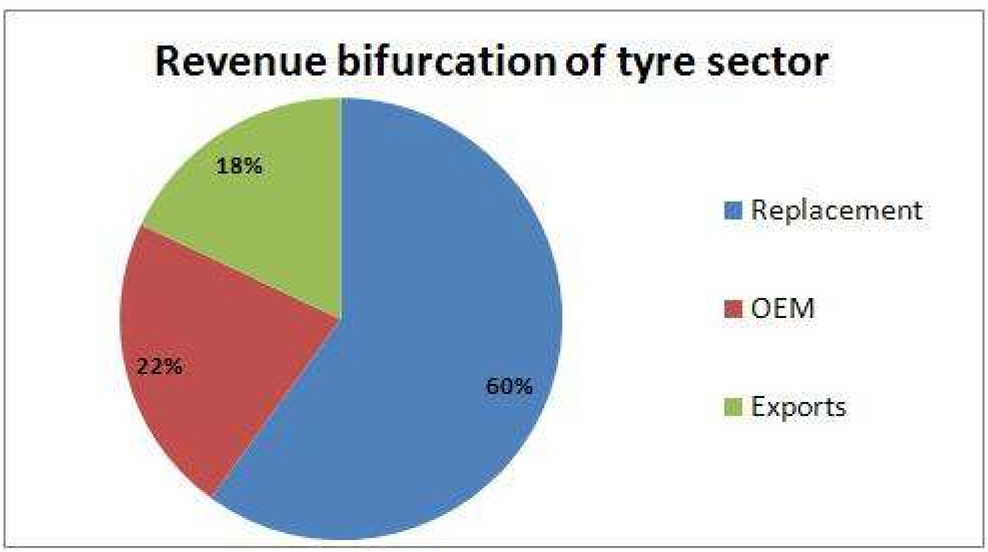
Digital push to drive growth for tyre sector

MAY 15, 2017

Tyre sector's outlook looks positive on strong demand from OEM, Replacement markets

Tyre Industry, has become the most competitive markets in the world and with the help of new technology, ultra modern production facilities and availability of raw materials at lower rate, the sector is set to grow further. The Indian tyre industry has witnessed a remarkable growth in last few years on the back of growth in automobiles demand, especially in passenger vehicles and two-wheeler segments.

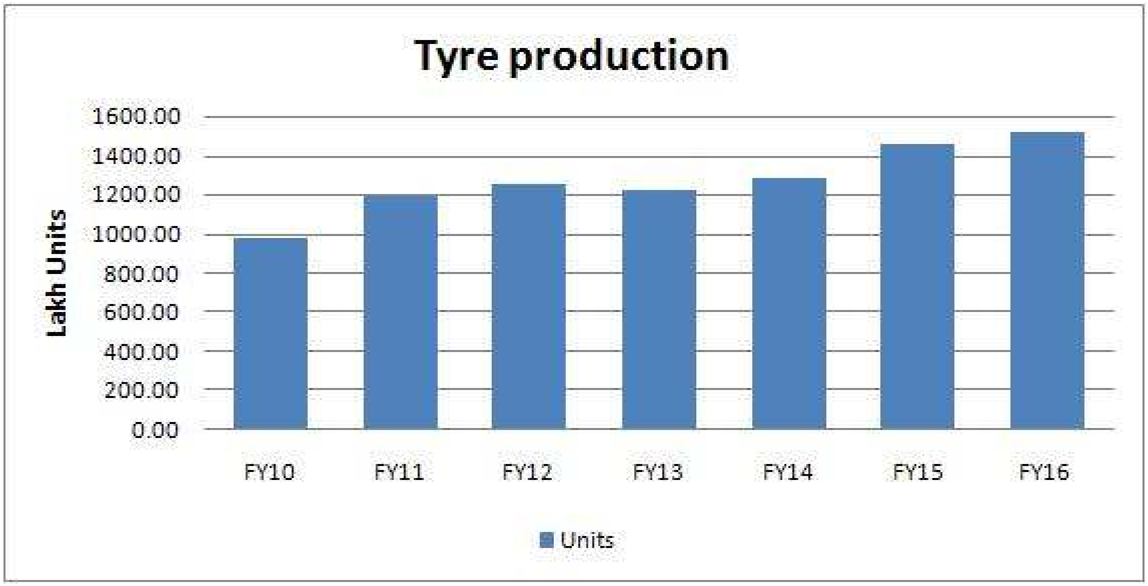
The industry can be divided principally into two key segments - the OEM and replacement markets. The demand for tyres in the OEM sector is dependent on the sales trend of new vehicles, while the demand in the replacement sector is related to usage patterns and replacement cycles. Driven by the strong demand in automobile OEM sector and replacement market, the Indian tyre industry has been witnessing stupendous growth since last two years. While in the Commercial and Farm segments, replacement sales forms a major chunk, in the passenger segment both Institutional and OEM and replacement sales play an almost equal role. The tyre industry provides direct and indirect employment to more than a million people, comprising of dealers, re-treaders and truck operators. The truck business is controlled by nearly 2.6 million small operators.



