

Q2FY21 result review
and earnings revision

Automobiles

Target price: Rs1,356

Earnings revision

(%)	FY21E	FY22E
Sales	↑ 6.5	↑ 8.4
EBITDA	↑ 10.7	↑ 12.3
EPS	↑ 23.8	↑ 16.0

Target price revision

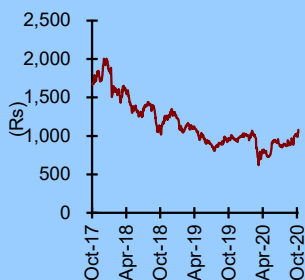
Rs1,356 from Rs995

Shareholding pattern

	Mar '20	Jun '20	Sep '20
Promoters	46.7	46.7	46.8
Institutional investors	37.1	37.2	39.9
MFs and other	6.2	6.6	11.4
FIs/Banks/Ins	2.7	3.0	4.6
FIIIs	28.2	27.6	23.9
Others	16.2	16.1	13.3

Source: BSE

Price chart



Research Analysts:

Nishant Vass

nishant.vass@icicisecurities.com
+91 22 6637 7260

Pratit Vajani

pratit.vajani@icicisecurities.com
+91 22 6637 7161

INDIA

CEAT

Replacement demand drives margins

BUY

Maintained

Rs1,143

CEAT's Q2FY21 performance was an all-round beat on consensus expectations. EBITDA margins came in at 14.8% (19 qtr. high). The beat was primarily driven by a) stronger revenue traction in M&HCV (33% share in H1FY21; FY20: ~31%) and 2W (30% share in H1FY21; FY20: 31%) and b) margin improvement: i) due to mix (replacement share up to 71% from 58%, ii) lower commodity prices on crude-linked derivatives. On balance sheet side, gross debt was lowered by ~Rs1.3bn to Rs18bn. Demand outlook for FY22 remains modest due to weakness in OEM demand; however, profitability is likely to remain healthy due to better mix and cost control. Current valuations remain inexpensive as stock trades at ~9% FCF yield on FY23E basis. We maintain our BUY rating.

Conference call on Oct 28, Wednesday, at 16:00 hours IST. Number: +91 22 62801146.

- **Key highlights of the quarter:** Revenue grew ~17% YoY to ~Rs19.6bn due to improvement in replacement sales in Q2 despite modest pick-up in economic activity in M&HCV segment. Gross margins improved 564bps YoY to 46.6bps driven by better mix and lower commodity costs. CEAT's employee costs remained sticky (up 92bps), even as other expenses remained flat as the company likely maintained tight cost control on discretionary spends (e.g. travel costs, marketing). Debt stood at Rs18bn vis-à-vis Rs19.29bn in FY20 reflecting strong cash flow management. CEAT's standalone financials also reflected the amalgamation of Speciality tyres business (CSTL), it led to deferred tax credit of Rs2bn thereby aiding reported PAT growth (up 240% YoY) at Rs17bn.
- **Relatively better placed:** CEAT has likely fared better vis-à-vis domestic peers, which we believe is attributable to: a) Relatively high share of "2W & farm" segment in revenues (~39%), which have witnessed one of best recoveries on industry wide basis; b) new product innovations continue to drive market share gains in existing OEMs (e.g. Hero Motocorp, Maruti Suzuki); and c) new customer additions (e.g. Kia, MG); d) M&HCV outperformance likely due to product quality improvement and brand acceptance under a curtailed imports regime.
- **Maintain BUY:** As we enter H2FY21, we like the growth rebound story, however, are apprehensive on maintenance of such high margin levels, believe as the mix normalises (OEM vis-à-vis replacement), margins are likely to mean revert lower (10-12% band). Commodity price inflation of natural rubber (up ~28% MoM) also remains a key risk. We rollover to Sep'22E, tweak our earnings estimates upwards (24%/16% for FY21E/FY22E) factoring in better growth outlook. We value CEAT on SoTP basis, maintain our standalone multiple to 15x Sep'22E EPS of Rs89 and reduce the ascribed value of Sri Lanka business at Rs22 per share. We maintain our **BUY** rating on the stock with a revised target price of Rs1,356 (earlier: Rs995).

