Stock Note Nov 09, 2013

HDFCSec Scrip Code	Industry	CMP (Rs.)	Recommended Action	Averaging Price Band (Rs.)	Price Target (Rs.)	Time Horizon
GOOINDEQNR	Tyres	341.7	Buy at CMP & add on dips	302-313	402	1-2 quarters

Price Chart

Stock Details

BSE Code	500168
NSE Code	**GOODYEAR**
Bloomberg	GDYR IN
Price (Rs) as on Nov 08, 2013	341.7
Equity Capital (Rs Mn)	231.0
Face Value (Rs)	10.0
Eq. Shares O/s (mn)	23.1
Market Cap (Rs Mn.)	7038.7
Book Value (Rs)	153.4
Avg. Volume (52 Week)	7,647
52 wk H/L	377.0/ 237.0

Shareholding Pattern

(As on Sept 30, 2013)	% Holding
FIIs	1.8
Institutions	8.6
Promoters	74.0
Non-Promoter Corp Hold.	2.4
Public & Others	13.2
Total	**100.0**

Background

Incorporated in 1961, Goodyear India Ltd. (GIL) manufactures automotive bias tyres viz. farm tyres and medium commercial truck tyres at its Ballabgarh plant and also trades in “Goodyear” branded tyres (including radial passenger and Off The Road (OTR) bias tyres manufactured by Goodyear South Asia Tyres Private Ltd (GSATPL) Aurangabad, pursuant to the offtake agreement. The other products in which GIL markets and sells include tubes and flaps.

Triggers

- We expect GIL’s net sales to grow at a gradual pace by 8% over CY12-14. Tyre demand is set to improve over the next two years on the back of some recovery expected in the automobile sector. While the growth in CY13 is expected to be marginal, we expect a decent growth in CY14, as the economic growth & spending power is likely to improve.
- GIL is a market leader in tractor tyre segment (market share of ~22% in front tyres & ~36% in rear tyres). The category accounts for ~62% of total tonnage offtake. Tractor tyres is likely to witness higher demand on the back of improved farm income, government’s thrust on improving farm output and higher planned expenditure for the same in the budget.
- GIL is tapping the growing replacement market through expansion of dealership network, which could further boost the growth.
- GIL’s OPM is likely to improve due to lower natural rubber (NR) prices (key input, which accounts for 65% of the total input cost). Focus on replacement market could also support the margins. Higher OPM, gradual growth in depreciation cost, nearly NIL interest cost would boost PAT & PAT margins.
- GIL could continue to receive technology support from its parent, which is one of the world’s leading tyre companies and has a strong balance sheet. Going forward, GIL could be a possible candidate for de-listing. As per some sources, the parent company is in advance stages of finalizing the deal. This could be a huge positive trigger for the stock.
- Dividend payouts could improve going forward with improved profitability & healthy cash reserves. Value unlocking from real estate could result in higher dividends.
- Despite being small in size, GIL has an edge over its competitors like Apollo Tyres, MRF, JK Tyres & Ceat Tyres due to MNC tag, debt-free & cash rich status (unlike its peers) and market leadership in tractor tyres. This justifies GIL’s premium valuations over its peers. Gradual & steady increase in institutional holding reflects their confidence on GIL’s future prospects.

Consolidated Financials at a Glance:

Particulars (Rs. in Mn)	CY11	CY12	CY13E	CY14E
Net Sales	**15134.3**	**14812.9**	**15773.1**	**17271.6**
% Growth (y-o-y)	16.7	-2.1	6.5	9.5
Operating Profit	**1123.5**	**952.6**	**1354.3**	**1526.2**
% Growth (y-o-y)	-3.8	-15.2	42.2	12.7
PAT (Adjusted)	**645.9**	**563.2**	**885.3**	**1031.3**
% Growth (y-o-y)	-13.7	-12.8	57.2	16.5
EPS	**28.0**	**24.4**	**38.4**	**44.7**
% Growth (y-o-y)	-13.7	-12.8	57.2	16.5
PE	**12.2**	**14.0**	**8.9**	**7.6**

Valuation & Recommendation

We feel GIL deserves to trade at atleast 9xCY14E EPS (10% premium to the last 5 year avg. 1 yr forward PE), which gives a price target of Rs. 402. Hence we feel investors could buy this stock at current levels and average it on dips in the price band of Rs. 302-313 (6.75-7.0x CY14E EPS) for our price target over the next one to two quarters. Any news on de-listing or land sale could result in re-rating in the stock price.

Business Profile

Incorporated in 1961, Goodyear India Ltd. (GIL) manufactures automotive bias tyres viz. farm tyres and medium commercial truck tyres at its Ballabgarh plant and also trades in “Goodyear” branded tyres (including radial passenger and Off The Road (OTR) bias tyres manufactured by Goodyear South Asia Tyres Private Ltd (GSATPL) Aurangabad, pursuant to the offtake agreement dated September 1, 2001 and thereby revised offtake agreement effective April 1, 2012 (executed on July 11, 2012 post receipt of Government approvals). The other products in which the Company markets and sells include tubes and flaps. The range of products produced in both plants is marketed through a chain of exclusive Goodyear Tire Centres as well as multi-brand dealers.

GIL’s presence in India is over 89 years old. The company is a 74% subsidiary of the Goodyear Orient Company (Pvt.) Ltd, Singapore (GOCPL), which is wholly owned subsidiary of The Goodyear Tire & Rubber Company, Akron (“GTRC”), the ultimate holding company and one of the world's leading tyre companies. GTRC is a $21 bn company, which employs ~73,000 people and manufactures its products in 54 facilities in 22 countries around the world.

Goodyear Milestones

For over a hundred years, Goodyear has been at the forefront of tyre technology. Through advanced research and manufacturing practices, Goodyear continues to push the boundaries of innovation and remains One Revolution Ahead.

1898	Frank Seiberling starts Goodyear Tire & Rubber Company. He chooses to name it in honour of inventor Charles Goodyear.
1908	Henry Ford's Model T, fitted with Goodyear tyres, is a sensation with middle class consumers. Car registrations skyrocket.
1922	Goodyear enters India Market.
1961	Starts production in India at Ballabgarh Plant.
1964	Using Goodyear tyres, Craig Breedlove becomes the first man to top 600 miles (960km) an hour.
1969	Goodyear Aerospace helps send astronauts safely to the moon and back.
1971	Goodyear tyres are the first tyres to land on the Moon.
1984	India's largest tyre, over 8 feet tall, rolls out of the factory.
1998	Goodyear celebrates its 100th anniversary.
2002	Goodyear becomes first company to launch tubeless tyre in India.
2006	Launch of 'Shop-in-shop' Branded Retail Outlet .
2008	Launch of Goodyear Assurance - passenger tyre made with Dupont KEVLAR.
2009	Launch of new farm tyre Vajra Super and commercial tyres Timber King and CTD 21.
2009	Launch of Goodyear DuraPlus and Duraco Hi-Miler - long milage passenger tyres made with TredLife Technology.

