

Kansai Nerolac (KNPL) ACCUMULATE

Input cost pressure to impact margins

Summary

Kansai Nerolac (KNPL) result was below our estimates due to higher than expected raw material cost pressure. Business recovery remained strong driven by resilient volume growth and price hikes (driven by input cost pressure). In international market; KNPL improved operating profit margins in Nepal and Bangladesh while reduced EBITDA loss in Srilanka during FY21. Raw material cost inflation remained a major concern. However, KNPL has been able to take price hike in decorative (by 2.5%) and industrial coatings (by 3-4%) businesses to offset inflation. Management expects raw material cost to subside due to tepid demand. Positively, KNPL introduced entire range of adhesives and construction chemical products in 3QFY21. This should help the company to accelerate revenue growth in non-industrial paint business. Our estimates incorporate the current slowdown in auto business and slower than expected demand recovery in decorative coatings. We have cut our EPS estimates by c. 4% in FY22E. Our revised rating stands at ACCUMULATE with a TP of Rs599 (valued at 40x FY23E EPS).

Key Highlights and Investment Rationale

- Volume growth and price hike drives revenue growth; lockdown impacts demand**
 Revenue grew by 35% YoY (v/s -14%YoY in Q4FY21) led by double digit volume growth and price hike; 2.5% in decorative coating and 3-4% in industrial coatings. KNPL has gained market share in industrial coatings business. Business recovery during first 20 days of Apr'21 has been robust however, post imposition of lockdowns, 70% depots are closed, the other 30% depots are operating for only 3-4 hours. Also, retailers are allowed to open shops only for restricted number of hours. This has impacted overall demand significantly.
- Cost control initiatives drive EBITDA margin expansion**
 Gross Margin contracted (after 6 consecutive quarters of expansion) by 409bps to 34.4% due to raw material cost pressure. EBITDA Margin expanded by 235bps to 15.3% led by lower employee expenses (+1.5%YoY, -162bps YoY as % of revenue) and other expenses (+1%YoY, -482bps YoY as % of revenue).
- Revised to ACCUMULATE**
 We have reduced our margin expectations due to input cost inflation. Consequently, we have trimmed our EPS estimate for FY22E by 4%. We maintain our TP at Rs599. Our revised rating stands at ACCUMULATE due to fall in stock price.

TP	Rs599	
CMP	Rs566	
Potential upside / downside	+6%	
Previous Rating	HOLD	
V/s Consensus		
EPS (Rs)	FY22E	FY23E
IDBI Capital	12.1	15.0
Consensus	12.5	14.6
% difference	(2.9)	2.9

Shareholding Pattern (%)

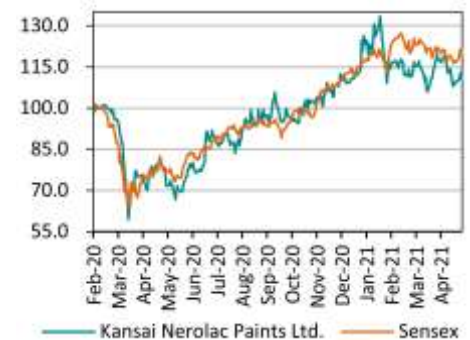
Promoters	75.0
FII	3.7
DII	12.7
Public	8.6

Price Performance (%)

	-1m	-3m	-12m
Absolute	(5.0)	(3.7)	57.4
Rel to Sensex	(4.8)	(0.1)	1.0

Key Stock Data	
Bloomberg / Reuters	KNPL IN/KANE.BO
Sector	Paints
Shares o/s (mn)	539
Market cap. (Rs mn)	305,190
Market cap. (US\$ mn)	4,152
3-m daily average value (Rs mn)	87.4
52-week high / low	Rs680 / 333
Nifty / Sensex	49,502 / 14,942

Relative to Sensex (%)



