

December 13, 2021

## Company Update

■ Change in Estimates |  Target |  Reco

### Change in Estimates

	Current		Previous	
	FY23E	FY24E	FY23E	FY24E
<b>Rating</b>	BUY		ACCUMULATE	
<b>Target Price</b>	707		651	
Sales (Rs. m)	70,799	80,490	70,799	80,490
% Chng.	-	-	-	-
EBITDA (Rs. m)	11,426	13,490	11,426	13,490
% Chng.	-	-	-	-
EPS (Rs.)	14.1	16.8	14.1	16.8
% Chng.	-	-	-	-

### Key Financials - Standalone

Y/e Mar	FY21	FY22E	FY23E	FY24E
Sales (Rs. m)	46,900	60,617	70,799	80,490
EBITDA (Rs. m)	8,479	7,995	11,426	13,490
Margin (%)	18.1	13.2	16.1	16.8
PAT (Rs. m)	5,566	5,072	7,574	9,067
EPS (Rs.)	10.3	9.4	14.1	16.8
Gr. (%)	4.0	(8.9)	49.3	19.7
DPS (Rs.)	4.4	4.5	5.0	6.0
Yield (%)	0.7	0.8	0.8	1.0
RoE (%)	14.1	12.0	16.5	17.7
RoCE (%)	18.0	15.3	21.2	22.7
EV/Sales (x)	6.7	5.2	4.4	3.8
EV/EBITDA (x)	37.1	39.1	27.1	22.8
PE (x)	57.8	63.4	42.5	35.5
P/BV (x)	7.9	7.4	6.7	5.9

### Key Data

KANE.BO | KNPL IN

52-W High / Low	Rs.678 / Rs.520
Sensex / Nifty	58,787 / 17,511
Market Cap	Rs.322bn / \$ 4,244m
Shares Outstanding	539m
3M Avg. Daily Value	Rs.290.38m

### Shareholding Pattern (%)

Promoter's	74.99
Foreign	3.40
Domestic Institution	13.34
Public & Others	8.27
Promoter Pledge (Rs bn)	-

### Stock Performance (%)

	1M	6M	12M
Absolute	0.4	3.1	7.7
Relative	3.0	(8.2)	(15.8)

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## Can growth revival reduce PE gap with APNT?

### Quick Pointers:

- Kansai trades at 45% PE discount to APNT versus 20% for last 10 years
- Kansai has filled in major product gaps in Industrial paints, waterproofing and wood coatings in past couple of years
- Margins have largely bottomed out from more than a decade low levels post 18-20% price increase in current year with QoQ improvement likely from 3Q

**Kansai's PE discount to APNT at 45% is at the lowest ebb in the last decade as it had multiple pain points across portfolio. However, we believe worst is over as 1) resolution of semiconductor issue will boost auto paints demand 2) gradual pick up in decorative segments partly aided by waterproofing and wood coatings segment and 3) increasing presence in niche industrial paints like performance coatings, coil coatings, rebar coatings and products for Infra and railways. We expect margins to bottom out in 3Q post 18-20% average price increase in current year and estimate 21% PAT CAGR over FY21-24. We value the stock at 42x FY24 and arrive at target price of Rs707 (Rs650@42xSept23 EPS earlier). our sensitivity analysis shows that volume growth revival in Kansai can reduce PE gap with APNT and provide upto 40% upside at 10-year average PE discount at TP of APNT (Rs3675@63x FY24). Upgrade to BUY.**

- **Kansai PE discount to APNT has increased to 34% in past 3 years:** Kansai Nerolac has hugely underperformed APNT in past few years with underperformance of 68-72% over 1,3 and 5 years' as against an average of 20% discount over past 10 years. APNT has always traded at premium due to **1) market leadership 2) decorative focus (95% of sales) which has higher pricing power and profitability. We believe increase in PE discount is led by 1) slow growth in Industrial paints which is 45% of Kansai sales 2) huge market growth in economy segment post GST where Kansai has weak presence and 3) lack of presence in high growth waterproofing segment.**
- **Worst seems over as Kansai getting its act together:** We believe that worst is over for Kansai as **1) auto paints demand is set to bounce back as shortage of semiconductors and components gets addressed in coming few months 2) High growth in Industrial paint segments like Power and performance coatings, ARF, coil coatings, rebar, floor coatings, Bridges, Metros, pipe, Railways coatings, sealants and underbody segments in automotive and Water-based Black Coating for Engines and 3) Kansai entered high growth waterproofing by acquisition of Nerolac Perma, B2B and B2C adhesives market in JV with Nerofix and wood coatings in tie up with ICRO.**
- **Sensitivity analysis suggest scope for higher returns:** We believe growth revival in kansai (both decorative and auto paints) has the potential to bridge the PE discount gap to APNT. We believe reduction in PE discount to 30%, 25% and 20% to target PE of APNT can increase the target price to Rs749, 802, 856 which implies an upside of 26-45% from CMP.

