

28 September 2015

Initiating Coverage (BUY)

Kajaria Ceramics

CMP

INR 776

Target Price

INR 1,037

Stock Details	
Industry	Ceramics & Granite
Bloomberg Code	KJC IN
BSE Code	500233
Face Value (Rs.)	2.00
Market Cap. (Rs. Mn)	6,170.77
52wk. High / Low (Rs.)	861.45/525.55

Shareholding Pattern Jun '15	
Promoter (%)	49.54
FII (%)	23.24
DII (%)	5.18
Public - Other (%)	22.04
No. of Share Outstanding (mn)	79.47

Valuation Summary				
	FY 14A	FY 15A	FY 16E	FY 17E
P/E (x)*	21	34	30	28
EV/EBITDA (x)	9.46	17.59	15.32	15.06
P/BV (x)	3.79	6.65	6.35	6.21

*Based On CMP on Reco Date for FY 15 and Market Price as on 1st Apr is taken for FY14

Key Financial				
Rs. Mn	FY 14A	FY 15A	FY 16E	FY 17E
Net Sales	18,382	21,941	24,707	28,902
EBITDA	2,870	3,556	4,516	5,439
Net Profit	1,242	1,756	2,293	2,943
EPS (Rs.)	16.7	22.7	28.9	37.0

Key Ratios				
	FY 14A	FY 15A	FY 16E	FY 17E
EBITDA Margin (%)	14.2%	14.7%	16.7%	17.2%
EBIT Margin (%)	11.9%	12.4%	14.3%	15.0%
Net Pro. Margin (%)	6.1%	7.3%	8.5%	9.3%
Debt/Equity (x)	0.16	0.13	0.06	0.03
RoNW (%)	27.9%	27.7%	27.4%	27.7%
RoCE (%)	19.3%	20.4%	21.4%	23.0%

We recommend 'BUY' on Kajaria Ceramics for a target of INR 1,037 - valuing the company at P/E of 28x 2017 Earning.

Growth in short term is likely to remain weak, long term growth drivers remain positive:

Kajaria Ceramics posted a strong volume growth of 21% CAGR between FY11-14 before it slowed down to 12.5% in FY15. Given moderation in demand environment mainly affected by lower off take of new projects (real estate demand) we expect volume growth in the range of 12-14% in FY16. Industry people and management is confident about revival in growth momentum in H2FY16 as economy picks up however we remain cautious about any strong growth momentum in short term. We expect volume growth to languish at 12-14% in subsequent quarters in FY16.

Because of near term weakness in demand environment we believe that long term structural growth driver remain intact for tiles industry.

- Emergence of tiles as the most convenient floor paving material replacing mosaic, marble etc.,
- Increasing uses of tiles from kitchen / bathroom to flooring and wall tiles
- Increasing product availability and
- Growing consumer preference for aesthetics and design driving spending on such products increasing government thrust on housing and infrastructure development is also likely to drive growth for tiles industry in long term.

To strengthen its presence in southern region, Kajaria entered into new JV in south:

Kajaria has announced another JV - Floera Ceramics, based in Andhra Pradesh by acquiring 51% stake in current quarter. This JV is in process of putting 5.7mn sqm capacity which is likely to be completed by Q1FY17 and will increase company's presence in southern region. Kajaria has only one plant in south Vennar Ceramics with capacity of 2.3mn sqm in ceramic wall tiles. This newly setup plant will help the company to reduce logistics cost as currently south market is being fed from Gujarat (Morbi) and will also reduce its working capital.

Valuations and View:

We remain positive on Kajaria given the scope of growth in the industry, favourable structural shift, its better margin and return ratio profile coupled with a strong balance sheet. Hence, we maintain our BUY recommendation on the stock. We value the stock at Rs. 1,037 at P/E of 28x FY17E EPS. Also we have performed DCF valuation and the real value of the stock comes around Rs. 1,037.

We await for near term catalysts like I) pick up in real estate demand II) Implementation of GST and sharp pick up in retail demand to drive company's earnings.

Q1 FY16 Result highlights:

Kajaria Ceramics Q1 profit rises 19.7% to Rs 46.2 cr. The company's total income was up 9.3 percent at Rs 548.7 crore against Rs 501.9 crore.

Registered a 19.7 percent jump in its first quarter consolidated net profit at Rs 46.2 cr against Rs 38.6 cr, in the same quarter last fiscal. The company's total income was up 9.3 percent at Rs 548.7 cr against Rs 501.9 cr during the same period.

