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Company update

Tiles

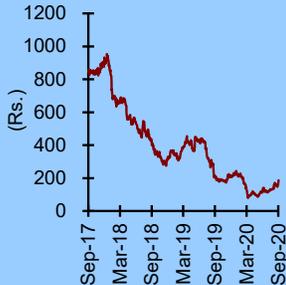
Target price: Rs304

Shareholding pattern

	Dec '19	Mar '20	Jun '20
Promoters	51.5	51.5	51.5
Institutional investors	22.9	21.8	20.5
MFs and others	17.6	16.6	15.3
FIs/Banks	0.1	0.1	0.1
Insurance	1.4	1.4	1.3
FII	3.8	3.7	4.0
Others	24.6	26.7	28.0

Source: NSE

Price chart



INDIA

Somany Ceramics

BUY

Maintained

Rs185

Making a qualitative comeback

We hosted Mr. Abhishek Somany, MD of Somany Ceramics, for the I-Sec Virtual Corporate Day event. The key takeaways from the event, which saw participation from 7 marquee investors, include: a) Faster-than-anticipated recovery in volumes thus far; b) impressive cash collection since Jun'20 leading to sizeable cash surplus situation (on standalone basis) despite prepayment of term loan worth Rs250mn in Aug'20; c) last phase of unwinding of treasury operations under way (left over ICDs at mere Rs120-130mn); likely paring of debt to the tune of Rs1bn over the next 12 months; e) likely fixed cost reduction of Rs500-550mn in FY21E of which Rs100-120mn would be of sustainable nature; and f) structural improvement in EBITDA margins with close to double-digit margins in FY21 (ex-Q1), 11-12% in FY22 and moving back to 13-14% margin trajectory post FY22. Maintain BUY.

Faster than anticipated sales recovery witnessed in Q2 thus far. After May and Jun'20 witnessed robust cash collections from the trade, the company has progressively seen a sharp recovery in sales over the last three months. The capacity utilisation too has seen a marked improvement during the same period. The sales recovery, capacity utilisation and cash collection trends post Covid-19 outbreak are highlighted as under:

Month	Capacity Utilisation	Sales recovery	Cash collection	Comments, if any
Apr'20	0%	0%	0%	Amid complete lockdown
May'20	0%	35%	Strong	Partial unlocking in last week of May
Jun'20	40%	65%	Strong	Firm demand witnessed in rural India
Jul'20	60%	80-85%	Strong	Demand recovery started in tier-2 and semi-urban towns
Aug'20	80%	100%	Strong	Recovery sustains; also aided by muted sales in states like Kerala (floods), J&K (Article 370) and Nepal in the base (Aug'19)
Sep'20E	100%	Unlikely to hit 100% mark due to higher base	Strong	Recovery likely to sustain. Few metros/tier-1 cities already witnessing initials signs of recovery. However, others still witnessing poor off take.

Source: Company data, I-Sec research

Demand drivers enabling better than anticipated sales recovery

- ▶ Firm demand from tier 2-5 cities and towns with unlocking (post Covid-19 outbreak) much quicker than anticipated
- ▶ Pick-up in new construction activities in smaller towns in particular
- ▶ Fast improving retail sales pan-India since Jun'20 with fears of Covid-19 receding - driving better than anticipated renovation demand
- ▶ Sharp curtailment in receivables enabling SOMC to focus on volumes
- ▶ Market share gains from tier-2 organised brands and unorganised Morbi players

Market Cap	Rs11.4bn/US\$155mn	Year to Mar	FY19	FY20	FY21E	FY22E
Reuters/Bloomberg	SOCE.BO/SOMC IN	Revenue (Rs mn)	17,151	16,101	14,551	17,612
Shares Outstanding (mn)	61.5	Rec. Net Income (Rs mn)	463	150	241	716
52-week Range (Rs)	462/77	EPS (Rs)	13.8	5.7	5.7	16.9
Free Float (%)	48.5	% Chg YoY	(34.2)	(67.6)	60.7	197.1
FII (%)	4.0	P/E (x)	16.9	52.3	32.5	10.9
Daily Volume (US\$'000)	230	CEPS (Rs)	21.4	17.4	20.2	32.1
Absolute Return 3m (%)	36.1	EV/E (x)	7.7	9.2	8.7	5.2
Absolute Return 12m (%)	(10.0)	Dividend Yield (%)	1.1	2.7	1.4	1.5
Sensex Return 3m (%)	14.2	RoCE (%)	10.9	6.9	5.4	10.1
Sensex Return 12m (%)	7.4	RoE (%)	8.5	3.5	3.3	9.2

