"CEAT Limited

Q2 FY '23 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the Q2 FY '23 Earnings Conference Call of CEAT Limited, hosted by Batlivala & Karani Securities India Private Limited. As a reminder, all participant lines will be in 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 star then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Annamalai Jayaraj from Batlivala & Karani Securities India Private Limited. Thank you, and over to you.

Annamalai Jayaraj: Thank you, Yashashree. Good afternoon, everyone. On behalf of B&K Securities, welcome to Q2 FY '23 post results conference call of CEAT Limited. I also take this opportunity to welcome the senior management team of CEAT Limited. We have with us today, Mr. Anant Goenka, Managing Director, and Mr. Kumar Subbiah, Chief Financial Officer. I will now invite Mr. Anant Goenka for his opening remarks. Also may I remind you of the Safe Harbor. The company may be making some forward-looking statements that has to be understood in conjunction with the uncertainty and the risk that the company takes. Over to you, sir.

Anant Goenka: Thank you, Mr. Jayaraj. Good afternoon, everyone, and a very warm welcome to CEAT's Q2 FY '23 earnings call. I'm Anant Goenka and I have with me our CFO, Mr. Kumar Subbiah on the call with us. I hope you all had a wonderful Diwali and a well rest during the festive season. As usual we start off with some brief remarks from me and Kumar, post which we can take up question and answers.

With respect to our sales performance, the demand environment has remained healthy carrying the momentum seen in quarter four FY '22 onwards. We were able to maintain our volumes achieved in quarter 1. On the replacement side, two-wheelers saw a moderate growth over quarter 1, PC/UV remained flat. Commercial volumes were seasonally a little bit weak, which was the same for tractor tyres as well.

On the OEM side, the two-wheelers continued to see some growth, while passenger car and commercial volumes were flattish. And on the export side, volumes were impacted by macro headwinds, especially in our traditional geographies. We were able to sustain momentum in Europe and US, driven by some new launches and channel addition. However, overall international business volume saw some minor dip over the previous quarter. Overall, volumes for quarter 2 were lower by about 1.5% on a quarter-on-quarter basis and grew by 7% on a year-on-year basis.

Going forward, in terms of outlook, domestic demand situation looks steady. As reflected by two-wheeler, vehicle demand and other consumption data, there is a pickup in rural sentiment. Abnormal rain may impact the Kharif output. The Rabi season is expected to be promising with improved water availability. Agri output prices have been on the higher side, so hopefully rural cash flows should improve further over the next few quarters.

Export demand may stay volatile for a few more quarters given the geopolitical uncertainties and weakening macroeconomic situation around inflation and recession fears across geographies. From a near-term perspective, quarter 3 would be the fourth normal quarter vis-a-vis COVID-related disruptions. So we are expecting routine seasonality to play out more prominently from now on.

On the cost front, we witnessed a commodity basket inflation of about 4% over quarter 1, marginally higher than our guidance. We were able to take adequate price increases, which covered for the raw material inflation during the quarter, and therefore expanded gross margin by about 80 basis points.

On the back of slightly higher revenues and similar operating costs, our standalone EBITDA margin expanded by 127 basis points over quarter 1 to reach 7.1%. Prices of base commodities like crude and natural rubber has been softening over the last few months that the benefit of which should start creeping in from the second half of quarter 3. We expect raw material basket for quarter 3 to decline by about 2.5% to 3% over quarter 2.

As indicated previously, we are tightly monitoring our capex and cash flows. Barring off-highway tyre segment, we believe we have sufficient capacities across product categories. The guidance for FY '23 project capex remains at INR750 crores, which we will review during Q3. Our current off-highway tyre expansion remains as per plan. The off-highway radial capacity at our Ambernath plant has reached 80 tons per day, which will further increase to 105 tons per day by mid-'24. We are also converting about 18 tons per day of truck bias capacity in our Bhandup plant to off-highway tyre bias. We have taken Board approval for adding another 55 tons per day radial capacity in our Ambernath plant over the next two years, which would come at a cost of about INR 395 crores. We will trigger the same based on the demand situation. Once implemented, our total off-highway radial capacity will reach 160 tons per day. The off-highway tyre category is a strategically important category for us and we are confident of generating the desired EBITDA margin and ROCE from this capex.

