Institutional Equity Research

Kajaria Ceramics

Consumer Durable | India

Initiating Coverage | September 14, 2017

CMP* (Rs)	710
Upside/ (Downside) (%)	21
Bloomberg Ticker	KJC IN
Market Cap. (Rs bn)	113
Free Float (%)	53
Shares O/S (mn)	159

BUY

Target Price: Rs861

Growing from Strength to Strength

Market leadership in tiles, accelerated macro initiatives, implementation of GST, improved operating leverage and strong new product funnel would be the key growth drivers for Kajaria Ceramics, going forward. We expect the Company to post 13.9% revenue and 19.3% earnings CAGR through FY17-19E. **We initiate coverage on the stock with BUY recommendation and Target Price of Rs861, which implies an upside of 21% from the current levels.**

GST – A Potential Game Changer

Currently, 60% of domestic tiles volumes are controlled by the unorganised players, out of which a large portion has been able to compete mainly due to avoiding payment of taxes. Complete audit trail of transactions under the GST regime would make it extremely difficult for these players to avoid taxes any more. It is estimated that 10-20% of the unorganised players would be out of business in due course. This should benefit large organised players like Kajaria and fasten the process of conversion of the industry from unorganised to organised.

Huge Headroom for Further Growth

In spite of being the market leader, Kajaria just has a market share of 10% in overall and 20% in organised tiles industry providing huge upside potential for growth. Increasing distribution reach, enhanced range of products, focussed advertising spends and faster conversion to organised industry would propel growth for Kajaria in coming years, in our view.

Multiple Macro Initiatives, Rising Urbanisation Augur Well

Several macro initiatives by the Central Government, which include projects such as Housing for All (60mn homes by 2022), Swachh Bharat Abhiyaan (60mn toilets by 2019), Smart City Mission (Phased development of 100 smart cities), implementation of RERA, interest subsidy on housing loans and Atal Mission for Rejuvenation & Urban transformation (AMRUT) would benefit the organised tiles industry in general and the market leader Kajaria Ceramics in particular.

Outlook & Valuation

We expect Kajaria to post consolidated revenues of Rs28.8bn and Rs33.1bn and net profit of Rs3bn and Rs3.6bn in FY18E and FY19E, respectively. Based on expected EPS of Rs22.6, the stock currently trades at reasonable P/E multiple of 31.5x FY19E earnings. Looking ahead, we expect Kajaria to command premium multiples in coming years on the back of market leadership, superior financial performance and strong new product funnel along with faster consolidation of organised industry under GST regime. **We initiate coverage on the stock with BUY recommendation and Target Price of Rs861, based on 34x Sep'19 EPS.**

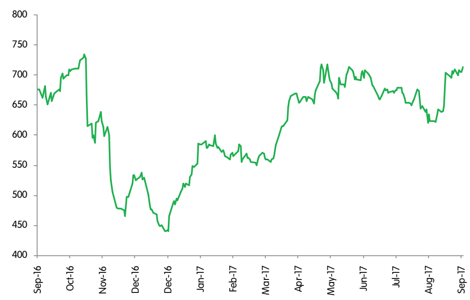
Key Financials (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
Sales	21,869	24,135	25,496	28,819	33,103
EBITDA	3,541	4,575	4,963	5,616	6,628
Net profit	1,814	2,313	2,521	2,960	3,587
EPS Rs)	11.1	14.6	15.9	18.6	22.6
DPS (Rs)	2.0	2.5	3.0	3.5	4.0
P/E (x)	64.2	48.8	44.6	38.1	31.5
P/B (x)	14.5	11.6	9.6	8.0	6.7
EV/EBITDA (x)	32.7	25.5	23.2	20.5	17.2
ROE (%)	30.7	29.9	26.5	25.9	26.1
Dividend yield (%)	0.3	0.4	0.4	0.5	0.6

Source: Company, RSec Research

Share price (%)	1 mth	3 mth	12 mth
Absolute performance	14.7	3.4	7.9
Relative to Nifty	10.7	(1.6)	(7.9)

Shareholding Pattern (%)	Mar'17	Jun'17
Promoter	47.4	47.4
Public	52.6	52.6

1 Year Stock Price Performance



*Note: * CMP as on Sept 13, 2017*

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Investment Rationale

Increasing Urbanisation & Multiple Macro Initiatives to Drive Demand Growth of Domestic Tiles Industry

The Central Government has undertaken several initiatives, which would drive the growth of ceramic tiles industry in coming years. Some of the macro-programmes include:

- **Housing for All:** The Government mulls building 60mn homes by 2022 with 40mn homes in rural and 20mn homes in urban areas.
- **Swachh Bharat Abhiyaan:** 60mn toilets are proposed to be built across 4,041 towns by 2019.
- **Smart City Mission:** First phase of development of 20 cities is underway and outlay to the tune of Rs508bn is earmarked for developing 100 cities.
- Atal Mission for Rejuvenation & Urban Transformation (AMRUT): 500 cities will be developed under this project.
- **Pradhan Mantri Awas Yojana:** Under this project, the Central Government provides assistance to local urban bodies for rehabilitation of existing slum dwellers, credit linked subsidy, affordable housing partnership and subsidy for beneficiary led individual house construction/enhancement.

Several other factors would also propel growth of the ceramic industry, which include:

- **Housing Deficit by 2022:** As per the white paper on Indian housing industry published by consultancy firm RNCOS, Demand supply mismatch, rising income levels and increasing migration to urban centers could lead to overall housing shortage of 34mn units by 2022.
- **RERA Implementation:** Implementation of Real Estate (Regulation and Development Act) 2016 is expected to facilitate timely completion of real estate projects.
- **Implementation of pay commission recommendations:** Implementation of 7th Pay Commission's recommendations would result in 23.6% overall increase in salaries, allowances and pension, which would increase the disposable incomes in the hands of the consumers.
- **GST Roll-out:** Rollout of Goods & Services Tax would enable the organised players to compete effectively with their unorganised counterparts. As the latter would now come under the tax net, it would result in lower price differential between the two. Currently, over half of industry demand is being catered to by the unorganised players.
- **Increased Affordability of Tiles:** Increasing operating efficiencies, higher economies of scale, technological advances have resulted in sharp fall in prices of ceramic tiles over the past few years. It also led to increased affordability of tiles, which has propelled growth of ceramics, Polished vitrified tiles (PVT) and Glazed vitrified tiles (GVT).
- **Anti Dumping Duty on Chinese Ceramic Tiles:** Imposition of anti dumping duty on Chinese ceramic tiles for five years with effect from Feb'2017 has resulted in increased price competitiveness of domestic players enabling them to fend off competition from the Chinese players.

Lower per-capita Consumption Provides Strong Headroom for Further Growth

Although India is the third largest producer and consumer of tiles globally, accounting for ~7% of total production and consumption, per capita consumption of tiles remains abysmally low. India's per capita consumption at 0.6sqm is very low compared to 3.6sqm for China and 4sqm for Brazil.

Exhibit 1: Trend in Indian Ties Consumption

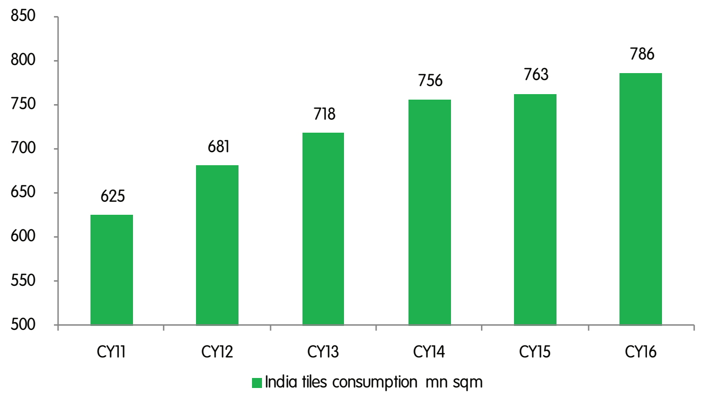
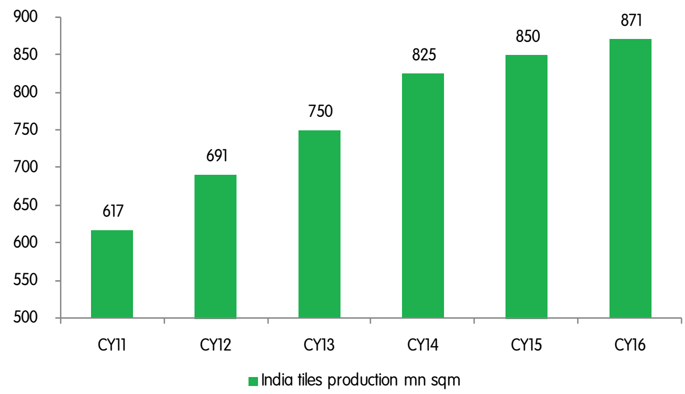
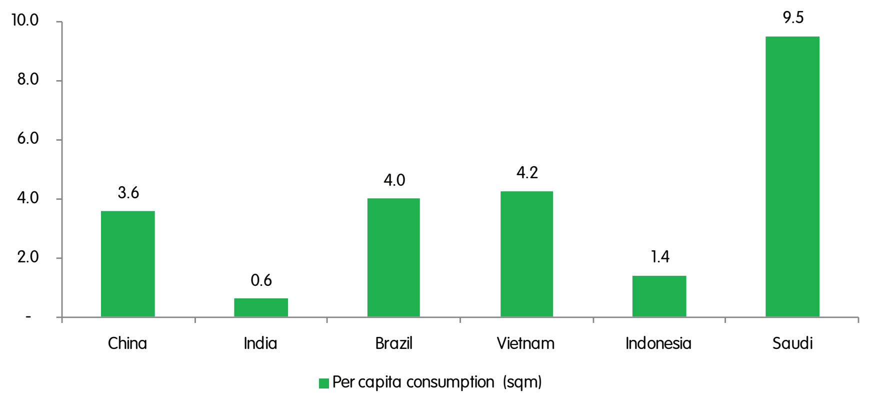