Financial snapshot

Year	FY19	FY20	FY21	FY22E	FY23E
Revenue	51,736	49,432	46,900	55,155	64,022
EBITDA	7,420	7,816	8,331	9,794	11,982
EBITDA (%)	14.3	15.8	17.8	17.8	18.7
Adj. PAT	4,674	5,354	5,310	6,498	8,065
EPS (Rs)	8.7	9.9	9.9	12.1	15.0
EPS Growth (%)	(9.5)	14.5	(0.8)	22.4	24.1
PE (x)	65.4	57.1	57.6	47.0	37.9
Dividend Yield (%)	0.5	0.5	0.8	0.4	0.4
EV/EBITDA (x)	41.1	38.9	36.6	30.5	24.6
RoE (%)	14.3	14.8	13.5	15.0	16.4
RoCE (%)	19.3	17.8	17.0	18.6	20.5

Source: Company; IDBI Capital Research

Conference Call Highlights

Business performance:

- Demand in the first 3 weeks of April remained strong across all geographies; however post April sales started slowing down. May and June are usually not big months and April should be able to cover the drop seen in May-June.
- During the second wave of COVID, there are limited supply side constraints (as factories are allowed to operate) but facing demand challenges as customers are apprehensive to invite painters to their home.
- Around 70% of depots and 90% of dealers are not operating. Those operating are for limited number of hours.
- In decorative coating, growth is lower than competition because company had limited presence in adhesives and construction chemicals.
- In decorative coatings, KNPL will be focusing on (i) differentiated products, (ii) new distribution model and (iii) new categories like construction chemicals and adhesives
- Recent entry of Grasim in paint industry is positive as it helps to create more awareness and market will grow faster. However, in the past, a lot of companies entered the market were not able to grow beyond a level.
- KNPL has seen c.13-14%inflation in commodity basket and has taken price increase of 2.5%/3-4% in decorative/industrial segment.
- COVID is more widespread this time as compared to the 1st wave and management expects recovery to take longer. Around 8% of employees were affected in 2nd wave of COVID (v/s 2% in first wave).

Industrial coatings:

- In FY21, KNPL gained market share across segments (general, auto OEM, auto refinish, protective) in industrial coating driven by better technology and service.
- On aggregate level in industrial coating, KNPL has taken a price hike of c.3-4%. In powder coating/ auto refinish and performance coating, company took 8%/5%/3% price hike.
- In auto OEM business, prices are contract based and these cannot be changed frequently as they require discussion. Therefore gross margin erosion is largely due to auto.

Subsidiaries performance

- Indian subsidiaries (Marpol, Perma and Nerofix) improved margins during the year led by cost optimization.
- Nepal market reported revenue de-growth of 20%YoY in FY21 as the market was fully shut for almost 3 quarters. However, EBITDA Margins improved by 200bps to 18%.
- Sri Lanka business topline grew by 20% while losses reduced during the year. Bangladesh topline grew by 15% as lockdown impact was restricted to Q1. EBITDA Margins improved to 6.1% (from 2.9% in FY20). KNPL infused equity in both Bangladesh and Sri Lanka during the year.

Digital Initiatives

- Company had launched Saathi app where dealers can directly place orders. It also introduced an app for salesmen (which has helped improve productivity) and influencer (to maintain connect with painters).
- The company is working with Kansai group across the world for new technology. Kansai Japan provided tech for Auto refinish which was largely used for premium products whereas Turkey provided tech for mid-range.

Others:

- KNPL has limited presence in projects business as margins are compressed and a separate team is required for the business which adds to the cost structure. Projects business is also witnessing labour challenges, however overall labour migration is lower compared to last year.
- Dealer footprint has remained at similar levels as previous year
- Construction chemicals is Rs70Bn market and the margins are similar to paints margin. Around 50% of construction chemical demand is serviced via cement dealers and remaining via paint dealers.
- New products like Beauty gold- washable & anti-bacterial and Suraksha dust resist have seen good traction as they provide premium benefit at popular price points.

