INDIAN TYRE INDUSTRY

Industry falls off peak as input costs rise

ICRA

ICRA RESEARCH SERVICES

Contacts:
Subrata Ray
+91 22 6114 3408
subrata@icraindia.com

Pavethra Ponniah
+91 44 4596 4314
pavethrap@icraindia.com

K Srikumar
+91 44 4596 4318
ksrikumar@icraindia.com

March 2017

Contents

List of Tables and Charts

Q3FY2017 - Revenue growth affected due to demonetization; margins fall with input costs moving north

The Indian tyre industry revenues grew at a moderate 3.4% YoY during Q3FY2017, impacted by the Nov '16 demonetisation and subdued realisations owing to weak pricing power. Interestingly, demonetisation benefited the Truck & Bus radial (TBR) segment as the currency crunch brought down the un-organised segment import of Chinese TBR tyres. But its adverse effect was witnessed in the rural-demand dependant two wheeler (2W) and tractor segments, where purchases were deferred. Further, price cuts taken in the initial part of Q3 affected the overall realizations even as some players started hiking prices towards the end of Q3 to compensate for the inching up in raw material (RM) prices.

With the spike in RM prices and falling realisations, industry margins contracted sharply during Q3 FY2017; the operating and net margins stood at 16.5% (down 317 bps) and 9.0% (down 127 bps) respectively. For 9M FY2017, the industry revenues were largely flat (up 1.7% YoY) with operating and net margins declining by 110 bps and 35 bps respectively.

Tyre Exports: Demand rebound in the current year, realizations to improve as higher RM prices gets passed on in Q4

Driven by strong growth across product segments, overall export volumes grew by ~29% during 9MFY2017. However with realisations falling by ~14% YoY; tyre exports (in value) grew by ~15%. Agri / construction segment, which represents over half of the tyre exports (in value) from India, grew at a strong 14% YoY during 9M FY2017. Export of Truck & Bus (T&B) and 2W tyres have also been on a rise with value growth of 5% and 21% respectively during 9M FY2017 while PV exports continued to de-grow (2%) for the second straight year.

In Q4FY2017, growth in tyre exports is expected to remain healthy as the pent up replacement demand in Agri / construction segment will be complemented by the expected rise in realizations, as exporters have started passing on the increase in input costs. Over the next three years, exports are projected to grow at 6%-8% led by stable demand and increased acceptance of Indian tyres in overseas markets, both in terms of quality and pricing.

TBR imports: Chinese tyres get an ADD/CVD reprieve from United States International Trade Commission; tyre imports to India likely to fall

The demonetisation drive November 2016 affected imported Chinese tyres which were being fed to the replacement segment through cash-driven unorganized channels. Despite this, overall tyre imports are still expected to grow by 10%-12% (value) in FY2017.

In a major reprieve to Chinese tyre exporters, in February 2017, the United States International Trade Commission (USITC) pronounced that tyre exports from China did not impact the US tyre industry; accordingly no ADD was imposed on Chinese tyres. During the period of dumping probe, export of Chinese tyres to USA had significantly reduced; US imports of T&B tyres from China which was worth $1.5 billion in 2015, but fell to over $1 billion in the first 11 months of 2016. Part of this decline in US demand for Chinese tyres was re-routed by China to other countries, including India. With the USITC's ruling, China's tyre exports to USA is expected to revive and this will bring down imports to India; demand and margins in the USA tyre industry is relatively higher than other markets. On the pricing front too, with global NR ruling at premium to domestic NR prices, the price deferential between Indian-made and imported tyres has reduced. Accordingly, import momentum into India is expected to drop in the medium term.

Outlook: Stable

Cash surplus industry continues to commission projects

During FY2014-17, the industry commissioned Rs. 11,500 crore worth of projects. The next four years FY2017-20 is expected to witness commissioning of another Rs. 21,000 crore worth of projects, of which project closer to completion are the Rs. 2,500 crore Maxxis Sanad 2W and PCR project (FY2018), the Rs. 650 crore Halol CEAT plant for PCR and TBR (FY2018), the Rs. 800 crore Butobori CEAT 2W project (FY2018), the Rs. 2,800 crore PCR/TBR Bridgestone project (FY2018) and the Rs. 800 crore Balasore PCR Kesoram project (FY2018).

