

Stock Update

Kansai Nerolac Paints Ltd.

August 19, 2022





Kansai Nerolac Paints Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Paints	Rs. 506.2	Buy in Rs 501-511 band and add more on dips in Rs 438-448 band	Rs. 556	Rs. 613	2 quarters

HDFC Scrip Code	KANNEREQNR
BSE Code	500165
NSE Code	KANSAINER
Bloomberg	KNPL IN
CMP – Aug 18, 2022	506.2
Equity Capital (Rs Cr)	54
Face Value (Rs)	1
Equity Share O/S (Cr)	54
Market Cap (Rs Cr)	27280
Book Value (Rs)	76.7
Avg. 52 Wk Volumes	363169
52 Week High	674
52 Week Low	358

Share holding Pattern % (Jun, 2022)	
Promoters	74.99
Institutions	16.67
Non Institutions	8.34
Total	100.0



HDFCsec Retail research
stock rating meter
for details about the ratings, refer at the end of the report

* 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.

Valuation & Recommendation:

Given KNPL's industrial-heavy revenue skew, the double whammy of (1) demand impact in auto industry, courtesy chip shortage and (2) runaway RM inflation were felt the most by it among top-tier paint companies. However, most of the pain seems to be over. Underperformance vis-à-vis the top-2 players has reduced and management highlighted its focus on recouping lost share via (1) increasing salience in premium products and (2) flexing the marketing lever, going forward. It has gained market share in industrial paints, but margins had fallen. Also, the company has exited 30% business in coil coating owing to low margin and has been focusing on premium industrial products (energy-efficient paints, environment-friendly paints, etc.). Revival in auto sales (30% revenue share for KNPL) and strong demand momentum in industrial paints would lead the recovery. Softening RM prices and focus on premiumisation in decorative segment would drive the margin expansion. **We think the base case fair value of the stock is Rs 556 (39.4x FY24E EPS) and the bull case fair value of is Rs 613 (43.5x FY24E EPS). Investors can buy the stock in Rs 501-511 band (36x FY24E EPS) and add more on dips in Rs 438-448 (31.5x FY24E EPS) band.**



Financial Summary

Particulars (Rs Cr)	Q1FY23	Q1FY22	YoY-%	Q4FY22	QoQ-%	FY21	FY22P	FY23E	FY24E
Operating Income	2051	1403	46.2%	1537	33.5%	5,074	6,369	7,514	8,467
EBITDA	255	191	33.9%	84	203.9%	863	649	943	1,264
APAT	152	111	36.5%	19	693.2%	526	343	541	759
Diluted EPS (Rs)	2.8	2.1	36.5%	0.4	693.2%	9.8	6.4	10.0	14.1
RoE-%						13.5	8.4	12.5	15.9
P/E (x)						51.9	79.5	50.4	36.0
EV/EBITDA						31.7	42.2	28.8	21.3

(Source: Company, HDFC sec)

Q1FY23 Result Update

Consolidated sales increased by 46% YoY, driven by 20%+ volume growth in decorative paints and ~30% in industrial and automotive paints. Key categories (paints-ex-putty, project business, premium emulsion) performed well in this quarter. Industrial segment witnessed a sharp rebound (on a low base) as PV/CV segment witnessed a sharp rebound. Further, decorative paints have seen higher growth in tier 1 cities than in others. The Q1 raw material price was 7% higher and the company hiked prices by ~2%, concentrated in industrial paints. The gross margin declined 430 bps YoY to ~30% due to higher raw material costs and delay in price hikes. However, savings in employee costs and other expenses (through better operating leverage) restricted EBITDA margin fall at 124 bps YoY to 13.1%. On subsidiaries, Nepal/Sri Lanka performed well in tough conditions while Bangladesh's performance remained muted.

