Contraire

BONANZA WEALTH MANAGEMENT RESEARCH

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CEAT – BUY
16th january 2020

CMP : 1020
Target Price : 1298
Upside : 27%+
Stop Loss : 888 (closing basis)

About the Company:

CEAT, the flagship company of the RPG Enterprises was incorporated in 1958, is among the best tyre manufacturers in India. Besides tyres, the company also manufacture and markets tubes and flaps. Today, CEAT is one of India's leading tyre manufacturers and has strong presence in global markets. CEAT produces over 15 million tyres a year and offers the widest range of tyres to all segments and manufactures world-class radials for: heavy-duty trucks and buses, light commercial vehicles, earthmovers, forklifts, tractors, trailers, cars, motorcycles and scooters as well as auto-rickshaws.By segment, replacement, OEM and exports accounted for 61%, 23% and 14% of its sales, respectively, in FY18E CEAT's global presence includes: a JV with Associated CEAT Holdings Company Private Limited (ACHL), which operates three manufacturing plants owned by its joint venture company CEAT-Kelani Holding Company Private Limited, and is in the process of setting up a Greenfield facility for manufacture of automotive bias tyres in Bangladesh with an initial capacity of 65MT per day by investing US$55mn.

Investment Thesis

Management guided for total capex of Rs3500 Cr for FY19- 21E. FY19E capex of Rs 1300 to 1500 Cr out of which they have spent around Rs 440 Cr of capex till now, Capex guidance for FY20 at Rs 1500 to 1700Cr. Company took a price hike of 4% in 2W segment in October'18 Price hike happened industry level in month of Oct 2018 and not just at once company level and therefore that the confidence is higher & 2% price increase in TBR.They have taken a price hike of about 5% say on a YTD basis across all categories.

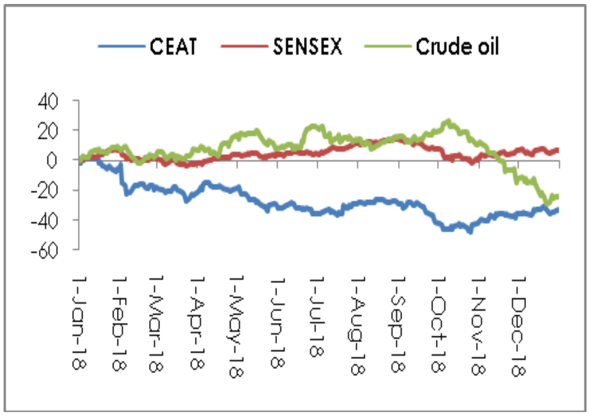
OTR 1st phase ramp-up has begun with 33 tons/day capacity which will go up to 100tons/day capacity.2W capacity expected to go to 3mn tyres/month by FY20 from currently 2mn tyres/month. (TBR)Truck radial capacity coming up in 4QFY19 will also help with that which will have capacity of 80,000 tyres / month with 1.5 years to reach full capacity. The plant is expected start of at 3000-5000 tyres / month and may ramp up with 3000-4000 tyres every month. While PCR capacity to come on stream from July-Aug'19. This would help in attaining a strategic product mix while scaling up revenue contribution from focus areas, thereby driving margin expansion.

Over FY11–18, CEAT's transformation from a predominantly truck & bus (T&B) player more than 55% of industry revenue to a star in the small, but highly-profitable passenger segment was driven by its strategy of differentiated distribution reach and building a strong brand. Within the segment, the initial focus was on 2W, leading to a strong market share gain. The company aims to replicate its success in 2W in the four-wheeler (4W) space. It is focusing on UVs, which account for 25% of the 4W industry and expanding capacity to tap potential demand in the segment. The company is also expanding capacity in the truck and bus radial (TBR) tyre segment, which has benefitted from higher demand in recent years.Since FY10, CEAT has significantly increased its focus on high-margin segments (2W, PV,specialty tyres), and has gained market share in the domestic 2W/UV segment even as domestic auto demand struggled. Increasing exposure in these segments helped both topline and operating performance expect the trends to continue as CEAT further transforms itself into a more focused, profitable entity. Current capacity utilization of Halol plant TBR is 80% with 60-70k tyres/month. Post ramp-up, the peak production could be in the vicinity of 120k tyres/month. 2W plant of CEAT is currently operating at 85-90% utilization (Nagpur plant is WIP).

