

ADD

TP: Rs 2,315 | ▲ 6%

CERA SANITARYWARE

Construction Materials

01 July 2020

Lockdown blues – downgrade to ADD

Cera Sanitaryware (CRS) reported below-expected Q4FY20 results as the lockdown derailed standalone revenue growth (-29% YoY). Operating margins contracted 98bps YoY to 14.5%, driving EBITDA/PBT declines of 34%/41% YoY. Management did not guide on demand trends but expects cost-cutting initiatives to mitigate the impact on margins. We lower FY21/FY22 earnings by 37%/9% and reduce our Mar'21 TP to Rs 2,315 (from Rs 2,550). Current valuations of 24.6x FY22E EPS offer limited upside – cut to ADD from BUY.

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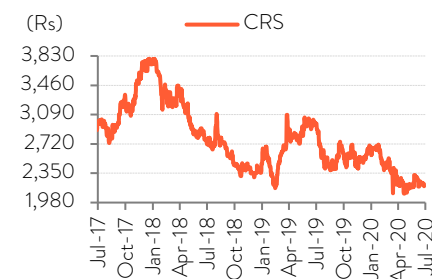
Lockdown dampens topline growth: CRS reported a 29% YoY decline in Q4 standalone revenue to Rs 2.9bn. The sanitaryware segment plunged 31% YoY whereas faucets/tiles fell 24%/30% YoY. As per management, the nationwide lockdown imposed during the seasonally busy period of March dented Q4 performance. The company believes clarity on demand trends post Covid-19 will emerge only after several quarters. Management highlighted the continued thrust on working capital discipline in these tough times.

Ticker/Price	CRS IN/Rs 2,185
Market cap	US\$ 376.2mn
Shares o/s	13mn
3M ADV	US\$ 0.2mn
52wk high/low	Rs 3,040/Rs 1,986
Promoter/FPI/DII	54%/14%/31%

Source: NSE

EBITDA/PBT slump: Gross margins expanded 275bps YoY, but CRS's standalone operating margins contracted 98bps YoY to 14.5% as employee expenses increased (+380bps YoY) on account of negative operating leverage. EBITDA/PBT slumped 34%/41% YoY. Gross margins improved due to a better product mix and lower raw material cost. Management expects various cost-cutting measures and benign commodity prices to somewhat cushion margins in a challenging demand environment.

STOCK PERFORMANCE



Source: NSE

Downgrade to ADD: Q4 was below estimates and given persistent demand sluggishness, we cut FY21/FY22 earnings estimates by 37%/9%. Our Mar'21 TP moves to Rs 2,315 (from Rs 2,550), set at an unchanged 26x one-year forward P/E. Downgrade from BUY to ADD on limited upside potential.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	11,776	13,444	12,237	9,925	12,368
EBITDA (Rs mn)	1,699	1,917	1,655	1,093	1,766
Adj. net profit (Rs mn)	970	1,010	1,133	596	1,157
Adj. EPS (Rs)	74.6	77.7	87.1	45.8	89.0
Adj. EPS growth (%)	0.9	4.1	12.1	(47.4)	94.1
Adj. ROAE (%)	17.2	15.5	15.4	7.5	13.4
Adj. P/E (x)	29.3	28.1	25.1	47.7	24.6
EV/EBITDA (x)	16.6	14.6	16.8	25.3	15.7

Source: Company, BOBCAPS Research

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FIG 1 – STANDALONE QUARTERLY PERFORMANCE

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
Total revenues	2,932	4,131	(29.0)	3,213	(8.7)	12,092	13,436	(10.0)
Total raw material consumed	1,391	2,073	(32.9)	1,635	(14.9)	5,852	6,457	(9.4)
% of sales	47.4	50.2	(276bps)	50.9	(344bps)	48.4	48.1	34bps
Employee exp	387	387	0.0	411	(5.9)	1,604	1,564	2.6
% of sales	13.2	9.4	383bps	12.8	39bps	13.3	11.6	162bps
Other exp	731	1,033	(29.3)	738	(1.0)	3,015	3,509	(14.1)
% of sales	24.9	25.0	(9bps)	23.0	195bps	24.9	26.1	(118bps)
Total expenditure	2,508	3,493	(28.2)	2,784	(9.9)	10,470	11,530	(9.2)
% of sales	86	84.6	98bps	86.6	(110bps)	87	85.8	78bps
EBITDA	424	638	(33.5)	429	(1.2)	1,621	1,906	(14.9)
% of sales	14.5	15.4	(98bps)	13.4	110bps	13.4	14.2	(78bps)
Depreciation	91	67	35.6	80	13.0	327	228	43.0
Other income	43	57	(25.1)	43	(1.1)	156	156	(0.6)
Interest cost	12	15	(22.3)	11	9.0	44	32	36.0
PBT	364	613	(40.6)	381	(4.5)	1,406	1,802	(22.0)
Taxes	(20)	233	(108.7)	98	(120.8)	247	651	(62.1)
Effective tax rate (%)	(5.6)	37.9	NA	25.6	NA	17.5	36.1	(1,860bps)
APAT	385	380	1.1	284	35.6	1,159	1,151	0.8

