

Kansai Nerolac Paints (KANNER)

CMP: ₹ 559

Target: ₹ 630 (13%)

Target Period: 12 months

HOLD

October 28, 2021

Higher raw material prices drag profitability...

About the stock: Kansai is the global leader in industrial coatings (automotive). However, in the last 10 years, it has increased its decorative paint mix to 55% of its total topline. Currently, Kansai is the third largest decorative paint player in India.

- Strong distribution network of ~28,000 dealers across the country with 75-80% penetration of tinting machine
- In the last two years, KNL has increased its total paint manufacturing capacity by 28% to 5.3 lakh tonnes at an investment of ~₹ 1100 crore

Q2FY22 Results: Delay in passing of higher raw material prices dented profitability but revenue growth was in line with our estimate.

- Favourable base and strong demand for decorative paints helped drive revenue up by 16% YoY to ₹ 1521 crore
- Sharp rise in raw material prices and delay in passing on the same dragged gross & EBITDA margin down by 1040 bps and 925 bps YoY, respectively
- PAT declined by ~41x YoY to ₹ 99 crore, tracking lower margins

What should investors do? Kansai's share price has grown by ~1.5x over the past five years (from ~₹ 379 in October 2016 to ~₹ 560 levels in October 2021).

- We revise our rating from BUY to Hold on the stock

Target Price and Valuation: We value Kansai at ₹ 630 i.e. 48x P/E on FY23E EPS.

Key triggers for future price performance:

- We believe the decorative paint will continue to grow ~2x of GDP growth considering, shortening of repainting cycle, growing urbanisation and increased distribution reach of organised players
- Revival in passenger vehicle sales and strong demand momentum in industrial paints would help in a recovery in 45% of KNL's revenue portfolio
- Focus on improving product mix towards premium products would help drive profitability, going forward

Alternate Stock Idea: We also like Asian Paints in our coverage universe.

- Asian Paints is the market leader in decorative paint and is expanding its product portfolio along with dealer expansion in tier II and tier III cities
- BUY with a target price of ₹ 3425

Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	5 Year CAGR (FY16-21)	FY22E	FY23E	FY24E	3 Year CAGR (FY21-24E)
Net Sales	5173.6	4943.2	4710.0	4.6	5896.4	7064.1	7919.3	18.9
EBITDA	742.0	781.6	854.6	7.5	763.8	1084.2	1269.8	14.1
EBITDA Margin (%)	14.3	15.8	18.1		13.0	15.3	16.0	
Net Profit	467.3	535.4	552.4	8.2	486.4	714.1	842.0	15.1
EPS (₹)	8.7	9.9	10.2		9.0	13.3	15.6	
P/E (x)	64.5	56.3	54.5		61.9	42.2	35.8	
Price/Book (x)	8.8	8.0	7.3		7.5	6.7	6.0	
Mcap/Sales (x)	5.8	6.1	6.4		5.1	4.3	3.8	
RoE (%)	13.6	14.1	13.7		12.1	16.0	16.9	
RoCE (%)	20.2	17.5	17.6		15.7	20.8	22.3	

Source: Company, ICICI Direct Research



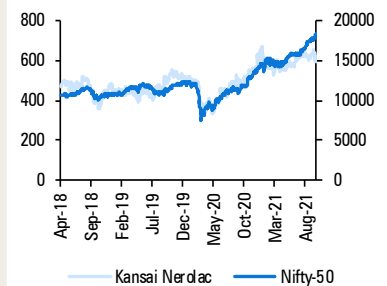
Particulars

Particular	Amount
Market Capitalization (₹ Crore)	30,125.6
Debt (FY21) (₹ Crore)	90.1
Cash & Inv (FY21) (₹ Crore)	764.8
EV (₹ Crore)	29,451.0
52 week H/L	680 / 493
Equity capital (₹ Crore)	53.9
Face value (₹)	1.0

Shareholding pattern

(in %)	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Promoter	75.0	75.0	75.0	75.0	75.0
FII	4.0	4.2	3.7	3.7	3.4
DII	12.2	12.3	12.9	11.6	13.3
Others	8.8	8.5	8.4	9.7	8.3

Price Chart



Recent event & key risks

- **Key Risk:** (i) Delay in volume offtake of industrial paint segment (ii) Delay in passing on high input prices

