

Paints Industry

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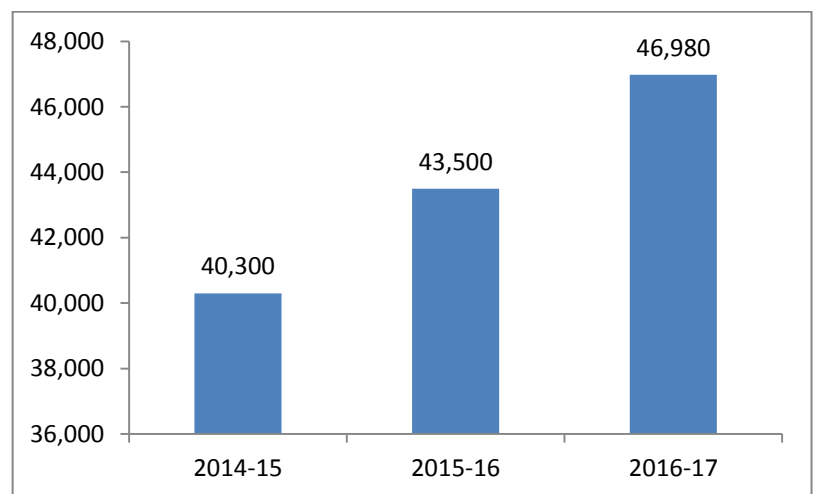
*In the financial year 2016-17, value of the paints industry grew by 8% on a y-o-y basis. This was backed by an improvement in disposable income, rising urbanization, focus on housing, rural growth, rise in automotive segment, increasing trend of nuclear families etc. The growth of paints industry is dependent on the growth of its two segments, decorative and industrial. In the financial year 2017-18, factors such as roll out of Seventh Pay Commission, salary revisions by States, normal monsoon, schemes for affordable housing, expected improvement in industrial output and growth in automotive segment are likely to augur well for the paints industry. **CARE Ratings thus expects paints industry to grow by 8-10% in 2017-18.***

The profit margin of the industry increased by 300-450 basis points in 2015-16 supported by lower input costs. Crude oil derivatives and titanium dioxide are major inputs used in manufacturing of paints. In 2016-17, the industry however witnessed no major expansion in profit margins as increase in raw material expenses weighed on the margins.

While the outlook for demand remains positive for paints industry for 2017-18, concerns for the industry would remain on the raw materials front if the y-o-y growth in crude oil prices continues.

Indian Paints Industry

Chart 1: Value of paints industry (in Rs. crore)



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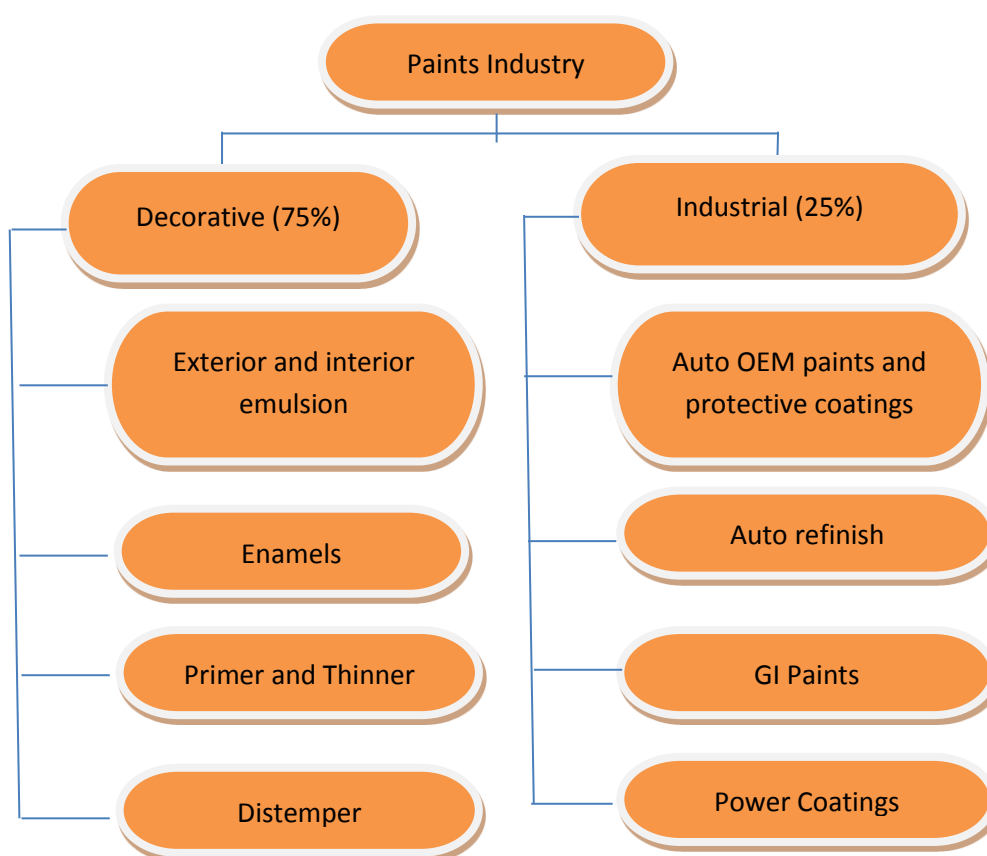
Source: Industry and CARE Ratings

