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Advisory Desk

March 10, 2012

Cera Sanitaryware

Organic growth and changing lifestyle to be the key drivers

Cera Sanitaryware Ltd. (CSL) is the third largest sanitary ware company in the organized sector with about 22% market share in India. The company is engaged into manufacturing sanitary ware and faucet ware (commenced since September 2010) products. The company also markets wellness products, which are majorly outsourced. Owing to the changing lifestyle of people, increasing awareness for improving sanitation coverage, expenditure on sanitary ware has been consistently increasing as a percentage of total construction expenditure, thereby providing significant traction for the sanitary ware sector. CSL is trading at an attractive PE of 7.6x and EV/Sales of 0.9x on FY2013E. We recommend Buy on CSL with a target price of ₹289, based on target PE of 10x and implied EV/Sales of 1.1x for FY2013E.

Investment rationale

Increased contribution of sanitary ware towards domestic expenditure

On the back of increasing awareness towards improving sanitation coverage, changing lifestyle of people towards nuclear families, the number of households is increasing, thereby creating robust demand for sanitary ware products. Simultaneously, increased disposable income has led to a shift from the unbranded to branded products. This trend is likely to drive strong growth for the sanitary ware industry going forward.

Capacity expansion and better utilisation to drive revenue growth

CSL is extending its installed sanitary ware capacity from 24,000MT to 32,400MT, which is expected to be operational by 1QFY2013. Also, CSL has entered into new avenues like production of faucet ware since September 2010 with initial capacity of 2,500mn pieces per annum, which was previously outsourced. Considering these factors, we expect CSL's top line to post a 26% CAGR over FY2011-13E.

Benefit from unmatched distribution network and high brand visibility

CSL has a very strong distribution network with 500 dealers and connection with nearly 5,000 retailers to distribute its products. Owing to continuous marketing activities, which are creating a high brand visibility, CSL's advertisement cost has witnessed a 30% CAGR over FY2007-11 and is consistently moving northwards.

Outlook and valuation

CSL's top line is expected to grow to ₹385cr in FY2013E. The company's revenue and profit are expected to post a CAGR of 26% and 16%, respectively, over FY2011-13E. The stock is currently trading at PE of 8.9x and 7.6x for FY2012E and FY2013E, which makes it attractive. **We recommend Buy on CSL with a target price of ₹289, offering an upside of 31% from current levels.**

Key financials

CSL	Sales (₹ cr)	OPM (%)	PAT (₹ cr)	EPS (₹)	ROIC (%)	P/E (x)	P/BV (x)	EV/ EBITDA (x)	EV/ Sales (x)
FY2011	243	18.8	27	22	38	10.2	2.5	6.0	1.1
FY2012E	296	18.2	31	25	29	8.9	2.0	5.9	1.0
FY2013E	385	17.2	37	29	24	7.6	1.6	5.2	0.9

Source: Company, Angel Research

BUY

CMP	₹220
Target Price	₹289
Investment Period	12 months

Sector	Ceramic products
Market Cap (₹ cr)	279
Beta	0.6
52 Week High / Low	248 / 150
Avg. Daily Volume	5,070
Face Value (₹)	5
BSE Sensex	17,503
Nifty	5,334
Reuters Code	CERA.BO
Bloomberg Code	CRS.IN

Shareholding Pattern (%)	
Promoters	55.0
MF / Banks / Indian FIs	4.7
FII / NRIs / OCBs	3.6
Indian Public / Others	36.7

Abs.(%)	3m	1yr	3yr
Sensex	3.7	(5.2)	9.9
CSL	20.3	39.1	299.6

Twinkle Gosar
Tel: 022- 3935 7800 Ext: 6848
Gosar.twinkle@angelbroking.com

Investment rationale

Increased contribution of sanitary ware towards domestic expenditure

Owing to the changing lifestyle of people, the role of sanitary products has advanced from being a necessity to a status statement – thus impacting the spending structure of individuals and improving the proportion expended on these basic amenities. Growth in per capita income, leading to a simultaneous increase in the disposable income of people, has been a vital factor supporting the changing lifestyle of people.

Also, requirement of personal space and privacy gaining an inevitable place, subsequently leading to nuclear families, have augmented residential figures, thereby increasing demand for sanitary products. This trend is expected to continue, providing sustainable demand visibility for sanitary ware products.

