



POKARNA LIMITED
India's No. 1 granite company

Quantra[®]
Natural Quartz surfaces from Pokarna
Technology. Powered by nature.



Pokarna Ltd (BSE Code: 532486) – Alpha/Alpha + stock report for Jun'15

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Company Snapshot (8th Jun'15)

BSE CMP – 924.00

Dividend yield – 0.32%

BSE Code – 532486

Market capitalization – Rs 573.00 cr.

Total Equity shares – 0.62 cr.

Face Value – Rs 10.00

52 Weeks High/Low – Rs 1070.00/150.00

Particulars (in cr.)	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15
Granite Sales (in cr.)	108.16	102.77	114.05	110.43	140.69	154.9	183.17
Quartz Surfaces sales (in cr.)	0	8.89	31.4	40.98	47.54	61.49	135.73
Total Income from operations	145.78	144.11	166.82	180.77	203.55	230.63	326.36
Total Cost of Goods sold	67.63	62.95	44.87	49.04	45.76	51.29	90.59
Gross profit	78.15	81.16	121.95	131.73	157.79	179.34	235.77
Gross Profit margin (%)	53.61%	56.32%	73.10%	72.87%	77.52%	77.76%	72.24%
EBITDA	18.48	15.11	25.35	27.84	34.93	46.37	83.57
EBITDA margin (%)	12.68%	10.49%	15.20%	15.40%	17.16%	20.11%	25.61%
Other Income							
exchange gain			0.88	2.88	3.23		
Miscellaneous income	0.50	0.40	0.72	0.68	1.89	1.07	7.15
Depreciation	-7.81	-13.31	-18.47	-18.58	-22.3	-20.41	-23.08
Interest	-10.01	-15.9	-30.25	-43.26	-34.47	-31.77	-32.23
PBT	1.16	-13.7	-21.76	-30.45	-16.73	-4.73	35.41
Adjusted PAT	0.61	-13.70	-21.53	-30.93	-16.60	-4.70	23.44
Net Reported PAT	0.31	-13.70	-21.53	-30.93	-6.64	11.68	31.35
ROAE	1.38%	-16.81%	-33.71%	-82.16%	-88.04%	-22.77%	59.49%
Cash flows from operations	33.35	3.62	-14.41	-0.05	-26.58	-47.12	
Net debt	277.74	289.45	304.55	306.24	308.24	318.31	277.23

Introduction

Pokarna Limited was founded in the year 1991 and is one of the largest exporters of finished granite from India dealing in over 70 premium colours. Pokarna processes its granite at two state-of-the-art manufacturing facilities and has its own quarries in the most sought after colours like Black Galaxy, Black Pearl, Black Coffee, Coffee Brown, Flash Blue, Golden Dream, Golden Spring, Hailstorm, Pokarna Green, Red Sapphire, Silver Pearl, Silver Waves, Tan Brown, Tan Brown Classic and Vizag Blue. Besides Indian stones, the company also processes several colours from carefully identified independent quarries in Angola, Norway & Ukraine as well.

Besides exporting finished granite, the company also manufactures and exports quartz based engineered stone under the brand name of “QUANTRA”. For the engineered stone, the company’s production facility is spread across 1.7 million sq. ft. at Visakhapatnam (Vizag). The company started with the commercial production of quartz based engineered stone in Oct’09 and spent ~200 crores on the set up of the production facility.

Pokarna is the exclusive licensee and the only producer of natural quartz surfaces in India using the patented technology – Bretonstone System of Breton S.P.A, Italy with the production capacity of approx. 885,000 sq. Mt. per year.

Industry Outlook – Both Granite and engineered stones are primarily used for flooring, kitchen countertops and walls in both residential and non-residential properties and the demand is driven by construction of new properties and renovation of existing properties.

Global demand for floor coverings and countertops is expected to register ~4.5% annual growth for the next few years.

In the countertop industry, granite with a share of 27% remains the preferred material while engineered stone is at infancy with ~10% market share and is the fastest growing category reflecting lower penetration rates in several markets including US.

It is important to note here that from 1999-2014 quartz as a countertop registered 15.7% CAGR at the industry level and its penetration has increased from 2% to ~10% in value terms. At the end of 2014 quartz market share was 8% in US (increased from 5% at the end of 2010) against 18% in Canada and 39% in Australia and therefore there's huge scope for further penetration in both developed and developing markets.

Quartz/engineered stone is finding greater acceptance and eating into the market share of other products as it is strong, durable, designer friendly, versatile and low maintenance all at the same time.

Engineered stone – growth engine for Pokarna: As mentioned above, the company started with the commercial production of engineered stone in Oct'09 and achieved sales of 8.90 crores in 6 months of FY 10.

Since then the company has consistently been recording strong growth and achieved sales of 136 crores from engineered stones in FY 15.

Though the actual details of capacity utilization are not known, we believe company's capacity utilization is still low at 40% and there's huge scope for expansion in sales over the next 2-3 years without any major CAPEX.

