

Paint market likely to pick-up pace in coming time

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The Indian paint industry has seen a gradual shift in the preferences of people from the traditional white wash to higher quality paints like emulsions and enamel paints. Growing popularity of new variants providing improved finishing & textures, increasing per capita income of people and efforts on the part of manufacturers to introduce improved versions like eco friendly, odor free and dust & water resistant paints, have propelled the growth of the paint market in India. The major boost to the growth in the Indian paint market has been provided by the decorative paint segment, which is anticipated to grow at a CAGR of more than 16 percent during the period 2013-14 to 2015-16. Under the decorative segment, the emulsion paint market has witnessed a massive demand over the past few years and is expected to drive the market in the coming years too.

Current scenario

FY14 was tough for the Indian paint sector. Hopes of a revival in demand after a good monsoon and during the festive season were dashed by high inflation. The demand for paint, being a discretionary expenditure, is typically hurt during periods of rising inflation. However, to their surprise, paint makers have found that while demand remained tepid in cities, consumption was rising in rural areas. The increasing reach of media in villages has also helped paint makers, making easier for them to advertise their products in these regions. Companies have also discovered that demand for premium paints is high even in remote locations.

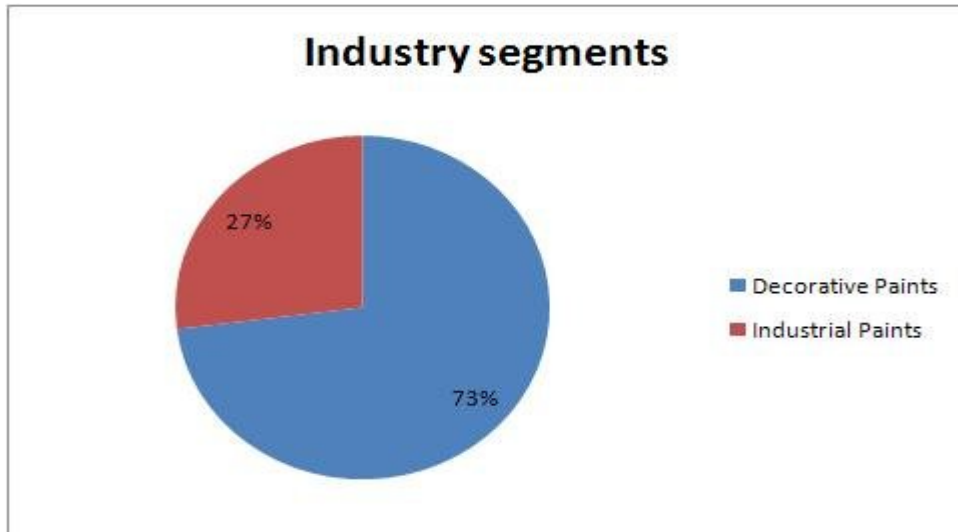
Performance on the margins was impacted by the rising prices of crude oil and titanium dioxide which increased the overall expenditure, thereby impacting profitability growth. However, companies are undertaking a gradual and calibrated price increase in order to shield margins. Nonetheless, as a complete pass on of raw material price increase is not possible in the industrial segment, the blended margins continue to suffer. A good harvest and festival season demand can boost volumes in the second half of FY15.

Moreover, all the key players are in an expansion phase. Asian Paints' plant in Khandala, Maharashtra recently got commissioned. Kansai Nerolac's capacity expansion plans at Jainpur and Bawal has culminated. Berger Paints has also undertaken capacity expansion for its plants located in Andhra Pradesh (AP). Further, expansion of water based plant at Rishra and Goa are also on track. As per estimates, paint capacities are expected to go up by 50-70 percent in the coming 3 to 5 years.

