Berger Paints India (BERPAI)

CMP: ₹ 519 | Target: ₹ 595 (15%) | Target Period: 15 months | **BUY**

April 27, 2020

Initiating Coverage

ICICI Securities – Retail Equity Research

Colourful growth story…

Berger Paint (BPIL) is the second largest decorative paint player in India with an organised market share of ~17%. The company has kept its market share intact despite aggressive expansion by the leader and other MNC paint players in domestic market. In the last five years, BPIL has invested heavily in capex, brand building (average 5% of sales in the last five years) and product innovation with a strong balance sheet position. **All these resulted in a sharp expansion in EBITDA margin by ~300 bps in the past five years and generated average RoE, RoCE of ~22%, 32%, respectively. We believe the current lockdown situation due to the Covid-19 pandemic would restrict FY21 volume growth. A strong demand recovery is expected to be witnessed from FY22E onwards supported by a surge in repainting demand. We also believe with a strong supply chain and distribution network in place BPIL is set to benefit from a spike in demand once the situation normalises post lockdown. We initiate coverage on Berger Paints with a BUY rating in view of: 1) long term growth drivers remaining intact, 2) expansion in gross margin and 3) market share gain from smaller, unorganised companies.**

Long term growth drivers remain intact for paint players

We believe FY21E will be a challenging year for the paint industry with 100% revenue losses in April 2020 and a gradual recovery from May 2020 owing to the Covid-19 related shutdown. Our dealer check suggests a strong recovery in paint demand from H2FY21E supported by festive demand. We believe that barring a few hiccups, the long term growth story of decorative paint with shortening repainting cycle, rising aspirations and urbanisation level in India remains intact. We believe the paint industry will grow at 8% CAGR in FY19-22E led by decorative paints with ~9% CAGR (against ~12% CAGR in the last 10 years). We also believe top players would outperform industry growth by 100 bps supported by market share gains from the unorganised pie, which is holding ~30% of total market share.

Despite near term challenges margin to remain intact

Berger Paints launched various innovative products (WeatherCoat Anti Dustt & Easy Clean) in the decorative paints category through a sharp increase in its R&D spend. Launch of premium products and favourable input prices drove gross margins up ~250 bps in FY12-19. With crude oil prices likely to remain low, we expect a further expansion in gross margin, thereby leading to an improvement in EBIDTDA margin by ~600 bps in FY19-22E.

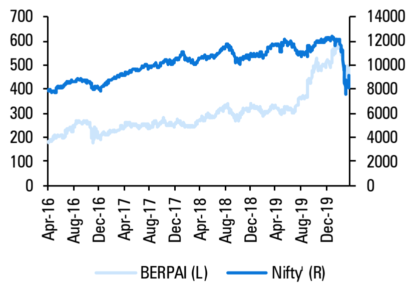
Valuation & Outlook

Berger Paints is likely to report revenue, earnings CAGR of 11%, 32%, respectively, in FY19-22E supported by elevated margins (backed by benign raw material prices) and lower corporate tax. Further, with the dominance of limited players and intact long term growth drivers, the premium valuation of the company is justified due to its robust fundamentals (strong distribution, debt free status and consistent positive CFO). We initiate coverage on the stock with a **BUY** rating and a target price of ₹ 595.

Stock Data

Particular	Amount
Market Capitalization (₹ Crore)	50,205.9
Total Debt (FY19) (₹ Crore)	499.9
Cash and Inv (FY19) (₹ Crore)	489.3
EV (₹ Crore)	50,216.5
52 week H/L (₹)	597/292
Equity capital (₹ Crore)	97.1
Face value (₹)	1.0

Price Chart



Key Highlights

- Strong No 2 decorative paint player with market share of ~17% and pan India distribution network of 28000
- Focus on launching premium products through strong R&D
- Long term growth drivers of paint industry remain intact and paint volume to pick from 2HFY21E post Covid-19
- Initiate coverage on Berger Paints with BUY rating and target price of ₹ 595

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Key Financial Summary

(₹Crore)	FY18	FY19	FY20E	FY21E	FY22E	CAGR (19-22E)
Net Sales	5165.7	6061.9	6504.5	6753.9	8314.5	11.1
EBITDA	807.0	881.6	1085.4	1276.5	1721.1	25.0
EBITDA Margin (%)	15.6	14.5	16.7	18.9	20.7	
Net Profit	460.8	497.5	685.4	814.2	1148.4	32.2
EPS (₹	4.7	5.1	7.1	8.4	11.8	
P/E (x)	108.9	100.9	73.2	61.7	43.7	
RoE (%)	21.0	20.1	25.7	24.9	29.0	
RoCE (%)	26.9	26.2	30.0	30.3	36.4	

Source: ICICI Direct Research, Company

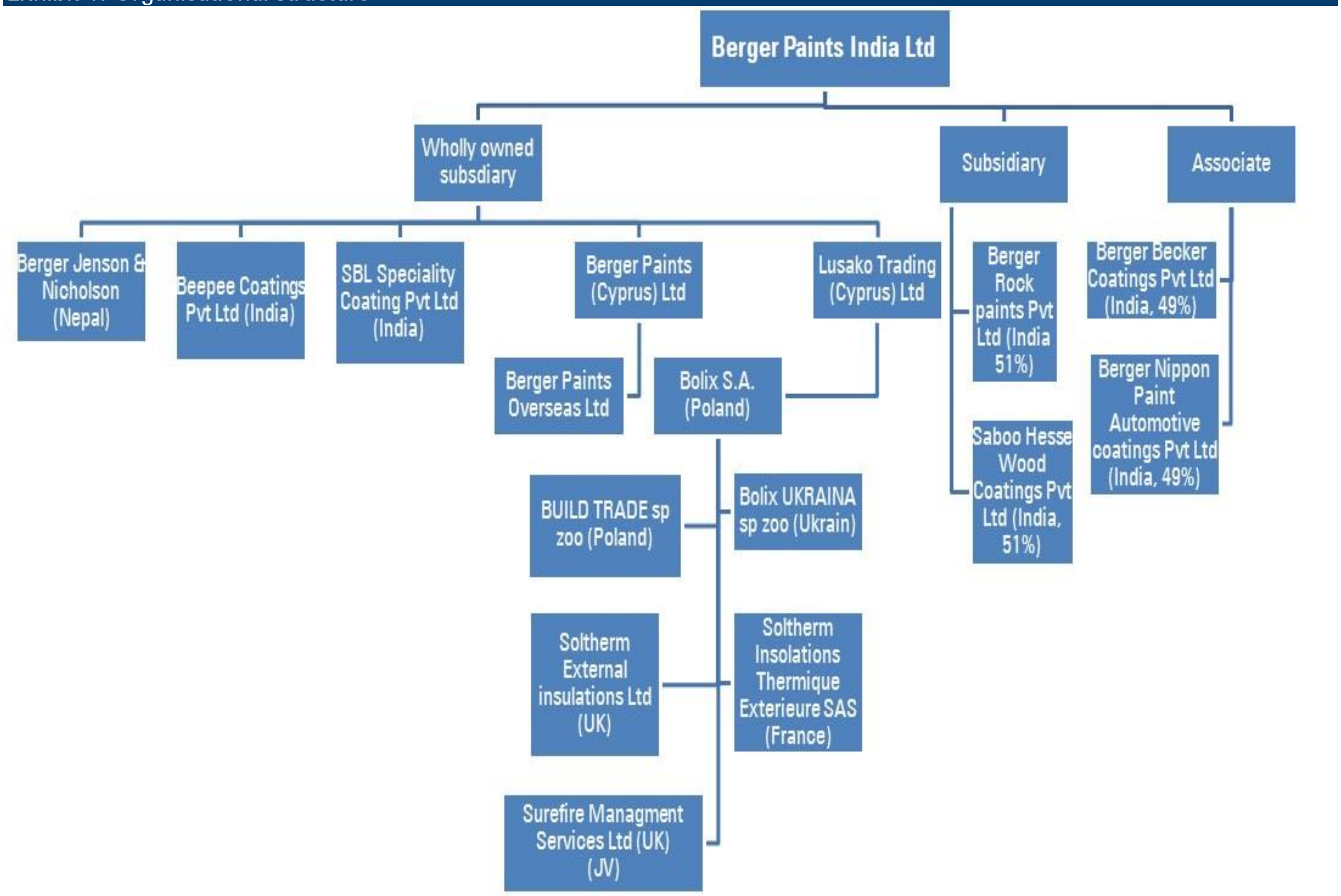
Company Background

Business profile

Berger Paints India (BPIL) is the second largest paint company in India with a presence both in decorative and industrial segments. The decorative paint segment contributes ~80% to the topline while balance 20% is contributed by industrial paints. The company has 20 manufacturing plants worldwide (of which 14 are in India) with total capacity of ~6.1 lakh metric tonnes (MT). BPIL has a diverse range of products under premium, budget (mid-range) and economic categories for interior and exterior applications. In terms of market share, Asian Paints is one of the largest decorative paint players in India with an organised market share of 53%. BPIL is the second largest decorative paint company with ~17% market share. BPIL gained market share through heavy expenditure on product development (average R&D expenses increased from 0.15% of sales in FY05-11 to average ~4% of sales in FY12-19), brand building exercise and expansion in dealer network (of ~28000) across India. Further, on the industrial front (contributes ~20% to topline) BPIL is present in protective coatings, automotive & general industrials and powder coatings. Further, it is the market leader in protective coatings, which contributes ~50% to its industrial paints revenue.

