

BSE SENSEX 35,600 S&P CNX 10,808

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Stock Info

Bloomberg	CEAT IN
Equity Shares (m)	40
52-Week Range (INR)	2030 / 1286
1, 6, 12 Rel. Per (%)	-6/-31/-42
M.Cap. (INR b)	54.4
M.Cap. (USD b)	0.8
Avg Val, INRm	1171.0
Free float (%)	49.2

Financials Snapshot (INR b)

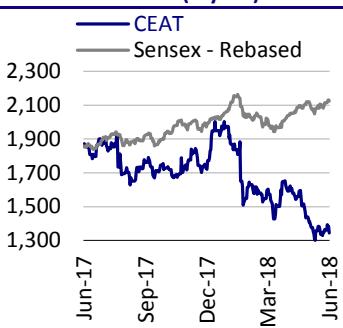
Y/E Mar	2018	2019E	2020E
Net Sales	62.3	70.4	84.1
EBITDA	6.1	7.4	10.3
PAT	2.6	3.4	4.7
EPS (INR)	64.0	84.9	115.3
Gr. (%)	-31.5	32.8	35.8
BV/Sh (INR)	644.3	717.9	818.0
RoE (%)	10.3	12.5	15.0
RoCE (%)	8.5	9.2	10.7
P/E (x)	21.0	15.8	11.7
P/BV (x)	2.1	1.9	1.6

Shareholding pattern (%)

As On	Mar-18	Dec-17	Mar-17
Promoter	50.8	50.8	50.8
DII	10.2	8.9	5.6
FII	25.1	25.9	27.4
Others	13.9	14.4	16.3

FII Includes depository receipts

Stock Performance (1-year)



CMP: INR1,345 TP: INR1,845(+37%)

Buy

Fueling growth on the back of capex

Strong focus on PCR, 2W and OHT bodes well for margins

We met CEAT's MD Mr Anant Vardhan Goenka and CFO Mr Kumar Subbiah at the RPG Annual Investor Conference 2018. Key takeaways:

- CEAT plans to invest INR35-40b over the next 3-5 years to expand its capacity. This would lead to its capacity increasing by ~50% post full ramp-up in FY21.
- Majority of this capex is directed toward its focus areas of passenger car radial tyres (PCR), 2W tyres and off-highway tyres (OHT). This would auger well for its revenue mix and margins.
- At the current pace of capacity addition, CEAT is confident of achieving ~15% revenue growth per annum over the next three years.
- With PCR capacity likely to more than double by FY21, the company is targeting a market share of 16-22% in the next 3-5 years (up from 8-10% currently).
- Despite intensifying competition in the 2Ws space (with MRF adding capacity and Maxxis setting up new capacity), CEAT expects to gain 3-5pp market share over the long term, led by its capacity addition and brand building & marketing efforts.
- In the TBR segment, CEAT intends to maintain its market share, led by capacity addition.
- The company expects some impact on margins from rising raw material prices over the next few quarters. However, it would take the necessary price actions. Price hikes would be higher in TBR compared to PCR/2W.
- Management targets RoCE of 13-14% by FY21 (v/s 8.5% in FY18).
- Despite the aggressive capex plans, net D/E is not expected to exceed 0.8x-1x. FY20/21E could witness peak D/E.

Betting big on PCR; Capacity to more than double by FY21

- PCR is one of the key focus areas for the company. CEAT is investing ~INR20b toward adding capacity in the PCR segment, which would lead to its capacity increasing from 500k tyres/month to 700k tyres/month. New capacity is expected to be on board by 3QFY20 with full ramp-up by 3QFY21.
- Management aims to increase its PCR market share to 16-22% over the next 3-5 years from the current level of 8-10%. It is confident of achieving this by leveraging on CEAT's strong brand equity in this segment. As a testament to CEAT's strong brand equity, Mr Goenka shared that the company managed to achieve 2x its internally targeted RFQs from OEMs in FY18.
- Within PCR, the focus would be on margin-accretive replacement and exports segments. CEAT's current market share in the replacement segment is ~10%, with scope for significant gains over the next few years. It is also targeting to strengthen its position in exports, particularly in Europe, where the market size opportunity is huge.
- Although majority of the additional capacity would come on board by FY20, management expects to increase capacity by ~20% (to ~600k tyres/month) in the near term through de-bottlenecking.