We successfully launched our EV tyre platforms across product categories like EnergyDrive EV for passenger car and UV tyres, EnergyRide for two-wheelers and WinEnergy for truck and bus segments. Many of these were the first in the Indian tyre industry. These platforms will also help sharpen our position as a leader in EV tyres and expand our market share.

We also rolled out our new SecuraDrive campaign for digital and mass media with the theme, Stay Ready for Rockstars on the Road. We are present on high impact properties like Kapil Sharma Show and Indian Idol with this campaign. Our previous campaign, which was called Switch to SecuraDrive, recently won International Advertising Association India Chapter Award in the auto and auto ancillary category.

We continue to remain committed to ensuring that our tyres provide maximum energy efficiency from an environment perspective. As a step forward, with our focus on sustainability, we have started energy certification of our tyres and initial set of each product in PCUV and TBR categories have received five-star rating from the Bureau of Energy Efficiency.

In H1 FY '23, about 22% of our local rubber requirement has been sourced via alternate transport, which has a lower carbon footprint. We plan to continue and build on this aspect of an environment-friendly supply chain. Though the tyre sector has seen unprecedented margin compression since the last seven quarters, we are beginning to see some green shoots now. We expect the commodity situation will remain a little benign and demand remains healthy in the coming months, resulting into quick and sustainable some amount of margin recovery. From a longer-term perspective, we have created multiple levers like scale, premiumization, growth in high-margin categories, a check on costs to achieve robust profitable growth.

With this, I hand over the call to our CFO, Kumar.

Kumar Subbiah: Thank you, Anant. Good afternoon, ladies and gentlemen, and thank you for joining our Q2 earnings call. I'll share some further financial data points with you all, post which we can enter the Q&A session.

First, as regards to our revenue, our consolidated net revenue for the quarter stood at INR 2,894 crores, a sequential growth of about 3%, which were largely driven by price growth and year-on-year growth of about 18%, which has a mix of both price growth as well as volume growth. As regards to our gross margin, during the quarter, the gross margin moved up by 80 basis points and our blended raw material cost went up by approximately 4% largely neutralized by price increase taken during the course of the quarter. The inflation was largely driven by increase in crude derivatives and natural rubber prices, both of them have cooled off since last few months. Some of the crude derivatives and chemicals are still holding up under correcting with a lag. We expect our overall RM cost basket to go down by 2.5% to 3% in quarter 3 over quarter 2.

Currency movement, however, has been adverse and is diluting the benefit from cost correction, since many of our inputs are pegged to US dollars. US dollars has gone up by almost 7.5% year-to-date. Due to recession fears, commodity prices may remain subdued in the near term, but currency may still have an adverse impact should the rupee continue to depreciate. We are monitoring the situation closely and taking necessary corrective actions.

Now coming to debt, our capital expenditure and working capital, we spent INR 205 crores on capex, including projects as well as routine during the quarter. And our working capital during the quarter went up by approximately INR 170 crores, sequentially due to higher inventory values. Overall, our net debt increased by about INR 163 crores in quarter 2 compared to end of quarter 1. We are keeping a close watch on our debt situation, which is still near our internal thresholds. We expect our debt to increase further in quarter 3 and quarter 4. However, as margins and cash flows improve, reasonable portion of our capex will come from internal accruals and hence incremental debt requirement will progressively come down.

As regards to our operational expenses and EBITDA, we had been working continuously on multiple cost optimization measures since last several quarters. Some are them have started yielding results. Despite inflationary pressures across the board, we have been able to contain our operating costs as a percentage of sales in quarter 2, in line with the previous quarters. And that has helped in terms of margin expansion. Our consolidated EBITDA stood at INR 204 crores during the quarter with a margin of about 7% and about 96 basis points over the previous quarter.

As part of our exercise to make our older factories cost competitive, we incurred about INR 23 crores towards VRS to our employees in our older factories. Our depreciation was similar to the last quarter. Our interest cost went up by about 11% during the quarter due to higher debt and also due to increase in the interest rates.

As part of our annual review of credit rating, our credit rating agency India Ratings affirmed the AA with stable outlook for long term and A1-Plus for short-term. We're also happy to share with you that Government of Madhya Pradesh awarded the best GST compliance company award to CEAT for the year 2021-2022. The Honorable Chief Minister handed the certificate and cash award of INR 12 lakhs to our taxation team last Friday.