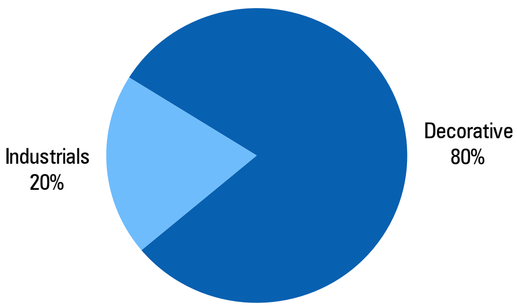
In FY12-19, BPIL reported a strong financial performance with consolidated revenue, earning CAGR of ~11% and 16% to ₹ 6062 crore, ₹ 498 crore, respectively, supported by notable EBITDA margin expansion of 425 bps. Further, despite heavy capital expenditure (~₹ 2000 crore in FY12-19 for organic and inorganic growth), BPIL's balance sheet remained clean with strong return ratios and increased dividend payout.

Exhibit 1: Organisational structure



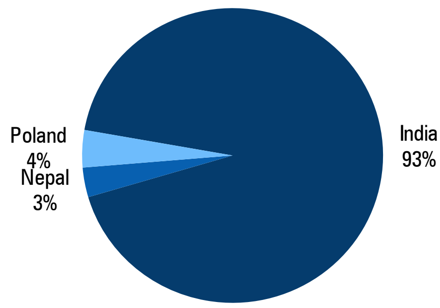
Source: Company, ICICI Direct Research

Exhibit 2: Product wise revenue contribution



Source: Company, ICICI Direct Research

Exhibit 3: Geography wise revenue breakup



Source: Company, ICICI Direct Research

Strong performance of subsidiaries

BPIL's overseas business (Nepal, Poland) contributes ~7% to its annual revenue. The company entered Nepal through acquisition of Jenson & Nicholson in 2000. It entered Poland through acquisition of Bolix SA in 2008. Berger Jenson and Nicholson Nepal (BJ&N) is in the decorative business while Bolix SA is in external insulation finishing systems with topline contribution of 3% and 4%, respectively. Further, both subsidiaries together recorded a strong performance with revenue, earnings CAGR of 20%, 31%, respectively, during FY16-19.

On the domestic front, the company acquired a majority stake in Berger Rock Paints, Saboo Coatings (India), Saboo Hesse Wood Coatings (India) and STP Ltd (India) in FY17-19. These acquisitions helped BPIL strengthen its presence in automotive refinish paints, industrial coatings and wood coating segments, respectively.

Exhibit 4: Subsidiary business profile and performance

Subsidiary	Holdings	Country	Business	Revenue (₹ crore)				PAT (₹ crore)			
				FY16	FY17	FY18	FY19	FY16	FY17	FY18	FY19
Berger Jenson & Nicholson	Subsidiary (100%)	Nepal	Decorative Paints	102.2	135.0	170.8	197.2	17.3	27.9	35.9	40.3
Bolix SA	Subsidiary (100%)	Poland	External Insulation Finishing Systems	157.8	189.7	199.2	247.9	4.4	8.5	6.2	8.8
Beepee Coatings Pvt Ltd	Subsidiary (100%)	India	Textured coatings	23.2	24.9	24.4	24.9	2.0	2.8	2.4	2.7
SBL Speciality coating Pvt Ltd (earlier Saboo Coatings)	Subsidiary (100%)	India	Industrial coatings	NA	NA	71.5	106.3	NA	NA	3.2	9.3
Saboo Hesse Wood Coatings	Subsidiary (51%)	India	Wood Coatings	NA	NA	NA	1.4	NA	NA	NA	0.1
Berger Rock Paints	Subsidiary (51%)	India	Automotive Refinish	NA	NA	NA	1.5	NA	NA	NA	-0.9

Source: Company, ICICI Direct Research

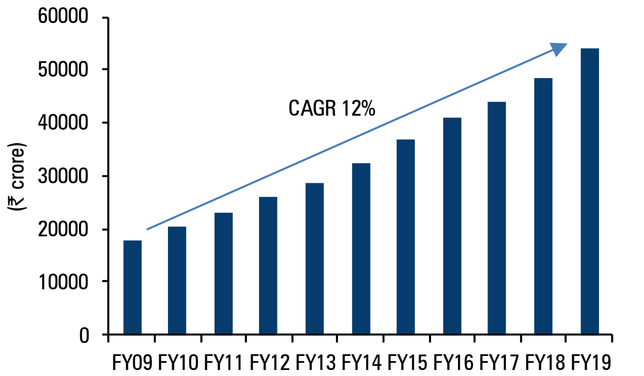
Investment Rationale

Near term headwinds to restrict industry growth to ~8% in FY19-22E

The Indian paint industry grew at ~12% CAGR in FY09-19 to ~₹ 55000 crore led by decorative paint segment (grew at 13% CAGR). Decorative paint comprises 75% of total paint demand in India while industrial paint category (includes automotive, performance coatings/general industrial and powder coating) comprises the remaining ~25%. Characterised by an oligopoly, the domestic decorative paint industry is largely dominated by organised players with 70% market share while unorganised/regional players hold the balance 30% market share. While historically decorative paint grew at ~1.5-2x GDP growth, the paint industry is likely to face near term challenges due to the Covid-19 related economic slowdown.

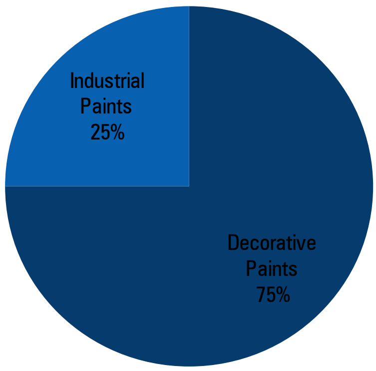
However, paint volume growth is expected to normalise from FY22E onwards with a recovery in GDP. We believe the paint industry would grow at a CAGR of ~8% in FY19-22E led by ~9% growth in the decorative paint segment. The decorative paint demand would be largely driven by shortening of repainting cycle, growing urbanisation and increased distribution reach of organised players. We also believe the strong fundamentals of organised players and rising tax compliance in India would help increase market share gain in the coming future from unorganised/regional players. On the other hand, the industrial paint category is expected to grow at a lower rate of 5% in FY19-22E due to slow recovery in industrial output and automotive industry, going forward.

Exhibit 5: Indian paint Industry



Source: Company, ICICI Direct Research

Exhibit 6: Decorative paints has 75% of total paint market



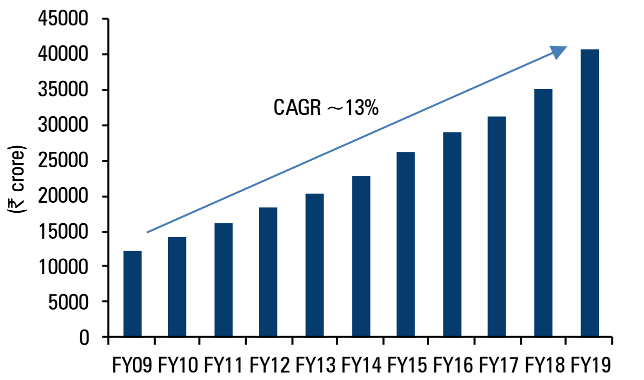
Source: Company, ICICI Direct Research

Decorative segment: Key growth driver

Decorative paint constitutes ~75% of total paint demand in India, which includes interior & exterior emulsion, enamels, distemper, primer & thinner, wood finishes, etc. The decorative segment is the faster growing paint category with a CAGR of 12% in FY09-19 led by strong demand from tier II, tier III cities and reduced repainting cycle (declined from seven years to five years). Within the decorative paint segment, the emulsion sub segment grew at a much faster pace (almost double the overall decorative paint growth) compared to other categories led by rising aspiration level in small towns (driven by rise in premiumisation trend). However, in the last two years, lower end categories (distemper, putties) recorded strong growth due to: 1) increasing penetration in rural markets, 2) market share gain from regional/unorganised players post rising tax compliance and reduction of GST rate from 28% to 18%, 3) various government measures such as Housing for all, Swachh Bharat Abhiyaan, Kisan Samman Nidhi, etc.