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Key takeaways of recent quarter & conference call highlights

Q2FY22 Results:

- Revenue growth of 16% YoY came in strong revival in the decorative paints (55% of revenue). However, industrial paint demand remained muted due to lower demand from automotive segment. Price hikes in the decorative paint segment was ~4-5% during Q2FY22
- Gross margin fell 1040 bps YoY mainly due to a delay in passing on of higher raw material prices. Company faced challenges in passing of higher raw material prices in the industrial category due to lower automotive demand
- PAT declined ~41% YoY to ₹ 99 crore, tracking lower margins

Q2FY22 Earnings Conference Call highlights

- **Demand Outlook:**
 - Decorative paint demand is likely to remain strong led strong repainting demand, launches of new products and dealer additions (increased by 10% YoY in H1FY22)
 - Increased focus towards premium emulsion categories as price hikes does not affect top end products demands.
 - New business category such as construction chemical, wood finishes will aid decorative paint revenue
 - Recovery in industrial paints will be delayed by shortage of semiconductor/chip. The company has gained market share in the automotive segment (market share ~60%). Focus to drive segment revenue from non-automotive segment (powder coating, performance coatings)
- **Margins:**
 - Value engineering (use of alternate raw materials), price hikes in coming quarters would help KNL to negate the adverse impact of raw material price. This coupled with focus on higher end emulsion (Premium category) would help margin recovery from Q4FY22 onwards
- **Distribution expansion:**
 - Dealer counts increased by 10% YoY to ~28,000. The company has a strong presence in the non-metros. Going forward, focus is to strengthen its metro and rural reach

Exhibit 1: Peer comparison

Company	Mcap ₹ cr	Revenue				EBITDA margin				PAT				RoCE				RoE				PE			
		FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E
Asian Paints	2,94,413	21713	26700	30959	36482	22	16	19	20	3207	2716	3894	5017	30	25	33	39	25	21	28	32	92	108	76	59
Berger Paints	70,606	6818	8351	9728	11321	17	17	18	19	720	918	1155	1432	25	29	34	36	21	25	28	29	98	77	61	49
Kansai Nero	30,126	4710	5896	7064	7919	18	13	15	16	552	486	714	842	18	16	21	22	14	12	16	17	55	62	42	36
Pidilite Ind	1,17,454	7293	9267	10535	11762	23	21	22	23	1126	1286	1561	1866	24	23	27	31	20	20	23	26	104	91	75	63

Source: Bloomberg, ICICI Direct Research

Kansai Nerolac (KNL) is the third largest decorative paint company with ~12% market share in the organised category. Over the last 10 years, KNL has increased its decorative paint contribution in revenue from 50% to 55%. We believe KNL's decorative paints will witness good demand traction in FY21-24E (volume CAGR of 15%) supported by strong repainting demand, dealer additions and launches of new products (in the construction chemicals, launch of premium products). However, we believe the industrial portfolio (mainly automotive portfolio) is likely to face challenges in the near term (due to shortage of chips). This coupled, delay in price hikes in the industrial category (due to lower demand) likely to weigh on EBITDA margin in FY22E (revised revenue, PAT estimate downside by 8%, 30%). Hence, we revised our rating from BUY to HOLD and value stock at ₹ 630/share i.e. 48x FY23E EPS.

Exhibit 2: Variance Analysis

	Q2FY22	Q2FY22E	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	Comments
Net Revenue	1,520.7	1,492.2	1,308.9	16.2	1,321.6	15.1	Favourable base and improved demand in the decorative paints drives revenue growth in Q2
Other Income	6.2	5.9	4.4	42.6	9.7	-35.6	
Raw Material Exp	1,081.0	974.2	793.9	36.2	867.9	24.6	Higher raw material costs and partial price hikes in the decorative paints dragged gross margin (down by 1040 bps YoY)
Employee Exp	69.3	66.6	66.4	4.5	72.1	-3.8	
Manuf & Other exp	205.7	215.0	185.8	10.7	191.9	7.2	
Total Expenses	1,356.1	1,255.8	1,046.1	29.6	1,131.9	19.8	
EBITDA	164.7	236.5	262.8	-37.3	189.7	-13.2	
EBITDA Margin (%)	10.8	15.8	20.1	-925 bps	14.4	-353 bps	Lower gross margins resulted in EBITDA margin decline of 925 bps YoY
Depreciation	38.0	37.1	35.6	6.8	37.7	0.7	
Interest	2.3	2.2	1.4	0.0	2.7	0.0	
PBT	130.6	203.1	219.4	-40.5	159.0	-17.8	
Total Tax	32.1	50.8	60.1	-46.7	40.1	-20.1	
Adj PAT	98.5	152.3	167.1	-41.0	118.8	-17.1	Sharp decline in PAT due to margin pressure
Key Metrics							
Volume Growth (%)	18.0	9.0	7.0		112.0		Strong volume growth led by decorative paints, however industrial paint demand remained muted due to lower demand from automotive industry
Realisation Growth (%)	-1.5	6.3	-3.0		5.5		Lower realisation is attributable to delay in price hikes in both decorative and industrial paint segments

