

Are you not entertained?!

Returning fire on Otzar Capital's Caesarstone report

- Viceroy find Otzar Capital's ties to one of Israel's larger investment relations & public relations groups concerning, especially considering the potential connections between the IR/PR and Otzar's reports. We have provided a portfolio of evidence in this regard to the SEC.
- Viceroy have concerns that the Investors may have entered into such investments with what appears to be a lack of disclosure.
- Otzar's report completely glosses over significant arguments made in our first report, including the pending silicosis class action, disappearing dividends and stock buybacks and nonsensical market data.
- Otzar had to go all the way to suburban Miami to meet a Lowe's retailer that sold Caesarstone's transform. Congratulations, you got us.
- Otzar's most convincing arguments: our misuse of Cosentino's major subsidiary vs the consolidated group accounts (which we are still unable to verify but will give the benefit of the doubt) **adds to our thesis**. Competitor margins in the consolidated numbers presented by Otzar are even smaller than Viceroy's previous figures, making Caesarstone's margins even more outrageous and enforcing our belief that Caesarstone's costs are understated.
- Otzar's management and supplier derived volume calculations imply that either resellers are operating on ~300% mark-ups or Caesarstone's facilities are producing well below capacity, yet amazingly they look to be correct! If this is the case, why build more lines?

"One of the main drivers of this report is to right the wrongs as laid out in the recent report by Viceroy. Thus the format of this report will review many of the claims in Viceroy's recent short report, test their validity and demonstrate how it is neither truthful, nor accurate."

- Otzar Capital



Contents

Disclaimer.....	3
1. Summary	4
2. Cannibalization.....	6
3. Average selling prices (ASPs)	7
4. Financial Comparison between Caesarstone & Cosentino	9
5. Caesarstone invests highly in equipment	10
6. The Leading Quartz Brand.....	10
7. Distribution & marketing	11
8. Transform product is actually sold at Lowe's	12
9. Increased Competition.....	13
10. Guidance	14
11. US Growing Pains will subside post 2018.	15
12. Breton quality claims	15
13. Inventory.....	16
14. Conclusion.....	16

Disclaimer

This report has been prepared for educational purposes only. This report and any statements made in connection with it are the authors' opinions, which have been based upon publicly available facts, field research, information, and analysis through our due diligence process, and are not statements of fact. This document or any information herein should not be interpreted as an offer, a solicitation of an offer, invitation, marketing of services or products, advertisement, inducement, or representation of any kind, nor as investment advice or a recommendation to buy or sell any investment products or to make any type of investment, or as an opinion on the merits or otherwise of any particular investment or investment strategy.

Any examples or interpretations of investments and investment strategies or trade ideas are intended for illustrative and educational purposes only and are not indicative of the historical or future performance or the chances of success of any particular investment and/or strategy.

As of the publication date of this report, you should assume that the authors have a direct or indirect interest/position in all stocks (and/or options, swaps, and other derivative securities related to the stock) and bonds covered herein, and therefore stand to realize monetary gains in the event that the price of either declines.

The authors intend to continue transacting directly and/or indirectly in the securities of issuers covered on this report for an indefinite period and may be long, short, or neutral at any time hereafter regardless of their initial recommendation.

1. Summary

Viceroy Research has been made aware of a research piece by Otzar Capital titled “Solid as a Rock: Sifting Fact from Fiction”, which was a focused rebuttal aimed at discrediting our short report on Caesarstone (NASDAQ:CSTE). We welcome feedback on our work.

As a prelude, we make note that Otzar is tied to an Israeli-based public relations contractor group consisting of:

- GK Investor Relations (GKIR)
- GK Public Relations
- Gelbart Kahana Investor Relations & Business Communication

*Collectively referred to as **the GK Group** in this report*

This was uncovered through publicly available information and channel checks conducted by Viceroy which, amongst other things, show Otzar’s emails are mailed from GKIR servers (and implying Otzar’s website is possibly hosted on a GKIR server).

The GK Group’s clients consist of numerous high-profile companies subject of Otzar long reports, and clients’ competitors subject to Otzar short reports.