ICRA RM price index expected to spike by 15%-18% QoQ during Q4FY2017

Domestic Natural rubber (NR) is currently (March 28, 2017) trading at Rs. 147/kg after breaking out from the three-year high of Rs. 160/kg in February 2017. Short-supplies from Thailand due to heavy rains and floods amidst increasing consumption from China and USA; and higher crude oil prices, resulted in a sharp ~30% and 50% jump in domestic and global NR prices respectively between November 2016 and January 2017. However, NR prices have corrected since the last week of February 2017 with rising production, falling crude oil prices and the Government of Thailand's decision to liquidate its large NR stockpile to cash in on the elevated NR prices.

Prices of crude linked derivates have spiked sharply in Q4 FY2017 although some moderation was witnessed in March 2017. WTI crude oil prices which surged by ~20% during Nov '16 -Jan '17 corrected in March'17 due to continued increase in US production and higher rig counts, and despite the cut in OPEC production. Breaking away from the muted growth in the last few quarters, the ICRA RM price index reflects a sharp 15%-18% estimated growth on a QoQ basis for Q4FY2017. While there has been some moderation in the prices in recent weeks, the blended cost for Q4FY2017 is expected to be significantly higher than the past ten quarters.

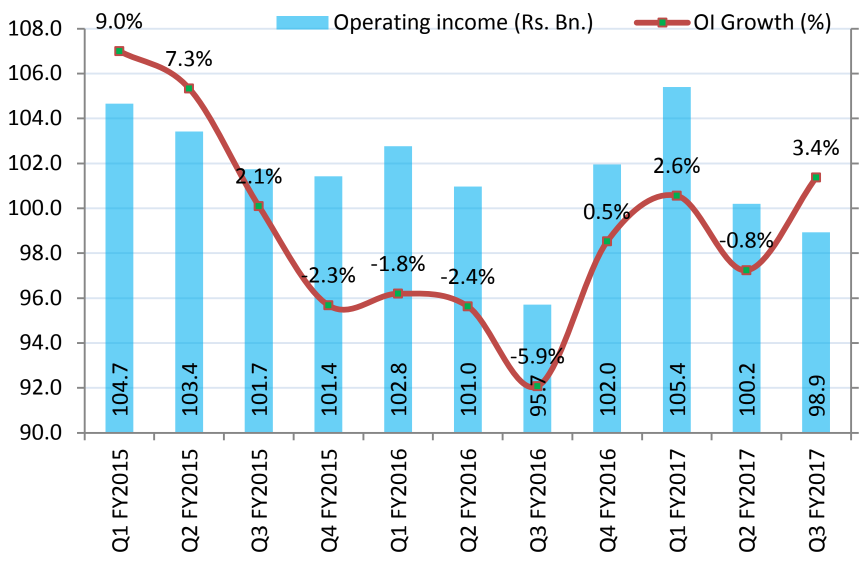
Outlook: Stable

The outlook for the domestic tyre industry over the near to medium term is stable supported by favourable tyre demand, both domestic and exports, and likely improvement in realisation. ICRA research expects revenue growth for the industry of ~12%-13% (CAGR) during FY2017-20. However the industry profit margins, which have been at elevated levels in the last two years, is expected to contract with hardening of raw material prices. Industry wide operating and net margins are expected to stabile over the next two years at ~14%-16% and 7%-9% respectively, in the absence of any un-natural price disruptions for crude and NR. With the resumption of debt funded capital expenditure plans (towards capacity additions), the capitalization and coverage indicators are likely to moderate marginally. Despite this, the industry credit profile will remain strong with net gearing of 1.0-1.3x and net debt to operating profit of 0.3x-0.4x.

