November 27, 2020

Kajaria Ceramics Limited: Ratings reaffirmed at [ICRA]AA(Stable)/A1+; rated amount reduced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Limits - Cash Credit	70.0	70.0	[ICRA]AA (Stable); reaffirmed
Fund-based Limits - Bill Discounting	125.0	100.0	[ICRA]A1+; reaffirmed
Non-fund Based Limits	55.5	40.0	[ICRA]A1+; reaffirmed
Unallocated	49.5	15.0	[ICRA]A1+; reaffirmed
Total	**300.0**	**225.0**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation continues to factor in the leadership position of Kajaria Ceramics Limited (KCL) in the domestic tile market, given its well-recognised brand, long track record of operations, significant manufacturing presence and pan-India distribution reach. The rating action also factors in the company's strong financial profile with steady annualised revenue growth (except in FY2020), healthy profitability indicators, low debt levels and strong liquidity profile.

Although the pandemic-induced lockdown adversely impacted KCL's financial performance in Q4 FY2020 and Q1 FY2021, the demand recovery in Q2 FY2021 supported a strong improvement in its profits and cash accruals. Notwithstanding the headwinds faced by the ceramic tiles industry in the backdrop of dampened residential real estate activity, KCL's revenues were driven by pent up retail demand post lockdown from tier II and III cities where the company, in the past, had expanded its distribution presence. Additionally, benefits of lower power and fuel expenses as well as various cost-control initiatives undertaken by the management aided operating margin expansion in Q2 FY2021 to 20.2% from 15.7% in Q2 FY2020. Although demand recovery is expected to continue in the near term, the loss of sales in Q1 FY2021 would result in the overall contraction in scale of operations for the fiscal, which coupled with fuel price increases and cost inflation would inhibit profit expansion in FY2021.

KCL's credit profile remains strong despite a challenging business environment due to its low reliance on external debt, comfortable capital structure with gearing of 0.09 times as on March 31, 2020 and aided by strong internal accrual generation over the years. The company has a strong liquidity position with cash and liquid investments to the tune of Rs. 424 crore as on September 2020 and healthy cash flow generation. Further, the near-term capex requirements are expected to be minimal with capacity addition expected only in FY2022 in case of steady recovery in demand.

At the same time, ICRA takes note of the intense competition in the tiles industry, given the presence of both large and organised players as well as numerous small-scale tile manufacturers. Intense competition in the backdrop of muted end-user demand has limited KCL's ability to pass on the increased input costs reflected in the decline in its average realisations and operating margins during FY2018–FY2020. Going forward as well, the company's profitability is expected to remain vulnerable to an increase in input costs, especially given the present sluggish demand scenario. Further, KCL's operations remain susceptible to growth prospects of the real estate industry.

Notwithstanding the stiff competition in the industry, regulatory developments, such as the ban by National Green Tribunal (NGT) on captive coal gasifier plants in the Morbi region and stricter implementation of GST/e-way bill have resulted in higher compliance costs for unorganised players. Moreover, the labour unavailability and liquidity challenges faced by many small players have resulted in consolidation and augur well for the market position of organised players in the near term. Furthermore, the rise in exports of ceramics tiles, particularly by unorganised players is likely to ease demand and pricing pressure in domestic markets as indicated by the flattish sales realisations in H1 FY2021.

The Stable outlook on the [ICRA]AA rating reflects ICRA's expectation that growth in KCL's revenues, profits and cash accruals will be supported by its strong business position and favourable long-term demand prospects for the end-user industry. The company is expected to maintain a strong credit profile with negligible reliance on external debt while maintaining sizeable liquidity.

