



Kajaria Ceramics Limited

Entering multi-year high growth period

Building Materials

Sharekhan code: KAJARIACER

Company Update

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	Change
Reco: Buy	↔
CMP: Rs. 997	
Price Target: Rs. 1,200	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 15,861 cr
52-week high/low:	Rs. 1016/295
NSE volume: (No of shares)	4.3 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	12.8	50.6	133.0	85.7
Relative to Sensex	14.6	41.2	100.9	44.1

Sharekhan Research, Bloomberg

Summary

- We retain Buy on Kajaria Ceramics with a revised PT of Rs. 1200, as we believe the company is entering into a high growth phase led by structural demand drivers.
- The tile industry is expected to grow at 8.6% CAGR over 2020-2027 led by residential market and new construction. Kajaria is poised to grow at higher than industry growth rates led by market share gains.
- Morbi tile exports continue to remain strong and is expected to close the fiscal year at higher exports numbers than last year. Hence, stable pricing and domestic market share gains for Kajaria remain intact.
- Natural Gas if brought under the GST ambit may lead to higher operating margins as companies claim input tax credit.

Kajaria Ceramics Limited (Kajaria) is expected to benefit from a strong demand growth outlook for the domestic tile industry. Indian tile industry valued at \$3720 million is expected to grow at a CAGR of 8.6% in value terms over 2020-2027 driven by residential real estate market especially the new construction segment. The residential segment (comprised more than 80% of the tile demand in 2019) is slated to grow at 9% CAGR over 2020-2027. Similarly, new construction segment comprises ~85% of the tile demand which is expected to grow at 8.8% CAGR over 2020-2027. Kajaria had witnessed 10.5% y-o-y rise in tile volumes in Q3FY2021 led by demand continuing from tier 1 to 3 cities along with a pickup in demand from metros. Further, Morbi tile industry had already reached Rs. 9797 crore ceramic tile exports as on January 2021 end and is further expected to end FY2021 with Rs. 12,200 crore exports versus ~Rs. 12,000 crore exports in FY2020. 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 expected to lead market share gain for Kajaria domestically led to achieving higher than industry growth rates. Consequently, the management showed optimism with 20-25% y-o-y rise in tile volume growth expectation for FY2022 (also due to low base of FY2021 due to covid) and 15%+ y-o-y rise in FY2023 and FY2024. Consequently, the management is 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). On the key input cost front, the gas prices increased sharply from December 2020 reaching peak levels in February 2021 owing to rise in crude prices due to winter season. However, the gas prices have begun to stabilize now. However, the tile industry has a tailwind of margin expansion if the Indian government brings natural gas under the ambit of GST which would aid in claiming input tax credit leading to higher operating margins for the industry. Kajaria has also improved its net cash position to Rs. 494 crore which along with strong cash flow generation and low capex requirement led to revision in its dividend policy (higher payout expected in the range of 40-45% vs 20-25% earlier). We believe Kajaria Ceramics is poised for multi-year high growth rate led by improving demand for tile industry and market share gains. 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. 1200.

Our Call

Valuation –Retain Buy with a revised PT of Rs. 1200: 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 believe Kajaria Ceramics is poised for multi-year high growth rate led by improving demand for tile industry and market share gains. 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. 1200.

Key Risks

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

Valuation (Consolidated)

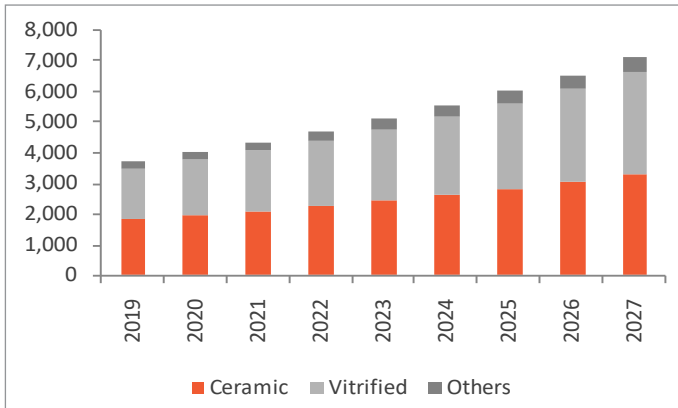
Particulars	FY20	FY21E	FY22E	FY23E
Revenue	2,808.0	2,565.2	3,139.6	3,647.0
OPM (%)	14.8	18.2	20.1	20.5
Adjusted PAT	255.3	279.3	382.4	454.3
% y-o-y growth	10.3	9.4	36.9	18.8
Adjusted EPS (Rs.)	16.1	17.6	24.1	28.6
P/E (x)	62.1	56.8	41.4	34.9
P/B (x)	9.2	8.7	7.9	7.0
EV/EBITDA (x)	36.9	32.8	24.3	20.5
RoNW (%)	15.5	15.9	20.2	21.4
RoCE (%)	15.4	15.5	19.9	21.1

