

SELL

TP: Rs 840 | ▼ 40%

CEAT

| Auto Components

| 22 July 2021

Gross margin pressure and poor demand hit profitability

- CEAT's Q1 revenue fell below projections at Rs 19bn and gross margin declined, weakening EBITDA margin to 8.7%. Adj. PAT was at Rs 199mn
- We believe high RM cost and limited scope for material hikes in tyre prices would continue to depress profitability
- We maintain our TP of Rs 840 based on an unchanged 14x FY23E P/E multiple and reiterate SELL

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Lacklustre quarter: CEAT's Q1FY22 revenue was below our projections, declining 17% QoQ to Rs 19bn (Rs 21.5bn est.). Volumes for Q1FY22 fell 20% QoQ while better product mix and price hikes supported a 3% increase in ASP's. Gross margin slipped further by 315bps QoQ to 38.7% (39.5% est.), reflecting the sharp increase in rubber and crude oil prices and the inability of tyre companies to take sufficient price hikes to mitigate the cost inflation. Below-expected other expenses partly offset the impact of deteriorating gross margins, limiting EBITDA margin contraction at 250bps QoQ to 8.7% (9% est.). Adj. PAT stood at Rs 199mn with EPS at Rs 4.9.

Surge in commodity prices to erode margins: Given the 12% QoQ cost increase in the raw material basket during Q4FY21 and Q1FY21 (per management) respectively, along with the inability of tyre companies to fully pass on the burden, we anticipate gross margin deterioration across the sector in FY22. We bake in a further decline of ~300bps in CEAT's gross margin for FY22 over FY21 levels, resulting in a weaker operating margin.

Estimates intact: We maintain our revenue and earnings estimates for FY22/FY23 and introduce forecasts for FY24, projecting a revenue/EBITDA /adj. PAT CAGR of +14%/+7%/-12% over FY21-FY24. Our FY22/FY23 EPS estimates are at Rs 58/ Rs 60, >40% lower than consensus. We diverge widely from the street as our gross margin assumptions of 40.5% for both years are ~200bps below consensus.

Maintain SELL: CEAT's Q1 gross margin has weakened to 38.7% and we do not see scope for quick recovery in the near term considering the steep increase in input cost and lag in price hikes taken by companies. External borrowings to fund capex will also undermine the balance sheet and depress profits due to higher interest cost. We maintain our Mar'22 TP of Rs 840, set at an unchanged 14x FY23E EPS – in line with the seven-year average. SELL.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	CEAT IN/Rs 1,400
Market cap	US\$ 759.3mn
Free float	53%
3M ADV	US\$ 5.0mn
52wk high/low	Rs 1,763/Rs 835
Promoter/FPI/DII	47%/28%/9%