Company approved 2 projects in water based decorative coatings at a capex of Rs290 Cr. These may commence operations in coming 2-2.5 years. Industrial business has capacity for next 2-3 years coupled with additional land for brownfield expansion (no incremental capex). Capacity utilization stood at 64-65%.

Despite price hikes, margins in industrial paints are 700-800 bps lower than in decorative segment. KNPL is planning to introduce technologically advanced products and make calibrated price hikes to bridge the gap in margins between the two segments.

KNPL has reinstated the advertising and digital marketing spends, a cut in which in the recent past led to market share loss.

Mr. Anuj Jain, the new MD of KNPL is taking steps to regain/increase the market shares in both segments.



Key highlights from FY22 Annual Report

Decorative paints:

The company focused on increasing its distribution network with opening of new dealers and also accelerating the CCD machine (Colorant Dispenser) installations. In the rural markets, the Company introduced distributor model for deeper penetration.

It witnessed high material price inflation during the year and had to take series of price increases to offset the inflation and maintain profitability

New brand expression: KNPL has envisioned its new brand expression as PAINT+ which stands for its sentiment to offer more to its customers i.e. paint with added benefits. The Company has positioned the brand with unique products that live up to the Paint+ promise enabled by Japanese technology.

Launched several need-based products

Business	Product
Decorative	Excel Mica marble stretch and sheen
	Nerolac zinc yellow primer (chrome free)
	Beauty ceiling emulsion
	Nerolac PU Enamel 10 in 1
Adhesive	Nerofix Super
	Nerofix Smart
	Nerofix AquaSmart
Wood	Nerolac Wonderwood-2K PU interior

New Businesses: KNPL has been steadily making investments in the new businesses of Adhesives, Construction Chemicals and High-end Wood Finishes. It has adopted a **multi-pronged approach** to strengthen them and increase market share. It focused on increasing product range, introduce new applications, expand distribution network, enhance influencer programmes and deepen engagement with consumers.

Wood Coating: KNPL has a complete range of products and is present in PU, Polyester, Melamine and NC Coatings. The PU range has been expanded by introducing 2K PU Interior.



It plans to launch more products in PU range leveraging its collaboration with the Italian company ICRO Coatings. For its NC range, KNPL developed sustainable and environment-friendly products, which were awarded REACH certification.

Construction Chemicals: KNPL with its acquisition of Perma, is focussed on providing a holistic product range to the customers through synergy between its paint and construction chemical portfolio.

In FY22, KNPL has launched 3 new products under general waterproofing category. With this, it has an entire range of construction chemicals consisting of General waterproofing, General repairs, Tiling, Admixture, High end waterproofing, sealants, structural repairs, flooring, industrial grouts and Waterproof putty.

It undertook drives for increasing channel participation as well as increasing reach through expanded dealer network. Going forward, the brand – Nerolac Perma, will focus on both retail & projects with an enhanced product range, channel expansion and adding newer waterproofing technologies.

Adhesives: Masking tape was launched during the year. Aggressive penetration in infrastructure projects with focus on new applications for retail and industrial segments to drive growth.

Launched the carpenter app (Nerofix Super Carpenter App) which attracted several carpenters to be on board and resulted in faster disbursements. Further, its launch of website (www.nerofixindia.com) enhanced visibility and established better customer connect.

Industrial Segment

KNPL has invested in setting up integrated plants across the country to service its customers. Strong intellectual capital coupled with multi-locational manufacturing set up has helped KNPL maintain its leadership position in the industrial paint segment.

In FY22, there was unprecedented inflation in material prices and the company had to seek a price increase from its customers. However, the price increase realized has been insufficient to offset the inflation for the industrial segment.

