# Morning Insight

MAY 8, 2019

| | 7-May | % Chg 1 Day | 1 Mth | 3 Mths |
|---|---|---|---|---|
| **Indian Indices** | | | | |
| SENSEX Index | 38,277 | (0.8) | (1.5) | 3.5 |
| NIFTY Index | 11,498 | (0.9) | (1.4) | 3.9 |
| NSEBANK Index | 29,288 | (1.1) | (2.6) | 6.9 |
| NIFTY 500 Index | 9,451 | (0.9) | (2.4) | 3.3 |
| CNXMcap Index | 17,134 | (1.2) | (6.1) | 1.7 |
| BSESMCAP Index | 14,302 | (0.8) | (4.9) | 3.8 |
| **World Indices** | | | | |
| Dow Jones | 25,965 | (1.8) | (1.4) | 3.4 |
| Nasdaq | 7,964 | (2.0) | 0.1 | 9.1 |
| FTSE | 7,260 | (1.6) | (2.6) | 2.7 |
| NIKKEI | 21,924 | (1.5) | (0.8) | 6.2 |
| Hangseng | 29,363 | 0.5 | (3.1) | 4.3 |
| Shanghai | 2,926 | 0.7 | (10.3) | 11.2 |

| Value traded (Rs cr) | 7-May | % Chg Day |
|---|---|---|
| Cash BSE | 2,201 | 3.9 |
| Cash NSE | 30,629 | 10.3 |
| Derivatives | 981,837 | 43.5 |

| Net inflows (Rs cr) | 6-May | MTD | YTD |
|---|---|---|---|
| FII | 308 | 764 | 68,985 |
| Mutual Fund | 426 | 172 | (2,490) |

| Nifty Gainers & Losers 7-May | Price (Rs) | Chg (%) | Vol (mn) |
|---|---|---|---|
| **Gainers** | | | |
| Hindustan Uniliver | 1,698 | 1.7 | 2.2 |
| Wipro | 294 | 1.0 | 4.4 |
| L&T | 1,367 | 1.0 | 2.6 |
| **Losers** | | | |
| Zee Entertainment | 369 | (4.8) | 19.9 |
| Tata Motors | 191 | (4.4) | 30.5 |
| ICICI Bank | 387 | (3.7) | 41.5 |

**Advances / Declines (BSE)**

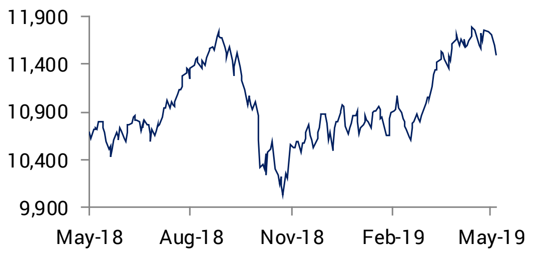
| 7-May | A | B | T | Total | % total |
|---|---|---|---|---|---|
| Advances | 112 | 296 | 42 | 450 | 100 |
| Declines | 344 | 674 | 70 | 1,088 | 242 |
| Unchanged | 4 | 26 | 10 | 40 | 9 |

**Commodity**

| | 7-May | % Chg 1 Day | 1 Mth | 3 Mths |
|---|---|---|---|---|
| Crude (US$/BBL) | 70.2 | 0.5 | (1.2) | 13.1 |
| Gold (US$/OZ) | 1,284.5 | 0.3 | (0.9) | (2.2) |
| Silver (US$/OZ) | 14.9 | 0.1 | (2.1) | (5.8) |

| Debt / Forex Market | 7-May | 1 Day | 1 Mth | 3 Mths |
|---|---|---|---|---|
| 10 yr G-Sec yield % | 7.4 | 7.4 | 7.4 | 7.3 |
| Re/US$ | 69.4 | 69.4 | 69.7 | 71.5 |

**Nifty**




*Source: Bloomberg*

## News Highlights

- **Alembic Pharma** entered into a joint venture contract with SPH Group and Adia to promote and sell pharma products for the Chinese markets. Subsequently, the JV plans to set up a manufacturing facility in China. The pharma company has a 44 percent stake in this arrangement. (BQ)
- **Biocon** retained economic interest in global commercialization of Hulio, a biosimilar drug which is licensed by Mylan and will gain a share of profits from global markets. (BQ)
- Ajay Piramal-led **Piramal Enterprises Ltd** said it has signed an agreement with Canada's largest pension fund manager Canada Pension Plan Investment Board (CPPIB), to co-sponsor India's first renewable energy focused Infrastructure Investment Trust (InvIT). (Mint)
- **BSE** board approved a buyback of 67.6 lakh shares, or 13.06 percent of total capital of the company at a price of Rs 680 per share aggregating to Rs 4.6 bn and appointed Justice Vikramjit Sen as the Chairman. (BQ)
- Private sector lender **Yes Bank** said it has acquired eight crore shares in electric equipment maker CG Power and Industrial Solutions which were pledged to it by a borrower. (Mint)
- The stake sale process of Zee **Entertainment Enterprises Ltd** undertaken by Essel Group, is in steady progress and at an advanced stage," Essel Group said in a statement (Mint)
- **IDBI Bank** board to consider passing enabling resolution for equity issue on May 13. (BQ)
- Seeking multiple concessions for acquiring bankrupt realty firm **Jaypee Infratech,** state-owned **NBCC** has offered to pay Rs 200 mn against over Rs 97.12 bn dues of operational creditors, including the income tax department and Yamuna Expressway development authority YEIDA. (ET)
- Pharma major **Lupin** has received tentative approval for its Fosaprepitant for Injection, 150-mg Single-Dose Vial, from the United States Food and Drug Administration. (BL)
- **Dewan Housing Finance** received the National Housing Bank's nod to sell entire stake of 9.15 percent in Aadhar Housing Finance to Blackstone's arm (BQ)
- Construction major **L&T** bought shares worth about Rs 1.44 bn of Mindtree through open market transactions. (BS)
- The lenders to the crippled **Reliance Communications (RCom)** moved NCLT to appoint a new resolution professional and form a committee of creditors, the first step to begin the bankruptcy process of the Anil Ambani group company that owes close to Rs 500 bn to 31 lenders led by State Bank of India. (ET)
- After **Eveready Industries India Ltd** downgrade, a rating agency downgraded the rating of bulk tea major McLeod Russels India with a negative outlook. The ICRA revised the long-term rating of McLeod Russels, part of the B M Khaitan group companies, from "A" to "BBB-" for Rs 10.3 bn line of credit. (ET)

## What's Inside

- **Result Update**: Greaves Cotton Ltd, Kansai Nerolac Paints Ltd

*Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, IE = Indian Express, BL = Business Line, BQ = BloombergQuint, ToI: Times of India, BSE = Bombay Stock Exchange, MC = Moneycontrol*

Kotak Securities Limited has two independent equity research groups: Institutional Equities and Private Client Group. This report has been prepared by the Private Client Group.

