

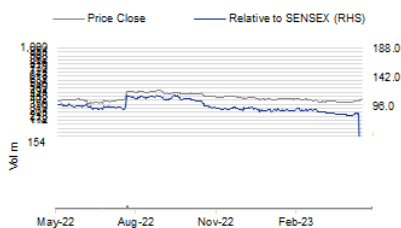
India

REDUCE (no change)

Consensus ratings*: Buy 10 Hold 3 Sell 7	
Current price:	Rs418
Target price:	Rs395
Previous target:	Rs432
Up/downside:	-5.5%
InCred Research / Consensus:	-14.1%
Reuters:	
Bloomberg:	KNPL IN
Market cap:	US\$3,105m Rs225,457m
Average daily turnover:	US\$1.3m Rs93.1m
Current shares o/s:	538.9m
Free float:	25.0%
*Source: Bloomberg	

Key changes in this note

- Lower target price to Rs395 from Rs432.
- Lower FY24F/25F EPS by 10.5%/11.9%.

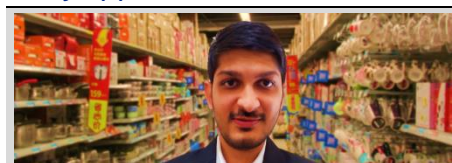


Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	8.5	(0.3)	5.1
Relative (%)	5.8	(1.5)	(10.5)

Major shareholders	% held
Promoter & Promoter Group	75.0
LIC	3.4
Franklin Resources Inc	1.4

Analyst(s)



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Kansai Nerolac Paints Limited

Industrial margin guidance is underwhelming

- KNPL's domestic double-digit volume-led sales growth of 13% in 4QFY23 was competitive and arrested a market share loss. However, we believe that regaining market share in the decorative paints segment is a tough task.
- EBITDA margin at 9.7% is subdued in the sub-10% range, despite full price hikes in the industrial segment, & no commodity headwinds. We find Industrial EBITDA margin guidance of low double digits (FY24F) underwhelming, given the efforts made to premiumize offerings and cut low-margin businesses.
- We believe KNPL is taking the right steps, but the timing is not on its side given the changing industry landscape. Retain REDUCE with a lower TP of Rs395.

Broad-based growth across segments

Kansai Nerolac Paints' (KNPL) 4QFY23 net sales grew by 12.8% yoy to Rs17.3bn. The growth was broad-based, driven by double-digit (volume/value) growth in decorative paints and industrial segments. Urban demand was stable while rural demand lagged and remained unpredictable. The share of new businesses (including waterproofing and construction chemicals) touched 7-8%. Incrementally, in the industrial business, KNPL believes that performance coating is emerging as a big area where it is focusing on sourcing premium profitable contracts (like bullet trains). In the decorative paints segment, the incremental focus is on 1) driving painting services (witnessing higher conversion), 2) increasing the engagement with influencers, and 3) driving premiumization (Paint Plus range). However, with the competitive intensity higher than it was ever before, we believe it will be a tall task for KNPL to regain lost market share in the decorative paints segment.

Margin outlook is tepid

In 4QFY23, KNPL's consolidated gross margin expanded by 400bp yoy (up 150bp qoq) to 31.9%. However, the EBITDA margin on a sequential basis declined by 100bp to 9.7%. Despite complete price hikes in the industrial segment, the EBITDA margin remained in high single digits. We found the EBITDA margin outlook of low double digits (10-11%) for the industrial segment to be underwhelming given 1) the efforts made to premiumize offerings, 2) cutting down low-margin products, and 3) rival Asian Paints reporting a 11.2% PBT margin in its industrial business in FY23. We expect KNPL to operate at a lower EBITDA margin band for a sustained period.

Recovery in market share is a tall task; maintain REDUCE rating

Our concerns over KNPL regaining its market share in the decorative paints segment and operating in a lower margin band for a prolonged period makes us retain our REDUCE rating on the stock with a lower target price of Rs395 (32x Mar 2025F EPS) from Rs432 earlier. Upside risks: Market share gain in the decorative paints segment and/or a sharp decline in crude oil prices.

