

Strong performance led by decorative paints...

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 ~36,000 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

Q1FY22 Results: Strong revival in decorative paints helped drive its performance.

- Favourable base and strong demand for decorative paints helped drive revenue up by 118% YoY to ₹ 1301 crore
- Improved operating leverage helped 92 bps rise in EBITDA margin to 14.4%
- PAT jumped ~3x YoY to ₹ 119 crore, supported by a favourable base and strong topline growth

What should investors do? Kansai's share price has grown by ~2x over the past five years (from ~₹ 370 in July 2016 to ~₹ 630 levels in August 2021).

- We maintain our BUY rating on the stock

Target Price and Valuation: We value Kansai at ₹ 750 i.e. 48x P/E on FY23E EPS.

Key triggers for future price performance:

- We believe the decorative paint will continue to grow ~2x of GDP growth considering, shortening of repainting cycle, growing urbanisation and increased distribution reach of organised players
- 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 profitability, going forward

Alternate Stock Idea: We also like Asian Paints in our coverage universe.

- Asian Paints is the market leader in decorative paint and is expanding its product portfolio along with dealer expansion in tier II and tier III cities
- BUY with a target price of ₹ 3665



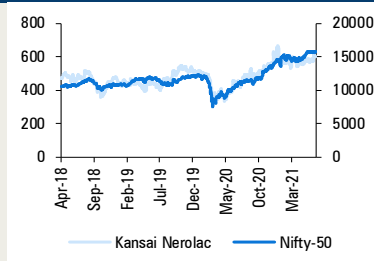
Particulars

Particular	Amount
Market Capitalization (₹ Crore)	33,952.0
Debt (FY21) (₹ Crore)	90.1
Cash & Inv (FY21) (₹ Crore)	743.4
EV (₹ Crore)	33,298.7
52 week H/L	680 / 419
Equity capital (₹ Crore)	53.9
Face value (₹)	1.0

Shareholding pattern

(in %)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Promoter	75.0	75.0	75.0	75.0	75.0
FII	3.9	4.4	4.0	4.2	3.7
DII	12.0	11.7	12.2	12.3	12.9
Others	9.1	8.9	8.8	8.5	8.4

Price Chart



Recent event & key risks

- **Key Risk:** (i) Delay in volume offtake of industrial paint segment (ii) Delay in passing on high input prices

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Key Financial Summary

(₹ Crore)	FY19	FY20	FY21	5 Year CAGR (FY16-21)	FY22E	FY23E	FY24E	3 Year CAGR (FY21-24E)
Net Sales	5173.6	4943.2	4690.0	4.6	6395.2	7456.0	8548.3	22.2
EBITDA	742.0	781.6	833.1	7.5	1046.3	1294.0	1503.6	21.8
EBITDA Margin (%)	14.3	15.8	17.8		16.4	17.4	17.6	
Net Profit	467.3	535.4	531.0	8.2	698.0	867.1	1009.9	23.9
EPS (₹)	8.7	9.9	9.9		13.0	16.1	18.7	
P/E (x)	72.6	63.4	63.9		48.6	39.2	33.6	
Price/Book (x)	9.9	9.0	8.3		8.1	7.1	6.2	
Mcap/Sales (x)	6.6	6.9	7.2		5.3	4.6	4.0	
RoE (%)	13.6	14.1	13.2		16.6	18.0	18.4	
RoCE (%)	20.2	17.5	17.2		21.5	23.4	24.2	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

Q1FY22 Results:

- A favourable base and improved demand post easing of lockdown restrictions helped drive demand for decorative and industrial paints. That helped revenue growth of 118% YoY to ₹ 1301 crore. However, if we compare to pre-Covid level sales, the recovery was 87%, mainly due to a slow recovery in industrial paints
- Gross margin declined 740 bps YoY (flat QoQ), mainly due to a delay in passing on of higher raw material prices. However, improved operating leverage helped drive EBITDA margin up by 92 bps YoY
- PAT grew ~179% YoY to ₹ 119 crore on a favourable base and higher sales

