

Decorative paints segment drives performance...

Kansai Nerolac reported a strong performance with ~15% YoY growth in decorative paint volumes in Q2FY21. The strong volume growth is attributable to intact demand from semi urban and rural regions along with continuous dealer additions (grew 4-5% in Q2FY21). Further, demand for premium range of emulsions witnessed a strong recovery with the opening up of metro and tier 1 regions. The decorative segment value growth at 7% YoY was largely led by a change in product mix and dealer discount policies. On the industrial paint segment, while July-August witnessed a gradual recovery, the company witnessed strong demand in September 2020 led by automotive segments. On the margin front, gross margin was up ~90 bps YoY largely tracking benign raw material prices. Also ~275 bps YoY saving in other costs helped drive EBITDA margin up by ~300 bps YoY to 20%. Finally, while PBT grew 17% YoY, PAT de-growth of 18% YoY was largely on account of tax reversal benefit in the base period. We introduce FY23 estimates, with revenue earning CAGR of ~13% and 12%, respectively, supported by ~11% of volume growth in FY20-23E.

Decorative paint segment drives topline growth

The topline growth of ~4% YoY at ₹ 1288 crore was led by strong performance of the decorative paint segment. On the volume front, the decorative paint segment posted healthy double digit volume growth in Q2FY21 led by pent up demand and market share gains largely from unorganised sector. On the other hand, industrial paint demand came with some lags and picked up in September 2020. However, looking at strong automotive sales, we believe the segment will record a strong recovery in H2FY21, led by good demand from auto sector. We introduce FY23 estimates and model revenue CAGR of 13% in FY20-23 led by volume CAGR of ~12%.

Strong EBITDA margin in Q2FY21

Gross margins during the period increased ~90 bps YoY in Q2FY21 led by benign raw material prices and change in product mix. In addition to this, various cost optimisation measures resulted in 60 bps and 150 bps saving in employee cost and other expenses, respectively. As a result, EBITDA margin moved up by 300 bps YoY to 20%. We believe restoration of operating costs and stabilisation of raw material prices would lead to normalised EBITDA margin for Kansai Nerolac, going forward.

Valuation & Outlook

We believe reopening of metro, tier 1 cities along with recovery in automotive industry would help drive volume for the company, going forward. We introduce FY23E estimates with revenue, earnings CAGR of 13%, 12% respectively. We roll over our valuation on FY23E and reiterate our **BUY** recommendation on the stock with a revised target price of ₹ 605.

Key Financial Summary

(₹ Crore)	FY19	FY20	FY21E	FY22E	FY23E	CAGR(FY20-23E)
Net Sales	5173.6	4943.2	4577.4	6181.7	7092.9	12.8
EBITDA	742.0	781.6	836.5	952.0	1091.5	11.8
EBITDA Margin (%)	14.3	15.8	18.3	15.4	15.4	
Net Profit	467.3	535.4	553.2	649.0	754.5	12.1
EPS (₹)	8.7	9.9	10.3	12.0	14.0	
P/E (x)	59.7	52.1	50.5	43.0	37.0	
Price/Book (x)	8.2	7.4	7.1	6.5	5.8	
Mcap/Sales (x)	5.4	5.7	6.1	4.5	4.0	
RoE (%)	13.6	14.1	14.3	15.1	15.7	
RoCE (%)	20.2	17.6	18.4	19.6	20.5	

Source: Company, ICICI Direct Research



Particulars

Particular	Amount
Market Capitalization (₹ Crore)	27,916.1
Debt (FY20) (₹ Crore)	49.0
Cash & Inv (FY20) (₹ Crore)	157.0
EV (₹ Crore)	27,808.1
52 week H/L	556 / 296
Equity capital (₹ Crore)	53.9
Face value (₹)	1.0

Key Highlights

- Strong volume growth in decorative segment by 15% YoY
- Month on month recovery in industrial paint demand
- Benign raw material prices help in expansion in gross margin
- Maintain BUY rating with revised target price of ₹ 605/share