Source: Company, BOBCAPS Research

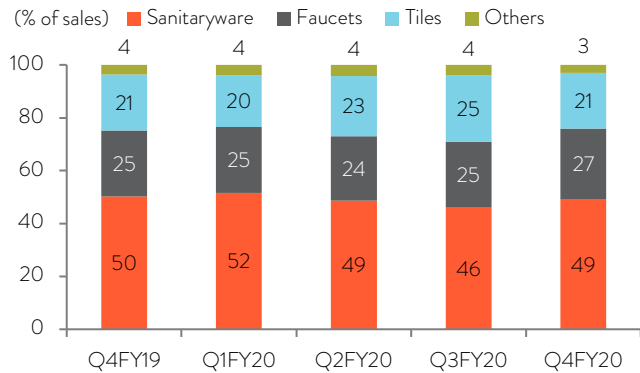
FIG 2 – CONSOLIDATED QUARTERLY PERFORMANCE

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
Total revenues	2,978	4,170	(28.6)	3,252	(8.4)	12,237	13,515	(9.5)
Total raw material consumed	1,325	1,993	(33.5)	1,542	(14.1)	5,503	6,062	(9.2)
% of sales	45.2	48.2	(307bps)	48.0	(280bps)	45.5	45.1	39bps
Employee exp	451	443	1.6	424	6.2	1,707	1,655	3.2
% of sales	15.4	10.7	463bps	13.2	216bps	14.1	12.3	181bps
Other exp	780	1,069	(27.0)	837	(6.9)	3,372	3,817	(11.6)
% of sales	26.6	25.9	73bps	26.1	54bps	27.9	28.4	(52bps)
Total expenditure	2,555	3,505	(27.1)	2,804	(8.9)	10,582	11,533	(8.2)
% of sales	87.1	84.8	230bps	87.2	(10bps)	87.5	85.8	168bps
EBITDA	423	665	(36.4)	449	(5.7)	1,655	1,983	(16.5)
% of sales	14.4	16.1	(166bps)	14.0	46bps	13.7	14.8	(107bps)
Depreciation	106	80	32.4	96	10.1	388	280	38.6
Other income	52	67	(22.0)	50	4.0	182	186	(1.8)
Interest cost	27	31	(14.5)	25	6.9	101	85	17.7
PBT	343	621	(44.7)	378	(9.2)	1,349	1,803	(25.2)
Taxes	(13)	234	(105.7)	96	(113.8)	243	652	(62.7)
Effective tax rate (%)	(3.9)	37.7	NA	25.4	NA	18.0	36.2	(1,811bps)
APAT	357	387	(7.8)	282	26.3	1,105	1,151	(4.0)
Less: Minority interest	(13.8)	3.1	NM	(0.7)	1,875.0	NM	0.2	(11,534.9)
Add: share of profit in associate	2.0	0.3	6.5	0.7	204.2	0.6	0.5	0.4
RPAT	372	384	(3.0)	284	31	1,133	1,151	(1.6)

