

REDUCE

TP: Rs 780 | ▼ 2%

KAJARIA CERAMICS

Construction Materials

21 January 2021

Margins surprise positively

Kajaria Ceramics (KJC) posted an above-expected Q3FY21 with 13% YoY revenue growth and volumes up 11%. EBITDA margins rose 670bps YoY to 21.7% due to lower fuel, employee and other costs, enabling EBITDA/PBT growth of 63%/89% YoY. Management expects volume growth of 20-25%/15% in FY22/FY23 with margins sustainable at 20%. We raise FY21-FY23 earnings 11-19% and roll over to a new Mar'22 TP of Rs 780(vs. Rs 585), valuing the stock at a revised 30x P/E (vs. 28x). Retain REDUCE on limited upside.

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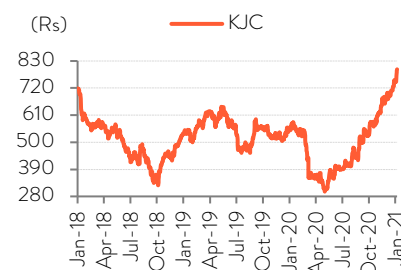
Double-digit tile volume growth: KJC's Q3 revenue increased 13% YoY with tile volumes rising 10.5% YoY whereas sanitaryware & faucets grew 36%. Growth was driven primarily by tier-2-and-below cities with metros returning to 70-75% of pre-Covid sales in the quarter. Management has guided for volume growth of 20-25% in FY22 (on a low FY21 base) and thereafter 15% for the next few years.

Operating margins expand: EBITDA margins swelled 670bps YoY to 21.7% due to higher gross margins (+170bps YoY) and lower employee (-190bps) and other expenses (-315bps). EBITDA/PBT thus grew 63%/89% YoY. Management has guided for sustainable 20% operating margins backed by lower A&P cost and operating leverage benefits. We believe margins face headwinds in the near term due to rising gas prices and normalisation of other expenses such as travelling – these may be partly mitigated by operating leverage as volumes rise.

Maintain REDUCE: We raise FY21-FY23 earnings by 11-19% to factor in above-expected volume and margin guidance, while resetting our target P/E to 30x (from 28x) – in line with the 5Y average. Rolling valuations forward, we have a revised Mar'22 TP of Rs 780 (earlier Rs 585). Though we like KJC, current valuations of 30.7x FY23E EPS offer limited upside – maintain REDUCE.

Ticker/Price	KJC IN/Rs 795
Market cap	US\$ 1.7bn
Shares o/s	159mn
3M ADV	US\$ 3.8mn
52wk high/low	Rs 840/Rs 296
Promoter/FPI/DII	48%/24%/29%

Source: NSE

STOCK PERFORMANCE

Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	29,562	28,080	26,594	32,220	37,095
EBITDA (Rs mn)	4,495	4,159	4,766	5,811	6,838
Adj. net profit (Rs mn)	2,314	2,553	2,770	3,470	4,121
Adj. EPS (Rs)	14.6	16.1	17.4	21.8	25.9
Adj. EPS growth (%)	(1.2)	10.3	8.5	25.3	18.8
Adj. ROAE (%)	15.8	15.5	15.9	19.1	21.6
Adj. P/E (x)	54.6	49.5	45.6	36.4	30.7
EV/EBITDA (x)	28.3	30.3	26.2	21.5	18.3

