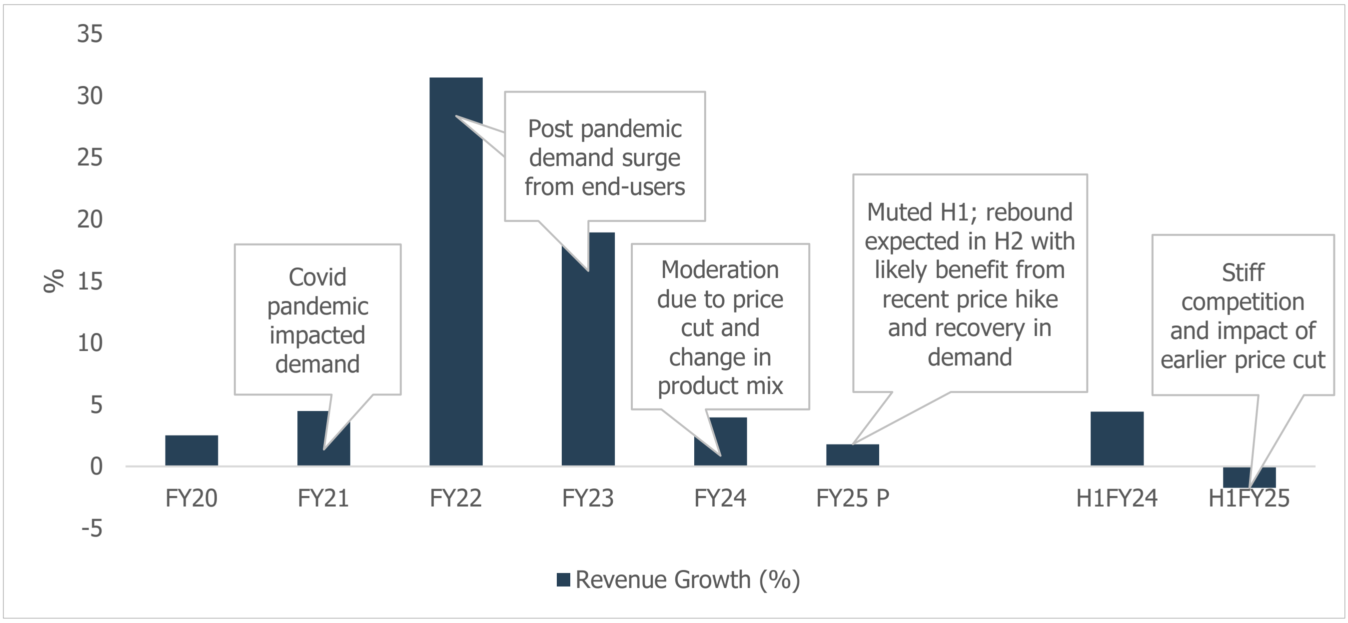
# Paint Sector: Operating Profitability to Drop by Another 200 bps by FY26

December 27, 2024 | Ratings

**Synopsis**

- After showcasing significant revenue growth in FY22 and FY23 post-pandemic, the growth rate of long-entrenched players[1] moderated to mid-single digits in FY24 and slipped into a negative zone in H1FY25 amid intensifying competition. However, revenue in H2FY25 is expected to witness a rebound on y-o-y basis on the back of benefits arising from the price hike taken in July-August 2024.
- The entry of new players[2] has sparked a surge in capital expenditure and heightened competition within the sector. Players are expanding their capacities, growing their dealer network, ramping up sales teams and accelerating ad spending in a bid to counter competition and secure market shares. Amid these developments, CareEdge Ratings expects a shift in cost structures, with ad and sales promotion spending of players likely to increase by 100 bps – 200 bps (as a percentage of revenue) in the medium term.
- Consequently, paints companies' operating profitability margin, which reduced to ~16% in H1FY25 from ~20% in FY24, is expected to further moderate to ~14% by FY26.
- However, strong credit risk profile characterised by conservative capital structure and healthy liquidity are expected to aid the incumbents in navigating through the increased competitive landscape whereby operating profitability margins are likely to moderate in the near to medium term.
- With existing and new players going for massive capex, the share of organised players is set to go up to ~80% in the medium term.