Source: Company; Sharekhan estimates

Domestic tile industry to grow at 8.6% CAGR over 2020-2027

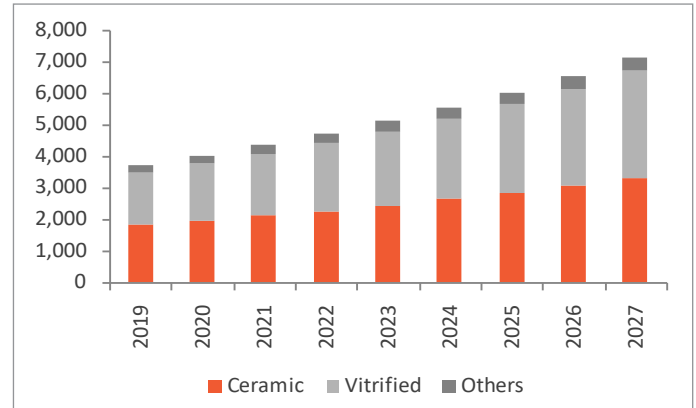
The India ceramic tiles market size was valued at \$3,720.2 million in 2019, and is projected to reach \$7,144.7million by 2027, growing at a CAGR of 8.6% from 2020 to 2027. By volume, the India ceramic tiles market was 821 million square meter (MSM) in 2019, and is projected to reach 1,384 MSM by 2027, growing at a CAGR of 6.9% from 2020 to 2027.

Indian Ceramic Tile Market (\$mn)



Source: Industry, Sharekhan Research

Indian Ceramic Tile Market (MSM)

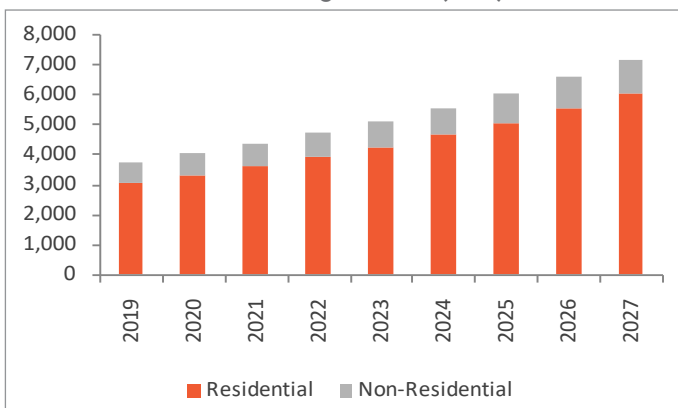


Source: Industry, Sharekhan Research

Residential segment especially new construction to drive tile industry growth

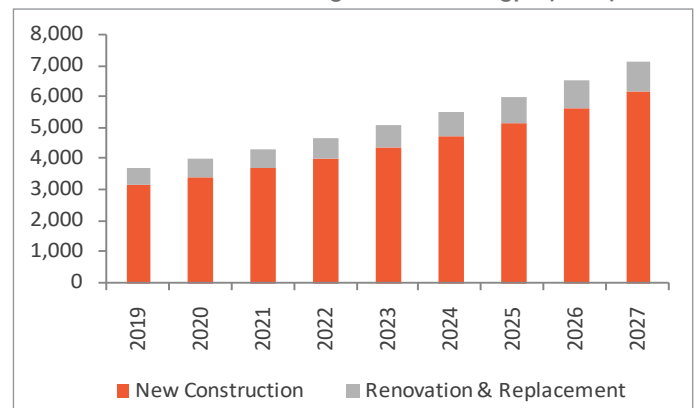
Rise in demand for residential and commercial infrastructure developments majorly drives the market growth. In addition, government programs to support tile industry continues to fuel the growth of the Indian ceramic tiles industry. Similarly, growth in the demand for residential development largely propel the market growth. The residential segment was the highest contributor to the market, with \$3,050.5 million in 2019, and is estimated to reach \$6,037.3 million by 2027, at a CAGR of 9.0% during the forecast period. The new construction segment was the highest contributor to the market, with \$3,162.1 million in 2019, and is estimated to reach \$558.0 million by 2027, at a CAGR of 8.8% during the forecast period.

