

**SELL**

TP: Rs 840 | ▼ 39%

**CEAT**

| Auto Components

| 17 June 2021

## Endeavouring to gain market share in non-core segments

- At its annual investor event, CEAT outlined plans for market share gains and capacity adds underpinned by an upbeat long-term demand outlook
- We believe CEAT's market share aspirations are stretched given intense competition from peers with comparable product & balance sheet strength
- We maintain SELL with a TP of Rs 840 due to competitive headwinds, rising RM cost and stress on FCF amid the planned expansion drive

Mayur Milak | Nishant Chowhan, CFA  
 researchreport@bobcaps.in

**Upbeat demand outlook:** The last five years have been challenging for the auto industry, marked by flattish sales due to various macro shocks (GST, demonetisation, BSVI, Covid-19), but CEAT is optimistic that demand will rebound as the current situation normalises and expects upcoming capacity additions to be utilised effectively. In the shorter term, the company noted that the pandemic has weakened demand and that it does not anticipate the swift sales uptick seen post last year's unlocking due to the greater damage in rural areas this time around.

**Commodity prices up 8-10% QoQ in Q1FY22:** Lower sale volumes and higher input costs are likely to impact the Q1FY22 operating margin. Management expects raw material prices to stabilise at Q1 exit levels. CEAT has been taking price hikes (3-4% in Apr-May) but it will need more in order to mitigate the rising costs.

**High market share aspirations:** CEAT remains a leader in the 2W segment with 28-30% market share and aims to reach 30-35% over the longer term. In PVs, it has clocked rapid share gains of 3-4% over the last year to 14% currently as Michelin lost ground amid import stoppage due to the pandemic. CEAT aims to expand PV share to 20% by leveraging brand equity, increasing OEM sales and rolling out new products.

In the truck & bus radial (TBR) and bias segments, the company commands 7% and 13% share respectively. Management aims to reach 13% market share in TBRs led by a planned capacity increase. It is also looking to cater to demand for TBRs in Europe, off-highway tyres in Europe and North America, and 2Ws in South Asia.

**Leader in 2W EVs:** CEAT supplies to all electric 2W OEMs and has ~50% market share. While these tyres are priced similar to conventional products, the requirements include lower noise levels and the ability to sustain greater wear and tear.

**Our view:** CEAT's market share gains appear ambitious amid stiff competition from peers, even as rising input cost pressure and the ability to generate FCF amid aggressive expansion would be key monitorables. We maintain SELL with a Mar'22 TP of Rs 840 set at 14x FY23E EPS – in line with its long-term average.

## Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	CEAT IN/Rs 1,380
Market cap	US\$ 753.6mn
Free float	53%
3M ADV	US\$ 4.7mn
52wk high/low	Rs 1,763/Rs 835
Promoter/FPI/DII	47%/28%/9%

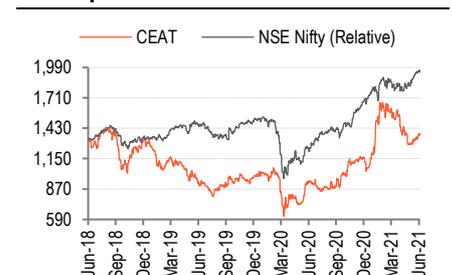
Source: NSE | Price as of 17 Jun 2021

## Key financials

Y/E 31 Mar	FY21P	FY22E	FY23E
Total revenue (Rs mn)	75,728	90,149	101,298
EBITDA (Rs mn)	9,738	8,901	10,438
Adj. net profit (Rs mn)	4,477	2,327	2,422
Adj. EPS (Rs)	110.7	57.5	59.9
Consensus EPS (Rs)	110.7	82.3	113.3
Adj. ROAE (%)	14.5	7.0	6.8
Adj. P/E (x)	12.5	24.0	23.0
EV/EBITDA (x)	7.1	7.9	6.9
Adj. EPS growth (%)	49.0	(48.0)	4.1

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

## Stock performance



Source: NSE



## Valuation methodology

Our FY22/FY23 revenue estimates for CEAT are in line with consensus, but our EPS forecasts of Rs 57/Rs 60 are 40% below due to lower gross margin assumptions (200bps below the street at 40.5%). The company's Q4FY21 gross margin stood at 41.8% and is likely to come under further pressure considering that management expects a 10% QoQ increase in raw material cost in Q1FY22. Despite CEAT taking a 3-4% price hike in Q1, we estimate that its gross margin would still contract by over 300bps sequentially. External borrowings to fund capex will also undermine the balance sheet and depress profits due to higher interest expense.

