

CMP: ₹ 1040

Target: ₹ 1210 (16%)

Target Period: 12 months

BUY

November 3, 2022

Margins to improve from Q3FY23...

About the stock: Kajaria Ceramics is the largest manufacturer of ceramic/vitrified tiles in India with a current annual capacity of 84.5 mn sq metre (MSM).

- Apart from completed capex of ₹ 250 crore on tiles, it is adding 3 MSM brownfield capex in Sikandrabad (~₹ 70 crore capex) and setting up a plant of 8 MSM in Nepal in JV with an investment of ~₹ 125 crore

Q2FY23 Results: Weak performance with muted volumes and margin decline.

- Topline was up 10.7% YoY at ₹ 1077.8 crore. Tiles sales volumes were muted (up ~0.5%) YoY at 24.9 MSM. Three-year volume CAGR was at 8%. Tiles revenues were up 11.5% YoY at ₹ 983.9 crore, with pricing growth contributing almost all growth, largely undertaken owing to a sharp rise in power costs
- EBITDA was at ₹ 129.4 crore, with resultant margins at 12%, down 653 bps YoY and 323 bps QoQ, owing to high gas prices
- PAT was at ₹ 69.9 crore, down 39.8% YoY

What should investors do? Kajaria's share price has grown at ~9% CAGR over the past five years (from ~₹ 671 in November, 2017 to ~₹ 1040 in November, 2022).

- Kajaria is a solid play on tiles segment with brand leadership reflecting in superior realisations & margins. We believe gas price uncertainty is fully built in and margins will improve from H2FY23. Thus, we maintain **BUY**

Target Price and Valuation: We value Kajaria at ₹ 1210/share, at 36x FY24 P/E.

Key triggers for future price performance:

- We expect ~12% CAGR in tiles volume and realisations CAGR of 3.4%, resulting in tiles revenues CAGR of ~16% over FY22-25 to ₹ 5237 crore
- The increased dividend payout (~45% vs. 20-25%, earlier) is likely to improve return ratios (RoCEs likely at 25%+ in FY25E vs ~21% in FY22)
- Gas prices will remain a key determinant of margins trajectory

Alternate Stock Idea: Besides Kajaria, we like Century Ply in buildings materials.

- A play on leadership in wood panel industry
- BUY with a target price of ₹ 675

Kajaria

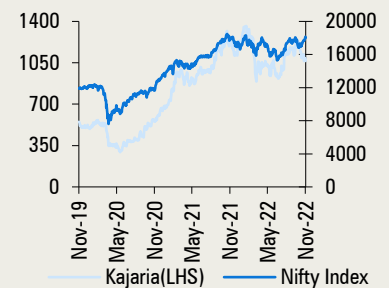
Particulars

Particular	Amount (₹ crore)
Market Capitalization	16,526
Total Debt (FY22)	128
Cash (FY22)	424
EV	16,229
52 week H/L (₹)	1375 / 885
Equity capital	15.9
Face value (₹)	1.0

Shareholding pattern

	Dec-21	Mar-22	Jun-22	Sep-22
Promoters	47.5	47.5	47.5	47.5
DII	16.8	19.7	21.8	22.2
FII	22.5	21.3	19.6	19.4
Other	13.3	11.5	11.2	10.9

Price Chart



Key Risks

- Key Risk:** (i) Slowdown in demand; (ii) Gas price rise

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Key Financial Summary

(₹ crore)	FY20	FY21	FY22	5 yr CAGR (FY17-22)	FY23E	FY24E	FY25E	3 yr CAGR (FY22-25E)
Net Sales	2,808.0	2,780.9	3,705.2	7.8%	4,544.0	5,264.9	5,816.7	16.2%
EBITDA	415.9	508.8	610.8	4.2%	635.1	842.3	931.8	15.1%
EBITDA Margin (%)	14.8	18.3	16.5		14.0	16.0	16.0	
PAT	255.3	308.1	377.1	8.3%	377.5	532.6	591.1	16.2%
EPS (₹)	16.1	19.4	23.7		23.7	33.5	37.2	
P/E (x)	64.8	53.7	43.9		43.8	31.1	28.0	
P/B (x)	9.6	8.8	7.8		7.2	6.4	5.6	
EV/EBITDA (x)	39.5	31.8	26.6		26.0	19.4	17.3	
RoCE (%)	16.3	19.7	21.5		20.3	25.1	25.0	
RoE	14.9	16.5	17.8		16.3	20.5	20.1	