Source: Company, BOBCAPS Research

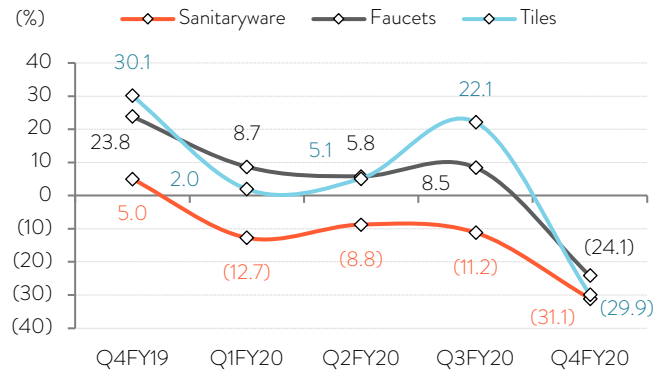
STANDALONE QUARTERLY TRENDS

FIG 3 – REVENUE BREAKUP



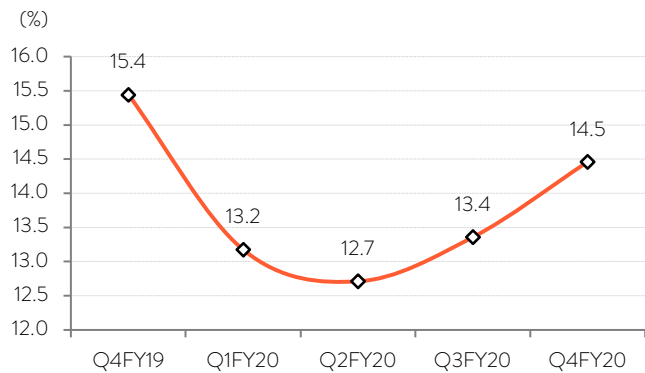
Source: Company, BOBCAPS Research

FIG 4 – SEGMENTAL GROWTH YOY



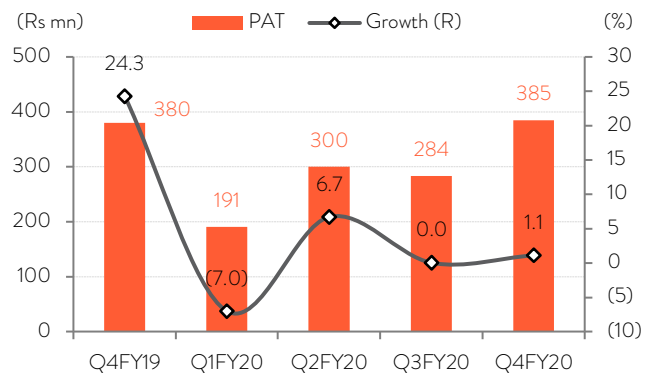
Source: Company, BOBCAPS Research

FIG 5 – EBITDA MARGIN



Source: Company, BOBCAPS Research

FIG 6 – PAT GROWTH YOY



Source: Company, BOBCAPS Research

Earnings call highlights

- March is seasonally the best month of the year for CRS as dealers strive to achieve yearly targets – it normally accounts for Rs 1.2bn-1.5bn of turnover, which was disrupted by the lockdown imposed in the second half of March.
- Loss of higher value-added sales affected the overall margin trend for the quarter.
- Collection trends have been healthy in April/May and hence CRS has not dipped into its cash reserves even in these difficult times.
- The raw material price environment is benign with clay prices falling 5% in FY20.
- In order to reduce costs, management is renegotiating pricing with vendors. Also, rental renegotiations are underway for warehouses and offices.

- Recent introduction of automated processes shall enable CRS to produce at lower cost.
- The company's manufacturing plant is running at one shift currently and will ramp up once demand improves.
- About 60% of CRS's labourers stay near the factory and hence production disruptions due to the pandemic have been minimal.
- The company launched a total of 165 new SKUs in FY20, mostly focused on the affordable housing category.
- CRS derived 55% of sales from tier-3 cities in FY20 whereas tier-1 cities accounted for 31% share. Management believes tier-3 cities will fuel sales in the near term.
- North India accounts for 30% of total turnover, South 42%, West 17% and East 10%.
- About 72% of CRS's revenue was derived from the dealer network in FY20 and the balance from institutional sales.
- Institutional sales are normally to large builders with a nationwide presence.
- CRS used 59% of its gas requirement from APM gas and purchased the balance 41% from Sabarmati Gas.
- Capex planned for FY21 totals ~Rs 220mn. Cash & cash equivalents on the books stood at ~Rs 2.3bn as of Mar'20.

Valuation methodology

CRS is one of the largest organised sanitaryware players in India. Over the years, the company has expanded its product portfolio from sanitaryware to tiles, faucets and wellness goods, to become a one-stop bathroom solution provider. We like CRS for its strong balance sheet and working capital discipline.