The paints industry in India grew at a CAGR of 12.9% from 2011-12 to 2014-15 to Rs.40,300 crore backed by an improvement in disposable income, rising urbanisation, rural growth, increasing trend of nuclear families, reduction in average repainting cycle on account of improvement in disposable income and lifestyle. The repainting cycle is now approximately 7-10 years compared to around 15 years earlier. These factors supported the industry’s growth in 2015-16 and 2016-17 as well. In 2016-17, the industry’s value grew by 8% on a y-o-y basis to Rs.46,980 crore.

Major segments of paints industry

The paints industry is mainly divided into two segments – Decorative and Industrial. The decorative segment accounts for a major portion of the paint industry’s value, around 75%, and the industrial segment accounts for the rest 25% of the industry’s value.

Chart 2: Structure of paints industry



Decorative paints

The decorative segment consists of exterior and interior emulsions, enamels, primer and thinner, distemper, wall putti. Emulsions and distempers are used for painting walls, enamels for wood and metals, primers and putties for bringing evenness on the walls before final paint is applied. Of the emulsion and distemper paints, emulsion paints are comparatively costlier on account of its better quality as emulsions provide smoother finish to walls and are more durable and long lasting compared to distempers.

Industrial paints

The industrial paint includes auto OEM paints and protective coatings, auto refinish, GI (General Industrial) paints, powder coatings. Auto OEM paints and protective coatings and auto refinish paints are used by auto producers for painting automotive interiors and exteriors, GI paints are used for construction, heavy engineering & agricultural equipment etc. Powder coatings are usually used for coating metals and for auto ancillaries, electrical equipments, consumer durables etc.

This segment is dependent on business cycle activity and economic conditions while the decorative paints segment is dependent on the housing sector and repainting cycle. The average price for decorative paints is in the range of Rs.110-Rs.120 per litre whereas for industrial paints, the average price is approximately Rs.300 per litre. Industrial paints are anti corrosive paints.

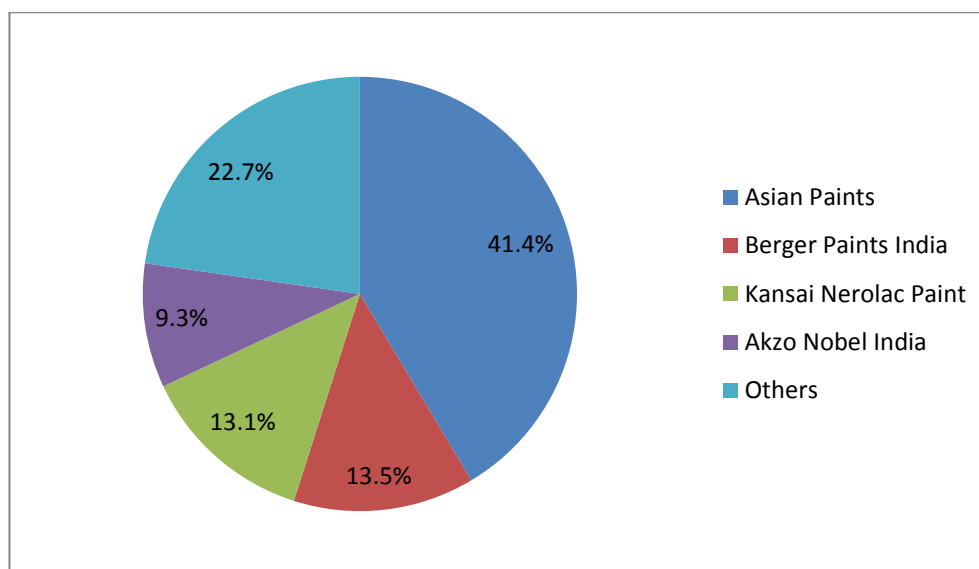
Organised and unorganised paints segment

