

01 April 2024

India | Equity research | Sector Update

Consumer Staples & Discretionary

Paints: Primary research – comparison of cash discount and trade credit of Birla Opus Paints with peers

Our primary research on comparing cash discount scheme and payment terms of Birla Opus Paints (BOP) with peers reveals: (1) Most dealers prefer to pay in 7-15 days to avail 5% cash discount offered by leading paint companies. Due to channel financing, dealers pay just ~10% interest cost per annum but still avail 5% cash discount in 15 days. (2) Dealers have limited space and do not want to hold excess inventory as it results in higher inventory holding cost (warehouse rent, pilferage, spoilage, etc.). (3) The 5% cash discount scheme also benefits paint companies as dealers start pushing secondary sales to release the blocked funds. We note BOP is offering credit up to 50 days @2% cash discount compared to maximum 30 days credit offered by peers.

While we do not model any material impact on the existing paint companies, we believe additional credit period may entice dealers to sell BOP as working capital is not blocked for 50 days. It may eventually result in higher paint inventory in the market. We reckon [comfortable] competitive equilibrium in paints is likely broken; we continue to be underweight on large-cap paint companies. Contrarian investors may consider owning Akzo Nobel / Indigo Paints / Kansai Nerolac.

Trade credit and cash discount offered by Birla Opus Paints

We note BOP is offering cash discount of 5% if dealer pays in 10 days, 4.25% if dealer pays in 20 days, 3.5% if dealer pays in 30 days and 2% if dealer pays in 50 days. BOP is also offering additional two days as credit to upcountry dealers. There will be no cash discount if the dealer pays after 50 days.

Current cash discount schemes in market offered by incumbents

The most common cash discount scheme is 5% discount if dealer pays in 15 days, 3% discount if dealer pays in 30 days and no discount after 30 days. Market-leading paint companies also offer different cash discounts based on the category/ ranking of the dealers too. Also we understand some cash discount plans of market-leading companies offer initial cash discount of 5% only when payment is done before seven days.

Channel financing benefits to larger companies

The dealer can pay to larger paint companies within 15 days to avail 5% cash discount by raising short-term debt (mostly channel financing). The dealer will benefit as he/she may raise debt at rate an interest of 10-12% per annum but may get the benefit of 5% cash discount. Cash discount of 2% for payment up to 50 days will not materially entice a dealer if he/she is tied up under channel financing scheme.

Focus on secondary sales increase in case of cash discounts

If the dealer has paid to a paint company within 15 days to avail 5% cash discount, he/she will also try to push secondary sales to release the funds blocked in working capital. This will eventually lead to higher sales for the paint company too. However, if the dealer is offered credit up to 50 days, he/she may not rush for secondary sales as his/her capital is not blocked.

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Asian Paints (REDUCE)

TP: INR 2,600

Berger Paints (REDUCE)

TP: INR 520

Kansai (ADD)

TP: INR 290

Akzo Nobel (HOLD)

TP: INR 2,520

Indigo Paints (HOLD)

TP: INR 1,380

Dealers prefer to pay within 7-15 days

As per discussion with dealers, we note most dealers prefer to pay within 7-15 days and avail the entire 5% discount. Most dealers do not want to carry the physical inventory as there is inventory carrying cost too (rent of the warehouse, pilferage, spoilage, etc.).

Attractive scheme for new entrant

We believe trade credit of 50 days is attractive for a new paint company. In our view, most dealers will be enticed to sell BOP as the working capital is not blocked for 50 days. We believe eventually the paint inventory in the market may increase.

Valuation and risks

We value paint stocks as per DCF methodology (WACC and TG ranging from 10-13% and 3-6% respectively). Key upside risk is: Better than expected gross margins due to correction in input prices. Key downside risk: Unexpected irrational competition due to deceleration in general consumption demand.

We have **ADD** rating on Kansai; **REDUCE** on Asian Paints, Berger; and **HOLD** on Akzo and Indigo.

Exhibit 1: Valuation summary

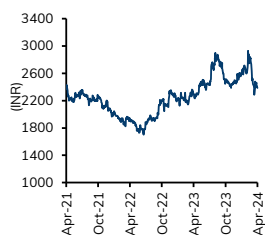
Company	TP (INR)	Rating	PE (x)		EV/EBITDA (x)		ADTV (USD mn)	Market Cap	
			FY25E	FY26E	FY25E	FY26E		(INR bn)	(USD bn)
Akzo Nobel	2,520	HOLD	25	23	16	14	0.7	110	1.3
Asian Paints	2,600	REDUCE	52	50	34	33	47.1	2,754	33.0
Berger Paints	520	REDUCE	54	48	34	31	7.6	660	7.9
Indigo Paints	1,380	HOLD	39	32	24	21	1.7	63	0.8
Kansai Nerolac	290	ADD	31	29	19	18	1.7	220	2.6

Company	EV/ sales (x)		P/B (x)		P/CEPS (x)		RoE (%)		RoCE (%)		CAGR (FY24E-FY26E) (%)		
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E	Revenues	EBITDA	PAT
Akzo Nobel	2	2	7	7	20	19	30	30	30	30	13	6	5
Asian Paints	7	6	13	12	43	40	26	24	24	22	9	3	0
Berger Paints	5	5	9	8	42	38	22	21	19	18	12	5	8
Indigo Paints	4	3	6	5	28	24	15	16	18	18	17	12	14
Kansai Nerolac	2	2	4	3	24	22	12	12	12	11	10	3	4

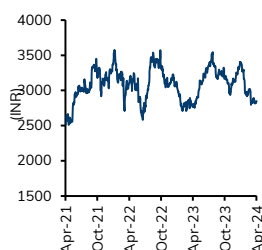
Source: Company data, I-Sec research

Price charts

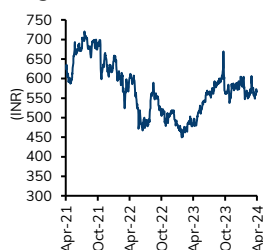
Akzo Nobel



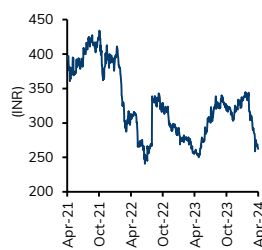
Asian Paints



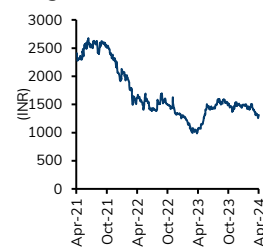
Berger Paints



Kansai Nerolac



Indigo Paints



Source: Bloomberg

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