New products

Business	Product
Performance Coating	“Neropoxy Solvent Free Coating” for Water Pipeline
	Five-coat anticorrosive system for marine environment
	Bonded metallic (chrome finish) for appliances



Automotive Paints	
Commercial Vehicle	High Weatherable Topcoat
Construction Equipment	Damp Protect Exterior
	Damp Protect Interior
	Rapid Set
4-Wheeler	Developed high solid anti-chip primer with reduction in VOC
	Metallic colours with 3C-1B Technology which offers lean process, energy conservation and high productivity have been introduced
2-Wheeler	Matt Lacquer for Petrol tank of Motorcycle with superior mar & scrub resistance
	Coating for Rotamould Nylon Petrol tank
3-Wheeler	High Weather endurance topcoat

Automotive Paints: It continues to work on offering innovative technology and entry into diversified product range in Auto segment to expand horizon. Introduction of coating technologies for new substrates like Plastic, Aluminum Die Castings are leading concepts in Auto Segment and KNPL product innovations continue to lead the market.

In two-wheeler segment, which has witnessed highest growth of EV, KNPL has a formidable presence and has tapped into both existing and new entrants and partnered for paint supplies. Also, in the PV segment, the Company has partnered with major players for paint supplies. KNPL is a strong player in the EV (Electric Vehicle) segment in the country and will continue to focus on this high growth segment with value-added products and solutions.

Performance Coatings: Under Performance Coatings, the company offers powder coatings for powder segment and liquid coatings for General Industrial segment & High Performance segments. In FY22, the company witnessed significant growth in all three segments and gained market share.

KNPL has also witnessed significant growth in niche segments that it entered i.e. rebar coatings, super durable powder in the powder coatings. It added new customers in rebar coatings and have achieved a significant market share. It achieved good growth in powder coating for alloy wheel segment as well. In pipe coatings, amongst the new products developed this year was “Neropoxy Solvent Free Coating” for Water Pipeline Internal coatings



Auto Refinish: Auto Refinish business was designated as a major thrust area for the company. It has developed a complete range of products catering to the Premium, Economy and Retail market. The key elements include new products launches, OEM approvals and greater reach through the development of the retail distribution network and body shops.

Coil Coatings: In line with its strategy to enter premium segment in coil coatings, KNPL introduced coil coating products for appliance industries. This has gained good momentum in the market assisted by increased service availability and targeted client base expansion. Also, KNPL now has a dedicated manufacturing facility for coil coating at Sayaka.

Integration

It has successfully integrated its subsidiaries, Marpol Private Limited (“Marpol”) and Perma Construction Aids Private Limited (“Perma”), allowing it to derive significant benefits from synergies that have resulted in better operational efficiencies, market penetration, and product mix for the Powder Coating and Construction Chemicals business.

Key risks

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 (TiO₂) forms. Therefore, any sharp increase in input costs could adversely impact the business.

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 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 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.



Disruption in the supply chain - In a year of high uncertainty in the macro environment and geopolitical relations, disruptions in supply chain could hamper the smooth production.

About the Company

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 4,50,000 MT 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).



Financials

Income Statement

Particulars (in Rs Cr)	FY20	FY21	FY22P	FY23E	FY24E
Net Revenues	5280	5074	6369	7514	8467
Growth (%)	-2.7	-3.9	25.5	18.0	12.7
Operating Expenses	4476	4211	5720	6571	7203
EBITDA	804	863	649	943	1264
Growth (%)	6.9	7.3	-24.8	45.3	34.0
EBITDA Margin (%)	15.2	17.0	10.2	12.6	14.9
Depreciation	142	165	170	187	208
Other Income	26	38	25	25	27
EBIT	688	736	505	782	1083
Interest expenses	21	24	29	30	29
PBT	667	712	476	752	1053
Tax	151	187	133	210	295
Adj. PAT	516	526	343	541	759
Growth (%)	15.2	1.9	-34.7	57.7	40.2
EPS	9.6	9.8	6.4	10.0	14.1

