

07 August 2023

India | Equity Research | Company Update

Kansai Nerolac

Consumer Staples & Discretionary

Visible trajectory improvement under leadership of Anuj Jain; Upgrade to ADD

Kansai has introduced multiple DCF-accretive initiatives under the leadership of Mr. Anuj Jain, MD such as (1) steady expansion of innovative product portfolio across sub-segments, (2) relaunched brand as 'Nerolac Paint+ with Japanese technology' supported by higher brand and R&D spends, (3) investments in projects, Next-gen painting services and influencer reach to connect with customers and generate pipeline, (4) Kansai has also expanded dealer reach to 31,000 outlets in FY23 from 19,000 in FY19 and has also leveraged distribution model to improve coverage of smaller cities and rural markets. We also believe differentiated product offerings in Industrial coatings and industry tailwinds like automotive recovery and commodity price correction offer growth and margin tailwinds. Upgrade to **ADD** as risk of higher competition appears priced in after flat one-year stock performance.

Aggressive investments in multiple growth initiatives

Kansai has invested in numerous growth initiatives such as (1) brand relaunch supported by higher R&D and ad-spends, (2) expansion of dealer network from 24,000 in FY19 outlets to 31,000 outlets in FY23, (3) leveraging distribution route to reach to customers in smaller cities and rural markets, (4) multiple programs to strengthen connect with influencers and (5) aggressive investments in product portfolio across sub-segments. It has expanded the reach for its Projects business. It has reached to 71 towns by end of FY23.

Industry tailwinds

Kansai generates ~45% revenues from Industrial coatings and is likely to be the biggest beneficiary of revival in Automotive and Industrial segments. It has also invested in differentiated offerings which help its customers in energy efficiency. It will also likely benefit from commodity correction in FY24-25.

Lowest impact in vulnerability index

We calculate the vulnerability index as per competitive intensity and likely increase in competition in sub-segments of paints. In our view, Kansai is likely to be least impacted paint company even if competition escalates ([link](#)).

Upgrade to ADD

We upgrade Kansai to ADD to factor in (1) investments in decorative business (2) revival in Automotive sector and (3) correction in RM prices. We model it to report revenue and PAT CAGR of 11.4% and 27.1%, respectively over FY23-25. We value Kansai at DCF based revised target price of INR 360.

Financial Summary

Y/E March (INR mn)	FY22A	FY23A	FY24E	FY25E
Net Revenue	63,694	75,427	82,352	93,578
EBITDA	6,494	8,180	10,809	11,816
EBITDA Margin (%)	10.2	10.8	13.1	12.6
Net Profit	3,432	4,685	6,705	7,565
EPS (Rs)	4.2	5.8	8.3	9.4
EPS % Chg YoY	(34.7)	36.5	43.1	12.8
P/E (x)	77.1	56.4	39.4	35.0
EV/EBITDA (x)	40.3	31.6	23.2	21.0
RoCE (%)	7.8	10.1	12.4	11.8
RoE (%)	8.3	10.8	13.2	12.9

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Market Data

Market Cap (INR)	264bn
Market Cap (USD)	3,198mn
Bloomberg Code	KNPL IN
Reuters Code	KANE.BO
52-week Range (INR)	354 /247
Free Float (%)	25.0
ADTV-3M (mn) (USD)	2.3

Price Performance (%)	3m	6m	12m
Absolute	25.3	18.3	(1.2)
Relative to Sensex	7.2	9.0	14.2

ESG Disclosure	2021	2022	Change
ESG score	55.6	56.6	1.0
Environment	44.3	40.9	(3.4)
Social	38.9	38.9	-
Governance	83.6	89.9	6.3

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

Previous Reports

04-08-2023: [Q1FY24 results review](#)

09-05-2023: [Q4FY23 results review](#)

Visible trajectory improvement under leadership of Anuj Jain

We note there are multiple positive developments in Kansai in its business fundamentals as well as industry. We model the benefits of the investments and industry tailwinds to lead to healthy value creation in FY24-25. We note (1) the company is investing in new product development, distribution expansion, tinting machines as well as influencers. It has also invested in brand development with brand relaunch, project business, painting services and (2) industry tailwinds such as revival in automotive sector and correction in commodity prices also augur well.