Research Analyst

Sanjay Manyal
sanjay.manyal@icicisecurities.com

Hitesh Taunk
hitesh.taunk@icicisecurities.com

Exhibit 1: Variance Analysis

	Q2FY21	Q2FY21E	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Comments
Net Revenue	1,288.1	1,303.5	1,243.5	3.6	598.1	115.4	Strong demand for decorative paint segment help drive revenue in Q2FY21
Other Income	4.3	8.0	3.9	10.2	7.9	-45.3	
Raw Material Exp	782.5	778.8	766.1	2.1	349.0	124.2	Benign raw material prices, favourable mix result in increase in gross margin by 90 bps YoY
Employee Exp	64.0	71.3	69.4	-7.8	64.5	-0.8	
Manuf & Other exp	182.2	213.7	195.1	-6.6	104.1	75.1	Various cost optimisation measures help in savings in other expenses
Total Expenses	1,028.7	1,063.8	1,030.6	-0.2	517.5	98.8	
EBITDA	259.4	239.7	212.9	21.8	80.5	222.2	
EBITDA Margin (%)	20.1	18.4	17.1	301 bps	13.5	667 bps	Saving in other cost and gross margin expansion help drive EBITDA margin up by 300 bps YoY
Depreciation	33.0	36.8	28.6	15.3	31.8	3.8	Higher depreciation provisioning would be on the back of commencement of new plants
Interest	1.1	1.3	1.2	0.0	1.3	0.0	
PBT	218.8	209.6	187.0	17.0	55.3	295.7	
Total Tax	60.2	52.4	-6.4	-1,040.8	12.6	378.6	Benefits of tax reversal in base period
Adj PAT	158.6	157.2	193.4	-18.0	42.7	271.2	
Key Metrics							
Volume Growth (%)	7.0	7.0	-3.3		-58.6		Pent up demand help drive decorative segment volume growth of ~15% YoY while industrial paint segment demand recovery started from September 2020
Realisation Growth (%)	-3.2	-2.0	-0.6		-1.4		Lower realisation attributable to change in product mix

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY21E			FY22E			FY23E	Comments
	Old	New	% Chg	Old	New	% Chg	Introduced	
Revenue	4,325.2	4577.4	5.8	5794.4	6181.7	6.7	7092.9	We tweak our FY21E-22E estimates factoring in current quarter performance. We introduce FY23 estimates with topline growth of 15% YoY
EBITDA	673.1	836.5	24.3	983.6	952.0	(3.2)	1091.5	
EBITDA Margin %	15.6	18.3	271bps	17.0	15.4	-156bps	15.4	We believe EBITDA margin would get normalise with reversal of some operating costs (including advertisement expenditure) along with stabilisation in raw material prices, going forward
PAT	427.8	553.2	29.3	637.3	649.0	1.8	754.5	
EPS (₹)	8.1	10.4	29.2	11.8	12.0	1.8	14.0	

Source: Company, ICICI Direct Research

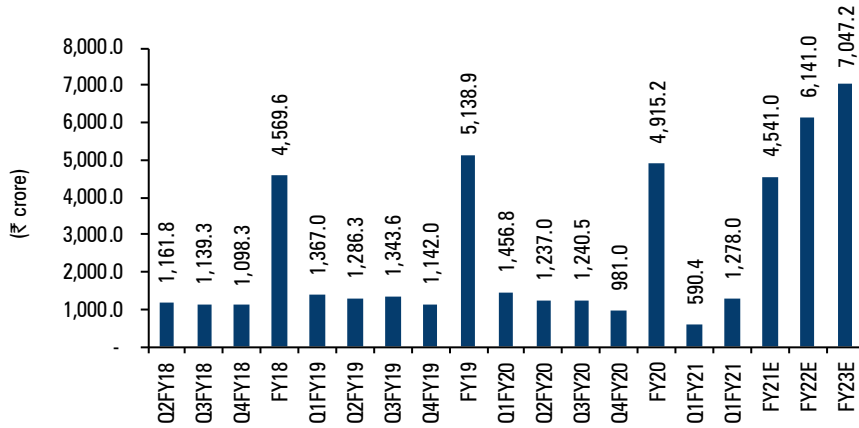
Exhibit 3: Assumption

	Current			FY23E	Earlier		Comments
	FY20E	FY21E	FY22E	Introduced	FY21E	FY22E	
Volume Growth (%)	-4.4	-7.8	31.9	13.4	-13.4	30.2	We believe decorative paint demand is likely to continue in the coming period supported by housing construction and repainting demand in tier I, tier II cities. In addition to this, revival in industrial paints demand led by automotive industry would help drive overall volume CAGR of 11% for FY20-23E
Realisation Growth (%)	0.0	0.4	2.4	1.1	1.1	2.9	

