

Consumer Sector

15 January 2021

Indigo Paints Ltd. IPO analyst meet takeaways

We attended the virtual Brokers & Analyst Meet of Indigo Paints Ltd. (Indigo) for its forthcoming Initial Public Offering (IPO). The management, represented by Mr. Hemant Jalan, Managing Director & Chief Executive Officer, Mr. Chetan Humane, Chief Financial Officer and Mr. Suresh Babu, Chief Operating Officer spoke about the journey of Indigo Paints till date and also shared details about the IPO. The following are the key takeaways:

Background: From a humble start in FY00, when it set up a cement paint manufacturing unit in Jodhpur, Indigo has become the fifth largest decorative paint manufacturer in India. The company has three manufacturing facilities - in Jodhpur, Kochi and Pudukkottai, strategically located in close proximity to the company's raw material sources. As of FY20, the company had a distribution network of 36 depots and 11,230 active dealers and a tinting machine population of 4,296 across India. Indigo is currently present in 27 states (it is yet to enter Himachal Pradesh) and 7 union territories as of date.

How is Indigo different vis-à-vis the top 4 players: (i) Around 28% of the company's revenue comes from highly differentiated products, which have high gross margins (inclusive of metallic emulsions, tile coat emulsions, bright ceiling coat emulsions, floor coat emulsions, dirtproof & waterproof exterior laminate, exterior & interior acrylic laminate and PU super gloss enamel). These products have been introduced by the company by identifying potential product needs from customers, thereby creating an altogether distinct market for itself. Such differentiated products take ~4-5 years to gain traction and the company believes that by the time larger players try to enter these categories, Indigo is already the leader in them. Further, the revenue addition from such categories may not be meaningful for larger players and thus they may avoid entering that particular space altogether. (ii) On an average, Indigo has entered one state every year since inception. It follows a bottom-up approach for entering a new geography i.e., first it enters tier 3/4 towns & rural areas and then penetrates into larger cities. Around 85% of the company's sales come from areas with population less than 300,000-400,000 (with the balance coming from larger towns), whereas for the large players ~50-55% sales come from small towns & rural areas. As per the management, the sales team is instructed to focus on tier 3/4 cities for 4-5 years and only when the Indigo brand is relatively established in these regions, the company moves to larger cities. (iii) In terms of dealer base and tinting machines, the company intends to grow at a faster pace in the coming years. At a dealer base of 11,230, Indigo is inching closer to the No. 4 player but has a long way to go compared to the market leader's base of +70,000. ~40% of Indigo's dealers have its tinting machines. This ratio stands at ~90% for Asian Paints and ~65-70% for Berger Paints. While it is very difficult to find dealers with less than 2 tinting machines, Indigo is offering its dealers tinting machines with a built-in computer, thereby occupying lesser space. (iv) The painter community, being a very important influencer (compared to a dealer) in driving demand, is key to any paint manufacturing company. While most players offer an extensive painter/contractor program, which is generally run by an outsourced third-party agency, Indigo has an in-house team of engineers who demonstrate the quality of the company's paint to the painter/contractor community. A blind-test is done ~500 times per month at the dealer's counter versus the peers, wherein the painters choose the product with the best quality without knowing the brand (as per the management, 100% of the times painters have selected Indigo's products). In the coming five years, the company will continue to focus on expansion of its distribution network, increasing the number of tinting machines, strengthening its brand equity through sustained advertising and match some large players in terms of dealer base, tinting machine population & brand saliency.

