

HOLD

TP: Rs 5,225 | ▼ 1%

CERA SANITARYWARE

Construction Materials

09 November 2022

Steady demand trends

- Consolidated Q2 revenue grew 3% YoY aided by demand from home renovation and upgrade projects
- EBITDA margin expanded 105bps YoY to 16.3% on a favourable mix and lower costs, with EBITDA up 10% to Rs 679mn
- Retain TP at Rs 5,225 (32x FY24E EPS) and maintain HOLD

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Modest rise in consolidated revenue: CRS's consolidated Q2FY23 revenue increased 3% YoY (+5% QoQ) to Rs 4.2bn on the back of demand for home upgrades and renovations. Standalone revenue grew 5% YoY (+5% QoQ) to Rs 4.1bn, with sanitaryware up 10% and faucetware up 7%. In the wake of softening raw material costs, the company took a price cut during Q2 in its new premium products (36% revenue share) with a view to gaining market share. Management retained guidance of doubling revenue within 3.5 years and achieving 50-75bps EBITDA margin expansion every year.

Better mix and lower cost drive margin gains: Consolidated gross margin increased 250bps YoY to 56% led by sweating of assets and lower raw material cost. EBITDA margin improved 105bps YoY (+50bps QoQ) to 16.3% as higher revenue contribution from the sanitaryware and faucetware segments (88% in Q2FY23 vs. 86% in Q2FY22) offset an increase in employee cost (+120bps YoY) from the company's capacity expansion spree. Standalone gross margin rose 525bps YoY to 56% and EBITDA margin was up 120bps to 16%.

Stable gas cost: In Q2, 54% of CRS's gas requirement was met by GAIL where prices remained at Rs 25.72/cbm (Rs 25.69/cbm in Q1FY23, Rs 11.13 in FY22). The balance 46% was met via Sabarmati Gas where prices stood at Rs 75.38/cbm (Rs 73.58/cbm in Q1FY23, Rs 59.46 in FY22). The weighted average price was at Rs 48.56/scm in Q2FY23 vs. Rs 32.93 in FY22. Gas cost is just 3.1% of the company's topline.

Strong prospects but priced in: The recent capacity debottlenecking and 40-50% expansion announced (to commence in 12-36 months) would lead the next leg of growth. Overall, we believe CRS's timely expansion plan, focus on product mix improvement, extensive distribution, healthy balance sheet and rising return ratios bode well for sustainable earnings growth. However, the positives appear priced in at current valuations of 32x FY24E EPS. We retain our TP of Rs 5,225, set at 32x FY24E EPS – a 12.5% discount to the stock's 5Y median of 36x – and maintain HOLD. Any weakness in stock price can be used as an opportunity to enter.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	CRS IN/Rs 5,256
Market cap	US\$ 838.4mn
Free float	46%
3M ADV	US\$ 1.1mn
52wk high/low	Rs 5,955/Rs 3,515
Promoter/FPI/DII	54%/18%/28%

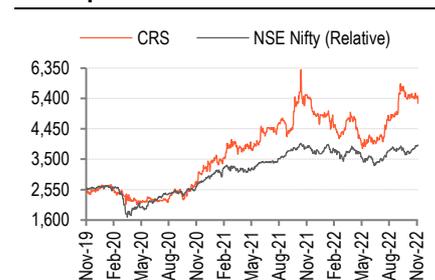
Source: NSE | Price as of 9 Nov 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	14,458	16,850	19,634
EBITDA (Rs mn)	2,287	2,694	3,202
Adj. net profit (Rs mn)	1,568	1,802	2,124
Adj. EPS (Rs)	120.6	138.5	163.3
Consensus EPS (Rs)	120.6	135.4	158.4
Adj. ROAE (%)	16.6	16.7	17.5
Adj. P/E (x)	43.6	37.9	32.2
EV/EBITDA (x)	29.6	25.2	21.4
Adj. EPS growth (%)	55.6	14.9	17.9

