

Kansai Nerolac Paints

ADD
Maintained

No correlation between PV cycle and PE multiples **Rs522**

Analysis of historical multiples of Kansai Nerolac Paints (KNPL) indicates that recovery in passenger volumes may result in higher earnings growth, but has no bearings on its PE multiples. There is no correlation between passenger vehicles volume growth and PE multiples of Kansai. The company's valuation discount to Asian Paints (Kansai PE/Asian Paints PE) over FY07-19 also has no correlation with passenger vehicle volume growth rates. With Kansai trading near its mean PE+ 1SD, we believe, there is limited stock price upside via multiple rerating and earnings growth will be a key driver for stock price movement. We expect the company to report PAT CAGR of 21.5% over FY19-FY22E and improve its return ratios across the same timeframe. Maintain ADD rating with a DCF-based target price of Rs565 (implied P/E 39x Sep'21E). [Please also refer to our note Anniversarization of decline in PV volumes.](#)

- **PE multiples have no correlation with PV cycle recovery:** We note the average PE multiples (One year forward) of Kansai show no correlation with recovery in passenger vehicle production cycle. Recovery in PV cycle will lead to better revenue/earnings growth for Kansai. While earnings trajectory may change with recovery in PV volumes, there is no correlation with PE multiples of Kansai.
- **No change in premium/discount to Asian Paints:** While recovery in PV cycle may offer higher growth prospects to Kansai (in short term), there is no change in premium/discount to market leader Asian Paints during this timeframe. KNPL has traded at an average discount of 20% to Asian Paints over FY07-19 and we note the discount remains similar during up/down cycle of passenger vehicles.
- **Price movement depends on earnings as multiples are at mean PE +1SD:** Kansai has traded at an average PE multiple (one-year forward) of 28.8x over FY07-19, whereas now it trades at mean PE + 1 standard deviation. We believe now the price movement will largely depend on earnings growth than PE rerating. We expect the company to report earnings CAGR of 21.5% over FY19-22E.
- **Maintain ADD:** We expect revenue and PAT CAGRs of 13.5% and 21.5%, respectively, over FY19-22E. Return ratios are also expected to improve during the same period. While revenue performance is likely to be weaker, we note tailwinds such as: 1) reduction in tax rates, and 2) commencement of Punjab factory to reduce freight cost, which would drive earnings growth in FY20E-FY21E. Maintain our **ADD** rating on the stock with target price of Rs565 at 39x Sep'21E EPS.

Company update

Paints

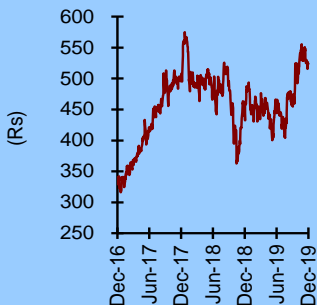
Target price: Rs565

Shareholding pattern

	Mar '19	Jun '19	Sep '19
Promoters	75.0	75.0	75.0
Institutional investors	15.4	15.4	15.7
MFs and others	6.6	7.5	7.5
Banks, FI's, Insurance co	3.7	3.7	3.5
FII's	5.1	4.2	4.7
Others	9.6	9.6	9.3

Source: BSE

Price chart



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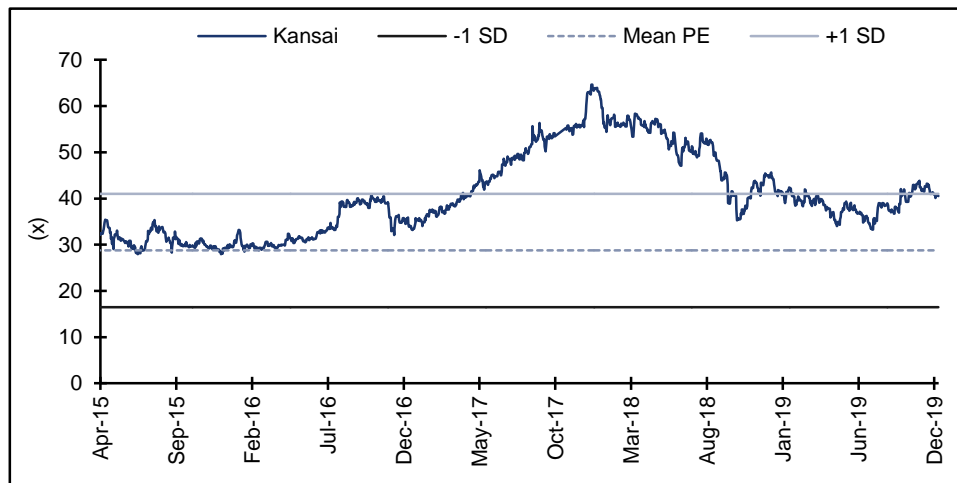
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Market Cap	Rs281bn/US\$4bn	Year to March	FY19	FY20	FY21E	FY22E
Reuters/Bloomberg	KANE.BO/KNPL IN	Net Revenue (Rs mn)	51,736	58,178	66,255	75,606
Shares Outstanding (mn)	538.9	Net Profit (Rs mn)	4,673	6,194	7,271	8,374
52-week Range (Rs)	555/400	Dil. EPS (Rs)	8.7	11.5	13.5	15.5
Free Float (%)	25.0	% Chg YoY	(9.5)	32.5	17.4	15.2
FII (%)	4.7	P/E (x)	60.2	45.4	38.7	33.6
Daily Volume (US\$'000)	1,414	CEPS (Rs)	10.4	13.4	15.5	17.7
Absolute Return 3m (%)	14.8	EV/EBITDA (x)	37.8	32.3	27.5	23.8
Absolute Return 12m (%)	17.9	Dividend Yield (%)	0.5	0.6	0.7	0.7
Sensex Return 3m (%)	9.1	RoCE (%)	13.9	16.5	17.3	17.6
Sensex Return 12m (%)	14.8	RoE (%)	14.3	17.0	17.7	18.0