**Result Update**

# GREAVES COTTON LTD

**PRICE RS.145** **TARGET RS.156** **ADD**

Greaves Cotton (GCL) profits missed our estimates on account of decline in EBITDA margins.

## Key Highlights

- New product segments like CNG engines and Electric Vehicles (Ampere) are driving incremental revenue growth.
- EBITDA margins declined due to weak "after sales" revenue and commodity price inflation
- GCL has approved a proposal to buy back shares up to 13.7 mn (5.6% of the share capital) through tender route at a price of Rs 175 per share. This is expected to be EPS and ROE accretive.

## Valuation and Outlook

GCL is currently trading at 15.8x and 13.9x FY20E and FY21E earnings respectively, which is attractive compared to peers in the capital goods and manufacturing sector stocks.

In the past, the company's growth has been lackluster on account of weak demand trend for Diesel fuelled 3W engines. To address this lacuna, the company is in the process of making inroads into CNG engines for 3W for auto majors and has also forayed into electric 2W/3W through acquisition of Ampere Electric Private Ltd. These initiatives, if successful, would provide the much needed growth impulse for the company. Apart from this, high dividend payout and occasional buyback are positive for shareholders.

We now value the stock at 16x average EPS of FY20E and FY21E as against 15x FY20E earlier, thus arriving at a price target of Rs 156 (Earlier Rs 146). In view of the modest upside, we review our rating a notch lower to "ADD" as against "BUY" earlier.

### Financial performance

| (Rs mn) | Q4FY19 | Q4FY18 | YoY (%) |
|---|---|---|---|
| **Net Revenues** | **5281** | **4862** | **8.6** |
| Expenditure | 4581 | 4163 | 10.1 |
| Raw Material costs | 3337 | 3130 | 6.6 |
| Purchase of traded goods | 347 | 192 | 80.6 |
| Staff costs | 422 | 380 | 11.1 |
| Other costs | 475 | 461 | 3.1 |
| **EBITDA** | **700** | **699** | **0.1** |
| Depreciation | 117 | 131 | -11.0 |
| Other income | 86 | 150 | -43.0 |
| **EBIT** | **669** | **718** | **-6.9** |
| Interest | 5 | 6 | -13.3 |
| **PBT** | **663** | **712** | **-6.8** |
| Tax | 161 | 278 | -42.2 |
| PAT before exc items | 503 | 434 | 15.8 |
| exceptional items | -129 | 133 | -196.7 |
| **Reported PAT** | **374** | **567** | **-34.1** |
| EBITDA (%) | 13.3 | 14.4 | |
| RM costs to sales (%) | 69.8 | 68.3 | |
| Other exp to sales (%) | 9.0 | 9.5 | |
| Tax rate (%) | 24.2 | 39.0 | |

*Source: Company*

### Stock Details

| | | |
|---|---|---|
| Market cap (Rs mn) | : | 35386 |
| 52-wk Hi/Lo (Rs) | : | 165 / 111 |
| Face Value (Rs) | : | 2 |
| 3M Avg. daily vol (Nos) | : | 389,631 |
| Shares o/s (mn) | : | 244 |

*Source: Bloomberg*

### Financial Summary

| Y/E Mar (Rs mn) | FY19 | FY20E | FY21E |
|---|---|---|---|
| Revenue | 19,938 | 22,034 | 24,352 |
| Growth (%) | 11.3 | 10.5 | 10.5 |
| EBITDA | 2,807 | 3,185 | 3,669 |
| EBITDA margin (%) | 14.1 | 14.5 | 15.1 |
| PAT | 1,932 | 2,113 | 2,407 |
| EPS | 7.9 | 9.2 | 10.4 |
| EPS Growth (%) | 25.8 | 9.4 | 13.9 |
| BV (Rs/share) | 37.7 | 32.2 | 36.0 |
| Dividend/share (Rs) | 5.5 | 5.5 | 5.5 |
| ROE (%) | 20.0 | 24.1 | 29.0 |
| ROCE (%) | 18.3 | 21.9 | 26.3 |
| P/E (x) | 18.3 | 15.8 | 13.9 |
| EV/EBITDA (x) | 11.0 | 9.5 | 8.8 |
| P/BV (x) | 3.9 | 4.6 | 4.1 |

*Source: Company, Kotak Securities - PCG*

### Shareholding Pattern (%)

| (%) | Mar 19 | Dec-18 | Sep-18 |
|---|---|---|---|
| Promoters | 51.7 | 51.7 | 51.0 |
| FII | 13.0 | 13.0 | 12.2 |
| DII | 15.9 | 15.9 | 17.5 |
| Others | 19.5 | 19.5 | 19.3 |

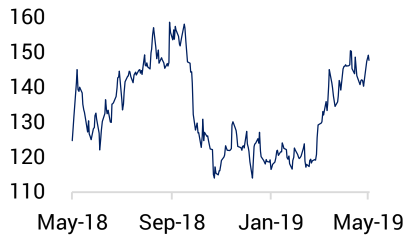
*Source: Bloomberg*

### Price Performance (%)

| (%) | 1M | 3M | 6M |
|---|---|---|---|
| Greaves Cotton | (0.8) | 20.9 | 17.5 |
| Nifty | (1.4) | 3.9 | 8.5 |

*Source: Bloomberg*

### Price chart (Rs)




*Source: Bloomberg*

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**Reported Vs Estimated performance**

| (Rs mn) | Reported | Estimated |
|---|---|---|
| Revenue | 5281 | 5500 |
| EBITDA (%) | 13.3 | 15.0 |
| PAT | 503 | 597 |

*Source: Kotak Securities – Private Client Research*

## Result Highlights

- GCL reported 8.6% y-o-y growth in revenue, aided by 9% y-o-y growth in engine volumes and accompanied by a minor y-o-y decline in average realization.
- On full year basis, revenue growth stood at 11% y-o-y and indicates that after several years of near stagnation, growth has started to look up.
- Pent-up demand on account of 3 years of stagnation and open permits issued by a few major cities shored up 3W demand.
- The company's revenue mix comprised 49% of engine sales, 24% of after market sales and the balance 26% being Genset, Agri equipment and Trading.
- Revenue from sale of Tillers was impacted by liquidity issue faced by the NBFCs, nevertheless, GCL managed to gain market share in full year. The stress in tillers will continue till elections, the management opined.
- Revenue from "New business" (CNG engines and Ampere Electric 2W) accounted for 10% of FY19 revenue (as against 3% in FY18) aided by doubling of sale of CNG engines over the previous fiscal.

