

**BUY**

TP: Rs 710 | ▲ 35%

**SOMANY CERAMICS**

Construction Materials

10 November 2022

## Gas prices continue to weigh on margins

- Q2 revenue growth at 9% YoY due to 24.5% increase in blended realisation (+13% QoQ); however, tile volumes declined 2% YoY
- EBITDA margin contracted 420bps YoY to 5.9% owing to lower gross margin (-350bps) and absence of price hikes
- We cut FY23/FY24 PAT by 11%/10% and revise our TP to Rs 710 (vs. Rs 830). Maintain BUY

Ruchitaa Maheshwari

research@bobcaps.in

**Margins contract:** SOMC's Q2FY23 revenue grew 9% YoY (+12% QoQ) to Rs 6.1bn aided by a 24.5% rise in blended realisation. However, volumes declined by 2% YoY. Due to an increase in gas cost and input cost inflation, gross margin contracted 350bps YoY. Hence, EBITDA margin declined 420bps to 5.9%, with EBITDA down 36% YoY. Consolidated revenue grew 10% YoY to Rs 6.2bn while EBITDA margin fell 535bps to 6.8% on a lower gross margin (-485bps) of 29.4%. The company has not taken any price hikes during the quarter, impacting margins.

**Gas price on the rise:** Rising gas cost is putting pressure on margins. Total gas cost increased by Rs 5/scm QoQ in Q2FY23 to Rs 64/scm (+100% YoY). Per management, the Q3 margin will improve owing to reduction in gas cost and LPG coming into system. Prices in the northern region have risen from Rs 58/scm in Q1FY23 to Rs 65/scm in Q2FY23, and in the south to Rs 75/scm in Q2 (Rs 60-62/scm currently). In Morbi, prices are stable at Rs 65/scm QoQ.

**Alternate fuel to improve margins:** Compared to gas cost which hovers at Rs 65/scm, LPG trades at Rs 50/scm. As per management, 50% of its units have been moved to alternate fuel, LPG. By the end of Nov'22, the company expects 60-62% of the units to run on LPG. Per management, switching to alternatives such as LPG and propane coupled with softening of gas prices should result in improvement in operating margins going forward. For Q3, management expects fuel cost at ~Rs 60/scm.

**Near-term demand headwinds:** Gas price uncertainty continues and there remains a risk of further global gas price spikes amid winter (H2) and prolonged geopolitical tensions. However, the switch to alternative fuel will provide much needed respite to financials. Due to the sharp spike in gas prices in European countries, Morbi's tiles competitiveness has improved and exports are expected to pick up. We lower our PAT estimates by 11% for FY23 and 10% for FY24 to incorporate the H1FY23 performance and a reduction in FY23 volume growth guidance to low double digits (earlier 15-20%). The stock is trading at 17.2x FY24E EPS vs. its 5Y median of 26.3x. Post estimate revision, we have a new TP of Rs 710 (vs. Rs 835), set at an unchanged 22x FY24E P/E multiple – retain BUY.

## Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	SOMC IN/Rs 527
Market cap	US\$ 273.0mn
Free float	45%
3M ADV	US\$ 0.2mn
52wk high/low	Rs 970/Rs 511
Promoter/FPI/DII	55%/2%/43%

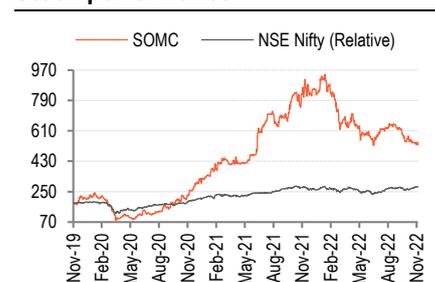
Source: NSE | Price as of 10 Nov 2022

## Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	20,945	23,167	27,140
EBITDA (Rs mn)	2,065	2,187	2,873
Adj. net profit (Rs mn)	888	893	1,370
Adj. EPS (Rs)	21.0	21.1	32.3
Consensus EPS (Rs)	21.0	26.2	38.7
Adj. ROAE (%)	13.0	11.6	15.7
Adj. P/E (x)	25.1	25.0	16.3
EV/EBITDA (x)	12.3	11.5	8.9
Adj. EPS growth (%)	24.8	0.6	53.4