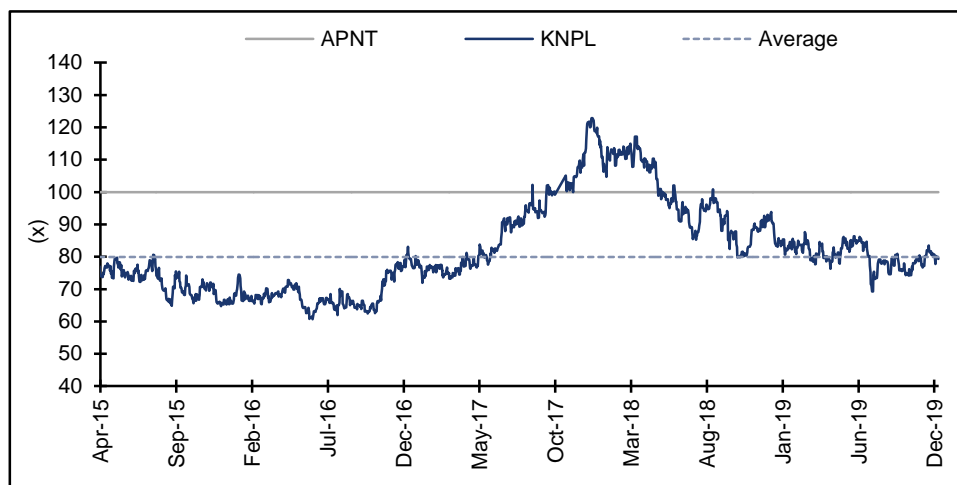
No correlation between PV cycle and PE multiples

Chart 1: Mean P/E and standard deviations



Source: Company, I-Sec research

Chart 2: Valuation Premium/discount to Asian Paints



Source: Company, I-Sec research

Table 1: Passenger vehicle production growth and KNPL multiples

Year	Avg PE multiple	KNPL relative multiple*	PV Volume growth (%)
FY07	19.3	106.8	4.0
FY08	18.3	82.0	13.7
FY09	11.2	64.8	4.5
FY10	12.8	76.1	28.4
FY11	22.3	85.1	25.9
FY12	21.4	78.7	5.0
FY13	25.1	76.5	3.6
FY14	25.7	74.0	(5.1)
FY15	30.2	76.1	5.0
FY16	30.6	70.9	5.8
FY17	35.7	70.6	11.3
FY18	51.6	97.6	5.9
FY19	46.5	91.7	0.4

Source: Company data, I-Sec research *assuming Asian Paints as 100

Reiterate **ADD**

We expect Kansai Nerolac to report revenue and PAT CAGRs of 13.5% and 21.5%, respectively, over FY19-FY22E. EBITDA margin is expected to improve to 15.3% in FY22E from 14.3% in FY19. Return ratios are also expected to remain stable over the same timeframe. We maintain our **ADD** rating on the stock with a DCF-based target price of Rs565 (implied P/E of 39x Sep'21E).

Key risk

Sharp increase in input prices as well as competitive pressures may impact our earnings estimates on Kansai Nerolac.