**Product volumes**

| (Nos) | Q4FY19 | Q4FY18 | YoY (%) | FY19 | FY18 | YoY (%) |
|---|---|---|---|---|---|---|
| 3W Engine | 74060 | 68861 | 7.5 | 284454 | 272890 | 4.2 |
| Other Auto Engines | 12587 | 12269 | 2.6 | 43147 | 45990 | -6.2 |
| DG sets | 1902 | 1211 | 57.1 | 6049 | 4474 | 35.2 |
| Pumpsets | 26162 | 22035 | 18.7 | 73782 | 76757 | -3.9 |
| Tillers | 478 | 1446 | -66.9 | 3929 | 3334 | 17.8 |
| Electric 2W<br>(Ampere Electric Ltd - subsidiary) | 3433 | 2291 | 49.8 | 14304 | 5528 | 158.8 |
| Other electric vehicles | 461 | 0 | | 898 | 0 | |

*Source: Company*

**Client OEMs of GCL in 3W**

| Corporate | Brand | Fuel | Engine |
|---|---|---|---|
| Piaggio | Ape Xtra and City | CNG, Diesel, LPG | 4 stroke single cylinder |
| M&M | Alfa and Champion | Diesel and CNG | 4 stroke single cylinder |
| TVS | King | Diesel | 4 stroke single cylinder |
| Atul Auto | Shakti, Gem and Gemini | Diesel | 4 stroke single cylinder |

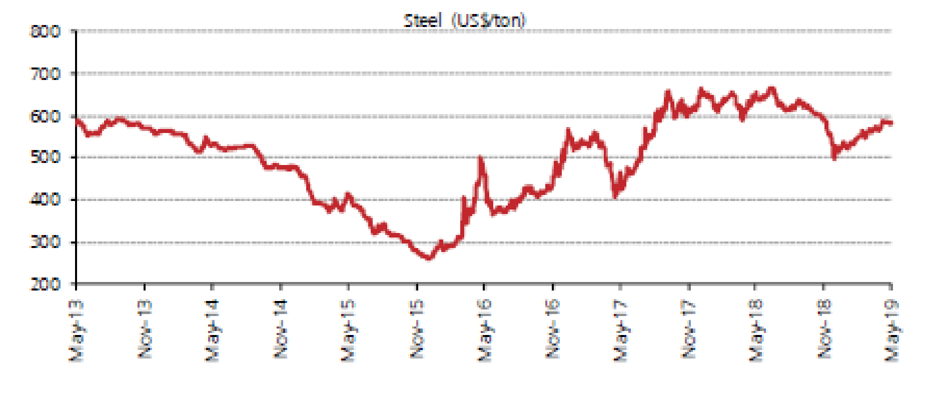
*Source: Company*

## EBITDA margins contracted due to weaker "after market" revenue and commodity inflation

- EBITDA margins contracted by 110 bps on a y-o-y basis to 13.3% in Q4FY19.
- The margin contraction was mainly due to lower gross margins at 30.2% as against 31.7% on a y-o-y basis.

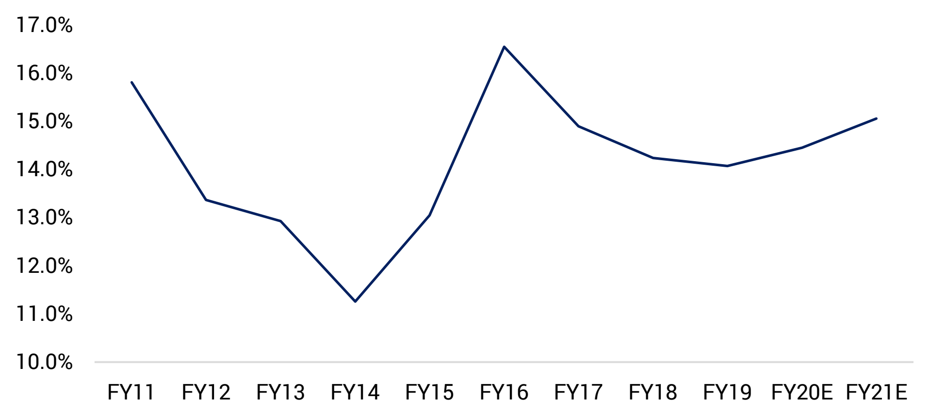
- The management attributed the decline in gross margins as well as EBITDA margins to weak "after sales" revenue (as these earn high margins) and continued commodity cost pressures.

**Steel price**




*Source: Bloomberg*

**EBITDA Margin (%)**




*Source: Kotak Securities - Private Client Group*

## PAT before exceptional items rose 16% y-o-y

- PAT before exceptional items rose 16% on a y-o-y basis led by moderate growth in revenues and lower tax charges.
- This was the fifth consecutive quarter of positive profit growth achieved by the company in the past eight quarters.
- Exceptional expenses in FY19 included 1) full provision for irrecoverability of fixed deposits in IL&FS amounting to Rs 205 mn and 2) gain on sale of properties valued at Rs 26.3 mn.

## Fuel mix shifting towards CNG engines from diesel/petrol engines:

In the Automotive Engine segment, the company provides fuel agnostic powertrain solutions to three-wheeled passenger and cargo vehicles and four-wheeled mini-trucks.

The company has a 75% market share in the 3-wheeler Diesel engines market. While earlier, diesel engines were the preferred mode for last mile connectivity, stricter environmental norms is driving sales of CNG engines even as the share of diesel engines have been reducing in recent years. In urban markets, replacement demand has been an important growth driver where in improving network of CNG fuel stations is driving replacement of older petrol or diesel powered 3Ws with ones based on CNG. In FY18, around 50% of the three wheeler sales were of CNG engines.

As the Government has set April 2020 deadline for the implementation of BS-VI norms, demand for conventional 3W diesel engines is likely to be affected in the future, the management opines.

