23 October 2024

Kajaria Ceramics

Soft quarter, but pickup expected in H2; upgrading to a Buy

Rating: Buy
Target Price (12-mth): Rs.1,695
Share Price: Rs.1,260

In line with ARe, Kajaria Ceramics' Q2 revenue grew 5% y/y to Rs11.8bn. EBITDA/PAT fell 12%/22% y/y to Rs1.6bn/Rs843m, below our estimated Rs1.7bn/Rs940m. Input cost pressures impacted the gross margin, which dipped 252bps y/y to 56.6%. Cost-control steps restricted the EBITDA margin's 255bps y/y drop to 13.5%. PAT slipped 20% y/y to Rs946m. Management expects good demand for the tiles industry in H2, assuming rub-off from the strong real estate sector.

Revenue growth remains soft. Revenue grew 5.4%/3.3% y/y for tiles/others. The revenue mix was broadly unchanged for tiles: others at 89:11.

Tile sales volume up 8.5% y/y to 28.7m sq.mtrs. Sales volume for own/subsidiaries' manufacturing/outsourcing grew 5.7%/12.7%/11.2% y/y to 15.64/5.43/7.63m sq. mtrs.

Front-loading of costs impacts margins. Front-loading of costs, led by commencement of operations in the Keronite tiles unit and under absorption of fixed overheads (owing to commissioning of capacity in the bathware segment) impacted margins.

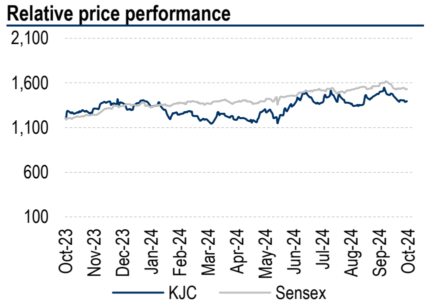
Outlook, Valuation. Demand was weak in Q2 due to extended monsoons. Management is hopeful of better offtake in H2. The company commissioned 5.1m sq.mtr of the ceramic tile and GVT capacity in Nepal; revenue to start flowing in. The structural story is intact, and we expect revenue/earnings CAGRs of 11.3%/16.9% over FY24-27. As the stock has slipped 19% from its recent highs and 9%/15% during the last one week/month, it offers a 35% potential upside, based on our higher 12-mth TP of Rs1,695, 40x FY27e earnings (earlier Rs1,520, 40x FY26e earnings). Hence, we upgrade to a Buy. **Risks:** Demand slowdown, rise in input and power & fuel costs, and stiff competition.

Key data	KJC IN / KAJR.BO
52-week high / low	Rs1579 / 1110
Sensex / Nifty	80082 / 24436
3-m average volume	$3.7m
Market cap	Rs201bn / $2389.9m
Shares outstanding	159m

Shareholding pattern (%)	Sep'24	Jun'24	Mar'24
Promoters	47.5	47.5	47.5
- *of which, Pledged*	-	-	-
Free float	52.5	52.5	52.5
- Foreign institutions	16.1	16.2	19.2
- Domestic institutions	28.4	27.8	24.9
- Public	8.0	8.5	8.4

Estimates revision (%)	FY25e	FY26e
Sales	(2.2)	(4.1)
EBITDA	(4.0)	(5.4)
EPS	(4.3)	(5.7)

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY23	FY24	FY25e	FY26e	FY27e
Sales (Rs m)	43,819	45,784	49,790	55,392	63,181
Net profit (Rs m)	3,445	4,221	4,797	5,711	6,751
EPS (Rs)	21.6	26.5	30.1	35.9	42.4
P/E (x)	58.2	47.6	41.8	35.1	29.7
EV / EBITDA (x)	33.6	28.2	25.6	21.8	18.5
P/BV (x)	8.6	7.7	6.7	5.8	4.9
RoE (%)	15.5	17.1	17.1	17.6	17.9
RoCE (%)	14.3	15.7	15.6	16.2	16.7
Dividend yield (%)	0.7	0.5	0.5	0.5	0.5
Net debt / equity (x)	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)

Source: Company, Anand Rathi Research

Rishab Bothra
Research Analyst

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY23	FY24	FY25e	FY26e	FY27e
Net revenues	**43,819**	**45,784**	**49,790**	**55,392**	**63,181**
Growth (%)	18.3	4.5	8.7	11.3	14.1
Direct costs	18,070	19,770	20,677	22,366	25,037
SG&A	9,275	10,357	11,358	12,463	14,018
EBITDA	**5,920**	**6,997**	**7,641**	**8,878**	**10,305**
EBITDA margins (%)	13.5	15.3	15.3	16.0	16.3
- Depreciation	1,329	1,480	1,556	1,644	1,777
Other income	336	462	498	554	632
Interest expenses	223	211	187	173	158
PBT	**4,625**	**5,768**	**6,396**	**7,615**	**9,002**
Effective tax rates (%)	25.1	24.9	25.0	25.0	25.0
+ Associates / (Minorities)	-18	-113	-	-	-
Net income	**3,445**	**4,221**	**4,797**	**5,711**	**6,751**
Adj. income	**3,445**	**4,221**	**4,797**	**5,711**	**6,751**
WANS	159	159	159	159	159
FDEPS (Rs)	21.6	26.5	30.1	35.9	42.4
Adj. FDEPS growth (%)	-8.6	22.5	13.6	19.1	18.2
Gross margin (%)	58.8	56.8	58.5	59.6	60.4