Segment Analysis

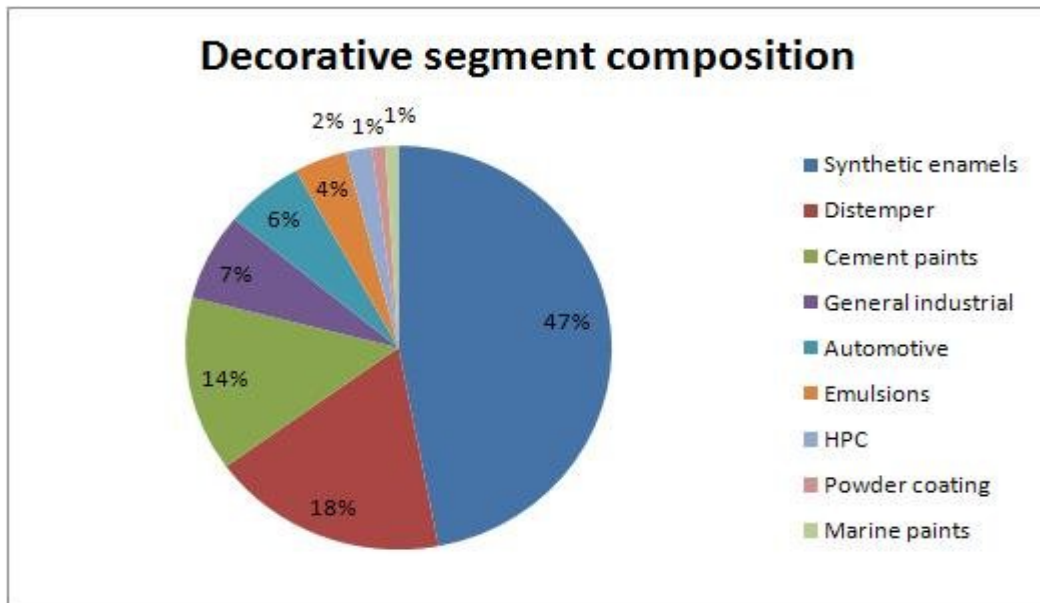
The paint industry is divided into decorative and industrial segments. Decorative paints enjoy a market share of 73 percent and industrial paints have the balance of 27 percent. Decorative paints can be further classified into higher end acrylic exterior and interior emulsions, medium range exterior and interior emulsions and enamel paints, low end distempers, wall putty, primers and thinners and wood coatings. They can also be broadly categorised into water and solvent based paints. Water based paints have an edge and are growing at a higher rate because most paintable surfaces in architectural constructions use water based coatings. It also has the added advantage of being more environmentally friendly. Industrial paints, on the other hand, comprise

automotive including auto refinish, general industrial including consumer durables, protective coatings, coil coatings and powder coatings.



Decorative paints segment:

Decorative paints account for the bulk of the market in terms of volume and value. The unorganized segment plays a huge role in the decorative paints segment due to low technical know-how and a highly scattered market. The decorative paints segment can be classified into interior paints and exterior or cement paints. 80 percent of the decorative paints account for interior paints, which consist of premium, medium and economy categories. The premium category consists of plastic emulsions, the medium-priced category consists of synthetic enamels and the economy category consists of distempers.