Source: Company, Bloomberg, BOBCAPS Research

## Stock performance



Source: NSE



## Earnings call highlights

- Management indicated a muted Oct'22 on the back of slower construction activity during the festive season coupled with low demand. The company expects demand to improve in Nov-Dec'22. Further, higher manufacturing cost in Europe and increased anti-dumping duty on Turkey should help to accelerate demand, benefiting the Indian tile industry.
- Management has guided for revenue growth at 15-20% for FY23 (expecting H2 to be better than H1), with decent low-double-digit volume growth. Management refrained from giving any margin guidance. However, it indicated that margins should improve in H2FY23 (assuming gas costs remain stable), aided by commissioning of new capacities which have better margins.
- The ~4 msm/annum greenfield slab tile manufacturing facility in Gujarat is expected to commence production during Q1FY24 at capex of ~Rs 1.7bn.
- Per management, the company's operating margin is expected to improve going forward due to a superior product mix and likely stabilisation of gas cost inflation. The upcoming slab plant in Gujarat in Q1FY24 will manufacture value-added products and will further aid margin expansion.
- PGVT (polished glazed vitrified tiles) has reduced to 28% in Q2FY23 vs. 34% in Q2FY22 and GVT (glazed vitrified tiles) increased to 33% vs. 28%. By the end of FY23, share of GVT is guided to be ~34%, rising to at least 35% of tile revenue with the commencement of the slab plant in Q1FY24.
- SOMC is aggressively working on branding initiatives and expects brand spends at 2-2.5% of revenue in FY23.
- Average capacity utilisation was 83% in tiles, 45% in sanitaryware and 93% in faucetware in Q2FY23.
- Sales mix in Q2 was as follows – own manufacturing (41%), joint ventures (35%) and others (24%).
- Standalone working capital days increased to 34 in Sep'22 vs. 27 in Mar'22 and 3 in Mar'21.
- Morbi is not expected to take any price cuts in the wake of gas cost stabilisation.

**Fig 1 – Consolidated quarterly performance**

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
<b>Net Revenue</b>	<b>6,178</b>	<b>5,607</b>	<b>10.2</b>	<b>5,591</b>	<b>10.5</b>	<b>11,769</b>	<b>8,907</b>	<b>32.1</b>
CQGS	4,364	3,689	18.3	3,868	12.8	8,232	5,720	43.9
% of sales	70.6	65.8	485bps	69.2	145bps	69.9	64.2	573bps
Employee expenses	737	645	14.2	712	3.5	1,449	1,246	16.3
% of sales	11.9	11.5	42bps	12.7	(80bps)	12.3	14.0	(168bps)
Other Expenses	655	591	10.8	562	16.5	1,217	1,028	18.4
% of sales	10.6	10.5	6bps	10.0	55bps	10.3	11.5	(120bps)
<b>EBITDA</b>	<b>422</b>	<b>682</b>	<b>(38.1)</b>	<b>449</b>	<b>(6.1)</b>	<b>872</b>	<b>913</b>	<b>(4.6)</b>
<b>EBITDA Margin (%)</b>	<b>6.8</b>	<b>12.2</b>	<b>(534bps)</b>	<b>8.0</b>	<b>(120bps)</b>	<b>7.4</b>	<b>10.3</b>	<b>(285bps)</b>
Depreciation/Amortisation	170	161	5.1	154	10.2	324	312	3.7
<b>EBIT</b>	<b>253</b>	<b>521</b>	<b>(51.5)</b>	<b>295</b>	<b>(14.5)</b>	<b>548</b>	<b>601</b>	<b>(8.9)</b>
<b>EBIT Margin (%)</b>	<b>4.1</b>	<b>9.3</b>	<b>(520bps)</b>	<b>5.3</b>	<b>(120bps)</b>	<b>4.7</b>	<b>6.8</b>	<b>(210bps)</b>
Net Interest Expenses	96	78	23.3	73	32.3	168	159	6.2
Other Income	29	38	(23.6)	40	(26.4)	69	94	(26.8)
<b>PBT</b>	<b>186</b>	<b>481</b>	<b>(61.4)</b>	<b>263</b>	<b>(29.2)</b>	<b>448</b>	<b>537</b>	<b>(16.5)</b>
Tax Expenses	47	128	(63.4)	69	(32.3)	116	144	(19.6)
Net Income before minority interest & extraordinary items	139	354	(60.7)	194	(28.2)	333	393	(15.3)
Minority Interest and Income from associates	30	(4)	(869.2)	12	154.2	42	6	596.7
Exceptional items	(22)	0	-	0	-	(22)	(4)	-
<b>Reported Net Income</b>	<b>147</b>	<b>350</b>	<b>(57.9)</b>	<b>205</b>	<b>(28.3)</b>	<b>353</b>	<b>395</b>	<b>(10.6)</b>