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY23	FY24	FY25e	FY26e	FY27e
Share capital	159	159	159	159	159
Net worth	23,268	26,165	30,007	34,762	40,557
Debt (incl. Preference shares)	2,093	1,706	1,640	1,598	1,541
Minority interest	776	591	591	591	591
Deferred tax liability / (Assets)	738	801	801	801	801
Capital employed	**26,876**	**29,263**	**33,039**	**37,752**	**43,490**
Net tangible assets	13,724	15,484	16,734	18,296	20,171
Net intangible assets	434	714	714	714	714
Goodwill	327	327	327	327	327
CWIP (tang. and intang.)	817	679	500	375	156
Investments (strategic)	-	37	37	37	37
Investments (financial)	-	-	-	-	-
Current assets	2,380	1,494	1,494	1,494	1,494
Cash	3,938	5,141	7,028	9,145	11,655
Current liabilities	3,300	3,196	3,343	3,259	3,181
Working capital	8,555	8,583	9,549	10,623	12,117
Capital deployed	**26,875**	**29,263**	**33,039**	**37,752**	**43,490**
Contingent liabilities	93.8	98.1	-	-	-

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY23	FY24	FY25e	FY26e	FY27e
PBT (Adj. OI and interest)	**4,625**	**5,768**	**6,396**	**7,615**	**9,002**
+ Non-cash items	1,329	1,480	1,556	1,644	1,777
Oper. prof. before WC	**5,954**	**7,248**	**7,952**	**9,259**	**10,779**
- Incr. / (decr.) in WC	(1,968)	471	(818)	(1,158)	(1,572)
Others incl. taxes	(983)	(1,205)	(1,412)	(1,731)	(2,092)
Operating cash-flow	**3,003**	**6,514**	**5,722**	**6,371**	**7,114**
- Capex (tang. + intang.)	(2,501)	(3,382)	(2,627)	(3,082)	(3,433)
Free cash-flow	**502**	**3,132**	**3,095**	**3,289**	**3,681**
Acquisitions	-	-	-	-	-
- Dividend	(1,433)	(956)	(956)	(956)	(956)
+ Equity raised	17	(1,806)	-	-	-
+ Debt raised	814	(387)	(66)	(43)	(57)
- Fin. investments	-	(37)	-	-	-
- Misc. items (CFI + CFF)	(205)	1,257	(187)	(173)	(158)
Net cash-flow	**(306)**	**1,203**	**1,887**	**2,117**	**2,510**

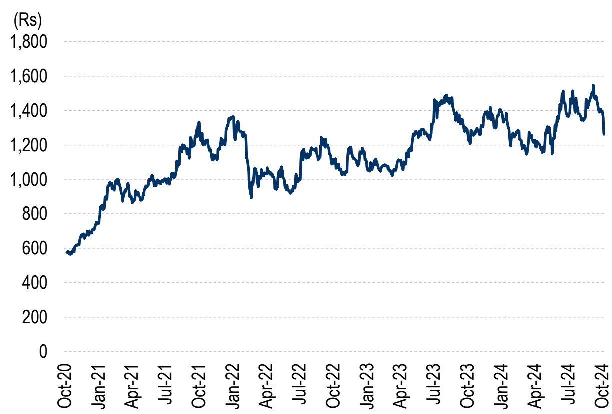
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY23	FY24	FY25e	FY26e	FY27e
P/E (x)	58.2	47.6	41.8	35.1	29.7
EV / EBITDA (x)	33.6	28.2	25.6	21.8	18.5
EV / Sales (x)	4.5	4.3	3.9	3.5	3.0
P/B (x)	8.6	7.7	6.7	5.8	4.9
RoE (%)	15.5	17.1	17.1	17.6	17.9
RoCE (%) - after tax	14.3	15.7	15.6	16.2	16.7
Fixed asset T/O (x)	16.9	18.7	19.3	21.0	22.3
DPS (Rs)	9.0	6.0	6.0	6.0	6.0
Dividend yield (%)	0.7	0.5	0.5	0.5	0.5
Dividend payout (%)	41.6	22.6	19.9	16.7	14.2
Net debt / equity (x)	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)
Receivables (days)	50.1	49.4	50.0	50.0	50.0
Inventory (days)	47.0	42.4	45.0	45.0	45.0
Payables (days)	25.9	23.4	25.0	25.0	25.0
CFO : PAT (%)	87.2	154.3	119.3	111.6	105.4