Balance Sheet

Particulars (in Rs Cr) -As at March	FY20	FY21	FY22P	FY23E	FY24E
SOURCE OF FUNDS					
Share Capital	54	54	54	54	54
Reserves	3706	3999	4078	4473	4972
Shareholders' Funds	3760	4053	4132	4527	5026
Minority Interest	22	36	19	19	19
Total Debt	178	172	203	203	203
Net Deferred Taxes	108	-22	-49	-49	-49
Total Sources of Funds	4068	4239	4305	4700	5199
APPLICATION OF FUNDS					
Net Block & Goodwill	1774	1751	1822	2010	2220
CWIP	169	207	225	225	225
Investments	306	669	211	211	211
Other Non-Curr. Assets	133	161	174	174	174
Total Non Current Assets	2381	2788	2431	2619	2829
Inventories	787	956	1093	1084	1221
Debtors	787	956	1093	1084	1221
Cash & Equivalents	192	125	106	299	521
Other Current Assets	515	246	206	243	204
Total Current Assets	2281	2283	2498	2710	3168
Creditors	595	907	981	1054	1164
Other Current Liab & Provisions	156	161	152	179	202
Total Current Liabilities	752	1068	1133	1233	1366
Net Current Assets	1529	1215	1366	1477	1801
Total Application of Funds	4068	4239	4305	4700	5199



Cash Flow Statement

Particulars (in Rs Cr)	FY20	FY21	FY22P	FY23E	FY24E
Reported PBT	667	712	476	752	1,053
Non-operating & EO items	-12	-20	-62	-25	-27
Interest Expenses	21	24	29	30	29
Depreciation	142	165	170	187	208
Working Capital Change	-57	-79	-426	-14	-67
Tax Paid	-166	-157	-162	-210	-295
OPERATING CASH FLOW (a)	595	646	25	719	902
Capex	-280	-101	-218	-374	-418
Free Cash Flow	315	545	-193	345	484
Investments	-90	-349	472	0	0
Non-operating income	-6	-3	-5	25	27
INVESTING CASH FLOW (b)	-376	-453	250	-349	-391
Debt Issuance / (Repaid)	45	-39	-7	0	0
Interest Expenses	-16	-16	-18	-30	-29
FCFE	344	490	-218	314	455
Share Capital Issuance	0	20	0	0	0
Dividend	-170	-239	-284	-146	-260
Others	0	0	0	0	0
FINANCING CASH FLOW (c)	-141	-274	-309	-177	-289
NET CASH FLOW (a+b+c)	78	-81	-35	193	221

One-year Share Price Data



Key Ratios

Particulars	FY20	FY21	FY22P	FY23E	FY24E
Profitability Ratios (%)					
EBITDA Margin	15.2	17.0	10.2	12.6	14.9
EBIT Margin	12.5	13.8	7.5	10.1	12.5
APAT Margin	9.8	10.4	5.4	7.2	9.0
RoE	14.4	13.5	8.4	12.5	15.9
RoCE	13.6	12.8	8.3	12.2	15.4
Solvency Ratio (x)					
Net Debt/EBITDA	0.0	0.1	0.1	-0.1	-0.3
Net D/E	0.0	0.0	0.0	0.0	-0.1
PER SHARE DATA (Rs)					
EPS	9.6	9.8	6.4	10.0	14.1
CEPS	12.2	12.8	9.5	13.5	17.9
Dividend	2.6	5.3	2.3	4.0	4.5
Book Value	69.8	75.2	76.7	84.0	93.3
Turnover Ratios (days)					
Debtor days	54	69	63	53	53
Inventory days	70	86	93	83	78
Creditors days	41	65	56	51	50
VALUATION					
P/E	52.9	51.9	79.5	50.4	36.0
P/BV	7.3	6.7	6.6	6.0	5.4
EV/EBITDA	33.9	31.7	42.2	28.8	21.3
EV / Revenues	5.2	5.4	4.3	3.6	3.2
Dividend Yield (%)	0.5	1.0	0.4	0.8	0.9

Source: Company, HDFC sec



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. These 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.

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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 cyclicity 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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