Narnolia™

CEAT LIMITED

ACCUMULATE

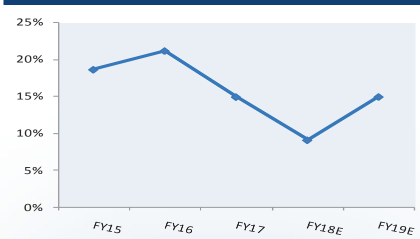
28-Aug-17

INDUSTRY -	Auto Ancillary
BSE Code -	500878
NSE Code -	CEATLTD
NIFTY -	9857

Company Data

CMP	1650
Target Price	**1800**
Previous Target Price	
Upside	**9%**
52wk Range H/L	1948/851
Mkt Capital (Rs Cr)	6,675
Av. Volume (,000)	57

RoE to improve sharply in FY19

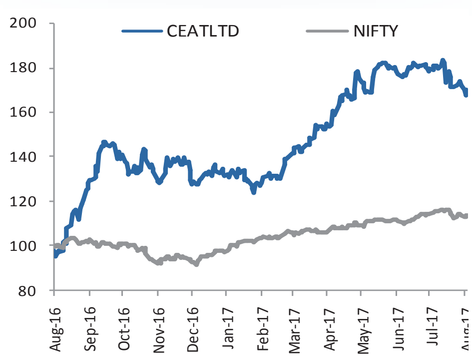


Shareholding patterns %

	1QFY18	4QFY17	3QFY17
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	(10.4)	(5.4)	93.3
Rel.to Nifty	(9.3)	(10.4)	79.1



NAVEEN KUMAR DUBEY
Naveen.dubey@narnolia.com

Key Highlights of the Report:

- ☑ Net sales was down by 0.7%YoY to Rs.1460 crore in 1QFY18. Sales volume declined by 5%YoY and realization was up by 4.3%YoY.
- ☑ EBITDA Margin contracted by 896 bps to 3.7% during 1QFY18 due to sharp increase in raw material prices in 4QFY17, higher spend on branding and IPL sponsorship during the quarter.
- ☑ 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.
- ☑ Considering the 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, we initiate coverage on CEATLTD with ACCUMULATE rating for target price of Rs.1800.

Financials/Valu	FY15	FY16	FY17	FY18E	FY19E
Net Sales	5,802	5,484	5,767	6,360	7,110
EBITDA	681	773	657	592	916
EBIT	587	665	514	406	698
PAT	314	438	361	238	449
EPS (Rs)	78	108	89	59	111
EPS growth (%)	3%	39%	-17%	-34%	88%
ROE (%)	19%	21%	15%	9%	15%
ROCE (%)	29%	25%	16%	12%	19%
BV	416	510	597	647	741
P/B (X)	1.9	2.1	2.2	2.6	2.2
P/E (x)	10	10	15	28	15

OTR facility to come up 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.

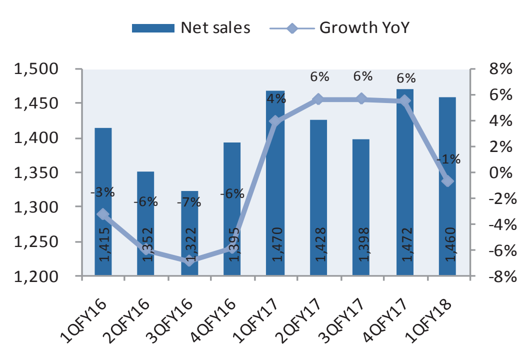
Quarterly Performance

Financials	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	YoY %	QoQ%	FY16	FY17	YoY %
Net Sales	1,470	1,428	1,398	1,472	1,460	-0.7%	-1%	5,484	5,767	5%
Other Income	6	4	6	4	10	82%	187%	27.68	18.63	-33%
COGS	836	819	820	925	961	15%	4%	3,091	3,400	10%
Employee Cost	96	100	106	105	100	5%	-4%	388	406	5%
Other Expenses	353	323	319	310	344	-3%	11%	1,231	1,304	6%
EBITDA	185	186	154	133	55	-71%	-59%	773	657	-15%
Depreciation	30	32	35	46	40	31%	-14%	108	143	33%
EBIT	155	155	118	86	15	-90%	-83%	665	514	-23%
Interest	25	16	19	21	23	-11%	6%	95	82	-14%
PBT	136	142	105	69	3	-98%	-96%	598	451	-25%
Exceptional Item	1	-	-	12	0	-60%	-97%	(11)	(13)	17%
Tax	42	43	26	(4)	5	-89%	-206%	187	106	-43%
PAT	104	108	84	66	1	-99%	-98%	438	361	-17%

