

December 09, 2022

Kajaria Ceramics Limited: Ratings reaffirmed; outlook revised to Stable from Positive; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based - Cash credit	70.0	110.0	[ICRA]AA reaffirmed/assigned for enhanced amount; outlook revised to Stable from Positive
Short-term Fund-based - Bill discounting	50.0	-	-
Short-term Non-fund based	90.0	140.0	[ICRA]A1+ reaffirmed/assigned for enhanced amount
Short-term Unallocated	15.0	-	-
Total	225.0	250.0	

*Instrument details are provided in Annexure-I

Rationale

The revision in rating outlook on the long-term rating reflects the impact of the unprecedented surge in gas prices on the profitability of Kajaria Ceramics Limited (KCL) (and the overall ceramic tiles industry) in H1 FY2023 and ICRA's expectation that the overall improvement in the company's credit profile will be more gradual than earlier anticipated. ICRA notes that the sharp increase in gas prices over the past several quarters moderated KCL's operating margins to 13.6% in H1 FY2023 (from 16.5% in FY2022 and 18.3% in FY2021). While it has implemented price hikes in the recent quarters, which should support the profitability going forward, the operating margins are expected to remain in the range of 13-14% in FY2023e and are likely to improve by 100-200 bps in FY2024e. The ratings continue to favourably factor in the company's long track record of operations and its leadership position in the domestic tile market, backed by a well-recognised brand presence and an expansive distribution network. The ratings reflect KCL's sizeable scale of operations and robust financial profile, characterised by a conservative capital structure and robust debt protection metrics. Moreover, its liquidity position remains strong, with cash and liquid investments of around Rs. 338 crore as on September 30, 2022, resulting in a negative net debt position. While the company has sizeable capex plans (of more than Rs. 310 crore) over FY2023-FY2024, ICRA expects it to maintain its net negative debt position over the medium term.

The rating strengths are partially offset by the intense competition in the tiles industry and the susceptibility of KCL's revenues and cash flows to the cyclical nature in the real estate industry, which is the major end-user of tiles. The ratings factor in the vulnerability of the company's operations to the fluctuations in input prices and limited ability to pass-on the same to the end-users, amid stiff competition, thereby keeping the profitability margins volatile. Coupled with the impact of increase in input prices, the operating margins are expected to remain around 13-14% for FY2023e and improve gradually. ICRA believes that the company is better placed to pass on the hikes in input prices to customers compared to other smaller and mid-sized players, given its leadership position in the domestic ceramic tiles industry and the relatively high share of retail sales.

Key rating drivers and their description

Credit strengths

Leading position in domestic tiles market; well-recognised brand with pan-India presence - KCL is the largest player in the domestic tiles industry with a track record of over three decades. It has a well-recognised brand presence and an expansive pan-India distribution network (1,700 dealers; 10,000 touchpoints). In terms of geographies, North India is the biggest market

for the company accounting for 40% of its revenues, followed by the South (30-35%), West (25-30%) and East (10%). Moreover, KCL has an established presence across both the retail and institutional segments, with retail constituting around 70-80% of the revenues.

Sizeable scale of operations with healthy return indicators - KCL has reported steady revenue growth over the years, aided by its established position in the Indian tiles industry and strong brand recognition. A steady retail demand and increasing penetration in tier-II and tier-III markets resulted in sizeable scale of operations, with revenues increasing to Rs. 3,705 crore in FY2022 (+33% YoY) and Rs. 2,086 crore in H1 FY2023 (+36% YoY) at a consolidated level. Further, despite the moderation in operating profitability to 13.6% in H1 FY2023 (from 16.5% in FY2022 and 18.3% in FY2021), its return indicators stood healthy, with the core RoCE at 22.4% in H1 FY2023 (29.9% in FY2022). Overall, the company continues to maintain a strong financial risk profile.

