Narnolia™

INDUSTRY -	AUTO ANCILLARY
BLOOMBERG	CEAT IN
BSE Code -	500878
NSE Code -	CEATLTD
NIFTY -	10118

CEAT LIMITED

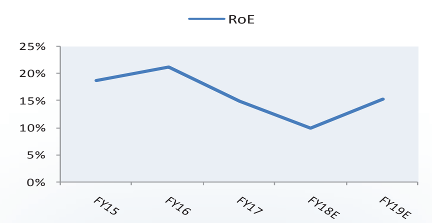
ACCUMULATE

16-Nov-17

Company Data

CMP	1746
Target Price	**1854**
Previous Target Price	1800
Upside	**6%**
52wk Range H/L	1948/1060
Mkt Capital (Rs Cr)	7,064
Av. Volume (,000)	55

RoE to improve sharply in FY19

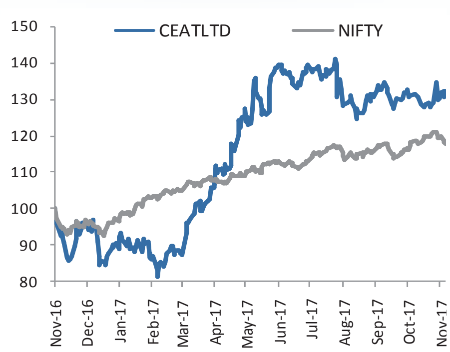


Shareholding patterns %

	2QFY18	1QFY18	4QFY17
Promoters	50.8	50.8	50.8
Public	49.2	49.2	49.2
Total	100.0	100.0	100.0

Stock Performance %

	1Mn	3Mn	1Yr
Absolute	0.8	2.7	41.8
Rel.to Nifty	1.9	(0.6)	17.0



NAVEEN KUMAR DUBEY
Naveen.dubey@narnolia.com

Key Highlights of the Report:

- ☑ Net revenue was up by 6.7%YoY to Rs.1523 crore in 2QFY18. Sales volume grew by 2%YoY and realization increased by 4.7%YoY.
- ☑ EBITDA soared by 220%QoQ to Rs.175 crores due to lower raw rubber prices during the quarter. EBITDA Margin jumped by whopping 780 bps QoQ to 11.5%.
- ☑ Management's strong focus towards the high margin Passenger vehicle segment (including 2Ws) has bode well for the company. EBITDA Margin moved to 11% from 6% in last 6 years.
- ☑ Factoring revival in export and ramp up in OTR facility from Q3FY18, we tweak our EPS estimates by 3% and maintain ACCUMULATE rating for a revised target price of Rs.1854.

Financials/Valu	FY15	FY16	FY17	FY18E	FY19E
Net Sales	5,802	5,484	5,767	6,297	7,270
EBITDA	681	773	657	621	936
EBIT	587	665	514	453	738
PAT	314	438	361	265	464
EPS (Rs)	78	108	89	66	115
EPS growth (%)	3%	39%	-17%	-27%	75%
ROE (%)	19%	21%	15%	10%	15%
ROCE (%)	29%	25%	16%	13%	20%
BV	416	510	597	653	749
P/B (X)	1.9	2.1	2.2	2.7	2.3
P/E (x)	10	10	15	27	15

OTR facility to come up fully in 2HFY18

- ✓ The company has set up a green field facility in Ambernath. The plant will produce Off Road Tyres(OTR) in the international market. The investment of Rs.330 crores for phase 1 capacity of 40MT/day and which can be further ramped up to 100MT/day.
- ✓ The company has already started testing of tyres in European markets from 1QFY18. These products will be tested for next 3-4 months and after then it can be produced and launched on larger scale.
- ✓ OTRs are high margin products and there are only two indian tyre manufacturers in this space, Balkrishna Industries and Alliance Tyres. CEAT has done extensive research and the findings were that there is scope for a third player in this segment.
- ✓ Major markets for OTRs include Europe and US. Initially CEAT will target European market to increase its presence.

