COMPANY REPORT

Kajaria Ceramics – HOLD

Market share gain to gather pace

Volume growth intact

Kajaria Ceramics (KCL) reported consolidated sales growth of 8.7% yoy in Q4FY19 as volumes grew by 10.7% yoy but realizations dipped by 2.9% yoy. The Company has done a commendable job of maintaining double digit volume growth for 3rd consecutive quarter amid extremely challenging demand environment (vs flat industry growth in FY19) driven by market share gain from unorganized players. EBITDA margin came at 14.9%, down 110bps yoy led by gross margin contraction of 468bps yoy & unfavorable revenue mix (Outsourced sales contribution was at 24% in Q4FY19 vs 20% in Q4FY18). Sales volume from own manufacturing/JVs/outsourced grew by 1.7%/15.3%/35.4% y-o-y, respectively. KCL has Rs2.5bn cash on books as of FY19 while limited capex requirement (Rs2.5bn over next 2 years) considering strong operating cash flow generation.

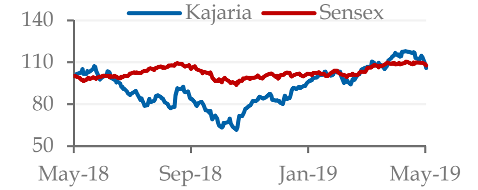
Management is eying to increase its volume share from 10% to 14% over next 3 years & has guided for ~15% volume growth with stable pricing regime in FY20E. Two-thirds of domestic unbranded ceramic tiles production, have been severely impacted by NGT's Mar'19 order regarding ban on coal gasifier which, in the event of any anti-dumping duties imposed by the Gulf nations (investigations have already been announced), will act like a double whammy. We believe that tightening compliance through stricter E-way implementation will likely be a game changer for the branded companies like KCL. However, we would wait for more clarity on its actual impact on unorganized Morbi manufacturers as well as some stability in GVT pricing and core demand recovery & hence building in 12% volume CAGR over FY19-21E. We assign HOLD rating with TP of Rs640 at 30x FY21 EPS.

CMP (Rs) 587	12-mths Target (Rs) 640	Upside 9%

Stock data (As on May 14, 2019) — **Sector: Building Materials**

Sensex:	37,789
52 Week h/l (Rs)	634/316
Market cap (Rs bn)	93.3
Enterprise value (Rs bn)	89.5
6m Avg t/o (Rs mn):	325
FV (Rs):	1
Div yield (%):	0.5
Bloomberg code:	KJC IN
BSE code:	500233
NSE code:	KAJARIACER

Stock performance



Shareholding pattern (As of Mar'19 end)

Promoter	47.6%
FII+DII	36.3%
Others	16.1%

Exhibit 1: Result table (Consolidated)

(Rs mn)	Q4 FY19	Q4 FY18	% yoy	Q3 FY19	% qoq
Volume (MSM)	22.5	20.3	10.7	20.2	11.2
ASP (Rs/sqm)	362	373	(2.9)	371	(2.3)
Total sales	8,153	7,500	8.7	7,586	7.5
EBITDA	1,215	1,201	1.2	1,208	0.6
EBITDAM (%)	14.9	16.0	(110.5)	15.9	(102.5)
Depreciation	(217)	(229)	(5.2)	(222)	(2.3)
Interest	(33)	(47)	(30.3)	(36)	(9.9)
Other income	65	51	27.0	45	44.2
PBT	1,031	977	5.6	996	3.6
Tax	(362)	(280)	29.3	(337)	7.6
Share in JVs/MI	0	(37)		0	
Adjusted PAT	669	660	1.3	659	1.5
Exceptional item	9	-		-	

Source: Company, YES Sec - Research

May 15, 2019

Research Analyst: Umesh Raut umesh.raut@yessecuritiesltd.in
Head of Research: Amar Ambani amar.ambani@yessecuritiesltd.in

Exhibit 2: Cost analysis (Consolidated)

As a % of net sales	Q4 FY19	Q3 FY19	bps yoy	Q4 FY18	bps qoq
COGS	28.4	25.8	263	24.7	376
Traded goods	15.1	13.0	205	14.4	63
Other expenses	12.9	14.1	(129)	13.3	(41)
Power & fuel	17.9	20.3	(242)	20.4	(254)
Employee cost	10.9	10.8	13	11.3	(42)
Total costs	85.1	84.0	110	84.1	103

Source: Company, YES Sec - Research

Double whammy for ceramic tile makers over NGT order & possible anti-dumping duties

National Green Tribunal (NGT) has ordered to shut all ceramic tile manufacturing units using coal gasifiers in the Morbi cluster of Gujarat, which accounts for 85% of ceramic tiles produced in India. Most of them have shifted to piped natural gas (PNG) and increased domestic prices of ceramic tiles (about three-fourths of production is sold within India) to partially pass on the rise in manufacturing costs and thus limited their margin contraction. However, ceramic tiles exports, which are largely dominated by SMEs, were severely hit, since players couldn't pass on cost hikes in an intensely competitive global market. Further, Gulf Cooperation Council (GCC) nations, which purchase about 40% of India's exports, announced anti-dumping duty investigations on tiles imported from India, China and Spain in Dec'18. While India will continue to export to the GCC region because of a production deficit there, margins are likely to be hit severely if any anti-dumping duty is imposed. Thus, the NGT order is expected to reduce the exports of SME tile manufacturers, leading to a fall in unbranded industry sales volume by 2-4% in FY20.

