

OCTOBER 18, 2016

#### RESULT

Coverage view: **Neutral**

Price (₹): **2,585**

Target price (₹): **2,050**

BSE-30: **28,051**

**Another steady quarter, but macro-outlook still subdued.** Cera reported another stable quarter. Focus remains on improving premium mix and margins. However, the market remains dull and is likely to continue be so over the next 3-4 quarters and hence, some expansion plans have been pushed back a notch. We continue to like the management and their approach to growth, but macro trends do not support current valuations at almost 28X FY2018E EPS on CMP. Maintain view.

#### Company data and valuation summary

Cera Sanitaryware

| Stock data                      |                        | Forecasts/Valuations |       |       |      |
|---------------------------------|------------------------|----------------------|-------|-------|------|
|                                 |                        | 2016                 | 2017E | 2018E |      |
| 52-week range (Rs) (high,low)   | 2,719-1,475            | EPS (Rs)             | 64.2  | 73.7  | 93.2 |
| Market Cap. (Rs bn)             | 33.6                   | EPS growth (%)       | 23.4  | 14.9  | 26.4 |
| <b>Shareholding pattern (%)</b> |                        | P/E (X)              | 40.3  | 35.1  | 27.7 |
| Promoters                       | 54.7                   | Sales (Rs bn)        | 9.3   | 11.1  | 13.4 |
| FIs                             | 11.1                   | Net profits (Rs bn)  | 0.8   | 1.0   | 1.2  |
| MFs                             | 7.3                    | EBITDA (Rs bn)       | 1.4   | 1.6   | 2.0  |
| <b>Price performance (%)</b>    |                        | EV/EBITDA (X)        | 23.3  | 20.5  | 16.3 |
| Absolute                        | 1M 8.8 3M 5.7 12M 21.3 | ROE (%)              | 21.6  | 20.8  | 21.8 |
| Rel. to BSE-30                  | 11.0 4.5 17.7          | Div. Yield (%)       | 0.3   | 0.3   | 0.4  |

#### Results review: 2QFY17

Cera's revenues for 2QFY17 stood at ₹2.5 bn, up 11% yoy, in line with our estimates. EBITA margins dropped marginally on a sequential basis, but remain high. Net income stood at ₹251 mn, in line with our estimates for the quarter.

#### Highlights from the management conference call

- ▶ As per the management, demand environment still remains subdued, especially in southern markets, Cera's largest. The management indicated a delay in opening additional capacity in sanitaryware (of 0.3 mn pieces /year) by a quarter or two, sighting slow demand. But Cera is expected to increase prices in 3QFY17 (Nov' 16) by 3-4.5% across the product range.
- ▶ For the quarter, sanitaryware grew 8%, faucets 12% and tiles 37%. The share of sanitaryware (along with its allied products) is 61% of revenue, faucets 21%, tiles 15% and wellness products 3%. The management expects high double digit growth to continue in faucets and tiles for FY2017, while sanitaryware could remain in single digits. Focus will continue on improving operating efficiencies and increasing premium product mix in sales.
- ▶ The tile JV has begun well with margins already in double digits. The management is contemplating plans to increase production of GVT tiles versus 90% of the current production which is soluble salt.

#### We maintain our net income CAGR estimates of 20% over FY2016-19E

We expect Cera's profits to grow at a CAGR of 20% over FY2016-19E reflecting strong growth in faucets/tiles businesses and steady sales in sanitaryware business with improving margins. Maintain view on the stock valuing it at 22X FY2018E EPS of ₹93.2/share. We have assumed 11.6% growth in sanitaryware, 39% in faucets and 20% in tiles in FY2017. Key risks to our estimates are better than estimated consolidated margins and lower growth in its faucets business.

