27 July 2015

# India Auto-Tyre Segment

Sensex: 27561

Nifty: 8361

*Revving up*

**We are positive on the tyre segment given that this is one of the rare occasions when OEM and replacement demand are expected to rise in unison. With rubber prices low, we expect tyre companies to register higher margins. We reckon that the threat from Chinese manufacturers would be mitigated by government action as was done a few years ago. Our top picks are Ceat, Apollo and MRF.**

**Robust demand driven by the OEM and replacement segments.** This is one of the rare occasions when we expect both OEM and replacement demand to rise in unison. Following flattish to negative growth during 2013-15, we expect domestic tyre demand through 2015-17 to grow 13-15%, driven by strong replacement growth and OEM demand. M&H CVs, two-wheelers and passenger vehicles are likely to support the growth, while we expect negative to flattish growth from tractors and LCVs.

**Low rubber prices to assist margins.** Rubber constitutes ~70% of the raw-material costs of a typical tyre company. The global outlook and soft off-take of Chinese manufacturers on account of weak demand and the shift to "greener" tyres could result in lower demand for natural rubber, thereby keeping prices low. Thus, we expect tyre companies to benefit from lower raw-material costs.

**Competition—Chinese threat.** Imports of truck and bus radial tyres (TBR) in 2014-15 rose 60% yoy, from 490,000 to 780,000 units. In the replacement segment, the market share of manufacturers in China has risen from 15% in FY14 to 25% in FY15. The risk to Indian companies is real. However, we are reasonably confident that the government would impose anti-dumping duties (as was done by the US in Jun'15).

**Top picks.** We initiate coverage on Ceat (Buy, TP: ₹1,020), MRF (Buy, TP: ₹43,500), Apollo (Buy, TP: ₹244) and JK Tyres (Buy, TP: ₹115). We prefer Ceat given its higher revenue growth (13% CAGR over FY15-17e) and margin expansion (120bps) resulting in high earnings growth (25% CAGR over FY15-17e). We also like MRF and Apollo given their high revenue from replacement demand (~70%). We maintain our Buy rating on Balkrishna.

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| Key Data | Reco | Market Cap (₹ bn) | CMP (₹) | Target Price (₹) | Upside (%) | Revenue CAGR (FY10-17) (%) | EBITDA CAGR (FY10-17) (%) | EBITDA Margin (FY17e) (%) | PAT CAGR (FY10-17) (%) | ROCE (FY17e) (%) | ROE (FY17e) (%) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Ceat | Buy | 33 | 805 | 1,020 | 26.7 | 14.4 | 18.2 | 11.4 | 16.4 | 22.8 | 24.6 |
| Apollo | Buy | 100 | 197 | 244 | 23.7 | 9.6 | 9.7 | 15.1 | 9.5 | 19.0 | 19.4 |
| MRF (FY15e) | Buy | 162 | 38,100 | 43,500 | 14.2 | 13.6 | 19.9 | 18.0 | 9.5 | 17.4 | 24.8 |
| JK Tyres | Buy | 23 | 100 | 115 | 15.0 | 10.1 | 7.4 | 12.7 | 1.5 | 17.8 | 23.1 |
| Balkrishna | Buy | 67 | 697 | 742 | 8.8 | 20.6 | 16.7 | 26.8 | 13.7 | 17.3 | 21.5 |

*Source: Company, Anand Rathi Research; Note: Prices as 23 July 2015*

# India Auto-Tyre Segment

*Revving up*

# Domestic replacement and OE demand to pick up over FY15-17

**Following flattish to negative growth during FY13-15, we expect domestic tyre demand through FY15-17 to grow 13-15%, driven by strong replacement growth and OEM demand. M&H CVs, two-wheelers and passenger vehicles are likely to support the growth, while we expect negative to flattish growth from tractors and LCVs**

Following two years of slowdown in demand because of the economic deceleration, high inflation, contracted consumption and tight liquidity, the domestic automotive industry is experiencing a gradual recovery in FY15-16. In the medium and heavy commercial vehicle (M&H CV) sub-segment, we expect strong demand revival (30% CAGR over FY15-17); the two-wheeler and passenger-car sub-segments continue growing at a decent pace at a 10% CAGR over FY15-17. The tractor and light-commercial-vehicle (LCV) sub-segments are struggling.

**Fig 1 – Segment Preference**

| Rank | |
|---|---|
| 1 | M&H CVs |
| 2 | PVs |
| 3 | Two-wheelers / Three-wheelers |
| 4 | LCVs |
| 5 | Tractors |

*Source: Anand Rathi Research*

**Fig 2 – Revenue break-up**

| (%) | CV | PV | 2w / 3w | OHT | LCV | Others |
|---|---|---|---|---|---|---|
| Ceat | 41.0 | 10.0 | 23.0 | 7.0 | 13.0 | 6.0 |
| Apollo | 46.0 | 36.0 | - | 11.0 | 6.0 | 1.0 |
| MRF | 48.0 | 11.0 | 29.0 | 11.0 | - | 1.0 |
| JK Tyres | 68.0 | 14.0 | - | 7.0 | 11.0 | - |
| Balkrishna | - | - | - | 64.0 | - | 36.0 |

*Source : Company, Anand Rathi Research*

During FY11-13, new commercial-vehicle sales recorded a 16% CAGR, passenger-vehicle sales were up 11% while two-wheeler sales registered a 15% CAGR, clearly indicating higher replacement demand in year ahead.

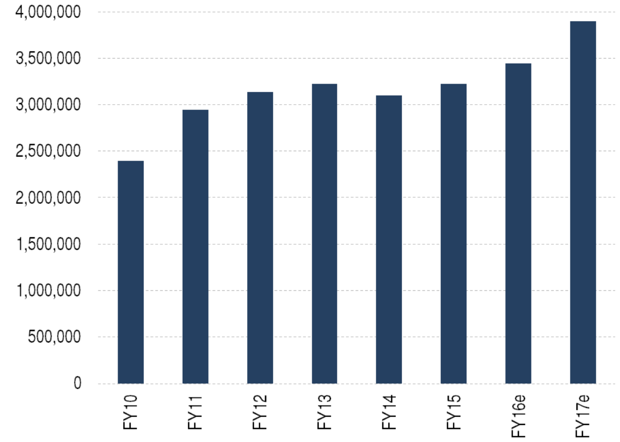
However, during FY13-15, new commercial vehicle sales declined (-8% CAGR), passenger vehicle sales grew (1% CAGR) and two wheeler sales grew (8% CAGR) clearly indicating postponement of demand. We expect this pent up demand in the OE segment.

The increase in freight rates and a lower base have supported M&H CV sales growth while LCVs experience demand contracting. The passenger vehicle (PV) sub-segment is aided largely by replacement demand. Growth in the tractor sub-segment is expected to be flattish to negative in FY15-16. Investment revival in infrastructure and manufacturing and an overall economic upturn are likely to lead to stronger demand for M&H CVs and a modest recovery in LCVs over the next two to three years.

For the next few years, the two-wheeler sub-segment may grow decently (10-12% CAGR), supported by favourable demographics and modest penetration. The growth in passenger cars is expected to revert to long-term growth trends as the economy turns favourable. Tractor demand may be sluggish in the near term

We expect domestic tyre demand to grow 13-15% over FY15-17, driven by strong growth in replacements and revival in the OEM segment.

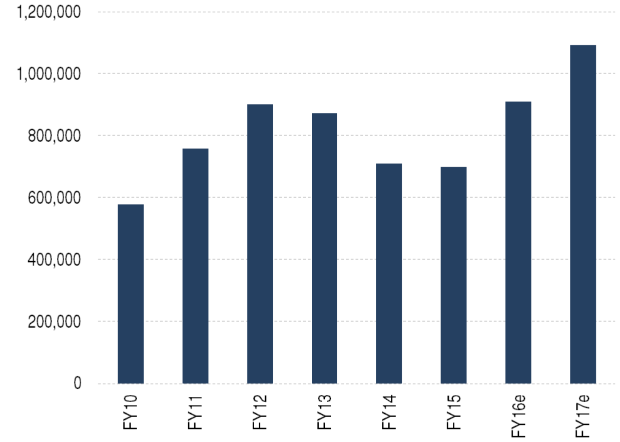
**Fig 3 – India passenger vehicle sales (in units)**




*Source: SIAM, Anand Rathi Research*

We expect the passenger vehicle industry to register a 10% CAGR during FY15-17.

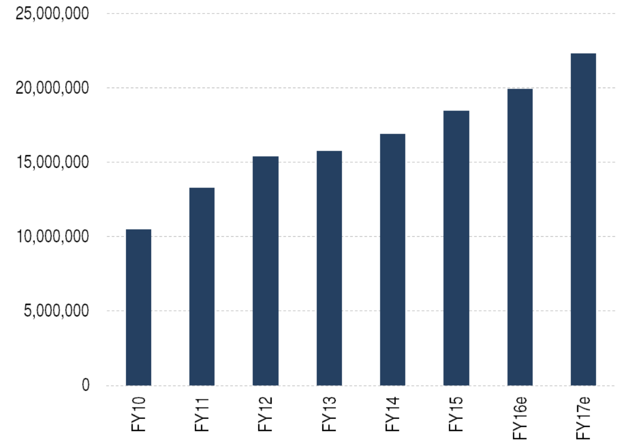
**Fig 4 – India commercial-vehicle sales (in units)**




*Source: SIAM, Anand Rathi Research*

We expect the M&HCV segment to record a 25% CAGR during FY15-17.

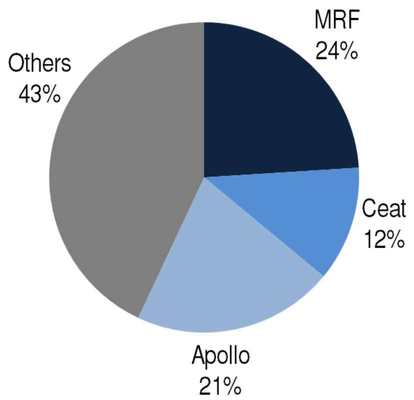
**Fig 5 – India two-wheeler sales (in units)**




*Source: SIAM, Anand Rathi Research*

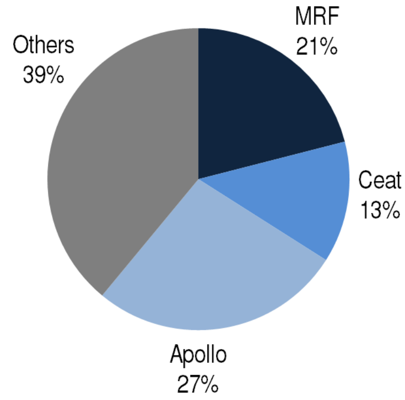
We expect the two-wheeler industry to see a 10% CAGR during FY15-17.

**Fig 6 – Commercial-vehicle-tyre market share**



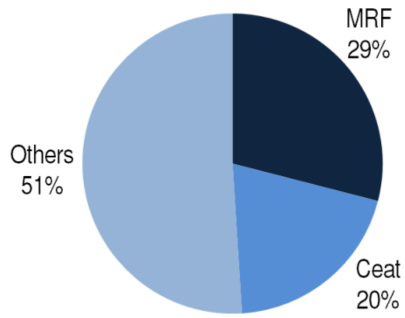

*Source: ATMA*

**Fig 7 – Passenger-vehicle-tyre market share**




*Source: ATMA*

**Fig 8 – Two/three-wheeler-tyre market share**




*Source: ATMA*

**Capex in full swing as tyre makers gear up to ride the next growth wave in automobiles.** The Automotive Tyre Manufacturers Association (ATMA) states that, anticipating strong demand, the industry is expanding capacities across sub-segments. A huge amount has been spent on greenfield facilities. The industry has recently spent over ₹260bn on capex expansion.

**Fig 9 – Capex details**

| Projects | TBR (units) | PCR (units) | 2W / 3W (units) | OTR / Specialty (MT) | Others (MT) | Investments (₹ bn) |
|---|---|---|---|---|---|---|
| Recently Commissioned | 466,000 | 1,826,000 | 450,000 | - | 4,167 | 117 |
| Greenfield | 102,500 | 952,000 | 729,200 | 86,400 | - | 77 |
| Brownfield | 171,000 | 642,000 | - | 6,310 | 66,750 | 66 |
| Total | **739,500** | **3,420,000** | **1,179,200** | **92,710** | **70,917** | **260** |

*Source: ATMA*

**Tyre exports to grow 6-8% in FY15-17; anti-dumping duty on Chinese tyres by the US to generate new opportunities for Indian tyre makers.** Growth in tyre exports has decelerated in the last two years due to restrained overseas demand. In FY13-14 India's tyre exports (by value) amounted to ₹102bn. Ahead, we expect tyre exports to grow 6-8% over FY15-17, partly assisted by the imposition of anti-dumping duties on Chinese tyres by the US and partly by the depreciating rupee.

# Rubber prices to be low; aid margins

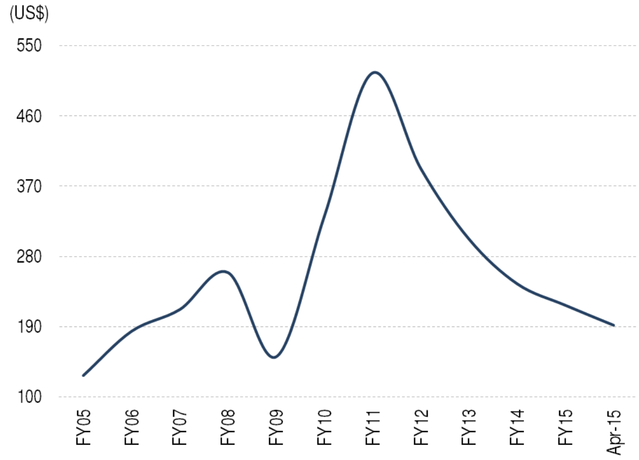
**Rubber constitutes ~70% of the raw-material costs of a typical tyre company. The global outlook and soft off-take of China manufacturers on account of weak demand and the shift to "greener" tyres could result in lower demand for natural rubber, thereby holding prices low. Thus, we expect tyre companies to continue to reap the benefits of lower raw material costs.**

Natural rubber is the most crucial input. Although India is one of the major producers of natural rubber in the world, a significant demand-supply gap exists.

Economists worldwide have predicted lower to stagnant growth for the Chinese economy, emphasising that crude-oil and rubber prices may be soft in the near future. Thus, tyre companies will continue to benefit from lower raw material costs.

**Plunge in crude oil prices brings down prices of synthetic rubber and other rubber chemicals:** Swelling oil supplies partly because of the US shale-oil boom and the demand slowdown in Europe, Japan and China have led to the plunge in oil prices in the last few months. Accordingly, the prices of crude derivatives (synthetic rubber), carbon black and caprolactum (feedstock for nylon-tyre-cord fabric) have been falling in recent months.

**Fig 10 – RSS-3 and RSS-4 grade rubber price movements in dollars (Kerala)**




*Source: ATMA, Anand Rathi Research*

# Natural rubber: The margin maker/ breaker

## Production deficit

The table below shows a major shortfall in the production of the raw material required by the tyre sector. The significant gap leaves no choice but to import the quantity required. While certain raw-material shortages are ~70%, there are a couple of items that are not at all produced in India.

**Fig 11 – Raw-material shortfall**

| | Domestic Production | Domestic Consumption | Shortfall | % |
|---|---|---|---|---|
| Nylon tyre-cord fabric | 65,000 | 125,000 | 60,000 | 48.0 |
| Rubber chemicals | 35,000 | 55,000 | 20,000 | 36.4 |
| Steel tyre cord | 15,000 | 40,000 | 25,000 | 62.5 |
| Polyster tyre cord | 3,000 | 9,000 | 6,000 | 66.7 |
| Polybutadine rubber (PBR) | 85,000 | 113,000 | 28,000 | 24.8 |
| Process oil | 96,000 | 150,000 | 54,000 | 36.0 |
| Styrene butadiene rubber (SBR) | - | 110,000 | 110,000 | 100.0 |
| Butyl rubber | - | 58,000 | 58,000 | 100.0 |

*Source: ATMA*

In May 2015 natural rubber production in India declined 9.4% yoy to 48,000 tonnes according to the latest estimate from the Rubber Board. Imports dipped as well, by 0.7% to 34,448 tonnes during the same period while consumption rose 2.4% to 84,000 tonnes.

According to a study conducted by The Rubber Research Institute of India, extreme temperatures are becoming more frequent in recent years in Kottayam, the major rubber-growing area in Kerala, and the impact of changing climate in this region may seriously affect rubber cultivation.

If the prediction about a rain shortfall is correct, rubber production may go down further in 2015 and a shortage-induced price rise cannot be ruled out.

The situation would be similar in the major rubber-growing countries of Southeast Asia as the El Nino phenomenon is forecast to affect the Asian region as a whole. The warm and dry weather caused by El Nino may constrict production of latex in coming months.

**Fig 12 – Production of Asian manufacturers**

| | 2013 | 2014 |
|---|---|---|
| Production In India (tonnes) | 796,000 | 705,500 |
| *Growth (%)* | *-13.4* | *-11.4* |
| | | |
| Production in Thailand | 4,170,000 | 3,997,000 |
| *Growth (%)* | | *-4.1* |
| | | |
| Production in Indonesia | 3,237,000 | 3,152,200 |
| *Growth (%)* | | *-2.6* |
| | | |
| Production in Malaysia | 826,400 | 655,000 |
| *Growth (%)* | | *-20.7* |

*Source: The Rubber Association of India,*

## Natural rubber: Why there is a so-called "inverted duty structure" and why we believe it will persist

In an "inverted duty structure", import duty on a finished product is lower than that on the raw material. This discourages domestic value addition. Currently, duty on Chinese tyres is 10%, while duty on imports of the raw material (natural rubber) is 20%.

Despite significant representation by the Tyre Association regarding its reversal, this has continued in order to protect domestic producers of natural rubber.

From a peak of ₹250/kg in 2011, the price of natural rubber in India has slid to ₹116, a 46% fall in three years. Considering the rise in cost of inputs, rubber cultivation will be profitable, farmers feel, only if they get at least ₹150-175/kg.

The Rubber Farmer Protection Committee is pressing its demand for immediate steps for a price rise. They want the government to urgently ban rubber imports and to procure rubber at a higher price.

The government recently raised duty on imported natural rubber, from 20% to 25%. This furthers our belief that this inverted duty structure on natural rubber and imported tyres will persist.

## 'What if' analysis: What if prices of natural rubber rise?

Prices of crude oil and natural rubber depend more on geopolitical issues than on pure demand and supply.

We take a what-if approach. Tyre companies are greatly affected by raw material prices. Any significant rise in prices of natural rubber dents the margins of most tyre manufacturers.

We believe that low prices may continue. China's imports of natural and synthetic rubber tumbled 20% in May 2015 yoy to 280,000 tonnes, according to preliminary trade data released by the country's General Administration of Customs. Some of the major companies are reducing production consequent on the US government's decision to raise anti-dumping duties on Chinese tyres. Another negative sentiment is that China may adopt, w.e.f. Jul'15, a new standard for compounded rubber, which cuts natural rubber content from 95% to 88%.

One buffer that, we believe, companies have established for themselves is the passing on of price rises. In the last 15 months, prices of tyres have either been flat or come off 1-2%. So, the companies can very easily pass on to end-consumers any slight increase in costs. This would help them protect margins in the near term.

# Chinese tyres

**Imports of truck and bus radial tyres in FY14-15 rose 60% yoy, from 490,000 to 780,000 units. In the replacement segment, the market share of China's manufacturers has risen from 15% in FY14 to 25% in FY15. The risk to Indian companies is real. However, we are reasonably confident that the government might impose anti-dumping duty (as was done by the US in Jun'15).**

## Background

CY14 was a bumper year for China's tyre industry. The falling price of natural rubber helped in substantial cost reduction for tyre vendors. Despite their shrunken revenue in CY14, almost all tyre producers saw higher profit margins. This continues in CY15, reflected in the falling price of natural rubber and the slight decline in tyre prices.

On 22nd Mar'15, the state-owned China National Tire & Rubber acquired a controlling stake in the world's fifth-largest tyre company, Pirelli. For a long time, Chinese tyre makers have not found a way into the field of sedan (OE) tyres. Hence, they primarily aimed at radials and the truck-tyre markets. Pirelli is the most important tyre supplier for BMW and the second-largest for Mercedes-Benz; it is also one of Ford's main suppliers. Through the Pirelli acquisition, China has begun to supply OE tyres for luxury cars.

China's tyre industry, especially for truck tyres, is plagued with serious over-capacity. Along with a decline in China's fixed investments and real estate, demand for trucks has sharply contracted. The highly competitive highway logistics sector sees low profits and minimises tyre changes. The US anti-dumping investigation hit China's tyre companies had, but more truck-tyre capacity in China is yet becoming operational. In 2015, new tyre capacity hit 120 million, with 20-25% overcapacity.

## Concerns about Chinese imports to India

Indian tyre makers have more reason to worry than ever before. China's tyre industry, the largest in the world, is estimated to experience a rapid 10% CAGR until 2020. The leading Chinese tyre companies are upgrading technology and scale to meet global norms.

India's increasing tyre imports from China have been a mounting cause of concern. In the wake of the global downturn, tyre demand from the United States, to which China exports the most tyres, has slackened. As a consequence, the Chinese economy is trying to sustain itself by thrusting its manufacturing produce into fast-growing developing economies such as India.

Chinese radial tyres are 25% cheaper than such tyres manufactured in India and thus command good replacement demand.

Domestic manufacturers strongly believe that a huge chunk of growth in replacement demand has been captured by such Chinese imports.

In 2014-15 imports of truck and bus radial tyres increased 60% yoy from 490,000 units to 780,000. Roughly 25% of domestic replacement demand for TBRs is met through imported tyres, says the Automotive Tyre Manufacturers Association.

China's share of tyre imports to India is now ~70%. The ATMA is of the view that huge surplus capacities and export subsidies in China have led to manufacturers there dumping tyres into India's replacement market. The domestic price in China is higher than the export price.

## How serious is the Chinese threat?

**China capturing domestic replacement market.** In CY14 China's tyre exports to India rose by over 50% for a couple of reasons. First, in Sep'14 India relaxed anti-dumping duties on Chinese tyres, leading to a surge in such imports toward the year-end. This was alongside the US proposal for anti-dumping duties (now effective) on imports of Chinese tyres. With the US charging anti-dumping duties of up to 87.99% on Chinese tyres and no similar duties in India, Chinese tyres have flooded India. Without appropriate remedial measures in India, such a trend is likely to persist.

**Correction of inverted duty structure.** While import duty on natural rubber is now 25%, that on tyres could be as low as 5% under various trade treaties. While given the falling prices of natural rubber, duty on such products are unlikely to be reduced, import duty on tyres are likely to increase.

**Re-imposition of antidumping duty.** With the imposition of anti-dumping duty by the US on Chinese tyre imports, the case for its re-imposition in India gets stronger. While the Indian tyre companies have been arguing for it for some time, the chances of it being acted upon by the Indian government now looks stronger.

**Reduced emphasis on exports by China.** A part of the recent slowdown in China is a deliberate attempt of the Chinese authorities to move away from an economic strategy of overt dependence on infrastructure investment and aggressive export promotion to a more domestic demand-, especially consumption, -oriented strategy. As a part of this, subsidies, especially on power and interest rate, are being withdrawn. To the extent tyres exports by the Chinese companies depend on such subsidies, the prices of Chinese tyre exports are likely to rise, leading to loss of competitiveness.