With that, I conclude. We can now open the floor for Q&A.

Moderator: [Operator Instructions]. We have our first question from the line of Ashutosh Tiwari from Equirus Securities.

Ashutosh Tiwari: Firstly, you mentioned that obviously in the second quarter, truck demand was sluggish quarter-on-quarter, but that was seasonality. But how are things looking up in October month and all, is the truck improving Y-o-Y now?

Anant Goenka: Yes, truck demand looks to be okay. I'd say that there were some challenges in international business on trucks. We did see some slowdown. In Indonesia market quota continues to be a challenge, also in some areas around the subcontinent and that has caused a larger impact on truck demand for us, more than domestic. Domestically, demand seems to be relatively okay, on the truck side.

Ashutosh Tiwari: Is demand growing Y-o-Y? Like say, October month in truck particularly?

Anant Goenka: Yes. October was relatively a soft month because of festive activities. We are back to normal from beginning of November onwards.

Ashutosh Tiwari: Okay. And in exports you mentioned Indonesia, you've got the markets like Europe and all which are build over last few years. Are they still growing for us Y-o-Y?

Anant Goenka: So currently we are seeing some recessionary pressure. Year-on-year, I think we are seeing positive growth, but quarter-on-quarter there is a slowdown with respect to European markets.

Ashutosh Tiwari: And on the RM side, you mentioned 2.5% to 3% decline would happen in this quarter. But in terms of price increases, how much we will take in last quarter and then I think some of the price increases were not effective over the full quarter, that impact also should come through in this quarter, right?

Anant Goenka: We've taken a effective price increase of about 4% in the quarter and we expect to take maybe another 1% or so between October, November of quarter 3 on an average across the board.

Ashutosh Tiwari: And this price increase of 4%, when it was last taken in Q2?

Anant Goenka: These were spread out. Between July, August, September, it was quite spread out. The largest price increase we took was of motorcycle, scooter in replacement of about 8% to 9% early August. That would have had the largest impact. The balance would be the routine anywhere between 1% to 2% in other categories.

Ashutosh Tiwari: And lastly on this capex that you announced INR 395 crores basically for off-road. So are you going to implement it right away from, let's say, recent times or it will take call and do the capex as then when required?

Anant Goenka: So there may be certain machinery, which will be very long lead time. Some amount of advances and payouts will happen I think in the next three months for that. But most of the expense will come in next year. If we decide to go ahead, there is a little bit of question mark on Europe at this point of time.

So by the time the plant comes up, and it will not be before April '24. So, that's when we hope even Europe bounces back to normalcy or it will happen soon after that. And then the ramp-up and all also takes a few months. We are trying to see how to marry the two in terms of EU and the recession coming to an end and being able to have the capacity ready as well.

Moderator: We have our next question from the line of Jinesh Gandhi from Motilal Oswal Financial Services Limited.

Jinesh Gandhi: My question pertains to the volume growth of 7% Y-o-Y, which we saw in second quarter. Can you break them down between replacement and OEM for 2Q and Y-o-Y basis how it came down?

Anant Goenka: Yes. So, our largest growth has come on the OEM side. Largely export and replacement both have been relatively flattish, whereas the balance growth has come mostly from the OEM side. So 20%-plus growth on OEM year-on-year basis.

Jinesh Gandhi: Okay. And do you expect this flattish trend in replacement to continue given that base is normal for last year and primarily overall trend, I mean overall inflationary impact will also be seen in coming quarters in the domestic market. So on replacement side, do you expect flattish trend or maybe expect Y-o-Y growth here?

Anant Goenka: So there will be a value growth certainly. On volume terms, we expect at least on a quarter-on-quarter, things to be growing positively. Monsoon time, our Q2 anyways is a slightly weaker quarter for us. So things should get better in quarter 3 and quarter 4, not substantially maybe, 200 basis points to 300 basis points improvement from quarter 2.

Jinesh Gandhi: So which effectively will mean on Y-o-Y basis, it could be more or less flattish?

Anant Goenka: Similar, yes, slight growth or flattish, yes. Year-on-year for the quarter. I don't have much colour on quarter 3 of last year, but quarter-on-quarter is easier to share.

