

Caesarstone (NASDAQ:CSTE)

Nothing on the counter.

- CSTE's major revenue growth product, marketed as a collaboration with Lowe's, is not for sale according to Lowe's Customer Services and store checks. This is contrary sell-side forecasts highlighting this as a growth driver.
- Of CSTE's listed sales agents, there is a growing percentage no longer sell (or have never sold) CSTE products, switching to higher margin products. Agents who sell CSTE are charging a higher retail price than consumers pay at IKEA for **identical** products. Ikea countertops include free installation!
- We believe CSTE's inventory should be revised materially downwards to reflect decreasing average selling prices within their larger customers.
- SEC enquiries into CSTE revenue growth factors inconsistently addressed by management. The major revenue variance factor, increased average selling price, is not supported by channel checks which show prices *decreasing* at major customers/outlets.
- CSTE's market analysis documents are illogical and over represent their poor market impact. In reality, the significance of growing competition in the USA goes unaddressed by CSTE. The market is extremely saturated with big players including Vadara Quartz, headed by the former CSTE USA division CEO Arik Tendler, and low-opex Asia-Pac players¹ who can better compete on price for a virtually undifferentiated product.
- Competitor analysis suggests CSTE are either not maintaining machinery adequately or that machinery is severely underutilised.
- CSTE has consistently missed guidance; a theme we identify and is unlikely to change.
- Shareholder friendly programmes discontinued. CSTE is now a negative earnings growth vehicle with no payout policy.

¹ <http://vicostone.com/>

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1. Short thesis

As a prelude to our piece, Ben Axler of Spruce Point Capital has written two good short reports on [CSTE](#) . We will not be doubling down on much of Ben's data, which remains relevant and should be considered concurrently.

Management has a big mouth, no results to back it up

Management has a history of producing inconsistent information, numerous revisions and profit downgrades. Management announced a decreased 2017 yoy earnings guidance in February; despite this the stock is up !

Caesarstone Ltd. and its subsidiaries				
U.S. dollars in thousands	Three months ended		Twelve months ended	
	December 31,		December 31,	
	2016	2015	2016	2015
(Unaudited)				
Reconciliation of Net Income to Adjusted EBITDA:				
Net income	\$ 15,316	\$ 19,392	\$ 76,483	\$ 79,458
Finance expenses, net	1,000	688	3,318	3,085
Taxes on income	2,790	2,563	13,003	13,843
Depreciation and amortization	7,211	6,706	28,254	22,334
Legal settlements and loss contingencies, net (a)	3,115	(64)	5,868	4,654
Compensation paid by a shareholder (b)	-	-	266	-
Share-based compensation expense (c)	535	1,147	3,068	2,293
Adjusted EBITDA (Non-GAAP)	\$ 29,967	\$ 30,432	\$ 130,260	\$ 125,667

(a) Consists of legal settlements expenses and loss contingencies, net, related to silicosis claims.
(b) One time bonus paid by a shareholder to Company's employees.
(c) Share-based compensation includes expenses related to stock options and restricted stock units granted to employees of the Company. In addition, includes expenses for phantom awards granted and related payroll expenses as a result of exercises.

Figure 1 2016 earnings results – 8 Feb 2017²

Guidance

The Company today issued guidance for the full-year of 2017. It expects its 2017 revenue to be in the range of \$580 million to \$595 million, and adjusted EBITDA to be in the range of \$119 million to \$126 million.

Figure 2 2017 earnings guidance – 8 Feb 2017³

Sellside appear to have jumped on the bag-holder bandwagon.

Despite guidance showing reduced yoy earnings, Chardan analysts claim that the business now represents LESS RISK, and therefore derive an increased valuation based on a reduced WACC:

² <http://ir.caesarstone.com/releasedetail.cfm?ReleaseID=1010928>

³ <http://ir.caesarstone.com/releasedetail.cfm?ReleaseID=1010928>

We upgrade our PT to \$43 on model roll-over and 0.5p.p. decrease in WACC to 9% to reflect stabilization of the company's US business. We haven't made changes to our CSTE financial forecasts following the 1Q17 report, although believe that our ~8% revenue growth forecast for 2017E is conservative. Despite growing competition, the US market remains a huge opportunity for the company in various price segments, given increasing quartz penetration and improving operations of CSTE US plant. Nonetheless, we downgrade our rating to NEUTRAL, as the stock price has reached our target and we need more visibility of revenue growth re-acceleration and margins stabilization in order to review our assumptions. The next catalyst for the stock is the company's Analyst Day in New York on May 18-19, where the new CEO Raanan Zilberman will make his first public

Figure 3 Chardan CSTE note – 11 May 2017

The Chardan valuation is on a similar 'Hollywood' justification as other sellside analysts, including Stifel, who appear to have the most inconsistent valuation on a stock ever:

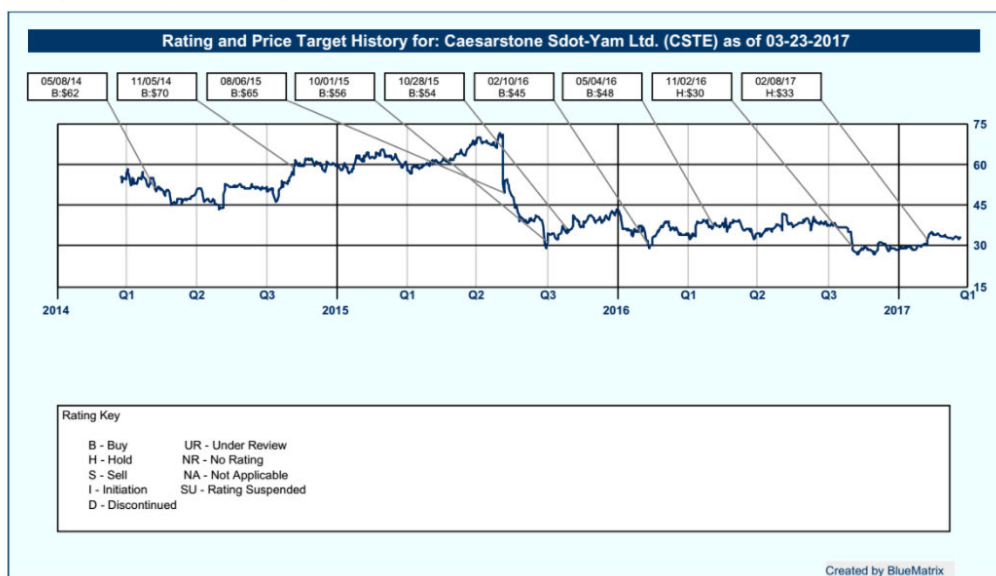


Figure 4 Stifel CSTE note – 24 March 2017

Earnings misses & downgrades, impromptu management changes, auditor concerns, quality concerns, increasingly competitive markets, and Kibbutz board backstabbing activism are apparently obscure concepts to Stifel, who simply provide a hindsight note after a major share price fall, then upgrade a few weeks later, all on the back of an obscure EV/EBITDA multiple.

On top of this, management embarrassingly had to revise its earnings downwards on the back of accounting misstatements, an issue perhaps foreshadowed in Spruce Point pieces.

Lowes

CSTE's 20F⁴ states that the company "commenced offering our products and related services in several Lowe's stores in the United States in the first quarter of 2017". Management commented further on this development in the company's Q1 earnings call⁵:

"We are already in around 200 stores in few of the states, that Lowe selected."

⁴ <https://www.sec.gov/Archives/edgar/data/1504379/000117891317000750/zk1719638.htm> (20F)

⁵ <https://seekingalpha.com/article/4071800-caesarstones-cste-ceo-raanan-zilberman-q1-2017-results-earnings-call-transcript?part=single>

It appears, that the company failed to inform Lowe's of this latest development or CSTE lack the foresight to communicate with their end-customers effectively to any material sales.

Our channel checks with Lowes's Customer Service confirm the Transform™ product is not available at Lowe's stores as of the date of this report, nor is any other CSTE product.

Physical channel checks into Lowe's stores and a review of their online catalogue confirms that no CSTE product is available for purchase at any Lowe's store as of the date of this report. Meanwhile, Lowe's is stocking what appears to be an increasing catalogue of products from CSTE competitors Silestone.

There are further concerns over the Transform™ product if it ever enters the market on a large scale basis. An experienced industry contractor has advised he would be hesitant to fit the product as the thin quartz layer is likely susceptible to wear and tear and cracking, and overlaid on top of old fittings, which are susceptible to rot and pungent stale water, causes smells near sinks⁶. The transform product is not a permanent solution.

SEC

The SEC issued a request for further information to clarify a number of ambiguous statements in CSTE's 2015 20-F, specifically in regards to revenue movements (including FX and average selling prices) and aggregated operating segments.

Management's address of revenue variance factors do not corroborate with our channel checks.

Increased average selling prices do not reflect ground level pricing, which we have found to be decreasing, and excessive volume increases do not correspond to the consensus of the CSTE reseller agents we contacted.

Caesarstone claim to have high quality products. Not only was this disproven by Sprucepoint Capital's work⁷, but also now in CSTE's own revenue growth and margins⁸. In CSTE's own conference, management were unable to explain how the growth occurred. Management could not explain how there was an increase in Ikea sales.

IKEA

CSTE's statements about average selling prices are contradicted by their customers' advertised selling prices.

