

Rating Rationale

October 25, 2023 | Mumbai

Kansai Nerolac Paints Limited

Ratings Reaffirmed

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Rating Action

Total Bank Loan Facilities Rated	Rs.350 Crore
Long Term Rating	CRISIL AAA/Stable (Reaffirmed)

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Rs.10 Crore Non Convertible Debentures	CRISIL AAA/Stable (Reaffirmed)
Rs.30 Crore Commercial Paper	CRISIL A1+ (Reaffirmed)

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1 crore = 10 million

Refer to Annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL Ratings has reaffirmed its CRISIL AAA/Stable/CRISIL A1+ ratings on the bank facilities and debt programmes of Kansai Nerolac Paints Limited (Kansai Nerolac; part of the Kansai Nerolac group).

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The ratings continue to reflect the market leadership of the group in the industrial paints segment in India and increasing focus on the decorative paint segment. Moreover, the group has leveraged its association with Kansai Paint Co., Ltd, Japan (Kansai), to maintain its dominance in the automotive paints segment. The ratings also factor in the robust financial risk profile. These strengths are partially offset by pricing pressure from automotive original equipment manufacturers (OEMs) and intense competition in the decorative segment limiting pricing flexibility.

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Revenues for fiscal 2023 grew by 19% to Rs. 7557 crore driven mainly by strong demand from auto industry as well as increase in price realizations across both industrial and decorative segments. During Q1FY24, revenues stood at Rs. 2157 crore witnessing growth of 5% year-on-year basis on the back of strong demand from auto industry mainly contributed by the passenger vehicle segment as the contribution from two-wheeler segment was marginal. Overall, the industrial segment contributed to ~45% of the overall sales while the balance was contributed by the decorative segment. Revenue growth over the medium term would be supported by increasing volumes, launch of new products, increasing premiumisation and technology-based products.

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Operating margins improved to 10.9% during fiscal 2023 after declining to 9.5% in fiscal 2022 with rising crude oil based raw material prices and inability to entirely pass on the same, particularly in the industrial segment. Operating margin is expected to remain at 13-14% over the medium term with launch of newer products and change in product mix by shifting towards premium products. Company's margins remain susceptible to increase in crude linked raw material prices compared to peers as it has a major portion of its revenues (~45%) is coming from the industrial segment wherein taking price hikes is comparatively tougher and takes time.

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Financial risk profile remains strong, supported by net debt-free balance sheet and sizeable liquid surplus of about Rs 613 crore as on March 31, 2023. Net worth stood at ~Rs.4523 crore as on March 31, 2023. Liquidity position will continue to remain robust with substantial net cash accruals and strong cash surplus that will be sufficient to meet the annual capex requirement in the medium term.

Analytical Approach

For arriving at its ratings, CRISIL Ratings has combined the business and financial risk profiles of Kansai Nerolac and its subsidiaries and associates, collectively referred to as the Kansai Nerolac group.

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Please refer Annexure - List of entities consolidated, which captures the list of entities considered and their analytical treatment of consolidation.

Key Rating Drivers & Detailed Description

Strengths:

- Leading position in the domestic industrial paints segment and established position in the decorative paints segment**

The strong position of the group is underpinned by its technological tie-ups, varied product portfolio and healthy relationships with major OEMs across the passenger car, utility vehicle and two-wheeler segments. Furthermore, technological support from the parent enables the group to introduce high-end products in the form of application as well as power consumption.

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- Established position in the domestic decorative paints industry**

The group is also the third-largest player in the domestic decorative paints segment, which forms 70-75% of the total domestic paints industry. Operations are supported by a strong network of ~29,500 dealers, ~20,000 colour-tinting machines and over 100 depots. The group has presence across product ranges and focuses on premium and innovative brands such as Nerolac Impressions, Beauty Gold, Suraksha Plus, Excel Top Guard and water-based enamels that support sales growth. The Soldier brand focussed on the rural market is gaining traction as well.

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- Benefits derived from the parent**

Kansai is a leading paint manufacturing company and among the top 10 coating manufacturers globally. It produces automotive coatings, refinishes, industrial coatings, architectural and marine coating, and is particularly strong in the automotive paint segment. In a sector where technology is a key factor in sustaining market position and determining relationships with OEMs, Kansai has helped the Kansai Nerolac group attain market leadership, retain clients and win new customers. Technical collaboration with renowned global players gives the group a competitive advantage, enabling it to offer products that meet stringent international specifications. The group also has technological tie-ups with Oshima

Kogyo Co Ltd, Japan (for heat-resistant paint), Protech Oxyplast Group, Canada (for powder coatings) and Cashew Ltd, Japan (automotive coatings).

