



Management Discussion and Analysis

Global economy

The global economic upswing that began around mid-2016 became broader and stronger in 2017. As a result, global GDP growth touched 3.8% in 2017, the fastest since 2011. Consequently, economic activity in 2017 ended on a high note, with growth in the second half of the year above 4%, the strongest since the second half of 2010, supported by a recovery in investment.

Financial conditions remained supportive, despite the recent volatility in equity markets and increase in bond yields following signs of hardening inflation in advanced economies. With broad-based momentum and expectations of sizable fiscal expansion in the United States over this year and the next, global growth is now projected at 3.9% for 2018–19.

(Source: www.imf.org)

Indian economy

Even as the impact of demonetisation was slow to allow consumer confidence to revive, India completely reset its indirect tax system to a comprehensive GST regime. While these reforms took the foot off India's economic progress in the first half of 2017-18, the nation bounced back with a 7%-plus GDP growth in the second half of the year. India's GDP growth of 7.7% in the last quarter of 2017-18 was its fastest in seven quarters, signaling a strong turnaround.

Nominal GDP (gross domestic product at market prices) grew at 9.5%, slower than the 11.75% growth assumed in the 2017-18 budget. The lower-than-anticipated nominal GDP growth has led to a slip in the fiscal deficit target for 2017-18, from 3.24% of GDP estimated in the budget to 3.29%.

The turnaround in the economy was led by robust growth in agriculture (4.5%) and manufacturing (9.1%), as well as double-digit growth in construction activities (11.5%) in the March quarter.

The economy also received a boost from higher government spending (13.3%) in the March quarter. Gross fixed capital formation at constant prices, a proxy for investment demand in the economy, expanded at a double-digit pace (14.4%) after a gap of seven quarters, signaling a revival in investment activities.

From a global perspective, India jumped up 30 notches into the top 100 rankings in the World Bank's 'Ease Of Doing Business' index, consequent to major improvements in indicators such as resolving insolvency, paying taxes, protecting minority investors, and getting credit.

Going forward, economic experts suggest that India would maintain its growth momentum. According to World Bank's India Report, India's GDP growth rate is expected to increase to 7.3% in 2018-19 and 7.5% in 2019-20.

(Source: www.mospi.gov.in (Ministry of Statistics and Programme Implementation))

Optimism over the medium-term

As India moves forward, there appears to be considerable promise over the horizon. This optimism is based on important realities.

The Government is determined to position India as a Good Governance business destination. This is showcased in its strong-willed policy initiatives, such as the GST regime and implementation of the e-way bill.

Moreover, the Government is also determined to strengthen the financial system in India through the introduction of the Insolvency Act, new NPA rules and tightening of banking norms for more disciplined lending, steps in the right direction. While this could lead to short-term disruption, it is expected to have a positive impact on the economy going forward.



Crude shock for India

The price of oil has hit its highest level since November 2014, reaching US\$80 per barrel (May 2018), as geopolitical fears (Iran and Venezuela) caused concern over potential disruptions in supplies.

As per ICRA, as India relies more than 80% of its oil needs through imports, a rise of every dollar per barrel in crude oil prices impacts the import bill by ₹823 crore (US\$0.13 billion). The same

is also the impact when currency exchange rate fluctuates by ₹1 per US dollar.

According to the former Chief Economist Adviser to the Government Dr. Arvind Subramanian, every US\$10 per barrel rise in oil price brings down GDP growth by around 0.2-0.3 percentage points and worsens the Current Account Deficit by about US\$9-10 billion dollars.

