"CEAT Limited Q3FY22 Earnings Conference Call"

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MODERATOR: **MR. RISHI VORA – KOTAK SECURITIES LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to CEAT Limited Q3 FY22 Earnings Conference Call hosted by Kotak Securities Limited.

As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone.

I would now like to hand the conference over to Mr. Rishi Vora from Kotak Securities Limited. Thank you. And over to you sir.

Rishi Vora: Hello, everyone. A very good morning to all. Hope you all and your families are keeping safe and feeling well. I would like to thank the Management of CEAT for giving us the opportunity to host this call. Today we have with us Mr. Anant Goenka - Managing Director, Mr. Kumar, Subbiah - CFO and Investor Relations Team.

With this, I like to hand over the call to Mr. Anant Goenka for his opening remarks, post which we can open the session for Q&A. Over to you.

Anant Goenka: Good morning, everyone. A warm welcome to CEAT's Q3 Earnings Calls and thank you all for joining us today. This is Anant Goenka and we have with us our CFO, Kumar Subbiah on the call with us.

I hope all of you are safe and well. And, as usual, we will start with brief remarks from me, and Kumar, and post that we will take up Q&A.

Q3 this year has been unusually challenging for the industry, primarily due to slowing domestic demand and unabated cost pressures. The results for the quarter reflect the challenges on this account, with negative growth in both the replacement and OEM segments. During this period our focus was predominantly on careful calibration of our response to the evolving demand dynamics, by ensuring adequate liquidity, by tightening cash flows and managing inventory levels by moderating production.

In terms of the replacement segment, commercial volumes, which include truck, bus and farm segments remained weak on account of liquidity pressures and high fuel prices. Passenger segments started to show some weakness towards the latter part of December due to the start of Wave-III, and some uncertainties as a result of that. Overall replacement volumes declined by about 4.5% sequentially, and 14% on a year-on-year basis. Sequential decline was more pronounced in passenger categories, while a year-on-year decline was led by commercial segments.

In terms of OEM demand, the truck and bus segments saw a good traction. PCUV also saw some improvement due to some easing in semiconductor shortage. However, farm and two-wheelers' demand was sluggish leading to overall OEM volume decline of about 3% sequentially and about 7% on a year-on-year basis. Exports has continued its healthy performance across categories, especially in the OHT segment. And this has resulted in sequential volume growth of about 5% and year-on-year growth of about 27%. Exports continues to be a focus area as we undertake investments across product, marketing and new markets and channel expansion.

Overall, we saw sequential volume decline of about 2% and a year-on-year decline of about 6% during Q3.

On the cost front, raw material basket per kg went up by about 4% sequentially on account of higher natural rubber and crude prices. This inflation is expected to continue although at a lower level into next quarter as well. We took staggered price increases to offset the raw material impact but these were towards the latter part of the quarter, and was lower than what was required. Coupled with some amount of adverse product mix and inventory impact the gross margins contracted by about 3% over Q2 level. We exercised strict cost control measures. And despite several headwinds, we were able to maintain our operating expenses at near Q2 levels. However, given severe gross margin and lower volumes, EBITDA margins contracted by about 3.4% over Q2. We ended the quarter with a negative PAT of approximately Rs. 15 crores on a standalone basis.

As a part of our efforts to align CAPEX with market outlook, we have decided to moderate some of our CAPEX plans. As regards to our truck radial expansion, we are primarily focusing on the Phase I which involved an investment of about Rs. 700 crores. We are planning to push that as well by about a year vis-à-vis our current schedule and indefinitely postpone the balance Rs. 500 crores of Phase II, because strategically we have decided to increase our focus on the OHT segment.

Meanwhile, we intend to complete this downstream capacity expansion of OHT to its full capacity of about 105 tonnes in the next 12 to 15 months. Given these changes, we would revise our growth CAPEX guidance to about Rs. 800 crores in FY22 versus Rs. 1000 crores that we had planned. And in FY23 to about Rs. 700 to Rs. 750 crores.

Our association with OEMs continues to improve. Recently Skoda unveiled its premium midsize sedan Slavia on CEAT tyres. The two-wheeler EV business is other exciting space with strong drivers such as rising fuel prices and Government incentives. We are working very closely with all the major two-wheeler EV OEMs.

We were also awarded for our R&D capabilities by Questel India recognizing the remarkable work done by us on intellectual properties. Also, our premium range of tyres has received encouraging response from the market on account of good quality products in nearly across segments.

