

**BUY**

TP: Rs 1,460 | ▲ 15%

**KAJARIA CERAMICS**

Construction Materials

21 January 2022

## Robust volume growth reflects strong demand; raise to BUY

- Q3 revenue grew 27% YoY (+10% QoQ) driven by 14% volume growth to 25.6msm – the highest-ever volumes for KJC
- EBITDA margin declined 450bps YoY to 17.2% on higher power & fuel cost (+520bps), of which gas cost surged by Rs 920mn
- We retain our TP of Rs 1,460 but upgrade the stock from HOLD to BUY given the recent correction

Ruchitaa Maheshwari

researchreport@bobcaps.in

**Demand rebound buoys topline:** KJC's Q3FY22 revenue surged 27% YoY to Rs 10.7bn (+10% QoQ), primarily led by a 14% rise in sale volumes to 25.6msm as urban demand rebounded to normal levels and smaller towns showed strong growth. Revenue from the tiles business rose 27% YoY to Rs 9.6bn, with the company's own manufacturing, subsidiaries and outsourcing businesses contributing Rs 5.5bn (+19% YoY), Rs 1.4bn (+11%) and Rs 2.7bn (+60%) respectively. Sanitaryware and plywood revenue climbed 33% YoY to Rs 1.1bn.

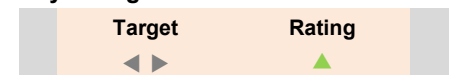
**Margins contract:** Due to higher power & fuel cost (+520bps YoY) – mainly gas cost which increased by Rs 920mn (average Rs 46.5/scm) – gross margin contracted 460bps to 27%. EBITDA margin declined 450bps YoY and 130bps QoQ to 17.2%.

**Gujarat Gas price outlook:** Gujarat Gas will be revising its minimum guaranteed offtake (MGO) every 15 days. The non-MGO price is Rs 106/scm. Currently, gas costs Rs 65/scm. For volumes above 5.5mn-6mn units, players have to pay spot prices. Gas price in the northern region is at Rs 40-45/scm and is linked to the movement of Brent crude. Around 70% of KJC's volumes come from its North India plant. As per management, gas prices should remain at Rs 46.5-47/scm for FY23.

**Long-term value play...:** We expect demand to sustain in the near-to-medium term led by (a) domestic market share gains from Morbi alongside an increasing focus on exports, (b) sustained traction in tier-1-and-above cities and towns, (c) pickup in new construction activity, (d) increasing absorption of real-estate inventory, and (e) rising replacement demand. Additionally, we believe a focus on non-tile businesses would aid rapid growth in bathware (26% CAGR) and plywood (55% CAGR) for KJC during FY21-FY24, which will strengthen its leadership in the domestic market.

**...upgrade to BUY:** KJC has corrected ~8% from its 52-week high (19 Jan 2022) and is trading at an FY24E P/E of 34.7x compared to its five-year median of 40x, which is reasonable given its increasing volumes and healthy return ratios. We continue to value the stock at 40x FY24E EPS and retain our TP at Rs 1,460 but upgrade our rating from HOLD to BUY given strong growth prospects and attractive valuations.

### Key changes



Ticker/Price	KJC IN/Rs 1,267
Market cap	US\$ 2.7bn
Free float	52%
3M ADV	US\$ 4.4mn
52wk high/low	Rs 1,375/Rs 806
Promoter/FPI/DII	48%/22%/30%

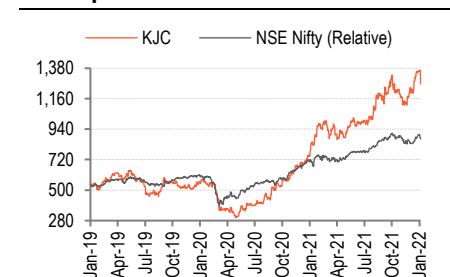
Source: NSE | Price as of 21 Jan 2022

### Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	27,809	35,098	41,030
EBITDA (Rs mn)	5,088	6,006	7,604
Adj. net profit (Rs mn)	3,081	3,626	4,710
Adj. EPS (Rs)	19.4	22.8	29.6
Consensus EPS (Rs)	19.4	24.3	30.0
Adj. ROAE (%)	17.2	18.9	23.3
Adj. P/E (x)	65.4	55.5	42.8
EV/EBITDA (x)	39.3	33.1	26.2
Adj. EPS growth (%)	20.6	17.7	29.9

