

**BUY**

TP: Rs 835 | ▲ 30%

**SOMANY CERAMICS**

Construction Materials

10 August 2022

**Good quarter; long term outlook remains positive**

- Q1 revenue growth at 67% YoY due to 42% increase in tile volumes (+20% vs Q1FY20) & 15.5% rise in blended realisation (+17% vs Q1FY20)
- EBITDA margin improved 240bps YoY to 6.8% owing to better operating leverage and price hikes of 2.5-3%
- Retain BUY with an unchanged TP of Rs 835 given an improving mix, demand tailwinds and capital allocation towards the core business

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**Higher realisations and volumes buoy topline:** SOMC's Q1FY23 revenue grew 67% YoY (-11% QoQ) to Rs 5.4bn off a low base, aided by a 42%/16% rise in tile volumes/ blended realisation. Despite 320bps YoY gross margin contraction, EBITDA margin rose 240bps to 6.8% due to operating leverage, with EBITDA up 158% YoY. Consolidated revenue grew 70% YoY to Rs 5.6bn and EBITDA margin was up 105bps to 8% on lower employee and other costs, which offset higher fuel cost (+790bps YoY to 31% of sales).

**Gas price on the rise...:** Rising gas cost is putting pressure on margins – prices in the northern region have risen from Rs 48/scm in Q4FY22 to Rs 58/scm in Q1FY23 and Rs 64/scm currently, and in the south from Rs 71/scm to Rs 90/scm (SOMC is in the process of acquiring cheaper gas from a third party). In Morbi, prices are up from Rs 65/scm in Q1 to Rs 67/scm currently. The company took price hikes of 2.5-3% in Q1 to mitigate the impact of rising cost inflation. It has a three-month contract with Gujarat Gas for gas currently priced at Rs 65/scm vs. Rs 36/scm in Q1FY22.

**...fuelling a shift to propane:** As per management, propane is Rs 7-8/scm cheaper than gas and many plants are converting to this fuel, though the conversion rate is low as the capex required is +Rs 10mn per plant. SOMC, however, is migrating to propane and has already converted two plants with one more being readied by August-end. Per the company, 150 out of 800 plants in the Morbi ceramic cluster have moved to propane.

**Growth getting back on track:** SOMC's growth hit a roadblock in Q4FY22 due to a host of macro (subdued demand and pricing pressure) and micro issues (stretched receivable days). However, we expect a revenue CAGR of 14% over the next two years led by ramp-up of new capacities and traction in the bathware segment. Given price hikes by tiles players to offset higher gas cost, a rising share of own manufacturing post completion of expansion, and higher contribution from glazed vitrified tiles (GVT: +35% in FY24E vs. 30% in Q1FY23), we expect SOMC to sustain 11-12% margins.

**Maintain BUY:** The stock is trading at 18x FY24E EPS vs. its 5Y median of 27.5x. We retain BUY with an unchanged TP of Rs 835, based on 23x FY24E EPS, given an improving mix, demand tailwinds and capital allocation towards the core business.

**Key changes**

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	SOMC IN/Rs 642
Market cap	US\$ 342.0mn
Free float	45%
3M ADV	US\$ 0.1mn
52wk high/low	Rs 970/Rs 511
Promoter/FPI/DII	55%/2%/43%

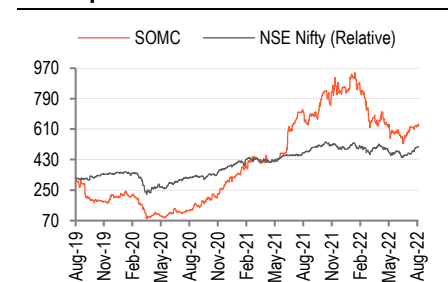
Source: NSE | Price as of 10 Aug 2022

**Key financials**

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	20,945	23,167	27,140
EBITDA (Rs mn)	2,065	2,442	3,212
Adj. net profit (Rs mn)	888	1,000	1,530
Adj. EPS (Rs)	21.0	23.6	36.1
Consensus EPS (Rs)	24.6	34.7	45.2
Adj. ROAE (%)	13.0	12.9	17.1
Adj. P/E (x)	30.6	27.2	17.8
EV/EBITDA (x)	14.7	12.3	9.4
Adj. EPS growth (%)	24.8	12.6	53.0

