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Season of Mergers

Indian companies are aggressively pursuing growth

Adding more gloss

Tile manufacturer Somany Ceramics is emerging from the crisis caused by the Covid pandemic

Abhishek: well-placed strategy

It would not be an exaggeration to say that the sprawling 57-acre Somany Ceramics plant at Kassar, Haryana (on the outskirts of the national capital, on the Delhi-Rohtak Road), presents a microcosmic view of the ceramics business. Walking through its different sections, India's second largest ceramic plant showcases all the processes involved in the value chain – ranging from basic clay collection (as many as 12 kinds of clay are gathered here), to actual tile production, designing (in a dedicated lab) and testing using state-of-the-art machinery, to final dispatch to dealers across the country from the warehouses which are within the campus. Simply put, it's a beehive of activities. The scene changes completely when you visit its model experience shop about 80 km away, which is located in Noida in the building adjacent to Somany Ceramics' headquarters. Walking through the store, you come across top notch finished ceramics, sanitaryware and bath-fitting products (the last two are recent additions) in a regal environment inviting you to adopt the best in class (experience stores are purely touch and feel points where no sales happen) and add more elegance to your existence.

At the helm to manage and make the best out of these contrasting scenes, Abhishek Somany (nearing 50), MD and CEO of the firm, presents a neutral demeanour while addressing the exciting and challenging dimensions of the business. He represents the third generation of the family which is known for being in the forefront of giving a structural shape to the ceramics business in the country. It was all started by his late grandfather HL Somany (one of the most revered figures of the Indian ceramics business) and carried to the next level by his father Sreekant Somany (chairman). And being in the business for the last 25 years, the third generation is now in operational command. Steering India's second largest ceramics firm (Kajaria occupies the top slot in size and other corresponding metrics) they seem to have a clear vision regarding the priorities of the company.

"I am not really obsessed with metrics like market cap or revenue. These are not exactly my critical growth parameters. Debt-free existence, enhancing profitable growth and climbing up in brand recall are my key concerns and as a company we have a well-placed strategy to achieve them," says he (there is a big gap between the market-caps of Kajaria and Somany). Though bogged down by a flat sales trajectory for three years in the latter half of the last decade and then Corona-led troubles, the company's financial position has much improved in recent years with a revival in demand and a new capex plan. According to Abhishek, the company today is in sweet spot on key fronts like finances and capacity and is ready for expanding its footprint in the coming years. And while doing so, it may opt for expanding its non-ceramic portfolio even as the tile business will continue to remain the core one.

Triumvirate dominance

As per an estimate, the Indian ceramics or tiles market has reached a sizeable scale and now accounts for nearly

₹35,000 crore of business. "With an installed capacity already in excess of 40 million pieces/year, India is the world's second largest ceramic tiles and sanitaryware producer after China. Almost 80 per cent of the tiles produced are consumed domestically and around 20 per cent are exported. The major factors driving this growth in domestic consumption are increasing urbanisation, low per capita consumption, increasing disposable income and stable replacement demand," a report released by rating agency CARE underlined in 2020. That Indian manufacturers are now making a bigger splash in the international market is a commonly accepted fact, especially so in the mid-tier segment where China has enjoyed supremacy for a long time. The premium segment though is still dominated by the Italian and Spanish firms who mostly sell in the US, Europe and elsewhere. Post-Covid, however, Indian ceramics exporters have gained, as the world at large has begun looking at an additional market for bulk sourcing. Industry insiders confirm that China + one has come into play and that the Indian ceramic tiles industry is benefitting from this trend.

