

ROYAL CERAMICS LANKA PLC [RCL.N0000]

PROTECTIONISM BOOST PROFITABILITY

VALUATION NOTE

Fair Value [FY22E]: LKR 280.0 [Range of LKR 250.0-310.0]

Import restriction aids to conquer the market

RCL group, the dominant local player in Tile and Sanitaryware products was a key beneficiary following the import restrictions employed by the Government via the implementation of “**Special Import License Regulation**” dated 16th Jul 2020 resulting in a complete import ban on all Tile and Sanitaryware products. RCL’s Pre-Covid 52% market share surged across all segments to 75% in floor tiles and 82% in wall tiles.

P/E 31 March	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Estimates (LKR 'Mn)							
Revenue	26,413	29,090	31,499	31,554	40,797	41,819	43,565
Gross Profit	10,863	10,933	10,296	10,481	14,626	14,624	15,040
EBIT	6,076	5,498	4,651	4,449	6,744	6,240	6,001
Net Profit	3,375	2,880	2,632	2,586	5,346	5,173	5,203
EPS (LKR)	30.5	26.0	23.8	23.3	48.3	46.7	47.0
YoY Growth (%)	15%	-15%	-9%	-2%	107%	-3%	1%
DPS (LKR)	9.0	7.0	5.7	5.7	11.5	11.1	11.2
Valuations							
PER (x)	8.5	10.0	10.9	11.1	5.4	5.6	5.5
PBV (x)	1.6	1.4	1.3	1.2	1.0	0.9	0.8
DY (%)	3.5%	2.7%	2.2%	2.2%	4.4%	4.3%	4.3%

Double whammy expands earning

RCL earnings growth surged over 100% to reach LKR 2.0Bn for 3QFY21, compared to the LKR 1.0Bn in 3QFY20 with 9MFY21 earnings expanding by 72% to LKR 3.3Bn. Profitability was mainly supported by the surge in GP margins, reduction in finance cost and increased contribution from associate profit from LFIN. RCL’s GP margins for the qtr was enlarged by 236bpsYoY to 39% amidst strong growth in volume and economies of scale supported by higher capacity utilization nearing 100%. Meanwhile EBIT and NP margins jumped 424bps and 691bps respectively.

RCL gears up for capacity expansion

RCL plans to increase tile and bath ware capacity by 10% expansion in the existing plants while also building a new plant in-order to further expand overall capacity by 20% during FY22E. New tile manufacturing plant is expected to target more price sensitive segment of the market. The ceramic industry is expecting more than LKR 15Bn in new investments, expanding industry production capacity with potential new players likely to enter the lucrative industry increasing competition over the next few years.

Import restriction relaxation on the cards

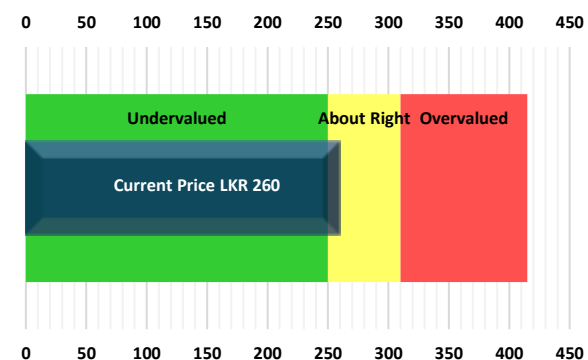
On 2nd Feb 2021 import relaxation gazette notification was overturned within 24 hrs maintaining the restrictions until further notice. On the sanitaryware segment, the Tile and Sanitaryware Importers Association (TSIA) reached an agreement with the government to allow import of products under restrictive

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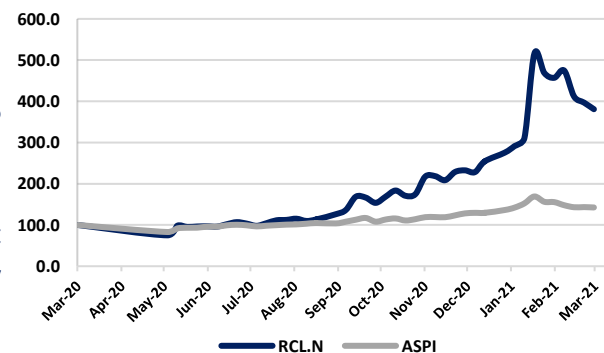
Fair Value Estimates



Price Performance (%)

	1 mth	3 mths	12mths
RCL	-17%	67%	321%
ASPI	24%	20%	13%

Price Movement of RCL vs ASPI and Past Recommendations



conditions. Few weeks later, on 1st Mar 2021, **TSIA** along with local manufactures reached an agreement after meeting with Treasury Secretary to remove restrictions allowing the importation of Tiles subject to **“SPECIAL CESS”**. However, gazette notification is yet to be released.

