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Moving up the value chain

Kajaria Ceramics is the largest manufacturer of ceramic/vitrified tiles in India with a product basket of more than 2,600 varieties of ceramic and vitrified tiles. It has an annual aggregate capacity of 63.90 mn. sq.

Investment Rationale

Well-diversified product portfolio

The company boasts of a broad-based product portfolio that straddles across different price-points to capture customers across the value chain ranging from low-end tiles to premium glazed tiles. In the polished vitrified tiles, the company offers value tiles of soluble salts (commodity products) to high end double-charge tiles for premium customers. Likewise, apart from manufacturing regular ceramic wall & floor tiles the company also caters to hi-definition polished digital ceramic tiles. The company's continuous focus on developing new and innovative products has aided the company in augmenting market share and strengthening its brand equity.

Strong brand recall

Kajaria enjoys strong brand recall given its broad-based product portfolio, well-entrenched distributor network and significant investment in brand building over the years translating into a dominant market share. Further the company has expanded its business from tiles to manufacturing of sanitaryware and faucets under the brand Kerovit. This has helped the company to position itself as a holistic bathroom solutions provider.

Positive macro policies to drive growth

The government's focus on affordable housing and building of smart cities coupled with thrust on Housing for All by 2022 bodes well for the growth of the domestic tile industry. Besides, the implementation of GST will prove to be a game changer for the ceramic tile industry as majority of the domestic tile industry is dominated by regional brands/unbranded players. Given Kajaria's dominant market position, pan-India presence, strong distribution network and adequate capacity, we believe the company is set to benefit from this transition from unorganised to organized.

Capacity expansion to help sustain growth momentum

Kajaria is adding 3.5 MSM ceramic wall and floor tile manufacturing capacity at its Gailpur (Rajasthan) plant which is expected to be completed by September 2017. Additionally, it is also setting up a 5 MSM GVT manufacturing unit through its joint venture partner Floera Ceramic in South India which is expected to be commission by September 2018. Apart from this, it has set a target of reaching 100 MSM of tiles capacity by 2020 through greenfield, brownfield and inorganic initiatives. We believe the capacity expansion drive will not only help the company in fortifying its leadership strength but will also aid in capturing any incremental demand revival. Hence, we factor volumes CAGR of 11% over FY17-19E.

Valuations:

Kajaria's dominant position coupled with impressive brand strength, expanding product portfolio, sustained market share gains and sound balance sheet strength will drive growth going ahead. Consequently, we estimate consolidated revenue/PAT to grow at a CAGR of 15%/22% over FY17-19E. The stock currently trades at 41.3x/31x FY18E/19E EPS. We value the stock at 34x FY19E EPS arriving at a target price (TP) of Rs. 802. Recommend HOLD.

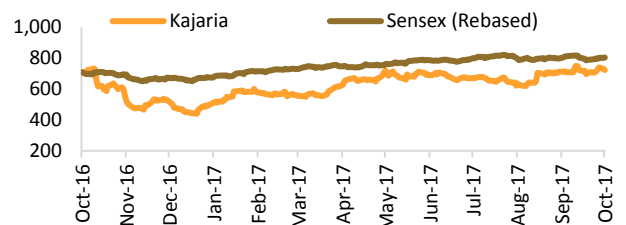
Market Data

Rating	HOLD
CMP (Rs.)	732
Target (Rs.)	802
Potential Upside	10%
Duration	Long Term
Face Value (Rs.)	1
52 week H/L (Rs.)	788/437
Adj. all time High (Rs.)	788
Decline from 52WH (%)	7.1
Rise from 52WL (%)	98.3
Beta	0.9
Mkt. Cap (Rs.Cr)	11,629

Fiscal Year Ended

Y/E	FY16	FY17	FY18E	FY19E
Revenue (Rs.Cr)	2,413	2,550	2,821	3,343
Adj. profit (Rs.Cr)	231	253	281	375
Adj. EPS (Rs.)	14.6	15.9	17.7	23.6
P/E (x)	50.3	46.0	41.3	31.0
P/BV (x)	12.0	9.9	8.4	6.9
ROE (%)	27.0	23.6	21.9	24.4