Source: Company, ICICI Direct Research

Key business highlight and outlook

- Volume driver and current volume traction:** Kajaria's sales volume in the tiles segment has improved merely by 0.5% (to 24.9 MSM) on a YoY basis during Q2FY23 mainly impacted by a subdued demand scenario and disruptions in natural gas supply followed by unprecedented increase in gas cost. However, revenue improved 11.5% YoY (to ₹ 983.9 crore) with better realisation and change in product mix (mix in volume terms: ceramics - 46%; vitrified - 26%; GVT - 28%). Further, higher gas prices and ad spends have impacted EBITDA margins in Q2FY23, which were at 12% (down 653 bps YoY; down 222 QoQ). **Going forward, the management is confident of a gradual demand pick-up during post festive seasons with revived customer sentiments, continued traction in the real estate sector, upped reconstruction/renovation and government's focus on infrastructure spending in spite of high input costs and increasing interest rates**
- Gas price rise:** Gas prices for the industry have continued to remain at an elevated level during Q2FY23. **For Kajaria, average gas prices for Q2FY23 in its northern, southern and Morbi plants were at ~₹ 60/SCM, ~₹ 69/SCM and ₹ 69/SCM, respectively (vs. average gas prices in its northern, southern and Morbi plants during Q1FY23 at ~₹ 52/SCM, ~₹ 60/SCM and ₹ 67/SCM, respectively).** Going forward, the management expects gas prices to soften as rates at current levels are unsustainable
- Use of alternate fuel:** The company has **started using LPG partly as an alternate to gas from November 2022 at Srikalahasti, Morbi and Gailpur plants in view of elevated gas prices over past several quarters.** LPG prices are currently hovering at ₹ 53-55/SCM at different locations. **Thus, the company's average fuel price is likely to come down to ₹ 55/SCM in Q3FY23 (vs. ₹ 62/SCM in Q2FY23) with softening in gas prices and use of LPG as an alternate fuel**
- Price hike:** In order to partially offset the rise in input costs, Kajaria has undertaken ~2% price hike mainly in tiles segment each during May 2022 and September 2022. In bathware segment, the company has not taken any price hike in Q2FY23 due to reduction in brass prices
- Allied business:** Kajaria's subsidiaries and allied businesses reported muted growth during Q2FY23 (3.2% YoY; to ₹ 98.8 crore). In the faucet and sanitaryware segment, revenues were flat on a YoY basis at ₹ 74.4 crore. **The management expects segmental revenue to improve to ~₹ 370 crore during FY23 (vs. ₹ 275 crore reported in FY22) to be led by introduction of newer products, strengthened distribution network, and larger acceptance by consumers.** In the plywood business, revenues improved 17.4% YoY and were at ₹ 19.4 crore, on the lower base while adhesive business contributed ₹ 9.7 crore to the overall topline
- Guidance:** The management has cautiously guided for ~15% YoY volume growth in the tiles segment during FY23 likely to be driven by a) expected rise in demand from Tier II and below cities, b) healthy capacity utilisation, c) expected increase in Kajaria's capacity, d) enhanced distribution network and e) strong brand recall. Also, **the company expects minimum 200 bps improvement in margin (to 14%+) during H2FY23 compared to Q2FY23 with relaxation in gas prices, use of alternate fuel and softening in raw material costs**
- Industry update:** As per the management, the overall size of the tiles industry in FY22 was at ~₹ 33,700 crore (domestic: ₹ 21,000 crore; export: ~₹ 12,700 crore). Exports opportunity for Indian players, however, remained muted in FY22 due to Covid-19 disruptions, significant rise in gas prices, higher freight costs, and unavailability of containers at desired levels. Going forward, the management expects healthy demand revival for Indian tiles in the foreign territory to be aided by competitive price advantage with significant rise in electricity and gas costs for European and Chinese players. With these, **exports from Indian manufacturers is likely to reach ~₹ 18,000 crore during FY23 (~₹ 7,500 crore during H1FY23).** Demand in domestic market is expected to improve 5- 6% during FY23 with rise in real-estate consumption.
- Update on Morbi players.** Inflated raw material costs, increased freight rates, shortage of containers, high gas prices and inadequate working capital have resulted in a fall in demand for tiles products mainly for export oriented Morbi players in the recent past. With that, units in Morbi had collectively

decided to shut production for 30 days from August 10 with a view to clear unsold inventories. Now, the production has resumed and, likewise, exports have picked up