Source: Company, BOBCAPS Research

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



FIG 1 – CONSOLIDATED QUARTERLY PERFORMANCE

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	9MFY21	9MFY20	YoY (%)
Net Sales	8,383	7,413	13.1	7,125	17.7	18,284	21,560	(15.2)
COGS	4,840	4,404	9.9	4,193	15.4	10,974	12,833	(14.5)
Employee cost	895	930	(3.7)	779	14.9	2,282	2,700	(15.5)
Other expenses	830	967	(14.1)	717	15.9	1,849	2,802	(34.0)
EBITDA	1,818	1,113	63.3	1,437	26.5	3,179	3,225	(1.4)
EBITDA Margin (%)	21.7	15.0	666bps	20.2	152bps	17.4	15.0	243bps
Depreciation and amortization	276	278	(0.8)	274	0.7	801	798	0.5
EBIT	1,542	835	84.6	1,163	32.6	2,378	2,428	(2.1)
EBIT Margin (%)	18.4	11.3	712bps	16.3	207bps	13.0	11.3	174bps
Net Interest expenses	26	48	(46.1)	21	25.5	81	146	(44.7)
Other non-operating inc (exp), net	65	51	25.7	48	34.7	139	172	(19.6)
Earnings before tax	1,581	838	88.5	1,190.4	32.8	2,435	2,454	(0.8)
Income taxes	370	226	64.0	294	25.9	658	407	61.6
Earnings after tax	1,210	613	97.6	896	35.0	1,777	2,047	(13.2)
Extraordinary items	0	0	-	0	-	0	0	n.m.
Minority interest (expense) income	21	(3)	(846.4)	5	301.9	(32)	(10)	213.6
Reported Net income (loss)	1,189	615	93.3	891.2	33.5	1,810	2,057	(12.0)

Source: Company, BOBCAPS Research

FIG 2 – CONSOLIDATED SEGMENTAL PERFORMANCE

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	9MFY21	9MFY20	YoY (%)
Segment Revenues								
Tiles	7,582	6,837	10.9	6,510	16.5	16,669	19,997	(16.6)
Other	801	576	39.0	615	30.2	1,615	1,562	3.4
Total	8,383	7,413	13.1	7,125	17.7	18,284	21,560	(15.2)
EBIT								
Tiles	1,480	850	74.1	1,151	28.6	2,369	2,487	(4.7)
Other	62	(14.5)	(527.6)	12.4	400.0	8.3	(59.3)	(114.0)
Total	1,542	836	84.6	1,163	32.6	2,378	2,428	(2.1)
EBIT Margins								
Tiles	19.5	12.4	709bps	17.7	184bps	14.2	12.4	178bps
Other	7.7	(2.5%)	1,026bps	2.0	572bps	0.5	(3.8%)	431bps