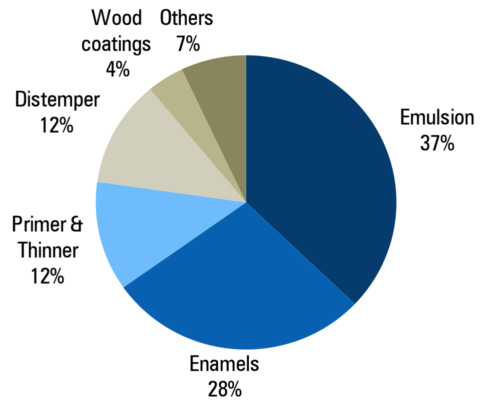
The relation between India's GDP growth and paint industry growth is likely to remain intact in the longer term. We believe a revival in GDP from FY22E onwards (that would drive per capita income) along with rising urbanisation and shorter repainting cycle would drive decorative paint demand by ~9% in FY19-22E.

Exhibit 7: Decorative paint segment growth trend



Source: Company, ICICI Direct Research

Exhibit 8: Decorative sub-segment



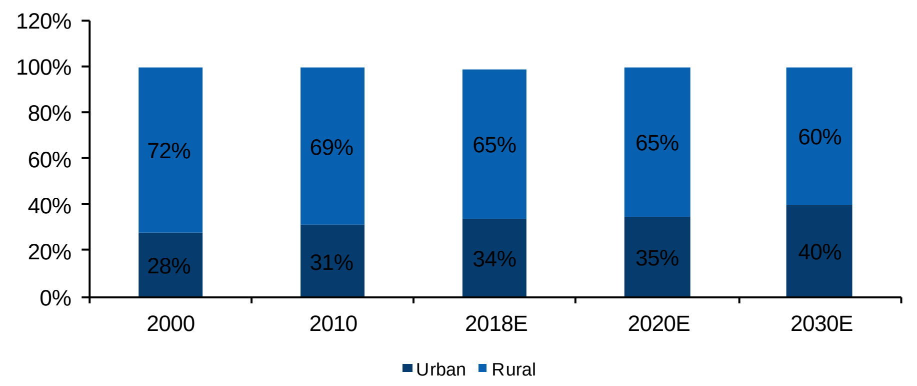
Source: Company, ICICI Direct Research

Industry major growth drivers:-

Urbanisation

The share of India's urban population in relation to its total population has been rising over the years. People from rural areas move to cities for better job opportunities, education and a better life among other reasons. According to a report published by the World Economic Forum, 40% of Indians are expected to be urban residents by the end of 2030. The top nine cities and 31 towns are anticipated to be richer than other cities. However, >5,000 small urban towns (50,000-100,000 persons each) and >50,000 developed rural towns (5,000-10,000 persons each) are expected to already have income profiles very similar to 31 top towns. Increasing urbanisation in India coupled with rising income levels have resulted in progressively increasing demand for housing, particularly quality housing, across Indian cities. We believe this growing demand for quality housing will drive demand for decorative paint demand, going forward.

Exhibit 9: India's urbanisation trend



Source: World Urbanisation Prospects, ICICI Direct Research

Rising income level

Rising income (per capita income grew at 10% CAGR) and increasing awareness about decorating/safeguarding home has fuelled decorative (exterior, interior) paint demand in India. Further, strong growth in demand for premium category paints was a result of rising aspirations and income level of middle class in the last 10 years. We believe changing trends in relation to home improvements and increasing disposable incomes would boost demand for decorative paints, going forward.

Exhibit 10: Household income in India

(in mn)	Income bracket	2012	2018E	2025E	2030E	Consumption pattern
Emerging	(₹ 2- 5 Lakh)	52	88	140	141	Unbranded clothing and toiletries, spend on generic products and domestic holidays
Aspiring	(₹5 - 12 Lakh)	30	35	62	101	Begins buying branded clothing & toiletries, decoration, take short-haul trips abroad, afford an entry-level car
Affluent	(> ₹ 12 Lakh)	12	24	50	71	Buys high-end smartphones, white goods, and luxury brands and décor
Household		**95**	**147**	**253**	**312**	

Source: Industry, ICICI Direct Research

Reducing repainting cycle

Repainting contributes 70-75% of total decorative paint demand in India while fresh painting accounts for ~25-30% of total demand. Our dealer check suggests there has been a gradual reduction in the repainting cycle from eight years to six years in the last 10 years. As far as urban India is concerned, the repainting cycle has reduced to five years largely driven by rising aspiration and income level. However, we believe lower repainting cycle in urban areas leaves little scope for demand growth while semi urban and rural India would be key growth drivers for the paint industry, going forward.

Lower GST rate to benefit organised players

While the domestic paint industry is largely dominated by organised players with 70% market share, unorganised/regional players still hold 30% of market. Unorganised/regional players are predominantly manufacturing low price products. Introduction of GST in FY18 and simultaneously rate reduction from 28% to 18% benefitted organised players due to a reduction in price gap between products of unorganised and organised players. In addition to this, organised players like Asian Paints, Berger Paints and Kansai Nerolac have expanded their reach to semi urban/rural regions and are emphasising on economy products (like putty, distemper). We believe a deeper reach and higher number of tinting machines will continue to help shift market share from smaller players to their larger counterparts.

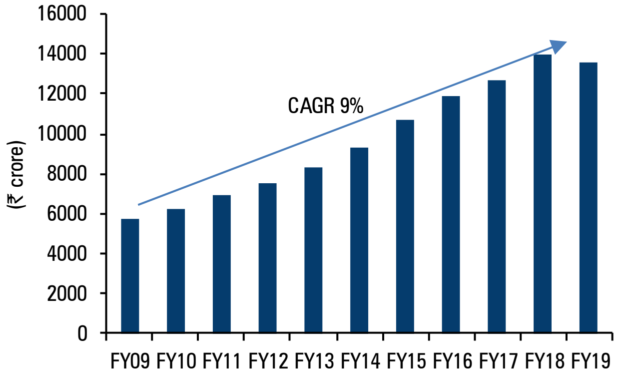
Pricing power in hand of top players

Given the oligopolistic nature of the business, the top four players contribute ~80% of organised market share. This results in high pricing power in the hand of players compared to other discretionary products. Market leader Asian Paints initiates price hikes that are followed by other players. The pricing power also differs from the product portfolios of companies. Under the paint universe, Asian Paints has the highest SKUs of premium paints (emulsion) followed by Berger Paints while regional/unorganised players have a higher presence in distempers and putty.

Industrial paint: Impacted by automotive industry slowdown

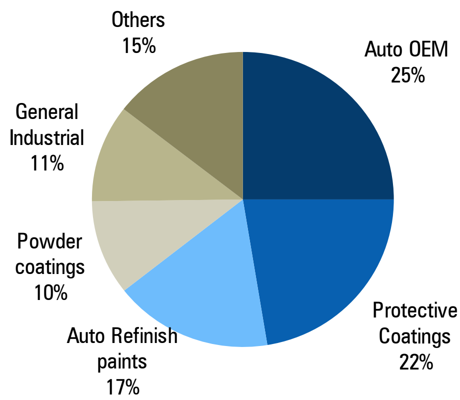
Industrial paint accounts for 25% of total paint demand in India and grew at 9% CAGR in FY09-19. The sub-segment includes auto OEM, refinishing, protective coatings, powder coatings, general industrial (GI) and other segments. Auto OEM and refinish forms the largest component of industrial paints in India. Unlike the decorative business model, which largely operates through strong distribution networks, in case of industrial paints the sales contribution of the dealer channel is low. Further, unlike decorative paints, industrial is more capital intensive and requires a strong corporate relation to run the business. Hence, the industrial paints category is dominated by organised players in India with minimal unorganised play. Kansai Nerolac is the market leader in automotive paint, general industrial segment (supplier to Maruti) while Berger Paints is the market leader in protective coatings. Further, domestic paint players also tied up with other international players for the tech know how in the industrial paint category. We believe industrial paint is likely to grow 5% in FY19-22E on a favourable base with a gradual recovery in automotive and industrials.

