

**ADD**

TP: Rs 625 | ▲ 11%

**KAJARIA CERAMICS**

Construction Materials

24 October 2019

## Tepid quarter; upsides capped – downgrade to ADD

**Kajaria Ceramics (KJC) posted a below-expected Q2FY20 with revenue down 1.5% YoY (volumes +1.1%, realisations –3.5%). Operating margins declined 30bps YoY to 14.7% due to higher raw material and employee costs, causing EBITDA/PBT to dip 3.4%/6.7%. Management has cut its FY20 tiles volume growth guidance to 9-10% vs. 12-13% and expects operating margins of 15-16%. We trim FY20-FY22 earnings by 7-8% and roll over to a Sep'20 TP of Rs 625 (vs. Rs 650); downgrade from BUY to ADD on limited upsides post the recent rally.**

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**Tepid volume growth:** KJC's Q2 revenue dipped 1.5% YoY to Rs 7.1bn as realisations declined 3.5% YoY (+1.6% QoQ) and volumes inched up just 1.1%. As per management, volume growth slowed due to floods in some markets, tight liquidity conditions, loss of sales in Kashmir (J&K together accounts for ~6% of revenues), and a general downturn in demand. Management has cut its FY20 volume growth guidance in the tiles segment from 12-13% to 9-10%, with 10%+ growth in H2FY20 vs. 5.1% in H1.

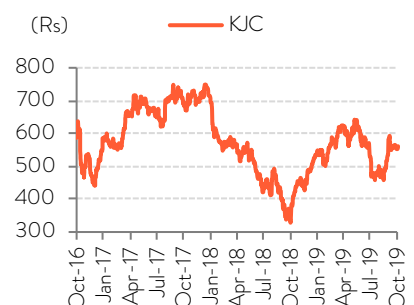
**Operating margins contract:** Operating margins declined by 30bps YoY to 14.7% due to lower gross margins (-64bps YoY) and higher employee cost (+84bps YoY), which was partly offset by lower other expenditure (-120bps YoY). EBITDA/PBT thus fell 3.4%/6.7% YoY, whereas a lower tax rate led to adj. PAT growth of 74% YoY. Gross margins suffered due to higher volumes from subsidiaries and outsourcing. Management has guided for operating margins of 15-16% in H2 (vs. 14.9% in H1) due to lower gas prices.

**Downgrade to ADD:** We cut FY20-FY22 earnings by 7-8% due to the tepid Q2 and move to a Sep'20 TP of Rs 625. The stock has rallied ~10% since our upgrade in Jul'19 to trade at 27x FY21E EPS; cut from BUY to ADD.

Ticker/Price	KJC IN/Rs 562
Market cap	US\$ 1.3bn
Shares o/s	159mn
3M ADV	US\$ 3.9mn
52wk high/low	Rs 650/Rs 310
Promoter/FPI/DII	48%/26%/26%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	27,106	29,562	31,089	34,659	38,657
EBITDA (Rs mn)	4,564	4,495	4,687	5,431	6,251
Adj. net profit (Rs mn)	2,342	2,314	2,782	3,291	3,833
Adj. EPS (Rs)	14.7	14.6	17.5	20.7	24.1
Adj. EPS growth (%)	(7.4)	(1.2)	20.2	18.3	16.5
Adj. ROAE (%)	18.5	15.8	16.6	17.3	17.6
Adj. P/E (x)	38.1	38.6	32.1	27.1	23.3
EV/EBITDA (x)	19.8	20.0	18.7	15.9	13.7

