# CEAT

## Buy

Result Update

### *Resilient performance in a weak environment*

- CEAT has displayed a decent operating performance in a relatively challenging demand environment led by cost control measures and reduction in promotional expenditure. Revenue de-grew 36% YoY to Rs 11.2bn, entirely attributed to volume. EBITDA de-grew 39% YoY to Rs 1.02bn with EBITDA margin at 9.1%.
- Replacement demand has witnessed a strong recovery after the lockdown was lifted and reached normal levels in the month of July. Management expects momentum to continue in the near to medium term.
- Being the market leader in 2W segment (31% of revenue share), and capacities in Specialty and Farm tyres (13% of revenue), the company has a well hedged portfolio to cushion the blow from downturn of CV demand. Company is focused on strengthening its existing relationships with OEMs and channel partners in order to efficiently manage working capital and cash.
- 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. The company is also aggressively working towards its reducing fixed cost through cost control measures. Although majority of the capex is already incurred, high leveraged balance sheet continues to put pressure on the near to medium term profitability.
- AT CMP, stock is trading at 13/11x for FY22/23E EPS (vs historical mean of 16x). We roll forward our estimates from FY22 to FY23E and upgrade our rating to Buy with TP of Rs 1,092 (based on 14x FY23E Cons EPS).

### Recovery in replacement volume expected from 2HFY21

While OEM demand for 2W/PVs is gradually picking up due to preference of personal mobility, we expect recovery in replacement demand from 2QFY21. We believe the uptick in OEM volume from FY22, continued replacement market growth, and commodity tailwind are likely to lead to sustain 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.

### Q1FY21 Result (Rs Mn)

| Particulars | Q1FY21 | Q1FY20 | YoY (%) | Q4FY20 | QoQ (%) |
|---|---|---|---|---|---|
| Revenue | 11,202 | 17,521 | (36.1) | 15,734 | (28.8) |
| Total Expense | 10,182 | 15,850 | (35.8) | 13,731 | (25.8) |
| EBITDA | 1,020 | 1,671 | (39.0) | 2,004 | (49.1) |
| Depreciation | 785 | 644 | 21.9 | 745 | 5.4 |
| EBIT | 235 | 1,027 | (77.1) | 1,259 | (81.4) |
| Other Income | 28 | 120 | (76.4) | 35 | (19.7) |
| Interest | 488 | 349 | 39.9 | 407 | 20.0 |
| EBT | (443) | 792 | (155.9) | 606 | (173.1) |
| Tax | (56) | 22 | (350.5) | 114 | (149.0) |
| RPAT | (352) | 822 | (142.9) | 517 | (168.1) |
| APAT | (135) | 828 | (116.2) | 799 | (116.8) |
| | | | (bps) | | (bps) |
| Gross Margin (%) | 40.3 | 39.5 | 73 | 45.6 | (540) |
| EBITDA Margin (%) | 9.1 | 9.5 | (43) | 12.7 | (363) |
| NPM (%) | (3.1) | 4.7 | (784) | 3.3 | (643) |
| Tax Rate (%) | 12.6 | 2.8 | 975 | 18.7 | (619) |
| EBIT Margin (%) | 2.1 | 5.9 | (377) | 8.0 | (590) |

| | |
|---|---|
| CMP | Rs 854 |
| Target / Upside | Rs 1,092 / 28% |
| BSE Sensex | 37,719 |
| NSE Nifty | 11,102 |

### Scrip Details

| | |
|---|---|
| Equity / FV | Rs 405mn / Rs 10 |
| Market Cap | Rs 35bn |
| | USD 462mn |
| 52-week High/Low | Rs 1,094/Rs 600 |
| Avg. Volume (no) | 1,67,579 |
| NSE Symbol | CEATLTD |
| Bloomberg Code | CEAT IN |

### Shareholding Pattern Jun'20(%)

| | |
|---|---|
| Promoters | 46.7 |
| MF/Banks/FIs | 9.6 |
| FIIs | 31.7 |
| Public / Others | 12.0 |

### Valuation (x)

| | FY21E | FY22E | FY23E |
|---|---|---|---|
| P/E | 21.4 | 13.5 | 11.0 |
| EV/EBITDA | 8.9 | 6.9 | 5.9 |
| ROE (%) | 5.4 | 8.2 | 9.4 |
| RoACE (%) | 5.9 | 7.3 | 8.0 |

