Tyre Sector

15 December 2020

Initiating Coverage

Ready to burn rubber

We expect healthy overall growth in tyre demand over FY21-23, as demand from original equipment manufacturers (OEMs) is expected to grow at a strong 18-20% CAGR during the same period. Higher demand will be seen across all the automobile segments over a pandemic-hit low base of FY21 amid expectations of Covid vaccines and improvement in demand cycle amid improving economy and consumer sentiments. We are already seeing a 'V' shaped recovery in most of the Auto segments and we expect OEM demand growth from PVs, 2Ws, and Tractor segments in the medium term and from CVs, PVs and 2Ws in the long term. Replacement demand for tyres has been strong whereas OEM sales have been tepid for the last 18-24 months. Replacement demand is expected to remain strong in the near term and eventually we expect it to normalise in the medium to long term period.

Post the lockdown, we have seen faster-than-anticipated recovery in the domestic replacement segment as economic activity has improved, imports have been restricted and most manufacturers expect positive revenue growth in FY21. For Apollo Tyres, in the replacement market, 2QFY21 volume growth was 18% YoY for TBR and 11% YoY for PCR. For CEAT, replacement demand was strong in 2QFY21 with all segments growing in double digits. Higher replacement segment share in revenues and lower commodity costs have supported margins of tyre manufacturers in the last few quarters. Going forward, we expect replacement demand to normalise in the next few quarters and we could see higher OEM sales growth for the next few years. OEM demand has started to pick up, driven by shift towards personal mobility (entry level 2Ws and PVs). Adverse product mix and rising rubber prices will weigh on margins going forward. But, improving utilisations will support the operating performance and should help in mitigating these overhangs.

We are initiating coverage on Apollo Tyres and CEAT with this thematic

Apollo Tyres: For the standalone business, driven by healthy replacement demand and upturn in the CV and PV cycles, we expect the revenue to grow at 10.5% CAGR over FY20-23E. Europe revenue should improve on the back of a gradual pick-up in replacement sales and market share gains. The company will benefit from staff reduction, improved distribution and shift from Dutch to Hungary plant. At a consolidated level, we expect revenue CAGR of 9.2% over FY20-23, EBITDA margin improvement of 230bps and PAT CAGR of 29.6%. This is a result of expected benefits from better scale, cost savings in employee expenses and other fixed costs and improved product mix. Given the strong revival, we value the stock at 14x Sept'22 consolidated EPS. It is a 15% premium to its long-term average multiple of 12x and gives us a target price (TP) of Rs227.

CEAT: Given its lower presence in the truck radial segment, we expect CEAT to lag its peers in terms of growth as CVs are set for a stronger revival due to extremely low base viz-a-viz other segments. That said, as the whole Auto sector is witnessing a 'V' shaped recovery, CEAT should also be a beneficiary of the upcycle. We expect 9.8% CAGR during FY20-23E. Margins are expected to expand on the back of an improved operating performance. As a result, PAT is expected to grow at 19.2% CAGR. We value the company at 12x Sept'22 EPS, which is its long-term average multiple. We have a TP of Rs1,243.

View: Positive

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Companies	Rating	Market capitalisation		CMP	Target	(%) Up/	EPS (Rs)			P/E (x)			RoE (%)		
		(Rsbn)	(US$bn)	(Rs)	Price (Rs)	(Down)	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Apollo Tyres	BUY	120	1.6	189	227	20.2	4.2	14.3	18.1	44.6	13.2	10.4	2.4	7.7	9.1
CEAT Ltd	ACC	47	0.6	1,163	1,243	6.9	82.7	98.0	109.2	14.1	11.9	10.6	10.5	11.3	11.4

Source: Nirmal Bang Institutional Equities Research

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Investment Rational

We expect healthy overall growth in tyre demand over FY21-23, as demand from original equipment manufacturers (OEMs) is expected to grow at a strong 18-20% CAGR during the same period. Higher demand will be seen across all the automobile segments over a pandemic-hit low base of FY21 amid expectations of Covid vaccines and improvement in demand cycle amid improving economy and consumer sentiments. We are already seeing a 'V' shaped recovery in most of the Auto segments and we expect OEM demand growth from PVs, 2Ws, and Tractor segments in the medium term and from CVs, PVs and 2Ws in the long term. Replacement demand for tyres has been strong whereas OEM sales have been tepid for the last 18-24 months. This is expected to remain strong in the near term and eventually we expect it to normalise in the medium to long term period.

Demand for tyres arises either from OEMs or the replacement market. OEM demand typically mirrors trend in vehicle production while the replacement market demand is linked to the economy, usage and replacement cycles.

Last couple of years have been challenging for the Indian auto sector. Tyre industry growth has been decelerating since 2QFY19 and went into the negative territory in 2QFY20. According to ICRA, tyre industry revenue declined by 7.4% in FY20. But, industry OPM increased by 300bps in FY20 to 13.8% on the back of softer RM prices. Higher capex over the last few years dragged PBT margins (due to higher depreciation) and ROCE down (ROCE declined by 280bps in FY20). Tyre industry takes cues from vehicle production levels. FY20 witnessed 18% decline in domestic auto production and sales due to a slowing economy and weak consumer sentiments. Exports volume grew by 3% in FY20. Domestic tyre production fell by 8% in FY20, the sharpest decline in the last 25 years. Industry revenue had declined twice in the past - in FY13 and FY95. Over the last 25 years, tyre demand has grown at 7% CAGR till the period ending FY19.

Tyre demand contracted the most in the commercial segments like Trucks & Bus (T&B) (-17%), LCVs (-8%) and Tractors (-18%) in FY20. Consumer segments like PVs and 2Ws were relatively resilient. Tyre demand from OEMs declined by 16.3% in FY20 vs. a 2.7% decline in the replacement segment. The product mix has shifted towards the replacement (57%) segment vs. OEM (43%) in the last 4 years.

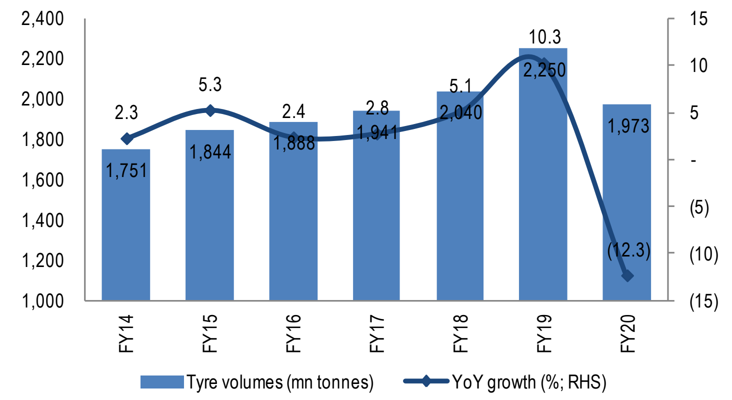
Post the lockdown, we have seen faster-than-anticipated recovery in the domestic replacement segment as economic activity has improved, imports have been restricted and most manufacturers expects positive revenue growth in FY21. For Apollo Tyres, in the replacement segment, volume growth was 18% YoY for TBR and 11% YoY for PCR in 2QFY21. For CEAT, replacement demand was strong during the quarter, with all segments growing in double digits. Higher replacement segment share in revenues and lower commodity costs have supported the margins of tyre manufacturers in the last few quarters. Going forward, we expect replacement demand to normalise in the next few quarters and we could higher OEM sales growth in the next few years. OEM demand has started to pick up, driven by the shift towards personal mobility (entry level 2W and PVs). An adverse product mix and rising rubber prices will weigh on margins going forward. But, improving utilisations will support the operating performance and should help in mitigating these overhangs.

Indian Tyre Industry Overview

Industry size

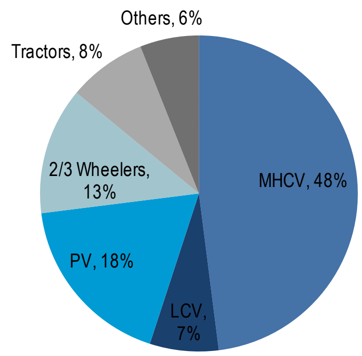
Tyre industry in India reached its peak size of ~2.25mn tonnes in FY19 when the auto industry was also at its peak in terms of new vehicle sales. The MHCV segment is the largest in terms of tonnage with 48% share of the pie followed by PVs at 18%, 2Ws/3Ws at 13%, Tractors at 8% and LCVs at 7%. In FY20, auto industry volume declined by 19% whereas tyre industry volume was down ~12% as replacement demand remained good.

Exhibit 1: Tyre volume (tons) grew at CAGR 2% over FY14-20



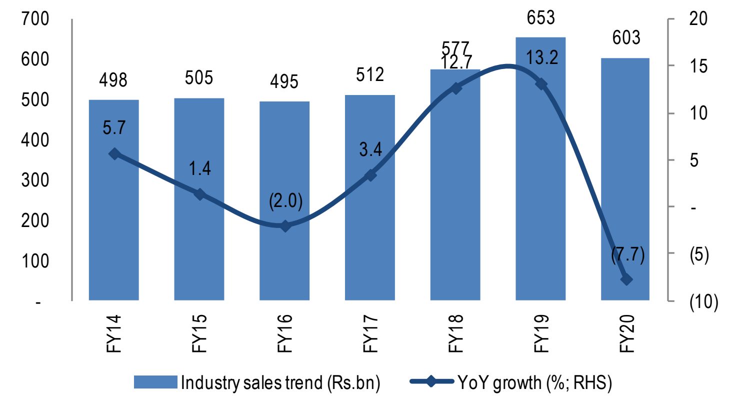
Source: ICRA, Nirmal Bang Institutional Equities Research

Exhibit 2: Segment mix – MHCV dominates industry tonnage



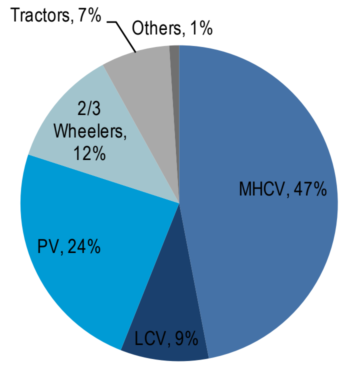
Source: ICRA, Nirmal Bang Institutional Equities Research

Exhibit 3: Industry sales grew at CAGR of 3.2% over FY14-20



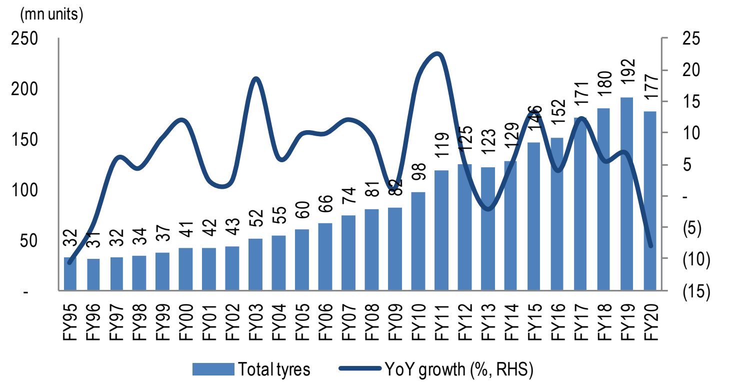
Source: Industry, Nirmal Bang Institutional Equities Research

Exhibit 4: MHCVs dominate industry sales followed by PVs



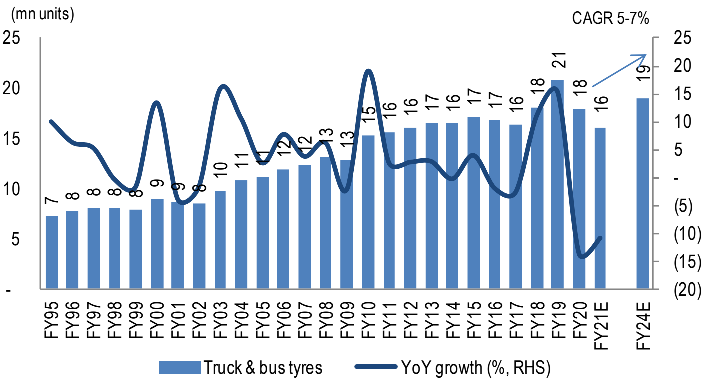
Source: Industry, Nirmal Bang Institutional Equities Research

Exhibit 5: Industry volume has grown at CAGR of 8.1% over the long term



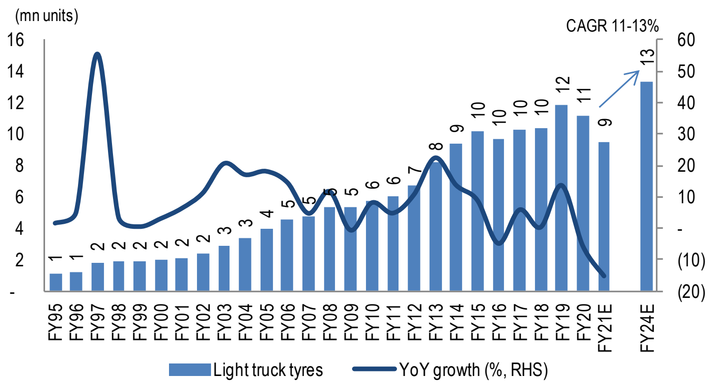
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 6: Truck & Bus tyre volume has grown at CAGR of 3.4%



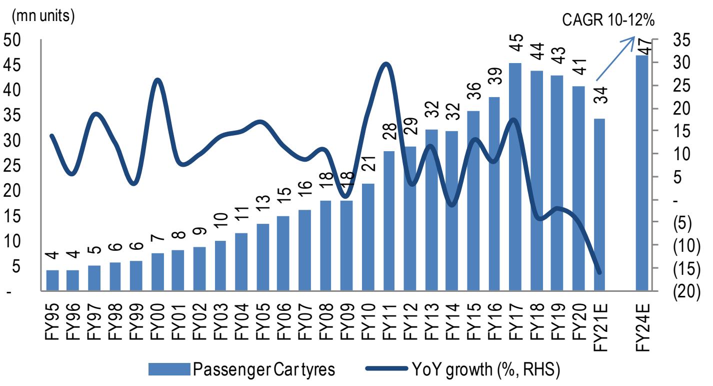
Source: CEIC, ICRA, Nirmal Bang Institutional Equities Research

Exhibit 7: LCV tyre volume has grown at CAGR of 8.4%



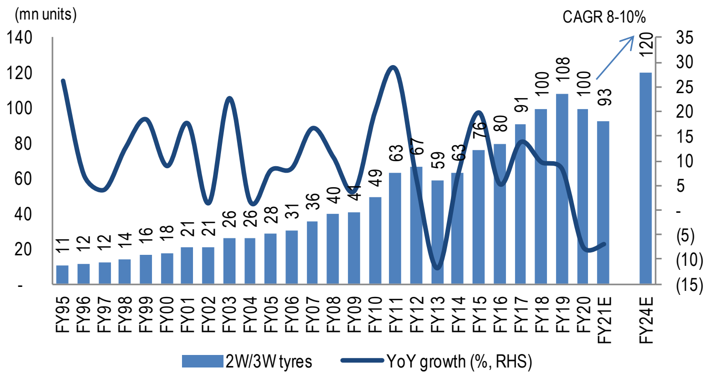
Source: CEIC, ICRA, Nirmal Bang Institutional Equities Research

Exhibit 8: PV tyre volume has grown at CAGR of 8.9%



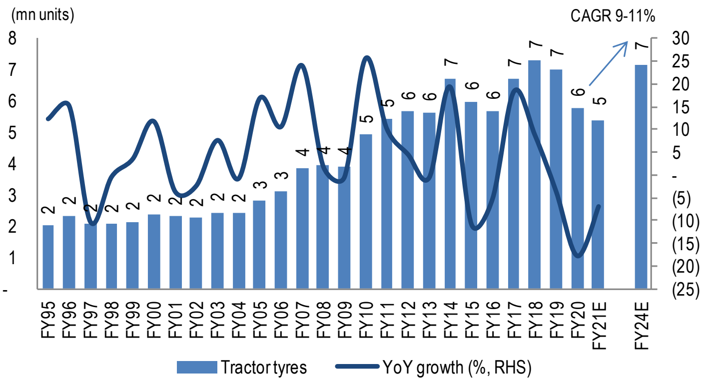
Source: CEIC, ICRA, Nirmal Bang Institutional Equities Research

Exhibit 9: 2W/3W tyre volume has grown at CAGR of 9.3%



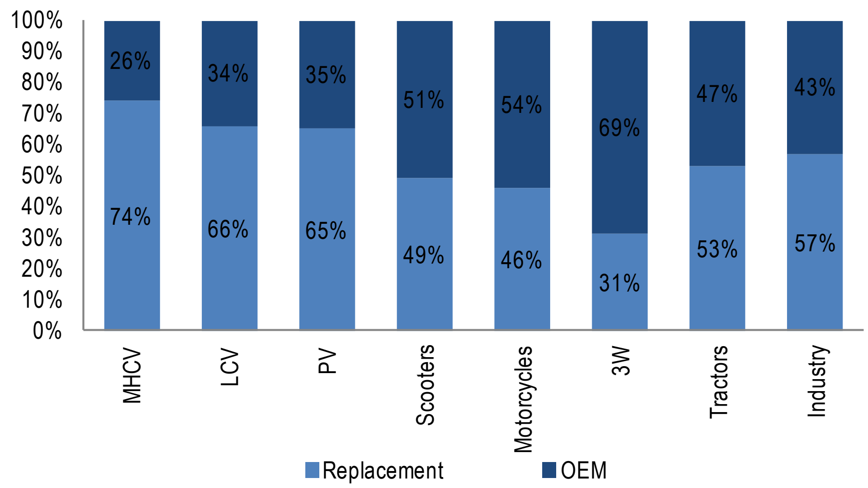
Source: CEIC, ICRA, Nirmal Bang Institutional Equities Research

Exhibit 10: Tractor tyre volume has grown at CAGR of 6%



Source: CEIC, ICRA, Nirmal Bang Institutional Equities Research

Exhibit 11: Segment-wise – channel mix (4-yr average)



Source: Company, Nirmal Bang Institutional Equities Research

Competitive Landscape & New Entrants:

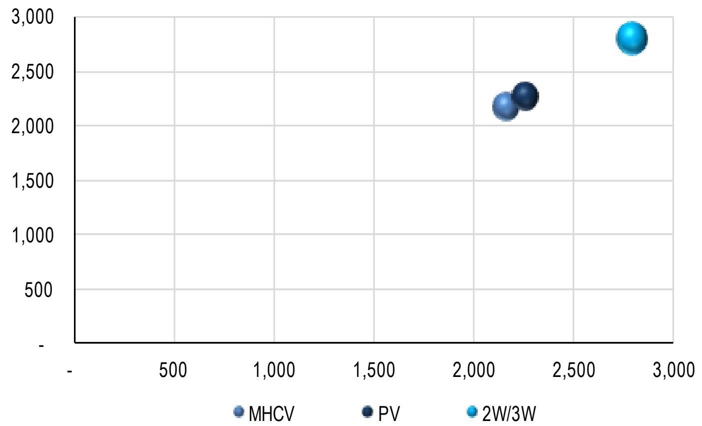
Bargaining power of buyers: The Indian tyre industry has over 40 players. Products are largely commoditized and there are no switching costs involved. Further, tyre companies have limited pricing power and cannot fully pass on the increased raw material prices to the buyers, especially in the OEM segment, who buy in bulk on long term contractual basis. Thus, the bargaining power of OEMs is high. However, tyre companies enjoy higher pricing power and better margins in the replacement segment as the bargaining power of buyers is relatively low.