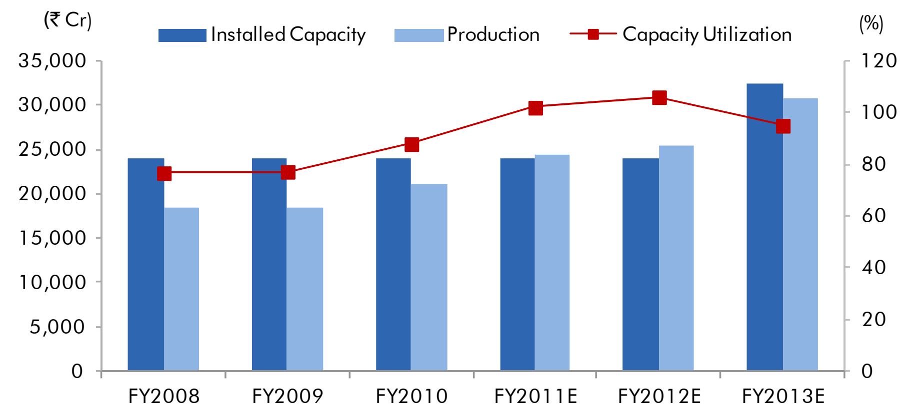
Considering India's dense population, its sanitation coverage is only ~40%. With increasing awareness for improving public health, the sanitary ware segment is expected to witness high attention.

Lastly, with aesthetics gaining a significant importance, CSL's initiatives to provide better designs and quality are bound to perk up its top line.

Capacity expansion and better utilisation to drive revenue growth

CSL is currently operating at its full capacity for its sanitary ware unit. The company is expanding its sanitary ware unit's capacity from the existing installed capacity of 24,000MT, which produces 2mn pieces per annum, to 32,400MT, which would produce 2.7mn pieces per annum at an estimated capital outlay of ₹125cr – thereby encashing the growing demand.

Exhibit 1: Capacity utilization of the sanitary ware unit



Source: Company, Angel Research

CSL started production at its faucet ware unit at Kadi in September 2010. The company had set up this plant with an initial investment of ₹10cr, met by internal accruals, with current capacity of 2,500 pieces per day, which would be doubled by FY2014E.

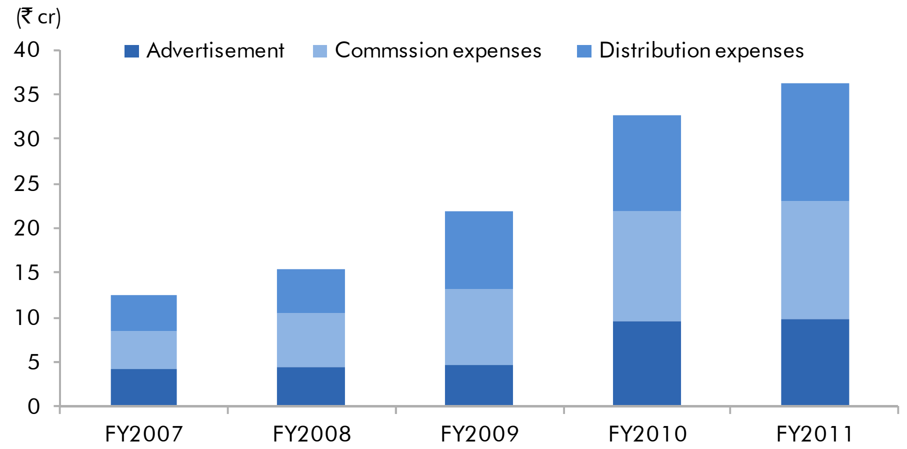
Faucets, which accounted for 17% of the company's revenue in FY2010, were mainly outsourced directly through imports from Chinese suppliers or from domestic markets. In-house production of the same is expected to boost the company's top-line going forward.

Benefit from unmatched distribution network and high brand visibility

CSL has a very strong distribution network with 500 dealers and connection with ~5,000 retailers to distribute its products. The company has established 12 major stock points, 10 zonal sales offices and 7 bath studios pan India to establish its presence. CSL has also initiated opening of *Cera Bath Galleries* in different towns.

Owing to continuous marketing activities that are creating high brand visibility, the advertisement cost of CSL is consistently moving northwards. Marketing expenses constitute around 15% of the company's net sales and have witnessed a 30% CAGR over FY2007-11. CSL has a strong foothold in northeast and central India, while the company is eyeing southern states such as Andhra Pradesh, Tamil Nadu and Karnataka to establish its footings.

