

RAK Ceramics PJSC

Lower revenue negates margin improvement weighed on bottom-line

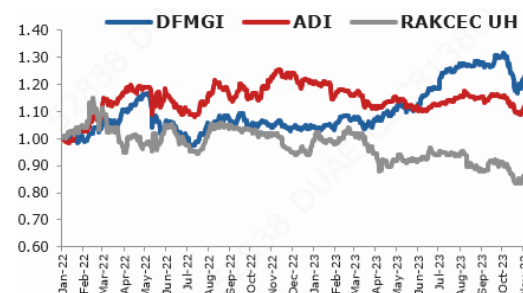
Current Price
AED 2.46

Target Price
AED 3.80

Upside/Downside (%)
+54%

Rating
BUY

- RAKCEC revenue declined 7.7% YOY to AED 837 Mn in 3Q23 amid volatile market conditions across all core markets except UAE led by rising interest rates and currency devaluation
- RAKCEC gross and EBITDA margin improved 267 bps YOY and 119 bps YOY respectively in 3Q23, mainly due to the positive shifts in the product mix
- RAK Ceramics' borrowings grew from AED 1,692 Mn in 2Q23 to AED 1,740 Mn in 3Q23 primarily owing to payment of interim dividend and minority to NCI
- RAKCEC T capex grew from AED 48.8 Mn in 2Q23 to AED 89 Mn in 3Q23 and is expected to incur AED 250-300 Mn during 2023 owing to its expansion and greenfield projects



3Q23 Net Profit in line with our estimate

Rak Ceramics PJSC (RAKCEC/"The Company") net profit declined 9.5% YOY to AED 77 Mn in 3Q23, in line with our estimate of AED 74 Mn. The decline in net profit is primarily attributable to a decline in revenue owing to continued macroeconomic conditions, market volatility and currency devaluation along with higher finance cost partially offset by a reduction in direct cost, and selling and distribution expenses. Net profit excluding one-off gain of AED 16.1 Mn amounted to AED 74.0 Mn in 3Q22 as compared to AED 83.9 Mn in 3Q23.

P&L Highlights

RAK Ceramics' revenue declined 7.7% YOY to AED 837 Mn in 3Q23 mainly due to ongoing macroeconomic conditions, currency devaluation, and rising interest rates across the core markets. The Company's tiles revenue declined 9.8% YOY to AED 475 Mn in 3Q23 attributable to a rise in competition from local peers that affected the growth in all the Middle east, Saudi Arabia, Bangladesh, and African markets. While sanitaryware revenue fell 3.1% YOY to AED 123 Mn in 3Q23, primarily owing to challenges in all the markets except UAE. However, tableware revenue increased 2.8% YOY to AED 93 Mn in 3Q23 owing to the launch of differentiated products. Faucets segment revenue declined 2.5% YOY to AED 114 Mn mainly due to decline in sales from the European markets. The Company's direct cost declined 11.4% YOY to AED 522 Mn in 3Q23 mainly due to decline in natural gas, direct labour and power and fuel costs. As a result, gross profit declined marginally 0.6% YOY to AED 315 Mn in 3Q23. However gross margin grew 267 bps YOY to 37.6% in 3Q23 owing to positive shifts in the product mix. On the other hand, operating expenses declined 4.1% YOY to AED 220 Mn in 3Q23 mainly due to a fall in freight and transportation charge and postage courier and stationery expenses.

Stock Information

Market Cap (AED, mm)	2,444.51
Paid Up Capital (mm)	993.70
52 Week High	3.00
52 Week Low	2.37
3M Avg. daily value (AED)	1,367,638

3Q23 Result Review (AED, mm)

Total Assets	5,356
Total Liabilities	3,068
Total Equity	2,288
EBITDA	145
Net Profit	77

Financial Ratios

Dividend Yield (12m)	8.13
Dividend Pay-out (%)	32.82
Price-Earnings Ratio(x)	8.55
Price-to-Book Ratio (x)	1.13
Book Value (AED)	2.18
Return-on Equity (%)	13.56

Stock Performance

5 Days	-1.60%
1 Months	3.36%
3 Months	-3.53%
6 Months	-5.75%
1 Year	-11.19%
Month to Date (MTD%)	1.23%
Quarter to Date (QTD%)	-5.38%
Year to Date (YTD%)	-13.07%

