Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Kajaria Ceramics Limited

High growth visibility warrants capacity expansion

Building Materials	Sharekhan code: KAJARIACER	Results 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. 1,016**	
Price Target: **Rs. 1,270**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

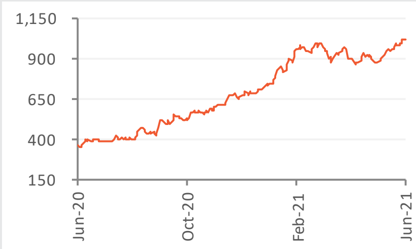
Company details

Market cap:	Rs. 16,168 cr
52-week high/low:	Rs. 1,054/345
NSE volume: (No of shares)	4.39 lakh
BSE code:	500233
NSE code:	KAJARIACER
Free float: (No of shares)	8.3 cr

Shareholding (%)

FII	25
Institutions	14
Public & others	13
Promoters	48

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	14.5	4.8	50.4	176.4
Relative to Sensex	8.5	0.5	36.8	118.3

Sharekhan Research, Bloomberg

Summary

- We retain Buy on Kajaria Ceramics with a revised PT of Rs. 1270, led by an upward revision in estimates and a strong 29% CAGR in net earnings estimated over FY2021-FY2023E.
- Better-than-expected performance for Q4 led by strong tile volume growth and improvement in realizations. Bathware and Plyboards registered strong growth y-o-y on low base.
- Demand optimism leads to brownfield expansions to be completed by FY2022 end at a capex of Rs. 250 crore with an incremental revenue potential of over Rs. 500 crore.
- Strong net cash position and healthy free cash flow generation to aid in capex plans without leveraging balance sheet.

Kajaria Ceramics Limited (Kajaria) reported better-than-expected results for Q4FY2021 led by strong tile volume growth and improvement in OPM y-o-y. The company saw a strong rise of 46.1% y-o-y (up 13.6% q-o-q) in consolidated revenues to Rs. 952.5 crore, led by a strong rise in tile volumes (up 39.2% y-o-y, up 12.4% q-o-q), sanitaryware/faucet revenue (up 73% y-o-y to Rs. 71 crore), and plywood revenue (up 2.7x y-o-y to Rs. 15 crore). Strong demand continued from tier 1 to 3 cities along with a pickup in demand from metros sustaining led to surge in volumes. Further, a sustained rise in exports for Morbi tile industry players (Rs. 11000 crore in FY2021 versus Rs. 9000 crore in FY2020) is said to have led to market share gain for Kajaria domestically along with improving pricing environment (blended tile realization improved 2.8%/1.6% y-o-y/q-o-q). Gross margins contracted by 701 bps y-o-y led by increased raw material costs and higher share of tile revenues from outsourcing (25% Vs 19% in Q4FY2020). However, higher operating leverage led to OPM expansion of 573bps y-o-y to 20% (marginally lower than our estimate). Hence, the operating profit jumped by 104.5% y-o-y. Strong operational performance led to consolidated PAT growth of 156% y-o-y to Rs. 127 crore (which was higher than our estimate). The company was able to achieve 75% and 35% of the targeted volumes in April and May 2021 while expects 75% in June 2021. It expects the demand environment to improve from July 2021 while it hopes to achieve 20-25% volume growth for FY2022. Over the longer term, the management is optimistic of healthy demand which has led to chalking out of brownfield capacity expansion plans at three locations aggregating to 12.4msm at a capex of Rs. 250 crores which is expected to get completed by FY2022 end. The said capex can potentially generate over Rs. 500 crore revenues. It also targets bath ware segment to touch Rs. 500 crore revenues over three years while plyboards revenues is expected to double in FY2022 with addition of laminates (to be outsourced from Morbi). The company may undertake tripling of faucet capacity in 3-4 months with an investment of Rs. 10-15 crores. The company has strong net cash position at Rs. 346 crore which would aid in capacity expansion plans. We have increased our net earnings estimates for FY2022E-FY2023E, factoring higher volume and OPM. We expect revenue/operating profit/net profit to rise at a 18%/26%/29% CAGR over FY2021-FY2023E. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 1270.

