



“CEAT Limited
Q1 FY2019 Earnings Conference Call”

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Moderator: Ladies and gentlemen good day and welcome to the CEAT Q1 FY2019 Earnings Conference Call hosted by Motilal Oswal Securities Limited. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing “*” then “0” on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Jinesh Gandhi from Motilal Oswal Securities. Thank you and over to you, Mr. Gandhi!

Jinesh Gandhi: Thank you Janis. Good evening everyone. On behalf of Motilal Oswal Securities, I would like to welcome you all to 1Q FY2019 post results call of CEAT. CEAT is represented by Mr. Anant Goenka – Managing Director, Mr. Kumar Subbiah –Chief Financial Officer. We would like to thank the management for taking time out for the call. We will start the session with commentary from the management followed by Q&A. I would now hand over the call to Mr. Goenka.

Anant Goenka: Thank you Jinesh. Good evening and a very warm welcome to all of you for our Q1 earnings call. I am Anant Goenka and I have with me our CFO, Kumar Subbiah. I will now share with you our performance for the quarter ended June 30, 2018 followed by some financial commentary by Kumar post which we will open the floor for questions.

For the quarter CEAT’s standalone revenues from operations grew by 1.6% on a Q-on-Q basis and 15.4% on a year-on-year basis, which stood at 1,674 Crores. All the segments saw robust revenue growth on a year-on-year basis especially on account of a low base last year because of GST effect.

Growth in the replacement segment was primarily driven by commercial vehicles. All segments saw impressive growth in OEM, while the passenger and M&HCV segments did well under exports.

On the volume front on a standalone basis, our growth was at 18.5% on a year-on-year basis and flat on quarter-on-quarter basis. On the raw material front, our prices went up by 2% on a quarter-on-quarter basis but were down by 10% year-on-year.

A few highlights for the quarter. CEAT continued to be the title sponsor for the ultimate table tennis championship through the second season. It had 24 of the best Indian and 24 international players competing through six clubs. We also hosted another edition of the CEAT Cricket Rating in the month of May. The event was a great success and was attended by some of the most prolific names in the cricketing world.

I am also happy to share that in the inaugural addition of the Investor Relations Awards organized by IR Magazine we won best IR Team Award under a mid-cap category.

With these updates for the quarter, I now hand over the call to our CFO, Kumar Subbiah.

Kumar Subbiah: Thank you Anant. Ladies and gentlemen, greeting for the day. I will now present before you the key financials relating to quarter one financial year 2019.

Our quarter one consolidated net revenue from operations grew by 16.9% year-on-year and 1.9% quarter-on-quarter. Our revenues stood at 1,706 Crores for the quarter, the growth has been largely driven by volumes.

Let me now go to gross margins. Our consolidated gross margins stood at 39.3% for Q1. It has contracted marginally by about 32-basis points sequentially largely due to increase in raw material cost arising out of increase in crude oil prices and depreciation in the Indian currency.

I will move to now EBITDA. Our consolidated EBITDA stood at 10.6% for Q1 of the year, an improvement of 660-basis points year-on-year and a decline of about 153-basis points sequentially.

Our EBITDA was impacted by gross margin drop arising out of the raw material prices as I mentioned and also on account of increase in advertisement cost for the quarter to the extent of about 1%. Normally we incur higher advertisement cost in Q1 linked to activities relating to IPL.

With respect to our profits, our consolidated net profit for the quarter stood at 71 Crores. Our tax rate for the quarter was higher at around 35% as it considers the impact of cess on profit for the quarter as well as on the accumulated balance of deferred tax.

With our ongoing capex plans we have been monitoring and managing our cash flows very closely as a result our consolidated debt-to-equity improved from 0.33 in Q4 to around 0.28 by end of Q1 of this year.

With this we will now open the Q&A. Thank you.

Moderator: Thank you very much. Ladies and gentlemen we will now begin the question and answer session. We will take the first question from the line of Jay Kale from Elara Capital. Please go ahead.