## Kansai PE discount to APNT has increased in past 3 years

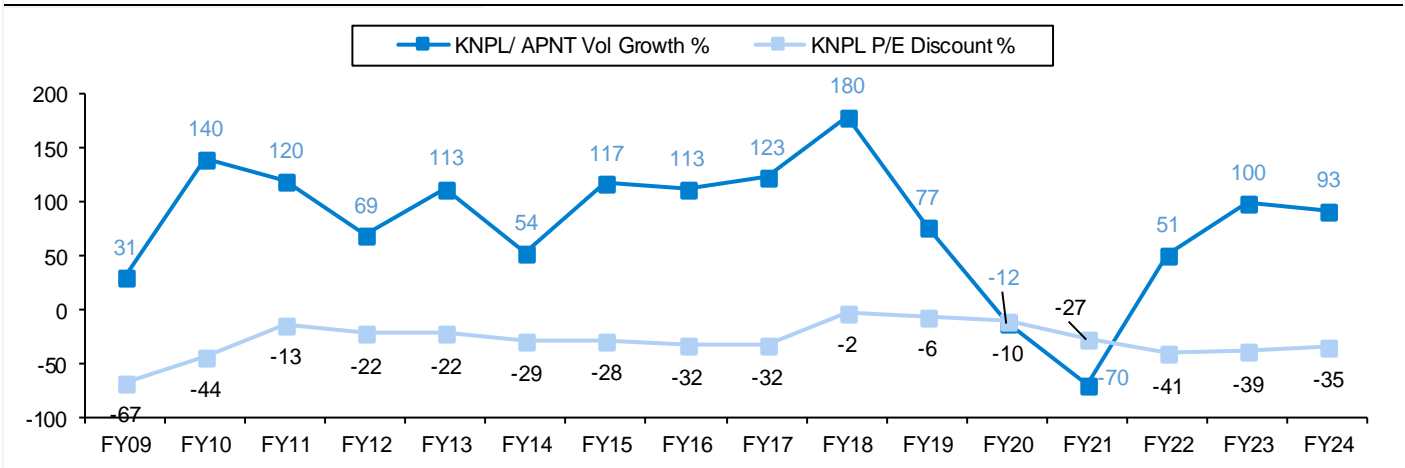
Kansai Nerolac has hugely underperformed APNT in past few years with underperformance of 68-72% over 1,3 and 5 years' period. Kansai historically trades at discount to APNT which has averaged at 20% excluding Lehman crisis period. Historical discounting has been due to **1)** market leadership position of APNT **2)** 45% share of Industrial paints in Kansai which have lesser pricing power and more margins volatility and **3)** aggression by APNT in expansion of distribution and innovations etc.

**Exhibit 1: APNT has outperformed Kansai by 68-72% in the past few years**

	KNPL			APNT			KNPL / APNT
	Price	CMP	Return	Price	CMP	Return	
1 Year	525	597	13.7%	2200	3283	49.2%	-72.1%
3 Year	421	597	41.8%	1321	3283	148.5%	-71.9%
5 Year	341	597	75.1%	962	3283	241.3%	-68.9%