One year Price Chart



Source: Company, In-house research

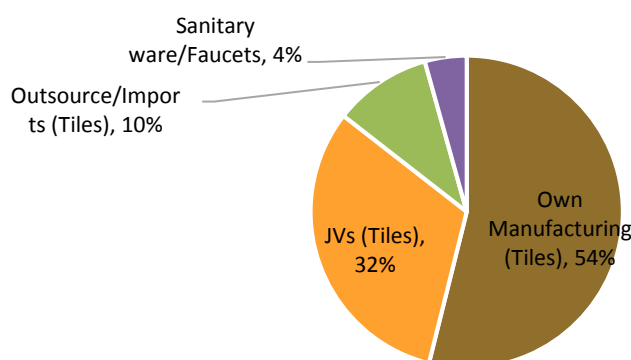
Shareholding Pattern

	Jun-17	Mar-17	Chg.
Promoters	47.4	47.4	0.0
FII's	24.0	23.4	0.6
MFs/Insti	5.3	5.7	(0.4)
Public	11.6	11.5	0.1
Others	11.7	12.0	(0.3)

Kajaria Ceramics Ltd: Business overview

Kajaria Ceramics is the largest manufacturer of ceramic/vitrified tiles in India with a product basket of more than 2,600 varieties of ceramic and vitrified tiles. It has an annual aggregate capacity of 63.90 mn. sq. meters, distributed across eight plants - Sikandrabad in Uttar Pradesh, Gailpur & Malootana in Rajasthan, four plants in Gujarat and one at Vijayawada in Andhra Pradesh. It offers more than 2000 options in ceramic wall & floor tiles, vitrified tiles, designer tiles, among others used across bathrooms, living rooms, corridors, study rooms & kitchen. Kajaria Ceramics exports to more than 30 countries globally. So far, the company has launched more than 500 designs across existing product verticals (ceramic wall and floor tiles, polished and glazed vitrified tiles).

Revenue mix



Source: Company, In-house research

Well-diversified product portfolio

The company boasts of a broad-based product portfolio ranging from ceramic wall & floor tiles, polished vitrified tiles, glazed vitrified tiles, sanitaryware & faucets and tiles adhesive & grout. Kajaria offers the widest product range with more than 2,600 varieties of ceramic and vitrified tiles, thus making the company the largest tile manufacturer in India. The tiles straddles across different price-points to capture customers across the value chain ranging from low-end tiles to premium glazed tiles. In the polished vitrified tiles, the company offers value tiles of soluble salts (commodity products) to high end double-charge tiles for premium customers. Likewise, apart from manufacturing regular ceramic wall & floor tiles the company also caters to hi-definition polished digital ceramic tiles. Given the industry demand gradually shifting towards premium products (vitrified tiles), this is clearly visible from significant uptick in volumes of vitrified tiles (grown at a CAGR of 16% over FY13-17) as against ceramic sales volume of 7% CAGR. The company's continuous focus on developing new and innovative products has aided the company in augmenting market share and strengthening its brand equity.

Strong brand equity

Kajaria enjoys a strong brand recall given its broad-based product portfolio, well-entrenched distributor network and significant investment in brand building over the years translating into a dominant market share. Over the last few years the company has significantly increased its ad spends to create consumer awareness in order to gain market share. Its advertisement spend has increased sharply from 1.8% of revenue in FY14 to 3.1% in FY17.

Notably, it is the only ceramic tile company in India conferred with “Superbrand” for eighth consecutive years. The company’s continuous focus on developing new and innovative products (developed and launched more than 500 designs across existing product verticals) will further aid in augmenting market share and strengthening its brand equity.

Diversification to provide scale

In order to de-risk its business model and to further scale-up its business, the company has forayed into manufacturing of sanitaryware and faucets under the brand Kerovit. This has helped the company to transform from a tile manufacturer into a holistic bathroom solutions provider. While, Kajaria commissioned the sanitaryware facility in 2014 with a capacity of 7 lac pieces per annum at Morbi (Gujarat), its 1 million pieces faucet facility at Gailpur (Rajasthan) commenced commercial production in July 2015. The company operates this business through its subsidiary Kajaria Bathware Pvt Ltd (KBL). The company has already developed 12 different product ranges and 100+ SKUs under this business. 60% of the sanitaryware dealers are its existing tile dealers leading to faster scale up of business. Kajaria is witnessing strong traction in the business as the revenue grew by more than 50% in FY17 albeit on a lower base, reflecting its brand strength and focus on quality as it sources key components from global brand leaders in the trade.