Source: Company, BOBCAPS Research

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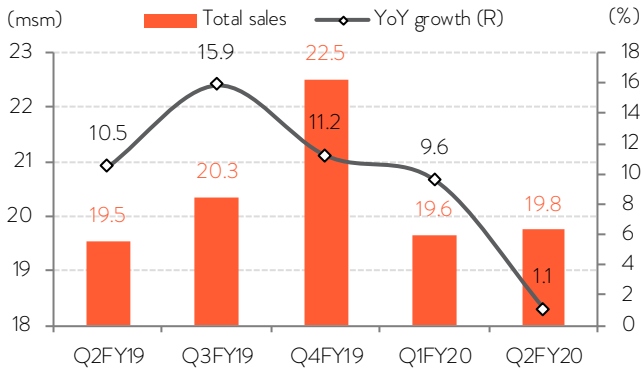
**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
<b>Net Sales</b>	<b>7,147</b>	<b>7,253</b>	<b>(1.5)</b>	<b>7,000</b>	<b>2.1</b>
COGS	4,281	4,298	(0.4)	4,148	3.2
Employee cost	888	841	5.7	882	0.7
Other expenses	925	1,025	(9.8)	910	1.7
<b>EBITDA</b>	<b>1,052</b>	<b>1,089</b>	<b>(3.4)</b>	<b>1,060</b>	<b>(0.7)</b>
EBITDA Margin (%)	14.7	15.0	(29bps)	15.1	(41bps)
Depreciation and amortization	262	225	16.1	258	1.3
<b>EBIT</b>	<b>791</b>	<b>864</b>	<b>(8.5)</b>	<b>802</b>	<b>(1.3)</b>
EBIT Margin (%)	11.1	11.9	(84bps)	11.5	(39bps)
Net Interest expenses	52	45	15.5	45	15.5
Other non-operating inc (exp), net	68	46	48.6	53	29.2
<b>Earnings before tax</b>	<b>807</b>	<b>865</b>	<b>(6.7)</b>	<b>809.1</b>	<b>(0.3)</b>
Income taxes	(124)	324	NA	305	NA
<b>Earnings after tax</b>	<b>931</b>	<b>540</b>	<b>72.2</b>	<b>504</b>	<b>84.7</b>
Extraordinary items	0	34	-	0	-
Minority interest (expense) income	(1)	4	NA	(6)	NA
<b>Reported Net income (loss)</b>	<b>932</b>	<b>502</b>	<b>85.6</b>	<b>510.1</b>	<b>82.7</b>
APAT	932	536	73.8	510	82.7