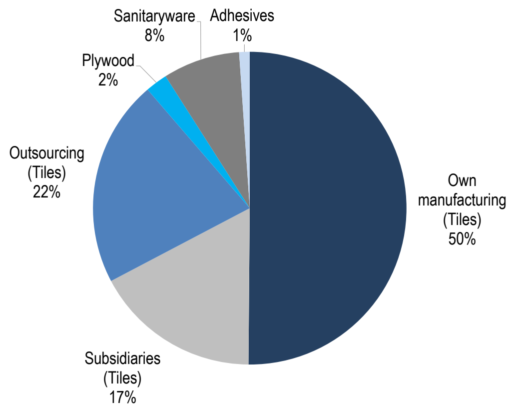
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg, Anand Rathi Research

Fig 6 – Revenue mix (FY24)



Source: Company, Anand Rathi Research

Results Highlights

Fig 7 – Quarterly performance

(Rs m)	Q2 FY24	Q1 FY25	Q2 FY25	% Y/Y	% Q/Q	H1 FY24	H1 FY25	% Y/Y	FY23	FY24	% Y/Y
Revenue	**11,216**	**11,137**	**11,793**	**5.1**	**5.9**	**21,859**	**22,930**	**4.9**	**43,819**	**45,784**	**4.5**
Raw material costs	4,582	4,722	5,115	11.6	8.3	9,299	9,837	5.8	18,070	19,770	9.4
Employee costs	1,300	1,394	1,443	11.1	3.6	2,436	2,837	16.5	4,612	5,053	9.5
Power & fuel expenses	2,211	2,127	2,244	1.5	5.5	4,148	4,372	5.4	10,554	8,661	(17.9)
Other expenses	1,327	1,224	1,401	5.6	14.5	2,486	2,625	5.6	4,663	5,304	13.8
EBITDA	**1,797**	**1,671**	**1,589**	**(11.6)**	**(4.9)**	**3,489**	**3,260**	**(6.6)**	**5,920**	**6,997**	**18.2**
Other income	83	102	99	19.3	(3.1)	175	201	14.4	336	462	37.5
Depreciation	361	421	406	12.5	(3.7)	666	827	24.2	1,329	1,480	11.4
Finance costs	43	47	47	11.0	1.1	95	94	(1.3)	223	211	(5.4)
Profit / Loss from Associate	(2)	(23)	(29)	1,227.3	27.0	(2)	(52)	2,510.0	(1)	(12)	1,400.0
PBT	**1,474**	**1,281**	**1,205**	**(18.2)**	**(5.9)**	**2,901**	**2,487**	**(14.3)**	**4,704**	**5,756**	**22.4**
Tax	366	358	350	(4.4)	(2.2)	702	708	0.8	1,163	1,435	23.4
MI	29	25	13	(55.6)	(49.2)	45	38	(15.3)	17	105	517.6
PAT	**1,080**	**898**	**843**	**(21.9)**	**(6.2)**	**2,155**	**1,741**	**(19.2)**	**3,513**	**4,217**	**20.0**
Adj. PAT	**1,080**	**898**	**843**	**(21.9)**	**(6.2)**	**2,155**	**1,741**	**(19.2)**	**3,524**	**4,217**	**19.7**
EPS (Rs)	**6.8**	**5.6**	**5.3**	(22.0)	(6.2)	**13.5**	**10.9**	(19.2)	**21.6**	**26.5**	22.5

As % of revenue				bps y/y	bps q/q			bps y/y			bps y/y
Material costs	40.8	42.4	43.4	252	97	42.5	42.9	36	41.2	43.2	194
Gross margins	**59.2**	**57.6**	**56.6**	**(252)**	**(97)**	**57.5**	**57.1**	**(36)**	**58.8**	**56.8**	**(194)**
Employee costs	11.6	12.5	12.2	65	(28)	11.1	12.4	123	10.5	11.0	51
Power & fuel expenses	19.7	19.1	19.0	(68)	(7)	19.0	19.1	9	24.1	18.9	(517)
Other expenses	11.8	11.0	11.9	5	90	11.4	11.4	7	10.6	11.6	94
EBITDA margins	**16.0**	**15.0**	**13.5**	**(255)**	**(153)**	**16.0**	**14.2**	**(175)**	**13.5**	**15.3**	**177**
Other income	0.7	0.9	0.8	10	(8)	0.8	0.9	7	0.8	1.0	24
Depreciation	3.2	3.8	3.4	23	(34)	3.0	3.6	56	3.0	3.2	20
Finance costs	0.4	0.4	0.4	2	(2)	0.4	0.4	(3)	0.5	0.5	(5)
PBT margins	**13.1**	**11.5**	**10.2**	**(16)**	**(5)**	**13.3**	**10.8**	**(13)**	**10.6**	**12.6**	**23**
Effective tax rates	24.8	27.4	28.3	14	3	24.2	27.9	15	24.7	24.9	(0)
Adj. PAT margin	**9.6**	**8.1**	**7.1**	**(20)**	**(7)**	**9.9**	**7.6**	**(17)**	**8.0**	**9.2**	**23**

