India Tile Industry

Not yet paved with gold, but on the way

INDIA | BUILDING MATERIAL | Sector Initiation

25 March 2019

Read this report for an in-depth view on the Indian tiles industry

What has plagued the industry in the last 2-3 years?

- In the past two years (FY17-18) our prediction – of the domestic-demand and supply mismatch scenario (**highlighted in our 2016 Ground View report**) due to large capacity additions in Morbi (increased competitive intensity), which resulted in pricing pressure and increase in working capital cycle – has played out.
- In addition, a subdued real-estate sector, weak construction activity, and implementation of GST and RERA dented domestic volumes – but this was partly offset by growing exports.

Current state

- Growth engines are showing signs of revival – government housing initiatives, exports, and a modest uptick in real-estate.
- Morbi's production pace is slowing – currently operating at c.60% CUF, smaller players are on the verge of closing down as they are operating at lower margins and as their higher working-capital cycle is squeezing their profitability. Additionally, stricter environmental norms by Gujarat Pollution Control Board (GPCB) will result in closure of smaller manufacturing units that are using coal gasifiers.
- Realisations are bottoming out in ceramic tiles and vitrified tiles.
- Working capital cycle has reached a peak – Morbi players are operating at unsustainable 120-150 days.

What next? Our take on what will happen over the next three years

- Real-estate will pick up as GST- and RERA-related challenges fade
- Government initiatives such as PMAY will remain strong
- China's slowdown will work well for Indian tile manufacturers
- Morbi will see consolidation (including shutdowns); it will not see significant capacity additions
- Large players focussing on premium products will see realisations rising
- Leading brands with strong balance sheets, cash flow, distribution network, and brand recall will be key beneficiaries. They will gain market share.

With this backdrop, we initiate coverage on the Indian tiles sector. While evaluating companies in the space, we have prioritised distribution model, brand recall, cash flow, working-capital management, and soundness of business model. We are covering Kajaria Ceramics and Somany Ceramics with BUY ratings.

Kajaria Ceramics Ltd (KJE) – Biggest beneficiary of improving business dynamics

- KJE, a leader in the Indian tiles industry (c. 18% market share), has rapidly expanded its product basket and distribution reach over the past decade. Its current dealer network is 1,883 vs. 1,400 in FY18.
- It is seeing improving volume visibility aided by its reach, product range, investment in branding, and a tightly managed balance sheet. We expect volume CAGR of 11% over the next two years, leading to revenue/earning CAGR of 13%/25% (FY19-21).
- Its continued focus on working capital will help generate FCF of Rs 2.2bn over next two years.
- Stock valuations do not reflect improving business dynamics. We initiate coverage with a BUY and a target of Rs 672 (30x PE FY21).

Somany Ceramics Ltd (SOMC) – Discount to Kajaria will narrow with business improvement

- SOMC is expanding and strengthening its distribution network while working on improving its cash flow cycle (which had deteriorated in FY17-18).
- Simultaneously, its new launches in tiles and bath fittings will help improve realisations.
- We expect revenue/EBITDA/PAT CAGR of 12%/25%/44% over FY19-21.
- Traditionally SOMC has traded at a discount to KJE, but the valuation gap has increased to 38% currently. With improvement in SOMC's profitability, working capital, and cash flow, this discount should narrow.
- We initiate coverage with a BUY rating and a target of Rs 529 (24x PE FY21 – 20% discount to KJE).

Companies

Kajaria Ceramics Ltd	**BUY**
CMP, Rs	584
Target Price, Rs	672
Somany Ceramics Ltd	**BUY**
CMP, Rs	386
Target Price, Rs	529

Our previous reports the sector:

ACETECH 2018
Building Material Conference
Morbi Visit

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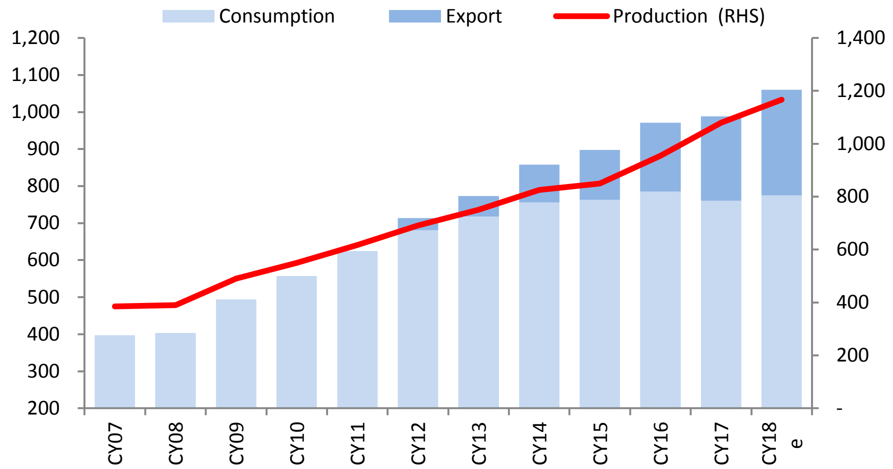
Companies Section

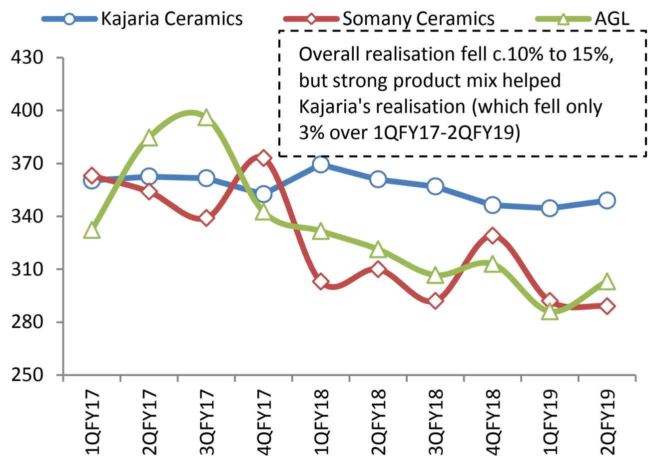
What plagued the tiles industry in the last 2-3 years?

Indian tiles: Higher capacity addition led to demand-supply mismatches in CY16-18… (msm)

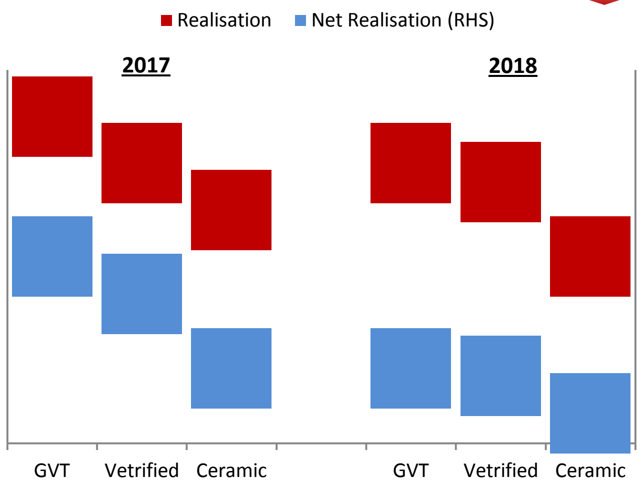


Key events over CY16-18
- Capacity addition (c.450 msm)
- Exports saw strong growth
- Subdued domestic demand
- Price war started with an aim to garner higher volumes

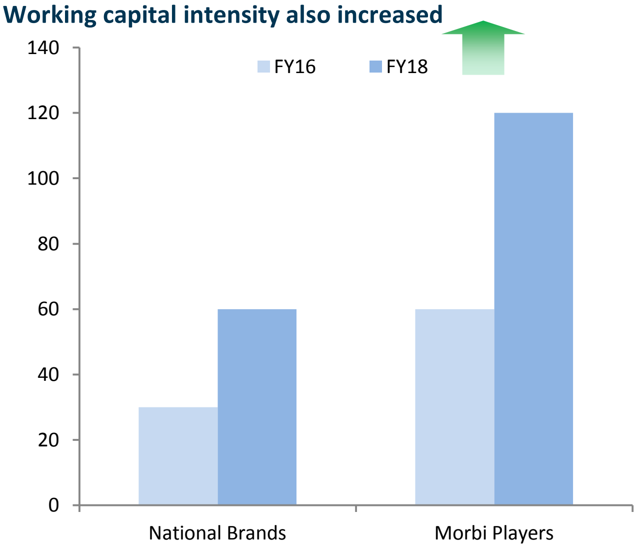
…which impacted realisations…



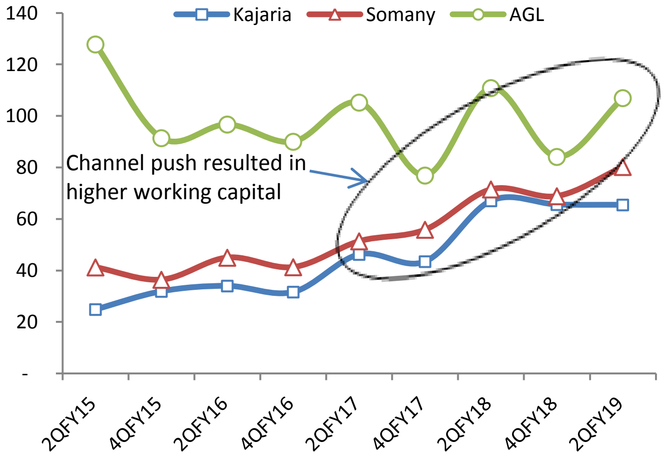
…and industry profitability (Rs/sqm)



Working capital intensity also increased



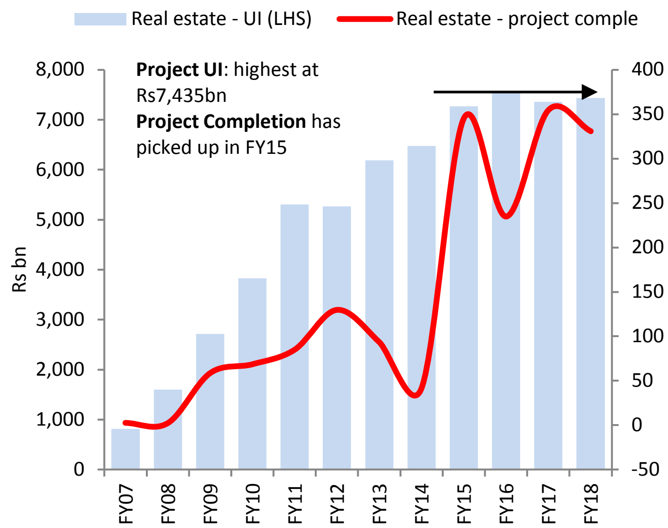
Working capital cycles of KJE, SOMC, and AGL (Days)



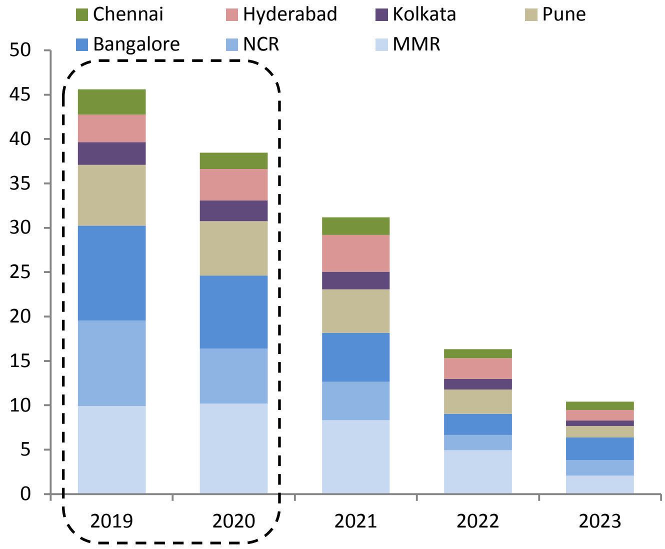
Source: Industry, Company, PhillipCapital Research Estimates

The way forward for the tiles industry

Execution of real-estate projects to improve

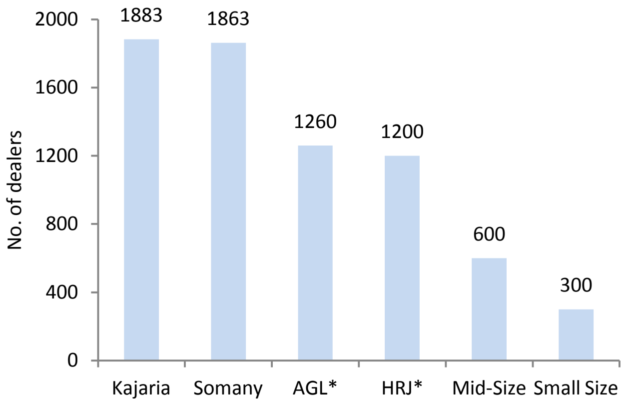


Expected delivery of major projects in key cities (msm)

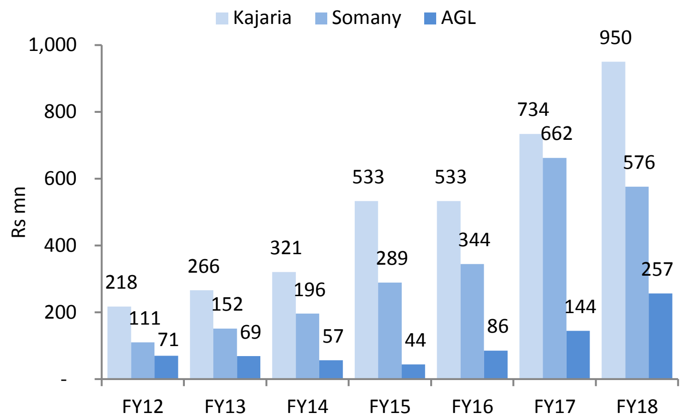


Source: Industry, Company, PhillipCapital Research Estimates, CMIE Capex

Players with strong reach...



...and continued investments in branding



Source: Industry, Company, PhillipCapital Research Estimates

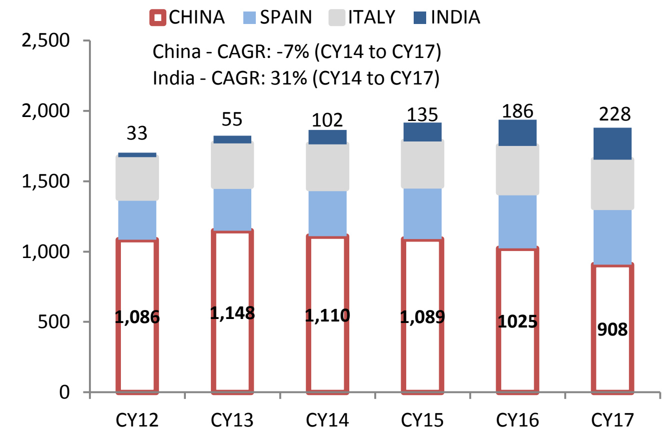
...should gain domestic market share

Market Share	FY10		FY11		FY12		FY13		FY14		FY15		FY16		FY17		FY18	
& Position	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank
H&R Johnson	31.1%	1	30.9%	1	27.8%	1	30.80%	1	31.10%	1	30.90%	1	24%	2	21%	3	21%	2
Kajaria Ceramics	**20.6%**	**2**	**21.7%**	**2**	**23.6%**	**2**	19.20%	2	20.60%	2	21.70%	2	28%	1	31%	1	32%	1
Somany Ceramics	**15.3%**	**3**	**16.4%**	**3**	**15.5%**	**3**	13.00%	4	15.30%	4	16.40%	3	20%	3	21%	2	20%	3
Nitco Tiles	10.4%	6	11.5%	4	13.5%	4	15.00%	3	10.40%	3	11.50%	6	9%	4	8%	4	7%	6
AGL	**11.0%**	**5**	**10.4%**	**5**	**9.9%**	**5**	9.80%	6	11.00%	6	10.40%	5	10%	5	11%	6	12%	4
Orient Bell	11.7%	4	9.2%	6	9.8%	6	12.20%	5	11.70%	5	9.20%	4	8%	6	8%	5	8%	5
Total	**100%**		**100%**		**100%**		**100%**		**100%**		**100%**		**100%**		**100%**		**100%**	

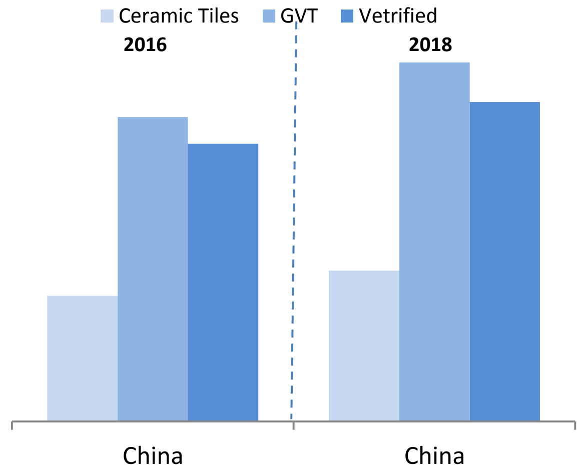
Note: Grey: Maintain market share, **Red: Decrease in market share**, **Green: Increase in market share**

Source: Company, Phillip Capital Research

In exports: India is gaining market share at China's expense...



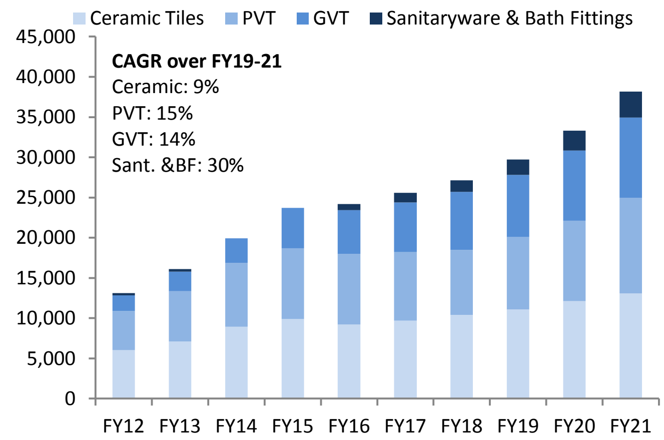
...as manufacturing cost has increased in China (Rs/sqm)*



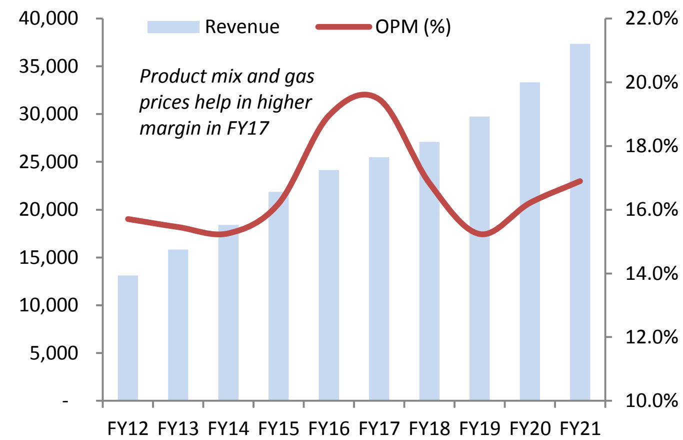
Source: Industry, Company, PhillipCapital Research Estimates, *Note: Channel Check

Kajaria Ceramics

FY19-21 revenue CAGR of 12%

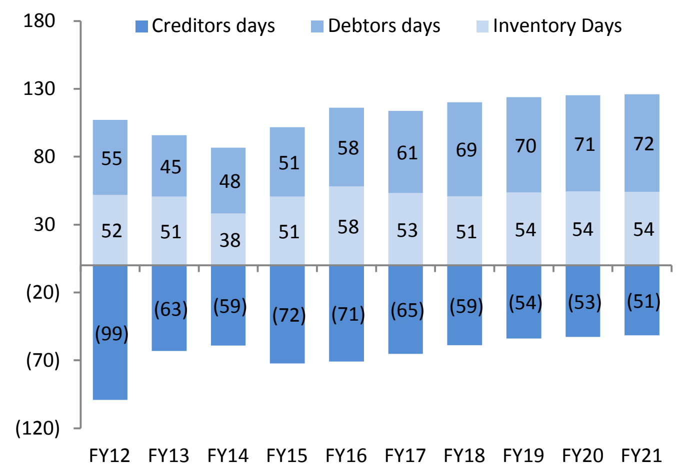


Improving product mix to lead to margin improvement

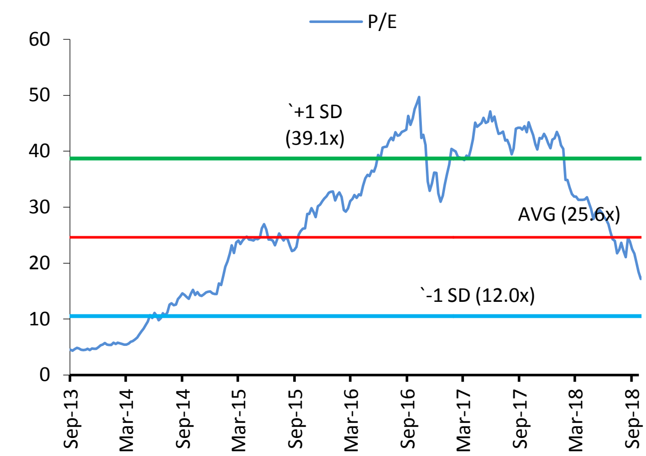


Source: Industry, Company, PhillipCapital Research Estimates

Controlled working capital...



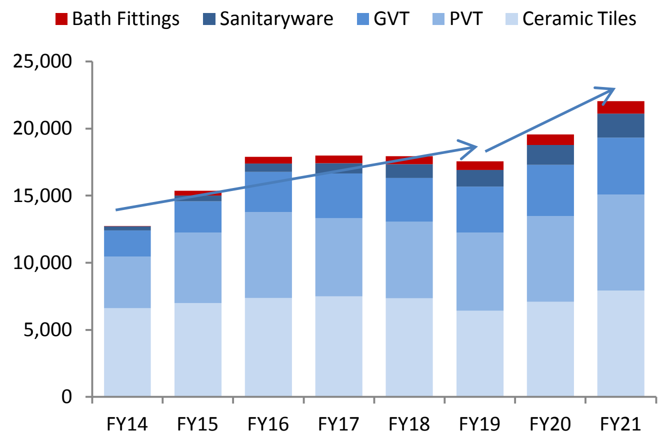
...should lead to a re-rating as it trades below historical averages

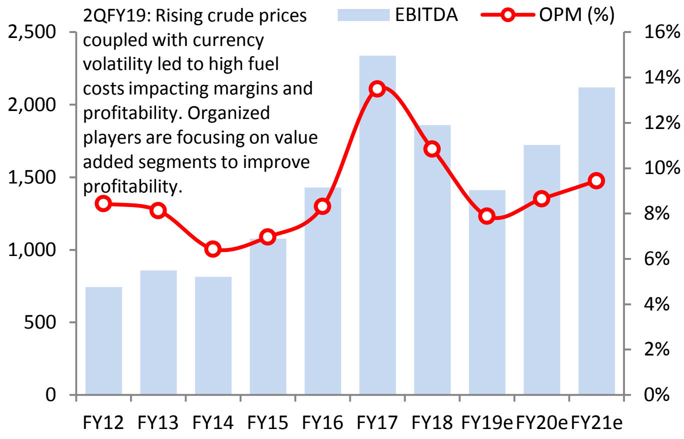


Source: Industry, Company, PhillipCapital Research Estimates

Somany Ceramics

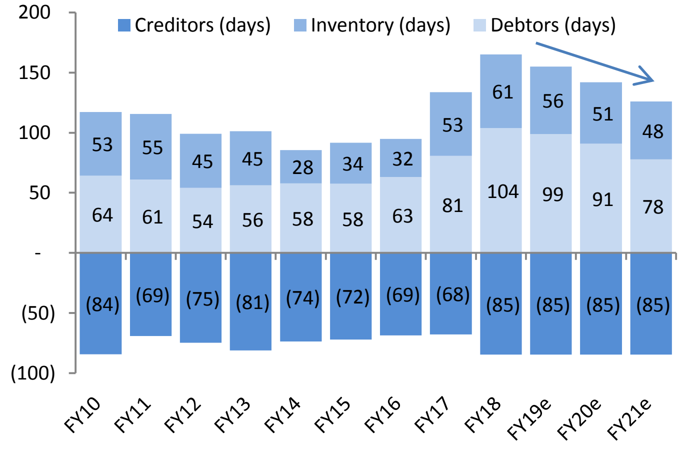
SOMC is moving up in premium products and strengthening its distribution network, leading to revenue and EBITDA CAGR of 12%/25% over FY19-21 (Rs mn)



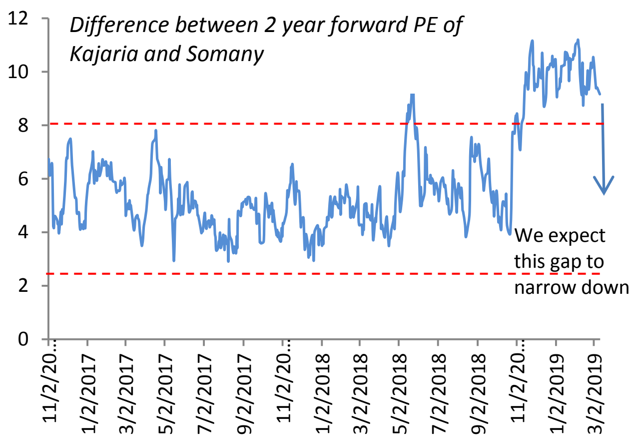


Source: Industry, Company, PhillipCapital Research Estimates

SOMC is correcting its working capital intensity…



…which should narrow its discount to KJE



Source: Industry, Company, Bloomberg, PhillipCapital Research Estimates

What happened to the Indian tiles industry over the last 2-3 years?

