

Kansai Nerolac Paints (KANNER)

CMP: ₹ 464

Target: ₹ 515 (11%)

Target Period: 12 months

HOLD

November 3, 2022

Sharp topline growth, margins remain flat...

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

Q2FY23 Results: Industrial paints demand drove topline growth.

- Q2 revenue up 19% YoY to ₹ 1814 crore led by higher demand for industrial paints and price hikes. Industrial paint volumes were up 33% (I-direct estimate) on low base while decorative paint volumes were flat YoY
- Improved product mix and price hikes helped gross margin remain flat YoY. Despite higher topline growth, EBITDA margin also remained flat YoY at ~11% due to increase in employee and other expenses
- PAT up 19% YoY to ₹ 117.3 crore led by topline growth

What should investors do? KNL's share price has given negative return over the past five years (from ₹ 495 in November 2017 to ₹ 464 levels in November 2022).

- We maintain our **HOLD** rating on the stock

Target Price and Valuation: We value Kansai at ₹ 515 i.e. 40x P/E on FY24E EPS.

Key triggers for future price performance:

- We believe regaining lost market share in the decorative paint (~55% of total revenue) will be a key trigger for company's future revenue growth
- 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 gross margin, going forward
- Higher ad expenses to keep overall EBITDA margin expansion under check

Alternate Stock Idea: We like Asian Paints (APL) in our coverage universe. APL is India's largest decorative paint company. The company derives ~98% revenue from the paints business. Robust b/s with RoCE, RoE of 30%, 25%, respectively.

- BUY with a target price of ₹ 3685



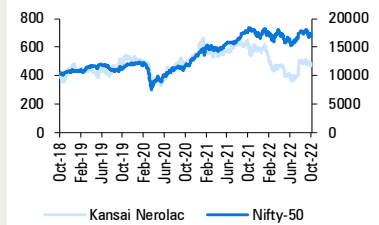
Particulars

Particular	Amount
Market Capitalization (₹ Crore)	25,005.9
Debt (FY22) (₹ Crore)	0.0
Cash & Inv (FY22) (₹ Crore)	310.1
EV (₹ Crore)	24,695.8
52 week H/L	630/ 358
Equity capital (₹ Crore)	53.9
Face value (₹)	1.0

Shareholding pattern

(in %)	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	75.0	75.0	75.0	75.0	75.0
FII	3.4	3.6	3.6	3.3	3.5
DII	13.3	13.2	13.2	13.4	13.3
Others	8.3	8.2	8.3	8.3	8.3

Price Chart



Recent event & key risks

- **Key Risk:** (i) Faster recovery in decorative paints segment (ii) Higher ad expenses to keep EBITDA margin under check

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Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	2 Year CAGR (FY22-24E)
Net Sales	5173.6	4943.2	4770.9	5948.9	8.3	7317.6	8162.6	17.1
EBITDA	742.0	781.6	843.5	647.3	-2.4	892.0	1120.9	31.6
EBITDA Margin (%)	14.3	15.8	17.7	10.9		12.2	13.7	
Net Profit	467.3	535.4	530.6	374.3	-5.8	545.1	696.2	36.4
EPS (₹)	8.7	9.9	9.8	6.9		10.1	12.9	
P/E (x)	53.5	46.7	47.1	66.8		45.9	35.9	
Price/Book (x)	7.3	6.6	6.1	6.0		6.0	5.4	
Mcap/Sales (x)	4.8	5.1	5.2	4.2		3.4	3.1	
RoE (%)	13.6	14.1	13.2	9.2		13.1	15.1	
RoCE (%)	20.2	17.5	17.2	12.1		17.0	19.9	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

Q2FY23 Results: Strong demand for industrial paints; while decorative paint volumes remain flat

- KNL's Q2FY23 performance was lower than our estimates. Revenues were up 19.3% YoY to ~₹ 1814.3 crore led by volume growth of ~16% (I-direct estimate). Volume growth was driven by industrial paints volume growth of 33% YoY (I-direct estimate) largely on a favourable base. However, decorative paint volume offtake was flat dragged by unseasonal rains and lower rural demand
- On a YoY basis, improved product mix and price increases helped keep gross margin flat. EBITDA margin likewise remained flat YoY at 11% despite higher topline growth as a result of increase in employee and other expenses
- PAT up 19% YoY to ~₹ 117.3 crore, tracking higher sales in Q2FY23