Jay Kale: Thanks for taking my question. Sir my first question was regarding your volume growth just wanted to get a sense of how the replacement and the OEM growth has panned out? If you can just throw some light on these two segments especially in the two-wheelers and the trucks segment?

Anant Goenka: We would not share the breakup segment wise, category wise, but I can share with you that overall the OEM and export segment both have shown high growth both at about over 20% kind of levels of growth. Replacement was on the lower side versus exports and OEM. Last year OEM if you recollect post BS-IV etc., the CV segment had undergone fair amount of challenging time in Q1 and therefore some low base effect also caused OEM to grow at quite a high rate. With respect to two-wheeler and commercial vehicles both saw a strong growth, commercial vehicle was again at 20% plus levels of growth across all categories. Similarly, two-wheeler side also saw high double-digit growth level so overall say 15% kind of levels. Scooter outperformed motorcycles because

overall there has been lot of positivity on the scooter growth across all categories. So I can share with as I said broad numbers, but specific numbers maybe in Q2.

Jay Kale: Sure. Just a clarification, high double-digit two-wheeler is in two wheeler OEM segment correct?

Anant Goenka: Across on average I am saying.

Jay Kale: Sir just on the cost side raw materials how much of the raw material impact was there say from Q1 to Q4 so Q1 was with Q-o-Q and what is the expectation going forward what kind of raw material pressures do you see going forward?

Anant Goenka: We saw about 2% price increases for the raw material in Q4 to Q1 and expect the similar kind of impact 2-3% from Q1.

Jay Kale: I just missed the last part I did not get that.

Anant Goenka: Yes, so Q1 to Q2 we expect a similar at about 2% to 3% price increase from Q1 to Q2.

Jay Kale: And any kind of price increases that you have taken in the Q1 and are expected in Q2?

Anant Goenka: Yes we took about approximately a 1.5% to 2% price increase in Q1 on an average across segments and we expect about at least a percentage price increase in Q2 based on what is visible right now. Let us see what happens we do not know the competitive environment maybe approximately at least 1% in Q2 also.

Jay Kale: Thanks and all the best Sir.

Moderator: Thank you. We will take the next question from the line of Asutosh Tiwari from Equirus Securities. Please go ahead.

Asutosh Tiwari: Sir last week, government notified its a new axle load norm how do you see that impact in the tyre industry per se?

Anant Goenka: I think what is going to happen is we expect there to be some sales pressure on the truck side, so commercial vehicles, the kind of growth it is showing is very high in the last say quarter and we expect that to continue but it will get tempered to a certain extent. So, while weight limit has increased by about 25% we think that the impact can be about maybe a 5%, 7% or 10% adverse impact on delta growth going forward. So, we expect OEM commercial vehicle sales to get impacted. The other is there can be some impact on tyre size of the future. So that's again something, which we are in touch with OEMs, we are not very clear exactly what will happen but as the weight increases your inch size will undergo some change so currently say the main size is 1020 that runs in the Indian market that can change to a slightly higher inch going forward.

