

BUY

TP: Rs 340 | ▲ 84%

SOMANY CERAMICS

Construction Materials

11 November 2019

Margins surprise positively

Somany Ceramics (SOMC) reported in-line consolidated revenue growth of 7.9% YoY in Q2FY20 to Rs 4.2bn, aided by a 4.8% uptick in tile volumes. Consolidated operating margins expanded 385bps YoY to 10.6%, ahead of estimates, propelling increases of 69%/109% YoY in EBITDA/PBT. Management guided for stronger margins in FY20 but lower 7-8% volume growth in tiles (earlier high single-digit to low double-digit growth). We thus cut FY20-FY22 PAT by 4-5% and roll to an unchanged Sep'20 TP of Rs 340.

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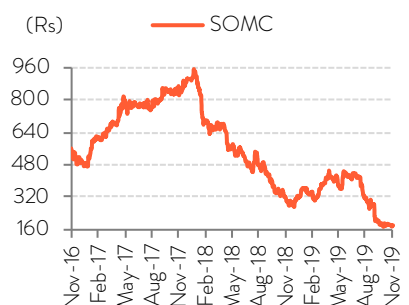
Modest volume growth: SOMC reported 7.9% YoY consolidated topline growth, with revenue from the tiles segment increasing 6.8% (as volumes/realisations rose 4.8%/2%) and sanitaryware & allied revenue also rising ~6.8% YoY. Volumes were affected by the tepid demand conditions, floods in several geographies and the shutdown in Kashmir during the quarter. SOMC indicated that volume growth in H2 should be similar to that in H1 (6.3%).

Ticker/Price	SOMC IN/Rs 185
Market cap	US\$ 109.6mn
Shares o/s	42mn
3M ADV	US\$ 0.3mn
52wk high/low	Rs 472/Rs 174
Promoter/FPI/DII	51%/3%/45%

Source: NSE

Operating margins expand: Consolidated operating margins increased 385bps YoY to 10.6% due to gross margin expansion (+433bps), aiding EBITDA growth of 69% YoY. Gross margins benefited from a better product mix and lower gas prices YoY. The company has provided for a sum of Rs 261.8mn due from Mentor Financial Services during the quarter, which affected reported PAT. Management stated that cash flows in future would be primarily used for debt repayment and not treasury operations.

STOCK PERFORMANCE



Source: NSE

Maintain BUY: We cut FY20-FY22 EPS estimates by 4-5% on lower growth guidance; rolling valuations forward, we have an unchanged Sep'20 TP of Rs 340. The stock is trading at a cheap 9x FY21E EPS and could remain subdued pending better internal control and use of cash flow for debt reduction.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	17,119	17,110	18,195	20,313	22,653
EBITDA (Rs mn)	1,878	1,576	1,865	2,133	2,390
Adj. net profit (Rs mn)	730	490	649	870	1,060
Adj. EPS (Rs)	17.2	11.6	15.3	20.5	25.0
Adj. EPS growth (%)	(24.7)	(32.9)	32.6	34.1	21.8
Adj. ROAE (%)	13.2	8.2	10.2	12.5	13.4
Adj. P/E (x)	10.7	16.0	12.1	9.0	7.4
EV/EBITDA (x)	6.7	7.5	6.7	5.4	4.5

Source: Company, BOBCAPS Research

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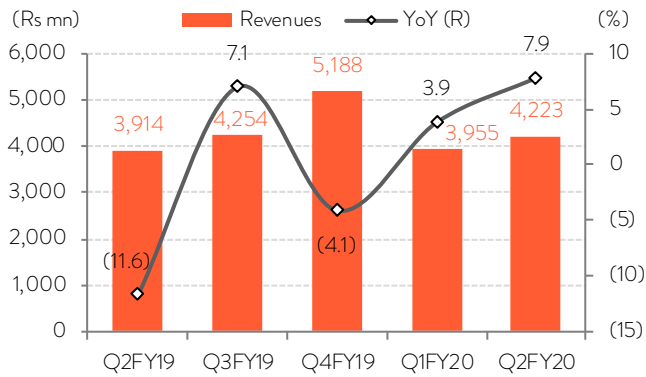


