

October 12, 2010

BUY

| | |
|--------|--------------|
| Price | Target Price |
| Rs 80 | Rs 91 |
| Sensex | 20,203 |

Price Performance

| (%) | 1M | 3M | 6M | 12M |
|----------------|----|----|----|-----|
| Absolute | 15 | 24 | 29 | 94 |
| Rel. to Sensex | 7 | 10 | 14 | 63 |

Source: Bloomberg

Stock Details

| | |
|------------------------------|----------|
| Sector | Ceramics |
| Reuters | KAJR.BO |
| Bloomberg | KJC@IN |
| Equity Capital (Rs mn) | 147 |
| Face Value (Rs) | 2 |
| No of shares o/s (mn) | 74 |
| 52 Week H/L (Rs) | 82/37 |
| Market Cap (Rs bn/USD mn) | 6/134 |
| Daily Avg Vol (No of shares) | 534668 |
| Daily Avg Turnover (US\$ mn) | 0.8 |

Shareholding Pattern (%)

| | J'10 | M'10 | D'09 |
|--------------|------|------|------|
| Promoters | 51.3 | 51.3 | 52.5 |
| FII/NRI | 2.5 | 3.5 | 1.7 |
| Institutions | 5.8 | 6.5 | 1.6 |
| Private Corp | 18.2 | 17.6 | 20.7 |
| Public | 22.2 | 21.2 | 23.5 |

Source: Capitaline

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- **Kajaria Ceramics' results were in line with estimates with 20% revenue growth and 52% PAT growth**
- **70bps yoy drop in EBITDA margins to 15.7% is on account of higher trading, increased by 78% yoy to Rs 1 bn**
- **PAT margins improved by 130bps to 6% due to lower fuel cost (switched to gas from high cost fuel) and interest charges**
- **With strong balance sheet (D/E <1x by FY12E) and RoE improvement to 26% and EPS CAGR of 37% (FY10-12E) we remain positive on the stock and maintain BUY**

Higher trading helped revenue growth of 20% however ...

Kajaria's net revenues increased by 20% to Rs 2.2 bn. In Q2FY11 purchase of traded goods increased by 78% yoy / 53% qoq to Rs 1 bn, facilitating higher revenue growth. The company commissioned manufacturing of polished vitrified tiles in Jan'10 which has helped it to report volume growth while improved product mix has resulted in higher realisations (as indicated by the management).

... EBITDA margins marginally declined by 70bps

The company has shifted from high cost propane to low cost natural gas from May'10 and helped it to reduce fuel cost. P&F cost declined by 15.6% to Rs 205 mn. P&F cost (as % of sales) declined by 390bps to 9.2%, was also driven by higher trading. However despite cost savings due to higher trading, contributing ~50% of revenues (as per the management while absolute details not available), EBITDA margins declined by 70bps yoy to 15.7%. EBITDA increased by 15% to Rs 349 mn.

PAT growth of 52%, driven by revenue growth interest savings

For Q2FY11, PAT increased by 52% yoy to Rs 133 mn resulting into EPS of Rs 1.8 for the quarter. Repayment of debt through internal generation and softening interest rates has lowered interest cost by 31% to Rs 81 mn reducing its average debt cost from 15.3% in Q2FY10 to 12.2% by Q2FY11. Its D/E also declined from 1.4x in FY10 to 1.2x and RoE has improved from 19% to 25%.

Capex on schedule, Maintain Buy

Company has chalked down capex plan 1) of Rs 194 mn for conversion of ceramic floor tile at Unit-3, Sikandrabad plant into vitrified tile with expected completion by Feb'11. 2) Its capex plan to put vitrified plans (polished and glazed) is as per schedule (expected completion by Jan'11) should drive its volume growth for FY12. With strong balance sheet (D/E <1x by FY12E), RoE improvement to 26% (from 20% in FY10) and EPS CAGR of 37% (FY10-12E) we remain positive on the stock and maintain our BUY recommendation with price target of Rs 91 based on 10 x FY12E EPS. We expect likely re-rating to offer further upside to our target price in future.