Quarterly Performance

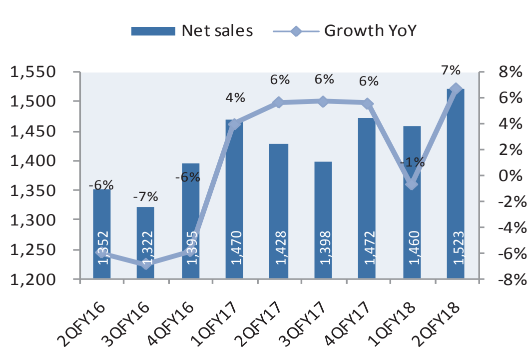
Financials	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	YoY %	QoQ%	FY16	FY17	YoY %
Net Sales	1,428	1,398	1,472	1,460	1,523	7%	4%	5,484	5,767	5%
Other Income	4	6	4	10	6	76%	-38%	27.68	18.63	-33%
COGS	819	820	925	961	923	13%	-4%	3,091	3,400	10%
Employee Cost	100	106	105	100	111	11%	11%	388	406	5%
Other Expenses	323	319	310	344	314	-3%	-9%	1,231	1,304	6%
EBITDA	186	154	133	55	175	-6%	220%	773	657	-15%
Depreciation	32	35	46	40	41	29%	3%	108	143	33%
EBIT	155	118	86	15	134	-13%	788%	665	514	-23%
Interest	16	19	21	23	24	46%	5%	95	82	-14%
PBT	142	105	69	3	117	-18%	4033%	598	451	-25%
Exceptional Item	-	-	12	0	8	0%	2180%	(11)	(13)	17%
Tax	43	26	(4)	5	42	-2%	786%	187	106	-43%
PAT	108	84	66	1	73	-32%	5188%	438	361	-17%

Slow restocking in the industry led to 2%YoY volume growth; EBITDA up by 220%QoQ on the back of declining commodity prices

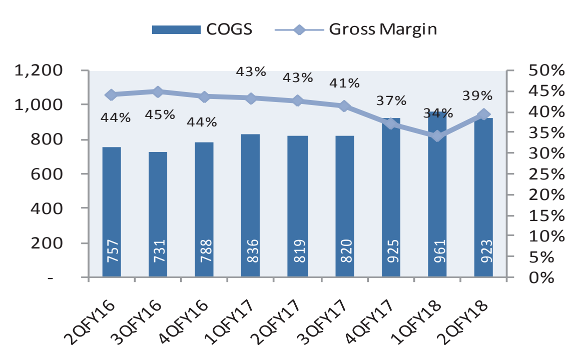
Lower raw material cost led to sharp spurt in EBITDA

- ✓ Net sales was up by 6.7%YoY to Rs.1523 crore in 2QFY18. Sales volume grew by 2%YoY and realization increased by 4.7%YoY.
- ✓ Earlier in 1QFY18 replacement demand was impacted by destocking due to GST on passenger vehicles and 2Ws side. However the industry has witnessed restocking from September onward and the replacement market has started gaining momentum. Exports volume declined because of import barriers in Indonesia and political unrest in other markets.
- ✓ EBITDA soared by 220%QoQ to Rs.175 crores due to lower raw rubber prices during the quarter. Though, the tyre manufacturers have already taken the hit of higher commodity prices in 4QFY17. Due to competitive intensity the company was not able to pass on the increasing raw material cost.
- ✓ Depreciation and Amortization expense for the quarter remain on higher due to commencement of production at Ambernath Plant.
- ✓ The company posted PAT of Rs.73 crores during the quarter. There was an exceptional item of Rs.8 crores which was related to VRS given to employees in 2QFY18.