We have presented a portfolio of evidence to the SEC in this regard as we believe this may be indicative of a stock promotion scheme, and have advised Otzar Capital of same. As a response, Otzar took down their website.

Cannibalization

“Lowe’s, as opposed to Ikea, is offering only the 13mm overlay which is more of a niche market focused on remodelling’s and therefore, unlikely to cannibalize sales from other stores.” – Otzar Capital Report

As you can see, Otzar’s argument against cannibalization appears to be based on a tenuous grasp of the concept, and is undermined by Caesarstone’s continuing deals with large retails chains.

Average selling prices (ASPs)

Otzar’s calculations on ASP’s appear to be spot on. This suggests that re-sellers are marking up prices to the tune of ~277% for *low end* products, and Ikea are marking up its range by, at least, 109% for its least popular, ¾” product.

A more conservative (but still very optimistic) mark-up of 50% at Ikea and 130% at resellers, a more realistic ASP would be \$35/sq ft. If we were to play along and assume Otzar’s volume calculations are accurate – and they appear to be accurate – this would indicate Caesarstone is operating well below capacity and in line with peers for which Otzar has also calculated volumes.

Caesarstone appears to be producing below capacity or there is a massive stockpile of excess off-balance sheet inventory which Caesarstone can’t sell. Both outcomes give rise to the question of why they are building more production lines.

Comparison with Cosentino

Giving Otzar the benefit of the doubt on Cosentino's consolidated results: the consolidated figures in Otzar's report show Caesarstone's EBITDA margin is 12 percentage points higher than an allegedly larger economy of scale competitor! This is even more extraordinary than compared with the supposed subsidiary results we presented in our original report.

Otzar's arguments provide no substantive information as to why Caesarstone's financial performance is so spectacular alongside a competitor which makes like-for-like the same product, selling those products at approximately the same prices, with equipment sourced from the same manufacturer, and selling to like-for-like the same geographies.

Transform actually sold at Lowe's!

Otzar had to go all the way to suburban Miami to meet a Lowe's retailer that sold Caesarstone's transform. Congratulations are in order.

Our questioning of customer service at various levels, which we have kept records, are extremely extensive. We spent time hounding Lowe's to let us know when CSTE's transform would hit the shelves, appear on pre-order, or be catalogued at any store and we remain highly convicted that the whole concept is purely a marketing gimmick.

We also point out that the evidence of Lowe's stocking of Transform is what appears to be some colour swatches and a large-form pamphlet. Our post-Otzar channel checks in Florida, Texas and Utah again showed no results for any Caesarstone products, including Transform.

Caesarstone's revamped reseller list

Since the publication of our report, Caesarstone have revamped the reseller list on their website. However, even post-revamp of the "where to buy" section of Caesarstone's website, we have found "Elite" resellers who have never stocked the product!

***ELITE RETAILER:**

Caesarstone Elite Retailers, and exclusive partners, are carefully selected to deliver an unmatched shopping experience. Each showroom features our entire collection of products, including Concetto.

***PREMIER RETAILER:**

Caesarstone Premier Retailers deliver a superior shopping experience by showcasing our unique collection of Classico and Motivo products.

***PREFERRED RETAILER:**

Caesarstone Preferred Retailers provide a remarkable shopping experience by highlighting our complete collection of Classico products.

Figure 1 Elite Retailer Definition CSTE USA – 18 July 2017¹

¹ Caesarstone – Where To Buy

<http://www.caesarstoneus.com/how-to-buy/>

2. Cannibalization

Otzar says: Cannibalization is not an issue.

Viceroy say: Otzar do not appear to understand the concept of cannibalization – the numbers don't lie.

"Furthermore, there are more, higher-end, options that are available at other premium kitchen and bath stores that are not available to Ikea." - Otzar Capital Report

Correct. Caesarstone is limiting its resellers to competing with a multinational big box hardware retailer in the low/mid-end market. The only competitive advantage resellers have is the sale of premium products, which do not form the majority of Caesarstone sales.

This is supported by Caesarstone's falling margins year-on-year since it signed its exclusivity agreement with Ikea in 2013.