Exhibit 2: Marketing expenses moving northwards



Source: Company

Immense fresh demand on the back of the construction sector's growth

In India, the construction sector is growing at a robust pace because of rapid urbanization. For the sanitary ware industry, ~93% of the demand is fresh demand. Only 7% is derived from the replacement segment, which arises out of renovations, improvement and refurnishing. In developed economies, 20% is fresh demand, while 80% demand is from the replacement segment. Considering the above facts, the Indian construction sector's development is bound to register strong growth for sanitary ware industry and eventually for CSL.

Also, CSL is trying to tap fresh construction activities in Tier 2 and 3 cities, the untapped potential markets, by building relationships with developers, consultants and interior designers in these areas. Moreover, the competitive pricing policy of the company to some extent has enabled it to secure an assured place in the consumer's mind.

Company financials

Key assumptions

We expect CSL's expanded sanitary ware capacity to be operational by 1QFY2013E; hence, we have not factored the same in our FY2012 estimates. Following are the other key assumptions used to forecast the company's financials:

Exhibit 3: Key assumptions

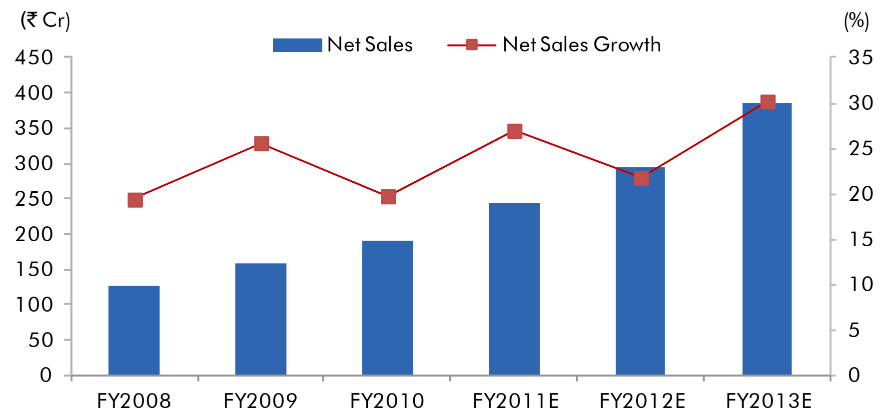
	FY2011	FY2012E	FY2013E
Sanitary ware			
Installed capacity (MT)	24,000	24,000	32,400
Capacity utilization (%)	102.0	106.0	95.0
Sales quantity growth (%)	14.9	12.0	20.0
Sales value growth (%)	28.5	25.0	28.4
Sale price/Unit growth (%)	11.8	7.0	7.0
Faucet ware			
Installed capacity ('000 units)	750	900	900
Capacity utilization (%)	11.6	20.0	20.0
Sales value (₹ cr)	0.0	5.0	12.0
Raw material			
Sanitaryware, allied products value growth (%)	15.0	20.0	40.0
Traded goods value growth (%)	1.6	1.6	1.4
Sandstone/Clay value growth (%)	11.8	20.0	40.0
Brass ingots value growth (%)	0.0	20.0	35.0

Source: Company, Angel Research

Net sales expected to post a 26% CAGR over FY2011-13E

With new developments in capacity and avenues, we expect CSL's net sales to post a 26% CAGR over FY2011-13E to ₹385 in FY2013E. Of the total sales, exports (majorly to Gulf and Africa) contribute ~5% to sales.

