RC Capital Management is an Investment Advisory Firm specializing in identifying and investing in high quality companies that trade at a substantial discount to our conservative estimates of Intrinsic Value.

This report is a compilation of our analysis of Financial / Business performance "**Cera Sanitaryware Limited**" from an investment perspective

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Company Analysis: CERA Sanitaryware Limited

About

Cera is a premium sanitary ware company with a 20% market share in the organized sector. The company manufacturers/ outsources and sells products such as vitreous sanitary ware, Faucet ware (fittings and taps), Wellness products such as Showers, panels, bathtubs, Kitchen sinks and allied products such as PVC cisterns and seat covers.

The company produces several of the above products at its plant at Kadi (Gujarat) and also outsources some of its requirement for premium products from china.

The company sells through a wide distribution network of 1000 dealers/ distributors and 10000+ retailers.

Financials

The company achieved a topline of around 320 Crs and net profit of 31.7 Crs in 2012. The company has been able to achieve a 20%+ growth in the topline and profit in the last 7 years.

The company has been able to reduce the debt equity ratio from around 0.7 in 2006 to 0.3 and if one nets off the excess cash from the debt, then the company is close to being debt free. This is an extremely good trend as it shows the capability of the company to generate free cash flows which are being used to pay down debt, fund growth and pay out a small level of dividend.

The company has been able to improve its asset turns from around 1.6 in 2006 to around 1.9 in 2012 (though inventory levels rose quite a bit in 2012 over 2011, after years of improvement). The company has also been able to improve its operating margins to around 17% and had a net margin of around 10% in the current year.

This has resulted in an improving ROE from around 20% in 2006 to 24% in 2012

Positives

The company has been able to grow rapidly in the last 6-7 years with clear focus on building a distribution network and investing in the brand (advertising and promotion expense is now running at around 10% of sales). This has helped the company to maintain and improve its competitive advantage which shows up in the financials in the form of improved ROE.

The company has been introducing new products and has been able to drive volume growth, while maintaining its margins and unit revenues. This shows that the company has been able to compete effectively without commoditizing its product and thus gain market share profitably.

Risks

The key to understanding the risk is to understand the main points of the idea. The company is a good idea as it is increasing its competitive advantage by building its distribution network and brand. These two assets in combination allows the company to sell an increasing quantity of product at above average prices (at or better margins than competition).

The strategy being followed by the company is not dependent on a single person and does not require some special insight. It does require consistent and focused execution by the management. The sudden death of the founder's son is a tragic incident and could impact the company in the long term, if the promoter loses focus and allows the company to slide. At the same time the recent appointment of the Ex-CEO as an acting CEO is an encouraging development. The blue print of success is already in place and the current and future CEOs need to just execute to it.

The industry is highly competitive with two key players – HSIL and Parryware, which are much larger than CERA. In addition, the industry has a large number of un-organized players and faces threat from imports. The import threat is not as high as CERA itself imports several products from china and is on a level playing field on that count. The brand awareness and distribution strength of HSIL and Parryware is much higher than CERA and will require an ongoing effort from the management to maintain the momentum.

At the same time, the underlying growth in the industry and migration to the organized sector should provide enough growth opportunities to the three key players in the industry. The last two years have been fairly tough for the housing industry and in spite of the poor macro conditions, the company has been able to maintain its margins and growth. This shows that the competition in the industry, though tough is not out of control.

Competitive analysis

The main competitors for the company (bathroom fittings) are HSIL and Parryware. HSIL is the no.1 company in the industry and has around 40% market share. Parryware and CERA are the no.2 and 3 companies in the industry. The organized sector is thus an oligopoly where the competition has been based on quality and brands and not on price (till date) and as a result the margins and return on capital has been quite good even during a slowdown in demand.

In addition, there is also a migration of sales from the un-organized to the organized sector as the industry moves to higher quality premium products.

Management quality checklist

- ***Management compensation***: This is one sore point in terms of corporate governance. The top management and their relatives draw around 10-12% of the profits as salary which is clearly excessive.
- ***Capital allocation record***: The capital allocation record has been good. The company has generated decent amount of free cash flows which has been used to fund the growth, pay down the debt and maintain a minimum level of dividend. The company has invested the free cash flow at decent levels of returns as can be seen from the increasing levels of ROE.
- ***Shareholder communication***: adequate. The company provides the requisite disclosures via the annual reports and annual updates.
- ***Accounting practice***: looks conservative and as per standards
- ***Conflict of interest***: None, other than high management compensation

Valuation

The company is currently selling (as of 15th Sept 2012) at a PE of around 13 times earnings. The stock price has seen a run up of around 70% since we created a position in the stock. The company appears over-valued if one looks the historical PE and past earnings.

At the same time if one does a discounted cash flow analysis, which is forward looking in nature, fair value ranges from 350-450 per share (details in the valuation template).

So what is the reality? Is it overvalued or undervalued?

There are a few points to keep in mind. The past valuations and earnings are a guide to valuation, but should never be used blindly. The utility of past numbers is reduced further if the company in question is growing rapidly and also improving its competitive advantage at the same time. In such as case, the past valuations would give much lower valuations than warranted. In such cases, the DCF method allows one to input the future expectation and come up with valuations for a range of scenarios. We have done that for the company as indicated earlier and using it for making our decision.

Conclusion

The stock was a quantitatively cheap idea when we created a position. The price has run up since then and there is a temptation of book some profits and move on. At the same time, one has to look beyond the raw numbers and try to understand the key points behind the thesis.

We are betting that the company will continue to invest in the brand, expand the distribution network and introduce new products though this network. If the company can continue to execute as it has been doing for the last 3-4 years, the earnings should keep rising and so will the stock price.

Q2-2013 Report Review

Posted on 30th October 2012

Cera Sanitaryware declared Q2 results recently and reported a 52% growth in top line and a 44% growth in profits. The company has delivered a 45% growth in the top line and 40% growth in profit for first half of 2013.

The company has been able to maintain a net margin of around 10% and an ROE of 25% for the year. In all the company is performing well and the stock price has reflected the performance. The only negative is a rise in inventory levels, which have increased from 70 days to around 95 days of sales. As a result of the increase, the free cash flow for the company has dropped with a corresponding rise in debt by around 40 crores in the last one year. We will continue to watch the performance closely and will take a decision based on how the company continues to manage the growth and free cash flows.