	2013	2014	2015	2016
Revenue	\$356,554	\$447,402	\$499,515	\$538,543
Ebitda	\$91,711	\$116,553	\$125,667	\$130,260
<i>margin</i>	25.72%	26.05%	25.16%	24.19%
Net Income	\$64,353	\$80,259	\$79,458	\$76,483
<i>margin</i>	18.05%	17.94%	15.91%	14.20%

To support their argument, Otzar announced:

"We visited some local high-end kitchen stores to gain insight in customer purchase patterns." - Otzar Capital Report

We question the logic of visiting high-end resellers to obtain knowledge about low and middle range cannibalization. *Of course* they are likely to report low incidences of cannibalization because their market share was never really at risk, but it will be.

Caesarstone's recent announcement of a supply agreement of the entire Caesarstone range at Nebraska Furniture Mart further cements our assertion that Caesarstone is effectively cannibalizing market share by undercutting high-end distributors who now face competition from large chain retailers.

*We would like to highlight that Caesarstone's announcement to sell their **entire** existing and new ranges at Nebraska Furniture Mart is effectively an elimination of the **one** remaining competitive advantage its resellers had.*

Otzar goes on to say:

"Lowe's, as opposed to Ikea, is offering only the 13mm overlay which is more of a niche market focused on remodelling's and therefore, unlikely to cannibalize sales from other stores." - Otzar Capital Report

Now you can add elegance to your home by resurfacing your countertops with the premium look and long lasting quality of Caesarstone in just hours. Transform by Caesarstone is a custom quartz overlay that's professionally applied on top of your existing countertops, giving you a luxurious update without the time, tear-out, and cost of a full countertop remodel.

Figure 2 Caesarstone Transform Web Page ²

The two statements above; one from Caesarstone, the other from Otzar, are in direct contradiction. If Transform reduces the need for a full countertop remodel then surely those customers now no longer need to purchase countertops from other stores.

Otzar's argument against cannibalization appears to be based on a tenuous grasp of the concept, and is undermined by Caesarstone's continuing deals with large retail chains. In light of this we do not see a bright future for Caesarstone's margins or its sales at resellers outside big-box chains.

3. Average selling prices (ASPs)

Otzar says: Average selling prices are falling. Currently estimated at ~\$21.5/sq. foot.

Figure 15: Estimate Volume and Units Sold Since IPO							
	2010	2011	2012	2013	2014	2015	2016
Revenue (\$K)	na	259,671	296,564	356,554	447,402	499,515	538,543
ASP per unit estimated (\$)	na	843	882	923	1,007	978	982
ASP per sq. meter est. (\$)	na	198	208	217	237	230	231
ASP per sq. foot est. (\$)	na	18.4	19.3	20.2	22.0	21.4	21.5
Unit volume estimated (K)	290	308	336	386	444	511	548
Volume Growth (reported)	na	6.0%	9.2%	14.9%	~15%	~15%	7.3%

Source: Otzar Estimates, volume growth and revenue as reported in annual reports

Figure 3 Otzar Estimated Volume and Units Sold calculations ³

Viceroy say: We know ASP's are falling. An ASP of \$21.5 would represent a ~277% mark-up at resellers and MINIMUM 100% mark-up at *IKEA*.

Otzar's calculations on ASP's appear to be spot on. There is a problem however: **the implied margins that resellers and Ikea are making would be immense.**

Per our previous report, we obtained retailer price lists suggesting Caesarstone's low-end products retail for ~\$87/sq. foot. This suggests that re-sellers are marking up prices something in the region of 277%. That's literally unbelievable - Caesarstone would be getting ripped off!

Alternatively, margins are marked up by resellers purposefully to include a number of free items including white goods, sinks as often is the case fitting. This would further diminish Caesarstone's claim of being a premium producer.