Focus on branding to drive market share gains in 2Ws

- Despite intensifying competition in the 2W segment (MRF is adding capacity and Maxxis is setting up new capacity), CEAT expects to gain 3-5pp market share over the long term on the back of its capacity addition and brand building & marketing efforts.
- CEAT's pricing action would trail MRF. This indicates that CEAT's price premium of 2-3% v/s MRF would be maintained at all times.
- Despite increasing RM prices over the past few months, price increase taken by the industry has been slow (a small price increase of 1.5% was taken recently). Management is confident that the industry would not witness any price cuts in the near term within 2Ws.
- 2W replacement market for CEAT is growing at 10%.

OHT presents attractive opportunity

- The high-margin and relatively less competitive segment of OHT is one of the key focus areas for CEAT.
- The company would be increasing its OHT capacity from 40tpd to 100tpd in the next 16-18 months.
- To gain a foothold after being a late entrant in this segment, CEAT would price its OHT tyres marginally lower than its domestic peers.
- Traditionally, OHT players have a large numbers of SKUs. CEAT, however, plans to have ~30% of SKUs compared to its competitors, which would cater to ~60% of the market.
- CEAT has ~20 distributors overseas. The focus remains on adding distributors in the European and US markets.

Intends to maintain market share in TBR

- CEAT is investing ~INR10b toward increasing its TBR capacity (210tpd). The new capacity should be on board by 3QFY19 with full ramp-up by 3QFY20.
- Growth in TBR would be led by capacity addition. This would help CEAT in maintaining its TBR market share.
- Chinese tyre imports have reduced significantly from the peak of 150k/month to 50k/month currently post the imposition of anti-dumping duty. CEAT was unable to benefit from the resultant increase in demand for TBR tyres due to capacity constraints.
- TBB segment is likely to witness slightly negative to flattish growth in the next 7-8 months, with low pricing pressure. However, in the long term, the decline would be sharper as pricing pressure increases.
- CV replacement market is ~45% of the replacement market in value terms. This segment is growing at 20% for CEAT. Around 80% of TBR sales for CEAT are in the replacement segment.

Other highlights

- CEAT had made certain investments to set up a 65MT bias tyre manufacturing facility in Bangladesh. However, this project has not yet commenced due to some land-related litigation. Subsequently, no further investments would be made toward this plant.
- Overall capacity utilization remains > 80%: TBR (100%), PCR (95%), 2W (80%) and TBB (85%).
- Management targets to reach RoCE of 13-14% by FY21.

Valuation and view

- **Focus on improving brand equity to drive market share gains:** CEAT has laid a strong emphasis on effective marketing and branding of its products. To position its products competitively, the company has developed creative ad campaigns based on extensive research/consumer insights and also invested in innovative marketing programs. Since the 2W/passenger car segment is consumer-facing, factors such as brand loyalty, visibility and recall go a long way in creating replacement market demand and improving market share, thereby benefiting the margin profile.
- **Ramp-up in areas of strategic focus to continue:** CEAT has identified 2W, passenger car and OTR (truck/off-road) tyre segments as its strategic focus areas, given their ability to boost margins and lower the company's dependence on the trucks segment. Revenue contribution from these areas of focus has increased significantly over the years, from 20% in FY10 to 48% in FY18. We believe with the ongoing capex plan, contribution from the focus areas could scale up to 60-65% over the next 4-5 years, which would also reflect positively in the company's operating performance. Over FY18-20, we expect a CAGR of 16% in revenue (with EBITDA margin expansion of ~230bp to 12.2% by FY20) and ~34% in PAT (on a low base).
- **Growth capex to increase capacity by ~50%:** CEAT has lined up capex of INR35-40b over FY18-21 to increase its capacity by ~50%. It is investing INR20b in PCR (for ~250tpd capacity), INR10b in TBR (for 210tpd capacity), ~INR4b in 2W (~140 tpd capacity) and INR5b in OTR (~60tpd addition). This would help in attaining a strategic product mix and scaling up revenue contribution from focus areas, thereby driving margin expansion. At peak capex cycle in FY20, we estimate peak net debt of ~INR21.5b (~0.7x equity and ~2.1x EBITDA).
- **Maintaining our earnings estimate for FY19/20:** CEAT trades at 15.8x/11.7x FY19/20E EPS. We value the company at 16x FY20E EPS. Maintain **Buy** with a target price of INR1,845 (37% upside).