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Status on demand from metros and tier-1 cities

- Some green shoots visible in cities like Ahmedabad, Delhi, Jaipur, Bangalore, Pune, etc
- Mumbai, Chennai and Kolkata still struggling in particular

Table 1: Current sales mix and its projected mix going forward

Markets	FY20 sales mix	Post Covid-19 mix	Targeted mix going forward
Retail	75%	85-90%	80%
Private builders	11%	10-15% from private	4%
Government	12%	builders, Govt and	12%
Corporates	2%	corporates	4%

Source: Company data, I-Sec research

Market share gains witnessed for top branded players post Covid-19

Post Covid-19 outbreak, top branded players have seen some market share gains in domestic market. This is largely attributed to dealers gradually preferring organised brands over Morbi unorganised brands driven by:

- Cash and carry model adopted even by Morbi players
- Morbi players moving away from aggressive discount structure
- Erratic supply in domestic market from Morbi players with increasing focus on exports

Key rationale behind likely traction in Q3FY21 revenues

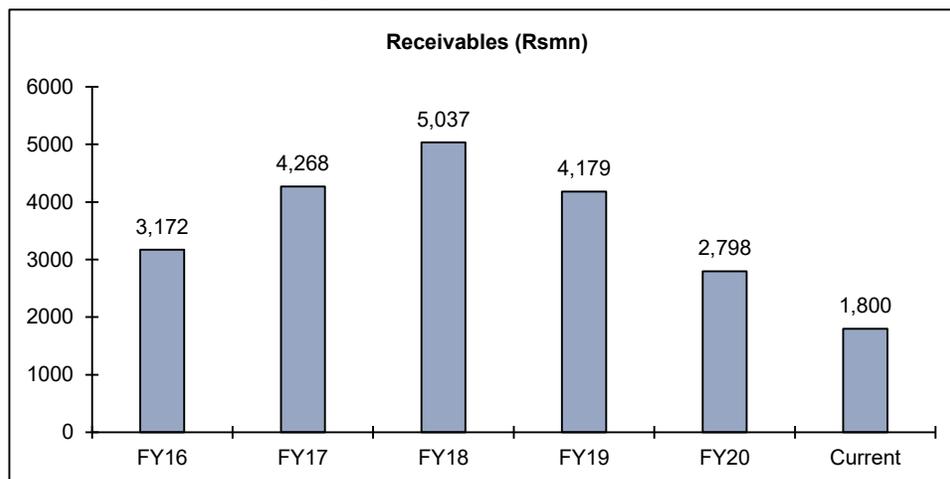
Management expects Q2 sales recovery at 85%+ in Q2FY21. Barring unforeseen circumstances of further lockdown in the wake of current pandemic, it expects growth to pick-up further in Q3 largely driven by:

- Impressive cash collections driven from higher CD (cash discounting) sales (45% of sales) post Covid-19 vs 23% of pre-Covid-19 sales.
- Sustained growth traction from tier 2-5 cities and towns
- Likely traction from metros and tier-1 cities

Sharp curtailment of receivables post Covid-19 outbreak

SOMC receivables stood at Rs5bn (108 days) in FY18. Since then, the company has been taking active steps to cut down its receivables. However, post Covid-19 outbreak, with the entire trade moving on to cash and carry model, the company has been able to put a firm check on its receivables which have now gone below 60-65 days. This has led to its receivables shrinking drastically to Rs1.8bn at present.

