

1 November 2013

Cera Sanitaryware

Sturdy sales growth; margin under pressure; Buy

Rating: **Buy**

Target Price: ₹725

Share Price: ₹577

Key takeaways

Revenue grows a strong 43% yoy. In 2QFY14 Cera Sanitaryware posted strong revenue growth, a whopping 43% yoy (25% qoq), despite a much stronger (52%) yoy growth in 1QFY13, continuing its strong quarterly performance. For 1HFY14, it has registered 41% yoy growth, the highest in the industry. The robust growth is likely to continue in FY14/15 following its fresh expansion into sanitaryware, more sales of wellness products and a foray into tiles. We expect a 31% CAGR in revenue over FY13-15.

At 5% yoy, EBITDA growth lower. The 2QFY14 EBITDA margin was 12.1% (16.5% in 2QFY13, 15.7% in 1QFY14). Pressure yoy arose from the rise in energy costs and greater expenses on product launches, promotions and marketing, necessary to achieve the desired revenue growth. The FY13 EBITDA margin stood at 15.4%. The increasing exposure to the faucets sub-segment and a venture into tiles (both low-margin businesses vs sanitaryware), also led to pressure on margins. We estimate the trend to continue in FY14/15 (lowered margins to below 14%) compared to past highs of 18-19%.

PAT dips 4% yoy. Led by lower EBITDA growth, a 54% yoy rise in depreciation and a 160-bp rise in the tax rate, 2Q PAT dipped 4% yoy. We have lowered FY14/15 EBITDA and earnings in line with the 1HFY14 trend.

Our take. In 2QFY14, the consistent show of robust quarterly growth continued. The addition of sanitaryware capacity of 0.7m pieces to the earlier 2m in Jan'13 along with more sales of faucets and (outsourced) wellness products would help to a 31% CAGR in revenue (and 19% in PAT) over FY13-15. Cera plans to spend ₹1.5bn over FY14-16 on expansion in sanitaryware, faucets and wind turbines. Its industry-leading EBITDA margins, driven by low-cost natural gas, the rise in asset turnover and its de-leveraged balance sheet are expected to drive return ratios. At our target of ₹725, the stock would trade at 14x FY15e PE, in line with the target multiples of its sector peers. **Risks.** Slowdown in real estate; rupee devaluation vs US\$/yuan.

Quarterly results (YE: Mar)	2QFY13	2QFY14	% yoy	1HFY13	1HFY14	% yoy
Sales (₹m)	1,114	1,588	42.5	2,019	2,854	41.3
EBITDA (₹m)	184	193	4.5	341	392	15.0
EBITDA margin (%)	16.5	12.1	(442)bps	16.9	13.7	(315)bps
Interest (₹m)	16	16	(1.3)	29	30	5.6
Depreciation (₹m)	20	31	54.3	42	59	41.5
Other income (₹m)	17	17	1.4	32	31	(5.0)
PBT (₹m)	164	162	(1.3)	302	333	10.1
Tax (₹m)	54	56	3.4	100	115	15.2
Tax rate (%)	32.9	34.5	159	33.0	34.5	152
PAT (₹m)	110	106	(3.7)	203	218	7.6

Source: Company, Anand Rathi Research

Key data	CRS IN / CERA.BO
52-week high / low	₹625 / ₹370
Sensex / Nifty	21179 / 6304
3-m average volume	US\$0.2m
Market cap	₹7.3bn / US\$122m
Shares outstanding	12.7m

Shareholding pattern (%)	Sep '13	Jun '13	Mar '13
Promoters	55.8	55.6	55.5
- of which, Pledged	-	-	-
Free Float	44.2	44.4	44.5
- Foreign Institutions	12.4	11.4	11.3
- Domestic Institutions	0.1	0.1	0.1
- Public	31.7	32.9	33.1

Estimates revision (%)	FY13	FY14	FY15
Sales	-	7.6	11.4
EBITDA	-	(4.5)	(0.4)
EPS	-	(7.3)	(4.8)

