

**BUY**

TP: Rs 1,460 | ▲ 36%

**KAJARIA CERAMICS**

Construction Materials

21 July 2022

### Margins healthy despite cost inflation; retain BUY

- Q1 revenue grew 80% YoY (-8.5% QoQ) spurred by a 15% (+2% QoQ) rise in tile realisations and 53% (-10% QoQ) volume growth
- EBITDA margin expanded 90bps YoY and 17bps QoQ to 15.2% despite higher power & fuel cost (+355bps YoY, +590bps QoQ)
- We retain BUY and our TP of Rs 1,460 given strong growth prospects and attractive valuations

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**Higher realisations and favourable base buoy topline:** KJC's Q1FY23 revenue increased 80% YoY (-8.5% QoQ) to Rs 10bn, backed by a 15% rise in realisations to Rs 393/sqm. Sale volumes grew 53% YoY (-10% QoQ) to 23.3msm off a low base. Revenue from the tiles business rose 77% YoY to Rs 9.2bn, with the company's own manufacturing, subsidiaries and outsourcing businesses contributing Rs 5.4bn (+65% YoY), Rs 1.4bn (+76%) and Rs 2.4bn (+108%) respectively. Sanitaryware and plywood revenue climbed 117% YoY to Rs 0.9bn.

**EBITDA margin maintained at 15%:** Despite higher power & fuel cost (+355bps YoY, +590bps QoQ) – mainly high gas cost averaging Rs 55/scm – gross margin contracted just 50bps YoY and 60bps QoQ to 25%. EBITDA margin improved 90bps YoY and 17bps QoQ to 15.2%.

**FY23 volume growth guided at 15-20%:** Management has guided for volume growth of 15-20% in FY23 and +15% in FY24 led by improving demand from tier-2-and-below cities and rising exports from Morbi. However, KJC avoided giving any outlook on margins as gas prices are at a peak and supply is erratic.

**85% of Morbi capacity to close for a month, benefitting organised players:** The Morbi ceramic cluster intends to shut down capacity from 10 Aug to 10 Sep 2022 (and halt dispatches till mid-Sep) so as to dispose of old inventory and earn better realisations going forward. KJC believes that 85% of Morbi capacity will be closed – a positive for organised players. Further, the KJC-Morbi JV will be fully functional though outsourcing from Morbi will be at only 70% functional.

**Long-term value play; retain BUY:** We believe that KJC has long-term structural growth drivers from improving real estate demand in tier-2-and-below towns, domestic market share gains from Morbi and an increasing focus on exports. The stock is trading at an FY24E P/E of 29.4x vs. its 5Y median of 40.4x, which is reasonable given increasing volumes and healthy return ratios. We continue to value the stock at 40x FY24E EPS and retain our TP of Rs 1,460 with a BUY rating given strong growth prospects and attractive valuations.

### Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	KJC IN/Rs 1,074
Market cap	US\$ 2.1bn
Free float	53%
3M ADV	US\$ 2.4mn
52wk high/low	Rs 1,375/Rs 885
Promoter/FPI/DII	48%/20%/33%

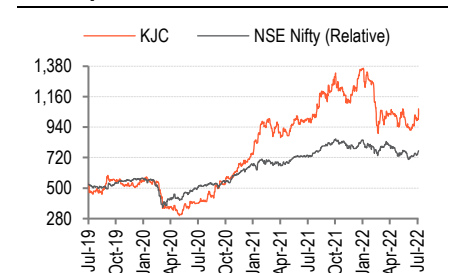
Source: NSE | Price as of 21 Jul 2022

### Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	27,809	37,052	43,635
EBITDA (Rs mn)	5,088	6,107	7,643
Adj. net profit (Rs mn)	3,081	3,770	4,710
Adj. EPS (Rs)	19.4	23.7	29.6
Consensus EPS (Rs)	19.4	23.7	31.8
Adj. ROAE (%)	17.2	18.9	21.6
Adj. P/E (x)	55.4	45.3	36.2
EV/EBITDA (x)	33.3	27.6	21.9
Adj. EPS growth (%)	20.6	22.4	24.9

Source: Company, Bloomberg, BOBCAPS Research

### Stock performance



Source: NSE



## Earnings call highlights

- **Sales:** Tier-2-and-below cities are witnessing a demand revival in the real estate sector, and management expects ceramics demand to come from these markets over the next three years. KJC is also planning to increase its reach pan-India.
- **Price hikes:** In order to offset the rise in gas price as well as higher transportation and packaging costs, KJC has increased prices of all products by ~2% since May'22. The previous hike was to the tune of 4-5% at the end of December. Per management, KJC takes a price increase with a lag effect of 15-30 days and is thus able to protect margins.
- **Gas cost:** The average gas cost stood at Rs 55/scm in Q1FY23 vs. Rs 49.79/scm in Q4FY22.