Jinesh Gandhi: And considering reduction in commodity prices, would it be fair to say that the price increases which we will be taking in November and October, primarily in third quarter, post that we don't need to take any material price increase and more or less, I mean, we'll be done with the under recovery as well?

Anant Goenka: So currently we don't see a price increase opportunity coming up besides, as I said, maybe 1% to 2% in certain categories only, but beyond that, which we expect to take in quarter 3, beyond that nothing else at this point.

Jinesh Gandhi: And lastly, can you share the utilization levels for two-wheelers this year in our truck and bus radial?

Anant Goenka: Yes, utilization is somewhere between 75% and 80% on an average. Most of the under-utilization is on the truck and bus bias kind of areas, but we are at about 70% to 80% in PCUV and two-wheeler, because we still have upside in Chennai, and two-wheeler also we still have about a 20% upside in terms of growth.

Jinesh Gandhi: And TBR would be between 80%, 85% or higher than that?

Anant Goenka: Similar, about 75% to 80%.

Jinesh Gandhi: 75% to 80%. Okay. So at least in the foreseeable future, we don't need to go back to our deferred capex on TBR side?

Anant Goenka: No, we don't need to.

Moderator: We have our next question from the line of Rishi Vora from Kotak Securities.

Rishi Vora: Sir, first bit on the other expenses standalone. I recollect that last quarter expenses were higher mainly on account of higher marketing expense due to IPL. Still on a sequential basis, volumes are -- our other expenses is still further up, assuming that marketing expense for the quarter would have come down. So is there any other inflationary pressures we're seeing on other expenses that if you could highlight it, that would be helpful?

Anant Goenka: See, largely the increase, on a sequential basis, increase in other expenses was on account of increase in power and fuel cost. And our outsourcing volume was little higher in quarter 2 vis-a-vis quarter 1. Okay. So therefore that led to increase in the expenses. Otherwise, it was more or less in line.

Rishi Vora: You expect it to -- the outsourcing volume to normalize in third quarter?

Anant Goenka: Yes.

Rishi Vora: And my second question is, sir, how do you expect competitive intensity now to pan-out given that we are seeing deflationary pressures across RM basket. So you expect to retain most of the benefits or how is the competition reacting to it in November or maybe what do you expect going forward or will there be some price cuts that can come through if there is a, let's say, little bit of slowdown in the replacement segment?

Anant Goenka: It is difficult to give an answer here. I would say that currently margins are still not at desirable levels. So clearly there is no desire to take any price cut. But if there is something that, I mean if there is a competitive action, we may have to respond. It depends on our strength on that category. So very difficult to give an answer. But I think there is still, margins are far from where they should be. So we are still playing a catch-up game which needs to fully reach a certain level of margin.

Rishi Vora: Sir, our last question on debt front. You highlighted that you expect debt levels to go up in third and fourth quarter. Obviously, we'll see operating performance of the company will improve. So do you expect capex spends to increase materially in second half

Kumar Subbiah: Our capex guidance at the beginning of the year for the current year was about INR 900 crores, INR 750 crores of project and INR 150 crores approximately of normal maintenance capex. In the first six months, we have spent INR 450 crores. And we continue to hold that capex forecast for the current full year, which would be another INR 450 crores will be spent in the second half. So it needs to be funded. So our operating cash flow is lower than that level. However, it will depend on our performance in the next six months. And therefore the gap between operational cash flow and the capex required will translate to debt increase. I think that's what we meant.

Moderator: We have our next question from the line of Nishit Jalan from Axis Capital.

Nishit Jalan: So the first question is on the RM cost side. We have seen a good 20% kind of a reduction in natural rubber prices, right. So just wanted to understand why are we seeing only 2.5%, 3% benefit on the RM cost per kg. Is there any other commodities where we're seeing higher inflation? And what is the trend that you are seeing in synthetic rubber because we are seeing crude and rubber moving in different directions. Just wanted to understand how are synthetic rubber prices reacting to that?

Kumar Subbiah: In general, our RM cost, okay, both increase as well as reduction gets reflected in our books with a lag of about three months, because we hold inventory, we have some both finished goods inventory, as well as RM inventory and we also have covers. So therefore, we expect the RM cost reduction to flow progressively month-on-month and as far as natural rubber is concerned, the international prices have come down close to the number that you have indicated. This is also partly impacted on account of currency depreciation. So currency in the beginning of the current financial year was closer towards INR 75, today it is about INR 83.