Chart 1: Curtailment of past receivables



Source: Company data, I-Sec research

Significant paring of debt likely by end-FY21

- SOMC's consolidated debt stood at Rs4.45bn (excluding current maturities) in FY20
- SOMC has repaid term loan (long term) to the tune of Rs250mn in Aug'20
- Surplus cash generation at Rs350-400mn due to zero/negative working capital at present
- Likely net debt as on Sep'20 at Rs3.8bn
- QIP surplus invested in bonds (Rs42mn), NCDs (Rs290mn) and ICDs (Rs130-140mn) to the tune of Rs470mn.
- Likely net debt (adjusting for QIP surplus) position by end-FY21 at Rs3.3bn

Consolidated margins likely to hit peak levels of 13-14% by FY23

OMC expects its consolidated margins to improve to 9-10% in FY21 and further to 11-12%/13-14% in

FY22/FY23, respectively. The levers for the same include:

- Recent cost cutting initiatives (like work from home, retrenchment of few employees/labour, travel, etc) to the tune of Rs150-200mn which are sustainable in nature
- Operating leverage
- Superior product mix

- Stable category realisations
- Traction in sale of higher margin allied products (sanitaryware and faucets)

Looking at dealer network expansion in a post Covid-19 environment

- 200-250 dealer addition likely this fiscal
- Zero showroom addition in Q1; 7-8 additions likely in Q2 and targeting 25 new showrooms in FY21
- Expect active exclusive franchisee showrooms mark to reach 325 by end-FY21
- Revenues from these showrooms likely at Rs6bn (42-43% of revenues)

Top to medium level management changes post slip-ups

- Hardly any change in mid-level management
- There have been some senior level management changes in past 4 years
 - Head of Sales Mr. Amit Sahai joined in place of Mr. Kalra
 - Mr. Saikat Mukhopadhyay joined SOMC as CFO – two and a half years back
 - Mr. T.R. Maheshwari (earlier CEO) has retired. Mr. Abhishek Somany replaces him as the new CEO
 - New plant head Mr. Amir Mahapatra also inducted into the system a year back
 - All product heads, CFO as well as plant heads, report to MD & CEO Mr. Abhishek Somany

Checks and balances in place post the employee fraud

- There has been a complete overhaul of internal processes and systems
- Key functions like purchase, accounts, etc have now been centralised
- Reduced number of signatories to 5 from 15-20 signatories earlier
- Standard operating procedures (SOPs) introduced for procurement, finance and other key functions

Status on earlier slip-ups

A) Employee fraud

- The employee (involved in fraud) and his wife have been nabbed
- Both are behind bars; conditional bail has been granted subject to payment of Rs70mn
- Expect some recovery in near term from sale of his assets

B) Broker fraud

- The broker default was to the tune of Rs260mn
- The case is currently contested by SOMC
- The company has already provided for this loss last year as a matter of accounting prudence
- Management expects recovery over medium term

C) ICDs pending to the tune of Rs120-130mn

- SOMC, which had its ICDs worth Rs330mn at the start of Apr'20, has already recovered ICDs to the tune of Rs200mn
- Duly received part disbursement of SREI Infrastructure bonds along with interest (due) in March last year
- Expect to recover balance ICDs (Rs120-130mn) in next 2-3 quarters
- These funds may be deployed back in the business or would be used to pare its debt

Status on Morbi ceramics sector

- 60-70 plants (which were using coal with old technology kilns) have shut down permanently post Covid-19 led lockdown
- Morbi's units are doing very well with exports going through the roof
- Checks suggest Morbi units have already been able to generate export revenues to the tune of Rs50-60bn over Apr-Jul'20 compared to FY20 revenues of Rs100bn
- Anti-dumping duty on GCC exports (levied on India and China) has had little impact post its imposition in Jun'20
- Firm exports demand and strong cash collections have deleveraged Morbi units to a large extent
- 20-30 additional Morbi units may come up in current fiscal
- Payback period of Morbi units has gone up to 7-8 years vs 2.5-3 years earlier.

Financial summary

Table 2: Profit & loss statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Net Revenues	17,151	16,101	14,551	17,612
Operating Expenses	15,517	14,787	13,293	15,675
EBITDA	1,634	1,314	1,258	1,937
% margins	9.5%	8.2%	8.6%	11.0%
Depreciation & Amortisation	443	590	615	644
Gross Interest	459	494	425	321
Other Income	192	127	71	53
Recurring PBT	924	358	288	1,025
Less: Taxes	268	(99)	73	258
Add: Profit from share of associates	-	-	-	-
Less: Minority Interest	69	45	(26)	50
Net Income (Reported)	586	412	241	716
Extraordinaries (Net)	(122)	(262)	-	-
Recurring Net Income	463	150	241	716

