IDBI capital

Kansai Nerolac (KNPL) BUY

On road to recovery

Summary

Kansai Nerolac (KNPL) result was above our estimates. Revenue growth was healthy driven by revival in auto-business, 3% hike in Industrial & Decorative coating segments respectively. Revenue mix was impacted due to (i) down-trading in decorative coating (ii) higher contribution from industrial due to healthy automotive paint business. The journey of exiting low-margin business while improving salience of premium products (improved by 2%) is progressing well. Salience of water-proofing business now stands at 6% (vs 5% in 1QFY23) by leveraging existing distribution channel (35% of total). Distribution expansion is tracking well with 3k retail outlet addition in 1HFY23. We broadly maintain our EPS estimates for FY23-24E. At current price; our rating stands BUY with revised TP of Rs 551.

Key Highlights and Investment Rationale

- **Extended Monsoon impacts Deco demand; Auto witnessed revival:** Revenue grew 19% YoY in 2QFY23 driven by revival in Auto segment. However, extended monsoon impacted demand for Decorative. Revenue from subsidiaries grew 18% YoY to Rs 1.17bn. Nepal business witnessed healthy double digit growth. Bangladesh, Sri Lanka & Nerofix revenue grew >20%/>50%/>40% YoY respectively.
- **Margins remained flat due to easing of RM inflation:** Gross margin contracted marginally by 32bp YoY to 28.6% driven by price-hike benefits and subsiding raw material cost pressure. EBITDA margin remained flat at 10.9%. Adjusted PAT grew 19%YoY to Rs1.2 bn.
- **BUY:** We maintain our EPS estimates for FY23-24E. We value KNPL at 35x FY24E EPS. At current price, our rating stands at BUY with a revised target price of Rs 551 (vs previous TP of Rs 544).

TP	Rs 551
CMP	**Rs 465**
Potential upside/downside	18%
Previous Rating	HOLD

Price Performance (%)

	-1m	-3m	-12m
Absolute	(5.3)	(8.3)	(18.2)
Rel to Sensex	(11.2)	(13.0)	(19.5)

V/s Consensus

EPS (Rs)	FY23E	FY24E
IDBI Capital	11.9	15.7
Consensus	11.6	15.2
% difference	*2.7*	*3.1*

Key Stock Data

Bloomberg/Reuters	KNPL IN/KANE.BO
Sector	Paints
Shares o/s (mn)	539
Market cap. (Rs mn)	250,598
3-m daily average value (Rs mn)	18.0
52-week high / low	Rs630 / 358
Sensex / Nifty	60,836 / 18,053

Shareholding Pattern (%)

Promoters	75.0
FII	3.5
DII	13.2
Public	8.3

Financial snapshot (Rs mn)

Year	FY20	FY21	FY22	FY23E	FY24E
Revenue	49,432	47,147	59,285	71,492	83,253
Change (yoy, %)	(4)	(5)	26	21	16
EBITDA	7,816	8,510	6,448	9,978	12,916
Change (yoy, %)	5	9	(24)	55	29
EBITDA Margin(%)	15.8	18.0	10.9	14.0	15.5
Adj.PAT	5,354	5,457	3,855	6,390	8,486
EPS (Rs)	9.9	10.1	7.2	11.9	15.7
Change (yoy, %)	14.5	1.9	(29.4)	65.8	32.8
PE(x)	47.0	46.1	65.3	39.4	29.7
Dividend Yield (%)	0.6	0.9	1.1	0.5	0.5
EV/EBITDA (x)	32.0	29.5	38.9	24.3	18.5
RoE (%)	14.8	13.9	9.3	14.4	16.9
RoCE (%)	17.8	17.4	11.4	18.2	21.4

