

CEAT

Muted performance; FY19 to be a year of investment

India Equity Research | Automobiles

CEAT's Q4FY18 EBITDA at INR2.0bn (up 44% YoY) came 8% below estimate due to adverse revenue mix and raw material cost pressure. Management has pegged FY19 capex at INR15-17bn (>25% FY18 sales) as the company is investing in a truck & bus radial tyre plant (production to commence in Q3) as well as a car radial tyre plant (to start in FY20). Hence, capacity is likely to jump 50% from current 1,000tonnes per day (TPD) over the next three years. Adverse mix and higher competitive intensity in the two-wheeler segment is likely to pressurise CEAT's margin. Hence, we revise down FY20E EPS 4%. Maintain 'BUY' with revised TP of INR1,839 (earlier INR1,918).

Q4FY18: Lower revenue leads to disappointment

Net revenue, at INR16.5bn, up 13.6% YoY (tonnage growth of 12% YoY and realisation increase of 2.6% YoY), was 3% below estimate. Management attributed this to adverse revenue mix—higher share of OEMs. Also, higher-than-expected raw material cost led to 240bps dip in gross margin to 38.8%. However, strong control on other expenses led to only 8% EBITDA miss at INR2bn.

FY19: Strong margin critical

Management reiterated its huge INR15-17bn capex plan for FY19. While internal accruals will be CEAT's first choice to fund the capex, free cash flow is likely to be negative. Also, rising competitive intensity in two wheelers (as competition is not raising prices) and cost pressure will restrict margin upside.

Outlook and valuations: Structural story intact; maintain 'BUY'

We like CEAT's unwavering and granular focus on branding. We estimate EPS CAGR of 34% over FY18-20. In our view, the stock should trade in the 12-15x PE band depending on its product mix, capex cycle and rubber prices. At CMP, the stock trades at 14x/12x FY19E/FY20E PER. We maintain 'BUY' with TP of INR1,839 (PER of 14x FY20E).

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Outperform

MARKET DATA (R: CEAT.BO, B: CEAT IN)

CMP	: INR 1,591
Target Price	: INR 1,839
52-week range (INR)	: 2,030 / 1,408
Share in issue (mn)	: 40.5
M cap (INR bn/USD mn)	: 64 / 963
Avg. Daily Vol. BSE/NSE ('000)	: 725.1

SHARE HOLDING PATTERN (%)

	Current	Q4FY12	Q3FY12
Promoters *	18.0	18.0	22.8
MF's, FI's & BKs	24.3	24.3	27.3
FII's	18.0	18.0	22.8
Others	18.0	18.0	22.8
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	5.3	3.4	(1.9)
3 months	(2.6)	(3.4)	(0.8)
12 months	13.6	(0.3)	(13.9)

Financials

(INR mn)

Year to March	Q4FY18	Q4FY17	% Chg	Q3FY18	% Chg	FY18	FY19E	FY20E
Net revenues	16,485	14,507	13.6	15,499	6.4	61,613	71,174	81,050
EBITDA	1,995	1,387	43.8	1,918	4.0	6,274	9,170	10,678
Adjusted Profit	1,021	837	22.1	916	11.5	2,972	4,745	5,313
Adjusted Diluted EPS	25.2	20.7	22.1	22.6	11.5	73.5	117.3	131.4
Diluted P/E (x)						21.7	13.6	12.1
EV/EBITDA (x)						11.1	8.5	7.3
ROAE (%)						11.5	17.3	16.8

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Q4FY18 conference call: Key takeaways

Volume performance and outlook

- While Q4 volume growth at 11.5% YoY, FY18 volumes grew 3.4% YoY.
- Strong growth in OEMs, particularly in the CV segment. OEM exports were also robust. OEM segment and exports growth outpaced replacement growth.
- **Two wheelers:** The company is strengthening its two wheelers' distribution network. The segment has grown at 20-25% YoY in the past, but has slowed down to ~15%. Overall, the company expects double digit growth for two wheelers. Motorcycles grew 10-12% YoY within the OEM segment.

Customer mix

- Given the strong growth in demand from OEMs, mix has moved towards the OEM segment by ~3% pts. in Q4FY18.