Source: Company, Anand Rathi Research

Q2 FY25 Results Highlights

- Revenue grew 5.1% y/y to Rs11.8bn. This was led by 6% y/y growth in tiles to Rs10.1bn as others segment revenue fell 1% y/y to Rs1.1bn.
- Input cost pressures led to the gross margin contracting 252bps y/y to 56.6%; however, higher revenue helped gross profit to remain flat at Rs6.7bn.
- EBITDA was 11.6% y/y lower at Rs1.6bn. The contraction in EBITDA was similar to the drop in gross margin, i.e., 255bps y/y to 13.5%.
- PAT margin squeezed 240bps y/y to 7.5%, resulting in profit after tax of Rs946m, which fell 20% y/y.

Other details

- The company has tile manufacturing capacity of 93.1m sq.mtrs spread over three facilities in Morbi, Gujarat, and one facility each in Sikandrabad, Uttar Pradesh, Gailpur and Malootana in Rajasthan, Srikalahasti in Andhra Pradesh, Balanagar in Telangana and a facility in Nawalparasi in Nepal.
- Tile capacity split was 37:16:47 for ceramic wall and floor tile: polished vitrified tiles (PVT): glazed vitrified tiles (GVT).
- The revenue mix for tiles: others was broadly the same at 89:11, with revenue respectively growing 5.4%/3.3% y/y for tiles/others.
- Revenue in tiles stems from i) own manufacturing, ii) manufacturing in subsidiaries and iii) contract manufacturing, while revenue in the others segment comes from i) plywood sales, ii) sanitaryware sales and iii) adhesives sales.

Segment details

Tiles

- Production volume increased 6.3%/19% y/y for own manufacturing and manufacturing in subsidiaries to 15.85/6.07m sq.mtrs.
- Despite softness in domestic demand, the company increased sales volumes in tiles business by 8.5% y/y to 28.7m sq.mtrs.
- Sales volume for own manufacturing/subsidiaries/outsourcing stood at 15.64/5.43/7.63m sq.mtrs, up 5.7%/12.7%/11.2% y/y. Similarly, revenue respectively grew 3%/6.6%/10.1% y/y.
- Profitability in tiles fell 10% y/y at the EBIT level to Rs1.3bn, resulting in the EBIT margin contracting 207bps y/y to 12%. This could be partly due to front-loading of costs related to the Keronite unit's commencement.

Others

- Revenue in plywood fell 25.6% y/y to Rs175m but grew in sanitaryware and adhesives by 5.7%/39.4% y/y to Rs900m/Rs182m.
- Profitability was impacted severely as the company reported loss of Rs107m at the EBIT level vs. Rs7m profit in Q2 FY24 and Rs2m loss in Q1 FY25. This was due to front-loading of certain costs, led by commissioning of capacity in sanitaryware.

- Working capital required increased by 3% to Rs8.84bn, compared to Mar'24; it increased marginally by two days to 70 days.
- Management aims to lower working capital days to 50 by end-FY25, through a combination of better receivables and inventory management.
- Gross debt increased 2.4x to Rs1.7bn, compared to Mar'24. However, the company continues to have surplus, with cash balance of Rs2.74bn (down 38.1%, compared to Mar'24).

Outlook

- Management expects good demand for the tiles industry in H2, assuming a rub-off effect from the strong real estate sector.

Q2 FY25 Concall highlights

- Demand was subdued due to sustained weakness in the domestic market, led by excessive rainfall in Aug and Sep.
- Q2 revenue was Rs11.8bn, indicating a 5% increase y/y.
- Tile volumes grew by 8.5% y/y to 28.7m sq.mtrs.
- The EBITDA margin remained soft at 13.5%, driven by muted margins of the bathware division.
- **Segment-wise y/y performance**
  - **Tiles**: Revenue grew 5% y/y to Rs10.5bn.
  - **Bathware**: Revenue rose 6% y/y to Rs901m.
  - **Plywood**: Revenue dipped 26% y/y to Rs175m.
  - **Adhesives:** Revenue rose 40% y/y to Rs182m.
- The gross margin contracted 252bps y/y, largely owing to the blended realization drop of ~3%. This could be partially led by the higher mix of outsourcing (up 26% from 23%).
- PAT was 22% y/y lower at Rs840m.
- As of 30th Sep'24, working capital required remained flat at 59 days, compared to 31st Mar'24.

