

## RAK Ceramics (RAKCEC)

Rising geopolitical tensions and lower sales volumes impact profitability

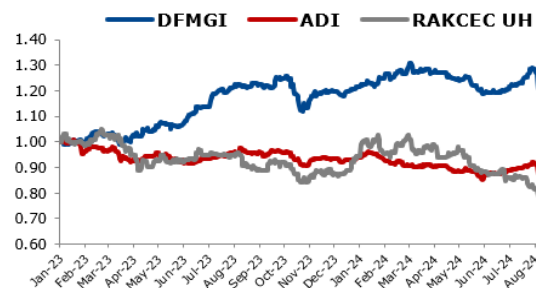
**Current Price**  
AED 2.40

**Target Price**  
AED 3.80

**Upside/Downside (%)**  
+58%

**Rating**  
BUY

- Gross margins grew 113 bps YOY to 39.6% in 2Q24.
- Net debt increased from AED 1.4 Bn in 1Q24 to AED 1.6 Bn in 2Q24. Net debt to EBITDA ratio rose from 2.1x in 1Q24 to 2.5x in 2Q24.
- Capex increased from AED 35 Mn in 1Q24 to AED 62 Mn in 2Q24 and further expects to invest AED 250-300 Mn in FY2024.
- The Company upgraded the Gris tiles plant in India to enhance the production capabilities of GVT tiles.
- RAK Ceramics focuses on increasing sales of premium products in KSA to maintain its margins.
- The board proposed an interim dividend of 10 fils per share amounting to AED 99.4 Mn for 1H24.



### 2Q24 Net Profit lower than our estimate

RAK Ceramics PJSC (RAKCEC/"The Company") reported a 27.8% YOY decline in net profit to AED 50 Mn in 2Q24, falling short of our estimate of AED 63 Mn. The decline in net profit is primarily due to lower revenue resulting from ongoing geopolitical instability and supply chain disruptions, lower other income and an increase in tax expense partially offset by a decline in direct cost and operating expenses.

### P&L Highlights

RAKCEC's revenue declined 10.9% YOY to AED 777 Mn in 2Q24 mainly due to rising geopolitical tension, decline in sales volumes, market volatility, high interest rates and currency devaluation. The Company's Tiles segment revenue dropped 13.4% YOY to AED 431 Mn in 2Q24, mainly driven by lower volumes across all markets except the UAE and strong competition driven by increased supply from local players that developed price sensitivity among consumers. Sanitaryware segment revenue declined 12.0% YOY to AED 117 Mn in 2Q24, owing to decline in volumes across all core markets. The Company also lost ground on competitive pricing due to higher freight costs, while competitors across the globe charged lower prices to overcome the decline in volumes. Furthermore, Tableware revenue remained flat with a marginal growth of 0.2% YOY to AED 92 Mn in 2Q24 despite lower demand due to the ongoing geopolitical crisis. In addition, the Faucets segment's revenue decreased 6.0% YOY to AED 110 Mn in 2Q24, mainly due to the impact on European and Asian markets caused by geopolitical instability. The Company's direct costs decreased 12.5% YOY to AED 470 Mn in 2Q24, resulting in 8.3% YOY decline in gross profit to AED 307 Mn. However, RAKCEC's gross profit margin improved by 113 bps YOY to 39.6% in 2Q24, primarily due to the net impact of lower natural gas prices in the UAE and a decline in productivity. Operating expenses decreased 6.3% YOY to AED 227 Mn in 2Q24, while the Company's operating profit declined 13.3% YOY to

### Stock Information

Market Cap (AED, mn)	2,384.89
Paid Up Capital (mn)	993.70
52 Week High	2.97
52 Week Low	2.23
3M Avg. daily value (AED)	1,529,744

### 2Q24 Result Review (AED, mn)

Total Assets	5,266
Total Liabilities	2,957
Total Equity	2,308
EBITDA	137
Net Profit	50

### Financial Ratios

Dividend Yield (12m)	8.33
Dividend Pay-out (%)	34.15
Price-Earnings Ratio(x)	9.27
Price-to-Book Ratio (x)	1.08
Book Value (AED)	2.23
Return on Equity (%)	11.62

### Stock Performance

5 Days	3.90%
1 Months	-1.23%
3 Months	-6.25%
6 Months	-14.89%
1 Year	-7.34%
Month to Date (MTD%)	3.90%
Quarter to Date (QTD%)	-1.23%
Year to Date (YTD%)	-10.11%

AED 80 Mn in 2Q24. RAK Ceramic's EBITDA fell 8.4% YOY to AED 137 Mn in 2Q24, with a 19 bps YOY decline in EBITDA margin to 17.6%. Impairments witnessed a marginal decline of 0.3% YOY to AED 8 Mn in 2Q24. Other income decreased 17.6% YOY to AED 17 Mn in 2Q24. Additionally, finance costs declined 3.8% YOY to AED 31 Mn in 2Q24. Tax expenses increased from AED 5 Mn in 2Q23 to AED 9 Mn in 2Q24, mainly due to the introduction of UAE corporate tax. Furthermore, the share of profit attributable to non-controlling interest holders decreased by 86.4% YOY to AED 1 Mn in 2Q24.

