

Kajaria Ceramics

21 January 2019

Reuters: KAJR.NS; Bloomberg: KJC IN

Solid Volume Growth & Cost Tailwind Lifts Performance

Kajaria Ceramics' (KCL) 3QFY19 outperformance was led by a strong 16% volume growth and crude oil price tailwind. Volume growth was supported by all regions as the real estate market shows signs of an early recovery of the business cycle. This was the second consecutive quarter of double-digit volume growth (12% in 2QFY19) after average growth of 8% in the previous 15 quarters. Revenues increased 15% YoY to Rs7,585mn, 2% above our and Bloomberg consensus estimates. The company reported EBITDA of Rs1,208mn which was 3% below our estimate, but 5% above Bloomberg consensus estimate. EBITDA margin for the quarter was 15.9%, 150bps above our estimate, but down 70bps YoY, which was largely expected because of the rise in gas costs compared to last year. PAT increased 19% YoY to Rs648mn following lower finance costs and higher other income. Working capital days inched up to 62 days (versus 59 days QoQ). KCL's stock price increased nearly 40% since our Buy call while initiating coverage in September last year. Even in the tough demand environment, the company continues to make efforts to remain ahead of the curve. Innovation in terms of product size, spray drying process and raw material used are a few recent examples. We like the company for its solid management skills, leadership position, lower working capital investment and best balance sheet in the sector. However, we believe the positives are well reflected in the current stock price and hence we have downgraded our rating to Accumulate. We have valued KCL at 26x exit multiple based on FY20 September EPS estimate of Rs19.66. Our updated target price of Rs510 (from Rs492 earlier) translates into a 4% downside from the CMP. Our exit multiple of 26x is nearly 30% discount to the stock's past five-year median multiple of 37x.

Brent crude oil price to keep margins volatile: Gas costs equal 20% of KCL's revenues and are actually slightly lower than the peer group because of better manufacturing practices. Gas prices depend on three-month average Brent crude oil prices which remained highly volatile in the past few months. During 3QFY19, Brent crude oil price averaged US\$68.6/bbl (11.6% YoY and -9.6% QoQ) and currently trades at US\$61.8/bbl. We expect Brent crude oil prices to average US\$65.0/bbl during 4QFY19 vs. US\$67.0/bbl YoY and US\$68.6/bbl QoQ. Thus, we have increased our EBITDA margin estimate for 4QFY19 by 75bps to 14.9%. KCL continues to improve its raw material quality and spray drying process which helps in reducing overall gas consumption. Having said that, empirical evidence suggests that the technological edge is difficult to maintain in this highly competitive industry.

Demand visibility to support our long-term Buy thesis: KCL's margins are already on the higher side because of the fall in crude oil prices. We believe the stock will continue to oscillate with Brent crude oil and gas prices, providing trading opportunities. We do not rule out solid gains to be made in such trading as Brent crude oil prices remain highly volatile (volatility is a trader's friend). However, any long-term Buy thesis on the stock depends largely on sustainable demand revival and market share gains. Therefore, we would like to see better demand visibility on the ground to upgrade our rating on the stock as competition remains tough.

Sanitaryware and faucet business growth at 41%: KCL continues to make strong inroads into the sanitary ware and faucet markets. Taking full advantage of its already established distribution network and strong relationship with dealers, KCL was able to push its new products very well. The combined sales of sanitary ware and faucets in 3QFY19 increased 41% YoY and 12% QoQ to Rs489mn and now contribute 6.5% to KCL's overall sales.

