Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Kajaria Ceramics Ltd

Weak Q2; OPM growth tailwinds ahead

Building Materials	Sharekhan code: KAJARIACER		
Reco/View: Buy ↔	CMP: Rs. 1,064	Price Target: Rs. 1,300 ↔	

↑ 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 23.98

Updated Aug 08, 2022

Medium Risk

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

Source: Morningstar

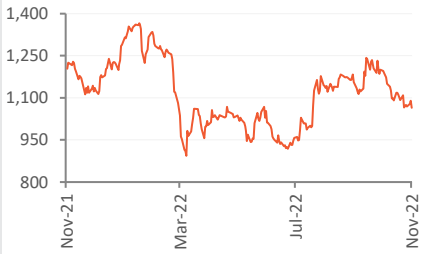
Company details

Market cap:	Rs. 16,943 cr
52-week high/low:	Rs. 1,379/886
NSE volume: (No of shares)	4.4 lakh
BSE code:	500233
NSE code:	KAJARIACER
Free float: (No of shares)	8.4 cr

Shareholding (%)

Promoters	47
FII	19
Institutions	23
Public & others	10

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-11.0	-6.2	4.5	-11.6
Relative to Sensex	-18.3	-10.6	-4.9	-13.5

Sharekhan Research, Bloomberg

Summary

- We retain a Buy rating on Kajaria Ceramics with an unchanged PT of Rs. 1300 rolling forward our valuation multiple to September 2024 earnings.
- The company reported a marginal miss on consolidated revenues, while OPM disappointed owing to lower-than-expected gross margins for Q2FY2023.
- The management would target 15% tile volume growth for FY2023 against earlier guidance of 15-20% y-o-y volume growth. OPM are slated to increase over 200bps from Q2 in H2FY2023 aided by higher usage of alternative fuels.
- The company would be setting up JV unit in Nepal with 8MSM capacity at a capex of Rs. 250 crores which would aid in incremental volumes from FY2025.

Kajaria Ceramics Limited (Kajaria) reported marginally lower than expected consolidated revenues at Rs. 1078 crore (up 10.7% y-o-y) led by higher blended tile realisations (up 10.2% y-o-y), while tile volumes remained almost flat y-o-y (up 0.5% y-o-y). The bathware segment revenues stayed flat y-o-y while plywood revenues grew by 17% y-o-y. The company disappointed on the OPM front with consolidated OPM at 12% (down 653bps y-o-y), mainly led by lower-than-expected gross margins (58.1% vs 62.9% in Q1FY2023). Consequently, consolidated operating profit/adjusted net profit was down 28%/37% y-o-y. The management targets 15% y-o-y tile volume growth for FY2023 (earlier 15-20%), while OPM is expected to improve more than 200bps from Q2FY2023 in H2FY2023 (increasing usage of alternate fuels). It is undertaking 3MSM GVT expansion at Sikandrabad at a capex of Rs. 81 crores and would be investing Rs. 125 crores (out of Rs. 250 crore project cost) as its share in JV unit in Nepal, which would have 8MSM capacity.

Key positives

- Healthy consolidated revenue growth of 10.7% y-o-y aided by higher realisations.
- Average gas consumption price to come down to Rs. 55/SCM in Q3FY2023 as against Rs. 61/SCM in Q2FY2023 which would aid expansion in operating margins in H2FY2023.

Key negatives

- Weak operating margins of 12% owing to a decline in gross margins q-o-q.
- Working capital days increased by five days q-o-q to 62 days, although the same is expected to return to 57 days by December 2022.

Management Commentary

- The management would target tile volume growth of 15% y-o-y for FY2023 as against earlier guidance of 15-20% y-o-y for FY2023. The bathware revenues are expected at Rs. 370 crores in FY2023 as against Rs. 275 crores in FY2022. The revenues from adhesives are targeted at Rs. 50 crores for FY2023.
- It took 2% price hikes each in May 2022 and September 2022.
- The exports from Morbi stood at Rs. 7500 crores in H1FY2023, while they are set to recover in H2FY2023. The company expects exports of Rs. 18000 crores in FY2023.