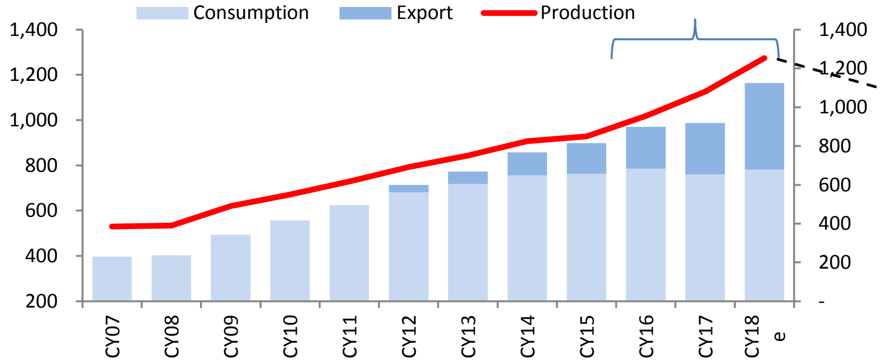
- Domestic demand and supply mismatch
- Strong increase in exports
- Higher capacity addition, which resulted in realisation pressure and increased working capital

As highlighted in **our 2016 GV – Playing Field Leveling Out,** the Indian tile industry saw higher capacity addition by Morbi players, which resulted in a demand-supply mismatch. This depressed realisations and elongated the working-capital cycle of the industry.

- **Domestic:** The industry's volume CAGR was 11% over FY15-18, driven by individual construction in non-urban areas, government spending on the social sector, and exports. The Indian ceramic tile industry achieved a size of Rs 270bn in CY18.
- **Exports:** Saw more than 80% CAGR over the last three years.

Last year, Morbi saw 100 plant additions (mainly in GVT) which resulted in over capacity and shrinking realisations

Indian tiles: Production/consumption/exports (msm)

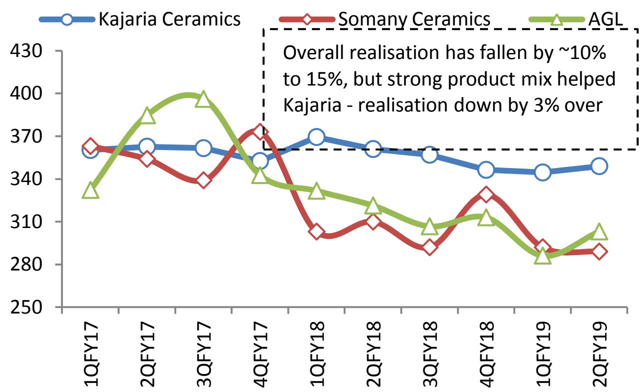


Indian tile industry has also seen 31% CAGR in exports over the last three years

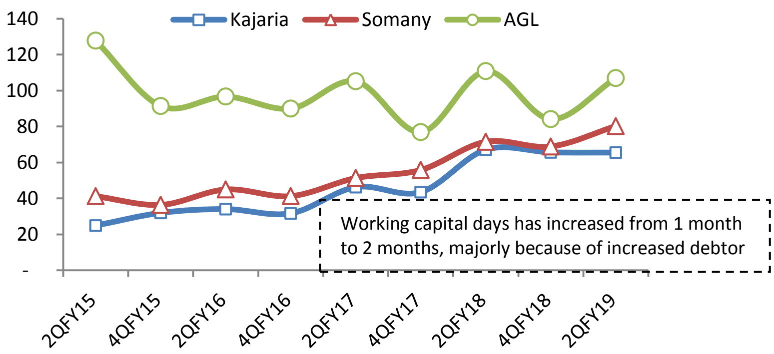
Higher capacity addition exacerbated decline in realisations

- GVT (glazed vitrified tiles) realisations in India fell by c.25% over the last year, which dented profitability – this happened because Morbi players began to offer higher incentives to their channel partners (such as discounts and credit) to achieve higher volume share.
- Meanwhile, strong growth in the exports market resulted in Morbi increasing its exposure in this segment and it started working on open credit, ensuing that a higher receivables cycle and bad debt depressed balance sheet and profitability.
- Strong competition from Morbi players dented the realisations and working capitals of large listed and unlisted companies (for details, check the Morbi section of our 2016 report here).

Impact on average realisations (Rs mn)



Working capital impact (Days)

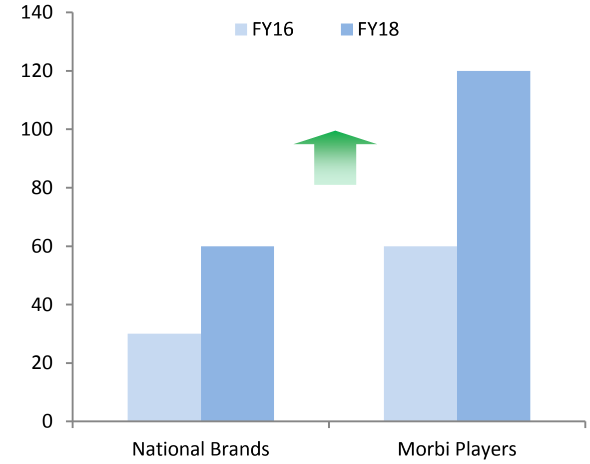


Source: Industry, PhillipCapital Research Estimates

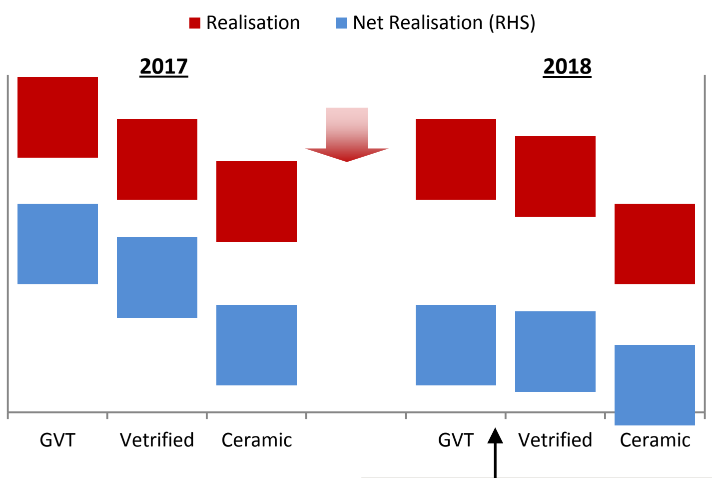
Strong capacity addition in Morbi hurt the industry

Lower off take in demand and strong capacity addition in Morbi (mismatch in demand and supply) dented industry realisations and resulted in increased inventory levels at both the manufacturing level and in the channel. Many channel partners emphasised that receivable days increased to 120 from 60 earlier, majorly for Morbi's mid-sized players. To stay ahead of the competition, some large national brands also fell into the working-capital trap by given higher credit to the channel.

Working capital increased to incentivise the channel



...leading to lower realisation and profitability (Rs/sqm)



Source: Industry Data, Channel Check

- Margins have been moving south; the only way to survive is innovation, i.e., moving up in premium products such as large slabs – the MD of an unlisted player in Morbi
- In basic products, some plants are operating at breakeven levels. We don't expect any further price falls in products such as ceramic tiles
- Margins are not exiting; so I don't expect any further capacity addition in Morbi – an industry expert

According to our interactions with some small and large Morbi players, realisations are at rock bottom – so there is not much scope for reducing prices further (mainly in basic products). Some players said that the only way to reduce prices even more is by reducing the weight of the tiles, which may impact the quality of the product.

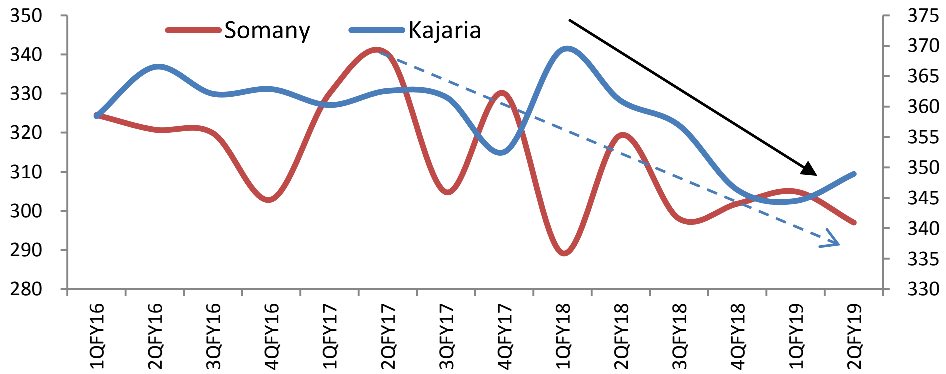
Cost of Morbi players: Not much room left for price erosion

Costing/box	Ceramic Tiles	Vitrified Tiles
Product size	12"*X18"	32" X 32"
Morbi Selling Price	110	310
Costing #	90	264
Margin %	14%	15%

If we add other costs like interest and inventory holding charges then Morbi players are operating at breakeven

Note: This costing does not include interest cost, top management salaries, and inventory holding costs.

Quarterly average realisation trend (Rs mn)



Q2FY17-Q2FY19
Kajaria: Realisation fell 4%
Somany: Realisation fell 12%

Source: Industry, Company, PhillipCapital Research Estimates

From here, consolidation is likely in Morbi

People working in Morbi expect the tiles industry there to undergo a consolidation, as smaller players are facing pressure in terms of realisations (selling products at cost mainly to run the plant) and working capital (receivables are up to 120 days). Smaller players do not have a strong enough balance sheet to avail loans, said a Morbi-based financial advisor.

Every year, 15-20 enterprises shut shop in Morbi due to various reasons, but rarely insolvency. However, this time there seem to be more shut downs and capacity consolidations. Many Morbi players believe there won't be too much capacity addition over the next two years because the focus has shifted to cash flows and survival.

Channel Check: In the last six months, no new order has been given to equipment suppliers from Morbi

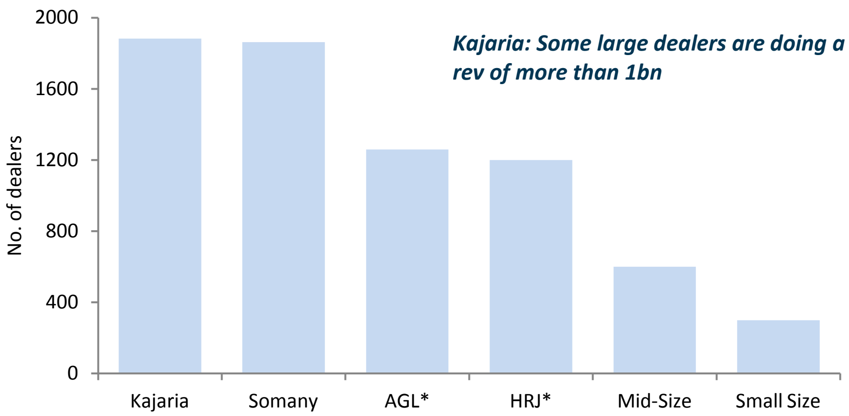
"Brands that have strong control on costs and offer contemporary products at the right price will have good market share. Today the customer is spoilt for choice, so a brand will only succeed if it delivers on its promise of price and quality simultaneously. Additionally, companies that have strong control on cash flow and balance sheet will stand out from the crowd," said a financial adviser for Morbi players.

"Instances of bankruptcy are less than 1% in Morbi, there are several other reasons for closure but this time we are witnessing a larger pain – expect more shutdowns or consolidation" – promoter of a large manufacturing unit in Morbi.

Brand/distribution network are the key; large players stand to gain

Over the last 5-6 years, players in Morbi have started focussing on brand creation (participating in exhibitions, road shows). Additionally, they started focussing on the B2C channel (added dealers/distributors). Channel checks suggest that over the last two years, Morbi-based brands have added considerable dealers and distributors to their network; leading brands already have a strong presence.

Large brands yield higher revenues per dealer while Morbi players lag



Source: Industry, Company, PhillipCapital Research Estimates

Large dealers (with strong balance sheets) are already associated with national brands

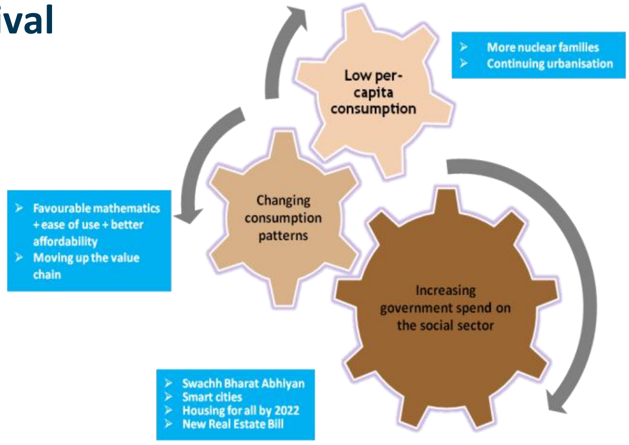
Dealer Name	City	Area of shop (sq. ft.)
Surendra Sangwan	Bhiwani, Haryana	13,000
Naresh Gupta	Dhanbad, Jharkhand	12,000
Eldho Varghese	Ernakulum, Kerala	30,000
S. Muthuraman	Coimbatore, Tamil Nadu	45,000
Neeraj Vasant	Raipur, Chattisgarh	10,000

Source: Kajaria Annual Report

Growth engines are showing signs of revival

Domestic demand
- ✓ Private builders' execution to pickup
- ✓ Pick up in real-estate
- ✓ Government initiatives
- ✓ Additional supply to Kerala
- ✓ Lower per capita consumption

Export demand
- ✓ China pollution
- ✓ Other countries opening doors for India

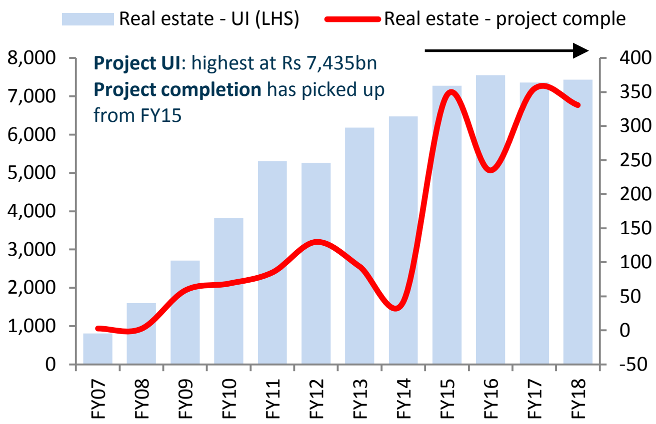


Private builders' execution to pickup

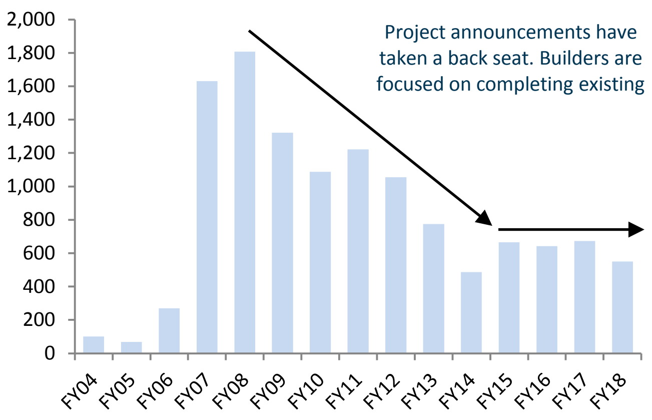
The real-estate market is poised to benefit from the government's policy towards early completion of projects (RERA). This has resulted in lower new launches and improved execution speed. Additionally, technology has also played an important role in reducing execution time.

Earlier real estate project completion took c.6 years, which has now come down to 4-5 years

CMIE: Project under implementation vs. completed (Rs bn)



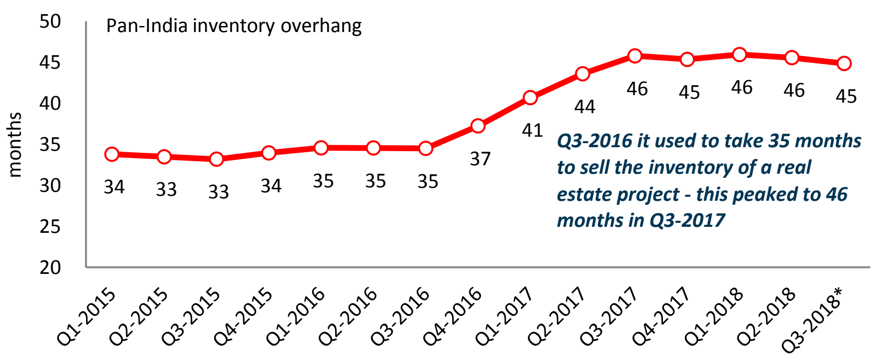
CMIE: Project announcements (Rs bn)



Source: CMIE Capex data, Industry (Data of Housing construction)

The real-estate market is picking up pace

The sector had slowed down from FY16 due to demonetisation, RERA, and GST. Cash inflows in the market are now strictly monitored. However, participants talk about some amount of revival over the past 2-3 quarters. The construction segment is slowly moving towards revival. RERA's stringent norms delivered a ray of hope for customers, but caused pain for builders who were delaying project deadlines. Inventory overhang reached its peak of 46 months in CY17 vs. 35 in CY16; as of 3QCY18, the inventory overhang has stabilised around 45 months. We believe this is a sign that the sector is moving towards revival.



Channel checks
- ***Residential demand is picking up over the last six months. It saw strong volume of 15-20% mainly coming from tier-2 nearby town of Coimbatore – Largest Marble/Tile dealer - Tamil Nadu***
- ***Overall small and mid-size ticket flats are in demand; premium flats are having high demand in NCR – Builder NCR***
- ***Commercial sector is picking up. Concepts such as We-work are coming in. IT hubs should see high demand.***
- ***PMAY is picking up in tier 2 and 3 cities.***
- ***In the south, small-ticket-size and larger builders are seeing strong demand***

Metro cities have started seeing a push in the commercial segment because of the lack of quality Grade-A commercial spaces and improving macros (whereby companies started putting up manufacturing facilities, offices, and commercial related properties.

In the interim budget, the government's focus was on real estate and taxpayers
Unexpectedly, in the 2019 interim budget, the government announced measures to push up demand (reduce inventory) for the real estate sector. Income tax sops for homebuyers, sustained focus on affordable housing, and tax sops for real-estate builders will be effective from April 2019. In addition, increase in tax slab will result in a boost for housing demand.

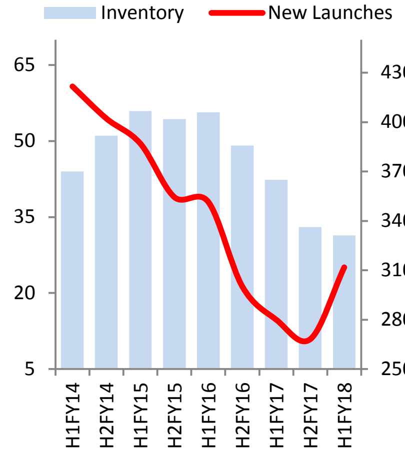
With leniency in the new tax regime, propensity to buy homes has increased by 60%

	Tax slab (Rs)*	Family tax return (1+1) (Rs)	Home loan eligibility (Rs mn)
Earlier	4,00,000	8,00,000	4.0
Revised	6,50,000	13,00,000	6.5

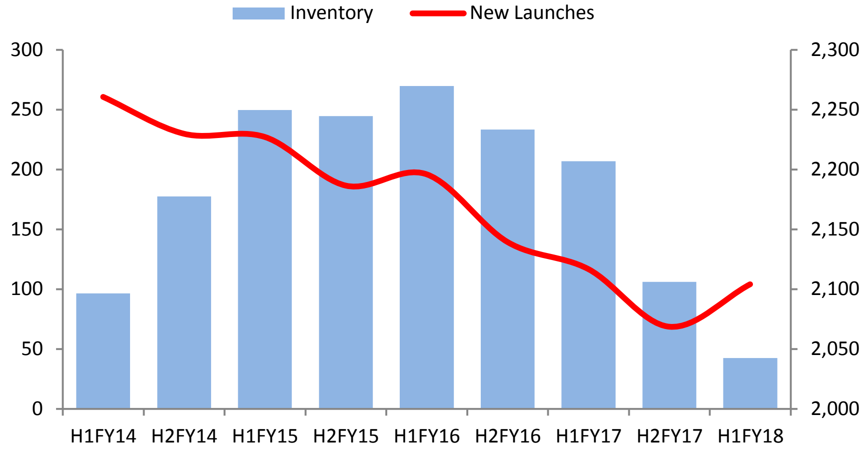
Note: * Factoring an investment of Rs 150,000

City-wise: Inventory vs. new launches

Bangalore



India – Major Seven Cities – Execution and new launches has picking up



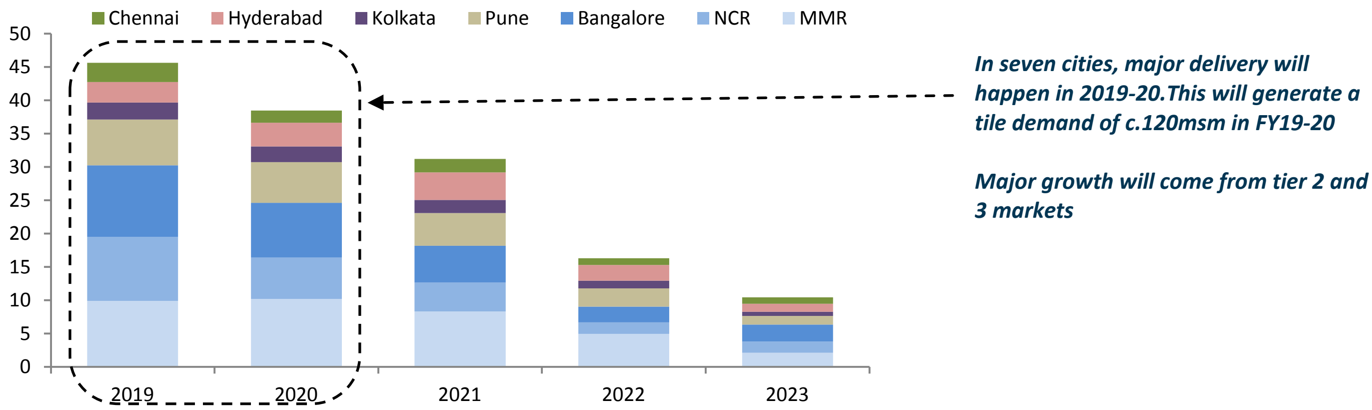
*MMR - Mumbai-Thane-Navi Mumbai; *NCR – Noida-Delhi-Gurgaon-Ghaziabad-Faridabad

Source: knight frank

PC's view on major cities

City Name	Comments	City Name	Comments
Bangalore	Commercial thrives – residential parasitic growth	NCR	Commercial moderate – residential suffers with massive inventory overhang
Pune	Commercial thrives – residential sluggish	MMR	Commercial Thrives – residential sluggish
Hyderabad	Commercial and residential thrives	Kolkata	Commercial thrives – residential flattish in growth with slight price appreciation
Chennai	Commercial thrives with residential demand intact		

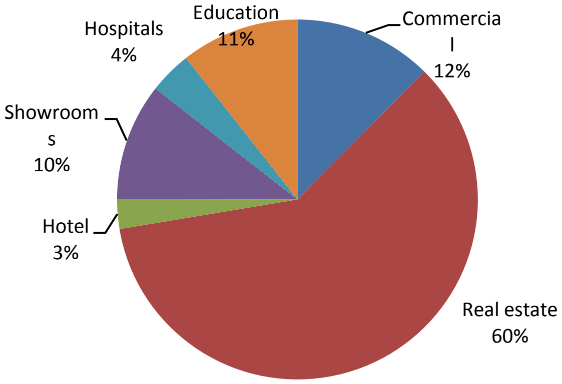
Expected delivery of major projects in key cities (msm)



Note: Taken construction time of 5 years. This is excluding new launches; data are based on current pipeline.

Source: Industry, PhillipCapital Research

Sector-wise projects under implementation



Source: CMIE Capex data

Total projects under implementation will give a boost to the tiles sector

Infrastructure	Rs mn	Construction Rate (Rs/sqf)#	Area (MSM)
Commercial complexes	2,163,367	4,000	50
Real estate	10,439,288	7,000	307
Hotel & tourism	462,874	16,000	3
Wholesale & retail trading	1,835,984	15,000	11
Health services	666,122	7,000	9
Education	1,846,725	4,000	43
Recreational services	473,146	5,000	9

Source: CMIE Capex data, Industry (Data of Housing construction), Note: # PhillipCapital Estimates

Government initiatives should drive growth

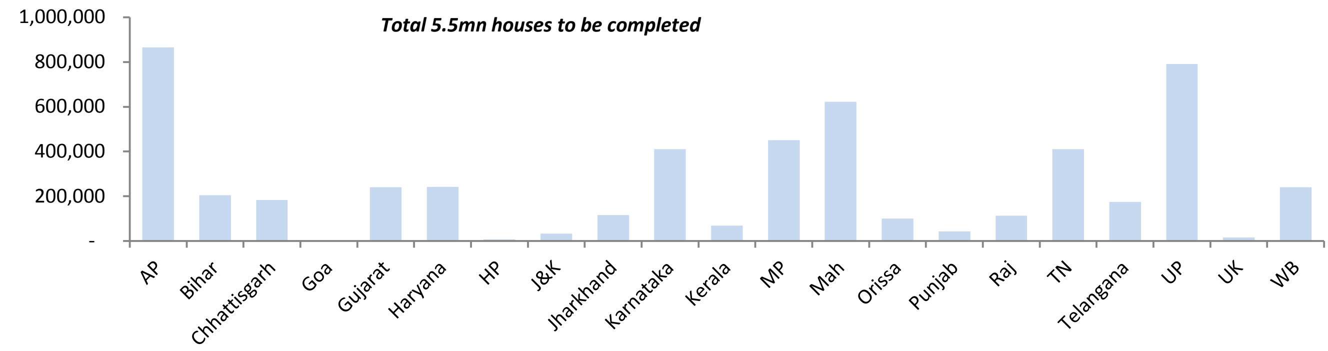
Increasing government spend on the social sector holds significant promise for the Indian tile industry. Implementation of several crucial policies should facilitate investment and accelerate construction activity.

