

**SELL**

TP: Rs 840 | ▼ 37%

**CEAT**

| Auto Components

| 06 May 2021

## Rising raw material costs to impact earnings; SELL

**CEAT's revenue was 8% ahead of our estimate at Rs 23bn in Q4FY21. Gross margin contracted 360bps QoQ, operating margin slipped 130bps YoY to 11.2%, and reported PAT was at Rs 1.4bn. Though we have raised FY22/FY23 revenue estimates based on market share gains and expected price hikes, these now stand in line with consensus. Our earnings projections are ~40% below consensus mainly because our gross margin assumptions are 200bps lower than the street. Maintain SELL with a new Mar'22 TP of Rs 840 (vs. Rs 780).**

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**Gross margin contracts 360bps QoQ:** At Rs 22.8bn (+50% YoY), Q4 revenue was 8% ahead of our estimate. Tonnage volumes grew 43% YoY in Q4. Gross margin declined 360bps sequentially, in line with our projections. EBITDA grew 34% YoY to Rs 2.6bn and the margin fell 130bps YoY to 11.2% (-350bps QoQ). On transition to the newer tax regime, CEAT recognised remeasurement gains in Q4, leading to PAT of Rs 1.4bn.

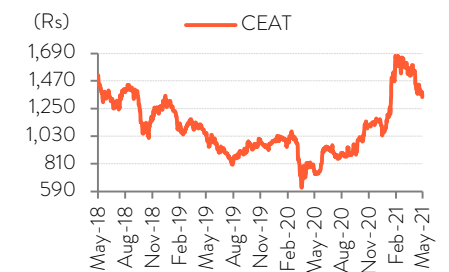
**Commodity price surge to erode margins:** With a 12% QoQ cost rise in the RM basket in Q4, a further expected rise of ~10% QoQ in Q1FY22 (per management) and the inability of tyre companies to fully pass on the cost burden, we anticipate gross margin deterioration for our tyre coverage (see our recent expert-led report: [Rubber prices headed for a structural bull run](#)). We factor in a further 130bps drop in CEAT's gross margin over Q4 levels, depleting operating margins.

**Maintain SELL:** Baking in market share gains in the PV segment and price hikes to offset costs, we raise our FY22/FY23 revenue estimates, leading to upward revision of earnings by 18%/7%. That said, we are still 40% below consensus due to lower margin forecasts. External borrowings to fund capex will also undermine the balance sheet and depress profits due to higher interest. We revise our Mar'22 TP to Rs 840, set at an unchanged 14x FY23E EPS. Maintain SELL.

Ticker/Price	CEAT IN/Rs 1,340
Market cap	US\$ 735.2mn
Shares o/s	40mn
3M ADV	US\$ 4.8mn
52wk high/low	Rs 1,763/Rs 712
Promoter/FPI/DII	47%/28%/9%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
Total revenue (Rs mn)	68,313	65,811	75,728	90,149	101,298
EBITDA (Rs mn)	5,965	7,053	9,738	8,901	10,438
Adj. net profit (Rs mn)	2,889	3,005	4,477	2,327	2,422
Adj. EPS (Rs)	71.4	74.3	110.7	57.5	59.9
Adj. EPS growth (%)	3.7	4.0	49.0	(48.0)	4.1
Adj. ROAE (%)	10.5	10.3	14.5	7.0	6.8
Adj. P/E (x)	18.8	18.0	12.1	23.3	22.4
EV/EBITDA (x)	10.2	8.9	7.0	7.7	6.7

Source: Company, BOBCAPS Research | P - Provisional

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**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)	FY21	FY20	YoY (%)
Net Revenues	22,790	15,236	49.6	22,125	3.0	75,728	66,231	14.3
<b>Total Income (A)</b>	22,790	15,236	49.6	22,125	3.0	75,728	66,231	14.3
<b>Operating Expenses:</b>								
Raw materials consumed	13,259	8,473	56.5	12,065	9.9	42,513	38,722	9.8
Employee Expenses	1,806	1,303	38.6	1,785	1.2	6,671	5,093	31.0
Other Expenses	5,172	3,561	45.2	5,017	3.1	16,810	15,402	9.1
<b>Total Expenditure (B)</b>	20,237	13,337	51.7	18,867	7.3	65,994	59,217	11.4
<b>EBITDA (A-B)</b>	2,553	1,899	34.4	3,258	(21.6)	9,734	7,013	38.8
Other Income	31	65	(51.6)	100	(68.7)	322	414	(22.3)
Depreciation	899	693	29.8	873	3.0	3,396	2,606	30.3
EBIT	1,685	1,271	32.6	2,485	(32.2)	6,660	4,822	38.1
Finance Costs	392	338	16.0	412	(4.7)	1,731	1,304	32.7
PBT before excep items	1,293	933	38.6	2,074	(37.6)	4,929	3,518	40.1
Exceptional items	(0)	(281)	(99.9)	(123)	(99.7)	(341)	(298)	14.6
PBT after excep items	1,293	652	98.2	1,951	(33.7)	4,588	3,220	42.5
Tax expense	(125)	94	(232.9)	675	(118.5)	453	678	(33.2)
<b>Reported PAT</b>	1,418	558	153.9	1,276	11.1	4,136	2,543	62.7
<b>Adj. PAT</b>	1,418	839	69.0	1,398	1.4	4,477	2,840	57.6
<b>Adj. EPS (Rs)</b>	35.1	20.7	69.0	34.6	1.4	110.7	70.2	57.6