Exhibit 4: Net sales and net sales growth

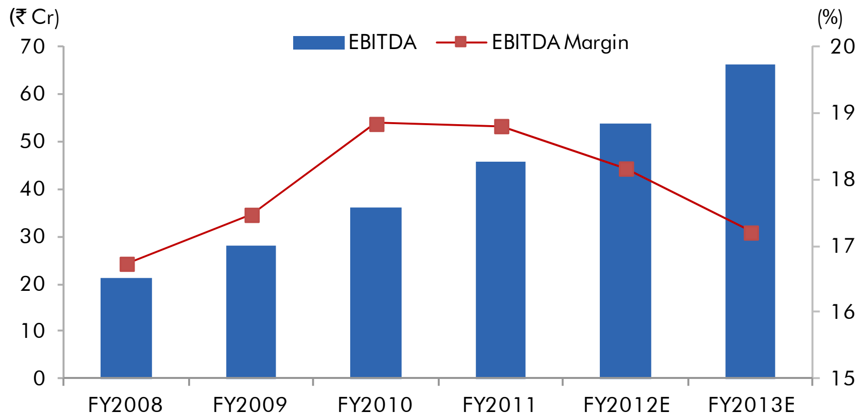


Source: Company, Angel Research

EBITDA to post a 20% CAGR over FY2011-13E

The company's EBITDA is expected to rise from ₹46cr in FY2011 to ₹66cr in FY2013E. However, the company's EBITDA margin is expected to dip from 18.8% in FY2011 to 18.2% in FY2012E and to 17.2% in FY2013E, mainly due to the increase in raw-material cost and transport cost to some extent. CSL is operating at its full capacity currently, thereby benefiting from economies of scale.

Exhibit 5: EBITDA and EBITDA margin



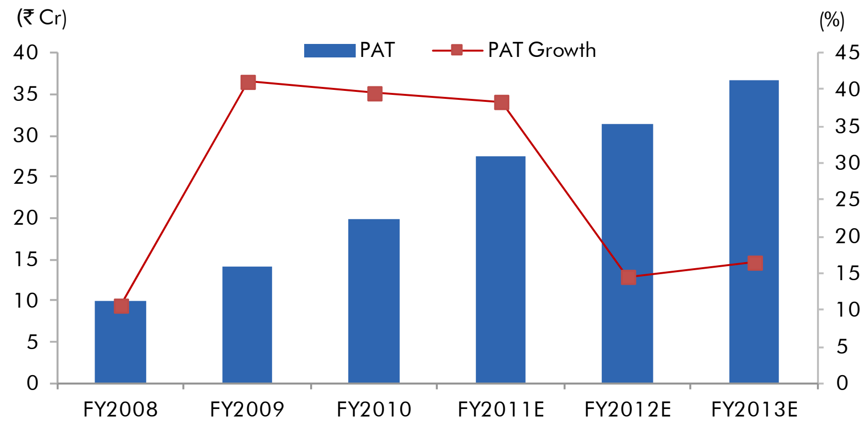
Source: Company, Angel Research

Net profit to post a 16% CAGR over FY2011-13E

On the back of remarkable growth in top-line, bottom-line too is expected to grow at 16% CAGR over FY2011-13E. We expect the company's net profit to increase from ₹27cr in FY2011 to ₹37cr in FY2013E.

Net profit margin is expected to dip from 11.3% in FY2011 to 10.3% in FY2012E and 9.5% in FY2013E, mainly due to increase in depreciation on extended capacity and increased interest cost. CSL's debt-equity ratio is comfortably placed at 0.4x FY2013E, keeping interest cost at a manageable level.

Exhibit 6: PAT and PAT growth



Source: Company, Angel Research

The company

CSL, a Gujarat-based company, is a premium bathroom solutions provider. Apart from sanitary ware and faucet ware products, CSL also deals in wellness products, consisting high-end and luxury bath tubs, steam cubicles, shower partitions and shower panels. The company has also expanded its brand presence to other related categories such as showers and PVC cistern (seat covers).

The company's sanitary ware product, *Snow White* was voted *Product Of The Year* in 2011. The product added to the company's list of innovations, which included products like water-saving twin-flush coupled WCs, four-liter flush WCs and one-piece WCs.

Sanitary ware unit

CSL has a ~22% market share in the Indian sanitary ware products market. The company is expanding its sanitary ware production capacity from 2mn pieces per annum currently to 2.7mn pieces per annum, nearly 25% addition, to be operational by 1QFY2013E.

Faucet ware unit

The Indian faucet ware industry is worth ~₹4,000cr. The industry offers a huge scope of growth to CSL. Until now, the company outsourced its faucet ware products from either China or domestic markets. However, CSL will now roll out its facet ware products from its own plant, which started production in September 2010. The plant is set up at Kadi, with an initial investment of ₹10cr (met by internal accruals) having initial capacity of 2,500 pieces per day. This capacity will be doubled to 5,000 pieces a day by FY2014E.

Wellness products

CSL's bath ware unit continues to market under the brand name *Cera*. Imported products such as shower cubicles, shower panels and steal cubicles form part of the unit's product portfolio, which has helped CSL to grow at a fast pace.

Power unit

CSL has wind farms in Gujarat for captive electricity generation. The installed capacity of the company's wind power unit is 4.97MW. Non-conventional wind power generation for FY2011 was 5,676MWH against 5,965MWH in FY2010. CSL's power requirement is met through electricity generated by its wind power unit and DG sets, which are completely based on natural gas.