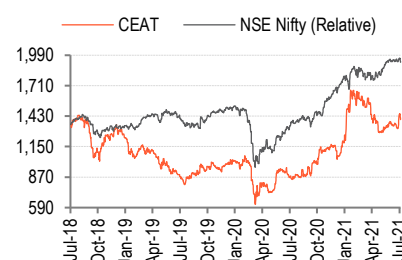
Source: NSE | Price as of 20 Jul 2021

Key financials

Y/E 31 Mar	FY21A	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	75.6	111.3
Adj. ROAE (%)	14.5	7.0	6.8
Adj. P/E (x)	12.6	24.3	23.4
EV/EBITDA (x)	7.2	8.0	7.0
Adj. EPS growth (%)	49.0	(48.0)	4.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)	FY21	FY20	YoY (%)
Net Revenues	18,978	11,162	70.0	22,790	(16.7)	71,915	62,156	15.7
Total Income (A)	18,978	11,162	70.0	22,790	(16.7)	71,915	62,156	15.7
Operating Expenses								
Raw materials consumed	11,638	6,696	73.8	13,259	(12.2)	40,892	36,946	10.7
Employee Expenses	1,753	1,492	17.4	1,806	(2.9)	6,618	5,282	25.3
Other Expenses	3,932	1,956	101.0	5,172	(24.0)	15,569	13,797	12.8
Total Expenditure (B)	17,322	10,144	70.8	20,237	(14.4)	63,079	56,025	12.6
EBITDA (A-B)	1,655	1,017	62.7	2,553	(35.2)	8,836	6,131	44.1
Other Income	39	149	(74.1)	31	23.4	329	499	(34.0)
Depreciation	965	785	22.8	899	7.3	3,462	2,698	28.3
EBIT	729	381	91.5	1,685	(56.7)	5,704	3,932	45.1
Finance Costs	453	483	(6.3)	392	15.4	1,791	1,449	23.6
PBT before excep items	277	(102)	(371.3)	1,293	(78.6)	3,913	2,483	57.6
Exceptional items	-	(218)	(100.0)	(0)	(100.0)	(341)	(235)	45.2
PBT after excep items	277	(320)	(186.5)	1,293	(78.6)	3,572	2,248	58.9
Tax expense	77	(61)	(226.8)	(125)	(161.9)	655	523	25.2
Reported PAT	199	(259)	(177.0)	1,418	(85.9)	2,918	1,725	69.1
Adj. PAT	199	(41)	(585.4)	1,418	(85.9)	3,258	1,960	66.3
Adj. EPS (Rs)	4.9	(1.0)	(585.4)	35.1	(85.9)	80.5	48.4	66.3

Source: Company, BOBCAPS Research.

Fig 2 – Key parameters

(%)	Q1FY22	Q1FY21	YoY (bps)	Q4FY21	QoQ (bps)	FY21	FY20	YoY (bps)
Gross margin	38.7	40.0	(133)	41.8	(314)	43.1	40.6	257
EBITDA margin	8.7	9.1	(39)	11.2	(247)	12.3	9.9	242
EBIT margin	3.8	3.4	43	7.4	(355)	7.9	6.3	160
PBT margin	1.5	(0.9)	237	5.7	(421)	5.4	4.0	144
Tax rate	27.9	19.0	886	(9.7)	3,755	18.3	23.3	(493)
Adj PAT margin	1.1	(0.4)	141	6.2	(517)	4.5	3.2	137

Source: Company, BOBCAPS Research

Earnings call highlights

- Demand was affected by the second Covid wave post Apr'21 but has recovered from mid-June. The OEM/replacement/export segments contributed 25%/55%/20% of revenue in Q1FY22.
- Volumes declined 20% QoQ in the replacement market while the OEM channel fell 30% QoQ.
- Raw material cost (per kg) increased 12% QoQ and management expects a further 2-3% rise in Q2.
- CEAT took a price increase of ~4% across categories in Q1 and intends to raise prices by ~3% in July (already announced). Management believes a further 2-3% hike would be needed to fully offset raw material cost inflation.
- Inventory increased by Rs 1.8bn in Q1FY22.
- The company has planned project capex of Rs 10bn for FY22, in addition to maintenance capex of Rs 1.5bn-2bn. Most capex would be towards the Chennai factory for the truck and bus radial (TBR) segment. In FY23-FY24, CEAT plans to spend Rs 7bn-8bn per year towards project capex.

Valuation methodology

We maintain our revenue and earnings estimates for FY22/FY23 and introduce forecasts for FY24, projecting a revenue/EBITDA /adj. PAT CAGR of +14%/+7%/-12% over FY21-FY24. Our FY22/FY23 EPS estimates are at Rs 58/Rs 60, >40% lower than consensus. We diverge widely from the street as our gross margin assumptions of 40.5% for both years are ~200bps below consensus.

CEAT's Q1FY22 gross margin has weakened to 38.7% and we do not see scope for sharp recovery in the near term considering the steep increase in input cost and lag in price hikes taken by companies. External borrowings to fund capex will also undermine the balance sheet and depress profits due to higher interest cost. We maintain our Mar'22 TP of Rs 840, set at an unchanged 14x FY23E EPS – in line with the seven-year average. Reiterate SELL.