### GCL's weak product positioning in CNG 3W engines has led to underperformance in the 3W sales growth

GCL's focus as well as its forte has been on light diesel engines (75% market share in light diesel engines), which is also aligned with the positioning of its prime client Piaggio Vehicles (PVPL), who is a leader in the 3W cargo segment. In Cargo, diesel engines are better suited than their CNG counterparts on account of higher load carrying capacity and lack of CNG pump infrastructure in rural/semi rural areas. Given the focus of GCL on diesel engine segment, it appears that the company has been late in having a strong product in the CNG engine space.

GCL currently has a larger engine (400 cc) in CNG 3W market which is mainly being used in the 5+1 passenger 3W segment. However, the major market for passenger 3W is in the 2+1 category where a smaller engine (200-230 cc) is fitted. GCL has been largely missing in this segment and even its existing diesel engine customers like Atul/Piaggio are not fully sourcing CNG engines from the company.

GCL has entered into technical collaboration with Pinnacle Engines for CNG and Petrol segments. The Pinnacle engine are BS-VI compliant and come with revolutionary piston technology that offers 25-30% fuel efficiency over the conventional ones.

The company's OEMs are currently field testing this engine and if found satisfactory would result in engine sourcing deals in the future, the management informed. This would plug a major product gap in the company's portfolio.

### BS VI cost inflation on engine yet to be worked out

There will be some increase in the costs following the implementation of the BS VI emission norms starting April 2020. With the introduction of the new norms, on-board diagnostics (OBD) become mandatory for all vehicles. The OBD unit will be able to identify likely areas of malfunction by means of default codes stored on a computer, thus ensuring that the sophisticated emission control device, which is fitted in a BS-VI vehicle, runs at optimum efficiency throughout the life of the vehicle. For two-wheelers, manufacturers have to introduce a fuel injection system, which will be a first in India. From consumer's point of view, the cost of engine will go up and so would affect the final price of the vehicle. Many fear that higher vehicle prices could impact affordability and could lead to a slowdown in demand, albeit temporarily.

The management indicated that despatches on BS VI engines will start around Q4FY20E and hence these are early days as cost increases on engine are still under discussion.

### Ampere Electric Vehicles (Subsidiary)

Ampere is one of the leading brands in the last mile mobility electric vehicles segment. It has strong in-house capabilities in designing, developing, manufacturing & marketing electric vehicles with a wide range of applications. Through this acquisition, Ampere can benefit from Greaves' distribution, aftermarket and service strengths to grow more rapidly.

Recently, the government has announced the second phase of the Faster doption and Manufacturing of Hybrid and Electric Vehicles (FAME-2) scheme, with an outlay of Rs 100 bn for a period of three years. The focus has also included creation of charging infrastructure and manufacturing capacity of lithium-ion batteries. Post FAME 2, there is likely to be some change in pricing of the 2W EV in line with the change in subsidy, the management noted.

The company is currently one of the major players in electric two wheelers market. Its current product offering is in the low speed segment but is in the process of rolling out a higher speed version of the electric 2W as well.

The company has 120 outlets of Ampere scooters across India, besides these scooters are also being retailed through the “Greaves Care” outlets.

The company is witnessing good volume growth in Ampere and optimistic of continuing the growth momentum.

Ampere is aiming for positive EBITDA in FY20E and positive PAT in FY21E, the management informed.

**Profit and Loss of Ampere Vehicles**

| (Rs mn) | FY18 | FY19 | Oct-Mar 2019 |
|---|---|---|---|
| Net Revenue | 185 | 536 | 275 |
| EBITDA | -81 | -24 | 22 |
| EBITDA (%) | -43.8% | -4.5% | 8.0% |
| PAT | -52 | -90 | -35 |

*Source: Company Presentation*

## BUYBACK at Rs 175

GCL has approved a proposal to buy back shares up to 13.7 mn (5.6% of the share capital) through tender route at a price of Rs 175 per share. (Source: BSE India)

The total outgo on account of this buyback would be Rs 2.4 bn.

The management has clarified that the promoters will not be participating in the buyback programme.

In our view, the buyback will enhance its return ratios as excess cash will get distributed to shareholders.

**Impact of Buy-back on FY21E**

| | Pre buyback | Post Buyback |
|---|---|---|
| EPS Rs per share | 9.9 | 10.0 |
| ROE % | 22.7 | 27.7 |
| ROCE % | 20.8 | 25.2 |

*Source: Kotak Securities – Private Client Research*

## Conference call highlights

- After market sale was weak in FY19 and especially in Q4FY19 due to liquidity constraints.
- The company now has 300 "Greaves Care" outlets and is servicing 15000 customers on a monthly basis.
- The management expects the EBITDA margins to remain stable at the current level of commodity prices, but could expand If commodity prices correct from present levels.

- The company has planned capex of Rs 750 mn in FY20, which would be mainly towards product development and R&D.
- The management believes that CNG engines will be one of the major growth drivers in FY20.

**Earnings Revision – FY20E**

| (Rs mn) | Revised | Earlier |
|---|---|---|
| Revenue | 22,034 | 21388 |
| EBITDA (%) | 14.5 | 15.2 |
| PAT | 2,113 | 2370 |

*Source:*

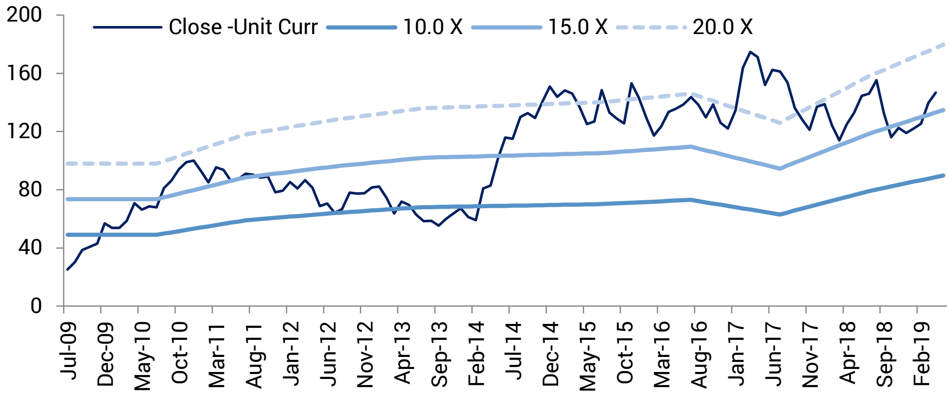
## Valuation and Target price

GCL is currently trading at 15.8x and 13.9x FY20E and FY21E earnings respectively, which is attractive compared to peers in the capital goods and manufacturing sector stocks.

