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INDIAN TILES INDUSTRY

Rising production cost to weigh on operating profitability of domestic tile players; expected to moderate further by 100-150 bps in FY2023

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Highlights

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Elevated PNG prices, packaging (kraft paper) and freight cost continue to weigh on the profitability of tile manufacturers in the near term. Elevated sea freight rates and container shortages impact exports.

- The Indian tiles industry has been grappling with rising input costs like that of piped natural gas (PNG), packaging (kraft paper) and freight rates – all of which have impacted the operating profitability by ~140 bps in FY2022 in line with ICRA's estimate of 100-200 bps drawn during November 2021. Given the continued input cost pressure, ICRA research expects further 100-150 bps contraction in operating margins during FY2023e

- PNG forms around 25-30% of the total cost and the PNG prices for the state-run Gujarat Gas Limited has increased by 150% over the last 16 months. While periodic price hikes have been taken by tile players to pass on such unprecedented surge in gas price, they have been unable to pass on the hike fully to their customers. The medium to small players have been under pressure to pass on these hikes due to limited retail presence and dependence on a few customers/contracts which limits the ability to pass on such hike frequently. Further, some of the players in the industry have also shifted to propane which remains cheaper to PNG by Rs. 3-4 per SCM after adjusting for calorific value. Though, further shift to propane could be restricted due to recent price increase for propane.

- The export container freight has also increased multi-fold which, along with container shortages, has further exacerbated the issue. Further, prices of kraft paper (used in packaging) has also increased substantially. The increase in gas, packaging cost and container freight has been a double whammy for small and medium-sized players, who are unable to pass on the hike in input costs. The export demand has also started tapering (year-on-year) since September 2021, which has also pushed export focused players into the domestic market, thereby constraining price expansion in the domestic market due to increased supply.

- ICRA expects that on an overall basis, the increase in input cost will adversely impact the operating margins of most tile players by 100-150 bps in FY2023. In addition, the finance cost is also expected to increase due to increasing interest rate and working capital borrowings to fund inventory build-up for exporting entities. The pressure on earnings and build-up of inventory could adversely affect the liquidity profile of small to mid-sized players while larger players have better financial flexibility and liquidity cushion to absorb this.

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Thank You!