28 October 2020

2QFY21 Results Update | Sector: Automobile

CEAT

Estimate change	↑
TP change	↑
Rating change	↔

Bloomberg	CEAT IN
Equity Shares (m)	40
M.Cap.(INRb)/(USDb)	46.4 / 0.6
52-Week Range (INR)	1249 / 602
1, 6, 12 Rel. Per (%)	16/22/18
12M Avg Val (INR M)	179

Financials & valuations (INR b)

Y/E March	FY20	FY21E	FY22E
Sales	67.8	71.1	81.8
EBITDA	7.2	9.0	10.7
EBITDA Margin (%)	10.7	12.6	13.1
Adj. PAT	2.3	3.5	3.9
EPS (INR)	57.1	86.9	97.0
EPS Gr. (%)	-14.7	52.2	11.6
BV/Sh. (INR)	719	788	870
Ratios			
RoE (%)	8.1	11.5	11.7
RoCE (%)	7.0	9.7	9.0
Payout (%)	25.3	16.1	14.9
Valuations			
P/E (x)	20.1	13.2	11.8
P/BV (x)	1.6	1.5	1.3
Div. Yield (%)	1.0	1.0	1.0
FCF Yield (%)	-3.5	-0.2	1.9

Shareholding pattern (%)

As On	Sep-20	Jun-20	Sep-19
Promoter	46.8	46.7	50.5
DII	16.2	9.6	7.0
FII	23.7	27.6	25.0
Others	13.3	16.1	17.5

FII Includes depository receipts

CMP: INR1,146 TP: INR1,317 (+15%) Buy

Above est., Higher volumes, lower RM prices drive beat

Mix normalization, natural rubber price inflation to hurt margins

- CEAT's 2QFY21 performance was driven by strong demand across segments, favorable mix, lower RM cost and operating leverage. While near-term performance would be impacted by higher OEM share and rubber price inflation, sustained demand recovery would help utilize recent capacity additions, drive FCF generation and balance sheet deleveraging.
- We upgrade our EPS for FY21/FY22E by 27%/8% to factor in one-time tax benefit in FY21 and expected increase in volume growth. Maintain **Buy**.

Strong volumes, lower RM and operating leverage drives margins

- CEAT's 2QFY21 revenues/EBITDA/PAT grew 17%/72%/309% YoY to INR19.8b/INR2.9b/INR1.8b. 1HFY21 revenues declined by10% while EBITDA/PAT grew 17%/16% YoY.
- Revenues grew 17% YoY to INR19.8b (v/s est. INR18.3b), totally driven by volume growth as realizations were largely flat. Replacement grew 30% YoY, driven by farm/CVs/PVs. OEMs declined in single-digits, while exports grew in single-digits.
- Gross margin expanded 530bp QoQ (620bp YoY) due to favorable mix as replacement share was 71% during quarter (v/s 60% in 2QFY20), lower RM cost (-9% YoY, -5% QoQ) and cost control initiatives.
- EBITDA margin expanded ~570bp QoQ (470bp YoY) to ~14.8% (v/s est. 13.6%), due to lower other expenses and operating leverage.
- EBITDA grew ~72% YoY to ~INR2.9b (v/s est. ~INR2.5b). One-time tax benefits due to accumulated losses of the specialty tyre company, which was merged with CEAT, resulted in adj. PAT of INR18.2b (v/s est. ~INR1.03b).

Highlights from management commentary

- Oct-Nov'20 demand outlook for OEMs as well replacement remains strong, though it leads to an adverse mix. Due to capacity constraints, CEAT would prioritize OEM supplies over replacement. The replacement market could see allocation problem due to capacity constraints and very low inventory.
- Natural rubber prices have increased to ~INR150/kg (from INR118/kg in 1HFY21). This would result in 2-3% QoQ increase in 3QFY21 (as it has low cost inventory) and would further increase in 4QFY21 (full reflection of current prices).
- EBITDA margins will come down from 2QFY21 level due to mix normalizing and RM cost inflation.
- Capex for FY21 stands at INR6.5-7b for projects and INR1.5b for maintenance capex. CEAT has invested INR2.6b in 1HFY21.
- Net debt has reduced by ~INR1.9b QoQ. However, net debt would go up as working capital normalizes and capex continues.

