

CEAT

Performance Highlights

Y/E March (₹ cr)	2QFY12	2QFY11	% chg (yoy)	1QFY12	% chg (qoq)
Net sales	1,118	843	32.7	1,078	3.7
EBITDA	61	44	39.5	(9)	-
EBITDA margin (%)	5.5	5.2	27bp	(0.9)	-
Reported PAT	6	15	(63.3)	(42)	-

Source: Company, Angel Research

CEAT reported strong operating performance for 2QFY2012; however, the company's bottom line was severely impacted due to high interest and depreciation expense because of commissioning of the new facility at Halol. The company returned back to profitability in 2QFY2012, after reporting losses at the operating as well as bottom-line front in 1QFY2012. **We broadly maintain our estimates and retain our Buy rating on the stock.**

Continuous ramp-up at the Halol plant improves operating performance: During 2QFY2012, the company's net sales grew strongly by 32.7% yoy (3.7% qoq) to ₹1,118cr on account of availability of additional capacity at the Halol plant and average price hike of ~10% in 1QFY2012. OEM and exports sales registered impressive growth of 57% and 90% yoy, respectively, while replacement sales grew by 14% yoy. Top-line growth also benefited from a 21.4% yoy increase in other operating income. Operating margin improved by 27bp yoy to 5.5%, largely due to ramp-up at the Halol facility and price increases carried out in 1QFY2012. While raw-material cost as a percentage of sales increased by 223bp yoy, the decline in staff cost and other expenditure as a percentage of sales (by 129bp and 132bp yoy, respectively) helped CEAT to maintain its margins. Net profit, however, fell sharply by 63.3% yoy to ₹6cr due to significant rise in depreciation (114.4% yoy) and interest (170.4% yoy) expense.

Outlook and valuation: We expect CEAT to report continuous improvement in its operating performance, led by improving utilization at the Halol plant and a gradual decline in raw-material prices. Consequently, we estimate CEAT to post an EPS of ₹20.8 in FY2013E. **We maintain our Buy recommendation on the stock with a target price of ₹104.**

Key financials

Y/E March (₹ cr)	FY2010	FY2011	FY2012E	FY2013E
Net sales	2,807	3,469	4,403	5,111
% chg	18.6	23.6	26.9	16.1
Net profit	165	28	13	71
% chg	-	(83.3)	(52.3)	443.0
EBITDA (%)	10.5	3.1	3.9	5.0
EPS (₹)	48.3	8.0	3.8	20.8
P/E (x)	1.6	11.6	19.8	3.6
P/BV (x)	0.4	0.4	0.4	0.4
RoE (%)	29.6	4.3	2.0	10.9
RoCE (%)	21.9	4.9	5.8	9.0
EV/Sales (x)	0.3	0.3	0.3	0.3
EV/EBITDA (x)	2.4	10.6	8.3	5.7

Source: Company, Angel Research

BUY

CMP	₹76
Target Price	₹104

Investment Period	12 Months
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Stock Info	
Sector	Tyre
Market Cap (₹ cr)	259
Beta	0.8
52 Week High / Low	163/71
Avg. Daily Volume	63,793
Face Value (₹)	10
BSE Sensex	17,193
Nifty	5,169
Reuters Code	CEAT.BO
Bloomberg Code	CEAT@IN

Shareholding Pattern (%)	
Promoters	50.2
MF / Banks / Indian Fls	22.9
FII / NRIs / OCBs	2.0
Indian Public / Others	24.9

Abs. (%)	3m	1yr	3yr
Sensex	0.8	(16.5)	74.7
Ceat	(16.5)	(52.1)	92.7

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Exhibit 1: Quarterly performance

