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Tyre stocks skid as MRF cautions on rising costs and greater competition

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No sooner had MRF Ltd announced the March quarter results than tyre stocks tumbled on the Street. MRF itself fell 3.4% as it painted a grim outlook of times to come. It also took other tyre stocks downhill—Ceat Ltd fell 2.6%, Apollo Tyres Ltd and JK Tyre and Industries Ltd closed 1.2% and 1.9% lower, respectively.

What pulled the rug was MRF's cautious statement along with the quarterly results. It signalled rising input costs, mainly on account of skyrocketing crude oil prices, that could take a toll on profitability. In fact, until a few months back, softening rubber prices had fired up tyre stocks, which rallied quite a bit.

As on Thursday, crude oil prices are up 40% from a year back and the company's press release said categorically that "escalation in the cost of crude-based inputs will add pressure to bottomline". Tyre firms' profit margins normally face the heat with a six-month lag as prices of crude derivatives such as carbon black rise a bit later. MRF's caution on future profit outlook is eminently justified.

This is not all. MRF reckons that the coming on stream of greenfield and brownfield expansions by many firms would lead to stiff competition in future. Note that Ceat and Apollo Tyres have significant capacities coming up in the next two-three years.

Ceat's capacity will jump by 50% from its current 1,000 tonnes per day over the next three years.

Of course, for now, the import duty has partly brought relief from Chinese tyre imports that were putting pressure on domestic prices.

MRF, whose shares are among the most expensive on BSE, quoting at Rs77,045 apiece, failed investor expectations in its March quarter performance. The 15.8% year-on-year growth in net sales was significantly below *Bloomberg*'s estimate. Worse, the operating profit at Rs686 crore was 7% lower than forecasts. Even the operating margin at 17.7%, albeit higher by 210 basis points from a year ago, fell short of what the Street had pencilled by about 100 basis points.

The strain on the business from rising costs is evident in the March quarter results too. Fortunately, the demand for tyres was robust on the back of zooming auto sales. So far, tyre firms were able to increase prices to pass on cost pressures and shore up performance. It is unlikely that this would continue.