Exhibit 1: Comparative valuations

Auto OEM's	CMP	Rating	TP	P/E (x)		EV/EBITDA (x)		RoE (%)		Div Yield (%)		EPS CAGR (%)
	(INR)*		(INR)	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E	FY18-20E
Bajaj Auto	2,890	Buy	3,450	17.3	15.1	11.9	9.9	24.0	24.7	2.4	2.8	12.6
Hero MotoCorp	3,684	Neutral	4,052	18.3	16.1	11.1	9.8	32.1	32.4	2.9	3.1	11.2
TVS Motor	584	Neutral	635	29.6	20.3	17.6	12.6	29.0	33.2	0.7	0.9	43.8
M&M	921	Buy	1,031	18.7	17.1	14.9	13.4	14.8	14.8	1.1	1.1	15.8
Maruti Suzuki	8,974	Buy	10,525	25.5	20.1	15.7	12.6	21.5	23.2	1.1	1.4	29.4
Tata Motors	306	Buy	471	7.1	5.8	2.7	2.0	14.2	15.0	0.1	0.1	51.9
Ashok Leyland	145	Buy	181	20.0	15.9	10.1	7.6	27.1	28.4	1.6	1.7	30.2
Eicher Motors	29,532	Buy	35,572	28.1	21.9	23.6	19.1	35.0	33.8	0.6	0.7	29.8
Auto Ancillaries												
Bharat Forge	647	Buy	806	25.5	20.0	14.7	12.1	23.2	24.6	0.8	1.0	35.1
Exide Industries	252	Buy	296	25.4	20.1	14.1	11.4	14.1	15.8	1.0	1.3	23.5
Amara Raja Batteries	773	Buy	952	24.5	20.3	12.5	10.2	17.1	17.9	0.6	0.8	17.4
BOSCH	18,271	Neutral	19,291	31.6	25.6	19.8	16.0	16.8	18.7	1.1	1.3	23.3
Endurance Tech	1,263	Buy	1,530	32.9	24.8	15.7	12.3	22.6	25.2	0.5	1.0	32.5
Motherson Sumi	314	Buy	426	25.9	18.4	9.7	6.8	25.0	29.0	1.0	1.5	44.6
Mahindra CIE	259	Buy	298	18.9	15.6	9.7	7.8	13.1	13.8	0.0	0.0	31.3
Escorts	918	Neutral	982	17.5	14.0	3.1	2.6	19.3	20.3	0.5	0.5	28.7
CEAT	1,345	Buy	1,845	15.8	11.7	10.1	7.4	12.5	15.0	0.7	0.9	34.3