Bargaining power of suppliers: The key raw material for tyre industry is natural rubber. The production of rubber is significantly lower than demand and India is a net importer of rubber. Rubber forms the major component of the overall raw material cost for a tyre and any disruption in supply chain or fluctuation in rubber prices can affect margins. In this context, the bargaining power of suppliers is high.

Competitive intensity in the industry: Top 10 players in the tyre industry hold ~90-95% market share. Further, in each segments – Truck & Bus, Passenger Cars and Two Wheelers, top 3-4 players hold ~70-80% market share. However, the individual market share of companies in each segment is quite close and thus no tyre company has a dominant position and pricing power. Thus, overall competitive intensity is moderate.

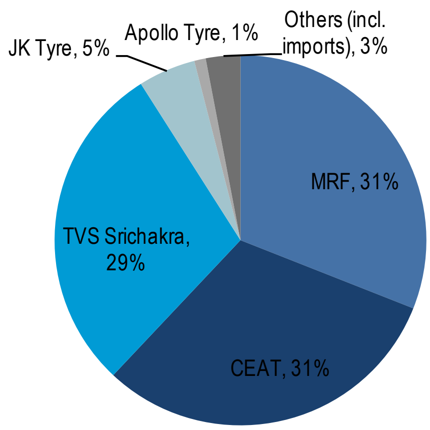
Competitive intensity varies based on the market share of companies in each segment. Our analysis of competitive intensity (as per the HHI) indicates relatively low competition in 2Ws/3Ws compared to PCR and MHCVs where the market is moderately competitive. There are only 5-6 key players in 2Ws, with top 3 tyre players having a combined market share of over ~90% compared to over a dozen players in the PV segment.

Exhibit 12: HHI index indicates relatively lower competition in 2W/3W tyres compared to MHCV & PV tyres



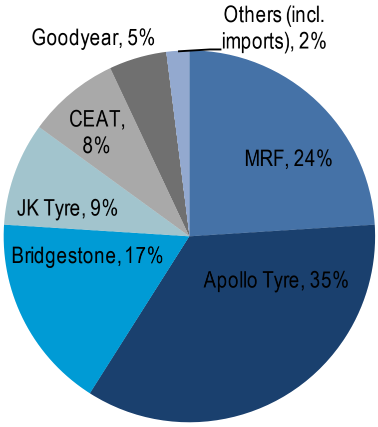
Source: Industry, Nirmal Bang Institutional Equities Research

Exhibit 13: 2W/3W tyre market share – 2W/3W tyre industry is dominated by 3 players



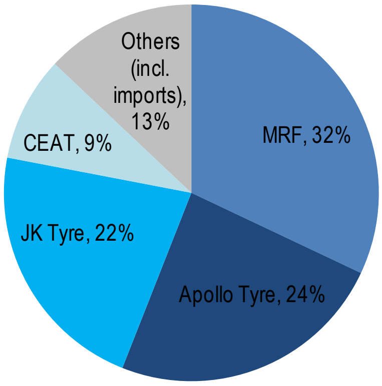
Source: Industry, Nirmal Bang Institutional Equities Research

Exhibit 14: Apollo leads PV market share followed by MRF



Source: Industry, Nirmal Bang Institutional Equities Research

Exhibit 15: MRF leads MHCV market share



Source: Industry, Nirmal Bang Institutional Equities Research

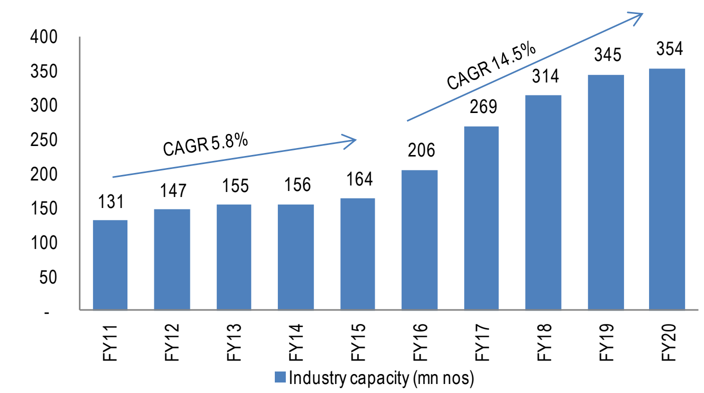
Substitutes: Retreading of tyres has been prevalent globally for the past several decades and is relatively a cheaper option (~20-25% of original cost of tyres). With the rise in radialisation, the share of retreading will further rise. However, it is not expected to be a big portion of the industry as retreading is largely an unorganized market and thus given the quality of retreaded tyres, it becomes economical to buy a new tyre. Furthermore, restrictions on tyre imports will restrict imports of low priced tyres, which was rampant 2-3 years ago. Thus, threat of substitutes is low.

Entry barriers: Prospect of a new entrant is moderate to low because the industry is highly capital intensive with relatively low returns. Besides investments in plant & machinery, consistent investment is required on branding and towards R&D. Tyre industry margins are low given the high competitive intensity. Therefore, it is difficult for new players to sustain in this competitive industry. Maxxis group, one of the latest entrants has been able to gain some share in the OEM business. However, before making a full-fledged entry in India in 2018, Maxxis had been serving the Indian market through OEMs and distributor channels for over a decade. Thus, it already had a brand presence and distribution channel established when it set up its first plant in India. However, automobile OEMs do have the ability to backward-integrate. They have access to required technological expertise, capital and do have good brand equity. TVS Srichakra is an example of a company which has backward integrated into tyre manufacturing.

Industry coming out of capex-heavy phase to drive returns and free cash flows:

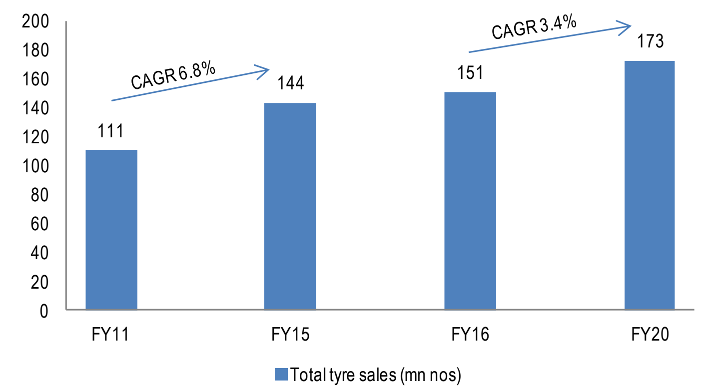
Over the last 5 years, the domestic tyre industry has witnessed significant capacity expansion. Domestic tyre industry's capacity has increased at a CAGR of 14.5% over FY16-20 vs. 5.8% over FY11-15. Increase in capacity over FY16-20 has been much more than the ~4% CAGR increase in demand over the same period. Increased capacity, coupled with demand slowdown over last 12-18 months led to fall in industry's utilization level. Shift towards radial tyres in the MHCV segment was also one of the reasons that drove higher capex. Bias tyre capacities to that extent were not usable, which also affected the utilization levels. The combined capex of domestic players like MRF, Apollo, Ceat, JK Tyre, Goodyear and TVS Srichakra was ~Rs291bn over FY16-FY20 vs. Rs117.5bn over FY11-FY15. This affected the returns and free cash flows (FCF) of these companies. Tyre demand has witnessed a slowdown from the OEM segment. Moreover, the Covid-19 pandemic has further hit demand for automobiles in FY21 with sales expected to fall by as much as 10-15% across segments. Replacement demand for tyres will also fall in FY21 as there will be fewer trips by the CV fleet and other private vehicles, which will result in reduced wear & tear of tyres. This will eliminate the need to replace tyres during the year. Therefore, many tyre manufacturing companies have deferred their capital expenditure plans amid low capacity utilization and the need to preserve cash. Thus, capex is expected to remain subdued over the next 2-3 years and demand recovery over the next 2 years is expected to boost FCF generation and returns for the industry.

Exhibit 16: Industry added capacity at 14.5% over FY16-20…



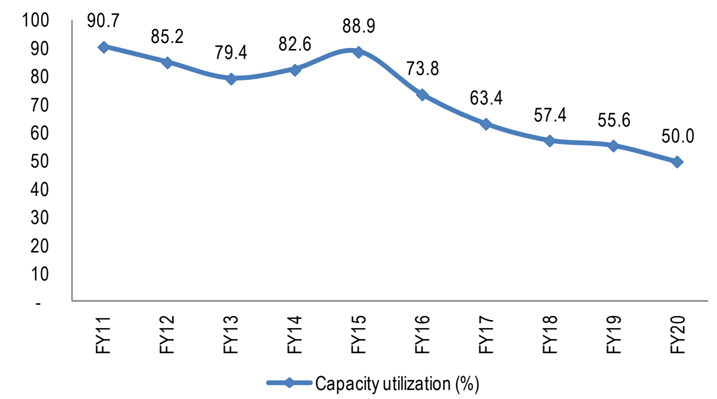
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 17: while volumes grew at ~4% over FY16-20…



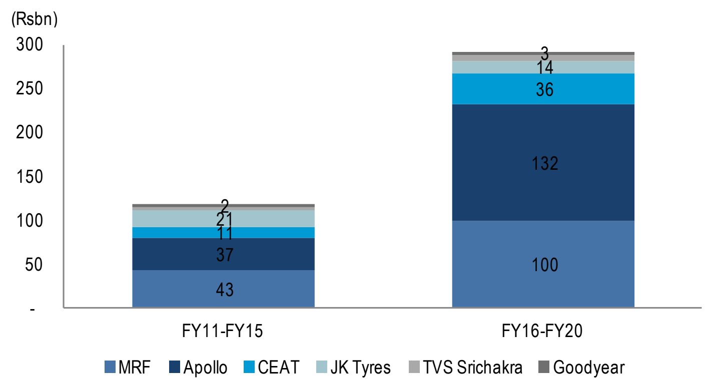
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 18: …driving down the capacity utilization



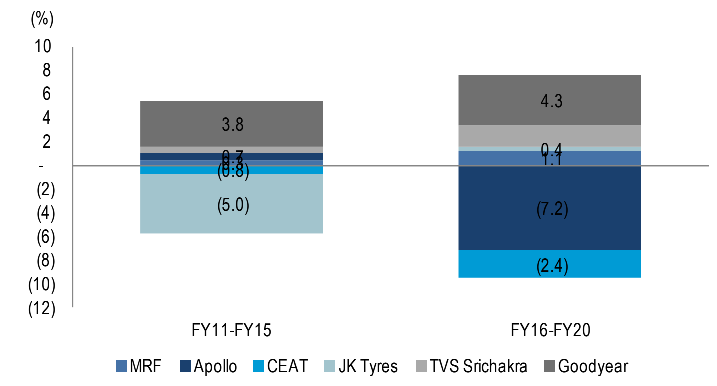
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 19: Combined capex of leading players more than doubled over last 5 years…



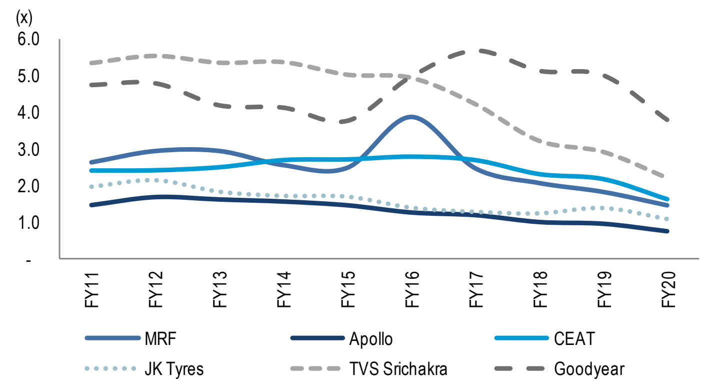
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 20: Impacting FCF as a % of sales over FY16-20



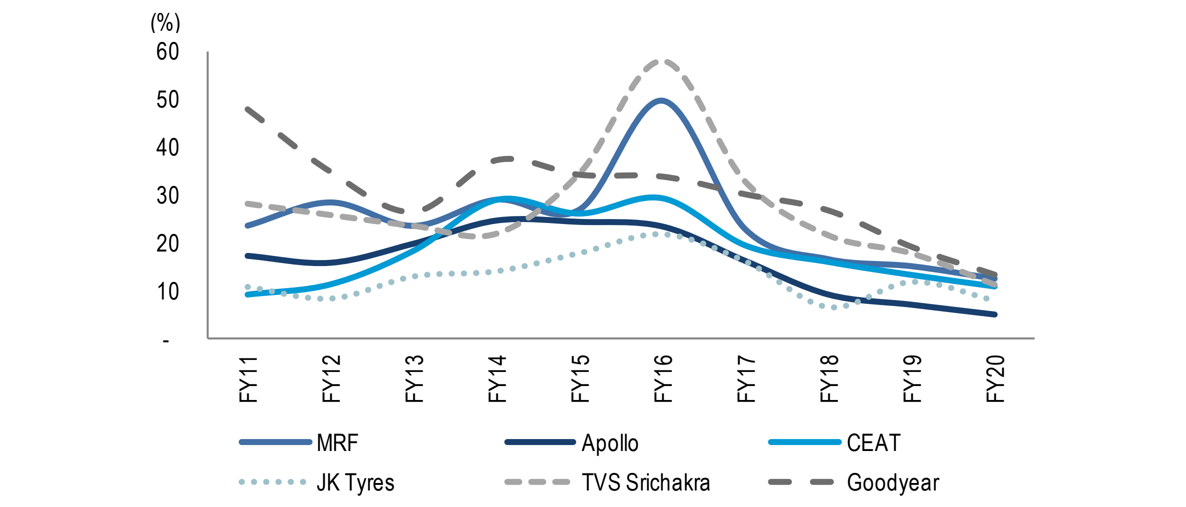
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 21: Fixed asset turnover trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 22: ROCEs have been declining over the last few years



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 23: Announced capex over the next 2-3 years

Company	Capex (Rsbn)	Project
Apollo Tyres	38	Phase 1 of greenfield facility at Andhra plant with a capacity to produce 15,000 passenger car tyres and 3,000 truck-bus radials per day.
CEAT	18	Towards further ramp up of Nagpur, Halol and Greenfield plant at Chennai.
MRF	45	Announced to spend Rs45bn over next few years to set up new facility in Gujarat.
TVS Srichakra	10	Expansion of two and three-wheeler tyres capacity by 25-30% and double the off-highway tyre capacity.
Maxxis	30	Phase 1 expansion of Sanand plant to increase capacity to 60,000 units of two-wheeler tyres per day from the current 20,000 units a day
Continental	NA	Announced capacity expansion initiative over 18 months to increase the product range along with the existing other range of TBR tyres

Source: Company, Nirmal Bang Institutional Equities Research

Radialisation:

With the growing emphasis on lowering emission levels and enhance fuel efficiency in vehicles, besides reducing weight, the Indian tyre industry is embracing new trends to meet the changing market dynamics. With increased focus on meeting various fuel efficiency norms, tyre companies have kept pace with technological improvements, with radialisation being one such instance. Radialisation in MHCVs is occurring at a rapid pace in India and has touched over 52% in the truck & bus segment from ~33% in FY15. While truck OEMs are ~77% radialised, radialisation in the truck replacement segment is still much lower at ~46%. Radialisation in segments like LCVs and Passenger Cars is ~40% and ~99%, respectively. Key benefits of radialisation include:

- Higher fuel efficiency due to reduced rolling resistance
- Longer tyre life due to less generation of heat
- Better high-speed performance. Uniform contact with the ground and wider footprints of tyres provide vehicle stability
- Tougher construction and higher puncture resistance reduce maintenance costs

We compared total cost of ownership of a radial tyres with bias tyres and found that even though the initial cost of owning a radial tyre is higher, TCO of radial tyres is lower/almost similar than bias tyres. However, if we include intangible benefits like higher fuel efficiency, better performance and vehicle stability, than TCO of radial tyres is much lower than bias tyres.

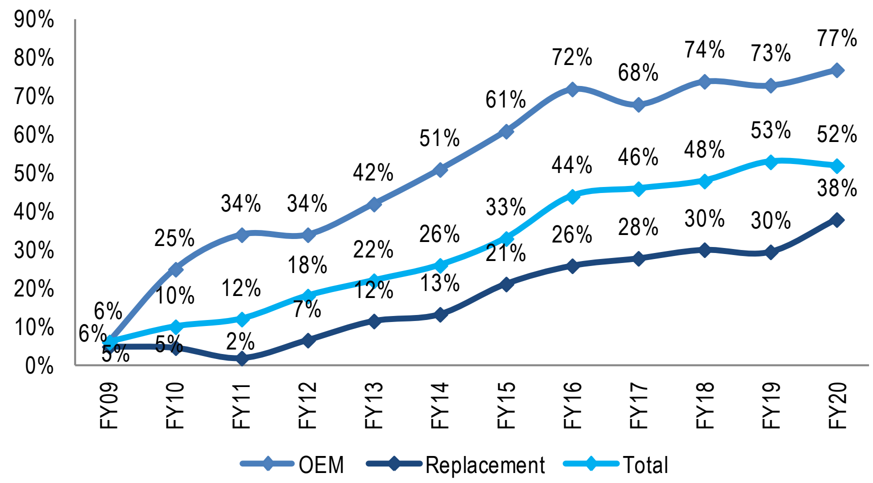
Exhibit 24: TCO of radial tyres vs. bias ply tyres

Particulars	Radial	Bias
Initial cost per Tyre (Rs)	30,000	15,000
New tyre life (Km)	100,000	60,000
Times Retreaded	2	1
Cost of retreading (Rs)	10,000	8,000
Total cost of retreading (Rs)	20,000	8,000
Km travel per retread	50,000	30,000
Total km under retread	100,000	30,000
Total cost (Rs)	50,000	23,000
Total Kms	200,000	90,000
Cost/km (Rs)	**0.25**	**0.26**

Source: Industry, Nirmal Bang Institutional Equities Research

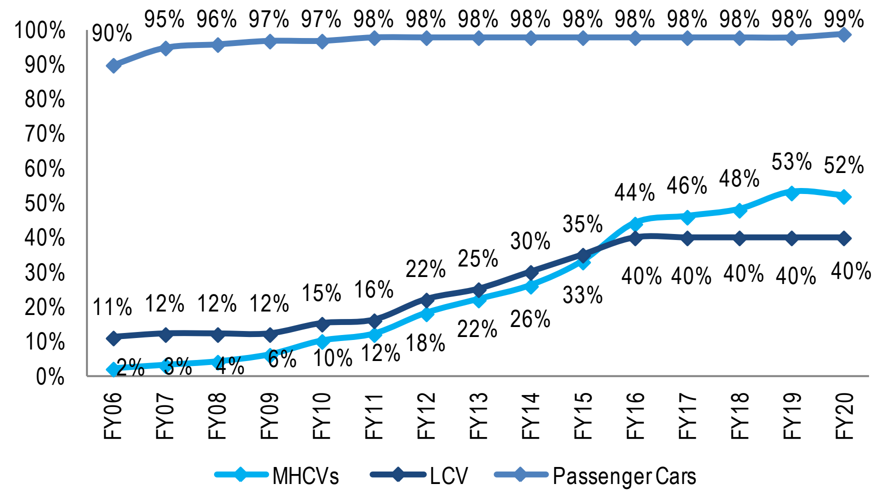
Cheaper imports of radial MHCV tyres from China and other Asian countries have acted as a key catalyst for faster shift to radialisation. Imported Chinese radial tyres cost almost equal to bias tyres manufactured in India. Recent import restrictions imposed by the government of India on tyre imports was expected to slow the radialisation trend given the relatively higher price of Indian radial tyres. However, our interactions with tyre dealers suggest that there has been no shift in preference until recently and thus we believe that the radialisation trend will likely continue, driving stronger growth of the TBR segment over the next few years.