Key positives

- Strong beat on earnings led by healthy volume growth and OPM expansion
- Capacity expansions to capture future growth opportunities

Key negatives

- Lower gross margins led by change in revenue mix and higher raw material costs

Our Call

Valuation –Retain Buy with a revised PT of Rs. 1270: Kajaria, is expected to be a beneficiary of the improving domestic demand from the housing sector along with rising exports from Morbi players maintaining pricing discipline. Given the strong demand outlook over the next two to three years, the company is has ventured into brownfield expansion which is expected to maintain strong earnings growth. Its rising free cash flow generation and high cash surplus would aid expansion plans without leveraging balance sheet. We have increased our net earnings estimates for FY2022E-FY2023E, factoring higher volume and OPM. We expect revenue/operating profit/net profit to rise at a 18%/26%/29% CAGR over FY2021-FY2023E. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 1270.

Key risk

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

Valuation (Consolidated) Rs cr

Particulars	FY20	FY21	FY22E	FY23E
Revenue	2,808.0	2,780.9	3,264.8	3,871.7
OPM (%)	14.8	18.3	20.3	20.9
Adjusted PAT	255.3	308.1	411.4	509.9
% y-o-ygrowth	10.3	20.6	33.5	24.0
Adjusted EPS (Rs.)	16.1	19.4	25.9	32.1
P/E (x)	63.3	52.4	39.3	31.7
P/B (x)	9.3	8.6	7.7	6.7
EV/EBITDA (x)	37.6	30.7	23.5	19.3
RoNW (%)	15.5	17.2	20.8	22.7
RoCE (%)	15.4	16.6	20.4	22.2

Source: Company; Sharekhan estimates

Better-than-expected performance led by strong volume growth and improvement in realizations: Kajaria Ceramics Limited (Kajaria) reported better-than-expected results for Q4FY2021 led by strong tile volume growth and improvement in OPM y-o-y. The company saw a strong rise of 46.1% y-o-y (up 13.6% q-o-q) in consolidated revenues to Rs. 952.5 crore, led by strong rise in tile volumes (up 39.2% y-o-y, up 12.4% q-o-q), sanitaryware/faucet revenue (up 73% y-o-y to Rs. 71 crore), and plywood revenue (up 2.7x y-o-y to Rs. 15 crore). Strong demand continued from tier 1 to 3 cities along with a pickup in demand from metros sustaining led to surge in volumes. Further, a sustained rise in exports for Morbi tile industry players (Rs. 11000 crore in FY2021 versus Rs. 9000 crore in FY2020) is said to have led to market share gain for Kajaria domestically along with improving pricing environment (blended tile realization improved 2.8%/1.6% y-o-y/q-o-q). Gross margins contracted by 701 bps y-o-y led by increased raw material costs and higher share of tile revenues from outsourcing (25% Vs 19% in Q4FY2020). However, higher operating leverage led to OPM expansion of 573bps y-o-y to 20% (marginally lower than our estimate). Hence, operating profit jumped by 104.5% y-o-y. Strong operational performance led to consolidated PAT growth of 156% y-o-y to Rs. 127 crore (which was higher than our estimate).

Brownfield capacity expansion to capture demand growth opportunities: The company was able to achieve 75% and 35% of the targeted volumes in April and May 2021 while expects 75% in June 2021. It expects the demand environment to improve from July 2021 while it would hope of achieving 20-25% volume growth for FY2022. Over the longer term, the management is optimistic of healthy demand which has led to chalking out of brownfield capacity expansion plans at three locations aggregating to 12.4msm at a capex of Rs. 250 crores which is expected to get completed by FY2022 end. The said capex can potentially generate over Rs. 500 crore revenues. It also targets bathware segment to touch Rs. 500 crore revenues over three years while plyboards revenues is expected to double in FY2022 with addition of laminates (to be outsourced from Morbi). The company may undertake tripling of faucet capacity in 3-4 months with an investment of Rs. 10-15 crores. The company has strong net cash position at Rs. 346 crore which would aid in capacity expansion plans.

