Stock Update

Kansai Nerolac Paints Ltd.

July 31, 2023

RETAILRESEARCH

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Kansai Nerolac Paints Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Paints	Rs. 328	Buy in Rs. 323-330 band and add more on dips in Rs. 289-296 band	Rs. 358	Rs. 384	2 -3 quarters

HDFC Scrip Code	KANNEREQNR
BSE Code	500165
NSE Code	KANSAINER
Bloomberg	KNPL IN
CMP (July 28, 2023)	328
Equity Capital (RsCr)	80
Face Value (Rs)	1
Equity Share O/S (Cr)	80
Market Cap (RsCr)	26,515
Book Value (Rs)	57
Avg. 52 Wk Volumes (in' 000s)	309
52 Week High	357
52 Week Low	247

Share holding Pattern % (June, 2023)	
Promoters	74.99
Institutions	16.51
Non Institutions	8.50
Total	100.0

* Refer at the end for explanation on Risk Ratings

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Our Take:

Kansai Nerolac Paints Ltd (KNPL) is a 74.99% subsidiary of Kansai Paints Co. Ltd., Japan. The parent is one of the world's top ten paint companies with manufacturing facilities in over 43 countries. KNPL is the largest industrial paint and third largest decorative paint company in India. While steadfastly strengthening its position in these traditional markets, it continues to venture into new customer need areas, such as wood coating, adhesives, construction chemicals in decorative and floor coatings, transportation coatings, coil coatings, rebar coatings and super durable powders in the industrial coatings segment. These ventures have helped it expand its product portfolio and offerings. Its manufacturing footprint spans six plants, all of which are strategically located near Automobile companies, thus giving it a strong competitive edge. Through technology, product innovation and well-established distribution, KNPL has strengthened its core and established itself as a strong consumer brand; it features in India's Top-40 brands. The company has been expanding its horizons by entering new market segments and geographies. Through acquisitions and joint ventures, it also operates internationally in Sri Lanka, Nepal, and Bangladesh. KNPL had announced bonus issue in May 2023 in the ratio of 1:2. The share has been quoting ex-bonus from July 4, 2023.

Valuation & Recommendation:

KNPL's decorative market share is estimated at 9-10%; it has lost its share in the past three years. Management intends to fix this by filling up white spaces in the portfolio via its new premium product (paint + range). The industrial segment continues its robust performance, backed by strong automotive demand. New products continue to grow in salience (now account for 7-8% of sales). In decorative, management intends to step up the pace of distribution growth (from its typical 8-10% annual run rate). Going ahead, we expect the company to report an improvement in EBITDA margin on the account of (1) previous price hikes caught up with RM inflation; (2) rising salience of premium products in the mix; and (3) input costs are moderating.

We think the base case fair value of the stock is Rs 358 (41x FY25E EPS) and the bull case fair value is Rs 384 (44x FY25E EPS). Investors can buy the in stock Rs 323-330 band (37x FY25E EPS) and add more on dips in Rs 289-296 band (34x FY25E EPS).

Financial Summary

Particulars (in Rs Cr)	Q4FY23	Q4FY22	YoY-%	Q3FY23	QoQ-%	FY21	FY22	FY23	FY24E	FY25E
Operating Income	1734	1537	12.8	1827	-5.1	5,074	6,369	7,543	8,417	9,447
EBITDA	168	84	100.3	196	-14.0	863	649	818	1,000	1,161
APAT	96	19	402.0	109	-11.7	526	343	468	595	699
Diluted EPS (Rs)	1.8	0.4	402.0	2.0	-11.7	6.5	4.2	5.8	7.4	8.6
RoE-%						13.5	8.4	10.8	12.6	13.5
P/E (x)						50	77	57	45	38
EV/EBITDA						31	41	32	27	23

(Source: Company, HDFC sec)

Q4FY23 result review: Standalone revenue grew at 13.6% YoY in Q4; consolidated revenue was up 12.8% YoY. GMs expanded 359/136bps YoY/QoQ to 31.6% as (1) previous price hikes caught up with RM inflation (esp on the industrial side). Despite the sequential GM improvement, EBITDAM declined 148 bps as management flexed the marketing lever to gain lost ground in the decorative segment. EBITDA grew 100% YoY to Rs 168 cr. APAT grew 4x YoY (on a low base) to Rs 96 cr.