Exhibit 11: Industrial paint segment growth trend



Source: Company, ICICI Direct Research

Exhibit 12: Automotive/refinish largest component of industrial paint



Source: Company, ICICI Direct Research

Exhibit 13: Berger Paint's international collaborations vis a vis competitors

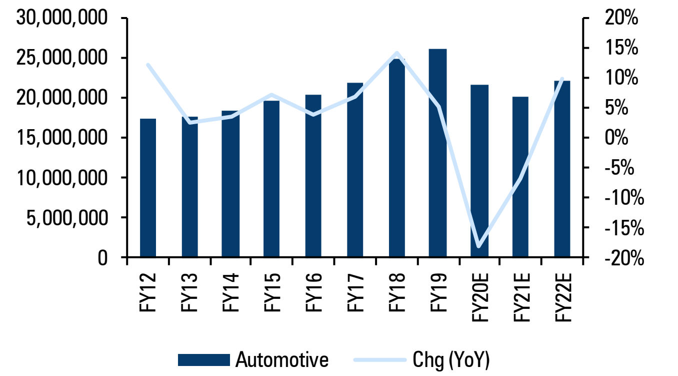
Company	International Collaborations	Details
Asian Paints	PPG Industries Inc (USA)	1) PPG-AP, the 50:50 JV with PPG Industries is second largest manufacturer of industrial coatings supplying to automotive OEM, refinish, marine etc 2) AP-PPG, the 50:50 JV with PPG Industries to cater protective coatings, floor coatings, road marking paints and powder coatings segments servicing customers in the infrastructure, oil and gas, power plants, white goods sectors, among others
Berger Paints	Becker Industrifarg (Sweden)	Berger Paints holds 49% stake in Berger Becker Coatings deals in the coil and special coatings segments
	Nippon Automotive Coatings	Berger Paints holds 49% stake in Berger Nippon Automotive Coatings deals in coatings for plastic auto components
	Rock Paints (Japan)	Berger Paints holds 51% stake in Berger Rock Paints deals in Automotive Refinish segment
Kansai Nerolac	Kansai Paint (Japan)	Holding company of Kansai Nerolac India, KPJ provides support on process design, quality improvement, technology in the automotive coatings segments
	Oshima Kogyo (Japan)	Technical Assistance Agreement for manufacturing heat resistance coatings
	Cashew (Japan)	Technical Assistance Agreement for coatings products and Thinner
	Protech Chemicals (Canada)	Technical Assistance Agreement for manufacturing powder coating products

Source: Company, ICICI Direct Research

Automotive: Revival in consumer sentiment to drive demand

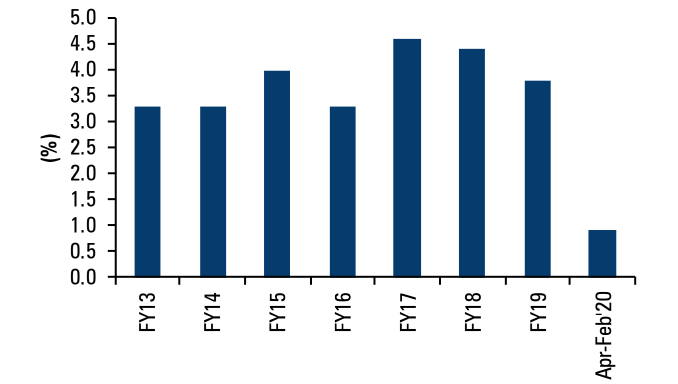
The domestic passenger vehicle segment has been witnessing a challenging time amid muted consumer sentiment, regulatory led increase in cost of ownership of vehicles and increasing penetration of shared mobility. Post a significant decline in FY20E (down 18% YoY), we expect a gradual recovery in the industry in FY20E-22E. This is primarily tracking low penetration of PV domestically, limited BS-VI led price increase especially in the petrol variants and muted retail fuel prices.

Exhibit 14: Domestic passenger vehicle unit sales



Source: Industry, ICICI Direct Research

Exhibit 15: IIP trend (need to update)



Source: Mospi, ICICI Direct Research

Weak private investment hurts infrastructure growth

The domestic economy continues to be driven by public sector investments, mainly in areas of urban transportation, airport, oil & gas and refining, roads allied infrastructure and rural electrification. The healthy domestic investment by the public sector was despite the multiple challenges on the economic front, with volatile crude oil prices, currency swings, pressure on fiscal and current account deficit, sharp temporary contraction in liquidity. However, weak investment by the private sector is a cause for concern. The overhang of bad debt, rising policy uncertainties and low capacity utilisation continue to impact Indian industry capex. The power and manufacturing sectors remained the worst affected. Also, surplus inventory in the residential sector and limited pick-up in requirement of new construction led to lower investments.

A slowdown in industrial activity (IIP growth declined from 4.6% in FY17 to 3.8% in FY19 and 0.9% in April-February 2020) impacted industrial paint demand in the recent past. However, we believe various government measures, undertaken during the Covid-19 pandemic, such as low interest rate, tax rate cut, etc, would fuel private capex in the coming period. This would help drive demand for industrial paint in the coming future.

Berger's focus on innovations drives product mix

Paint consumption by Indian households is undergoing a paradigm shift in terms of preference from limestone coatings to distemper and now premium range of emulsion. Over the years, Berger Paints has shifted its focus from economic products to premium emulsion by launching innovative products. This is evident from higher R&D expenditure (average R&D expenses increased from 0.15% of sales in FY05-11 to ~4% in FY12-19) and rising gross margin profile (up ~250 bps in FY12-19). The key innovative products of the company include:

WeatherCoat Anti Dustt

WeatherCoat Anti Dustt is a dust repellent coating for exterior. This paint has been developed for dry, dusty regions of India where rainfall is meagre. It helps reduce dust accumulation on the walls reducing painting frequency and making the building look new for a longer period.

