AUTOMOBILES | **#1 Meeting of Minds: An Expert Perspective** | 23 April 2021

Rubber prices headed for a structural bull run

We hosted Robert Meyer, an expert on natural rubber (NR). According to Meyer, NR prices are headed for a structural rise amidst a global GDP recovery and short supply situation. He expects prices to test 2010-11 highs, climbing from the current US$ 2/kg to US$ 5/kg. We believe this structural shift could have a significant impact on gross margins of Indian tyre manufacturers. Given a historical inability to pass on sudden cost increases, their earnings would be adversely affected. We maintain our negative stance on the tyre industry.

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Structural rise in NR price but not a super cycle: Many believe that NR, like other commodities, may also be in a super cycle alongside the global recovery. While this may not be entirely true, there is no denying that rubber prices are in a structural upward trajectory due to limited supply amidst global demand revival.

Fundamental supply-side issues: Globally, ~14mn hectares of land is under NR cultivation, producing ~14mn tonnes per annum (mtpa). While hectarage is measured precisely, the health of rubber trees has been a concern for quite some time now and thus global tapping could be overstated. The lower prices since FY12-FY13 have forced farmers to look at alternatives, thereby impacting supplies. Commercial tapping commences seven years after first planting.

Rubber prices could test 2010-11 highs: NR prices have soared over 75% from their lows after the pandemic hit demand and are currently hovering at ~US$ 2/kg (Rs 170/kg). With rising global demand and limited supplies, prices could easily test 2010-11 highs of US$ 5/kg over the next five years.

Our view: Back in 2010-11, NR prices hovered around Rs 220-240/kg. With significant rupee depreciation since then, US$ 5 now translates to Rs 370-380/kg, a jump of >50% since 2010-11. Back then, most Indian tyre manufacturers reported negative EBITDA growth despite an increase in revenue.

Global automotive demand absorbs most production: About 75% of NR is used for automotive tyres. Another 6-7% is used for other auto parts. In all, ~83% of NR produced is consumed by the auto sector. The demand forecast for CY21 amidst a global recovery is estimated at 13-15mtpa. Supply issues will start reflecting from CY22 when demand will keep rising while supplies will be impossible to increase.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
APTY IN	202	140	SELL
BIL IN	1,693	1,340	SELL
CEAT IN	1,440	780	SELL
JKI IN	110	70	SELL
MRF IN	78,350	67,000	SELL
SRTY IN	1,704	1,200	SELL

Price & Target in Rupees | Price as of 23 Apr 2021

Meeting of Minds
– **A BOBCAPS Auto & Aviation Initiative**

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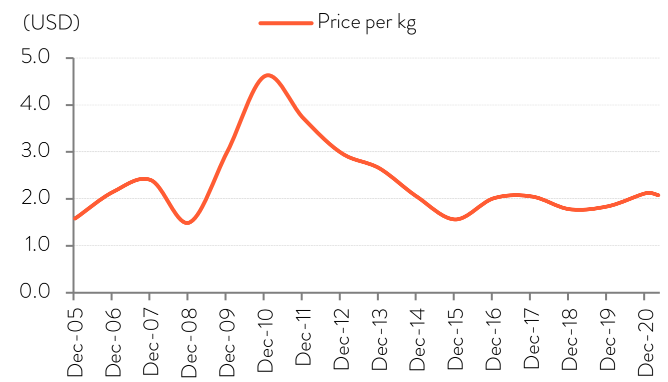
Other takeaways

