

India

**HOLD** (no change)

Consensus ratings\*: Buy 8 Hold 6 Sell 7

Current price:	Rs501
Target price: ▲	Rs500
Previous target:	Rs404
Up/downside:	-0.2%
InCred Research / Consensus:	12.2%
Reuters:	
Bloomberg:	KNPL IN
Market cap:	US\$3,721m Rs270,187m
Average daily turnover:	US\$2.1m Rs154.2m
Current shares o/s:	538.9m
Free float:	25.0%

\*Source: Bloomberg

**Key changes in this note**

- Raise target price to Rs500 from Rs404.
- Introduce FY25F estimates.
- Raise FY23F/24F revenue by 8.5/10.5%.

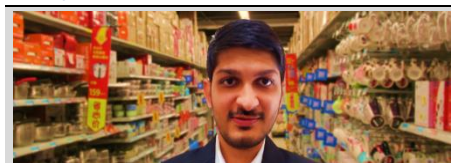


Source: Bloomberg

<b>Price performance</b>	1M	3M	12M
Absolute (%)	34.6	7.9	(21.1)
Relative (%)	22.8	2.9	(26.5)

<b>Major shareholders</b>	% held
Promoter & Promoter Group	75.0
LIC	3.4
Aditya Birla Sunlife AMC	2.2

**Analyst(s)**



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# Kansai Nerolac Paints Limited

## Walking the tight rope of growth & margins

- Standalone sales grew 47.1% yoy in 1QFY23. Overall volume growth was c.22-24%. Industrial segment grew at a higher pace vs. decorative segment.
- Sequential improvement in gross margin was led by the industrial segment. The focus is on scaling up margin-accretive premium portfolio.
- Maintain Hold rating with a higher target price of Rs500 (36x Jun 2024F EPS).

### Sales growth led by revival in the industrial segment

Standalone sales of Kansai Nerolac Paints (KNPL) in 1QFY23 at Rs19.4bn were up 47.1% yoy (3-year CAGR of 10.1% vs. 20.1% for Asian Paints or APNT). Given a better mix and pricing actions, decorative segment's volume growth of c.18-20%, as per our calculations, was much lower when compared to APNT (37%). KNPL's lower salience to metro/Tier-1 cities (40%) vs. industry (50%), reduced participation in low-margin products (like putty) and a lower share in premium products hit its decorative segment's growth. Project business (low single-digit revenue share) grew 2x. KNPL's industrial segment's growth of more than 50% was comparable to APNT's automotive/industrial subsidiary's growth of 63%/56% yoy, respectively. Easing chip shortage problem leading to revival in auto OEM sales coupled with price hikes bode well for a recovery in the industrial segment.

### Focus on premium products and profitable growth

KNPL, across its decorative and industrial segments, is focusing more on high-margin premium products and cutting down on low-margin products. Within the industrial segment, its strategy is to offer technologically advanced and energy-efficient products. It has exited 10%/30% low-margin business in performance/coil-coating segments, respectively. In decorative space, the company will be focusing more on premium/luxury products and expanding the product range in adjacent segments like waterproofing.

### Strong operating performance

Standalone gross margin improved by 195bp qoq to 29.9% (vs. APNT: down 159bp qoq) led by a strong qoq increase in the industrial segment's margins. Cost inflation increased 7% qoq vs. price hike of 2% in 1Q, necessitating further price hikes. Standalone EBITDA at Rs2.5bn was up 34.7% yoy while EBITDA margin contraction was limited to 121bp yoy at 13.1%. Employee cost/other expenses fell 146bp/174bp yoy, respectively. KNPL's stance to increase its marketing expenditure targeting a higher share of voice (15-16%) vs. share of market (10-11%), will, to some extent, offset the benefit from higher gross margin.

### Maintain Hold rating with higher target price of Rs500

Semi-conductor shortage problem easing is expected to drive the automotive sector's growth while increased focus on margin-accretive premium portfolio might come at the cost of revenue growth. We retain Hold rating on KNPL with a higher target price of Rs500 (36x Jun 2024F P/E). Upside risk: Market share gain in the decorative segment leading to stock rerating. Downside risk: Further rise in inflation affecting demand as well as margins.