Source: Company, Bloomberg, BOBCAPS Research

### Stock performance



Source: NSE



## Earnings calls highlights

- **Sales:** As per management, sales in tier I, II and III cities have resumed in full swing.
- **Capacity utilisation:** Average capacity utilisation during Q3FY22 was at ~100% with the pickup in sales. Management expects utilisation to remain high given robust demand for tiles due to a resurgence in construction activities.
- **Price hikes:** In order to offset the rise in gas prices and higher transportation cost, KJC has increased prices of all products by 9-10% since Apr'21. Per management, the company takes a price increase with a lag effect of 15-30 days and is thus able to protect margins. The full benefit of the hike will be visible from Jan'22 onwards.
- **Exports:** Exports currently stand at 2-3% of the topline which should increase to 5-8% in a couple of years. Management indicated that exports are uncompetitive and hence not a focus area for the company. Europe has seen a cost increase of EUR 1.5-2/sqm during Q3 which does make exports from India competitive, excluding high ocean freight rates.
- **Sanitaryware:** KJC is targeting Rs 2.8bn-3bn in revenue from sanitaryware in FY22. Over 2-3 years, the company expects the segment to cross Rs 5bn in revenue.
- **Capex plans:** (1) Gailpur plant – Rs 600mn capex, adding 4.2msm of capacity; (2) Srikalahasti plant – Rs 1.1bn, adding 3.8msm of capacity; (3) Jaxx plant – Rs 800mn, adding 4.4msm of capacity with revenue potential of Rs 1.5bn-1.6bn; and (4) Kajaria Bathware – Rs 6mn, adding 600,000 pieces of capacity with revenue potential of Rs 500mn-600mn. All the capex will be completed in Mar-Apr'22.
- **Investments:** The board has approved a Rs 2.1bn investment in Kajaria Ultima to set up a slab manufacturing facility with a production capacity of 5msm p.a. in the state of Gujarat. The segment has revenue potential of Rs 4bn. The board has also approved an Rs 800mn investment in Kerovit Global Pvt Ltd to set up a sanitaryware manufacturing facility with a capacity of 700,000 pieces p.a. in Gujarat.
- **Working capital:** Working capital days increased to 58 days in Q3FY22 vs. 56 in Q2FY22.

**Fig 1 – Consolidated quarterly performance**

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
Net Sales	10,682	8,383	27.4	9,736	9.7	26,034	18,284	42.4
COGS	6,731	4,840	39.1	5,999	12.2	15,988	10,974	45.7
Employee cost	1,066	895	19.1	1,020	4.5	3,019	2,282	32.3
Other expenses	1,047	830	26.2	912	14.8	2,580	1,849	39.5
<b>EBITDA</b>	<b>1,838</b>	<b>1,818</b>	<b>1.1</b>	<b>1,805</b>	<b>1.9</b>	<b>4,448</b>	<b>3,179</b>	<b>39.9</b>
<b>EBITDA Margin (%)</b>	<b>17.2</b>	<b>21.7</b>	<b>(447bps)</b>	<b>18.5</b>	<b>(133bps)</b>	<b>17.1</b>	<b>17.4</b>	<b>(30bps)</b>
Depreciation and amortization	281	276	1.9	282	-0.3	827	801	3.2
EBIT	1,558	1,542	1.0	1,523	2.3	3,620	2,378	52.3
EBIT Margin (%)	14.6	18.4	(381bps)	15.6	(107bps)	13.9	13.0	90bps
Net Interest expenses	30	26	15.3	27	10.7	88	81	8.4
Other non-operating inc (exp), net	74	65	15.0	71	4.2	205	139	48.2
Earnings before tax	1,602	1,581	1.3	1,567	2.2	3,738	2,435	53.5
Income taxes	355	370	(4.2)	374	(5.3)	883	658	34.2
Earnings after tax	1,247	1,210	3.1	1,193	4.5	2,855	1,777	60.6
Extraordinary items	0	0	-	0	-	0	0	-
Minority interest (expense) income	27	21	29.7	32	(14.8)	43	(32)	(232.8)
<b>APAT</b>	<b>1,220</b>	<b>1,189</b>	<b>2.6</b>	<b>1,161</b>	<b>5.1</b>	<b>2,812</b>	<b>1,810</b>	<b>55.4</b>