Structural improvements in Decorative business

Steady expansion of product portfolio

The company has done multiple new product launches in recent past. It has introduced products across premium and economy paints. It has also expanded product portfolio of waterproofing and construction chemicals. It has expanded the product portfolio of primers and wood coatings.

We believe strong investments in innovation will likely result in attracting more consumers across income levels leading to strong revenue growth.

Exhibit 1: Product portfolio expansion

Decoratives segments	New product / range launch
Paints	Impressions Kashmir
	Excel Everlast 12
	Suraksha Plus NXT
	Excel Anti Peel NXT
	Beauty Smooth NXT
	True Sheen Exterior Emulsion
Waterproofing & construction chemicals	Prema NoDamp+
	Perma Damp Lock
	Tile Adhesive
Primer & Thinners	Premium Primer NXT
	Economy Exterior Primer
	1K Epoxy Primer
	Economy Interior Primer
Wood coatings and others	TermiProtect
	Wonderwood 111 thinner

Source: Company data, I-Sec research

Brand relaunch as 'Paint+ with Japanese technology'...

Kansai has relaunched the brand in India as 'Nerolac Paint+ with Japanese technology'. We believe the new logo is likely to rejuvenate the entire value chain of dealers, painters and customers. Also the usage of words like 'Japanese technology' helps to premiumize the brand imagery.

Exhibit 2: Nerolac – brand relaunched

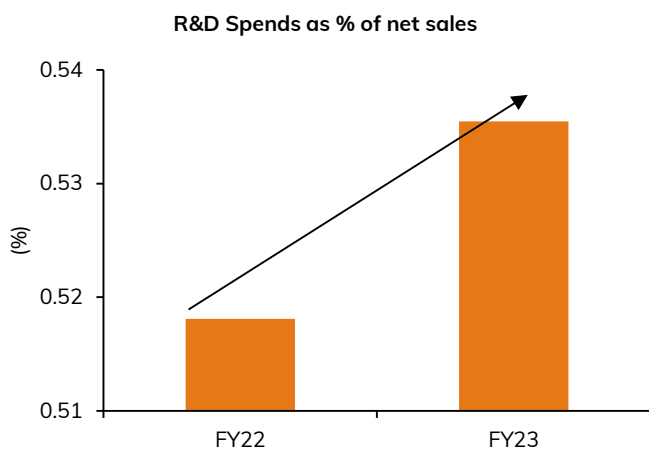


Source: Company data, I-Sec research

...Supported by higher R&D Spends and brand building spends

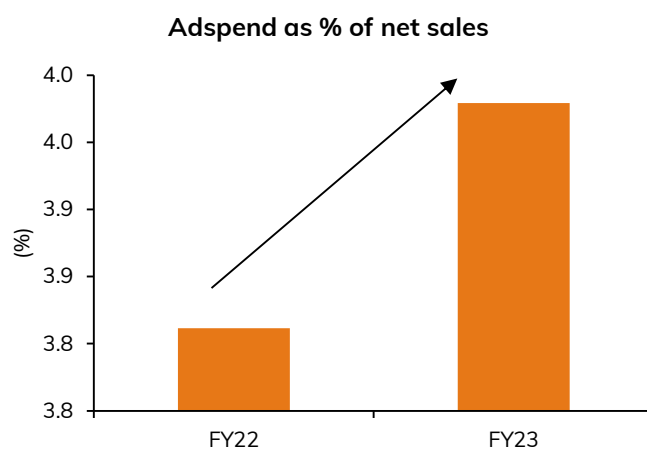
The company has upped the spends in R&D as well as brand building. We believe increase in innovation could allow to expand the product portfolio at faster pace. We also believe increase in share of voice (higher ad-spends) will eventually result in market share gains.

