Outlook for Tyre industry looks robust for near future

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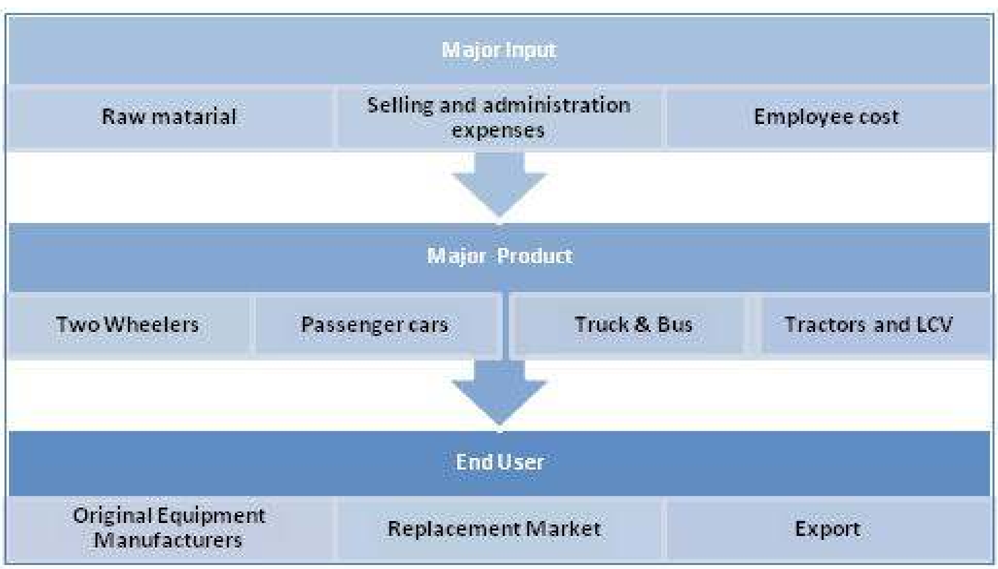
The Indian tyre industry has became one of the most competitive markets in the world and with the help of new technology, ultra modern production facilities and availability of raw materials at lower rate, the sector is set to grow further. At present, India has forty large and medium tyre manufacturing companies, of which the top 10 account for over 90 percent of the country's total tyre production. The industry gives direct and indirect employment to over a million people comprising of dealers, retreaders and truck operators. During 2013-14, the Indian tyre industry witnessed a turnover of Rs 47,500 crore, producing 123 million tyres. The industry has witnessed muted growth during the period largely aided by the two wheeler and tractor segments. Overall demand from the replacement segment was modest, while original equipment makers (OEM) demand increased just by 2-4 percent. Industry-wide revenues during 2013-14 have been higher than before at around 6 percent on the back of the improvement in product mix, limited price discounting despite the falling input costs and higher realisations in the export markets.

Strong growth ahead

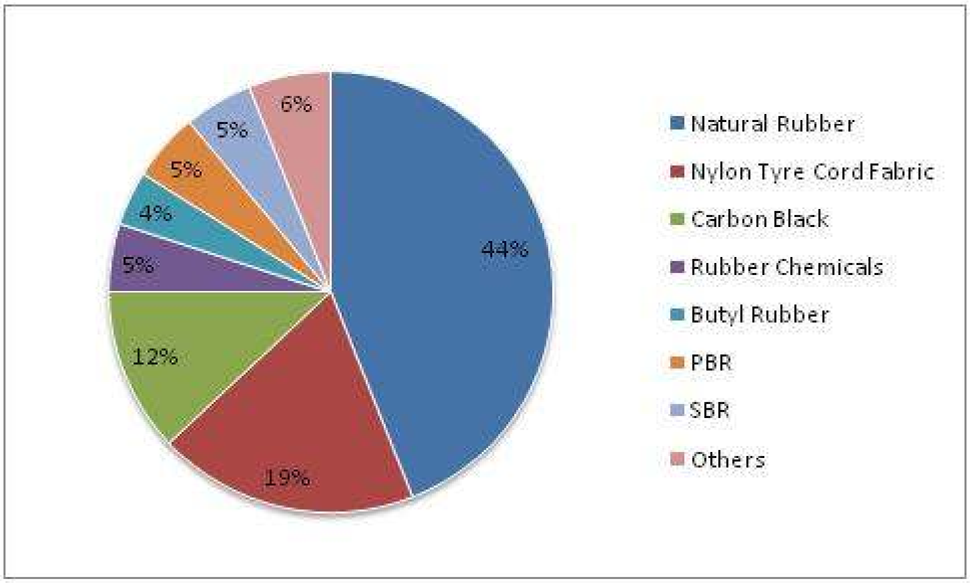
After witnessing modest three presents growth during 2013-14, Indian tyre industry is likely to grow by a Compounded annual growth rate (CAGR) of around 11 percent during the next 3 to 4 years with revenues crossing Rs 62,300 crore by 2016-17. The industry growth would be on the back of both OEM and replacement demand led by the economic revival. For FY15, the industry is expected to grow by 8 percent to Rs 49,300 crore, supported by domestic volume growth as falling raw material prices would allow tyre companies to pass some benefits to the replacement segment.

