

BUY

TP: Rs 3,040 | ▲ 25%

CERA SANITARYWARE

Construction Materials

14 November 2019

Weak product mix crimps margins

Cera Sanitaryware (CRS) reported tepid Q2FY20 standalone revenue of Rs 3.3bn (-1.1% YoY), with the sanitaryware segment contracting 9% YoY. Operating margins declined 105bps YoY to 12.7% as gross margins slipped 60bps and employee expense climbed 50bps YoY. EBITDA/PBT thus decreased 9%/16% YoY. Management expects a better H2 despite the challenging demand environment. We cut FY20-FY22 earnings estimates by 6-9% and roll forward to a revised Sep'20 TP of Rs 3,040 (earlier Rs 3,135).

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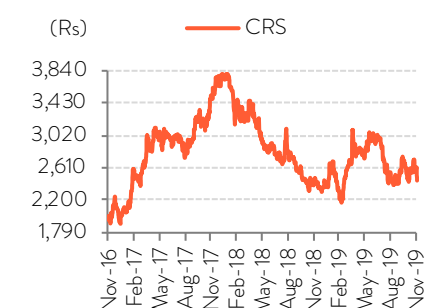
Revenue decline led by sanitaryware segment: CRS reported a 1.1% YoY decrease in standalone revenue to Rs 3.3bn in Q2. The sanitaryware segment fell 9% YoY whereas faucets/tiles grew ~6%/5% YoY. As per management, revenue performance was undermined by a lacklustre demand climate. Management nonetheless expects some improvement in H2 over H1 due to the company's strong branding, distribution and product portfolio.

Ticker/Price	CRS IN/Rs 2,440
Market cap	US\$ 441.5mn
Shares o/s	13mn
3M ADV	US\$ 0.3mn
52wk high/low	Rs 3,195/Rs 2,144
Promoter/FPI/DII	55%/8%/37%

Source: NSE

Margins contract on weak product mix: CRS's standalone operating margins declined 105bps YoY to 12.7% due to lower gross margins (-60bps YoY) and higher employee expenses (+50bps YoY) – this caused EBITDA/PBT to contract 8.7%/15.5% YoY. Gross margin slippage stemmed from an adverse product mix marked by a reduced share of high-margin sanitaryware products. Management aims to maintain operating margins in the region of 14-15% over the medium term.

STOCK PERFORMANCE



Source: NSE

Maintain BUY: We trim PAT estimates for FY20-FY22 by 6-9% due to the difficult demand environment. Maintain BUY as we roll to a revised Sep'20 target price of Rs 3,040 (earlier Rs 3,135), set at unchanged 26x one-year forward P/E.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	11,776	13,444	14,016	15,391	17,047
EBITDA (Rs mn)	1,699	1,917	1,920	2,155	2,421
Adj. net profit (Rs mn)	970	1,010	1,233	1,418	1,622
Adj. EPS (Rs)	74.6	77.7	94.8	109.1	124.7
Adj. EPS growth (%)	0.9	4.1	22.0	15.1	14.4
Adj. ROAE (%)	17.2	15.5	16.4	16.5	16.5
Adj. P/E (x)	32.7	31.4	25.7	22.4	19.6
EV/EBITDA (x)	18.5	16.2	16.2	14.5	12.8

Source: Company, BOBCAPS Research

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FIG 1 – STANDALONE QUARTERLY PERFORMANCE

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
Total revenues	3,272	3,310	(1.1)	2,674	22.4
Total raw material consumed	1,595	1,593	0.2	1,231	29.6
% of sales	48.8	48.1	63bps	46.0	272bps
Employee exps	407	394	3.2	399	2.0
% of sales	12.4	11.9	52bps	14.9	(249bps)
Other exp	854	867	(1.5)	692	23.5
% of sales	26.1	26.2	(9bps)	25.9	23bps
Total expenditure	2,856	2,854	0.1	2,321	23.0
% of sales	87	86.2	106bps	86.8	46bps
EBITDA	416	456	(8.7)	352	18.1
% of sales	12.7	13.8	(106bps)	13.2	(46bps)
Depreciation	79	56	41.5	77	3.3
Other income	41	40	2.8	29	39.6
Interest cost	10	5	105.3	11	(9.5)
PBT	367	434	(15.5)	293	25.2
Taxes	67	153	(56.4)	102	(34.9)
Effective tax rate (%)	18.2	35.2	(1,703bps)	34.9	(1,676bps)
APAT	300	281	6.7	191	57.4