Steep contraction in Q3FY2017 profit margins with sharp spike in RM prices; revenue growth remains muted

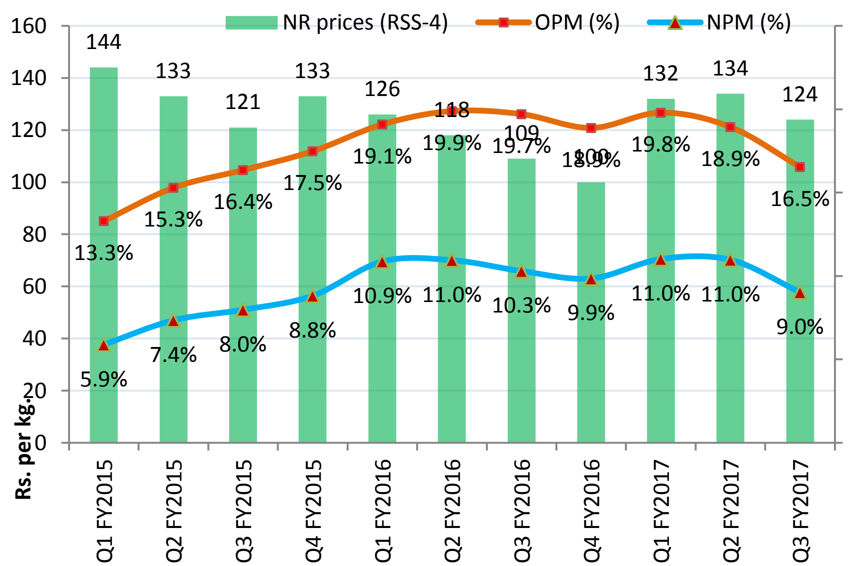
- Demonetization in November 2016 had an adverse impact on the tyre industry, especially the rural-demand dependant two wheelers (2W) industry. MRF and TVS Srichakra, which collectively meet over 60% of the 2W tyre demand, reported a 0.8% and 4.5% YoY de-growth respectively during Q3 FY2017 while others recorded a moderate 2%-5% growth. However, Truck & Bus radial (TBR) segment benefited from demonetization as the currency crunch brought down the un-organised segment import of Chinese TBR tyres, which are fed to the replacement market. Falling TBR tyre imports is expected to be temporary and should pick up in FY2018. That said, with the United States International Trade Commission deciding not to impose anti-dumping duty on Chinese TBR tyres, and China restarting exports to USA, aggressive dumping into India is likely to be under control.
- The industry revenue growth was also affected by lower realisations on the back of weak pricing power despite rising RM prices since December 2016. Limited price hikes coupled with fall in 2W tyre volumes (which represents ~50% and 15% of tyre industry, in volume and value terms) had resulted in a moderate revenue growth of 3.4% YoY during Q3 FY2017.
- Company wise, revenue growth of BKT (+26.3%), CEAT (+4.9%), JK Tyres (+4.7%), Apollo (+2.0%) and Goodyear (+3.7%) were positive during Q3 FY2017. BKT's revenue growth was the highest across players for the second straight quarter supported by strong replacement demand from agriculture / construction segments in USA and Europe. Healthy export demand supported BKT's growth while strong TBR volumes (with falling imports) aided the revenue growth of Apollo and JK Tyres.
- Industry wide operating margins have been contracting in the last two quarters with increasing RM prices. Following a 100 bps contraction in Q2FY2017, the profit margins witnessed further correction during Q3FY2017 (down 350bps YoY). With falling operating margins, interest coverage ratio moderated to 8.9x in Q3FY2017 from the peak levels of 12.1x in Q3FY2017.
- ICRA's RM tyre price index grew by 2% YoY in Q3FY2017 as prices of both NR and crude derivatives inched up. Domestic NR prices averaged at Rs. 153 per kg in Q4 FY2017 against Rs. 130 per kg in 9MFY2017. With RM prices increasing sharply during the period Dec-16 to Feb-17, operating and net margins are likely to contract by ~200-300 bps and 100-200 bps respectively.