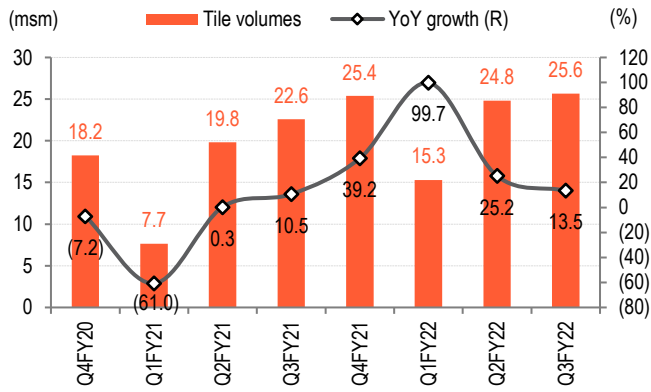
Source: Company, BOBCAPS Research

**Fig 2 – Consolidated segmental performance**

(Rs mn)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	9MFY22	9MFY21	YoY (%)
<b>Segment Revenues</b>								
Tiles	9,616	7,582	26.8	8,826	9.0	23,635	16,669	41.8
Other	1,066	801	33.1	910	17.2	2,399	1,615	48.5
<b>Total revenues</b>	<b>10,682</b>	<b>8,383</b>	<b>27.4</b>	<b>9,736</b>	<b>9.7</b>	<b>26,034</b>	<b>18,284</b>	<b>42.4</b>
<b>EBIT</b>								
Tiles	1491.5	1480.1	0.8	1459.1	2.2	3482.5	2369.2	47.0
Other	66.2	62	6.8	64.3	3.0	137.6	8.3	1557.8
<b>Total</b>	<b>1,558</b>	<b>1,542</b>	<b>1.0</b>	<b>1,523</b>	<b>2.3</b>	<b>3,620</b>	<b>2,378</b>	<b>52.3</b>
<b>EBIT Margins</b>								
Tiles	15.5	19.5	(401bps)	16.5	(102bps)	14.7	14.2	52bps
Other	6.2	7.7	(153bps)	7.1	(86bps)	5.7	0.5	522bps