Economy at a glance



6.7%

GDP growth in 2017-18 against 7.1% in 2016-17



160

Trade deficit for 2017-18 (US\$ billion)



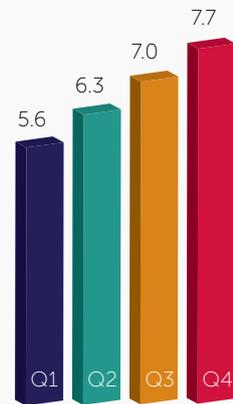
2.61

Gross Domestic Product (US\$ trillion)



1.9%

Current account deficit (2017-18)



GDP growth in 2017-18 (%) (at constant prices)



4.3%

Growth in IIP over 2016-17



3.53%

Fiscal deficit (2017-18)



422

Forex reserves as on March 31, 2018 (US\$ billion)



5.4%

Growth in per capita income in 2017-18 (₹)



2.74%

Wholesale Price Index (WPI) inflation index (2017-18)



100th

Position in 'Ease of Doing Business' ranking by World Bank (billion)



Global tile sector

The Calendar Year 2016 had delivered improved fortunes as global production and consumption of ceramic tiles grew by 5.7% and 5.0%, respectively.

Global tile production crossed the 13.00 billion sq. mtr. mark, while consumption stood at 12.78 billion sq. mtr. In 2016, world exports increased by 48.00 million sq. mtr to 2.79 billion sq. mtr, maintaining a fairly limited growth trend for the last many years.

In 2016, India overtook Brazil to become the world's second largest tile producer and consumer. While production jumped by 12.40%, the increase in consumption was modest at 2.90%. Low domestic consumption growth was however compensated by a healthy uptick in exports, primarily from Morbi tile producers.

Global ceramic tile production, CY 2016

13,056 Global production (MSM)	1,304 European Union (28) (MSM) 10% of world production +7.1% variance 2016/2015
	573 Other European (MSM) 4.4% of world production +1.1% variance 2016/2015
	358 North America (MSM) 2.7% of world production +8.5% variance 2016/2015
	1,086 Central & South America (MSM) 8.3% of world production -9.0% variance 2016/2015
	9,331 Asia (MSM) 71.5% of world production +8.1% variance 2016/2015
	399 Africa (MSM) 3.1% of world production -3.4% variance 2016/2015
	5 Oceania (MSM) 0.0% of world production 0.0% variance 2016/2015

Source: Ceramic World Review

Indian tile sector

During the last two decades, the Indian Ceramic Tile Industry has recorded phenomenal growth in product profile, geographical spread and value-added products. The growth was mainly driven by the transformation of ceramic tiles from being typically hygiene products into adornment and aesthetic solutions for every household.

But 2017-18 was a particularly challenging year for the tile industry as its progress was thwarted by significant road blocks. While the real estate sector continued to be in a quagmire due to a sluggish environment (impacting institutional offtake of tiles), the newly launched GST regime impacted the MSME sector, resulting in a drop in tile demand.

In addition, the industry also faced pressures on its profitability margin owing to a surge in gas prices, which could not be passed on to the consumers.

Important growth drivers

The low per capita consumption of tiles, rapid urbanisation, increasing disposable income of nuclear families, untapped rural market and stable replacement demand all continue to augur well for the Indian tile industry. In addition, forecast of a normal monsoon, improved consumer sentiment and implementation of the e-way bill promise healthier performance, going forward.

product profile Geographical
GST transformation per capita
rural Gas prices MSME sector
urbanization e-way bill GST