Source: Company, BOBCAPS Research

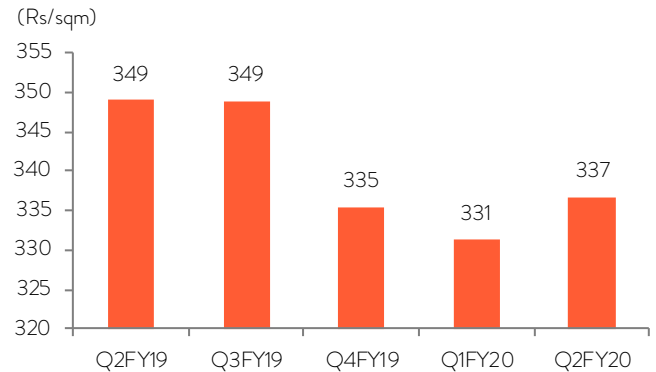
**QUARTERLY TRENDS**

**FIG 2 – VOLUMES**



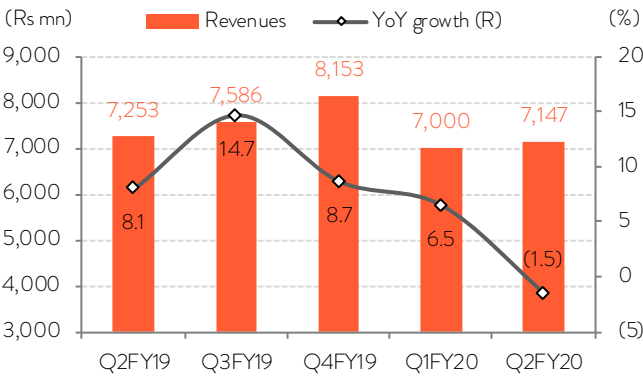
Source: Company, BOBCAPS Research

**FIG 3 – NET REALISATIONS**



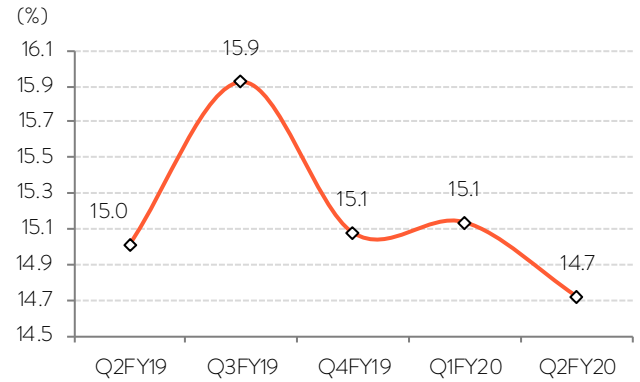
Source: Company, BOBCAPS Research

**FIG 4 – REVENUES**



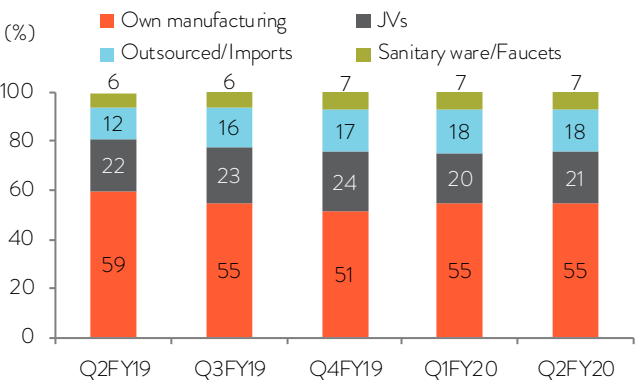
Source: Company, BOBCAPS Research

**FIG 5 – EBITDA MARGIN**



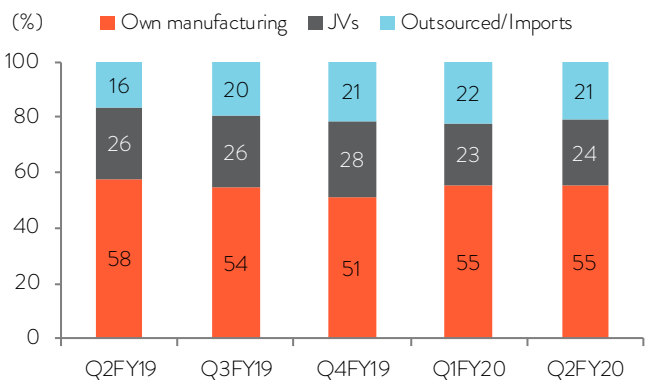
Source: Company, BOBCAPS Research

**FIG 6 – REVENUE BREAKUP**



Source: Company, BOBCAPS Research

**FIG 7 – TILE VOLUME BREAKUP**



Source: Company, BOBCAPS Research

## Valuation methodology

KJC is the largest organised player in the Indian tiles market, with an organised market share of ~22% (~10.6% of the total market). Unorganised players currently comprise ~50% of the Rs 270bn tiles market. We expect the company to benefit from the gradual formalisation of demand post-GST and e-way bill implementation, given its strong brand, wide distribution reach and market leadership.

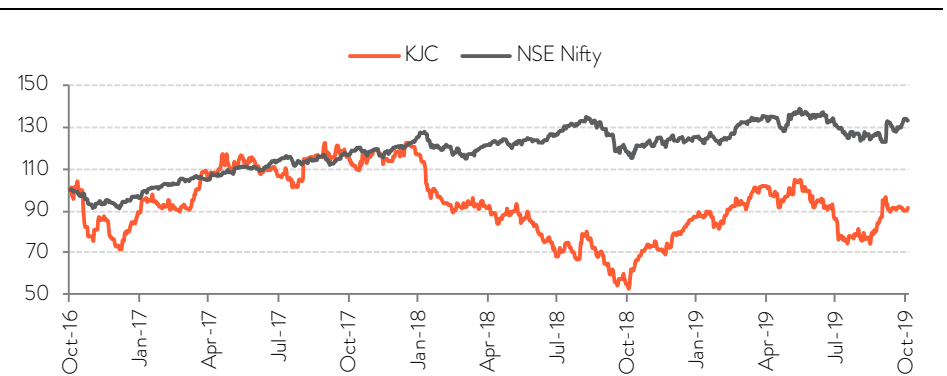
We cut FY20-FY22 earnings estimates by 7-8% due to the tepid Q2FY20 performance and lower guidance. Rolling valuations forward, we have a revised Sep'20 target price of Rs 625 (earlier Rs 650), set at an unchanged 28x one-year forward P/E – in line with the stock's five-year average. The stock has run up ~10% since **our upgrade** on 23 Jul 2019 and is trading at 27x FY21E EPS. Upsides from current levels look limited, leading us to cut our rating from BUY to ADD.