Exhibit 3: Higher R&D spends as % of Net sales



Source: Company data, I-Sec research

Exhibit 4: Increase in Ad-spend as % of Net sales



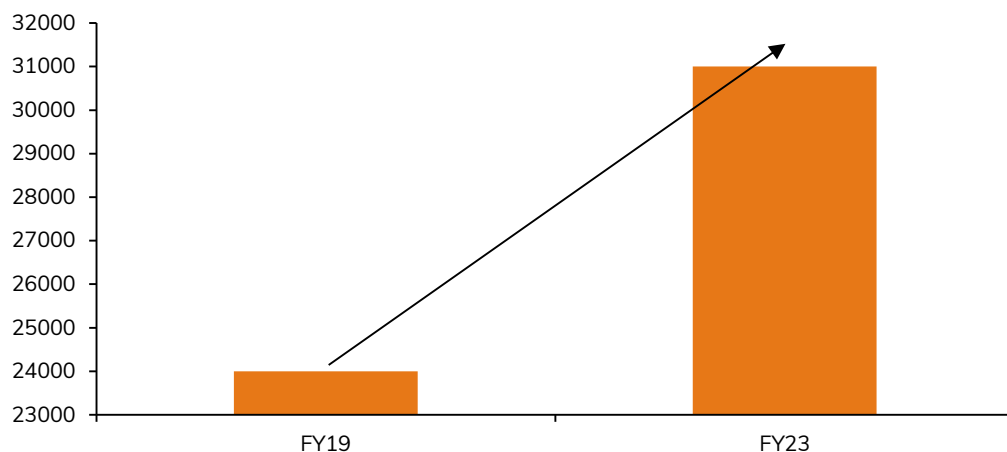
Source: Company data, I-Sec research

Expansion of distribution network

The company has steadily expanded the distribution reach to 31,000+ outlets in FY23 from 24,000+ outlets in FY19. Its pace of distribution expansion has also accelerated now. We believe Nerolac brand had strong awareness. With improving availability (distribution expansion) of products, we believe there is strong scope to leverage the brand and expand market shares.

Steady investments in tinting machines will also lead to higher throughput-per-store and it will also strengthen the moats in distribution.

Exhibit 5: Dealer network expansion



Source: Company data, I-Sec research

Investments in driving influencer reach

Influencer (painters, architects etc) are critical in paints sector and help the consumers while making decisions about paints. The company has initiated multiple projects and strengthened the teams to reach out to multiple influencers. While some benefits of these initiatives are already visible, we believe the majority of the benefits will likely be realized in FY24-26.

Exhibit 6: Investments in influencer reach

Investment details	Particulars
Increase in headcount of demand generation assistants	DGAs are first point contact for painters Increase in number of DGAs in multiple cities will help to generate demand
Pragati program for painters	Several benefits and schemes for Painters with direct benefit transfer to painters Enhancement of Pragati app in FY23
Training to painters	Advanced training to 61,000 painters via classroom session or mobile training academy.
Illuminati program	Program to capture interest of Architects and interior designers Also developed APP 'LEAD' to drive connect.
Expansion of on-ground team for Projects	Team to identify and create a demand pipeline. Also integrated construction chemicals and projects teams to emerge as complete solution provider
Next gen painting services	Reached to 450 cities in Next gen painting services
Distributor model	Apart from dealer network, distributor model is helping to expand reach in Tier II, Tier III and rural markets.

Source: Company data, I-Sec research

Investments in Industrial coatings

Kansai has investments in introducing R&D backed product offerings to its customers which help in energy efficiency. It has also introduced differentiated coatings and vibrant colours. We note the company has gained market shares in Two wheelers as well as Electric vehicles. It has also expanded product portfolio in performance coatings.

Exhibit 7: Product portfolio expansion of Industrial coatings

Investment details	Particulars
Entry in new segments (PV)	Kansai entered Seam sealer, underbody blacks, alloy wheels and fasteners coating segment
	Introduced tin free CED coating in PV segment
Market share gains in Two Wheelers	Achieved market share gains in Two wheelers in FY23
	Introduced innovative coating solution that comply with E20 and E30 norms
Commercial vehicles	Introduced energy efficient products that reduce carbon footprint during use/ application phase
Electric vehicles	Focussed on market penetration and introduced vibrant colours
Performance coatings	Introduced multiple differentiated offerings to penetrate further