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY22E			FY23E			FY24E			Comments
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg	
Revenue	6,395.2	5896.4	(7.8)	7456.0	7064.1	(5.3)	8548.3	7919.3	(7.4)	Revised our revenue downside considering slow recovery in the Industrial paint
EBITDA	1,046.3	763.8	(27.0)	1294.0	1084.2	(16.2)	1503.6	1269.8	(15.5)	
EBITDA Margin %	16.4	13.0	-341bps	17.4	15.3	-201bps	17.6	16.0	-157bps	We have revised our EBITDA margin downward factoring in sharp rise raw material prices and delay in passing of inflationary pressure in the industrial paints
PAT	698.0	486.4	(30.3)	867.1	714.1	(17.6)	1009.9	842.0	(16.6)	
EPS (₹)	13.0	9.0	(30.3)	16.1	13.3	(17.6)	18.7	15.6	(16.6)	

Source: ICICI Direct Research

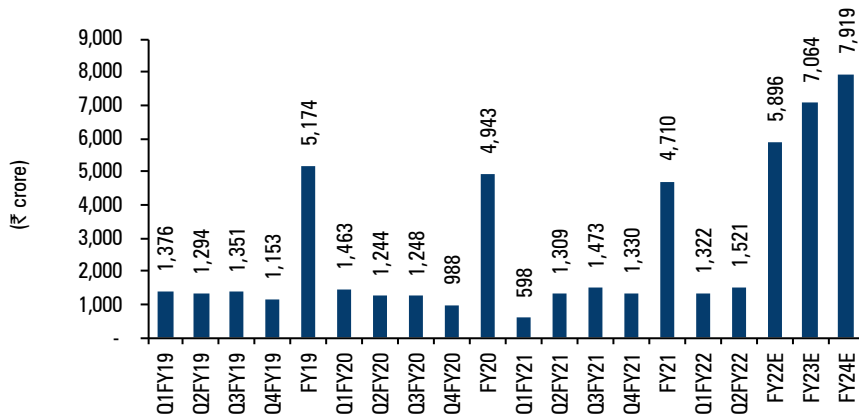
Exhibit 4: Assumptions

	Current			Earlier				Comments
	FY21E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	
Volume Growth (%)	-3.9	19.1	14.7	8.8	29.4	11.5	11.3	We have our volume estimates downside considering a slow recovery in the industrial paint demand
Realisation Growth (%)	-0.9	5.1	4.5	3.0	5.4	4.5	3.0	