Government schemes that could influence consumption of tiles

Government policies	Details	Comments (Current Status)
Swachh Bharat Abhiyan	To build 90mn toilets across the country by 2019	92mn household toilets built with 30 open defecation free states
Smart Cities	Covering 100 Smart Cities - will construct approximately 5mn new houses	As on January 2019, tenders given – Rs 1,045bn and completed – Rs 615.5bn
Pradhan Mantri Awas Yojana	Affordable housing - target is to build 20mn affordable houses by 31 March 2022	Houses sanctioned: 6mn Grounded for construction: 3.17mn Completed: 0.9mn

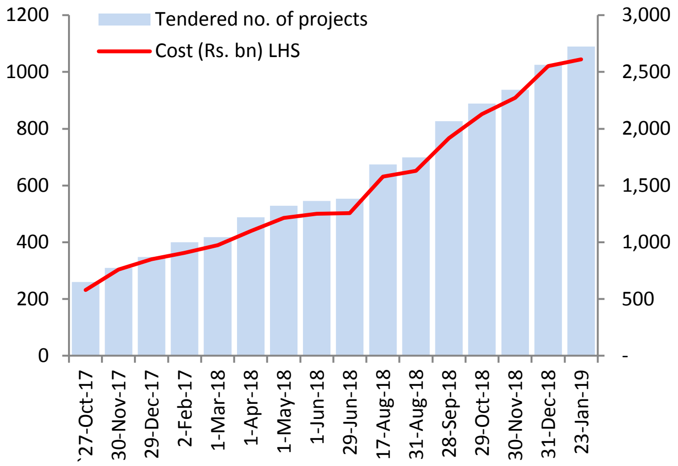
Source: Government data

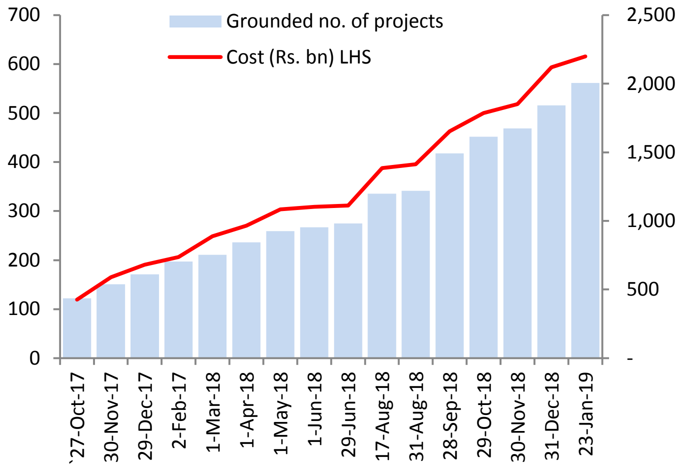
Pradhan Mantri Awas Yojana (PMAY): Number of projects to be completed



Source: PMAY data

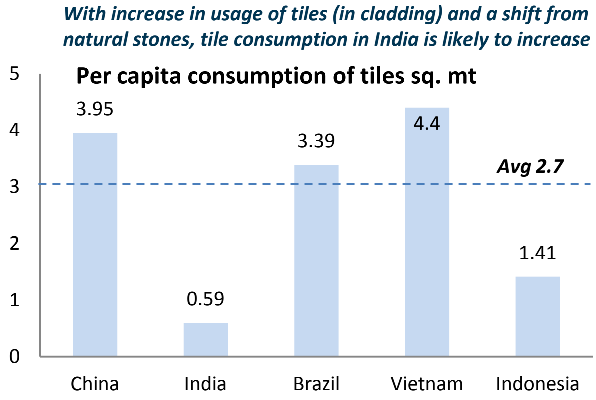
Smart Cities: Tendered and grounded (under implementation) projects





Source: Government data, Industry, PhillipCapital Research

Lower per capita consumption vs. global players



Source: Industry, Census Data, PhillipCapital Research

We expect Mosaic and floor tiles share to increase...

Percentage of households by flooring material (%)

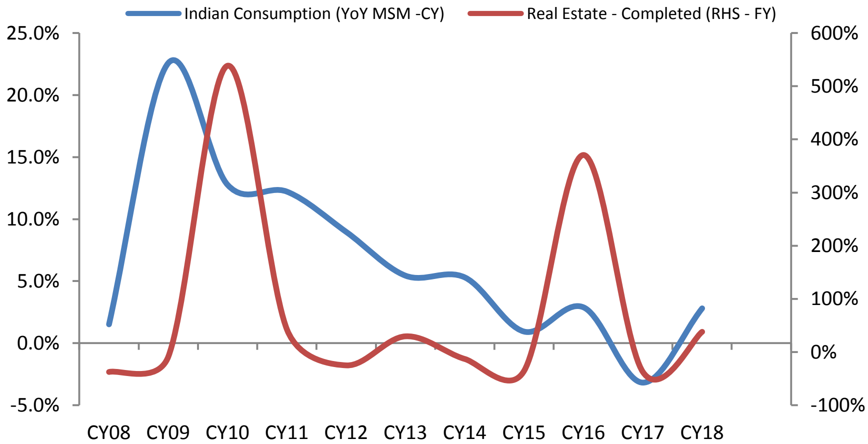
	India			Rural		Urban	
	1991	2001	2011	2001	2011	2001	2011
Mud	67	57	47	72	63	18	12
Stone	-	6	8	5	6	9	12
Cement	21	27	31	18	24	48	46
Mosaic/Floor tiles	**4**	**7**	**11**	**2**	**4**	**21**	**26**
Others	8	3	4	3	3	4	4
	100	**100**	**100**	**100**	**100**	**100**	**100**

Source: Census data

Pick up in construction and real estate will lead to strong demand

The tiles industry is backed by demand from commercial and real estate construction. As most of the execution/delivery of projects will happen in FY20-22, the industry should see very strong volume growth in that period. We expect the industry's volume CAGR at 10% for the next 2-3 years. Overall, we expect the Indian tiles industry to see a demand of c. 300msm from the domestic market over the next 2-3 years, majorly driven by private builders, commercial construction, government initiatives, and residential construction.

Empirically too, the tile industry has a high correlation with real-estate construction

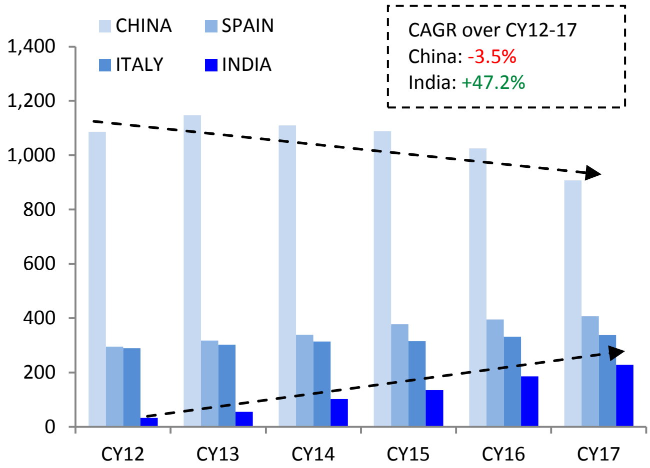


Source: CMIE Capex Data & Indian Tile Industry, Note: Taken construction time of five years

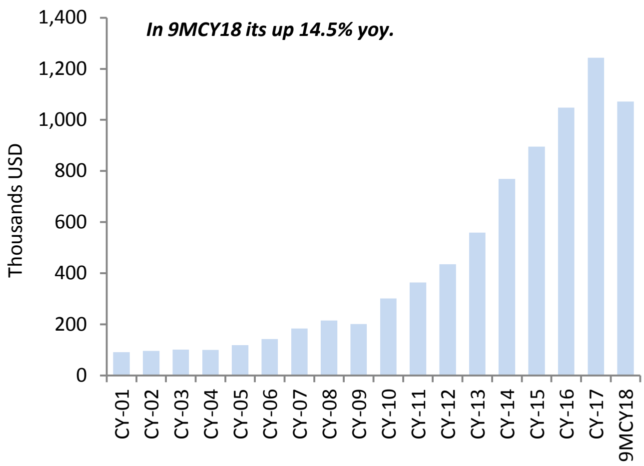
Exports: A big opportunity for Indian tiles companies

Over the last 3-4 years, with domestic production outpacing demand, Indian tile manufacturers have been increasingly focused on exports. At present, these account for c.20% of the industry, higher than c.10% in FY16. Contributing factors include capex by Indian manufacturers (capacity increase in Morbi), increasing customisation for international markets (road shows and exhibitions to attract foreign buyers), a globally competitive manufacturing-cost profile, and innovations that match international standards. Additionally, global imposition of anti-dumping duty (ADD) on Chinese tiles should result in an abatement of supplies, serving as a boost for Indian manufacturers to ramp up exports. Currently, Middle East is one of the largest exports markets; countries such as Bangladesh, Sri Lanka, Brazil, and Africa are also becoming quite big.

Top exporting countries (msm)

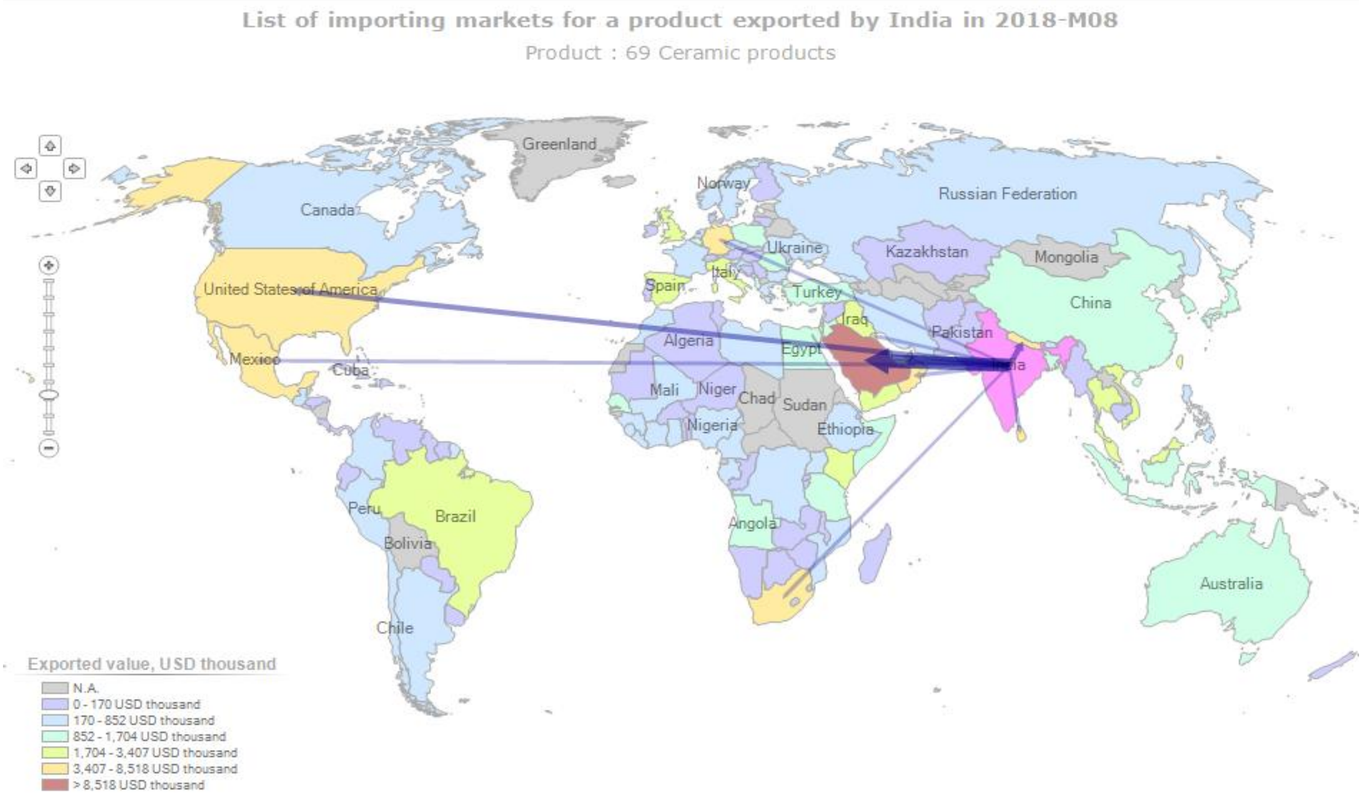


Total export from India (ceramic products – USD '000)



Source: Industry, PhillipCapital India Research

India: Opening doors in exports market, adding new geographies



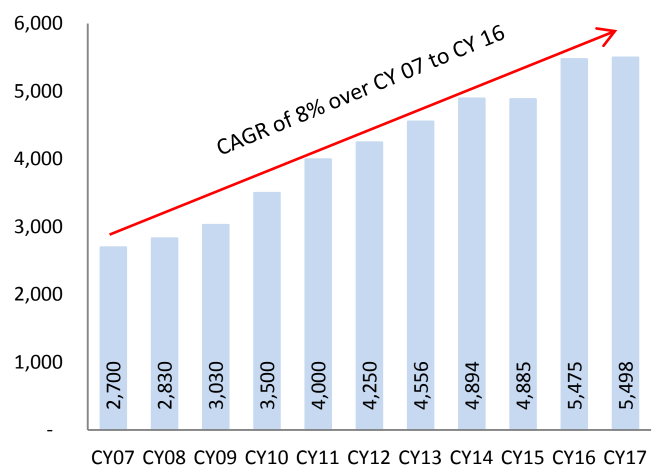
Source: trademark.org

China's environmental issues offer huge exports opportunities

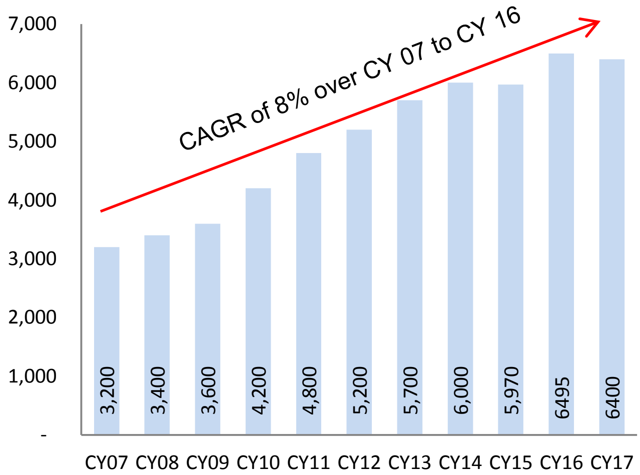
China is the largest producer of tiles: China = 6.5bsm vs. India = 955msm. However, it is in the process of a massive environment conservation exercise due to extensive excessive manufacturing-related damage to its ecology. It has started transforming its coal-based plants to natural gas and shifting its manufacturing units to outside the cities.


Source: Reuters

China tile production (msm) – *50% of global tile production*



China domestic consumption msm



Source: Indian Ceramic Association, Industry

China's central government has ordered regions near the capital to shut 44,000 coal-fired boilers that provide steam and energy for factories, including steel rolling mills, ceramics, and chemical manufacturers – and convert, replace them with gas-fired boilers, or switch to electricity. They have also been asked to shift manufacturing clusters/hubs to outside the cities.

Impact on China's tile industry

Zibo, a Chinese city, was its ceramics capital with a production capacity of c.1.3bn msm, mainly floor and wall tiles. In November 2017, Zibo shut more than 150 companies and 250 production lines as part of a ruthless war on pollution – thereby slashing its capacity by 70%.

Comments from the industry

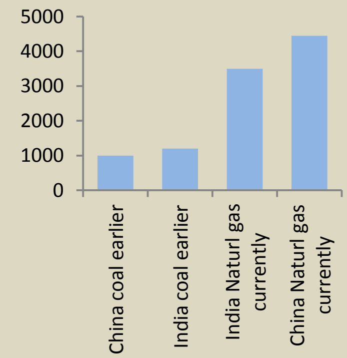
A factory owner in China said that he has lost 80% of domestic clients and half his overseas ones, with many frustrated by the stop-start nature of production. Many players are shutting down their plants – mainly because the price of gas is 6-7 CNY per cubic meter, up from 2 CNY 2017. "If we open, we are going to run at a loss. It is difficult for me to secure gas supplies," he said.

Dr. Hu's observations about energy costs during PC's China Visit

DR. Hu is the Professor and Senior Principal Investigator in Zhegiang University and current founder of Zheda Panaco Chemical Company.

The ban on coal usage and mandatory shift to natural gas resulted in a multi-fold jump in energy costs for all manufacturers. Gas costs four times more than coal to produce the same amount of energy. In the first place, supply of natural gas is limited. With additional demand, gas prices have already shot up.

Energy costs in china saw a huge jump after a coal ban



Source: Reuters, Industry.

Morbi tile manufacturers' key comments about exports:

- Currently, c.30% of the plants is exporting tiles.
- In exports, Morbi has seen c.40% growth.
- The margins in exports are better than domestic margins. In fact, a Morbi player who is a sanitary ware manufacturer has now started sourcing tiles from other Morbi players and exporting them. "Realisations are better in export," he shrugged.
- Recently, some (Qutone, AGL) have bagged orders for exports to China.
- Supplying tiles to China under white labels. Also supplying to other countries under Chinese brands.
- Indian players compete with China in PGVT.
- Chinese players are visiting Morbi for tie-ups. China has started importing large-format tiles and value added products from Morbi players.
- Due to pollution, China was impacted by c.50% (exports head of a Gujarat-based tile company).

Environmental issues in China are resulting in…

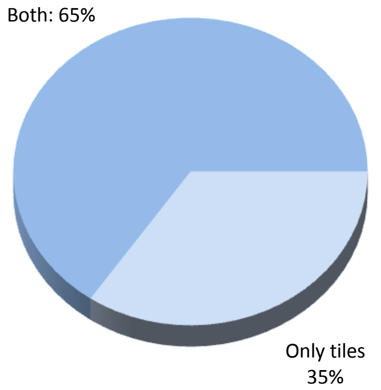
- **Production loss:** Many plants have shut down due to shifting from coal to gas and outside cities.
- **Increasing manufacturing cost:** Rising demand for natural gas has resulted in demand/supply mismatch (availability shortage) and price increases. Additionally, employee cost, which used to be c.7% of total cost has increased 2-3x. Some peg increase in production cost at c.30%. During the physical shifting of a manufacturing unit, production undergoes disruption (stop-start) which has resulted in business losses, delays in dispatches, and losing customers.
- **Production shortage:** Shut down of some plants, which used to mainly focus on lower value-added products and were not able to pass on the prices.
- **Increase in realisations:** 15-25% increase seems to have already taken place.

PC View: This transformation in China has resulted in some production loss and increase in production cost by c.30%. We expect this will lead to an increase in realisation by c.25% (channel checks suggest 20%-25%) and production shortage due to shut down of some plants, which mainly focus on lower value-added products and are not able to pass on prices. In CY17, China's total production/exports were 6,400/ 900msm – 1.3%/-3.9% CAGR over the last three years. The second-largest producer, India, saw a production of 1,080 msm with domestic consumption of 760msm and export of 228msm. In a base case scenario, if China's production is hit by c.10%, it will lead to a demand of c.640msm, which is 60% of India production in CY17. We expect the change in China's tile production to be a big exports opportunity to India and other countries. This has already started reflecting in India's exports numbers of the last three years – 31% annual growth. We expect export momentum to continue and expect annual export growth of 25-30% over the next couple of years. Additionally, an increase in power and employee costs resulted in a c.25% increase in cost and 25% increase in realisation (Morbi players becoming more prices competitive).

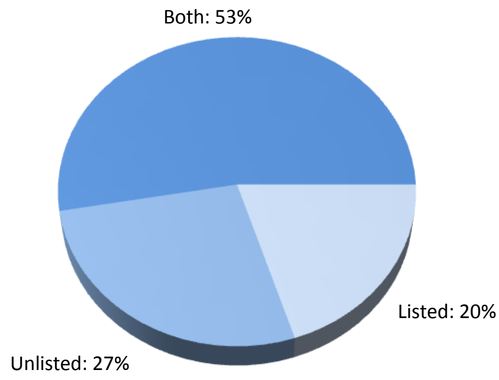
Frankly speaking – our survey of 70 participants

In light of the significant construction activity all over India, and the number of stakeholders involved, it was imperative to seek a balanced opinion of the state-of-affairs by interacting with all parties. We talked to 70 participants including developers, channel partners, and architects, all of whom play a vital role in determining the fortunes of domestic tile companies. We spoke to channel partners (dealer/distributors) and builders as well. Here are their answers:

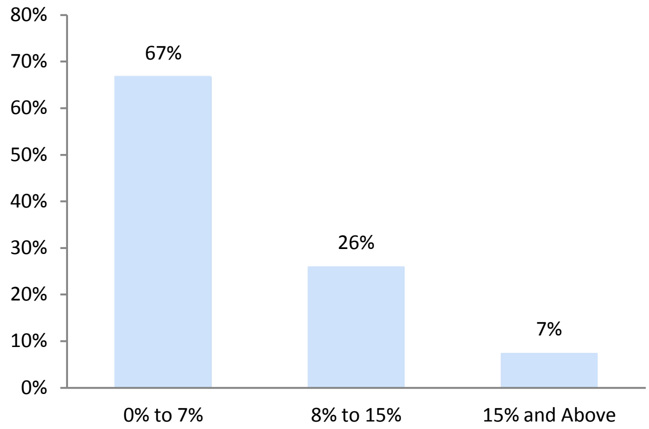
Do you deal in tiles only or sanitary-ware as well?



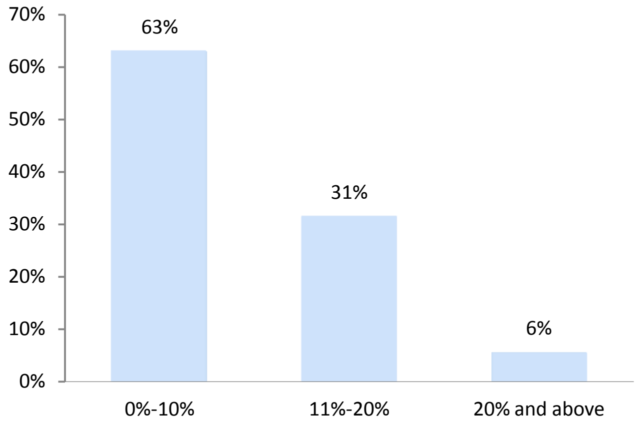
Are you selling or consuming tiles of listed or unlisted players, or both?



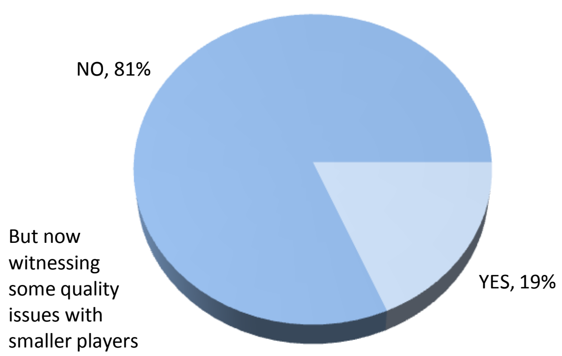
What industry growth you expect in next 2-3 years?



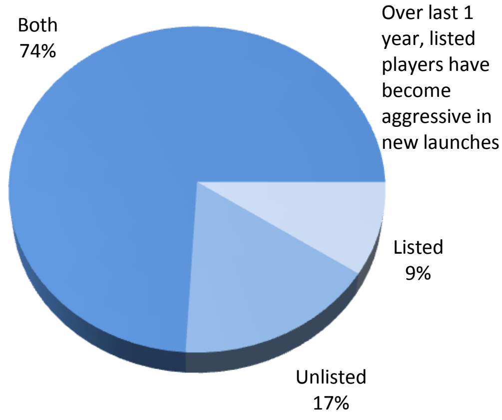
What is the difference between branded and unbranded players' products prices?



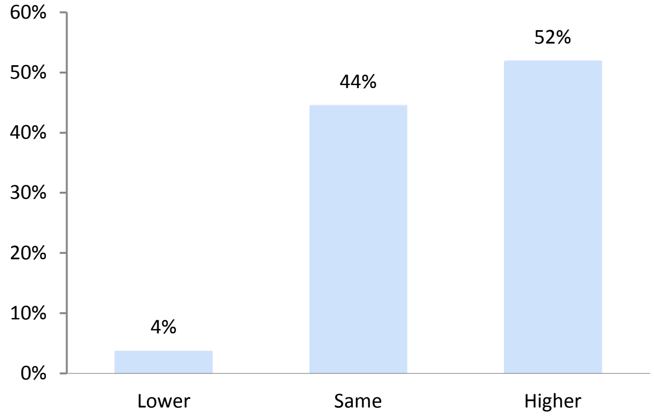
Is there any quality difference between listed and unlisted players?



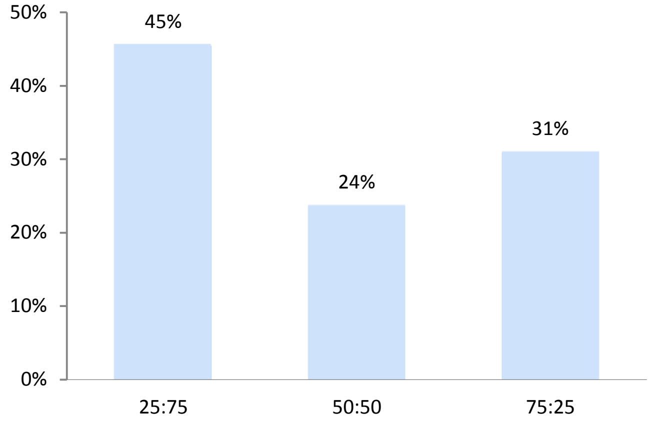
Who launches new products more frequently in the market – listed, unlisted or both?



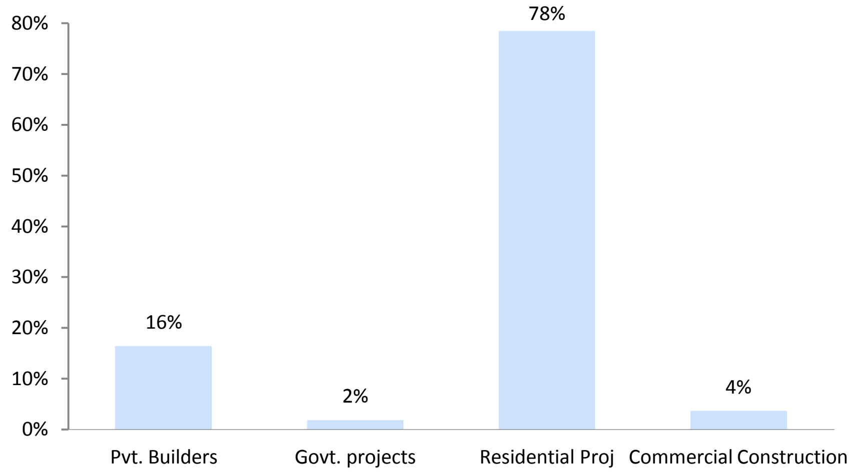
How is the margin different between listed and unlisted players?