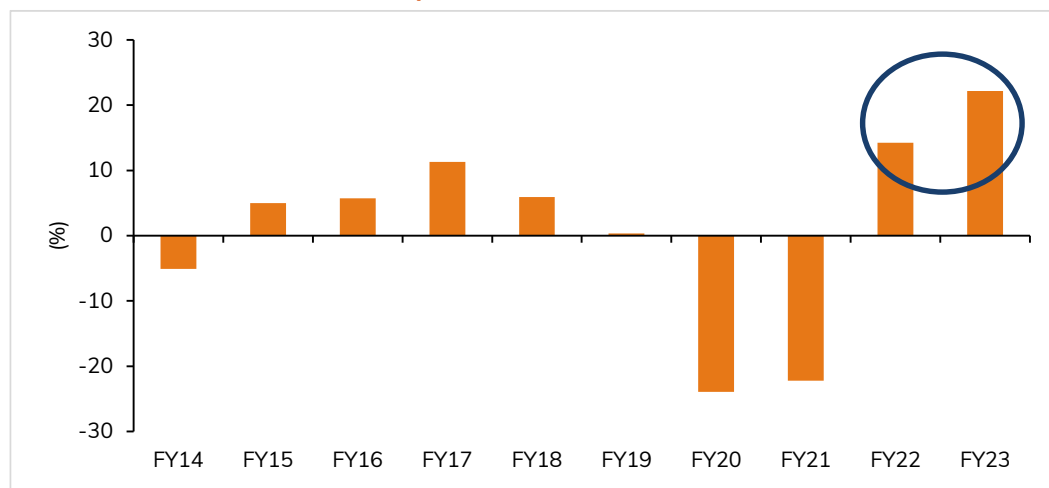
Source: Company data, I-Sec research

Industry tailwinds to drive growth

Revival in automotive production

Post steep decline in PV production during covid, the PV production was also impacted due to chip availability in FY21 and H1FY22. As both these issues are largely behind, we believe the steady revival in automotive sector will likely result in higher growth of Industrial paints. Kansai generates ~45% revenues from Industrial coatings. Revival of Automotive sector is also expected to benefit it maximum among the peers.

Exhibit 8: Revival in automotive production (PV)

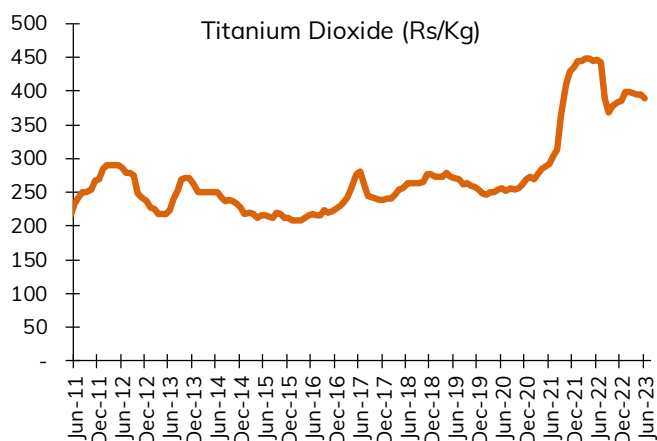


Source: Company data, I-Sec research

Correction in Commodity prices

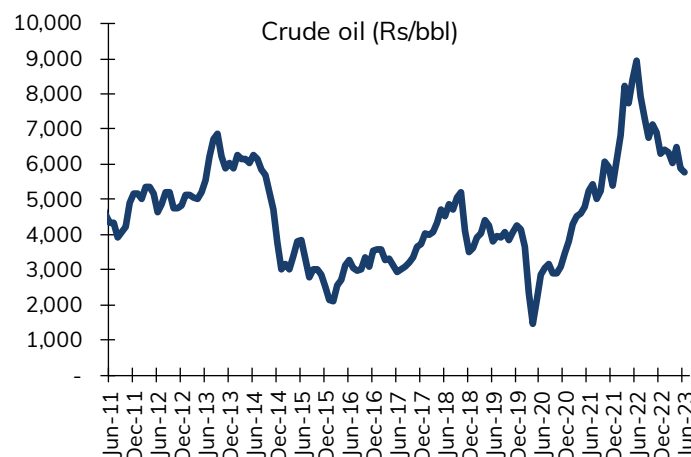
Most commodity prices have corrected YoY. We believe it will likely provide margin tailwinds in FY24.