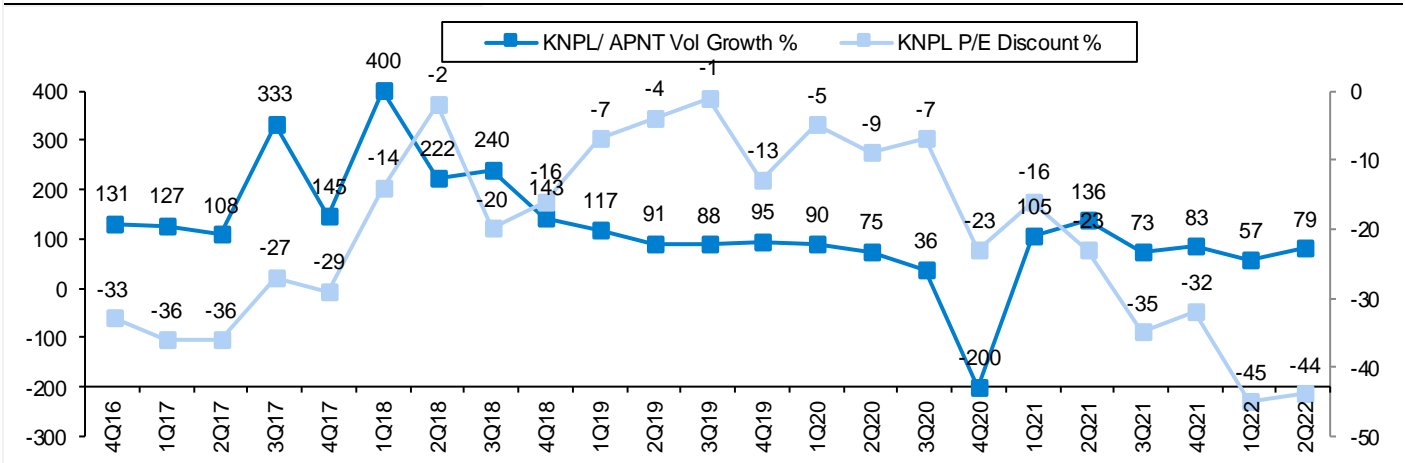
Source: Company, PL

**Exhibit 2: Volume growth underperformance has led to higher PE discounts for KNPL v/s APNT**



Source: Company, PL

**Exhibit 3: KNPL/APNT average discount is 20%, current discounts at 10-year high (1 year Forward)**



Source: Company, PL

We note that Kansai grew volumes faster than APNT in 7 out of 9 years between 2010 to 2018, however post that it has seen a sharp decline in volume growth while APNT saw a sharp re-bounce since 2018. The PE discount which averaged around 20% from 2011 to 2019 has since increased to current levels of 45%. We believe superior performance by APNT and relatively subdued growth in KNPL has led to this PE gap widening. Even in the current quarter whereas APNT reported 34% volume growth, Kansai volumes grew by 18% in decorative segment.

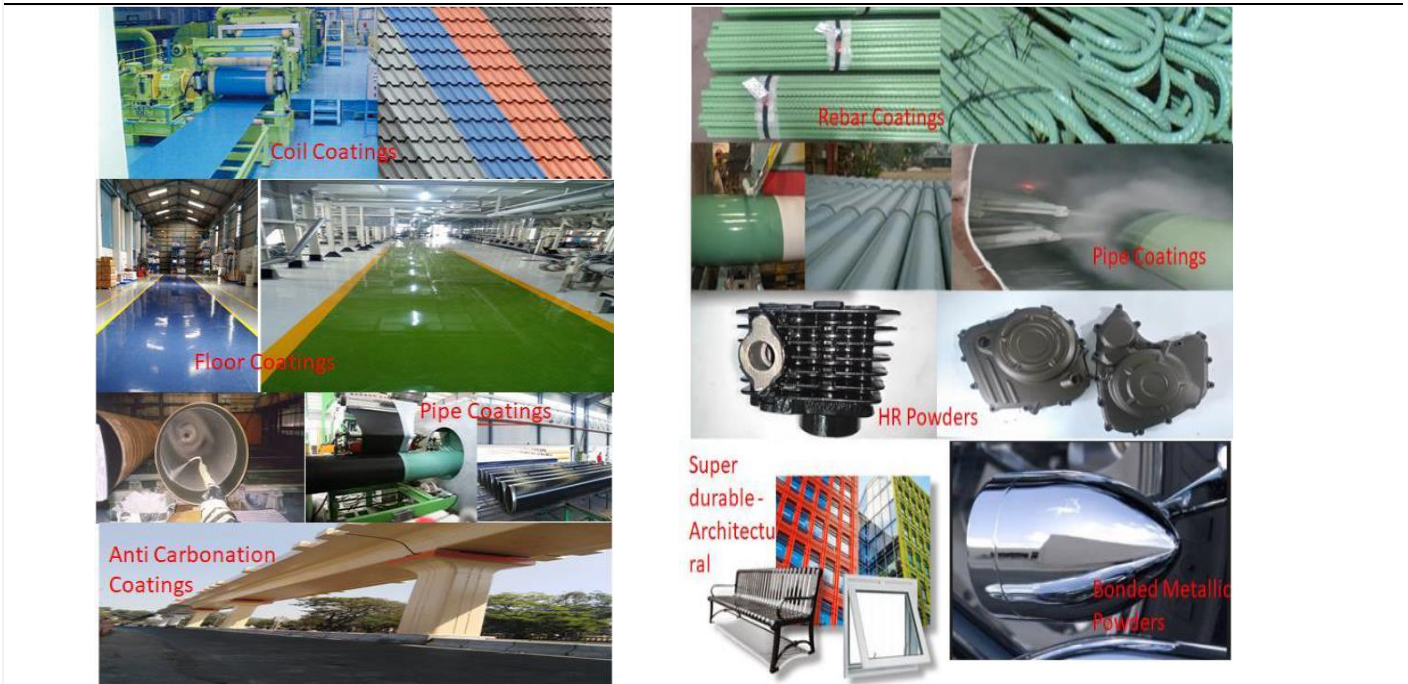
- **Slowdown in auto paints:** Kansai is market leader in auto paints which are ~70% of Industrial paints sales (45% of total sales). Kansai is the largest supplier of auto paints to Japanese OEM's given strong global tie ups with parent (Kansai Japan). Over the years it has created a niche in auto paints and has increased share in non-Japanese OEM's. Consequently, it has suffered in past 3 years due to demand slowdown in 2019, Covid first wave in 2020 and second wave and semiconductor shortage in current year.
- **Huge growth in economy segment post GST:** Post GST phase saw significant thrust by APNT on economy segment where it expanded its range of products under Tractor emulsions. Kansai launched Soldier in the economy segment but it could only make limited impact in segment dominated by APNT and Berger. This led to APNT volumes growing faster than KNPL.
- **Delay in entering waterproofing and allied segments:** Waterproofing is an emerging segment as it is used at **1)** time of construction and **2)** at the time of painting/ repainting. Sensing this opportunity APNT entered the waterproofing segment in 2014 which has been dominated by Dr. Fixit (Pidilite) and Sunanda. APNT and Berger initially focused on the waterproofing jobs carried out at the time of painting and not construction. Overtime APNT has achieved annual sales of ~Rs12-15bn in this segment. Kansai has been very slow and did not have a presence even after 5/6 years of APNT and Berger having entered the segment which impacted its growth.