Consolidated results (Rsmn)	3QFY19	3QFY18	2QFY19	YoY (%)	QoQ (%)	9MFY19	9MFY18	YoY (%)
Net sales & other income	7,586	6,612	7,253	14.7	4.6	21,409	19,606	9.2
Purchase of finished goods	(1,095)	(809)	(899)	35.3	21.8	(2,683)	(2,456)	9.2
COGS	(3,419)	(2,958)	(3,399)	15.6	0.6	(9,940)	(8,910)	11.6
Opt & mfg. expenses	(1,864)	(1,745)	(1,866)	6.8	(0.1)	(5,520)	(4,877)	13.2
EBITDA	1,208	1,100	1,089	9.9	10.9	3,266	3,363	(2.9)
EBITDA margin (%)	15.9	16.6	15.0	(70bps)	90bps	15.3	17.2	(190bps)
Depreciation	(221.8)	(222.6)	(225.3)	(0.4)	(1.6)	-674	(657)	2.6
EBIT	987	877	864	12.5	14.2	2,592	2,706	(4.2)
EBIT margin	13.0	13.3	11.9	(30bps)	110bps	12.1	13.8	(170bps)
Net interest income & other income (cost)	9	(35)	(33)	(126)	(127)	(42)	(130)	(67.4)
PBT	996	843	830	18.2	19.9	2,549	2,577	(1.1)
Tax	(337)	(311)	(324)	8.1	3.9	(931)	(987)	5.7
PAT	659	531	506	24.1	30.1	1,619	1,590	1.8
PAT margin (%)	8.7	8.0	7.0	70bps	170bps	7.6	8.1	(50bps)
Diluted EPS	4.1	3.3	3.2	24.0	30.4	10.17	10.00	1.7
Minority interest	11	12	4	NA	NA	17	100	(82.8)
Consolidated PAT	670	543	511	23.3	31.2	1,636	1,690	(3.2)

Source: Company, Nirmal Bang Institutional Equities Research

ACCUMULATE

Sector: Building Materials

CMP: Rs533

Target Price: Rs510

Downside: 4%

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Key Data

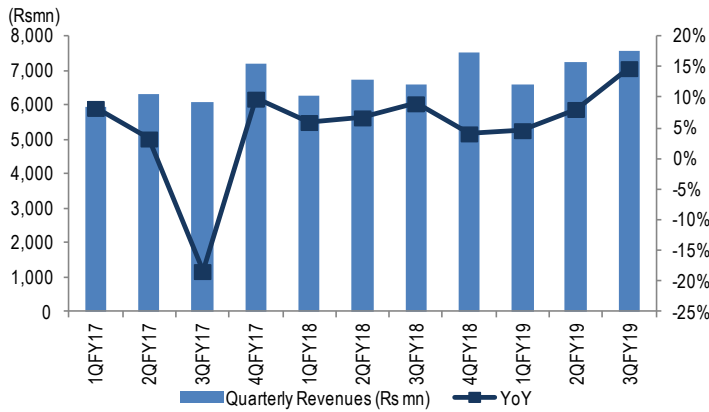
Current Shares O/S (mn)	159.0
Mkt Cap (Rsbn/US\$bn)	85/1.2
52 Wk H / L (Rs)	739/310
Daily Vol. (3M NSE Avg.)	727,666

Price Performance (%)

	1 M	6 M	1 Yr
Kajaria Ceramics	9.9	27.6	(25.4)
Nifty Index	1.4	(0.9)	0.1

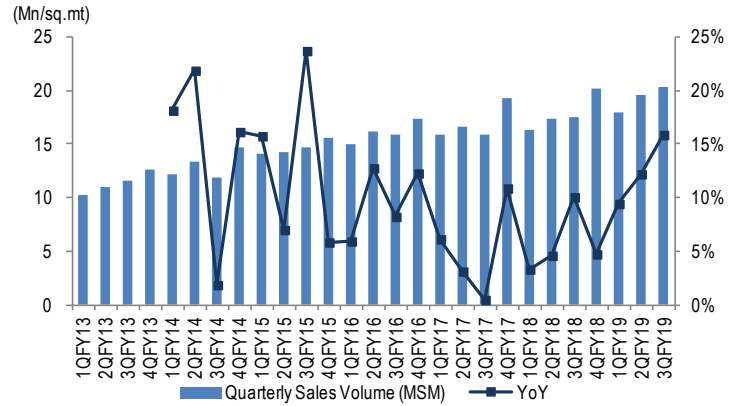
Source: Bloomberg

Exhibit 1: Quarterly revenues (Rsmn)