Source: IDBI Capital Research

Conference call highlights

- KNPL took 3% price hike (vs 7-8% inflation) in Decorative and Industrial segments during 1HFY23
- In 2QFY23, volume growth was driven by putty at industry level (c. 10-12% YoY growth) while decorative volume growth was low
- For KNPL, putty growth has been negative as company selectively participated in this segment due to competitive pricing pressure. However, Decorative segment witnessed double digit value growth
- In powder coating, KNPL increased salience of premium products by 2%
- For New business, salience increased to 6% during 2QFY23 (vs 5% in 1QFY23)
- Company has developed a product which will be able to use blended ethanol petrol (can be mixed up to 30%) as RM. KNPL will also foray in alloy wheel market
- KNPL got approval to supply paints for Mumbai-Ahmedabad bullet train, Vande Bharat trains and Refineries
- Currently, KNPL's 35% of existing distribution channel sells waterproofing products
- KNPL aims to exit low margin industrial business while increasing salience of premium products. Company increased salience of premium products by 1% during 2QFY23
- Company expects to maintain Share of Voice at c. 15%
- South witnessed higher growth followed by North, West and East. Growth in Tier 2-3 cities was close to Tier 1. However, in Tier 3 cities (population < 20,000) growth has been lower
- Company added 3,000 new retail outlets (decorative paints) during YTDFY23. KNPL aims to leverage existing distribution channel to sell super-premium products. Company will launch Next Gen range of products through select distributors
- KNPL extended 5 days Dust-Free Painting service to 50 towns during 2QFY23 (vs 6 towns in 1QFY23
- During 2QFY23 KNPL added 50 Next Gen Paint Shoppe stores and 25 stores are finalized in 3QFY23E
- Management expects margins to improve during 4QFY23E

Exhibit 1: Actual vs. Estimates

(Rs mn)

	Actual	IDBI Estimate	% variation IDBI
Revenue	18,143	17,458	3.9%
EBITDA	1,973	1,524	29.4%
Margin (%)	*10.9%*	*8.7%*	
APAT	1,173	872	34.5%

Source: Company; IDBI Capital Research

Exhibit 2: Standalone Quarterly Snapshot

(Rs mn)

Financial Snapshot	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	YTDFY23	YTDFY22	YoY (%)
Revenues	**18,143**	**15,207**	***19.3***	**19,446**	***-6.7***	**37,588**	**28,219**	***33.2***
COGS	12,955	10,810	*19.8*	13,629	*-4.9*	26,583	19,370	*37.2*
Gross profit	5,188	4,397	*18.0*	5,817	*-10.8*	11,005	8,849	*24.4*
Gross Margin (%)	*28.6*	*28.9*	*-32 bps*	*29.9*	*-132 bps*	*29.3*	*31.4*	*-208 bps*
Employee expenses	827	693	*19.3*	775	*6.7*	1,602	1,392	*15.1*
% of net sales	*4.6*	*4.6*	*0 bps*	*4.0*	*57 bps*	*4.3*	*4.9*	*-67 bps*
Other Expenses	2,388	2,057	*16.1*	2,486	*-3.9*	4,873	3,939	*23.7*
% of net sales	*13.2*	*13.5*	*-37 bps*	*12.8*	*38 bps*	*13.0*	*14.0*	*-99 bps*
EBITDA	**1,973**	**1,647**	***19.8***	**2,556**	***-22.8***	**4,529**	**3,518**	***28.7***
EBITDA Margin (%)	*10.9*	*10.8*	*5 bps*	*13.1*	*-227 bps*	*12.0*	*12.5*	*-42 bps*
Depreciation	412	380	*8.5*	393	*5.0*	805	738	*9.1*
EBIT	**1,561**	**1,267**	***23.2***	**2,164**	***-27.85***	**3,725**	**2,781**	***33.9***
Other Income	35	62	*-43.2*	44	*-19.2*	79	159	*-50.2*
Interest Expenses	25	23	*8.3*	23	*6.4*	48	48	*0.0*
PBT	**1,572**	**1,306**	***20.3***	**2,184**	***-28.0***	**3,756**	**2,892**	***29.9***
Taxes	399	321	*24.5*	555	*-28.1*	954	719	*32.6*
Adjusted PAT	**1,173**	**985**	***19.0***	**1,629**	***-28.0***	**2,802**	**2,172**	***29.0***
Extra-ordinary items	0	0		0		0	0	
Reported PAT	**1,173**	**985**	***19.0***	**1,629**	***-28.0***	**2,802**	**2,172**	***29.0***
Diluted EPS (Rs)	**2.18**	**1.83**	***19.0***	**3.02**	***-28.0***	**5.20**	**4.03**	***29.0***