Year-end: Mar	FY14e	FY15e
Sales (₹m)	6,677	8,322
Net profit (₹m)	532	656
EPS (₹)	42.0	51.9
Growth (%)	15.1	23.4
PE (x)	13.7	11.1
P/B (x)	3.2	2.6
RoE (%)	26.2	25.8
RoCE (%)	32.3	34.0
Dividend yield (%)	0.8	1.0
Net gearing (x)	0.1	0.0

Source: Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY11	FY12	FY13	FY14e	FY15e
Net revenues	2,430	3,194	4,879	6,677	8,322
Revenue growth (%)	27.0	31.5	52.7	36.9	24.6
- Op. expenses	1,553	1,972	2,660	4,125	5,764
EBIDTA	457	534	753	913	1,140
EBITDA margins (%)	18.8	16.7	15.4	13.7	13.7
- Interest expenses	27	40	71	70	75
- Depreciation	65	77	94	122	140
+ Other income	51	68	90	85	85
- Tax	150	165	216	274	353
Effective tax rate (%)	36.1	33.9	31.9	34.0	35.0
Reported PAT	265	320	462	532	656
+/- Extraordinary items	-	-	-	-	-
+/- Minority interest	-	-	-	-	-
Adjusted PAT	265	320	462	532	656
Adj. FDEPS (₹/share)	21.0	25.3	36.5	42.0	51.9
Adj. FDEPS growth (%)	(32.7)	20.7	44.2	15.1	23.4

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY11	FY12	FY13	FY14e	FY15e
Share capital	63	63	63	63	63
Reserves & Surplus	1,052	1,329	1,732	2,196	2,768
Net worth	1,115	1,392	1,795	2,259	2,831
Minority interest	-	-	-	-	-
Total Debt	379	476	610	560	560
Def. tax liab. (net)	139	136	162	162	162
Capital employed	1,633	2,004	2,568	2,981	3,554
Net Fixed assets	845	1,012	1,294	1,622	1,882
Investments	78	11	14	14	14
- of which, Liquid	-	-	-	-	-
Net Working capital	346	668	856	1,090	1,250
Cash and bank balance	365	313	404	256	408
Capital deployed	1,633	2,004	2,568	2,981	3,554
Net debt	14	163	207	305	152
WC (days)	44	58	57	53	51
Book value (₹/sh)	88	110	142	178	224

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹m)

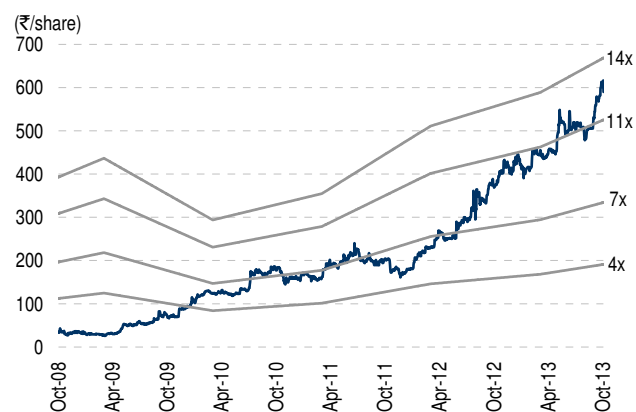
Year-end: Mar	FY11	FY12	FY13	FY14e	FY15e
PAT	265	320	462	532	656
+ Non-cash items	72	75	120	122	140
Cash profit	337	395	582	654	796
- Incr./ (Decr.) in WC	105	322	188	234	160
Operating cash-flow	232	73	394	420	636
- Capex	202	245	376	450	400
Free cash-flow	30	(172)	18	(30)	236
- Dividend	18	37	44	59	68
+ Equity raised	0	0	(1)	8	(2)
+ Debt raised	107	97	134	(50)	-
- Investments	78	(67)	3	-	-
- Misc. items	16	7	14	17	14
Net cash-flow	24	(52)	91	(148)	152
+ Opening cash	341	365	313	404	256
Closing cash	365	313	404	256	408