Q3-2013 Report Review

Posted on 28th January 2013

Cera Sanitaryware declared Q3 results recently and reported a 56% growth in top line and a 51% growth in profits. The company seems to be on track to do an EPS of around 35 for the year 2013. The company has been able to maintain a net margin of around 9.5% and an ROE of 25% for the year. In all the company is performing well and the stock price has reflected the performance. The company is selling at around 12 times FY 2013 earnings and seems to be fairly priced at these levels. We already hold a full position in the stock in the model portfolio and will not add to it. At the same time, the current price is still attractive to buy if one does not hold a full position in the stock.

Please note: A full position in the model portfolio is around 5% of the portfolio size.

Q4-2013 Report Review

Posted on 4th May 2013

Cera Sanitaryware declared Q4 results recently and reported a 56% growth in top line and a 49% growth in profits. The company ended the year with an EPS of 36.5. The company has been able to deliver a 52% growth in sales and 45% growth in profits for the entire year.

The company has been able to maintain a net margin of around 9.5%, same as last year in spite of increase in raw material costs – which could be due to the tiles business and increased third party sourcing. This was done by controlling overhead as % of sales. The company has also improved inventory turns to 5.2 from 3.5 in 2012 and thus been able to control the inventory levels in the current fiscal. The company was able to maintain an ROE of 25% for the year, by improving the overall asset turns.

In all, the company is performing well and the stock price has reflected the performance. The company is selling at around 12 times FY 2013 earnings and seems to be reasonably priced at these levels.

Annual Report Review – 2013

Posted on 22nd July 2013

Key risk (identified earlier) and their current status

Management depth –

The unfortunate demise of the founder's son, who was playing a major role in the top management, is a cause of concern. The company has appointed an ex-director (resigned in 2008) as the CEO of the company.

The company has a w ell laid out strategy to grow the business – invest in sales and distribution and in brand building. In addition, the company is also launching new products such as tiles and other product extensions regularly. This strategy has been in place for some years now and the organization has been executing it quite well. In the medium term (2-4 years) as long as the company can stick to the plan, it should continue to do well. It remains to be seen how the long term will play out in terms of management structure and strategy.

Competitive threat –

The main competitors for CERA are HSIL and Kajaria ceramics (in tiles). Both the companies have been growing well and earning a high return on capital. We are probably seeing a migration from the unorganized to the organized sector and as a result, the top companies in this space should continue to do well for the next 2-3 years.

Imports –

The company imports around 20% of its sales. The depreciation of the rupee may have an impact on the cost and margins of the company. At the same the higher import costs, should reduce the competitive impact of the Chinese imports.

New opportunities

The company has forayed into tiles in the current year. This is a much larger market, though the profit margins are lower than other products such as Sanitaryware, faucets etc. The company should be able to leverage its current assets such as the distribution network and brand, to expand in this new segment and earn a good return on capital.

Changes to fair value

The fair value of the company has been calculated at around 850/share which comes to around 23 times 2013 earnings. In view of the growth prospects and the above average return on capital, we will keep the fair value at the same level for the time being.

Q1-2014 Results Review

Posted on 12th August 2013

Cera Sanitaryware reported a 40% growth in top line and a 21% growth in profits. The company reported a small dip in net margins from 9.5% to 8.8% in the current quarter – due to higher overheads and employee expenses (as percentage of sales).

The company continues to perform well in most of the product segments and is now expanding in the tiles business too. At the same time companies like Kajaria ceramics are expanding into the Sanitaryware business, thus making the two companies direct competitors now. For the time being, there is enough growth in the market to accommodate multiple companies and Cera is likely to do well for some time to come.

Q2-2014 Results Review

Posted on 1st November 2013

Cera Sanitaryware reported a 42% growth in top line and a minor de-growth in profits. The growth in top line for H1 2014 continues to be 40%+, but the profit growth has dropped to around 7%

The profit growth has dropped mainly due to a rise in the raw material cost as a percentage of sales. We need to explore further the reason behind the drop in gross margins. The balance sheet however has improved in the current year. Inventory levels which shot up to 100 days in 2012 are now down to around 53 days, which is quite good. Receivables are also around 51 days of sales. Work capital has improved from around 60 days of sales in March 2013 to 58 days in September 2013

The company continues to perform well from a top line perspective. We need to monitor the gross margins to understand if the cause in the drop is due to newer products or due to higher competitive intensity.

Q3-2014 Results Review

Posted on 23rd February 2014

Cera Sanitaryware reported a 25% growth in top line and a 11% de-growth in profits. The growth in top line for YTD 2014 was 35%, but the profit growth has dropped to around 1%

The profit growth has dropped mainly due to a rise in the raw material cost as a percentage of sales. The management took a conscious decision to hold the prices (and accept lower margins) to keep up the top line momentum. The company has recently taken a price increase and should be able to improve the margins in the coming quarters.

The company continues to invest in the business which is translating into the top line growth and due to the pricing power available to the company, should be able improve the margins and the profit growth too. The company has expanded into the tiles and faucet ware categories and expects good growth from these categories in the future years, although the margins are likely to be lower.

One point to keep in mind – One should not look at margins in isolation (as some analysts do). If the top line growth is high and the Return on capital continues to be maintained at 20%+ levels, then a lower margin profile is fine and continues to create value for the shareholder.

The company seems to be fairly valued at current price levels and the future price increase is likely to come from profit growth than an expansion in PE levels.

Q4-2014 Results Review

Posted on 1st May 2014

Cera Sanitaryware reported a 38% growth in top line and a 36% growth in profits for Q4 2014. The growth in top line for 2014 was 36%, but the profit growth was around 12.3%

The profit growth dropped mainly due to a rise in the raw material cost as a percentage of sales. As I wrote in the last update, the management took a conscious decision to hold the prices (and accept lower margins) to keep up the top line momentum. The company recently took a price increase and been able to restore the operating and net margin to the previous levels.

The company continues to invest in the business which is translating into the top line growth and due to the pricing power available to the company, should be able to maintain the margins and the profit growth too. The company has expanded into the tiles and faucet ware categories and expects good growth from these categories in the future years, although the margins are likely to be lower.

One point to keep in mind – One should not look at margins in isolation (as some analysts do). If the top line growth is high and the Return on capital continues to be maintained at 20%+ levels, then a lower margin profile is fine and continues to create value for the shareholder. One additional point – the company has been able to improve (reduce) the working capital requirement, by improving the inventory turns and receivables. As a result, the company was able to reduce the debt during the current year.