### Financial Summary

	Mar-21A	Mar-22A	Mar-23F	Mar-24F	Mar-25F
Revenue (Rsm)	50,743	63,694	77,386	86,106	93,175
Operating EBITDA (Rsm)	8,633	6,494	9,022	11,799	12,487
Net Profit (Rsm)	5,258	3,432	5,378	7,386	7,841
Core EPS (Rs)	9.8	6.4	10.0	13.7	14.5
Core EPS Growth	1.9%	(34.7%)	56.7%	37.3%	6.1%
FD Core P/E (x)	51.39	78.73	50.24	36.58	34.46
DPS (Rs)	4.4	4.0	4.7	5.6	6.6
Dividend Yield	0.88%	0.80%	0.94%	1.11%	1.31%
EV/EBITDA (x)	30.72	41.64	29.45	22.31	20.82
P/FCFE (x)	162.78	102.07	38.38	50.64	39.79
Net Gearing	(13.0%)	0.1%	(10.5%)	(14.5%)	(19.4%)
P/BV (x)	6.67	6.54	6.09	5.53	5.08
ROE	13.5%	8.4%	12.6%	15.9%	15.4%
% Change In Core EPS Estimates			6.88%	8.91%	
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

## Walking the tight rope of growth & margins

### Key takeaways from earnings call:

#### Decorative segment (55% of sales):

- Volume growth was c.22-24% in 1QFY23 on a low base. Paint+ brand extension Mica Marble was expanded (launched in 4Q) pan-India in 1Q. More products will be added in the premium and super-premium range as salience is currently high for the economy range. The distribution growth for new products is c.50%
- Pragati App for painters, gives fastest payouts to painters in the industry. Participation has increased. The focus is on increasing wallet share.
- **Distribution:** In 1Q, it grew in high double digits, and added 50 preferred counters (with existing dealers). The reach in FY22 was at 27-28,000 in dealer count, a growth of 7-8%.
- **Trade channel stocking:** Dealers stocked less in 4QFY22, it picked up in Apr 2022 but normalized by the end of 1QFY23.
- The institutional business doubled in 1Q. The share of institutional business to decorative segment is in low single digits, considerably lower compared to industry (Asian Paints' institutional business contributes 15-20% of decorative sales).
- **NeroFix (JV):** Targeted 5% salience earlier. In 1Q, achieved that target. Around 30% of existing counters sell construction chemicals now.
- Completed the range expansion in Soldier and Nerolac range, gaps in the product range have been filled (barring some enamels).
- **Next Gen painting services:** Launched five-day painting services in six cities, which will be expanded to other cities soon.
- Metro and Tier-1 cities contributed 40% to sales (vs. 50% for industry) while Tier-2 and below cities contributed 60% to sales.
- Generally, the mix for the decorative segment is favourable in 1Q and 3Q.

#### Industrial segment (45% of sales - 70:30 auto/non-auto; auto market share: 50%+)

- Industrial segment's growth was higher than the decorative segment's growth.
- Earlier, management had said the industrial segment's market share improved, but the focus was on driving price hikes (18%/21% taken in industrial/decorative segments last year). The focus now is on expanding high technology products which have slightly better margins. Salience went up in 1Q.
- **Performance coatings:** Margins were low. In 1Q, due to low-end business, the company exited 10% of the business (which was not performing well) and focused on the high-tech premium range in performance coatings.
- **Coil coatings:** KNPL was witnessing lower margins and so the focus moved to high-tech appliances (earlier, only present in sheets). It has now exited 30% of the sheet business. Salience in coil coatings went up to 3%. As its market share in the premium range is lower, the focus is on increasing market share in this segment.

#### Input cost and margins

- Approx. 2% price hike taken in 1QFY23. Price hikes in the industrial segment were much lower than the inflation witnessed last year. A small price hike is expected in the decorative segment but more hikes are required for the industrial segment going ahead.
- Advertising and promotion or A&P spending was towards the Paint+ range, with the share of voice (SOV) at 15%. Unlike the last two-to-three years, where

the reduced SOV affected overall performance, the company will maintain SOV at 15% level.

- Difference at the EBITDA level is 7-8% between decorative and industrial segments. Improvement in margins will trickle in from new product launches, price hikes and formulation efficiencies, but bulk of the improvement will be contingent on a recovery in the industrial segment (due to the gap currently).

