

RESULT UPDATE ✓

Kansai Nerolac Paints (GOONER)

WHAT'S CHANGED...

PRICE TARGET.....	Changed from Rs 502 to Rs 351
EPS (FY09E).....	Changed from Rs 45.4 to Rs 38.2
EPS (FY10E).....	Changed from Rs 50.2 to Rs 43.9
RATING.....	Changed from OUTPERFORMER to HOLD

Current Price Rs 360	Target Price Rs 351
Downside 2.5%	Time Frame 12-15 months

HOLD
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Drab show...

Kansai Nerolac Paints continued to post dismal results in Q3FY09 on the back of sluggish demand for automotive paints, which are predominantly driven by automobile companies. The company posted de-growth in topline by 8.4% to Rs 316.4 crore in Q3FY09 from Rs 345.4 crore in the corresponding quarter of last year. The EBITDA margin dipped to 10.9% from 14.4% in Q3FY08 on account of higher raw material to sales. Interest costs increased substantially by 42.1% to Rs 0.5 crore from Rs 0.4 crore in Q3FY08 due to higher interest rates. Consequently, net profit declined by 29.7% to Rs 21.3 crore from Rs 30.2 crore in Q3FY08.

Highlight of the quarter

Kansai, with more than 50% of revenues coming from the industrial sector, has been severely affected by the slump in automotive sales. Although the company witnessed moderate growth in sales during the first half of the year led by decorative paint demand, the recent slowdown in real estate has also affected decorative paint demand this quarter.

Valuations

At the current price of Rs 360 the stock is discounting its FY09E EPS of Rs 38.2 by 9.4x and FY10E EPS of Rs 43.9 by 8.2x. With the tremors of the slowdown reverberating in the automobile and real estate sector we believe the demand for industrial and decorative paints remaining subdued. Although margins are likely to improve, a decline in volume growth is imminent. Subsequently, we value the stock at 8x its FY10EPS of Rs 43.9 to arrive at a price target of Rs 351 downgrading from our earlier target of Rs 502.

Stock data....

Market Cap.	Rs 970.0 Cr
Debt (FY08)	Rs 124.8Cr
Cash (FY08)	Rs 34.3 Cr
EV	Rs 1060.5 Cr
52 week H/L (Rs)	850 / 321
Equity capital	Rs 26.9 Cr
Face value	Re 10
MF Holding	2.8%
FII Holding	5.3%

Price performance (%)

Company	1M	3M	6M	12M
Asian	2.8	-13.0	-15.0	-21.5
Kansai	3.9	-19.3	-34.8	-53.0
Berger	4.9	3.0	-11.9	-39.3

Exhibit 1: Key Financials

	(Rs crore)								
	Q3FY09A	Q3FY09E	Q3FY08	Q2FY09	YoY Gr.	QoQ Gr.	YTDFY09	FY09E	FY10E
Net Sales	316.4	354.7	345.4	390.6	-8.4%	-19.0%	1061.7	1363.9	1500.3
EBIDTA	34.5	39.2	49.8	45.4	-30.6%	-23.9%	124.9	179.8	207.0
EBIDTA Margin (%)	10.9%	11.0%	14.4%	11.6%			11.8%	13.2%	13.8%
Depreciation	9.8	9.2	10.3	9.1	-5.4%	7.2%	27.5	36.8	47.5
Interest	0.5	0.6	0.4	0.6	42.1%	-1.8%	1.5	2.2	3.2
Other Income	5.2	9.9	4.9	4.0	5.7%	29.1%	16.1	21.3	21.9
Reported Net Profit	21.3	26.7	30.2	27.1	-29.7%	-21.5%	78.5	102.9	118.3
EPS (Rs)	7.9	9.9	11.2	10.0	-29.7%	-21.5%	29.1	38.2	43.9
Valuation									
PE (x)	-	-	-	-	-	-	-	9.4	8.2
Target PE (x)	-	-	-	-	-	-	-	9.2	8.0
EV to EBIDTA (x)	-	-	-	-	-	-	-	5.3	4.6
Price to book (x)	-	-	-	-	-	-	-	1.5	1.3
RoNW	-	-	-	-	-	-	-	15.8%	15.6%
RoCE	-	-	-	-	-	-	-	19.3%	23.9%

Source: Company, ICICIdirect.com Research

Result analysis

Revising estimates

In view of the grim macroeconomic environment and deteriorating demand we have revised our estimates. We have changed net sales to Rs 1363.9 crore from Rs 1477.8 crore in FY09E while net profit has been changed to Rs 102.9 crore from Rs 115.5 crore in FY09E. For FY10E, we have changed net sales to Rs 1500.3 crore from Rs 1648.1 crore while net profit has been changed to Rs 118.3 crore from Rs 135.3 crore.