Source: Company, Bloomberg, BOBCAPS Research

**Stock performance**



Source: NSE



## Earnings call highlights

- Management indicated that a 10-day trucker/transport strike is likely to be announced in Morbi post 15 August. SOMC does not expect the strike to go beyond 3-4 days and is hopeful of making up the losses during Q2FY23. Further, management is not concerned about the planned mass shutdown at Morbi for one month from 10 August to 10 September, as it expects this to benefit organised players. Out of the 800 plants in Morbi, 60-70 will be running. Also, the company has requisite stocks available with its outsourcing partner, while its joint venture is running at 100%, and hence sees no impact from the shutdown. The impact will be largely from the transport strike if it happens.
- As per management, Morbi players typically shut down for 7-8 days during the festivals of Janmashtami and Diwali. This is done to bolster demand and increase the prices of products.
- Per management, demand for ceramics has slowed from June onwards and remains a bit tepid in Q2.
- Management has maintained its volume growth guidance at 15-20% for FY23 and expects slight margin expansion provided gas costs remain stable and value-added sales increase. For bathware, management expects 30-35% revenue growth to Rs 2.8bn-3bn. Per management, the contribution of GVT tiles to increase to ~33% in FY23E and +35% in FY24E from 30% in Q1FY23.
- The company's greenfield expansion in Gujarat for manufacturing large size tiles is expected to have 4.5mn sqm capacity, will incur capex of Rs 1.7bn-1.8bn and can be commissioned in the next 13-14 months. Per management, the project has revenue potential of ~Rs 2.5bn.
- Faucetware would double capacity to 1.3mn pieces in Dera Bassi, Punjab, by Q3FY23, lending an impetus to growth.
- SOMC is aggressively working on branding initiatives and expects brand spends at 2.5-2.6% of revenue in FY23. Q1 A&P spend is typically lower and Q4 the highest, resulting in lower other expenses (-7% QoQ) on an absolute basis for Q1.
- Average capacity utilisation in tiles was 85%, ~88% in sanitaryware and ~95% in faucetware in Q1FY23.
- SOMC has added 70 dealers (net) in Q1 and aims to add 300 more (net) in FY23.
- To bridge the margin differential with competitor KJC (15% EBITDA margin vs. ~7% for SOMC), the company is planning to increase the contribution of value-added and GVT sales.