As a result, operating profit grew 8.7% YOY to AED 95 Mn in 3Q23. EBITDA declined marginally 0.8% YOY to AED 145 Mn in 3Q23. While, EBITDA margin rose 119 bps YOY to 17.3% in 3Q23. Impairments grew from AED 7 Mn in 3Q22 to AED 8 Mn in 3Q23 as the Company recorded impairment loss on other receivable in 3Q23. Other income reduced significantly from AED 65 Mn in 3Q22 to AED 36 Mn in 3Q23. Moreover, finance cost grew 19.9% YOY to AED 32 Mn in 3Q23 due to higher benchmark rates. Furthermore, tax expenses declined from AED 30 Mn in 3Q22 to AED 8 Mn in 3Q23 whereas the share of profit attributable to non-controlling interest holders stood at AED 7 Mn in 3Q23 as compared to AED 5 Mn in 3Q22.

Balance Sheet Highlights

RAK Ceramics' borrowings grew from AED 1,692 Mn in 2Q23 to AED 1,740 Mn in 3Q23 primarily owing to payment of interim dividend and minority to NCI. While net debt stood at AED 1,449 Mn in 3Q23 which remained flat as compared to 2Q23. The company maintained net debt to EBITDA remained stable at 2.43x in 3Q23 as compared to 2.44x in 2Q23. Cash and cash equivalents along with bank deposits also remained stable at AED 241 Mn in 3Q23 compared to AED 243 Mn in 2Q23. The Company's capex grew from AED 84.3 in 3Q22 to AED 89.0 Mn in 3Q23. While, the 2023 capex guidance of the Company remained at AED 250-300 Mn. Cash flow from operations stood at AED 318 Mn in 9M23 as compared to AED 360 Mn in 9M22 mainly due to increase 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's performance remains impacted in 3Q23 primarily due to ongoing market volatility, rising interest rates, and the currency devaluation. The rising competition from the local peers and moderate demand also impacted the Company's operating performance. RAKCEC's revenue declined 7.6% YOY in 3Q23. The Company's revenue hindered in KSA, Middle east, Bangladesh and Africa except UAE due to ongoing macro-economic challenges and rising competition from local peers. However, the revenue from UAE achieved a robust revenue growth of 23.4% YOY in 3Q23 owing to strategic emphasize towards project channel sales. 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 and EBITDA margin improved 267 bps YOY and 119 bps YOY respectively in 3Q23 mainly due to the improved production efficiency and shifts in the product mix. The Company expansion plans of UAE tableware capacity of 10 Mn pcs is completed and it also commenced trial for commercial production. While, the Company is currently also assessing upgrades to both India's Samalkot and Gris Plant with the aim of enhancing production efficiencies and expanding capacity through innovative measures. Moreover, the expansion of the existing tile production line capacity in Bangladesh is underway and expected to commence production from 1Q24. Furthermore, the Company plans to establish a new Faucets plant in Bangladesh, and obtained all the required approvals for the factory's construction. In addition, the Company is in the process of finalizing the layout design for the facility, and construction is scheduled to commence in the 4Q23. RAKCEC's capex grew from AED 48.8 Mn in 2Q23 to AED 89 Mn in 3Q23 and is expected to incur AED 250-300 Mn during 2023 owing to its expansion and greenfield projects. RAKCEC's is expected to generate a dividend yield of 8.1% in 2023 which is one of the highest among the listed peers in the UAE. 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)	13.4	14.9	NA	9.9	8.1	8.3
PB (x)	1.0	1.0	1.1	1.1	1.1	1.1
EV/EBITDA	9.2	8.4	10.9	7.3	6.7	6.9
Dividend yield	5.5%	5.8%	3.0%	8.1%	8.1%	8.1%