² Caesarstone – Transform

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

³ Otzar Report – page 23

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	\$112.50/sq.ft.
Eggshell	Fresh Concrete	2cm Thick
Espresso	Frosty Carrina	Black Crocodile
Ginger	London Grey	Lace
Haze	Nobel Grey	White Crocodile
Jet Black	Platra Grey	
Lagos Blue	Pure White	
Linen	Raw Concrete	
Misty Carrara	Symphony Grey	
Mocha	Taj Royal	
Nougat	Tuscan Dawn	
Ocean Foam	Urban Safari	
Organic White	Vanilla Noir	
Oyster	Vivid White	
Pebble	Woodlands	
Quartz Reflections		
Raven		
Red Shimmer		
Shitake		
Sleek Concrete		
Wild Rice		

Figure 4 Retail re-seller price list sample – obtained by Viceroy

Similarly, IKEA would be imposing, at a minimum, a mark-up of 109% for its ¾” offering, which we understand is the least common, and 152% for its low-end 1 ¼” slabs. **This would be well above Ikea’s gross margin of 50%, and Ikea’s consolidated group is mostly vertically integrated!**

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					-
1 1/2" (3cm)	\$39/sq.ft	\$49/sq.ft	\$59/sq.ft		-
Quartz thickness				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 5 IKEA SEKTION price list - 2017 ⁴

Simply put, Otzar’s ASP calculations appear absurdly low...and yet:

“According to management, the full year revenue capacity of a single line at Caesarstone is around \$100 million per line.” - Otzar Capital Report

“Given that some downtime is required to clean and maintain lines as well as switch product ingredients, we will assume the lines are producing two-third (67%) of the day. We assume the lines are operating on all work days (305 in a typical year with a six day work week in Israel).” - Otzar Capital Report

⁴ Ikea SEKTION - Countertops Sinks and Faucets

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

We are kicking ourselves for not coming up with this. It would have been great for our short thesis! The above production and value calculations imply Caesarstone's inventory is far in excess of the amount reported or they are producing far under capacity.

If we play along and assume Otzar's volume calculations are accurate (they appear accurate), and assume a more conservative (but still very optimistic) mark-up of 50% at Ikea and 130% at resellers, a more realistic ASP would be \$35/square ft.

If Caesarstone's lines were running at full capacity as claimed by Otzar, who derived calculation on the back of advice from Caesarstone's management and machinery supplier, then there would be a MAJOR excess inventory lying around somewhere...or Caesarstone are producing well below capacity.

So, either:

- a. Caesarstone is not producing at capacity, giving rise to the question of why they are building more lines. Spruce Point's follow up report suggests Caesarstone's facilities are substantially more expensive to build than competitors on an area basis, which is a major red flag for us⁵.
- b. There is a bunch of inventory lying around which is off balance sheet which Caesarstone can't sell.

Both scenarios give rise to why Caesarstone are building more facilities.

4. Financial Comparison between Caesarstone & Cosentino

Otzar says: Viceroy did not use consolidated account. Grupo Cosentino consolidated earnings are much worse than Cosentino S.A.

Viceroy say: Embarrassing indeed, but Otzar have further increased our conviction that Caesarstone's margins are suspect.

Giving Otzar the benefit of the doubt, the consolidated figures increase our belief that Caesarstone's margins are unreal.

Otzar's arguments provide no substantive information as to why Caesarstone's financial performance is so spectacular alongside a competitor which makes like-for-like the same product, with equipment sourced from the same manufacturer and selling to like-for-like the same geographies at similar price points.

The consolidated figures in Otzar's report show Caesarstone's EBITDA margin is 12 percentage points higher than an allegedly larger economy of scale competitor! This is even more extraordinary than compared with the supposed subsidiary results we presented in our original report.

⁵ Downgrading Caesarstone On Concerns About Its Capital Expenditure Accounting And Management's History At Tefron
<https://seekingalpha.com/article/3553876-downgrading-caesarstone-concerns-capital-expenditure-accounting-managements-history-tefron>

5. Caesarstone invests highly in equipment

Otzar says: Caesarstone do not underinvest in maintenance capex.

Viceroy say: Otzar conclusions show that Caesarstone underinvest in maintenance capex.

*“While Cosentino’s retail pricing is similar to Caesarstone and they are using the same Breton machines, their full capacity on their 11 quartz machines would be expected to produce revenues of around \$1.1 billion. Given their overall sales are €730 million which is \$830 million, **and these sales also include granite and natural stone as well as quartz**, it means Cosentino is operating significantly below capacity- greater than 30%.” – Otzar Capital Report*

Implying Cosentino is producing significantly below capacity is only valid if you presume Caesarstone’s results are accurate. We think they are overstated, and that is why we went through all this trouble.