GIL’s presence is largely in the OEM segment. The company supplies to OEMs like Maruti, Tata Motors, Hyundai, in the Passenger Vehicle (PV) segment, and is a preferred tyre supplier within the foreign PV players in India like Volkswagen, GM, Toyota and Ford. The company is the market leader in the farm category (tractor tyre segment), with a market share of over 22% in the front tyres and ~36% in the rear tyres segment. The category accounts for close to 62% of the total tonnage offtake of GIL. The company supplies to almost all the major tractor players in India. The company has a small presence in the Commercial Vehicle tyre segment and is absent in the two wheelers segment. Goodyear India has also been a pioneer in introducing tubeless radial tyres in this segment.

GIL is primarily a domestic player, generating majority of its sales (97.5%) locally. The company has a small presence in the overseas markets (2.5%). The company exports its products to countries like Australia, Nepal, Bangladesh, Colombia, Egypt, Japan, Jordan, New Zealand, Nicaragua, Pakistan, Peru, South Africa, Sri Lanka, Thailand, Tanzania, United Arab Emirates and Vietnam etc. GIL has been taking various initiatives to increase export presence like development of new export markets for products and services and export plans.

GIL imports around 27% of its raw material requirements (~15% of the total sales). Its major inputs are natural rubber, carbon black, fabrics & pigments. Natural rubber accounts for 65% of the total raw material cost.

Investment Rationale

Reputed brand image, market leadership in tractor tyre business

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Vajra Super (farm tyre), Timber King and CTD 21 (commercial tyres), Assurance Fuel Max (passenger tyre made with Dupont KEVLAR, a material that is five times stronger than steel), Goodyear DuraPlus and Duraco Hi-Miler (long milage passenger tyres made with TredLife Technology). Some of the launches are through GSATPL, with whom the company has an offtake agreement. Being an MNC company, it has a reputed brand image. Technologies and innovations over the years have enabled GIL to establish a strong presence in India and also in the overseas markets and remain competitive. Various technologies of GIL over the years include Active Cornergrip technology (enables you to manoeuvre tight turns with the greatest of ease), Armorgrip technology (provides safe and effective braking), 3 Zone technology (delivers on three counts; safety, handling & comfort zone), SilentArmor technology (latest innovation that gives SUV drivers a strong, tough tyre with the quiet, comfortable performance of a passenger car), One Tred technology (boasts a tread design that improves stability) and Run On Flat technology (keep the car running for up to 80km with no air pressure after a puncture or blowout).

Parental support with continuing focus on India

GIL's presence in India is over 89 years old. The company is a 74% subsidiary of the Goodyear Orient Company (Pvt.) Ltd, Singapore (GOCPL), which is wholly owned subsidiary of The Goodyear Tire & Rubber Company, Akron ("GTRC"), the ultimate holding company. GTRC is one of the world's leading tyre companies with net sales of $21 bn and net income of $0.2 bn (in CY12). Together with its U.S. and international subsidiaries and joint ventures, GTRC develops, manufactures, markets and distributes tires for most applications. It also manufactures and markets rubber-related chemicals for various applications. GTRC is one of the world's largest operators of commercial truck service and tire retreading centers. In addition, it operates approximately 1,400 tire and auto service centre outlets where it offers its products for retail sale and provides automotive repair and other services. The company employs approximately 73,000 people and manufactures its products in 54 facilities in 22 countries around the world. It has marketing operations in almost every country around the world.

GTRC's two Innovation Centers in Akron, Ohio and Colmar-Berg, Luxembourg strive to develop state-of-the-art products and services that set the technology and performance standard for the industry. In 2010-11, Goodyear was awarded the prestigious super brands status, besides recognition from its most elite customers, including M&M, Maruti Suzuki and Toyota. It has also received the Environmental Achievement of the Year award for introducing innovative technology, which uses biomass instead of petrochemicals, to manufacture synthetic rubber.

While GTRC is the world's largest tyre company and is present all over the world, it continues to focus on the emerging markets like India. It sees India as a growth market and significant opportunity going forward. Hence GIL would continue to receive support from its parent company (which is huge in terms of size, has market leadership in tyres and is cash rich) in terms of technology, innovation & new launches going forward.

Tapping the growing replacement market through expansion of dealership network

The three major segments of the tyre industry are original equipment (OEM 26%), replacement (63%) and exports (11%). The replacement segment absorbs close to 57% of total tyre production (in tonnage terms) in India. The segment has the highest realisations, followed by the export market and then OE segment. GIL's major presence is in tractor tyre market, where replacement demand is high. GIL mainly caters to the OEM segment, but has recently expanded its dealership network into 36 cities in India in order to tap the growing replacement markets. As a part of the future strategic growth driver, GIL is testing farm radial tyres in selected markets.

The continuing pressure on automobile sales owing to challenging economic environment substantially impacted the original equipment manufacturer (OEM) demand for tyres in FY13. However, healthy rise in replacement demand helped to keep tyre sales afloat. As per the data released by the Automobile Tyre Manufacturers Association (ATMA) for April-December FY13 period, the replacement demand in unit terms has witnessed a growth of 10%. In tonnage terms, the replacement demand witnessed a strong rise of around 27% on y-o-y basis.

Replacement demand is expected to remain the growth engine for the industry in short to medium term period. CARE Research believes considerable addition on vehicles on road during last one decade will continue to fuel replacement demand for tyres. It foresees replacement demand in FY14 to grow in a range of around 12% in unit terms, whereas in tonnage the growth is expected to be around 14-15%, suggesting higher rise in replacement demand.

CARE Research believes, initiatives taken by key tyre manufacturers (both domestic and global) to impart awareness about the benefits of the radial tyres would fuel growth for these tyres in replacement market in medium to long-term period. CARE Research estimates the proportion of TBR in replacement market which was estimated to be around 20% in FY13, is expected to increase to 30% in FY15. GIL has launched a couple of new brands in the radial tyre TBR segment. With low penetration of about 20% in MHCV radial tyres, there exists enough room for expansion going forward.

Higher contribution from the replacement market in tractor tyres (including radial) and T&B radial tyres would help GIL report better operating margins going forward.