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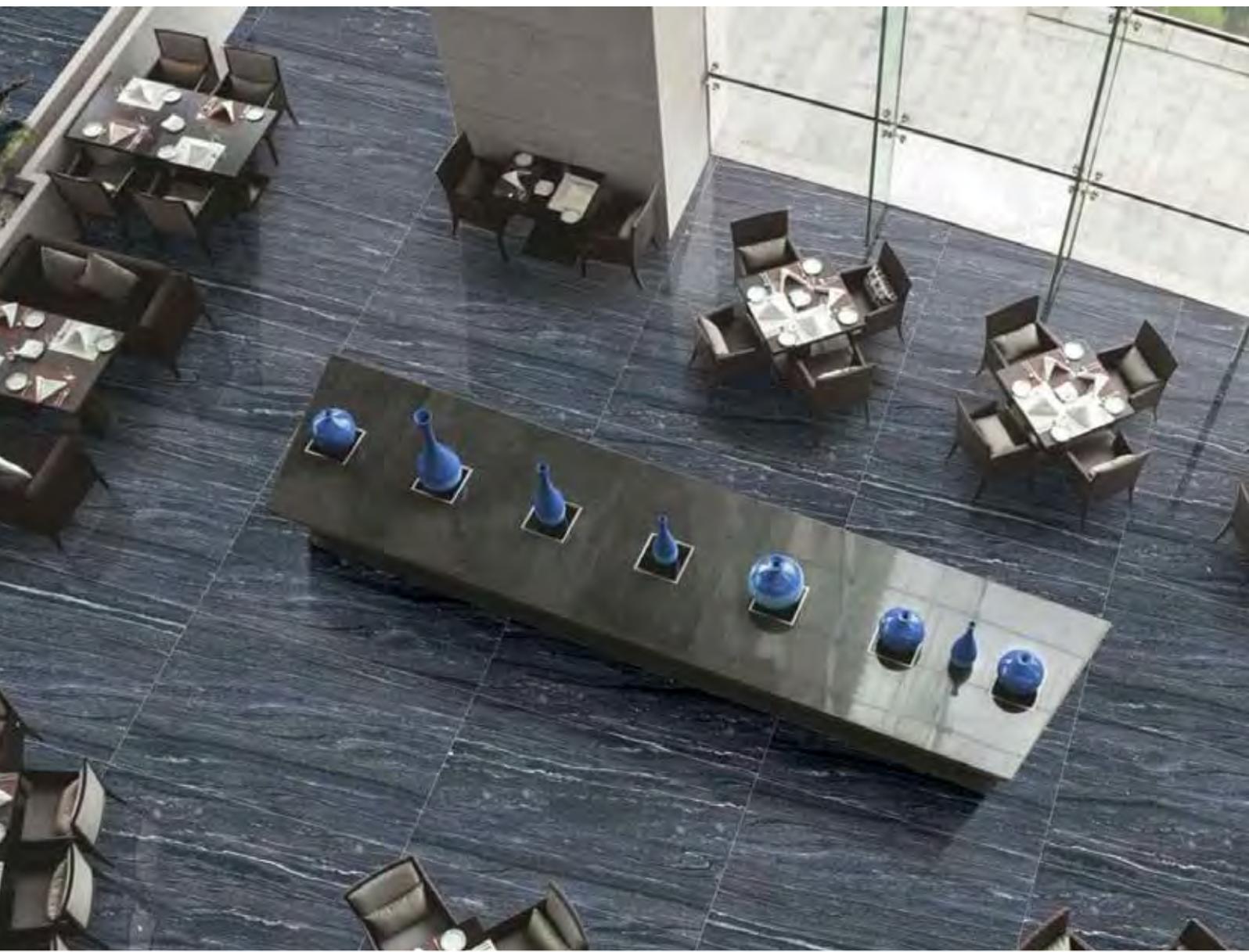
product profile Geographical
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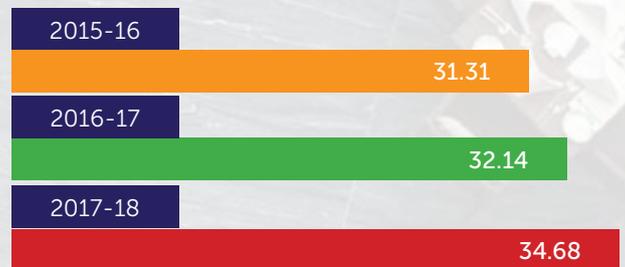
Business performance

Kajaria enjoys a broad sectoral presence covering ceramic wall & floor tiles, polished vitrified tiles, glazed vitrified tiles, and bathware. The Company offers more than 2,800 SKUs in different sizes in tiles and more than 250 SKUs in bathware. It delivers on its promise via the largest tile dealer network, translating into a dominant market share.