Performance – Prior to commencement of engineered stone production, Pokarna was profitable; however the company spent 200 crores on engineered stone production facility in 2009-10 and funded the same largely through debt and FCCBs.

200 crore CAPEX resulted in ~18-20 crore additional annual interest burden and 12-14 crore increase in depreciation while the capacity utilization of the plant increased only gradually (8.90 crore sales in FY 10, 30 crore in FY 11, 40.91 crore in FY 12, 47.53 crore in FY 13, 61.49 crore in FY 14 and 135.73 crore in FY 15) and achieved very strong profitability in FY 15 at capacity utilization of ~40%.

During the last 4-5 years when the company was consistently reporting losses, it was still generating decent cash flows from operations and as there was no major CAPEX

requirement, it didn't raise much debt during the period. Further, recently company redeemed the entire outstanding FCCB with face value of USD 12 million and the net debt has also reduced to ~275 crores against the highs of 310-320 crores.

Going forward, we don't foresee any major CAPEX for the next few years and therefore the depreciation cost is likely to remain around current levels while interest charge could go down and with incremental capacity utilization, the net earnings of the company could witness very strong growth over the next 2-3 years.

Assuming modest growth of 20% in revenues in for the ongoing financial year, we believe POKARNA can achieve 50-55 crore pre-tax earnings in FY 16.

On trailing twelve months earnings, the stock is trading at an EV/EBIT ratio of 13.4.

Pokarna – digging deeper

Established in 1991, Pokarna has basically three lines of products: Granites, Quartz surfaces and Apparels. Out of the 3, granites and quartz surfaces accounted for more than 95% of the sales of the company while apparels accounted for the rest.

The company focuses largely on exports of granite and quartz surfaces as the realizations in the export markets are better than domestic market. In FY 14, domestic sales accounted for only 24% of the total sales of granite and quartz surfaces combined and only 6% of the quartz surfaces on standalone basis.

Granite

Pokarna Limited is one of the largest exporter of granite surfaces from India and provides quality material to its clients from various markets like U.S.A, Europe, Russia and Australia to name a few, apart from the domestic market. Initially Pokarna entered the industry with quarrying and thereafter expanded its operations into production of slabs, tiles and cut to size for the various requirements in the industry all over the world.

The company has its own quarries in the most sought after colors like Black Galaxy, Absolute Black, Tan Brown, Sapphire Blue, Coffee Brown, Seaweed Green, Silver Pearl, Golden Dream, Pokarna Green, Vizag Blue and Flash Blue. Besides Indian stones, the company also processes several colours from carefully identified independent quarries in Saudi Arabia, Iran, Angola, Norway & Ukraine as well.

For processing granite, Pokarna has two state-of-the art manufacturing complexes, each with equipments imported from the finest companies in the world like Breton, Pedrini, Pellegrini and Giorgini Maggi. Pokarna's granite processing capacity is in excess of 6.3 lakhs sq. Mt. per year.

The company has supplied its stones to prestigious projects such as Reliant NFL Stadium, Houston, USA; Radisson Hotel, Flint, Michigan, USA; Buckhead Village, Atlanta, Georgia, USA; Tidel Park, Chennai, India; and Amaravathi Buddhist Museum, Guntur, India; Reliance H.Q., Mumbai, India; TCS Chennai, Hyderabad, Pune, India; Novotel, Vishakhapatnam, India; Marriott, Hyderabad, Chennai, India; Hyderabad Airport, India ; UB City, Bengaluru, India; Victoria Secret, USA.

Granite sales have been recording steady growth and contributed 56% to the overall sales of the company.

Granite	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15
Sales	108.16	102.77	114.05	110.43	140.69	154.9	183.17
PBIT	16.63	10.5	12.88	13.57	23.85	29.1	46.03

Quartz surfaces

Pokarna developed a state-of-the-art facility at a CAPEX of ~200 crores for producing its own line of quartz surfaces - named Quantra - in Vishakapatnam, India in 2009-10. The production capacity of the company for quartz surfaces is approx. 885,000 sq. Mt. per year.

The quartz products are commercially supplied and distributed across globe under the brand name of QUANTRA, which is the registered trademark of Pokarna Engineered Stone Ltd, a wholly owned subsidiary of Pokarna.

The plant's location in the port city of Vishakapatnam - often referred to as Vizag - has several advantages, according to Pokarna. Among them, it allows the factory to utilize quartz from its home state of Andhra Pradesh, which is noted for its strong physical characteristics and high level of clarity and the same allows for a bright finished product.

Finished products have a quartz content of approximately 93%, and elements like steel, copper, mother-of-pearl and glass can be added to the mix for a unique aesthetic. Quantra quartz surfaces are acid-resistant as well as stain and scratch-resistant. They are also slip resistant, have exceptional durability and are design friendly.