Source: Company, Anand Rathi Research

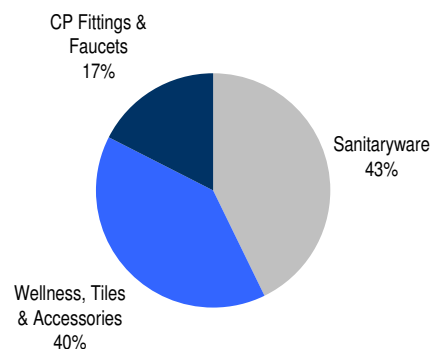
Fig 4 – Ratio analysis @ ₹577

Year-end: Mar	FY11	FY12	FY13	FY14e	FY15e
P/E (x)	27.5	22.8	15.8	13.7	11.1
P/CEPS (x)	22.1	18.4	13.1	11.2	9.2
P/B (x)	6.5	5.2	4.1	3.2	2.6
EV/EBITDA (x)	15.8	14.0	9.9	8.3	6.5
RoE (%)	26.5	25.6	29.0	26.2	25.8
RoCE (%)	32.9	29.6	33.2	32.3	34.0
Fixed Asset turnover (x)	2.3	2.6	3.2	3.4	3.5
Dividend yield (%)	0.4	0.5	0.7	0.8	1.0
Dividend payout (%)	11.9	11.9	11.0	11.0	11.0
Interest exp./Sales	1.1	1.3	1.5	1.0	0.9
Debtors (days)	58	52	62	49	44
Revenue growth (%)	27.0	31.5	52.7	36.9	24.6
EBITDA growth (%)	26.8	16.7	41.2	21.2	24.9
PAT growth (%)	35.4	20.7	44.2	15.1	23.4
EPS growth (%)	(32.7)	20.7	44.2	15.1	23.4

Source: Company, Anand Rathi Research

Fig 5 – PE band


Source: Bloomberg, Anand Rathi Research

Fig 6 – Revenue mix, FY13


Source: Company, Anand Rathi Research

Result review

Fig 7 – 2QFY14 Results vs Expectations

Quarterly results (YE: Mar)	2QFY14	2QFY14e	% var	2QFY13	% yoy	1QFY14	% qoq
Sales (₹m)	1,588	1,448	9.6	1,114	42.5	1,266	25.4
EBITDA (₹m)	193	217	(11.4)	184	4.5	199	(3.3)
EBITDA margin (%)	12.1	15.0	(287)bps	16.5	(442)bps	15.7	(360)bps
Interest (₹m)	16	20	(19.3)	16	(1.3)	14	13.2
Depreciation (₹m)	31	28	10.1	20	54.3	28	10.1
Other income (₹m)	17	20	(15.9)	17	1.4	14	21.0
PBT (₹m)	162	189	(14.2)	164	(1.3)	171	(4.9)
Tax (₹m)	56	62	(10.2)	54	3.4	59	(4.8)
Tax rate (%)	34.5	33.0	153	32.9	159	34.5	4
PAT (₹m)	106	127	(16.1)	110	(3.7)	112	(5.0)

Source: Company, Anand Rathi Research

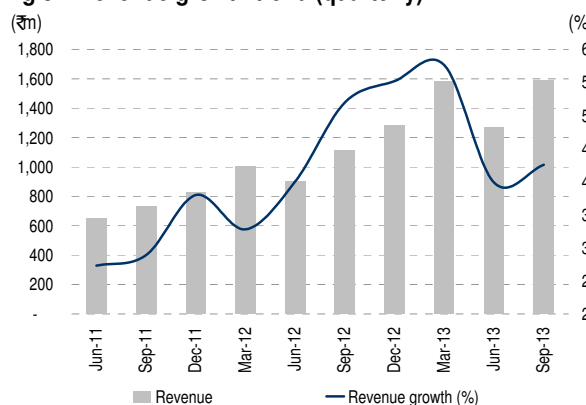
Revenue growth continues sturdy 43% yoy

In 2QFY14 Cera Sanitaryware posted strong revenue growth, a whopping 43% yoy (25% qoq), despite a much stronger (52%) yoy growth in 1QFY13, continuing its strong quarterly performance. For 1HFY14, it has registered 41% yoy growth, the highest in the industry. The robust growth is likely to continue in FY14/15 following its fresh expansion into sanitaryware, more sales of wellness products and a foray into tiles. We expect a 31% CAGR in revenue over FY13-15.