- Asutosh Tiwari:** I think the axle load for single axle two-tyre load is now described at 7.5 tonnes so do we have these tyres available in India or we heard that only 6.9 tonne is the maximum that we can go into current tyres available in the market?
- Anant Goenka:** Yes most of the tyres are there, either they are getting exported or sold even in the Indian market now. There could be one or two sizes that may need to be tested which may cause about six months of testing time at least for that sales to start happening. I think that would be approximately an industry wide issue is what I feel.
- Asutosh Tiwari:** So even to say that it would take six months for the industry to come up with the tyres compliance to 7.5 tonnes rate?
- Anant Goenka:** Yes, so I think the impact that could happen is that you may just have to buy some moulds. So moulds will take some time to come in and may be one or two SKUs as I said will have to be tested in the new size.
- Asutosh Tiwari:** And so as and now the tyres are imported in India, or any NCPA supplying in India?
- Anant Goenka:** No currently, we supply all the tyres that are needed right. I am assuming that with the future need of the new axle weight that is going to happen, we expect there to be some changes in the rim size, that rim size as I said is something which is still not fully clear, we may have to increase the number of moulds that we have say for example if there is going to be a large shift from say 1020 to a 22.5 inch size etc., so that is something which is still fully not clear, but I say the capability is very much there for producing that new size.
- Asutosh Tiwari:** Sir lastly any impact of that on uses of bias or radial tyres?
- Anant Goenka:** Not really. I do not think there should be any impact on that.
- Asutosh Tiwari:** Thanks a lot.
- Moderator:** Thank you. We will take the next question from the line of Nishit Jalan from Kotak Securities. Please go ahead.
- Nishit Jalan:** Sir just to complete the previous question, in India do you see a chance of 10R20 size moving to 11R20 or to 295 in that sense.
- Anant Goenka:** That is what it is not very clear. We are not fully sure whether it could be either one of the two sizes you are right.
- Nishit Jalan:** What implications does it have on your capex plan for TBR as in you are in the stage of expanding your capacity so will you go so will the mould size increase and mould size and all lead to any capex increase meaningful capex increase in that sense?

Anant Goenka: No, I think mould in the big picture it is not very high percentage of cost. So in the end it is something that good inside the press of the tyre. So even if it goes up it could be having first of all in our case lot of the incoming mould is spread overtime. Getting new mould does not take too long it takes maybe couple of month's time for moulds to come in. So I am not sure exactly how we are exactly spread out the orders but say something was coming in, in March that change can also be done and total impact will not be much in the bigger picture as the 1000 Crores worth mould will be 10, 20 Crores kind of impact not more than that.

Nishit Jalan: Sir coming back to generally your performance across segments. In terms of pricing you mentioned that you have taken a 1.5% to 2% price increase, have you taken any price, have you been able to take any price increase in the two wheeler segment as well, because that is one segment where we have not seen much price increases over the last year or so.

Anant Goenka: Yes, so we have taken a small price increase as of the month of July in two-wheeler. So as of earlier this month we took an increase of about a percent or so in two-wheeler segment.

Nishit Jalan: In July you are saying?

Anant Goenka: Yes that is right.

Nishit Jalan: Sir on the debt side, if I look at your debt has come down consistently over the last. Even if I look at from March levels the debt is down to almost 120 Crores. While we are incurring capex so just wanted to understand how has the working capital requirement changed or you have done something to reduce the working capital requirement because that could be the only reason why the debt has come down by certain extent?

Anant Goenka: Yes so I think I leave that to our CFO because he has done that.

Kumar Subbiah: You are right we have managed to bring our working capital down and we have given of about 130 Crores or so in Q1. So that helped us to repay the debt and whatever cash that we were able to generate was more or less matching with the additional capex required, so we are able to achieve both in terms of ensuring capex requirement is met and also in bringing the capex debt levels to come down.

Nishit Jalan: Sir can you throw some more detail just to what has led to this working capital coming down which part of the working capital has come down and is it sustainable going ahead?

Kumar Subbiah: We have been focusing on working capital for over 15 months or so. So, if you had seen even last year you are able to bring our working capital down more or less same amount of about 140 Crores or so. Focus as far as Q1 is concerned was mainly on debtors and inventory. So, both of them contributed equally about 50, 60 Crores in raw material inventory as well as on receivables. I think the second question is it sustainable? A higher level of activity will always mean higher quantum of working capital in the normal course. So, we have been trying to front-load our capex through

our own internal accruals. So as part of that we could do it in Q1. We will continue to have close watch on working capital and try to make it very efficient. So our plan is to keep it closer to the current level. I think it may marginally go up, but we will try to keep it around current level.

Nishit Jalan: Sir why I asked this is because if you look at in terms of segments, you highlighted that OEM and export segments have grown much faster and I would tend to assume that your debtor days would probably be higher in these two segments more in the replacement segment and despite that you have shown such improvement so that is what I wanted to understand?

Kumar Subbiah: See the debtors came down, receivables came down more in replacement side but though OEM has grown but it is on a smaller base, so therefore that has not led to any significant increase in receivables during the quarter.