Source: Company, BOBCAPS Research

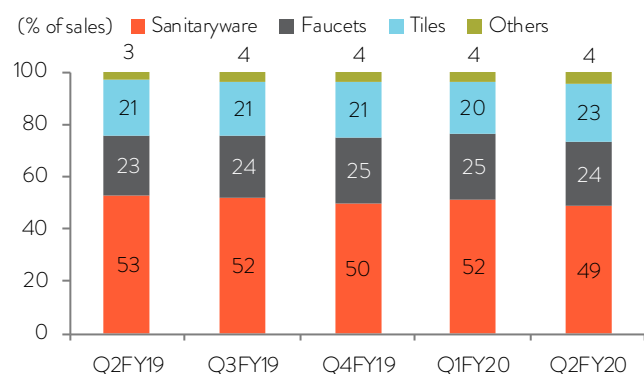
FIG 2 – CONSOLIDATED QUARTERLY PERFORMANCE

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
Total revenues	3,294	3,324	(0.9)	2,712	21.5
Total raw material consumed	1,491	1,479	0.8	1,146	30.1
% of sales	45.6	44.7	86bps	42.8	270bps
Employee exps	421	406	3.7	411	2.4
% of sales	12.9	12.3	60bps	15.4	(252bps)
Other exp	952	961	(0.9)	803	18.6
% of sales	29.1	29.0	7bps	30.0	(92bps)
Total expenditure	2,864	2,846	0.6	2,359	21.4
% of sales	87.5	86.0	153bps	88.3	(74bps)
EBITDA	431	478	(10.0)	353	22.1
% of sales	13.2	14.4	(129bps)	13.2	(3bps)
Depreciation	95	69	38.2	91	4.5
Other income	47	46	1.7	33	44.5
Interest cost	24	18	37.0	25	(4.0)
PBT	358	438	(18.2)	269	33.3
Taxes	63	149	(57.5)	97	(34.8)
Effective tax rate (%)	17.7	34.1	(1,639bps)	36.2	(1,849bps)
APAT	295	289	2.1	172	71.9
Less: Minority interest	(3)	4	NA	(9)	NA
Add: share of profit in associate	(2.05)	0.07	NA	0.03	NA
RPAT	296	285	3.6	181	63

