Tyres - On the Move

India Research - Stock Broking

Capacity Expansion By Leading OEMs Indicate Demand Revival

Industry at a Glance

The Indian tyre industry accounts for nearly 3% of the country's manufacturing GDP and is an oligopolistic market dominated by a handful of manufacturers such as MRF, TVS SriChakra, Apollo, CEAT, JK Tyres, Bridgestone, Michelin, Continental and Good Year. These players cater to specific or all automobile segments. For example CEAT & TVS Sri Chakra is dominant in the 2W tyre segment and Apollo has expertise in passenger vehicle and commercial tyres. On the other hand, MRF caters to all automobile segments having a notable market share in each segment. ATMA, known as the Automotive Tyre Manufacturers' Association comprises of 11 tyre manufacturers (including the ones mentioned previously) which together account for more than 90% of the market requirement. The total tyre production in India grew at a CAGR of 6% during FY12-17 making ~ 170 Mn tyres. The growth in the tyre industry has more than doubled from Rs. 25000 Cr in 2010 to Rs. 53000 Cr in 2016 (ATMA).

Export Presence

Most of the domestic tyre players like Apollo and Balkrishna have global presence especially in Europe/USA. They benefit on being low cost manufacturers which enables them to sell their product at discount compared to other international manufacturers. Also, these tyre firms have set up subsidiaries in global locations to facilitate the same. Some of the big global tyre manufacturers are:

World's largest tyre producers (2017)

Brand	$ Bn	Origin
Bridgestone	26.2	Japan
Michelin	23.4	France
Good Year	14.6	U.S
Continental	12.6	Germany
Sumitomo Rubber Industries	6.3	Japan

Source: Bloomberg, Karvy Research

Segment	Replacement time
2 Wheeler	3-4 years
Passenger vehicles	3-4 years
Commercial vehicles (Radial)	12-18 months
Commercial vehicles (Bias)	8-12 months

Source: Karvy Research

End-User Market

The two end-user categories can be classified as the OEMs and the replacement segment. Consumption by OEMs is dependent on new automobile sales volume while demand from replacement market depends on the replacement cycle. The replacement market dominates the industry considering the large sample of vehicles already in use which necessitates the need to replace tyres periodically. Around 70% of the industry volumes comprise the replacement market.

Coverage

We have identified investment opportunities for Apollo Tyres Ltd and CEAT Ltd as we believe that these companies are well placed to benefit from the tyre demand revival. We have rated "**BUY**" for Apollo Tyres Ltd at a target price of Rs. 254 and a "**HOLD**" for CEAT Ltd at a target price of Rs. 1255.

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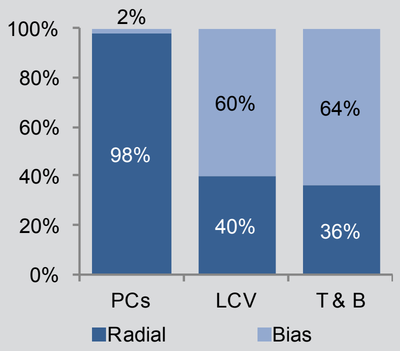
Radial penetration



Source: Industry, Karvy Research

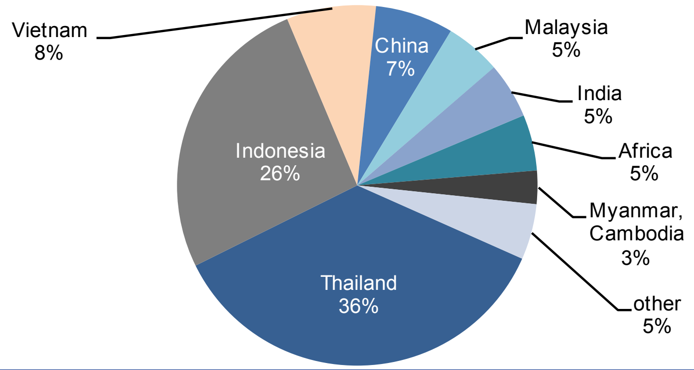
Types of Tyres and Technology

Tyres are broadly classified under Bias and Radial where a radial tyre is constructed using steel belts running at a 90 degree angle of the tread center line whereas a bias ply tyre is constructed with nylon belts of the tyre running at a 30-45 degree angle of the tread center line. (*Rec Stuff*). The benefits of choosing a radial tyre is that it has a wider foot-print and longer tread life which makes it tougher and durable. Radial penetration in the passenger vehicles segment is ~ 98% while it is 40-45% in the commercial vehicle segment. Radial technology is expected to give better mileage and reduce rolling resistance and eventually gain market share for this reason.

Raw Material and Procurement

The main raw material groups in tyre manufacturing are natural rubber, synthetic rubbers, fillers, chemicals and reinforcing materials. Natural rubber constitutes ~ 40% of the total raw material volume which is usually imported as there is not enough domestic supply. As rubber is an actively traded commodity, manufacturers hedge their procurement cost by entering into forward contracts.

Distribution of the natural rubber production worldwide (2017), by country



Source: Industry, Karvy Research

Rubber price RSS 4 Rs./Kg	RSS 4 Kottayam	RSS 4 Thailand
2009-10	115	112
2010-11	190	195
2011-12	208	211
2012-13	177	176
2013-14	166	155
2014-15	133	112
2015-16	113	96
2016-17	134	131
2017-18	145	144

Source: ATMA, Karvy Research

External Risks and Amendments

The Chinese automotive industry has grown at an incredible pace and has propelled the development of the country's tyre segment both in terms of production as well as consumption. China is the largest producer of tyres in the world, followed by the US and Japan. This led to cheap Chinese imports in India which impacted the sales of the local manufacturers. To create a level playing field for the domestic tyre industry, Government of India in FY 2017-18 imposed the Anti-Dumping Duty (ADD) on Truck and Bus Radial (TBR) tyres from China by increasing the customs duty on tyres to 15% from 10%. The Government of India imposed Anti-Dumping Duty (ADD) for 5 years on import of certain types of TBR tyres to protect domestic manufacturers from below-cost shipments from China. ADD has been imposed on tyres in the range of $ 245.35 and $ 452.33 per tonne. With this, the Chinese tyre imports dropped by almost half. Since then, domestic tyre companies have been witnessing an increase in demand and their capacity utilization has also gone up. The demand got another boost with the implementation of the GST.

Carbon black is an important supporting material and filler in rubber products both in the tyre and non-tyre segments constituting 25% of the product by weight. According to Automotive Tyre Manufacturers Association (ATMA), the demand-supply gap for carbon black in the domestic market stood at 14% in the FY 2016-17 and has increased to 20% in 2018. This interrupted carbon black supply remains a concern where certain manufacturers have begun setting up their own carbon black facility which is expected to bring upon some cost reduction.

Policy Environment (ATMA)

- All categories of tyres can be exported freely.
- All categories of new tyres can be imported freely. No WTO bound rates for tyres and tubes.
- Imports of Second hand/Retreaded tyres (major categories) are restricted under EXIM Policy and can be done against an import license.
- Tyre imports under Regional Trade Agreements (Asia Pacific Trade Agreement, Indo-Sri Lanka, SAFTA, India-Singapore, ASEAN, India-Malaysia, etc) allowed at preferential rates of import duty.
- All tyre industry related raw-materials can be imported freely (under OGL).
- Tyre industry de-licensed in September 1989.
- Natural Rubber (NR) principal raw material of Tyre Industry is in the 'Negative List` (i.e. not eligible for any concession in Custom duty) under various Trade Agreements, i.e. India ASEAN Free Trade Agreement, India Sri Lanka Free Trade Agreement, South Asian Free Trade Agreement (SAFTA), India Malaysia Comprehensive Economic Cooperation Agreement (CECA), India-Singapore Comprehensive Economic Cooperation Agreement and India-South Korea Comprehensive Economic Partnership Agreement (CEPA).

Production of tyres	(Lakh units)
2010-11	1192
2011-12	1254
2012-13	1228
2013-14	1289
2014-15	1461
2015-16	1520
2016-17 (Apr-Dec)	1273

Source: ATMA, Karvy Research

Key risks to the industry

- Disruption in supply of key raw materials such as Natural rubber and carbon black may impact the cost of production leading to lower margins.
- Intense price competition from domestic players and higher risk of cheap imports make it difficult to maintain/improve profit margins.
- Higher preference for radial tyres over bias may necessitate manufacturers to increase capacity. This may lead to increase in borrowing costs.
- Fluctuating raw material prices can affect profit margins considerably.
- Rubber growers to make tyres: The proposed Integrated Rubber Farmers Producer Company is planning to open a facility at the rubber park near Kochi for manufacturing tyres for 2-W and 3-W. *(Economic Times)*.