# Valuations and Recommendations

**We initiate coverage on Ceat, MRF, Apollo Tyres and JK Tyres. We prefer Ceat given its higher revenue growth (a 13% CAGR over FY15-17e) and margin expansion (120bps) resulting in high earnings growth (a 25% CAGR over FY15-17e). We also like MRF and Apollo given their high revenue from replacement demand (~70%). We maintain our Buy rating on Balkrishna.**

**Fig 13 – Peer comparison (FY15 - FY17e)**

| (%) | Revenue CAGR | EBITDA CAGR | EBITDA Margin | PAT CAGR |
|---|---|---|---|---|
| Ceat | 13.4 | 19.1 | 11.4 | 25.0 |
| MRF (FY15e) | 13.0 | 7.5 | 18.0 | 12.2 |
| Apollo | 10.0 | 8.1 | 15.0 | 12.2 |
| Balkrishna | 11.3 | 5.5 | 24.0 | 10.2 |
| JK | 10.7 | 12.3 | 13.3 | 20.9 |

*Source : Company, Anand Rathi Research*

**Fig 14 – Revenue break-up**

| (%) | CV | PV | 2w / 3w | OHT | LCV | Others |
|---|---|---|---|---|---|---|
| Ceat | 41.0 | 10.0 | 23.0 | 7.0 | 13.0 | 6.0 |
| Apollo | 46.0 | 36.0 | - | 11.0 | 6.0 | 1.0 |
| MRF | 48.0 | 11.0 | 29.0 | 11.0 | - | 1.0 |
| JK Tyres | 68.0 | 14.0 | - | 7.0 | 11.0 | - |
| Balkrishna | - | - | - | 64.0 | - | 36.0 |

*Source : Company, Anand Rathi Research*

**Fig 15 – Share in revenues**

| | Replacements (%) |
|---|---|
| Ceat | 61 |
| Apollo | 77 |
| MRF | 76 |
| JK Tyres | 60 |
| Balkrishna | 75 |

*Source: Company, Anand Rathi Research*

A significant share of Ceat, Apollo and MRF's revenues arises from the commercial-vehicle segment, which currently is our top preference for anticipated growth.

Two-wheeler segment tyres also contribute significantly to Ceat's and MRF's revenues.

Looking at all the parameters, we select **Ceat** as our top pick, followed by **Apollo Tyres** and **MRF**.

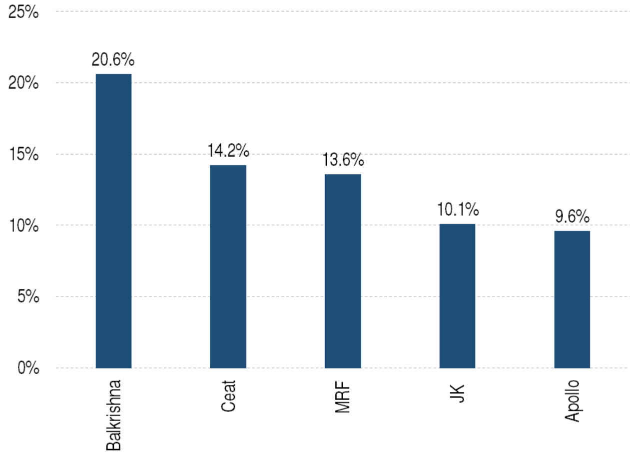
Our basic reasons for our selection are steady revenue growth, leading positions in the growth-oriented M&H CV and two-wheeler sub-segments and strong brand recall in the replacement market. Soft rubber prices would benefit all the companies but their leading position in different sub-segments helps command better margins than peers.

Ceat has traded at an average P/E of 9x during the last five years. We estimate 25% PAT growth during FY15-17 and an EPS of ₹113 in FY17. Based on 9x FY17e, we expect an upside of 27% at a target of ₹1,020.

Apollo Tyres has traded at an average P/E of 10x during the last five years. It currently trades at 8.1x FY17e. We value the company at 10x FY17e and expect a target price of ₹244 having a potential upside of 24%.

MRF may be the market leader, but we believe that this fact has been priced into the stock, which now trades at 10.5x FY17e. We estimate its EPS for FY17 at ₹3,628. We expect a price target of ₹43,500 giving an upside of 15%.

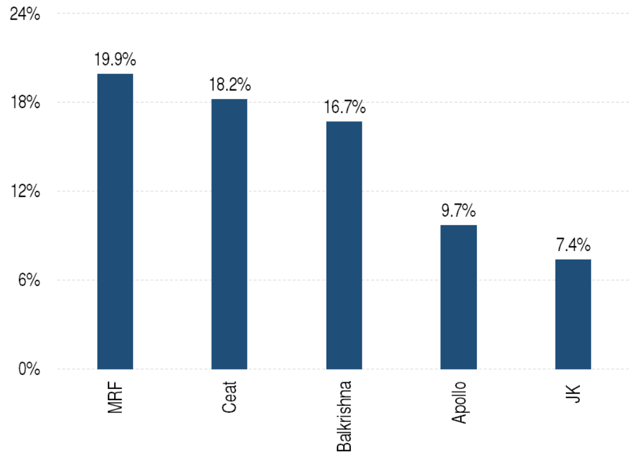
**Fig 16 – Revenue CAGR (%) FY10-17e**




*Source: Company, Anand Rathi Research*

The chart above depicts the FY10-17 revenue CAGR of the companies we cover. While Balkrishna saw significant growth in exports, Ceat registered growth in its two- and three-wheeler and passenger-vehicle tyre sales. Being an all-rounder, MRF grew in all segments. We expect this to continue. We believe that, ahead, Ceat and MRF are set to derive the maximum advantage from domestic growth.

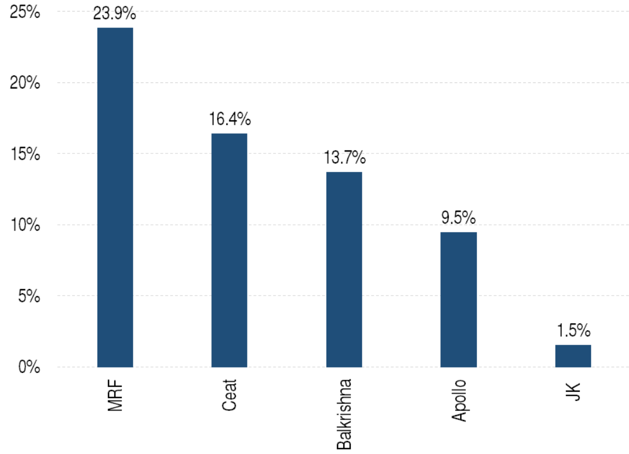
**Fig 17 – EBITDA CAGR FY10-17e (%)**




*Source: Company, Anand Rathi Research*

The chart above clearly depicts MRF's margin supremacy. Its strong brand recall, greater share of the replacement market and pricing power is clearly visible in its performance. Ceat is the second best for its leading position in the high-volume two- and three-wheeler sub-segments.

**Fig 18 – PAT CAGR FY10-17e (%)**




*Source: Company, Anand Rathi Research*

Due to its market leadership, we expect MRF to make the maximum profits, followed by Ceat. The strong growth in M&H CVs and in the replacement market would turn MRF the most profitable of the lot. Ceat, of course, due to its leading position in the high-volume two- and three-wheeler tyres, gains more due to its greater operating leverage.

### Fig 19 – Revenue comparison of the top-30 tyre vendors worldwide ($ m)

| CY | 2010 | 2011 | 2012 | 2013 | 2014 | CAGR (%) | Rank |
|---|---|---|---|---|---|---|---|
| Bridgestone | 28,200 | 28,593 | 31,965 | 30,989 | 29,136 | 0.8 | 1 |
| Michelin | 23,696 | 26,829 | 27,590 | 26,927 | 25,947 | 2.3 | 2 |
| Goodyear | 18,832 | 22,767 | 20,992 | 19,540 | 18,138 | -0.9 | 3 |
| Continental | 10,460 | 11,529 | 12,418 | 12,745 | 12,997 | 5.6 | 4 |
| Pirelli | 6,326 | 7,783 | 7,749 | 8,134 | 7,981 | 6.0 | 5 |
| Sumitomo | 5,838 | 6,716 | 7,463 | 6,973 | 6,903 | 4.3 | 6 |
| Hankook | 4,943 | 5,692 | 6,242 | 6,447 | 6,344 | 6.4 | 7 |
| Yokohama | 4,691 | 5,081 | 5,357 | 6,159 | 5,903 | 5.9 | 8 |
| Cheng Shin Tire | 3,256 | 4,268 | 4,631 | 4,478 | 4,248 | 6.9 | 9 |
| Zhongce | 3,345 | 4,286 | 4,558 | 4,529 | 3,790 | 3.2 | 10 |
| Giti Tyre | 3,870 | 4,189 | 3,970 | 3,817 | 3,710 | -1.1 | 11 |
| Cooper | 3,360 | 3,908 | 4,201 | 3,439 | 3,425 | 0.5 | 12 |
| Kumho | 3,026 | 3,435 | 3,595 | 3,378 | 3,265 | 1.9 | 13 |
| Toyo | 2,506 | 2,969 | 3,088 | 2,962 | 2,948 | 4.1 | 14 |
| Triangle Tyre | 2,262 | 2,601 | 2,709 | 2,712 | 2,849 | 5.9 | 15 |
| ***MRF*** | ***1,740*** | ***2,408*** | ***2,455*** | ***2,293*** | ***2,400*** | ***8.4*** | ***16*** |
| ***Apollo Tyres*** | ***1,943*** | ***2,271*** | ***2,448*** | ***2,214*** | ***2,235*** | ***3.6*** | ***17*** |
| Titan International | 882 | 1,487 | 1,821 | 2,164 | 1,896 | 21.1 | 18 |
| Nokian | 1,402 | 1,967 | 2,071 | 2,023 | 1,845 | 7.1 | 19 |
| Double Coin | 1,344 | 1,692 | 1,921 | 1,888 | 1,834 | 8.1 | 20 |
| Xingyuan Tire | 1,040 | 1,357 | 1,528 | 1,776 | 1,798 | 14.7 | 21 |
| Sailun Tire | 407 | 640 | 1,141 | 1,143 | 1,760 | 44.2 | 22 |
| Nexen | 1,157 | 1,472 | 1,684 | 1,578 | 1,670 | 9.6 | 23 |
| Linglong Tire | 1,429 | 2,324 | 2,068 | 1,884 | 1,660 | 3.8 | 24 |
| Aeolus Tyre | 1,199 | 1,586 | 1,431 | 1,456 | 1,325 | 2.5 | 25 |
| Shengtai Tire | 918 | 1,150 | 1,140 | 1,248 | 1,218 | 7.3 | 26 |
| ***JK Tyres*** | ***1,303*** | ***1,216*** | ***1,191*** | ***1,120*** | ***1,140*** | ***-3.3*** | ***27*** |
| P T Gajah Tunggal Tbk | 986 | 1,236 | 1,254 | 1,047 | 1,100 | 2.8 | 28 |
| Kenda | 911 | 1,021 | 1,063 | 1,119 | 1,068 | 4.1 | 29 |
| ***Ceat*** | ***760*** | ***966*** | ***897*** | ***1,002*** | ***958*** | ***6.0*** | ***30*** |

*Source: researchinchina.com*

# Company Section

ANANDRATHI

India I Equities

**Autos**

**Initiating Coverage**

**27 July 2015**

# Ceat

Rating: **Buy**
Target Price: ₹1,020
Share Price: ₹805

*Brand recall to aid growth; initiating, with a Buy*

**We initiate coverage on Ceat, with a Buy rating and a target price of ₹1,020. We reckon the focus on the two- and three-wheeler and passenger-car sub-segments and on creating strong brand awareness would not only offer stable revenue growth but also improve margins significantly.**

**Focus on non-CV sub-segments: Twin advantage.** Ceat has decided to strategically focus more on the passenger-vehicle, and two- and three-wheeler sub-segments. This we believe gives it a dual advantage. One, it avoids competition from its peers (including the Chinese), which are all aiming at CV radials. Two, it strengthens its leading position in two-wheelers.

**Robust distribution network and creating brand awareness.** With its all-India distribution network (more than 3,500 dealers, over 300 franchisees—CEAT Shoppe + CEAT hubs), the company plans to increase the number of Shoppes and Hubs and raise its budget for promotional expenses to generate stronger brand recall. It will continue to target market-share gains in its focused sub-segments, two-wheeler tyres, where it is the second-largest manufacturer with a 22—23% market share) and PCRs.

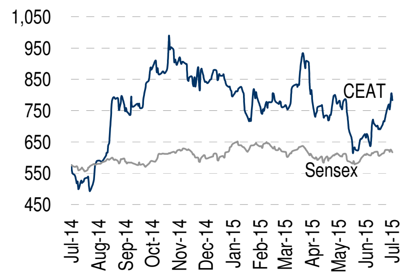
**Short-term consolidated margin to stabilise at ~12—13%.** The company's gradual shift toward two- and three-wheelers and to the passenger-vehicle sub-segments has not only provided it with steady revenue growth but also supported significant margin improvement.

**Valuation**. We initiate coverage on Ceat, with a Buy rating and a price target of ₹1,020 based on 9x FY17e, amid a 13% earnings CAGR over FY15-17e. **Risks:** Sharp upswing in rubber and crude prices; adverse cross-currency movements.

| Key data | CEAT IN / CEAT.BO |
|---|---|
| 52-week high / low | ₹1,010 / ₹485 |
| Sensex / Nifty | 27561 / 8361 |
| 3-m average volume | $6.3m |
| Market cap | ₹33bn / $0.5bn |
| Shares outstanding | 40m |

| Shareholding pattern (%) | June '15 | Mar '15 | Dec '14 |
|---|---|---|---|
| Promoters | 50.76 | 50.76 | 50.76 |
| *- of which, Pledged* | - | - | - |
| Free Float | 49.24 | 49.24 | 49.24 |
| - Foreign Institutions | 21.28 | 22.28 | 24.81 |
| - Domestic Institutions | 8.15 | 7.7 | 6.16 |
| - Public | 19.81 | 19.26 | 18.27 |

**Relative price performance**




*Source: Bloomberg*

| Key financials (Year-end: Mar) | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Sales (₹ m) | 48,815 | 53,548 | 55,917 | 62,487 | 71,946 |
| Net profit (₹ m) | 1,341 | 2,638 | 3,052 | 3,823 | 4,582 |
| EPS (₹) | 39.1 | 73.4 | 75.4 | 94.5 | 113.3 |
| Growth (%) | 1,289.6 | 87.4 | 2.8 | 25.3 | 19.9 |
| PE (x) | 20.6 | 11.0 | 10.7 | 8.5 | 7.1 |
| PBV (x) | 3.7 | 3.0 | 2.6 | 2.1 | 1.6 |
| RoE (%) | 18.0 | 27.3 | 24.6 | 24.2 | 23.0 |
| RoCE (%) | 20.9 | 26.8 | 22.8 | 24.9 | 25.8 |
| Dividend yield (%) | 0.5 | 1.2 | 1.0 | 1.2 | 1.5 |
| Net gearing (%) | 72.2 | 67.5 | 63.7 | 57.3 | 51.0 |

*Source: Company, Anand Rathi Research*

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mayurmilak@rathi.com

# Quick Glance – Financials and Valuations

## Fig 1 – Income statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Net revenues | 48,815 | 53,548 | 55,917 | 62,487 | 71,946 |
| Revenue growth (%) | 9.2 | 9.7 | 4.4 | 11.7 | 15.1 |
| - Oper. expenses | 44,570 | 47,364 | 49,530 | 54,738 | 62,953 |
| **EBITDA** | 4,245 | 6,184 | 6,387 | 7,748 | 8,993 |
| EBITDA margin (%) | 8.7 | 11.5 | 11.4 | 12.4 | 12.5 |
| - Interest expenses | 1,944 | 1,692 | 1,305 | 1,396 | 1,452 |
| - Depreciation | 782 | 826 | 879 | 981 | 1,051 |
| + Other income | 215 | 205 | 286 | 292 | 298 |
| - Tax | 394 | 1,234 | 1,439 | 1,841 | 2,206 |
| Effective tax rate (%) | 27.0 | 32.7 | 32.5 | 32.5 | 32.5 |
| Reported PAT | 1,064 | 2,538 | 2,990 | 3,823 | 4,582 |
| +/- Extraordinary items | | | | | |
| Adjusted PAT | 1,341 | 2,638 | 3,052 | 3,823 | 4,582 |
| PAT growth (%) | 1,289.6 | 96.8 | 15.7 | 25.3 | 19.9 |
| Adj. FDEPS (₹/sh) | 39.1 | 73.4 | 75.4 | 94.5 | 113.3 |
| Adj. FDEPS growth (%) | 1,289.6 | 87.4 | 2.8 | 25.3 | 19.9 |

*Source: Company, Anand Rathi Research*

## Fig 2 – Balance sheet (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Share capital | 342 | 360 | 405 | 405 | 405 |
| Reserves & surplus | 7,088 | 9,311 | 11,978 | 15,396 | 19,493 |
| Shareholders' fund | 7,466 | 9,671 | 12,383 | 15,801 | 19,898 |
| Minority interest | | | | | |
| Debt | 9,396 | 9,973 | 11,973 | 11,473 | 10,973 |
| Deferred tax / others | 745 | 1,091 | 1,091 | 1,091 | 1,091 |
| **Capital employed** | **17,608** | **20,735** | **25,446** | **28,365** | **31,961** |
| | | | | | |
| Fixed assets | 15,129 | 15,044 | 18,666 | 19,685 | 20,634 |
| Investments | 447 | 1,243 | 1,743 | 2,243 | 2,743 |
| Working capital | 1,219 | 3,417 | 3,482 | 4,029 | 4,989 |
| Cash | 814 | 1,030 | 1,555 | 2,407 | 3,595 |
| **Capital deployed** | **17,608** | **20,735** | **25,446** | **28,365** | **31,961** |
| Net Debt | 8,136 | 7,700 | 8,674 | 6,822 | 4,635 |
| W C turn (days) | 29 | 52 | 52 | 52 | 52 |
| Book value (₹/sh) | 218 | 269 | 306 | 391 | 492 |

*Source: Company, Anand Rathi Research*

## Fig 3 – Cash-flow statement (₹m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| PAT | 1,064 | 2,538 | 2,990 | 3,823 | 4,582 |
| + Non-cash items | 782 | 826 | 879 | 981 | 1,051 |
| Cash profit | 1,845 | 3,364 | 3,869 | 4,804 | 5,633 |
| - Incr./(Decr.) in WC | 703 | 2,290 | 53 | 653 | 1,066 |
| Operating cash-flow | 1,142 | 1,074 | 3,815 | 4,150 | 4,567 |
| - Capex | 535 | 742 | 4,500 | 2,000 | 2,000 |
| Free-cash flow | 607 | 332 | -685 | 2,150 | 2,567 |
| - Dividend | 137 | 360 | 324 | 405 | 485 |
| + Equity raised | 0 | 17 | 45 | 0 | 0 |
| + Debt raised | -1,326 | 576 | 2,000 | -500 | -500 |
| - Investments | -298 | 796 | 500 | 500 | 500 |
| - Misc. items | -1,037 | -447 | 11 | -106 | -106 |
| Net cash-flow | 479 | 216 | 526 | 852 | 1,188 |
| + Op. cash & bank bal. | 334 | 814 | 1,030 | 1,555 | 2,407 |
| Cl. cash & bank bal. | 814 | 1,030 | 1,555 | 2,407 | 3,595 |

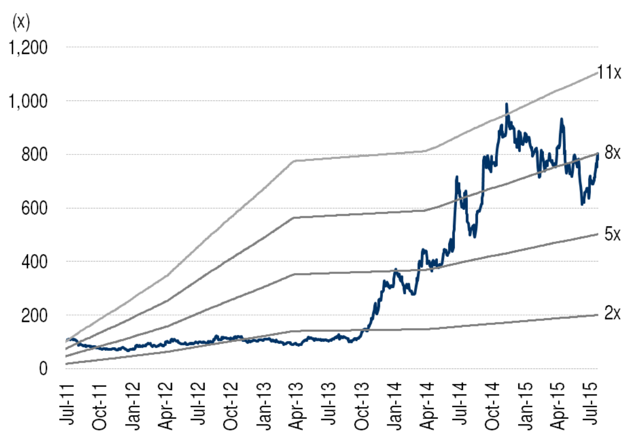
*Source: Company, Anand Rathi Research*

## Fig 4 – Ratio analysis @ ₹805

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| P/E (x) | 20.6 | 11.0 | 10.7 | 8.5 | 7.1 |
| P/B (x) | 3.7 | 3.0 | 2.6 | 2.1 | 1.6 |
| EV/sales | 0.7 | 0.7 | 0.8 | 0.7 | 0.6 |
| EV/EBITDA (x) | 8.4 | 5.9 | 6.5 | 5.1 | 4.1 |
| RoE (%) | 18.0 | 27.3 | 24.6 | 24.2 | 23.0 |
| RoCE (%) | 20.9 | 26.8 | 22.8 | 24.9 | 25.8 |
| Dividend yield | 0.5 | 1.2 | 1.0 | 1.2 | 1.5 |
| Dividend payout (%) | 14.8 | 16.3 | 12.4 | 12.2 | 12.2 |
| RM to sales (%) | 67.8 | 62.6 | 61.4 | 59.5 | 59.5 |
| EBITDA growth (%) | 66.1 | 45.7 | 3.3 | 21.3 | 16.1 |
| EPS growth (%) | 1289.6 | 87.4 | 2.8 | 25.3 | 19.9 |
| PAT margin (%) | 2.7 | 4.9 | 5.5 | 6.1 | 6.4 |
| Inventory days | 61.3 | 68.1 | 78.0 | 78.0 | 76.9 |
| Debtors days | 47.1 | 46.5 | 48.2 | 46.7 | 46.0 |
| Creditors days | 79.0 | 78.7 | 72.7 | 72.6 | 71.6 |

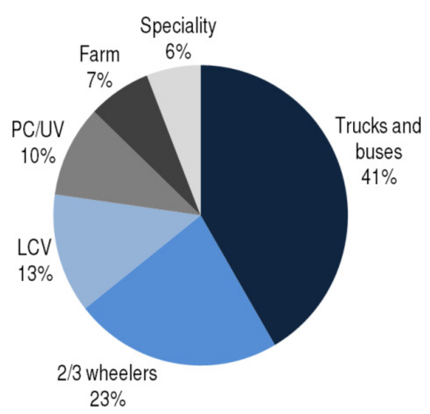
*Source: Company, Anand Rathi Research*

## Fig 5 – PE band




*Source: Bloomberg, Anand Rathi Research*

## Fig 6 – Revenue breakup (FY15)



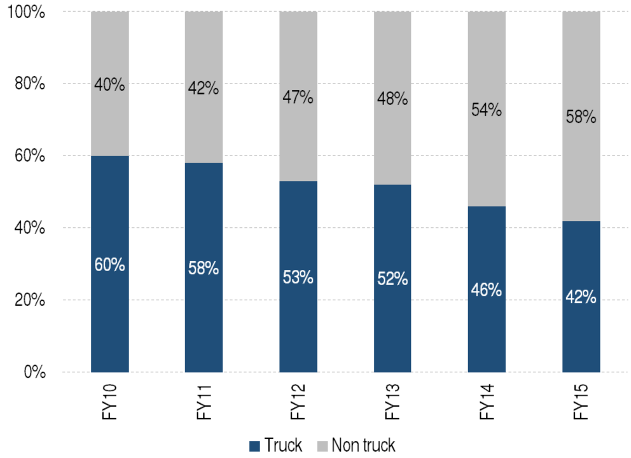

*Source: Company*

## Focus on non-CV segments: dual edge

CEAT's strategy to sharpen its focus on the passenger vehicle, two- and three-wheeler sub-segments gives it, we believe, a dual advantage. One, it avoids competition from its peers (including the Chinese) which are all targeting CV radials. Two, it strengthens its leading position in the two-wheeler sub-segment.

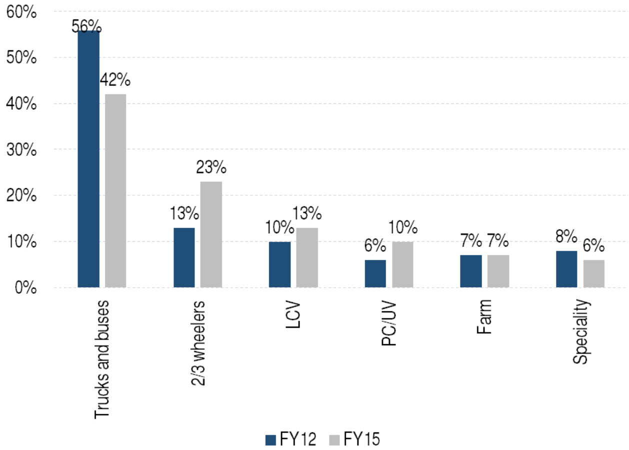
In the past five years, it has significantly reduced dependence on the T&B segment, from 61% in FY10 to 42% in FY15.

