

Beat estimates; Short term blip, long term positive

- CEAT reported a strong operating performance in Q4FY20, despite challenging conditions. EBITDA grew 23% YoY to Rs 2bn. Operating margin benefited from lower RM prices, operational efficiency, and 40bps in positive impact due to finished goods inventory absorption. EBITDA margin, adjusted for one-offs, expanded 190bps QoQ to 12.3% (versus our estimate of Rs.10.3bn). Consolidated revenue de-grew 10.6% YoY to Rs.15.7bn (versus our estimate of Rs.16.1bn).
- Management said there is an uptick in demand for farm tyres, due to good crop season, followed by 2W tyres. Further, PV tyre demand will also gradually pick up from 2Q onwards. The company has resumed partial operations at all its plants and has commissioned the Chennai Greenfield plant in Q4FY20.
- We expect Fall in crude derivatives and natural rubber prices are a positive for operating margin, partially offset by negative operating leverage and Rupee depreciation.
- Given new capacities (TBR/PCR/2W), CEAT is now well positioned to benefit from the revival of the OEMs and replacement volume for medium to long term. However, the debt funded capacity expansion at a time of weak demand continues to put pressure on the near term profitability.
- AT CMP, stock is trading at 17/12x for FY21/22E EPS vs historical mean of 16x. We recommend to Accumulate with TP of Rs 960 (based on 14x FY22E Consolidated EPS).

Recovery in replacement volume expected from Q2FY21

While OEM sales are likely to remain weak in the next six months, we expect recovery in replacement demand from 2QFY21, after the partial resumption of economic activities from the COVID-lockdown. We believe the uptick in OEM volume from FY22, continued replacement market growth, and commodity tailwind are likely to lead to a sharp recovery in operating profit. However, higher capacity addition, lower utilization, higher depreciation, and interest outflow will continue to put pressure on net profit and suppress return ratios.

Q4FY20 Result (Rs Mn)

Particulars	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)
Revenue	15,734	17,605	(10.6)	17,618	(10.7)
Total Expense	13,731	15,981	(14.1)	15,786	(13.0)
EBITDA	2,004	1,623	23.4	1,832	9.4
Depreciation	745	508	46.7	705	5.6
EBIT	1,259	1,116	12.8	1,127	11.7
Other Income	35	306	(88.5)	36	(1.7)
Interest	407	269	51.1	380	7.0
EBT	606	747	(19.0)	780	(22.4)
Tax	114	137	(17.0)	301	(62.3)
RPAT	517	642	(19.5)	525	(1.5)
APAT	799	1,048	(23.7)	528	51.5
			(bps)		(bps)
Gross Margin (%)	45.6	39.3	638	43.0	268
EBITDA Margin (%)	12.7	9.2	351	10.4	233
NPM (%)	3.3	3.6	(36)	3.0	31
Tax Rate (%)	18.7	18.3	44	38.6	(1990)
EBIT Margin (%)	8.0	6.3	166	6.4	160

CMP	Rs 810
Target / Upside	Rs 960 / 19%
BSE Sensex	32,395
NSE Nifty	9,490

Scrip Details

Equity / FV	Rs 405mn / Rs 10
Market Cap	Rs 33bn
	USD 434mn
52-week High/Low	Rs 1,094/Rs 600
Avg. Volume (no)	1,41,946
NSE Symbol	CEATLTD
Bloomberg Code	CEAT IN

Shareholding Pattern Mar'20(%)

Promoters	46.7
MF/Banks/FIs	6.1
FIIIs	28.2
Public / Others	19.0

Valuation (x)

	FY20A	FY21E	FY22E
P/E	12.5	16.7	11.8
EV/EBITDA	7.4	9.0	6.9
ROE (%)	8.2	6.6	8.8
RoACE (%)	8.1	6.6	7.8

Estimates (Rs mn)

