

COMPANY UPDATE

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KAJARIA CERAMICS LTD**PRICE: Rs.755****TARGET PRICE: Rs.860****RECOMMENDATION: BUY****FY17E P/E: 20.6x**

- ❑ **Strong volume growth expected on account of ongoing expansion**
- ❑ **Margins are likely to remain strong due to change in product mix and decline in gas prices**
- ❑ **Expected GST implementation by April,2016 is likely to be a game changer for the sector**
- ❑ **Benefit of Swachh Bharat Abhiyaan are also expected to translate into higher volumes for the company going forward**
- ❑ **We introduce FY17 estimates for the company and continue to maintain BUY recommendation on the stock.**

Summary table

(Rs mn)	FY15E	FY16E	FY17E
Sales	21,993	28,366	32,477
Growth (%)	20.0	29.0	14.0
EBITDA	3,409	4,539	5,196
EBITDA margin (%)	15.5	16.0	16.0
PBT	2,515	3,682	4,356
Net profit	1,649	2,447	2,908
EPS(Rs)	20.8	30.8	36.6
Growth (%)	26.0	48.0	19.0
CEPS (Rs)	28.3	39.5	46.2
BVPS (Rs)	92.7	119.4	152.0
DPS (Rs)	3.5	3.5	3.5
ROE (%)	26.0	29.0	27.0
ROCE (%)	29.3	34.1	34.0
Net debt	1,855	1,257	(159)
NW capital (Days)	45.0	45.0	45.0
P/E (x)	36.4	24.5	20.6
P/BV (x)	8.1	6.3	5.0
EV/Sales (x)	2.8	2.2	1.8
EV/EBITDA (x)	18.1	13.5	11.5

Source: Company, Kotak Securities - Private Client Research

Key highlights about the company**Demand growth to remain strong**

Consumption of tiles has grown at a CAGR of 13% over last 4-5 years and has been led by increasing consumerism and urbanization. Despite slowdown being witnessed in the real estate sector, we expect the demand scenario to remain strong going forward in medium to long term coming mainly from tier 2 and tier 3 cities led by rising income levels, increasing urbanization, change in consumer preferences as well as on account of replacement demand. This is likely to benefit Kajaria Ceramics as company is ideally positioned to capture incremental demand with its strong distribution network.

Ongoing capex to lead to strong growth in volumes

Kajaria Ceramics has expanded its capacity by 7.5 Mn sq m during H1FY15 and another 5 Mn sq m expansion at Taurus JV is likely to commission by March, 2015. Company is also on track for its brownfield expansion of 3 Mn sq m at its existing location in Rajasthan for ceramics tiles. Thus, it plans to reach a capacity of 62.1 mn sq m by end of FY15. With further greenfield expansion of 5 Mn sq m of polished vitrified tiles at a new location in Rajasthan, company is expected to increase its capacity to 67.1 mn sq m during FY16. This is likely to result in strong volume growth going forward. We thus expect volumes to grow at a CAGR of 15.6% between FY14-FY17.

Expected GST implementation to benefit organized sector players

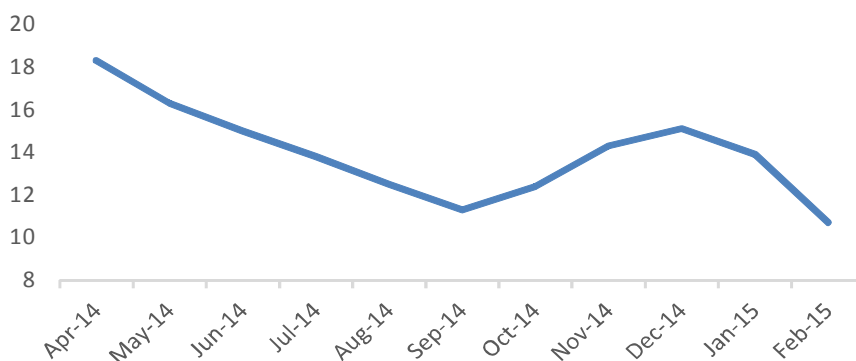
GST implementation is likely to be a game changer for the sector as it is likely to result in higher taxation for the unorganized sector. Due to excise duty avoidance and lower taxes being paid by the unorganized sector, they were able to price their products at cheaper rates as compared to the organized players. Expected implementation of GST by April, 2016 is likely to reduce the cost differential between the unorganized and organized players, thereby providing a level playing field. This is then likely to result in shift in customer's preferences towards organized sector due to lower cost differential, better quality and design. We expect Kajaria Ceramics to benefit significantly post the implementation of GST.