⁶ <https://www.houzz.com/discussions/4428918/caesarstone-transform-quartz-that-fits-over-your-existing-counters>

⁷ <http://www.sprucepointcap.com/cste-ltd-followup/> <http://www.sprucepointcap.com/cste-ltd-followup/>

⁸ http://files.shareholder.com/downloads/AMDA-EF2TF/4640176075x0x932856/DFCF7C3C-5B79-4C84-B0BC-0A5A9E349A63/2016_Caesarstone_Annual_Report.pdf

*Between 2015 and 2017, CSTE's Ikea catalogue prices decreased by between ~3% and 15% (excluding enticements, **and free installation!**).*

The reality is Ikea is suffering as a result of greater competition in the market place.

Silicosis – The cost of doing business!

Silicosis is an emerging risk in workers who process quartz and other silicon dust producing materials. This is an unknown variable for CSTE. Although provisions have been made for those claims filed, it's noteworthy that there is a significant class action that could have a material impact on the company's balance sheet, approximately, \$56m.

There has been no provision for this \$56m class action.

Competition

Quartz countertops are undoubtedly a market where competition is growing significantly. Price reductions are being seen in the range of 3-15% in IKEA alone. IKEA prices their stock at a 18%-35% discount to identical CSTE reseller retail prices.

With so many companies intending to compete within the marketplace, it is of additional concern that CSTE USA's former CEO Arik Tendler has entered the market with a product who's marketing appears to address many of CSTE's negative online reviews related highlighting quality concerns.

Comparisons

A comparative financial analysis against competitor Silestone reinforces our belief that Caesarstone's financial statements are misrepresented. Specifically:

- Caesarstone's marketing expenses are remarkably low, considering they allege to have over 10x distributors in the USA vs Silestone
- Caesarstone's maintenance capex spending is substantially lower than Silestone, despite CSTE's higher revenues and COGS
- Silestone's margins (as a premium product) are 20% higher, suggesting less volume sold per unit of revenue and therefore lower wear & tear machinery expenses
- All quartz machinery (incl. frequent wear & tear replacement parts) is bought from niche group of suppliers with limited price variances.

2. The Disappearing Bull Case



Have CSTE investors forgotten what was previously on the counter?

The bull-case is highly predicated on growth and taking more market share despite lower profitability. Analysts suggest the possibility of a take-outs or M&A. The reality is nothing has ever been concluded, including the CEO jumping ship with significant exit payment of US\$2.9m⁹.

The Bull Case	Reality
Steady top line growth	x Slow top line growth more than offset by increased cost margins.
Dividends	x Discontinued ¹⁰ , despite reported >\$106m cash balance
Stock buyback programme	x Discontinued ¹¹ , despite reported >\$106m cash balance
Increased target price on less-risky WACC	x Earnings guidance is down yoy, and there is a >\$50m unrecorded class action pending. How does this pose less risk?

⁹ <http://www.themarket.com/markets/1.3931649>

¹⁰ <http://ir.caesarstone.com/releasedetail.cfm?ReleaseID=954206>
<http://ir.caesarstone.com/releasedetail.cfm?ReleaseID=954206>

¹¹ <http://ir.caesarstone.com/releasedetail.cfm?ReleaseID=1010928>
<http://ir.caesarstone.com/releasedetail.cfm?ReleaseID=1010928>

3. Nothing on the counter at Lowe's

Caesarstone's market expansion strategy took on another direction in their most recent filings announcing a collaboration with Lowe's™, marketing a new overlay product called Transform™.

CSTE's 20F¹² states that the company "*commenced offering our products and related services in several Lowe's stores in the United States in the first quarter of 2017*".

It appears that either the company failed to inform Lowe's of this latest development or the time expectations of commercialising this agreement are entirely flawed. **The product is not available at Lowe's stores via Customer Service for purchase, pre-order or samples as of the date of this report. In fact, Lowe's Customer service has never heard of this product!**

Lowe's in-store channel checks

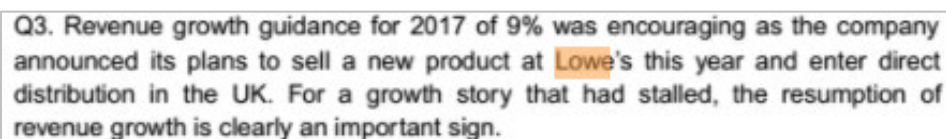
Analysts and investors should check Lowe's sales channels before suggesting its significance as a growth driver.

We spoke with Lowe's on multiple occasions from the time of CSTE's first collaboration announcement¹³ (8 February 2017) to the date of this report making extensive inquiries. **Not one of Lowe's customer service representatives we spoke to was able to locate Caesarstone's Transform™ product (or any CSTE product)!**

Two customer service agents suggested we try Ikea™ or purchasing another product: Silestone. It is worthwhile noting that while Lowe's stocks no Caesarstone of any kind, they have an extensive range of Silestone and a few other brands, including their own brand.

Not one of Lowe's customer service representatives we spoke to were able to locate Caesarstone's Transform™ product! (Or any Caesarstone product whatsoever)

The sell side are expecting a *material* upside in the Lowe's collaboration and a reputed revenue 'growth driver'. Based on this data, it's likely investors are going to be left *materially* disappointed.



Q3. Revenue growth guidance for 2017 of 9% was encouraging as the company announced its plans to sell a new product at Lowe's this year and enter direct distribution in the UK. For a growth story that had stalled, the resumption of revenue growth is clearly an important sign.

Figure 5 Stifel Earnings Analysis – 8 Feb 2017

¹² <https://www.sec.gov/Archives/edgar/data/1504379/000117891317000750/zk1719638.htm> (20F)

¹³ <http://ir.caesarstone.com/secfiling.cfm?filingID=1178913-17-338&CIK=1504379>

Online channel check

We conducted an online search on Lowe's website searching by brand (search term: [Quartz Countertops](#)*)¹⁴ (Accessed [June 07, 2017](#)).

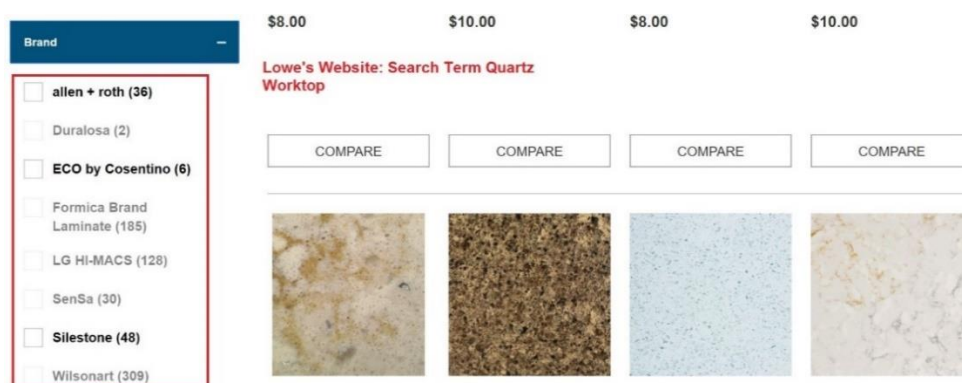


Figure 6 Lowe's Website Results - Search Term Quartz Countertops

*Other failed search terms included [Transform Worktop](#), [Caesarstone](#), and [Overlay Worktop](#)

A Caesarstone product search on Lowe's website returned no results, and instead offered a healthy range of competitors' products.

Key Takeaways

Despite extensive searches, both in-store, via customer services and Lowe's website, there was no evidence of a Transform roll-out programme. There was no product sample availability, no staff awareness of the product and Lowe's customer service advised there was no pre-order availability for any "Transform™" or Caesarstone product.

Investors in CSTE would be wise to consider Lowe's spring sales are a key period for the company, as with most home-center retailers¹⁵. Despite stating sales were expected to start in 2017 Q1, Caesarstone have clearly missed this window of opportunity that the building products sector has traditionally been reliant on.

Additionally, if the Transform™ product becomes available at Lowe's at some stage in the future, investors would be wise to consider:

- Lowe's is a mass-market retailer with no premium status, similar to IKEA, and such an agreement will further destroy whatever remaining premium-brand recognition CSTE has left¹⁶.
- CSTE will have to play "Lowe's-margin" game
- Offering a cheaper substitute product through Lowe's would further deteriorate earnings through cannibalisation as CTE would essentially be undercutting themselves.

¹⁴ <https://web.archive.org/web/20170614125742/https://www.lowes.com/pl/Kitchen-countertop-samples-Kitchen-countertops-accessories-Kitchen/4294735654?refinement=4294772983> (Lowe's Quartz Worktop Search) Accessed: June 14, 2017

¹⁵ <https://newsroom.lowes.com/news-releases/lowes-seasonal-hiring/>

¹⁶ See Spruce Point's CSTE research for more details on why CSTE is not a premium product - <http://www.sprucepointcap.com/cste-ltd/>

4. Sales Channels – increased competition, fabricated product offerings & phantom agents

We conducted substantial channel checks into agents listed on CSTE's website and into product lines over the last 3 months. Our main findings were that:

- The Transform™ product is so far unavailable for purchase at Lowe's.
- CSTE's supply chain is filled with phantom agents who no longer sell (and in many instances, have never sold) Caesarstone products.
- With apparent lack of supply chain management, we doubt that CSTE attempting to recover any stock they have loaned or extended on credit terms to its reseller agents
- A decline in prices over the past year and CSTE's market being more competitive, it raises the question as to the real value of their inventory and finished goods. It is our view that CSTE have to revalue their in-house finished goods inventory and inventory held by resellers represented within CSTE's accounts receivable.
- CSTE USA's former CEO Arik Tendler appears to have entered the USA market with a superior product under the brand Vadara Quartz. Vadara's marketing appears to address quality issues that plague Caesarstone online reviews (cracking/chipping, staining¹⁷ & using chemicals¹⁸).