Production

Total tyre production in FY16 has witnessed a marginal growth of around 4 per cent to 1520.32 lakh unit as compared to 1461.50 lakh unit sold in FY15 on the back of steady demand from original equipment manufacturers (OEMs) and an improvement in replacement demand. Persistent weakness in OEMs demand in select key segments, weak agricultural activity and consequent subdued rural demand; and relatively muted infrastructural activity for most of the year affected tyre demand during FY 2016.

Of total, production of OTR tyre grew 17 per cent to 4.98 lakh unit from 4.27 in FY15, two/ three wheeler tyre rose 5 per cent to 799.42 lakh unit as compared to 759.89 lakh unit in previous year and passenger car tyre (including jeep) was up by 8 per cent to 387.02 lakh unit from 357.43 lakh unit in FY15. However, production of truck & bus tyre declined 2% to 167.64 lakh unit as compared to 171.12 lakh unit in FY15. Moreover, production of LCV tyre and farm/tractor (incl. front, rear and trailer) tyre slipped 5 percent and 3 percent respectively.



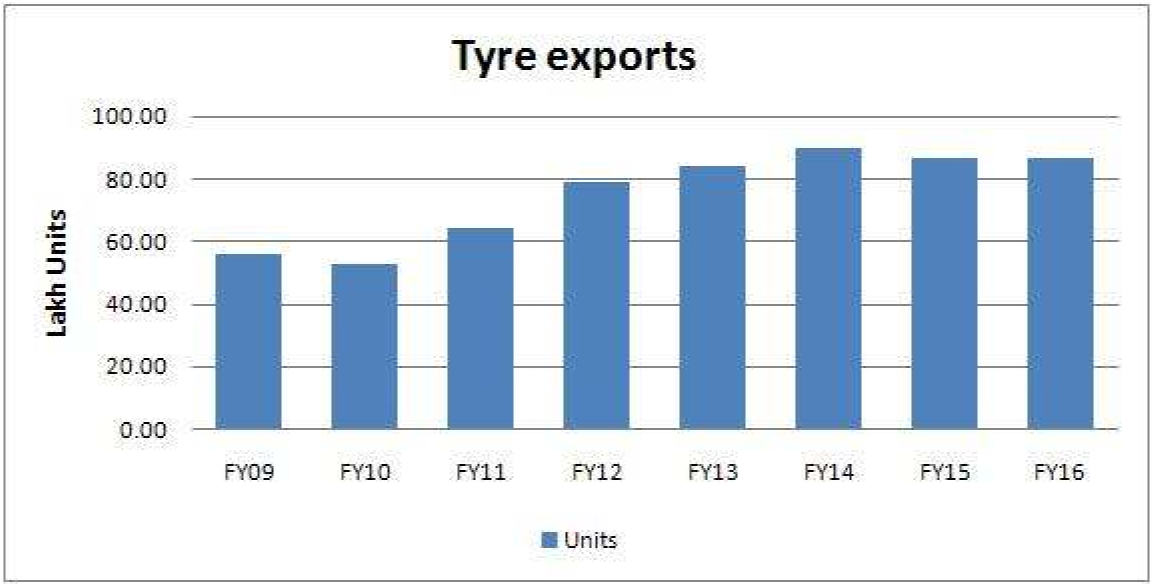
Imports

Currently 40% of the replacement demand in truck and bus radial tyres (TBR) is being met by imports while domestic capacities are faced with the prospects of ever declining utilization. India's import of TBR tyre jumped by 64 per cent in 2015-16 to 12.8 lakh units from from 7.8 lakh units in the previous fiscal, with increased 'dumping' from China. In the last two years, truck and bus radial tyre (TBR) import has gone up by 2.5 times. It called for anti-dumping measures on import from China as it accounted for a major chunk. From an average per month import of about 40,000 units in FY14 and 65,000 units in FY15, the TBR import figure has crossed one lakh units per month in FY16. Most of the import of TBR in India is from China, whose share has more than doubled to 90 per cent in 2015-16 from 40 per cent in 2013-14.