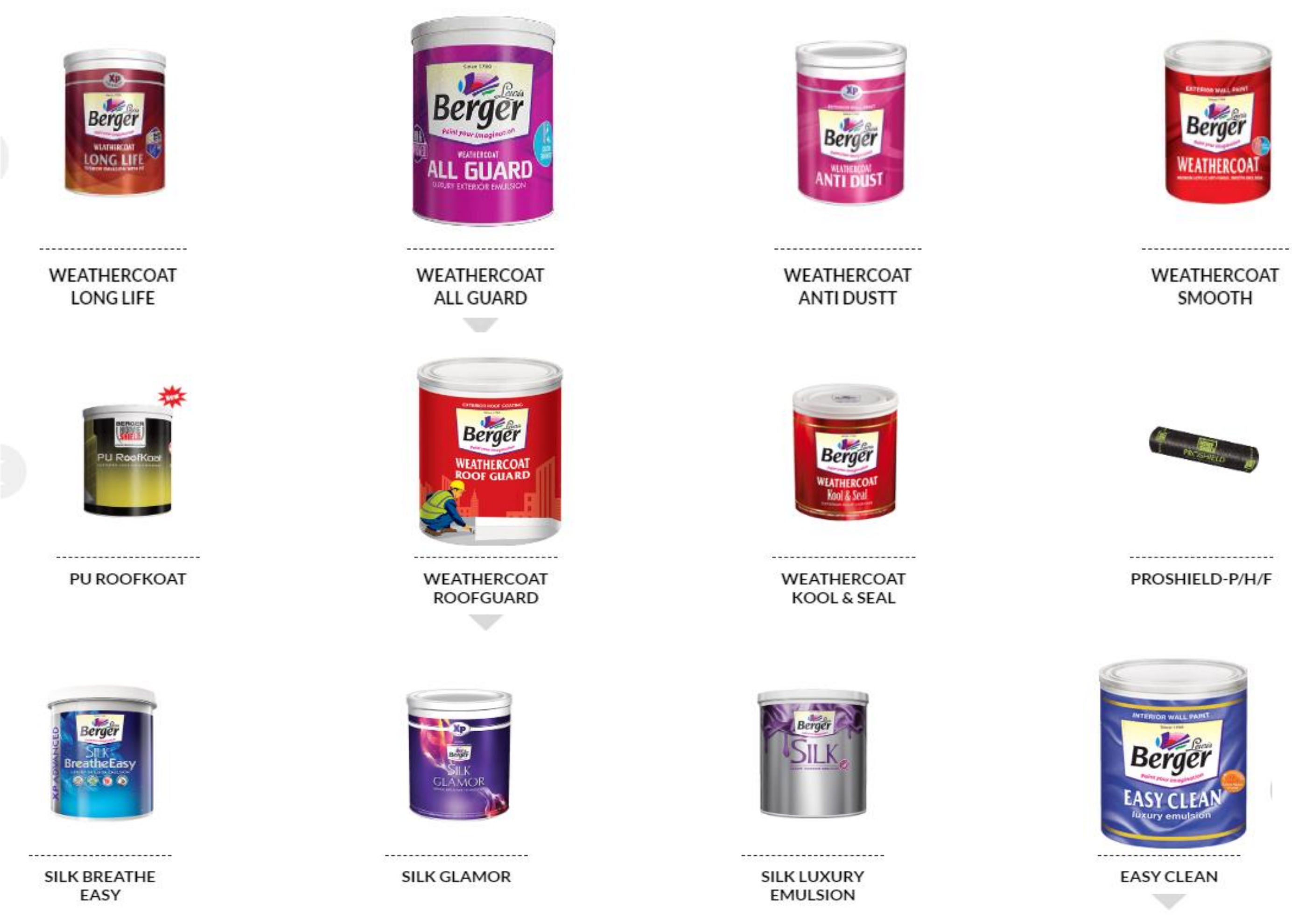
Kool & Seal

Berger launched energy efficient products such as WeatherCoat Kool & Seal and WeatherCoat Roof Guard, which reflect high energy infrared rays and help maintain room temperature.

Easy Clean

An interior emulsion with cross linking polymer technology ensures stubborn stains can be cleaned easily. Under its new variant, this paint is able to absorb offensive odours such as cigarette smoke, etc.

Exhibit 16: Product portfolio of Berger Paints



Source: Company, ICICI Direct Research

Express Paintings: Pioneer in painting services

Berger has introduced an innovative home painting services in the domestic painting sector ‘Express Painting’ in 2014. This service enables faster home painting (40% faster than traditional painting) with low dust, low spillage, low volatile organic compound (VOC) while applied. The ‘Express Painting’ service involves use of automated tools (sanding machine, mixer, automatic rollers, etc) and trained labour. The company is selling the automated equipment at a reasonable price to painters and incentivised them to buy the company’s products, for which he gets a credit period or business through Berger’s advertising. The hassle free fast painting results in shorter painting time, which helps in doubling or tripling painting contracts for painters thereby increasing its business. The number of painters who partner with Berger has tripled — from 4,000 at the start of the service in 2014 to over 12,000 now. While this service is also offered by other paint players, we believe Berger is the preferred player in this service as it does not charge consumers extra.

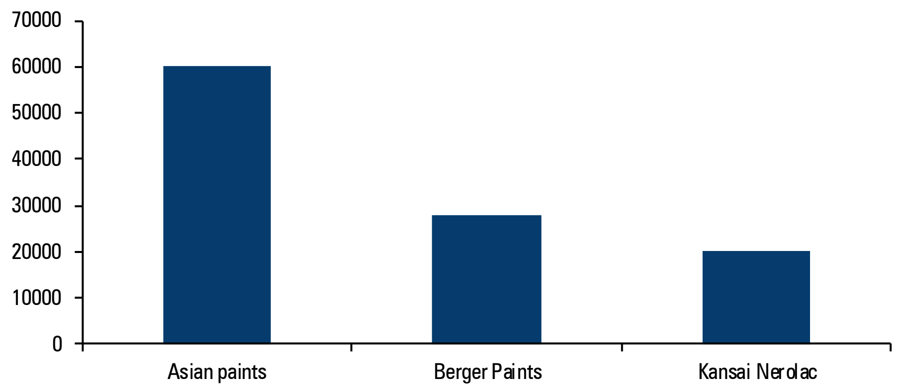
Exhibit 17: Berger home painting services “Express Painting”

Source: Company, ICICI Direct Research

Focus on expanding distribution reach

Indian paint distribution is highly underpenetrated with little over 1 lakh outlets compared to FMCG where distribution is done through over 1 million outlets. The difference is largely due to voluminous nature, slim dealer margin and high working capital requirements. Asian Paints covers ~60% of outlets (i.e. 60000) followed by Berger Paints with a dealer network of 28000 across India. With extensive distribution and cutting-edge marketing initiatives, Asian Paints is catering to a wide cross-section of customers with a comprehensive products basket across varied price points. Berger Paints is expanding its distribution network by 10-12% annually with nearly 85% coverage of tinting machines. We believe the gap of distribution between the leader and Berger Paints would shrink faster in the coming future given Berger’s low base and its ability to launch strong product portfolios in domestic markets. The expansion in distribution would help continue to drive the growth of the company.

Exhibit 18: Second largest dealer network in India



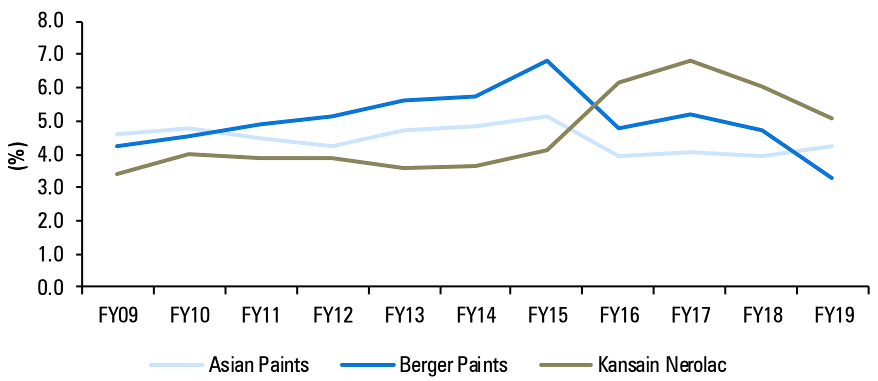
Source: Industry, ICICI Direct Research

Aggressive marketing strategy of Berger Paints

BPIL has one of the highest A&P spend as a percentage of standalone sales (average 5% of sales in the last five years vs. 4.3% of Asian Paints) in the industry. The higher A&P spend is mainly to strengthen its brand visibility and gain market share across product ranges. The A&P expenses of BPIL would be higher by ~100 bps, if we adjust industrial paint revenue, which is ~20% of revenue. Further, top three players (Asian Paints, Berger Paints and Kansai Nerolac) have spent heavily on television advertisement by signing top Bollywood celebrities to promote their brands. This, in turn, helped organised players create awareness about products in rural India thereby gradually gaining use of economy emulsion/distemper in place of limestone.

Historically, it has been observed that paint companies spend on A&P increases with a decline in raw material prices (for example in FY15). However, looking at the current scenario, companies are expected to limit A&P expenditure despite lower input prices resulting in strong gain in EBITDA margin despite lower operating leverage.

Exhibit 19: Higher ad spend as percentage of sales help Berger gain market share



Source: Industry, ICICI Direct Research

Industrial paints: No relief in near term

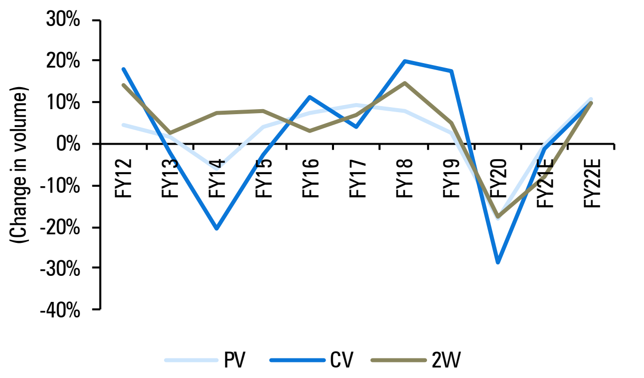
BPIL's industrial paint (contributes ~20% in topline) comprises protective coatings, automotive & general industrials and powder coatings. The company's protective coating segment contributes 50% to its industrial paints revenue with Berger the market leader in this category. The major clients for protective coatings include Railways, highways, bridges, flyover, coach factory, power plants, oils & gas installations, airports, etc. While government spending on these segments remained satisfactory, the private sector capex witnessed a lull in the last two years. We believe a revival in capex, new launches in the protective coating segment by Berger (specialty floor coatings, road marking paints, construction chemicals) and market share gains from small players would drive segment revenue growth in the coming future.

