

CEAT LTD



CEAT Ltd

Rising input cost weighs on profitability

CMP INR 1,588	Target INR 1,766	Potential Upside 11.2%	Market Cap (INR Mn) 61516.5	Recommendation Accumulate	Sector Auto
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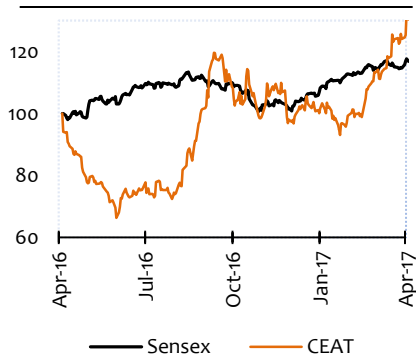
Company Overview

CEAT Ltd, a part of the RPG group and is one of the leading manufacturer of automobile tyres for CV, 2/3 wheeler, PC and UV segments with over 50 years of presence in India. The company offers the widest range of tyres to leading Original Equipment Manufacturers across the world and is highly present in replacement market. It has a very strong brand name with a 27% market share in 2W segment and 7% market share in Passenger Vehicle segment. The company has six manufacturing facilities at Bhandup (bias tyres), Nashik (bias & radial), Halol (radial), Nagpur (2W & 3W), Ambarnath (OHT) and in Sri Lanka.

MARKET DATA

Shares outs (Mn)	40
Equity Cap (INR Mn)	404
Mkt Cap (INR Mn)	61516
52 Wk H/L (INR)	1575/731
Volume Avg (3m K)	1024.26
Face Value (INR)	10
Bloomberg Code	CEAT IN

SHARE PRICE PERFORMANCE



MARKET INFO

SENSEX	29918
NIFTY	9304

Key Financials

Particulars (INR Mn)	FY15	FY16	FY17	FY18E	FY19E
Net Sales	57521.4	57141.2	57674.5	64722.7	75656.8
EBITDA	6804.0	8222.9	6567.7	7593.1	9302.3
APAT	3171.8	4464.9	3612.0	3857.4	4762.9
EPS	78.41	110.38	89.30	95.36	117.75
OPM	11.83%	14.39%	11.39%	11.73%	12.30%
NPM	5.51%	7.81%	6.26%	5.96%	6.30%

Source: Company, KRChoksey Research

Result Update:

- In Q4FY17, CEAT reported consolidated net sales of INR 16,413 Mn which (was broadly in-line with our estimates of INR 16,501 Mn) increased by 4.9% Y-o-Y and increased by 5.4% Q-o-Q. Top line growth was driven by growth in Replacement segment.
- The consolidated EBITDA stood at INR 1,352 Mn which (decreased 28.9% Y-o-Y and 13.6% Q-o-Q) reported below our estimate of INR 1,694 Mn. EBITDA margins came in at 8.1% in Q4 FY17 (declined 386bps Y-o-Y and 179bps Q-o-Q) on account of increase in natural rubber prices, higher SG&A spend and lower utilization in recently commissioned plants impacted EBITDA margin.
- Adjusted PAT came in at INR 725Mn (declined by 23.8% Y-o-Y and 10.0% Q-o-Q). Adj. PAT Margin stood at 4.4% down by (168 bps Y-o-Y and declined 76bps Q-o-Q). Voluntary Retirement Scheme (VRS), increased in depreciation and decline in other income resulted in fall in profit margin for the company.

Consumer facing segments and expanding capacities to drive growth ahead:

In FY13, CEAT derived 54% revenue from Truck & Bus (T&B) segment while 2Wheeler (2W) contributed only 11% in FY11. Over the last few years, CEAT has gradually shifted its focus from the Truck & Bus (T&B) (FY13- 54% of total Revenue to 33% in FY17) segment towards two-wheelers (2W) (11% of Total Revenue in FY13 to 29% in FY17) and passenger vehicle (PV 7% in FY13 to 13% in FY17) segment, which are more consumer facing segment.

We believe CEAT's recent capacity expansion in 2-W and PV will be driven by market share gains and expanding product in consumer facing segment. Hence, we expect company's top-line to grow at 14.4% CAGR between FY17 to FY19E from INR 63,971Mn to INR 83,768Mn.