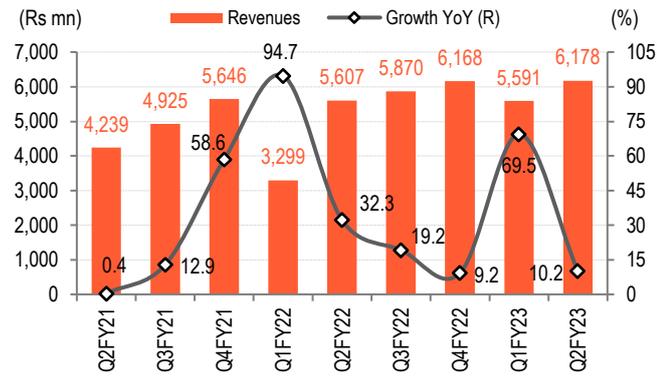
Source: Company, BOBCAPS Research

**Fig 2 – Standalone quarterly performance**

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY23	H1FY22	YoY (%)
<b>Net Revenue</b>	<b>6,089</b>	<b>5,575</b>	<b>9.2</b>	<b>5,444</b>	<b>11.8</b>	<b>11,533</b>	<b>8,830</b>	<b>30.6</b>
CQGS	4,663	4,072	14.5	4,091	14.0	8,754	6,415	36.5
% of sales	76.6	73.0	353bps	75.1	143bps	75.9	72.6	326bps
Employee expenses	536	469	14.2	504	6.3	1,039	910	14.2
% of sales	8.8	8.4	38bps	9.3	(46bps)	9.0	10.3	(129bps)
Other Expenses	531	468	13.4	477	11.2	1,008	796	26.7
% of sales	8.7	8.4	32bps	8.8	(5bps)	8.7	9.0	(27bps)
<b>EBITDA</b>	<b>360</b>	<b>565</b>	<b>(36.4)</b>	<b>372</b>	<b>(3.3)</b>	<b>732</b>	<b>710</b>	<b>3.1</b>
<b>EBITDA Margin (%)</b>	<b>5.91</b>	<b>10.14</b>	<b>(423bps)</b>	<b>6.83</b>	<b>(93bps)</b>	<b>6.34</b>	<b>8.04</b>	<b>(169bps)</b>
Depreciation/Amortisation	106	119	(10.2)	104	2.4	210	227	(7.3)
<b>EBIT</b>	<b>253</b>	<b>447</b>	<b>(43.3)</b>	<b>268</b>	<b>(5.6)</b>	<b>521</b>	<b>483</b>	<b>8.0</b>
<b>EBIT Margin (%)</b>	<b>4.2</b>	<b>8.0</b>	<b>(385bps)</b>	<b>4.9</b>	<b>(77bps)</b>	<b>4.5</b>	<b>5.5</b>	<b>(95bps)</b>
Net Interest Expenses	20	22	(7.7)	20	4.1	40	45	(10.5)
Other Income	69	54	28.0	75	(8.2)	144	119	21.8
<b>PBT</b>	<b>302</b>	<b>479</b>	<b>(36.9)</b>	<b>324</b>	<b>(6.8)</b>	<b>626</b>	<b>557</b>	<b>12.4</b>
Tax Expenses	74	129	(42.7)	83	(10.4)	156	149	5.0
Net Income before extraordinary items	228	350	(34.8)	241	(5.5)	469	408	15.2
Exceptional items	(10)	0	-	0	-	0	0	-
<b>Reported Net Income</b>	<b>218</b>	<b>350</b>	<b>(37.6)</b>	<b>241</b>	<b>(9.5)</b>	<b>469</b>	<b>408</b>	<b>15.2</b>

