

Kansai Nerolac Paints

Sensex: 17,144

CMP: INR 900

Target: INR 1,050



Paints

Kansai Nerolac Paints (KNP) Q1FY13 sales at INR 7,235mn, a YoY growth of 11%, was slightly lower than our expectation due to lackluster demand in decorative paints segment. EBIDTA margin at 13.39% was down by 84bps YoY but surprisingly up by 245bps QoQ on back of price hikes taken by the company. PAT at INR 449mn was up by 3.38% YoY, in line with our expectation. Going ahead, bad monsoon and slowdown in auto industry could pose significant headwinds to demand scenario but expected improvement in margins owing to moderation in RM cost and exchange rate stabilization would aid the profitability. We maintain BUY recommendation with the target price of INR 1,050, discounting FY14E earnings at 20x.

Price hikes supported sales growth

KNP reported 11% YoY growth in sales in Q1FY13 on the back of sluggish volume growth of ~4-5%, lower than our expectation. Volume growth came largely from industrial paints segment and was flattish in decorative paints segment. High proportion of price hikes in decorative paints (cumulative ~25% in last two years), persistent high inflation and higher stocking by dealers in previous quarter weighed on volume growth in decorative segment. Going ahead, bad monsoon could pose a dampner on overall demand for decorative as well as industrial paints. Beside ongoing trouble in Maruti Suzuki and general slowdown in auto industry volume would continue to suppress overall demand for auto paints that account for ~35% of company's sales.

Price hikes aided QoQ margin expansion

KNP took ~12% & ~3% average price hikes in FY12 and ~5% and ~4% in Q1FY13 respectively in decorative and industrial paints segment. Consequently, gross margins improved by 336bps QoQ but remained lower by 113bps compared to the corresponding quarter in previous year. Despite moderation in international prices of key RM like TiO2 and crude derivatives, depreciation in INR vis-à-vis USD erased any possible gains. Control on other expenditure helped the company to contain YoY decline in EBIDTA margin by 84bps to 13.39%. Going ahead, we expect stabilization in exchange rate will lead to moderation in RM cost that would aid margin expansion.

Acquisition of 68% stake in Nepal Shalimar

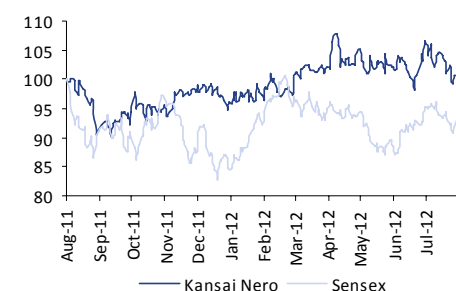
Company initiated process of acquiring 68% stake in Nepal Shalimar Private Ltd. (NSPL) in Q1FY13 to capture growth in Nepal market. Company expects acquisition to be completed by Q2FY13 for a sum of ~INR 75.5mn. Further, KNP would be giving a loan of ~INR 61.2mn to fund the working capital requirement of NSPL. With this, company came in par with its peers having manufacturing facility in the country. Previously, KNP used to export its products to Nepal primarily in premium segment due to 35-40% import duty on paints. NSPL had a turnover of ~INR 123.4mn in FY11 with a market share of ~8%.

Outlook & Valuation

KNP had been successful in taking price hikes of ~4% in industrial paints segment in Q1FY13 that bodes well for margin expansion going forward, provided exchange rate remains at current level. On the demand front, there had been some moderation owing to persistent high inflation and successive price hikes that impacted the overall consumer confidence in decorative paints segment, whereas slowdown in auto industry has had an impact on demand in industrial paints segment compared to previous year. Bad monsoon, however, could be a further dampner to overall demand scenario and therefore is key watchable. Despite slower growth, we expect profitability to be aided by margin expansion. We maintain BUY recommendation with 18 months target price of INR 1,050, discounting FY14E earnings at 20x.

