

Industrial segment drives performance...

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

Q1FY23 Results: Favourable base and strong demand of industrial paints drives overall performance.

- Revenue increased 49% YoY to ₹ 1945 crore in Q1FY23 led by volume growth of ~30%. As per our estimates, industrial and decorative paint volumes are up 40% and 23% YoY, respectively
- Gross margin remained under pressure due to delay in price hikes. However, EBITDA margin fall was restricted at 124 bps YoY to 13.1% through savings in employee costs and other expenses
- PAT up 37% YoY to ₹ 163 crore, tracking topline growth

What should investors do? Kansai's share price has grown at CAGR of ~2% over the past five years (from ~₹ 455 in August 2017 to ~₹ 502 levels in August 2022).

- We change our rating on stock from REDUCE to HOLD

Target Price and Valuation: We value Kansai at ₹ 560 i.e. 42x P/E on FY24E EPS.

Key triggers for future price performance:

- We believe regaining of lost market share in decorative paint (~55% of total revenue) will be key trigger for the 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 Asian Paints in our coverage universe. Asian Paints (APL) is India's largest decorative paint company. It derives ~98% revenue from the paints business. Robust b/s with RoCE, RoE of 30%, 25%, respectively

- BUY with a target price of ₹ 3700



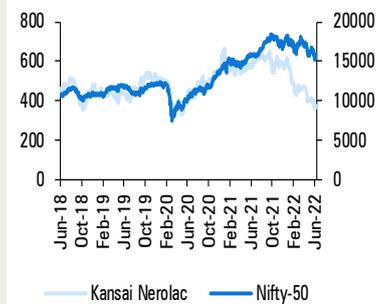
Particulars

Particular	Amount
Market Capitalization (₹ Crore)	27,053.8
Debt (FY22) (₹ Crore)	0.0
Cash & Inv (FY22) (₹ Crore)	310.1
EV (₹ Crore)	26,743.7
52 week H/L	675/358
Equity capital (₹ Crore)	53.9
Face value (₹)	1.0

Shareholding pattern

(in %)	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
Promoter	75.0	75.0	75.0	75.0	75.0
FII	3.7	3.4	3.6	3.6	3.3
DII	11.6	13.3	13.2	13.2	13.4
Others	9.7	8.3	8.2	8.3	8.3

Price Chart



Recent event & key risks

- **Key Risk:** (i) Faster recovery in decorative paints segment (ii) Higher ad expenses to keep EBITDA margin under check

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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	7447.8	8393.4	18.8
EBITDA	742.0	781.6	843.5	647.3	-2.4	995.7	1161.1	33.9
EBITDA Margin (%)	14.3	15.8	17.7	10.9		13.4	13.8	
Net Profit	467.3	535.4	530.6	374.3	-5.8	624.2	722.4	38.9
EPS (₹)	8.7	9.9	9.8	6.9		11.6	13.4	
P/E (x)	57.9	50.5	51.0	72.3		43.3	37.5	
Price/Book (x)	7.9	7.1	6.6	6.5		6.4	5.8	
Mcap/Sales (x)	5.2	5.5	5.7	4.5		3.6	3.2	
RoE (%)	13.6	14.1	13.2	9.2		14.7	15.4	
RoCE (%)	20.2	17.5	17.2	12.1		19.1	20.2	

Key takeaways of recent quarter & conference call highlights

Q1FY23 Results: Favourable base, demand revival drive topline

- Kansai's Q1FY23 performance came in better than our estimates. Revenues were up 49% YoY to ~₹ 1945 crore led by volume growth of ~30%. Favourable base and revival in demand for industrial paints helped drive volume growth for the company. We believe industrial and decorative paints volume increased by 40% and 23% YoY, respectively, in Q1FY23 on revival of demand of automotive industry and new product launches. The company has taken price hike of ~2% in Q1FY23
- The gross margin declined 430 bps YoY to ~30% due to higher raw material costs and delay in price hikes. However, savings in employee costs and other expenses (through better operating leverage) restricted EBITDA margin fall at 124 bps YoY to 13.1%
- PAT up ~37% YoY to ~₹ 163 crore, tracking higher sales in Q1FY23