Fig 3 – Key assumptions

Parameters	FY21	FY22E	FY23E	FY24E
Volume (MT)	362,825	413,620	454,982	500,481
Revenues	75,728	90,149	101,298	111,989
Gross Margins	43.9	40.5	40.5	40.5
EBITDA	9,738	8,901	10,438	11,797
OPM (%)	12.9	9.9	10.3	10.5
Adj. PAT	4,477	2,327	2,422	2,837
EPS (Rs)	111	58	60	70

Source: Company, BOBCAPS Research

Fig 4 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
					FY22E	FY23E	FY22E	FY23E	
CEAT	CEAT IN	SELL	840	15.7	57.5	59.9	7.0	6.8	14
Apollo Tyres	APTY IN	SELL	140	11.3	7.9	8.9	4.3	4.7	16
Balkrishna Inds	BIL IN	SELL	1,550	12.4	64.8	70.3	17.9	16.8	22
MRF	MRF IN	SELL	67,000	15.9	2,769.2	3,080.1	7.7	7.9	22
TVS Srichakra	TVSL IN	SELL	1,200	15.2	78.3	85.2	6.8	7.1	14
JK Tyres	JKI IN	SELL	90	12.8	8.0	12.6	6.6	9.6	7

Source: BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- above-expected volume growth,
- meaningful expansion in operating margin, and
- softening raw material prices.

Sector recommendation snapshot

Stock	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Apollo Tyres	APTY IN	2	222	140	SELL
Balkrishna Industries	BIL IN	6	2,319	1,550	SELL
Ceat	CEAT IN	1	1,400	840	SELL
JK Tyre & Industries	JKI IN	0	142	90	SELL
MRF	MRF IN	5	81,640	67,000	SELL
TVS Srichakra	SRTY IN	0	2,195	1,200	SELL

Source: BOBCAPS Research, NSE | Price as of 20 Jul 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	65,811	75,728	90,149	101,298	111,989
EBITDA	7,053	9,738	8,901	10,438	11,797
Depreciation	2,554	3,396	4,155	4,987	5,627
EBIT	4,912	6,660	4,912	5,616	6,336
Net interest inc./(exp.)	(1,230)	(1,731)	(1,801)	(2,378)	(2,543)
Other inc./(exp.)	413	318	165	165	165
Exceptional items	(298)	(341)	0	0	0
EBT	3,385	4,589	3,111	3,238	3,792
Income taxes	678	453	784	816	956
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	2,708	4,136	2,327	2,422	2,837
Adjustments	298	341	0	0	0
Adjusted net profit	3,005	4,477	2,327	2,422	2,837

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	11,714	19,436	18,178	19,509	21,732
Other current liabilities	6,933	10,370	12,573	12,821	14,075
Provisions	1,598	1,525	1,525	1,525	1,525
Debt funds	15,676	13,620	19,120	24,120	22,120
Other liabilities	1,645	1,645	1,645	1,645	1,645
Equity capital	405	405	405	405	405
Reserves & surplus	28,869	30,515	32,843	35,265	38,101
Shareholders' fund	29,274	30,920	33,247	35,669	38,506
Total liab. and equities	66,839	77,516	86,288	95,289	99,603
Cash and cash eq.	266	386	332	332	683
Accounts receivables	7,047	9,223	9,879	10,824	11,966
Inventories	8,795	11,125	11,855	12,489	13,807
Other current assets	2,066	2,315	2,439	2,548	2,677
Investments	3,202	1,181	1,181	1,181	1,181
Net fixed assets	38,205	47,884	56,730	64,743	66,116
CWIP	9,338	7,029	5,500	4,800	4,800
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(2,611)	(2,656)	(2,656)	(2,656)	(2,656)
Other assets	532	1,029	1,029	1,029	1,029
Total assets	66,839	77,516	86,288	95,289	99,603

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	11,990	13,068	7,552	9,513	11,729
Capital expenditures	(14,139)	(10,766)	(11,471)	(12,300)	(7,000)
Change in investments	(72)	2,021	0	0	0
Other investing cash flows	413	318	165	165	165
Cash flow from investing	(13,798)	(8,427)	(11,306)	(12,135)	(6,835)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	3,071	(2,056)	5,500	5,000	(2,000)
Interest expenses	(1,230)	(1,731)	(1,801)	(2,378)	(2,543)
Dividends paid	(1,150)	(728)	0	0	0
Other financing cash flows	785	(7)	0	0	0
Cash flow from financing	1,476	(4,520)	3,699	2,622	(4,543)
Chg in cash & cash eq.	(332)	121	(54)	0	351
Closing cash & cash eq.	266	386	332	332	683

