable brand equity. However, this is only possible when the player has achieved a certain scale, leading to a “chicken-and-egg” problem.

Exhibit 46: Leading players typically spend 3–6% of sales on ad spends and promotions

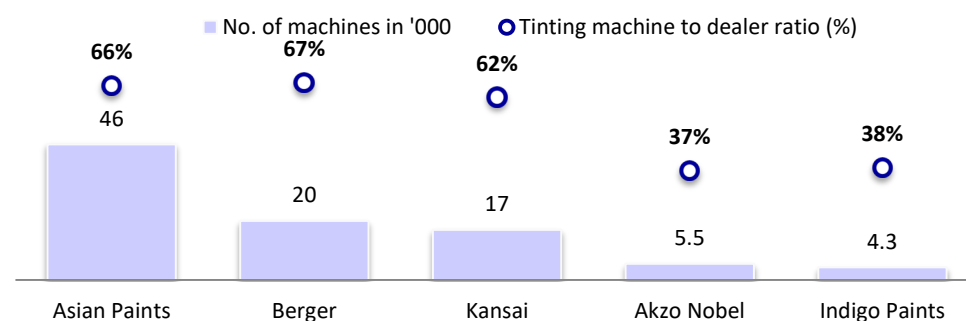


Source: Companies, MOFSL

C) Significant penetration of tinting machines by incumbents

- The Top 4 players have already significantly penetrated their dealer networks with tinting machines. Tinting machines have multiple benefits such as: (i) they have the capability to offer a wide range of colors in less time to a customer that is spoilt for choice, and (ii) they are space savers – as retailers only need to stock the base paints and then tint them as per the requirement.
- The output of a dealer increases 2.5x owing to tinting machines while reducing their inventory.
- Tinting machines cost INR0.13–0.15m and are thus capital-intensive.
- Many dealers may already have one or two tinting machines and may not be keen to add more unless they see strong traction from the new brand. Also, the severe lack of space at retail outlets may add to the dealer’s hesitance.
- Thus, a new entrant has to build brand equity and then convince the dealers to put up the tinting machine – a challenging task.

Exhibit 47: Significant penetration of tinting machines in leading players*



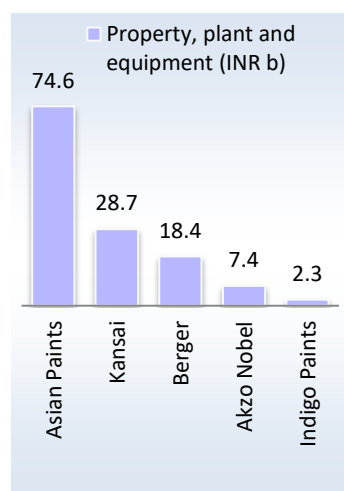
*also see exhibits 4 and 10; data as of FY20

Source: INDIGOPN, MOFSL

Key trends in India's Decorative Paints industry

- **The GST rate reduction** from 28% to 18% has boosted volumes, particularly in lower end segments such as Emulsions, Distempers, and Putties.
- **Paint companies are entering new categories** such as Waterproofing and Building Chemicals.
- **Premiumization** has been gaining salience as the share of paints in a painting job has been declining, owing to which consumers are willing to spend more on them. The ratio of paints to labor cost has declined from 70:30 to 40:60 now.
- **The shift in preference from distempers to emulsions** is driven by the availability of economical paints and a better value-for-money proposition offered by emulsions. Faster **bottom-of-the-pyramid growth** (economical emulsions, distempers, putties, and primers) is led by higher consumer awareness regarding applying an undercoat before applying paint.
- With 50% of the demand coming from rural regions, leading companies have been focusing on **expanding in the rural markets**. The total universe of dealers in the country is expected to be 120–150k and is expanding at a 10% CAGR.
- A market **shift is seen towards low-VOC products** such as water-based coatings, driven by health and environmental concerns. Paint companies are also increasingly offering **value-added products** such as anti-dust and anti-stain paints. The recent pandemic has led to companies launching anti-viral paints.