Exhibit 25:OEM-Replacement - radialisation trend



Source: Industry, Nirmal Bang Institutional Equities Research

Exhibit 26: Segment-wise radialisation trend



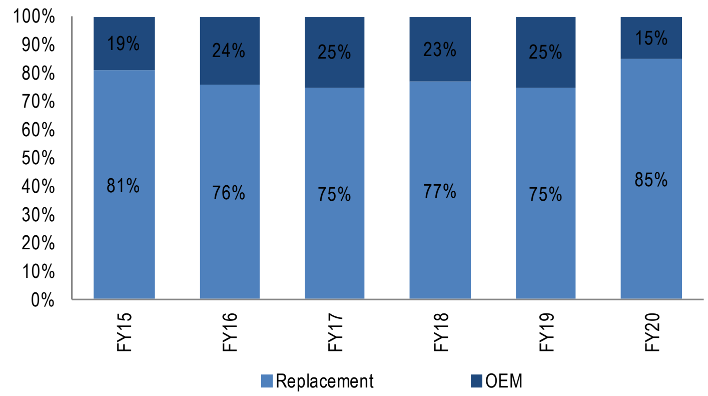
Source: Industry, Nirmal Bang Institutional Equities Research

Aftermarket

Segment-wise replacement mix: Trucks & Buses: 54%; PVs: 15-18%; LCVs: 9%; Motorcycles: 10%; Scooters: 5%; Tractors: 8-10%.

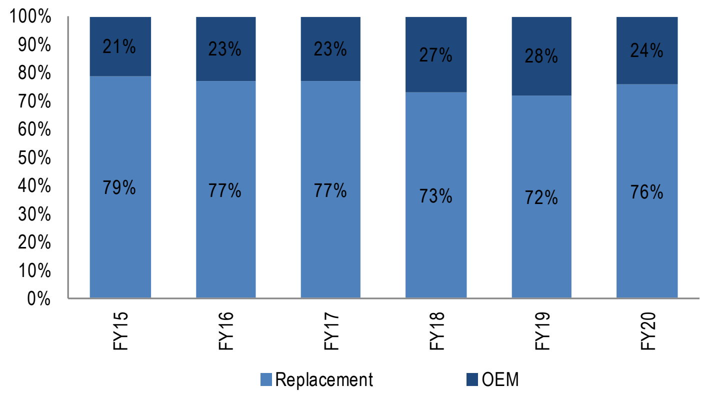
Tyre demand from OEMs declined 16.3% in FY20 vs. 2.7% decline in replacement demand. Mix shifted towards replacement (57%) vs. OEM (43%) over the last 4 years.

Exhibit 27: OEM - Replacement mix for MHCVs



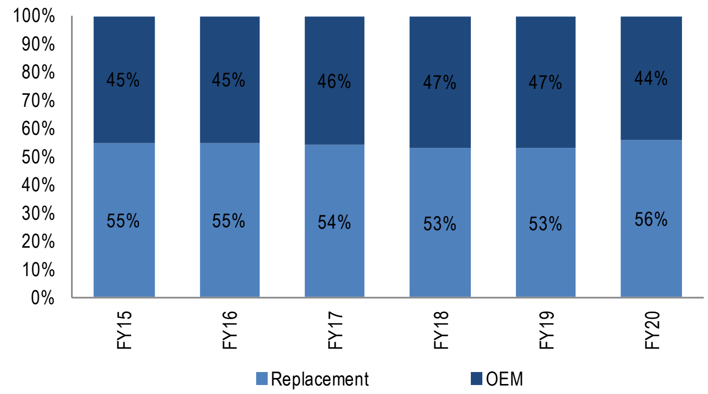
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 28: OEM - Replacement mix for LCVs



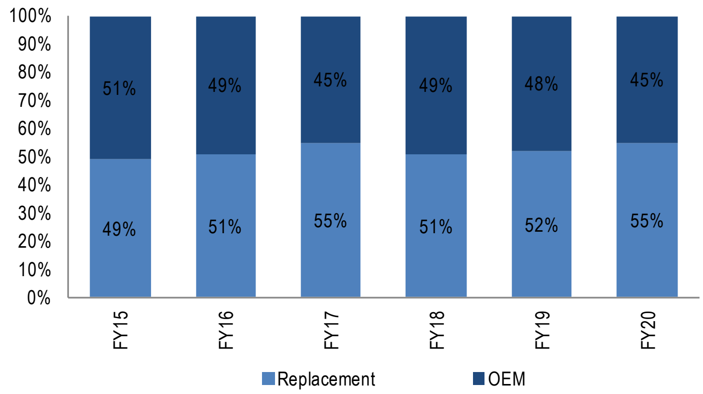
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 29: OEM - Replacement mix for PVs



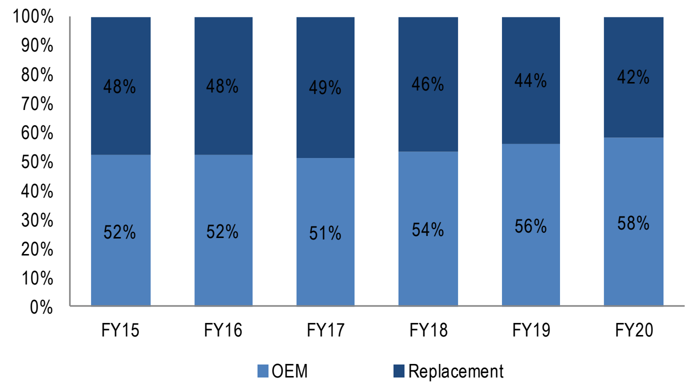
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 30: OEM - Replacement mix for 2Ws/3Ws



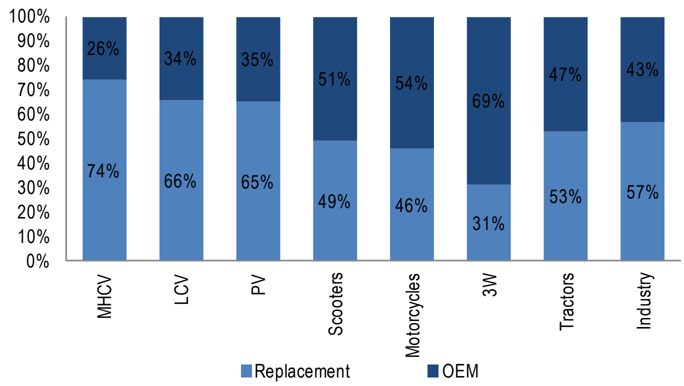
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 31: OEM - Replacement mix for Tractors



Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 32: Segment-wise OEM-Replacement mix for FY20



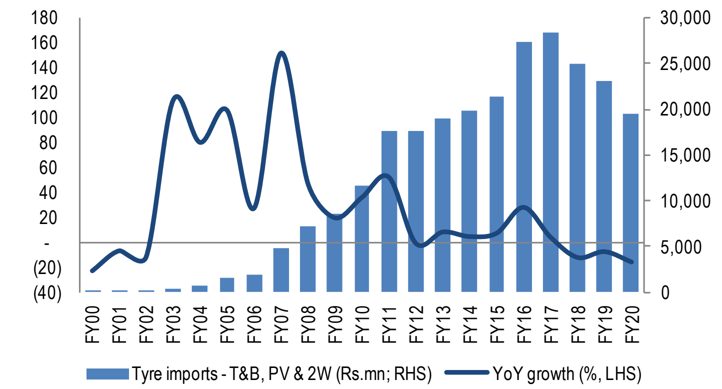
Source: ICRA, Nirmal Bang Institutional Equities Research

Import of Tyres:

India's tyre imports (T&B, PV & 2W) have grown over the last decade at a CAGR of 5% to reach Rs19.55bn in FY20. In volume terms, tyre imports have grown at a CAGR of 7% to reach ~9.5mn units in FY20. Majority of these tyre imports are radials and most of these are imported from China, Thailand and Vietnam, among others. These imports have been a threat to the domestic tyre industry as imported radials are significantly cheaper and are available at the price of domestically manufactured bias tyres. Our channel checks suggest that quality of these imported radials is not significantly different from domestically manufactured tyres (~85-90k km new truck tyre life vs. 1L km for domestically manufactured tyres), which also drove higher radialisation in the replacement segment. However, over the last 3 years, increased customs duty on tyres, levy of additional dumping duty on tyres and implementation of GST have reduced the price gap between imported and domestically manufactured tyres.

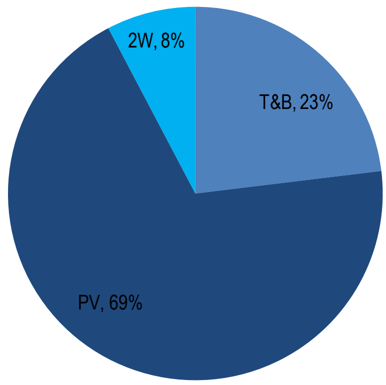
In June'20, the government imposed curbs on imports of certain new pneumatic tyres used in motor cars, buses, lorries and motorcycles to promote domestic manufacturing. Majority of tyre categories have been moved from free to restricted imports, which means an importer would now require a licence from the DGFT for import of tyres. Our channel checks suggest that import restrictions have put additional pressure on the replacement segment, which is already reeling under short supply post unlock due to pent-up demand, higher demand from OEMs and gradual ramp-up in production by tyre manufacturers. Thus, we expect import restrictions to act as a tailwind for domestic tyre manufacturers and the threat of cheaper imports will remain low in the medium term.

Exhibit 33: Tyre imports grew at CAGR of 5.3% over last 10yrs



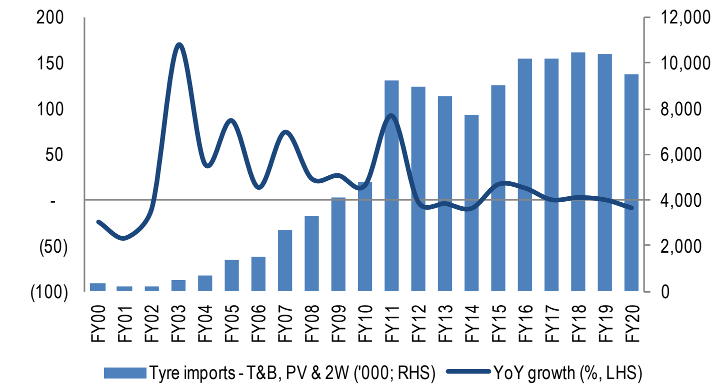
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 34: PV tyres dominated import value in FY20



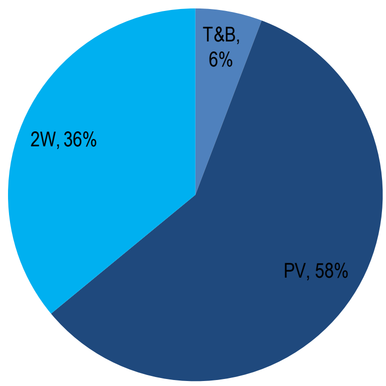
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 35: Import volume grew at CAGR of 7.1% over last 10yrs



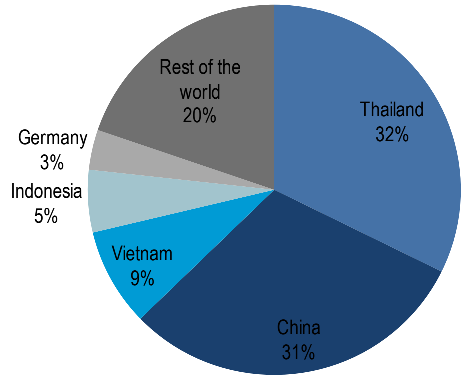
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 36: PVs lead import volume share in FY20, 2Ws follow



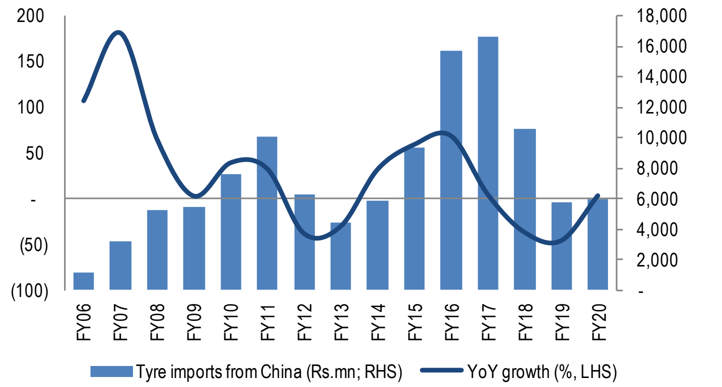
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 37: Thailand and China topped the value of tyre import



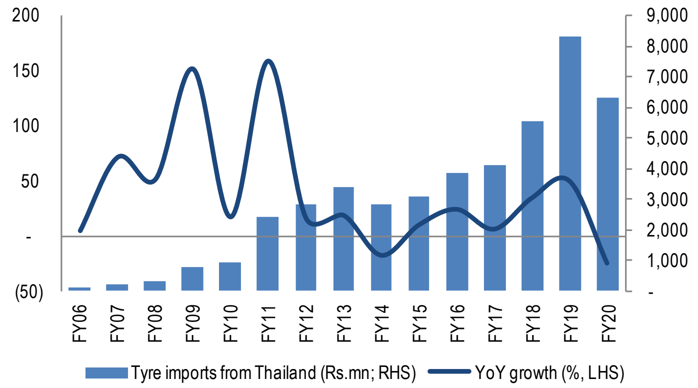
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 38: Value of imports from China grew 5.2x over FY06-20



Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 39: While value of imports from Thailand grew at ~51x over the same period

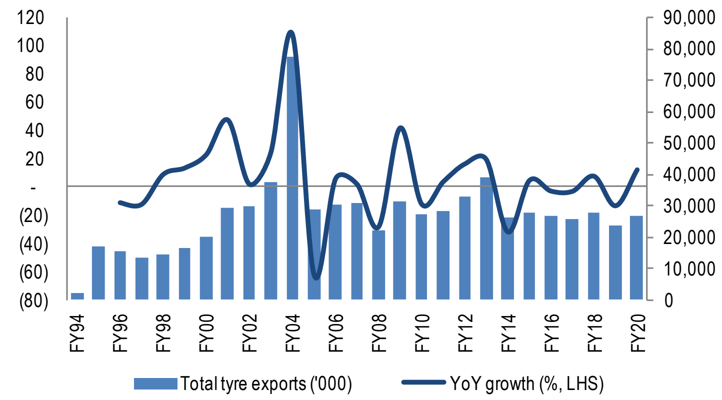


Source: CEIC, Nirmal Bang Institutional Equities Research

Exports

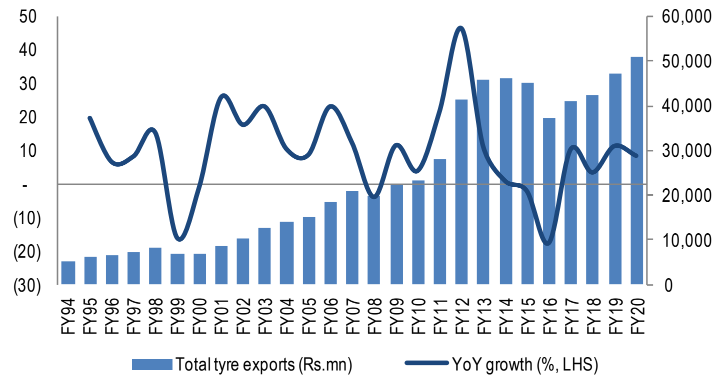
USA, Germany and the Middle-East are the major export markets. Agri & Construction tyres are the major export segments. FY18 and FY19 witnessed strong growth due to better acceptance and favourable demand in the export markets. Demand contracted in FY20 due to slowdown in the global economy amid trade conflicts. Tyre export volume grew by 0.2% in FY20. In value terms, tyre exports declined by 0.8% in FY20. ICRA estimate: weak automotive demand outlook, restrictions on ports and at export destinations is expected to significantly affect demand for tyres in FY21.

Exhibit 40: Tyre export volume grew at -0.3% over 10yrs…



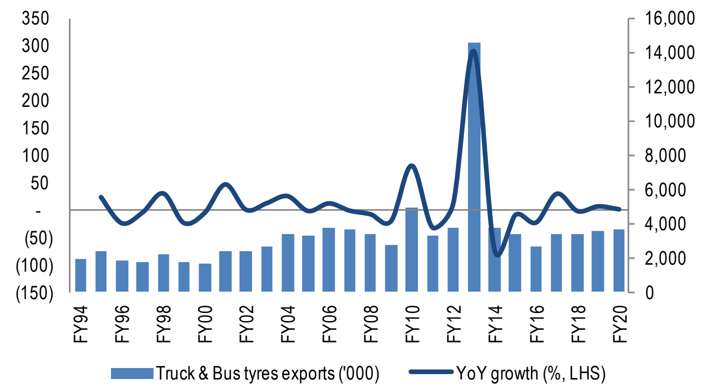
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 41: while export value grew at 8% over the same period



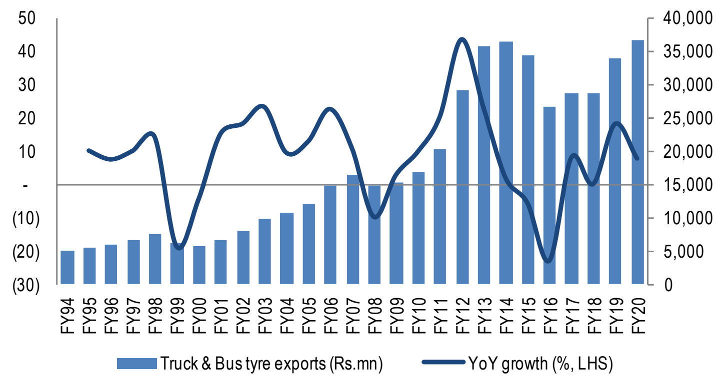
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 42: T&B tyre export volume grew at -3% over 10 yrs…



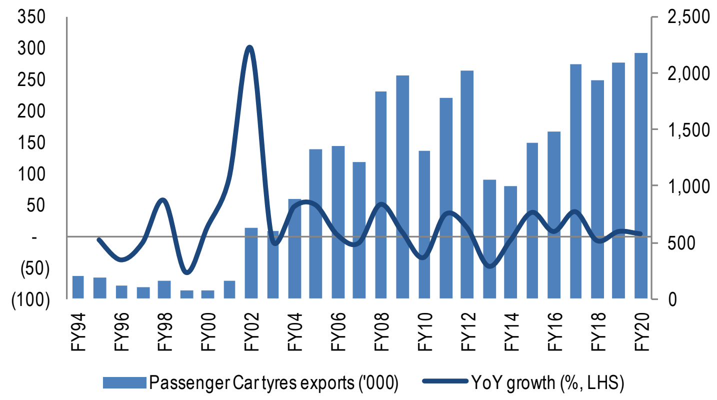
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 43: while export value grew at 8.1% over the same period