So that has also taken away some part of the benefit. And in the local market, natural rubber prices have moved down from INR 170, INR 172 level to around INR 150 per kg level. So it's about 12%, 13% kind of an impact. So this is flowing through, but progressively month-on-month. So as far as the current quarter is concerned, we expect the impact to be around the range that we had indicated.

In case of synthetic rubber prices, also we are seeing correction but correction with a lag. If crude drops, then butadiene drops, then the synthetic rubber drops, then after that we get that benefit. So there is a lag there as well. We have seen a drop in the synthetic rubber prices also in the double digits anywhere between 12% and 15% in the last two, three months. And that benefit will also flow through, subject to after adjusting for the currency impact, because even when we buy synthetic rubber from the local suppliers, it is an import parity kind of a pricing. So therefore, depreciation of rupee will have an impact on the delivered cost. So we have considered all of that, while giving the RM cost guidance for the current quarter.

Nishit Jalan: Just to clarify, this 12% to 15% fall in synthetic rubber prices is in INR terms, right?

Kumar Subbiah: Yes. In case of synthetic rubber, yes, approximately 12% would be the INR term.

Nishit Jalan: Sir, just wanted to understand your thoughts, you would be interacting with lot of rubber suppliers, and generally you have a good sense. What according to you is the reason why rubber prices are softening the way it is. We are not seeing this kind of a trend in other commodities. Do you think China demand has a big role to play in this? And when China start recovering, rubber prices starts going up or do you think that it's a downtrend which can sustain for a slightly longer period of time? Just your thoughts based on your understanding, your interaction with experts, how do you see that panning out?

Kumar Subbiah: As far as natural rubber is concerned, we are broadly in agreement with what you said. Chinese demand actually influences the prices of natural rubber. So therefore lower demand from China is the reason for drop in the international prices of natural rubber. So in case of synthetic rubber, it's a combination of both overall global macroeconomic factors as well as crude. So both of them influence, natural rubber, it is largely because of lower Chinese demand.

Nishit Jalan: Sir, one last question on the balance sheet side. If I look at your payables, your payables are almost 80 days of sales and maybe about 120 days, 130 days of RM cost, which seems to be on the higher side, right, four months payables. So just wanted to understand why is that -- are you looking to do some funding from payables. So that your debt doesn't go up or this is the normal and this kind of a credit period you're getting from your suppliers because four-month of credit period from suppliers look a bit on the higher side?

Kumar Subbiah: No, it's a combination of both imports as well as local and most of our local purchases are closer to about anywhere in the range of 75 to 90 days. That is a kind of a credit period that we have with local suppliers. And in case of international, it could be, it is even higher than that 120 days, 150 days is also possible. Sometimes vendors, we do have a vendor discounting schemes, particularly for priority sector suppliers, they're able to borrow at lower rate of interest, say for example, natural rubber, where the credit period can be even higher. So it's a combination of all three.

Moderator: We have our next question from the line of Mitul Shah from Reliance Securities.

Mitul Shah: Sir, one clarification on raw material basket indication of 2.5% to 3% reduction. In that assumption are we assuming exchange rate at current level of INR 80 to INR 83 or what was your assumption for that?

Kumar Subbiah: No, we have assumed at current exchange rate of INR 82.50 to INR 83.

Mitul Shah: And second thing, sir, you highlighted that outsourcing increased, so that's why other expense has gone up. But -- increase outsourcing then wouldn't that be a part of the raw material cost or you sector it in other expenses, how it works?

Kumar Subbiah: See, outsourcing our arrangement is on conversion basis. So therefore raw material cost stays in our books, it's only the cost of outsourcing that goes there. But overall, if you really look at all our other expenses, the increase is very marginal from INR 553 crores to about INR 565 crores. The question was why has it gone up. I indicated that as one of the reasons where the quantum of increase even on outsourcing was marginal. And entire outsourcing cost comes as other expenses and the raw material goes as raw material costs in our books.

Mitul Shah: Sir, one broader question, in terms of product life cycle. How it has stepped up in last two, three years after this improvement in quality, reduced friction, etcetera, for various categories or overall what it was three, four years ago and what it is now for overall lifecycle of the products tyre?