The paints industry is largely dominated by organised players accounting for about 65% of the industry's value and the unorganised players accounting for the rest 35%.

Of the two segments in the paints industry, the industrial paints segment mainly comprises organised players whereas the decorative segment also involves some component of unorganised players as the decorative paints segment is not significantly dependent on technology compared to the industrial paints segment that involves higher technical know-how.

The unorganised segment involves selling of low end products like low end distemper, cement paints etc.

Chart 3: Market share of top players in organised paints industry for 2016-17 (in %)



Source: Ace Equity and CARE Ratings

Around 80% of the organised market of paints industry is covered by the top players with the largest share of 41.4% held by Asian Paints followed by Berger Paints India, Kansai Nerolac Paint and Akzo Nobel India with a share of 13.5%, 13.1% and 9.3%, respectively, during 2016-17.

Among these players, Asian Paints is the market leader in the decorative paints segment while Kansai Nerolac Paint is the market leader in the industrial paints segment.

Water-based paints and solvent-based paints

The paints manufactured are of two types – Water based paints and solvent based paints (also sometimes called as oil-based paints). For water based paints, binder is water-based while for solvent based paints, the binder is oil-based.

Emulsions are water-based paints and enamels are solvent-based paints. The emulsions are ideal for painting walls while enamels are used for woodwork and metals. Also, solvent-based paints are ideal for bathrooms and kitchens as these paints are not much affected by water.

The solvent based paints release Volatile Organic Compounds (VOCs) into the atmosphere that harms the environment while water-based paints do not release such harmful compounds and thus have least impact on the environment. Also, solvent-based paints are known to produce bothersome odor.

Inputs used for manufacturing paints

The manufacturing of paints involves a significant input cost as raw materials account for around 45-50% of the industry’s sales on an average. The raw materials used for manufacturing paints include resins (binders), pigments, solvents, additives. One of the key pigments used in the manufacture of paints is titanium dioxide. It accounts for about 15-20% of the total raw materials cost of the industry.

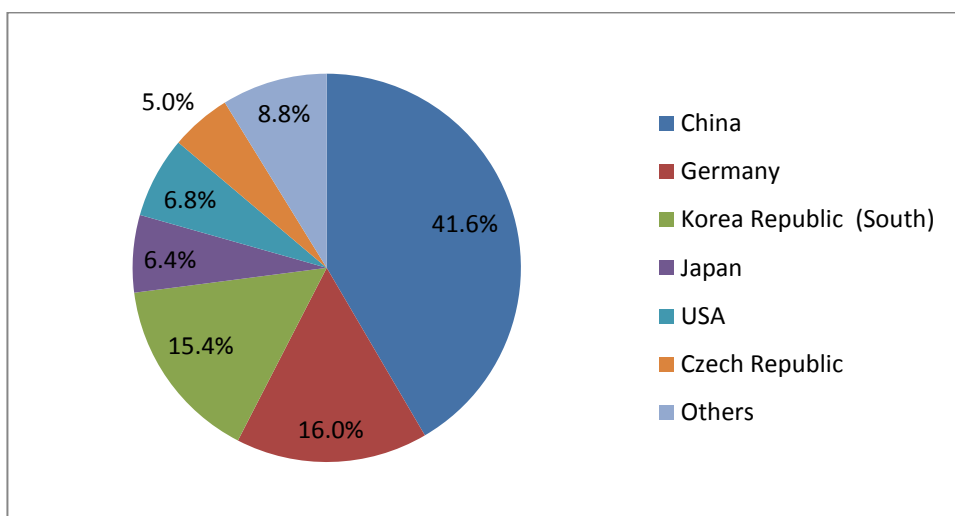
Titanium dioxide

Titanium dioxide is a white pigment that provides white colour to liquids, pastes or coatings. Apart from this, titanium dioxide scatters light and is Ultraviolet (UV) resistant which prevents decolouration and also titanium dioxide makes substance more opaque.