Segment differentiation between peers

By Product Line (%)	CEAT	JK Tyres	Apollo Tyres	Balkrishna Ind
Truck and Bus tyres	32.0	67	41.0	
2/3 wheeler tyres	30.0	0	0.0	
LCV tyres	12.0	12	6.0	
Passenger Cars/Utility vehicles	14.0	15	39.0	
Farm Tyres	7.0	4	14.0	63.0
Specialty tyres	4.0	2	0.0	35.0

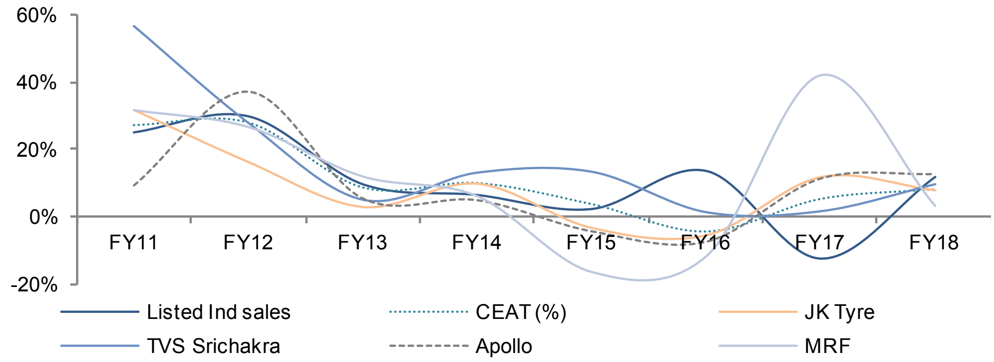
Source: Industry, Karvy Research

Geographical differentiation between peers

Geography (%)	CEAT	JK Tyres	Apollo Tyres	Balkrishna Ind
India	86.0	87.0	60.0	17.0
Europe			32.0	54.0
USA			0.0	15.0
RoW	12.0	12.6	8.0	14.0

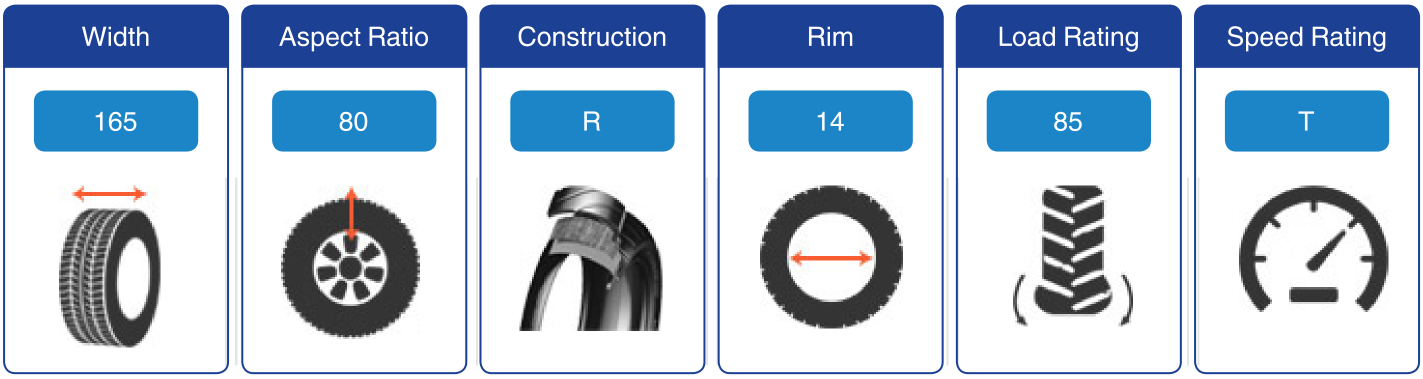
Source: Industry, Karvy Research

Revenue growth trend of key listed tyre manufacturers in India



Source: Industry, Karvy Research

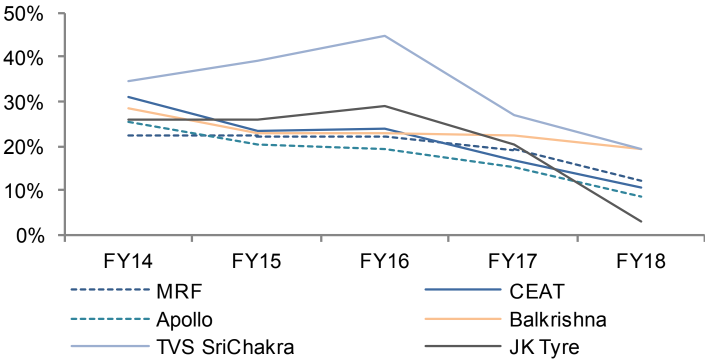
Tyre Specifications



The above diagram represents the features of tyres which is specific to the type of automobile it is being fitted into. As suggested above, higher the load rating and speed rating higher is the price. For commercial vehicles the load rating is usually higher and is comparatively lower for 2/3 wheelers.

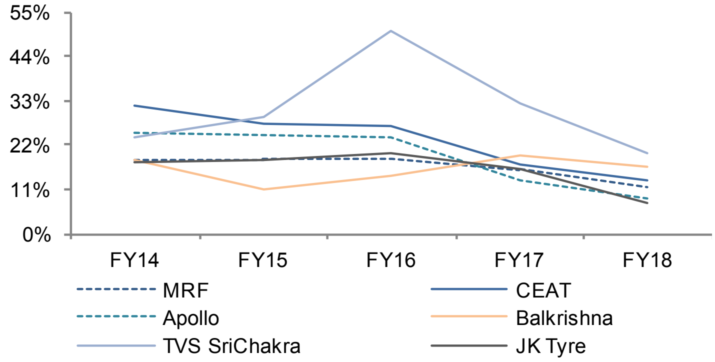
Peer Comparatives

RoE (%)- Declining trend due to capex



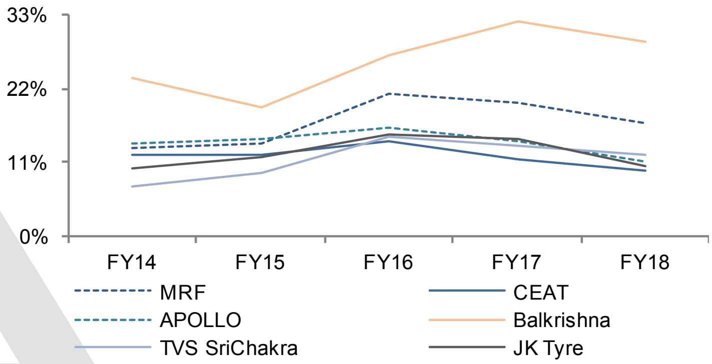
Source: Company, Karvy Research

RoCE (%)- Declining trend due to debt on account of capex



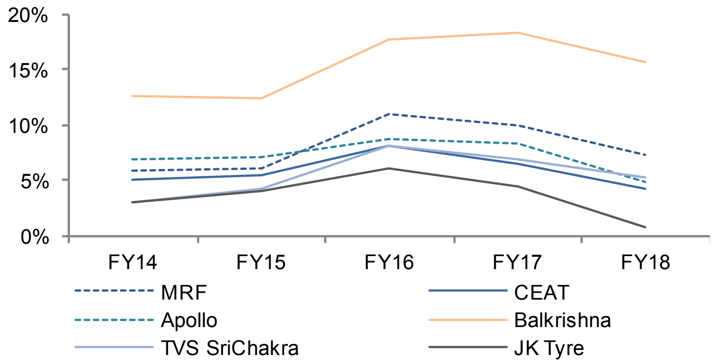
Source: Company, Karvy Research

EBITDA Margin (%)- Commodity cost volatility



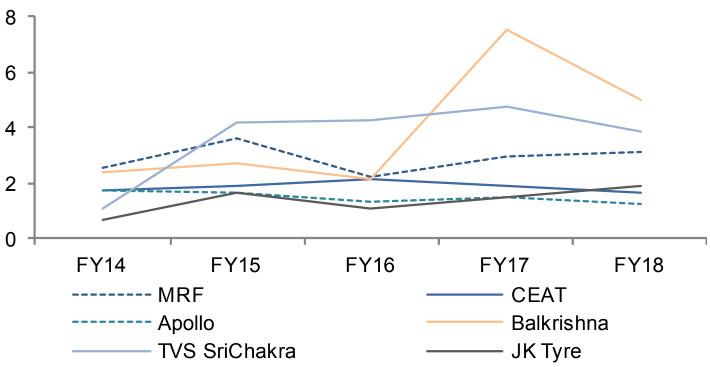
Source: Company, Karvy Research

PAT Margin (%)



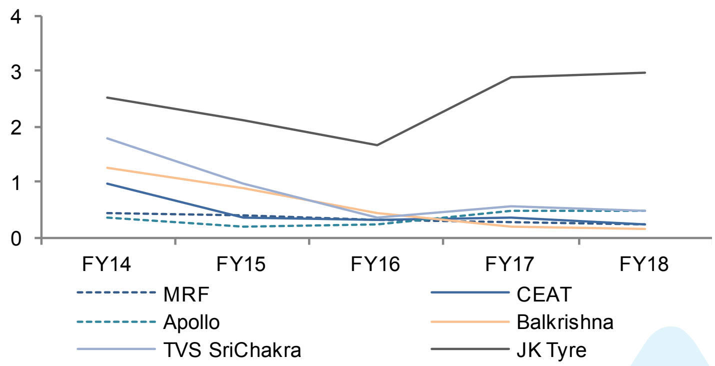
Source: Company, Karvy Research

P/BV - Corrected to lower valuation led by weak demand



Source: Company, Karvy Research

Debt/Equity



Source: Company, Karvy Research

Apollo Tyres Ltd

Bloomberg Code: APTY IN

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BUY

Investments to Start Yielding

European sales to pick-up: Ramp-up of the Hungary plant may help improve EBITDA margins to a sustainable level of 12-13% on account of better operating stabilities. The overall capacity in Europe between the two plants is expected to be ~28000 tyres per day.