Outlook and valuations:

We expect CEAT to get benefits from its strategic focus on the higher growth (two-wheeler and passenger vehicle) segments. Additionally, the company's CAPEX program is expected to be completed by FY18-end, which should help CEAT reap benefits of operating leverage in FY19. We expect the company to continue its Industry leading performance, improving asset utilization, lowering D/E to fetch higher valuation. However, company's failure in passing rising RM cost, increase in Chinese competition and slower than expected improvement utilization as key risk to our estimates. Hence, we have a cautious stance on company's earnings.

At CMP of INR 1,588 the stock is trading at 17.8x FY17 EPS of INR 89.3, 16.6x FY18E EPS of INR 95.3 and 13.5x FY19E EPS of INR 117.7. We recommend "**ACCUMULATE**" rating on the stock and value the stock at 15x FY19E EPS of INR 117.7 with a target price of INR 1,766 indicating 11.2% upside from CMP.

SHARE HOLDING PATTERN (%)

Particulars	Mar 17	Dec 16	Sep 16
Promoters	50.76	50.76	50.76
FIIIs	23.91	27.35	25.5
DIIIs	7.51	5.58	7.87
Others	17.82	16.32	15.88
Total	100	100	100



Revenue CAGR between FY 17 and FY 19E



PAT CAGR between FY 17 and FY 19E

ANALYST

Ankit Merchant, ankit.merchant@krchoksey.com, 91-22-6696 533
Shweta Koltharkar, shweta.koltharkar@krchoksey.com, 91-22-6696 567

KRChoksey Research

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Thomson Reuters, Factset and Capital IQ

91-22-6696 5555 / 91-22-6691 9569
www.krchoksey.com

CEAT Ltd

About CEAT:

CEAT, the flagship Company of RPG group is one of India's leading tyres manufacturing company. It offers widest range of tyres for all user segments including heavy-duty Trucks & Buses, LCV, Earthmovers and Forklifts (specialty segment), PC, tractors, trailers, scooters (2/3 wheelers), motorcycles, auto-rickshaws and OTR. CEAT, an established brand in the tyre segment, follows a combination of Dealership and Franchisee (CEAT Shoppe) model for the domestic market. CEAT is a supplier to Original Equipment Manufacturers (OEMs) like TATA Motors, Ashok Leyland, Mahindra & Mahindra, and Maruti etc. CEAT has a strong presence in both the domestic as well as international markets. The company exports tyres to nearly 112 countries across America, Europe, Africa and Asia. CEAT's products have found high acceptance with several OEMs in Europe despite stiff competition from other global players. The company has more than 4,000 dealers and 390+ exclusive franchise and in more than 100 countries its products are sold.

Business Overview

CEAT Ltd is leading manufacturer of automobile tyres for CV, 2/3 wheeler, PC and UV segments with over 50 years of presence. It has a very strong brand name in the 2W segment with a 27% market share and 7% market share in Passenger Vehicle. The company has six manufacturing facilities at Bhandup (bias tyres), Nashik (bias & radial), Halol (radial), Nagpur (2W & 3W), Ambarnath (OHT) and Sri Lanka. It is present through 50-50 Joint Venture (JV) with Kelani Tyres Ltd. and operates from two manufacturing facilities in Sri Lanka. The company offers the widest range of tyres to leading Original Equipment Manufacturers across the world. CEAT manufacture a range of tyres catering various segments, which includes tyres for heavy duty Trucks and Buses (T&B), Light Commercial Vehicles (LCVs), Earthmovers and Forklifts (specialty segment), tractors, trailers, passenger cars (PC), motorcycles, scooters and auto-rickshaws.

CEAT is gaining orders from :

- OEMs like HMSI, Suzuki Motorcycles would also benefit growth. Among models, CEAT is now the primary supplier for the Royal Enfield Himalayan, Honda Navi, Bajaj V15, Hero Splendor iSmart 110, Suzuki Access 125, etc.

- In PVs, CEAT is the primary supplier for Renault Kwid, M&M TUV 300 and Datsun Redigo. Renault was a new addition to its OEM customer base.