IPL 2021 continued in October and we were associated with the event as the Strategic Timeout Partner once again. Our Puncture Safe Tyres also won the Best New Product Launch in The Smarties India 2021 and Gold Medal in the Brand Equity Media Strategy Awards.

With respect to ESG we have achieved close to 32% gender diversity in our new hirings so far in FY22. We also introduced a program in-house called INWEAVE, it's an internship program for women aspiring to return to the corporate world and for specially abled candidates. We received a very overwhelming response and have been recruiting women to come back into the workforce back into CEAT as well.

The current environment for the auto and tyre industry has been benign since Wave II, because of the uncertainty brought about the disruptions in economic activity as a result, coupled with high fuel prices and other commodity prices which had an impact on overall spends at all levels and resulted in lower confidence as well. However, we have witnessed sharp spurt in growth during the brief periods of stability. We believe that as the pandemic eases we should see a more robust growth across categories with improved economic activity and consumer spends.

I feel confident that despite the challenging quarter that we are well positioned to leverage on the opportunities to get back on growth with strong product mix and consequent improvement in margins and profitability as and when the demand uptick happens. With this I will hand over the call to Kumar.

Kumar Subbiah: Thank you Anant. Good morning ladies and gentlemen. Thank you for joining our Q3 FY22 Earnings Call. I will share some further financial data points with you all, posts which we can enter Q&A session.

First regarding revenue, our consolidated revenue for the quarter stood at Rs. 2413 crores a sequential decline of about 2% which was led by volume decline. And year-on-year growth of about 9% which was driven by higher realization on account of price increases that we took in the last 12 months.

Now, coming to gross margins, raw material costs continue to rise and impacted our gross margins, which stood at 34% a sequential decline of about 290 basis points. Our blended raw material cost went up by 4%, in line with our estimates. We managed to take approximately a little over 2% price increase during the quarter. And the increases have happened across categories and product mix also played a role adversely due to lower replacement sales, leading to drop in gross margins during the quarter.

RM prices continue to increase though at a slower pace now. As per the current market conditions we expect that our blended raw material cost to go up by about 1.5% in Q4 over Q3, which means that we will still need to take more price increases in the current quarter and also in the coming quarters and hope the demand situation improves and becomes more conducive for the same.

Our overall debt increased by about Rs. 256 crores on a consolidated basis, sequentially. And now, our debt as of 31st December stood at Rs. 2260 crores. We incurred a project CAPEX of Rs. 145 crores in Q3, and overall about Rs. 480 crores in the first nine months of the current financial year.

Our project CAPEX outlook for currently stands revised from earlier estimate of Rs. 1000 crores to around Rs. 800 crores for the current expansion projects as covered by Anant. During the quarter we also managed to bring down our inventory levels by about Rs. 112 crores. However, as payables declined more significantly during the quarter, our working capital still went up by about Rs. 63 crores. We intend to further reduce our inventory largely in raw materials in Q4. And also, our decision to review our working capital and reduction in the estimate for the current year, we expect our debt levels to be within our internal leverage ratio thresholds.

Now coming to operational expenses, we continue to monitor our costs tightly. Inflation was prominent across other costs including our distribution costs on account of increase in fuel costs. We were able to largely curtail some discretionary spends and maintain our operating costs at Q2 level in the Q3. Our consolidated EBITDA for the quarter stood at Rs. 143 crores translating to margin of 5.9% of our turnover.

Depreciation declined versus Q2, as there was one off effect in the previous quarter that is in Q2 on account of treatment of long term leases which we had explained during our last call. During the quarter, the credit rating agency CARE carried out rating assessment and affirmed "AA" rating for long term and "A1+" for short term with stable outlook.

Now we can open the floor for Q&A. Thank you.

Moderator: Thank you very much. Ladies and gentlemen we will now begin the question and answer session. The first question is from the line of Ashutosh Tiwari from Equirus Securities. Please go ahead.

Ashutosh Tiwari: So, firstly, you mentioned the replacement volume declined 14% YoY. So, can you give us some color on the segment wise decline like two-wheelers, tractors, bus and all?

Anant Goenka: Yes, so, overall majority of this decline came in the truck segment. Last year, same time was a very high kind of a base with fair amount of pent-up demand that came in if you recollect our growth rates may have been somewhere around 25% and that caused an impact on the market. So, I would say truck, bus was primarily down by over 20% to 25% out of this impact. The rest of it was much more positive, we saw positive growth in PCUV, good growth in PCUV in fact, good growth in two-wheeler. It was only in the commercial vehicle segment and the tractor segments that we saw negative growth.