Exhibit 1: Actual vs. Estimates

(Rs mn)

	Actual	IDBI Estimate	% variation IDBI
Revenue	13,305	12,531	6.2
EBITDA	2,034	2,193	(7.3)
Margin (%)	15.3	17.5	
APAT	1,278	1,405	(9.0)

Source: Company; IDBI Capital Research

Exhibit 2: Standalone Quarterly Snapshot

(Rs mn)

Financial Snapshot	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)	FY21	FY20	YoY (%)
Revenues	13,305	9,880	34.7	14,734	-9.7	46,900	49,432	-5.1
COGS	8,729	6,078	43.6	9,071	-3.8	29,114	30,576	-4.8
Gross profit	4,576	3,802	20.4	5,663	-19.2	17,786	18,856	-5.7
Gross Margin (%)	34.4	38.5	-409 bps	38.4	-404 bps	37.9	38.1	-22 bps
Employee expenses	659	649	1.5	642	2.5	2,586	2,694	-4.0
% of net sales	5.0	6.6	-162 bps	4.4	59 bps	5.5	5.4	6 bps
Other Expenses	1,884	1,875	0.5	2,122	-11.2	6,869	8,346	-17.7
% of net sales	14.2	19.0	-482 bps	14.4	-24 bps	14.6	16.9	-224 bps
EBITDA	2,034	1,278	59.1	2,898	-29.8	8,331	7,816	6.6
EBITDA Margin (%)	15.3	12.9	235 bps	19.7	-439 bps	17.8	15.8	195 bps
Depreciation	405	320	26.3	336	20.3	1,390	1,199	15.9
EBIT	1,629	958	70.1	2,562	-36.42	6,941	6,617	4.9
Other Income	124	40	210.3	141	-11.9	387	269	44.1
Interest Expenses	40	13	211.6	10	286.5	75	50	49.8
PBT	1,713	985	73.9	2,692	-36.4	7,253	6,836	6.1
Taxes	435	270		673		1,835	1,482	
Adjusted PAT	1,278	715	78.8	2,019	-36.7	5,418	5,354	1.2
Extra-ordinary items	0	0		0		108	0	
Reported PAT	1,278	715	78.8	2,019	-36.7	5,310	5,354	-0.8
Diluted EPS (Rs)	2.37	1.33	78.8	3.75	-36.7	9.85	9.93	-0.8

Source: Company; IDBI Capital Research

Exhibit 3: Consolidated Quarterly Snapshot

(Rs mn)

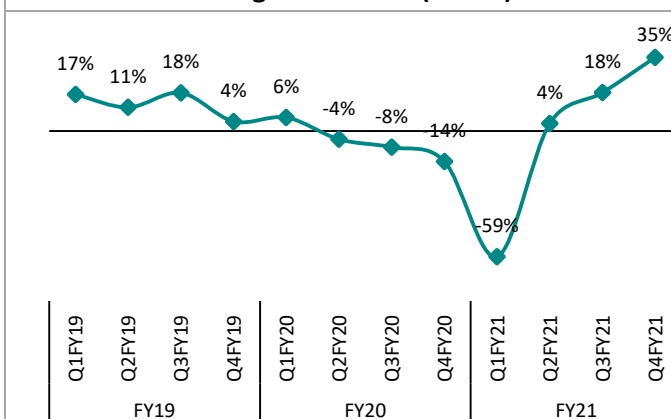
Financial Snapshot	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)	FY21	FY20	YoY (%)
Revenues	14,596	10,801	35.1	15,926	-8.4	50,743	52,800	-3.9
COGS	9,552	6,593	44.9	9,777	-2.3	31,465	32,586	-3.4
Gross profit	5,044	4,208	19.9	6,149	-18.0	19,277	20,213	-4.6
<i>Gross Margin (%)</i>	<i>34.6</i>	<i>39.0</i>	<i>-440 bps</i>	<i>38.6</i>	<i>-405 bps</i>	<i>38.0</i>	<i>38.3</i>	<i>-29 bps</i>
Employee expenses	787	748	5.1	760	3.5	3,047	3,104	-1.8
<i>% of net sales</i>	<i>5.4</i>	<i>6.9</i>	<i>-154 bps</i>	<i>4.8</i>	<i>62 bps</i>	<i>6.0</i>	<i>5.9</i>	<i>13 bps</i>
Other Expenses	2,123	2,117	0.3	2,345	-9.5	7,598	9,065	-16.2
<i>% of net sales</i>	<i>14.5</i>	<i>19.6</i>	<i>-506 bps</i>	<i>14.7</i>	<i>-18 bps</i>	<i>15.0</i>	<i>17.2</i>	<i>-220 bps</i>
EBITDA	2,135	1,342	59.1	3,044	-29.9	8,633	8,044	7.3
<i>EBITDA Margin (%)</i>	<i>14.6</i>	<i>12.4</i>	<i>220 bps</i>	<i>19.1</i>	<i>-449 bps</i>	<i>17.0</i>	<i>15.2</i>	<i>178 bps</i>
Depreciation	482	384	25.5	399	20.6	1,653	1,421	16.3
EBIT	1,653	958	72.5	2,645	-37.51	6,980	6,623	5.4
Other Income	109	38	184.6	143	-23.6	382	255	49.7
Interest Expenses	78	62	25.7	50	54.7	237	209	13.5
PBT	1,684	935	80.2	2,738	-38.5	7,125	6,669	6.8
Taxes	448	281		693		1,867	1,512	
Adjusted PAT	1,236	653	89.2	2,045	-39.6	5,257	5,157	1.9
Extra-ordinary items	0	0		0		0	0	
Minority Interest	7	19		-7		38	52	
Profit attributable to owners	1,243	672	84.9	2,038	-39.0	5,296	5,210	1.6
EPS	2.31	1.25	84.9	3.78	-39.0	9.8	9.7	1.7