Key Conference call takeaways

- **Current & Future outlook:** The company did 75% and 35% of targeted sales volume during April and May 2021. May was affected as around 90% of the dealer network was closed. However, June looks promising and it expects to achieve 75% of the targeted volumes. The company refrained from giving guidance for FY2022 as it expects it will get clear view during first week of September. However, it expects to do better than competitors and try to achieve 20-25% volume growth for FY2022.
- **Capacity expansions:** The company is optimistic of demand environment going ahead. Hence, it has lined by three brownfield expansion plans which would get completed by March 2022. They are 1) 4.2msm floor tiles at Galipur, Rajasthan at a cost of Rs. 60 crores 2) 3.8msm GVT of larger size at its subsidiary KTPL, Srikalahasti, A.P. at a cost of Rs. 110 crores and 3) 4.4msm capacity at Jaxx plant, Morbi, Gujarat at a cost of Rs. 80 crores. The faucet capacity can be increased from current 10 lakh pieces per annum to 30 lakh pieces per annum over three to four months with an investment of Rs. 10-15 crores. The company is also adding laminate which will be outsourced from Morbi. It expects Plyboards revenues to increase to Rs. 80-90 crores in FY2022 from Rs 39 crores in FY2021. Overall, the capex for FY2022 is estimated at Rs. 250-270 crore.
- **Turnover from new capacities:** The company expects Rs. 135-140 crore turnover from Galipur capacity addition, Rs. 165-175 crore from Srikalahasti and Rs. 200 crores from Jaxx.
- **Exports:** The exports from Morbi grew from 9000 crores in FY2020 to Rs. 11000 crores in FY2021. However, domestic revenues were down 20% y-o-y. For kajaria, exports is hardly 3%.

- **Price hikes:** The company increased tile prices by 2.5-3% during Q4FY2021, bathware prices by 10% from 1st May 2021 and sanitaryware prices by 6% from 1st May 2021. The company has increased prices as gas prices increased 20%+ over one year, increased brass prices (up 50% over last year), rise in paper prices from 1st week of May 2021 and increase in internal freight costs. The gas prices are currently at Rs. 32/scm as against Rs. 28.46 in Q4FY2021.
- **Bathware:** The company's target is to touch Rs. 500 crore in revenues over three years.
- **Rising industry capacities:** The management is of the view that rising capacities in the industry would get absorbed as the capacity additions are delayed by six months and exports will continue to rise.
- **Dealer network:** Currently, the company has 1700 dealers of which 1500 are operational (of which 300-350 are exclusive dealers). It targets to increase exclusive dealers to 600 over three years. The company added 200 dealers and eased out 150 dealers leading to 50 net dealer addition during FY2021. It expects to add another 150 dealers in FY2022.
- **Ad spends:** The company spent Rs. 90 crores in advertising in FY2020, Rs. 46 crores in FY2021 and expects to spend Rs. 70 crores in FY2022.

Results (Consolidated) Rs cr

Particulars	Q4FY2021	Q4FY2020	y-o-y%	Q3FY2021	q-o-q%
Net sales	**952.5**	**652.0**	**46.1%**	**838.3**	**13.6%**
other income	7.4	6.9	7.5%	6.5	15.3%
Total income	960.0	659.0	45.7%	844.8	13.6%
Total expenses	761.6	558.7	36.3%	656.6	16.0%
Operating profit	**190.9**	**93.4**	**104.5%**	**181.8**	**5.0%**
Depreciation	26.5	28.3	-6.4%	27.6	-3.7%
Interest	2.6	4.9	-46.5%	2.6	1.1%
Exceptional items	0.0	0.0		0.0	
Profit Before Tax	**169.2**	**67.0**	**152.5%**	**158.1**	**7.1%**
Taxes	38.0	18.2	109.0%	37.0	2.7%
Minority Interest	4.1	-0.8		2.1	
PAT	127.1	49.6	156.3%	118.9	6.9%
Adjusted PAT	**127.1**	**49.6**	**156.3%**	**118.9**	**6.9%**
EPS (Rs.)	8.0	3.1	156.3%	7.5	6.9%
OPM (%)	20.0%	14.3%	573 bps	21.7%	-164 bps
NPM (%)	13.3%	7.6%	574 bps	14.2%	-85 bps
Tax rate (%)	22.5%	27.2%	-468 bps	23.4%	-95 bps

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Expect operations to recover faster

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 its 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% as compared to pre-COVID levels. Scaling-up of revenue is also expected to lead to better absorption of fixed costs going ahead, aiding a recovery in net earnings. The industry is expected to rebound with strong growth in FY2022.