Ashutosh Tiwari: So, two-wheeler and PCR was like good growth means, is it high single digit or it was lower than that?

Anant Goenka: So, passenger car would be at about double-digit growth 15% plus, kind of growth levels. Two-Wheeler would be somewhere to single digit growth and truck and bus was at negative growth. Primarily most of this coming out of the truck bus buyer segment.

Ashutosh Tiwari: And in terms of price increases, we have mentioned the 2% increase was taken during the quarter. So, was it effective for the full quarter or some part came in December month?

Anant Goenka: No, it wasn't for the full quarter. I think some of it came early part of November or mid-November. So, I will say between November 1st and 15th was the time when a large part of the price increase took effect.

Ashutosh Tiwari: And any price increase, let's say January or December end?

Anant Goenka: We have taken about a percentage price increase in the two-wheeler segment in January. We are hoping to take about a couple of percentage points in this quarter. But nothing is firmed up yet, but between Jan and March, maybe another 2% points across the board.

Ashutosh Tiwari: And lastly, on this payable receivable you mentioned there is an increase quarter-on-quarter, so let's say it was around 1022 crores as of September 30th. So, why do you think the demand was weak? And how do you see it going ahead in this March quarter?

Kumar Subbiah: I didn't say receivables, I said payables came down, okay, receivables were largely similar as of 30th September.

Moderator: Thank you. The next question is from the line of Jay Kale from Elara Securities. Please go ahead.

Jay Kale: So, I just wanted a qualitative comments on the demand trajectory, you mentioned on the replacement side specifically, you mentioned that it was a high base of last year and tractor segment had declined, but how would you rate this demand, is it more of a high base or would we be still lower than the 2019 December levels or we are still above those 2019 levels and it's just pent-up of last year has caused this double-digit decline on the CV side?

And how are you seeing the trend going in Jan, Feb March, because what we understand is that in this quarter in Q3, the price increases has been a tad lower than what you had seen in the earlier two to three quarters. So, is it to do that you are a little more cautious now in taking the price increases, given the weakness in demand or you think that this is a temporary phenomenon and price increases can be very much possible in this current quarter?

Anant Goenka: So, I think on the commercial vehicle side, there is a slowdown in demand on the replacement side that we had seen. To that extent, I think there is still continued pressure on the CV size. But two and three, wheeler and PCUV were pretty good in the last quarter, except for the latter half of December, when this Wave III kind of impact started coming. There were some closures that happened in some of the cities, lower footfalls, lower travel, etc. But with this resuming, things getting better, maybe by February, I am quite confident about two to three-wheeler and PCUV coming back on the replacement side.

On the OEM side, I am quite confident about I mean there is a clear uptick we are seeing on commercial vehicle demand. And that I think, is a considerable shift between what was happening say maybe in August, September, October, going forward into Q3 and Q4, OEM will make up for the loss in replacement segments, to some extent, at least.

And International Business is looking quite strong. We have seen good growth and that momentum is continuing into this year as well.

Jay Kale: And also, if you can just broadly comment from Q3FY21 last year, December quarter, till now and going up till Q4 of FY22 how much of an overall cost increase have you seen, and how much of an overall price increase you have taken? And how much more is needed to offset that pressures? And would Q4 be the last of the raw material pressures as of what you see today. And Q1, it should start kind of declining.

Anant Goenka: So, on a year-on-year basis, we have seen about a 40% increase in raw material prices. And against that we have taken about a 15% kind of price increases. We are short I would say by about 5% to 6% which is what is reflected in our average margin. Say an average margin is 10% to 12%, 10% range say we are at about 5% EBITDA margin. So, that is the kind of price increase that we need to take in addition to whatever further inflation that may happen.

As Kumar said, we are at about, we are seeing about another 1.5% increase in raw material from Q3 to Q4 and then hopefully things should stabilize. If you look at natural rubber, it at peaked at about Rs. 180 to Rs. 190 per kg. It is now at about Rs. 165 to Rs. 175 kind of range. So, to that extent, there has been some minor correction on that side. Crude on the other hand has gone up a little bit but looks like the pace of inflation has certainly come down. And hopefully Q1 will remain stable in comparison to Q4. And between now and say the next four months, five months' time we will be able to take some price increases. The ability to take price increases is difficult, I don't have an answer to that. But we are going to endeavor for making up this loss or the gaps in the price increases. And I think it is an industry issue. I don't think we have lost market share, nor have we taken lower pricing increase than competition. So, to that extent, I feel confident that if the industry is down, I think everyone will be under a fair amount of pressure to take price increases.