Financial Summary	Mar-21A	Mar-22A	Mar-23A	Mar-24F	Mar-25F
Revenue (Rsm)	50,743	63,694	75,427	82,715	89,073
Operating EBITDA (Rsm)	8,633	6,494	8,180	10,382	10,902
Net Profit (Rsm)	5,258	3,432	4,685	6,329	6,659
Core EPS (Rs)	9.8	6.4	8.7	11.7	12.4
Core EPS Growth	1.9%	(34.7%)	36.5%	35.1%	5.2%
FD Core P/E (x)	42.88	65.70	48.12	35.62	33.85
DPS (Rs)	4.4	4.0	4.7	5.6	6.6
Dividend Yield	1.05%	0.96%	1.13%	1.33%	1.57%
EV/EBITDA (x)	25.54	34.75	27.18	21.72	20.68
P/FCFE (x)	135.83	83.56	300.44	0.00	0.00
Net Gearing	(13.0%)	0.1%	(7.4%)	0.0%	0.0%
P/BV (x)	5.56	5.46	4.97	4.69	4.41
ROE	13.5%	8.4%	10.8%	13.5%	13.4%
% Change In Core EPS Estimates				(10.55%)	(11.91%)
InCred Research/Consensus EPS (x)					

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Underwhelming industrial margin guidance

Key takeaways from the analyst meet

Highlights

- **On demand:** All divisions reported double-digit growth in 4QFY23, with the decorative paints business reporting double-digit volume growth. With the Diwali festival falling in Nov 2023, the festive period sales this year are expected to be healthier owing to a longer gap between the end of the monsoon season and the festive period.
- New businesses now make up 7-8% of the company's sales.
- **Tile adhesives:** KNPL has made progress. Management stated that confidence in the business has increased.
- **Industrial segment:** No. 1 in automotive and industrial segments. Margins are now at a comfortable level, as per management. The share of industrial business is expected to increase, as per management, but it is targeting faster growth from the decorative segment.
- **Two-wheelers & commercial vehicles:** Gained market share. Aligning the technology towards newer compliances for E-20 and E-30.
- **Refinishes market:** KNPL was a late entrant. Market share has grown. Profitability is higher in refinishes.
- There is potential to grow the non-automobile segment of industrial business.
- **Performance coatings market is becoming larger than the automotive market.** Increased government spending is also aiding growth. Problems with respect to margins led to the exit of non-profitable segments from the business (10% of sales), which was completed in 4Q. The focus will only be on premium products now and large projects (like trans-harbour link, etc).
- **Manufacturing:** Total capacity of 606m litres per annum in FY23. Capex of Rs1,600m/1,300m/260m incurred across facilities in Vizag/Jainpur/Hosur, respectively, in FY23. Total capex outlay of Rs3,160m in FY23. Total capacity from these facilities stands at 1,54,080klpa.
- **KNPL is weaker in the premium range vs. peers.** The focus is on plugging gaps.

Services & digital offerings

- Doing 500 homes digitally per day (painting services). Picks up pace over the last three-to-four months.
- KNPL has set up a team to increase the share of wallet from influencers - doing training, site visits, etc. to drive growth. 100k painters participated in the exercise.
- **Architects/designer channels** - Focusing on towns where interior decorators have a higher influence. Started providing support to them, which has resulted in some business through this channel as well.
- **New launches:** The Paint Plus range was launched in FY23. The focus is on driving customer awareness. The Paint Plus range is growing in double digits. The new range of white paints launched under Paint Plus is superior vs. others in the market.
- **NXTGEN Service** – Crossed services in 100 cities in FY23 and expansion is underway.
- KNPL was among the first to disburse payments to painters within minutes (vs. an average of 30 days earlier) through its app.

Subsidiaries' performance

- Nepal market is under pressure.
- Bangladesh saw positive EBITDA in FY23 (vs. a loss last year).
- Sri Lanka grew 83% yoy in sales, with market share improvement.
- Nerofix has become a wholly-owned subsidiary of KNPL. Synergies with KNPL are strong.
- **Capital employed for international subsidiaries:** Made additional infusion in Bangladesh and Sri Lanka subsidiaries. International subsidiaries have turned around. Will take some time to mature.