Quartz is the fastest growing segment for Pokarna with a gain in revenue contribution from 27% in FY 14 to 42% in FY 15.

Quartz	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15
Sales	0	8.89	31.4	40.98	47.54	61.49	135.73
PBIT	0	-3.51	-1.2	1.77	2.49	9.78	31.63

Exclusive licensee of Breton Stone technology – For manufacturing quartz slabs and tiles, Pokarna uses the Breton Stone technology.

BRETONSTONE® SYSTEM is the patented technology of Breton s.p.a, Italy and Pokarna has the exclusive right to make use of this technology in manufacturing quartz surfaces in India.

Breton Stone technology manufactures superior quality of Quartz products. Globally, only 10-12 sizeable manufacturers produce quartz using the Breton Stone technology. Pokarna's exclusive technology contract with Breton Stone for India gives it an edge over other quartz slab producers in India as well as over quartz manufactured using Chinese technology.

Quality and safety Certifications – Pokarna is among the few companies in the world and the first Indian quartz surfaces manufacturer to have the GREENGUARD, GREENGUARD Gold and NSF – 51 certifications. These certifications ensure that the company's products are safe for food contact, meet stringent standards for low-chemical emissions into the indoor environment and are acceptable for use in sensitive environments such as schools and health care facilities. These certifications again give an edge to the company as it exports its products to quality and safety conscious US and European markets.

Understanding Quartz and its demand

As is known from the above segments, Pokarna is primarily an exporter of Granite and Quartz slabs and tiles and the two products are largely used for kitchen countertops, for flooring, wall cladding, etc.

Granite as a countertop, flooring material has been in use since long and is expected to record a steady growth on the back of uptick in re-modeling/renovation and improvement in new housing sales in the developed world, especially US.

For Pokarna, while granite is expected to record steady 10-15% growth, the major growth is expected to be recorded in Quartz surfaces because of both low penetration and increasing acceptance over materials like laminates, solid surfaces, etc.

Below, we have briefly tried to explain the quartz surfaces, their penetration in countertop industry and the growth drivers.

What is Quartz?

Quartz is a naturally occurring silicate mineral composed of silicon dioxide (SiO₂). It is one of the most common and available minerals on the earth's surface. It ranks 7.0 on MOH (Measurement of

Hardness) scales, behind topaz (8.0), sapphire (9.0) and diamond (10.0). Granite is ranked 6 on the scale.

What is Engineered Quartz Stone?

Quartz exists naturally in clusters and does not form huge stone blocks like granite (which contains 40% - 60% quartz), limestone or other types of rock. This makes it unsuitable for use in its natural state in countertops or other large slab applications. This means that it needs to be converted into another form i.e. engineered stone, to make it usable in such applications.

Engineered quartz stone (also known as reconstituted or re-composed stone) is manufactured from a mix of quartz aggregate chips, a resin binder (typically unsaturated polyester), pigments and additives. Engineered stone slabs and counter tops are available in a wide range of colors, patterns, and even textures. Its texture can be fine or coarse, depending on how it is processed, and can be combined with glass and other reflective materials for a sparkling finish. They are increasingly becoming popular in high-end applications combining the benefits of granite's durability and non-porous nature of quartz.

Technology for manufacturing Engineered Quartz Stone

Breton S.P.A., a privately held company of Treviso Italy, is the dominant supplier of equipment for making engineered stone. A mixture of approximately 93% stone aggregates and 7% polymer resin by weight is pressed into slabs (or larger blocks) using Breton's "vibro-compression vacuum process". Stone aggregates are the major filler, although other material like coloured glass, shells, metals, or mirrors might be added.

Although Breton was the original manufacturer of moulding equipment and still holds multiple international patents on the process, there are now several other companies producing similar machinery.

PRODUCTS • SURFACE COMPARISON

	Granite	Engineered Quartz	Solid Surface	Laminates	Butcher Block
<i>What is it?</i>	100% Natural stone quarried from within the earth	Man-made: 85%-95% crushed quartz with a resin binder	Man-made: Acrylic or Polyester Plastics	Man-made: Printed colors/patterns on a fiberglass backing	Various species of 100% Natural wood
<i>Heat Resistance</i>	Not affected by heat	Can be affected by high heat (over 400F)	Hot pots can warp, melt, crack, or discolor the surface	Hot pots can warp, melt, or discolor the surface	Hot pots can burn the surface
<i>Cleanliness</i>	Independent studies have found granite to be one of the most bacteria-resistant surfaces available	Non-porous - very resistant to bacteria	Deep scratches can harbor dirt and or moisture	Non-porous - easy to clean	Independent studies have found wood to be resistant to bacteria (better than plastic)
<i>Scratch Resistance</i>	Highly scratch resistant - small scratches can be professionally repaired	Highly scratch resistant	Scratches easily - can be sanded	Can be scratched - not easily repaired	Scratches and abrasions can usually be sanded out
<i>Fabrication</i>	May require seams - various edge profiles available	May require seams - various edge profiles available	Seamless - usually set on a wood sub-structure - various edge profiles available	Sheet material is applied to a wood sub-structure - limited edge profiles	Wood blanks can be custom made into many shapes and edge types
<i>Appearance</i>	Highly polished finish - every piece is naturally unique in color and patterning	Polished finish - consistent and uniform color and patterning	Matte finish - with consistent and uniform color and patterning	Highly visible seams - consistent and uniform color and patterning	Can be oiled or vanished depending on the application and intended look
<i>Maintenance</i>	May require periodic sealing to prevent staining	n/a	Scratches can be sanded out		Oil finish needs reapplied approx every 6 weeks
<i>Price</i>	\$35 sq/ft and up (20 sq/ft min.)	Comprable to Levels 4 & 5 granite	Price varies based on color - many of which are more expensive than granite	Inexpensive	Price various by species of wood

