

**HOLD**

TP: Rs 5,225 | ▲ 11%

**CERA SANITARYWARE**

Construction Materials

05 August 2022

**Strong Q1; upside capped post rally – cut to HOLD**

- Consolidated Q1 revenue grew 74% YoY backed by high demand from home renovation projects, real estate launches and price hikes
- EBITDA margin expanded 670bps YoY to 15.8% on a favourable mix and lower costs, with EBITDA tripling to Rs 628mn
- Retain TP at Rs 5,225 (32x FY24E EPS) but downgrade from BUY to HOLD as the recent 20% stock rally leaves limited upside

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**Sharp rise in consolidated revenue:** CRS’s consolidated Q1FY23 revenue increased 74% YoY (-3.1% QoQ) to ~Rs 4bn owing to strong demand from home upgrades, real estate launches and price hikes of 3% in sanitaryware and 5% in faucetware by CRS during mid-May. Standalone revenue grew 78% YoY to Rs 3.9bn.

**Better mix and lower cost drove margin gains:** Consolidated gross margin declined 550bps YoY to 53.5%. However, a higher revenue contribution of sanitaryware and faucetware at 89% in Q1FY23 vs. 81% in Q1FY22 had a positive bearing on operating margin. This coupled with price hike benefits and lower employee & other expenses spurred EBITDA margin gains of 670bps YoY (-360bps QoQ) to 15.8%. Standalone gross margin rose 210bps YoY to 53.7% and EBITDA margin was up 655bps to 15.5%.

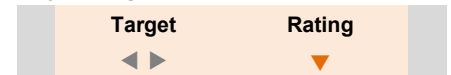
**Higher gas cost had limited impact:** In Q1, ~49% of CRS’s gas requirement was met by GAIL where prices increased to Rs 25.69/cbm from Rs 13.26/cbm in Mar’22. The balance 51% was met via Sabarmati Gas where prices declined to Rs 73.58/cbm for the quarter from Rs 75.01/cbm in Mar’22. Gas cost is just 3.06% of the company’s topline.

**Healthy demand outlook:** Management has guided for a 50-75bps rise in EBITDA margin each year. In addition, the company is confident of doubling revenue within the next three-and-a-half years from five years earlier.

**Strong growth prospects...:** The recent capacity debottlenecking and 40-50% expansion announced (to commence in 12-36 months) would lead the next leg of growth. CRS’s timely capacity expansion plan, focus on improving product mix, extensive distribution, healthy balance sheet and rising return ratios bode well for sustainable earnings growth. Further, the company is growing at 1.5x the industry.

**...but priced in post rally; downgrade to HOLD:** CRS is trading at 29x FY24E EPS after rallying 20% in the last three months, leaving only 11% upside potential from the current price. We thus downgrade our rating to HOLD from BUY while retaining our TP of Rs 5,225, set at 32x FY24E EPS (vs. its 5Y median of 36.2x).

**Key changes**



Ticker/Price	CRS IN/Rs 4,725
Market cap	US\$ 775.4mn
Free float	46%
3M ADV	US\$ 1.1mn
52wk high/low	Rs 6,450/Rs 3,515
Promoter/FPI/DII	54%/18%/27%

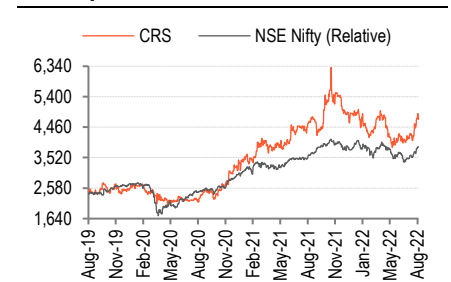
Source: NSE | Price as of 5 Aug 2022

**Key financials**

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	14,458	16,850	19,634
EBITDA (Rs mn)	2,287	2,694	3,202
Adj. net profit (Rs mn)	1,568	1,802	2,124
Adj. EPS (Rs)	120.6	138.5	163.3
Consensus EPS (Rs)	120.6	135.4	158.4
Adj. ROAE (%)	16.6	16.7	17.5
Adj. P/E (x)	39.2	34.1	28.9
EV/EBITDA (x)	26.6	22.6	19.2
Adj. EPS growth (%)	55.6	14.9	17.9