Q1FY23 Earnings Conference Call highlights

Demand Outlook

- **Decorative Paints Segment:**
 - There is higher demand for decorative paints from metro and Tier-1 cities
 - Kansai Nerolac has expanded its reach in institutional business in metro cities
 - The company plans to add more products every quarter in premium and super premium category in this segment. New products added in the previous quarter have seen good growth
 - Among listed paint companies, Kansai Nerolac has ~10% market share in this segment
- **Industrial paints segment:**
 - There is a revival in demand in this segment led by easing of chip shortages in the automotive industry. The revenue contribution from this segment is ~45%. Out of this, the automotive industry contributes ~70% to revenue from the industrial paints segments
 - The company has stopped production of low margin products in this segment
 - KNL is planning to introduce high technology products in this segment to drive demand
 - The company is going to increase its focus on premium segments of performance coatings
- **Margins:**
 - KNL has taken ~2% price increase in Q1FY23
 - The company is moving towards high technology & premium products to improve its margins
 - More price increases will be required in industrial paints segment to offset inflation
 - The product mix is inferior in the second quarter of financial compared to the first quarter due to seasonality. Hence, scope for improvement in margins is low in Q2FY23. However, due to pick up in demand for industrial paints, margins can see some improvement. The company generally has a better product mix in the first and third quarter of the financial year
 - EIBTDA margin gap between Industrial and decorative ranges between 7-8 percentage point. The company focuses on reducing the gap by launching superior products
- **Distribution Expansion:**
 - In the decorative paints, ~40% revenue comes from the tier 1,2 cities (lower than industry average of 55%) while small cities & rural contributes 60% to the company's topline
 - The company had ~28000 dealers in the decorative paints segment in FY22. In Q1FY23, the distribution reach has increased by higher double digit

- **Capex**
 - KNL envisages capex of ₹ 290 crore (excluding maintenance capex of ₹ 60 crore) over FY23E-24E to increase its water based paints capacity
 - The industrial paint capacity is enough to serve rising demand from the OEMs for the next two years

Exhibit 1: Peer comparison

Company	Mcap ₹ cr	Revenue				EBITDA margin				PAT				RoCE				RoE				PE			
		FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E
Asian Paints	3,29,608	21713	29101	35169	38675	22	17	19	21	3207	3085	4521	5431	30	27	36	39	25	23	30	32	103	107	73	61
Berger Paints	63,620	6818	8762	9870	11203	17	15	15	16	720	833	960	1151	25	23	28	30	21	21	25	27	88	76	66	55
Kansai Nero	27,054	4771	5949	7448	8393	18	11	13	14	531	374	624	722	17	12	19	21	13	9	15	16	51	72	43	37
Pidilite Ind	1,27,966	7293	9921	10874	12126	23	19	18	20	1126	1207	1319	1634	24	22	23	26	20	19	19	21	114	106	97	78

Source: Bloomberg, ICICI Direct Research

Kansai Nerolac’s Q1FY23 performance came in better than our estimates driven by strong recovery in both industrial as well as decorative paints demand. Revival in automotive industry and launch of new product helped drive the performance of the industrial paints in Q1FY23. The company has remained market leader with ~50% value market share in the automotive paints. On the decorative paint segment, we believe the volume growth (of ~23%) is much lower than industry leader considering slow launches of new products. On a three year basis, Kansai’s overall revenue CAGR of 10% is much lower than 20% CAGR Asian Paints. 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. While KNL’s decorative paint contribution has gone up from 51% to 55%, revenue growth and profitability has been lower compared to the leader. Therefore, the valuation gap persists. We revise our revenue, earning estimate upward for FY23E-24E factoring in Q1FY23 performance and ease in raw material prices. We change our rating from REDUCE to **HOLD** on the stock with a revised target price of ₹ 560/share (valuing stock at 42x FY24E, 35% discount to Asian Paints).