Q2FY23 Earnings Conference Call highlights

Demand Outlook

- **Decorative Paints Segment:**
 - Demand growth in decorative paints was value led, with volume growth remaining flat YoY. Growth in this segment was led by putty and new business in Q2FY23. Excluding ancillary (i.e. ex putty, primer) core paints segment volume offtake was muted
 - Demand is expected to be subdued in Q3FY23 owing to higher base, extended monsoon (in some regions) and lower rural demand
 - KNL has added 3000 new retail outlets YTD in the decorative paints segment
 - The company has also started 50 new Next Generation Premium Shoppes, which is an experience store and plans to add 25 more Shoppes in FY23. These stores are expected to boost the demand for premium products
 - Introduction of new products has resulted in increased growth in the premium category. KNL is also planning to add new products in the premium and super premium category in decorative paints segment
 - New product contribution (that includes water proofing products) to overall topline increased to 6% in Q2FY23 (vs. 5% in Q1FY23)
- **Industrial paints segment:**
 - KNL's topline growth was led by industrial paints as a result of revival in demand of auto industry. Demand from passenger vehicles largely contributed to the topline in Q2FY23
 - According to the management, the company is continuing to gain market share in industrial paints led by high demand from automotive
 - The company is in negotiations with its customers for further price hike in automotive paints
 - KNL is entering new markets such as decal and alloys in the automotive segment
 - For its performance coatings vertical, the company has received approvals for projects such as Mumbai-Ahmedabad bullet train and Vande Bharat trains. The company has exited some of the low margin products and is now focusing on high margin products
 - Under the power coating segment, the company has added new customers in Q2FY23
 - Going forward, the management expects growth momentum in the passenger vehicle industry and commercial vehicles to sustain. Two-wheeler segment demand is expected to improve but will remain below pre-Covid levels

Margins:

- KNL has taken 3% price hikes in decorative as well as industrial paints segment in H1FY23
- The management expects 2-3% improvement in gross margin in Q4FY23
- EBITDA margins are expected to improve, going forward, but KNL is planning higher advertisement expenses in the decorative paints segment due to which such impact in margins may not be visible

Exhibit 1: Peer comparison

Company	Mcap ₹ cr	Revenue				EBITDA margin				PAT				RoCE				RoE				PE			
		FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E
Asian Paints	3,01,606	21713	29101	34685	40371	22	17	17	19	3207	3085	3914	5194	30	27	32	39	25	23	27	32	94	98	77	58
Berger Paints	58,861	6818	8762	10375	11439	17	15	15	16	720	833	962	1195	25	23	28	31	21	21	25	28	82	71	61	49
Kansai Nero	25,006	4771	5949	7318	8163	18	11	12	14	531	374	545	696	17	12	17	20	13	9	13	15	47	67	46	36
Pidilite Ind	1,34,313	7293	9921	11859	13262	23	19	18	22	1126	1207	1413	2026	24	22	24	30	20	19	20	25	119	111	95	66
Sheela Foam	13,902	2435	2982	3364	3797	15	11	11	12	238	217	253	322	24	18	20	23	20	16	16	19	58	64	55	43

Source: Bloomberg, ICICI Direct Research

Kansai Nerolac reported a robust volume growth in Q2FY23 led by its industrial paints segment (~45% of revenue). Recovery in the automotive demand and new launches in the non-automotive segment drove industrial paint demand for KNL. The company has remained a market leader with ~50% value market share in the automotive paints. However, on the decorative paint segment, we believe flattish volume growth in Q2 is much lower than industry leader mainly due to slow launches of new products. On a three-year basis, KNL’s overall revenue CAGR of 13% is much lower than 18% CAGR of Asian Paints. We believe the market leader is more aggressive on product launch in the decorative paint segments, which, in turn, restricted volume growth for peers such as Kansai Nerolac. Going forward, we build in KNL’s overall revenue CAGR of 17% on a favourable base and strong demand for industrial paints. The decorative paint segment is likely to grow at CAGR of ~15% supported by new product launches and dealer expansion in tier II and III cities. We believe company’s focus on regaining lost market share in the decorative segment will delay EBITDA margin recovery due to higher advertisement and promotional expenses. We cut our PAT estimate by ~13%, 4% for FY23E and FY24E, respectively, owing to slow recovery in EBITDA margin. We maintain our HOLD rating on the stock with a revised target price of ₹ 515/share (valuing the stock at 40x FY24E, 40% discount to Asian Paints).

