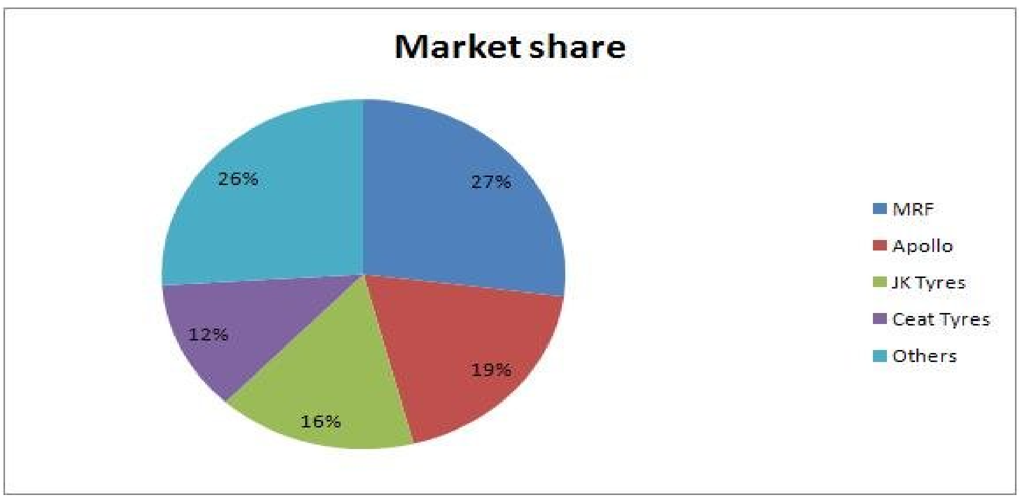
Sector Outlook - Tyre

Indian Tyre industry to benefit from improving auto demand, lower raw material costs

May 7, 2015

The Indian tyre industry has been witnessing tremendous growth for the past few years on account of growth in automobiles demand, especially in passenger vehicles and two-wheeler segments. In fact, availability of raw material (natural rubber) and ultramodern production facilities has led the country to emerge as one of the world's most competitive tyre markets. Driven by the strong demand in automobile OEM sector and replacement market, the India tyre industry has been witnessing stupendous growth from since the last two fiscal years. India's market for radial tyres in commercial vehicles section is still in its infancy. The passenger car segment switched to radial tyres in a short period of time, with radial tyre penetration level for the category reaching 100%. However, penetration level of radial tyre has also started to increase rapidly in the light commercial vehicles and truck & bus segment. This segment will be the largest growth area over the next few years.

The tyre companies are looking for overseas plantation of rubber to meet their raw materials need which will help the companies to acquire raw material at cheaper prices. Further, tubeless tyres are gaining ground in Indian market as almost all the automobile manufacturers are launching their vehicles with tubeless tyres. This shows that tubeless tyre market has tremendous growth opportunity in the coming years. Moreover, top tyre companies in Indian such as MRF, Apollo tyres, JK tyres, Ceat have strong hold in the market, however they face immense competition from global tyre companies such Bridgestone, Goodyear etc. to sell their products in the Indian markets. The Indian MNCs too have set up units in various overseas countries and some like Apollo Tyres are even acquiring companies there.



Domestic tyre demand

Following a 2% de-growth in 2012-13 and a muted 0-1% growth in 2013-14, domestic tyre demand is expected to grow by 6-8% during 2014-15 driven by a 5-6% growth in the OEM segment and 6-7% growth in the replacement segment. M&HCV, Scooters, Motorcycles and Passenger vehicles are likely to support the growth while negative growth is expected from tractor and LCVs segments. In tonnage terms, a growth 3-4% is expected for FY15 due to the higher skew of product mix towards the smaller 2w, but higher tonnage growth is expected for 2015-16 contributed by M&HCV and MCE segments.

