Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Kajaria Ceramics Ltd

Weak Q4; margins stress priced in

Building Materials	Sharekhan code: KAJARIACER
Reco/View: Buy ↔	CMP: **Rs. 943**
	Price Target: **Rs. 1,200** ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING Updated Feb 08, 2022	23.98

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

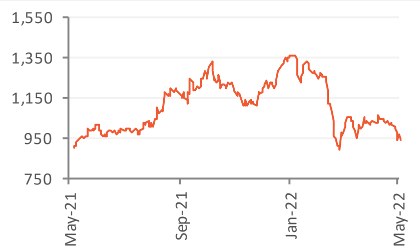
Company details

Market cap:	Rs. 15,015 cr
52-week high/low:	Rs. 1,379/878
NSE volume: (No of shares)	4.4 lakh
BSE code:	500233
NSE code:	KAJARIACER
Free float: (No of shares)	8.4 cr

Shareholding (%)

Promoters	48
FII	21
Institutions	20
Public & others	11

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-8.5	-25.2	-19.4	4.2
Relative to Sensex	-3.5	-19.1	-10.5	-4.0

Sharekhan Research, Bloomberg

Summary

- Kajaria's Q4 numbers lagged expectations led by muted tile volume growth and a steep rise in gas prices along with other raw materials weighing on OPM.
- The management guided for a 15-20% tile volume growth for FY2023 supported by completion of capacity expansions during April-May 2022 and sustained demand from real estate sector. OPM guidance reframed due to volatility in gas prices.
- The company withdrew a 5 MSM slab manufacturing capacity expansion plan at Gujarat. It would continue to undertake close to Rs. 300 crore of capex per annum over the next three years.
- We retain a Buy rating on Kajaria Ceramics with a revised PT of Rs. 1200, factoring downwardly revised estimates and believing recent correction factors in the rise in gas prices.

Kajaria Ceramics Limited (Kajaria) reported lower-than-expected performance during Q4FY2022. The consolidated revenues at Rs. 1102 crore (up 15.7% y-o-y) in Q4FY22, was led higher blended tile realizations (up 13.1% y-o-y) while volumes (up 2.3% y-o-y) were affected by lockdowns in several states during January-February. Revenues from the bathware and plywood segments rose by 15.9% y-o-y and 25.4% y-o-y. Consolidated OPM at 15.1% (down 498 bps y-o-y) was affected by higher gas prices, reduction in gas supply and sharp rise in other raw materials. Hence, consolidated operating profit/net profit were down 13%/25% y-o-y (also aided by higher interest, depreciation and effective tax rate). The management expects a 15-20% rise in tile volumes (aided by completion of three expansion plans) and 20-25% tile revenue growth for FY2023 although reframed from giving guidance on OPM due to high gas prices, increased raw material costs and freight costs. The company withdrew its 5 MSM slab manufacturing capacity expansion in Gujarat due to rise in gas prices and inconsistency in gas supply at Morbi.

Key positives

- Blended tile realizations were up 13% y-o-y. Revenues from Sanitary ware and plywood were up 16% y-o-y and 25% y-o-y respectively.
- Working capital days reduced to 52 days from 58 days in Q3FY2022. Net cash surplus strong at Rs. 373 crores.

Key negatives

- Muted tile volume growth of 2% y-o-y for Q4FY2022. OPM were severely hit by rise in gas prices and increase in other raw materials.
- Higher than expected interest expense, depreciation and effective tax rate for Q4FY2022.

Management Commentary

- The management expects tile volume growth of 15-20% y-o-y for FY2023 and tile revenues growth of 20-25% y-o-y. In bathware, it targets 30-35% revenue growth per annum over next three years. The management reframed from giving guidance on OPM due to high gas prices, paper costs and freight costs.
- Cumulative price hikes taken during FY2022 were 10% in tiles, 15% in Sanitaryware and 12-13% in bath fittings. It has undertaken 2% price hike in tile from 1st May 2022 although costs have gone up by 3-3.5% as compared to Q4FY2022.
- Industry tile exports to remain strong in FY2023 at Rs. 17000 crore to Rs. 18,000 crore compared to estimated Rs. 12,700 crore in FY2022.