## Outlook

- **Paints:** Focus will be on growing faster than the market through distribution expansion, influencer marketing and improving the reach led by product innovation.
- **Distribution:** Earlier (FY18-19) focus was on enhancing mind share. Now marketing activities are focused on converting that to market share. The focus on growing painter (influencer) wallet share to continue.
- A good monsoon may lead to sales pick-up in the two-wheeler segment, which is currently subdued.
- General automotive demand is likely to continue to grow. The focus on margin improvement will continue.
- **EV segment strategy:** Over a period, as EV penetration increases, given new players outsource painting (who are KNPL's customers), it is expected to aid growth.
- **Auto segment:** Witnessing encouraging growth in passenger vehicles. The focus is on tech (3 coat one bake launched last year - lowers customers energy cost). In auto refinishes, the focus is on improving salience of refinishes and driving margin profile.

## Other highlights

- Capacity utilization stood at 64% in 1Q.
- **Capex:** The company approved two projects (decorative segment) for water-based categories, and they are expected to commercialize over 25-30 months with a Rs2.9bn capex. It has enough capacity for the industrial segment.
- Despite a tough business environment, Nepal and Sri Lanka registered good topline growth, while Bangladesh reported muted growth.

**Figure 1: Quarterly summary - Consolidated**

Y/E, Mar (Rs. m)	1QFY22	4QFY22	1QFY23	YoY (%)	QoQ (%)	FY21	FY22	Gr (%)
<b>Revenue</b>	<b>14,028</b>	<b>15,366</b>	<b>20,514</b>	46.2	33.5	<b>50,743</b>	<b>63,694</b>	25.5
<b>Expenditure</b>	<b>12,122</b>	<b>14,527</b>	<b>17,963</b>	48.2	23.7	<b>42,110</b>	<b>57,200</b>	35.8
Consumption of RM	9,230	11,074	14,379	55.8	29.8	31,465	44,273	40.7
as % of sales	65.8%	72.1%	70.1%			62.0%	69.5%	
Employee cost	821	1,077	884	7.8	-17.9	3,047	3,556	16.7
as % of sales	5.8%	7.0%	4.3%			6.0%	5.6%	
Other expenditure	2,072	2,375	2,700	30.3	13.7	7,598	9,371	23.3
as % of sales	14.8%	15.5%	13.2%			15.0%	14.7%	
<b>EBITDA</b>	<b>1,905</b>	<b>839</b>	<b>2,550</b>	<b>33.9</b>	<b>203.9</b>	<b>8,633</b>	<b>6,494</b>	<b>-24.8</b>
Depreciation	417	430	431	3.4	0.2	1,653	1,698	2.7
<b>EBIT</b>	<b>1,488</b>	<b>409</b>	<b>2,119</b>	<b>42.4</b>	<b>418.4</b>	<b>6,980</b>	<b>4,796</b>	<b>-31.3</b>
Other income	99	-10	48	-51.4	-597.9	382	254	-33.5
Interest	67	78	85			237	286	
<b>PBT</b>	<b>1,521</b>	<b>321</b>	<b>2,083</b>	<b>36.9</b>	<b>549.0</b>	<b>7,125</b>	<b>4,764</b>	<b>-33.1</b>
Total tax	407	129	562	38.1	335.0	1,867	1,333	-28.6
<b>Adjusted PAT</b>	<b>1,114</b>	<b>192</b>	<b>1,521</b>	<b>36.5</b>	<b>693.2</b>	<b>5,257</b>	<b>3,431</b>	<b>-34.7</b>
Minority interest (MI)	-27	-56	-43			-40	-157	
<b>APAT after MI</b>	<b>1,141</b>	<b>247</b>	<b>1,563</b>	<b>37.0</b>	<b>532.1</b>	<b>5,297</b>	<b>3,589</b>	<b>-32.3</b>
Extraordinary Items	0	0	0	-	-	0	0	
<b>Reported PAT</b>	<b>1,141</b>	<b>247</b>	<b>1,563</b>	<b>37.0</b>	<b>532.1</b>	<b>5,297</b>	<b>3,589</b>	<b>-32.3</b>
<b>Adjusted EPS</b>	<b>2.1</b>	<b>0.4</b>	<b>2.8</b>	<b>36.5</b>	<b>693.2</b>	<b>3.9</b>	<b>4.0</b>	<b>2.2</b>
<b>Margins (%)</b>	<b>1QFY22</b>	<b>4QFY22</b>	<b>1QFY23</b>	<b>YoY (bp)</b>	<b>QoQ (bp)</b>	<b>FY21</b>	<b>FY22</b>	<b>(bp)</b>
Gross margin	34.2%	27.9%	29.9%	-430	200	38.0%	30.5%	-750
EBITDA	13.6%	5.5%	12.4%	-110	700	17.0%	10.2%	-680
EBIT	10.6%	2.7%	10.3%	-30	770	13.8%	7.5%	-620
EBT	10.8%	2.1%	10.2%	-70	810	14.0%	7.5%	-660
PAT	7.9%	1.2%	7.4%	-50	620	10.4%	5.4%	-500
Effective tax rate	26.8%	40.3%	27.0%	20	-1,330	26.2%	28.0%	180

