

BUY

TP: Rs 640 | ▲ 25%

KAJARIA CERAMICS

Construction Materials

23 July 2019

Modest Q1; upgrade to BUY on reasonable valuations

Kajaria Ceramics (KJC) posted below-expected Q1FY20 revenue growth of 6.5% YoY, with volumes up 9.6% but realisations down 3.8%. Operating margins rose 40bps YoY to 15.1% on lower other expenses and employee costs, leading to EBITDA/adj. PAT growth of 9.5%/11.9% YoY. Management has cut its FY20 tiles volume growth guidance to 12-13% vs. 15%. We trim FY20/FY21 earnings by 4%/3% and roll over to an unchanged Jun'20 TP of Rs 640. Post the recent fall, the stock is trading at an inexpensive 23.1x FY21E P/E – upgrade from ADD to BUY.

Arun Baid

research@bobcaps.in

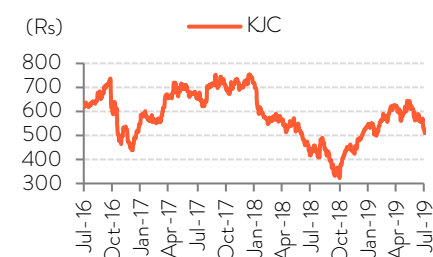
Modest revenue growth despite strong volume uptick: KJC reported revenue growth of 6.5% YoY to Rs 7bn, aided by volume growth of 9.6% whereas realisations fell 3.8%. Management has cut its FY20 volume growth guidance in the tiles segment from 15% to 12-13% due to continued tough market conditions. The sanitaryware, plywood & allied segment grew at a robust 24% YoY in Q1, and management expects sustained traction in FY20 off a low base. Working capital days expanded by ~5 days YoY to 62 during the quarter.

Ticker/Price	KJC IN/Rs 511
Market cap	US\$ 1.2bn
Shares o/s	159mn
3M ADV	US\$ 5.1mn
52wk high/low	Rs 650/Rs 310
Promoter/FPI/DII	48%/26%/26%

Source: NSE

Operating margins expand: Despite a 125bps YoY shrinkage in gross margins, EBITDA margins increased 40bps YoY to 15.1% backed by a reduction in employee/other expenses of 62bps/103bps – this supported EBITDA/adj. PAT growth of 9.5%/11.9% YoY. Gross margins slipped due to a higher proportion of outsourced sales during the quarter at 18% vs. 11% in the year-ago period. Management has guided for operating margins of 15-16% in FY20.

STOCK PERFORMANCE



Source: NSE

Valuations attractive; upgrade to BUY: We trim FY20/FY21 earnings estimates by 4%/3% to factor in lower margins; on rolling valuations forward, we have an unchanged Jun'20 TP of Rs 640, set at 28x one-year forward P/E. The stock has corrected ~13% since our downgrade in May'19 and is now trading at a reasonable 23.1x FY21E P/E, prompting us to upgrade our rating to BUY.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	2,342	2,314	2,937	3,515	4,020
Adj. EPS (Rs)	14.7	14.6	18.5	22.1	25.3
Adj. EPS growth (%)	(7.4)	(1.2)	26.9	19.7	14.4
Adj. ROAE (%)	18.5	15.8	17.4	18.2	18.2
Adj. P/E (x)	34.6	35.1	27.6	23.1	20.2
EV/EBITDA (x)	18.0	18.2	14.6	12.3	10.7