Revision in estimates – We have revised our estimates downwards for FY2023-FY2024 factoring higher input costs and power & fuel costs.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 1,200: Kajaria is expected to be a beneficiary of the strong domestic demand from the housing sector and market share gains from unorganized players. Its increased capacity from early FY2023 would aid in healthy volume growth for FY2023. However, it is expected to face pressure on OPM in the near term due to a sharp rise in gas prices led by global factors. The price hikes undertaken by the company during FY2022 and FY2023 till date covers the rise in costs partially. The recent decline seen in international gas prices hint towards possible softening of domestic gas prices, which was provide OPM expansion tailwinds. The stock has corrected over 25% during trailing three months and is currently trading at a P/E of 26x its FY2024E earnings, which we believe fairly prices in volatility in gas prices. Hence, we retain a Buy rating on the stock with a revised price target (PT) of Rs. 1200 led by downwardly revised estimates.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	2,780.9	3,705.2	4,509.1	5,104.0
OPM (%)	18.3	16.5	16.3	17.1
Adjusted PAT	308.1	377.0	467.8	573.7
% y-o-ygrowth	*20.6*	*22.4*	*24.1*	*22.6*
Adjusted EPS (Rs.)	19.4	23.7	29.4	36.0
P/E (x)	48.7	39.8	32.1	26.2
P/B (x)	8.0	7.0	6.2	5.4
EV/EBITDA (x)	28.5	23.8	19.8	16.6
RoNW (%)	17.2	18.9	20.7	22.2
RoCE (%)	16.6	18.3	20.0	21.5

Source: Company; Sharekhan estimates

Weak operational performance: Kajaria Ceramics Limited (Kajaria) reported lower-than-expected performance during Q4FY2022. The consolidated revenues at Rs. 1102 crore (up 15.7% y-o-y) in Q4FY22, was led higher blended tile realizations (up 13.1% y-o-y) while volumes (up 2.3% y-o-y) was affected by lockdowns in several states during January-February. The revenues from the bathware and plywood segments rose by 15.9% y-o-y and 25.4% y-o-y to Rs. 83 crore and Rs. 19 crore, respectively. Consolidated OPM at 15.1% (down 498 bps y-o-y) was affected by higher gas prices, reduction in gas supply and sharp rise in other raw materials. Hence, consolidated operating profit declined by 13% y-o-y to Rs. 166 crore. Further, interest expenses (up 51% y-o-y), higher depreciation (up 23% y-o-y) and higher effective tax rate (28.7% versus 22.5% in Q4FY2021) dragged down consolidated net profit by 25% y-o-y to Rs. 96 crore.

Capacity additions and expansion plans: In April 2022, it commissioned 4.40 MSM of PVT capacity at its plant Kajaria Vitrified (formerly known as Jaxx Vitrified). The other two projects i.e 4.20 MSM of ceramic floor tiles at Gailpur plant (Rajasthan) and 3.80 MSM of value added glazed vitrified tiles at SriKalahasti Plant (Andhra Pradesh) have also been commissioned during May 2022. In the previous quarter, it had announced the organic expansion of 5 MSM of slab manufacturing capacity in Gujarat with planned investment of Rs.210 crore. The company has decided to withdraw the proposed investment as project has become less viable due to a steep rise in the prices of natural gas and inconsistency in gas supply at Morbi. However, the company would be incurring close to Rs. 300 crore per annum capital expenditure over the next three years.