The company seems to be fairly valued at current price levels and the future price increase is likely to come from profit growth than an expansion in PE levels. We will continue to hold the stock in the model portfolio as long as the company can maintain its business momentum.

Annual Results Review – 2014

Posted on 27th July 2014

Key risk (identified earlier) and their current status

Competitive threat –

The main competitors for CERA are HSIL and Kajaria ceramics (in tiles). Both the companies have been growing well and earning a high return on capital. We are probably seeing a migration from the unorganized to the organized sector and as a result, the top companies in this space should continue to do well for the next 2-3 years.

Imports –

The company imports around 20% of its sales. The depreciation of the rupee may have an impact on the cost and margins of the company. At the same the higher import costs, should reduce the competitive impact of the Chinese imports.

New opportunities

The company has been investing in building its brand and expanding its distribution network – from around 10000 dealers to 14000 dealers. This is a long term asset which the company can leverage to sell more of existing products and launch new products

The company has expanded into faucet ware in the past and has been able to do quite well in this segment. The company is now increasing capacity and plans to use its wide distribution to further increase the volume.

The company has also forayed into tiles in the current year. This is a much larger market, though the profit margins are lower than other products such as sanitary ware, faucets etc. The company should be able to leverage its distribution network and brand, to expand in this new segment and earn a good return on capital.

Changes to fair value

The company now sells at around 30 times FY13 earnings and appears to be fairly valued. At the same time, the company has tapped just a small portion of an expanding pie (bathroom fittings, sanitary ware and tiles) and can continue growing for a considerable period of time.

The various building blocks are already in place and company should do well in the long run. We will continue to hold the stock for the time being and may even add to it if I feel that the stock is available at a reasonable valuation (though it is unlikely to get cheap now)

Q1-2015 Results Review

Posted on 1st August 2014

Cera Sanitaryware reported a 28% growth in top line and a 22.5% growth in profits for Q1 2015 on a year on year basis.

Operating margins have improved 7.8% to 8.5% in the quarter as the company took the long overdue price hikes. The company continues to invest in the business which is translating into the top line growth and due to the pricing power available to the company, should be able to maintain the margins and the profit growth too. The company has expanded into the tiles and faucet ware categories and expects good growth from these categories in the future years, although the margins are likely to be lower.

The company continues to earn a high Return on capital of 20%+ which combined with a 20% growth has resulted in value creation for the shareholder. If the company can maintain the same working capital turns as Q4 2014, then the quality of the business will be higher and could more than justify a high valuation. We will keep a track of this variable in the coming quarters.
The company is no longer an unknown stock, selling at a low valuation as it was when we first invested. The change in fundamentals and past growth had not been recognized. The undervaluation was corrected in 6-7 months with the stock price rising by 70% in that period of time.

It would have been a mistake to have sold the stock and move on to some other idea, especially when CERA itself had a large opportunity ahead of itself and all the basics were in place to take advantage of it.

The situation has not changed since then. The competitive advantage of the company has improved with investments in the sales and distribution network and in the brand. The company continues to introduce new products and still has a large opportunity ahead of itself. The only change is that the quality of the company is now more widely recognized.

We will continue to hold the stock in the model portfolio as long as the company can maintain its business momentum and does not become wildly overpriced.

Q2-2015 Results Review

Posted on 16th October 2014

Cera Sanitaryware reported a 26.6% growth in top line and a 48% growth in profits for Q2 2015 on a year on year basis. The corresponding numbers for the first half of the year were 26.7% and 34%.

Operating margins have improved slightly from 14.2% for 2014 to 14.3% in the first half of the year. The company continues to invest in the business via addition to the fixed assets which is translating into the top line growth and due to the pricing power available to the company, should be able to maintain the margins and the profit growth too. The company has expanded into the tiles and faucet ware categories and expects good growth from these categories in the future years, although the margins are likely to be lower.

The company continues to earn a high Return on capital of 20%+ which combined with a 20% growth has resulted in value creation for the shareholder. The company earned around 23% return on equity for the first half of the year with a small amount of leverage (debt equity of around .24). The leverage is being taken to add to the capacity and is quite reasonable.

The company is no longer an unknown stock, selling at a low valuation as it was when we first invested. The change in fundamentals and past growth had not been recognized. The undervaluation was corrected in 6-7 months with the stock price rising by 70% in that period of time.

It would have been a mistake to have sold the stock and move on to some other idea, especially when CERA itself had a large opportunity ahead of itself and all the basics were in place to take advantage of it.

The situation has not changed since then. The competitive advantage of the company has improved with investments in the sales and distribution network and in the brand. The company continues to introduce new products and still has a large opportunity ahead of itself. The only change is that the quality of the company is now more widely recognized.

We will continue to hold the stock in the model portfolio as long as the company can maintain its business momentum and does not become wildly overpriced.

Q3-2015 Results Review

Posted on 5th February 2015

Cera Sanitaryware reported a 30% growth in top line and a 49% growth in profits quarter. The corresponding numbers for the year to date were 28% and 35%.

Operating margins have improved slightly from 14.2% for 2014 to 15%. The company has expanded into the tiles and faucet ware categories and expects good growth from these categories in the future years, although the margins are likely to be lower.

The company continues to earn a high Return on capital of 20%+ which combined with a 20% growth has resulted in value creation for the shareholder.

The company is no longer an unknown stock, selling at a low valuation as it was when we first invested. The change in fundamentals and past growth had not been recognized. The undervaluation was corrected in 6-7 months with the stock price rising by 70% in that period of time.

It would have been a mistake to have sold the stock and move on to some other idea, especially when CERA itself had a large opportunity ahead of itself and all the basics were in place to take advantage of it.

The situation has not changed since then. The competitive advantage of the company has improved with investments in the sales and distribution network and in the brand. The company continues to introduce new products and still has a large opportunity ahead of itself. The only change is that the quality of the company is now more widely recognized.

The company is now selling at fairly high valuations and any short term slowdown will hurt the stock in the short term. However, the long term prospects continue to be good and as a result we will continue to hold the stock in the model portfolio as long as the company can maintain its business momentum and does not become wildly overpriced.

Q4-2015 Results Review

Posted on 5th May 2015

Cera Sanitaryware reported a 14.6% growth in top line and similar growth in profits for the quarter. The corresponding numbers for the year were 23.8% and 34%.