Shelf-space ratio of listed:unlisted



Which sector is contributing to growth?



Note: Survey sample size of retailers, resulting in lower government projects

8-10% margin on branded players and 15% on Morbi players (margins are higher in premium tiles)

Government organizations prefer tie up with branded companies such as Kajaria due to its quality

Commercial projects to play a big role

Slowly, demand is picking up from private builders. Currently seeing demand from residential projects – mainly from tier-2 and tier-3 towns

Competitive landscape: Highly fragmented

In the Indian ceramic tiles industry, small and mid-sized players account for a large chunk of production. The larger (mostly listed) peers (about 14) account for Rs 120bn (48% of total value). Within these, Kajaria, Somany, H&R Johnson, AGL, Orient Bell and a couple of other players are established leaders with an estimated share of c.40% of the total domestic production.

Listed players market share (revenue %) in the listed space and their ranking

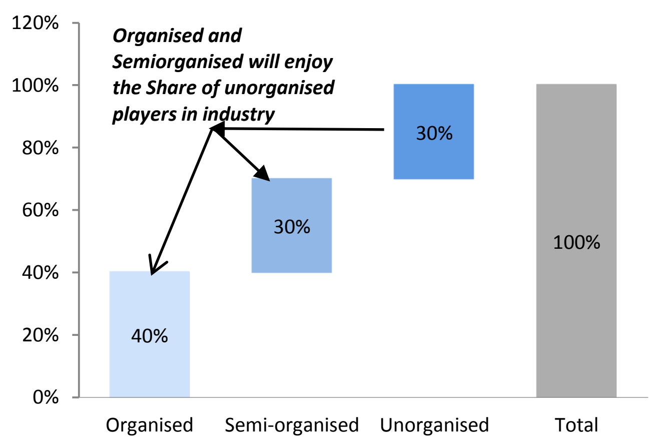
Market Share	FY10		FY11		FY12		FY13		FY14		FY15		FY16		FY17		FY18	
& Position	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank	M.Sha	Rank
H&R Johnson	31.1%	1	30.9%	1	27.8%	1	30.8%	1	31.10%	1	30.9%	1	24%	2	21%	3	21%	2
Kajaria Ceramics	**20.6%**	**2**	**21.7%**	**2**	**23.6%**	**2**	19.2%	2	20.60%	2	21.7%	2	28%	1	31%	1	32%	1
Somany Cramics	**15.3%**	**3**	**16.4%**	**3**	**15.5%**	**3**	13.0%	4	15.30%	4	16.4%	3	20%	3	21%	2	20%	3
Nitco Tiles	10.4%	6	11.5%	4	13.5%	4	15.0%	3	10.40%	3	11.5%	6	9%	4	8%	4	7%	6
AGL	**11.0%**	**5**	**10.4%**	**5**	**9.9%**	**5**	9.8%	6	11.00%	6	10.4%	5	10%	5	11%	6	12%	4
Orient Bell	11.7%	4	9.2%	6	9.8%	6	12.2%	5	11.70%	5	9.2%	4	8%	6	8%	5	8%	5
Total	**100%**		**100%**		**100%**		**100%**		**100%**		**100%**		**100%**		**100%**		**100%**	

Note: Grey: Maintain market share, **Red: Decrease in market share, Green: Increase in market share**

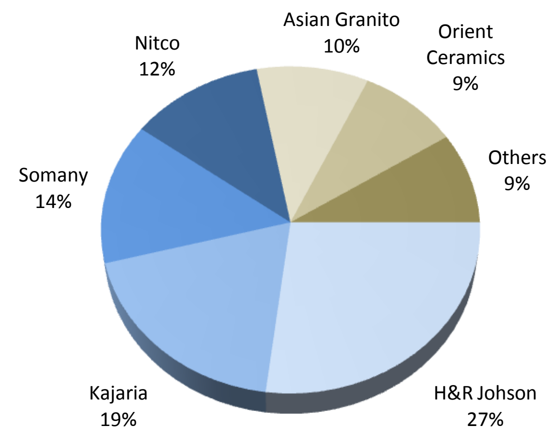
Kajaria, Somany and AGL moving up by increasing their market share.

Mid-small players account for c.60% of the total industry (by volumes); 90% of these are located in the Morbi. The town has some 700 manufacturing units, which includes about 60 large facilities of mid-sized players. The location accounts for c.85% of the total production of ceramic tiles in India, a large chunk of which consists of ceramic tiles (new plants are mostly for vitrified or GVT).

Organised to unorganised shift



Organised players' market share of the tiles market



Source: Industry, Company, PhillipCapital Research Estimates

Scale and reach of Indian tiles companies: Mindful of the rapidly evolving consumption pattern, large and mid-sized players are gradually squeezing out the unorganized sector. While a balanced product profile, efficient operations, and extensive distribution are common in most companies, a key differentiating factor is the pedigree of the management.

We expect that out of total unlisted/unorganised space (c.60% of total); c.30% comes from semi-organised players majorly based out of Gujarat (Morbi). These players are now becoming sizable – some have even crossed c.Rs 6bn in revenues, taking essential steps for moving towards becoming fully organised such as focussing on branding and recruiting professionals for business. Remaining c.30% of the unorganised players in Indian tile industry are mainly small Morbi tile manufacturers. With formalisation, this ratio should come down. Additionally, stricter environmental

On the National Green Tribunal (NGT)'s order, GPBC (Gujarat Pollution Control Board) has issued closure notices to nearly half of all units at Morbi and Wankaner running on coal gasifiers.

It has strictly warned these units to switch to LNG/PNG and if they fail to do so, it has ordered to shut down these plants. Source: GPBC

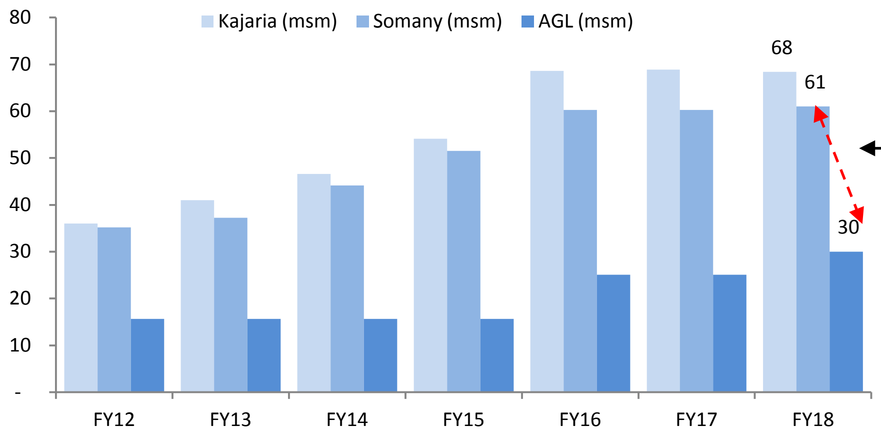
As many as 550 out of 1,000-odd manufacturing units face closure

Channel check highlighted closure or c. 40 plants in Morbi due to stricter environmental norms

norms by Gujarat Pollution Control Board (GPCB) will result in closure of smaller manufacturing units that are using coal gasifiers or they will have to shift to LNG/PNG.

In the current environment, mid-sized players will manage their balance sheets and cash flow, which will help them survive in the tough market and also help them move up the ladder. Larger players with strong distribution network, brand recall, and product offering will gain market share.

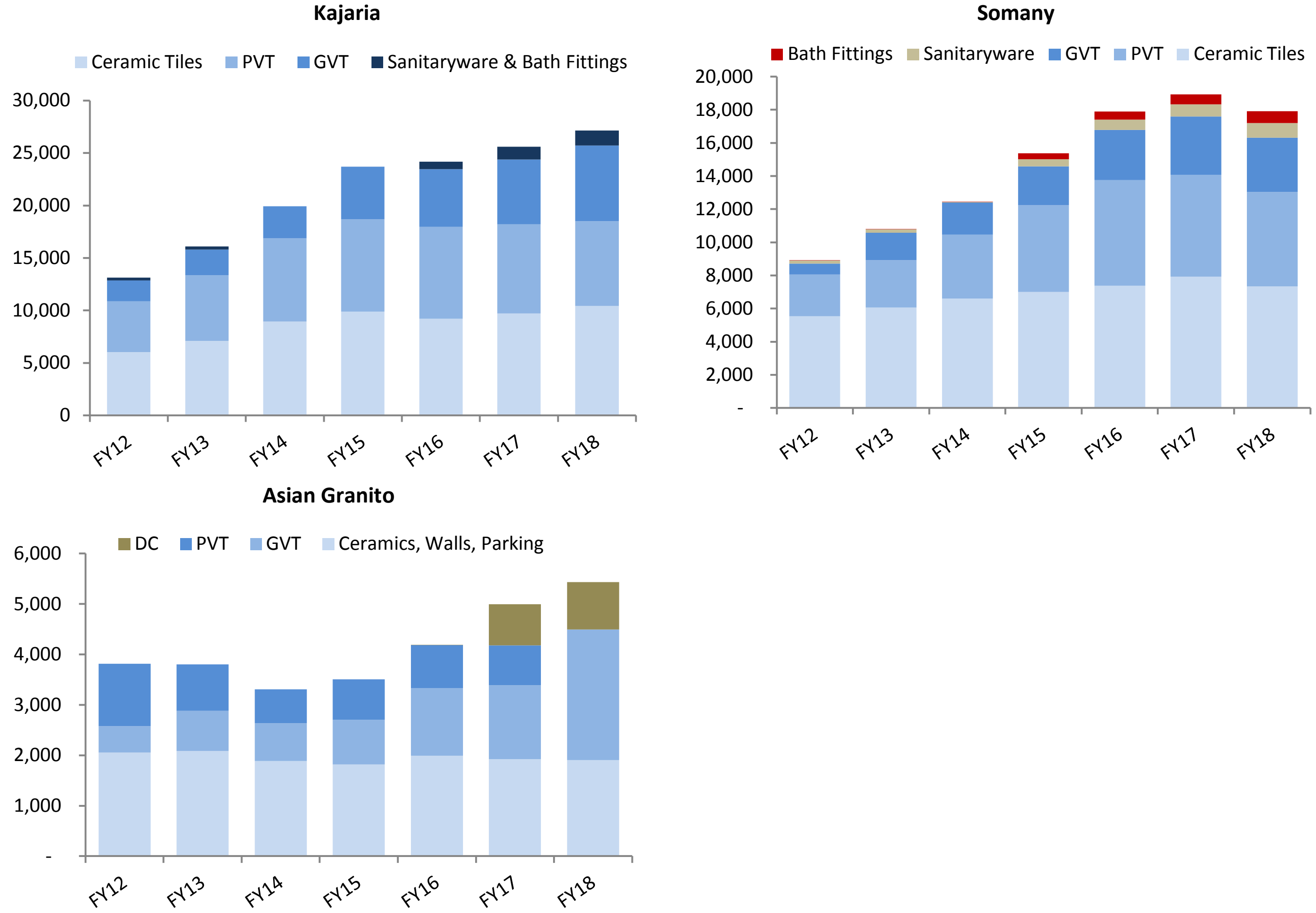
Installed capacity of Kajaria, Somany and AGL (owned + JV)



Larger players have 2x the capacity of mid-sized players

Source: *Company Data, PhillipCapital*

Improving revenue mix (Rs mn): Moving up in premium products will help in increasing realisation



Source: Company Data, PhillipCapital Research

Kajaria and Somany have a strong pan-India network and are present in areas with highest construction activity

State	Outstanding - Project Cost (Rs.bn)	Kajaria	Somany
Maharashtra	4,211	162	152
Uttar Pradesh	2,262	271	243
Karnataka	1,896	85	109
Gujarat	1,501	46	127
Haryana	949	94	86
Tamil Nadu	730	142	128
Telangana	708	52	57
Delhi	707	47	85
West Bengal	611	95	103
Kerala	**294**	**161**	**168**
Rajasthan	285	81	94
Andhra Pradesh	266	52	46
Odisha	238	41	0
Madhya Pradesh	216	78	53
Punjab	199	76	79
Jharkhand	85	50	34
Himachal Pradesh	63	46	5
Assam	57	28	9
Goa	53	12	14
Uttarakhand	47	79	43
Bihar	36	59	52
Chattisgarh	27	40	29
Chandigarh	25	13	6
Jammu & Kashmir	15	51	53
PONDICHERRY	9	6	12
Nagaland	4	2	1
Meghalaya	4	2	0
Andaman & Nicobar	1	1	2
Others States	226	11	73
India	**15,723**	**1,883**	**1,863**

Source: As per company's website, PhillipCapital Research

Leading brands (Kajaria and Somany) have a well distributed pan India network of 1,883/1,863 dealers

Kajaria's top-7 states have 70% of total outstanding construction projects

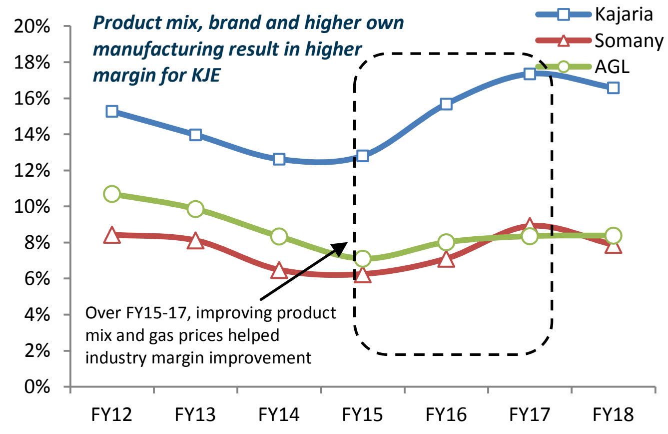
State	No. Of Dealer	Rs bn*	% of tota
Uttar Pradesh	271	2262	14
Maharashtra	162	4211	27
Kerala	161	294	2
Tamil Nadu	142	730	5
West Bengal	95	611	4
Haryana	94	949	6
Karnataka	85	1896	12

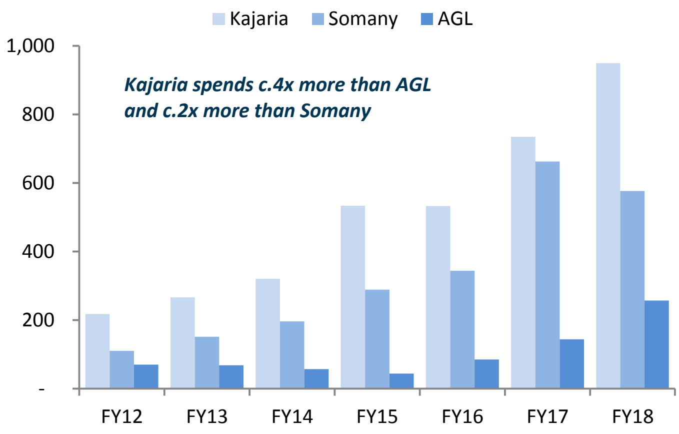
Somany's top-7 states have c.73% of total outstanding construction projects

State	No. Of Dealer	Rs bn	% of total
Uttar Pradesh	243	2262	14%
Kerala	168	294	2%
Maharashtra	152	4211	27%
Tamil Nadu	128	730	5%
Gujarat	127	1501	10%
Karnataka	109	1896	12%
West Bengal	103	611	4%

Note: Outstanding project cost Rs bn from CMIE Capex Data

High margins → allow spending on brand (Rs mn)…

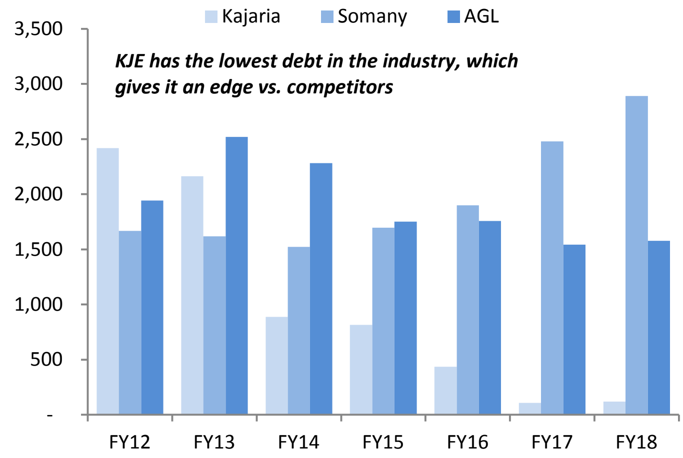




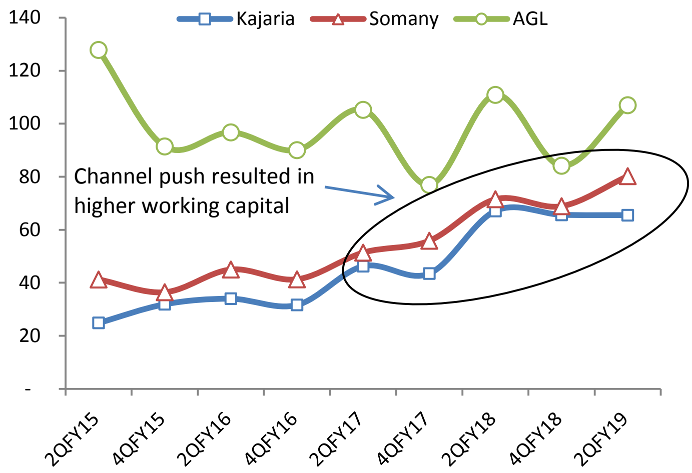
Source: Company Data, PhillipCapital Research

...without impacting balance sheet

Debt (Rs mn)

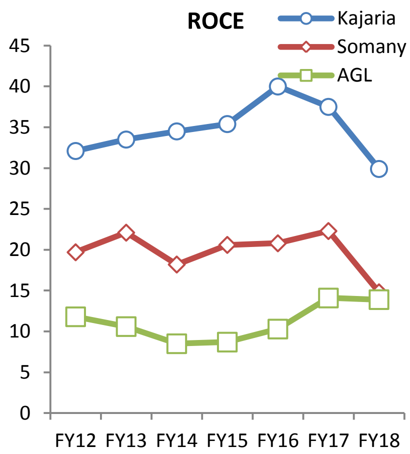


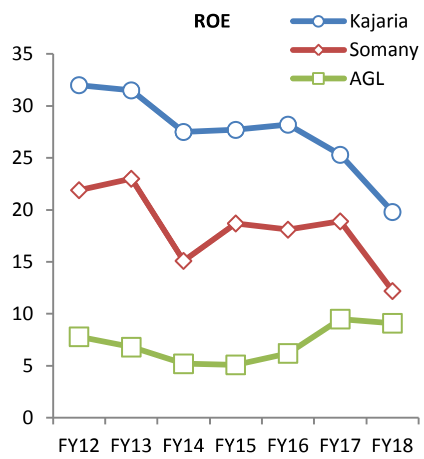
and working capital

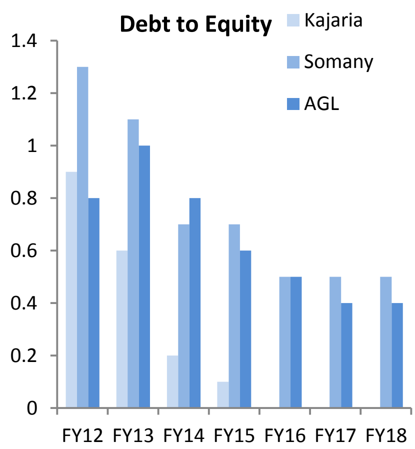


Source: Industry, Company, PhillipCapital Research Estimates

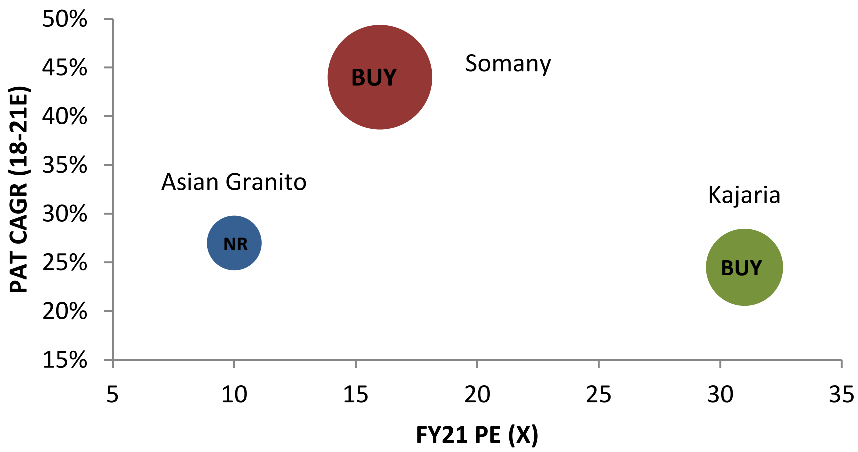
In FY17-18, lower margin and lower volume (lower asset turnover) resulted in lower return ratios







Indian Tile sector picks



Source: Company, PhillipCapital India Research, NR- Not Rated

Scorecard: For tiles companies (selected top-2 companies from the space)

Kajaria Ceramics	Weightage	Rank	Weak	Inline	Strong
Ranking			**1**	**2**	**3**
Weighted score	**2.55**				
Corporate governance	30%	3.0	-	-	0.90
End market opportunity	20%	2.0	-	0.40	-
Market positioning	15%	3.0	-	-	0.45
Revenue growth	10%	2.0	-	0.20	-
Earnings growth	15%	2.0	-	0.30	-
Cash flow generation	10%	3.0	-	-	0.30
Score	**100%**		**-**	**0.90**	**1.65**

Somany Ceramics	Weightage	Rank	Weak	Inline	Strong
Ranking			**1**	**2**	**3**
Weighted score	**2.15**				
Corporate governance	30%	2.0	-	0.60	-
End market opportunity	20%	2.0	-	0.40	-
Market positioning	15%	2.0	-	0.30	-
Revenue growth	10%	2.0	-	0.20	-
Earnings growth	15%	3.0	-	-	0.45
Cash flow generation	10%	2.0	-	0.20	-
Score	**100%**		**-**	**1.70**	**0.45**

AGL	Weightage	Rank	Weak	Inline	Strong
Ranking			**1**	**2**	**3**
Weighted score	**1.35**				
Corporate governance	30%	1.0	0.30	-	-
End market opportunity	20%	2.0	-	0.40	-
Market positioning	15%	1.0	0.15	-	-
Revenue growth	10%	1.0	0.10	-	-
Earnings growth	15%	2.0	-	0.30	-
Cash flow generation	10%	1.0	0.10	-	-
Score	**100%**		**0.65**	**0.70**	**-**

Source: PhillipCapital India Research

Valuation Table

Company Name	CMP	M Cap.	Revenue FY18	Revenue FY19E	Revenue FY20E	Revenue FY21E	EBITDA FY18	EBITDA FY19E	EBITDA FY20E	EBITDA FY21E	EBITDA Margin % FY18	EBITDA Margin % FY19E	EBITDA Margin % FY20E	EBITDA Margin % FY21E	PAT FY18	PAT FY19E	PAT FY20E	PAT FY21E
TILES & CERAMICS																		
KAJARIA CERAMICS LTD	566	89,982	27,437	29,965	34,158	38,889	4,716	4,667	5,617	6,556	17.2%	15.6%	16.4%	16.9%	2,419	2,406	3,036	3,625
SOMANY CERAMICS LTD	365	15,468	17,362	17,563	19,949	22,562	1,653	1,473	1,965	2,377	9.5%	8.4%	9.9%	10.5%	754	448	764	1,005
ASIAN GRANITO INDIA LTD	206	6,209	11,292	12,102	13,827	16,141	1,487	976	1,257	1,740	13.2%	8.1%	9.1%	10.8%	529	258	457	721
CERA SANITARYWARE LTD	2,570	33,428	11,711	13,326	15,276	17,547	1,754	1,893	2,270	2,675	15.0%	14.2%	14.9%	15.2%	1,039	1,118	1,355	1,603
PLYWOOD																		
GREENLAM INDUSTRIES LTD	802	19,361	11,551	12,745	14,241	15,961	1,590	1,618	1,917	2,197	13.8%	12.7%	13.5%	13.8%	680	783	955	1,149
GREENPLY INDUSTRIES LTD	151	18,504	17,228	17,906	21,724	25,355	2,596	1,939	2,613	3,184	15.1%	10.8%	12.0%	12.6%	1,384	743	1,022	1,245
CENTURY PLYBOARDS INDIA LTD	188	41,702	20,589	22,918	26,062	29,411	3,325	3,298	3,917	4,449	16.1%	14.4%	15.0%	15.1%	1,755	1,737	2,186	2,593
PIPES																		
ASTRAL POLY TECHNIK LTD	1,200	143,762	21,929	25,513	30,636	36,479	3,111	3,984	4,913	5,989	14.2%	15.6%	16.0%	16.4%	1,753	2,130	2,840	3,646

Company Name	P/E FY18	P/E FY19E	P/E FY20E	P/E FY21E	ROE% FY18	ROE% FY19E	ROE% FY20E	ROE% FY21E	Net Debt FY18	Net Debt FY19E	Net Debt FY20E	Net Debt FY21E	EV/SALES FY18	EV/SALES FY19E	EV/SALES FY20E	EV/SALES FY21E	EV/EBITDA FY18	EV/EBITDA FY19E	EV/EBITDA FY20E	EV/EBITDA FY21E
TILES & CERAMICS																				
KAJARIA CERAMICS LTD	37.2	37.6	29.7	24.9	19.0	16.4	18.2	19.0	1,561	(221)	(1,118)	(2,169)	3.3	3.0	2.6	2.3	19.1	19.3	16.0	13.7
SOMANY CERAMICS LTD	20.5	34.4	20.4	15.4	13.6	7.4	11.5	13.8	1,149	4,316	4,253	4,118	1.2	1.2	1.0	0.9	12.5	14.1	10.5	8.7
ASIAN GRANITO INDIA LTD	11.3	24.0	13.6	8.6	11.9	8.8	11.9	13.8	3,068	n.a.	n.a	n.a.	0.9	0.8	0.7	0.6	6.6	10.0	7.8	5.6
CERA SANITARYWARE LTD	31.9	29.8	24.7	20.8	18.3	17.1	17.8	18.1	(483)	(758)	(1,149)	(1,671)	2.8	2.5	2.2	1.9	18.9	17.5	14.6	12.4
PLYWOOD																				
GREENLAM INDUSTRIES LTD	28.5	24.8	20.4	16.9	20.8	19.8	20.2	19.8	1,869	1,414	639	(165)	1.9	1.7	1.5	1.3	13.5	13.3	11.2	9.8
GREENPLY INDUSTRIES LTD	13.3	24.7	18.2	14.8	16.9	8.2	10.1	11.1	6,786	9,281	8,800	8,217	1.5	1.4	1.2	1.0	9.7	13.0	9.7	7.9
CENTURY PLYBOARDS INDIA	23.7	24.0	19.1	16.1	22.4	18.7	20.0	20.7	7,056	5,683	5,138	4,185	2.3	2.0	1.8	1.6	14.0	14.1	11.8	10.4
PIPES																				
ASTRAL POLY TECHNIK LTD	82.4	67.8	50.9	39.6	18.5	18.5	20.5	22.1	714	411	(1,625)	(4,230)	6.7	5.7	4.8	4.0	46.9	36.6	29.7	24.4

Source: Company, PhillipCapital India Research Estimates

Risk to thesis

Volatility in gas/fuel prices

Gas prices: In tiles energy (gas) cost is the highest at c.30% of sales.
Diesel cost: Transportation cost is 8-10% of sales. Any sharp movement in fuel/gas prices may reduce realisations and margins.

