

Volume dip, cost inflation dents profit...

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

Q4FY22 Results: Lower volume offtake (in both decorative and industrial) and delay in passing of higher raw material prices dented profitability

- The company reported price led revenue growth of 4% YoY to ₹ 1413 crore in Q4FY22. However, the lower volume growth was led by ~8% drop in the volume of decorative paints
- Sharp rise in raw material prices and delay in passing on the same dragged gross & EBITDA margin down by 660 bps and 937 bps YoY, respectively
- PAT declined 81% YoY to ₹ 25 crore, tracking lower margins

What should investors do? Kansai's share price has declined at CAGR of -0.39% over the past five years (from ~₹ 410 in May 2017 to ~₹ 402 levels in May 2022).

- We change our rating on stock from HOLD to **REDUCE**

Target Price and Valuation: We value Kansai at ₹ 360 i.e. 30x P/E on FY24E EPS.

Key triggers for future price performance:

- We believe regaining of lost market share in the decorative paint segment (~55% of total revenue) will be 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 advertisement expenses will keep overall EBITDA margin expansion under check

Alternate Stock Idea: We like Supreme Industries in our coverage universe.

- Supreme is market leader in plastic piping segment with ~14% market share. Robust b/s with average RoE, RoCE of 24%, 27%, respectively
- BUY with a target price of ₹ 2320



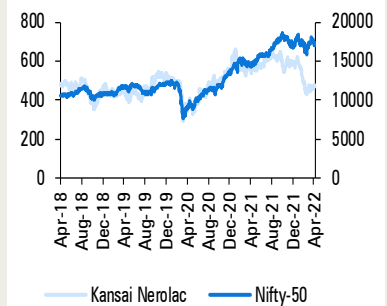
Particulars

Particular	Amount
Market Capitalization (₹ Crore)	21,664.6
Debt (FY22) (₹ Crore)	0.0
Cash & Inv (FY22) (₹ Crore)	310.1
EV (₹ Crore)	21,354.5
52 week H/L	675/ 395
Equity capital (₹ Crore)	53.9
Face value (₹)	1.0

Shareholding pattern

(in %)	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Promoter	75.0	75.0	75.0	75.0	75.0	75.0
FII	4.2	3.7	3.7	3.4	3.6	3.6
DII	12.3	12.9	11.6	13.3	13.2	13.2
Others	8.5	8.4	9.7	8.3	8.2	8.3

Price Chart



Recent event & key risks

- **Key Risk:** (i) Faster recovery in Decorative paints segment (ii) Substantial recovery in the EBITDA margin

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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	6683.8	7549.9	12.7
EBITDA	742.0	781.6	843.5	647.3	-2.4	838.6	1013.2	25.1
EBITDA Margin (%)	14.3	15.8	17.7	10.9		12.5	13.4	
Net Profit	467.3	535.4	530.6	374.3	-5.8	524.4	651.2	31.9
EPS (₹)	8.7	9.9	9.8	6.9		9.7	12.1	
P/E (x)	46.4	40.5	40.8	57.9		41.3	33.3	
Price/Book (x)	6.3	5.7	5.3	5.2		5.2	4.9	
Mcap/Sales (x)	4.2	4.4	4.5	3.6		3.2	2.9	
RoE (%)	13.6	14.1	13.2	9.2		12.7	14.6	
RoCE (%)	20.2	17.5	17.2	12.1		16.8	19.5	

Key takeaways of recent quarter & conference call highlights

Q4FY22 Results:

- Revenues increased albeit a slow pace of 4.2% YoY to ~₹ 1413 crore led by only price hike. We believe the company has reported overall volume dip of 5% YoY led by 8% dip in the volume of decorative paints. The industrial paint demand remained muted due to lower demand from automotive segment. The company has taken price hike of 21% and ~18% in the decorative and industrial paints segments, respectively, during FY22
- The company has clocked one of its lowest EBITDA margin of 5.9% in Q4FY22, down by 937 bps YoY. This was led by 660 bps YoY drop in gross margin and one-time retirement benefit of ~₹ 24 crore. The company was unable to pass on complete price hike in the industrial paints segment
- PAT declined sharply by ~81% YoY to ~₹ 25 crore, tracking lower margins