Revision in estimates – We have marginally revised our estimates downwards for FY2023-FY2025E, factoring in lower OPM.

Our Call

Valuation – Retain Buy with an unchanged PT of Rs. 1,300: Kajaria is expected to be a beneficiary of the strong domestic demand from the housing sector and market share gains from unorganised players. Its operating margins are expected to improve from the trough witnessed in Q2FY2023, led by an anticipated easing of gas prices from April 2023 onwards. The exports from Morbi cluster is expected to pick up in H2FY2023, which would help organized players like Kajaria increase their domestic market share. Outpacing industry growth rates, along with normalization of gas prices remain strong growth tailwinds for the company over the next two to three years. We retain a Buy rating on the stock with an unchanged price target (PT) of Rs. 1300, rolling forward our valuation multiple to September 2024 earnings.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	3,705.2	4,482.4	5,218.2	6,080.7
OPM (%)	16.5	14.2	16.3	16.8
Adjusted PAT	377.0	384.4	527.4	653.6
% y-o-ygrowth	*22.4*	*2.0*	*37.2*	*23.9*
Adjusted EPS (Rs.)	23.7	24.1	33.1	41.1
P/E (x)	44.9	44.1	32.1	25.9
P/B (x)	7.9	7.3	6.4	5.4
EV/EBITDA (x)	26.8	25.6	19.2	16.0
RoNW (%)	18.9	17.3	21.3	22.7
RoCE (%)	18.3	16.8	20.6	22.1

Source: Company; Sharekhan estimates

Revenues are marginally lower while OPM disappoints

Kajaria Ceramics Limited (Kajaria) reported reported marginally lower than expected consolidated revenues at Rs. 1078 crore (up 10.7% y-o-y) led by higher blended tile realisations (up 10.2% y-o-y), while tile volumes remained almost flat y-o-y (up 0.5% y-o-y). The bathware segment revenues stayed flat y-o-y while plywood revenues grew by 17% y-o-y. The overall volumes were affected by weak July and August months while September saw some uptick in demand. Further, October month saw muted demand owing to the festive season. However, it expects demand to pick up from November 2022 onwards and has set a tile volume growth target of 15% for FY2023. The company disappointed on the OPM front with consolidated OPM at 12% (down 653bps y-o-y) mainly led by lower-than-expected gross margins (58.1% vs 62.9% in Q1FY2023). Consequently, consolidated operating profit/adjusted net profit were down 28%/37% y-o-y.

Key Conference call takeaways

- **Guidance:** The management would target tile volume growth of 15% y-o-y for FY2023 against earlier guidance of 15-20% y-o-y for FY2023. The bathware revenues are expected at Rs. 370 crores in FY2023 as against Rs. 275 crores in FY2022. The revenues from adhesives are targeted at Rs. 50 crores for FY2023. The domestic industry size is expected to grow from Rs. 21000 crore in FY2022 to Rs. 22000 crore in FY2023. The OPMs are expected to be at least 200bps higher in Q3FY2023 and Q4FY2023 as against Q2FY2023.
- **Q2FY2023 performance:** The company's revenues grew by 10% y-o-y in Q2FY2023 mainly led by value-led growth while volumes remained flat y-o-y. The July-August months witnessed weak demand, while it saw some uptick in September. However, October month remained weak due to festive season. The bathware segment remained flat y-o-y at Rs. 74 crores while Plywood revenues were up 17% y-o-y at Rs. 19 crores. The working capital days increased by five days q-o-q to 62 days which is expected to go down to 57 days by December 2022.
- **Capacity expansion:** It is undertaking 3MSM GVT expansion at its Sikandrabad, U.P. plant at a capex of Rs. 80.58 crores. The same is expected to be completed by September 2023. It will also be investing Rs. 125 crores (50% of project cost of Rs. 250 crores) in setting up a production facility in Nepal having 8MSM capacity on a JV basis with Ramesh Corp, Nepal. The facility is expected to be operational by March 2024.
- **Gas prices:** The average gas price for the company in Q2FY2023 was Rs. 61/SCM, which is expected to come down to Rs. 55/SCM in Q3FY2023. It would use 15-18% alternate fuels (LPG/Propane) of the total fuel mix in Q3. Currently, LPG prices are Rs. 53-55/SCM. By April 2023, gas prices are expected to come down.
- **Nepal venture:** The Nepal market size is 25MSM. With the JV unit, it expects to capture large market share after two years. Currently, the company is doing Rs. 25 crore in sales through exports to Nepal. There is a 45% import duty in Nepal. Hence, setting up a production facility in Nepal would benefit the company.
- **Price hikes:** It took 2% price hikes each in May 2022 and September 2022.
- **Morbi exports:** The exports from Morbi stood at Rs. 7500 crore in H1FY2023, while they are set to recover in H2FY2023. The company expects exports of Rs. 18000 crore in FY2023.
- **Other expenses:** The other expense during Q2FY2023 were higher on account of increased ad spending. It has spent Rs. 31 crores and Rs. 50 crores in advertisement in Q2FY2023 and H1FY2023. It would be spending Rs. 100 crore in FY2023 versus Rs. 80 crore spent in FY2022.
- **Product mix:** In Q2FY2023, the product wise volume mix was Ceramic – 46%, PVT – 26% and GVT –