Anti-dumping duty on Indian tiles from the Gulf market

Industry estimates indicate that 25% of exports from India are headed to the GCC (c.6-7% of total industry) and hence could be at risk.

Outlook: Survival of the Fittest

After big shocks, the tile industry has slowly started correcting past mistakes. While large branded players with deep pockets also faced difficulties, their strong balance sheets, cash flows, and organized structure provided them with sustaining power. Overall, companies are trying to reduce working capital – it had increased by 60-90 days for most players in 1HFY19. Small players have started shutting down their plants or operating only 1 klin, as most haven't been able to deal with mounting debts. Being unorganised, smaller players do not have ready access to inexpensive bank funding. As such, companies with stronger balance sheets and cash flows will be the 'last ones standing' in this down cycle.

Future Tense or Future Perfect – Which is it to be?

A little bit of both. Extensive interactions with companies (listed and unlisted), channel partners, architects, and industry observers indicate several changes on the horizon for the domestic tiles industry. The real questions are about the extent and timing of these shifts. Cash-flow management will also take centre stage.

Mid-term view	Long-term view
Prices to remain static in the near term An increase in competitive intensity could contribute to pricing pressure. For basic products, not much price correction is likely as plants are operating at cost. In premium products, pressure on realisations should continue, mainly because of higher competition. Within these, premium products such as large-slabs are operating at healthy margins. Manufacturing costs (power, fuel) will also play an important role; for example, companies have recently hiked prices due to an increase in fuel costs. Any sharp movements in gas prices will result in price movements in tiles. **National brands to churn out more products frequently** Most companies introduce 3-4 new tile designs every month. Dealers and architects point out that in order to step up their game and compete effectively against imports and from smaller Morbi players, listed players and larger Morbi players are gradually stepping up this tempo. While this could not be individually verified from Gujarat-based players, it seems perfectly logical since this would contribute immensely towards maintaining market share, presence, and customer satisfaction. **Export focus to intensify** The imposition of punitive duties on Chinese tile exports in most global markets and the pollution issue (capacity shut down in China) has opened up exports avenues for Indian companies, either through white-label supplies or under their own brand. While markets in the neighbouring SAARC countries have always been targeted, manufacturers in Morbi are increasing their shipments to the Middle East and Europe. Using dynamic feedback, exporters from Morbi are stepping up customisation and broadening their range. This, coupled with competitive pricing, is enabling several unlisted Indian manufacturers on increasing their quantum of exports – a trend that should gather momentum in the near term. Additionally, with capacity shutdowns and increasing costs, India has started exporting tiles to China. Morbi players said that Chinese players have started looking at JVs or partnerships with them to supply products to China and other countries.	**Innovation, distribution, brand are keys to success** In this competitive environment, players who will continue to focus on new launches, innovation, continue offering new product to customer, and have a very strong distribution network and brand recall – will stand out. **Growth through the JV model/outsourcing will be pursued more aggressively** Several rounds of capacity expansions are likely over the next decade, as manufacturers move to satisfy volume and variety – both local and exports. However, capital efficiency and compartmentalisation of competencies could lead to companies collaborating with each other through JVs. These alliances could be for outsourcing production, sharing of specified output, marketing tie-ups, or a combination of all three in a hybrid form. **Cash-flow management will be a key focus area for small and large players** Smaller players will have to up their game or face stagnation. Competitive intensity in the domestic tile industry will increase necessitating innovation and operational flexibility. Companies with smaller scale may have to invest more bandwidth and material resources to be fleet-footed in order to survive and grow.

Appendix 1

Some interesting takeaways from our recent GV story on tiles

Where is the Cash?

Construction activity has slowed after demonetization, GST, and RERA. Markets in south India were dependent on cash inflows from the Midde East because a large number of people from Kerala work in the Middle East. These cash inflows took a big hit as regulations in India became stringent. Many small players are facing difficulties while running their businesses – late payments or payment defaults abound. Cash inflows have reduced substantially, which has slowed down growth in construction. However, over the last six months, construction has seen a comeback driven by new projects in the affordable segment and some pick up in tier 2 and tier 3 cities.

Usually you see such huge discounts on clothes, not on tiles

One man's loss is another man's gain

With intensive competition and market conditions, many players have started losing share. This has proved advantageous to those tile manufacturers that have not compromised on quality, added new products, maintained a strong balance sheet, and are aggressive in marketing. Dealers and distributors have started selecting companies that give them higher margins and provide them more shelf space. Players have started to deepen their reach. Unbranded and cheaper tiles are preferred in tier 2 and 3 cities.

Stock clearance hoardings

S A L E – S A L E – S A L E

Larger Morbi players had to cut down their prices due to intensive competition. Tile manufacturers started dumping material on dealers to increase sales volumes. Inventory started piling up and caused problems for dealers, as they had to sell at lower prices than competitors to maintain market presence. Slowdown in the construction segment was also a big factor that caused disruption in the tiles market. To remain competitive, branded players focused on volume growth and increased their creditor days, which stretched their working capital cycle as inventories began piling up.

Too big to fail

Lured by good margins and low entry barriers small players (dealers-distributors) moved into the market and slashed their prices to increase sales. A price war ensued and damaged the entire industry. Many dealers started selling products at 50% discount just to clear their stock – a clear indicator of a major slowdown ahead. Meanwhile, many new dealerships of leading brands were created in the past year, increasing competition. In the aftermath, it looks like only those channel partners (distributors/dealers) with a strong base (balance sheet and cash flows) are likely to survive. The channel has already begun to feel major pressure in terms of working-capital receivable days – which increased to more than 80 in southern India from 15-30 earlier. This has resulted in weaker (usually smaller) players shutting shop.

Customized creative tile products

Quality is when the customer comes back, not the product

With margins shrinking, small tile manufacturers started compromising on their product quality, which caused loss of customer faith. With more customer complaints, dealers started shifting back to organized branded players with better product quality and durability. Branded players have always maintained their quality and kept launching new products with different designs. This helped them to remain strong in a volatile market. The sales head of leading tiles brand said, “We have seen some amount of orders coming back, mainly because of our quality. While some customers were taking products from Morbi’s small players earlier, they have now started buying from us or other leading brands. For government orders too, all leading brands are supplying).

Johnson increasing its market presence in south India

Survival of the fittest

After big shocks, the tile industry has slowly started correcting past mistakes. While large branded players with deep pockets also faced difficulties, their strong balance sheets, cash flows, and organized structure provided them with sustaining power. Overall, companies are trying to reduce working capital – it had increased by 60-90 days for most players in 1HFY19. Small players have started shutting down their plants or operating only 1 klin, as most haven’t been able to deal with mounting debts. Being unorganised, smaller players do not have ready access to inexpensive bank funding. As such, companies with stronger balance sheets and cash flows will be the ‘last ones standing’ in this down cycle.

It’s all about cash-flow management

Smaller players will have to up their game or face stagnation. Competitive intensity in the domestic tile industry will increase necessitating innovation and operational flexibility. Companies with smaller scale may have to invest more bandwidth and material resources to be fleet-footed in order to survive and grow.

Appendix 2: About MORBI

With extracts from our GV issues in 2016 and January 2019

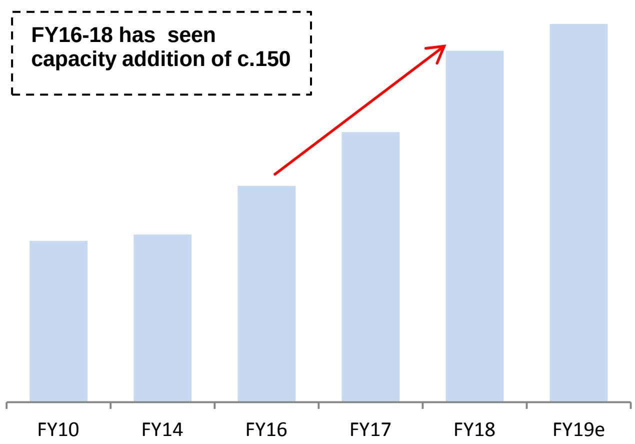
Morbi is Asia's largest tile manufacturing hub. This Gujarat town accounts for c.80% of the Indian tiles industry and generates in excess of Rs 220bn in annual revenue. The town emerged as a global manufacturing hub due to easy availability of raw materials, reliable supply of power, and logistics (it is near the ports).

Mr KG Kundalia, President, Morbi Ceramic Manufacturers Association: Everything here in Morbi operates on the principle of co-operation, everybody helps each other

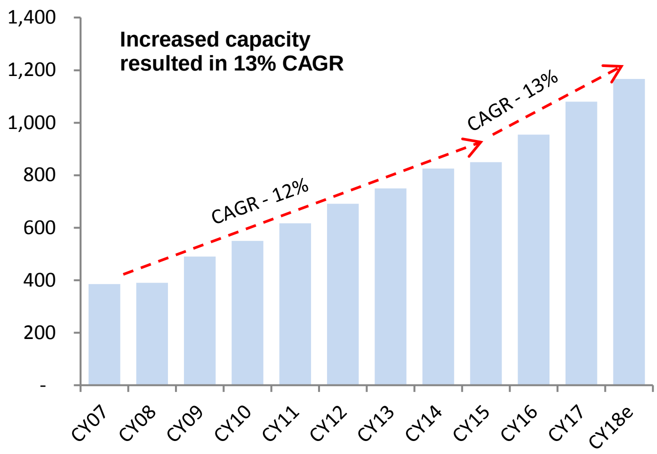
This pretty much sums up how the town has metamorphosed into the second-largest tile manufacturing cluster in the world in a short span of two decades

Housing close to 700 units of various sizes, manufacturing in Morbi is dominated by the enterprising Gujarati Patel community. The inherent abilities of co-operating manufacturing, outsourcing model and cost management made Morbi India's largest tile hub. Additionally, faster technology adoption (such as digital printing systems for large slabs) kept Morbi a step ahead in new launches. Its ability to match operational costs of manufacturers in China (excluding logistics costs) also helped. Morbi has made its name in cost management and new launches, which is why many big brands (domestic and overseas) outsource products from Morbi.

Morbi plant addition: Added c.150 plants in the last two years



Indian tile production (msm)



Source: Industry Data, Channel Check

Morbi players and listed brands: P&L comparison (in %)

Costing Matrix (%)	National Brands	Morbi Players
RM cost as % of Sales	36%	45%
Gross Margin (%)	64%	55%
Exp. As % of Sales:		
Adv & Sales	3%	5%
Power & Fuel	18%	17%
Emp. Cost	11%	9%
Stores spares cons	3%	1%
Other (Manf. + Others)	9%	8%
OPM (%)	19%	16%

The co-operative and outsourcing culture helped Morbi lower its operating and fixed overheads

Co-operative culture, cost management, aggressive launches, and strong interest from national and overseas brands resulted in strong growth for Morbi players over CY14-17. Additionally, it was easier to install plants in Morbi because of easy available of resources, equipment, and Morbi's working style – in Morbi it takes 6-8 months for plants to become fully operational while in the rest of the country it takes 1.5 years. Not surprisingly, Morbi saw strong capacity addition of c.100 plants (300msm) in CY17. Capacity addition in GVT was mainly because of higher realisations (margins).

Companies Section

Kajaria Ceramics Ltd (KJE IN)

Best in class

25 March 2019

INDIA | BUILDING MATERIALS | Initiating Coverage

As one of India's leading ceramic tiles companies, Kajaria has a strong pan-India presence. This, coupled with an improving product offering, brand recognition, recovery in construction activity, Morbi slowing down, and a debt-free balance sheet – should lead to market share gains for KJE. Strong product portfolio allows it to maximise its share of spending on a per-household basis. Consequently, we expect 24% CAGR in KJE's FY19-21 earnings. We believe current valuations are not reflective of improving business dynamics. We initiate coverage with a BUY rating and a target of Rs 672.

Wide product basket and focus on new launches: KJE has a vast product portfolio in tiles (ceramic, GVT, PGVT), sanitary-ware, and plywood. It seems to have become aggressive in new launches – it has added premium products in tiles in the past 12 months (*Ultima*, large slabs, full body slab), which will help it to improve its average realisations (ASP). We expect its tiles ASPs to improve by 1.0%/1.7% in FY20/21 despite a tough environment. Additionally, it is rapidly increasing its product offering in bath fittings (30% yoy growth). With all this, and aided by a decline in gas prices, we expect KJE's operating margins to improve by 180bps over FY19-21.

Strong brand recall with a pan-India presence: KJE has invested in branding (A&P spends at c.4% of sales – highest in the industry) and is focused on increasing its touch points (dealer network of c.1,900 – the highest in the industry). Its strategy of multi-location plants that are closer to demand centres also gives it an edge over its peers and has helped it to maintain its industry leading market share even in the slump of FY17-18, when the industry faced a supply glut from Morbi.

Controlled working capital + limited capex = FCF and debt-free balance sheet: KJE refrains from predatory vendor credit schemes while maintaining a robust collection cycle, allowing it to tightly control its working capital (average 43 days in the past five years). In addition, its capex cycle is winding down, which should lead to healthy cash-flow generation and help it to maintain its leverage-free balance sheet. Strong cash flows also give KJE an edge over its peers in driving growth in a high-demand scenario.

Volume growth to revive on a pickup in construction: Our interaction with channel partners/industry experts suggests that construction demand has started picking up based on capex data (we expect c.9% growth over 2-3 years vs. consensus' 7%), which should lead to a volume uptick for Kajaria, mainly because of its greater reach, product, and brand. We expect volume growth at 10%/9% in FY20/21 (vs. 6%/11% in FY18/19).

BUY for 23% earnings growth: KJE has an impressive growth record with five-year earnings CAGR of 18%. We find it credible that the company has increased its monthly revenues to Rs 2.5bn currently from Rs 794mn in FY11, without leveraging its balance sheet. We believe that as Morbi slows down, pricing should stabilise. This, coupled with improvement in KJE's product mix should help expand margins that bottomed in FY18. We expect 24% earnings CAGR over FY19-21 driven by margin expansion of 180bps and volume-led revenue CAGR of 13%, as we model only modest ASP growth.

Stock valuations are not reflective of the improving business dynamics that benefit players such as KJE. We initiate coverage with a BUY rating and a target of Rs 672, valuing the company at 30x PE FY21.

Key risks: (1) Increase in gas prices and (2) further capacity addition by Morbi players.

BUY

CMP RS 584
TARGET RS 672 (+15%)

COMPANY DATA

O/S SHARES (MN) :	159
MARKET CAP (RSBN) :	93
MARKET CAP (USDBN) :	1.3
52 - WK HI/LO (RS) :	596 / 316
LIQUIDITY 3M (USDMN) :	4.5
PAR VALUE (RS) :	1

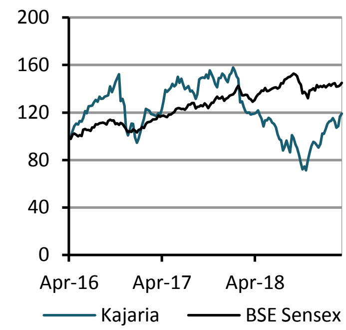
SHARE HOLDING PATTERN, %

	Dec 18	Sep 18	Jun 18
PROMOTERS :	47.6	47.6	47.6
FII / NRI :	25.1	24.7	26.5
FI / MF :	10.3	9.7	9.6
NON PRO :	2.0	2.2	2.2
PUBLIC & OTHERS :	15.1	15.8	14.2

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	13.7	28.5	2.6
REL TO BSE	9.9	23.6	-8.1

PRICE VS. SENSEX



Source: Phillip Capital India Research

KEY FINANCIALS

Rs mn	FY19E	FY20E	FY21E
Net Sales	29,741	33,321	38,201
EBIDTA	4,668	5,526	6,633
Net Profit	2,299	2,870	3,562
EPS, Rs	13.9	17.5	21.8
PER, x	40.6	32.5	26.2
EV/EBIDTA, x	21.0	17.5	14.4
P/BV, x	6.2	5.3	4.6
ROE, %	18.5%	16.1%	17.6%

Source: PhillipCapital India Research Est.

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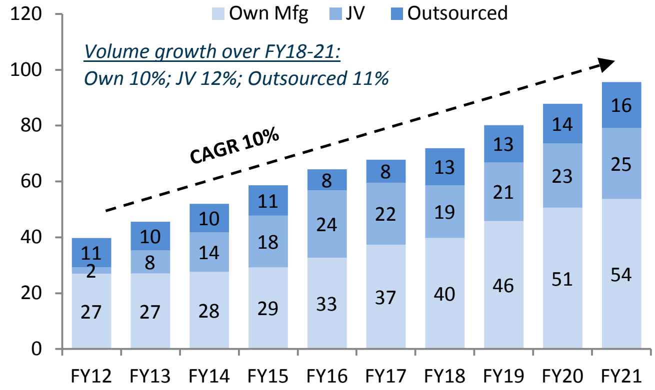
Revenue growth to be driven by product mix (new launches) + distribution + brand recall

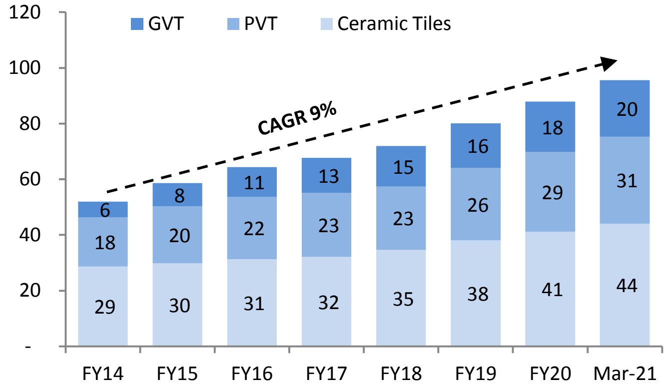
We expect KJE to see revenue CAGR of 13% over FY19-21. Management continues to remain positive on the demand scenario for tiles, guiding double-digit volume growth in FY19 and FY20 and operating margins improving by 150-200bps over FY20-21.

Volume growth will also be driven by product + distribution + brand

Volume CAGR of 11% over FY19-21



Higher volume from premium (GVT, PVT) products



Source: Company, PhillipCapital India Research Estimates

Strong product basket with aggressive focus on new launches

Kajaria has very strong product basket, with presence in the entire product segment – tiles, sanitary-ware, bath fittings, and plywood. Although Morbi players have always been ahead in terms of new launches mainly because of their higher risk appetite and lower cost, Kajaria has persistently improved its product offering by adding new products and designs.

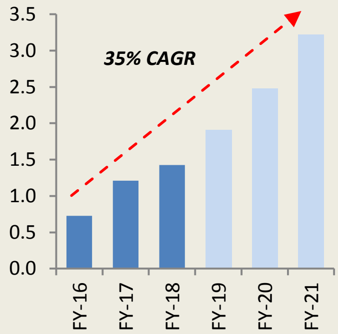
It launched premium products in tiles (*Ultima*, large slabs, full body slabs) in the last 6-7 months, which should help it to improve its average realisations – we expect these to improve 1.0%/1.7% in FY20/21 even in a tough pricing environment. Additionally, aggressive new launches in bath fitting and an increasing presence (created c.300 dealers dedicated to bath fittings) will also help margins.

Key product launches over the last three years; 2,800 design variations

2018	
Designer Series and Impression Series	
New Luxury Collection	120x180cm; 120x120cm; 80x160cm; 20x180xm and 29x180cm
Ultima Luxury collection	80x160cm
Grestough slabs	80x120cm
Grestough planks	20x120 cm & 20x100cm
double-charge tile for indoor application	60x120cm
planks of wooden appeal	20x180cm & 29x180cm
2017	
new large-format tiles	120x180cm, 120x120cm, 120x80cm & 80x80cm
Ceramic floor tile	80x80cms
Polished vitrified tile	60x120 cms double charge
Glazed vitrified tile	120x180cm
faucets	4 new products
2016	
Ceramic Digital Polished Floor tiles	80x80cm
Ceramic body in wall tile	25x75cm & 40x80cm
Polished ceramic body in Floor tile	60x60cm and 80x80cm
Wall tile	30x120cm with 8mm thickness
floor tile	13x80cm

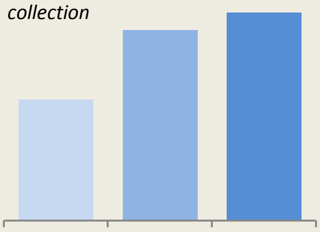
Source: Company – Annual Report, PhillipCapital India Research

Increasing product offering and visibility will lead to strong growth in sanitary-ware and bath fittings (Rs bn)



No. of major new product launches

In FY18, KJE launched a 'designer' series with 70 new variants and 98 in luxury collection



Source: Company, PhillipCapital India Research

Premium products in tiles:

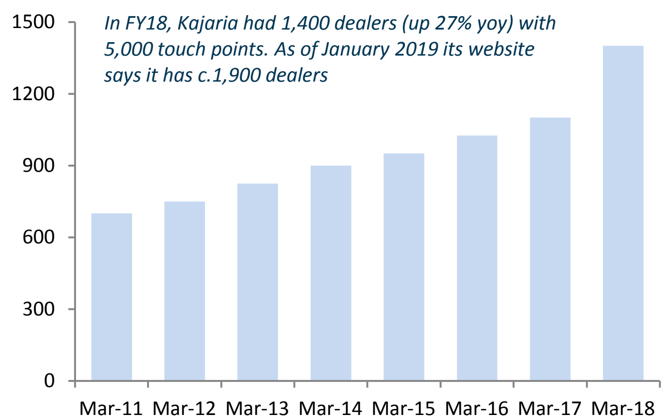
- Ultima – extra-large vitrified slabs
- Gres Tough – 60X120 cm – HD digital ceramic floor tiles
- Terrazzo – full-body vitrified tiles

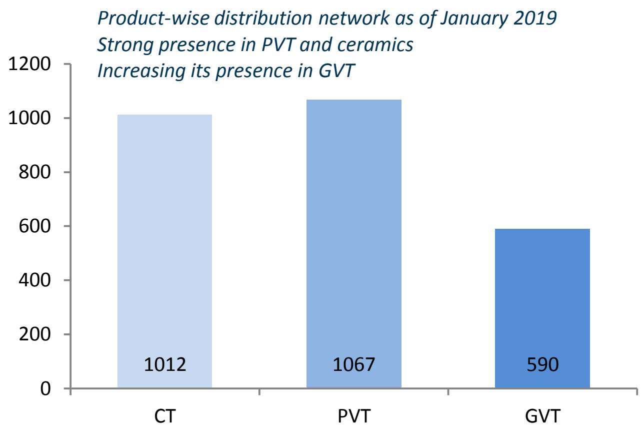
For more new launches – refer page no. 39 (Channel Check)

Largest distribution network with strong brand recall

KJE has one of the largest distribution networks with a dealer network of c.1,900 spread across India. According to our channel checks, large dealers that have bigger networks and balance sheets are associated with KJE (we have observed this ourselves). This should help to strengthen the visibility of its products and support it in a tough environment. It is continuously increasing its touch points in weaker geographies.