### Estimates (Rs mn)

| | FY21E | FY22E | FY23E |
|---|---|---|---|
| Revenue | 63,980 | 71,893 | 79,533 |
| EBITDA | 6,571 | 8,203 | 9,187 |
| PAT | 1,616 | 2,556 | 3,156 |
| EPS (Rs.) | 40.0 | 63.2 | 78.0 |

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### Growth and margin levers in place

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 due to delayed launches of 4-5 new vehicles. At full capacity, the plant can produce 28,500 PCR TPD and 2,500 2Ws TPD. Given new capacities, CEAT is now well positioned to capture the revival of the 2W/PV/CV market from FY22. Company has invested Rs 15bn over the past 2 years with Asset Turnover of 1.3, company is aiming to achieve incremental turnover of Rs 20bn.

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 at the end of Q1FY21 was Rs 19.98bn (increased by Rs 700mn on sequential basis). Net debt reduced by Rs 700mn due to efficient cash flow management. Consolidated Gross Debt: Equity was 0.69.

**Exhibit 1:** Change in estimates

| Rs Mn | FY21E | | | FY22E | | |
|---|---|---|---|---|---|---|
| | New | Previous | Chg (%) | New | Previous | Chg (%) |
| Revenue | 63,980 | 63,980 | 0.0 | 71,893 | 71,893 | 0.0 |
| EBITDA | 6,571 | 6,571 | 0.0 | 8,203 | 8,203 | 0.0 |
| EBITDA Margin (%) | 10.27 | 10.27 | - | 11.41 | 11.41 | - |
| PAT* | 1,616 | 1,963 | (17.7) | 2,528 | 2,771 | (8.8) |
| EPS (Rs) | 40.0 | 48.5 | (17.7) | 62.5 | 68.5 | (8.8) |

*Source: Company, DART*

**Exhibit 2:** Assumption Sheet

| Standalone revenue mix (%) | FY18 | FY19 | FY20 | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|---|
| Truck & Bus (MHCV) | 32 | 32 | 32 | 32 | 31 | 32 |
| - TBR | 9 | 11 | 15 | 17 | 17 | 18 |
| - TBB | 23 | 23 | 17 | 15 | 14 | 14 |
| 2W/3W | 31 | 31 | 32 | 30 | 31 | 30 |
| PV | 14 | 14 | 14 | 14 | 15 | 15 |
| LCV | 12 | 12 | 11 | 11 | 11 | 11 |
| Farm | 7 | 7 | 6 | 7 | 7 | 6 |
| Specialty | 4 | 4 | 5 | 6 | 6 | 6 |

*Source: Company, DART*

## Key Concall Takeaways

- The management cited that the macro-economic conditions are unfavorable to support growth in FY21. Revenue decline of 37% in Q1 was entirely attributed to volumes. Net realization has marginally improved (3-4% QoQ/1.5% YoY), due to favorable product and market mix.
- Entire month of April was a washout, while May witnessed traction in CV and Farm tyres. Replacement demand in June picked up for 2W and PCR tyres, with unlocking of the economy. With improvement of fleet utilization to 70%, TBR replacement demand has seen decent growth. This trend continued in July. Replacement demand is likely to slow down going ahead with markets resuming normalcy.
- Strong bounce back in the replacement demand helped sustain de-growth in the OEM demand (10-20% of normal level). Buoyancy of rural economy led to

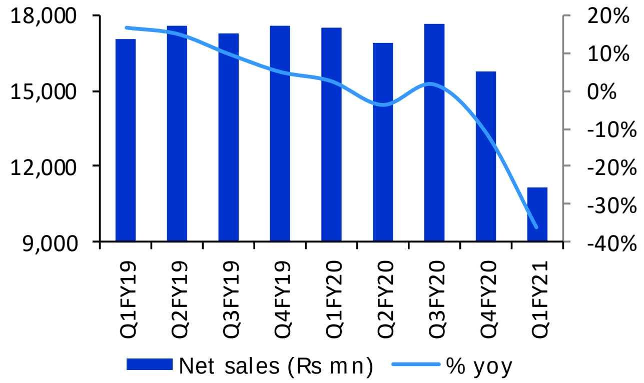
stronger replacement demand across segments with 2w and tractor segment outperforming.