- **Working capital:** Working capital has increased to 62 days (vs. 57 days at Q1FY23-end) due to build-up in inventories for newly commissioned plant and steep decline in creditors days. **Going forward, the management expects working capital days to hover at current levels of 50-60 days**
- **Ad spends:** Kajaria has spent ~₹ 31 crore, ~₹ 50 crore towards marketing and advertisement during Q1FY23, H1FY23, respectively. **The spend is likely to remain at an elevated level, going forward (expects to be at ₹ 100 crore in FY23 vs. ~₹ 80 crore in FY22)**
- **Expansions:** Kajaria had commissioned 4.4 MSM of PVT capacity at its Morbi (Gujarat) plant during April 2022. The other two projects i.e. 4.2 MSM of ceramic floor tiles at Gailpur plant (Rajasthan) and 3.8 MSM of value added glazed vitrified tiles at Srikalahasti Plant (Andhra Pradesh) have also been commissioned during May 2022. Further, **the company has announced expansion of glazed vitrified tiles capacity of 3 MSM/annum at Sikandrabad plant recently, which will increase the total capacity of the plant from 8.4 MSM/annum to 11.4 MSM/annum at the capex of ₹ 70 crore.** The expansion is likely to be completed by September 2023. Additionally, the company is expected to invest ₹ 70 crore to set up a 6 lakh pieces per annum sanitaryware manufacturing facility in Gujarat (revenue potential: ~₹ 150 crore at full capacity utilisation). The expansion is expected to be completed by December 2023. Further, the company is adding new capacity of 6 lakh pieces/annum in their faucet plant at Gailpur, which will take the total the capacity to 16 lakh pieces/ annum. Estimated cost for this expansion is ~₹ 5 crore and expected to be completed by November 2022
- **Acquisition:** Kajaria has approved acquisition of 51% equity shares of South Asian Ceramic Tiles Pvt Ltd at a consideration of ₹ 28.5 crore and will have capital employed of ~₹ 60 crore. It has a facility at Balanagar, Telangana and manufactures 60 x 60 cm and 60 x 120 cm ceramic floor tiles (annual capacity of 4.8 MSM). The acquisition is mainly targeted to strengthen its foothold in South India thereby enlarging Kajaria's tiles markets to get more dealers, by reducing the transit time and by increasing the rotation of re-ordering by the dealers of the company. Capex at greenfield unit of such capacity would have been ~₹ 120 crore and would have taken 24 months to commission the plant. The company is targeting revenue of ₹ 130 crore, ₹ 180 crore in FY23, FY24, respectively, from the plant
- **Investment in Nepal:** The Board has approved an investment up to ₹ 125 crore (i.e. 50% of project cost of ₹ 250 crore) in a company to be incorporated in Nepal, by way of equity and/or loan, for establishing a tile manufacturing facility in Nepal, with annual capacity of 8 MSM/annum, on JV basis between the company and various individuals affiliated with Ramesh Corp, Nepal. The plant is likely to get commissioned by March 2024. **Kajaria expects production of tiles with plant at Nepal to benefit it largely with rise in market share backed by a) significant market size: Indian manufacturers exports tiles worth ₹ 500 crore (25 MSM) at Nepal, and b) higher 45% import duty for Indian producers. Margins would be better compared to Indian plant**
- **Dealer additions:** Kajaria had a base of 1,700 dealers across India at FY22-end. Moreover, the company has added 75 dealers during H1FY23 and is planning to add another ~125 dealers overall during H2FY23. Overall, the company is targeting to reach 2,100+ dealers over the next two to three years (125-150 dealers are likely to be added each during FY24, FY25)

Kajaria with a net cash balance sheet and superior brand, is a solid play on the tiles sector with expanding reach to tier II, III cities. We believe gas price uncertainty is fully built in and recovery in margin is likely in H2. We maintain **BUY**. We value it at multiple at 36x FY24E P/E to ascribe a revised target price of ₹ 1210/share.