**Fig 1 – Consolidated quarterly performance**

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
<b>Net Revenue</b>	<b>5,591</b>	<b>3,299</b>	<b>69.5</b>	<b>6,168</b>	<b>(9.3)</b>	<b>20,945</b>	<b>16,505</b>	<b>26.9</b>
CQGS	3,868	2,031	90.5	4,330	(10.7)	14,015	10,575	32.5
% of sales	69.2	61.6	763bps	70.2	(102bps)	66.9	64.1	284bps
Employee expenses	712	601	18.5	660	7.9	2,571	2,248	14.4
% of sales	12.7	18.2	(548bps)	10.7	204bps	12.3	13.6	(135bps)
Other Expenses	562	437	28.6	672	(16.4)	2,293	1,774	29.3
% of sales	10.0	13.2	(319bps)	10.9	(85bps)	10.9	10.7	20bps
<b>EBITDA</b>	<b>449</b>	<b>231</b>	<b>94.5</b>	<b>507</b>	<b>(11.3)</b>	<b>2,065</b>	<b>1,908</b>	<b>8.3</b>
EBITDA Margin (%)	8.0	7.0	104bps	8.2	(17bps)	9.9	11.6	(170bps)
Depreciation/Amortisation	154	151	2.3	171	(9.7)	640	613	4.3
<b>EBIT</b>	<b>295</b>	<b>80</b>	<b>267.4</b>	<b>336</b>	<b>(12.1)</b>	<b>1,426</b>	<b>1,294</b>	<b>10.2</b>
EBIT Margin (%)	5.3	2.4	285bps	5.4	(16bps)	6.8	7.8	(103bps)
Net Interest Expenses	73	81	(10.3)	64	13.6	296	401	(26.1)
Other Income	40	56	(29.0)	15	173.8	134	128	5.0
<b>PBT</b>	<b>263</b>	<b>56</b>	<b>373.2</b>	<b>287</b>	<b>(8.4)</b>	<b>1,264</b>	<b>1,021</b>	<b>23.7</b>
Tax Expenses	69	16	323.3	60	16.0	328	229	43.4
Net Income before minority interest & extraordinary items	194	39	393.9	227	(14.8)	935	792	18.1
Minority Interest and Income from associates	12	10	19.2	(34)	(134.8)	(47)	(36)	32.5
Exceptional items	0	(4)	n.m.	0	n.m.	0	(180)	n.m.
<b>Reported Net Income</b>	<b>205</b>	<b>45</b>	<b>359.5</b>	<b>193</b>	<b>6.3</b>	<b>888</b>	<b>577</b>	<b>53.9</b>

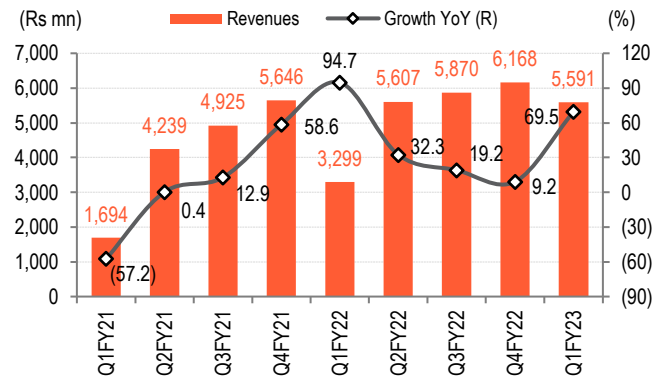