**Revenue growth of long-entrenched players likely to remain muted**



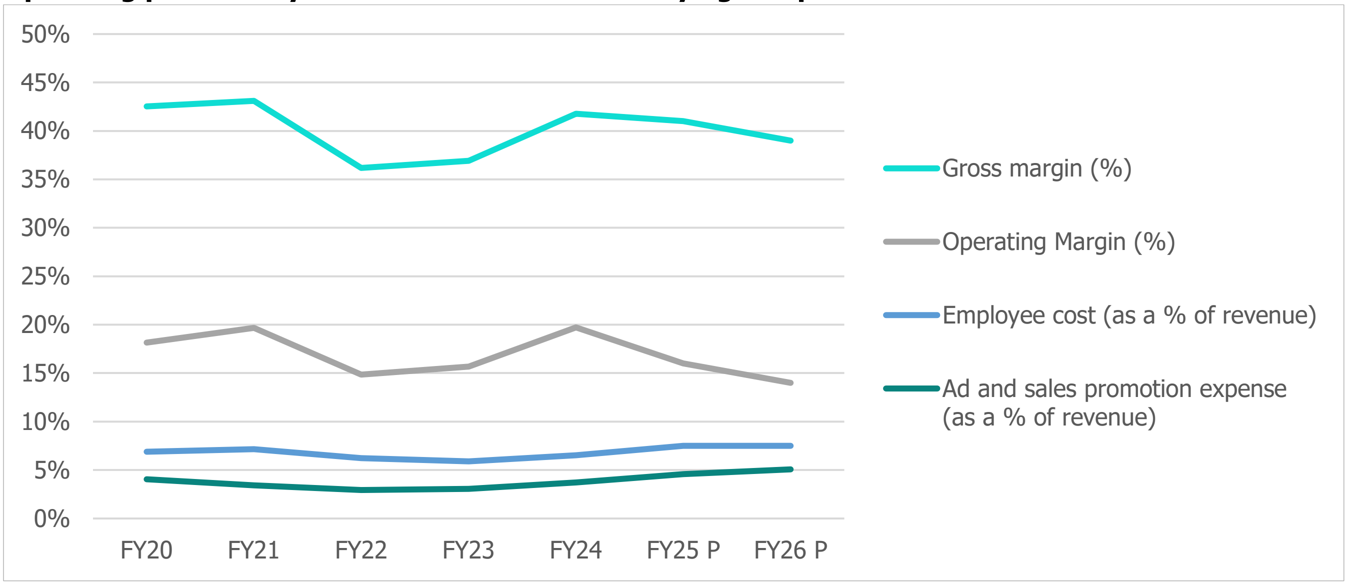

Source: Company Annual reports and CareEdge Ratings

[1] Asian Paints Ltd, Berger Paints India Ltd, Kansai Nerolac Paints Ltd, Akzo Nobel India Ltd and Indigo Paints Ltd
[2] JSW Paints Pvt Ltd, Grasim Industries Ltd, Pidilite Industries Ltd, JK Cement group, Astral group

After registering a robust Compounded Annual Growth Rate (CAGR) of 14%-15% over the five years FY19-FY23, the revenue growth of long-entrenched entities moderated to 4% in FY24. While the volume growth remained high at over 10%, the revenue moderation can be attributed to price cuts undertaken by the players to partly pass on softening raw material cost and change in product mix with a growing share of lower value products. The revenue was further impacted in H1FY25 due to stiff competition, general elections, prolonged monsoon, and the continued effect of price cuts. The growth rate in revenue of the new entrants is anticipated to be relatively higher driven by promotional schemes to attract consumers, contractors and dealers, and higher burn on branding. Amidst an intensifying competitive landscape, existing players have taken price hikes in July-August 2024 (1.5%-2.5%) to pass on the rise in input costs. Recent price increases along with expected demand pickup are likely to lead to a rebound in revenue growth, albeit expected to remain muted. Future growth shall be driven by effective branding, growth in tinting machines and dealer networks, product innovation networks, and expansion into new categories.

Demand for decorative paint, accounting for 70%-75% of paint demand, is primarily driven by new construction (20%) and repainting (80%). The repainting segment is further boosted by population growth, a shorter repainting cycle, increased rental homes, and rising incomes. The real estate sector is expected to stay strong in FY25 & FY26 due to project completions and government spending on housing and infrastructure. CareEdge Ratings expects the housing demand to remain resilient over the next two years, accompanied by an increase in launches and sales growth of 10%-15%. Industrial paints represent the remaining 25% to 30% of total paint demand, mainly coming from the automotive industry, as well as sectors like oil and gas, aerospace, marine, and electronics.

