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Stock Update

Result Update

Kajaria Ceramics Ltd

Weak quarter, downgrade to Hold

Building Materials	Sharekhan code: KAJARIACER
Reco/View: Hold ↓	CMP: Rs. 1,097 / Price Target: Rs. 1,230 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We downgrade Kajaria Ceramics to Hold with a revised PT of Rs. 1,230 as roll-forward of valuation multiple to FY2025E gets offset by a downward revision in earnings and valuation multiple. We await a better entry point.
- Company reported a strong miss on net earnings on account of lower OPM while consolidated revenues came in tad below estimate. Weak demand in October and higher gas prices y-o-y affected OPM.
- The management targets 13-15% tile volume growth for FY2024 while OPM is expected to improve from Q4FY2023. Demand remains tough in the near term.
- The company is undertaking modernisation of Gailpur ceramic production while its 8MSM Nepal JV unit is expected to commence operations from March 2024.

Kajaria Ceramics Limited (Kajaria) reported lower-than-estimated net earnings for Q3FY2023 led by miss on operating margins while consolidated revenues were a tad below estimate. The consolidated revenues grew by 2.1% y-o-y at Rs. 1091 crore owing to weak demand in October due to festive season (volume declined 1% y-o-y), while blended tile realization remained flat y-o-y (lower 3.8% q-o-q due to higher dealer discounts passing over lower gas prices). Bathware/plywood segment revenues declined by 3%/48% y-o-y. OPM disappointed with consolidated OPM at 12.2% (down 501bps y-o-y), mainly led by higher gas prices. Consequently, consolidated operating profit/ adjusted net profit was down 28%/39% y-o-y. Demand environment remains tough in the near term while OPM is expected to improve from Q4FY2023 onwards (aided by usage of low cost biofuel in its Northern and Western plants). The management expects 13-15% y-o-y tile volume growth for FY2024. It is modernizing its Gailpur ceramic production to produce bigger size tiles while its 8-MSM Nepal JV plant is expected to commence from March 2024.

Key positives

- Gross margins improved 136 bps y-o-y and 120 bps q-o-q to 59.3%.
- Average fuel cost declined to Rs. 53/scm from Rs. 56/scm in Q2FY2023 and is further expected to tread lower to Rs. 47-48/scm in Q4FY2023.

Key negatives

- Tile volumes declined 1% y-o-y due to weak demand in October. Weak operating margins of 12.2% owing to higher gas prices y-o-y.
- Working capital days increased by four days q-o-q to 66 days. Interest cost increased 2.8x y-o-y to Rs. 8.3 crore. Net cash surplus declined to Rs. 188 crore from Rs. 198 crore in Q2FY2023.

Management Commentary

- Management targets tile volume growth of 13-15% y-o-y for FY2024. OPM are expected to be 14%+ for Q4FY2023 while it is too early to give OPM guidance for FY2024.
- Over next three years, it would be adding 450-500 dealers (125 dealers added during 9MFY2023 including 35 exclusive showrooms). Currently, its dealer count is 1,825.
- Bio-fuel consumption mix will increase from 11-12% in December to 24% in January and 30% in February.

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

Our Call

Valuation – Downgrade to Hold with a revised PT of Rs. 1,230: Kajaria is expected to be affected by general weakness being seen in demand for building materials sector in the near term. The same is expected to passing off benefits of lower gas prices to dealers via higher discounts leading to lower OPMs than earlier expected. However, barring near-term headwinds, the demand environment is expected to remain healthy with lower gas prices staying a key tailwind. Stock is currently trading at a P/E of 39x and 31x its FY2024E and FY2025E earnings. We have downwardly revised our PT to Rs. 1,230 as rolling forward of valuation multiple to FY2025E gets offset by downward revision in estimates and valuation multiple. Hence, we downgrade the stock to Hold owing to near term headwinds and awaiting a better entry point.

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	4,315.0	4,861.0	5,651.9
OPM (%)	16.5	13.0	15.3	16.0
Adjusted PAT	377.0	328.1	447.3	566.2
% y-o-y growth	22.4	(13.0)	36.3	26.6
Adjusted EPS (Rs.)	23.7	20.6	28.1	35.6
P/E (x)	46.3	53.2	39.1	30.9
P/B (x)	8.2	7.7	6.9	6.0
EV/EBITDA (x)	27.6	30.0	22.7	18.6
RoNW (%)	18.9	15.0	18.8	21.0
RoCE (%)	18.3	14.6	18.2	20.4

Source: Company; Sharekhan estimates

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 Dec 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. 17473 cr
52-week high/low:	Rs. 1371/886
NSE volume: (No of shares)	4.3 lakh
BSE code:	500233
NSE code:	KAJARIACER
Free float: (No of shares)	8.4 cr

Shareholding (%)