Exhibit 2: Variance Analysis

	Q1FY23	Q1FY23E	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	Comments
Net Revenue	1,944.6	1,823.7	1,301.2	49.4	1,412.8	37.6	Favourable base and revival in the industrial paints demand drives topline growth
Other Income	4.4	10.9	9.7	-54.7	7.6	-42.5	
Raw Material Exp	1,362.9	1,245.2	856.0	59.2	1,017.7	33.9	Delay in price hike put dents on gross margin by ~430 bps YoY
Employee Exp	77.5	79.3	69.8	11.1	96.6	-19.8	
Manuf & Other exp	248.6	272.1	188.2	32.1	215.6	15.3	
Total Expenses	1,689.0	1,596.6	1,114.1	51.6	1,329.9	27.0	
EBITDA	255.6	227.1	187.1	36.6	82.9	208.2	
EBITDA Margin (%)	13.1	12.5	14.4	-124 bps	5.9	727 bps	Savings in employee costs and other expenses restricted EBITDA margin fall at 124 bps YoY
Depreciation	39.3	45.6	35.8	9.8	39.1	0.4	
Interest	2.3	2.5	2.5	0.0	2.6	0.0	
PBT	218.4	189.9	158.5	37.8	37.4	483.2	
Total Tax	55.5	47.8	39.9	39.2	12.9	329.9	
Adj PAT	162.9	142.0	118.7	37.3	24.5	563.9	PAT growth is tracking higher topline growth

Key Metrics

Volume Growth (%)	30.0	21.0	112.0		-5.0		Favourable base and recovery in the automotive demand helped drive overall volume growth of the company. We believe industrial and decorative paint volume increased by 40% and 23% YoY respectively
Realisation Growth (%)	15.0	15.8	5.5		9.7		The company has taken price hike of ~2% QoQ

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY23E			FY24E			Comments
	Old	New	% Chg	Old	New	% Chg	
Revenue	6683.8	7447.8	11.4	7549.9	8393.4	11.2	We have revised our revenue estimate upside for FY23E-24E factoring in Q1FY23 performance. We model revenue CAGR 19% over FY22-24 supported by blended volume CAGR of 14%
EBITDA	838.6	995.7	18.7	1013.2	1161.1	14.6	
EBITDA Margin %	12.5	13.4	87bps	13.4	13.8	43bps	We have revised our EBITDA margin upward for FY23-24E factoring in price hike and improve operating leverage
PAT	524.4	624.2	19.0	651.2	722.4	10.9	
EPS (₹)	9.7	11.6	19.0	12.1	13.4	10.9	

Source: ICICI Direct Research

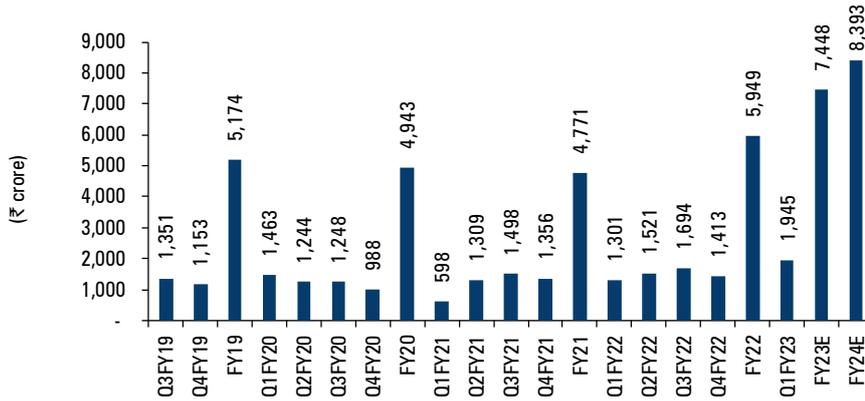
Exhibit 4: Assumptions

Assumptions	Current				Earlier		Comments
	FY21E	FY22E	FY23E	FY24E	FY23E	FY24E	
Volume Growth (%)	-3.9	17.4	16.1	11.5	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 14% FY22-24E
Realisation Growth (%)	0.4	6.2	7.8	1.1	7.7	0.3	