**Fig 1 – Gas prices**

Avg Price (Rs/scm)	Q1FY23	Q4FY22	Q3FY22	FY22	FY21
North	52.0	45.5	43.0	41.0	26.0
South	60.0	60.0	55.5	44.0	12.5
West	67.0	62.0	58.2	49.0	28.5

Source: Company

- **Propane vs. gas:** Despite propane is 3 months cheaper compared to a 12 months gas costs, the company will not shift to a propane facility as it does not expect gas cost to remain elevated. Further, volume generation from the propane and LPG facility is lower than the gas facility.
- **Expansion projects commissioned:** In Apr'22, KJC commissioned 4.4msm of PVT capacity at subsidiary Kajaria Vitrified Pvt Ltd (formerly Jaxx Vitrified) and achieved optimal utilisation in Q1FY23. In May'22, the company commissioned a 4.2msm capacity for ceramic floor tiles at the Gailpur plant (Rajasthan) and 3.8msm of value-added glazed vitrified tiles at Srikalahasti (Andhra Pradesh).
- **51% Stake acquisition in South Asian Ceramics Tiles:** The board has approved the acquisition of 51% in South Asian Ceramics Tiles Pvt Ltd, Telangana, by making an investment of up to Rs 285mn. The acquisition cost is at an EV of Rs 1.2bn. South Asian Ceramics has an annual production capacity of 4.8msm of ceramic floor tiles (in two sizes: 60x60cm and 60x120cm). KJC expects it to deliver revenue of Rs 1.3bn in FY23 and Rs 1.8bn in FY24. The acquisition was made to strengthen the base in South India and cut down the logistics from Morbi. The plant has an LPG connection.
- **Sanitaryware and Plywood:** The segment reported a lower EBIT margin of 4.4% in Q1FY23 vs. 5.6% in Q4FY22 due to a 10% QoQ decline in sales and higher cost inflation. Management expects margins to improve in Q2.
- **Other expenses:** A&P spend was at Rs 190mn in Q1FY23 vs. Rs 720mn in Q4FY22 as these spends are typically lower in Q1 and increase gradually. For FY23, A&P is guided to be more than Rs 1bn vs. Rs 800mn in FY22.

- **Working capital:** The working capital cycle increased by 5 days to 55 days in Q1FY23 due to a build-up of stocks in newly commissioned plants.
- **Exports:** KJC's exports currently stand at 2-3% of the topline and are targeted to rise to 5-8% in a couple of years. Management indicated that exports have become lucrative as costs in Europe, Italy and China have increased by 300-400% owing to the higher gas and power expenses. This will drive up exports from Morbi which, in turn, will vacate the space for domestic players.
- **Industry exports:** Management estimates that industry-wide exports for FY23 will exceed Rs 160bn vs. Rs 127bn in FY22.
- **Dealers:** KJC will add 400 dealers in FY23, of which 170-175 will be exclusively dedicated to the company.
- **Dividend policy:** The company plans to pay out 14-15% of earnings as dividend.