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Earnings call highlights

- **Guidance maintained:** Management maintained its guidance of doubling revenue within three-and-a-half years and achieving 50-75bps expansion in EBITDA margin every year. Growth is expected to come from new product introductions as no price hikes are on the cards in the near term given softening raw material costs.
- **Enhanced faucetware capacity:** CRS's programme to take faucetware capacity to 400,000 pieces per month commenced in Jul'22 and is scheduled to go onstream in Jul'23, with ramp up to full production in FY24. Requisite approvals from the Gujarat government are in place. The total project cost is Rs 690mn (building and civil work: Rs 370mn, equipment and plant: Rs 275mn, and electrical substations Rs 75mn) and will be funded entirely from operating cash flows. The facility will largely be used to produce higher priced coloured/painted products which are in greater demand than chrome-based products. The faucets facility is guided to have an asset turnover of 2.5-3x.
- **New sanitaryware capacity:** The greenfield sanitaryware capacity will cost ~Rs 1.3bn and take 24-30 months to commence after finalisation of land, water and gas supply, among others, with due diligence underway. CRS hopes to finalise the land parcel before Mar'23 (expected cost of Rs 250mn). The plant is guided to have an asset turnover of 1.5-2x.
- **Revenue mix:** Sanitaryware contributed 54% of Q2FY23 revenue (52% in Q2FY22/54% in Q1FY23), faucetware 34% (34%/35%), tiles 10% (12%/10%) and wellness 2% (2%/1%). Sanitaryware and faucetware together formed 88% of the topline in Q2FY23 vs. 86% in Q2FY22.

Fig 1 – Product contribution by price category

(%)	Q2FY23	Q1FY23	FY22
Entry	27.0	27.0	30.0
Mid	30.0	30.0	28.0
Premium	43.0	43.0	42.0

Source: Company, BOBCAP Research

- **Input cost:** During Q2FY23, CRS witnessed stable raw material cost with a downward bias in both the sanitaryware and faucetware segments. It therefore did not hike prices in Q2. In sanitaryware, key raw materials such as China clay, plaster of paris, etc (95% of input cost) declined 16% during Q2. Faucetware saw declines in zamac (from Rs 371/t to Rs 317/t, a saving of Rs 3mn) and brass (from Rs 545/t to Rs 495/t, a saving of Rs 38.2mn) in Q2.
- **Utilisation:** CRS intends to continue focusing on outsourcing and will only make high-end, value-added products at its own facilities. During Q2, capacity utilisation at the sanitaryware (~115%) and faucetware (~116%) plants was at optimal levels. Management has guided for utilisation to remain at similar levels in FY23. Production in faucetware (inhouse plus outsourcing) totalled 290,000 pieces in Sep'22 vs. 218,000 pieces per month in FY22 and 125,000 pieces per month in FY21, signaling strong demand.

- **China outsourcing:** CRS's imports and outsourcing through China have reduced as the company has been able to manufacture in-house and meet domestic requirements through small production batches. In H1FY23, its imports from China totalled ~Rs 277mn or 3.4% of sales. For FY22, this figure was at Rs 679mn or 4.7% of sales vs. Rs 572mn or 4.8% for FY21.
- **Domestic outsourcing:** During Q2FY23, the inhouse/outsourced production mix was at 40%/60% in sanitaryware (41%/59% in Q2FY22) and 48%/52% in faucetware (43%/57%). Management expects the contribution from in-house manufacturing to increase going forward due to a better product mix.
- **A&P spends:** A&P normally hovers at 3.5% of total revenue, but the company indicated a possible rise to ~5% in FY23.
- **SKU:** CRS currently has 518 SKUs (stock keeping units) in sanitaryware and 994 in faucetware.
- **Capex:** CRS has cash worth Rs 5.73bn as of Q2FY23 vs. Rs 4.85bn in Q2FY22. The company has planned capex (other than capacity expansion) worth ~Rs 2.5bn in FY23 which includes Rs 770mn/Rs 640mn for sanitaryware/faucetware automation plants, Rs 660mn for land purchase for the sanitaryware plant, and ~Rs 400mn in routine capex. The balance planned capex for sanitaryware will be incurred in FY24 as approvals would take time after land acquisition. According to management, internal accruals would be adequate to fund these plans with no requirement to raise debt or dilute equity.
- **Working capital cycle:** Management expects the working capital cycle to increase in coming quarters due to growing demand and the need to rebuild inventory. Inventory days rose to 81 in Q2FY23 vs. 60 days in Q2FY22. Receivable days stood at 26 vs. 36 and payable days at 36 vs. 35 in the year-ago quarter. Net working capital days were at 71 vs. 61 days in Q2FY22.