Financial summary

Table 2: Profit & loss statement

(Rs mn, year ending March 31)

	FY19	FY20E	FY21E	FY22E
Net Revenues	51,736	58,178	66,255	75,606
Operating Expenses	44,316	49,557	56,157	64,017
EBITDA	7,420	8,621	10,098	11,589
% margins	14.3%	14.8%	15.2%	15.3%
Depreciation & Amortisation	905	1,001	1,080	1,142
Gross Interest	-	-	-	-
Other Income	619	657	698	744
Recurring PBT	7,134	8,277	9,717	11,191
Less: Taxes	2,461	2,083	2,446	2,817
Less: Minority Interest	-	-	-	-
Net Income (Reported)	4,673	6,194	7,271	8,374
Extraordinaries (Net)	-	-	-	-
Recurring Net Income	4,673	6,194	7,271	8,374

Source: Company data, I-Sec research

Table 3: Balance sheet

(Rs mn, year ending March 31)

	FY19	FY20E	FY21E	FY22E
Assets				
Total Current Assets	23,708	26,211	30,073	35,536
of which cash & cash eqv.	814	2,493	3,276	5,183
Total Current Liabilities & Provisions	7,730	9,477	11,253	13,462
Net Current Assets	15,979	16,734	18,821	22,074
Investments	3,045	3,545	3,545	3,545
Net Fixed Assets	13,159	16,158	19,078	21,936
Capital Work-in-Progress	3,147	3,147	3,147	3,147
Goodwill	-	-	-	-
Total Assets	35,330	39,583	44,591	50,702
Liabilities				
Borrowings	34	34	34	34
Deferred Tax Liability	1,051	1,051	1,051	1,051
Minority Interest	-	-	-	-
Equity Share Capital	539	539	539	539
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus*	33,706	37,959	42,967	49,078
Less: Misc. Exp. n.w.o.	-	-	-	-
Net Worth	34,245	38,498	43,506	49,617
Total Liabilities	35,330	39,583	44,591	50,702

Source: Company data, I-Sec research

Table 4: Cashflow statement

(Rs mn, year ending March 31)

	FY19	FY20E	FY21E	FY22E
Operating Cashflow	5,578	7,195	8,351	9,516
Working Capital Changes	(5,831)	924	(1,304)	(1,346)
Capital Commitments	(3,714)	(4,000)	(4,000)	(4,000)
Free Cashflow	(3,966)	4,119	3,047	4,170
Cash flow from Investing Activities	2,413	(500)	-	-
Issue of Share Capital	9	0	(0)	(0)
Inc (Dec) in Borrowings	(63)	-	-	-
Dividend paid	(1,689)	(1,940)	(2,263)	(2,263)
Change in Deferred Tax Liability	247	-	-	-
Chg. in Cash & Bank balances	(3,050)	1,679	783	1,907

Source: Company data, I-Sec research

Table 5: Key ratios

(Year ending March 31)

	FY19	FY20E	FY21E	FY22E
Per Share Data (Rs)				
EPS	8.7	11.5	13.5	15.5
Cash EPS	10.4	13.4	15.5	17.7
Dividend per share (DPS)	2.6	3.0	3.5	3.5
Book Value per share (BV)	63.5	71.4	80.7	92.1
Growth (%)				
Net Sales	12.8	12.5	13.9	14.1
EBITDA	-6.0	16.2	17.1	14.8
PAT	-9.5	32.5	17.4	15.2
Cash EPS	-5.8	29.0	16.1	14.0
Valuation Ratios (x)				
P/E	60.2	45.4	38.7	33.6
P/CEPS	50.4	39.1	33.7	29.6
P/BV	8.2	7.3	6.5	5.7
EV / EBITDA	37.8	32.3	27.5	23.8
EV / Sales	5.4	4.8	4.2	3.7
Operating Ratios				
Raw Material / Sales (%)	63.8	63.3	62.9	62.9
Employee cost / Sales (%)	4.9	5.0	5.0	5.0
SG&A / Sales (%)	16.9	16.9	16.8	16.8
Other Income / PBT (%)	8.7	7.9	7.2	6.7
Effective Tax Rate (%)	34.5	25.2	25.2	25.2
Working Capital (days)	106	89	85	81
Inventory Turnover (days)	73	70	70	70
Receivables (days)	47	49	49	49
Payables (days)	69	76	80	84
Net D/E Ratio (x)	0.0	0.0	0.0	0.0
Profitability Ratios (%)				
Net Income Margins	9.0	10.6	11.0	11.1
RoACE	13.9	16.5	17.3	17.6
RoAE	14.3	17.0	17.7	18.0
Dividend Payout	30.0	26.1	25.9	22.5
Dividend Yield	0.5	0.6	0.7	0.7
EBITDA Margins	14.3	14.8	15.2	15.3

Source: Company data, I-Sec research

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