Exhibit 2: Trend in Indian Tiles Production



Source: Company, RSec Research

Exhibit 3: Per Capita Consumption of tiles in key countries

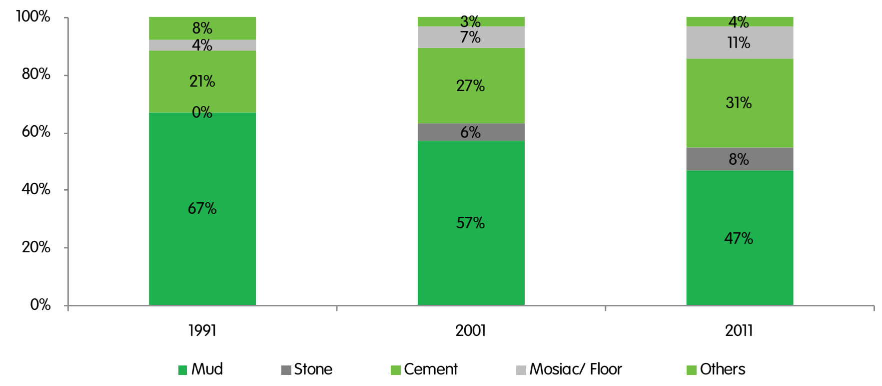


Source: Company, RSec Research

Data from Census 2011 clearly depict huge potential for the domestic tiles industry in coming years. As per the Census, *Mud is used as floor material in 47% of households, while cement is used in 31% households. Mosaic/floor tiles account for just 11% of total households. However, the share of Mud floorings has fallen from 67% in 1991 to 47% in 2011, while share of tiles has increased from 4% to 11% in the same period.*

With higher income levels, increasing urbanisation, rising aspirations, better awareness and easier availability, we expect the share of Mud and Cement flooring to come down substantially in coming years with the increased usage of floor tiles.

Exhibit 4: Different types of material for Flooring



Source: Census 2011, RSec Research

The consumption pattern is dramatically different in rural and urban areas. While in rural areas, 63% of HH's use Mud as flooring material, which accounts for just 12% in urban areas. Cement is used as flooring material in 24% of rural HH's, while it accounts for 46% in urban areas. **Despite a steady rise in share of mosaic/floor tiles from 21% to 26% in urban areas, there exists huge underlying opportunity to further enhance the penetration levels, in our view.**

Exhibit 5: Types of material for flooring-Rural

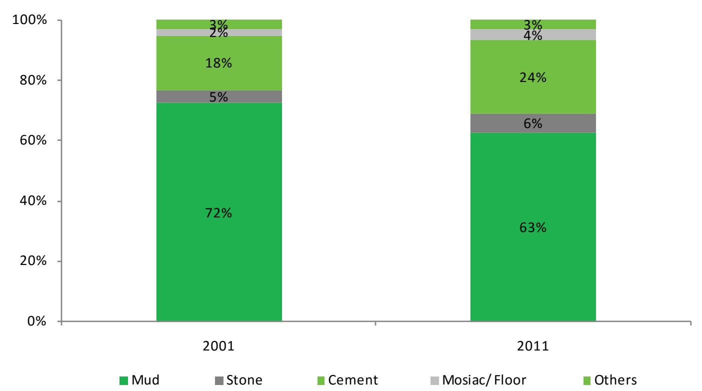
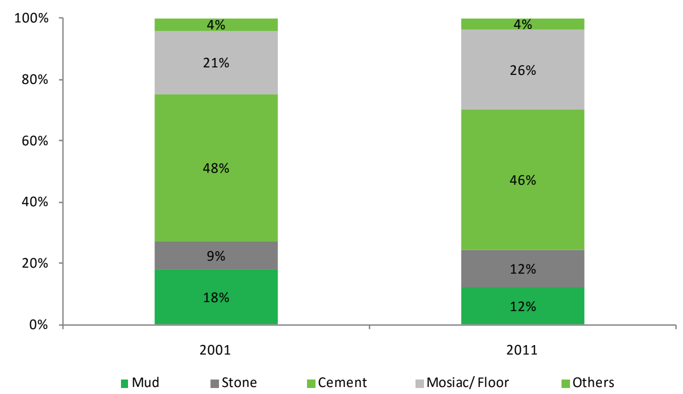


Exhibit 6: Types of material for flooring-Rural



Source: Census 2011, RSec Research

In volume terms, the overall industry size stands at 786msm. In value terms, it accounts to ~Rs260bn. While ceramic tiles account for 56% of total volumes, polished vitrified tiles contribute 34% and glazed vitrified tiles account for the remaining 10%. In value terms, ceramic tiles and polished vitrified tiles both contribute 42% each to industry, while GVT accounts for the remaining 16%.

Exhibit 7: Bifurcation of tiles industry in volume terms

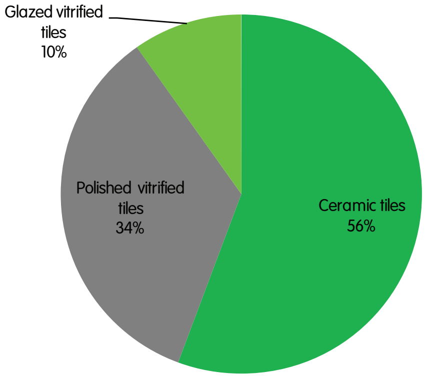
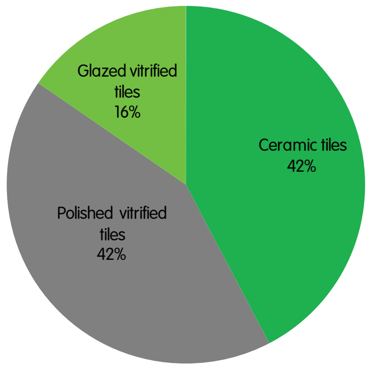
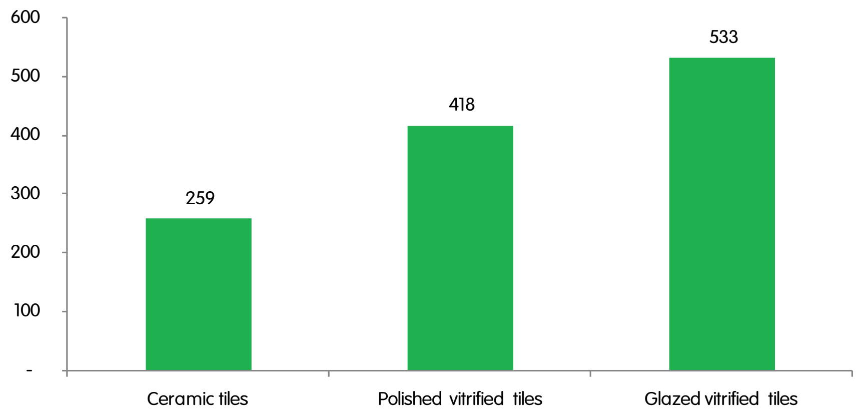


Exhibit 8: Bifurcation of tiles industry in value terms



Source: Company, RSec Research

Exhibit 9: Average Realisation Rs per sqm



Source: Company, RSec Research

Exhibit 10: Types of Tiles & Their Key Characteristics

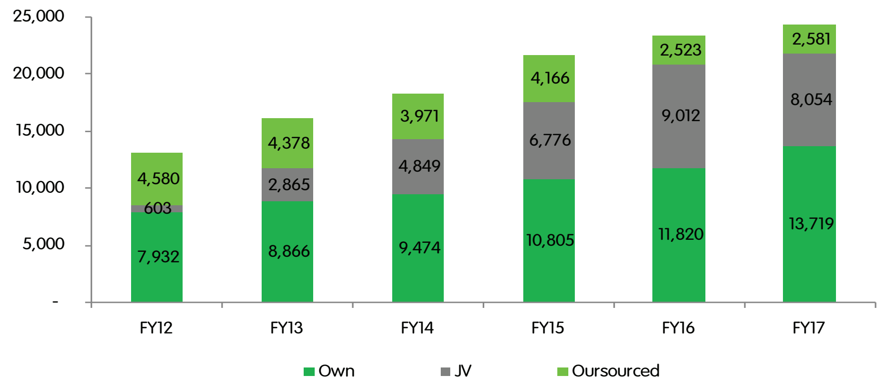
Types of Tiles	Structure & Key Features
Ceramic tiles	Made of clay
Vitrified	Mixture of clay, silica, quartz and feldspar
Soluble salt vitrified	Upgraded ceramic tiles with higher kiln temperature providing better durability
Double charged vitrified	Fed through a press that prints pattern with double layer of pigment 3-4mm more than normal tiles
Full body	Vitrified tiles that have pigment in entire body of the tile
Glazed vitrified	Vitrified tile with glaze on the surface
Digital print tiles	Tiles, designs of which are printed on the surface. Created by photos on the computer platform and then applied to tiles using Ink-jets

Source: Company, RSec Research

Increasing Thrust on JV Business Model

Over the past few years, Kajaria has focussed on increasing its capacities through the Joint Venture (JV) model instead of expanding Greenfield operations. Increasing share of JV tiles has resulted in falling share of expensive outsourced tiles too, thereby benefiting the Company.