Our channel checks suggest CSTE is meeting their demand straight from the production line, and reseller built up inventory appears to be unpopular stock which is difficult to sell.

Poor sales channel management

Industry professionals indicate that the market place is significantly more competitive, raising the question as to whether CSTE can afford to be failing so miserably in managing their customer referral points.

OMNI-Channel marketing 101 suggest CSTE are ignoring all the basic rules. In the USA, U.K. and Australian Markets there is an apparent failure to maintain basic up-to-date reseller agent information. There was basic referral information missing such as email, website and/or telephone details.

An industry professional questioned 'whether there is any management of Caesarstone's sales channels at all.'

As a comparison, [Silestone's US](#) agent and supplier list appears well maintained, with basic rules of online sales and referrals being followed.

¹⁷ <https://countertopinvestigator.com/caesarstone-countertops/>

¹⁸ <http://ths.gardenweb.com/discussions/2698923/caesarstone-staining>

What is the real number of reseller agents in Caesarstone's network?

CSTE has more than tenfold the number of alleged registered reseller agents compared to the likes of Silestone. CSTE's agent count is circa 4,050, whereas Silestone's is a mere 368 (Fig 2). Silestone list outlets such as Home Depot and Lowe's.

4043	A6UJ9A007M37	Ray's Carpet One	7441 Paseo Del Norte NE	#6 Albuquerque NM 87113	(505) 217-1107
4044	A6UJ9A005PV7	Santa Fe Granite	5640 Venice Ave NE	Ste I Albuquerque NM 87113	(505) 310-3142
4045	A6UJ9A004UID	ACB	4800 Hawkins St NE Albuquerque NM 87	(505) 345-4331	
4046	A6UJ9A004VFT	American Design and Remodeling	1540 Juan Tabo Albuquerque NM 87112	(505) 293-1698	
4047	A6UJ9A004UPS	Alexandria Kitchen & Bath Studio	1502 King St Alexandria VA 22314	(703) 549-1415	
4048	A6UJ9A0055AN	Cullen's Floor to Ceiling	1632 N Nokomis St NE Alexandria MN 56	(320) 762-5211	
4049	A6UJ9A00535U	GLB Tile & Marble Co.	6314-K Gravel ave. Alexandria VA 22310	(703) 971-4104	
4050	A6UJ9A0058GV	Firuze Tile Kitchen & Bath	5701 K General Washington Dr Alexandri	(703) 663-1190	
4051					
4052					
4053					

Figure 7 Caesarstone Agents Downloaded as of 16 March 2016



Figure 8 Silestone Registered Agents as of April 20, 2017¹⁹

Our channel checks demonstrated that a good percentage of these agents do not sell, or in some instances, have never sold Caesarstone, which raises the question why they were ever recorded as reseller agents in the first place.

Of those alleged registered agents/suppliers contacted, there was a theme. A significant number of contractors would entice and promote other products including granite, on the merits of quality, price point, and/or not being a Caesarstone agent.

CSTE's raw ingredient costs were previously exposed by Spruce Point as being materially higher than what was disclosed. This is compounded by increased **competition in top line sales and a decreasing average selling price, reinforced by new and existing competitors expanding and/or entering the North American Market.**

¹⁹ <https://www.silestoneusa.com/where-to-buy/>

It's likely that CSTE's biggest customer after Ikea is their own marketing department. If CSTE's reseller database is accurate, they would require a significant volume of samples.

Given the spread of their reseller network, it's no wonder that CSTE's forecasted revenues in Ikea (the largest customer to date) is a "finger in the wind exercise" and subject to SEC enquiries²⁰.

With a lack of supplier management, we pose the question: **what is the cost of display items and stock on loan to resellers who are no longer selling Caesarstone products?** Should agent inventory be reflected on CSTE's accounts or on a returns basis if it is not sold a end user, it is our view that CSTE will have to impair their finished goods inventory held by such agents, (i.e. receivables impairment).

Australia

It is difficult to assess CSTE's commercial relationship footprint in Australia; its second largest market. There appears to be a significant lack of reselling agents:

<http://www.caesarstone.com.au/find-a-display>

Only one display room is listed in Sydney, a CSTE branded showroom, and only two in Melbourne, despite these being high population areas. With competition increasing, CSTE appear to be falling behind its competitors on a **real, targeted** footprint basis.

U.K.

It appears that CSTE has purchased or collated a defunct database of kitchen fitters, worktop fabricators and suppliers and transformed this into a reseller catalogue. There is a similar theme to the USA where agents are either no longer operating, no longer sell Caesarstone, are exclusive to competitors or have never sold CSTE products.

²⁰ <https://www.sec.gov/Archives/edgar/data/1504379/000117891317000754/zk1719670.htm>

5. The Transform Issue

Much hype has surrounded CSTE's new line at Lowe's, expected to have commenced sales Q1 2017: the 13mm quartz overlay branded as the Transform range. The range is being marketed as a new alternative to traditional benchtops by fitting a 13mm overlay onto an existing worktop²¹. Note that prior to this announcement Caesarstone has never sold 13mm thickness quartz as a countertop option in the North Americas.

On face value investors would be excited about a new product reaching an as-yet untapped market, however Caesarstone's international sales websites tell a different story. Our channel checks suggest Transform is a repackaged pre-existing product that has been available for sale in overseas market as far back as March 2016.

Pure White™ Specifications					
Collection	Classico	Motivo	Concetto		
Range	Standard	Deluxe	Premium	Supernatural	Supernatural Ultra
Available Thickness	13mm	20mm	25mm	30mm	
Surface Finish	Polished	Honed	Textured		
Dimensions	3,060mm by 1,440mm				
Weights	13mm = 143kg (32kg per m ²)				
	20mm = 220kg (50kg per m ²)				
	30mm = 330kg (75kg per m ²)				

22

Pure White 13mm thickness on Australian website dated 13/4/2016

²¹ <http://www.caesarstoneus.com/newsroom/transform/transform/>

²² <https://web.archive.org/web/20160314111106/http://www.caesarstone.com.au:80/colour/1141-pure-white>

Frosty Carrina™ Specifications

Collection	Classico	Motivo	Concetto	
Range	Standard	Deluxe	Premium	Supernatural
Available Thickness	13mm	20mm	25mm	30mm
Surface Finish	Polished	Honed	Textured	
Dimensions	3,060mm by 1,440mm			
Weights	13mm = 143kg (32kg per m²)			
	20mm = 220kg (50kg per m²)			
	30mm = 330kg (75kg per m²)			

23

Frosty Carrina 13mm thickness on Australian website dated 15/4/2016

13mm product options are listed on many of CSTE's international websites including but not limited to Brazil, Australia, the UK and Israel.

Caesarstone has also sold the 13mm quartz in North America before in some of the same colour ranges as the Transform product but as bathroom splashbacks, not countertops.



5141 Frosty Carrina™ wall and floor panels

Rendering for illustration purposes only



Frosty Carrina™ 5141

Caesarstone® has specially selected a range of colours and designs in 13mm thickness for bathroom wall panels.

The reality of the situation is that Caesarstone's Transform is likely a mish-mash of 13mm products that were unsellable overseas and are now being repackaged as a low-margin solution through Lowe's, in the hope of avoiding substantial inventory impairments.

Is Lowes transform old stock that CSTE were unable to sell, and is now being repackaged in the hope of avoiding inventory writedowns?

13mm products sold as splashbacks, what are the cracking and heat fracture risks?

6. Increasing competition

CSTE's understatement of the year:

"We have also experienced instances of our competitors marketing products with similar appearances and similar model names to some of our products. Competition of this nature may increase in the markets in which we operate and may develop in new markets.²⁴"

Increased Competition

The market is becoming significantly more competitive, with the following brands recently entering into competing with CSTE in the North Americas:

- Arenastone
- Cimstone
- Diresco
- Hanstone
- Okite
- Quarella
- Quartz Compac
- Quantra (Pokarna Quartz)
- Stone Italiana
- Radianz by Samsung
- Technistone
- Trafficstone
- Unistone
- Vadara Quartz
- Vicostone
- Zodiaq by Dupont

In addition established players such as Pokarna Quartz have aspirations to expand their US footprint²⁵

²⁶.

These competitors have advantages over CSTE, be they input costs, cost of labour, FX benefits or quality claims. Based on CSTE's projections and forecasts, they appear to be ignoring the bottom- and top-line risks including the carrying value of their ever-increasing inventory and finished goods.

Competition is hotting up globally, with established producers increasingly competing for the same international market share. Examples being Cambria – a big US quartz manufacturing company moving

²⁴ <https://www.sec.gov/Archives/edgar/data/1504379/000117891317000750/zk1719638.htm>

²⁵ <http://www.stoneupdate.com/news-info/company-insider/1283-pokarna-to-make-48-million-quartz-investment>

²⁶

<http://www.quantra.in/>

into international markets²⁷. “developing the strategic and operational structure for expanding sales, marketing and distribution of Cambria worldwide.”

Vadara Quartz – another slab in the back for CSTE

Mr Arik Tendler is the former CSTE USA CEO and accredited with the expansion and early development of the Company. The former USA division CEO also appears to be a reader of Spruce Point’s research. We speculate that Arik Tendler identified the issues and inferior levels of quartz in Spruce Point’s previous report²⁸.