Sales growth to improve over CY12-14 with recovery in automobile sector; good monsoon to increase demand for tractor tyres

GIL's net sales have grown by 13.4% on a CAGR basis over CY09-12. While the growth in CY10 and CY11 were robust, CY12 was disappointing, as the net sales de-grew by 2.1% due to slowdown in the automobile industry, which resulted in reduced demand for tyres. However, the fall was not significant, since GIL's India's Farm business (tractor tyre segment) achieved a Y-o-Y volume growth of 4.3%. Additionally, the company also increased its market share over CY11. There was a significant slowdown witnessed in the MHCV segment. In Q1CY13 also, the net sales grew marginally by 1.7%. GIL seems to have witnessed significant pricing pressure in its segments in CY12 and in Q1CY13. However, there is some recovery being witnessed over the last two quarters (Q2 & Q3 of CY13).

Tyre consumption to improve with the recovery in the automotive sector

We expect the automobile industry to recover marginally in FY14 on the back of low base. Due to weak rupee & rising inflation, the probability of reduction in the interest rates in the next six months looks low. Infact recently, the RBI has increased the interest rates in order to tighten the liquidity. This is likely to impact the growth of automobile industry in FY14. However, once the rupee stabilizes and inflation cools off (could take a few months), RBI would resort to rate cuts. This could result in recovery in economic growth and improvement in spending power and drive the automobile industry growth in FY15. Growth is likely to be driven by LCV demand, stable two-wheeler (2W) demand and pick up in tractor demand. While the near term outlook for the passenger vehicle (PV) and the Medium and Heavy Commercial Vehicle (M&HCV) segments is weak, we do not anticipate any further de-growth. Infact, once the economy recovery, we expect these segments to also pick up growth. With the recovery in the automobile sector, we expect the demand for tyres to improve over the next two years. As per Crisil, tyre consumption is estimated to increase by 6-8% in FY14 and by 7-9% on CAGR basis over the next five years.

Increasing demand for tractor tyres bodes well with GIL

We expect demand for tractors to grow at a robust rate in future, given the government's thrust on improving farm output and higher planned expenditure for the same in the budget. Normal monsoon is likely to improve to farm income & agri growth and further improve the demand for tractors. Moreover, increasing awareness regarding the use of modern techniques of farming among farmers is expected to trigger tractor sales in the years to come. This would result in higher demand for tractor tyres.

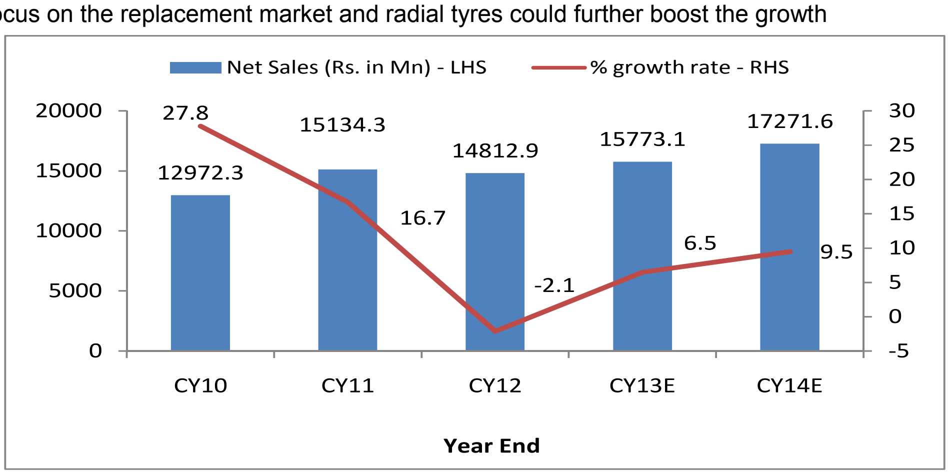
Infact, the demand for tractors have already started to improve over the last two quarters. This is evident from the fact that the tractor sales volumes growth (Y-o-Y) of major players Mahindra & Mahindra and Escorts have improved significantly over the last two quarters as given in the table below:

	Sep-13	Sep-12	VAR [%]	Jun-13	Jun-12	VAR [%]	Mar-13	Mar-12	VAR [%]	Dec-12	Dec-11	VAR [%]
Escorts	14842	12950	14.6	19518	16083	21.4	14764	15001	-1.6	17106	16616	2.9
M&M	59264	49840	18.9	74577	59698	24.9	49664	52075	-4.6	64800	65754	-1.5

GIL has cut down its already low presence in MHCV bias tyre segment and has replaced it by high margin tractor tyres. With market leadership in the tractor tyre segment, the company is well placed to capitalise on the available opportunities.

Net Sales to grow at a CAGR of 8% over CY12-14

With the improvement expected in the tyre consumption, especially the tractor tyres, we expect GIL's net sales to grow at a CAGR of 8% over CY12-14. The growth is likely to be better in CY14, as we expect the economic growth and spending power to improve. Focus on the replacement market and radial tyres could further boost the growth



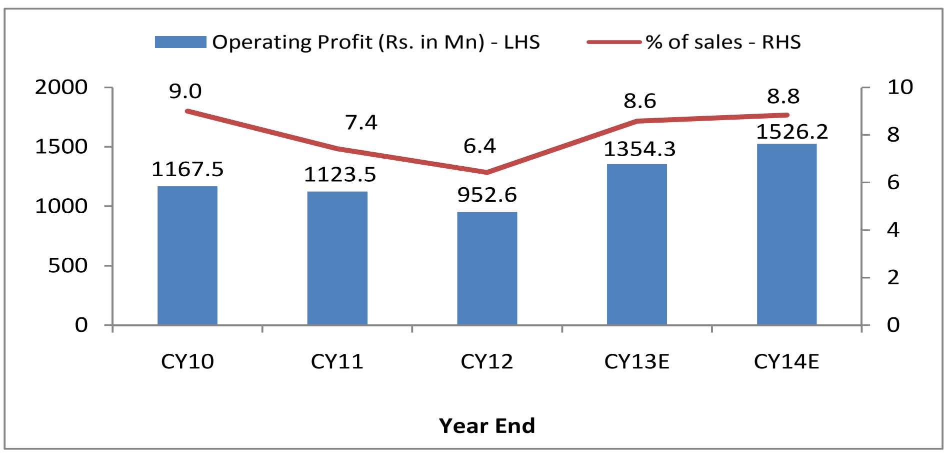
Margins to expand on the back of soft rubber prices, focus on replacement market

GIL's operating profit declined by 8.9% over CY09-12, while the OPM declined from 9% in CY10 to 6.4% in CY12, largely on the back of sharp increase in the domestic natural rubber (NR) prices (especially in CY10 & CY10), which is a key input used in tyres (65% of the total raw material cost). In CY12, the decline in OPM was mainly due to higher employee cost and other expenses. However, over the last two years, a positive emerging out of the weakness in auto demand globally has been the sharp price correction witnessed in NR and other inputs like Butadiene and Caprolactum. The domestic natural rubber prices have declined by 30.5% from a peak of Rs. 243 per kg in April 2011 to Rs. 163.3 in Oct 2013. This has resulted in improved margins of tyre manufacturers. In 9MCY13, GIL's OPM improved significantly by 248 bps Y-o-Y to 8.7%.