Apollo tyres gains from radialization in the truck and bus segment: Penetration of radial tyres in the truck and bus segment is about 40-45% and this is expected to increase to 70-75% in the next two years. Apollo having a notable share in the T&B segment is expected to benefit from this. Another significant drive would be increasing proportion of the Ultra high performance in the overall passenger car radial segment which has improved the product mix.

Technological upgradation attracts OEM business: The OEM journey has been a strategic move both in terms of establishing themselves as a technological leader and also that a good proportion of OEM sales translating into replacement sales. As share of business increases with the OEMs, this is likely to reflect better in the replacement market.

Apollo pacing itself for the next gen growth: The company is banking on product differentiators in terms of compound mixing and process technology for which the APTY recently inaugurated an R&D centre in Chennai. These solutions are likely to improve long-term prospects through value accretion. More focus on the TBR technology where the company has a notable market share will enable better market penetration when the industry changes. The R&D centre at Europe is working on ultra low resistance tyres with OEMs such as Ford, Daimler and VW.

Valuation and Risks

We value Apollo Tyres at a P/E of 13x for FY21E EPS of Rs. 19.6 for a target price of Rs. 254, representing an upside potential of 18%. Our rating on Apollo Tyres is "**BUY**". However, the downside risk to our call could be the demand condition in Europe which is currently mute due to implementation of WLTP norms. Nevertheless, we expect demand revival for both domestic and exports and believe capacity expansion plans to start yielding during FY20-21E.

Exhibit 1: Valuation Summary

YE Mar (Rs. Mn)	FY17	FY18	FY19E	FY20E	FY21E
Net Sales	131800	148405	178086	201237	227398
EBITDA	18487	16513	20124	22740	25696
EBITDA Margin (%)	14.0	11.1	11.3	11.3	11.3
Net Profit	10990	7239	8779	9654	11188
EPS (Rs.)	21.6	12.7	15.3	16.9	19.6
RoE (%)	15.1	8.5	8.7	8.9	9.6
PE (x)	9.7	21.7	14.1	12.8	11.0

*Source: Company, Karvy Research; *Represents multiples for FY17 & FY18 are based on historic market price*

Recommendation (Rs.)

CMP *(as on Apr 16, 2019)*	216
Target Price	254
Upside (%)	18

Stock Information

Mkt Cap (Rs.mn/US$ mn)	123563 / 1817
52-wk High/Low (Rs.)	307/192
3M Avg. daily value (Rs.mn)	531.3
Beta (x)	0.9
Sensex/Nifty	39001 / 11706
O/S Shares(mn)	572.1
Face Value (Rs.)	1.0

Shareholding Pattern (%)

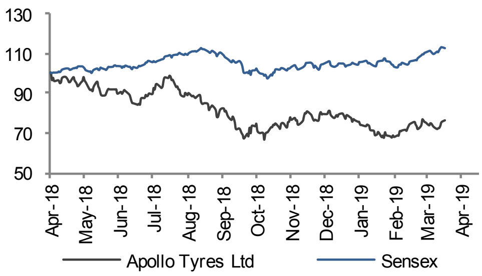
Promoters	40.8
FIIs	20.0
DIIs	22.6
Others	16.6
Promoter Pledge	6.16

Stock Performance (%)

	1M	3M	6M	12M
Absolute	3	(4)	6	(19)
Relative to Sensex	(5)	(11)	(1)	(31)

Source: Bloomberg

Relative Performance*



*Source: Bloomberg; *Index 100*

Investment Rationale

- Higher automobile growth during previous years (FY16-18) is expected to be a growth driver for the replacement segment as vehicles are due for replacing tyres.
- After radial penetration in the truck and bus segment, the next segment in focus is likely to be the 2W segment.
- Furthermore, increasing investment in infrastructure to enable better connectivity between tier 2 and tier 3 towns is likely to help the sector grow.
- Product differentiation in terms of higher technology like lower rolling resistance, RFID tags for tyres are expected to add value for the manufacturer.
- Increased focus on R&D for product development will help in gaining market share when the industry standards get upgraded.

Company Background

Incorporated in the year 1972, Apollo Tyres Ltd is engaged in manufacturing tyres catering to various automobile segments and is headed by Mr. Onkar S Kanwar. They have four manufacturing facilities in India and two in Europe (Netherlands & Hungary). Their corporate headquarters is situated in Gurugram, India. The company sells its products under two major brands; Apollo & Vredestein which are made available across India & Europe through a wide dealership network. During FY18, the company clocked a turnover of Rs. 148 Bn supported by ~16000 employees. The company endeavors to be a premium tyre company with a diversified & multinational presence.

Key Management Personnel

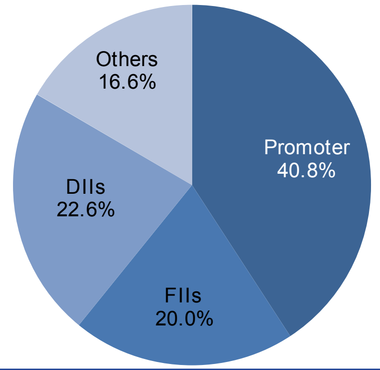
Onkar S Kanwar *Chairman & Managing Director*

Neeraj S Kanwar *Vice Chairman & Managing Director*

Sunam Sarkar *President & Chief Business Officer*

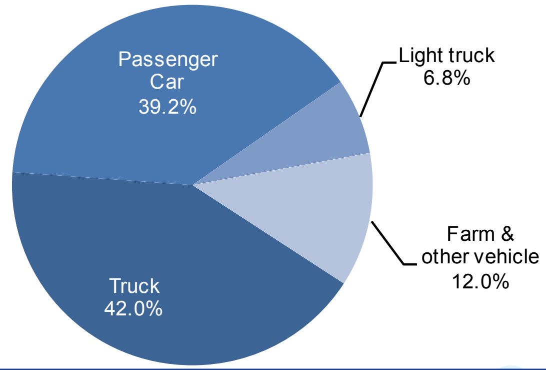
Gaurav Kumar *Chief Financial Officer*

Shareholding Pattern (%)



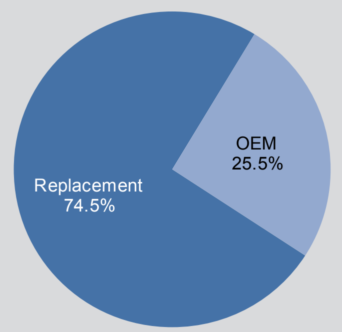
Source: BSE, Karvy Research

Revenue Mix (%)



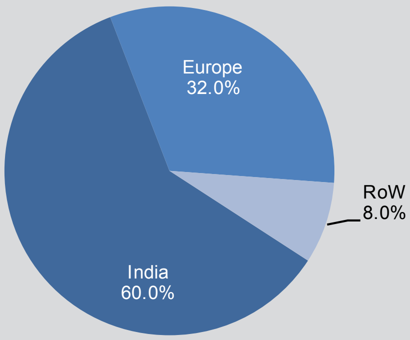
Source: Company, Karvy Research

Channel mix



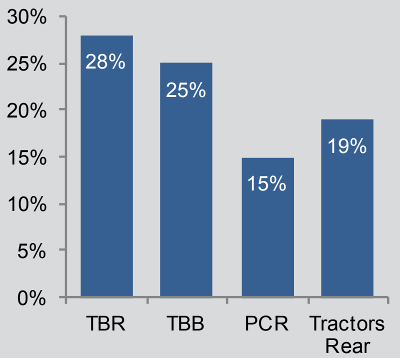
Source: Company, Karvy Research

Geography mix



Source: Company, Karvy Research

Market share



Source: Company, Karvy Research

Revenue segmentation

Apollo derives 42% of revenue from truck tyres and 39% from passenger car tyres. The company holds ~ 28% market share in the radial truck tyres and ~ 25% in bias truck tyres. Industry is rapidly shifting from bias to radial which now constitutes more than 40% of the total domestic truck tyres as compared to ~20% in FY13-14. On the other hand, passenger car tyres are completely radial while in the 2-3 wheeler market it is minimal. Going forward, we expect radial tyres to gain prominence even in the 2/3 wheeler market given that the tyre manufacturers are adding capacity in this category.