In the end, Otzar’s measure of Cosentino’s D&A / Total Expenses makes sense, but derives the same conclusion as we did in our original thesis:

D&A/Total expenses	2014	2015	2016
Cosentino subsidiary	7.2%	10.9%	9.1%
Cosentino consolidated	5.7%	7.7%	na
Caesarstone	4.9%	5.6%	6.4%

Source: Calculated from reported data in Cosentino annual financial report, Cosentino subsidiary annual financial report and Caesarstone annual report

Figure 6 D&A / Total Expenses – Otzar Report page 16

According to the figures above and our original report Caesarstone appear to be underinvesting in maintenance capex.

6. The Leading Quartz Brand

Otzar says: Caesarstone maintains a solid position in its core markets relative to its peers and leads in operating margins through investment in its premium brand.

Viceroy say: Premium brands are not sold at Ikea, Lowe’s, or Nebraska Furniture Mart.

The assertion that Caesarstone is a premium brand is entirely subjective. Our initial report and Spruce Point's Caesarstone reports both highlight numerous quality issues within Caesarstone which demonstrate the product is no better than any competitor.

Competitors operating at similar economies of scale to Caesarstone offer products at similar prices. Throwing the phrase "Premium Brand" around as a justification for Caesarstone's unreal margins is ludicrous.

On the 24th of July 2017 Caesarstone announced that their **full range of colours** would now be available at all 4 locations of Nebraska Furniture Mart. Nebraska Furniture Mart is the largest home furnishing store in North America whose motto: "you'll get it here for less" make us question how Caesarstone plans to maintain a premium brand image.

7. Distribution & marketing

Otzar says: Short Seller Report is Wrong about Distribution and Marketing.

Viceroy say: Otzar rebuttal nonsensical, validates our argument.

Off the bat, of course we meant resellers. We even used pictures to highlight that were comparing Caesarstone resellers vs Cosentino resellers – Otzar’s wording is semantics.

“Some may be small local K&B shops that may indeed have never had the opportunity to sell a Caesarstone countertop but could potentially order one from Caesarstone for a customer that wants one.” – Otzar Capital Report

Once again we thank Otzar for confirming our argument: that is exactly the issue! When making calls to many distributors in many locations, we encountered numerous examples of listed resellers which have never sold the product. Many of these locations were showrooms, some were stonemasons and others still were kitchen outfitters who largely subcontracted work. With a reseller definition of “could potentially order one” we would question the use of a reseller list in the first place.

Since the publication of our report, Caesarstone has revamped the reseller list on their website. However, even post-revamp of the “where to buy” section of Caesarstone’s website, we have found “Elite” resellers who have never stocked the product!

Here is Caesarstone’s classification of an Elite Retailer:

***ELITE RETAILER:**

Caesarstone Elite Retailers, and exclusive partners, are carefully selected to deliver an unmatched shopping experience. Each showroom features our entire collection of products, including Concetto.

***PREMIER RETAILER:**

Caesarstone Premier Retailers deliver a superior shopping experience by showcasing our unique collection of Classico and Motivo products.

***PREFERRED RETAILER:**

Caesarstone Preferred Retailers provide a remarkable shopping experience by highlighting our complete collection of Classico products.

Figure 7 Elite Retailer Definition Caesarstone USA – 18 July 2017⁶

In conclusion, we are still convinced that Caesarstone’s reseller list is fiction. If you don’t believe us, try it yourselves. Once again Otzar’s assertion that a reseller is anyone that “could potentially order one” is a flimsy attempt to move the goalposts and hide a weak or inflated market penetration.

⁶ Caesarstone – How to Buy
<http://www.caesarstoneus.com/how-to-buy/>

8. Transform product is actually sold at Lowe's

Otzar says: Caesarstone available at Lowe's.