Gross margin

- Q4FY18 gross margin contraction driven primarily by increase in raw material costs and change in customer mix, both of which impacted gross margin by 1% each.

Raw material cost pressure

- Management expects Q1FY19 to feel the impact of ~1-2% increase in cost due to higher crude prices. Q2 could see a larger impact at ~2.0-2.5% if crude oil price rise sustains.
- Carbon black has been on an upswing driven by crude oil price rise. Natural rubber has shown some downward trend.

Price hikes

- 0.5% average price hike taken across categories in April 2018.

Employee cost

- Expenses related to VRS are linked only for the Bhandup plant – INR250mn.
- Going forward, employee increments are expected to be in line with industry standards (7-13%). Overall employee costs are expected to increase slightly as new plants ramps up and taper as these plants ramp up. Older plants (for e.g., Bhandup) have long-term settlements coming up (once in three years), which will also weigh on costs.

Capex

- FY18 capex was ~INR3.8bn, of which INR2.0bn was spent on capacity expansion projects and balance the on Nagpur plant and routine maintenance.
- For FY19, capex is expected to be in the INR15-17bn range, while for FY20 it could be ~INR8bn.
- **Status of plants:** Truck radial plant (brownfield expansion in Baroda) will come on stream in Q3FY19. Passenger car greenfield facility will be commissioned sometime in the next year, while the off highway tyre plant will take over a year to get ready. Expects plant to achieve desired utilisation over 18 months from time of commissioning. Breakeven levels for new plant will vary from 50% to 70%.
- Management expects strong TBR growth for CVs once new facility starts operations.

- Ambernath plant (manufacturing off-highway tyres) is currently operating at 30% utilisation level (total capacity of 40TPD). As the plant ramps up, margin should normalise around 20%. For FY19, CEAT expects average TPD of 20-25t.
- Management indicated that once a plant is commissioned, it typically takes around 18-24 months to ramp up. Can be lower/higher depending on demand.

Capacity:

- Total capacity was at 1,000TPD as of FY18 end, which should reach ~1,500TPD over the next three years— ~200TPD will be added by new truck radials, 250TPD will be added by PCR and 60TPD by off-highway tyres.

Depreciation & interest costs

- Depreciation for FY18 was around INR1.6bn for standalone entity and is expected to increase to INR1.8bn in FY19.
- Interest cost stood at INR860mn for FY18 and should remain around similar level for FY19. FY20 interest cost to increase by INR300-400mn.

Debt

- Debt levels by FY20 are expected to be ~INR20bn. The objective is to fund capex via internal accrual to the extent possible. Expects debt/equity to stay well below 1x.

Chart 1: CEAT Revenue trend

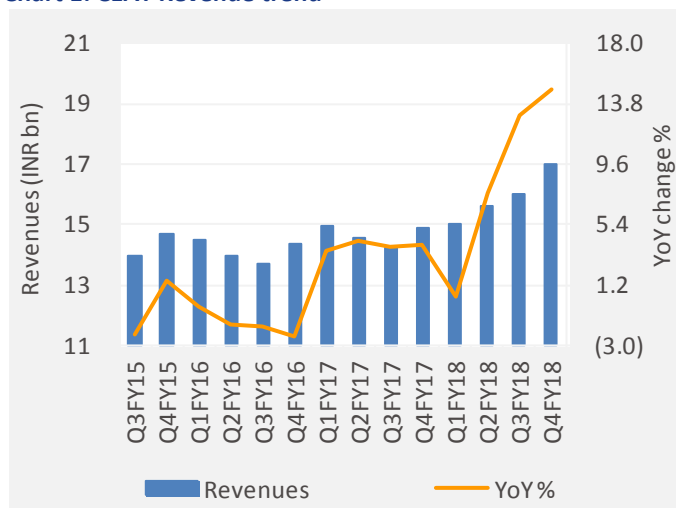
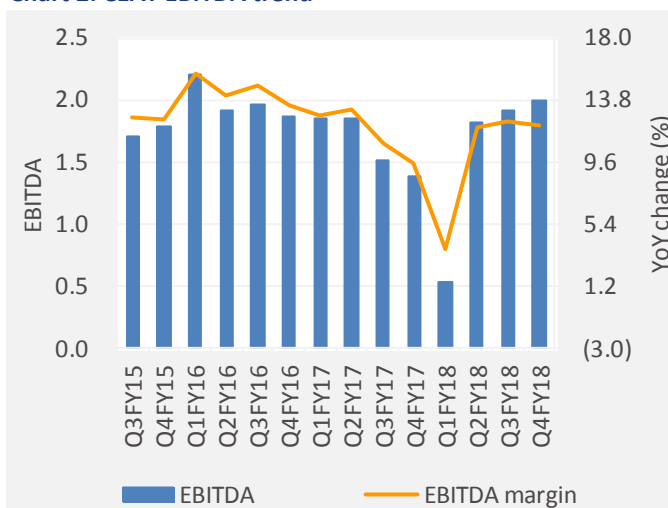