Source: Company; IDBI Capital Research

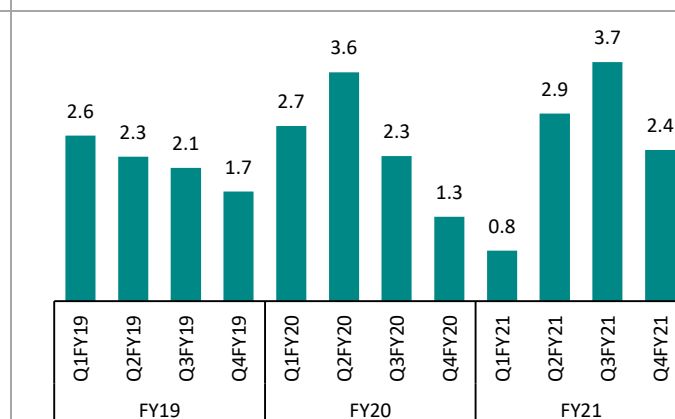
Exhibit 4: Change in estimates

	FY22E			FY23E		
	New	Old	(%) Chg	New	Old	(%) Chg
Revenue (Rs mn)	55,155	55,155	0.0	64,022	64,022	0.0
EBITDA (Rs mn)	9,794	10,196	-3.9	11,982	11,982	0.0
EBITDA margin (%)	17.8	18.5		18.7	18.7	
Net profit (Rs mn)	6,498	6,769	-4.0	8,065	8,061	0.0
EPS (Rs)	12.1	12.6	-4.0	15.0	15.0	0.0

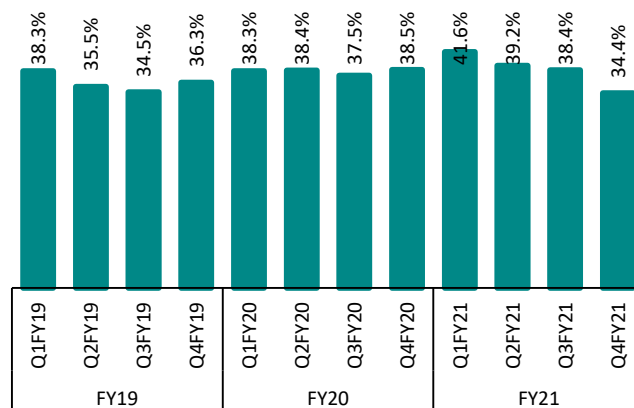
Source: Company; IDBI Capital Research

Exhibit 5: Revenue growth trend (% YoY)


