



3R MATRIX

	+	=	-
Right Sector (RS)	✓	■	■
Right Quality (RQ)	✓	■	■
Right Valuation (RV)	■	✓	■

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	■	↔	■
RQ	■	↔	■
RV	■	↔	■

Reco/View

Reco: Buy	↔
CMP: Rs. 795	
Price Target: Rs. 950	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

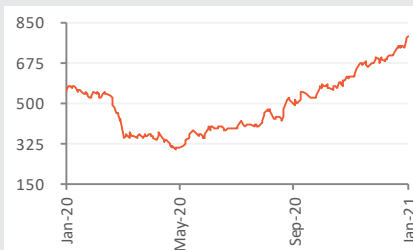
Company details

Market cap:	Rs. 12,650 cr
52-week high/low:	Rs. 839/295
NSE volume: (No of shares)	4.4 lakh
BSE code:	500233
NSE code:	KAJARIACER
Free float: (No of shares)	8.3 cr

Shareholding (%)

FII	24
Institutions	16
Public & others	13
Promoters	48

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	17.7	36.3	101.3	44.3
Relative to Sensex	9.8	13.9	70.3	23.6

Sharekhan Research, Bloomberg

Summary

- We retain Buy on Kajaria Ceramics with a revised PT of Rs. 950, led by upward revision in estimates and strong 28% CAGR in net earnings estimated over FY2021E-FY2023E.
- Strong outperformance on all fronts, led by higher than expected volumes, lower gas prices leading to strong rise in OPM.
- Management expects strong volume led growth along with healthy OPM during FY2022 to FY2024. Key growth triggers such as positive housing sector outlook, rising exports for Morbi players, soft gas prices likely to sustain.
- Rising net cash position, healthy free cash flow generation and low capex requirement to improve dividend payout.

Kajaria Ceramics Limited (Kajaria) continued to outperform during Q3FY2021 on all fronts. The company saw a strong rise of 13.1% y-o-y (up 17.7% q-o-q) in consolidated revenues to Rs. 838 crore, led by strong rise in tile volumes (up 10.5% y-o-y, up 14.1% q-o-q), sanitaryware/faucet revenue (up 36% y-o-y to Rs. 43 crore), and plywood revenue (up 58% y-o-y to Rs. 13 crore). Strong demand continuing from tier 1 to 3 cities along with a pickup in demand from metros (reaching 75% sales as against 45% in July 2020) led to higher-than-expected surge in volumes. Further, a sustained rise in exports for Morbi tile industry players (benefiting from anti-dumping duty on Chinese imports by US and anti-China sentiments) is said to have led to market share gain for Kajaria domestically along with improving pricing environment (blended tile realization improved 2% q-o-q). The lower power and fuel costs (average gas prices during Q3FY2021 being lower by 15-18% y-o-y) and decline in other expense (low overheads due to low ad spends) led to strong beat on OPM (up 666 bps y-o-y) to 21.7%. Hence, operating profit jumped by 63.3% y-o-y. Strong operational performance led to consolidated PAT growth of 93.3% y-o-y to Rs. 119 crore (which was much higher than our as well as street estimates). The management upped its guidance for next two to three years as it expects demand to be continued to be driven by housing sector along with strong rise in exports for Morbi tile industry. The management expects 20-25% y-o-y rise in tile volume for FY2022 and 15%+ y-o-y rise in FY2023 and FY2024. The optimism has led to the management planning capex of Rs. 150-200 crore for brownfield expansion during FY2022 (10MSM tile capacity can be added at a capex of Rs. 200 crores). It also targets to scale its profitable bathware segment from Rs. 210 crore expected in FY2021 to Rs. 280-290 crore in FY2022. The plywood division is expected to be loss making for next couple of years although revenue is expected to rise to Rs. 70 crore in FY2022 from Rs. 40 crore expected in FY2021. On the OPM front, the management expects to maintain 20% OPM for Q4FY2021 and in FY2022 led by stable pricing environment, soft gas prices and lower ad spends. The company also improved upon its net cash position at Rs. 494 crore (versus Rs. 358 crore/Rs. 108 crore as of Q2FY2021/FY2020). Its strong cash flow generation and low capex requirement has led to revision in its dividend policy (higher payout expected in the range of 40-45% vs 20-25% earlier). We have increased our net earnings estimates for FY2021E-FY2023E, factoring higher volume and OPM. We expect revenue/operating profit/net profit to rise at a 19%/26.5%/27.6% CAGR over FY2021E-FY2023E. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 950.