Stock Details	
Market Cap (RsCr)	4103.26
BSE Code	500878
NSE Code	CEATLTD
Sector/Index	Tyre/S&P BSE 500
Year End	March
52 w.High/Low	1178/731
Shares in Issue (cr)	4
BSE Sensex	41933
NSE Nifty	12,321

Shareholding Pattern	
Indian Promoters	51.0%
DIIs	10.4%
FIIs	21.5%
Public & others	17.1%

Key Ratios	
Div Yield	0.9%
TTM PE	16.0
ROE	11.5%



The PCR plant is running at full capacity and the Chennai plant will commission from the middle of Feb'20. OHT plant is currently at 50% utilization. The plant is expected to turn profitable at 75-80% utilization level in next 6 months they are trying to achieve. The Company remains focused on OHT export to EU.

Financials

During the past 5 years, revenue of CEAT's grew at a CAGR of 15% while PAT grew at a CAGR of 13% in the same period.

Particulars	FY17	FY18	FY19	FY20E	FY21E
Net Revenue	5701.7	6161.3	7343.1	8444.6	9880.1
EBITDA	666.9	617.8	675.6	1030.2	1225.1
EBITDA Margin	11.7%	10.0%	9.2%	12.2%	12.4%
Net Profit	362.7	278.7	284.2	443.6	588.0
Growth	-18.5%	-23.2%	2.0%	56.1%	32.5%
Net Profit Margin	14.5%	16.1%	16.0%	15.8%	15.6%
Adjusted EPS	89.7	68.9	70.3	109.7	145.4
ROE	17.0%	11.5%	10.7%	14.9%	17.1%
RoCE	18.6%	15.1%	14.5%	19.1%	20.2%

Key Business Highlights

The tyre industry in India has been seeing strong volume growth, driven by buoyant aftermarket demand, especially in the truck & bus (T&B) segment. The price of the key input -natural rubber (NR) has been down by 17.5%. The only noteworthy concern for the industry has been the sharp rise in crude-linked commodities (synthetic rubber-SR,carbon black-CB, chemicals, etc.). With the recent correction in crude price, the earnings outlook for tyre-makers has improved substantially. Valuations came off with margin pressure; there is scope for re-rating due to better earnings visibility. Recent weakness in OEM sales is not a big concern;OEM segment is a small revenue contributor vs. after-market.

Q3 FY20 result Update.

Soft commodities aid gross margin improvement: Gross margin improved 150bps YoY / 183bps QoQ led by soft commodity prices driven by petrochemical derivatives and superior product mix The rise in natural rubber prices in Q3 may have an adverse impact on gross margins in Q4.Ongoing Capex and debt: The Company has revised its standalone capex outlook to Rs 3000 Cr (vs Rs 3500 Cr earlier) which is to be incurred over FY19-22E Out of the total capex outlay, the company has incurred Rs 1900 Cr and has spent Rs 880 Cr till date for FY20e. The Halol capacity has reached 35% utilization leves. The consolidated debt stands at Rs 1880 Cr with D/E ratio at 0.65x. Volume expansion drives revenue: Consol revenue increased 3.6% QoQ at Rs1760 Cr. Volumes increased +2% YoY as OEM volume declined -8-9% YoY while replacement and exports grew +8-10%. Realizations remained flat QoQ. Lower RM cost and favorable mix resulted in gross margins expansion at 43% (+150bps YoY/180bps QoQ). However, this was partially offset by higher other expenses at Rs.430 Cr resulting into consolidated EBITDA margins at 10.4%