Source: MOSL

Story in Charts

Exhibit 2: Revenue to post 16% CAGR over FY18-20E

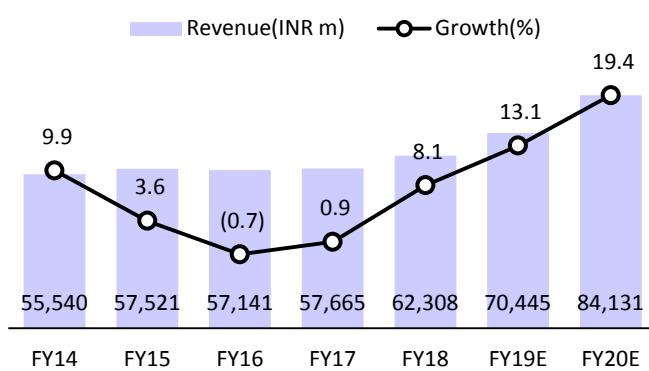


Exhibit 3: Increasing contribution from strategic focus areas

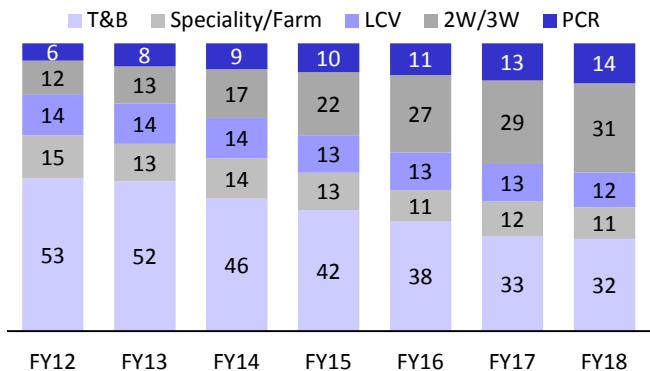


Exhibit 4: Investing substantially in brand building

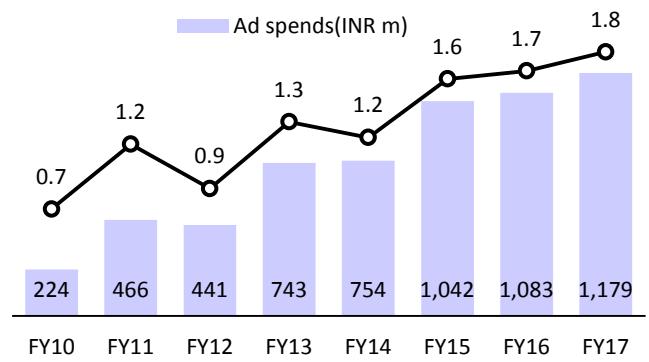


Exhibit 5: Total capacity would go up by ~50% by FY21E

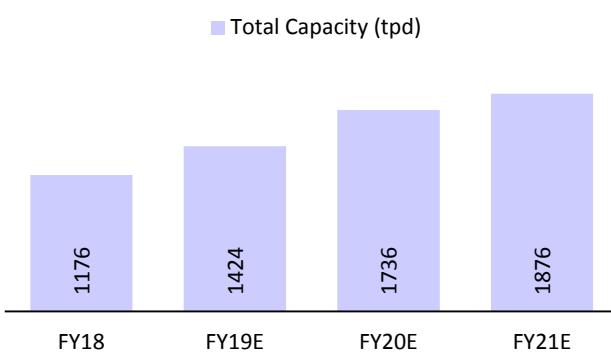


Exhibit 6: EBITDA to post 29% CAGR over FY18-20E

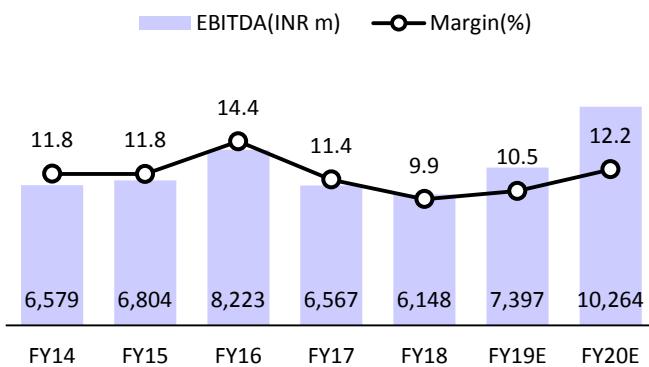


Exhibit 7: PAT to post 33% CAGR over FY18-20E

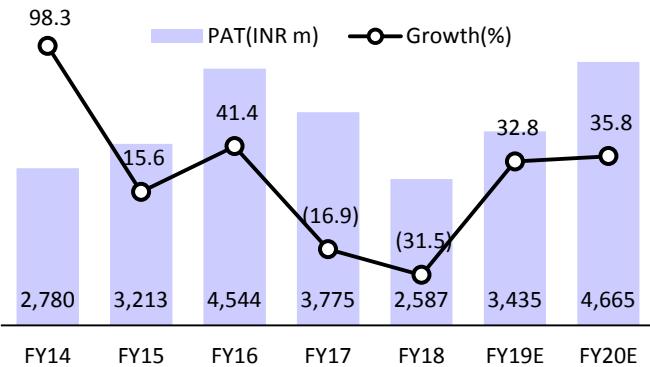


Exhibit 8: Net debt to rise due to heavy capex planned

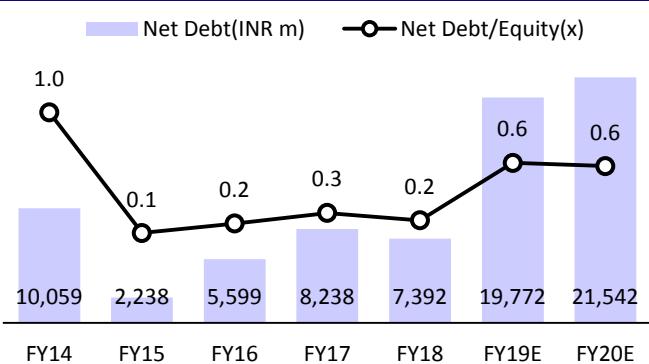
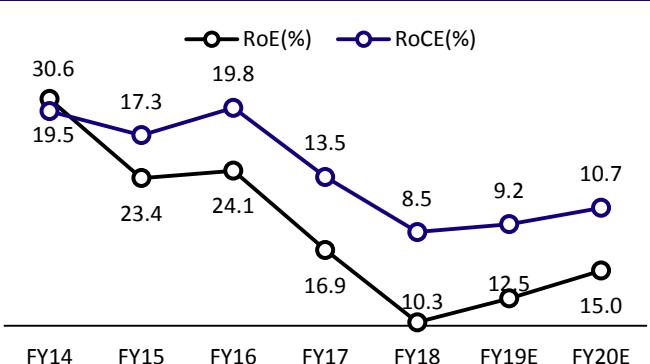


Exhibit 9: Return ratios to improve from FY18 lows



Financials and Valuations

Consolidated - Income Statement							
	(INR Million)						
Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Net Revenues from Ops	55,540	57,521	57,141	57,665	62,308	70,445	84,131
Change (%)	9.9	3.6	-0.7	0.9	8.1	13.1	19.4
EBITDA	6,579	6,804	8,223	6,567	6,148	7,397	10,264
Margin (%)	11.8	11.8	14.4	11.4	9.9	10.5	12.2
Depreciation	865	934	1,075	1,431	1,686	1,996	2,428
EBIT	5,713	5,870	7,148	5,137	4,462	5,400	7,836
Int. and Finance Charges	1,720	1,319	907	817	974	1,051	1,780
Other Income	140	226	299	186	295	330	363
PBT bef. EO Exp.	4,133	4,777	6,539	4,506	3,783	4,679	6,418
EO Items	-100	-61	-114	133	-340	0	0
PBT after EO Exp.	4,032	4,716	6,425	4,639	3,443	4,679	6,418
Total Tax	1,324	1,576	1,978	1,064	1,340	1,544	2,054