Fig 2 – Consolidated quarterly performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Total revenues	4,159	4,033	3.1	3,972	4.7	8,131	6,315	28.8
Total raw material consumed	1,838	1,881	(2.3)	1,847	(0.5)	3,685	2,817	30.8
% of sales	44.2	46.6	(247bps)	46.5	(232bps)	45.3	44.6	71bps
Employee expenses	556	491	13.3	497	11.9	1,053	937	12.4
% of sales	13.4	12.2	120bps	12.5	86bps	13.0	14.8	(188bps)
Other exp	1,086	1,045	4.0	1,000	8.7	2,086	1,737	20.1
% of sales	26.1	25.9	21bps	25.2	95bps	25.7	27.5	(185bps)
Total expenditure	3,480	3,416	1.9	3,344	4.1	6,824	5,490	24.3
% of sales	83.7	84.7	(105bps)	84.2	(51bps)	83.9	86.9	(302bps)
EBITDA	679	616	10.2	628	8.1	1308	824	58.6
EBITDA margin (%)	16.3	15.3	105bps	15.8	51bps	16.1	13.1	302bps
Depreciation	82	92	(10.9)	75	9.7	157	181	(13.0)
Other income	106	79	33.3	(6)	(1786.3)	99	145	(31.3)
Interest cost	14	20	(29.0)	11	27.6	25	41	(39.1)
PBT	688	583	18.1	536	28.5	1224	747	63.9
Taxes	177	143	23.7	137	29.0	314	192	64.2
Effective tax rate (%)	25.7	24.6	117bps	25.6	11bps	25.7	25.6	4bps
PAT before minority interest/associates	511	440	16.2	399	28.3	910	555	63.8
Less: extraordinary profit/(loss)	0	0	-	0	-	(57)	0	-
Less: Minority interest	3.9	9.6	(58.9)	3.8	4.2	7.7	3.1	147.6
Add: Share of profit in associate	0.0	0.1	(100.0)	0.0	-	0.0	0.2	(100.0)
RPAT	507	430	17.9	395	28.5	845	553	52.9