Grasim likely to be second largest Paints player in India by capacity



Source: Company, MOFSL

New entrants unlikely to affect Indigo, but may impact larger players

- The attractiveness of the Paints industry has led to large companies such as JSW Paints and Grasim foraying into this business. Grasim recently announced its foray into the Paints industry with an investment of INR50b – a significant portion of this would be utilized towards capex. With this, it would be the second largest paints company in India by capacity.
- The opportunity for Grasim is attractive as the Paints industry offers high growth and high ROCEs (15–20% ROCEs of big players v/s Grasim's 4.7% in FY20).
- We believe these new entrants are likely to foray into the urban markets first as:
 - The high quantum of investment means it is unlikely to deploy the patient approach of gradually building up from the rural markets to urban.
 - The large capacity created implies it would be easier to drive volumes through the urban markets – which have a higher density of dealers, making them easier to access and service.
- While Grasim aims to leverage UltraTech's cement dealer network, we believe this may not be feasible to drive volumes. This is because customers (painters/contractors) prefer to purchase all of their requirements from one shop as this is more convenient and offers better bargaining power. We would monitor this space for more details from the company.
- As Indigo has a higher salience in the rural markets, it is unlikely to be affected by Grasim's entry.
- However, larger players, including APNT and Berger Paints India Ltd (BRGR), may be impacted depending on the strategy employed by Grasim. APNT's reluctance to take commensurate price hikes until 2QFY22 amid high commodity inflation was also a likely signal to these new players that it would strive to protect its turf.
- The sheer size of the investment earmarked by Grasim indicates that it cannot be taken lightly. The impact of its entry would be better understood when details on the product portfolio and route-to-market become clearer.

Financials and valuations

Income Statement consol.

(INR m)

Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Net Sales	4,015	5,356	6,248	7,233	9,042	12,025	15,032
Change (%)		33.4	16.6	15.8	25.0	33.0	25.0
Raw Materials	2,377	2,985	3,220	3,765	5,036	6,494	7,816
Gross Profit	1,638	2,371	3,028	3,468	4,005	5,532	7,215
Margin (%)	40.8	44.3	48.5	47.9	44.3	46.0	48.0
Operating Expenses	1,380	1,830	2,118	2,243	2,710	3,457	4,216
EBITDA	258	541	910	1,225	1,295	2,075	2,999
Change (%)		109.6	68.2	34.7	5.7	60.2	44.6
Margin (%)	6.4	10.1	14.6	16.9	14.3	17.3	20.0
Depreciation	90	171	196	244	326	399	453
Int. and Fin. Charges	45	47	56	38	14	15	17
Other Income	16	16	16	36	106	90	80
Profit before Taxes	139	340	674	979	1,061	1,750	2,609
Change (%)		145.2	98.2	45.2	8.4	64.9	49.1
Margin (%)	3.5	6.4	10.8	13.5	11.7	14.6	17.4
Tax	-3	48	147	271	267	441	657
Deferred Tax	0	20	49	15	0	0	0
Tax Rate (%)	-2.2	20.1	29.1	29.2	25.2	25.2	25.2
Adjusted PAT	142	272	478	693	794	1,309	1,952
Change (%)		91.7	76.0	45.0	14.5	64.9	49.1
Margin (%)	3.5	5.1	7.7	9.6	8.8	10.9	13.0
Exceptional/Prior Period inc	13	3	0	0	0	0	0
Reported PAT	155	275	478	693	794	1,309	1,952

Balance Sheet

(INR m)

Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Share Capital	286	289	290	476	476	476	476
Reserves	989	1,186	1,680	5,159	5,953	7,262	9,214
Net Worth	1,275	1,475	1,971	5,635	6,429	7,738	9,689
Loans	316	516	392	0	0	0	0
Other Liability	77	115	132	157	157	157	157
Capital Employed	1,667	2,106	2,495	5,792	6,586	7,895	9,846
Gross Block	686	1,006	1,669	2,339	4,039	4,989	5,289
Less: Accum. Depn.	67	137	245	452	713	1,024	1,344
Net Fixed Assets	619	869	1,424	1,887	3,326	3,965	3,945
Capital WIP	25	44	11	31	31	31	31
Right to Use Assets	97	311	278	301	277	239	156
Investments	184	197	208	497	797	1,197	1,697
Curr. Assets, L&A	1,641	2,002	1,967	4,983	4,435	5,479	7,775
Inventory	552	693	768	947	1,183	1,574	1,967
Account Receivables	968	1,038	1,045	1,212	1,515	2,015	2,519
Cash and Bank Balance	46	140	57	2,583	1,426	1,496	2,795
Others	75	130	97	241	311	394	495
Curr. Liab. and Prov.	1,307	1,623	1,698	2,212	2,586	3,322	4,063
Account Payables	1,085	1,362	1,386	1,856	2,229	2,965	3,706
Other Liabilities	220	261	289	315	315	315	315
Provisions	1	0	24	42	42	42	42
Net Current Assets	335	379	269	2,771	1,849	2,158	3,712
Goodwill on Cons.	407	306	306	306	306	306	306
Application of Funds	1,667	2,106	2,495	5,792	6,586	7,895	9,846

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Basic (INR)							
EPS	3.0	5.7	10.1	14.6	16.7	27.5	41.0
Cash EPS	4.9	9.3	14.2	19.7	23.5	35.9	50.6
BV/Share	26.8	31.0	41.4	118.5	135.1	162.7	203.7
Valuation (x)							
P/E	652.2	340.3	193.4	133.4	116.5	70.6	47.4
Cash P/E	398.6	209.1	137.2	98.7	82.6	54.1	38.5
EV/Sales	13.9	10.5	9.1	12.4	10.0	7.5	5.9
EV/EBITDA	215.8	104.0	62.1	73.0	69.7	43.3	29.3
P/BV	72.6	62.7	46.9	16.4	14.4	12.0	9.5
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Return Ratios (%)							
RoE	11.1	19.8	27.8	18.2	13.2	18.5	22.4
RoCE	11.3	16.4	22.5	17.4	13.0	18.2	22.1
RoIC		16.8	23.3	24.8	17.5	21.8	28.4
Working Capital Ratios							
Debtor (Days)	88	71	61	61	61	61	61
Asset Turnover (x)	2.4	2.5	2.5	1.2	1.4	1.5	1.5
Leverage Ratio							
Debt/Equity (x)	0.2	0.4	0.2	0.0	0.0	0.0	0.0