Source: Company, BOBCAPS Research.

**FIG 2 – KEY PARAMETERS**

(%)	Q4FY21	Q4FY20	YoY (bps)	Q3FY21	QoQ (bps)	FY21	FY20	YoY (bps)
Gross margin	41.8	44.4	(257)	45.5	(365)	43.9	41.5	233
EBITDA margin	11.2	12.5	(126)	14.7	(352)	12.9	10.6	226
EBIT margin	7.4	8.3	(95)	11.2	(383)	8.8	7.3	151
PBT margin	5.7	6.1	(45)	9.4	(370)	6.5	5.3	120
Tax rate	(9.7)	14.4	NA	34.6	NA	9.9	21.0	(1,118)
Adj PAT margin	6.2	5.5	71	6.3	(10)	5.9	4.3	162

Source: Company, BOBCAPS Research

## Earnings call highlights

- Demand momentum remains healthy with volumes up 43% YoY in Q4FY21. Tonnage volume in Q4 was similar to Q3, per management. Replacement segment sales declined 5-6% QoQ while OEM sales were positive.
- Management believes demand would be driven by the truck & bus segment going ahead, whereas 2Ws and PVs would be under pressure given adequate channel inventory and the impact from the second Covid wave. Higher OEM sales are expected to result in an adverse margin mix for CEAT.
- Blended RM costs (per kilo) increased 12% QoQ in Q4 and management anticipates a further 10% QoQ rise in Q1FY22.
- CEAT took a blended price hike of ~3% on the replacement side in Q4. Prices with OEMs are indexed to RM prices and should be recovered with a one-quarter lag. No hike has been taken post Q4.
- The company's current market share is 28-30% in the 2W segment and 9% in truck & bus. In PVs, it has increased market share by 500-600bps in FY21 to 15-16% currently.
- Gross debt stood at Rs 15.6bn at the end of 9MFY21 and has declined to Rs 14.2bn at the end of Q4FY21. However, with additional capex and increasing working capital needs, debt can move up.
- CEAT incurred capex of Rs 4.7bn in FY21 and intends to spend a further Rs 12bn in FY21 (including Rs 1.5bn of maintenance outlay). The board has also approved capex for expansion of the Chennai truck & bus radial (TBR) plant by 190tpd and has earmarked Rs 12bn towards this project. The expansion will take place over the next four years.
- Plans are underway to expand capacities at CSTL (specialty tyres division) to 45tpd as the plant is currently fully utilised.

## Valuation methodology

Factoring in market share gains of >500bps in the PV segment and price hikes to offset RM costs, we raise our FY22/FY23 revenue estimates for CEAT by 6%/8% (drawing in line with consensus), leading to upward revision of earnings by 18%/7%. Nevertheless, our EPS forecasts of Rs 57/Rs 60 are still 40% below consensus due to lower gross margin assumptions (200bps below the street at 40.5%).

CEAT's Q4FY21 gross margin stood at 41.8% and could come under further pressure considering that management expects a 10% QoQ increase in RM costs in Q1FY22. We estimate that even if the company were to take another 3% price hike in Q1, gross margin would still slump by over 300bps sequentially. External borrowings to fund capex will also undermine the balance sheet and depress profits due to higher interest.