Robust dealer network

The company’s focused approach towards gradually increasing the dealer network and strong brand recall has translated into a dominant market share in the domestic market. Currently, the company operates through a robust pan-India dealer network of 1,200 (up from 750 in FY12) who operate through various outlets like Galaxy, Star, Kajaria Eternity World, Prima Plus, Prima and Studio. These dealers cater to around 5000 associate dealers across the country. Kajaria is focusing on expanding its reach in the Tier 1, 2 & 3 cities & towns. A well thought out dealer expansion strategy has enabled the company to provide a wide variety of options to customers while also allowing it to periodically renew the product displays and refurbish the look of the stores in order to increase footfalls.

On an expansion spree

Started in 1988 with an initial capacity of 1 MSM per annum at Sikandrabad Uttar Pradesh, the company over the years has significantly increased its tile manufacturing capacity through both organic and inorganic route to 68.6 MSM in FY17. However, with the company selling its entire stake in the subsidiary - Taurus Tiles in June 2017, the installed capacity of the company stood at 63.9 MSM. With the company operating at capacity utilisation of ~90%, it is further expanding its capacity to cater to burgeoning demand.

It is adding a line of 3.50 MSM per annum to manufacture high value ceramic wall and floor tiles at its Gailpur (Rajasthan) plant which is expected to be completed by September 2017. Additionally, one of its subsidiary- Floera Ceramics is setting up a 5 MSM p.a manufacturing facility of glazed vitrified tiles which is expected to be commissioned by September 18. Post this, the capacity of the company will increase to ~72 MSM. Besides, the company has a long-term target of reaching 100 MSM capacity by 2020 through a combination of greenfield, brownfield and inorganic initiatives to scale up its multi-region manufacturing capability.

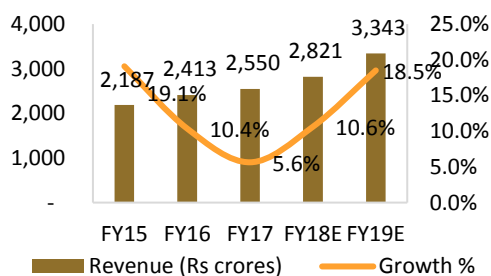
...Growing through the inorganic route

In order to reduce its capital intensity and quickly gain access to new capacities, the company in the recent years has entered into various joint ventures (JVs). Kajaria has formed JVs with 5 companies namely; Soriso Ceramics (Morbi, Gujarat), Jaxx Vetrified (Morbi, Gujarat), Vennar Ceramics (Vijayawada, Andhra Pradesh), Cosa Ceramics (Morbi, Gujarat) and Taurus Tiles (Morbi, Gujarat) by acquiring majority stake in such companies. Of the overall capacity, Kajaria's in-house capacity stood at 41.5 MSM and capacity from joint ventures was ~27 MSM. However, post the divestment of 46% stake in Taurus JV, the capacity from joint venture stood at ~22 MSM. While the company's overall tiles production has grown at a CAGR of ~12% over FY13-17, production from JVs grew at a rapid pace of 44% CAGR during the same period. As a result, tiles sales from the JVs witnessed a tremendous growth of 28% CAGR over FY13-17, leading to significant increase in the contribution from JVs in the overall mix to 33% in FY17 from 18% in FY13. We believe the company's focus on asset light business model to increase its capacity will aid it in sustaining healthy return ratios going forward.

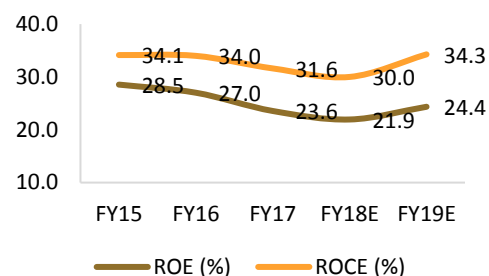
Revenue to grow at 15% CAGR

Kajaria's revenue has grown at a decent CAGR of 12% over FY14-17 primarily driven by healthy growth in volumes. The company has clocked volume growth of ~10% CAGR during the period driven by consistent new product launches and market share gains. Going ahead, we expect volume growth to remain steady (11% CAGR over FY17-19E) on the back of its sustained focus on developing innovative products, increasing market share, capacity expansion and aggressive brand spending. Moreover, the company's focus on improving its product mix through development of value-added products will also drive realisation. Hence, we have modelled revenue CAGR of 15% over FY17-19E.