Q1FY22 Earnings Conference Call highlights

- **Demand Outlook:**
 - Opening up of economy post ease in lockdown restrictions, dealer additions in semi urban regions and new business category (such as construction chemical, wood finishes) will help drive future demand for decorative paints
 - Recovery in industrial paints will be delayed by shortage of semiconductor/chip
- **Margins:**
 - The company has taken three price hikes in March-June 2021 to offset inflationary pressure
 - KNL is likely to take further price hikes (in case raw material prices remain firm) to maintain gross margin. This, coupled with introduction of high end emulsions, would help the company to maintain its pre-Covid-19 level of gross margin. However, the company's cost reduction programme and improved operating leverage will help drive overall EBITDA margin for company
- **Capex:**
 - A planned capex of ₹ 280 crore for FY22

Exhibit 1: Peer comparison

	Mcap ₹ cr	Revenue				EBITDA margin				PAT				RoCE				RoE				PE			
		FY21E	FY22E	FY23E	FY24E	FY21E	FY22E	FY23E	FY24E	FY21E	FY22E	FY23E	FY24E	FY21E	FY22E	FY23E	FY24E	FY21E	FY22E	FY23E	FY24E	FY21E	FY22E	FY23E	FY24E
Asian Paints	2,84,823	21713	27378	32255	37647	22.4	20.5	21.8	21.8	3206.8	3786.4	4836.6	5672.2	29.6	32.6	36.8	38.2	25.0	27.6	27.6	30.7	88.8	75.2	58.9	50.2
Kansai Nero	33,952	4690.0	6395.2	7456.0	8548.3	17.8	16.4	17.4	17.6	531.0	698.0	867.1	1009.9	17.2	21.5	23.4	24.2	13.2	16.6	16.6	18.0	63.9	48.6	39.2	33.6

Source: Bloomberg, ICICI Direct Research

Kansai Nerolac (KNL) is the third largest decorative paint company with ~12% market share in the organised category. Over the last 10 years, KNL has increased its decorative paint contribution in revenue from 50% to 55%. While KNL's automotive portfolio is likely to face challenges in the near term (due to shortage of chips), we believe demand for decorative paints will see continuous demand traction, supported by opening up of the economy and the upcoming festive season. For the long term, we believe decorative paints demand would be largely driven by shortening repainting cycle and pushing of new product category into the existing dealer network. On the industrial front, a revival in PV sales and focus on increasing contribution of coil coating and functional powder coatings will drive segment sales. We introduce FY24 estimates and model revenue, earning CAGR of 22%, 24%, respectively, led by volume CAGR of 17%. We maintain our BUY rating on the stock.

Exhibit 2: Variance Analysis

	Q1FY22	Q1FY22E	Q1FY21	YoY (%)	Q4FY21	QoQ (%)	Comments
Net Revenue	1,301.2	1,032.5	598.1	117.6	1,330.5	-2.2	Low base and strong demand for decorative paints helped drive topline in Q1FY22
Other Income	9.7	10.2	7.9	21.9	12.4	-21.9	
Raw Material Exp	856.0	655.2	349.0	145.3	872.9	-1.9	Higher raw material costs and partial price hikes in the decorative paints dragged gross margin (down by 740 bps YoY). However, three price hikes from March 2021 to June 2021 helped maintain QoQ gross margins
Employee Exp	69.8	77.5	64.5	8.2	65.9	6.0	
Manuf & Other exp	188.2	143.2	104.1	80.8	188.4	-0.1	Various cost optimisation measures aided in saving in other expenses
Total Expenses	1,114.1	875.9	517.5	115.3	1,127.1	-1.2	
EBITDA	187.1	156.6	80.5	132.4	203.4	-8.0	
EBITDA Margin (%)	14.4	15.2	13.5	92 bps	15.3	-90 bps	Lower gross margins completely offset by improved operating leverage helped drive EBITDA margin up by 90 bps YoY
Depreciation	35.8	41.6	31.8	12.3	40.5	-11.6	
Interest	2.5	1.3	1.3	0.0	4.0	0.0	
PBT	158.5	123.9	55.3	186.7	171.3	-7.4	
Total Tax	39.9	31.2	12.6	216.9	43.5	-8.3	
Adj PAT	118.7	92.7	42.7	177.8	127.8	-7.2	Mainly tracking strong revenue growth and EBITDA margin expansion on a YoY basis
Key Metrics							
Volume Growth (%)	112.0	67.0	-58.6		31.0		Low base and strong demand in urban regions helped drive demand for decorative paint demand. However, industrial paint recovery over Q1FY20 (i.e. pre-Covid-19 sales) was delayed due to low slow demand recovery
Realisation Growth (%)	5.5	3.4	-1.4		2.8		