In the past, the company's growth has been lackluster on account of weak demand trend for Diesel based 3W engines. To address this lacuna, the company is in the process of making inroads into CNG engines for 3W for auto majors and has also forayed into electric 2W/3W through acquisition of Ampere Electric Private Ltd. These initiatives if successful would provide the much needed growth impulse for the company. Apart from this, high dividend payout and occasional buyback are positive for shareholders.

We now value the stock at 16x average EPS of FY20E and FY21E as against 15x FY20E earlier, thus arriving at a price target of Rs 156 (Earlier Rs 146). In view of the modest upside, we review our rating a notch lower to "ADD" as against "BUY" earlier.

**One year Forward PE chart**




*Source: Kotak Securities – Private Client Research*

## Company Background

Greaves Cotton Limited, established in 1859, is into manufacturing of Diesel / Petrol Engines, Gensets and Pumpsets. Greaves has a strong knowledge base in single cylinder diesel engines used for low cost transportation and its engines are extensively used in the three wheeler segment. Mr. Karan Thapar, who is Non-Executive Chairman of the company. The day-to-day management is vested with Mr. Mr. Nagesh Basavanhalli, Managing Director and CEO of the company, who is a professional and has joined the company in 2016.

**The Business Divisions are:**

| Business Division | Product Lines |
|---|---|
| Agricultural Equipment | Petrol / Kerosene Engines: 1 to 5 HP, Pumpsets and Power Tillers |
| Automotive | Light Diesel Engines: |
| Auxiliary Power | Large Diesel Generating Sets Range: 2.5 KVA to 500 kVA single unit and upto 2500 kVA in parallel running |
| Industrial Engines | Diesel Engines: 1.4 to 1000 HP range |

*Source: Company*

# Financials: Standalone

## Profit and Loss Statement (Rs mn)

| (Year-end Mar) | FY18 | FY19 | FY20E | FY21E |
|---|---|---|---|---|
| **Revenues** | **17,921** | **19,938** | **22,034** | **24,352** |
| % change YoY | 9.6 | 11.3 | 10.5 | 10.5 |
| **EBITDA** | **2,553** | **2,807** | **3,185** | **3,669** |
| % change YoY | 4.8 | 9.9 | 13.5 | 15.2 |
| Other Income | 452.6 | 416.3 | 350.9 | 348.5 |
| Depreciation | 523.5 | 488.3 | 549.2 | 615.7 |
| **EBIT** | **2,482** | **2,735** | **2,987** | **3,402** |
| % change YoY | 3.1 | 14.2 | 13.7 | 15.8 |
| Net interest | 8.1 | 33.3 | 11.0 | 11.0 |
| **Profit before tax** | **2,474** | **2,702** | **2,976** | **3,391** |
| % change YoY | 0.5 | 9.2 | 10.1 | 13.9 |
| Tax | 939 | 770 | 863 | 983 |
| as % of PBT | 37.9 | 28.5 | 29.0 | 29.0 |
| PAT before exceptional items | 1,536 | 1,932 | 2,113 | 2,407 |
| % change YoY | (13.9) | 25.8 | 9.4 | 13.9 |
| Exceptional items | 481.7 | (178.7) | 0 | 0 |
| **Reported PAT** | **2,017** | **1,753** | **2,113** | **2,407** |
| Shares outstanding (m) | 244.2 | 244.2 | 230.5 | 230.5 |
| **EPS (before exp items) (Rs)** | **6.3** | **7.9** | **9.2** | **10.4** |
| CEPS (Rs) | 8.4 | 9.9 | 11.6 | 13.1 |
| DPS (Rs) | 5.5 | 5.5 | 5.5 | 5.5 |

*Source: Company, Kotak Securities – Private Client Research*

## Balance sheet (Rs mn)

| (Year-end Mar) | FY18 | FY19 | FY20E | FY21E |
|---|---|---|---|---|
| Cash and cash equivalents | 298 | 384 | 804 | 1,739 |
| Accounts receivable | 2,527 | 3,365 | 3,320 | 3,670 |
| Inventories | 1,094 | 1,152 | 1,505 | 1,664 |
| Loans and Adv & Others | 881 | 317 | 881 | 881 |
| Current assets | 4,800 | 5,218 | 6,510 | 7,954 |
| Intangible assets | 536 | 828 | 828 | 828 |
| Other assets | 419 | 504 | 504 | 504 |
| LT investments | 5,186 | 5,085 | 3,085 | 3,085 |
| Net fixed assets | 2,475 | 2,458 | 2,409 | 2,293 |
| Def tax assets | 0 | 0 | 0 | 0 |
| **Total assets** | **13,416** | **14,092** | **13,335** | **14,663** |
| Payables | 3,304 | 3,942 | 4,966 | 5,421 |
| Others | 0 | 0 | 0 | 0 |
| Current liabilities | 3,304 | 3,942 | 4,966 | 5,421 |
| Provisions | 233 | 196 | 233 | 233 |
| LT debt | 0 | 0 | 0 | 0 |
| Other liabilities | 275 | 263 | 263 | 263 |
| Equity | 488 | 488 | 461 | 461 |
| Reserves | 9,116 | 9,203 | 7,412 | 8,286 |
| **Total liabilities** | **13,416** | **14,092** | **13,335** | **14,663** |
| BVPS (Rs) | 37 | 38 | 32 | 36 |

*Source: Company, Kotak Securities – Private Client Research*

## Cash flow Statement (Rs mn)

| (Year-end Mar) | FY18 | FY19 | FY20E | FY21E |
|---|---|---|---|---|
| PBDIT | 2,553 | 2,807 | 3,185 | 3,669 |
| Direct tax paid | (919) | (770) | (863) | (983) |
| Adjustments | 28 | (392) | - | - |
| **Cash flow from operations** | **1,663** | **1,645** | **2,322** | **2,685** |
| Net Change in Working Capital | 689 | 269 | 189 | (54) |
| Net Cash from Operations | 2,352 | 1,914 | 2,511 | 2,632 |
| Capital Expenditure | (241) | (472) | (500) | (500) |
| **Cash from investing** | **(505)** | **255** | **2,351** | **348** |
| Net Cash from Investing | (746) | (217) | 1,851 | (152) |
| Interest paid | (8) | (33) | (11) | (11) |
| Issue of Shares/(buyback) | - | - | (2,398) | - |
| Dividends Paid | (1,472) | (1,571) | (1,534) | (1,534) |
| Debt and other liabilities | 72 | 77 | - | - |
| **Net cash from financing** | **(1,408)** | **(1,527)** | **(3,942)** | **(1,545)** |
| Net change in cash | 198 | 170 | 420 | 935 |
| Free cash flow | 2,111 | 1,442 | 2,011 | 2,132 |
| cash at end | 298 | 384 | 804 | 1,739 |