	FY20A	FY21E	FY22E
Revenue	67,788	63,980	71,893
EBITDA	7,238	6,571	8,203
PAT	2,611	1,963	2,771
EPS (Rs.)	64.6	48.5	68.5

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New capacity to drive long term growth, but high debt is a short-term concern

PCR and 2W tyres have commenced production at the Chennai greenfield facility in Q4FY20. This will assist in fulfilling a strong order book from OEMs and further improve its market share in the PCR segment. However, due to the COVID crisis, ramp up will take longer than anticipated. At full capacity, the plant can produce 28,500 PCR TPD and 2,500 2Ws TPD. With the onset of new capacities at the Halol plant, TBR segment recorded growth of 20% YoY on a low base. Given new capacities, CEAT is now well positioned to capture the revival of the 2W/PV/CV market from FY22.

The debt funded capacity expansion for TBR/PCR/2W at a time of weak demand from both OEMs and replacement segment continues to put pressure on the return ratios and profitability. Gross debt stands at Rs 19.3bn in FY20 (vs Rs 14.9bn in FY19) and Net debt for FY20 is Rs 18.9bn (vs Rs 14.2bn in FY19). DE ratio for FY20 stands at 0.66 (vs 0.54 in FY19) with debt service covering ratio at 2.63 (vs 3.14 for FY19) and interest coverage ratio at 3.31 (vs 4.47 for FY19).

Exhibit 1: Actual vs DART Estimates

Particulars (Rs mn)	Actual	DART Est	Var (%)	Comment
Revenue	15,734	16,110	(2.3)	-
EBITDA	2,004	1,740	15.1	Improved mix and fall in RM cost
EBITDA Margin (%)	12.7	10.3	224bps	-
PAT	517	405	27.7	Low tax rate and exceptional exp

Source: Company, DART

Exhibit 2: Change in estimates

Rs Mn	FY21E			FY22E		
	New	Previous	Chg (%)	New	Previous	Chg (%)
Revenue	63,980	74,696	(14.3)	71,893	82,700	(13.1)
EBITDA	6,571	7,078	(7.2)	8,203	8,268	(0.8)
EBITDA Margin (%)	10.27	9.48	79bps	11.41	10.00	141bps
PAT*	1,963	1,979	(0.8)	2,771	2,687	3.1
EPS (Rs)	48.5	48.9	(0.8)	68.5	66.4	3.1

Source: Company, DART

Exhibit 3: Assumption Sheet

Standalone revenue mix (%)	FY17	FY18	FY19	FY20	FY21E	FY22E
Truck & Bus (MHCV)	33	32	32	32	32	31
- TBR	8	9	11	15	17	17
- TBB	25	23	23	17	15	14
2W/3W	29	31	31	32	30	31
PV	13	14	14	14	14	15
LCV	13	12	12	11	11	11
Farm	7	7	7	6	7	7
Specialty	5	4	4	5	6	6