Chart 2: CEAT EBITDA trend



Source: Company, Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q4FY18	Q4FY17	% change	Q3FY18	% change	FY18	FY19E	FY20E
Net revenues	16,485	14,507	13.6	15,499	6.4	61,613	71,174	81,050
Raw material	10,082	9,120	10.6	9,104	10.7	38,035	43,455	49,587
Staff costs	1,063	989	7.5	1,056	0.7	4,131	4,535	4,874
Other expenses	3,346	3,012	11.1	3,422	(2.2)	13,173	14,014	15,911
EBITDA	1,995	1,387	43.8	1,918	4.0	6,274	9,170	10,678
Depreciation	412	458	(10.0)	405	1.7	1,617	1,953	2,485
EBIT	1,583	929	70.3	1,513	4.6	4,657	7,216	8,193
Other income	92	50	84.4	87	6.6	568	597	626
Interest	193	204	(5.4)	217	(11.3)	865	937	1,229
Profit before tax	1,236	651	89.9	1,373	(10.0)	4,097	6,876	7,590
Provision for taxes	385	(51)	(849.5)	464	(17.0)	1,309	2,132	2,277
Reported net profit	851	702	21.3	910	(6.4)	2,787	4,745	5,313
Adjusted Profit	1,021	837	22.1	916	11.5	2,972	4,745	5,313
Diluted shares (mn)	40	40		40		40	40	40
Adjusted Diluted EPS	25.2	20.7	22.1	22.6	11.5	73.5	117.3	131.4
Diluted P/E (x)	-	-		-		21.7	13.6	12.1
EV/EBITDA (x)	-	-		-		11.1	8.5	7.3
ROAE (%)	-	-		-		11.5	17.3	16.8
Raw material	61.2	62.9		58.7		61.7	61.1	61.2
Employee cost	6.4	6.8		6.8		6.7	6.4	6.0
Other expenses	20.3	20.8		22.1		21.4	19.7	19.6
EBITDA	12.1	9.6		12.4		10.2	12.9	13.2
Adjusted net profit	6.2	5.8		5.9		4.8	6.7	6.6
Reported net profit	5.2	4.8		5.9		4.5	6.7	6.6

Company Description

CEAT is the flagship company of the RPG Group and the fourth largest tyre manufacturer in Indian in revenue terms. The company's product portfolio spans across the automotive spectrum and offers tyres for 2W, 3W, passenger cars, UVs, trucks & buses and OTR (offthe-road) vehicles. In terms of market segmentation, replacement, OEM and export segments account for 64%, 23% and 13%, respectively. Since 2011, its strategy has been to focus more on profitable segments like 2Ws and PVs (especially UVs), unlike other peers who remained focused on the T&B segment.

Investment Theme

CEAT's metamorphosis from a predominantly truck & bus (T&B) player (>55% of industry revenue) to a star in the small, but highly profitable passenger segment over FY11-16 was buttressed by a differentiated distribution reach and strong brand building. Within the segment, initial focus was on 2W, leading to strong market share gain. Going ahead, the company is targeting to replicate its success in 2W in the 4W space. It is initially focusing on utility vehicles (UVs), which account for ~25% of 4W industry. CEAT is expanding capacity by ~35% to ensure adequate capacities to meet the potential demand recovery in the sector. Post the expansion, we estimate the passenger segment's revenue contribution to catapult to 50% in FY18 from 38% in FY16 and 15% in FY11

Key Risks

Rising Chinese imports.