FIG 1 – CONSOLIDATED QUARTERLY PERFORMANCE

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
Net Revenue	4,223	3,914	7.9	3,955	6.8
CQGS	2,581	2,562	0.8	2,525	2.2
% of sales	61.1	65.5	(433bps)	64	(271bps)
Employee Expenses	596	554	7.5	579	2.9
% of sales	14.1	14.2	(6bps)	15	(53bps)
Other Expenses	598	533	12.3	549	9.1
% of sales	14.2	13.6	55bps	14	30bps
EBITDA	448	265	69.1	303	47.7
EBITDA Margin	10.6	6.8	384bps	7.7	294bps
Depreciation/Amortisation	149	108	38.7	121	23.3
EBIT	299	157	89.9	182	63.9
EBIT Margin	7.1	4.0	305bps	4.6	246bps
Net Interest Expenses	132	112	18.4	117	13.0
Other Income	18	43	(57.3)	48	(62.0)
PBT	185	89	108.7	114	62.8
Tax Expenses	(165)	34	NA	42	NA
Net Income before minority interest & extraordinary items	350	55	536.7	71	390.5
Minority Interest and Income from Associates	(24)	(9)	153.2	3	NA
Exceptional Items	(262)	0	NA	0	NA
Reported Net Income	65	46	41.7	74	(13.2)