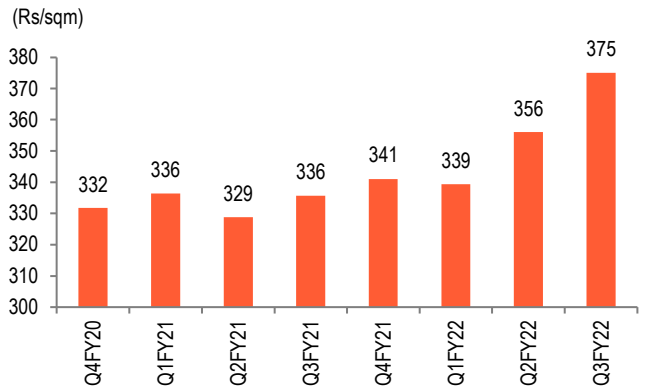
Source: Company, BOBCAPS Research

**Fig 3 – Tile volumes**



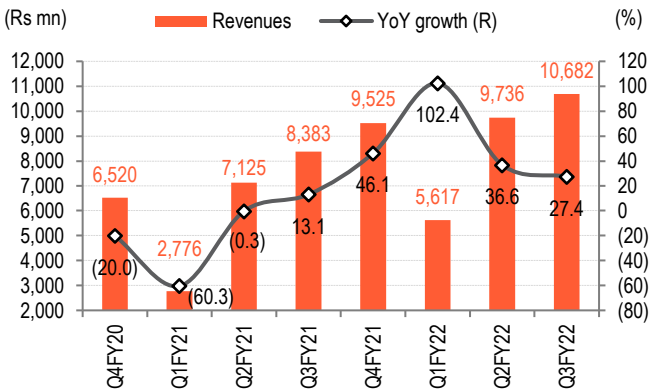
Source: Company, BOBCAPS Research

**Fig 4 – Tile net realisations**



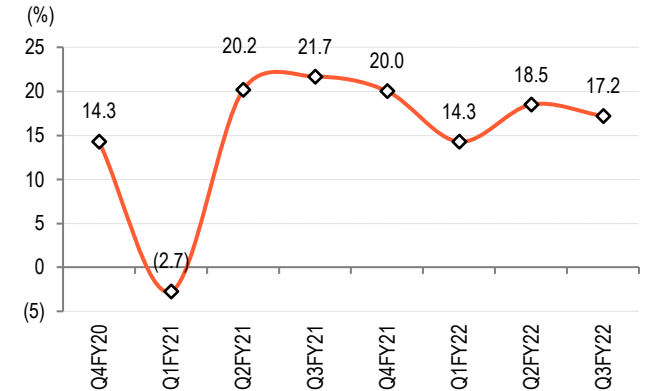
Source: Company, BOBCAPS Research

**Fig 5 – Consolidated revenue trend**



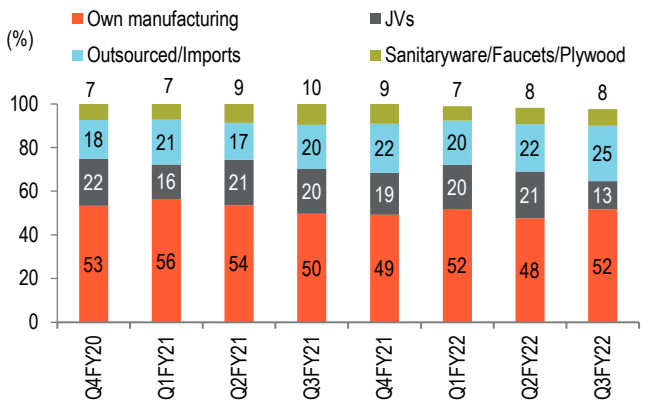
Source: Company, BOBCAPS Research

**Fig 6 – Consolidated EBITDA margin trend**



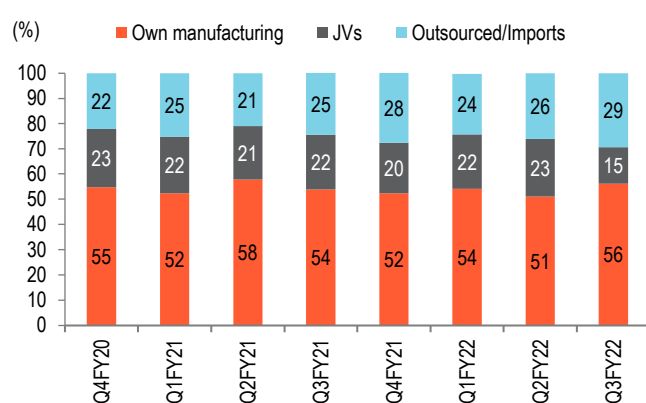
Source: Company, BOBCAPS Research

**Fig 7 – Revenue breakup**



Source: Company, BOBCAPS Research

**Fig 8 – Tile volume breakup**



Source: Company, BOBCAPS Research

## Valuation methodology

We expect demand to sustain in the near-to-medium term led by (a) market share gains from Morbi in the domestic space alongside an increasing focus on exports, (b) sustained traction in tier-1-and-above cities and towns, (c) pickup in new construction activity, (d) increasing absorption of real-estate inventory, and (e) rising replacement demand. Additionally, we believe a focus on the non-tile businesses would aid rapid growth in bathware (26% CAGR) and plywood (55% CAGR) for KJC during FY21-FY24, which will strengthen its leadership in the domestic market.

In our view, KJC 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 has corrected ~8% from its 52-week high (19 Jan 2022) and is now trading at an FY24E P/E of 37.3x compared to its five-year median of 40x, which is reasonable given increasing volumes and healthy return ratios. We thus upgrade our rating from HOLD to BUY while retaining our TP at Rs 1,460 based on an unchanged 40x FY24E P/E multiple.

**Fig 9 – Key assumptions**

Parameter	FY21	FY22E	FY23E	FY24E
Tiles Volume	75.4	90.5	104.1	117.6
Growth (%)	(3.4)	20.0	15.0	13.0
Tiles revenue (Rs mn)	25,328	31,372	36,439	41,176
Growth (%)	(2.8)	23.9	16.2	13.0
Sanitaryware/Faucetware revenue (Rs mn)	2,090	2,926	3,511	4,213
Growth (%)	19.9	40.0	20.0	20.0
Plywood (Rs mn)	392	800	1,080	1,458
Growth (%)	35.4	104.3	35.0	35.0