Nishit Jalan: Thank you.

Moderator: Thank you. We take the next question from the line of Aryn Pirani from Deutsche Bank. Please go ahead.

Aryn Pirani: Thanks for the opportunity. My first question is actually on the price hike on two-wheelers that you mentioned, which had happened actually after a very long time. So just wanted to get a sense is the competitive environment getting slightly more benign or is this unilateral decision that you have taken at your end?

Anant Goenka: No. It is unilateral decision that we have taken right now. We are seeing some buoyancy also in the market for two-wheeler tyres. So as of now it is a unilateral decision that we have taken.

Aryn Pirani: The price gap in competition would have increased even further because you were already at a premium if I am not wrong?

Anant Goenka: Yes.

Aryn Pirani: On your capex can you just remind me what is the capex, cash outlay that you plan for this year and how much have you already done in 1Q?

Kumar Subbiah: Approximately we estimate our capex to be around 1500 Crores during the year, the current financial year and in quarter one we incurred little lower 200 Crores of capex.

Aryn Pirani: So bulk of it is still over the next three quarters basically?

Kumar Subbiah: Yes true.

Aryn Pirani: Just lastly on your volume growth, you mentioned that even on the CV side, you have seen strong volume growth but you are also facing some constraints so is it because of the base that the growth

is looking strong in CV or is there some freeing up of capacity some debottlenecking that you have been able to do?

Anant Goenka: Sorry could you repeat the question?

Amyr Pirani: I was just asking that in the volume growth you did mentioned that part of it is also because of the strong growth in CVs, so in CVs since you are facing capacity constraints, is it because of the base that the growth is looking strong or you have been able to do some capacity debottlenecking which has led to the growth in CVs?

Anant Goenka: I think on the truck radial side there was hardly any space for further growth. It is on the truck bias side that there has been some space so that has been one thing that has helped and last year I think if you look on a year-on-year basis we were not fully utilized last year's same time, but on a quarter-on-quarter basis, I do not think there would have been a major shift in that sense. So in bias there is always a little bit of capacity that is there that is under-utilization.

Amyr Pirani: Just lastly on the passenger side, I think you had some delays in some machine commissioning, which was constraining your growth, is that behind us now where are we on that one.

Anant Goenka: No. I think we will need about a month and a half further. We were waiting for some installation of some imported robotic equipment and that has I think just come in it will take at least 25 days for commissioning and then just see how that works out but I think that should help resolve the issues. So we expect there to be some improvement say from middle of next month – yes say at least a month from now.

Amyr Pirani: Thanks for the opportunity.

Moderator: Thank you. We take the next question from the line of Ayushi Mota from CD Equisearch. Please go ahead.

Ayushi Mota: Good evening Sir. Sir what is the current capacity utilization on the Ambernath plant?

Anant Goenka: Ambernath plant is at a very early stage. It is still early stage of ramp up maybe at close to 25% kind of capacity utilization today 25% to 30% level.

Ayushi Mota: Sir capex now that could you just repeat it for 1000 Crores approximately?

Anant Goenka: Yes this year is about 1500 Crores.

Ayushi Mota: Thank you so much.

Moderator: Thank you. We will take the next question from the line of Bharat Gianani from Sharekhan. Please go ahead.

Bharat Gianani: Good evening Sir. Thank you for the opportunity. Sir just on the coming back on the axle load probably CV sales as you pointed out remain in a pressure till the new tyre norms are met so basically one on the OEM side, if the tyre upgrade would have or would happen like as you pointed out one of the two sizes may get approved so what is the kind of realization difference that is there in case we had tyre is approved and how much time it will take for actual commercial production to actually you start supply to the OEMs that would be my first question?

Anant Goenka: I think there should be no real major realization difference between these two on a per kg basis. Second thing is I would say that this transition time I say it is a little difficult to say if I would to hazard a guess maybe about three months' time or so, but I would still wait and watch and maybe give you an update in the next quarter.