Key rating drivers

Credit strengths

Leading position in domestic tiles market; well-recognised brand with pan-India presence in distribution and manufacturing - KCL is the largest player in the domestic tiles industry with over three-decade-long track record of operations, well-recognised brand and pan-India distribution reach. The company has a widespread distribution network comprising around 5,000 touch points, including dealers, sub-dealers and franchisee-managed showrooms/display centres. With presence across multiple price points and products, significant distribution reach as well as strong brand recognition, the company has been able to maintain a leading position in the tiles industry. In terms of revenue break-up, North India is the biggest market for the company, accounting for 40% of its revenues in FY2020, followed by South (25%), West (25%) and East (10%).

Large scale of operations with well-diversified customer base - KCL has reported steady revenue growth over the years, aided by its established position in the Indian tiles industry and strong brand recognition. This has resulted in sizeable scale of operations for the company with revenues of Rs. 2,808 crore in FY2020. Moreover, KCL has a well-diversified customer base with established presence across both retail and institutional segments, with retail constituting around 90% of the revenues. Stronger retail demand and penetration in tier II and III markets have supported a sharp rebound in the company's sales during Q2 FY2021, even as the pandemic-induced lockdown adversely impacted sales in Q4 FY2020 and Q1 FY2021.

Comfortable capital structure, strong debt protection metrics and robust liquidity - Strong internal 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. 1,714 crore as on March 31, 2020), has resulted in a comfortable capital structure with gearing of 0.09 times as on March 31, 2020. Further, low debt levels and healthy profitability have resulted in strong debt protection metrics as reflected by total debt/OPBDITA of 0.40 times and interest coverage of 21.4 times as on March 31, 2020. Additionally, the company has around Rs. 424-crore cash and liquid investments as of September 30, 2020 as well as average cushion of Rs. 55–60 crore in working capital facilities, indicating robust liquidity. Its funding requirements towards capex as well as dividend outflows are expected to remain negligible in the current fiscal.

Favourable demand prospects for organised tile manufacturers - The tiles industry houses a large number of unorganised players, resulting in intense competition. Despite regulatory developments (such as the ban by NGT on captive coal gasifier plants in the Morbi region along with stricter implementation of GST/e-way bill) that have resulted in higher compliance costs, the competition remains high in the industry. However, the issue of labour unavailability and liquidity challenges faced by many small players have resulted in consolidation and augur well for the market position of organised players.

Credit challenges

Intense competition and pricing pressures prevalent in tiles industry - Presence of large organised players and numerous small-sized players along with high pace of capacity additions in the recent past has intensified competition in the tiles industry. This, coupled with subdued demand scenario, has resulted in pricing pressures for various players, including KCL. This is reflected in the decline in its realisations over the last three years, though realisations are expected to remain stable in the near term because of an increase in costs pertaining to compliance and labour of unorganised players while power and fuel prices have remained favourable amid the pandemic.

Vulnerability of profitability to changes in raw material and fuel prices - KCL's profitability continues to be vulnerable to any increase in the prices of raw materials and natural gas as the combination of these two categories forms a major part of the cost structure. Given the low prevailing demand from the end-user segment, KCL may not be able to fully pass on the increase in input prices, which may impact its profitability, as witnessed during FY2016–FY2020.

Liquidity position

KCL's liquidity profile remains **strong**, as evident from the free cash balance and liquid investment of Rs. 424 crore as on September 30, 2020. Moreover, over the last 12 months, KCL has maintained an average utilisation of 15% of its fund-based sanctioned limits with cushion of ~Rs. 55–60 crore with respect to the sanctioned limits (on a standalone basis). The company has annual debt repayment commitments of Rs. 5–10 crore each year over the next three years, which are expected to be comfortably met through its internal accruals.

Rating sensitivities

Positive triggers - An upward movement in rating could happen if the company demonstrates higher-than-anticipated improvement in scale of operations along with significant improvement in its operating profitability on a sustained basis driven by improved demand for tiles, while maintaining its strong liquidity profile and low leverage on a sustained basis.

Negative triggers - Negative pressures on KCL's rating could arise if there is deterioration in its financial metrics, including muted/negative revenue growth, decline in profitability reflected by core RoCE falling below 20% on a sustained basis, or any significant debt-funded capex/investments impact its leverage profile and debt coverage metrics, or any stretch in its receivables cycle leading to an increase in working capital cycle that adversely impacts its liquidity position.