Apollo has two manufacturing plants in Europe (Netherlands & Hungary) and four in India. Accordingly, 60% of revenue comes from domestic sales and 32% from Europe. European tyre market is primarily focused on high & ultra high performance such as winter tyres and run flat tyres which are differentiated based on energy efficiency and its associated speed rating. Also, passenger car and light truck segment tyres dominate the European market accounting for ~ 93% of the total industry requirement. Being a cyclical industry, tyre consumption is directly impacted by seasonality, labour market and private consumption. Furthermore, stricter labeling laws in Europe are expected to keep Chinese imports (low cost tyres) at check and help revive domestic production.

The company is also expanding in other ASEAN countries and the US which altogether adds to 8% of the revenue. So, domestic requirements are serviced from the local plants while European orders are mostly fulfilled by their European facilities. Other exports are managed from Indian operations.

Pricing Environment

The tyre market being oligopolistic makes it both easier and tougher to increase prices. During FY18-19 cost of raw material prices increased by 10% where the major contributors to this cost push were carbon black, synthetic rubber, nylon fabric, chemicals and natural rubber in addition to increase in oil prices. Moreover, as the carbon black supply lagged due to capacity creation, the fiscal witnessed a severe shortage. The problem further compounded due to the anti-dumping duty of carbon black from China which is one of the largest supplier of this material. The usual trend is that, the market leader in a particular segment initially increases prices and the other players follow suit. This is usually done during peak commodity cycles. Furthermore, tyre manufacturers having brand equity can also use that leverage for increasing prices. In other cases, companies tend to lose market share. In the European market, the density of players in the All-season segment is increasing resulting in price pressure.

Capacity Expansion Plans

Apollo Tyres is investing Rs. 1800 Cr for a manufacturing facility in Andhra Pradesh which is expected to be operational by end of FY20-21.

Facility & Product

Location	Product	Strategy
Enschede, Netherlands	PC & Agri Tyres	
Gyöngyöshalász, Hungary	PC & Trucks	Proximity to carbon black & steel cord suppliers
Oragadam, TN	PC & Trucks	Proximity to the port, OEMs & R&D centre
Limda, Gujarat	PC, Light truck, TBB/TBR, Farm	Proximity to the port
Kalamassery, Gujarat	Light truck, TBB/TBR, Farm vehicles & OHV	Proximity to rubber plantations
Perambra, Kerala	PC, Light truck, TBB/TBR, Farm	Proximity to rubber plantations

Source: Company, Karvy Research

Business and Operations

Country	India	Europe	Other geographies
Brands	Apollo, Kaizen	Apollo, Vredestein	Apollo, Vredestein
Product portfolio	CV, PC, OTR	CV, PC, Bicycles, OTR	CV, PC, OTR
New ventures	Recently forayed into 2W	Forayed online thorugh acquisition of Reifencom	Increasing presence in ASEAN
		Specialty products (space master & air master)	SAARC & Middle East
Facilities	Corporate office: Gurugram	Europe Head office at Amsterdam	Global Marketing office: London, UK
	Oragadam (Tamil Nadu)	Enschede - Netherlands	Sales & Marketing Office:
	Limda (Gujarat)	Gyöngyöshalász, Hungary ~ 12500 tyres/day	Bangkok (Thailand), Kuala Lumpur
	Perambra (Kerala)		Dubai, UAE, Johannesburg , SA
	Kalamassery (Kerala)		Atlanta, US
			Global procurement office: Singapore
R&D Centre	Chennai & Bengaluru	Europe - Enschede & Raunheim (satellite R&D centre)	
Retail Dealers	~5300 third party dealers (1700 exclusive dealers)	~5800 third party dealers	140 third party dealers in Thailand 80 distributors in rest of ASEAN 49 distributors in MEA

Source: Company, Karvy Research

Key Business drivers for the next two years

India: Apart from the automobile growth, doubling of Chennai TBR capacity will help capture the growing demand for TBR tyres. In addition to this, new Greenfield facility in Andhra Pradesh will help gain prominence in South India thereby, maintaining market share. Return on the new capacity expansion may reap during FY21with higher incremental cash flows.

Furthermore, government's focus on infrastructure development, better fleet utilization & shift towards larger trucks with more number of tyres are expected to keep the demand for TBB/TBR tyres afloat.

Europe: The European market is on track for recovery with revival in major markets like Germany as western Europe constitutes more than 70% of the total European tyre volumes (as on FY17).

Passenger Car & Light Truck (PCLT) sales are expected to grow at a CAGR of 1.8% from CY16-21E. This growth is likely to come from higher private consumption, improving labour market and growing real disposable income.

The aim is to substantially increase market share in the premium category by increasing distribution channels in core markets such as Germany, Austria, Switzerland, Netherlands, Belgium and Luxembourg.

Macro risks:

- Raw material price volatility and availability.
- Economic slowdown in European and Indian markets.
- Threat of low-cost Chinese import of truck tyres.
- Pricing competition.

Business Assumptions

Y/E Mar (Rs. Mn)	FY18	FY19E	FY20E	FY21E	Comments
Consolidated					
Revenue	148405	178086	201237	227398	We expect revenue to grow at 13.7% CAGR for the next two years as we think benefits from European market to kick in once the cycle revives there after facing weakness due to WLTP norms.
Revenue Growth (%)	12.6	20.0	13.0	13.0	
EBITDA	16513	20124	22740	25696	
EBITDA Margins (%)	11.1	11.3	11.3	11.3	EBITDA margins are expected to be maintained above 11% as we believe that the company can manage pricing as it has a notable market share in the TBR segment tyres.
PAT (normalized)	7239	8779	9654	11188	
EPS (Rs.)	12.7	15.3	16.9	19.6	
EPS Growth (%)	(41.4)	21.3	10.0	15.9	
Capex	(30672)	(24500)	(21500)	(21500)	
Net CFO	17197	21305	21728	22933	
Net Debt	38465	44387	48295	51167	We have assumed borrowing on account of the capex expense the company plans to deploy over the next two years.
Free Cash Flow	(13820)	(3195)	228	1433	

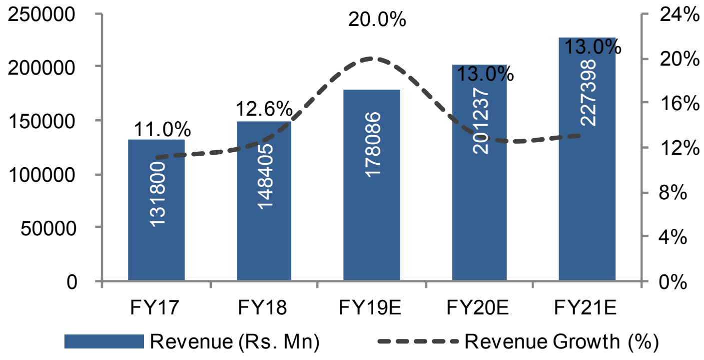
Source: Company, Karvy Research

Karvy vs Consensus

	Karvy	Consensus	Divergence (%)	Comments
Revenues (Rs. Mn)				
FY19E	178086	178333	(0.1)	We have estimated revenue to grow at CAGR 13.7% during FY19-21E.
FY20E	201237	203013	(0.9)	
FY21E	227398	225592	0.8	
EBITDA (Rs. Mn)				
FY19E	20124	20716	(2.9)	
FY20E	22740	25443	(10.6)	
FY21E	25696	28891	(11.1)	
EPS (Rs.)				
FY19E	15.3	16.3	(5.8)	
FY20E	16.9	20.8	(18.9)	
FY21E	19.6	23.0	(14.9)	