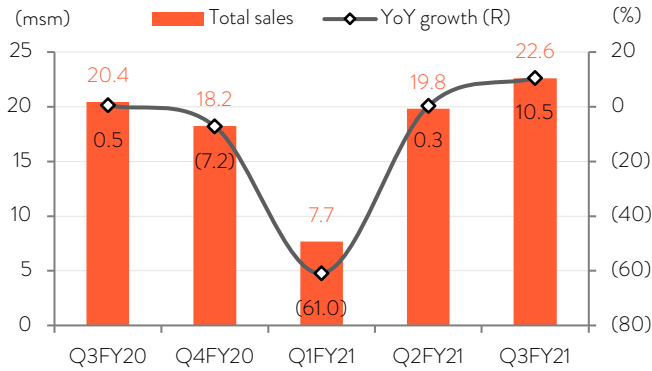
Source: Company, BOBCAPS Research

Earnings call highlights

- Growth has been picking up MoM since July led by tier-2-and-below cities.
- Metro markets have started to see traction, returning to 70-75% of pre-Covid demand levels during Q3FY21.
- All of KJC's plants barring one ran at 100% capacity utilisation during the quarter.
- Retail sales continue to account for 80% of turnover whereas institutional sales form 20%.
- The company has taken price hikes of 6-9% in sanitaryware from Jan'21 but has no increase planned for the tiles segment.
- Management expects the sanitaryware & faucet segment to record total sales of ~Rs 2.1bn in FY21 and Rs 2.8bn-2.9bn in FY22.
- The tiles segment is guided to clock volume growth of 20-25% in FY22 (due to a low FY21 base) and 15% thereafter.
- Exports from unorganised players in Morbi (Gujarat) remain high and will reach Rs 110bn-115bn in FY21 (vs. Rs 93bn in FY20), per KJC. For FY22, management believes Morbi exports will grow at 20-25%.
- The biggest export market for Morbi players is now the US which has imposed higher duties on China and is seeing anti-China sentiment. Morbi is the most cost-competitive tiles producer after China.
- Gas prices have risen from end-Q3 and could adversely impact KJC's operating margins by 1-1.5% in Q4FY21.
- The company has reduced A&P spend to Rs 450mn in FY21 from Rs 1bn in FY20 and plans to incur ~Rs 0.7bn in FY22.
- Management believes 20% EBITDA margins are sustainable due to rising operating leverage as volumes increase.
- Capex of Rs 500mn will be incurred in FY21 and Rs 1.5bn-2bn in FY22.
- KJC plans to increase dividend payout from 20-25% to 40-50%.