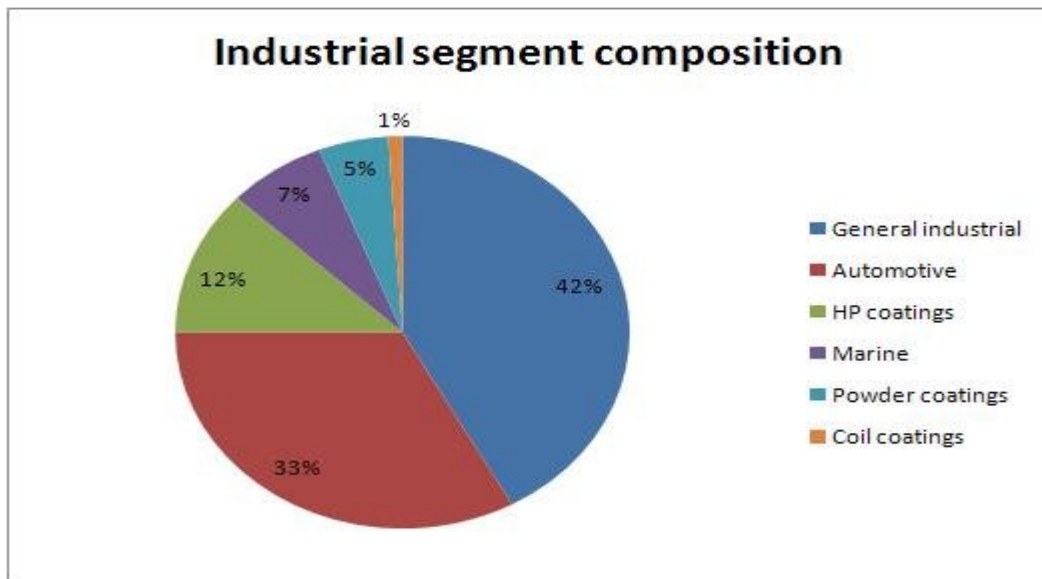


The products under the decorative finishes can be limestone coatings, primers, distempers, cement paints, matt/lustre finishes, enamels, emulsions (first quality), and premium emulsions. Consumption of paints is skewed towards decorative paints which account for 70 percent of paints sold in India. This is in a sharp contrast to the trend in developed countries, where the ratio is skewed towards the industrial segment. This segment is marked by the presence of a large number of players from the organized as well as unorganized sector. Competition is high and margins tend to be low in this segment. Products of this segment are relatively price sensitive. Demand for decorative paints is seasonal with bulk of sales taking place during the festival seasons from September to December. Besides, sales remain slack during the monsoon months from June to August.

Industrial paints segment:

The industrial paints segment is dominated by the organized sector due to its high technology orientation. It is also the more profitable segment. It comprises 27 percent of the market include automotive paints, high performance coatings, coil coatings, powder coatings, marine paints and general industrial coatings. The automotive segment is further bifurcated into OEMs and auto refinishes. The automotive and general industrial coatings occupy top slot in terms of production. Demand for these paints is relatively price inelastic, but is prone to business cycles and depends on industrial and economic growth. Major end user industries include shipping, capital goods, white goods and heavy industries.

The industrial paints segment due to specialized technology and high capital expenditure attracts fewer players. Most Indian companies have tied up with or are in the process of tying up with international paint majors to have access to the latest technology. A tie-up with a global paint manufacturer also enables the domestic company to supply to local customers of its partner. For example, Goodlass Nerolac is a major supplier to Maruti Suzuki because of Kansai, its Japanese collaborator and Suzuki relations. It is for the same reason that Asian Paints (tie-up with PPG Industries, USA) is a major supplier of paints to Opel Astra.



