

RAK Ceramics PJSC

Challenges across all core markets except UAE impacted profitability

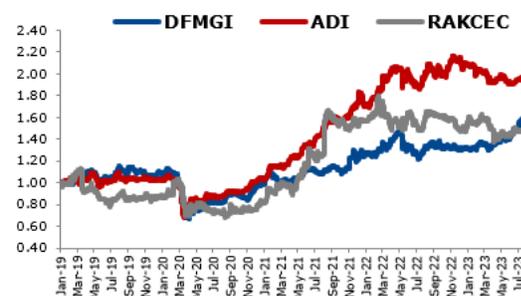
Current Price
AED 2.55

Target Price
AED 3.80

Upside/Downside (%)
+49%

Rating
BUY

- RAKCEC revenue declined 5.9% YOY to AED 872 Mn in 2Q23 amid volatile market conditions across all core markets except UAE, led by record interest rates and currency devaluation.
- RAK Ceramics' gross margin declined 110bps YOY to 37.3% in 2Q23, owing to lower capacity utilization leading to unutilized fixed cost.
- RAK Ceramics' proposed a cash dividend of 10 fils per share for 1H23, resulting in an attractive dividend yield of 7.8% in 2023.
- RAKCEC is enhancing operational performance through digitization and enabling advanced analytics, and data-driven decision-making capabilities.



2Q23 Net Profit lower than our estimate

Rak Ceramics PJSC (RAKCEC/"The Company") net profit declined 23.7% YOY to AED 70 Mn in 2Q23, lower than our estimate of AED 92 Mn. The fall in net profit is mainly attributable to a decline in revenue due to currency devaluation and challenging macroeconomic conditions and high finance cost partially offset by a reduction in direct cost, selling and distribution expenses, and a significant decline in impairments.

P&L Highlights

RAK Ceramics' revenue declined 5.9% YOY to AED 872 Mn in 2Q23 mainly due to currency devaluation, rising interest costs, and challenging economic conditions in the Tile and Sanitaryware segment. The Company's tiles revenue declined 16.4% YOY to AED 497 Mn in 2Q23 attributable to a rise in competition, contraction in liquidity, and economic uncertainties that affected the growth in all the markets except UAE. While sanitaryware revenue fell 8.9% YOY to AED 133 Mn in 2Q23, attributed to postponed purchases by households and property developers due to inflation and higher borrowing costs. However, tableware revenue increased 3.0% YOY to AED 92 Mn in 2Q23 owing to the launch of differentiated products and strong demand in Europe. The faucets segment reported a revenue of AED 116.5 Mn in 2Q23 out of which AED 110.6 Mn is contributed by the KLUDI Group. The Company's direct cost declined 4.2% YOY to AED 547 Mn in 2Q23 due to higher changes in inventory of finished goods and a decline in natural gas cost. As a result, gross profit declined 8.7% YOY to AED 325 Mn in 2Q23, while gross margin declined 37.3% in 2Q23 as compared to 38.4% in 2Q22, primarily due to lower capacity utilization resulting in unabsorbed fixed cost impacting gross margin. On the other hand, operating expenses declined 5.0% YOY to AED 233 Mn in 2Q23 mainly due to a fall in freight and transportation charge. As a result, operating profit

Stock Information

Market Cap (AED, mm)	2,533.95
Paid Up Capital (mm)	993.70
52 Week High	3.02
52 Week Low	2.50
3M Avg. daily value (AED)	2,580,223

2Q23 Result Review (AED, mm)

Total Assets	5,344
Total Liabilities	3,027
Total Equity	2,317
EBITDA	155
Net Profit	70

Financial Ratios

Dividend Yield (12m)	7.84
Dividend Pay-out (%)	32.82
Price-Earnings Ratio(x)	8.49
Price-to-Book Ratio (x)	1.16
Book Value (AED)	2.20
Return-on Equity (%)	13.73

Stock Performance

5 Days	-0.39%
1 Months	-4.85%
3 Months	-3.04%
6 Months	-12.97%
1 Year	-13.85%
Month to Date (MTD%)	-5.20%
Quarter to Date (QTD%)	-4.85%
Year to Date (YTD%)	-9.89%

decreased 16.9% YOY to AED 92 Mn in 2Q23. EBITDA declined 5.5% YOY to AED 155 Mn in 2Q23. While the EBITDA margin improved 9 bps YOY to 17.8% in 2Q23. Impairments declined significantly from AED 35 Mn in 2Q22 to AED 7 Mn in 2Q23 as the Company recorded nil impairment loss on other receivable in 2Q23. Other income reduced 4.1% YOY to AED 21 Mn in 2Q23. Moreover, finance cost increased 41.0% YOY to AED 32 Mn in 2Q23 due to higher benchmark rates. Furthermore, tax expenses declined 7.7% YOY to AED 5 Mn in 2Q23 whereas the share of profit attributable to non-controlling interest holders stood at AED 5 Mn in 2Q23 as compared to AED 11 Mn in 2Q22.