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY22E			FY23E			FY24E	Comments
	Old	New	% Chg	Old	New	% Chg	New	
Revenue	5,979.8	6395.2	6.9	7017.3	7456.0	6.3	8548.3	We tweak our FY22E-23E estimates upwards considering strong demand recovery in the decorative paints segments
EBITDA	981.3	1046.3	6.6	1162.9	1294.0	11.3	1503.6	
EBITDA Margin %	16.4	16.4	-5bps	16.6	17.4	76bps	17.6	We marginally revise our EBITDA margin upward, factoring in price hikes and various cost optimisation measures by the company
PAT	653.4	698.0	6.8	775.4	867.1	11.8	1009.9	
EPS (₹)	12.1	13.0	6.8	14.4	16.1	11.8	18.7	

Source: ICICI Direct Research

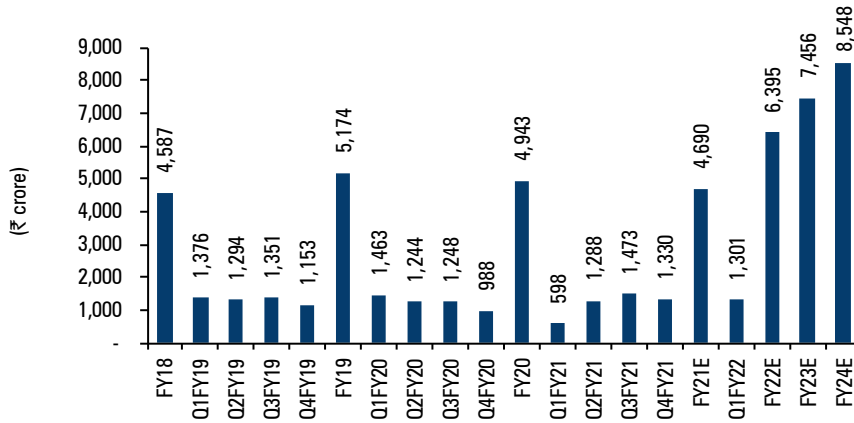
Exhibit 4: Assumptions

	Current			Earlier			Comments
	FY21E	FY22E	FY23E	FY24E	FY22E	FY23E	
Volume Growth (%)	-4.0	29.4	11.5	11.3	19.7	13.3	We believe demand for decorative and industrial paints is likely to be hit by second wave of Covid-19 in the short to medium term. However, we continue to believe long term growth drivers such as reducing repainting cycle and lower per capita consumption would drive growth
Realisation Growth (%)	-1.2	5.4	4.5	3.0	6.6	3.6	

