

Ceat Faces a Tough Ride on High Rubber Prices

New capacity at Halol plant in Gujarat likely to drive topline in FY12

Mid-Cap Mantra

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The stock of tyre maker Ceat has shed 12% in one month. Of this, three-fourth of the fall occurred in the past seven trading sessions, after the company declared a net loss during the March 2011 quarter.

A sharp increase in rubber prices eroded the company's profits in the past quarter. Higher input costs are likely to impact its performance until the September quarter. The management expects rubber prices to cool off in the second half of the December quarter, which may reduce pressure on margins.

Profits and profitability of the country's fourth-largest tyre maker are largely a function of prices of raw materials, including rubber, carbon black, and other related chemicals. For instance, its topline grew by a robust 27% to ₹2,873



crore in FY11, but at ₹26.5 crore, net profit reduced to one-sixth of the previous year's level.

The steep fall in net profit is due to rising raw material costs, which formed 75% of revenue. This was much higher than its proportion of 60% in the prior year. The price of rubber, a major raw material, doubled during FY11. But not all of it could be passed on to consumers, which include commercial and individual users.

The company typically experiences a lag between the increase in

rubber prices and the corresponding increase in product prices. Further, being a relatively smaller player, Ceat follows the pricing trend of larger players in the sector due to competitive pressure.

In FY12, what should drive its topline growth is the new capacity at its Halol plant in Gujarat. At an investment of ₹650 crore, the plant will churn out 150 tonne per day of tyres on the upper end of the capacity. When it's fully operational by the end of FY12, the plant is expected to generate ₹500 crore in revenue annually.

Ceat has also enhanced its focus on overseas markets. Last year, the company obtained global rights to the Ceat brand from Italian tyre major Pirelli for nine million euros (around ₹55 crore). This will expand Ceat's reach in Europe and Latin America. Its benefit, however, will not accrue in the immediate future since the company would require to build a strong brand presence in these regions.

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