Q1FY24 result preview: We model a 9% topline growth in Q1. (4-year CAGR: 10%). We expect 215/16 bps YoY/QoQ expansion in gross margin to 32.1%. Expect Industrial portfolio to grow at 12.5%. GM recovery to be partially offset by higher ad spends as efforts are made to recover lost ground in decorative business. This will drive EBITDA margin up by 101/466 bps YoY/QoQ to 14.2%. QoQ.

Key highlights from FY23 annual report:

New product introductions

In Decorative business, KNPL continued to launch products with the Paint+ promise. Nerolac Impressions Kashmir and Nerolac Excel Everlast 12 are some unique products launched. In Construction chemicals category, the company launched Damp Lock and NoDamp+ under which provides properties of waterproofing, durability and protection.

In the Industrial Business, KNPL has introduced several new generation products and solutions which are environment friendly, Resource-efficient and Value-adding technologies like low bake technology, high solids low VOC, Monocoats, Direct to Metal. KNPL introduced breakthrough products like Tin free CED in Auto, High resistance coating for fuel tanks for 2 Wheelers, Fluro Undercoat & Flouro Topcoat (5 coat system) for performance coating and High Abrasion resistance powder for powder coating. Further, market share gains in Automotive paints in a challenging environment exudes KNPL’s strength in superior technology-based offerings towards Auto OEMs.

New launches in decorative paints in FY23

(Source: Company, HDFC sec)

Foray into new segments

In Decorative business, KNPL forayed into the tile adhesive and customized admixture category this year. In Industrial business, KNPL entered into new segments such as seam sealer, underbody blacks, alloy wheels, and the fasteners coatings segment.

Pragati Program for Painters improving painter engagement

This is KNPL's flagship programme to engage with painters and contractors. KNPL offers several benefits and schemes to painters through this programme. In FY23, the Pragati app was enhanced with more features and ease of use. Also, more than 61,000 painters were imparted advanced training in paint application through classroom sessions or by using a Mobile Training Academy.

NXTGEN: NXTGEN programme is KNPL's move to touch base with the customer to offer superior painting experience. The company aims to provide a hassle-free and seamless painting service, ensuring customer satisfaction. NXTGEN Painting Services offers a range of services, including expert visits, site preparation, colour consultation, and application, all delivered by a team of experienced professionals. In FY23, the company painted over 20,000 houses under this scheme. The company expanded its geographical reach by adding more retail touchpoints and experience stores - Nxtgen Shoppe.

Positioning as complete solutions provider helping growth of projects business

KNPL's projects business witnessed significant growth during FY23. On the product side, the Super series range of products was modified to meet the customers' specific requirements. Also, there was synergy created with the industrial products like floor coating and epoxy products. The integration of the construction chemical and projects teams has positioned Nerolac as a complete solution provider with customers.

Expansion plans

In decorative segment, KNPL is planning to invest ~Rs 316 cr by way of capacity enhancement of water based paints (42% of current capacity of 606 mn litres). In addition, the company would invest towards backward integration – commenced resin capacity at Sayakha and polyester powder coating resin capacity at Lote.

Future Capacity Addition		
Location	Capacity KL/yr	Capex Rs cr
Vizag	82,500	160
Jainpur	52,800	130
Hosur	18,780	26
Total	**1,54,080**	**316**

