

BUY

TP: Rs 445 | ▲ 39%

SOMANY CERAMICS

Construction Materials

05 August 2019

Decent volume growth but lower margins

Somany Ceramics (SOMC) reported in-line consolidated revenue growth of 3.9% YoY in Q1FY20 to Rs 3.95bn, as tile volumes grew 8% YoY. Consolidated operating margins declined 57bps YoY to 7.7%, translating to a 3.3%/12.6% fall in EBITDA/PAT. Management has guided for high single-digit to low double-digit volume growth in tiles and stronger margins in FY20. We trim FY20/FY21 PAT estimates by 5%/9%, reduce our target P/E to 20x (vs. 22x) on weakening demand, and move to a new Jun'20 TP of Rs 445 (vs. Rs 505).

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Decent volume growth: SOMC reported 3.9% YoY consolidated topline growth, with revenue from tiles increasing 6.5% (as volumes rose 8% whereas realisations fell 1.4%) and sanitaryware revenue rising ~7.6% YoY. Management stated that volumes were affected by anaemic demand conditions and the company's tight leash on debtors. SOMC has guided for high single-digit to low double-digit volume growth in FY20 (vs. a minimum of double-digit growth guided earlier for the tiles segment).

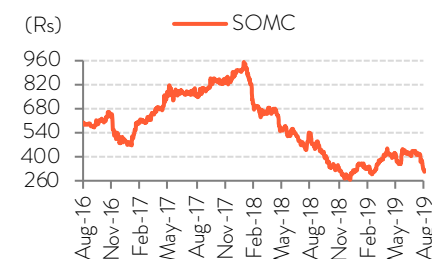
Operating margins contract: Consolidated operating margins declined 57bps YoY to 7.7% primarily due to gross margin slippage (-300bps), partly cushioned by lower employee/other expenses (-66bps/-178bps). Gross margins were depleted by lower realisations and higher sales of outsourced tiles. Management has maintained its guidance for improvement in FY20 margins.

Maintain BUY: With the results falling short of expectations, we prune FY20/FY21 EPS estimates by 5%/9%. We also cut our target one-year forward P/E multiple to 20x (from 22x) amid a continued difficult demand environment. On rolling valuations over, we have a revised Jun'20 TP of Rs 445 (earlier Rs 505).

Ticker/Price	SOMC IN/Rs 320
Market cap	US\$ 192.8mn
Shares o/s	42mn
3M ADV	US\$ 0.2mn
52wk high/low	Rs 560/Rs 270
Promoter/FPI/DII	51%/3%/45%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	730	590	688	895	1,087
Adj. EPS (Rs)	17.2	13.9	16.2	21.1	25.6
Adj. EPS growth (%)	(24.7)	(19.2)	16.7	30.1	21.5
Adj. ROAE (%)	13.2	9.9	10.7	12.4	13.3
Adj. P/E (x)	18.6	23.0	19.7	15.2	12.5
EV/EBITDA (x)	9.7	10.8	9.9	8.2	7.1

Source: Company, BOBCAPS Research

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FIG 1 – CONSOLIDATED QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Net Revenue	3,955	3,807	3.9	5,188	(23.8)
CQGS	2,525	2,316	9.0	3,355	(24.7)
% of sales	63.8	60.8	301bps	65	(83bps)
Employee expenses	579	582	(0.6)	543	6.6
% of sales	14.6	15.3	(66bps)	10	417bps
Other Expenses	549	596	(8.0)	586	(6.4)
% of sales	13.9	15.7	(178bps)	11	258bps
EBITDA	303	314	(3.3)	705	(57.0)
EBITDA margin (%)	7.7	8.2	(57bps)	13.6	(592bps)
Depreciation/Amortisation	121	110	9.6	115	5.6
EBIT	182	203	(10.3)	590	(69.1)
EBIT margin (%)	4.6	5.3	(73bps)	11.4	(677bps)
Net Interest Expenses	117	116	0.9	117	0.2
Other Income	48	48	0.4	56	(14.1)
PBT	114	136	(16.2)	530	(78.6)
Tax Expenses	42	49	(13.0)	110	(61.6)
Net Income before minority interest & extraordinary items	71	87	(17.9)	420	(83.0)
Minority Interest and Income from associates	3	(2)	(257.9)	(48)	(106.2)
Exceptional items	0	0	NA	(131)	(100.0)
Reported Net Income	74	85	(12.6)	241	(69.1)
Adjusted PAT	74	85	(12.6)	344	(78.4)