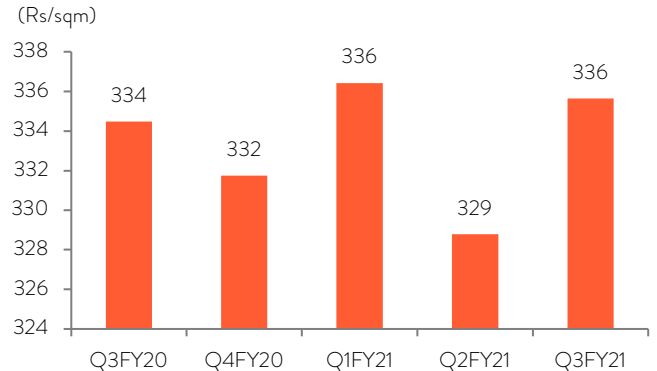
QUARTERLY TRENDS

FIG 3 – TILE VOLUMES



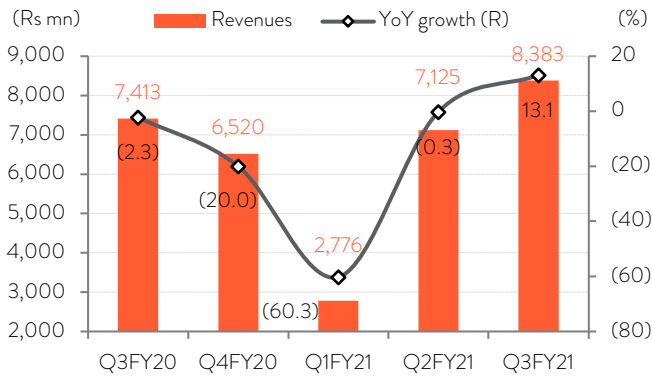
Source: Company, BOBCAPS Research

FIG 4 – TILES NET REALISATIONS



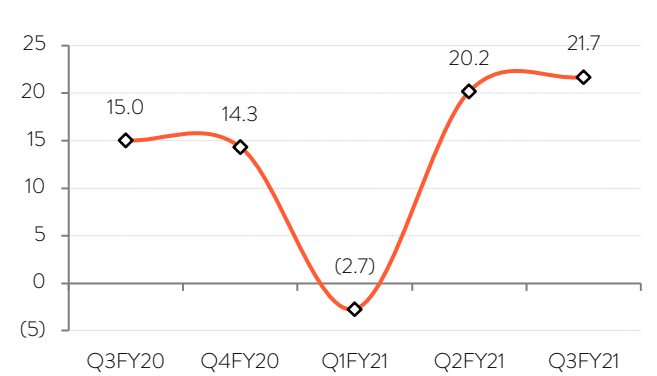
Source: Company, BOBCAPS Research

FIG 5 – CONSOLIDATED REVENUES



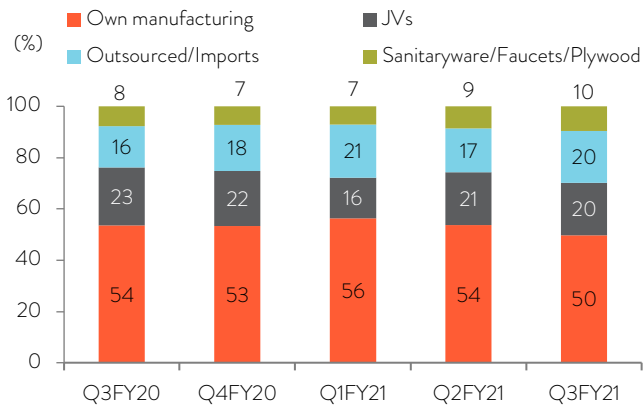
Source: Company, BOBCAPS Research

FIG 6 – CONSOLIDATED EBITDA MARGIN



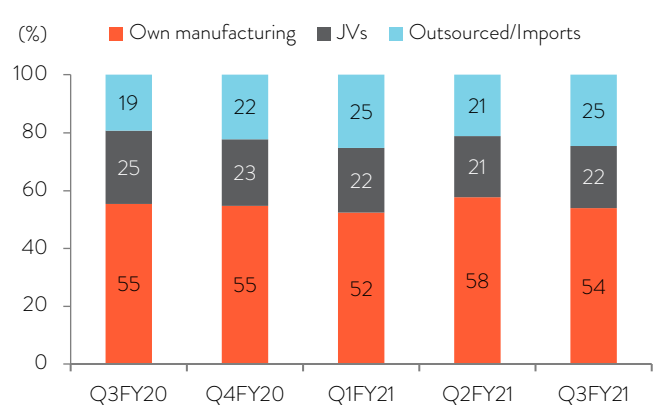
Source: Company, BOBCAPS Research

FIG 7 – REVENUE BREAKUP



Source: Company, BOBCAPS Research

FIG 8 – TILE VOLUME BREAKUP



Source: Company, BOBCAPS Research

Valuation methodology

KJC is the largest organised player in the ~Rs 300bn Indian tiles market (~50% unorganised). We expect the company to benefit from the gradual formalisation of demand post-GST and e-way bill implementation, given its strong brand, wide distribution reach and market leadership.

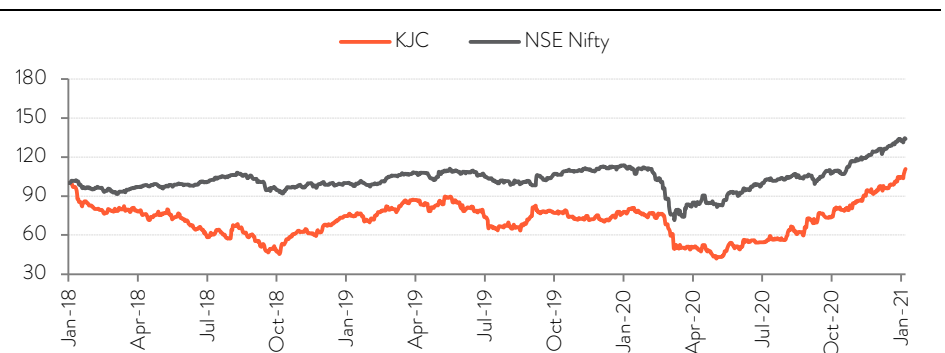
We raise FY21-FY23 earnings estimates by 11-19% to factor in above-expected volume and margin guidance, while resetting our target P/E to 30x (from 28x) – in line with the five-year average. Rolling valuations forward, we have a revised Mar'22 target price of Rs 780 (earlier Rs 585). Though we like KJC for its market leadership and strong balance sheet, current valuations of 30.7x FY23E EPS offer limited upside – maintain REDUCE.