Source: Company; IDBI Capital Research

Exhibit 3: Consolidated Quarterly Snapshot **(Rs mn)**

Financial Snapshot	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	YTDFY23	YTDFY22	YoY (%)
Revenues	**19,310**	**16,196**	***19.2***	**20,514**	***-5.9***	**20,514**	**14,028**	***46.2***
COGS	13,744	11,514	*19.4*	14,379	*-4.4*	14,379	9,230	*55.8*
Gross profit	5,565	4,683	*18.8*	6,135	*-9.3*	6,135	4,798	*27.9*
Gross Margin (%)	*28.8*	*28.9*	*-9 bps*	*29.9*	*-108 bps*	*29.9*	*34.2*	*-430 bps*
Employee expenses	940	801	*17.4*	884	*6.3*	884	821	*7.8*
% of net sales	*4.9*	*4.9*	*-8 bps*	*4.3*	*56 bps*	*4.3*	*5.8*	*-154 bps*
Other Expenses	2,632	2,255	*16.7*	2,700	*-2.5*	2,700	2,072	*30.3*
% of net sales	*13.6*	*13.9*	*-29 bps*	*13.2*	*47 bps*	*13.2*	*14.8*	*-161 bps*
EBITDA	**1,994**	**1,628**	***22.5***	**2,550**	***-21.8***	**2,550**	**1,905**	***33.9***
EBITDA Margin (%)	*10.3*	*10.0*	*28 bps*	*12.4*	*-211 bps*	*12.4*	*13.6*	*-115 bps*
Depreciation	451	421	*7.3*	431	*4.7*	431	417	*3.4*
EBIT	**1,542**	**1,207**	***27.8***	**2,119**	***-27.23***	**2,119**	**1,488**	***42.4***
Other Income	41	65	*-37.2*	48	*-15.7*	48	99	*-51.4*
Interest Expenses	63	69	*-8.0*	85	*-25.8*	85	67	*27.5*
PBT	**1,520**	**1,203**	***26.3***	**2,083**	***-27.0***	**2,083**	**1,521**	***36.9***
Taxes	408	330	*23.4*	562	*-27.5*	562	407	*38.1*
Adjusted PAT	**1,112**	**873**	***27.4***	**1,521**	***-26.9***	**1,521**	**1,114**	***36.5***
Extra-ordinary items	0	0		0		0	0	
Minority Interest	0	-47		-43		-43	27	
Profit attributable to owners	**1,112**	**826**	***34.7***	**1,563**	***-28.9***	**1,563**	**1,141**	***37.0***
EPS	**2.06**	**1.71**	***20.8***	**2.90**	***-28.9***	**2.9**	**2.1**	***37.0***

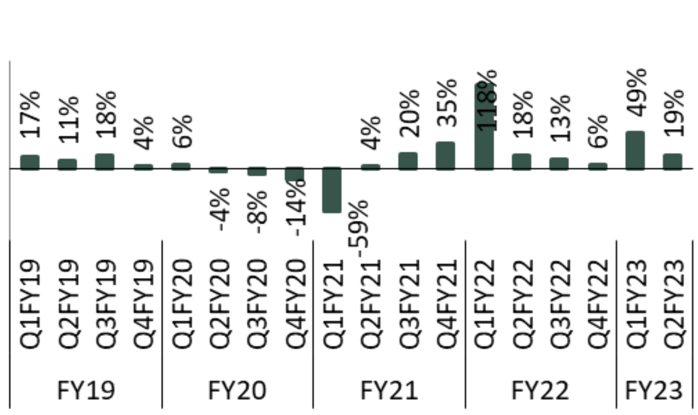
Source: Company; IDBI Capital Research

Exhibit 4: Change in estimates

	FY23E			FY24E		
	New	Old	*(%)Chg*	New	OLD	*(%)Chg*
Revenue (Rs mn)	71,492	70,328	*1.7%*	83,253	81,459	*2.2%*
EBITDA (Rs mn)	9,978	9,768	*2.1%*	12,916	12,572	*2.7%*
EBITDA margin (%)	*14.0%*	*13.9%*		*15.5%*	*15.4%*	
Net profit (Rs mn)	6,390	6,375	*0.2%*	8,486	8,381	*1.3%*
EPS (Rs)	11.9	11.8	*0.2%*	15.7	15.5	*1.3%*