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Robust financial risk profile and strong liquidity

Strong Tangible net-worth of ~Rs. 4523 crore for fiscal 2023, backed by negligible debt resulting in healthy gearing of 0.04 times. Liquidity is supported by cash surplus of over Rs.613 crore as on March 31, 2023, as well as fund-based bank limits that are largely unutilized. Return on capital employed (RoCE) improved to 14.3% in fiscal 2023 as against 10.5% in fiscal 2022 led by an operating margin expansion of 140 bps followed by nil net-debt and robust net worth. ROCE is expected to improve around 16-17% in the medium term on account of on the back of strong demand from auto industry both industrial and decorative segments.

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Weaknesses:

Pricing pressure from automotive OEMs

The prices of raw materials (account for 55-60% of total sales) such as titanium dioxide, crude oil derivatives, pigments and resins are affected by volatility in crude oil prices and foreign exchange (forex) rates, which can affect margins. However, players have largely been able to pass on cost increases in recent years, aided by strong demand and concentration. Besides, the group imports some inputs to ensure superior quality. Moreover, despite being a market leader in the industrial paint segment, the Kansai group has limited pricing flexibility, particularly with auto OEMs, which are major contributors to revenue. As a result, operating margin has fluctuated between 10% and 17% over the past decade.

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Intense competition in the decorative segment limiting pricing flexibility

While the organised paint industry is dominated by a few large players, paint manufacturers face competition from strong regional players, especially in the mass-market product sector. Consequently, while players have the flexibility to pass on increase in cost, their ability to absorb cost benefits and increase the margin is limited.

Liquidity: Superior

Liquidity continues to remain superior with cash surplus of more than Rs. 613 crore as on Mar 31, 2023. Fund-based working capital limit of Rs 350 crores is largely unutilised. Cash accrual and cash and equivalents will adequately cover debt obligation, incremental working capital requirement and capex and investment requirements in various subsidiaries.

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ESG Profile

CRISIL Ratings believes KNPL's Environment, Social, and Governance (ESG) profile supports its already strong credit risk profile.

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The paint (chemical) sector has a significant impact on the environment owing to high water consumption, waste generation and Green House Gas (GHG) emission. The sector's social impact is characterized by health hazards leading to higher focus on employee safety and well-being and the impact on local community given the nature of its operation.

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KNPL has continuously focused on mitigating its environmental and social risks.

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Key ESG highlights

- There has been an improvement in the GHG emission intensity from 6.26 tCO2/revenue in 2022 to 6.08 tCO2/revenue in 2023. The Company aims to become carbon neutral and targets to achieve 70% of its electricity consumption from renewable sources by 2030.
- The specific water consumption has declined from 87.35 kl/revenue in 2022 to 76.03 kl/revenue in 2023. It targets to be water positive by fiscal 2024-25.
- Gender diversity at KNPL though has increased from 2.25% in 2022 to 3.20% in 2023, however, it is still lower than that of its peers.
- Lost Time Injury Frequency Rate is nil during 2023 and is better as compared to its peers, representing healthy employee safety and well-being standards.
- Kansai Nerolac's governance profile is marked by 43% of its board comprising independent directors, split in chairman and CEO position and presence of robust internal control systems and processes. It also has extensive disclosures.

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There is growing importance of ESG among investors and lenders. The commitment of KNPL to ESG principles will play a key role in enhancing stakeholder confidence and access to capital markets.

Outlook: Stable

The business risk profile of the group will continue to benefit from its leading position in the industrial paints market, support from the parent, and increasing revenue contribution from the decorative segment. Strong cash accrual is expected to be sufficient to meet capex and incremental working capital requirement and help maintain healthy financial risk profile.

Rating Sensitivity factors

Downward factors

- Intensifying competition leading to steep decline in market share in the industrial or decorative segments.
- Significant increase in input prices impacting profitability, with margin declining to less than 10% on a sustained basis
- Sizeable, debt-funded capex or acquisition materially impacting key credit metrics or leading to material reduction in liquid surplus.

About the Group

The Kansai Nerolac group, a 74.99% subsidiary of Kansai, has strong presence in the decorative and industrial paint segments. In the industrial paint segment, the group manufactures automotive, high-performance, powder and general industrial coatings.

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Kansai Nerolac entered into a joint venture with Polygel Industries Pvt Ltd to form Nerofix Pvt Ltd (Nerofix) in fiscal 2020. Nerofix manufactures adhesives, sealants, construction chemicals, admixtures, waterproofing compounds, textures and paints. KNPL on March 03, 2023, has announced for acquisition of additional 40% stake in Nerofix from Polygel. The acquisition got completed by March 2023, post which Nerofix became wholly owned (100%) subsidiary of KNPL.