Jay Kale: So, out of the 5% required price increase, maybe 2% you could take in Q4, as you mentioned. So, balance 3% to 4% is something that you will require over Q1, Q2 to get back to your original margin, is that a fair understanding?

Anant Goenka: Approximately yes, I didn't take into account, the 5% is something I say we should have taken until now since we are seeing another 1.5% price increase maybe I would change this to 6%, because there is further inflation that may happen. But range bound, yes, that's what I hope we are able to do.

Jay Kale: I know it's early days, but on your EV two-wheeler OEM orders from the startups, is it fair to assume that we would have a higher market share on the OEM side with the EVs that you have in the ICE, say maybe more than 30%? And going forward how does it look now the incumbents also coming up with new launches, how are your orders for the EV launches.

Anant Goenka: So, we are very happy with us position there. We are there with maybe 80% to 90% of all the EVs in the market. And we would be having a share of business of about 60% overall for the market, whereas a normal Two-Wheeler market share is at about 28% to 30%. So, we are happy with our position on the OEM EV side.

Moderator: Thank you. The next question is from the line of Vivek Ramakrishnan from DSP Mutual Fund. Please go ahead.

Vivek Ramakrishnan: Just to reconfirm your price increase would depend on demand conditions. So, you think it's a tough to call kind of decision, so I just wanted to confirm that. And the second question is on the payables which have fallen, is that like, is that a one off or would you like for example, in the March quarter, would the payables increase, is it part of a regular cycle. And could you also reiterate your internal debt guidelines?

Anant Goenka: Sure. So, I think price increases is something which is much needed at this point of time. And as I said, I feel it is an industry while commercial vehicle demand is under pressure Two-Wheeler and passenger car is relatively okay. We will aim for further price increases, but difficult for me to give a clear answer as to when and how much it will happen.

Kumar Subbiah: See payable reduction in Q3 is an account of lower arrival of materials and mix of material, like we had more imported raw materials and less of local materials. When you import materials you tend to pay on arrival in case of local materials you tend to have a little longer payment cycle or payment terms, okay. So, what also happened in Q3 was that the import arrival was more, because the transit times came down. And it was taking around 60 days for a consignment to come from Southeast Asia to India till October and early November. And however, the transit time came down from 60 days to 38 days and eventually toward December, it came back to a normal pre-COVID level of around 25 to 26 days. So, therefore, it is more imported materials and that led to paying those suppliers on arrival.

So, it's more a one off, we expect our receivables to come back to a normal level, approximately our payables are in the range of about Rs. 1900 to Rs. 2000 crores covering all, not only raw materials, services. And during the quarter we witnessed about Rs. 180 crores kind of reduction, we expect it to come back to normal levels, but we will still control our receipts in the Q4 of raw materials. So, you may not see a big jump in payables by end of March. But however, that drop, that we witnessed in Q3, we will be able to partly reverse in Q4.

Regarding your last question on debt level, our internal threshold with respect to debt, our debt EBITDA threshold is 3. And we would be in line with that internal threshold with respect to debt in Q4.

Vivek Ramakrishnan: If I can squeeze in one more interest industry related question, the CV segment, do you see that the freight operators are not able to pass on the higher cost that is increased freight rates? Or are you just seeing that the utilization itself dropped in the last month or so?

Anant Goenka: So, I think utilization has come down to a certain extent, but I think the freight price increases which were not passed on as much in the last quarter has begun to get passed on whether it is corporates or whether it is Government there has been some shifts that have happened. I think also one change this time after Wave II is that the EMI moratorium that was given in the last Wave I that is of course not there, so to that extent the EMIs by the fleet operators need to be paid, so all of that is putting some pressure on the industry.

Moderator: Thank you. The next question is from the line of Jinesh Gandhi from Motilal Oswal Financial Services. Please go ahead.

Jinesh Gandhi: Can you first talk about what was the overall volume decline in the quarter?

Anant Goenka: Yes, I did share that with you about 4%. Overall, just give me a second I think about 3%, 4.5% was in replacement segment but I think overall was at about 2% to 3%.

Jinesh Gandhi: On QonQ basis?

Anant Goenka: YoY was at about 5.5%.

Jinesh Gandhi: And second question pertains to the pricing pressure. So, are we seeing pricing or for lack of price increases, adequate price increases across segments or any particular segments where pressures are higher where competition is not taking adequate price increases?