Business Model

Competitive Edge

Strategy shifts to 2W & PV segments with better pricing power

Strong distribution network across 600 districts focused on brand-building

Doubling of 2W & PV capacity to aid in capitalizing market growth

14.5%

Revenue CAGR between
FY 17 and FY 19E

14.5%

Revenue CAGR between
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Financial Structure

During FY2016-2017 company had revenue of INR 57,675 Mn, EBITDA at INR 6,568 Mn with a margin of 11.4% and recorded a PAT of INR 3,309 Mn. As of FY17 company's debt stood at INR 9,104 Mn and Net D/E stood at 0.3x.

Key Competitors

The company has been competing with various companies across tyre segment namely MRF, Apollo Tyre, JK Tyre, Balkrishna Industries etc

Industry Revenue Drivers

India's tyre space is a ~530bn (USD 8bn) in FY16. Indian Tyre industry is expected to do well in upcoming year after subdued demand for last 2 years. Passenger cars, trucks/bus sales are expected to grow at 8-10% while 2 wheeler segment is expected to grow in double digits. It will act as a demand booster for tyre industry. Demand for tractor tyres is dependent on the season and is not expected to show any significant growth in the coming year.

Current business Strategy

As a strategy, the company now is focusing on 2 wheelers, passenger cars and utility vehicles in domestic market and for international markets it is focusing on off highway tyres with focus on emerging markets. In Sri Lanka the company enjoys leadership position, the company has also planned manufacturing facility in Bangladesh.

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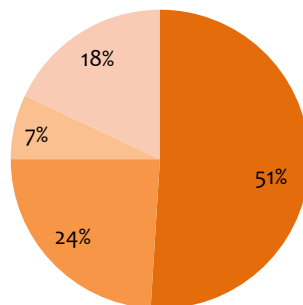
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Management team:

Name	Designation	Executive / Non-Executive
H V Goenka	Chairman	Non-Executive
Paras K Chowdhary	Independent Director	Non-Executive
Anant Vardhan Goenka	Managing Director	Executive
Vinay Bansal	Independent Director	Non-Executive
Atul C Choksey	Independent Director	Non-Executive
S Doreswamy	Independent Director	Non-Executive
Mahesh S Gupta	Independent Director	Non-Executive
H Khaitan	Independent Director	Non-Executive
Hari L Mundra	Director	Non-Executive
Arnab Banerjee	Executive Director (Operation)	Executive
Punita Lal	Independent Director	Non-Executive
Ranjit V Pandit	Independent Director	Non-Executive
Shruti Joshi	Company Secretary	NA

Source: Company, KRChoksey Research

Share Holding Pattern:



■ Promoters ■ FIIs ■ DIIs ■ Others

Source: Company, KRChoksey Research

Top Fund Holdings:

Fund Holding as on Mar 2017	Market Value (INR Mn)	No of Shares
Tata Mutual Fund	491.79	371400
IDFC Mutual Fund	179.54	142300
AXIS Mutual Fund	129.83	98000
Edelweiss Mutual Fund	85.5	64534
Kotak Mahindra Mutual Fund	74.19	56000
Principal PNB Mutual Fund	20	15094
Reliance Mutual Fund	17.62	13300
Motilal Oswal Mutual Fund	1.11	836
Mirae Asset Mutual Fund	0	0