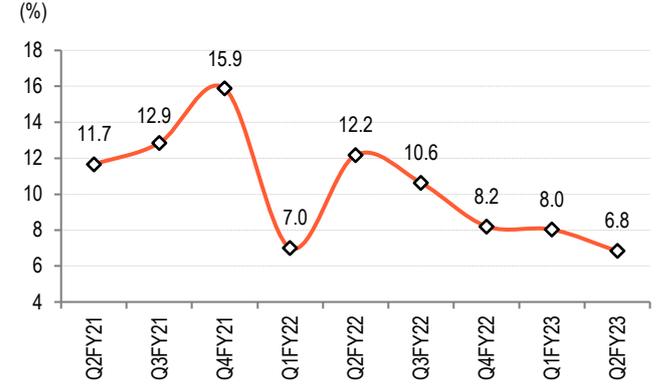
Source: Company, BOBCAPS Research

**Fig 3 – Consolidated revenue growth**



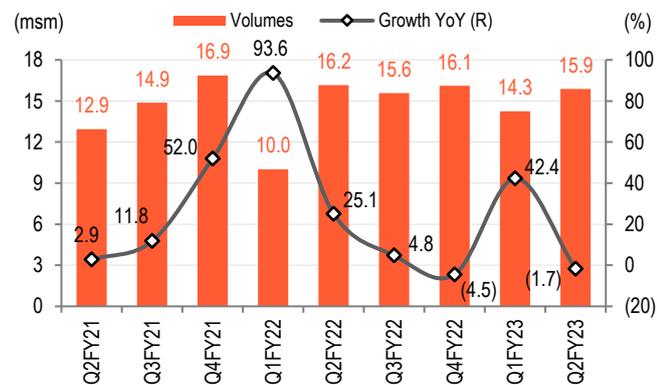
Source: Company, BOBCAPS Research

**Fig 4 – Consolidated EBITDA margin**



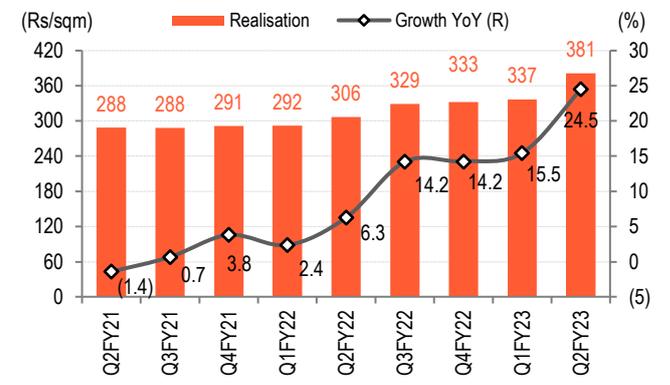
Source: Company, BOBCAPS Research

**Fig 5 – Tile volume growth**



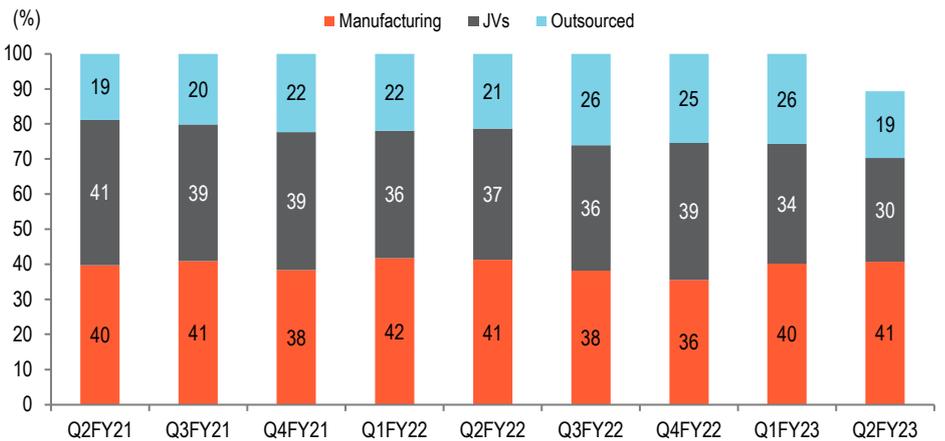
Source: Company, BOBCAPS Research

**Fig 6 – Tile realisation growth**



Source: Company, BOBCAPS Research

**Fig 7 – Revenue breakup**



Source: Company, BOBCAPS Research

## Valuation methodology

Gas price uncertainty continues and there remains a risk of further global gas price spikes amid winter (H2) and prolonged geopolitical tensions. However, the switch to alternative fuel will provide much needed respite to financials. Further, due to the sharp spike in gas prices in European countries, Morbi's tiles competitiveness has improved and exports are expected to pick up. These should reduce supply pressure in domestic markets, driving better pricing and margin recovery. We lower our PAT estimates by 11% for FY23 and 10% for FY24 to incorporate the H1FY23 performance and reduction in FY23 volume growth guidance to low double digits (earlier 15-20%).