## Worst Seems over for Kansai

Kansai has seen a slow growth phase form past few years, however we believe that worst is over and growth rates will revive over next few quarters.

- **Auto growth to bounce back once component shortage ends:** Kansai has suffered in auto paints in 1H22 due to shortage of semiconductors which resulted in loss of production of 60% and 40% in Sept/Oct at its largest customer, Maruti Suzuki. Although semiconductor shortage is likely to sustain for some more time, worst will likely be over by 4Q22. We believe pickup in growth in auto paints will boost growth rates on lower base in FY23.
- **Non-Auto industrial coatings hold promise:** Kansai has been focusing on niche non-auto paints segments like Power and performance coatings, ARF, coil coatings, rebar and floor coatings. It has identified and focused on Bridges, Metros, pipe and Railways coatings. Kansai entered sealants and underbody segments in automotive and Water-based Black Coating for Engines and Matt Coating System for Helmets. Entry into high growth niche segments and economic recovery post covid augurs well for growth.

Exhibit 4: KNPL has forayed into emerging segments like Rebar Coatings, Pipe coatings, floor coatings etc.



Source: Company, PL

- **Kansai has entered waterproofing, Adhesives and wood coatings**
  - **Waterproofing:** KNPL acquired Perma constructions in FY20 and launched a new range of construction chemicals product under the Nerolac Perma Brand. It now has full range of products which caters to pre and post construction requirements with sales of R359mn in FY21.
  - **Adhesives:** KNPL has set up a 60% JV, Neroflx (Rs120mn) with Polygel for entry in B2B and B2C adhesives market to capitalize on supply chain and 'go to market' capabilities.
  - **ICRO tie up for wood coatings:** KNPL entered into a tie up with ICRO Coatings, Italy for launch of premium wood coatings, a high growth segment which has seen entry of Pidilite (ICA JV) and Sirca (JV) paints. KNPL is looking at wood coatings as a future growth area and is already setting up a production line at its Jainpur facility