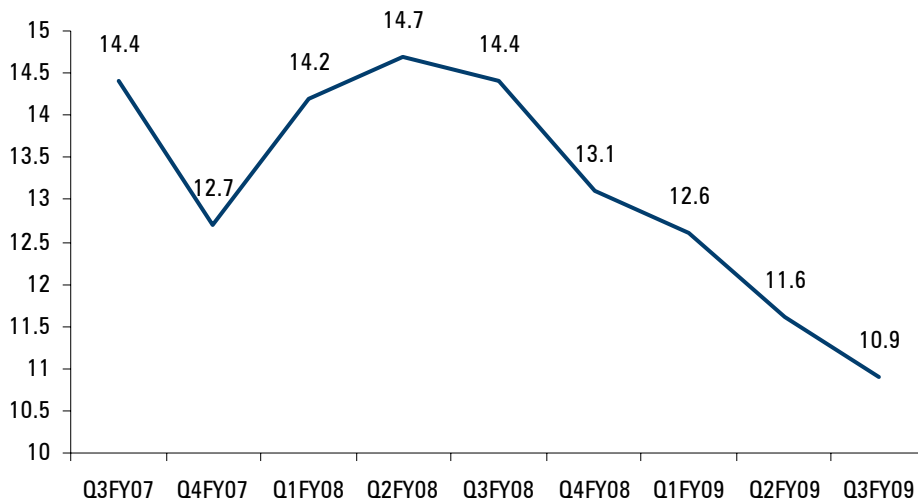
Automotive paint demand decelerates on breaks in auto demand

With auto companies scaling down production on account of weakening macro fundamentals and tightening liquidity the near term implications of the automobile sector are negative. The substantial hike in interest rates along with the reluctance of financial institutions to lend have adversely affected the demand for automobiles. This, in turn, has crippled the demand for industrial paints, which is primarily driven by the automobile industry. A moderate improvement in the outlook for the automobile sector in the long run hinges on a host of factors. These factors are softening of input costs and fuel prices, price cuts, excise duty cuts and governmental initiatives stipulating financial arrangements between public sector banks and non banking finance companies and higher depreciation provisions for commercial vehicles before April 2009. Thus, we expect growth to be muted in the near term.

Depreciating rupee dents margin

The company registered a considerable rise in input costs as a percentage of sales and a significant dip in the EBITDA margin due to the combined effect of high crude prices and the depreciating rupee. Although crude has declined in recent times the adverse impact of a lag effect prevailed.

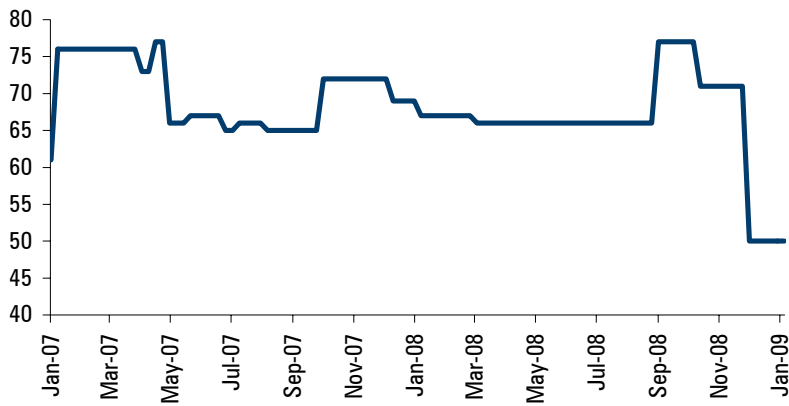
Exhibit 2: EBITDA margin (%)