Industry value chain analysis



Major Input

The Indian tyre industry is highly raw material (RM) intensive, with RM accounting for about 65-70% of the production cost. The price of RM directly influences the profitability of tyre companies. The pie chart gives the composition of raw-materials as a percentage (%) of Total Raw Material Cost.

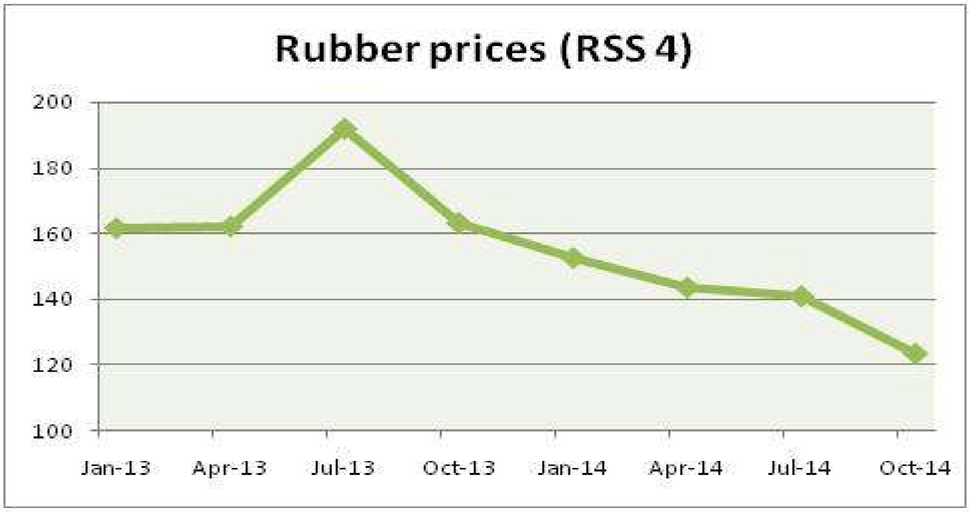


Cost analysis

Raw material consumption by industry (MT)

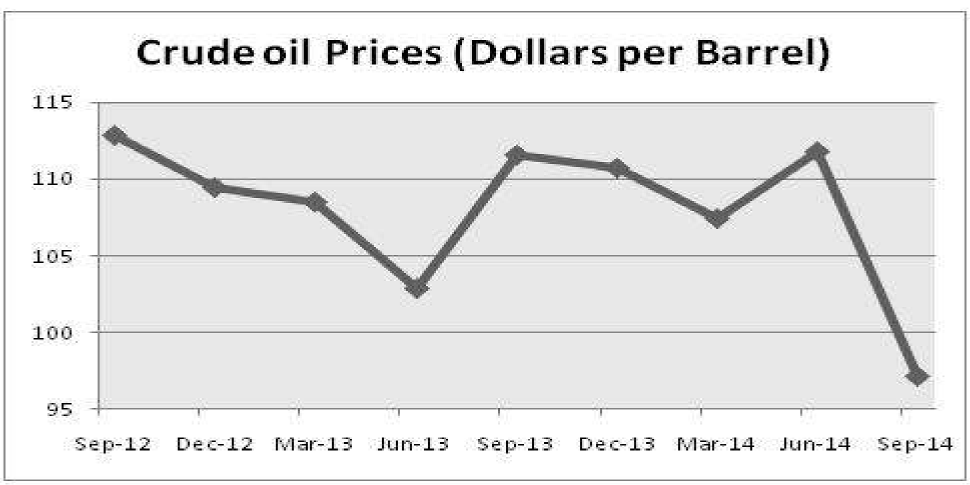
Natural Rubber: The key raw materials for tyre are natural rubber, carbon black, nylon tyre cord fabric and rubber chemicals. The price of Natural rubber (NR), the key raw material constituting around 44% of total raw material costs, has been witnessing a sharp decline during last two-three years. Currently, domestic rubber prices are trading at Rs 127/kg (one of the lowest in 5 years) and have corrected 27% YoY due to weak demand for the commodity in the wake of general economic slowdown and lower price in international market. Besides, a slowdown in demand from China, the world's biggest consumer of rubber, along with over supply in markets such as Thailand, has sent international rubber prices spiralling down in the past year.