How does Indigo's margin stack up versus top 4 players: (i) Given that Indigo generates ~28% of its revenue from high gross margin differentiated products where no discounts are offered (difference can be as high as 8-10% than conventional paint products), the company's overall gross margin tends to be higher compared to its peers. Further, since the company's plants are located in close proximity to raw material sources, inward freight costs are lower, thereby aiding higher gross margins. Even if outward freight costs (which are higher for the company as it has to transport products from its 3 plants to its depots which are present across India) are added to the raw material cost, Indigo's gross margin is almost in line with that of the market leader. In terms of discounts offered to the retailer, Akzo offers the highest discount followed by Asian Paints and then Indigo. (ii) In terms of A&SP spends, all the large paint companies have been advertising for emulsions, but Indigo has been focusing on advertising its differentiated products over the past 4-5 years. In absolute terms, core media spends of Indigo (~Rs620mn in FY20) was as high as that of Berger Paints and Kansai Nerolac. Going ahead, while absolute ad spends will keep on increasing, ad spends as a % of revenue will start moderating as economies of scale starts to kick in. (iii) Other advantages playing in favor of the company are its low attrition rate as the company prefers to recruit freshers even for the mid-level management (which has fair amount of responsibility, thereby driving employee performance) and eventually incentivizing them with variable compensation and ESOPs.

Objects of the offer: The offer comprises of a fresh issue aggregating up to Rs3bn and an offer for sale of up to 5.8mn equity shares aggregating up to Rs86.9bn by the selling shareholders. The proceeds of the fresh issue are proposed to be utilized for financing the project cost towards expansion of the Pudukkottai (Tamil Nadu) plant (likely to commence in August 2022), purchase of tinting machines & gyro shakers and repayment/prepayment of certain borrowings. Other highlights from the presentation continued on next page.

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Exhibit 1: Financial summary

Y/E March (Rsmn)	FY18	FY19	FY20	1HFY21
Net revenues	3,951	5,356	6,248	2,594
YoY growth (%)	-	35.6	16.6	-4.8
EBITDA	258.0	540.9	909.9	480.9
EBITDA margin (%)	6.5	10.1	14.6	18.5
PAT	142	272	478	272
EPS (Rs)	3.2	6.0	10.6	6.0
YoY growth (%)	-	41.5	50.9	353.9
RoCE (post-tax) (%)	-	17.3	23.8	27.2
RoE (%)	-	19.8	27.8	28.7

Source: Indigo RHP, Nirmal Bang Institutional Equities Research

Note: FY18 net revenues are net of excise; Return ratios for 1HFY21 are annualized and are on average basis; Growth in 1HFY21 is over 1HFY20

Exhibit 2: Key issue details

Sector	Consumer – Paints
Price band (Rs)	1488-1490
Face Value (Rs)	10
Issue size (Rsbn)	Fresh issue of Rs3bn and offer for sale of up to 5.8mn shares aggregating to Rs86.9bn by selling shareholders
Anchor Book	19 th January 2021
Offer Opens on	20 th January 2021
Issue Closes on	22 nd January 2021

Source: Indigo RHP, Nirmal Bang Institutional Equities Research

Other key highlights from the presentation

About the company's journey

- After setting up a cement paint manufacturing in Jodhpur in FY00, Indigo spent the next 6 years diversifying its product portfolio to include water-based paints (emulsions, distemper, etc). By FY10, it had reached annual turnover of Rs170mn and had a small footprint in 10 states.
- Indigo believes Sequoia Capital's investment during FY15 was a major inflection point.
- Subsequently, Indigo got the opportunity to acquire Kerala-based Hi-Build Coatings Pvt. Ltd. during FY16.
- Over the last 2-3 years, the company has been aggressively expanding its geographical footprint and increasing its brand saliency.
- Indigo's revenue has grown at a CAGR of +42% over FY10-FY19. Even during FY20, when all companies were affected by the outbreak of Covid-19, Indigo managed to post a healthy revenue growth of +16%.
- As per the management, the company has a significantly high level of corporate governance on account of Sequoia being a marquee investor and E&Y being the company's auditor for the last 6 years.
- The company has incurred high ad spends in the last 4-5 years and is now leveraging its brand equity to strengthen the presence of tinging machines across retailers.