FIG 9 – REVISED ESTIMATES

(Rs mn)	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	26,594	32,220	37,095	25,516	28,872	32,434	4.2	11.6	14.4
EBITDA	4,766	5,811	6,838	4,203	4,840	5,591	13.4	20.1	22.3
PAT	2,770	3,470	4,121	2,501	2,905	3,455	10.8	19.4	19.3

Source: BOBCAPS Research

FIG 10 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key upside risks to our view are:

- **Benign raw material prices:** Any abnormal decrease in prices of key raw materials (such as gas) which are not passed along will result in above-expected profitability.
- **Lower competition from informal sector:** A decline in competitive intensity from the unorganised market of Morbi will result in better profitability for KJC.
- **Sharp improvement in housing demand:** A better-than-anticipated revival in the housing sector may result in above-expected revenue and profitability.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	29,562	28,080	26,594	32,220	37,095
EBITDA	4,495	4,159	4,766	5,811	6,838
Depreciation	(891)	(1,081)	(1,094)	(1,162)	(1,281)
EBIT	3,604	3,078	3,673	4,649	5,557
Net interest income/(expenses)	(156)	(195)	(117)	(57)	(27)
Other income/(expenses)	180	242	225	243	279
Exceptional items	(48)	0	0	0	0
EBT	3,629	3,125	3,780	4,835	5,809
Income taxes	(1,293)	(589)	(1,021)	(1,305)	(1,569)
Min. int./Inc. from associates	(22)	18	10	(60)	(120)
Reported net profit	2,266	2,553	2,770	3,470	4,121
Adjustments	48	0	0	0	0
Adjusted net profit	2,314	2,553	2,770	3,470	4,121

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	2,890	2,105	2,079	2,267	2,621
Other current liabilities	2,211	2,311	2,154	2,040	2,472
Provisions	200	288	313	338	363
Debt funds	949	1,171	471	221	21
Other liabilities	1,073	731	746	771	796
Equity capital	159	159	159	159	159
Reserves & surplus	15,590	16,984	17,538	18,405	19,435
Shareholders' fund	15,749	17,143	17,697	18,564	19,594
Total liabilities and equities	23,732	24,386	24,087	24,888	26,674
Cash and cash eq.	2,524	2,350	2,515	1,210	531
Accounts receivables	4,751	3,967	4,226	4,943	5,691
Inventories	4,058	5,127	4,809	5,649	6,504
Other current assets	581	640	801	794	915
Investments	3	3	3	3	3
Net fixed assets	10,671	11,854	11,468	11,986	12,695
CWIP	934	257	50	70	80
Intangible assets	107	103	103	103	103
Other assets	103	85	112	129	152
Total assets	23,732	24,386	24,087	24,888	26,674

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	4,519	4,205	4,874	5,997	7,090
Interest expenses	156	195	117	57	27
Changes in working capital	48	(943)	(260)	(1,452)	(912)
Other operating cash flows	(1,215)	(986)	(1,008)	(1,314)	(1,571)
Cash flow from operations	3,508	2,472	3,723	3,287	4,634
Capital expenditures	(976)	(1,213)	(500)	(1,700)	(2,000)
Other investing cash flows	1	0	0	0	0
Cash flow from investing	(975)	(1,213)	(500)	(1,700)	(2,000)
Debt raised/repaid	(402)	222	(700)	(250)	(200)
Interest expenses	(156)	(195)	(117)	(57)	(27)
Dividends paid	(570)	(1,150)	(2,216)	(2,602)	(3,091)
Other financing cash flows	294	(310)	(25)	17	4
Cash flow from financing	(833)	(1,433)	(3,058)	(2,892)	(3,313)
Changes in cash and cash eq.	1,700	(174)	165	(1,305)	(679)
Closing cash and cash eq.	2,524	2,350	2,515	1,210	531

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	14.3	16.1	17.4	21.8	25.9
Adjusted EPS	14.6	16.1	17.4	21.8	25.9
Dividend per share	3.0	3.0	11.2	13.1	15.6
Book value per share	99.1	107.9	111.3	116.8	123.3