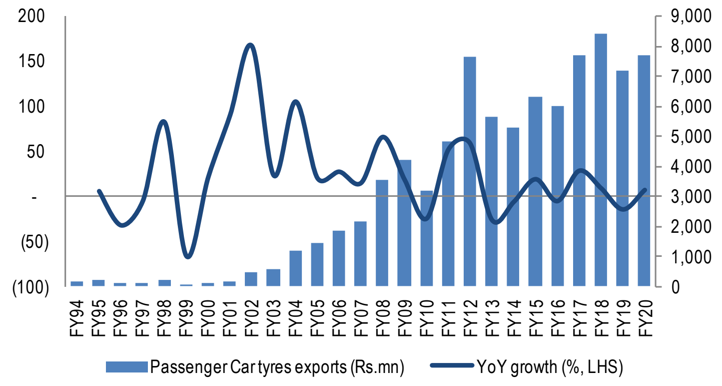
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 44: PV tyre export volume grew at 5.2% over 10 yrs…



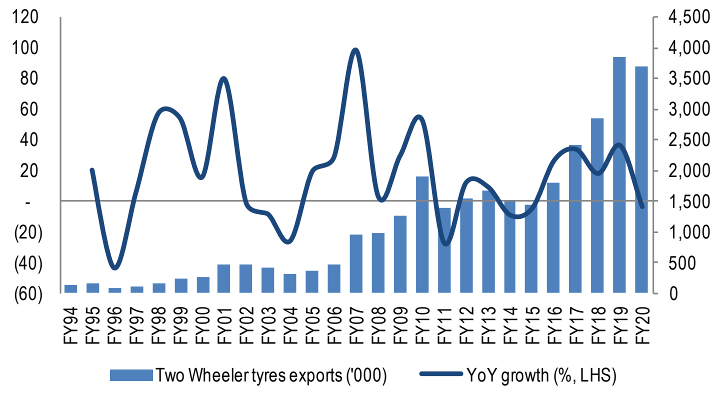
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 45: while export value grew at 9.3% over the same period



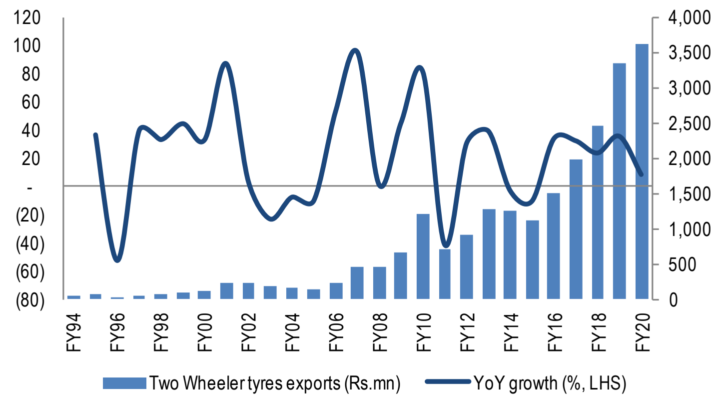
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 46: 2W tyre export volume grew at 6.8% over 10 yrs…



Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 47: while export value grew at 11.6% over the same period

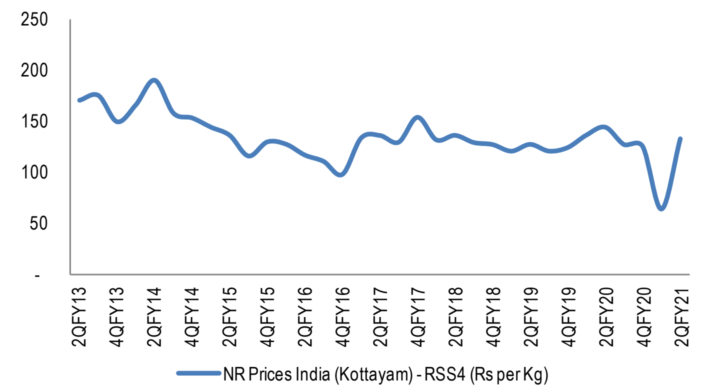


Source: CEIC, Nirmal Bang Institutional Equities Research

Raw material

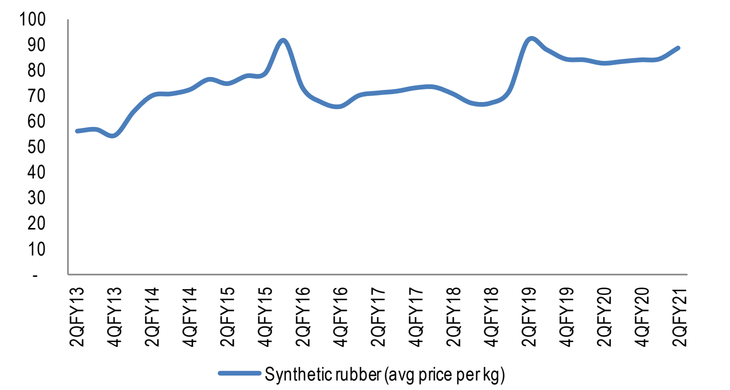
RM price basket has been declining since the start of FY20, driven by lower prices of crude derivates. Prices of crude derivatives and carbon black declined by 20% in FY20 whereas natural rubber (which forms ~35% of total raw material cost for a tyre) price increased by over 7%. Overall decline in raw material prices (partially offset by negative operating leverage on lower volume) aided operating margins by 30bps in FY20. In 1QFY20, natural rubber prices stood at avg Rs120 per kg vs. avg Rs138 per kg in FY20. Crude derivative prices have also declined sharply due to Covid-19. Overall RM prices are expected to remain soft for the rest of FY21.

Exhibit 48: Natural rubber prices have seen a sharp rebound in last 6 months



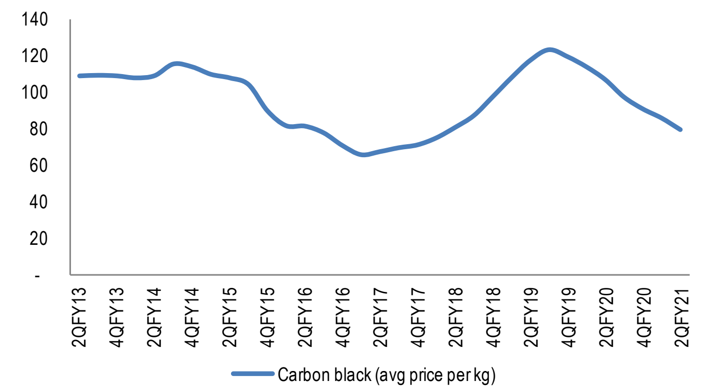
Source: ACE Equity, Nirmal Bang Institutional Equities Research

Exhibit 49: Synthetic rubber price trend



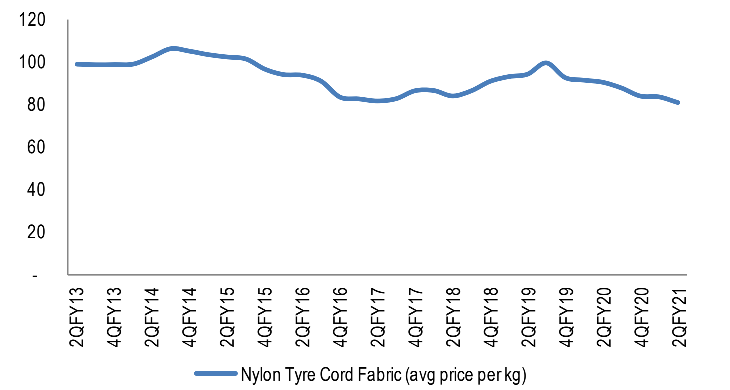
Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 50: Carbon black price trend



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 51: Nylon Tyre Cord Fabric price trend



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Outlook

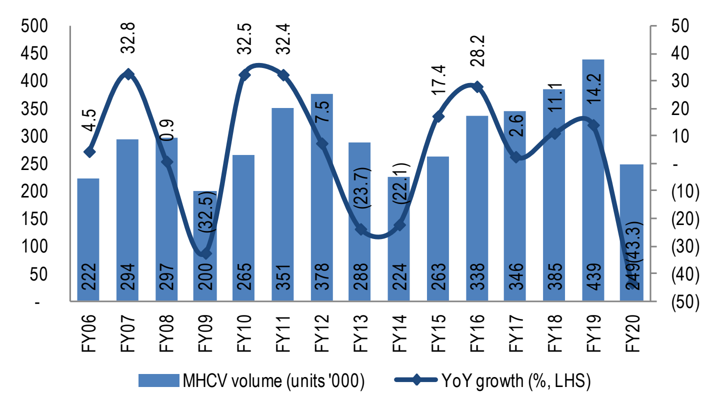
OEM industry outlook

Commercial Vehicles

In the long term, tyre demand from OEMs is expected to grow on the back of continuous improvement in economic growth, which will lead to higher vehicle demand. However, the shift towards higher tonnage vehicles and commissioning of the dedicated freight corridor by the Indian Railways are expected to restrict any further increase in MHCV sales.

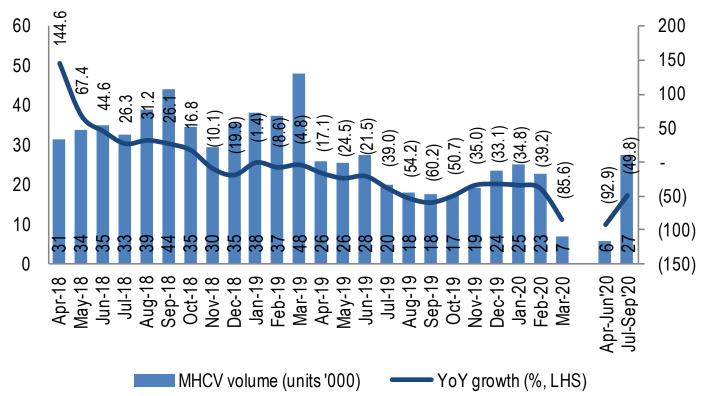
In the long term, tyre demand from the replacement segment is expected to grow due to increase in vehicle running time, which is likely to outdo the increase in tyre life. Radialisation level is expected to reach 60-65% by fiscal 2023. Since bias tyres have 30-40% lower life vs. radial tyres, they have shorter replacement cycles. Hence, in the long run, with an expected improvement in radialisation levels, we see the replacement cycle getting prolonged too. Another factor that is likely to affect the tyre replacement cycle is better road infrastructure, which will boost tyre life. These factors are likely to moderate tyre demand in the long run.

Exhibit 52: MHCV volumes have grown at CAGR of 1.1% over the long term



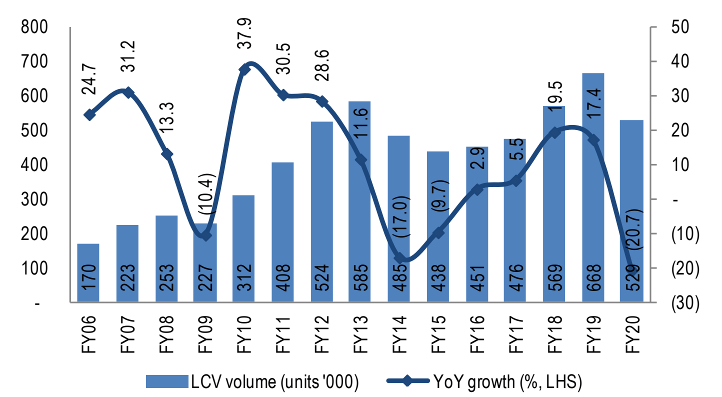
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 53: MHCVs - monthly volume trend



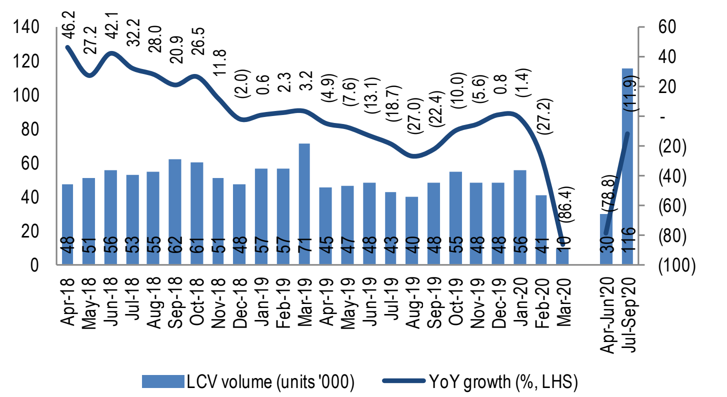
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 54: LCV volumes have grown at CAGR of 9.5% over the long term



Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 55: LCVs – monthly volume trend



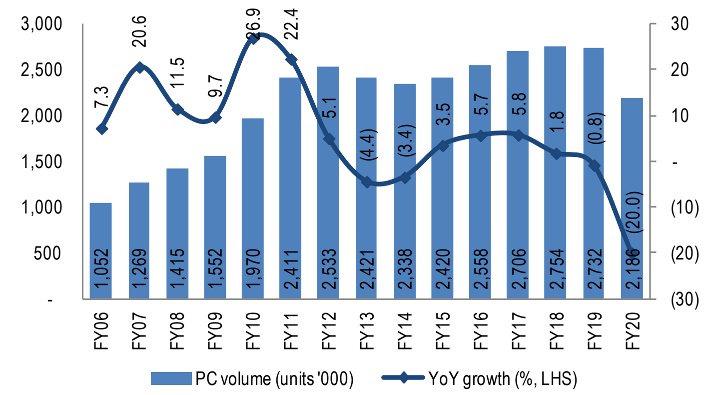
Source: CEIC, Nirmal Bang Institutional Equities Research

Passenger Vehicles

In the long term, tyre demand from the OEM segment is expected to increase due to moderate growth in demand for cars and UVs. Demand is expected to be driven by expansion of the addressable market, fast-paced infrastructure development, relatively stable cost of vehicle ownership, government's support for farm incomes and easy availability of finance. However, increasing road congestion, improvement in public transport and rising popularity of shared mobility may arrest the growth in demand to an extent.

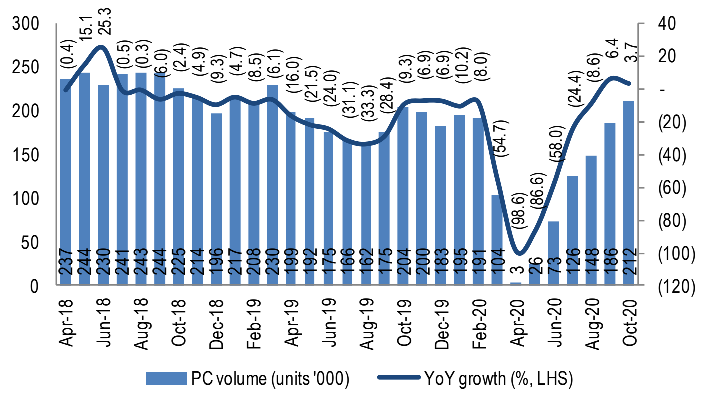
In the long term, the replacement tyre demand is expected to moderately grow on account of muted inflation and positive macro-economic indicators. Four consecutive years of growth in domestic PV sales will result in higher number of tyres due for replacement. Also, increasing share of the commercial segment is likely to hasten replacement of tyres, leading to higher demand.

Exhibit 56: PC volumes have grown at CAGR of 5.5% over the long term



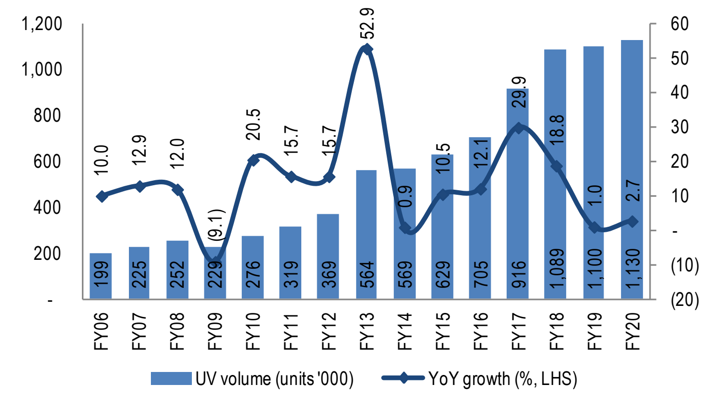
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 57: PCs – monthly volume trend



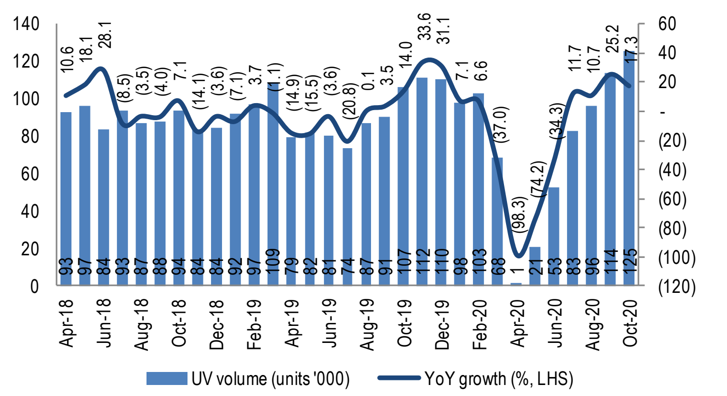
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 58: UV volumes have grown at CAGR of 13% over the long term



Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 59: UVs – monthly volume trend



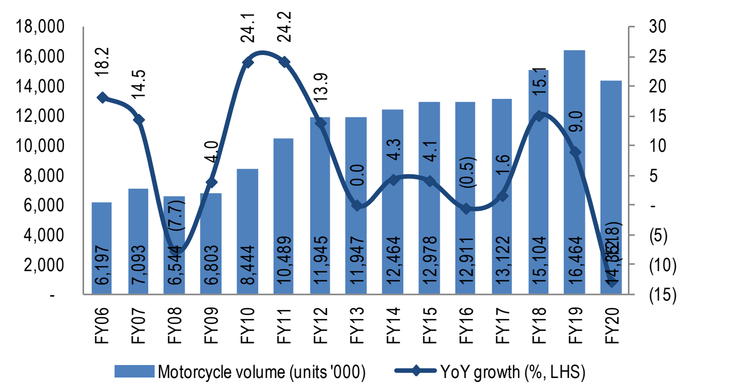
Source: CEIC, Nirmal Bang Institutional Equities Research

Two-Wheelers

In the long term, demand for OEM tyres is expected to grow as demand for two-wheelers/three-wheelers will increase in the domestic market. Domestic two-wheeler sales are expected to improve on the back of improved rural infrastructure, manufacturers' focus on rural markets and expansion of distribution network into semi-urban and rural areas. New model launches in the 125cc segment and better product positioning will also drive up volume.

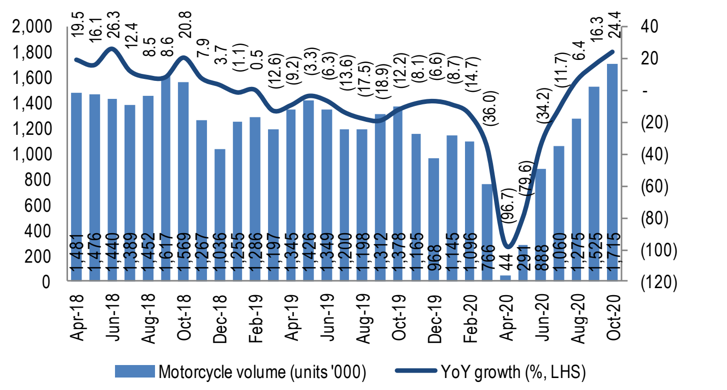
In the long term, the replacement tyre demand is expected to moderately grow on account of muted inflation, positive macro-economic indicators and growth in farm income if the government policies do not fall flat. Consecutive years of growth in two-wheeler / three-wheeler volume are also expected.