Gas pricing

- Gas prices are Rs38 in the north, Rs37 in the south, Rs35 in the west, with the average at Rs37. Prices did not change much during H1 FY25.
- Also, the company is using 22-23% biofuel overall; in the north, it is close to 30%+.

Capex

- The company completed capex of Rs1.35bn during H1, including the Nepal project.
- For the full year, capex will be ~Rs2bn.

A. Nepal project

- A 5.1m sq.mtr capacity of ceramic tiles and GVT, where commercial operations began in Sep'24.
- The total market size is expected to be of Rs25bn and in volume terms, 20-25m sq.mtrs. The company aims to ramp up sales in the next three-six months as the plant stabilizes and showrooms on a dealer level are in place.
- The plant will be working at 100% capacity; the company's target is to sell 100% of the capacity, going forward.

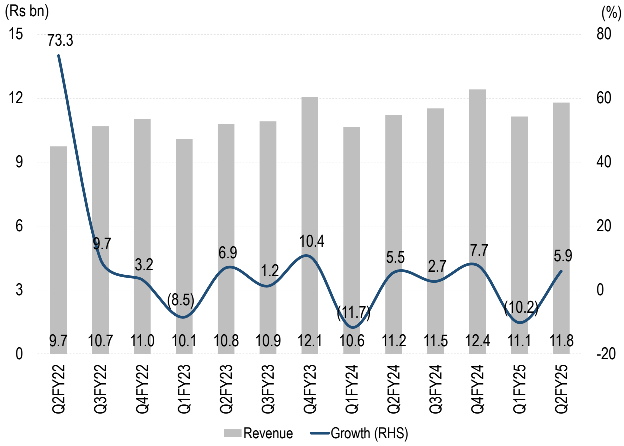
Other Highlights

- India's tile exports dropped 15% during Apr-Aug. Tile exports stood at Rs74bn vs. Rs87bn during the same period last year. This was largely attributed to the significant jump in ocean freight rates and lack of container availability due to the ongoing Red Sea crisis.
- Performance in H1 was affected by elections and excessive rainfall.

- Bathware contributed to ~90-100bps contraction in margins as the segment incurred losses. In bathware, there was some softness in faucets due to increase in prices of metals, which the company passes on to customers with a lag.
- The company has an optimistic outlook for H2 on positive dealer feedback and demand inflows from real estate.
- Realisations will largely remain flat and may increase due to more value-added tiles coming into the market.
- Margins fell mainly due to setting up of the tile unit for Keronite and another unit for the bathware division, both of which are stabilizing. The negative impact of these will vanish in the next half year.
- Tile constitutes the company's core business. It performed better than the industry in volume terms, with no fall in realizations.
- The company's continued focus on government projects is on track and is at least 25% more than that of the previous year as it now has a project team in the east, west and south, apart from the north. Thus, management aims to increase the share of government business to at least 12.5-13% of overall volumes vs. 10% last year.