Input cost and margins

- The gap between industrial and decorative paints segments' margins has narrowed as margins from the industrial segment have recovered to near double-digit levels in 4Q, led by price hikes. Management does not expect further price hikes in the industrial segment going ahead and sees EBITDA margin for the segment in the range of 10-11% while the decorative segment's EBITDA margin to gradually recover to 14-15% level, 400-500bp lower than the market leader.

Figure 1: Quarterly summary - consolidated

Y/E, Mar (Rs. m)	4QFY22	3QFY23	4QFY23	YoY (%)	QoQ (%)	FY22	FY23	Gr (%)
Revenue	15,366	18,268	17,336	12.8	-5.1	63,694	75,427	18.4
Expenditure	14,527	16,313	15,655	7.8	-4.0	57,200	67,247	17.6
Consumption of RM	11,074	12,714	11,806	6.6	-7.1	44,273	52,643	18.9
as % of sales	72.1%	69.6%	68.1%			69.5%	69.8%	
Employee Cost	1,077	938	1,008	-6.4	7.4	3,556	3,771	6.0
as % of sales	7.0%	5.1%	5.8%			5.6%	5.0%	
Other expenditure	2,375	2,661	2,841	19.6	6.8	9,371	10,834	15.6
as % of sales	15.5%	14.6%	16.4%			14.7%	14.4%	
EBITDA	839	1,955	1,681	100.3	-14.0	6,494	8,180	26.0
Depreciation	430	460	458	6.4	-0.4	1,698	1,801	6.1
EBIT	409	1,495	1,223	199.2	-18.2	4,796	6,379	33.0
Other Income	-10	74	97	-1100.0	31.4	254	260	2.2
Interest	78	74	68			286	290	
PBT	321	1,495	1,252	290.2	-16.2	4,764	6,349	33.3
Total Tax	129	405	290	124.2	-28.4	1,333	1,664	24.9
Adjusted PAT	192	1,090	962	402.0	-11.7	3,431	4,685	36.5
Minority Interest	-56	-10	25			-157	-51	
APAT after MI	247	1,099	938	279.2	-14.7	3,589	4,736	32.0
Extraordinary items	0	0	0	-	-	0	0	
Reported PAT	247	1,099	938	279.2	-14.7	3,589	4,736	32.0
Adjusted EPS	0.4	2.0	1.8	402.0	-11.7	3.9	4.0	2.2
Margins (%)	4QFY22	3QFY23	4QFY23	YoY (bp)	QoQ (bp)	FY22	FY23	(bp)
Gross Margin	27.9%	30.4%	31.9%	400	150	30.5%	30.2%	-30
EBITDA	5.5%	10.7%	9.7%	420	-100	10.2%	10.8%	60
EBIT	2.7%	8.2%	7.1%	440	-110	7.5%	8.5%	90
EBT	2.1%	8.2%	7.2%	510	-100	7.5%	8.4%	90
PAT	1.2%	6.0%	5.6%	430	-40	5.4%	6.2%	80
Effective Tax Rate	40.3%	27.1%	23.1%	(1,710)	-390	28.0%	26.2%	-180

SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 2: Consolidated EBITDA margin expanded by 420bp yoy to 9.7% in 4QFY23