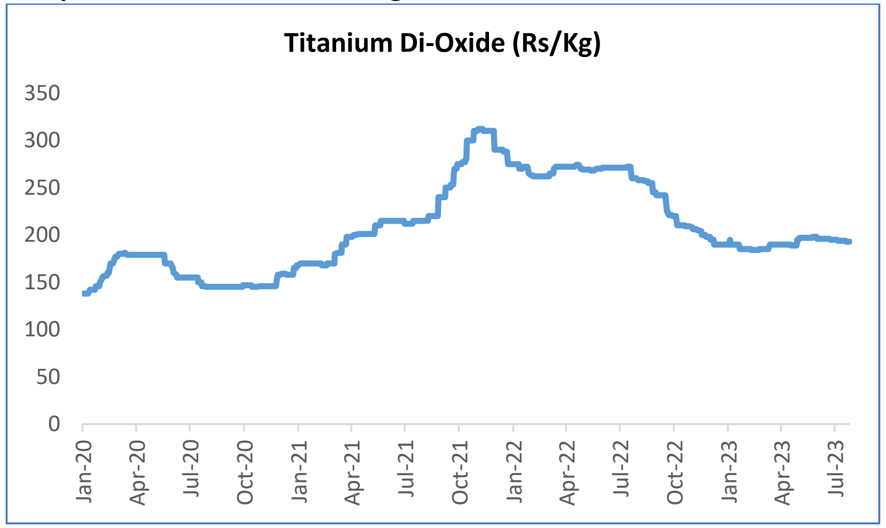
(Source: Company, HDFC sec)

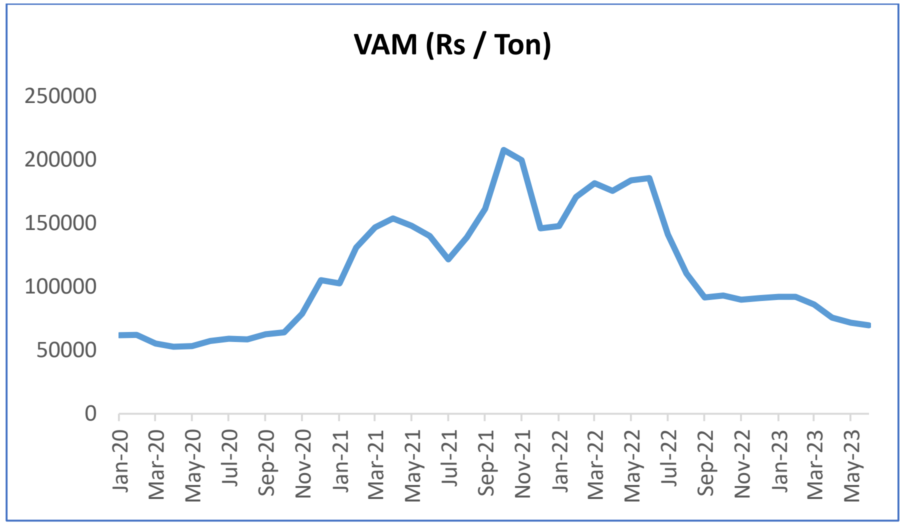
Key Concerns

Correlation between sales and the economy - The volume growth rate of the paint industry has been a multiplier of GDP growth and, thus, any slowdown in GDP growth will impact the sector's growth.

Sharp rise in input costs - Solvents, pigments, resins, latex, monomers, and titanium dioxide are the key raw materials for KNPL. Titanium dioxide is one of the key raw materials in paints. It is a pigment, which is used to impart whiteness, brightness, opacity (elimination of transparency), and UV protection, and it is largely imported. Approximately 70% of the input costs can be accounted for by crude derivations. The remaining ~30% of the input costs arise from non-crude (TiO_2) forms. Therefore, any sharp increase in input costs could adversely impact the business.

RM prices have been trending down in recent times





(Source: Bloomberg)

Rising heat in the industry – Kansai Nerolac operates in a highly competitive industry. Currently, it is oligopolistic in nature where the top-4 players (Asian Paints, Berger Paints, Kansai Nerolac and AkzoNobel India) account for 75% of the country's market. Other smaller players in the organized segment include Indigo Paints, Shalimar Paints, Nippon Paints, Kamdhenu Paints, Esdee Paints, etc., which have also been eyeing the fast-growing paints sector. The impending entry of JSW and Grasim and the unnecessary price wars by smaller players or new entrants to make inroads into the industry can affect the volume growth and margins.