Key positives

- Strong beat on net earnings led by higher-than-expected volume and OPM
- Net cash position continues to rise
- Management gives strong guidance for FY2022 and FY2023

Key negatives

- Expect marginal dip in OPM for Q4FY2021 to 20% led by increase in gas prices
- Plywood business to continue to be loss making for couple of years

Our Call

Valuation – Retain Buy with a revised PT of Rs. 950: Like its peers in building materials, Kajaria, is expected to be a beneficiary of the improving demand from the housing sector. It is also expected to benefit from domestic market share gains due to rising exports from Morbi players. Given the strong demand outlook over next two to three years, the company is exploring the idea of brownfield expansion. Its rising free cash flow generation and low capex requirement is expected to reward shareholders through higher dividend payouts. We have increased our net earnings estimates for FY2021E-FY2023E, factoring higher volume and OPM. We expect revenue/operating profit/net profit to rise at a 19%/26.5%/27.6% CAGR over FY2021E-FY2023E. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 950.

Key risk

Weak macro-economic environment, pressure on realisation, and increased gas prices are key risks to our call.

Valuation (Consolidated)

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	2,808.0	2,565.2	3,139.6	3,647.0
OPM (%)	14.8	18.2	20.1	20.5
Adjusted PAT	255.3	279.3	382.4	454.3
% y-o-y growth	10.3	9.4	36.9	18.8
Adjusted EPS (Rs.)	16.1	17.6	24.1	28.6
P/E (x)	49.5	45.3	33.1	27.8
P/B (x)	7.3	7.0	6.3	5.6
EV/EBITDA (x)	29.5	26.3	19.5	16.4
RoNW (%)	15.5	15.9	20.2	21.4
RoCE (%)	15.4	15.5	19.9	21.1

Source: Company; Sharekhan estimates

Beat on net earnings continue led by higher than expected volume and OPM: Kajaria Ceramics Limited (Kajaria) continued to outperform during Q3FY2021 on all fronts. The company saw strong 13.1% y-o-y rise (up 17.7% q-o-q) in consolidated revenue to Rs. 838 crore, led by a strong rise in tile volumes (up 10.5% y-o-y, up 14.1% q-o-q), sanitaryware/faucet revenue (up 36% y-o-y to Rs. 43 crore), and plywood revenue (up 58% y-o-y to Rs. 13 crore). Strong demand continuing from tier 1 to 3 cities along with a pickup in demand from metros (reaching 75% sales as against 45% in July 2020) led to higher than expected surge in volumes. Further, sustained rise in exports for Morbi tile industry players (benefiting from anti-dumping duty on Chinese imports by US and anti-China sentiments) is said to have led to market share gain for Kajaria domestically along with improving pricing environment (blended tile realization improved 2% q-o-q). The lower power and fuel costs (average gas prices during Q3FY2021 being lower by 15-18% y-o-y) and decline in other expense (low overheads due to low ad spends) led to strong beat on OPM (up 666 bps y-o-y) to 21.7%. Hence, operating profit jumped by 63.3% y-o-y. Strong operational performance led to consolidated PAT growth of 93.3% y-o-y to Rs. 119 crore (which was much higher than our as well as street estimates). The company also improved upon its net cash position at Rs. 494 crore (versus Rs. 358 crore/Rs. 108 crore as of Q2FY2021/FY2020).