Source: Company, KRChoksey Research

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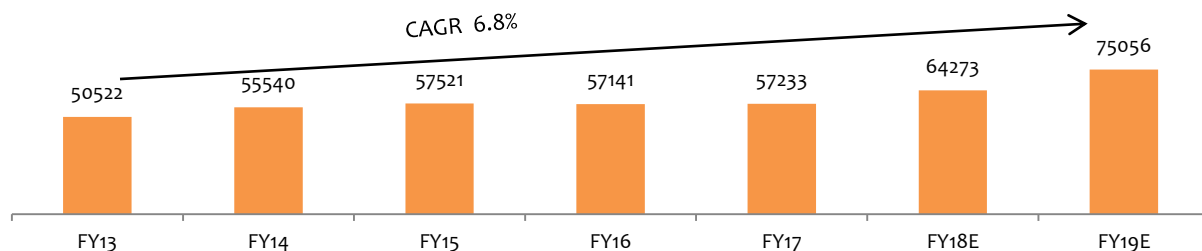
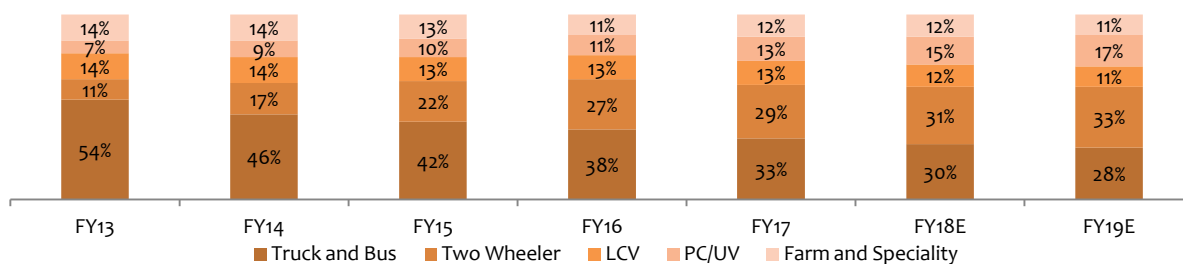
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Consumer facing segments and expansion in capacities to drive growth ahead:

In FY13, CEAT derived 54% revenue from Truck & Bus (T&B) segment while 2Wheeler (2W) contributed only 11% in FY11. Over the last few years, CEAT has gradually shifted its focus from the Truck & Bus (T&B) segment towards two-wheelers (2W) and passenger vehicle (PV) segment, which are more consumer facing segment.

This help CEAT register a revenue growth CAGR of 7.9% in FY11-FY17 largely on account of diversification. This diversification was further led by expanding capacities away from Trucks & Buses to other segments. Currently CEAT has three plants with total capacity of 1000MTPD.

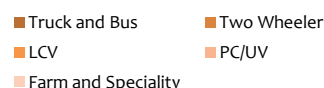
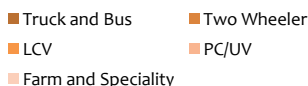
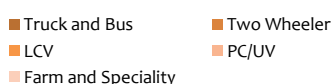
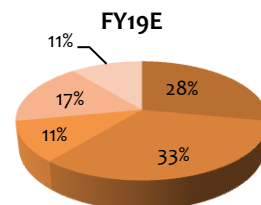
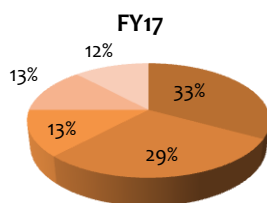
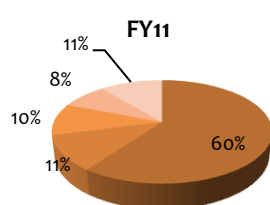
CEAT Consolidated Revenue (INR Mn)

Revenue Breakup (%)

The ongoing capex program is for 2W, PVs and OHT segment:

Capacity expansion	Category	Already commissioned	Further expansion
Nagpur plant	2W	67MTPD	Aims to achieve 120 tons/day production by 1HFY18.
Halol Phase II	PV	76MTPD	Aims to achieve 120 tons/day by 1HFY18.
Ambarnath Plant	OHT	NA	Aims to achieve 100 tons/day by FY18

Source: Company, KRChoksey Research

CEAT is currently going under a capex program, which is scheduled over a three year time frame starting FY16 and to be completed by FY18. We expect the change in product mix improvement trend for CEAT to continue ahead as well. With the first phase of capacity expansion (INR14bn) likely to be completed by 1HFY18, the product mix is expected to improve further (revenue share of 2W/PV likely to increase from 42% to 50% over FY17-19E).

We believe, this will lead to significant change in product and help CEAT achieve faster volume growth. Hence Going forward we expect company's sales to be mainly driven by 2-W (15 % CAGR volume growth between FY17 to FY19E), followed by MHCV (9% CAGR between FY17 to FY19E) and passenger Vehicles (4.9% CAGR from FY17 to FY19E). We also believe CEAT's recent capacity expansion in 2-W and PV will be driven by market share gains and expanding product reach. Hence, we expect company's top-line to grow at 14.4% CAGR between FY17 to FY19E from INR 63,971Mn to INR 83,768Mn.



