

AUTOMOBILES

04 March 2021

Tyre input costs still on the boil – retain negative stance

Prices of natural rubber and crude derivatives have skyrocketed 25% and 55% respectively since Oct'20. Most tyre companies took price hikes in November and, further aided by low-cost inventory, managed to report steady sequential gross margins in Q3FY21. But the sustained rise in input costs coupled with limited headroom to effect further price hikes leaves tyre makers at risk of severe margin and earnings erosion. We find current valuations rich and reiterate a strong SELL on our entire tyre coverage.

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Adverse sales mix to erode margins: While OE tyre demand has been sluggish in FY21 thus far, strong replacement demand (due to negligible imports from China and a reviving economy) has supported a favourable margin mix for domestic tyre manufacturers. We anticipate a healthy revival in OE tyre demand in FY22 due to a low base and strong expected economic growth – this together with an unfavourable base for replacement sales would weaken the sales mix and hence erode operating margins for tyre players.

Natural rubber and crude derivative prices continue to rise: Natural rubber and crude derivatives are key components in tyres – as a percentage of tyre cost, these together form ~70%. With a ~25% jump in natural rubber and ~55% spike in crude derivative prices over the past six months, we estimate that input costs will rise ~25% over Q2FY21 levels. To mitigate this impact, tyre companies will have to effect price hikes of over 15%, which looks challenging.

Recommend strong SELL amidst rich valuations: Our revenue forecasts are in line with consensus. Most tyre companies had taken price hikes of 2-3% in Nov'20 – this coupled with low-cost inventory aided steady gross margins QoQ in Q3FY21. Despite the relentless rise in input costs, most companies have guided for meagre 2-3% hikes in Mar'21, indicating their inability to raise prices further in order to protect margins. The resulting earnings erosion despite our strong revenue forecasts leaves us skeptical of current valuations which are running much ahead of long-term averages.

We reiterate SELL on all tyre companies under our coverage, viz. Apollo Tyres, MRF, JK Tyre, Balkrishna Industries, CEAT and TVS Srichakra.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
APTY IN	259	140	SELL
BIL IN	1,638	1,340	SELL
CEAT IN	1,611	780	SELL
JKI IN	127	70	SELL
MRF IN	89,501	67,000	SELL
SRTY IN	1,921	1,200	SELL

Price & Target in Rupees

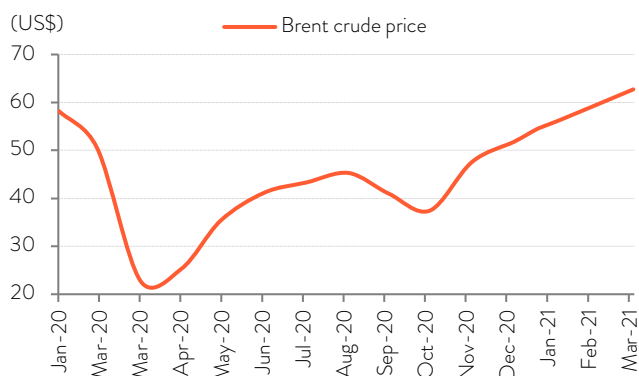


FIG 1 – BOBCAPS VS. BLOOMBERG CONSENSUS ESTIMATES FOR TYRE PLAYERS

(%)	Revenues	EBITDA	Adj. PAT
FY22E	0	(15)	(16)
FY23E	0	(13)	(15)

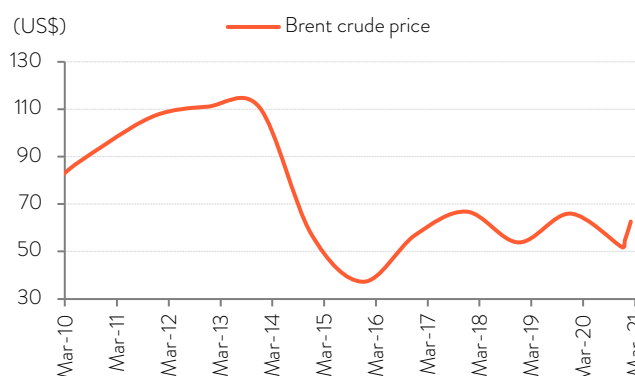
Source: Company, BOBCAPS Research, Bloomberg

FIG 2 – BRENT CRUDE PRICES UP 55% IN LAST SIX MONTHS...