Source: ICICI Direct Research

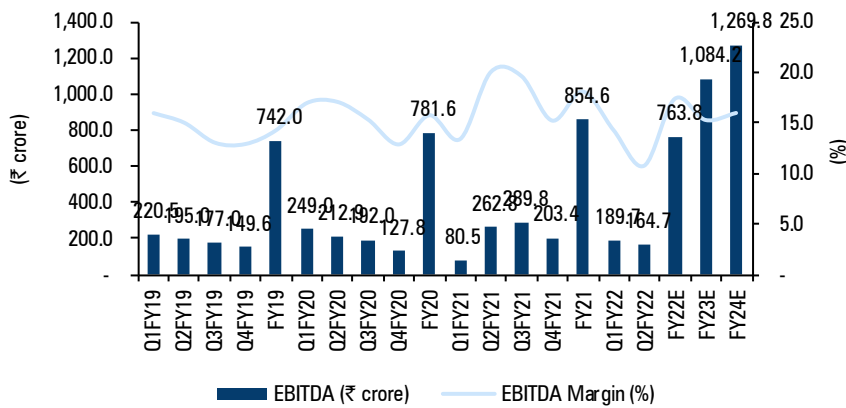
Financial story in charts

Exhibit 5: Revenue trend



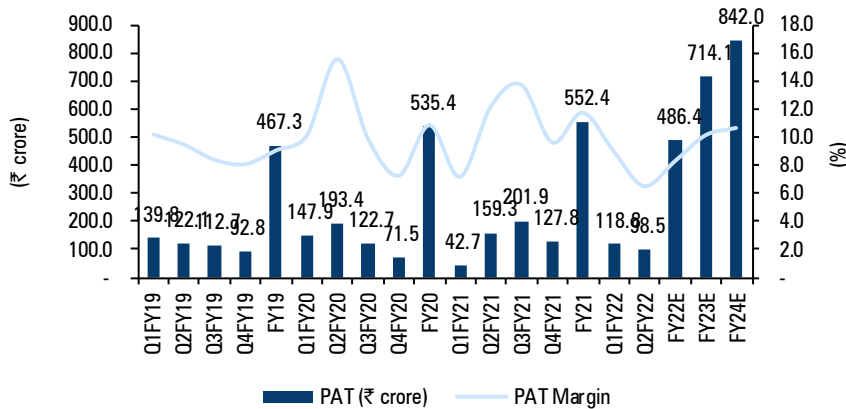
Source: Company, ICICI Direct Research

Exhibit 6: EBITDA margin movement



Source: Company, ICICI Direct Research

Exhibit 7: PAT movement



Source: Company, ICICI Direct Research

Financial Summary

Exhibit 8: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
Total operating Income	4,710.0	5,896.4	7,064.1	7,919.3
Growth (%)	-4.7	25.2	19.8	12.1
Raw Material Expenses	2,909.9	4,012.6	4,618.7	5,125.8
Employee Expenses	258.6	282.2	300.2	334.3
Other expenses	686.9	837.7	1,061.0	1,189.4
Total Operating Expenditure	3,855.4	5,132.5	5,979.9	6,649.4
EBITDA	854.6	763.8	1,084.2	1,269.8
Growth (%)	9.3	-10.6	41.9	17.1
Depreciation	139.0	153.3	175.5	196.7
Interest	7.8	10.1	10.3	10.4
Other Income	38.7	46.9	56.2	62.9
Exceptional Income	10.8	0.0	0.0	0.0
PBT	735.8	647.3	954.6	1,125.7
Total Tax	183.4	160.9	240.6	283.7
PAT	552.4	486.4	714.1	842.0

Source: Company, ICICI Direct Research

Exhibit 9: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
Profit before Tax	552.4	486.4	714.1	842.0
Add: Depreciation	139.0	153.3	175.5	196.7
(Inc)/dec in Current Assets	-721.5	127.6	-530.5	-310.0
Inc/(dec) in CL and Provisions	289.1	31.1	95.2	130.3
Others	7.8	10.1	10.3	10.4
CF from operating activities	266.8	808.4	464.4	869.3
(Inc)/dec in Investments	-15.6	-50.0	-50.0	-150.0
(Inc)/dec in Fixed Assets	-197.8	-200.0	-200.0	-200.0
Others	15.6	50.0	50.0	150.0
CF from investing activities	-659.0	-323.7	-122.1	-250.0
Inc/(dec) in loan funds	30.1	-5.0	12.0	-60.0
Dividend paid & dividend tax	-342.1	-260.7	-260.7	-325.8
Others	97.4	-327.5	-10.3	-10.4
CF from financing activities	-214.6	-593.2	-258.9	-396.2
Net Cash flow	-69.9	-34.8	-44.5	123.1
Opening Cash	163.6	93.7	58.9	14.5
Closing Cash	93.7	58.9	14.5	137.6

