

SELL

TP: Rs 780 | ▼ 40%

CEAT

Auto Components

20 January 2021

Healthy Q3 but long-term woes remain; maintain SELL

CEAT surprised positively on both revenue and earnings in Q3FY21, led by strong replacement demand and above-expected gross margins which could be a function of low-cost inventory. Revenue was up 30% YoY and operating margin expanded 410bps YoY. We continue to believe that capex (~Rs 35bn) will far exceed estimated operating cash flow (~Rs 25bn) over FY21-FY23, necessitating external funding and adding pressure on both balance sheet and earnings. We retain our TP of Rs 780 (14x Mar'23E EPS) and maintain SELL.

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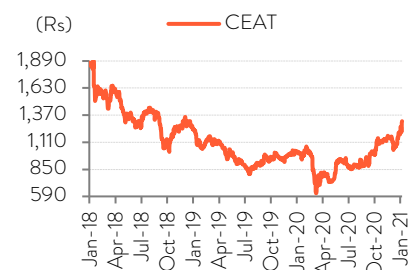
Strong Q3: At Rs 22.1bn (+30% YoY), revenue was 10% ahead of our estimate backed by strong replacement demand which was up ~35% YoY. Gross margin declined 100bps sequentially against an estimated ~400bps contraction. Further, higher operating efficiencies supported EBITDA growth of 80% YoY to Rs 3.3bn. EBITDA margin thus stood at 14.7% and adj. PAT grew 2.2x YoY to Rs 1.4bn.

Ticker/Price	CEAT IN/Rs 1,310
Market cap	US\$ 726.1mn
Shares o/s	40mn
3M ADV	US\$ 5.3mn
52wk high/low	Rs 1,353/Rs 600
Promoter/FPI/DII	47%/28%/9%

Source: NSE

Surge in commodity prices to erode earnings: With the >30% rise in both rubber and Brent crude prices from Q2FY21 levels, we anticipate gross margin deterioration for tyre companies (see our recent report [Spiking RM costs to puncture earnings](#)). To mitigate this impact, players will have to effect price hikes of over 15% which looks difficult. We bake in a decline of ~150bps YoY in CEAT's FY22 gross margin, resulting in a drop in operating margin and earnings.

STOCK PERFORMANCE



Source: NSE

Maintain SELL: External borrowings to fund capex will not only undermine the balance sheet but also depress profits due to higher interest. Management believes rising input costs could pressure margins. We model for EBITDA margin shrinkage to 10.5% in FY23 and project a revenue/EBITDA /adj. PAT CAGR of +13%/−4%/−20% over FY21-FY23. Our Mar'22 TP remains at Rs 780, set at an unchanged 14x FY23E EPS. SELL.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	68,313	65,811	73,158	84,906	93,560
EBITDA (Rs mn)	5,965	7,053	9,213	8,497	9,867
Adj. net profit (Rs mn)	2,889	3,005	3,721	1,964	2,263
Adj. EPS (Rs)	71.4	74.3	92.0	48.6	55.9
Adj. EPS growth (%)	3.7	4.0	23.8	(47.2)	15.2
Adj. ROAE (%)	10.5	10.3	11.4	5.7	6.1
Adj. P/E (x)	18.3	17.6	14.2	27.0	23.4
EV/EBITDA (x)	10.0	8.8	7.2	8.4	7.8