Finance risks originating out of currency fluctuations - The inputs are priced based on USD-INR exchange rate. Hence, a depreciation of INR vis-à-vis the USD could affect the company's bottom line directly by the way of gross margins.

Company Overview

KNPL was incorporated in 1920 as Gahagan Paints and Varnish Company. Later, in 1930, three British companies were merged to form Lead Industries Group. In 1933, Lead Industries Group Ltd. acquired the entire share capital of Gahagan Paints and Goodlass Wall (India) Ltd. was born, which later became popular as Goodlass Nerolac Paints (Pvt.) Ltd. It came under the fold of Tata Forbes Group in 1976 as Forbes Gokak acquired the entire stake from Lead Industries. In 1986, Kansai Paints (Japan) acquired a 36% stake and entered a JV with the company. In 1999, Kansai Paints (Japan) acquired the entire stake of Forbes Gokak, following which KNPL became a subsidiary of the former. At present, KNPL is the largest industrial paint and third-largest decorative paint company of India, based in Mumbai. The company manufactures a diversified range of products, ranging from decorative paints coatings for homes, offices, hospitals, and hotels to sophisticated industrial coatings for most of the industries. It has six paint manufacturing plants with a capacity of 606 mn litre at ~100 sales depots across India. The Nerolac-owned plants are at (1) Jainpur, Kanpur Dehat (Uttar Pradesh); (2) Bawal (Haryana); (3) Lote, Chiplun (Maharashtra); (4) Hosur (Tamil Nadu); (5) Sayakha (Gujarat); (6) Goindwal (Punjab); (7) Visakhapatnam (Andhra Pradesh) and Kakoda, Goa (Marpol). It has a strong distribution network with 27,500+ dealers. It also operates in other geographies through its subsidiaries: Nepal (KNP Japan), Sri Lanka (Kansai Paints) and Bangladesh (RAK Paints).

Peer Comparison

Company	M Cap (in Rs. Cr.)	Revenue (in Rs. Cr.)			EBITDA Margin (%)			PAT			RoCE (%)			P/E (X)		
		FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
Asian Paints	325177	34489	37622	42240	18%	20%	21%	4058	5232	5957	29%	30%	28%	80	62	55
Berger Paints	66037	10568	11789	13313	14%	18%	18%	860	1293	1218	18%	21%	25%	76	51	44
Kansai Nerolac	26515	7543	8417	9575	11%	12%	12%	468	582	689	10%	12%	13%	57	45	38

(Source: Company, HDFC sec)

Financials

Income Statement

Particulars (in Rs Cr)	FY21	FY22	FY23	FY24E	FY25E
Net Revenues	**5074**	**6369**	**7543**	**8417**	**9447**
Growth (%)	***-3.9***	***25.5***	***18.4***	***11.6***	***12.2***
Operating Expenses	4211	5720	6725	7417	8287
EBITDA	**863**	**649**	**818**	**1000**	**1161**
Growth (%)	***7.3***	***-24.8***	***26.0***	***22.2***	***16.1***
EBITDA Margin (%)	***17.0***	***10.2***	***10.8***	***11.9***	***12.3***
Depreciation	165	170	180	198	220
Other Income	38	25	26	27	27
EBIT	**736**	**505**	**664**	**828**	**968**
Interest expenses	24	29	29	23	23
PBT	**712**	**476**	**635**	**805**	**945**
Tax	187	133	166	210	247
PAT	**526**	**343**	**468**	**595**	**699**
Share of Asso./Minority Int.	0	0	0	0	0
Adj. PAT	**526**	**343**	**468**	**595**	**699**
Growth (%)	***1.9***	***-34.7***	***36.5***	***27.0***	***17.4***
EPS	6.5	4.2	5.8	7.4	8.6