Sanitary ware industry

The Indian sanitary ware industry, estimated to be ₹1,500cr-1,800cr, contributes to ~8% of the world's sanitary ware production. The industry has a sustained growth rate of 12-14% per annum due to increasing housing demand, purchasing power and consciousness towards hygiene. India is emerging as the second largest sanitary ware market in India and is expected to witness robust growth owing to the following:

Low penetration in Indian sanitation coverage

Considering India's dense population, its sanitation coverage is only ~40%, which is considered to be one of the lowest in the world, thus increasing the risk of health hazards and epidemics. With increasing awareness towards improving public health, the sanitary ware segment is expected to witness high attention.

Changing lifestyle and rising awareness about health and fitness

Demand for premium sanitary ware products will be driven by the growing shift towards upper-class lifestyle, rising per capita income, increasing awareness about health and fitness and changing consumer mindsets. The concept of making a clean and hygienic toilet is growing rapidly in rural areas, where a toilet did not even exist a few years ago.

Wide exports horizon

Indian sanitaryware products are very competitive because of their low production costs and, hence, export from India is increasing every day. Seven foreign brands such as *H&R Johnson*, *Roca* and *Kohler* have established their operations in India.

Competition

The Indian sanitary ware industry comprises players from the organized sector, unorganized sector, foreign players establishing facilities in India, domestic players and even retailers importing (mainly from China) and marketing in the domestic market.

HSIL is the market leader in sanitary ware products with ~41% market share, followed by Roca Parryware (~26% share) and CSL (~22% share). While in the faucet ware segment (where the company has just entered), Jaguar has the major market share of 45-50%.

Exhibit 7: Peer comparison

	Sales (₹ cr)	OPM (%)	PAT (₹ cr)	EPS (₹)	ROE (%)	P/E (x)	P/BV (x)	EV/EBITDA (x)
CSL								
FY2011	243	18.8	27	22	27	10.2	2.5	6.0
FY2012E	296	18.2	31	25	25	8.9	2.0	5.9
FY2013E	385	17.2	37	29	23	7.6	1.6	5.2
HSIL								
FY2011	1,079	17.5	77	11	12	8.4	1.2	5.2
FY2012E	1,410	18.2	107	16	16	8.7	1.3	5.1
FY2013E	1,740	18.2	135	20	17	6.9	1.1	4.1

Source: Angel Research, Bloomberg

As compared to market leader HSIL, CSL has consistently given higher returns of on equity. Considering the expansion and development plans being undertaken by the company, CSL's returns are expected to rise further and valuations are likely to become more attractive on forward basis.

Risk factors

- Unorganized and local players pose the main risk to the sanitary ware segment. Unorganized sanitary ware manufacturers enjoy the benefit of nil excise duty and sales tax and, hence, their products are ~70% cheaper than the organized sector's products. The increase in excise duty, from 8% to 10% and further to 12%, will make products from organized players more expensive.
- The advent of foreign brands in India also poses a threat because people are shifting to better, bigger brands, with increasing purchasing power.
- Low-cost imports from China.
- Any drastic changes in government policy related to housing construction and imports, among others, is bound to impact the industry.
- Any increase in the price of brass, the main raw material for faucets, may dent EBITDA margin.
- Any slowdown in the housing segment will cease growth, as in India the major demand for sanitary ware is fresh demand.