- Revenue mix for Q1FY21 (one off): Replacement: OEM: Export - 80:10:10
- CEAT has 4-5 new OEM launches planned for the coming months and is optimistic about strengthening its OEM presence and expects recovery from Q4FY21.
- Exports improved gradually on a MoM basis and is likely to grow in the coming months.
- Raw material basket cost decreased by 6% YoY, due to substantial finished goods movement. Further improvement in gross margins will reflect in Q2 due to lower RM prices (NR and crude derivatives), partially offset in by rupee depreciation and high inventory levels.
- Company undertook several structural cost reduction initiatives w.r.t. operating expenditure like power and utility, lowering wastage, sales promotion and consultancy costs and is aiming to reduce costs by 15% over the next two quarters.
- The commissioning of the Chennai Greenfield facility and ramp up of TBR at the Halol plant in Q4FY20 led to increase in depreciation and interest costs.
- Exceptional cost of Rs 220mn was incurred towards Covid detection charges, idle contract labor costs and interest expenses towards idle plant.
- All plants are operational with utilization back at pre-Covid level due to timely ramp up.
- CEAT initiated customer centric services like doorstep fitment of tyres to cater to the replacement market. It also relaxed various channel policies to ensure channel partners were comfortable and is currently concentrating on channel filling.
- Immense focus has been put on preserving cash flow by efficient WC management by improvement in receivables and timely payments to vendors, lenders and statutory dues. The company has not availed moratorium on any of the borrowings and have repaid instalments as per schedule.
- Restrictions on import of tyres imposed by the government may lead to reduction in imports by 50-60% under normal market conditions, which increases the market size for domestic players by 3-4%. This is likely to benefit the TBR the most, followed by PCR and 2W. Imported tyres account for 6-10% of overall Indian tyre market.
- Gross debt at the end of Q1 was Rs 19.98bn (increased by Rs 700mn on sequential basis). Net debt reduced by Rs700mn due to efficient cash flow management. Consolidated Gross Debt: Equity was 0.69.
- NCLT has approved merger of CEAT with CEAT Specialty Tyres Ltd (CSTL) which is likely to be completed in FY21.
- No pricing action were undertaken across segments.

**Capex guidance**

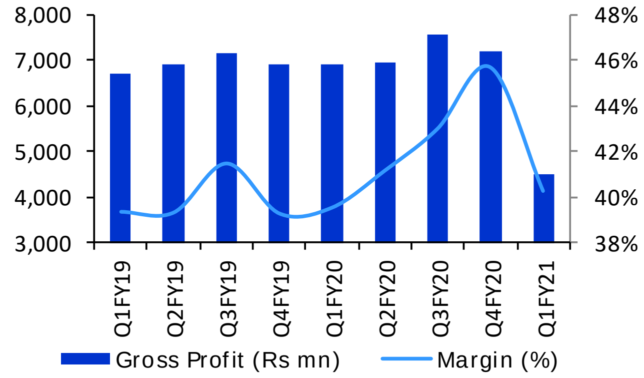
- Capex incurred was Rs 1,050mn in Q1FY21, largely towards payment for machinery. For FY21, CEAT has given a capex guidance of Rs 5.5bn on a standalone basis and Rs 1bn towards CSTL (Specialty business).
- Out of the overall planned capex of Rs 35bn, CEAT has incurred capex of Rs 22.5bn till date (including Specialty Business capex of Rs 3.5-4bn till date).
- The debt levels will reduce gradually as majority of capex is already incurred.