Balance Sheet

Particulars (in Rs Cr) - As at March	FY21	FY22	FY23	FY24E	FY25E
SOURCE OF FUNDS					
Share Capital	54	54	54	81	81
Reserves	3999	4078	4480	4856	5312
Shareholders' Funds	**4053**	**4132**	**4534**	**4937**	**5393**
Minority Interest	36	19	27	27	27
Total Debt	172	203	160	160	160
Net Deferred Taxes	-22	-49	-62	-62	-62
Other Non-Curr. Liablities	96	116	127	127	127
Total Sources of Funds	**4335**	**4421**	**4786**	**5189**	**5645**
APPLICATION OF FUNDS					
Net Block & Goodwill	1732	1802	1906	2228	2286
CWIP	207	225	113	113	113
Goodwill	20	20	20	20	20
Other Non-Curr. Assets	161	174	182	182	182
Total Non-Current Assets	**2119**	**2221**	**2221**	**2543**	**2601**
Inventories	956	1093	1238	1381	1538
Debtors	246	206	228	185	208
Cash & Equivalents	125	106	127	109	282
Other Current Assets	915	416	729	686	709
Total Current Assets	**3194**	**3245**	**3823**	**4038**	**4604**
Creditors	907	981	1016	1110	1233
Other Current Liab & Provisions	161	152	331	370	415
Total Current Liabilities	**1068**	**1133**	**1347**	**1480**	**1648**
Net Current Assets	2126	2113	2476	2557	2956
Total Application of Funds	**4335**	**4421**	**4786**	**5189**	**5645**

Kansai Nerolac Paints Ltd.

Cash Flow Statement

Particulars (in Rs Cr)	FY21	FY22	FY23	FY24E	FY25E
Reported PBT	712	476	635	805	945
Non-operating & EO items	-20	-62	-13	-27	-27
Interest Expenses	24	29	29	23	23
Depreciation	165	170	180	198	220
Working Capital Change	-79	-426	-236	-99	-225
Tax Paid	-157	-162	-187	-210	-247
OPERATING CASH FLOW (a)	**646**	**25**	**408**	**691**	**689**
Capex	-101	-218	-122	-521	-277
Free Cash Flow	545	-193	287	170	412
Investments	-349	472	-115	0	0
Non-operating income	-3	-5	9	27	27
INVESTING CASH FLOW (b)	**-453**	**250**	**-227**	**-494**	**-250**
Debt Issuance / (Repaid)	-39	-7	-59	0	0
Interest Expenses	-16	-18	-19	-23	-23
FCFE	490	-218	209	147	388
Share Capital Issuance	20	0	0	27	0
Dividend	-239	-284	-55	-218	-243
Others	0	0	0	0	0
FINANCING CASH FLOW (c)	**-274**	**-309**	**-133**	**-215**	**-266**
NET CASH FLOW (a+b+c)	**-81**	**-35**	**49**	**-18**	**173**

One-year share price chart (adjusted)

Key Ratios

Particulars	FY21	FY22	FY23	FY24E	FY25E
Profitability Ratios (%)					
EBITDA Margin	17.0	10.2	10.8	11.9	12.3
EBIT Margin	13.8	7.5	8.5	9.5	10.0
APAT Margin	10.4	5.4	6.2	7.1	7.4
RoE	13.5	8.4	10.8	12.6	13.5
RoCE	12.6	8.1	10.5	12.2	13.3
Solvency Ratio (x)					
Net Debt/EBITDA	0.1	0.1	0.0	0.1	-0.1
Net D/E	0.0	0.0	0.0	0.0	0.0
PER SHARE DATA (Rs)					
EPS	6.5	4.2	5.8	7.4	8.6
CEPS	8.5	6.3	8.0	9.8	11.4
Dividend	5.3	2.3	2.7	3.0	3.5
Book Value	50.1	51.1	56.1	61.1	66.7
Turnover Ratios (days)					
Debtor days	69	63	60	60	59
Inventory days	86	93	84	81	80
Creditors days	65	56	49	48	48
Valuation (X)					
P/E	50	77	57	45	38
P/BV	7	6	6	5	5
EV/EBITDA	31	41	32	27	23
EV / Revenues	5	4	4	3	3
Dividend Yield (%)	1.6	0.7	0.8	0.9	1.1

(Source: Company, HDFC sec)

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HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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