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SECTOR UPDATE
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ANTIQUE

India Tyre Sector

Mean reversion in margin to offset demand revival; to run in negative FCF amid heavy capex ahead

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SECTOR UPDATE

India Tyre Sector

Mean reversion in margin to offset demand revival; to run in negative FCF amid heavy capex ahead

Indian tyre industry is all set to undergo a period of margin reversal post witnessing the most spectacular rally in terms of margin improvement in the past couple of years. Aided by benign raw material basket (RMB) prices and strong pricing discipline in the replacement market over FY14-16, the industry has seen its gross profit per kg move up by 30% to INR90-95/kg resulting in strong FCF generation amid a weak demand environment & limited capex outflow. As a result the financial leveraging for majority of the players reduced structurally. With ~25% of the market in the form of truck bus bias (TBB) tyre replacement getting impacted by Chinese truck bus radial (TBR) imports, rest of the major replacement segments in the form of domestic TBR, Passenger Car Radial (PCR), 2/3w tyres and farm/LCV tyres could drive the volume growth by ~6-8% for the industry off-late. We believe the strategy of outperforming the market by focusing on the 2/3W tyre market segment is not sustainable in the longer run as competition is all set to increase substantially down the line, posing a risk to market share of existing leaders . We are factoring a 12-15% volume growth for the players for FY18e, factoring in benefits of the fresh capacities coming up by the domestic incumbents like Apollo Tyres (APTY IN) and CEAT (CEAT IN). We believe with pricing power for the industry being pretty weak presently being unable to hike prices across segments despite a 30% increase in RMB over past three months, margin levels for the players are under risk from March quarter onwards, unless sharp reversal happens soon. With least chances of compromising on marketing and branding expenses, we believe the margin reversal from the record levels is just a matter of time and would have its impact on earnings growth in turn. With declining ROCE and declining earnings in FY16-18e, we expect the tyre pack valuation to rationalize in coming quarters.

Channel checks suggest ground level demand yet to pick up post sudden surge led by impact of demonetisation on Chinese imports in Nov-Dec

As per our recent dealer checks for truck tyres, fleet owners are also preferring to go for re-trading to the maximum extent instead of buying new tyres as business at ground level has been pretty muted, irrespective of the effect of recent demonetisation. Thus with limited off-take at retail level, few of the tyre makers have resorted to increase incentives for target based off-takes along with surge in finished goods inventory to some extent. No price hikes per say have been reported off late as demand is still low and inventory levels are high, especially in the 2W segment. In the truck tyres some pick up has been seen, as cash transactions came to a halt, impacting purchase of Chinese tyres in November-December, which we believe is temporary in nature. Though expectation of anti-dumping duty on Chinese TBR is high, but still it is a mere speculation at present juncture. The most recent price hike was done by CEAT three months ago (~2.5%) in the 2W tyre space. Also as per our talks with a rubber supplier to MRF and APTY, post demonetization, the off take of rubber has been low as the tyre makers already had stocked up cheaper rubber. Thus with lack of visibility on demand in coming months amid surging NR prices, the tyre makers are preferring to have a wait and watch policy instead of buying at high cost.

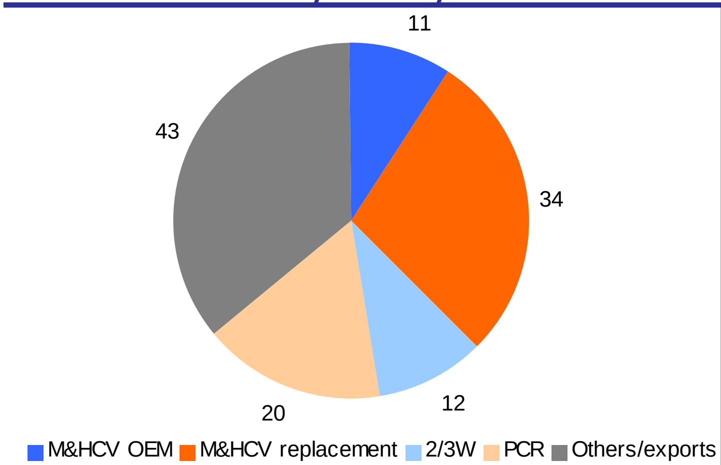
Valuation and outlook

On back of limited earnings growth, stress in capital efficiency & no signs of major turnaround in revenue growth we expect the players to trade at the mid-cycle valuation levels as against the higher end of the curve presently. We are assigning target FY19e earnings multiples of 10x, 10x and 8x for APTY, CEAT and JKI with Buy rating on APTY and have Hold rating on CEAT & JKI with price targets of INR222, INR1,109 and INR116 respectively. We do not have a formal rating on MRF.

Market structure: TBR the prime growth driver in the longer run; personal mobility segments to give stability

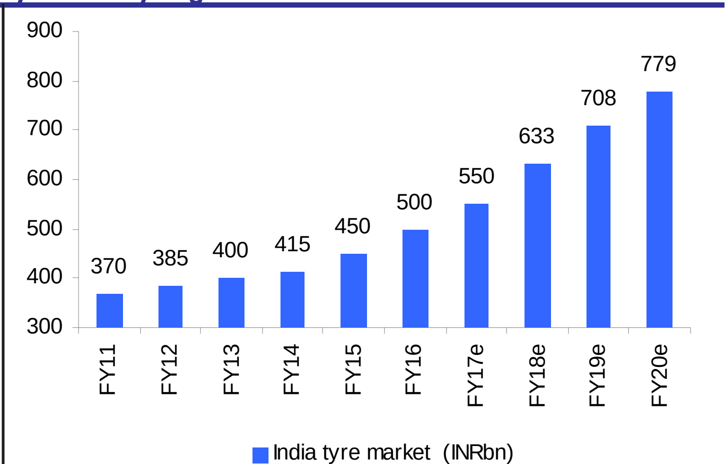
Indian tyre market is of the size of ~INR550bn and has grown at a CAGR of 6% over past five years, with volume growth across this period being in sync with the revenue growth. Almost half of the Indian tyre market constitutes of the M&HCV tyre segment with 25% of it being driven by OEMs and remaining 75% coming from the replacement segment. Within this segment, radialisation is close to 45%, with radialisation in OEMs being as high as ~75% and being at low levels of ~35% in the replacement segment. We believe ex-Chinese TBR imports, radialisation in domestic M&HCV tyre replacement market would be ~40% and has a long way to go ahead and the recent spree of investments for TBR capacity by various incumbents is the step in the right direction. With majority of the period in the past five years being weak in terms of replacement demand in the M&HCV tyre segment, overall industry volume remained flat, with rising replacement demand of PCRs and 2W tyres driving growth. With PCR and 2W tyres having grown at a ~12-13% CAGR in the same period as against sub-5% growth in the M&HCV tyre segment, focus of industry participants have started shifting towards capacity building in the PCR and 2W tyre segments. Thus truck bias (TBB) tyre capacity as percentage of systemic capacity declined at a rapid pace to ~20-30% levels from ~40-50% levels five years back and is expected to come down further in years to come with rising acceptance of radialisation in replacement market. Capacities of TBB and TBR are not fungible in nature as shifting a TBB capacity to TBR asks for capex cost similar to a fresh TBR capacity addition to the tune of INR90-100mn/TPD. Thus barring changing from TBB to bias off-the road (OTR) applications, utilisation for TBB would continue to decline gradually on back of rising radialisation in the longer run, barring temporary demand drivers like anti dumping duty on Chinese tyres, if at all, increasing demand for domestic TBB.

MHCV contributes 45% of tyre industry



Source: Industry, Antique

Tyre industry to grow at a CAGR of ~12% over FY16-20e



Source: Industry, Antique

Chinese TBRs gaining share from domestic TBBs

Typically a pair of domestic incumbent made TBRs cost ~INR38k as against TBB price of ~INR32k and Chinese TBR price of ~INR28k. Over past few years the acceptance of multi-axled haulage trucks have increased tremendously in India resulting in gradual increase in average number of tyres per truck moving up from ~8 to ~9, in turn pushing demand for mid-axle tyres. Thus amid road freight industry not doing well for an extended period, tendency for the fleet owners to save operating costs have resulted in rising acceptance for the Chinese TBRs in place of TBB tyres, especially for the middle axle tyres. With TBRs operating well under optimal loading and temperature conditions, acceptance of Chinese TBRs have been more in the Western, Eastern and Southern markets. Thus over past couple of years, Chinese TBR imports have doubled to INR17bn and is presently having a ~40% market share within TBR replacement and a ~10% share in overall M&HCV tyre replacement market. Thus industry level radialisation is at ~45%, though ex-Chinese TBRs it would be closer to ~40%. In FY15-16 despite revival in the domestic CV cycle, demand off-take of CV tyres in the replacement market did not kick-off as the substitution of domestic TBB by Chinese TBRs impacted growth of the domestic incumbents to a large scale. Though fleet owners acknowledge the quality of the domestic TBRs and thus ready to pay the extra premium for it, the major impact was felt by the domestic TBB market. We believe with no incremental capacity coming up in TBB as against present utilisation level by the industry in TBB at ~70%, only anti-dumping duty on Chinese TBRs can create incremental demand in general and enhance utilisation levels. Today as per industry data, the total M&HCV replacement market size in volume terms is12mn tyres per annum out of which 4mn is TBR and 8mn is TBB. OEM market for M&HCV tyres consists of close to 2mn TBRs and a million of TBB. Chinese TBR import quantum is close to 1.3mn presently and is mainly used for the mid-axle tyres and not for the front or rear axle tyres in general.

Anti-Dumping Duty (ADD) on Chinese TBRs: the potential impact on the existing incumbents

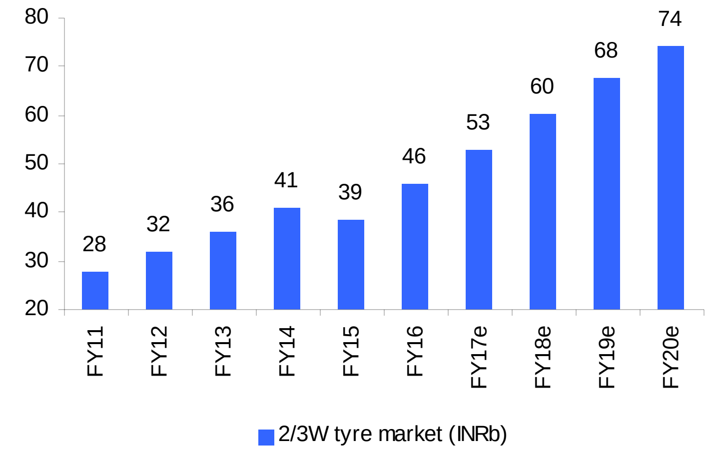
As per our interactions with various players and industry people, the size of the Chinese TBR imports today in India is close to INR17bn. In the TBR replacement segment, market share of Chinese tyres is ~40% and in the M&HCV replacement tyre market overall the Chinese tyre market share is ~10%. Thus with pricing gap of ~20% with the domestic TBB tyres, we believe the best case scenario assuming ADD to drive demand from Chinese TBRs to domestic TBB would be addition of ~INR20bn revenue (assuming ~20% price differential shift) spread across the players. Thus assuming a ~10-12% EBITDA margin for this incremental business on implementation of ADD, the potential EBITDA accretion would be to the tune of INR2.5bn. Factoring a 6x EV/EBITDA for the incremental TBB led operating income, potential market cap accretion on implementation of ADD would be to the tune of INR15bn as against combined market cap of the major players being at ~INR400bn presently, thus adding merely close to 4-5% to the market cap for the industry. Even factoring an element of re-rating on back of positive sentiment on ADD implementation, we believe ideally there is not much of scope left.

Riding on 2W tyres not a sustainable mode of growth in longer run though it seems to be a winning strategy as of now

2/3W tyres presently contribute close to 15% of the domestic tyre industry and as per our ball park analysis this segment has been growing at a 12-13% CAGR over past five years. With rising size of 2W population, the replacement demand has been providing a steady demand uptick of ~12-14% in general in addition to the ~6% CAGR in the OEM segment. We expect the segment to grow at a similar ~12% CAGR in next four years in value terms. With MRF having ~35% market share in the segment followed by CEAT at ~27%, residual ~40% is shared by TVS Srichakra and other smaller regional players like Ralco, Metro etc. On back of low cyclicality in demand, much stronger margin relative to other segments and relatively lower competitive intensity MRF, CEAT and TVS Srichakra made best out of this space over past three years amid a weak demand environment for TBB. Thus on back of this over past six months APTY, JKI (though acquisition of Birla Tyres), Balkrishna Industries (BIL), Bridgestone, Michelin and even an ancs player like Gabriel have entered this space. This signifies the quantum of competitive intensity set to increase in this space ahead resulting in weaker pricing power and margin in turn.

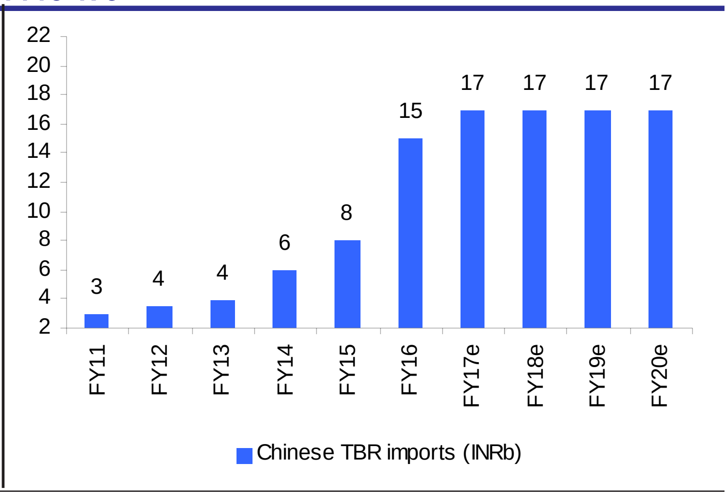
On back of the recent success in this space, CEAT is on the verge of completing its Nagpur facility, fully dedicated for this segment with a capacity of 120TPD (expandable to 220TPD) as against its existing fully outsourced 200TPD capacity for 2/3W tyres. APTY is set to work on an outsourcing model similar to CEAT and so will be BIL. Thus as per our ball park calculations, revenue from these new players should be close to INR8-10bn in next couple of years, signifying market share of ~15-20% shifting hands from existing players to the new entrants. Though Birla Tyres is an existing entity in the 2W tyre space, the low brand presence and low utilisation of its 95TPD capacity, signifies scope for market share gain down the line.

