

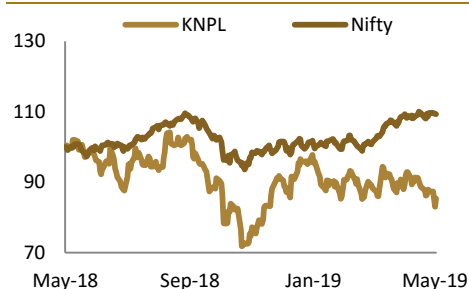
Market statistics

Current stock price (₹)	427
Shares O/S (cr.)	53.9
Mcap (₹ cr)	23,236
52W H/L (₹)	543/343
6m avg. volume	1,99,735
Bloomberg	KNPL IN

Shareholding pattern

Promoters	74.99
Domestic Institution	10.72
Foreign Institution	4.65
Non-institution more than 1%	9.64
Franklin India Debt Hybrid	1.27
Aditya Birla Advantage Fund	1.97

KNPL vs Nifty



Capital efficiency & valuations

Particulars	FY19	FY20E	FY21E
RoE (%)	13.6	14.5	15.0
RoCE (%)	18.5	19.9	20.7
P/B (x)	6.7	6.1	5.5
EV/OCF (x)	75.3	37.7	40.8
EV/EBITDA (x)	30.6	26.0	22.7
P/E (x)	49.2	41.8	36.5

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Kansai Nerolac's (KNPL) 4QFY19 standalone PAT declined 12% YoY affected by weak industrial volume growth. Revenue increased just 4% YoY despite decent higher single digit volume growth in decorative business. However industrial segment witnessed negative volume growth led by weakness in domestic Automobile sector. The effect of higher input costs is reflected in gross margins which declined 173bps YoY to 36.3%; although on QoQ basis there is an improvement of 174bps. EBITDA declined 11% YoY to Rs1.5b lower than est. of Rs1.75b; while EBITDA margin contracted by 233bps YoY to 13%. Although stock has underperformed its peers due to weak industrial performance, improvement in domestic automobile sector remains the key factor to watch. Maintain Hold.

Subdued operating performance despite high single digit deco volume growth

Revenue increased mere 4.5% YoY to Rs11.5b; lower than est. of Rs12.5b, on the back of negative volume growth in auto segment; although decorative segment witnessed higher single digit volume growth. Similar slackening of demand was also seen in other OEM segments. Decorative business volume growth was healthy at ~9% although lower than earlier quarters. Weak demand and inadequate pricing action in industrial segment affected margins. In Decorative segment, companies have undertaken price hikes regularly over last few quarters to mitigate higher raw material prices. Although cost pressures were abated during the quarter, prices of derivatives still remain high. Higher crude and weakening rupee against dollar can put further pressure on decorative margins. However price hikes comes with a lag in industrial segment for KNPL and over last few quarters, it has been able to take only part increase in prices to mitigate rising costs. Kansai is looking at increasing its revenue from decorative paints as decorative have higher margins and pricing power than industrial paints. It also has lower margin volatility than industrial paints.

Rising proportion of decorative demands capacity expansion

KNPL has 4 factories located at Jainpur (UP), Lote (Maharashtra), Bawal (Haryana) and Hosur (Tamil Nadu). In addition, an industrial facility will be commissioned at Sayakha (Gujarat) to cater mainly to automobile customers. All activities of Phase-1 of the manufacturing unit have been completed and the unit is commissioned during this quarter. KNPL is also setting up a 52800KLP A Decorative Plant at Amritsar at revised Capex of Rs2.2b and construction work of the manufacturing unit is in full swing and operations are likely to commence in this quarter. Another Greenfield industrial plant at Vishakhapatnam is being planned, and land acquisition is over and the project is in the planning stage. As proportion of decorative revenue increase over period to over 55% KNPL needs to gather pace for capacity expansion.

Overseas subsidiaries can contribute meaningfully in FY20

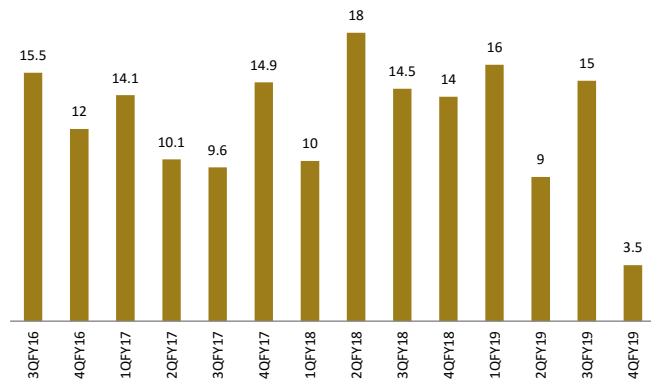
In April 2018, KNPL acquired 100% equity shareholding in Marpol P. Ltd, Goa (Marpol), which is one of the leading companies in powder coating business, for an aggregate consideration of Rs360m. Marpol manufactures products such as epoxy polyester, pure polyester, pure epoxy and polyurethane powder. KNPL expects post acquisition synergy benefits in raw material and other miscellaneous costs. Softening raw materials would aid overseas operations to contribute meaningfully in FY20.