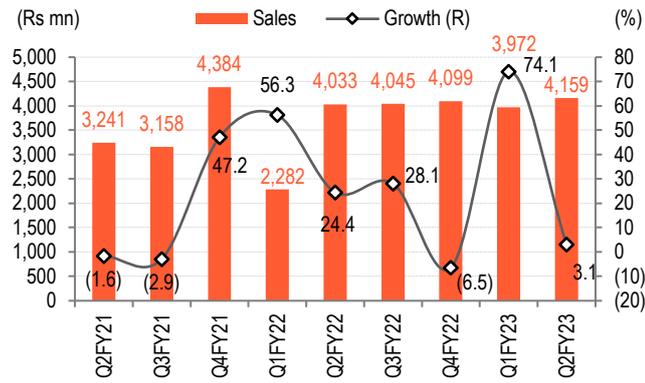
Source: Company, BOBCAPS Research

Fig 3 – Standalone quarterly performance

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
Total revenues	4,143	3,932	5.3	3,958	4.7	8,100	6,161	31.5
Total raw material consumed	1,832	1,944	(5.8)	1,832	0.0	3,664	2,930	25.1
% of sales	44.2	49.4	(523bps)	46.3	(209bps)	45.2	47.6	(232bps)
Employee expenses	548	474	15.4	489	11.9	1,037	905	14.6
% of sales	13.2	12.1	116bps	12.4	86bps	12.8	14.7	(189bps)
Other exp	1,103	935	18.0	1,024	7.7	2,127	1,549	37.4
% of sales	26.6	23.8	286bps	25.9	74bps	26.3	25.1	112bps
Total expenditure	3,482	3,353	3.8	3,346	4.1	6,828	5,383	26.8
% of sales	84	85	(122bps)	85	(49bps)	84	87	(308bps)
EBITDA	660	579	14.0	612	8.0	1272	777	63.6
EBITDA margin (%)	15.9	14.7	122bps	15.5	49bps	15.7	12.6	308bps
Depreciation	77.1	76.1	1.3	69.9	10.3	146.9	148.9	(1.3)
Other income	109.5	69.7	57.1	(2.7)	(4226.5)	106.9	127.2	(16.0)
Interest cost	12.7	10.3	23.6	9.4	34.8	22.1	20.7	6.7
PBT	680	562	20.9	530	28.4	1210	735	64.6
Taxes	173.1	141.6	22.3	133.3	29.9	306.4	185.0	65.6
Effective tax rate (%)	25.4	25.2	28bps	25.2	28bps	25.3	25.2	16bps
APAT	507	421	20.5	396	28.0	903	550	64.2
Less: Extraordinary items	0	0	-	0	-	0	0	-
RPAT	507	421	20.5	396	28.0	903	550	64.2

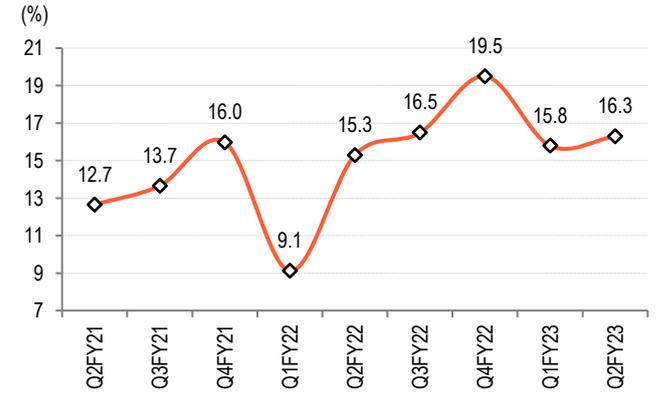
Source: Company, BOBCAPS Research

Fig 4 – Consolidated revenue growth



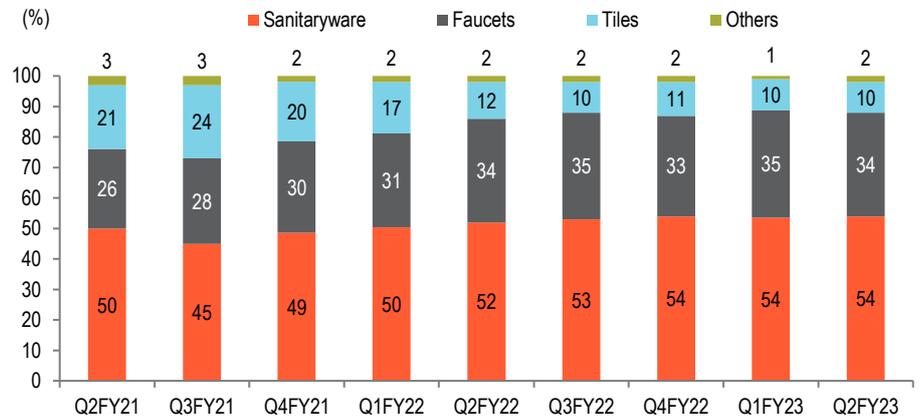
Source: Company, BOBCAPS Research

Fig 5 – EBITDA margin trend



Source: Company, BOBCAPS Research

Fig 6 – Segmental revenue contribution



Source: Company, BOBCAPS Research

Valuation methodology

CRS remains focused on tier-2/3 markets where it faces limited competition, enabling it to maintain pricing power. About 70% of the company's sales are from the retail channel while the balance is from institutions, which supports a healthy gross margin of ~55%.

We believe CRS is in a sweet spot given sustained growth in its bathroom solutions segment backed by (a) market share gains across the product portfolio from import substitution in the sanitaryware and faucet segments, (b) a sizeable shift in demand from the unorganised to organised sector, and (c) demand pickup in the housing sector (new construction and replacement). The recent capacity debottlenecking and 40-50% expansion announced (to commence in 12-36 months) would lead the next leg of growth.