Source: ICICI Direct Research

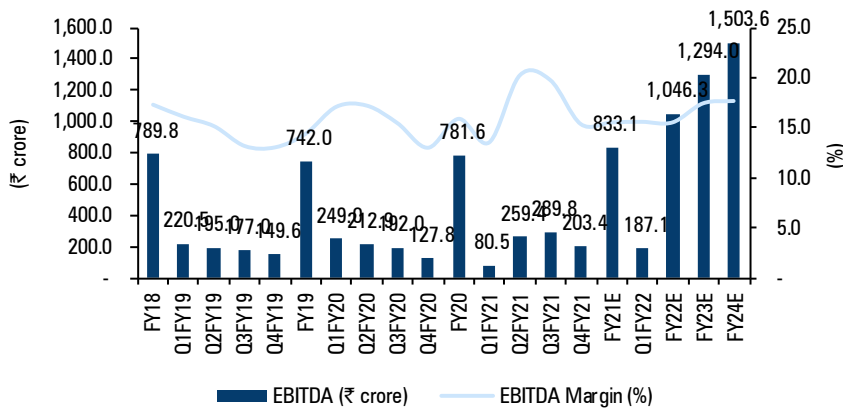
Financial story in charts

Exhibit 5: Revenue trend



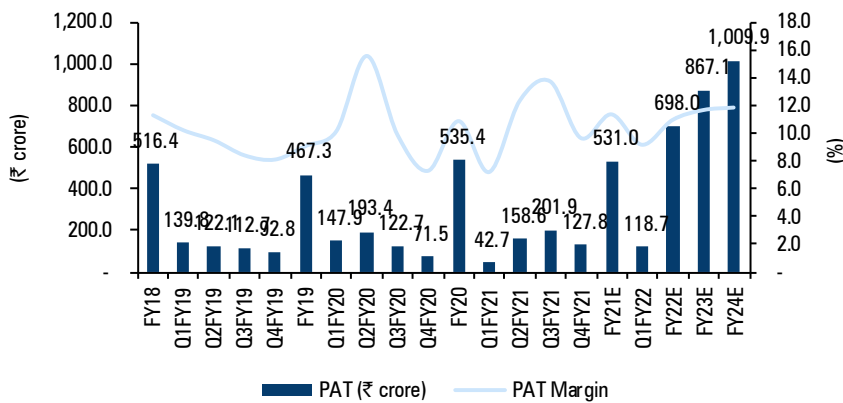
Source: Company, ICICI Direct Research

Exhibit 6: EBITDA margin movement



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	FY22E	FY23E	FY24E
Total operating income	4,690.0	6,395.2	7,456.0	8,548.3
Growth (%)	-5.1	36.4	16.6	14.6
Raw Material Expenses	2,911.4	4,112.9	4,698.1	5,366.5
Employee Expenses	258.6	313.8	343.6	394.0
Other expenses	686.9	922.1	1,120.2	1,284.3
Total Operating Expenditure	3,856.9	5,348.8	6,162.0	7,044.8
EBITDA	833.1	1,046.3	1,294.0	1,503.6
Growth (%)	6.6	25.6	23.7	16.2
Depreciation	139.0	158.8	185.2	212.3
Interest	7.5	8.8	8.9	9.0
Other Income	38.7	50.9	59.3	68.0
Exceptional Income	10.8	0.0	0.0	0.0
PBT	714.5	929.6	1,159.2	1,350.2
Total Tax	183.5	231.6	292.1	340.2
PAT	531.0	698.0	867.1	1,009.9

Source: Company, ICICI Direct Research

Exhibit 9: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
Profit before Tax	531.0	698.0	867.1	1,009.9
Add: Depreciation	139.0	158.8	185.2	212.3
(Inc)/dec in Current Assets	-721.5	-61.7	-555.6	-408.9
Inc/(dec) in CL and Provisions	289.1	114.1	71.9	166.4
Others	7.5	8.8	8.9	9.0
CF from operating activities	245.1	918.0	577.6	988.7
(Inc)/dec in Investments	-15.6	-50.0	-50.0	-150.0
(Inc)/dec in Fixed Assets	-197.8	-280.0	-250.0	-350.0
Others	15.6	50.0	50.0	150.0
CF from investing activities	-659.0	-323.7	-122.1	-330.0
Inc/(dec) in loan funds	30.1	-5.0	12.0	-60.0
Dividend paid & dividend tax	-342.1	-260.7	-260.7	-325.8
Others	97.7	-326.3	-8.9	-9.0
CF from financing activities	-214.3	-591.9	-257.6	-394.8
Net Cash flow	-91.3	-3.9	20.0	93.9
Opening Cash	163.6	72.3	68.3	88.3
Closing Cash	72.3	68.3	88.3	182.2