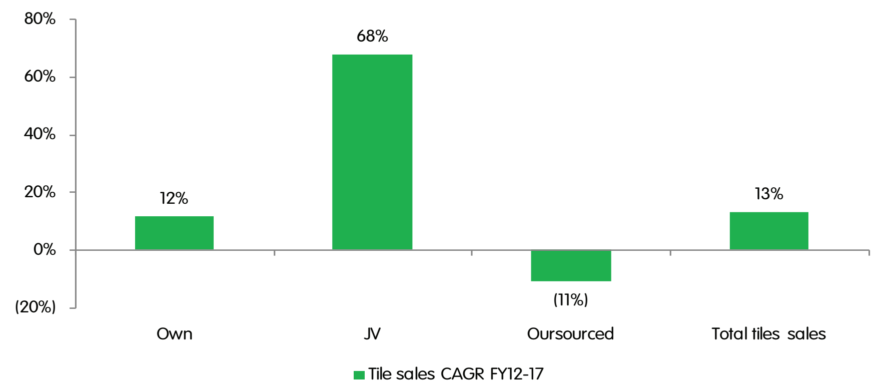
Exhibit 11: Bifurcation of revenues by different sources



Source: Company, RSec Research

While Kajaria's overall tiles sales have witnessed 13% CAGR through FY12-17, in-house tile sales grew by 12%, while outsourced tiles sales fell by 11% p.a. Share of the tiles from several JVs witnessed a phenomenal 68% CAGR through FY12-17. The share of tiles sold through the JVs has increased to 33% in FY17 from 5% in FY12.

Exhibit 12: Tile sales CAGR FY12-17



Source: Company, RSec Research

There are several advantages of JV model, which benefit both large organised players like Kajaria and the contract manufacturers. That include:

- Lower capital requirement
- Faster access to new capacities through lower lead times
- Quicker payback
- Better control over production
- Freedom to focus on key aspects of designs, branding and marketing
- Asset light business model

- Improvement in debt equity levels
- Allows each partner to focus on its respective strengths
- Underwriting of production by large players giving growth visibility to contract manufacturers

Kajaria's total manufacturing capacity stood at 68.9msm in March'17, out of which its in-house capacity stood at 41.5msm while the rest 27.4msm comes from several JV partners. It has three in-house manufacturing facilities located in Rajasthan (26.6 msm in Galipur and 6.5 msm in Malutana) and Uttar Pradesh (8.4 msm in Sikandrabad). Out of its 5 JVs, 4 are based at Morbi (the ceramic hub of India) and 1 in Vijayawada (AP). However, post divestment of Taurus JV, combined capacity now stands at 63.9msm.

Exhibit 13: Total Capacity as per regions (March'17)

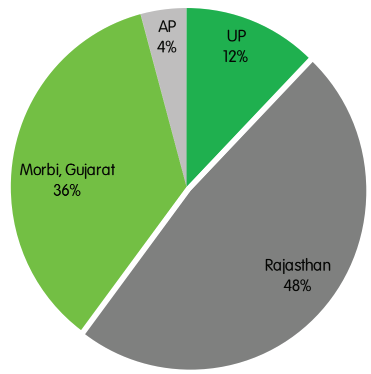
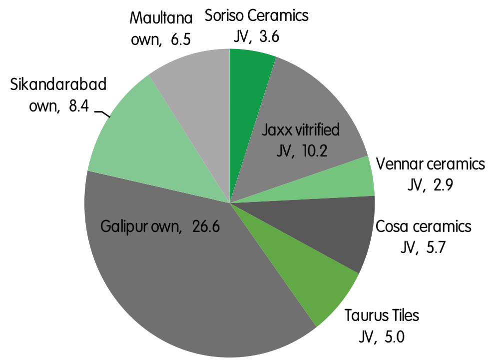


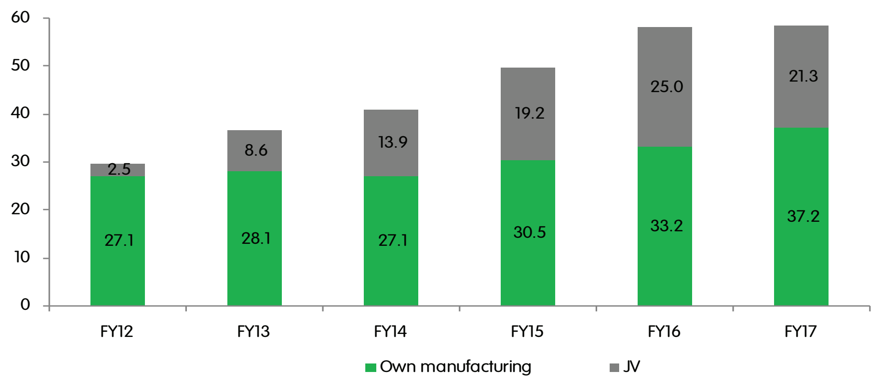
Exhibit 14: Total capacity as per manufacturing facilities (March'17)



Source: Company, RSec Research

While Kajaria's overall tiles production witnessed 15% CAGR from 29.6mn sqm in FY12 to 58.5mn sqm in FY17, its in-house production witnessed just 6% CAGR in the same period, while production from JVs delivered a staggering 54% CAGR through FY12-17.

Exhibit 15: Bifurcation between own & JV production



Source: Company, RSec Research

Following is the list of the JVs entered into by Kajaria over the past 6 years, which helped the Company to increase its overall production at a rapid pace.

Exhibit 16: JV Partners – A Bird's Eye View as in FY17

Joint Venture	Capacity (msm)	Stake (%)	Month of Acquisition	FY17 Sales (Rs mn)
Soriso Ceramics JV	3.6	51	Feb-11	757
Jaxx vitrified JV	10.2	61	Feb-12	3,114
Vennar ceramics JV	2.9	51	Apr-12	784
Cosa ceramics JV	5.7	51	Oct-12	1,816
Taurus Tiles JV	5.0	51	Jun-15	567

Source: Company, RSec Research

Kajaria has recently decided to divest its entire stake in Taurus Tiles JV for Rs38mn in wake of poor demand scenario. In Jun'15, the Company entered in to a 51% JV with Floera Ceramics which is setting up a GVT facility in AP with a total capacity of 5mn sqm. The JV has already acquired land for the project and expects it to commission by Sept'18. Subsequently, the Management has acquired additional 19% stake in the JV to take its overall stake to 70%.

Exhibit 17: Different Types of Tiles & Segment-wise Production Break-up (FY17)

Particulars	Ceramics	PV	GVT	Total
Number of facilities	3	5	2	10
Capacities	25.4	27.4	16.1	68.9
Sales Rs bn	11	10	7	28
Price range per sqm	225-650	400-1000	550-1100	
Revenue contribution (%)	37	33	25	

Source: Company, RSec Research

Foray into Sanitary Ware & Bath Ware Fittings Segment: Kajaria forayed into sanitary ware and bath ware fittings segment in FY15 under the brand *Kerovit*. The Company commissioned 0.7mn pieces sanitary ware capacity in Morbi (Gujarat) in Aug14. Its 1mn pieces faucet facility too has been commissioned in Jul'15. Kajaria's revenues from this business rose to Rs1.1bn in FY17 from Rs743mn in FY16. The company intends to add another sanitaryware capacity of 1.2mn pieces through brownfield expansion.

The Management expects increased traction in this business on the back of Kajaria's brand strength. Notably, ~60% of sanitary ware dealers are its existing tiles dealers. The Company is focussing on enhancing its dealer network, improving brand awareness and expanding the product range.

Exhibit 18: Revenues from sanitaryware and faucet businesses

Source: Company, RSec Research

Looking ahead, we expect the contribution of this business to Kajaria's overall revenues to increase from 3% in FY16 to 6% in FY19E, even then the tiles segment will remain as the dominant segment for years to come.