Source: Company, KRChoksey Research

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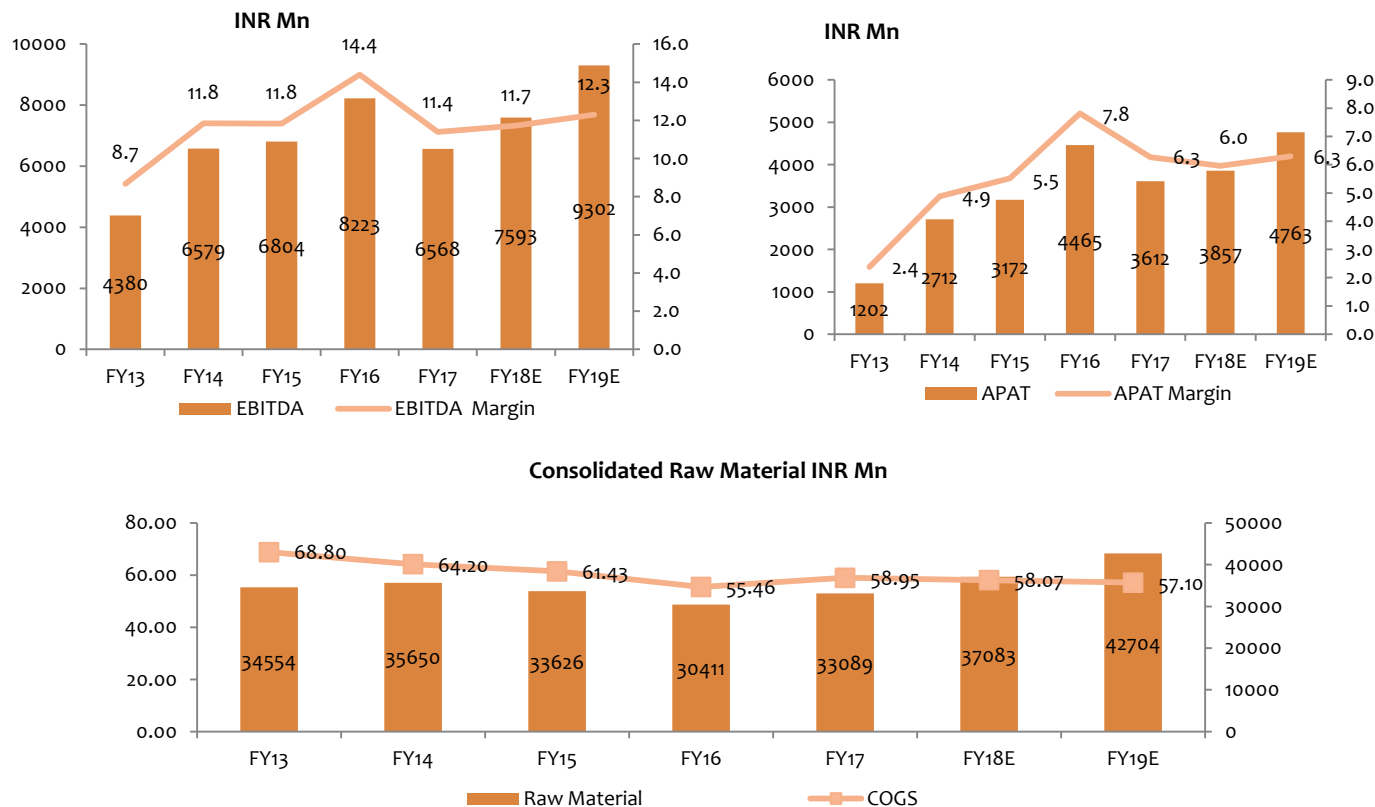
91-22-6696 5555 / 91-22-6691 9569
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Softening raw material prices to expand margins:

Over FY13-17, EBITDA and PAT witnessed a CAGR of 10.7% and 28.8%, respectively. Company over the last three years has been improving its EBITDA margin from (8.7% in FY13 to 11.4% in FY17) mainly on account of lower raw material cost (natural rubber and crude oil) further aided by better product mix. Going forward, we expect raw material prices to remain benign leading to stable raw material cost. We have assumed RM/Tons to increase at 2% CAGR between FY17 to FY19E leading to 14% CAGR increase in total RM cost.