*Source: Company, Kotak Securities – Private Client Research*

## Ratio Analysis

| (Year-end Mar) | FY18 | FY19 | FY20E | FY21E |
|---|---|---|---|---|
| EBITDA margin (%) | 14.2 | 14.1 | 14.5 | 15.1 |
| EBIT margin (%) | 11.3 | 11.6 | 12.0 | 12.5 |
| Net profit margin (%) | 8.6 | 9.7 | 9.6 | 9.9 |
| Receivables (days) | 51.5 | 61.6 | 55.0 | 55.0 |
| Inventory (days) | 22.3 | 21.1 | 24.9 | 24.9 |
| Sales/gross assets(x) | 5.2 | 5.1 | 5.0 | 5.0 |
| Interest coverage (x) | 315.2 | 84.3 | 289.6 | 333.5 |
| | | | | |
| Debt/equity ratio(x) | - | - | - | - |
| | | | | |
| ROE (%) | 16.3 | 20.0 | 24.1 | 29.0 |
| ROCE (%) | 17.1 | 18.3 | 21.9 | 26.3 |
| | | | | |
| EV/ Sales | 1.8 | 1.6 | 1.4 | 1.3 |
| EV/EBITDA | 12.1 | 11.0 | 9.5 | 8.8 |
| Price to earnings (P/E) | 23.5 | 18.3 | 15.8 | 13.9 |
| Price to book value (P/B) | 4.0 | 3.9 | 4.6 | 4.1 |

*Source: Company, Kotak Securities – Private Client Research* kotak Securities

## Result Update

### Stock Details

| | | |
|---|---|---|
| Market cap (Rs mn) | : | 231762 |
| 52-wk Hi/Lo (Rs) | : | 543 / 343 |
| Face Value (Rs) | : | 1 |
| 3M Avg. daily vol (Nos) | : | 203,640 |
| Shares o/s (mn) | : | 539 |

*Source: Bloomberg*

### Financial Summary

| Y/E Mar (Rs mn) | FY19 | FY20E | FY21E |
|---|---|---|---|
| Revenue | 51,736 | 55,288 | 62,550 |
| Growth (%) | 12.4 | 6.9 | 13.1 |
| EBITDA | 7,428 | 7,740 | 9,383 |
| EBITDA margin (%) | 14.4 | 14.0 | 15.0 |
| PAT | 4,681 | 5,052 | 6,186 |
| EPS | 8.7 | 9.4 | 11.5 |
| EPS Growth (%) | -8.8 | 7.9 | 22.4 |
| BV (Rs/share) | 59.1 | 65.7 | 73.8 |
| Dividend/share (Rs) | 2.6 | 3.0 | 3.5 |
| ROE (%) | 15.6 | 15.0 | 16.5 |
| ROCE (%) | 23.5 | 22.2 | 24.3 |
| P/E (x) | 49.5 | 45.9 | 37.5 |
| EV/EBITDA (x) | 27.6 | 26.3 | 21.9 |
| P/BV (x) | 7.1 | 6.4 | 5.7 |

*Source: Company, Kotak Securities - PCG*

### Shareholding Pattern (%)

| (%) | Mar 19 | Dec-18 | Sep-18 |
|---|---|---|---|
| Promoters | 75.0 | 75.0 | 75.0 |
| FII | 4.6 | 4.6 | 5.5 |
| DII | 10.6 | 10.6 | 10.0 |
| Others | 9.8 | 9.8 | 9.4 |

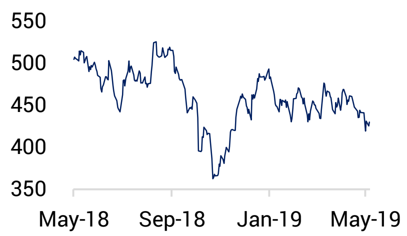
*Source: Bloomberg*

### Price Performance (%)

| (%) | 1M | 3M | 6M |
|---|---|---|---|
| Kansai Nerolac | (8.3) | (8.7) | 10.5 |
| Nifty | (1.4) | 3.9 | 8.5 |

*Source: Bloomberg*

### Price chart (Rs)




*Source: Bloomberg*

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# KANSAI NEROLAC PAINTS LTD (KNPL)

**PRICE RS.430** **TARGET RS.435** **REDUCE**

Stable volume growth in the decorative segment and weakness in the industrial segment (primarily automotive), continued raw material price inflation and small price hikes in Q4FY19 were the highlights of the results for KNPL during the quarter. Recommend Reduce (from Add) with a lower TP of Rs 435 (from Rs 460) at 38x FY21E earnings (lowered from 40x).

## Key Highlights

- As per management commentary, KNPL experienced mid-single digit YoY growth in the decorative segment and reported de-growth of ~5% YoY in the automotive and industrial segment.
- Weakness in the automotive segment is a key near term risk.
- Management commented that inflation (including raw material cost), volatility in crude prices and INR movement continue to impact the operating margins in Q4 as well. Management is making efforts to increase product prices and reduce various cost to counter the situation.
- Sales (excluding GST) was reported at Rs 11.53 bn (+4.5% YoY). Raw material price inflation and weakness in the industrial segment (especially Auto) impacted the Gross margin and EBIDTA margin for the quarter.
- Company took one small price hike in the decorative segment, to counter the steep increase in raw material (RM) prices including crude derivatives. However, these hikes were not enough to mitigate the increase in RM costs.
- Management mentioned that the industrial segment including automotive segment is weak and it is difficult to pass on the RM hikes in this segment. While decorative is strong for the entire industry.
- Consequently, PAT was reported at Rs 928 mn vs. our expectation of Rs 1070 mn.