Operating margins have improved slightly from 14.2% for 2014 to 14.3% in the current year. The company has expanded into the tiles and faucet ware categories and expects good growth from these categories in the future years, although the margins are likely to be lower.

The return on capital for the company dropped to around 19.1%, due to higher investments in fixed assets and receivables towards the end of the year.

The company has reported a much lower growth during the quarter due to lower institutional demand. The company saw minimal sales growth in the months of Jan and Feb. As a result, the management has re-oriented its sales approach from march (become more pro-active in reaching out to customers) and has been seeing better results since then.

The management expects to achieve 20%+ growth p.a. in the next few years, based on the increasing demand for Sanitaryware and continued growth of the organized sector.

The stock is now a stock market favourite and seems to be held by a lot of short term momentum traders due to which any short term drop in growth rates will not be taken lightly. We had a 15+% drop in price after the results were announced.

I personally do not play the short term earnings game, as I am not good at it, even though it could possibly add a few percentage points to the overall returns. As I have shared with all of you in the past, I will hold on to a position till the long term prospects are attractive and the stock does not sell at very high valuations.

The stock currently accounts for 15%+ of the model portfolio and it is quite a high proportion of the portfolio. A case can be made for reducing the weight of this holding by selling some of it to reduce the risk. I am still thinking on this and a bit conflicted on it. I will share an update as soon as I make up my mind.

Annual Results Review – 2015

Posted on 26th June 2015

Not much has changed since the last annual report. This is a good thing. If a company has a decent competitive advantage and large opportunity ahead of it, I would prefer as an investor that the competitive scenario remains the same so that the company can continue to do well in the long run.

Key risk (identified earlier) and their current status

Competitive threats –

The main competitors for CERA are HSIL and Kajaria ceramics (in tiles). Both the companies have been growing well. We are seeing a migration from the unorganized to the organized sector and as a result, the top companies in this space should continue to do well for the next 2-3 years.

Imports –

The Company imports around 10% of its sales which is going down. This is a good development as the company is constantly working on substituting local raw materials in its production process. This reduces the risk of an exchange rate shock

Demand slow down –

We are seeing a slowdown in demand due to the stagnation in the real estate sector. The company is increasing its effort in improving sales, but it is quite likely that the sales growth may slow down from the 30%+ levels to 20% level in the medium term. In spite of the price action of the stock and the reaction of the short term traders, this is not a calamity. The long term performance of any company, even the good ones, is not in a straight line and there are always ups and downs over time.

New opportunities

The Company has been continually investing in building its brand and expanding its distribution network. This is a long term asset which the company can leverage to sell more of existing products and launch new ones.

The company has expanded into faucet ware in the past and has been able to do quite well in this segment. The company has increased capacity and plans to use its wide distribution to further increase the volume.

The company has also forayed into tiles and is making good progress. This is a much larger market, though the profit margins are lower than other products such as sanitary ware, faucets etc. The company should be able to leverage its distribution network and brand, to expand in this new segment and earn a good return on capital.

Changes to fair value

The company now sells at around 37 times FY15 earnings. It can always be argued that the company is 10-20% overpriced and a case made to hold or sell it.

I have practiced a quantitative approach to investing in the past. However, in the last few years, I have also started focusing on the competitive strength of a company and the opportunity ahead of it. It is difficult to boil down some of these aspects to a number. As a result, a decision to hold or reduce will continue to be a subjective one for the model portfolio.

There is no change to the fair value as published in the portfolio creation note here.

Q1-2016 Results Review

Posted on 23rd August 2015

Cera Sanitaryware reported a 19.8% growth in top line and a 14.7 % growth in net profits. Operating margin stood at 14.4% for the quarter.

The company has expanded into tiles and faucet ware categories and expects good growth from these categories in the future, although the margins are likely to be lower. The Sanitaryware segment grew by 5%, Faucet ware by around 25% and tiles by around 12-15% during the quarter.

The two main competitors for Cera are HSIL and Kajaria in the organized space. HSIL had a flat top line and Kajaria had a growth of around 12-13% volume growth during the quarter. Based on these numbers, we can assume that Cera is doing slightly better than the organized industry and as a whole (including unorganized) could be gaining market share.

In the current circumstances (real estate slowdown), I think this is fairly good performance. The company should be able to capitalize when the demand comes back

To exit or not to exit

I recently published the Ashiana Housing note and received a few emails on whether we should consider reducing our position in Cera and other housing related stocks.

Let me share my thoughts on it and what I plan to do for my and for the model portfolio.

The standard advice in such cases is that one should exit the position and wait till the industry starts turning around. Once that happens, we should re-enter the stock and get back to the original position size. That way, we may be able to avoid the opportunity loss and may even be able to reduce the cost basis.

Even if I ignore the impact of taxes and trading costs, I do not subscribe to this approach which seems very seductive, especially when seen in hindsight. What could be more attractive than to have sold off Ashiana @300 and to start buying now. If that is truly the case, how many investors are now plunging into the stock and re-building the position. The price is usually the lowest at the point of maximum pessimism. How do we know if we are there yet in case of Ashiana Housing and hence how will we know the same for any other company such as CERA?

I know I am not smart enough to identify such turning points and hence prefer to stick with a company, where the long term outlook is good. It is important to know your own limitations and work with it (I have paid quite a price whenever I have ignored it)

I am not being sanguine and blind to what is happening in the industry. In the short to medium term if the real estate market continues to slow down, the top line growth for CERA could suffer and so will the stock price.

The management has indicated that they are seeing a slowdown in the industry, but still expect to grow at around 20% for the year. We have to take such projections with a grain of salt as even the management cannot control their destiny in spite of all the efforts

Look beyond the immediate

Let's try to look beyond the next 1-2 years. Let's say we are looking at 2018. Unless the economy collapses by then (in which case we will have to worry about more important things), real estate volumes should recover (prices may not) and so will the demand for all kinds of building material.

CERA with its strong competitive position (possibly even no.2) due to new products, expanding distribution and investments in brands, should be able to take its share of the expanded industry. You have to keep in mind that 68% of the population still does not have access to toilets and housing/ sanitation is definitely a basic need which is met, once someone is able to afford it.

There will be pain

This position is around 15% of the portfolio. Unlike a symphony which accounts for around 2%, any movement in this stock will kill the returns of the portfolio in the short term. As a result, the high weightage and volatility could become a reason for me to reduce the weightage. I may do that for the model portfolio to reduce the volatility, but unlikely to do so for my own portfolio as I can personally take the pain in the short term.