Exhibit 1: Variance Analysis

	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Net Sales	1,077.8	1,123.4	973.6	10.7	1,008.2	6.9	Tiles sales volumes were muted (up ~0.5% YoY at 24.9 MSM. Three-year volume CAGR stood at 8%. Tiles Revenues were up 11.5% YoY at ₹ 983 crore, with pricing growth contributing almost all the growth, largely undertaken owing to sharp rise in power costs. Faucet and Sanitaryware revenues were flat YoY at ₹ 74.4 crore. Plywood revenues were up 17% YoY at ₹ 19.4 crore
Other Income	7.6	8.0	7.1	7.2	8.1	-5.7	
Net Purchase of Stock in Trad	240.8	201.0	208.3	15.6	120.6	99.7	
Cost of Materials Consumed	211.1	268.0	214.0	-1.3	253.4	-16.7	
Staff cost	113.8	116.0	102.0	11.6	114.4	-0.5	
Other expenditure	115.4	110.0	91.2	26.6	97.8	18.1	
Power & Fuel cost	267.2	260.0	177.6	50.5	268.5	-0.5	
EBITDA	129.4	168.4	180.5	-28.3	153.6	-15.7	
EBITDA Margin (%)	12.0	15.0	18.5	-653 bps	15.2	-323 bps	
Depreciation	33.7	33.0	28.2	19.5	32.4	4.0	
Interest	3.2	3.5	2.7	16.2	3.6	-12.5	
PBT	96.6	139.9	156.7	-38.4	125.7	-23.2	
Taxes	27.7	36.0	37.4	-26.0	32.8	-15.5	
PAT	69.9	102.9	116.1	-39.8	92.3	-24.3	

Key Metrics

Sales Volume (in MSM)	24.9	25.8	24.8	0.5	23.3	6.8
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Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY22		FY23E		FY24E		FY25E		Comments
	Old	New	% Change	Old	New	% Change	New		
Revenue	3,705.2	4,642.9	4,544.0	-2.1	5,351.6	5,264.9	-1.6	5,816.7	Realign estimates
EBITDA	610.8	740.8	635.1	-14.3	880.7	842.3	-4.4	931.8	
EBITDA Margin (%)	16.5	16.0	14.0	-198 bps	16.5	16.0	-46 bps	16.0	
PAT	377.1	457.7	377.5	-17.5	553.6	532.6	-3.8	591.1	
EPS (₹)	23.7	28.8	23.7	-17.5	34.8	33.5	-3.8	37.2	

Source: Company, ICICI Direct Research

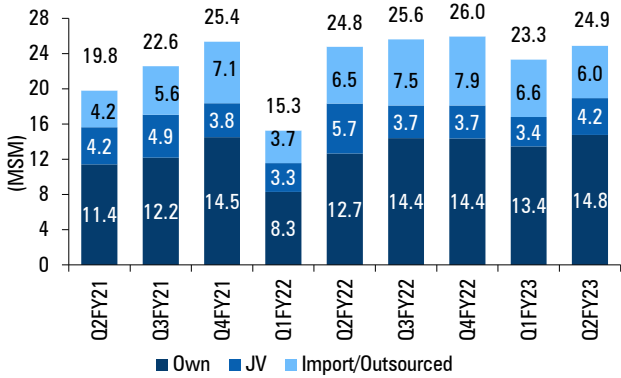
Exhibit 3: Assumptions

Volume in MSM	FY21	FY22	Current	Earlier	New	Earlier	New	Comments
			FY23E	FY23E	FY24E	FY24E	FY25	
Production	52.0	68.4	80.4	84.3	85.7	89.4	92.1	
Own	37.7	50.4	62.7	63.0	67.3	67.8	69.0	
JV	14.3	17.9	17.7	21.3	18.5	21.6	23.1	
Sales	75.4	91.7	103.6	107.6	119.2	123.4	129.1	
Own	44.6	51.9	61.2	61.8	67.3	67.8	69.0	
JV	12.1	14.3	15.5	15.4	18.5	21.6	23.1	
Import/Outsourced	18.7	25.4	26.9	30.5	33.5	34.0	37.0	