28%. The product wise revenue mix was Ceramic – 40%, PVT – 27% and GVT – 33%. For Q2FY2022, the product-wise revenue mix was Ceramic – 38%, PVT – 31% and GVT – 31%.

- **Capex:** The company would be incurring Rs. 80 crore capex in FY2023 (Rs. 50 crore for Sikandrabad unit, Rs. 30 crore for Nepal unit) and Rs. 120 crore in FY2024 (Rs. 30 crore for Sikandrabad, Rs. 90 crore for Nepal).
- **Dealer network:** As on FY2022, it had 1700 dealers. It has added 75 dealers in H1FY2023. It plans to add 400-450 dealers over three year period.

Results (Consolidated) **Rs cr**

Particulars	Q2FY2023	Q2FY2022	y-o-y%	Q1FY2023	q-o-q%
Net sales	**1077.8**	**973.6**	**10.7%**	**1008.2**	**6.9%**
other income	7.6	7.1	7.2%	8.1	-5.7%
Total income	1085.4	980.7	10.7%	1016.3	6.8%
Total expenses	948.4	793.1	19.6%	854.6	11.0%
Operating profit	**129.4**	**180.5**	**-28.3%**	**153.6**	**-15.7%**
Depreciation	33.7	28.2	19.5%	32.4	4.0%
Interest	3.2	2.7	16.2%	3.6	-12.5%
Exceptional items	-3.7	0.0		0.0	
Profit Before Tax	**96.6**	**156.7**	**-38.4%**	**125.7**	**-23.2%**
Taxes	27.7	37.4	-26.0%	32.8	-15.5%
Minority Interest	-1.0	3.2		0.7	
PAT	69.9	116.1	-39.8%	92.3	-24.3%
Adjusted PAT	**73.5**	**116.1**	**-36.7%**	**92.3**	**-20.3%**
EPS (Rs.)	4.6	7.3	-36.7%	5.8	-20.3%
Margins					
OPM (%)	12.0%	18.5%	-653 bps	15.2%	-323 bps
NPM (%)	6.5%	11.9%	-545 bps	9.2%	-267 bps
Tax rate (%)	28.7%	23.9%	479 bps	26.1%	261 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 affected its peak sales period of the year. Additionally, its high fixed cost structure affected OPM, dragging down its net earnings. However, since June, the sector has been one of the fastest in recovery with the easing of lockdowns domestically. The sector has witnessed a 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.

