Rubber prices puncture Ceat's profits

Ceat Ltd slipped into losses in the March quarter, hit by a sharp and sustained increase in rubber prices during fiscal 2011 (FY11). The **RPG Enterprises**-owned tyre maker had a tough year, with each of the first three quarters of the current fiscal seeing a decline in profit margins.

While analysts had expected its net profit to be a meagre ₹10 crore in the last quarter, the firm incurred a loss of about ₹12 crore. It had earned a net profit of about ₹15 crore in the year-ago period and ₹5 crore in the preceding quarter.

What is ironic is that booming sales of automobiles—both commercial and passenger vehicles—have actually buoyed demand substantially. In the March quarter, Ceat's revenue rose by a robust 28% year-on-year (y-o-y) and 11.8% sequentially.

The rise in volumes was also backed by a 5% rise in tyre prices, but mainly in the replacement market, which comprises a little over three-fifths of the revenue. Passing on price increases in the original equipment maker segment is difficult because customers have better bargaining power.

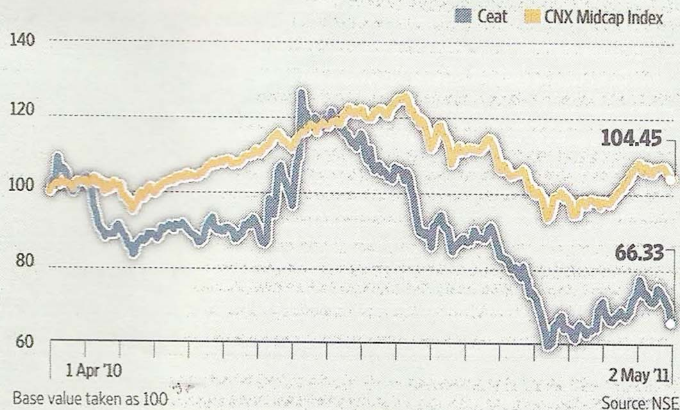
However, the hike in tyre prices did not compensate for the 11% rise in rubber prices in the last three months. During FY11, while rubber prices soared by 37%, the firm was able to raise tyre prices by just about 18%.

Operating margin for the March quarter plunged to 1.5%, 365 basis points (bps) lower y-o-y, and 300 bps down sequentially. Its operating profit fell by 63.5% from a year ago to ₹14.5 crore. One basis point is one-hundredth of a percentage point.

Notwithstanding the cost pressures, Ceat has been expanding capacity to cater to growing demand. During end-March, it inaugurated a 150-tonne-per-day radial tyre plant at Halol; this capacity is under one-third of Ceat's total tyre capacity.

The plant will cater to the passenger and the truck and bus segments, and enhance the share of radial tyres in Ceat's product mix. Radial tyres fetch higher prices and, hence, earn better margins compared with bias tyres.

While rising interest costs ate into profitability, higher interest costs are further affecting profits. Interest outgo doubled from a year ago to ₹22 crore. "Higher inventory due to sluggish sales in March, working capital and lower interest earnings when compared with the year-ago period were key reasons," says Anant Goenka, deputy managing director of Ceat.



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Consolidated net profit for FY11 dropped 83.4% y-o-y on account of poor operating margins. The firm is hiking prices at consistent intervals—in April, there was a 4.5% hike and a similar hike is expected in May, too.

So far, rubber, which accounts for about two-thirds of the cost of making a tyre, is showing no signs of shedding prices. It is ruling firm at ₹235 a kg. Hence, any improvement on the operating margin front does not seem likely, for now.

Perhaps, Ceat's profitability may improve from the second half of FY12, as higher radial tyre volumes from its Halol plant will translate into better realizations and margins. Commercial production commenced in March. The impact of higher depreciation and interest costs from starting the plant will be felt in the June quarter, too.

Not surprisingly, shares of the firm dipped 6% to close at ₹100 apiece. Consolidated earnings per share for FY12 plummeted to ₹7.70, a mere one-sixth of the previous year's level.

On the brighter side, volume growth is robust. If that continues in FY12, a fall in rubber prices should bring investors back to the counter.