Shareholding (%)	Mar-12
Promoters	69.27
FIIIs	6.57
DIIS	4.66
Others	19.50

Relative Price Performance

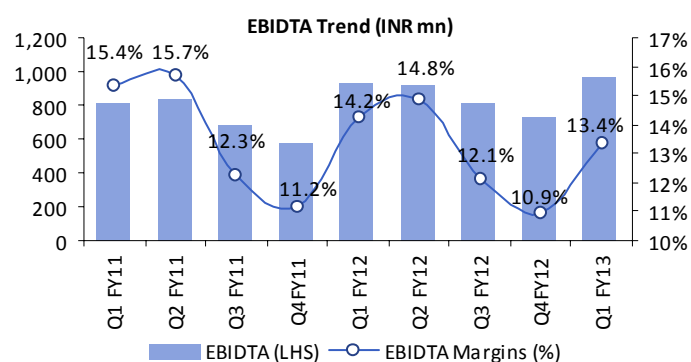
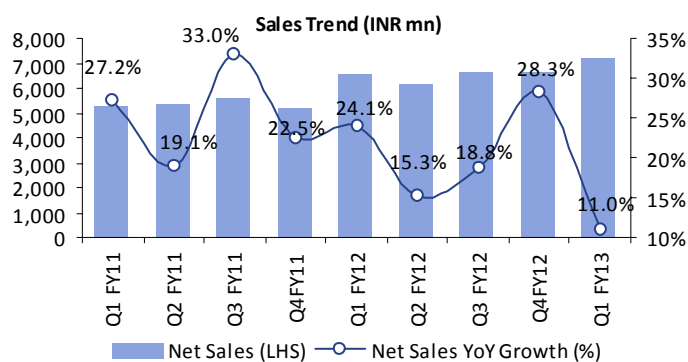


Key Data	
BSE Code	500165
NSE Code	KANSAINER
Bloomberg Code	KNPL IN
Reuters Code	KANE.BO
Shares Outstanding (mn)	53.9
Face Value	10
Mcap (INR bn)	48.5
52 Week H/L	970/790
2W Avg. Qty, NSE	22,532
Beta 1 yr. Nifty	0.12

(INR mn)	FY11	FY12	FY13E	FY14E
Net Sales	21,399	26,006	30,671	34,999
Growth (%)	25.33%	21.53%	17.94%	14.11%
EBIDTAM (%)	13.63%	12.99%	13.10%	13.57%
Adj. PAT	1,853	2,159	2,403	2,831
Growth (%)	14.30%	16.52%	11.29%	17.81%
Adj. PATM (%)	8.66%	8.30%	7.83%	8.09%
Adj. EPS (INR)	34.38	40.06	44.59	52.53
P/E (x)	25.25	22.46	20.18	17.13
EV/EBIDTA	16.33	14.56	12.23	10.34
Net Debt/Equity	(0.36)	(0.16)	(0.11)	(0.23)
RoACE (%)	20.00%	20.31%	19.65%	19.82%
RoANW (%)	21.94%	21.82%	20.74%	20.69%

Quarterly Standalone Financials

Particulars (INR mn)	Q1FY13	Q1FY12	YoY (%)	Q4FY12	QoQ (%)
Total Income	7,235	6,521	10.96%	6,668	8.50%
COGS	4,827	4,277	12.87%	4,673	3.30%
Gross Profit	2,408	2,244	7.31%	1,995	20.70%
Gross Profit Margins %	33.28%	34.41%	-113bps	29.92%	+336bps
Employees' Cost	293	254	15.58%	271	8.12%
as a % of sales	4.05%	3.89%	+16bps	4.06%	-1bps
Other Expenditure	1,146	1,063	7.86%	994	15.29%
as a % of sales	15.84%	16.29%	-46bps	14.91%	+93bps
EBIDTA	969	928	4.42%	730	32.74%
EBIDTA Margins %	13.39%	14.23%	-84bps	10.95%	+245bps
Depreciation	156	120	29.89%	163	-4.29%
EBIT (excl. Other income)	813	808	0.63%	567	43.39%
Other Income	67	57	17.75%	82	-18.29%
EBIT	880	865	1.76%	649	35.59%
Interest	-	3	-100.00%	-	-
Exceptional Item	-	-	-	-	-
EBT	880	862	2.05%	649	35.59%
Tax Expense (Total)	247	250	-1.20%	200	23.50%
Net Profit	633	612	3.38%	449	41.0%
Net Profit Margins %	8.75%	9.39%	-64bps	6.73%	+202bps
EPS	11.75	11.36	3.38%	8.33	40.98%



