

REDUCE

TP: Rs 585 | ▲ 2%

KAJARIA CERAMICS

Construction Materials

20 October 2020

Good performance but in the price – downgrade to REDUCE

Kajaria Ceramics (KJC) posted an above-expected Q2FY21 with stable YoY revenue and volumes, aided by better traction in tier-2 cities and below. EBITDA margins rose 545bps YoY to 20.2% due to lower fuel, employee and other costs, enabling EBITDA/PBT growth of 37%/48%. Management expects volume growth to return from Q4 and has guided for 18% margins in H2FY21. We raise FY21-FY23 earnings by 13-61%, hike our target P/E to 28x from 26x, and roll to a new Dec'21 TP of Rs 585 (vs. Rs 450). Cut from ADD to REDUCE on limited upside.

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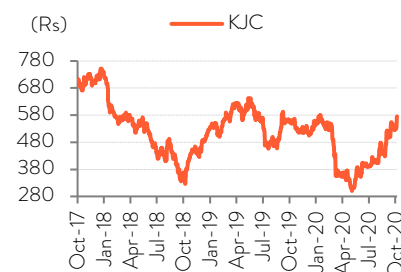
Decent volumes in a tough environment: KJC's Q2 revenue (Rs 7.1bn) and volumes were stable YoY due to better traction from tier-2 and below cities. Management believes this trend will continue in the near term due to Covid-19 pressures in larger cities and has guided for a flat Q3, followed by ~10% YoY volume growth in Q4 off a tepid base. The company has gained market share and believes the gains are sustainable. Management is targeting 15% volume growth over the next 3-5 years aided by expansion in smaller cities.

Operating margins expand: EBITDA margins swelled 545bps YoY to 20.2% due to higher gross margins (+105bps YoY) and lower employee (-150bps) and other expenses (-290bps). EBITDA/PBT thus grew 37%/48% YoY. Despite reversing salary cuts in Oct'20 and seeing a gradual increase in A&P activity, management has guided for operating margins of ~18% in H2 on lower gas prices.

Positives priced in – cut to REDUCE: We increase FY21-FY23 earnings estimates by 13-61% primarily due to lower input prices, while resetting our target P/E to 28x (from 26x) – in line with the 5Y average. Rolling valuations forward, we have a revised Dec'21 TP of Rs 585 (earlier Rs 450). Following the recent rally, KJC is trading at 26.5x FY23E EPS which offers limited upside potential – cut from ADD to REDUCE.

Ticker/Price	KJC IN/Rs 575
Market cap	US\$ 1.2bn
Shares o/s	159mn
3M ADV	US\$ 2.9mn
52wk high/low	Rs 596/Rs 296
Promoter/FPI/DII	48%/22%/31%

Source: NSE

STOCK PERFORMANCE

Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	29,562	28,080	25,516	28,872	32,434
EBITDA (Rs mn)	4,495	4,159	4,203	4,840	5,591
Adj. net profit (Rs mn)	2,314	2,553	2,501	2,905	3,455
Adj. EPS (Rs)	14.6	16.1	15.7	18.3	21.7
Adj. EPS growth (%)	(1.2)	10.3	(2.1)	16.2	18.9
Adj. ROAE (%)	15.8	15.5	13.8	14.4	15.4
Adj. P/E (x)	39.5	35.8	36.6	31.5	26.5
EV/EBITDA (x)	20.5	21.9	21.4	18.4	15.6

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – CONSOLIDATED QUARTERLY PERFORMANCE

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
Net Sales	7,125	7,147	(0.3)	2,776	156.7	9,901	14,147	(30.0)
COGS	4,193	4,281	(2.1)	1,940	116.1	6,133	8,429	(27.2)
Employee cost	779	888	(12.3)	608	28.0	1,387	1,771	(21.7)
Other expenses	717	925	(22.6)	303	136.6	1,019	1,835	(44.5)
EBITDA	1,437	1,052	36.5	(76)	(1,998.2)	1,361	2,112	(35.5)
EBITDA Margin (%)	20.2	14.7	544bps	(2.7)	2,289bps	13.7	14.9	(118bps)
Depreciation and amortization	274	262	4.6	252	8.5	526	520	1.2
EBIT	1,163	791	47.1	(328)	(454.8)	835	1,592	(47.5)
EBIT Margin (%)	16.3	11.1	526bps	(11.8)	2,814bps	8.4	11.3	(282bps)
Net Interest expenses	21	52	(60.2)	34	(38.5)	55	97	(43.9)
Other non-operating inc (exp), net	48	68	(29.8)	26	82.8	74	121	(38.8)
Earnings before tax	1,190	807	47.5	(335.5)	(454.8)	855	1,616	(47.1)
Income taxes	294	(124)	(337.3)	(6)	(4919.7)	288	181	58.7
Earnings after tax	896	931	(3.7)	(329)	(372.1)	567	1,434	(60.5)
Extraordinary items	0	0	-	0	-	0	0	n.m.
Minority interest (expense) income	5	(1)	(533.3)	(58)	(108.9)	(53)	(8)	609.3
Reported Net income (loss)	891	932	(4.4)	(271.0)	(428.9)	620	1,442	(57.0)