EBITDA growth lower at 5% yoy

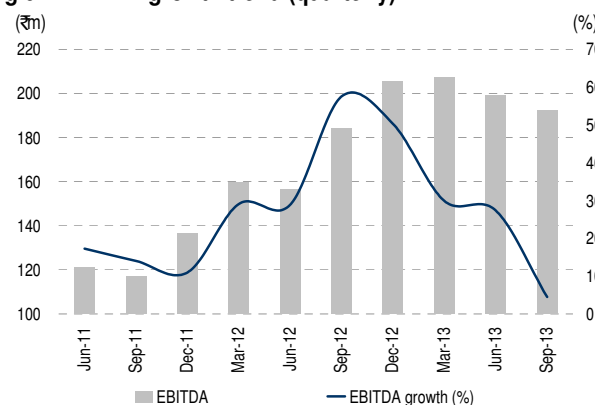
The 2QFY14 EBITDA margin was 12.1% (16.5% in 2QFY13, 15.7% in 1QFY14). Pressure yoy arose from the rise in energy costs and greater expenses on product launches, promotions and marketing, necessary to achieve the desired revenue growth. The FY13 EBITDA margin stood at 15.4%. The increasing exposure to the faucets sub-segment and the venture into tiles (both low-margin businesses vs sanitaryware), also led to pressure on margins. We estimate the trend to continue in FY14/15 (lower margins to below 14%) compared to past highs of 18-19%.

Fig 8 – Revenue growth trend (quarterly)



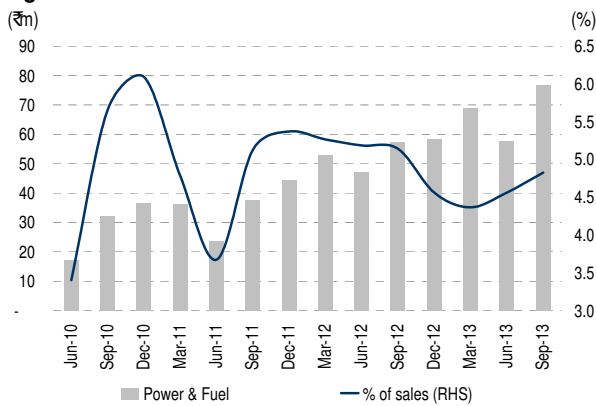
Source: Company, Anand Rathi Research

Fig 9 – EBITDA growth trend (quarterly)