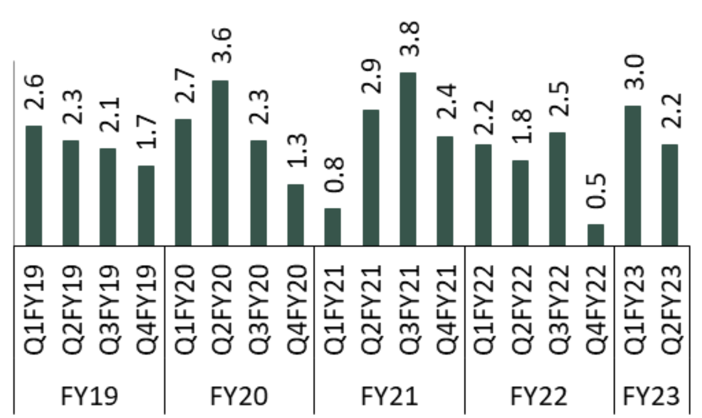
Source: Company; IDBI Capital Research

Exhibit 5: Revenue growth trend (% YoY)



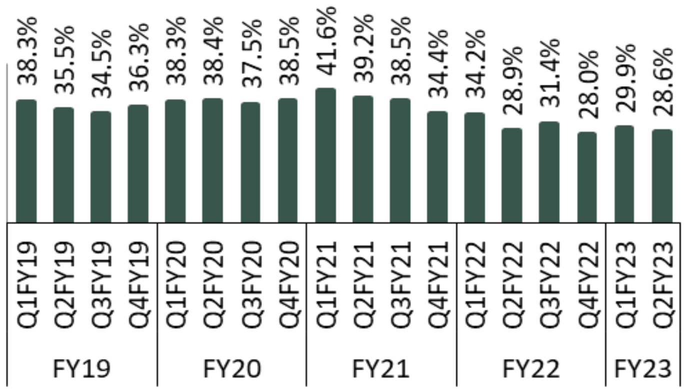
Source: Company; IDBI Capital Research

Exhibit 6: EPS trend



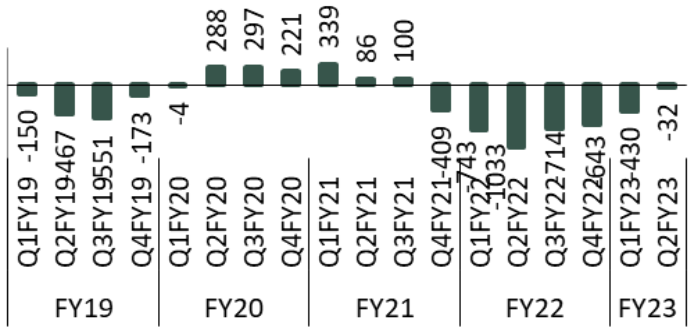
Source: Company; IDBI Capital Research

Exhibit 7: Gross margin trend (% YoY)



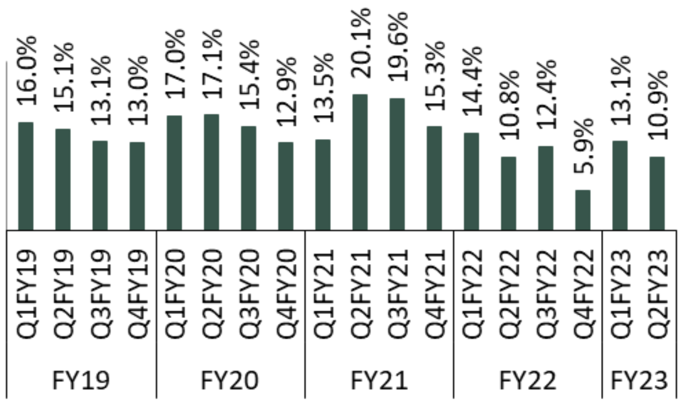
Source: Company; IDBI Capital Research

Exhibit 8: Change in gross margin (YoY in bp)