Higher natural rubber prices and lower utilization in recently commissioned plants has dented the EBITDA margin in FY17. But we believe, the improving mix in the 2W & PV segment is expected to improve EBITDA margin in FY19E (from 11.4% in FY17 to 12.3% in FY19E). This should result in EBITDA CAGR of 19% over FY17-19E.



Source: Company, KRChoksey Research

Healthy Financial profile :

CEAT planned an outlay of INR 14bn for capital expenditure over FY16-18 out of which the company has already incurred a capex of INR 8bn in March 2016 and balance capex i.e INR 6bn is expected to be completed by FY18. Company's expansion plan is managed from a mix of internal accruals and debt. Currently, CEAT's net debt in FY17 stands at INR 9,104.2Mn. Going forward, we expect strong cash flow from operations (INR 5,651 in FY19E) would help maintain the debt under control. We expect total debt to decrease from INR 9,104.2 Mn to INR 7,604.2 Mn in FY19E. We expect debt to equity to decrease from 0.38x in FY17 to 0.24x in FY19E.

Higher Capex cycle impacted the ROE and ROCE in FY17. But we believe company's on-going capacity expansion should remain light on CEAT's balance sheet, and we expect D/E to peak out FY18. We expect resultant change in profitability (11.4% EBITDA margin in FY17 to 12.3% in FY18) and reducing debt (0.38x in FY17 to 0.24x by FY19E) will lift CEAT's return on capital employed from 16.6% in FY17 to 19.1% by FY19E.

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Q4FY17 Result Snapshot

Particulars (Mn)	Q4FY17	Q3FY17	Q4FY16	Q-o-Q	Y-o-Y
Gross Sales	16273	15455	15541	5.29%	4.71%
Other operating income	140	117	92	19.78%	52.73%
Net Sales & Other Operating Income	16413	15572	15632	5.40%	4.99%
Total Expenditure	15088	14037	13766	7.49%	9.60%
(Increase) / Decrease In Stocks	-63	-317	368	-80.08%	-117.14%
Purchase of Finished Goods	371	410	461	-9.63%	-19.57%
Cost of Raw Materials	8945	8105	7050	10.37%	26.88%
Other Expensess	3095	3186	3278	-2.84%	-5.59%
Employee Cost	1046	1057	925	-1.03%	13.09%
Excise Duty	1695	1596	1684	6.16%	0.62%
PBIDT (Excl OI)	1325	1535	1866	-13.69%	-28.99%
EBITDA Margins (%)	8.1%	9.9%	11.9%	-179bps	-386bps
Depreciation	460	351	350	31.04%	31.45%
EBIT & Exceptional Item	865	1184	1516	-26.96%	-42.95%
Exceptional items	124		103.5	-	19.8%
Other Income	36	57	67	-36.84%	-46.03%
EBIT	777	1241	1479	-37.41%	-47.48%
Interest	212	191	264	11.33%	-19.47%
EBT	565	1050	1216	-46.25%	-53.55%
Tax	-45	262	303	-117.08%	-114.77%
Net Profit from ordinary activity after tax	609	788	912	-22.67%	-33.19%
Minority Interest	-4.60	-3.10	63.20	48.39%	-107.28%
Share of profit after tax of associate	49.90	47.10	-7.50	5.94%	-765.33%
PAT	664	838	983	-20.80%	-32.45%
PAT Margin (%)	4.0%	5.4%	6.3%	-134bps	-224bps
Extraordinaries adj.	61	-32	-31	-287.96%	-299.67%
APAT	725	806	952	-10.06%	-23.89%
APAT Margin	4.4%	5.2%	6.1%	-76bps	-168bps
EPS	16.40	20.72	24.30	-20.87%	-32.51%

Source: Company, KRChoksey Research

Key takeaways of conference call:

- CEAT's volume in Q4 FY17 volume declined 4% y-o-y leading from demonetization. Company also witnessed decline in OEM and export segment . However, only replacement demand witnessed a growth of 10%.