Net sales trend



COGS and Gross Margin trend

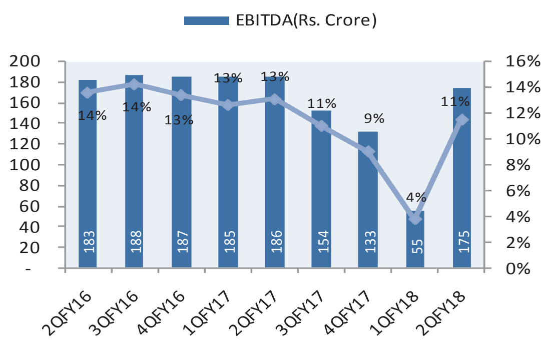


15%QoQ decline in rubber prices led to 520bps improvement in Gross Margins

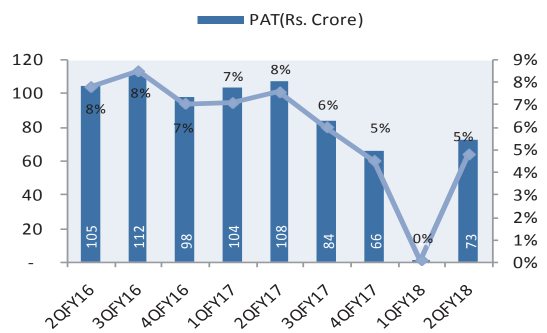
Margin %	*2QFY17*	*3QFY17*	*4QFY17*	*1QFY18*	*2QFY18*	*YoY(+/-)*	*QoQ(+/-)*	*FY16*	*FY17*	*YoY(+/-)*
Gross Margin	43%	41%	37%	34%	39%	***-3.26%***	***5.2%***	44%	41%	***-0.03***
EBITDA Margin	13%	11%	9%	4%	12%	***-1.55%***	***7.8%***	14%	11%	***-0.03***
PAT Margin	8%	6%	5%	0%	5%	***-2.75%***	***4.7%***	8%	6%	***-0.02***

- ✓ Gross Margin contracted by 520 bps QoQ to 39% on the back of lower natural rubber prices and other crude derivatives.
- ✓ EBITDA Margin jumped by whopping 780 bps QoQ to 11.5%. This was attributed to lower commodity prices and reduction in other expenses which was higher in 1QFY18 due to IPL.
- ✓ PAT margin was up by 470 bps QoQ to 4.8% in 2QFY18 from 0.09% in 1QFY18. This was mainly because of higher commodity prices.

EBITDA and EBITDA Margin trend



PAT and PAT Margin trend



Concall Highlights:

- ✓ Volume growth in Passenger vehicle segment to pick up from Q2 onwards due to lower base in 3QFY17.
- ✓ The company faced challenging time on the exports front as there were issues like rupee appreciation, import barriers in Indonesia and political unrest in some other markets.
- ✓ Management expects raw material price to remain stable for rest of the year.
- ✓ The management does not anticipate any further price hike due to high competitive intensity in the industry.
- ✓ The company has starterd production of Off the road tyres in its Ambernath facility and testing for these tyres is in process in Europe. Once the testing will complete the company will launch these tyres in Indian market also. OTR tyres have margin of over 20%.
- ✓ Debt to Equity ratio stands at 0.4:1.
- ✓ Capacity utilization for new facilities at Nagpur and Halol stand at 60% and 75% respectively.
- ✓ CEAT has market share of 28-30% on the 2W replacement market and targets to achieve 35% in next couple of years. Market share in the passenger car segment is around 12% and this segment may face some capacity constraints in near future looking at the demand scenario.
- ✓ Capex in FY18 to be Rs.500-600 crores largely towards new capacity expansion.
- ✓ Tax rate will be in the range of 32-33% for FY18.
- ✓ TBR and TBB mix is 33:67. The company has some capacity constraints on the TBR side.

Investment Arguments:

- ✓ **Rising income level to drive Passenger Vehicle demand-** The passenger vehicle industry has grown at a healthy pace in last 3 years because of increase in the per capita income and living of standards. However, the passenger vehicle penetration in India is very low among the fastest growing economies. We expect that the penetration will increase and demand for tyres in both OEM and replacement segment will boost going forward.