Source: Company, ICICI Direct Research

Exhibit 10: Balance Sheet				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
Liabilities				
Equity Capital	53.9	53.9	53.9	53.9
Reserve and Surplus	4,027.0	4,146.9	4,753.3	5,437.5
Total Shareholders funds	4,080.9	4,200.8	4,807.2	5,491.4
Total Debt	90.1	85.1	97.1	37.1
Deferred Tax Liability	88.4	88.4	88.4	88.4
Total Liabilities	4,259.4	4,374.3	4,992.7	5,616.8
Assets				
Gross Block	2,778.4	3,164.2	3,414.2	3,764.2
Less: Acc Depreciation	1,052.3	1,211.1	1,396.3	1,608.6
Net Block	1,726.1	1,953.1	2,017.9	2,155.6
Capital WIP	205.8	100.0	100.0	100.0
Total Fixed Assets	1,931.9	2,053.1	2,117.9	2,255.6
Non-Current Investments	165.5	215.5	265.5	415.5
Inventory	1,090.2	1,226.5	1,511.6	1,686.2
Debtors	836.2	876.0	1,082.7	1,241.3
Loans and Advances	20.8	25.0	29.1	33.4
Investments & Other CA	824.9	654.1	698.9	790.3
Cash	72.3	68.3	88.3	182.2
Total Current Assets	2,908.4	2,966.1	3,541.7	4,044.5
Creditors	809.0	876.0	919.2	1,053.9
Provisions & other CL	140.7	187.7	216.5	248.2
Total Current Liabilities	949.7	1,063.8	1,135.7	1,302.1
Net Current Assets	1,958.7	1,902.4	2,406.0	2,742.4
Others Non-Current Assets	203.3	203.3	203.3	203.3
Application of Funds	4,259.4	4,374.3	4,992.7	5,616.8

Source: Company, ICICI Direct Research

Exhibit 11: Key ratios				
(Year-end March)	FY21	FY22E	FY23E	FY24E
Per share data (₹)				
EPS	9.9	13.0	16.1	18.7
Cash EPS	12.4	15.9	19.5	22.7
BV	75.7	77.9	89.2	101.9
DPS	6.3	4.8	4.8	6.0
Cash Per Share	19.5	22.5	25.9	29.8
Operating Ratios (%)				
EBITDA Margin	17.8	16.4	17.4	17.6
EBIT Margin	14.8	13.9	14.9	15.1
PAT Margin	11.5	10.9	11.6	11.8
Inventory days	85	70	74	72
Debtor days	65	50	53	53
Creditor days	63	50	45	45
Return Ratios (%)				
RoE	13.2	16.6	18.0	18.4
RoCE	17.2	21.5	23.4	24.2
RoIC	22.3	25.1	26.9	27.8
Valuation Ratios (x)				
P/E	63.9	48.6	39.2	33.6
EV / EBITDA	40.8	32.5	26.2	22.5
EV / Net Sales	7.2	5.3	4.6	4.0
Market Cap / Sales	7.2	5.3	4.6	4.0
Price to Book Value	8.3	8.1	7.1	6.2
Solvency Ratios				
Debt/EBITDA	0.1	0.1	0.1	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	2.3	2.3	2.6	2.6
Quick Ratio	1.1	1.1	1.3	1.3