Q4FY22 Earnings Conference Call highlights

- **Demand Outlook:**

- **Decorative Paints Segment:**

- Kansai Nerolac lost its market share in decorative paints segment as the leader was very aggressive in the economy product category
 - Delay in launching of new products in both premium and economy products along with lower advertisement expenses (declined from 5% in FY20 to 3% in FY21) led to market share loss for the company
 - The management is aiming for single digit volume growth in FY23E supported by corrective measures in the decorative paints
 - For the future, Kansai Nerolac aims to regain the lost market share through product differentiation and competitive pricing
 - The company is also planning to increase its focus on adding more products in the premium and super premium category along with increasing its advertising expenditure
 - The management expects waterproofing and construction chemical to be 5% of company's total topline by the end of FY23
 - The management suggested that its influencer programme (through influencer Pragati APP) will drive demand in coming years

- **Industrial Paints Segment:**

- The industrial paint volume growth was impacted due to lower demand from automotive segment.
 - For this segment, the company has taken price hike of 18% in FY22. The company is in negotiation with its key clients for further price hike in this segment (largely to offset cost inflation)
 - The company aims to continue market share gain in the automotive paint segment. In the non-automotive category, the company plans to launch premium products

- **Margins:**

- Going forward, improved product mix (launch of premium products in decorative paints segment) and gradual price hikes in the industrial paints segment will help company to recover gross margin at pre-Covid level
 - The company plans to increase its advertisement expenses in FY23E to regain lost market share

- **Distribution expansion:**

- Kansai Nerolac currently has ~28000 dealers and aims to increase its dealer base by 8-10% in FY23
 - Tinting machines account for around 80-85% of the company's dealer base

Exhibit 1: Peer comparison

Company	Mcap ₹ cr	Revenue				EBITDA margin				PAT				RoCE				RoE				PE			
		FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E
Asian Paints	2,91,440	21713	29101	33133	37848	22	17	18	19	3207	3085	4129	5013	30	27	33	37	25	23	28	31	91	94	71	58
Berger Paints	64,099	6818	8736	9781	11122	17	15	15	17	720	844	932	1218	25	28	29	34	21	23	24	28	89	76	69	53
Kansai Nero	21,665	4771	5949	6684	7550	18	11	13	13	531	374	524	651	17	12	17	20	13	9	13	15	41	58	41	33
Pidilite Ind	1,07,400	7293	9851	10331	11408	23	19	19	22	1126	1214	1313	1688	24	22	23	30	20	19	20	25	95	88	82	64

Source: Bloomberg, ICICI Direct Research

Kansai’s decorative paints Q4FY22 volume de growth of 8% YoY came in much lower than 8% volume growth of the industry leader. For the full year, Kansai’s overall volume growth of ~17% is much lower than 31% growth of market leader. We believe the market leader is more aggressive on product launch in the decorative paint segments, which, in turn, restricted volume growth for Kansai Nerolac. On the industrial paint segment weak volume offtake is attributable lower demand from auto OEMs due on going cheap shortage. While Kansai’s decorative paint contribution has gone up from 51% to 55%, revenue growth and profitability has been lower compared to industry leader. Therefore, the valuation gap persists. We cut our revenue and earnings estimate by ~6%/11% for FY24 considering slow recovery of decorative paints and higher advertisement expenditure. We change our rating from HOLD to REDUCE on the stock with a revised target price of ₹ 360/share (valuing stock at 30x FY24E, 55% discount to Asian Paints).