Source: Company, Bloomberg, BOBCAPS Research

**Stock performance**



Source: NSE



## Earnings call highlights

- Revenue potential of new capacities:** CRS's newly announced faucets facility is scheduled to commence from Q1FY24 and will be largely used to produce higher priced coloured/painted products which are in greater demand than chrome-based SKUs. The greenfield sanitaryware capacity will take 24-30 months to commence after finalisation of land, water and gas supply, among others, with due diligence underway. Overall, these new capacities have revenue potential of Rs 1.8bn-2bn each for faucets (2.5-3x asset turnover) and sanitaryware (1.5-2x).
- Revenue mix:** Sanitaryware contributed 53.6% of Q1FY23 revenue (50.4% in Q1FY22/54% in Q4FY22), faucetware 35.2% (30.9%/33%), tiles 10.3% (16.7%/11%) and wellness 1% (2%/2%). Sanitaryware and faucetware together formed 89% of the topline in Q1FY23 vs. 81.3% in Q1FY22.

CRS is focused on maintaining a higher share of retail sales in the mix at 68-72% (68% in Q1FY23). Management's objective is to increase the B2C contribution as the company can monetise its brand power and hike prices.

- Geographical mix:** Tier-3-and-below cities (<1mn population) formed 56% of the revenue, tier-2 (1mn-2.5mn) 13%, and tier-1 (+2.5mn) 30%. Exports formed 1% of total revenue.
- Price hikes:** CRS took a price hike of 3% in sanitaryware and 5% in faucetware in mid-May'22. Prices of key raw materials and gas have been correcting and hence the company will refrain from taking hikes in the foreseeable future. Also, hikes, if any, will have a lag effect.

**Fig 1 – Product extension contribution post price hikes**

(%)	Q1FY23	Q1FY22
<b>Sanitaryware</b>		
Entry	46.7	40.5
Mid	43.1	49.9
Premium	10.2	9.6
<b>Faucetware</b>		
Entry	51.7	59.5
Mid	31.4	22.8
Premium	17.9	17.6

Source: Company, BOBCAP Research | Note: Base changes due to hike

- Sanitaryware RM cost:** Higher cost of key raw materials such as China clay and plaster of Paris, which constitute 95% of the segment's RM cost, had an impact of just 2% on total cost in Q1.
- Growth outlook:** Management expects faucetware to grow 50% higher than the industry, of which half will be volume-led and half price-led. Sanitaryware is guided to grow 25% higher than the industry, again with a 50:50 volume and price split.
- Tiles business exit:** CRS has exited the tiles business under Anjani Tiles in Q4FY22. This apart, in 2018, CRS had invested Rs 80.6mn in Milo Tiles (Milo) for a 26% stake and also entered into an LLP agreement with the company for supply of

glazed vitrified tiles. Recently, Milo has been unable to maintain CRS's quality parameters and has also stopped manufacturing operations. Hence, the company has served a legal notice to Milo and the other LLP partners for non-compliance with the terms of the agreement. The quantum of investment impairment in Milo has not yet been determined and hence no provision was made.