- Management has also attributed slowness in passing off the price hike. In Q4 FY17 took a price of price hike of 3-4% in latter part of the quarter leading to lower than realization.

- Going forward, Management expects raw material cost to remain elevated in Q1FY18 but Management expects price hike in coming months to mitigate the rise in Raw Material cost.

- Company recently commissioned its Nagpur plant (67 MT/day capacity as of March 2017), and Halol Phase II plant (76 MT/day) and is on course to ramp-up its utilization in coming months.

- Management has guided a Capex of INR INR 6000 Mn towards expansion in facility at Halol and Nagpur for FY18-19 and a Routine capex of INR 1500 Mn.

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Financials :

Profit & Loss (INR Mn)	FY16	FY17	FY18E	FY19E
Total Sales	57141.2	57674.5	64722.7	75656.8
Total Raw Materials	31689.2	33997.7	37583.3	43203.5
COGS	31689.2	33997.7	37583.3	43203.5
EBITDA	8222.9	6567.7	7593.1	9302.3
Depreciation	1075.0	1430.8	1618.1	1891.4
Amortization	0.0	0.0	0.0	0.0
Interest & Finance charges	907.4	817.2	970.8	1210.5
Other Income	298.6	186.3	323.6	378.3
Extraordinary items	114.0	132.7	0.0	0.0
EBT (as reported)	6425.1	4373.3	5327.8	6578.7
Tax	1978.4	1064.2	1470.5	1815.7
PAT	4446.7	3309.1	3857.4	4762.9
Min. Int.	-18.2	-19.2	0.0	0.0
Share in gain/loss of assoc.	0.0	283.7	0.0	0.0
RPAT	4464.9	3612.0	3857.4	4762.9
Extraordinaries adj.	0.0	0.0	0.0	0.0
APAT	4464.9	3612.0	3857.4	4762.9
RPAT after pref. div.	4464.9	3612.0	3857.4	4762.9
APAT after pref. div.	4464.9	3612.0	3857.4	4762.9

Source: Company, KRChoksey Research

Balance Sheet (INR Mn)	FY16	FY17	FY18E	FY19E
Equity Share Capital	404.5	404.5	404.5	404.5
Other equity related items	0.0	0.0	0.0	0.0
Warrants application money	0.0	0.0	0.0	0.0
Share application money	0.0	0.0	0.0	0.0
Reserves	20240.8	23745.0	27012.4	31185.3
Net worth	20645.3	24149.5	27416.9	31589.8
Preference Shares issued by Subsidiaries	0.0	0.0	0.0	0.0
Minority Interest	322.5	291.5	291.5	291.5
Total loans	6285.5	9104.2	8604.2	7604.2
Deferred tax liability (Net)	1567.0	2133.5	2225.1	2404.4
Capital Employed	29233.1	36355.1	39400.3	42987.5
Gross Block	29438.0	34316.7	38816.7	43316.7
Depreciation	9053.0	10483.8	12166.7	14116.6
Net block	20385.0	23832.9	26650.0	29200.1
CWIP	3034.2	3192.8	3199.7	3111.2
Goodwill	205.0	0.0	0.0	0.0
Intangible	607.0	762.2	762.2	762.2
Investments	1.5	1673.3	500.0	500.0
Inventories	6620.6	9434.8	9055.9	10618.8
Sundry debtors	6188.0	6138.0	7106.4	8562.1
Cash and bank	1072.6	359.2	1793.7	951.2
Loans and advances	1477.6	12.7	218.5	494.2
Other Current Assets	91.7	1832.3	1968.6	2198.7
Total Current assets	15450.5	17777.0	20143.0	22825.0
Total Current liabilities	12148.2	13498.6	14979.5	17285.3
Net Current assets	3302.3	4278.4	5163.6	5539.7
Misc. Expense (not (w/o)	0.0	0.0	0.0	0.0
Capital Deployed	29233.1	36355.1	39400.3	42987.5