Ceramic wall and floor tiles

Sales volumes (MSM)





Business overview

The Ceramic Division has catered to its key product segment for more than three decades keeping pace with growing aspirations across the consumption pyramid. The Company's 29.47 MSM ceramic wall and floor tile capacity rolls out tile sizes, designs and finishes, which address all customer price-points. It markets its large product basket comprising more than 1,800 SKUs through its wide and entrenched pan-India dealer network. The Company created a highly successful new distribution channel, 'Kajaria Prima Plus' exclusively for marketing its ceramic wall and floor tiles.

Business in 2017-18

Kajaria worked on a multi-pronged strategy to enhance business volumes not just for itself but also for the extended Kajaria family (its dealers).

One, it introduced new value added products, namely the Designer Collection and the Impression Series, in the 30x60 cms size with 70 new concepts. The Designer Collection comprised a set of wall and floor tiles, with state-of-the-art third firing highlighters being the eye catcher (owing to its exquisite design), to generate volume. The Impression Series comprised two finishes – one that provided an embossed look on the tile surface; the other, a sparkling effect on the tile surface. Towards the end of the fiscal, the Company launched its New Luxury Collection, consisting of 98 concepts in multiple sizes.

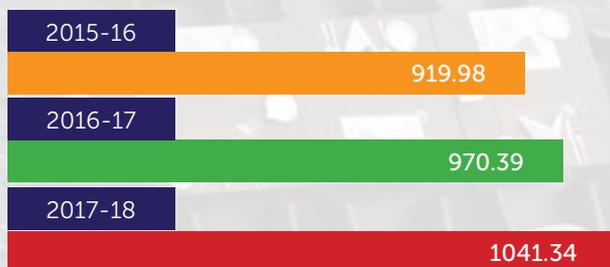
Two, the Company widened its opportunity canvas by launching new bigger sizes namely Grestough slabs, an authentic replacement of high-end marble (80 x 120 cm range) and Grestough planks, with the feel and finish of authentic wood (20 x 120 cm and 20 x 100 cm), the first of its kind in the Indian tile market, which were very well received by the customers.

Three, the Company organised the Caravan shows in key consuming markets to increase customer awareness of its innovation and creative capabilities. The first show was organised in May 2017 in 20 cities, the second was organised in January 2018. These campaigns provided the perfect platform for launching its above mentioned product series.

Business forward

By enriching its portfolio with eye-catching concepts and pioneering finishes that attract discerning customers by rolling out the new sizes 20x20 and 80x120 - this will bring presence in all segments from commodity to high value. Also planning to increase the network of "Prima Plus" showrooms, which showcases ceramics wall & floor tiles exclusively to give customers new experience of buying tiles.

Revenue (Net Sales) (₹ crores)





Polished vitrified tiles

Sales volumes (MSM)





Business overview

Kajaria possesses a manufacturing infrastructure of 22.40 MSM, at four facilities in Rajasthan and Morbi, rolling out soluble salts and double charge vitrified tiles in diverse sizes, designs and finishes. The Company's more than 173 SKUs, marketed through its multi-format distribution channel, address every price point pan India.

Business in 2017-18

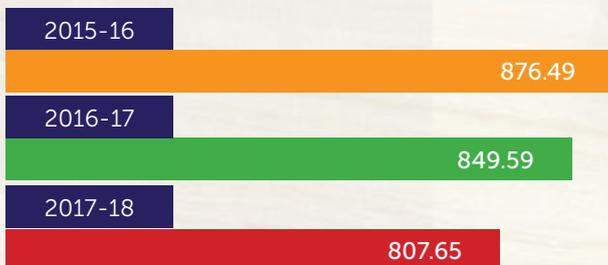
The team took up the challenge of strengthening business profitability even as it continued to focus on growing business revenue. The Company adopted a multi-pronged strategy, which comprised improving internal efficiencies, expanding the product basket and widening product awareness and reach.