Bharat Gianani: Sir realization per kg might not defer but what would be the weight difference like if one higher tyre is approved just roughly if you could?

Anant Goenka: As the weight detail but maybe I think about what is about 5, 6 kgs is more approximately but I can get back to you with that information. I do not have the accurate size of that.

Bharat Gianani: So 5 kgs would approximately mean about 10% of that so roughly around that. Sir my last question is that this increase in the axle load norms what could be the implications on the replacement demand because if higher overloading is allowed so what kind of impact implication will have been on replacement demand your reading on this thing would be really helpful?

Anant Goenka: These are very difficult questions to answer because we have to still wait and watch now on top of this loading will there be further overloading that will happen, how strongly is the government now going to enforce restrictions on overloading, some of these are state level issues so who will crack down, how will it work. I would still say that on the replacement side more difficult to say. There could be an adverse impact but how much and also if you look at the overall growth rates now if you look Q1, Q2 was relatively lower quarters. So on a year-on-year basis growth you still may see strong growth in Q1, Q2. Q3 I also think started to get quite good for the industry so again if you look at Q3 year-on-year growth of CV maybe relatively slower. So, it depends on your base there are too many factors that would influence to that extent the replacement impact of CV tyres.

Bharat Gianani: So you are saying because of the strict clampdown on overloading which might happen because the axle load norms are relaxed. So overall it could have a slightly adverse impact on the replacement demand going forward?

Anant Goenka: Yes it will have an adverse impact in my view but now how much is I am saying I cannot give an answer.

Bharat Gianani: Thanks sir and best of luck.

Moderator: Thank you. Next question is from the line of Tushar Sharma from UBS Securities. Please go ahead.

Sonal Gupta: Now just again a similar question. Just again in terms of the overall we have been seeing radialization happening in the replacement market also, but my understanding is that the bias tyres are probably more amenable to overloading. So, do we see these norms changes and increase if there was an increase for existing trucks and increase in axle load as well that the demand for bias could sort of go back up in that sense versus say radial, how would you think about the radialization on the replacement side?

Anant Goenka: I think less likely. The reason is that now we are all at least seven, eight years ago radial was a new technology, confidence of selling in overload segment at that time was lower. Now I say the industry is developing the right tyres for overload market and therefore the overloading hypothesis of bias being better is less applicable in today's terms. Also now when you are looking at new sizes getting developed whichever one it is I think there is more likely that the industry will do more development on the truck radial side because that is the future rather than investing in future development of truck bias. So I do not think it should reduce the pace of radialization.

Sonal Gupta: Thank you so much.

Moderator: Thank you. We take the next question from the line of Jinesh Gandhi from Motilal Oswal. Please go ahead.

Jinesh Gandhi: My question pertains to the OTR segment. So how has been our progress there? What is the feedback from customer which we are getting?

Anant Goenka: Yes on the OTR segment there are two parts I would like to talk about one is the traditional bias tyres that we have been selling. There our capacities have been stagnant for quite some time and therefore we are fully utilized on the capacity. We do not see too much growth potential out there, but there has been growth and we have at possibly maximum sales on that front. The other is the new plant that we setup in Ambernath. There capacity utilization as I shared was around 30% or so. So there, there is fair amount of headroom for growth. This growth I think will ramp up in the second half of the year because that is when season picks up and the other is that our tyre quality feedback has been very positive. I think that is a big positive. The other is that we need to quickly look at investing in the next phase of expansion because range becomes important. We have just have 35, 40 tonne per day kind of plant we are still do not have the adequate range so and now with the confidence of the products being there if we ramp up quickly to 100 tonnes per day, not ramp up, but do the project and reach 100 tonnes per day full capacity it will help in increasing our range and selling adequate numbers as well.

Jinesh Gandhi: So the 100 tonnes will happen in next 12 months or should slightly longer?

Anant Goenka: It will take about 18 months time. The project has not been started yet so we will hopefully kick that up sometime in Q3 and then about at least 12 months for that to be ready.