Key Features of Engineered Quartz Stone

As the manufacturing process allows uniformity and consistency in dimension and shade, pre selection effort (also known as dry-lay – a common practice when using natural stones) is minimized. This saves considerable time during construction.

The high MOH score and better scratch resistance properties make the material suitable for commercial flooring applications where traffic and abrasion factors are high.

Most patterns of engineered stones resemble natural stone, but with a consistent pattern, texture and color. Thus flooring or countertops have a uniform appearance.

The hard, non-porous surface retains its polished lustre and does not need sealing treatment on the surface. It can also be cleaned and maintained with normal or soapy water.

In addition to kitchen countertops, engineered stone products are suitable for shower and tub surrounds, vanity tops and other surfaces in wet areas, unlike porous stones, which can foster bacteria growth. They are therefore ideal for locations such as commercial buildings, canteens, hospital food service areas, etc.

As they are man-made, these materials can be fabricated in large sizes, resulting in less joints and better aesthetics.

An American architect's (Princeton, NJ-based architect Joshua Zinder) take on Engineered Surfaces:

Many Americans nowadays care about making eco-friendly choices. And when it comes to countertops, engineered stone is one of the most environmentally sensitive choices available in the market. But this type of surface offers a host of other benefits, too. It's durable, beautiful, hygienic and easy to care for.

NJ-based architect Joshua Zinder's take on quartz surfaces is as below.

What kind of engineered stone can be used as a countertop?

Most engineered stones are fantastic for high-wear uses such as kitchen countertops. The products should be acid-resistant and non-absorptive. The size and types of materials

used to make the engineered stone will determine its best uses. For example, an engineered surface with large chunks of marble will be limited in performance to the pieces of marble it contains.

What makes engineered stone good as a countertop surface?

Unlike solid surfacing or plastic laminate, which are temperature-sensitive and can catch fire, engineered stone resists heat well. And unlike some other surfaces—even natural stones—engineered ones resist stains from liquids like wine or coffee.

What are its primary characteristics?

Strong, durable, and attractive, engineered stone is very consistent in look and pattern. It is also heat-resistant and does not accumulate bacteria. The surfaces are easy to maintain, too. They can be specified with bacteria-resistant surfaces, but since they are non-absorptive and resistant to heat anyway, they should not be collecting bacteria in the first place.

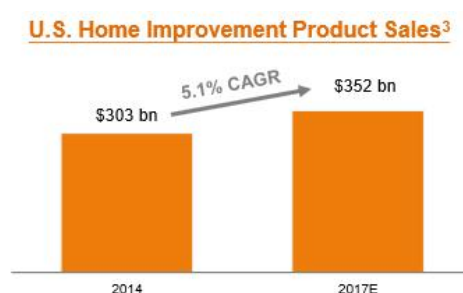
What are its pros?

Pros include brute strength and heat resistance, as well as varied colors and styles. Some engineered stone products are made to look like limestone or marble, enabling you to get the look you want but with better performance. If you like using recycled materials or protecting natural resources like real marble, engineered stone counters will do the trick. The products may have natural colors or added colors with various textures. Many contractors are familiar with the products and will install them properly.

US demand for Countertops

Pokarna primarily exports granite and quartz surfaces with more than 40% sales to US and therefore demand pattern in US will play a major role in the overall growth of Pokarna's sales.

As per the report by Freedonia, U.S. demand for countertops is forecast to increase 5.1% per year to 750 million square feet in 2017, representing a brisk turnaround from the declines of the 2007-2012 period. Going forward, countertop demand will be spurred by a recovery in U.S. building construction, and in particular, gains in single-family housing completions through 2017. Advances will also stem from a relaxation in credit requirements, providing homeowners with needed financing to go forward with countertop remodeling plans.