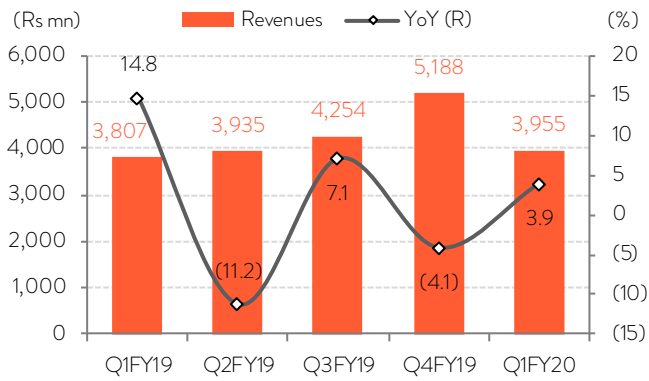
Source: Company, BOBCAPS Research

FIG 2 – STANDALONE QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Net Revenue	3,872	3,622	6.9	5,150	(24.8)
CQGS	2,781	2,544	9.3	3,733	(25.5)
% of sales	72	70	160bps	72	(65bps)
Employee expenses	427	411	3.9	400	6.6
% of sales	11.0	11.3	(32bps)	7.8	325bps
Other Expenses	454	451	0.8	501	(9.4)
% of sales	11.7	12.4	(71bps)	9.7	200bps
EBITDA	209	216	(3.3)	515	(59.5)
EBITDA margin (%)	5.40	5.96	(57bps)	10.01	(461bps)
Depreciation/Amortisation	81	75	9.1	79	2.9
EBIT	128	141	(9.8)	436	(70.8)
EBIT margin (%)	3.3	3.9	(61bps)	8.5	(518bps)
Net Interest Expenses	51	63	(19.1)	69	(26.2)
Other Income	60	52	14.6	73	(17.9)
PBT	136	131	4.4	440	(69.0)
Tax Expenses	49	47	4.5	112	(56.4)
Net Income before minority interest & extraordinary items	87	84	4.3	328	(73.4)
Exceptional items	0	0	NA	(130)	(100.0)
Reported Net Income	87	84	4.3	198	(55.8)
Adjusted PAT	87	84	4.3	281	(68.9)