The large-scale production capability which India has developed in the ceramics and aligned business has its own set of unique nuances. The market is believed to be dominated by a handful of organised players (10-15) and the rest come from a large unorganised segment usually based in some specific clusters across the country. In fact, as per an earlier report released by ETA Consulting, while Morbi in Gujarat is a well-known cluster for ceramics,

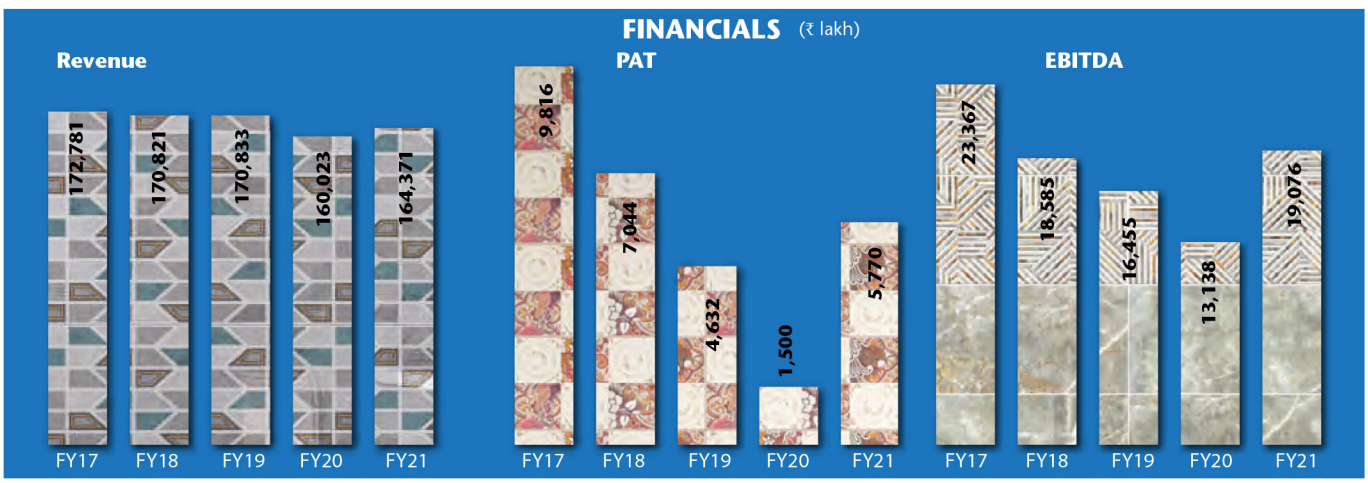
Shreekant: carried to the next level

there are other hubs too which have created a niche for themselves. These include: Thangarh in Gujarat, Khurja in Uttar Pradesh and Virudachalam in Tamil Nadu. Among these, Morbi qualifies as a super hub and is referred to as 'Morbi producer' in common parlance. "Morbi has been a traditional hub for this sector for a very long time. Its proximity to various ports has further strengthened its positioning as accessibility to gas becomes easier and exports pick up momentum. Today, it has a sizeable number of units manufacturing only for exports," points out PK Sharma, Secretary General, Indian Council of Ceramic Tiles and Sanitaryware. "The organised sector in India accounts for around 50 per cent of the industry and the other half is represented by regional players present in clusters such as Morbi. Morbi has continued its rapid growth and is now estimated to have more than 500 production lines, many of which are devoted to products for exports," the CARE report had earlier underlined.

It is in this kind of scenario that Somany Ceramics, formed in the late 1960s, enjoys a leadership positioning. Abhishek points to an interesting perspective. "In the past 50 years, many players have come and gone and many of them have been even marginalised. But there has been one constant factor that ironically denotes no change – the names in the top three brackets. Johnson, Kajaria and Somany have been the three leading players for past several decades. Today in terms of size and revenue, it's Kajaria that leads the pack, followed by us and then Johnson," Abhishek says. According to him, of the total ₹35,000 crore current ceramic business, exports account for ₹12,000 crore worth of the business. And in the remaining pie of ₹23,000 crore, the expected revenue share of the big three would be close to ₹7,000 crore or 30 per cent of the business. "The three of us are not participating in the exports game big time. Our cumulative exports earning will not be more than ₹200 crore," he adds.

