FIRST LIGHT

05 March 2021

RESEARCH

Automobiles

Tyre input costs still on the boil – retain negative stance

SUMMARY

Automobiles

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.

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	1,000
GAIL	Buy	160
Petronet LNG	Buy	330
TCS	Buy	3,710
Tech Mahindra	Buy	1,130

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	3,750
Greenply Industries	Buy	195
Laurus Labs	Buy	480
Transport Corp	Buy	330
Mahanagar Gas	Sell	750

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.48	9bps	42bps	43bps
India 10Y yield (%)	6.23	0bps	33bps	1bps
USD/INR	72.72	0.9	0.3	0.7
Brent Crude (US$/bbl)	64.07	2.2	14.7	25.3
Dow	31,270	(0.4)	4.3	15.4
Shanghai	3,577	1.9	2.7	18.8
Sensex	51,445	2.3	11.1	33.9
India FII (US$ mn)	**2 Mar**	**MTD**	**CYTD**	**FYTD**
FII-D	(227.7)	(333.0)	(1,817.2)	(5,910.8)
FII-E	361.2	477.1	5,470.9	35,446.6

Source: Bank of Baroda Economics Research

BOBCAPS Research
research@bobcaps.in

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

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.

Mayur Milak | Nishant Chowhan, CFA
research@bobcaps.in

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

Disclaimer

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)

Rating distribution

As of 28 February 2021, out of 88 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 42 have BUY ratings, 12 have ADD ratings, 5 are rated REDUCE and 29 are rated SELL. None of these companies have been investment banking clients in the last 12 months.

Analyst certification

Each of the analysts mentioned in this research report certify, with respect to the sections of the report for which they are responsible, that (1) all of the views expressed in this report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

Important disclosures

This product is a compilation of previously published research notes. To view the complete report along with the associated Analyst certifications and Company-specific disclosures, please click on the hyperlink accompanying each excerpt.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2025. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities —that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS’s prior written consent.

Other disclosures

BOBCAPS does not have any financial interest in the subject company. BOBCAPS does not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS is not engaged in any market making activities for the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS’s associates may have financial interest in the subject company. BOBCAPS’s associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.