

RAK Ceramics

Solid expansion strategy to boost profitability

1Q23 Net Profit higher than our estimate

RAK Ceramics PJSC (RAKCEC/"The Company") reported a 29.7% YOY growth in net profit to AED 73 Mn in 1Q23, higher than our estimate of AED 53 Mn. The rise in net profit is mainly attributable to a healthy growth in revenue partially offset by an increase in direct cost, rise in operating expenses, and higher finance cost.

P&L highlights

RAK Ceramics' revenue grew 12.7% YOY to AED 882 Mn in 1Q23 mainly driven by a growth in tableware, faucets and tiles revenue partially offset by a decline in revenue from the sanitaryware segment. The Company's tableware revenue reported a robust growth of 28.9% YOY to AED 98 Mn in 1Q23 supported by growing demand, the launch of a new series of products, and a strong growth in the tourism industry. While the tiles segment reported a marginal growth of 0.9% YOY to AED 521 Mn in 1Q23 owing to the rise in selling prices and change in the product mix coupled with strong sales in UAE market. The faucets segment reported revenue of AED 111.6 Mn in 1Q23 out of which AED 105.1 Mn is contributed by the consolidation from KLUDI Group. KLUDI group performance showed early signs of improvement due to the ongoing implementation of a turnaround strategy. However sanitaryware segment reported a decline in revenue of 16.6% YOY to AED 129 Mn in 1Q23 mainly due to lower off-take in the European market due to ongoing economic challenges coupled with disruption in the Bangladesh business owing to temporary lower pressure in gas supply. The Company's direct cost increased 11.0% YOY to AED 548 Mn in 1Q23 due to high input prices. As a result, gross profit rose 15.5% YOY to AED 334 Mn in 1Q23 with a gross margin of 37.9% in 1Q23 as compared to 37.0% in 1Q22. On the other hand, operating expenses rose 9.3% YOY to AED 231 Mn in 1Q23 due to a hike in staff cost, promotional expenses, depreciation expenses, and other expenses. As a result, operating profit inclined 32.4% YOY to AED 103 Mn in 1Q23. Depreciation and amortization charges grew 23.5% YOY to AED 50 Mn in 1Q23 whereas EBITDA rose 32.4% YOY to AED 157 Mn in 1Q23. While the EBITDA margin inclined 265 bps YOY to 17.8% in 1Q23. Impairments declined 20.8% YOY to AED 6 Mn in 1Q22. Other income declined 25.3% YOY to AED 15 Mn in 1Q23. Finance cost increased significantly 60.0% YOY to AED 29 Mn in 1Q23 due to higher benchmark rates. Furthermore, tax expenses declined 27.6% YOY to AED 5 Mn in 1Q23, While, the share of profit relating to non-controlling interest holders stood at AED 7 Mn in 1Q23 as compared to AED 13 Mn in 1Q22.

Balance Sheet highlights

RAK Ceramics' borrowings rose to AED 1,851 Mn in 1Q23 as compared to AED 1,740 Mn in 4Q22. While net debt rose from AED 1,301 Mn in 4Q22 to AED 1,459 Mn in 1Q23 with a net debt to EBITDA ratio of 2.42x in 1Q23 as compared to 2.26x in 4Q22. The rise in the net debt is primarily due to the dividend payment and increase in working capital. Cash and cash equivalents along with bank deposits stood at AED 393 Mn in 1Q23 as compared to AED 439 Mn in 4Q22. Cash flow from operations stood low at AED 38 Mn in 1Q23 due to an increase in working capital.