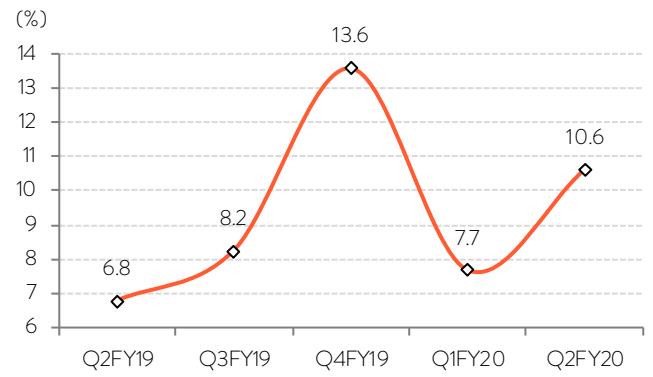
Source: Company, BOBCAPS Research

FIG 2 – CONSOLIDATED REVENUE GROWTH



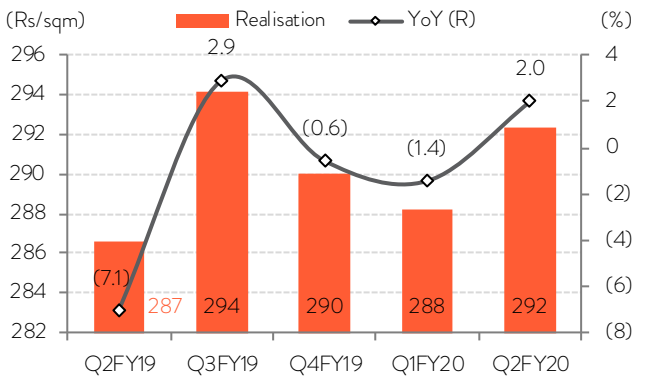
Source: Company, BOBCAPS Research

FIG 3 – CONSOLIDATED EBITDA MARGINS



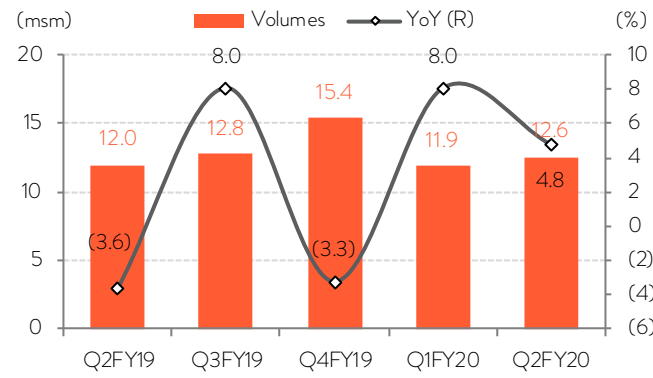
Source: Company, BOBCAPS Research

FIG 4 – TILE REALISATIONS



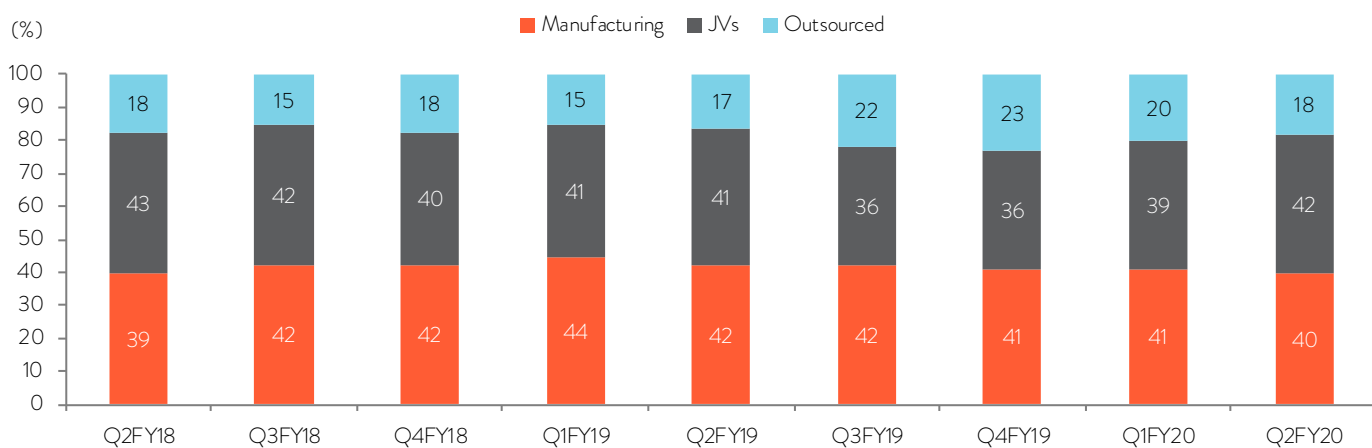
Source: Company, BOBCAPS Research

FIG 5 – TILE VOLUME GROWTH



Source: Company, BOBCAPS Research

FIG 6 – REVENUE BREAKUP



Source: Company, BOBCAPS Research

Earnings call highlights

- Demand was tepid during the quarter. Also, floods in many markets and the shutdown in J&K affected volume growth.
- The private builder market remains under stress. Retail is doing better but the channel is seeing liquidity stress.
- Management believes prices of ceramic and PVT tiles have bottomed out and are unlikely to fall further. However, GVT tile prices can see some downside given scope for price cuts.
- Provisional duty on tiles by GCC countries will have no effect on ceramic wall tile exports from India, as per management, though lower end GVT tiles could be affected.
- Despite a tepid H1 for the sanitaryware segment, management expects 16-17% growth for FY20.
- Sanitaryware has operating margins of 14-15% and as revenue share increases, blended margins should rise. FY20 margins are guided to improve over FY19.
- Average gas price for the quarter was ~Rs 32/scm (+2% QoQ), though management expects a reduction in Q3FY20.
- The company has spent ~3.5% of revenues on A&P in H1FY20. A&P is guided to remain at this level for the next two quarters given the recent hiring of Salman Khan as brand ambassador.
- Receivable days declined by ~10 days YoY to 79 in Q2. SOMC believes debtor days could have been lower but for the sanitaryware segment where the company has lower bargaining power.
- The new plant in South India ran at ~80% utilisation during Q2, leading to higher GVT revenue contribution at 44% (40% YoY).
- Entry into the geyser segment is mainly by outsourcing and there are no plans to enter any other appliance category.
- The employee who defrauded the company of ~Rs 160mn in FY19 has been arrested; management believes they will be able to recover most of the dues.
- SOMC has no significant capex plans for the next 18 months and has guided for Rs 300mn-400mn of outlay in FY21.
- The company has decided to use cash flows generated primarily for repayment of debt going ahead.

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 post lower GST rates.