Management gives strong guidance for FY2022 and FY2023: The management upped its guidance for next two to three years as it expects demand to be driven by the housing sector along with strong rise in exports for Morbi tile industry. The management expects a 20-25% y-o-y rise in tile volume for FY2022 and 15%+ y-o-y rise in FY2023 and FY2024. The optimism has led to management planning capex of Rs. 150-200 crore for brownfield expansion during FY2022 (10MSM tile capacity can be added at a capex of Rs. 200 crores). It also targets to scale its profitable bathware segment from Rs. 210 crore expected in FY2021 to Rs. 280-290 crore in FY2022. The Plywood division is expected to be loss making for next couple of years although revenue is expected to rise to Rs. 70 crore in FY2022 from Rs. 40 crore expected in FY2021. On the OPM front, the management expects to maintain 20% OPM for Q4FY2021 and in FY2022 led by stable pricing environment, soft gas prices and lower ad spends.

Key Conference call takeaways

- ◆ **Guidance upped significantly:** Expect 20-25% tile volume growth for FY22 and 15%+ for FY23 and FY24. Expect OPM to be 20% for Q4 (earlier guidance of 18%) and also going ahead.
- ◆ **Basis of optimism:** 1) Building industry outlook is positive 2) Exports by Morbi players to continue to grow at 20% p.a. easing pressure domestically 3) Gas prices have softened (had led to 2% +ve impact on OPM) 4) Cutting down on advertisement budget (50% y-o-y cut down in FY21) 5) Improvement in JV profitability to add on margins (Q3FY21 profit of Rs. 11 crore vs loss of Rs. 1 crore in Q3FY20).
- ◆ **Demand environment:** Metro cities have reached 75% sale level from 45% in July. Tier I to III cities have been driving demand. Timely payment by Tier I to III dealers. The company is to cover 100 to 150 Loksabha constituencies next year for growth. All of company's subsidiaries are running at full capacity utilization except Cosa where PVT to GVT conversion is being done for exports.
- ◆ **Capex:** The capital expenditure for FY21 is expected to be Rs. 50 crore. The capex for FY22 is expected to be Rs. 150-200 crore which will be used for brownfield expansion only. The company can add 10MSM capacity at a capex of Rs. 200 crore.
- ◆ **Morbi scenario:** Morbi cluster did exports of Rs. 9000-9500 crore in FY20 while till December it has done Rs. 7300 crore exports and is expected to do Rs. 11,000-11,500 crore exports in FY21. The management expects Morbi exports to grow 25-30% y-o-y during FY22. The rising exports is led by anti-dumping duties on Chinese exports and along with anti-China sentiments in major global countries. Organised players like Kajaria are to focus on domestic markets as exports have very low margins.

- ◆ **Gas prices:** This year Gas prices have been lower by Rs. 4-5.5 per SCM. Q3FY21 average gas price (long term plus spot combined) is Rs. 25.5/scm versus Rs. 30-31/scm in Q3FY20. Expect gas prices rise of 3 to 4% in Q4FY21.
- ◆ **Bathware division outlook:** Expect revenues of Rs. 210 crore and Rs. 280-290 crore in FY21 and FY22 as against Rs. 186 crore in FY20. OPM in Q3FY21 is at 13-14% versus single digit in Q3FY20. Positive profitability expected for Q4FY21 and FY22. Product prices increased by 6-9% in-line with industry owing to increase in key costs (20-25% rise in brass prices, rise in transportation costs).
- ◆ **Plywood division outlook:** Expect Rs. 40 crore turnover in FY21 and Rs. 70 crore in FY22. The business to lose money for next two years before turning net profit positive.
- ◆ **Dividend policy changed:** The company has increased dividend payout to 40-45% from 20-25%. Company's board has decided to pay interim dividend of Rs. 10 per share for this year.