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	9MFY21	9MFY20	YoY (%)
Net Revenues	22,125	17,086	29.5	19,651	12.6	52,938	50,994	3.8
Total Income (A)	22,125	17,086	29.5	19,651	12.6	52,938	50,994	3.8
Operating Expenses:								
Raw materials consumed	12,065	9,814	22.9	10,493	15.0	29,254	30,249	(3.3)
Employee Expenses	1,785	1,340	33.2	1,589	12.3	4,866	3,790	28.4
Other Expenses	5,017	4,120	21.8	4,665	7.6	11,637	11,841	(1.7)
Total Expenditure (B)	18,867	15,274	23.5	16,746	12.7	45,757	45,880	(0.3)
EBITDA (A-B)	3,258	1,812	79.9	2,905	12.2	7,181	5,114	40.4
Other Income	100	57	75.7	42	136.0	291	350	(16.9)
Depreciation	873	648	34.8	839	4.0	2,497	1,913	30.5
EBIT	2,485	1,221	103.6	2,108	17.9	4,974	3,551	40.1
Finance Costs	412	301	36.9	444	(7.3)	1,338	966	38.5
PBT before excep items	2,074	920	125.4	1,664	24.6	3,636	2,585	40.7
Exceptional items	(123)	(3)	4,808.0	-	NA	(341)	(17)	1,951.8
PBT after excep items	1,951	918	112.6	1,664	17.2	3,295	2,568	28.3
Tax expense	675	297	127.4	(37)	(1,920.5)	577	584	(1.1)
Reported PAT	1,276	621	105.6	1,702	(25.0)	2,718	1,984	37.0
Adj. PAT	1,398	623	124.4	1,702	(17.8)	3,059	2,001	52.9
Adj. EPS (Rs)	34.6	15.4	124.4	42.1	(17.8)	75.6	49.5	52.9

Source: Company, BOBCAPS Research.

FIG 2 – KEY PARAMETERS

(%)	Q3FY21	Q3FY20	YoY (bps)	Q2FY21	QoQ (bps)	9MFY21	9MFY20	YoY (bps)
Gross margin	45.5	42.6	291	46.6	(114)	44.7	40.7	406
EBITDA margin	14.7	10.6	412	14.8	(6)	13.6	10.0	354
EBIT margin	11.2	7.1	409	10.7	50	9.4	7.0	243
PBT margin	9.4	5.4	399	8.5	90	6.9	5.1	180
Tax rate	34.6	32.4	225	(2.2)	3,685	17.5	22.7	(521)
Adj PAT margin	6.3	3.6	267	8.7	(234)	5.8	3.9	185

Source: Company, BOBCAPS Research.

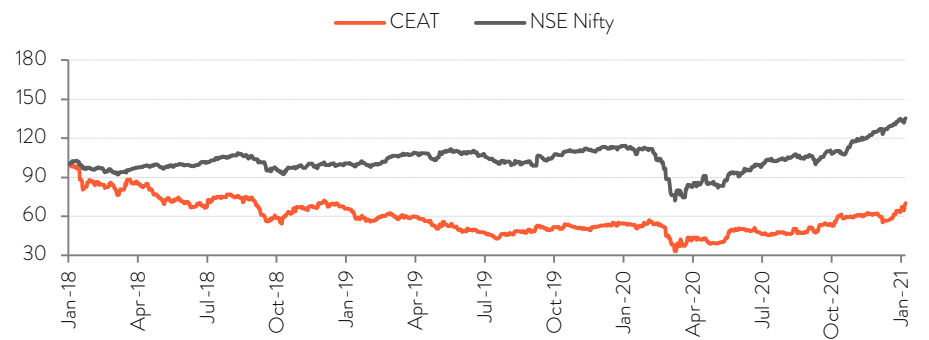
Earnings call highlights

- Demand momentum remains healthy with volumes up 28% YoY in Q3FY21. Most of the demand was driven by the replacement segment which grew 35% YoY; OEMs and exports grew 15% each. Tonnage volume in Q4FY21 should be similar to Q3, per management.
- Demand for MHCV tyres has been picking up given normalcy in economic activity and more vehicles plying on the road.
- Inventory levels remain lower than average at less than one month despite higher capacity utilisation across plants.
- Commodity prices have increased sharply with rubber currently at Rs 160/kg (vs. Rs 130 in Q2). This trend is expected to continue with exit commodity prices in Mar'21 likely to be ~10% higher than current levels.
- CEAT has taken a price increase of ~3% across categories (except 2Ws) in the last two months and would likely effect another hike of 3% in Q4 to partially mitigate the raw material cost burden.
- Gross debt stood at Rs 15.6bn at the end of 9MFY21, down by Rs 3.5bn since end-FY20. However, with additional capex to be commissioned and increasing working capital needs, debt can move up.
- CEAT plans to incur capex of Rs 6.5bn in FY21. Over FY22-FY23, the company intends to incur project capex of ~Rs 15bn and maintenance capex of Rs 3bn.