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

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



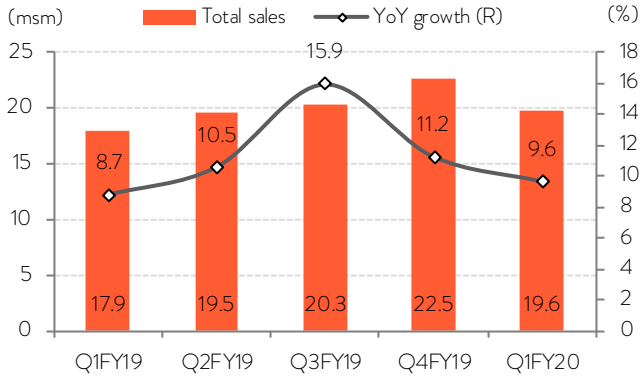
FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Net sales	7,000	6,570	6.5	8,153	(14.1)
COGS	4,148	3,812	8.8	5,002	(17.1)
Employee cost	882	869	1.5	888	(0.6)
Other expenses	910	922	(1.3)	1,034	(12.0)
EBITDA	1,060	968	9.5	1,229	(13.8)
EBITDA margin (%)	15.1	14.7	40bps	15.1	6bps
Depreciation and amortization	258	227	13.9	217	19.1
EBIT	802	741	8.1	1,013	(20.8)
EBIT margin (%)	11.5	11.3	17bps	12.4	(97bps)
Net Interest expenses	45	42	8.4	33	38.2
Other non-operating inc (exp), net	53	24	121.8	65	(19.1)
Earnings before tax	809	724	11.8	1,045.2	(22.6)
Income taxes	305	270	13.2	362	(15.7)
Earnings after tax	504	454	11.0	683	(26.2)
Extraordinary items	0	0	-	14	-
Minority interest (expense) income	(6)	(2)	215.0	9	(173.3)
Reported net income (loss)	510	456	11.9	660.0	(22.7)
APAT	510	456	11.9	674	(24.4)