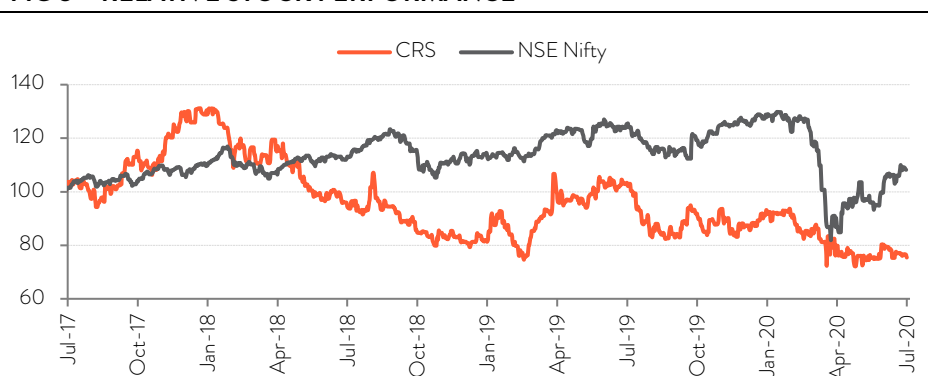
However, in light of a below-expected Q4FY20 performance and persistent demand weakness due to Covid-19, we reduce FY21/FY22 earnings estimates by 37%/9%. Our Mar'21 target price moves to Rs 2,315 (from Rs 2,550) and is set at an unchanged 26x one-year forward P/E. Downgrade from BUY to ADD as current valuations of 24.6x FY22E EPS offer limited upside potential.

FIG 7 – REVISED ESTIMATES

(Rs mn)	Old		New		Change (%)	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Revenue	11,374	13,931	9,925	12,368	(12.7)	(11.2)
EBITDA	1,536	1,922	1,093	1,766	(28.8)	(8.1)
PAT	949	1,273	596	1,157	(37.2)	(9.1)

Source: BOBCAPS Research

FIG 8 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Sharp rise in raw material prices:** CRS's key raw material is natural gas; any sharp increase in prices may affect near-term profitability.
- **Increased competition from unorganised players:** All of CRS's business segments have a large unorganised presence (~50% of the total market). An inability to compete effectively may affect the company's profitability.
- **Prolonged slowdown in housing market:** A continued slowdown in the housing market would hit growth prospects.
- **Prolonged Covid-19 outbreak:** If pandemic fears prevail for a prolonged period of time, revenues will be adversely affected.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue	11,776	13,444	12,237	9,925	12,368
EBITDA	1,699	1,917	1,655	1,093	1,766
Depreciation	(271)	(280)	(388)	(402)	(428)
EBIT	1,428	1,637	1,267	692	1,339
Net interest income/(expenses)	(98)	(85)	(101)	(77)	(64)
Other income/(expenses)	129	110	182	168	231
Exceptional items	90	141	0	0	0
EBT	1,459	1,662	1,349	783	1,505
Income taxes	(488)	(652)	(243)	(197)	(379)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	(1)	0	27	10	31
Reported net profit	1,061	1,151	1,133	596	1,157
Adjustments	(90)	(141)	0	0	0
Adjusted net profit	970	1,010	1,133	596	1,157

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	944	1,109	953	789	915
Other current liabilities	1,840	1,979	2,180	1,441	1,796
Provisions	201	365	132	149	186
Debt funds	962	906	844	620	600
Other liabilities	391	436	299	319	351
Equity capital	65	65	65	65	65
Reserves & surplus	5,991	6,944	7,642	8,123	9,046
Shareholders' fund	6,056	7,009	7,707	8,188	9,111
Total liabilities and equities	10,461	11,908	12,194	11,573	12,995
Cash and cash eq.	327	193	21	113	97
Accounts receivables	2,680	2,984	2,228	2,175	2,406
Inventories	1,935	2,158	2,430	1,550	1,999
Other current assets	782	747	840	625	712
Investments	1,086	1,779	2,283	2,900	3,600
Net fixed assets	3,591	3,845	4,373	4,192	4,164
CWIP	52	195	5	5	5
Intangible assets	7	9	12	12	12
Total assets	10,461	11,908	12,194	11,573	12,995

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	1,332	1,431	1,520	998	1,585
Interest expenses	98	85	101	77	64
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(648)	(22)	4	261	(248)
Other operating cash flows	(3)	45	(137)	20	32
Cash flow from operations	778	1,540	1,489	1,356	1,433
Capital expenditures	(470)	(678)	(450)	(220)	(400)
Change in investments	(215)	(693)	(504)	(617)	(700)
Other investing cash flows	(64)	(10)	(45)	(10)	(31)
Cash flow from investing	(749)	(1,381)	(999)	(847)	(1,131)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	124	(56)	(62)	(224)	(20)
Interest expenses	(98)	(85)	(101)	(77)	(64)
Dividends paid	(188)	(188)	(396)	(105)	(203)
Other financing cash flows	(107)	36	(103)	(10)	(31)
Cash flow from financing	(268)	(293)	(661)	(417)	(318)
Changes in cash and cash eq.	(239)	(134)	(171)	92	(16)
Closing cash and cash eq.	327	193	21	113	97