Quarterly trend in rubber prices (RSS 4)



Other Raw Materials: Apart from rubber, all other raw materials in tyre manufacturing are mostly dependent on crude oil prices, so their prices move with the international prices of petroleum products. Therefore, the drop in crude oil prices to below $100 a barrel is a big positive for tyre makers. With the falling raw material cost as well as development in economical growth, tyre companions will show some significant turnaround in their operating margin.

Quarterly trend in crude oil prices



Major products:

The Indian tyre industry is generally divided into 6 categories based on the different auto segments. Of which, Two Wheelers is the biggest market segment followed by Passenger cars and Truck & Bus. Although Tractors and LCV are quite old market segments but they are not very big in size. Besides, in Indian tyre sector one thing is notable that there are many manufacturers who all are in the product categories but yet there is clear demarcation in the product line.

End Users

- **Original Equipment Manufacturers:** Indian Tyre industry's performance is directly linked to that of the Automotive Sector. The percentage share of tyre supplies to Original Equipment Manufacturers, has been increasing consistently for all major tyre categories i.e. CV, Passenger Car, 2/3 Wheeler, Tractor etc. With the ongoing slowdown of the automotive sector, the Tyre Industry too has faced a sustained slow growth in the last fiscal.
- **Replacement Market:** These are the end customers who replace old tyres of their vehicles. The replacement segment constitutes more than 50% of the industry and a key focus area for the tyre manufacturers due to higher margins. Replacement demand for tyres depends on on-road vehicle population, road conditions, vehicle scrappage rules, overloading norms, retreading intensity and miles driven.
- **Export market:** The export market share to the total tyre industry turnover has been very less over the years due to capacity constraints and intense competition from China and other South East Asian countries. Although exports contribute very less to the revenue but with each passing day, companies are focusing more and more on exports. During FY14 and Q1FY15, muted growth in tyre volume exports was seen due to weak global demand conditions although rupee depreciation had partly offset the demand impact. Tyre exports (value) from India have increase by 7.5% during 2013-14 aided mostly by the weak rupee.