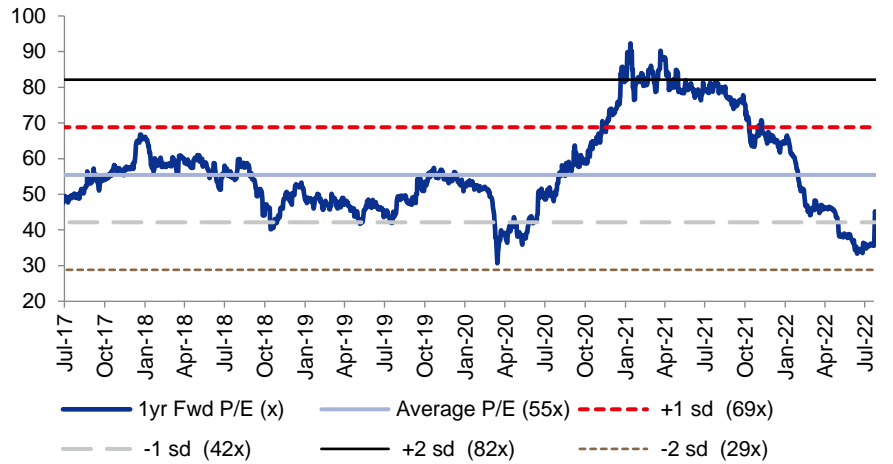
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 2: Revision in our earnings estimates**

Y/E, Mar (Rs. m)	FY23F			FY24F			FY25F
	Earlier	Revised	% change	Earlier	Revised	% change	Introduced
Revenue	71,301	77,386	8.5	77,949	86,106	10.5	93,175
EBITDA	8,245	9,022	9.4	10,645	11,799	10.8	12,487
EBITDA margin (%)	11.6%	11.7%	10 bp	13.7%	13.7%	0 bp	13.4%
APAT	5,074	5,378	6.0	6,809	7,386	8.5	7,841
EPS	9.4	10.0	6.2	12.6	13.7	8.9	14.5