2/3W tyre market expected to grow at a 12-13% CAGR ahead



Source: Industry, Antique

Chinese TBR imports saw a massive jump in demand in FY16-17e

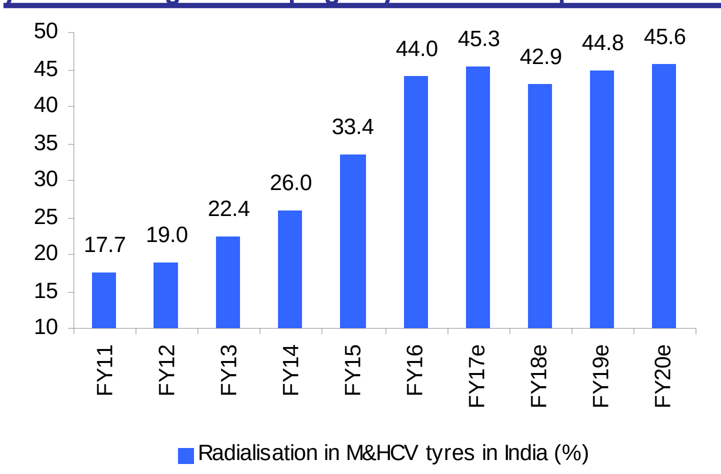


Source: Industry, Antique

Demand for TBRs in replacement market substituting TBB to happen with improving road infra

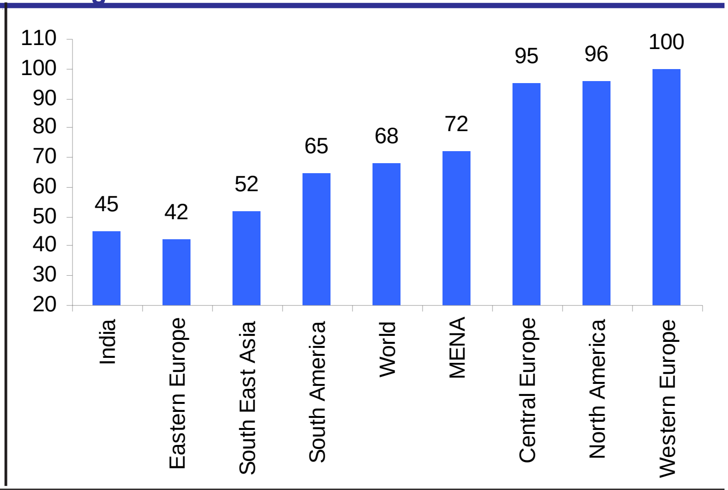
Presently radialisation in the M&HCV tyre in India is ~45%, with penetration in OEMs being pretty much on the higher side at ~75% and in replacement being at ~35%. The radialisation in truck tyre replacement market is also aided by the recent surge in the Chinese TBR demand. Thus going ahead bulk of the incremental demand for TBR set to come from the shift from TBB to TBR in replacement market theoretically, and for that the players are setting up their capacities too in advance to get prepared for the demand upsurge in TBRs. As per our interactions with industry, TBRs perform well under optimal load conditions and in optimal climatic conditions. Thus with extreme levels of overloading and high temperature conditions in Northern hilly states, it gets tough for the fleet owners to justify buying the TBRs, that too paying a higher price. Thus with central government focus on improving road infra along with implementation of GST set to improve the per day plying of trucks, demand for TBRs set to improve down the line, as we do not foresee Chinese TBRs as a potential threat for the TBRs made by the incumbents. TBB replacement demand would ideally see a declining trend in the longer run and thus nobody is adding capacity in it or trying to replace TBB capacity by OTR bias capacity. But going by comparables with other markets, assuming radialisation in CV tyres to go past 50% from present 45% in next three to four years, we believe is tough to assume and do not foresee the TBB assets to become obsolete soon, though utilisation levels would remain sub-70% in the longer run. Cost of setting up a green field TBR capacity is ~INR100mn/TPD as against that for TBB being ~INR65-75mn/TPD.

Radialisation to remain closer to the 45% level in next few years assuming anti-dumping duty on Chinese imports



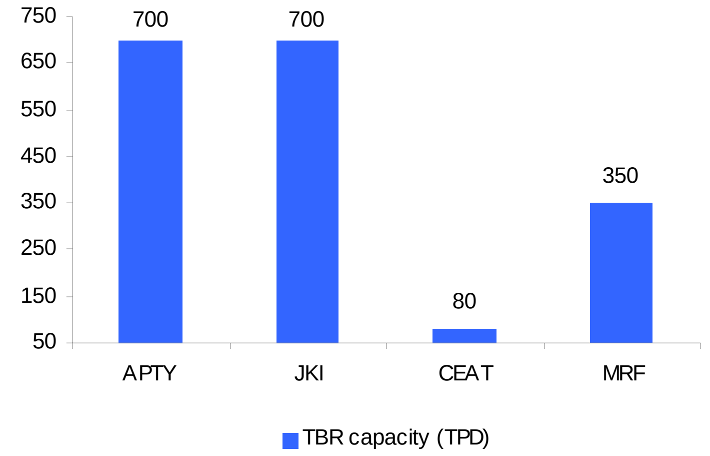
Source: Industry, Antique

In developing markets, truck tyre radialisation in between 40-65% in general



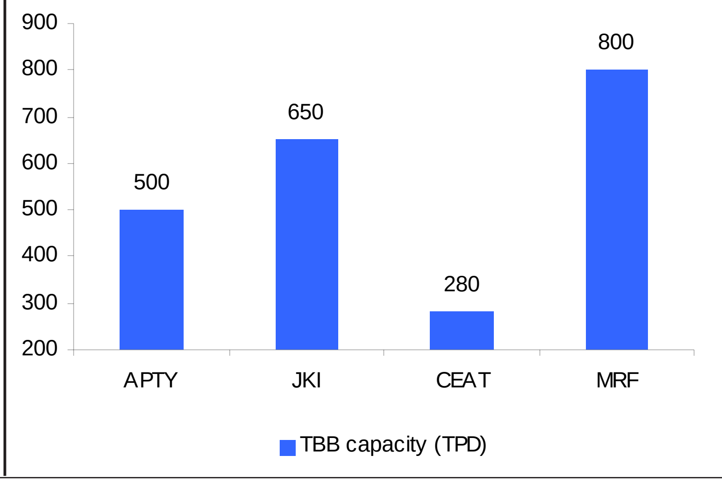
Source: Industry, Antique

TBR capacity of the major player's post their recent capex plans get completed by FY19-20



Source: Industry, Company data, Antique

TBB capacity to remain at present levels going ahead (JKI TBB capacity includes acquired Kesoram capacity)



Source: Industry,, Company data, Antique

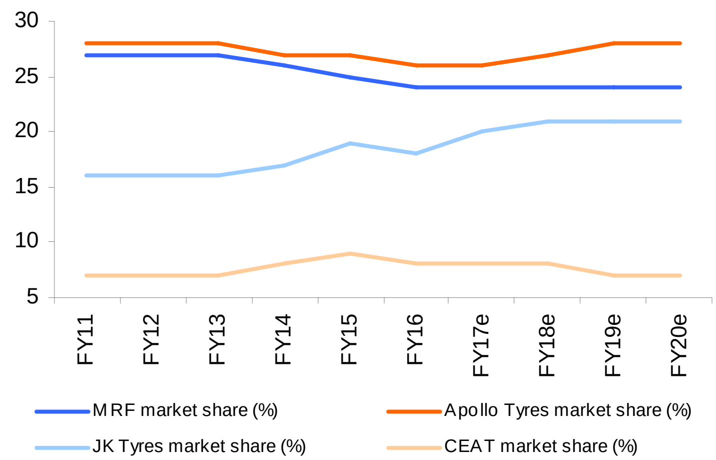
Capacity break across major players in the industry and segmental market share trend

Segment wise capacity of the front end players

Segmentwise capacity	Apollo		JKI (inluding Cavendish)		MRF		CEAT	
in TPD	FY17e	FY18e	FY17e	FY18e	FY17e	FY18e	FY17e	FY18e
CV Bias	500	500	650	650	800	800	280	280
TBR	350	700	600	700	300	350	70	80
PCR	450	500	250	250	500	550	200	200
LCV	100	100	70	70	100	120	85	85
2W	-	100	100	180	350	420	320	360
Farm Segment /OTR	100	100	100	100	200	220	50	90
Total Tonne per day	**1,500**	**2,000**	**1,770**	**1,950**	**2,250**	**2,460**	**1,005**	**1,095**

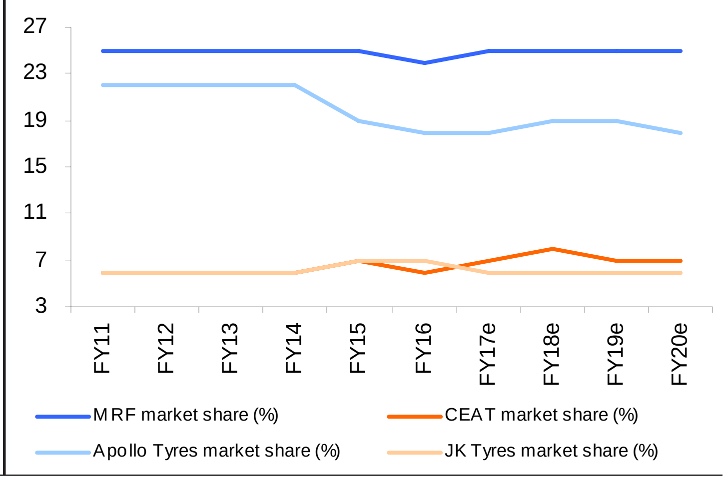
Source: Industry, Company data, Antique

Market share trend in the domestic M&CV tyre segment



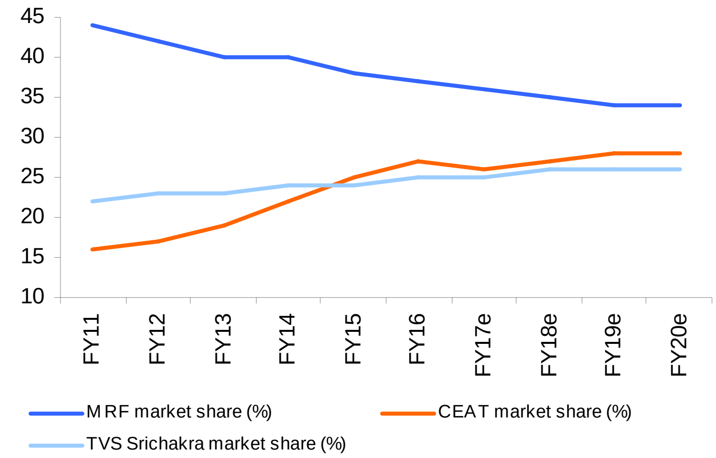
Source: Industry, Company data, Antique

Market share trend in the domestic PCR tyre segment



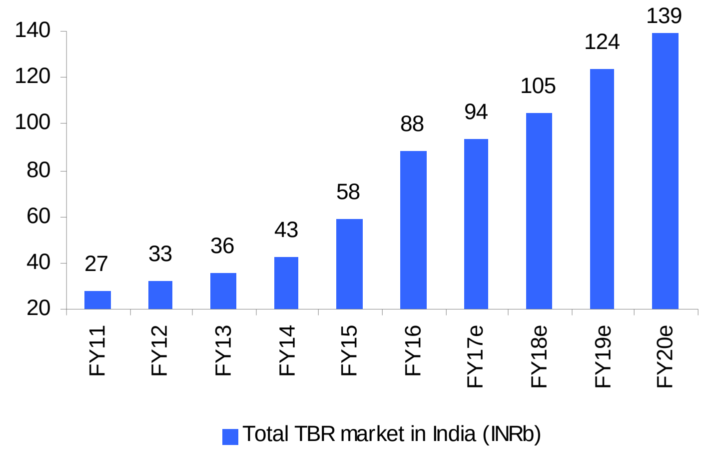
Source: Industry, Company data, Antique

Market share trend in the domestic 2/3W tyre segment



Source: Industry, Company data, Antique

Industry size trend of domestic TBR market



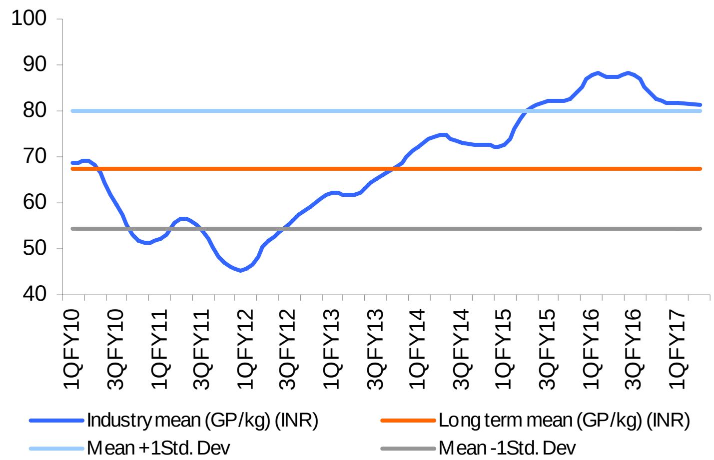
Source: Industry, Antique

Gross margin on the verge of undergoing mean reversion; pricing power also not favorable presently

We believe the domestic tyre industry went through a period of strong pricing power in FY15-16 amid benign raw material environment and tepid demand. This resulted in lack of price cuts in the replacement market despite major decline in raw material basket (RMB) costing and thus pushing up the gross margin to record highs at above 2x standard deviation from long term mean levels. Now with ~35% of the market being the M&HCV replacement segment tyres, lack of volume growth for a prolonged period aided by rise in Chinese TBR imports have resulted in weak pricing power, in turn resulting in inability for the market to pass on the recent ~30% surge in NR prices since October. Also on a broader basis the industry has been unable to make any worthwhile price hikes in the PCR or 2W replacement markets too, giving us the confidence of expecting a major mean reversion in gross margin from the forthcoming quarter itself. NR prices have shot up from INR115/kg levels in 2QFY17 to INR150/kg levels presently in addition to inflationary trend in crude derivative chemicals and carbon black. Thus in this cost inflationary period amid no price hikes across segments seems much risky for the gross margin structure in the near term. We believe that for the industry as a whole operating at margin levels ~400-600bps above long term mean levels is not sustainable in the longer run, especially with the fact that competitive intensity in higher margin 2/3W segment is set to increase manifold. Thus to compensate this potential damage to the margin, revenue growth CAGR needs to be ~14-18% for the players in FY17-19e to remain EBITDA neutral.