Exhibit 9: Titanium di-oxide

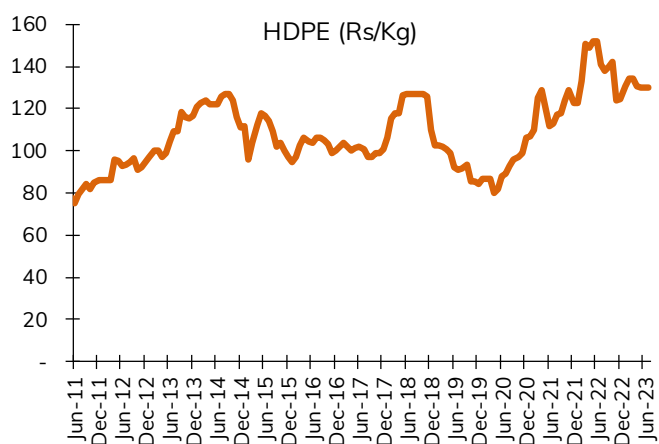


Source: Company data, I-Sec research

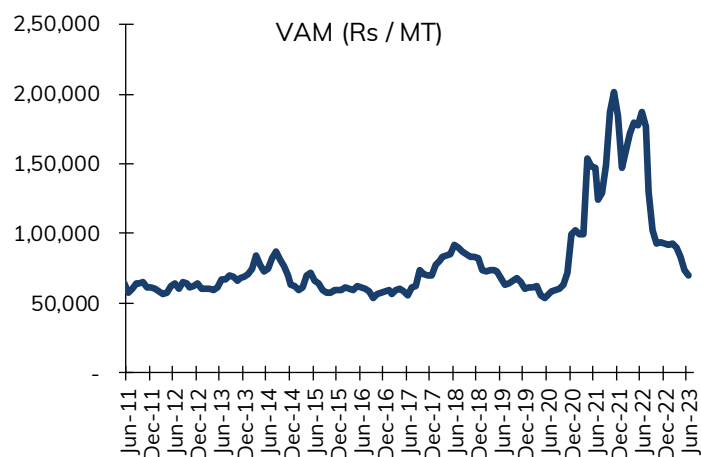
Exhibit 10: Crude oil



Source: Company data, I-Sec research

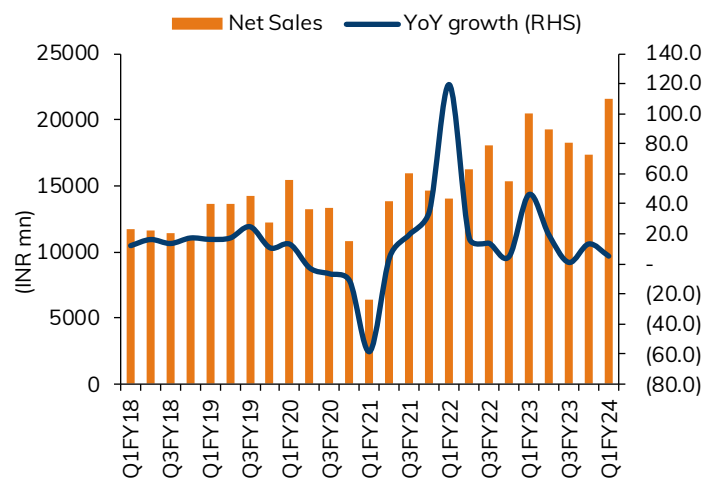
Exhibit 11: Packaging material - HPDE

Source: Company data, I-Sec research

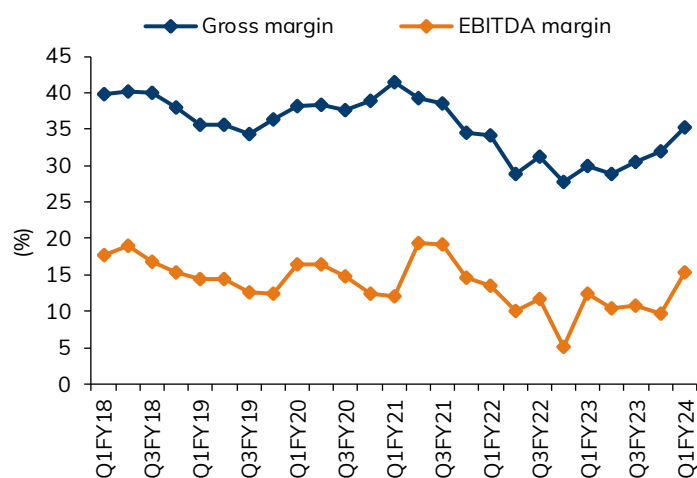
Exhibit 12: VAM prices

Source: Company data, I-Sec research

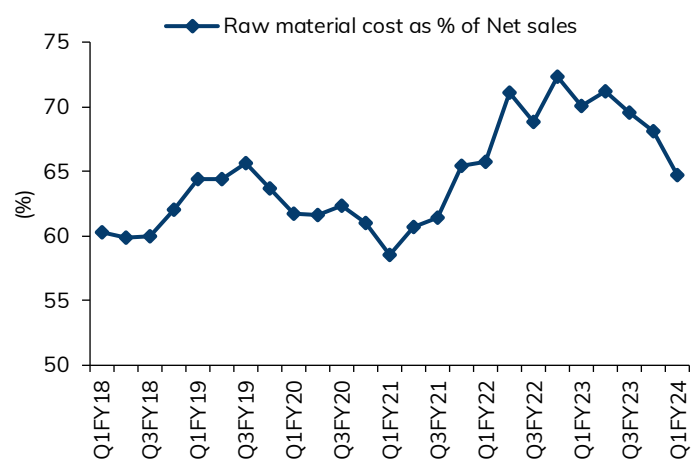
Operational highlights (Quarterly)