Source: ICICI Direct Research

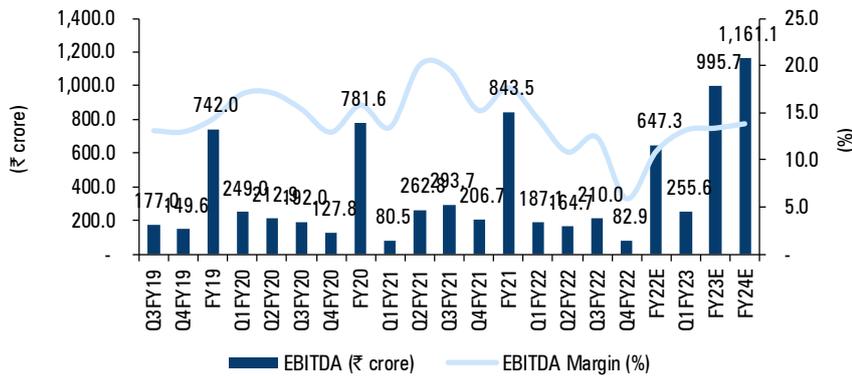
Financial story in charts

Exhibit 5: Industrial paints segment revenue



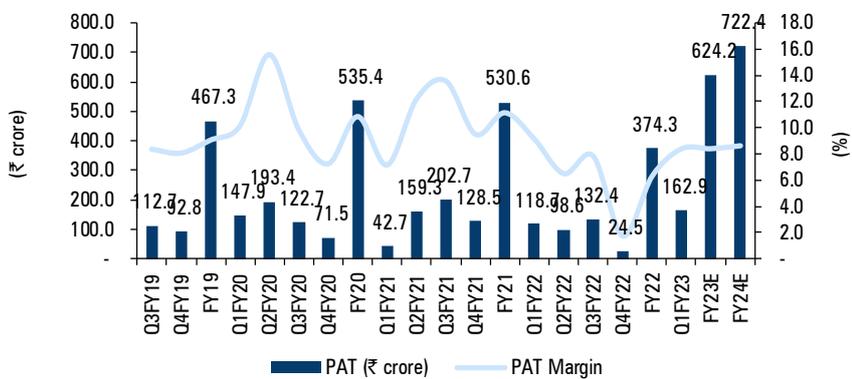
Source: Company, ICICI Direct Research

Exhibit 6: Decline in EBITDA margin due to increase in raw material prices



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	7,447.8	8,393.4
Growth (%)	-3.5	24.7	25.2	12.7
Raw Material Expenses	2,957.4	4,129.3	5,138.1	5,654.9
Employee Expenses	268.6	312.4	315.1	366.9
Other expenses	701.3	859.9	998.9	1,210.4
Total Operating Expenditure	3,927.4	5,301.6	6,452.1	7,232.3
EBITDA	843.5	647.3	995.7	1,161.1
Growth (%)	7.9	-23.3	53.8	16.6
Depreciation	149.0	153.8	163.9	193.0
Interest	8.5	9.9	10.0	10.2
Other Income	38.8	32.9	14.8	18.4
Exceptional Income	10.8	11.4	0.0	0.0
PBT	714.0	505.1	836.7	976.2
Total Tax	183.5	130.8	212.5	253.8
PAT	530.6	374.3	624.2	722.4