Source: Company; IDBI Capital Research

Exhibit 9: EBITDA margin trend (% YoY)



Source: Company; IDBI Capital Research

Exhibit 10: Change in EBITDA margin (YoY in bp)

Source: Company; IDBI Capital Research

Financial Summary

Profit & Loss Account

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Net sales	**51,736**	**49,432**	**47,147**	**59,285**	**71,492**	**83,253**
Change (yoy, %)	*12.8*	*(4.5)*	*(4.6)*	*25.7*	*20.6*	*16.4*
Operating expenses	(44,316)	(41,616)	(38,637)	(52,837)	(61,514)	(70,336)
EBITDA	**7,420**	**7,816**	**8,510**	**6,448**	**9,978**	**12,916**
Change (yoy, %)	*-6.0*	*5.3*	*8.9*	*-24.2*	*54.8*	*29.4*
Margin (%)	*14.3*	*15.8*	*18.0*	*10.9*	*14.0*	*15.5*
Depreciation	(905)	(1,199)	(1,415)	(1,518)	(1,551)	(1,699)
EBIT	**6,515**	**6,617**	**7,094**	**4,929**	**8,427**	**11,217**
Interest paid	-	(50)	(77)	(97)	(97)	(97)
Other income	619	269	387	328	209	220
Pre-tax profit	**7,134**	**6,836**	**7,405**	**5,160**	**8,540**	**11,340**
Tax	(2,461)	(1,482)	(1,839)	(1,305)	(2,149)	(2,854)
Effective tax rate (%)	*34.5*	*21.7*	*24.8*	*25.3*	*25.2*	*25.2*
Minority Interest	-	-	-	-	-	-
Net profit	**4,674**	**5,354**	**5,565**	**3,855**	**6,390**	**8,486**
Exceptional items	-	-	108	-	-	-
Adjusted net profit	**4,674**	**5,354**	**5,457**	**3,855**	**6,390**	**8,486**
Change (yoy, %)	*(9.5)*	*14.6*	*1.9*	*(29.4)*	*65.8*	*32.8*
EPS	8.7	9.9	10.1	7.2	11.9	15.7
Dividend per sh	2.6	2.6	4.4	5.2	2.5	2.5
Dividend Payout %	*30.0*	*26.2*	*43.5*	*73.4*	*21.1*	*15.9*

Balance Sheet

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Shareholders' funds	**34,245**	**37,869**	**40,809**	**41,709**	**46,752**	**53,890**
Share capital	539	539	539	539	539	539
Reserves & surplus	33,706	37,330	40,270	41,170	46,213	53,351
Total Debt	**34**	**-**	**-**	**-**	**-**	**-**
Other liabilities	1,051	1,340	1,611	2,038	2,038	2,038
Curr Liab & prov	**7,730**	**6,716**	**9,671**	**10,210**	**13,524**	**15,542**
Current liabilities	7,552	6,559	9,481	10,025	13,339	15,357
Provisions	177	157	190	186	186	186
Total liabilities	**8,815**	**8,056**	**11,282**	**12,248**	**15,562**	**17,580**
Total equity & liabilities	**43,059**	**45,924**	**52,091**	**53,957**	**62,314**	**71,470**
Net fixed assets	16,304	18,731	19,318	20,999	21,088	22,189
Investments	1,091	1,499	1,655	911	911	911
Other non-curr assets	4,042	3,061	2,179	2,335	2,198	2,198
Current assets	**21,622**	**22,634**	**28,940**	**29,713**	**38,117**	**46,172**
Inventories	10,528	9,301	10,902	15,315	14,494	16,879
Sundry Debtors	6,740	6,745	8,362	9,654	10,677	12,679
Cash and Bank	814	1,663	753	807	9,009	12,677
Loans and advances	-	-	-	-	-	-
Total assets	**43,059**	**45,924**	**52,091**	**53,957**	**62,314**	**71,470**