Results (Consolidated)

Particulars	Rs cr				
	Q3FY2021	Q3FY2020	y-o-y%	Q2FY2021	q-o-q%
Net sales	838.3	741.3	13.1%	712.5	17.7%
other income	6.5	5.1	25.7%	4.8	34.7%
Total income	844.8	746.4	13.2%	717.3	17.8%
Total expenses	656.6	630.0	4.2%	568.8	15.4%
Operating profit	181.8	111.3	63.3%	143.7	26.5%
Depreciation	27.6	27.8	-0.8%	27.4	0.7%
Interest	2.6	4.8	-46.1%	2.1	25.5%
Exceptional items	0.0	0.0	-	0.0	-
Profit Before Tax	158.1	83.8	88.5%	119.0	32.8%
Taxes	37.0	22.6	64.0%	29.4	25.9%
Minority Interest	2.1	-0.3	-	0.5	-
PAT	118.9	61.5	93.3%	89.1	33.5%
Adjusted PAT	118.9	61.5	93.3%	89.1	33.5%
EPS (Rs.)	7.5	3.9	93.3%	5.6	33.5%
OPM (%)	21.7%	15.0%	666 bps	20.2%	152 bps
NPM (%)	14.2%	8.3%	589 bps	12.5%	168 bps
Tax rate (%)	23.4%	26.9%	-351 bps	24.7%	-127 bps

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Strong recovery in operations to sustain

The building materials industry was severely affected by COVID-19 led lockdown during Q1FY2021, which had affected its peak sales period of the year. Additionally, its high fixed cost structure had affected OPM, dragging down net earnings. However, from June, the sector has been one of the fastest in recovery with easing of lockdowns domestically. The sector witnessed resumption of dealer and distribution networks and a sharp improvement in capacity utilisation levels. Most players have begun to see demand and revenue run-rate reaching 80-90% compared to pre-COVID levels. Scaling up of revenue is also expected to lead to better absorption of fixed costs going ahead, aiding net earnings recovery. The industry is expected to rebound with strong growth in FY2022 and FY2023.

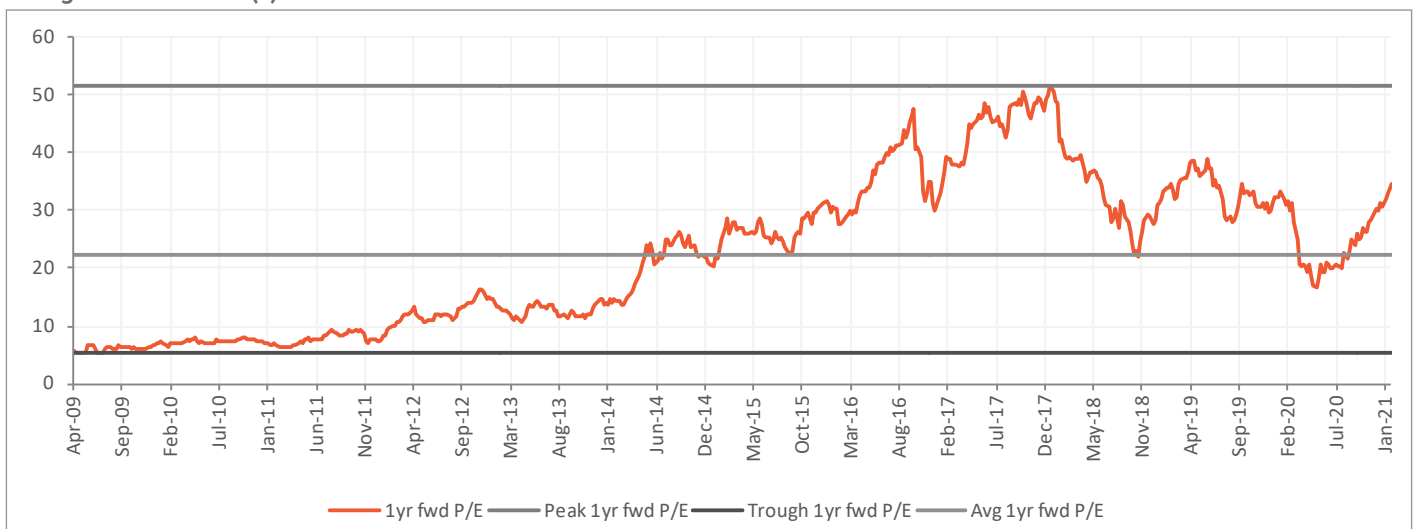
■ Company Outlook – Demand environment to remain strong over next couple of years