Titanium dioxide (TiO₂) is commercially available in two forms – anatase and rutile. Of these two forms, rutile titanium dioxide is considered more durable and stable compared to anatase titanium dioxide. Rutile form is also considered to be more efficient in scattering light.

Imports of titanium dioxide

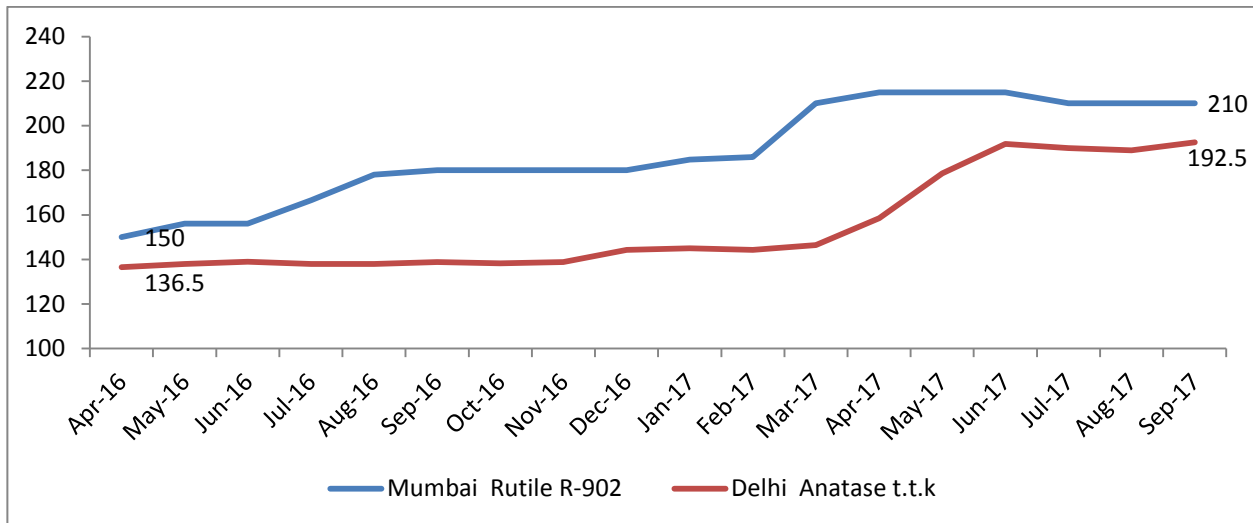
Chart 4: Country-wise quantity share of imports of titanium dioxide by India for 2016-17(in %)



Source: CMIE

Most of the paint companies in India meet the requirements of titanium dioxide through imports. Of the total titanium dioxide quantity imported by India from various countries, China accounted for the largest share of 41.6% followed by Germany, Korea Republic (South) accounting for 16%, 15.4%, respectively, during the year 2016-17. India imported 13,901 tonnes of titanium dioxide in 2016-17.

Chart 5: Rutile and anatase price movements in India (in Rs. /kg)