### Quarterly Performance (Standalone)

| (Rs mn) | Q4FY18 | Q3FY19 | Q4FY19 | QoQ (%) | YoY (%) |
|---|---|---|---|---|---|
| **Net Sales** | **11,035** | **13,506** | **11,532** | **(14.6)** | **4.5** |
| Raw Material consumed | 6842 | 8841 | 7349 | (16.9) | 7.4 |
| Employee cost | 571 | 671 | 609 | (9.2) | 6.7 |
| Other expenses | 1,933 | 2,217 | 2,078 | (6.3) | 7.5 |
| Total operating cost | 9,346 | 11,729 | 10,036 | (14.4) | 7.4 |
| **EBIDTA** | **1,689** | **1,777** | **1,496** | **(15.8)** | **(11.4)** |
| EBIDTA % | 15.3 | 13.2 | 13.0 | | |
| Depreciation | 197 | 235 | 235 | - | 19.3 |
| Interest | 0 | 0 | 0 | | |
| Other income | 186 | 198 | 145 | (26.8) | (22.0) |
| **PBT** | **1,678** | **1,740** | **1,406** | **(19.2)** | **(16.2)** |
| Exceptional | 0 | 0 | 0 | | |
| Taxes | 621 | 606 | 478 | (21.1) | (23.0) |
| ETR (%) | 37 | 35 | 34 | | |
| **PAT** | **1,057** | **1,134** | **928** | **(18.2)** | **(12.2)** |
| Equity | 539 | 539 | 539 | - | - |
| **EPS** | **2.0** | **2.1** | **1.7** | **(18.2)** | **(12.2)** |

*Source: Company*

### Sales was driven by:

Management indicated the sales performance of Q4FY19 could be attributed to:

- Mid-single digit volume growth in the decorative segment
- Weakness in automotive demand and weak private sector capex leading to weakness in the industrial segment

### Automobile demand (passenger vehicle (PV)) to improve in H2FY20

Industrial segment contributes ~45% to KNPL's revenues with automotive segment contributing 75% of the industrial segment revenues. KNPL's strong dominance in automotive paints segment is supplemented by its parent Kansai's association with global OEMs that have a strong presence in India.

Automotive PV production was weak in FY19 with volume of 40.26 lakh units (against 40.2 lakh units in FY18 and +1.5% YoY) which compelled SIAM and various other agencies to reduce growth forecast for FY20. We believe the demand to remain under pressure for the next 2 quarters. Post that , demand for PV can improve led by—(1) improvement in penetration of PV, especially in the bigger cities; (2) benign interest rates; (3) falling crude prices; (4) appreciating INR and (5) stable raw material prices. Weakness in automotive segment in FY20 is estimated to keep margins and earnings under pressure for KNPL.

**Domestic car production data (in lakhs)**

| | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 | FY19 |
|---|---|---|---|---|---|---|---|
| Total | 32.37 | 30.93 | 32.23 | 34.14 | 37.91 | 40.20 | 40.26 |
| YoY Growth (%) | 3.5 | -4.4 | 4.2 | 5.9 | 11 | 7.9 | 1.5 |

*Source: SIAM*

### However, decorative segment expected to remain strong

KNPL has maintained a low double digit or high single digit volume growth rate in the decorative segment for the last 12 quarters in the decorative segment on the back of:

1) New product offerings - New product launches which are eco-friendly, lead free, low VOC etc.
2) Aggressive marketing by KNPL- KNPL is one of the largest spender on Advertisement, which is around 9% of the decorative segment revenue as against 6% of Asian Paints and Berger
3) Improving geographical reach – north India is the strongest market for KNPL, now the company is focussing on West and South (which are strongholds of Asian Paints)
4) Huge Dealer Base – Company current has 20000+ dealers which is growing at 10% CAGR. These dealers are serviced through 102 depots.
5) Aggressive sales pitch and higher dealer margins
6) Connecting directly with the customers through initiatives like tinting machines- 75% of the dealers of the company have tinting machines
7) Other factors like increasing disposable income, shortening painting cycle to 5 years (from 10 years over a decade) and increase in per-capita consumption to 3.3 kg (from 1.5 kg over a decade)

## Margin may remain under pressure in FY20

KNPL experienced almost 600 bps expansion in margins from FY12 to date on the back of benign raw material prices, strong growth in the automotive segment, healthy demand in the decorative segment, premiumisation and up trading. Though the company was able to pass on price hikes in the decorative segment, a delay or lack of ability to completely pass on the price hikes in the industrial segment impacted EBITDA margin in FY19 and estimated to repeat in H1FY20. However, we estimate things to normalize for KNPL in H2FY20 as automotive downturns historically has lasted for not more than 1 to 1.5 years

## Valuation and Outlook

We estimate that branded paint demand will remain robust in a country like India where per capita consumption is very low and 30% paint market is still unorganised. Management of KNPL also indicated that the volume trends remain strong for the company in the decorative segment and expect the trend to continue in medium term. However, the automotive segment is weak and expected to remain weak in H1FY20. We also estimate the gross margin of the company to remain under pressure with continued RM inflation and the company's restricted ability to pass on cost inflation to its industrial paint clients (45% of revenue). In view of the impact on gross margins and weakness in the industrial segment, we cut our EPS forecast for FY20E and introduce FY21E numbers and assign a lower PE multiple to the stock in a weak macro environment. Recommend Reduce (from Add) with a lower TP of Rs 435 (from Rs 460) at 38x FY21E earnings (lowered from 40x). Multiple of 38x is at the lower end of the PE band for KNPL of the last 3 years.

## Company Background

Kansai Nerolac Paints Ltd. (KNPL), a subsidiary of Kansai Paint, Japan, is one of India's leading paint companies and the largest player in the industrial segment. KNPL had its beginning as Gahagan Paints and Varnishes Co. Ltd. in the year 1920. In over 93 years of its existence the Company has built a strong brand and gained a reputation for high quality, innovation and differentiated product offerings. The Company has 4 manufacturing facilities at Lote in Maharashtra, Bawal in Haryana, Jainpur in UP and in Hosur in Tamil Nadu with a total capacity of 4.31 lakh metric tonnes per annum. The company is the market leader in the automotive coating segment in India with a dominant market share. Over the years, it has maintained its leadership position in the Industrial Coatings segment with a wide range of products in the Automotive, Powder, General Industrial and High performance Coatings space.