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	74.3	110.7	57.5	59.9	70.1
Adjusted EPS	74.3	110.7	57.5	59.9	70.1
Dividend per share	24.0	18.0	0.0	0.0	0.0
Book value per share	723.7	764.4	821.9	881.8	951.9

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	1.0	0.9	0.8	0.7	0.7
EV/EBITDA	9.3	7.2	8.0	7.0	6.6
Adjusted P/E	18.8	12.6	24.3	23.4	20.0
P/BV	1.9	1.8	1.7	1.6	1.5

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	88.8	97.6	74.8	74.8	74.8
Interest burden (PBT/EBIT)	68.9	68.9	63.3	57.7	59.9
EBIT margin (EBIT/Revenue)	7.5	8.8	5.4	5.5	5.7
Asset turnover (Rev./Avg TA)	151.1	163.2	179.9	175.5	181.1
Leverage (Avg TA/Avg Equity)	1.5	1.5	1.6	1.7	1.7
Adjusted ROAE	10.6	14.9	7.3	7.0	7.6

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	(3.7)	15.1	19.0	12.4	10.6
EBITDA	18.2	38.1	(8.6)	17.3	13.0
Adjusted EPS	4.0	49.0	(48.0)	4.1	17.1
Profitability & Return ratios (%)					
EBITDA margin	10.7	12.9	9.9	10.3	10.5
EBIT margin	7.5	8.8	5.4	5.5	5.7
Adjusted profit margin	4.6	5.9	2.6	2.4	2.5
Adjusted ROAE	10.3	14.5	7.0	6.8	7.4
ROCE	9.0	12.9	7.3	7.3	7.7
Working capital days (days)					
Receivables	40	39	39	37	37
Inventory	51	48	47	44	43
Payables	113	134	128	114	113
Ratios (x)					
Gross asset turnover	0.7	0.8	0.8	0.8	0.8
Current ratio	0.9	0.7	0.8	0.8	0.8
Net interest coverage ratio	(4.0)	(3.8)	(2.7)	(2.4)	(2.5)
Adjusted debt/equity	0.5	0.4	0.6	0.7	0.6

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

Disclaimer

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

BUY – Expected return >+15%

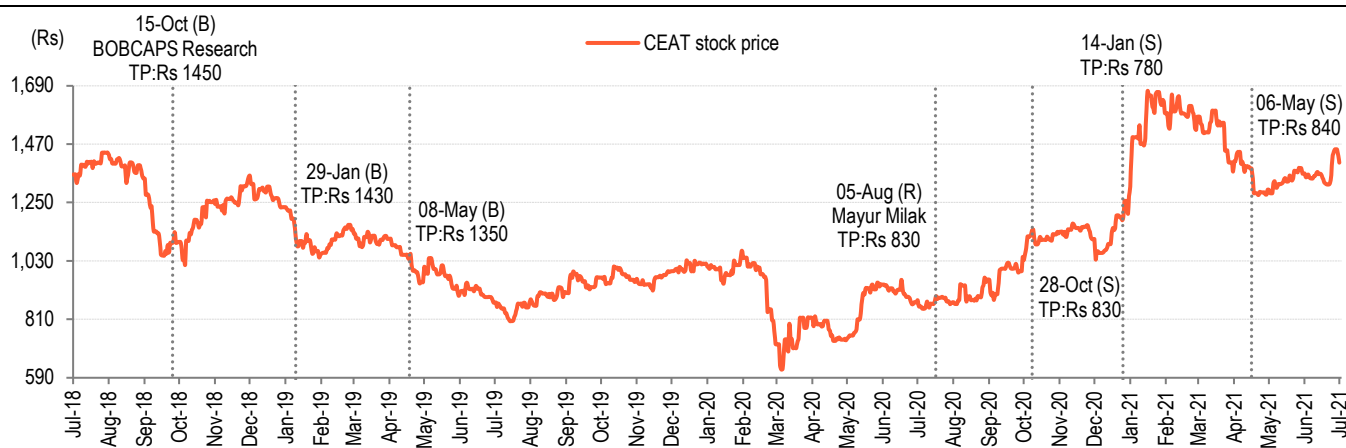
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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, H – Hold, S – Sell, A – Add, R – Reduce

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