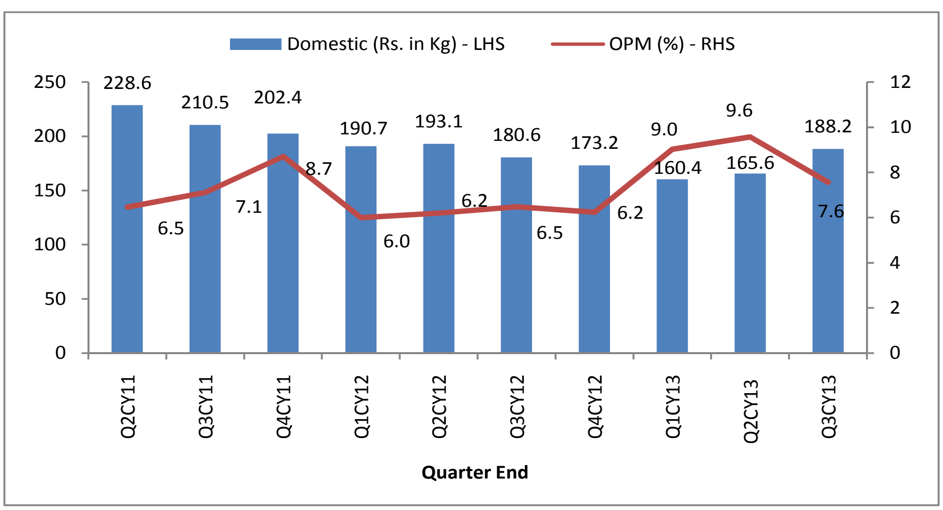
The domestic rubber prices increased by 12.5% from May to Aug 2013. However, it has cooled off again to Rs. 163.3 in Oct 2013. We feel the short term spike was a temporary phenomenon due to a supply crunch in India's main production centre, Kerala (accounts for 80% of the domestic production of the commodity). Natural rubber production in Kerala fell during summer due to extremely high temperatures which was followed by torrential rains in June, impacting rubber tapping activity for two consecutive months. However, now they have cooled off again. In October, they fell sharply, as farmers, local traders, and political parties held the steady increase in import of rubber by the industry tapping on low tariff rate.

Over the next two years, we expect the NR rubber prices in the international and domestic market to fall further (though not significantly). The global supply of NR is likely to exceed the demand. This could result in improved margins for tyre manufacturers like GIL. We expect GIL's OPM to improve by 216 bps to 8.6% in CY13 and further to 8.8% in CY14. The expansion in OPM is likely to be marginal in CY14, as we expect the company to pass on the NR price reduction partly to its consumers in the coming months and also because the pace of fall in the rubber prices is likely to reduce in CY14, as the demand situation for tyres improves. GIL's focus on the replacement market (which has higher realisations) is likely to further aid in margin expansion.

GIL's operating profit & OPM since CY10 along with our future projections



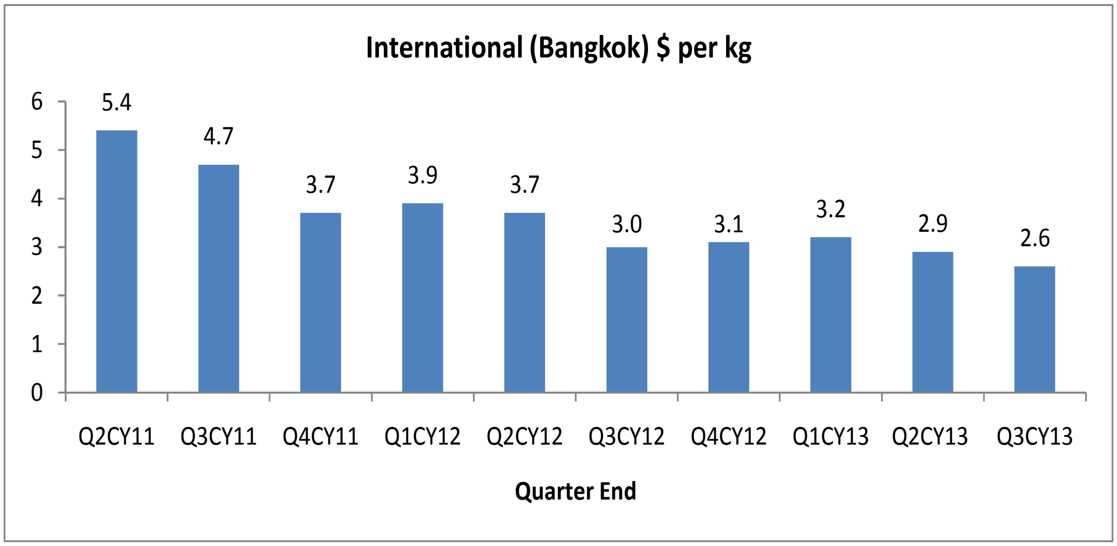
Inverse Correlation of domestic NR prices (quarterly average) and GIL's OPM (though with a time lag)



Outlook on NR prices

The domestic natural rubber prices have declined by 32.8% from a peak of Rs. 243 per kg in April 2011 to Rs. 163.3 in Oct 2013. However, the international prices (Bangkok) have fallen by close to 58% from their peak level during the same period. This has been largely due to demand-supply mismatch (weak global demand for NR along with increasing output).

Average International NR price trend since Q2CY11



Global NR surplus in 2013 and 2014 could continue to put pressure on the rubber prices

Rubber is headed for the biggest glut on record, prolonging the bear market as supply exceeds demand for a third year and Southeast Asian exporters ended curbs on shipments. The surplus would expand 57% to 490,000 metric tons this year, enough to meet U.S. demand for six months, according to RCMA Commodities Asia Group, the Singapore-based company that has traded rubber for nine decades. Thailand, Malaysia and Indonesia, representing about 70% of supply, failed to agree on new curbs after reducing exports by 300,000 tons in the six months through March 2013. While record global car production signals rising demand for tires, that won't end the glut caused by farmers expanding output by 18% in three years after prices more than doubled since the end of 2008. According to the International Rubber Study Group (IRSG), the world production and consumption of NR in 2013 is estimated at 11.77 and 11.59 million tons respectively with a surplus of 179,000 tons. In 2014, IRSG estimates the world NR production and consumption to be 12.45 and 12.30 million tons with a surplus of 150,000 tons.