Samar Sarda  
samar.sarda@kotak.com  
Mumbai: +91-22-4336-0874

## Exhibit 1: Another steady quarter

Cera: 2QFY17 and 1HFY17 results snapshot, March discal year-ends (Rs mn)

|                        | 2QFY17  | 2QFY17E | 2QFY16  | 1QFY17  | % change |        |        | 1HFY17  | 1HFY16  | % change | FY2017E |
|------------------------|---------|---------|---------|---------|----------|--------|--------|---------|---------|----------|---------|
|                        |         |         |         |         | 2QFY17E  | 2QFY16 | 1QFY17 |         |         |          |         |
| Financials snapshot    |         |         |         |         |          |        |        |         |         |          |         |
| Net sales              | 2,492   | 2,503   | 2,253   | 2,136   | (0)      | 11     | 17     | 4,628   | 4,196   | 10       | 11,052  |
| Operating costs        | (2,079) | (2,072) | (1,961) | (1,773) | 0        | 6      | 17     | (3,852) | (3,622) | 6        | (9,447) |
| EBITDA                 | 413     | 431     | 292     | 362     | (4)      | 42     | 14     | 775     | 574     | 35       | 1,606   |
| Other income           | 24      | 13      | 35      | 13      | 83       | (33)   | 87     | 36      | 47      | (23)     | 76      |
| Interest costs         | (9)     | (18)    | (12)    | (7)     | (51)     | (25)   | 19     | (16)    | (29)    | (45)     | (72)    |
| Depreciation           | (41)    | (42)    | (39)    | (40)    | (1)      | 5      | 4      | (81)    | (76)    | 6        | (167)   |
| PBT                    | 387     | 384     | 276     | 328     | 1        | 40     | 18     | 714     | 516     | 39       | 1,442   |
| Taxes                  | (135)   | (131)   | (97)    | (114)   | 3        | 40     | 19     | (249)   | (180)   | 38       | (476)   |
| PAT                    | 251     | 253     | 179     | 214     | (1)      | 41     | 18     | 465     | 335     | 39       | 966     |
| EPS (Rs/share)         | 19.3    | 19.5    | 13.8    | 16.5    |          |        |        | 35.8    | 25.8    |          | 73.7    |
| Key ratios             |         |         |         |         |          |        |        |         |         |          |         |
| EBITDA margin (%)      | 16.6    | 17.2    | 12.9    | 17.0    |          |        |        | 16.8    | 13.7    |          | 14.5    |
| PAT margin (%)         | 10.1    | 10.1    | 7.9     | 10.0    |          |        |        | 10.1    | 8.0     |          | 8.7     |
| Effective tax rate (%) | 35.0    | 34.1    | 35.1    | 34.7    |          |        |        | 34.9    | 34.9    |          | 33.0    |

Source: Company, Kotak Institutional Equities estimates

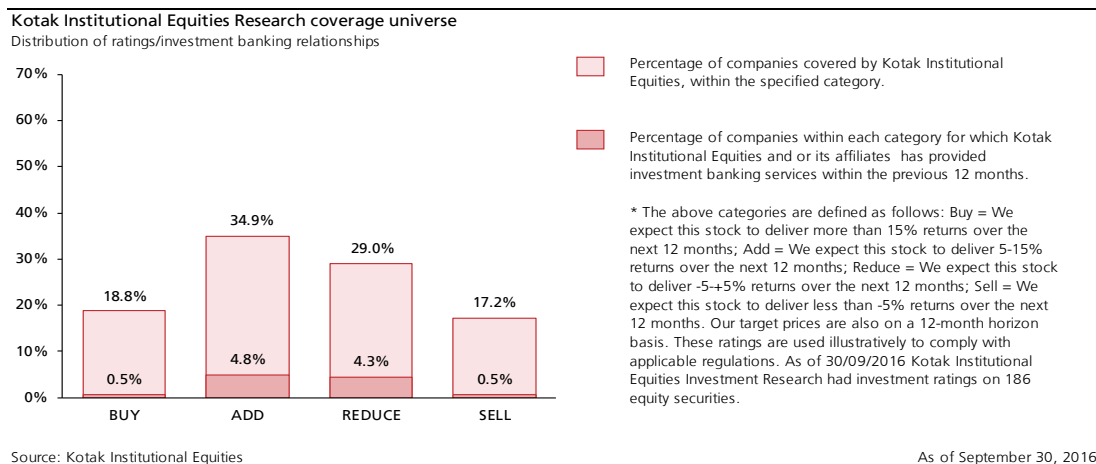
## Exhibit 2: We expect Cera's net income to growth at 20% CAGR over FY2016-19E