Comfortable capital structure and strong debt protection metrics - Healthy accrual generation, over the years, has limited KCL's reliance on external debt for funding its capex requirements. This, coupled with a strong net worth base (Rs. 2,236 crore as on September 30, 2022), has resulted in a comfortable capital structure with gearing of 0.1 times as on September 30, 2022. Further, the low debt levels led to strong debt protection metrics as reflected in total debt/OPBDITA of 0.4 times and interest coverage of 41.8 times as on September 30, 2022. Additionally, it had around Rs. 338-crore of cash and liquid investments as on September 30, 2022, resulting in a net negative debt position. Going forward, while KCL has sizeable capex and investment plans of over Rs. 310 crore for FY2023-FY2024, ICRA believes that the company is likely to continue maintaining a net negative debt position.

Credit challenges

Vulnerability of profitability to changes in raw material and fuel prices - KCL's profitability remains vulnerable to any increase in the prices of raw materials and natural gas, as these two components form a major part of the cost structure. ICRA notes that gas prices have more than doubled in the past few quarters, which along with an increase in other input costs, has resulted in a moderation in the company's operating margins to 13.6% in H1 FY2023 (from 16.5% in FY2022 and 18.3% in FY2021). However, given its leadership position in the domestic tiles industry and relatively higher share of retail sales, KCL is better placed to pass on the hikes in input prices to customers compared to other smaller and mid-sized players. With an improvement in average realisations (+6% in H1 FY2023) and the recent softening in gas prices, the company's profitability is expected to improve from Q2 FY2023 levels (viz. 12%) in the forthcoming quarters. Going forward, KCL's ability to fully and timely pass on the rise in input costs to its customers, amid intense industry competition, will remain the key for its margin improvement.

Intense competition and cyclicity in real estate industry - Presence of a few large, organised players and numerous mid-to-small-sized players, along with high pace of capacity addition, in the recent past, has intensified competition in the tiles industry. Moreover, the real estate industry remains the major end-user of tiles and hence, KCL's revenues and cash flows remain vulnerable to the cyclicity in the end-user industry.

Environmental and social risks

Environmental considerations - Tiles manufacturing is an energy-intensive process requiring substantial quantities of fuel and thus, resulting in greenhouse gas emissions, waste generation and pollution. As such, the industry's (and KCL's) exposure to litigation/penalties arising from issues related to waste and pollution management remains relatively high. However, as per the company's annual report of FY2022, it has taken initiatives towards the use of clean technology and energy efficiency. Its plants run on natural gas, instead of coal, to combat the rising pollution. Its hazardous waste and emissions have remained within the permissible limits of CPCB/SPCB in FY2022. Nonetheless, KCL's cash flows remain exposed to the increasing investment requirements to comply with stringent pollution norms.

Social considerations - Social risk in the industry stems from the health and safety concerns of employees involved in the mining of clay, among other things. Further, given the dependence on human capital, entities in the tiles industry are exposed to labour-related risks and risks of protests/social issues with local communities, which could impact expansion/modernisation plans or disrupt regular operations. While these issues have not hindered KCL's expansion plans in the past, a lack of sensitivity in managing these risks could result in cost overruns in the context of its large medium-term capacity expansion plans. It also remains exposed to any major shift in consumer preferences, which are a key driver for demand, and accordingly may need to make material investments to realign its product portfolio.

Liquidity position: Strong

KCL's liquidity is strong, as evidenced by cash and liquid investments of Rs. 338 crore and undrawn working capital lines of ~Rs. 90 crore as on September 30, 2022 at a standalone level. ICRA notes that most of these surplus investments is parked in fixed deposits with reputed and financially strong banks. Additionally, healthy accruals from the business, coupled with negligible debt obligations and favourable working capital cycle, drive the company's strong financial profile. While KCL has sizeable capex and investment plans, in excess of Rs. 310 crore over FY2023-FY2024, it is expected to be entirely funded through internal accruals. Further, its low gearing and healthy net worth support its financial flexibility to raise additional debt in case of any adverse business scenario.

Rating sensitivities

Positive factors - The ratings may be upgraded if the company is able to exhibit a significant improvement in its scale of operations and profitability, on a sustained basis, while maintaining a comfortable working capital cycle and strong liquidity.

Negative factors - Negative pressure on KCL's ratings could arise if the revenue or profitability declines, causing the core RoCE to fall below 20% on a sustained basis. Further, any significant debt-funded capex/investments, which impacts its leverage profile or debt coverage metrics, or any stretch in the working capital cycle that adversely impacts its liquidity position, may lead to a downward pressure on the company's ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of KCL. As on September 30, 2022, KCL had seven subsidiaries and two step-down subsidiaries which are all enlisted in Annexure – II.