Source: Company, BOBCAPS Research

**Fig 2 – Standalone quarterly performance**

(Rs mn)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY22	FY21	YoY (%)
<b>Net Revenue</b>	<b>5,444</b>	<b>3,255</b>	<b>67.2</b>	<b>6,093</b>	<b>(10.7)</b>	<b>20,738</b>	<b>16,302</b>	<b>27.2</b>
CQGS	4,091	2,343	74.6	4,775	(14.3)	15,577	11,902	30.9
% of sales	75.1	72.0	319bps	78.4	(321bps)	75.1	73.0	210bps
Employee expenses	504	441	14.3	470	7.1	1,858	1,639	13.4
% of sales	9.3	13.5	(429bps)	7.7	153bps	9.0	10.1	(109bps)
Other Expenses	477	328	45.7	516	(7.4)	1,801	1,377	30.8
% of sales	8.8	10.1	(130bps)	8.5	31bps	8.7	8.4	24bps
<b>EBITDA</b>	<b>372</b>	<b>144</b>	<b>157.8</b>	<b>333</b>	<b>11.8</b>	<b>1,502</b>	<b>1,384</b>	<b>8.5</b>
EBITDA Margin (%)	6.8	4.4	240bps	5.5	137bps	7.2	8.5	(125bps)
Depreciation/Amortisation	104	108	(4.2)	128	(18.6)	468	443	5.8
<b>EBIT</b>	<b>268</b>	<b>36</b>	<b>646.8</b>	<b>205</b>	<b>30.7</b>	<b>1,034</b>	<b>942</b>	<b>9.8</b>
EBIT Margin (%)	4.9	1.1	382bps	3.4	156bps	5.0	5.8	(79bps)
Net Interest Expenses	20	23	(13.3)	21	(8.0)	86	144	(40.4)
Other Income	75	65	16.6	36	108.0	221	152	45.7
<b>PBT</b>	<b>324</b>	<b>78</b>	<b>315.7</b>	<b>220</b>	<b>47.2</b>	<b>1,170</b>	<b>949</b>	<b>23.2</b>
Tax Expenses	83	20	312.5	51	62.1	305	211	44.1
Net Income before extraordinary items	241	58	316.8	169	42.7	865	738	17.2
Exceptional items	0	0	n.m.	0	n.m.	0	(179)	n.m.
<b>Reported Net Income</b>	<b>241</b>	<b>58</b>	<b>316.8</b>	<b>169</b>	<b>42.7</b>	<b>865</b>	<b>559</b>	<b>54.7</b>
<b>Adjusted Net Income</b>	<b>241</b>	<b>58</b>	<b>316.8</b>	<b>169</b>	<b>42.7</b>	<b>865</b>	<b>681</b>	<b>27.0</b>