**Exhibit 3:** Revenue declined QoQ/YoY



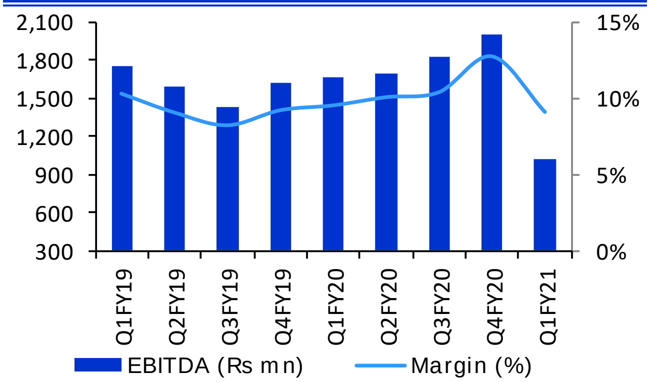

*Source: DART, Company*

**Exhibit 4:** Gross margin declined QoQ



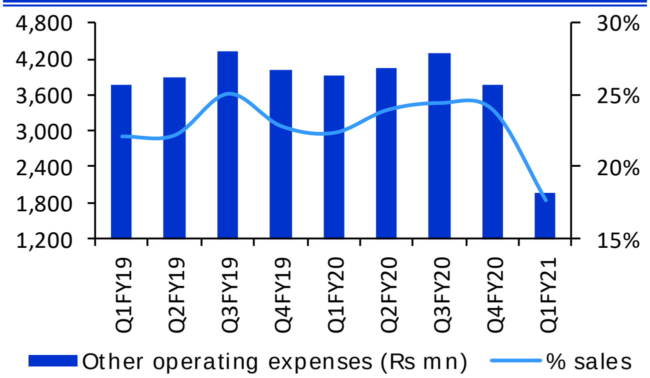

*Source: DART, Company*

**Exhibit 5:** EBITDA and margin improvement



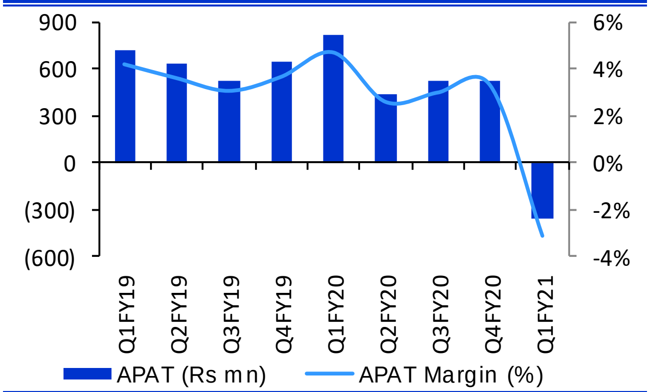

*Source: DART, Company*

**Exhibit 6:** Other Expenses (Rs mn vs % of Sales)



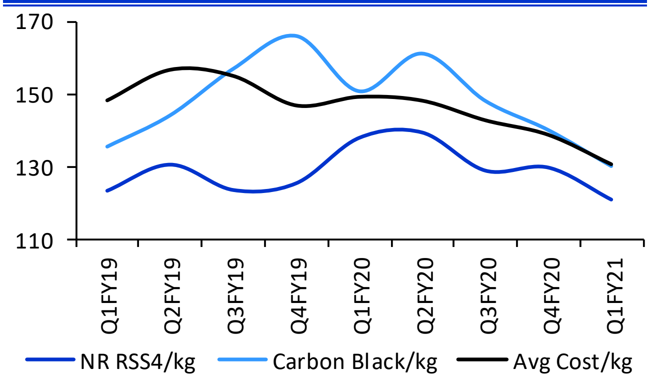

*Source: DART, Company*

**Exhibit 7:** APAT (Rs mn) vs Margin (%)



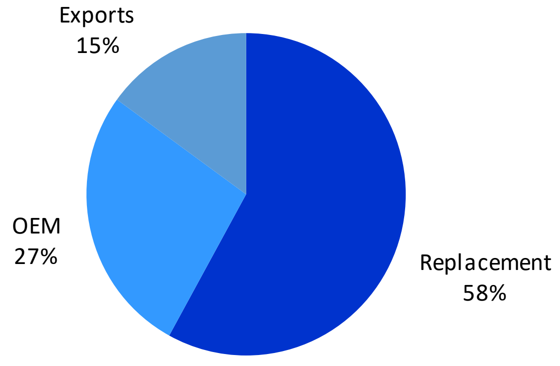

*Source: DART, Company*

**Exhibit 8:** Favorable Raw Material Prices (Rs/kg)QoQ



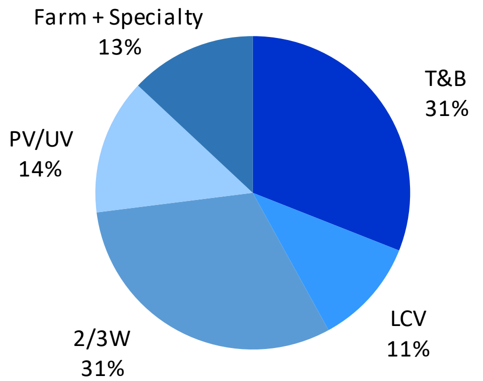

*Source: DART, Company*

**Exhibit 9:** Revenue Breakup by Market (FY20) (%)




*Source: DART, Company*

**Exhibit 10:** Revenue Breakup by Product (FY20) (%)




*Source: DART, Company*

### Profit and Loss Account

| (Rs Mn) | FY20A | FY21E | FY22E | FY23E |
|---|---|---|---|---|
| **Revenue** | **67,788** | **63,980** | **71,893** | **79,533** |
| **Total Expense** | **60,550** | **57,409** | **63,690** | **70,346** |
| COGS | 39,151 | 36,819 | 40,856 | 45,774 |
| Employees Cost | 5,418 | 5,233 | 5,905 | 6,363 |
| Other expenses | 15,981 | 15,356 | 16,930 | 18,209 |
| **EBIDTA** | **7,238** | **6,571** | **8,203** | **9,187** |
| Depreciation | 2,765 | 3,152 | 3,435 | 3,729 |
| **EBIT** | **4,473** | **3,419** | **4,768** | **5,458** |
| Interest | 1,509 | 1,764 | 1,803 | 1,730 |
| Other Income | 205 | 225 | 300 | 320 |
| Exc. / E.O. items | (298) | 0 | 0 | 0 |
| **EBT** | **2,871** | **1,880** | **3,265** | **4,048** |
| Tax | 742 | 376 | 849 | 1,053 |
| RPAT | 2,313 | 1,616 | 2,556 | 3,156 |