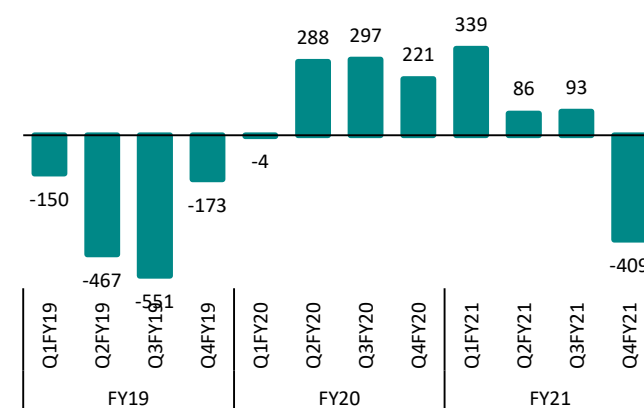
Source: Company; IDBI Capital Research

Exhibit 6: EPS trend


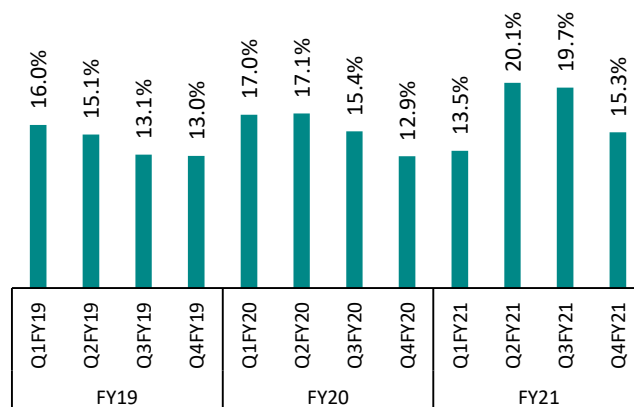
Source: Company; IDBI Capital Research

Exhibit 7: Gross margin trend (% YoY)


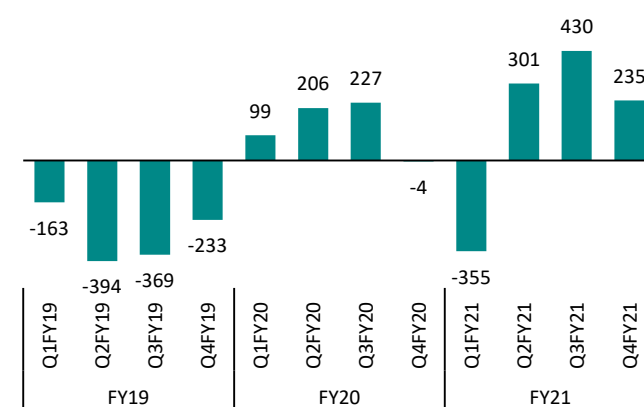
Source: Company; IDBI Capital Research

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	FY20	FY21	FY22E	FY23E
Net sales	49,432	46,127	55,155	64,022
<i>Growth (%)</i>	<i>(4.5)</i>	<i>(6.7)</i>	<i>19.6</i>	<i>16.1</i>
Operating expenses	(41,616)	(38,121)	(45,361)	(52,040)
EBITDA	7,816	8,005	9,794	11,982
<i>Growth (%)</i>	<i>5.3</i>	<i>2.4</i>	<i>22.3</i>	<i>22.3</i>
Depreciation	(1,199)	(1,361)	(1,434)	(1,548)
EBIT	6,617	6,644	8,360	10,434
Interest paid	(50)	(55)	(55)	(55)
Other income	269	359	378	399
Pre-tax profit	6,836	6,948	8,683	10,778
Tax	(1,482)	(1,744)	(2,186)	(2,713)
<i>Effective tax rate (%)</i>	<i>21.7</i>	<i>25.1</i>	<i>25.2</i>	<i>25.2</i>
Minority Interest	-	-	-	-
Net profit	5,354	5,204	6,498	8,065
Exceptional items	-	-	-	-
Adjusted net profit	5,354	5,204	6,498	8,065
<i>Growth (%)</i>	<i>14.6</i>	<i>(2.8)</i>	<i>24.8</i>	<i>24.1</i>
<i>Shares o/s (mn nos)</i>	<i>539</i>	<i>539</i>	<i>539</i>	<i>539</i>

Cash Flow Statement

(Rs mn)