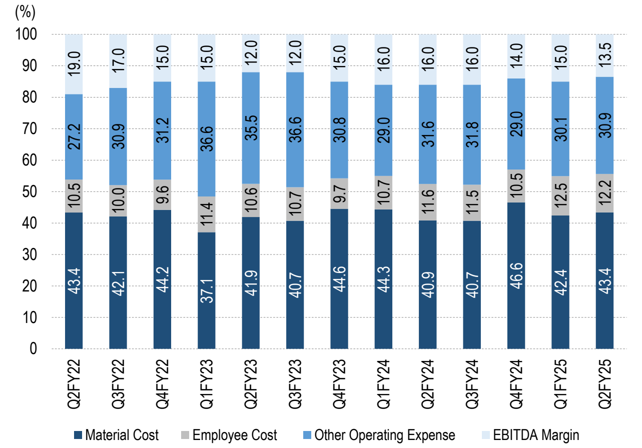
Story in charts

Fig 8 – Quarterly revenue trend & growth



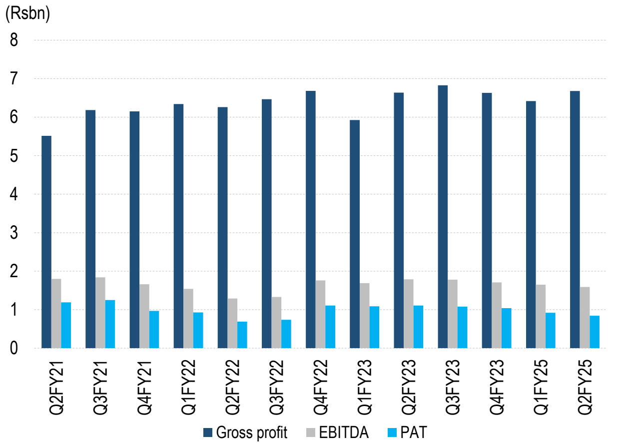
Source: Company, Anand Rathi Research

Fig 9 – Quarterly cost breakup



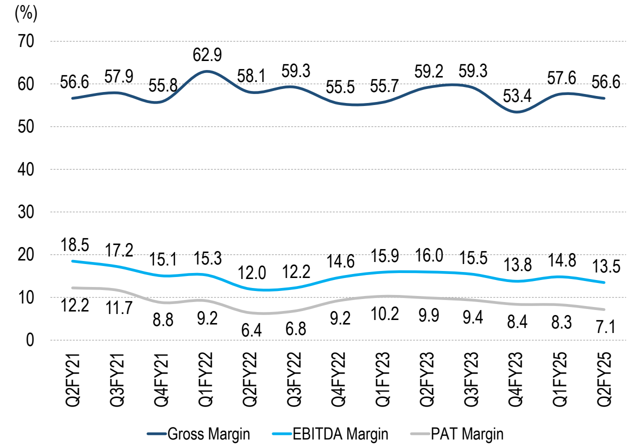
Source: Company, Anand Rathi Research

Fig 10 – Profitability trend



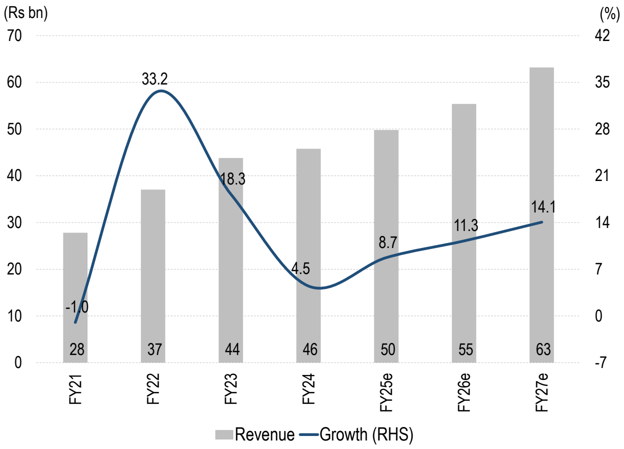
Source: Company, Anand Rathi Research

Fig 11 – Margin trend



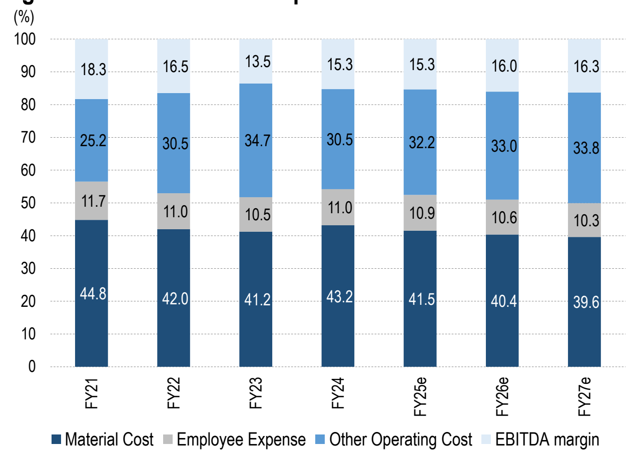
Source: Company, Anand Rathi Research

Fig 12 – Annual revenue and growth



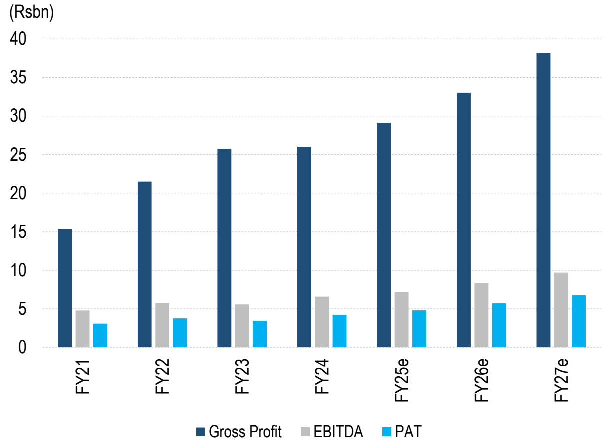
Source: Company, Anand Rathi Research

Fig 13 – Annual cost breakup



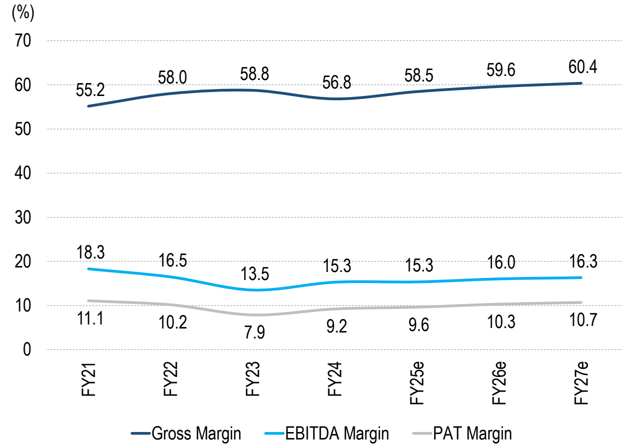
Source: Company, Anand Rathi Research

Fig 14 – Annual profitability trend



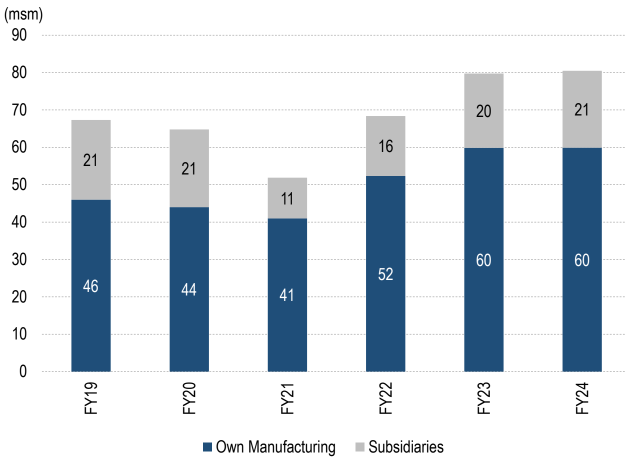
Source: Company, Anand Rathi Research

Fig 15 – Annual margin trend



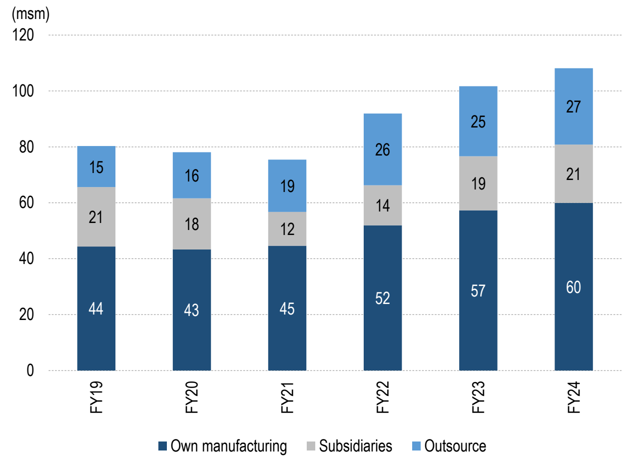