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 March 31, 2020, the company had six subsidiaries and one step-down subsidiary, that are enlisted in Annexure-2

About the company

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 its operations in 1988 with a capacity of 1 million sqm (MSM) per annum at its ceramic tiles manufacturing facility at Sikanderabad (UP). Since then, the company has expanded its production capacities as well as product range.

At present, the company manufactures, outsources and trades ceramic and vitrified tiles (under its brand name, Kajaria). In addition, KCL sells sanitaryware marketed under the Kerovit brand. The company's manufacturing facilities are located at Sikanderabad (UP), Gailpur (Rajasthan) and Malootana (Rajasthan) and Srikalahasti (Andhra Pradesh) and have an aggregate capacity of 49.2 msm. In addition, the company has 21.2 msm capacity under various subsidiaries/joint ventures, which takes the cumulative capacity to 70.4 msm.

Apart from tiles, KCL has a sanitaryware plant in Morbi, Gujarat and a faucet manufacturing facility in Gailpur, Rajasthan under its step-down subsidiary Kajaria Bathware Pvt. Ltd. The capacity of the sanitaryware plant is 7.5 lakh pieces and that of the faucet plant is 1 million pieces.

For FY2020, the company reported a net profit of Rs. 253.5 crore on an OI of Rs. 2,808.0 crore against a net profit of Rs. 228.8 crore on an OI of Rs. 2,956.2 crore in FY2019.

Key financial indicators (audited)

	FY2019	FY2020
Operating Income (Rs. crore)	2,956.2	2,808.0
PAT (Rs. crore)	228.8	253.5
OPBDIT/ OI (%)	15.4%	14.9%
RoCE (%)	21.7%	17.7%
Total Outside Liabilities/Tangible Net Worth (times)	0.45	0.37
Total Debt/OPBDITA (times)	0.26	0.40
Interest Coverage (times)	29.2	21.4
DSCR	6.5	7.7

Source: *KCL*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2021)				Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Rating	FY2020	FY2019	FY2018
					27 Nov 2020	27 Jan 2020	02 Jan 2019	24 Nov 2017
1	Fund based limits	Long Term	70.0	-	[ICRA]AA (Stable)	AA(Stable)	AA(Stable)	AA(Stable)
2	Fund based limits	Short Term	100.0	-	A1+	A1+	-	-
3	Non-fund based limits	Short Term	40.0	-	A1+	A1+	A1+	A1+
4	Unallocated limits	Short term	15.0		A1+	A1+	A1+	A1+

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund based limits	-	-	-	70.0	[ICRA]AA(Stable)
NA	Fund based limits	-	-	-	100.0	[ICRA]A1+
NA	Non-fund based limits	-	-	-	40.0	[ICRA]A1+
NA	Unallocated limits	-	-	-	15.0	[ICRA]A1+

Source: KCL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Jaxx Vitrified Private Limited	87.37%	Full Consolidation
Vennar Ceramics Limited	51.00%	Full Consolidation
Cosa Ceramics Private Limited	51.00%	Full Consolidation
Kajaria Tiles Private Limited*	100.00%	Full Consolidation
Kajaria Bathware Private Limited	85.00%	Full Consolidation
Kajaria Plywood Private Limited	98.00%	Full Consolidation
Kajaria Sanitaryware Private Limited	69.70%	Full Consolidation

*Source: KCL,*formerly Kajaria Floera Ceramics Private Limited*

ANALYST CONTACTS

Sabyasachi Majumdar
+91-124-4545304
sabyasachi@icraindia.com

Anupama Arora
+91-124-4545303
anupama@icraindia.com

Anupama Reddy
+91-40-40676516
anupama.reddy@icraindia.com

Pooja Banthiya
+91 124 4545300
pooja.banthiya@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

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ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999