

## Consumer Sector

24 January 2021

### Grasim ventures into Paints sector; Aims to become no. 2 player

Aditya Birla Group's (ABG) flagship company Grasim Industries Ltd. (Grasim) has announced its foray into the paints sector, with its Board, on 22<sup>nd</sup> January 2021, approving an initial investment of up to Rs50bn towards capex, spread over the next 3 years. Within Paints, the company plans to primarily enter the decorative space by introducing latest range of paint products that are in line with global mega-trends. The management has stated that the foray into Paints is a strategic portfolio choice for Grasim as it looks to identify new growth avenues which can add size, scale, diversity and stability to cash flows of its existing business portfolio and that the sector is likely to be value accretive to its shareholders. Grasim aims to become a strong no. 2 profitable company in the Paints space over a reasonable period. While we await finer details about Grasim's timeline of product launch and strategy for tinting machines, this foray will make the domestic paints industry even more competitive especially for smaller players in the initial phase. It will be interesting to see how Grasim scales up its Paints foray and challenge the leaders, over the longer term, in an industry where distribution has been a major entry barrier for decades. We continue to believe that Indian organized players will continue to benefit from the shift from the unorganized market. Due to rich valuations, we have a Sell rating on Asian Paints and Berger Paints.

**Rationale:** Grasim's rationale for strategically choosing to enter the decorative paints industry includes (i) India's Paints industry has grown at a 5-year CAGR of ~11% over FY14-FY19 and is expected to grow faster going ahead, owing to demographic-led demand, rapid urbanization, shortening of repainting cycles (boosted by increase in rental houses), affordable housing programs etc. Furthermore, ~25% of the overall decorative paints market, currently valued at ~Rs400bn, is shared by the unorganized players and hence the management believes that there will be shift of demand from unorganized to organized players, which may be catalyzed or accelerated with Grasim's entry (ii) With a strong balance sheet (which will further get strengthened from proceeds coming from the sale of the fertilizer business) and standalone businesses of Viscose Staple Fibre (VSF) and Chemicals being established market leaders, Grasim believed that it was the right time to add a high growth-high RoE business to enable high growth and consistency in standalone earnings. Even though the company has not had paints as a separate line of business so far, it believes that is not new to the paints industry as it is already present in adjacencies, and has been present in consumer homes through cement, white cement and putty. Grasim aims to achieve +20% IRR through in the Paints project. Similar to its other standalone businesses, the paints division will also be operated in an independent manner.

**Finer details of the strategy:** The company aims to become a **strong no. 2 player** in the Paints industry over a reasonable period of time (in terms of scale and profit). The management understands the fact that to be successful in the industry, a strong distribution network and brand saliency is required. Grasim will use a multi-pronged strategy to ensure that (i) the brand launched is strong and is able to capture consumer's imagination (ii) products are differentiated and of high quality, not only meeting current aspirations but also in line with global trends and (iii) costs are kept in check through synergy, automation and leveraging hindsight benefit (no legacy costs). The company plans to incur an initial capex of ~Rs50bn over 3 years, to be funded through internal accruals and debt. The plan is to set up multi-location manufacturing plants and Grasim is also in ongoing discussions with many states for the same. Further, the company is in discussion with multiple divisions & companies within ABG to see if they have locations available to add capacity. The company will focus on in-house manufacturing of water-based & oil-based paints and may also look at backward integration for some of the key raw material components. Grasim has already been doing pre-preparatory work over the last 9-12 months. The team set up (comprising talent identified within the group and industry veterans) has been working on multiple fronts, including product portfolio, technology, R&D and has carried out intensive consumer research, trade partner research and influencer research to understand present market practices. Now that all the plans are ready and the Board's approval is in place; the company will move on to the execution stage. The management stated that it is still premature to comment on the brand or to share the timeline of the launch. Although brands take time to build, Grasim believes it has an inherent advantage to leverage the brand equity of *Birla White* and *Aditya Birla* through the subsidiary's (UltraTech Cement Ltd. - UCL) existing touchpoints using influencers (Applicator & Painters). *Birla White* has been in this business for many decades and its white cement & putty products are distinct from UltraTech's products, which are in the grey cement space. Major chunk of *Birla White* distribution is through paint outlets and have a pan-India presence.