One, the Company pioneered the 80 x 160 cm size in the double-charge segment – this is the biggest size available in polished vitrified tiles in the double charge format in India. It also launched, for the first time in India, the 60x120 cm double-charge tile for indoor applications. In addition, an entire range of penetrative products (different sizes and designs) were launched, filling in product gaps in the price chain for this particular segment.

Two, it successfully introduced another value-added tile variant - Stone Art – which complements its existing product Sandune. This has further enhanced the product portfolio with natural elegance and value addition.

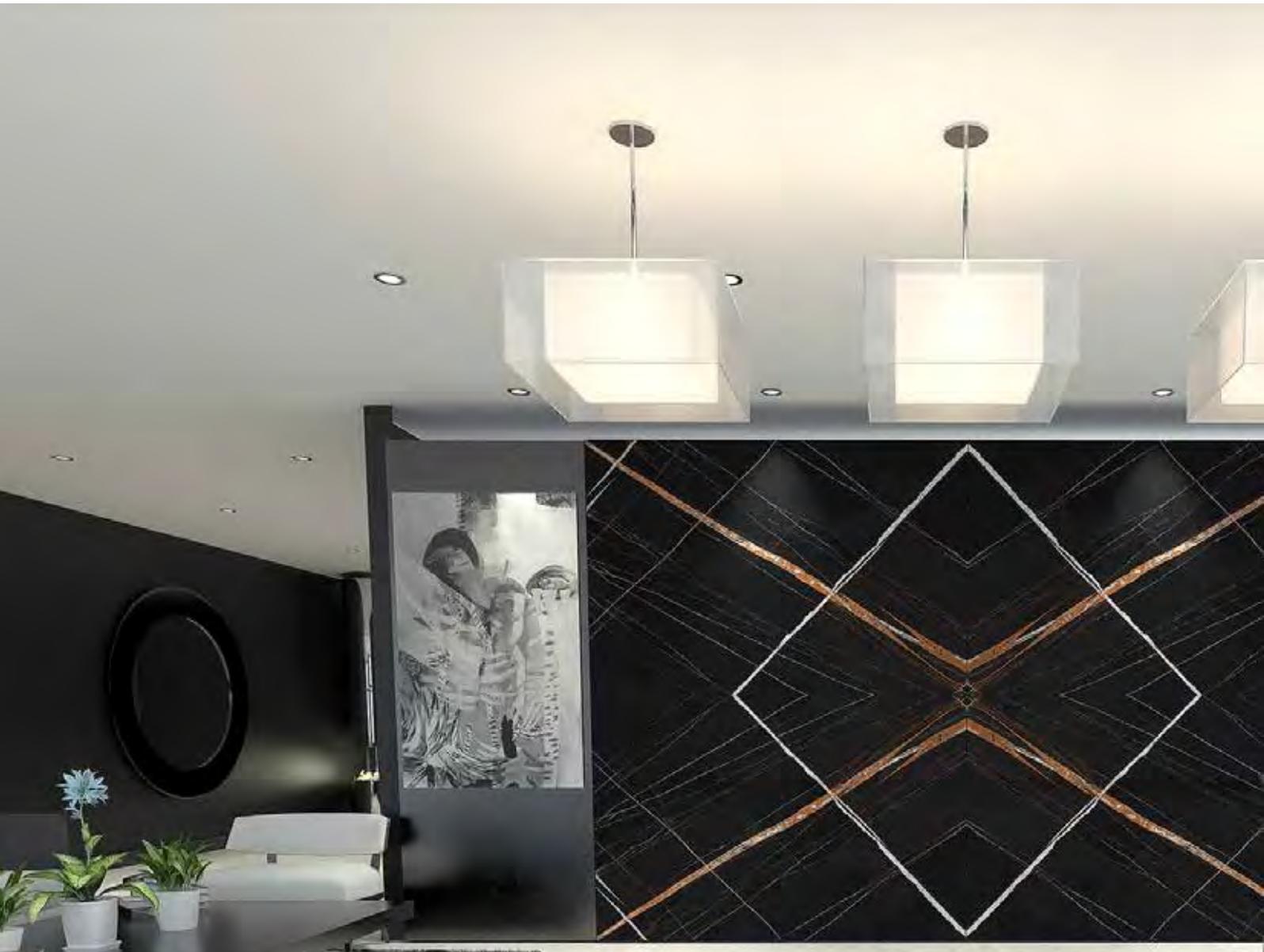
Three, the team replaced the existing feeder system in Jaxx Vitrified, a joint venture partner, with a contemporary variant, which facilitated the manufacture of a value-added range from the same line, with superior cost-effective designs, enhancing man-machine productivity.