Financial Snapshot

Rs Mn

| YE- | Net | EBITDA | | EPS | EPS | RoE | | EV/ | | |
|-------|-------|--------|------|------|------|--------|------|------|--------|------|
| Mar | Sales | (Core) | (%) | APAT | (Rs) | % chg | (%) | P/E | EBITDA | P/BV |
| FY09 | 6,649 | 949 | 14.3 | 89 | 1.2 | (40.7) | 5.6 | 66.1 | 9.5 | 3.6 |
| FY10 | 7,355 | 1,148 | 15.6 | 359 | 4.9 | 302.8 | 20.4 | 16.4 | 7.3 | 3.1 |
| FY11E | 8,644 | 1,399 | 16.2 | 496 | 6.7 | 38.3 | 23.7 | 11.9 | 6.5 | 2.6 |
| FY12E | 9,747 | 1,684 | 17.3 | 671 | 9.1 | 35.4 | 26.3 | 8.8 | 5.1 | 2.1 |

Key Financials – Quarterly

| Rs mn | Q2FY10 | Q3FY10 | Q4FY10 | Q1FY11 | Q2FY11 | YoY (%) | QoQ (%) | YTD'11 | YTD'10 | YoY (%) |
|--------------------------------|--------------|--------------|--------------|--------------|--------------|-------------|-------------|--------------|--------------|-------------|
| Revenue | 1,854 | 1,797 | 2,149 | 1,955 | 2,222 | 19.9 | 13.7 | 4,177 | 3,414 | 22.4 |
| Expenditure | 1,550 | 1,509 | 1,841 | 1,642 | 1,873 | 20.8 | 14.1 | 3,515 | 2,857 | 23.0 |
| <i>as % of sales</i> | 83.6 | 84.0 | 85.7 | 84.0 | 84.3 | | | 84.2 | 83.7 | |
| Consumption of RM | 924 | 831 | 1,171 | 908 | 1,278 | 38.4 | 40.7 | 2,186 | 1,644 | 33.0 |
| <i>as % of sales</i> | 49.8 | 46.3 | 54.5 | 46.4 | 57.5 | | | 52.3 | 48.2 | |
| Power & Fuel | 243 | 304 | 278 | 244 | 205 | (15.6) | (16.0) | 449 | 467 | (4.0) |
| <i>as % of sales</i> | 13.1 | 16.9 | 12.9 | 12.5 | 9.2 | | | 10.7 | 13.7 | |
| Employee Cost | 158 | 162 | 157 | 186 | 188 | 18.8 | 0.8 | 374 | 293 | 27.4 |
| <i>as % of sales</i> | 8.5 | 9.0 | 7.3 | 9.5 | 8.4 | | | 8.9 | 8.6 | |
| Other expenditure | 226 | 212 | 235 | 304 | 203 | (10.3) | (33.3) | 507 | 453 | 12.0 |
| <i>as % of sales</i> | 12.2 | 11.8 | 10.9 | 15.6 | 9.1 | | | 12.1 | 13.3 | |
| EBITDA | 304 | 288 | 308 | 313 | 349 | 14.9 | 11.5 | 662 | 557 | 18.9 |
| Depreciation | 65 | 65 | 74 | 74 | 78 | 19.8 | 5.3 | 151 | 128 | 17.7 |
| EBIT | 239 | 224 | 235 | 239 | 271 | 13.6 | 13.4 | 511 | 428 | 19.3 |
| Other Income | 1 | 2 | - | - | - | (100.0) | #DIV/0! | - | 1 | (100.0) |
| Interest | 118 | 100 | 48 | 78 | 81 | (30.9) | 4.5 | 159 | 227 | (29.9) |
| PBT | 122 | 125 | 186 | 162 | 190 | 55.6 | 17.6 | 352 | 203 | 73.5 |
| Total Tax | 35 | 43 | 59 | 49 | 57 | 65.2 | 17.5 | 106 | 55 | 92.9 |
| Adjusted PAT | 88 | 83 | 128 | 113 | 133 | 51.9 | 17.7 | 246 | 148 | 66.4 |
| (Profit)/loss from JV's/Ass/MI | 0 | 0 | 0 | 0 | 0 | | | 0 | 0 | |
| APAT after MI | 88 | 83 | 128 | 113 | 133 | 51.9 | 17.7 | 246 | 148 | 66.4 |
| Extra ordinary items | 0 | 0 | 0 | 0 | 0 | | | 0 | 0 | |
| Reported PAT | 88 | 83 | 128 | 113 | 133 | 51.9 | 17.7 | 246 | 148 | 66.4 |
| Reported EPS | 1.2 | 1.1 | 1.7 | 1.5 | 1.8 | 51.9 | 17.7 | 3.3 | 2.0 | 66.4 |

| Margins (%) | | | | | | (bps) | (bps) | | | (bps) |
|--------------------|------|------|------|------|------|-------|-------|------|------|-------|
| EBIDTA | 16.4 | 16.0 | 14.3 | 16.0 | 15.7 | (68) | (31) | 15.8 | 16.3 | (46) |
| EBIT | 12.9 | 12.4 | 10.9 | 12.2 | 12.2 | (67) | (3) | 12.2 | 12.5 | (31) |
| EBT | 6.5 | 6.9 | 8.7 | 8.3 | 8.6 | 201 | 29 | 8.4 | 5.9 | 252 |
| PAT | 4.7 | 4.6 | 5.9 | 5.8 | 6.0 | 126 | 20 | 5.9 | 4.3 | 156 |
| Effective Tax rate | 28.2 | 33.9 | 31.5 | 30.0 | 30.0 | 174 | (3) | 30.0 | 27.0 | 301 |