- **Utilisation:** CRS intends to continue focusing on outsourcing and will only make high-end, value-added products at its own facility. During Q1, capacity utilisation at the sanitaryware (~110%) and faucetware (~103%) plants was at optimal levels. Management has guided for utilisation to remain at similar levels for FY23. Production in faucetware (inhouse plus outsourcing) totalled 180,000 pieces per month up to H1FY22, which increased to 250,000 in Mar'22 and 300,000 pieces in June, signaling strong demand.
- **Outsourcing:** Outsourcing in sanitaryware stood at 50% in Q1FY23 (vs. 55.2% in Q1FY22) and in faucetware at 54.8% (vs. 54.6%) to meet demand as in-house capacities are running at peak. For FY23 as well, outsourcing is guided to be as high as 55%+ for both segments because capex will commence later and also company will free up the capacity to manufacture complicated products in-house.
- **SKU:** The company currently has 550 SKUs in sanitaryware and 978 in faucetware.
- **Capex:** CRS has cash worth Rs 5.7bn as of Q1FY23 vs. Rs 4.3bn in Q1FY22. It has planned capex (other than capacity expansion) worth ~Rs 2.5bn in FY23 (Rs 770mn for sanitaryware automation plant, Rs 640mn for faucetware automation plant, Rs 660mn toward land purchase for sanitaryware plant, and Rs 440mn for regular capex). The balance planned capex for sanitaryware will be incurred in FY24 since approvals would take time after land acquisition. As per management, internal accruals would be adequate to fund these plans with no requirement for debt raising or equity dilution.
- **Working capital cycle:** Management expects the working capital cycle to increase in coming quarters due to growing demand and the need to rebuild inventory. Inventory days rose to 73 in Q1FY23 vs. 61 days in Q1FY22. Receivable days stood at 26 vs. 39 and payable days at 39 vs. 29. Net working capital days were at 60 vs. 70 days in Q1FY22.
- **Imports:** Lower imports in India owing to macro challenges (higher freight cost from US\$ 600 per container to US\$ 7,000-8,000 currently and shortage of container availability), along with pressure on smaller players, has led to a focus on better product availability. Hence, CRS expects inventory days to be elevated even in FY23.

**Fig 2 – Consolidated quarterly performance**

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
<b>Total revenues</b>	<b>3,972</b>	<b>2,282</b>	<b>74.1</b>	<b>4,099</b>	<b>(3.1)</b>	<b>14,458</b>	<b>12,243</b>	<b>18.1</b>
Total raw material consumed	1,847	936	97.4	2,181	(15.3)	6,836	6,268	9.1
% of sales	46.5	41.0	550bps	53.2	(670bps)	47.3	51.2	(392bps)
Employee exps	497	446	11.4	501	(0.7)	1,936	1,537	26.0
% of sales	12.5	19.5	(703bps)	12.2	30bps	13.4	12.6	84bps
Other exp	1,000	692	44.5	621	61.1	3,399	2,858	18.9
% of sales	25.2	30.3	(515bps)	15.1	1003bps	23.5	23.3	17bps
Total expenditure	3,344	2,074	61.2	3,302	1.3	12,171	10,663	14.1
% of sales	84.2	90.9	(669bps)	80.5	363bps	84.2	87.1	(291bps)
<b>EBITDA</b>	<b>628</b>	<b>208</b>	<b>201.7</b>	<b>797</b>	<b>(21.2)</b>	<b>2287</b>	<b>1581</b>	<b>44.7</b>
EBITDA margin (%)	15.8	9.1	669bps	19.5	(363bps)	15.8	12.9	291bps
Depreciation	75	89	(15.3)	48	56.3	324	396	(18.1)
Other income	(6)	65	(109.6)	38	(116.3)	236	252	(6.0)
Interest cost	11	21	(48.4)	(8)	(242.1)	53	97	(45.7)
<b>PBT</b>	<b>536</b>	<b>164</b>	<b>227.3</b>	<b>795</b>	<b>(32.6)</b>	<b>2147</b>	<b>1339</b>	<b>60.3</b>
Taxes	137.3	48.3	184.4	211.5	(35.1)	560.1	340.1	64.7
Effective tax rate (%)	25.6	29.5	(386bps)	26.6	(97bps)	26.1	25.4	69bps
PAT before minority interest/associates	<b>399</b>	<b>115</b>	<b>245.2</b>	<b>584</b>	<b>(31.7)</b>	<b>1587</b>	<b>999</b>	<b>58.8</b>
Less: extraordinary profit/(loss)	0	0	-	(57)	-	(57)	0	-
Less: Minority interest	3.8	(6.5)	(158.4)	3.1	22.7	18.6	(8.2)	(326.7)
Add: Share of profit in associate	0.0	0.1	(100.0)	2.5	(100.0)	0.1	0.5	(84.0)
<b>RPAT</b>	<b>395</b>	<b>122</b>	<b>223.5</b>	<b>526</b>	<b>(24.9)</b>	<b>1511</b>	<b>1008</b>	<b>49.9</b>