About the company

Kajaria Ceramics Limited (KCL) was incorporated in 1985 as a manufacturer of floor and wall tiles by Mr. Ashok Kajaria in technical collaboration with Todagres SA, Spain. It started operations in 1988 with a capacity of 1 million sq. metre (msm) per annum at its ceramic tiles manufacturing facility at Sikanderabad (Uttar Pradesh). Since then, the company has expanded its production capacities as well as product range. At present, it manufactures, outsources and trades ceramic and vitrified tiles under the brand name, Kajaria. In addition, KCL sells sanitaryware marketed under the Kerovit brand. The company's manufacturing facilities are in Sikanderabad (Uttar Pradesh), Gailpur and Malootana (Rajasthan) and Srikalahasti (Andhra Pradesh), with an aggregate capacity of 62.2 msm. It also has 22.6 msm capacity under various subsidiaries/joint ventures, which takes the cumulative capacity to 84.8 msm. Apart from tiles, KCL has a sanitaryware plant at Morbi, Gujarat, and a faucet manufacturing facility at Gailpur, Rajasthan, under its step-down subsidiary Kajaria Bathware Pvt Ltd. The company went public in 1988 and is listed on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE).

Key financial indicators (audited)

	Standalone			Consolidated		
	FY2021	FY2022	H1 FY2023*	FY2021	FY2022	H1 FY2023*
Operating income (Rs. crore)	2,523.2	3,299.4	1,893.6	2,780.9	3,705.2	2,086.0
PAT (Rs. crore)	308.0	362.3	172.5	308.9	382.7	161.9
OPBDIT/OI (%)	18.3%	16.1%	13.5%	18.3%	16.5%	13.6%
PAT/OI (%)	12.2%	11.0%	9.1%	11.1%	10.3%	7.8%
Total outside liabilities/Tangible net worth (times)	0.2	0.3	0.2	0.3	0.4	0.4
Total debt/OPBDIT (times)	0.1	0.1	0.1	0.2	0.3	0.4
Interest coverage (times)	90.9	87.0	87.6	47.5	48.0	41.8

Source: ICRA Research; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; *Limited Review

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current Rating (FY2023)		Chronology of Rating History for the Past 3 Years			
		Amount Rated (Rs. crore)	Amount Outstanding as on Sep 30, 2022 (Rs. crore)	Date & Rating on	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
				Dec 9, 2022	Feb 11, 2022	Nov 27, 2020	Jan 27, 2020
1 Fund-based - Cash credit	Long-term	110.0	NA	[ICRA]AA (Stable)	[ICRA]AA (Positive)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2 Fund-based - Bill discounting	Short-term	-	NA	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3 Non-fund based	Short-term	140.0	NA	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4 Unallocated	Short-term	-	NA	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based - Cash credit	Simple
Short-term Non-fund based	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, are available on ICRA's website: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund based - Cash credit	NA	NA	NA	110.0	[ICRA]AA (Stable)
NA	Non-fund based	NA	NA	NA	140.0	[ICRA]A1+

Source: Kajaria Ceramics Limited

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Annexure II: List of entities considered for consolidated analysis

Company	Ownership	Consolidation Approach
Kajaria Vitrified Pvt Ltd (formerly Jaxx Vitrified)	87%	Full Consolidation
Kajaria Infinity Pvt Ltd (formerly Cosa Ceramics) *	68%	Full Consolidation
Vennar Ceramics Ltd	51%	Full Consolidation
Kajaria Plywood Pvt Ltd	100%	Full Consolidation
Kajaria International DMCC, Dubai	100%	Full Consolidation
South Asian Ceramic Tiles Pvt Ltd	51%	Full Consolidation
Kajaria Bathware Pvt Ltd	85%	Full Consolidation
Kajaria Sanitaryware Pvt Ltd	100% (Step-down subsidiary)	Full Consolidation
Kerovit Global Pvt Ltd	100% (Step-down subsidiary)	Full Consolidation

Source: Company Annual Report FY2022; *KCL has proposed to increase its stake in Kajaria Infinity to 77% from erstwhile 51%

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