Source: Company, BOBCAPS Research

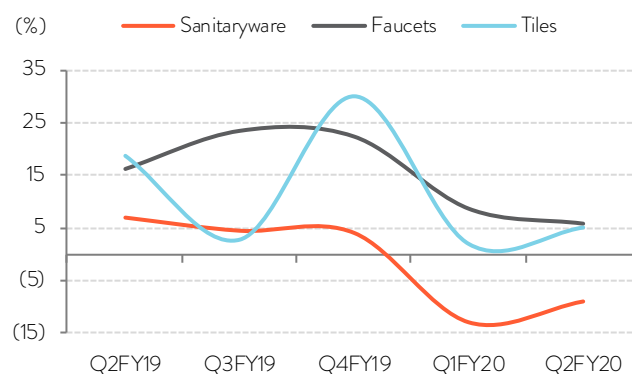
STANDALONE QUARTERLY TRENDS

FIG 3 – REVENUE BREAKUP



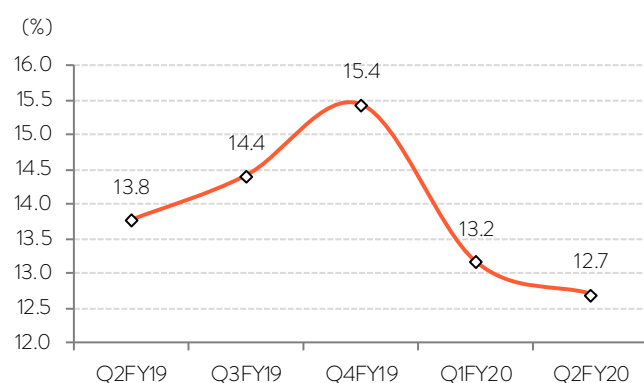
Source: Company, BOBCAPS Research

FIG 4 – SEGMENTAL GROWTH



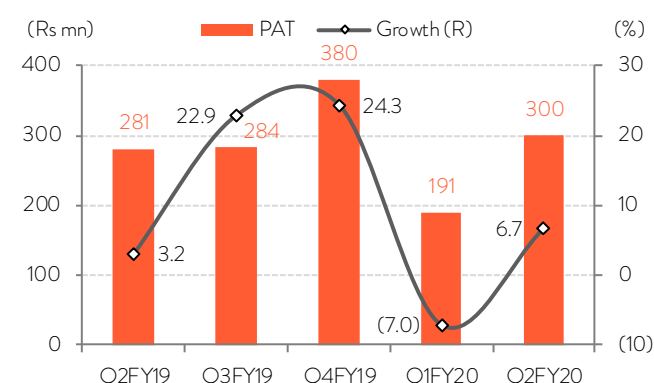
Source: Company, BOBCAPS Research

FIG 5 – EBITDA MARGIN



Source: Company, BOBCAPS Research

FIG 6 – PAT GROWTH YOY



Source: Company, BOBCAPS Research

Earnings call highlights

- Demand conditions in Q2FY20 were difficult as customers continued to defer purchases. Several dealers moved to just-in-time inventory management as retailers faced a liquidity crunch during the quarter.
- About 72% of CRS’s revenues are derived from the dealer network and the balance from institutional sales.
- Management expects a demand pickup from H2FY20 as the company has a sizeable presence in the affordable housing market which continues to do well and remains a focus area of the government.
- The company is targeting 12-15% revenue growth and operating margins of 14-15% over the medium term, aided by strong branding, wide distribution reach and a large product portfolio.

- Revenue share of the tiles segment is targeted to be maintained at ~20% of total turnover over the medium term and sanitaryware segment at ~50%.
- Value-added tile sales now account for ~80% of total tiles turnover.
- Senator, Jeet and ISEVA brands together form less than ~Rs 500mn of turnover on an annual basis.
- The company is steadily expanding its product range and now has 360 SKUs in sanitaryware and 882 in faucetware.
- Its distribution network comprises close to 3,300 dealers and 11,300+ retailers.
- The top 100 dealers account for 37% of turnover and top 500 dealers 67%.
- Capex planned for FY20 totals ~Rs 560mn, of which ~Rs 190mn has been spent in H1FY20. Cash & cash equivalents on the books totalled ~Rs 2bn as of 30 June.

Valuation methodology

CRS is the third largest organised sanitaryware player in India with 21-22% organised market share. Over the years, the company has expanded its product portfolio from sanitaryware to tiles, faucets and wellness goods, to become a one-stop bathroom solution provider.

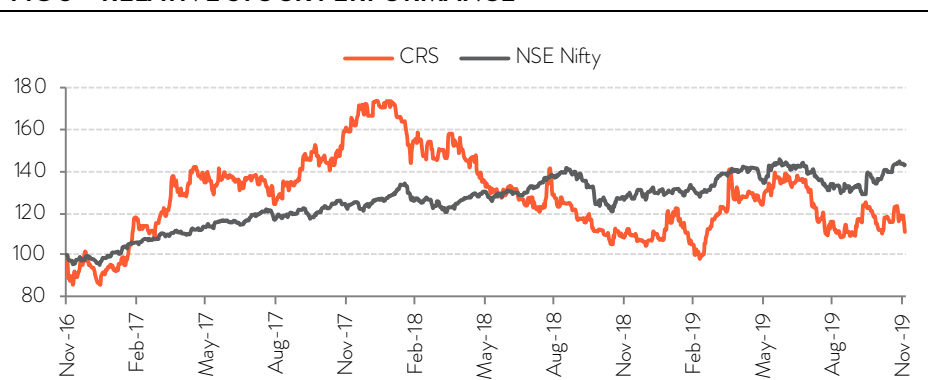
Due to a tepid H1FY20 and continued demand challenges, we reduce our PAT estimates for FY20-FY22 by 6-9%. Rolling valuations forward, we move to a revised Sep'20 target price of Rs 3,040 (earlier Rs 3135), set at unchanged 26x one-year forward P/E. Maintain BUY.