Anant Goenka: There has not been a dramatic shift in overall life cycle of the product. What's happened is that customers over the years have become more and more nuanced for which we have launched various platforms. For example, you have a long life platform, which is our mileage tyre. That certainly offers a much longer life than, say, that was in the past. Similarly, you have high grip or you will have electric vehicle platform, you'll have a comfort for a more premium platform. So each of those have different offerings. And that has changed to that extent.

But I would say, where life has changed is particularly in our long life platform where we have continuously invested in increasing life, which will be largely say for the taxi segment or other commercial vehicle segments that are there.

Mitul Shah: So overall, on a broader basis, there is no major change or no major increase in terms of number of months. So replacement cycle remains broadly similar, right?

Anant Goenka: Largely similar. Yes.

Mitul Shah: So last question. Sir, on replacement side, do you expect any of the segment which can grow high-single digit or close to double digit kind of number in next six months? You indicated some improvement, but any of the segment where do you see more promising volumes?

Anant Goenka: Yes. I think passenger car segment we're doing well. We've seen continuous market share increase as well as growth out there. So we are quite excited about that space. OEM, there has been large demand across. So on a year-on-year basis, OEM will continue to do well. Off-highway tyre segment also has seen 30% plus kind of growth level. So that too is continuing to do well. So these are some segments that stand-out. Quarter-on-quarter basis, two, three-wheeler also has relatively stood out. So these are the four or five categories, which we feel quite optimistic about.

Moderator: We have our next question from the line of Chirag Shah from Nuvama.

Chirag Shah: Anant, first question is on the price hike of 8%, 9% that you indicated for two-wheelers, right? Did I hear it correct?

Anant Goenka: That's right.

Chirag Shah: It's a very strong price hike that you have taken. Is it an industrial-phenomena or you were able to push the envelope for yourselves?

Anant Goenka: So I believe, one or two players in the industry did take approximate price hike of a similar nature, not everyone. So I'd say that it is kind of mixed with what I understood from the intelligence in the market. But on the other hand, if you look at the last say 12 months, all other categories have seen continuous price hikes of 2%, 3% every quarter, whereas two-wheeler did not see it. So it was overdue on the two-wheeler side and it just happened to happen in a single shot.

Chirag Shah: But what gave you the confidence to take such a price hike because if you're taking 1%, 2% high every quarter is a different thing than taking a three-quarter hike in one go is a very big thing, sir. What gives you confidence, the demand is so strong, but the price will be exempt, therefore more from your own cost sheet perspective it was done with the risk that demand can surprise negatively?

Anant Goenka: No, it was a mix of competitor actions as well as an overdue where margins had come under pressure. So we felt that this was something that could be done.

Chirag Shah: And you were able to hold on the prices, right. There is no pushback coming from dealers with respect to acceptance?

Anant Goenka: Not yet. There could be a push back of about 1%, 1.5% -- 1% or so that could happen in the month of November.

Chirag Shah: Second question was on RMC. If I understood, there is an average 15% kind of a reduction in the RMC basket in general. So Q4 the benefit could be far bigger than Q3 that you've indicated. Would it be right because 15%, 60% of 15% is around 8%, 9% kind of RMC benefit that we expect assuming other things being constant. There is no major upward move in currency or RMC basket. Could we expect Q4 a much bigger number?

Kumar Subbiah: Beginning of quarter four, January should be better. We had largely covered for next three months from today. We would like to wait and then respond to this because the commodity prices can bounce back very quickly and crude also went below $90, stayed at $85, $86, I am talking about Brent. Now, it's largely moving in a range of $95 to $100. So these things will do have an impact. Some of our raw materials, you agree a price for a quarter. So therefore, I think, in terms of trend, quarter four should be lower than quarter three, but I think closer to quarter four is when I think we would be able to provide more clarity.

So even in the current quarter also we expect December prices to be lower than November and November to be lower than October progressively. And as we could also see in terms of what our January month prices could be, January could also be little less than December. That is a trend that we're seeing for the next three months, including current month. For whole of quarter four, we would be able to comment closer to that period.

Chirag Shah: Yes. Last question, if I can ask is, on the import side given that the international freight rates have cooled-off significantly now, any threats that you have seen off-late with imports sort of going up in the system?