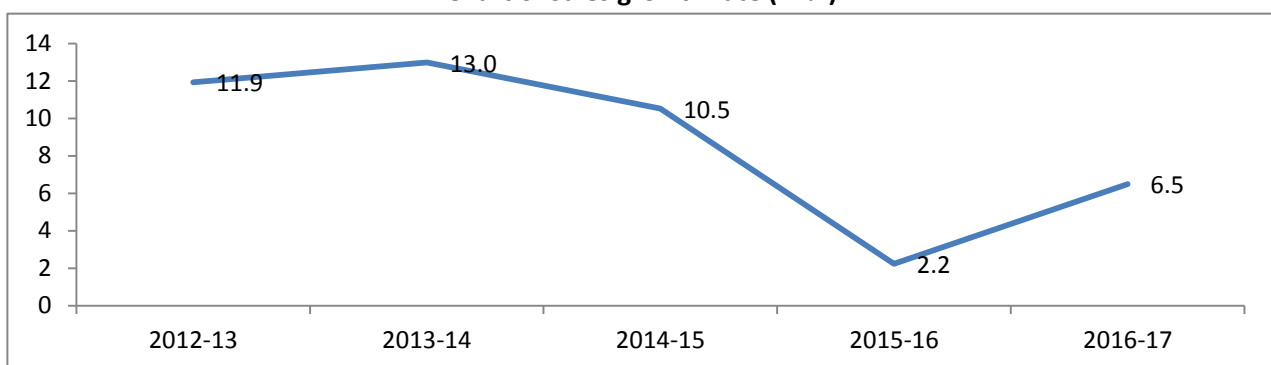
Source: CMIE

The prices of rutile in Mumbai remained in the range of Rs.150-Rs.186 per kg during the period April 2016-February 2017 and the prices of anatase were in the range of Rs.136-Rs.147 during the period April 2016-March 2017. On an m-o-m basis, the prices of rutile increased by 12.9% to Rs.210 per kg in March 2017 and that of anatase grew by 8.2% to Rs.158.5 per kg in April 2017. Prices for rutile then remained in the range of Rs.210-Rs.215 per kg during March-September 2017 and for anatase they were in the range of Rs.158-Rs.193 per kg during April-September 2017. Resultantly, the prices of rutile and anatase averaged 29.2% and 32.9% higher, respectively, during the period April-September 2017 on a y-o-y basis.

This increase in prices can be attributed to the growth in titanium dioxide prices in China from which India imported 41.6% of titanium dioxide during 2016-17. The prices in China grew on account of stricter regulations imposed by the government on production of titanium dioxide to control air pollution in the country.

Financials of the paints industry

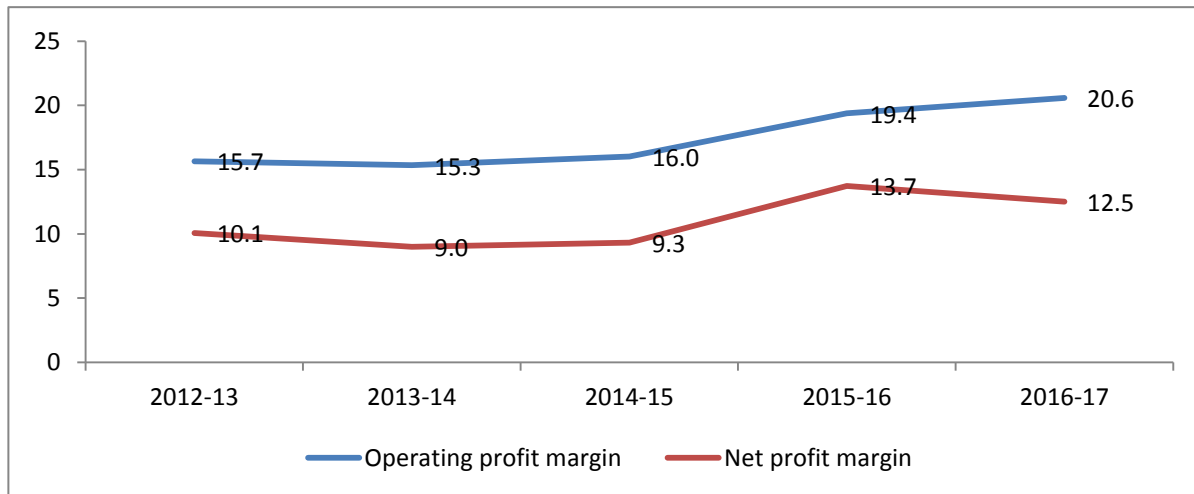
Chart 6: Sales growth rate (in %)



Source: Ace Equity

In the financial year 2016-17, sales of the 6 paint companies in our sample increased by 6.5% on a y-o-y basis compared to 2.2% growth reported by the industry in 2015-16. The increase in sales in 2016-17 was on account of various product-mixes offered by the industry. However, sales growth was impacted in second-half of the year due to demonetisation announced by the government in November 2016.