**Plans to tackle the key barriers:** Now that Grasim has the Board's approval, it will engage in formal discussions with UltraTech Cement Ltd. to discuss the way ahead, to synergize & gain access to the latter's distribution network. The arrangement will be on an arm's length basis and will ensure value accretion to the parent and subsidiary. Currently, there are two distribution channels that UltraTech operates through: (i) *UltraTech* brand & other allied brands under grey cement business are sold through cement outlets. Grasim is not relying on this channel since very limited paints products are sold through these outlets. (ii) The second channel is the paint dealers, which sell the entire paint portfolio, including undercoats/putty. *Birla White* is primarily sold through this channel and some from hardware stores. *Birla White* has ~54,000 dealers and 70-80% of them are in the paint industry. As per the management, *Birla White*'s distribution is the second largest in the paints industry and the pan-India operator is present across metro & tier 1 cities and also has deep roots in rural areas with presence in ~6,000 towns. Once the company is ready with a full product portfolio, it will further expand to other outlets. Further, the company is aware of entry barriers in terms of tinting machines and has a strategy to tackle the same but is currently not in a position to share due to competitive reasons.

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**Exhibit 1: Valuation summary of our coverage paint companies**

Company	Rating	Mcap		CMP (Rs)	TP (Rs)	Upside/ Downside (%)	P/E (x)			EV/EBITDA (x)			RoCE (%)		
		Rsbm	\$bn				FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
APNT	Sell	2495	34	2601	2455	-6	83	67	58	53	45	39	26	28	28
BRGR	Sell	751	10	774	595	-23	102	78	68	63	50	44	23	26	26

Source: Companies, Nirmal Bang Institutional Equities Research

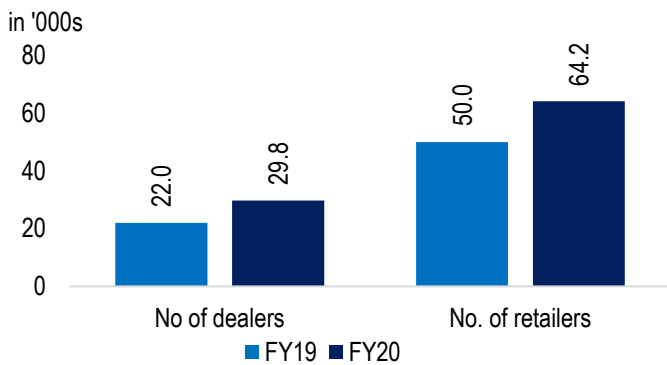
**Other highlights from the conference call**
**Company specific commentary**

- Grasim has a long & successful history of incubating large new businesses for the Aditya Birla Group. While it started as a textiles company 74 years back, Grasim has incubated many leadership businesses, including Chemicals, VSF, Cement, Finance etc. over the years.
- The company feels the need to create a third standalone business (VSF & Chemicals being two) so that standalone as a % of consolidated business is meaningful, in terms of scale & value. Also, consumer-centric business, like paints, will reduce overall volatility compared to Chemicals & VSF segments. Further, as standalone business gets hefty over a period of time, holding company discount will reduce.
- The company did not foray into paints through UltraTech as it is a large pure-play cement company. UltraTech already has some expansion plans in place and hence would prioritize its capital towards the same. Further, selling cement and paints requires different skill sets.
- The company did not opt for venturing into paints by creating a subsidiary since cash fungibility would have been lost and there would be other costs related to setting up another company.
- Grasim does not plan to merge *Birla White* brand with itself. Main focus will be to access the latter's distribution might.
- The management believes that technology is important and will look at the latest technology adoptable for its new business.
- There can be further capex as the journey goes on.
- White cement and other businesses are a small component of Ultratech in terms of value.
- Grasim is not in a hurry to launch the Paints products and will not launch any product before being satisfied with its quality.
- The company has the benefit of being a part of Aditya Birla Group, which opens up platform for recruiting talent across its manufacturing, supply chain/logistics operations. Grasim already has a Chief Operating Officer - Mr. Ajit Kumar, having 26-28 years of experience in the paints industry and is in the process of recruiting relevant people for its paints business.
- Even *Birla White* will get benefits from the proposed arrangement as it will help grow its current range of putty & white cement business wherein it can enter outlets which didn't stock its products earlier as they did not have the entire paints portfolio.
- Besides a sales team, *Birla White* has a strong service team whose main job is to launch new products, train applicators & painters and update all trade partners for its range of products.
- From the perspective of consumer requirement, white cement requirement has reduced whereas requirement for putty has increased. White cement wash is the second largest application and falls in the lower end category of paint, largest segment being putty, which is an undercoat. Over a period of time, white cement, which was earlier sold in hardware outlets, has mostly migrated to paint outlets.