Source: Company, ICICI Direct Research

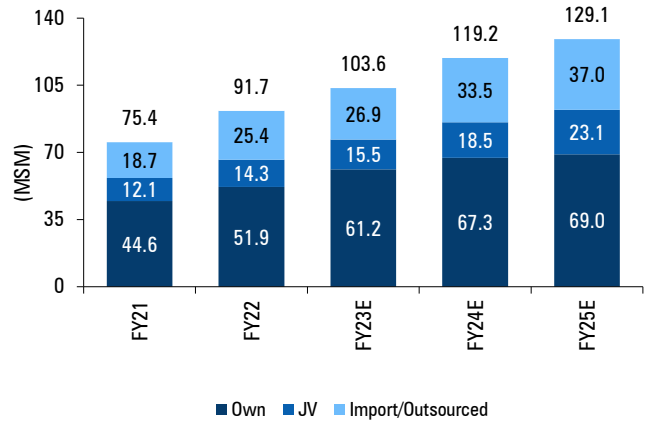
Company Analysis

Exhibit 4: Quarterly sales volume trend



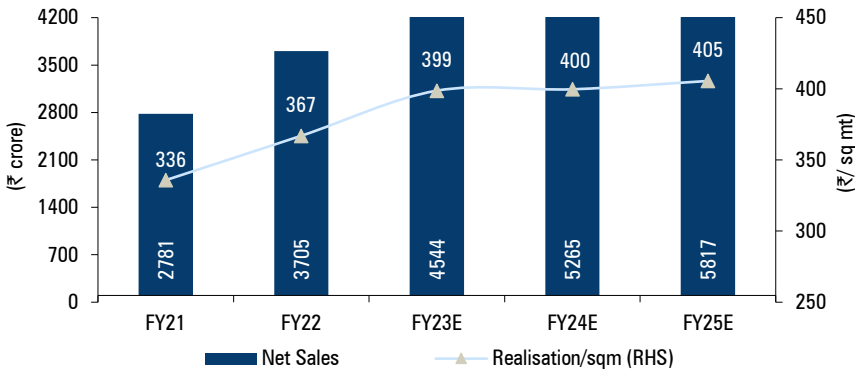
Source: Company, ICICI Direct Research

Exhibit 5: Annual sales volume trend



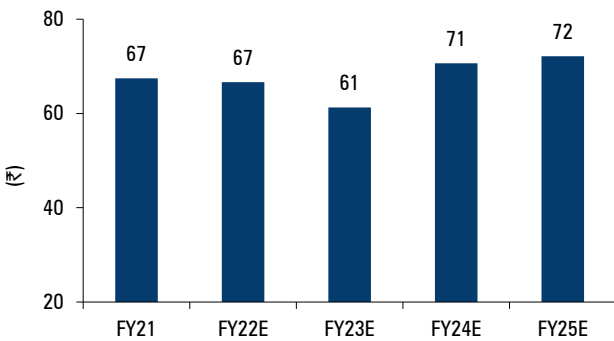
Source: Company, ICICI Direct Research

Exhibit 6: Revenue, realisation trend



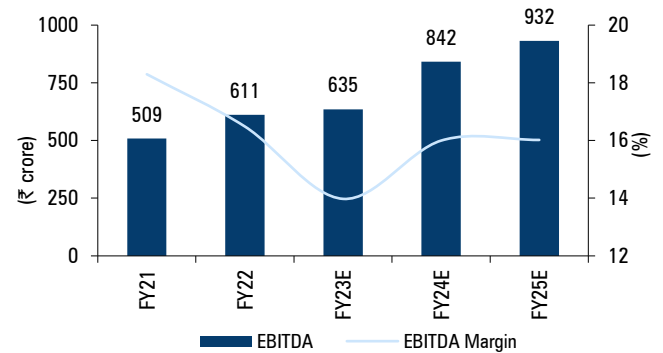
Source: Company, ICICI Direct Research

Exhibit 7: EBITDA/sq metre trend



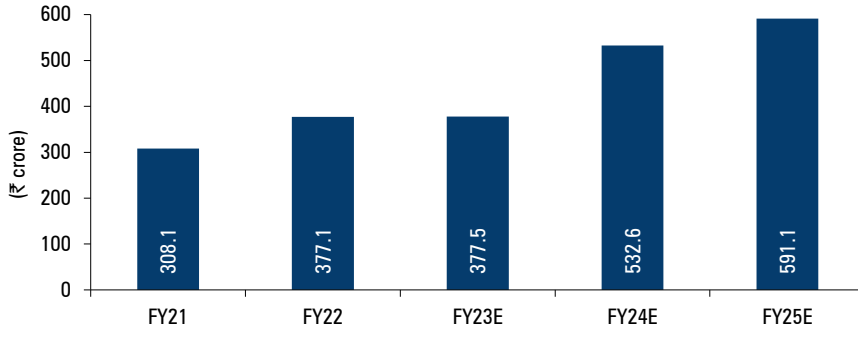
Source: Company, ICICI Direct Research

Exhibit 8: EBITDA and EBITDA margin trend



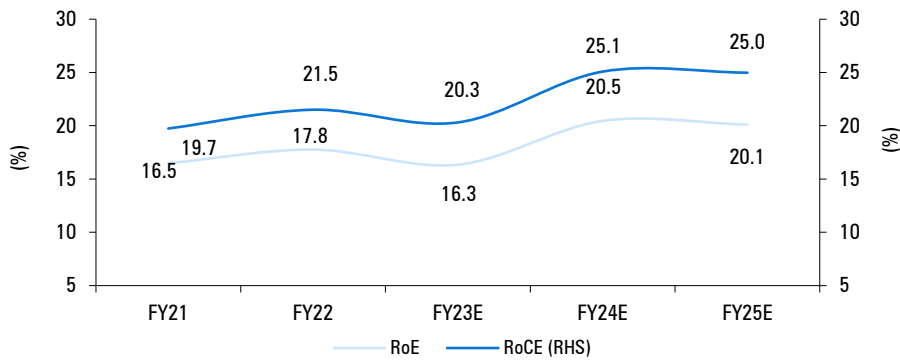
Source: Company, ICICI Direct Research

Exhibit 9: PAT growth trend



Source: Company, ICICI Direct Research

Exhibit 10: Return ratios trend



Source: Company, ICICI Direct Research