Valuation and view

- Good demand recovery, new capacities ramping up, largely stable RM cost and cost-cutting measures should drive steady performance. This coupled with lower capex intensity would drive balance sheet deleverage.
- Valuations at 13.2x/11.8x FY21/22E consol. EPS does not fully capture the benefit of substantial capacity addition. Maintain **Buy** with TP of INR1,317.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

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

Consolidated - Quarterly Earning Model (INR M)

Y/E March	FY20				FY21E				FY20	FY21E	FY21E
	1Q	2Q	3Q	4QE	1Q	2Q	3Q	4QE			2QE
Net operating revenues	**17521**	**16916**	**17618**	**15734**	**11202**	**19785**	**19908**	**20224**	**67788**	**71118**	**18,269**
Change (%)	2.7	-4.6	1.8	-10.6	-36.1	17.0	13.0	14.8	-294.5	491.3	8.0
EBITDA	**1671.3**	**1703.7**	**1832.1**	**2003.5**	**1020.1**	**2924.7**	**2544.9**	**2471.2**	**7,238**	**8,961**	2,487
EBITDA Margins (%)	9.5	10.1	10.4	12.7	9.1	14.8	12.8	12.2	10.7	12.6	13.6
Depreciation	644.2	670.7	705.3	744.9	785.4	839.2	855	876.83	2,765	3,356	800.0
EBIT	**1027.1**	**1033**	**1126.8**	**1258.6**	**234.7**	**2085.5**	**1689.9**	**1594.4**	**4473.2**	**5,605**	1,687
EBIT Margins (%)	5.9	6.1	6.4	8.0	2.1	10.5	8.5	7.9	6.6	7.9	9.2
Interest	349	374	380	407	488	450	490	510	1,509	1,937	490
Non-operating income	120	43	36	35	28	38	50	84	205	200	50
PBT after EO items	**1095**	**693**	**780**	**605**	**-443**	**1674**	**1250**	**1169**	**3174**	**3650**	1,247
Effective Tax Rate (%)	30	44	39	19	13	-1	22	23	33	13	22.0
PAT	**826**	**440**	**528**	**519**	**-348**	**1819**	**1030**	**824**	**2312**	**3325**	1,034
Adjusted PAT	**626**	**445**	**530**	**708**	**-158**	**1819**	**1030**	**824**	**2309**	**3515**	1,034
Change (%)	-14.7	-30.9	0.4	-11.6	-125.2	308.5	94.5	16.5	-14.7	52.2	132.3
Key Performance Indicators											
RM Cost (% of sales)	60.5	58.9	57.0	54.4	59.7	53.5	55.5	56.1	57.8	55.8	54.0
Staff Cost (% of sales)	7.7	7.2	8.2	9.0	13.5	8.1	8.2	8.2	8.0	9.0	8.3
Other Cost (% of sales)	22	24	24	24	18	24	24	24	24	23	24.1
Gross margin (%)	39.5	41.1	43.0	45.6	40.3	46.5	44.5	43.9	42.2	0.0	46.0
EBITDA Margins (%)	9.5	10.1	10.4	12.7	9.1	14.8	12.8	12.2	10.7	12.6	13.6
EBIT Margins (%)	5.9	6.1	6.4	8.0	2.1	10.5	8.5	7.9	10.7	12.6	9.2