Industry's SWOT Analysis

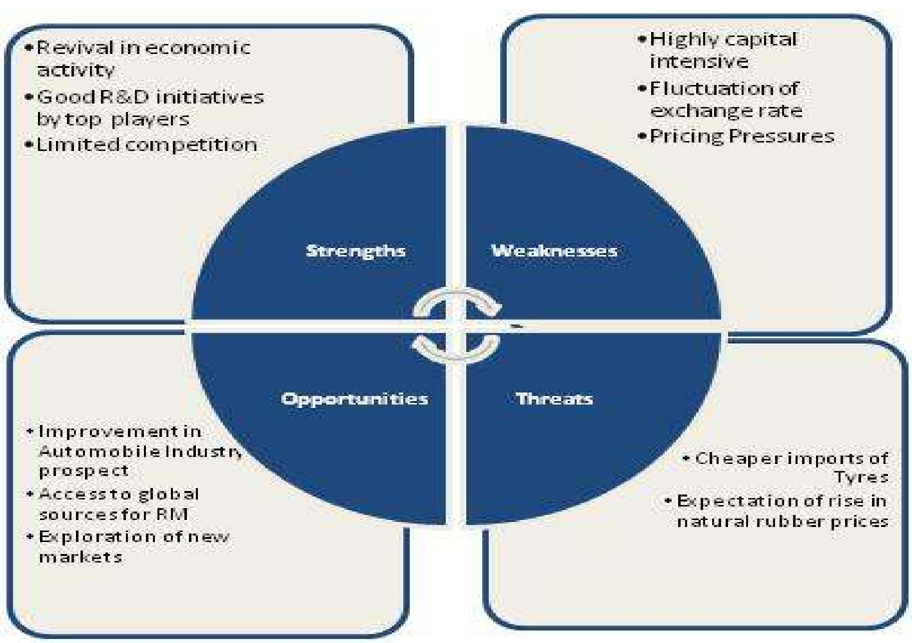
Strengths

- **Revival in economic activity**: After reporting falling car sales over the past two fiscal, India's automotive industry had begun a gradual recovery as customer sentiment improved following the general election in May 2014. India's new government, led by Prime Minister Narendra Modi promising to revive economic growth and kick-start investment. With economic growth, demand revival likely to sustain in consumer durables, particularly in automobiles, it would have a positive impact on the tyre sector. Besides, emphasis on infrastructure in terms of development of roads will also increase demand for tyres.
- **R&D initiatives by top players**: With the focus on providing better products and services, the Indian tyre manufacturers are setting up well-equipped in-house R&D centers with emphasis on developing cutting edge technology for compound development, development of new designs for different segments, reinforcement materials, cost optimization for quality improvements and orientation towards changing customer requirements. Although most of the tyre players do not engage in basic research

- due to the high costs involved, but a significant proportion of R&D effort in the tyre sector is being carried out by four- five top companies.
- **Limited competition**: Despite having more than 40 players in the Indian market, the industry's competition is limited to top ten players only as the industry is controlled by these top ten players, holding 90 to 95% of the market share.

Weakness

- **Highly capital intensive:** The tyre industry is highly capital intensive and the level of technological expertise required is also highly specific. One requires roughly Rs 400 crore to set up a radial tyre plant with a capacity of 15 Lakh tyres and around Rs 150-200 crore, for a cross-ply tyre plant of a 15 Lakh tyre-manufacturing capacity.
- **Fluctuation of exchange rate:** As most of the tyre companies are expanding their operations around the globe there is a widespread impact of sharp currency fluctuations. In simple terms, it shrinks the receivables of exporters and makes life easier for importers as the prices of imports get cheaper. A sharp fluctuation in the currency hits the small and mid-cap companies harder than their larger peers, as the larger players can manage the situation through actively managing (hedging) the currency and working with the scale. Eg. Balkrishna Industries' approximately 90% revenues are generated through exports and the Company also imports lot of its raw materials and capital equipments; it is exposed to high risks due to currency fluctuations.
- **Pricing Pressures:** The tyre industry in India is a highly competitive sector with a very cut throat competition among the leading players. Any rise in raw material costs would result in pressure on the realisations and though the players vouch to increase the prices, due to competitive pressures, they have not been able to pass on the entire increase to the consumers.



Opportunities

- **Improvement in Automobile Industry prospect:** Growing economy leads to improving Automobile Industry prospect which further leads to Increasing OEM demand that in turn leads to Subsequent rise in replacement demand. With continued emphasis being placed by the Central Government on development of infrastructure, particularly roads, agricultural and manufacturing sectors, the Indian economy and the automobile sector/ tyre industry are poised for an impressive growth.
- **Access to global sources for raw materials:** with the access to global sources for raw materials, Indian tyre industry can stabilize price fluctuation in raw materials and control their margins. Furthermore, Indian tyre companies can also follow and maintain global quality standards and international process and system certifications, which will help them during export. Eg. Balkrishna Industries imports natural rubber and has very little exposure to domestic rubber price fluctuations and thus margins have remained strong.
- **Exploration of new markets:** Many Indian tyre companies are exploring the opportunities to enter into new markets. Recently, Apollo Tyres confirmed Hungary as the location for its first Greenfield facility outside India. The company has decided to set-up facility over there after receiving the necessary approval from its board of directors on the proposed investment towards setting-up a Greenfield facility in Eastern Europe. This facility will produce both, Apollo and Vredestein branded tyres, and will cater to the entire European market, and will complement Apollo Tyres' existing facility in the Netherlands.