On the other hand, while Berger is one of the largest suppliers of automotive paints in the two-wheeler (2-W) category and commercial vehicle (CV) categories, its presence in three-wheeler (3-W) and four-wheeler (4-W) has been limited. The company has formed two joint ventures with Japan's Nippon Automotive Paints and Rock Paints in 2007 and 2018, respectively, to increase its presence in the 3-W and 4-W automotive industry where Kansai Nerolac is the market leader. We believe near term challenges for the auto industry are likely to continue due to the economic slowdown and lockdown situation in India. Hence, we expect Berger's industrial paints segment to grow at 8% CAGR in FY20-22E post a pick-up in GDP growth, going forward.

Exhibit 20: Clientele for industrial paint category

Source: Company, ICICI Direct Research

Exhibit 21: Challenging phase of automotive industry



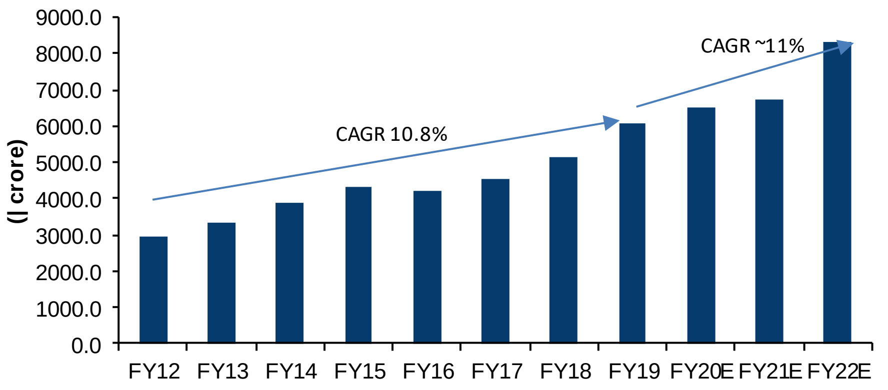
Source: Industry, ICICI Direct Research

Financials

Strong recovery from H2FY21E with return of normalcy

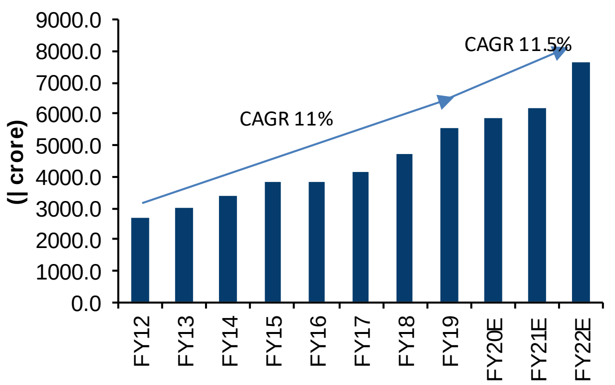
We believe the lockdown situation across India owing to the Covid-19 pandemic would impact sales in Q4FY20E and Q1FY21E. The paint industry is likely to witness ~100% revenue loss for the entire April 2020 with a partial recovery starting from May 2020. Hence, the real demand pick-up is expected to start only from H2FY21E in the wake of festive season and availability of labour. Berger is likely to benefit from a robust supply chain and dealer network across India to recoup the sales it lost in H2FY21E. We believe consolidated sales would grow at a CAGR of ~11% in FY19-22E, mainly led by volume growth in the domestic markets. We also expect a gradual recovery in its overseas business (Poland, Nepal) from H2FY21E onwards and model lower revenue CAGR of ~7% in FY19-22E (compared to ~10% in FY12-19).

Exhibit 22: Berger Paints consolidated revenue growth trend



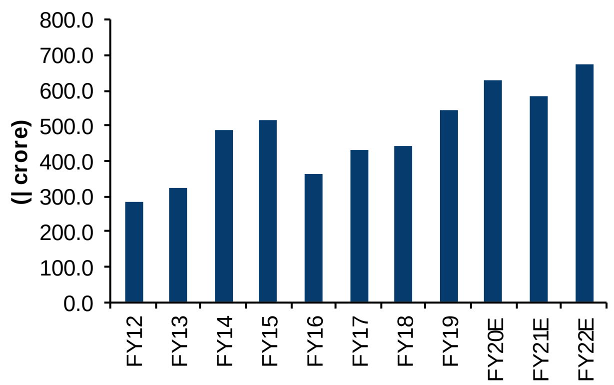
Source: Company, ICICI Direct Research

Exhibit 23: Domestic revenue growth trend



Source: Company, ICICI Direct Research

Exhibit 24: Overseas subsidiaries revenue growth trend

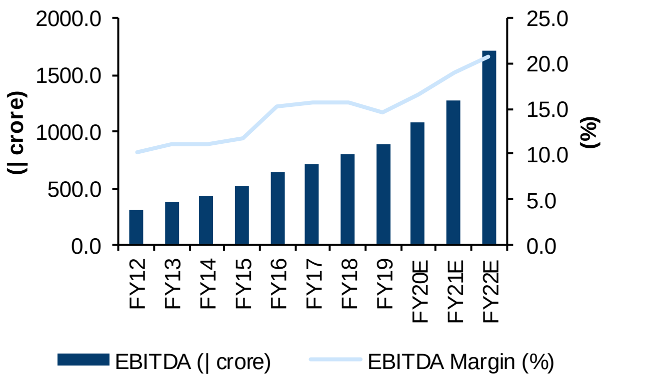


Source: Company, ICICI Direct Research

Strong EBITDA margin to drive PAT growth, going forward

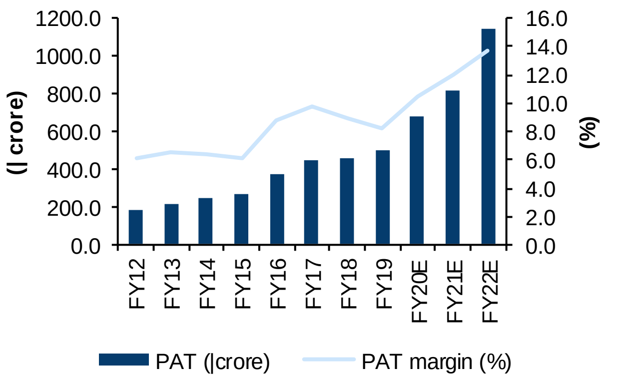
Berger has witnessed a shift in its EBITDA margin trajectory from average ~11% during FY12-15 to ~15% during FY16-19. The shift in trajectory was on the back of expansion in gross margin (due to a sharp decline in crude oil prices) and operating leverage. Also, due to the oligopoly nature of the business, paint players keep bulk of the benefits of lower raw material prices and pass on limited benefits to customers. We believe the recent fall in raw material prices would benefit Berger in terms of expansion in gross margin by ~600 bps in FY19-22E thereby reporting a sharp expansion in EBITDA margin in the same period. Finally, Berger is expected to record a PAT CAGR of ~32% in FY19-22E led by expansion in EBITDA margin and lower corporate tax rate.

Exhibit 25: EBITDA margin trend



Source: Company, ICICI Direct Research

Exhibit 26: PAT margin trend

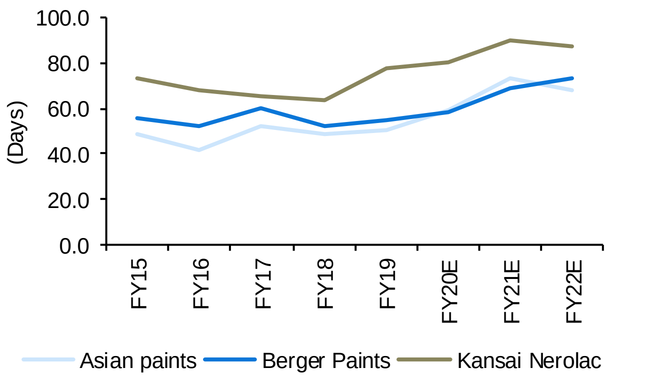


Source: Company, ICICI Direct Research

Lean b/s, strong cash flow suggest long term play of Berger

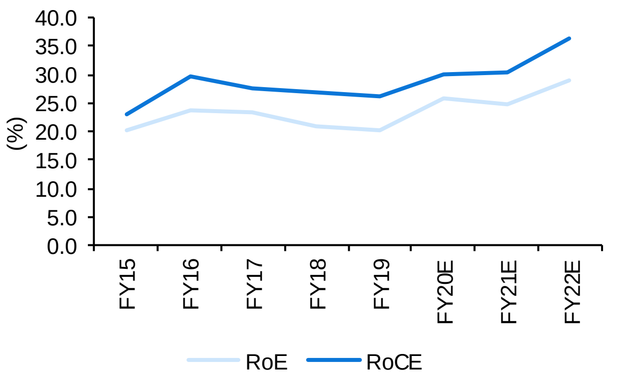
The balance sheet of Berger remained strong with debt to equity at 0.2x and average asset turnover ratio of 3x despite being a capital intensive business. The company managed its working capital efficiently despite various macro headwinds (like demonetisation and introduction of GST in the recent past). However, the industry may face a slight deterioration in the cash conversion cycle to support its dealer during Covid-19 related shutdown in the medium term. We believe Berger being the second largest player in India is well placed to handle the situation with its cash rich position and expansion in EBITDA margin, going forward. With a payout ratio of ~40% and no major capex (major capex only incudes ₹ 250 crore Sandila Project in UP likely to commence operation at the end of FY21E) in the medium term, we believe return ratios RoE and RoCE of the company would remain at attractive level.