**Fig 2 – Consolidated quarterly performance**

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
<b>Net Sales</b>	<b>10,082</b>	<b>5,617</b>	<b>79.5</b>	<b>11,018</b>	<b>(8.5)</b>	<b>37,052</b>	<b>27,809</b>	<b>33.2</b>
COGS	6,425	3,259	97.1	7,153	(10.2)	23,141	16,619	39.2
Employee cost	1,144	933	22.6	1,058	8.1	4,077	3,247	25.6
Other expenses	978	620	57.7	1,148	(14.8)	3,727	2,856	30.5
<b>EBITDA</b>	<b>1,536</b>	<b>805</b>	<b>90.9</b>	<b>1,659</b>	<b>(7.4)</b>	<b>6,107</b>	<b>5,088</b>	<b>20.0</b>
EBITDA Margin (%)	15.2	14.3	91bps	15.1	17bps	16.5	18.3	(181bps)
Depreciation and amortization	324	265	22.0	326	(0.8)	1,154	1,067	8.1
<b>EBIT</b>	<b>1,212</b>	<b>539</b>	<b>124.7</b>	<b>1,333</b>	<b>(9.1)</b>	<b>4,953</b>	<b>4,022</b>	<b>23.2</b>
EBIT Margin (%)	12.0	9.6	242bps	12.1	(8bps)	13.4	14.5	(109bps)
Net Interest expenses	36	30	19.5	40	(9.3)	127	107	18.9
Other non-operating inc (exp), net	81	60	34.8	70	15.1	276	213	29.4
Earnings before tax	<b>1,257</b>	<b>569</b>	<b>120.9</b>	<b>1,364</b>	<b>(7.8)</b>	<b>5,102</b>	<b>4,127</b>	<b>23.6</b>
Income taxes	328	154	112.4	391	(16.3)	1,274	1,038	22.7
Earnings after tax	<b>930</b>	<b>415</b>	<b>124.0</b>	<b>972</b>	<b>(4.4)</b>	<b>3,827</b>	<b>3,089</b>	<b>23.9</b>
Extraordinary items	0	0	-	0	-	0	0	n.m.
Minority interest (expense) income	(7)	(16)	(58.8)	15	(144.9)	58	9	577.6
<b>APAT</b>	<b>936</b>	<b>431</b>	<b>117.2</b>	<b>958</b>	<b>(2.2)</b>	<b>3,770</b>	<b>3,081</b>	<b>22.4</b>

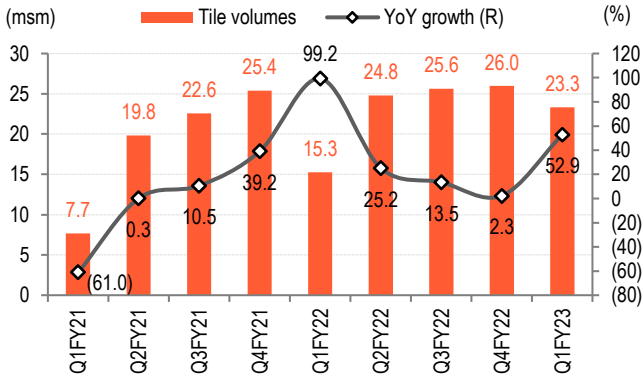
Source: Company, BOBCAPS Research

**Fig 3 – Consolidated segmental performance**

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
<b>Segment Revenues</b>								
Tiles	9,165	5,193	76.5	9,999	(8.3)	33,634	25,328	32.8
Other	917	423	116.7	1,019	(10.0)	3,418	2,482	37.7
<b>Total revenues</b>	<b>10,082</b>	<b>5,617</b>	<b>79.5</b>	<b>11,018</b>	<b>(8.5)</b>	<b>37,052</b>	<b>27,809</b>	<b>33.2</b>
<b>EBIT</b>								
Tiles	1172	532	120.4	1276	(8.1)	4758	3940.9	20.7
Other	40	7	464.8	57	(30.0)	195	80.6	141.8
<b>Total</b>	<b>1,212</b>	<b>539</b>	<b>124.9</b>	<b>1,333</b>	<b>(9.1)</b>	<b>4,953</b>	<b>4,022</b>	<b>23.2</b>
<b>EBIT Margins (%)</b>								
Tiles	12.8	10.2	255bps	12.8	3bps	14.1	15.6	(141bps)
Other	4.4	1.7	270bps	5.6	(125bps)	5.7	3.2	245bps