Standalone Profit and Loss Account

Y/E March (₹ cr)	FY2008	FY2009	FY2010	FY2011	FY2012E	FY2013E
Gross sales	139	171	200	256	311	405
Less: Excise duty	12	11	9	13	15	20
Net Sales	127	160	191	243	296	385
Other operating income	-	-	-	-	-	-
Total operating income	**127**	**160**	**191**	**243**	**296**	**385**
% chg	*19.4*	*25.6*	*19.8*	*27.0*	*21.8*	*30.2*
Net raw materials	**47**	**59**	**67**	**86**	**110**	**147**
% chg	*17.4*	*26.1*	*12.8*	*29.6*	*27.2*	*33.4*
Other Mfg costs	9	9	12	15	18	24
% chg	*29.9*	*1.4*	*31.8*	*18.8*	*21.8*	*30.2*
Power	6	5	6	12	15	19
% change	*31.2*	*(14.1)*	*27.1*	*94.3*	*22.0*	*25.0*
Personnel	19	22	23	28	40	53
% chg	*33.2*	*14.8*	*3.9*	*21.1*	*44.4*	*32.5*
Other	25	36	47	56	59	77
% chg	*13.9*	*46.8*	*29.4*	*19.4*	*5.7*	*30.2*
Total Expenditure	106	132	155	197	242	319
EBITDA	**21**	**28**	**36**	**46**	**54**	**66**
% chg	*12.7*	*31.2*	*29.2*	*26.8*	*17.7*	*23.3*
(% of Net Sales)	*16.7*	*17.5*	*18.8*	*18.8*	*18.2*	*17.2*
Depreciation & Amortisation	5	6	6	7	10	13
EBIT	**16**	**22**	**30**	**39**	**44**	**53**
% chg	*6.4*	*34.5*	*36.3*	*30.8*	*11.8*	*20.7*
(% of Net Sales)	*12.9*	*13.8*	*15.7*	*16.1*	*14.8*	*13.7*
Interest & other charges	3	4	3	3	4	6
Other Income	2	2	2	5	8	9
(% of Net Sales)	*1.9*	*1.2*	*1.3*	*2.1*	*2.7*	*2.3*
Recurring PBT	**13**	**18**	**27**	**36**	**40**	**47**
% chg	*0.8*	*36.8*	*52.2*	*32.9*	*8.9*	*17.7*
Extraordinary expense/(Inc.)	(0)	(1)	(0)	(1)	(1)	(1)
PBT (reported)	**16**	**20**	**30**	**42**	**49**	**57**
Tax	5	7	10	15	17	20
(% of PBT)	*35.3*	*34.2*	*34.4*	*35.3*	*35.3*	*35.3*
PAT (reported)	**10**	**14**	**20**	**27**	**31**	**37**
PAT after MI (reported)	**10**	**14**	**20**	**27**	**31**	**37**
ADJ. PAT	**10**	**14**	**20**	**27**	**31**	**37**
% chg	*10.7*	*41.1*	*39.5*	*38.4*	*14.6*	*16.5*
(% of Net Sales)	*7.9*	*8.9*	*10.4*	*11.3*	*10.6*	*9.5*
Basic EPS (₹)	**8**	**11**	**16**	**22**	**25**	**29**
Fully Diluted EPS (₹)	**8**	**11**	**16**	**22**	**25**	**29**
% chg	*10.7*	*41.1*	*39.5*	*38.4*	*14.6*	*16.5*
Dividend	1	1	2	3	3	3
Retained Earning	9	13	18	24	28	33

Standalone Balance Sheet

Y/E March (₹ cr)	FY2008	FY2009	FY2010	FY2011	FY2012E	FY2013E
SOURCES OF FUNDS						
Equity Share Capital	3	3	3	6	6	6
Preference Capital	-	-	-	-	-	-
Reserves & Surplus	55	68	85	105	134	167
Shareholders' Funds	**58**	**71**	**89**	**112**	**140**	**173**
Minority Interest	-	-	-	-	-	-
Total Loans	39	36	27	38	57	85
Deferred Tax Liability	12	14	13	14	14	14
Total Liabilities	**110**	**120**	**129**	**163**	**211**	**272**
APPLICATION OF FUNDS						
Gross Block	94	99	99	113	173	233
Less: Acc. Depreciation	19	24	30	35	45	58
Net Block	**76**	**74**	**69**	**78**	**128**	**175**
Capital Work-in-Progress	1	0	2	6	3	3
Lease adjustment	-	-	-	-	-	-
Goodwill	-	-	-	-	-	-
Investments	-	-	-	8	8	8
Current Assets	71	89	120	146	148	187
Cash	11	22	34	36	13	15
Loans & Advances	8	10	17	21	26	34
Inventory	27	27	36	50	57	72
Debtors	26	31	33	39	53	66
Current liabilities	38	44	62	75	86	109
Net Current Assets	**33**	**45**	**58**	**71**	**63**	**78**
Mis. Exp. not written off	-	-	-	-	-	-
Total Assets	**110**	**120**	**129**	**163**	**211**	**272**