Exhibit 27: Trend of cash conversion cycle of Berger



Source: Company, ICICI Direct Research

Exhibit 28: Strong return ratios despite macro headwinds



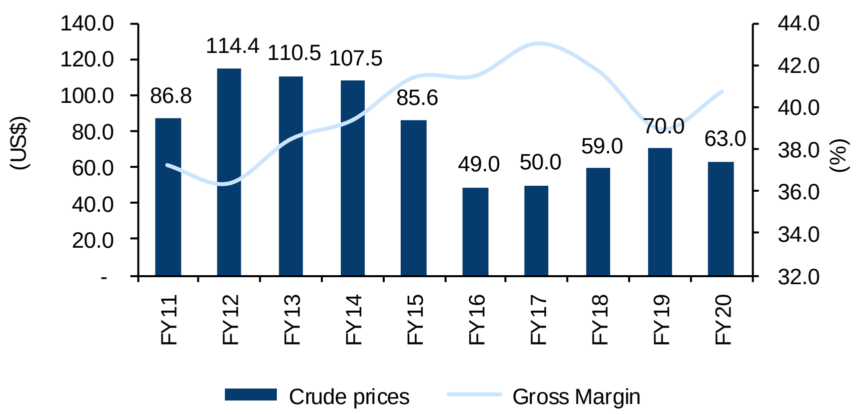
Source: Company, ICICI Direct Research

Risks & Concerns

Reversal in raw material prices to limit margin expansion

Historically, paint companies have been one of the biggest beneficiaries of benign raw material prices resulting in significant gross margin expansion. For example, in FY12-17, crude oil prices dropped 57%, resulting in ~700 bps expansion in gross margin. We build in ~600 bps expansion in our gross margin estimate from FY19-22E considering the same level of drop in crude oil prices. However, a significant rebound in crude prices from current levels poses a significant risk to our gross margin estimates and, thus, on EBITDA margin of Berger Paints.

Exhibit 29: Lower crude prices lead to sharp expansion in gross margin

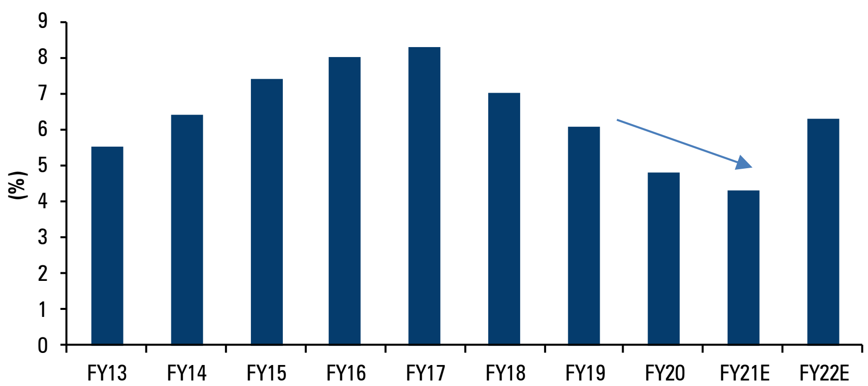


Source: Bloomberg, ICICI Direct Research

Weak macro condition to weigh on GDP growth

Typically, paints volume growth is 1.5-2x of GDP growth. With slowing GDP (sharp downward revisions of GDP estimate for FY21E due to nationwide lockdown) there is downside risk to volume growth. Consumers may increasingly choose to postpone their repainting decision in such challenging conditions on fears of loss of income.

Exhibit 30: Trend of India's GDP rate



Source: Bloomberg, ICICI Direct Research

Delay in revival of construction activity may weigh on decorative volume growth

Paint demand is considered to be highly discretionary in nature with volume offtake largely dependent on repainting demand. While repainting accounts for a major chunk of decorative paints sales at ~70% of industry demand, new construction accounts for ~30% of demand. A delay in revival of construction activity (launches of new projects) due to migration of labour on fear of a pandemic may also lead to longer than expected time for a recovery in repainting demand.

Challenges in auto industry to restrict industrial paint demand

The auto industry is one of the largest contributors of industrial paint demand. The industry is going through a rough phase (due to macro headwinds), which has directly impacted demand for industrial paints. Though Berger has limited exposure (~20% of sales) to the industrial paint category, a late recovery in the automotive sector may keep 20% of business under stress.

Late recovery in overseas business

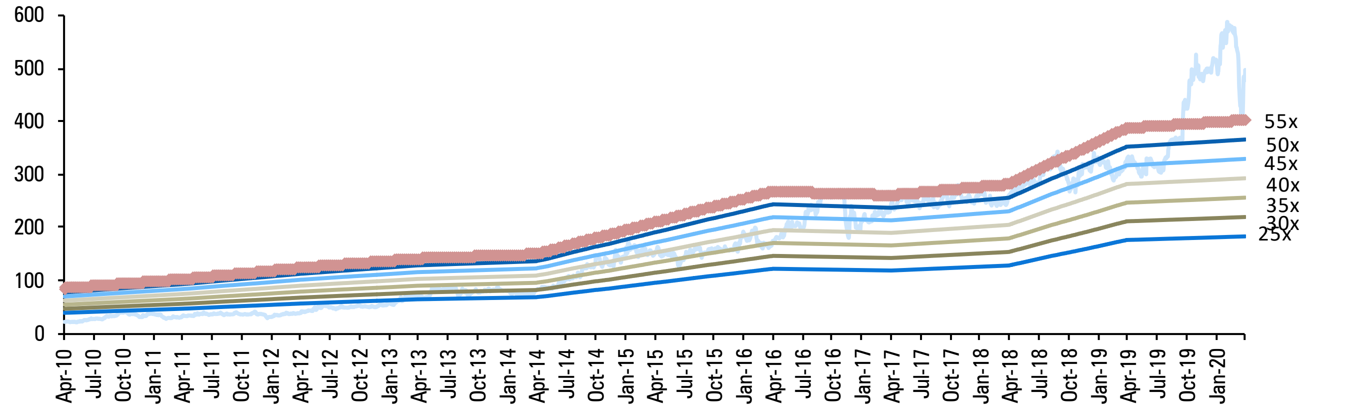
While the overseas business (mainly Nepal and Poland) contributes little over 7%, they jointly recorded a strong revenue, earning CAGR of ~20% and ~30%, respectively. However, a delay in demand recovery in such regions may result in a significant fall in their growth rates in the near future.

Valuation

Berger Paints is a strong No. 2 player in the decorative paint industry in India. The company reported revenue, earnings CAGR of ~11%, 16%, respectively, in FY12-19 supported by expansion in EBITDA margin. This growth mainly led by 1) capacity addition, 2) launch of innovation products, 3) market share gain in premium products and 4) continuous addition of dealer network across India. Despite various macros headwinds like demonetisation, GST implementation and floods at important operating regions, the company has maintained its market share without compromising profitability and leveraging balance sheet. Despite capacity expansion and addition of pan India dealers, the company's balance sheet condition remained strong with robust average RoCE, RoE of 25%, 22%, respectively. We model revenue, earnings CAGR of 11%, 32%, respectively, in FY19-22E supported by elevated EBITDA margin (due to benign raw material cost) and lower corporate tax.