Source: Company, ICICI Direct Research

Exhibit 10: Balance Sheet				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
Liabilities				
Equity Capital	53.9	53.9	53.9	53.9
Reserve and Surplus	4,048.4	3,956.7	4,410.1	4,926.3
Total Shareholders funds	4,102.3	4,010.6	4,464.0	4,980.2
Total Debt	90.1	85.1	97.1	37.1
Deferred Tax Liability	88.4	88.4	88.4	88.4
Total Liabilities	4,280.8	4,184.1	4,649.5	5,105.7
Assets				
Gross Block	2,778.4	3,084.2	3,284.2	3,484.2
Less: Acc Depreciation	1,052.3	1,205.6	1,381.1	1,577.8
Net Block	1,726.1	1,878.6	1,903.2	1,906.5
Capital WIP	205.8	100.0	100.0	100.0
Total Fixed Assets	1,931.9	1,978.6	2,003.2	2,006.5
Non-Current Investments	165.5	215.5	265.5	415.5
Inventory	1,090.2	1,130.8	1,432.2	1,562.2
Debtors	836.2	807.7	967.7	1,084.8
Loans and Advances	20.8	23.0	27.6	30.9
Investments & Other CA	824.9	654.1	698.9	767.0
Cash	93.7	58.9	14.5	137.6
Total Current Assets	2,929.8	2,767.4	3,253.5	3,686.6
Creditors	809.0	807.7	870.9	976.3
Provisions & other CL	140.7	173.1	205.1	229.9
Total Current Liabilities	949.7	980.8	1,076.0	1,206.3
Net Current Assets	1,980.1	1,786.6	2,177.5	2,480.4
Others Non-Current Assets	203.3	203.3	203.3	203.3
Application of Funds	4,280.8	4,184.1	4,649.5	5,105.7

Source: Company, ICICI Direct Research

Exhibit 11: Key ratios				
(Year-end March)	FY21	FY22E	FY23E	FY24E
Per share data (₹)				
EPS	10.2	9.0	13.3	15.6
Cash EPS	12.8	11.9	16.5	19.3
BV	76.1	74.4	82.8	92.4
DPS	6.3	4.8	4.8	6.0
Cash Per Share	19.5	22.4	25.6	29.3
Operating Ratios (%)				
EBITDA Margin	18.1	13.0	15.3	16.0
EBIT Margin	15.2	10.4	12.9	13.6
PAT Margin	11.9	8.2	10.1	10.6
Inventory days	84	70	74	72
Debtor days	65	50	50	50
Creditor days	63	50	45	45
Return Ratios (%)				
RoE	13.7	12.1	16.0	16.9
RoCE	17.6	15.7	20.8	22.3
RoIC	23.0	18.2	23.6	25.7
Valuation Ratios (x)				
P/E	54.5	61.9	42.2	35.8
EV / EBITDA	35.2	39.5	27.9	23.6
EV / Net Sales	6.4	5.1	4.3	3.8
Market Cap / Sales	6.4	5.1	4.3	3.8
Price to Book Value	7.3	7.5	6.7	6.0
Solvency Ratios				
Debt/EBITDA	0.1	0.1	0.1	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	2.3	2.3	2.6	2.5
Quick Ratio	1.1	1.1	1.2	1.2