Balance Sheet Highlights

RAK Ceramics' borrowings declined from AED 1,851 Mn in 1Q23 to AED 1,692 Mn in 2Q23. While net debt stood at AED 1,449 Mn in 2Q23 which remained flat as compared to 1Q23. The company maintained net debt to EBITDA remained stable at 2.44x in 2Q23 as compared to 2.42x 1Q23. Cash and cash equivalents along with bank deposits declined from AED 393 Mn in 1Q23 to AED 243 Mn in 2Q23 due to the repayment of loans and capex. Cash flow from operations stood at AED 92 Mn in 2Q23 as compared to AED 38 Mn in 1Q23. The improvement is mainly due to a decline in investment in working capital.

Target Price and Rating

We maintain our BUY rating on RAK Ceramics PJSC, with an unchanged target price of AED 3.80. The company navigated through a challenging environment marked by solid competition. Additionally, high inflation, rising interest rates, and currency fluctuations impacted the Company's performance during 2Q23. The tiles segment faced significant challenges across various regions, whereas the sanitaryware and faucets business also witnessed a pullback. On a positive note, the tableware division achieved a strong performance due to the introduction of new and differentiated products. RAKCEC gross margin was impacted due to lower capacity utilization, however, EBITDA margins improved due to a decline in operating expenses. The Company plans to expand its UAE tableware capacity by 10 Mn pcs which is scheduled to be completed in 3Q23 while commercial production is targeted in 4Q23. Moreover, the enhancement of the existing tile production line capacity in Bangladesh is currently underway and its production commencement is delayed by a quarter to 2Q24. RAKCEC obtained approval for the modification of India's current infrastructure at the Samalkot Plant while this modification aims to facilitate the manufacturing of large format tiles. Additionally, the Gris Plant will be upgraded to enable the production of GVT products. The company is also working on greenfield projects in Bangladesh and Saudi Arabia where it is preparing for necessary permissions and approvals to finalize the factory layout plan for further expansion. Furthermore, RAKCEC restructured its showroom in UAE and expanded its network in Saudi Arabia. The Company's capex grew 37.0% YOY to AED 48.8 Mn in 2Q23 and is expected to incur AED 250-300 Mn during 2023. Moreover, the board of directors proposed an interim cash dividend of 10 fils per share for 1H23 and it is expected to generate an attractive dividend yield of 7.8% based on 2023 financials. Thus, based on the above-mentioned factors, we assign a BUY rating to the stock.

RAK Ceramics - Relative valuation

(at CMP)	2018	2019	2020	2021	2022	2023F
PE (x)	14.0	15.6	NA	10.4	8.5	8.7
PB (x)	1.0	1.1	1.2	1.1	1.2	1.1
EV/EBITDA	9.5	8.6	11.3	7.5	6.9	7.0
Dividend yield	5.3%	5.5%	2.9%	7.8%	7.8%	7.8%

FABS Estimates & Co Data

RAK Ceramics – P&L

AED mm	2Q22	1Q23	2Q23	2Q23F	Var.	YOY Ch	QOQ Ch	2022	2023F	Change
Revenue	927	882	872	1,001	-12.9%	-5.9%	-1.2%	3,517	3,760	6.9%
Direct costs	-571	-548	-547	-619	-11.6%	-4.2%	-0.3%	-2,247	-2,354	4.8%
Gross profit	356	334	325	382	-14.9%	-8.7%	-2.7%	1,270	1,406	10.7%
Selling & overhead exp.	-245	-231	-233	-262	-11.1%	-5.0%	0.8%	-942	-1,004	6.6%
EBITDA	154	157	155	167	-6.9%	-5.5%	-1.1%	577	589	2.0%
D&A charges	43	50	45	47	-3.2%	5.1%	-10.4%	179	187	4.6%
Operating profit	111	103	92	120	-23.2%	-16.9%	-10.4%	328	402	22.4%
Impairment	-35	-6	-7	-7	2.8%	-79.5%	21.6%	-53	-26	-50.6%
Other income	22	15	21	20	5.5%	-4.1%	40.5%	149	83	-44.5%
Investment & other inc.	2	2	5	2	NM	NM	NM	7	7	-0.6%
Financial charges	-23	-29	-32	-29	11.5%	41.0%	11.4%	-93	-114	23.3%
Profit before tax	108	85	80	107	-24.8%	-25.6%	-5.9%	372	350	-5.9%
Tax expense	-5	-5	-5	-7	-33.1%	-7.7%	-0.1%	-32	-30	-5.9%
Profit before minorities	102	80	75	99	-24.2%	-26.5%	-6.3%	340	320	-5.9%
Minorities	-11	-7	-5	-7	-17.9%	-50.2%	-17.9%	-37	-25	-34.2%
Profit to shareholders	91	73	70	92	-24.7%	-23.7%	-5.2%	303	295	-2.4%