Revenue (Net Sales) (₹ crores)



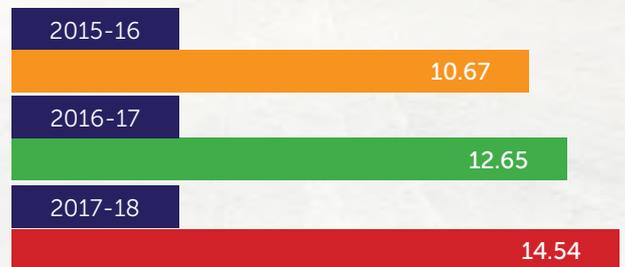
Business forward

To focus on improving utilisation and increasing market penetration, we are enhancing product-mix and the market base of value added tiles. The team plans on launching the full-body vitrified tiles both in Salt & Pepper and Solid Colours- a popular concept in high traffic areas. Further, we are introducing large size showrooms under the KAJARIA AMBIANCE format, an international buying experience, showcasing large sized tiles and other value added products.



Glazed vitrified tiles

Sales volumes (MSM)





Business overview

Kajaria is the dominant player in the glazed vitrified tiles market in India, with a manufacturing capacity of 16.50 MSM, housed in its two manufacturing units at Gailpur and Sikandrabad. The Company offers the largest product basket in terms of designs and sizes. The Company’s array of products, comprising around 890 SKUs in 15 sizes, are marketed under the ‘Kajaria Eternity’ brand through an entrenched network of dealers (Kajaria Eternity World, Kajaria Galaxy and Kajaria Boutique chains). The Company offers the largest number of tiles in various finishes in the large format.

Business in 2017-18

The team continued its efforts to strengthen its competitive advantages.

One, it focused on enriching its product basket with a greater number of aspirational products. It launched The ‘Ultima’ – a Luxury collection comprising 181 designs in five sizes (120x180 cm, 120x120 cm, 80x160 cm, 20x180 cm and 29x180 cm); it also added a new size (80x160 cm) to the Ultima range. The range is being positioned as an alternative to Italian marble / granite. The team also introduced large planks with a wooden appeal (20x180 cm and 29x180 cm) as an alternative to wooden planks (use for wooden flooring).

Two, even as it continued to rejuvenate its product basket through innovative designs and sizes, it worked towards expanding its product reach and increasing awareness of its products among end-consumers and opinion influencers.

Business forward

With growing acceptance of the Eternity brand pan-India, the Company is working on establishing a manufacturing facility (through the joint-venture route) for glazed vitrified tiles in South India. This would strengthen its capability to cater to customers in South, West and Central India. In addition, the team will continue to draw customers to its dealer showrooms through novel designs and concepts.

Revenue (Net Sales) (₹ crores)





Faucets &
Sanitaryware



Business overview

Kajaria's presence in the sanitaryware and faucets space is through its wholly-owned subsidiary Kajaria Bathware Pvt Ltd. The Company's 1-mn piece faucet manufacturing facility at Gailpur (Rajasthan) manufactures more than 250 SKUs, bucketed in 15 different product ranges that address various price points.