E:MOFSL Estimates

CONFERENCE CALL

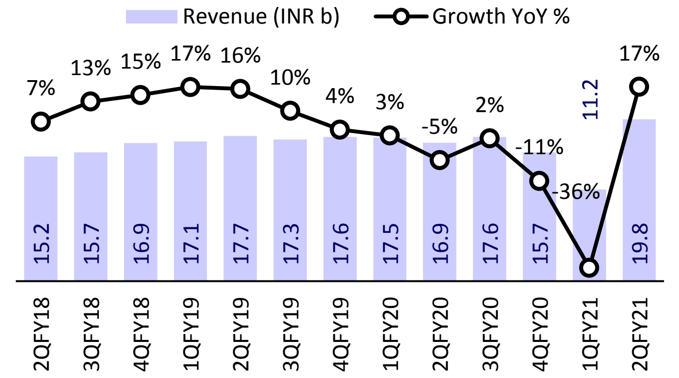
Highlights from management commentary

- **Demand:** Demand remains strong in Oct-Nov for OEMs as well as for replacement, though it leads to an adverse mix. Replacement grew 30% with farm segment showing highest growth of 17-18%. All others saw minimum double-digit growth. TBB saw higher demand as measure of cost cutting by truck operators. OEMs saw decline in single-digit while exports grew in single digit.
- Due to capacity constraints, CEAT would prioritize OEM supplies over replacement. Replacement market could see allocation problem due to capacity constraints and very low inventory.
- Gross margin improved due to lower commodity prices, favorable mix as replacement share was 70% during the quarter (v/s 60% in 2QFY20), and cost controls. RM cost/kg came down by 5% QoQ and 9% YoY, mainly due to carbon black price reduction while price of other materials reduced by 5-10% YoY.
- Natural rubber prices have increased to ~INR150/kg (from INR118/kg in 1HFY21). This would result in 2-3% QoQ increase in 3QFY21 (as it has low cost inventory) and further increase in 4QFY21 (full reflection of current prices).
- Merger of CSTL: Accumulated losses accounted in 2QFY21, resulted in tax benefit of ~INR550m. It has absorbed all accumulated losses in 2QFY21.
- OTR business is operating at 85-90% utilization. There are plans to increase capacity from 30-35tpd now by 10-15tpd modules.
- Margin expansion was led by operating leverage. Advertisement expenses were up 20% YoY (3% of sales v/s ~2% in 2QFY20) due to signing Mr. Aamir Khan (actor) as brand ambassador and continued IPL screen time.
- Employee cost was higher YoY as cost in 2QFY20 was lower by INR210m due to write-backs. It is expected to remain high due to the ongoing ramp-up at Chennai, Halol and Nagpur plants.
- Capex for FY21 stands at INR6.5-7b for projects and INR1.5b for maintenance. The company has invested INR2.6b in 1HFY21.

- Working capital has reduced by ~INR1.9b in 1HFY21; however, it would increase by INR1b as finished goods inventory is very low currently.
- Net debt has reduced by ~INR1.9b QoQ. However, net debt is expected to increase as working capital normalizes and capex continues.

