

Smoother road ahead for tyre firms

Steady softening of rubber prices brings good tidings for tyre companies as the material accounts for nearly two-thirds of the costs in making a tyre. Domestic rubber prices (RSS-Grade 4) have fallen 20% from an average of ₹237 a kg in April last year, and 4.7% from the December average price of ₹200 a kg. Naturally, profitability is expected to get better.

An analysis of 12 listed tyre firms shows that with the increase in costs outstripping growth in revenues, the firms' operating margins during the December quarter fell to an average of 7.9%, nearly 160 basis points lower than the year-ago period and about half that scaled during the days (September 2009) of heady margins. One basis point is one-hundredth of a percentage point.

Aggravating the pressure on margins was the sluggish sales offtake in the replacement market in the past two quarters, where profitability is better than that in the original equipment segment. A report by **Emkay Global Financial Services Ltd** on **Apollo Tyres Ltd** shows the raw material cost hike per tonne from the quarter ended December 2010

Easing rubber prices, along with an expected increase in automobile sales, may buoy margins of tyre makers in the coming quarters

to December 2011 was 31.2% compared with sales growth per tonne of only 18.3%. This gap has narrowed as raw material prices are receding.

Meanwhile, an estimated 4% rise in domestic rubber production during fiscal 2013 would keep rubber prices in check. The average rubber price during the current quarter is estimated to be around ₹190 a kg compared with ₹210 a kg in the December quarter. Further, automobile sales may nudge up as retail interest rates dip.

Therefore, tyre sales will improve, which in turn will raise utilization of capacity at tyre plants, providing cost leverage to ease the pressure on margins. Also, the industry is shifting towards radial tyres, which enjoy better margins in

the longer term. The risk of a weak rupee inflating import bills for tyre makers who import rubber, is also ebbing.

These factors will push up operating margins over the ensuing quarters, although they may not reach the year-ago levels yet. Firms will not be compelled to carry high inventory levels, as they did in the past few quarters, which will help ease the working capital needs and lower interest costs. Firms such as **Ceat Ltd** and **Apollo Tyres** reported a jump of 113% and 41%, respectively, in interest costs year-on-year during the December quarter, partly due to borrowings to fund capacity expansion.

Lower interest costs will improve net profit. During the December quarter, net profit for the 12 listed companies contracted by an average of 10% compared with the year-before period. The current quarter could see a lower decline or flat profit growth compared with a year ago.

The positive outlook for tyre companies has already seen a run-up in tyre stocks in the last one month. Cautions **Surjit Arora** of **Prabhudas Lilladher Pvt. Ltd**, "Although the outlook is clearing up for tyre firms, there will be better valuation and price upsides in large tyre makers such as **Apollo Tyres** and **MRF Ltd**, when compared with the rest."

VATSALA KAMAT