The Company sources key components from globally respected players in the space to ensure that its products deliver on the performance promised. The Company's sanitaryware facility at Morbi (Gujarat) is capable of manufacturing 5.40 lac pieces per annum in diverse designs and colours aligned to customer preferences.

Business in 2017-18

The Company focused on strengthening this business vertical, as it is an important contributor to business growth and profitability. To this end, the Company made significant investments in strengthening its capacity and capability to meet customer aspiration.

One, the team invested in a new technology, enabling it to manufacture single-piece toilets which were earlier outsourced – widening its growth potential. In addition, the team launched aesthetically and functionally superior products – faucets and sanitaryware, which received a heartening response from urban customers.

Two, the management invested in enhancing the capacity of its sanitaryware unit from 5.40 lacs pieces per annum to 6.00 lacs pieces per annum (with an ability to produce more value-added products), which will come onstream in July, 2018.

Three, the team enlisted many new dealers in its distribution channel to widen its presence in the growing Indian market place. In addition, the Company has also created around 300 dealers dedicated to these products.

Four, the team signed up celebrity youth icon Anushka Sharma as the brand ambassador for the Kerovit brand; launched a TV ad featuring the new brand ambassador, which was beamed on key national channels and other media platforms.

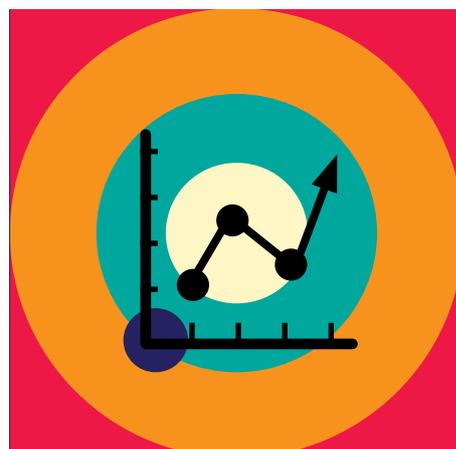
Business forward

Compared to the other business verticals, this revenue vertical is still a fledgling. It, however, has the potential to become an important business driver over the coming years. To translate the vision into reality, the team has adopted a two-pronged strategy – one, it would optimise its operating costs and two, it would drive sales volumes. The combination of these two factors would enable the Company to achieve its articulated goal.

Analysis of financial statements

“When the external environment is impacted by strong and multifarious adversities, every sectoral participant will be tested for their organisational resilience to face these headwinds. For some it could mean their start towards their end. For others, it would emerge as an opportunity to strengthen their robust core.”

Ashok Kajaria



Statement of Profit and Loss

Despite the challenging environment that impacted tile demand, Kajaria registered a 6.31% revenue growth, from ₹2,549.63 crore in 2016-17 to ₹2,710.60 crore in 2017-18. This improvement is owed to the launch of innovative products and new sizes, strengthening the distribution network, and the branding initiatives.

Even as revenue improved, business profitability declined marginally. EBIDTA declined by 8.05% from ₹496.33 crore in 2016-17 to ₹456.36 crore in 2017-18. This was primarily a consequence of the increase in gas prices, which could not be passed on to the end consumer owing to tepid demand. In addition, the decline

in realisation of GVT products and operational issues at some joint-venture units further impacted business margins. As a result, the EBIDTA margin declined by 263 bps, from 19.47% in 2016-17 to 16.84% in 2017-18.

Interest liability declined by 29.12% from ₹34.00 crore in 2016-17 to ₹24.10 crore in 2017-18 owing to a drop in interest rates and prudent utilisation of operating cash flow to lower the Company's debt burden.

Net Profit (after minority interest) for the year declined by 7.07% from ₹252.81 crore in 2016-17 to ₹234.96 crore in 2017-18 while net profit margins stood at 8.67% in 2017-18 against 9.92% in 2016-17.

Despite a decline in profits the Company maintained a dividend payout of ₹3 per share in line with the payout in the previous year.