Source: Freedonia February 2015; Company estimates

¹ Calculation applies 1% increase in quartz penetration (by volume) based on 2014 total market volume and 2014 quartz prices as provided by Freedonia February 2015 report

² HousingEconomics.com – Feb'15

³ Home Improvement Research Institute, March 2015

US Countertop Demand (million sq. Ft.)					
Item	2007	2012	2017	% Annual Growth	
				2007-2012	2012-2017
Total Countertop Demand	670	585	750	-2.70%	5.10%
Laminates	353	277	330	-4.70%	3.60%
Natural Stone	88	90	130	0.50%	7.60%
Solid Surface	87	77	97	-2.40%	4.70%
Quartz-Engineered Stone	36	54	77	8.40%	7.40%
Cast Polymers	53	40	55	-5.50%	6.60%
Tile	43	35	44	-4.00%	4.70%
Other Materials	10	12	17	3.70%	7.20%

The residential market is critical to the countertop industry and typically accounts for nearly four-fifths of total countertop demand. Accordingly, rough times for the residential construction market over the last few years did not bode well for countertops. In terms of new construction, the number of single-family homes completed in 2012 was 40% of 2007 levels. Tougher financing standards imposed by banks over the 2007-2012 period also restricted remodeling activity and reduced existing home sales. As a result, countertop demand actually declined over the five-year time frame. Coming off of this low 2012 base, however, countertop demand is poised for a significant rebound. Through 2017, demand for countertops in the smaller non-residential market is anticipated to advance 5.8% annually to 131 million square feet. Approximately 70% of demand in the non-residential market is from the institutional, office, and commercial segments.

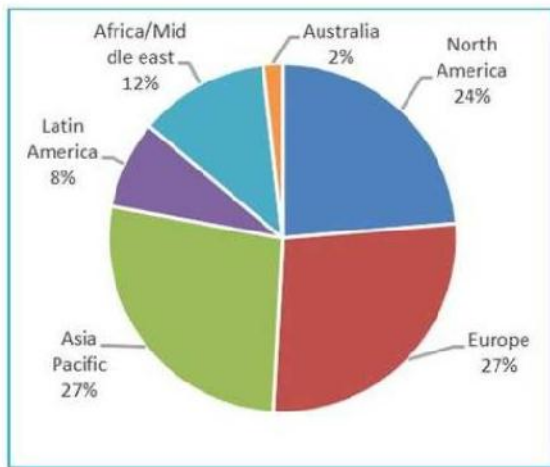
Natural stone and engineered stone will be among the fastest growing countertop materials, while laminates will remain the largest product category.

Laminates are the countertop material of choice in US; however their share will continue to slide as they face rising competition from a wider variety of surfaces. A drop in the average price for granite (partially due to an increase in low-cost imports) has extended the availability of this material to a larger portion of the mass market. As such, concrete, engineered stone, natural stone other than granite, high-end tile, and stainless steel and other metals, and recycled materials will benefit as high-end homeowners and business owners seek novel, higher-value materials to distinguish their countertops from the mass market.

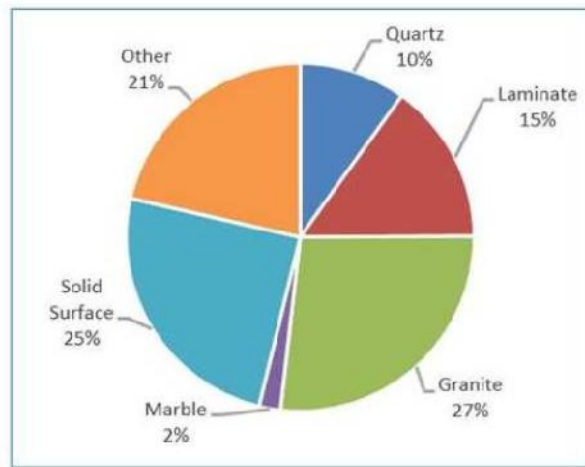
Engineered Quartz stone penetration in the Industry

The global countertop industry generated approximately \$81 billion in sales to end consumers in 2014, based on average installed price, which includes installation and other related costs. Sales to end-consumers include sales to end-consumers of countertops as opposed to sales at the wholesale level from manufacturers to fabricators and distributors.

2014 Global Countertop Demand



2014 Global Countertop Demand by Material



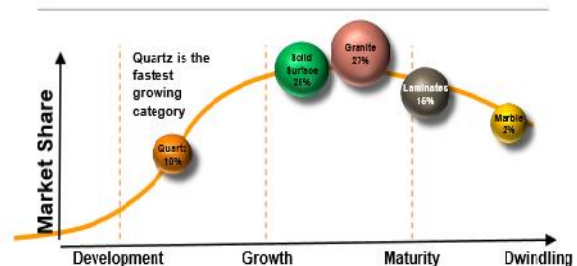
Although the use of quartz is relatively new, it is the fastest growing material in the countertop industry and continues to take market share from other materials, such as manufactured solid surfaces and laminate. Between 1999 and 2014, global engineered quartz sales to end-consumers grew at a compound annual growth rate of 15.7% compared to a 4.4% compound annual growth rate in total global countertop sales to end-consumers during the same period and quartz surfaces penetration increased from 2% to ~10% in value terms.