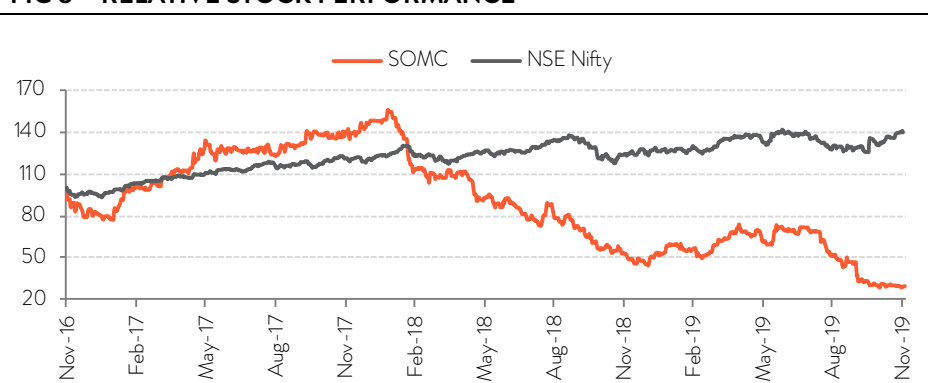
We cut FY20-FY22 PAT estimates by 4-5% on lower growth guidance; rolling valuations forward, we have an unchanged Sep'20 target price of Rs 340 based on 15x one-year forward P/E. The stock is trading at a cheap 9x FY21E EPS and valuations could remain subdued pending better internal controls and usage of free cash flows for debt reduction. Maintain BUY.

FIG 7 – REVISED ESTIMATES

(Rs mn)	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenues	18,195	20,313	22,653	18,742	21,079	23,525	(2.9)	(3.6)	(3.7)
EBITDA	1,865	2,133	2,390	1,771	2,066	2,364	5.3	3.2	1.1
PAT	649	870	1,060	682	912	1,107	(4.7)	(4.5)	(4.2)

Source: BOBCAPS Research

FIG 8 – 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	FY19A	FY20E	FY21E	FY22E
Total revenue	17,119	17,110	18,195	20,313	22,653
EBITDA	1,878	1,576	1,865	2,133	2,390
Depreciation	(413)	(443)	(569)	(603)	(640)
EBIT	1,465	1,134	1,296	1,530	1,750
Net interest income/(expenses)	(399)	(459)	(473)	(385)	(326)
Other income/(expenses)	143	149	151	152	154
Exceptional items	0	0	0	0	0
EBT	1,209	824	974	1,298	1,578
Income taxes	(393)	(265)	(249)	(332)	(404)
Extraordinary items	(10)	(26)	(195)	0	0
Min. int./Inc. from associates	(87)	(69)	(75)	(95)	(114)
Reported net profit	720	463	455	870	1,060
Adjustments	10	26	195	0	0
Adjusted net profit	730	490	649	870	1,060

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	2,332	1,986	2,144	2,393	2,669
Other current liabilities	1,258	1,275	1,296	1,447	1,614
Provisions	116	59	91	102	113
Debt funds	5,396	5,731	4,600	3,950	3,300
Other liabilities	524	532	532	532	532
Equity capital	85	85	85	85	85
Reserves & surplus	5,722	6,045	6,461	7,294	8,307
Shareholders' fund	5,807	6,130	6,546	7,379	8,391
Total liabilities and equities	16,391	16,580	16,150	16,839	17,770
Cash and cash eq.	187	460	147	277	402
Accounts receivables	5,037	4,179	4,736	5,120	5,710
Inventories	2,597	2,545	2,592	2,838	3,103
Other current assets	667	1,366	698	779	869
Investments	1,142	683	800	800	800
Net fixed assets	6,429	7,048	6,879	6,726	6,586
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	16,580	16,150	16,839	17,770

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	1,133	906	1,024	1,473	1,699
Interest expenses	399	459	473	385	326
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(413)	(174)	275	(301)	(490)
Other operating cash flows	48	(182)	(120)	95	114
Cash flow from operations	1,167	1,009	1,652	1,652	1,649
Capital expenditures	(1,337)	(1,028)	(400)	(450)	(500)
Change in investments	44	459	(117)	0	0
Other investing cash flows	0	0	195	0	0
Cash flow from investing	(1,294)	(569)	(323)	(450)	(500)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	427	335	(1,131)	(650)	(650)
Interest expenses	(399)	(459)	(473)	(385)	(326)
Dividends paid	(134)	(138)	(114)	(132)	(161)
Other financing cash flows	106	96	75	95	114
Cash flow from financing	(1)	(167)	(1,643)	(1,072)	(1,023)
Changes in cash and cash eq.	(128)	274	(314)	130	126
Closing cash and cash eq.	187	460	147	277	402