Rating : BUY

First Look Note – 1Q23

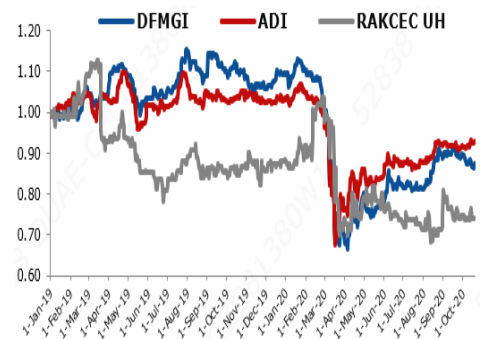
Sector: Industrial

Recommendation

Current Price (19-May-23)	2.61
Target Price (AED)	3.80
Upside/Downside (%)	+46%

Stock Information

Market Cap (mm)	2,603.50
Paid Up Capital (mm)	993.70
52 Week High	3.03
52 Week Low	2.50
3M Avg. daily value (AED)	1,730,222



Financial Ratios

Dividend Yield (12m)	7.66
Dividend Pay-out (%)	32.82
Price-Earnings Ratio (x)	8.15
Price-to-Book Ratio (x)	1.22
Book Value (AED)	2.13
Return-on Equity (%)	14.80
Earning Per Share (AED)	0.32
Beta	0.44

Stock Performance

5 Days	1.16%
1 Months	2.75%
3 Months	-11.19%
6 Months	-4.73%
1 Year	-6.09%
Month to Date (MTD)	0.00%
Quarter to Date (QTD)	-2.60%
Year to Date (YTD)	-7.42%

Target price and rating

We maintain our BUY rating on RAK Ceramics PJSC, with a target price of AED 3.80. The company's performance remains strong, despite ongoing economic problems such as increasing interest rates, currency devaluation, recessionary fears in major markets, and strong competition. Rak Ceramic reported robust revenue growth of 12.7% YOY in 1Q23 despite the challenging environment, out of which around 74% of the revenue is contributed by the tiles and sanitaryware segment. Acquisition of KLUDI group has benefited the company and contributed a revenue of AED 105.1 Mn during 1Q23 in the faucets segment. The company is continuously focused on expanding its business footprint across various markets and started the commercial production facility of smart tiles factory in the UAE with a production capacity of 4.6 Mn sqm of GP tiles. The factory consists of automation and IoT technologies for the production of tiles, which will boost the level of production and quality of manufacturing. Moreover, tableware capacity expansion is currently ongoing, with commercial production of additional 10 million pieces targeted till 3Q23. Also, sanitaryware production started with an increased capacity of 260 thousand pieces and reached 80% capacity utilization while the company aims to achieve full capacity utilization by 3Q23. Additionally, the company is also working on greenfield projects in Bangladesh and received the mutation certificate and is currently working to finalize consultants for designing factory layout while applications have been filed by Rak Ceramics to KSA's Ministry of Energy for Gas allocation approval which will further add fuel to the Company's global expansion strategy. The company maintained its margin by adding differentiated products which supported and maintained its market position in the project and retail segment. The Company is incurring promotional expenses by participating in international events to showcase its products. Further to maintain its market position and attract a new customer base the company launched two new showrooms in India and three executive dealer showrooms in Bangladesh. The Company also launched its new surface & tableware collection across five showrooms. Furthermore, lower freight charges and international expansion further aids in Rak Ceramics' business growth. 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)	14.2	15.8	NA	10.5	8.6	7.1
PB(X)	1.0	1.1	1.2	1.2	1.2	1.1
EV/EBITDA	9.6	8.7	11.4	7.6	7.0	6.6
Dividend yield	5.2%	5.5%	2.9%	7.7%	7.7%	7.7%