Import

In a major development, in January 2015, the US Commerce Department's International Trade Administration levied preliminary ADD on Chinese tyres in the US market - duty rates varying between 19.17% and 87.99%. Incidentally, the US anti-dumping duty on Chinese tyres has led to the Chinese tyremakers dumping some stocks in India, causing a 15 per cent surge in tyre imports in the first half of FY15. Representation from Automotive Tyre Manufacturers' Association (ATMA) to the Government of India (GoI) continues towards increasing the customs duty on tyres from 10% at present to 20% as the industry remain affected by the inverted duty structure.

Export

The export market is showing signs of life after decelerating in the past two-and-a-half years due to relatively subdued demand conditions in the overseas markets. The Indian tyre industry exports to some 65 countries, but global economic slowdown stymied the growth in this past few years. For the period, April to November 2014, tyre exports (value) from India saw a modest 3.6% YoY growth; this follows a 7.3% YoY growth achieved in 2013-14 although this growth was primarily supported by the depreciating rupee. Meanwhile, exports are projected to grow 4-6 per cent in FY15 and a little faster thereafter as US' decision to slap anti-dumping duty on cheaper Chinese tyres have created opportunities for Indian tyremakers. But what has created an opportunity overseas is translating into a big threat for the industry back home.

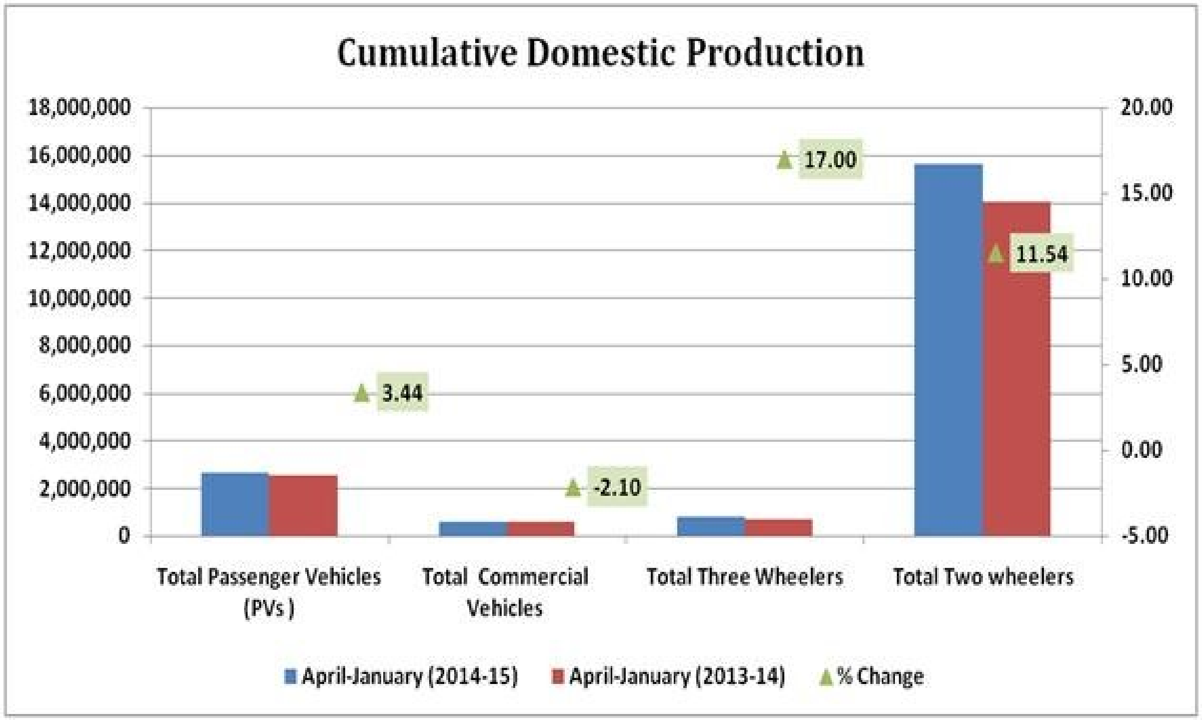
Capacity addition

Following the postponements in 2013-14, tyre industry is witnessing strong capacity additions across segments as tyre makers prepare themselves to cash in the expected growth in auto industry. While the industry has continued to invest during the past several years-particularly towards radial capacities, a marked step up on capital expenditure is expected between 2015-17, with investments towards enhancement of existing capacities-both Greenfield and Brownfield in India and new capacities in other countries like Hungary and Bangladesh. This will be funded through anticipated increase in profits going forward and the flexibility built up in the balance sheet on the back of the past three good years, leading to improvement in the capital structure and coverage metrics for the industry. Moreover, the cash build up is likely to lead to more announcements on the capacity front from the industry going forward.