Overall revenue to grow at 15% CAGR during FY17-19E



RoE to remain above 20%



Source: Company, In-house research

Key Risks:

- Slowdown in real estate sector could have a bearing on tiles demand.
- Increasing competition.
- Increase in natural gas prices could impact margins.

Profit & Loss Account (Consolidated)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Total operating Income	2,413	2,550	2,821	3,343
Raw Material cost	846	919	1,173	1,370
Employee cost	252	289	338	401
Other operating expenses	857	845	786	908
EBITDA	457	496	524	664
Depreciation	73	81	89	98
EBIT	385	415	435	566
Interest Cost	34	34	23	14
Other income	10	15	17	17
Profit before tax	361	396	428	569
Tax	125	142	145	194
PAT	236	254	282	376
Minority Interest	5	1	1	1
P/L from Associates	-	-	-	-
Adjusted PAT	231	253	281	375
E/o income / (Expense)	-	-	-	-
Reported PAT	231	253	281	375

Balance Sheet (Consolidated)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Paid up capital	16	16	16	16
Reserves and Surplus	956	1,159	1,374	1,672
Net worth	972	1,175	1,389	1,688
Minority interest	76	76	77	78
Total Debt	253	171	121	51
Other non-current liabilities	10	10	10	10
Total Liabilities	1,310	1,432	1,597	1,827
Net fixed assets	1,110	1,167	1,248	1,321
Capital WIP	8	8	8	8
Goodwill	11	11	11	11
Investments	0	0	0	0
Net Current Assets	247	326	410	567
Deferred Tax Assets (Net)	(95)	(111)	(111)	(111)
Other non-current assets	30	31	31	31
Total Assets	1,310	1,432	1,597	1,827

Cash Flow Statement (Consolidated)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Pre-tax profit	361	396	428	569
Depreciation	73	81	89	98
Chg in Working Capital	(53)	(49)	(42)	(86)
Others	39	38	7	(3)
Tax paid	(103)	(129)	(145)	(194)
Cash flow from operating activities	316	338	336	384
Capital expenditure	(276)	(147)	(170)	(170)
Chg in investments	-	(0)	-	-
Other investing cashflow	9	7	17	17
Cash flow from investing activities	(267)	(140)	(154)	(153)
Equity raised/(repaid)	3	-	-	-
Debt raised/(repaid)	22	(82)	(50)	(70)
Dividend paid	(38)	(49)	(67)	(77)
Other financing activities	(26)	(37)	(23)	(14)
Cash flow from financing activities	(39)	(168)	(140)	(160)
Net chg in cash	10	30	42	71

Key Ratios (Consolidated)

Y/E	FY16	FY17	FY18E	FY19E
Valuation(x)				
P/E	50.3	46.0	41.3	31.0
EV/EBITDA	26.1	23.8	22.4	17.5
EV/Net Sales	5.0	4.6	4.2	3.5
P/B	12.0	9.9	8.4	6.9
Per share data (Rs.)				
EPS	14.6	15.9	17.7	23.6
DPS	2.5	3.0	3.5	4.0
Growth (%)				
Net Sales	10.6	5.7	10.6	18.5
EBITDA	29.2	8.5	5.5	26.7
Net profit	27.6	9.3	11.3	33.1
Margin (%)				
EBITDA	19.0	19.5	18.6	19.8
EBIT	15.9	16.3	15.4	16.9
NPM	9.6	9.9	10.0	11.2
Return Ratios (%)				
RoE	27.0	23.6	21.9	24.4
RoCE	34.0	31.6	30.0	34.3
Turnover Ratios (x)				
Sales/Total Assets	1.7	1.6	1.6	1.8
Sales/Working Capital	13.7	10.2	9.5	9.3

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	Buy	More than equal to 15%
Hold	Upside or downside is less than 10%	Accumulate*	Upside between 10% & 15%
Reduce	Less than equal to -10%	Hold	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* Kajaria is a mid-cap company.

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