FABS Estimates & Co Data

RAK Ceramics - P&L

AED mm	1Q22	4Q22	1Q23	1Q23F	Var.	YOY Ch	QOQ Ch	2022	2023F	Change
Revenue	783	901	882	900	-1.9%	12.7%	-2.0%	3,517	3,760	6.9%
Direct costs	-494	-593	-548	-561	-2.2%	11.0%	-7.6%	-2,247	-2,325	3.5%
Gross profit	289	308	334	339	-1.4%	15.5%	8.6%	1,270	1,435	13.0%
Selling & overhead exp.	-212	-255	-231	-270	-14.3%	9.3%	-9.4%	-942	-993	5.4%
EBITDA	119	138	157	117	34.4%	32.4%	14.3%	577	622	7.7%
Dep.& amortization	41	48	50	48	5.3%	23.5%	5.9%	328	442	34.8%
Operating profit	78	52	103	69	49.2%	32.4%	96.4%	328	442	34.8%
Impairment	-7	-4	-6	-4	31.7%	-20.8%	44.2%	-53	-30	-43.6%
Other income	20	41	15	23	-35.7%	-25.3%	-63.7%	149	105	-29.3%
Investment & other inc.	2	2	2	3	-16.7%	34.8%	43.3%	7	9	32.7%
Financial charges	-18	-26	-29	-25	13.4%	60.0%	11.3%	-93	-96	3.2%
Profit before tax	77	68	85	64	32.0%	11.0%	26.0%	372	431	15.6%
Tax expense	-7	10	-5	-3	55.0%	-27.6%	NM	-32	-37	15.6%
Profit before minorities	70	78	80	61	30.7%	14.9%	2.6%	340	393	15.6%
Minorities	-13	-8	-7	-8	-17.3%	-49.1%	-17.3%	-37	-26	-30.7%
Profit to shareholders	57	70	73	53	38.1%	29.7%	5.0%	303	367	21.4%

FABS Estimates & Co Data

RAK Ceramics - Margins

	1Q22	4Q22	1Q23	YOY Ch	QOQ Ch	2022	2023F	Change
Gross profit margin	37.0%	34.2%	37.9%	93	372	36.1%	38.2%	205
EBITDA margin	9.9%	5.8%	11.7%	174	585	9.3%	11.8%	243
Operating profit margin	15.1%	15.3%	17.8%	265	254	16.4%	16.5%	12
Net Margin	7.2%	7.8%	8.3%	109	55	8.6%	9.8%	116

FABS estimate & Co Data

Valuation:

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

Valuation Method	Target	Weight	Weighted Value
DCF	3.92	70.0%	2.75
Relative	3.53	30.0%	1.06
Weighted Average Valuation (AED)			3.80
Current market price (AED)			2.61
Upside/Downside (%)			+45.6%

1) DCF Method:

Rak Ceramics is valued using free cash flow to firm. We have discounted the cash flow using the weighted average cost of capital of 7.6%. It is arrived after using cost of equity of 8.2% and after tax cost of debt of 5.9% with debt to equity ratio of 56.2%. Cost of equity is calculated by using 10-year government bond yield of 4.3%, beta of 1.00 and equity risk premium of 3.9%. 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 5.9% after adjusting a tax rate of 8.6%. Also, assumed a terminal growth rate of 2.00%.

Sum of PV (AED, Mn)	1,128
Terminal value (AED, Mn)	4,354
FV to Common shareholders (AED, Mn)	3,900
No. of share (Mn)	994
Current Market Price (AED)	2.61
Fair Value per share (AED)	3.92

DCF method

(All Figures in AED Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E
NOPAT	404	390	392	386	406
D&A	179	189	169	170	179
Change in Working Capital	41	-169	-124	-126	-101
(-) Capex	-325	-200	-175	-170	-150
Free Cash Flow to Firm (FCFF)	299	210	262	261	334
Discounting Factor	0.96	0.89	0.83	0.77	0.71
Discounted FCFF	286	187	216	200	239

2) Relative Valuation:

We have used local as well as international peers to value Rak Ceramics and it is valued using the 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 8.2x compared to a peer valuation of 11.7x.

Company	Market (USD Mn)	EV/EBITDA (x)		PE (x)	
		2023	2024	2023	2024
Somany Ceramics Limited	239	11.7	8.4	21.7	14.0
Saudi ceramic company	638	8.3	7.5	13.7	13.1
Kajaria Ceramic tiles	2,116	20.2	16.9	32.2	26.3
Dynasty Ceramic	731	9.3	8.7	14.3	13.6
Cera Sanitaryware limited	794	19.1	18.4	29.5	25.7
Average		13.7x	12.0x	22.3x	18.5x
Median		11.7x	8.7x	21.7x	14.0x
Max		19.1x	16.9x	29.5x	25.7x
Min		9.3x	8.4x	14.3x	13.6x

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in UAE 2016
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