GST – A Potential Game Changer

Currently, over half of the ceramic tile industry is controlled by the unorganised players in value terms, while in volume terms their share is even higher at 60%. Several unorganised players have been able to compete aggressively with large organised peers due to avoidance of tax in pre-GST regime during which the organised players like Kajaria used to incur indirect tax of ~26-27% comprising of Excise, VAT and other local taxes.

Exhibit 19: Volume bifurcation of tiles industry

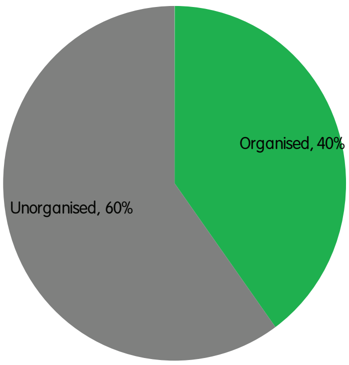
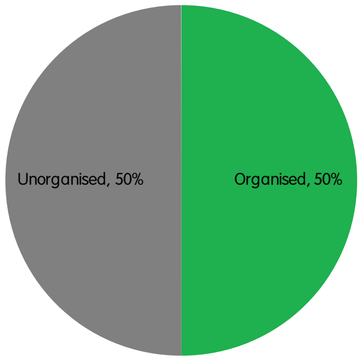


Exhibit 20: Value bifurcation of tiles industry



Source: Company, RSec Research

The Government has rolled-out Goods & Services tax (GST) with effect from July 01, 2017 with a GST rate of 28% for the Ceramic tiles industry. We believe that GST rate of 18% would have fasten the conversion of the industry from unorganised to organised, as the organised players would have passed on the benefit to the consumers reducing the price gap between the two. Nevertheless, increased transparency post GST rollout will make business difficult for the unorganised players for sure.

We expect GST roll-out would prove to be a game changer in this regard. Under GST, all players are required to account for all taxes paid in the value chain before goods arrive at their end, in the absence of which they will not be able to claim any input tax credit for the same. There are several checks and balances are in place, which will prevent slippage of tax revenues for the government making it even more difficult for the unorganised players to avoid taxes any more.

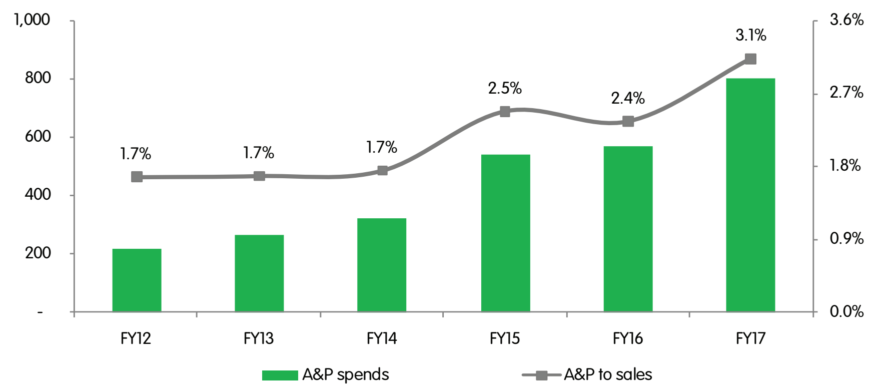
Our interactions with several companies suggest that 10-20% of unorganised players would be out of business under GST regime. Similarly, other players would move at a rapid pace to align with large their organised counterparts like Kajaria.Initial feedback suggests that non compliance and under-reporting of invoices has come down, though not at a rapid rate. Major impact is expected to be felt post introduction of E-Way bills without which any movement of goods is prohibited.

Due to the trade pipeline correction prior to rollout of GST, Kajaria reported subdued set of numbers in 1QFY18. We expect the situation to normalise over a period of time especially in 2HFY18. Due to concerns over input tax credit, the dealers were wary of keeping unsold inventory in the run-up to GST which resulted in substantial decline in primary sales from company to the dealers in June. However, we believe that the inventory levels will revert to pre-GST era and normalisation would be achieved by 2HFY18. Benefits from GST roll-out substantially outweigh the near term concerns, in our view.

Focussed Spends on Brand

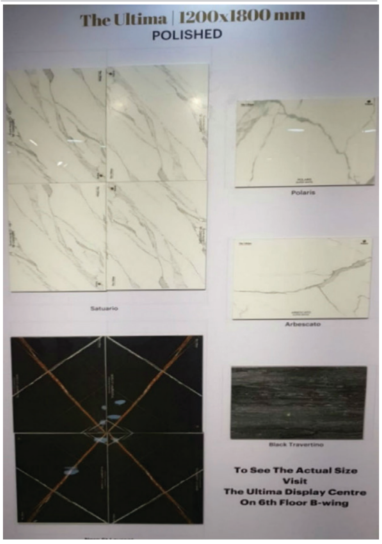
Over the past three years, Kajaria has been making large investments on the brand through higher A&P spends. Its average Advertising spends have increased at a CAGR of 22% through FY12-17 and account for ~3% of its revenues.

Exhibit 21: Increasing investment behind brands



Source: Company, RSec Research

Eternity-Ultima collection-I



Eternity-Ultima collection-II

Source: Company, RSec Research

The Company roped in actor Akshay Kumar as its brand ambassador in 2HFY17 and has introduced several print and advertising campaigns featuring the actor with strong thrust on nationalist tagline *'Desh Ki Mitti Se Bani Tile Se Desh Ko Banate Hain'.*

Continuous effort to strengthen its brands through increased investment is expected to benefit Kajaria in coming years, even more so in the context of GST implementation that could wipe out a large part of unorganised players, thereby benefiting the incumbents.

The Company has been able to create a strong brand recall amongst its consumers. In this endeavour, it has focussed on outdoor display campaigns at major airports i.e. Mumbai, New Delhi, Hyderabad and Bangalore among others to improve the brand perception in the psyche of the consumers. Kajaria is the only ceramic tile company in India that has been conferred with "Superbrand" title for eight consecutive years.

Some of the new launches include Signature Walls in PVT with sizes of 30x60cm and 40x80cm and double charge in 60x120cm, Sapphire for the first time in India, Stone finished vitrified tiles Stone Art in 60x60cm and new additions in Solitaire range. The company has also introduced The Ultima technical body slabs with digital printing.

Instead of focussing on volatile and low-margin institutional segment, Kajaria has consistently stressed on growing its retail customer base and has built its brand in that direction. While the industry as a whole derives half of its revenues from institutional segment, Kajaria has focussed aggressively on growing the retail base, which accounts for ~70% of its revenues, while institutional segment contributes the rest.

Exhibit 22: Ceramic Industry customer profile

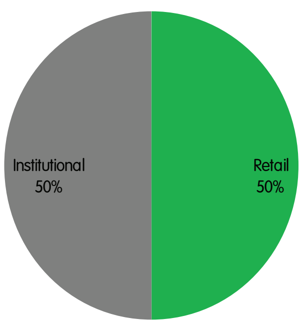
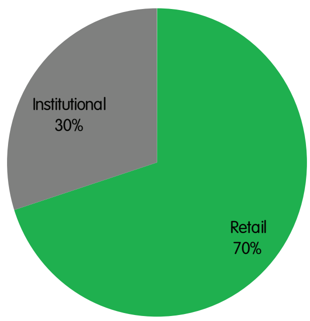


Exhibit 23: Kajaria ceramics customer profile



Source: Company, RSec Research

Steady Increase in Distribution Footprint

Kajaria has a strong distribution network, which comprises of 1,100 dealers spread across several outlets i.e. Galaxy, Star, World, Prima Plus, Prima and Studio.

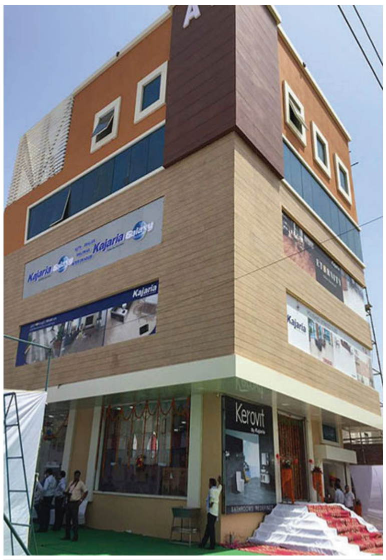
Exhibit 24: Store Formats

Types of Stores	Speciality
Kajaria Galaxy	Standalone store of around 4,000sqft. That has dedicated verticals for all types of tiles
Prima Plus	Exclusive focus on ceramic wall and floor tiles (41 showrooms)
Kajaria Prima	Dealer store which provides dedicated space for display of ceramic wall and floor tiles without keeping any other ceramic tile brand (161 showrooms)
Kajaria World	Standalone store of around 2,000sqft. With dedicated space to high end tiles
Kajaria Studio	Shop in shop concept where dealer provides dedicated space only for Kajaria's PVT and GVT
Kajaria	Multi brand dealers

Source: Company, RSec Research

Enhancing brand visibility

Large size Galaxy showroom in Rajasthan



Source: Company, RSec Research

Apart from the showrooms, Kajaria has 25 large company owned display centers across the country, which innovatively showcase its extensive selection of tiles, sanitaryware and bath fitting products and help consumers make informed choices.