Retaining volume and margin; the biggest challenge

In FY22E, with a more relaxed environment in terms of trade coupled with the new capacity RCL margins are likely to significantly dip although offset by increased volumes and higher contribution from LFIN, we expect RCL to maintain profitability of LKR 4.5Bn-5.0Bn in the next few years.

Valuation Summary

Expected RCL price for FY22E	
DCF based target price	272.9
PER Valuation based target price	280.2
Average Target Price	276.5
Target Price after Rounding off	280.0

Return	FY22E
Target Price	280.0
Current Price	260.0
Capital Gain (LKR)	20.0
Dividends upto 31.03.2022 (LKR)	10.0
Capital Gain %	8%
Dividend Yield %	4%
Total Return %	11%
Annualized Return %	11%

Discounted Cash flow Valuation

DCF based Valuation	
Enterprise Value	41,315
Debt (-)	-13,308
Cash (+)	2,225
Total Value of Equity	30,232
No. of Shares (Mn)	111
Target Price	272.9

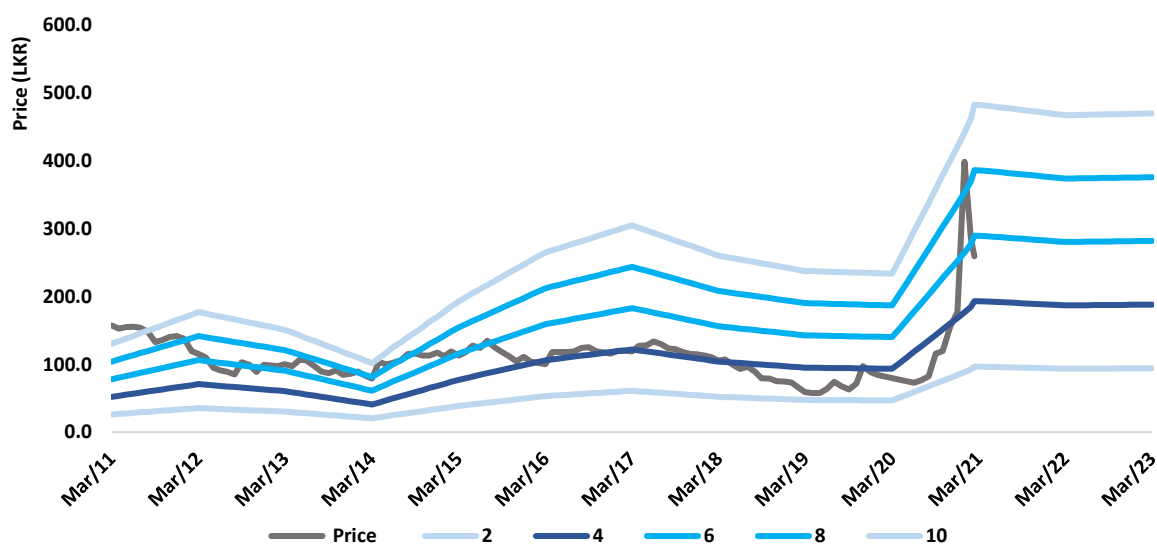
COE	
Rf	7.0%
Rm	15.0%
Growth %	3.0%
β	1.00
$Ke=Rf+\beta(Rm-Rf)$	15.0%

PER Valuation

PER based Valuation	
FY22E Earnings (LKR 'Mn)	5,173
No. of Shares ('Mn)	111
FY22E EPS	46.70
Expected PER	6.0x
Price at 6.0x FY22E Earnings	280.2

WACC	
Ke	15.0%
Kd	7.2%
D/E Assumption	40/60
Terminal Growth (%)	3.0%
WACC	11.5%

PER Chart





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