Source: Company, BOBCAPS Research

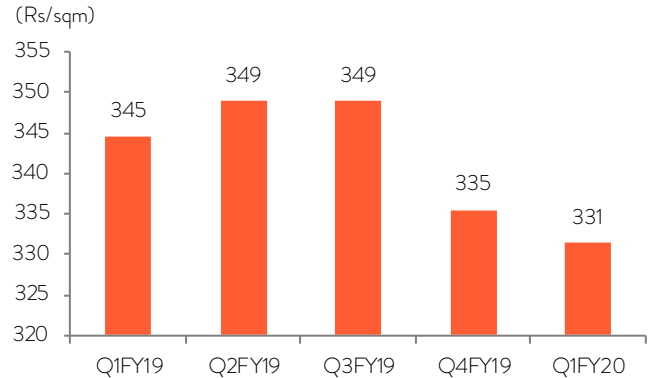
QUARTERLY TRENDS

FIG 2 – VOLUMES



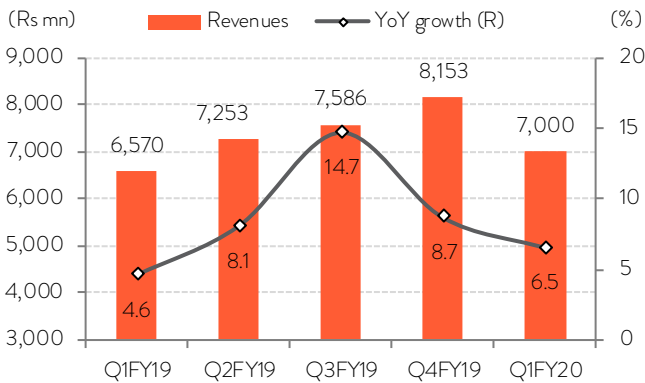
Source: Company, BOBCAPS Research

FIG 3 – NET REALISATIONS



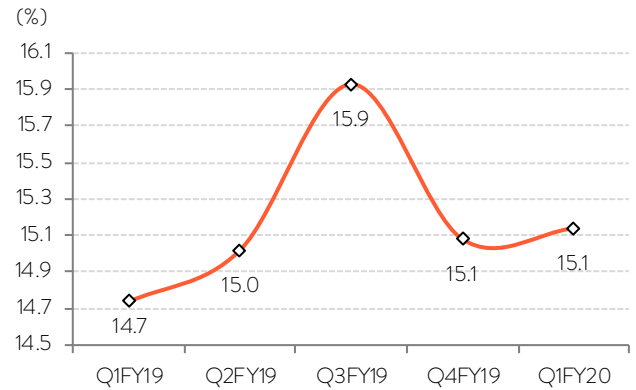
Source: Company, BOBCAPS Research

FIG 4 – REVENUES



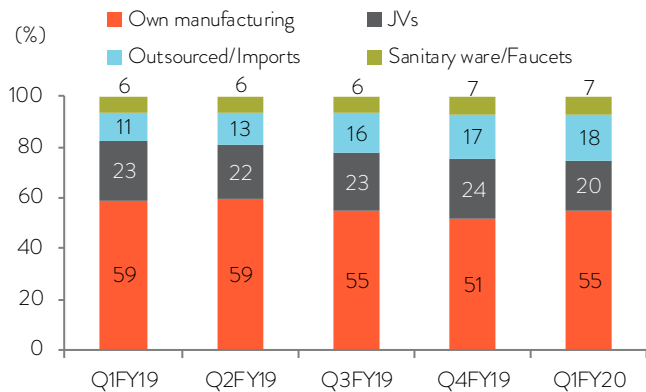
Source: Company, BOBCAPS Research

FIG 5 – EBITDA MARGIN



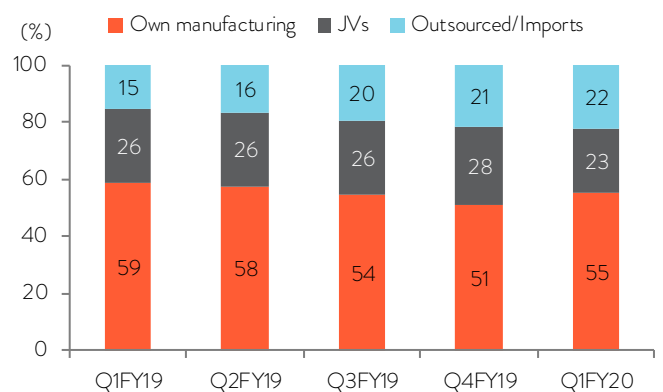
Source: Company, BOBCAPS Research

FIG 6 – REVENUE BREAKUP



Source: Company, BOBCAPS Research

FIG 7 – TILE VOLUME BREAKUP



Source: Company, BOBCAPS Research

Valuation methodology

KJC is the largest organised player in the Indian tiles market, with an organised market share of ~22% (~10.6% of the total market). Unorganised players currently comprise ~50% of the Rs 270bn tiles market. We expect the company to benefit from the gradual formalisation of demand post-GST and e-way bill implementation, especially given its strong brand, wide distribution reach and market leadership.

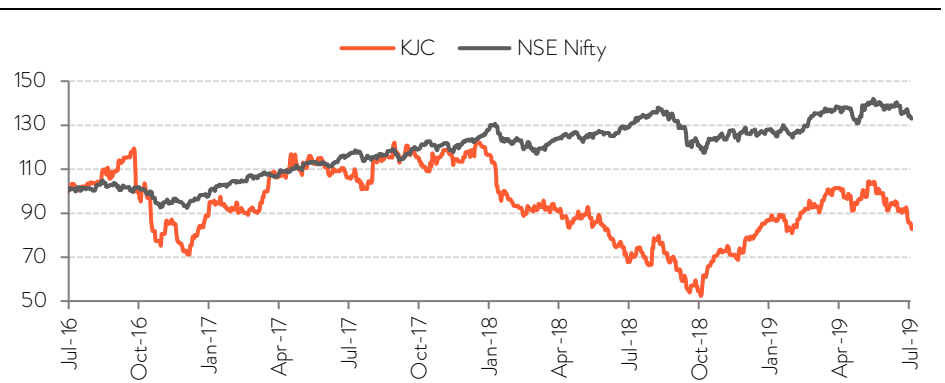
We trim FY20/FY21 earnings estimates by 4%/3% to factor in lower margins; on rolling valuations forward, we have an unchanged Jun'20 target price of Rs 640, set at 28x one-year forward P/E – in line with the stock's five-year average. KJC has corrected ~13% since our downgrade in May'19 and is now trading at a reasonable 23.1x FY21E P/E, prompting us to upgrade our rating from ADD to BUY.