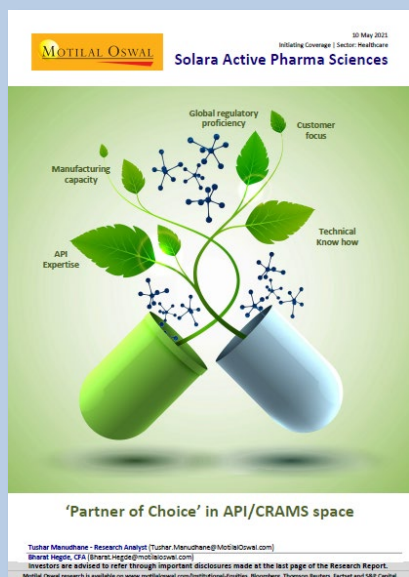
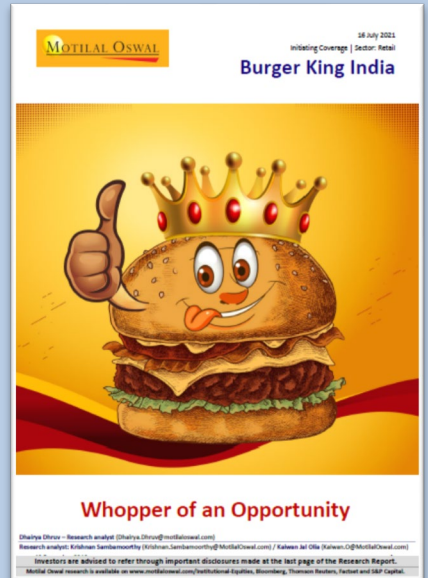
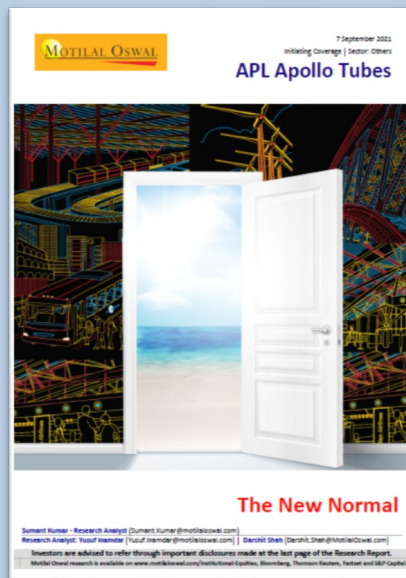
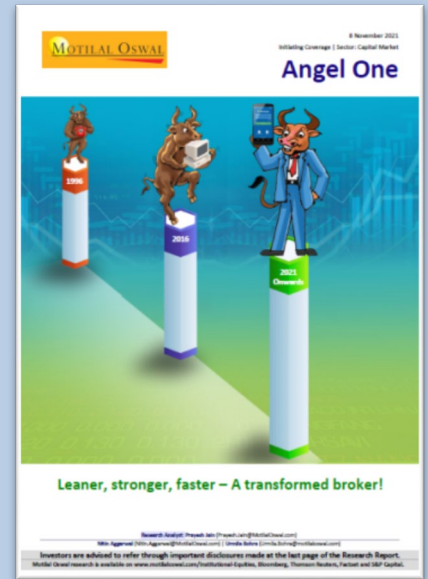
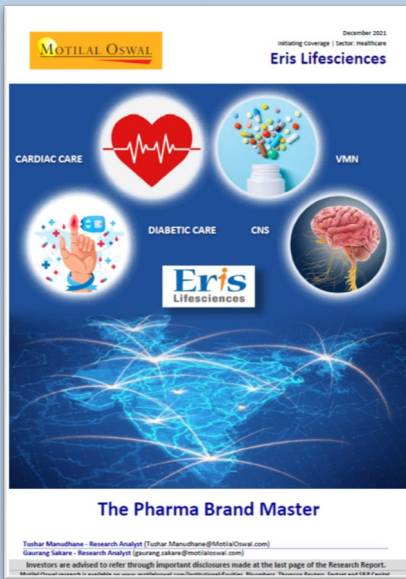
Cash Flow Statement

Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
OP/(loss) before Tax	126	337	674	979	1,061	1,750	2,609
Depreciation	90	171	196	244	326	399	453
Net interest	44	45	54	22	-92	-75	-63
Others	4	6	-8	-5	0	0	0
Direct Taxes Paid	0	-44	-124	-164	-267	-441	-657
(Incr)/Decr in WC	-25	2	-69	137	-236	-238	-256
CF from Operations	238	516	723	1,214	792	1,395	2,085
Incr in FA	-181	-633	-613	-660	-1,676	-912	-217
Free Cash Flow	57	-117	110	553	-884	483	1,868
Pur of Investments	5	0	0	-2,522	-300	-400	-500
Others	5	23	-21	2,138	-24	-47	-92
CF from Invest.	-171	-611	-634	-1,044	-2,000	-1,359	-809
Issue of Shares	0	17	18	2,932	0	0	0
Incr in Debt	-30	209	-143	-500	0	0	0
Dividend Paid	0	0	0	0	0	0	0
Net interest Paid	-38	-37	-47	-33	-120	-105	-97
Others	0	0	0	-41	-41	-41	-41
CF from Fin. Activity	-68	189	-172	2,357	-161	-147	-138
Incr/Decr of Cash	-1	94	-83	2,526	-1,369	-110	1,138
Add: Opening Balance	47	46	140	57	2,583	1,214	1,104
Closing Balance	46	140	57	2,583	1,214	1,104	2,243

E: MOFSL Estimates

REPORT GALLERY

RECENT INITIATING COVERAGE REPORTS



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