Exhibit 2: Variance Analysis

	Q4FY22	Q4FY22E	Q4FY21	YoY (%)	Q3FY22	QoQ (%)	Comments
Net Revenue	1,412.8	1,424.0	1,355.8	4.2	1,693.7	-16.6	Topline growth was mainly driven by industrial paint, however decorative paint revenues were impacted by sharp volume dip
Other Income	7.6	10.3	12.4	-38.7	9.3	-18.1	
Raw Material Exp	1,017.7	955.1	887.3	14.7	1,162.7	-12.5	Delay in price hike put dents on gross margin by ~660 bps YoY
Employee Exp	96.6	68.9	68.8	40.5	74.3	30.0	Employee costs includes one time retirement benefit of ₹ 24 crore in Q4FY22
Manuf & Other exp	215.6	219.2	193.1	11.6	246.7	-12.6	
Total Expenses	1,329.9	1,243.2	1,149.1	15.7	1,483.7	-10.4	
EBITDA	82.9	180.8	206.7	-59.9	210.0	-60.5	
EBITDA Margin (%)	5.9	12.7	15.2	-937 bps	12.4	-653 bps	Lower gross margins and higher employee costs resulted EBITDA margin decline of 937 bps YoY
Depreciation	39.1	39.0	42.9	-8.9	39.0	0.3	
Interest	2.6	4.0	4.2	0.0	2.3	0.0	
PBT	37.4	148.1	172.0	-78.2	178.1	-79.0	
Total Tax	12.9	38.1	43.5	-70.3	45.7	-71.7	
Adj PAT	24.5	110.0	128.5	-80.9	132.4	-81.5	Sharp decline in PAT due to margin pressure
Key Metrics							
Volume Growth (%)	-5.0	-8.0	31.0		7.0		Overall volume de-growth was led by ~8% drop in volume of decorative paints. We believe, Industrial paint demand was also impacted due to supply disruption
Realisation Growth (%)	9.7	16.3	2.8		5.7		Company has taken YTD price hike of ~21% in decorative paints and ~18% in Industrial paints respectively (major chunk of hikes taken in the middle of Q3FY22)

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY23E			FY24E			Comments
	Old	New	%Chg	Old	New	%Chg	
Revenue	7218.4	6683.8	(7.4)	7994.4	7549.9	(5.6)	We have cut our revenue for FY23E-24E considering slow recovery in the decorative paints segment. We model revenue CAGR 13% over FY22-24 supported by blended volume CAGR of 10%
EBITDA	908.8	838.6	(7.7)	1133.2	1013.2	(10.6)	
EBITDA Margin %	12.6	12.5	-5bps	14.2	13.4	-78bps	We have revised our EBITDA margin downward for FY23-24E factoring in delay in passing of inflationary pressure in the industrial paints and higher advertisement expenditure
PAT	570.3	524.4	(8.1)	728.9	651.2	(10.7)	
EPS (₹)	10.6	9.7	(8.1)	13.5	12.1	(10.7)	

Source: ICICI Direct Research

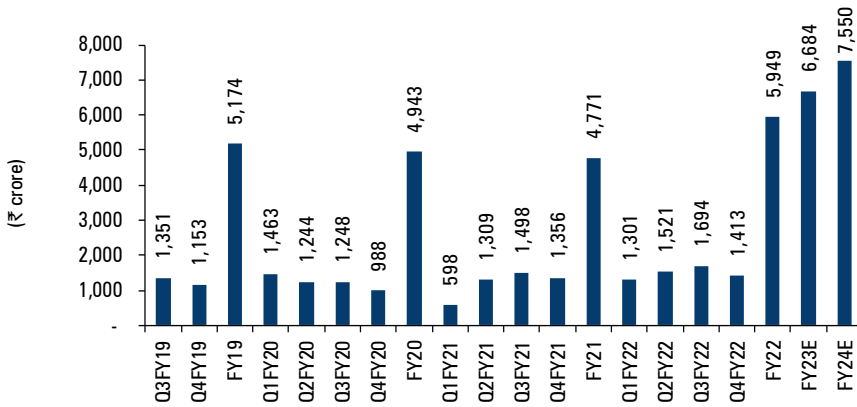
Exhibit 4: Assumptions

Assumptions	Current				Earlier			Comments
	FY21E	FY22E	FY23E	FY24E	FY23E	FY24E		
Volume Growth (%)	-3.9	17.4	7.5	12.6	13.2	9.7	Recovery in the automotive paint demand on a favourable base and launch of new products in the decorative segment will drive overall volume CAGR of 10% FY22-24E	
Realisation Growth (%)	0.4	6.2	4.5	0.3	7.7	0.3		