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	624.2	722.4
Add: Depreciation	149.0	153.8	163.9	193.0
(Inc)/dec in Current Assets	-721.5	-54.6	-179.9	-372.0
Inc/(dec) in CL and Provisions	289.1	93.6	99.4	74.5
Others	8.5	9.9	10.0	10.2
CF from operating activities	255.7	577.1	717.5	628.1
(Inc)/dec in Investments	-15.6	74.7	0.0	0.0
(Inc)/dec in Fixed Assets	-197.8	-332.0	-200.0	-350.0
Others	15.6	-74.7	0.0	0.0
CF from investing activities	-659.0	-323.7	-122.1	-194.4
Inc/(dec) in loan funds	30.1	-90.1	0.0	0.0
Dividend paid & dividend tax	-342.1	-260.7	-260.7	-260.7
Others	96.7	-33.1	-304.2	-10.2
CF from financing activities	-215.3	-383.9	-564.8	-270.8
Net Cash flow	-81.7	-1.2	84.8	7.3
Opening Cash	163.6	81.9	80.7	165.5
Closing Cash	81.9	80.7	165.5	172.8

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	4,186.3	4,648.1
Total Shareholders funds	4,080.5	4,170.9	4,240.2	4,702.0
Total Debt	90.1	0.0	0.0	0.0
Deferred Tax Liability	88.4	95.6	95.6	95.6
Total Liabilities	4,259.0	4,352.4	4,421.7	4,883.5
Assets				
Gross Block	2,778.4	3,092.3	3,416.2	3,766.2
Less: Acc Depreciation	1,062.3	1,216.2	1,380.0	1,573.0
Net Block	1,716.1	1,876.2	2,036.2	2,193.1
Capital WIP	205.8	223.9	100.0	100.0
Total Fixed Assets	1,921.9	2,100.0	2,136.2	2,293.1
Non-Current Investments	165.5	90.9	90.9	90.9
Inventory	1,090.2	1,531.5	1,428.4	1,609.7
Debtors	836.2	965.4	1,163.1	1,310.7
Loans and Advances	20.8	0.0	29.1	32.8
Investments & Other CA	824.9	392.5	437.3	413.7
Cash	81.9	80.7	165.5	172.8
Total Current Assets	2,918.0	2,971.3	3,236.1	3,615.4
Creditors	809.0	890.4	979.4	1,034.8
Provisions & other CL	140.7	152.9	163.3	182.4
Total Current Liabilities	949.7	1,043.3	1,142.8	1,217.2
Net Current Assets	1,968.3	1,928.0	2,093.4	2,398.1
Others Non-Current Assets	203.3	233.5	101.3	101.3
Application of Funds	4,259.0	4,352.4	4,421.7	4,883.5

Source: Company, ICICI Direct Research

Exhibit 11: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS	9.8	6.9	11.6	13.4
Cash EPS	12.6	9.8	14.6	17.0
BV	75.7	77.4	78.7	87.2
DPS	6.3	4.8	4.8	4.8
Cash Per Share	19.7	22.6	25.6	29.2
Operating Ratios (%)				
EBITDA Margin	17.7	10.9	13.4	13.8
EBIT Margin	14.6	8.3	11.2	11.5
PAT Margin	11.3	6.4	8.4	8.6
Inventory days	83	94	70	70
Debtor days	64	59	57	57
Creditor days	62	55	48	45
Return Ratios (%)				
RoE	13.2	9.2	14.7	15.4
RoCE	17.2	12.1	19.1	20.2
RoIC	22.4	13.7	21.7	22.6
Valuation Ratios (x)				
P/E	51.0	72.3	43.3	37.5
EV / EBITDA	32.1	41.7	27.0	23.2
EV / Net Sales	5.7	4.5	3.6	3.2
Market Cap / Sales	5.7	4.5	3.6	3.2
Price to Book Value	6.6	6.5	6.4	5.8
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	2.6
Quick Ratio	1.1	1.1	1.2	1.3