Exhibit 2: Variance Analysis

	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Net Revenue	1,814.3	1,854.5	1,520.8	19.3	1,944.6	-6.7	Strong demand for industrial paints led by automotive industry and price hikes drove overall topline growth in Q2
Other Income	3.5	4.2	6.2	-43.2	4.4	-19.2	
Raw Material Exp	1,295.5	1,297.8	1,081.0	19.8	1,362.9	-4.9	Gross margin remained flat on a YoY basis supported by price hike and improved product mix
Employee Exp	82.7	75.8	69.3	19.3	77.5	6.7	Annual increment in July 2022 led to increase in employee expenses QoQ
Manuf & Other exp	238.8	226.9	205.7	16.1	248.6	-3.9	
Total Expenses	1,616.9	1,600.5	1,356.1	19.2	1,689.0	-4.3	
EBITDA	197.3	254.0	164.7	19.8	255.6	-22.8	
EBITDA Margin (%)	10.9	13.7	10.8	5 bps	13.1	227 bps	EBITDA margin remained flat on a YoY basis
Depreciation	41.2	40.8	38.0	8.5	39.3	5.0	
Interest	2.5	2.4	2.3	8.3	2.3	0.0	
PBT	157.2	215.0	130.6	20.3	218.4	-28.0	
Total Tax	39.9	54.6	32.1	24.5	55.5	-28.1	
Adj PAT	117.3	160.4	98.6	19.0	162.9	-28.0	PAT growth is tracking higher topline growth
Key Metrics							
Volume Growth (%)	15.8	19.0	18.0		30.0		Strong volume growth led by ~33% YoY growth in industrial paints demand. However, decorative paints volume growth was flat due to extended monsoon and slower offtake in the rural
Realisation Growth (%)	3.0	2.5	-1.5		15.0		The company has taken price hike of ~1% QoQ (3% YTD)

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

₹ Crore)	FY23E			FY24E			Comments
	Old	New	%Chg	Old	New	%Chg	
Revenue	7447.8	7317.6	(1.7)	8393.4	8162.6	(2.7)	We slightly tweak our revenue estimate downward for FY23E-24E factoring in slower offtake of decorative paints. We model revenue CAGR 18% over FY22-24E led by industrial paint segment revenue CAGR of 20%. We build in blended volume CAGR of 14%
EBITDA	995.7	892.0	(10.4)	1161.1	1120.9	(3.5)	
EBITDA Margin %	13.4	12.2	-121bps	13.8	13.7	-7bps	We revise our EBITDA margin downward for FY23 factoring in Q2FY23 performance and higher advertisement expenditure
PAT	624.2	545.1	(12.7)	722.4	696.2	(3.6)	
EPS (₹)	11.6	10.1	(12.7)	13.4	12.9	(3.6)	

Source: ICICI Direct Research

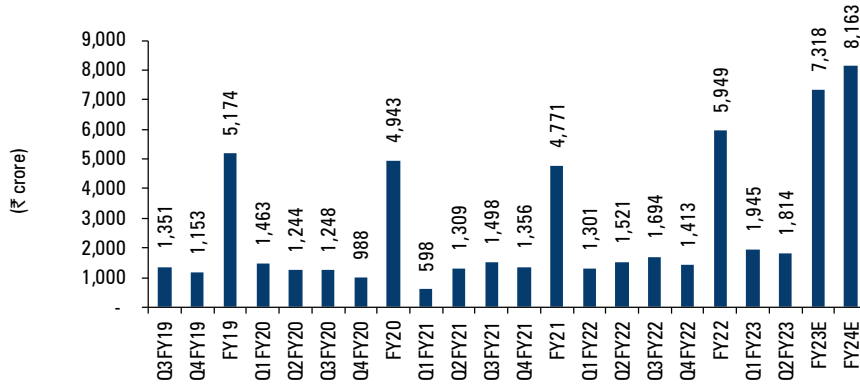
Exhibit 4: Assumptions

Assumptions	Current				Earlier		Comments
	FY21E	FY22E	FY23E	FY24E	FY23E	FY24E	
Volume Growth (%)	-3.9	17.4	18.6	10.3	16.1	11.5	Recovery in automotive paint demand on a favourable base and launch of new products in the decorative segment will drive overall volume CAGR of 14% FY22-24E
Realisation Growth (%)	0.4	6.2	3.7	1.1	7.8	1.1	