Unlike other players, Kajaria has been slow and steady in expanding its distribution footprint. It has been continuously focussing on introducing new products and increase the throughput from the existing stores.

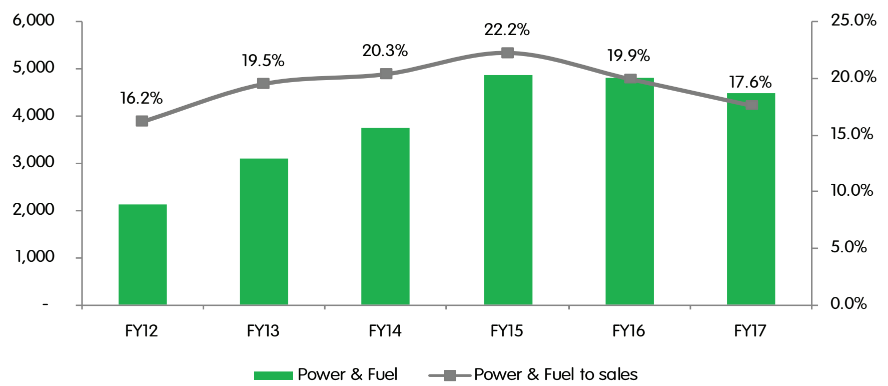
The Company has worked towards avoiding cannibalisation in the dealers' network and enable them to generate a healthy return on investment.

It has encouraged dealers to open larger size outlets thereby providing visual merchandising with a view to increasing their throughput. It also takes dealers to international exhibitions to keep them abreast with latest trends. Kajaria also undertakes continuous training of dealer staff and masons with respect to the product virtues and characteristics. The company also guides trade on periodically renewing product display and refurbishing the look of the store.

Lower Power & Fuel Cost – Key to Margin Sustenance

Power & Fuel cost is one of the most vital cost parameter for tiles industry, the average cost of which accounts for ~18-20% of Kajaria's sales. The Company procures gas through Petronet LNG, which sources supply through Qatar-based RasGas. Falling natural gas prices in the past couple of years (down 460bps from 22.2% in FY15 to 17.6% in FY17) has aided improvement in EBITDA margins for the company.

Exhibit 25: Lower natural gas prices have aided margin expansion



Source: Company, RSec Research

The new contract entered into in January 2016 would expire in 2028 and price for the buyer is based on market dynamics based on crude price linked formula. The earlier contract (Fixed price take or pay) was renegotiated by the Government of India in light of decline in global LNG prices.

With respect to domestic natural gas prices, the central government has revised the pricing guideliness. It considers the weighted average price of four benchmark rates that include Henry Hub (USA), Alberts (Canada), NBP (UK) and Russian Gas. The domestic prices are now benchmarked to prices of gas in the prior year and kicks in with a lag of one quarter and is reset every six months.

Exhibit 26: Exchange rate between USD/INR

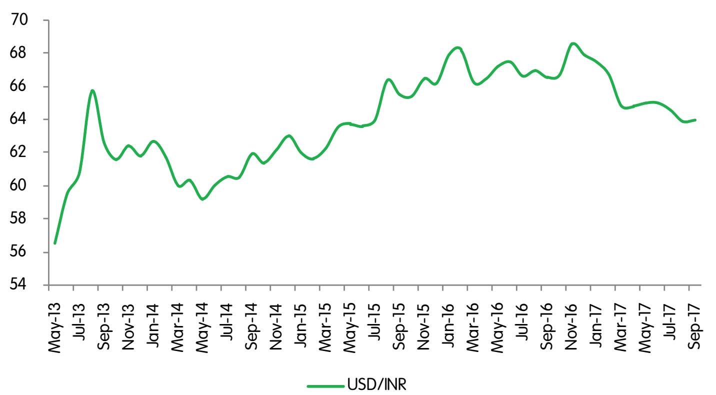
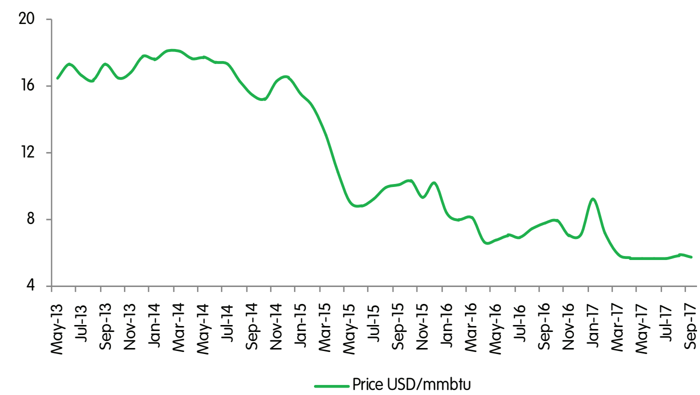
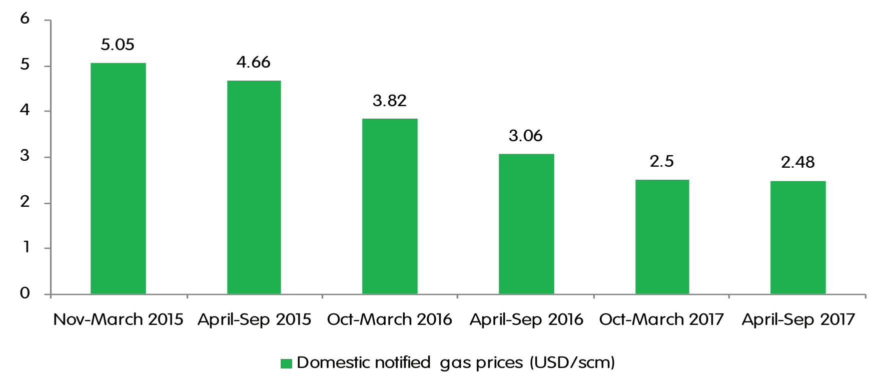


Exhibit 27: Natural gas prices USD/mmbtu



Source: Company, RSec Research

Exhibit 28: Domestic notified gas prices (USD/scm)



Source: Company, RSec Research

Superior Financial Performance over its Peers

Kajaria has been at the forefront of driving consumption of tiles over the past decade. Compared to average revenue CAGR of 7% reported by Top-7 players through FY12-17, Kajaria has grown at 2x the industry growth rate of 14% in the same period. Similarly, Kajaria's EBITDA has witnessed 18% CAGR in the same period, which is 3x the growth of Top-7 players.

Exhibit 29: Revenue CAGR FY12-17

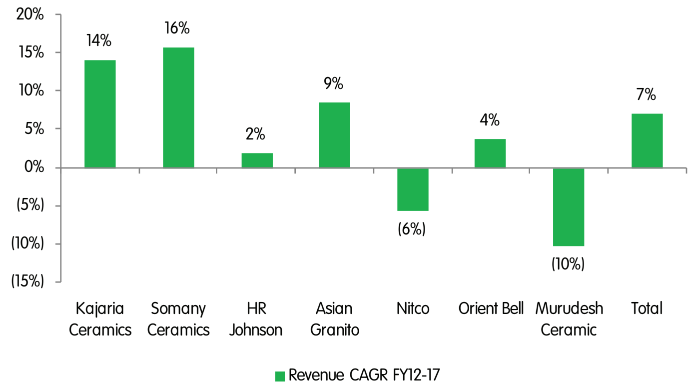
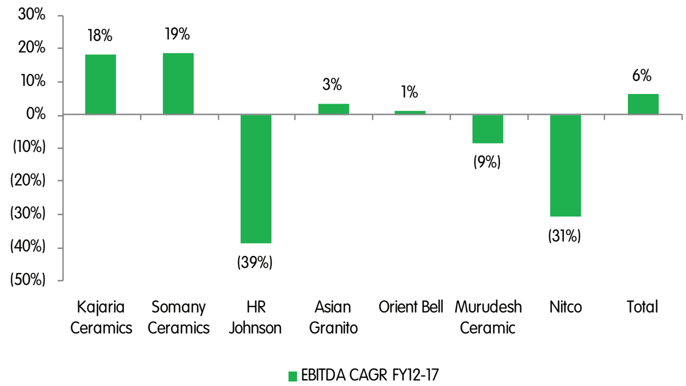


Exhibit 30: EBITDA CAGR FY12-17



Source: Company, RSec Research

Kajaria's overall revenue share among the Top-7 players has increased to 30% in FY17 from 22% in FY12. Similarly, its EBITDA share has increased to 56% in FY17 from 33% in FY12. Strong brands, control over cost, increasing distribution footprint, premiumisation and increasing share of JV have enabled Kajaria to report standalone operating profit margins of 17% in FY17 compared to 7% by the industry as a whole.