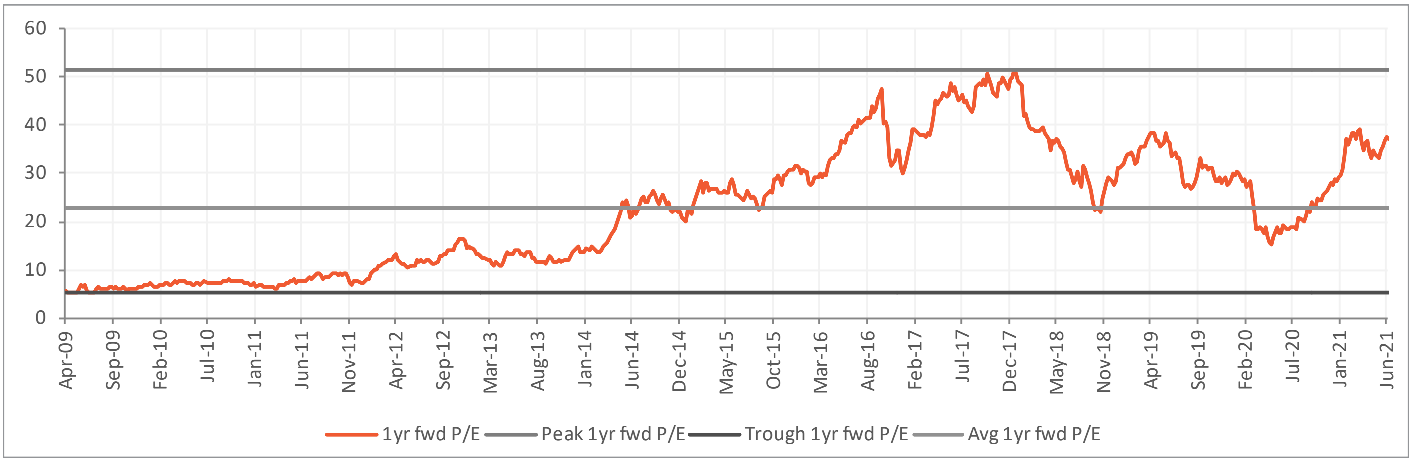
■ Company Outlook – Demand environment to remain strong over next couple of years

Kajaria is expected to see an improvement in operations and demand environment post easing of lockdowns in the domestic market. The company's asset utilization have been on an improving trend and is expected to improve further . The anti-China sentiments in the US and European countries 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. It expects the demand environment to improve from July 2021 while it would hope of achieving 20-25% volume growth for FY2022. Over the longer term, the management is optimistic of healthy demand which has led to chalking out of brownfield capacity expansion plans at three locations aggregating to 12.4msm at a capex of Rs. 250 crores which is expected to get completed by FY2022 end. The said capex can potentially generate over Rs. 500 crore revenues.

■ Valuation – Retain Buy with a revised PT of Rs. 1,270

Kajaria, is expected to be a beneficiary of the improving domestic demand from the housing sector along with rising exports from Morbi players maintaining pricing discipline. Given the strong demand outlook over next two to three years, the company is has ventured into brownfield expansion which is expected to maintain strong earnings growth. Its rising free cash flow generation and high cash surplus would aid in expansion plans without leveraging balance sheet. We have increased our net earnings estimates for FY2022E-FY2023E, factoring higher volume and OPM. We expect revenue/operating profit/net profit to rise at a 18%/26%/29% CAGR over FY2021-FY2023E. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 1,270.

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 companyhas an annual capacity of 70.4 mn. sq. meterspresently, 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 undertaking brownfield expansion. Its rising free cash flow generation and high cash surplus would aid in expansion plans without leveraging balance sheet.

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

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 detoriating 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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