Source: ICICI Direct Research

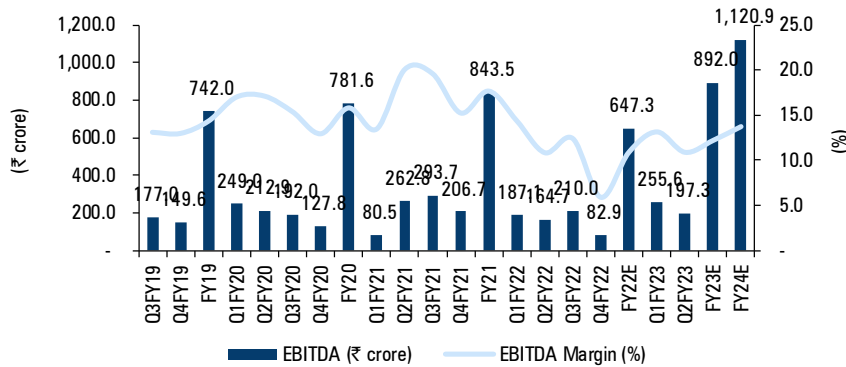
Financial story in charts

Exhibit 5: Industrial paints segment revenue



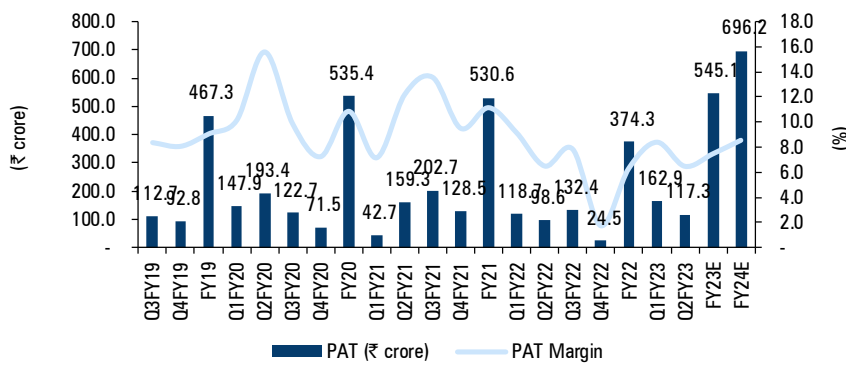
Source: Company, ICICI Direct Research

Exhibit 6: EBITDA and 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	FY22	FY23E	FY24E
Total operating Income	4,770.9	5,948.9	7,317.6	8,162.6
Growth (%)	-3.5	24.7	23.0	11.5
Raw Material Expenses	2,957.4	4,129.3	5,144.5	5,617.1
Employee Expenses	268.6	312.4	319.1	356.9
Other expenses	701.3	859.9	962.1	1,067.8
Total Operating Expenditure	3,927.4	5,301.6	6,425.7	7,041.7
EBITDA	843.5	647.3	892.0	1,120.9
Growth (%)	7.9	-23.3	37.8	25.7
Depreciation	149.0	153.8	168.3	187.7
Interest	8.5	9.9	10.0	10.2
Other Income	38.8	32.9	14.6	17.9
Exceptional Income	10.8	11.4	0.0	0.0
PBT	714.0	505.1	728.2	940.8
Total Tax	183.5	130.8	183.1	244.6
PAT	530.6	374.3	545.1	696.2