Tax Rate (%)	32.8	33.4	30.8	22.9	38.9	33.0	32.0
Reported PAT	2,712	3,172	4,465	3,878	2,380	3,435	4,665
Adjusted PAT	2,780	3,213	4,544	3,775	2,587	3,435	4,665
Change (%)	98.3	15.6	41.4	-16.9	-31.5	32.8	35.8
Margin (%)	5.0	5.6	8.0	6.5	4.2	4.9	5.5
Consolidated - Balance Sheet							
	(INR Million)						
Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Equity Share Capital	360	405	405	405	405	405	405
Net Worth	10,286	17,134	20,547	24,150	26,061	29,041	33,087
Minority Interest	363	327	322	292	234	234	234
Total Loans	11,738	7,640	6,632	9,240	8,717	19,317	22,567
Deferred Tax Liabilities	1,148	1,259	1,582	1,449	1,893	1,893	1,893
Capital Employed	23,535	26,361	29,084	35,130	36,904	50,484	57,780
Gross Block	23,041	15,014	21,394	27,029	31,428	48,428	54,908
Less: Accum. Deprn.	7,617	0	1,073	2,504	4,190	6,186	8,615
Net Fixed Assets	15,424	15,014	20,321	24,525	27,238	42,242	46,293
Goodwill on Consolidation	227	0	0	0	0	0	0
Capital WIP	823	2,238	2,991	3,263	3,100	3,100	4,620
Total Investments	0	4,430	1,955	2,316	2,135	2,135	2,135
Curr. Assets, Loans&Adv.	18,927	16,134	15,813	19,066	19,137	20,423	25,316
Inventory	7,536	6,534	6,397	9,435	7,846	9,500	11,131
Account Receivables	7,545	6,732	5,935	6,138	7,472	8,674	9,841
Cash and Bank Balance	1,679	973	630	359	863	-917	563
Curr. Liability & Prov.	11,865	11,456	11,996	14,039	14,706	17,416	20,583
Account Payables	6,888	6,379	6,353	7,737	8,851	9,500	11,131
Net Current Assets	7,061	4,678	3,817	5,026	4,432	3,008	4,732
Appl. of Funds	23,535	26,361	29,084	35,130	36,904	50,484	57,780