Exhibit 13: Revenues and growth rates


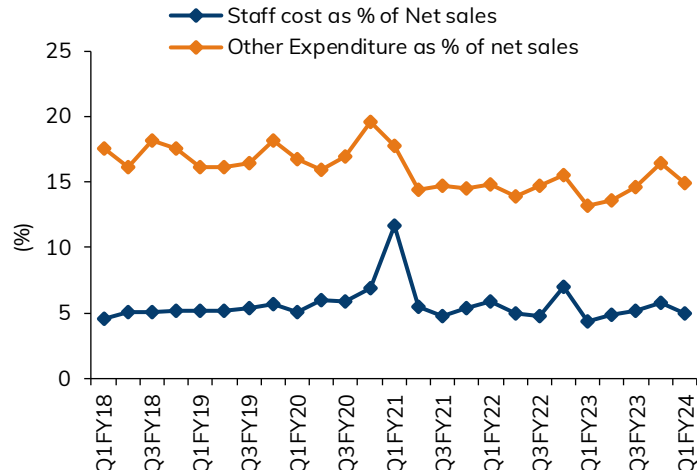
Source: Company data, I-Sec research

Exhibit 14: Gross and EBITDA margins


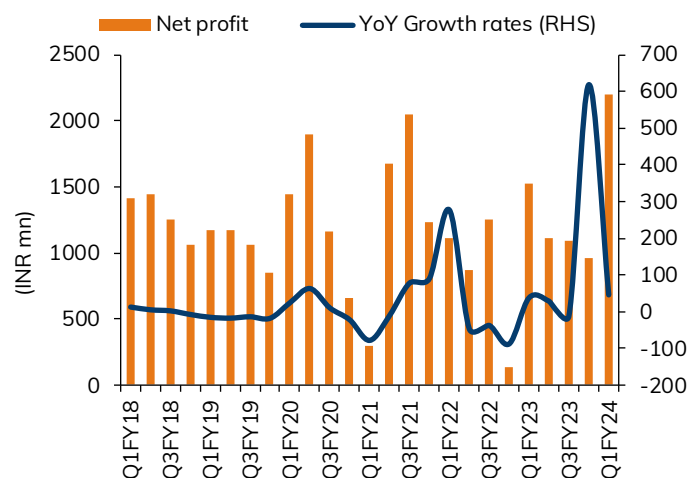
Source: Company data, I-Sec research

Exhibit 15: Raw material cost


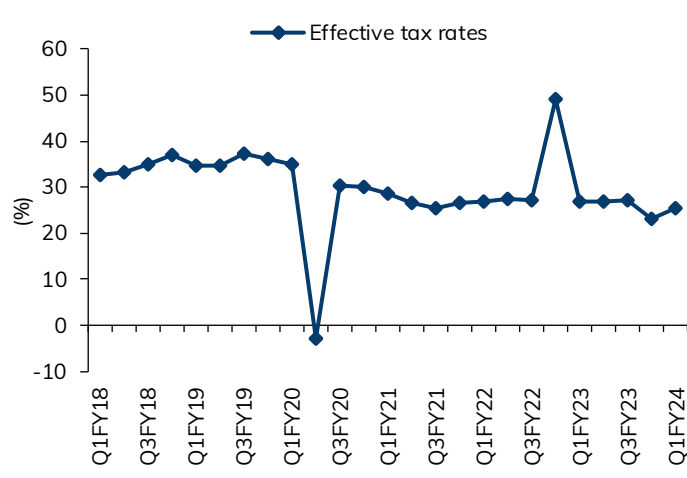
Source: Company data, I-Sec research

Exhibit 16: Staff and other expenditure


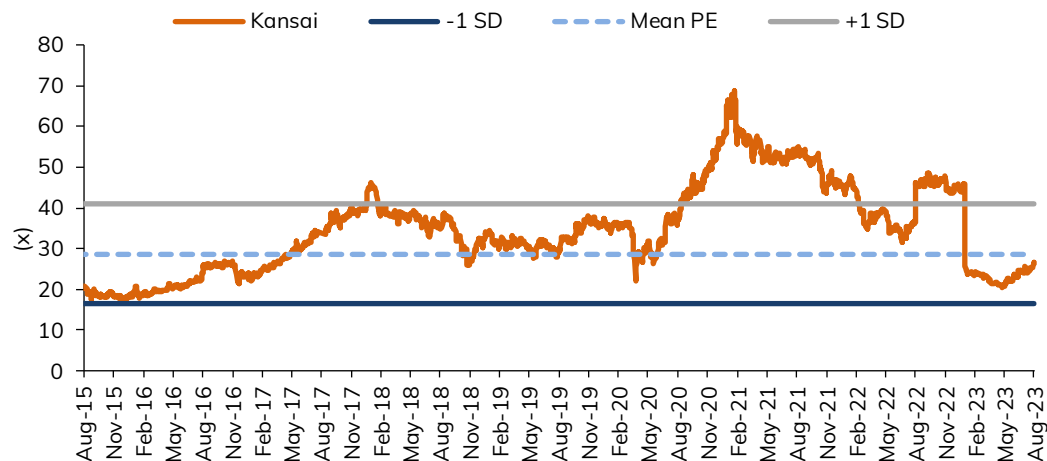
Source: Company data, I-Sec research

Exhibit 17: Net profit and growth rates


Source: Company data, I-Sec research

Exhibit 18: Effective tax rate


Source: Company data, I-Sec research

Exhibit 19: Mean P/E and standard deviation

Source: Company data, I-Sec research

Key risks:

Higher-than-expected competition and steep inflation in input prices.

Exhibit 20: Shareholding pattern

%	Dec'22	Mar'23	Jun'23
Promoters	75.0	75.0	75.0
Institutional investors	16.7	16.7	16.5
MFs and other	5.7	5.1	4.3
FIs/ Banks	-	-	-
Insurance Cos.	7.6	7.7	7.9
FIIIs	3.4	3.9	4.3
Others	8.3	8.3	8.5

Source: Bloomberg, I-Sec research

Exhibit 21: Price chart

Source: Bloomberg, I-Sec research

Financial Summary

Exhibit 22: Profit & Loss

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Net Sales	63,694	75,427	82,352	93,578
Operating Expenses	12,927	14,605	17,085	19,571
EBITDA	6,494	8,180	10,809	11,816
EBITDA Margin (%)	10.2	10.8	13.1	12.6
Depreciation & Amortization	1,698	1,801	1,929	2,087