Source: Company, BOBCAPS Research

FIG 2 – CONSOLIDATED SEGMENTAL PERFORMANCE

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
Segment Revenues								
Tiles	6,510	6,651	(2.1)	2,577	152.6	9,087	13,161	(31.0)
Other	615	495	24.2	199	209.8	814	986	(17.5)
Total revenues	7,125	7,147	(0.3)	2,776	156.7	9,901	14,147	(30.0)
Segment Results								
Tiles	1,151	821	40.2	(261.8)	(539.6)	889	1,637	(45.7)
Other	12	(30)	(140.9)	(66)	(118.8)	(54)	(45)	19.9
Total	1,163	791	47.1	(328)	(454.8)	835	1,592	(47.5)
Segment Margins								
Tiles	17.7	12.3	533bps	(10.2)	2,784bps	9.8	12.4	(265bps)
Other	2.0	(6.1)	813bps	(33.3)	3,530bps	(6.6)	(4.5)	(206bps)

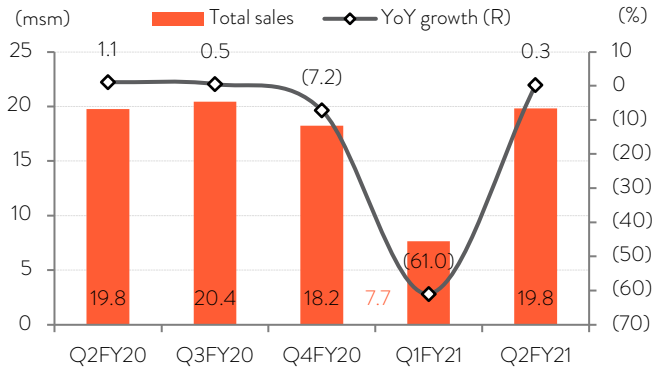
Source: Company, BOBCAPS Research

Earnings call highlights

- During Q2FY21, KJC's manufacturing plant ran in excess of 90%.
- Demand during the quarter arose mainly from tier-2 and below cities and management expects this trend to continue.
- Sales in July reached 85% of year-ago levels, whereas August was at 100% and September at 115%. Management expects a flat Q3 followed by volume growth of 10% YoY in Q4 aided by a tepid base.
- In Oct'20, KJC reversed recent salary cuts and now expects employee cost to normalise in H2.
- A&P expenses will increase from H2 and normalise in FY22.
- Management does not expect any significant increase in gas prices till Mar'21 and is thus targeting ~18% margins in H2FY21.
- Due to a tough Q1 across the industry, there has not been product price cuts despite lower input cost. Management does not foresee any product price cuts in the near term.
- Ceramic units in Morbi (Gujarat) have seen a good pickup in export demand from markets such as the US (post the country's anti-dumping duty on tiles from China in May), curbing pressure from these players on domestic prices.
- Exports from Morbi totalled Rs 75bn-80bn in FY20 and management expects a similar number in FY21 too.
- The company is targeting over 25% growth in the bathware segment going ahead and has internal revenue targets of Rs 5bn for this segment over the next 3-4 years.
- KJC is focusing on retail sales and this segment now contributes ~90% of revenues. The project segment continues to face hurdles and management has decided to only deal with customers that make prompt payment.
- The dealer network has not been expanded in FY21 as sales targets are on track.
- Cash collection was robust and the working capital cycle has improved by 14 days YoY to 50 days in Q2.