Promoters	47
FII	19
Institutions	25
Public & others	9

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-3.1	1.8	-6.8	-17.7
Relative to Sensex	-0.5	4.1	-9.9	-20.0

Sharekhan Research, Bloomberg

Revenues are marginally lower while OPM disappoints materially

Kajaria Ceramics Limited (Kajaria) reported lower-than-estimated net earnings for Q3FY2023 led by miss on operating margins while consolidated revenues were tad below estimate. The consolidated revenues grew by 2.1% y-o-y at Rs. 1091 crore owing to weak demand in October due to festive season (volume declined 1% y-o-y) while blended tile realization remained flat y-o-y (lower 3.8% q-o-q due to higher dealer discounts passing over lower gas prices). The bathware/plywood segment revenues declined by 3%/48% y-o-y. The company disappointed on the OPM front with consolidated OPM at 12.2% (down 501bps y-o-y), mainly led by higher gas prices. Consequently, consolidated operating profit/adjusted net profit was down 28%/39% y-o-y.

Key Conference Call Takeaways

- **Guidance:** The management targets tile volume growth of 13-15% y-o-y for FY2024. OPM are expected to be 14%+ for Q4FY2023 while it is too early to give OPM guidance for FY2024. Demand scenario remains very tough for entire building materials sector. Over next three years, it would be adding 450-500 dealers (125 dealers added during 9MFY2023 including 35 exclusive showrooms). Currently, its dealer count is 1825.
- **Q3FY2023 performance:** The company's consolidated revenues grew by 2% y-o-y to Rs. 1091 crore in Q3FY2023 on account of weak demand (volume decline 1% y-o-y, Extended holidays impacted demand during October while November and December saw 10% y-o-y rise each). Bathware revenues declined 3% y-o-y to Rs. 79 crore. Plywood revenues stood at Rs. 19 crore versus Rs. 25 crore in Q3FY2022. Consolidated OPM was at 12.2% versus 17.21% in Q3FY2022. Lower OPM was on account of increase in discounts, disruption in supply of natural gas and higher cost of gas y-o-y. Consolidated PAT was Rs. 74.32 crore. Working capital days increased by 4 days to 66 days.
- **Q4FY2023 outlook:** The demand remained tough in January while it expects February to be better.
- Fuel cost: The average fuel price for the company during Q2FY2023 was Rs. 56/scm while for Q3FY2023 it was Rs. 53/scm. It expects average fuel cost of Rs. 47-48/scm for Q4FY2023.
- **Gas prices:** Regionwise gas price during Q3FY2023 was North – Rs. 57/scm, South – Rs. 44/scm, West – Rs. 48/scm, Average – Rs. 53/scm. For Q2FY2023 the same was North – Rs. 59/scm, South – Rs. 48/scm, West – Rs. 53/scm, Average – Rs. 56/scm.
- **Alternate fuels:** It is using biofuel in spray dryers in its Sikandrabad and Gailpur plants. It started usage of Bio-fuel in December with complete usage of the fuel expected to complete by February end. The bio-fuel consumption mix will increase from 11-12% in December to 24% in January and 30% in February. Mustard husk is used at bio-fuel which is available throughout the year. However, mustard being seasonal and comes in early March till four months, currently, it is paying the highest cost.
- **Nepal venture:** It is yet to start project in Nepal due to elections. It expects to start by March 15, 2023 and would commission by March 2024. The plant will be coal fired while spray dryers would use bio fuel.
- **Capex:** The capex for 9MFY2023 was Rs. 75-80 crore. For FY2023, it is estimated at Rs. 90 crores while for FY2024, it will be over Rs. 300 crores.
- **Gailpur modernisation:** It is undertaking modernisation of its Gailpur ceramic tiles manufacturing at a capex of Rs. 51.11 crore to produce bigger size of ceramic tiles. It is expected to complete by July 2023.
- **Vennar:** It is divesting its 51% stake in 2.9msm ceramic walls tiles subsidiary, Vennar Ceramics for Rs. 18.25 crore.
- **Morbi exports:** The exports during November and December stood at Rs. 1500 crore per month. In Q4, it is expected it to be Rs. 5000 crore. Morbi exports are expected to be at Rs. 15000-16000 crore in FY2023 versus Rs. 12700 crore in FY2022.
- **Cash flow from operations:** It generated cash flow from operations of Rs. 106 crore and Rs. 335 crore during Q3FY2023 and 9MFY2023 respectively. The net cash surplus stands at Rs. 188 crore.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Net sales	**1091.1**	**1068.2**	**2.1%**	**1077.8**	**1.2%**
Other income	7.5	7.4	0.8%	7.6	-2.0%
Total income	1098.6	1075.7	2.1%	1085.4	1.2%
Total expenses	958.1	884.4	8.3%	948.4	1.0%
Operating profit	**133.1**	**183.8**	**-27.6%**	**129.4**	**2.8%**
Depreciation	32.5	28.1	15.9%	33.7	-3.3%
Interest	8.3	3.0	176.1%	3.2	163.0%
Exceptional items	0.0	0.0		-3.7	
Profit Before Tax	**99.7**	**160.2**	**-37.8%**	**96.6**	**3.3%**
Taxes	26.1	35.5	-26.5%	27.7	-5.9%
Minority Interest	-0.7	2.7		-1.0	
PAT	74.3	122.0	-39.1%	69.9	6.4%
Adjusted PAT	**74.3**	**122.0**	**-39.1%**	**73.5**	**1.1%**
EPS (Rs.)	4.7	7.7	-39.1%	4.6	1.1%
Margins					
OPM (%)	12.2%	17.2%	-501 bps	12.0%	19 bps
NPM (%)	6.8%	11.4%	-461 bps	6.5%	33 bps
Tax rate (%)	26.1%	22.1%	399 bps	28.7%	-254 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.