FIG 8 – REVISED ESTIMATES

(Rs mn)	New		Old		Change (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	34,138	38,665	34,138	38,927	0.0	(0.7)
EBITDA	5,469	6,435	5,708	6,624	(4.2)	(2.9)
PAT	2,937	3,515	3,072	3,616	(4.4)	(2.8)

Source: Company, BOBCAPS Research

FIG 9 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Higher raw material prices:** Any abnormal increase in prices of key raw materials, such as gas, coupled with an inability to pass this along could adversely affect KJC's profitability.
- **Increased competition from informal sector:** Higher competition from the informal sector primarily based out of Morbi, Gujarat, can hurt profitability.
- **Housing market slowdown:** A slowdown in the housing market would affect demand for KJC's products.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Total revenue	27,106	29,562	34,138	38,665	43,237
EBITDA	4,564	4,495	5,469	6,435	7,318
EBIT	3,678	3,604	4,499	5,338	6,078
Net interest income/(expenses)	(241)	(156)	(123)	(91)	(52)
Other income/(expenses)	108	180	234	270	283
Exceptional items	8	(48)	0	0	0
EBT	3,546	3,629	4,610	5,517	6,309
Income taxes	(1,267)	(1,293)	(1,646)	(1,970)	(2,252)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	64	(22)	(27)	(32)	(37)
Reported net profit	2,350	2,266	2,937	3,515	4,020
Adjustments	(8)	48	0	0	0
Adjusted net profit	2,342	2,314	2,937	3,515	4,020

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Accounts payables	2,578	3,091	3,299	3,709	4,133
Other current liabilities	2,153	2,211	2,421	2,796	3,167
Provisions	0	0	0	0	0
Debt funds	1,351	949	699	399	99
Other liabilities	1,151	1,073	1,073	1,073	1,073
Equity capital	159	159	159	159	159
Reserves & surplus	13,351	15,590	17,793	20,430	23,445
Shareholders' fund	13,510	15,749	17,952	20,589	23,604
Total liabilities and equities	21,403	23,732	26,130	29,283	32,830
Cash and cash eq.	824	2,524	2,719	3,109	3,517
Accounts receivables	4,507	4,751	4,583	4,979	5,567
Inventories	3,785	4,058	4,676	5,297	5,923
Other current assets	574	581	842	953	1,066
Investments	4	3	3	3	3
Net fixed assets	11,627	11,712	13,132	14,742	16,528
CWIP	0	0	0	0	0
Intangible assets	0	0	0	0	0
Deferred tax assets, net	82	103	175	199	224
Other assets	0	0	0	0	0
Total assets	21,403	23,732	26,130	29,283	32,830

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Net income + Depreciation	4,431	4,519	5,580	6,614	7,549
Interest expenses	241	156	123	91	52
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,251)	48	(293)	(343)	(533)
Other operating cash flows	(1,209)	(1,215)	(1,646)	(1,945)	(2,227)
Cash flow from operations	2,212	3,508	3,764	4,417	4,841
Capital expenditures	(657)	(976)	(2,390)	(2,707)	(3,027)
Change in investments	0	0	0	0	0
Other investing cash flows	(3)	1	0	0	0
Cash flow from investing	(660)	(975)	(2,390)	(2,707)	(3,027)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(355)	(402)	(250)	(300)	(300)
Interest expenses	(241)	(156)	(123)	(91)	(52)
Dividends paid	(572)	(590)	(734)	(879)	(1,005)
Other financing cash flows	(79)	314	(72)	(50)	(50)
Cash flow from financing	(1,248)	(833)	(1,179)	(1,320)	(1,406)
Changes in cash and cash eq.	304	1,700	195	391	408
Closing cash and cash eq.	824	2,524	2,719	3,109	3,517

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19P	FY20E	FY21E	FY22E
Reported EPS	14.8	14.3	18.5	22.1	25.3
Adjusted EPS	14.7	14.6	18.5	22.1	25.3
Dividend per share	3.0	3.0	3.7	4.4	5.1
Book value per share	85.0	99.1	112.9	129.5	148.5

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19P	FY20E	FY21E	FY22E
EV/Sales	3.0	2.8	2.3	2.0	1.8
EV/EBITDA	18.0	18.2	14.6	12.3	10.7
Adjusted P/E	34.6	35.1	27.6	23.1	20.2
P/BV	6.0	5.2	4.5	3.9	3.4