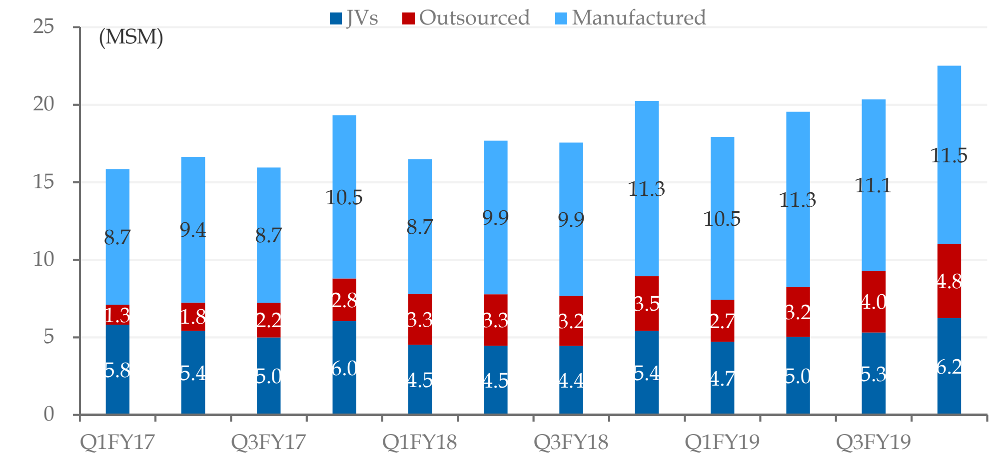
Margin recovery on the cards

NGT's order stating ban on the usage of coal gasifiers on Morbi tile manufacturers (450 units were running on gasifiers out of ~850 units) have mandated unorganized players to switch to natural gas as fuel source. This entails an increase in tax compliance, working capital requirements (Gas availability at 10-15 payable days versus 90-120 days for coal) and higher security deposits for gas which has increased the cost of production for unorganized players narrowing the price gap of products with the national players like Kajaria Ceramics. Management has indicated that these organized players have taken a price hike of 5-8% recently across all the tiles products categories to counter the increasing cost pressures. KCL has also taken a 5-6% price hike in west & south regions. Hence, we believe competitive pricing pressures for KCL to ease out in near term. Assuming gas prices remain less volatile, margin recovery could be on the cards for KCL in coming quarters.

Minimal capex plans in near term

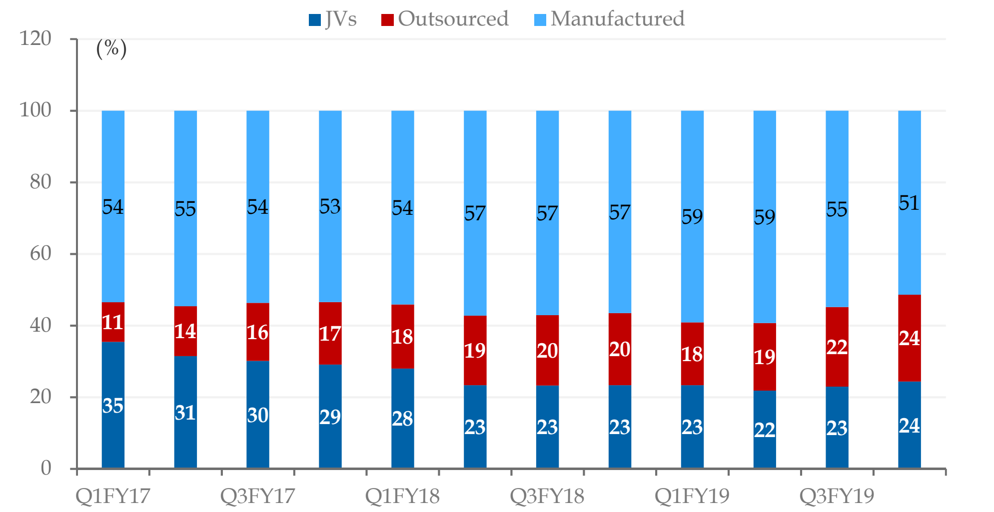
Kajaria would be incurring Rs2.5 bn capex over the next two years of which Rs1.5bn would be towards Southern India expansion, Rs210mn in Sanitaryware, balance being maintenance capex. The company's 5 million square meter (MSM) GVT manufacturing plant in Andhra Pradesh is expected to be commissioned by August 2019. The sanitaryware segment which is operating at full capacity utilization will see an increase of 1.5 lacs pieces p.a. expansion from 6 lacs pieces p.a. by August 2019. The faucet manufacturing facility of 1 million pcs p.a. operated at 65% capacity utilization during FY19 (45% in FY18) is expected to attain a 90% capacity utilization in FY20. The bathware segment reported revenues of Rs1.85bn in FY19 & company expects it to grow by 30% yoy over next 3-4 years.