Source: Company data, I-Sec research

Table 3: Balance sheet

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Assets				
Total Current Assets	8,586	7,393	8,238	9,161
of which cash & cash eqv.	400	201	154	162
Total Current Liabilities & Provisions	3,945	3,705	4,394	5,122
Net Current Assets	4,640	3,688	3,844	4,039
Investments	683	341	104	90
Net Fixed Assets	7,056	7,706	10,234	7,872
Capital Work-in-Progress	247	60	-	-
Goodwill	44	73	73	73
Total Assets	12,670	11,869	14,255	12,073
Liabilities				
Borrowings	5,106	4,451	6,298	3,607
Deferred Tax Liability	567	413	413	413
Minority Interest	867	941	1,362	1,290
Equity Share Capital	85	85	85	85
Face Value per share (Rs)	2	2	2	2
Reserves & Surplus*	6,045	5,980	6,097	6,679
Less: Misc. Exp. n.w.o.	-	-	-	-
Net Worth	6,130	6,065	6,182	6,764
Total Liabilities	12,670	11,869	14,255	12,073

*Excluding revaluation reserves

Source: Company data, I-Sec research

Table 4: Quarterly trend

(Rs mn, year ending March 31)

	Sep-19	Dec-19	Mar-20	Jun-20
Net revenues	4,223	4,362	3,561	1,694
% growth (YoY)	7.4	2.4	(31.3)	(56.9)
EBITDA	448	403	139	(116)
Margin (%)	10.6	9.2	3.9	(6.9)
Other income	18	31	30	19
Extraordinaries (Net)	(262)	-	-	-
Net profit	65	104	(93)	(220)

Source: Company data, I-Sec research

Table 5: Cashflow statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
Operating Cashflow	865	722	488	1,514
Working Capital Changes	315	798	902	(237)
Capital Commitments	(1,029)	(1,053)	(300)	(400)
Free Cashflow	151	467	1,090	878
Cashflow from Investing Activities	459	341	238	14
Issue of Share Capital	-	-	-	-
Inc (Dec) in Borrowings	(290)	(656)	(1,251)	(750)
Dividend paid	(99)	(198)	(124)	(134)
Change in Deferred Tax Liability	43	(154)	-	-
Chg. in Cash & Bank balance	264	(200)	(47)	8

Source: Company data, I-Sec research

Table 6: Key ratios

(Year ending March 31)

	FY19	FY20	FY21E	FY22E
Per Share Data (Rs)				
EPS	13.8	5.7	5.7	16.9
Cash EPS	21.4	17.4	20.2	32.1
Dividend per share (DPS)	2.0	5.0	2.5	2.7
Book Value per share (BV)	165.1	165.3	178.0	190.0
Growth (%)				
Net Sales	0.0	-6.3	-9.1	21.0
EBITDA	-12.1	-19.6	-4.3	54.0
PAT	-34.2	-67.6	60.7	197.1
Cash EPS	-18.9	-18.4	15.8	58.9
Valuation Ratios (x)				
P/E	16.9	52.3	32.5	10.9
P/CEPS	8.7	10.6	9.2	5.8
P/BV	1.1	1.1	1.0	1.0
EV / EBITDA	7.7	9.2	8.7	5.2
EV / Sales	0.7	0.8	0.7	0.6
Operating Ratio				
Raw Material / Sales (%)	41.3	37.0	44.3	43.6
Employee cost / Sales (%)	13.2	14.9	14.0	13.3
Other Income / PBT (%)	23.9	133.0	24.6	5.2
Effective Tax Rate (%)	33.5	-103.5	25.3	25.2
Working Capital (days)	101.2	99.2	73.0	73.0
Inventory Turnover (days)	54.4	74.9	55.0	55.0
Receivables (days)	89.3	63.8	60.0	60.0
Payables (days)	42.4	39.4	42.0	42.0
Net D/E Ratio (x)	0.7	0.6	0.4	0.3
Return/Profitability Ratio (%)				
Net Income Margins	3.4	1.5	1.7	4.1
RoACE	10.9	6.9	5.4	10.1
RoAE	8.5	3.5	3.3	9.2
Dividend Payout	21.4	132.2	51.4	18.7
Dividend Yield	1.1	2.7	1.4	1.5
EBITDA Margins	9.6	8.2	8.6	11.0

Source: Company data, I-Sec research

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