Source: Company, DART

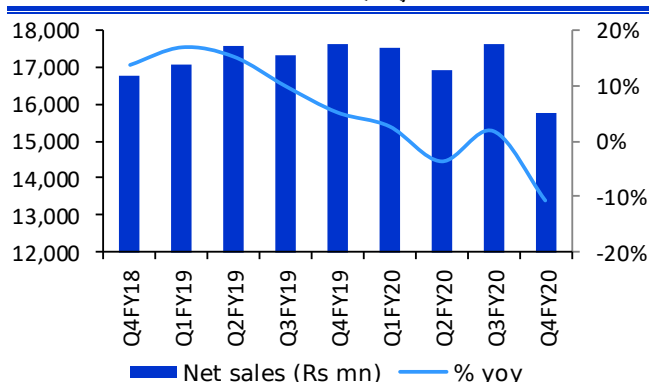
Key Concall Takeaways

- Since reopening, CEAT has seen a good uptick in demand for farm tyres due to good crop season, followed by 2W tyres. Further, CV tyre sales have done comparatively better compared to the PCR segment. However, CV tyre demand is likely to be the most impacted in FY21, due to unavailability of drivers and retrieval of stranded trucks. Current fleet utilization is around 15-20%.
- Raw material basket declined by 2.4% sequentially, positively impacting margins. The company is likely to further benefit from lower raw material costs, due to decline in prices of natural rubber and crude, partially offset by rupee depreciation and high inventory levels.
- Standalone revenue declined 3.7% YoY in FY20, while volume de-grew 4.8% YoY, and was partially offset by the product mix. In Q4FY20, volume de-grew by 10% QoQ, and realization remained stable sequentially.
- The shutdown due to COVID-19 at the end of March led to revenue loss of Rs 2bn in Q4FY20.
- In FY20, PCR and 2W segments performed better. TBR volume grew 20% YoY, which was offset by de-growth in the TBB segment. Farm segment was challenging due to slower growth. Replacement demand was stronger than OEMs, especially in the farm, 2W and T&B segments. Specialty tyres experienced a reasonable pickup with lower reported losses.
- In FY20, CEAT gained market share in the PCR segment, and currently commands 10-11% share. It is looking to further increase this by 5-7% over the coming years.
- CEAT undertook several cost optimization measures by lowering operational expenses w.r.t outsourcing and distribution costs, advertisement cost, and improving the product mix. A&P expenditure as a percentage of sales is likely to remain constant.
- CEAT has not faced any labor issues due to the migrant crisis, and continues to pay its contract labor and suppliers on time.
- The commissioning of the Chennai greenfield facility and ramp up of TBR at the Halol plant increased depreciation costs.
- The Chennai greenfield facility was inaugurated in Q4FY20 on schedule. However, due to the COVID crisis, ramp up will take longer than anticipated. At full capacity, the plant will produce 28,500 PCR TPD and 2,500 2Ws TPD.
- Improved working capital had helped fund capital expansion to a certain extent.
- The company has not availed moratorium on any of the borrowings and have repaid instalments as per schedule.
- TBR segment is operating at 65-70% utilization and attributed to 15% of overall sales. With onset of new capacities at the Halol plant, TBR segment recorded growth of 20% YoY on a low base.
- Tyre dealers are doing relatively better than OEM dealerships. Some challenges are faced by CV dealers.
- CEAT plans to remain in the old tax regime. The effective tax rate was 14.4% in Q4FY20.

Capex guidance

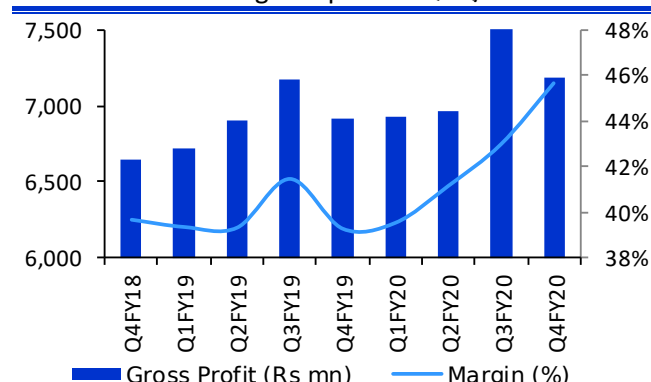
- Capex incurred was Rs 11.05bn in FY20, of which Rs 2.05bn was incurred for standalone business in Q4FY20.
- CEAT has given a capex guidance of Rs 5.5bn for FY21 on a consolidated basis.
- Out of the overall standalone capex of Rs 35bn, CEAT has incurred capex of Rs 21bn till date. Remaining capex of about Rs 5bn is deferred and will be incurred depending on the market scenario. The company has adequate capacity to cater to the demand for the next 18 months.
- The company incurs a maintenance capex of Rs 1.5bn under normal conditions.