Source: ICICI Direct Research

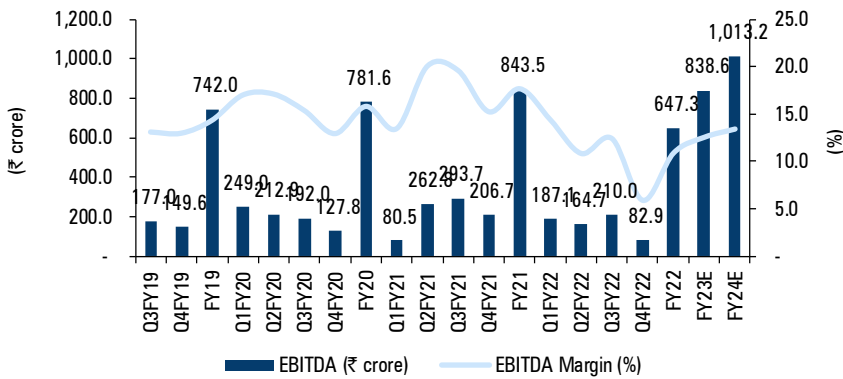
Financial story in charts

Exhibit 5: Lower volume offtake hits revenue



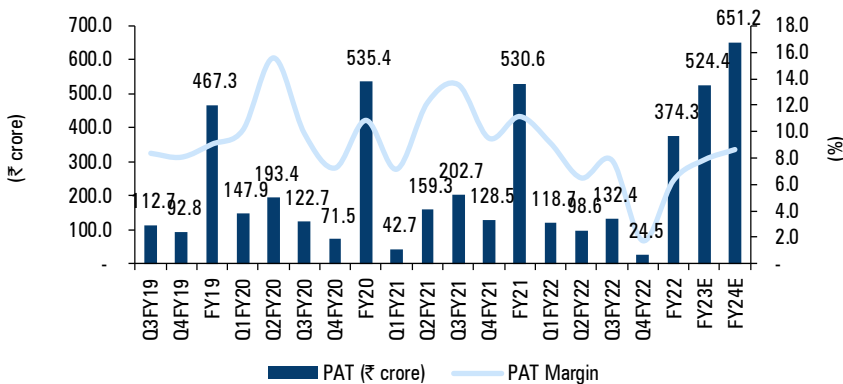
Source: Company, ICICI Direct Research

Exhibit 6: Decline in EBITDA margin due to delay in price hikes



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	6,683.8	7,549.9
Growth (%)	-3.5	24.7	12.4	13.0
Raw Material Expenses	2,957.4	4,129.3	4,519.0	4,989.6
Employee Expenses	268.6	312.4	308.0	337.9
Other expenses	701.3	859.9	1,018.2	1,209.2
Total Operating Expenditure	3,927.4	5,301.6	5,845.2	6,536.7
EBITDA	843.5	647.3	838.6	1,013.2
Growth (%)	7.9	-23.3	29.6	20.8
Depreciation	149.0	153.8	167.1	181.2
Interest	8.5	9.9	9.9	10.2
Other Income	38.8	32.9	41.2	48.8
Exceptional Income	10.8	11.4	0.0	0.0
PBT	714.0	505.1	702.8	870.6
Total Tax	183.5	130.8	178.5	219.4
PAT	530.6	374.3	524.4	651.2

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	524.4	651.2
Add: Depreciation	149.0	153.8	167.1	181.2
(Inc)/dec in Current Assets	-721.5	-54.6	85.7	-303.6
Inc/(dec) in CL and Provisions	289.1	93.6	-6.5	219.0
Others	8.5	9.9	9.9	10.2
CF from operating activities	255.7	577.1	780.6	757.9
(Inc)/dec in Investments	-15.6	74.7	-50.0	-150.0
(Inc)/dec in Fixed Assets	-197.8	-332.0	-200.0	-200.0
Others	15.6	-74.7	50.0	150.0
CF from investing activities	-659.0	-323.7	-122.1	-194.4
Inc/(dec) in loan funds	30.1	-90.1	12.0	-60.0
Dividend paid & dividend tax	-342.1	-260.7	-260.7	-325.8
Others	96.7	-33.1	-304.1	-10.2
CF from financing activities	-215.3	-383.9	-552.8	-396.0
Net Cash flow	-81.7	-1.2	24.1	11.9
Opening Cash	163.6	81.9	80.7	104.7
Closing Cash	81.9	80.7	104.7	116.6