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The company is listed on the Bombay Stock Exchange and the National Stock Exchange. As on March 31, 2022, the promoters held 74.99% stake and the remaining was held by the public.

Key Financial Indicators

Particulars	Unit	2023	2022
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Revenue	Rs crore	7514	6303
Profit after tax (PAT)	Rs crore	468	343
PAT margin	%	6.2	5.4
Adjusted debt/adjusted net worth	Times	0.04	0.05
Interest coverage**	Times	28.8	21.9

**not adjusted for any non-cash items

Any other information: Not applicable

Note on complexity levels of the rated instrument:

CRISIL Ratings` complexity levels are assigned to various types of financial instruments and are included (where applicable) in the 'Annexure -A Details of Instrument'Â in this Rating Rationale.

CRISIL Ratings will disclose complexity level for all securities -Â including those that are yet to be placed -Â based on available information. The complexity level for instruments may be updated, where required, in the rating rationale published subsequent to the issuance of the instrument when details on such features are available.

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Annexure - Details of Instrument(s)

ISIN	Name of instrument	Date of allotment	Coupon rate (%)	Maturity date	Issue size (Rs crore)	Complexity level	Rating assigned with outlook
NA	Cash Credit*	NA	NA	NA	180	NA	CRISIL AAA/Stable
NA	Proposed Working Capital Facility	NA	NA	NA	170	NA	CRISIL AAA/Stable
NA	Non-convertible debentures#	NA	NA	NA	10	Simple	CRISIL AAA/Stable
NA	Commercial paper	NA	NA	7-365 days	30	Simple	CRISIL A1+

*Interchangeable with buyer's credit, working capital loan, letter of credit and bank guarantee

#Yet to be issued

Annexure -A List of entities consolidated

Names of entities consolidated	Extent of consolidation	Rationale for consolidation
KNP Japan Pvt Ltd	Fully consolidated	Subsidiary; business linkages
Nerofix Pvt Ltd	Fully consolidated	Subsidiary; business linkages
Kansai Paints Lanka (Pvt) Ltd	Fully consolidated	Subsidiary; business linkages
Kansai Nerolac Paints (Bangladesh) Ltd (formerly, RAK Paints Ltd)	Fully consolidated	Subsidiary; business linkages

Annexure - Rating History for last 3 Years

Instrument	Current			2023 (History)		2022Â		2021Â		2020Â		Start of 2020
	Type	Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Fund Based Facilities	LT	350.0	CRISIL AAA/Stable	05-05-23	CRISIL AAA/Stable	12-07-22	CRISIL AAA/Stable	23-06-21	CRISIL AAA/Stable	06-07-20	CRISIL AAA/Stable	CRISIL AAA/Stable
Â	Â	Â	--	Â	--	31-05-22	CRISIL AAA/Stable	Â	--	23-06-20	CRISIL AAA/Stable	--
Commercial Paper	ST	30.0	CRISIL A1+	05-05-23	CRISIL A1+	12-07-22	CRISIL A1+	23-06-21	CRISIL A1+	06-07-20	CRISIL A1+	CRISIL A1+
Â	Â	Â	--	Â	--	31-05-22	CRISIL A1+	Â	--	23-06-20	CRISIL A1+	--
Non Convertible Debentures	LT	10.0	CRISIL AAA/Stable	05-05-23	CRISIL AAA/Stable	12-07-22	CRISIL AAA/Stable	23-06-21	CRISIL AAA/Stable	06-07-20	CRISIL AAA/Stable	CRISIL AAA/Stable
Â	Â	Â	--	Â	--	31-05-22	CRISIL AAA/Stable	Â	--	23-06-20	CRISIL AAA/Stable	--

All amounts are in Rs.Cr.

Annexure - Details of Bank Lenders & Facilities

Facility	Amount (Rs.Crore)	Name of Lender	Rating
Cash Credit*	25	Standard Chartered Bank Limited	CRISIL AAA/Stable
Cash Credit*	105	HDFC Bank Limited	CRISIL AAA/Stable
Cash Credit*	22	ICICI Bank Limited	CRISIL AAA/Stable
Cash Credit*	28	ICICI Bank Limited	CRISIL AAA/Stable
Proposed Working Capital Facility	170	Not Applicable	CRISIL AAA/Stable

*Interchangeable with buyer's credit, working capital loan, letter of credit and bank guarantee

Criteria Details

Links to related criteria
CRISILs Approach to Financial Ratios
Rating criteria for manufacturing and service sector companies
CRISILs Bank Loan Ratings - process, scale and default recognition
Rating Criteria for Chemical Industry
CRISILs Criteria for Consolidation

CRISILs Criteria for rating short term debt

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