### Balance Sheet Highlights

RAKCEC's gross debt increased from AED 1.7 Bn in 1Q24 to AED 1.8 Bn in 2Q24. Net debt increased from AED 1.4 Bn in 1Q24 to AED 1.6 Bn in 2Q24. The net debt to EBITDA ratio grew from 2.1x in 1Q24 to 2.5x in 2Q24. Cash and cash equivalents including bank deposits fell to AED 202 Mn in 2Q24 from AED 308 Mn in 1Q24. The Company's capex increased from AED 35 Mn in 1Q24 to AED 62 Mn in 2Q24 and further expects to invest AED 250-300 Mn in FY2024. RAK Ceramic's net cash flow from operations decreased from AED 139 Mn in 1Q24 to AED 56 Mn in 2Q24.

### 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 gross margins improved 113 bps YOY to 339.6% in 2Q24 despite ongoing geopolitical issues, market volatility, and supply chain disruptions. RAK Ceramics continues to focus on protecting its market share by enhancing its production capabilities, diversifying operations, strengthening its retail presence, creating brand awareness in key markets, and accelerating digitization to make data-driven decisions. The Company upgraded the Gris tiles plant in India to enhance the production capabilities of GVT tiles. RAK Ceramics launched its first tableware retail showroom in Dubai Hills Mall and introduced an e-commerce website for the Tableware Retail business in the UAE. Furthermore, the Company is also working towards establishing its production facility in KSA. RAK Ceramics segregated its sales teams, upgraded products, increased marketing, and expanded dealer networks in Bangladesh to overcome the severe gas crisis and intense local competition. In the European market, the company implemented initiatives to strengthen brand awareness among architects and designers through events and engagement activities. Besides, it aims to focus on increasing sales of premium products in KSA to maintain its margins. RAKCEC aims to incur a capex of AED 250-300 Mn during FY2024. In addition, the board proposed an interim dividend of 10 fils per share amounting to AED 99.4 Mn for 1H24. Thus, based on the above-mentioned reasons, we maintain our BUY rating on the stock.

### RAK Ceramics - Relative valuation

(at CMP)	2019	2020	2021	2022	2023	2024F
PE (x)	14.6	NA	9.8	7.9	8.3	8.5
PB (x)	1.0	1.1	1.1	1.1	1.1	1.0
EV/EBITDA	8.3	10.8	7.2	6.6	6.1	6.4
Dividend yield	5.9%	3.1%	8.3%	8.3%	8.3%	8.3%

FABS Estimates & Co Data

**RAK Ceramics – P&L**

AED mn	2Q23	1Q24	2Q24	2024F	Var.	YOY Ch	QOQ Ch	2023	2024F	Change
Revenue	872	782	777	838	-7.3%	-10.9%	-0.6%	3,458	3,318	-4.1%
Direct costs	-537	-474	-470	-518	-9.4%	-12.5%	-0.9%	-2,149	-1,998	-7.0%
<b>Gross profit</b>	<b>335</b>	<b>307</b>	<b>307</b>	<b>320</b>	<b>-3.9%</b>	<b>-8.3%</b>	<b>0.0%</b>	<b>1,309</b>	<b>1,320</b>	<b>0.8%</b>
Selling & overhead exp.	-243	-218	-227	-222	2.4%	-6.3%	4.2%	-930	-896	-3.7%
<b>EBITDA</b>	<b>155</b>	<b>151</b>	<b>137</b>	<b>149</b>	<b>-8.4%</b>	<b>-11.8%</b>	<b>-9.3%</b>	<b>647</b>	<b>629</b>	<b>-2.8%</b>
D&A charges	45	51	50	52	-3.5%	10.3%	-1.3%	195	205	5.2%
<b>Operating profit</b>	<b>92</b>	<b>89</b>	<b>80</b>	<b>98</b>	<b>-18.3%</b>	<b>-13.3%</b>	<b>-10.4%</b>	<b>379</b>	<b>424</b>	<b>11.9%</b>
Impairment	-7	-5	-7	-8	-14.4%	-0.3%	38.4%	-37	-25	-32.3%
Other income	21	19	17	21	-16.9%	-17.6%	-10.1%	119	86	-27.4%
Investment & other inc.	6	7	2	1	NM	-66.4%	-72.1%	7	10	54.8%
Financial charges	-32	-36	-31	-29	7.8%	-3.8%	-12.4%	-119	-125	5.2%
<b>Profit before tax</b>	<b>80</b>	<b>74</b>	<b>60</b>	<b>81</b>	<b>-26.3%</b>	<b>-25.3%</b>	<b>-19.1%</b>	<b>345</b>	<b>367</b>	<b>6.3%</b>
Tax expense	-5	-11	-9	-12	-27.5%	75.7%	-20.5%	-25	-55	NM
<b>Profit before minorities</b>	<b>75</b>	<b>63</b>	<b>51</b>	<b>69</b>	<b>-26.1%</b>	<b>-32.1%</b>	<b>-18.9%</b>	<b>321</b>	<b>312</b>	<b>-2.7%</b>
Minorities	5	5	1	6	-88.0%	-86.4%	-85.9%	30	29	-1.8%
<b>Profit to shareholders</b>	<b>70</b>	<b>58</b>	<b>50</b>	<b>63</b>	<b>-19.9%</b>	<b>-27.8%</b>	<b>-12.7%</b>	<b>291</b>	<b>283</b>	<b>-2.8%</b>