Cash flow

Y/E March (₹ cr)	FY2008	FY2009	FY2010	FY2011	FY2012E	FY2013E
Profit Before Tax	16	20	30	42	49	57
Depreciation	5	6	6	7	10	13
Interest paid	3	4	3	3	4	6
Change in WC	3	(1)	(0)	(11)	(15)	(14)
Other income	(2)	(2)	(2)	(5)	(8)	(9)
Direct taxes paid	(5)	(7)	(10)	(15)	(17)	(20)
Others	(8)	(2)	(2)	(0)	(1)	(1)
Cash from Operations	10	18	23	21	21	32
(Inc)/ Dec in Fixed Assets	(31)	(5)	(0)	(14)	(60)	(60)
(Inc)/Dec In Investments	-	-	-	8	-	-
Other Income	2	2	2	5	8	9
Others	7	(1)	(4)	(26)	(5)	(1)
Cash from Investing	(21)	(4)	(1)	(28)	(57)	(52)
Issue of Equity	0	0	0	3	-	-
Inc/(Dec) in Debt	10	(4)	(8)	11	19	28
Dividend Paid (Incl. Tax)	(1)	(1)	(2)	(3)	(3)	(3)
Interest paid	(3)	(4)	(3)	(3)	(4)	(6)
Others	5	6	3	4	-	2
Cash from Financing	11	(3)	(9)	9	12	21
Inc/(Dec) in cash	-	11	12	2	(24)	1
Opening cash balance	11	11	22	34	36	13
Closing cash balance	11	22	34	36	13	15

Key ratios

Y/E March	FY2008	FY2009	FY2010	FY2011	FY2012E	FY2013E
Valuation Ratio (x)						
P/E (on FDEPS)	27.7	19.6	14.1	10.2	8.9	7.6
P/CEPS	18.6	13.8	10.8	8.2	6.7	5.6
P/BV	4.8	3.9	3.2	2.5	2.0	1.6
Dividend yield (%)	0.3	0.4	0.6	0.2	0.2	0.2
EV/Sales	2.4	1.8	1.4	1.1	1.1	0.9
EV/EBITDA	14.4	10.5	7.5	6.0	5.9	5.2
EV / Total Assets	2.8	2.4	2.1	1.7	1.5	1.3
Per Share Data (₹)						
EPS (Basic)	8.0	11.2	15.7	21.7	24.8	28.9
EPS (fully diluted)	8.0	11.2	15.7	21.7	24.8	28.9
Cash EPS	11.9	15.9	20.5	26.8	32.7	39.6
DPS	0.7	1.0	1.2	2.5	2.5	2.5
Book Value	46.1	55.8	69.9	88.2	110.5	136.9
DuPont Analysis						
EBIT margin	12.9	13.8	15.7	16.1	14.8	13.7
Tax retention ratio	0.6	0.7	0.7	0.6	0.6	0.6
Asset turnover (x)	1.3	1.6	2.1	2.2	1.6	1.6
ROIC (Post-tax)	10.7	14.7	21.2	22.4	15.2	13.8
Cost of Debt (Post Tax)	5.2	7.4	6.1	4.6	4.6	4.6
Leverage (x)	0.5	0.2	(0.1)	(0.1)	0.3	0.4
Operating ROE	13.4	16.1	20.0	21.4	17.9	17.2
Returns (%)						
ROCE (Pre-tax)	16.7	19.1	24.0	26.8	23.4	21.9
Angel ROIC (Pre-tax)	20.0	22.3	31.3	38.1	29.3	24.4
ROE	19.1	22.0	24.9	27.4	25.0	23.4
Turnover ratios (x)						
Asset Turnover	1.3	1.6	1.9	2.1	1.7	1.7
Inventory / Sales (days)	67	61	60	65	65	64
Receivables (days)	69	64	61	54	65	63
Payables (days)	129	113	124	127	129	125
WC cycle (ex-cash) (days)	65	54	46	52	61	60
Solvency ratios (x)						
Net debt to equity	0.5	0.2	(0.1)	(0.1)	0.3	0.4
Net debt to EBITDA	1.3	0.5	(0.2)	(0.1)	0.7	0.9
Int. Coverage (EBIT / Int.)	5.2	5.5	11.8	14.4	10.7	8.6

Advisory Team Tel: (91) (022) 39500777 E-mail: advisory@angelbroking.com Website: www.angelbroking.com

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Disclosure of Interest Statement	**Cera Sanitary**
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹ 1 lakh for Angel, its Group companies and Directors

Ratings (Returns):	*Buy (> 15%)* Reduce (-5% to 15%)	*Accumulate (5% to 15%)* Sell (< -15%)	*Neutral (-5 to 5%)*