Mr Tendler is now CEO of [Vadara Quartz](#)^{29,30} a relatively new brand within the quartz worktop market. Vadara appear to address quality issues Spruce Point have previously raised and that plague Caesarstone’s online reviews (cracking/chipping, staining³¹ & using chemicals³²), which appear to be a deterrent to purchasing CSTE’s worktops. Vadara Quartz appears to have addressed concerns of consumers and tested their products to the following:

TEST	RESULT	TEST	RESULT	TEST	RESULT
Water Absorption	0.01%	Acids & Alkalines		Stain Resistance – 24hr Contact	
Porosity	0.01%	• Hydrochloric Acid (3%)	No Visible Effect	• Coca Cola	No Visible Effect
Mohs Hardness	Min. 6	• Lactic Acid	No Visible Effect	• Red Wine	No Visible Effect
Household Chemicals	No Visible Effect	• Potassium hydroxide (30g/l & 100g/l)	No Visible Effect	• Black Coffee	No Visible Effect
• Ammonium Chloride (100g/l)				• Orange Juice (removed with damp cloth)	No Visible Effect
Swimming Pool Salts	No Visible Effect				
• Sodium hypochlorite (20mg/l)					

Figure 9 Extract from Vadara Quartz Quality & Performance Claims ³³

Key Takeaways

- If production is ramping up in CSTE’s new facility, where is the demand for this?
- Agents we have contacted suggest is that CSTE is not a quality product, and most prefer to redirect us to other hard surface worktops.
- Some agents, despite being registered as suppliers/contact points to purchase CSTE products either do not sell it (in some cases, have never sold it) or actually are registered distributors and/or agents for other products.
- We believe CSTE wants to give the impression of a company with greater reach, depth and market share than the reality.
- Arik Tendler, accredited with the development and expansion of CSTE, is now in direct competition with Caesarstone.

²⁷ <https://www.cambriausa.com/About-Us/news-events/cambria-international-announcement/>

²⁸ <http://www.sprucepointcap.com/cste-ltd/> (Page 9) “Quartz Supply Contracts, Lab Tests Suggest Product and Financial Misrepresentations”

²⁹ <https://www.linkedin.com/in/arik-tendler-2750b84a/>

³⁰ <http://www.vadaraquartz.com/aboutus>

³¹ <https://countertopinvestigator.com/caesarstone-countertops/>

³² <http://ths.gardenweb.com/discussions/2698923/caesarstone-staining>

³³ <http://www.vadaraquartz.com/aboutus>

7. SEC gets involved in ambiguous disclosures

On September 26 2016 the SEC issued a request for further information in order to clarify a number of ambiguous statements in the company's 20-F³⁴.

While these requests are SEC filings attached to the CSTE ticker, they are nowhere to be found on CSTE's "SEC Filings" section of their website.

Management's address of revenue variance factors do not correlate with our channel checks. Specifically, increased average selling prices do not reflect ground level pricing, which we have found to be decreasing, and excessive volume increases do not correspond to the consensus of CSTE resellers we contacted.

The Average Selling Price & IKEA ambiguities

The SEC questioned CSTE's revenue variance³⁵.

Form 20- F for the Year Ended December 31, 2015

Item 5: Operating and Financial Review and Prospects, page 48

A. Operating Results, page 48

Revenues, page 57

1. We note that you identify increased average selling prices, growth in the business from IKEA, and unfavorable exchange rates as having impacted the increase in revenues, in addition to the 15 % increase in sales volume. When you identify multiple factors that contribute to a material change between periods, please revise future filings to quantify the impact of each factor, including the impact of changes in average selling prices. Please also revise future filings to address your expectation regarding extending your agreements with IKEA and IKEA Canada beyond the current terms. Refer to Item 5 of Form 20- F.

Figure 10 – SEC Query re ambiguity of revenue variance factors

CSTE responded as follows³⁶:

Response:

The Company respectfully acknowledges the Staff's comment. In future filings, the Company will:

- quantify the impact of each major factor that contributes to a material change in its revenues, including the impact of changes in average selling prices; and
- enhance its disclosure in connection with possible extensions of the IKEA agreements.

With respect to the extension of the IKEA agreements, the Company notes that it would intend to make disclosure on an expectation only if it has actual knowledge of relevant information or reasonable basis for a forward- looking statement. Absent such information or reasonable basis, the Company would expect to advise investors that it cannot assess the probability of the IKEA agreements being extended at that time and will also include relevant risk factor disclosure on that point.

Figure 11 – CSTE response to SEC Query re ambiguity of revenue variance factors

³⁴ <https://www.sec.gov/Archives/edgar/data/1504379/000000000016094507/filename1.pdf>

³⁵ SEC Letter – 26 Sep 2016 –

<https://www.sec.gov/Archives/edgar/data/1504379/000000000016094507/filename1.pdf>

³⁶ CSTE Response to SEC Letter –

<https://www.sec.gov/Archives/edgar/data/1504379/000117891316006696/filename1.htm>

The following year's 20-F provided insight into various metrics which we address below:

Revenues increased by \$39.0 million, or 7.8%, to \$538.5 million in 2016 from \$499.5 million in 2015. The increase in revenues resulted mainly from a 7.3% increase in volume of sales contributing approximately \$34 million to revenues. Increased average selling prices related to a higher portion of differentiated products contributed approximately \$6 million to revenues. These factors were partially offset by unfavorable exchange rates, primarily related to the weakening of the Canadian and the Australian dollar against the U.S. dollar. On a constant currency basis, revenues grew by \$41.7 million in 2016, representing 8.4% growth compared to 2015. The growth was primarily driven by double-digit growth in Canada and Australia, which grew on a constant currency basis by 25.4% and 19.0% respectively. Growth in Canada and Australia was primarily driven by continued quartz penetration and improved product offerings and was achieved despite weakening housing environment. The growth rate in Canada also benefited from the ramp-up of the IKEA business in the first six months of 2016. In the United States, our revenue dropped 0.3% compared to 2015. This reduction was a result of a single digit core growth along with revenue drop from IKEA business.

Figure 12 – 2016 Revenue Movement concerns

Forecasting, Competition

With increased competition, margin pressures and a sales network that needs serious updating, it's no wonder CSTE are the subject of SEC enquiries relating to the inherent risks in their forecasts³⁷. CSTE's financial forecasting is akin to holding their finger in the wind.

Increased Volume?

The consensus from the resellers we have contacted is that CSTE is not a quality product, and many prefer to redirect us to other hard surface worktops. We actively saw merchants moving away from this product. How is it that the largest portion of CSTE's FY 2016 growth was driven by increased volumes?

Increased Average Selling Price?

Our comprehensive channel checks showed no increase in the prices of CSTE products at over the last two years. In fact, a review of Ikea's catalogue shows that stock prices are generally decreasing^{38, 39}

Price includes: Template/Fabrication/Installation (incl. all seams and site seams) All sink, faucet and cooktop cutouts. Installation of under-mount stainless steel sink. All sweep or 3" radius corners. All finished ends. Delivery (up to 47 miles from the store). Additional option charges may apply.				
Acrylic thickness	Level 0	Level 1	Level 2	Level 3
1½" (3 cm)	\$35/sq.ft.	\$46/sq.ft.	\$56/sq.ft.	-
Quartz thickness	Level 0	Level 1	Level 2	Level 3
¾" (2 cm)	\$43/sq.ft.	-	-	-
1½" (3 cm)	-	\$59/sq.ft.	\$69/sq.ft.	\$89/sq.ft.

Figure 13 – IKEA Sektion price list – FY 2015

³⁷ <https://www.sec.gov/Archives/edgar/data/1504379/000000000016094507/filename1.pdf>

³⁸ http://www.ikea.com/ms/en_US/pdf/buying_guides_fy15/sektion/SEKTION-bg-ct.pdf

³⁹ http://www.ikea.com/ms/en_US/pdf/buying_guides_fy17/SEKTION_countertops_sinks_faucets_bg_080216.pdf

Price includes:
 Template/Fabrication/Installation.
 Two rough cutouts, 3 faucet cutouts.
 Delivery (see local store for details).
 Additional option charges may apply.
 Limited lifetime warranty.

	Level 0	Level 1	Level 2	Level 3	Level 4
Acrylic thickness	Level 0	Level 1	Level 2		-
1 1/2" (3cm)	\$39/sq.ft	\$49/sq.ft	\$59/sq.ft		-
Quartz thickness	Level 0	Level 1	Level 2	Level 3	Level 4
3/4"	\$45/sq.ft	-	-		-
1 1/4"	-	\$53/sq.ft	\$61/sq.ft	\$69/sq.ft	\$77/sq.ft
FIXA bracket 702.746.28	\$2.99				

Figure 14 – IKEA Sektion price list – FY 2015

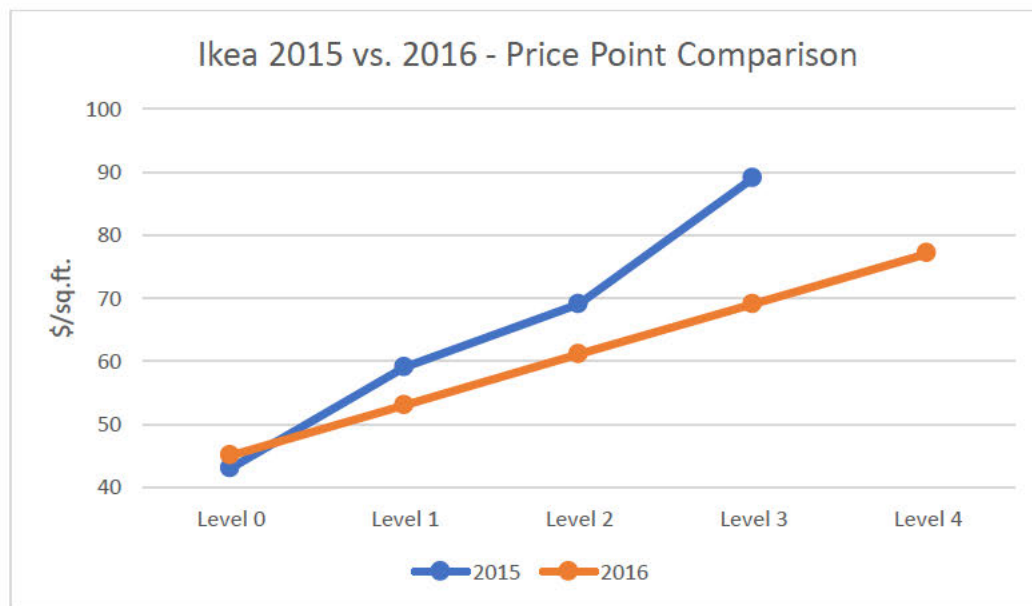


Figure 15 – IKEA Sektion prices yoy

Note that "Level 0" items are a thinner, 3/4" thick product. No contractors recommended buying Quartz this thin as it was much more prone to cracking from impacts or weight.