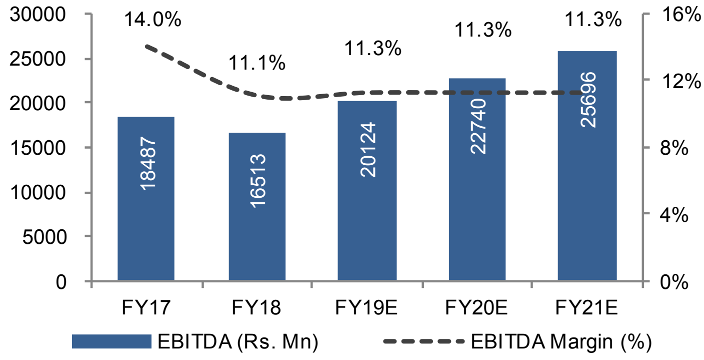
Source: Bloomberg, Karvy Research

Revenue & Revenue Growth



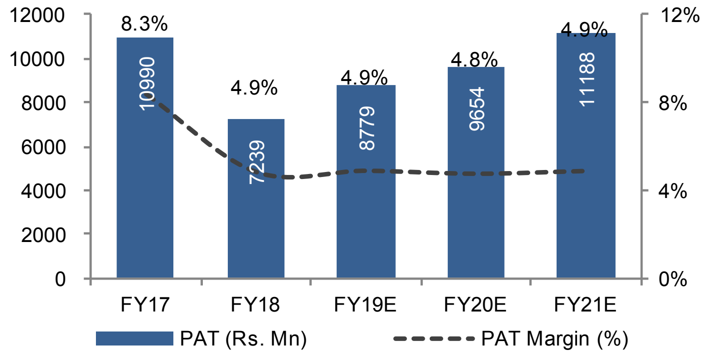
Source: Company, Karvy Research

EBITDA & EBITDA Margin



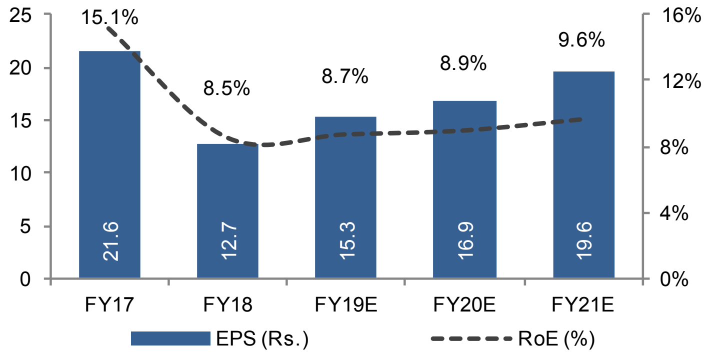
Source: Company, Karvy Research

PAT & PAT Margin



Source: Company, Karvy Research

EPS & RoE



Source: Company, Karvy Research

Company Snapshot (Ratings)

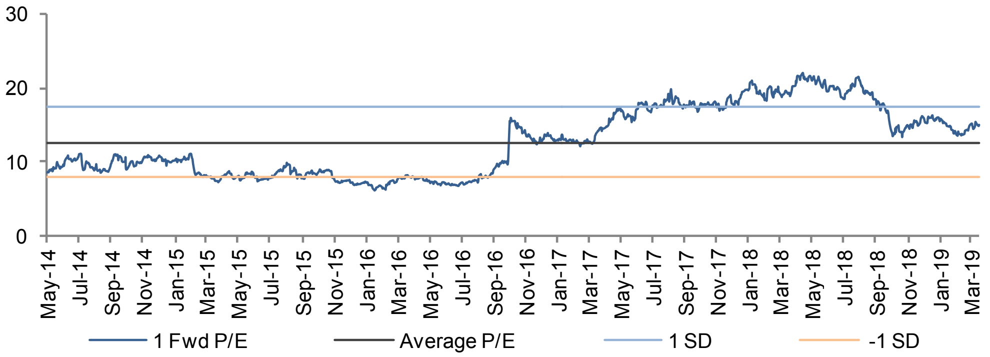
	Low				High
	1	2	3	4	5
Quality of Earnings			✓		
Domestic Sales			✓		
Exports			✓		
Net Debt/Equity			✓		
Working Capital Requirement				✓	
Quality of Management				✓	
Depth of Management				✓	
Promoter			✓		
Corporate Governance				✓	

Source: Company, Karvy Research

Valuation & Outlook

We value Apollo Tyres at a P/E of 13x for FY21E EPS of Rs. 19.6 for a target price of Rs. 254, representing an upside potential of 18%. Our rating on Apollo Tyres is **"BUY"**. However, the downside risk to our call could be the demand condition in Europe which is currently mute due to implementation of WLTP norms. Nevertheless, we expect demand revival for both domestic and exports and believe capacity expansion plans to start yielding during FY20-21E. We expect return on assets to improve upon higher utilization levels.

PE Band



Source: Company, Karvy Research

Comparative Valuation Summary

	CMP	Mcap	EV/EBITDA (x)				P/E (x)				EPS (Rs.)			
	(Rs.)	(Rs. Mn)	FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E
Apollo	216	123563	9.8	8.1	7.1	6.3	21.7	14.1	12.8	11.0	12.7	15.3	16.9	19.6
CEAT	1125	45345	8.7	8.1	7.2	6.4	15.3	17.1	14.6	13.4	73.3	65.8	76.9	83.7

Source: Bloomberg, Karvy Research

Comparative Operational Metrics Summary

	CAGR % (FY18-21E)			RoE (%)				Price Perf (%)			Net Sales (Rs. Mn)			
	Sales	EBITDA	EPS	FY18	FY19E	FY20E	FY21E	3m	6m	12m	FY18	FY19E	FY20E	FY21E
Apollo	13.7	14.2	14.0	8.5	8.7	8.9	9.6	(3.7)	5.9	(18.6)	148405	178086	201237	227398
CEAT	9.8	9.4	4.0	10.5	9.8	10.6	10.6	(12.5)	(0.2)	(24.9)	62308	69162	76769	85214

Source: Bloomberg, Karvy Research

Financials

Revenue growth to be driven by demand revival in the domestic replacement market and Hungary plant ramp up.

Income Statement

YE Mar (Rs. Mn)	FY17	FY18	FY19E	FY20E	FY21E
Revenues	131800	148405	178086	201237	227398
Growth (%)	11.0	12.6	20.0	13.0	13.0
Operating Expenses	113313	131893	157963	178498	201702
EBITDA	18487	16513	20124	22740	25696
Growth (%)	14.0	(10.7)	21.9	13.0	13.0
Depreciation & Amortization	4618	5926	7752	8594	9384
EBIT	13869	10587	12372	14146	16312
Other Income	1518	1165	1158	1281	1410
Interest Expenses	1029	1629	1825	2019	2183
PBT	14355	10123	11705	13409	15539
Tax	3365	2884	2926	3754	4351
Adjusted PAT	10990	7239	8779	9654	11188
Growth (%)	2.2	(34.1)	21.3	10.0	15.9

Source: Company, Karvy Research

Due to capacity addition, asset turn over ratio is low and will turnaround at higher utilization levels.

Balance Sheet

YE Mar (Rs. Mn)	FY17	FY18	FY19E	FY20E	FY21E
Cash & Cash Equivalents	3369	5992	6301	7782	9479
Receivables	11275	14350	16101	18194	20559
Inventory	26455	29454	31714	33080	36135
Loans & Advances	63	37	38	40	43
Other current assets	5728	6765	7924	8826	9847
Net Block	94292	125011	141759	154665	166782
Good will	1774	2061	2061	2061	2061
Investments	3962	13402	13402	14742	16214
Other non-current assets	6042	4461	5343	6037	6822
Total Assets	**152961**	**201532**	**224642**	**245427**	**267941**
Current Liabilities	33686	42165	50395	56807	64053
Long term and short term debt	32445	44457	50687	56076	60646
Other non-current Liabilities	13931	17144	19074	20463	22033
Total Liabilities	**80062**	**103766**	**120156**	**133346**	**146731**
Shareholders Equity	509	572	572	572	572
Reserves & Surplus	72391	97195	103914	111509	120637
Total Networth	**72900**	**97767**	**104486**	**112081**	**121209**
Total Networth & Liabilities	**152961**	**201532**	**224642**	**245427**	**267941**

Source: Company, Karvy Research

Cash Flow Statement

YE Mar (Rs. Mn)	FY17	FY18	FY19E	FY20E	FY21E
PBT	14356	10123	11705	13409	15539
Depreciation	4618	5926	7752	8594	9384
Tax Paid	(3264)	(2465)	(2926)	(3754)	(4351)
Inc/dec in Net WC	(7230)	3154	4107	2742	1588
Other income	(486)	(1170)	(1158)	(1281)	(1410)
Finance costs	1029	1629	1825	2019	2183
Cash flow from operating activities	**9023**	**17197**	**21305**	**21728**	**22933**
Inc/dec in capital expenditure	(32636)	(30672)	(24500)	(21500)	(21500)
Other investments & income	3115	(7956)	1158	(58)	(63)
Cash flow from investing activities	**(29521)**	**(38628)**	**(23342)**	**(21558)**	**(21563)**
Proceeds from issue of shares (net)		14761			
Change in Borrowings	20841	11608	6231	5389	4570
Interest paid	(658)	(1323)	(1825)	(2019)	(2183)
Dividend paid	(1237)	(1838)	(2059)	(2059)	(2059)
Cash flow from financing activities	**18946**	**23209**	**2347**	**1311**	**327**
Forex Effects	(536)	2837	0	0	0
Net change in cash	(2088)	4614	309	1481	1697