KJE: Continuously increasing its distribution network and going deeper into tier-2 cities





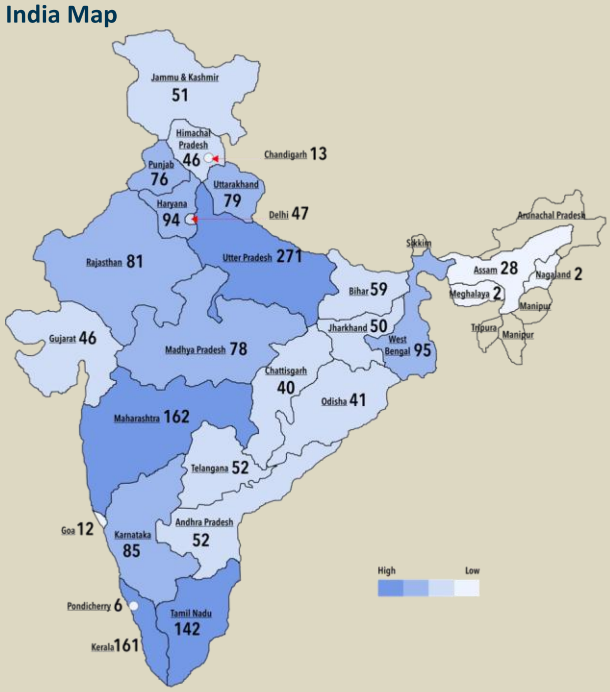
Source: Company, PhillipCapital India Research, Company website

Distribution network as of January 2019 - strong pan-India presence

Dealer Network	CT	PVT	GVT	Total
UTTAR PRADESH	134	124	107	271
MAHARASHTRA	115	95	51	162
KERALA	84	91	49	161
TAMIL NADU	55	106	28	142
WEST BENGAL	51	59	22	95
Haryana	49	50	33	94
KARNATAKA	52	50	22	85
RAJASTHAN	42	53	21	81
Uttarakhand	44	32	25	79
MADHYA PRADESH	42	48	25	78
PUNJAB	44	42	26	76
Bihar	37	34	19	59
Andhra Pradesh	26	26	21	52
TELANGANA	28	31	13	52
JAMMU & KASHMIR	34	28	10	51
JHARKHAND	26	28	19	50
Delhi	26	21	16	47
Gujarat	16	28	13	46
HIMACHAL PRADESH	36	22	15	46
ODISHA	18	24	17	41
Chattisgarh	16	31	10	40
Assam	4	19	13	28
Chandigarh	9	5	4	13
Goa	10	7	4	12
PONDICHERRY	3	2	2	6
TRIPURA	1	4	0	4
Arunachal Pradesh	1	1	1	2
Manipur	1	1	1	2
MEGHALAYA	1	1	1	2
NAGALAND	2	2	0	2
NEPAL	2	0	0	2
Andaman & Nicobar	1	1	1	1
ORISSA	1	0	0	1
Total	**1,011**	**1,066**	**589**	**1,883**

Source: Company, PhillipCapital India Research

India Map



It has a strong presence in states where major construction activity is going on (according to CMEI capex data). For reference, please see page 11 and 12 in the industry section.

Large dealers are associated with Kajaria, which they consider a national brand
KJE's association with quality dealers (strong background and balance sheet) helps it to increase market share and visibility. Strong relationships with its dealers have been a backbone in dark times. It plans to keep adding to its network by 15-20% every year and improving it.

Increasing presence in exports market
KJE exports to more than 35 countries. It manages this market segment through a specialist export division that manages a network of international agents and distributors. KJE enjoys a similar brand recall in international markets as it does in domestic markets. In January 2019, it opened a showroom in India's export hub, Morbi, in order to increase its presence in the exports market.

Large tile dealers associated with Kajaria for more than 10 years

Dealer Name	City	Area of shop (sq. ft.)
Surendra Sangwan	Bhiwani, Haryana	13,000
Naresh Gupta	Dhanbad, Jharkhand	12,000
Eldho Varghese	Ernakulum, Kerala	30,000
S. Muthuraman	Coimbatore, Tamil Nadu	45,000
Neeraj Vasant	Raipur, Chattisgarh	10,000

KJE's global presence in 35 countries

It opened a display centre and regional office in Morbi, Gujarat, to increase its focus on exports

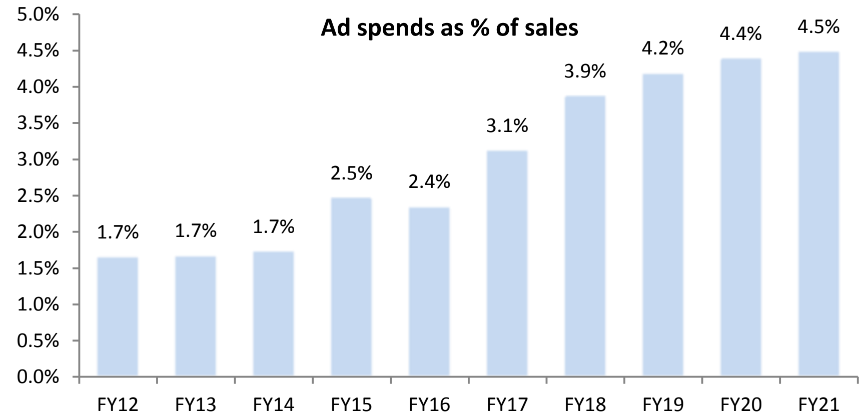
Source: Company, PhillipCapital India Research

Strong brand recall

Kajaria, an already respected and reputed India tile brand, is continuously investing in its brand. In FY19, it has invested Rs c. 1.2bn in branding. Akshay Kumar is its brand ambassador for tiles, Anushka Sharma for Kerovit – faucets and sanitary ware, and it recently tied up with Ranveer Singh for plywood. It has a presence in 30 airports (tier 1, 2, and 3) and has aggressively built on social media presence with more than 1mn followers.

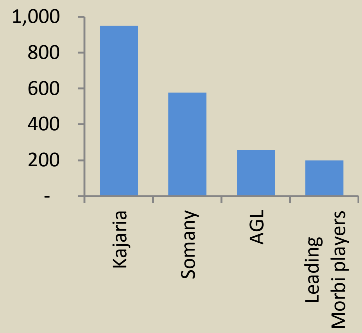
Kajaria Ply introduced Ranveer Singh as its Brand Ambassador

We expect Kajaria to continue investing c.4% of sales on brand building activities



Source: Company, PhillipCapital India Research Estimates

Branding spends in FY18 (Rs mn)

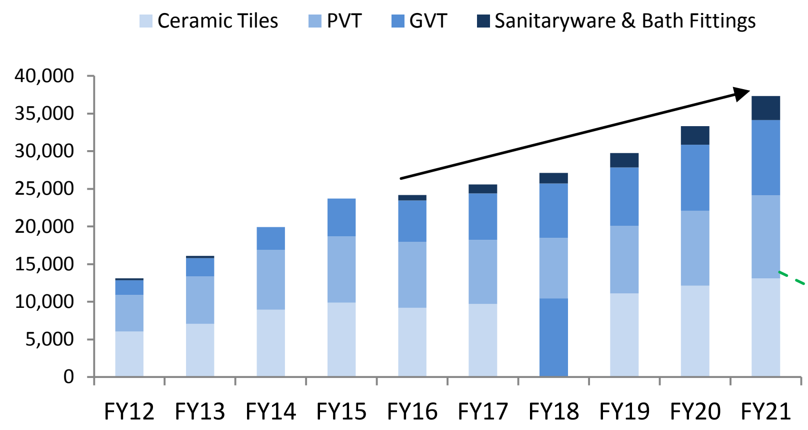


Kajaria spends more than 4x on its brand vs. Morbi players and c. 2x vs. listed ones

Impact on financial performance

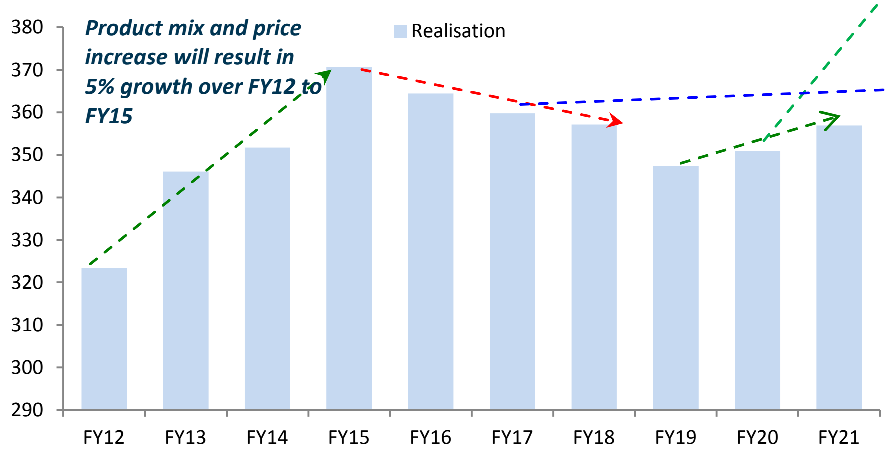
Strong product mix and increasing share of premium products will lead to improvement in margin – we expect 180bps improvement in operating margins over the next two years and revenue CAGR of 11% over FY18-21.

Revenue CAGR of 11% over FY19-21



Stable price environment + Improving in product mix + favorable gas prices will result in improvement in realization and margins.

Product mix and new launches will help in realisation improvement



Demand-supply mismatch and price war resulted in realizations falling from Rs 371 to 347 between FY15 and FY19, but the performance was much better than competitors

Product mix (more premium products), will lead to a 180bps margin improvement in FY19-21

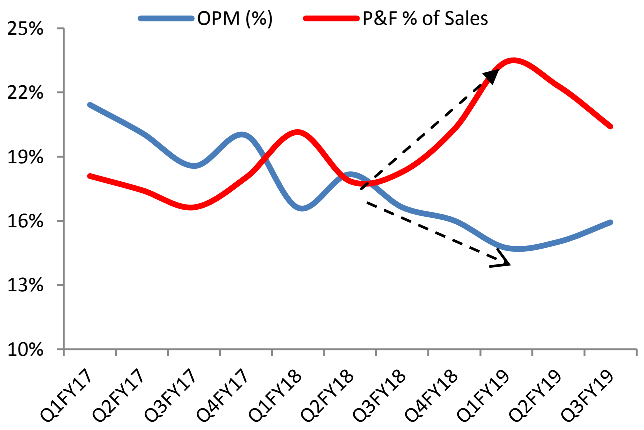
Gas prices have also started softening, which will help margins (however, not in our calculations)

Channel checks say KJE has taken a price hike of c. 3% in December 2018

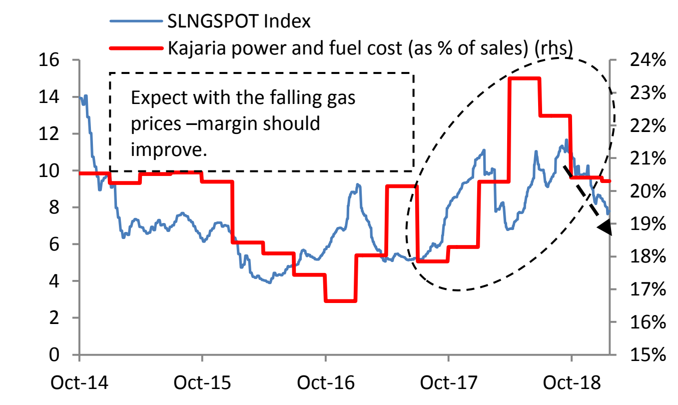
Source: Company, PhillipCapital India Research Estimates

Gas prices play an important role for tile companies' margins

KJE: OPM and fuel cost as % of sales



Gas prices and KJE's power & fuel costs (as % of sales)



Source: Company, PhillipCapital India Research

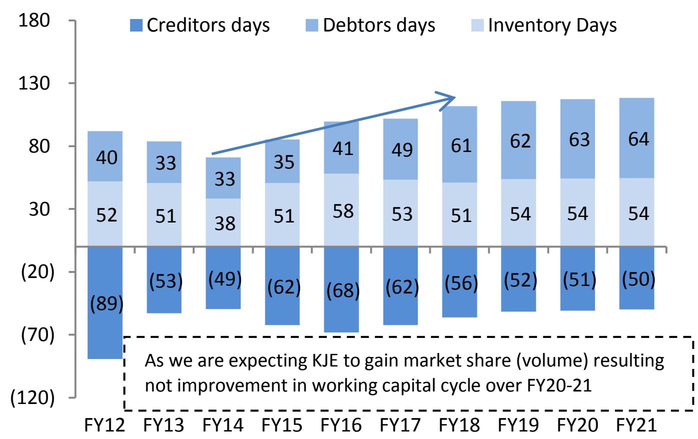
Year on year, liquefied Natural Gas (LNG) prices have increased significantly – this will negatively affect every tile manufacturer. However, over the last 4-5 months we have seen some softness in gas prices, which should help companies to improve margins.

Demand-supply mismatch in the tiles industry has made it impossible for KJE and other companies to take price hikes (until recently). Our channel check now suggests that companies have started hiking prices.

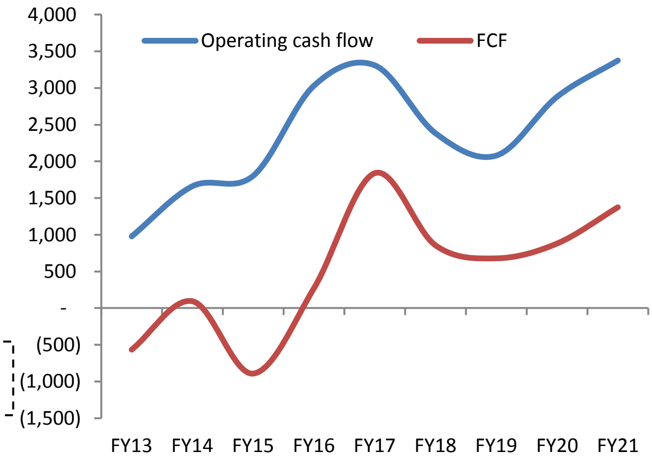
Balance sheet and cash flows will help gain market share

Recent events such as price war and dumping of products severely impacted the sector. Our channel checks indicate that the working-capital cycle for Morbi's small and mid-sized players has increased to 80-120 days and that the price cut resulted in lower operating margins. All this may result in forcible shutdowns/consolidation in Morbi. In this environment, Kajaria may stand out because it is the market leader with a strong network, brand, and financials (P&L, balance sheet, and cash flow), which it can use to gain incremental volume market share; this also gives it additional bargaining power in tough business environments.

Controlled working-capital cycle

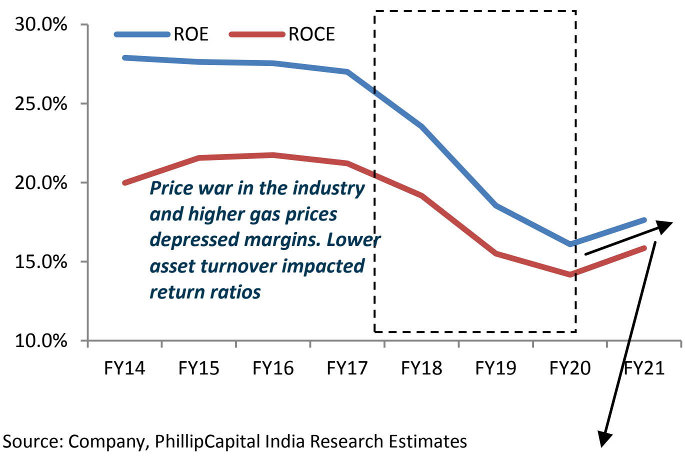


We expect FCF of Rs 2.2bn over next two years

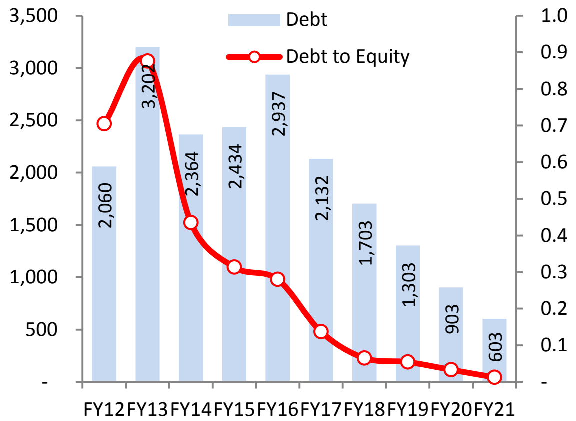


Source: Company, PhillipCapital India Research Estimates

Improvement in profitability; result improvement in ratios



Debt-to-equity to remain below 0.1



Source: Company, PhillipCapital India Research Estimates

Improvement in product mix and stabilisation of prices results in better profitability. Improving asset turnover will result in better return ratios.

DuPont table

DuPont analysis	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E	FY22E	FY23E
Tax Burden (x)	0.6	0.6	0.6	0.6	0.7	0.6	0.6	0.6	0.6	0.6
Interest Burden (x)	0.9	0.9	0.9	1.0	1.0	1.0	1.0	1.0	1.0	1.0
EBIT Margin (%)	0.1	0.1	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Asset Turnover (x)	2.3	2.3	2.0	1.8	1.7	1.8	1.8	1.8	1.8	1.8
Leverage Multiplier (x)	1.8	1.5	1.4	1.3	1.2	1.2	1.1	1.1	1.1	1.1
RoE (%)	27.9%	27.6%	27.0%	23.5%	18.5%	16.1%	17.6%	18.2%	18.1%	18.7%

Source: Company, PhillipCapital India Research Estimates

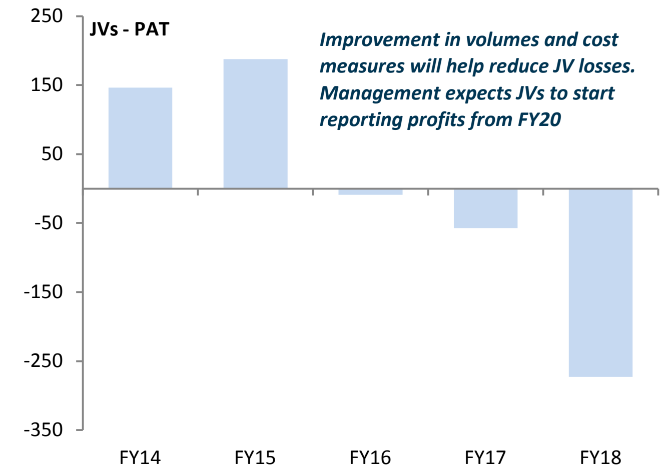
Average PE of 31

Average PE of 27

KJE's JVs are driving volume growth and profitability for the company

Recently, KJE's subsidiaries have been a drag on its bottom-line, incurring losses in the last two years. However, the management remains committed to transforming its subsidiary units into profitable operations – individually and collectively. To do so, its team has tried to improve shop-floor efficiency. It is expected that KJE will achieve its goal in FY20.

JV companies' PAT



Source: Company, PhillipCapital India Research

Revenue impact of JV companies

Subsidiaries	Revenue FY16	Revenue FY17	Revenue FY18	PAT FY16	PAT FY17	PAT FY18
Soriso Ceramics	1,047	757	586	38	32	17
Jaxx Vitrified	2,883	3,115	2,291	(141)	9	(185)
Vennar Ceramics	781	795	631	16	10	(67)
Cosa Ceramics	2,313	1,816	1,632	145	83	60
Kajaria Bathware	721	1,201	1,412	(78)	(191)	(98)
Kajaria Ceramics, Kazkhstan	(4)	-	-	(5)	-	-
Taura Tiles	867	-	-	19	-	-

Source: Company, PhillipCapital India Research

Risk-reward – sensitivity analysis

	Worst case FY20	Worst case FY21	Current / Base FY20	Current / Base FY21	Best Case FY20	Best Case FY21
Key Estimates:						
Volume Growth	7%	8%	10%	11%	13%	14%
Realisation Growth	-2%	-1%	1%	2%	1%	3%
NWC days	78	80	73	75	68	70
Outcome:						
Sales	31,447	34,047	33,321	38,201	34,217	40,814
% yoy	6%	8%	12%	15%	15%	19%
EBITDA	4,940	5,614	5,401	6,490	5,717	7,138
EBITDA margin	15.7%	16.5%	16.2%	17.0%	16.7%	17.5%
Rec PAT	2,575	3,002	2,870	3,562	3,072	3,977
EPS	16	19	18	22	19	25
ROE	16.0%	16.3%	17.6%	18.8%	18.8%	20.5%
ROIC	13.6%	13.9%	15.3%	16.9%	16.6%	19.6%
PE	25		30		30	
TP	472		672		750	
Upside	-20%		15%		28%	

Source: Company, PhillipCapital India Research

We have taken base case in our estimates – 10% volume growth and 1% realisation growth. This gives us an earning CAGR of 13% over the next two years

Consensus vs. PC estimates

Estimates Change	PC Estimates			Bloomberg Consensus			Consensus Vs Estimates		
(Rs bn)	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Sales	29,741	33,321	38,201	29,965	34,158	38,889	0.8%	2.5%	1.8%
EBITDA	4,530	5,401	6,490	4,667	5,617	6,556	3.0%	4.0%	1.0%
EBITDA margin (%)	15.2%	16.2%	17.0%	15.6%	16.4%	16.9%	34	24	(13)
Recurring PAT	2,299	2,870	3,562	2,406	3,036	3,625	**4.7%**	**5.8%**	**1.8%**
EPS Recurring (Rs)	14	18	22	15	19	23	3.4%	5.6%	1.6%

Source: Company, PhillipCapital India Research Estimates, Bloomberg

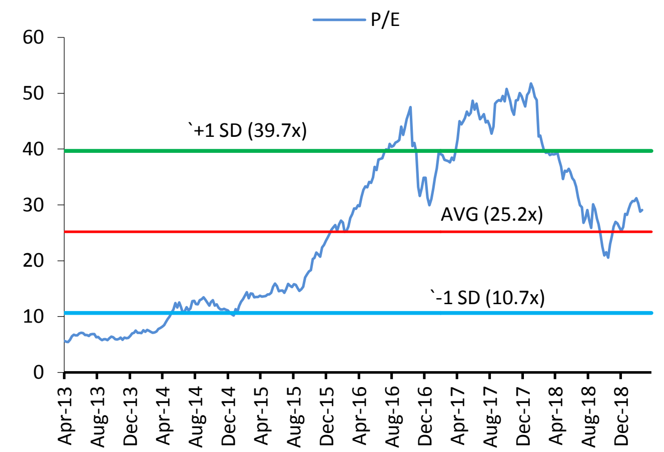
Outlook and valuations

KJE has demonstrated an impressive growth record (five year earning CAGR of 18%). We find it credible that the company has increased its monthly revenues from Rs 794mn in FY11 to Rs 2.5bn currently without leveraging its balance sheet. We believe as Morbi slows down, pricing should stabilise. This, coupled with improvement in KJE's product mix should help expand margins, which bottomed in FY18. We expect a 24% CAGR in earnings driven by margin expansion (180bps FY19-21) and volume-led revenue growth of 13%, as we model for only modest ASP growth.

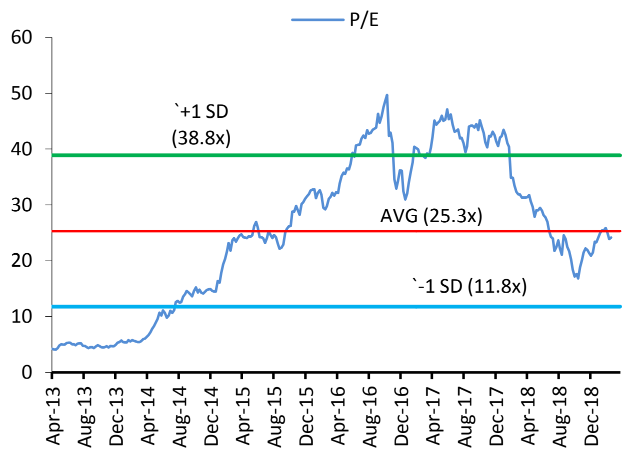
Stock valuations, are not reflective of the improving business dynamics, which are beneficial for players such as KJE. We initiate coverage with a BUY rating. We have ascribed an earnings multiple of 30x to our FY21 EPS to arrive at a target of Rs 672, which represents an upside of 15% from current levels. We initiate coverage with a BUY recommendation.

Key risks: (1) Increase in gas prices and (2) further capacity addition by Morbi.

PE Chart: One-year forward

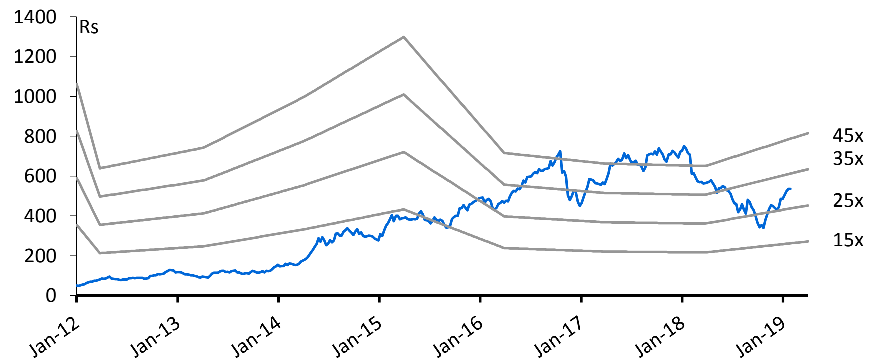


Two-year forward (five-year average is 25x)



Source: Company, PhillipCapital India Research

One-year forward PE band chart (start this chart from FY12)



Source: Company, PhillipCapital India Research

Channel check

- Kajaria's new collections in premium-category products will help it to improve its realisations.
- Kerovit by Kajaria launched a three-way premium product in bath-ware (three streamlined pressured water outlets); it will launch six-way products soon. Three-way products cost up to Rs 100,000.
- It is entering the Rs 200bn plywood market with Kajaria Ply. It will launch a new low-cost product in marine ply soon.