Source: Company, ICICI Direct Research

Exhibit 9: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit before Tax	530.6	374.3	545.1	696.2
Add: Depreciation	149.0	153.8	168.3	187.7
(Inc)/dec in Current Assets	-721.5	-54.6	-130.1	-333.5
Inc/(dec) in CL and Provisions	289.1	93.6	79.5	61.0
Others	8.5	9.9	10.0	10.2
CF from operating activities	255.7	577.1	672.8	621.7
(Inc)/dec in Investments	-15.6	74.7	0.0	0.0
(Inc)/dec in Fixed Assets	-197.8	-332.0	-200.0	-350.0
Others	15.6	-74.7	0.0	0.0
CF from investing activities	-659.0	-323.7	-122.1	-194.4
Inc/(dec) in loan funds	30.1	-90.1	0.0	0.0
Dividend paid & dividend tax	-342.1	-260.7	-260.7	-260.7
Others	96.7	-33.1	-304.2	-10.2
CF from financing activities	-215.3	-383.9	-564.9	-270.9
Net Cash flow	-81.7	-1.2	40.1	0.8
Opening Cash	163.6	81.9	80.7	120.8
Closing Cash	81.9	80.7	120.8	121.6

Source: Company, ICICI Direct Research

Exhibit 10: Balance Sheet				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Liabilities				
Equity Capital	53.9	53.9	53.9	53.9
Reserve and Surplus	4,026.6	4,117.0	4,107.3	4,542.9
Total Shareholders funds	4,080.5	4,170.9	4,161.2	4,596.8
Total Debt	90.1	0.0	0.0	0.0
Deferred Tax Liability	88.4	95.6	95.6	95.6
Total Liabilities	4,259.0	4,352.4	4,342.7	4,778.2
Assets				
Gross Block	2,778.4	3,092.3	3,416.2	3,766.2
Less: Acc Depreciation	1,062.3	1,216.2	1,384.5	1,572.2
Net Block	1,716.1	1,876.2	2,031.7	2,194.0
Capital WIP	205.8	223.9	100.0	100.0
Total Fixed Assets	1,921.9	2,100.0	2,131.7	2,294.0
Non-Current Investments	165.5	90.9	90.9	90.9
Inventory	1,090.2	1,531.5	1,403.4	1,565.4
Debtors	836.2	965.4	1,142.8	1,274.7
Loans and Advances	20.8	0.0	28.6	31.9
Investments & Other CA	824.9	392.5	437.3	413.7
Cash	81.9	80.7	120.8	121.6
Total Current Assets	2,918.0	2,971.3	3,141.6	3,475.8
Creditors	809.0	890.4	962.3	1,006.4
Provisions & other CL	140.7	152.9	160.5	177.4
Total Current Liabilities	949.7	1,043.3	1,122.8	1,183.8
Net Current Assets	1,968.3	1,928.0	2,018.8	2,292.1
Others Non-Current Assets	203.3	233.5	101.3	101.3
Application of Funds	4,259.0	4,352.4	4,342.7	4,778.2

Source: Company, ICICI Direct Research

Exhibit 11: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS	9.8	6.9	10.1	12.9
Cash EPS	12.6	9.8	13.2	16.4
BV	75.7	77.4	77.2	85.3
DPS	6.3	4.8	4.8	4.8
Cash Per Share	19.7	22.6	25.7	29.2
Operating Ratios (%)				
EBITDA Margin	17.7	10.9	12.2	13.7
EBIT Margin	14.6	8.3	9.9	11.4
PAT Margin	11.3	6.4	7.4	8.5
Inventory days	83	94	70	70
Debtor days	64	59	57	57
Creditor days	62	55	48	45
Return Ratios (%)				
RoE	13.2	9.2	13.1	15.1
RoCE	17.2	12.1	17.0	19.9
RoIC	22.4	13.7	19.0	22.1
Valuation Ratios (x)				
P/E	47.1	66.8	45.9	35.9
EV / EBITDA	29.7	38.5	27.9	22.2
EV / Net Sales	5.2	4.2	3.4	3.0
Market Cap / Sales	5.2	4.2	3.4	3.1
Price to Book Value	6.1	6.0	6.0	5.4
Solvency Ratios				
Debt/EBITDA	0.1	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	2.3	2.6	2.5	2.6
Quick Ratio	1.1	1.1	1.2	1.3