| Minority Interest | (12) | (12) | (20) | (10) |
| **Profit/Loss share of associates** | **172** | **100** | **120** | **150** |
| **APAT** | **2,611** | **1,616** | **2,556** | **3,156** |

### Balance Sheet

| (Rs Mn) | FY20A | FY21E | FY22E | FY23E |
|---|---|---|---|---|
| **Sources of Funds** | | | | |
| Equity Capital | 405 | 405 | 405 | 405 |
| Minority Interest | 237 | 225 | 205 | 195 |
| Reserves & Surplus | 28,675 | 29,875 | 31,802 | 34,220 |
| **Net Worth** | **29,079** | **30,280** | **32,207** | **34,625** |
| Total Debt | 20,840 | 24,390 | 23,690 | 22,440 |
| Net Deferred Tax Liability | 2,565 | 2,565 | 2,565 | 2,565 |
| **Total Capital Employed** | **52,720** | **57,459** | **58,665** | **59,824** |
| | | | | |
| **Applications of Funds** | | | | |
| Net Block | **41,598** | **46,529** | **49,359** | **50,433** |
| CWIP | 10,685 | 8,685 | 6,685 | 6,185 |
| Investments | 2,679 | 2,679 | 2,679 | 2,679 |
| **Current Assets, Loans & Advances** | **18,388** | **17,844** | **20,737** | **24,297** |
| Inventories | 9,257 | 8,764 | 9,848 | 10,895 |
| Receivables | 6,744 | 6,516 | 7,322 | 8,100 |
| Cash and Bank Balances | 342 | 404 | 1,343 | 3,066 |
| Loans and Advances | 57 | 57 | 57 | 57 |
| Other Current Assets | 1,989 | 2,103 | 2,167 | 2,179 |
| | | | | |
| **Less: Current Liabilities & Provisions** | **20,630** | **18,278** | **20,794** | **23,770** |
| Payables | 18,995 | 16,652 | 18,712 | 20,700 |
| Other Current Liabilities | 1,635 | 1,626 | 2,082 | 3,070 |
| *sub total* | | | | |
| Net Current Assets | (2,242) | (434) | (58) | 527 |
| **Total Assets** | **52,720** | **57,459** | **58,665** | **59,824** |