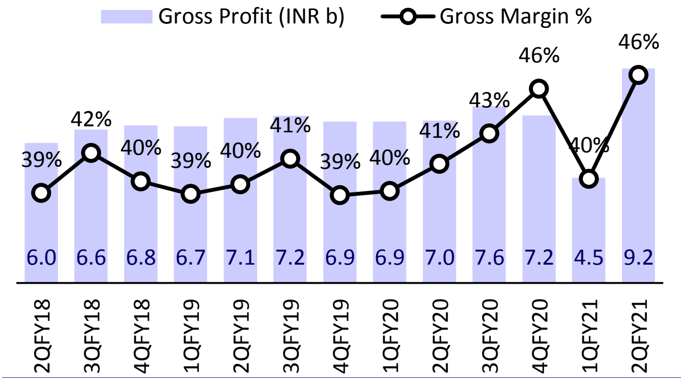
Key exhibits

Exhibit 1: Trend in revenues



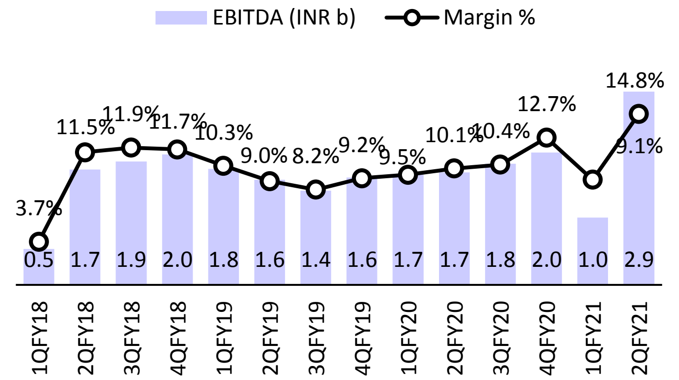
Source: MOFSL, Company

Exhibit 2: Trend in gross margins



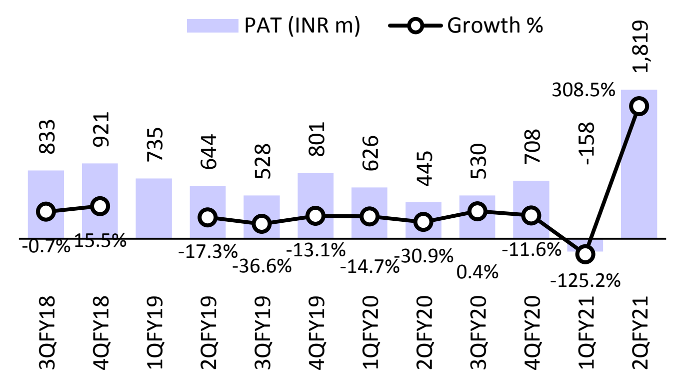
Source: MOFSL, Company

Exhibit 3: EBITDA and EBITDA margin trend



Source: MOFSL, Company

Exhibit 4: PAT and PAT growth trend



Source: MOFSL, Company

Valuation and view

Focus on improving brand equity to drive market share gains: CEAT has laid strong emphasis on effective marketing and branding of products. To position its products competitively, the company has developed creative ad campaigns based on extensive research/consumer insights and invested in innovative marketing programs. Since the 2W/PV segments are consumer-facing, we believe factors such as brand loyalty, visibility and recall go a long way in creating replacement market demand and improving market share, which would in turn benefit its margin profile.

Ramp-up in strategic focus areas to continue: CEAT has identified the 2W, PV 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 focus areas has increased significantly over the years – to 48% in FY18 from 20% in FY10. We believe that with the on-going capex plan, contribution from focus areas could scale up to 60-65% over the next 4-5 years, which would also reflect positively in the company's operating performance. We expect revenue/EBITDA/PAT CAGR of ~5%/13%/15% over FY20-22E, based on EBITDA margin expansion of ~180bp by FY22E to 12.5%.

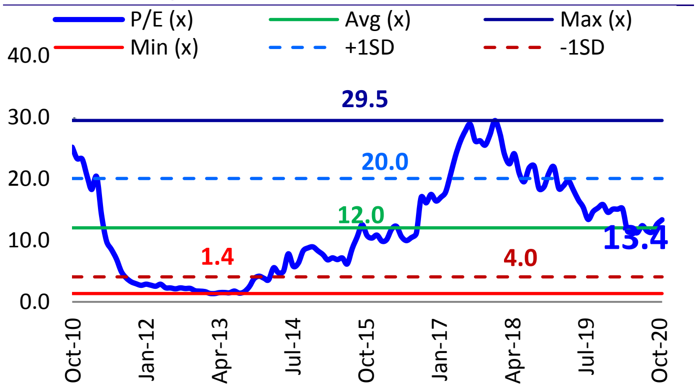
Growth capex to increase capacity by ~50%: CEAT has lined up capex of ~INR35b over FY19-23E to increase its capacity by ~50%. It is investing in PCR (for ~240tpd capacity), TBR (for 208tpd capacity), 2W (~140tpd capacity), and OTR (~60tpd addition). This would help the company attain strategic product mix, while scaling up revenue contribution from focus areas, thereby driving margin expansion. With large part of the capex behind and capacity-ready, CEAT has substantial headroom to grow from the current capacity. This is not fully reflected in our estimates for FY21/FY22E.