Cera: Profit model, balance sheet, cash flow model, March fiscal year-ends, 2014-19E (Rs mn)

|   | 2014  | 2015  | 2016  | 2017E  | 2018E  | 2019E  |
|---|-------|-------|-------|--------|--------|--------|
| Profit model                              |       |       |       |        |        |        |
| Net sales                                 | 6,637 | 8,217 | 9,337 | 11,052 | 13,416 | 16,110 |
| EBITDA                                    | 949   | 1,175 | 1,413 | 1,606  | 2,012  | 2,388  |
| Other income                              | 62    | 66    | 100   | 76     | 80     | 85     |
| Interest                                  | (64)  | (77)  | (55)  | (72)   | (107)  | (89)   |
| Depreciation                              | (122) | (155) | (163) | (167)  | (169)  | (186)  |
| Pre-tax profits                           | 824   | 1,009 | 1,295 | 1,442  | 1,816  | 2,198  |
| Tax                                       | (265) | (253) | (394) | (476)  | (599)  | (725)  |
| Deferred taxation                         | (40)  | (80)  | (66)  | —      | —      | —      |
| Net income                                | 519   | 677   | 835   | 966    | 1,217  | 1,473  |
| Adjusted net income                       | 519   | 677   | 835   | 959    | 1,212  | 1,459  |
| Earnings per share (Rs)                   | 41.0  | 52.0  | 64.2  | 73.7   | 93.2   | 112.2  |
| Balance sheet                             |       |       |       |        |        |        |
| Total equity                              | 2,240 | 3,517 | 4,210 | 5,028  | 6,084  | 7,386  |
| Minority interests                        | —     | —     | 0     | 8      | 12     | 26     |
| Non-current liabilities                   | 646   | 769   | 898   | 952    | 1,085  | 891    |
| Current liabilities                       | 1,647 | 2,156 | 2,358 | 2,850  | 3,095  | 3,292  |
| Total liabilities and equity              | 4,532 | 6,442 | 7,466 | 8,837  | 10,276 | 11,595 |
| Net fixed assets                          | 1,569 | 2,223 | 2,300 | 2,748  | 3,207  | 3,468  |
| Other non-current assets and advances     | 283   | 320   | 368   | 394    | 426    | 458    |
| Current assets                            | 2,559 | 3,421 | 4,126 | 5,496  | 6,442  | 7,469  |
| Investments                               | 121   | 478   | 671   | 200    | 200    | 200    |
| Total assets                              | 4,532 | 6,442 | 7,466 | 8,837  | 10,276 | 11,595 |
| Free cash flow                            |       |       |       |        |        |        |
| Operating cash flow excl. working capital | 681   | 908   | 1,064 | 1,060  | 1,381  | 1,645  |
| Working capital changes                   | (70)  | (554) | 141   | (536)  | (453)  | (820)  |
| Capital expenditure                       | (398) | (809) | (240) | (614)  | (628)  | (446)  |
| Investments                               | (107) | (356) | (194) | 471    | —      | —      |
| Free cash flow                            | 106   | (812) | 771   | 380    | 299    | 379    |
| Ratios (%)                                |       |       |       |        |        |        |
| Debt/equity                               | 21.5  | 19.4  | 8.3   | 15.1   | 14.6   | 8.0    |
| Net debt/equity                           | 7.8   | 11.0  | (5.8) | (9.7)  | (10.5) | (11.8) |
| RoE (%)                                   | 25.7  | 23.5  | 21.6  | 20.9   | 21.9   | 21.9   |
| RoCE (%)                                  | 19.9  | 18.6  | 18.0  | 17.7   | 19.3   | 20.1   |
| Book value per share (Rs)                 | 177   | 270   | 324   | 387    | 468    | 568    |

Source: Company, Kotak Institutional Equities estimates

"I, Samar Sarda, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report."



## Ratings and other definitions/identifiers

### Definitions of rating

BUY. We expect this stock to deliver more than 15% returns over the next 12 months.

ADD. We expect this stock to deliver 5-15% returns over the next 12 months.

REDUCE. We expect this stock to deliver -5+5% returns over the next 12 months.

SELL. We expect this stock to deliver <-5% returns over the next 12 months.

Our target prices are also on a 12-month horizon basis.

### Other definitions

Coverage view. The coverage view represents each analyst's overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: Attractive, Neutral, Cautious.

### Other ratings/identifiers

NR = Not Rated. The investment rating and target price, if any, have been suspended temporarily. Such suspension is in compliance with applicable regulation(s) and/or Kotak Securities policies in circumstances when Kotak Securities or its affiliates is acting in an advisory capacity in a merger or strategic transaction involving this company and in certain other circumstances.