EBIT	4,796	6,379	8,880	9,729
Interest expenditure	286	290	283	283
Other Non-operating Income	254	260	363	663
Recurring PBT	4,764	6,349	8,960	10,110
Profit / (Loss) from Associates	-	-	-	-
Less: Taxes	1,333	1,664	2,255	2,545
PAT	3,432	4,685	6,705	7,565
Less: Minority Interest	(159)	(53)	(60)	(60)
Extraordinaries (Net)	32	102	5,159	-
Net Income (Reported)	3,622	4,839	11,924	7,625
Net Income (Adjusted)	3,432	4,685	6,705	7,565

Source Company data, I-Sec research

Exhibit 23: Balance sheet

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Total Current Assets	30,208	33,050	43,473	50,250
of which cash & cash eqv.	1,060	1,269	8,779	10,832
Total Current Liabilities & Provisions	11,340	13,513	14,754	16,765
Net Current Assets	18,868	19,536	28,719	33,484
Investments	4,680	7,803	7,803	7,803
Net Fixed Assets	19,762	20,882	21,953	22,866
ROU Assets	-	-	-	-
Capital Work-in-Progress	2,246	1,131	1,131	1,131
Total Intangible Assets	198	198	198	198
Long Term Loans & Advances	-	-	-	-
Deferred Tax assets	-	-	-	-
Total Assets	45,754	49,550	59,803	65,482
Liabilities				
Borrowings	3,174	2,827	2,827	2,827
Deferred Tax Liability	1,065	1,119	1,119	1,119
Provisions	-	-	-	-
Other Liabilities	-	-	-	-
Equity Share Capital	539	539	539	539
Reserves & Surplus	40,783	44,798	55,051	60,730
Total Net Worth	41,322	45,337	55,590	61,269
Minority Interest	193	267	267	267
Total Liabilities	45,754	49,550	59,803	65,482