Overall, we believe CRS's timely expansion plan, focus on product mix improvement, extensive distribution, healthy balance sheet and rising return ratios bode well for sustainable earnings growth. However, the positives appear priced in at current valuations of 32x FY24E EPS. We retain our TP of Rs 5,225, set at 32x FY24E EPS – a 12.5% discount to the stock's five-year median of 36x – and maintain HOLD. Any weakness in stock price can be used as an opportunity to enter.

Key risks

Key upside risks to our estimates are:

- significant correction in input prices which may expand profitability,
- strong demand in real estate demand,
- faster economic revival, and
- slower offtake from new competitors.

Key downside risks are:

- Slowdown in demand from housing market,
- continuous higher input prices, which may dent demand / profitability

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Century Plyboards	CPBI IN	1.6	586	735	BUY
Cera Sanitaryware	CRS IN	0.8	5,256	5,225	HOLD
Greenpanel Industries	GREENP IN	0.6	382	595	BUY
Greenply Industries	MTLM IN	0.2	164	215	BUY
Kajaria Ceramics	KJC IN	2.0	1,039	1,325	BUY
Pidilite Industries	PIDI IN	16.5	2,652	1,870	SELL
Somany Ceramics	SOMC IN	0.3	541	830	BUY

Source: BOBCAPS Research, NSE | Price as of 9 Nov 2022

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Total revenue	12,220	12,243	14,458	16,850	19,634
EBITDA	1,654	1,581	2,287	2,694	3,202
Depreciation	(388)	(396)	(324)	(408)	(486)
EBIT	1,266	1,185	1,963	2,286	2,716
Net interest inc./(exp.)	(101)	(97)	(53)	(70)	(62)
Other inc./(exp.)	65	252	236	222	220
Exceptional items	119	0	(57)	0	0
EBT	1,230	1,339	2,147	2,438	2,874
Income taxes	(243)	(340)	(560)	(636)	(750)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	27	9	(18)	0	0
Reported net profit	1,133	1,008	1,511	1,802	2,124
Adjustments	(119)	0	57	0	0
Adjusted net profit	1,013	1,008	1,568	1,802	2,124

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	953	1,554	1,335	1,616	1,883
Other current liabilities	2,102	2,186	2,968	3,001	3,496
Provisions	136	171	114	236	275
Debt funds	919	729	452	400	350
Other liabilities	299	303	354	386	418
Equity capital	65	65	65	65	65
Reserves & surplus	7,642	8,652	10,086	11,348	12,834
Shareholders' fund	7,707	8,717	10,152	11,413	12,899
Total liab. and equities	12,194	13,777	15,517	17,193	19,464
Cash and cash eq.	125	104	149	938	1,324
Accounts receivables	2,228	2,095	1,648	2,308	2,690
Inventories	2,430	1,997	2,937	3,001	3,496
Other current assets	737	670	1,785	1,293	1,506
Investments	2,283	4,743	5,621	5,500	5,500
Net fixed assets	4,373	4,147	3,362	4,139	4,933
CWIP	5	13	7	7	7
Intangible assets	12	8	8	8	8
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	12,194	13,777	15,517	17,193	19,464

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Cash flow from operations	1,517	2,858	838	2,516	2,415
Capital expenditures	(450)	(140)	468	(1,186)	(1,280)
Change in investments	(504)	(2,460)	(879)	121	0
Other investing cash flows	(45)	5	25	0	0
Cash flow from investing	(999)	(2,595)	(386)	(1,065)	(1,280)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	13	(191)	(277)	(52)	(50)
Interest expenses	(101)	(97)	(53)	(70)	(62)
Dividends paid	(396)	0	(153)	(541)	(637)
Other financing cash flows	(103)	5	25	0	0
Cash flow from financing	(586)	(283)	(457)	(663)	(749)
Chg in cash & cash eq.	(68)	(20)	(6)	789	386
Closing cash & cash eq.	125	104	98	938	1,324

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	87.1	77.5	116.2	138.5	163.3
Adjusted EPS	77.9	77.5	120.6	138.5	163.3
Dividend per share	13.0	13.0	35.0	34.6	40.8
Book value per share	592.6	670.3	780.5	877.5	991.8