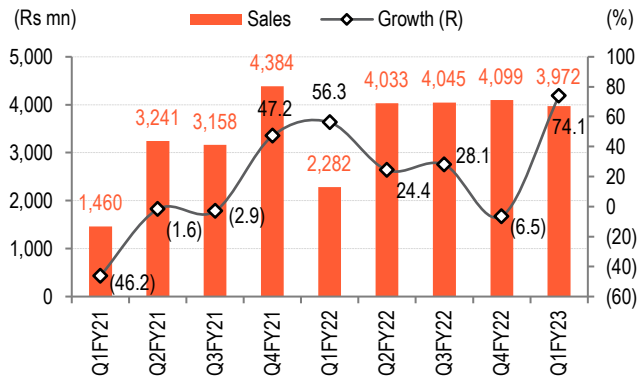
Source: Company, BOBCAPS Research

**Fig 3 – Standalone quarterly performance**

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
<b>Total revenues</b>	<b>3,958</b>	<b>2,228</b>	<b>77.6</b>	<b>4,387</b>	<b>(9.8)</b>	<b>14,418</b>	<b>12,017</b>	<b>20.0</b>
Total raw material consumed	1,832	985	86.0	2,041	(10.2)	6,810	6,473	5.2
% of sales	46.3	44.2	209bps	46.5	(23bps)	47.2	53.9	(663bps)
Employee exps	489	430	13.6	521	(6.1)	1,907	1,443	32.2
% of sales	12.4	19.3	(696bps)	11.9	49bps	13.2	12.0	122bps
Other exp	1,024	614	66.8	1,000	2.4	3,488	2,601	34.1
% of sales	25.9	27.6	(168bps)	22.8	308bps	24.2	21.6	254bps
Total expenditure	3,346	2,030	64.8	3,563	(6.1)	12,205	10,518	16.0
% of sales	85	91	(655bps)	81	333bps	85	88	(287bps)
<b>EBITDA</b>	<b>612</b>	<b>198</b>	<b>208.3</b>	<b>824</b>	<b>(25.8)</b>	<b>2212</b>	<b>1500</b>	<b>47.5</b>
EBITDA margin (%)	15.5	8.9	655bps	18.8	(333bps)	15.3	12.5	287bps
Depreciation	69.9	72.9	(4.1)	77.7	(10.1)	304.3	332.3	(8.4)
Other income	(2.7)	57.5	(104.6)	58.9	(104.5)	227.8	217.9	4.5
Interest cost	9.4	10.4	(9.8)	15.2	(38.2)	45.9	42.7	7.5
<b>PBT</b>	<b>530</b>	<b>173</b>	<b>206.8</b>	<b>790</b>	<b>(33.0)</b>	<b>2090</b>	<b>1342</b>	<b>55.7</b>
Taxes	133.3	43.4	206.8	211.9	(37.1)	539.1	329.4	63.7
Effective tax rate (%)	25.2	25.2	0bps	26.8	(166bps)	25.8	24.5	126bps
APAT	<b>396</b>	<b>129</b>	<b>206.8</b>	<b>578</b>	<b>(31.4)</b>	<b>1551</b>	<b>1013</b>	<b>53.1</b>
Less: Extraordinary items	0	0	-	(57)	-	(57)	0	-
<b>RPAT</b>	<b>396</b>	<b>129</b>	<b>206.8</b>	<b>521</b>	<b>(23.9)</b>	<b>1494</b>	<b>1013</b>	<b>47.4</b>

