

BSE SENSEX	S&P CNX
37,789	11,359
Bloomberg	CEAT IN
Equity Shares (m)	40
M.Cap.(INRb)/(USDb)	42.8 / 0.6
52-Week Range (INR)	1536 / 984
1, 6, 12 Rel. Per (%)	-3/-17/-36
12M Avg Val (INR M)	776
Free float (%)	48.9

Financials & Valuations (INR b)

Y/E Mar	2019	2020E	2021E
Net Sales	69.8	79.7	92.2
EBITDA %	6.4	7.9	10.0
PAT	2.6	3.0	3.7
EPS (INR)	63.6	73.1	91.2
Gr. (%)	-0.5	14.9	24.7
BV/Sh (INR)	683.8	741.9	817.4
RoE (%)	9.6	10.3	11.7
RoCE (%)	7.7	7.3	8.1
P/E (x)	16.6	14.5	11.6
P/BV (x)	1.5	1.4	1.3

Estimate change

TP change

Rating change


CMP: INR1,057
TP: INR1,277(+21%)
Buy
Above est. led by cost control; demand remains weak

- **Realizations drive revenue growth:** 4QFY19 consol. revenue grew 4% YoY (+2% QoQ) to INR17.6b (in-line). While volumes declined 3%, realization grew ~6%. EBITDA margin came in at 9.2% (v/s est. of 8.5%, +100bp QoQ), driven by cut in discretionary costs, which diluted impact of price cuts (-50bp QoQ). Higher other income restricted adj. PAT decline to 28% YoY (+27% QoQ) to INR669m (v/s est. of INR528m). For FY19, revenue/EBITDA/PAT grew ~12%/5%/-0.5%.
- **Earnings call highlights:** (a) Price cut of ~1% across products in the replacement segment. (b) Replacement segment remains sluggish. But, industry should grow in single-digits. CEAT hopes to outperform driven by TBR & PCR capacity addition. (c) With inflation in crude and international rubber prices, it expects some cost pressures to reflect in 2QFY20. In a weak demand environment, it sees limited scope for a price hike in the near future, and hence, margins should be under stress. (d) FY20 consol. capex guidance is at INR15-16b (~INR11b in FY19). 2W capacity should start in the next few months and PCR capacity should be commence in 3QFY20.
- **Valuation and view:** We are lowering our FY20/21 consol. EPS estimates by 11%/7% to factor in lower volume growth due to a weak demand environment and commodity cost inflation. The tyre industry is facing the double whammy of commodity cost inflation and weak demand in OEMs and the replacement segment. This coupled with upcoming capacities, particularly in 2Ws and PCR, would test pricing discipline of the industry. We like CEAT for its focus on branding and on the B2C segments of 2Ws and PCR. Also, as a large part of the growth capex will be incurred by FY20, we expect strong growth and positive generation from FY21 onwards. Maintain **Buy** with TP of ~INR1,277.

Consolidated - Quarterly Earning Model

Y/E March	FY18				FY19				(INR Million)		FY19	Var %
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	FY18	FY19	4QE	
Net Sales	14,597	15,230	15,742	16,861	17,063	17,546	17,299	17,605	62,430	69,845	17,185	2
YoY Change (%)	-0.7	6.7	12.6	14.6	16.9	15.2	9.9	4.4	8.3	11.9	2.7	
RM cost (%)	65.8	60.6	58.2	59.9	60.7	60.7	58.5	60.7	61.0	59.9	59.5	118
Employee cost (%)	6.9	7.3	7.1	6.8	7.0	8.1	8.2	7.3	7.0	7.6	8.8	-158
Other expenses (%)	23.6	20.6	22.8	21.6	22.1	22.2	25.0	22.8	22.1	23.3	23.1	-27
EBITDA	547	1,747	1,870	1,976	1,758	1,592	1,426	1,623	6,139	6,425	1,469	10
Margins (%)	3.7	11.5	11.9	11.7	10.3	9.1	8.2	9.2	9.8	9.2	8.5	67
Depreciation	396	409	433	448	460	477	482	508	1,686	1,927	533	
Interest	226	237	273	238	204	186	222	269	974	880	241	
Other Income	103	65	66	69	37	33	40	306	303	390	40	
PBT before EO expense	28	1,166	1,230	1,359	1,131	962	762	1,153	3,783	4,008	736	57
Exceptional item	4	80	10	246	23	20	0	556	340	599	0	
PBT	25	1,086	1,220	1,113	1,108	943	762	597	3,443	3,409	736	-19
Tax Rate (%)	193.1	38.7	38.9	35.7	39.9	39.3	39.7	48.1	38.9	41.1	37.6	
MI & Profit/Loss of Asso. Cos.	-39	-65	-82	-55	-54	-59	-68	-32	-277	-213	-68	
Adj PAT	13	779	833	929	734	643	528	669	2,587	2,573	528	27
YoY Change (%)	-98.8	-27	-1	16	5,570	-17	-37	-28	-30	-1	-45.3	