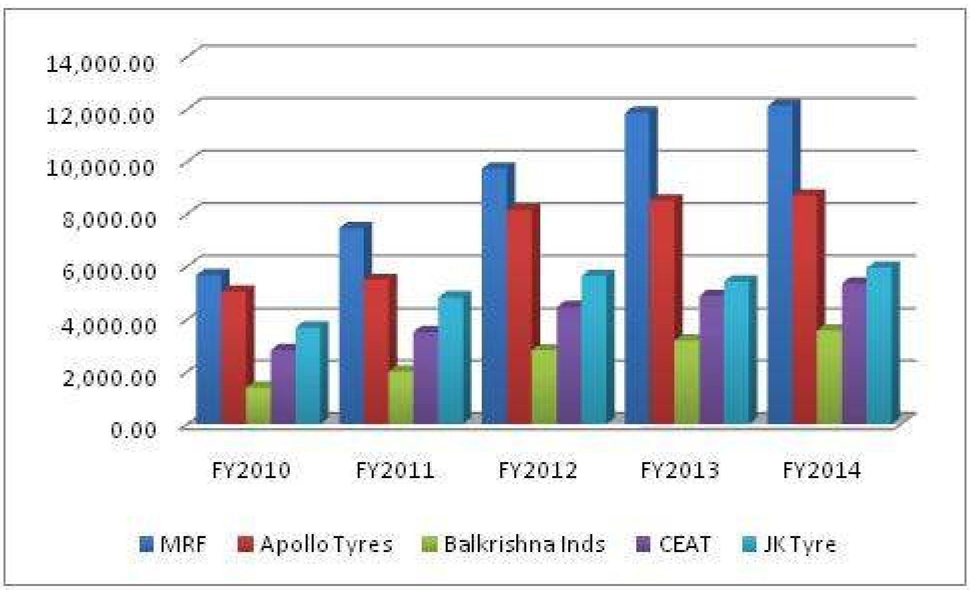
Threats

- **Introduction of other transport facilities:** Introduction of other transport facilities like metro, monorails and local trains keeping pollution hazards caused by combustion of automobile fuels.
- **Cheaper imports of Tyres:** The major concern for the Indian manufacturers is that the price of the tyres in the overseas market like China and South Korea is comparatively low compared to domestic market. Therefore, many automobile manufacturers have switched to the option of importing tyres from international market. The landed cost of tyres from China is much lower than the Indian price. In addition, tyres from South Korea are imported at 30% customs duty while from other countries the duty levied is 35%. Therefore in both cases the Indian tyre manufacturers are on receiving end.
- **Expectation of rise in natural rubber prices:** Natural rubber prices, which accounts for over one third of total raw material costs, are expected to rise as Total output of Natural rubber in India is likely to drop over 10 percent in 2014/15 from the previous crop year, hit by heavy rain in key growing regions and as farmers suspends tapping due to lower prices.

Performance review of top players

Indian tyre industry is mostly dominated by the organised players. At present, India has 40 large and medium tyre manufacturing companies, of which the top 5 account for over 60 percent of the country's total tyre production. Table given below shows the top five companies, their Revenue and Compound annual growth rate (CAGR) for FY10-FY14.

Revenue Growth (Cr)	FY2010	FY2011	FY2012	FY2013	FY2014	CAGR (FY10-FY14)
MRF	5,672.84	7,463.74	9,743.17	11,870.18	12,131.16	20.93
Apollo Tyres	5,036.80	5,490.74	8,157.88	8,507.49	8,711.73	14.68
Balkrishna Inds	1,394.30	2,002.88	2,819.96	3,190.57	3,576.72	26.56
CEAT	2,830.61	3,516.33	4,472.01	4,881.45	5,354.81	17.28
JK Tyre	3,691.64	4,831.22	5,643.71	5,430.83	5,951.08	12.68
Total	**18,626.19**	**23,304.91**	**30,836.73**	**33,880.52**	**35,725.50**	**17.68**



The industry top five companies' CAGR revenue growth was stood at 17.98% for FY10-FY14. Among all, MRF is a market leader in the Indian Tyre Industry with operating revenue of Rs 12,131.16 crore and average CAGR of 20.93%. A well-diversified product portfolio, well entrenched and dedicated distribution channel leading to higher share in replacement market have helped MRF register better than industry growth and profitability. However, in terms of revenue growth, Balkrishna Industries is far ahead from other industry players. Its revenue grew strongly at a CAGR of 26.56% in last 5 years. The company has built a substantive export business in off'highway'tyres (OHT), a niche area, where it enjoys a global market share of 4%.

Industry analysis through 'Porter's Five Forces Model'

As per 'Porter's Five Forces Analysis, it has been that there are five important forces that determine competitive power in a business situation. These are:

1. **Bargaining power of customers:** The Indian Tyre industry has more than 40 players. Therefore, the customers have lots of options to choose from and can clearly articulate their needs. Thus, bargaining power of customers is high.