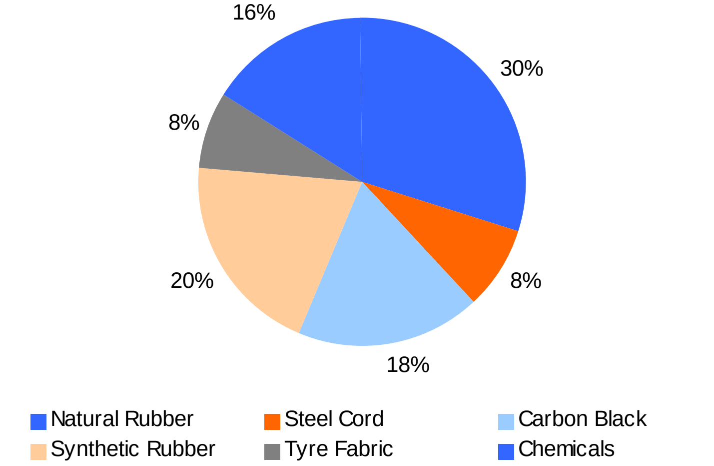
We have plotted in the chart below gross profit per kg (GP/kg) for the industry players (ex-MRF) on a quarterly basis for past six years. It clearly reflects the fact that the GP/kg is all set to undergo mean reversion soon, presently being at more than 1x standard deviation above long term mean levels. Thus on back of higher natural rubber prices, rising crude prices and lack of pricing power in the replacement market, we believe the industry is all set to see margin decline ahead as against record high margin levels executed in past few quarters. Also as per ANRPC data, rubber plantation growth post CY07 has slowed down considerably, signifying its corresponding impact on tapping with a lag of ~8 yrs from CY17 onwards. With natural rubber constituting close to 30% of volume along with crude derivatives constituting close to 50% of the volume, recent upsurge in RMB by 10% is pretty well justified, we believe.

Mean reversion in gross profit/kg for the industry on the cards soon



Source: Industry, Company data, Antique

Pie chart of constituents of the tyres in India on a ball park basis



Source: Industry, Company data, Antique

Yet to see any major price hike amid massive surge in raw material basket cost

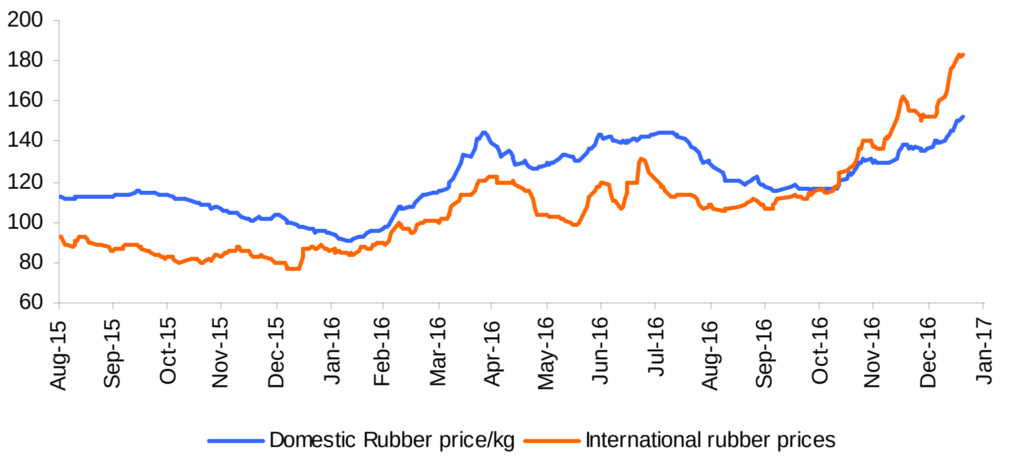
In the past five months Natural Rubber prices have increased by ~60% across the ANRPC markets like Thailand, Vietnam etc to present levels of ~INR183/kg (adjusted for currency exchange rates) as against domestic Kerala based NR prices having inched up barely by 10% in the same period. This has been primarily led by combination of floods in Thailand impacting supply, surge in crude prices from USD45/bbl to USD55/bbl, Dollar index surge and stronger NR demand led by a 15% growth in Chinese PV market in CY16. In the same time period, domestic NR prices corrected to INR116/kg (first half of October) levels from highs of INR140/kg (in first half of August) and has subsequently followed the global trend off late and has surged up ~30% in past three months to a three year high level of INR152/kg. Government of India had increased the import duty on NR from April 2015 to 25% or INR30/kg, whichever is lower, when the international NR price was at INR104/kg and domestic NR prices were at INR122/kg to protect the domestic rubber industry. Since last three months the situation has reversed and international rubber prices have moved up significantly with the difference between the domestic and international prices being close to INR30/kg. Including import duty and logistics related expenses the difference is now closer to ~INR70/kg, literally unviable for domestic tyre makers to import NR. As per our interaction with various domestic tyre makers like CEAT (CEAT), Apollo Tyres (APTY) and JK Tyres (JKI), import content of NR is generally in the range of 60-65% presently, with few exceptions like MRF and TVS Srichakra. Also for PCR makers, few varieties of NR are only imported in general, irrespective of the costing. Also as per the tyre makers, sudden shifting of NR sourcing is not easy to execute and takes at least a couple of quarters to change sourcing policies. Also with domestic NR supply not being able to cater to whole of domestic demand, we do not foresee significant substitution of imports by domestic NR sourcing ahead. Thus we believe most of the tyre manufacturers will be forced to import at the present higher rates with additional burden of a weakening INR. During the August highs of Kerala NR prices, companies were able to source cheaper NR through imports, thus protecting their gross margins in 2Q results. Now with NR prices surging by ~30% and ~62% over past three months, we believe there will be limited scope to protect gross margin in 4QFY17 and ahead, as pricing power of the industry is not that strong to mitigate impact of such a sharp surge in NR prices. Also SBR prices have inched up to INR135/kg from INR110/kg in last three months, led by rising crude prices along with Carbon Black prices too inching up by ~10% in the same period. Stock prices of tyre majors holding up despite this adversity in raw material prices as markets are looking forward towards reversal in NR prices post this sudden surge with supply scenario normalizing in Thailand in a few months time.

Rising dependence on NR imports getting reflected as per the Rubber Board of India amid muted volume growth for the tyre industry

FY	Rubber area (ha)	Tappable Rubber area (ha)	Production (tonne)	Average yield (kg/ha)	Consumption (tonne)	Import (tonne)	Export (tonne)	Average price of RSS-4 at Kottayam (INR/kg)
2008-09	661,980	463,130	864,500	1,867	871,720	77,762	46,926	101.1
2009-10	686,515	468,480	831,400	1,775	930,565	177,130	25,090	115.0
2010-11	711,560	477,230	861,950	1,806	947,715	190,692	29,851	190.0
2011-12	734,780	490,970	903,700	1,841	964,415	214,433	27,145	208.0
2012-13	757,520	504,040	913,700	1,813	972,705	262,753	30,594	177.0
2013-14	778,400	518,100	774,000	1,629	981,520	360,263	5,398	166.0
2014-15	795,135	533,675	645,000	1,443	1,020,910	442,130	1,002	132.6
2015-16p	811,000	559,000	562,000	1,437	994,415	458,374	865	113.1
YTD Aug			**245,000**		**433,930**	**197,442**		
Synthetic rubber								
2015-16			199,845		553,370	351,301		
YTD Aug			**97,079**		**231,530**	**165,106**		

Source: Rubber Board, Antique

International NR prices exceeding domestic prices by ~20% in the recent surge as against being at a ~10-20% discount in general



Source: Bloomberg, Antique

Record margins despite weak volume growth and rising need for ad and marketing expenses

Over past couple of years with revenue levels broadly remaining static on back of falling realisations and weak demand, ad and promotion expenses have shot up pretty significantly in order to push sales. Thus other expenses to sales have increased by ~400-500bps over past six to eight quarters in general amid falling RMB prices. We believe going ahead there is not much scope of cutting down ad & marketing expenses as demand is not expected to pick up in the near term. Thus on back of decline in gross margin along with steady or rising other expenses, margin trend is all set to reverse from 4QFY17.

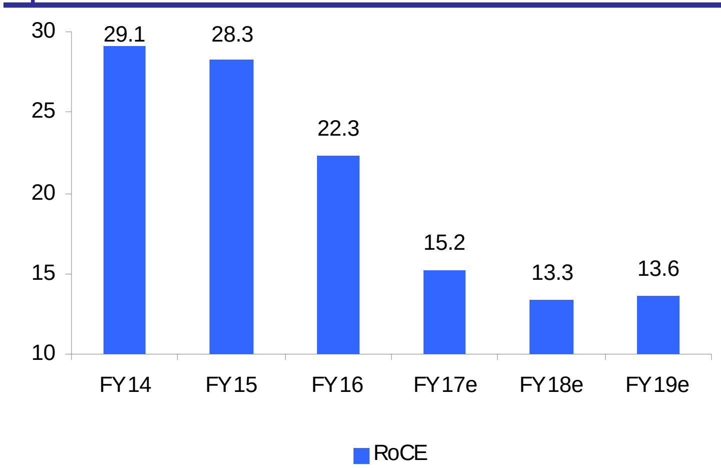
In terms of operating leverage led margin benefits, we do not see much scope, as most of the companies are adding major capacities in the TBR, PCR and 2W tyre space and should reach optimum utilisation only by 2HFY19 or beyond, barring in TBR. Average utilisation across the industry presently is around 75% and with rising capacity on one side and ~10-12% volume CAGR on other side, utilisation broadly should remain unchanged in the near term.

Static earnings amid rising capex to impact capital efficiency

Our ball park calculation suggests combined capex in FY18-19e for the four major players APTY, MRF, CEAT and JKI to be of the tune of 40% of the capital employed by the end of FY17 for them combinedly. This huge capital deployment is coming on the back of consolidated earnings broadly being static between FY16-18e and thus should undoubtedly impact capital efficiency significantly in the period. With large planned capex in the form of Hungary plant of APTY, TBR brown field expansion of APTY, Hallol and Nagpur plant addition of CEAT along with the recently announced mega capex plan of INR7bn per annum, Kesoram acquisition and expansion within that for JKI, we expect the cash in-flows to get reflected in the balance sheet fully by FY20e for these investments. Thus from industry average ROCE levels of ~25% in FY16 we expect it to go down to ~16% at pre-tax level by FY18e, which in turn potentially should impact valuation multiples too from present levels. In terms of asset turns, we believe a raw material inflation led revenue growth in addition to demand recovery would enhance the asset turn from present levels of muted revenue, though impacting margin on the other side.

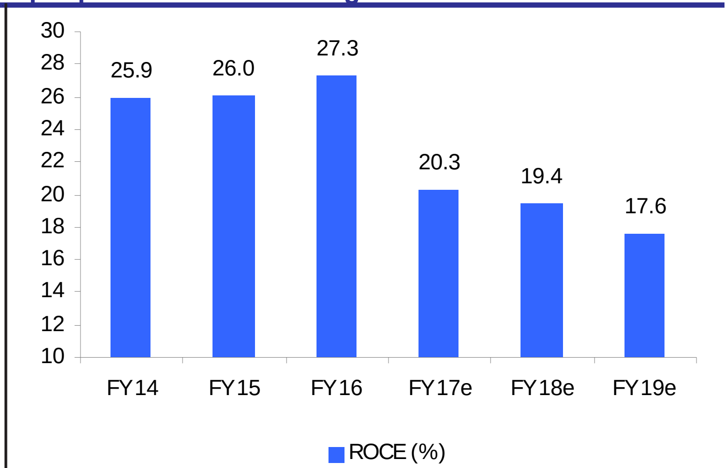
The good part for the industry in this cycle compared to past ones is the extent of leveraging in the balance sheet. Barring JKI, net debt to equity for the rest is set to be sub-0.6x despite the heavy capex most of them are undergoing presently. Over the past three years amid the benign RMB, strong margin led cash flows for industry in general reduce debt significantly and is now well prepared to face the next earnings down cycle without much pressure on the balance sheet health. Thus in times of stress in absolute EBITDA generation, impact on earnings led by interest outgo would be minimal, resulting in much lesser cyclicality in terms of earnings, which in turn ideally should result in a structural betterment in valuation multiples for the sector as a whole as against average levels across previous cycles.

APTY ROCE to go down to sub-15% on back of aggressive capex in the near term



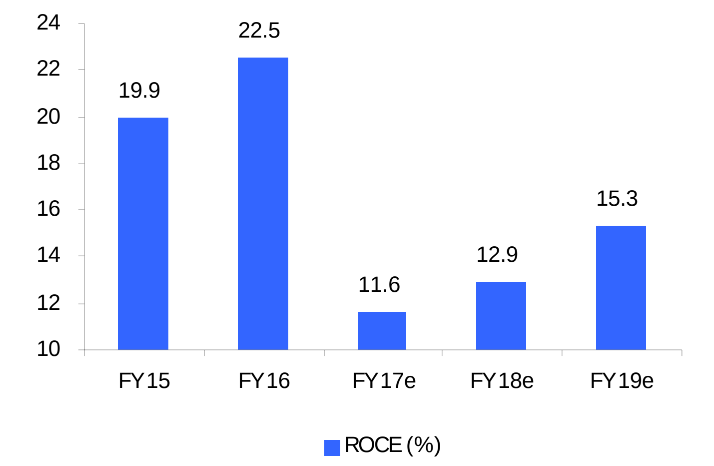
Source: Company, Antique

CEAT undergoing a ~900bps decline in ROCE on back of fresh capex plans and stress on margin



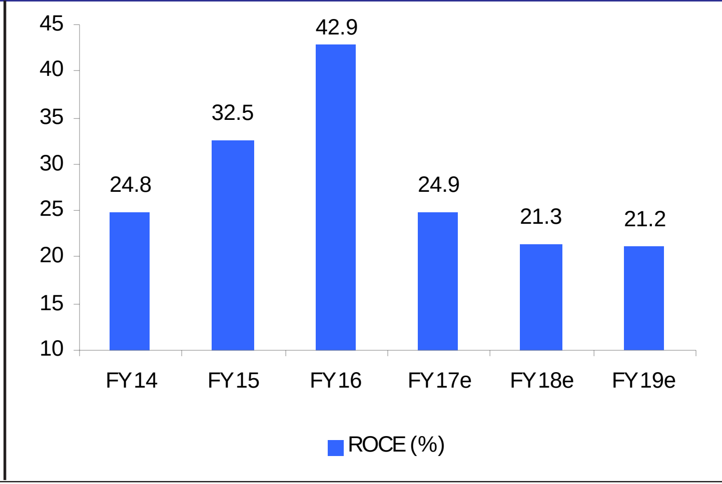
Source: Company, Antique

JKI ROCE already at its lowest levels in FY17e led by Kesoram deal



Source: Company, Antique

MRF ROCE around the ~25% levels as no major skewed capex is expected

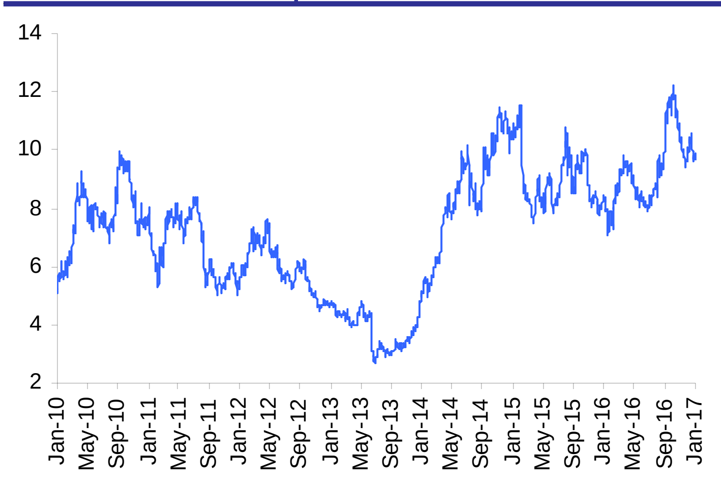


Source: Company, Antique

Valuation multiple set to contract further as margin is expected to be under pressure

On back of visibility of declining ROCE for the players in FY17-19e along with earnings remaining literally flat, we expect valuation multiples for the industry players to trade at the lower end of the curve in general. Though as discussed earlier, we expect improvement in the structural valuation levels of the sector on back of cleaner balance sheets, we expect slight moderation from present levels of valuation in coming quarters for the various players as anyhow they are trading at much higher than historical means. We prefer APTY within the tyre pack ahead of JKI and CEAT on back of its well diversified portfolio in terms of market and product, visibility of rising cash flows from EU and incremental domestic TBR capacity from FY19 onwards. We have a Hold rating on JKI and CEAT as we believe balance sheet health concerns for JKI and rising competition and subsequent impact on margin for CEAT to be the key risks for the businesses respectively in FY17-19e. We do not have a formal rating on MRF.