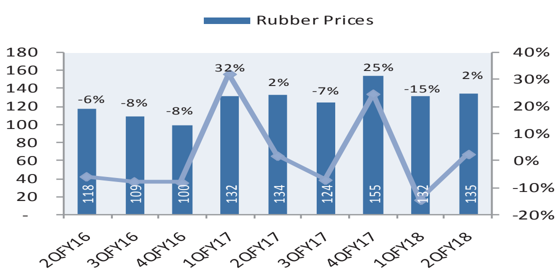
- ✓ **Margins to boost going forward-** Management's focused strategy to increase passenger vehicle and 2 wheelers contribution has bode well for the company and its margin expanded by over 600 bps in last 5 years. Foray into the OTR (off the road) segment in international market will further boost the margins as this segment has margins of over 20%.

Investment of Rs.2800 crores towards capacity expansion

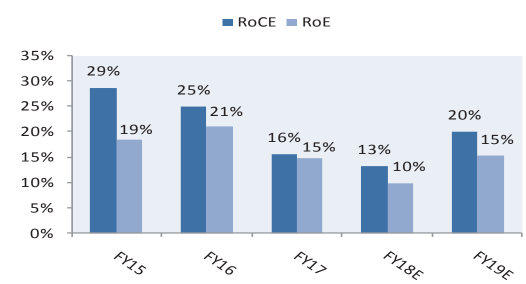
- ✓ **Capacity expansion drive to cater future demand**- Considering the huge demand from automobile OEMs in near future CEAT has already started the expanding its 2Ws and Passenger vehicle tyres. The company is also setting up one new green field facility in Ambernath to produce Off the road tyres. The company has also a capex plan of Rs.2800 crores which will be spent over a period of 5 years till FY2022.

- ✓ **Strong distribution network and brand recall**- The company has over 4500 dealers and approx. 450 exclusive CEAT frenchisees. CEAT has spent aggressively on expanding its distribution network to make it available to every part of the country. This has resulted in the increase in the market share in 2Ws and passenger vehicle segment. Going forward the management will keep spending on the advertising and promotion to make it global brand.

Decline in domestic natural rubber prices



RoE and RoCE to improve sharply in FY19



View & Valuation

CEAT LTD is one of the leading 2Ws and passenger vehicle tyre manufacturers in India. The company posted Q2FY18 results better than its peers. Net sales grew by 6.7%YoY to Rs.1523 crores owing to 2%YoY volume growth and 4.7%YoY pricing growth (better product mix). However, EBITDA margin improved sequentially by 770 bps to 11.5% on account of declining raw material prices. PAT for the quarter stood at Rs.73 crore. Management's focused strategy to increase its presence in the high margin Passenger vehicle (including 2Ws) space has bode well for the company. Revenue contribution from this segment has increased to approx.40% from 15% and the margin rose to 11% from 6% in last 6 years. Going ahead we believe increasing PV penetration in urban as well as in rural areas will provide ample opportunity for growth for the company. The company is also setting up green-field facility in Ambernath to cater OTR (off-road tyres) segment in the international market, which is again a high margin (over 20%) segment. Increasing OEM penetration, capacity expansion drive to cater future demand, cost-cutting initiatives and strong distribution reach will drive the revenue and margins up going ahead. Factoring revival in export and ramp up in OTR facility from Q3FY18, we tweak our EPS estimates by 3% and maintain ACCUMULATE rating for a revised target price of Rs.1854.

Financials Snap Shot

Income Statement

Rs in Crores

Y/E March	FY16	FY17E	FY18E	FY19E
Revenue from Operation	5,484	5,767	6,297	7,270
Change (%)	*-5%*	*5%*	*9%*	*15%*
Other Operating Income				
EBITDA	*773*	*657*	*621*	*936*
Change (%)	14%	-15%	-6%	51%
Margin (%)	**14%**	**11%**	**10%**	**13%**
Dep & Amortization	*108*	*143*	*167*	*198*
EBIT	665	514	453	738
Interest & other finance cost	*95*	*82*	*88*	*70*
Other Income	28	19	25	14
EBT	598	451	390	682
Exceptional Item	**(11)**	**(13)**	-	-
Tax	187	106	125	218
Minority Int & P/L share of Ass.	(2)	(2)	-	-
Reported PAT	*400*	*331*	*265*	*464*
Adjusted PAT	**438**	**361**	**265**	**464**
Change (%)	*39%*	*-17%*	*-27%*	*75%*
Margin(%)	8%	6%	4%	6%