Exhibit 1: Quarter-wise comparison of NR prices and Operating margins



Source: *ICRA estimates for sample of seven large companies (standalone)*

Exhibit 2: Quarter-wise coverage indicators

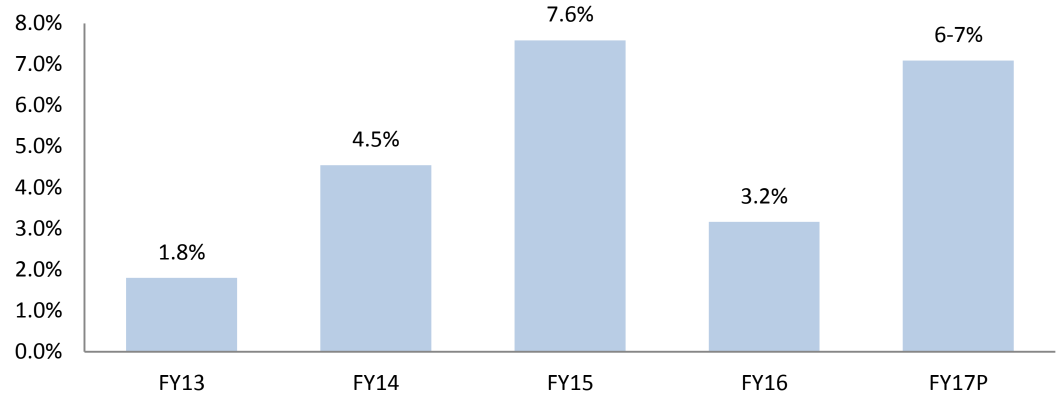


Source: *ICRA estimates for sample of seven large companies (standalone); OPM=Operating profit margin, NPM=Net profit margin*

Automotive demand scenario: Demonetisation hits demand in Q3FY 17

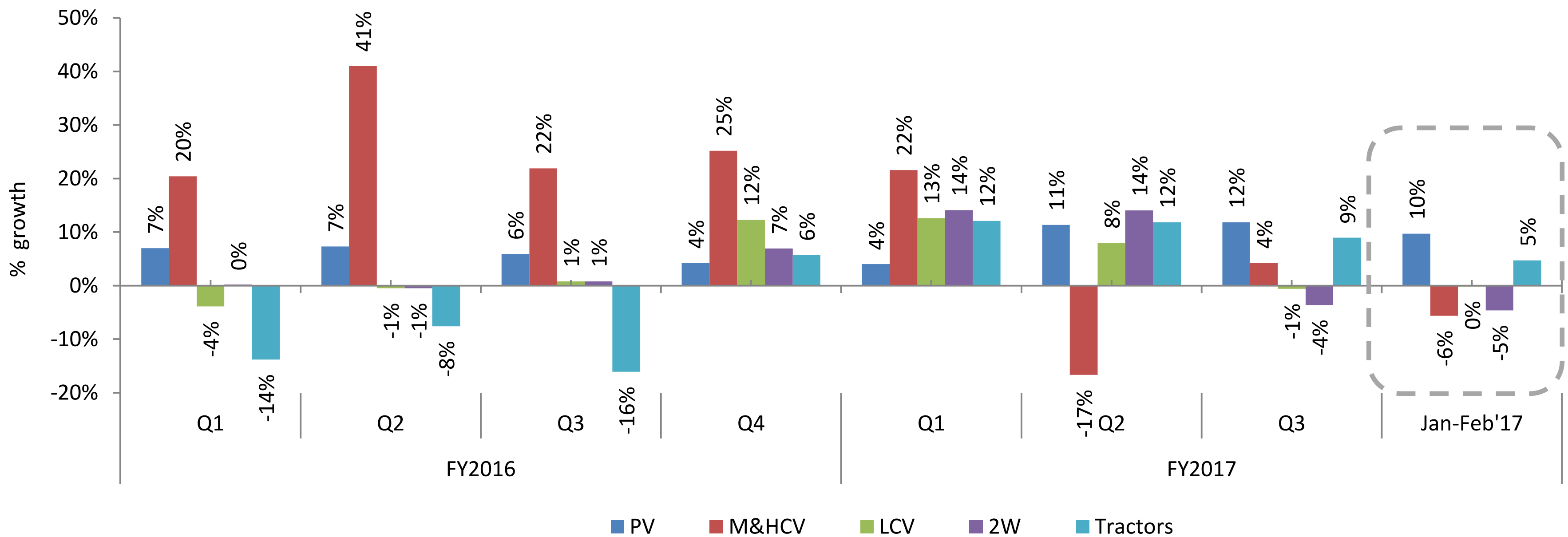
- Compared to the 10.9% YTD August-16 growth, automotive industry sales (domestic + exports) growth contracted during Q3FY17 across most segments. Demonetisation led to a systemic cash crunch leading to deferment of replacements and discretionary purchases. Rural demand was hit hard as the currency economy collapsed briefly.
- ICRA research's estimate for automotive sales (Domestic + Exports) stands at 6-7% for FY2017, *(Exhibit 1)*.