Q2-2016 Results Review

Posted on 29th October 2015

I would encourage you to read the Q1 analysis as I written about my thoughts on position size, real estate slowdown and its impact to CERA.

Cera Sanitaryware reported a 13.1% growth in topline and a 13.4 % growth in net profits. Operating margin stood at 12.9% for the quarter.

The real estate industry is going through a crunch and in light of the macro situation and considering that most of CERA's sale is to new projects, I think a 13% volume growth was quite good. The company has not taken a price hike in the last 18 months and plans to take one in the coming quarters.

The management has dropped the full year target to around 20% topline growth (from an earlier 20-25%). I think this was bound to happen due to the macro situation, but I do not find this as a cause of worry. The company continues to do well and although we do not have the industry figures, my guess is that the company is gaining share in the industry (including unorganized).

We should see higher growth once the headwind reduces and the normal demand comes back.

The market of course is looking out a few quarters and has punished the stock after the result. This is likely to continue till the volume growth comes back to the 20%+ levels of the last few years.

On the balance sheet front, the company is now debt free and has improved the working capital days from 63 to around 58 days which is a very good performance in the current situation. Finally, the company recently announced a JV with Anjani tiles which would allow the company to expand capacity and achieve topline growth with a lower investment in fixed assets

We will continue to maintain the position subject to the position size as shared in the previous quarter update.

Q3-2016 Results Review

Posted on 9th February 2016

I would encourage you to read the Q1 analysis as I have written about my thoughts on position size, real estate slowdown and its impact on CERA.

Cera Sanitaryware reported an 11.5% growth in top line and a 24.8 % growth in net profits. Operating margin stood at 15.3% for the quarter.

The real estate industry is going through a crunch and considering that most of CERA's sale is to new projects, the 11.5% top line is not surprising. As I suspected, the management was over optimistic of achieving a 20% level of top line growth and has since then scaled back the targets in view of the market realities.

I personally think this is a good response as this ensures that the trade level discipline is maintained (in terms of receivables) in the long run. As I have shared with some of you in the past, I have worked in the consumer goods industry in the sales and marketing function and have seen the damage done by a blind pursuit of growth (at the expense of trade and health of the brand).

The company has taken a price increase in the current quarter to the tune of 3-7% across different products to balance out the increases in some costs. However, a drop in the fuel cost, has resulted in an expansion of the operating profit margin to around 15.3%

The newer products of the company – faucets and tiles are now doing quite well. Faucets are now growing at around 50% per annum and should contribute to a larger percentage of the top line in the future.

The company has formed a JV with Anjani tiles and plans to start production by mid-march. The company expects to grow much faster in the tiles segment once the JV is operational and has the infrastructure at the same location to expand the capacity by 2-3X the current levels.

On the balance sheet front, the company is now debt free and has a cash of around 30 Crs which will be used for future capex. The market condition continues to be weak and though the management is targeting a 20% top line growth, they are not sure of achieving it due to the weak demand condition.

We will continue to maintain the position subject to the position size as shared in the previous quarter update.

Q4-2016 Results Review

Posted on10th May 2016

Cera Sanitaryware reported a 12% growth in top line and a 34.8 % growth in net profits for the quarter. Operating margin stood at 17.1% for the same period. For the year, sales have grown by 13.6% and net profits by 23.4%.

The company has shown an improvement in working capital days which have dropped from 63 to around 50 days. A slightly better asset efficiency and lower work capital days has resulted in asset turns improving to around 2.5 from the 2.3 levels in the previous year.

I have personally noticed the general fixation on growth and a much lesser focus on the ROE and asset efficiency. However, if a company has to create value for the shareholder, then the ROE needs to remain at 15%+ levels along with the above average growth. A high ROE driven by margins is not as sustainable (due to competition) as one driven by higher efficiency (asset turns). Hence my consistent focus on the ROE and asset turns for all the companies in our portfolio.

The real estate industry is going through a crunch and considering that most of CERA's sale is to new projects, the 12% top line is reasonable. As I suspected, the management was over optimistic of achieving a 20% level of top line growth and has since then scaled back the targets in view of the market realities. The management expects a 20% in the next year, which for now seems to be aggressive.

I think the improvement in working capital and inventory levels, with steady receivables is quite good and shows that the management is not pushing sales at the expense of trade discipline. Although this impacts the growth numbers in the short term, it is a very healthy approach for the long run.

The company had taken a price increase in the previous quarter to the tune of 3-7% across different products to balance out the increases in some costs. However, a drop in the fuel cost, has resulted in an expansion of the operating profit margin to around 17.1%

The newer products of the company – faucets and tiles are now doing quite well. Faucets are growing at around 50% per annum and should contribute to a larger percentage of the top line in the future.

The company has formed a JV with Anjani tiles and started production in march. The company expects to grow much faster in the tiles segment as the JV is operational and has the necessary infrastructure at the same location to expand the capacity by 2-3X the current levels.

On the balance sheet front, the company is now debt free and has a cash of around 51 Crs which can be used for future capex. The market condition continues to be weak and though the management is targeting a 20% top line growth, they are not sure of achieving it due to the weak demand condition.

We will continue to maintain the position subject to the position size as shared in the previous quarter update.

2016 Annual Results Review

Posted on15th June 2016

The company continues to make progress on the long term drivers of performance, namely investing in the brand and expanding the sales and distribution network.

Key risk (identified earlier) and their current status

Competitive threats – The main competitors for CERA are HSIL and Kajaria ceramics. Both the companies have been growing well. In the past, these companies were focused on specific niches such as tiles in the case of Kajaria ceramics. However, we are now seeing a convergence in terms of product profiles as CERA moving into tiles (from FY17) and Kajaria launching a sanitary ware and faucet product range.

The overall industry has a large opportunity space and hence the top few companies in this space should be able to perform well in spite of the higher competition in the organized sector. In addition to this, we are seeing a migration from the unorganized to the organized sector and as a result, the top companies in this space should continue to do well for the next 2-3 years.