Source: Company, ICICI Direct Research

Exhibit 12: ICICI Direct Consumer Discretionary universe

Sector / Company	Rating	M Cap	EPS (₹)				P/E (x)				EV/EBITDA (x)				RoCE (%)			RoE (%)				
		(₹ Cr)	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E
Asian Paints (ASIPAI)	Buy	3,01,606	33.4	32.2	40.8	54.2	94.1	97.8	77.1	58.1	61.2	62.2	51.3	39.4	29.6	27.1	32.5	38.7	25.0	23.0	27.3	32.1
Berger Paints (BERPAI)	Hold	58,861	7.4	8.6	9.9	12.3	81.8	70.7	61.2	49.3	49.3	44.4	38.9	32.1	24.9	23.3	27.6	31.0	21.3	21.2	25.2	27.7
Kansai Nerolac (KANNER)	Hold	25,006	9.8	6.9	10.1	12.9	47.1	66.8	45.9	35.9	29.7	38.5	27.9	22.2	17.2	12.1	17.0	19.9	13.2	9.2	13.1	15.1
Pidilite Industries (PIDIND)	Hold	1,34,313	22.2	23.8	27.8	39.9	119.3	111.3	95.1	66.3	79.7	72.6	63.5	45.2	23.8	22.2	23.9	30.0	20.2	18.8	20.2	25.0
Sheela Foam (SHEFOA)	BUY	13,902	48.7	44.5	51.8	65.9	58.5	64.0	55.0	43.2	38.5	44.8	38.2	30.3	24.3	18.0	19.6	22.6	20.1	15.6	16.4	18.8
Bajaj Electricals (BAJELE)	BUY	13,334	16.5	10.8	21.0	31.7	70.4	107.2	55.2	36.7	44.8	52.9	36.4	25.5	15.1	13.5	19.6	24.2	10.7	7.8	14.4	18.3
Crompton Greaves(CROGR)	Hold	22,753	9.8	9.2	8.9	11.1	36.9	39.3	40.7	32.7	30.1	29.7	26.2	21.8	34.4	16.2	16.6	20.5	31.9	24.0	21.7	23.4
Havells India (HAVIND)	Buy	75,594	16.7	19.1	17.6	27.1	72.4	63.3	68.4	44.6	47.5	41.8	45.6	31.0	24.9	23.7	23.0	33.8	20.1	20.0	19.4	28.7
Polycab India (POLI)	Buy	41,097	59.3	61.4	76.3	86.8	46.4	44.8	36.0	31.7	36.2	31.6	23.1	20.4	20.6	20.2	24.7	23.8	17.9	15.6	18.4	18.0
Symphony (SYMLIM)	Hold	5,750	15.3	17.3	26.1	34.8	53.7	47.5	31.5	23.6	40.1	34.6	24.1	18.2	15.2	15.9	24.5	29.0	14.9	14.4	23.6	27.4
V-Guard Ind (VGUARD)	Hold	11,135	4.7	5.3	5.3	7.1	55.2	48.7	48.9	36.6	34.8	32.8	31.6	23.8	23.9	21.2	23.4	27.8	16.7	16.2	17.7	21.2
Voltas Ltd (VOLTAS)	Hold	28,542	16.0	15.3	16.1	23.0	54.0	56.4	53.4	37.5	43.8	40.9	40.1	28.6	15.0	14.0	16.3	20.1	10.6	9.2	11.0	14.1
Amber Enterprises (AMBEN)	Hold	6,806	24.7	33.0	45.7	73.7	81.7	61.1	44.2	27.4	30.7	26.0	20.4	15.1	7.7	6.8	10.2	13.2	5.2	6.4	8.7	12.3
Dixon Technologies (DIXTEC)	Buy	26,897	27.3	32.1	57.9	85.4	166.2	141.3	78.2	53.1	93.9	71.3	44.0	32.1	23.5	17.7	27.8	31.5	21.7	19.1	31.8	34.2
Supreme Indus (SUPIND)	Buy	27,971	77.0	76.2	63.1	80.4	28.6	28.9	34.9	27.4	21.2	22.1	24.1	18.7	33.1	25.9	22.6	27.1	30.9	25.2	20.5	23.6
Astral Ltd (ASTPOL)	Hold	41,703	20.3	24.4	25.8	35.9	102.2	85.0	80.6	57.8	64.1	54.5	48.0	36.5	27.5	26.6	25.5	29.3	21.5	21.0	19.6	23.1
Time Techno (TIMTEC)	BUY	2,307	4.8	8.5	10.1	13.1	21.4	12.0	10.1	7.8	7.5	6.0	5.2	4.4	8.7	11.3	12.8	14.6	5.7	9.3	10.7	12.5

Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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