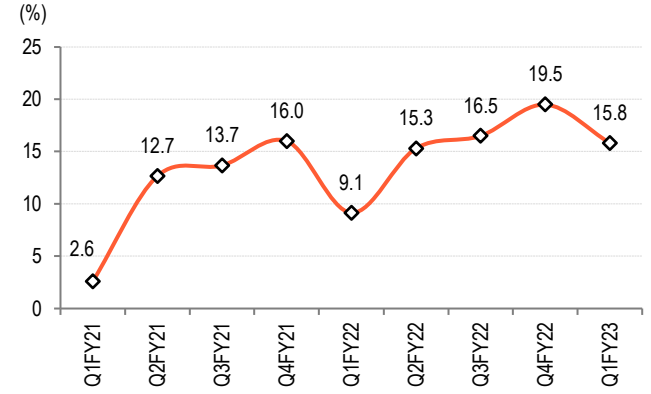
Source: Company, BOBCAPS Research

**Fig 4 – Consolidated revenue growth**



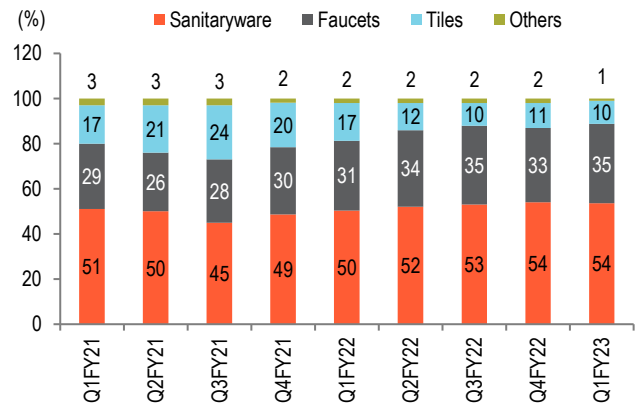
Source: Company, BOBCAPS Research

**Fig 5 – EBITDA margin trend**



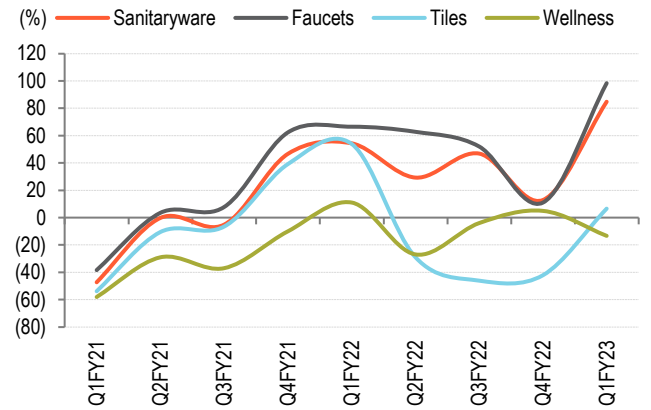
Source: Company, BOBCAPS Research

**Fig 6 – Segmental revenue contribution**



Source: Company, BOBCAPS Research

**Fig 7 – Segmental growth YoY**



Source: Company, BOBCAPS Research

## Valuation methodology

CRS remains focused on tier-2/3 markets where it faces limited competition, enabling it to maintain pricing power. About 70% of the company's sales are from the retail channel while the balance is from institutions, which supports a healthy gross margin of ~55%.

We believe CRS is in a sweet spot given sustained robust growth in its bathroom solutions segment backed by (a) market share gains across the product portfolio from import substitution in the sanitaryware and faucet segments, (b) a sizeable shift in demand from the unorganised to organised sector, and (c) demand pickup in the housing sector (new construction and replacement). The recent capacity debottlenecking and 40-50% expansion announced (to commence in 12-36 months) would lead the next leg of growth.

Despite CRS's strong growth prospects, we downgrade our rating from BUY to HOLD as the positives look priced in following a 20% rally in stock price over the last three months. The stock is currently trading at 29x FY24E EPS. We retain our TP of Rs 5,225, set at 32x FY24E EPS (vs. its five-year median of 36.2x).