Outlook & Valuation

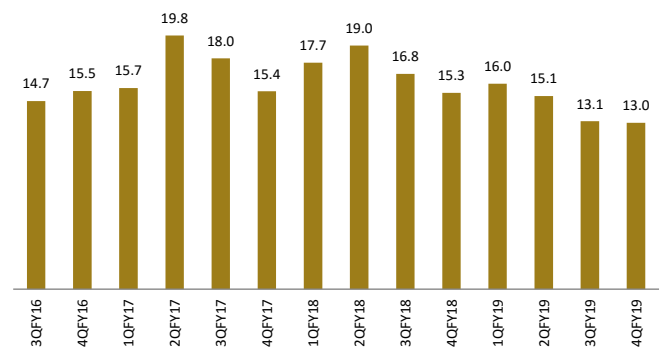
Post strong double digit volume growth over last few quarters, KNPL delivered muted performance as industrial segment deteriorated further. Management's commentary was very cautious for near term demand outlook which suggests weaker 1HFY20 and may give good entry point for long term investors. Over FY07-19 KNPL has delivered 13%, 12% and 11% CAGR in revenue, EBITDA and PAT, respectively. We expect KNPL to deliver 14%, 15% and 16% CAGR growth over FY19-21E in revenue, EBITDA & PAT, respectively due to its rising focus on distribution network, gradual recovery in Auto sector and overall domestic economy. We cut our FY20 EPS by 12% on weaker near term demand (pricing and volume) assumptions. Stock trades at 36.5x FY21E EPS of Rs11.7 which is not too lucrative. Maintain **HOLD**.

**Exhibit 1: Quarterly Performance**

Particulars (₹ mn)	4QFY18	3QFY19	4QFY19	YoY Chg (%)
Total Income	11,036	13,507	11,532	4.5
Total RM	6,842	8,842	7,349	7.4
Gross Profit	4,194	4,664	4,183	-0.3
Gross Margin (%)	38.0	34.5	36.3	-173bps
Employee Cost	571	677	609	6.7
% of sales	5.2	5.0	5.3	11bps
Other Expenditure	1,934	2,218	2,078	7.4
% of sales	17.5	16.4	18.0	50bps
EBITDA	1,689	1,770	1,496	-11.4
EBITDA Margin (%)	15.3	13.1	13.0	-233bps
Depreciation	197	235	235	19.4
Other Income	186	198	145	-22.4
EBIT	1,679	1,733	1,406	-16.3
EBIT Margin (%)	15.2	12.8	12.2	-302bps
Interest	0	0	0	
PBT	1,679	1,733	1,406	-16.3
Total Tax	621	606	478	-23.0
Effective tax rate (%)	37.0	35.0	34.0	-299bps
Reported PAT	1,058	1,127	928	-12.3
Adjusted PAT	1,058	1,127	928	-12.3

Exhibit 2: Volume growth falters

Source: Company, Trust

Exhibit 3: Quarterly EBITDA margins trend

Source: Company, Trust



Financials – Consolidated

P&L Statement

Y/E Mar (₹ mn)	FY17	FY18	FY19	FY20E	FY21E
Net Sales	39,991	45,866	51,736	58,114	67,040
Change (%)	7.0	14.7	12.8	12.3	15.4
Raw Materials	20,711	24,472	33,025	32,544	37,542
Operating Expenses	11,618	13,115	11,291	16,908	19,640
EBITDA	7,662	8,278	7,420	8,662	9,858
Change (%)	26.1	8.0	-10.4	16.7	13.8
Margin (%)	19.2	18.0	14.3	14.9	14.7
Depreciation	685	746	905	955	1,004
Int. and Fin. Charges	0	0	0	0	0
Other Income	982	724	619	681	749
Profit before Taxes	7,959	8,256	7,134	8,388	9,602
Tax	2,535	2,700	2,461	2,877	3,294
Tax Rate (%)	31.8	32.7	34.5	34.3	34.3
PBT Before Minority	5,424	5,556	4,674	5,511	6,309
Adjusted PAT	5,424	5,556	4,674	5,511	6,309
Change (%)	38.3	2.4	-15.9	17.9	14.5
Margin (%)	13.6	12.1	9.0	9.5	9.4
Exceptional/Prior Period inc	0	0	0	0	0
Reported PAT	5,424	5,556	4,674	5,511	6,309