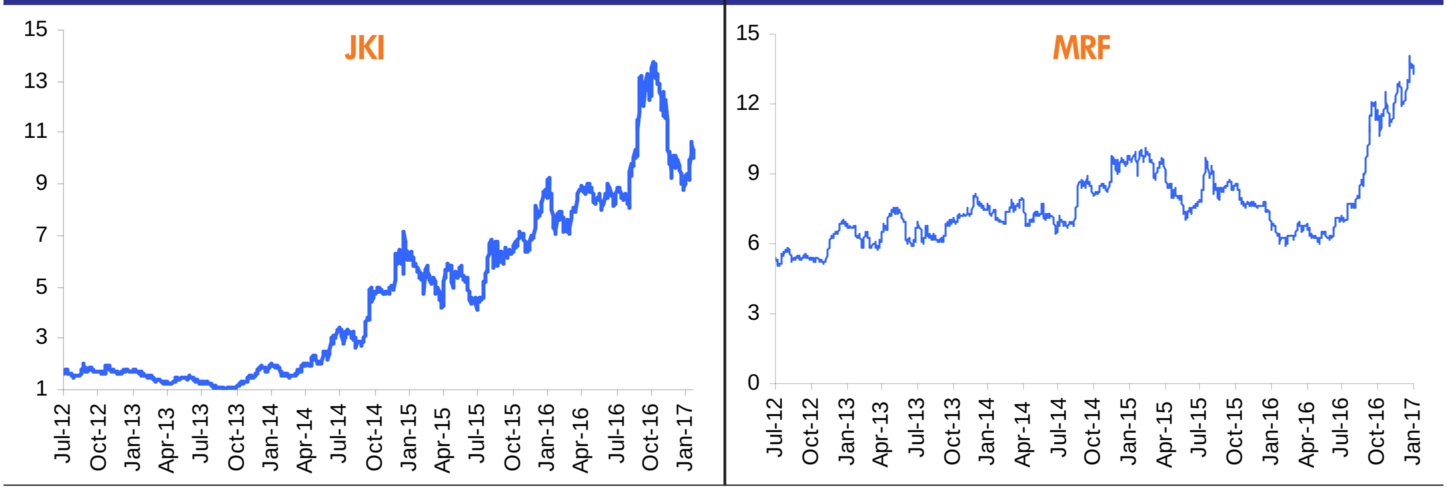
Forward traded P/E multiple trends of APTY and CEAT



Source: Company, Antique

Source: Company, Antique

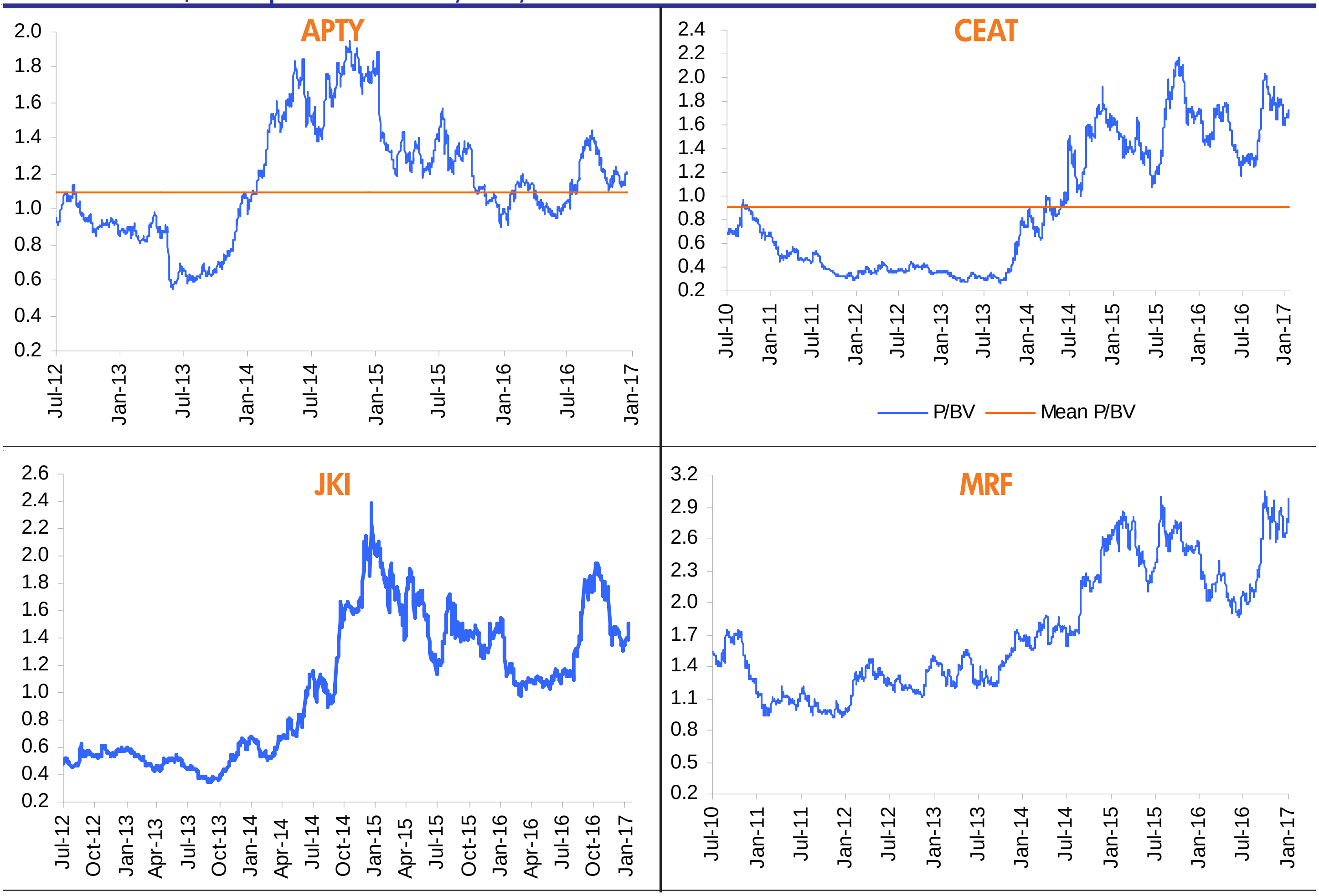
Forward traded P/E multiple trends of JKI and MRF



Source: Company, Antique

Source: Company, Antique

Forward traded P/B multiple trends of APTY, CEAT, JKI and MRF



Source: Company, Antique

Current Reco	:	BUY
Previous Reco	:	BUY
CMP	:	INR187
Target Price	:	INR222
Potential Return	:	19%

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Market data

Sensex	:	27,882
Sector	:	Auto
Market Cap (INRbn)	:	95.4
Market Cap (USDbn)	:	1.4
O/S Shares (m)	:	509.0
52-wk HI/LO (INR)	:	235/133
Avg Daily Vol ('000)	:	2,556
Bloomberg	:	APTY IN

Source: Bloomberg

Valuation

	FY17e	FY18e	FY19e
EPS (INR)	18.1	19.4	22.2
PE (x)	10.3	9.6	8.4
P/BV (x)	1.2	1.1	1.0
EV/EBITDA (x)	6.9	6.7	5.9
Dividend Yield (%)	1.1	1.1	1.1

Source: Bloomberg

Returns (%)

	1m	3m	6m	12m
Absolute	(0)	(6)	16	29
Relative	(8)	(6)	17	13

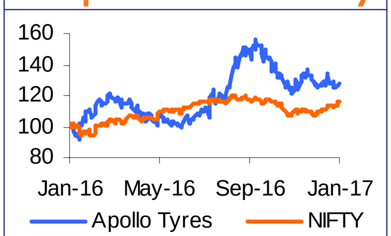
Source: Bloomberg

Shareholding pattern

Promoters	:	44%
Public	:	56%
Others	:	0%

Source: Bloomberg

Price performance *vs* Nifty



Source: Bloomberg Indexed to 100

COMPANY UPDATE

Apollo Tyres Limited

Capacity doubling in TBR to drive operating profit; Hungary cash flows to start trickling in from FY19

Apollo Tyres (APTY) is presently undergoing a major capex programme taking care of the green field Hungary project (~INR40bn) and Chennai TBR plant brown field expansion (~INR30bn) other than the proposed bias to OTR conversion project at Kerala plant, green field 2W tyre dedicated plant in Andhra along with maintenance capex need to the tune of INR4bn p.a at a consolidated level. Thus amid muted demand environment, margin pressure on account of rising raw material basket costing and higher fixed costs in EU operations, pew-tax ROCE of APTY is undergoing a major contraction presently to as low as ~12-13% levels, resulting in generated capital efficiency being lower than the cost of capital for an extended period in FY17-19e. Thus traded forward earnings multiple of APTY broadly has been hovering around the historical range of ~8-10x as against other peers like CEAT, JKI, MRF trading at re-rated levels, above their historical range. Though the risk of a sudden large ticket inorganic deal is always there for APTY, assuming no such development taking place, we believe APTY is the best placed business in terms of diversification and valuation within the space at present juncture. With capex cycle peaking out in FY18, we expect cash flows from the added TBR capacity and the new Hungary plant to start reviving back the capital efficiency gradually from FY20 onwards. Also with ~550TPD of bias truck tyre capacity (~30% of overall capacity), APTY would be one of the prime beneficiaries of anti-dumping duty on Chinese TBRs, if at all. We have a Buy rating on APTY with a 10x FY19e earnings based PT of INR222.

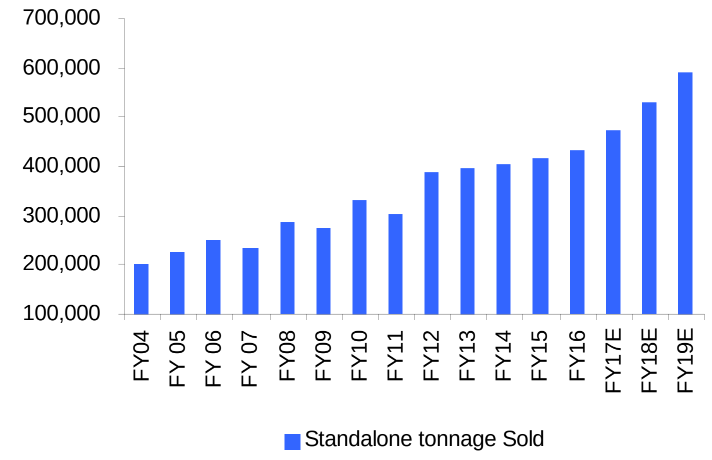
Doubling TBR capacity to ~700TPD; Hungary plant to go on stream in FY18

Amid a weak demand scenario in the M&HCV tyre replacement space and intense competition from Chinese TBR imports, TBR capacity of APTY is still running at close to full capacity. Thus with the 350TPD TBR capacity moving up all the way to 700TPD by mid-FY18, we believe APTY would be in a position to grow its domestic volume by ~12% CAGR in FY17-19e post reporting a 4% CAGR in FY13-17e. Also attaining a 5% market share in a space of three years post entering the 2W tyre space signifies revenue from the segment to be ~INR3.5-4bn in FY19e, ~3-4% of standalone revenue. With ~30% of the present India capacity being dedicated for truck bias tyres and operating at ~70% utilisation levels, anti-dumping duty on Chinese TBRs would only enhance demand for bias tyres for APTY, propping up the utilisation levels and add on to margin. Also the EU facility of Vredestein is operating at close to 90% utilisation on a capacity of ~200TPD. Thus the new Hungary plant of ~300TPD capacity would more than double EU capacity and help APTY expand into newer markets.

Domestic margin to rationalize down from present highs; expecting EU margins to inch up

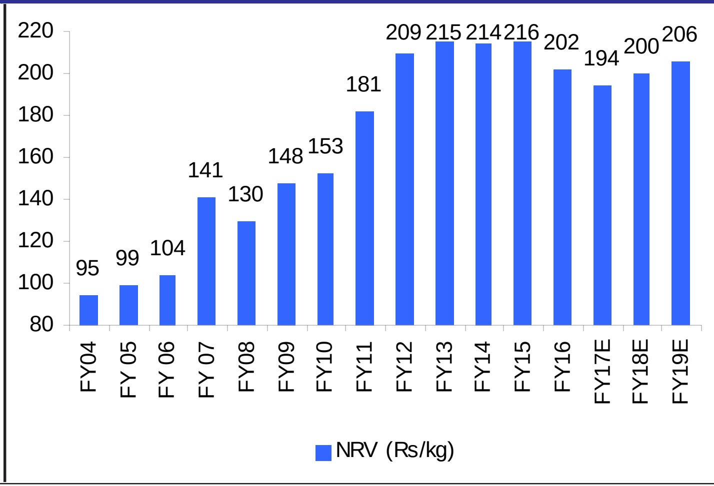
Domestic EBITDA margin for APTY has moved up to as high 16-18% levels as against a decade long mean of 12% on back of ability to hold on to prices in the replacement market despite commodity deflation for an extended period in FY15, FY16 and 1HFY17. Now amid muted demand scenario in the market and rising input commodity prices, industry as well as APTY is finding it tough to commensurately increase prices in the replacement market to pass on cost inflation. NR prices have moved up from INR115/kg to INR180/kg (Thailand, Vietnam market prices adjusted in INR) over past one quarter and APTY imports close to 65% of its NR needs form these markets. Also SBR prices of Reliance Industries have inched up to INR130/kg from INR120/kg a quarter back. Also with volume demand not picking up, operating leverage factor also not going to support APTY maintain its margin in the near term amid gross margin erosion and thus we are estimating APTY standalone margin at ~14% in FY18-19e, as against the 16-18% levels presently. For the EU business, we believe with rising scale of the newly built Hungary plant, margins are set to gradually claw back towards the ~16-17% levels from present lows of ~12-13%.