E: MOSL Estimates

Financials and Valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Basic (INR)							
EPS	68.7	79.4	112.3	93.3	64.0	84.9	115.3
Cash EPS	90.1	102.5	138.9	128.7	105.6	134.3	175.4
BV/Share	254.3	423.6	508.0	597.0	644.3	717.9	818.0
DPS	9.1	10.0	11.5	11.5	11.5	9.3	12.7
Payout (%)	15.8	14.3	12.0	14.5	23.6	13.3	13.3
Valuation (x)							
P/E		16.9	12.0	14.4	21.0	15.8	11.7
Cash P/E		13.1	9.7	10.4	12.7	10.0	7.7
P/BV		3.2	2.6	2.3	2.1	1.9	1.6
EV/Sales		1.1	1.1	1.1	1.0	1.1	0.9
EV/EBITDA		9.0	7.3	9.6	10.1	10.1	7.4
Dividend Yield (%)	0.7	0.7	0.9	0.9	0.9	0.7	0.9
Return Ratios (%)							
RoE	30.6	23.4	24.1	16.9	10.3	12.5	15.0
RoCE	19.5	17.3	19.8	13.5	8.5	9.2	10.7
RoIC	19.9	19.7	23.4	15.0	9.1	9.4	11.0
Working Capital Ratios							
Asset Turnover (x)	2.4	2.2	2.0	1.6	1.7	1.4	1.5
Inventory (Days)	50	41	41	60	46	49	48
Debtor (Days)	50	43	38	39	44	45	43
Creditor (Days)	45	40	41	49	52	49	48
Leverage Ratio (x)							
Net Debt/Equity	1.0	0.1	0.2	0.3	0.2	0.6	0.6

Cash Flow Statement

(INR Million)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
OP/(Loss) before Tax	4,032	4,716	5,869	4,373	3,783	4,679	6,418
Depreciation	865	934	1,077	1,431	1,686	1,996	2,428
Interest & Finance Charges	1,720	1,319	-74	-55	679	721	1,417
Direct Taxes Paid	-891	-1,123	-1,686	-1,017	-1,340	-1,544	-2,054
(Inc)/Dec in WC	-3,736	1,714	820	-2,174	1,098	-356	-245
CF from Operations	1,991	7,560	6,006	2,558	5,906	5,497	7,965
Others	-23	-73	1,015	789	0	0	0
CF from Operating incl EO	1,968	7,487	7,021	3,347	5,906	5,497	7,965
(Inc)/Dec in FA	-1,446	-2,999	-7,137	-5,824	-4,236	-17,000	-8,000
Free Cash Flow	523	4,488	-117	-2,477	1,670	-11,503	-35
(Pur)/Sale of Investments	370	0	2,491	-333	181	0	0
Others	57	-2,990	321	722	295	330	363
CF from Investments	-1,018	-5,989	-4,326	-5,434	-3,760	-16,670	-7,637
Issue of Shares	109	3,934	0	0	0	0	0
Inc/(Dec) in Debt	1,387	-3,994	-1,354	2,963	-523	10,600	3,250
Interest Paid	-1,723	-1,476	-930	-765	-974	-1,051	-1,780
Dividend Paid	-167	-404	-979	-7	-561	-455	-618
Others	2	0	0	0	184	300	300
CF from Fin. Activity	-392	-1,940	-3,264	2,191	-1,873	9,393	1,152
Inc/Dec of Cash	558	-442	-569	104	272	-1,780	1,480
Opening Balance	1,121	1,679	706	137	240	863	-917
Closing Balance	1,679	1,237	137	240	512	-917	563

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

"In case the recommendation given by the Research Analyst becomes inconsistent with the investment rating legend, the Research Analyst shall within 28 days of the inconsistency, take appropriate measures to make the recommendation consistent with the investment rating legend.

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