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	4.3	4.5	4.7	3.9	3.4
EV/EBITDA	28.3	30.3	26.2	21.5	18.3
Adjusted P/E	54.6	49.5	45.6	36.4	30.7
P/BV	8.0	7.4	7.1	6.8	6.5

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	64.6	81.7	73.3	71.8	70.9
Interest burden (PBT/EBIT)	99.3	101.5	102.9	104.0	104.5
EBIT margin (EBIT/Revenue)	12.2	11.0	13.8	14.4	15.0
Asset turnover (Revenue/Avg TA)	131.0	116.7	109.7	131.6	143.9
Leverage (Avg TA/Avg Equity)	1.5	1.5	1.4	1.4	1.4
Adjusted ROAE	15.8	15.5	15.9	19.1	21.6

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	9.1	(5.0)	(5.3)	21.2	15.1
EBITDA	(1.5)	(7.5)	14.6	21.9	17.7
Adjusted EPS	(1.2)	10.3	8.5	25.3	18.8
Profitability & Return ratios (%)					
EBITDA margin	15.2	14.8	17.9	18.0	18.4
EBIT margin	12.2	11.0	13.8	14.4	15.0
Adjusted profit margin	7.8	9.1	10.4	10.8	11.1
Adjusted ROAE	15.8	15.5	15.9	19.1	21.6
ROCE	14.0	13.8	14.2	17.7	20.3
Working capital days (days)					
Receivables	57	57	56	52	52
Inventory	68	83	95	86	87
Payables	39	38	35	30	29
Ratios (x)					
Gross asset turnover	1.7	1.5	1.3	1.5	1.6
Current ratio	2.0	2.1	2.5	2.6	2.5
Net interest coverage ratio	23.1	15.8	31.4	82.2	209.2
Adjusted debt/equity	(0.1)	(0.1)	(0.1)	(0.1)	0.0

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

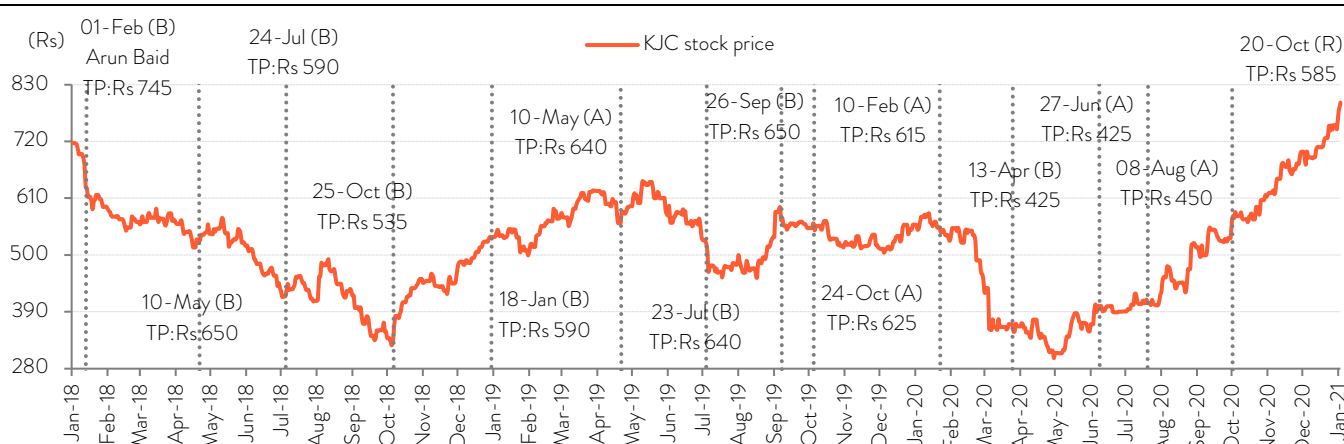
ADD – Expected return from >+5% to +15%

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)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): KAJARIA CERAMICS (KJC IN)



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

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