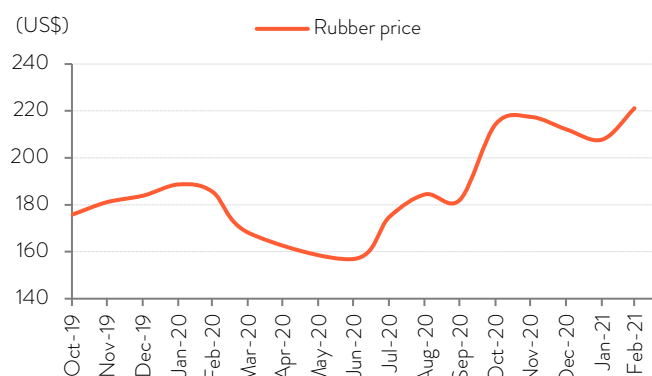
Source: Company, BOBCAPS Research, Bloomberg

FIG 3 – ...AND NOW RANGEBOUND AT LAST THREE-YEAR AVERAGE



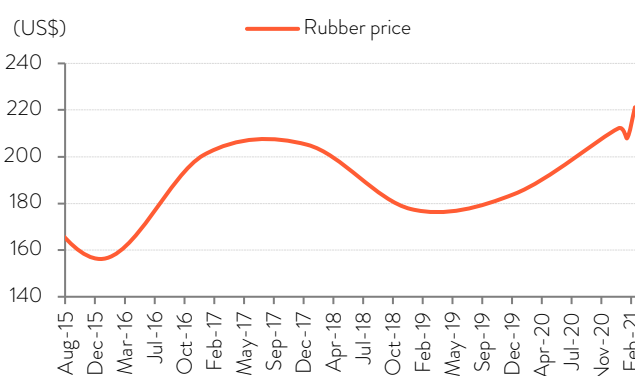
Source: Company, BOBCAPS Research, Bloomberg

FIG 4 – RUBBER PRICES UP ~25% IN LAST SIX MONTHS...



Source: Company, BOBCAPS Research, Bloomberg

FIG 5 – ...AND NOW ABOVE FIVE-YEAR AVERAGE



Source: Company, BOBCAPS Research, Bloomberg

With the steep jump in input prices, it is highly unlikely that tyre companies will achieve consensus estimates

FIG 6 – GROSS MARGIN ESTIMATES: BOBCAPS VS. BLOOMBERG CONSENSUS

Company	Q3FY21A	Gross margins			
		BOBCAPS		Bloomberg Consensus	
		FY22E	FY23E	FY22E	FY23E
Tyres					
APTY IN	43.2	43.0	43.0	42.4	42.7
BIL IN	59.9	57.0	57.0	58.6	58.6
CEAT IN	45.5	40.7	40.9	43.1	43.6
MRF IN	44.8	40.1	40.0	41.4	41.2
JKI IN	42.9	36.0	36.0	NA	NA
SRTY IN	43.7	38.3	38.3	38.3	38.3

Source: BOBCAPS Research, Company, Bloomberg

FIG 7 – BOBCAPS VS. BLOOMBERG CONSENSUS ESTIMATES (AS ON 4 MAR 2021)

FY22E												
Company	Revenue (Rs mn)			EBITDA (Rs mn)			EBITDA margin (%)			EPS (Rs)		
	Consensus	BOBCAPS	Diff (%)	Consensus	BOBCAPS	Diff (%)	Consensus	BOBCAPS	Diff (bps)	Consensus	BOBCAPS	Diff (%)
Tyres												
APTY IN	195,304	194,327	(1)	28,249	23,709	(16)	14.5	12.2	(226)	14.6	7.6	(48)
BIL IN	64,548	61,457	(5)	17,985	17,190	(4)	27.9	28.0	11	65.5	53.2	(19)
CEAT IN	86,993	84,906	(2)	11,451	8,497	(26)	13.2	10.0	(316)	94.4	48.6	(49)
MRF IN	188,904	192,002	2	32,121	28,394	(12)	17.0	14.8	(222)	3,237.0	2768.3	(14)
JKI IN	100,415	104,012	4	13,650	10,408	(24)	13.6	10.0	(359)	6.4	5.6	(13)
SRTY IN	22,417	22,135	(1)	2,660	2,177	(18)	11.9	9.8	(203)	119.7	75.0	(37)

FY23E												
Company	Revenue (Rs mn)			EBITDA (Rs mn)			EBITDA margin (%)			EPS (Rs)		
	Consensus	BOBCAPS	Diff (%)	Consensus	BOBCAPS	Diff (%)	Consensus	BOBCAPS	Diff (bps)	Consensus	BOBCAPS	Diff (%)
Tyres												
APTY IN	214,707	212,751	(1)	31,471	25,948	(18)	14.7	12.2	(246)	18.0	8.6	(52)
BIL IN	72,800	68,033	(7)	19,730	19,089	(3)	27.1	28.1	96	74.2	60.8	(18)
CEAT IN	96,600	93,560	(3)	12,787	9,867	(23)	13.2	10.5	(269)	110.8	55.9	(50)
MRF IN	208,700	212,354	2	36,063	31,763	(12)	17.3	15.0	(232)	3,525.0	3,060.0	(13)
JKI IN	109,765	115,118	5	13,786	11,785	(15)	12.6	10.2	(232)	10.8	9.6	(11)
SRTY IN	24,694	25,620	4	2,965	2,651	(11)	12.0	10.3	(166)	134.6	85.9	(36)

Source: Company, BOBCAPS Research, Bloomberg

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

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

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

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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