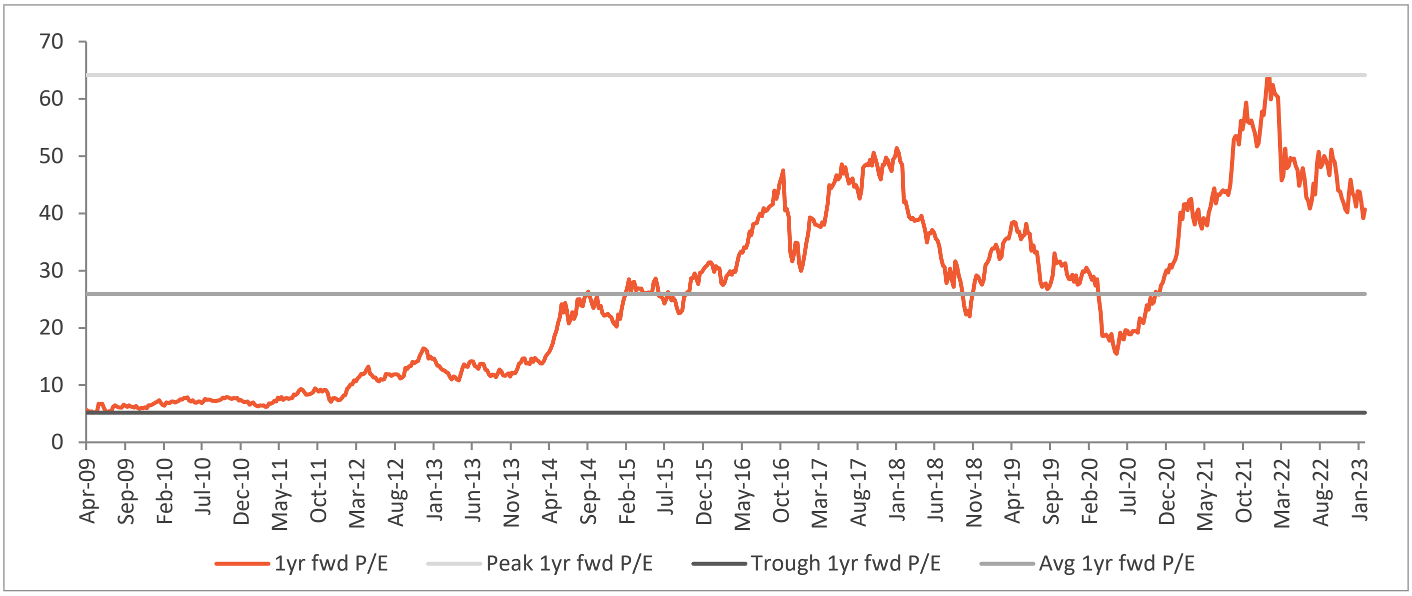
Company outlook - The demand environment to remain strong over long term

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 13-15% y-o-y tile volume growth for FY2024, while OPM is slated to increase going ahead, led by an expected decrease in gas prices and usage of alternate fuels. The company would invest in expanding capacities in its Sikandrabad plant and JV unit in Nepal.

Valuation - Downgrade to Hold with a revised PT of Rs. 1,230

Kajaria is expected to be affected by general weakness being seen in demand for building materials sector in the near term. The same is expected to passing off benefits of lower gas prices to dealers via higher discounts leading to lower OPMs than earlier expected. However, barring near-term headwinds, the demand environment is expected to remain healthy with lower gas prices staying a key tailwind. Stock is currently trading at a P/E of 39x and 31x its FY2024E and FY2025E earnings. We have downwardly revised our PT to Rs. 1,230 as rolling forward of valuation multiple to FY2025E gets offset by downward revision in estimates and valuation multiple. Hence, we downgrade the stock to Hold owing to near term headwinds and awaiting a better entry point.

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

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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