**Fig 7 – Focus on non-CV sub-segments**




*Source: Company*

**Fig 8 – Product-wise revenue distribution**




*Source: Company*

## Short-term consolidated margin to stabilise at ~12%

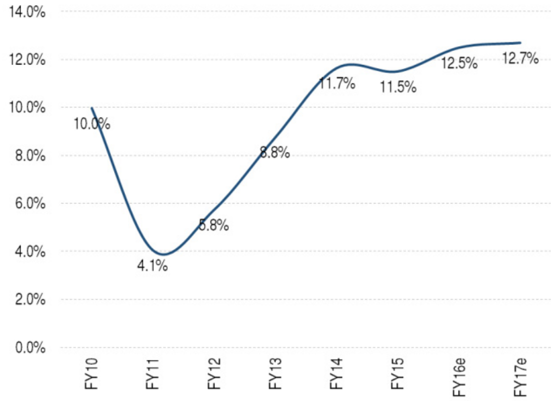
The company is the second-largest manufacturer of two-wheeler tyres, with a 23% market share. In the past 2-3 years, it has doubled this, capturing market share from major manufacturers who have curtailed production due to financial constraints. Again, in the PV sub-segment, it has ~8% market share. Among PVs, management is keen to focus more on UV tyres because of better realisations and margins.

The gradual shift toward the two- and three-wheeler and personal-vehicle sub-segments has not only provided the company with steady revenue growth, but also aided in significant margin improvement. The PV sub-segment is more price inelastic than the CV sub-segment, besides offering higher realisations/kg.

In two-wheelers, the company operates through an outsourcing model, which not only helps capture market share fast at a very low initial capital investment but also aids in improving profitability.

The company has recently started supplying to Honda (HMSI) and should gain significantly from OE growth.

**Fig 9 – EBITDA margin**

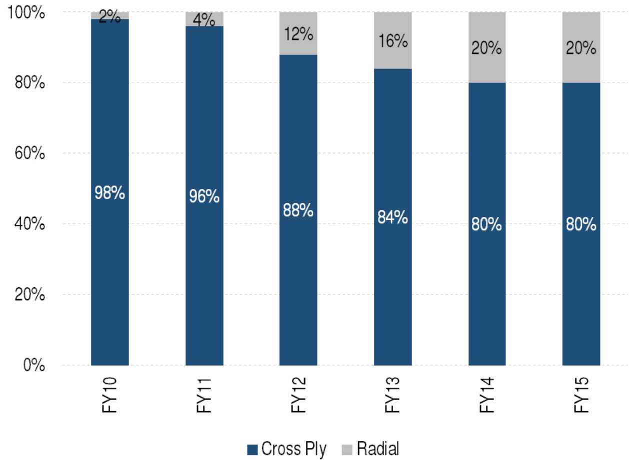



*Source: Company, Anand Rathi Research*

### The radial trend

Replacement demand for both two-wheeler and four-wheeler tyres is robust and commands higher margins. Since the commissioning of the Halol radial plant in 2009, the company estimated future demand for radials and undertook timely radial capacity expansion to cater to swelling demand. The proportion of radial tyres, which command higher margins of ~500-600bps than those of cross-plies, steeply increased, from 2% in FY10 to 20% in FY15, thereby aiding in margin expansion.

**Fig 10 – Increasing proportion of radial tyres**




*Source: Company*

## Robust distribution network and branding

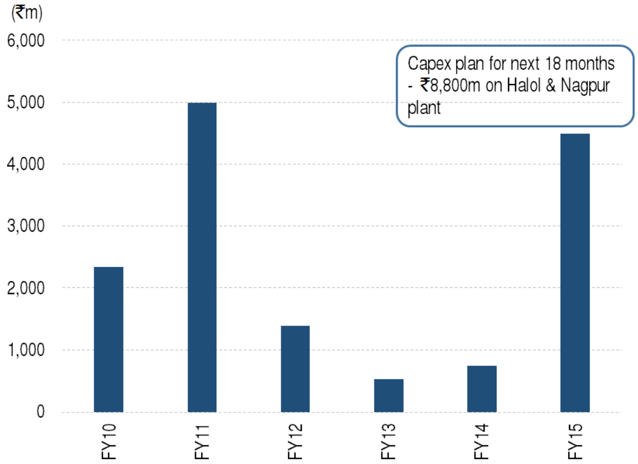
The company's all-India distribution network comprises more than 3,500 dealers and 300 franchisees (CEAT Shoppe + CEAT Hubs).

It maintains its renewed focus on expanding its distribution network in tier-2 and tier-3 cities, beef up its presence in the two-wheeler replacement market and build brand awareness through effective advertising campaigns.

It plans to increase the number of CEAT Shoppes and Hubs and raise its budget for promotional expenses to create a stronger brand recall.

It will continue to target market-share gains in the focused sub-segments, namely two-wheelers (where it is the second-largest with a 22—23% market share) and PCRs.

**Fig 11 – Capex in the right direction, assisting revenue and margins**




*Source: Company*

### Sri Lanka JV update

Ceat operates in Sri Lanka through a 50% JV with Kelani Tyres. Ceat Kelani operates in the truck, light-truck, three-wheeler, two-wheeler and other radial tyre sub-segments in Sri Lanka.

The JV has two manufacturing plants in Sri Lanka, with capacity of 61 tonnes per day. Manufacturing within Sri Lanka enables avoidance of import duty on tyres, thereby enabling Ceat Kelani to competitively price products.

### Bangladesh JV update

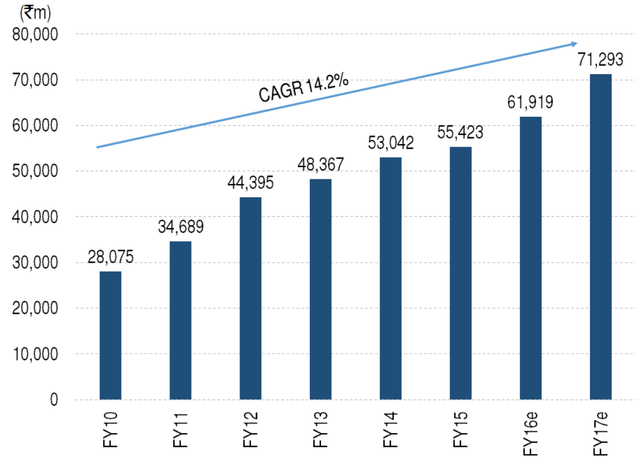
Our recent interaction with the senior management turned us a mite sceptical about the Bangladesh venture in the near future. Management admitted that, despite several measures involving the Bangladesh government, it has so far not gained control over the land it had acquired for its venture.

# Financials

### Revenue expected at a 13% CAGR through FY15-17

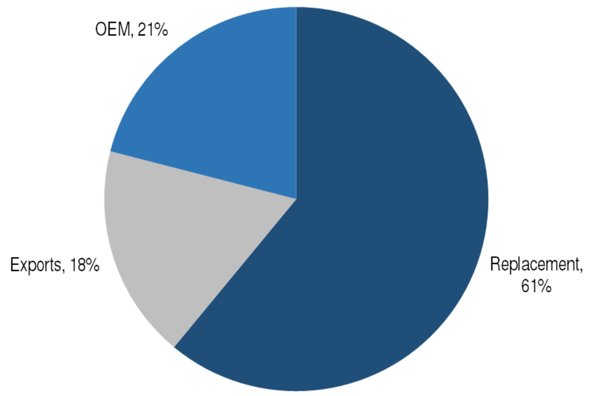
During FY10-15, the company registered 15% revenue growth. We expect a similar performance through FY15-17. This growth is likely to come from stronger replacement demand as well as higher OE demand. Exports are a little soft but management is confident that export growth may soon be on track.

**Fig 12 – Revenue growth**




*Source: Company, Anand Rathi Research.*

**Fig 13 – Segment-wise revenue breakup (FY15)**



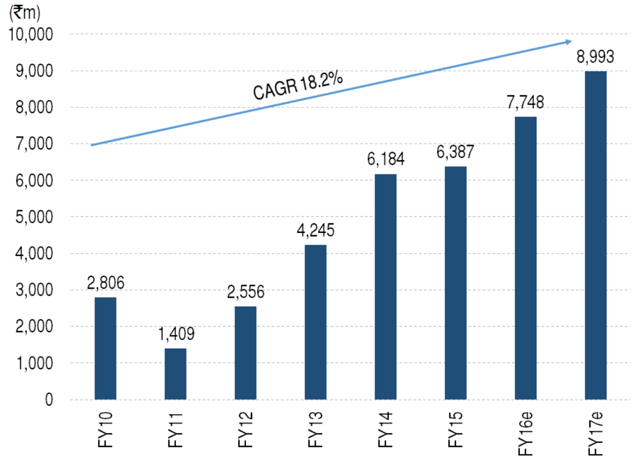

*Source: Company*

### EBITDA growth to be aided by lower rubber prices

Raw materials account for ~70% of the revenues of a typical tyre company, with natural rubber being the most crucial. Economists have predicted lower to stagnant growth for China's economy, emphasising that crude oil and rubber prices may be soft in the future.

We expect EBITDA to register ~19% CAGR through FY15-17.

**Fig 14 – Steady EBITDA growth**

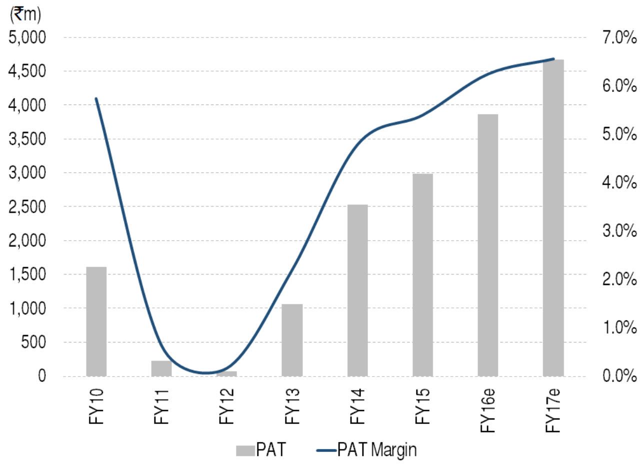



*Source: Company, Anand Rathi Research*

## PAT to record a 25% CAGR over FY15-17

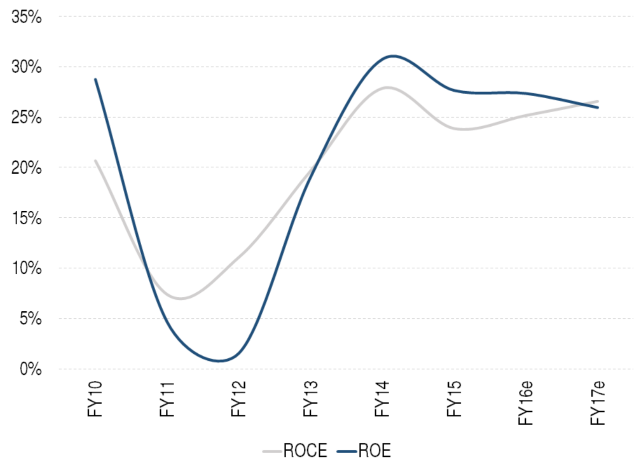
Fuelled by 13% revenue growth, we expect the company to record 25% PAT growth during FY15-17. This converts to an EPS of ₹115 for FY17.

**Fig 15 – PAT growth and margin**




*Source: Company, Anand Rathi Research*

**Fig 16 – RoE and RoCE**




*Source: Company, Anand Rathi Research*

## Fig 17 – Income statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Net sales | 48,367 | 53,042 | 55,423 | 61,919 | 71,293 |
| Other operating income | 447 | 507 | 494 | 568 | 653 |
| Total income | 48,815 | 53,548 | 55,917 | 62,487 | 71,946 |
| Raw material | -33,778 | -34,672 | -35,748 | -38,742 | -44,607 |
| Employee expenses | -2,691 | -2,891 | -3,499 | -3,999 | -4,605 |
| Other operating expenses | -8,101 | -9,801 | -10,283 | -11,997 | -13,742 |
| Operating expenses | -44,570 | -47,364 | -49,530 | -54,738 | -62,953 |
| **EBITDA** | **4,245** | **6,184** | **6,387** | **7,748** | **8,993** |
| *EBITDA margin (%)* | 8.8 | 11.7 | 11.5 | 12.5 | 12.6 |
| Depreciation | -782 | -826 | -879 | -981 | -1,051 |
| **EBIT** | **3,463** | **5,358** | **5,509** | **6,767** | **7,942** |
| Interest paid | -1,944 | -1,692 | -1,305 | -1,396 | -1,452 |
| Other income | 215 | 205 | 286 | 292 | 298 |
| **Pre-tax profit** | **1,734** | **3,872** | **4,490** | **5,664** | **6,788** |
| Tax provided | -394 | -1,234 | -1,439 | -1,841 | -2,206 |
| **Profit after tax** | **1,341** | **2,638** | **3,052** | **3,823** | **4,582** |

*Source: Company, Anand Rathi Research*

## Fig 18 – Balance sheet (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| **Sources of Funds** | | | | | |
| Share Capital | 342 | 360 | 405 | 405 | 405 |
| Reserves | 7,088 | 9,311 | 11,978 | 15,396 | 19,493 |
| **Net Worth** | **7,466** | **9,671** | **12,383** | **15,801** | **19,898** |
| Deferred Tax | 745 | 1,091 | 1,091 | 1,091 | 1,091 |
| Loans | 9,396 | 9,973 | 11,973 | 11,473 | 10,973 |
| **Capital Employed** | **17,608** | **20,735** | **25,446** | **28,365** | **31,961** |
| **Application of Funds** | | | | | |
| Gross Fixed Assets | 21,785 | 22,527 | 27,027 | 29,027 | 31,027 |
| Less: Depreciation | 6,657 | 7,483 | 8,361 | 9,342 | 10,393 |
| **Net Fixed Assets** | **15,129** | **15,044** | **18,666** | **19,685** | **20,634** |
| Investments | 447 | 1,243 | 1,743 | 2,243 | 2,743 |
| **Curr. Assets, L & Adv.** | **14,986** | **17,489** | **18,864** | **21,690** | **25,626** |
| Inventory | 5,314 | 7,183 | 7,501 | 8,382 | 9,651 |
| Sundry Debtors | 6,357 | 7,158 | 7,475 | 8,353 | 9,618 |
| Cash & Bank Balances | 814 | 1,030 | 1,555 | 2,407 | 3,595 |
| Loans & Advances | 2,232 | 1,685 | 1,885 | 2,085 | 2,285 |
| Others | 269 | 433 | 448 | 463 | 478 |
| **Current Liab. & Prov.** | **12,954** | **13,042** | **13,827** | **15,254** | **17,042** |
| Sundry Creditors | 7,761 | 6,693 | 6,989 | 7,810 | 8,992 |
| Other Liabilities | 4,418 | 5,483 | 5,983 | 6,483 | 6,983 |
| Provisions | 775 | 866 | 855 | 961 | 1,067 |
| **Net Current Assets** | **2,032** | **4,447** | **5,037** | **6,436** | **8,584** |
| **Application of Funds** | **17,608** | **20,735** | **25,446** | **28,365** | **31,961** |

*Source: Company, Anand Rathi Research*

### Fig 19 – Cash-flow statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| OP/(Loss) before Tax | 3,463 | 5,358 | 5,509 | 6,767 | 7,942 |
| Interest/Div. Received | 215 | 205 | 286 | 292 | 298 |
| Depreciation & Amort. | 782 | 826 | 879 | 981 | 1,051 |
| Direct Taxes Paid | 127 | -888 | -1,439 | -1,841 | -2,206 |
| (Inc)/Dec in Working Capital | -163 | -2,199 | -64 | -547 | -960 |
| Other Items | 0 | 0 | 0 | 0 | 0 |
| CF from Oper. Activity | 4,424 | 3,303 | 5,170 | 5,652 | 6,125 |
| Extra-ordinary Items | -277 | -100 | -61 | 0 | 0 |
| Other Items | 0 | 0 | 0 | 0 | 0 |
| CF after EO Items | 4,147 | 3,203 | 5,109 | 5,652 | 6,125 |
| | | | | | |
| (Inc)/Dec in FA+CWIP | -535 | -742 | -4,500 | -2,000 | -2,000 |
| (Pur)/Sale of Invest. | 298 | -796 | -500 | -500 | -500 |
| CF from Inv. Activity | -238 | -1,538 | -5,000 | -2,500 | -2,500 |
| Changes in Reserves | -24 | 63 | 45 | 0 | 0 |
| Inc/(Dec) in Debt | -1,326 | 576 | 2,000 | -500 | -500 |
| Interest Paid | -1,944 | -1,692 | -1,305 | -1,396 | -1,452 |
| Dividends Paid | -137 | -360 | -324 | -405 | -485 |
| CF from Fin. Activity | -3,430 | -1,412 | 417 | -2,300 | -2,437 |
| Inc/(Dec) in Cash | 479 | 252 | 526 | 852 | 1,187 |
| Add: Beginning Balance | 334 | 814 | 1,030 | 1,555 | 2,407 |
| Closing Balance | 814 | 1,066 | 1,555 | 2,407 | 3,595 |

*Source: Company, Anand Rathi Research*

### Fig 20 – Ratio analysis @ ₹805

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Operational & financials ratios | | | | | |
| EPS (INR) | 39.1 | 73.4 | 75.4 | 95.6 | 115.5 |
| CEPS (INR) | 62.0 | 96.3 | 97.2 | 119.1 | 140.7 |
| DPS (INR) | -4.0 | -6.0 | -7.1 | -8.9 | -10.7 |
| BVPS (INR) | 218.0 | 268.9 | 306.1 | 391.7 | 495.2 |
| Tax rate (%) | 22.7 | 31.9 | 32.0 | 32.5 | 32.5 |
| Dividend payout ratio (%) | -10.2 | -8.2 | -9.4 | -9.3 | -9.2 |
| Debt/Equity (x) | 1.3 | 1.0 | 1.0 | 0.7 | 0.5 |
| Growth ratios | | | | | |
| Net sales growth (%) | 8.9 | 9.7 | 4.5 | 11.7 | 15.1 |
| EBITDA growth (%) | 66.1 | 45.7 | 3.3 | 21.3 | 17.0 |
| EBIT growth (%) | 87.1 | 54.7 | 2.8 | 23.4 | 18.4 |
| Net profit growth (%) | 1,154.1 | 96.8 | 15.7 | 26.7 | 20.9 |
| EPS growth (%) | 1,154.1 | 87.4 | 2.8 | 26.7 | 20.9 |
| Margin ratios | | | | | |
| EBITDA margin (%) | 8.8 | 11.7 | 11.5 | 12.5 | 12.7 |
| EBIT margin (%) | 7.2 | 10.1 | 9.9 | 11.0 | 11.3 |
| Net profit margin (%) | 2.8 | 5.0 | 5.5 | 6.2 | 6.6 |
| Performance ratios | | | | | |
| Other income/PBT (%) | 12.4 | 5.3 | 6.4 | 5.2 | 4.6 |
| ROE (%) | 19.1 | 30.8 | 27.7 | 27.4 | 26.0 |
| ROCE (%) | 19.7 | 27.9 | 23.9 | 25.2 | 26.6 |
| Incremental ROCE (%) | 1,648.8 | 60.6 | 3.2 | 43.5 | 33.9 |
| Debtor days | 48 | 49 | 49 | 49 | 49 |
| Inventory days | 40 | 49 | 49 | 49 | 49 |
| Price/Book (x) | 0.7 | 0.5 | 0.5 | 0.4 | 0.3 |
| Yield (%) | -2.7 | -4.1 | -4.8 | -6.1 | -7.3 |

*Source: Company, Anand Rathi Research*

# Outlook and Valuations

We expect revenue to come at a 13% CAGR during FY15-17, driven by strong replacement and OE demand. Soft rubber prices would also assist toward better margins. We expect ~12% EBITDA margins. The company has in the past been valued at a P/E of 9x.

We value it at 9x FY17e earnings. Based on the ruling price, the stock is trades at 7.1x FY17e earnings. We initiate coverage on it, with a Buy and a target price of ₹1,020.

### Risks

- Any sharp upswing in rubber and crude oil prices;
- Adverse cross-currency movements could impact margins.

27 July 2015

# Apollo Tyres

*Biggest beneficiary of the CV revival; initiating, with a Buy*

Rating: **Buy**
Target Price: ₹244
Share Price: ₹197

**We initiate coverage on Apollo Tyres, with a Buy rating and a target price of ₹244. As the market leader in the truck-bus bias (TBB) and truck-bus radial (TBR) sub-segments, it is poised to be the largest beneficiary of the revival in the M&H CV sub-segment. Helped by strong replacement demand, lower raw-material prices and global expansion, Apollo seems to be on a roll.**

**Buoyancy in demand to continue.** As the market leader in commercial-vehicle tyres and the fastest-growing in passenger-car radials (PCR), we expect the company to be a major beneficiary of the boom in the M&H CV sub-segment. We also expect it to benefit from stronger replacement demand.

**Huge investment plans.** It has huge investment plans for Europe. It intends to set up a greenfield plant in eastern Europe in the next five years at a potential ₹35bn. It also plans to expand its Chennai plant's radial capacity in the next three years at a potential ₹15bn.

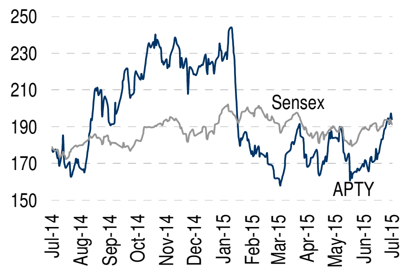
**EBITDA margins to be steady.** Considering the company's operational efficiencies, supported by strong volume growth and a better product mix, we expect its consolidated EBITDA margin to come at a steady 14—14.5%. Raw-material prices, especially natural rubber, are expected to be soft, which would further assist in maintaining the margin level.