India to meet the shortfall through imports

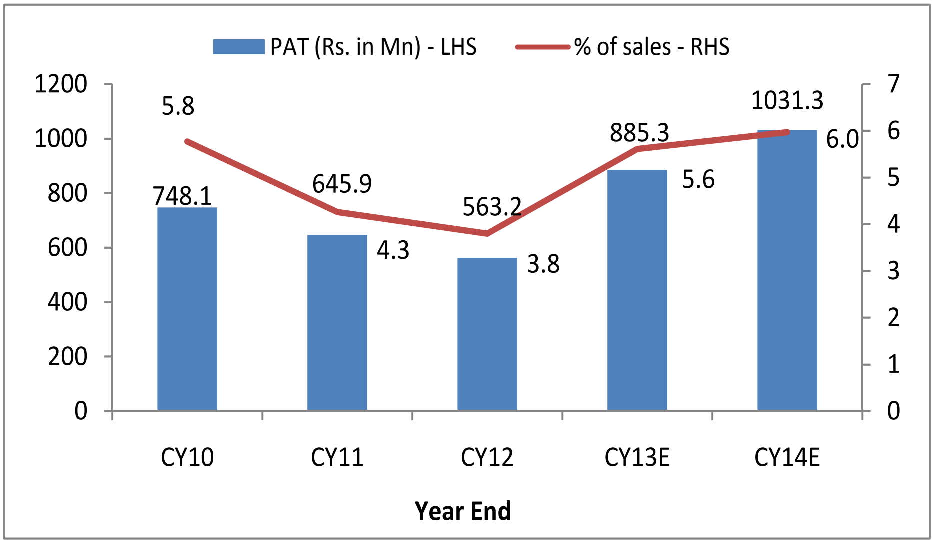
In India, 45% of the total rubber consumption is by tyre companies and the sluggish growth in this sector affects the demand. So, the market expects the bearish phase to continue in near term. Domestic rubber consumption has increased just 0.8% during 2012-13, compared to the previous financial year. In 2011-12, consumption increased 1.8%. According to Rubber Board estimates, NR consumption by tyre sector in 2012-13 was flat with a negligible growth of 0.01%, whereas in non-tyre sector, consumption rose 2.3%. There are indications that the situation may improve by 2014 and the market may gain momentum. India's production and consumption of NR in 2013-14 are projected at 960,000 tons and 1020,000 tons respectively with a deficit of 60,000 tons. However, there will not be any shortage of NR in the domestic market in 2013-14, as the estimated opening stock of NR in April 2013 is 266,000 tons and the rubber consuming industry has entitlement to import more than 100,000 tons of NR through duty free channels. Excess supply of NR in the global markets is likely to keep the domestic rubber prices at lower levels.

No hike in the import duty on Natural Rubber comes as a relief for Domestic tyre manufacturers

Since the second half of December 2012 and early January this year, the pitch was getting louder for review of import duty on natural rubber. Pressure was also mounted on the Finance Ministry to hike the specific duty component of import duty on natural rubber. However, the Centre in April 2013 decided against increasing customs duty on natural rubber imports. This stance has come as a relief for the domestic tyre manufacturers who had been urging Finance Minister P. Chidambaram to retain the current import duty structure on natural rubber imports. This is likely to keep the NR prices under control.

PAT to grow at a CAGR of 35.3% over CY12-14

Improved OPM, nearly zero interest liability and gradual rise in the depreciation cost is likely to result in better PAT growth of 35.3% over CY12-14. PAT margins are likely to improve from 3.8% in CY12 to 5.6% in CY13 and further to 6% in CY14.



Could be a possible candidate for delisting going forward

GIL's parent company M/s Goodyear Orient Company (Private) Ltd (GOCPL), Singapore holds 74% stake in GIL. GOCPL is the wholly owned subsidiary of The Goodyear Tire & Rubber Company, Akron (GTRC), the ultimate holding company. GIL could be a possible de-listing candidate for delisting going forward with the parent company holding a large stake. In 2010, GTRC had made an open offer to buy back the shares of the Indian company (at Rs. 340). However, the process failed due to poor response from the shareholders. To delist from the bourse, the company was required to acquire a minimum of 36,90,642 shares out of 59,97,292 equity shares from the public. However, the company received only 21,69,237 shares from the public and 11,36,505 shares were at or below the discovered price

The parent organisation, which is cash-rich with net cash and cash equivalent amounting to USD2386 mn as on March 31, 2013, might again try to increase their stake and delist the Indian entity shares from the stock exchanges. Infact, as per some sources, the parent company is in advance stages of finalizing the deal. The company has also appointed two bankers for finalizing the delisting plan. While the timing of the same is uncertain, whenever the de-listing offer comes up, we feel it could be at an attractive price (might be at 30-40% premium to the current market price) to attract the shareholders interest and prevent another failure. This could be a huge positive trigger for the stock.

Sitting on huge parcels of land, value unlocking possible going forward

GIL is sitting on huge parcels of land in Ballabgarh, Faridabad. In June 2011, the company had made an announcement for the sale of this land after it obtains necessary approvals. As per some sources, the sale proceeds were expected to be around Rs. 1-1.5 bn. However, this process got terminated pursuant to a Circular Resolution passed by the Board of Directors on June 21, 2012. In case, the company once again decides to sell this real estate and the plan materializes, it could result in value unlocking. GIL already has cash reserves to the tune of Rs. 2.4 bn (in CY12). The land sale could further strengthen its cash position. The surplus could be distributed to shareholders in the form of dividend. Hence any progress on the land sale could provide an upside trigger to the stock.

Cash Rich, Debt free player with healthy return ratios

GIL, unlike its peers, is a cash rich and a debt free company with cash reserves of Rs. 2.4 bn as on Dec 31, 2012, which is 35% of its market capitalisation. This translates into cash per share of Rs. 103. This has enabled the company to fund its expansion plans over the years through internal accruals. GIL is the only listed player in the tyre industry that has such a strong balance sheet. The company enjoys healthy return ratios. It's ROCE & ROE in CY12 stood at 25% & 15.9% respectively. With no interest liability and turnaround expected in profits, we expect the return ratios to improve over the next two years. With a strong cash balance, healthy operating cash flow generation every year (last five year average: Rs. 860 mn p.a), we expect GIL to remain debt-free going forward.