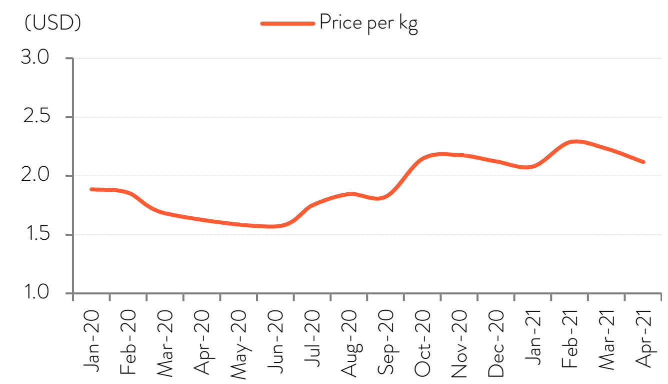
- **NR cannot be replaced by cheaper synthetic rubber:** Owing to its unique properties, only 4-5% of NR can be replaced in a tyre by synthetic rubber. Also, butadiene which is a key component in the manufacture of synthetic rubber tends to be short supply and hence would impede production.
- **Future contract pricing to reflect fundamentals:** Currently, NR prices are derived from future contracts traded on the China, Japan and Singapore exchanges. Prices at most times are a function of speculation (hedging instrument) given that rubber is the second most traded commodity on Chinese exchanges. With the sudden jump in NR prices, futures prices are converging more towards fundamental drivers of rubber prices.
- **Negligible inventory with lead producing nations:** Surging demand will drive NR prices as leading producers, including Vietnam, India and Malaysia, are holding negligible inventory. Most of the current inventory is believed to be lying with China (1.2-1.3mt) but would not be available for global consumption given the stricter laws and duty structure on the country's exports.

FIG 1 – NATURAL RUBBER PRICE (LONG TERM)



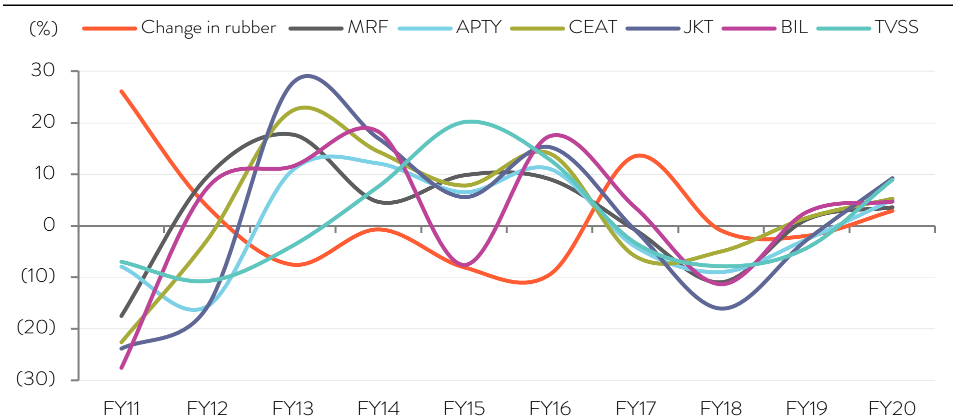
Source: Indian Rubber Board, BOBCAPS Research

FIG 2 – NATURAL RUBBER PRICE (LAST 15M)



Source: Indian Rubber Board, BOBCAPS Research

FIG 3- GROSS MARGINS OF TYRE COMPANIES INVERSELY CORRELATED TO RUBBER PRICE MOVEMENT



Source: Companies, BOBCAPS Research, Rubber Board of India

About the Speaker: Robert Meyer

Robert Meyer founded boutique venture firm Halcyon Management Partners in Singapore in 2004. In 2016, Halcyon Agri acquired the natural rubber business of Chinese state-owned Sinochem International.

Halcyon Agri deals with the entire value chain of how natural rubber is grown, sourced, processed and distributed. It is headquartered in Singapore and listed on the Singapore Exchange. Its key operating assets are located in Indonesia, Malaysia, Thailand, China and Africa. The firm is supported by a network of logistics assets, storage and terminals, laboratories and sales offices in Southeast Asia, China, South Africa, Europe, the UK and US. Meyer continued as Halcyon Agri's CEO until Jun'20. Since then, he has been actively managing Angsana Investments, an early-stage venture capital firm with a focus on impact investing.

Meyer has a keen interest in geopolitics and served on Singapore's Economic Strategies Committee (ESC) in 2010. He is currently a member of the National University of Singapore Health International Council (NIC).

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BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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