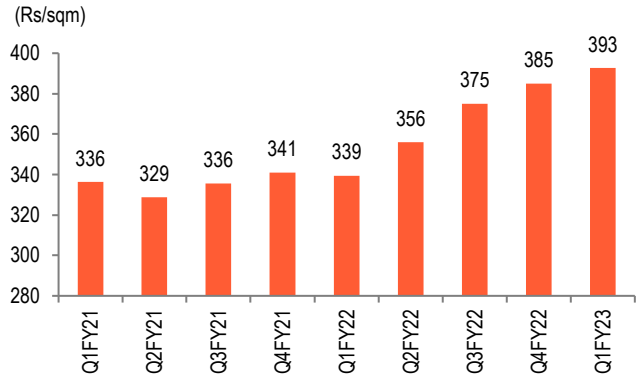
Source: Company, BOBCAPS Research

**Fig 4 – Tile volumes**



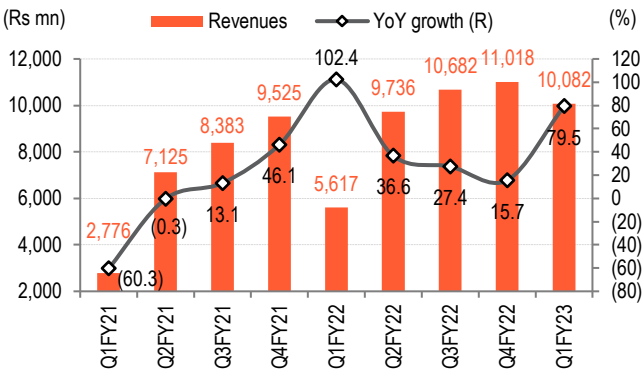
Source: Company, BOBCAPS Research

**Fig 5 – Tile net realisations**



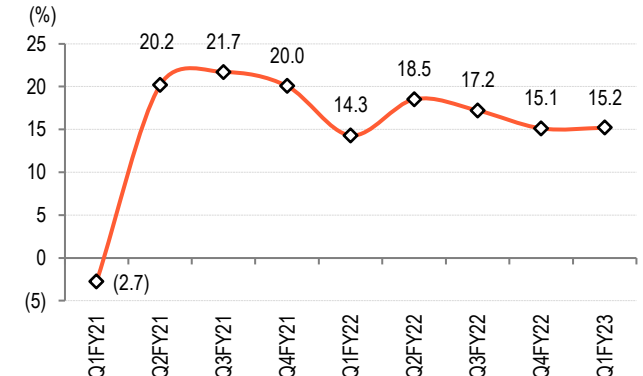
Source: Company, BOBCAPS Research

**Fig 6 – Consolidated revenue trend**



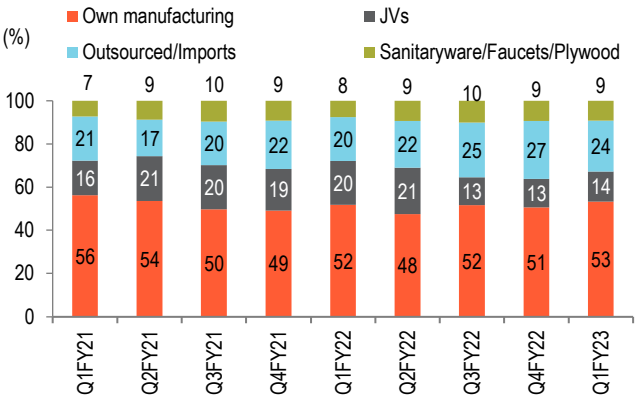
Source: Company, BOBCAPS Research

**Fig 7 – Consolidated EBITDA margin trend**



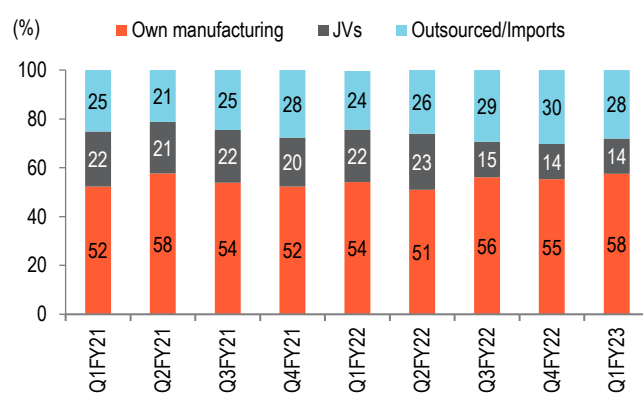
Source: Company, BOBCAPS Research

**Fig 8 – Revenue breakup**



Source: Company, BOBCAPS Research

**Fig 9 – Tile volume breakup**



Source: Company, BOBCAPS Research

## Valuation methodology

We believe that KJC has long-term structural growth drivers from improving real estate demand in tier-2-and-below towns, domestic market share gains from Morbi and an increasing focus on exports. In our view, the company is in a sweet spot on the back of its leadership in the tile industry, strong growth prospects, pricing power, wide distribution reach, brand name, broad product profile, debt-free balance sheet and robust return ratios.

The stock is trading at an FY24E P/E of 29.4x vs. its five-year median of 40.4x, which is reasonable given increasing volumes and healthy return ratios. We continue to value KJC at 40x FY24E EPS and retain our TP of Rs 1,460 with a BUY rating given strong growth prospects and attractive valuations.