CS = Coverage Suspended. Kotak Securities has suspended coverage of this company.

NC = Not Covered. Kotak Securities does not cover this company.

RS = Rating Suspended. Kotak Securities Research has suspended the investment rating and price target, if any, for this stock, because there is not a sufficient fundamental basis for determining an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.

NA = Not Available or Not Applicable. The information is not available for display or is not applicable.

NM = Not Meaningful. The information is not meaningful and is therefore excluded.

## Corporate Office

Kotak Securities Ltd.  
27 BKC, Plot No. C-27, "G Block"  
Bandra Kurla Complex, Bandra (E)  
Mumbai 400 051, India  
Tel: +91-22-43360000

## Overseas Affiliates

Kotak Mahindra (UK) Ltd  
8th Floor, Portoken House  
155-157 Minories  
London EC3N 1LS  
Tel: +44-20-7977-6900

Kotak Mahindra Inc  
369 Lexington Avenue  
28th Floor, New York  
NY 10017, USA  
Tel: +1 212 600 8856

Copyright 2016 Kotak Institutional Equities (Kotak Securities Limited). All rights reserved.

1. Note that the research analysts contributing to this report may not be registered/qualified as research analysts with FINRA; and
2. Such research analysts may not be associated persons of Kotak Mahindra Inc and therefore, may not be subject to NASD Rule 2711 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.
3. Any U.S. recipients of the research who wish to effect transactions in any security covered by the report should do so with or through Kotak Mahindra Inc and (ii) any transactions in the securities covered by the research by U.S. recipients must be effected only through Kotak Mahindra Inc at [nilesh.jain@kotak.com](mailto:nilesh.jain@kotak.com).

This report is distributed in Singapore by Kotak Mahindra (UK) Limited (Singapore Branch) to institutional investors, accredited investors or expert investors only as defined under the Securities and Futures Act. Recipients of this analysis / report are to contact Kotak Mahindra (UK) Limited (Singapore Branch) (16 Raffles Quay, #35-02/03, Hong Leong Building, Singapore 048581) in respect of any matters arising from, or in connection with, this analysis / report. Kotak Mahindra (UK) Limited (Singapore Branch) is regulated by the Monetary Authority of Singapore.

Kotak Securities Limited and its affiliates are a full-service, integrated investment banking, investment management, brokerage and financing group. We along with our affiliates are leading underwriter of securities and participants in virtually all securities trading markets in India. We and our affiliates have investment banking and other business relationships with a significant percentage of the companies covered by our Investment Research Department. Our research professionals provide important input into our investment banking and other business selection processes. Investors should assume that Kotak Securities Limited and/or its affiliates are seeking or will seek investment banking or other business from the company or companies that are the subject of this material and that the research professionals who were involved in preparing this material may participate in the solicitation of such business. Our research professionals are paid in part based on the profitability of Kotak Securities Limited, which include earnings from investment banking and other business. Kotak Securities Limited generally prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, Kotak Securities Limited generally prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover. Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of clients of Kotak Securities Limited. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice. The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. Kotak Securities Limited does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment.

Certain transactions -including those involving futures, options, and other derivatives as well as non-investment-grade securities - give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavor to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so. We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein. Kotak Securities Limited and its non US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies affectively assume currency risk. In addition options involve risks and are not suitable for all investors. Please ensure that you have read and understood the current derivatives risk disclosure document before entering into any derivative transactions.

Kotak Securities Limited established in 1994, is a subsidiary of Kotak Mahindra Bank Limited. Kotak Securities is one of India's largest brokerage and distribution house.

Kotak Securities Limited is a corporate trading and clearing member of BSE Limited (BSE), National Stock Exchange of India Limited (NSE), MSEI and United Stock Exchange of India Limited (USEIL). Our businesses include stock broking, services rendered in connection with distribution of primary market issues and financial products like mutual funds and fixed deposits, depository services and Portfolio Management.

Kotak Securities Limited is also a depository participant with National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL). Kotak Securities Limited is also registered with Insurance Regulatory and Development Authority as Corporate Agent for Kotak Mahindra Old Mutual Life Insurance Limited and is also a Mutual Fund Advisor registered with Association of Mutual Funds in India (AMFI). Kotak Securities Limited is registered as a Research Analyst under SEBI (Research Analyst) Regulations, 2014.