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	4,086.5	4,411.9
Total Shareholders funds	4,080.5	4,170.9	4,140.4	4,465.8
Total Debt	90.1	0.0	12.0	-48.0
Deferred Tax Liability	88.4	95.6	95.6	95.6
Total Liabilities	4,259.0	4,352.4	4,248.0	4,513.3
Assets				
Gross Block	2,778.4	3,092.3	3,416.2	3,616.2
Less: Acc Depreciation	1,062.3	1,216.2	1,383.2	1,564.4
Net Block	1,716.1	1,876.2	2,032.9	2,051.7
Capital WIP	205.8	223.9	100.0	100.0
Total Fixed Assets	1,921.9	2,100.0	2,132.9	2,151.7
Non-Current Investments	165.5	90.9	140.9	290.9
Inventory	1,090.2	1,531.5	1,245.2	1,406.5
Debtors	836.2	965.4	1,007.2	1,096.3
Loans and Advances	20.8	0.0	26.1	29.5
Investments & Other CA	824.9	392.5	437.3	413.7
Cash	81.9	80.7	104.7	116.6
Total Current Assets	2,918.0	2,971.3	2,909.7	3,225.2
Creditors	809.0	890.4	842.3	1,034.2
Provisions & other CL	140.7	152.9	194.5	221.6
Total Current Liabilities	949.7	1,043.3	1,036.8	1,255.8
Net Current Assets	1,968.3	1,928.0	1,872.9	1,969.4
Others Non-Current Assets	203.3	233.5	101.3	101.3
Application of Funds	4,259.0	4,352.4	4,248.0	4,513.3

Source: Company, ICICI Direct Research

Exhibit 11: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS	9.8	6.9	9.7	12.1
Cash EPS	12.6	9.8	12.8	15.4
BV	75.7	77.4	76.8	82.9
DPS	6.3	4.8	4.8	6.0
Cash Per Share	19.7	22.6	25.7	29.0
Operating Ratios (%)				
EBITDA Margin	17.7	10.9	12.5	13.4
EBIT Margin	14.6	8.3	10.0	11.0
PAT Margin	11.3	6.4	7.8	8.6
Inventory days	83	94	68	68
Debtor days	64	59	55	53
Creditor days	62	55	46	50
Return Ratios (%)				
RoE	13.2	9.2	12.7	14.6
RoCE	17.2	12.1	16.8	19.5
RoC	22.4	13.7	18.0	21.0
Valuation Ratios (x)				
P/E	40.8	57.9	41.3	33.3
EV / EBITDA	25.7	33.3	25.7	21.2
EV / Net Sales	4.5	3.6	3.2	2.8
Market Cap / Sales	4.5	3.6	3.2	2.9
Price to Book Value	5.3	5.2	5.2	4.9
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	2.3
Quick Ratio	1.1	1.1	1.3	1.2