Exhibit 60: Motorcycle volumes have grown at CAGR of 6.9% over the long term



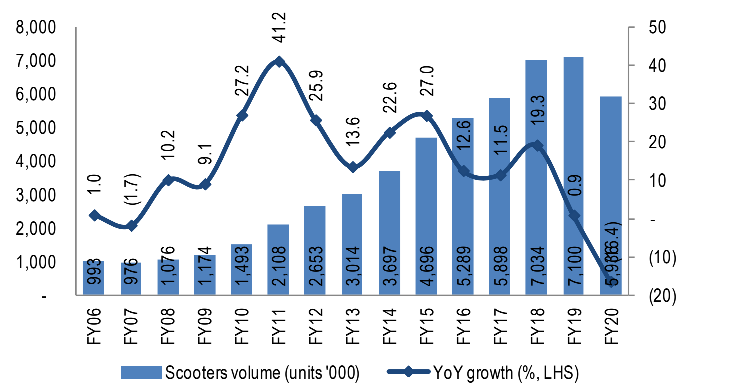
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 61: Motorcycles – monthly volume trend



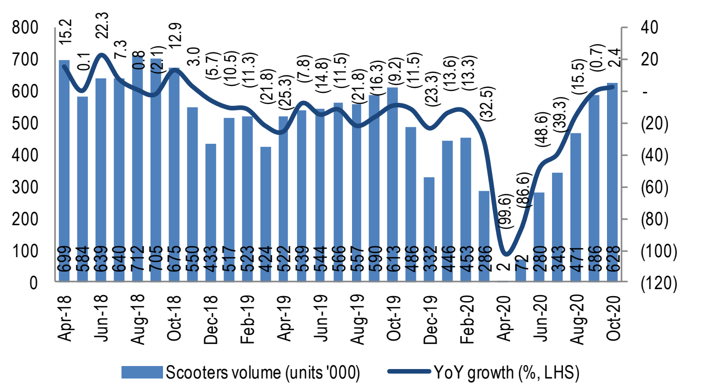
Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 62: Scooter volumes have grown at CAGR of 12.7% over the long term



Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 63: Scooters – monthly volume trend



Source: CEIC, Nirmal Bang Institutional Equities Research

Others

Capex cycle and leverage

Tyre industry incurred capex of Rs750bn in FY20, partially funded by debt. Capex was at all-time high - 15.3% of other income against average 9-10% of other income. Recently, tyre manufacturers have slashed their capex guidance for FY21 by ~30% on account of demand uncertainty. ICRA expects industry to incur capex of Rs40bn over the next few years. Majority of this capex is expected to be for TBR and PV tyres. Leverage is expected to increase in FY21 due to lower earnings. However, long-term outlook remains stable.

Radial Bias mix

Popularity of radial tyres increased towards the end of the last decade, as Indian transporters shifted to lower priced Chinese TBR (truck & bus radial) tyres. This forced domestic manufacturers to invest heavily in radial capacities in the truck & bus and passenger car segments. Low levels of radialisation and huge underlying potential attracted several international players such as Michelin and Bridgestone into the Indian market. Apart from importing tyres, these players also committed substantial capex to set up radial capacities in India and increase their market share.

In M&HCVs, radialisation level is expected to reach 60-65% by Fiscal 2023. Since bias tyres have 30-40% lower life than radial tyres, they have shorter replacement cycles. Hence, in the long run, with an expected improvement in radialisation levels, we see the replacement cycle getting prolong too.

In LCVs, radialisation level is expected to reach 50-55% by fiscal 2023 from 40% in fiscal 2018. Thus, higher radialisation and better road infrastructure are expected to prolong the replacement cycle and moderate the demand for tyres.

Valuation - Indian vs. Global Peers

Exhibit 64: Peer valuation

Company	CMP	M-Cap (bn)	EPS (Rs/USD)			ROE (%)			PER (x)			EV/EBITDA (x)		
			FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Indian peers (Rs)														
CEAT Ltd	1,163	47	82.7	98.0	109.2	10.5	11.3	11.4	14.1	11.9	10.6	7.9	6.8	5.9
Apollo Tyres	189	120	4.2	14.3	18.1	2.4	7.7	9.1	44.6	13.2	10.4	9.6	6.4	4.9
MRF*	77,475	328	2,636	3,353	3,779	8.8	10.2	10.4	29.4	23.1	20.5	11.3	9.7	8.7
JK Tyres*	79.8	20	0.6	8.6	12.3	0.5	8.8	10.7	140.7	9.3	6.5	7.1	5.5	4.8
Balkrishna Industries	1,651	319	50.7	63.4	76.0	17.0	18.2	18.7	32.6	26.0	21.7	19.6	15.8	13.2
Global peers (USD)														
Michelin*	129.1	23	5.2	10.3	12.7	4.7	10.6	12.2	24.6	12.5	10.1	7.3	5.7	5.2
GoodYear Tire*	10.4	2	(2.2)	0.8	1.7	(19.5)	7.7	12.6	NA	13.5	6.5	15.8	5.5	4.7
Continental AG*	135.1	27	0	10	13	(0.7)	10.0	12.9	434.8	14.0	10.1	8.6	5.2	4.5
Bridgestone*	35.1	25	0.2	2.7	3.3	2.1	9.0	10.0	159.4	13.0	10.8	7.3	5.6	5.1
Pirelli*	5.4	5	0.2	0.4	0.5	2.5	6.1	7.6	27.6	13.4	10.8	10.8	8.4	7.7
Yokohoma*	15.3	3	1.2	1.7	1.9	4.0	6.4	7.0	12.7	9.0	8.0	7.2	6.0	5.5

*Source: Bloomberg; Nirmal Bang Institutional Equities Research *Bloomberg estimates*

Covid-19 impact and how was it managed

Because of Covid-19, business for April'20 and most part of the May'20 was a complete washout. However, there has been a remarkable demand recovery since then, firstly on the replacement side and then on the OEM side, driven by pent-up demand, restrictions on imports of tyres, rise in preference for personal mobility and strong sentiments in rural and semi-urban markets. Though the replacement volume fell in high double digits in 1QFY21, for June'20, replacement volume grew in double digits for majority of the players, driven by pent-up demand and restrictions on the import of tyres. For JK Tyre, June'20 replacement market sales were the highest ever for the company. According to CEAT management, good monsoon and healthy rabi crop kept the rural economy buoyant, leading to strong demand for farm and two-wheeler tyres and replacement demand exceeding expectations. According to the management of Apollo Tyres, - two significant takeaways from 1QFY21 are: One, April'20 saw negligible sales volume but thereafter things have improved significantly and the management is very positively surprised by the demand momentum, especially in the replacement segment. Secondly, despite the current demand environment, pricing environment has remained fairly stable. Companies also witnessed higher demand in the replacement segment for TBB and passenger car tyres due import restrictions on tyres. The companies worked on managing supply chains and smooth distribution of products. For instance, CEAT's supply chain team has ensured timely availability of products by adopting dynamic fulfillment model so as to ramp up production to meet the increased demand. The companies also started providing doorstep fitment of tyres and other associated services that customers would need. Companies increased their focus on digitization and online collaboration, which can help reduce marketing and travelling costs with digital launches of products and digital marketing. Focus was on reducing fixed costs like ad & marketing spends, travelling costs, employee costs and other discretionary costs. According to CEAT's management, structural cost reduction initiatives will start yielding results after 3-6 months and it expects to reduce 15% of fixed costs on a sustainable basis. According to Apollo Tyre's management, cost reduction initiatives, supply chain optimization and digitization in product launches, marketing and other aspects of the business will help curtail SG&A expenses and travelling costs on a sustainable basis. Focus on reducing working capital, curtailment of capex spends and tight cost control management helped companies like CEAT and Apollo Tyres to bounce back sharply with a leaner cost structure aiding margins on full volume recovery.

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Company Section

Apollo Tyres

15 December 2020

Reuters: APLO.BO; Bloomberg: APTY IN

Initiating Coverage

Ticking all the right boxes, time to ride the tide

We expect Apollo Tyres to gain with revival in CV and PV cycles in India. With all the investments in capacity, R&D, brand building, distribution, specifically in the rural markets in India, the company is very well placed to leverage the demand recovery as and when it fructifies. 60% of its India business comes from the CV segment and 18% from the PV segment. In India, the company is a leader in truck tyres and it has been adding capacity ahead of competition. Furthermore, the company is gaining market share in the Indian PV segment. Import restrictions on tyres should also be beneficial. This will help Apollo even in the long term because a lot of imports were in the higher end of the product mix (imported from Michelin, Bridgestone and other Asian players). Apollo has 11 years' experience in selling high-end tyres in Europe. So, it will not have to reinvent the technology. Passenger Car Radials imports traditionally had 15% market share (15% of 41mn tyres sold in the domestic PC market). This will come to domestic players.

Apollo is the No 1 player in India in radial tyres. It has recently gained new customers like Kia, which is gaining share with its fresh offerings. During the pandemic, Apollo has focused on improving its distribution to cash in on the imminent upcycle. The company added more than 350 dealers in 1HFY21. It is focusing on expanding its distribution footprint in the rural area (4,000 touchpoints now vs. 2,000 – most dealers are multi-products i.e. 2W, car, tractor etc) and has already tripled the touch points in 1HFY21. Helped by these initiatives in the first five months of FY21, the company has gained 500bps market share in Passenger Car Radials and the Agri segment and more than 350bps market share in the Truck & Bus segment, as per its internal estimates. The company reported best ever volume in Truck Bus Replacement and Passenger Car Radial segment in Sept'20. Radialisation trend has slightly come to a halt during the ongoing pandemic and is stable now at TBB:TBR of 50:50. Radialisation trend will continue and Apollo stands to benefit given its strong brand equity and product strength in the TBR segment. But, it has also made substantial gains in TBB market share.

In line with the standalone business, the company added more than 200 dealers in Europe in 1HFY21. The company continues to focus on laying the building blocks in Europe by adding new networks across countries and introducing new products that have achieved podium position in some of the test magazines in Germany. Despite subdued sentiments, the company gained 12bps market share in ultra-high performance (UHP) and UUHP passenger car segments in Europe. It also gained 23bps market share in the TBR segment and 25bps market share in Farm products. The work with respect to specialization of the Dutch plant is on track and the company is expected to see significant gains from this exercise FY22 onwards in terms of cost competitiveness (500 people reduction will lead to EUR40-50mn savings from FY22).

For the standalone business, driven by healthy replacement demand and upturn in the CV and PV cycles, we expect the revenue to grow at 10.5% CAGR over FY20-23E. Europe revenue should improve on the back of a gradual pick-up in replacement sales and market share gains. The company will benefit from staff reduction, improved distribution and shift from Dutch to Hungary plant. At a consolidated level, we expect revenue CAGR of 9.2% over FY20-23, EBITDA margin improvement of 230bps and PAT CAGR of 29.6%. This will be underpinned by expected benefits from better scale, cost savings in employee expenses and other fixed costs and improved product mix. Given the strong revival, we value the stock at 14x Sept'22 consolidated EPS. It is a 15% premium to its long-term average multiple of 12x and gives us a target price (TP) of Rs227.

Y/E March (Rsmn)	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	175,488	163,270	148,460	191,927	212,431
% Growth	*18.2*	*(7.0)*	*(9.1)*	*29.3*	*10.7*
EBITDA	19,586	19,155	17,073	25,286	29,825
EBITDA margin (%)	*11.2*	*11.7*	*11.5*	*13.2*	*14.0*
Adj PAT	8,798	4,764	2,425	8,200	10,382
EPS (Rs)	15.4	8.3	4.2	14.3	18.1
EPS growth (%)	*21.6*	*(45.9)*	*(49.1)*	*238.1*	*26.6*
P/E (x)	12.3	22.7	44.6	13.2	10.4
EV/Sales (x)	0.9	1.0	1.1	0.8	0.7
EV/EBITDA (x)	7.6	8.7	9.6	6.4	4.9
P/BV	1.1	1.1	1.1	1.0	0.9
Dividend yield (%)	1.7	1.6	0.8	1.8	2.1
RoCE (%)	*8.4*	*5.1*	*3.4*	*7.9*	*9.7*
RoE (%)	*6.8*	*4.8*	*2.4*	*7.7*	*9.1*

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: Automobile

CMP: Rs193

Target Price: Rs227

Upside: 20.2%

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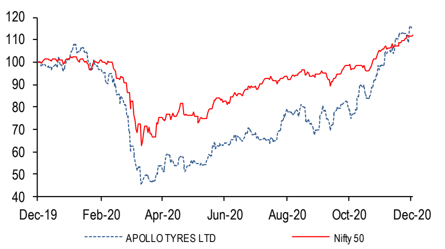
Key Data

Current Shares O/S (mn)	472.1
Mkt Cap (Rsbn/US$bn)	109.7/1.5
52 Wk H / L (Rs)	195/73
Daily Vol. (3M NSE Avg.)	8,342,615

Share holding (%)	4QFY20	1QFY21	2QFY21
Promoter	41.8	41.8	37.6
Public	58.4	58.3	62.4
Others	-	-	-

One Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
Apollo Tyres.	16.5	79.8	15.0
Nifty Index	5.8	35.6	11.9

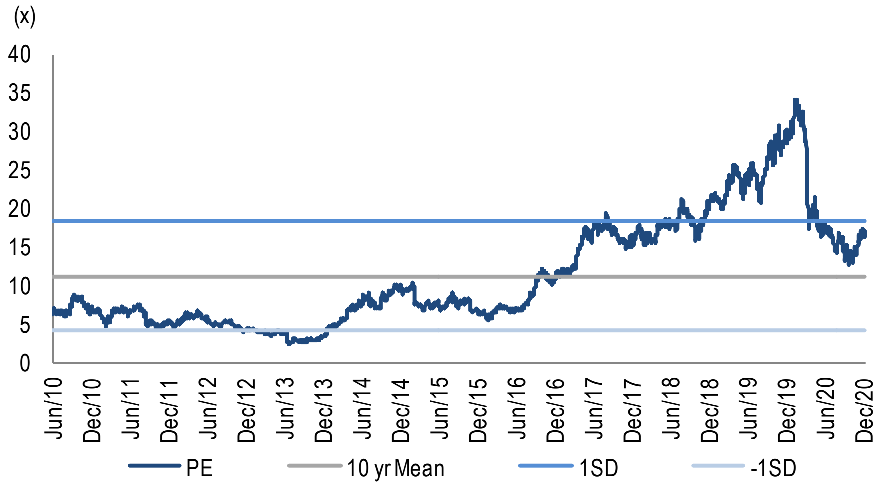
Source: Bloomberg

Valuation/stock price performance

Apollo Tyres is one of the leading global tyre companies with presence across India, Europe and other growing economies of Asia. It has sales presence in more than 100 countries globally with extensive distribution in India (6,200 dealers, including ~2,300 exclusive retail dealers) and Europe (~5,400 third party dealers). The company has strong presence in truck bus bias (TBB), truck bus radial (TBR), passenger car radials (PCR) and Agriculture segments. Europe expansion was a result of acquiring Vredestein and Reifencom in 2009 and 2016, respectively. Post these acquisitions, it now has a well-diversified mix across geographies and product segments. In India, the company sells tyres under the Apollo brand in PV, CV, 3W and OHT segments. In Europe, the company sells tyres under the Vredestein brand in PV, 2W, OGT and Bicycle segments. It is a niche premium brand known for its ultra high performance and all season ranges. Our conviction on Apollo is based on the following factors: (1) a cyclical recovery in India's truck and passenger car tyre demand (2) improved operating performance in the domestic market and (3) cost savings and ramp-up of new capacity in Europe. In India, the company is a leader in truck tyres and it has been adding capacity ahead of competition. Moreover, the company is gaining market share in the Indian PV tyre segment.

The standalone business will be driven by healthy replacement demand and upturn in the CV and PV cycles, with revenue growing at 10.5% CAGR over FY20-23E. Europe revenue should improve on the back of a gradual pick-up in replacement sales and market share gains. The company will benefit from staff reduction, improved distribution and shift from Dutch to Hungary plant. At a consolidated level, we expect revenue CAGR of 9.2% over FY20-23, EBITDA margin improvement of 230bps and PAT CAGR of 29.6%. This is a result of expected benefits from better scale, cost savings in employee expenses and other fixed costs and improved product mix. Given the strong revival, we value the stock at 14x Sept'22 consolidated EPS. It is a 15% premium to its long term average multiple of 12x and gives us a TP of Rs227.

Exhibit 1: One-year forward P/E band



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 2: Top five institutional shareholders of Apollo Tyres

Name	Holding (%)
HDFC Trustee Company ltd	8.82
ICICI Prudential AMC	3.98
Nippon Life AMC	1.90
Franklin Resources Inc	1.66
HDFC Life Insurance	1.53

Source: Bloomberg

Exhibit 3: Peer valuation

Company	EPS (Rs)			ROE (%)			PER (x)			EV/EBITDA (x)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Apollo Tyres	4.2	14.3	18.1	2.4	7.7	9.1	44.6	13.2	10.4	9.6	6.4	4.9
CEAT Ltd	82.7	98.0	109.2	10.5	11.3	11.4	14.1	11.9	10.6	7.9	6.8	5.9
MRF*	2,636	3,353	3,779	8.8	10.2	10.4	29.4	23.1	20.5	11.3	9.7	8.7
JK Tyres*	0.6	8.6	12.3	0.5	8.8	10.7	140.7	9.3	6.5	7.1	5.5	4.8
BKT	50.7	63.4	76.0	17.0	18.2	18.7	32.6	26.0	21.7	19.6	15.8	13.2

*Source: Bloomberg; Nirmal Bang Institutional Equities Research *Bloomberg estimates*

Investment rationale

India Business

Apollo is the No 1 radial player in India. It has gained new customers like Kia. It added more than 350 dealers in 1HFY21. The company is focusing on expanding its distribution footprint in the rural area (4,000 touch points now vs. 2,000 – most dealers are multi-products i.e. 2W, car, tractor etc) and it has already tripled the touch points in 1HFY21. Helped by these initiatives, in the first five months of FY21, the company gained 500bps market share in Passenger Car Radials and Agri segments and more than 350bps market share in the Truck & Bus segment, as per its internal estimates. The company reported best ever volume in Truck Bus Replacement and Passenger Car Radial segments in Sept'20.

While the company has limited ability to forecast given the uncertainty around COVID-19, it is witnessing very strong demand momentum on the ground. Secondly, given all the investments in capacity, R&D, brand building, distribution, specifically in the rural markets of India, the company is very well placed to leverage the demand recovery as and when it fructifies. T&B, both bias and radial, have clocked higher numbers so has passenger car radials. The company launched motorcycle radials (MCR) in 2QFY21, which are also showing positive signs and are highly profitable. It also launched light truck radial tyres and the same are witnessing huge demand (high margin category).

PCR market share gain of 500bps - all the plants are commissioned and are running at 85-90% capacity. There has been a very clear focus in building brand and technologies that are going behind these tyres. Some of the brand rankings tracked on a regular basis show Apollo as No. 1 brand in India in various magazines. An enriched product mix – earlier 12-13 inch tyres formed 50-60% of the basket, which has slowly fallen to 40-45%. OEM: replacement mix in PCR is 50:50.