Quartz Market Opportunity:

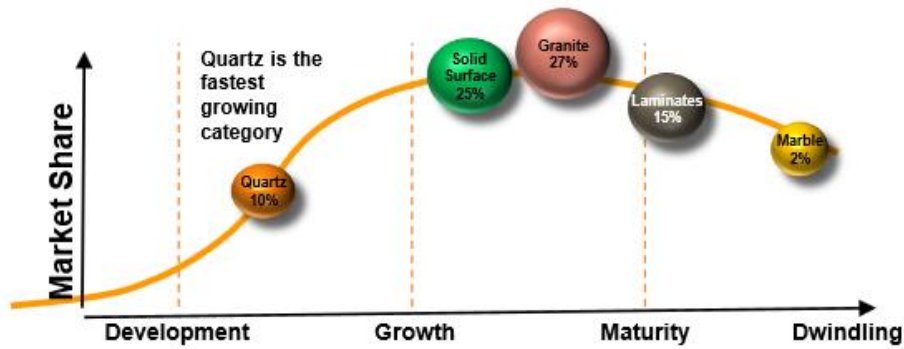
- 2014 market penetration: 10% by sales
- Fastest growing surfaces category ('99 - '14)
 - Grew at 15.7% CAGR
 - From 2% penetration in 1999
- Capturing high % market share in key markets

Source: Freedonia February 2015

Quartz Is the Fastest Growing Category in a \$81bn Market



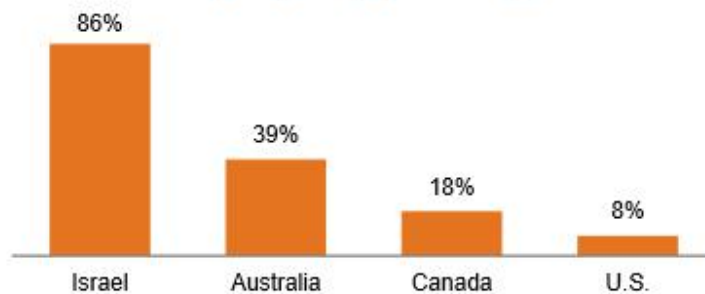
Quartz Is the Fastest Growing Category in a \$81bn Market



In recent years, quartz penetration rate has increased in key markets, as detailed in the following chart.

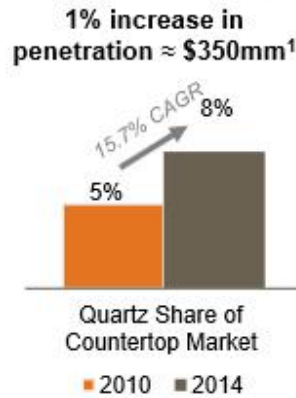
Quartz Penetration in key markets			
For the year ended December 31			
Region	2010	2012	2014
United States	5%	6%	8%
Australia	32%	35%	39%
Canada	9%	12%	18%
Israel	82%	85%	86%

2014 Quartz Share of Countertop Market by Region (by volume)



Source: Freedonia February 2015; company estimates
Note: Quartz share based on value

U.S. Market Penetration (by volume)



Quartz surfaces are primarily used as kitchen countertops in the renovation and remodeling and residential construction end markets. Other applications include vanity tops, wall panels, back splashes, floor tiles, stairs and other interior surfaces that are used in a variety of residential and non-residential applications. Quartz surface's hardness, as well as their non-porous characteristics, offer superior scratch, stains and heat resistance, making them durable and ideal for kitchen and other applications relative to competing products such as manufactured solid surfaces and laminate.



¹ Freedonia February 2015; Sales to end-consumers in 2014 based on average installed price, which includes installation and other related costs; the Company estimates that 40-50% of the total sales represents sales by manufacturers
² 2014 by sales

Pokarna – Performance Snapshot

A company may not have a great past record, however at the same time it's important to look for improvement in performance and the factors guiding the improvement in performance. Once those are established and there's a view on long term sustainability of the same, the company could make for an interesting investment bet and that's what believe is the case with Pokarna Ltd.

Particulars (in cr.)	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15
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Gross profit	78.15	81.16	121.95	131.73	157.79	179.34	235.77
Gross Profit margin (%)	53.61%	56.32%	73.10%	72.87%	77.52%	77.76%	72.24%
EBITDA	18.48	15.11	25.35	27.84	34.93	46.37	83.57
EBITDA margin (%)	12.68%	10.49%	15.20%	15.40%	17.16%	20.11%	25.61%
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exchange gain			0.88	2.88	3.23		
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Depreciation	-7.81	-13.31	-18.47	-18.58	-22.3	-20.41	-23.08
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PBT	1.16	-13.7	-21.76	-30.45	-16.73	-4.73	35.41
Adjusted PAT	0.61	-13.70	-21.53	-30.93	-16.60	-4.70	23.44
Net Reported PAT	0.31	-13.70	-21.53	-30.93	-6.64	11.68	31.35
ROAE	1.38%	-16.81%	-33.71%	-82.16%	-88.04%	-22.77%	59.49%
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Net debt	277.74	289.45	304.55	306.24	308.24	318.31	277.23