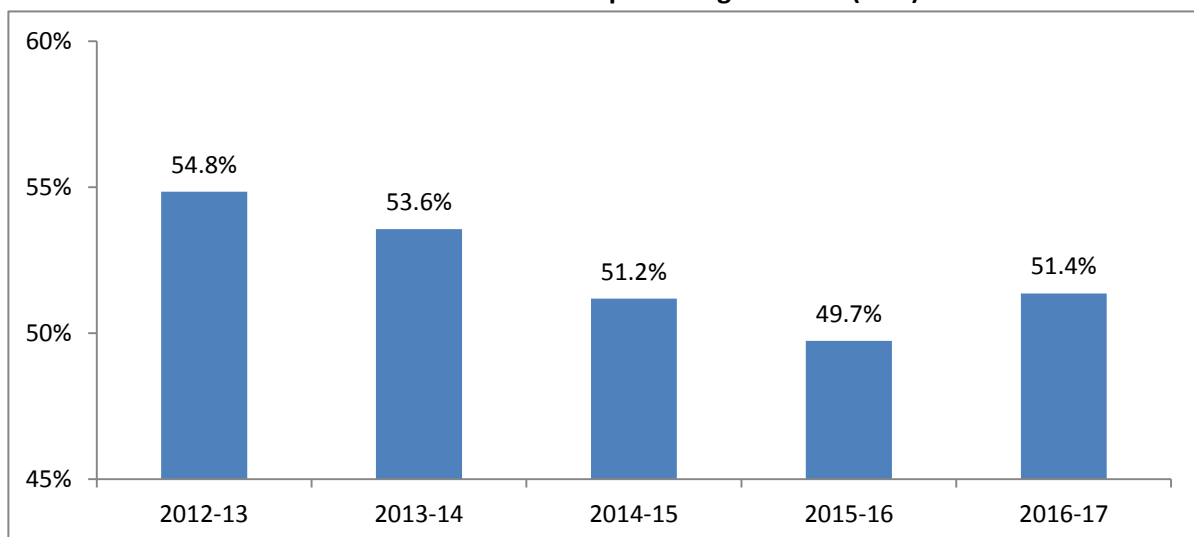
Chart 7: Operating and net margin (in %)



Source: Ace Equity

As seen from the above chart, the operating and net profit margin expanded by 300-450 basis points in 2015-16 on a y-o-y basis and the expansion in margins was maximum during the year among the years mentioned above. The expansion in profit margins was mainly on account of input costs as raw materials as percentage of sales dropped to 49.7% in 2015-16 from 51.2% in 2014-15.

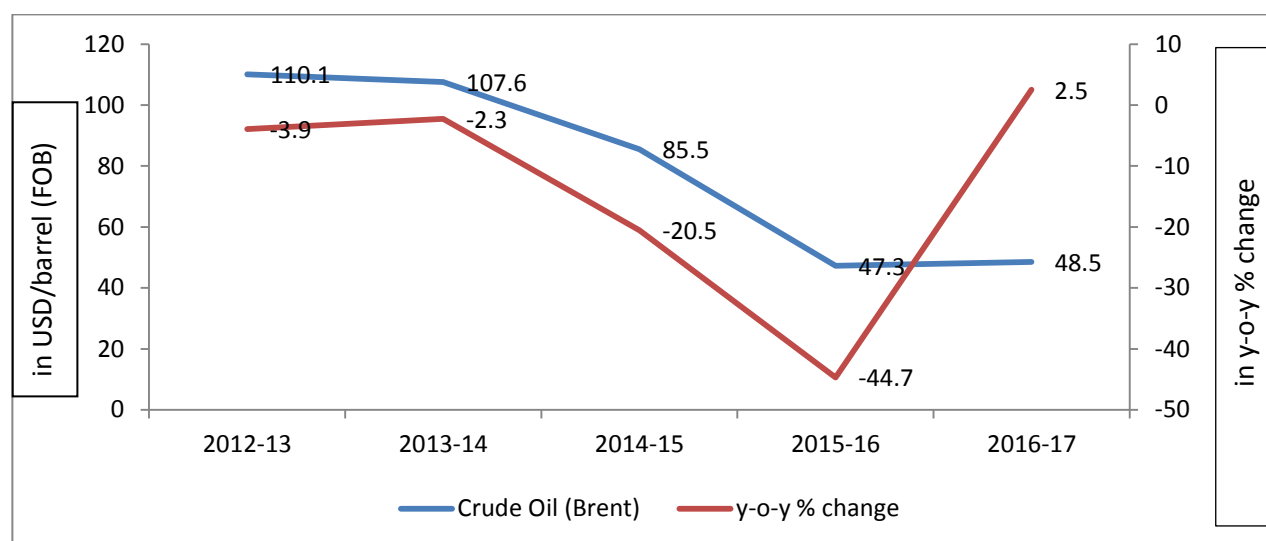
Chart 8: Raw materials as percentage of sales (in %)