Cash Flow Statement

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Pre-tax profit	7,134	6,836	7,157	5,160	8,540	11,340
Depreciation	905	1,199	1,390	1,538	1,551	1,699
Tax paid	(2,978)	(1,560)	(1,463)	(1,506)	(2,149)	(2,854)
Chg in working capital	(3,452)	(147)	(631)	(4,066)	3,163	(2,369)
Other operating activities	(505)	(122)	(55)	(426)	97	97
Cash flow from operations (a)	**1,104**	**6,206**	**6,398**	**700**	**11,201**	**7,913**
Capital expenditure	(5,235)	(2,170)	(965)	(2,138)	(1,641)	(2,800)
Chg in investments	5,898	(1,310)	(3,648)	4,652	137	-
Other investing activities	192	41	-	-	-	-
Cash flow from investing (b)	**855**	**(3,439)**	**(4,613)**	**2,515**	**(1,504)**	**(2,800)**
Equity raised/(repaid)	-	-	-	-	(0)	(0)
Debt raised/(repaid)	(86)	(63)	-	-	-	-
Dividend (incl. tax)	(1,401)	(1,401)	(2,371)	(2,829)	(1,348)	(1,348)
Chg in monorities	-	-	-	-	-	-
Other financing activities	(3,267)	(455)	(311)	(415)	(97)	(97)
Cash flow from financing (c)	**(4,754)**	**(1,920)**	**(2,682)**	**(3,244)**	**(1,445)**	**(1,445)**
Net chg in cash (a+b+c)	**(2,795)**	**847**	**(897)**	**(29)**	**8,252**	**3,668**

Financial Ratios

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Book Value (Rs)	64	70	76	77	87	100
Adj EPS (Rs)	*8.7*	*9.9*	*10.1*	*7.2*	*11.9*	*15.7*
Adj EPS growth (%)	*(9.5)*	*14.5*	*1.9*	*(29.4)*	*65.8*	*32.8*
EBITDA margin (%)	*14.3*	*15.8*	*18.0*	*10.9*	*14.0*	*15.5*
Pre-tax margin (%)	*13.8*	*13.8*	*15.7*	*8.7*	*11.9*	*13.6*
Net Debt/Equity (x)	*(0.0)*	*(0.0)*	*(0.0)*	*(0.0)*	*(0.2)*	*(0.2)*
ROCE (%)	*19.3*	*17.8*	*17.4*	*11.4*	*18.2*	*21.4*
ROE (%)	*14.3*	*14.8*	*13.9*	*9.3*	*14.4*	*16.9*
DuPont Analysis						
Asset turnover (x)	1.2	1.1	1.0	1.1	1.2	1.2
Leverage factor (x)	1.3	1.2	1.2	1.3	1.3	1.3
Net margin (%)	*9.0*	*10.8*	*11.6*	*6.5*	*8.9*	*10.2*
Working Capital & Liquidity ratio						
Inventory days	74	69	84	94	74	74
Receivable days	48	50	65	59	55	56
Payable days	52	46	76	62	73	74

Valuations

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
PER (x)	53.9	47.0	46.1	65.3	39.4	29.7
Price/Book value (x)	7.4	6.6	6.2	6.0	5.4	4.7
EV/Net sales (x)	4.9	5.1	5.3	4.2	3.4	2.9
EV/EBITDA (x)	33.8	32.0	29.5	38.9	24.3	18.5
Dividend Yield (%)	*0.6*	*0.6*	*0.9*	*1.1*	*0.5*	*0.5*

Source: Company; IDBI Capital Research

Notes

Dealing	(91-22) 6836 1111	dealing@idbicapital.com

Key to Ratings Stocks:

BUY: 15%+;   **HOLD:** -5% to 15%;   **SELL:** -5% and below.

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