Meanwhile, Tyre manufacturers in India have made major investments towards greenfield and brownfield projects for manufacturing of state of the art radial tyres but indiscriminate import and dumping of cheap tyres from China are queering the pitch for domestic manufacturing. Domestic tyre industry has put in around Rs 35,000 crore in capacity expansion in the last few years by way of greenfield and brownfield projects. Unfortunately, as the new radial capacities have just gone on stream, cheap imports are surging.

Exports

In FY16, export of tyre declined marginally by 0.30 per cent to 86.54 lakh units as compared to 86.81 lakh units exported in FY15. Moreover, tyre exports have seen contraction during the current fiscal across key categories. Exports of Truck & Bus tyres declined 12 per cent to 19.39 lakh unit in FY16 as compared to 22.03 lakh unit in FY15 and passenger car tyres dropped 12 per cent to 23.32 lakh unit from 26.54 lakh unit in FY15, however, exports of LCV Tyres edged higher by 11 per cent to 16.94 lakh unit as compared to 15.29 lakh unit in FY15.



Strong demand in OEM and Replacement market

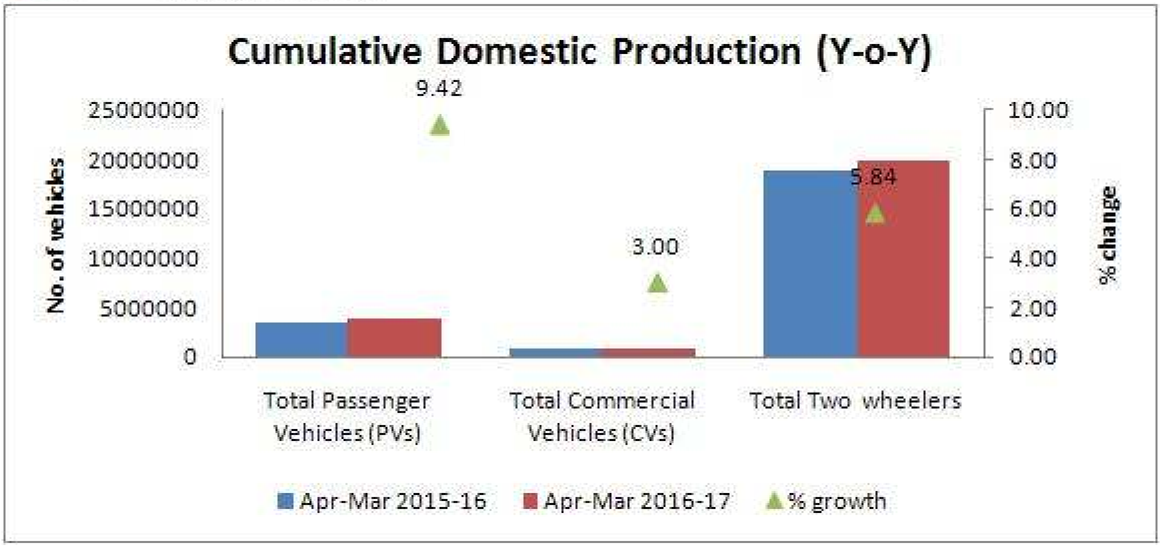
Demand of two-wheelers and small cars has been hit slightly in past few months on account of demonetization. However, auto sector has seen some recovery on the back of lower cost of ownership of auto vehicles, triggered by series of interest rate cuts and push on manufacturing and infrastructure segment by the government.

Indian Tyre manufacturers are likely to take benefit from this turnaround in OEM demand and stable replacement demand. Tyre manufacturers who supplies to commercial vehicles, passengers vehicles and tractors segment are likely to get the maximum advantage in the near term, as outlook for these auto segments in the Indian market is relatively more positive than two-wheelers.

The trend in tyre production and sales for OEM market has been in line with the automobile sales over the past few years i.e., production of tyres has been about 1.5 times that of a vehicle produced. Moreover, domestic and export demand for tyres is likely to remain strong during2017-18 on the back of steady growth prospects for Auto OEMs as well as the stable replacement market.