Source: Company, ICICI Direct Research

Exhibit 12: ICICI Direct Consumer Discretionary universe

Sector / Company	CMP (₹)	TP(₹)	Rating	M Cap (₹ Cr)	EPS (₹)				P/E (x)				EV/EBITDA (x)				RoCE (%)				RoE (%)			
					FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E
Asian Paints (ASIPAI)	3,039	3,400	Hold	2,91,440	33.4	32.2	43.1	52.3	90.9	94.5	70.6	58.1	59.1	60.1	47.2	39.3	29.6	27.1	33.3	36.8	25.0	23.0	28.4	30.9
Berger Paints (BERPAI)	660	755	Hold	64,099	7.4	8.7	9.6	12.5	89.1	76.0	68.8	52.6	53.7	47.6	43.5	34.0	24.9	27.7	29.1	33.9	21.3	23.1	24.0	27.7
Kansai Nerolac (KANNER)	402	360	Reduce	21,665	9.8	6.9	9.7	12.1	40.8	57.9	41.3	33.3	25.7	33.7	26.0	21.6	17.2	13.0	16.5	19.2	13.2	9.9	12.7	14.6
Pidilite Industries (PIDIND)	2,115	2,575	Hold	1,07,400	22.2	23.9	25.9	33.2	95.4	88.5	81.8	63.6	63.7	57.4	54.5	43.3	23.8	22.1	23.5	29.5	20.2	18.6	19.9	25.0
Bajaj Electricals (BAJELE)	917	1,100	Hold	10,504	16.5	11.2	24.7	33.0	55.6	81.8	37.1	27.8	35.4	40.5	25.0	19.7	15.1	14.0	21.0	23.3	10.7	9.2	16.5	18.6
Crompton Greaves(CROGR)	346	440	Hold	21,687	9.8	8.7	8.6	10.6	35.2	39.7	40.0	32.5	28.6	28.3	26.9	22.3	34.4	35.2	25.2	29.3	31.9	27.7	23.3	24.9
Havells India (HAVIND)	1,199	1,375	Hold	74,806	16.7	17.8	19.3	26.7	72.0	67.5	62.3	44.9	47.0	44.6	41.6	30.7	24.9	24.2	25.9	34.7	20.1	20.4	21.8	29.2
Polycab India (POLI)	2,428	2,850	Buy	36,285	59.3	61.4	62.9	80.8	41.0	39.6	38.6	30.1	31.8	27.8	24.8	19.4	20.6	20.2	20.7	23.0	17.9	15.6	15.7	17.5
Symphony (SYMLIM)	1,004	1,215	Hold	7,024	15.3	17.3	26.1	34.8	65.6	58.0	38.4	28.9	49.2	42.5	29.6	22.3	15.2	15.9	24.5	29.0	14.9	14.4	23.6	27.4
V-Guard Ind (VGUARD)	203	252	Buy	8,694	4.7	4.6	5.7	7.0	43.1	43.8	35.8	28.9	27.0	26.5	23.3	18.8	23.9	23.1	24.8	27.5	16.7	16.7	18.9	21.1
Voltas Ltd (VOLTAS)	951	1,120	Hold	31,453	16.0	15.3	21.0	28.9	59.5	62.2	45.3	32.9	48.3	45.2	37.5	26.7	15.0	14.0	18.0	21.0	10.6	9.2	13.8	16.6
Amber Enterprises (AMBEN)	3,184	4,330	Buy	10,728	24.7	45.7	76.4	104.5	128.8	69.7	41.7	30.5	48.5	34.7	23.5	18.3	7.7	11.1	15.2	18.0	5.2	9.2	13.4	15.6
Dixon Technologies (DIXTEC)	3,402	5,700	Buy	20,191	27.3	35.9	78.5	110.9	124.7	94.7	43.3	30.7	70.4	49.1	27.0	20.0	23.5	27.4	39.9	39.7	21.7	26.4	39.9	38.3
Supreme Indus (SUPIND)	1,849	2,320	Buy	23,487	77.0	76.2	78.8	92.7	24.0	24.3	23.5	20.0	17.7	18.5	17.7	14.5	33.1	25.9	25.2	26.7	30.9	25.2	24.3	25.1
Astral Ltd (ASTPOL)	1,783	2,165	Hold	35,817	20.3	24.9	27.5	33.9	87.7	71.6	64.7	52.5	54.9	46.2	42.7	35.2	27.5	29.6	28.8	30.3	21.5	23.0	22.3	23.3

Source: Bloomberg, ICICI Direct Research

RATING RATIONALE

ICICI Direct endeavours to provide objective opinions and recommendations. ICICI Direct assigns ratings to its stocks according to their notional target price vs. current market price and then categorizes them as Buy, Hold, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock

Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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