Source: Company, ICICIdirect.com Research

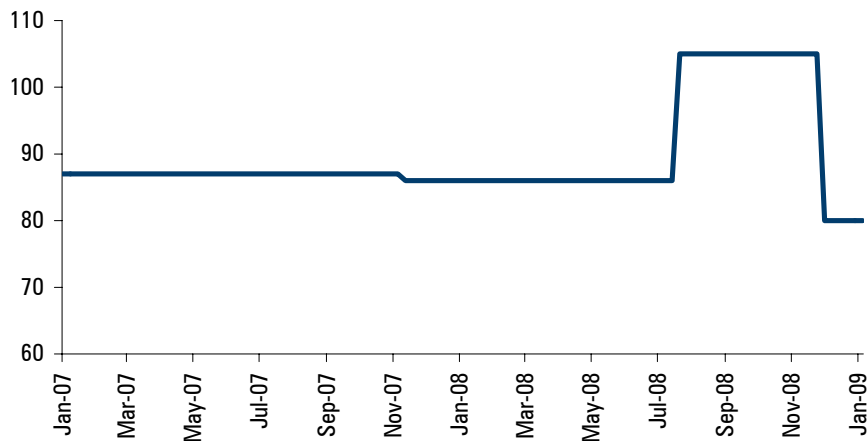
With crude cooling off phthalic anhydride (PAN) and pentaerythritol (Penta) the two key petro-based inputs used in the manufacture of decorative paints that closely follows crude oil prices, will also register a decline. This will, however, be with a lag. Since crude-based inputs constitute about 40% of the raw materials used in the manufacture of paints we believe this phenomenon would enable the company to gain some respite in margins, going forward.

Exhibit 3: PAN (Rs per kg)



Source: Company, ICICIdirect.com Research

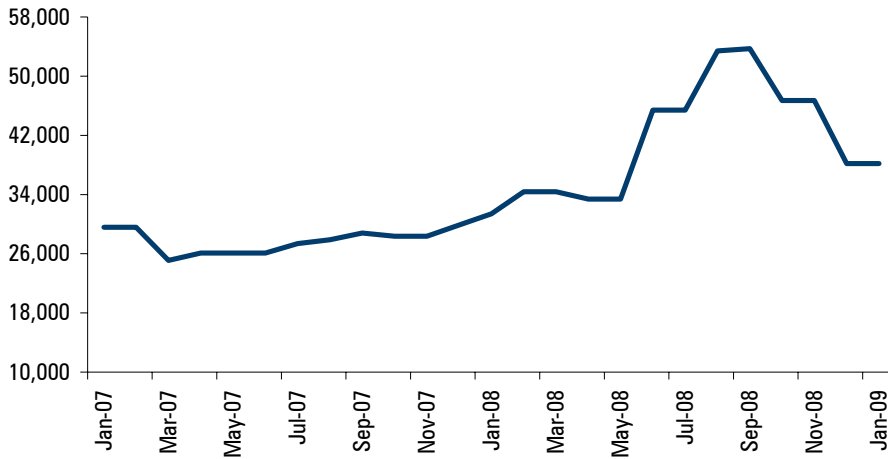
Exhibit 4: Penta (Rs per kg)



Source: Company, ICICIdirect.com Research

Additionally, the prices of mineral turpentine oil (MTO) have also fallen in the current circumstances. We believe this incident along with the aforementioned phenomenon pertaining to PAN and Penta will help the company's margins ease some pressure in the coming quarters.

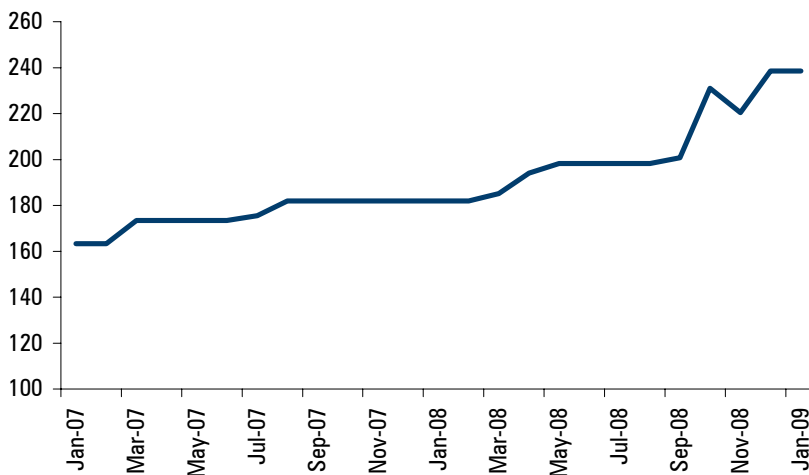
Exhibit 5: Mineral turpentine oil (Rs per kilo litre)



Source: Company, ICICIdirect.com Research

Conversely, the prices of titanium dioxide have remained firm during the quarter. Since this component is usually imported by the company the depreciating rupee catalysed the adverse impact with the company witnessing a rise in raw material prices. Although the prices of titanium dioxide are expected to remain firm in the near term we do believe any significant appreciation in the rupee can subdue the impact.