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Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Realizations drive revenue growth

- CEAT's 4QFY19 consol. revenue grew 4.4% YoY (+1.8% QoQ) to INR17.6b (in-line).
- While volumes declined ~3% YoY, realization grew by ~6% aided by price increase and product mix. However in 4QFY19, CEAT has taken price cut of ~1% QoQ across segment in replacement (on back of price roll-back in Dec-18).

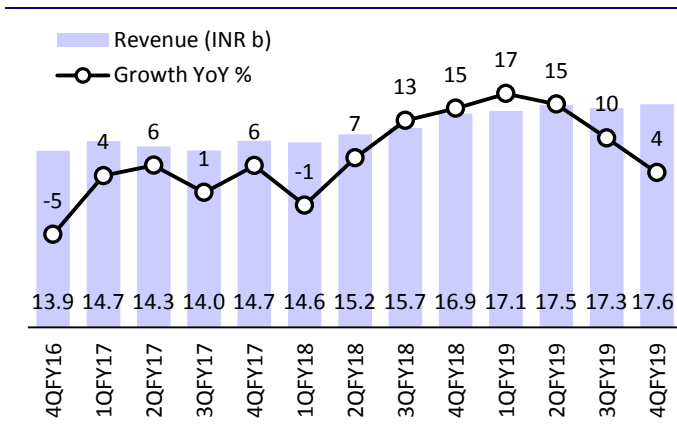
Gross margin contracts 220bp QoQ impacted by lower FG inventory

- RM price remained flat QoQ. Despite of this, gross margin contracted 220bp QoQ to 39.3% (est 40.5%), led by ~170bp impact on account of lower finished goods inventory and ~50bp due to lower realizations.

Cost controls elevate EBITDA margin; +100bp QoQ

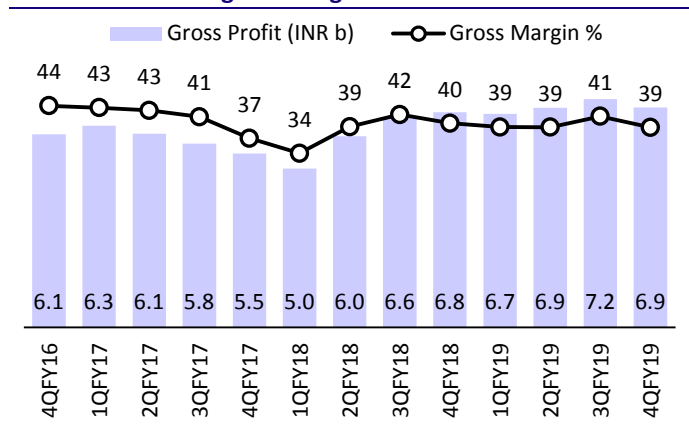
- EBITDA declined 18% YoY (+14% QoQ) to INR1.6b (est INR1.5b), aided by decline in staff cost at 7.3% (est 8.8%) due to lower provision for retirement benefit as well as lower production QoQ. Further, lower promotion (by INR54m) and conversion cost also aided margins QoQ.
- EBITDA margin expanded 100bp QoQ (-250bp YoY) to 9.2% (est 8.5%).
- Other income came in higher at INR306m (est INR40m) as company received interest income on IT refund worth INR250m.
- This restricted Adj. PAT decline at 28% YoY (+27% QoQ) to INR669m (est INR528m).