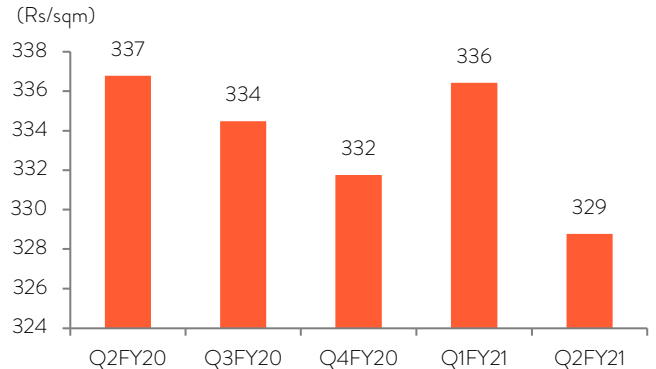
QUARTERLY TRENDS

FIG 3 – VOLUMES



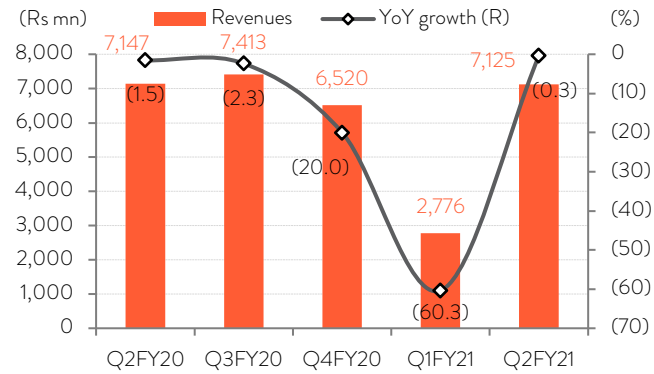
Source: Company, BOBCAPS Research

FIG 4 – NET REALISATIONS



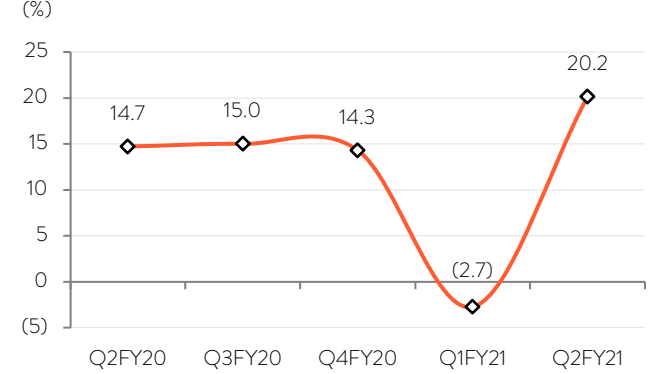
Source: Company, BOBCAPS Research

FIG 5 – CONSOLIDATED REVENUES



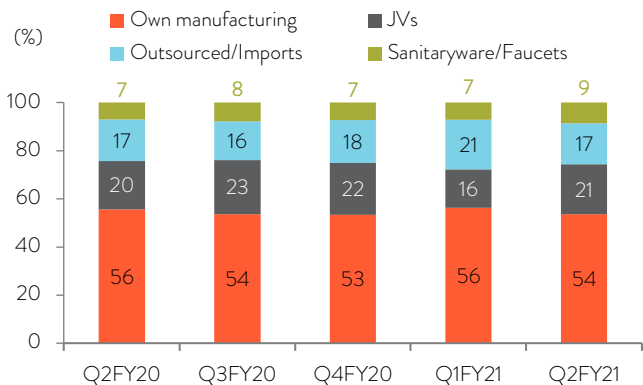
Source: Company, BOBCAPS Research

FIG 6 – CONSOLIDATED EBITDA MARGIN



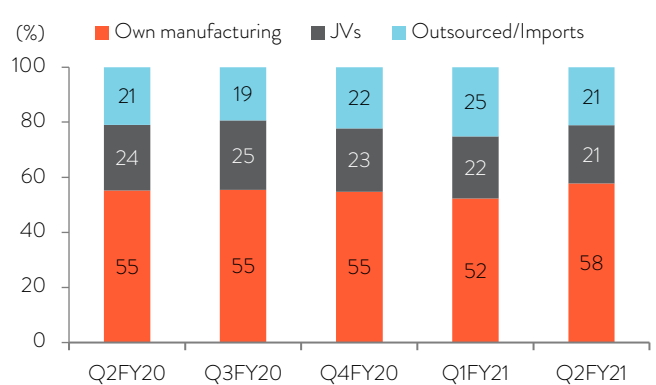
Source: Company, BOBCAPS Research

FIG 7 – REVENUE BREAKUP



Source: Company, BOBCAPS Research

FIG 8 – TILE VOLUME BREAKUP



Source: Company, BOBCAPS Research

Valuation methodology

KJC is the largest organised player in the ~Rs 300bn Indian tiles market (~50% unorganised). 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. However, the near-term outlook may be challenging due to the Covid-19 outbreak.