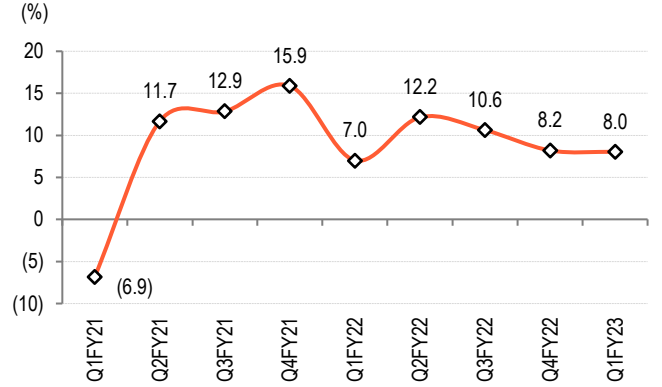
Source: Company, BOBCAPS Research

**Fig 3 – Consolidated revenue growth**



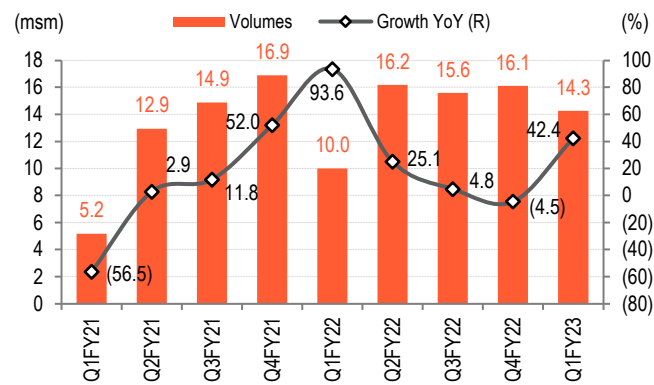
Source: Company, BOBCAPS Research

**Fig 4 – Consolidated EBITDA margin**



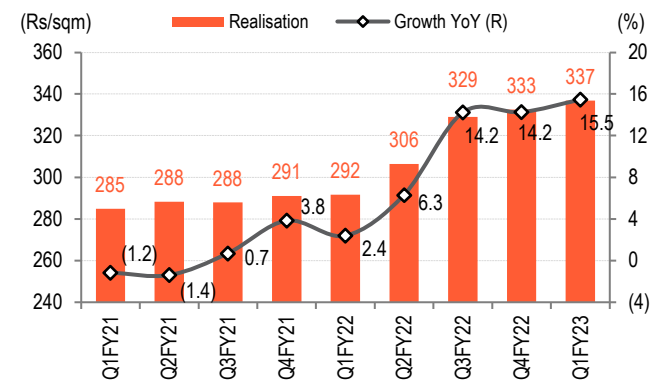
Source: Company, BOBCAPS Research

**Fig 5 – Tile volume growth**



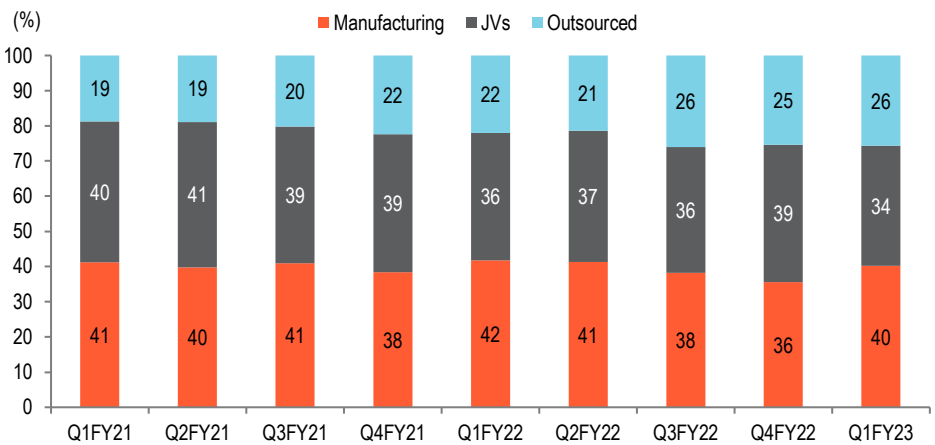
Source: Company, BOBCAPS Research

**Fig 6 – Tile realisation growth**



Source: Company, BOBCAPS Research

**Fig 7 – Revenue breakup**



Source: Company, BOBCAPS Research

## Valuation methodology

SOMC's growth hit a roadblock in Q4FY22 due to a host of macro (subdued demand and pricing pressure) and micro issues (stretched receivable days). However, we expect a revenue CAGR of 14% over the next two years led by ramp-up of new capacities and traction in the bathware segment. Given price hikes by tiles players to offset higher gas cost, a rising share of own manufacturing post completion of capacity expansion, and higher contribution from glazed vitrified tiles (+35% in FY24E vs. 30% in Q1FY23), we expect SOMC to sustain 11-12% margins.

The stock is trading at 18x FY24E EPS vs. its five-year median of 27.5x. We retain BUY with an unchanged TP of Rs 835, based on 23x FY24E EPS, given an improving mix, demand tailwinds and capital allocation towards the core business.

## Key risks

Key downside risks to our estimates are:

- **Higher raw material prices:** Any abnormal increase in prices of key raw materials, such as gas, coupled with an inability to pass these along could adversely affect SOMC's profitability.
- **Increased competition from informal sector:** E-way bill implementation, if executed poorly as is currently the case, may allow competition from the unorganised sector to increase, affecting growth prospects.
- **Housing market slowdown:** A slowdown in the housing market will hinder demand for the company's products.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Century Plyboards	CPBI IN	1.7	600	735	BUY
Cera Sanitaryware	CRS IN	0.8	4,735	5,225	HOLD
Greenpanel Industries	GREENP IN	0.7	436	595	BUY
Greenply Industries	MTLM IN	0.3	181	235	BUY
Kajaria Ceramics	KJC IN	2.3	1,137	1,460	BUY
Pidilite Industries	PIDI IN	16.8	2,637	1,870	SELL
Somany Ceramics	SOMC IN	0.3	642	835	BUY