**Valuation.** The stock trades at 7x FY17e earnings. We initiate coverage on it, with a Buy rating and a target price of ₹244 based on 10x FY17e earnings. **Risk:** Higher rubber prices may dent margins.

| Key data | APTY IN / APLO.BO |
|---|---|
| 52-week high / low | ₹250 / ₹155 |
| Sensex / Nifty | 27561 / 8361 |
| 3-m average volume | $7.4m |
| Market cap | ₹100bn / $1.6bn |
| Shares outstanding | 509m |

| Shareholding pattern (%) | June '15 | Mar '15 | Dec '14 |
|---|---|---|---|
| Promoters | 44.06 | 44.06 | 44.06 |
| *- of which, Pledged* | *11.97* | *11.92* | *9.18* |
| Free Float | 55.94 | 55.94 | 55.94 |
| - Foreign Institutions | 24.38 | 30.69 | 34.99 |
| - Domestic Institutions | 17.71 | 10.93 | 8.00 |
| - Public | 13.85 | 14.32 | 12.95 |

**Relative price performance**




*Source: Bloomberg*

| Key financials (Year-end: Mar) | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Revenues (₹ m) | 127,989 | 134,120 | 127,852 | 138,080 | 154,650 |
| Net profit (₹ m) | 6,126 | 10,051 | 9,776 | 10,750 | 12,187 |
| EPS (₹) | 12.2 | 19.9 | 19.4 | 21.3 | 24.2 |
| Growth (%) | 49.4 | 64.1 | -2.7 | 10.0 | 13.4 |
| PE (x) | 14.0 | 8.5 | 8.8 | 8.0 | 7.0 |
| PBV (x) | 2.5 | 1.9 | 1.6 | 1.3 | 1.1 |
| RoE (%) | 19.7 | 25.2 | 19.4 | 17.8 | 17.1 |
| RoCE (%) | 14.2 | 22.1 | 19.0 | 16.7 | 16.2 |
| Dividend yield (%) | 0.3 | 0.4 | 0.4 | 0.4 | 0.4 |
| Net gearing (%) | 0.5 | 0.3 | 0.2 | 0.2 | 0.2 |

*Source: Company, Anand Rathi Research*

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**Research Analyst**
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mayurmilak@rathi.com

# Quick Glance – Financials and Valuations

### Fig 1 – Income statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Net revenues | 127,989 | 134,120 | 127,852 | 138,080 | 154,650 |
| Revenue growth (%) | 5.3 | 4.8 | -4.7 | 8.0 | 12.0 |
| - Oper. expenses | 113,381 | 115,365 | 108,546 | 117,839 | 132,177 |
| **EBITDA** | 14,608 | 18,755 | 19,306 | 20,242 | 22,472 |
| EBITDA margins (%) | 11.4 | 14.0 | 15.1 | 14.7 | 14.5 |
| - Interest | 3,128 | 2,838 | 1,828 | 1,596 | 1,425 |
| - Depreciation | 3,966 | 4,109 | 3,883 | 4,210 | 4,702 |
| + Other income | 902 | 978 | 538 | 600 | 700 |
| +Extra ord. & others | 169 | -468 | -825 | 0 | 0 |
| - Tax | 2,448 | 2,269 | 3,532 | 4,285 | 4,858 |
| Effective tax rate (%) | 28.5 | 18.4 | 26.5 | 28.5 | 28.5 |
| Reported PAT | 6,137 | 10,051 | 9,776 | 10,750 | 12,187 |
| - Minority Interest | -8 | 0 | 0 | 0 | 0 |
| Adjusted PAT | 6,126 | 10,051 | 9,776 | 10,750 | 12,187 |
| Adj. FDEPS (₹/sh) | 12.2 | 19.9 | 19.4 | 21.3 | 24.2 |
| Adj. FDEPS growth (%) | 49.4 | 64.1 | -2.7 | 10.0 | 13.4 |

*Source: Company, Anand Rathi Research*

### Fig 2 – Balance sheet (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Share capital | 504 | 504 | 504 | 504 | 504 |
| Reserves & surplus | 33,396 | 45,134 | 54,468 | 64,776 | 76,520 |
| Shareholders' fund | 34,008 | 45,746 | 55,080 | 65,388 | 77,132 |
| Minority Interest | 0 | 0 | 0 | 0 | 0 |
| Debt | 22,816 | 9,889 | 9,889 | 8,889 | 8,389 |
| Deferred tax / others | 4,928 | 5,241 | 5,358 | 5,358 | 5,358 |
| **Capital employed** | 61,752 | 60,876 | 70,327 | 79,635 | 90,879 |
| | | | | | |
| Fixed assets | 44,892 | 45,022 | 47,675 | 55,964 | 63,562 |
| Investments | 546 | 637 | 637 | 3,637 | 6,637 |
| Working capital | 12,968 | 8,676 | 16,939 | 12,973 | 16,022 |
| Cash | 3,348 | 6,541 | 5,076 | 7,060 | 4,658 |
| **Capital deployed** | 61,753 | 60,876 | 70,327 | 79,635 | 90,879 |
| Net Debt | 18,923 | 2,711 | 4,176 | -1,809 | -2,907 |
| W C turn (days) | 48 | 43 | 53 | 56 | 48 |
| Book value (₹/sh) | 67 | 91 | 109 | 130 | 153 |

*Source: Company, Anand Rathi Research*

### Fig 3 – Cash-flow statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Reported PAT | 6,137 | 10,051 | 9,776 | 10,750 | 12,187 |
| + Depreciation | 4,748 | 4,435 | 3,883 | 4,210 | 4,702 |
| Cash profit | 10,886 | 14,485 | 13,659 | 14,961 | 16,889 |
| - Incr./(Decr.) in WC | -2,799 | -4,162 | 8,263 | -3,966 | 3,049 |
| Operating cash-flow | 13,685 | 18,647 | 5,396 | 18,927 | 13,840 |
| - Capex | 3,976 | 4,239 | 6,535 | 12,500 | 12,300 |
| Free-cash flow | 9,709 | 14,408 | -1,139 | 6,427 | 1,540 |
| - Dividend | 295 | 442 | 442 | 442 | 442 |
| + Equity raised | -150 | 2,129 | 0 | 0 | 0 |
| + Debt raised | -5,904 | -12,928 | 0 | -1,000 | -500 |
| - Investments | 388 | 91 | 0 | 3,000 | 3,000 |
| - Misc. items | 1,362 | -117 | -117 | 0 | 0 |
| Net cash-flow | 1,611 | 3,193 | -1,465 | 1,985 | -2,402 |
| + Opening cash | 1,730 | 3,348 | 6,541 | 5,076 | 7,060 |
| Closing cash | 3,348 | 6,541 | 5,076 | 7,060 | 4,658 |

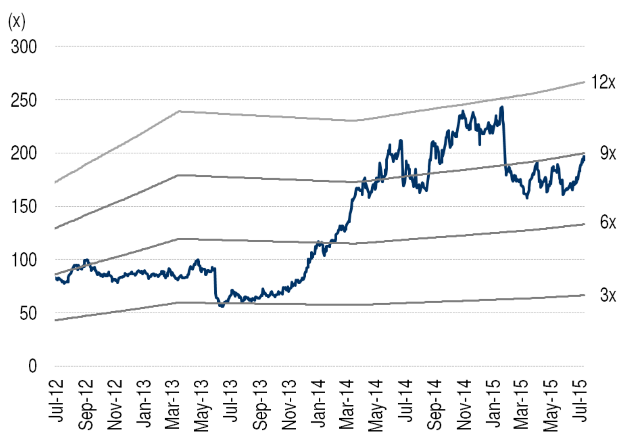
*Source: Company, Anand Rathi Research*

### Fig 4 – Ratio analysis @ ₹197

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| P/E (x) | 14.0 | 8.5 | 8.8 | 8.0 | 7.0 |
| P/B (x) | 2.5 | 1.9 | 1.6 | 1.3 | 1.1 |
| EV/EBITDA (x) | 7.2 | 4.7 | 4.7 | 4.3 | 4.0 |
| RoE (%) | 19.7 | 25.2 | 19.4 | 17.8 | 17.1 |
| RoCE (%) | 14.2 | 22.1 | 19.0 | 16.7 | 16.2 |
| Dividend yield | 0.3 | 0.4 | 0.4 | 0.4 | 0.4 |
| Dividend payout (%) | 4.8 | 4.4 | 4.5 | 4.1 | 3.6 |
| RM to sales (%) | 62.5 | 57.9 | 55.2 | 56.0 | 57.0 |
| EBITDA growth (%) | 25.3 | 28.4 | 2.9 | 4.8 | 11.0 |
| EPS growth (%) | 49.4 | 64.1 | -2.7 | 10.0 | 13.4 |
| PAT margin (%) | 4.8 | 7.5 | 7.6 | 7.8 | 7.9 |
| Debtor days | 29 | 26 | 27 | 25 | 25 |
| Inventory days | 57 | 56 | 56 | 52 | 52 |
| Creditors days | 47 | 49 | 53 | 51 | 53 |
| Working capital days | 48 | 43 | 53 | 56 | 48 |

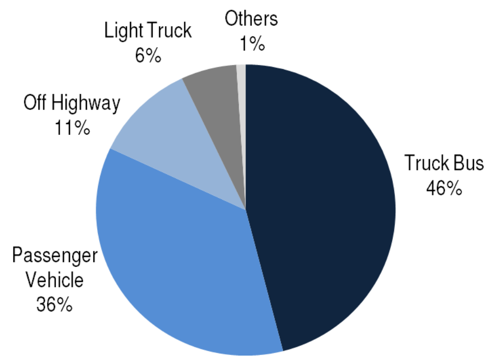
*Source: Company, Anand Rathi Research*

### Fig 5 – PE band




*Source: Bloomberg, Anand Rathi Research*

### Fig 6 – FY15 revenue breakup (standalone)




*Source: Company*

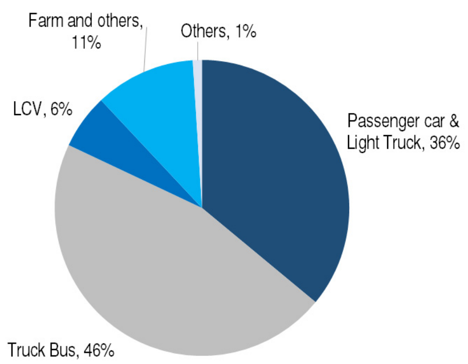
## Buoyancy in demand to continue

Being a market leader in commercial-vehicle (CV) tyres and the fastest-growing manufacturer of passenger-car radials (PCR), Apollo Tyres, we expect, would be a major beneficiary of the rising demand in the M&H CV sub-segment. We expect it to benefit also from stronger replacement demand.

The OE market has been declining for two years running. Despite that, Apollo outperformed the replacement market both in India and Europe in the passenger car and truck/bus sub-segments.

Management expects a strong recovery during H2 FY16.

**Fig 7 – Product Wise Revenue Distribution FY15**




*Source: Company, Anand Rathi Research*

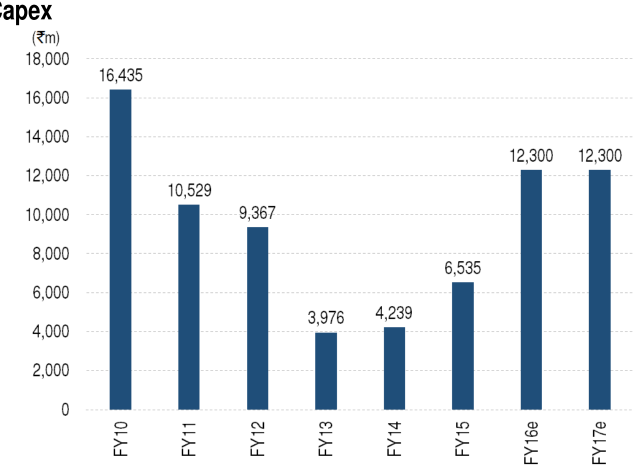
## Huge investment plans

Apollo has one of the largest radial-tyre capacities in India, of 1,640 tonnes a day. Ahead, it is poised to benefit from growing demand.

Currently, it is ranked 17th among the top-30 in the world. It has huge investments plans for Europe. In the next five years it intends to set up a greenfield plant in eastern Europe at a potential ₹35bn.

It also plans to expand its Chennai radial capacity in the next three years at a potential ₹15bn.

**Fig 8 – Capex**




*Source: Company, Anand Rathi Research*

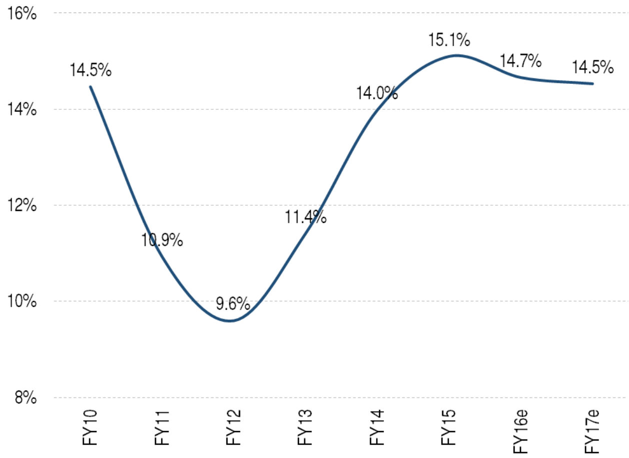
## EBITDA margins to be stable

Considering the company's operational efficiencies supported by strong volume growth and a better product mix, we expect the consolidated EBITDA margin to come at a steady 14—14.5%.

Raw material costs comprise ~70% of revenue, with natural rubber being the most crucial. Although India is one of the major producers of natural rubber in the world, a significant demand-supply gap exists.

Economists worldwide have predicted lower to stagnant growth for the Chinese economy, emphasising that crude oil and rubber prices may be soft in the near future. Thus, tyre companies will reap the benefits of lower raw material costs.

**Fig 9 – EBITDA margins**



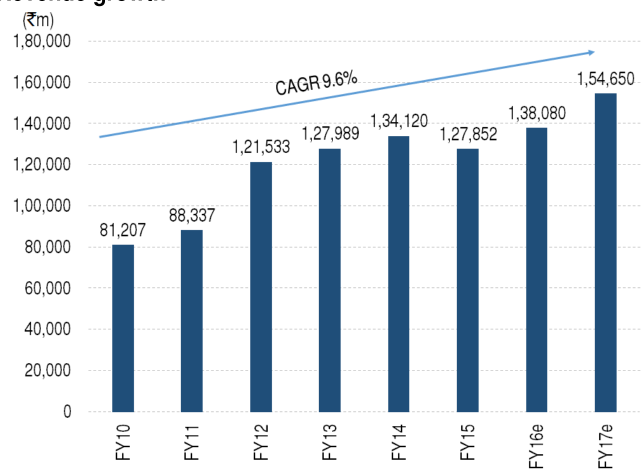

*Source: Company, Anand Rathi Research*

# Financials

### Revenue expected at a 10% CAGR in FY15-17

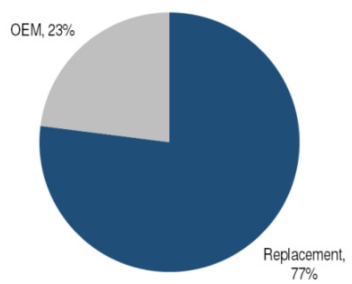
During FY13-15, the company registered a mere 2% revenue CAGR, the prime reason being the South African unit's non-performance. We expect a much better performance through FY15-17. This growth is likely to arise from stronger replacement demand as well as greater OE demand. European demand also seems to be much better than before, as a result of which the company has planned a greenfield expansion in the next few years.

**Fig 10 – Revenue growth**




*Source: Company, Anand Rathi Research*

**Fig 11 – Segment-wise revenue breakup (FY15)**



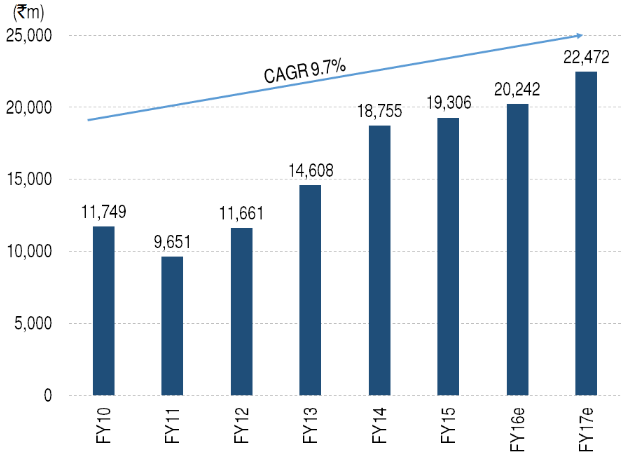

*Source: Company*

### Ability to maintain EBIDTA margins; soft rubber prices would help

Natural rubber is the most crucial component for tyre manufacturers. Economists worldwide have predicted lower to stagnant growth for the Chinese economy, emphasising that crude-oil and rubber prices may be soft in the near future.

Despite lower revenue growth during FY13-15, the company maintained its EBITDA margin at ~14%. We expect it to hold to that (~14—14.5%) during FY15-17.

**Fig 12 – Steady EBITDA growth**

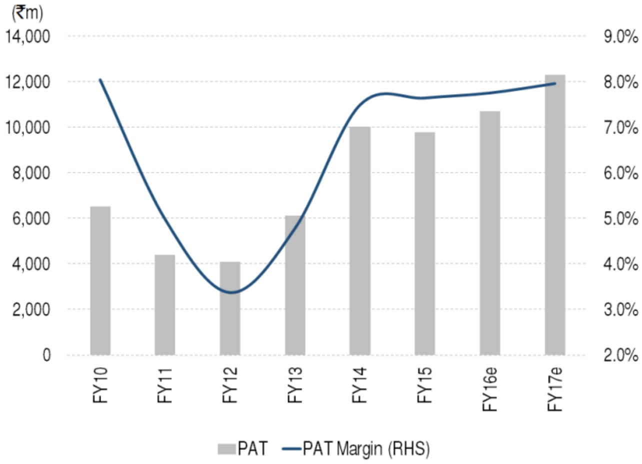



*Source: Company, Anand Rathi Research*

## PAT to register an 11% CAGR over FY15-17

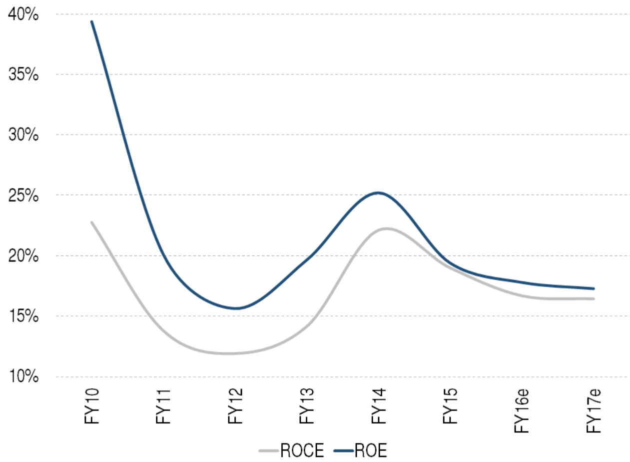
Driven by 10% revenue growth, the company may see PAT growth of 11% during FY15-17. This converts to an EPS of ₹24 for FY17.

**Fig 13 – PAT growth and margin**




*Source: Company, Anand Rathi Research*

**Fig 14 – RoE and RoCE**




*Source: Company, Anand Rathi Research*

### Fig 15 – Income statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Net Sales | 1,27,989 | 1,34,120 | 1,27,852 | 1,38,080 | 1,54,650 |
| Raw Materials | 79,969 | 77,721 | 70,628 | 77,325 | 88,150 |
| Employee Cost | 14,714 | 16,146 | 16,336 | 17,316 | 18,355 |
| Other Expenses | 18,698 | 21,498 | 21,582 | 23,197 | 25,672 |
| Total Expenditure | 1,13,381 | 1,15,365 | 1,08,546 | 1,17,839 | 1,32,177 |
| EBITDA | 14,608 | 18,755 | 19,306 | 20,242 | 22,472 |
| Other Income | 902 | 978 | 538 | 600 | 700 |
| Interest | 3,128 | 2,838 | 1,828 | 1,596 | 1,425 |
| Depreciation | 3,966 | 4,109 | 3,883 | 4,210 | 4,702 |
| PBT | 8,586 | 12,319 | 13,308 | 15,035 | 17,045 |
| Total tax | 2,448 | 2,269 | 3,532 | 4,285 | 4,858 |
| PAT | 6,137 | 10,051 | 9,776 | 10,750 | 12,187 |
| Less: Adjustments | 12 | 0 | 0 | 0 | 0 |
| Adjusted PAT | 6,126 | 10,051 | 9,776 | 10,750 | 12,187 |

*Source: Company, Anand Rathi Research*

### Fig 16 – Balance sheet (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Equity capital | 504 | 504 | 504 | 504 | 504 |
| Reserves & Surplus | 33,396 | 45,134 | 54,468 | 64,776 | 76,520 |
| Net worth | **34,008** | **45,746** | **55,080** | **65,388** | **77,132** |
| Minority interest | 0 | 0 | 0 | 0 | 0 |
| Total debt | **22,816** | **9,889** | **9,889** | **8,889** | **8,389** |
| Total | **58,191** | **57,070** | **66,404** | **75,712** | **86,956** |
| | | | | | |
| Net block | 40,651 | 43,571 | 44,688 | 52,477 | 59,775 |
| Capital WIP | 3,199 | 465 | 2,000 | 2,500 | 2,800 |
| Total fixed assets | **44,892** | **45,022** | **47,675** | **55,964** | **63,562** |
| Investments | 546 | 637 | 637 | 3,637 | 6,637 |
| Current Assets | **38,671** | **43,304** | **39,271** | **44,682** | **45,710** |
| Inventories | 20,310 | 20,664 | 18,539 | 21,126 | 23,352 |
| Debtors | 10,197 | 10,427 | 9,845 | 10,632 | 11,753 |
| Cash & bank | 3,348 | 6,541 | 5,076 | 7,060 | 4,658 |
| Other Current Assets | 4,816 | 5,672 | 5,812 | 5,864 | 5,946 |
| Current Liabilities & Provisions | **22,425** | **28,027** | **17,196** | **24,589** | **24,970** |
| Creditors | 9,750 | 11,294 | 9,182 | 12,372 | 13,399 |
| Other liabilities | 7,883 | 11,044 | 6,015 | 10,017 | 9,071 |
| Provisions | 4,791 | 5,689 | 2,000 | 2,200 | 2,500 |
| Net Deferred Tax Assets | -4,928 | -5,241 | -5,358 | -5,358 | -5,358 |
| Total | **58,191** | **57,070** | **66,404** | **75,712** | **86,956** |

*Source: Company, Anand Rathi Research*

### Fig 17 – Cash-flow statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| PAT | 6,126 | 10,051 | 9,776 | 10,750 | 12,187 |
| Add: Depreciation | 3,966 | 4,109 | 3,883 | 4,210 | 4,702 |
| Add: Interest expense | 3,128 | 2,838 | 1,828 | 1,596 | 1,425 |
| Less: Other income | -902 | -978 | -538 | -600 | -700 |
| Change in working capital | 1,336 | 4,291 | -8,263 | 3,966 | -3,049 |
| Others | -1,366 | -1,045 | -558 | -558 | -558 |
| Cash flow from operations | **12,287** | **19,265** | **6,128** | **19,365** | **14,008** |
| Change in fixed assets | -3,976 | -4,239 | -6,535 | -12,500 | -12,300 |
| Change in investments | -388 | -91 | 0 | -3,000 | -3,000 |
| Other income | 902 | 978 | 538 | 600 | 700 |
| Cash flow from investing activities | **-3,461** | **-3,352** | **-5,997** | **-14,900** | **-14,600** |
| Change in debt | -5,904 | -12,928 | 0 | -1,000 | -500 |
| Dividend & dividend tax | -295 | -442 | -442 | -442 | -442 |
| Change in equity & share premium | 0 | 0 | 0 | 0 | 0 |
| Interest paid | -3,128 | -2,838 | -1,828 | -1,596 | -1,425 |
| Other Adjustments | 2,004 | 3,488 | 675 | 558 | 558 |
| Cash flow from financing activities | **-7,323** | **-12,720** | **-1,596** | **-2,481** | **-1,810** |
| Change in cash & cash equivalents | 1,611 | 3,193 | -1,465 | 1,984 | -2,402 |
| Opening cash and cash equivalents | 1,730 | 3,348 | 6,541 | 5,076 | 7,060 |
| Closing cash and cash equivalents | 3,348 | 6,541 | 5,076 | 7,060 | 4,658 |

*Source: Company, Anand Rathi Research*

### Fig 18 – Ratio analysis @ ₹197

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| % of net sales | | | | | |
| Raw material costs | 62.5 | 57.9 | 55.2 | 56.0 | 57.0 |
| Employee costs | 11.5 | 12.0 | 12.8 | 12.5 | 11.9 |
| Total expenses | 88.6 | 86.0 | 84.9 | 85.3 | 85.5 |
| EBITDA | 11.4 | 14.0 | 15.1 | 14.7 | 14.5 |
| PAT | 4.8 | 7.5 | 7.6 | 7.8 | 7.9 |
| Asset-based ratios (%) | | | | | |
| RoCE | 14.2 | 22.1 | 19.0 | 16.7 | 16.2 |
| RoE | 19.7 | 25.2 | 19.4 | 17.8 | 17.1 |
| Turnover ratios (days) | | | | | |
| Debtor days | 29 | 26 | 27 | 25 | 25 |
| Inventory days | 57 | 56 | 56 | 52 | 52 |
| Creditors days | 47 | 49 | 53 | 51 | 53 |
| Working capital days | 48 | 43 | 53 | 56 | 48 |
| Growth ratios (%) | | | | | |
| Net Sales | 5.3 | 4.8 | (4.7) | 8.0 | 12.0 |
| EBITDA | 25.3 | 28.4 | 2.9 | 4.8 | 11.0 |
| EPS | 49.4 | 64.1 | (2.7) | 10.0 | 13.4 |
| CEPS | 36.9 | 40.1 | (3.5) | 9.5 | 12.9 |
| Per share (₹) | | | | | |
| EPS | 12.2 | 19.9 | 19.4 | 21.3 | 24.2 |
| CEPS | 20.0 | 28.1 | 27.1 | 29.7 | 33.5 |
| BV | 67.5 | 90.7 | 109.3 | 129.7 | 153.0 |
| DPS | 0.5 | 0.7 | 0.7 | 0.7 | 0.7 |
| Valuations (x) | | | | | |
| P/E | 14.0 | 8.5 | 8.8 | 8.0 | 7.0 |
| P/CEPS | 8.5 | 6.1 | 6.3 | 5.7 | 5.1 |
| P/BV | 2.5 | 1.9 | 1.6 | 1.3 | 1.1 |
| Yield (%) | 0.3 | 0.4 | 0.4 | 0.4 | 0.4 |
| EV/EBITDA | 7.2 | 4.7 | 4.7 | 4.3 | 4.0 |
| EV/sales | 0.8 | 0.7 | 0.7 | 0.6 | 0.6 |
| Solvency ratios | | | | | |
| Current ratio | 1.7 | 1.5 | 2.3 | 1.8 | 1.8 |
| Quick ratio | 0.1 | 0.2 | 0.3 | 0.3 | 0.2 |
| D/E ratio | 0.7 | 0.2 | 0.2 | 0.1 | 0.1 |
| Interest coverage ratio | 2.6 | 4.5 | 6.4 | 7.5 | 9.3 |

*Source: Company, Anand Rathi Research*

# Outlook and Valuations

After a 2% CAGR through FY13-15, we expect revenue to register a 10% CAGR through FY15-17, driven by strong replacement demand and higher OE demand. Also, soft rubber prices would assist toward better margins. We expect the EBITDA margin to come at ~14—14.5%. The stock has in the past five years been valued at an average P/E of 10x.