We pencil in a revenue/EBITDA/adj. PAT CAGR of +10%/+2%/–19% for the company over FY21-FY23. Maintain SELL with an unchanged Mar'22 TP of Rs 840, set at 14x FY23E EPS (in line with the stock's long-term average).

**Fig 1 – Peer comparison**

Company	Rating	Target Price (Rs)	Revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
				FY22E	FY23E	FY22E	FY23E	
Apollo Tyres	SELL	140	11	7.6	8.9	4.0	4.6	16
Balkrishna Industries	SELL	1,550	12	64.8	70.3	17.9	16.8	22
CEAT	SELL	840	16	57.5	59.9	7.0	6.8	14
JK Tyres	SELL	90	16	8.0	12.6	6.6	9.6	7
MRF	SELL	67,000	16	2,769	3,080	8.5	8.7	22
TVS Srichakra	SELL	1,200	17	75.0	85.9	6.7	7.3	14

Source: BOBCAPS

## Key risks

Key upside risks to our estimates are:

- above-expected volume growth,
- softening raw material prices, and
- above-estimated market share gains.

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
<b>Total revenue</b>	<b>68,313</b>	<b>65,811</b>	<b>75,728</b>	<b>90,149</b>	<b>101,298</b>
EBITDA	5,965	7,053	9,738	8,901	10,438
Depreciation	1,743	2,554	3,396	4,155	4,987
EBIT	4,775	4,912	6,660	4,912	5,616
Net interest inc./(exp.)	(677)	(1,230)	(1,731)	(1,801)	(2,378)
Other inc./(exp.)	553	413	318	165	165
Exceptional items	340	(298)	(341)	0	0
EBT	4,438	3,385	4,589	3,111	3,238
Income taxes	1,209	678	453	784	816
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
<b>Reported net profit</b>	<b>3,229</b>	<b>2,708</b>	<b>4,136</b>	<b>2,327</b>	<b>2,422</b>
Adjustments	(340)	298	341	0	0
<b>Adjusted net profit</b>	<b>2,889</b>	<b>3,005</b>	<b>4,477</b>	<b>2,327</b>	<b>2,422</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Accounts payables	12,078	11,714	19,436	18,178	19,509
Other current liabilities	4,498	6,933	10,370	12,573	12,821
Provisions	1,436	1,598	1,525	1,525	1,525
Debt funds	12,605	15,676	13,620	19,120	24,120
Other liabilities	414	1,645	1,645	1,645	1,645
Equity capital	405	405	405	405	405
Reserves & surplus	27,106	28,869	30,515	32,843	35,265
Shareholders' fund	27,510	29,274	30,920	33,247	35,669
<b>Total liab. and equities</b>	<b>58,541</b>	<b>66,839</b>	<b>77,516</b>	<b>86,288</b>	<b>95,289</b>
Cash and cash eq.	597	266	386	332	332
Accounts receivables	7,265	7,047	9,223	9,879	10,824
Inventories	9,652	8,795	11,125	11,855	12,489
Other current assets	2,133	2,066	2,315	2,439	2,548
Investments	3,130	3,202	1,181	1,181	1,181
Net fixed assets	28,463	38,205	47,884	56,730	64,743
CWIP	7,494	9,338	7,029	5,500	4,800
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(2,077)	(2,611)	(2,656)	(2,656)	(2,656)
Other assets	1,884	532	1,029	1,029	1,029
<b>Total assets</b>	<b>58,542</b>	<b>66,839</b>	<b>77,516</b>	<b>86,288</b>	<b>95,289</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
<b>Cash flow from operations</b>	<b>5,575</b>	<b>11,990</b>	<b>13,068</b>	<b>7,552</b>	<b>9,513</b>
Capital expenditures	(11,434)	(14,139)	(10,766)	(11,471)	(12,300)
Change in investments	70	(72)	2,021	0	0
Other investing cash flows	553	413	318	165	165
<b>Cash flow from investing</b>	<b>(10,811)</b>	<b>(13,798)</b>	<b>(8,427)</b>	<b>(11,306)</b>	<b>(12,135)</b>
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	6,196	3,071	(2,056)	5,500	5,000
Interest expenses	(677)	(1,230)	(1,731)	(1,801)	(2,378)
Dividends paid	(465)	(1,150)	(728)	0	0
Other financing cash flows	49	785	(7)	0	0
<b>Cash flow from financing</b>	<b>5,103</b>	<b>1,476</b>	<b>(4,520)</b>	<b>3,699</b>	<b>2,622</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(133)</b>	<b>(332)</b>	<b>121</b>	<b>(54)</b>	<b>0</b>
<b>Closing cash &amp; cash eq.</b>	<b>597</b>	<b>266</b>	<b>386</b>	<b>332</b>	<b>332</b>

### Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21P	FY22E	FY23E
Reported EPS	71.4	74.3	110.7	57.5	59.9
Adjusted EPS	71.4	74.3	110.7	57.5	59.9
Dividend per share	11.5	24.0	18.0	0.0	0.0
Book value per share	680.1	723.7	764.4	821.9	881.8

### Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21P	FY22E	FY23E
EV/Sales	0.9	1.0	0.9	0.8	0.7
EV/EBITDA	10.5	9.2	7.1	7.9	6.9
Adjusted P/E	19.3	18.6	12.5	24.0	23.0
P/BV	2.0	1.9	1.8	1.7	1.6

### DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21P	FY22E	FY23E
Tax burden (Net profit/PBT)	65.1	88.8	97.6	74.8	74.8
Interest burden (PBT/EBIT)	92.9	68.9	68.9	63.3	57.7
EBIT margin (EBIT/Revenue)	7.0	7.5	8.8	5.4	5.5
Asset turnover (Rev./Avg TA)	187.7	151.1	163.2	179.9	175.5
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.6	1.7
Adjusted ROAE	10.9	10.6	14.9	7.3	7.0

### Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	10.0	(3.7)	15.1	19.0	12.4
EBITDA	(1.6)	18.2	38.1	(8.6)	17.3
Adjusted EPS	3.7	4.0	49.0	(48.0)	4.1
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	8.7	10.7	12.9	9.9	10.3
EBIT margin	7.0	7.5	8.8	5.4	5.5
Adjusted profit margin	4.2	4.6	5.9	2.6	2.4
Adjusted ROAE	10.5	10.3	14.5	7.0	6.8
ROCE	9.5	9.0	12.9	7.3	7.3
<b>Working capital days (days)</b>					
Receivables	38	40	39	39	37
Inventory	46	51	48	47	44
Payables	92	113	134	128	114
<b>Ratios (x)</b>					
Gross asset turnover	0.5	0.7	0.8	0.8	0.8
Current ratio	1.1	0.9	0.7	0.8	0.8
Net interest coverage ratio	(7.1)	(4.0)	(3.8)	(2.7)	(2.4)
Adjusted debt/equity	0.5	0.5	0.4	0.6	0.7

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

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

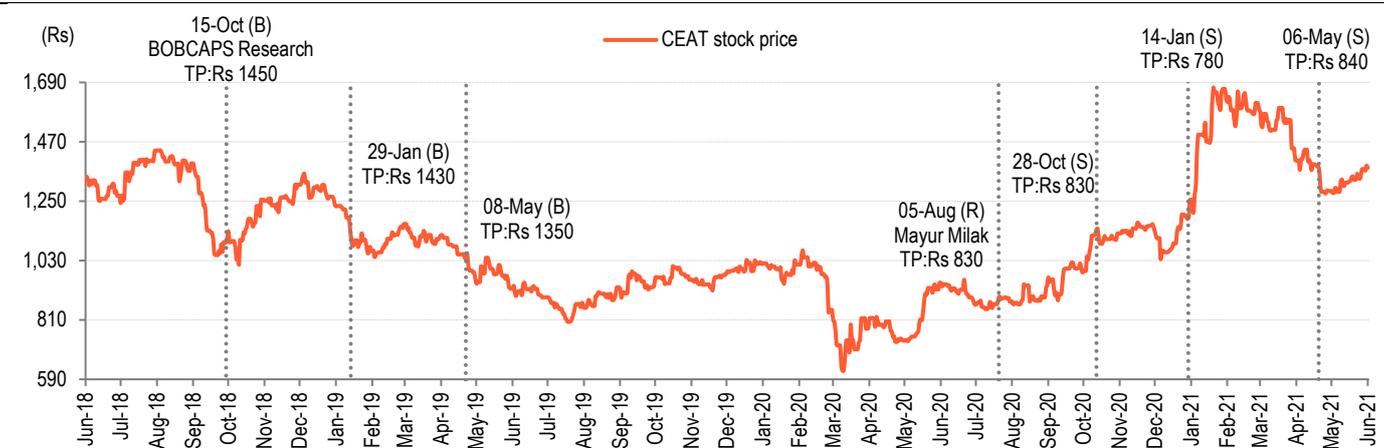
**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

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

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### Ratings and Target Price (3-year history): CEAT (CEAT IN)



B – Buy, A – Add, R – Reduce, S – Sell

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