Source: Company, KRChoksey Research

ANALYST

Ankit Merchant, ankit.merchant@krchoksey.com, 91-22-6696 533
 Shweta Koltharkar, shweta.koltharkar@krchoksey.com, 91-22-6696 567

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is also available on Bloomberg KRCS<GO>
 Thomson Reuters, Factset and Capital IQ

91-22-6696 5555 / 91-22-6691 9569
www.krchoksey.com

CEAT Ltd

Cash Flow Statement:

Particular (INR Mn)	FY16	FY17	FY18E	FY19E
PAT	4674.7	3574.5	3857.4	4762.9
Depreciation & Amortization	749.8	1430.8	1682.9	1950.0
Incr/(Decr) in Deferred Tax Liability	317.5	566.5	91.6	179.3
(Incr)/Decr in Working Capital	-617.0	-1689.5	549.3	-1218.6
(Incr)/Decr in Mis. Expense not written off	0.0	0.0	0.0	0.0
Cash Flow from Operating	5106.6	3863.1	6181.1	5673.7
(Incr)/ Decr in Gross PP&E	-6123.4	-4878.7	-4500.0	-4500.0
(Incr)/Decr In Work in Progress	-743.9	-158.6	-6.9	88.6
(Incr)/Decr In Investments	2721.2	-1912.8	1044.8	-188.6
(Incr)/Decr in Other Non-Current Assets	-386.7	-626.6	-380.8	-560.9
Cash Flow from Investing	-4532.9	-7576.8	-3842.9	-5161.0
(Decr)/Incr in Debt	100.5	3082.3	-313.7	-765.1
(Decr)/Incr in Minority Int.	13.9	-11.8	0.0	0.0
(Decr)/Incr in Other reserves	-4125.7	-2984.5	-3267.4	-4172.9
Dividend	-548.9	-590.0	-590.0	-590.0
Cash Flow from Financing	-737.5	3000.2	-903.7	-1355.1
Incr/(Decr) in Balance Sheet Cash	-163.7	-713.4	1434.5	-842.5
Cash at the Start of the Year	1236.3	1072.6	359.2	1793.7
Cash at the End of the Year	1072.6	359.2	1793.7	951.2

Source: Company, KRChoksey Research

Ratio Analysis:

Particular (INR Mn)	FY16	FY17	FY18E	FY19E
Growth (%)				
Total Sales	-0.7	0.9	12.2	16.9
EBITDA	20.9	-20.1	15.6	22.5
APAT	40.8	-19.1	6.8	23.5
Profitability (%)				
EBITDA Margin	14.4	11.4	11.7	12.3
Adj. Net Profit Margin	7.8	6.3	6.0	6.3
ROIC	19.2	12.6	12.1	13.8
ROE	23.8	16.1	15.0	16.1
Per Share Data (Rs.)				
AEPS	110.4	89.3	95.4	117.7
Reported CEPS	145.1	117.2	135.4	164.5
BVPS	510.4	597.0	677.8	781.0
Valuations (x)				
PER (x)	14.4	17.8	16.6	13.5
PEG (x)	0.4	-0.9	2.4	0.6
P/BV (x)	3.1	2.7	2.3	2.0
EV/EBITDA (x)	8.6	11.2	9.6	7.7
EV/Net Sales (x)	1.2	1.3	1.1	1.0
Dividend Yield (%)	0.7	0.8	0.8	0.8
Turnover days				
Debtor Days	42.3	39.3	37.6	38.1
Payable Days	146.1	137.7	138.3	136.3
Gearing Ratio				
D/E	0.3	0.4	0.3	0.2

Source: Company, KRChoksey Research

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Kisan Ratilal Choksey Shares and Securities Pvt. Ltd

Registered Office:

1102, Stock Exchange Tower, Dalal Street, Fort, Mumbai – 400 001.

Phone: 91-22-6633 5000; Fax: 91-22-6633 8060.

Corporate Office:

ABHISHEK, 5th Floor, Link Road, Andheri (W), Mumbai – 400 053.

Phone: 91-22-6696 5555; Fax: 91-22-6691 9576.

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