As can be observed from the above snapshot, Pokarna reported losses from FY 10 to FY 14 and made a significant turnaround in FY 15. However, what is important to note is that while the company was reporting losses, there was steady improvement at various levels:

- Sales kept on growing on the back of steady growth in granite sales and huge growth in Quartz surfaces sales, though on a lower base.
- The company's gross margins expanded significantly from 55-56% to 72-77%
- On the back of improvement in gross margins and economies of scale, the EBITDA margins kept on improving from 10-12% to 20% in FY 14 and 25.6% in FY 15
- Absolute EBITDA increased by 200% between FY 10 and FY 14 and by more than 350% between FY 09 and FY 15
- Between FY 11 and FY 15 interest outgo and depreciation charge has remained more or less same despite the fact that sales have almost doubled
- Absolute EBIT of the company increased from 1.8 crores in FY 10 to 25.96 crores in FY 14 and 60.49 crores in FY 15
- Despite the losses the company's net debt has reduced in the last 5 years

Overall, Pokarna reported continuous improvement in performance at all the fronts like sales, gross margins, EBITDA, EBIT, reduction in indebtedness, etc.

So, what caused the losses between FY 10 and FY 14? Prior to commencement of engineered stone production, Pokarna was profitable; however the company spent 200 crores on engineered stone production facility in 2009-10 and funded the same largely through debt and FCCBs.

Quartz	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15
Sales	0	8.89	31.4	40.98	47.54	61.49	135.73
PBIT	0	-3.51	-1.2	1.77	2.49	9.78	31.63

200 crore CAPEX resulted in ~18-20 crore additional annual interest burden and 12-14 crore increase in depreciation charge while the capacity utilization of the plant increased only gradually (as depicted above) and therefore the company was reporting losses, however as the sales were improving the losses were also getting reduced and in FY 15 the company achieved very strong profitability despite the capacity utilization being only about ~40%.

What's the way ahead? As we know from the performance snapshot of Pokarna, the company has turned profitable and has reported very good set of numbers for FY 15. We believe, for the next few years there are several factors that can lead to overall improvement in sales and much higher growth in profitability of the company and they are as below:

- In the last 4 years the company has reported 12.5% CAGR in the sales of granite surfaces and more than 40% CAGR in the sales of quartz surfaces. As indicated in the sections above, granite and quartz are expected to be the fastest growing surfaces in US countertop industry and we therefore expect Pokarna to continue reporting 10-12% growth rate in granite surfaces and more than 25% in Quartz surfaces over the next few years.
- Earlier the capacity utilization in quartz surfaces was low, however the company has now reached critical utilization rate of ~40% and from here on there should be further improvement resulting in operating leverage and probable expansion in EBITDA margins.
- The company's cash flows from operations have been good which enabled it to repay ~60-70 crores of FCCBs. Going forward, the incremental CAPEX is expected to be very low and with both high profitability and cash flow generation we expect the company to repay much of its 280 crore net debt. Thus, lower financial charges should further boost up the profitability of the company.
- The depreciation charge will remain almost same while the company will accrue benefits of higher capacity utilization. Thus, while EBITDA is likely to grow in line with sales, profit before tax is expected to report much higher growth.
- The capacity for quartz surfaces can be further expanded at existing locations and therefore CAPEX cost per sq. Mt. of additional capacity will be substantially lower than Greenfield expansion carried out by the company in the past and since the expansion will be at existing locations, the addition in overheads should also be lower.

Considering the above factors in mind and assuming modest growth of 20% in revenues (Pokarna achieved 41.5% growth in FY 15) for the ongoing financial year, we believe POKARNA can achieve 50-55 crore pre-tax earnings in FY 16.

Further, unless the company embarks on a major CAPEX, there could be complete transformation of the capital structure of the company with much lower absolute debt and debt equity ratio.

Shareholding pattern

	Mar'15	Dec'14	Sep'14	Jun'14	Mar'14
Promoter and Promoter Group	56.67%	56.67%	56.67%	56.67%	56.67%
India	56.67%	56.67%	56.67%	56.67%	56.67%
Foreign					
Public	43.33%	43.33%	43.33%	43.33%	43.33%
Institutions	1.88%	1.93%	3.15%	--	--
FII	1.88%	1.93%	3.15%	--	--
DII	--	--	--	--	--
Non-Institutions	41.45%	41.40%	40.18%	43.33%	43.33%
Bodies Corporate	9.15%	10.48%	6.95%	7.30%	6.33%
Custodians	--	--	--	--	--
Total	62,00,800	62,00,800	62,00,800	62,00,800	62,00,800

From a passive investor's perspective it's important for the ones running the company to have high ownership as it aligns their interest in line with those of minority shareholders and in the case of Pokarna the promoters own reasonably good stake at 56.67%.