Indian Ceramic Tile Market by end user (\$mn)



Source: Industry, Sharekhan Research

Indian Ceramic Tile Market by construction type (MSM)

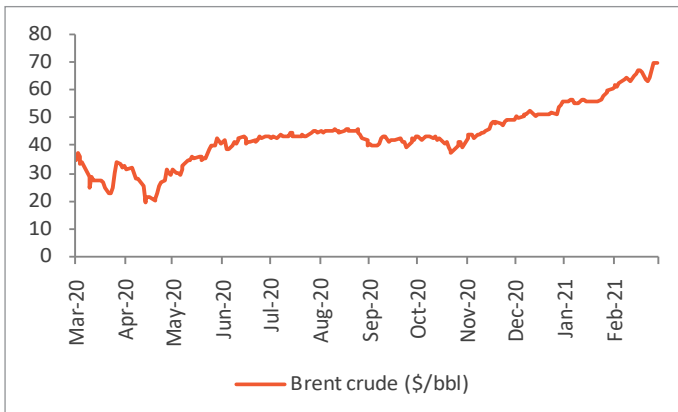


Source: Industry, Sharekhan Research

Gas prices rise in tandem with crude – Expect to stabilise

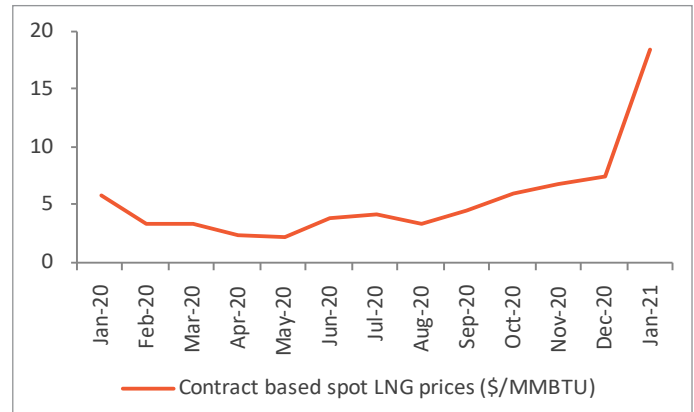
The gas prices increased sharply from December 2020 reaching at peak levels in February 2021 following a rise in crude prices. However, the crude prices are expected to stabilize with winter season getting over. Hence, tile manufacturers might entail higher power & fuel costs especially during Q4FY2021 but the same are expected to get stabilized.

LNG prices contract based



Source: Industry, Sharekhan Research

Brent crude price trend



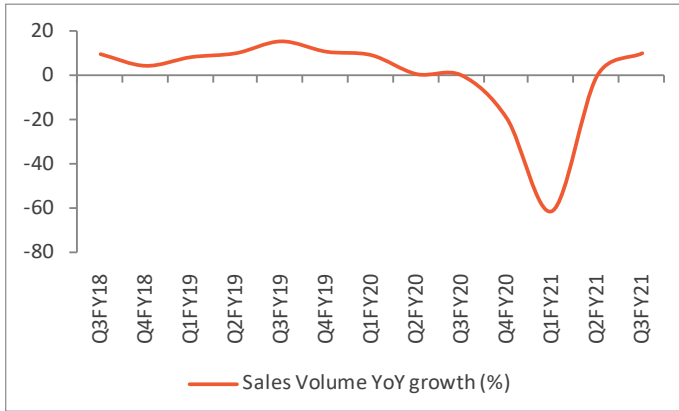
Source: Industry, Sharekhan Research

Bringing Gas under GST ambit to help improve margins

The Indian government has been making consistent efforts towards the availability of natural gas cheaper and uniform domestically for which it may bring natural gas under the GST ambit. Currently, the lack of claiming input tax credit has affected natural gas based user industries. However, if the natural gas is brought under the GST ambit, the tile manufacturing industry would be able to take input tax credit on taxes leading to higher operating margins (as power & fuel costs comprise over 20% of sales). However, the extent of expansion of margins is ascertainable at this point.