Exhibit 5: Nerolac Perma JV enabled entry in Adhesives and Construction aid



Source: Company, PL



Exhibit 6: Foray into new segments – Wood coatings and adhesives

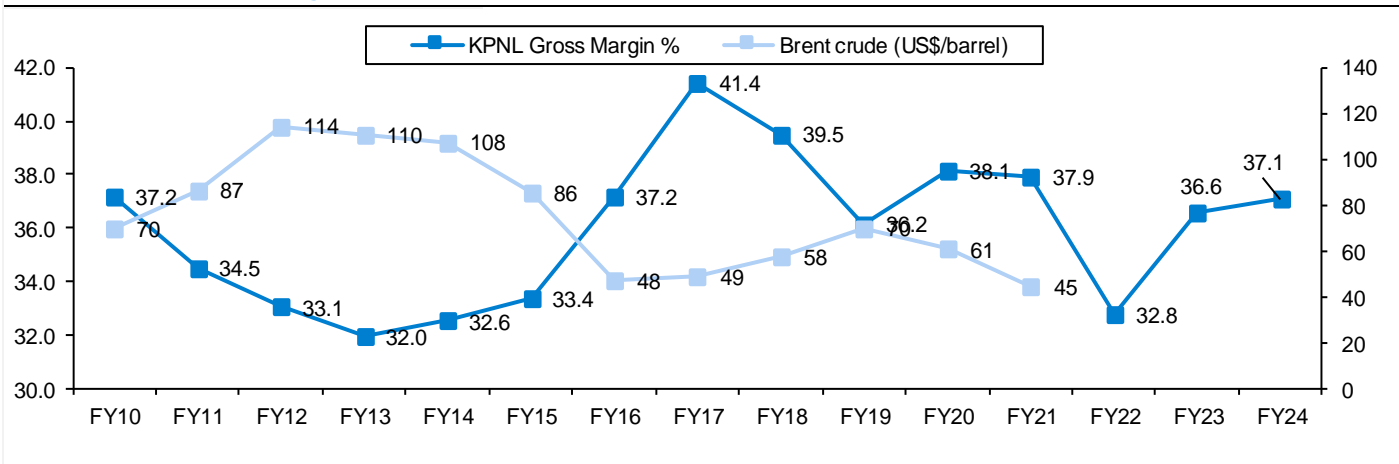


Source: Company, PL

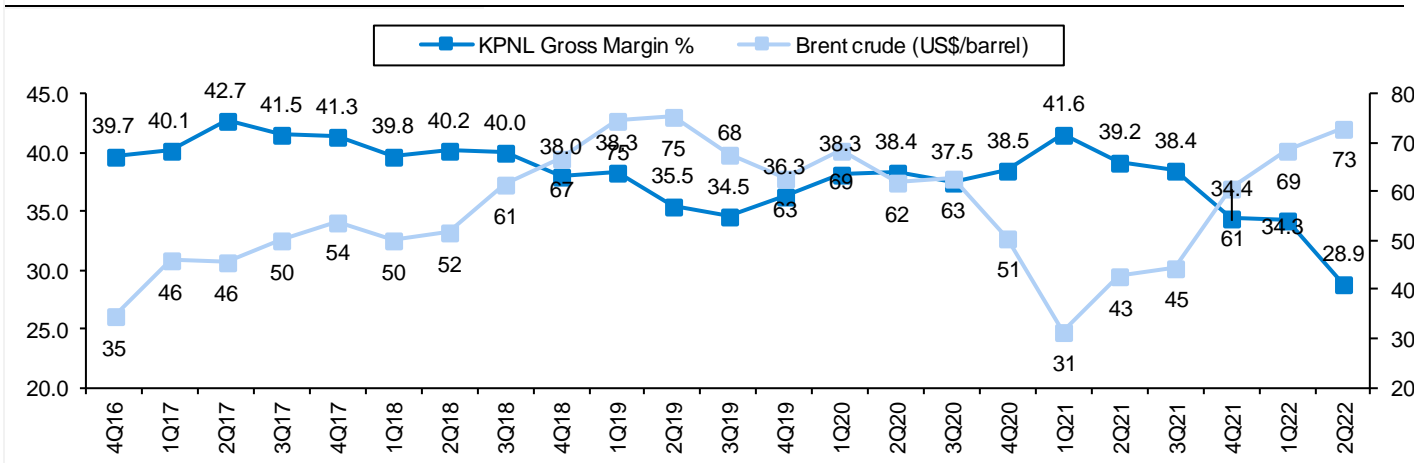
### Margins have bottomed out, pick up in volume growth can reduce PE gap with APNT

Kansai has higher correlation of input costs and margins as 45% of sales are that of Industrial paints where the pass through of input costs come after a lag given B2B nature and limited pricing power. Kansai's Gross margins in 2Q22 have declined to 28.9%, 100bps lower than last 10 year low margins of 29.9% achieved in 2QFY12, despite 7% price increase taken by Industry in 1HFY22, as input cost inflation for paints is at 25-30 year high. We have seen a price increase of 7-10% in November and 3-5% in Dec across paint segments which will partly restore 10.3% decline in 2Q margins. We believe margins are close to bottom and expect QoQ improvement to set in from 3Q22 while YoY margin expansion might take another quarter or so. We expect gross margins to expand from 32.8% in FY22 to 36.6% and 37.1% in FY23 and FY24.

Exhibit 7: FY22 Gross margins will be the lowest since FY13



Source: Company, PL

**Exhibit 8: Kansai margins hit is higher during crude spike on account of higher auto/industrial contribution**


Source: Company, PL

We note that pick up in decorative volume growth for KNPL has the potential to reduce the PE multiple gap with APNT. We believe spruced up portfolio with waterproofing and wood coatings and bounce back in Industrial paints can push volume growth on a low base. As we expect KNPL volume growth to catch up, PE discount to APNT might come down over time. Our target price of APNT (DCF based) at Rs3675 values the stock at 63.6x FY24 EPS. We value kansai at 42x FY24 in the base case and arrive at a target price of Rs707.

As of now we are unsure of the market trends, whether Kansai PE multiple will move up or APNT comes down over a period of time.