Market Cap	Rs46.2bn/US\$627mn	Year to Mar (Std)	FY20	FY21E	FY22E	FY23E
Reuters/Bloomberg	CEAT.BO/CEAT IN	Revenue (Rs mn)	65,811	62,262	71,344	80,119
Shares Outstanding (mn)	40.5	Rec. Net Income (Rs mn)	2,707	2,383	2,973	4,222
52-week Range (Rs)	1143/621	Rec. EPS (Rs)	66.9	58.9	73.5	104.4
Free Float (%)	53.2	% Chg YoY	(6.3)	(12.0)	24.7	42.0
FII (%)	23.9	P/E (x)	17.2	19.6	15.7	11.0
Daily Volume (US\$/'000)	3,150	CEPS (Rs)	130.1	138.2	160.3	199.5
Absolute Return 3m (%)	33.3	EV/E (x)	9.2	8.9	7.5	6.1
Absolute Return 12m (%)	21.5	Dividend Yield (%)	2.1	0.9	1.1	1.3
Sensex Return 3m (%)	7.1	RoCE (%)	11.2	8.9	10.4	12.5
Sensex Return 12m (%)	4.4	RoE (%)	9.5	7.9	9.2	0.0

Please refer to important disclosures at the end of this report

Table 1: Q2FY21 result review (standalone)*(Rs mn, year ending March 31)*

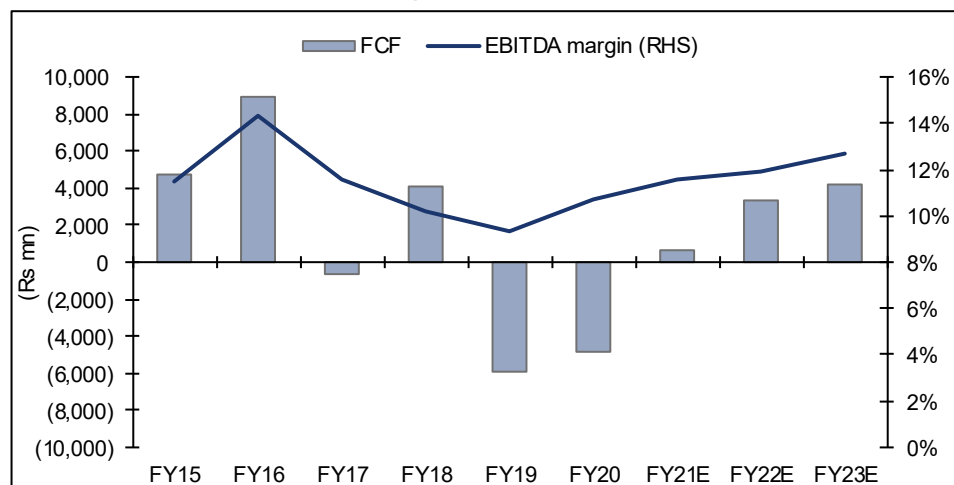
(Standalone)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Total operating income	19,651	16,873	16.5	11,162	76.1
Raw material costs	10,493	9,960	5.3	6,696	56.7
Employee costs	1,589	1,210	31.3	1,492	6.5
Other expenditures	4,665	4,007	16.4	1,956	138.5
Total operating expenses	16,746	15,177	10.3	10,144	65.1
EBITDA	2,905	1,696	71.3	1,017	185.6
EBITDA margin (%)	14.8	10.1	473 bps	9.1	567 bps
Depreciation & Amortization	839	671	25.1	785	6.9
Other income	42	145	-70.9	149	-71.6
Interest costs	444	370	20.1	483	-8.0
PBT	1,664	800	108.1	-102	-1,731.8
Exceptional Items	-	8	-	218	-
Taxes	-37	298	-112.5	-61	NC
Reported PAT	1,702	494	244.5	-259	NC
Adjusted PAT	1,702	500	240.6	-106	NC