2015 Revenue movement concerns:

CSTE was also made to amend FY 2015 revenue movement. Their explanation is as follows:

Revenues

Revenues increased by \$52.1 million, or 11.6%, to \$499.5 million in 2015 from \$447.4 million in 2014. The increase in revenues resulted from an approximate 15% increase in volume of sales, which contributed approximately \$65 million to revenues, most notably in Canada, the United States and Europe. Higher average selling prices and growth in the business from IKEA, mainly in Canada added approximately \$7 million to revenues. Higher average selling prices were attributable to the introduction of new differentiated products, including the new Calacatta and Statuario designs, increased portion of the Supernatural collection, and selective regional price increases related to exchange rates trends. These factors were partially offset by unfavorable exchange rates which lowered revenues by approximately \$47 million, primarily related to the weakening of the Australian and the Canadian dollar against the U.S. dollar. On a constant currency basis, revenues grew by \$99.0 million in 2015, representing 22.1% growth compared to 2014. Our revenues on a constant currency basis showed double-digit growth in all regions except Israel, our most mature market, which grew 5.3%. The growth was primarily driven by continued demand in the United States, the Company's largest market, which grew by 20.3%. Canada and Australia delivered the highest growth rates on a constant currency basis, growing 41.2% and 24.0%. Growth in Canada was primarily driven by our collaboration with IKEA, continued quartz penetration and improved product offerings. Growth in Australia leveraged continued quartz penetration, improved product offering, price increases to partially offset erosion of the Australian dollar, and a positive-trending housing market.

Figure 16 – Revenue movement explanatory note

Unfavourable movements to the AUD & CAD?

Canada and Australia make up approximately 40% of CSTE's revenue, or c. \$215m. This end figure was negatively impacted by forex movement to the tune of ~ 18%. We question the implication that volume has offset an 18% move in forex. We have already expressed our reservations on CSTE's alleged volume growth:

Geographical Region	Year ended December 31,					
	2016		2015		2014	
	% of total revenues	Revenues in thousands of USD	% of total revenues	Revenues in thousands of USD	% of total revenues	Revenues in thousands of USD
United States	41.3%	\$ 222,597	44.7%	\$ 223,341	41.5%	\$ 185,583
Australia (incl. New Zealand)	24.3	130,910	22.1	110,290	24.0	107,539
Canada	15.9	85,740	14.2	70,739	12.9	57,898
Israel	7.9	42,545	7.9	39,645	9.2	41,286
Europe	4.8	25,606	4.8	23,949	5.2	23,109
Rest of world	5.8	31,145	6.3	31,551	7.2	31,987
Total	100.0%	\$ 538,543	100.0%	\$ 499,515	100.0%	\$ 447,402

Figure 17 – Segment revenue

8. IKEA: Caesarstone's high-margin cannibalisation

Our extensive channel checks identified that CSTE's IKEA offerings are also offered by independent contractors, only IKEA's prices their stock at a 18%-35% discount to CSTE contractors' retail price.

The contractor price list

A USA based CSTE agent was kind enough to provide a copy of his retail price list of CSTE stock, as follows:

Caesar Stone- Contractor Price		
3cm Thick \$81.25/sq.ft.	3cm Thick \$93.75/sq.ft	3cm Thick \$106.25/sq.ft
Atlantic Salt	Alpine Mist	Calacatta Nuvo
Blizzard	Bianco Drift	Statuario Maximus
Buttermilk	Coastal Grey	Statuario Nuvo
Chocolate Truffle	Cosmopolitan White	
Clamshell	Dreamy Marfil	
Concrete	Emperadoro	
Eggshell	Fresh Concrete	2cm Thick \$112.50/sq.ft.
Espresso	Frosty Carrina	Black Crocodile
Ginger	London Grey	Lace
Haze	Nobel Grey	White Crocodile
Jet Black	Piatra Grey	
Lagos Blue	Pure White	
Linen	Raw Concrete	
Misty Carrara	Symphony Grey	
Mocha	Taj Royal	
Nougat	Tuscan Dawn	
Ocean Foam	Urban Safari	
Organic White	Venilla Noir	
Oyster	Vivid White	
Pebble	Woodlands	
Quartz Reflections		
Raven		
Red Shimmer		
Shitake		
Sleek Concrete		
Wild Rice		

Figure 18 – Reseller retail price list

The IKEA Sektion catalogue

Note that many of the above listed designs are also available at Ikea:⁴⁰

⁴⁰ IKEA FY 2017 Sektion catalogue (pg. 9)
http://www.ikea.com/ms/en_US/pdf/buying_guides_fy17/SEKTION_countertops_sinks_faucets_bg_080216.pdf

These colors are available in four edge styles.

Price level 1: 1-6. Price level 2: 7-15. Price level 3: 16-23. Price level 4: 24-29.



Figure 19 – IKEA Sektion catalogue

Despite being identical products, IKEA's buyer catalogue is between 18% and 35% *cheaper* than the regular CSTE agent's retail price, *and includes* installation!⁴¹

⁴¹ IKEA FY 2017 Sektion catalogue (pg. 19)

http://www.ikea.com/ms/en_US/pdf/buying_guides_fy17/SEKTION_countertops_sinks_faucets_bg_080216.pdf

Price includes:
 Template/Fabrication/Installation.
 Two rough cutouts, 3 faucet cutouts.
 Delivery (see local store for details).
 Additional option charges may apply.
 Limited lifetime warranty.

	Level 0	Level 1	Level 2		
Acrylic thickness	Level 0	Level 1	Level 2		-
1 1/2" (3cm)	\$39/sq.ft	\$49/sq.ft	\$59/sq.ft		-
Quartz thickness	Level 0	Level 1	Level 2	Level 3	Level 4
3/4"	\$45/sq.ft	-	-		-
1 1/4"	-	\$53/sq.ft	\$61/sq.ft	\$69/sq.ft	\$77/sq.ft
FIXA bracket 702.746.28	\$2.99				

Figure 20 – IKEA Sektion quartz price list

The consequence

This business model raises two revenue cannibalisation issues that benefit everyone except Caesarstone.

The first obvious issue is: who would (willingly) pay a premium price for an identical product, given the choice (especially an IKEA product)? The answer is "no one". Consumers will obviously opt for the low margin, extremely cheap IKEA product.

Secondly, resellers are increasingly discouraged to sell CSTE products, opting instead for a higher margin, premium products.

The first obvious issue is: who would pay a premium price for an identical product, given the choice (especially an IKEA product)? The answer is "no one". Consumers will obviously opt for the low margin, extremely cheap IKEA product.

9. Silicosis – cost of doing business

The elephant in the room

Silicosis liabilities have a significant range of assumption issues, on the one hand the company made provisions for the legal action to date, after insurance of circa \$19M. So far there had been no provisions for the class-action suit that was filed in 2014 (circa \$56M) , the progress of this case is unknown to date. ⁴²

Prudence dictates that these legal claims should be risked into any price target going forward. ⁴³ CSTE discreetly mention that “Consistent with the experience of other companies involved in silica-related litigation, there may be an increase in the number of asserted claims against us.”

“Consistent with the experience of other companies involved in silica-related litigation, there may be an increase in the number of asserted claims against us.”

⁴² <https://www.sec.gov/Archives/edgar/data/1504379/000117891317000750/zk1719638.htm>

⁴³ <http://www.themarket.com/markets/1.3931649>

10. Caesarstone vs. Silestone – financial comparison

A comparative financial analysis against Silestone (a.k.a. **Cosentino**) reinforces our belief that Caesarstone's financial statements are misrepresented. Specifically:

- Caesarstone's marketing expenses are remarkably low considering they allege to have over 10 times as many distributors in the USA as Silestone.
- Caesarstone's maintenance capex spending is substantially lower than Silestone's, despite CSTE's higher revenues and COGS.
- Silestone's margins are 20% higher, suggesting less volume sold per unit of revenue and therefore lower wear & tear machinery expenses.
- All quartz machinery (incl. frequent wear & tear replacement parts) are bought from niche group of suppliers with limited price variance⁴⁴.

We believe that CSTE is either not properly maintaining its assets, or overstating its sales volume and revenue while PPE remains underutilized.

Unlevered modelling exercise

In order to make a fair comparison, we have derived unlevered operational cash-flows for both businesses over a 5-year period - CSTE ending in FY 2016, Silestone ending FY 2015 as FY 2016 results have not yet been released.