Consistent dividend payouts – could improve gradually with improved profitability, healthy cash reserves

GIL has a decent track record of paying dividends consistently to its shareholders over the last seven years, despite periods of sharp slowdown in the tyre industry in between. The dividend payments have increased gradually from Rs. 115.3 mn in CY06 to Rs. 161.5 mn in CY12. The dividend payout in % terms has been in the range of 21-29% over the last four years. With turnaround in the profitability, we expect GIL to continue enriching its shareholders' wealth with healthy dividend payouts. While we don't expect the company to significantly increase its dividend payouts, we can expect a gradual and steady increase going forward, given rich cash reserves and improvement expected in profits. Further, if the process of land sale materialises in future, there could be a possibility of company announcing special dividend as well.

Competitive Profile

GIL faces competition from other established tyre manufacturers like Apollo Tyres, MRF, Ceat Tyres & JK Tyres. At CMP, the stock trades at a PE of 7.6x CY14E & 9.5x its trailing EPS (TTM). This is at a premium to all its peers, which are trading in the range of 3.5-9x their trailing EPS (TTM). GIL's premium valuation despite smaller business size and lower operating margins is justifiable. GIL is the only listed player in tyre industry having a debt free status. The company funds its CAPEX plans through internal accruals. NIL interest liability provides margin of safety. MNC tag further provides support to higher valuations. Further, GIL is a market leader in tractor tyre segment, which accounts for close to 62% of the total tonnage offtake. Other companies have lower presence in tractor tyre segment and higher presence in MHCV segment, which is presently witnessing a sharp slowdown. Hence the competition is not significant. Demand for tractor tyres is estimated to grow at a faster pace on the back of normal monsoon and improved farm income, while the demand outlook for MHCV is likely to remain subdued in the near term.

Gradual & steady increase in institutional holding despite premium valuations reflects their confidence on GIL's future prospects

Institutional holding in GIL has increased at a gradual and steady pace over the last three years from 2.4% in March 2010 to 10.36% in Sept 2013. This is unlike most of its peers like Ceat Tyres, JK Tyre, Apollo Tyres and Falcon Tyres, which have witnessed a decline in their institutional holdings during the same period, as given below in the table.

	Institutional Holding	
Company	As on March 31, 2010	As on Sept 30, 2013
Ceat Tyres	21.6%	10.2%
JK Tyre	21.7%	14.2%
Apollo Tyres	42.9%	41.5%
Falcon Tyres	1.4%	0.4%
GIL	2.4%	10.4%

Though GIL's peers (except Falcon Tyres and Ceat Tyres) have higher percentage of institutional holdings, they have been declining. It is worth noting that GIL's institutional holding has increased despite the company trading at a premium to its peers. This reflects their confidence on GIL's future prospects. MNC tag, clean balance sheet, cash rich & debt-free status provides further support. With turnaround expected in the financial performance over the next two years, we expect the institutional holdings in GIL to continue to increase gradually. With this, we expect GIL to continue to command premium valuations vis-à-vis its peers.

Risks and concerns

- GIL's growth fortunes are linked to the growth of automobile industry. If the automobile sector takes time to recover, then GIL's sales growth (volume offtake) could continue to be impacted. The ongoing slowdown in the Automobile industry has already impacted the sales and profit growth of GIL, which declined by 2.1% & 12.8% in CY12. In Q1CY13, the sales growth was marginal. However, some recovery was witnessed in Q2 & Q3 of CY13.
- ~20% of the net sales of GIL are attributable to the sale of products procured from Goodyear South Asia Tyres Private Limited (GSATPL), pursuant to the offtake agreement. Hence any disruption in the agreement could have a significant impact on the company's turnover.
- Poor monsoon or decline in the agri / rural income could impact the demand for tractors, resulting into lower offtake of tractor tyres in which GIL has large presence (62% of the total tonnage offtake)
- Sharp rise in the prices of Natural rubber, a key input for tyres (65% of the total raw material cost) could impact GIL's margins significantly, if the company is unable to pass on the price increase to its consumers.
- GIL imports around 27% of its raw material requirements (~15% of the total sales). However, its exports are just 2.5%. Hence, sharp rupee depreciation could make the imports costlier and impact GIL's margins.
- Increasing competition from the local players & import market could put pressure on pricing and impact the volume growth.
- GIL's Ballabgarh plant (farm tyres & MHCV truck & bus tyres) is operating at close to 95% capacity utilisation. Hence it will have to expand its capacity in the next one to two years to meet the demand and improve its volume growth.

- Besides GIL, GIL's parent company has one more wholly subsidiary, Goodyear South Asia Tyres Private Ltd. (GSATPL), which manufactures passenger tyres (including radial tyres) and off the road bias tyres at Aurangabad facility. Hence there is a conflict of interest, as going forward parent's focus could shift in favour of GSATPL, especially during times when demand for tractor tyre is subdued.
- Hike in import duty on natural rubber by the Indian Govt could increase the cost of raw material for all tyre companies affecting their margins.

Q3CY13 Quarterly snapshot

Standalone

Y-o-Y:

- Net Sales increased by 10% Y-o-Y to Rs. 4058.9 mn (Q3CY12: Rs. 3688.8 mn). While the demand for tyres remains subdued due to slowdown in the automobile sector, the growth in this quarter was much better than the Y-o-Y growth in the previous quarters.
- On the profit front, the results were impressive. Operating profit grew by 28.4% Y-o-Y to Rs. 302 mn (Q3CY12: Rs. 239.1 mn), while OPM improved by 108 bps Y-o-Y to 7.6% on the back of decline in the material cost / net sales (down 187 bps to 72.6%) and relatively lower growth in the employee cost (up 8.4% Y-o-Y). However, higher other expenses (up 17.1% Y-o-Y) restricted further expansion in the margins.
- PAT increased by 33.3% Y-o-Y to Rs. 200.4 mn (Q3CY12: Rs. 150.4 mn), while PAT margins improved by 86 bps Y-o-Y to 4.9%, led by decline in the interest cost (down 48.5% Y-o-Y), marginal rise in the depreciation cost (up 4.4% Y-o-Y) and lower effective tax rate (down 187 bps Y-o-Y to 33.6%). EPS for the quarter stood at Rs. 8.7 vs Rs. 6.5 in Q3CY12.

Q-o-Q:

- Sequentially, the results appeared disappointing due to exceptionally good Q2. Net sales de-grew by 12.6%, while operating profit & PAT de-grew by 40.8% and 41.3% Q-o-Q respectively.
- OPM declined by 201 bps Q-o-Q on the back of higher material cost / net sales (up 105 bps Q-o-Q). Natural Rubber prices increased sharply in June & July 2013 due to a supply crunch in India's main production centre, Kerala (accounts for 80% of the domestic production of the commodity)
- Lower OPM impacted the PAT growth. PAT declined by 41.3%, while PAT margins fell by 113 bps Q-o-Q.