Volume growth to pick up in FY19e post new capacities get ready in FY18



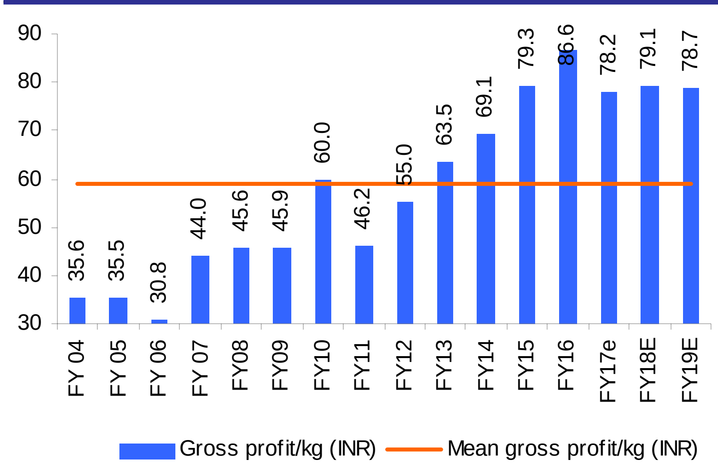
Source: Company, Antique

Commodity inflation to push pricing for the industry down the line



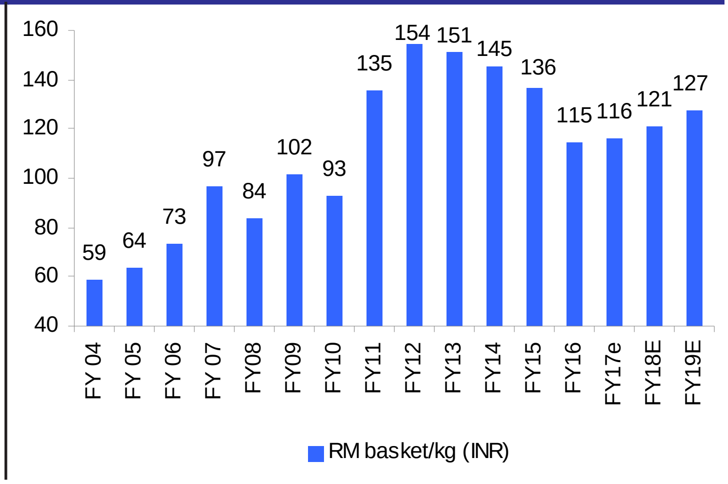
Source: Company, Antique

Expecting gross profit/kg to settle down at present levels of ~78-80/kg from highs of INR87/kg



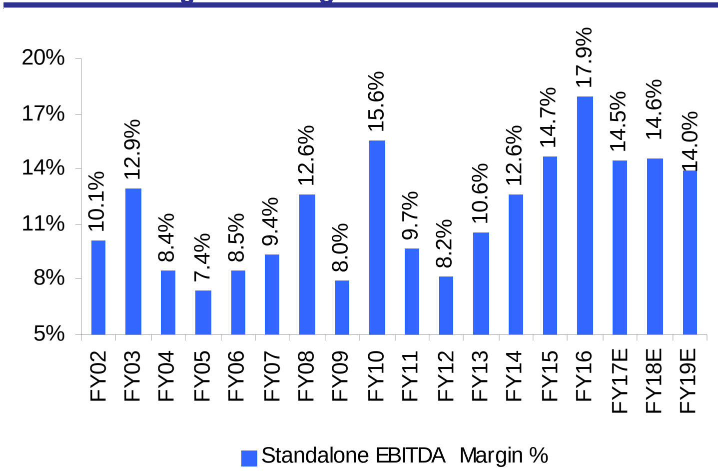
Source: Company, Antique

RMB to inch up slowly from the lows of FY16



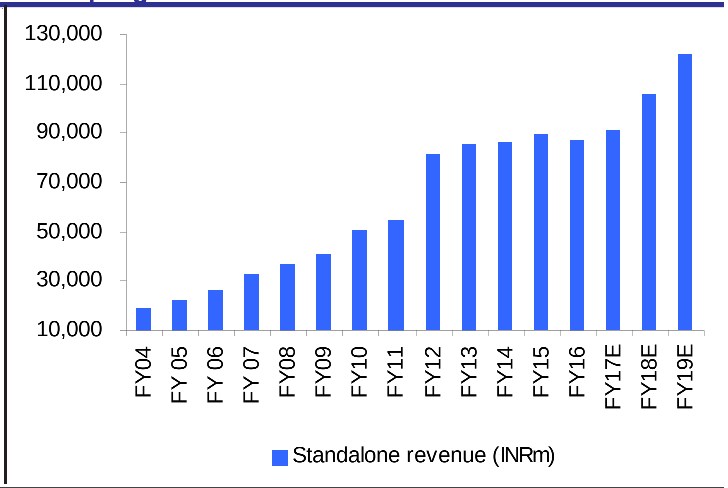
Source: Company, Antique

Standalone EBITDA margin expected to settle down close to 14% levels as against the highs of 18% in FY16



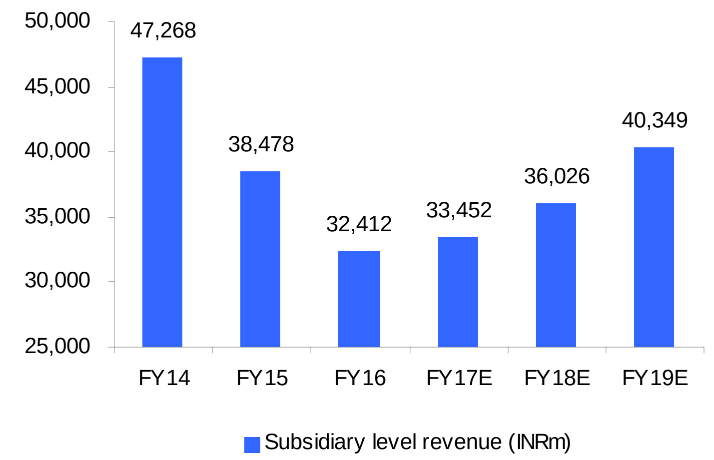
Source: Company, Antique

Revenue set to inch up in FY19 with volume and pricing set to move up together



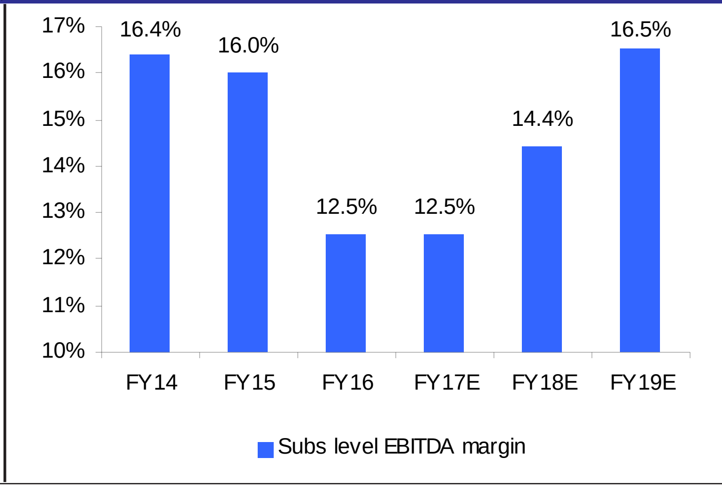
Source: Company, Antique

EU subs revenue to pick up from FY19 with Hungary plant getting on stream mid-FY18



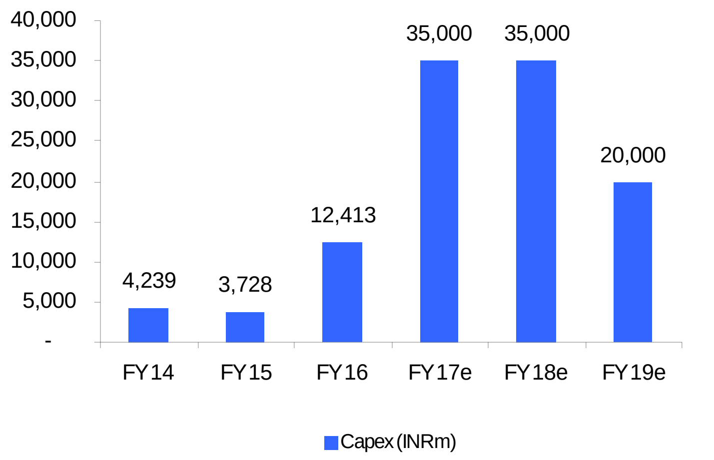
Source: Company, Antique

EU margin to recover back to ~16% by FY19 with rising scale



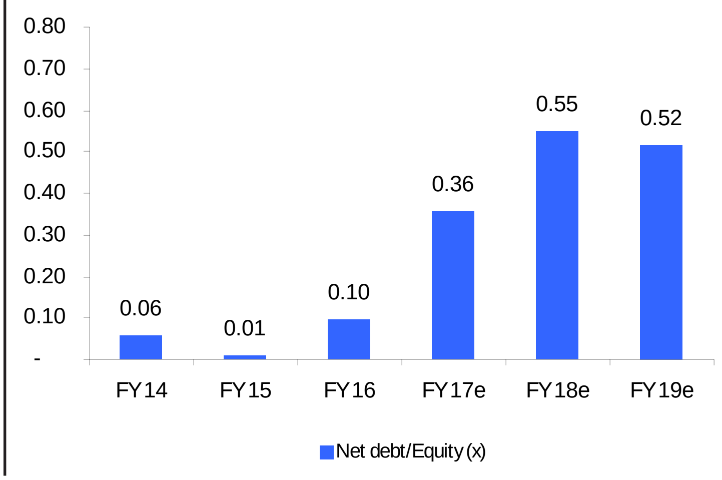
Source: Company, Antique

Capex to normalize post FY19, hoping no major inorganic deal then



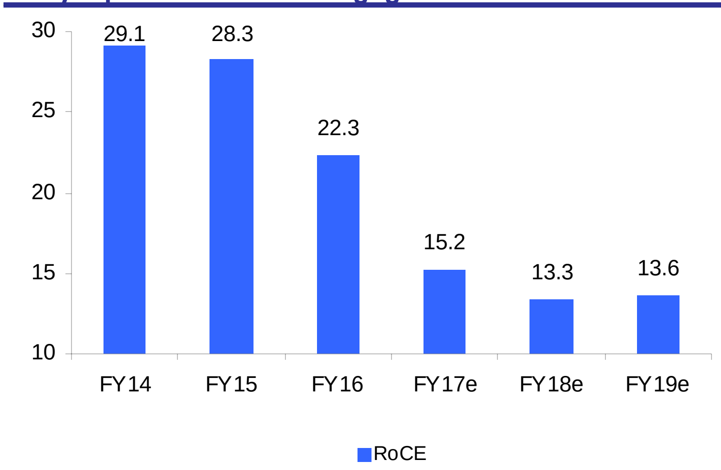
Source: Company, Antique

In a position to manage the INR90bn capex in FY17-19e and keep net debt to equity under control



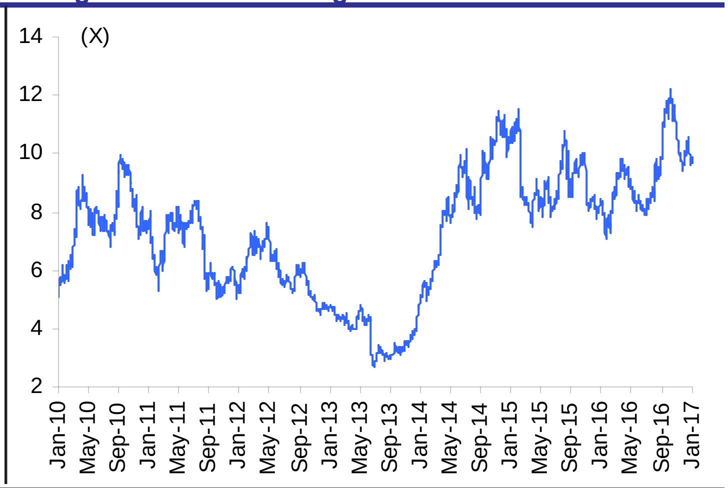
Source: Company, Antique

Capital efficiency to remain constrained in FY17-19e amid heavy capex and muted earnings growth



Source: Company, Antique

Trading ~10x forward earnings



Source: Bloomberg, Antique

Financials

Profit and loss account (INRm)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Revenues	**127,853**	**117,930**	**124,927**	**141,646**	**162,192**
Expenses	108,547	98,248	107,485	121,056	138,515
EBITDA	**19,306**	**19,682**	**17,442**	**20,590**	**23,677**
Depreciation & amortisation	3,883	4,239	4,459	5,230	6,219
EBIT	**15,423**	**15,444**	**12,983**	**15,359**	**17,458**
Interest expense	1,828	916	1,650	2,700	2,910
Other income	538	1,000	1,200	550	550
Profit before tax	**14,133**	**15,528**	**12,533**	**13,210**	**15,098**
Taxes incl deferred taxation	3,532	4,776	3,384	3,435	3,926
Profit after tax	**10,601**	**10,752**	**9,149**	**9,775**	**11,173**
Adjusted PAT	**10,601**	**10,752**	**9,149**	**9,775**	**11,173**
Recurring EPS (INR)	**20.8**	**21.1**	**18.1**	**19.4**	**22.2**

Balance sheet (INRm)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Share Capital	509	509	504	504	504
Reserves & Surplus	49,914	61,613	70,138	78,734	88,727
Networth	**50,423**	**62,122**	**70,642**	**79,238**	**89,231**
Debt	8,006	13,497	27,497	44,997	48,497
Capital Employed	**58,429**	**75,618**	**98,139**	**124,234**	**137,727**
Gross Fixed Assets	94,930	107,343	139,343	174,343	194,343
Accumulated Depreciation	52,063	56,302	60,761	65,991	72,210
Capital work in progress	2,000	2,000	5,000	5,000	5,000
Net Assets	**44,867**	**53,041**	**83,582**	**113,352**	**127,133**
Investments	1,470	1,226	1,226	1,226	1,226
Current Assets, Loans & Advances					
Inventory	17,782	19,454	18,934	20,642	23,636
Debtors	9,589	10,843	9,583	10,090	11,553
Cash & Bank balance	5,946	6,241	1,050	309	1,212
Loans & advances and others	6,199	20,133	15,343	13,753	11,613
Current Liabilities & Provisions					
Liabilities	15,338	21,735	19,935	22,603	25,882
Provisions	7,176	8,030	6,645	7,534	7,765
Net Current Assets	**17,003**	**26,907**	**18,331**	**14,657**	**14,369**
Deferred expenses	4,912	5,556	5,000	5,000	5,000
Application of Funds	**58,429**	**75,618**	**98,139**	**124,234**	**137,727**