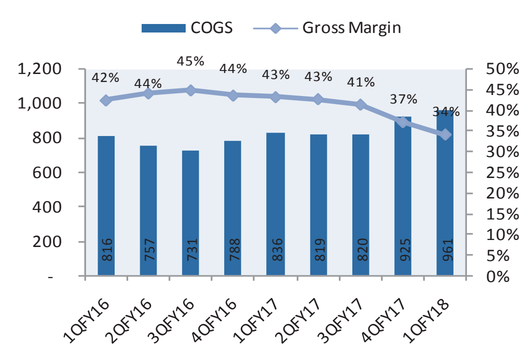
Revenue stable, PAT sunk to Rs.1 crore due to higher raw material prices

- ✓ Net sales was down by 0.7%YoY to Rs.1460 crore in 1QFY18. Sales volume declined by 5%YoY and realization was up by 4.3%YoY.
- ✓ Replacement demand was impacted by destocking due to GST on passenger vehicles and 2Ws side. Commercial vehicle demand was down due to BS-IV transition in the 4QFY17. Passenger vehicle segment grew by 5%YoY and scooters grew by 10%YoY during the quarter. Exports volume declined because of import barriers in Indonesia.
- ✓ EBITDA declined by 71%YoY to Rs.55 crores due to higher raw material cost and other expenses. Other expenses was higher during the quarter on account of advertising expenses and IPL sponsorship.
- ✓ Depreciation and Amortization expense for the quarter remain on higher due to operationalization of Ambernath Plant.
- ✓ PAT stood at Rs.1 crore for the quarter as compared to Rs.104 crore in 1QFY17.

Net sales trend



COGS and Gross Margin trend

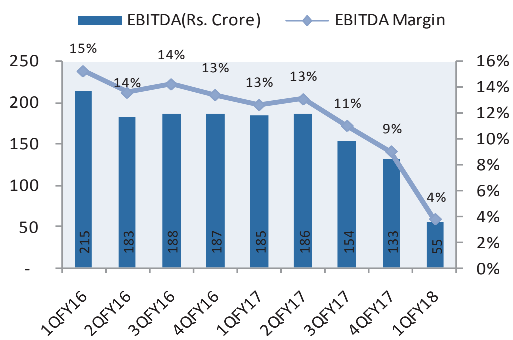


Margins plunge 886 bps to 3.7% in 1QFY18

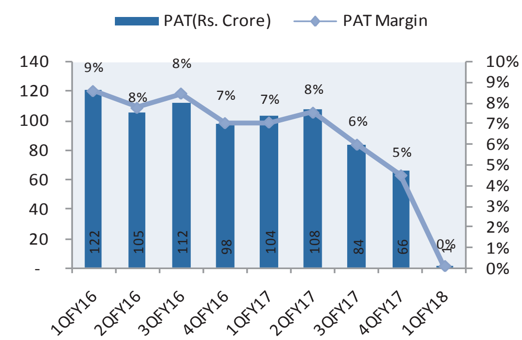
Margin %	*1QFY17*	*2QFY17*	*3QFY17*	*4QFY17*	*1QFY18*	*YoY(+/-)*	*QoQ(+/-)*	*FY16*	*FY17*	*YoY(+/-)*
Gross Margin	43%	43%	41%	37%	34%	***-8.96%***	***-3.0%***	44%	41%	***-0.03***
EBITDA Margin	13%	13%	11%	9%	4%	***-8.86%***	***-5.3%***	14%	11%	***-0.03***
PAT Margin	7%	8%	6%	5%	0%	***-6.98%***	***-4.4%***	8%	6%	***-0.02***