Exhibit 3: Automotive Industry Production Growth (Volumes)



Source: SIAM; ICRA research; Production= Domestic + Exports

Exhibit 4: Automotive Industry Segment Wise Production Growth



Source: SIAM; ICRA research

Segment forecasts

Segment wise production trends

Exhibit 5: M&HCV: Waning replacement demand and uncertainty around GST hit demand in FY17; FY18 M&HCV truck to grow by 6-8%

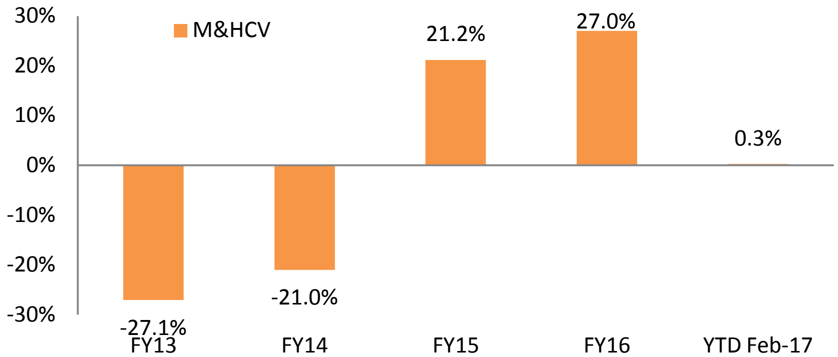


Exhibit 6: Two-wheelers: Demon. hit demand; segment to grow by 8-10% in FY2018

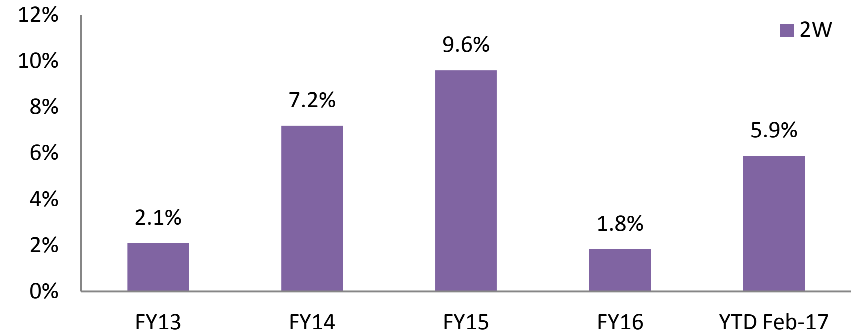


Exhibit 7: LCV: Demand from last mile e-commerce segment to drive demand; FY18 LCV trucks to grow by 7-8%