Exhibit 31: Revenue share FY12

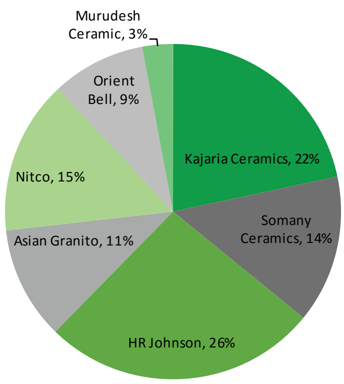
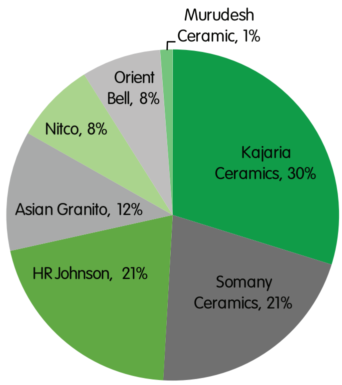


Exhibit 32: Revenue share FY17



Source: Company, RSec Research

CMP* (Rs)	710
Upside/ (Downside) (%)	21
Bloomberg Ticker	KJC IN

BUY

Target Price: Rs861

Exhibit 33: EBITDA share FY12

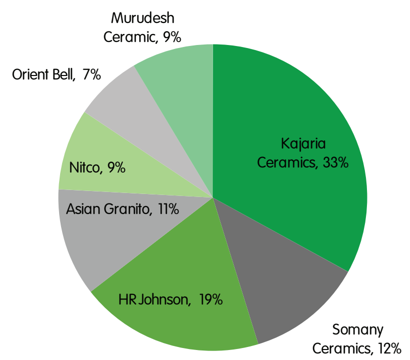
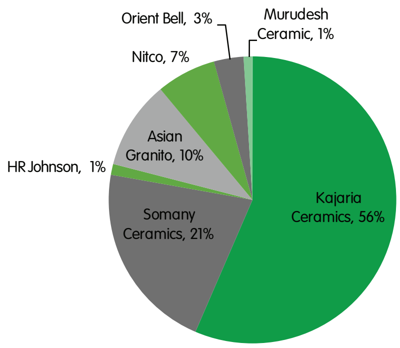


Exhibit 34: EBITDA share FY17



Source: Company, RSec Research

Kajaria has a market share of ~10% in domestic ceramic tiles industry, including the unorganised players. We believe that over the years, the Company has laid strong foundation for growth by focusing on creating a strong brand, new product introduction, increasing distribution footprint and higher share of JVs. In our view, Kajaria is well-placed to capitalise on the burgeoning opportunity in tiles industry in coming years.

Compared to other market leaders in other segments of building materials i.e. Asian Paints (Paints) and Pidilite (Adhesives & Sealants) over the past few years, the performance of Kajaria has been solid. Through FY12-17, Kajaria has delivered revenue CAGR of 14% compared to 12% by Pidilite and 10% by Asian Paints. Kajaria's net profit has witnessed 25% CAGR vs. 22% and 14% CAGR reported by Pidilite and Asian Paints, respectively.

Exhibit 35: Net Sales CAGR

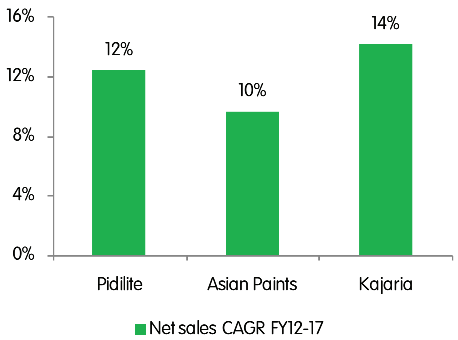


Exhibit 36: EBITDA CAGR

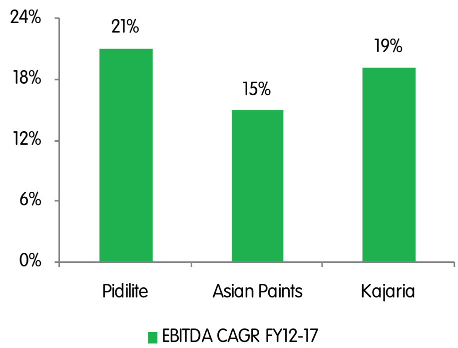
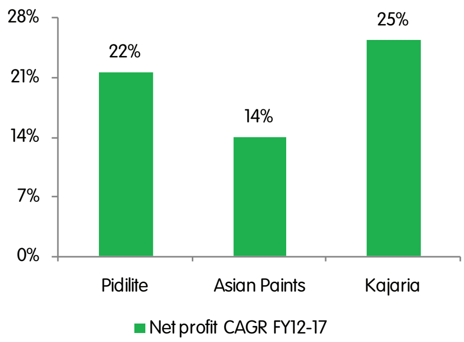


Exhibit 37: Net Profit CAGR



Source: Company, RSec Research

Average volume growth for Kajaria in the same period stood at 11.3% compared to 9.5% for Pidilite and 9.3% for Asian Paints. Similarly, the average ROCE in the same period for Kajaria was superior at 41% vs. 36% for Pidilite and 33% for Asian Paints. Even on the working capital front, Kajaria's cash conversion cycle was impressive at 49 days in FY17 compared to 72 days for Pidilite and 35 for Asian Paints.

Exhibit 38: Average Volume Growth

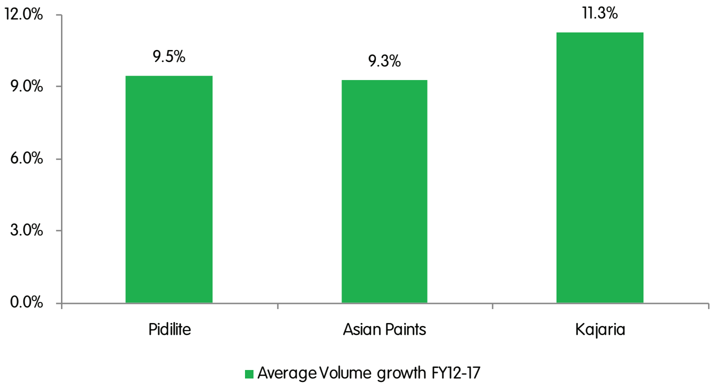
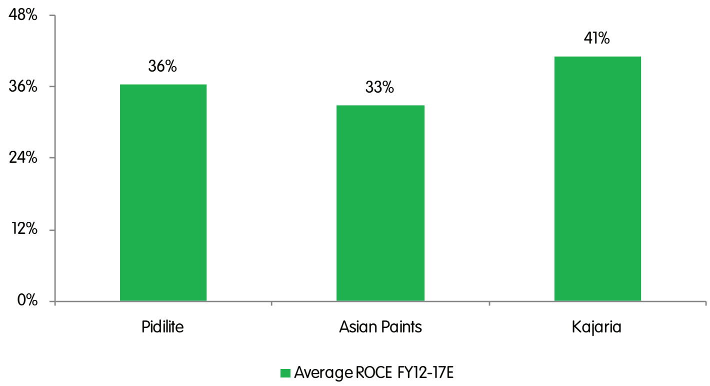


Exhibit 39: Average ROCE



Source: Company, RSec Research

In spite of superior financial performance, Kajaria trades at 30% PE discount to Asian Paints and 15% PE discount to Pidilite. Similarly, it trades at a 35-40% discount to these two players based on FY19E EV/EBITDA multiple.

Exhibit 40: Valuation discount to narrow down

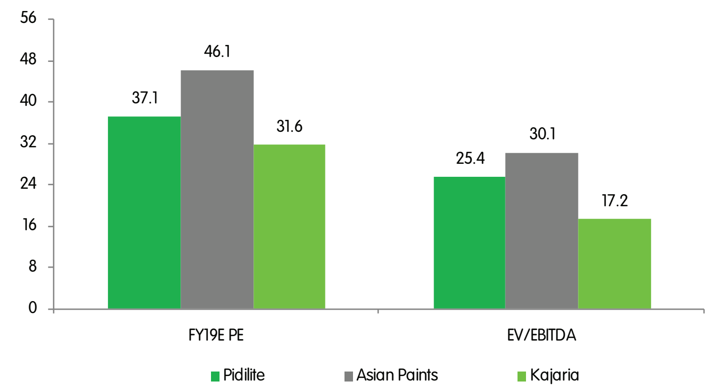
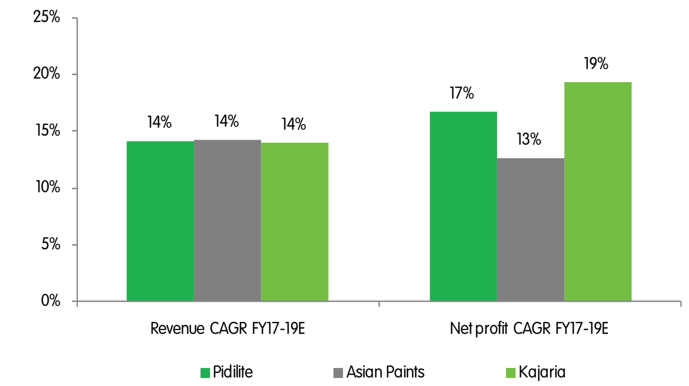


Exhibit 41: Kajaria's growth trajectory remains firm



Source: Company, RSec Research

Increasing market shares, superior financial performance, higher proportion of organised players post GST roll-out and increase in pace of government initiatives towards mass housing would result in narrowing down of these multiples, going forward.