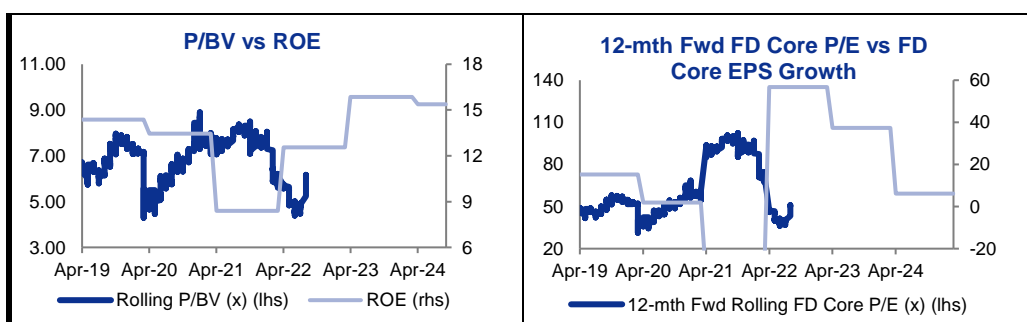
SOURCE: INCRED RESEARCH, COMPANY REPORTS

**Figure 3: KNPL's one-year forward P/E trades above -1 SD P/E but below its five-year average P/E**



SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS



Profit & Loss

(Rs mn)	Mar-21A	Mar-22A	Mar-23F	Mar-24F	Mar-25F
<b>Total Net Revenues</b>	<b>50,743</b>	<b>63,694</b>	<b>77,386</b>	<b>86,106</b>	<b>93,175</b>
<b>Gross Profit</b>	<b>19,277</b>	<b>19,421</b>	<b>24,982</b>	<b>29,546</b>	<b>31,594</b>
<b>Operating EBITDA</b>	<b>8,633</b>	<b>6,494</b>	<b>9,022</b>	<b>11,799</b>	<b>12,487</b>
Depreciation And Amortisation	(1,653)	(1,698)	(1,816)	(1,907)	(1,991)
<b>Operating EBIT</b>	<b>6,980</b>	<b>4,796</b>	<b>7,206</b>	<b>9,892</b>	<b>10,496</b>
Financial Income/(Expense)	145	(32)	(3)		3
Pretax Income/(Loss) from Assoc.					
Non-Operating Income/(Expense)					
<b>Profit Before Tax (pre-EI)</b>	<b>7,125</b>	<b>4,764</b>	<b>7,203</b>	<b>9,891</b>	<b>10,499</b>
Exceptional Items					
<b>Pre-tax Profit</b>	<b>7,125</b>	<b>4,764</b>	<b>7,203</b>	<b>9,891</b>	<b>10,499</b>
Taxation	(1,867)	(1,333)	(1,825)	(2,505)	(2,659)
Exceptional Income - post-tax					
<b>Profit After Tax</b>	<b>5,258</b>	<b>3,432</b>	<b>5,378</b>	<b>7,386</b>	<b>7,841</b>
Minority Interests					
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
<b>Net Profit</b>	<b>5,258</b>	<b>3,432</b>	<b>5,378</b>	<b>7,386</b>	<b>7,841</b>
Recurring Net Profit	5,258	3,432	5,378	7,386	7,841
<b>Fully Diluted Recurring Net Profit</b>	<b>5,258</b>	<b>3,432</b>	<b>5,378</b>	<b>7,386</b>	<b>7,841</b>

Cash Flow

(Rs mn)	Mar-21A	Mar-22A	Mar-23F	Mar-24F	Mar-25F
<b>EBITDA</b>	<b>8,633</b>	<b>6,494</b>	<b>9,022</b>	<b>11,799</b>	<b>12,487</b>
Cash Flow from Invt. & Assoc.	157				
Change In Working Capital	54	(4,912)	1,446	(2,359)	(1,691)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
<b>Other Operating Cashflow</b>					
Net Interest (Paid)/Received	(237)	(286)	(260)	(260)	(260)
Tax Paid	(1,867)	(1,333)	(1,825)	(2,505)	(2,659)
<b>Cashflow From Operations</b>	<b>6,739</b>	<b>(37)</b>	<b>8,383</b>	<b>6,675</b>	<b>7,878</b>
Capex	(2,089)	(2,715)	(1,600)	(1,600)	(1,350)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments	(3,631)	4,585			
Other Investing Cashflow	382	254	257	260	263
<b>Cash Flow From Investing</b>	<b>(5,337)</b>	<b>2,124</b>	<b>(1,343)</b>	<b>(1,340)</b>	<b>(1,087)</b>
Debt Raised/(repaid)	257	560			
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	(2,371)	(2,156)	(2,544)	(3,001)	(3,542)
Preferred Dividends					
Other Financing Cashflow	194	(834)	205	95	31
<b>Cash Flow From Financing</b>	<b>(1,920)</b>	<b>(2,430)</b>	<b>(2,339)</b>	<b>(2,907)</b>	<b>(3,511)</b>
Total Cash Generated	(518)	(343)	4,701	2,428	3,279
<b>Free Cashflow To Equity</b>	<b>1,660</b>	<b>2,647</b>	<b>7,040</b>	<b>5,335</b>	<b>6,791</b>
<b>Free Cashflow To Firm</b>	<b>1,640</b>	<b>2,373</b>	<b>7,300</b>	<b>5,595</b>	<b>7,051</b>