Exhibit 1: Trend in revenues



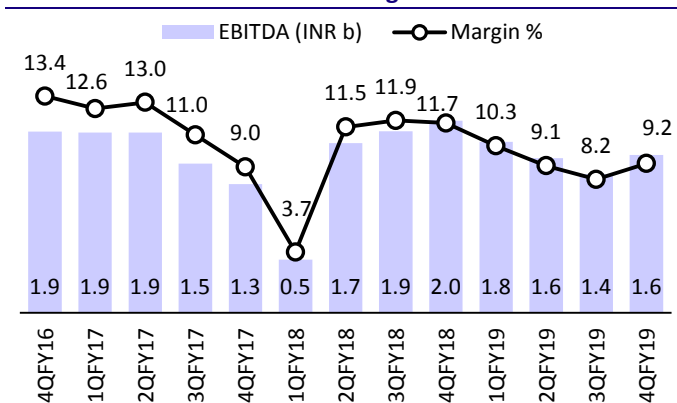
Source: MOFSL, Company

Exhibit 2: Trend in gross margins



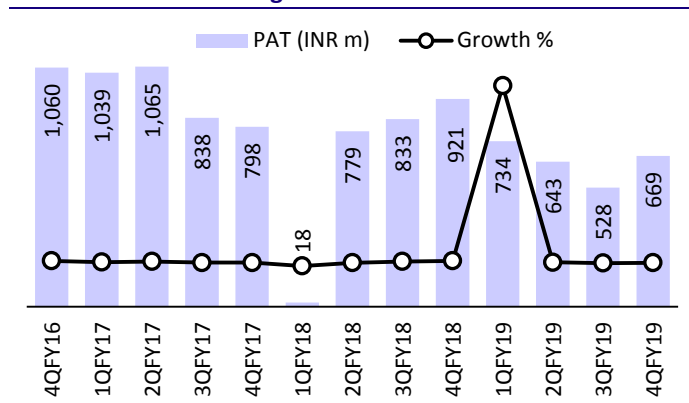
Source: MOFSL, Company

Exhibit 3: EBITDA and EBITDA margin trend



Source: MOFSL, Company

Exhibit 4: PAT and PAT growth trend



Source: MOFSL, Company

Conference call takeaways

- Volumes in OEM and replacement segments are currently under pressure. The replacement segment is facing challenges since Nov'19; **CEAT does not expect any meaningful improvement in the same in the coming 3-5 months.**
- The TBR segment has been growing in single-digit since Nov'19 (v/s over 20% growth achieved in 1HFY19).
- In FY20, industry volume is expected to grow in single-digits. But, CEAT should grow faster due to the new TBR & PCR capacity. In PCR, it already has OEM orders.
- With increase in crude and international rubber prices, **RM cost pressure** is expected to gradually increase from 2QFY20. Do not expect pricing environment to change in the replacement segment.
- **Price cuts of 1%** were taken across categories during 4Q in the replacement segment.
- Commenced commercial production of TBR (peak capacity of 80k/month) in Jan'19. TBR's new capacity would focus on gaining market share in both replacement and OEMs. Current market share in TBR is at 3-4% v/s ~13% in TBB.
- **CV radialization level** at OEMs - 80% and replacement — 50%. Expect radialization at industry level to increase to 65-70% and stabilize at that level.
- Capex guidance of INR13-14b for standalone and INR2b in OTR.

Valuation and view

Focus on improving brand equity to drive market share gains: CEAT has laid a 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 also invested in innovative marketing programs. Since the 2W/passenger car segment is consumer-facing, we believe factors such as brand loyalty, visibility and recall go a long way in creating replacement market demand and improving its market share, which would in turn benefit its margin profile.