Industry specific comments

- Demand for decorative paints in India has been very resilient on the back of repainting (which is 78% of demand vs fresh painting) and reduction in repainting cycle.
- Emulsions comprise ~50% of the market whereas enamels comprise ~20% of the market.
- Paint industry has adopted a direct distribution model and cannot employ a two-tier distribution model (stockists/wholesalers), which is done by most FMCG companies in India on account of large number of SKUs handled (3,000-4,000).
- As per the management, capacity utilization is a misleading parameter to track, as the paint manufacturing business is seasonal. While the months of June, July and August witness significant dip in utilization for the industry, the demand for paints doubles just before Diwali (especially in the northern regions) and in the months of March & April (pan-India). Hence, on an annual basis, average capacity utilization for any paint company will generally be low.
- Dealers across India offer multi-brand products (not loyal to one brand).

- Management believes that paints in India cannot be sold by reducing prices since it is not an everyday-commodity (painting is done once in ~5 years). Also, actual cost of paints is only 40% of the overall painting cost.
- Competitive intensity in small towns is as high as in urban areas.
- Wood paints is quite a tough market since players have to deal with polishers (not painters), and thus creating brand equity is not easy. However, Indigo is seeing traction in this category in a few states.

Operations specific commentary

- Since the conventional method of a top-down approach would have been counter-productive (consumers in large cities are highly brand conscious and hence new players would face difficulty), the company took up a bottom-up approach while entering new markets. Similar model was followed by Asian Paints many years ago.
- While large paint players have 12-15 sub-brands, Indigo has followed the one-brand strategy (similar to AMUL).
- The company has no intention of manufacture raw material for captive consumption (3 out of 4 top players do so) since it believes that the value-add component in doing so is fairly low and there are enough underutilized capacities with many raw material suppliers in India.
- Management finds it logistically feasible for manufacturing activities to remain in its current locations for the next 5-6 years.
- Company sees the decorative business opportunity in India to be huge and thus has no plans to expand into home-décor/adjacencies/industrial paint businesses. It also does not have any plans to enter other countries for a long period of time. The company also does not have any component of institutional sales.
- Region-specific commentary:
 - The company has entered different states at different points of time and hence each state is at a different stage of evolution in terms of distribution. E.g. States like Maharashtra, Telangana, Gujarat etc for Indigo are still work-in-progress on rural front compared to other states like Kochi, Kanpur, Patna, Ranchi, Thiruvananthapuram, etc. In North India, company has just recently entered.
 - Kerala is the largest revenue generating state for the company where it ranks third (Asian Paints is the leader, followed by Berger; Indigo is twice the size of the fourth largest player and is not far behind Berger). Around 7-8 states compete for the second and third spot for the company (including states like West Bengal, Bihar, Maharashtra, Uttar Pradesh, etc)
 - The company is seeing good traction in Delhi and Mumbai. While the company has a depot in Mumbai, it does not have one in Delhi and supplies to this market from the Ghaziabad depot.
- Company believes that making paints is not a rocket science and hence R&D spends are miniscule in nature and believes that understanding the consumer mindset is a bigger challenge in the business.
- All large players use Bollywood personalities as their brand ambassadors while Indigo chose Mr. M.S. Dhoni for better connect & pan-India appeal (even in South India where Bollywood actors do not have a major appeal).

Comments on financial performance

- Post the IPO, Indigo would be a debt free company.
- Sequoia Capital intends to remain invested for another 5-6 years.
- Indigo's average working capital cycle of 23 days is the lowest in the business.
- During 1HFY21, while there were no conscious cost reduction measures taken (company even implemented salary increments in June, which was delayed slightly from the usual increments done in April), EBITDA margin expanded on account of lower ad spends during the period, as April and May, which is generally an ad-heavy period, witnessed lockdown.