Financials & Valuation

Kajaria has witnessed impressive 14% revenue and 25% earnings CAGR through FY12-17. Its average volume growth in past five years has also been impressive at 11.3%. In the same period, its EBITDA margins have improved from 15.7% to 19.5%.

Exhibit 42: Trend in Sales volumes

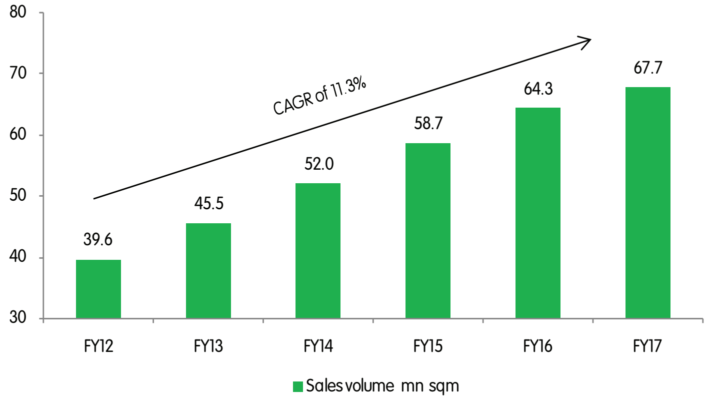
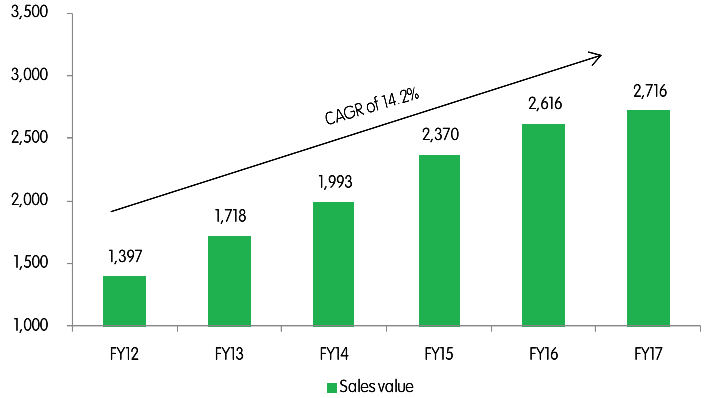


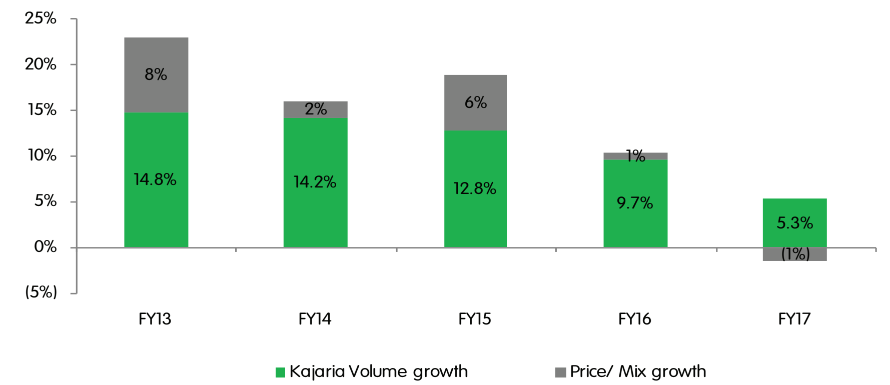
Exhibit 43: Trend in value sales



Source: Company, RSec Research

Increasing share of high value PVT and GVT tiles coupled with lower gas prices and higher operating leverage resulted in faster growth in profit vs. growth in revenue. However, Kajaria reported lower growth in FY17 on account of weak consumer demand environment and adverse impact of demonetisation in 2HFY17.

Exhibit 44: Bifrucation between volume and price/mix led growth



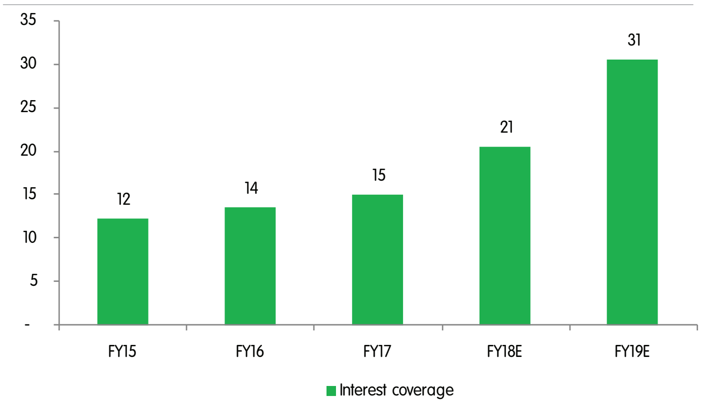
Source: Company, RSec Research

We expect Kajaria to post consolidated revenues of Rs28.8bn and Rs33.1bn and net profit of Rs3bn and Rs3.6bn in FY18E and FY19E, respectively. Improved product-mix, higher operating leverage and better volume growth are expected to result in modest improvement in EBITDA margins from 19.5% in FY17 to 20% to FY19E.

Kajaria's debt equity levels remains pretty benign with significantly high interest coverage ratio. Increasing capacities through the JV model has enabled the Company to manage its capital allocation in a more efficient manner. We expect the debt equity ratio for Kajaria to improve further from 0.2x in FY17 to 0.1x in FY19E. Similarly, the interest coverage ratio is likely to expand from 15times in FY17 to 30.6times in FY19E.

Exhibit 45: Falling Debt Equity Ratio

Exhibit 46: Expanding Interest Coverage



Source: Company, RSec Research

Operating cash flow generation remains strong for Kajaria. Increasing operating leverage and higher base would result in improved free cash flow levels in coming years, in our view.

Exhibit 47: Strong operating cash generation

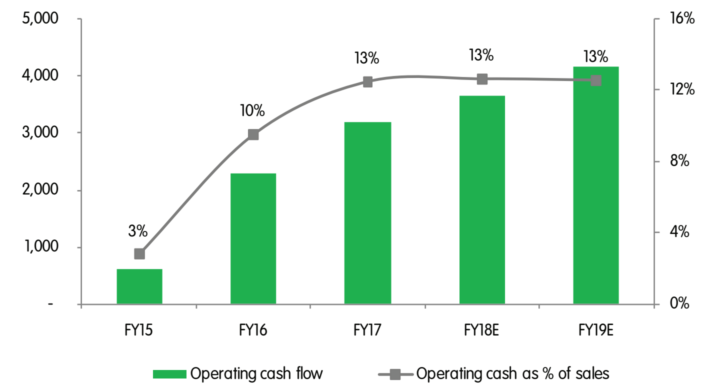
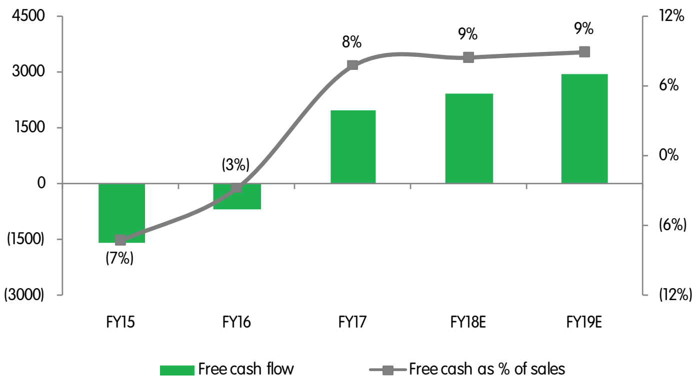


Exhibit 48: Free cash flow on an uptrend



Source: Company, RSec Research

Exhibit 49: DuPont Analysis

	FY14	FY15	FY16	FY17	FY18E	FY19E
NPM %	6.8	8.0	9.6	9.9	10.3	10.8
Asset T/O ratio	2.7	2.4	2.0	1.8	1.9	1.9
Equity multiplier	1.7	1.6	1.6	1.5	1.4	1.3
Return on Equity	32.2	30.7	29.9	26.5	25.9	26.1

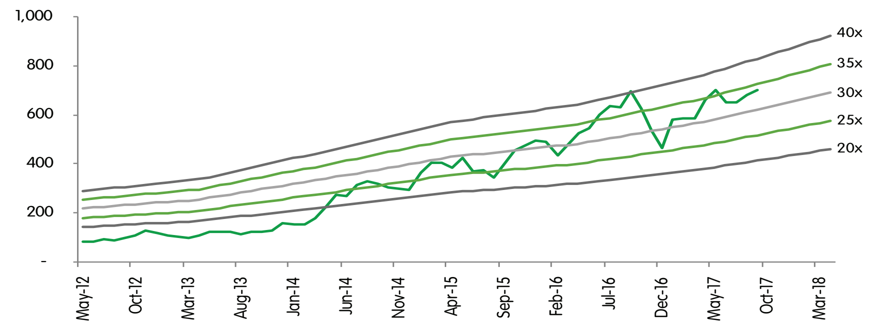
Source: Company, RSec Research

CMP* (Rs)	710
Upside/ (Downside) (%)	21
Bloomberg Ticker	KJC IN

BUY

Target Price: Rs861

Exhibit 50: One-year forward P/E Band



Source: Company, RSec Research

Over the past three years, Kajaria has traded at average one-year forward PE multiple of 31x earnings. We believe that increased visibility in earnings and superior financial performance coupled with GST roll-out would enable Kajaria Ceramics to command premium multiples.