Source: Company, ICICI Direct Research

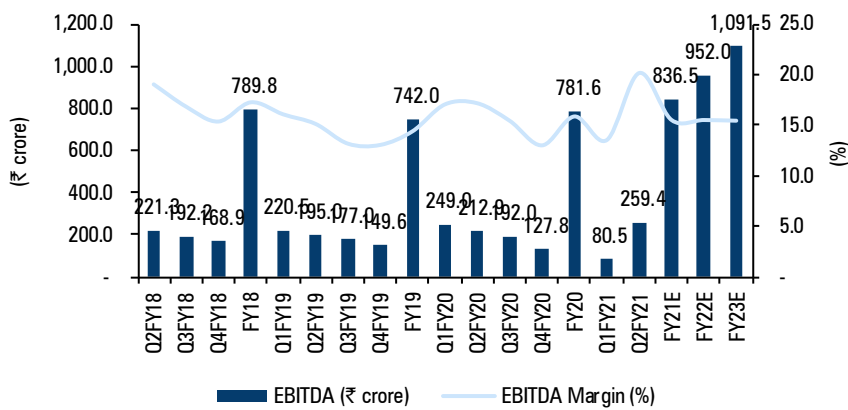
Financial story in charts

Exhibit 4: Expect strong recovery from FY22E onwards



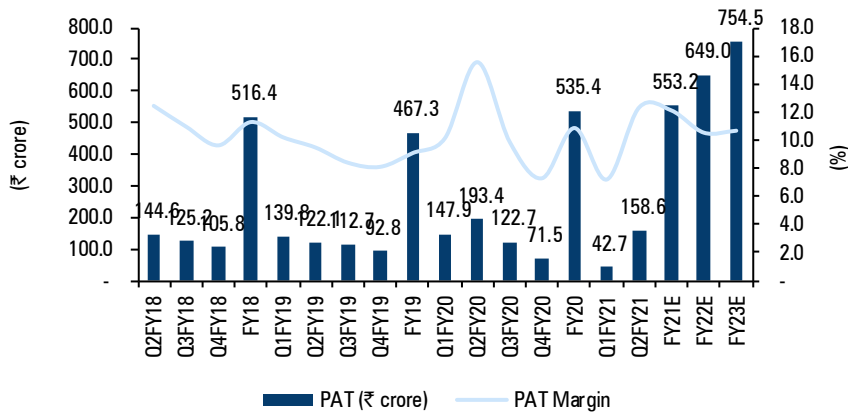
Source: Company, ICICI Direct Research

Exhibit 5: EBITDA margin movement



Source: Company, ICICI Direct Research

Exhibit 6: PAT movement

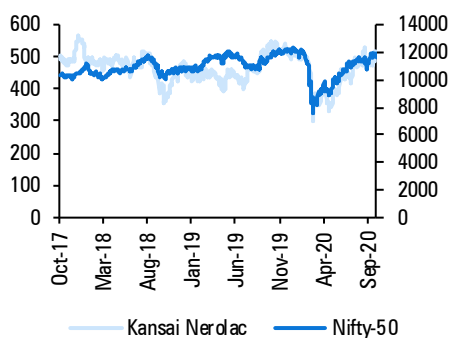


Source: Company, ICICI Direct Research

Conference call key takeaways

- Strong demand from tier II and tier III cities helped drive demand for decorative paint industry
- For paint industry, metro regions contribute ~30% to overall decorative paint sales in India. Demand in metro regions has started picking up with easing of lockdown restrictions. That said, it would help drive demand for higher end products (emulsions), going forward
- Despite demand being driven by upcountry markets, the company has not witnessed any down-trading of products
- Current dealer strength was at 25000, which has grown 4-5% YoY in Q2FY21. The company aims to increase dealer network by 10% annually
- Putty & construction chemical segments contribute ~10% to topline
- Kansai launched new products in the lower end emulsion categories
- It increased focus on construction chemical business. On the dealer's front, ~20% of its dealers have started selling products. The company aims to take it to ~50% of total dealers
- For industry, exterior paints contribute ~50-55% of sales while ~45-50% sales comes from interior coatings
- The recovery in industrial paint demand started from September 2019 onwards. Industrial paint demand is likely to inch up with recovery in sales of passenger vehicles and two wheeler categories, going forward
- While raw material prices started moving up, going forward, the margin is likely to be elevated level considering better operating leverage from industrial paints segments
- The company has planned a capex of ₹ 150-175 crore for FY21 of which ~₹ 70 crore would be for maintenance capex

Exhibit 7: Price chart Kansai vs. Nifty 50



Source: Capitaline, Company, ICICI Direct Research

Exhibit 8: Shareholding Pattern

(in %)	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
Promoter	75.0	75.0	75.0	75.0	75.0
FII	3.8	3.7	3.9	4.4	4.4
DII	11.0	12.1	12.0	11.7	12.2
Others	10.3	9.2	9.1	8.9	8.4