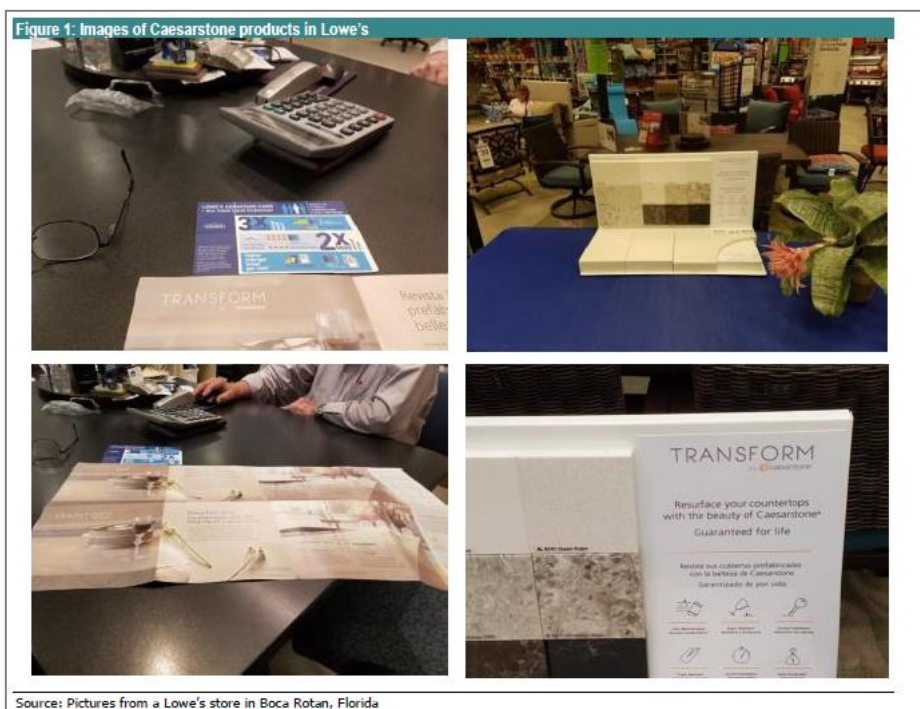


Figure 8 – Otzar Capital's proof of Transform product offering at Lowe's

Viceroy say: You got us.

Otzar had to go all the way to suburban Miami to meet a Lowe's retailer that sold Caesarstone's transform. Congratulations are in order.

We spent over months hounding Lowe's to let us know when Caesarstone's transform would hit the shelves, appear on pre-order, or be catalogued at any store and we remain convicted that the whole concept is purely a marketing gimmick. Our questioning of customer service at various levels regarding the availability of the product, which we have recorded, are extremely extensive.

We speculate it is more than convenient that the Boca Raton store is located a few minutes' drive from Caesarstone's USA headquarters in Fort Lauderdale (aka the fraud capital of the USA⁷).

We would also point out that the evidence of Lowe's stocking Caesarstone's Transform product is what appears to be some colour swatches and a large-form pamphlet.

*"Transform is not old recycled unsold backsplash inventory as the Viceroy report claims." –
Otzar Capital Report*

Transform appears to have the same qualities and is available in the same design, as the old recycled unsold backsplash.

"Furthermore, we've learned the thinner transform product can actually be slightly more expensive than the traditional Caesarstone countertop, despite using less raw material

⁷ Why do Florida metro areas dominate the nation for fraud complaints?

<http://www.tampabay.com/news/business/why-do-florida-metro-areas-dominate-the-nation-for-fraud-complaints/2220355>

content. This is because the fabrication and installation process, carried out by third party fabricators, can be more delicate for certain styles.” -Otzar Capital Report

If this is the case, doesn't it entirely defeat the purpose of the product per Caesarstone's product description?

Now you can add elegance to your home by resurfacing your countertops with the premium look and long lasting quality of Caesarstone in just hours. Transform by Caesarstone is a custom quartz overlay that's professionally applied on top of your existing countertops, giving you a luxurious update without the time, tear-out, and cost of a full countertop remodel.

Figure 9 Caesarstone Transform Web Page ⁸

9. Increased Competition

Otzar says: Overall growth of the market more than offsets Caesarstone's loss in market share.