- Jinesh Gandhi:** In terms of the pricing of OTR products, how it is vis-à-vis our Indian competitors is it similar or at reasonable discount to them?
- Anant Goenka:** It is similar price. Sometime for testing you have to give a discount because very often they are new products, but over time they will stabilize to similar kind of levels.
- Jinesh Gandhi:** Secondly on the other expenses in this quarter we had seen a reasonable increase on our Q-o-Q and Y-o-Y basis particularly Q-o-Q if you see there has been a reasonable increase of about 110 basis points on Q-o-Q is there any one half there or this is a normalized run rate?
- Kumar Subbiah:** It is largely because of advertisement cost about 16 Crores of advertisement cost that we had incurred more in Q1 versus Q4 if we are looking at the number sequentially.
- Jinesh Gandhi:** Lastly in terms of the tax rate if I look at consolidated tax rate it is close to about 40%. How should we look at that, is that the rate at which we should be providing for tax or this will normalize?
- Kumar Subbiah:** See it is always good to look at tax rate on a standalone basis. At this point in time CEAT specialty business is still reporting losses because it is initial period and largely it is interest cost and depreciation cost. If you look at CEAT standalone for the quarter one it is marginally higher than the normal income tax rate because one is that cess on income tax had gone up during the last finance budget and we had to consider that on a deferred tax amount also which is more a onetime otherwise 34% kind of a tax rate on a standalone basis where could assumption to take.
- Jinesh Gandhi:** Thanks. I will come back in queue.
- Moderator:** Thank you. Next question is from the line of Basudeb Banerjee from Ambit Capital. Please go ahead.
- Basudeb Banerjee:** Thanks for taking my questions. Few aspects, one I missed out in the initial part of your call what was the quantum and time when you took the two-wheeler price hike?
- Anant Goenka:** Early part of July.
- Basudeb Banerjee:** And quantum Sir?
- Anant Goenka:** Around 1%.
- Basudeb Banerjee:** With the current juncture with rupee back at Rs.69 so what percentage of your natural rubber is now domestic sourcing and import sourcing?
- Kumar Subbiah:** It varies. We do not have any specific percentage, but when we buy from local source it is largely sheet rubber and block rubber we always import because it not produce in India; however, the percentage vary depending on availability and also what is the kind of cover that we would like to have.

- Basudeb Banerjee:** Yes, so definitely as your import or domestic sourcing varies significantly so just wanted to understand presently it is more domestic biased or import biased?
- Kumar Subbiah:** No see if I am domestically only buy sheet rubber we do not buy block rubber. Block rubber is not produced in India and therefore we do not buy, so the flexibility of buying from India local versus import arises only in sheet rubber, but we would not see significant various between months or quarters.
- Basudeb Banerjee:** Presently like where do you see the raw material basket positioned at because last quarter whatever crude derivatives increased and rupee weakness happened natural rubber was largely static. So what is your view on your raw material basket now for the coming couple of quarter as such?
- Kumar Subbiah:** Normally the raw material prices impact us with the lag of about two to three months and depending on our overall physical and total covers. Anant had responded to one of the earlier questions saying we expect raw material prices to move up anywhere between 2% and 3% in the current quarter versus quarter one based on current crude oil prices and currency rate.
- Basudeb Banerjee:** So slight lag effect of crude derivative is still pending in your overall numbers, which should get mitigated by the 1% price hike largely in the two-wheeler segment?
- Kumar Subbiah:** Yes, the lag effect would be there in Q2 and imports will happen at prevailing exchange rate etc.
- Basudeb Banerjee:** Thanks.
- Moderator:** Thank you. Ladies and gentlemen that seems to be the last question for today. As there are no further questions, I would like to hand the conference over to the management for their closing comments.
- Anant Goenka:** Thank you. Thank you everyone for your interest in CEAT and I look forward to see you once again and answering your question in Q2 in three months, time. Thank you so much.
- Moderator:** Thank you very much. Ladies and Gentlemen, on behalf of Motilal Oswal Securities Limited, we conclude today's conference. Thank you all for joining us. You may disconnect your lines now.