Source: Company, ICICI Direct Research

Exhibit 12: ICICI Direct Consumer Discretionary universe

Sector / Company	Rating	M Cap		EPS (₹)				P/E (x)				EV/EBITDA (x)				RoCE (%)			RoE (%)			
		(₹ Cr)	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E
Asian Paints (ASIPAI)	Buy	3,29,608	33.4	32.2	47.1	56.6	102.8	106.8	72.9	60.7	67.0	68.0	48.5	40.9	29.6	27.1	36.4	39.1	25.0	23.0	30.2	31.9
Berger Paints (BERPAI)	Hold	63,620	7.4	8.6	9.9	11.9	88.4	76.4	66.3	55.3	53.3	48.0	42.2	35.7	24.9	23.3	27.9	30.4	21.3	21.2	25.2	27.0
Kansai Nerolac (KANNER)	Hold	27,054	9.8	6.9	11.6	13.4	51.0	72.3	43.3	37.5	32.1	41.7	27.0	23.1	17.2	12.1	19.5	21.1	13.2	9.2	14.7	15.6
Pidilite Industries (PIDIND)	Hold	1,27,966	22.2	23.8	26.0	32.2	113.6	106.0	97.1	78.3	75.9	69.1	64.6	52.4	23.8	22.2	22.6	25.6	20.2	18.8	19.1	21.4
Bajaj Electricals (BAJELE)	Hold	12,944	16.5	10.8	22.0	29.5	68.3	104.0	51.2	38.2	43.5	51.4	38.3	29.1	15.1	13.5	19.1	22.1	10.7	7.8	14.9	17.2
Crompton Greaves(CROGR)	Hold	24,571	9.8	9.2	8.4	10.5	39.8	42.5	46.8	37.3	32.6	32.0	28.5	23.6	34.4	16.2	16.0	19.7	31.9	24.0	20.5	22.6
Havells India (HAVIND)	Hold	79,859	16.7	19.1	19.4	25.1	76.8	66.8	65.9	50.9	50.2	44.2	44.4	35.2	24.9	23.7	24.6	31.4	20.1	19.9	20.9	26.6
Polycab India (POLI)	Buy	35,224	59.3	61.4	67.1	77.6	39.8	38.4	35.1	30.4	30.9	27.0	23.1	19.8	20.6	20.2	21.8	22.1	17.9	15.6	16.5	16.7
Symphony (SYMLIM)	Hold	6,492	15.3	17.3	26.1	34.8	60.7	53.7	35.5	26.7	45.4	39.2	27.3	20.6	15.2	15.9	24.5	29.0	14.9	14.4	23.6	27.4
V-Guard Ind (VGUARD)	Hold	10,184	4.7	5.3	5.4	6.8	50.1	44.2	43.7	34.9	31.8	30.0	28.5	22.8	23.9	21.2	23.7	26.6	16.7	16.2	17.9	20.3
Voltas Ltd (VOLTAS)	Hold	32,478	16.0	15.3	21.0	28.9	61.4	64.2	46.8	33.9	49.9	46.7	38.7	27.6	15.0	14.0	18.0	21.0	10.6	9.2	13.8	16.6
Amber Enterprises (AMBEN)	Hold	8,312	24.7	33.0	60.4	86.2	99.8	74.7	40.9	28.6	37.5	31.5	22.7	17.0	7.7	6.8	10.5	13.4	5.2	6.4	11.2	13.8
Dixon Technologies (DIXTEC)	Buy	22,256	27.3	32.1	55.4	83.6	137.5	116.9	67.7	44.8	77.6	59.1	38.3	27.3	23.5	17.7	27.0	31.4	21.7	19.1	30.9	34.1
Supreme Indus (SUPIND)	Buy	23,614	77.0	76.2	77.1	87.0	24.1	24.4	24.1	21.4	17.8	18.6	18.7	16.1	33.1	25.9	24.2	24.9	30.9	25.2	23.9	24.1
Astral Ltd (ASTPOL)	Hold	37,907	20.3	24.4	28.8	35.1	92.9	77.3	65.5	53.8	58.2	49.5	42.2	35.2	27.5	26.6	27.3	28.5	21.5	21.0	21.4	22.3
Time Techno (TIMTEC)	Hold	2,352	4.8	8.5	10.0	12.4	21.8	12.2	10.4	8.4	7.6	6.1	5.2	4.5	8.7	11.3	12.8	14.1	5.7	9.3	10.6	11.9

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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