Source: Company, Anand Rathi Research

Fig 16 – Tiles – production



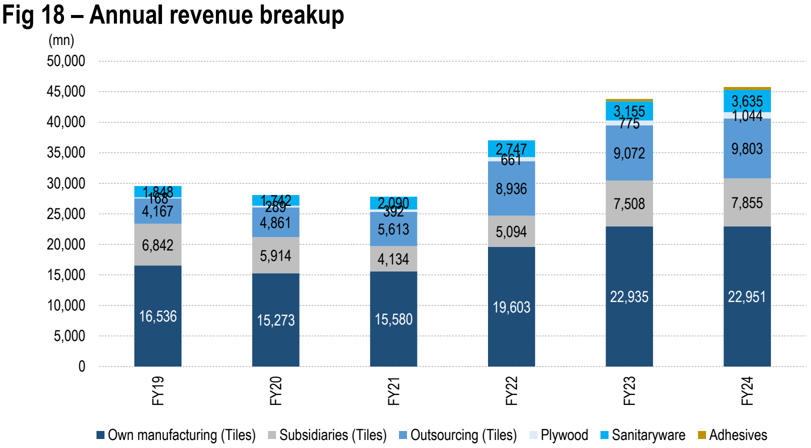
Source: Company, Anand Rathi Research

Fig 17 – Tiles - volumes sold



Source: Company, Anand Rathi Research

Fig 18 – Annual revenue breakup



Source: Company, Anand Rathi Research

Outlook & Valuations

Demand for the tile sector continues to be encouraging because of robust demand in real estate and infrastructure. However, demand was weak in Q2 owing to extended monsoons. Management is hopeful of better offtake in H2, assuming rub-off from the strong real estate sector.

The company commissioned a 5.1m sq.mtr ceramic tile and GVT capacity in Nepal; revenue to start flowing in. Management believes that the company will grow 5-6% ahead of the industry's growth rate. Overall volumes would grow 9-10% and margins ~15% this year. The structural story is intact, and we expect revenue/earnings CAGRs of 11.3%/16.9% over FY24-27.