**FIG 8 – REVISED ESTIMATES**

(Rs mn)	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	31,089	34,659	38,657	32,753	36,502	40,700	(5.1)	(5.0)	(5.0)
EBITDA	4,687	5,431	6,251	4,978	5,746	6,589	(5.8)	(5.5)	(5.0)
PAT	2,782	3,291	3,833	3,037	3,563	4,124	(8.4)	(7.7)	(7.0)

Source: BOBCAPS Research

**FIG 9 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

- **Higher raw material prices:** Any abnormal increase in prices of key raw materials, such as gas, coupled with an inability to pass this along could adversely affect KJC's profitability.
- **Increased competition from informal sector:** Higher competition from the informal sector primarily based out of Morbi, Gujarat, can hurt profitability.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Total revenue</b>	<b>27,106</b>	<b>29,562</b>	<b>31,089</b>	<b>34,659</b>	<b>38,657</b>
EBITDA	4,564	4,495	4,687	5,431	6,251
Depreciation	(885)	(891)	(1,025)	(1,147)	(1,283)
EBIT	3,678	3,604	3,663	4,285	4,968
Net interest income/(expenses)	(241)	(156)	(123)	(91)	(52)
Other income/(expenses)	108	180	234	270	283
Exceptional items	8	(48)	0	0	0
EBT	3,546	3,629	3,774	4,463	5,199
Income taxes	(1,267)	(1,293)	(966)	(1,143)	(1,331)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	64	(22)	(25)	(30)	(35)
<b>Reported net profit</b>	<b>2,350</b>	<b>2,266</b>	<b>2,782</b>	<b>3,291</b>	<b>3,833</b>
Adjustments	(8)	48	0	0	0
<b>Adjusted net profit</b>	<b>2,342</b>	<b>2,314</b>	<b>2,782</b>	<b>3,291</b>	<b>3,833</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	2,578	3,091	3,038	3,363	3,729
Other current liabilities	2,153	2,211	2,421	2,546	2,839
Provisions	0	0	0	0	0
Debt funds	1,351	949	699	399	99
Other liabilities	1,151	1,073	1,073	1,073	1,073
Equity capital	159	159	159	159	159
Reserves & surplus	13,351	15,590	17,677	20,145	23,020
Shareholders' fund	13,510	15,749	17,836	20,304	23,179
<b>Total liabilities and equities</b>	<b>21,403</b>	<b>23,732</b>	<b>25,751</b>	<b>28,400</b>	<b>31,668</b>
Cash and cash eq.	824	2,524	3,519	4,007	4,671
Accounts receivables	4,507	4,751	4,174	4,463	4,978
Inventories	3,785	4,058	4,259	4,748	5,296
Other current assets	574	581	767	855	953
Investments	4	3	3	3	3
Net fixed assets	11,627	11,712	12,864	14,143	15,566
CWIP	0	0	0	0	0
Intangible assets	0	0	0	0	0
Deferred tax assets, net	82	103	166	180	201
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>21,403</b>	<b>23,732</b>	<b>25,751</b>	<b>28,400</b>	<b>31,668</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	4,431	4,519	4,798	5,610	6,482
Interest expenses	241	156	123	91	52
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,251)	48	348	(416)	(503)
Other operating cash flows	(1,209)	(1,215)	(966)	(1,129)	(1,310)
<b>Cash flow from operations</b>	<b>2,212</b>	<b>3,508</b>	<b>4,304</b>	<b>4,156</b>	<b>4,720</b>
Capital expenditures	(657)	(976)	(2,176)	(2,426)	(2,706)
Change in investments	0	0	0	0	0
Other investing cash flows	(3)	1	0	0	0
<b>Cash flow from investing</b>	<b>(660)</b>	<b>(975)</b>	<b>(2,176)</b>	<b>(2,426)</b>	<b>(2,706)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(355)	(402)	(250)	(300)	(300)
Interest expenses	(241)	(156)	(123)	(91)	(52)
Dividends paid	(572)	(590)	(696)	(823)	(958)
Other financing cash flows	(79)	314	(63)	(28)	(41)
<b>Cash flow from financing</b>	<b>(1,248)</b>	<b>(833)</b>	<b>(1,132)</b>	<b>(1,241)</b>	<b>(1,351)</b>
<b>Changes in cash and cash eq.</b>	<b>304</b>	<b>1,700</b>	<b>995</b>	<b>488</b>	<b>663</b>
<b>Closing cash and cash eq.</b>	<b>824</b>	<b>2,524</b>	<b>3,519</b>	<b>4,007</b>	<b>4,671</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	14.8	14.3	17.5	20.7	24.1
Adjusted EPS	14.7	14.6	17.5	20.7	24.1
Dividend per share	3.0	3.0	3.5	4.1	4.8
Book value per share	85.0	99.1	112.2	127.7	145.8