Per share data

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
No. of shares (m)	509.0	509.0	504.1	504.1	504.1
BVPS (INR)	108.7	133.0	150.1	167.1	186.9
CEPS (INR)	26.8	29.5	27.0	29.8	34.5
DPS (INR)	2.0	2.0	2.0	2.0	2.0

Margins (%)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
EBITDA	15.1	16.7	14.0	14.5	14.6
EBIT	12.1	13.1	10.4	10.8	10.8
PAT	8.3	9.1	7.3	6.9	6.9

Source: Company, Antique

Key assumptions

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Standalone volume (tonne)	414,355	432,586	471,519	528,101	591,473
Standalone NRV (INR/kg)	216	202	194	200	206
Standalone gross profit/kg (INR)	79	87	78	79	79
Subsidiary EBITDA margin (%)	16.0	12.5	12.5	14.4	16.5
Standalone EBITDA margin (%)	14.7	17.9	14.5	14.6	14.0

Cash flow statement (INRm)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
PBT	**14,133**	**15,528**	**12,533**	**13,210**	**15,098**
Depreciation & amortisation	3,883	4,239	4,459	5,230	6,219
Interest expense	1,828	916	1,650	2,700	2,910
(Inc)/Dec in working capital	(2,591)	(6,062)	3,385	2,933	1,190
Tax paid	(3,532)	(4,776)	(3,384)	(3,435)	(3,926)
CF from operating activities	**13,720**	**9,844**	**18,643**	**20,639**	**21,492**
Capital expenditure	(3,728)	(12,413)	(35,000)	(35,000)	(20,000)
Inc/(Dec) in investments	(833)	245	-	-	-
CF from investing activities	**(4,561)**	**(12,168)**	**(35,000)**	**(35,000)**	**(20,000)**
Inc/(Dec) in share capital	5				
Inc/(Dec) in debt	(1,883)	5,491	14,000	17,500	3,500
Dividends paid/Other charges	(7,876)	(2,871)	(2,834)	(3,879)	(4,089)
CF from financing activities	**(9,754)**	**2,620**	**11,166**	**13,621**	**(589)**
Net cash flow	**(595)**	**296**	**(5,191)**	**(741)**	**902**
Opening balance	6,541	5,946	6,241	1,050	309
Closing balance	**5,946**	**6,242**	**1,050**	**309**	**1,212**

Growth indicators (%)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Revenue	(4.7)	(7.8)	5.9	13.4	14.5
EBITDA	2.9	2.0	(11.4)	18.0	15.0
PAT	0.8	1.4	(14.9)	6.8	14.3
EPS	(0.2)	1.4	(14.1)	6.8	14.3

Valuation (x)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
P/E	9.0	8.9	10.3	9.6	8.4
P/BV	1.7	1.4	1.2	1.1	1.0
EV/EBITDA	5.0	5.1	6.9	6.7	5.9
EV/Sales	0.7	0.9	1.0	1.0	0.9
Dividend Yield (%)	1.1	1.1	1.1	1.1	1.1

Financial ratios

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
RoE	21.0	17.3	13.0	12.3	12.5
RoCE	28.3	22.3	15.2	13.3	13.6
Net debt/Equity (x)	0.01	0.10	0.36	0.55	0.52
EBIT/Interest (x)	8.4	16.9	7.9	5.7	6.0

Source: Company Antique

Current Reco	:	HOLD
Previous Reco	:	HOLD
CMP	:	INR1,205
Target Price	:	INR1,109
Potential Return	:	-8%

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Market data

Sensex	:	27,882
Sector	:	Auto
Market Cap (INRbn)	:	48.8
Market Cap (USDm)	:	717
O/S Shares (m)	:	40.5
52-wk HI/LO (INR)	:	1422/730
Avg Daily Vol ('000)	:	692
Bloomberg	:	CEAT IN

Source: Bloomberg

Valuation

	FY17e	FY18e	FY19e
EPS (INR)	95.5	107.5	110.9
PE (x)	12.6	11.2	10.9
P/BV (x)	1.9	1.6	1.5
EV/EBITDA (x)	7.3	6.7	6.5
Dividend Yield (%)	1.0	1.0	1.1

Source: Bloomberg

Returns (%)

	1m	3m	6m	12m
Absolute	5	1	37	32
Relative	(2)	1	37	15

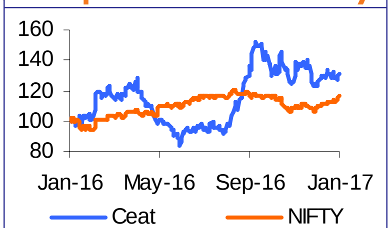
Source: Bloomberg

Shareholding pattern

Promoters	:	51%
Public	:	49%
Others	:	0%

Source: Bloomberg

Price performance *vs* Nifty



Source: Bloomberg Indexed to 100

COMPANY UPDATE

Ceat Limited

Entering a period of heavy capex amid rising competition in the 2W segment

CEAT Ltd. (CEAT) recently announced its plans of a ~INR7bn capex per annum for next five years, which would include 125TPD incremental TBR capacity addition, the OTR plant at Ambernath with initial 40TPD capacity, capacity enhancements in the PCR and 2W tyre segment along with basic maintenance capex across. On the other side close to 28% of revenue comes from 2W tyres and potentially ~40-42% of EBITDA comes from the 2W tyre segment. Increase in competition within that segment from new large ticket entrants like Apollo Tyres and JK Tyres would ideally result in loss in market share from present highs of ~28-30% for CEAT and in turn result in decline in revenue and EBITDA mix, impacting overall margin in turn. Also we believe as against ~25% tyre margin in the 2W replacement market segment presently with only three large scale players like MRF, CEAT and TVS Srichakra operating, with rise in competition through new player entry, margin levels in this segment is all set to rationalize ahead too, impacting margin of CEAT in turn. We believe CEAT is very rightly enhancing its TBR capacity from present miniscule level of ~80TPD, as TBR would be the prime driver of volume growth down the line for the industry and minor presence in that space would result in lack of ability to garner scale of the business, as 2W tyres constitute barely 12-15% of the domestic tyre market. We have a Hold on CEAT with a 10x FY19e earnings based PT of INR1,109.

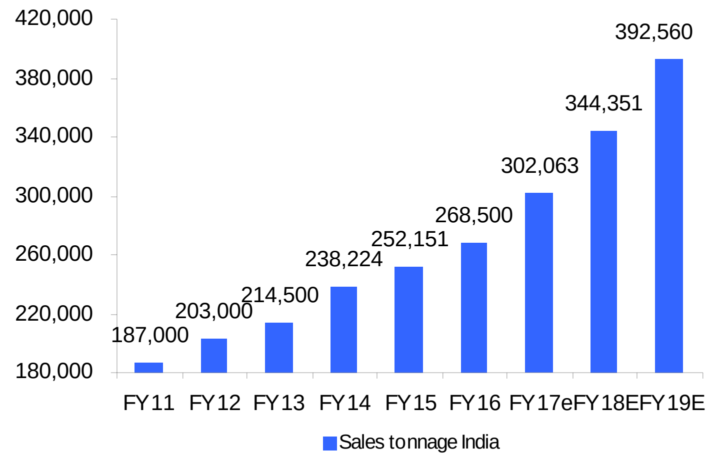
Noble intention of trying to diversify portfolio from being a 2W tyre dominated one; right quality product in TBR space can be a big game changer

As per our recent channel checks across multiple fleet owners in Mumbai, Kolkata, Delhi, Pune and Ahmedabad the recall value of CEAT brand in the truck replacement segment is far below the likes of MRF, Apollo and JK, that too especially in the TBR space. Similarly CEAT is not the go too brand in the PCR space too and is preferred by the taxi community or cost conscious buyers as it gets sold at ~5-10% lower prices compared to Apollo and MRF. Recall value of CEAT is pretty strong in the 2W tyre space and it sells at ~10% discount to MRF and a premium of ~10-15% to TVS Srichakra and ~20% premium to new entrant JK Tyres. Thus we believe, revving up its market share in the truck tyre space and especially in the TBR segment is crucial to maintain its utilisation post the enhanced capacity getting on stream. With present level or perception in the market, new initiatives like the "Win" series of TBRs are necessary on a regular basis to gain confidence of the end users and change market perception as "Win" series tyres have helped CEAT improve its volume in TBR to a large extent and it gave CEAT the confidence of expanding its TBR capacity finally. Similarly CEAT needs an overhaul in its PCR segment brand perception and focusing only in UVR would not help it achieve the desirable scale as UVs are ~15-20% of the PV population and competition is also ramping up in that space. We believe CEAT is an old and established brand and has the ability to scale up and improve the brand equity in the spaces other than 2W tyres too in the years to come in order to ramp up market share and scale up production amid rising capacities.

Noble intention of trying to diversify portfolio from being a 2W tyre d

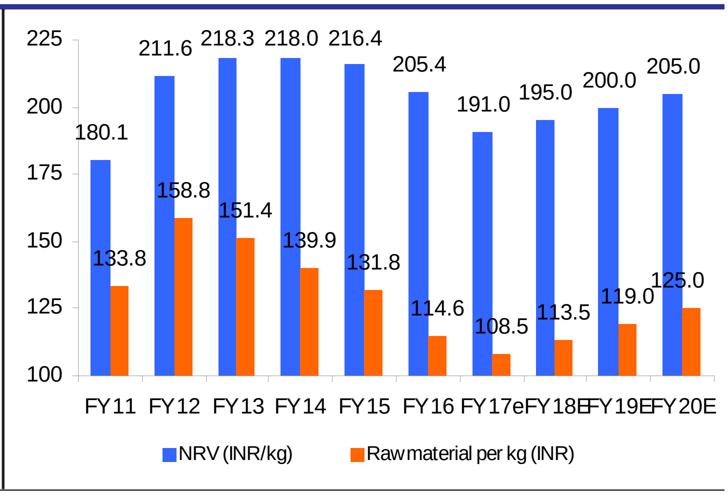
As per our recent channel checks across multiple fleet owners in Mumbai, Kolkata, Delhi, Pune and Ahmedabad the recall value of CEAT brand in the truck replacement segment is far below the likes of MRF, Apollo and JK, that too especially in the TBR space. Similarly CEAT is not the go too brand in the PCR space too and is preferred by the taxi community or cost conscious buyers as it gets sold at ~5-10% lower prices compared to Apollo and MRF. Recall value of CEAT is pretty strong in the 2W tyre space and it sells at slight discount to MRF and a premium of ~10-15% to TVS Srichakra and ~20% premium to new entrant JK Tyres. Thus we believe, revving up its market share in the truck tyre space and especially in the TBR segment is crucial to maintain its utilisation post the enhanced capacity getting on stream.

Factoring a strong volume CAGR of 14% in FY17-19e



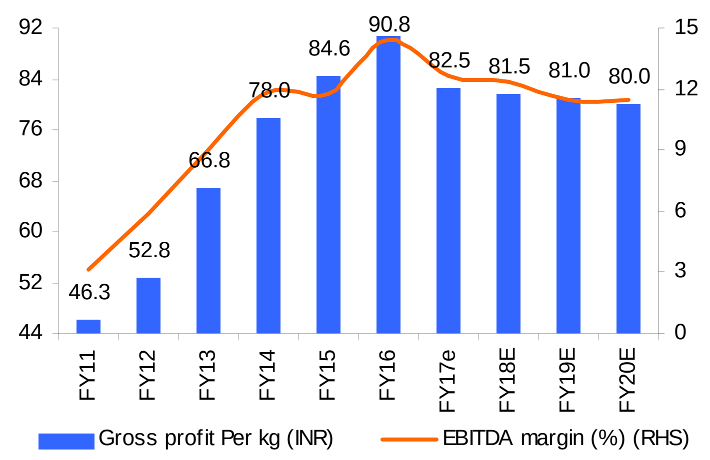
Source: Company, Antique

Expecting RMB to inch up down the line resulting in rising realisation levels



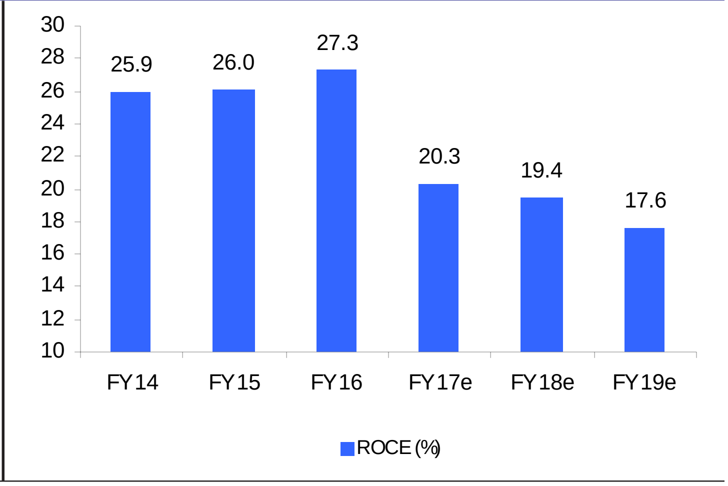
Source: Company, Antique

Do not foresee scope for further enhancement in gross profit per kg



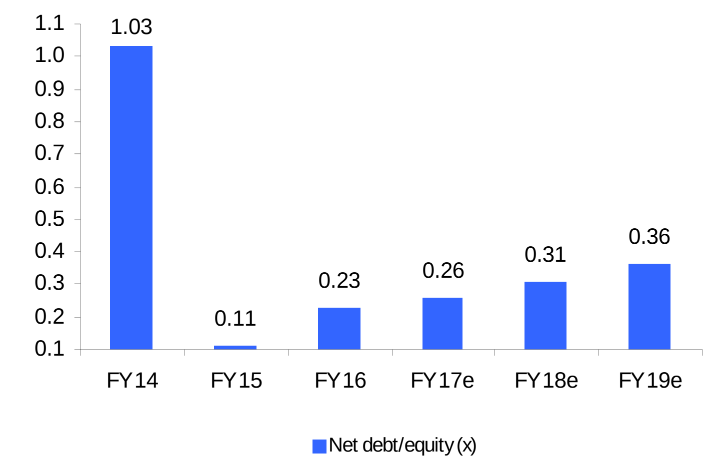
Source: Company, Antique

Rising capex and lower margin levels to impact ROCE for the time being



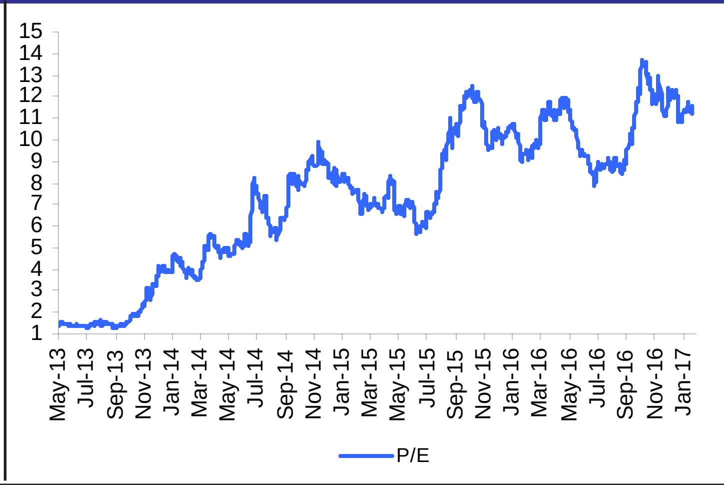
Source: Company, Antique

Should be able to manage the heavy capex plans keeping financial leverage under control