Exhibit 4: Revenue declined QoQ/YoY



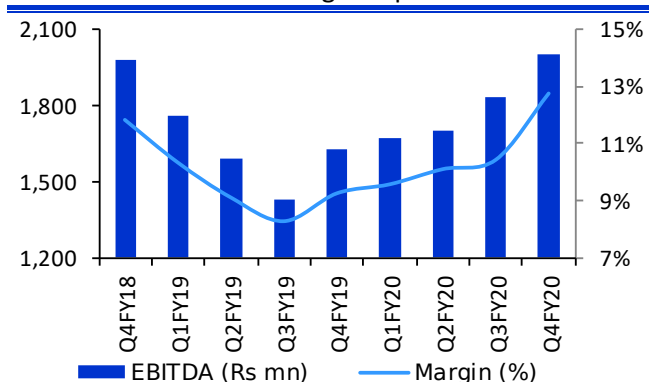
Source: DART, Company

Exhibit 5: Gross margin improved QoQ/YoY



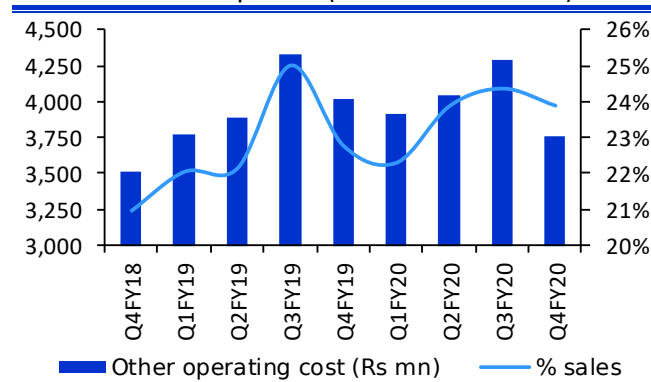
Source: DART, Company

Exhibit 6: EBITDA and margin improvement

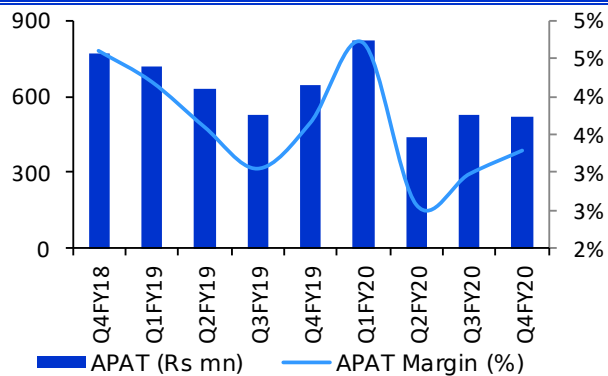


Source: DART, Company

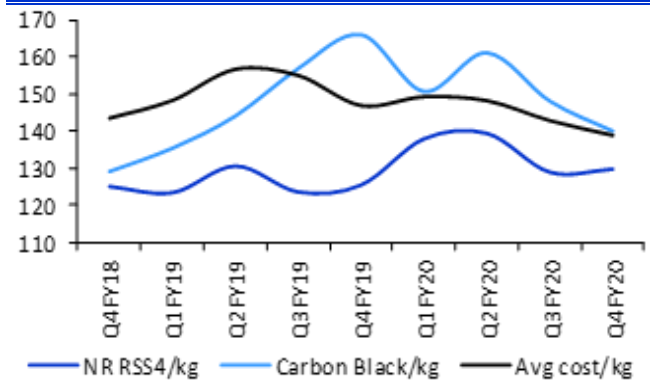
Exhibit 7: Other Expenses (Rs mn vs % of Sales)