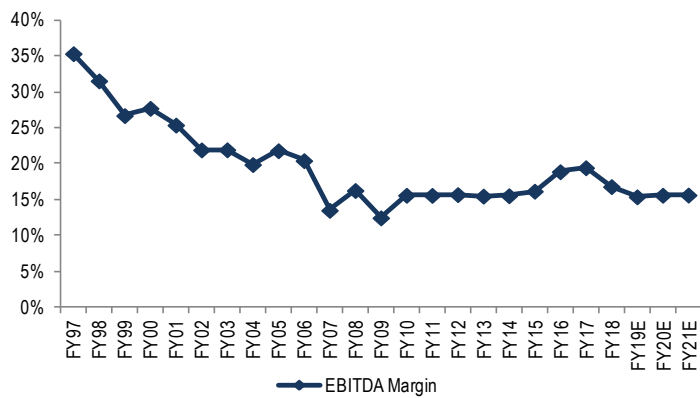
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Quarterly sales volume (msm)



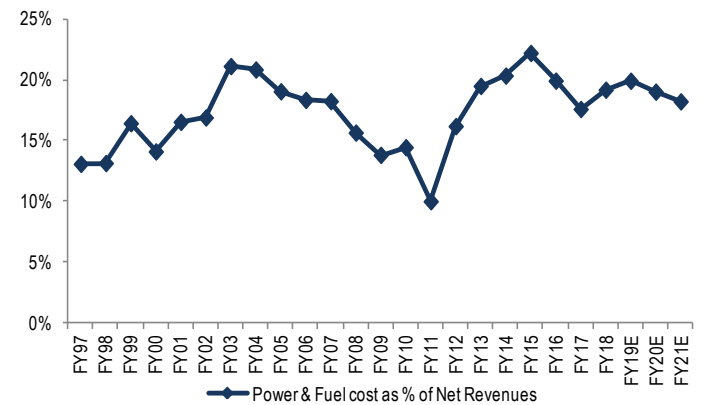
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Long-term EBITDA margin



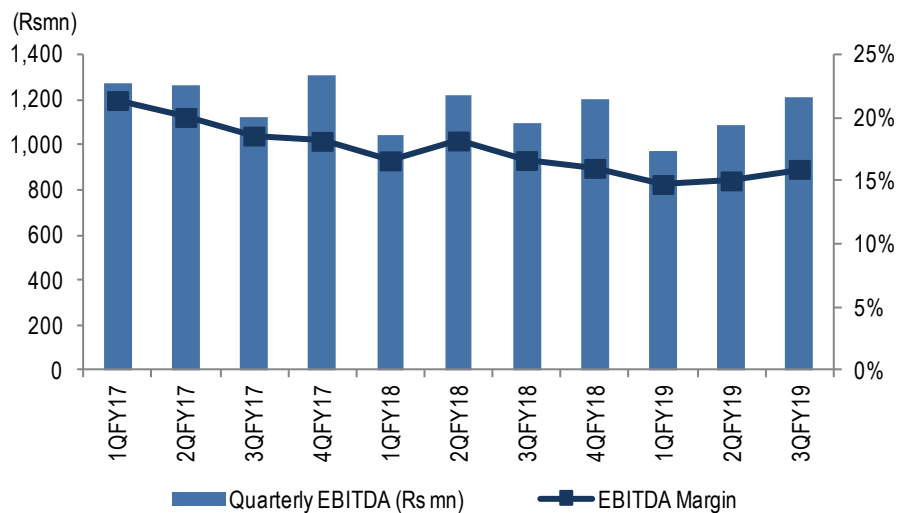
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Power & fuel costs as a percentage of net revenues



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Quarterly EBITDA (Rsmn)