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19P	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	65.9	64.6	63.7	63.7	63.7
Interest burden (PBT/EBIT)	96.6	99.3	102.5	103.3	103.8
EBIT margin (EBIT/Revenue)	13.6	12.2	13.2	13.8	14.1
Asset turnover (Revenue/Avg TA)	129.7	131.0	136.9	139.6	139.2
Leverage (Avg TA/Avg Equity)	1.7	1.5	1.5	1.4	1.4
Adjusted ROAE	18.5	15.8	17.4	18.2	18.2

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	6.5	9.1	15.5	13.3	11.8
EBITDA	(8.1)	(1.5)	21.7	17.7	13.7
Adjusted EPS	(7.4)	(1.2)	26.9	19.7	14.4
Profitability & Return ratios (%)					
EBITDA margin	16.8	15.2	16.0	16.6	16.9
EBIT margin	13.6	12.2	13.2	13.8	14.1
Adjusted profit margin	8.6	7.8	8.6	9.1	9.3
Adjusted ROAE	18.5	15.8	17.4	18.2	18.2
ROCE	15.9	14.0	15.8	16.7	16.9
Working capital days (days)					
Receivables	53	57	50	45	45
Inventory	72	68	65	66	67
Payables	45	41	41	40	40
Ratios (x)					
Gross asset turnover	1.6	1.7	1.8	1.8	1.7
Current ratio	1.8	2.0	2.1	2.1	2.1
Net interest coverage ratio	15.3	23.1	36.4	58.7	117.1
Adjusted debt/equity	0.0	(0.1)	(0.1)	(0.1)	(0.1)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

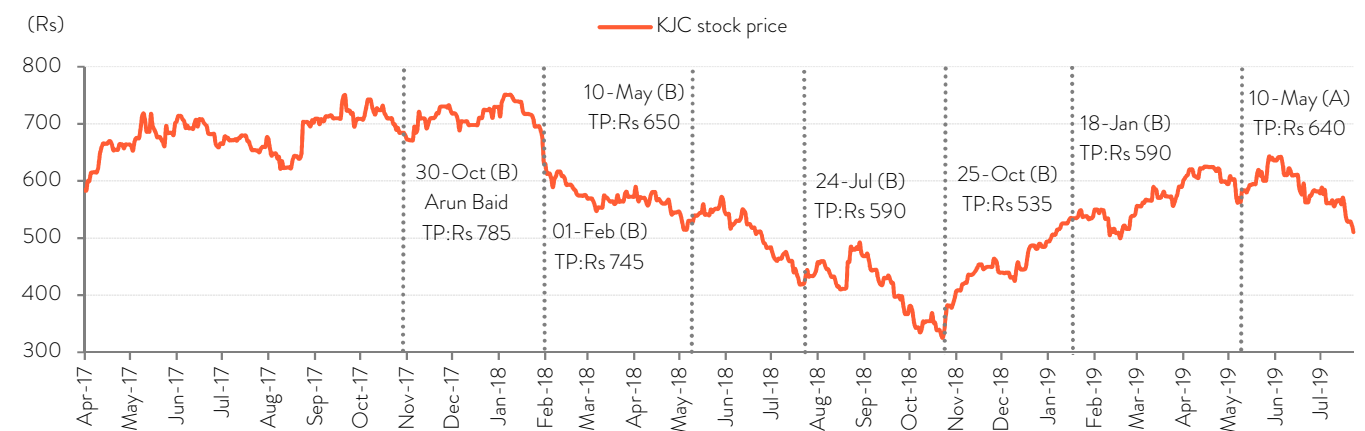
ADD – Expected return from >+5% to +15%

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: KAJARIA CERAMICS (KJC IN)



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

Rating distribution

As of 30 June 2019, out of 76 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 43 have BUY ratings, 15 are rated ADD, 10 are rated REDUCE and 8 are rated SELL. None of these companies have been investment banking clients in the last 12 months.

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance, wealth management and portfolio management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2020. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations

expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities — that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.