In order to remove the effects of growth, we have estimated maintenance capex as the D&A recorded for the given year. This is fundamentally the value of the assets that will have to be replaced in order for the businesses to continue its operations.

This analysis highlights what was already apparent at first glance of the accounts: Caesarstone's free cash flow is inexplicably and illogically better than its competitors. Note that while we have modelled in CSTE's lower tax rate, this does not affect our comparative analysis conclusions.

Marketing Expenses

CSTE's marketing expenses have averaged around 13% of revenues over the last four years. We derived marketing expenses from Silestone's account by way of elimination⁴⁵, which appear to be in the region of 20% of their revenue over the last 2 years. In any case, Silestone have much higher OPEX overall per Figure 21 below⁴⁶.

As mentioned through this report, CSTE has over 10 times more distributors than Silestone. CSTE's marketing expenses do not reflect this enormous client upkeep with a maintenance cost consequence. This was reflected in our channel checks where a numerous CSTE's listed agents simply did not sell the product.

⁴⁴ <http://www.breton.it/engineeredstone/en#ad-image-0>

⁴⁵ Salaries accounted for, only other costs could be admin, which, given high salaries, are presumably done in house and thus would not be recognised as "External Services".

⁴⁶ Silestone FY 2014 Financial Statements. Note: Note: we were unable to retrieve full financial statements for FY 2015, only raw financial data sourced from S&P Capital IQ.

COSENTINO, S.A.
(Sociedad Unipersonal)
Cuentas de Pérdidas y Ganancias
para los ejercicios anuales terminados en
31 de diciembre de 2014 y 2013
(Expresadas en euros)

	<i>Nota</i>	<i>2014</i>	<i>2013</i>
Importe neto de la cifra de negocios	Nota 26	291.655.784	264.131.104
Ventas		286.555.501	260.710.674
Prestaciones de servicios		5.100.283	3.420.430
Variación de existencias de productos terminados y en curso de fabricación	Nota 15	7.468.244	7.136.254
Trabajos realizados por la empresa para su activo		651.655	6.288.959
Aprovisionamientos		(138.801.356)	(126.368.818)
Consumo de materias primas y otras materias consumibles	Nota 26	(135.522.248)	(123.057.012)
Trabajos realizados por otras empresas		(3.279.108)	(3.311.806)
Otros ingresos de explotación		3.446.629	3.686.231
Ingresos accesorios y otros de gestión corriente		3.312.771	3.570.359
Subvenciones de explotación incorporadas al resultado del ejercicio	Nota 18	133.858	115.872
Gastos de personal		(54.205.168)	(49.414.707)
Sueldos, salarios y asimilados		(41.128.985)	(37.496.500)
Cargas sociales	Nota 26	(13.076.183)	(11.918.207)
Otros gastos de explotación		(58.750.812)	(54.469.858)
Servicios exteriores		(56.263.219)	(51.851.137)
Tributos		(637.226)	(733.653)
Pérdidas, deterioro y variación de provisiones por operaciones comerciales	Nota 13	(773.071)	(1.455.455)
Otros gastos de gestión corriente		(444.674)	(237.045)
Gastos medioambientales	Nota 24	(632.622)	(192.568)
Amortización del inmovilizado	Notas 5 y 6	(18.080.996)	(13.364.085)
Imputación de subvenciones de inmovilizado no financiero y otras	Nota 18	2.390.264	1.901.526
Deterioro y resultado por enajenaciones del inmovilizado	Nota 26	142.305	275.364
Resultados por enajenaciones y otras		142.305	275.364
Otros resultados		(12.457)	(12.666)
Resultado de explotación		35.904.092	39.789.304

Figure 21 – Silestone (Cosentino) Financial Statements FY 2014

Maintenance Capex

As a prelude: all quartz manufacturers buy their machinery from a limited number of manufacturers and suppliers which are niche to the industry. Industry experts and competitors have advised that these machines suffer a measurable amount of wear and tear with parts requiring replacement after a given “mileage” (think of tread on car tires). It is therefore reasonable to assume that CSTE’s depreciation and maintenance capex schedule would be very similar to its competitors. It is not.

Note that we are discussing *maintenance* capex, not any other type of acquisition or expansion based investment outflows, examples of which can be seen over Figures 22 & 23.

Y, PLANT AND EQUIPMENT, NET

	December 31,	
	2015	2014
and manufacturing equipment, net(1)	\$ 218,610	\$ 173,9
ment and furniture	12,757	8,6
les	855	9
nd leasehold improvements	99,607	77,2
enses related to operating lease(2)	939	9
	332,768	261,7
nd depreciation	107,330	88,7
cost	€ 225,438	€ 173,0

Figure 22 – CSTE FY 2015 Financial Statements

Y, PLANT AND EQUIPMENT, NET

	December 31,	
	2016	2015
and manufacturing equipment, net (1)	\$ 231,914	\$ 218,610
ment and furniture	14,828	12,757
les	1,043	855
nd leasehold improvements	106,422	99,607
enses related to operating lease (2)	939	939
	355,146	332,768
nd depreciation	132,328	107,330
cost	\$ 222,818	\$ 225,438

Figure 23 – CSTE FY 2016 Financial Statements

Our analysis removed the capital structure effects on the business, transaction costs, minority interest earnings, and one-time costs. The results can be found on the next the page and are labelled Figures 24 & 25.

EBITDA Margins

Readers should also note that Silestone's EBITDA margins have also declined by over 6 percentage points over the last 5 years, reflecting the increasingly competitive market in which it operates. Despite having substantially lower gross margins (almost 20 percentage points!), CSTE's EBITDA has grown in the midst of competition and has overtaken Cosentino's margins!

This means CSTE had to make up more than 20 percentage points of revenue in savings from marketing or staff cuts just to make up the proportional COGS difference between the two.

NOTE: CSTE figures are in USD, Cosentino figures are in EUR

COSENTINO	2010	2011	2012	2013	2014	2015
Revenue	248.3	231.0	253.0	283.4	305.8	367.1
Cost Of Goods Sold	94.2	95.3	104.4	126.4	138.8	153.7
Gross Profit	154.2	135.7	148.6	157.1	167.0	213.4
<i>Gross Margin</i>	<i>62%</i>	<i>59%</i>	<i>59%</i>	<i>55%</i>	<i>55%</i>	<i>58%</i>
Selling General & Admin Exp.	(91.3)	(83.9)	(94.9)	(101.5)	(111.1)	(145.0)
Depreciation & Amort.	(21.4)	(17.6)	(13.1)	(13.4)	(18.1)	(32.9)
Other Operating Expense/(Income)	(2.1)	(1.8)	(2.7)	(2.4)	(1.9)	(2.7)
Operating Expenses (incl. D&A)	(114.8)	(103.3)	(110.7)	(117.3)	(131.0)	(180.6)
Operating Income	39.4	32.4	37.9	39.8	35.9	32.8
EBITDA	60.8	50.0	51.0	53.2	54.0	65.7
<i>Margin</i>	<i>24.5%</i>	<i>21.7%</i>	<i>20.1%</i>	<i>18.8%</i>	<i>17.7%</i>	<i>17.9%</i>
Unlevered Assumptions						
EBIT	39.4	32.4	37.9	39.8	35.9	32.8
Tax (25% tax rate)	(9.8)	(8.1)	(9.5)	(9.9)	(9.0)	(8.2)
Add: D&A	21.4	17.6	13.1	13.4	18.1	32.9
Unlevered Cashflow From Ops (exp.)	50.9	41.9	41.5	43.2	45.0	57.5
Capex (assume D&A for maintenance)	(21.4)	(17.6)	(13.1)	(13.4)	(18.1)	(32.9)
Cash from ops/ CAPEX	2.382	2.383	3.166	3.233	2.489	1.747
FCF	29.5	24.3	28.4	29.8	26.9	24.6
COGS	94.2	95.3	104.4	126.4	138.8	153.7
Capex/COGS	(0.227)	(0.184)	(0.126)	(0.106)	(0.130)	(0.214)

Figure 24 – Cosentino Unlevered Maintenance Cashflow Assumptions

CAESARSTONE	2011	2012	2013	2014	2015	2016
Revenue	259.7	296.6	356.6	447.4	499.5	538.5
Cost Of Goods Sold	149.6	168.3	197.7	257.5	299.3	326.1
Gross Profit	110.1	128.3	158.8	189.9	200.2	212.5
<i>Gross Margin</i>	<i>42%</i>	<i>43%</i>	<i>45%</i>	<i>42%</i>	<i>40%</i>	<i>39%</i>
Selling General & Admin Exp.	(64.8)	(76.3)	(84.1)	(92.0)	(96.1)	(110.5)
Depreciation & Amort. (incl. in SG&A)	(11.2)	(10.5)	(11.6)	(14.0)	(19.2)	(25.9)
R & D Exp.	(2.5)	(2.1)	(2.0)	(2.6)	(3.1)	(3.3)
Operating Expenses (incl. D&A)	(67.3)	(78.4)	(86.1)	(94.6)	(99.2)	(113.8)
Operating Income	42.8	49.8	72.7	95.3	101.0	98.7
EBITDA	54.0	60.4	84.4	109.2	120.3	124.6
<i>Margin</i>	<i>20.8%</i>	<i>20.4%</i>	<i>23.7%</i>	<i>24.4%</i>	<i>24.1%</i>	<i>23.1%</i>
Unlevered Assumptions						
EBIT	42.8	49.8	72.7	95.3	101.0	98.7
Tax (15% tax rate)	(6.4)	(7.5)	(10.9)	(14.3)	(15.2)	(14.8)
Add: D&A	11.2	10.5	11.6	14.0	19.2	25.9
Unlevered Cashflow From Ops (exp.)	47.6	52.9	73.4	95.0	105.1	109.8
Capex (assume D&A for maintenance)	(11.2)	(10.5)	(11.6)	(14.0)	(19.2)	(25.9)
Cash from ops/ CAPEX	4.255	5.018	6.318	6.795	5.463	4.235
FCF	36.4	42.4	61.8	81.0	85.9	83.9
COGS	149.6	168.3	197.7	257.5	299.3	326.1
Capex/COGS	(0.075)	(0.063)	(0.059)	(0.054)	(0.064)	(0.080)

Figure 25 – CSTE Unlevered Maintenance Cashflow Assumptions

Comparison to actual figures

Cosentino spent c. €33.5m (US\$43m, assuming a conservative €1 = US\$1.3) on PPE in FY 2014. Cosentino did not expand its operations in 2014.