Valuation and view: We upgrade our EPS for FY21/FY22E by 27%/8% to factor in one-time tax benefit in FY21 and the expected increase in volume growth. CEAT's recent capacity addition gives ample headroom for meeting demand over the next 2-3 years with minimal balancing capex. Good demand recovery, new capacities ramping up coupled with largely stable RM cost and cost cutting measures should drive steady performance. This along with lower capex intensity will drive balance sheet deleverage. Valuations at 13.2x/11.8x FY21/FY22E consol. EPS does not fully capture the benefit of substantial capacity addition. Maintain **Buy** with TP of ~INR1,317 (~12.5x Sep'22E consol. EPS).

Exhibit 5: Change in estimates

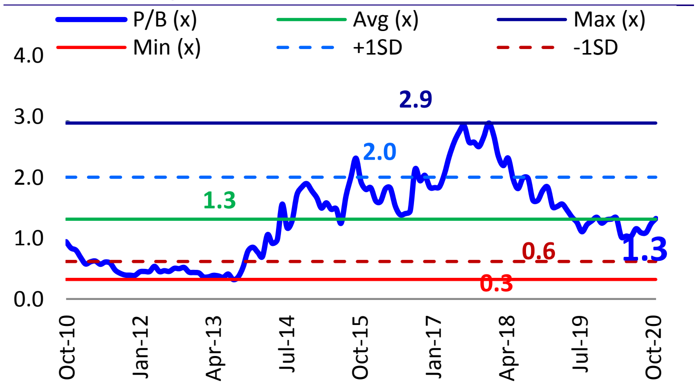
(INR m)	FY21E			FY22E		
	Rev	Old	Chg (%)	Rev	Old	Chg (%)
Net Sales	71,118	68,303	4.1	81,759	78,475	4.2
EBITDA	8,961	8,333	7.5	10,710	10,045	6.6
EBITDA (%)	12.6	12.2	40bp	13.1	12.8	30bp
Adj. PAT	3,515	2,769	27.0	3,922	3,628	8.1
EPS (INR)	86.9	68.4	27.0	97.0	89.7	8.1