FIG 7 – REVISED ESTIMATES

(Rs mn)	Old			New			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	14,369	15,762	17,440	14,016	15,391	17,047	(2.5)	(2.4)	(2.3)
EBITDA	2,069	2,270	2,546	1,920	2,155	2,421	(7.2)	(5.1)	(4.9)
PAT	1,354	1,517	1,724	1,233	1,418	1,622	(8.9)	(6.5)	(5.9)

Source: Company, BOBCAPS Research

FIG 8 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Sharp rise in raw material prices:** CRS's key raw material is natural gas and any sharp increase in prices may affect near-term profitability.
- **Increased competition from unorganised players:** All of CRS's business segments have a large unorganised presence (~50% of the total market). An inability to compete effectively may affect the company's profitability.
- **Prolonged slowdown in housing market:** A continued slowdown in the housing market would hit growth prospects.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	11,776	13,444	14,016	15,391	17,047
EBITDA	1,699	1,917	1,920	2,155	2,421
Depreciation	(271)	(280)	(373)	(408)	(451)
EBIT	1,428	1,637	1,548	1,747	1,969
Net interest income/(expenses)	(98)	(85)	(75)	(61)	(64)
Other income/(expenses)	129	110	171	197	244
Exceptional items	90	141	0	0	0
EBT	1,459	1,662	1,644	1,883	2,149
Income taxes	(488)	(652)	(414)	(474)	(542)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	(1)	0	3	10	15
Reported net profit	1,061	1,151	1,233	1,418	1,622
Adjustments	(90)	(141)	0	0	0
Adjusted net profit	970	1,010	1,233	1,418	1,622

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	944	1,109	1,075	1,181	1,308
Other current liabilities	1,840	1,979	1,997	2,193	2,429
Provisions	201	365	210	231	256
Debt funds	962	906	590	700	650
Other liabilities	391	436	436	436	436
Equity capital	65	65	65	65	65
Reserves & surplus	5,991	6,944	7,952	9,107	10,425
Shareholders' fund	6,056	7,009	8,018	9,172	10,490
Total liabilities and equities	10,461	11,908	12,426	14,003	15,644
Cash and cash eq.	327	193	25	33	231
Accounts receivables	2,680	2,984	2,918	3,205	3,550
Inventories	1,935	2,158	2,150	2,361	2,615
Other current assets	782	747	806	886	981
Investments	1,086	1,779	2,250	3,000	3,500
Net fixed assets	3,584	3,840	4,067	4,310	4,559
CWIP	52	195	195	195	195
Intangible assets	13	13	13	13	13
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	10,461	11,908	12,426	14,003	15,644

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	1,332	1,431	1,605	1,826	2,074
Interest expenses	98	85	75	61	64
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(648)	(22)	(158)	(254)	(306)
Other operating cash flows	(3)	45	0	0	0
Cash flow from operations	778	1,540	1,522	1,633	1,832
Capital expenditures	(470)	(678)	(600)	(650)	(700)
Change in investments	(215)	(693)	(471)	(750)	(500)
Other investing cash flows	(64)	(10)	(3)	(10)	(15)
Cash flow from investing	(749)	(1,381)	(1,074)	(1,410)	(1,215)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	124	(56)	(316)	110	(50)
Interest expenses	(98)	(85)	(75)	(61)	(64)
Dividends paid	(188)	(188)	(221)	(254)	(289)
Other financing cash flows	(107)	36	(3)	(10)	(15)
Cash flow from financing	(268)	(293)	(615)	(215)	(418)
Changes in cash and cash eq.	(239)	(134)	(168)	8	198
Closing cash and cash eq.	327	193	25	33	231

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	81.5	88.5	94.8	109.1	124.7
Adjusted EPS	74.6	77.7	94.8	109.1	124.7
Dividend per share	12.0	13.0	14.2	16.2	18.5
Book value per share	465.7	538.9	616.5	705.3	806.6