# Financials: Consolidated

## Profit and Loss Statement (Rs mn)

| (Year-end Mar) | FY18 | FY19 | FY20E | FY21E |
|---|---|---|---|---|
| **Revenues** | **46,024** | **51,736** | **55,288** | **62,550** |
| % change YoY | 15.1 | 12.4 | 6.9 | 13.1 |
| Raw material cost | 24,986 | 33,025 | 30,961 | 34,715 |
| Employee cost | 1,693 | 2,547 | 2,212 | 2,502 |
| Other expenses | 11,476 | 8,736 | 14,375 | 15,950 |
| Total Operating expd | 38,155 | 44,308 | 47,548 | 53,168 |
| **EBITDA** | **7,869** | **7,428** | **7,740** | **9,383** |
| Depreciation | 759 | 905 | 900 | 900 |
| **EBIT** | **7,110** | **6,523** | **6,840** | **8,483** |
| Other income | 725 | 619 | 700 | 750 |
| Interest expense | 0 | 0 | 0 | 0 |
| Profit before tax | 7,835 | 7,142 | 7,540 | 9,233 |
| Tax | 2,701 | 2,461 | 2,488 | 3,047 |
| ETR (%) | 34.5 | 34.5 | 33.0 | 33.0 |
| **Profit after tax** | **5,134** | **4,681** | **5,052** | **6,186** |
| Minorities& Associates | 0 | 0 | 0 | 0 |
| **Net income** | **5,134** | **4,681** | **5,052** | **6,186** |
| % change YoY | 2.0 | -8.8 | 7.9 | 22.4 |
| Shares outstanding (m) | 539 | 539 | 539 | 539 |
| **EPS** | **9.5** | **8.7** | **9.4** | **11.5** |

*Source: Company, Kotak Securities – Private Client Research*

## Cash flow Statement (Rs mn)

| (Year-end Mar) | FY18 | FY19 | FY20E | FY21E |
|---|---|---|---|---|
| PAT | 5,134 | 4,681 | 5,052 | 6,186 |
| Depreciation | 1,520 | 1,715 | 1,638 | 1,646 |
| Change in working capital | (307) | (1,269) | (1,566) | (995) |
| **Cash flow from operations** | **6,347** | **5,127** | **5,124** | **6,837** |
| Capex | (3,482) | (3,707) | (3,485) | (3,420) |
| Investments | (615) | (500) | (250) | (300) |
| **Cash flow from investments** | **(4,097)** | **(4,207)** | **(3,735)** | **(3,720)** |
| Equity issuance | - | - | - | - |
| Debt raised | - | 10 | - | - |
| Dividend Paid | (1,654) | (1,908) | (2,226) | (2,544) |
| Miscellanous items | - | - | - | - |
| **Cash flow from financing** | **(1,654)** | **(1,898)** | **(2,226)** | **(2,544)** |
| | | | | |
| Net cash flow | 596 | (977) | (836) | 573 |
| Opening cash | 4,343 | 4,939 | 3,962 | 3,126 |
| **Closing cash** | **4,939** | **3,962** | **3,126** | **3,699** |

*Source: Company, Kotak Securities – Private Client Research*

## Balance sheet (Rs mn)

| (Year-end Mar) | FY18 | FY19 | FY20E | FY21E |
|---|---|---|---|---|
| Cash | 4,939 | 3,962 | 3,126 | 3,699 |
| Debtors | 6,771 | 7,795 | 9,046 | 9,452 |
| Inventory | 7,640 | 8,795 | 10,206 | 11,756 |
| Other current assets | 1,910 | 2,199 | 2,552 | 2,671 |
| Total current assets | 16,321 | 18,789 | 21,804 | 23,879 |
| LT investments | 1,450 | 1,950 | 2,200 | 2,500 |
| Net fixed assets | 13,817 | 16,618 | 19,203 | 21,723 |
| **Total assets** | **36,527** | **41,319** | **46,333** | **51,802** |
| | | | | |
| Creditors | 6,430 | 7,402 | 8,590 | 9,352 |
| Other current liabilities | 1,515 | 1,742 | 2,003 | 2,321 |
| Total current liabilities | 7,945 | 9,144 | 10,593 | 11,673 |
| LT debt | 330 | 340 | 340 | 340 |
| Minority Interest | 0 | 0 | 0 | 0 |
| Equity Capital | 539 | 539 | 539 | 539 |
| Reserves | 27,713 | 31,296 | 34,860 | 39,249 |
| Networth | 28,252 | 31,835 | 35,399 | 39,788 |
| **Total liabilities** | **36,527** | **41,319** | **46,333** | **51,802** |
| BVPS (Rs) | 52.4 | 59.1 | 65.7 | 73.8 |

*Source: Company, Kotak Securities – Private Client Research*

## Ratio Analysis

| (Year-end Mar) | FY18 | FY19 | FY20E | FY21E |
|---|---|---|---|---|
| EBITDA margin (%) | 17.1 | 14.4 | 14.0 | 15.0 |
| EBIT margin (%) | 15.4 | 12.6 | 12.4 | 13.6 |
| Net profit margin (%) | 11.2 | 9.0 | 9.1 | 9.9 |
| ROE (%) | 19.6 | 15.6 | 15.0 | 16.5 |
| ROCE (%) | 29.6 | 23.5 | 22.2 | 24.3 |
| DPS | 2.6 | 3.0 | 3.5 | 4.0 |
| Dividend payout (%) | 32.2 | 40.8 | 44.1 | 41.1 |
| | | | | |
| Working capital turnover (days) | 65.2 | 63.6 | 68.8 | 68.3 |
| Debt Equity (x) | 0.0 | 0.0 | 0.0 | 0.0 |
| | | | | |
| PER (x) | 45.1 | 49.5 | 45.9 | 37.5 |
| P/C (x) | 34.8 | 36.2 | 34.6 | 29.6 |
| Dividend yield (%) | 0.6 | 0.7 | 0.8 | 1.0 |
| P/B (x) | 8.0 | 7.1 | 6.4 | 5.7 |
| EV/Sales (x) | 4.8 | 4.3 | 4.0 | 3.5 |
| EV/ EBITDA (x) | 25.8 | 27.6 | 26.3 | 21.9 |

*Source: Company, Kotak Securities – Private Client Research*

## RATING SCALE

**Definitions of ratings**

| | | |
|---|---|---|
| **BUY** | – | We expect the stock to deliver more than 15% returns over the next 12 months |
| **ADD** | – | We expect the stock to deliver 5% - 15% returns over the next 12 months |
| **REDUCE** | – | We expect the stock to deliver -5% - +5% returns over the next 12 months |
| **SELL** | – | We expect the stock to deliver < -5% returns over the next 12 months |
| **NR** | – | **Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only. |
| **SUBSCRIBE** | – | We advise investor to subscribe to the IPO. |
| **RS** | – | **Rating Suspended.** Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon. |
| **NA** | – | **Not Available or Not Applicable.** The information is not available for display or is not applicable |
| **NM** | – | **Not Meaningful.** The information is not meaningful and is therefore excluded. |
| **NOTE** | – | Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark. |

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