Intensifying competition in 2W.

Commodity price inflation.

Financial Statements

Key Assumptions

Year to March	FY17	FY18	FY19E
Macro			
GDP(Y-o-Y %)	6.6	6.8	7.4
Inflation (Avg)	4.5	4.0	4.5
Repo rate (exit rate)	6.3	5.8	5.8
Sector			
Motorcycle - dom. vol. (% YoY)	4.0	5.0	8.0
Cars - domestic vol. (% YoY)	4.0	8.0	8.0
UV - domestic vol. (% YoY)	35.0	20.0	15.0
MHCV - domestic vol (% YoY)	1.0	8.0	8.0
Natural rubber prices (INR/MT)	135,000	132,000	130,000
Synthetic rubber prices (INR/MT)	110,000	135,000	135,000
Fabric prices (INR/MT)	245,000	260,000	260,000
Carbon Black prices (INR/MT)	66,230	70,000	70,000
Company			
Revenue assumptions	5	8	20
Capex (INR mn)	5,542	6,000	6,000
Net borrowings (INR mn)	7,615	8,615	8,615
Cash conversion cycle	49	32	32
Dividend payout (%)	12.8	16.5	9.3
Depreciation (% of rev.)	2.5	2.7	2.5
Inventory days	59	44	44
Payable days	48	50	50
Interest Exp (% of Debt)	10.4	10.5	9.8
Tax rate (%)	21.7	31.0	31.0
Tonnage growth (%YoY)	10.2	4.9	16.1

Income statement

(INR mn)

Year to March	FY17	FY18	FY19E	FY20E
Total Tonnage (MT)	295,924	310,454	352,889	399,311
% Growth	10.2	4.9	13.7	13.2
Income from operations	57,017	61,613	71,174	81,050
Materials costs	33,753	38,035	43,455	49,587
Employee costs	3,839	4,131	4,535	4,874
Total SG&A expenses	12,826	13,173	14,014	15,911
Total operating expenses	50,417	55,340	62,004	70,372
EBITDA	6,600	6,274	9,170	10,678
Depreciation	1,420	1,617	1,953	2,485
EBIT	5,180	4,657	7,216	8,193
Add: Other income	414.57	568.1	596.5	626.33
Less: Interest Expense	795	865	937	1,229
Add: Exceptional items	(133)	(264)	-	-
Profit Before Tax	4,667	4,097	6,876	7,590
Less: Provision for Tax	1,039	1,309	2,132	2,277
Reported Profit	3,627	2,787	4,745	5,313
Exceptional Items	(104)	(185)	-	-
Adjusted Profit	3,732	2,972	4,745	5,313
Shares o/s (mn)	40	40	40	40
Adjusted Basic EPS	92.3	73.5	117.3	131.4
Diluted shares o/s (mn)	40	40	40	40
Adjusted Diluted EPS	92.3	73.5	117.3	131.4
Adjusted Cash EPS	127.4	113.4	165.6	192.8
Dividend per share (DPS)	11.5	12.5	14.0	14.0
Dividend Payout Ratio(%)	12.5	17.0	11.9	10.7

Common size metrics

Year to March	FY17	FY18	FY19E	FY20E
Operating expenses	88.4	89.8	87.1	86.8
Materials costs	59.2	61.7	61.1	61.2
Staff costs	6.7	6.7	6.4	6.0
S G & A expenses	22.5	21.4	19.7	19.6
Depreciation	2.5	2.6	2.7	3.1
Interest Expense	1.4	1.4	1.3	1.5
EBITDA margins	11.6	10.2	12.9	13.2
Net Profit margins	6.5	4.8	6.7	6.6

Growth ratios (%)

Year to March	FY17	FY18	FY19E	FY20E
Revenues	4.5	8.1	15.5	13.9
EBITDA	(16.8)	(4.9)	46.2	16.4
PBT	(25.7)	(12.2)	67.9	10.4
Adjusted Profit	(17.7)	(20.4)	59.6	12.0
EPS	(17.7)	(20.4)	59.6	12.0