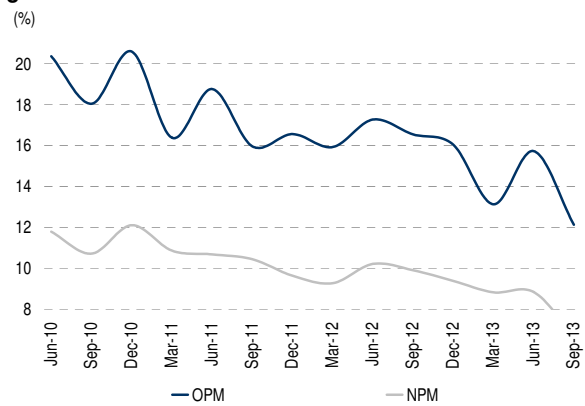
Source: Company, Anand Rathi Research

Fig 10 – Power & Fuel cost trend



Source: Company, Anand Rathi Research

Fig 11 – OPM and NPM trend

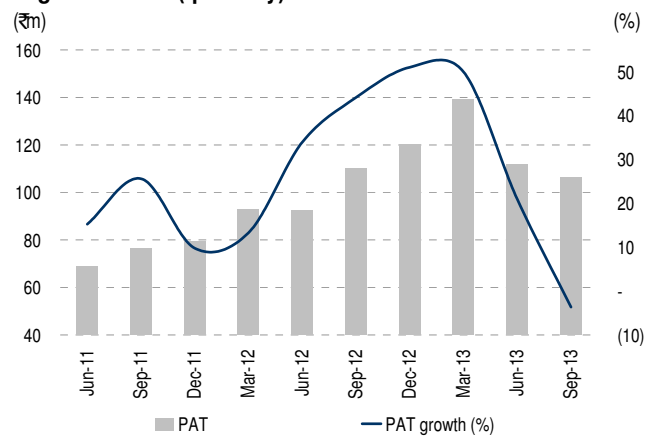


Source: Company, Anand Rathi Research

PAT growth slows to 21% yoy

Led by lower EBITDA growth, a 54% yoy rise in depreciation and a 160-bp increase in the tax rate, 2QFY14 PAT dipped 4% yoy. We have lowered FY14/15 EBITDA and earnings in line with the 1HFY14 trend.

Fig 12 – PAT growth trend (quarterly)



Source: Company, Anand Rathi Research

Outlook

In 2QFY14, the consistent show of robust quarterly growth continued. The addition of sanitaryware capacity of 0.7m pieces to the earlier 2m in Jan’13 along with more sales of faucets and (outsourced) wellness products would help to a 31% CAGR in revenue (and 19% in PAT) over FY13-15. Cera plans to spend ₹1.5bn over FY14-16 on expansion in sanitaryware, faucets and wind turbines. Its industry-leading EBITDA margins, driven by low-cost natural gas, the rise in asset turnover and its de-leveraged balance sheet are expected to drive return ratios.

Valuations

Our target of ₹725 is based on 14x FY15e PE (a premium to the last five-year-average multiple). The one-year forward-PE multiple ranges between 4x and 12x. At the ruling price of ₹577, the stock trades at PE of 11.2x and 9.2x FY14e and FY15e earnings respectively, and EV/EBITDA of 8.3x and 6.5x.

Fig 13 – Twelve-month forward-EV/EBITDA: Past band



Source: Bloomberg, Anand Rathi Research

Risks

- **Currency risk.** The company imports ~20% of its requirements; hence, currency fluctuations would cut into its earnings.
- **Slowdown in real estate.** As demand for sanitaryware is directly correlated with real-estate demand, a slowdown in real estate would squeeze demand for Cera's products.
- **Chinese imports.** Any change in China's policy to curtail its exports or India's policy to rein in imports would be negative for Cera.

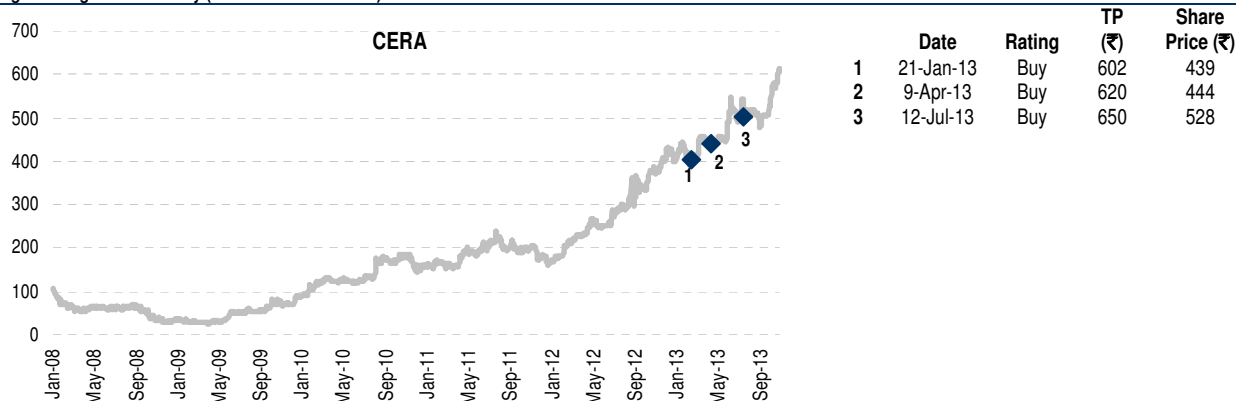
Appendix

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