Y/E March (₹ cr)	2QFY12	2QFY11	% chg	1HFY12	1HFY11	% chg
Net Sales	1,118	843	32.7	2,196	1,620	35.6
Consumption of RM	818	583	40.2	1,665	1,119	48.9
(% of Sales)	73.2	69.2		75.8	69.0	
Staff costs	59	55	7.2	116	105	11.0
(% of Sales)	5.3	6.6		5.3	6.5	
Purchases of TG	10	21	(53.8)	27	48	(43.6)
(% of Sales)	0.9	2.5		1.2	2.9	
Other expenses	170	139	22.3	336	264	27.1
(% of Sales)	15.2	16.5		15.3	16.3	
Total Expenditure	1,057	799	32.3	2,144	1,535	39.7
EBITDA	61	44	39.5	52	85	(38.9)
EBITDA margin (%)	5.5	5.2		2.4	5.2	
Interest	36	13	170.4	70	25	177.5
Depreciation	17	8	114.4	33	16	104.8
Other Income	-	-	-	1	-	-
PBT (excl. Extr. Items)	8	23	(63.4)	(51)	44	-
Extr. Income/(Expense)	-	-	-	-	-	-
PBT (incl. Extr. Items)	8	23	(63.4)	(54)	44	-
(% of Sales)	0.7	2.7		(2.4)	2.7	
Provision for taxation	3	7	(63.6)	(17)	15	-
(% of PBT)	32.4	32.6		32.4	33.3	
Reported PAT	6	15	(63.3)	(36)	29	-
PATM (%)	0.5	1.8		(1.7)	1.8	
Equity capital (₹ cr)	34.2	34.2		34.2	34.2	
EPS (₹)	1.6	4.5	(63.3)	(10.6)	8.5	-

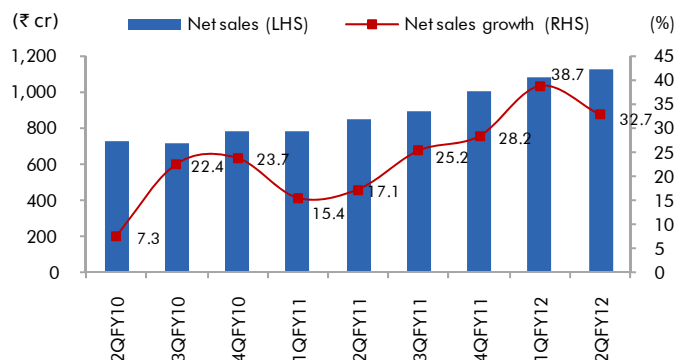
Source: Company, Angel Research

Strong top-line growth of 32.7% yoy: CEAT reported strong net sales growth of 32.7% yoy (3.7% qoq) to ₹1,118cr on account of continuous ramp-up at the Halol plant and average price hike of ~10% in 1QFY2012. Growth was aided by the 57% yoy growth in the OE segment and 14% yoy growth in the replacement segment. Exports recorded robust 90% yoy growth, following strong demand momentum in Middle East, Africa and South East Asia. Top-line growth also benefited from a 21.4% yoy increase in other operating income.

During 2QFY2012, capacity at the Halol plant was ramped up to 50TPD from 36TPD in 1QFY2012. Further, utilization increased to 60–70TPD in October 2011. CEAT plans to utilize the full capacity of 150TPD at Halol by the end of 1QFY2013.

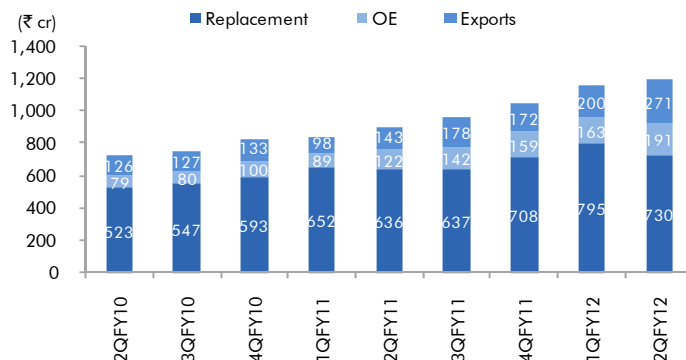
Management has indicated that 3QFY2012 could result in a little subdued performance, as the company's operations were impacted due to the 23-day strike at the Nashik plant in October 2011.