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 6: Income statement

Y/E March (Rsmn): Consolidated	FY17	FY18	FY19E	FY20E	FY21E
Net revenues	25,496	27,106	30,049	34,254	39,260
YoY (%)	6	6	11	14	15
Purchase of finished goods	(2,297)	(3,432)	(3,936)	(4,852)	(5,553)
% of sales	9	13	13	14	14
COGS	(12,601)	(13,274)	(13,829)	(15,631)	(17,916)
Gross profit	10,599	10,400	12,285	13,770	15,792
Selling, general & admin. expenses	(2,372)	(2,307)	(3,215)	(3,460)	(3,965)
Other operating & employee expenses	(3,263)	(3,529)	(4,439)	(4,956)	(5,679)
EBITDA	4,963	4,564	4,631	5,354	6,147
Depreciation	(814)	(885)	(898)	(925)	(1,061)
EBIT	4,149	3,678	3,733	4,429	5,087
YoY (%)	8	(11)	1	19	15
Interest expenses	(340)	(241)	(157)	(135)	(135)
Interest income	23	35	136	130	190
Other Income	130	81	(34)	0	0
PBT (adjusted)	3,833	3,472	3,711	4,424	5,142
- Income tax expenses	(1,425)	(1,267)	(1,314)	(1,527)	(1,773)
Effective tax rate (%)	36	36	36	35	34
- Minority interest	(10)	64	-	-	-
PAT (adjusted)	2,398	2,269	2,398	2,898	3,368
Diluted EPS (adjusted)	15.1	14.2	15.1	18.2	21.1

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Balance sheet

Y/E March (Rsmn): Consolidated	FY17	FY18	FY19E	FY20E	FY21E
Equity	159	159	159	159	159
Reserves	11,592	13,351	15,212	17,530	20,056
Net worth	11,751	13,510	15,371	17,689	20,215
Accounts payables	2,677	2,578	2,677	3,086	3,536
Other ST liabilities	2,312	2,153	2,153	2,153	2,153
Short-term loans	551	757	757	757	757
Total current liabilities	5,540	5,487	5,586	5,996	6,446
Long-term loans	1,155	594	594	594	594
Other LT liabilities	1,195	1,151	1,151	1,151	1,151
Minority interest	760	661	661	661	661
Total equity & liabilities	20,401	21,403	23,363	26,091	29,067
Gross block	16,504	16,833	18,366	19,907	21,438
Depreciation	(4,845)	(5,497)	(6,395)	(7,321)	(8,381)
Net block	11,658	11,336	11,970	12,587	13,057
Other LT assets + WIP	522	549	549	549	549
Long-term investments	1	4	4	4	4
Inventories	3,720	3,785	3,991	4,602	5,272
Debtors	3,389	4,507	4,281	4,786	5,486
Cash & ST Investments	520	824	2,169	3,165	4,300
Other current assets	592	398	398	398	398
Total current assets	8,221	9,513	10,839	12,950	15,456
Net current assets	2,681	4,026	5,253	6,955	9,010
Total assets	20,401	21,403	23,363	26,090	29,066

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Cash flow

Y/E March (Rsmn): Consolidated	FY17	FY18	FY19E	FY20E	FY21E
PBT	3,963	3,553	3,711	4,424	5,142
Depreciation & amortisation	814	885	898	925	1,061
Other non-cash adjustments	(916)	(1,046)	(1,314)	(1,527)	(1,773)
Changes in working capital	(485)	(1,009)	119	(706)	(920)
Cash from operating activities	3,377	2,383	3,415	3,117	3,508
Disposal of fixed assets	45	145	-	-	-
Capital expenditure	(1,470)	(1,527)	(1,533)	(1,541)	(1,531)
Increase in investments & subsidiaries	35	-	-	-	-
Decrease in investments	-	-	-	-	-
Other investing activities	28	(21)	-	-	-
Cash from investment activities	(1,362)	(1,403)	(1,533)	(1,541)	(1,531)
Dividends paid	(491)	(572)	(537)	(580)	(842)
Change in short-term borrowing	(554)	306	-	-	-
Increase in long-term borrowing	-	-	-	-	-
Decrease in long-term borrowing	(266)	(225)	-	-	-
Increase in capital stock	(28)	12	-	-	-
Decrease in capital stock	-	-	-	-	-
Other financing activities	(340)	(241)	-	-	-
Cash from financing activities	(1,679)	(720)	(537)	(580)	(842)
Net change in cash balance	336	260	1,345	996	1,135