Ramp-up in areas of strategic focus to continue: CEAT has identified 2W, Passenger cars and OTR (truck/off-road) tyre segments as its strategic focus areas, given their ability to boost margins and lower the company's dependence on the truck segment. Revenue contribution from these areas of focus has increased significantly over the years, from 20% in FY10 to 48% in FY18. We believe with the on-going capex plan, contribution from focus areas could scale up to 60-65% in the next 4-5 years, which would also reflect positively in the company's operating performance. We expect revenue to grow at 15% CAGR over FY19-21E, with EBITDA margin expansion of ~100bp by FY21E to 10.9% and PAT CAGR of ~20%.

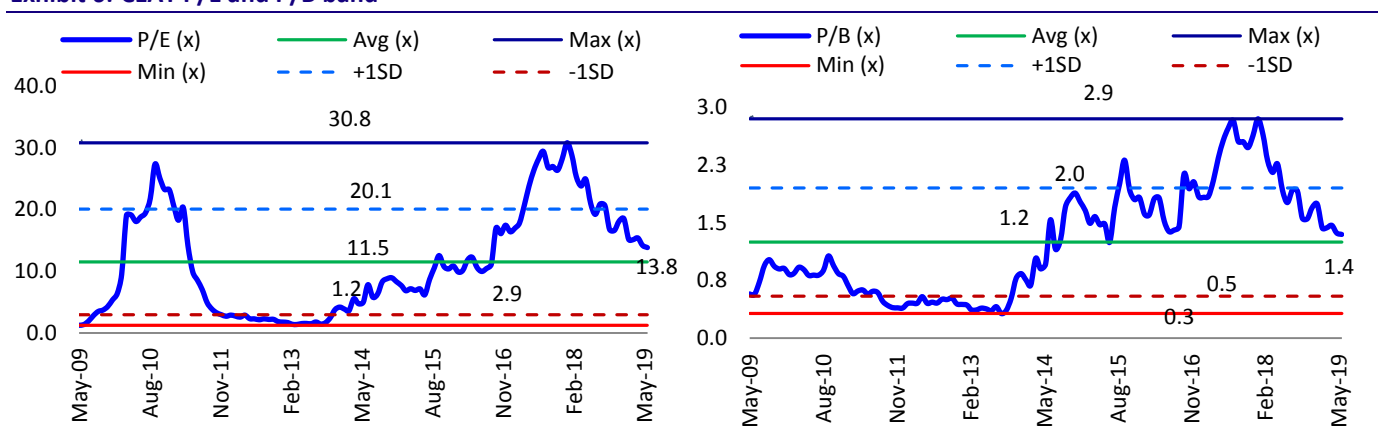
Growth capex to increase capacity by ~50%: CEAT has lined up capex of ~INR40b over FY19E-21E, for increasing its capacity by ~50%. It is investing INR21b in PCR (for ~240tpd capacity), INR10b in TBR (for 208tpd capacity), ~INR4.5b in 2W (~140 tpd capacity) and INR5b in OTR (~60tpd addition). This would help in attaining a strategic product mix while scaling up revenue contribution from focus areas, thereby driving margin expansion.

Valuation: We are lowering our FY20/21 consol. EPS estimates by 11%/7% to factor in for lower volume growth due to weak demand environment and commodity cost inflation. Tyre industry is facing double whammy of weak demand in OEMs as well as replacement and commodity cost inflation. This coupled with upcoming capacities, particularly in 2Ws and PCR, would test pricing discipline of the industry. We believe current weakness in demand is temporary (recovery in OEM volumes from 2QFY20 and normalization in replacement demand). However, cost inflation would test our hypothesis of sanity in pricing over next couple of quarters. We like CEAT for its focus on brand and B2C segments of 2W & PCR. This coupled with large part of growth capex incurred by FY20, we expect strong growth and positive generation from FY21 onwards. Maintain Buy with TP of ~INR1,277 (~14x FY21 consol EPS).