Source: Company, Karvy Research

Key Ratios

YE Mar	FY17	FY18	FY19E	FY20E	FY21E
EBITDA Margin (%)	14.0	11.1	11.3	11.3	11.3
EBIT Margin (%)	10.5	7.1	6.9	7.0	7.2
Net Profit Margin (%)	8.3	4.9	4.9	4.8	4.9
Dividend Payout Ratio (%)	13.9	23.7	19.5	17.8	15.3
Net Debt/Equity (x)	0.4	0.5	0.5	0.5	0.5
RoE (%)	15.1	8.5	8.7	8.9	9.6
RoCE (%)	13.2	8.6	8.3	8.8	9.3

Source: Company, Karvy Research

Valuation Parameters

YE Mar	FY17	FY18	FY19E	FY20E	FY21E
EPS (Rs.)	21.6	12.7	15.3	16.9	19.6
DPS (Rs.)	3.0	3.0	3.0	3.0	3.0
BVPS (Rs.)	143.2	170.9	182.7	195.9	211.9
PE (x)	9.7	21.7	14.1	12.8	11.0
P/BV (x)	1.5	1.3	1.2	1.1	1.0
EV/EBITDA (x)	8.8	9.8	8.1	7.1	6.3
EV/Sales (x)	1.2	1.1	0.9	0.8	0.7

*Source: Company, Karvy Research; *Represents multiples for FY17 & FY18 are based on historic market price*

CEAT Ltd

Bloomberg Code: CEAT IN

India Research - Stock Broking

HOLD

To Benefit from Demand Revival

Pricing is competitive compared to other brands in the 2W and PC space: CEAT's tyres are priced in the mid-range giving the necessary comfort for buyers especially in the 2/3 wheeler market. This helps the company maintain market share in these segments. On the flip side, EBITDA margin expansion during lower commodity cycle may be restricted due to pricing and at the same time maintaining EBITDA margin at the adequate range during commodity upswings may become challenging. This explains that the company should bank more on volumes to be able to capitalize on the costs to achieve better economies of scale.

Capex plans to yield results in the three years: Capacity addition across segments with superior technology is expected to capture both domestic and export opportunity. The current outsourced model of 2W tyres is expected to continue even after the capacity is added. Also, the company is expanding in the OTR segment though exports which may bring some cross-currency benefits and also provide some hedge on imports. CEAT has a planned capex of Rs. 4500 Mn for the next two years sourced from both debt and internal accruals.

Industry is also pacing itself for the next gen growth: Majority (> 70%) of the industry tyre sales represent the replacement market followed by OEM sales. Currently, the automobile industry is witnessing some weakness in demand where especially H2FY19 has completely reversed as compared to H1FY19. However, we would like to argue that the replacement demand is due to pick up on the back of a higher sample of vehicles running in the country. So, all the sales growth reported until H1FY19 should now (in one year) be due for replacement.

Valuation and Risks

We rate **HOLD** for CEAT at a P/E of 15x FY21E EPS of Rs. 83.7 for a target price of Rs. 1255 representing a 12% upside potential. We are confident that the branding strategy of the company will lead to higher volumes. However, raw material prices remain a key risk to our call. In addition to this, high industry fragmentation especially in the 2W space is a disadvantage for the company as it impacts pricing. Still, we believe there is an upside catalyst after the capex cycle concludes.

Exhibit 1: Valuation Summary

YE Mar (Rs. Mn)	FY17	FY18	FY19E	FY20E	FY21E
Net Sales	57665	62308	69162	76769	85214
EBITDA	6643	6061	6464	7270	8165
EBITDA Margin (%)	11.5	9.7	9.3	9.5	9.6
Net Profit	3840	2965	2663	3109	3384
EPS (Rs.)	94.9	73.3	65.8	76.9	83.7
RoE (%)	16.6	10.5	9.8	10.6	10.6
PE (x)	11.9	15.3	17.1	14.6	13.4

*Source: Company, Karvy Research; *Represents multiples for FY17 & FY18 are based on historic market price*

Recommendation (Rs.)

CMP *(as on Apr 16, 2019)*	1125
Target Price	1255
Upside (%)	12

Stock Information

Mkt Cap (Rs.mn/US$ mn)	45345 / 666
52-wk High/Low (Rs.)	1650 / 985
3M Avg. daily value (Rs.mn)	585.4
Beta (x)	1.1
Sensex/Nifty	38988 / 11711
O/S Shares(mn)	40.5
Face Value (Rs.)	10.0

Shareholding Pattern (%)

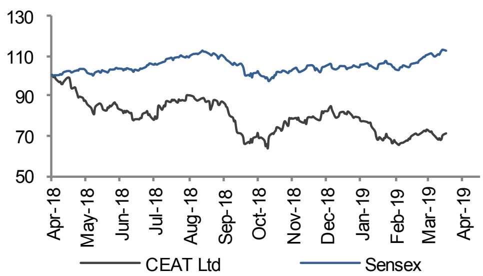
Promoters	51.0
FIIs	21.8
DIIs	10.4
Others	16.8

Stock Performance (%)

	1M	3M	6M	12M
Absolute	2	(13)	(0)	(25)
Relative to Sensex	(6)	(19)	(6)	(36)

Source: Bloomberg

Relative Performance*



*Source: Bloomberg; *Index 100*

Investment Rationale

- *Higher automobile growth during previous years (FY16-18) is expected to be a growth driver for the replacement segment as vehicles are due for replacing tyres.*
- *Furthermore, increasing investment in infrastructure to enable better connectivity between tier 2 and tier 3 towns is likely to help the sector grow.*
- *Strategic OEM tie-ups to help keep the growth momentum.*
- *We think that the company is poised for a recovery with a revival in the replacement demand and also believe that the brand marketing for IPL will boost sales growth.*
- *The company has a good reach in terms of distribution outlets pan India (> 4500 outlets).*
- *Product diversification ranging between various automotive segments flags off risks arising from demand slowdown and provides the leverage in being able to manage pricing to maintain adequate realizations.*

Company Background

Established in the year 1958, CEAT Limited is the flagship company of the RPG Group and is amongst the key tyre manufacturers in India. They cater to all major segments of the automobiles such as 2/3 wheelers, passenger and utility vehicles, commercial vehicles and Off-the-Road segment. The company derives 85% of the revenue from the domestic requirement while the rest constitute exports to various countries. CEAT has consolidated its position in Bangladesh and Sri Lanka by forming JVs with strategic partners. Manufacturing facilities are located at Bhandup (Mumbai), Nashik, Halol, Nagpur, Ambernath and is setting up a Greenfield facility at Chennai. Each facility caters to a certain segment where the aggregate utilization is close to 85%. The company has more than 4500 dealerships and 500+ CEAT shops.

Key Management Personnel

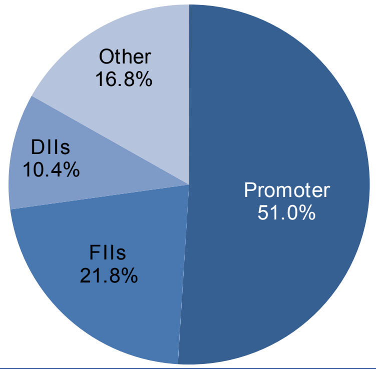
Mr. Harsh Vardhan Goenka *Chairman*

Mr. Anant Vardhan Goenka *Executive Director*

Mr. Kumar Subbiah *President & Chief Business Officer*

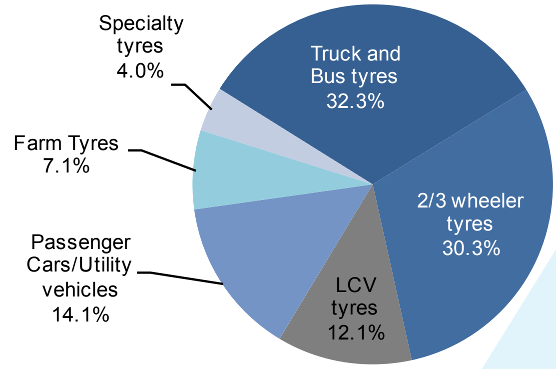
Ms. Vallari Gupte *Chief Financial Officer*

Shareholding Pattern (%)



Source: BSE, Karvy Research

Revenue By Product Line (%)



Source: Company, Karvy Research

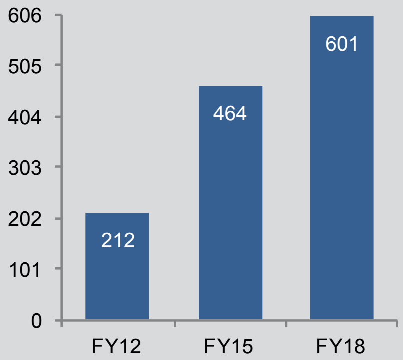
Capacity and Expansion plans

The overall capacity utilization is above 85% across the segments. CEAT is investing ~Rs. 4000 Cr in the next three years for capacity addition in 2W, truck-bus radial and passenger car segments. With this, we expect the revenue pie to shift slightly towards the truck bus segment due to value accretion. However, EBITDA margin is expected to sustain at the current level as profitability is weak in the commercial vehicle segment.