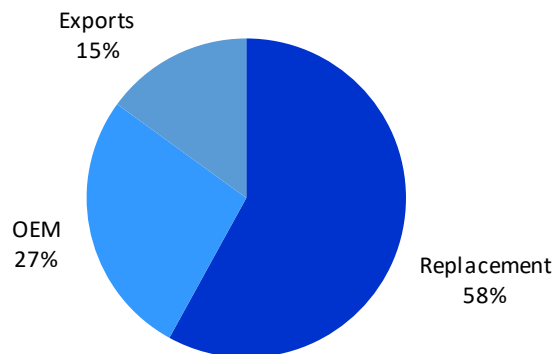
Source: DART, Company

Exhibit 8: APAT (Rs mn) vs Margin (%)


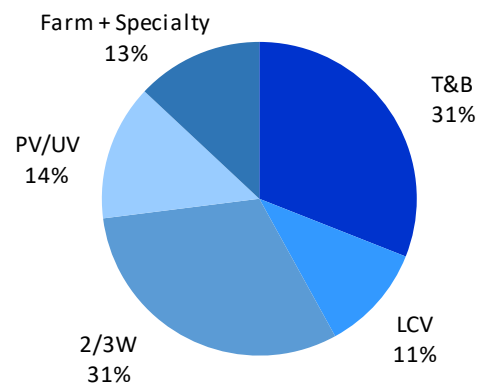
Source: DART, Company

Exhibit 9: Favorable Raw Material Prices (Rs/kg)QoQ


Source: DART, Company

Exhibit 10: Revenue Breakup by Market (%)


Source: DART, Company

Exhibit 11: Revenue Breakup by Product (%)


Source: DART, Company

Profit and Loss Account

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Revenue	69,845	67,788	63,980	71,893
Total Expense	63,420	60,550	57,409	63,690
COGS	41,818	39,151	36,819	40,856
Employees Cost	5,301	5,418	5,233	5,905
Other expenses	16,301	15,981	15,356	16,930
EBIDTA	6,425	7,238	6,571	8,203
Depreciation	1,927	2,765	3,079	3,369
EBIT	4,498	4,473	3,492	4,834
Interest	880	1,509	1,790	1,925
Other Income	390	205	800	685
Exc. / E.O. items	(448)	(298)	0	0
EBT	3,560	2,871	2,502	3,594
Tax	1,251	742	650	934
RPAT	2,522	2,313	1,963	2,771
Minority Interest	(11)	(12)	(12)	(12)
Profit/Loss share of associates	202	172	100	100
APAT	2,820	2,611	1,963	2,771

Balance Sheet

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
Sources of Funds				
Equity Capital	405	405	405	405
Minority Interest	238	237	225	213
Reserves & Surplus	27,257	28,675	30,201	32,322
Net Worth	27,661	29,079	30,605	32,726
Total Debt	14,515	20,840	26,890	24,440
Net Deferred Tax Liability	1,630	2,565	2,565	2,565
Total Capital Employed	44,044	52,720	57,284	59,943

Applications of Funds

Net Block	31,795	41,598	44,019	45,149
CWIP	8,329	10,685	10,685	10,685
Investments	3,278	2,679	2,679	2,679
Current Assets, Loans & Advances	20,067	18,388	18,097	20,126
Inventories	10,056	9,257	8,764	9,848
Receivables	7,064	6,744	6,516	7,322
Cash and Bank Balances	735	342	657	732
Loans and Advances	48	57	57	57
Other Current Assets	2,164	1,989	2,103	2,167
Less: Current Liabilities & Provisions	19,425	20,630	18,196	20,446
Payables	18,036	18,995	16,652	18,712
Other Current Liabilities	1,389	1,635	1,544	1,734
<i>sub total</i>				
Net Current Assets	642	(2,242)	(99)	(320)
Total Assets	44,044	52,720	57,284	59,943