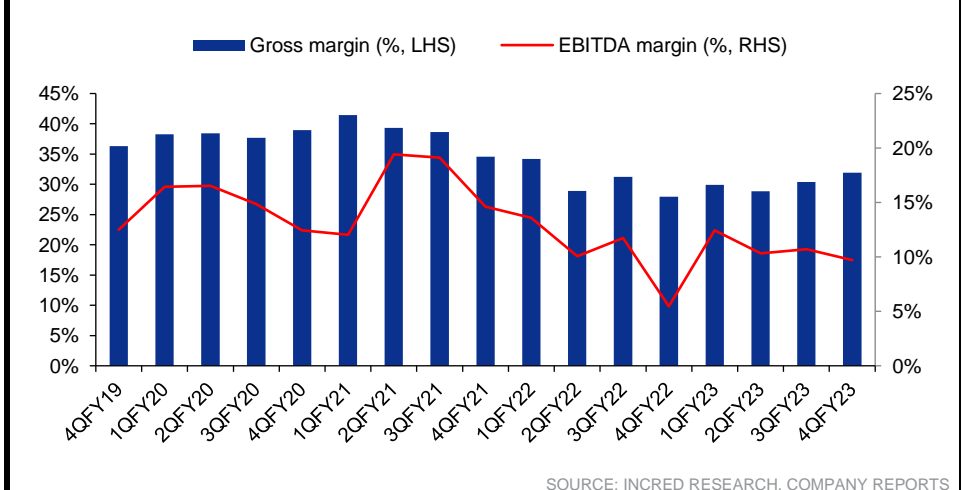


Figure 3: Our revised earnings estimates

Y/E, Mar (Rs. m)	FY24F			FY25F		
	Earlier	Revised	% change	Earlier	Revised	% change
Revenue	84,445	82,715	(2.0)	91,780	89,073	(2.9)
EBITDA	11,393	10,382	(8.9)	12,123	10,902	(10.1)
EBITDA Margin (%)	13.5%	12.6%	-90 bp	13.2%	12.2%	-100 bp
APAT	7,075	6,329	(10.5)	7,560	6,659	(11.9)
EPS	13.1	11.7	(10.5)	14.0	12.4	(11.9)

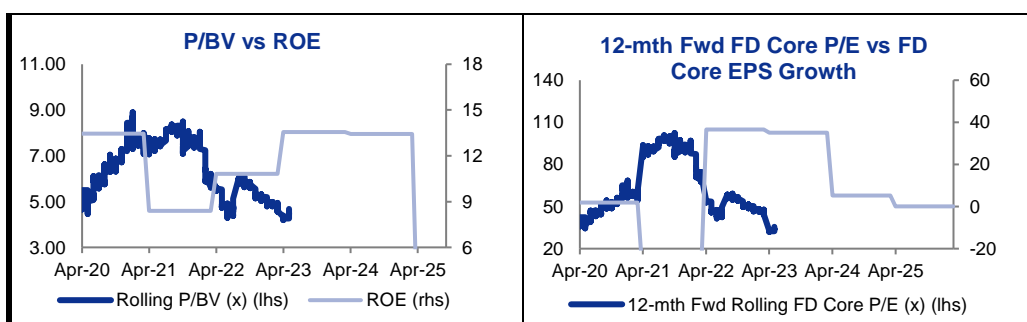
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 4: KNPL's one-year forward P/E trades between 10-year average and -1SD



SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS



Profit & Loss

(Rs mn)	Mar-21A	Mar-22A	Mar-23A	Mar-24F	Mar-25F
Total Net Revenues	50,743	63,694	75,427	82,715	89,073
Gross Profit	19,277	19,421	22,785	26,979	28,695
Operating EBITDA	8,633	6,494	8,180	10,382	10,902
Depreciation And Amortisation	(1,653)	(1,698)	(1,801)	(1,925)	(2,006)
Operating EBIT	6,980	4,796	6,379	8,457	8,896
Financial Income/(Expense)	145	(32)	(30)	5	8
Pretax Income/(Loss) from Assoc.					
Non-Operating Income/(Expense)					
Profit Before Tax (pre-EI)	7,125	4,764	6,349	8,462	8,903
Exceptional Items					
Pre-tax Profit	7,125	4,764	6,349	8,462	8,903
Taxation	(1,867)	(1,333)	(1,664)	(2,133)	(2,244)
Exceptional Income - post-tax					
Profit After Tax	5,258	3,432	4,685	6,329	6,659
Minority Interests					
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	5,258	3,432	4,685	6,329	6,659
Recurring Net Profit	5,258	3,432	4,685	6,329	6,659
Fully Diluted Recurring Net Profit	5,258	3,432	4,685	6,329	6,659