Exhibit 6: Titanium dioxide (Rs per kg)



Source: Company, ICICIdirect.com Research

Recent bloodbath in real estate sector takes a toll on paints

The credit crunch continues to filter into the Indian real estate market, which is seeing a pronounced effect not only from the lack of corporate and residential demand, but from challenges of obtaining credit. As the economy continues to slow down due to the knock-on effect of the global financial crisis, financial institutions continue to remain cautious by imposing tighter lending norms, thereby causing developers to delay their new and ongoing expansion plans. The imposition of this financial constraint coupled with the hike in interest rates and weak consumer sentiment continues to remain an overhang on the real estate and construction sector severely eroding consumer affordability and curtailing the demand for housing and paints, thereafter. However, the recently introduced cut in home loan rates will revive some activity in the real estate sector and improve the demand for paints from FY10 onwards.

Risk & concerns

Fluctuating raw material prices and volatile exchange rates:

PAN and Penta — two petro-based inputs used in the production of paints — are predominantly dependent on the price of crude oil. Any striking increase in crude prices will negatively affect input costs and, thereby, pressurise margins. In addition to this, titanium dioxide, which accounts for 30% of the total raw material costs, is imported. Any significant depreciation in the rupee will accentuate the impact.

Downturn to lead to shrink in demand:

With the Indian economy reeling under the wrath of the global financial crisis, the paint sector seems to be undergoing tumultuous times. On account of the correlation between the economy and paint demand, we believe the paints industry, which managed to clock a growth rate of 14-15% during the last three years, will only witness an 8-10% growth in the coming quarters. Moreover, since 65-70% of the demand for decorative paints emanates from repainting, which, in turn, is heavily dependent on a country's economic condition we believe the current slowdown has taken a toll on the demand for decorative paints. Additionally, since paints constitute a discretionary category of spending a dip in volumes in a gloomy scenario is impending. As a result, the company will have to introduce several promotional initiatives and price cuts to push sales to gain some respite in volumes, going forward.

Valuations

At the current price of Rs 360, the stock is discounting its FY09E EPS of Rs 38.2 by 9.4x and FY10E EPS of Rs 43.9 by 8.2x. With the tremors of the slowdown reverberating in the automobile and real estate sector we believe the demand for industrial and decorative paints remaining subdued. Although the margin is likely to improve, a decline in volume growth is imminent. Subsequently, we value the stock at 8x its FY10EPS of Rs 43.9 to arrive at a price target of Rs 351, downgrading from our earlier target of Rs 502.

Exhibit 7: Valuation Matrix

	Sales (Rs Crore)	EPS (Rs)	PE (x)	EV/EBIDTA (x)	RoNW (%)	RoCE (%)
FY08	1399.9	44.4	8.1	5.1	21.1%	30.8%
FY09E	1363.9	38.2	9.4	5.3	15.8%	19.3%
FY10E	1500.3	43.9	8.2	4.6	15.6%	23.9%

Source: Company, ICICIdirect.com Research

ICICIdirect.com Coverage Universe

Exhibit 8: Valuation Matrix

Asian Paints			Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBIDTA (x)	RoNW	RoCE
Idirect Code	ASIPAI CMP(Rs)	764 FY08	3416.2	39.1	19.5	13.7	59.4%	57.2%
	Target(Rs)	909 FY09E	4081.0	38.3	19.9	14.5	45.9%	47.5%
Mcap	7520.1 % Upside	19.0% FY10E	4332.6	45.6	16.8	11.4	42.4%	48.6%
Kansai Nerolac			Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBIDTA (x)	RoNW	RoCE
Idirect Code	GOONER CMP(Rs)	360 FY08	1399.9	44.4	8.1	5.2	21.1%	30.8%
	Target(Rs)	351 FY09E	1363.9	38.2	9.4	5.3	15.8%	19.3%
Mcap	970.0 % Downside	2.5% FY10E	1500.3	43.9	8.2	4.6	15.6%	23.9%

Source: Company, ICICIdirect.com Research

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