Anant Goenka: So, I think there is more pressure on the commercial vehicle segment, the passenger segments is a little bit on the lesser side at this point of time. As we have taken the price increase on Two-Wheeler in January about 1%. Passenger car is also relatively okay versus CV at this point of time. But overall it is clearly much less than what we would have liked.

Jinesh Gandhi: And lastly on the OHT capacity expansion which we are doing so what would be our current capacity and utilization and by when do we plan to take it 105 tonnes per day?

Anant Goenka: So, we are today at about 50 tonnes per day. We are fully utilized at this point of time. We are going to be taking this up to 80 tonnes per day approximately by middle of this calendar year. So, by July or August, this expansion will be completed. And then we will be looking at another 105 tonnes per day that investment has not yet begun. But over the course of the next 15 months or so, we hope to invest that and look at taking it up 105 tonnes per day.

Jinesh Gandhi: So, from 80 to 105 we are not yet committed the CAPEX.

Anant Goenka: That's right so 80 tonnes by say Q3 or latter part of Q2 and then 100 plus tonnes from about I would say a year and a half from now. That is our farm radial capacity. We also have bias capacity, which we already have in our older plants.

Jinesh Gandhi: Another question on the export side. So, export clearly has been doing well and OHT is driving this part of it. But on the non-OHT side also I believe momentum has been fairly strong with good growth across the segment. So, can you talk more about how do we expect growth in Exports over next two to three years? Which segments apart from OHT will also be benefiting out of that?

Anant Goenka: Yes, I think we are most excited about the International Business for us. People are looking at China-Plus-One strategy and that presents a great opportunity for Indian players. And to that extent, we are seeing very good growth now and continuing going forward into the next few months or years time, across all categories. So, for us, we will be starting, we are looking at huge growth in EU passenger car, where we have already been present. We are increasing our range entering new countries like France and Germany. And with that, we will be looking at very high growth in EU.

In addition, we are going to be launching our trucks radial tyres for EU. Again, you are talking about a very large market there. And that will help in strong utilizations. This will happen in another four to six months time, we will be launching that. And that will help in further growth. And then over time, I would say we are still about a year out where we will be looking at U.S. markets as well for passenger car and truck radial. So, with that, we think the International Business as a percentage of our revenues will grow substantially.

Jinesh Gandhi: So, Exports should grow much, much ahead of the domestic market over next two to three years?

Anant Goenka: That's right. Margins are also strong in that category. So, I think the mix will really improve.

Moderator: Thank you. The next question is from the line of Nishit Jalan from Axis Capital. Please go ahead.

Nishit Jalan: Sorry to probe more on the price hike side of it. Just wanted to understand, on price hike obviously, what kind of pushback are you getting, is it more because of inflation, that you are getting pushback from dealers? Is it because the demand is weak, you are not able to take through? Or is it because the competition are not going through ahead with the price hike that you are not able to take a price hike? So, just some more details on that front.

Anant Goenka: So, item 2 and 3 are in a way linked, right. If demand is down, people want to sell more tyres or more products and therefore price increases don't happen as easily when utilization is a little bit lower. So, I think it is between points 2 and 3 when demand is under a little bit of pressure on the replacement side and competitors are not taking up price increase so we have to manage that way, particularly as I said in the CV segment, where we are not in the top 2 or 3 players at this point. On OEM side, it is largely formula based. So, we are seeing continuous price increases happening there. And on the Exports, International Business side also, we are seeing steady price increases. So, it is primarily the replacement segment where there is some pressure.

Nishit Jalan: So, if I have to take this point ahead, in the last two years, if I look at this quarter versus two years back revenues, the revenues are up almost 40%. Even if I take a 15% impact of pricing, the volumes are still up almost 25% right. So, two year growth of 25% still means a double digit growth. This quarter YoY growth decline is partly due to high base as well. So, we cannot just say that the demand is really weak. The demand came back quite sharply last year, same quarter, that's what you also highlighted. And on that base, we are not seeing a growth coming in. There is no major problem of growth on an overall basis. So, I was just wondering –

Anant Goenka: No, you have highlighted it absolutely correctly, that it is on I mean, substantially higher base that we are talking about this challenge. Is it that post-COVID there has been an abnormal lull. I would say that no, last year, we bounced back quite well and at that level, is what we are talking about, you know, flat growth this year.

Nishit Jalan: So, that means that demand is not that big an issue, it's probably more of a competition, because of which you are not able to take price increase.

Anant Goenka: That's right. And also utilization levels right to that extent.