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Decline in gas prices to benefit the company going forward

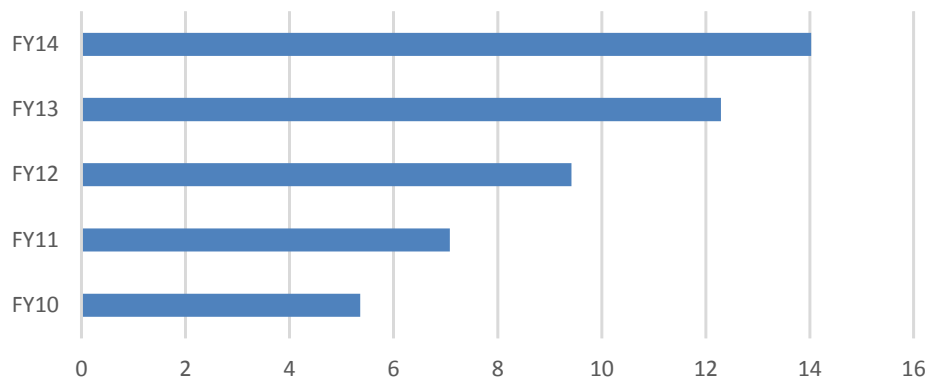
Company has been able to witness an improvement in margins mainly led by higher tile realizations and more value added products in the sales. Going ahead we believe that decline in long-term LNG contract rates, post the steep decline in spot rates, would be margin accretive for the company. For its Gujarat JVs, gas prices are linked to spot RLNG prices which has witnessed a decline in past few months due to decline in crude prices. We thus expect gas prices for the company to come down going forward since currently industry is paying a high price for purchasing gas.

Japan Arrival based spot LNG import price (USD/mmbtu)



Source: Bloomberg

RLNG prices (US \$/mmbtu)



Source: Company

Financial outlook

- **Revenues** - We expect volumes to grow at a CAGR of 15.6% between FY14-17 led by higher volumes from JVs and own production. Imported tile volumes are likely to remain flat. With improvement in average tile realizations, we expect revenues to grow at a CAGR of 21% between FY14-17.
- **Operating margins** - Margins are likely to remain strong at 15.5%/16%/16% for FY15/16/17 led by improvement in product mix towards more high value added products as well as expected decline in the gas prices.
- **Net profits** - We thus expect net profits to grow at a CAGR of 32.4% between FY14-17 led by strong volume growth and higher margins. Its return ratios are also likely to improve further due to asset light approach of expansion through joint ventures being carried out by the company. We expect RoCE to move to 34% for FY17 as against 29.1% witnessed during FY14.

**We recommend BUY on Kajaria
Ceramics Ltd with a price target
of Rs.860**

Valuation and recommendation

Stock is currently trading at attractive valuations of 24.5x and 20.6x P/E on FY16 and FY17 estimates. We tweak our estimates and also introduce FY17 estimates. We value the company at 23.5x P/E and arrive at a revised price target of Rs 860 on FY17 estimates (Rs 712 on FY16 estimates earlier). We continue to maintain **BUY** recommendation on the stock.

Key risk to our recommendation would come from sharp hike in gas prices or rupee depreciation or demand slowdown.