Financials

Exhibit 3: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20	1HFY21
Net Sales	3,951*	5,356	6,248	2,594
% YoY Growth	-	35.6	16.6	-4.8
COGS	2,313	2,985	3,220	1,352
Staff costs	303	364	420	220
Other expenses	1,077	1,466	1,699	541
Total expenses	3,693	4,815	5,338	2,113
EBITDA	258	541	910	481
% growth		109.6	68.2	105.0
EBITDA margin (%)	6.5	10.1	14.6	18.5
Other income	16	16	16	8
Interest costs	45	47	56	25
Depreciation	90	171	196	112
Profit before tax	139	340	674	352
Tax	-3	68	196	80
PAT before NCI/Subs/Assoc.	142	272	478	272
Share of profit from Assoc/JV/Subs/NCI	0	0	0	0
Adjusted PAT	142	272	478	272
PAT margin (%)	3.6	5.1	7.6	10.5
% Growth	-	41.5	50.9	353.9

Source: Indigo RHP, Nirmal Bang Institutional Equities Research

*net of excise

Exhibit 5: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20	1HFY21
Share capital	286	289	290	290
Instruments in the nature of equity	183	183	183	183
Reserves	806	1,003	1,497	1,770
Net worth	1,275	1,475	1,971	2,244
Lease liabilities	77	94	63	57
Other Long Term Liabilities	18	32	38	35
Borrowings	316	516	392	193
Deferred Tax Assets / Liabilities	0	21	70	57
Total liabilities	1,685	2,137	2,534	2,587
Net block	1,124	1,486	2,007	1,985
Capital work-in-progress	25	44	11	26
Investments	184	197	208	306
Other LTA	54	100	89	118
Inventories	552	693	768	673
Debtors	968	1,038	1,045	856
Cash	46	140	57	121
Other current assets	20	33	35	28
Total current assets	1,587	1,905	1,904	1,678
Creditors	1,085	1,362	1,386	1,191
Other current liabilities & provisions	204	232	300	335
Total current liabilities	1,289	1,594	1,686	1,526
Net current assets	298	311	218	151
Total assets	1,685	2,137	2,534	2,587

Source: Indigo RHP, Nirmal Bang Institutional Equities Research

Exhibit 4: Cash flow

Y/E March (Rsmn)	FY18	FY19	FY20	1HFY21
PAT	125	293	550	264
Depreciation	90	171	196	112
(Inc./dec. in working capital)	(25)	2	(69)	131
Others	48	51	46	25
Cash flow from operations	238	516	723	532
Capital expenditure (-)	(181)	(633)	(613)	(135)
Net cash after capex	57	(117)	110	397
Inc./(dec.) in investments and other assets	11	23	1	(93)
Cash from investing activities	(170)	(610)	(613)	(227)
Dividends paid (-)	0	0	0	0
Inc./(dec.) in share	-	17	18	-
Inc./(dec.) in borrowings	(6)	243	(101)	(199)
Others	(63)	(72)	(89)	(40)
Cash from financial activities	(68)	189	(172)	(240)
Opening cash balance	47	46	118	57
Closing cash balance	46	140	57	121
Change in cash balance	(1)	94	(62)	65

Source: Indigo RHP, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

Y/E March	FY18	FY19	FY20	1HFY21
Per share (Rs)				
EPS	3.2	6.0	10.6	6.0
Book value	28.5	32.8	43.7	45.7
DPS	0.0	0.0	0.0	0.0
Return ratios (%)				
RoCE	-	17.3	23.8	27.2
RoE	-	19.8	27.8	28.7
RoIC	-	18.6	25.2	40.8
Profitability ratios (%)				
Gross margin	41.5	44.3	48.5	47.9
EBITDA margin	6.5	10.1	14.6	18.5
EBIT margin	4.2	6.9	11.4	14.2
PAT margin	3.6	5.1	7.6	10.5
Liquidity ratios (%)				
Current ratio	1.2	1.2	1.1	1.1
Quick ratio	0.8	0.8	0.7	0.7
Solvency ratio (%)				
Debt to Equity ratio	0.1	0.1	0.1	(0.1)
Turnover ratios				
Total asset turnover ratio (x)	2.3	2.5	2.5	0.0
Fixed asset turnover ratio (x)	3.5	3.6	3.1	1.3
Inventory days	-	42	43	49
Debtors days	-	68	61	58
Creditor days	-	83	80	85

Source: Indigo RHP, Nirmal Bang Institutional Equities Research

Note: Return ratios for 1HFY21 are annualized

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