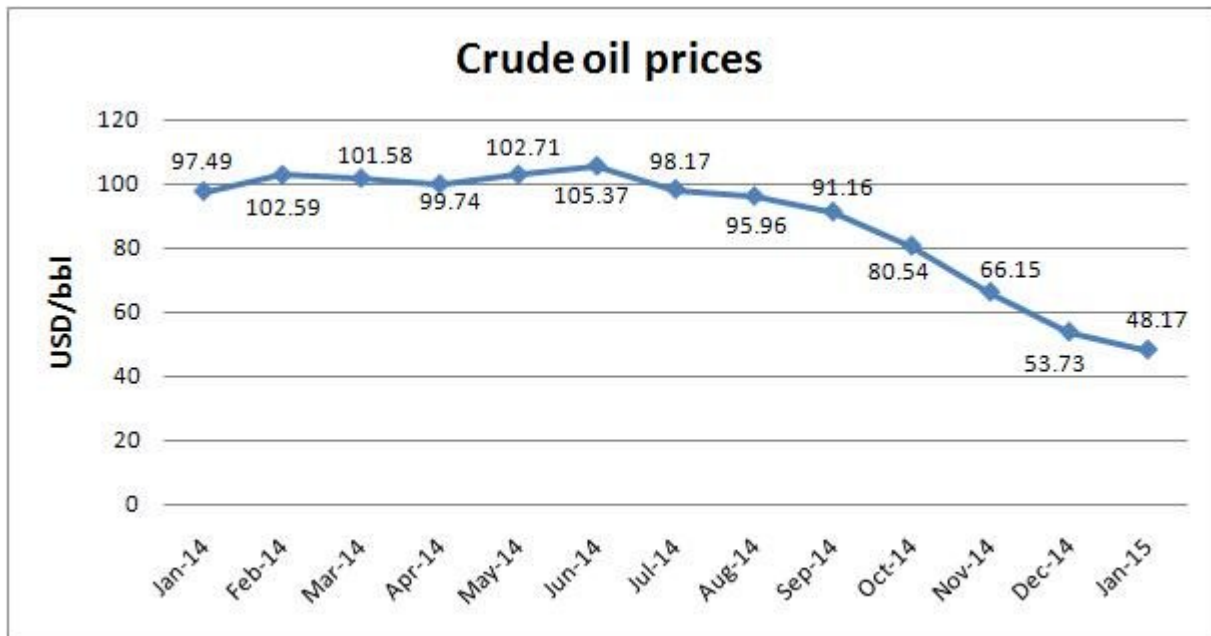
Positive for the industry

Falling crude oil prices bring cheer to paint companies

Crude prices have declined significantly in past six months and are hovering at around a six -year low. Lower input costs and volume growth may lead to a 300 basis points (bps) margin expansion for Asian Paints. Even other paint companies may see earnings and margin expansion. Berger Paints will also see about 120-130 bps benefit on operating margin as crude prices have dropped by over 65 percent since the beginning of October.

Some paint companies might pass on the benefit of softening oil prices to consumers to propel volume growth by keeping realizations low, while others might resort to brand investments or capacity expansion. Lower prices and an improvement in demand from the automotive and industrial segment as economic recovery gathers steam should help paint companies clock volume growth in the range of 9-13 percent for FY15-16.

The prices of another key raw material -- titanium dioxide -- which makes up a sizeable proportion of the input costs for paint companies are also benign, but this has been priced into the stocks. Raw material costs as a percentage of net sales for five listed paint companies dropped to 59.1 percent, the lowest in around four years in the September quarter.



Outlook

The Indian paint industry has seen a gradual shift in the preferences of people from the traditional whitewash to higher quality paints like emulsions and enamel paints. The rural market grew 20 percent in 2013-14. Rural India's incremental consumption expenditure is growing well. And, the rural sector has a major share of the decorative paints segment. Thus, any benefit to the

rural sector's disposable income is directly correlated to the paint industry's growth. Besides, decorative paints are marketing well, backed by large advertisement campaigns and dealership networks.

Indian paint industry is likely to see a 20 percent compounded annual growth rate until 2016 on the back of increasing demand from retail consumers, on rapid urbanisation, and development of rural markets. A rise in disposable income of the average middle class coupled with increasing investment on education, urbanisation, development of the rural market and various launches of many innovative products will also be major drivers.

Companies Financial Data In Industry

Company Name	CMP	MCAP (Rs Crore)	BOOK VALUE	DIV. YEILD %	TTM EPS	TTM PE
Kansai Nerolac Paints Ltd.	2240.10	12072.34	290.68	0.49	44.47	50.38
Akzo Nobel India Ltd.	1449.90	6765.28	200.39	5.17	36.99	39.19
Hardcastle & Waud Manufacturing Company Ltd.	512.15	34.80	664.96	0.00	13.76	37.22
Asian Paints Ltd.	843.50	80908.33	42.05	0.63	12.60	66.92
Jenson & Nicholson (India) Ltd.	6.42	24.03	-105.33	0.00	11.70	0.55
Berger Paints India Ltd.	226.40	15695.95	18.09	0.49	3.54	63.92
Dera Paints & Chemicals Ltd.	6.80	3.92	-5.45	0.00	-0.19	0.00
Shalimar Paints Ltd.	162.60	307.77	34.46	0.00	-7.41	0.00

Sorted with TTM EPS (High to Low)

Source – Ace Equity

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