Viceroy say: Otzar rebuttal based on figures we thoroughly dismissed as incorrect.

Otzar's market analysis of Caesarstone's market placement is based on the 20-F marketing data prepared by Freedonia. We conclusively proved this data was inaccurate in our previous report.

We find no fault in Otzar's claim that:

*"Caesarstone has seen increased competition from low quality Chinese manufacturers as well as other mid-tier players, such as LG and Dupont coming into the market. While difficult to come by exact figures, they have all lost market share over the past four years."*⁹ – Otzar Capital Report

We note that Otzar conducted no testing but generalises that all imports outside of Caesarstone and Silestone are somehow inferior.

According to US import data; Israeli engineered stone imports are down while imports as a whole are up and China's imports are increasing. This is damning given the opening of Caesarstone's Georgia manufacturing facility seems to have very little impact on the encroachment of foreign operations on major Caesarstone turf.

Year-on-Year increase in US imports by square feet			
Region	2016/2015	2015/2014	2014/2013
All countries	+25.6%	+55.1%	+46.6%
China	+78.3%	+136.5%	+77.3%
Israel	-11.5%	+0.9%	+60.5%

Figure 10 – U.S. Surface Imports ^{10 11 12}

The clear trend above is that while the market is indeed growing, the lower-cost Chinese imports are fast outpacing Israeli imports.

⁸ Caesarstone – Transform

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

⁹ Otzar Report – page 4

¹⁰ <http://www.stoneupdate.com/us-stone-imports/analysis-mid-yearannual/1330-u-s-surface-imports-2016-not-so-even-steven>

¹¹ <http://www.stoneupdate.com/us-stone-imports/analysis-mid-yearannual/1092-u-s-surface-imports-2015-more-than-one-number>

¹² <http://www.stoneupdate.com/us-stone-imports/analysis-mid-yearannual/849-2014-u-s-quartz-imports-set-record-again>

10. Guidance

Otzar says: Viceroy claims about guidance are misleading

Viceroy say: Otzar claims about guidance are misleading; our claims are ok.

Viceroy would like to thank Otzar for conceding that Caesarstone's business is facing a wave of cheaper international competitors and is exceeding its cost limits and time frame for its USA plant. This is probably the biggest argument we laid out in our short thesis– the current situation is indeed a “bad quarter every so often”. The problem is that their “ever so often” have been getting more and more frequent.

Otzar goes on to claim that the company has never missed guidance:

Figure 13: Guidance Summary

Number of	
Results press releases	21
Newly issued guidance	6
Lowered guidance	2
Increased guidance	4
Reiterated guidance	8
Tightens guidance range	1
Beats	2
Misses	0
Within range (one of which hit a previously lowered range)	3

Source: Caesarstone's published press releases and Otzar analysis.

Figure 11 Otzar Capital Caesarstone Report – 1 July 2017¹³

This is true only if you ignore the fact that the business has revised its guidance down throughout the years; Otzar is yet again comparing apples and oranges! This is akin to a Formula 1 driver who drops five places with a lap to go and decides to let the team know “we won't make first place, but we're looking good for 6th”, and coming 5th. That's not a beat, but it is a beat in Otzar's case. Caesarstone can apparently win as long as the guidance forecasts failure.

The most ridiculous claim by Otzar in this respect is an earnings/revenue “beat” in 2015 in a chart that's unconvincingly titled “A relatively good guidance track record”:

	Results PR dated				ACTUAL
	31-Dec-15	31-Mar-16	30-Jun-16	30-Sep-16	FULL YEAR
Guidance	FY 2015	FY 2016	FY 2016	FY 2016	
Revenue low	550	550	550	524	539
Revenue up	505	505	505	534	
EBITDA low	138	138	138	125	130
EBITDA upper	145	145	145	130	
Comment	New issue	Maintained	Maintained	Lowered	Beat

Figure 12 Otzar Capital Caesarstone Report – page 19¹⁴

These downwards revisions have only become common within the last two years, which further supports our assertion that Caesarstone's future success is uncertain. This is not a piece about the “good old days”, it is about the present.