We value it at 10x FY17e earnings. Based on the current price, it is valued at 8.1x FY17e. We initiate coverage of it, with a Buy and a target price of ₹244.

### Risks

- Sharp upswing in prices of rubber and crude oil;
- Any unfavourable merger/ acquisition.

27 July 2015

# MRF

Rating: **Buy**
Target Price: ₹43,500
Share Price: ₹38,100

*Leadership all the way; initiating, with a Buy*

**We initiate coverage on MRF, with a Buy rating and target price of ₹43,500. It would be one of the largest beneficiaries of the rise in demand in the domestic auto sector, especially in CVs. Natural rubber prices are expected to be contained, enhancing the already "best in the lot" margins.**

**Revenue growth to be fuelled by strong replacement demand.** MRF is India's largest tyre manufacturer with diversified operations across sub-segments (two-wheeler, passenger car, commercial vehicle and tractor tyres). We expect its revenue to record a 10% CAGR over the next two years, supported by recovery in the CV sub-segment in India, increasing acceptance of radials in the T&B sub-segment and recovery in overall auto-sector demand.

**Better mix with pricing power aids stronger margins.** The greater proportion of replacement tyres (~76%), strong brand recall and a better product mix have helped the company to report higher gross margins. Its diversified product mix has helped it maintain a high utilisation level (which reduces EBITDA volatility in a downturn).

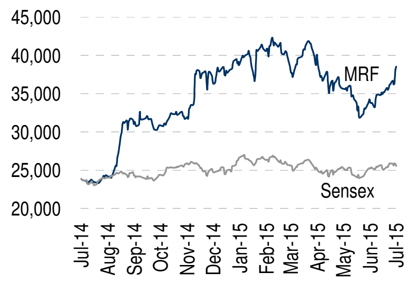
**Wide dealer network and strong brand recall.** The company has the widest distribution network in India, establishing its strong all-India presence with ~4,500 dealers and 300 franchisees (exclusively selling MRF tyres besides offering specialised services such as computerised wheel alignment and balancing). Moreover, ~76% of its revenue arises from the replacement market.

**Valuation.** The stock trades at 10.5x FY17e. Our target price of ₹43,500 is based on 12x FY17e earnings. **Risks.** Increase in prices of natural rubber may dent margins.

| Key data | MRF IN / MRF.BO |
|---|---|
| 52-week high / low | ₹42,799 / ₹22,433 |
| Sensex / Nifty | 27561 / 8361 |
| 3-m average volume | $6.5m |
| Market cap | ₹162bn / $2.5bn |
| Shares outstanding | 4m |

| Shareholding pattern (%) | June '15 | Mar '15 | Dec '14 |
|---|---|---|---|
| Promoters | 27.34 | 27.32 | 27.22 |
| *- of which, Pledged* | 0.47 | 0.47 | 0.57 |
| Free Float | 72.66 | 72.68 | 72.78 |
| - Foreign Institutions | 8.97 | 9.45 | 8.75 |
| - Domestic Institutions | 9.52 | 9.14 | 9.38 |
| - Public | 54.17 | 54.09 | 54.65 |

Relative price performance




*Source: Bloomberg*

| Key financials (Year-end: Mar) | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Sales (₹ m) | 121,321 | 131,879 | 142,429 | 160,945 | 181,867 |
| Net profit (₹ m) | 8,022 | 8,979 | 12,764 | 14,127 | 15,386 |
| EPS (₹) | 1,891.6 | 2,117.2 | 3,010.5 | 3,331.8 | 3,628.7 |
| Growth (%) | 40.2 | 11.9 | 42.2 | 10.7 | 8.9 |
| PE (x) | 20.1 | 18.0 | 12.7 | 11.4 | 10.5 |
| PBV (x) | 4.4 | 3.6 | 2.8 | 2.3 | 1.9 |
| RoE (%) | 24.7 | 22.0 | 24.8 | 21.9 | 19.4 |
| RoCE (%) | 15.6 | 15.0 | 17.4 | 16.6 | 16.5 |
| Dividend yield (%) | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Net gearing (%) | 0.4 | 0.4 | 0.2 | 0.2 | 0.1 |

*Source: Company, Anand Rathi Research*

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# Quick Glance – Financials and Valuations

### Fig 1 – Income statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Net revenues | 121,321 | 131,879 | 142,429 | 160,945 | 181,867 |
| Revenue growth (%) | 2.4 | 8.7 | 8.0 | 13.0 | 13.0 |
| - Oper. expenses | 103,655 | 112,599 | 116,814 | 133,364 | 152,244 |
| **EBIDTA** | **17,666** | **19,279** | **25,615** | **27,580** | **29,623** |
| EBITDA margin (%) | 14.6 | 14.6 | 18.0 | 17.1 | 16.3 |
| - Interest expenses | 1,959 | 2,316 | 2,474 | 2,149 | 1,906 |
| - Depreciation | 3,729 | 4,231 | 4,718 | 5,078 | 5,438 |
| + Other income | 290 | 656 | 600 | 700 | 650 |
| - Tax | 4,246 | 4,410 | 6,259 | 6,927 | 7,544 |
| Effective tax rate (%) | 34.6 | 32.9 | 32.9 | 32.9 | 32.9 |
| Reported PAT | 8,022 | 8,979 | 12,764 | 14,127 | 15,386 |
| +/- Extraordinary items | 0 | 0 | 0 | 0 | 0 |
| +/- Minority interest | 0 | 0 | 0 | 0 | 0 |
| Adjusted PAT | 8,022 | 8,979 | 12,764 | 14,127 | 15,386 |
| Adj. FDEPS (₹/sh) | 1,891.6 | 2,117.2 | 3,010.5 | 3,331.8 | 3,628.7 |
| Adj. FDEPS growth (%) | 40.2 | 11.9 | 42.2 | 10.7 | 8.9 |

*Source: Company, Anand Rathi Research*

### Fig 2 – Balance sheet (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Share capital | 42 | 42 | 42 | 42 | 42 |
| Reserves & surplus | 36,409 | 45,134 | 57,644 | 71,517 | 86,649 |
| Shareholders' fund | 36,451 | 45,176 | 57,687 | 71,560 | 86,692 |
| Minority Interest | | | | | |
| Debt | 15,990 | 19,028 | 19,028 | 14,028 | 5,028 |
| Deferred tax / others | 2,223 | 2,353 | 2,353 | 2,353 | 2,353 |
| **Capital employed** | **54,664** | **66,557** | **79,068** | **87,941** | **94,072** |
| | | | | | |
| Fixed assets | 33,287 | 40,554 | 39,569 | 39,991 | 40,053 |
| Investments | 9,062 | 10,879 | 11,879 | 12,879 | 13,879 |
| Working capital | 9,008 | 8,048 | 13,498 | 16,951 | 20,068 |
| Cash | 3,308 | 7,077 | 14,121 | 18,120 | 20,072 |
| **Capital deployed** | **54,665** | **66,557** | **79,068** | **87,941** | **94,072** |
| Net Debt | 3,620 | 1,072 | -6,973 | -16,971 | -28,924 |
| W C turn (days) | 64 | 70 | 85 | 98 | 99 |
| Book value (₹/sh) | 8,595 | 10,652 | 13,605 | 16,877 | 20,446 |

*Source: Company, Anand Rathi Research*

### Fig 3 – Cash-flow statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Reported PAT | 8,022 | 8,979 | 12,764 | 14,127 | 15,386 |
| + Depreciation | 4,085 | 4,361 | 4,718 | 5,078 | 5,438 |
| Cash profit | 12,107 | 13,340 | 17,482 | 19,205 | 20,824 |
| - Incr./(Decr.) in WC | 813 | 150 | 5,450 | 3,453 | 3,117 |
| Operating cash-flow | 11,294 | 13,190 | 12,032 | 15,752 | 17,706 |
| - Capex | 3,732 | 11,498 | 3,733 | 5,500 | 5,500 |
| Free-cash flow | 7,562 | 1,693 | 8,299 | 10,252 | 12,206 |
| - Dividend | 149 | 254 | 254 | 254 | 254 |
| + Equity raised | 0 | 0 | 0 | 0 | 0 |
| + Debt raised | -1,089 | 3,038 | 0 | -5,000 | -9,000 |
| - Investments | 4,815 | 1,818 | 1,000 | 1,000 | 1,000 |
| - Misc. items | -1,899 | -1,370 | 0 | 0 | 0 |
| Net cash- flow | 3,409 | 4,029 | 7,045 | 3,998 | 1,952 |
| + Opening cash | 611 | 3,308 | 7,077 | 14,121 | 18,120 |
| Closing cash | 3,308 | 7,077 | 14,121 | 18,120 | 20,072 |

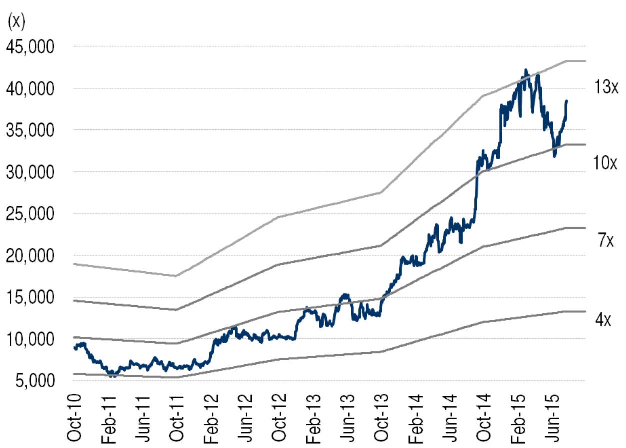
*Source: Company, Anand Rathi Research*

### Fig 4 – Ratio analysis @ ₹ 38,100

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| P/E (x) | 20.1 | 18.0 | 12.7 | 11.4 | 10.5 |
| P/B (x) | 4.4 | 3.6 | 2.8 | 2.3 | 1.9 |
| EV/EBITDA (x) | 9.9 | 9.0 | 6.5 | 5.7 | 4.9 |
| RoE (%) | 24.7 | 22.0 | 24.8 | 21.9 | 19.4 |
| RoCE (%) | 15.6 | 15.0 | 17.4 | 16.6 | 16.5 |
| Dividend yield | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Dividend payout (%) | 1.9 | 2.8 | 2.0 | 1.8 | 1.7 |
| RM to sales (%) | 65.1 | 63.5 | 58.5 | 59.5 | 60.5 |
| EBITDA growth (%) | 40.1 | 9.1 | 32.9 | 7.7 | 7.4 |
| EPS growth (%) | 40.2 | 11.9 | 42.2 | 10.7 | 8.9 |
| PAT margin (%) | 6.6 | 6.8 | 9.0 | 8.8 | 8.5 |
| Debtor days | 41 | 41 | 41 | 40 | 40 |
| Inventory days | 52 | 50 | 50 | 50 | 50 |
| Creditors days | 30 | 33 | 35 | 33 | 33 |
| Working capital days | 64 | 69 | 85 | 98 | 99 |

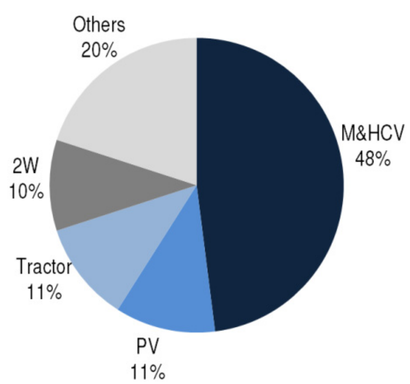
*Source: Company, Anand Rathi Research*

### Fig 5 – PE band




*Source: Bloomberg, Anand Rathi Research*

### Fig 6 – FY11 revenue breakup (standalone)




*Source: Company*

## Revenue growth to be driven by strong replacement demand

Of India's tyre manufacturers, MRF is the largest, with diversified operations across sub-segments (two-wheelers, passenger cars, commercial vehicles and tractors). In the last five years, its strong brand image and diversified products have resulted in a 19% revenue CAGR, against 17% reported by the tyre sector overall, with a best-in-class EBITDA margin.

In CV tyres, the company is the second-largest with a 21% market share. Our channel checks suggest that it has a strong brand image among dealers and CV-fleet operators. It sells both its low-demand products along with its regular-demand ones. Also, it is the only company which determines the price at which dealers should sell its products.

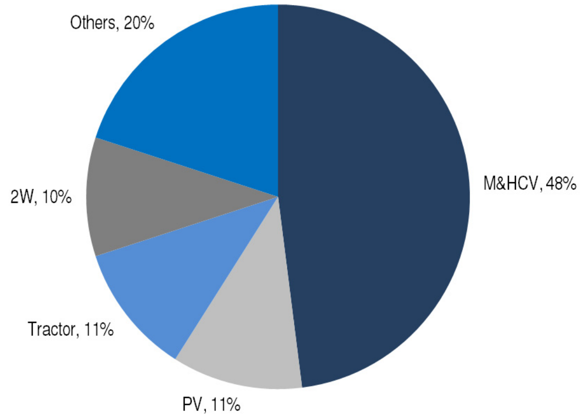
We believe that it would be the one of the largest beneficiaries of the domestic CV recovery due to its extensive distribution network and strong brand image.

Seventy-six percent of its revenue comes from the replacement market. Given the recovery in domestic auto demand, we expect the company's revenue to register a 10% CAGR over FY16-17.

### Focus on Defence to benefit it in the long run

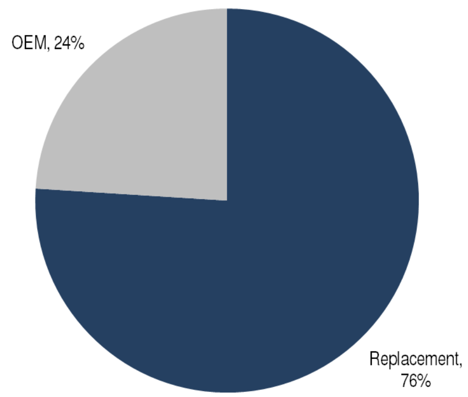
The first Indian company to venture into Defence, in 2008, MRF was the sole supplier of tyres for the Chetak helicopter of the Indian Air Force and for Hindusthan Aeronautics. It also supplies the main-wheel tyres for Sukhoi 30 MKI, the most advanced fighter aircraft in the IAF fleet, making it one of the few global OEMs supplying tyres to the Defence Department. Although at present the contribution from this sub-segment is negligible, it could be the next big thing for MRF.

**Fig 7 – Segment-wise revenue in FY14 (Sep-end)**




*Source: Company*

**Fig 8 – Breakup of sales in FY14 (Sep-end)**




*Source: Company*

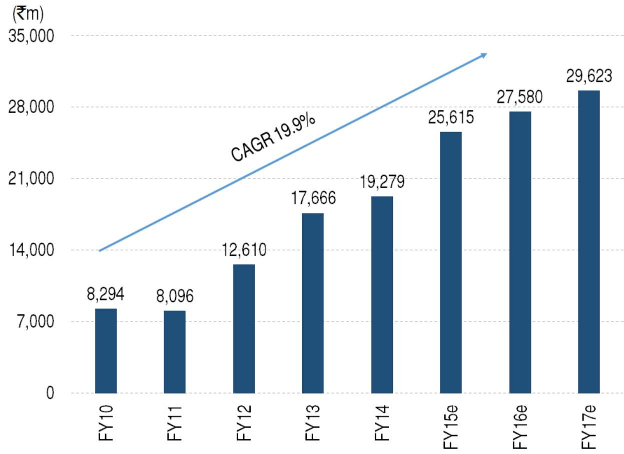
## Better mix and pricing power help to better margins

Its exposure to the replacement market has aided MRF in maintaining its margin, the best of its peers, consistently. The greater proportion of replacement tyres (~76%), strong brand recall and a better product mix have pushed up its gross margins. Also, its diversified product mix has assisted it in high utilisation, reducing EBITDA volatility in a downturn.

The EBITDA margin has improved from 10.6% in FY12 to ~18% expected in FY15 (Sep ending). Apart from the better product mix, lower raw material prices (of rubber and crude oil) have contributed to this gain. Ahead, the radialisation trend is expected to grow significantly.

We believe that MRF will maintain its industry-leading EBITDA margin supported by scale, its strong brand recall, higher pricing power and better product mix, and lower rubber prices.

**Fig 9 – EBITDA growth**




*Source:*

## Wide dealer network, strong brand recall

The largest tyre manufacturer in India, MRF has diversified operations in two-wheeler, PV, LCV, M&H CV and tractor tyres. In the last two years, when the domestic CV sub-segment went through its toughest downturn, all major tyre manufacturers suffered. With its diversified operations, though, MRF outpaced the overall sector growth as well as that of its peers. In the last five years, it registered a 19% CAGR, against the 17% CAGR reported by the tyre sector.

It has the widest distribution network in India, ~4,500 dealers and 300 Tyre & Service franchisees (exclusively marketing MRF tyres and offering specialised services such as computerised wheel alignment and balancing). Moreover, 76% of its revenue arises ~ from the replacement market.

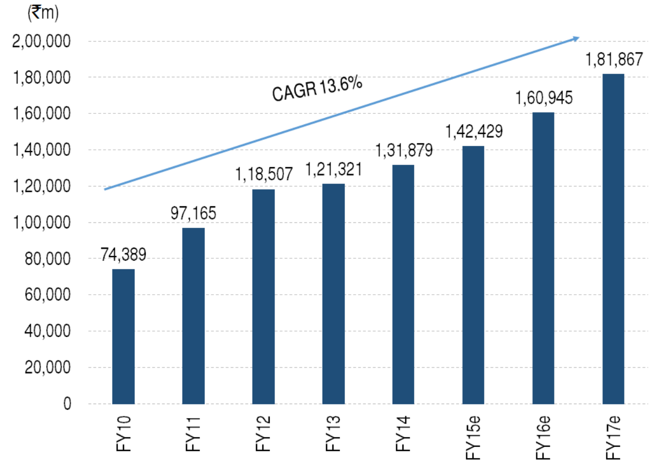
We believe that MRF, after Apollo Tyres, would be one of biggest beneficiaries of the domestic CV recovery because of its wide distribution network and strong brand image. Our channel checks suggest that it has a strong brand image among dealers and CV fleet operators, helping it retain a high market share despite stiff competition.

# Financials

### Revenue expected at a 13% CAGR over FY15-17

During FY13-15, the company registered a 7% revenue CAGR. We expect a much better performance over FY15-17. This growth is likely to come from stronger replacement demand as well as greater original-equipment demand, primarily driven by the M&H CV sub-segment.

**Fig 10 – Revenue growth**



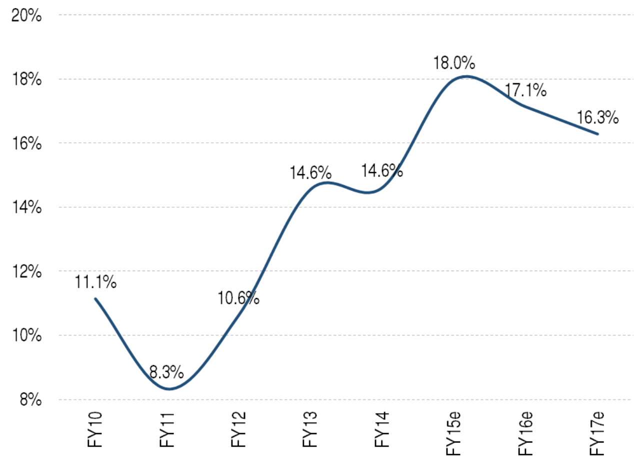

*Source: Company, Anand Rathi Research*

### Best-in-class margins

The cost of raw materials amounts to ~70% of the revenue of a typical tyre company, with natural rubber being the most crucial input. Economists worldwide have predicted lower to stagnant growth for China, emphasising that prices of crude oil and rubber may continue soft in the near future.

Despite lower revenue growth during FY13-15, the company maintained its EBITDA margin at ~15%. In fact, its EBITDA margins for the last two quarters have come at ~18%. We expect it to hold to an EBITDA margin of ~17% during FY15-17.

**Fig 11 – Steady EBITDA margin**

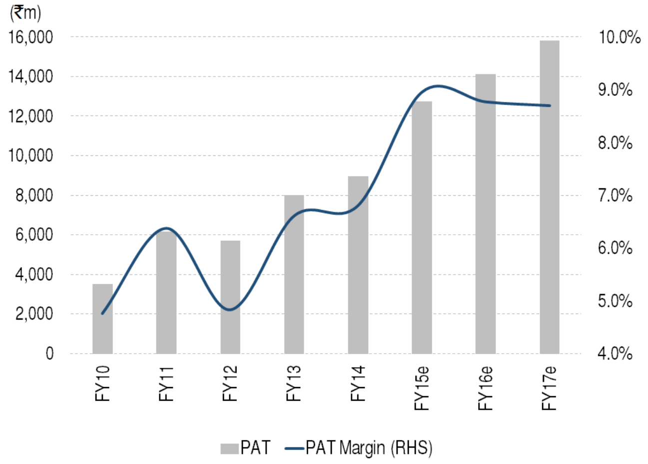



*Source: Company, Anand Rathi Research*

## PAT to come at a 10% CAGR over FY15-17

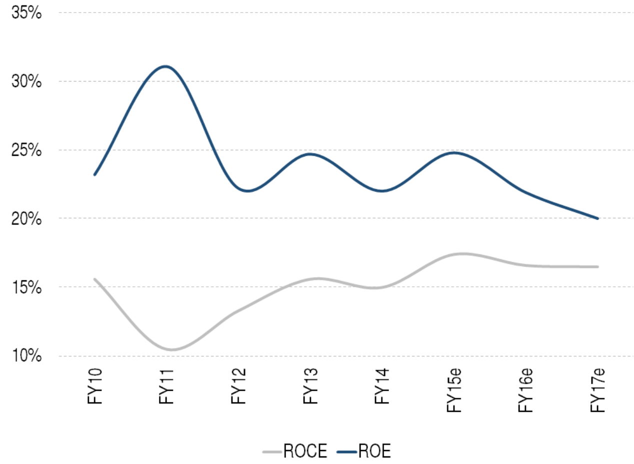
Driven by 13% revenue growth, the company may register 9% PAT growth through FY15-17. This converts to an EPS of ₹3,629 for FY17.