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	81.5	88.5	87.1	45.8	89.0
Adjusted EPS	74.6	77.7	87.1	45.8	89.0
Dividend per share	12.0	13.0	13.0	6.8	13.0
Book value per share	465.7	538.9	592.6	629.6	700.6

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	2.4	2.1	2.3	2.8	2.2
EV/EBITDA	16.6	14.6	16.8	25.3	15.7
Adjusted P/E	29.3	28.1	25.1	47.7	24.6
P/BV	4.7	4.1	3.7	3.5	3.1

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	62.6	56.0	84.0	76.1	76.9
Interest burden (PBT/EBIT)	108.5	110.1	106.4	113.2	112.5
EBIT margin (EBIT/Revenue)	12.1	12.2	10.4	7.0	10.8
Asset turnover (Revenue/Avg TA)	116.2	120.2	101.5	83.5	100.7
Leverage (Avg TA/Avg Equity)	1.8	1.7	1.6	1.5	1.4
Adjusted ROAE	17.2	15.5	15.4	7.5	13.4

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
YoY growth (%)					
Revenue	17.0	14.2	(9.0)	(18.9)	24.6
EBITDA	(1.1)	12.8	(13.7)	(33.9)	61.6
Adjusted EPS	0.9	4.1	12.1	(47.4)	94.1
Profitability & Return ratios (%)					
EBITDA margin	14.4	14.3	13.5	11.0	14.3
EBIT margin	12.1	12.2	10.4	7.0	10.8
Adjusted profit margin	8.2	7.5	9.3	6.0	9.4
Adjusted ROAE	17.2	15.5	15.4	7.5	13.4
ROCE	14.7	13.8	12.5	5.9	10.8
Working capital days (days)					
Receivables	76	77	78	81	68
Inventory	121	123	152	163	117
Payables	32	33	36	36	29
Ratios (x)					
Gross asset turnover	2.5	2.6	2.1	1.6	1.9
Current ratio	1.6	1.5	1.5	1.7	1.6
Net interest coverage ratio	14.6	19.2	12.6	9.0	20.9
Adjusted debt/equity	0.1	0.1	0.1	0.1	0.1

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

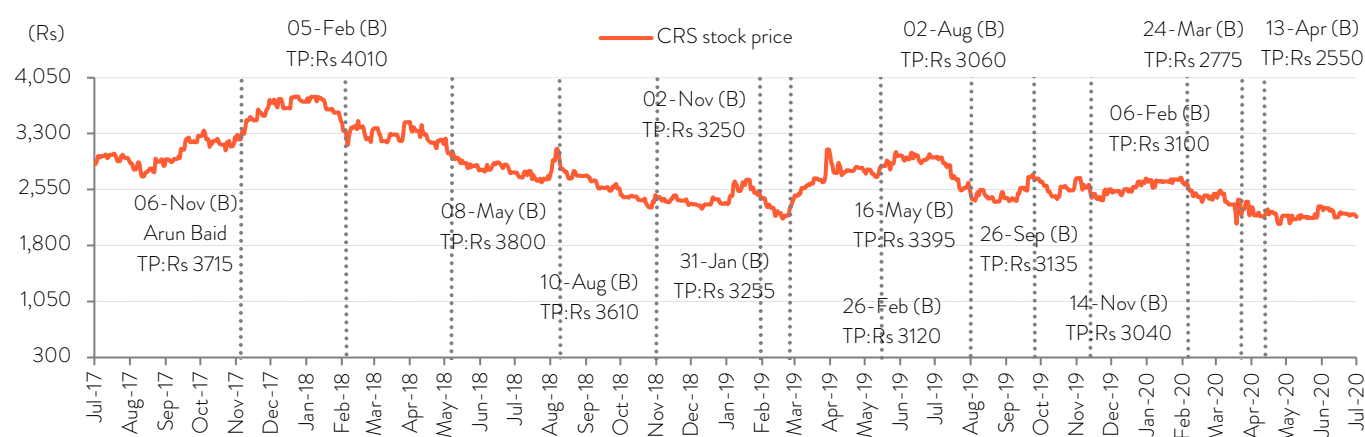
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: CERA SANITARYWARE (CRS IN)



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

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