¹³ Otzar Capital Report – Page 20

¹⁴ Otzar Capital Report – Page 20

11. US Growing Pains will subside post 2018.

Otzar says: Expanding capacity at the US factory and bringing further lines online will be a simpler process than the initial two were and should cost less. From 2018, we believe much of the growing pains are behind Caesarstone.

Viceroy say: This argument has zero facts and is contradictory.

Otzar have blind belief that an expansion of Caesarstone facilities in the USA beyond the current (still not full capacity) lines will be a simpler process and should cost less. This is only logical if we assume that the underperforming team who are establishing the first two lines now know what they are doing.

The assertion that “growing pains” will be gone from 2018 is contradictory to Otzar’s prior concessions. The industry is facing an increasing number of competitors? Margins are falling? Otzar have bypassed this issue.

12. Breton quality claims

Otzar says: Breton confirms Caesarstone, as well as Cosentino, make the highest quality quartz countertops available in the market today.

Viceroy say: Of course Breton think Caesarstone and Silestone make the highest quality slabs – they are their biggest customers!

Breton, the supplier of engineered quartz manufacturing lines, is not an unbiased party. Both Caesarstone and Cosentino are valuable customers of theirs, both using the same production technology making it unlikely for them to:

- Denounce the quartz countertop quality of either party
- Make a direct comparison between either party
- Give overly high operating expense figures

In fact, choosing Breton as a source almost ensures that not a bad word is spoken against Caesarstone and that operating expense figures are kept low.

Caesarstone and Otzar’s claim that resin is more expensive than quartz is put into perspective by the previous Spruce Point piece highlighting their failure to inform shareholders that the price of quartz had increased. This revelation resulted in legal action by Caesarstone shareholders against the company for failing to inform them of this¹⁵. Caesarstone had claimed that the price of quartz had increased 4% when in fact it had increased ~20%. The case was settled with awards to the plaintiff¹⁶. Otzar sidelined this issue:

47. The statements in ¶¶ 19-46 above were materially false and/or misleading because the misrepresented and failed to disclose the following adverse facts, which were known to defendants or recklessly disregarded by them, including that: (i) that the cost of quartz rose substantially by approximately 20% in 2014 while the Company stated in SEC filings the impact was just 4%; (ii) independent lab tests show CaesarStone’s samples contain less quartz than

*Figure 13 Extract from *Tapia-Matos, et. al. v. Caesarstone* – page 28¹⁷*

¹⁵ Tammy Tapia-Matos, et al. v. Caesarstone Sdot-Yam, LTD., et al. 15-CV-06726 Class Action http://securities.stanford.edu/filings-documents/1056/CSYL00_01/2015825_f01c_15CV06726.pdf

¹⁶ Caesarstone Final Notice and Claim <http://www.strategicclaims.net/wp-content/uploads/2017/05/Caesarstone-Final-Notice-and-Claim.pdf>

13. Inventory

Otzar says: Zero inventory sits with Caesarstone customers and distributors.

Viceroy say: this is a blatant lie, many Caesarstone resellers (those who do actually sell it) have photos of built up inventory. A secondary market also exists.

Otzar's assertion that resellers and customers don't hold Caesarstone inventory is easily disprovable; channel checks to resellers, especially stonemasons, immediately showed that stock is indeed kept on site. There is even a secondary marketplace for the product in many classifieds lists internationally. Even eBay has sellers selling whole slabs of Caesarstone easily debunking Otzar's thesis.

14. Conclusion

Criticism and debate are the lifeblood of the investing community. The report by Otzar capital, however, is a thinly veiled attempt at discrediting our research through flawed logic, blind optimism and selective ignorance of the facts.

As we have detailed above, Otzar appears to have little regard for basic logic or criticism. In fact we believe that the entire report seems more concerned with attempting to discredit claims than of evaluating the veracity of their own.

Otzar have also not addressed pertinent issues we have previously highlighted including:

- The growing threat of silicosis lawsuits
- Discontinued stock buyback despite substantial cash reserves
- Discontinued dividends despite substantial cash reserves
- Slowed top-line growth
- Nonsensical market data by Freedonia

Due to the issues we have raised, we are still not in a position to define a target price for Caesarstone.