We do the sensitivity of kansai stock price versus APNT with PE multiple discount by taking APNT as a base. At the current rate of discount based on 42x FY24 we arrive at a target price of Rs707, 18% upside in base case.

**Exhibit 9: Sensitivity of Kansai stock price versus discount to APNT**

APNT Target PE	63.6	Target Price	3675
Kansai	PE	Discount to APNT	Target Price
	42.0	-34%	707
	44.5	-30%	749
	47.7	-25%	802
	50.9	-20%	856

Source: PL

## Financials

### Income Statement (Rs m)

Y/e Mar	FY21	FY22E	FY23E	FY24E
<b>Net Revenues</b>	<b>46,900</b>	<b>60,617</b>	<b>70,799</b>	<b>80,490</b>
YoY gr. (%)	(5.1)	29.2	16.8	13.7
Cost of Goods Sold	29,116	40,741	44,859	50,661
Gross Profit	17,784	19,875	25,940	29,829
Margin (%)	37.9	32.8	36.6	37.1
Employee Cost	2,586	3,122	3,646	4,185
Other Expenses	4,308	5,122	6,159	6,922
<b>EBITDA</b>	<b>8,479</b>	<b>7,995</b>	<b>11,426</b>	<b>13,490</b>
YoY gr. (%)	8.5	(5.7)	42.9	18.1
Margin (%)	18.1	13.2	16.1	16.8
Depreciation and Amortization	1,390	1,533	1,667	1,827
<b>EBIT</b>	<b>7,089</b>	<b>6,461</b>	<b>9,759</b>	<b>11,662</b>
Margin (%)	15.1	10.7	13.8	14.5
Net Interest	75	94	130	161
Other Income	387	411	492	615
<b>Profit Before Tax</b>	<b>7,401</b>	<b>6,778</b>	<b>10,121</b>	<b>12,116</b>
Margin (%)	15.8	11.2	14.3	15.1
Total Tax	1,835	1,706	2,547	3,050
Effective tax rate (%)	24.8	25.2	25.2	25.2
<b>Profit after tax</b>	<b>5,566</b>	<b>5,072</b>	<b>7,574</b>	<b>9,067</b>
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
<b>Adjusted PAT</b>	<b>5,566</b>	<b>5,072</b>	<b>7,574</b>	<b>9,067</b>
YoY gr. (%)	4.0	(8.9)	49.3	19.7
Margin (%)	11.9	8.4	10.7	11.3
Extra Ord. Income / (Exp)	(108)	-	-	-
<b>Reported PAT</b>	<b>5,458</b>	<b>5,072</b>	<b>7,574</b>	<b>9,067</b>
YoY gr. (%)	1.9	(7.1)	49.3	19.7
Margin (%)	11.6	8.4	10.7	11.3
Other Comprehensive Income	2	-	-	-
Total Comprehensive Income	5,460	5,072	7,574	9,067
<b>Equity Shares O/s (m)</b>	<b>539</b>	<b>539</b>	<b>539</b>	<b>539</b>
<b>EPS (Rs)</b>	<b>10.3</b>	<b>9.4</b>	<b>14.1</b>	<b>16.8</b>

Source: Company Data, PL Research

### Balance Sheet Abstract (Rs m)

Y/e Mar	FY21	FY22E	FY23E	FY24E
<b>Non-Current Assets</b>				
<b>Gross Block</b>	<b>25,781</b>	<b>28,349</b>	<b>30,859</b>	<b>33,369</b>
Tangibles	25,593	28,151	30,651	33,151
Intangibles	188	198	208	218
<b>Acc: Dep / Amortization</b>	<b>9,896</b>	<b>11,132</b>	<b>12,458</b>	<b>13,897</b>
Tangibles	9,719	10,953	12,275	13,709
Intangibles	177	179	183	188
<b>Net fixed assets</b>	<b>15,885</b>	<b>17,217</b>	<b>18,401</b>	<b>19,472</b>
Tangibles	15,874	17,197	18,376	19,442
Intangibles	12	19	26	30
Capital Work In Progress	2,058	2,000	2,000	2,000
Goodwill	-	-	-	-
Non-Current Investments	1,801	1,813	1,826	1,839
Net Deferred tax assets	(884)	(928)	(974)	(1,023)
Other Non-Current Assets	3,408	2,797	3,320	3,758
<b>Current Assets</b>				
Investments	6,681	8,395	10,643	13,409
Inventories	10,902	12,048	12,669	14,406
Trade receivables	8,362	9,077	10,606	11,621
Cash & Bank Balance	753	879	1,009	1,173
Other Current Assets	2,179	1,818	2,124	2,415
<b>Total Assets</b>	<b>52,091</b>	<b>56,104</b>	<b>62,669</b>	<b>70,174</b>
<b>Equity</b>				
Equity Share Capital	539	539	539	539
Other Equity	40,270	42,917	47,796	53,629
<b>Total Network</b>	<b>40,809</b>	<b>43,456</b>	<b>48,335</b>	<b>54,168</b>
<b>Non-Current Liabilities</b>				
Long Term borrowings	-	50	50	50
Provisions	-	-	-	-
Other non current liabilities	-	-	-	-
<b>Current Liabilities</b>				
ST Debt / Current of LT Debt	-	-	-	-
Trade payables	8,090	9,370	10,766	12,159
Other current liabilities	1,581	1,809	2,053	2,284
<b>Total Equity &amp; Liabilities</b>	<b>52,091</b>	<b>56,104</b>	<b>62,669</b>	<b>70,174</b>