Conclusion & Recommendation:

We expect GIL's net sales to grow at a gradual pace by 8% over CY12-14. Tyre demand is set to improve over the next two years on the back of some recovery expected in the automobile sector. While the growth in CY13 is expected to be marginal, we expect a decent growth in CY14, as the economic growth & spending power is likely to improve. The company is a market leader in tractor tyres (close to 62% of the total tonnage offtake of GIL), which is likely to witness higher demand on the back of government's thrust on improving farm output and higher planned expenditure for the same in the budget. Normal monsoon is likely to improve to farm income and agri growth and improve the demand for tractors. GIL has cut down its already low presence in MHCV bias tyre segment and has replaced it by high margin tractor tyres. The company is largely present in OEM segment, but is now tapping the growing replacement market through expansion of dealership network, which could further boost the growth.

Global natural rubber (NR) surplus in 2013 and 2014 could continue to put pressure on the NR prices over the next two years. This could enable GIL to expand its margins (though it is expected to pass on the benefits partly) from 6.4% in CY12 to 8.8% in CY14. Focus on the replacement market could also support the margins. Higher OPM, gradual growth expected in depreciation cost (since no major CAPEX is likely to be incurred), nearly NIL interest liability would boost PAT & PAT margins.

GIL could continue to receive technology support from its parent company "GTRC", which is one of the world's leading tyre companies and has a strong balance sheet. Going forward, GIL could be a possible candidate for de-listing. While GTRC failed in its earlier attempt of de-listing, the next attempt (whenever it happens) could be at a decent premium to the current market price to attract the shareholders. As per some sources, the parent company is in advance stages of finalizing the deal. The company has also appointed two bankers for finalizing the delisting plan.

While the dividend payout is slightly lower in our view, we feel it could improve gradually with improved profitability and healthy cash reserves. While the sale process of a land at Ballabgarh plant has been terminated, any revival of the same in future could result in value unlocking for the shareholders, which could be in the form of higher dividends.

Despite having a smaller business size, GIL has an edge over its competitors like Apollo Tyres, MRF, JK Tyres & Ceat Tyres on the back of MNC tag, debt-free & cash rich status (unlike its peers) and market leadership in tractor tyres (peers are mainly into MHCV segment). This justifies GIL's premium valuations over its peers. Gradual & steady increase in institutional holding despite premium valuations reflects their confidence on GIL's future prospects. With turnaround expected in the financial performance over the next two years, we expect the institutional holdings in GIL to continue to increase gradually.

We feel GIL deserves to trade at atleast 9xCY14E EPS (10% premium to last 5 year avg. 1 yr forward PE), which gives a price target of Rs. 402. Hence we recommend investors to buy this stock at current levels and average it on dips in the price band of Rs. 302-313 (6.75-7.0x CY14E EPS) for our price target over the next one to two quarters. On a higher side, the stock has traded at 14x 1 yr forward PE. Any news on de-listing or land sale could result in re-rating in the stock price.

Quarterly Financial Performance: (Standalone)

(Rs. In Million)

Particulars	Q3CY13	Q3CY12	VAR [%]	Q2CY13	VAR [%]	Q1CY13	Q4CY12
Net Sales	4058.9	3688.8	10.0	4221.9	-12.6	3358.1	3823.5
Other Operating Income	6.4	4.5	42.2	8.0	-43.8	7.7	14.2
Total Income	4065.3	3693.3	10.1	4229.9	-12.7	3365.8	3837.7
Total Expenditure	3758.3	3454.2	8.8	3825.9	-9.7	3062.5	3599.1
Raw Material Consumed	1829	2127.2	-14.0	1913.3	11.2	1917.8	1890.0
Stock Adjustment	-21	-302.7	-	184.9	-	-207.3	358.9
Purchase of Finished Goods	1139.1	922.8	23.4	922.9	0.0	656.0	561.3
Employee Expenses	209.9	193.6	8.4	208.5	-7.1	198.9	197.7
Other Expenses	601.3	513.3	17.1	596.3	-13.9	497.1	591.2
Operating Profit	307.0	239.1	28.4	404.0	-40.8	303.3	238.6
Other Income	63.1	64.4	-2.0	65	-0.9	67.4	76.0
PBIDT	370.1	303.5	21.9	469.0	-35.3	370.7	314.6
Interest	5.1	9.9	-48.5	4.8	106.3	5.0	11.2
Depreciation	63.4	60.7	4.4	62.4	-2.7	61.6	63.6
PBT	301.6	232.9	29.5	401.8	-42.0	304.1	239.8
Tax (incl. DT & FBT)	101.2	82.5	22.7	145.6	-43.3	96.0	78.7
PAT	200.4	150.4	33.2	256.2	-41.3	208.1	161.1
EPS	8.7	6.5	33.2	11.1	-41.3	9.0	7.0
Equity	230.7	230.7	0.0	230.7	0.0	230.7	230.7
Face Value	10.0	10.0	0.0	10.0	0.0	10.0	10.0
OPM (%)	7.6	6.5	16.7	9.6	-32.3	9.0	6.2
PATM (%)	4.9	4.1	21.1	6.1	-32.8	6.2	4.2

(Source: Company, HDFC Sec Estimates)

Financial Estimations: (Consolidated)

Profit & Loss A/c

(Rs. In Million)

YE December	CY11	CY12	CY13E	CY14E
Net Sales	15134.3	14812.9	15773.1	17271.6
Other Operating Income	52.6	45.1	29.3	32.2
Total Operating Income	15186.9	14858.0	15802.5	17303.8
Material Cost	11326.3	11023.8	11293.6	12383.7
Employee Benefits Expense	728.7	808.5	836.0	924.0
Conversion & Other Related charges	0.0	0.0	0.0	0.0
Advertisement & Sales Promotion	0.0	0.0	0.0	0.0
Other Expenditure	2008.4	2073.1	2318.7	2469.8
Total Operating Expenses	14063.4	13905.4	14448.2	15777.6
Operating Profit	1123.5	952.6	1354.3	1526.2
Other Income	87.9	172.8	267.8	321.4
EBITDA	1211.4	1125.4	1622.1	1847.6
Interest	52.1	38.2	26.7	16.0
Depreciation	196.9	240.9	254.0	269.0
PBT	962.4	846.3	1341.4	1562.6
Tax (including FBT & DT)	316.5	283.1	456.1	531.3
PAT	645.9	563.2	885.3	1031.3

(Source: Company, HDFC Sec Estimates)

Yearly Balance Sheet

(Rs. In Million)