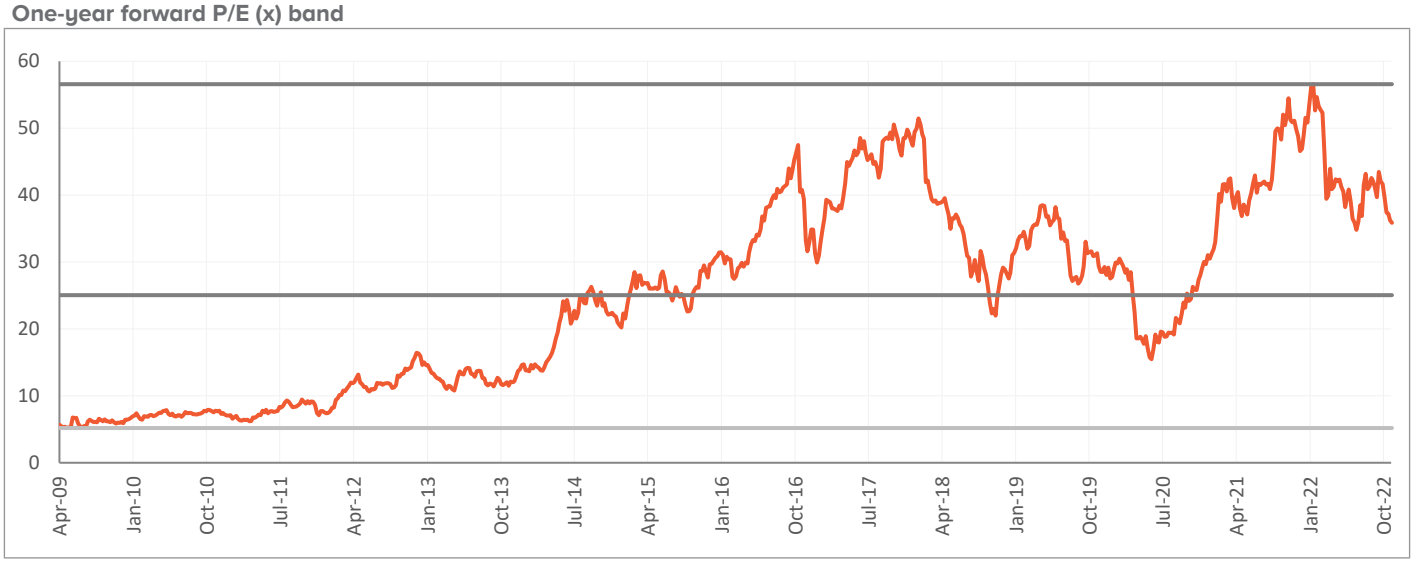
Company Outlook – The demand environment to remain strong over the next couple of years

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 an improved pricing environment for organised players such as Kajaria and an increase in market share domestically. The management has guided for 15% y-o-y tile volume growth for FY2023, while OPM is slated to increase going ahead, led by an expected decrease in gas prices. The company would invest in expanding capacities in its Sikandrabad plant and JV unit in Nepal.

Valuation – Retain Buy with an unchanged PT of Rs. 1,300

Kajaria is expected to be a beneficiary of the strong domestic demand from the housing sector and market share gains from unorganised players. Its operating margins are expected to improve from the trough witnessed in Q2FY2023, led by an anticipated easing of gas prices from April 2023 onwards. The exports from the Morbi cluster are expected to pick up in H2FY2023, which would help organized players like Kajaria increase domestic market share. Outpacing industry growth rates, along with normalisation of gas prices remain strong growth tailwinds for the company over the next two to three years. We retain a Buy rating on the stock with an unchanged price target (PT) of Rs. 1300, rolling forward our valuation multiple to September 2024 earnings.

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 eighth largest tile manufacturer. The company has an annual capacity of 84.45 mn. sq. meters presently, distributed across eight plants - one at Sikandrabad in Uttar Pradesh, one at Gailpur, one at Malootana in Rajasthan, two at Morbi in Gujarat, one at Vijayawada, one at Srikalahasti in Andhra Pradesh and one at Balanagar in Telangana.

Investment theme

Kajaria like other building material players is expected to witness benefits arising from improving demand in 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 an improved pricing environment for organised players such as Kajaria and an increase in market share domestically. Given the strong demand outlook over the 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 the 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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