Improvement being witnessed in automobile sector

The performance of Auto Industry for 'FY15' has been fairly decent on almost all the parameters including production, sales and exports. However, it would still take some time for the industry to completely stabilize since the production of commercial vehicles segment continues to show de-growth indicating lack of demand for this segment of vehicles.

A total of 19,644,496 vehicles were produced during April - January FY15 which is 10.15% more than that produced in the same period in 2013-14. Barring the commercial vehicle segment, all the other segments recorded growth in their production on account of declining prices of fuel and improving consumer sentiment.



The total production of commercial vehicles April - January FY15 has declined by 2.10% at 564,379 vehicles as compared to 576,475 in the same period of the previous year.

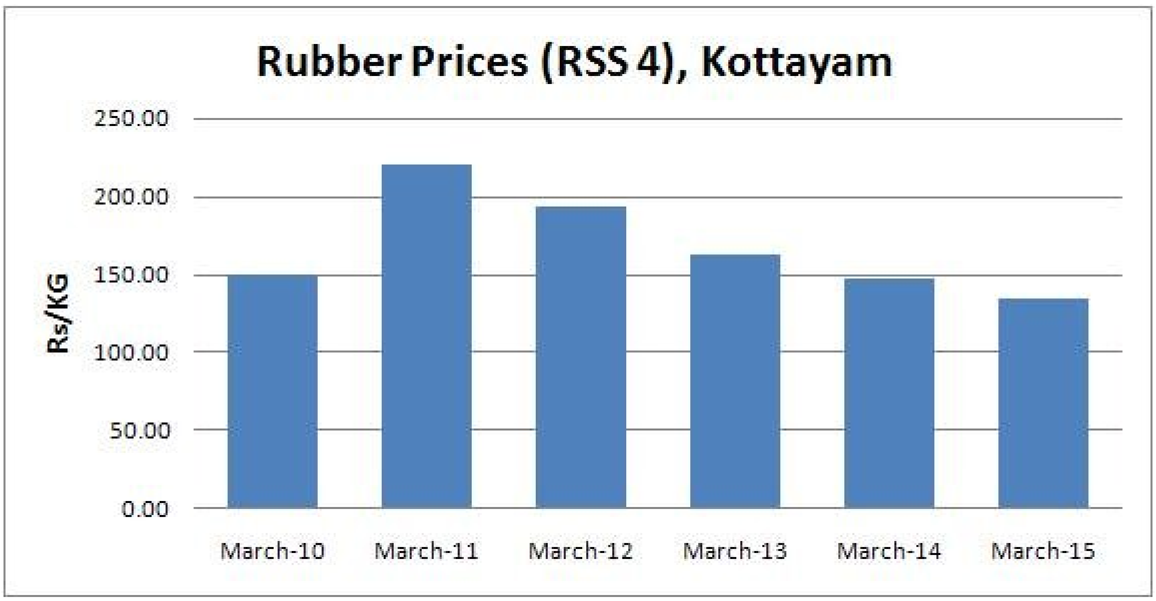
On the flip side, production in three wheeler segment registered 17% growth at 810,136 vehicles during April - January FY15 as compared to 692,400 vehicles in the corresponding period of the previous year, this was followed by two wheeler segment registering 12% growth at 15,628,896 vehicles against 14,012,082 vehicles in the corresponding period of the previous year. Lastly, passenger vehicle segment recorded 3.44% growth by producing 2,641,085 units as compared to 2,553,279 units produced in the corresponding period of 2013-14.