Kumar Subbiah: Raw material cost impact when earlier someone asked that question, actually we responded based on the delivered cost basis. On import basis, approximately about $40, $50 per ton kind of a freight rate correction that we have seen in the last three months. For us, we were also impacted because of shorter transit times. We ended up actually with little more inventory as of end September, while our total covers were lower.

Would there be any threat on account of freight? I don't think so. Even today as we speak, the local, for example, local natural rubber prices are higher than input prices. And normally based on whether the requirement is short-term or long-term. So for a short-term, that arbitrage between the two different sources can always exist.

But we don't expect any impact on account of lower input freight or ocean freight to have in terms of flow of materials from other sources. We expect the local prices to get corrected automatically based on the delivered cost, which include the freight cost element also.

Chirag Shah: Sir, I was also referring to finished goods imports. Our tyre imports factors to move up or inch up are expected because there are some indications where imports could start coming back to some extent. Any colour where we are getting from them?

Anant Goenka: There has been some increase in imports from Thailand. There has also been some wrong classification of tyres that we do see happening, where there are used tyres coming in, but they are actually fresh. So those are some pointers, but I would say not enough necessarily to move the needle or worry us about.

Chirag Shah: And this will be largely in trucks, right, not in PCR or two-wheeler?

Anant Goenka: Yes, more in trucks. I believe, there is an anti-dumping duty on trucks, but despite that there is some tyres coming in.

Chirag Shah: And last housekeeping one, FY24 capex, how should we look at it? It would be lower than this year capex or significantly lower because large part of your capex program except for OSPR would be likely to be done?

Anant Goenka: Yes. So we go through annual planning exercise in December. After that, we will be freezing into the capex, so maybe by Jan quarter we will give you some clarity on capex for the following years.

Chirag Shah: But directionally, would it be lower than this INR 950 crores, INR1,000 crores that you've been doing over last year?

Anant Goenka: Yes, it will be lower than INR 950 crores, INR 1,000 crores capex versus the past.

Moderator: Thank you. We have our next question from the line of Siddhartha Bera from Nomura. Please go ahead.

Siddhartha Bera: Sir, first question on the mix, which you had shared for the half of the year. So we have seen that OE mix has gone up quite substantially from 21%, 23%, 24% to 29%. But on the margin side, we have maintained or improved even sequentially. So how to read this, is this impact getting offset by the higher mix of PCR or quarter-on-quarter there is not much difference in terms of the mix?

Anant Goenka: Sorry, I didn't get your question clearly. One is you said OE is increasing higher than other categories, other markets, and after that.

Siddhartha Bera: OEM is still going up over the quarters, but margins have largely been maintained. So is the negative impact of higher OEM is getting offset by some other category or nothing more to read across here?

Anant Goenka: So OE certainly is having an impact on mix and therefore adversely affecting realization. But on the other hand, there are so many other factors that play with respect to price increases, so much catch up that has to be done. Also category mix does have a role to a certain extent. There's not been a dramatic shift in category mix at an overall level, just the way like OE have seen a substantial shift, here we've seen a larger sale on off-highway tyres and some amount in PCUV which is slightly higher margin, but clearly there has been some adverse impact because of higher OE sales. We are not seeing it because there are so many other factors at play.

Siddhartha Bera: And second on this employee side. So if we look at the costs, so when we were doing, say probably INR 2,000 crore topline, we used to be at about INR 180 crores and now at close to INR 2,800 crore topline, we are at about INR 160 crore in terms of employee cost. So how to look at this, VRS we have been paying off for quite some time. So is that having an impact? And when can we expect the costs again to go up because of the new capacities and plans we are adding?

Kumar Subbiah: Right. So on VRS, we did incur a VRS in this quarter. And to that extent that is reflected below EBITDA level. That will have a marginal impact maybe on employee cost going forward. But overall, July onwards also you have your increment cycles also. There will be normalized increase in employee cost from quarter three versus the previous quarter.

Siddhartha Bera: Will there be increase to sort of come through the second half?

Kumar Subbiah: Yes, there will be.

Moderator: We have our next question from the line of Navin Matta from Mahindra Manulife.

Navin Matta: One question. I wanted to understand on the export side. You've mentioned in your presentation that EU and Americas are focus areas going forward. So are you seeing any significant opportunity especially as we look at the cars that we enjoy on the power and fuel side, especially?