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	3.3	3.0	2.8	2.5	2.2
EV/EBITDA	19.8	20.0	18.7	15.9	13.7
Adjusted P/E	38.1	38.6	32.1	27.1	23.3
P/BV	6.6	5.7	5.0	4.4	3.9

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	65.9	64.6	73.7	73.7	73.7
Interest burden (PBT/EBIT)	96.6	99.3	103.0	104.2	104.7
EBIT margin (EBIT/Revenue)	13.6	12.2	11.8	12.4	12.9
Asset turnover (Revenue/Avg TA)	129.7	131.0	125.7	128.0	128.7
Leverage (Avg TA/Avg Equity)	1.7	1.5	1.5	1.4	1.4
Adjusted ROAE	18.5	15.8	16.6	17.3	17.6

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

**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	6.5	9.1	5.2	11.5	11.5
EBITDA	(8.1)	(1.5)	4.3	15.9	15.1
Adjusted EPS	(7.4)	(1.2)	20.2	18.3	16.5
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	16.8	15.2	15.1	15.7	16.2
EBIT margin	13.6	12.2	11.8	12.4	12.9
Adjusted profit margin	8.6	7.8	8.9	9.5	9.9
Adjusted ROAE	18.5	15.8	16.6	17.3	17.6
ROCE	15.9	14.0	14.9	15.7	16.3
<b>Working capital days (days)</b>					
Receivables	53	57	52	45	45
Inventory	72	68	68	66	66
Payables	45	41	42	40	40
<b>Ratios (x)</b>					
Gross asset turnover	1.6	1.7	1.6	1.6	1.6
Current ratio	1.8	2.0	2.1	2.2	2.3
Net interest coverage ratio	15.3	23.1	29.7	47.1	95.7
Adjusted debt/equity	0.0	(0.1)	(0.2)	(0.2)	(0.2)

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

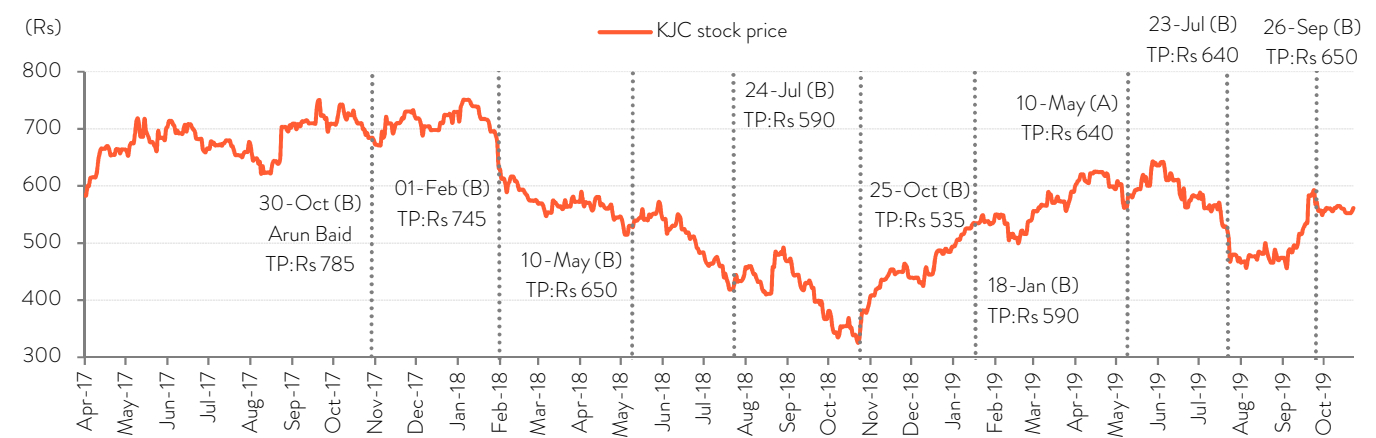
**ADD** – Expected return from >+5% to +15%

**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: KAJARIA CERAMICS (KJC IN)



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

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