View and Valuation

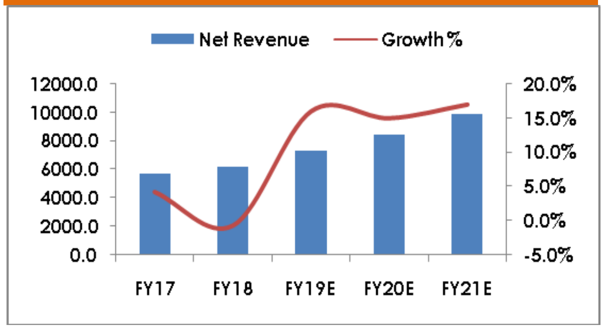
As initial signs of stability in OEM volumes, low base in replacement business and new capacities, CEAT should see faster revenue growth in FY21-22. This coupled with benign natural rubber prices should aid strong EPS growth. Valuations at 8.41x FY21E consol. EPS doesn't fully capture the benefit of substantial capacity addition. Buy with TP of Rs 1,298(8.41x Dec'21,EPS).

Risk & Concern

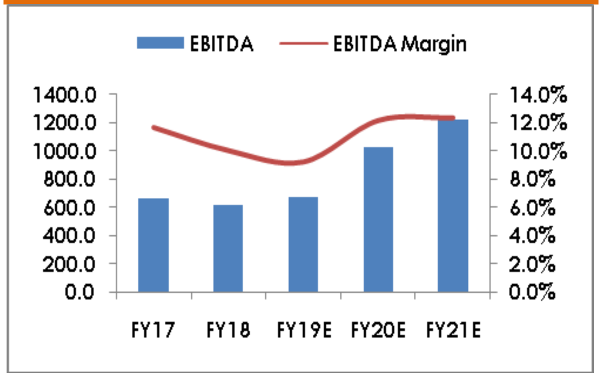
Rising Chinese imports
Intensifying competition in 2W
Commodity price inflation
Slower capex spend

Graphs & Charts

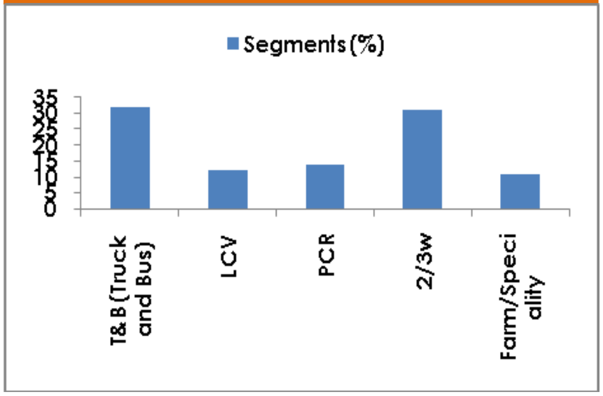
Net Sales Trend



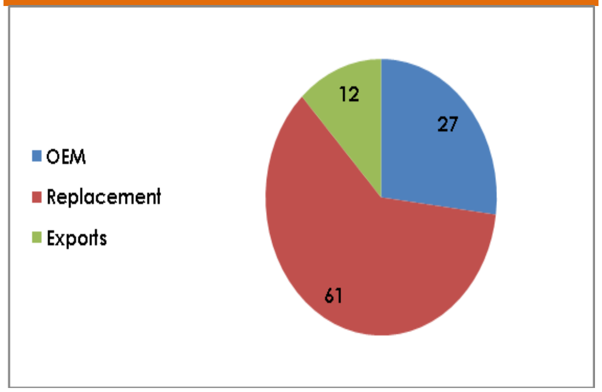
EBITDA & EBITDA Margin Trend



Revenue split FY18



Channel Mix FY18



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