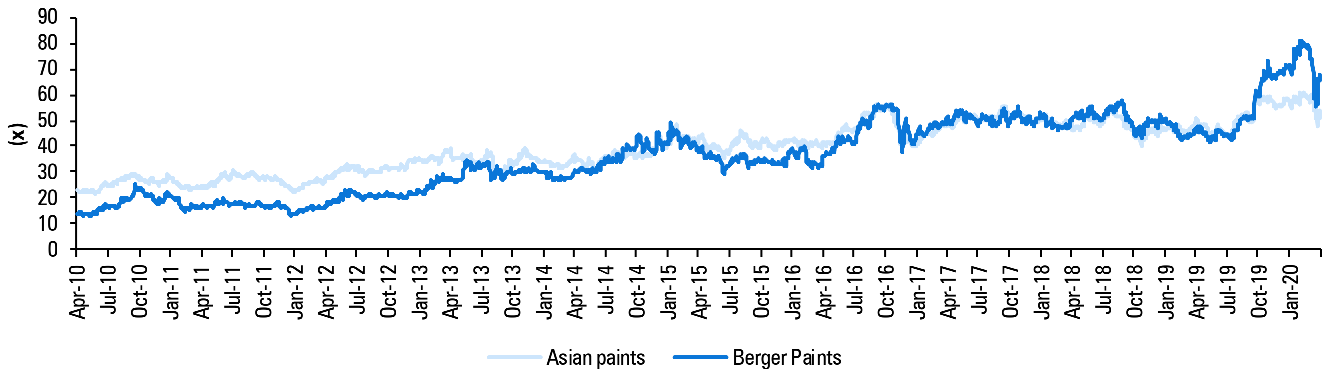
We believe Berger's premium valuation is supported by its strong fundamentals of EBITDA margin expansion, debt free balance sheet and credible management that cushions the company from various macro headwinds. This, along with limited presence of organised players in the paint industry resulted in a contraction in one year forward earnings multiple gap between Berger Paints and Asian Paints (that once happened to be higher by ~33% in the FY10-13 phase). Hence, we believe the top decorative paint companies would continue to command premium valuations considering their pricing power, strong balance sheet condition and conducive domestic demographics. Hence, we initiate coverage on Berger Paint with a BUY recommendation and a target price of ₹ 595/share.

Exhibit 31: P/E band of Berger Paints



Source: Company, ICICI Direct Research

Exhibit 32: Comparison of one year forward P/E of Asian Paints, Berger Paints



Source: Company, ICICI Direct Research

Exhibit 33: Valuation Matrix (Peer)

	Mcap	Revenue			EBITDA margin			PAT			D/E			RoCE			RoE			PE		
	Rs cr	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Asian Paints	1,66,387	20623	22531	25950	20.5	20.6	21.3	2866.7	3114.2	3700.9	0.0	0.0	0.0	30.7	31.5	33.5	26.6	26.3	27.8	61.1	56.2	47.3
Berger Paint	50,206	6504	6754	8314	16.7	18.9	20.7	685.4	814.2	1148.4	0.2	0.1	0.1	30.0	30.3	36.4	25.7	24.9	29.0	73.2	61.7	43.7
Kansai Nero	21,395	4998	5072	6192	16.3	17.2	17.0	578.4	595.2	710.7	0.0	0.0	0.0	19.8	19.3	20.7	16.0	14.9	16.0	36.0	35.0	29.3

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 34: Profit & Loss Statement

(Year-end March	FY19	FY20E	FY21E	FY22E
Revenue	**6,061.9**	**6,504.5**	**6,753.9**	**8,314.5**
Growth (%)	17.3	7.3	3.8	23.1
Raw material expe	3,242.6	3,356.8	3,241.9	3,949.4
Employee expense	408.5	436.3	506.5	598.6
Other expenses	1,072.2	1,129.2	1,215.7	1,413.5
Total Operating Ex	5,180.3	5,419.1	5,477.4	6,593.4
EBITDA	**881.6**	**1,085.4**	**1,276.5**	**1,721.1**
Growth (%)	9.2	23.1	17.6	34.8
Depreciation	137.8	188.6	202.6	249.4
Interest	32.3	47.2	40.3	26.0
Other Income	60.0	65.0	64.2	91.5
PBT	771.5	914.7	1,097.8	1,537.2
Total Tax	273.2	219.5	276.6	387.4
PAT	497.5	685.4	814.2	1,148.4
Growth (%)	7.9	37.8	18.8	41.0
EPS (₹	5.1	7.1	8.4	11.8

Source: Company, ICICI Direct Research

Exhibit 35: Cash Flow Statement

(Year-end March)	FY19	FY20E	FY21E	FY22E
Profit after Tax	497.9	685.4	814.2	1148.4
Add: Depreciation	137.8	188.6	202.6	249.4
(Inc)/dec in Current Assets	-167.2	-231.1	-355.5	-620.6
Inc/(dec) in CL and Provisions	60.5	46.4	29.3	222.0
Others	32.3	47.2	40.3	26.0
CF from operating activities	561.2	736.5	730.9	1025.3
(Inc)/dec in Investments	-38.6	0.0	-20.0	-20.0
(Inc)/dec in Fixed Assets	-310.8	-150.0	-150.0	-250.0
Others	3.2	-50.0	-50.0	-50.0
CF from investing activities	-346.1	-200.0	-220.0	-320.0
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	70.4	-55.0	-65.0	-135.0
Dividend paid & dividend tax	-210.7	-209.7	-209.7	-466.1
Others	-41.3	-325.1	-40.3	-26.0
CF from financing activities	-181.5	-589.9	-315.0	-627.1
Net Cash flow	33.5	-53.4	195.9	78.2
Opening Cash	204.9	238.5	185.1	381.0
Closing Cash	238.5	185.1	381.0	459.2

Source: Company, ICICI Direct Research

Exhibit 36: Balance Sheet

(Year-end March)	FY19	FY20E	FY21E	FY22E
Liabilities				
Equity Capital	97.1	97.1	97.1	97.1
Reserve and Surplus	2,375.6	2,573.3	3,177.8	3,860.1
Total Shareholders func	2,472.7	2,670.4	3,274.9	3,957.2
Total Debt	499.9	444.9	379.9	244.9
Other non current liabilit	95.1	95.1	95.1	95.1
Total Liabilities	**3,067.7**	**3,210.4**	**3,749.8**	**4,297.2**
Assets				
Gross Block	1,496.2	1,646.2	1,796.2	2,046.2
Less: Acc Depreciation	393.3	582.0	784.6	1,034.0
Total Fixed Assets	1,272.8	1,234.1	1,181.5	1,182.1
Investments	144.1	144.1	164.1	184.1
Inventory	1,233.5	1,336.5	1,443.3	1,776.8
Debtors	671.5	784.1	925.2	1,139.0
Loans and Advances	24.9	26.7	31.1	34.1
Other CA	187.0	200.7	303.9	374.2
Cash	238.5	185.1	381.0	459.2
Total Current Assets	2,355.4	2,533.1	3,084.5	3,783.3
Creditors	999.0	1,071.9	1,091.7	1,252.9
Provisions	38.9	41.8	42.5	48.8
Other CL	257.1	227.7	236.4	291.0
Total Current Liabilities	1,295.0	1,341.4	1,370.7	1,592.7
Net current assets	1,060.4	1,191.7	1,713.8	2,190.6
Other non current asse	590.4	640.4	690.4	740.4
Total Assets	**3,067.7**	**3,210.4**	**3,749.8**	**4,297.2**

Source: Company, ICICI Direct Research

Exhibit 37: Key Ratios

(Year-end March	FY19	FY20E	FY21E	FY22E
Per share data (₹)				
EPS	5.1	7.1	8.4	11.8
Cash EPS	6.5	9.0	10.5	14.4
BV	25.5	27.5	33.7	40.7
DPS	2.2	2.2	2.2	4.8
Operating Ratios (%)				
EBITDA Margin	14.5	16.7	18.9	20.7
PAT Margin	8.2	10.5	12.1	13.8
Asset Turnover	4.1	4.0	3.8	4.1
Inventory Days	74.3	75.0	78.0	78.0
Debtor Days	40.4	44.0	50.0	50.0
Creditor Days	60.2	60.2	59.0	55.0
Return Ratios (%)				
RoE	20.1	25.7	24.9	29.0
RoCE	26.2	30.0	30.3	36.4
RoIC	32.0	36.7	39.1	45.7
Valuation Ratios (x)				
P/E	100.9	73.2	61.7	43.7
EV / EBITDA	57.0	46.2	39.1	28.8
EV / Net Sales	8.3	7.7	7.4	6.0
Market Cap / Sales	8.3	7.7	7.4	6.0
Price to Book Value	20.3	18.8	15.3	12.7
Solvency Ratios				
Debt / Equity	0.2	0.2	0.1	0.1
Current Ratio	2.0	2.1	2.4	2.6
Quick Ratio	0.9	0.9	1.1	1.2

Source: Company, ICICI Direct Research

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Reduce: -15% to -5%;

Sell: <-15%

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