Balance Sheet

Even though performance during the year was impacted, the Company continued to strengthen its Balance Sheet. The Company's net worth grew by 15% as a result of the plough back of business surplus and issue of shares (12,300 shares), pursuant to exercise of options under the Employee Stock Option Plan. Net Worth increased from ₹1,175.12 crore as on March 31, 2017 to ₹1,350.38 crore as on March 31, 2018.

The Company's gross debt declined from ₹213.16 crore as on March 31, 2017 to ₹170.33 crore as on March 31, 2018, strengthening its debt equity ratio from 0.17x as on March 31, 2017 to 0.12x as on March 31, 2018.

The subdued business environment resulted in growing inventories and receivables – this expanded the working capital cycle from 46 days as on March 31, 2017 to 60 days as on March 31, 2018 (off from a peak of 71 days in December 2017).

₹3

Dividend payout in 2017-18 (per share)

0.12x

Debt-equity ratio as on March 31, 2018

RISK MANAGEMENT

If you don't invest in risk management, it doesn't matter what business you're in, it's a risky business. – *Gary Cohn*

Kajaria's risk management framework encompasses strategy and operations and seeks to proactively identify, address and mitigate existing and emerging risks. The risk management framework goes far beyond traditional boundaries and seeks to involve all key managers of the Company.

COMPETITION RISK

01 Growing competition from the unorganised segment could hamper the Company's progress, going forward.

Relevance: The tile industry is witnessing rising competition from unorganised players at Morbi, Gujarat, which could affect margins.

Mitigation: In India, the vast disparity in affordability has resulted in two distinct customer categories - the brand conscious and the cost conscious. Both these categories would prevail in all sectors and scenarios. The tile segment is no exception to this trend. It is expected though that the share of the branded players would increase. This optimism is based on the following factors:

- The reduction of tax under GST and the recent implementation of the e-way bill are expected to create a level playing field among all tile manufacturers.
- Given the promise that India's economic resurgence will result in an increase in disposable income in the hands of the average Indian, it appears that the preference towards branded products would increase over the medium term.

BRAND CLUTTER RISK

02 New brands cluttering the tile sector could impact sales offtake.

Relevance: Some tile manufacturers from Morbi cluster are increasing their focus on branding and advertisement – a threat to branded players.

Mitigation: A brand is not just a name, it's an emblem of trust. Trust to deliver quality products, deliver a value-proposition and deliver with speed.

Through their investment in branding and advertisement, Morbi-based tile manufacturers could at best become regional players primarily because of their ability to offer a value proposition to customers; however, their pan-India reach would be limited owing to their locational disadvantage (manufacturing facility in the West only).

Kajaria is much better placed than most others in the tile manufacturing industry because of its multi-locational manufacturing base (closer to key consuming clusters), its largest dealer network and the highest brand recall.

INVESTMENT RISK

03 The joint-venture companies are appearing to be a drag on the Company's performance.

Relevance: Kajaria's subsidiaries have been a drag on its bottom-line in the recent past as they have incurred losses in the last two financial years.

Mitigation: While spreading its manufacturing presence across geographies, to serve the growing landmass better, is regarded as a step in the right direction, the management remains committed to transforming its subsidiary units into profitable operations – individually and collectively. To do so, the team has worked passionately to improve shop floor efficiency. It is expected that the Company will achieve its goal in the current financial year.

COST RISK

04 Rising fuel costs could impact the Company's margins.

Relevance: Liquefied Natural Gas (LNG) prices have increased significantly over the previous year; subdued demand has thwarted the Company's efforts to pass on increased costs to customers.

Mitigation: Increase in gas prices is an external phenomenon which has impacted every tile manufacturing player, and Kajaria is part of this universe. In the past, the tile industry was able to pass on the increased gas cost to its customers. While this did not happen in 2017-18 owing to subdued demand for tiles, the team believes that improving customer sentiments would enable the industry to pass on this cost going forward, which should help protect its margin.