Source: Company, ICICI Direct Research

Exhibit 12: ICICI Direct Consumer Discretionary universe

Sector / Company	CMP (₹)	TP(₹)	Rating	M Cap (₹ Cr)	EPS (₹)				P/E (x)				EV/EBITDA (x)				RoCE (%)				RoE (%)			
					FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E
Asian Paints (ASIPAI)	3,070	3,425	Buy	2,94,413	33.4	28.3	40.6	52.3	91.8	108.4	75.6	58.7	59.7	70.0	50.5	39.5	29.6	25.0	33.0	38.5	25.0	21.1	27.9	32.1
Berger Paints (BERPAI)	727	860	Hold	70,606	7.4	9.5	11.9	14.7	98.1	76.9	61.1	49.3	59.2	49.2	40.2	32.7	24.9	29.0	33.9	36.0	21.3	24.7	27.6	29.2
Kansai Nerolac (KANNER)	559	630	Buy	30,126	10.2	9.0	13.3	15.6	54.5	61.9	42.2	35.8	35.2	39.5	27.9	23.6	17.6	15.7	20.8	22.3	13.7	12.1	16.0	16.9
Pidilite Industries (PIDIND)	2,313	2,390	Hold	1,17,454	22.2	25.3	30.7	36.8	104.3	91.3	75.3	62.9	69.6	60.8	51.3	43.3	23.8	23.0	26.9	30.8	20.2	19.5	22.5	25.7
Bajaj Electricals (BAJELE)	1,150	1,250	Buy	13,173	16.5	23.0	34.0	39.2	69.7	50.1	33.9	29.3	44.2	32.0	22.9	20.3	15.1	19.3	25.2	24.2	10.7	16.3	19.9	19.1
Crompton Greaves(CROGR)	461	525	Buy	28,895	9.8	9.1	11.6	13.1	46.9	50.8	39.8	35.2	38.6	37.9	30.3	26.7	34.4	36.0	41.5	41.5	31.9	28.5	32.7	32.3
Havells India (HAVIND)	1,268	1,545	Buy	79,111	16.7	20.6	24.7	28.9	76.1	61.7	51.3	43.8	49.8	41.6	34.7	29.5	24.9	27.5	30.9	32.9	20.1	22.9	25.5	26.8
Polycab India (POLI)	2,310	2,710	Buy	34,446	59.4	52.6	76.4	90.5	38.9	44.0	30.2	25.5	28.7	28.9	20.4	17.0	21.9	19.1	24.2	24.4	18.5	14.9	18.6	18.7
Symphony (SYMLIM)	1,051	1,050	Hold	7,352	15.3	20.8	32.1	39.3	68.7	50.6	32.7	26.8	51.6	39.7	25.5	20.8	15.2	21.1	29.1	30.7	14.9	19.9	27.0	28.0
V-Guard Ind (VGUARD)	243	310	Buy	10,407	4.7	5.3	7.0	8.2	51.5	46.0	34.5	29.5	32.5	31.5	24.7	20.9	23.9	24.2	28.4	29.0	16.7	18.5	22.0	22.5
Voltas Ltd (VOLTAS)	1,190	1,170	Buy	39,357	16.0	22.0	28.8	34.2	74.4	54.1	41.3	34.8	60.7	48.2	35.9	33.4	15.0	20.2	22.8	21.1	10.6	14.9	17.0	17.4
Amber Enterprises (AMBER)	3,400	3,365	Buy	11,456	24.7	43.2	87.7	109.7	137.6	78.6	38.8	31.0	51.8	38.0	22.0	17.8	7.7	11.0	18.3	19.7	5.2	8.8	15.2	16.0
Dixon Technologies (DIXTE)	4,995	5,050	Buy	29,245	27.3	52.3	97.4	152.5	183.2	95.5	51.3	32.8	102.0	62.0	35.4	22.7	23.5	34.6	47.4	50.6	21.7	33.9	41.7	41.4
Supreme Indus (SUPIND)	2,329	2,740	Buy	29,585	77.0	67.6	80.7	91.1	30.2	34.5	28.9	25.6	22.4	25.0	20.7	18.2	33.1	25.7	27.3	27.6	30.9	24.4	25.1	25.0
Astral Polytechnik (ASTPOL)	2,137	2,160	Hold	42,929	20.3	24.6	31.8	40.6	105.2	86.7	67.2	52.7	66.0	55.9	43.7	34.4	27.5	29.2	32.5	34.0	21.5	22.8	24.9	26.0
EPL (ESSPRO)	216	279	Hold	6,810	7.7	9.4	11.6	13.3	27.9	22.9	18.7	16.3	11.5	10.4	8.6	7.5	16.2	17.7	20.8	21.5	14.8	16.6	18.9	19.7
Time Techno (TIMTEC)	71	100	Buy	1,606	4.8	8.3	10.7	11.5	14.9	8.5	6.6	6.2	5.7	4.6	3.8	3.5	8.7	12.2	13.9	13.9	5.7	9.5	11.3	11.1
Moldtek Packaging (MOLP)	672	675	Buy	1,863	17.3	22.5	30.6	38.0	38.9	29.9	22.0	17.7	20.8	16.3	12.7	10.4	21.4	24.8	29.1	30.1	20.7	21.9	24.1	23.9

Source: Bloomberg, ICICI Direct Research

RATING RATIONALE

ICICI Direct endeavours to provide objective opinions and recommendations. ICICI Direct assigns ratings to its stocks according to their notional target price vs. current market price and then categorizes them as Buy, Hold, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock

Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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