Source: BSE, ICICI Direct Research

Financial summary

Exhibit 9: Profit and loss statement		₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E	
Total operating Income	4,943.2	4,577.4	6,181.7	7,092.9	
Growth (%)		-7.4	35.0	14.7	
Raw Material Expenses	3,057.6	2,769.6	3,833.8	4,405.9	
Employee Expenses	269.4	271.8	322.8	360.0	
Other expenses	834.6	699.6	1,073.1	1,235.5	
Total Operating Expenditure	4,161.6	3,741.0	5,229.8	6,001.4	
EBITDA	781.6	836.5	952.0	1,091.5	
Growth (%)		7.0	13.8	14.7	
Depreciation	119.9	136.2	153.5	169.1	
Interest	5.0	5.0	5.1	5.2	
Other Income	26.9	45.4	73.7	91.6	
Exceptional Income	0.0	10.8	0.0	0.0	
PBT	683.6	729.8	867.0	1,008.7	
Total Tax	148.2	176.6	218.0	254.2	
PAT	535.4	553.2	649.0	754.5	

Source: Company, ICICI Direct Research

Exhibit 10: Cash flow statement		₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E	
Profit before Tax	535.4	553.2	649.0	754.5	
Add: Depreciation	119.9	136.2	153.5	169.1	
(Inc)/dec in Current Assets	-18.1	-34.4	-474.5	-357.7	
Inc/(dec) in CL and Provisions	-112.4	-10.3	194.7	124.7	
Others	5.0	5.0	5.1	5.2	
CF from operating activities	529.8	649.8	527.9	696.0	
(Inc)/dec in Investments	-41.0	0.0	-50.0	-50.0	
(Inc)/dec in Fixed Assets	-358.0	-200.0	-300.0	-300.0	
Others	41.0	0.0	50.0	50.0	
CF from investing activities	-369.3	-659.0	-319.3	-200.0	
Inc/(dec) in loan funds	45.6	10.0	-5.0	12.0	
Dividend paid & dividend tax	-205.3	-208.5	-260.7	-260.7	
Others	27.3	-217.3	-5.1	-5.2	
CF from financing activities	-132.4	-415.8	-270.8	-253.9	
Net Cash flow	78.1	34.0	-92.9	92.1	
Opening Cash	78.9	157.0	191.0	98.1	
Closing Cash	157.0	191.0	98.1	190.2	

Source: Company, ICICI Direct Research

Exhibit 11: Balance sheet		₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E	
Liabilities					
Equity Capital	53.9	53.9	53.9	53.9	
Reserve and Surplus	3,733.0	3,865.4	4,253.8	4,747.6	
Total Shareholders funds	3,786.9	3,919.3	4,307.6	4,801.5	
Total Debt	49.0	59.0	54.0	66.0	
Deferred Tax Liability	85.0	85.0	85.0	85.0	
Total Liabilities	3,920.9	4,063.3	4,446.7	4,952.5	
Assets					
Gross Block	2,617.6	2,882.0	3,182.0	3,482.0	
Less: Acc Depreciation	913.3	1,049.6	1,203.1	1,372.2	
Net Block	1,704.3	1,832.5	1,978.9	2,109.8	
Capital WIP	164.4	100.0	100.0	100.0	
Total Fixed Assets	1,868.7	1,932.5	2,078.9	2,209.8	
Non-Current Investments	149.9	149.9	199.9	249.9	
Inventory	930.1	933.1	1,177.7	1,351.5	
Debtors	674.5	771.4	925.4	1,061.9	
Loans and Advances	19.2	17.7	24.0	27.5	
Investments & Other CA	472.8	411.6	450.8	446.9	
Cash	157.0	191.0	98.1	190.2	
Total Current Assets	2,271.7	2,340.1	2,721.6	3,171.4	
Creditors	519.5	522.5	673.0	772.3	
Provisions & other CL	141.1	127.8	172.1	197.5	
Total Current Liabilities	660.6	650.3	845.0	969.8	
Net Current Assets	1,611.1	1,689.7	1,876.6	2,201.6	
Others Non-Current Assets	291.2	291.2	291.2	291.2	
Application of Funds	3,920.9	4,063.3	4,446.7	4,952.5	