Source: Company, Antique

Factoring in target earnings multiple at 10x forward earnings



Source: Bloomberg, Antique

Financials

Profit and loss account (INRm)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Revenues	**58,024**	**57,141**	**59,287**	**68,824**	**80,282**
Expenses	51,217	48,918	51,762	60,294	71,050
EBITDA	**6,806**	**8,223**	**7,526**	**8,531**	**9,232**
Depreciation & amortisation	934	1,075	1,260	1,391	1,601
EBIT	**5,872**	**7,148**	**6,266**	**7,139**	**7,631**
Interest expense	1,319	907	895	1,125	1,470
Other income	224	299	230	200	250
Profit before tax	**4,777**	**6,539**	**5,600**	**6,214**	**6,411**
Taxes incl deferred taxation	1,577	1,978	1,736	1,864	1,923
Profit after tax	**3,200**	**4,561**	**3,864**	**4,350**	**4,488**
Adjusted PAT	**3,200**	**4,561**	**3,864**	**4,350**	**4,488**
Recurring EPS (INR)	**79.1**	**112.7**	**95.5**	**107.5**	**110.9**

Balance sheet (INRm)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Share Capital	405	405	405	405	405
Reserves & Surplus	16,744	20,564	23,860	27,618	31,490
Networth	**17,149**	**20,968**	**24,264**	**28,023**	**31,895**
Debt	6,260	6,286	7,786	9,786	12,786
Capital Employed	**23,409**	**27,254**	**32,050**	**37,808**	**44,680**
Gross Fixed Assets	25,953	33,377	39,377	46,377	53,377
Accumulated Depreciation	8,519	9,594	10,854	12,246	13,847
Capital work in progress	449	449	449	449	449
Net Assets	**17,883**	**24,232**	**28,972**	**34,580**	**39,979**
Investments	3,124	403	403	403	403
Current Assets, Loans & Advances					
Inventory	6,802	6,621	6,822	7,919	9,238
Debtors	7,050	6,188	6,497	7,542	8,798
Cash & Bank balance	1,263	1,073	1,078	701	821
Loans & advances and others	1,888	2,866	3,023	3,527	4,072
Current Liabilities & Provisions					
Liabilities	12,559	11,723	12,309	14,289	16,668
Provisions	1,007	838	869	1,009	1,177
Net Current Assets	**3,436**	**4,186**	**4,242**	**4,392**	**5,085**
Deferred expenses	1,034	1,567	1,567	1,567	786
Application of Funds	**23,409**	**27,254**	**32,050**	**37,808**	**44,680**

Per share data

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
No. of shares (m)	40.5	40.5	40.5	40.5	40.5
BVPS (INR)	449.5	557.1	638.6	731.5	807.9
CEPS (INR)	102.2	139.3	126.7	141.9	150.5
DPS (INR)	10.0	11.5	12.0	12.5	13.0

Margins (%)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
EBITDA	11.7	14.4	12.7	12.4	11.5
EBIT	10.1	12.5	10.6	10.4	9.5
PAT	5.5	8.0	6.5	6.3	5.6

Source: Company, Antique

Key assumptions

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Standalone volume (tonne)	252,151	268,500	302,063	344,351	392,560
Sri Lanka/B'desh JV volume (tonne)	15,980	16,200	16,686	17,187	17,702
Blended realisation (INR/kg)	216	205	191	195	200
Gross profit/kg (INR)	85	91	83	82	81

Cash flow statement (INRm)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
PBT	**4,777**	**6,539**	**5,600**	**6,214**	**6,411**
Depreciation & amortisation	934	1,075	1,260	1,391	1,601
Interest expense	1,319	907	895	1,125	1,470
(Inc)/Dec in working capital	3,530	(772)	(82)	(667)	(741)
Tax paid	(1,577)	(1,978)	(1,736)	(1,864)	(1,923)
CF from operating activities	**8,984**	**5,772**	**5,938**	**6,200**	**6,818**
Capital expenditure	(2,392)	(7,219)	(6,000)	(7,000)	(7,000)
Inc/(Dec) in investments	(3,124)	2,721	-	-	-
CF from investing activities	**(5,516)**	**(4,498)**	**(6,000)**	**(7,000)**	**(7,000)**
Inc/(Dec) in share capital	3,996	-	-	-	-
Inc/(Dec) in debt	(6,022)	26	1,500	2,000	3,000
Dividends paid/Other charges	(1,858)	(1,490)	(1,432)	(1,577)	(2,698)
CF from financing activities	**(3,884)**	**(1,464)**	**68**	**423**	**302**
Net cash flow	**(416)**	**(191)**	**6**	**(377)**	**120**
Opening balance	1,679	1,263	1,073	1,078	701
Closing balance	**1,263**	**1,072**	**1,078**	**701**	**822**

Growth indicators (%)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Revenue	4.5	(1.5)	3.8	16.1	16.6
EBITDA	3.5	20.8	(8.5)	13.4	8.2
PAT	14.0	42.5	(15.3)	12.6	3.2
EPS	1.3	42.5	(15.3)	12.6	3.2

Valuation (x)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
P/E	15.2	10.7	12.6	11.2	10.9
P/BV	2.7	2.2	1.9	1.6	1.5
EV/EBITDA	7.4	6.5	7.3	6.7	6.5
EV/Sales	0.9	0.9	0.9	0.8	0.8
Dividend Yield (%)	0.8	1.0	1.0	1.0	1.1

Financial ratios

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
RoE	18.7	21.8	15.9	15.5	14.1
RoCE	26.0	27.3	20.3	19.4	17.6
Debt/Equity (x)	0.1	0.2	0.3	0.3	0.4
EBIT/Interest (x)	4.5	7.9	7.0	6.3	5.2

Source: Company Antique

Current Reco	:	HOLD
Previous Reco	:	HOLD
CMP	:	INR127
Target Price	:	INR116
Potential Return	:	-9%

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Market data

Sensex	:	27,882
Sector	:	Auto
Market Cap (INRbn)	:	28.7
Market Cap (USDm)	:	423
O/S Shares (m)	:	226.8
52-wk HI/LO (INR)	:	162/74
Avg Daily Vol ('000)	:	1,026
Bloomberg	:	JKI IN

Source: Bloomberg

Valuation

	FY17e	FY18e	FY19e
EPS (INR)	9.4	9.9	14.6
PE (x)	13.5	12.8	8.7
P/BV (x)	1.5	0.9	1.1
EV/EBITDA (x)	7.3	5.3	5.1
Dividend Yield (%)	1.4	1.4	1.0

Source: Bloomberg

Returns (%)

	1m	3m	6m	12m
Absolute	15	(9)	39	41
Relative	7	(9)	40	24

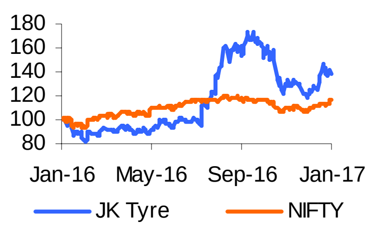
Source: Bloomberg

Shareholding pattern

Promoters	:	52%
Public	:	48%
Others	:	0%

Source: Bloomberg

Price performance *vs* Nifty



Source: Bloomberg Indexed to 100

COMPANY UPDATE

JK Tyre & Industries Limited

Balance sheet cleaning the matter of foremost priority

Post the acquisition of Haridwar facility of Birla Tyres just after completing the asset intensive project of brown field expansion of TBR capacity in Chennai JK Tyres (JKI) net debt/equity has reached as high as ~2.5x in mid-FY17 as against most of the peer set are operating with a sub-0.5x net debt/equity. Additionally demand traction YTD in the truck tyre replacement segment for JKI has been pretty muted and as ~70% of its standalone revenue comes from this segment, outlook for FY17-18 volume growth doesn't seem very encouraging. Moreover the recent surge in input commodity prices is another major deterrent against healthy FCF generation for JKI in order to reduce the financial leverage and grow ahead. Also with more than 50% of the truck and bus tyre revenue coming from the fully utilized TBR capacity of 2.3mn tyres at Chennai, anti-dumping duty on Chinese TBRs or revival of domestic bias tyres would be necessary for JKI to grow ahead. JKI recently announced its plan of raising INR10bn through various equity fund raising modes like QIP, pref allotment, ADR, FCCB etc in order to reduce the financial leverage on its books. Ball park calculations assuming fund getting raised at INR125 suggests nil earnings dilution for FY18e as equity dilution of ~27% would get balanced by the benefit of post tax interest saving to the earnings and take the net debt/equity coming down all the way to 1x by FY18e end. We believe this equity dilution led balance sheet clean up would give JKI the opportunity to ramp up its next leg of capex to enhance 2W tyres and TBR capacities across Haridwar and Chennai in order to grow profitably ahead. We have a Hold on JKI with a 8x FY19e earnings based PT of INR116.

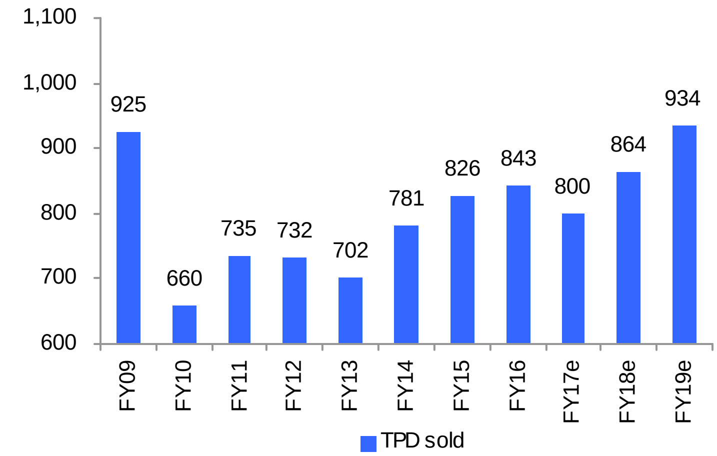
On the verge of getting starved for capacity to grow; equity dilution would give immediate headroom to initiate next leg of capex

We believe with TBR capacities being at the verge of fully utilized, JKI is in need for immediate capex in the TBR segment as its acquired facility in Haridwar would also run short of capacity in next 12 months. With rest of portfolio being largely TBB, additional growth can only come from the existing PCR capacity and rising utilisation of the acquired 2W tyre capacity at Haridwar. Our ball park calculations suggest, post raising INR10bn through equity fund raising, net debt/equity of JKI would come down to 1x by FY18 as against 2.5x presently, keeping the EPS neutral as post tax savings on interest cost would largely balance out the eqity dilution impact. Thus JKI would be in a position to initiate the next major plan for TBR capacity expansion, though they might get short of TBR capacity in FY19. Thus with rising mix of 2W tyres and TBRs, JKI would be relatively better positioned to protect overall margin from present level for standalone business as against the peers. We expect Tornel to contribute ~16% of consolidated EBITDA in FY18 with Cavendish facility contributing ~8% of overall EBITDA.

Reported margin of consol business not sustainable ahead; Haridwar facility running close to EBITDA breakeven level

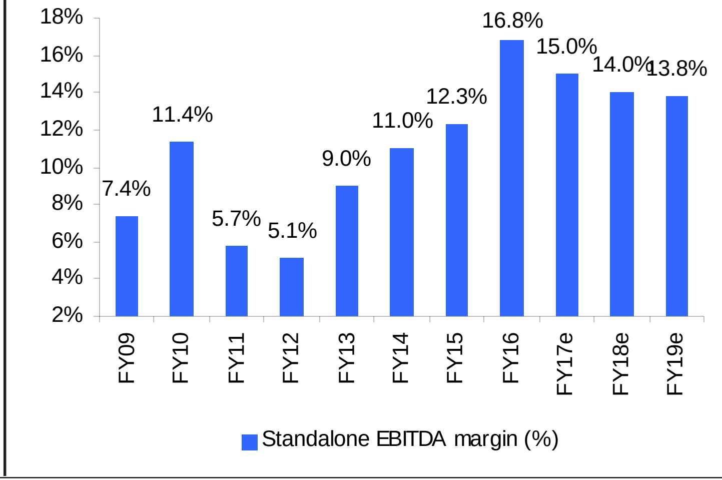
1HFY17 reported consol numbers of JKI implies the acquired Haridwar plant was operating at EBIT margin of ~25%. This is primarily on back of certain provision reversals made by JKI under the Cavendish operations & would persist till FY17 end, adjusting for which, the Haridwar facility is just at EBITDA breakeven levels. We have factored the recurring business numbers in our FY17 estimates and that's why it is looking much lower than the YTD reported earnings figure. We believe reported earnings in FY17 would be inflated to the extent of INR2-2.2bn on account of that reversal. On back of a underutilized 650TPD TBB capacity of JKI, especially post addition of ~350TPD of capacity from Haridwar facility, ROCE of JKI got impacted severely all the way down to ~12-13% levels from the ~20% levels in FY15-16. We believe it would at least 3 years for JKI to go back to the ~20% ROCE levels with no major incremental trigger for volume growth and margin being visible at present juncture. We are valuing JKI at a 20% discount to target earnings multiple of APTY and CEAT at 8x FY19e earnings.