**Other distribution specific commentary**

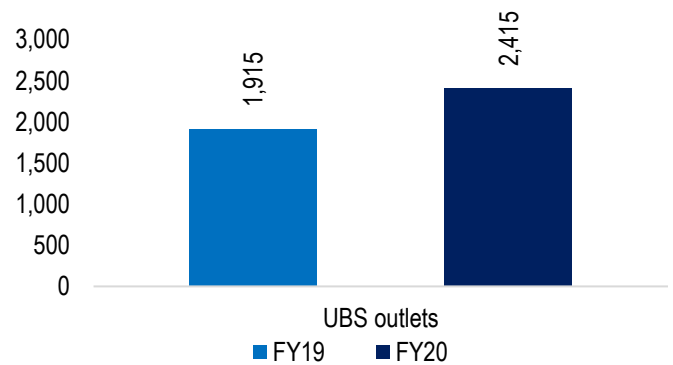
- Distribution of grey cement is completely different and does not overlap with paints distribution.
- *Birla White* uses stockists to deliver to retailers but that does not mean that the company has no relationship with retailers. It has an IT system in place where paint dealers and hardware stores are registered and the company has direct relation with them. Most promotions are directly handed over to dealers.

**Exhibit 2: No. of dealers & retailers**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 3: No. of UltraTech Building Solution (UBS) outlets**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 4: Ultratech's retail chain of UBS stores are a One-Stop-Shop for all construction needs**

**UltraTech: UBS**  
One-Stop-Shop for all your construction needs

ULTRATECH CEMENT LIMITED

**Services:**

- Paint Preview
- Vaastu
- Masonry
- Electricals
- Plumbing
- Carpentry
- Pest Control
- Home Finance

**Construction Material:**

- Paints
- Tiles
- Steel
- Water Tanks
- Construction Chemicals
- PVC Products
- Sanitary ware
- Wood Ply

**Value Added Products:**

- White Cement
- Putty
- Dry mix
- Water proofing & Building Products Range

FIGURE 30

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 5: Grasim can leverage Ultratech's UBS network for its upcoming paint portfolio**

**UltraTech: UBS**  
Addressing the future

ULTRATECH CEMENT LIMITED

First and only Indian cement company to launch a retail chain – servicing a product

Retail chain developed with the objective to provide quality products and services to consumers

Relationship-driven approach through the construction cycle

End-to-end solution provider; empathetic expert assisting customers for construction needs

Partners leading brands to provide quality construction products for individual home builders

<p><b>Footprint</b> 21 Number of States presence</p>	<p><b>Coverage</b> 2300+ UltraTech Building Solution outlets</p>	<p><b>Penetration</b> 70 Percentage of outlets in rural and Tier 3 geographies</p>	<p><b>Fulfilment</b> 60+ Percentage of customer needs addressed by UltraTech</p>

FIGURE 31

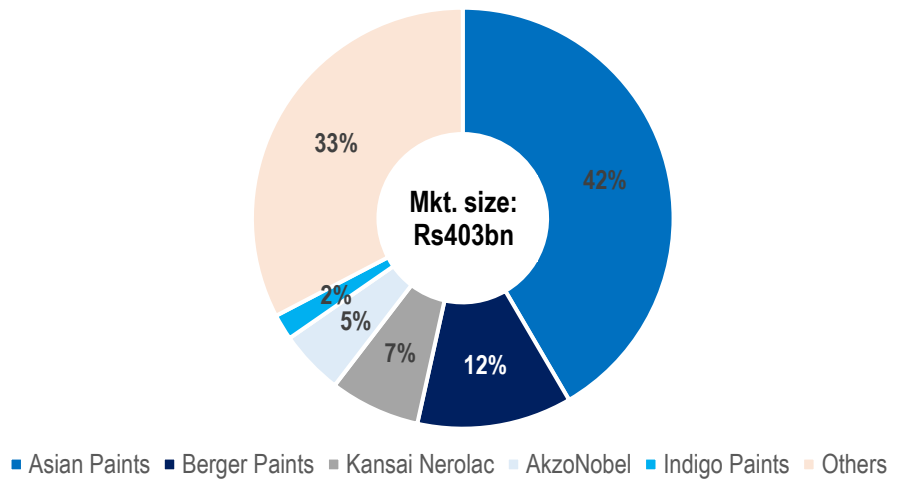
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 6: Apart from Putty, Ultratech is competing with paint companies on adjacencies like construction chemicals/waterproofing and adhesives.**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 7: Market share of top players in terms of value as on 2019**