Cost analysis

The main raw materials of a tyre are natural rubber, synthetic rubber, carbon black and oil. The share of rubber compounds in the total weight of a tyre is more than 80%. The rest consists of various kinds of reinforcing materials. Around half of the rubber is natural rubber from a rubber tree.

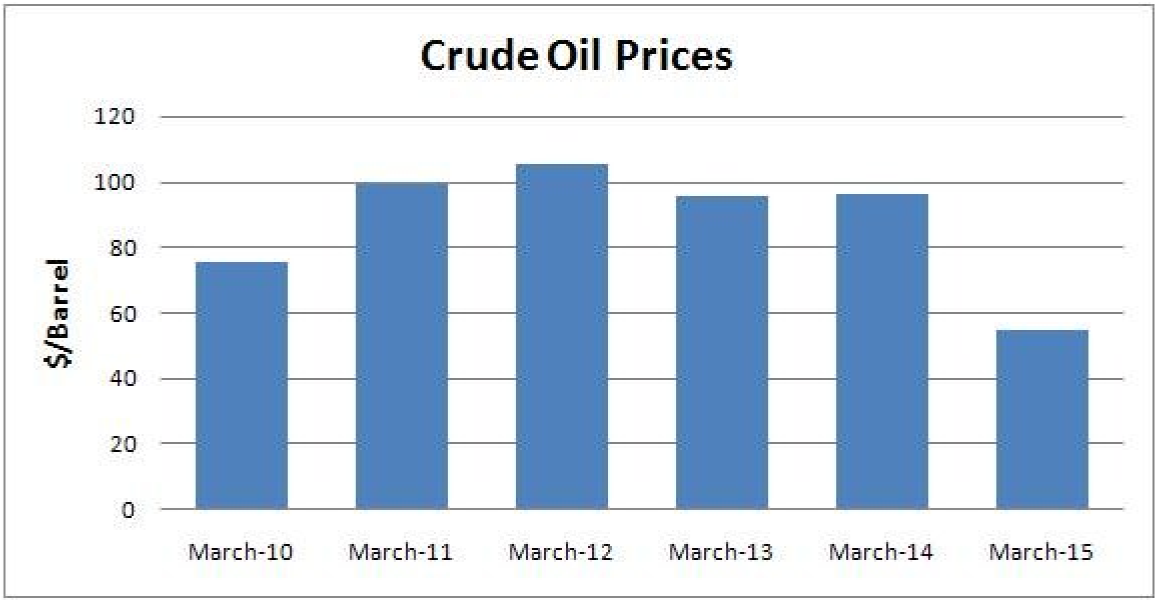
Rubber prices continue to decline

Rubber price is under pressure both in the domestic and international markets. The relative price weakness reflects a slowdown in demand in emerging economies, particularly China, as the majority of natural rubber is used for tire production. The rubber prices (RSS 4) declined around 9 percent to Rs 134.70 per KG in March 2015 as compared to Rs 148.02 per KG in March 2014 and declined by over 17 percent from Rs 162.74 per KG in March 2013. Moreover, from a demand perspective, 2015 is likely to be one of slow growth. Of course, with over 70 percent share in world demand, Asia will drive the rubber market. China, the dominant player, accounts for 36 per cent of global demand while India's share is 9 per cent; Japan 6 per cent and the rest of Asia 21 per cent.



Fall in crude oil prices

Crude oil prices continued to trade southward and declined over 42 percent to $55.04 per barrel in March 2015, as compared to $96.18 per barrel in March 2014 as demand for oil in places like Europe, Asia, and the US began tapering off, thanks to weakening economies and new efficiency measures. Despite weakening in demand, Organization of Petroleum Exporting Countries (OPEC), like Saudi Arabia and Iran refused to cut production. However, the economic stimulus program from China and the interest rate cut could support the oil market. It's under a credit crunch situation due to lower oil prices. China is a key lender to oil exporting economies. Lower oil prices would increase the demand for oil in the near term from economies like India.