Nishit Jalan: And second point is I think you alluded to it briefly, but we have seen CEAT's margins moving from 5% to 6% band to 15% also. So, on a steady state what's your target, which you wish to maintain EBITDA margin assuming things are constant in the external world. What's your target profitability levels that we should be looking at from the company perspective? There can be ups and downs depending on demand competition and all those sort of things, but what is your aspirational level or what is the level at which you will be happy maintaining your margins?

Anant Goenka: I would like to see at least somewhere between 12% to 14% on average, we have been maintaining about 10% to 11%. But ideally if we can take it up to that kind of level by at least 3% points higher, that would be much better. So, I think that's what I would put as our target, whether it is through mix improvements, shifting our strategic focus to different areas, whether it is International Business, OHT business. If we can improve our mix towards these areas, that's what we are endeavoring for.

If you look to our Two-Wheeler business is quite profitable, that's about 30% of our business, OHT today is only about 5%. But we would like to take this up to about 10% plus over time, International Business where there is an overlap with OHT is about 18% to 20% today, but if we can take that up to about 25%. So, in that sense, the more profitable categories will be a much larger share of our business. And that's where we are looking at making that shift. And in light of that, also, we have curbed our TBR ambition as well and we will look at shifting that investment to OHT if demand allows that.

Nishit Jalan: If I take this point a bit ahead, that we want your company's average margin to move towards 12% to 14%. And if you are saying that Two-Wheeler and Exports are a higher margin business, is it fair to assume that Two-Wheeler and Exports will be an 18% to 20% kind of a margin business. And increase in mix of these segments will help you take our margin higher assuming at some point commodity pressure will normalize and you will be able to take price hikes.

Anant Goenka: That's right. So, these are higher margin businesses and if we can move towards that, is what we are endeavoring for.

Moderator: Thank you. The next question is from the line of Joseph George from IIFL. Please go ahead.

Joseph George: I have two or three questions. The first is when you mentioned that you have cut down your CAPEX plans, I wanted to understand the reasons for that. So, one is the fact that the profitability and revenues have been hit so your operating cash flows are weaker, that is one. And then you want to maintain prudence in terms of leverage on the book so that is one possibility. The second is that the market share gain targets that you had, for example, in TBR, etc. the achievement or the market share is not as much as you thought that might be the second reason. And the third reason might be that the overall industry or the overall industry volumes are not as strong as you thought would be.

Can you please explain to us which of these three pockets would that decision to cut CAPEX fall in?

Anant Goenka: So, for us, I would say one is as we highlighted, there has been some delays because of the market situation as well as cash flow, with respect to our desire to maintain our debt to EBITDA, and other key balance sheet ratios so that has resulted in the delay. But I would say strategically, we are looking at shifting our focus more towards other categories, which would be International Business, OHT business, passenger anyways we are focused on.

With that, as we are looking at that shift, we would like to keep some capital at least as an option to choose to invest, if we are seeing growth in those categories, these are our priority category. Truck would be same maybe fourth or fifth in terms of our own internal priorities. So, if we can invest in our core categories, or our focus categories, we will be happier with that. So, that's why we have decided to postpone or at least, currently only focus on that Rs. 700 crore of TBR CAPEX at the max at this point of time.

Joseph George: And in terms of our internal benchmarks of how you expected market share in TBR to progress, is that meeting expectations or is there some issue there?

Anant Goenka: No, I think on the replacement side it is slower than what we had hoped for. We were at about 4% to 5%, we moved to about 7% now. We had hoped to be at about maybe a couple of percentage points more at this point of time.

Joseph George: The next question that I had was in lieu of the cut in CAPEX and in lieu of expectations of lower cash flow from operations, when do you expect your debt levels to peak, is it at the end of FY22 or FY23 can you give some sense on that? I know it's difficult but there are too many moving parts but internally, how do you think about it? Is it going to peak at FY22 end or FY23 end, can you give some sense on that?

Kumar Subbiah: I think we could peak in the coming year, coming financial year. We are largely finishing off our capacity expansion CAPEX in the coming year, what we had originally planned that Rs. 3500 crores plus Rs. 500 crores of specialty, large part of it would be spent by next year. So, that is when it is going to peak.

Joseph George: The last question that I had was when I look at the inventory adjustment number in the cost of goods sold, I noticed that in 2Q you had over produced which would have resulted in over utilization of overheads. Whereas in 3Q you under produced, which means you utilized the inventory from the past. So, this inventory accounting how much would have impacted gross margins by in this quarter, maybe say on a QonQ basis?