Key Ratios

Y/E March	FY16	FY17E	FY18E	FY19E
ROE	21%	15%	10%	15%
ROCE	25%	16%	13%	20%
Asset Turnover	1.3	1.2	1.2	1.3
Debtor Days	41.2	38.9	37.0	37.0
Inventory Days	44.1	59.7	48.9	48.9
Payable Days	42.8	48.0	48.0	48.0
Interest Coverage	7	6	5	11
P/E	10.0	14.8	26.6	15.2
Price / Book Value	2.1	2.2	2.7	2.3
EV/EBITDA	*6.3*	*9.4*	*12.5*	*8.2*
FCF per Share	(8.9)	(62.6)	50.9	32.2
Dividend Yield	1.1%	0.9%	0.7%	0.7%

Assumptions

Y/E March	FY16	FY17E	FY18E	FY19E
Volume ('000)	2,68,500	2,95,924	3,13,403	3,55,600
Volume Growth	7%	10%	6%	13%
Realization Growth	(0)	(0)	0	0
Capex(Rs crore)	669	582	510	710

Balance Sheet

Rs in Crores

Y/E March	FY16	FY17E	FY18E	FY19E
Share Capital	40	40	40	40
Reserves	2,024	2,375	2,598	2,988
Networth	**2,065**	**2,415**	**2,639**	**3,028**
Debt	*628.548*	*910.4*	*802.3*	*697.3*
Other Non Current Liab	198	281	268	274
Total Capital Employed	*2,693*	*3,325*	*3,441*	*3,725*
Net Fixed Assets (incl CWIP)	*2,403*	*2,779*	*3,112*	*3,425*
Non Current Investments	*0*	*167*	*109*	*34*
Other Non Current Assets	*150*	*197*	*197*	*197*
Non Current Assets	**150**	**365**	**307**	**232**
Inventory	662	943	843	973
Debtors	*619*	*614*	*638*	*737*
Cash & Bank	107	36	47	39
Other Current Assets	**9**	**170**	**185**	**214**
Current Assets	1,397	*1,763*	*1,713*	*1,963*
Creditors	643	758	828	956
Provisions	84	*54*	*96*	*111*
Other Current Liabilities	488	538	548	566
Curr Liabilities	1,215	1,350	1,472	1,633
Net Current Assets	**182**	**413**	**241**	**330**
Total Assets	*4,138*	*4,985*	*5,211*	*5,660*

Cash Flow Statement

Rs in Crores

Y/E March	FY16	FY17E	FY18E	FY19E
PBT	587	437	390	682
(inc)/Dec in Working Capital	82	(217)	186	(91)
Non Cash Op Exp	108	143	167	198
Interest Paid (+)	95	82	88	70
Tax Paid	(169)	(102)	(125)	(218)
others	(1)	(9)	-	-
CF from Op. Activities	**702**	**335**	**707**	**641**
(inc)/Dec in FA & CWIP	*(738)*	*(588)*	*(501)*	*(510)*
Free Cashflow	*(36)*	*(253)*	*206*	*130*
(Pur)/Sale of Investment	274	(21)	(14)	50
others	(4)	37	58	60
CF from Inv. Activities	**(433)**	**(543)**	**(457)**	**(400)**
inc/(dec) in NW	382	350	225	392
inc/(dec) in Debt	78	331	(108)	(105)
Interest Paid	(93)	(76)	(88)	(70)
Dividend Paid (inc tax)	**(98)**	**(1)**	**(41)**	**(72)**
others	(214)	(35)	-	-
CF from Fin. Activities	(326)	219	(238)	(247)
Inc(Dec) in Cash	(57)	10	12	(7)
Add: Opening Balance	**71**	**14**	**24**	**35**
Closing Balance	14	24	49	30