- Tepid volume growth of 6% yoy in Q1FY16 weakens topline growth at 9% to Rs 5.5bn while lower tax and stable margins leads to PAT growth of 20% yoy to Rs 462mn
- To strengthen its presence in southern region and to save on logistics cost and working capital, company has entered into another JV (with 5mn sqm capacity) in Andhra Pradesh
- Though long term structural growth drivers remain intact, we believe that near term weakness in volume growth to limit stock price return

Q1 FY16 Performance Highlight (Standalone Basis)							
(in Million)	1Q FY15	2Q FY15	3Q FY15	4Q FY15	1Q FY16	YoY (%)	QoQ (%)
Revenue	5,119.40	5,469.70	5,667.90	6,052.90	5,651.80	10.4%	-6.6%
Other Income	12.20	24.20	27.50	42.50	43.20	254.1%	1.6%
Total Income	5,131.60	5,493.90	5,695.40	6,095.40	5,695.00	11.0%	-6.6%
Expenditure	(4,466.70)	(4,798.60)	(4,955.60)	(5,307.50)	(4,889.20)		
As a % of Sales	87.3%	87.7%	87.4%	87.7%	86.5%		
Interest	(23.90)	(24.20)	(2.00)	(9.60)	(22.70)	-5.0%	136.5%
PBDT	641.00	671.10	737.80	778.30	783.10		
As a % of Sales	12.5%	12.3%	13.0%	12.9%	13.9%		
Depreciation	(98.60)	(102.70)	(96.70)	(95.80)	(111.10)		
PBT	542.40	568.40	641.10	682.50	672.00	23.9%	-1.5%
As a % of Sales	10.6%	10.4%	11.3%	11.3%	11.9%		
Tax	(179.00)	(176.20)	(188.20)	(207.40)	(208.30)	16.4%	0.4%
Net Profit	363.40	392.20	452.90	475.10	463.70	27.6%	-2.4%
As a % of Sales	7.1%	7.2%	8.0%	7.8%	8.2%		
Equity	151.20	151.20	158.90	158.90	158.90	5.1%	0.0%
EPS	4.81	5.19	5.78	5.98	5.83	21.2%	-2.5%
OPM %	12.99	12.71	13.05	13.02	14.26		
NPM %	7.1	7.17	7.99	7.85	8.2		

Company Background:

Kajaria Ceramics Limited is an India-based company engaged in manufacturing and trading of ceramics, polished and glazed vitrified tiles. The Company offers ceramic wall and floor tiles, polished vitrified tiles, glazed vitrified tiles, and sanitary ware and faucets. Its polished vitrified tiles consist of three categories: soluble salts, double charge and full-body vitrified tiles. The Company's glazed vitrified tiles are marketed through Kajaria World, Kajaria Galaxy, Kajaria Studio and other dealers. Its sanitary ware and faucet product range comprises about 65 stock keeping units (SKUs) catering to a range of customer requirements. The Company's range of products includes Nucleus, Hydrus plus, Orion, Dream, Chime and Qua. The Company's subsidiaries include Soriso Ceramics Private Limited, Jaxx Vitrified Private Limited, Vennar Ceramics Limited, Cosa Ceramics Private Limited, Taurus Tiles Private Limited, Kajaria Bathware Private Limited and Kajaria Ceramics Kazakhstan LLP.

Capacity addition through organic, inorganic route:

Kajaria has nearly doubled its capacity from 23.4 msm in FY10 to 45.2 msm in FY14. This was driven mainly through the acquisition of a stake in Cosa, Soriso, Vennar and Jaxx and expansion/conversion of existing facilities. During Q2FY15, the production capacity of Kajaria's subsidiary companies were enhanced viz. Jaxx by 4.5 msm (from 5.7 msm per annum to 10.2 msm per annum) and Cosa by 3 msm (from 2.7 msm to 5.7 msm). With this incremental addition of 7.5 msm in Q2FY15 its capacity has reached 54.1 msm. Furthermore, Kajaria is looking to augment its capacity to 67.1 msm by FY16E. For that, it has acquired a 51% stake in Taurus Tiles Pvt Ltd, which is in the process of setting up a plant with 5 msm annual capacity of polished vitrified tiles. The production is expected to commence by Q1FY16. Additionally, it plans to set up a greenfield facility in Rajasthan for production of 5 msm of polished vitrified tiles. The project is expected to be completed by June 2015. Also, the company has decided to put up a brownfield facility at its existing location in Rajasthan for production of 3 msm capacity of ceramic wall tiles. Hence, we highlight that we have built in the additional 13 msm of capacity, which would lead to cumulative capacity of 67.1 msm by the end of FY16.

Sales volume to be supported by incremental capacity, going ahead:

Over the last four years, the key driver of sales volume (24.5% CAGR in FY11-15) for Kajaria has been the capacity expansion mainly through JV (Jaxx, Cosa, Soriso acquisition and their expansion).