SOURCE: INCRED RESEARCH, COMPANY REPORTS

**BY THE NUMBERS...cont'd**

<b>Balance Sheet</b>					
<b>(Rs mn)</b>	<b>Mar-21A</b>	<b>Mar-22A</b>	<b>Mar-23F</b>	<b>Mar-24F</b>	<b>Mar-25F</b>
Total Cash And Equivalents	7,926	3,155	7,856	10,284	13,564
Total Debtors	9,564	10,933	10,901	12,032	12,998
Inventories	11,979	16,296	14,219	15,698	16,987
Total Other Current Assets	4,517	4,492	6,342	7,023	7,567
<b>Total Current Assets</b>	<b>33,985</b>	<b>34,876</b>	<b>39,317</b>	<b>45,037</b>	<b>51,116</b>
Fixed Assets	20,993	22,010	21,793	21,486	20,845
Total Investments	10	11	11	11	11
Intangible Assets	198	198	198	198	198
Total Other Non-Current Assets	148				
<b>Total Non-current Assets</b>	<b>21,348</b>	<b>22,218</b>	<b>22,002</b>	<b>21,694</b>	<b>21,053</b>
Short-term Debt	1,684	2,157	2,157	2,157	2,157
Current Portion of Long-Term Debt					
Total Creditors	10,499	10,898	12,744	13,701	14,831
Other Current Liabilities					
<b>Total Current Liabilities</b>	<b>12,183</b>	<b>13,054</b>	<b>14,901</b>	<b>15,857</b>	<b>16,987</b>
Total Long-term Debt	943	1,031	1,031	1,031	1,031
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities					
<b>Total Non-current Liabilities</b>	<b>943</b>	<b>1,031</b>	<b>1,031</b>	<b>1,031</b>	<b>1,031</b>
Total Provisions	1,316	1,494	1,065	1,065	1,065
<b>Total Liabilities</b>	<b>14,442</b>	<b>15,579</b>	<b>16,996</b>	<b>17,953</b>	<b>19,083</b>
Shareholders Equity	40,529	41,322	44,362	48,841	53,171
Minority Interests	363	193	193	193	193
<b>Total Equity</b>	<b>40,892</b>	<b>41,515</b>	<b>44,554</b>	<b>49,034</b>	<b>53,364</b>

<b>Key Ratios</b>					
	<b>Mar-21A</b>	<b>Mar-22A</b>	<b>Mar-23F</b>	<b>Mar-24F</b>	<b>Mar-25F</b>
Revenue Growth	(3.9%)	25.5%	21.5%	11.3%	8.2%
Operating EBITDA Growth	7.3%	(24.8%)	38.9%	30.8%	5.8%
Operating EBITDA Margin	17.0%	10.2%	11.7%	13.7%	13.4%
Net Cash Per Share (Rs)	9.83	(0.06)	8.66	13.17	19.26
BVPS (Rs)	75.21	76.68	82.32	90.63	98.67
Gross Interest Cover	29.44	16.78	27.71	38.05	40.37
Effective Tax Rate	26.2%	28.0%	25.3%	25.3%	25.3%
Net Dividend Payout Ratio	45.1%	62.8%	47.3%	40.6%	45.2%
Accounts Receivables Days	62.70	58.73	51.49	48.60	49.03
Inventory Days	127.97	116.55	106.27	96.53	96.86
Accounts Payables Days	103.70	88.20	82.33	85.33	84.56
ROIC (%)	18.9%	11.1%	17.7%	23.1%	24.0%
ROCE (%)	16.4%	10.7%	15.3%	19.4%	19.0%
Return On Average Assets	9.8%	6.2%	9.1%	11.5%	11.3%

<b>Key Drivers</b>					
	<b>Mar-21A</b>	<b>Mar-22A</b>	<b>Mar-23F</b>	<b>Mar-24F</b>	<b>Mar-25F</b>
Decorative paints revenue growth	N/A	27.0%	19.0%	9.0%	6.0%
Industrial paints revenue growth	(12.4%)	23.2%	33.8%	15.2%	11.5%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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