

April 30, 2020

Near term pressure due to lockdown

The domestic paint industry has grown strongly by ~12% in the last 10 years despite various macro challenges like demonetisation, introduction of GST, floods in various states, volatility in input prices. Major paint players like Asian Paints, Berger Paints and Kansai Nerolac have been seen to have bounced back strongly supported by 1) India's long term growth drivers staying intact, 2) strong supply chain networks, 3) higher promotional spends, 4) pan India dealer reach, 5) strong management. Considering the gradual relaxation from lockdown (as of now ~76% districts either in orange zone or in green zone), we believe the Covid-19 impact on paint companies will be limited till H1FY21 only while a gradual demand recovery would start from the festive season. The assumption of demand recovery is based on our recent interaction with some paint dealers (key points below). In addition to this, significant input cost correction in a short span of time along with pricing power of paint companies would structurally help in gross margin expansion. Hence, we remain structurally positive on paint stocks.

Key conference call takeaways...

- The slight improvement in paint demand during January-February was offset by poor sales in March. Also, Q1 & Q2FY21 demand will be impacted by lockdown and monsoon
- Dealers have inventory of one month with them. They expect a slow pick up in repainting cycle as they expect an extended lockdown in Maharashtra, West Bengal, Delhi and unavailability of labours
- Companies have planned to extend support to paint contractors (and labours) by distributing them mask and sanitisers. This will help them to start painting work without any fear as soon as lockdown opens. This is creating a significant difference between organised and unorganised players (that are largely cash strapped due to lockdown)
- Major paint companies have directly transferred cash to the bank of account of paint contractors, which are struggling from cash crunch in the period of lockdown. These cash transfers are against the points which contractors gained as part of promotional offers of companies
- The companies have increased cash discounts to dealers by ~3.5% from the start of April 2020. Companies are providing extra discounts to dealers (depending on the size of dealers) to realise the cash as early as possible (to avoid the fear of any default)
- Dealers are expecting companies to pass on the benefit of lower input cost with a lag of 45 days. Hence, we believe the major impact of benign raw material prices would come from Q3FY21 onwards
- Major dealers are managing inventory of ~30 days while for small dealers it is ~7 days
- Some of the dealers in the rural regions have managed to liquidate their inventory prior to lockdown. Asian Paints and Berger Paints both have increased focus on rural India with the push of lower end products (economic emulsion, distemper and putty). The post lockdown recovery in volume will be higher from these two players considering their strong reach in tier-III and tier-IV cities, which are less affected by Covid-19

Key Highlights

- Lockdown situation to hurt sales of industry. Demand recovery expected from H2FY20
- Most dealers holding ~30 days of inventory
- Higher cash discount depending on size of dealers. Most dealers paid their outstanding amount to get the cash discount at the start of the month
- Launch of sanitisers and masks for paint contractors to start work as soon as lockdown opens

Pan-India dealers network

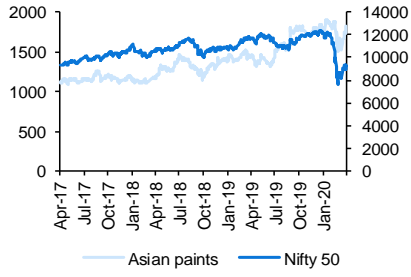
Companies	Dealers
Asian paints	60,000
Berger Paints	28,000
Kansai Nerolac	20,000

Research Analyst

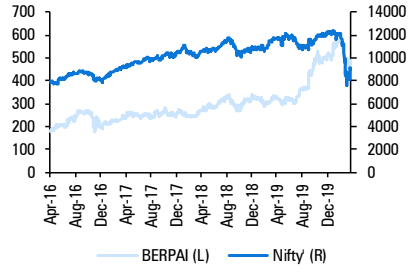
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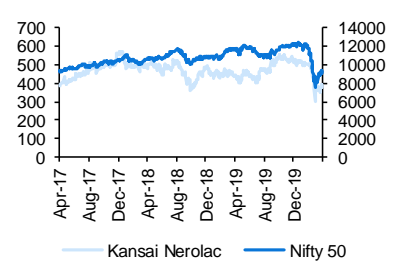
Berger Paints



Berger Paints



Kansai Nerolac



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