Key Financials

Income Statement

| Y/E, Mar (Rs. mn) | FY09 | FY10 | FY11E | FY12E |
|--------------------------------------|--------------|--------------|--------------|--------------|
| Net Sales | 6,649 | 7,355 | 8,644 | 9,747 |
| Growth (%) | 32.3 | 10.6 | 17.5 | 12.8 |
| Expenditure | 5,700 | 6,207 | 7,245 | 8,063 |
| Materials Consumed | 3,602 | 3,644 | 4,505 | 4,884 |
| Employee Cost | 505 | 613 | 692 | 731 |
| Other Exp | 1,593 | 1,951 | 2,048 | 2,448 |
| EBITDA | 949 | 1,148 | 1,399 | 1,684 |
| Growth (%) | 15.9 | 21.0 | 21.8 | 20.4 |
| EBITDA margin (%) | 14.3 | 15.6 | 16.2 | 17.3 |
| Depreciation | 249 | 267 | 322 | 351 |
| EBIT | 700 | 881 | 1,076 | 1,333 |
| EBIT margin (%) | 10.5 | 12.0 | 12.5 | 13.7 |
| Other Income | 10 | 8 | 10 | 10 |
| Interest expenses | 582 | 375 | 378 | 384 |
| PBT | 127 | 514 | 708 | 959 |
| Tax | 38 | 156 | 212 | 288 |
| Effective tax rate (%) | 30.2 | 30.3 | 30.0 | 30.0 |
| Adjusted PAT | 89 | 359 | 496 | 671 |
| Growth (%) | (40.7) | 302.8 | 38.3 | 35.4 |
| Net Margin (%) | 1.3 | 4.9 | 5.7 | 6.9 |
| (Profit)/loss from JVs/Ass/MI | - | - | - | - |
| Adjusted PAT After JVs/Ass/MI | 89 | 359 | 496 | 671 |
| E/O items | - | - | - | - |
| Reported PAT | 89 | 359 | 496 | 671 |
| PAT after MI | 89 | 359 | 496 | 671 |
| Growth (%) | (40.7) | 302.8 | 38.3 | 35.4 |

Cash Flow

| Y/E, Mar (Rs. mn) | FY09 | FY10 | FY11E | FY12E |
|------------------------------|-------------|--------------|--------------|--------------|
| PBT (Ex-Other income) | 118 | 506 | 698 | 949 |
| Depreciation | 249 | 267 | 322 | 351 |
| Interest Provided | 274 | 241 | 378 | 384 |
| Other Non-Cash items | 3 | 7 | - | - |
| Chg in working cap | (92) | 406 | (206) | (385) |
| Tax paid | -33 | -117 | -142 | -208 |
| Operating Cashflow | 519 | 1,310 | 1,050 | 1,092 |
| Capital expenditure | (121) | (471) | (1,290) | (30) |
| Free Cash Flow | 398 | 839 | -240 | 1,062 |
| Other income | 10 | 8 | 10 | 10 |
| Investments | - | - | - | - |
| Investing Cashflow | 10 | 8 | 10 | 10 |
| Equity Capital Raised | - | - | - | - |
| Loans Taken / (Repaid) | (121) | (623) | 800 | (500) |
| Interest Paid | (274) | (241) | (378) | (384) |
| Dividend paid (incl tax) | (17) | (17) | (86) | (103) |
| Income from investments | 0 | 0 | 0 | 0 |
| Others | 0 | 0 | 0 | 0 |
| Financing Cashflow | -412 | -882 | 336 | -987 |
| Net chg in cash | -4 | -34 | 106 | 85 |
| Opening cash position | 83 | 79 | 45 | 151 |
| Closing cash position | 79 | 45 | 151 | 236 |