Volume to grow at a CAGR of 8% over FY17-19e



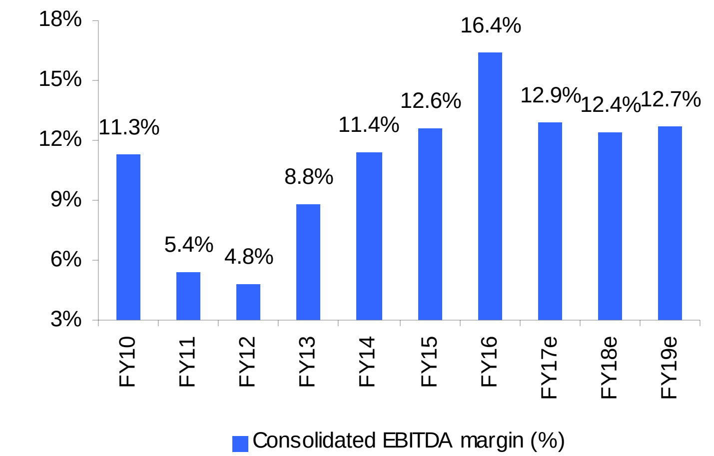
Source: Company, Antique

Standalone EBITDA margin to fall further led by lower volume and rising input prices



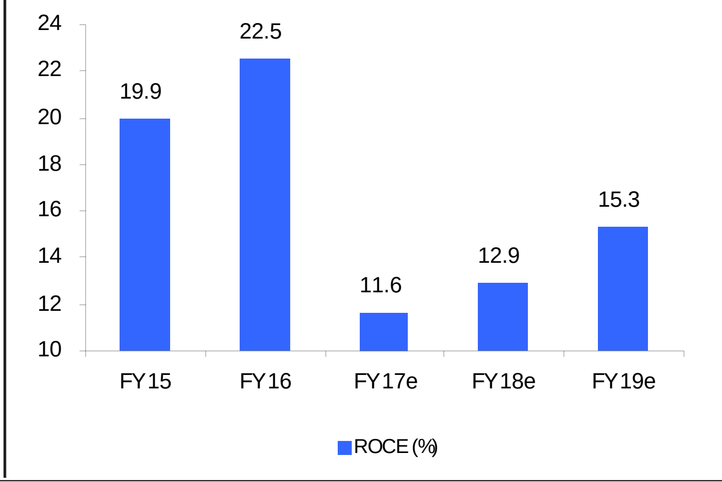
Source: Company, Antique

Consolidated EBITDA margin to be under pressure led by addition of Cavendish



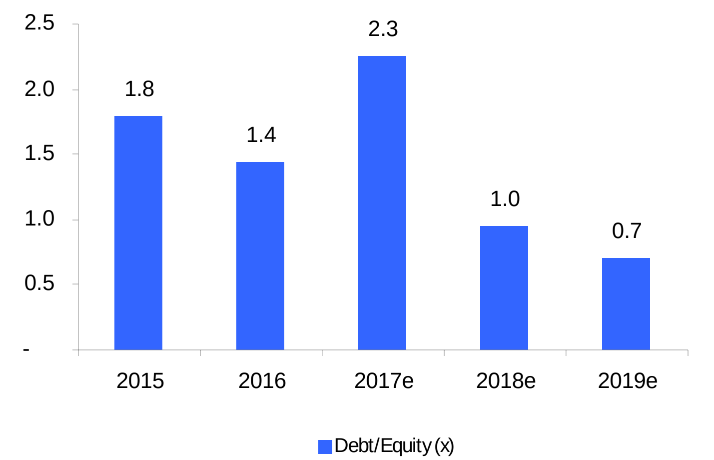
Source: Company, Antique

Lower volume growth and gradual improvement in Cavendish operations to improve ROCE



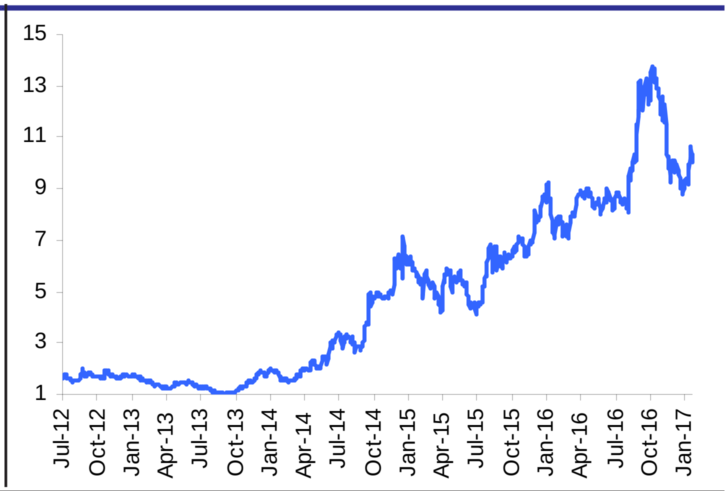
Source: Company, Antique

Debt/Equity to improve gradually led by improvement in FCF and proposed equity fund raising



Source: Company, Antique

Factoring target earnings multiple of 8x



Source: Bloomberg, Antique

Financials

Profit and loss account (INRm)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Revenues	**73,837**	**69,531**	**76,553**	**90,305**	**99,896**
Expenses	64,530	58,116	66,648	79,095	87,245
EBITDA	**9,308**	**11,415**	**9,905**	**11,210**	**12,651**
Depreciation & amortisation	1,578	1,961	3,063	3,501	3,469
EBIT	**7,730**	**9,454**	**6,842**	**7,709**	**9,182**
Interest expense	2,574	2,454	4,048	3,393	2,673
Other income	169	167	280	300	300
Extraordinary Items	(469)	(478)	-	-	-
Profit before tax	**4,856**	**6,690**	**3,074**	**4,616**	**6,809**
Taxes incl deferred taxation	1,617	2,157	953	1,339	1,975
Minority Interest	58	105	16	(244)	(368)
Adjusted PAT	**3,766**	**5,116**	**2,137**	**3,034**	**4,467**
Adjusted EPS (INR)	**16.6**	**22.6**	**9.4**	**9.9**	**14.6**

Balance sheet (INRm)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Share Capital	454	454	454	614	614
Reserves & Surplus (incl MI)	13,558	17,031	18,770	31,106	35,034
Networth	**14,011**	**17,485**	**19,224**	**31,719**	**35,648**
Debt	27,094	26,697	43,697	31,697	27,697
Capital Employed	**41,105**	**44,182**	**62,921**	**63,416**	**63,345**
Gross Fixed Assets	54,505	59,738	82,738	83,988	85,238
Accumulated Depreciation	20,689	22,650	25,713	29,215	32,684
Capital work in progress	1,500	1,500	1,500	1,500	1,500
Net Assets	**35,316**	**38,588**	**58,525**	**56,273**	**54,054**
Investments	1,403	1,548	1,548	1,548	1,548
Current Assets, Loans & Advances					
Inventory	8,750	8,725	9,347	11,026	13,089
Debtors	14,346	14,027	13,633	16,082	14,232
Cash & Bank balance	1,906	1,394	415	1,359	2,663
Loans & advances and others	7,318	9,164	9,669	10,155	10,713
Current Liabilities & Provisions					
Liabilities	10,545	9,554	10,060	12,046	11,118
Provisions	14,189	15,355	15,800	16,625	17,481
Net Current Assets	**7,585**	**8,401**	**7,203**	**9,950**	**12,098**
Deferred tax (assets)/liabilities	3,198	4,355	4,355	4,355	4,355
Application of Funds	**41,105**	**44,182**	**62,921**	**63,416**	**63,345**

Per share data

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
No. of shares (m)	226.8	226.8	226.8	306.8	306.8
Adj BVPS (INR)	68	77	85	103	116
Adj CEPS (INR)	26	31	23	29	26
Adj DPS (INR)	2	3	2	2	1

Margins (%)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
EBITDA	12.6	16.4	12.9	12.4	12.7
EBIT	10.5	13.6	8.9	8.5	9.2
PAT	5.1	7.4	2.8	3.4	4.5

Source: Company, Antique

Key assumptions

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Standalone	301,494	307,524	292,148	315,520	340,761
Growth (%)	5.8	2.0	-5.0	8.0	8.0
Realisation/kg (INR)	203	191	190	194	198
Gross profit/kg (INR)	72	82	81	79	79
Tornel volume	62,050	56,575	60,225	63,875	69,350
Growth (%)	(18.4)	(8.8)	6.5	6.1	8.6
Standalone OPM (%)	12.3	16.8	15.0	14.0	13.8
Tornel OPM (%)	14.2	14.1	13.5	12.5	12.5

Cash flow statement (INRm)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
PBT	**4,856**	**6,690**	**3,074**	**4,616**	**6,809**
Depreciation & amortisation	1,578	1,961	3,063	3,501	3,469
Interest expense	2,574	2,454	4,048	3,393	2,673
(Inc)/Dec in working capital	685	(1,328)	218	(1,803)	(843)
Tax paid	(1,617)	(2,157)	(953)	(1,339)	(1,975)
CF from operating activities	**8,075**	**7,619**	**9,450**	**8,369**	**10,133**
Capital expenditure	(8,220)	(5,233)	(23,000)	(1,250)	(1,250)
Inc/(Dec) in investments	(248)	(145)	-	-	-
Income from investments					
CF from investing activities	**(8,468)**	**(5,378)**	**(23,000)**	**(1,250)**	**(1,250)**
Inc/(Dec) in share capital	142			10,000	
Inc/(Dec) in debt	2,034	(397)	17,000	(12,000)	(4,000)
Others	(2,241)	(2,356)	(4,429)	(4,175)	(3,579)
CF from financing activities	**(65)**	**(2,753)**	**12,571**	**(6,175)**	**(7,579)**
Net cash flow	**(457)**	**(512)**	**(979)**	**944**	**1,304**
Opening balance	2,363	1,906	1,394	415	1,359
Closing balance	**1,906**	**1,394**	**415**	**1,359**	**2,663**

Growth indicators (%)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Revenue	(3.5)	(5.8)	10.1	18.0	10.6
EBITDA	6.8	22.6	(13.2)	13.2	12.9
Adj PAT	16.8	35.8	(58.2)	42.0	47.2
Adj EPS	5.7	35.8	(58.2)	5.0	47.2

Valuation (x)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
P/E (Adj)	7.6	5.6	13.5	12.8	8.7
P/BV	1.9	1.6	1.5	1.2	1.1
EV/EBITDA	5.5	4.7	7.3	5.3	5.1
EV/Sales	0.7	0.8	0.9	0.7	0.6
Dividend Yield (%)	1.5	2.3	1.4	1.4	1.0

Financial ratios

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
RoE (%)	26.9	29.3	11.1	9.6	12.5
RoCE (%)	19.9	22.5	11.6	12.9	15.3
Debt/Equity (x)	1.8	1.4	2.3	1.0	0.7

Source: Company Antique

MRF - Financials

Profit and loss account (INRm)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Revenues	**135,255**	**202,440**	**127,349**	**139,928**	**158,833**
Expenses	106,797	159,341	101,260	113,987	130,487
EBITDA	**28,458**	**43,098**	**26,089**	**25,941**	**28,346**
Depreciation & amortisation	4,674	7,347	5,768	6,414	7,059
EBIT	**23,784**	**35,751**	**20,322**	**19,528**	**21,287**
Interest expense	2,286	3,397	2,241	1,468	988
Other income	1,554	1,749	3,750	3,000	4,000
Profit before tax	**23,052**	**34,103**	**21,831**	**21,059**	**24,298**
Taxes incl deferred taxation	7,416	10,826	6,986	6,528	7,533
Profit after tax	**15,637**	**23,278**	**14,845**	**14,531**	**16,766**
Adjusted PAT	**15,637**	**23,278**	**14,845**	**14,531**	**16,766**
Recurring EPS (INR)	**3,688**	**5,490**	**3,501**	**3,427**	**3,954**

Balance sheet (INRm)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Share Capital	42	42	42	42	42
Reserves & Surplus	60,756	67,644	82,021	96,084	112,382
Networth	**60,798**	**67,687**	**82,064**	**96,127**	**112,425**
Debt	17,199	19,735	14,735	9,735	6,735
Capital Employed	**77,998**	**87,422**	**96,799**	**105,862**	**119,160**
Gross Fixed Assets	77,411	84,738	92,738	104,604	112,604
Accumulated Depreciation	33,665	36,338	42,106	48,519	55,579
Capital work in progress	7,867	7,867	7,867	4,000	4,000
Net Assets	**51,612**	**56,267**	**58,499**	**60,085**	**61,026**
Investments	18,561	27,893	27,893	27,893	27,893
Current Assets, Loans & Advances					
Inventory	19,215	18,797	16,747	18,402	20,888
Debtors	17,986	18,317	15,701	17,251	19,582
Cash & Bank balance	7,583	805	6,878	12,506	22,083
Loans & advances and others	5,122	5,757	3,646	4,001	4,533
Current Liabilities & Provisions					
Liabilities	36,680	36,821	30,305	31,791	34,025
Provisions	5,401	3,592	2,260	2,484	2,819
Net Current Assets	**7,824**	**3,262**	**10,407**	**17,884**	**30,241**
Application of Funds	**77,997**	**87,422**	**96,799**	**105,862**	**119,160**

Per share data

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
No. of shares (m)	4.2	4.2	4.2	4.2	4.2
BVPS (INR)	14,339	15,964	19,355	22,671	26,515
CEPS (INR)	4,790	7,223	4,862	4,940	5,619
DPS (INR)	60.0	100.0	100.0	100.0	100.0

Margins (%)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
EBITDA	21.0	21.3	20.5	18.5	17.8
EBIT	17.6	17.7	16.0	14.0	13.4
PAT	11.6	11.5	11.7	10.4	10.6

Source: Company, Antique

Cash flow statement (INRm)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
PBT	**23,052**	**34,103**	**21,831**	**21,059**	**24,298**
Depreciation & amortisation	4,674	7,347	5,768	6,414	7,059
Interest expense	2,286	3,397	2,241	1,468	988
(Inc)/Dec in working capital	3,828	(2,927)	(1,071)	(1,849)	(2,780)
Tax paid	(7,416)	(10,826)	(6,986)	(6,528)	(7,533)
CF from operating activities	**26,425**	**31,094**	**21,783**	**20,563**	**22,034**
Capital expenditure	(15,733)	(7,327)	(8,000)	(8,000)	(8,000)
Inc/(Dec) in investments	(7,682)	(9,332)	-	-	-
CF from investing activities	**(23,415)**	**(16,659)**	**(8,000)**	**(8,000)**	**(8,000)**
Inc/(Dec) in share capital	-	-	-	-	-
Inc/(Dec) in debt	(951)	2,536	(5,000)	(5,000)	(3,000)
Dividends paid/Other charges	(1,554)	(23,749)	(2,708)	(1,936)	(1,457)
CF from financing activities	**(2,505)**	**(21,213)**	**(7,708)**	**(6,936)**	**(4,457)**
Net cash flow	**506**	**(6,778)**	**6,075**	**5,627**	**9,577**
Opening balance	7,076	7,582	804	6,879	12,506
Closing balance	**7,582**	**804**	**6,879**	**12,506**	**22,083**

Growth indicators (%)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
Revenue	2.5	49.7	(37.1)	9.9	13.5
EBITDA	47.6	51.4	(39.5)	(0.6)	9.3
PAT	74.1	48.9	(36.2)	(2.1)	15.4
EPS	74.1	48.9	(36.2)	(2.1)	15.4

Valuation (x)

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
P/E	14.2	9.5	14.9	15.2	13.2
Cash P/E	10.9	7.2	10.7	10.6	9.3
P/BV	3.6	3.3	2.7	2.3	2.0
EV/EBITDA	7.7	5.1	8.1	7.7	6.6
EV/Sales	1.6	1.1	1.7	1.4	1.2
Dividend Yield (%)	0.1	0.2	0.2	0.2	0.2

Financial ratios

Year ended 31 Mar	2015	2016	2017e	2018e	2019e
RoE	25.7	34.4	18.1	15.1	14.9
RoCE	32.5	42.9	24.9	21.3	21.2
Debt/Equity (x)	(0.0)	0.0	(0.1)	(0.2)	(0.3)
EBIT/Interest (x)	10.4	10.5	9.1	13.3	21.5

Source: Company Antique

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