South (Kerala) channel check:

- Kajaria is market leader in Kerala with revenue of Rs 3.50bn from the state. It sees c.14% growth in FY19.
- Strong builders with strong balance sheets are showing pick up in execution.
- In the premium segment, Kajaria has a strong presence with *Eternity*. It has hiked prices by c.4% in this segment. Only 3-4 players from Morbi are in the premium segment; Kajaria is a leader in this segment in terms of volume.
- Builders of economic (affordable) projects are still facing liquidity issues

Lakshmi Ceramics – Coimbatore

Lakshmi Ceramics – Coimbatore

Three-way shower bath-ware product

Affordable housing project

Kajaria plywood products

Pro Build	Marine	Platinum
MRP: Rs. 110	MRP: Rs. 170	MRP: Rs. 215
Cost: Rs. 76	Cost: Rs. 116	Cost: Rs. 140

Kajaria Ply will soon launch a new low range product in its marine ply segment

Financials

Income Statement

Y/E Mar, Rs mn	FY18	FY19E	FY20E	FY21E
Net sales	**27,106**	**29,741**	**33,321**	**38,201**
Growth, %	6.3%	9.7%	12.0%	14.6%
Other income	108	137	125	143
Total income	**27,214**	**29,878**	**33,446**	**38,344**
Raw material expenses	10,603	11,251	12,404	14,159
Employee expenses	3,177	3,440	3,767	4,213
Other Operating expenses	8,763	10,520	11,749	13,340
EBITDA (Core)	**4,672**	**4,668**	**5,526**	**6,633**
Growth, %	-8.7%	-0.1%	18.4%	20.0%
Margin, %	17.2%	15.6%	16.5%	17.3%
Depreciation	885	918	944	1,012
EBIT	**3,787**	**3,750**	**4,582**	**5,621**
Growth, %	-12.0%	-1.0%	22.2%	22.7%
Margin, %	13.9%	12.5%	13.7%	14.7%
Interest paid	241	165	121	83
Pre-tax profit	**3,546**	**3,584**	**4,461**	**5,538**
Tax provided	1,267	1,290	1,606	1,994
Profit after tax	**2,279**	**2,294**	**2,855**	**3,544**
Others (Minorities, Associates)	64	5	15	18
Net Profit	**2,342**	**2,299**	**2,870**	**3,562**
Growth, %	-7.4%	-1.8%	24.8%	24.1%
Net Profit (adjusted)	**2,342**	**2,299**	**2,870**	**3,562**
Unadj. shares (m)	159	159	159	159
Wtd avg shares (m)	159	159	159	159

Balance Sheet

Y/E Mar, Rs mn	FY18	FY19E	FY20E	FY21E
Cash & bank	824	317	350	838
Debtors	4,507	5,052	5,751	6,698
Inventory	3,785	4,377	4,962	5,702
Loans & advances	623	669	732	817
Total current assets	9,739	10,415	11,795	14,055
Investments	4	4	4	4
Gross fixed assets	16,751	17,651	19,002	20,677
Less: Depreciation	-5,440	-6,358	-7,302	-8,314
Add: Capital WIP	202	702	1,351	1,675
Net fixed assets	11,512	11,994	13,050	14,039
Non-current assets	115	115	115	115
Total assets	**21,370**	**22,528**	**24,964**	**28,213**
Current liabilities	4,182	4,205	4,637	5,224
Provisions	179	179	179	179
Total current liabilities	4,362	4,384	4,817	5,403
Non-current liabilities	2,837	2,437	2,037	1,737
Total liabilities	7,199	6,821	6,854	7,140
Paid-up capital	159	159	159	159
Reserves & surplus	13,351	14,892	17,310	20,290
Shareholders' equity	13,510	15,051	17,469	20,449
Minority interest	661	656	641	623
Total equity & liabilities	**21,370**	**22,528**	**24,964**	**28,213**

Source: Company, PhillipCapital India Research Estimates

Cash Flow

Y/E Mar, Rs mn	FY18	FY19E	FY20E	FY21E
Pre-tax profit	3,553	3,584	4,461	5,538
Depreciation	885	918	944	1,012
Chg in working capital	-1,009	-1,161	-914	-1,186
Total tax paid	-1,275	-1,290	-1,606	-1,994
Other operating activities	229	28	-4	-60
Cash flow from operating activities	**2,383**	**2,079**	**2,881**	**3,310**
Capital expenditure	-1,527	-1,400	-2,000	-2,000
Other investing activities	159	103	125	143
Cash flow from investing activities	**-1,368**	**-1,297**	**-1,875**	**-1,857**
Free cash flow	856	679	881	1,310
Equity raised/(repaid)	12	0	0	0
Debt raised/(repaid)	81	-400	-400	-300
Dividend (incl. tax)	-475	-724	-452	-582
Other financing activities	-338	-165	-121	-83
Cash flow from financing activities	**-720**	**-1,289**	**-973**	**-965**
Net chg in cash	295	-507	33	487

Valuation Ratios

	FY18	FY19E	FY20E	FY21E
Per Share data				
EPS (INR)	14.3	13.9	17.5	21.8
Growth, %	(6.5)	(2.7)	26.2	24.4
Book NAV/share (INR)	85.0	94.7	109.9	128.6
CEPS (INR)	20.3	20.2	24.0	28.8
CFPS (INR)	15.0	13.1	18.1	20.8
DPS (INR)	1.8	1.8	2.4	3.0
Return ratios				
Return on assets (%)	11.7%	10.9%	12.3%	13.5%
Return on equity (%)	18.5%	16.1%	17.6%	18.8%
Return on capital employed (%)	15.5%	14.2%	15.9%	17.3%
Turnover ratios				
Asset turnover (x)	1.7	1.8	1.8	1.8
Sales/Total assets (x)	1.3	1.4	1.4	1.4
Sales/Net FA (x)	2.4	2.6	2.9	3.2
Working capital/Sales (x)	0.2	0.2	0.2	0.2
Fixed capital/Sales (x)	0.4	0.4	0.4	0.4
Receivable days	60.7	62.0	63.0	64.0
Inventory days	51.0	53.7	54.3	54.5
Payable days	56.3	51.6	50.8	49.9
Working capital days	55.3	64.1	66.6	68.6
Liquidity ratios				
Current ratio (x)	2.2	2.4	2.4	2.6
Quick ratio (x)	1.4	1.4	1.4	1.5
Interest cover (x)	15.3	21.8	36.7	66.1
Dividend cover (x)	8.3	8.1	7.6	7.4
Total debt/Equity (%)	0.1	0.1	0.1	0.0
Net debt/Equity (%)	0.1	0.1	0.0	(0.0)
Valuation				
PER (x)	39.9	40.6	32.5	26.2
Price/Book (x)	6.9	6.2	5.3	4.6
Yield (%)	0.3%	0.3%	0.4%	0.5%
EV/Net sales (x)	3.5	3.2	2.8	2.5
EV/EBITDA (x)	20.8	21.0	17.5	14.4
EV/EBIT (x)	25.8	26.3	21.2	17.1

PhillipCapital

Somany Ceramics (SOMC IN)

Learning from past mistakes

INDIA | BUILDING MATERIALS | Initiating Coverage

25 March 2019

PAST	
Internal • SAP implementation • Receivable management • Inventory push • Disruption in gas supply during routine maintenance	**External** • Diminishing volume growth • Price war • Kerala Flood & Truckers strike in July
PRESENT	
Internal • Improving receivable cycle (105 days in FY18 to 95 days in 2QFY19) • C.70% of dealers are back to a 60-day cycle	**External** • Gradual increase in volume growth • Morbi growth cooling down. Price war halted. Capacity expansion on a back foot. • Softening gas prices
FUTURE	
Internal • Receivable days reverting to normal (management expects 65 days in FY20). • Better product mix helping margin expansion	**External** • Increase in volume growth driven by government, commercial, private builders

Getting its act together: In FY18, to gain volume share, SOMC sacrificed its working capital. Receivable days increased to 104 in FY18 from 63 days in FY16. Its margins were impacted by external factors such as lower volume growth, competitive pricing, Kerala floods (25% of sales), and rise in fuel prices. Based on our interaction with channel partners, we expect that c.70% of the network has reverted to a 60-day receivable cycle. Management expects to pull back its receivables to 65 days in FY20. This should address one of investors' major concerns that led to a sharp de-rating in the past 12 months in an otherwise strong franchise.

Continuous branding and channel expansion will lead to strong brand recall: Its long-term strategy is to invest on advertisement and increase its touch points. Currently, SOMC spends c.3.5% of sales on A&P vs. 1.6% in FY14 and has plans to increase it further to c.4.0% in FY20. It has also increased its touch points by adding c.170 dealers and operates with a total of 1,903 dealers network (as per its website); largest network in the industry next to Kajaria. SOMC plans to add 1,000 franchises over the next three years. These initiatives coupled with a pickup in commercial real estate (SOMC has a higher presence in B2B segment vs. KJE), government housing initiatives, re-building of Kerala and improvement of project execution in residential real estate should help it to achieve 9%/10% volume growth in FY20/21. Additionally, its first plant in its south India JV (3.5msm; GVT) is expected to be operational by April 2019, which will aid volumes.

Improvement in product mix should help recoup margins: SOMC is focussing on improving its product mix with value-added (premium) products in all the three tiles segments. It is also launching new variants in bath fittings. Improving product mix and revision to mean of OPM will lead to a 190bps improvement in margins over the next two years; decline in gas prices is a tailwind. Management expects EBITDA margins to revert to 10% in FY20; we expect this to happen in FY21.

Initiate coverage with a BUY rating and TP Rs 529: SOMC is expanding and strengthening its distribution network while working on improving its cash-flow cycle (which had deteriorated in FY17-18). Simultaneously, its new launches in tiles and bath fittings will help improve its realisations. We expect a revenue/EBITDA/PAT CAGR of 12%/25%/40% over FY19-21. It has traditionally traded at discount to KJE, but the valuation gap has increased to 38% currently. We expect this discount will narrow with improvement in profitability, working capital, and cash flows. We initiate coverage with a BUY rating and a target of Rs 529, based on 24x FY21 PE. Key risks: Inability to improve it working capital cycle and volatility in gas prices.

BUY

CMP RS 386

TARGET RS 529 (+37%)

COMPANY DATA

O/S SHARES (MN) :	42
MARKET CAP (RSBN) :	16
MARKET CAP (USDBN) :	0.2
52 - WK HI/LO (RS) :	720 / 271
LIQUIDITY 3M (USDMN) :	0.3
PAR VALUE (RS) :	2

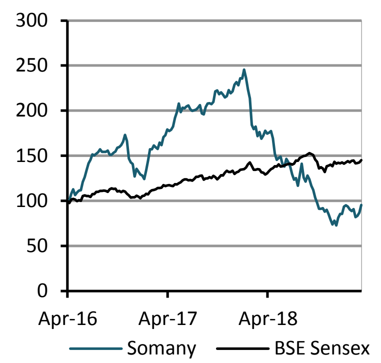
SHARE HOLDING PATTERN, %

	Dec 18	Sep 18	Jun 18
PROMOTERS :	51.5	51.5	51.5
FII / NRI :	4.2	4.7	5.0
FI / MF :	21.5	20.7	20.1
NON PRO :	8.7	7.6	7.9
PUBLIC & OTHERS :	14.0	15.5	15.5

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	21.9	30.1	-40.9
REL TO BSE	18.1	25.2	-51.6

PRICE VS. SENSEX



Source: Phillip Capital India Research

KEY FINANCIALS

Rs mn	FY19E	FY20E	FY21E
Net Sales	17,879	19,904	22,431
EBIDTA	1,410	1,743	2,190
Net Profit	432	667	956
EPS, Rs	10.2	15.7	22.5
PER, x	36.3	25.1	17.5
EV/EBIDTA, x	15.1	12.1	9.3
P/BV, x	2.6	2.4	2.1
ROE, %	7.2	9.5	12.0

Source: PhillipCapital India Research Est.

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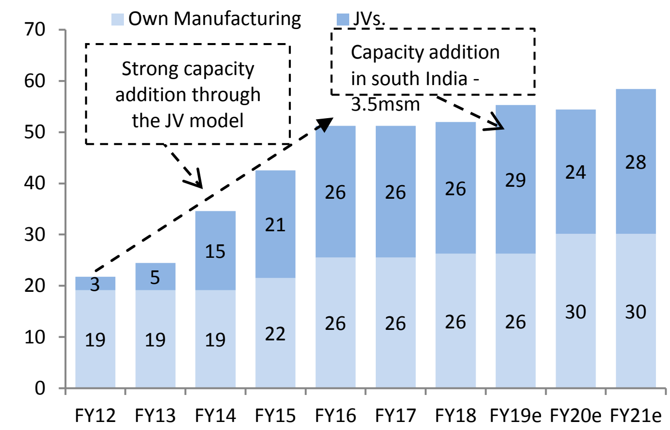
Capacity expansion and footing in the south market

SOMC has continuously expanded its capacity through an asset-light model (JV) from 2013 to 2018, adding 22.54 msm. It currently has a capacity of 61 msm (Own 26.28msm, JV 25.71, outsourced 9 + sanitary). It is expanding its presence to the south India market through a JV in Andhra Pradesh, which is expected to be operational by March 2019 with a capacity of 3.5mn in GVT. This JV will also help reduce logistic cost. We expect this plant to add Rs 3.5-4.0msm in FY20/21.

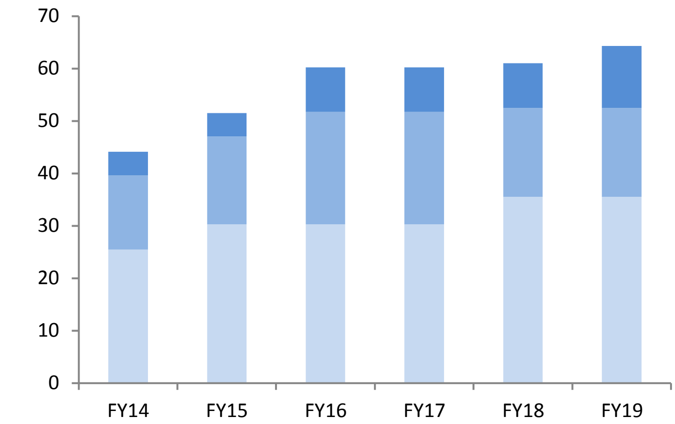
SOMC's installed capacity

Particulars	Capacity msm
Own (Haryana, Gujarat)	26.2msm
JVs (Morbi)	24.25msm
Sanitary ware –JV	1.15 mn pcs
Bath Fitting – JV	0.65 mn pcs

Capacity breakup – Own manufacturing/JV



GVT capacity has increased by 21% over the last five years

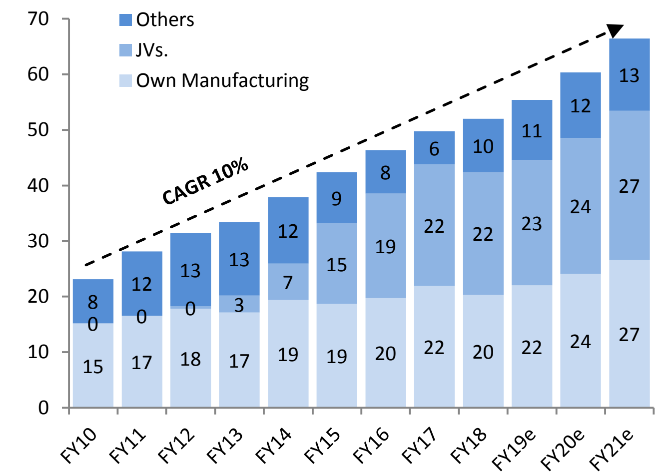


Source: Company, PhillipCapital India Research

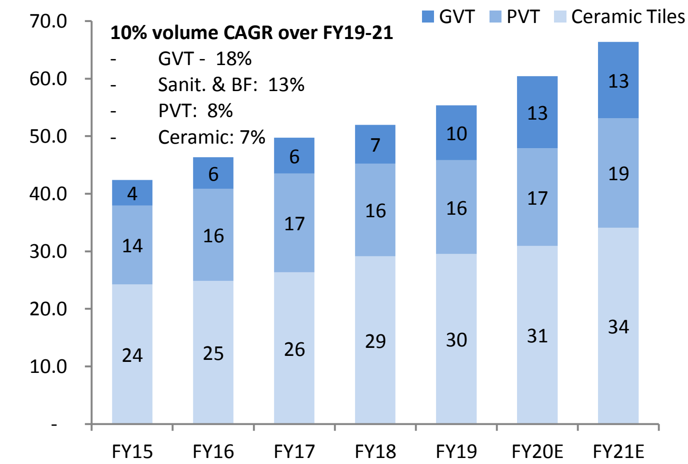
Better internal/external dynamics = growth

Strengthening existing network, adding more touch points, improving product mix, new capacity in south India, brand-strengthening program, and improving business dynamics will result in a volume growth of 9%/10% in FY20/21. Management expects double-digit volume growth over the next 2-3 years.

Volume breakup: Own manufacturing/JV

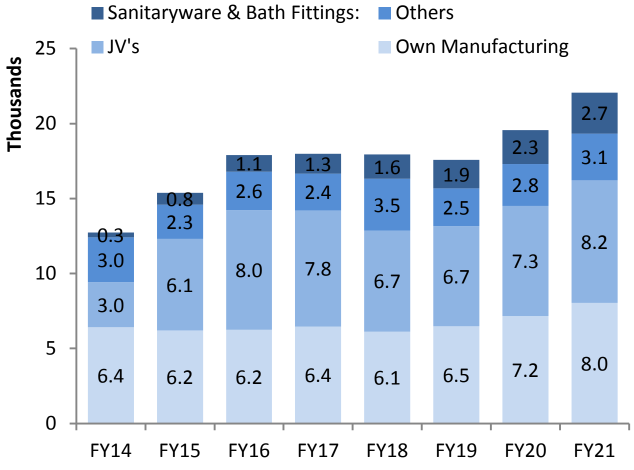


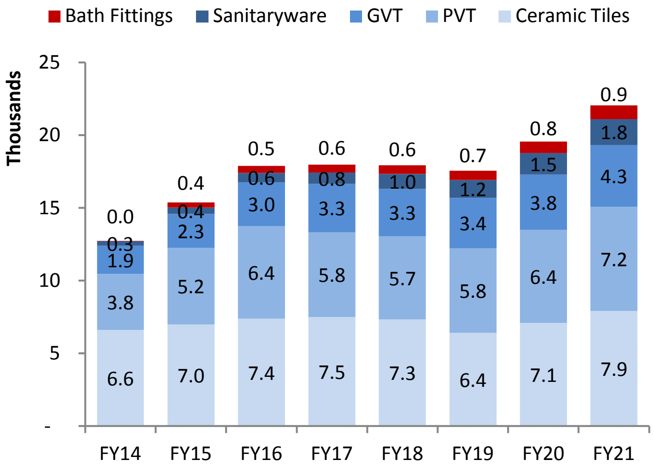
Volume breakup: Ceramic/GVT/PVT/bath fittings



Source: Company, PhillipCapital India Research

We expect revenue CAGR of 12% over next two years driven by product mix and geographical expansion



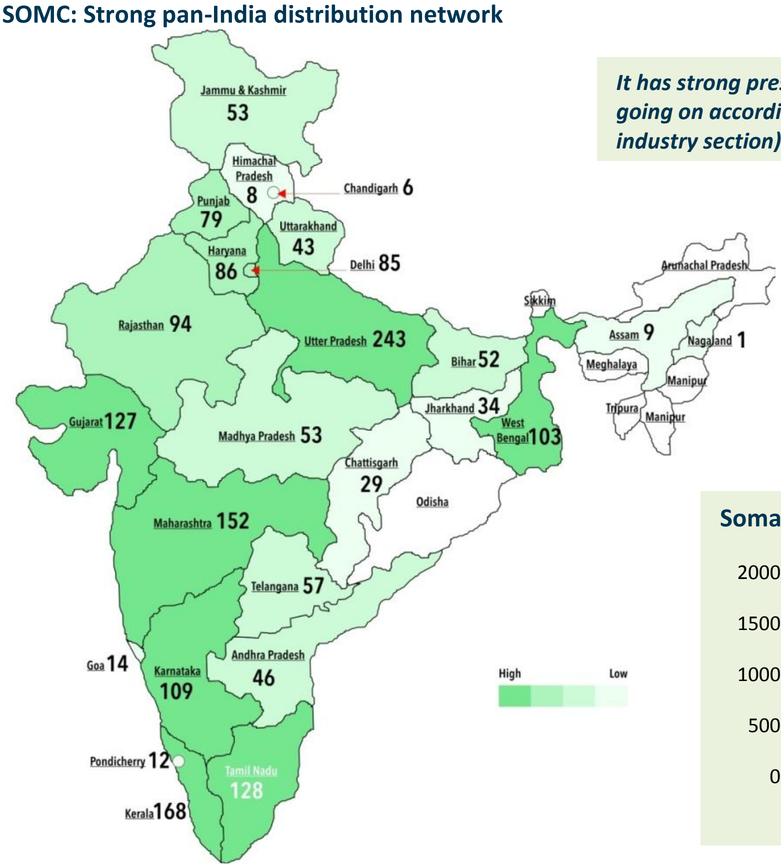


Source: Company, PhillipCapital India Research

Strengthening network, adding more touch points, branding

According to our channel check, SOMC is strengthening its existing network, which was negatively affected by the aggressive channel push (higher discounts, incentives, and higher credit). Now it is focussing on strengthening its channel by lowering inventory, reducing its collection cycle, faster settlements, and improving pricing and product offering. According to SOMC's website, it currently operates with a total network of 1,903 dealers one of the largest networks in the industry. In FY18, it has a network of 1,736. It plans to add 1,000 franchises over the next three years and aims to have a showroom in every town with a population of 100,000.

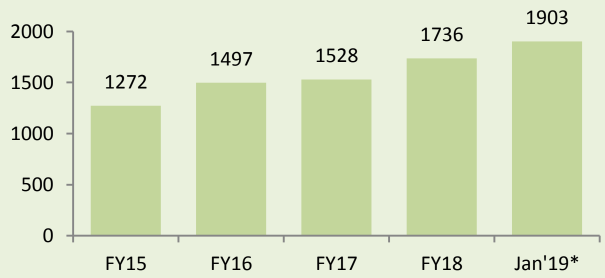
SOMC: Strong pan-India distribution network



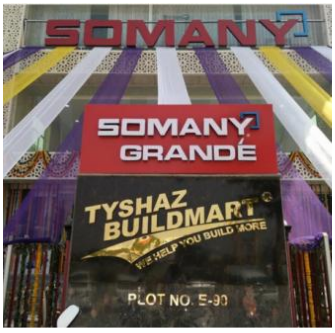
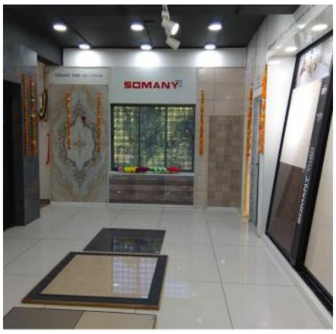
It has strong presence in states where major construction activity is going on according to CMEI capex data. (Refer page no. 11 - 12 the industry section)

It also has strong presence in exports market (Europe, Middle East, Asia, and Africa). Currently exports are c.4% of its revenue

Somany's dealer network



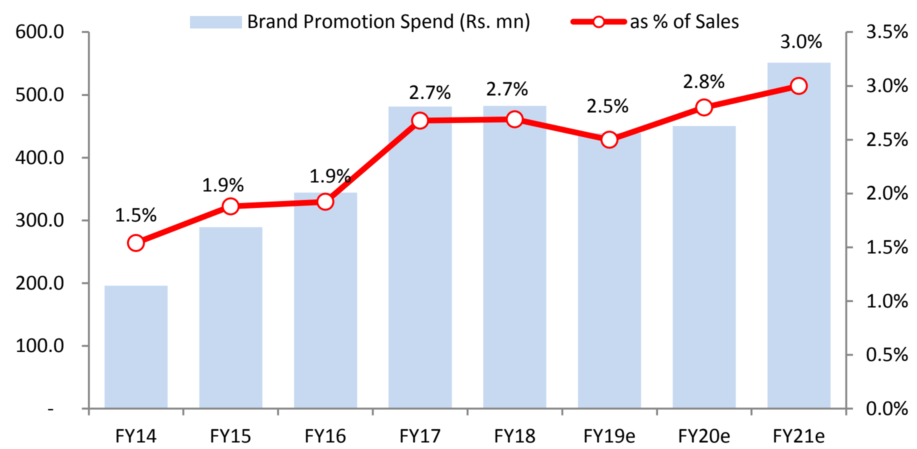
Recent channel additions

			
Date: October 2018 City: Noida	Date: December2018 City: Jammu	Date: December 2018, City – Sumerpur Raj.	Date:Jan'19 City: Bhubaneswar

Focus on branding continues

Branding helps SOMC to create a strong recall, makes its products move faster off the shelves, and facilitates higher realisations. In line with its long-term strategy, it is continuously spending on advertisement. Even in a tough environment, SOMC did not reduce its marketing expenses – its margin fell from 10.8% in FY17 to 7.9% in FY18. In FY18, it spent c.3.5% of its net sales on advertising vs. 1.6% in FY14 and has plans to increase this to c.4.0% in FY20. SOMC is becoming aggressive in TV ads, airport branding, and exclusive stores.

We expect brand promotion to increase to c.3% by FY21



Source: Company, PhillipCapital India Research

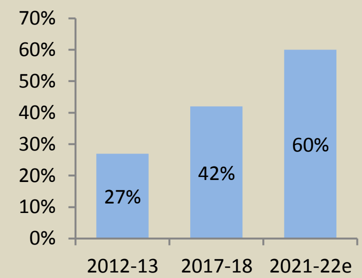
Updated its website

TVC:

Premiumisation to drive profits

To improve realisations and profitability, it is working on improving its product offering and increasing the share of premium products and higher-profit products. In FY18, it launched its collection series in the name of Durages Tesoro, Durages Artistain (GVT), Glosstra Plus, and Ultra Gloss Technology. We expect tiles and bath fittings realisation growth at 11%/12% in FY20/21.