YE December	CY11	CY12	CY13E	CY14E
Equity & Liabilities				
Shareholders' Funds	**3165.3**	**3539.6**	**4182.1**	**4916.6**
Share Capital	230.7	230.7	230.7	230.7
Reserves & Surplus	2934.6	3308.9	3951.4	4685.9
Non-Current Liabilities	**288.5**	**299.4**	**324.6**	**344.1**
Minority Interest	0.0	0.0	0.0	0.0
Long Term borrowings	0.0	0.0	0.0	0.0
Deferred Tax Liabilities (Net)	110.3	111.3	122.4	123.7
Other Long Term Liabilities	0.0	0.0	0.0	0.0
Long Term Provisions	178.2	188.1	202.2	220.4
Current Liabilities	**3534.3**	**3568.5**	**3721.0**	**4038.7**
Short Term Borrowings	0.0	0.0	0.0	0.0
Trade Payables	2534.3	2554.3	2720.3	2938.0
Other Current Liabilities	749.6	777.0	757.6	833.3
Short Term Provisions	250.4	237.2	243.1	267.4
Total Equity & Liabilities	**6988.1**	**7407.5**	**8227.8**	**9299.4**
Assets				
Non-Current Assets	**2247.8**	**2338.8**	**2357.1**	**2378.1**
Fixed Assets	**2094.8**	**2150.7**	**2150.2**	**2140.2**
Gross Block	3734.3	3983.0	4233.0	4483.0
Depreciation	1836.2	2007.2	2261.2	2530.2
Net Block (Tangible Assets)	1898.1	1975.8	1971.8	1952.8
Capital Work-in-Progress	196.7	174.9	178.4	187.3
Long -term Loans and Advances	152.9	188.0	206.8	237.8
Other Non-Current Assets	0.1	0.1	0.1	0.1
Current Assets	**4740.3**	**5068.7**	**5870.6**	**6921.3**
Inventories	854.5	1042.6	1099.9	1209.9
Trade Receivables	1307.9	1543.7	1644.0	1808.4
Cash & Cash Equivalents	2490.9	2383.4	3013.9	3775.7
Short Term Loans & Advances	47.1	58.7	70.4	84.5
Other Current Assets	39.9	40.3	42.3	42.7
Total Assets	**6988.1**	**7407.5**	**8227.8**	**9299.4**

(Source: Company, HDFC Sec Estimates)

Key Ratios

YE December	CY11	CY12	CY13E	CY14E
FD EPS (Rs.)	**28.0**	**24.4**	**38.4**	**44.7**
PE (x)	**12.2**	**14.0**	**8.9**	**7.6**
Book Value (Rs.)	137.2	153.4	181.3	213.1
P/BV (x)	2.5	2.2	1.9	1.6
OPM (%)	7.4	6.4	8.6	8.8
PBT (%)	6.4	5.7	8.5	9.0
NPM (%)	4.3	3.8	5.6	6.0
ROCE (%)	32.1	25.0	32.7	32.1

RONW (%)	20.4	15.9	21.2	21.0
Debt-Equity (x)	0.0	0.0	0.0	0.0
Current Ratio (x)	1.3	1.4	1.6	1.7
Mkt. Cap / Sales (x)	0.5	0.5	0.5	0.5
EV/EBITDA (x)	4.5	4.9	3.0	2.2

(Source: Company, HDFC Sec Estimates)

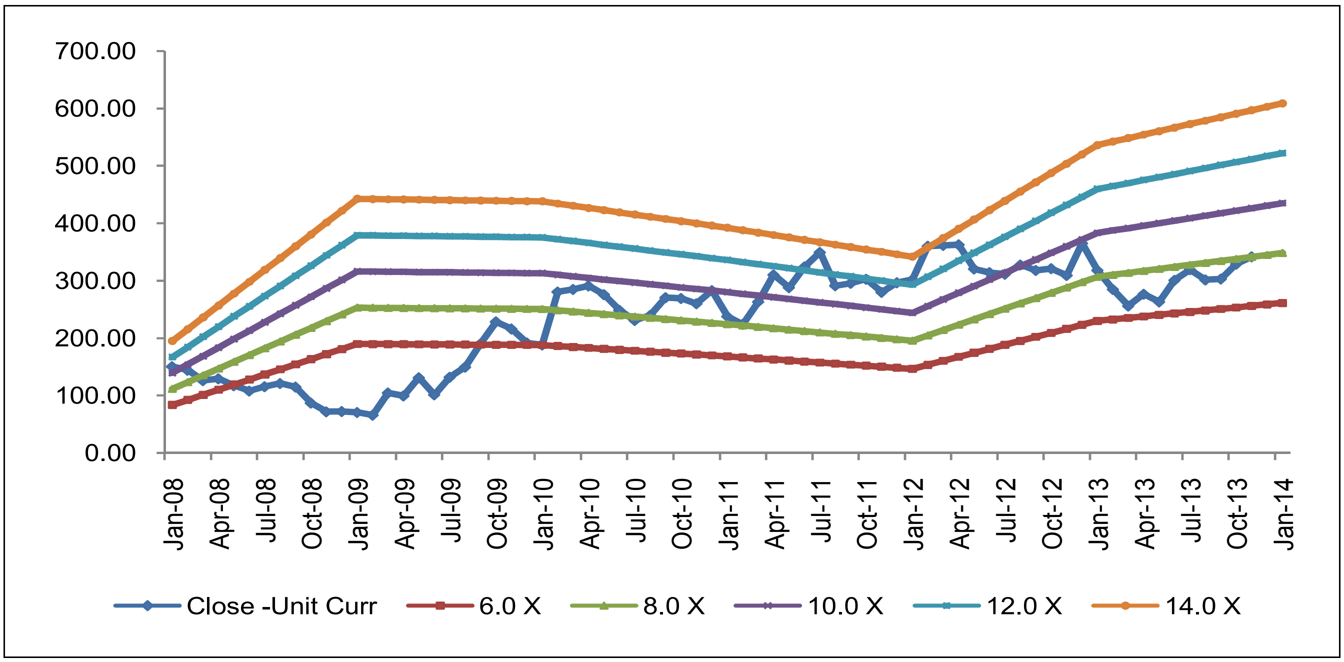
Cash Flow Statement

(Rs. In Million)

YE December	CY11	CY12	CY13E	CY14E
Profit Before Tax	962.4	846.3	1341.4	1562.6
Net Opt Cash Flow	781.6	261.0	1158.3	1346.4
Net Cash from Investing Activities	346.9	-1777.3	-272.3	-289.9
Net Cash from Financing Activities	-229.6	-225.4	-255.5	-294.6
Cash & Cash Equivalents (including term deposits)	2490.9	2383.4	3013.9	3775.7
Net Inc/(Dec) in Cash	898.9	-1741.7	630.5	761.8

(Source: Company, HDFC Sec Estimates)

GIL's price chart with 1 yr forward PE



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