Cash Flow

(Rs mn)	Mar-21A	Mar-22A	Mar-23A	Mar-24F	Mar-25F
EBITDA	8,633	6,494	8,180	10,382	10,902
Cash Flow from Invt. & Assoc.	157	51			
Change In Working Capital	54	(4,912)	(706)		
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow					
Net Interest (Paid)/Received	(237)	(286)	(290)	(257)	(257)
Tax Paid	(1,867)	(1,333)	(1,664)	(2,133)	(2,244)
Cashflow From Operations	6,739	14	5,520		
Capex	(2,089)	(2,715)	(1,804)	(1,600)	(1,350)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments	(3,631)	4,585	(2,908)		
Other Investing Cashflow	382	254	260	262	265
Cash Flow From Investing	(5,337)	2,124	(4,453)	(1,338)	(1,085)
Debt Raised/(repaid)	257	560	(317)		
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)	1,951	(555)	(95)
Cash Flow From Financing	(1,920)	(2,430)	(910)	(3,556)	(3,637)
Total Cash Generated	(518)	(291)	158		
Free Cashflow To Equity	1,660	2,698	750		
Free Cashflow To Firm	1,640	2,424	1,357		

SOURCE: INCRED RESEARCH, COMPANY REPORTS

BY THE NUMBERS...cont'd

Balance Sheet					
(Rs mn)	Mar-21A	Mar-22A	Mar-23A	Mar-24F	Mar-25F
Total Cash And Equivalents	7,926	3,155	6,250		
Total Debtors	9,564	10,933	12,379	11,503	12,304
Inventories	11,979	16,296	17,291	14,931	15,978
Total Other Current Assets	4,517	4,492	4,900	6,804	7,291
Total Current Assets	33,985	34,876	40,821		
Fixed Assets	20,993	22,010	22,013	21,688	21,032
Total Investments	10	11	32	32	32
Intangible Assets	198	198	198	198	198
Total Other Non-Current Assets	148				
Total Non-current Assets	21,348	22,218	22,243	21,918	21,262
Short-term Debt	1,684	2,157	1,824	1,824	1,824
Current Portion of Long-Term Debt					
Total Creditors	10,499	10,898	13,011	13,220	14,152
Other Current Liabilities					
Total Current Liabilities	12,183	13,054	14,834	15,044	15,976
Total Long-term Debt	943	1,031	1,047	1,047	1,047
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities					
Total Non-current Liabilities	943	1,031	1,047	1,047	1,047
Total Provisions	1,316	1,494	1,579	1,119	1,119
Total Liabilities	14,442	15,579	17,460	17,209	18,141
Shareholders Equity	40,529	41,322	45,337	48,110	51,133
Minority Interests	363	193	267	267	267
Total Equity	40,892	41,515	45,604	48,377	51,400

Key Ratios					
	Mar-21A	Mar-22A	Mar-23A	Mar-24F	Mar-25F
Revenue Growth	(3.9%)	25.5%	18.4%	9.7%	7.7%
Operating EBITDA Growth	7.3%	(24.8%)	26.0%	26.9%	5.0%
Operating EBITDA Margin	17.0%	10.2%	10.8%	12.6%	12.2%
Net Cash Per Share (Rs)	9.83	(0.06)	6.27		
BVPS (Rs)	75.21	76.68	84.13	89.27	94.88
Gross Interest Cover	29.44	16.78	22.00	32.87	34.57
Effective Tax Rate	26.2%	28.0%	26.2%	25.2%	25.2%
Net Dividend Payout Ratio	45.1%	62.8%	54.3%	47.4%	53.2%
Accounts Receivables Days	62.70	58.73	56.41	52.69	48.78
Inventory Days	127.97	116.55	116.44	105.51	93.42
Accounts Payables Days	103.70	88.20	82.88	85.89	82.73
ROIC (%)	18.9%	11.1%	14.6%		
ROCE (%)	16.4%	10.7%	13.4%	16.6%	16.6%
Return On Average Assets	9.8%	6.2%	7.8%		

Key Drivers					
	Mar-21A	Mar-22A	Mar-23A	Mar-24F	Mar-25F
Revenue growth (%)	(3.9%)	25.5%	18.4%	9.7%	7.7%
Gross margin (%)	38.0%	30.5%	30.2%	32.6%	32.2%

SOURCE: INCRED RESEARCH, COMPANY REPORTS

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been engaged in market making activity for the subject company	NO	NO

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