Source: Company Data, PL Research

**Cash Flow (Rs m)**

Y/e Mar	FY21	FY22E	FY23E	FY24E
PBT	7,251	6,778	10,121	12,116
Add. Depreciation	1,390	1,533	1,667	1,827
Add. Interest	75	94	130	161
Less Financial Other Income	387	411	492	615
Add. Other	781	408	(490)	(403)
Op. profit before WC changes	9,497	8,813	11,428	13,702
Net Changes-WC	(4,259)	(1,706)	(3,073)	(4,195)
Direct tax	(1,835)	(1,706)	(2,547)	(3,050)
<b>Net cash from Op. activities</b>	<b>3,403</b>	<b>5,401</b>	<b>5,807</b>	<b>6,457</b>
Capital expenditures	(1,713)	(2,806)	(2,851)	(2,898)
Interest / Dividend Income	-	-	-	-
Others	(156)	-	-	-
<b>Net Cash from Inv. activities</b>	<b>(1,869)</b>	<b>(2,806)</b>	<b>(2,851)</b>	<b>(2,898)</b>
Issue of share cap. / premium	-	-	-	-
Debt changes	-	50	-	-
Dividend paid	(2,371)	(2,425)	(2,695)	(3,234)
Interest paid	(75)	(94)	(130)	(161)
Others	3	-	(1)	-
<b>Net cash from Fin. activities</b>	<b>(2,443)</b>	<b>(2,469)</b>	<b>(2,825)</b>	<b>(3,395)</b>
<b>Net change in cash</b>	<b>(910)</b>	<b>126</b>	<b>130</b>	<b>164</b>
Free Cash Flow	1,690	2,595	2,955	3,559

Source: Company Data, PL Research

**Quarterly Financials (Rs m)**

Y/e Mar	Q3FY21	Q4FY21	Q1FY22	Q2FY22
<b>Net Revenue</b>	<b>14,734</b>	<b>13,305</b>	<b>13,216</b>	<b>15,207</b>
YoY gr. (%)	18.0	34.7	121.0	18.1
Raw Material Expenses	9,071	8,729	8,679	10,810
Gross Profit	5,663	4,576	4,537	4,397
Margin (%)	38.4	34.4	34.3	28.9
<b>EBITDA</b>	<b>2,898</b>	<b>2,034</b>	<b>1,897</b>	<b>1,647</b>
YoY gr. (%)	51.0	59.1	135.7	(36.5)
Margin (%)	19.7	15.3	14.4	10.8
Depreciation / Depletion	336	405	377	380
<b>EBIT</b>	<b>2,562</b>	<b>1,629</b>	<b>1,520</b>	<b>1,267</b>
Margin (%)	17.4	12.2	11.5	8.3
Net Interest	10	40	27	23
Other Income	141	124	97	62
<b>Profit before Tax</b>	<b>2,692</b>	<b>1,713</b>	<b>1,590</b>	<b>1,306</b>
Margin (%)	18.3	12.9	12.0	8.6
Total Tax	673	435	401	321
Effective tax rate (%)	25.0	25.4	25.2	24.5
<b>Profit after Tax</b>	<b>2,019</b>	<b>1,278</b>	<b>1,189</b>	<b>985</b>
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
<b>Adjusted PAT</b>	<b>2,019</b>	<b>1,278</b>	<b>1,189</b>	<b>985</b>
YoY gr. (%)	64.6	78.8	178.3	(41.8)
Margin (%)	13.7	9.6	9.0	6.5
Extra Ord. Income / (Exp)	-	-	-	-
<b>Reported PAT</b>	<b>2,019</b>	<b>1,278</b>	<b>1,189</b>	<b>985</b>
YoY gr. (%)	64.6	78.8	178.3	(37.8)
Margin (%)	13.7	9.6	9.0	6.5
Other Comprehensive Income	(5)	15	(2)	(2)
<b>Total Comprehensive Income</b>	<b>2,015</b>	<b>1,293</b>	<b>1,187</b>	<b>984</b>
Avg. Shares O/s (m)	539	539	539	539
<b>EPS (Rs)</b>	<b>3.7</b>	<b>2.4</b>	<b>2.2</b>	<b>1.8</b>