Channel sales

Tyre buying is more of a physical activity which also includes fitting the tyres. Therefore, the higher the number of touch points for a tyre manufacturer better will be the reach of the product. On the other hand, online buying is quite minimal. CEAT has more than 4500 dealers pan India covering 601 districts as on FY18 compared to 464 districts during FY15.

CEAT Dealer Network



Source: Company, Karvy Research

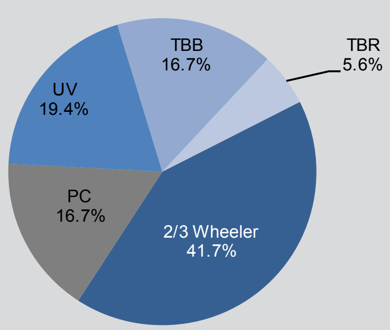
Customer Behavior:

Pricing has always been an integral issue for tyre manufacturers due to industry fragmentation. Also, dumping from neighboring countries led to uncertainty in the market which now has substantiated due to Anti Dumping Duty being imposed on imports. Customer retention is hard to determine and studies indicate that more than 30% of the vehicle owners tend to switch from the brand during replacement (from what was provided during the initial purchase by the OEMs) based on price and durability. However, by and large, owners stick to the brand that was initially provided. Therefore, establishing strong OEM relationships bring advantage in retaining customers.

Subsidiary Performance

CEAT Specialty Tyres Ltd (CSTL) is a wholly owned subsidiary of the company and is engaged in manufacturing OTR tyres which find application across industries including ports, construction, mining and agriculture. The manufacturing facility dedicated to CSTL is located at Ambernath, Maharashtra. In addition to this, CSTL has set up an overseas subsidiary in the USA. During FY18, CSTL reported revenue of Rs. 2666 Mn with a net loss of Rs. 371 Mn.

Market Share



Source: Company, Karvy Research

Facilities & Utilization

Facility	Type of tyre	Capacity	Utilization
1. Nagpur	2-3 wheeler	12 Lakh Tyres /month	80-85%
2. Halol	PC/UV	180 Tonnes/day=63000 T/ annum	80-85%
	TBR	90T/day= 31500 Tonnes/annum	
3. Nashik	TBB - Farm+LCV	100 T/ Day	
4. Bhandup	TBB - Farm+LCV	150 T/ Day	
5. Ambernath	Specialty tyre segment	40T /day	20%
6. Chennai	PC, UV and 2W radial	240 T: PCR; 12 T: 2W radial	

Source: Company, Karvy Research

Expansion Plans

Facility	Capacity addition	SOP	Objective	Break-up
1. Nagpur	Rs. 400 Cr for Phase II to add 15 Lakh tyres a month	FY20E	Target the export market	35 OEM: 65 rep
2. Halol	Rs. 1000 Cr for 210T/day	FY20-21	Upstream and Downstream capacity	Total 300 T/ day
3. Chennai	252 Tonnes /day	FY21E	SOP by H1FY20 and revenue for FY21E	

Source: Company, Karvy Research

Business Assumptions

Y/E Mar (Rs. Mn)	FY18	FY19E	FY20E	FY21E	Comments
Consolidated					
Revenue	62308	69162	76769	85214	We expect revenue to grow at 10% CAGR during FY18-21E considering that the average 8-year growth rate is 11%. The industry is yet to witness a demand upswing.
Revenue Growth (%)	8.1	11.0	11.0	11.0	
EBITDA	6061	6464	7270	8165	
EBITDA Margins (%)	9.7	9.3	9.5	9.6	EBITDA margins may not expand owing to higher fixed costs attributed to upcoming capacity additions.
PAT (normalized)	2965	2663	3109	3384	
EPS	73.3	65.8	76.9	83.7	
EPS Growth (%)	(22.8)	(10.2)	16.8	8.8	
Capex	(4872)	(5000)	(7000)	(7000)	
Net CFO	7097	3862	5673	6421	
Net Debt	5,740	7,880	10,981	13,572	We have assumed borrowing on account of the capex expense the company plans to deploy over the next two years.
Free Cash Flow	2225	(1138)	(1327)	(579)	

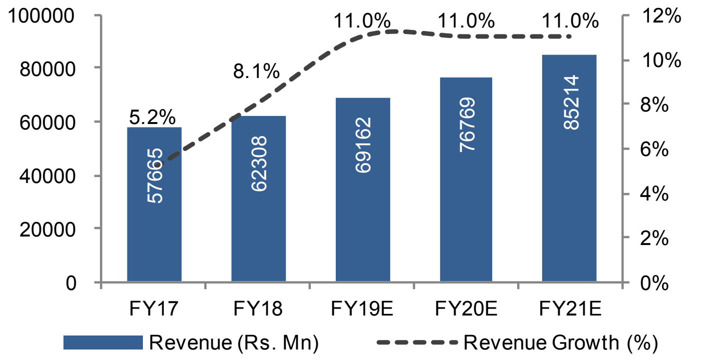
Source: Company, Karvy Research

Karvy vs Consensus

	Karvy	Consensus	Divergence (%)	Comments
Revenues (Rs. Mn)				
FY19E	69162	69918	(1.1)	Our estimates are conservative compared to consensus as we expect pricing to be an issue due to high competition.
FY20E	76769	79774	(3.8)	
FY21E	85214	89882	(5.2)	
EBITDA (Rs. Mn)				
FY19E	6464	6671	(3.1)	We have maintained our EBITDA margin estimates flat on account of volatile raw material prices.
FY20E	7270	8516	(14.6)	
FY21E	8165	10021	(18.5)	
EPS (Rs.)				
FY19E	65.8	71.6	(4.9)	
FY20E	76.9	84.6	(7.5)	
FY21E	83.7	97.5	(10.3)	

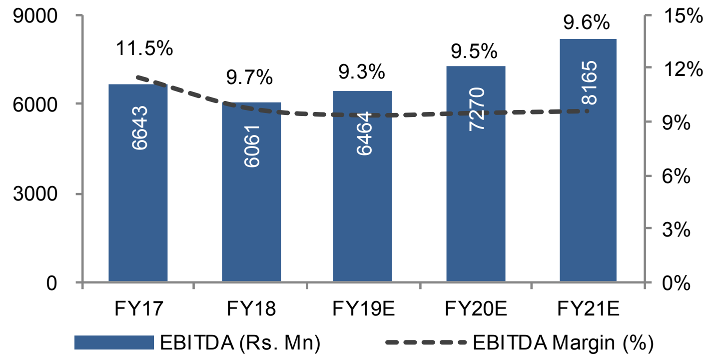
Source: Bloomberg, Karvy Research

Revenue & Revenue Growth



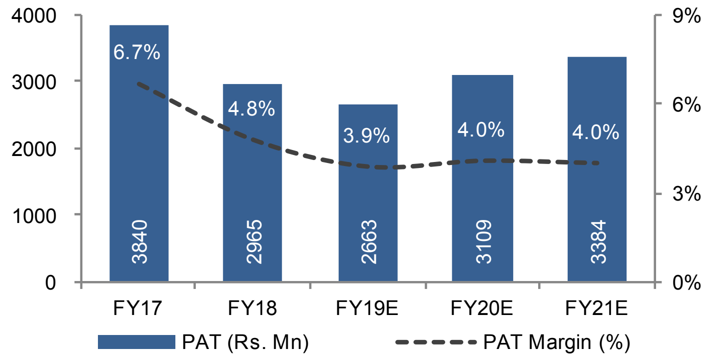
Source: Company, Karvy Research

EBITDA & EBITDA Margin



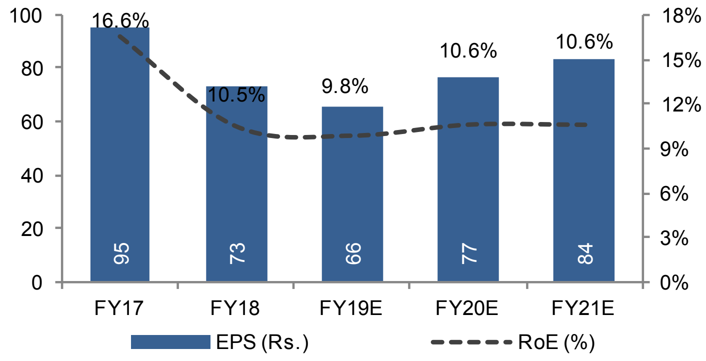
Source: Company, Karvy Research

PAT & PAT Margin



Source: Company, Karvy Research

EPS & RoE



Source: Company, Karvy Research

Exhibit : Company Snapshot (Ratings)