### Fig 12 – PAT growth and margin




*Source: Company, Anand Rathi Research*

### Fig 13 – RoCE and RoE




*Source:Company, Anand Rathi Research*

### Fig 14 – Income statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15e | FY16e | FY17e |
|---|---|---|---|---|---|
| **Net Sales** | **121,321** | **131,879** | **142,429** | **160,945** | **181,867** |
| Raw Materials | 79,002 | 83,696 | 83,321 | 95,762 | 110,030 |
| Employee Cost | 6,035 | 7,327 | 8,426 | 9,437 | 10,569 |
| Other Expenses | 18,618 | 21,577 | 25,067 | 28,165 | 31,645 |
| **Total Expenditure** | **1,03,655** | **112,599** | **116,814** | **133,364** | **152,244** |
| **EBITDA** | **17,666** | **19,279** | **25,615** | **27,580** | **29,623** |
| Other Income | 290 | 656 | 600 | 700 | 650 |
| Interest | 1,959 | 2,316 | 2,474 | 2,149 | 1,906 |
| Depreciation | 3,729 | 4,231 | 4,718 | 5,078 | 5,438 |
| **PBT** | **12,268** | **13,389** | **19,023** | **21,054** | **22,930** |
| Total tax | 4,246 | 4,410 | 6,259 | 6,927 | 7,544 |
| **PAT** | **8,022** | **8,979** | **12,764** | **14,127** | **15,386** |
| Less: Adjustments | 0 | 0 | 0 | 0 | 0 |
| **Adjusted PAT** | **8,022** | **8,979** | **12,764** | **14,127** | **15,386** |

*Source: Company, Anand Rathi Research*

**Fig 15 – Balance sheet (₹ m)**

| Year-end: Mar | FY13 | FY14 | FY15e | FY16e | FY17e |
|---|---|---|---|---|---|
| Equity capital | 42 | 42 | 42 | 42 | 42 |
| Reserves & Surplus | 36,409 | 45,134 | 57,644 | 71,517 | 86,649 |
| **Net worth** | **36,451** | **45,176** | **57,687** | **71,560** | **86,692** |
| Minority interest | 0 | 0 | 0 | 0 | 0 |
| **Total debt** | **15,990** | **19,028** | **19,028** | **14,028** | **5,028** |
| **Total** | **63,626** | **76,571** | **89,081** | **97,954** | **1,04,086** |
| | | | | | |
| Net block | 29,642 | 34,217 | 34,499 | 34,421 | 33,983 |
| Capital WIP | 3,591 | 6,267 | 5,000 | 5,500 | 6,000 |
| **Total fixed assets** | **33,287** | **40,554** | **39,569** | **39,991** | **40,053** |
| Investments | 9,062 | 10,879 | 11,879 | 12,879 | 13,879 |
| Net Working capital | | | | | |
| **Current Assets** | **39,876** | **46,116** | **57,140** | **66,508** | **74,165** |
| Inventories | 17,953 | 17,997 | 20,652 | 23,337 | 26,007 |
| Debtors | 15,561 | 17,085 | 18,373 | 20,601 | 23,279 |
| Cash & bank | 3,308 | 7,077 | 14,121 | 18,120 | 20,072 |
| Other Current Assets | 3,054 | 3,957 | 3,994 | 4,451 | 4,806 |
| **Current Liabilities & Provisions** | **16,724** | **19,046** | **17,575** | **19,492** | **22,079** |
| Creditors | 7,014 | 7,997 | 7,915 | 9,289 | 10,673 |
| Other liabilities | 7,019 | 7,916 | 8,439 | 8,982 | 10,185 |
| Provisions | 2,691 | 3,133 | 1,221 | 1,221 | 1,221 |
| Net Deferred Tax Assets | -2,223 | -2,353 | -2,353 | -2,353 | -2,353 |
| Miscellaneous Exp | 0 | 0 | 0 | 0 | 0 |
| **Total** | **63,626** | **76,571** | **89,081** | **97,954** | **104,086** |

*Source: Company, Anand Rathi Research*

**Fig 16 – Cash-flow statement (₹ m)**

| Year-end: Mar | FY13 | FY14 | FY15e | FY16e | FY17e |
|---|---|---|---|---|---|
| PAT | 8,022 | 8,979 | 12,764 | 14,127 | 15,386 |
| Add: Depreciation | 3,729 | 4,231 | 4,718 | 5,078 | 5,438 |
| Add: Interest expense | 1,959 | 2,316 | 2,474 | 2,149 | 1,906 |
| Less: Other income | -290 | -656 | -600 | -700 | -650 |
| Change in working capital | 374 | 960 | -5,450 | -3,453 | -3,117 |
| Others | 0 | 0 | 0 | 0 | 0 |
| **Cash flow from operations** | **13,795** | **15,830** | **13,906** | **17,201** | **18,962** |
| Change in fixed assets | -3,732 | -11,498 | -3,733 | -5,500 | -5,500 |
| Change in investments | -4,815 | -1,818 | -1,000 | -1,000 | -1,000 |
| Other income | 290 | 656 | 600 | 700 | 650 |
| Others | 0 | 0 | 0 | 0 | 0 |
| **Cash flow from investing activities** | **-8,256** | **-12,659** | **-4,133** | **-5,800** | **-5,850** |
| Change in debt | -1,089 | 3,038 | 0 | -5,000 | -9,000 |
| Dividend & dividend tax | -149 | -254 | -254 | -254 | -254 |
| Change in equity & share premium | 0 | 0 | 0 | 0 | 0 |
| Interest paid | -1,959 | -2,316 | -2,474 | -2,149 | -1,906 |
| Other Adjustments | 356 | 130 | 0 | -0 | 0 |
| **Cash flow from financing activities** | **-2,841** | **598** | **-2,728** | **-7,403** | **-11,160** |
| Change in cash & cash equivalents | 2,697 | 3,769 | 7,045 | 3,998 | 1,952 |
| Opening cash and cash equivalents | 611 | 3,308 | 7,077 | 14,121 | 18,120 |
| Closing cash and cash equivalents | 3,308 | 7,077 | 14,121 | 18,120 | 20,072 |

*Source: Company, Anand Rathi Research*

**Fig 17 – Ratio analysis @ ₹38,100**

| Year-end: Mar | FY13 | FY14 | FY15e | FY16e | FY17e |
|---|---|---|---|---|---|
| Percent of net sales | | | | | |
| Raw material costs | 65.1 | 63.5 | 58.5 | 59.5 | 60.5 |
| Employee costs | 5.0 | 5.6 | 5.9 | 5.9 | 5.8 |
| Total expenses | 85.4 | 85.4 | 82.0 | 82.9 | 83.7 |
| EBIDTA | 14.6 | 14.6 | 18.0 | 17.1 | 16.3 |
| PAT | 6.6 | 6.8 | 9.0 | 8.8 | 8.5 |
| Asset based ratios (%) | | | | | |
| ROCE | 15.6 | 15.0 | 17.4 | 16.6 | 16.5 |
| ROE | 24.7 | 22.0 | 24.8 | 21.9 | 19.4 |
| Turnover ratios (days) | | | | | |
| Debtor days | 41 | 41 | 41 | 40 | 40 |
| Inventory days | 52 | 50 | 50 | 50 | 50 |
| Creditors days | 30 | 33 | 35 | 33 | 33 |
| Working capital days | 64 | 70 | 85 | 98 | 99 |
| Growth ratios (%) | | | | | |
| Net Sales | 2.4 | 8.7 | 8.0 | 13.0 | 13.0 |
| EBITDA | 40.1 | 9.1 | 32.9 | 7.7 | 7.4 |
| EPS | 40.2 | 11.9 | 42.2 | 10.7 | 8.9 |
| CEPS | 34.5 | 12.4 | 32.4 | 9.9 | 8.4 |
| Per share (₹) | | | | | |
| EPS | 1,891.6 | 2,117.2 | 3,010.5 | 3,331.8 | 3,628.7 |
| CEPS | 2,770.9 | 3,114.8 | 4,123.2 | 4,529.5 | 4,911.3 |
| BV | 8,595.0 | 10,652.3 | 13,605.4 | 16,877.3 | 20,446.1 |
| DPS | 29.9 | 50.0 | 50.0 | 50.0 | 50.0 |
| Valuations (x) | | | | | |
| P/E | 18.7 | 16.7 | 11.7 | 10.6 | 9.7 |
| P/CEPS | 12.8 | 11.3 | 8.6 | 7.8 | 7.2 |
| P/BV | 4.1 | 3.3 | 2.6 | 2.1 | 1.7 |
| Yield (%) | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| EV/EBITDA | 9.2 | 8.4 | 6.0 | 5.3 | 4.6 |
| EV/sales | 1.3 | 1.2 | 1.1 | 0.9 | 0.7 |
| Solvency ratios | | | | | |
| Current ratio | 2.4 | 2.4 | 3.3 | 3.4 | 3.4 |
| Quick ratio | 0.2 | 0.4 | 0.8 | 0.9 | 0.9 |
| D/E ratio | 0.4 | 0.4 | 0.3 | 0.2 | 0.1 |
| Interest coverage ratio | 4.7 | 4.5 | 5.8 | 7.2 | 8.7 |

*Source: Company, Anand Rathi Research*

# Outlook and Valuations

After a 6% CAGR through FY13-15, we expect revenue to register a 13% CAGR during FY15-17, driven by strong replacement demand and greater original-equipment demand. Also, soft rubber prices would assist in better margins. We expect the EBITDA margin to come at ~17%. In the past five years, the company has been valued at an average P/E of 12x.

We value it at 12x FY17e earnings. We initiate coverage, with a Buy and a target price of ₹43,500.

### Risks

- Steep rises in prices of rubber and crude oil.

ANANDRATHI

India I Equities

Auto

Initiating Coverage

27 July 2015

# JK Tyres

Rating: **Buy**
Target Price: ₹115
Share Price: ₹100

*Pure play on CV recovery; initiating, with a Buy*

**We initiate coverage on JK Tyres, with a Buy rating and a target price of ₹115. Being a leading player in the domestic truck-and-bus radial-tyre sub-segment, it is poised to grow significantly as we expect the M&H CV sub-segment to register a 15% CAGR through FY15-17. Also, lower rubber prices could help improve margins.**

**Leader in domestic truck and bus radials.** The company leads the market in the truck-and-bus radial-tyre sub-segment, with a 34% domestic market share, along with a 30% market share in light commercial vehicle (LCV) tyres.

**Capacity increase in TBRs and passenger-car radials (PCR).** The company is on the verge of raising its Indian TBR capacity (by 0.8m units) and its PCR capacity (by 1.64m units). Production at these expanded capacities is expected to come on-stream from H2 CY15. We expect the Indian capacities to register ~12% operating revenue CAGR during FY15-17 together with greater capacity utilisation.

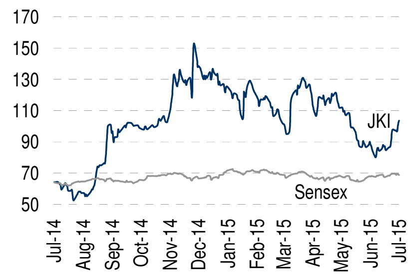
**Better operations at Tornel.** The Mexico-based Tornel accounts for ~23% of revenue and 52% of net profit. It has raised PCR capacity (by ~1.65m units), which is likely to come on-stream in H2 CY15. We expect the Mexican operations to register an operating revenue CAGR of over 12% during FY15-17.

**Valuation**. The growth cycle is expected to be kick-started from FY16 as capex on the expanded capacities would then start generating returns. We expect higher revenues (an 11% CAGR over FY15-17) along with expanded margins. We initiate coverage on JK Tyres & Industries with a Buy rating, valuing it at 5.5x FY17e for a target of ₹115. **Risks** Higher rubber prices, competition from Chinese tyres in the truck bus tyre sub-segment.

| Key data | JKI IN / JKIN.BO |
|---|---|
| 52-week high / low | ₹163 / ₹51 |
| Sensex / Nifty | 27561 / 8361 |
| 3-m average volume | $3.5m |
| Market cap | ₹23bn / $0.4bn |
| Shares outstanding | 227m |

| Shareholding pattern (%) | June '15 | Mar '15 | 8 Jan '15 |
|---|---|---|---|
| Promoters | 52.34 | 52.34 | 52.34 |
| *- of which, Pledged* | - | - | - |
| Free Float | 47.66 | 47.66 | 47.66 |
| - Foreign Institutions | 12.32 | 14.31 | 12.06 |
| - Domestic Institutions | 2.59 | 2.71 | 5.62 |
| - Public | 32.75 | 30.64 | 29.98 |

Relative price performance




*Source: Bloomberg*

| Key financials (Year-end: Mar) | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Sales (₹ m) | 69,852 | 76,518 | 73,837 | 81,292 | 90,342 |
| Net profit (₹ m) | 4,711 | 5,483 | 3,239 | 4,446 | 4,682 |
| EPS (₹) | 22.9 | 26.7 | 14.3 | 19.6 | 20.6 |
| Growth (%) | 99.0 | 16.4 | (46.5) | 37.3 | 5.3 |
| PE (x) | 4.7 | 3.8 | 6.3 | 5.0 | 4.8 |
| PBV (x) | 0.5 | 0.4 | 0.3 | 0.2 | 0.2 |
| RoE (%) | 52.0 | 50.6 | 23.1 | 24.3 | 20.5 |
| RoCE (%) | 21.3 | 26.1 | 17.8 | 18.7 | 17.6 |
| Dividend yield (%) | 0.7 | 0.7 | 0.8 | 0.8 | 0.9 |
| Net gearing (%) | 76.9 | 73.0 | 71.0 | 66.0 | 60.9 |

*Source: Company, Anand Rathi Research*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# Quick Glance – Financials and Valuations

### Fig 1 – Income statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Net revenues | 69,852 | 76,518 | 73,837 | 81,292 | 90,342 |
| Revenue growth (%) | 3.0 | 9.5 | -3.5 | 10.1 | 11.1 |
| - Oper. expenses | 60,929 | 64,877 | 64,530 | 70,239 | 78,646 |
| **EBIDTA** | 8,923 | 11,641 | 9,308 | 11,053 | 11,696 |
| EBITDA margin (%) | 12.8 | 15.2 | 12.6 | 13.6 | 12.9 |
| - Interest expenses | 2,328 | 2,762 | 2,574 | 2,728 | 2,777 |
| - Depreciation | 1,328 | 1,795 | 1,578 | 1,907 | 2,157 |
| + Other income | 137 | 183 | 169 | 156 | 161 |
| - Tax | 675 | 1,188 | 1,617 | 2,128 | 2,241 |
| Effective tax rate (%) | 12.5 | 17.8 | 33.3 | 32.4 | 32.4 |
| Reported PAT | 4,711 | 5,483 | 3,239 | 4,446 | 4,682 |
| +/- Extraordinary items | 0 | 0 | 0 | 0 | 0 |
| +/- Minority interest | 0 | 0 | 0 | 0 | 0 |
| Adjusted PAT | 4,711 | 5,483 | 3,239 | 4,446 | 4,682 |
| Adj. FDEPS (₹/sh) | 22.9 | 26.7 | 14.3 | 19.6 | 20.6 |
| Adj. FDEPS growth (%) | 99.0 | 16.4 | (46.5) | 37.3 | 5.3 |

*Source: Company, Anand Rathi Research*

### Fig 2 – Balance sheet (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Share capital | 411 | 411 | 454 | 454 | 454 |
| Reserves & surplus | 8,654 | 10,561 | 13,557 | 17,867 | 22,402 |
| Net worth | 9,065 | 10,848 | 14,010 | 18,321 | 22,856 |
| Minority interest | 0 | 0 | 0 | 0 | 0 |
| Total debt | 25,347 | 25,060 | 27,094 | 28,094 | 29,094 |
| Def. tax liab. (net) | 1,921 | 2,524 | 3,198 | 3,213 | 3,228 |
| **Capital employed** | **36,332** | **38,555** | **44,303** | **49,628** | **55,178** |
| Net fixed assets | 27,144 | 26,903 | 35,316 | 38,409 | 41,251 |
| Investments | 1,039 | 1,154 | 1,403 | 1,403 | 1,403 |
| *- of which, Liquid* | | | | | |
| Net working capital | 5,986 | 6,364 | 5,678 | 6,003 | 6,857 |
| Cash and bank balance | 1,401 | 2,363 | 1,406 | 3,065 | 4,668 |
| **Capital deployed** | **36,332** | **38,555** | **44,302** | **49,628** | **55,178** |
| Net debt | 252.7 | 198.6 | 169.8 | 131.8 | 104.2 |
| WC days | 57 | 58 | 63 | 61 | 60 |
| Book value (₹/sh) | 44.2 | 53.4 | 61.8 | 80.8 | 100.8 |

*Source: Company, Anand Rathi Research*

### Fig 3 – Cash-flow statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| PAT | 4,711 | 5,483 | 3,239 | 4,446 | 4,682 |
| + Non-cash items | 1,328 | 1,795 | 1,578 | 1,907 | 2,157 |
| Cash profit | 6,039 | 7,278 | 4,817 | 6,353 | 6,839 |
| - Incr./(Decr.) in WC | -4,910 | -378 | 686 | -325 | -854 |
| Operating cash-flow | 1,129 | 6,900 | 5,503 | 6,028 | 5,985 |
| - Capex | -2,887 | -2,563 | -8,719 | -5,250 | -5,250 |
| Free-cash flow | -1,758 | 4,337 | -3,216 | 778 | 735 |
| - Dividend | -144 | -154 | -181 | -192 | -204 |
| + Equity raised | -3,121 | -3,497 | -76 | 0 | 0 |
| + Debt raised | 4,897 | -287 | 2,034 | 1,000 | 1,000 |
| - Investments | 32 | 116 | 248 | 0 | 0 |
| - Misc. items | 446 | 447 | 235 | 73 | 73 |
| Net cash-flow | 352 | 962 | -956 | 1,659 | 1,603 |
| + Op. cash & bank bal. | 1,049 | 1,401 | 2,363 | 1,406 | 3,065 |
| Cl. cash & bank bal. | 1,401 | 2,363 | 1,406 | 3,065 | 4,668 |

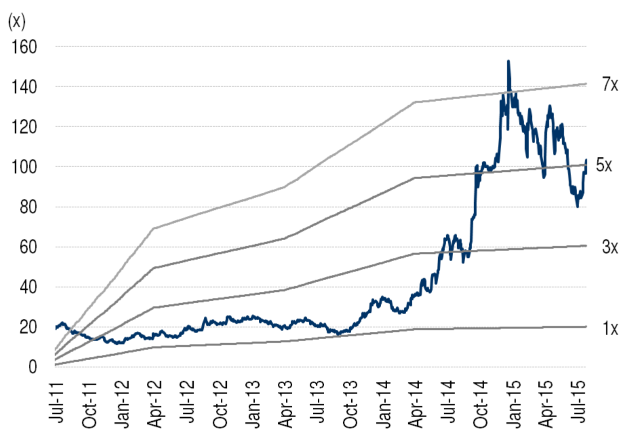
*Source: Company, Anand Rathi Research*

### Fig 4 – Ratio analysis @ ₹100

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| P/E (x) | 4.7 | 3.8 | 6.3 | 5.0 | 4.8 |
| P/B (x) | 0.5 | 0.4 | 0.3 | 0.2 | 0.2 |
| EV/sales | 0.4 | 0.3 | 0.4 | 0.3 | 0.3 |
| EV/EBITDA (x) | 3.0 | 2.2 | 3.1 | 2.5 | 2.4 |
| RoE (%) | 52.0 | 50.0 | 23.1 | 24.3 | 20.5 |
| RoCE (%) | 21.3 | 26.0 | 17.8 | 18.7 | 17.6 |
| Dividend yield | 0.7 | 0.7 | 0.8 | 0.8 | 0.9 |
| Dividend payout (%) | 3.0 | 2.8 | 5.5 | 4.2 | 4.2 |
| RM to sales (%) | 69.2 | 63.9 | 61.9 | 60.2 | 61.2 |
| EBITDA growth (%) | 47.8 | 30.5 | -20.0 | 18.8 | 5.8 |
| EPS growth (%) | 99.0 | 16.4 | (46.5) | 37.3 | 5.3 |
| PAT margin (%) | *6.8* | *7.3* | *4.5* | *5.5* | *5.2* |
| Debtors (days) | 54.9 | 63.7 | 71.5 | 70.0 | 69.0 |
| Inventory (days) | 48.8 | 44.7 | 43.6 | 41.0 | 40.0 |
| Creditors (days) | 47.0 | 50.2 | 52.5 | 53.0 | 53.5 |

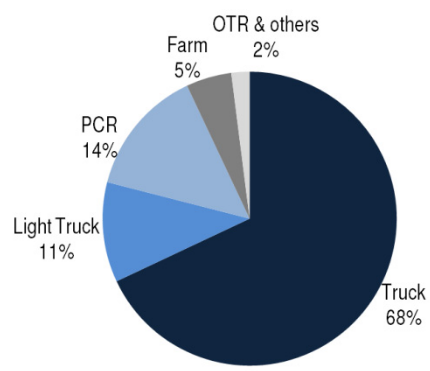
*Source: Company, Anand Rathi Research*

### Fig 5 – PE band




*Source: Bloomberg, Anand Rathi Research*

### Fig 6 – FY15 revenue breakup




*Source: Company*

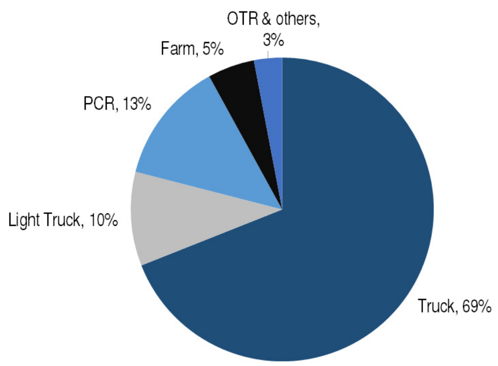
## Leader in domestic truck/bus radials

Domestic tyre demand, following flattish to negative growth during 2013-15, would grow 12-15% during 2015-17, we expect, driven by a robust rise in replacements. M&H CVs, scooters, motorcycles and passenger vehicles are likely to support this, while negative to flattish growth is expected from the tractor and LCV sub-segments

The M&H CV sub-segment, including buses, constitutes ~60% of demand in the Indian tyre sector.

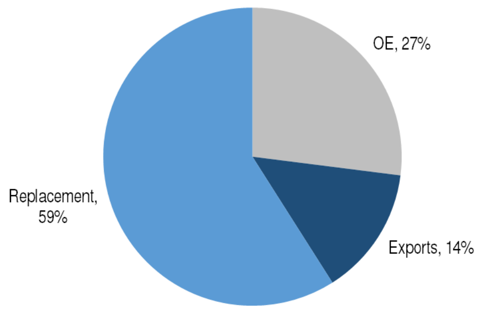
JK Tyres leads the market in the truck-and-bus radial-tyre sub-segment with a 34% domestic market share, along with a 30% market share in light commercial vehicle tyres. Thus, we believe the company is poised to grow during FY15-17.

Fig 7 – Product wise Revenue Distribution FY14




*Source: Company, Anand Rathi Research*

Fig 8 – Segment wise Revenue Distribution FY15




*Source: Company, Anand Rathi Research*

## Greater capacities in TBRs and PCRs

The Indian automobile sector is one of the largest automobile markets in the world. Besides sturdy replacement demand, the sector is on a recovery-cum-growth mode. This would significantly drive demand for tyres in the original-equipment market.

Although passenger vehicles are now more than 90% radial-compliant, the level of radialisation in the M&H CV tyre sub-segment is very low. Various government projects such as the Golden Quadrilateral Project, the North-South and East-West Corridors and various state highway projects are being executed. Completion of these would significantly boost demand for radial tyres in the country in coming years.

The company is on the verge of increasing its Indian TBR capacity, by 0.8m units, and its PCR capacity, by 1.64m units. Production from these expanded capacities is expected to come on-stream from H2 CY15. We expect the Indian operations to register a more than 11% operating revenue CAGR over FY15-17 and greater capacity utilisation.

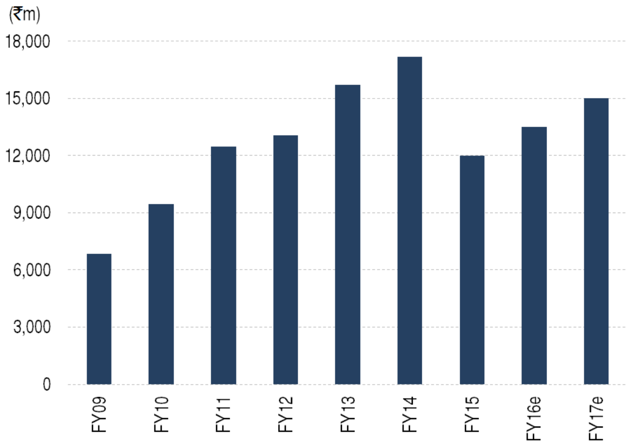
## Improvement in Tornel operations

Tornel in Mexico brings in ~23% to revenue and 52% to net profit. It has expanded capacity in PCRs by ~1.65m units, expected to come on stream in H2 CY15.

We expect the Mexican unit to register ~12% operating revenue CAGR through FY15-17.