Imports – The Company imports around 8.8% of its sales which is going down. This is a good development as the company is constantly working on substituting local raw materials in its production process. This reduces the risk of an exchange rate shock

Demand slow down – We have seen a slowdown in demand due to stagnation in the real estate sector. This has resulted in slowing down of growth from the 30% levels to around 13.6% in the current year. The company has been able to perform well in the Tier 2 and 3 towns which continue to be their focus markets. We should see the headwinds in the real estate sector reduce and that should improve the growth levels for the company

Key man risk – I have not focused on this point in the past, but I think it is a point worth noting. After the death of Vidush Somany (the MD's son), the company has been managed by the MD/ promoter with the CEO Mr. Subhash Kothari. As can be seen from the performance of the last few years, the company has done well and is headed in the right direction. The risk is that there does not seem to be a next level management layer which can take over from the current MD/CEO who are both in their late 60s.

This is not a risk till the MD is able to lead the company and maintains good health. We need to keep an eye on the succession plan to be assured that the company can do well even after the current management team.

New opportunities

The Company has been continually investing in building its brand and expanding its distribution network. This is a long term asset which the company can leverage to sell more of existing products and launch new ones.

The company has expanded into faucet ware in the past and has been able to do quite well in this segment. The company has increased capacity and plans to use its wide distribution to further increase the volume.

The company has also forayed into tiles and has made good progress during the year. This is a much larger market (around 25000 Crs and growing at 10%+), though the profit margins are lower than other products such as sanitary ware, faucets etc.

The company has started production from April of the current fiscal and should be able to leverage its distribution network and brand, to expand in this new segment and earn a good return on capital.

Changes to fair value

The company now sells at around 31 times FY16 earnings and appears to be fairly to slightly over valued at the current valuation. At the current levels, we could see future returns accrue from a growth in earning which should be above average in view of the good long term prospects of the industry.

The fair value or intrinsic value of the company is unchanged.

Q1-2017 Results Review

Posted on 4th August 2016

Cera Sanitaryware reported a 12% growth in top line and a 36 % growth in net profits for the quarter. Operating margin stood at 16.2% for the same period and expanded by 1% due to lower cost of raw materials & energy and better efficiency at the plants.

The real estate industry is going through a crunch and considering that most of CERA's sale is to new projects, the 12% top line is reasonable. The management has not shared any specific growth targets, but expects better performance from the tiles division, where new capacity has come on-stream in the current quarter.

The management is seeing higher demand from the affordable housing segment and is optimistic that they will see better performance from the Tier 2,3 and 4 towns where the company has a higher presence. The newer products of the company – faucets and tiles are now doing well and growing at around 18-20%.

The company continues to improve its competitive position via continuous expansion of distribution and by investing in the brand (Ad spend is around 4% of sales). The recent passage of GST should accelerate the migration of demand to the organized sector and this tailwind should benefit the company.

We will continue to maintain the position subject to the position size as shared in the previous quarter update.

Q2-2017 Results Review

Posted on 2nd November 2016

Cera Sanitaryware reported a 12.3% growth in topline and a 39.4 % growth in net profits for the first half of the year. Operating margin stood at 16.7% for the same period and expanded by 1.5% due to lower cost of raw materials & energy and better efficiency at the plants.

The real estate industry is going through a crunch and considering that most of CERA's sale is to new projects, the 12% topline growth is reasonable. The management expects 12-15% topline growth for the year, but is not fully confident of it as demand in the real estate market continues to be weak

The first half year performance appears average, but I think there are several improvements occurring which are getting masked by the headwinds in the market. Let's review the changes

- The company is constantly improving its sales mix to high value (premium) products. As a result, this product segment has gone up from 21-22% of sales to close to 25%. The benefit of selling higher value products is that there is a positive rub off on the CERA brand. In addition, the margin and return on capital number continue to improve due to a higher proportion of premium products

- The company has been expanding its distribution network especially in the north east, where it has been traditionally weak. The number of distributors have gone up from 8000-9000 to close to 16000 now in the last 3 years. The company plans to expand this further to 20000 dealers in the next 2-3 years.

- The company has formed a JV with Anjani tiles and the plant is now operating at 80-90% capacity. As I shared in the past updates, tiles are a new product for the company and is now growing at 30%+, though from a low base. This product should provide the company with good growth opportunities

- The company continues to focus on the super-premium segment as this is also a fast-growing segment and has a positive rub off effect. For now, the company is importing an Italian brand to establish a presence in the category.

- The company continues to focus on work capital turns and has improved the inventory days from 51 to 48.7 days and receivables from 73 to 62 days.

- The management is making good progress on multiple business drivers and continues to strengthen the competitive position of the company. The company performance and the improvements are not hidden from the market as the company continues to sell at elevated valuations.

We have sold small quantities of this stock in the past to keep the position around 10% of the portfolio. I will continue to follow the same approach going forward, unless the valuations exceed all reasonable estimates.

Q3- 2017 Results Analysis

Posted on 13th February 2017

Cera sanitaryware reported a 3% growth in topline and 11 % growth in net profits for the quarter. The company has delivered 9% topline growth and 30.2% growth in net profits for the year to date

The Operating margin stood at 15.7% for the same period and has expanded due to lower cost of raw materials & energy and better efficiency at the plants.

The performance for the quarter is commendable. Anything which can go wrong in the macro environment for the company has gone wrong in the last 1 year. The real estate industry is going through a crunch and considering that most of CERA's sale is to new projects, the performance is quite good under the circumstances. If this wasn't enough, demonetization in the last quarter meant that any discretionary sale was essentially postponed and this impacted the building materials industry, including CERA.

The performance appears average, but I think there are several improvements occurring which are getting masked by the headwinds in the market. Let's review the changes

- The company is constantly improving its sales mix to high value (premium) products. As a result, this product segment has gone up from 21-22% of sales to close to 25%. The benefit of selling higher value products is that there is a positive rub off on the CERA brand. In addition, the margin and return on capital number continue to improve due to a higher proportion of premium products
- The company has been expanding its distribution network especially in the north east, where it has been traditionally weak. The number of distributors have gone up from 8000-9000 to close to 16000 now in the last 3 years. The company plans to expand this further to 20000 dealers in the next 2-3 years.
- The company has formed a JV with Anjani tiles and the plant is now operating at 70% capacity. As I shared in the past updates, tiles is a new product for the company and is now growing rapidly. The company is doing around 150 Crs in tiles and would like to take this to 1000 Crs in the next 4-5 years. Tiles thus appear to be the next growth driver for the company.
- The company continues to focus on the super-premium segment as this is also a fast-growing segment and has a positive rub off effect on its brand. For now, the company is importing an Italian brand to establish a presence in the category.