Source: BOBCAPS Research, NSE | Price as of 10 Aug 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
<b>Total revenue</b>	<b>16,030</b>	<b>16,505</b>	<b>20,945</b>	<b>23,167</b>	<b>27,140</b>
EBITDA	1,299	1,908	2,065	2,442	3,212
Depreciation	(589)	(613)	(640)	(771)	(815)
EBIT	709	1,294	1,426	1,672	2,398
Net interest inc./(exp.)	(494)	(401)	(296)	(327)	(273)
Other inc./(exp.)	125	128	134	141	148
Exceptional items	0	0	0	0	0
EBT	339	1,021	1,264	1,485	2,273
Income taxes	112	(229)	(328)	(374)	(573)
Extraordinary items	(256)	(180)	0	0	0
Min. int./Inc. from assoc.	(45)	(36)	(47)	(111)	(170)
<b>Reported net profit</b>	<b>150</b>	<b>577</b>	<b>888</b>	<b>1,000</b>	<b>1,530</b>
Adjustments	70	134	0	0	0
<b>Adjusted net profit</b>	<b>220</b>	<b>711</b>	<b>888</b>	<b>1,000</b>	<b>1,530</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	1,729	1,839	2,255	2,475	2,900
Other current liabilities	1,347	1,641	1,749	1,904	2,231
Provisions	98	96	105	162	190
Debt funds	4,981	4,235	5,112	3,335	2,735
Other liabilities	358	321	323	323	323
Equity capital	85	85	85	85	85
Reserves & surplus	5,980	6,323	7,178	8,157	9,554
Shareholders' fund	6,064	6,407	7,263	8,242	9,639
<b>Total liab. and equities</b>	<b>15,519</b>	<b>15,536</b>	<b>17,882</b>	<b>17,406</b>	<b>18,812</b>
Cash and cash eq.	173	1,491	1,486	771	1,245
Accounts receivables	2,798	2,211	2,368	2,856	3,346
Inventories	3,282	2,455	2,737	3,174	3,718
Other current assets	1,085	806	903	952	1,115
Investments	341	898	600	0	0
Net fixed assets	7,779	7,588	7,520	7,386	7,121
CWIP	60	86	2,267	2,267	2,267
Intangible assets	0	0	0	0	0
Deferred tax assets, net	54	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>15,519</b>	<b>15,536</b>	<b>17,882</b>	<b>17,406</b>	<b>18,812</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
<b>Cash flow from operations</b>	<b>1,191</b>	<b>3,168</b>	<b>1,967</b>	<b>1,447</b>	<b>2,029</b>
Capital expenditures	(664)	(414)	(2,779)	(550)	(550)
Change in investments	341	(557)	298	600	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(323)</b>	<b>(970)</b>	<b>(2,481)</b>	<b>50</b>	<b>(550)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(750)	(747)	878	(1,778)	(600)
Interest expenses	(494)	(401)	(296)	(327)	(273)
Dividends paid	(204)	(102)	(119)	(218)	(303)
Other financing cash flows	38	56	79	(111)	(170)
<b>Cash flow from financing</b>	<b>(1,411)</b>	<b>(1,193)</b>	<b>541</b>	<b>(2,434)</b>	<b>(1,346)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(543)</b>	<b>1,004</b>	<b>27</b>	<b>(937)</b>	<b>133</b>
<b>Closing cash &amp; cash eq.</b>	<b>(83)</b>	<b>1,178</b>	<b>1,518</b>	<b>549</b>	<b>905</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	3.5	13.6	21.0	23.6	36.1
Adjusted EPS	5.2	16.8	21.0	23.6	36.1
Dividend per share	2.0	2.4	2.4	4.4	6.1
Book value per share	143.1	150.9	171.1	194.2	227.1

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	2.0	1.9	1.4	1.3	1.1
EV/EBITDA	24.3	16.6	14.7	12.3	9.4
Adjusted P/E	123.6	38.2	30.6	27.2	17.8
P/BV	4.5	4.3	3.8	3.3	2.8