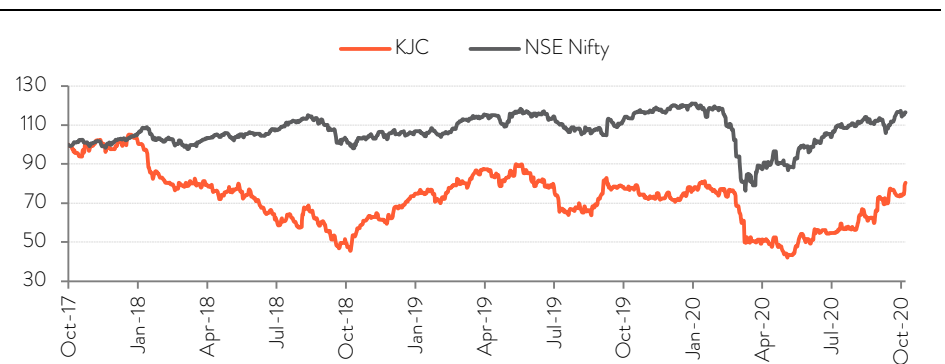
We increase FY21-FY23 earnings estimates by 13-61% primarily due to lower input prices, while resetting our target P/E to 28x (from 26x) – in line with the five-year average. Rolling valuations forward, we have a revised Dec'21 target price of Rs 585 (earlier Rs 450). Following the recent rally, KJC is trading at 26.5x FY23E EPS which offers limited upside potential – cut from ADD to REDUCE.

FIG 9 – REVISED ESTIMATES

(Rs mn)	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	25,516	28,872	32,434	22,857	28,158	31,387	11.6	2.5	3.3
EBITDA	4,203	4,840	5,591	3,005	4,420	4,977	39.9	9.5	12.3
PAT	2,501	2,905	3,455	1,551	2,565	2,956	61.2	13.2	16.9

Source: BOBCAPS Research

FIG 10 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key upside risks to our view are:

- **Benign raw material prices:** Any abnormal decrease in prices of key raw materials (such as gas), which is not passed along will result in above-expected profitability.
- **Lower competition from informal sector:** A decline in competitive intensity from the unorganised market of Morbi will result in better profitability for KJC.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	29,562	28,080	25,516	28,872	32,434
EBITDA	4,495	4,159	4,203	4,840	5,591
Depreciation	(891)	(1,081)	(1,113)	(1,182)	(1,240)
EBIT	3,604	3,078	3,090	3,658	4,350
Net interest income/(expenses)	(156)	(195)	(117)	(57)	(27)
Other income/(expenses)	180	242	249	269	322
Exceptional items	(48)	0	0	0	0
EBT	3,629	3,125	3,222	3,870	4,646
Income taxes	(1,293)	(589)	(741)	(975)	(1,171)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	(22)	18	20	10	(20)
Reported net profit	2,266	2,553	2,501	2,905	3,455
Adjustments	48	0	0	0	0
Adjusted net profit	2,314	2,553	2,501	2,905	3,455

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	2,890	2,105	2,023	2,032	2,285
Other current liabilities	2,211	2,311	2,154	1,957	2,215
Provisions	200	288	313	338	363
Debt funds	949	1,171	471	221	21
Other liabilities	1,073	731	746	771	796
Equity capital	159	159	159	159	159
Reserves & surplus	15,590	16,984	18,969	21,002	23,421
Shareholders' fund	15,749	17,143	19,128	21,161	23,580
Total liabilities and equities	23,732	24,386	25,452	27,088	29,887
Cash and cash eq.	2,524	2,350	4,300	5,344	6,608
Accounts receivables	4,751	3,967	4,055	4,430	4,976
Inventories	4,058	5,127	4,614	5,062	5,687
Other current assets	581	640	769	712	800
Investments	3	3	3	3	3
Net fixed assets	10,671	11,854	11,448	11,246	11,495
CWIP	934	257	50	70	80
Intangible assets	107	103	103	103	103
Deferred tax assets, net	0	0	0	0	0
Other assets	103	85	110	119	134
Total assets	23,732	24,386	25,452	27,088	29,887

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	4,519	4,205	4,335	5,052	5,886
Interest expenses	156	195	117	57	27
Non-cash adjustments	0	0	0	0	0
Changes in working capital	48	(943)	82	(929)	(724)
Other operating cash flows	(1,215)	(986)	(731)	(991)	(1,181)
Cash flow from operations	3,508	2,472	3,804	3,189	4,008
Capital expenditures	(976)	(1,213)	(500)	(1,000)	(1,500)
Change in investments	0	0	0	0	0
Other investing cash flows	1	0	0	0	0
Cash flow from investing	(975)	(1,213)	(500)	(1,000)	(1,500)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(402)	222	(700)	(250)	(200)
Interest expenses	(156)	(195)	(117)	(57)	(27)
Dividends paid	(570)	(1,150)	(515)	(871)	(1,037)
Other financing cash flows	294	(310)	(21)	32	20
Cash flow from financing	(833)	(1,433)	(1,354)	(1,146)	(1,243)
Changes in cash and cash eq.	1,700	(174)	1,951	1,043	1,265
Closing cash and cash eq.	2,524	2,350	4,300	5,344	6,608