Exhibit 5: Revised forecast

(INR M)	FY20E			FY21E		
	Rev	Old	Chg (%)	Rev	Old	Chg (%)
Net Sales	79,719	83,539	-4.6	92,183	96,936	-4.9
EBITDA	7,852	8,980	-12.6	10,048	10,857	-7.5
EBITDA (%)	9.9	10.8	-90bp	10.9	11.2	-30bp
Adj. PAT	2,958	3,337	-11.4	3,689	3,959	-6.8
EPS (INR)	73.1	82.5	-11.4	91.2	97.9	-6.8

Source: MOFSL

Exhibit 6: CEAT P/E and P/B band

Source: MOFSL

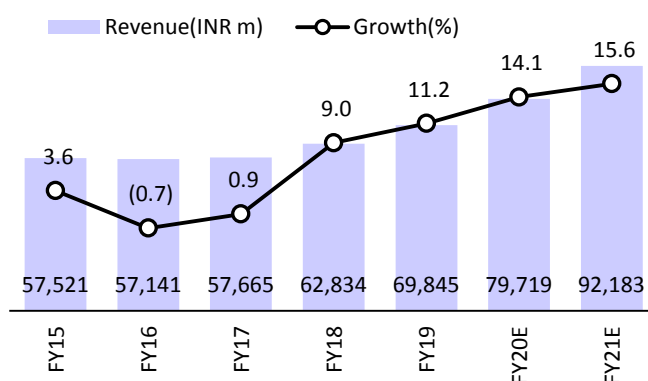
Exhibit 7: Comparative Valuation

	CMP	Rating	TP	P/E (x)		EV/EBITDA (x)		RoE (%)		Div Yield (%)		EPS CAGR (%)
	(INR)		(INR)	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E	FY18-20E
Auto OEM's												
Bajaj Auto	2,963	Neutral	3,131	18.2	16.5	13.2	11.1	23.3	23.0	2.0	2.4	9.0
Hero MotoCorp	2,501	Neutral	2,912	14.8	14.1	8.9	8.1	27.5	26.1	3.5	3.6	-2.3
TVS Motor	490	Neutral	480	34.8	27.0	17.5	14.0	21.5	23.5	0.7	0.8	14.1
M&M	624	Buy	793	15.3	14.1	11.7	10.4	14.2	13.1	1.6	1.6	3.7
Maruti Suzuki	6,632	Buy	8,047	26.8	23.9	15.1	13.5	16.3	16.4	1.2	1.9	2.0
Tata Motors	186	Neutral	195	-25.5	15.3	4.5	3.5	-3.1	6.2	0.2	0.2	-27.2
Ashok Leyland	86	Buy	113	12.3	11.8	7.3	5.8	26.4	24.1	3.0	3.1	10.6
Eicher Motors	20,277	Buy	23,657	24.9	23.1	19.6	18.4	28.3	25.1	0.6	0.6	4.8
Escorts	629	Neutral	760	11.8	10.9	10.0	8.3	19.3	17.7	0.4	0.5	21.0
Auto Ancillaries												
Bharat Forge	462	Buy	604	19.3	16.9	11.5	9.9	22.0	21.4	1.1	1.4	21.7
Exide Industries	209	Buy	274	23.1	19.2	12.5	10.5	12.9	14.0	1.1	1.5	15.3
Amara Raja Batteries	637	Buy	861	22.2	17.7	11.2	8.8	15.6	17.2	0.7	0.9	14.3
BOSCH	17,357	Neutral	19,556	32.6	28.3	22.6	19.0	15.5	17.4	1.0	1.2	14.3
Endurance Tech	1,135	Buy	1,351	33.2	26.4	14.9	12.2	20.4	22.0	0.5	0.9	21.7
Motherson Sumi	130	Buy	186	24.8	18.8	8.3	6.3	16.7	19.4	1.0	1.4	13.3
Mahindra CIE	220	Buy	340	15.6	12.9	8.7	7.8	13.3	14.0	0.0	0.0	32.4
CEAT	1,057	Buy	1,277	16.6	14.5	8.8	8.2	9.6	10.3	1.1	1.2	6.9