Added 7.50 million square metres to its production capacity in 2014-15. Implementing a 20.20 MSM capacity addition:

- The 3 MSM ceramic floor tile capacity at the existing location in Gailpur is complete; full-fledged production is expected to commence by September/October 2015.
- Taurus Tiles Private Limited, our joint venture partner, commissioned a 5 MSM polished vitrified tiles facility in June 2015.
- Kajaria is setting up a 6.50 MSM polished vitrified tile greenfield facility in Rajasthan by Q4/FY16.
- Kajaria entered into a joint venture with Floera Ceramics Pvt Ltd., which plans to put up a 5.70 MSM polished vitrified tile facility in Andhra Pradesh by 2016-17.

Even as Kajaria continues to analyse other growth opportunities pan-India.

Going ahead, we expect sales volumes of Kajaria to be supported by incremental capacity addition in the above-mentioned expansion and JVs. Consequently, we expect sales volumes of Kajaria to rise to 84.1 MSM in FY17 vs. 54 MSM in FY15.

Looking Forward..

Ceramic wall and floor tiles (41% Contribution to revenues in 2014-15)

Added 3 million square metres of ceramic floor tile capacity which is expected to deliver incremental revenues from September/October 2015 onwards

- Deriving increased volumes from the newly commissioned capacity
- Implementing capacity expansion initiatives, leading to cost optimization
- Widening presence and deepening penetration to carve out a larger share of the market
- Widening the customer choice by introducing new sizes and designs

Polished vitrified tiles (37% Contribution to revenues in 2014-15)

- Supplement the production of double-charged tiles (value-added variant) over soluble salts; commence production from Taurus, a new joint venture of Kajaria Ceramics
- Increase presence in Tier-II and Tier-III locations
- Strengthen display points across central and eastern India
- Setting up a 6.50 MSM greenfield facility in Rajasthan by Q4/FY16
- Entered into a joint venture with Floera Ceramics Pvt Ltd., which plans to put up a 5.70 MSM polished vitrified tile facility in Andhra Pradesh, to be commissioned in 2016-17

Glazed vitrified tiles (20% Contribution to revenues in 2014-15)

- The Company intends to enhance capacity and presence in key global markets.
- The Company expects to widen customer choice by introducing new sizes like 13x80 cm and more designs in existing sizes.

Sanitaryware and faucets

- The Company commissioned a 7-lac-piece facility at Morbi, Gujarat, in May 2014, the operations of which will reach the optimum level in the current fiscal. The product range comprises 65 SKUs catering to diverse customer requirements.
- The Company put up a 1-million-piece faucet facility at Gailpur (Rajasthan), which commenced commercial production in July 2015.

Management View:

- The ceramic industry grew 11-12% to Rs. 24,000 crore in FY15. The industry is expected to grow 13-14% while the management is very confident of beating the industry growth by 5-6% to 18-20% in the next coming years
- For such growth, Kajaria is looking to add 200 dealers every year on a net basis, going forward
- Kajaria incurred Rs. 55 crore in advertisement expense in FY15 and is looking to raise it up to Rs. 80 crore in FY16E to increase visibility
- Going ahead, the management is expecting an improvement in EBITDA margin on account of a reduction in gas prices. The RLNG cost for Kajaria has come down to \$14.1 per mmbtu from \$15.4 per mmbtu earlier
- Though Kajaria has entered the sanitary ware and faucet business, it is expecting a maximum 4-5% of revenue contribution from these businesses in the coming few years

Industry Overview:

The Indian tile industry: Ceramic tiles are hygiene products, evident from their varied use in bathrooms and kitchens in most Indian households as well as in medical centres, labs, milk booths, schools, public convenience spaces, shopping malls, among others. The Indian tile industry is expected to sustain momentum over the medium-term for the following reasons:

Qualitatively superior than other flooring materials:

In India, 47% of the population lives in houses with mud flooring, 37% with cement flooring and 11% with mosaic and tile flooring. Nearly 26% of India's urban population lives in houses with tile flooring and 46% lives in houses with cement flooring. On the other hand, only 3.7% of India's rural population lives in houses with tile flooring and 62.6% of population lives in houses with mud flooring – a huge opportunity. As urbanisation intensifies, an increasing number of people will shift from rural pockets to cities, catalysing a demand for flooring materials. (Census 2011)

Urban India:

- About 10 million people are moving to Indian cities each year.
- The per capita income in urban India is expected to treble from US\$2,800 in 2012 to US\$8,300 in 2028.

Government policies:

The Government's progressive policies – Housing for All by 2022, Swachh Bharat Abhiyaan (Sanitisation for All by 2019), Atal Mission for Rejuvenation and Urban Transformation (AMRUT) and Smart Cities Mission – should facilitate investment, accelerate construction activities and give a fillip to the economy. These schemes aim to meet the needs of around 40% of India's population and hold significant promise for the real estate sector.