E – Estimates

### Important Ratios

| Particulars | FY20A | FY21E | FY22E | FY23E |
|---|---|---|---|---|
| **(A) Margins (%)** | | | | |
| Gross Profit Margin | 42.2 | 42.5 | 43.2 | 42.4 |
| EBIDTA Margin | 10.7 | 10.3 | 11.4 | 11.6 |
| EBIT Margin | 6.6 | 5.3 | 6.6 | 6.9 |
| Tax rate | 25.9 | 20.0 | 26.0 | 26.0 |
| Net Profit Margin | 3.4 | 2.5 | 3.6 | 4.0 |
| **(B) As Percentage of Net Sales (%)** | | | | |
| COGS | 57.8 | 57.5 | 56.8 | 57.6 |
| Employee | 8.0 | 8.2 | 8.2 | 8.0 |
| Other | 23.6 | 24.0 | 23.5 | 22.9 |
| **(C) Measure of Financial Status** | | | | |
| Gross Debt / Equity | 0.7 | 0.8 | 0.7 | 0.6 |
| Interest Coverage | 3.0 | 1.9 | 2.6 | 3.2 |
| Inventory days | 50 | 50 | 50 | 50 |
| Debtors days | 36 | 37 | 37 | 37 |
| Average Cost of Debt | 8.5 | 7.8 | 7.5 | 7.5 |
| Payable days | 102 | 95 | 95 | 95 |
| Working Capital days | (12) | (2) | 0 | 2 |
| FA T/O | 1.6 | 1.4 | 1.5 | 1.6 |
| **(D) Measures of Investment** | | | | |
| AEPS (Rs) | 64.6 | 40.0 | 63.2 | 78.0 |
| CEPS (Rs) | 132.9 | 117.9 | 148.1 | 170.2 |
| DPS (Rs) | 14.4 | 10.0 | 15.1 | 18.0 |
| Dividend Payout (%) | 22.3 | 25.0 | 23.8 | 23.1 |
| BVPS (Rs) | 718.9 | 748.6 | 796.2 | 856.0 |
| RoANW (%) | 8.2 | 5.4 | 8.2 | 9.4 |
| RoACE (%) | 8.1 | 5.9 | 7.3 | 8.0 |
| RoAIC (%) | 9.3 | 6.2 | 8.3 | 9.6 |
| **(E) Valuation Ratios** | | | | |
| CMP (Rs) | 854 | 854 | 854 | 854 |
| P/E | 13.2 | 21.4 | 13.5 | 11.0 |
| Mcap (Rs Mn) | 34,561 | 34,561 | 34,561 | 34,561 |
| MCap/ Sales | 0.5 | 0.5 | 0.5 | 0.4 |
| EV | 55,058 | 58,546 | 56,907 | 53,934 |
| EV/Sales | 0.8 | 0.9 | 0.8 | 0.7 |
| EV/EBITDA | 7.6 | 8.9 | 6.9 | 5.9 |
| P/BV | 1.2 | 1.1 | 1.1 | 1.0 |
| Dividend Yield (%) | 1.7 | 1.2 | 1.8 | 2.1 |
| **(F) Growth Rate (%)** | | | | |
| Revenue | (2.9) | (5.6) | 12.4 | 10.6 |
| EBITDA | 12.7 | (9.2) | 24.8 | 12.0 |
| EBIT | (0.6) | (23.6) | 39.4 | 14.5 |
| PBT | (19.4) | (34.5) | 73.6 | 24.0 |
| APAT | (7.4) | (38.1) | 58.2 | 23.5 |
| EPS | (7.4) | (38.1) | 58.2 | 23.5 |

### Cash Flow

| (Rs Mn) | FY20A | FY21E | FY22E | FY23E |
|---|---|---|---|---|
| CFO | 9,563 | 4,679 | 8,051 | 8,931 |
| CFI | (10,755) | (5,500) | (3,500) | (3,000) |
| CFF | 790 | 882 | (3,612) | (4,207) |
| FCFF | (1,536) | (821) | 4,551 | 5,931 |
| Opening Cash | 735 | 342 | 404 | 1,343 |
| Closing Cash | 342 | 404 | 1,343 | 3,066 |

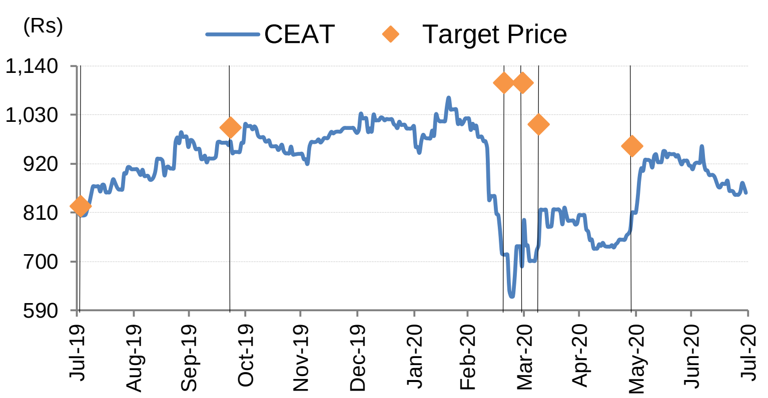
E – Estimates

## *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.) |
|---|---|---|---|
| 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 |
| May-20 | Accumulate | 960 | 810 |

**Price as on recommendation date*

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