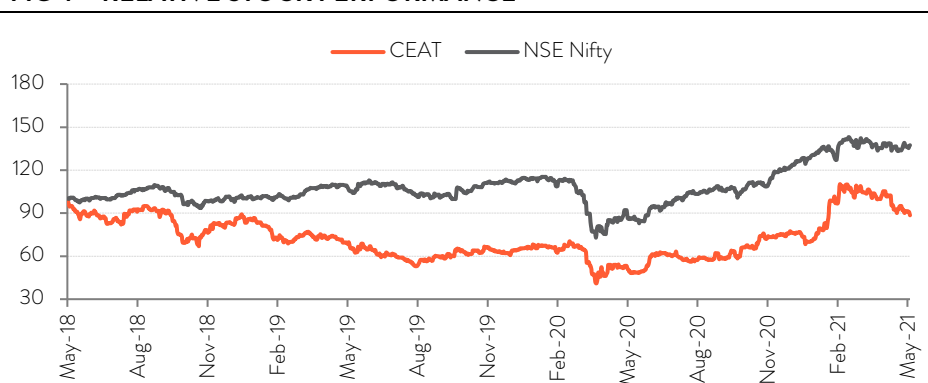
Post estimate revision, we now pencil in a revenue/EBITDA/adj. PAT CAGR of +10%/+2%/–19% for the company over FY21–FY23. We have a revised Mar'22 target price of Rs 840 (vs. Rs 780), set at an unchanged 14x FY23E EPS, and maintain SELL.

**FIG 3 – REVISED ESTIMATES**

(Rs mn)	New		Old		Change (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Revenues	90,148.5	101,298.2	84,906.0	93,560.0	6.2	8.3
EBITDA	8,901.5	10,437.8	8,497.0	9,867.0	4.8	5.8
OPM (%)	9.9	10.3	10.0	10.5	(13bps)	(24bps)
Adj. PAT	2,327.3	2,422.1	1,964.0	2,263.0	18.5	7.0
EPS (Rs)	57.5	59.9	48.6	55.9	18.4	7.1

Source: Company, BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

- Above-expected volume growth
- Softening raw material price

## 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 income/(expenses)	(677)	(1,230)	(1,731)	(1,801)	(2,378)
Other income/(expenses)	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 associates	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 liabilities 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>

Source: Company, BOBCAPS Research

### Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Net income + Depreciation	4,972	5,262	7,532	6,482	7,409
Interest expenses	677	1,230	1,731	1,801	2,378
Non-cash adjustments	(553)	(413)	(318)	(165)	(165)
Changes in working capital	954	5,957	5,835	(565)	(109)
Other operating cash flows	(475)	(45)	(1,711)	0	0
<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>Changes in cash and cash eq.</b>	<b>(133)</b>	<b>(332)</b>	<b>121</b>	<b>(54)</b>	<b>0</b>
<b>Closing cash and 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	10.2	8.9	7.0	7.7	6.7
Adjusted P/E	18.8	18.0	12.1	23.3	22.4
P/BV	2.0	1.9	1.8	1.6	1.5

### 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 (Revenue/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

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

**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

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

**BUY** – Expected return >+15%

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

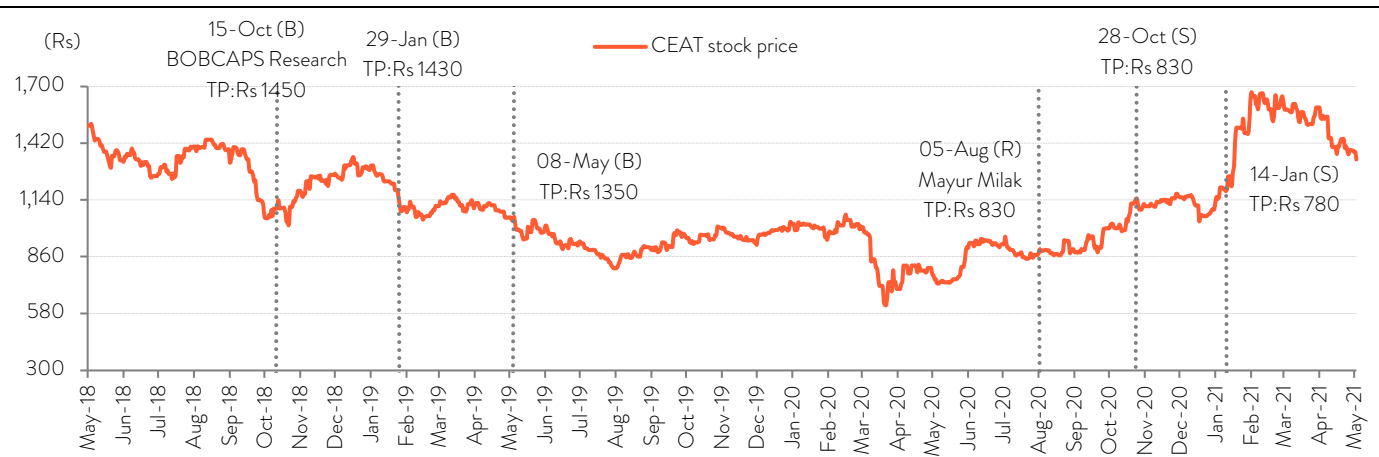
**REDUCE** – Expected return from -5% to +5%

**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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