Source: MOFSL

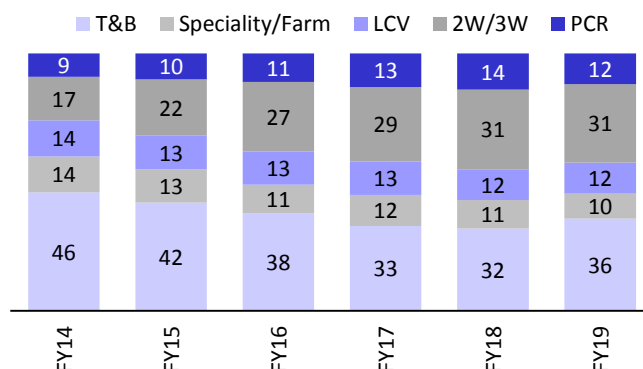
Story in charts

Exhibit 8: Revenue and growth trend



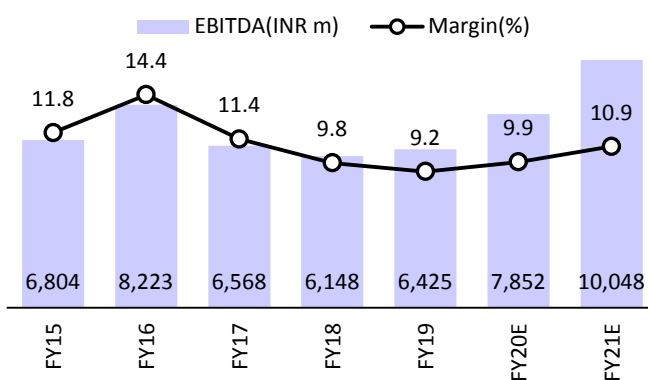
Source: MOFSL, Company

Exhibit 9: Key revenue segments



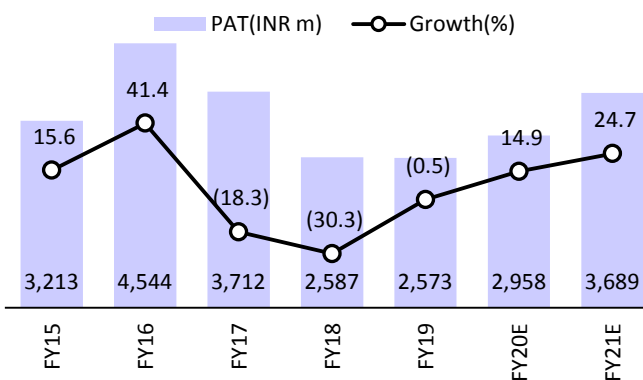
Source: MOFSL, Company

Exhibit 10: EBITDA and EBITDA margin trend



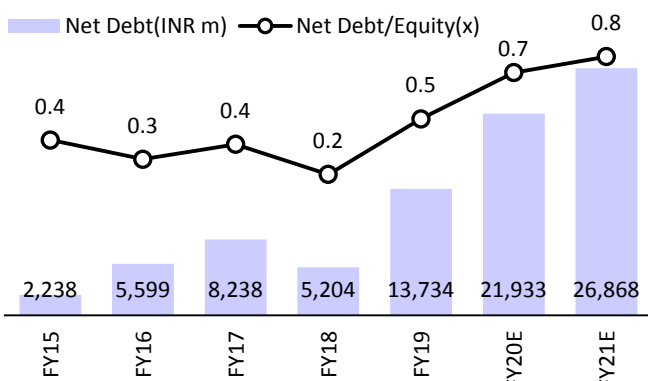
Source: MOFSL, Company

Exhibit 11: PAT and PAT growth trend



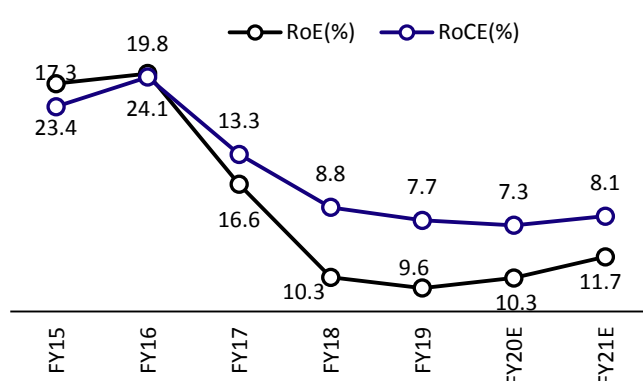
Source: MOFSL, Company

Exhibit 12: Trend in debt levels



Source: MOFSL, Company

Exhibit 13: Trend in return profile



Source: MOFSL, Company

Financials and valuations

Consolidated - Income Statement

(INR M)

Y/E March	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Net Revenues from Ops	57,521	57,141	57,665	62,834	69,845	79,719	92,183
Change (%)	3.6	-0.7	0.9	9.0	11.2	14.1	15.6
EBITDA	6,804	8,223	6,568	6,148	6,425	7,852	10,048
Margin (%)	11.8	14.4	11.4	9.8	9.2	9.9	10.9
Depreciation	934	1,075	1,431	1,686	1,927	2,479	3,368
EBIT	5,870	7,148	5,137	4,462	4,498	5,374	6,680
Int. and Finance Charges	1,319	907	817	974	880	1,233	1,712
Other Income	226	299	186	295	390	158	165
PBT bef. EO Exp.	4,777	6,539	4,506	3,783	4,008	4,298	5,133
EO Items	-61	-114	-133	-340	-599	0	0
PBT after EO Exp.	4,716	6,425	4,373	3,443	3,409	4,298	5,133
Total Tax	1,576	1,978	1,064	1,340	1,402	1,590	1,694
Tax Rate (%)	33.4	30.8	24.3	38.9	41.1	37.0	33.0
MI/Share of (profit) from JV	-33	-18	-303	-277	-213	-250	-250
Reported PAT	3,172	4,465	3,611	2,380	2,221	2,958	3,689
Adjusted PAT	3,213	4,544	3,712	2,587	2,573	2,958	3,689