Source: Company data, I-Sec research

Table 2: Earnings revision table (standalone)*(Rs mn)*

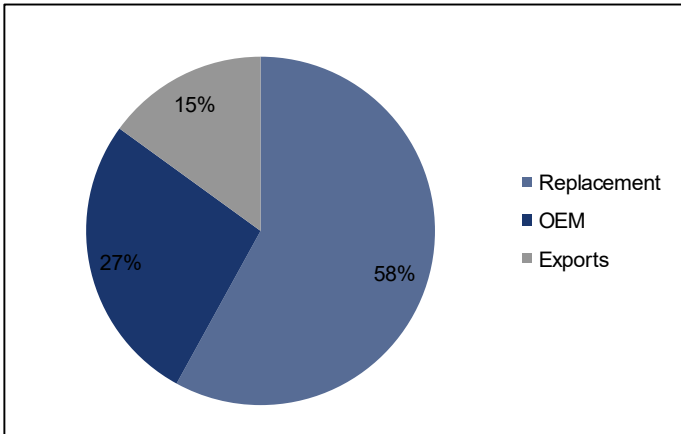
	FY21E			FY22E			FY23E
	Previous	New	Chg (%)	Previous	New	Chg (%)	Introduced
Sales	58,484	62,262	6.5	65,841	71,344	8.4	80,119
EBITDA	6,531	7,231	10.7	7,563	8,496	12.3	10,175
PAT	1,925	2,383	23.8	2,562	2,973	16.0	4,222
EPS (Rs)	47.6	58.9	23.8	63.3	73.5	16.0	104.4