Younger and smaller families:

The average household size is expected to decline from 4.8 to about 4.4.

The fall in household size is expected to increase the demand for 10 million new housing units.

About 35% of India's population is between the 15-35 year age bracket, which is expected to drive housing demand for the next 15 years.

Outlook and valuation:

Kajaria has exhibited impressive revenue and earnings growth of 24.5% and 30.5%, respectively, over FY11-15 led by its capacity expansion and by moving to high value vitrified tiles. The Long Term leverage has reduced sharply to 0.13x currently, from 0.46x in FY11.

Going ahead, we expect Kajaria to remain a beneficiary of the rising organised market pie given the preference for branded products as well as consolidation in the form of JV with local players. Amid the slowdown in the current demand situation Kajaria is expected to witness 12% and 17% growth in topline in FY16E and FY17E respectively and as benefited from new JV, reduction in operating expenses growth in earnings is expected to 31% and 28%, respectively, over FY16E-17E.

Going ahead, we remain positive on Kajaria given the sturdy growth in the industry, favourable shift towards organised players post the Morbi fuel development, its better margin and return ratio profile coupled with a healthy balance sheet. We maintain our BUY recommendation on the stock with a target price of Rs.1,037 (valuing it at 28x PE FY17E). Overall, we remain optimistic on Kajaria's business prospects in the organised space and believe the robust growth trajectory will continue.

FINANCIAL OVERVIEW

Income Statement (Consolidated)

Y/E Mar (Rs mn)	FY 12A	FY 13A	FY 14A	FY 15A	FY 16E	FY 17E	FY 18E
Net Sales	13,130	16,120	18,363	21,869	24,628	28,814	33,425
Other Income	15	30	19	72	79	87	96
Expenditure	11,068	13,673	15,512	18,328	20,191	23,463	26,997
EBITDA	2,077	2,477	2,870	3,614	4,516	5,439	6,524
Depreciation	393	446	470	559	648	698	756
EBIT	1,684	2,031	2,400	3,055	3,869	4,741	5,768
Interest Expenses	485	454	408	294	329	247	179
PBT	1,199	1,577	1,992	2,761	3,540	4,494	5,589
Tax	381	499	678	854	1,143	1,429	1,758
Extraordinary Items	-	-	-	58	-	-	-
Net Income Before Adjustment	818	1,078	1,314	1,849	2,397	3,065	3,832
Minority Int./Income from Assoc.	10	33	71	93	104	122	141
Adjusted PAT	809	1,045	1,242	1,756	2,293	2,943	3,690

Balance Sheet (Consolidated)

Y/E Mar (Rs mn)	FY 12A	FY 13A	FY 14A	FY 15A	FY 16E	FY 17E	FY 18E
Equity share capita	147	147	151	159	159	159	159
Reserves & surplus	2,674	3,462	4,890	7,251	9,170	11,735	15,048
Share Warrants	-	-	250	-	-	-	-
Misc Expenditure	-	-	-	-	-	-	-
Net worth	2,821	3,609	5,292	7,409	9,329	11,894	15,207
Minority Interest	72	275	409	625	700	766	831
Share Application Money	-	-	4	-	-	-	-
Loan Funds	917	893	851	964	536	322	122
Net deferred tax liability	644	656	713	791	791	791	791
Lpon-term Provisions	62	87	89	103	173	276	866
Total Liabilities	4,516	5,520	7,357	9,892	11,529	14,049	17,816
Net block	5,233	6,278	7,321	9,378	10,261	11,012	11,708
Investment, Loan & Adv.	137	176	282	411	460	538	1,103
Total Current Assets	3,540	4,022	4,153	5,803	6,361	8,455	11,482
Current Liabilities & Provisions	4,394	4,955	4,399	5,701	5,553	5,956	6,476
Net Current Assets	(854)	(933)	(246)	103	808	2,499	5,006
Total Assets	4,516	5,520	7,357	9,892	11,528	14,049	17,816

Cash Flow (Consolidated)

Y/E Mar (Rs mn)	FY 15A	FY 16E	FY 17E	FY 18E
Operating Cash Flow	1,802	2,573	2,967	2,489
Cash Flow from Investments	(2,630)	(1,505)	(1,424)	(1,427)
Cash Flow from Financing	875	(1,030)	(826)	(513)
Net Changes in Cash	47	38	716	549
Opening Cash	51	98	136	852
Closing Cash Balance	98	136	852	1,401

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1.Analyst ownership of the stocks mentioned above	No
2.Served as an officer, director or employee	No

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