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THE COMPASS

Brighter year ahead for paint companies

They should clock better volumes on higher demand

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Share prices of most paint companies have lagged the S&P BSE Sensex in the last six months on worries over rising prices of key inputs and expectations of muted volumes, also partly reflecting in the October-December 2017 (Q3) performance. However, things are changing for the better.

Higher prices of titanium-dioxide, mainly due to a supply disruption in China, and crude-based derivatives — key raw materials used by paint companies — weighed on their gross profit margins in Q3.

Gross profit is calculated by deducting the cost of goods sold (raw material, inventory drawdown, goods purchased) from net sales. Companies could not pass on the high input costs due to goods and services tax (GST)-related disruptions. Most of them had last revised their selling prices in May 2017.

The good thing is that most of them still managed to improve their earnings before interest, tax, depreciation and amortisation (Ebitda) margins in Q3, albeit marginally, aided by cost-control measures and an effective product mix.

Asian Paints and Berger Paints have also hiked prices by 1.5 per cent, effective March 2018. This, however, may not ease the gross margin pressure in the January-March 2018 quarter (Q4).

Sachin Bobade, analyst at Dolat Capital, said, "Since till February 2018 (two months of Q4) the companies did not pass on the high input cost pressure, the gross margin of paint firms will continue to remain under pressure in Q4."

Nevertheless, FY19 could be brighter for paint firms, as titanium dioxide prices (accounting for a major chunk of raw material costs) seem to have stabilised. "The (paint) companies did not hike prices due to the GST for a long time. So, there might be margin pressure for one more quarter. However, they will now surely pass on the input cost pressure even as titanium dioxide prices have started to soften. Hence, their margins will improve (in FY19)," said Sameer Deshmukh, analyst at Reliance Securities.

Volume growth is also seen improving. Given the pickup in the rural economy and expected growth of the automobile and infrastructure sectors, major paint players are likely to clock double-digit growth in volume in the next financial year. "Though volume growth was not up to the mark in Q3, it will be higher in Q4. Companies like Asian Paints are likely to report double-digit volume growth FY19 onward on the back of a continued premiumisation trend and strong growth in rural markets, coupled with recovery in urban demand," Deshmukh said.

Overall, investors can expect paint companies to do well in FY19, which should also help them deliver better stock returns. Analysts' target prices for the paint stocks indicate a potential upside of 14-21 per cent.

COST PRESSURES

	Asian Paints	Berger Paints	Kansai Nerolac
Raw material cost as % of sales*			
Q3 FY18	55.6	56.0	63.3
Q2 FY18	51.8	55.3	60.3
Q3 FY17	54.9	54.1	58.4
Ebitda margin (%)			
Q3 FY18	20.9	16.6	16.8
Q2 FY18	18.8	15.5	19.0
Q3 FY17	19.6	15.6	18.0

* includes cost of goods purchased
Sources: Companies, brokerage reports