Exhibit 3: Quarterly volume trends



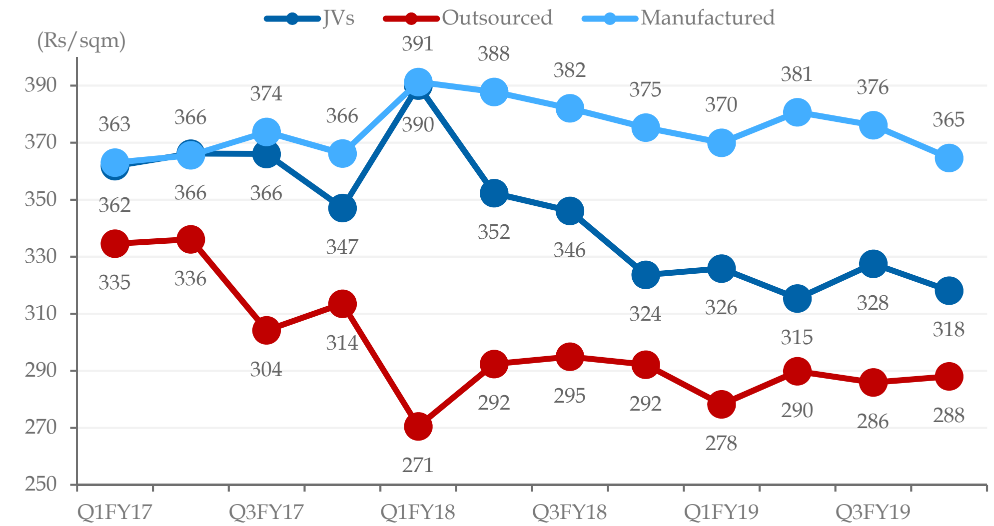
Source: Company, YES Sec - Research

Exhibit 4: Outsourcing sale was at 24% Q4FY19 vs 20% Q4FY18



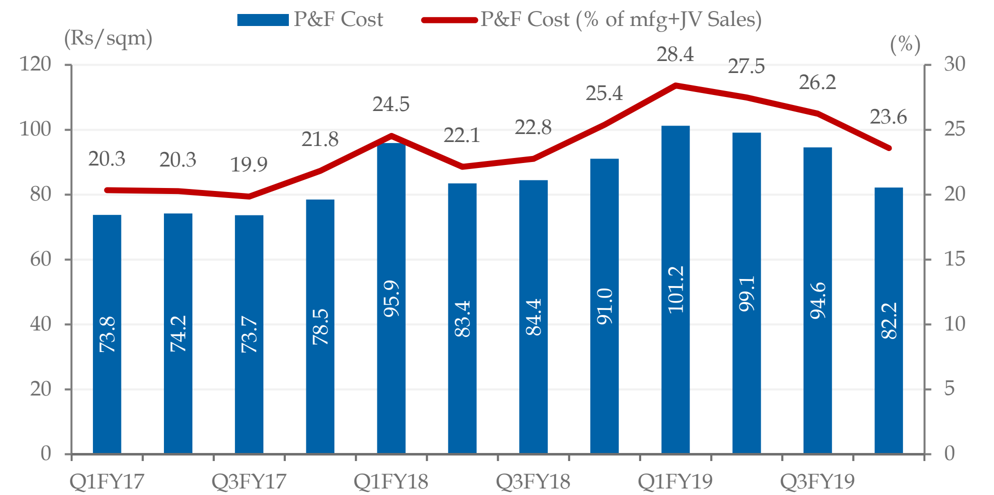
Source: Company, YES Sec - Research

Exhibit 5: Realizations have bottomed out now



Source: Company, YES Sec - Research

Exhibit 6: Power & fuel cost is on declining trend



Source: Company, YES Sec - Research

Exhibit 7: Financial summary

Y/e 31 Mar (Rs mn)	FY17	FY18	FY19	FY20E	FY21E
Revenues	25,496	27,106	29,562	32,981	37,479
yoy growth (%)	5.6	6.3	9.1	11.6	13.6
EBITDA	4,963	4,564	4,495	5,216	6,140
EBITDAM (%)	19.5	16.8	15.2	15.8	16.4
Adjusted PAT	2,528	2,342	2,314	2,820	3,391
yoy growth (%)	9.3	(7.4)	(1.2)	21.9	20.2
EPS (Rs)	15.9	14.8	14.3	17.7	21.3
P/E (x)	36.4	39.1	40.6	32.6	27.1
P/BV (x)	7.8	6.8	5.8	5.1	4.4
EV/EBITDA (x)	19.0	20.4	20.3	17.4	14.6
D/E (x)	0.2	0.1	0.1	0.1	0.0
ROE (%)	23.5	18.5	15.8	16.7	17.5
ROCE (%)	32.4	26.3	24.0	25.3	26.5

Source: Company, YES Sec - Research

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BUY > 15%

ADD 5% to 15%

HOLD -15% to +5%

SELL > - 15%

NOT RATED

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