Exhibit 2: Net sales up 32.7%



Source: Company, Angel Research

Exhibit 3: Revenue contribution trend



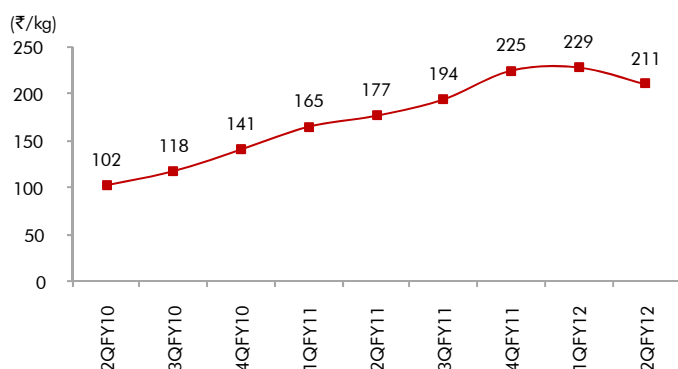
Source: Company, Angel Research

Operating performance back in black in 2QFY2012: CEAT's operating margin improved by 27bp yoy to 5.5%, largely due to ramp-up at the Halol facility and price increases carried out in 1QFY2012. While raw-material cost as a percentage of sales increased by 223bp yoy, the decline in staff cost and other expenditure as a percentage of sales (by 129bp and 132bp yoy, respectively) helped CEAT to maintain its margins. As a result, operating profit witnessed an increase of 39.5% yoy to ₹61cr during the quarter.

During the quarter, average rubber price for the company stood at ₹210-215/kg, whereas prices of nylon tyre cord fabric and carbon black stood at ₹250-270/kg and ₹64-74/kg, respectively.

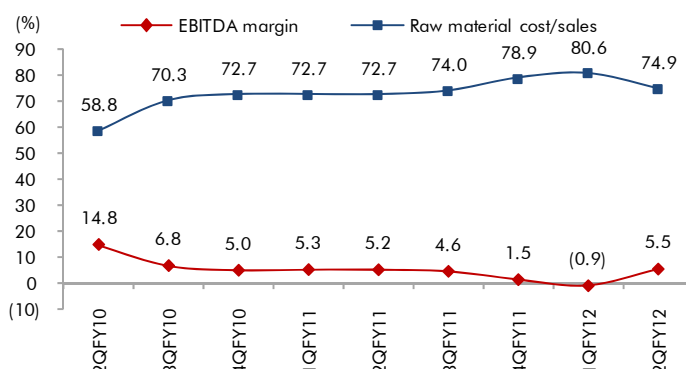
Management expects a marginal increase in the company's operating margin in 3QFY2012, as there has been a slight decline in raw-material costs. CEAT did not carry out any price hikes in 2QFY2012 and does not expect to raise prices in 3QFY2012 as well.

Exhibit 4: Average natural rubber price trend



Source: Company, Rubber Board, Angel Research

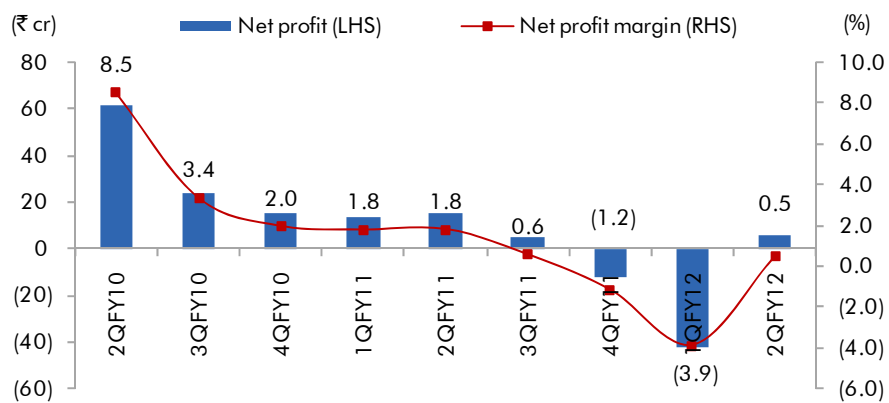
Exhibit 5: EBITDA margin at 5.5%



Source: Company, Angel Research

Net profit sharply down by 63.3%: CEAT witnessed a sharp decline of 63.3% yoy in its net profit to ₹6cr. Due to commissioning of the Halol facility, the company's depreciation and interest expense jumped substantially by 114.4% and 170.4% yoy, respectively, during the quarter.