The management is making good progress on multiple business drivers and continues to strengthen the competitive position of the company. The company performance and the improvements are not hidden from the market as the company continues to sell at elevated valuations.

We have sold small quantities of this stock in the past to keep the position around 10% of the portfolio. I will continue to follow the same approach going forward, unless the valuations exceed all reasonable estimates.

Q4- 2017 Results Analysis

Posted on 11th May 2017

Cera sanitary ware reported a 12% growth in topline and 8 % growth in net profits for the quarter. The company has delivered 9.3% topline growth and 18.9% growth in net profits for the year to date

The Operating margin stood at 18.2% for the same period and has expanded due to lower cost of raw materials & energy and better efficiency at the plants.

The performance for the quarter is commendable. Anything which can go wrong in the macro environment for the company has gone wrong in the last 1 year. The real estate industry is going through a crunch and considering that most of CERA's sale is to new projects, the performance is quite good under the circumstances. Sales for the quarter grew at 12% although the real estate sector is still reeling from the overall slowdown and demonetization in the previous quarter.

The performance appears average, but I think there are several improvements occurring which are getting masked by the headwinds in the market. Let's review the changes

- The company is constantly improving its sales mix to high value (premium) products. As a result, this product segment has gone up from 21-22% of sales to close to 25%. The benefit of selling higher value products is that there is a positive rub off on the CERA brand. In addition, the margin and return on capital number continue to improve due to a higher proportion of premium products

- The company has been expanding its distribution network especially in the north east, where it has been traditionally weak. The number of distributors have gone up from 8000-9000 to close to 16000 now in the last 3 years. The company is planning to focus on the quality of the network and improve the number of active dealers in the mix.

- The company has formed a JV with Anjani tiles and the plant is now operating at 70% capacity. As I shared in the past updates, tiles is a new product for the company and is now growing rapidly (40% in FY17). The company is doing around 180 Crs in tiles and would like to take this to 1000 Crs in the next 4-5 years. Tiles thus appear to be the next growth driver for the company

- The company continues to focus on the super-premium segment as this is also a fast-growing segment and has a positive rub off effect on its brand. For now, the company is importing an Italian brand to establish a presence in the category.

The management is making good progress on multiple business drivers and continues to strengthen the competitive position of the company. The performance and the improvements are not hidden from the market as the company continues to sell at elevated valuations.

We have sold small quantities of this stock in the past to keep the position around 10% of the portfolio. The valuations are now fairly high and it is quite likely that I will start reducing the position size if the valuations continue to increase.

Q1- 2018 Results Analysis

Posted on 9th September 2017

Cera sanitaryware reported a 9.3% growth in topline and 13.1 % drop in net profits for the quarter. Operating margin stood at 13.5% for the same period and has dropped as the company has not raised the selling price in light of increase in input prices. This should get corrected in the coming quarters as the management has increased prices by 2-5% in July and expects operating margin to approach the historical levels of 16-18%.

The performance for the quarter is commendable. Anything which can go wrong in the macro environment for the company has gone wrong in the last 1 year. The real estate industry is going through a crunch and considering that most of CERA's sale is to new projects, the performance is quite good under the circumstances.

Sales which were growing by 15-20% in the months of April and June, de-grew by 10% in June due to de-stocking in the channel on account of GST. This disruption has started normalizing in the current quarter and management expects 11-13% topline growth for the year.

The performance appears average, but I think there are several improvements occurring which are getting masked by the headwinds in the market. Let's review the changes

- The company is constantly improving its sales mix to high value (premium) products. As a result, this product segment has gone up from 21-22% of sales to close to 25%. The benefit of selling higher value products is that there is a positive rub off on the CERA brand. In addition, the margin and return on capital number continue to improve due to a higher proportion of premium products

- The company has been expanding its distribution network especially in the north east, where it has been traditionally weak. The number of distributors have gone up from 8000-9000 to close to 16000 now in the last 3 years. The company is planning to focus on the quality of the network and improve the number of active dealers in the mix.

- The company has formed a JV with Anjani tiles and the plant is still operating below optimum capacity. As I shared in the past updates, tile is a new product for the company and is now growing rapidly (40% in FY17). This should be the next growth driver for the company

- The company has also started tapping the middle-east market now via a small trading operation in UAE. In addition, the company has started a new service for bathroom renovations in select cities. These initiatives are still in a nascent stage, but should add to the visibility and growth of the company in the future.

The management is making good progress on multiple business drivers and continues to strengthen the competitive position of the company. The performance and the improvements are not hidden from the market as the company continues to sell at elevated valuations.

We have sold small quantities of this stock in the past to keep the position around 10% of the portfolio. The valuations are now fairly high and it is quite likely that I will start reducing the position size if valuations continue to increase.

Q2- 2018 Results Analysis

Posted on 8th November 2017

Cera sanitaryware reported a 17.8% growth in topline and 6.5% growth in operating profits for the quarter. Operating margin stood at 16.1% for the same period and has dropped slightly from the previous year due to higher overheads. This has improved from the previous quarter as the company raised prices by 3-5% in July and management expects the margins to improve further going forward as growth picks up.

The performance for the quarter is commendable. Anything which can go wrong in the macro environment for the company has gone wrong in the last 1 year. The real estate industry is going through a crunch and considering that most of CERA's sale is to new projects, the performance is quite good under the circumstances.

Sales growth dropped in Q1 due to GST, but has started picking up now as the issues around GST are slowly being resolved and real estate is picking up with projects becoming RERA compliant

There are several other improvements occurring in the company. Let's review the changes

- The company is constantly improving its sales mix to high value (premium) products. As a result, this product segment has gone up from 21-22% of sales to close to 25%. The benefit of selling higher value products is that there is a positive rub off on the CERA brand. In addition, the margin and return on capital number continue to improve due to a higher proportion of premium products

- The company has been expanding its distribution network especially in the north east, where it has been traditionally weak. The number of distributors have gone up from 8000-9000 to close to 16000 now in the last 3 years. The company is planning to focus on the quality of the network and improve the number of active dealers in the mix.

- The tiles segment is now becoming the growth driver and is contributing to 20% of sales from just 13% a year back. The JV with Anjani tiles is now running at 80% capacity and generating double digit EBDITA.