Kumar Subbiah: You are right, I think your reading of that number is right. So, it's approximately about Rs. 75 crores plus last quarter, that is in Q2 and Rs. 72 to Rs. 73 crores minus Q3. So, it has a double effect. The way gross margin is worked out, you are right.

Joseph George: Kumar, would you be able to quantify the QoQ impact on gross margin because of this?

Kumar Subbiah: Yes, approximately increase in inventory in last quarter versus reduction in inventory; this is about 1.4% approximately.

Joseph George: QonQ basis, 140 bps.

Moderator: Thank you. The next question is from the line of Sachin Kasera from Swan Investment. Please go ahead.

Sachine Kasera: Just to follow up again on this CAPEX, debt and realignment of the CAPEX across segments. So, you mentioned that one of the reasons that CV represents the pressure is because of competition and the reason for that is that the market is slow. So, if you could just tell us what is your sense of the current industry utilization of TBR, that you can give us some idea as to what is the type of pickup we need to see before the pricing comes.

Anant Goenka: So, I think on the TBR side, we have seen actually growth on a year-on-year basis. So, even though we are talking about competitive pressures, OEM has seen much stronger growth in the last quarter, Exports has also grown. And to that extent, year-on-year there has been growth. So, utilization levels would not have come down. But when we are talking about pricing impact and CAPEX plans, there are two elements one is that the pricing pressure is on the replacement side, that is where sales levels actually absolute sales levels have come down and that is what is causing some amount of pricing pressure.

The other question you had was on utilization, in our case at least we have done some amount of capital investment on TBR and therefore we have upside to grow. I won't have data on the others. But I do believe that others will also have some amount of upside to grow on the TBR side.

Sachin Kasera: And within TBB and TBR is it that there is one particular segment where the pressure is more in replacement in terms of pricing and margin or it is equally across both TBB and TBR?

Anant Goenka: So, TBB is a declining segment altogether, the technology every year we have been seeing continuously 5% or so negative growth, approximately, 0% to 5% and that has been taken over by truck radial. Last year was an abnormal year, where actually truck bias also grew by about 30% which was completely unexpected. And therefore, the dramatic drop in TBR that we have seen currently. So, truck bias, we expect to be continuously underutilization pressure or negative growth and we will have to shift those capacities to other kinds of bias tyres or close down those plants or take those kinds of calls at some point of time.

Sachin Kasera: The second question was on debt and the CAPEX. So, we are already at 3 times debt to EBITDA, reported numbers. And you alluded that next year also we are looking at say on Rs. 100 to Rs. 200 crores of CAPEX. So, if the current situation doesn't improve, we will also have to realign the CAPEX for next year that we have done for the current year, in the sense we will keep calibrating the CAPEX depending on the cash flows and the debt, EBITDA levels or for a year or so we will be okay. And we would be looking at a long-term picture. And you know, maybe for a quarter or two probably break that 3 times debt to EBITDA number.

Kumar Subbiah: In the coming year, as of now I think our plan is to be within the threshold, as of 31st March. And we expect margins to normalize over a period of time so as the inflation and commodity prices is moderating at this point in time against 10%, 5%, now it's about 1.5% that we are talking about Q4. And we hope margins would normalize in the coming quarters. And therefore our cash flow from operations would certainly improve. So, I think there is still some scope for us to extract some cash from working capital side. I think we will be prudent in the coming year too and depending on how the next year unfolds. We would moderate our CAPEX in the event, we continue to operate at slightly at a lower margin in the coming year, but our intent is to keep the debt EBITDA within that range of around 3.

Sachin Kasera: And just lastly, on this TBR CAPEX, so because of the pressure that you are seeing in the market of replacement, this temporary deferral for maybe four to six quarters, and then we again have aspiration to grow our market share and become a relevant player in TBR, over the next three to five years. Or is it just strategically we have decided that Exports and passenger cars and these are the OHT segments, where the margins and return capital are far better. So, strategically in terms of priority now for the next three to four years want to focus there and improve our margins and return on capital, rather than look in terms of becoming a very strong player in the TBR segment.

Anant Goenka: So, for us winning is, we are looking at winning in the passenger space. So, which means passenger car, Two-Wheeler segment where we have very strong momentum in Two-Wheelers, we are already up there. On the passenger car, we are growing well. For us in truck radial, we never had ambitions to win or gain abnormal, largely be amongst maybe in the top one or two players. It is important to be there in the truck radial segment from a scale covering of fixed cost as well as more from the customer side. When you are looking at going to dealers in India, you have to have the entire range of tyres. So, that's the perspective that we have on truck radial.