## Key risks

Key upside risks to our estimates are:

- Significant correction in input prices which may expand profitability,
- Strong demand in real estate demand,
- faster economic revival, and
- slower off-take from the new competition.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Century Plyboards	CPBI IN	1.8	634	735	BUY
Cera Sanitaryware	CRS IN	0.8	4,725	5,225	HOLD
Greenpanel Industries	GREENP IN	0.7	443	595	BUY
Greenply Industries	MTLM IN	0.3	183	260	BUY
Kajaria Ceramics	KJC IN	2.3	1,123	1,460	BUY
Pidilite Industries	PIDI IN	16.9	2,641	1,870	SELL
Somany Ceramics	SOMC IN	0.3	634	835	BUY

Source: BOBCAPS Research, NSE | Price as of 5 Aug 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
<b>Total revenue</b>	<b>12,220</b>	<b>12,243</b>	<b>14,458</b>	<b>16,850</b>	<b>19,634</b>
EBITDA	1,654	1,581	2,287	2,694	3,202
Depreciation	(388)	(396)	(324)	(408)	(486)
EBIT	1,266	1,185	1,963	2,286	2,716
Net interest inc./(exp.)	(101)	(97)	(53)	(70)	(62)
Other inc./(exp.)	65	252	236	222	220
Exceptional items	119	0	(57)	0	0
EBT	1,230	1,339	2,147	2,438	2,874
Income taxes	(243)	(340)	(560)	(636)	(750)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	27	9	(18)	0	0
<b>Reported net profit</b>	<b>1,133</b>	<b>1,008</b>	<b>1,511</b>	<b>1,802</b>	<b>2,124</b>
Adjustments	(119)	0	57	0	0
<b>Adjusted net profit</b>	<b>1,013</b>	<b>1,008</b>	<b>1,568</b>	<b>1,802</b>	<b>2,124</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	953	1,554	1,335	1,616	1,883
Other current liabilities	2,102	2,186	2,968	3,001	3,496
Provisions	136	171	114	236	275
Debt funds	919	729	452	400	350
Other liabilities	299	303	354	386	418
Equity capital	65	65	65	65	65
Reserves & surplus	7,642	8,652	10,086	11,348	12,834
Shareholders' fund	7,707	8,717	10,152	11,413	12,899
<b>Total liab. and equities</b>	<b>12,194</b>	<b>13,777</b>	<b>15,517</b>	<b>17,193</b>	<b>19,464</b>
Cash and cash eq.	125	104	149	938	1,324
Accounts receivables	2,228	2,095	1,648	2,308	2,690
Inventories	2,430	1,997	2,937	3,001	3,496
Other current assets	737	670	1,785	1,293	1,506
Investments	2,283	4,743	5,621	5,500	5,500
Net fixed assets	4,373	4,147	3,362	4,139	4,933
CWIP	5	13	7	7	7
Intangible assets	12	8	8	8	8
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>12,194</b>	<b>13,777</b>	<b>15,517</b>	<b>17,193</b>	<b>19,464</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
<b>Cash flow from operations</b>	<b>1,517</b>	<b>2,858</b>	<b>838</b>	<b>2,516</b>	<b>2,415</b>
Capital expenditures	(450)	(140)	468	(1,186)	(1,280)
Change in investments	(504)	(2,460)	(879)	121	0
Other investing cash flows	(45)	5	25	0	0
<b>Cash flow from investing</b>	<b>(999)</b>	<b>(2,595)</b>	<b>(386)</b>	<b>(1,065)</b>	<b>(1,280)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	13	(191)	(277)	(52)	(50)
Interest expenses	(101)	(97)	(53)	(70)	(62)
Dividends paid	(396)	0	(153)	(541)	(637)
Other financing cash flows	(103)	5	25	0	0
<b>Cash flow from financing</b>	<b>(586)</b>	<b>(283)</b>	<b>(457)</b>	<b>(663)</b>	<b>(749)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(68)</b>	<b>(20)</b>	<b>(6)</b>	<b>789</b>	<b>386</b>
<b>Closing cash &amp; cash eq.</b>	<b>125</b>	<b>104</b>	<b>98</b>	<b>938</b>	<b>1,324</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	87.1	77.5	116.2	138.5	163.3
Adjusted EPS	77.9	77.5	120.6	138.5	163.3
Dividend per share	13.0	13.0	35.0	34.6	40.8
Book value per share	592.6	670.3	780.5	877.5	991.8