Balance sheet		(INR mn)			
As on 31st March	FY17	FY18	FY19E	FY20E	
Share capital	405	405	405	405	
Reserves & Surplus	22,657	25,064	28,956	33,618	
Shareholders' funds	23,062	25,468	29,361	34,023	
Short term borrowings	551	551	551	551	
Long term borrowings	7,064	5,858	13,858	13,908	
Total Borrowings	7,615	6,409	14,409	14,459	
Long Term Liabilities	272	129	129	129	
Def. Tax Liability (net)	1,635	1,782	1,782	1,782	
Sources of funds	32,583	33,788	45,680	50,392	
Gross Block	25,709	28,018	43,018	49,018	
Net Block	23,406	24,098	37,145	40,660	
Capital work in progress	488	1,619	1,619	1,619	
Total Fixed Assets	24,576	26,371	39,418	42,933	
Non current investments	2,187	2,801	2,801	2,801	
Cash and Equivalents	542	1,130	1,016	1,266	
Inventories	9,234	7,550	8,580	9,770	
Sundry Debtors	5,921	7,122	7,410	8,438	
Loans & Advances	520	1,679	585	666	
Other Current Assets	(2,014)	(3,539)	(3,539)	(3,539)	
Current Assets (ex cash)	15,675	16,350	16,575	18,875	
Trade payable	7,496	8,485	9,750	11,103	
Other Current Liab	888	839	839	839	
Total Current Liab	8,384	9,325	10,589	11,942	
Net Curr Assets-ex cash	7,291	7,025	5,985	6,932	
Uses of funds	32,583	33,788	45,680	50,392	
BVPS (INR)	570.1	629.6	725.8	841.1	

Free cash flow		(INR mn)			
Year to March	FY17	FY18	FY19E	FY20E	
Reported Profit	3,627	2,787	4,745	5,313	
Add: Depreciation	1,420	1,617	1,953	2,485	
Interest (Net of Tax)	623	605	646	860	
Others	(229)	(45)	(306)	(258)	
Less: Changes in WC	(2,000)	266	1,040	(947)	
Operating cash flow	3,440	5,230	8,078	7,454	
Less: Capex	5,542	2,309	15,000	6,000	
Free Cash Flow	(2,102)	2,921	(6,922)	1,454	

Cash flow metrics				
Year to March	FY17	FY18	FY19E	FY20E
Operating cash flow	3,440	5,230	8,078	7,454
Investing cash flow	(4,190)	(2,355)	(14,403)	(5,374)
Financing cash flow	777	(2,652)	6,211	(1,830)
Net cash Flow	27	223	(114)	250
Capex	(5,542)	(2,309)	(15,000)	(6,000)
Dividend paid	536	581	651	651

Profitability and efficiency ratios				
Year to March	FY17	FY18	FY19E	FY20E
ROAE (%)	17.0	11.5	17.3	16.8
ROACE (%)	19.9	16.7	20.7	19.1
Debtors Days	38	42	38	38
Payable Days	48	50	50	50
Cash Conversion Cycle	49	37	32	32
Current Ratio	1.9	1.9	1.7	1.7
Gross Debt/EBITDA	1.2	1.0	1.6	1.4
Gross Debt/Equity	0.3	0.3	0.5	0.4
Adjusted Debt/Equity	0.3	0.3	0.5	0.4
Net Debt/Equity	0.3	0.2	0.5	0.4
Interest Coverage Ratio	6.5	5.4	7.7	6.7

Operating ratios				
Year to March	FY17	FY18	FY19E	FY20E
Total Asset Turnover	1.9	1.9	1.8	1.7
Fixed Asset Turnover	2.6	2.5	2.3	2.0
Equity Turnover	2.7	2.5	2.6	2.6

Valuation parameters				
Year to March	FY17	FY18	FY19E	FY20E
Adj. Diluted EPS (INR)	92.3	73.5	117.3	131.4
Y-o-Y growth (%)	(17.7)	(20.4)	59.6	12.0
Adjusted Cash EPS (INR)	127.4	113.4	165.6	192.8
Diluted P/E (x)	17.3	21.7	13.6	12.1
P/B (x)	2.8	2.5	2.2	1.9
EV / Sales (x)	1.3	1.1	1.1	1.0
EV / EBITDA (x)	10.8	11.1	8.5	7.3
Dividend Yield (%)	0.7	0.8	0.9	0.9