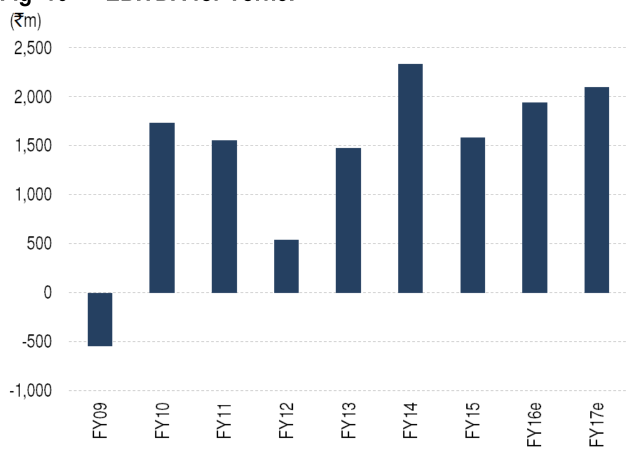
Also, we expect EBITDA to grow ~18% during FY15-17, assisted by better capacity utilisation and lower rubber prices. We expect ~15% EBITDA margin for Tornel.

**Fig 9 – Tornel's revenue**



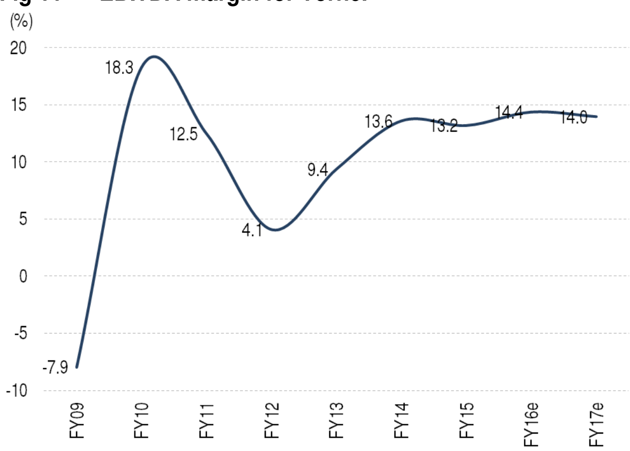

*Source: Company, Anand Rathi Research*

**Fig 10 – EBITDA for Tornel**




*Source: Company, Anand Rathi Research*

**Fig 11 – EBITDA margin for Tornel**



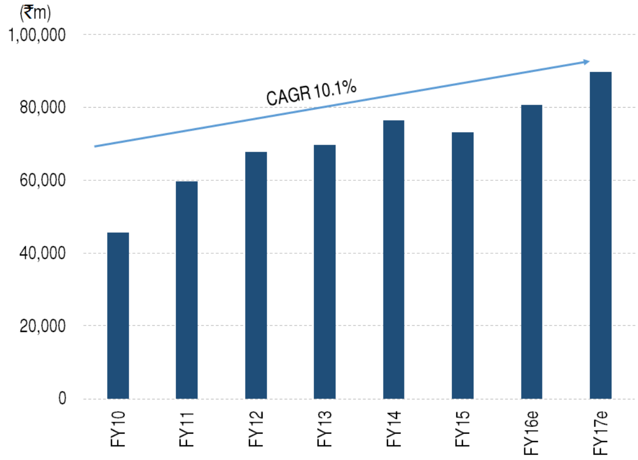

*Source: Company, Anand Rathi Research*

# Financials

## Revenue expected at an 11% CAGR over FY15-17

During FY13-15, the company registered a mere 3% revenue CAGR, the prime reason being the Tornel unit's non performance. Now, we expect a much better performance during FY15-17. This growth is likely to come from stronger replacement demand and higher OE demand.

**Fig 12 – Revenue growth**



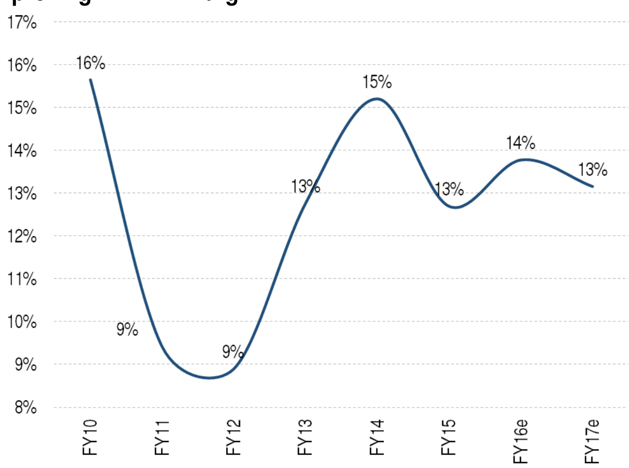

*Source: Company, Anand Rathi Research*

## Margins to improve on soft rubber prices

The cost of raw materials amounts to ~70% of the revenues of a typical tyre company, with natural rubber being the most crucial input. Economists worldwide have predicted lower to stagnant growth in the Chinese economy, emphasising that prices of crude oil and rubber may be soft in the near future.

During FY11-15, the company's average EBITDA was ~12%. We expect it to improve its EBITDA margins to ~13—13.5% during FY15-17.

**Fig 13 – Improving EBIDTA margin**

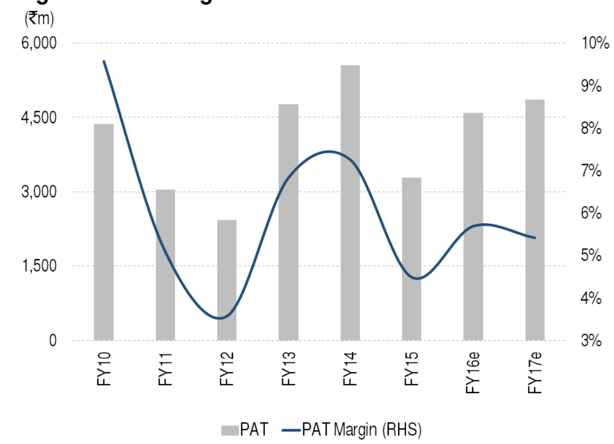



*Source: Company, Anand Rathi Research*

## PAT to record a 22% CAGR over FY15-17

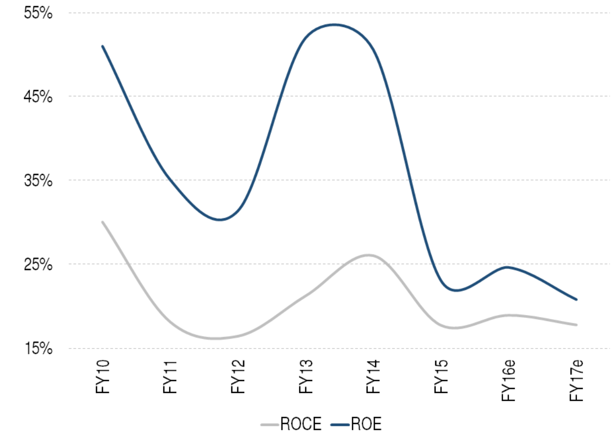
Driven by 11% revenue growth, the company may see 22% PAT growth through FY15-17. This converts to an EPS of ₹21.5 for FY17.

**Fig 14 – PAT growth and margin**




*Source: Company, Anand Rathi Research*

**Fig 15 – RoCE and RoE**




*Source: Company, Anand Rathi Research*

### Fig 16 – Income statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| **Total Income** | 69,852 | 76,518 | 73,837 | 81,292 | 90,342 |
| *Change (%)* | *3.0* | *9.5* | *-3.5* | *10.1* | *11.1* |
| **Expenditure** | 60,929 | 64,877 | 64,530 | 70,239 | 78,646 |
| Incr/Decr in RM | -528 | -385 | 832 | 0 | 0 |
| Raw Material | 48,843 | 49,303 | 44,884 | 48,997 | 55,313 |
| Employee Cost | 5,903 | 7,550 | 7,289 | 8,330 | 9,179 |
| Other Expenses | 6,711 | 8,409 | 11,525 | 12,912 | 14,154 |
| **EBITDA** | 8,923 | 11,641 | 9,308 | 11,053 | 11,696 |
| *% of Net Sales* | *12.8* | *15.2* | *12.6* | *13.6* | *12.9* |
| Depreciation | 1,328 | 1,795 | 1,578 | 1,907 | 2,157 |
| EBIT | 7,595 | 9,846 | 7,730 | 9,146 | 9,539 |
| Interest & Finance Charges | 2,328 | 2,762 | 2,574 | 2,728 | 2,777 |
| Other Income | 137 | 183 | 169 | 156 | 161 |
| **PBT** | 5,386 | 6,672 | 4,856 | 6,574 | 6,923 |
| Tax | 675 | 1,188 | 1,617 | 2,128 | 2,241 |
| **PAT** | 4,711 | 5,483 | 3,239 | 4,446 | 4,682 |
| **EPS (₹)** | 22.9 | 26.7 | 14.3 | 19.6 | 20.6 |

*Source: Company, Anand Rathi Research*

### Fig 17 – Balance sheet (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| **Sources of Funds** | | | | | |
| Equity Capital | 411 | 411 | 454 | 454 | 454 |
| Reserves | 8,654 | 10,437 | 13,557 | 17,867 | 22,402 |
| **Net Worth** | **9,065** | **10,848** | **14,010** | **18,321** | **22,856** |
| Net Deferred Tax | 1,921 | 2,524 | 3,198 | 3,213 | 3,228 |
| Loans | 25,347 | 25,060 | 27,094 | 28,094 | 29,094 |
| **Capital Employed** | **36,332** | **38,432** | **44,303** | **49,628** | **55,178** |
| | | | | | |
| **Application of Funds** | | | | | |
| Gross Fixed Assets | 44,752 | 46,756 | 56,746 | 61,746 | 66,746 |
| Less: Depreciation | 17,608 | 19,853 | 21,431 | 23,338 | 25,495 |
| **Net Fixed Assets** | **27,144** | **26,903** | **35,316** | **38,409** | **41,251** |
| Capital WIP | 762 | 1,771 | 500 | 750 | 1,000 |
| Investments | 1,039 | 1,154 | 1,403 | 1,403 | 1,403 |
| **Curr. Assets, L & Adv.** | **26,681** | **30,597** | **31,819** | **35,061** | **39,023** |
| Inventory | 9,338 | 9,368 | 8,750 | 9,073 | 9,838 |
| Sundry Debtors | 10,499 | 13,351 | 14,346 | 15,491 | 16,970 |
| Cash & Bank Balances | 1,401 | 2,363 | 1,406 | 3,065 | 4,668 |
| Loans & Advances | 5,306 | 4,498 | 6,380 | 6,455 | 6,530 |
| Other current assets | 136 | 1,018 | 938 | 978 | 1,018 |
| Int. accr. on inv. | 0 | 0 | 0 | 0 | 0 |
| **Current Liab. & Prov.** | **19,294** | **21,871** | **24,736** | **25,994** | **27,498** |
| Current Liabilities | 16,744 | 19,269 | 21,362 | 22,585 | 24,054 |
| Creditors | 8,999 | 10,532 | 10,545 | 11,729 | 13,158 |
| Other Liabilities | 7,745 | 8,737 | 10,816 | 10,856 | 10,896 |
| Provisions | 2,550 | 2,602 | 3,374 | 3,409 | 3,444 |
| **Net Current Assets** | **7,387** | **8,727** | **7,084** | **9,067** | **11,524** |
| Miscellaneous Expenditures | 0 | 0 | 0 | 0 | 0 |
| **Application of Funds** | **36,332** | **38,555** | **44,302** | **49,628** | **55,178** |

*Source: Company, Anand Rathi Research*

### Fig 18 – Cash-flow statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| OP/(Loss) before Tax | 7,595 | 9,846 | 7,730 | 9,146 | 9,539 |
| Interest/Div. Received | 137 | 183 | 169 | 156 | 161 |
| Depreciation & Amort. | 1,328 | 1,795 | 1,578 | 1,907 | 2,157 |
| Direct Taxes Paid | -230 | -585 | -943 | -2,113 | -2,226 |
| (Inc)/Dec in Wkg. Capital | -4,910 | -378 | 686 | -325 | -854 |
| Other Items | 0 | 0 | 0 | 0 | 0 |
| CF from Op. Activity | 3,920 | 10,861 | 9,220 | 8,771 | 8,777 |
| | | | | | |
| Extraordinary Items | 46 | -521 | -411 | 58 | 58 |
| Other Items | | | | | |
| **CF after EO Items** | **3,967** | **10,340** | **8,809** | **8,829** | **8,835** |
| | | | | | |
| (Incr.)/Decr. in FA+CWIP | -2,887 | -2,563 | -8,719 | -5,250 | -5,250 |
| (Pur)/Sale of Invest. | -32 | -116 | -248 | 0 | 0 |
| **CF from Inv. Activity** | **-2,919** | **-2,678** | **-8,967** | **-5,250** | **-5,250** |
| | | | | | |
| Incr../(Decr.) in Net worth | -3,121 | -3,621 | 47 | 0 | 0 |
| Incr./(Decr.) in Debt | 4,897 | -287 | 2,034 | 1,000 | 1,000 |
| Interest Paid | -2,328 | -2,762 | -2,574 | -2,728 | -2,777 |
| Dividends Paid | -144 | -154 | -181 | -193 | -204 |
| **CF from Fin. Activity** | **-696** | **-6,824** | **-674** | **-1,921** | **-1,982** |
| | | | | | |
| **Incr./(Decr.) in Cash** | **352** | **838** | **-832** | **1,658** | **1,603** |
| Add: Beginning Balance | 1,049 | 1,401 | 2,363 | 1,406 | 3,065 |
| **Closing Balance** | **1,401** | **2,239** | **1,530** | **3,064** | **4,668** |

*Source: Company, Anand Rathi Research*

### Fig 19 – Ratio analysis @ ₹100

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| **Basic (₹)** | | | | | |
| EPS Consolidated | 23.3 | 29.0 | 15.9 | 19.9 | 20.9 |
| *Cons. EPS growth (%)* | *74.4* | *24.4* | *-39.4* | *24.7* | *5.2* |
| Cash EPS | 29.4 | 35.5 | 21.2 | 28.0 | 30.2 |
| Book Value per Share | 44.2 | 53.4 | 61.8 | 80.8 | 100.8 |
| DPS | 0.7 | 0.8 | 0.8 | 0.9 | 0.9 |
| Payout % | 3.0 | 2.8 | 5.5 | 4.3 | 4.3 |
| **Valuation (x)** | | | | | |
| P/E Consolidated (Diluted) | 4.7 | 3.8 | 6.3 | 5.0 | 4.8 |
| Cash P/E | 3.4 | 2.8 | 4.7 | 3.6 | 3.3 |
| EV/EBITDA | 3.0 | 2.2 | 3.1 | 2.5 | 2.4 |
| EV/Sales | 0.4 | 0.3 | 0.4 | 0.3 | 0.3 |
| Price to Book Value | 0.5 | 0.4 | 0.3 | 0.2 | 0.2 |
| Dividend Yield (%) | 0.7 | 0.8 | 0.8 | 0.9 | 0.9 |
| **Profitability Ratios (%)** | | | | | |
| RoE | 52.0 | 50.0 | 23.1 | 24.3 | 20.5 |
| RoCE | 21.3 | 26.0 | 17.8 | 18.7 | 17.6 |
| RoIC | 28.2 | 32.7 | 23.5 | 24.7 | 24.1 |
| Turnover Ratios | | | | | |
| Debtors (days) | 54.9 | 63.7 | 71.5 | 70.0 | 69.0 |
| Inventory (days) | 48.8 | 44.7 | 43.6 | 41.0 | 40.0 |
| Creditors (days) | 47.0 | 50.2 | 52.5 | 53.0 | 53.5 |
| Working Capital (days) | 56.6 | 58.1 | 62.5 | 58.0 | 55.5 |
| Asset Turnover (x) | 1.9 | 2.0 | 1.7 | 1.6 | 1.6 |
| **Leverage Ratio** | | | | | |
| Debt/Equity (x) | 2.8 | 2.3 | 1.9 | 1.5 | 1.3 |

*Source: Company, Anand Rathi Research*

# Outlook and Valuations

After a 3% CAGR through FY13-15, we expect revenue to record an 11% CAGR during FY15-17 driven by a revived M&H CV sub-segment. Also, soft rubber prices would assist in better margins. We expect a ~13—13.5% EBITDA margin. In the past five years the company has been valued at an average 5.5x P/E.

We value it at 5.5x FY17e earnings. At the ruling price, it is valued at 4.8x FY17e. We initiate coverage with a Buy and a target price of ₹115.

### Risks

- A steep rise in prices of rubber and crude oil.
- Competition from Chinese tyres in the truck and bus tyre sub-segment.

**27 July 2015**

# Balkrishna Industries

*Export-oriented niche play, best margins; Buy*

Rating: **Buy**
Target Price: ₹742
Share Price: ₹697

**Balkrishna Industries' robust business model consists of make in India and serve the global market. Approx. 88% of its revenue comes from exports. Because of this, despite its products being priced 20-25% lower than those of its international peers, its EBITDA margin was ~23%.**

**Robust business model.** The company mainly caters to the higher-margin segments (off-road vehicles, agricultural tyres). Its basic advantages—of various SKUs, focus on exports (which command higher pricing power), price advantage over competitors and higher-than-domestic-tyre-industry margins—are expected to continue. ~88% of its revenue arises from exports.

**India production and international market give it a competitive edge and much better margins.** With India as a manufacturing base, the company has a huge competitive edge in the global off-highway tyre (OHT) market. Proximity to the largest rubber-producing nations—Thailand, Malaysia and Indonesia—results in significantly lower raw-material sourcing and logistics costs than those of global peers. The company leverages its cost benefits significantly by positioning products ~25% cheaper than the leading brands while retaining ~23% EBITDA margins.

**Capacity expansion and international foray.** With its new plant at Bhuj, the company can now make a foray into much-larger radial tyres. Radials command higher realisations (3-4% more). With this plant, its radial sales volumes are expected to move up from around 30% now to over 40% in the next three years. It plans to set up warehouses in the US and other overseas markets in the near future to deepen its penetration level there.

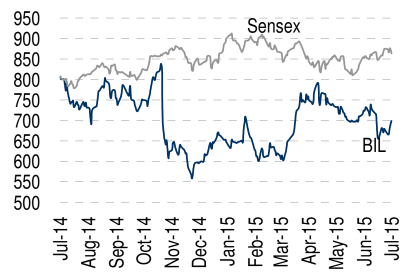
**Valuation.** With ~88% of its revenue coming from exports, Balkrishna will also benefit from the rupee depreciation in the past six months. The stock is fairly valued at 11.3x FY17e. We maintain a Buy, with a price target of ₹742. **Risk.** Slowdown in the global economy.

| Key data | BIL IN / BLKI.BO |
|---|---|
| 52-week high / low | ₹856 / ₹536 |
| Sensex / Nifty | 27561 / 8361 |
| 3-m average volume | $0.9m |
| Market cap | ₹67bn / $1bn |
| Shares outstanding | 97m |

| Shareholding pattern (%) | Jun '15 | Mar '15 | Dec '14 |
|---|---|---|---|
| Promoters | 58.3 | 58.3 | 58.3 |
| *- of which, Pledged* | - | - | - |
| Free Float | 41.7 | 41.7 | 41.7 |
| - Foreign Institutions | 15.37 | 14.23 | 13.41 |
| - Domestic Institutions | 15.56 | 15.88 | 15.99 |
| - Public | 10.77 | 11.59 | 12.3 |

| Estimates revision (%) | FY15 | FY16e | FY17e |
|---|---|---|---|
| Sales | -4 | -6 | -10 |
| EBITDA | 6 | -3 | -7 |
| EPS | 10 | 11 | 5 |

**Relative price performance**




*Source: Bloomberg*

| Key financials (Year-end: Mar) | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Sales (₹ m) | 31,906 | 35,767 | 37,799 | 42,154 | 46,843 |
| Net profit (₹ m) | 3,597 | 4,879 | 4,925 | 5,379 | 5,977 |
| EPS (₹) | 37.2 | 50.5 | 51.0 | 55.6 | 61.8 |
| Growth (%) | 35.5 | 35.7 | 0.9 | 9.2 | 11.1 |
| PE (x) | 18.7 | 13.8 | 13.7 | 12.5 | 11.3 |
| PBV (x) | 4.7 | 3.6 | 2.9 | 2.4 | 2.0 |
| RoE (%) | 25.3 | 25.9 | 21.5 | 19.2 | 17.7 |
| RoCE (%) | 15.7 | 16.9 | 17.3 | 16.8 | 17.5 |
| Dividend yield (%) | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 |
| Net gearing (%) | 55.9 | 60.1 | 43.9 | 32.6 | 25.5 |

*Source: Company, Anand Rathi Research*

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**Research Analyst**
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mayurmilak@rathi.com

# Quick Glance – Financials and Valuations

### Fig 1 – Income statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Net revenues | 31,906 | 35,767 | 37,799 | 42,154 | 46,843 |
| Revenue growth (%) | 13.1 | 12.1 | 5.7 | 11.5 | 11.1 |
| - Oper. expenses | 25,262 | 26,989 | 27,769 | 32,037 | 35,694 |
| **EBIDTA** | **6,644** | **8,779** | **10,030** | **10,117** | **11,149** |
| EBITDA margin (%) | 20.8 | 24.5 | 26.5 | 24.0 | 23.8 |
| - Interest expenses | 200 | 255 | 437 | 340 | 310 |
| - Depreciation | 1,077 | 1,650 | 2,392 | 1,914 | 2,105 |
| + Other income | 42 | 298 | 112 | 129 | 148 |
| - Tax | 1,794 | 2,293 | 2,387 | 2,613 | 2,904 |
| Effective tax rate (%) | 33.5 | 32.0 | 32.8 | 32.7 | 32.7 |
| Reported PAT | 3,558 | 4,884 | 4,898 | 5,379 | 5,977 |
| +/- Extraordinary items | 57 | -5 | 27 | 0 | 0 |
| +/- Minority interest | 0 | 0 | 0 | 0 | 0 |
| Adjusted PAT | 3,597 | 4,879 | 4,925 | 5,379 | 5,977 |
| Adj. FDEPS (₹/sh) | 37.2 | 50.5 | 51.0 | 55.6 | 61.8 |
| Adj. FDEPS growth (%) | 35.5 | 35.7 | 0.9 | 9.2 | 11.1 |

*Source: Company, Anand Rathi Research*

### Fig 2 – Balance sheet (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Share capital | 193 | 193 | 193 | 193 | 193 |
| Reserves & surplus | 13,996 | 18,655 | 22,724 | 27,878 | 33,608 |
| Shareholders' fund | 14,190 | 18,848 | 22,917 | 28,071 | 33,802 |
| Debt | 20,636 | 23,440 | 19,927 | 19,314 | 16,314 |
| Deferred tax / others | 999 | 1,722 | 1,887 | 2,075 | 2,283 |
| **Capital employed** | **35,824** | **44,010** | **44,731** | **49,460** | **52,398** |
| Fixed assets | 22,232 | 28,058 | 30,488 | 31,574 | 33,469 |
| Investments | 329 | 4,265 | 4,449 | 1,550 | 825 |
| Working capital | 10,599 | 11,589 | 5,483 | 8,747 | 10,021 |
| Cash | 2,663 | 98 | 4,311 | 7,589 | 8,083 |
| **Capital deployed** | **35,824** | **44,010** | **44,731** | **49,460** | **52,398** |
| Net Debt | 17,643 | 19,077 | 11,167 | 10,175 | 7,406 |
| No. of shares (m) | 97 | 97 | 97 | 97 | 97 |
| Net Debt/Equity (%) | 124.3 | 101.2 | 48.7 | 36.2 | 21.9 |
| W C turn (days) | 80 | 83 | 60 | 80 | 80 |
| Book value (₹/sh) | 147 | 195 | 237 | 290 | 350 |