Financial summary

Exhibit 11: Profit and loss statement ₹ crore

(₹ Crore)	FY22	FY23E	FY24E	FY25E
Net Sales	3,705.2	4,544.0	5,264.9	5,816.7
Other Operating Income	-	-	-	-
Total operating income	3,705.2	4,544.0	5,264.9	5,816.7
Raw Material Expenses	730.3	817.9	921.4	1,017.9
Cost of Materials Consumed	824.8	1,067.8	1,216.2	1,337.8
Employee benefit expenses	407.7	463.5	526.5	587.5
Other Expenses	1,131.7	1,559.6	1,758.6	1,941.6
Total operating expenses	3,094.4	3,908.9	4,422.6	4,884.9
EBITDA	610.8	635.1	842.3	931.8
Interest	12.7	13.4	13.4	13.4
Depreciation	115.4	134.4	144.2	155.2
Other income	27.6	32.0	35.0	40.0
PBT	510.2	515.6	719.6	803.2
Taxes	127.4	134.1	181.1	202.1
PAT before MI	382.8	381.5	538.6	601.1
Minority Interest	5.8	4.0	6.0	10.0
PAT	377.1	377.5	532.6	591.1
Growth (%)	22.4	0.1	41.1	11.0
EPS (₹)	23.7	23.7	33.5	37.2