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	FY23E	FY24E
Tax burden (Net profit/PBT)	64.8	69.7	70.3	67.3	67.3
Interest burden (PBT/EBIT)	47.9	78.9	88.6	88.9	94.8
EBIT margin (EBIT/Revenue)	4.4	7.8	6.8	7.2	8.8
Asset turnover (Rev./Avg TA)	99.6	105.9	124.8	131.0	149.9
Leverage (Avg TA/Avg Equity)	2.6	2.5	2.5	2.3	2.0
Adjusted ROAE	3.6	11.4	13.0	12.9	17.1

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	(6.3)	3.0	26.9	10.6	17.1
EBITDA	(17.6)	46.9	8.3	18.3	31.5
Adjusted EPS	(55.1)	223.3	24.8	12.6	53.0
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	8.1	11.6	9.9	10.5	11.8
EBIT margin	4.4	7.8	6.8	7.2	8.8
Adjusted profit margin	1.4	4.3	4.2	4.3	5.6
Adjusted ROAE	3.6	11.4	13.0	12.9	17.1
ROCE	5.7	8.5	8.4	9.6	14.0
<b>Working capital days (days)</b>					
Receivables	79	55	40	41	42
Inventory	105	99	68	69	69
Payables	46	45	40	42	41
<b>Ratios (x)</b>					
Gross asset turnover	1.9	1.8	2.1	2.2	2.5
Current ratio	1.2	1.1	1.0	1.1	1.3
Net interest coverage ratio	1.4	3.2	4.8	5.1	8.8
Adjusted debt/equity	0.8	0.4	0.5	0.3	0.2

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

## Disclaimer

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

**BUY** – Expected return >+15%

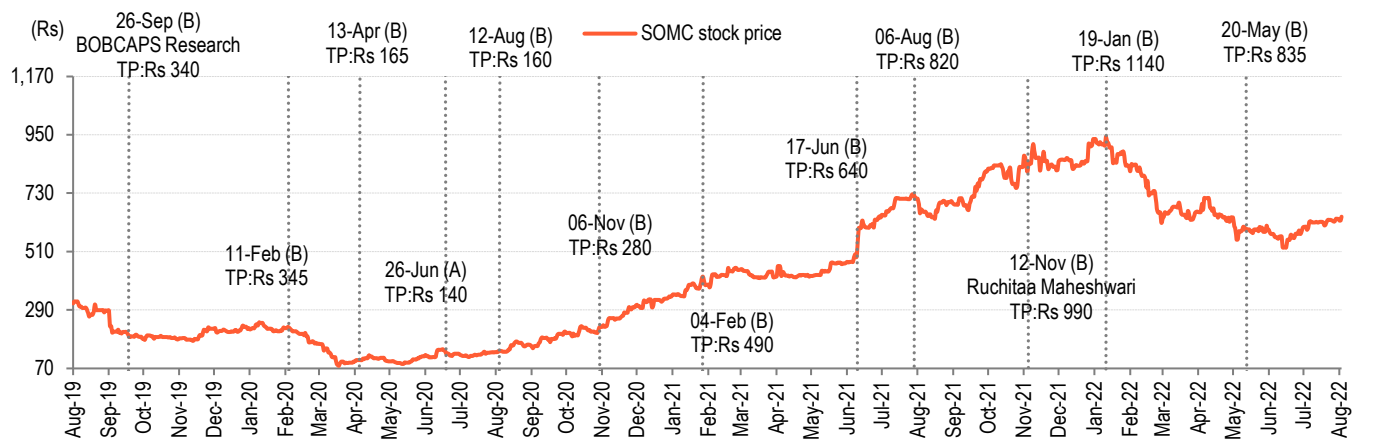
**HOLD** – Expected return from -6% to +15%

**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): SOMANY CERAMICS (SOMC IN)



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

### Rating distribution

As of 31 July 2022, out of 119 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 71 have BUY ratings, 26 have HOLD ratings, 5 are rated ADD\*, 1 is rated REDUCE\* and 16 are rated SELL. Of these, 2 companies rated BUY and 1 rated ADD 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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