Source: Company, ICICI Direct Research

Exhibit 12: ICICI Direct Consumer Discretionary universe

Sector / Company	CMP			M Cap			EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)			
	(₹)	TP(₹)	Rating	(₹ Cr)	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Asian Paints (ASIPAI)	2,979	3,665	Buy	2,85,686	33.4	39.5	50.4	89.1	75.4	59.1	61.5	53.2	42.4	25.0	27.6	30.7	29.6	32.6	36.8			
Astral Polytechnik (ASTPOL)	2,178	1,915	Hold	32,814	20.3	21.8	29.3	107.2	100.0	74.4	55.0	51.8	39.6	27.5	27.0	31.4	21.5	20.7	23.9			
Amber Enterprises (AMBEN)	3,012	3,130	Buy	9,472	24.7	45.7	88.2	121.9	65.9	34.1	38.8	27.5	16.5	7.7	11.5	18.3	5.2	9.2	15.2			
Bajaj Electricals (BAJELE)	1,160	1,280	Buy	13,188	16.5	23.8	35.7	64.9	45.0	30.0	40.9	29.6	20.7	15.1	20.0	26.1	10.7	16.8	20.6			
Berger Paints (BERPAI)	842	835	Hold	81,775	7.4	9.3	12.3	113.6	90.9	68.5	64.7	56.2	43.5	24.9	28.3	34.6	21.3	24.3	28.4			
Crompton Greaves(CROGR)	489	480	Buy	30,660	9.8	9.2	11.9	49.7	53.4	41.2	33.1	32.5	25.4	34.4	36.1	42.1	31.9	28.7	33.2			
Dixon Technologies (DIXTEC)	4,357	5,050	Buy	25,510	27.3	52.3	97.4	159.8	83.3	44.7	89.8	54.6	31.1	23.5	34.6	47.4	21.7	33.9	41.7			
EPL (ESSPRO)	256	275	Hold	8,077	7.7	9.2	11.4	33.0	27.7	22.5	13.5	12.2	10.2	16.2	17.6	20.6	14.8	16.3	18.7			
Havells India (HAVIND)	1,185	1,345	Buy	73,932	16.7	18.8	24.3	71.1	61.3	48.8	44.9	40.9	31.8	24.9	25.6	31.1	20.1	21.3	25.7			
Kansai Nerolac (KANNER)	630	750	Buy	33,952	9.9	13.0	16.1	63.9	48.6	39.2	40.8	32.5	26.2	17.2	21.5	23.4	13.2	16.6	18.0			
Moldtek Packaging (MOLPLA)	525	675	Buy	1,456	17.3	22.5	30.6	29.5	22.8	16.7	16.1	12.6	9.7	21.4	24.8	29.1	20.7	21.9	24.1			
Pidilite Industries (PIDIND)	2,263	2,035	Hold	1,14,915	22.2	26.3	31.8	102.0	86.0	71.2	55.9	47.3	39.9	23.8	23.9	29.9	20.2	20.1	25.2			
Polycab India (POLI)	1,864	2,100	Hold	28,138	59.4	59.2	77.7	31.8	31.9	24.3	23.3	21.5	16.6	21.9	21.1	24.2	18.5	16.5	18.5			
Supreme Indus (SUPIND)	2,117	2,450	Buy	26,892	77.0	64.1	75.9	27.3	32.8	27.6	20.2	23.0	18.8	33.1	25.1	25.9	30.9	23.4	23.5			
Symphony (SYMLIM)	954	1,050	Hold	6,674	15.3	20.8	33.0	64.9	47.8	30.9	48.7	37.6	24.3	15.2	22.1	31.8	14.9	21.1	30.1			
Time Techno (TIMTEC)	81	100	Buy	1,832	4.8	8.5	10.8	17.0	9.5	7.5	6.5	5.2	4.4	8.7	12.1	13.7	5.7	9.7	11.3			
V-Guard Ind (VGUARD)	247	320	Buy	10,579	4.7	5.5	7.3	59.0	50.4	38.1	37.3	35.4	27.3	23.9	25.1	29.0	16.7	19.2	22.5			
Voltas Ltd (VOLTAS)	1,053	1,150	Buy	34,826	16.0	21.2	28.9	65.9	49.8	36.4	50.8	41.8	29.8	15.0	19.5	23.0	10.6	14.4	17.1			

Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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