Source: Company Data, PL Research

**Key Financial Metrics**

Y/e Mar	FY21	FY22E	FY23E	FY24E
<b>Per Share(Rs)</b>				
EPS	10.3	9.4	14.1	16.8
CEPS	12.9	12.3	17.1	20.2
BVPS	75.7	80.6	89.7	100.5
FCF	3.1	4.8	5.5	6.6
DPS	4.4	4.5	5.0	6.0
<b>Return Ratio(%)</b>				
RoCE	18.0	15.3	21.2	22.7
ROIC	16.7	14.7	21.3	23.8
RoE	14.1	12.0	16.5	17.7
<b>Balance Sheet</b>				
Net Debt : Equity (x)	(0.2)	(0.2)	(0.2)	(0.3)
Net Working Capital (Days)	87	71	64	63
<b>Valuation(x)</b>				
PER	57.8	63.4	42.5	35.5
P/B	7.9	7.4	6.7	5.9
P/CEPS	12.9	12.3	17.1	20.2
EV/EBITDA	37.1	39.1	27.1	22.8
EV/Sales	6.7	5.2	4.4	3.8
Dividend Yield (%)	0.7	0.8	0.8	1.0

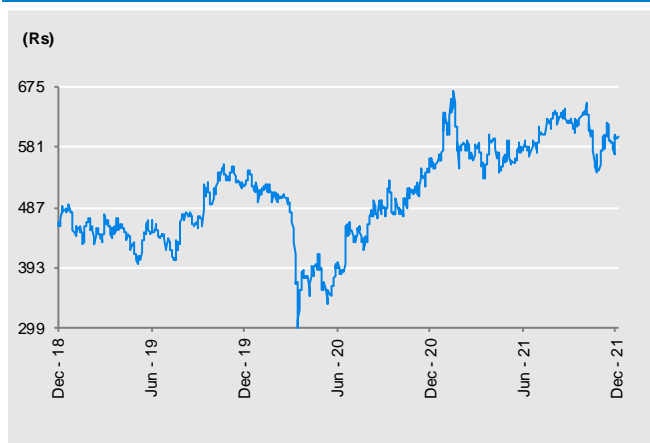
Source: Company Data, PL Research

**Key Operating Metrics**

Y/e Mar	FY21	FY22E	FY23E	FY24E
Volume Gr %	(9.5)	18.0	15.0	13.0
Gross Margins %	37.9	32.8	36.6	37.1

Source: Company Data, PL Research



**Price Chart**
**Recommendation History**


No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	27-Oct-21	Accumulate	651	560
2	6-Oct-21	Accumulate	661	646
3	2-Aug-21	Accumulate	661	628
4	5-Jul-21	Accumulate	620	587
5	10-May-21	Accumulate	620	566
6	7-Apr-21	BUY	653	596
7	3-Feb-21	BUY	653	579
8	7-Jan-21	UR	-	613

**Analyst Coverage Universe**

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Asian Paints	BUY	3,675	3,002
2	Avenue Supermarts	Accumulate	5,359	5,324
3	Bajaj Electricals	Accumulate	1,230	1,092
4	Britannia Industries	Accumulate	4,093	3,622
5	Burger King India	BUY	242	163
6	Colgate Palmolive	Accumulate	1,852	1,532
7	Crompton Greaves Consumer Electricals	BUY	530	451
8	Dabur India	Accumulate	647	598
9	Emami	Accumulate	624	536
10	Havells India	Accumulate	1,400	1,286
11	Hindustan Unilever	Accumulate	2,930	2,547
12	ITC	BUY	270	238
13	Jubilant FoodWorks	Accumulate	4,111	3,965
14	Kansai Nerolac Paints	Accumulate	651	560
15	Marico	Hold	544	564
16	Mold-tek Packaging	BUY	725	669
17	Nestle India	Accumulate	19,501	18,965
18	Pidilite Industries	Hold	2,491	2,474
19	Titan Company	BUY	2,651	2,460
20	Voltas	Hold	1,200	1,245
21	Westlife Development	Accumulate	603	574

**PL's Recommendation Nomenclature (Absolute Performance)**

<b>Buy</b>	: > 15%
<b>Accumulate</b>	: 5% to 15%
<b>Hold</b>	: +5% to -5%
<b>Reduce</b>	: -5% to -15%
<b>Sell</b>	: < -15%
<b>Not Rated (NR)</b>	: No specific call on the stock
<b>Under Review (UR)</b>	: Rating likely to change shortly



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