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Ceat Ltd	963	13.6	12.1	8.5	7.3	17.3	16.8
Amara Raja Batteries	2,203	25.9	21.6	13.7	11.7	18.1	18.7
Exide Industries	3,161	24.7	21.2	14.0	12.0	14.7	15.2
Suprajit Engineering	584	-	-	0.2	(0.1)	22.4	22.3
Median	-	19.1	16.7	11.1	9.5	17.7	17.7
AVERAGE	-	16.1	13.7	9.1	7.7	18.1	18.2

Source: Edelweiss research

Additional Data

Directors data

Mr H.V.Goenka	Chairman	Mr Mahesh S. Gupta	Independent Director
Mr Anant V. Goenka	Managing Director	Mr Paras K. Chowdhary	Non-independent Director
Mr Arnab Banerjee	Executive Director	Mrs Punita Lal	Independent Director
Mr Atul C. Choksey	Independent Director	Mr Ranjit V. Pandit	Independent Director
Mr Haigreve Khaitan	Independent Director	Mr S. Doreswamy	Independent Director
Mr Hari L. Mundra	Non-independent Director	Mr Vinay Bansal	Independent Director
Mr Kantikumar R. Podar	Independent Director		

Auditors - SRBC & Co LLP

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Instant holdings ltd	28.46	Swallow associates l	11.09
Jwalamukhi inv hldgs	8.04	Societe ceat d inves	4.41
Amansa holdings priv	3.58	Westbridge crossover	3.51
Stel holdings ltd	3.39	Mirae asset global i	3.21
Dimensional fund adv	2.49	Summit securities lt	2.37

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
03 Apr 2018	Instant Holdings Ltd	Buy	275000	1556.35
03 Apr 2018	Chattarpati Apartments Llp	Sell	275000	1556.35

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): Automobiles

Ashok Leyland, Amara Raja Batteries, Bajaj Auto, Ceat Ltd, Eicher Motors, Exide Industries, Hero MotoCorp, Minda Corporation, Mahindra & Mahindra Ltd, Maruti Suzuki India Ltd, Motherson Sumi Systems, Suprajit Engineering, Tata Motors Ltd

Recent Research

Date	Company	Title	Price (INR)	Recos
30-Apr-18	Maruti Suzuki	Muted quarter; outlook healthy; <i>Result Update</i>	8,815	Buy
25-Apr-18	Mahindra & Mahindra	Has its time finally come?; <i>Company Update</i>	839	Buy
20-Apr-18	Ashok Leyland	On course; <i>Company Update</i>	151	Buy

Distribution of Ratings / Market Cap

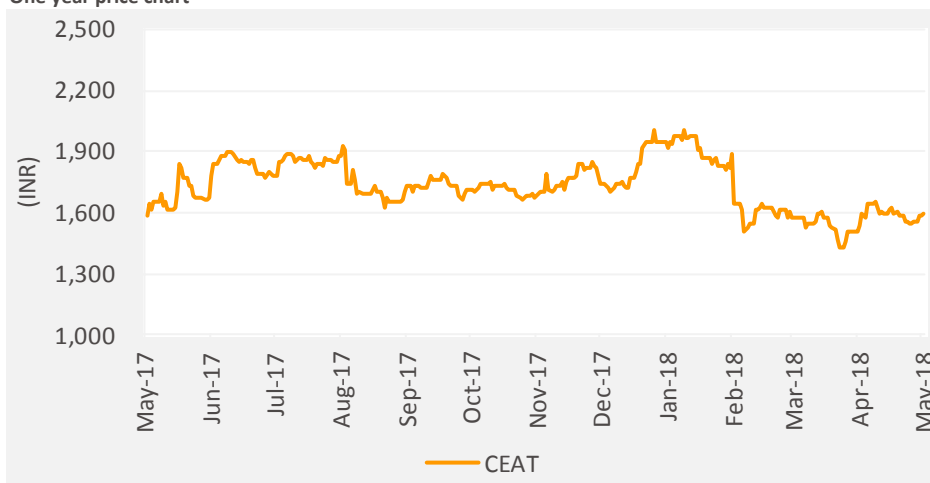
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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