Import restrictions on tyres have also been beneficial for Apollo. This will help Apollo even in the long term because a lot of imports were in the higher end of the product mix (imported from Michelin, Bridgestone and other Asian players). Apollo has 11 years' experience of selling high-end tyres in Europe. So, it will not have to reinvent the technology. PCR imports traditionally had 15% market share (15% of 41mn tyres sold in domestic PC market). This will come to domestic players.

Radialisation trend has slightly come to a halt and is stable - TBB:TBR mix stood at 50:50. Radialisation trend will continue and Apollo stands to benefit given its strong brand equity and product strength in the TBR segment. But, it has also made substantial gains in TBB market share.

India revenue was driven by volume growth in the replacement segment. OEM demand also recovered towards the end of 2QFY21. All the product categories posted double-digit growth in the replacement segment. OEM segment witnessed growth in Sept'20. Looking ahead, the company expects the demand momentum to remain strong, both in replacement and OEM segments.

Europe Business

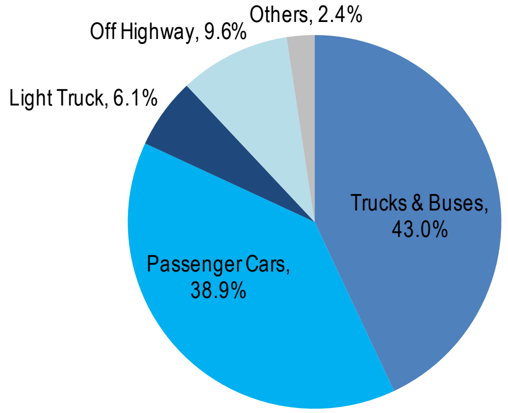
The company added more than 200 dealers in 1HFY21. It continues to focus on laying the building blocks in Europe by adding new networks across countries and introducing new products that have achieved podium position in some of the test magazines in Germany. Despite subdued sentiments, the company gained 12bps market share in ultra-high performance (UHP) and UUHP passenger car segments in Europe. It also gained 23bps market share in the TBR segment and 25bps market share in Farm products. The work with respect to specialization of Dutch plant is on track and the company is expected to see significant gains from this exercise FY22 onwards in terms of cost competitiveness (500 people reduction will lead to EUR40-50mn savings from FY22).

In Europe, winter has been slow, leading to very slow demand pick-up in winter tyres. Also, given the lockdowns in Italy, France, Spain, Germany and the Netherlands, the demand for winter tyres is slow. But, weak winters haves been a problem for a while now (since 2015-2016). Apollo has been emphasizing more on all-season tyres and today Vredestein is clearly the No 1 player in all-season tyres in Europe.

Europe ROE driver – when only one plant was operated in Enschede, Apollo was profitable by sweating assets and touched revenue of EUR450-480mn in 2014-15. Markets then dived as far as prices are concerned and Apollo is not a price leader. This put a lot of pressure on its cost competitiveness. Currently, Enschede, the Netherlands plant operates at around EUR 2.6 per kilo in terms of the cost of manufacturing whereas the same in Hungary fell below EUR 1 per kilo recently in Sept'20. That is the difference in cost of manufacturing. After specialization of the Netherlands plant is over, capacity to cater to sales volume in Europe will shift partly to Hungary and partly to India. Hungary will reach a state of 90% to 95% utilization level. Also, new dealers are getting added, which along with product mix improvement will drive ROCE.

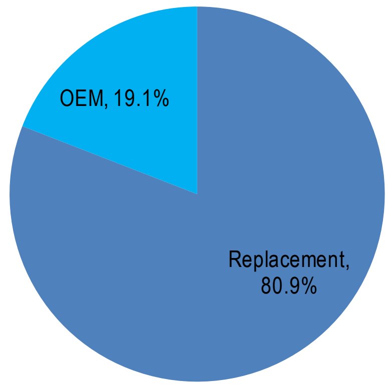
EU sales were flat YoY. While the business was affected by Covid-19, the company gained market share in the key segments like the high-end passenger car tyres, UHP and UUHP, and TBR tyres.

Exhibit 4: Apollo's consolidated revenue mix by segments



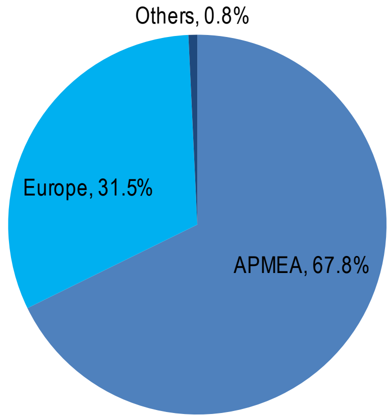
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Apollo's consolidated revenue mix by channel



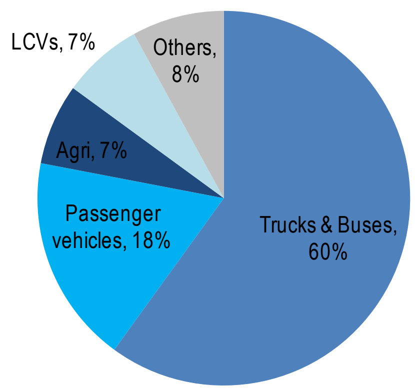
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Apollo's consolidated revenue mix by geography



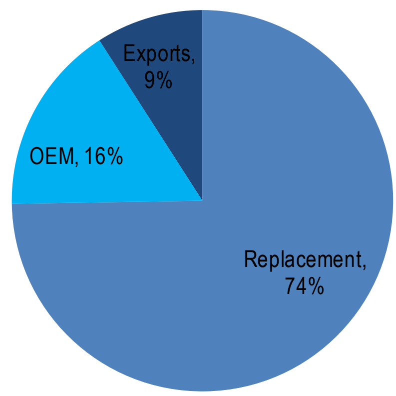
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Apollo's India revenue mix by segments



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Apollo's India revenue mix by channel

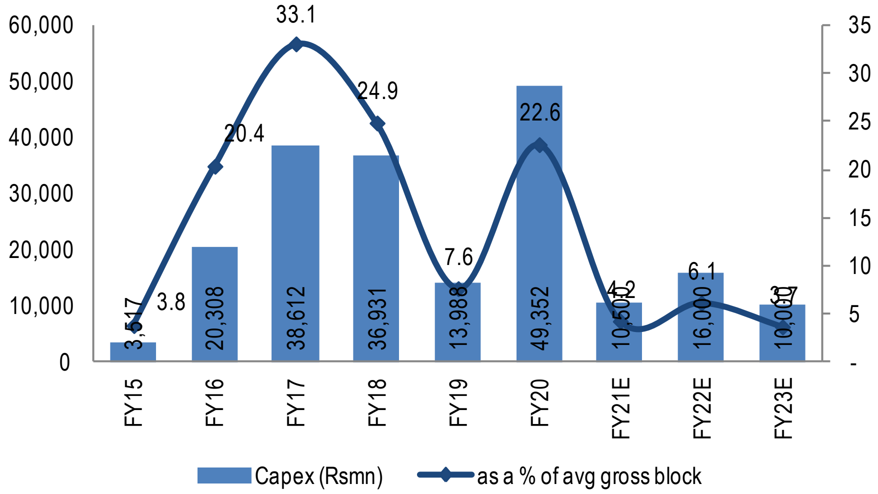


Source: Company, Nirmal Bang Institutional Equities Research

Easing capex cycle

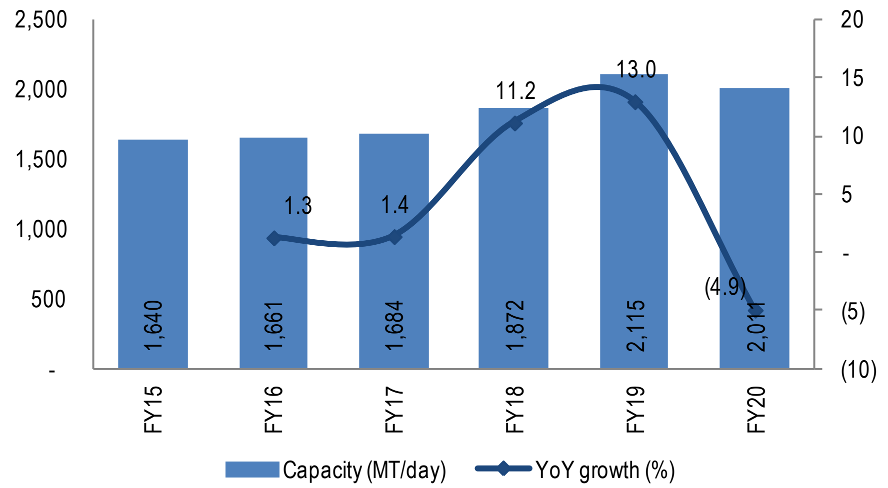
The company is towards the end of its current capex cycle. Going forward, focus would be on sweating the assets and de-leveraging the balance sheet. Capex intensity will fall in the next few years, which coupled with recovery in demand should help generate positive FCF and further de-leverage the balance sheet. Between 2010 and 2015, ROCE was at a healthy double-digit level. Investments made, both in Hungary and Andhra plants led to a decline in ROCE. Now, the capex cycle is near its tailend and going forward focus will be on sweating the assets by running the plants at high utilization levels. The management believes that over the next 2-3 years, ROCE will reach double digits.

Exhibit 9: Capex trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Apollo's capacity expansion trend



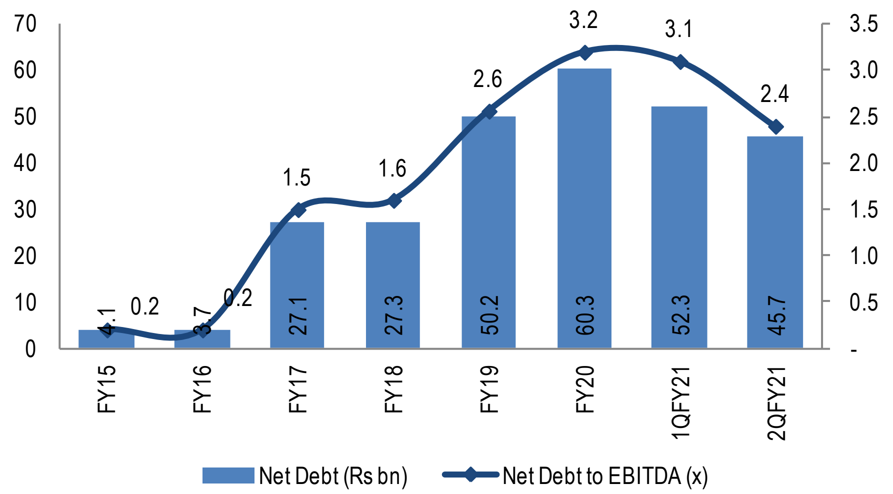
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Segment-wise capacity

Capacity (MT/day)	FY17	FY18	FY19	FY20
Apollo Tyres				
PCR	256	256	280	352
TBR	465	608	775	775

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Consolidated Debt / EBITDA is expected to come down to 1.6x



Source: Company, Nirmal Bang Institutional Equities Research

2QFY21 Update

The demand recovery continued to be extremely positive. Apollo reported growth in India and was also able to maintain a flattish topline in its European operations. Significant improvement in operating results was on the back of increase in volume in replacement and the OE segments, reduced raw material costs and reduction in fixed costs and overall manufacturing costs. Dealer incentives were not there in the market due to demand-supply situation and even going forward, incentives will be at bare minimum. Input prices have been rising and there will be a price hike in either 3QFY21 or 4QFY21 (sitting on low cost RM inventory). The company saw a marginal price increase in the US and expects some price increase in the EU in the near term.

There is an increased focus on digitisation and on online collaboration, which would help in bringing down costs on a long-term sustainable basis. The company is making consistent efforts to bring down fixed costs (rental, A&P and travel; digital launch – cost due to digital launched reduced from US$7Lac to US$1.2Lac). Supply chain costs have been reduced by redesigning the network (digitization and hired a new senior person as a chief design officer in the UK. It looked at re-dispatch centers across India and tried to move goods directly to dealers), thereby reducing inventories of both raw materials and finished goods to new benchmark norms, which has resulted in optimisation of working capital and positive free cash flows in both the regions. This helped reduce fixed costs by ~15% in H1FY21. Significant part of this cost savings will be sustainable. But, the company continues to focus and invest in the key areas of the business i.e. R&D, brand building, enhancing network distribution and enriching the product mix.

Net debt declined to Rs46bn as on Sept'20 from Rs60bn in March'20. Consolidated net debt/EBITDA came down from 3.2x to 2.4x.

India capex will be Rs10.5bn for FY21 and Rs16bn for FY22. EU capex will be EUR25-30mn a year. Andhra capex left is Rs16bn. Total Andhra capex of Rs39bn remains unchanged. Payback period is 7 years.

Apollo does import some natural rubber for truck & bus radials and that will continue. Import share of rubber will be consistent going forward as well. The company is holding inventory at less price between 45 to 60 days in India.

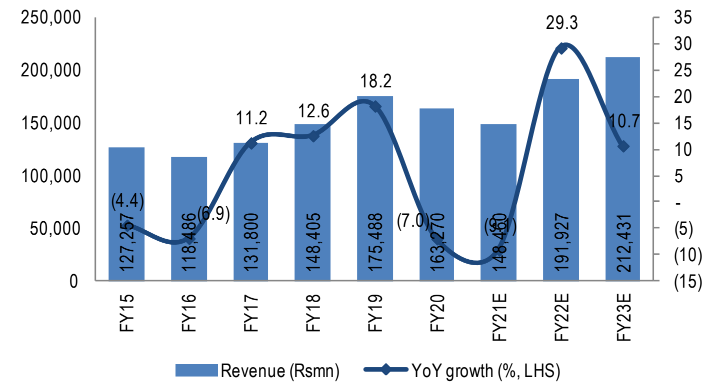
In the replacement segment, during 2Q, the YoY truck volume growth was 18% while the same was 11% for passenger cars. October also witnessed strong demand for the company. Apollo hit record numbers in all categories of tyres, including farm, motorcycle radial, passenger car and truck & bus tyres. The trend line is expected to remain positive at least till December. Given the dynamic situation, the company can't predict demand from January onwards but management is very bullish on 4Q. FG inventory in 2Q fell from 31 days to 21 days.

1HFY21 revenue declined by 20% YoY and the full-year target is to hit positive single digit revenue growth. Strong replacement market and recovery in OEMs will drive it. The company expects double-digit growth in the replacement segment in 2HFY21 unless there is fresh pick-up in Covid cases. 3Q seasonally is good for EU and overall with the impact of better operating leverage and tighter control over costs, management expects to mitigate the impact of higher RM prices.

Financials and Valuation

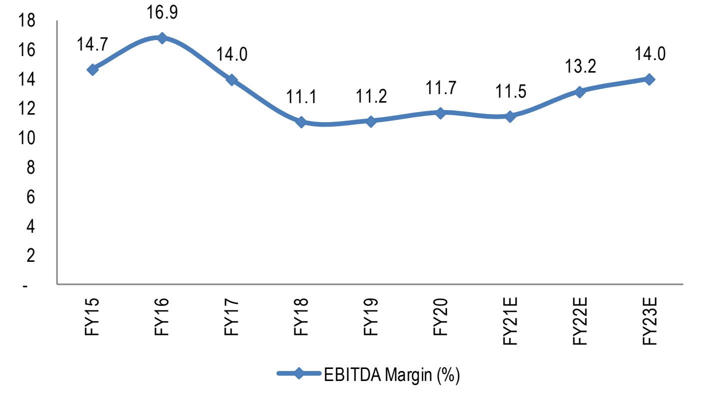
For the standalone business, driven by healthy replacement demand and upturn in the CV and PV cycles, we expect revenue to grow at 10.5% CAGR over FY20-23E. Europe revenue should improve on the back of a gradual pick-up in replacement sales and market share gains. The company will benefit from staff reduction, improved distribution and shift from Dutch to Hungary plant. At a consolidated level, we expect revenue CAGR of 9.2% over FY20-23, EBITDA margin improvement of 230bps and PAT CAGR of 29.6%. This is a result of expected benefits from better scale, cost savings in employee expenses and other fixed costs and improved product mix. Given the strong revival, we value the stock at 14x Sept'22 consolidated EPS. It is a 15% premium to its long-term average multiple of 12x and gives us a TP of Rs227.

Exhibit 13: Expect Apollo's consolidated revenue to grow at CAGR 10.6% over FY20-23E



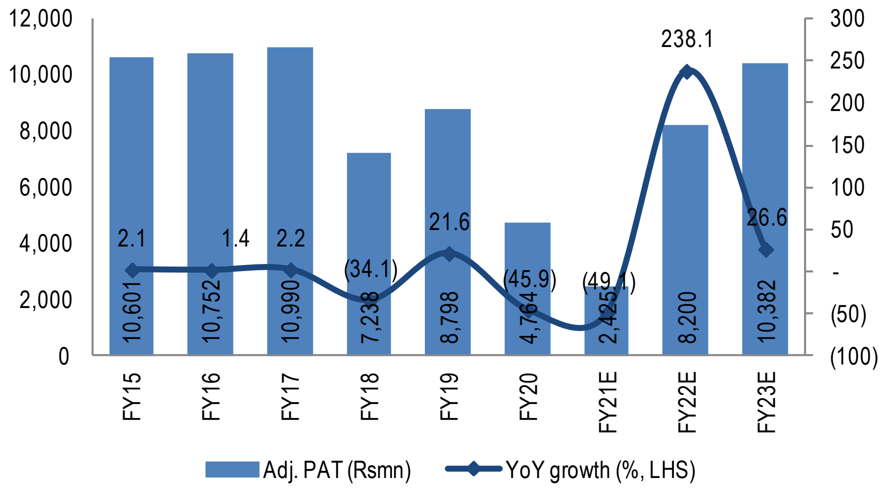
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Expect Apollo's consolidated EBITDA margin to expand 230bps over FY20-23E driven by better utilization and cost efficiencies



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Apollo's consolidated PAT is expected to grow at CAGR 36% over FY20-23E



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 16: Income statement

Y/E March (Rsmn)	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	**175,488**	**163,270**	**148,460**	**191,927**	**212,431**
% Growth	***18.2***	***(7.0)***	***(9.1)***	***29.3***	***10.7***
Raw material	101,265	90,756	83,137	108,295	119,726
Staff costs	24,562	24,822	23,754	27,829	29,740
Other expenses	30,075	28,537	24,496	30,516	33,139
Total expenses	155,902	144,115	131,387	166,640	182,606
EBITDA	**19,586**	**19,155**	**17,073**	**25,286**	**29,825**
% Growth	***18.6***	***(2.2)***	***(10.9)***	***48.1***	***18.0***
EBITDA margin (%)	***11.2***	***11.7***	***11.5***	***13.2***	***14.0***
Other income	1,231	469	516	567	601
Interest costs	1,811	2,808	2,472	2,556	2,540
Depreciation	8,127	11,381	11,925	12,508	14,226
Profit before tax (before exceptional items)	10,880	5,434	3,191	10,790	13,660
Exceptional items	2,000	-	-	-	-
Tax	2,083	670	766	2,589	3,278
Adj PAT	**8,798**	**4,764**	**2,425**	**8,200**	**10,382**
% Growth	***21.6***	***(45.9)***	***(49.1)***	***238.1***	***26.6***
Adj PAT margin (%)	***5.0***	***2.9***	***1.6***	***4.3***	***4.9***
EPS (Rs)	**15.4**	**8.3**	**4.2**	**14.3**	**18.1**
% Growth	*21.6*	*(45.9)*	*(49.1)*	*238.1*	*26.6*
DPS (Rs)	3.3	3.0	1.5	3.5	4.0
Payout (incl. div. tax) (%)	*31.9*	*42.6*	*40.7*	*28.1*	*25.3*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 18: Balance sheet