Valuation methodology

External borrowings to fund capex will not only undermine the balance sheet but also depress profits due to higher interest. Rising input costs could pressure margins, per management. We model for EBITDA margin shrinkage to 10.5% in FY23 (From 12.6% estimated in FY21) and project a revenue/EBITDA/adj. PAT CAGR of +13%/-4%/-20% over FY21-FY23. Our Mar'22 target price remains at Rs 780, set at an unchanged 14x FY23E EPS. Maintain SELL.

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Above-expected volume growth
- Meaningful expansion in operating margin
- Softening raw material prices

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	68,313	65,811	73,158	84,906	93,560
EBITDA	5,965	7,053	9,213	8,497	9,867
Depreciation	1,743	2,554	3,272	4,085	4,897
EBIT	4,775	4,912	6,344	4,863	5,420
Net interest income/(expenses)	(677)	(1,230)	(1,748)	(2,237)	(2,395)
Other income/(expenses)	553	413	403	450	450
Exceptional items	340	(298)	(218)	0	0
EBT	4,438	3,385	4,378	2,626	3,025
Income taxes	1,209	678	876	662	762
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	3,229	2,708	3,503	1,964	2,263
Adjustments	(340)	298	218	0	0
Adjusted net profit	2,889	3,005	3,721	1,964	2,263

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	12,078	11,714	12,890	13,920	15,187
Other current liabilities	4,498	6,933	7,411	9,184	9,584
Provisions	1,436	1,598	1,598	1,598	1,598
Debt funds	12,605	15,676	24,507	27,507	29,507
Other liabilities	414	1,645	1,645	1,645	1,645
Equity capital	405	405	405	405	405
Reserves & surplus	27,106	28,869	32,321	34,285	36,548
Shareholders' fund	27,510	29,274	32,725	34,690	36,953
Total liabilities and equities	58,541	66,839	80,776	88,543	94,474
Cash and cash eq.	597	266	2,334	1,761	2,444
Accounts receivables	7,265	7,047	8,819	8,839	9,741
Inventories	9,652	8,795	10,022	10,468	11,022
Other current assets	2,133	2,066	2,747	3,204	3,394
Investments	3,130	3,202	3,002	3,002	3,002
Net fixed assets	28,463	38,205	44,932	55,848	60,950
CWIP	7,494	9,338	11,000	7,500	6,000
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(2,077)	(2,611)	(2,611)	(2,611)	(2,611)
Other assets	1,884	532	532	532	532
Total assets	58,542	66,839	80,776	88,543	94,474

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	4,972	5,262	6,775	6,049	7,160
Interest expenses	677	1,230	1,748	2,237	2,395
Non-cash adjustments	(553)	(413)	(403)	(450)	(450)
Changes in working capital	954	5,957	(2,025)	1,878	22
Other operating cash flows	(475)	(45)	0	0	0
Cash flow from operations	5,575	11,990	6,095	9,714	9,127
Capital expenditures	(11,434)	(14,139)	(11,662)	(11,500)	(8,500)
Change in investments	70	(72)	200	0	0
Other investing cash flows	553	413	403	450	450
Cash flow from investing	(10,811)	(13,798)	(11,059)	(11,050)	(8,050)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	6,196	3,071	8,831	3,000	2,000
Interest expenses	(677)	(1,230)	(1,748)	(2,237)	(2,395)
Dividends paid	(465)	(1,150)	0	0	0
Other financing cash flows	49	785	(51)	0	0
Cash flow from financing	5,103	1,476	7,032	763	(395)
Changes in cash and cash eq.	(133)	(332)	2,068	(572)	683
Closing cash and cash eq.	597	266	2,334	1,761	2,444