Key Conference call takeaways

- **Guidance:** The management expects tile volume growth of 15-20% y-o-y for FY2023 and tile revenues growth of 20-25% y-o-y. In bathware, it targets 30-35% revenue growth per annum over next three years. The management reframed from giving guidance on OPM due to high gas prices, paper costs and freight costs.
- **Gujarat plant setup withdrawn:** The company withdrew investment proposal of Rs. 210 crore for setting up slab manufacturing facility in Gujarat due to high gas prices along with inconsistency in supply of gas.
- **Outlook:** The management expects strong demand from tier 3 cities and below along with high replacement demand over the next three years.
- **Price hikes:** Cumulative price hikes taken during FY2022 were 10% in tiles, 15% in Sanitaryware and 12-13% in bath fittings. It has undertaken 2% price hike in tile from 1st May 2022 although costs have gone up by 3-3.5% compared to Q4FY2022.
- **Industry size and growth:** The domestic industry size in FY2022 is estimated at Rs. 21000 crore and exports at Rs. 12,700 crore. During FY2023, domestic industry size is expected to rise to Rs. 23000 crore and exports to Rs. 17,000 crore to Rs. 18,000 crore.
- **Gas prices:** The gas prices for its Galipur plant increased from Rs. 29/scm in Q4FY2021 to Rs. 49/scm in Q4FY2022. For FY2022, the company's gas consumption price was Rs. 42.21/kg (North – Rs. 41/kg, South – Rs. 44/kg, West – Rs. 49/kg). The gas consumption price region-wise during FY2021 were North – Rs. 26/kg, South – Rs. 12.5/kg and West – Rs. 28.5/kg. Currently gas prices region-wise are North – Rs. 52/kg, South – Rs. 59/kg, West – Rs. 68.5/kg. The Morbi region has seen gas price increase from Rs. 36/kg to Rs. 68.5/kg over a period of nine months. However, the international gas prices have come down to $21 from $33 one and a half month back.

- **Capex:** The company spent Rs. 250-260 crore in FY2022. It expects a capex of close to Rs. 300 crore per annum in the next three years.
- **Dealer addition:** It targets to add 400 dealers over next three years including 170-175 exclusive dealers.
- **A&P spends:** The A&P spends for FY2022 stood at Rs. 80 crores. It expect slight increase in A&P spends for FY2023.
- **Exports:** The company would continue to maintain 3% exports share going ahead.

Results (Consolidated) Rs cr

Particulars	Q4FY2022	Q4FY2021	y-o-y%	Q3FY2022	q-o-q%
Net sales	**1101.8**	**952.5**	**15.7%**	**1068.2**	**3.1%**
other income	7.0	7.4	-5.5%	7.4	-5.3%
Total income	1108.8	960.0	15.5%	1075.7	3.1%
Total expenses	935.8	761.6	22.9%	884.4	5.8%
Operating profit	**165.9**	**190.9**	**-13.1%**	**183.8**	**-9.7%**
Depreciation	32.6	26.5	23.0%	28.1	16.2%
Interest	4.0	2.6	50.8%	3.0	32.2%
Exceptional items	0.0	0.0		0.0	
Profit Before Tax	**136.4**	**169.2**	**-19.4%**	**160.2**	**-14.9%**
Taxes	39.1	38.0	2.9%	35.5	10.4%
Minority Interest	1.5	4.1		2.7	
PAT	95.8	127.1	-24.7%	122.0	-21.5%
Adjusted PAT	**95.8**	**127.1**	**-24.7%**	**122.0**	**-21.5%**
EPS (Rs.)	6.0	8.0	-24.7%	7.7	-21.5%
Margins					
OPM (%)	15.1%	20.0%	-498 bps	17.2%	-215 bps
NPM (%)	8.7%	13.3%	-465 bps	11.4%	-273 bps
Tax rate (%)	28.7%	22.5%	622 bps	22.1%	657 bps

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Expect operations to recover faster

The building materials industry was severely affected by the COVID-19-led lockdown during Q1FY2021, which had affected its peak sales period of the year. Additionally, its high fixed cost structure 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 has witnessed resumption of dealer and distribution networks and a sharp improvement in capacity utilisation. 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.