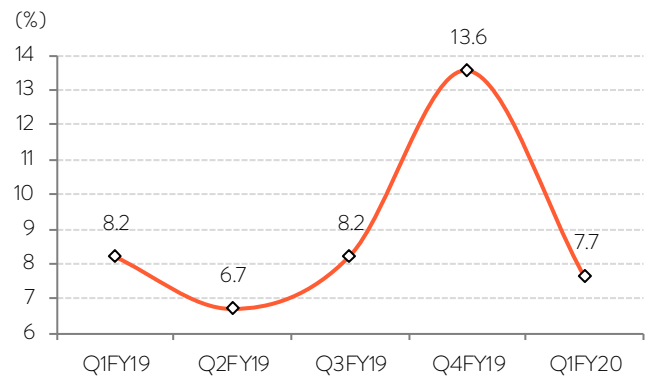
Source: Company, BOBCAPS Research

FIG 3 – CONSOLIDATED REVENUE GROWTH



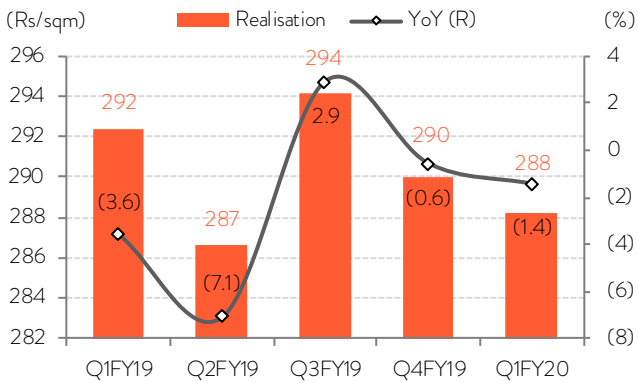
Source: Company, BOBCAPS Research

FIG 4 – CONSOLIDATED EBITDA MARGINS



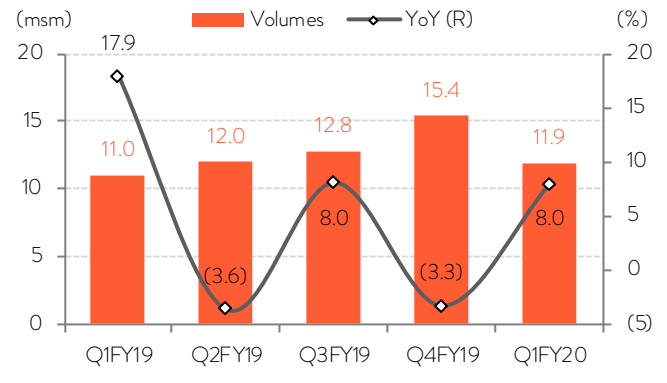
Source: Company, BOBCAPS Research

FIG 5 – TILE REALISATIONS



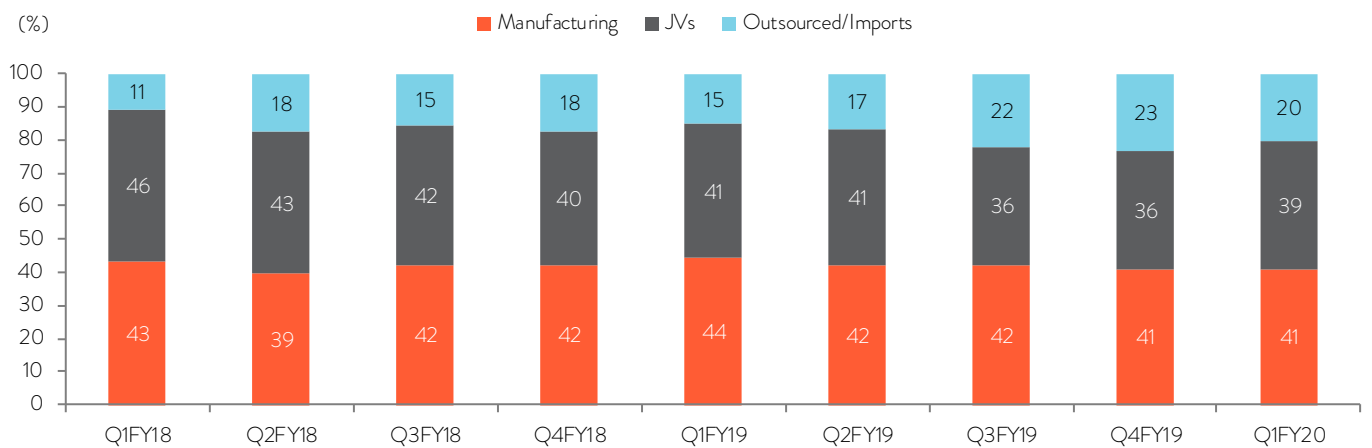
Source: Company, BOBCAPS Research

FIG 6 – TILE VOLUME GROWTH



Source: Company, BOBCAPS Research

FIG 7 – REVENUE BREAKUP



Source: Company, BOBCAPS Research

Earnings call highlights

- Demand was tepid during the general elections in May'19 and stayed soft in June due to a liquidity shortage in the market.
- SOMC observed consumers postponing purchases in tier-2 and tier-3 cities as well. Demand conditions in South India which is a major market for the company is much worse than in its other geographies.
- A tight control on debtor days also mounted pressure on growth during the quarter.
- Full e-way bill implementation is yet to kick in and thus the benefit of GST remains limited.
- Average gas price for the quarter was ~Rs 31.5/scm (+3% QoQ), though management expects a reduction in Q2FY20.
- Rival players in Morbi, Gujarat, have witnessed a 7-10% decrease in gas prices in the month of June, which could fuel pricing pressure for the company.
- The new plant in South India ran at ~73% utilisation during Q1. Further ramp-up in coming months should aid profitability.
- SOMC expects glazed vitrified tiles (GVT) contribution to rise due to increased contribution from the new South India plant.
- Management has guided for high single-digit to low double-digit volume growth in tiles in FY20 accompanied by improved margins.
- Sanitaryware expansion should be completed by Sep'19, aiding stronger growth from this segment.
- The company has no significant capex plans for the next 18 months as current capacities are not being fully utilised.
- Salman Khan is the new brand ambassador for the company. A&P spends are guided to remain at 3-3.5% of sales in FY20.

Valuation methodology

SOMC is the third largest organised player in the Indian tiles market with ~15% organised market share. We expect the company to be one of the prime beneficiaries of a shift in tiling demand from the unorganised segment (~50% of India's Rs 270bn tiles market) to the formal market in the wake of lower GST rates.