Balance Sheet

| Y/E, Mar (Rs. mn) | FY09 | FY10 | FY11E | FY12E |
|-------------------------------|--------------|--------------|--------------|--------------|
| Equity share capital | 147 | 147 | 147 | 147 |
| Reserves & surplus | 1,474 | 1,746 | 2,139 | 2,673 |
| Net worth | 1,621 | 1,893 | 2,286 | 2,820 |
| Minority Interest | | | | |
| Secured Loans | 2,927 | 2,588 | 3,388 | 2,888 |
| Unsecured Loans | 325 | 40 | 40 | 40 |
| Loan Funds | 3,252 | 2,628 | 3,428 | 2,928 |
| Net deferred tax liability | 535 | 549 | 619 | 699 |
| Total Liabilities | 5,407 | 5,070 | 6,333 | 6,447 |
| Gross Block | 5,015 | 5,435 | 6,711 | 6,751 |
| Less: Depreciation | 1,738 | 1,988 | 2,310 | 2,661 |
| Net block | 3,277 | 3,448 | 4,401 | 4,090 |
| Capital work in progress | 0 | 25 | 40 | 30 |
| Investment | 34 | 34 | 34 | 34 |
| Current Assets | 2,968 | 2,976 | 3,393 | 3,896 |
| Inventories | 1,385 | 1,403 | 1,658 | 1,869 |
| Sundry debtors | 678 | 773 | 829 | 935 |
| Cash & bank balance | 79 | 45 | 151 | 236 |
| Loans & advances | 827 | 756 | 756 | 856 |
| Other current assets | - | - | - | - |
| Current lia & Prov | 872 | 1,413 | 1,535 | 1,603 |
| Current liabilities | 830 | 1,198 | 1,303 | 1,335 |
| Provisions | 42 | 216 | 233 | 267 |
| Net current assets | 2,096 | 1,563 | 1,858 | 2,293 |
| Misc. exp | - | - | - | - |
| Total Assets | 5,407 | 5,070 | 6,333 | 6,447 |

Key Ratios

| Y/E, Mar | FY09 | FY10 | FY11E | FY12E |
|----------------------------|-------|-------|-------|-------|
| Profitability (%) | | | | |
| EBITDA Margin | 14.3 | 15.6 | 16.2 | 17.3 |
| Net Margin | 1.3 | 4.9 | 5.7 | 6.9 |
| ROCE | 13.1 | 17.0 | 19.1 | 21.0 |
| ROE | 5.6 | 20.4 | 23.7 | 26.3 |
| RoIC | 13.2 | 17.2 | 19.4 | 21.8 |
| Per Share Data (Rs) | | | | |
| EPS | 1.2 | 4.9 | 6.7 | 9.1 |
| CEPS | 4.6 | 8.5 | 11.1 | 13.9 |
| BVPS | 22.0 | 25.7 | 31.1 | 38.3 |
| DPS | 0.2 | 1.0 | 1.2 | 1.6 |
| Valuations (x) | | | | |
| PER | 66.1 | 16.4 | 11.9 | 8.8 |
| P/CEPS | 17.4 | 9.4 | 7.2 | 5.8 |
| P/BV | 3.6 | 3.1 | 2.6 | 2.1 |
| EV / Sales | 1.4 | 1.1 | 1.1 | 0.9 |
| EV / EBITDA | 9.5 | 7.3 | 6.5 | 5.1 |
| Dividend Yield (%) | 0.3 | 1.2 | 1.5 | 2.0 |
| Gearing Ratio (x) | | | | |
| Net Debt/ Equity | 193.7 | 134.6 | 141.9 | 94.3 |
| Net Debt/EBITDA | 3.3 | 2.2 | 2.3 | 1.6 |
| Working Cap Cycle (days) | 68 | 49 | 50 | 55 |

Recommendation History: Kajaria Ceramics – KJC IN

| Date | Reports | Reco | CMP | Target |
|------------|-------------------------------------------------------|------|-----|--------|
| 14/07/2010 | Kajaria Ceramics Q1FY11 Result Update | BUY | 67 | 91 |
| 29/04/2010 | Kajaria Ceramics Initiating Coverage | Buy | 66 | 91 |

Recent Research Reports

| Date | Reports | Reco | CMP | Target |
|------------|-----------------------------------------------------|------------|-----|--------|
| 03/08/2010 | GSFC Q1FY11 Result Update | Accumulate | 312 | 368 |
| 03/08/2010 | GNFC Q1FY11 Result Update | Buy | 115 | 157 |
| 03/08/2010 | Tata Chemicals Q1FY11 Result Update | Accumulate | 349 | 393 |
| 29/07/2010 | TNPL Q1FY11 Result Update | Buy | 122 | 143 |

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