Balance Sheet

Y/E Mar (₹ mn)	FY17	FY18	FY19E	FY20E	FY21E
Share Capital	539	539	539	539	539
Total Reserves	27,514	30,712	33,769	37,394	41,439
Net Worth	28,053	31,251	34,308	37,933	41,978
Long Term Borrowings	183	97	77	57	37
Deferred Tax Liability	792	804	804	804	804
Other LT Liabilities & provisions	0	0	0	0	0
Trade Payables	5,502	6,836	7,591	8,527	9,836
Other Current Liabilities	1,174	1,442	1,442	1,442	1,442
Short Term Borrowings	0	0	0	0	0
Total Liabilities	35,974	40,679	44,471	49,011	54,346
Net Fixed Assets	9,464	10,064	10,259	10,305	10,300
Capital WIP	1,421	3,431	4,331	5,331	6,331
Non current Investments	222	260	260	260	260
Long term loans & advances	1,320	1,618	1,618	1,618	1,618
Inventory	6,913	8,058	10,631	11,145	12,986
Account Receivables	5,717	6,757	7,503	8,428	9,723
Cash and Bank Balance	2,497	3,609	2,986	5,042	6,246
Short term loan & advances	2,966	1,523	1,523	1,523	1,523
Currents Investments	5,308	5,200	5,200	5,200	5,200
Total Assets	35,974	40,679	44,471	49,011	54,346

**Cash Flow**

Cash Flow Statement (₹ mn)	FY17	FY18	FY19E	FY20E	FY21E
PBT before EO items	7,959	8,256	7,134	8,388	9,602
Add : Depreciation	685	746	905	955	1,004
Interest	0	0	0	0	0
Less : Direct taxes paid	2,535	2,700	2,461	2,877	3,294
(Inc)/Dec in WC	4,605	-528	2,564	504	1,825
CF from Operations	1,504	6,830	3,014	5,962	5,488
Extraordinary	666	12	0	0	0
CF from Op after extra	2,170	6,842	3,014	5,962	5,488
(Incr)/Decr in FA	1,885	3,356	2,000	2,000	2,000
(Pur)/Sale of Investments	63	-70	0	0	0
CF from Invest.	-1,948	-3,286	-2,000	-2,000	-2,000
Inc/(Dec) in equity	-783	-957	0	0	0
Inc/(Dec) in debt	-105	-86	-20	-20	-20
Dividend paid	1,617	1,401	1,617	1,886	2,263
CF from fin. activity	-2,504	-2,444	-1,637	-1,906	-2,283
Incr/Decr of Cash	-2,282.0	1,112.2	-622.9	2,056.0	1,204.2
Add: Opening Balance	4,779	2,497	3,609	2,986	5,042
Closing Balance	2,497	3,609	2,986	5,042	6,246

Key Ratios

Y/E Mar (%)	FY17	FY18	FY19	FY20E	FY21E
Raw Material Cost/Sales	51.8	53.4	56.9	56.0	56.0
Manpower Cost/Sales	4.6	4.6	4.9	4.8	4.8
Operating & Other Cost/Sales	24.5	24.0	23.9	24.3	24.5
Revenue Growth	7.0	14.7	12.8	12.3	15.4
EBITDA Margins	19.2	18.0	14.3	14.9	14.7
Net Income Margins	13.6	12.1	9.0	9.5	9.4
ROCE	24.0	23.4	18.5	19.9	20.7
ROE	19.3	17.8	13.6	14.5	15.0

Valuation Parameters

Y/E Mar	FY17	FY18	FY19	FY20E	FY21E
EPS (₹)	10.1	10.3	8.7	10.2	11.7
P/E (x)	37.7	41.4	49.2	41.8	36.5
BV (₹)	52.1	58.0	63.7	70.4	77.9
P/BV (x)	7.3	7.4	6.7	6.1	5.5
EV/EBITDA (x)	26.3	27.3	30.6	26.0	22.7
Fixed assets turnover ratio (x)	4.2	4.6	5.0	5.6	6.5
Net Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0
EV/Sales (x)	5.0	4.9	4.4	3.9	3.3

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