FABS Estimates & Co Data

RAK Ceramics – P&L

AED mm	3Q22	2Q23	3Q23A	3Q23F	Var.	YOY Ch	QOQ Ch	2022	2023F	Change
Revenue	906	872	837	905	-7.5%	-7.7%	-4.0%	3,517	3,482	-1.0%
Direct costs	-589	-547	-522	-583	-10.5%	-11.4%	-4.5%	-2,247	-2,164	-3.7%
Gross profit	317	325	315	322	-2.2%	-0.6%	-3.2%	1,270	1,318	3.8%
Selling & overhead exp.	-230	-233	-220	-227	-3.1%	-4.1%	-5.5%	-942	-919	-2.4%
EBITDA	146	155	145	140	3.0%	-0.8%	-6.9%	577	586	1.5%
D&A charges	47	45	50	46	9.4%	6.0%	10.2%	179	187	4.6%
Operating profit	87	92	95	95	-0.1%	8.7%	2.8%	328	399	21.5%
Impairment	-7	-7	-8	-6	29.6%	23.8%	14.1%	-53	-24	-54.3%
Other income	65	21	36	24	51.5%	-45.5%	68.8%	149	77	-48.6%
Investment & other inc.	2	5	2	0	NM	33.4%	-55.9%	7	12	65.6%
Financial charges	-27	-32	-32	-27	18.3%	19.9%	0.0%	-93	-114	23.3%
Profit before tax	120	80	92	85	7.9%	-23.7%	14.8%	372	348	-6.6%
Tax expense	-30	-5	-8	-5	47.2%	-73.6%	60.7%	-32	-30	-6.6%
Profit before minorities	90	75	84	80	5.2%	-6.9%	11.7%	340	318	-6.6%
Minorities	-5	-5	-7	-5	25.6%	37.2%	25.6%	-37	-24	-34.7%
Profit to shareholders	85	70	77	74	3.7%	-9.5%	10.6%	303	293	-3.1%

FABS estimate & Co Data

RAK Ceramics - Margins

	3Q22	2Q23	2Q23	YOY Ch	QOQ Ch	2022	2023F	Change
Gross margin	35.0%	37.3%	37.6%	267	33	36.1%	37.9%	174
Operating margin	9.6%	10.6%	11.3%	170	75	9.3%	11.5%	213
EBITDA margin	16.1%	17.8%	17.3%	119	-54	16.4%	16.8%	41
Net profit margin	9.4%	8.0%	9.2%	-19	122	8.6%	8.4%	-18

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	4.08	70.0%	2.86
Relative Valuation (RV)	3.13	30.0%	0.94
Weighted Average Valuation (AED)			3.80
Current market price (AED)			2.46
Upside/Downside (%)			+54%

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 8.0%. It is arrived after using cost of equity of 9.5% and after-tax cost of debt of 5.0% with a debt-to-equity ratio of 61.3%. Cost of equity is calculated by using 10-year government bond yield of 4.5%, beta of 1.00 and equity risk premium of 5.0%. 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 cost of 5.0% after adjusting a tax rate of 8.6%. Also, assumed a terminal growth rate of 2.0%.

Sum of PV (AED, Mn)	865
Terminal value (AED, Mn)	4,909
FV to Common shareholders (AED, Mn)	4,054
No. of share (Mn)	994
Current Market Price (AED)	2.46
Fair Value per share (AED)	4.08

DCF Method

(All Figures in AED Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E
NOPAT	365	357	383	430	471
D&A	187	167	172	178	179
Change in working capital	164	-158	-113	-126	-87
(-) Capex	-325	-250	-225	-200	-167
Free Cash Flow to Firm (FCFF)	65	116	217	282	396
Discounting Factor	0.99	0.92	0.85	0.79	0.73
Discounted FCFF	64	106	184	222	288

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 8.7x compared to a peer valuation of 10.2x.

Company	Market (USD Mn)	EV/EBITDA (x)		P/E (x)	
		2023F	2024F	2023F	2024F
Somany Ceramics Limited	345	13.0	10.2	25.3	18.2
Saudi Ceramic Company	512	11.4	8.1	19.5	12.9
Kajaria Ceramic Tiles	2,447	28.0	26.0	42.5	34.8
Dynasty Ceramic	388	6.9	6.7	10.8	10.8
Cera Sanitaryware Limited	1,371	31.7	26.4	44.8	37.6
Average		18.2x	15.5x	28.6x	22.9x
Median		13.0x	10.2x	25.3x	18.2x
Max		28.0x	26.0x	42.5x	34.8x
Min		11.4x	8.1x	19.5x	12.9x

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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