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	5.5	5.5	4.7	4.0	3.5
EV/EBITDA	40.9	42.8	29.6	25.2	21.4
Adjusted P/E	67.4	67.8	43.6	37.9	32.2
P/BV	8.9	7.8	6.7	6.0	5.3

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	FY23E	FY24E
Tax burden (Net profit/PBT)	75.1	75.2	75.1	73.9	73.9
Interest burden (PBT/EBIT)	106.6	113.0	106.4	106.7	105.8
EBIT margin (EBIT/Revenue)	10.4	9.7	13.6	13.6	13.8
Asset turnover (Rev./Avg TA)	101.4	94.3	98.7	103.0	107.1
Leverage (Avg TA/Avg Equity)	1.6	1.6	1.6	1.5	1.5
Adjusted ROAE	13.8	12.3	16.6	16.7	17.5

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
YoY growth (%)					
Revenue	(9.4)	0.2	18.1	16.5	16.5
EBITDA	(15.8)	(4.4)	44.7	17.8	18.8
Adjusted EPS	0.3	(0.6)	55.6	14.9	17.9
Profitability & Return ratios (%)					
EBITDA margin	13.5	12.9	15.8	16.0	16.3
EBIT margin	10.4	9.7	13.6	13.6	13.8
Adjusted profit margin	8.3	8.2	10.8	10.7	10.8
Adjusted ROAE	13.8	12.3	16.6	16.7	17.5
ROCE	12.4	9.7	14.2	14.9	15.8
Working capital days (days)					
Receivables	78	64	47	43	46
Inventory	152	129	132	142	133
Payables	36	43	43	38	39
Ratios (x)					
Gross asset turnover	2.1	2.0	2.4	2.6	2.5
Current ratio	1.5	1.2	1.4	1.5	1.6
Net interest coverage ratio	12.6	12.2	37.2	32.5	43.9
Adjusted debt/equity	0.1	0.1	0.0	0.0	(0.1)

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

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

BUY – Expected return >+15%

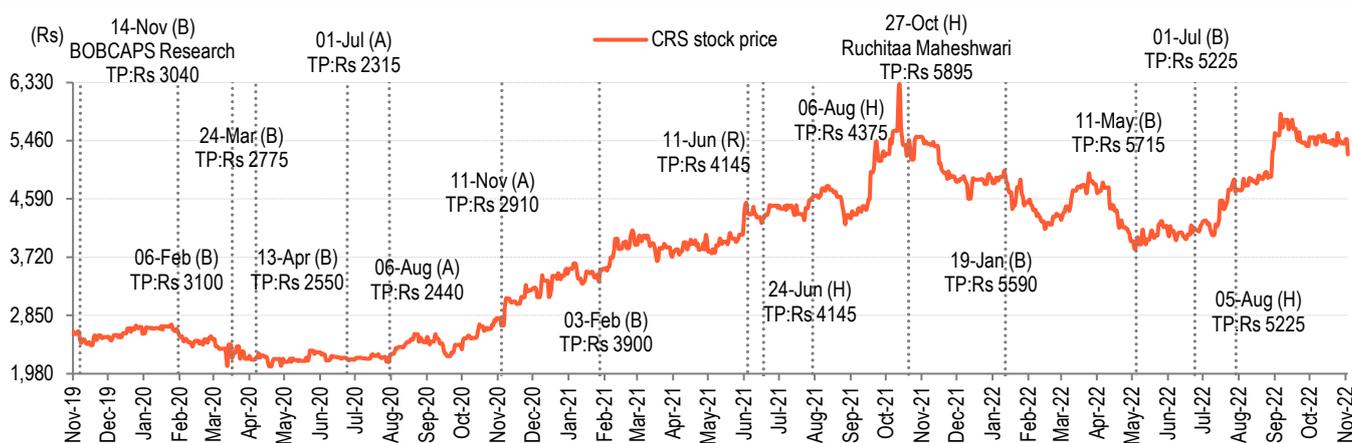
HOLD – Expected return from -6% to +15%

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): CERA SANITARYWARE (CRS IN)



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

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