Exhibit 6: One-year forward P/E



Source: MOFSL, Company

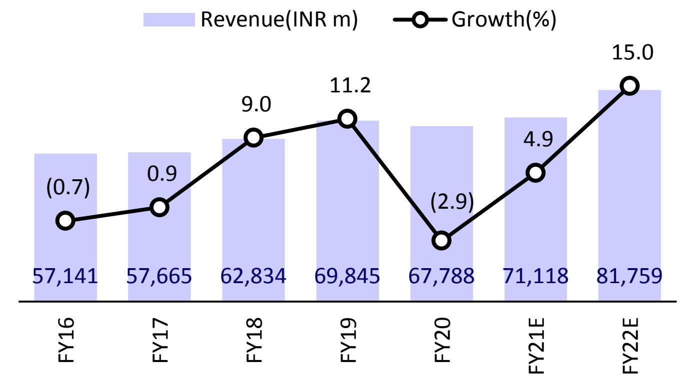
Exhibit 7: One-year forward P/B band



Source: MOFSL, Company

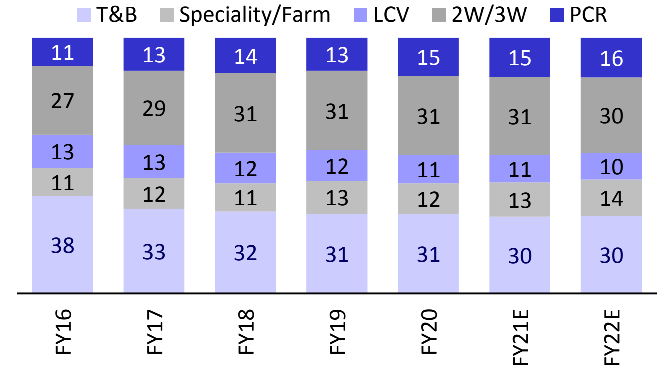
Story in charts

Exhibit 8: Revenue and growth trend



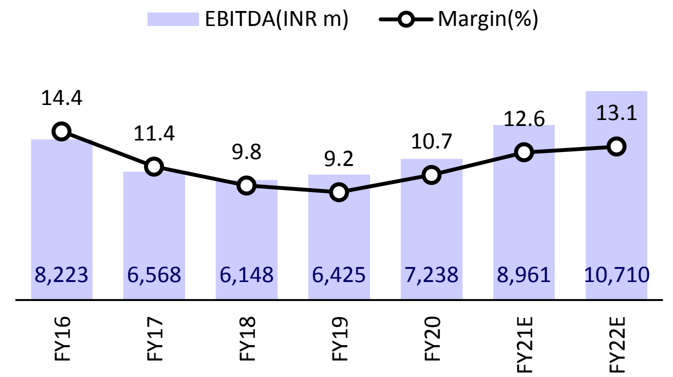
Source: MOFSL, Company

Exhibit 9: Key revenue segments



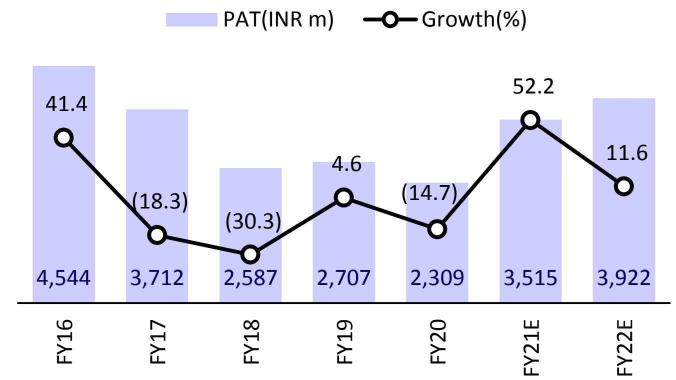
Source: MOFSL, Company

Exhibit 10: EBITDA and EBITDA margin trend



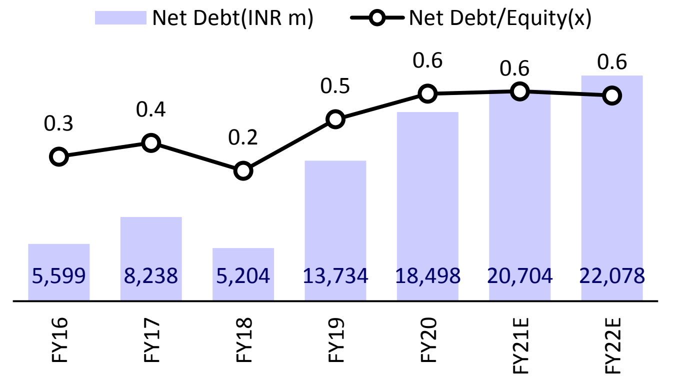
Source: MOFSL, Company

Exhibit 11: PAT and PAT growth trend



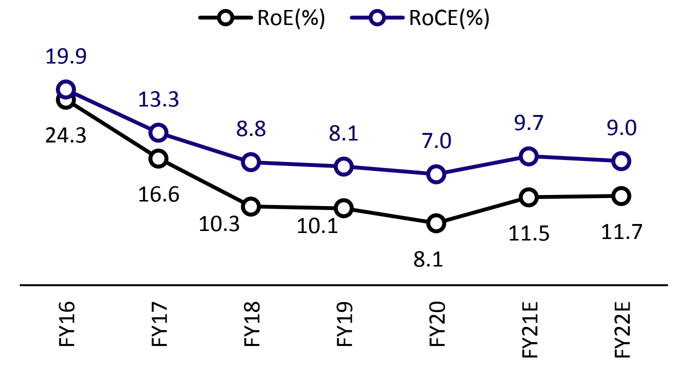
Source: MOFSL, Company

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	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**	**FY21E**	**FY22E**
Net Revenues from Ops	**57,141**	**57,665**	**62,834**	**69,845**	**67,788**	**71,118**	**81,759**
Change (%)	-0.7	0.9	9.0	11.2	-2.9	4.9	15.0
EBITDA	**8,223**	**6,568**	**6,148**	**6,425**	**7,238**	**8,961**	**10,710**
Margin (%)	14.4	11.4	9.8	9.2	10.7	12.6	13.1
Depreciation	1,075	1,431	1,686	1,927	2,765	3,356	3,516
EBIT	**7,148**	**5,137**	**4,462**	**4,498**	**4,473**	**5,605**	**7,195**
Int. and Finance Charges	907	817	974	880	1,509	1,937	2,168
Other Income	299	186	295	390	205	200	290
PBT bef. EO Exp.	**6,539**	**4,506**	**3,783**	**4,008**	**3,169**	**3,867**	**5,317**
EO Items	-114	-133	-340	-297	5	-218	0
PBT after EO Exp.	**6,425**	**4,373**	**3,443**	**3,711**	**3,174**	**3,650**	**5,317**
Total Tax	1,978	1,064	1,340	1,402	1,046	474	1,595
Tax Rate (%)	30.8	24.3	38.9	37.8	33.0	13.0	30.0
Minority Interest/Share of (profit) from JV	-18	-303	-277	-213	-184	-150	-200
Reported PAT	**4,465**	**3,611**	**2,380**	**2,522**	**2,312**	**3,325**	**3,922**
Adjusted PAT	**4,544**	**3,712**	**2,587**	**2,707**	**2,309**	**3,515**	**3,922**
Change (%)	41.4	-18.3	-30.3	4.6	-14.7	52.2	11.6