Source: Company, ICICI Direct Research

Exhibit 13: Balance sheet ₹ crore

(₹ Crore)	FY22	FY23E	FY24E	FY25E
Liabilities				
Equity Capital	15.9	15.9	15.9	15.9
Reserve and Surplus	2,106.5	2,293.2	2,587.3	2,923.9
Total Shareholders funds	2,122.4	2,309.1	2,603.2	2,939.9
Minority Interest	64.8	68.8	74.8	84.8
Total Debt	127.9	127.9	127.9	127.9
Other Liabilities	98.5	98.5	98.5	98.5
Total Liabilities	2,431.5	2,622.3	2,922.3	3,269.0
Assets				
Gross Block	1,990.0	2,422.2	2,622.2	2,822.2
Less Acc. Dep	851.2	985.7	1,129.9	1,285.1
Net Block	1,138.8	1,436.5	1,492.3	1,537.1
Net Intangibles Assets	10.8	10.8	10.8	10.8
Capital WIP	263.4	263.4	263.4	263.4
Total Fixed Assets	1,413.0	1,710.7	1,766.5	1,811.3
Investments				
Inventory	465.9	572.7	663.5	733.1
Sundry Debtors	513.3	647.4	750.1	828.7
Loans & Advances	138.3	169.6	196.5	217.1
Cash & Bank Balances	424.4	170.8	302.6	518.4
Other Current Assets	31.8	31.8	31.8	31.8
Total Current Assets	1,573.6	1,592.2	1,944.4	2,329.0
Trade Payable	298.1	365.6	423.6	468.0
Other Current Liabilities	248.9	305.2	353.7	390.7
Provisions	8.0	9.8	11.3	12.5
Net Current Assets	1,018.6	911.5	1,155.8	1,457.7
Total Assets	2,431.5	2,622.3	2,922.3	3,269.0

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement ₹ crore

(₹ Crore)	FY22	FY23E	FY24E	FY25E
Profit after Tax	377.1	377.5	532.6	591.1
Depreciation	115.4	134.4	144.2	155.2
Interest	12.7	13.4	13.4	13.4
Others	99.9	102.1	146.1	162.1
Cash Flow before wc changes	605.0	627.5	836.3	921.8
Net Increase in Current Assets	(277.7)	(272.2)	(220.5)	(168.8)
Net Increase in Current Liabilities	174.6	125.6	108.0	82.7
Net CF from operating activities	377.1	346.9	542.7	633.6
(Purchase)/Sale of Fixed Assets	(321.0)	(432.2)	(200.0)	(200.0)
Net CF from Investing activities	(288.4)	(400.2)	(165.0)	(160.0)
Inc / (Dec) in Equity Capital	3.8	(0.0)	-	-
Dividend	(127.3)	(190.8)	(238.5)	(254.4)
Interest paid	(12.7)	(13.4)	(13.4)	(13.4)
Inc / (Dec) in Secured Loans	30.9	-	-	-
Inc / (Dec) in Unsecured Loans	(1.8)	-	-	-
Net CF from Financing activities	(107.0)	(200.2)	(245.9)	(257.8)
Net Cash flow	(18.4)	(253.6)	131.8	215.8
Opening Cash	442.7	424.4	170.8	302.6
Closing Cash/ Cash Equivalent	424.4	170.8	302.6	518.4

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios

	FY22	FY23E	FY24E	FY25E
Per Share Data (₹)				
EPS - Diluted	23.7	23.7	33.5	37.2
Cash EPS	31.0	32.2	42.6	46.9
Book Value	133.5	145.2	163.7	184.9
Dividend per share	11.0	14.0	15.0	16.0
Operating Ratios (%)				
EBITDA / Net Sales	16.5	14.0	16.0	16.0
PAT / Net Sales	10.2	8.3	10.1	10.2
Inventory Days	46	46	46	46
Debtor Days	51	52	52	52
Creditor Days	29	29	29	29
Return Ratios (%)				
RoNW	17.8	16.3	20.5	20.1
RoCE	21.5	20.3	25.1	25.0
RoIC	28.6	23.0	29.8	31.4
Valuation Ratios (x)				
EV / EBITDA	26.6	26.0	19.4	17.3
P/E (Diluted)	43.9	43.8	31.1	28.0
EV / Net Sales	4.4	3.6	3.1	2.8
Market Cap / Sales	4.5	3.6	3.1	2.8
Price to Book Value	7.8	7.2	6.4	5.6
Dividend Yield (%)	1.1	1.3	1.4	1.5
Solvency Ratios (x)				
Net Debt / Equity	(0.1)	(0.0)	(0.1)	(0.1)
Debt/EBITDA	0.2	0.2	0.2	0.1
Current Ratio	2.1	2.1	2.1	2.1
Quick Ratio	1.2	1.2	1.2	1.2

Source: Company, ICICI Direct Research

RATING RATIONALE

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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