Kajaria has seen a sharp improvement in operations and demand environment m-o-m during the easing of lockdowns in the domestic market. The company's asset utilization have been on an improving trend and is expected to further improve. Further, anti-China sentiments in the US and European countries along with soft gas prices have boosted exports for the Morbi cluster, which houses around 850 manufacturing units. This has led to improved pricing environment for organised players such as Kajaria and increase in market share domestically. The company expects strong 20-25% volume growth for FY2022 and 15%+ volume growth for FY2023 and FY2024. It expects OPM to be strong at 20% during FY2022. The confidence over demand revival has led to the company planning for brownfield expansion.

■ Valuation – Retain Buy with a revised PT of Rs. 950

Kajaria is expected to be a beneficiary of improving demand from the housing sector. It is also expected to benefit from domestic market share gains due to rising exports from Morbi players. The strong demand outlook over next two to three years has led to the company exploring brownfield expansion. Its rising free cash flow generation and low capex requirement is expected to reward shareholders through higher dividend payouts. We have increased our net earnings estimates for FY2021E-FY2023E, factoring higher volume and OPM. We expect revenue/operating profit/net profit to rise at a 19%/26.5%/27.6% CAGR over FY2021E-FY2023E. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 950.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Kajaria Ceramics is India's largest manufacturer of ceramic/vitrified tiles and the world's ninth largest tile manufacturer. The company has an annual capacity of 70.4 mn. sq. meters presently, distributed across eight plants - one in Sikandrabad in Uttar Pradesh, one in Gailpur, one in Malootana in Rajasthan, three in Morbi in Gujarat, one in Vijaywada, and one in SriKalahasti in Andhra Pradesh.

Investment theme

Kajaria like other building material players is expected to witness benefits arising from improving demand from the housing sector. Further, anti-China sentiments in the US and European countries along with soft gas prices have boosted exports for the Morbi cluster, which has led to improved pricing environment for organised players such as Kajaria and increase in market share domestically. Given the strong demand outlook over next two to three years, the company is exploring the idea of brownfield expansion. Its rising free cash flow generation and low capex requirement is expected to reward shareholders through higher dividend payouts.

Key Risks

- ◆ Increased crude oil prices followed by higher gas prices.
- ◆ Pressure on pan-India residential housing market leading to overall lower volume offtake for the industry.

Additional Data

Key management personnel

Mr. Ashok Kumar Kajaria	Executive Director-Chairperson related to Promoter
Sanjeev Agarwal	Chief Financial Officer
R C Rawat	Company Secretary & Compliance Officer
Mr. Chetan Kajaria	Executive Director
Mr. Rishi Kajaria	Executive Director

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	RISHI KAJARIA FAMILY TRUST	16.27
2	CHETAN KAJARIA FAMILY TRST	16.27
3	CK TRUSTEES PVT LTD	16.27
4	RK TRUSTEES PVT LTD	16.27
5	VERSHA KAJARIA FAMILY TRST	8.14
6	VK TRUSTEES PVT LTD	8.14
7	Norges Bank	4.73
8	GOVERNMENT PENSION FUND - GLOBAL	4.63
9	Mirae Asset Global Investments Co Ltd	4.24
10	Franklin Resources Inc	3.73

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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