Consistent addition

Being in the top three league and now at a decisive number two position for more than a decade has been a result of consistent efforts to upgrade and expand both quantitatively and qualitatively. A look at the



Source: Company Annual Report, 2021

The company has a wide range of ceramic products

over 50-year-old journey of the company reflects decisive milestones being added every now and then. The company took off as Somany Pilkington in the late 60s but the group promoters had acquired Pilkington's Tile Holding's (UK) equity stake of 26 per cent in 1994. Prior to this, mother production hubs were established at Kassar and Kadi in Gujarat. Of course, they were small units then which have expanded tremendously over the decades as part of brownfield capacity enhancement initiatives. In 1995, a double fast firing (DFF) plant was set up at Kassar with a manufacturing capacity of 6,000 sqm per day to make larger formats of wall tiles. Around the middle of the 90s, Somany's corporate chip also moved up in the market with listings on the Bombay Stock Exchange and National Stock Exchange. In 1997, the company commissioned a new production unit at Kassar with its third fire printing technology, another first of its kind in India. 2001 saw the debut of a new floor tiles manufacturing plant at Kadi with a capacity of 6,000 sq m per day. On the new product offering side, the company introduced heavy duty vitrified tiles in 2005 under the brand name Durastone. These tiles are considered to be best suited for outdoor use. In 2008, Somany Ceramics earned the patent for its invention of a high abrasion glaze resistant composition which is known as VC Shield Hard-Coat technology. The latter years saw its entry in sanitaryware and bath fittings and the last one decade has been decisively marked by the expansion of its marketing network through the franchise route and experiential showrooms.

The company today claims to be a complete solution provider in terms of décor solutions with wide product selection categories – ceramic wall and floor, polished vitrified tiles, glazed vitrified tiles, sanitaryware and bath fittings as well as tile laying solutions. According to Abhishek, who entered the business in the mid-90s, his company along with Kajaria, is the only player in the country which has a pan-India presence, not only as a selling firm but with a distinctive manufacturing presence in different geographies. "We have our own manufacturing units in Kadi in Gujarat and Kassar in Haryana. Plus, we have a large manufacturing unit in the south in Tirupati in a JV format. Together, these three plants contribute to about 55 per cent of our production. Plus, we have eight other JVs in Morbi – one for sanitaryware and the remaining for tiles. Near Chandigarh, we have a plant for bath fittings. We have ten plants in total which includes sanitaryware and bath fittings into which we have forayed over the last decade," he says. The current cumulative production capacity of Somany is estimated at around 55 million sq m (recent additions have taken it up further) while market leader Kajaria has a production base of over 70 million sq m, as per an estimate released in 2021.

"Our JV platform is quite robust. We are investing in these JVs and these units produce exclusively for us. Our JV associates are manufacturing partners in the deal and we are the selling partner. We also outsource to some other production partners periodically. But there is no binding clause on them," Amit Sahai, President (Sales & Marketing) explains. Furthermore, as Sahai emphasises, the company has an expansive network of associates on the distribution side as well as other critical functionalities which are giving it an edge. "If I talk about our entire network, we have more than 3,000 dealers and over 400 exclusive showrooms across the country. Additionally, there are more than 11,000 sub-dealers, 1,000 contractors and 1800 architects in our loop," he further adds.

Next frontiers

According to Abhishek, the company in the last six-seven years has made an investment in the vicinity of ₹500 crore in ramping up operations and making marks in new areas like sanitaryware as well as the technological upgradation of its operations. The company, however, had maintained a flat sales trajectory in the years preceding Corona (*see graph*). But this is considered to be a sector-centric phenomenon, as market analysts and research reports point out. "The growth between 2015 till the Corona crisis in 2020 was broadly in low, single digit numbers in the industry. There were a host of structural issues," claims Sharma. According to the CARE report, the low sentiments in the real estate sector were the major challenge holding back the ceramics business. "The ceramics industry was already passing through a dull phase in FY2019 due to challenges faced by the user industry (real estate) before the spread of Covid-19," says the CARE report.

The outbreak of Corona in 2020 and the consequent national lockdown further worsened the situation. According to the CARE report, the net sales of the ceramic industry had declined by 55 per cent from ₹2,482 crore in Q1FY20 to ₹1,127 in Q1FY21. Similarly, operating profit nosedived by 76 per cent to ₹43 crore in Q1FY21 compared with ₹320 crore in the same period last year. Abhishek asserts that the sector has been facing extreme pressures which were further aggravated by Corona-led troubles. "The

last five years have not been an easy period for us. We were under pressure and so was the industry leader. Before the pandemic, we were growing by 4-5 per cent. And then in 2020, we had three months of operational shutdown and another two months were wasted during the second wave of Corona."