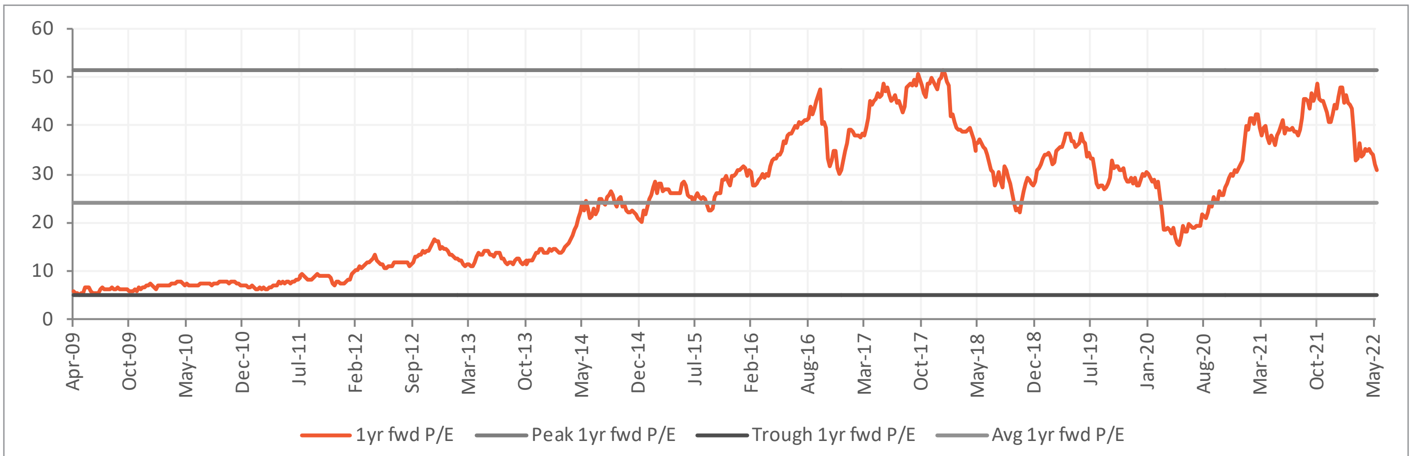
■ Company Outlook – Demand environment to remain strong over next couple of years

Kajaria is expected to see an improvement in operations and demand going ahead. The company's asset utilisation has been improving and is expected to grow further. Anti-China sentiments in the US and European countries have boosted exports for the Morbi cluster, which houses ~850 manufacturing units. This has led to improved pricing environment for organised players such as Kajaria and an increase in market share domestically. The management has guided for 15-20% y-o-y volume growth for FY2023 although reframed from guiding on OPM due to current volatility in gas prices. The company would be investing close to Rs. 300 crore per annum capital expenditure over the next three years in augmenting its capacities.

■ Valuation – Retain Buy with a revised PT of Rs. 1,200

Kajaria is expected to be a beneficiary of the strong domestic demand from the housing sector and market share gains from unorganized players. Its increased capacity from early FY2023 would aid in healthy volume growth for FY2023. However, it is expected to face pressure on OPM in the near term due to a sharp rise in gas prices led by global factors. The price hikes undertaken by the company during FY2022 and FY2023 till date covers the rise in costs partially. The recent decline seen in international gas prices hint towards possible softening of domestic gas prices, which was provide OPM expansion tailwinds. The stock has corrected over 25% during trailing three months and is currently trading at a P/E of 26x its FY2024E earnings, which we believe fairly prices in volatility in gas prices. Hence, we retain a Buy rating on the stock with a revised price target (PT) of Rs. 1200 led by downwardly revised estimates.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Kajaria Ceramics is India's largest manufacturers 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 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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