Source: Company, SPA Research

Financials Standalone

Income statement

Year End March (INR mn)	FY11	FY12	FY13E	FY14E
Net Sales	21,399	26,006	30,671	34,999
Growth (%)	25.33%	21.53%	17.94%	14.11%
Cost of Goods Sold	14,003	17,430	20,563	23,266
Employee Cost	916	1,069	1,227	1,400
Other Operating Expenses	3,563	4,129	4,864	5,584
Total Operating Expenses	18,482	22,627	26,654	30,250
EBIDTA (excl. OI)	2,917	3,379	4,017	4,749
EBIDTA Margin (%)	13.63%	12.99%	13.10%	13.57%
Depreciation/Amortization	494	564	735	920
EBIT	2,423	2,815	3,282	3,829
Interest Expense	8	7	6	5
Other Income (OI)	223	243	150	207
Exceptionals	254	-	-	-
EBT	2,891	3,051	3,427	4,031
Tax Expenses	832	892	1,024	1,200
PAT	2,060	2,159	2,403	2,831
Adjustment to PAT	(207)	-	-	-
APAT	1,853	2,159	2,403	2,831
Growth (%)	14.30%	16.52%	11.29%	17.81%
APAT Margin (%)	8.66%	8.30%	7.83%	8.09%

Key Ratios

Year End March	FY11	FY12	FY13E	FY14E
Per Share Data (INR)				
Reported EPS	38.22	40.06	44.59	52.53
Adj. EPS	34.38	40.06	44.59	52.53
Growth (%)	14.30%	16.52%	11.29%	17.81%
DPS	10.00	11.00	12.00	14.00
BVPS	170.00	197.28	232.65	275.00
Return Ratios (%)				
RoACE	20.00%	20.31%	19.65%	19.82%
RoANW	21.94%	21.82%	20.74%	20.69%
RoIC	23.98%	23.57%	22.60%	22.58%
Liquidity Ratios				
Net Debt/Equity	(0.36)	(0.16)	(0.11)	(0.23)
Interest Coverage Ratio	288.44	433.09	567.32	709.93
Current Ratio	1.49	1.64	1.56	1.55
Efficiency Ratios				
Asset Turnover Ratio	1.56	1.64	1.67	1.64
Inventory Days	78	85	84	82
Debtor Days	42	43	45	45
Payable Days	84	82	84	86
Valuation Ratios				
P/E (x)	25.25	22.46	20.18	17.13
P/BV (x)	5.11	4.56	3.87	3.27
Dividend Yield (%)	1.15%	1.22%	1.33%	1.56%
EV/Net Sales (x)	1.91	1.63	1.38	1.21
EV/EBIDTA (x)	16.33	14.56	12.23	10.34

Balance Sheet

Year End March (INR mn)	FY11	FY12	FY13E	FY14E
Sources of Funds				
Share Capital	539	539	539	539
Reserves and Surplus	8,623	10,093	11,999	14,281
Total Networth	9,162	10,632	12,538	14,820
Total Debt	825	690	640	600
Total	9,987	11,322	13,178	15,420
Application of Funds				
Net Block	2,782	4,078	6,527	7,572
CWIP	1,036	1,684	1,560	258
Investments	3,718	1,835	1,320	3,344
Current Assets	7,043	9,282	10,305	11,714
Current Liabilities	4,727	5,659	6,621	7,546
Net Current Assets	2,316	3,623	3,685	4,168
Deferred Tax Asset (Net)	134	102	86	78
Total	9,987	11,322	13,178	15,420

Cash Flow

Year End March (INR mn)	FY11	FY12	FY13E	FY14E
EBT	2,891	3,051	3,427	4,031
Less: Other Income/Exceptionals	477	243	150	207
Add: Depreciation	494	564	735	920
Add: Interest Paid	8	7	6	5
Taxes Paid	(796)	(892)	(1,024)	(1,200)
Change in Working Capital	(822)	(712)	(38)	(384)
Others	7	6	3	4
Cash Flows from Operations (a)	1,306	1,781	2,957	3,170
Capital Expenditure	(1,268)	(2,508)	(3,000)	(605)
Asset Sales	1	-	-	-
Change in Investment	297	1,392	515	(2,024)
Others	405	302	353	328
Cash Flows from Investments (b)	(565)	(814)	(2,132)	(2,301)
Change in Equity	-	-	-	-
Debt Raised/(Repaid)	(275)	(135)	(50)	(40)
Dividend paid (including tax)	(471)	(631)	(694)	(757)
Interest Paid	(8)	(7)	(6)	(5)
Cash Flows from Financing (c)	(755)	(772)	(749)	(802)
Net Change in Cash (a+b+c)	(14)	195	77	66
Opening Cash	411	397	592	669
Closing Cash	397	592	669	735

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2. Group/Directors ownership of the stock - No
3. Broking relationship with company covered - No

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