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	17.0	10.9	10.7	20.5	25.0
Adjusted EPS	17.2	11.6	15.3	20.5	25.0
Dividend per share	2.7	2.0	2.3	2.7	3.3
Book value per share	137.0	144.6	154.5	174.1	198.0

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	0.7	0.7	0.7	0.6	0.5
EV/EBITDA	6.7	7.5	6.7	5.4	4.5
Adjusted P/E	10.7	16.0	12.1	9.0	7.4
P/BV	1.3	1.3	1.2	1.1	0.9

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	60.3	59.5	66.7	67.1	67.2
Interest burden (PBT/EBIT)	82.5	72.7	75.1	84.8	90.1
EBIT margin (EBIT/Revenue)	8.6	6.6	7.1	7.5	7.7
Asset turnover (Revenue/Avg TA)	111.1	103.8	111.2	123.2	130.9
Leverage (Avg TA/Avg Equity)	2.8	2.8	2.6	2.4	2.2
Adjusted ROAE	13.2	8.2	10.2	12.5	13.4

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	(1.1)	(0.1)	6.3	11.6	11.5
EBITDA	(20.1)	(16.0)	18.3	14.4	12.1
Adjusted EPS	(24.7)	(32.9)	32.6	34.1	21.8
Profitability & Return ratios (%)					
EBITDA margin	11.0	9.2	10.3	10.5	10.6
EBIT margin	8.6	6.6	7.1	7.5	7.7
Adjusted profit margin	4.3	2.9	3.6	4.3	4.7
Adjusted ROAE	13.2	8.2	10.2	12.5	13.4
ROCE	8.5	6.2	7.8	9.3	10.3
Working capital days (days)					
Receivables	99	98	89	89	87
Inventory	83	86	82	78	77
Payables	48	51	46	46	46
Ratios (x)					
Gross asset turnover	2.7	2.3	2.2	2.4	2.5
Current ratio	1.1	1.2	1.3	1.5	1.6
Net interest coverage ratio	3.7	2.5	2.7	4.0	5.4
Adjusted debt/equity	0.9	0.9	0.7	0.5	0.3

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

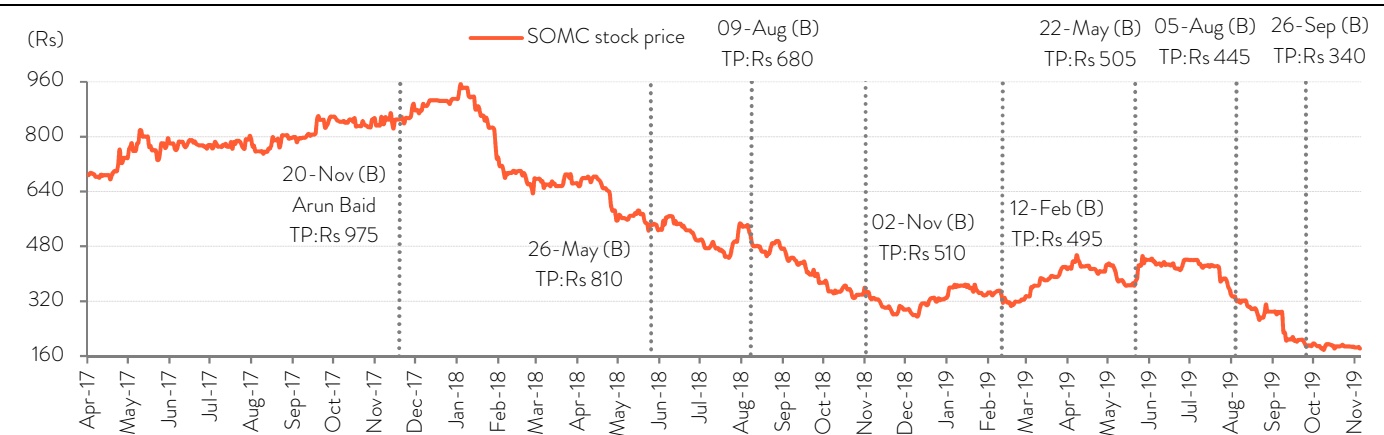
ADD – Expected return from >+5% to +15%

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: SOMANY CERAMICS (SOMC IN)



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

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