	2014	2013
Flujos de efectivo de las actividades de explotación		
Resultado del ejercicio antes de impuestos	39.457.940	38.520.075
Ajustes del resultado		
Amortización del inmovilizado	18.080.996	13.364.085
Correcciones valorativas por deterioro	1.296.516	1.488.925
Variación de provisiones	61.999	(514.959)
Imputación de subvenciones	(2.390.264)	(1.901.526)
Resultados por bajas y enajenaciones de inmovilizado	142.305	275.364
Ingresos financieros	(5.812.541)	(6.085.120)
Gastos financieros	8.739.003	7.217.543
Diferencias de cambio	(11.478.544)	597.667
Cambios en el capital corriente		
Existencias	(5.972.937)	(8.786.796)
Deudores y cuentas a cobrar	(8.035.064)	7.965.428
Otros activos corrientes	(699.123)	(36.502.884)
Acreedores y otras cuentas a pagar	44.797.573	24.828.561
Otros pasivos corrientes	(14.761.782)	1.531.939
Otros activos y pasivos no corrientes	(7.421.351)	(2.300.079)
Otros flujos de efectivo de las actividades de explotación		
Pagos de intereses	(8.739.003)	(7.217.543)
Pagos por impuestos sobre beneficios	(10.094.072)	(8.143.723)
Cobros de intereses	5.812.541	6.085.120
Flujos de efectivo de las actividades de explotación	42.984.192	30.422.077
Flujos de efectivo de las actividades de inversión		
Pagos por inversiones		
Empresas del grupo y asociadas	(10.712.481)	(11.188.317)
Inmovilizado intangible	(132.838)	(814.909)
Inmovilizado material	(33.552.875)	(42.878.933)
Otros activos financieros	(611.705)	(1.711.078)
Otros activos	(416.804)	(663.817)
Cobros por desinversiones		
Empresas del grupo y asociadas	14.636.214	7.909.157
Inmovilizado material	824.985	6.508.989
Otros activos financieros	52.324.600	(74.577.871)
Flujos de efectivo de las actividades de inversión	22.359.096	(117.416.779)

Figure 26 – Cosentino FY 2014 Statement of cash flows extract

Cosentino's sales in FY 2014 were €291m, or US\$378m

In 2016, which was a non-expansionary year for CSTE, it spent a mere US\$23m on PPE:

	2016
Cash flows from operating activities:	
Net income	\$ 76,483
Adjustments required to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	28,254
Share-based compensation expense	3,068
Accrued severance pay, net	(150)
Changes in deferred tax, net	(963)
Capital loss from sale of property, plant and equipment	32
Compensation paid by a shareholder	266
Increase in trade receivables	(4,184)
Decrease (increase) in other accounts receivable and prepaid expenses	(5,617)
Increase in inventories	(5,376)
Increase (decrease) in trade payables	1,424
Increase (decrease) in warranty provision	100
Legal settlements and loss contingencies, net	5,868
Increase (decrease) in accrued expenses and other liabilities including related party	2,314
Net cash provided by operating activities	101,519
Cash flows from investing activities:	
Redemption of short-term deposits	60
Acquisition of the business of Prema Asia Marketing PTE Ltd. (see also Note 1(b))	-
Purchase of property, plant and equipment	(22,943)
Proceeds from sale of property, plant and equipment	22
Decrease (increase) in long-term deposits	(452)
Net cash used in investing activities	(23,313)

Figure 27 – CSTE FY 2016 Statement of cash flows extract

As a means of comparison, consider the following:

- CSTE's FY 2016 revenue was US\$538m, against US\$378m by Silestone in FY 2014.
- CSTE's gross margin was 39%, compared to Silestone's 57%.

Given all the machinery and frequent wear and tear parts are provided by, fitted and maintained by a limited number of niche suppliers with limited cost variables, it is reasonable to presume that :

- Cost per unit of volume sold in both factories are the roughly the same
- Silestone's higher margin suggests less sales volume is required per US\$1 of revenue.
- Silestone's would be expected to require less maintenance costs associated with wear and tear

We note that the suppliers for the equipment are based in the Euro zone, however even the appreciation of the USD does not compensate for this massive discrepancy.

We have no idea how CSTE can spend so little on its CAPEX; but we can hazard a guess. We believe maintenance is down because production is down, either that or CSTE is failing to maintain its machines in good order.

Both are equally damning.

We believe the SEC are similarly suspicious on CSTE's incredible margins and low maintenance capex. It issued a letter on 26 September 2016 asking why US production lines and Israel production lines are aggregated into a single reporting segment, reducing visibility on utilisation of each plant⁴⁷:

⁴⁷ <https://www.sec.gov/Archives/edgar/data/1504379/000000000016094507/filename1.pdf>

7. We refer to your previous assertion that your subsidiaries have similar economic characteristics, and therefore, you aggregate your operating segments into a single reportable segment. Please demonstrate to us that the start-up of the U.S. production lines has not materially changed the economic characteristics of Caesarstone USA such that all of your aggregated operating segments remain economically similar.

Figure 28 – SEC Letter Extract – September 26 2016

We believe it would be prudent for the SEC to persist in this matter, as the financial evidence suggests that it is not feasible for CSTE to achieve their reported results. We believe transparency into CSTE's reportable segments would ultimately prove our thesis.

11. Market data: The gaping hole in CSTE's market penetration logic

In each year's financial statements CSTE give a breakdown of global countertop markets and demand developed "independently" by Freedonia Market Research, who conducted the research "on behalf of" CSTE⁴⁸. We have reservations on the accuracy of this data because:

- Contrary to CSTE's suggestions of independence, Freedonia's data should not be considered independent. Freedonia source information from CSTE themselves and are compensated for the data by CSTE!⁴⁹
- Freedonia's pie charts do not reconcile with CSTE's revenues and alleged market penetration.

Relevant data is as follows:

The global countertop industry generated approximately \$95 billion in sales to end consumers in 2016 based on average installed price, which includes fabrication, 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. The following charts show the global countertop market by region and by material, based on sales to end-users in 2016:

Figure 29 – Global countertop market

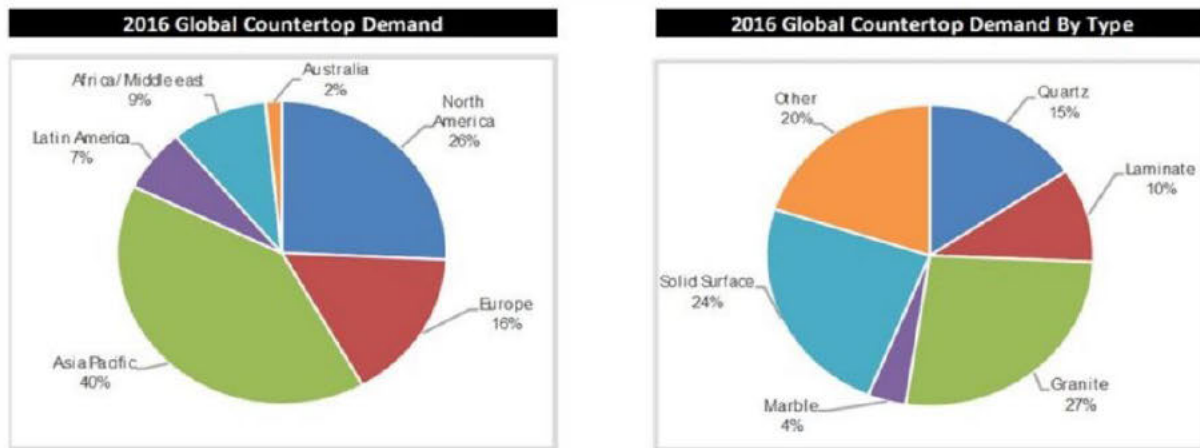


Figure 30 – Geographical & material distribution

Quartz penetration in our key markets

	For the year ended December 31,			
	2016	2014	2012	2010
United States	14%	8%	6%	5%
Australia (not including New Zealand)	45%	39%	35%	32%
Canada	24%	18%	12%	9%
Israel	87%	86%	85%	82%

Figure 31 – CSTE market penetration in key markets

⁴⁸ CSTE FY 2016 Financial Statements (pg. 4) http://files.shareholder.com/downloads/AMDA-EF2TF/4191133591x0x932856/DFCF7C3C-5B79-4C84-B0BC-0A5A9E349A63/2016_Caesarstone_Annual_Report.pdf

⁴⁹ Refer to Spruce Point Capital CSTE Research, August 19 2015 (pg. 44) - <http://www.sprucepointcap.com/cste-ltd/>

Geographical Region	Year ended December 31,					
	2016		2015		2014	
	% of total revenues	Revenues in thousands of USD	% of total revenues	Revenues in thousands of USD	% of total revenues	Revenues in thousands of USD
United States	41.3%	\$ 222,597	44.7%	\$ 223,341	41.5%	\$ 185,583
Australia (incl. New Zealand)	24.3	130,910	22.1	110,290	24.0	107,539
Canada	15.9	85,740	14.2	70,739	12.9	57,898
Israel	7.9	42,545	7.9	39,645	9.2	41,286
Europe	4.8	25,606	4.8	23,949	5.2	23,109
Rest of world	5.8	31,145	6.3	31,551	7.2	31,987
Total	100.0%	\$ 538,543	100.0%	\$ 499,515	100.0%	\$ 447,402

Figure 32 – CSTE market penetration in key markets

Consider the following

You could calculate CSTE's alleged 14% quartz penetration in the USA backwards. CSTE's North American revenue should be as follows according to Freedonia data:

$$\begin{aligned}
 &\$96,000m \text{ Global Sales} \times 15\% \text{ Quartz Preference} \times 26\% \text{ North Am. Segment} \\
 &\quad \times 14\% \text{ CSTE US Market Penetration} = \$524m
 \end{aligned}$$

\$524m is 97% of total revenues in FY 2016, and 70% more than CSTE's reported North American segment revenue of \$308m.