**Operating profitability to moderate due to intensifying competition**



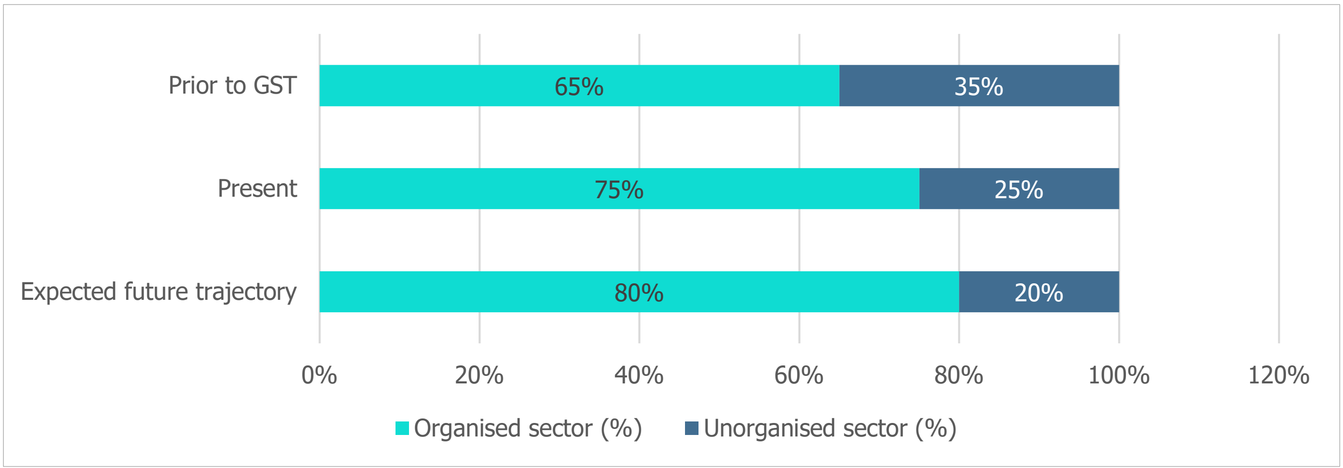

Source: Company Annual Report and CareEdge Ratings

A recent price hike of 1.5%-2.5% to pass on the rise in cost of raw materials which are primarily crude oil derivatives, shall enable the players to maintain gross margin at a five-year average (FY20-FY24) of around 40% in FY25. Operating margin, which remained healthy at an average of around 18% in the previous five years period, is, however, slated to take a hit in the medium term. H1FY25 witnessed a decline in the margin of sample players to ~16%, primarily attributed to the margin correction of the market leader. CareEdge Ratings expects operating margins of incumbents to moderate to ~14% by FY26 amidst pricing pressure due to increased competition.

**Organised players' share expected to grow to ~80% in the medium term with new capacities coming online**

The capacity of the long-entrenched players is pegged at around 4.3 Bn litre per annum (LPA) as of end of FY24. The existing and new players have planned a massive capex entailing capacity addition of about 70% over the next three to four years, out of which the majority is expected to become operational in FY25 and FY26. Close to 1 Bn LPA capacity has been added in current fiscal, most of which is from a new entrant belonging to a large conglomerate.

Prior to the GST application on paints, organised players had an estimated market share of about 65% in the domestic paint sector, which has now increased to about 75%. With incremental capacity from larger companies, the organised sector's share is expected to go up to 80% in the medium term.




Source: CareEdge Ratings and CMIE

The credit risk profile of established industry players remains robust, with an overall gearing ratio of around 0.1x and ample surplus liquidity accumulated over the years through healthy cashflows. The strong credit risk profile shall support the ambitious expansion plans of the players without significantly leveraging the balance sheets in the medium term. New players' capex is primarily funded through a mix of debt and equity infusion from large conglomerates with deep pockets.

**CareEdge Ratings' View**

"With significant investment plans by new players having substantial financial resources, the industry is likely to experience changes in market share and pressure on the operating margin due to the twin impact of cost and price. Nonetheless, the sector is poised to grow at 8%-10% with a somewhat lower operating margin of around 14% in FY26 as compared to the average of around 18% in the last five years, reinforced by urbanisation and increasing affluence, rising disposable income, shortening of the re-painting cycle, demand recovery from semi-urban and rural areas, affordable housing projects, spending on large scale infrastructure projects and demand from automobiles sector," said Richa Bagaria, Associate Director at CareEdge Ratings.

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