The stock is trading at 17.2x FY24E EPS vs. its five-year median of 26.3x. Post estimate revision, we have a new TP of Rs 710 (vs. Rs 835), set at an unchanged 22x FY24E P/E multiple – retain BUY.

**Fig 8 – Revised estimates**

(Rs mn)	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Net Sales	23,167	27,140	23,167	27,140	0.0	0.0
EBITDA	2,187	2,873	2,442	3,212	(10.4)	(10.5)
EBITDA margin (%)	9.4	10.6	10.5	11.8	(110bps)	(120bps)
PAT	893	1,370	1,000	1,530	(10.7)	(10.4)

Source: BOBCAPS Research

## Key risks

Key downside risks to our estimates are:

- **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 executed poorly as is currently the case, may allow competition from the unorganised sector to increase, affecting growth prospects.
- **Housing market slowdown:** A slowdown in the housing market will hinder demand for the company's products.

## Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Century Plyboards	CPBI IN	1.7	607	735	BUY
Cera Sanitaryware	CRS IN	0.8	5,287	5,225	HOLD
Greenpanel Industries	GREENP IN	0.6	379	595	BUY
Greenply Industries	MTLM IN	0.2	164	215	BUY
Kajaria Ceramics	KJC IN	2.0	1,027	1,325	BUY
Pidilite Industries	PIDI IN	16.5	2,656	2,380	SELL
Somany Ceramics	SOMC IN	0.3	527	710	BUY