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.7	2.3	2.2	2.0	1.8
EV/EBITDA	18.5	16.2	16.2	14.5	12.8
Adjusted P/E	32.7	31.4	25.7	22.4	19.6
P/BV	5.2	4.5	4.0	3.5	3.0

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	62.6	56.0	75.0	75.3	75.5
Interest burden (PBT/EBIT)	108.5	110.1	106.2	107.8	109.1
EBIT margin (EBIT/Revenue)	12.1	12.2	11.0	11.4	11.6
Asset turnover (Revenue/Avg TA)	116.2	120.2	115.2	116.5	115.0
Leverage (Avg TA/Avg Equity)	1.8	1.7	1.6	1.5	1.5
Adjusted ROAE	17.2	15.5	16.4	16.5	16.5

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	17.0	14.2	4.3	9.8	10.8
EBITDA	(1.1)	12.8	0.2	12.2	12.3
Adjusted EPS	0.9	4.1	22.0	15.1	14.4
Profitability & Return ratios (%)					
EBITDA margin	14.4	14.3	13.7	14.0	14.2
EBIT margin	12.1	12.2	11.0	11.4	11.6
Adjusted profit margin	8.2	7.5	8.8	9.2	9.5
Adjusted ROAE	17.2	15.5	16.4	16.5	16.5
ROCE	14.7	13.8	13.8	14.0	13.9
Working capital days (days)					
Receivables	76	77	77	73	72
Inventory	121	123	123	118	117
Payables	32	33	33	31	31
Ratios (x)					
Gross asset turnover	2.5	2.6	2.5	2.5	2.5
Current ratio	1.6	1.5	1.6	1.6	1.7
Net interest coverage ratio	14.6	19.2	20.7	28.5	30.7
Adjusted debt/equity	0.1	0.1	0.1	0.1	0.0

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

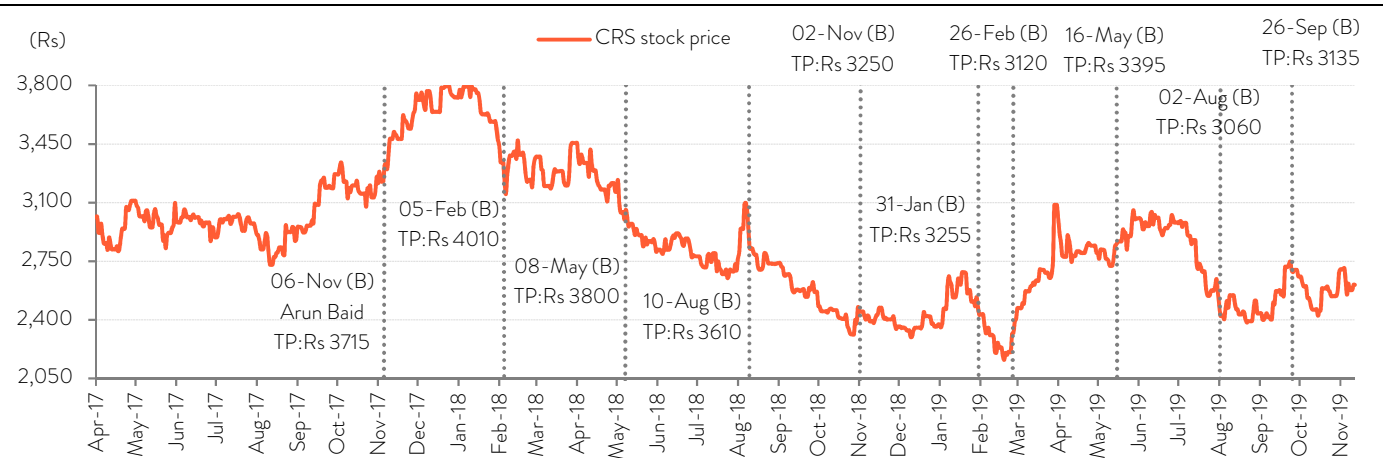
ADD – Expected return from >+5% to +15%

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: CERA SANITARYWARE (CRS IN)



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

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