Exhibit 6: Net profit down sharply by 63.3% yoy



Source: Company, Angel Research

Investment arguments

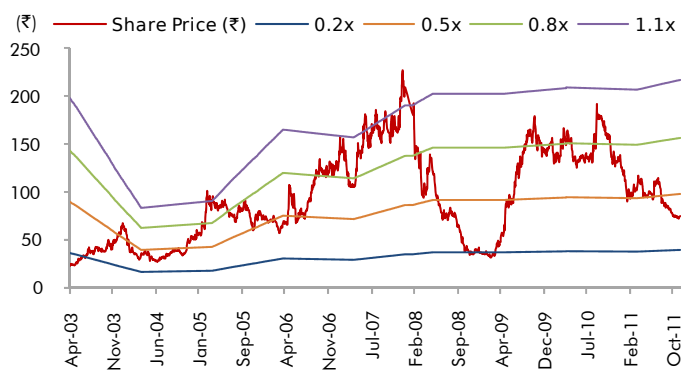
- Tyre industry – Set for a structural shift:** Currently, manufacturing radial tyres is far more capital intensive than cross-plys. Investment per tpd is 3.2x of cross-ply at ₹6.1cr/tpd. On the other hand, the selling price of radial tyres is around 20% higher than cross-ply tyres. Taking into account the difference in capital requirements and the consequent impact on asset turnover, interest cost and depreciation, to generate similar RoCE and RoE, tyre companies would need to earn EBITDA margins of around 21% compared to around 9% being earned on cross-ply tyres. Thus, higher capital requirements will help protect margins from upward-bound input costs, as the business model evolves bearing in mind final RoEs rather than margins. With the sector set for a structural shift and apparent pricing flexibility, it will result in an improvement in RoCE and RoE of tyre manufacturers going forward.
- Volume growth to benefit from capacity expansion:** CEAT's volume growth has been healthy across segments, including T&B, passenger vehicles (PV) and OTR. Further, the company's product mix is skewed towards the commercial vehicle segment (T&B tyres account for almost 61% of the total tonnage, while light commercial vehicles (LCV) and PV segments account for 22% and 15%, respectively), which is set to grow at a CAGR of ~12% between FY2011–13E.
- Increasing focus on exports:** CEAT has been increasingly focusing on exports, especially the high-margin specialty tyres, in a bid to offset volatility in its domestic tyre business in the long run.

Outlook and valuation

We expect CEAT to report continuous improvement in its operating performance, led by improving utilization at the Halol plant and a gradual decline in raw-material prices. As a result, we estimate CEAT to post an EPS of ₹20.8 in FY2013E. **We maintain our Buy rating on CEAT with a target price of ₹104.**

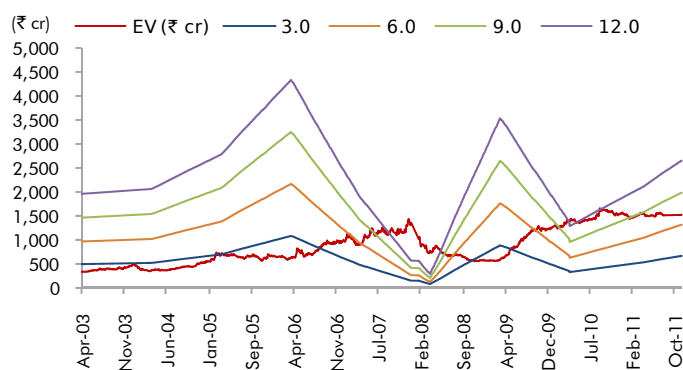
Key downsides risk to our call: Rise in input costs, increasing competitive intensity with major players diversifying globally and lower-than-anticipated growth in replacement tyre demand pose downside risks to our estimates.