E – Estimates

Important Ratios

Particulars	FY19A	FY20A	FY21E	FY22E
(A) Margins (%)				
Gross Profit Margin	40.1	42.2	42.5	43.2
EBIDTA Margin	9.2	10.7	10.3	11.4
EBIT Margin	6.4	6.6	5.5	6.7
Tax rate	35.1	25.9	26.0	26.0
Net Profit Margin	3.6	3.4	3.1	3.9
(B) As Percentage of Net Sales (%)				
COGS	59.9	57.8	57.5	56.8
Employee	7.6	8.0	8.2	8.2
Other	23.3	23.6	24.0	23.5
(C) Measure of Financial Status				
Gross Debt / Equity	0.5	0.7	0.9	0.7
Interest Coverage	5.1	3.0	2.0	2.5
Inventory days	53	50	50	50
Debtors days	37	36	37	37
Average Cost of Debt	8.4	8.5	7.5	7.5
Payable days	94	102	95	95
Working Capital days	3	(12)	(1)	(2)
FA T/O	2.2	1.6	1.5	1.6
(D) Measures of Investment				
AEPS (Rs)	69.7	64.6	48.5	68.5
CEPS (Rs)	117.4	132.9	124.7	151.8
DPS (Rs)	13.8	14.4	10.5	15.8
Dividend Payout (%)	19.8	22.3	21.7	23.0
BVPS (Rs)	683.8	718.9	756.6	809.0
RoANW (%)	9.4	8.2	6.6	8.8
RoACE (%)	9.3	8.1	6.6	7.8
RoAIC (%)	11.7	9.3	6.4	8.3
(E) Valuation Ratios				
CMP (Rs)	810	810	810	810
P/E	11.6	12.5	16.7	11.8
Mcap (Rs Mn)	32,763	32,763	32,763	32,763
MCap/ Sales	0.5	0.5	0.5	0.5
EV	46,542	53,260	58,996	56,470
EV/Sales	0.7	0.8	0.9	0.8
EV/EBITDA	7.2	7.4	9.0	6.9
P/BV	1.2	1.1	1.1	1.0
Dividend Yield (%)	1.7	1.8	1.3	1.9
(F) Growth Rate (%)				
Revenue	12.1	(2.9)	(5.6)	12.4
EBITDA	4.5	12.7	(9.2)	24.8
EBIT	0.8	(0.6)	(21.9)	38.4
PBT	3.4	(19.4)	(12.9)	43.6
APAT	3.7	(7.4)	(24.8)	41.2
EPS	3.7	(7.4)	(24.8)	41.2

Cash Flow

(Rs Mn)	FY19A	FY20A	FY21E	FY22E
CFO	5,614	9,563	4,980	8,339
CFI	(10,605)	(10,755)	(5,500)	(4,500)
CFF	4,844	790	835	(3,763)
FCFF	(5,459)	(1,536)	(520)	3,839
Opening Cash	863	735	342	657
Closing Cash	735	342	657	732

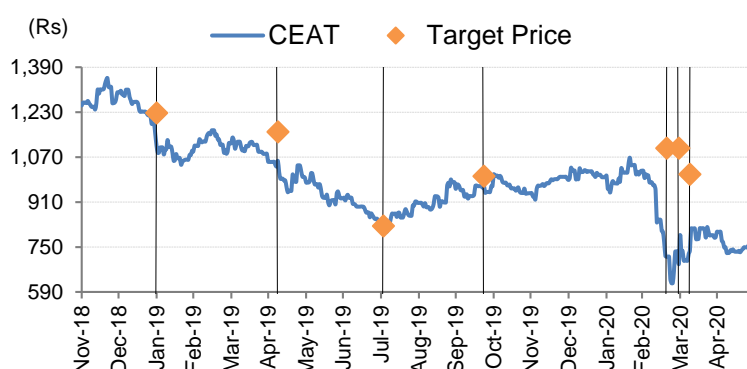
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
Jan-19	Buy	1,227	1,111
May-19	Accumulate	1,160	1,057
Aug-19	Reduce	825	803
Oct-19	Reduce	1,002	970
Mar-20	Buy	1,102	715
Mar-20	Buy	1,102	690
Apr-20	Buy	1,009	739

*Price as on recommendation date

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