Change (%)	15.6	41.4	-18.3	-30.3	-0.5	14.9	24.7
Margin (%)	5.6	8.0	6.4	4.1	3.7	3.7	4.0

Consolidated - Balance Sheet

(INR M)

Y/E March	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Equity Share Capital	405	405	405	405	405	405	405
Total Reserves	16,730	20,143	23,745	25,656	27,257	29,605	32,661
Net Worth	17,134	20,547	24,150	26,061	27,661	30,010	33,065
Minority Interest	327	322	292	234	238	238	238
Total Loans	7,640	6,632	9,240	6,467	14,469	23,469	27,269
Deferred Tax Liabilities	1,259	1,582	1,449	1,893	2,198	2,198	2,198
Capital Employed	26,361	29,084	35,130	34,655	44,566	55,914	62,770
Gross Block	15,014	21,394	27,017	31,270	37,900	52,229	65,929
Less: Accum. Deprn.	0	1,073	2,492	4,178	6,105	8,584	11,951
Net Fixed Assets	15,014	20,321	24,525	27,092	31,795	43,646	53,978
Capital WIP	2,238	2,991	3,263	3,100	8,329	10,000	7,800
Total Investments	4,430	1,955	2,316	2,135	1,814	1,814	1,814
Curr. Assets, Loans&Adv.	16,134	15,813	19,066	19,137	22,111	22,828	24,888
Inventory	6,534	6,397	9,435	7,846	10,056	10,042	11,476
Account Receivables	6,732	5,935	6,138	7,472	7,064	8,062	9,323
Cash and Bank Balance	973	630	359	863	735	1,536	401
Loans and Advances	1,896	2,850	3,134	2,956	4,256	3,189	3,687
Curr. Liability & Prov.	11,456	11,996	14,039	16,810	19,484	22,374	25,710
Account Payables	6,379	6,353	7,582	8,705	10,529	12,011	13,727
Other Current Liabilities	4,254	4,537	5,556	7,257	7,566	8,769	10,140
Provisions	824	1,106	902	848	1,389	1,594	1,844
Net Current Assets	4,678	3,817	5,026	2,328	2,627	454	-822
Appl. of Funds	26,361	29,084	35,130	34,655	44,566	55,914	62,770