Source: Company, ICICI Direct Research

Exhibit 12: Key ratios		₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E	
Per share data (₹)					
EPS	9.9	10.3	12.0	14.0	
Cash EPS	12.2	12.8	14.9	17.1	
BV	70.3	72.7	79.9	89.1	
DPS	3.8	3.9	4.8	4.8	
Cash Per Share	16.9	19.5	22.3	25.5	
Operating Ratios (%)					
EBITDA Margin	15.8	18.3	15.4	15.4	
EBIT Margin	13.5	15.4	13.0	13.1	
PAT Margin	10.9	12.4	10.6	10.7	
Inventory days	69	75	70	70	
Debtor days	50	62	55	55	
Creditor days	39	42	40	40	
Return Ratios (%)					
RoE	14.1	14.3	15.1	15.7	
RoCE	17.6	18.4	19.6	20.5	
RoIC	22.1	21.7	21.6	22.5	
Valuation Ratios (x)					
P/E	52.1	50.5	43.0	37.0	
EV / EBITDA	35.6	33.2	29.3	25.5	
EV / Net Sales	5.7	6.1	4.5	3.9	
Market Cap / Sales	5.7	6.1	4.5	4.0	
Price to Book Value	7.4	7.1	6.5	5.8	
Solvency Ratios					
Debt/EBITDA	0.1	0.1	0.1	0.1	
Debt / Equity	0.0	0.0	0.0	0.0	
Current Ratio	2.7	2.9	2.8	2.8	
Quick Ratio	1.3	1.5	1.4	1.4	

Source: Company, ICICI Direct Research

Exhibit 13: ICICI Direct Coverage Universe (Consumer Discretionary)

Sector / Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Asian Paints (ASIPAI)	2,223	2,440	Buy	2,13,186	29.0	28.9	35.9	76.7	77.1	61.9	47.9	45.8	37.4	27.4	24.2	27.3	30.5	28.1	31.7
Astral Polytechnik (ASTPOL)	1,146	1,120	Hold	17,266	16.6	15.0	23.3	69.2	76.6	49.2	36.1	39.3	27.8	20.5	17.0	23.1	16.6	13.1	17.9
Amber Enterprises (AMBEN)	2,250	2,600	Buy	7,075	52.2	19.0	70.6	43.1	118.4	31.9	22.8	33.1	15.2	14.3	6.3	16.2	14.5	4.2	13.7
Bajaj Electricals (BAJELE)	509	495	Buy	5,787	0.0	4.1	14.8	NM	124.3	34.5	26.1	26.3	15.0	8.4	6.7	13.4	4.5	4.2	10.2
Berger Paints (BERPAI)	644	580	Hold	62,545	6.8	6.1	9.7	95.3	105.1	66.1	51.7	55.0	37.8	26.6	22.0	31.3	24.7	19.7	27.1
EPL (ESSPRO)	257	270	Buy	8,108	6.7	7.0	9.5	38.3	36.6	27.1	13.6	12.4	10.5	15.6	16.5	19.4	14.3	13.9	16.3
Havells India (HAVIND)	812	835	Buy	50,661	11.7	14.1	16.4	69.1	57.6	49.5	42.5	32.7	28.4	19.6	21.5	24.4	17.0	18.5	20.0
Kansai Nerolac (KANNER)	518	605	Buy	27,916	9.9	10.3	12.0	52.1	50.5	43.0	35.6	33.2	29.3	17.6	18.4	19.6	14.1	14.3	15.1
Pidilite Industries (PIDIND)	1,582	1,595	Buy	80,334	22.1	17.8	28.0	71.6	88.7	56.6	43.5	53.3	35.1	31.0	23.4	34.0	26.1	19.2	27.7
Polycab India (POLI)	920	1,040	Buy	13,697	51.4	58.4	62.9	17.9	15.8	14.6	11.4	11.2	9.5	26.5	21.4	23.2	20.0	18.2	18.0
Supreme Indus (SUPIND)	1,447	1,695	Buy	18,381	36.8	44.9	47.8	39.3	32.2	30.3	22.5	20.1	19.4	22.5	23.3	22.5	20.7	22.3	21.2
Symphony (SYMLIM)	844	960	Buy	5,904	26.0	20.5	32.0	32.4	41.1	26.4	26.7	33.9	21.0	28.8	23.5	37.0	29.0	23.0	35.1
Time Techno (TIMTEC)	39	47	Hold	882	7.5	3.4	9.4	5.2	11.5	4.2	3.3	4.5	3.0	12.5	7.4	13.5	9.3	4.3	11.0
V-Guard Ind (VGUARD)	171	210	Buy	7,324	4.3	3.7	5.3	39.6	46.2	32.3	28.2	31.0	22.9	24.8	20.1	25.2	18.6	15.1	19.4
Voltas Ltd (VOLTAS)	730	725	Buy	24,144	15.8	10.7	22.7	46.3	68.3	32.1	29.4	51.3	23.6	19.5	11.5	20.4	13.0	8.0	15.6

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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