This can be explained by segregating two parts as follows

- **Original equipment manufacturers (OEM's)** - The bargaining power of OEM's is always greater due to many of them having contract with their relative tyre manufacturer under which the prices of tyre remains stable for the OEM irrespective of market price. The benefits are given to them as they are buying in bulk and the relation gives the tyre firms something called brand association.
- **Replacement -** The scope of replacement segment is quite reverse as the bargaining power for the replacement segment is moderate due to the fact that the buyers are not that strong as compared to OEMs. The demand in buses and truck segment is always high because of Indian poor road conditions. Thus, bargaining power of customers is moderate compared to OEM's but high compared to other industries.

2. Bargaining power of suppliers: The major raw material of the tyre industry is natural rubber. Rubber prices falling continuously are trading near 5-year lows. This tends to support margins of tyre companies in the medium term. Besides, low crude prices too contribute to lower input costs. Thus, bargaining power of suppliers is low.

3. Competition in the industry: Although there are more than 40 players in the Indian market, the industry has relatively high concentration with the top 10 players holding 90 to 95% of the market share. Furthermore, in every category like Passenger cars, two wheelers etc. top 3-4 players command close to 75% of market share. However, the individual market share of companies is quite close to each other. As a result they cannot fully pass on any price rise to OEMs due to fear of loss of market share. Therefore, the competitive rivalry is Medium.

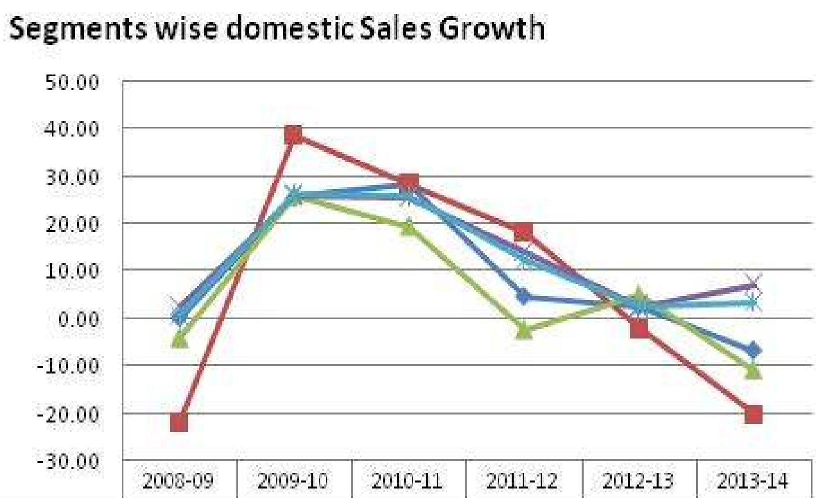
4. Threat of substitute products: Tyre industry is facing opposition from retreading sector all over the globe. This cheaper option of around 20-25% of the original tyre cost, is present in developed countries since last some decade and this is heading towards a strong position here in India too. Furthermore, if domestic tyre prices are higher than the overseas market, the automobile companies start buying tyres from overseas markets. This usually happens when rubber prices decrease significantly in international market. However, consumers who buy tyres in the replacement mark do not have this liberty. Thus, threat of substitution is Medium.

5. Potential of new entrants into industry: Potential of new entrant is modest or can be describe as low because the industry is highly capital intensive and the level of technological expertise required is also highly specific. Besides, the margins are also very low. Therefore, it is very difficult for the new players to sustain in this competitive industry. However, the automobile players have the ability to do backward-integration with ease because they have expertise, source of finance and brand image. TVS Srichakra is one of the best examples of an auto player backward integrating into tyre manufacturing.