## Key risks

Key downside risks to our estimates are:

- sharp uptick in raw material prices and gas costs,
- substantial decrease in exports from Morbi players,
- increasing competition from the informal sector, and
- slowdown in economic revival and in housing demand.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Century Plyboards	CPBI IN	1.6	580	735	BUY
Cera Sanitaryware	CRS IN	0.7	4,296	5,225	BUY
Greenpanel Industries	GREENP IN	0.8	504	595	BUY
Greenply Industries	MTLM IN	0.3	176	260	BUY
Kajaria Ceramics	KJC IN	2.1	1,074	1,460	BUY
Pidilite Industries	PIDI IN	15.0	2,362	1,870	SELL
Somany Ceramics	SOMC IN	0.3	619	835	BUY

Source: BOBCAPS Research, NSE | Price as of 21 Jul 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Total revenue</b>	<b>28,080</b>	<b>27,809</b>	<b>37,052</b>	<b>43,635</b>	<b>49,791</b>
EBITDA	4,159	5,088	6,107	7,643	9,225
Depreciation	(1,081)	(1,067)	(1,154)	(1,393)	(1,538)
EBIT	3,078	4,022	4,953	6,250	7,687
Net interest inc./(exp.)	(195)	(107)	(127)	(128)	(108)
Other inc./(exp.)	242	213	276	303	334
Exceptional items	0	0	0	0	0
EBT	3,125	4,127	5,102	6,426	7,913
Income taxes	(589)	(1,038)	(1,274)	(1,619)	(1,994)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	18	(9)	(58)	(96)	(118)
<b>Reported net profit</b>	<b>2,553</b>	<b>3,081</b>	<b>3,770</b>	<b>4,710</b>	<b>5,800</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>2,553</b>	<b>3,081</b>	<b>3,770</b>	<b>4,710</b>	<b>5,800</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	2,105	1,760	2,644	2,891	3,280
Other current liabilities	2,311	2,201	2,741	2,919	3,437
Provisions	288	313	338	363	388
Debt funds	1,171	971	1,279	1,079	879
Other liabilities	731	687	985	1,010	1,035
Equity capital	159	159	159	159	159
Reserves & surplus	16,984	18,530	21,065	22,242	23,692
Shareholders' fund	17,143	18,689	21,224	22,401	23,851
<b>Total liab. and equities</b>	<b>24,386</b>	<b>25,266</b>	<b>29,858</b>	<b>31,407</b>	<b>33,733</b>
Cash and cash eq.	2,350	4,477	4,244	1,464	1,251
Accounts receivables	3,967	4,317	5,133	6,575	7,503
Inventories	5,127	3,731	4,659	7,053	8,048
Other current assets	640	615	1,623	956	1,091
Investments	3	0	0	0	0
Net fixed assets	11,854	11,911	13,947	15,044	15,506
CWIP	257	50	70	80	80
Intangible assets	103	112	112	112	112
Deferred tax assets, net	15	13	0	0	0
Other assets	70	40	70	122	141
<b>Total assets</b>	<b>24,386</b>	<b>25,266</b>	<b>29,858</b>	<b>31,407</b>	<b>33,733</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Cash flow from operations</b>	<b>2,472</b>	<b>4,963</b>	<b>3,524</b>	<b>3,634</b>	<b>6,433</b>
Capital expenditures	(1,213)	(1,012)	(2,500)	(2,500)	(2,000)
Change in investments	0	0	0	0	0
Other investing cash flows	0	3	0	0	0
<b>Cash flow from investing</b>	<b>(1,213)</b>	<b>(1,009)</b>	<b>(2,500)</b>	<b>(2,500)</b>	<b>(2,000)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	222	(201)	309	(200)	(200)
Interest expenses	(195)	(107)	(127)	(128)	(108)
Dividends paid	(1,150)	(1,591)	(2,827)	(3,533)	(4,350)
Other financing cash flows	(310)	72	1,389	(53)	12
<b>Cash flow from financing</b>	<b>(1,433)</b>	<b>(1,827)</b>	<b>(1,257)</b>	<b>(3,914)</b>	<b>(4,646)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(174)</b>	<b>2,127</b>	<b>(233)</b>	<b>(2,780)</b>	<b>(213)</b>
<b>Closing cash &amp; cash eq.</b>	<b>2,350</b>	<b>4,477</b>	<b>4,244</b>	<b>1,464</b>	<b>1,251</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	16.1	19.4	23.7	29.6	36.5
Adjusted EPS	16.1	19.4	23.7	29.6	36.5
Dividend per share	3.0	10.0	14.2	17.8	21.9
Book value per share	107.9	117.6	133.5	140.9	150.1