Further, what is important to note is that despite the financial troubles the promoters didn't choose the easier option of diluting equity at any point of time and therefore protected the interests of shareholders.

As on 31st Mar'15, the major shareholders of the company and their stakes are as below:

Name of the shareholder	Category	% stake in Pokarna
Promoters and PAC	Promoters	56.67%
Ashish Kacholia	Public	4.89%
Nemi Chand	Public	4.84%
Sanjiv Dhiresbhai Shah	Public	2.42%
Premier Investment Fund Ltd	Public	1.88%

Globe Capital Market Ltd	Public	1.37%
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Dividend Policy

Dividend Payout ratio					
	FY 11	FY 12	FY 13	FY 14	FY 15
Dividend Payout ratio				10.61%	5.93%

The company didn't pay any dividend for FY 11 to FY 13 and resumed dividend payout from FY 14 as the company started reporting net profit.

While resumption of dividend payout is indicative of the management's intent of sharing wealth with shareholders, at the same time it's also important to not go overboard with the same, especially when the debt is high and Pokarna seems to be doing a fine job with both the resumption and low payout.

Valuations

Before discussing valuations, let's recall all that we have learnt about Pokarna in the above sections:

- Pokarna is one of the leading manufacturers and exporters of granite and quartz surfaces from India.
- The company's granite surfaces business has been growing at a steady rate of 12.5% annually while the quartz surfaces business has been recording 40%+ CAGR, though on a smaller base.
- For manufacturing quartz surfaces, Pokarna is the exclusive licensee of patented Breton Stone technology and therefore has an edge over both the local and Chinese manufacturers.
- Pokarna is among the few companies in the world and the first Indian quartz surfaces manufacturer to have the GREENGUARD, GREENGUARD Gold and NSF – 51 certifications. These certifications ensure that the company's products are safe

for food contact, meet stringent standards for low-chemical emissions into the indoor environment and are acceptable for use in sensitive environments such as schools and health care facilities. These certifications again give an edge to the company as it exports its products to quality and safety conscious US and European markets.

- Granite and Quartz are basically used in kitchen countertops, flooring, wall cladding, etc and after a lull of 2007-2012 in US and Global housing market; the next few years are expected to be good on account of increased remodeling/renovation activities and new housing construction.
- As per the report by Freedonia, Natural stone and engineered stone/quartz will be among the fastest growing countertop materials.
- Although the use of quartz is relatively new, it is the fastest growing material in the countertop industry and continues to take market share from other materials, such as manufactured solid surfaces and laminate.
- Between 1999 and 2014, global engineered quartz sales to end-consumers grew at a compound annual growth rate of 15.7% compared to a 4.4% compound annual growth rate in total global countertop sales to end-consumers during the same period and quartz surfaces penetration increased from 2% to ~10% in value terms.
- Quartz surfaces are finding greater acceptance and eating into the market share of other products as they are strong, durable, designer friendly, versatile and low maintenance all at the same time.
- With just 8% penetration in US and much higher penetration in countries like Canada, Australia, the demand from US is expected to be huge and bodes well for quartz surface manufacturers.
- For Pokarna, quartz surface sales will be the growth engine with steady growth from granite sales. With just 40% capacity utilization at quartz plant, the company has turned around and has started reporting very good profitability.
- With no major CAPEX expected in the near future, strong cash flows and profitability should enable the company to repay much of its debt and therefore while the sales are expected to record ~20% + CAGR, the growth in profitability should be much higher.
- Experienced promoters and long term investors with their interests directly aligned with those of minority shareholders.

Coming back to valuations, assuming modest growth of 20% in revenues in for the ongoing financial year, we believe POKARNA can achieve 50-55 crore pre-tax earnings in FY 16 against the 573 crore market capitalization at the time of initiation of the report.

On trailing twelve months earnings, the stock is trading at an EV/EBIT ratio of 13.4.

The valuations of the company might seem slightly high on current earnings, however going forward both operating and financial leverage should act in favor of the company enabling very strong growth in earnings in the next few years.

Risks & Concerns

- The company derives almost 70% of its sales from exports and therefore currency fluctuations can impact the earnings of the company.
- It's important for the company to sustain current level of sales or improve upon the same because otherwise the fixed charges in the form of depreciation and interest costs are still very high.
- The penetration of quartz in Indian markets is still very low, so although the same should result in good opportunity for the company in the long run, the current domestic demand is insufficient and therefore Pokarna is dependent on export markets for its growth.
- The company also has an apparels business which has been reporting losses. Though with the growth of granite and quartz surfaces businesses, the contribution of apparels has decreased to a low of ~5%, we hope management does not misallocate capital by investing further behind the apparels business.

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