Source: Company, BOBCAPS Research

**Fig 10 – Peer comparison**

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
					FY22E	FY23E	FY22E	FY23E	
Kajaria Ceramics	KJC IN	BUY	1,460	21.5	22.8	29.6	18.9	23.3	40
Somany Ceramics	SOMC IN	BUY	1,140	19.0	20.5	32.8	12.5	17.3	25
Greenply Ind	MTLM IN	BUY	260	18.0	7.7	10.2	19.7	21.4	22
Century Plyboard	CPBI IN	HOLD	735	23.8	13.6	16.7	22.1	22.1	35
Greenpanel Ind	GREENP	BUY	595	34.0	16.0	21.7	23.7	25.1	23
Cera Sanitaryware	CRS IN	BUY	5,590	17.1	109.8	134.9	15.4	16.9	35
Astral	ASTRA IN	HOLD	2,465	22.3	22.5	29.5	22.5	26.0	65
Finolex Ind	FNXP IN	HOLD	220	7.7	10.2	9.4	19.0	15.9	22
Supreme Ind	SI IN	HOLD	2,535	15.7	74.7	80.7	28.0	26.7	30

Source: BOBCAPS Research

## 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
Cera Sanitaryware	CRS IN	0.8	4,691	5,590	BUY
Greenpanel Industries	GREENP IN	0.8	473	595	BUY
Greenply Industries	MTLM IN	0.3	208	260	BUY
Kajaria Ceramics	KJC IN	2.7	1,267	1,460	BUY
Pidilite Industries	PIDI IN	18.5	2,701	2,445	SELL
Somany Ceramics	SOMC IN	0.5	903	1,140	BUY

Source: BOBCAPS Research, NSE | Price as of 21 Jan 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>35,098</b>	<b>41,030</b>	<b>46,847</b>
EBITDA	4,159	5,088	6,006	7,604	9,197
Depreciation	(1,081)	(1,067)	(1,186)	(1,352)	(1,497)
EBIT	3,078	4,022	4,820	6,252	7,700
Net interest inc./(exp.)	(195)	(107)	(97)	(72)	(52)
Other inc./(exp.)	242	213	224	246	271
Exceptional items	0	0	0	0	0
EBT	3,125	4,127	4,947	6,426	7,918
Income taxes	(589)	(1,038)	(1,247)	(1,619)	(1,995)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	18	(9)	(74)	(96)	(118)
<b>Reported net profit</b>	<b>2,553</b>	<b>3,081</b>	<b>3,626</b>	<b>4,710</b>	<b>5,805</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>2,553</b>	<b>3,081</b>	<b>3,626</b>	<b>4,710</b>	<b>5,805</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	2,105	1,760	2,292	2,659	3,016
Other current liabilities	2,311	2,201	2,191	2,765	3,232
Provisions	288	313	338	363	388
Debt funds	1,171	971	721	521	321
Other liabilities	731	687	712	737	762
Equity capital	159	159	159	159	159
Reserves & surplus	16,984	18,530	19,436	20,614	22,065
Shareholders' fund	17,143	18,689	19,595	20,773	22,224
<b>Total liab. and equities</b>	<b>24,386</b>	<b>25,266</b>	<b>26,569</b>	<b>28,633</b>	<b>30,877</b>
Cash and cash eq.	2,350	4,477	1,259	269	48
Accounts receivables	3,967	4,317	5,289	6,183	7,059
Inventories	5,127	3,731	5,770	6,632	7,573
Other current assets	640	615	769	899	1,027
Investments	3	0	0	0	0
Net fixed assets	11,854	11,911	13,205	14,343	14,846
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	95	115	132
<b>Total assets</b>	<b>24,386</b>	<b>25,266</b>	<b>26,569</b>	<b>28,633</b>	<b>30,877</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>2,382</b>	<b>5,305</b>	<b>6,369</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)	(250)	(200)	(200)
Interest expenses	(195)	(107)	(97)	(72)	(52)
Dividends paid	(1,150)	(1,591)	(2,720)	(3,533)	(4,353)
Other financing cash flows	(310)	72	(33)	10	15
<b>Cash flow from financing</b>	<b>(1,433)</b>	<b>(1,827)</b>	<b>(3,100)</b>	<b>(3,795)</b>	<b>(4,591)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(174)</b>	<b>2,127</b>	<b>(3,218)</b>	<b>(990)</b>	<b>(221)</b>
<b>Closing cash &amp; cash eq.</b>	<b>2,350</b>	<b>4,477</b>	<b>1,259</b>	<b>269</b>	<b>48</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	16.1	19.4	22.8	29.6	36.5
Adjusted EPS	16.1	19.4	22.8	29.6	36.5
Dividend per share	3.0	10.0	13.7	17.8	21.9
Book value per share	107.9	117.6	123.3	130.7	139.8