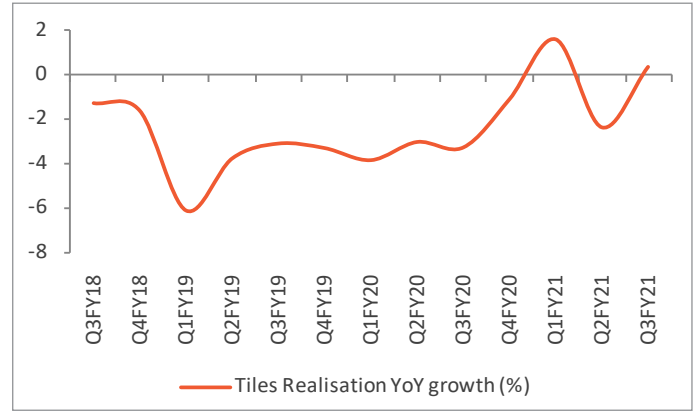
Financials in charts

Tile Volume Trend



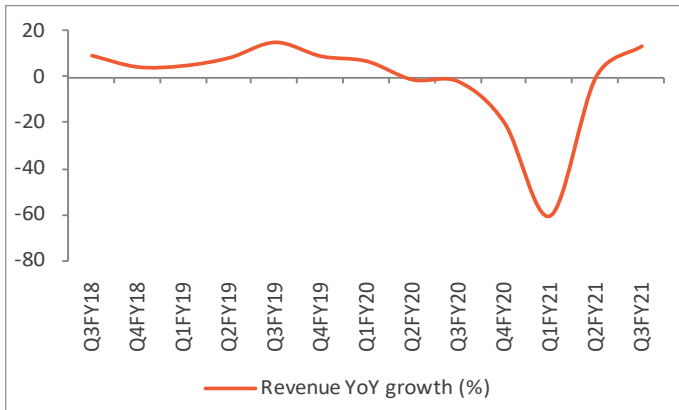
Source: Company, Sharekhan Research

Tile Realisation Trend



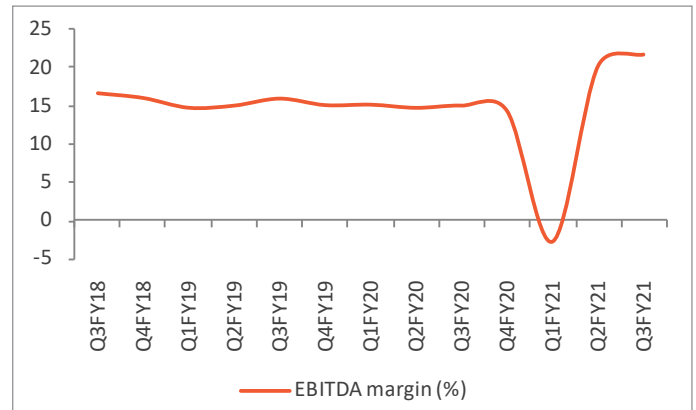
Source: Company, Sharekhan Research

Revenue Trend



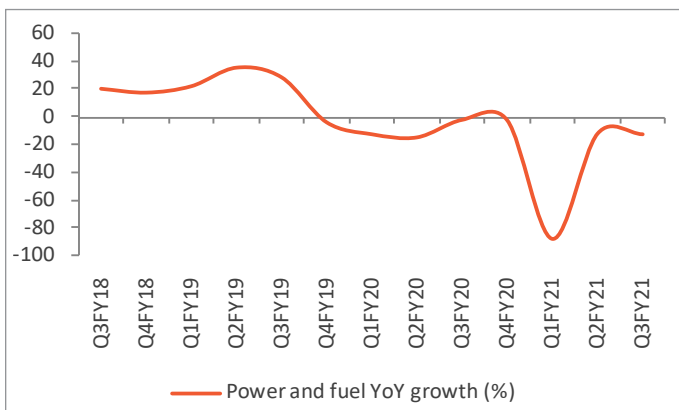
Source: Company, Sharekhan Research

EBITDA margin Trend



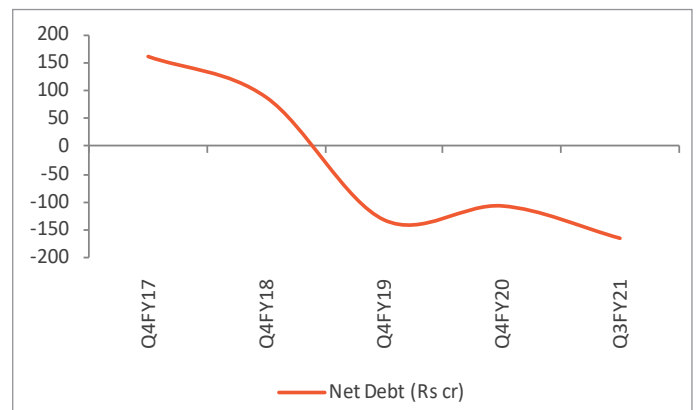
Source: Company, Sharekhan Research

Power & fuel cost Trend



Source: Company, Sharekhan Research

Net Debt Trend



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 witnessed one of the fastest 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.