- ✓ Gross Margin contracted by 896 bps YoY to 34% on the back of higher natural rubber prices and other crude derivatives.
- ✓ EBITDA Margin also declined by 886 bps to 3.7% during the quarter due to higher other expenses which rose because of higher spend on branding and IPL sponsorship during the quarter.
- ✓ PAT margin shrinked to 0.1% in 1QFY18 from 7% in 1QFY17. 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.
- ✓ The management expects restocking to happen from 15th August onwards. Currently there is no growth or restocking happening.
- ✓ Due to higher RM cost margins to remain under pressure for couple of quarters.
- ✓ Other expenses to remain higher due to continued spend on marketing and advertising
  GST didn't have any major impact in tax rate, earlier it was 26.5% and the new rate is 28%.
- ✓ Testing for speciality tyres(OTR) in process in Europe.
- ✓ Chinese tyres have approx. 20% market share in TBB and TBR category.
- ✓ The talk on anti dumping duty is in process and the management expects duty in the range of 10-15 percent.
- ✓ Capacity utilization for new facilities at Nagpur and Halol stand at 60% and 75% respectively.
- ✓ The management do not expect to cut down 2Ws outsourced production. The new facility will supplement the out sourced production.
- ✓ Capex for FY18 to be Rs.500-600 crores largely towards new capacity expansion.
- ✓ The company has taken marginal price hike during the 2QFY18 and was unable to take further price hike because of intense competition.

Investment Arguments:

- ✓ **Rising income level to drive Passenger Vehicle demand-** The passenger vehicle industry has grown at a healthy pace in last 3 yearr because of increase in the per capita income and living of standards. Though 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.

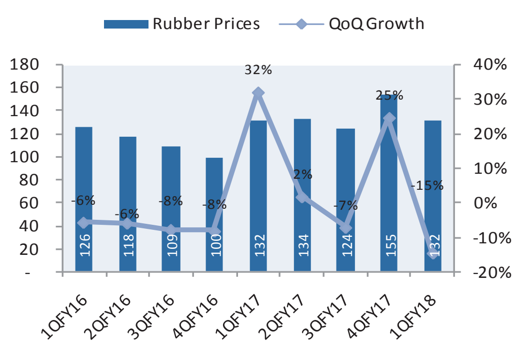
- ✓ **Margins to boost going forward-** Management's focused strategy to increase passenger vehicle contribution has bode well for the company and it's margin expanded by over 600 bps in last 5 years. Foray into the OTR (off the road) segment in international market will further boost the margins going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

- ✓ **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.

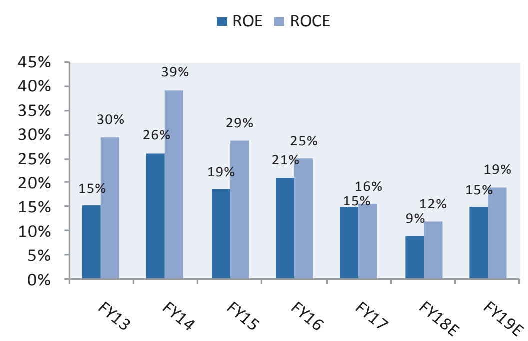
- ✓ **Many levers to commercial vehicle industry growth-** We expect that the commercial vehicle industry has many levers like scrappage policy, overloading norms, improving infrastructure activity and GST. About 30% of CEAT's revenue comes from CV segment.

- ✓ **Strong distribution network and brand recall**- The company has over 4500 dealers and approx. 450 exclusive CEAT frenchisees. The company 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 manufacturer in India. 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.43% 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 of growth for the company. The company is also setting up greenfield facility in Ambernath to cater OTR (off road tyres) segment in the international market, which is again a high margin segment. Increase in commodity prices in 4QFY17 and slow down in demand due to GST led to sharp decline in the margins for the company but the recent correction in raw material prices in 1QFY18 will ease the margin pressure going forward. Considering the 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, we initiate coverage on CEATLTD with ACCUMULATE rating for target price of Rs.1800.