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
Basic (INR)							
EPS	79.4	112.3	91.8	64.0	63.6	73.1	91.2
Cash EPS	102.5	138.9	127.1	105.6	111.3	134.4	174.5
BV/Share	423.6	508.0	597.0	644.3	683.8	741.9	817.4
DPS	10.0	11.5	11.5	11.5	12.0	12.5	13.0
Payout (%)	14.3	12.0	15.5	23.6	26.3	20.6	17.2
Valuation (x)							
P/E	13.3	9.4	11.5	16.5	16.6	14.5	11.6
Cash P/E	10.3	7.6	8.3	10.0	9.5	7.9	6.1
P/BV	2.5	2.1	1.8	1.6	1.5	1.4	1.3
EV/Sales	0.9	0.9	0.9	0.8	0.8	0.8	0.8
EV/EBITDA	7.3	5.9	7.9	7.9	8.8	8.2	6.9
Dividend Yield (%)	0.9	1.1	1.1	1.1	1.1	1.2	1.2
Return Ratios (%)							
RoE	23.4	24.1	16.6	10.3	9.6	10.3	11.7
RoCE	17.3	19.8	13.3	8.8	7.7	7.3	8.1
RoIC	19.7	23.4	14.7	9.4	8.5	8.9	9.4
Working Capital Ratios							
Asset Turnover (x)	2.2	2.0	1.6	1.8	1.6	1.4	1.5
Inventory (Days)	41	41	60	46	53	46	45
Debtor (Days)	43	38	39	43	37	37	37
Creditor (Days)	40	41	48	51	55	55	54
Leverage Ratio (x)							
Net Debt/Equity	0.4	0.3	0.4	0.2	0.5	0.7	0.8

Consolidated - Cash Flow Statement

(INR M)

Y/E March	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
OP/(Loss) before Tax	4,716	5,869	4,373	3,443	4,008	4,298	5,133
Depreciation	934	1,077	1,431	1,686	1,927	2,479	3,368
Interest & Finance Charges	1,319	-74	-55	974	490	1,075	1,547
Direct Taxes Paid	-1,123	-1,686	-1,017	-979	-1,402	-1,590	-1,694
(Inc)/Dec in WC	1,714	820	-2,174	1,667	-427	2,973	143
CF from Operations	7,560	6,006	2,558	6,791	4,597	9,235	8,496
Others	-73	1,015	789	-34	-599	0	0
CF from Operating incl EO	7,487	7,021	3,347	6,757	3,999	9,235	8,496
(Inc)/Dec in FA	-2,999	-7,137	-5,824	-4,872	-11,860	-16,000	-11,500
Free Cash Flow	4,488	-117	-2,477	1,885	-7,861	-6,765	-3,004
(Pur)/Sale of Investments	0	2,491	-333	376	321	0	0
Others	-2,990	321	722	345	390	158	165
CF from Investments	-5,989	-4,326	-5,434	-4,151	-11,148	-15,843	-11,335
Issue of Shares	3,934	0	0	0	0	0	0
Inc/(Dec) in Debt	-3,994	-1,354	2,963	-523	8,002	9,000	3,800
Interest Paid	-1,476	-930	-765	-973	-880	-1,233	-1,712
Dividend Paid	-404	-979	-7	-528	-585	-609	-634
Others	0	0	0	-1	486	250	250
CF from Fin. Activity	-1,940	-3,264	2,191	-2,025	7,023	7,408	1,704
Inc/Dec of Cash	-442	-569	104	582	-127	800	-1,134
Opening Balance	1,679	706	137	240	863	735	1,536
Closing Balance	1,237	137	240	822	735	1,536	401

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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