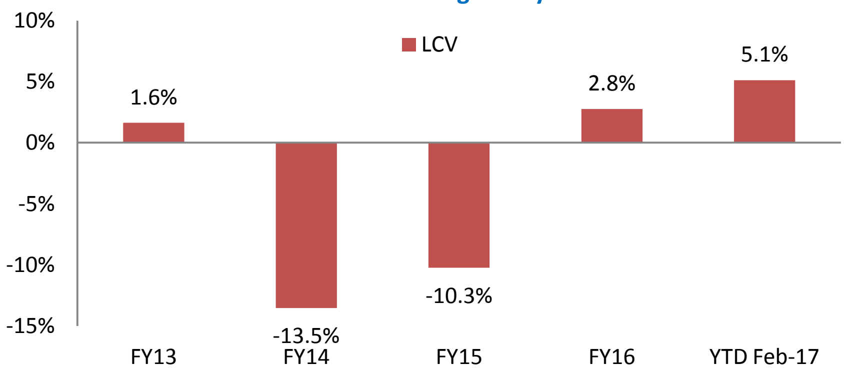


Exhibit 8: PV: Growth slowed due to demon.; FY 18 growth pegged at 9-10%

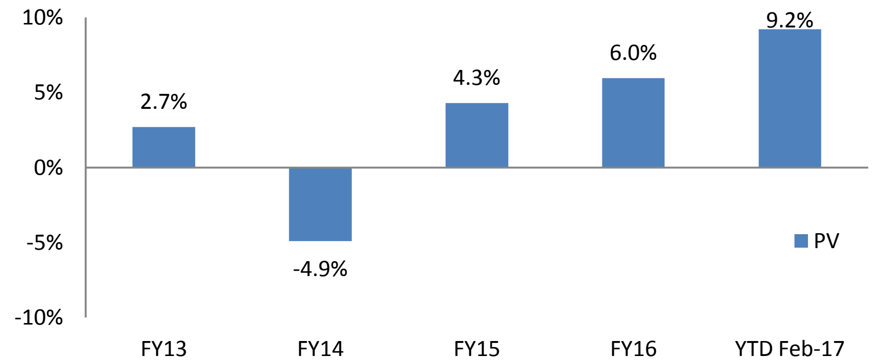
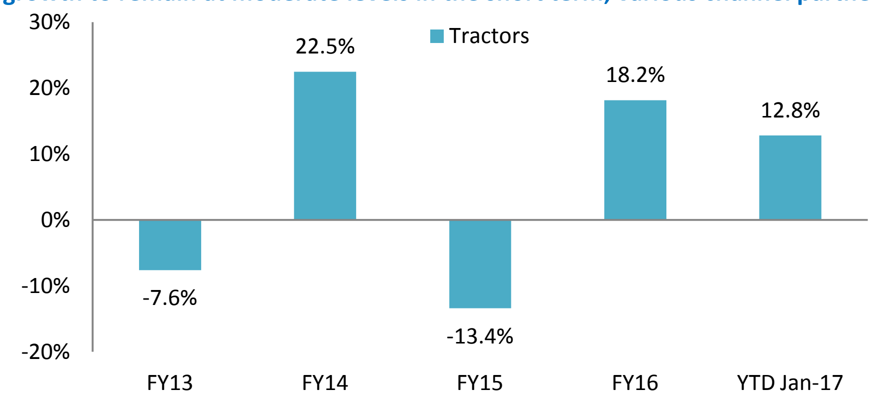


Exhibit 9: Tractors growth to remain at moderate levels in the short term; various channel partners remain circumspect



***Source**: SIAM, CMIE, ICRA research; Graph representing YoY growth %*

ICRA Limited

CORPORATE OFFICE

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300; Fax: +91 124 4545350

Email: info@icraindia.com, Website: www.icra.in

REGISTERED OFFICE

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50; Fax: +91 11 23357014

Branches: **Mumbai**: Tel.: + (91 22) 24331046/53/62/74/86/87, Fax: + (91 22) 2433 1390 **Chennai**: Tel + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294, Fax + (91 44) 2434 3663 **Kolkata**: Tel + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008, Fax + (91 33) 2287 0728 **Bangalore**: Tel + (91 80) 2559 7401/4049 Fax + (91 80) 559 4065 **Ahmedabad**: Tel + (91 79) 2658 4924/5049/2008, Fax + (91 79) 2658 4924 **Hyderabad**: Tel +(91 40) 2373 5061/7251, Fax + (91 40) 2373 5152 **Pune**: Tel + (91 20) 2552 0194/95/96, Fax + (91 20) 553 9231