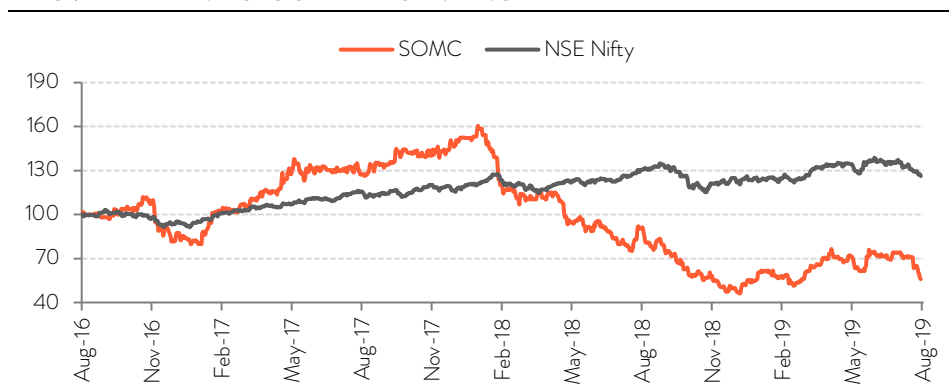
SOMC's Q1FY20 operating results have been weaker than expected; we therefore trim our FY20-FY21 PAT estimates by 5%/9%. We also reduce our target multiple from 22x to 20x one-year forward P/E due to the difficult demand environment. Upon rolling valuations forward, we have a revised Jun'20 target price of Rs 445 (from Rs 505). Maintain BUY.

FIG 8 – REVISED ESTIMATES

(Rs mn)	New		Old		Change (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenues	18,742	21,079	19,329	22,136	(3.0)	(4.8)
EBITDA	1,856	2,171	1,914	2,302	(3.0)	(5.7)
PAT	688	895	726	982	(5.3)	(8.8)

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 these along could adversely affect SOMC's profitability.
- **Increased competition from informal sector:** E-way bill implementation, if continued to be executed poorly, may allow competition from the unorganised sector to increase, thereby affecting the company's growth prospects.
- **Housing market slowdown:** A slowdown in the housing market will hinder demand for the company's products

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Total revenue	17,119	17,151	18,742	21,079	23,525
EBITDA	1,878	1,634	1,856	2,171	2,482
EBIT	1,465	1,191	1,385	1,669	1,947
Net interest income/(expenses)	(399)	(459)	(442)	(403)	(384)
Other income/(expenses)	143	192	213	234	257
Exceptional items	0	0	0	0	0
EBT	1,209	924	1,156	1,500	1,820
Income taxes	(393)	(265)	(393)	(510)	(619)
Extraordinary items	(10)	(126)	0	0	0
Min. int./Inc. from associates	(87)	(69)	(75)	(95)	(114)
Reported net profit	720	463	688	895	1,087
Adjustments	10	126	0	0	0
Adjusted net profit	730	590	688	895	1,087

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Accounts payables	2,332	1,986	2,311	2,599	2,900
Other current liabilities	1,258	1,901	1,335	1,502	1,676
Provisions	116	59	131	148	165
Debt funds	5,396	5,106	4,500	4,250	4,100
Other liabilities	524	567	567	567	567
Equity capital	85	85	85	85	85
Reserves & surplus	5,722	6,045	6,704	7,558	8,594
Shareholders' fund	5,807	6,130	6,789	7,642	8,678
Total liabilities and equities	16,391	16,616	16,424	17,404	18,669
Cash and cash eq.	187	400	233	155	146
Accounts receivables	5,037	4,179	4,878	5,429	6,059
Inventories	2,597	2,545	2,567	2,888	3,223
Other current assets	667	1,461	719	809	902
Investments	1,142	683	650	750	1,000
Net fixed assets	6,429	7,048	7,078	7,075	7,040
CWIP	279	247	247	247	247
Intangible assets	52	52	52	52	52
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	16,391	16,616	16,424	17,404	18,669

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Net income + Depreciation	1,133	906	1,158	1,398	1,622
Interest expenses	399	459	442	403	384
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(413)	356	(147)	(489)	(566)
Other operating cash flows	48	0	0	0	0
Cash flow from operations	1,167	1,721	1,453	1,311	1,441
Capital expenditures	(1,337)	(1,028)	(500)	(500)	(500)
Change in investments	44	459	33	(100)	(250)
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(1,294)	(569)	(467)	(600)	(750)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	427	(290)	(606)	(250)	(150)
Interest expenses	(399)	(459)	(442)	(403)	(384)
Dividends paid	(134)	(99)	(105)	(136)	(165)
Other financing cash flows	106	(90)	0	0	0
Cash flow from financing	(1)	(938)	(1,153)	(789)	(699)
Changes in cash and cash eq.	(128)	214	(167)	(78)	(9)
Closing cash and cash eq.	187	400	233	155	146