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	7.2	7.2	5.7	4.9	4.3
EV/EBITDA	48.3	39.3	33.1	26.2	21.9
Adjusted P/E	78.9	65.4	55.5	42.8	34.7
P/BV	11.7	10.8	10.3	9.7	9.1

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	81.7	74.6	73.3	73.3	73.3
Interest burden (PBT/EBIT)	101.5	102.6	102.6	102.8	102.8
EBIT margin (EBIT/Revenue)	11.0	14.5	13.7	15.2	16.4
Asset turnover (Rev./Avg TA)	116.7	112.0	135.4	148.7	157.4
Leverage (Avg TA/Avg Equity)	1.5	1.4	1.4	1.4	1.4
<b>Adjusted ROAE</b>	<b>15.5</b>	<b>17.2</b>	<b>18.9</b>	<b>23.3</b>	<b>27.0</b>

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	(5.0)	(1.0)	26.2	16.9	14.2
EBITDA	(7.5)	22.3	18.0	26.6	21.0
Adjusted EPS	10.3	20.6	17.7	29.9	23.2
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	14.8	18.3	17.1	18.5	19.6
EBIT margin	11.0	14.5	13.7	15.2	16.4
Adjusted profit margin	9.1	11.1	10.3	11.5	12.4
Adjusted ROAE	15.5	17.2	18.9	23.3	27.0
ROCE	13.8	15.3	17.4	21.7	25.3
<b>Working capital days (days)</b>					
Receivables	57	54	50	51	52
Inventory	83	81	70	80	82
Payables	38	31	25	27	28
<b>Ratios (x)</b>					
Gross asset turnover	1.5	1.4	1.6	1.7	1.8
Current ratio	2.1	2.7	2.5	2.3	2.3
Net interest coverage ratio	15.8	37.5	49.7	86.8	147.9
<b>Adjusted debt/equity</b>	<b>(0.1)</b>	<b>(0.2)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

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

## Disclaimer

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

**BUY** – Expected return >+15%

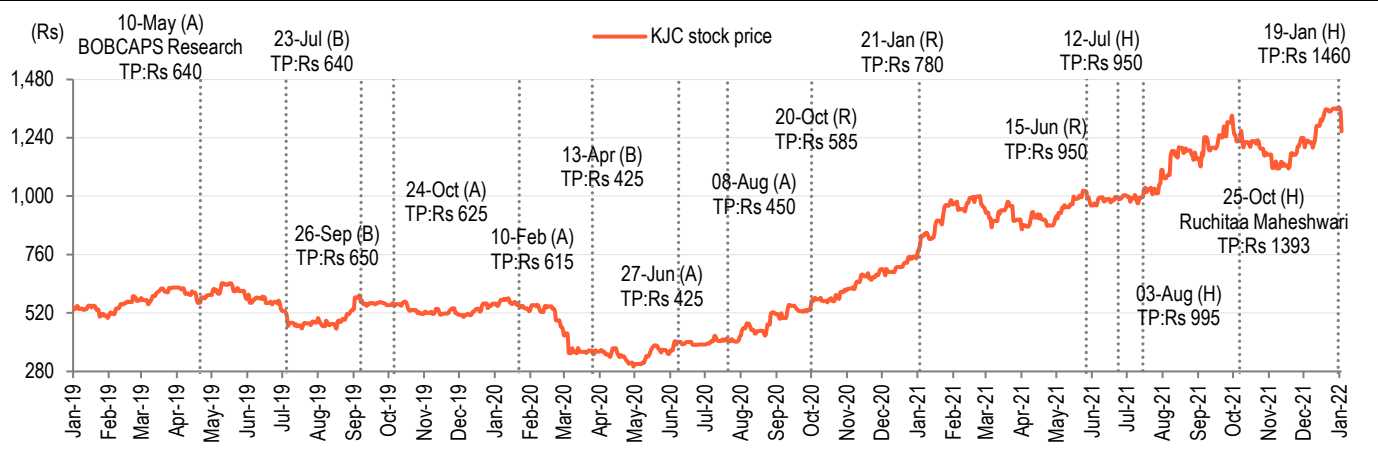
**HOLD** – Expected return from -6% to +15%

**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

### Rating distribution

As of 31 December 2021, out of 115 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 57 have BUY ratings, 31 have HOLD ratings, 5 are rated ADD\*, 2 are rated REDUCE\* and 20 are rated SELL. None of these companies have been investment banking clients in the last 12 months. (\*Our ADD and REDUCE ratings are in the process of being migrated to the new recommendation structure.)

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