Margin (%)	8.0	6.4	4.1	3.9	3.4	4.9	4.8

Consolidated - Balance Sheet							(INR M)
Y/E March	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**	**FY21E**	**FY22E**
Equity Share Capital	405	405	405	405	405	405	405
Total Reserves	20,143	23,745	25,656	27,257	28,675	31,464	34,801
Net Worth	**20,547**	**24,150**	**26,061**	**27,661**	**29,079**	**31,868**	**35,205**
Minority Interest	322	292	234	238	237	237	237
Total Loans	6,632	9,240	6,467	14,469	18,772	24,272	25,272
Deferred Tax Liabilities	1,582	1,449	1,893	2,198	2,744	2,744	2,744
Capital Employed	**29,084**	**35,130**	**34,655**	**44,566**	**50,832**	**59,121**	**63,458**
Gross Block	21,394	27,017	31,123	37,663	50,231	59,816	74,116
Less: Accum. Deprn.	1,073	2,492	4,030	5,868	8,633	11,989	15,505
Net Fixed Assets	**20,321**	**24,525**	**27,092**	**31,795**	**41,598**	**47,827**	**58,611**
Goodwill on Consolidation	0	0	0	0	0	0	0
Capital WIP	2,991	3,263	3,100	8,329	10,685	7,800	2,000
Total Investments	**1,955**	**2,316**	**2,135**	**1,814**	**1,837**	**1,837**	**1,837**
Curr. Assets, Loans&Adv.	**15,813**	**19,066**	**19,137**	**22,111**	**19,410**	**22,884**	**25,343**
Inventory	6,397	9,435	7,846	10,056	9,257	8,685	9,927
Account Receivables	5,935	6,138	7,472	7,064	6,744	7,075	8,133
Cash and Bank Balance	630	359	863	735	274	3,568	3,194
Loans and Advances	2,850	3,134	2,956	4,256	3,135	3,556	4,088
Curr. Liability & Prov.	**11,996**	**14,039**	**16,810**	**19,484**	**22,697**	**21,226**	**24,332**
Account Payables	6,353	7,582	8,705	10,529	11,948	10,558	12,069
Other Current Liabilities	4,537	5,556	7,257	7,566	9,114	9,245	10,629
Provisions	1,106	902	848	1,389	1,635	1,422	1,635
Net Current Assets	**3,817**	**5,026**	**2,328**	**2,627**	**-3,288**	**1,658**	**1,010**
Appl. of Funds	**29,084**	**35,130**	**34,655**	**44,566**	**50,832**	**59,121**	**63,458**