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19P	FY20E	FY21E	FY22E
Reported EPS	17.0	10.9	16.2	21.1	25.6
Adjusted EPS	17.2	13.9	16.2	21.1	25.6
Dividend per share	2.7	2.0	2.1	2.7	3.3
Book value per share	137.0	144.6	160.1	180.2	204.7

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19P	FY20E	FY21E	FY22E
EV/Sales	1.1	1.0	1.0	0.8	0.8
EV/EBITDA	9.7	10.8	9.9	8.2	7.1
Adjusted P/E	18.6	23.0	19.7	15.2	12.5
P/BV	2.3	2.2	2.0	1.8	1.6

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19P	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	60.3	63.8	59.5	59.7	59.7
Interest burden (PBT/EBIT)	82.5	77.5	83.5	89.9	93.5
EBIT margin (EBIT/Revenue)	8.6	6.9	7.4	7.9	8.3
Asset turnover (Revenue/Avg TA)	111.1	103.9	113.5	124.6	130.4
Leverage (Avg TA/Avg Equity)	2.8	2.8	2.6	2.3	2.2
Adjusted ROAE	13.2	9.9	10.7	12.4	13.3

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	(1.1)	0.2	9.3	12.5	11.6
EBITDA	(20.1)	(13.0)	13.6	17.0	14.3
Adjusted EPS	(24.7)	(19.2)	16.7	30.1	21.5
Profitability & Return ratios (%)					
EBITDA margin	11.0	9.5	9.9	10.3	10.6
EBIT margin	8.6	6.9	7.4	7.9	8.3
Adjusted profit margin	4.3	3.4	3.7	4.2	4.6
Adjusted ROAE	13.2	9.9	10.7	12.4	13.3
ROCE	8.5	7.0	7.6	8.9	9.9
Working capital days (days)					
Receivables	99	98	88	89	89
Inventory	83	86	79	75	76
Payables	48	51	46	47	48
Ratios (x)					
Gross asset turnover	2.7	2.3	2.2	2.4	2.5
Current ratio	1.1	1.3	1.3	1.4	1.5
Net interest coverage ratio	3.7	2.6	3.1	4.1	5.1
Adjusted debt/equity	0.9	0.8	0.6	0.5	0.5

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

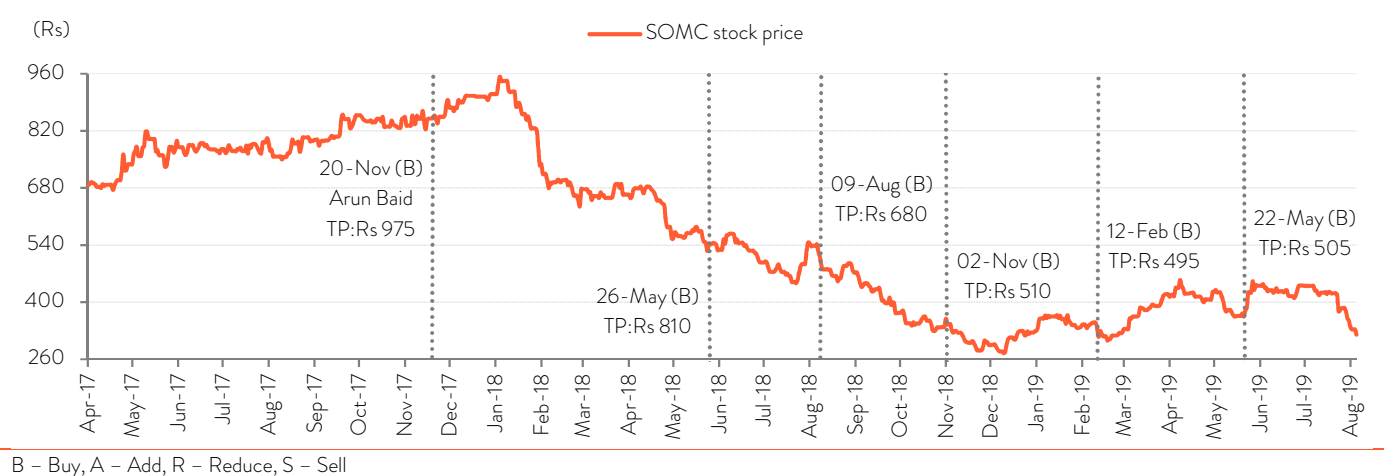
ADD – Expected return from >+5% to +15%

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)

HISTORICAL RATINGS AND TARGET PRICE: SOMANY CERAMICS (SOMC IN)



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