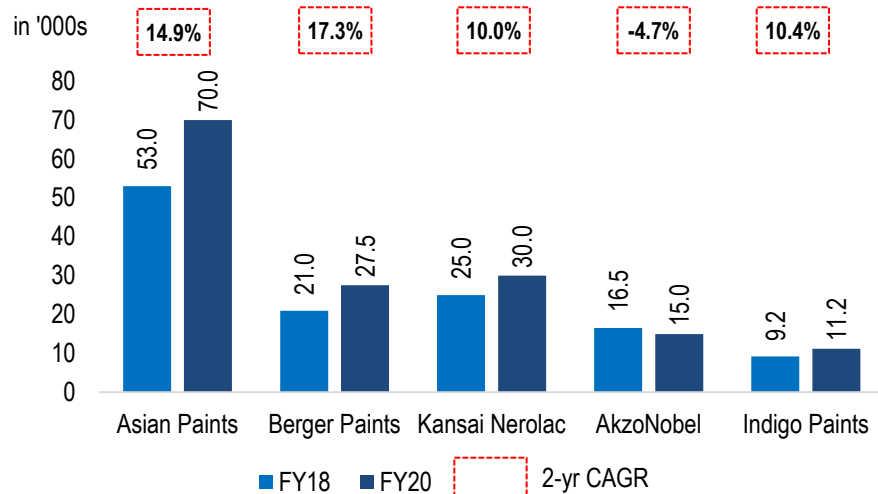
Source: Indigo Paints RHP, Nirmal Bang Institutional Equities Research

**Exhibit 8: Company-wise capacity over FY18-FY20**

Capacities (in MMT)	FY18	FY19	FY20
Asian Paints	1.130	1.710	1.730
Berger Paints	0.570	0.640	0.640
Kansai Nerolac	0.400	0.440	0.520
Indigo Paints	0.095	0.125	0.195

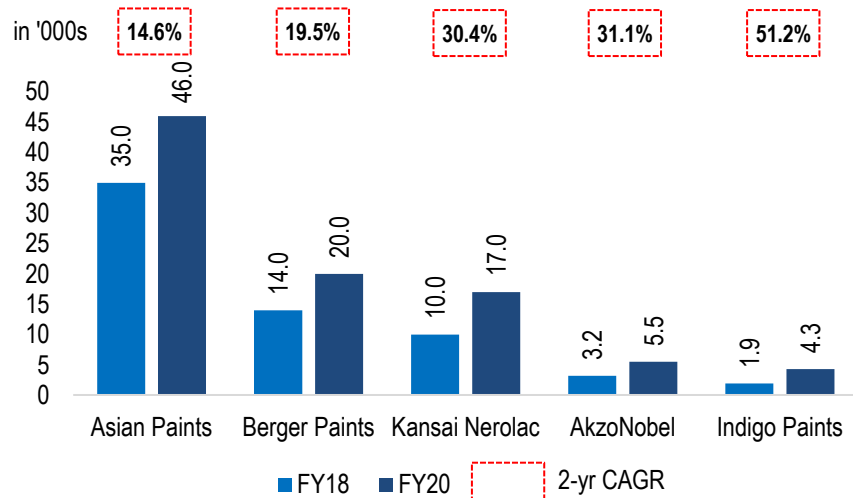
Source: Indigo Paints RHP, Nirmal Bang Institutional Equities Research

**Exhibit 9: 4 of 5 top decorative paint companies have increased their distribution network over FY18-FY20**



Source: Indigo Paints RHP, Nirmal Bang Institutional Equities Research

**Exhibit 10: All companies have grown their tinting machine count over FY18-FY20**



Source: Indigo Paints RHP, Nirmal Bang Institutional Equities Research

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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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