Recovery in volume growth, Improving operating efficiencies, focus on new product introductions and increasing distribution network would continue to drive growth for Kajaria, going forward.

We expect Kajaria to post revenues of Rs28.8bn and Rs33.1bn and net profit of Rs3bn and Rs3.6bn in FY18E and FY19E, respectively. Kajaria is expected to report consolidated EPS of Rs18.6 in FY18E and Rs22.6 in FY19E. Based on expected EPS, the stock currently trades at 31.5x FY19E earnings.

Considering its superior financial performance, GST roll-out coupled with a strong brand equity, we expect Kajaria to sustain premium multiples in coming years. We initiate coverage on the stock with a BUY recommendation and Target Price of Rs861, based on 34x Sep'19 earnings (10% premium over average forward PE of past three years).

Our DCF calculation arrives at a target price of Rs841, which is an upside of 18% from the CMP. We have calculated WACC of 10.2% and terminal growth rate of 5%.

Exhibit 51: Key DCF Assumptions

	(Rs mn)
PV of free cash flow	31,652
Terminal value	104,286
Present value of the firm	135,938
Debt(Net of cash)	2,380
Cash flow to equity	133,559
Number of shares	159
Target price (Rs)	841
Upside (%)	18
Risk free rate (%)	6.5
Cost of equity (%)	10.5
WACC (%)	10.2
Terminal growth rate (%)	5.0

Source: Company, RSec Research

Key Risks

- Delay in recovery in consumer demand
- Sustained disruption in trade channel due to rollout of GST
- Sharp increase in power & fuel costs

Institutional Equity Research

Kajaria Ceramics

Initiating Coverage | India

CMP* (Rs)	710
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Bloomberg Ticker	KJC IN

BUY

Target Price: Rs861

Profit & Loss Statement

Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
Net Sales	**21,869**	**24,135**	**25,496**	**28,819**	**33,103**
Total operating income	21,869	24,135	25,496	28,819	33,103
% chg	19.1	10.4	5.6	13.0	14.9
Total Expenditure	18,328	19,560	20,533	23,203	26,475
Cost of Materials	7,497	8,464	9,194	10,449	12,003
Power & Fuel	4,854	4,805	4,480	5,043	5,793
Employee costs	2,073	2,523	2,887	3,291	3,752
Others	3,904	3,769	3,971	4,419	4,927
EBITDA	**3,541**	**4,575**	**4,963**	**5,616**	**6,628**
% chg	23.9	29.2	8.5	13.1	18.0
(% of Net Sales)	16.2	19.0	19.5	19.5	20.0
Depreciation& Amortisation	559	726	814	891	998
EBIT	**2,983**	**3,848**	**4,149**	**4,725**	**5,630**
% chg	24.9	29.0	7.8	13.9	19.1
(% of Net Sales)	13.6	15.9	16.3	16.4	17.0
Interest & other Charges	**294**	**345**	**340**	**281**	**223**
Other Income	72	104	154	180	195
(% of PBT)	2.6	2.9	3.9	3.9	3.5
Recurring PBT	2,761	3,608	3,963	4,623	5,602
% chg	38.6	30.7	9.8	16.7	21.2
PBT (reported)	**2,761**	**3,608**	**3,963**	**4,623**	**5,602**
Tax	854	1,247	1,425	1,618	1,961
(% of PBT)	30.9	34.6	36.0	35.0	35.0
PAT (recurring)	**1,907**	**2,361**	**2,538**	**3,005**	**3,641**
% chg	45.1	23.8	7.5	18.4	21.2
(% of Net Sales)	8.7	9.8	10.0	10.4	11.0
Minority interest	(93)	(48)	(17)	(45)	(55)
Net profit	**1,814**	**2,313**	**2,521**	**2,960**	**3,587**
Basic EPS (Rs)	11.1	14.6	15.9	18.6	22.6
Fully Diluted EPS (Rs)	11.1	14.6	15.9	18.6	22.6
% chg	34.5	31.7	9.3	17.1	21.2

Balance Sheet

Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
Share capital	159	159	159	159	159
Reserves	7,601	9,560	11,592	13,885	16,709
Net worth	7,760	9,719	11,751	14,044	16,868
Total borrowings	3,193	3,891	2,900	2,400	1,900
Minority Interest	625	761	760	805	860
Deferred tax	818	949	1,106	1,290	1,498
Total liabilities	**12,395**	**15,320**	**16,518**	**18,539**	**21,127**
Gross block	12,447	15,414	16,618	17,818	19,018
Less: Acc. depreciation	3,846	4,209	4,845	5,736	6,735
Net block	8,601	11,205	11,773	12,082	12,284
CWIP	778	78	83	83	83
Investments	1	1	1	850	1,250
Current assets	6,293	7,897	8,545	9,914	12,552
Inventories	**3,033**	**3,842**	**3,720**	**4,323**	**5,131**
Debtors	2,152	2,741	3,389	3,602	3,972
Cash	112	215	520	953	2,260
Other CA	600	762	684	773	888
Loans and advances	396	338	232	262	301
Current liabilities	3,100	3,677	3,678	4,157	4,775
Provisions	177	184	206	232	267
Net current assets	3,016	4,036	4,662	5,524	7,510
Total Assets	**12,395**	**15,320**	**16,518**	**18,539**	**21,127**

Institutional Equity Research

Kajaria Ceramics

Initiating Coverage | India

CMP* (Rs)	710
Upside/ (Downside) (%)	21
Bloomberg Ticker	KJC IN

BUY

Target Price: Rs861

Cash Flow Statement

Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
Net profit	**1,907**	**2,361**	**2,538**	**3,005**	**3,641**
Depn and w/o	559	726	814	891	998
Deferred tax	81	134	161	183	209
Change in working cap	(1,932)	(916)	(321)	(429)	(680)
Operating cash flow	**614**	**2,304**	**3,192**	**3,650**	**4,169**
Capital expenditure	(2,204)	(2,967)	(1,205)	(1,200)	(1,200)
Investments	-	-	-	(849)	(400)
Investing cash flow	**(2,204)**	**(2,967)**	**(1,205)**	**(2,049)**	**(1,600)**
Free cash flow	**(1,590)**	**(663)**	**1,987**	**2,450**	**2,969**
Dividend	(381)	(477)	(572)	(667)	(763)
Debt/Preference shares	1,255	698	(991)	(500)	(500)
Financing cash flow	**873**	**222**	**(1,563)**	**(1,167)**	**(1,263)**
Others	767	545	(120)	-	-
Net change in cash	**50**	**104**	**304**	**434**	**1,306**
Opening cash	**61**	**112**	**215**	**520**	**953**
Closing cash	**112**	**215**	**520**	**953**	**2,260**

Key Ratio

Y/E Mar (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
Valuation Ratio (x)					
P/E (on FDEPS)	64.2	48.8	44.6	38.1	31.5
P/CEPS	48.7	37.1	33.8	29.3	24.6
P/BV	14.5	11.6	9.6	8.0	6.7
Dividend yield (%)	0.3	0.4	0.4	0.5	0.6
EV/Sales	5.3	4.8	4.5	4.0	3.4
EV/EBITDA	32.7	25.5	23.2	20.5	17.2
Per Share Data (Rs)					
EPS (Basic)	11.1	14.6	15.9	18.6	22.6
Core EPS	11.1	14.6	15.9	18.6	22.6
Cash EPS	14.6	19.1	21.0	24.2	28.9
DPS	2.0	2.5	3.0	3.5	4.0
Book Value	48.8	61.2	74.0	88.4	106.2
Returns (%)					
RoCE	39.7	38.1	36.2	37.3	38.8
RoE	30.7	29.9	26.5	25.9	26.1
Turnover ratios (x)					
Asset Turnover (Gross Block)	2.4	2.0	1.8	1.9	1.9
Inventory / Sales (days)	51	58	53	55	57
Receivables (days)	36	41	49	46	44
Payables (days)	52	56	53	53	53
Cash conversion cycle (days)	35	44	49	48	48

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BUY

Target Price: Rs861

Rating Guides

Rating	Expected absolute returns (%) over 12 months
BUY	>10%
HOLD	-5% to 10%
REDUCE	>-5%

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