Source: Ace Equity

The drop in this ratio was primarily because of the decline in crude oil prices. The prices of crude oils were at multi-year low during the year 2015-16 as shown below. Many of the inputs used in the manufacturing of paints are crude oil derivatives that accounts for about 30-35% of the total raw materials cost of the industry.

Chart 9: Prices of Crude oil (Brent) Europe



Source: CMIE

The crude oil prices that ruled in the range of USD 107-115 per barrel during the financial years 2011-14 slumped to USD 85.5 per barrel in 2014-15 and declined to USD 47.3 per barrel in 2015-16. In fact, the Brent crude oil prices were at their lowest in 2015-16 when compared to the last 10 years. The fall in prices was due to global surplus oil production.

In the year 2016-17, no major expansion was seen in profit margins compared to the expansion witnessed in profit margins during 2015-16. An increase in raw material expenses is believed to have weighed on the margins. The prices of crude oil and titanium dioxide which were lower on a y-o-y basis in the initial months of the year 2016-17 increased on a y-o-y basis in later half of the year. Crude oil derivatives and titanium dioxide are major raw materials used in manufacturing of paints.

Outlook

The implementation of GST is unlikely to have caused any major disturbances in demand for paints though it is believed to have resulted in de-stocking of paints. With GST, paints have been put under the highest tax rate slab of 28% compared to the earlier 24-27% taxes paid through excise, value added tax (VAT), entry taxes.

The paints industry is expected to rise by 8-10% in the financial year 2017-18 backed by a growth in its two segments, decorative and industrial. The roll out of Seventh Pay Commission and salary revisions by States is expected to result in increase in income thus supporting the demand for decorative paints. In addition to this, normal monsoon is likely to result in rural growth which, in turn, is expected to aid the consumption of decorative paints in rural areas. Also, the festive season is anticipated to support the demand for paints. Further, roll out of schemes like Housing for all and Pradhan Mantri Awas Yojna (PMAY) for affordable housing is also likely to help increase consumption of decorative paints going forward.

The demand for industrial paints is also likely to grow backed by an expected improvement in industrial output. In addition to this, CARE Ratings expects 10-12% growth in the two-wheeler segment (accounting for about 80% of the automobile industry’s sales) which is also likely to augur well for the paints industry. The automotive segment drives the demand for industrial paints as it forms a significant component of industrial paints.

While the outlook for demand remains positive, concerns for paints industry would remain on the raw materials front if the y-o-y growth in crude oil prices continues. The Brent crude oil prices averaged at USD 50.9 per barrel during April-September 2017, implying a y-o-y increase of 11.5%.

Concluding remarks

- *The demand for paints is likely to grow on account of an expected increase in income backed by the roll out of Seventh Pay Commission and salary revisions by States, normal monsoon, festive season, scheme for affordable housing. In addition to this, a likely improvement in industrial output coupled by an expected growth in automotive segment will aid the demand for industrial paints. The paints industry thus is expected to grow by 8-10% in the financial year 2017-18.*
- *While the outlook for demand remains positive, concerns for paints industry would remain on the raw materials front if the y-o-y growth in crude oil prices continues.*
- *The implementation of GST is unlikely to have caused any major disturbances in demand for paints though it is believed to have resulted in de-stocking of paints.*

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