But FY22 has brought in positive reversal tidings for the industry and Somany seems to be making the most of it. Its quarterly results have shown modest to major upticks (on a corresponding quarter comparison yardstick) and according to a leading brokerage house analysis released in February, during the first nine months period in FY22, the company's net sales shot up by 36 per cent, touching ₹1,477 crore as against ₹1,085 crore in the corresponding period in FY21. The third quarter result saw its sales reaching close to the ₹600 crore mark, which was a jump of over 19 per cent.

Going ahead with its capex plans even in the midst of an extremely adverse situation seems to have worked well for the company. January onwards, the company has added 20 per cent capacity by ramping up three plants at an investment of ₹200 crore. And another ₹170 crore capex plan has been mooted to set up a greenfield manufacturing facility for large format slabs in Gujarat. The facility is expected to go live before the end of March next year. The company, meanwhile, in recent years has notched a major distinction as it announced becoming a debt free company in 2021 (the receivable period has also been slashed from 110 to 40 days). According to Abhishek, there are a host of positive factors in support of the company's future growth. "I never had this kind of situation in the last 50 years. We have ₹200 crore debt, mostly in JVs where we have a stake. Our whole interest burden is ₹20 crore on a balance sheet of ₹2,000 crore and we have an EBITA of ₹200 crore. In so many years, we never expanded capacity by 20 per cent in one go." Market analysts recognise these favourable factors in no uncertain terms. The two brokerage houses which have maintained buy on Somany shares in recent months have projected a growth in its revenue in the range of ₹2,300-₹2,400 crore by the end of FY23.

If Abhishek is to be believed, the company, now propelled by a host of positive factors, is brimming with new confidence and the management has drawn a strategy to reap rich dividends in the coming years. In capacity terms, Somany Ceramics is poised to reach close to 70 million sq m in the next couple of years with an additional capex plan. And it may toy with the idea of adding more products to its portfolio in sanitaryware and bath fittings (eg geysers and adhesives). But the revenue share from these segments is in single digits; nor are these segments anywhere close to the tiles business (it contributes 88 per cent of Somany's business) in terms of scope and potential. The company, therefore, is not looking at engineering any major churning in its list of major earners. "Tiles are a ₹35,000 crore business which is growing at a decent high single-digit number. In comparison to this, sanitaryware and bath fittings are smaller businesses (₹6,000 crore to ₹9,000 crore). The good news is: considering our strong pan-India presence, our dealers who have been our partners for decades have begun taking our products in these categories seriously and more products will gradually be introduced. But tiles will continue to be our mainstay," he specifies.

Somany Ceramics is poised to reach close to 70 million sq m in the next couple of years

Similarly, the company is not planning to make extra efforts to spruce up exports. "I would not like to ignore the international market considering my strong presence in one of the leading manufacturing and exporting markets. But my focus would be more on the domestic market where Somany is a strong brand in its category. So, at best, the share of exports to my business will go up to five per cent from the current base of three per cent."

In the near run, the abnormal escalation in gas prices since the beginning of the third quarter of FY21 is believed to a major challenge for players across the value chain in the ceramics business. "Prices of gas used in this business have gone up by as much as 130 per cent in places like Gujarat. This has begun impacting the margins of players across the spectrum. Big players have passed on this increased input cost to their end users. But this will keep the pressure on their margins. This trend will contribute for at least the next two quarters," observes Mayank Agrawal, Senior Analyst, ICRA.

Abhishek calls it a cyclical issue and maintains the company is rather focused on a set of new targets for the near to medium run. "We would like to attain double-digit growth numbers and enhance our profitability. And then I want to bridge the gap in the EBITA figure between the industry leader and us and eventually achieve 20 per cent of the EBITA levels of Asian Paints. It would obviously address other things. Also, we want to further climb up in recall value. When you buy a home, we should be your primary consideration for ceramic products," he specifies. The man who has set out to create a glossier surface, obviously knows the ingredients he will need. ◆

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