FABS estimate & Co Data

**RAK Ceramics - Margins**

	2Q23	1Q24	2Q24	YOY Ch	QOQ Ch	2023	2024F	Change
Gross margin	38.4%	39.3%	39.6%	113	22	37.9%	39.8%	192
Operating margin	10.6%	11.4%	10.3%	-29	-113	11.0%	12.8%	182
EBITDA margin	17.8%	19.3%	17.6%	-19	-169	18.7%	19.0%	24
Net profit margin	8.0%	7.4%	6.5%	-151	-90	8.4%	8.5%	11

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	3.74	70.0%	2.62
Relative Valuation (RV)	3.94	30.0%	1.18
<b>Weighted Average Valuation (AED)</b>			<b>3.80</b>
Current market price (AED)			2.40
Upside/Downside (%)			+58%

### 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 9.3% and after-tax cost of debt of 5.9% with a debt-to-equity ratio of 72.9%. Cost of equity is calculated by using 10-year government bond yield of 5.0%, beta of 1.00 and equity risk premium of 4.3%. Government bond yield is calculated after adding Abu Dhabi 10-year spread over 10-year US risk-free rate. Cost of debt of 5.9% is calculated after adjusting a tax rate of 7.1%. Also, assumed a terminal growth rate of 2.0%.

Sum of PV (AED, Mn)	871
Terminal value (AED, Mn)	4,590
<b>FV to Common shareholders (AED, Mn)</b>	<b>3,715</b>
No. of share (Mn)	994
Current Market Price (AED)	2.40
<b>Fair Value per share (AED)</b>	<b>3.74</b>

### DCF Method

(All Figures in AED Mn)	FY 2024E	FY 2025E	FY 2026E	FY 2027E	FY 2028E
NOPAT	360	334	394	430	440
D&A	205	216	226	239	241
Change in working capital	37	-135	-220	-226	-202
(-) Capex	-275	-275	-200	-200	-100
<b>Free Cash Flow to Firm (FCFF)</b>	<b>126</b>	<b>139</b>	<b>200</b>	<b>243</b>	<b>379</b>
Discounting Factor	0.97	0.90	0.83	0.77	0.71
<b>Discounted FCFF</b>	<b>122</b>	<b>125</b>	<b>166</b>	<b>187</b>	<b>271</b>

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 close to its multiple. It is valued at EV/EBITDA of 9.0x compared to a peer valuation of 15.0x.

Company	Market (USD Mn)	EV/EBITDA (x)		P/E (x)	
		2024F	2025F	2024F	2025F
Somany Ceramics Limited	340	10.5	11.2	25.1	23.2
Saudi Ceramic Company	722	15.0	11.4	34.7	21.4
Kajaria Ceramic Tiles	2,678	25.8	27.4	43.7	45.4
Dynasty Ceramic	530	9.0	8.2	14.2	13.3
Cera Sanitaryware Limited	1,533	26.4	36.9	36.9	49.9
<b>Average</b>		<b>17.3x</b>	<b>19.0x</b>	<b>30.9x</b>	<b>30.6x</b>
<b>Median</b>		<b>15.0x</b>	<b>11.4x</b>	<b>34.7x</b>	<b>23.2x</b>
<b>Max</b>		<b>25.8x</b>	<b>27.4x</b>	<b>36.9x</b>	<b>45.4x</b>
<b>Min</b>		<b>10.5x</b>	<b>11.2x</b>	<b>25.1x</b>	<b>21.4x</b>

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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