Key Risks and Concerns

- Hike in import duty of rubber: In the wake of declining domestic rubber prices, the Indian Rubber Growers Association (IRGA) and farmers from Kerala have asked the Union Government to increase the import duty of rubber to lower of 20% or 30/kg, from currently lower of 20% or Rs 20/kg and suspend duty free imports for six months. Implementation of these measures will have an adverse impact on tyre companies' profitability.
- Volatile rubber prices: The prices of Natural rubber (NR), the key raw material constituting around 44% of total raw material costs has remained volatile during the last two years and has been declining in the recent past due to slowdown in automobile production and import through duty-free channels. Apart from demand- supply relations, the natural rubber (NR) price is influenced by many factors such as weather, currencyexchange rates, oil prices, policy changes in major countries and speculative factor. Domestic rubber prices, after having peaked at about Rs.238.68 per kg in April 2011, declined to Rs.160-Rs.170 per kg during 2012-13 and to Rs.123.28 at September 2014. However, any increase in rubber prices would have a negative impact on tyre companies EBITDA margin and consequently on its profit.
- Slowdown in automobile industry: The automobile demand in India across most segments had been on a tight leash for three consecutive years until FY 2014 on the back of a slowing economy and rising inflation, causing pressure on household disposable income and hence consumption. Despite attractive discounts schemes announced by manufacturers, Consumers are deserting showrooms and deferring purchases due to high fuel prices and interest rates. The total domestic sales for 2013-14 recorded 3.4% growth at 18,421,538 units against 17,815,618 units sold during 2012-13. Two Wheeler Domestic Sales recorded positive growth of 7.3% in FY 13-14 against FY 12-13 while Passenger Vehicle sales fall by 6.8%. Commercial Vehicle sales registered 20.2% de-growth while three wheeler sales fell by 10.9%.

Domestic vehicle sales trend



	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Passenger Vehicles sales growth	0.18	25.67	28.20	4.66	2.61	-6.80
Commercial Vehicles sales growth	-21.67	38.66	28.57	18.20	-2.02	-20.22
Three Wheelers sales growth	-4.13	25.92	19.44	-2.43	4.88	-10.90
Two Wheelers sales growth	2.60	25.99	25.59	14.16	2.69	7.30
Industry Growth	0.72	26.44	25.91	12.24	2.53	3.40

Outlook

After a softer input costs regime over the past one year, Indian trye industry may show some healthy growth in coming years. Prices of natural rubber, the most important raw material for the industry, have dropped to multi-year low in the domestic as well as international market on account of poor demand from countries like China and oversupply of the commodity. Besides, the fall in crude prices is a double bounty for tyre companies as petroleum-based products account for over 30% of the raw material used in the industry. A fall in crude prices will be a complementary sweetener for tyre makers which have already seen operating margins improved to double digits in the last two quarters due to a steady drop in natural rubber prices. However, some significant hurdles towards attaining growth could be raw material related price volatility, rupee appreciation and the looming threat of cheap Chinese imports. The Indian tyre companies need to make active efforts to search newer markets as the existing markets for bus-truck tyres, which account for about 45% of the total export volume, is nearing saturation. There is also an urgent need to increase the degree of radialization in order to safeguard their share in the export market. Global tyre companies have been making constant efforts to innovate and provide a diverse range of products like tyres with pressure warning systems, run flat tyres, eco-friendly tyres and energy efficient tyres. In this situation, the Indian tyre companies have to make a growth strategy of continuous innovation and increasing emphasis on product differentiation.

Companies Financial Data In Industry

Company Name	CMP	MCAP	BOOK VALUE	DIV. YEILD %	TTM EPS	TTM PE
MRF Ltd.	31678.65	13435.37	9964.56	0.09	1803.95	17.56
TVS Srichakra Ltd.	1655.95	1267.97	316.75	0.97	98.59	16.80
Ceat Ltd.	896.85	3224.69	300.81	1.12	69.06	12.99
Balkrishna Industries Ltd.	622.55	6017.48	215.98	0.32	50.03	12.44
Goodyear India Ltd.	633.80	1461.96	217.99	1.42	47.61	13.31
JK Tyre & Industries Ltd.	513.95	2110.25	224.46	0.97	39.48	13.02
Apollo Tyres Ltd.	223.70	11386.88	59.79	0.34	10.62	21.06
Modi Rubber Ltd.	22.00	55.09	58.92	0.00	4.33	5.09
PTL Enterprises Ltd.	41.15	272.37	13.64	2.43	2.77	14.88
Govind Rubber Ltd.	24.05	52.52	14.59	0.00	0.99	24.32
Krypton Industries Ltd.	14.13	20.77	20.42	0.00	0.29	48.98
Surya Industrial Corporation Ltd.	30.15	28.13	6.18	0.00	-0.02	0.00
Dunlop India Ltd.	21.45	261.65	20.04	0.00	-0.32	0.00
Falcon Tyres Ltd.	21.10	163.47	24.15	0.00	-2.79	0.00

Sorted with TTM EPS (High to Low)

Source – Ace Equity

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