Growth in automobile sector

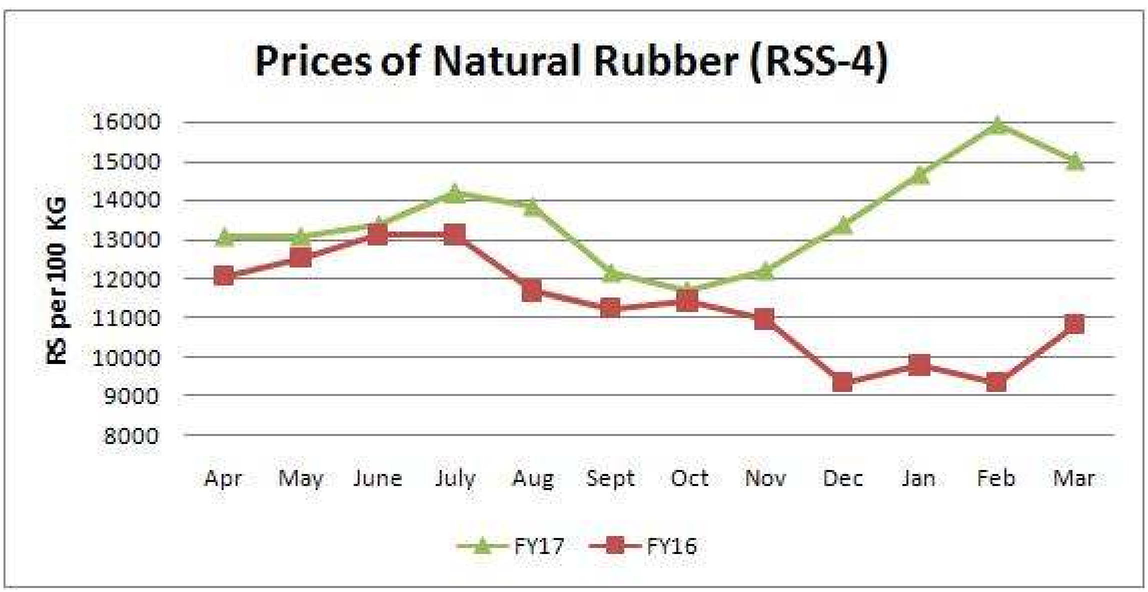
Tyre demand is directly proportional to the automobiles demand. Therefore, demand swings in automobiles have an impact on the demand for tyres. India's annual automobiles production registered a growth of 5.84% y-o-y in FY17 to 2,53,14,460 units as compared to 2,40,16,068 units in FY16. This led to rise in demand for tyres as well during the year. Of total, production of Passenger vehicle increased the most with a growth of 9.42%, while production of commercial vehicle and two-wheeler vehicle surged by 3% and 5.84% respectively.



Raw material prices

Rubber prices

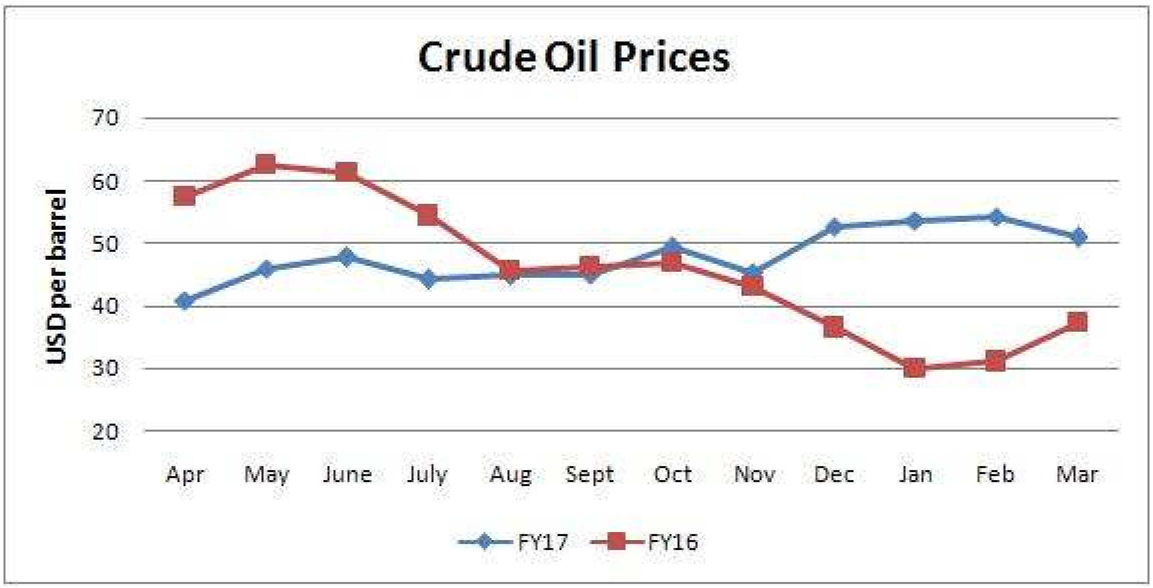
Domestic prices of natural rubber, which makes up more than 50 per cent of the cost of a tyre, have been increasing continuously. The domestic RSS 4 price at Kottayam market increased at Rs 15,024 per 100 kilogram (kg) in March 2017 as compared to Rs 10812 per 100 kg during same month previous year. Domestic RSS-4 price touched highest level of Rs 15,942 per 100 kg in February 2017, while it touched lowest level of Rs 11692 per 100 kg in October 2016.