Exhibit 7: One-year forward P/BV band



Source: Company, Bloomberg, Angel Research

Exhibit 8: One-year forward EV/EBITDA band



Source: Company, Bloomberg, Angel Research

Exhibit 9: Tyre - Recommendation summary

Company	Reco.	CMP (₹)	Tgt. price (₹)	Upside (%)	P/E (x)		EV/EBITDA (x)		RoE (%)		FY11-13E EPS
					FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	CAGR (%)
Apollo Tyres*	Buy	61	74	21.6	8.5	6.6	5.2	4.3	12.2	14.8	3.0
CEAT	Buy	76	104	37.4	19.8	3.6	8.3	5.7	2.0	10.9	60.9
JK Tyre*	Buy	75	99	33.4	7.9	3.4	6.9	5.6	4.5	10.0	17.4

Source: Company, Angel Research; Note: *Consolidated

Profit and Loss Statement

Y/E March (₹ cr)	FY08	FY09	FY10	FY11	FY12E	FY13E
Gross sales	2,603	2,611	2,990	3,752	4,762	5,528
Less: Excise duty	275	245	183	283	359	417
Net sales	2,328	2,366	2,807	3,469	4,403	5,111
Total operating income	2,328	2,366	2,807	3,469	4,403	5,111
% chg	9.1	1.7	18.6	23.6	26.9	16.1
Total Expenditure	2,133	2,343	2,511	3,361	4,231	4,856
Net raw materials	1,528	1,799	1,869	2,594	3,247	3,714
Other Mfg costs	205	211	253	307	392	454
Personnel	141	159	190	208	266	309
Other	258	175	200	252	326	378
EBITDA	194	23	296	107	172	256
% chg	41.0	(88.1)	1,178.1	(63.7)	60.3	48.5
(% of Net sales)	8.3	1.0	10.5	3.1	3.9	5.0
Depreciation & Amortization	33	26	27	34	66	70
EBIT	161	(2)	269	73	106	185
% chg	51.1	-	-	(72.8)	44.9	74.5
(% of Net sales)	6.9	(0.1)	9.6	2.1	2.4	3.6
Interest & other Charges	66	84	72	100	138	146
Other Income	102	49	42	60	50	58
(% of PBT)	74.8	(134.1)	17.6	156.4	284.5	59.4
Recurring PBT	197	(37)	239	33	17	98
% chg	223.9	-	-	(86.1)	(47.4)	457.8
Extraordinary Items	60	(0)	(0)	(5)	0	0
Tax	49	(21)	74	11	4	26
(% of PBT)	35.6	57.1	31.0	28.5	25.0	27.0
PAT	149	(16)	165	22	13	71
Adj. PAT	88	(16)	165	28	13	71
% chg	111.5	-	-	(83.3)	(52.3)	443.0
(% of Net sales)	3.8	(0.7)	5.9	0.8	0.3	1.4
Basic EPS (₹)	43.4	(4.7)	48.2	6.5	3.8	20.8
Fully Diluted EPS (₹)	25.8	(4.6)	48.3	8.0	3.8	20.8
% chg	182.1	-	-	(83.3)	(52.3)	443.0

Balance Sheet

Y/E March (₹ cr)	FY08	FY09	FY10	FY11	FY12E	FY13E
SOURCES OF FUNDS						
Equity Share Capital	34	34	34	34	34	34
Reserves & Surplus	479	454	594	615	608	658
Shareholders' Funds	513	488	629	649	642	692
Total Loans	478	645	654	1,019	1,319	1,394
Deferred Tax Liability	27	16	20	24	24	24
Total Liabilities	1,018	1,150	1,303	1,692	1,985	2,110
APPLICATION OF FUNDS						
Gross Block	1,214	1,234	1,256	1,882	2,201	2,390
Less: Acc. Depreciation	428	459	487	520	587	657
Net Block	787	775	769	1,361	1,615	1,733
Capital Work-in-Progress	3	20	234	123	110	72
Investments	10	43	59	87	79	95
Current Assets	772	819	1,032	1,216	1,417	1,663
Cash	42	202	140	48	62	90
Loans & Advances	81	79	109	132	176	204
Other	649	538	782	1,036	1,179	1,369
Current liabilities	554	507	790	1,094	1,237	1,452
Net Current Assets	218	312	241	121	181	211
Mis. Exp. not written off	-	-	-	-	-	-
Total Assets	1,018	1,150	1,303	1,692	1,985	2,110