Y/E March (Rsmn)	FY19	FY20	FY21E	FY22E	FY23E
Share capital	572	572	572	572	572
Reserves	99,826	98,728	100,167	106,064	113,815
Net worth	100,398	99,300	100,739	106,636	114,387
Total debt	45,407	65,799	57,799	55,799	45,799
Net deferred tax liability	7,707	7,032	7,032	7,032	7,032
Minority Interest	-	-	-	-	-
Capital employed	**153,512**	**172,131**	**165,570**	**169,467**	**167,217**
Gross block	193,899	242,083	252,583	268,583	278,583
Depreciation	78,352	89,734	101,659	114,167	128,393
Net block	115,547	152,350	150,924	154,416	150,190
Capital work-in-progress	15,393	16,420	16,420	16,420	16,420
Investments	1,993	2,134	2,134	2,134	2,134
Inventories	60	194	194	194	194
Debtors	34,841	32,069	27,994	33,700	37,313
Cash	11,547	9,399	9,998	12,962	14,351
Loans & advances	5,627	7,496	2,749	3,194	6,427
Other current assets	-	-	-	-	-
Total current assets	14,905	11,993	12,593	13,222	13,883
Creditors	66,919	60,957	53,334	63,078	71,974
Other current liabilities & provisions	22,483	23,090	17,996	23,331	25,832
Total current liabilities	23,918	36,834	39,441	43,445	47,863
Net current assets	46,400	59,924	57,437	66,776	73,695
Application of funds	**20,518**	**1,033**	**(4,103)**	**(3,698)**	**(1,721)**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 17: Cash flow

Y/E March (Rsmn)	FY19	FY20	FY21E	FY22E	FY23E
OP/(loss) before tax	11,460	7,774	5,148	12,778	15,599
Other income	1,231	469	516	567	601
Depreciation & amortization	8,127	11,381	11,925	12,508	14,226
Direct taxes paid	(1,809)	(1,345)	(766)	(2,589)	(3,278)
(Inc.)/dec. in working capital	(11,724)	21,355	389	40	1,256
Other/extra-ordinary Items	(1,999)	(0)	(0)	(0)	(0)
Cash flow from operations (after E/O)	**5,286**	**39,634**	**17,212**	**23,304**	**28,404**
Capital expenditure (-)	(13,988)	(49,352)	(10,500)	(16,000)	(10,000)
Free cash flow	**(8,703)**	**(9,718)**	**6,712**	**7,304**	**18,404**
Other investing activites	13,365	(134)	-	-	-
Dividends paid (-)	(2,171)	(2,028)	(987)	(2,303)	(2,631)
Interest Paid (-)	(1,811)	(2,808)	(2,472)	(2,556)	(2,540)
Inc./(dec.) in total borrowings	950	20,392	(8,000)	(2,000)	(10,000)
Others	(1,996)	(3,834)	0	0	0
Cash from financial activities	**(5,028)**	**11,722**	**(11,459)**	**(6,858)**	**(15,171)**
Opening cash balance	5,992	5,627	7,496	2,749	3,194
Closing cash balance	5,627	7,496	2,749	3,194	6,427
Change in cash balance	(365)	1,869	(4,747)	445	3,232

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 19: Key ratios

Y/E March	FY19	FY20	FY21E	FY22E	FY23E
Per share (Rs)					
EPS	15.4	8.3	4.2	14.3	18.1
EPS Growth (%)	21.6	(45.9)	(49.1)	238.1	26.6
Cash EPS	26.1	28.2	25.1	36.2	43.0
Book value per share	175.5	173.6	176.1	186.4	200.0
DPS	3.3	3.0	1.5	3.5	4.0
Payout (incl. div. tax) %	31.9	42.6	40.7	28.1	25.3
Valuation (x)					
P/E	12.3	22.7	44.6	13.2	10.4
Cash P/E	7.3	6.7	7.5	5.2	4.4
EV/EBITDA	7.6	8.7	9.6	6.4	4.9
EV/Sales	0.9	1.0	1.1	0.8	0.7
P/BV	1.1	1.1	1.1	1.0	0.9
Dividend yield (%)	1.7	1.6	0.8	1.8	2.1
Return ratios (%)					
RoCE	8.4	5.1	3.4	7.9	9.7
RoE	6.8	4.8	2.4	7.7	9.1
Profitability ratios (%)					
EBITDA margin	11.2	11.7	11.5	13.2	14.0
PAT margin	5.0	2.9	1.6	4.3	4.9
Turnover ratios					
Debtors (days)	24	21	25	25	25
Inventory (days)	74	73	70	65	65
Creditors (days)	48	52	45	45	45
Asset turnover (x)	1.1	0.9	0.9	1.1	1.3
Leverage Ratio					
Debt/equity (x)	0.5	0.7	0.6	0.5	0.4

Source: Company, Nirmal Bang Institutional Equities Research

CEAT

15 December 2020

Reuters: CEAT.BO; Bloomberg: CEAT IN

Initiating Coverage

Lower truck radial presence to hurt recovery

CEAT is the 4th largest tyre manufacturer in India and is a strong player in its operating niche of 2W tyres. This segment is witnessing growth as well as price appreciation. The company has identified 2W, PV and OTR tyre segments as its strategic focus areas given the lower exposure to the Truck segment. In the segments of Trucks and PVs, the company is a contender as it is adding capacities, which should allow it to grow slightly faster than the overall growth in these segments. The company also has a strong presence in the replacement market, which was 58% of the revenue in FY20. This improved to 71% in 1HFY21 and led to growth in both revenue as well as margins in 2QFY21. This robust demand in the replacement segment has been driven by the company's strong emphasis on effective marketing and branding of its products. To position its products competitively, the company has developed creative ad campaigns based on extensive research/consumer insights and invested in innovative marketing programs. In 2QFY21, Amir Khan joined the CEAT Tyre family as its brand ambassador for a period of two years, to specifically focus on premium offerings. CEAT continues to be associated with IPL and extended the partnership with the Torino Football Club. Thus, ad spends were up 20% YoY in 2QFY21. Despite this, standalone EBITDA margin expanded by 470bps YoY to 14.8% on account of operating leverage and improvement in product & market mix.

The company started seeing green-shoots in the replacement segment towards the end of 1QFY21, with demand recovery persisting subsequently with every month being better than the previous month. All the categories in the replacement segment have grown in double digits – some of the drivers are import restrictions, strong rural economy and move towards personal mobility. But, growth was restricted because of capacity constraints. Demand continued to be good in Oct'20 and Nov'20 with strong demand from OEMs as well as replacement segments. Mix will be adverse going forward as OEM demand has increased and the company will have to allocate higher volume to OEMs. Demand from January'21 onwards will be on wait & watch mode.

In 2QFY21, CEAT's standalone revenue grew by 16.5% YoY, driven by volume gains across segments, especially in the Farm, CV, PC and UV segments. The OEM business declined YoY in single digits while the replacement segment posted strong 30% YoY growth. Exports grew in low single digits. The share of replacement segment rose to 71% of revenue against the normal level of 60%.

The company commissioned phase II of the Nagpur plant during 2QFY21. As a result of this commissioning and ongoing ramp-up of Halol and Chennai facilities, employee cost increased by ~31% YoY. Other expenses increased by 16% YoY on higher production.

Given its lower presence in the truck radial segment, we expect CEAT to lag its peers in terms of growth, as CVs are set for a stronger revival due to an extremely low base viz-a-viz other segments. That said, as the whole Auto sector is witnessing a 'V' shape recovery, CEAT should also be a beneficiary of the upcycle. We expect 9.8% CAGR in revenue during FY20-23E. Margins are expected to expand due to an improved operating performance. As a result, PAT is expected to grow at 19.2% CAGR during FY20-23. We value the company at 12x Sept'22 EPS, which is its long-term average multiple. We have a target price of Rs1,243.

Y/E March (Rsmn)	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	69,845	67,788	69,232	81,597	89,757
% Growth	*12.2*	*(3.5)*	*2.0*	*18.0*	*10.0*
EBITDA	6,425	7,238	8,221	10,326	11,800
EBITDA margin (%)	*9.2*	*10.7*	*11.9*	*12.7*	*13.1*
Adj PAT	2,970	2,611	3,346	3,964	4,418
EPS (Rs)	73.4	64.5	82.7	98.0	109.2
EPS growth (%)	*9.2*	*(12.1)*	*28.1*	*18.5*	*11.5*
P/E (x)	15.8	18.0	14.1	11.9	10.6
EV/Sales (x)	0.9	1.0	1.0	0.9	0.8
EV/EBITDA (x)	9.2	8.9	7.9	6.8	5.9
P/BV	1.7	1.6	1.5	1.3	1.2
Dividend yield (%)	1.0	1.0	1.1	1.3	1.5
RoCE (%)	*11.0*	*9.1*	*9.4*	*10.9*	*11.9*
RoE (%)	*10.7*	*9.0*	*10.5*	*11.3*	*11.4*

Source: Company, Nirmal Bang Institutional Equities Research

ACCUMULATE

Sector: Automobile

CMP: Rs1,163

Target Price: Rs1,243

Upside: 6.9%

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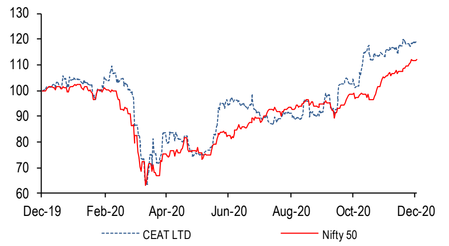
Key Data

Current Shares O/S (mn)	40.5
Mkt Cap (Rsbn/US$mn)	47.1/640.5
52 Wk H / L (Rs)	1,249/600
Daily Vol. (3M NSE Avg.)	266,861

Share holding (%)	4QFY20	1QFY21	2QFY21
Promoter	46.8	46.7	46.7
Public	53.2	53.3	53.3
Others	-	-	-

One Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
CEAT	3.0	26.1	19.2
Nifty Index	5.8	35.6	11.9

Source: Bloomberg

Valuation/stock price performance

Given its lower presence in the Truck radial segment, we expect CEAT to lag its peers in terms of growth as CVs are set for a stronger revival due to extremely low base viz-a-viz other segments. That said, as the whole Auto sector is witnessing a 'V' shape recovery, CEAT should also be a beneficiary of the upcycle. We expect 9.8% CAGR revenue growth during FY20-23E. Margins are expected to expand due to an improved operating performance. As a result, PAT is expected to grow at 19.2% CAGR during FY20-23. We value the company at 12x Sept'22 EPS, which is its long-term average multiple. We have a target price (TP) of Rs1,243.

Exhibit 1: One-year forward P/E band

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 2: Top five institutional shareholders of CEAT

Name	Holding (%)
Amansa Holdings Pvt Ltd	9.29
Mirae Asset Global Investments Co	8.11
Jwalamukhi Investment Holdings	5.77
Tata Asset Management Ltd	2.21
New India Assurance Co Ltd/The	2.08

Source: Bloomberg

Exhibit 3: Peer valuation

Company	EPS (Rs)			ROE (%)			PER (x)			EV/EBITDA (x)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
CEAT Ltd	82.7	98.0	109.2	10.5	11.3	11.4	14.1	11.9	10.6	7.9	6.8	5.9
Apollo Tyres	4.2	14.3	18.1	2.4	7.7	9.1	44.6	13.2	10.4	9.6	6.4	4.9
MRF*	2,636	3,353	3,779	8.8	10.2	10.4	29.4	23.1	20.5	11.3	9.7	8.7
JK Tyres*	0.6	8.6	12.3	0.5	8.8	10.7	140.7	9.3	6.5	7.1	5.5	4.8
BKT	50.7	63.4	76.0	17.0	18.2	18.7	32.6	26.0	21.7	19.6	15.8	13.2

*Source: Bloomberg; Nirmal Bang Institutional Equities Research *Bloomberg estimates*

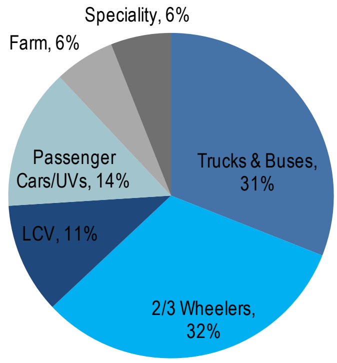
Investment rationale

CEAT became part of the RPG Group in 1982, which is now one of India's fastest growing conglomerates with 20000+ employees, presence in 100+ countries and annual gross revenue of over US$3bn. It is India's leading tyre company with over 50 years of presence and a strong distribution network of 3400+ dealers, 300+ exclusive CEAT franchisees and 7 manufacturing facilities (at Bhandup, Nasik, Halol, Nagpur, Ambernath, Chennai and Sri Lanka). It supplies its products in 100+ countries where products are sold with a strong brand recall.

CEAT is the No 1 player in Sri Lanka in terms of market share. The company has a manufacturing facility in Sri Lanka and leadership position with 50%+ market share. The company is continuously working on a focused product and distribution strategy for select clusters and countries.

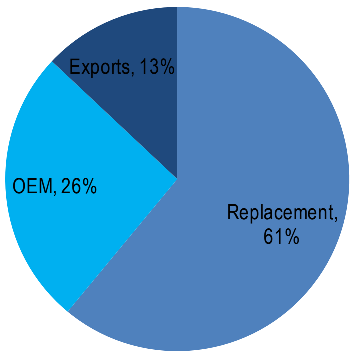
CEAT is a strong player in its operating niche of 2W tyres, which is witnessing growth as well as pricing improvement. In the segments of Trucks and PVs, the company is a contender as it is adding capacities, which should allow it to grow slightly faster than the overall growth in the segments.

Exhibit 4: CEAT's revenue mix by segments



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: CEAT's revenue mix by channel



Source: Company, Nirmal Bang Institutional Equities Research

Speciality Tyres

The company completed the merger of CEAT Specialty Tyres during the quarter. Specialty Tyres business operates in the off-highway tyres segment, which is quite different from other tyre segments with respect to the high number of SKUs, lower volume and longer gestation period. The product lifecycle is very long (6-7 years) and is seasonal (spring dating and high demand periods). Building of the entire range takes 2-3 years time. Product is very well established and seeing good growth in this segment. Capacity utilisation in this business is nearly full at ~85-90%. Current capacity is ~30-35 tonnes/day and will be increased by 15-20 tonnes/day over time. So, capex will be low and expansion will be measured based on utilization. It is seeing good feedback for its products from Europe and US markets. Domestic farm business (has always been there with CEAT) has lower-than-average company margins but international farm business (for which this specialty subsidiary has been set up) has higher margins. Competitors are earning 20%+ margins.

The company was set up as a separate unit in 2015. However, to derive the benefit of operational efficiencies, Specialty Tyres business was merged with CEAT Ltd. But, from a business and sales point of view, Specialty Tyres will continue to act as an independent unit. The company focused on strengthening its supply chain and adding more dealers and distributors. It added ~200 new outlets across categories and regions. CEAT has partnered with M&M for the launch of the latter's Thar model and will supply 16-inch and 18-inch tyres for the two variants of Thar.

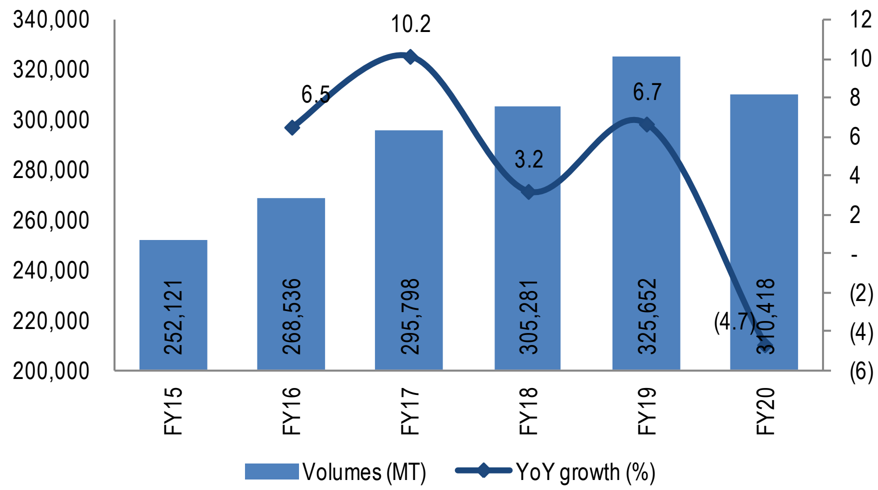
Capex and capacity expansion

CEAT continues to focus on minimizing capex and efficient management of working capital. Overall working capital fell by Rs550mn in 2QFY21 following the Rs1.34bn reduction in 1QFY21. Debt declined by Rs1.9bn vs. June'20, largely supported by operating cash flows and efficiencies in working capital and capex. Consolidated debt-to-equity ratio stood at 0.6x vs. 0.9x as on June'20. FY21 capex is expected to be at Rs5.5bn-6bn (project related) and Rs1.5bn (routine capex), plus some additional capex in the specialty business (spend in 1HFY21 was Rs2.6bn). So, in 2HFY21, debt will rise, in line with capex. And, as working capital efficiency goes back to normal level (by ~Rs1bn) (finished goods inventory is quite low), debt will increase accordingly. Out of the total project capex plan of Rs35bn, Rs23bn has been spent till 30th Sept'20 while the balance Rs12bn will be spent this year, next year and the following year. Further, Rs5bn will be spent on the specialty business for ~100 tonnes of capacity, subject to achievement of milestone (Rs1bn in this year). So, in summary, balance capex is Rs17bn (CEAT + Specialty).

While the plant has been commissioned, truck radial capacity is static as the downstream equipment will get commissioned over the next 6-9 months. Current capacity is ~120,000 tyres/month (phase 1 + phase 2) and the plant is currently operating at ~50% of its terminal capacity i.e. between 60,000-70,000 tyres p.m production level. With respect to passenger cars, the Chennai facility is at very early stage of ramp up and eventual capacity will be 20,000 tyres/day. Current capacity is 5,000 tyres/day and the next phase will add 10,000 tyres/day. Ramp up was slowed earlier due to demand uncertainty on account of Covid-19, but now it is working on a faster ramp up.

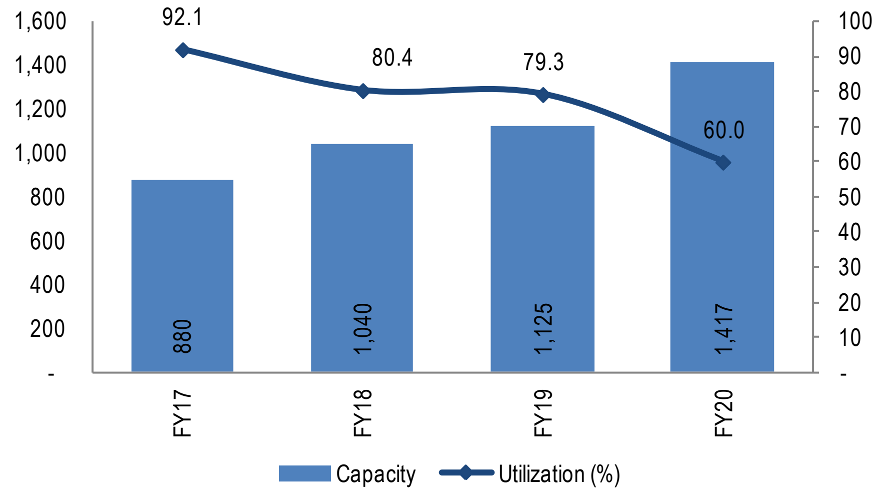
Segment-wise capacity: TBR – 120,000 tyres/month. PCR – 40,000 tyres/day. 2Ws – 3-3.5mn tyres/month.