- The company has also started tapping the middle-east market now via a small trading operation in UAE. In addition, the company has started a new service for bathroom renovations in select cities. Finally, the company has also launched a cheaper set of products under the JEET brand, to target the affordable segment. These initiatives are still in a nascent stage, but should add to the visibility and growth of the company in the future.

The management is making good progress on multiple business drivers and continues to strengthen the competitive position of the company. The performance and the improvements are not hidden from the market as the company continues to sell at elevated valuations.

We have reduced the position during the year, mainly due to high valuations and it is now around 5% of the portfolio. We will keep the position as is for now.

Q3- 2018 Results Analysis

Posted on 7th February 2018

Cera sanitaryware reported a 22.6% growth in topline and 3.5% growth in operating profits for the quarter. Operating margin stood at 14.5% for the same period and has dropped from the previous year due to higher overheads and lower gross margins.

The company is investing in expanding the tiles business which is now growing at 50%+. The company has been seeding the market with this product and is also investing in manpower to grow the segment. The net result of these investments is that although the topline growth has picked up, margins have been impacted.

The overall growth for the company has started picking up as indicated earlier by the management and the company is likely to close the year with a 15% topline growth

There are several other improvements occurring in the company. Let's review the changes

- The tiles segment is now becoming the growth driver and is contributing to 22% of sales from just 13% a year back. The JV with Anjani tiles is now running at 90% capacity and generating double digit EBDITA. Management is now investing in the product range and distribution and expects this product to contribute meaningfully to the topline and profit growth from FY19
- The company has launched a cheaper brand – JEET, for the lower end, affordable housing market. The company is targeting the institutional segment for this product for now and expects higher contributions from this brand from FY 19.
- The company has also started tapping the middle-east market now via a small trading operation in UAE. In addition, the company has started a new service for bathroom renovations in select cities.

Management is making good progress on multiple business drivers and continues to strengthen the competitive position of the company. The performance and improvements are not hidden from the market as the company continues to sell at elevated valuations.

We have reduced the position during the year, mainly due to high valuations. However, I may increase the position size if growth starts picking up for the company. For now, we will track the performance of the company and see how the management executes for the next few quarters.

Q4- 2018 Results Analysis

Posted on 14th June 2018

Cera sanitaryware reported a 10.8% growth in topline and 3.5 % growth in operating profits for the quarter. Operating margin stood at 15.4% for the same period and has dropped from the previous year due to higher overheads, manpower costs and lower gross margins.

The company reported an 12.5% growth in topline and 6% growth in net profits for the year

The company is investing in expanding the tiles business which is now growing at 40%+. The company has been seeding the market with this product and is also investing in manpower to grow the segment. The net result of these investments is that although the topline growth has picked up, margins have been impacted for the year.

The management has indicated that operating margins are likely to improve by around 1-1.5% next year as the company improves operating scale and is also able to pass through some of the input price increases.

The overall growth of the company is still weak as the number of new project launches continues to be low due to which the growth in sanitaryware demand has been around 4-5%.

There are several other improvements occurring in the company. Let's review the changes

- The tiles segment is now becoming the growth driver and is contributing to 19% of sales from just 13% a year back. The JV with Anjani tiles is now running at 90% capacity and generating double digit EBDITA. Management is now investing in the product range and distribution and expects this product to contribute meaningfully to the topline and profit growth from FY19

- The company has launched a cheaper brand – JEET, for the lower end, affordable housing market. The company is targeting the institutional segment for this product for now and expects higher contributions from this brand from FY 19.

- Management has indicated that they are launching premium products in all the categories and this should improve the overall margins of the company

Management is making good progress on multiple business drivers and continues to strengthen the competitive position of the company. The performance and improvements are not hidden from the market as the company continues to sell at elevated valuations.

We reduced the position during the year, mainly due to high valuations. However, I may increase the position size if growth starts picking up for the company. For now, we will track the performance of the company and see how the management executes for the next few quarters.

Q1- 2019 Results Analysis

Posted on 15th September 2018

Cera sanitaryware reported a 14.6% growth in topline and 6.8 % growth in net profits for the quarter. Operating margin stood at 13.1% for the same period and has dropped from the previous year due to higher overheads, manpower costs and lower gross margins.

The sanitaryware and tiles segment grew by around 11% and faucet business grew by 18%.

Due to the accounting standard change the numbers for the current year are not comparable to last year. On a like to like basis, the company grew by 19.7% which is a fairly good performance in view of the slowdown in the real estate industry.

As per the management, the company is now focusing equally on all the three segments and as a result has seen an improvement in growth in the sanitaryware & faucet segment. Overall however demand continues to be subdued due to the macro conditions.

The company has not taken price hikes due to the above conditions and would prefer to maintain its market share for now. Management is confident that margins will improve once the demand picks up and they decide to pass the cost increase in fuel prices and raw materials.

Management is making good progress on multiple business drivers and continues to strengthen the competitive position of the company.

We reduced the position during the year, mainly due to high valuations. However, I may increase the position size if growth continues for the company or if the price continues to drift down from the current levels. For now, we will track the performance of the company and see how the management executes for the next few quarters.

Q2- 2019 Results Analysis

Posted on 5th December 2018

Cera sanitaryware reported a 12.7% growth in topline and minimal growth in net profits for the quarter. Operating margin stood at 14.6% for the same period and has dropped from the previous year due to higher overheads, manpower costs and lower gross margins.

Sanitaryware grew by 7%, tiles segment grew by 20% and faucet business grew by 16%. The company has grown faster than the industry and other competitors in each of the product segment and is thus gaining share in the market.

The performance is quite good considering the headwinds in the real estate sector and floods in Kerala. Both these factors reduced growth in the recent quarter and management feels that they should be able to do a 20%+ CAGR once the macro environment turns favourable.

As per the management, the company is now focusing equally on all the three segments and as a result has seen an improvement in growth in the sanitaryware & faucet segment. Overall demand continues to be subdued due to the macro conditions.

The company has not taken a price hike in the last quarter due to the above conditions and would prefer to maintain and improve its market share. There has been a 3-5% price hike in October to offset some of the increase. Management is confident that margins will improve once demand picks up and they decide to pass the cost increase in fuel prices and raw materials.

Management is making good progress on multiple business drivers such as new products and geographic expansion and continues to strengthen the competitive position of the company.

We reduced the position during the year, mainly due to high valuations. However, I may increase the position size if growth continues for the company or if the price continues to drift down.

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