Source: Company data, I-Sec research

Chart 1: FCF and EBITDA margin trends

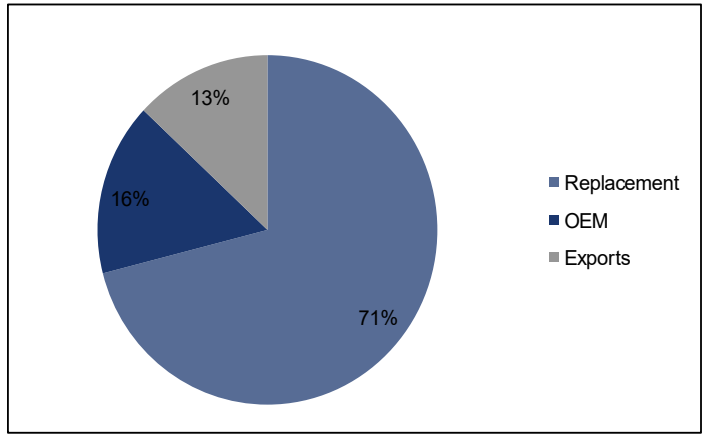
Source: Company data, I-Sec research

Chart 2: End Use revenue mix – H1FY20



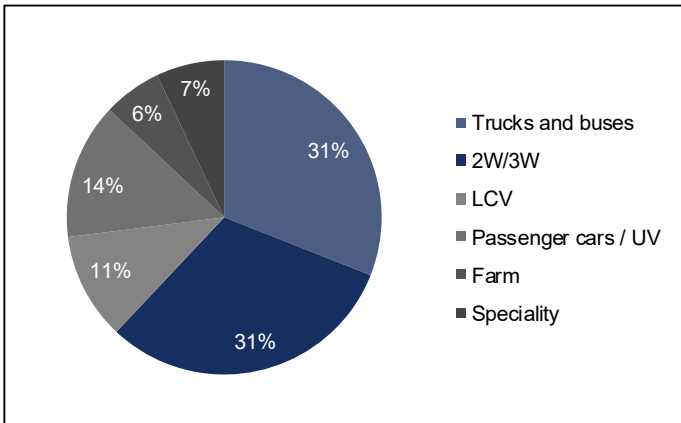
Source: Company presentation

Chart 3: End Use revenue mix – H1FY21



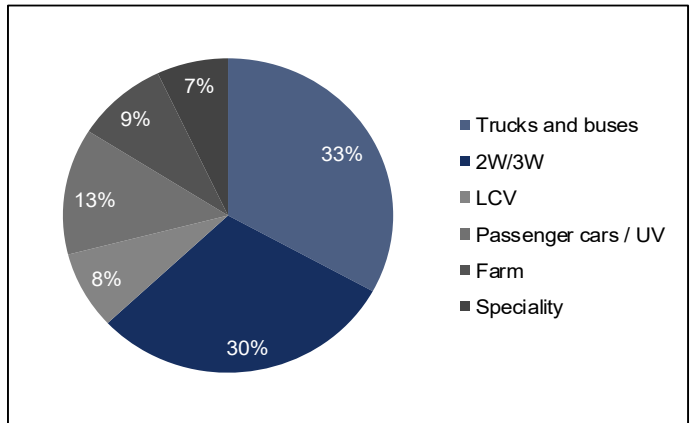
Source: Company presentation

Chart 4: Segmental revenue mix – Segmental – H1FY20



Source: Company presentation

Chart 5: Segmental revenue mix – Segmental – H1FY21

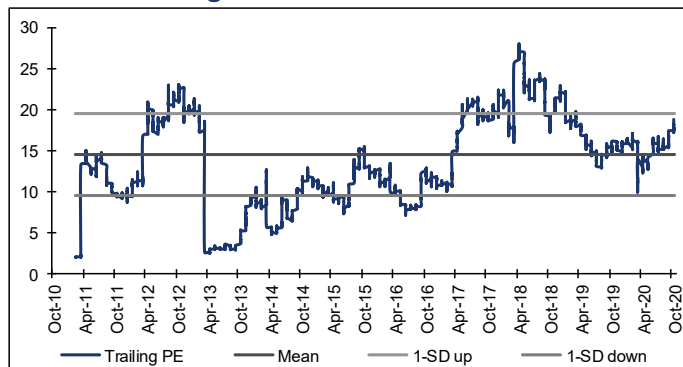


Source: Company presentation

Valuation

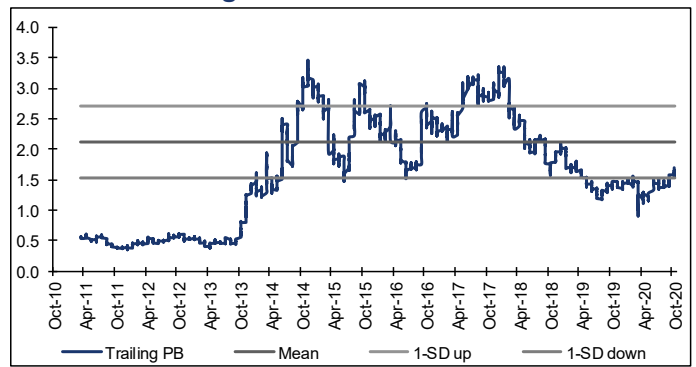
As we enter H2FY21, we like the growth rebound story however are apprehensive on maintenance of such high margin levels, believe as the mix normalises (OEM vis-à-vis replacement), margins are likely to mean revert lower (10-12% band). Commodity price inflation of natural rubber (up ~28% MoM) also remains a key risk. We rollover to Sep'22E, tweak our earnings estimates upwards (24%/16% for FY21E/FY22E) factoring in better growth outlook. We value CEAT on SoTP basis, maintain our standalone multiple to 15x Sep'22E EPS of Rs89 and reduce the ascribed value of Sri Lanka business at Rs22 per share. We maintain our **BUY** rating on the stock with a revised target price of Rs1,356 (earlier: Rs995).

Chart 6: Trailing P/E



Source: I-Sec research, 12m trailing data

Chart 7: Trailing P/B



Source: I-Sec research, 12m trailing data

Financial summary (standalone)

Table 3: Profit and loss statement
(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Total Op. Income (Sales)	65,811	62,262	71,344	80,119
Operating Expenses	58,758	55,030	62,848	69,944
EBITDA	7,053	7,231	8,496	10,175
<i>% margins</i>	<i>10.7%</i>	<i>11.6%</i>	<i>11.9%</i>	<i>12.7%</i>
Depreciation & Amortisation	2,554	3,208	3,511	3,847
EBIT	4,499	4,023	4,985	6,328
Other Income	413	351	404	485
Gross Interest	1,230	1,726	1,673	1,535
PBT	3,683	2,648	3,716	5,278
Less: Exceptionals	298	-	-	-
PBT after Exceptionals	3,385	2,648	3,716	5,278
Less: Taxes	678	265	743	1,056
Less: Minority Interest	-	-	-	-
Add: Profit from Associates	-	-	-	-
Net Income (Reported)	2,707	2,383	2,973	4,222
Net Income (Adjusted)	2,707	2,383	2,973	4,222

Source: Company data, I-Sec research

Table 4: Balance sheet
(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
ASSETS				
Current Assets	17,954	18,778	22,347	25,653
<i>Cash & cash eqv.</i>	<i>266</i>	<i>1,679</i>	<i>2,754</i>	<i>3,650</i>
Current Liabilities & Provisions	19,532	18,245	20,954	23,410
Net Current Assets	(1,578)	534	1,394	2,244
Investments	3,202	1,202	1,202	1,202
Total Fixed Assets	47,543	50,334	51,823	53,476
<i>Capital Work-in-Progress</i>	<i>9,338</i>	<i>9,338</i>	<i>9,338</i>	<i>9,338</i>
Other non-current asset	2,406	2,406	2,406	2,406
Total Assets	51,574	54,477	56,826	59,329
LIABILITIES				
Borrowings	18,682	19,682	19,682	18,682
<i>long-term borrowings</i>	<i>16,313</i>	<i>17,313</i>	<i>17,313</i>	<i>16,313</i>
<i>short-term borrowings</i>	<i>2,369</i>	<i>2,369</i>	<i>2,369</i>	<i>2,369</i>
Deferred Tax Liability Net	2,611	2,611	2,611	2,611
Other Non-current Liabilities	1,007	1,007	1,007	1,007
Equity Share Capital	405	405	405	405
Reserves & Surplus	28,870	30,773	33,122	36,624
Net Worth	29,274	31,177	33,526	37,029
Total Liabilities	51,574	54,477	56,826	59,329