We hereby declare that our activities were neither suspended nor we have defaulted with any stock exchange authority with whom we are registered in last five years. However SEBI, Exchanges and Depositories have conducted the routine inspection and based on their observations have issued advise letters or levied minor penalty on KSL for certain operational deviations. We have not been debarred from doing business by any Stock Exchange / SEBI or any other authorities; nor has our certificate of registration been cancelled by SEBI at any point of time.

We offer our research services to primarily institutional investors and their employees, directors, fund managers, advisors who are registered with us

Details of Associates are available on our website i.e. [www.kotak.com](http://www.kotak.com)

Research Analyst has served as an officer, director or employee of subject company(ies): No

We or our associates may have received compensation from the subject company(ies) in the past 12 months.

We or our associates have managed or co-managed public offering of securities for the subject company(ies) in the past 12 months. YES

We or our associates may have received compensation for investment banking or merchant banking or brokerage services from the subject company(ies) in the past 12 months. We or our associates may have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company(ies) in the past 12 months. We or our associates may have received compensation or other benefits from the subject company(ies) or third party in connection with the research report.

Our associates may have financial interest in the subject company(ies).

Research Analyst or his/her relative's financial interest in the subject company(ies): No

Kotak Securities Limited has financial interest in the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: YES

Our associates may have actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report.

Research Analyst or his/her relatives has actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No

Kotak Securities Limited has actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No

Subject company(ies) may have been client during twelve months preceding the date of distribution of the research report.

A graph of daily closing prices of securities is available at [www.nseindia.com](http://www.nseindia.com) and <http://economictimes.indiatimes.com/markets/stocks/stock-quotes>. (Choose a company from the list on the browser and select the "three years" icon in the price chart).

Kotak Securities Limited. Registered Office: 27 BKC, C 27, G Block, Bandra Kurla Complex, Bandra (E), Mumbai 400051. CIN: U99999MH1994PLC134051, Telephone No.: +91-22 43360 000, Fax No.: +91-22- 6713 2430. Website: [www.kotak.com](http://www.kotak.com). SEBI Registration No: NSE INB/INF/INE 230808130, BSE INB 010808153/INF 011133230, MSEI INE 260808130/INB 260808135/INF 260808135, Research Analyst INH000000586, AMFI ARN 0164 and PMS INP000000258. NSDL: IN-DP-NSDL-23-97. CDSL: IN-DP-CDSL-158-2001.

Compliance Officer Details: Mr. Manoj Agarwal. Call: +91-22-4285 6825, or Email: [ks.compliance@kotak.com](mailto:ks.compliance@kotak.com).

In case you require any clarification or have any concern, kindly write to us at below email ids:

Level 1: For Trading related queries, contact our customer service at 'service.securities@kotak.com' and for demat account related queries contact us at [ks.demat@kotak.com](mailto:ks.demat@kotak.com) or call us on: Online Customers - 30305757 (by using your city STD code as a prefix) or Toll free numbers 18002099191 / 1800222299, Offline Customers - 18002099292

Level 2: If you do not receive a satisfactory response at Level 1 within 3 working days, you may write to us at [ks.escalation@kotak.com](mailto:ks.escalation@kotak.com) or call us on +91-22-4285 8445 and if you feel you are still unheard, write to our customer service HOD at [ks.servicehead@kotak.com](mailto:ks.servicehead@kotak.com) or call us on +91-22-4285 8208.

Level 3: If you still have not received a satisfactory response at Level 2 within 3 working days, you may contact our Compliance Officer (Name: Manoj Agarwal) at [ks.compliance@kotak.com](mailto:ks.compliance@kotak.com) or call on +91-22-4285 6825.

Level 4: If you have not received a satisfactory response at Level 3 within 7 working days, you may also approach CEO (Mr. Kamlesh Rao) at [ceo.ks@kotak.com](mailto:ceo.ks@kotak.com) or call on +91-22-6652 9160.

First Cut notes published on this site are for information purposes only. They represent early notations and responses by analysts to recent events. Data in the notes may not have been verified by us and investors should not act upon any data or views in these notes. Most First Cut notes, but not necessarily all, will be followed by final research reports on the subject. There could be variance between the First cut note and the final research note on any subject, in which case the contents of the final research note would prevail. We accept no liability for the contents of the First Cut Notes.