Revenue from highly profitable tiles is continuously increasing; to result in better margins



Source: Annual Report, Phillip Capital Estimates

Somany – new launches

2018	2017	2016
Ceramic polished range in ceramic tiles	Gvt for wall (40x80inch)	Slip shield tiles
Duragres Tesoro	French Collection	
Duragres Artistain		
Glosstra Plus		

Source: Company, PhillipCapital India Research

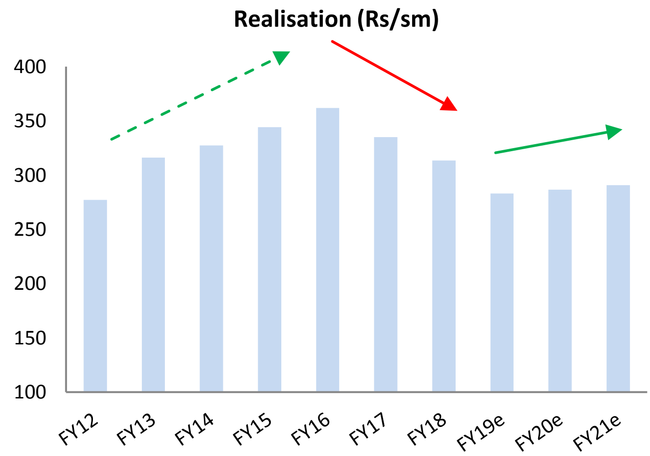
Some recent new launches by SOMC

Launched in December 2019
French Collection – Premium bathware fittings

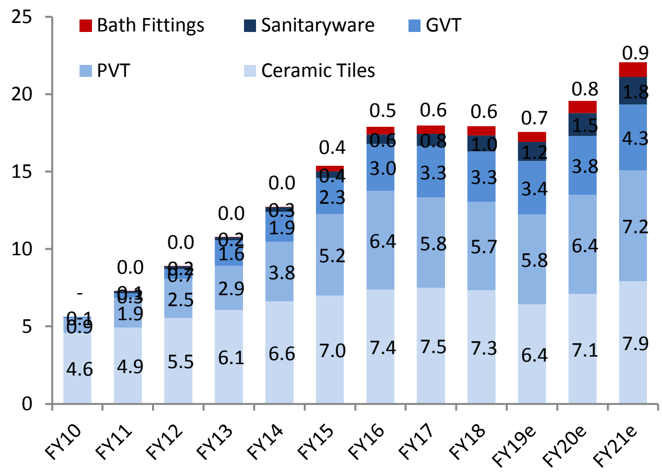
Duragres Max Tiles collection

Somany Duragres range
premium marble finish tiles

Realisations trend



Revenue break up: Ceramic/GVT/PVT/bath fittings



Source: Company, PhillipCapital India Research

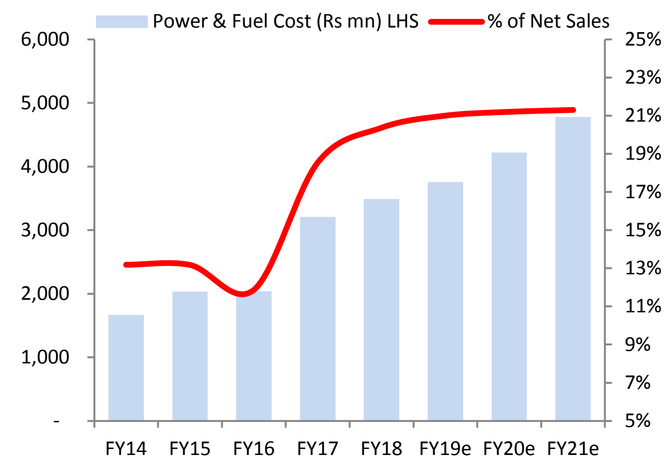
FY12-16: *Product mix, price hike and supportive gas prices resulted in realization CAGR of 7%.*

FY16-18: *Demand-supply mismatch and price war resulted in realizations falling from Rs 371 to 347 between FY15 and FY19.*

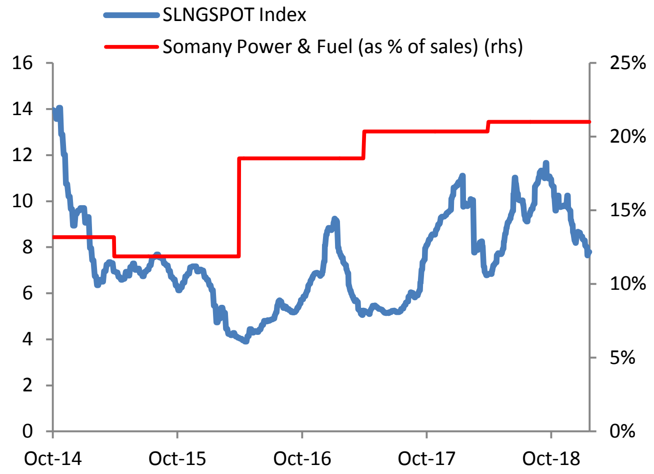
FY19-21E: *Stable price environment + Improving in product mix + favorable gas prices will result in improvement in realization and margins.*

Gas price plays an important role in margins

Power and fuel cost trend



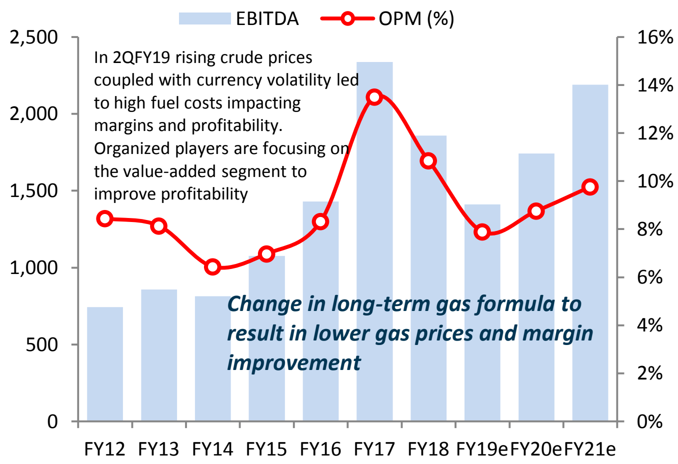
Gas price vs. SOMC fuel cost



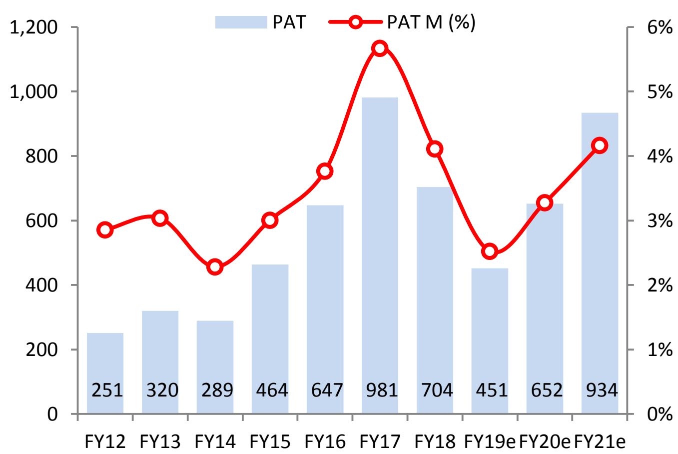
Source: Company, PhillipCapital India Research

- The company has installed coal-firing technology in the north India plant (capex of Rs 30mn), leading to savings of Rs 4-5mn per month in fuel costs.
- In FY18, gas prices in north India, where 30% of SOMC's capacity is, increased by 28%, which affected margins. Over the last 6-7 months, these prices have increased at Morbi as well, resulting in the industry hiking prices in December 2018 by 3-5%.
- Softness in gas prices over the last 2-3 months will help SOMC improve margins. If gas price go below Rs 32 in Gujarat, then coal becomes expensive so Morbi players have started using gas vs. coal earlier.
- We have not taken any impact of gas prices in our margin improvement estimates.

EBITDA and OPM trend



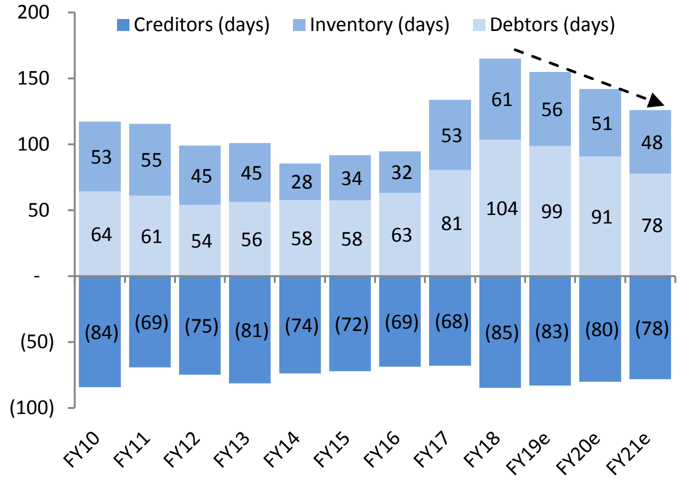
PAT, PAT margin



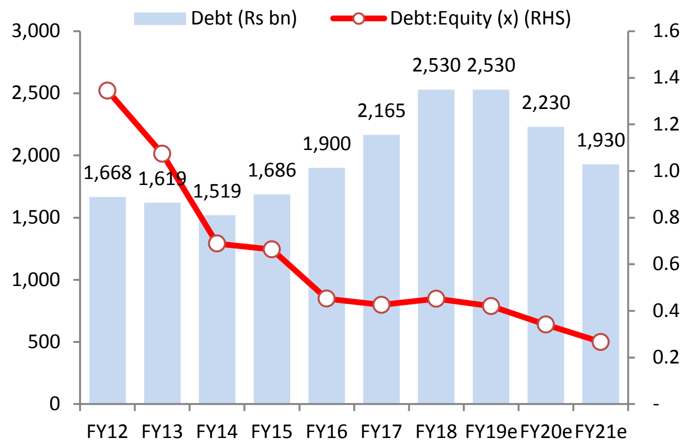
Source: Company, PhillipCapital India Research

Improving balance-sheet and cash flows

Working capital days to fall to 48 by FY21



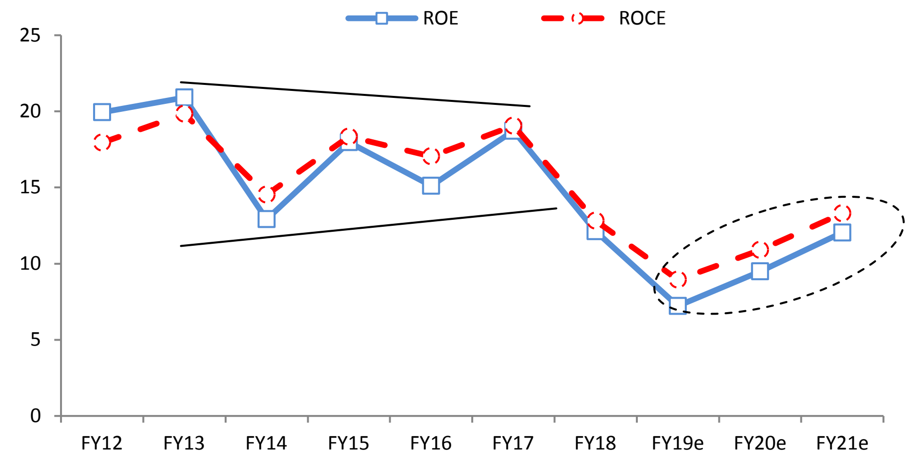
Debt and debt/equity (standalone)



Source: Company, PhillipCapital India Research

- In FY18, to gain market share and increase its volumes, SOMC pushed the channel and went into a working capital trap where its receivable days increased to 104 days in FY18 from 63 days in FY16.
- To improve its working capital cycle, it is now taking firm decisions about strictly streamlining its receivable days and aims to get its cycle back to 62 days.
- According to our channel check, c.70% of the channel partners have returned to 60-day receivable days. Management expects receivable days to come down to 65 days by FY20; we expect these at 62/48 in FY20/21.

ROCE and ROE improvement of 472bps and 427bps over the next two years



Source: Company, PhillipCapital India Research

Higher asset sweating + improving working capital cycle + improving profitability = Improvement in return ratios

- Over FY12-17, SOMC's return ratios were 15-20%
- Over FY17-19, a sharp reduction in profitability and increase in the working-capital cycle resulted in 10%/12% decline in ROCE and ROE
- We expect return ratios to start improving from FY20 mainly because of better profitability (due to product mix, improved realisation, and strengthened channel)
- Reduction in the working capital cycle will result in cash-flow generation of Rs 394mn in FY21, which will help company to reduce its debt

Dupont Table

DuPont analysis	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E	FY22E	FY23E
Tax Burden (x)	0.7	0.7	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Interest Burden (x)	0.6	0.7	0.7	0.8	0.8	0.8	0.7	0.6	0.7	0.8	0.8	0.8
EBIT Margin (%)	6.5	6.4	4.9	5.7	7.2	12.7	9.5	6.4	7.2	8.2	8.6	8.7
Asset Turnover (x)	2.8	3.1	3.0	3.2	2.4	1.5	1.4	1.4	1.5	1.6	1.7	1.7
Leverage Multiplier (x)	2.5	2.2	1.9	1.9	1.7	2.1	2.1	2.0	1.9	1.8	1.5	1.5
RoE (%)	19.7	20.7	11.8	17.8	15.2	20.9	13.3	7.2	9.5	12.1	12.2	12.1

Source: Company, PhillipCapital India Research

Risk-reward – sensitivity analysis

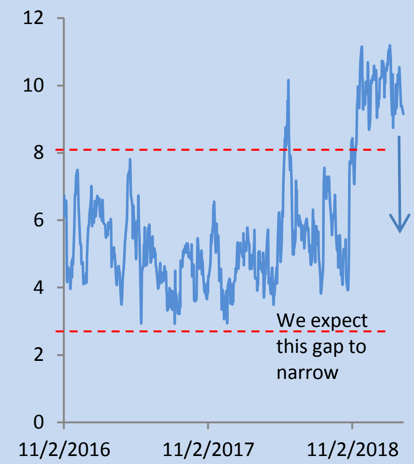
	Current / Base		Worst case		Best Case	
	FY20	FY21	FY20	FY21	FY20	FY21
Key Estimates						
Volume Growth	8%	7%	9%	10%	10%	12%
Realisation Growth	-3%	-1%	1%	2%	1%	2%
NWC days	72	72	62	48	55	41
Outcome:						
Sales	18,949	20,230	19,904	22,431	20,096	23,106
% yoy	6.0%	6.8%	11.3%	12.7%	12.4%	15.0%
EBITDA	1,564	1,874	1,743	2,190	2,010	2,487
EBITDA margin	8.3%	9.3%	8.8%	9.8%	10.0%	10.8%
Rec PAT	533	723	652	934	831	1,133
EPS	13	17	15	22	20	27
ROE	8.2%	10.2%	9.5%	12.0%	12.5%	14.9%
ROIC	12.1%	13.9%	12.9%	15.3%	15.5%	20.9%
PE	20		24		24	
TP	341		529		641	
Upside	-12%		37%		66%	

Source: Company, PhillipCapital India Research

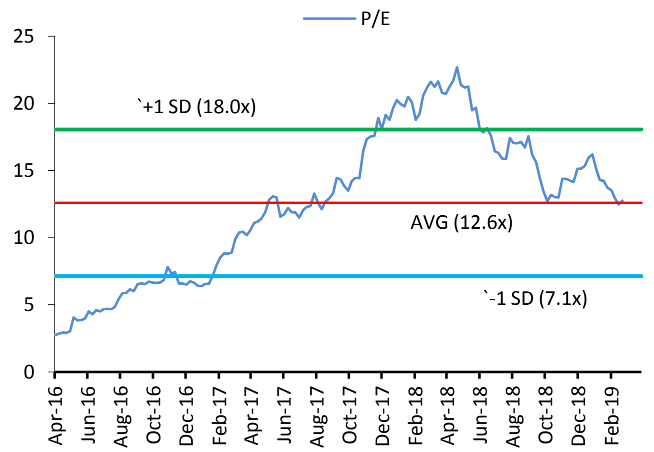
Outlook and valuations

- Somany's stock has fallen 60% from its peak while Kajaria has fallen by 30%
- Somany has seen a higher fall mainly because of underperformance vs. Kajaria mainly due to SAP implementation and an elongated working capital cycle over FY15-18, which hit margins and profitability.
- SOMC has now streamlined its receivables cycle back to 62 days.
- We expect SOMC to see double-digit volume growth driven by commercial construction, government initiative in construction and real estate, re-building of Kerala and improvement of project execution in real estate market. Additionally, its south India JV (3.5msm - GVT), which is expected to operational by March 2019, will boost volume further. We expect volume growth of 9%/10% in FY20/FY21. Product mix and operating leverage will result in 190 bps improvement in margin over FY20-FY21. We expect earning CAGR of 40% over the next two years.
- With improvement in working capital requirement and not much capex ahead, we expect an FCF of Rs 394mn over the next two years, which will help SOMC to reduce its debt to 4.5bn by FY21 from 5.3bn in FY18.
- Strong earnings growth and improving balance sheet and cash flows will help improve return ratios.
- At CMP, it trades at FY20/21 PE of 22/16 (38% discount to Kajaria on FY21).
- We initiate coverage on SOMC with a BUY rating and a target of Rs 529 (24 FY21 PE).

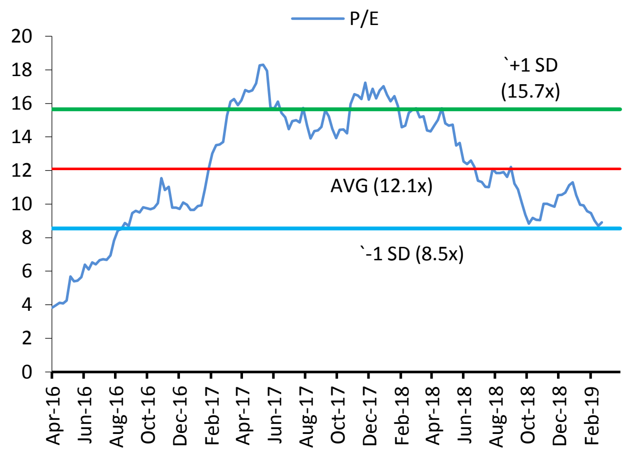
Valuation Gap between KJE and SOMC



PE Chart: Standard deviation one-year forward

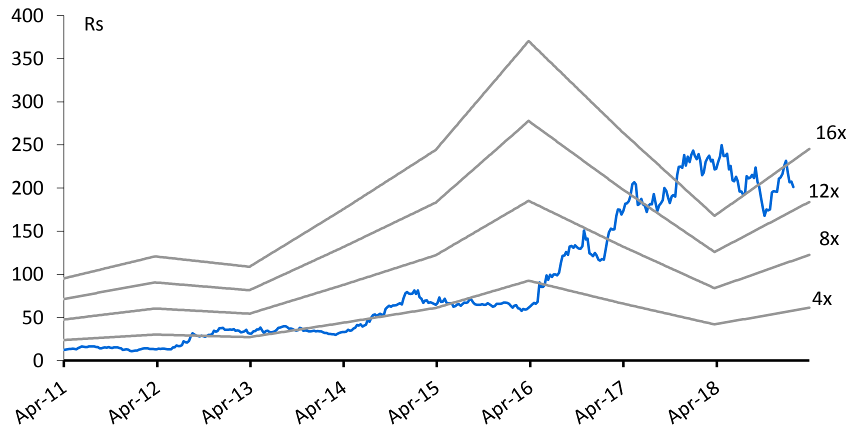


Two-year forward



Source: Company, PhillipCapital India Research

One-year forward PE band chart



Source: Company, PhillipCapital India Research

Consensus vs. PC estimates

Estimates Change	PC Estimates			Bloomberg Consensus			Consensus Vs Actual		
(Rs bn)	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Sales	17,879	19,904	22,431	17,563	19,949	22,562	-1.8%	0.2%	0.6%
EBITDA	1,410	1,743	2,190	1,473	1,965	2,377	4.4%	12.8%	8.6%
EBITDA margin (%)	7.9%	8.8%	9.8%	8.4%	9.9%	10.5%	50	109	77
Recurring PAT	451	652	934	448	764	1,005	**-0.7%**	**17.1%**	**7.6%**
EPS Recurring (Rs)	10.6	15.4	22.0	10.1	17.5	23.0	-5.3%	13.7%	4.6%

Source: Company, PhillipCapital India Research

Key takeaways from our channel check

- ✓ **Pricing:** Increased prices by 2-5% in 3QFY19 mostly in ceramic tiles.
- ✓ **Demand:** Project business is picking up, retail business is still recovering.
- ✓ **Working-capital cycle:** It has started aggressively focussing on improving the receivables cycle by giving higher cash discount (CD). It has sales closures twice a month now, vs. once earlier – this helps keep track of the collection cycle. If a channel partner wants a cash discount, it has to clear all old dues. All these steps have resulted in improving collection days to 70 days from 90 days. It expects these to fall to 50-60 days in next 4-5 months. Currently it has a collection policy of 45 days.
- ✓ **New launches:** Launched new faucets, large-format slabs.

Kerala visit update: SOMC has c.14% revenue share from Kerala

- ✓ Demand is picking up; 3QFY19 volumes were flat, expect growth in 4QFY19.
- ✓ It has also aggressively increased its touch points – added 6-7 channel partners in 3Q and will be adding 3-4 in 4QFY19.
- ✓ Incentive schemes (such as foreign trips) to reduce the collection cycle.
- ✓ North Kerala collection cycle has improved to 75 days from 90 days; PC expects it to come down to 60 days.

Increased cash discount slab resulting in improved collection cycle

Earlier		Now	
Payment Time Period	Cash Discount	Payment Time Period	Cash Discount
In 48 hr payment	3%	In 24hr	4%
7 days payment	2%	In 25 days	3%
		In 30 days	2%

Note: Cash discount is applicable only, if the channel partner has cleared old dues.

Financials

Income Statement

Y/E Mar, Rs mn	FY18	FY19E	FY20E	FY21E
Net sales	**17,127**	**17,879**	**19,904**	**22,431**
Growth, %	-1.0	4.4	11.3	12.7
Other income	181	150	170	170
Total income	17,308	18,029	20,074	22,601
Raw material expenses	-6,370	-6,835	-7,391	-8,098
Employee expenses	-2,175	-2,414	-2,703	-3,028
Other Operating expenses	-6,725	-7,220	-8,067	-9,116
EBITDA (Core)	**1,858**	**1,410**	**1,743**	**2,190**
Growth, %	(20.5)	(24.1)	23.5	25.7
Margin, %	10.8	7.9	8.8	9.8
Depreciation	-413	-440	-472	-515
EBIT	**1,445**	**971**	**1,271**	**1,675**
Growth, %	(28.6)	(32.8)	31.0	31.8
Margin, %	8.4	5.4	6.4	7.5
Interest paid	-399	-462	-445	-418
Other Non-Operating Income	181	150	170	170
Pre-tax profit	**1,227**	**659**	**996**	**1,427**
Tax provided	-393	-227	-329	-471
Profit after tax	**835**	**432**	**667**	**956**
Net Profit	**835**	**432**	**667**	**956**
Growth, %	(29.9)	(48.3)	54.6	43.2
Margin, %	4.9%	2.4%	3.4%	4.3%
Net Profit (adjusted)	**835**	**432**	**667**	**956**
Unadj. shares (m)	42	42	42	42
Wtd avg shares (m)	42	42	42	42

Balance Sheet

Y/E Mar, Rs mn	FY18	FY19E	FY20E	FY21E
Cash & bank	136	112	57	313
Debtors	5,037	4,906	5,020	4,847
Inventory	2,597	2,573	2,585	2,712
Loans & advances	2,294	2,344	2,394	2,444
Total current assets	**10,064**	**9,935**	**10,055**	**10,315**
Investments	**1,142**	**1,192**	**1,242**	**1,292**
Gross fixed assets	7,097	7,997	8,897	10,097
Less: Depreciation	615	1,055	1,527	2,042
Add: Capital WIP	279	279	279	279
Net fixed assets	**6,761**	**7,221**	**7,650**	**8,335**
Total assets	**17,967**	**18,348**	**18,946**	**19,942**
Current liabilities	3,589	3,797	4,036	4,386
Provisions	1,692	1,692	1,692	1,692
Total current liabilities	5,281	5,489	5,727	6,077
Non-current liabilities	6,879	6,607	6,346	6,103
Total liabilities	12,160	12,095	12,074	12,181
Paid-up capital	85	85	85	85
Reserves & surplus	5,722	6,168	6,788	7,676
Shareholders' equity	5,807	6,253	6,873	7,761
Total equity & liabilities	**17,967**	**18,348**	**18,947**	**19,942**

Source: Company, PhillipCapital India Research Estimates

Cash Flow

Y/E Mar, Rs mn	FY18	FY19E	FY20E	FY21E
Pre-tax profit	1,183	689	996	1,427
Depreciation	413	440	472	515
Chg in working capital	-482	313	63	345
Total tax paid	-327	-227	-329	-471
Other operating activities	50	0	0	0
Cash flow from operating activities	**1,108**	**1,496**	**1,477**	**2,064**
Capital expenditure	-1,299	-900	-900	-1,200
Chg in investments	59	-50	-50	-50
Other investing activities	136	197	195	206
Cash flow from investing activities	**-1,104**	**-753**	**-755**	**-1,044**
Free cash flow	-590	135	132	446
Debt raised/(repaid)	422	-300	-300	-300
Dividend (incl. tax)	-533	-467	-478	-464
Other financing activities	15	0	0	0
Cash flow from financing activities	**-96**	**-767**	**-778**	**-764**
Net chg in cash	-91	-23	-56	256

Valuation Ratios

	FY18	FY19E	FY20E	FY21E
Per Share data				
EPS (INR)	19.7	10.2	15.7	22.5
Growth, %	(28.2)	(35.9)	44.6	43.2
Book NAV/share (INR)	2.8	2.6	2.4	2.1
CEPS (INR)	26.3	21.0	26.5	34.2
CFPS (INR)	26.1	35.3	34.8	48.7
DPS (INR)	-	0.1	0.6	0.9
Return ratios				
Return on assets (%)	13.2	5.7	7.9	10.1
Return on equity (%)	12.1	7.2	9.5	12.0
Return on capital employed (%)	12.8	8.9	10.9	13.3
Turnover ratios				
Asset turnover (x)	1.0	1.0	1.1	1.1
Sales/Total assets (x)	1.4	1.4	1.5	1.6
Sales/Net FA (x)	2.7	2.6	2.7	2.8
Working capital/Sales (x)	0.3	0.2	0.2	0.2
Fixed capital/Sales (x)	0.5	0.5	0.4	0.4
Receivable days	84.6	83.0	80.0	78.0
Inventory days	61.2	56.2	51.2	48.2
Payable days	103.8	98.8	90.8	77.8
Working capital days	80.4	72.0	62.0	48.0
Liquidity ratios				
Current ratio (x)	1.9	1.8	1.8	1.7
Quick ratio (x)	1.4	1.3	1.3	1.3
Interest cover (x)	4.0	3.0	3.6	4.5
Dividend cover (x)	n.a.	522.7	118.0	121.0
Total debt/Equity (%)	0.9	0.8	0.7	0.6
Net debt/Equity (%)	0.9	0.8	0.7	0.5
Valuation				
PER (x)	23.2	36.3	25.1	17.5
Price/Book (x)	2.8	2.6	2.4	2.1
Dividend Yield (%)	0%	0%	0%	0%
EV/Net sales (x)	1.3	1.2	1.1	0.9
EV/EBITDA (x)	11.6	15.1	12.1	9.3
EV/EBIT (x)	13	19	15	11

Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	>= +15%	Target price is equal to or more than 15% of current market price
NEUTRAL	-15% > to < +15%	Target price is less than +15% but more than -15%
SELL	<= -15%	Target price is less than or equal to -15%.

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