Investments

Some of the major investment plans in the Sector:

- MRF is planning to expand its capacity, in facilities including Hyderabad, Trichy and Goa, with an investment of Rs 4000 crore in next three years. It currently has a capacity of 1.2 lakh tyres a day.The investment would be from internal accruals and there would not be any fund raising for this.
- Ceat is planning to invest Rs 400 crore in the first phase to set up a tyre plant at Butibori in Nagpur, Maharashtra. The plant will be set up in three phases. The first tyre is expected to roll out of the plant by April, 2016, and on completion, the plant will have a capacity to make 1.2 million tyres annually. The new plant will be highly automated, and will make two and three-wheeler tyres.
- JK Tyre is expecting its Rs 1,430 crore expansion plan near Chennai to be completed by mid-2015. Post the expansion company would have more than doubled its capacities of truck/bus radials and passenger radials in last three years.
- US-based tyre major Goodyear is looking at India with 'renewed interest', expecting to grow significantly in the country which is one of its biggest markets in Asia. Its arm Goodyear India is looking to bring in products with new technologies such as the recently launched Assurance TripleMax, in order to be among the top two-three players in passenger cars tyres segment.

Outlook

Indian tyre industry's outlook is likely to be positive in near term as growth in domestic tyre volumes is expected to increase by around 10%during 2015-16 on the back of pickup in auto demand and an improving economy; continued benefits of expected lower raw material costs, particularly during first half of FY16; and anticipated increase in exports are expected to support demand for the industry. On the concern side, prices of several key inputs are currently at all time lows on account of fall in global demand. Over the next 10-12 months input prices are expected to gradually increase, capping further margin expansion in 2015-16. Moreover, with the US imposing anti-dumping duty on Chinese tyres, imports of such tyres into India has surged over the past several months, adding to pressure on Indian tyre makers. Total value of Chinese tyre imports must have closed in around Rs 800 crore by the end of last financial year. This has added to the financial pressure on Indian tyre makers despite the cost of natural rubber being benign since the last few months. Nevertheless, capacity addition in the industry remains strong in anticipation of recovery in auto demand, supported by improved accruals generated on the back of a benign rubber prices. Moreover, there appears to be a marked shift in the capex plans of tyre majors with the focus shifting from the commercial to the consumer segment.

Companies Financial Data In Industry

Company Name	CMP	MCAP (Rs Crore)	BOOK VALUE	DIV. YEILD %	TTM EPS	TTM PE
MRF Ltd.	36345.00	15414.43	10651.94	0.14	2837.11	12.81
TVS Srichakra Ltd.	1768.25	1353.96	351.31	0.90	119.44	14.81
Ceat Ltd.	743.30	3006.66	386.21	1.35	66.28	11.21
Balkrishna Industries Ltd.	737.35	7127.12	229.42	0.27	50.65	14.56
Goodyear India Ltd.	595.25	1373.03	182.37	1.68	43.89	13.56
Apollo Tyres Ltd.	165.20	8409.09	62.97	0.45	11.64	14.20
JK Tyre & Industries Ltd.	116.05	2632.17	45.91	0.86	8.74	13.27
PTL Enterprises Ltd.	33.65	222.72	14.31	2.97	2.71	12.40
Modi Rubber Ltd.	25.50	63.85	55.63	0.00	1.86	13.68
Govind Rubber Ltd.	21.05	45.97	14.81	0.00	1.13	18.69
Krypton Industries Ltd.	11.48	16.87	20.49	0.00	0.23	49.62
Tirupati Tyres Ltd.	104.20	35.88	6.05	0.00	0.03	0.00
Surya Industrial Corporation Ltd.	9.84	9.18	6.02	0.00	-0.17	0.00
Dunlop India Ltd.	13.03	158.94	-2.63	0.00	-0.26	0.00
Falcon Tyres Ltd.	12.80	99.16	22.80	0.00	-3.89	0.00

Sorted with TTM EPS (High to Low)

Source – Ace Equity