Exhibit 6: CEAT's volume (tonnage) trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: With capex cycle coming to an end, capacity utilization is expected to increase going ahead



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Segment-wise Capacity

Capacity (MT/day)	FY17	FY18	FY19	FY20
CEAT				
2W/3W	290	290	290	302
PCR	80	180	180	330
TBR	80	95	185	255
TBB	240	240	240	240
Others/ LCV	190	190	190	190
Farm radial		40	40	60
Total Capacity	**880**	**1,040**	**1,125**	**1,417**
YoY growth (%)	-	*18%*	*8%*	*26%*

Source: Company, Nirmal Bang Institutional Equities Research

Export opportunity

The road conditions abroad are very different, driving habits are different, seats are different and even weather patterns are different. So, one has to create a specific product range, test it out and then supply to those markets, which can take about 1.5 years to 2 years time. It will take some time to enter these overseas markets. Currently, CEAT is exporting to Europe and has an R&D office in Frankfurt for the European market. CEAT was an erstwhile Italian brand, so to that extent, European markets like Italy, Spain and Germany are all important for the company. CEAT has been growing very well in these markets.

Sharp OEM Focus

CEAT is focusing on OEMs and its recent entries include: Honda Activa (BS-VI), Honda CB Shine SP (BS-VI), Hero MotoCorp Splendor iSmart (BS-VI), Hero MotoCorp HF Deluxe (BS-VI), Hero Dare 125, Hero Duet E, Maruti Suzuki Alto VXI+, Hero Glammer Refresh, Mahindra Jeeto Z Series and Tata Intra. Recent entries into OEMs' existing models include – JBM CNG Bus, Mahindra Scorpio S3, Honda Bikes till 125 CC, Yamaha FZ 150 CC, Suzuki Gixxer 150 CC, Ashok Leyland Truck 1618, Daimler BS-VI Trucks and Piaggio Aprilia 150 CC. Platforms like Fuelsmart, Gripp, Mileage X3, SecuraDrive etc.

Other levers

Significant investments have been made in tyre testing infrastructure like Anechoic Chamber, Flat Track Test Machine. Focus is on upcoming technologies like Electric Vehicle, Sustainability and Smart Tyres.

CEAT is a strong player in its operating niche of 2W tyres, which is witnessing growth as well as pricing improvement. In the segments of Trucks and PVs, the company is a challenger but is adding capacities, which should allow it to grow slightly faster than the overall growth in the segments.

2QFY21 update

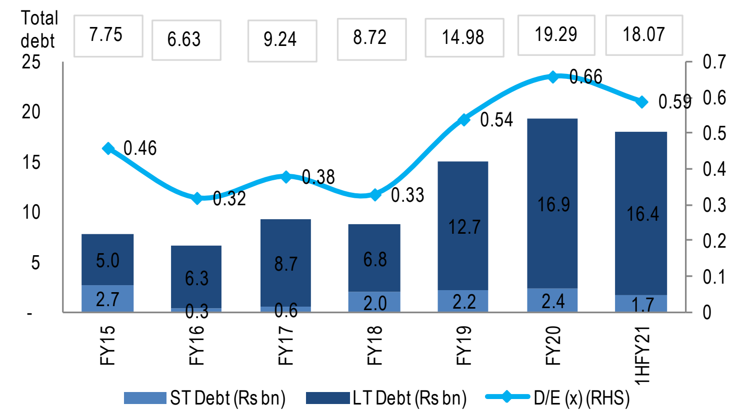
The company started seeing greenshoots in the replacement segment towards the end of 1QFY21 with demand recovery persisting subsequently with every month being better than the previous one. All the categories in the replacement segment have grown in double digits – some of the drivers are import restrictions, strong rural economy and move towards personal mobility. Growth was restricted because of capacity constraints. Demand continued to be good in Oct'20 and Nov'20, with strong demand from OEM as well as Replacement segments. Mix will be adverse going forward as OEM demand has risen and the company will have to allocate higher volume to OEMs. Demand from Jan'21 onwards will be on wait & watch mode.

Standalone revenue grew by 16.5% YoY in 2QFY21, driven by volume gains across segments, especially in the Farm, CV, PC and UV segments. OEM business declined YoY in single digits while the replacement segment posted strong 30% YoY growth. Exports grew in low single digits. Share of the replacement segment rose to 71% of revenue against the normal level of 60%.

The company commissioned phase II of the Nagpur plant during the quarter. As a result of this commissioning and ongoing ramp up of Halol and Chennai facilities, employee cost increased by ~31% YoY. Other expenses increased by 16% YoY on the back of higher production. During the quarter, Amir Khan joined the CEAT Tyre family as its brand ambassador for a period of two years to specifically focus on premium offerings. CEAT continues to be associated with IPL and extended the partnership with the Torino Football Club. Thus, ad spends were up 20% YoY in 2QFY21. Despite this, standalone EBITDA margin expanded by 470bps YoY to 14.8% on account of operating leverage and improved product & market mix.

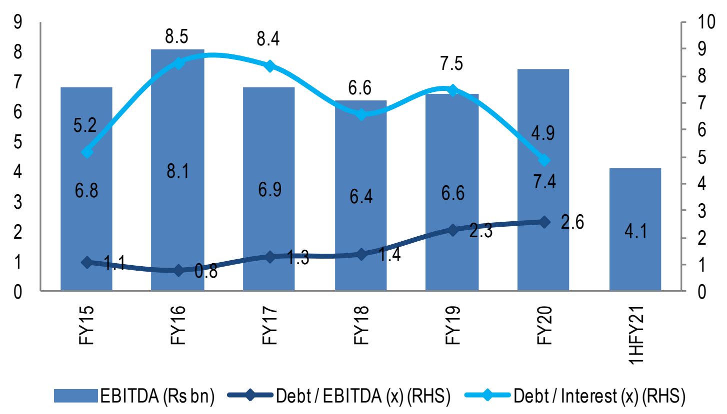
Consolidated revenue grew by 17% YoY, driven by volume gains. Consolidated gross margin expanded by 530bps to 46.5% on account of lower raw material costs, favorable business & product mix and astute cost management. RM cost declined by 5% QoQ and 9-10% YoY largely due to lower carbon black prices. Prices of NR, SR, fabric was also lower by ~10% YoY. However, prices of NR increased (Rs132/kg pre-covid level to Rs150/kg currently). So, expect RM cost to increase by 2-3% in 3Q and appreciate further in 4Q. Cost reduction program that the company is working on is still underway, aiming for ~Rs1bn reduction in costs (utility cost reduction, power fuel network redesign, cost towards direct delivery etc) but it will take about 6-9 months to show the results. Income tax was lower by Rs450mn due to carry forward losses of the merged specialty business (all benefits accrued in 2Q and going forward normal rate).

Exhibit 9: CEAT's debt and D/E trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: CEAT's Debt / EBITDA trend

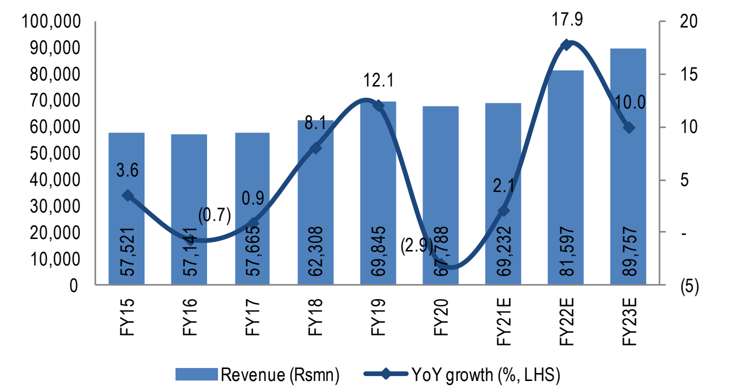


Source: Company, Nirmal Bang Institutional Equities Research

Financials and Valuation

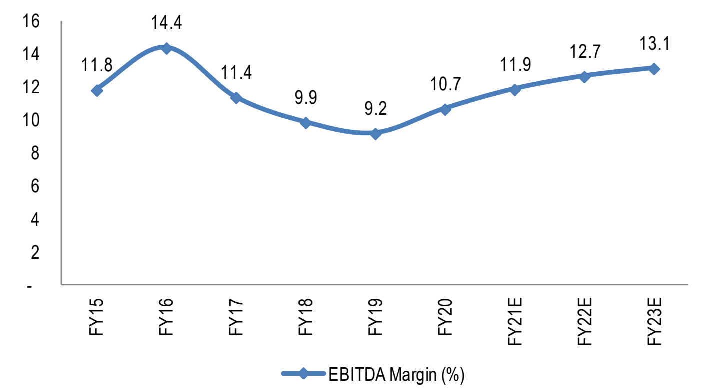
Given its lower presence in the truck radial segment, we expect CEAT to lag its peers in terms of growth as CVs are set for a stronger revival due to extremely low base viz-a-viz other segments. That said, as the whole Auto sector is witnessing a 'V' shape recovery, CEAT should also be a beneficiary of the upcycle. We expect 9.8% revenue CAGR during FY20-23E. Margins are expected to expand due to the improved operating performance. As a result, PAT is expected to grow at 19.2% CAGR. We value the company at 12x Sept'22 EPS, which is its long-term average multiple. We have a TP of Rs1,243.

Exhibit 11: Expect CEAT's revenue to grow at CAGR 8.4% over FY20-23E



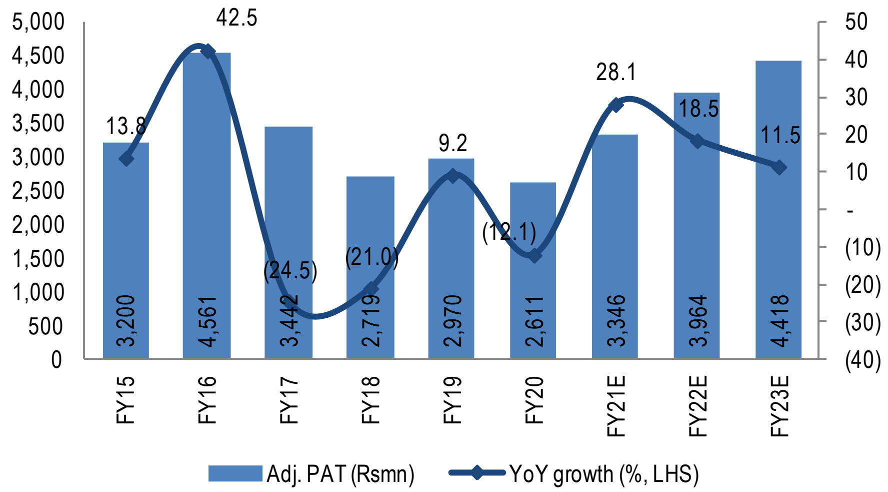
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Expect CEAT's EBITDA margin to expand 260bps over FY20-23E driven by higher utilization, mix improvement and cost efficiencies



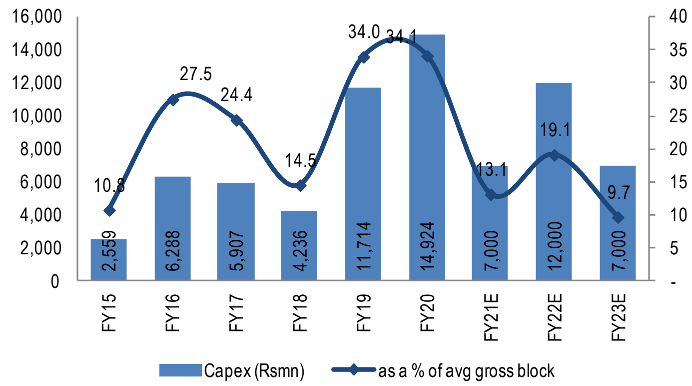
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: CEAT's PAT is expected to grow at CAGR 16.8% over FY20-23E



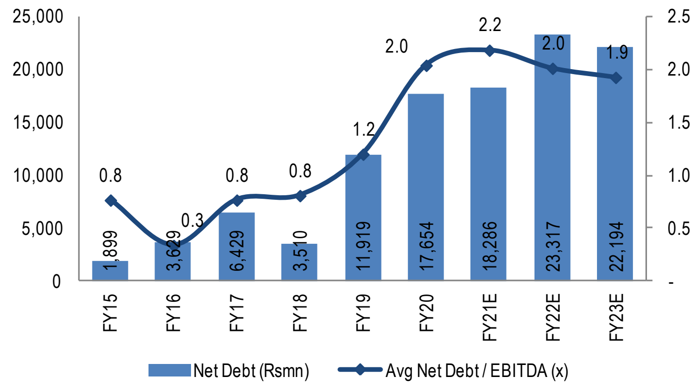
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Capex to come down from FY21 onwards



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Net Debt / EBITDA is expected to come down to 1.6x



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 16: Income statement

Y/E March (Rsmn)	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	**69,845**	**67,788**	**69,232**	**81,597**	**89,757**
% Growth	***12.2***	***(3.5)***	***2.0***	***18.0***	***10.0***
Raw material	41,818	39,151	38,634	45,427	49,882
Staff costs	5,301	5,418	6,598	7,384	7,769
Other expenses	16,301	15,981	15,780	18,460	20,306
Total expenses	63,420	60,550	61,011	71,271	77,957
EBITDA	**6,425**	**7,238**	**8,221**	**10,326**	**11,800**
% Growth	***4.5***	***12.7***	***13.6***	***25.6***	***14.3***
EBITDA margin (%)	***9.2***	***10.7***	***11.9***	***12.7***	***13.1***
Other income	390	205	318	350	385
Interest costs	880	1,509	1,605	2,014	2,463
Depreciation	1,927	2,765	3,217	3,708	4,200
Profit before tax (before exceptional items)	4,008	3,169	3,717	4,955	5,523
Exceptional items	448	298	-	-	-
Tax	1,251	742	372	991	1,105
Adj PAT	**2,970**	**2,611**	**3,346**	**3,964**	**4,418**
% Growth	***9.2***	***(12.1)***	***28.1***	***18.5***	***11.5***
Adj PAT margin (%)	***4.3***	***3.9***	***4.9***	***4.9***	***5.0***
EPS (Rs)	**73.4**	**64.5**	**82.7**	**98.0**	**109.2**
% Growth	*9.2*	*(12.1)*	*28.1*	*18.5*	*11.5*
DPS (Rs)	12.0	12.0	13.0	15.0	17.5
Payout (incl. div. tax) (%)	*22.1*	*24.2*	*18.0*	*17.2*	*17.7*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 18: Balance sheet

Y/E March (Rsmn)	FY19	FY20	FY21E	FY22E	FY23E
Share capital	405	405	405	405	405
Reserves	27,257	28,675	31,414	34,677	38,279
Net worth	27,661	29,079	31,818	35,082	38,684
Total debt	14,469	19,832	21,832	25,832	25,832
Net deferred tax liability	2,198	2,744	2,744	2,744	2,744
Minority Interest	238	237	-	-	-
Capital employed	**44,566**	**51,892**	**56,394**	**63,658**	**67,260**
Gross block	37,663	49,795	56,795	68,795	75,795
Depreciation	5,868	8,197	11,414	15,122	19,322
Net block	31,795	41,598	45,381	53,673	56,473
Capital work-in-progress	8,329	10,685	10,685	10,685	10,685
Investments	1,814	1,837	2,337	2,337	2,337
Inventories	10,056	9,257	9,288	10,960	12,056
Debtors	7,064	6,744	6,766	7,984	8,783
Cash	735	342	1,210	179	1,302
Loans & advances	48	57	62	69	76
Other current assets	4,207	3,010	3,311	3,642	4,007
Total current assets	22,111	19,410	20,638	22,834	26,223
Creditors	10,529	11,948	11,988	14,146	15,560
Other current liabilities & provisions	8,955	9,690	10,659	11,725	12,897
Total current liabilities	19,484	21,637	22,647	25,870	28,457
Net current assets	2,627	(2,228)	(2,008)	(3,036)	(2,235)
Application of funds	**44,566**	**51,892**	**56,394**	**63,658**	**67,260**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 17: Cash flow

Y/E March (Rsmn)	FY19	FY20	FY21E	FY22E	FY23E
OP/(loss) before tax	4,498	4,473	5,004	6,618	7,600
Other income	390	205	318	350	385
Depreciation & amortization	1,927	2,765	3,217	3,708	4,200
Direct taxes paid	(946)	(196)	(372)	(991)	(1,105)
(Inc.)/dec. in working capital	(531)	4,462	649	(3)	322
Other/extra-ordinary Items	(448)	(298)	-	-	-
Cash flow from operations (after E/O)	**4,890**	**11,411**	**8,816**	**9,682**	**11,402**
Capital expenditure (-)	(11,714)	(14,924)	(7,000)	(12,000)	(7,000)
Free cash flow	**(6,824)**	**(3,514)**	**1,816**	**(2,318)**	**4,402**
Other investing activites	321	(22)	(500)	-	-
Dividends paid (-)	(485)	(485)	(526)	(607)	(708)
Interest Paid (-)	(880)	(1,509)	(1,605)	(2,014)	(2,463)
Inc./(dec.) in total borrowings	8,002	5,364	2,000	4,000	-
Others	(437)	(409)	(81)	(93)	(109)
Cash from financial activities	**6,199**	**2,960**	**(212)**	**1,287**	**(3,279)**
Opening cash balance	822	735	342	1,210	179
Closing cash balance	518	159	1,447	179	1,302
Change in cash balance	(304)	(576)	1,105	(1,032)	1,123

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 19: Key ratios

Y/E March	FY19	FY20	FY21E	FY22E	FY23E
Per share (Rs)					
EPS	73.4	64.5	82.7	98.0	109.2
EPS Growth (%)	9.2	(12.1)	28.1	18.5	11.5
Cash EPS	121.1	132.9	162.2	189.7	213.1
Book value per share	683.8	718.9	786.6	867.3	956.3
DPS	12.0	12.0	13.0	15.0	17.5
Payout (incl. div. tax) %	22.1	24.2	18.0	17.2	17.7
Valuation (x)					
P/E	15.8	18.0	14.1	11.9	10.6
Cash P/E	9.6	8.8	7.2	6.1	5.5
EV/EBITDA	9.2	8.9	7.9	6.8	5.9
EV/Sales	0.9	1.0	1.0	0.9	0.8
P/BV	1.7	1.6	1.5	1.3	1.2
Dividend yield (%)	1.0	1.0	1.1	1.3	1.5
Return ratios (%)					
RoCE	11.0	9.1	9.4	10.9	11.9
RoE	10.7	9.0	10.5	11.3	11.4
Profitability ratios (%)					
EBITDA margin	9.2	10.7	11.9	12.7	13.1
PAT margin	4.3	3.9	4.9	4.9	5.0
Turnover ratios					
Debtors (days)	39	39	39	39	39
Inventory (days)	52	49	49	49	49
Creditors (days)	55	65	65	65	65
Asset turnover (x)	1.6	1.3	1.2	1.3	1.3
Leverage Ratio					
Debt/equity (x)	0.5	0.7	0.7	0.7	0.7

Source: Company, Nirmal Bang Institutional Equities Research

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