Source Company data, I-Sec research

Exhibit 24: Quarterly trend

(INR mn, year ending March)

	Sep-22	Dec-22	Mar-23	Jun-23
Net Sales	19,310	18,268	17,336	21,568
% growth (YOY)	19.2%	0.9%	13.2%	5.1%
EBITDA	1,994	1,955	1,681	3,315
Margin %	10.3%	10.7%	9.7%	15.4%
Other Income	41	74	97	172
Extraordinaries	44.1	-4.2	8.5	5,159
Adjusted Net Profit	1,112	1,090	962	2,198

Source Company data, I-Sec research

Exhibit 25: Cashflow statement

(INR mn, year ending March)

	FY22A	FY23A	FY24E	FY25E
Operating Cashflow	241	6,080	6,962	6,939
Working Capital Changes	(4,864)	(460)	(1,672)	(2,713)
Capital Commitments	(2,715)	(1,806)	(3,000)	(3,000)
Free Cashflow	(2,474)	4,274	3,962	3,939
Other investing cashflow	4,367	(3,123)	-	-
Cashflow from Investing Activities	1,652	(4,929)	(3,000)	(3,000)
Issue of Share Capital	-	-	-	-
Interest Cost	-	-	-	-
Inc (Dec) in Borrowings	730	(347)	-	-
Dividend paid	(1,213)	(1,455)	(1,671)	(1,886)
Others	-	-	-	-
Cash flow from Financing Activities	(2,079)	(942)	3,548	(1,886)
Chg. in Cash & Bank balance	(185)	209	7,510	2,053
Closing cash & balance	1,060	1,269	8,779	10,832

Source Company data, I-Sec research

Exhibit 26: Key ratios

(Year ending March)

	FY22A	FY23A	FY24E	FY25E
Per Share Data (INR)				
Reported EPS	4.2	5.8	8.3	9.4
Adjusted EPS (Diluted)	4.2	5.8	8.3	9.4
Cash EPS	6.3	8.0	10.7	11.9
Dividend per share (DPS)	1.5	1.8	2.1	2.3
Book Value per share (BV)	51.1	56.1	68.8	75.8
Dividend Payout (%)	35.3	31.1	24.9	24.9
Growth (%)				
Net Sales	26.3	18.4	9.2	13.6
EBITDA	(24.8)	26.0	32.1	9.3
EPS (INR)	(34.7)	36.5	43.1	12.8
Valuation Ratios (x)				
P/E	77.1	56.4	39.4	35.0
P/CEPS	51.6	40.8	30.6	27.4
P/BV	6.4	5.8	4.8	4.3
EV / EBITDA	40.3	31.6	23.2	21.0
P / Sales	4.2	3.5	3.2	2.8
Dividend Yield (%)	0.0	0.0	0.0	0.0
Operating Ratios				
Gross Profit Margins (%)	30.5	30.2	33.9	33.5
EBITDA Margins (%)	10.2	10.8	13.1	12.6
Effective Tax Rate (%)	28.0	26.2	25.2	25.2
Net Profit Margins (%)	5.4	6.2	8.1	8.1
Net Debt / Equity (x)	(0.1)	(0.1)	(0.2)	(0.3)
Net Debt / EBITDA (x)	(0.4)	(0.8)	(1.3)	(1.3)
Fixed Asset Turnover (x)	2.0	2.2	2.2	2.4
Working Capital Days	20	23	9	3
Inventory Turnover Days	104	91	87	89
Receivables Days	70	65	63	64
Payables Days	15	16	16	16
Profitability Ratios				
RoCE (%)	7.8	10.1	12.4	11.8
RoE (%)	8.3	10.8	13.2	12.9
RoIC (%)	7.8	10.1	12.4	11.8

Source Company data, I-Sec research

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