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	5.0	5.0	4.2	3.6	3.1
EV/EBITDA	36.7	38.4	26.6	22.6	19.2
Adjusted P/E	60.6	61.0	39.2	34.1	28.9
P/BV	8.0	7.0	6.1	5.4	4.8

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	FY23E	FY24E
Tax burden (Net profit/PBT)	75.1	75.2	75.1	73.9	73.9
Interest burden (PBT/EBIT)	106.6	113.0	106.4	106.7	105.8
EBIT margin (EBIT/Revenue)	10.4	9.7	13.6	13.6	13.8
Asset turnover (Rev./Avg TA)	101.4	94.3	98.7	103.0	107.1
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.5	1.5
Adjusted ROAE	13.8	12.3	16.6	16.7	17.5

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	(9.4)	0.2	18.1	16.5	16.5
EBITDA	(15.8)	(4.4)	44.7	17.8	18.8
Adjusted EPS	0.3	(0.6)	55.6	14.9	17.9
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	13.5	12.9	15.8	16.0	16.3
EBIT margin	10.4	9.7	13.6	13.6	13.8
Adjusted profit margin	8.3	8.2	10.8	10.7	10.8
Adjusted ROAE	13.8	12.3	16.6	16.7	17.5
ROCE	12.4	9.7	14.2	14.9	15.8
<b>Working capital days (days)</b>					
Receivables	78	64	47	43	46
Inventory	152	129	132	142	133
Payables	36	43	43	38	39
<b>Ratios (x)</b>					
Gross asset turnover	2.1	2.0	2.4	2.6	2.5
Current ratio	1.5	1.2	1.4	1.5	1.6
Net interest coverage ratio	12.6	12.2	37.2	32.5	43.9
Adjusted debt/equity	0.1	0.1	0.0	0.0	(0.1)

Source: Company, BOBCAPS Research | Note: TA = Total Assets

## Disclaimer

### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

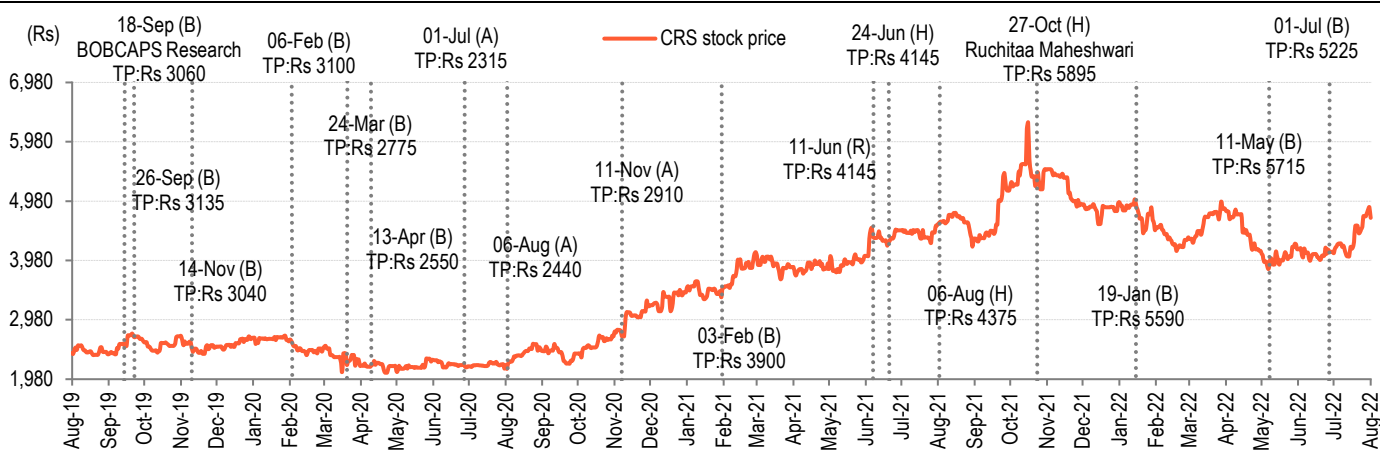
**HOLD** – Expected return from -6% to +15%

**SELL** – Expected return <-6%

**Note:** Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): CERA SANITARYWARE (CRS IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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