Financials Snap Shot

Income Statement

Rs in Crores

Y/E March	FY16	FY17E	FY18E	FY19E
Revenue from Operation	5,484	5,767	6,360	7,110
Change (%)	*-5%*	*5%*	*10%*	*12%*
Other Operating Income				
EBITDA	*773*	*657*	*592*	*916*
Change (%)	14%	-15%	-10%	55%
Margin (%)	**14%**	**11%**	**9%**	**13%**
Dep & Amortization	*108*	*143*	*186*	*218*
EBIT	665	514	406	698
Interest & other finance cost	*95*	*82*	*88*	*70*
Other Income	28	19	23	13
EBT	598	451	340	641
Exceptional Item	**(11)**	**(13)**	-	-
Tax	187	106	102	192
Minority Int & P/L share of Ass.	(2)	(2)	-	-
Reported PAT	*400*	*331*	*238*	*449*
Adjusted PAT	**438**	**361**	**238**	**449**
Change (%)	*39%*	*-17%*	*-34%*	*88%*
Margin(%)	8%	6%	4%	6%

Key Ratios

Y/E March	FY16	FY17E	FY18E	FY19E
ROE	21%	15%	9%	15%
ROCE	25%	16%	12%	19%
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	10
P/E	10.0	14.8	28.0	14.9
Price / Book Value	2.1	2.2	2.6	2.2
EV/EBITDA	*6.3*	*9.4*	*12.5*	*7.9*
FCF per Share	(8.9)	(62.6)	47.4	38.6
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	3,16,287	3,50,481
Volume Growth	7%	10%	7%	11%
Realization Growth	(0)	(0)	0	0
Capex(Rs crore)	669	582	510	510

Balance Sheet

Rs in Crores

Y/E March	FY16	FY17E	FY18E	FY19E
Share Capital	40	40	40	40
Reserves	2,024	2,375	2,577	2,955
Networth	**2,065**	**2,415**	**2,617**	**2,996**
Debt	*628.5482*	*910.4*	*802.3*	*697.3*
Other Non Current Liab	198	281	268	273
Total Capital Employed	*2,693*	*3,325*	*3,419*	*3,693*
Net Fixed Assets (incl CWIP)	*2,403*	*2,779*	*3,094*	*3,386*
Non Current Investments	*0*	*167*	*104*	-
Other Non Current Assets	*150*	*197*	*192*	*192*
Non Current Assets	**150**	**365**	**296**	**192**
Inventory	662	943	851	952
Debtors	*619*	*614*	*645*	*721*
Cash & Bank	107	36	48	63
Other Current Assets	**9**	**170**	**187**	**209**
Current Assets	1,397	*1,763*	*1,730*	*1,945*
Creditors	643	758	836	935
Provisions	84	*54*	*97*	*109*
Other Current Liabilities	488	538	549	562
Curr Liabilities	1,215	1,350	1,482	1,605
Net Current Assets	**182**	**413**	**248**	**339**
Total Assets	*4,138*	*4,985*	*5,199*	*5,602*

Cash Flow Statement

Rs in Crores

Y/E March	FY16	FY17E	FY18E	FY19E
PBT	587	437	340	641
(inc)/Dec in Working Capital	82	(217)	180	(70)
Non Cash Op Exp	108	143	186	218
Interest Paid (+)	95	82	88	70
Tax Paid	(169)	(102)	(102)	(192)
others	(1)	(9)	-	-
CF from Op. Activities	**702**	**335**	**692**	**666**
(inc)/Dec in FA & CWIP	*(738)*	*(588)*	*(501)*	*(510)*
Free Cashflow	*(36)*	*(253)*	*192*	*156*
(Pur)/Sale of Investment	274	(21)	-	-
others	(4)	37	63	104
CF from Inv. Activities	**(433)**	**(543)**	**(438)**	**(406)**
inc/(dec) in NW	382	350	202	379
inc/(dec) in Debt	78	331	(108)	(105)
Interest Paid	(93)	(76)	(88)	(70)
Dividend Paid (inc tax)	**(98)**	**(1)**	**(37)**	**(70)**
others	(214)	(35)	-	-
CF from Fin. Activities	(326)	219	(234)	(245)
Inc(Dec) in Cash	(57)	10	21	16
Add: Opening Balance	**71**	**14**	**24**	**36**
Closing Balance	14	24	45	51