Anant Goenka: Yes. So we'll have to look at it at a category level. In the US, we only sell off-highway tyres at this point of time. So that category is going strong and we have continued to be optimistic about US sales in off-highway. EU also, we expect to see some headwinds. We are seeing some stresses. But we're being able to maintain our sales growth and maintain our own internal budgeted numbers.

So off-highway tyre, we continue to be optimistic about. It is largely in the passenger car segment we are beginning to see some slowdown. To me, overall we expect to see some pressure in EU going forward. The worst is yet to come of the recession as per economists. So let's just wait and watch what will happen. On the other side, we continue to expand our range. We launched some TBR tyres in EU. So hopefully, limited impact. The other is that people may trade down from the premium players to value players, and therefore the overall impact maybe a little bit lesser on us. But I'd still say growth overall will slow down because of recession.

Navin Matta: As you mentioned, let's say, the shift down to value players from premium players. Is that a sizable opportunity not now maybe over a two, three year period or you think it's just transitionary so people will not make too large changes in terms of their overall supply chain.

Anant Goenka: No, I think this is a large chain that has been going on for years. So seven, eight years, there has been a clear shift. The value that we offer to the customers are very high in comparison to the price versus say the larger or the premium players. So to that extent, this is a continuous trend that we see happening in the longer term.

Moderator: We have our next question from the line of Disha Sheth from Anvil PMS.

Disha Sheth: Yes. Wanted to check that since we took 8% to 9% price hike increase in two-wheeler, are we seeing that high growth in two-wheeler because of which we are able to take such a big price hike?

Kumar Subbiah: As I shared that there was a large pending price hike, we have not taken any price hike or very limited maybe 1%, 2% in the last year, year-and-a-half when raw materials has gone up by about 25%, 30% plus kind of levels. So to that extent, there was a large amount of price hike pending, which we were able to take at this point of time. Margins had gone down to a relatively lower level. So it was that as well as competitive action that prompted us to be able to take that price increase.

Disha Sheth: So it is more from the margin perspective than demand perspective?

Kumar Subbiah: That's right. But demand also is beginning to get a little bit better. So we've seen despite price increases, we saw a quarter-on-quarter growth in replacement and in OEM segment in two-wheelers, in volume terms.

Disha Sheth: In terms of volume, okay. And sir, in terms of just category-wise, you mentioned that commercial and tractor are still weak or do we see signs of improvement, because they were weak for some monsoon reason, now is it picking on?

Kumar Subbiah: Yes. So I think tractors hopefully should get better or tractor particularly saw a slowdown in replacement segment in this quarter. But monsoon having gone up well, we are hoping that tractors picks up. Truck is anyways a relatively lean season. So again, by post-Diwali season with good collections and money coming into the fleets' hands, things should hopefully get better here as well.

Disha Sheth: Then PCR, both OEM and replacement momentum should continue hopefully?

Kumar Subbiah: Yes. That's true.

Moderator: We have our next question from the line of Nishit Jalan from Axis Capital.

Nishit Jalan: Sir, just one follow-up. You talked about imports. So government had put a tyre imports under restricted category. So is there a change to that? Just wondering how our imports coming from Thailand and all these places you mentioned, it's not meaningful, but we have started to see some. Are they able to bypass the restrictions or government has eased off some restrictions in certain categories?

Anant Goenka: Yes, I think one is that by restricted categories, I think importers have to apply for a license to import the tyres, which is not that imports are zero, there are imports coming in. There are tyres coming in from Thailand. I think there is an anti-dumping duty from China. And therefore, Thailand imports have gone up. Yes, these are the two and then there is some amount of misclassification what we understand happens where new tyres are coming in as used tyres.

Nishit Jalan: But according to you, it's still not meaningful and not impacting the pricing power that we have in the market, right?

Anant Goenka: That's right.

Moderator: Thank you. As there are no further questions, I now hand the conference over to management for closing remarks. Over to you, sir.

Anant Goenka: So thank you to B&K for hosting the call and thank you everyone for your time and interest in CEAT. Look forward to meeting you once again same time next quarter. All the best.

Moderator: Thank you. On behalf of Batlivala & Karani Securities, that concludes this conference. Thank you for joining us and you may now disconnect your lines.