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	14.3	16.1	15.7	18.3	21.7
Adjusted EPS	14.6	16.1	15.7	18.3	21.7
Dividend per share	3.0	3.0	2.6	4.4	5.2
Book value per share	99.1	107.9	120.3	133.1	148.4

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	3.1	3.2	3.5	3.1	2.7
EV/EBITDA	20.5	21.9	21.4	18.4	15.6
Adjusted P/E	39.5	35.8	36.6	31.5	26.5
P/BV	5.8	5.3	4.8	4.3	3.9

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	64.6	81.7	77.6	75.1	74.4
Interest burden (PBT/EBIT)	99.3	101.5	104.3	105.8	106.8
EBIT margin (EBIT/Revenue)	12.2	11.0	12.1	12.7	13.4
Asset turnover (Revenue/Avg TA)	131.0	116.7	102.4	109.9	113.9
Leverage (Avg TA/Avg Equity)	1.5	1.5	1.4	1.3	1.3
Adjusted ROAE	15.8	15.5	13.8	14.4	15.4

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	9.1	(5.0)	(9.1)	13.1	12.3
EBITDA	(1.5)	(7.5)	1.1	15.2	15.5
Adjusted EPS	(1.2)	10.3	(2.1)	16.2	18.9
Profitability & Return ratios (%)					
EBITDA margin	15.2	14.8	16.5	16.8	17.2
EBIT margin	12.2	11.0	12.1	12.7	13.4
Adjusted profit margin	7.8	9.1	9.8	10.1	10.7
Adjusted ROAE	15.8	15.5	13.8	14.4	15.4
ROCE	14.0	13.8	12.1	13.0	14.1
Working capital days (days)					
Receivables	57	57	57	54	53
Inventory	68	83	96	88	87
Payables	39	38	35	31	29
Ratios (x)					
Gross asset turnover	1.7	1.5	1.3	1.4	1.5
Current ratio	2.0	2.1	2.8	3.4	3.6
Net interest coverage ratio	23.1	15.8	26.4	64.7	163.7
Adjusted debt/equity	(0.1)	(0.1)	(0.2)	(0.2)	(0.3)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

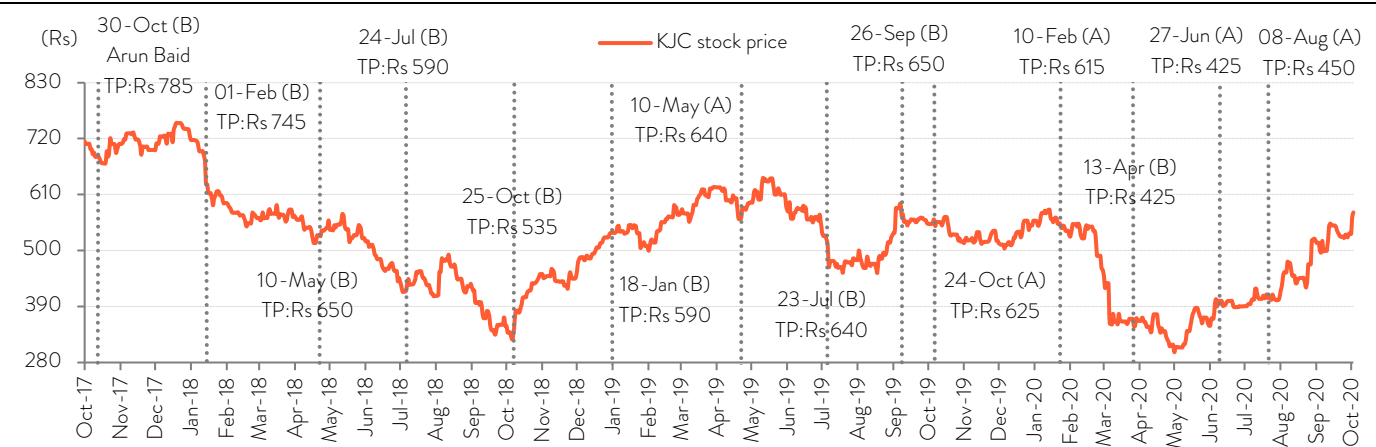
ADD – Expected return from >+5% to +15%

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)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): KAJARIA CERAMICS (KJC IN)



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

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