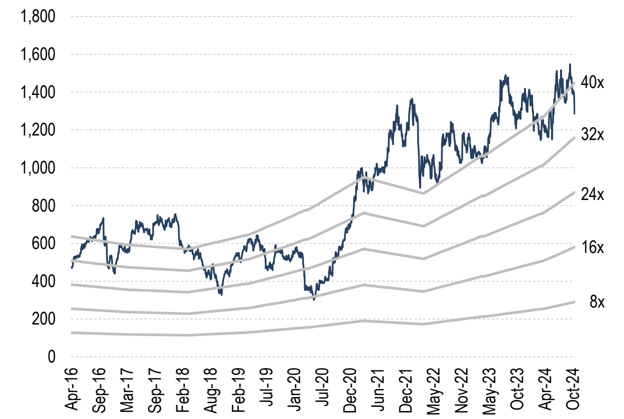
As the stock slipped 19% from its recent highs and 9%/15% during the last one week/month, it provides a potential upside of 35% based on our higher 12-mth TP of Rs1,695, 40x FY27e earnings (earlier Rs1,520, 40x FY26e earnings). Hence, we upgrade to a Buy.

Fig 19 – Change in estimates

(Rs m)	Old			New			Variance %		
	FY25e	FY26e	FY27e	FY25e	FY26e	FY27e	FY25	FY26	FY27
Sales	50,935	57,779	-	49,790	55,392	63,181	(2.2)	(4.1)	-
EBITDA	7,959	9,389	-	7,641	8,878	10,305	(4.0)	(5.4)	-
PAT	5,014	6,053	-	*15.3*	*16.0*	*16.3*	*(28)*	*(22)*	-
EPS (Rs)	31.5	38.0	-	4,797	5,711	6,751	(4.3)	(5.7)	-

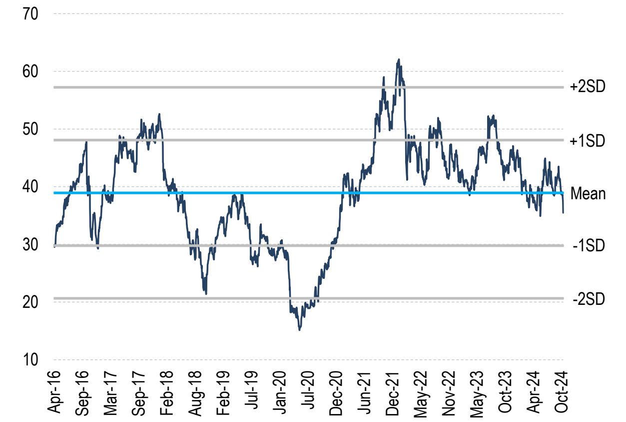
Source: Anand Rathi Research

Fig 20 – P/E band – standard deviation



Source: Bloomberg, Anand Rathi Research

Fig 21 – P/E band – One-year forward



Source: Bloomberg, Anand Rathi Research

Risks

- Slowdown in commercial and/or residential real estate to curb demand.
- A lower GDP growth rate might curb consumers' purchasing power, which might crimp demand for renovation.
- Keener competition from the informal segment or from peers in the formal one might slash realisations, cutting into profitability.
- Higher raw material and fuel (gas) costs might compress gross margin.

Appendix

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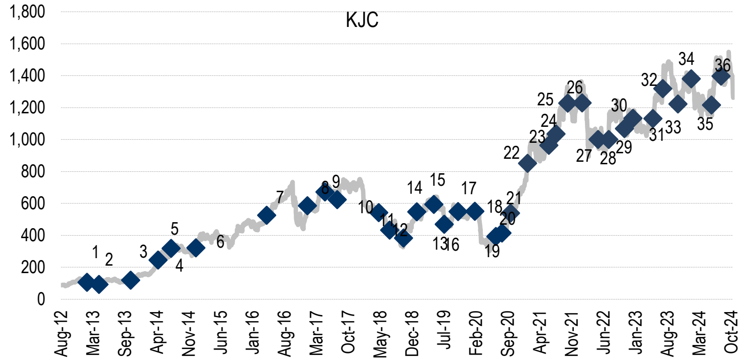
Rating and Target Price History (as of 23 October 2024)



	Date	Rating	TP (Rs)	Share Price (Rs)
23	17-Jun-21	**Hold**	1047	974
24	8-Aug-21	**Hold**	1116	1029
25	25-Oct-21	**Hold**	1341	1227
26	22-Jan-22	**Hold**	1356	1267
27	18-May-22	**Hold**	1090	955
28	22-Jul-22	**Hold**	1184	1109
29	4-Nov-22	**Hold**	1200	1050
30	31-Jan-23	**Buy**	1231	1059
31	20-May-23	**Buy**	1443	1194
32	28-Jul-23	**Buy**	1641	1356
33	23-Oct-23	**Buy**	1525	1222
34	3-Feb-24	**Hold**	1470	1346
35	11-May-24	**Hold**	1347	1181
36	3-Aug-24	**Hold**	1520	1461

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