CERAMICS

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Expert call: Demand moderation, cost inflation to hit Q1 margins

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- **Rising gas costs driving Morbi ceramic manufacturers to switch to propane which is 5% cheaper**
- **Tile exports is expected to improve in Q2FY23 led by lower freight costs; exports to double in four years**
- **Ceramic players to face near-term margin pressure owing to domestic demand slowdown and rising commodity cost inflation**

We interacted with Tapan Jena, Founder of SANVT Ceramics, to gain a perspective on the ceramic industry's growth prospects and gas cost outlook. Key takeaways:

Long-term gas costs up by ~30%: Gas forms 30-35% of the total production cost for ceramic manufacturers. Long-term gas cost has risen from Rs 52-53/scm levels over the last 3-4 months to Rs 68/scm plus taxes currently and forms 80% of contractual quantity. The additional 20% is purchased on spot basis. The industry has been able to pass on 60% of the cost inflation. Going forward, however, companies will find it difficult to take price hikes and will thus face margin pressure in Q1FY23.

Morbi industry enhancing gas-to-propane switching facilities: With propane prices at a 5% discount to gas currently, many players have switched to this alternative fuel to curb rising fuel costs. Propane costs are expected to fall by a further 5-7% next year which will, in turn, push down gas prices.

Tile industry expected to grow 12-15% in FY23: India is the second largest tile manufacturer after China with a Rs 500bn market (up >10% from last year), of which Rs 13bn-14bn is branded (40% met through Morbi) and the balance is unbranded. The industry is expected to grow at 12-15% in FY23.

Tile exports to double in four years: Tile exports have risen to Rs 12.7bn now compared to Rs 12.5bn in FY20, supported by a 15% jump in volumes even as realisations declined. While Q1FY23 will likely face sluggishness in exports and realisations, Q2 should see a revival as freight costs expects to ease. Further, tile exports are expected to double in the next four years.

Ceramic players to face margin pressure in Q1: Post Covid, the ceramic industry witnessed strong pent-up demand which allowed players to take multiple price hikes. Real estate demand has been robust which increased the churning of old inventory. Though, the rising cost inflation have hindered new construction activity over the last six months. However, players have been unable to fully pass on the rising commodity costs. Margins will thus remain under pressure.

Other takeaways

- **Domestic ceramic (tiles and sanitaryware) demand to slow in Q1:** Post Covid, the increased churning of old real estate inventory and replacement market revival led to robust demand for ceramic players. However, with commodity cost inflation and the absorption of pent-up demand, new construction activity has slowed, impacting demand for tiles and sanitaryware in April and May. That said, Q2FY23 should see a revival as exports improve led by lower freight costs.
- **Narrowing price differential of Morbi players with organised players:** The price differential has narrowed to 10-15% from 20-25% with increasing contract work from Morbi capacity.
- **Sanitaryware industry to grow at 15-17% in FY23:** India's sanitaryware industry is worth just ~Rs 8bn and projected to grow 15-17% in FY23.
- **Shift from granite to tile flooring:** Of late, the use of granite marble for flooring has reduced because of its limited availability and designs (being a natural product), logistical difficulties in handling, the larger range of tile sizes on offer, and greater affordability of tiles vs. marble.
- **Breakeven timelines:** In the tiles business, for a capacity of 600,000sqm/month Morbi players invest Rs 800mn-900mn and achieve breakeven in 6-8 months. A branded player will invest Rs 1bn-1.2bn and take 12-14 months to breakeven a similar capacity. In sanitaryware, for a capacity of 2,000 pieces/month, Morbi players invest Rs 300mn-400mn and reach breakeven in 1.5-2 years. For a branded player, the investment is Rs 400mn-500mn with a 2-2.5-year breakeven point.

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