FABS estimate & Co Data

RAK Ceramics - Margins

	2Q22	1Q23	2Q23	YOY Ch	QOQ Ch	2022	2023F	Change
Gross margin	38.4%	37.9%	37.3%	-113	-57	36.1%	37.4%	127
Operating margin	12.0%	11.7%	10.6%	-139	-109	9.3%	10.7%	135
EBITDA margin	17.7%	17.8%	17.8%	9	1	16.4%	15.7%	-76
Net profit margin	9.8%	8.3%	8.0%	-185	-34	8.6%	7.9%	-75

FABS estimate & Co Data

Valuation:

We use Discounted Free Cash Flow (DCF) and Relative Valuation (RV) to value RAK Ceramics. We have assigned 70% weight to DCF and 30% to RV.

Valuation Method	Target	Weight	Weighted Value
DCF Method	3.82	70.0%	2.68
Relative Valuation (RV)	3.76	30.0%	1.13
Weighted Average Valuation (AED)			3.80
Current market price (AED)			2.55
Upside/Downside (%)			+49%

1) DCF Method:

Rak Ceramics is valued using free cash flow to the firm. We have discounted the cash flow using the weighted average cost of capital of 7.4%. It is arrived after using cost of equity of 8.5% and after-tax cost of debt of 5.0% with a debt-to-equity ratio of 56.5%. Cost of equity is calculated by using 10-year government bond yield of 4.5%, beta of 1.00 and equity risk premium of 4.0%. Government bond yield is calculated after adding Abu Dhabi 10-year spread over 10-year US risk-free rate. Cost of debt is calculated using the cost of 5.5% after adjusting a tax rate of 8.6%. Also, assumed a terminal growth rate of 2.00%.

Sum of PV (AED, Mn)	1,015
Terminal value (AED, Mn)	4,462
FV to Common shareholders (AED, Mn)	3,800
No. of share (Mn)	994
Current Market Price (AED)	2.55
Fair Value per share (AED)	3.82

DCF Method

(All Figures in AED Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E
NOPAT	367	408	397	390	417
D&A	187	166	172	178	178
Change in working capital	52	-189	-118	-125	-104
(-) Capex	-325	-250	-225	-200	-167
Free Cash Flow to Firm (FCFF)	281	136	225	243	324
Discounting Factor	0.97	0.91	0.84	0.79	0.73
Discounted FCFF	274	123	190	191	237

Source: FAB Securities

2) Relative Valuation:

We have used local as well as international peers to value Rak Ceramics, and it is valued using the 2024 EV/EBITDA multiple. We have applied a discount to the peer valuation as there is only one regional peer listed and we choose to value it in line with its multiple. It is valued at EV/EBITDA of 9.0x compared to a peer valuation of 12.6x.

Company	Market (USD Mn)	EV/EBITDA (x)		P/E (x)	
		2023F	2024F	2023F	2024F
Somany Ceramics Limited	384	12.8	12.6	29.0	25.5
Saudi Ceramic Company	625	13.2	9.5	23.8	15.7
Kajaria Ceramic Tiles	2,765	28.4	28.1	48.8	45.5
Dynasty Ceramic	521	8.9	7.6	14.3	11.6
Cera Sanitaryware Limited	1,318	30.0	26.1	42.4	36.5
Average		18.7x	16.8x	31.7x	27.0x
Median		13.2x	12.6x	29.0x	25.5x
Max		28.4x	26.1x	42.4x	36.5x
Min		12.8x	9.5x	23.8x	15.7x

Source: FAB Securities

Research Rating Methodology:

Rating	Upside/Downside potential
BUY	Higher than +15%
ACCUMULATE	Between +10% to +15%
HOLD	Lower than +10% to -5%
REDUCE	Between -5% to -15%
SELL	Lower than -15%

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