Oil prices

The tyre industry is raw material intensive, which accounts for more than 60% of the production cost. Since most of these raw materials are petroleum based, their prices fluctuate with the international prices of petroleum products. The main raw materials for tyre are rubber (natural or synthetic), carbon black, nylon tyre cord and rubber chemicals. Except natural rubber, the costs of all other raw materials in tyre production are related to crude oil prices.

Crude oil prices increased 36.34 per cent to $50.91 per barrel in March 2017 as compared to $37.34 per barrel in same month previous year. Crude oil prices touched highest level of Rs 54.36 per barrel in February 2017, while it touched lowest level of 40.75 per barrel in April 2016.



Indian tyre manufacturer to benefit from shift of Chinese tyres to US markets

US department of commerce has refused to levy anti dumping, countervailing duty on Chinese truck and bus tyres; Chinese tyre players will focus back on US market thus reducing exports to other destinations such as India. The U.S. Commerce Department had earlier determined final subsidy rates ranging from 38.61% to 65.46% and anti-dumping margins ranging from 9% to 22.57% on Chinese tyre imports. As of 2015, US imported about $1.5 billion worth truck and bus tyres from China which fell to about $1 billion in January 2016-November 2016 period given the investigation undertaken by US authorities. No levy of duties would enable Chinese players to shift focus back on the US market leading to reduced exports to other destinations. This is positive for domestic tyre players like Apollo Tyres, MRF, JK Tyres and Ceat etc.

Sector Outlook - Tyre Industry

Corporate developments

- Ceat is planning to invest around Rs 2,800 crores over a period of five years up to FY2022 to raise its tyre manufacturing capacity. With this investment, Ceat is aiming to raise capacity by 1 million tyres per annum for truck bus radials, 17 million tyres per annum for 2-wheelers and 6 million tyres per annum for passenger car radials.
- Apollo Tyres will invest around Rs 525 crores for setting up a production facility in Andhra Pradesh bordering the south-eastern coast of India. A memorandum of understanding to this effect was signed by the company with the government of Andhra Pradesh. The new facility will manufacture tyres for two-wheelers and pick-up vehicles, which is currently being manufactured by some third-party on behalf of Apollo tyres.
- JK Tyre and Industries is planning to set up a new R&D centre of excellence in Mysuru. In this regard, the company will invest Rs 100 crore. It will initially have about 200 engineers and scientists and the number will double during the next one year.

Outlook

Indian tyre industry's outlook seems to be positive in near term as growth in domestic tyre volumes is expected to increase on the back of steady demand and an improving economy. Further, with US rejecting to levy anti dumping duty on Chinese tyres, Chinese players have shifted focus back to US leading to lower exports to markets like India. Hence, import of Chinese tyre into the country will continue to remain under pressure, which is positive for domestic tyre companies. On the concern side, impact of demonetisation along with an increase in raw materials will be negative for tyre firms. Nevertheless, strong demand from OEM and Replacement market will help in increasing tyre demand. Tyre sector will also get some support with increased demand for automobiles and the government's move to ramp up infrastructure sector.

Companies Financial Data In Industry

Company Name	CMP	MCAP	BOOK VALUE	DIV. YEILD %	TTM EPS	TTM PE
MRF Ltd.	65391.35	27733.41	0.00	0.09	3421.44	19.11
TVS Srichakra Ltd.	3947.20	3022.39	750.91	1.28	202.86	19.46
Ceat Ltd.	1682.90	6807.35	570.12	0.68	89.67	18.77
Balkrishna Industries Ltd.	1491.25	14414.21	367.12	NA	73.99	20.16

Sorted with TTM EPS (High to Low)

Source – Ace Equity