	Low				High
	1	2	3	4	5
Quality of Earnings			✓		
Domestic Sales				✓	
Exports		✓			
Net Debt/Equity			✓		
Working Capital Requirement			✓		
Quality of Management				✓	
Depth of Management				✓	
Promoter			✓		
Corporate Governance				✓	

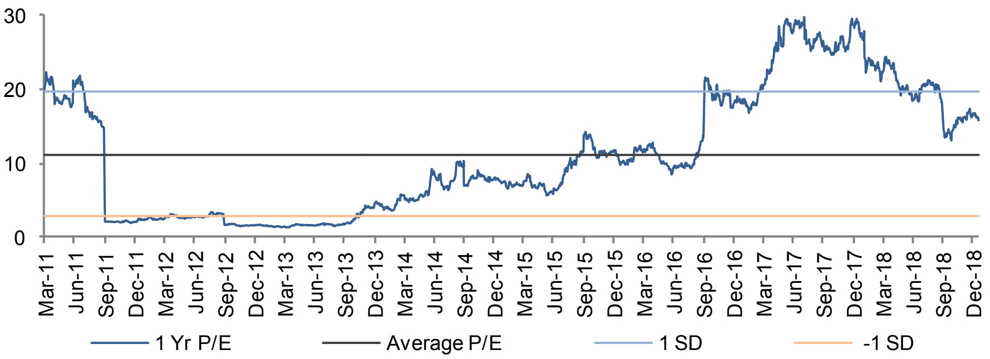
Source: Company, Karvy Research

Valuation & Outlook

We rate **HOLD** for CEAT at a P/E of 15x FY21E EPS of Rs. 83.7 for a target price of Rs. 1255 representing a 12% upside potential. We are confident that the branding strategy of the company will lead to higher volumes. Also, capacity expansion to improve product reach is favorable for the company. However, raw material prices remain a key risk to our call. In addition to this, high industry fragmentation is a disadvantage for the company as it impacts pricing.

The 5-year average fwd P/E is 12x having a standard deviation of 8 which is quite high. We cannot rule out the volatility of the sector which is highly sensitive to commodity prices. However, as rubber and crude prices have stabilized, we think the tyre sector has the advantage now. Historically, the capex cycle has been a key determinant of stock performance and now that the capex cycle is about to conclude we can expect higher return ratios driven by increasing asset turnover ratio.

PE Band



Source: Company, Karvy Research

Comparative Valuation Summary

	CMP	Mcap	EV/EBITDA (x)				P/E (x)				EPS (Rs.)			
	(Rs.)	(Rs. Mn)	FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E
CEAT	1125	45345	8.7	8.1	7.2	6.4	15.3	17.1	14.6	13.4	73.3	65.8	76.9	83.7
Apollo	216	123563	9.8	8.1	7.1	6.3	21.7	14.1	12.8	11.0	12.7	15.3	16.9	19.6

Source: Bloomberg, Karvy Research

Comparative Operational Metrics Summary

	CAGR % (FY18-21E)			RoE (%)				Price Perf (%)			Net Sales (Rs. Mn)			
	Sales	EBITDA	EPS	FY18	FY19E	FY20E	FY21E	3m	6m	12m	FY18	FY19E	FY20E	FY21E
CEAT	9.8	9.4	4.0	10.5	9.8	10.6	10.6	(12.5)	(0.2)	(24.9)	62308	69162	76769	85214
Apollo	13.7	14.2	14.0	8.5	8.7	8.9	9.6	(3.7)	5.9	(18.6)	148405	178086	201237	227398

Source: Bloomberg, Karvy Research

Financials

8 year average revenue growth was 11%. Healthy automotive growth in the previous years is expected to improve replacement demand.

The company follows a 60 day credit period for distributors.

Income Statement

YE Mar (Rs. Mn)	FY17	FY18	FY19E	FY20E	FY21E
Revenues	57665	62308	69162	76769	85214
Growth (%)	5.2	8.1	11.0	11.0	11.0
Operating Expenses	51023	56247	62698	69499	77049
EBITDA	6643	6061	6464	7270	8165
Growth (%)	(14.8)	(8.8)	6.6	12.5	12.3
Depreciation & Amortization	1431	1686	1471	1661	1950
EBIT	5212	4375	4993	5609	6216
Other Income	190	444	100	100	100
Interest Expenses	896	1036	1118	1267	1482
PBT	4506	3783	3975	4441	4834
Tax	931	1001	1312	1332	1450
Minority Interest	19	47	-	-	-
Associate Profit	284	230	-	-	-
Adjusted PAT	3840	2965	2663	3109	3384
Growth (%)	(15.9)	(22.8)	(7.2)	15.0	11.7

Source: Company, Karvy Research

Balance Sheet

YE Mar (Rs. Mn)	FY17	FY18	FY19E	FY20E	FY21E
Cash & Cash Equivalents	359	863	723	540	539
Sundry Debtors	6138	7472	7579	8413	9339
Inventory	9435	7846	9664	10727	11907
Loans & Advances	3080	2867	3181	3531	3920
Net Block	27788	30338	33867	39205	44256
Investments	2316	2135	1812	1812	1812
Other assets	54	90	90	90	90
Total Assets	**49169**	**51610**	**56920**	**64322**	**71866**
Current Liabilities	5152	6925	7608	8445	9374
Debt	9251	6603	8603	11521	14112
Other non-current Liabilities	10326	11788	12334	13480	14750
Total Liabilities	**24728**	**25315**	**28545**	**33445**	**38236**
Shareholders Equity	405	405	405	405	405
Reserves & Surplus	24037	25890	27971	30473	33226
Total Networth	**24441**	**26295**	**28375**	**30877**	**33630**
Total Networth & Liabilities	**49169**	**51610**	**56920**	**64322**	**71866**

Source: Company, Karvy Research

We expect high RoE as capacity utilization improves.

Cash Flow Statement

YE Mar (Rs. Mn)	FY17	FY18	FY19E	FY20E	FY21E
PBT	4506	3783	3975	4441	4834
Depreciation	1431	1686	1471	1661	1950
Tax Paid	(1017)	(979)	(1312)	(1332)	(1450)
Inc/dec in Net WC	(2174)	1667	(1010)	(265)	(294)
Other Income	734	939	1018	1167	1382
Other items	0	0	(280)	0	0
Cash flow from operating activities	**3480**	**7097**	**3862**	**5673**	**6421**
Inc/dec in capital expenditure	(5877)	(4872)	(5000)	(7000)	(7000)
Others	443	721	423	100	100
Cash flow from investing activities	(5434)	(4151)	(4577)	(6900)	(6900)
Change in Borrowings	**3310**	**(523)**	**2276**	**2918**	**2591**
Interest paid	(765)	(973)	(1118)	(1267)	(1482)
Dividend paid	(7)	(473)	(582)	(607)	(631)
Others	(347)	(56)	0	0	0
Cash flow from financing activities	**2191**	**(2025)**	**575**	**1044**	**478**
Net change in cash	237	921	(140)	(183)	(0)

Source: Company, Karvy Research

Exhibit : Key Ratios

YE Mar	FY17	FY18	FY19E	FY20E	FY21E
EBITDA Margin (%)	11.5	9.7	9.3	9.5	9.6
EBIT Margin (%)	9.0	7.0	7.2	7.3	7.3
Net Profit Margin (%)	6.4	4.2	3.9	4.0	4.0
Dividend Payout ratio	12.6	17.7	18.2	16.3	15.5
Debt/Equity	0.4	0.3	0.3	0.4	0.4
RoE (%)	16.6	10.5	9.8	10.6	10.6
Return on Assets (%)	13.0	10.2	10.7	10.8	10.7
RoCE (%)	17.3	13.2	14.4	14.2	13.9

Source: Company, Karvy Research

Exhibit : Valuation Parameters

YE Mar	FY17	FY18	FY19E	FY20E	FY21E
EPS (Rs.)	94.9	73.3	65.8	76.9	83.7
DPS (Rs.)	11.5	11.5	12.0	12.5	13.0
BVPS (Rs.)	604.2	650.1	701.5	763.3	831.4
PE (x)	11.9	15.3	17.1	14.6	13.4
P/BV (x)	1.9	1.7	1.6	1.5	1.4
EV/EBITDA (x)	7.9	8.7	8.1	7.2	6.4
EV/Sales (x)	0.9	0.8	0.8	0.7	0.6

*Source: Company, Karvy Research; *Represents multiples for FY17 & FY18 are based on historic market price*

Stock Ratings		Absolute Returns
Buy	:	> 15%
Hold	:	5-15%
Sell	:	< 5%

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