Cash Flow Statement

Y/E March (₹ cr)	FY08	FY09	FY10	FY11	FY12E	FY13E
Profit before tax	137	(37)	239	39	17	98
Depreciation	33	26	27	34	66	70
Change in working capital	108	(44)	252	162	3	(26)
Less: Other income	226	(163)	204	99	(167)	(186)
Direct taxes paid	49	(21)	74	11	4	26
Cash Flow from Operations	3	128	241	124	249	302
(Inc.)/Dec. in Fixed Assets	(95)	(36)	(237)	(515)	(307)	(150)
(Inc.)/Dec. in Investments	118	(33)	(16)	(28)	7	(16)
(Inc.)/Dec. in loans and adv.	17	3	(8)	15	(99)	(28)
Other income	102	49	42	60	50	58
Cash Flow from Investing	143	(16)	(218)	(468)	(349)	(136)
Issue of Equity	(11)	-	-	-	-	-
Inc./(Dec.) in loans	(15)	168	9	365	300	75
Dividend paid (Incl. Tax)	16	-	-	16	8	20
Others	(135)	(119)	(93)	(129)	(194)	(234)
Cash Flow from Financing	(145)	48	(84)	252	114	(139)
Inc./(Dec.) in Cash	1	160	(61)	(92)	14	28
Opening Cash balance	41	42	202	140	48	62
Closing Cash balance	42	202	140	48	62	90

Key Ratios

Y/E March	FY08	FY09	FY10	FY11	FY12E	FY13E
Valuation Ratio (x)						
P/E (on FDEPS)	1.7	-	1.6	11.6	19.8	3.6
P/CEPS	2.1	27.3	1.4	4.2	3.3	1.8
P/BV	0.5	0.5	0.4	0.4	0.4	0.4
Dividend yield (%)	5.3	0.0	5.3	2.6	6.6	6.6
EV/Sales	0.3	0.3	0.3	0.3	0.3	0.3
EV/EBITDA	3.5	28.5	2.4	10.6	8.3	5.7
EV / Total Assets	0.7	0.6	0.5	0.7	0.7	0.7
Per Share Data (₹)						
EPS (Basic)	43.4	(4.7)	48.2	6.5	3.8	20.8
EPS (fully diluted)	25.8	(4.6)	48.3	8.0	3.8	20.8
Cash EPS	35.4	2.8	55.0	18.0	23.1	41.4
DPS	4.0	0.0	4.0	2.0	5.0	5.0
Book Value	149.9	142.6	183.6	189.6	187.6	202.2
Dupont Analysis						
EBIT margin	6.9	(0.1)	9.6	2.1	2.4	3.6
Tax retention ratio	0.6	0.4	0.7	0.7	0.8	0.7
Asset turnover (x)	2.8	2.5	2.8	2.6	2.6	2.7
RoIC (Post-tax)	12.3	(0.1)	18.5	3.9	4.7	7.2
Cost of Debt (Post Tax)	8.8	6.4	7.7	8.6	8.9	7.8
Leverage (x)	0.8	0.8	0.8	1.0	1.6	1.8
Operating RoE	15.2	(5.5)	26.8	(0.9)	(2.0)	6.0
Returns (%)						
RoCE (Pre-tax)	16.9	(0.2)	21.9	4.9	5.8	9.0
Angel RoIC (Pre-tax)	16.7	(0.3)	24.4	4.7	5.8	9.6
RoE	19.8	(2.8)	29.6	4.3	2.0	10.9
Turnover ratios (x)						
Asset Turnover (Gross Block)	2.0	1.9	2.3	2.2	2.2	2.2
Inventory / Sales (days)	44	43	41	51	52	52
Receivables (days)	45	48	45	44	46	46
Payables (days)	80	78	81	96	94	94
WC cycle (ex-cash) (days)	15	22	14	9	8	9
Solvency ratios (x)						
Net debt to equity	0.8	0.8	0.7	1.4	1.8	1.7
Net debt to EBITDA	2.2	17.3	1.5	8.2	6.8	4.7
Interest Coverage (EBIT/Interest)	2.4	(0.0)	3.7	0.7	0.8	1.3

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Disclosure of Interest Statement

Disclosure of Interest Statement	CEAT
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	Yes
3. Angel and its Group companies' Directors ownership of the stock	Yes
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors.

Ratings (Returns) :	Buy (> 15%)	Accumulate (5% to 15%)	Neutral (-5 to 5%)
	Reduce (-5% to 15%)	Sell (< -15%)	