The pie charts provided by management separate geographies and countertop type demands based on *volume*, not revenue. However if we were to translate these pie charts *into* revenue, we would expect that:

- Premium countertop materials (Granite, Marble and Quartz) would be more heavily weighed than non-premium products (laminare, solid surface, other), as premium products are obviously more expensive. For example, where Quartz represents 15% of countertops by volume, we would expect it to represent >15% by revenue.
- Developed geographies would be more heavily weighted than less-developed geographies. For example, we would expect a countertop to be more expensive in North America than in Latin America or Asia. Therefore North America's demand distribution of revenue would be greater than its distribution of volume (i.e. >26%)

North America/Granite would have a larger revenues relative to volumes, making our calculations conservative.

We back tested these calculations using Australian geographical data. CSTE's Australian segment comprises 24.3% of total revenue, with market volume comprising (allegedly) 2% of global demand and where they claim to have 45% market penetration. Therefore:

$$\begin{aligned}
 &\frac{45\% \times 2\%}{24.3\%} = \text{Global portion of revenues from 1\% of their sales} = 0.037 \\
 &0.037 \times (41.3\% + 15.9\%) = \text{CSTE North Am. sales as \% of global sales} = 2.116\% \\
 &\frac{2.116\%}{26\% \text{ (North Am. \% of global demand)}} = \mathbf{8.14\% \text{ market penetration in USA}}
 \end{aligned}$$

CSTE alleges 14% market penetration in North America.

Whilst this calculation does not consider countertop material preference by geography or even by volume, **it would certainly be a stretch to say that the product mix of surfaces in Australia is so substantially different to that of the USA**, as the calculation is derived from Australian figures.

The mismatch speaks volumes. We believe either:

- **CSTE's performance is not correlated to the global market** in which case the data is useless.
- **CSTE's market penetration figures are inflated** in which case the data is wrong

Year-on-year quartz growth

The surface demand mix increase yoy for quartz countertops appears extreme considering that:

- There was an obvious recommendation and sales data channel checked countertop fitters which suggest a preference towards granite or quartz.
- Granite and quartz are the same price

While Quartz surface has grown in the product mix by 50% since 2014, granite's mix has stayed flat:

2014 Global Countertop Demand by Material

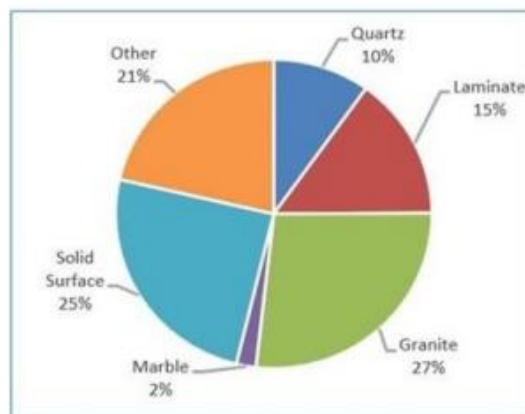


Figure 33 – 2014 Global countertop demand by type

2016 Global Countertop Demand By Type

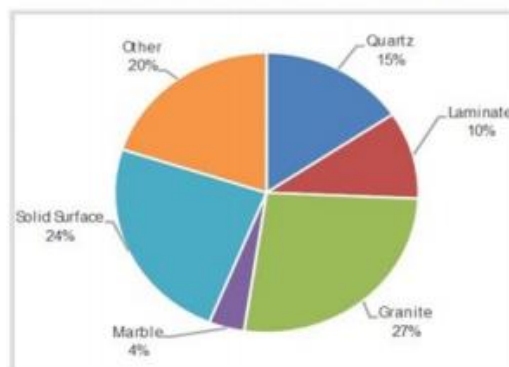


Figure 34 – 2016 Global countertop demand by type

Key takeaways

We believe Freedonia's marketing material is a redundant exercise, and the SEC should seek more clarity into:

- Verification of CSTE's geographical segment data
- Authentication of CSTE's market research data

12. Market Highlights, some key points investors should be aware of.

Stifel analysts recently (March 2017) upgraded the stock after their last earnings report. CSTE has guided for lower earnings power this year, yet the stock is up significantly YTD. These are the same analysts who said “buy” in early 2015 the peak prices.

CSTE has materially missed its capex costs for the Georgia facility and continually revised earnings lower.

Slide 13 of Spruce Point report⁵⁰ details the repeated raising of capex guidance associated with the Georgia plant. We know now that the Georgia plant has not performed up to expectations and been a drag on margins.

Q4'14 Results (Feb 2015)⁵¹

- **Company Issues FY15 Guidance, expects continued growth**
- Taking into consideration, among other items, current exchange rates and the temporary inefficiencies associated with opening its new U.S. manufacturing facility, it expects its 2015 revenues to be in the range of \$515 million to \$525 million, and adjusted EBITDA to be in the range of \$123 million to \$129 million
- Stock moves higher

Q2'15 Results (August 2015)⁵²

- **Reiterates. Full Year Adjusted EBITDA Guidance on lower revenue expectations**
- The Company's U.S. manufacturing facility in Richmond Hill, Georgia remains on track, with the first line in the U.S. now operational, and the second line in the U.S. expected to begin production in the fourth quarter of 2015.
- The Company today reiterated its guidance for full-year adjusted EBITDA of \$123 to \$129 million and commented that it now expects to achieve that range with better than previously expected margins.
- As a result of slightly lower-than-expected U.S. growth and the further negative impact of foreign exchange rates, the Company moderated its full-year revenue guidance to a new range of \$495 million to \$505 million as compared to its prior range of \$515 million to \$525 million.
- The stock corrects lower significantly.
- Spruce Point report follows.

Q4'15 Results (Feb 2016)⁵³

- Issues disappointing guidance.
- Says “The Company is ramping up its U.S. manufacturing facility in Richmond Hill, Georgia with both lines operating at a higher pace. This ramp will enable the Company to better serve the U.S. market and support the Company's ongoing growth.”

⁵⁰ <http://www.sprucepointcap.com/cste-ltd-followup/>

⁵¹ https://www.sec.gov/Archives/edgar/data/1504379/000117891315000414/exhibit_99-1.htm

⁵² https://www.sec.gov/Archives/edgar/data/1504379/000117891315002495/exhibit_99-1.htm

⁵³ https://www.sec.gov/Archives/edgar/data/1504379/000117891316004262/exhibit_99-1.htm

- Announces buyback.
- The stock declines significantly but bounces back on the support of the corporate buyback.

Q1'2016 (May 2016) ⁵⁴

- Company reiterates full year guidance, stock rallies.
- CEO Shiran abandons what we believe is a sinking ship, just 20 days after reiterating full year guidance⁵⁵.

Nov 2, 2016 Q3 ⁵⁶

- CSTE Revises 2016 Guidance downward significantly.

Q4'16 Results (Feb 2017) ⁵⁷

- CSTE issues guidance which shows revenue growth, but a decline in adjusted EBITDA (and by extension EPS)
- The Company issued guidance for the full-year of 2017. It expects its 2017 revenue to be in the range of \$580 million to \$595 million, and adjusted EBITDA to be in the range of \$119 million to \$126 million.
- Company promotes the Lowe's deal

Takeaway - Looking back you can see this 2017 EBITDA range is even lower than the range that was forecasted in the same period in 2015!

CSTE Stifel analyst ascribes a 9% improvement in numbers for the full year 2017. They best get their skates on as near two quarters are over and we have found no evidence of CSTE's sub-premium Transform product at Lowe's.

March 24, 2017

- Stifel analyst upgrades to buy
- Shares rallied post publication

⁵⁴ https://www.sec.gov/Archives/edgar/data/1504379/000117891316005256/exhibit_99-1.htm

⁵⁵ https://www.sec.gov/Archives/edgar/data/1504379/000117891316005512/Exhibit_99-1.htm

⁵⁶ https://www.sec.gov/Archives/edgar/data/1504379/000117891316006751/exhibit_99-1.htm

⁵⁷ https://www.sec.gov/Archives/edgar/data/1504379/000117891317000338/exhibit_99-1.htm

13. Conclusion

Due to the irregularities displayed in CSTE's accounts, we have not derived a target price, as we would have incorporated too many assumptions.