Source: BOBCAPS Research, NSE | Price as of 10 Nov 2022

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
<b>Total revenue</b>	<b>16,030</b>	<b>16,505</b>	<b>20,945</b>	<b>23,167</b>	<b>27,140</b>
EBITDA	1,299	1,908	2,065	2,187	2,873
Depreciation	(589)	(613)	(640)	(674)	(713)
EBIT	709	1,294	1,426	1,513	2,160
Net interest inc./(exp.)	(494)	(401)	(296)	(327)	(273)
Other inc./(exp.)	125	128	134	141	148
Exceptional items	0	0	0	0	0
EBT	339	1,021	1,264	1,327	2,035
Income taxes	112	(229)	(328)	(334)	(513)
Extraordinary items	(256)	(180)	0	0	0
Min. int./Inc. from assoc.	(45)	(36)	(47)	(99)	(152)
<b>Reported net profit</b>	<b>150</b>	<b>577</b>	<b>888</b>	<b>893</b>	<b>1,370</b>
Adjustments	70	134	0	0	0
<b>Adjusted net profit</b>	<b>220</b>	<b>711</b>	<b>888</b>	<b>893</b>	<b>1,370</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
Accounts payables	1,729	1,839	2,255	2,475	2,900
Other current liabilities	1,347	1,641	1,749	1,904	2,231
Provisions	98	96	105	162	190
Debt funds	4,981	4,235	5,112	3,335	2,735
Other liabilities	358	321	323	323	323
Equity capital	85	85	85	85	85
Reserves & surplus	5,980	6,323	7,178	8,038	9,258
Shareholders' fund	6,064	6,407	7,263	8,123	9,343
<b>Total liab. and equities</b>	<b>15,519</b>	<b>15,536</b>	<b>17,882</b>	<b>17,300</b>	<b>18,546</b>
Cash and cash eq.	173	1,491	1,486	568	780
Accounts receivables	2,798	2,211	2,368	2,856	3,346
Inventories	3,282	2,455	2,737	3,174	3,718
Other current assets	1,085	806	903	952	1,115
Investments	341	898	600	0	0
Net fixed assets	7,779	7,588	7,520	7,482	7,320
CWIP	60	86	2,267	2,267	2,267
Intangible assets	0	0	0	0	0
Deferred tax assets, net	54	0	0	0	0
Other assets	0	0	0	0	0
<b>Total assets</b>	<b>15,519</b>	<b>15,536</b>	<b>17,882</b>	<b>17,300</b>	<b>18,546</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22A	FY23E	FY24E
<b>Cash flow from operations</b>	<b>1,191</b>	<b>3,168</b>	<b>1,967</b>	<b>1,256</b>	<b>1,785</b>
Capital expenditures	(664)	(414)	(2,779)	(550)	(550)
Change in investments	341	(557)	298	600	0
Other investing cash flows	0	0	0	0	0
<b>Cash flow from investing</b>	<b>(323)</b>	<b>(970)</b>	<b>(2,481)</b>	<b>50</b>	<b>(550)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(750)	(747)	878	(1,778)	(600)
Interest expenses	(494)	(401)	(296)	(327)	(273)
Dividends paid	(204)	(102)	(119)	(218)	(303)
Other financing cash flows	38	56	79	(99)	(152)
<b>Cash flow from financing</b>	<b>(1,411)</b>	<b>(1,193)</b>	<b>541</b>	<b>(2,422)</b>	<b>(1,328)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(543)</b>	<b>1,004</b>	<b>27</b>	<b>(1,116)</b>	<b>(93)</b>
<b>Closing cash &amp; cash eq.</b>	<b>(83)</b>	<b>1,178</b>	<b>1,518</b>	<b>370</b>	<b>476</b>

### Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22A	FY23E	FY24E
Reported EPS	3.5	13.6	21.0	21.1	32.3
Adjusted EPS	5.2	16.8	21.0	21.1	32.3
Dividend per share	2.0	2.4	2.4	4.4	6.1
Book value per share	143.1	150.9	171.1	191.4	220.1

### Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22A	FY23E	FY24E
EV/Sales	1.7	1.6	1.2	1.1	0.9
EV/EBITDA	20.5	14.1	12.3	11.5	8.9
Adjusted P/E	101.4	31.4	25.1	25.0	16.3
P/BV	3.7	3.5	3.1	2.8	2.4

### DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22A	FY23E	FY24E
Tax burden (Net profit/PBT)	64.8	69.7	70.3	67.3	67.3
Interest burden (PBT/EBIT)	47.9	78.9	88.6	87.7	94.2
EBIT margin (EBIT/Revenue)	4.4	7.8	6.8	6.5	8.0
Asset turnover (Rev./Avg TA)	99.6	105.9	124.8	131.4	151.4
Leverage (Avg TA/Avg Equity)	2.6	2.5	2.5	2.3	2.1
Adjusted ROAE	3.6	11.4	13.0	11.6	15.7

### Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22A	FY23E	FY24E
<b>YoY growth (%)</b>					
Revenue	(6.3)	3.0	26.9	10.6	17.1
EBITDA	(17.6)	46.9	8.3	5.9	31.4
Adjusted EPS	(55.1)	223.3	24.8	0.6	53.4
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	8.1	11.6	9.9	9.4	10.6
EBIT margin	4.4	7.8	6.8	6.5	8.0
Adjusted profit margin	1.4	4.3	4.2	3.9	5.0
Adjusted ROAE	3.6	11.4	13.0	11.6	15.7
ROCE	5.7	8.5	8.4	8.7	12.8
<b>Working capital days (days)</b>					
Receivables	79	55	40	41	42
Inventory	105	99	68	68	68
Payables	46	45	40	41	40
<b>Ratios (x)</b>					
Gross asset turnover	1.9	1.8	2.1	2.2	2.5
Current ratio	1.2	1.1	1.0	1.1	1.2
Net interest coverage ratio	1.4	3.2	4.8	4.6	7.9
Adjusted debt/equity	0.8	0.4	0.5	0.3	0.2

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

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## Disclaimer

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

**BUY** – Expected return >+15%

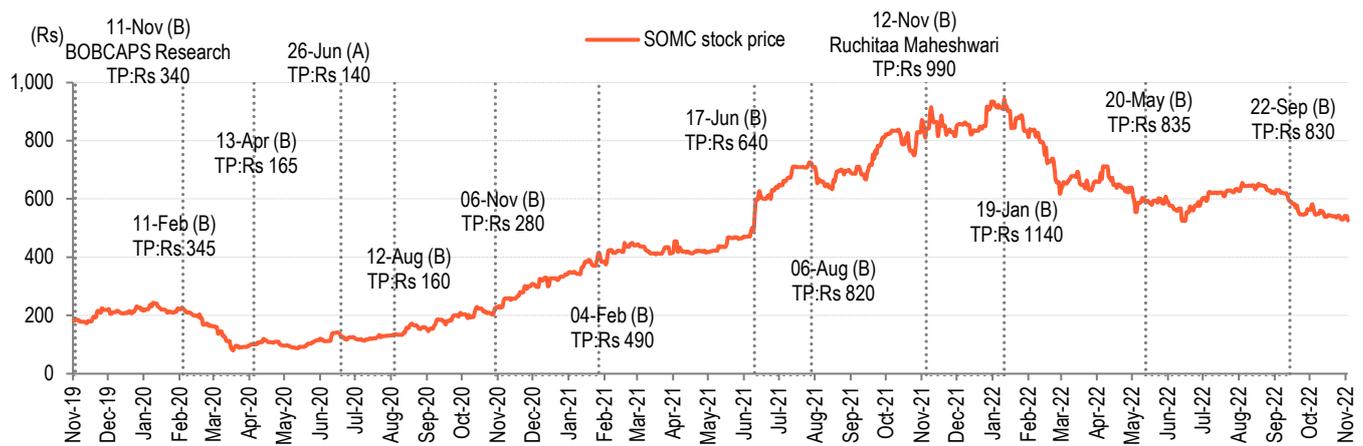
**HOLD** – Expected return from -6% to +15%

**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): SOMANY CERAMICS (SOMC IN)



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

### Analyst certification

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