Source: Company data, I-Sec research

Table 5: 5-stage DuPont analysis
(year ending March 31)

<i>All figures in %</i>	FY20	FY21E	FY22E	FY23E
Tax Burden	0.8	0.9	0.8	0.8
Interest Burden	0.8	0.7	0.7	0.8
EBIT Margin	0.1	0.1	0.1	0.1
Asset Turnover	1.3	1.1	1.3	1.4
Financial Leverage	1.8	1.7	1.7	1.6
ROE	9.5	7.9	9.2	0.0

Source: Company data, I-Sec research

Table 6: Cashflow statement
(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Operating cashflow before working capital changes	6,491	7,318	8,157	9,604
Net Working Capital Changes	2,513	(698)	215	46
Others	286	-	-	-
Operating Cashflow	9,290	6,619	8,371	9,650
Capital Commitments	(14,139)	(6,000)	(5,000)	(5,500)
Free Cashflow	(4,849)	619	3,371	4,150
Cashflow from Investing Activities	(9,740)	(4,000)	(5,000)	(5,500)
Issue of Share Capital	-	-	-	-
Inc/(Dec) in securities premium	-	-	-	-
Inc/(Dec) in Borrowings	6,077	1,000	-	(1,000)
Dividend paid	(1,139)	(480)	(624)	(720)
Interest paid	(1,230)	(1,726)	(1,673)	(1,535)
Others	(3,599)	-	-	-
Cashflow from Financing Activities	110	(1,206)	(2,297)	(3,254)
Net Cashflow	(341)	1,413	1,075	896
Opening Cash & Bank balance	597	266	1,679	2,754
Closing Cash & Bank balance	257	1,679	2,754	3,650
Increase / (Decrease) in Cash & cash equivalents	(341)	1,413	1,075	896

Source: Company data, I-Sec research

Table 7: Key ratios
(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
Per Share Data (in Rs.)				
EPS (Basic)	66.9	58.9	73.5	104.4
EPS (Adjusted)	66.9	58.9	73.5	104.4
Cash EPS	130.1	138.2	160.3	199.5
Dividend per share (DPS)	23.7	10.0	13.0	15.0
BVPS (Adjusted)	723.7	770.8	828.8	915.4
Growth Ratios (%)				
Total Op. Income (Sales)	-3.7	-5.4	14.6	12.3
EBITDA	10.6	2.5	17.5	19.8
Net Income (Adjusted)	-6.3	-12.0	24.7	42.0
EPS (Adjusted)	-6.3	-12.0	24.7	42.0
Cash EPS	13.6	6.3	16.0	24.5
BVPS (Adjusted)	6.4	6.5	7.5	10.4
Valuation Ratios (x)				
P/E (Adjusted)	17.2	19.6	15.7	11.0
P/BV (Adjusted)	1.6	1.5	1.4	1.3
EV/EBITDA	9.2	8.9	7.5	6.1
EV/Sales	1.0	1.0	0.9	0.8

Return/Profitability Ratios (%)

EBITDA Margin	10.7	11.6	11.9	12.7
Net Income Margin (Adjusted)	4.1	3.8	4.2	5.3
RoCE	11.2	8.9	10.4	12.5
RoNW	9.5	7.9	9.2	12.0
Dividend Payout Ratio	35.5	17.0	17.7	14.4
Dividend Yield	2.1	0.9	1.1	1.3

Solvency/Wkg. Cap. Ratios (x)

Net D/E	0.6	0.6	0.5	0.4
Debt/EBITDA	2.6	2.7	2.3	1.8
EBIT/Interest	3.7	2.3	3.0	4.1
Current Ratio	0.9	1.0	1.1	1.1
Quick Ratio	0.5	0.6	0.6	0.6
Inventory (days)	49	50	51	51
Receivables (days)	39	40	39	39
Payables (days)	99	97	98	98

Source: Company data, I-Sec research

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