Year-end: March	FY20	FY21	FY22E	FY23E
Pre-tax profit	6,836	6,948	8,683	10,778
Depreciation	1,199	1,390	1,434	1,548
Tax paid	(1,560)	(1,463)	(2,186)	(2,713)
Chg in working capital	(147)	(631)	1,303	(1,879)
Other operating activities	(122)	(55)	55	55
Cash flow from operations (a)	6,206	6,190	9,290	7,789
Capital expenditure	(2,170)	(965)	(1,500)	(2,800)
Chg in investments	(1,310)	(3,648)	-	-
Other investing activities	41	-	-	-
Cash flow from investing (b)	(3,439)	(4,613)	(1,500)	(2,800)
Equity raised/(repaid)	-	-	-	0
Debt raised/(repaid)	(63)	-	-	-
Dividend (incl. tax)	(1,401)	(2,371)	(1,348)	(1,348)
Chg in minorities	-	-	-	-
Other financing activities	(455)	(311)	(55)	(55)
Cash flow from financing (c)	(1,920)	(2,682)	(1,403)	(1,403)
Net chg in cash (a+b+c)	847	(1,105)	6,388	3,586

Balance Sheet

(Rs mn)

Year-end: March	FY20	FY21	FY22E	FY23E
Net fixed assets	18,731	19,318	19,384	20,636
Investments	1,499	1,655	1,655	1,655
Other non-curr assets	3,061	2,179	2,179	2,179
Current assets	22,634	28,940	35,558	42,578
Inventories	9,301	10,902	11,182	12,980
Sundry Debtors	6,745	8,362	8,362	9,998
Cash and Bank	1,663	753	7,091	10,677
Marketable Securities	-	-	-	-
Loans and advances	-	-	-	-
Total assets	45,924	52,091	58,775	67,048
Shareholders' funds	37,869	40,809	45,959	52,677
Share capital	539	539	539	539
Reserves & surplus	37,330	40,270	45,421	52,138
Total Debt	-	-	-	-
Secured loans	-	-	-	-
Unsecured loans	-	-	-	-
Other liabilities	1,340	1,611	1,611	1,611
Curr Liab & prov	6,716	9,671	11,205	12,760
Current liabilities	6,559	9,481	11,015	12,570
Provisions	157	190	190	190
Total liabilities	8,056	11,282	12,816	14,371
Total equity & liabilities	45,924	52,091	58,775	67,048
Book Value (Rs)	70	76	85	98

Source: Company; IDBI Capital Research

Financial Ratios

Year-end: March	FY20	FY21	FY22E	FY23E
Adj. EPS (Rs)	9.9	9.9	12.1	15.0
Adj. EPS growth (%)	14.5	(0.8)	24.8	24.1
EBITDA margin (%)	15.8	17.4	17.8	18.7
Pre-tax margin (%)	13.8	15.1	15.7	16.8
ROE (%)	14.8	13.2	15.0	16.4
ROCE (%)	17.8	16.3	18.6	20.5
Turnover & Leverage ratios (x)				
Asset turnover (x)	1.1	0.9	1.0	1.0
Leverage factor (x)	1.2	1.2	1.3	1.3
Net margin (%)	10.8	11.3	11.8	12.6
Net Debt/Equity (x)	(0.0)	(0.0)	(0.2)	(0.2)
Working Capital & Liquidity ratio				
Inventory days	69	86	74	74
Receivable days	50	66	55	57
Payable days	46	77	78	79

Valuation

Year-end: March	FY20	FY21	FY22E	FY23E
P/E (x)	57.1	58.7	47.0	37.9
Price / Book value (x)	8.1	7.5	6.6	5.8
PCE (x)	46.6	46.5	38.5	31.8
EV / Net sales (x)	6.1	6.6	5.4	4.6
EV / EBITDA (x)	38.9	38.1	30.5	24.6
Dividend Yield (%)	0.5	0.8	0.4	0.4



Notes

Dealing

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Key to Ratings Stocks:
BUY: Absolute return of 15% and above; **ACCUMULATE:** 5% to 15%; **HOLD:** Upto $\pm 5\%$; **REDUCE:** -5% to -15%; **SELL:** -15% and below.

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