*Source: Company, Anand Rathi Research*

### Fig 3 – Cash-flow statement (₹ m)

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| Reported PAT | 3,597 | 4,879 | 4,925 | 5,379 | 5,977 |
| + Depreciation | 1,077 | 1,650 | 2,392 | 1,914 | 2,105 |
| Cash profit | 4,674 | 6,529 | 7,317 | 7,292 | 8,082 |
| - Incr/(Decr) in WC | 780 | -990 | 6,106 | -3,264 | -1,274 |
| Operating cash flow | 5,431 | 5,241 | 13,311 | 3,899 | 6,661 |
| - Capex | -10,529 | -7,475 | -4,822 | -3,000 | -4,000 |
| Free cash flow | (5,098) | (2,234) | 8,489 | 899 | 2,661 |
| - Dividend | -169 | -185 | -204 | -224 | -247 |
| + Equity raised | 0 | 0 | 0 | 0 | 0 |
| + Debt raised | 4,006 | 2,805 | -3,513 | -613 | -3,000 |
| - Investments | -7 | -3,936 | -184 | 2,899 | 725 |
| - Misc. items | 0 | 0 | 0 | 0 | 0 |
| Net cash flow | -911 | -2,565 | 4,213 | 3,278 | 494 |
| + Opening cash | 3,574 | 2,663 | 98 | 4,311 | 7,589 |
| Closing cash | 2,663 | 98 | 4,311 | 7,589 | 8,083 |

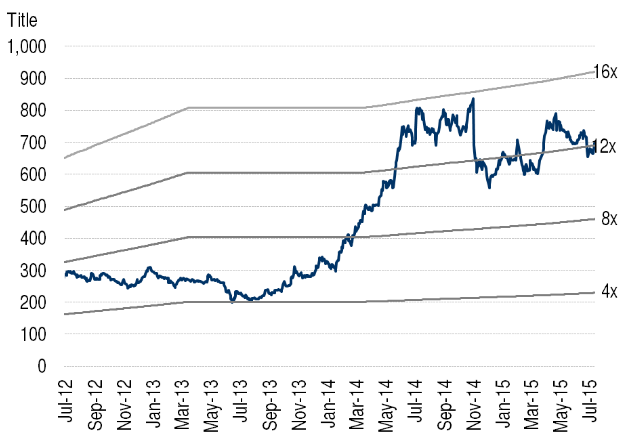
*Source: Company, Anand Rathi Research*

### Fig 4 – Ratio analysis @ ₹697

| Year-end: Mar | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| P/E (x) | 18.7 | 13.8 | 13.7 | 12.5 | 11.3 |
| P/B (x) | 4.7 | 3.6 | 2.9 | 2.4 | 2.0 |
| EV/sales | 2.7 | 2.4 | 2.1 | 1.9 | 1.6 |
| EV/EBITDA (x) | 12.8 | 9.8 | 7.8 | 7.7 | 6.7 |
| RoE (%) | 25.3 | 25.9 | 21.5 | 19.2 | 17.7 |
| RoCE (%) | 15.7 | 16.9 | 17.3 | 16.8 | 17.5 |
| Dividend yield | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 |
| Dividend payout (%) | 4.7 | 3.8 | 4.1 | 4.2 | 4.1 |
| RM to sales (%) | 55.8 | 48.0 | 51.9 | 51.0 | 51.5 |
| EBITDA growth (%) | 31.4 | 32.1 | 14.3 | 0.9 | 10.2 |
| EPS growth (%) | 35.5 | 35.7 | 0.9 | 9.2 | 11.1 |
| PAT margin (%) | 11.3 | 13.6 | 13.0 | 12.8 | 12.8 |
| Inventory days | 50 | 55 | 38 | 55 | 55 |
| Receivables days | 58 | 64 | 59 | 55 | 55 |
| Payables days | 28 | 35 | 37 | 30 | 30 |

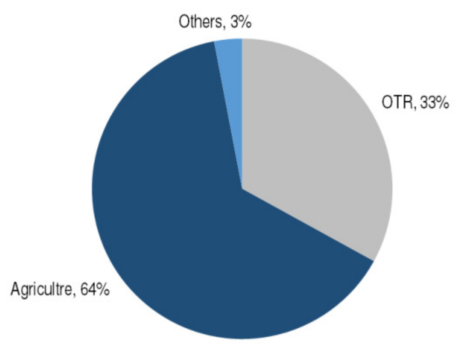
*Source: Company, Anand Rathi Research*

### Fig 5 – PE band




*Source: Anand Rathi Research*

### Fig 6 – Product-wise revenue distribution (FY15)




*Source: Company, Anand Rathi Research*

# Robust business model

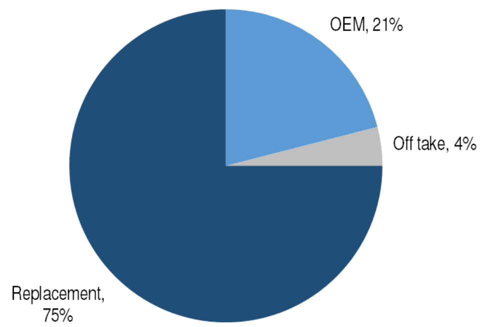
India's leading manufacturer in the off-highway tyre (OTH) market, Balkrishna Industries has capabilities to manufacture over 2,200 SKUs. With its recently set-up plant at Bhuj, its capacity is now 300,000 tonnes a year.

Approx. 88% of its revenue arises from export markets, chief being Europe (54%), the US (19%), and the rest of the world (15%).

Segment-wise, 64% of its sales come from agriculture (tractor, trailer and farm-equipment sub-segments), 33% from the OTR sub-segment, which includes the industrial, construction and earth-moving equipment sub-segments.

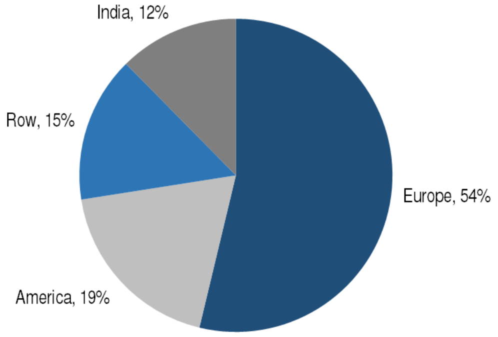
The company mainly caters to the higher-margin segments–off-road vehicles and agricultural tyres. Its basic advantages—of various SKUs, focus on exports (which offer higher pricing power) coupled with its price advantage over competitors and higher-than-domestic-tyre-industry margins—are expected to continue. Being primarily an exporter, it derives ~88% of its revenues from exports.

**Fig 7 – OEM / Replacement pie chart**




*Source: Company*

**Fig 8 – Region-wise exports**




*Source: Company*

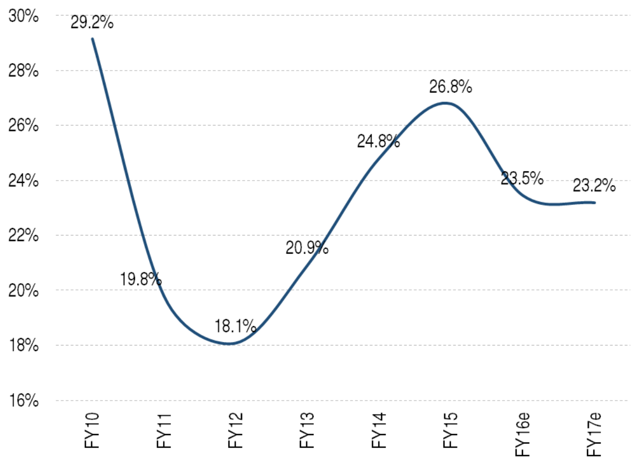
# Competitive edge and better margins

Its manufacturing base in India gives Balkrishna a huge competitive advantage in the global OHT market. Being labour intensive, tyre-manufacturing in India leads to considerably lower labour costs than those of its global peers. Proximity to the largest rubber-producing nations—Thailand, Malaysia, Indonesia—is an added advantage. This results in significantly lower raw material sourcing and logistics costs than incurred by its global peers. Lower selling and distributing expenses from sales through its distributor network further augment its margins.

The company leverages its cost benefits significantly by pricing its products ~25% lower than the leading brands while retaining ~23% EBITDA margins.

With ~88% of its revenue coming from exports, it will also benefit from the rupee depreciation in the past six months

**Fig 9 – EBITDA margin**




*Source: Company, Anand Rathi Research*

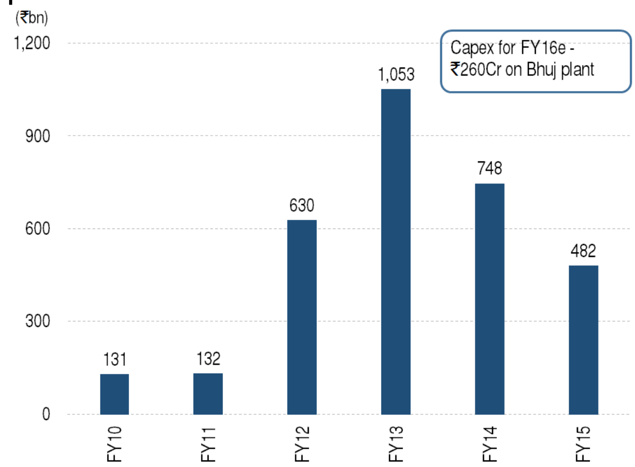
# Capacity expansion, international foray

With its new plant at Bhuj, it can now make a foray into much larger radial tyres. Radials command higher realisations (3-4% more). With this plant, its radial sales volumes are expected to move up, from around 30% now to over 40% in the next three years. It plans to set up warehouses in the US and other overseas markets in the near future to increase penetration levels there.

In a bid to tap newer markets to maintain revenue growth, it is expanding its operations to high-growth countries such as Africa, Russia and the CIS.

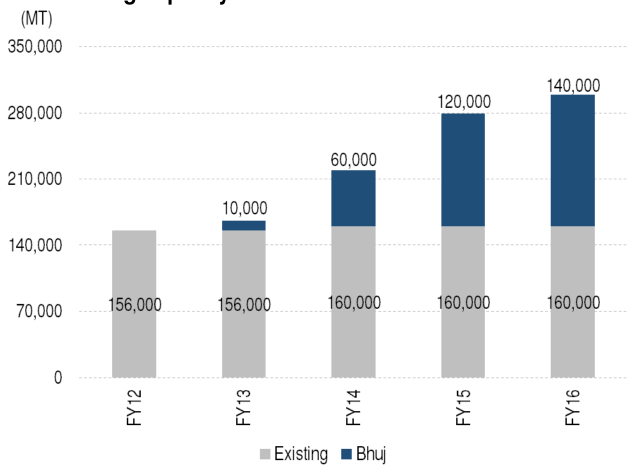
With additional capacity at Bhuj, it plans to expand operations in OEMs and increase market share in India and other emerging markets.

**Fig 10 – Capex details**




*Source: Company*

**Fig 11 – Manufacturing capacity**



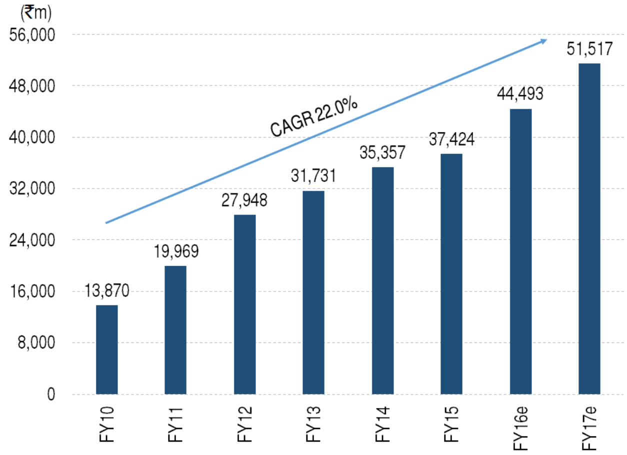

*Source: Company*

# Financials

### Revenue expected to see a 17% CAGR during FY15-17

During FY13-15, the company registered a 10% revenue CAGR. Over FY15-17, we expect a much better performance. This growth would be based on its roadmap for the future where it intends to increase its exposure to OEs and focus on newer emerging territories.

**Fig 12 – Revenue growth**



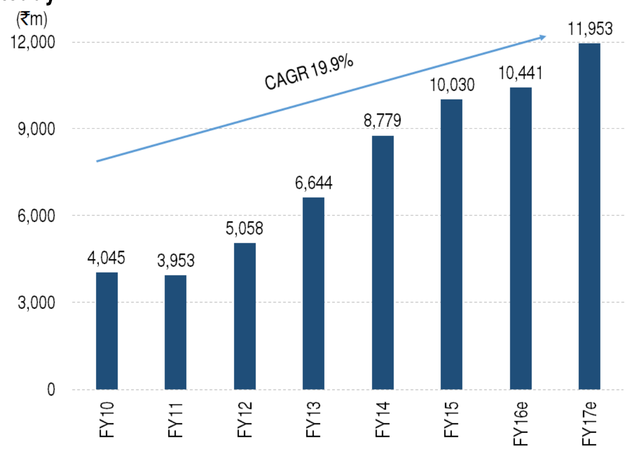

*Source: Company, Anand Rathi Research*

### Highest EBIDTA margins in the industry; soft rubber prices and depreciating rupee would further help

The cost of raw materials amounts to ~70% of the revenues of a typical tyre company, with natural rubber being the most crucial input. Economists worldwide have predicted lower to stagnant growth for the Chinese economy, emphasising that crude oil and rubber prices may be soft in the near future.

The company has successfully maintained its EBITDA margins of ~23—24% despite fluctuations in rubber prices primarily because of its ability to pass on any change. We expect it to maintain its EBITDA margins.

**Fig 13 – Steady EBITDA**

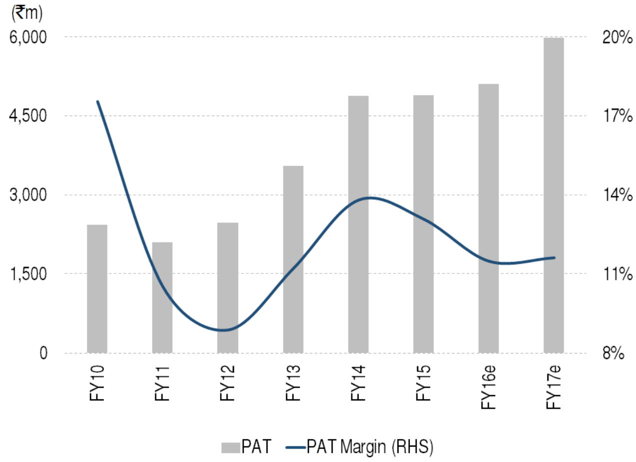



*Source: Company, Anand Rathi Research*

## PAT to see an 11% CAGR over FY15-17

Driven by the 17% revenue growth, the company may record 11% PAT growth during FY15-17. This converts to an EPS of ₹62 for FY17.

### Fig 14 – PAT and PAT margin




*Source: Company, Anand Rathi Research*

### Fig 15 – Income statement (₹ m)

| Year-end: March | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| **Net Sales** | **31,731** | **35,357** | **37,424** | **41,741** | **46,389** |
| Operating other income | 175 | 410 | 376 | 413 | 454 |
| **Total Income** | **31,906** | **35,767** | **37,799** | **42,154** | **46,843** |
| **Expenditure** | **25,262** | **26,989** | **27,769** | **32,037** | **35,694** |
| Change in stocks | -364 | 35 | 158 | 0 | 0 |
| Raw Material | 18,179 | 17,120 | 19,448 | 21,498 | 24,124 |
| Purch. of finished goods | 95 | 55 | 73 | 63 | 70 |
| Total RM Cost | 17,910 | 17,210 | 19,679 | 21,562 | 24,194 |
| Employee Cost | 1,075 | 1,386 | 1,944 | 1,897 | 2,014 |
| Manufacturing Expenses | 4,073 | 5,685 | 3,104 | 5,691 | 6,324 |
| Administrative expenses | 533 | 894 | 832 | 843 | 937 |
| Selling & Distribution Exp | 518 | 644 | 643 | 738 | 820 |
| **EBITDA** | **6,644** | **8,779** | **10,030** | **10,117** | **11,149** |
| Depreciation | 1,077 | 1,650 | 2,392 | 1,914 | 2,105 |
| **EBIT** | **5,567** | **7,129** | **7,638** | **8,203** | **9,044** |
| Interest & Finance Charges | 200 | 255 | 437 | 340 | 310 |
| Other Income | 42 | 298 | 112 | 129 | 148 |
| **PBT** | **5,352** | **7,177** | **7,286** | **7,992** | **8,881** |
| Tax | 1,794 | 2,293 | 2,387 | 2,613 | 2,904 |
| **Rep. PAT** | **3,558** | **4,884** | **4,898** | **5,379** | **5,977** |
| Current EPS (₹) | 37.2 | 50.5 | 51.0 | 55.6 | 61.8 |

*Source: Company, Anand Rathi Research*

## Fig 16 – Balance sheet (₹ m)

| Year-end: March | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| **Sources of Funds** | | | | | |
| Issued Equity Share Capital | 193 | 193 | 193 | 193 | 193 |
| Reserves | 13,996 | 18,655 | 22,724 | 27,878 | 33,608 |
| **Net Worth** | **14,190** | **18,848** | **22,917** | **28,071** | **33,802** |
| **Net Deferred Tax** | **999** | **1,722** | **1,887** | **2,075** | **2,283** |
| **Total Loans** | **20,636** | **23,440** | **19,927** | **19,314** | **16,314** |
| **Capital Employed** | **35,824** | **44,010** | **44,731** | **49,460** | **52,398** |
| | | | | | |
| **Application of Funds** | | | | | |
| **Net Fixed Assets** | **22,232** | **28,058** | **30,488** | **31,574** | **33,469** |
| Capital WIP | 0 | 0 | 0 | 0 | 0 |
| **Total Net Fixed Assets** | **22,232** | **28,058** | **30,488** | **31,574** | **33,469** |
| **Investments** | **329** | **4,265** | **4,449** | **1,550** | **825** |
| **Curr. Assets, L & Adv.** | **17,326** | **16,417** | **18,209** | **24,633** | **27,033** |
| Inventory | 4,325 | 5,291 | 3,920 | 6,290 | 6,990 |
| Sundry Debtors | 5,045 | 6,185 | 6,018 | 6,290 | 6,990 |
| Cash & Bank Balances | 2,663 | 98 | 4,311 | 7,589 | 8,083 |
| Loans & Advances | 5,229 | 4,838 | 3,933 | 4,433 | 4,933 |
| **Current Liab. & Prov.** | **4,063** | **4,730** | **8,415** | **8,297** | **8,929** |
| Sundry Creditors | 2,410 | 3,431 | 3,799 | 3,431 | 3,813 |
| Other Liabilities | 1,438 | 1,023 | 4,249 | 4,499 | 4,749 |
| Provisions | 215 | 276 | 368 | 368 | 368 |
| **Net Current Assets** | **13,263** | **11,687** | **9,794** | **16,336** | **18,104** |
| **Application of Funds** | **35,824** | **44,010** | **44,731** | **49,460** | **52,398** |

*Source: Company, Anand Rathi Research*

## Fig 17 – Cash-flow statement (₹ m)

| Year-end: March | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| OP/(Loss) before Tax | 5,567 | 7,129 | 7,638 | 8,203 | 9,044 |
| Interest/Div. Received | 42 | 298 | 112 | 129 | 148 |
| Depreciation & Amort. | 1,077 | 1,650 | 2,392 | 1,914 | 2,105 |
| Direct Taxes Paid | -1,421 | -1,570 | -2,223 | -2,425 | -2,697 |
| (Inc)/Dec in Working Capital | 780 | -990 | 6,106 | -3,264 | -1,274 |
| Other Items | -1 | -40 | -625 | 0 | 0 |
| **CF from Oper. Activity** | **6,044** | **6,477** | **13,400** | **4,556** | **7,326** |
| | | | | | |
| Extra-ordinary Items | -57 | 5 | -27 | 0 | 0 |
| Other Items | 0 | 0 | 0 | 0 | 0 |
| **CF after EO Items** | **5,987** | **6,481** | **13,373** | **4,556** | **7,326** |
| | | | | | |
| (Inc)/Dec in FA+CWIP | -10,529 | -7,475 | -4,822 | -3,000 | -4,000 |
| (Pur)/Sale of Invest. | -7 | -3,936 | -184 | 2,899 | 725 |
| **CF from Inv. Activity** | **-10,536** | **-11,411** | **-5,006** | **-101** | **-3,275** |
| | -4,549 | -4,930 | 8,367 | 4,455 | 4,051 |
| | | | | | |
| Issue of Shares | 0 | 0 | 0 | 0 | 0 |
| Inc/(Dec) in Debt | 4,006 | 2,805 | -3,513 | -613 | -3,000 |
| Interest Paid | -200 | -255 | -437 | -340 | -310 |
| Dividends Paid | -169 | -185 | -204 | -224 | -247 |
| **CF from Fin. Activity** | **3,638** | **2,365** | **-4,154** | **-1,178** | **-3,557** |
| | | | | | |
| **Inc/(Dec) in Cash** | **-911** | **-2,565** | **4,213** | **3,278** | **494** |
| Add: Beginning Balance | 3,574 | 2,663 | 98 | 4,311 | 7,589 |
| **Closing Balance** | **2,663** | **98** | **4,311** | **7,589** | **8,083** |

*Source: Company, Anand Rathi Research*

## Fig 18 – Ratio analysis @ ₹697

| Year-end: March | FY13 | FY14 | FY15 | FY16e | FY17e |
|---|---|---|---|---|---|
| **Basic (₹)** | | | | | |
| Current EPS | 37.2 | 50.5 | 51.0 | 55.6 | 61.8 |
| EPS Growth (%) | 35.5 | 35.7 | 0.9 | 9.2 | 11.1 |
| Diluted EPS | 37.2 | 50.5 | 51.0 | 55.6 | 61.8 |
| EPS Growth (%) | 35.5 | 35.7 | 0.9 | 9.2 | 11.1 |
| Cash EPS | 48.0 | 67.6 | 75.4 | 75.4 | 83.6 |
| Book Value per Share | 146.8 | 195.0 | 237.1 | 290.4 | 349.7 |
| DPS | 1.5 | 1.7 | 1.8 | 2.0 | 2.2 |
| Payout (Incl. Div. Tax) % | 4.7 | 3.8 | 4.1 | 4.2 | 4.1 |
| Core EPS | 36.8 | 47.4 | 49.8 | 54.3 | 60.3 |
| **Valuation (x)** | | | | | |
| P/E | 18.7 | 13.8 | 13.7 | 12.5 | 11.3 |
| Cash P/E | 14.5 | 10.3 | 9.2 | 9.2 | 8.3 |
| EV/EBITDA | 12.8 | 9.8 | 7.8 | 7.7 | 6.7 |
| EV/Sales | 2.7 | 2.4 | 2.1 | 1.9 | 1.6 |
| Price to Book Value | 4.7 | 3.6 | 2.9 | 2.4 | 2.0 |
| Dividend Yield (%) | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 |
| Core P/E | 19.0 | 14.7 | 14.0 | 12.8 | 11.6 |
| **Turnover Ratios** | | | | | |
| Inventory days | 49.8 | 54.6 | 38.2 | 55.0 | 55.0 |
| Debtor days | 58.0 | 63.8 | 58.7 | 55.0 | 55.0 |
| Creditor days | 27.7 | 35.4 | 37.1 | 30.0 | 30.0 |
| Net curent asset days | 152.6 | 120.6 | 95.5 | 142.8 | 142.4 |
| Asset Turnover (x) | 0.9 | 0.8 | 0.8 | 0.8 | 0.9 |
| Fixed Asset Turnover (x) | 1.2 | 1.0 | 0.9 | 1.0 | 1.0 |
| | | | | | |
| **Profitability Ratios (%)** | | | | | |
| RoE | 25.3 | 25.9 | 21.5 | 19.2 | 17.7 |
| RoCE | 15.7 | 16.9 | 17.3 | 16.8 | 17.5 |
| Oper RoCE | 17.0 | 18.0 | 21.2 | 20.3 | 20.8 |
| | | | | | |
| **Leverage Ratio** | | | | | |
| Debt/Equity (x) | 1.5 | 1.2 | 0.9 | 0.7 | 0.5 |

*Source: Company, Anand Rathi Research*

# Outlook and Valuations

After a 10% CAGR through FY13-15, we expect the company to maintain its revenue at an 11% CAGR during FY15-17. Also, soft rubber prices would assist in better margins. We expect the EBITDA margin to come at ~24%. In the past five years, the stock has been valued at an average P/E of 12x.

We continue to value it at 12x FY17e. We maintain our Buy rating, with a target price of ₹742.

### Risks

- Steep rises in the prices of rubber and crude oil, slowdown in exports

## Appendix

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|---|---|---|---|
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