E: MOFSL Estimates

Financials and valuations

Ratios							
Y/E March	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**	**FY21E**	**FY22E**
Basic (INR)							
EPS	**112.3**	**91.8**	**64.0**	**66.9**	**57.1**	**86.9**	**97.0**
Cash EPS	138.9	127.1	105.6	114.6	125.4	169.9	183.9
BV/Share	508.0	597.0	644.3	683.8	718.9	787.8	870.3
DPS	11.5	11.5	11.5	12.0	12.0	11.0	12.0
Payout (%)	12.0	15.5	23.6	23.2	25.3	16.1	14.9
Valuation (x)							
P/E	10.2	12.5	17.9	17.1	20.1	13.2	11.8
Cash P/E	8.3	9.0	10.9	10.0	9.1	6.7	6.2
P/BV	2.3	1.9	1.8	1.7	1.6	1.5	1.3
EV/Sales	0.9	1.0	0.8	0.9	1.0	0.9	0.8
EV/EBITDA	6.4	8.4	8.5	9.4	9.0	7.5	6.4
Dividend Yield (%)	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Return Ratios (%)							
RoE	24.3	16.6	10.3	10.1	8.1	11.5	11.7
RoCE	19.9	13.3	8.8	8.1	7.0	9.7	9.0
RoIC	23.0	14.7	9.4	9.0	8.4	11.6	9.8
Working Capital Ratios							
Fixed Asset Turnover (x)	2.7	2.1	2.0	1.9	1.3	1.2	1.1
Asset Turnover (x)	2.0	1.6	1.8	1.6	1.3	1.2	1.3
Inventory (Days)	41	60	46	53	50	45	44
Debtor (Days)	38	39	43	37	36	36	36
Creditor (Days)	41	48	51	55	64	54	54
Leverage Ratio (x)							
Current Ratio	1.3	1.4	1.1	1.1	0.9	1.1	1.0
Interest Cover Ratio	7.9	6.3	4.6	5.1	3.0	2.9	3.3
Net Debt/Equity	0.3	0.4	0.2	0.5	0.6	0.65	0.6

Consolidated - Cash Flow Statement							(INR M)
Y/E March	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**	**FY21E**	**FY22E**
OP/(Loss) before Tax	5,869	4,373	3,443	3,560	2,871	3,867	5,317
Depreciation	1,077	1,431	1,686	1,927	2,765	3,356	3,516
Interest & Finance Charges	-74	-55	974	880	1,509	1,737	1,878
Direct Taxes Paid	-1,686	-1,017	-979	-808	-181	-474	-1,595
(Inc)/Dec in WC	820	-2,174	1,667	235	2,582	-1,652	273
CF from Operations	**6,006**	**2,558**	**6,791**	**5,794**	**9,546**	**6,835**	**9,389**
Others	1,015	789	-34	-267	17	-218	0
CF from Operating incl EO	**7,021**	**3,347**	**6,757**	**5,527**	**9,563**	**6,617**	**9,389**
(Inc)/Dec in FA	-7,137	-5,824	-4,872	-11,073	-11,183	-6,700	-8,500
Free Cash Flow	**-117**	**-2,477**	**1,885**	**-5,547**	**-1,620**	**-83**	**889**
(Pur)/Sale of Investments	2,491	-333	376	320	9	0	0
Others	321	722	345	236	419	200	290
CF from Investments	**-4,326**	**-5,434**	**-4,151**	**-10,517**	**-10,755**	**-6,500**	**-8,210**
Issue of Shares	0	0	0	0	0	0	0
Inc/(Dec) in Debt	-1,354	2,963	-523	6,260	3,854	5,500	1,000
Interest Paid	-930	-765	-973	-889	-1,925	-1,937	-2,168
Dividend Paid	-979	-7	-528	-526	-1,139	-536	-585
Others	0	0	-1	0	0	150	200
CF from Fin. Activity	-3,264	2,191	-2,025	4,844	790	3,177	-1,552
Inc/Dec of Cash	**-569**	**104**	**582**	**-146**	**-402**	**3,294**	**-374**
Opening Balance	706	137	240	822	675	274	3,568
Closing Balance	**137**	**240**	**822**	**675**	**274**	**3,568**	**3,194**

NOTES

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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