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Key ratios

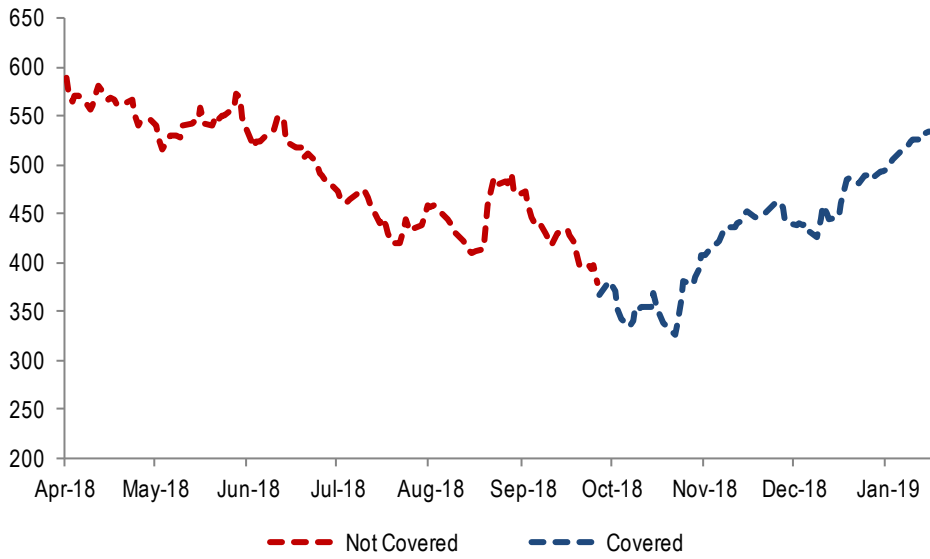
Y/E March (Rsmn): Consolidated	FY17	FY18	FY19E	FY20E	FY21E
Profitability & return ratios					
EBITDA margin (%)	19.5	16.8	15.4	15.6	15.7
EBIT margin (%)	16.3	13.6	12.4	12.9	13.0
Adj. Net profit margin (%)	9.4	8.4	8.0	8.5	8.6
RoE (%)	23.6	18.6	16.4	17.5	17.8
RoCE (%)	31.3	25.3	23.4	24.8	25.1
Pre-tax RoIC (%)	32.2	26.5	25.8	29.1	30.7
Working capital ratios					
Receivables (days)	44	53	52	51	51
Inventory (days)	93	82	82	82	82
Payables (days)	69	57	55	55	55
Cash conversion cycle	68	78	79	78	78
Leverage and FCF ratios					
Net cash (debt) (Rsmn)	(1,612)	(879)	818	1,814	2,949
Net debt (cash)/equity (%)	(14)	(7)	5	10	15
Total debt/equity (%)	0.18	0.13	0.09	0.08	0.07
FCFyield (%)	2.1	1.1	2.2	1.9	2.3
FCF/sales (%)	7.7	3.7	6.3	4.6	5.0
Valuation ratios					
EV/sales (x)	3.7	3.4	2.9	2.5	2.2
EV/EBITDA (x)	19.2	20.2	18.7	16.2	14.1
P/E (x)	38.8	40.0	35.6	29.4	25.3
P/BV (x)	7.9	6.7	5.5	4.8	4.2

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
28 September 2018	Buy	380	492
26 October 2018	Buy	390	492
21 January 2019	Accumulate	533	510

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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