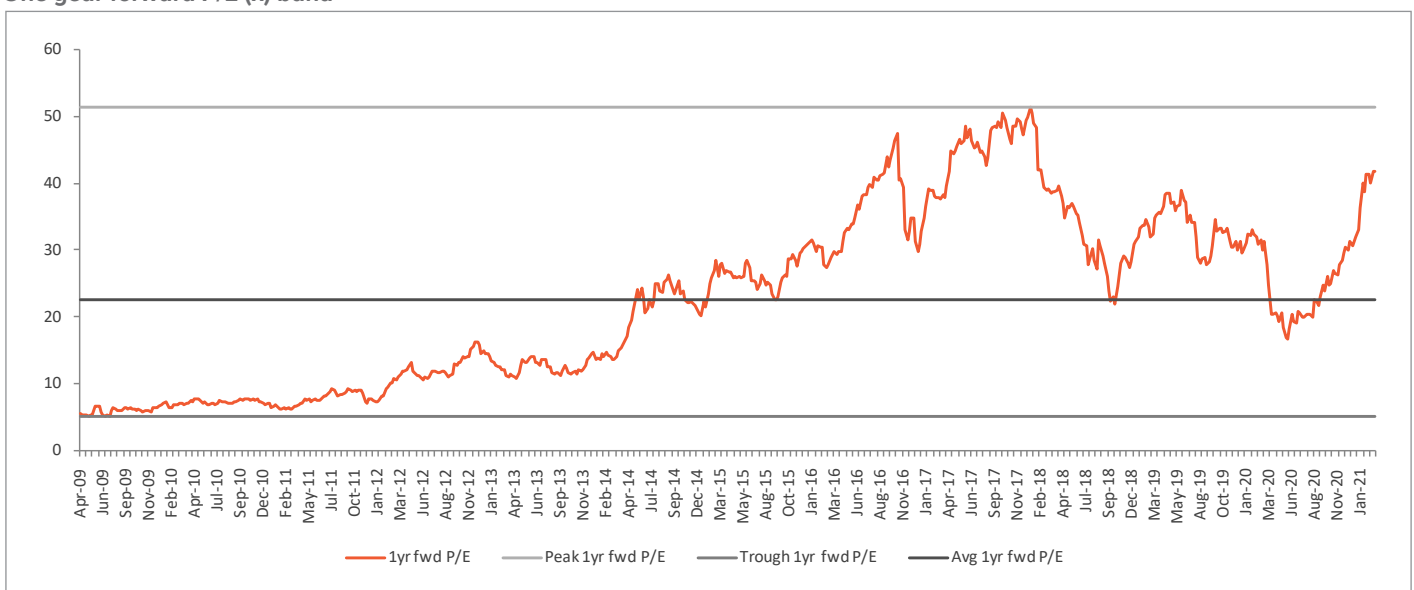
■ Company outlook - Demand environment to remain strong over next couple of years

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 an 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. 1200

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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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Rishi Kajaria Family Trust	16.27
2	Chetan Kajaria Family Trust	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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