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	71.4	74.3	92.0	48.6	55.9
Adjusted EPS	71.4	74.3	92.0	48.6	55.9
Dividend per share	11.5	24.0	0.0	0.0	0.0
Book value per share	680.1	723.7	809.0	857.6	913.5

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	0.9	0.9	0.9	0.8	0.8
EV/EBITDA	10.0	8.8	7.2	8.4	7.8
Adjusted P/E	18.3	17.6	14.2	27.0	23.4
P/BV	1.9	1.8	1.6	1.5	1.4

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	65.1	88.8	85.0	74.8	74.8
Interest burden (PBT/EBIT)	92.9	68.9	69.0	54.0	55.8
EBIT margin (EBIT/Revenue)	7.0	7.5	8.7	5.7	5.8
Asset turnover (Revenue/Avg TA)	187.7	151.1	138.7	138.4	141.8
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.7	1.8	1.8
Adjusted ROAE	10.9	10.6	12.0	5.8	6.3

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	10.0	(3.7)	11.2	16.1	10.2
EBITDA	(1.6)	18.2	30.6	(7.8)	16.1
Adjusted EPS	3.7	4.0	23.8	(47.2)	15.2
Profitability & Return ratios (%)					
EBITDA margin	8.7	10.7	12.6	10.0	10.5
EBIT margin	7.0	7.5	8.7	5.7	5.8
Adjusted profit margin	4.2	4.6	5.1	2.3	2.4
Adjusted ROAE	10.5	10.3	11.4	5.7	6.1
ROCE	9.5	9.0	9.6	5.9	6.1
Working capital days (days)					
Receivables	38	40	40	38	36
Inventory	46	51	47	44	42
Payables	92	113	109	97	96
Ratios (x)					
Gross asset turnover	0.5	0.7	0.8	0.8	0.9
Current ratio	1.1	0.9	1.1	1.0	1.0
Net interest coverage ratio	(7.1)	(4.0)	(3.6)	(2.2)	(2.3)
Adjusted debt/equity	0.5	0.5	0.7	0.8	0.8

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

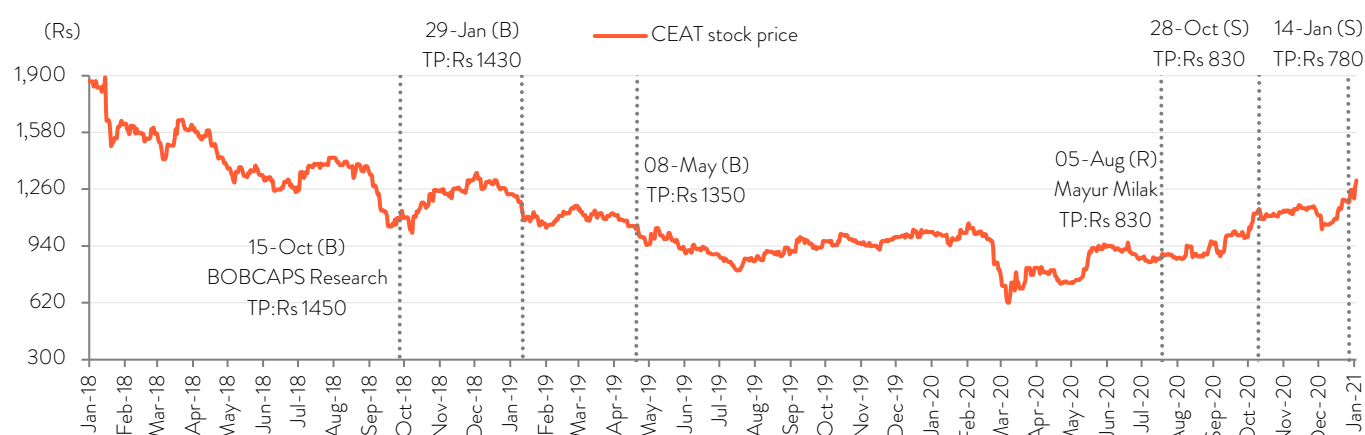
ADD – Expected return from >+5% to +15%

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)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): CEAT (CEAT IN)



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

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