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	6.1	6.1	4.5	3.8	3.4
EV/EBITDA	40.9	33.3	27.6	21.9	18.3
Adjusted P/E	66.8	55.4	45.3	36.2	29.4
P/BV	10.0	9.1	8.0	7.6	7.2

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	81.7	74.6	73.9	73.3	73.3
Interest burden (PBT/EBIT)	101.5	102.6	103.0	102.8	102.9
EBIT margin (EBIT/Revenue)	11.0	14.5	13.4	14.3	15.4
Asset turnover (Rev./Avg TA)	116.7	112.0	134.4	142.4	152.9
Leverage (Avg TA/Avg Equity)	1.5	1.4	1.4	1.4	1.4
Adjusted ROAE	15.5	17.2	18.9	21.6	25.1

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	(5.0)	(1.0)	33.2	17.8	14.1
EBITDA	(7.5)	22.3	20.0	25.2	20.7
Adjusted EPS	10.3	20.6	22.4	24.9	23.1
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	14.8	18.3	16.5	17.5	18.5
EBIT margin	11.0	14.5	13.4	14.3	15.4
Adjusted profit margin	9.1	11.1	10.2	10.8	11.6
Adjusted ROAE	15.5	17.2	18.9	21.6	25.1
ROCE	13.8	15.3	17.1	19.7	23.1
<b>Working capital days (days)</b>					
Receivables	57	54	47	49	52
Inventory	83	81	56	70	80
Payables	38	31	26	28	28
<b>Ratios (x)</b>					
Gross asset turnover	1.5	1.4	1.7	1.7	1.8
Current ratio	2.1	2.7	2.3	2.3	2.3
Net interest coverage ratio	15.8	37.5	38.9	48.9	71.2
Adjusted debt/equity	(0.1)	(0.2)	(0.1)	0.0	0.0

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

## Disclaimer

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

**BUY** – Expected return >+15%

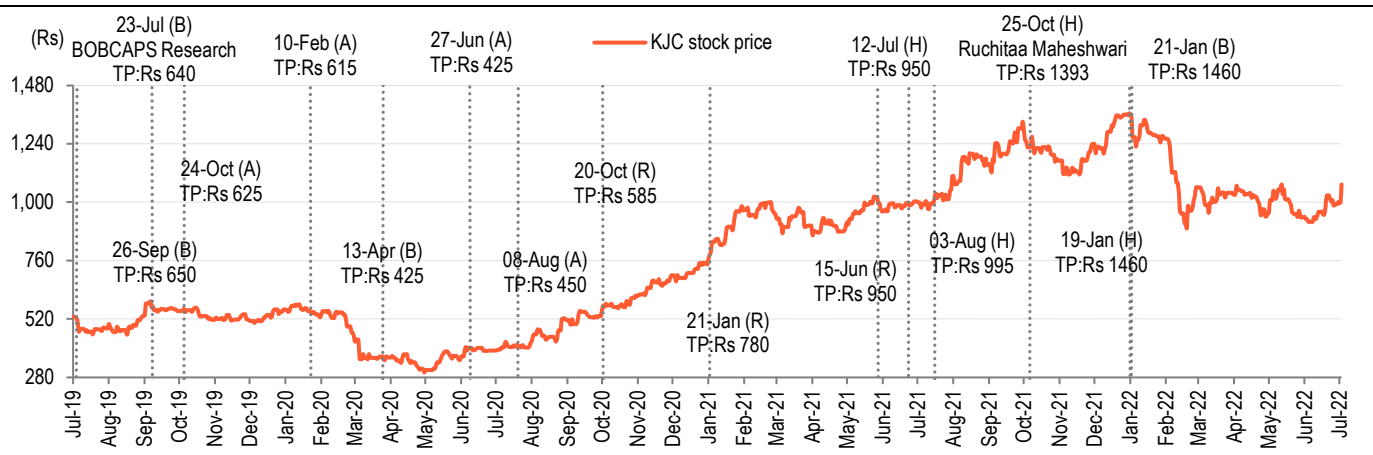
**HOLD** – Expected return from -6% to +15%

**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): KAJARIA CERAMICS (KJC IN)



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

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