Going forward, we will manage truck radial more for profit. So, we will sell in more profitable segments if we can and whatever presence we need to have to manage the channel, we will do that. But if we need to increase for example, International Business, which gives us higher margins, we will focus a lot more in that. So, over time, as I said, in terms of our growth aspirations will be much higher on the passenger and OHT and International Business rather than the domestic truck segments. And that I would say our shift has become a little bit more sharper over the last say, three, four months from an intent perspective.

Moderator: Thank you. The next question is from the line of Basudeb Banerjee from ICICI Securities. Please go ahead.

Basudeb Banerjee: My question is to Kumar sir, in the initial comments you mentioned some forex impact also in this gross margin. Can you quantify that?

Kumar Subbiah: I didn't mention any forex impact.

Basudeb Banerjee: Second, is because of this Phase II of TBR, which you cancelled so at current juncture if you can mention the TPD existing Halol capacity and Phase I how much you are adding?

Anant Goenka: We are doing about, at end peak capacity Halol will be at about 140,000 truck tyres per month. This will add another 40,000 truck radial when we look at that Phase I of expansion in Chennai for TBR.

Basudeb Banerjee: So, basically for 40,000 tyres per day this Rs. 700 crore for Phase I?

Anant Goenka: That's right.

Basudeb Banerjee: That will be operational fully by when?

Anant Goenka: It will be at least a year and a half from now, not before that. So, we had planned on for it to be ready by the end of this year, which is this calendar year. We have delayed it by about nine months at least.

Basudeb Banerjee: And your existing Halol TBR is operating at what utilization?

Anant Goenka: We would be at about 75% utilization.

Basudeb Banerjee: And would things at, from capital allocation perspective that you are shifting from that low ROCE TBR when market shares are also low to better margin products. So, one thing which came to my mind is like typically in those developed markets like Europe, U.S. the typical difficult route of going through the OEM supplier then making a mark in replacement. So, like how are you strategically positioning your brand in those developed markets?

Anant Goenka: I would say one is on the truck segment you don't need to be present in OEM for replacement sales. So, anyways, if you look at the market, it is about 80-20 or 90-10 towards the replacement segment even in India or internationally. So, in the passenger car side too, there was a very strong Chinese presence in these countries, and to that extent, there have been anti dumping duties imposed and there is a strong demand for passenger car tyres. In terms of positioning, we will not position ourselves at the Chinese level. But since there is a vacuum there are opportunities for value players to come in where we are offering very good quality tyres at a much lower price.

So, to that extent, that is the positioning that we will take and look at entering. So, you will have the maybe Michelin Bridgestone at the highest level followed by maybe the Kumho, etc. And then it would be largely the Indian players, a few other Korean players is where we will be looking at positioning ourselves.

Basudeb Banerjee: And last question if quarter-by-quarter every time we see the Sri Lankan business numbers, so for example, this quarter I see standalone console revenue gap of Rs. 7 crores and the loss gap of almost Rs. 5 crores so any plans of hiving that off down the line because it's not adding much of financial value as such.

Anant Goenka: No, I think that is maybe because there was, that is not correct. I think Sri Lanka margins are very strong. We are at over 15% plus EBITDA margin there, growth has also been good. We are near monopoly position in Sri Lanka with over 50% market share in Sri Lanka. So, we are very happy we don't plan to hive off Sri Lanka, it’s a very successful operation.

Moderator: Thank you. The next question is from the line of Chirag Shah from Edelweiss. Please go ahead.

Chirag Shah: First question is the on demand elasticity, do you think that after such a strong price hike that have been taken, it has now started affecting demand or ability of consumer to take the price hike. And that is the reason of the sequential slowdown because over the last 12 months if there is a 15% to 20% hike, is that the key reason of drivers?

And secondly as a combination question even Two-Wheelers and PV seem to have seen a slowdown at least on QonQ basis in the replacement market would that assessment be correct?

Anand Goenka: So, on the truck radial yes price increases could have had some impact, I would say difficult there are so many aspects that would be there but I mean, if you look at their own fuel price increase, it has been quite substantial. So, yes, inflation would have affected them. As I said for them also it is important to pass on the price increases. And to certain extent some amount of that price increase has been passed on. So, yes, I would attribute inflation to a certain extent. But there are many other factors which I did share would be having impact on the TBR side.

Chirag Shah: Is there a slowdown on sequential which is at least in Two-Wheelers and PCR replacement? solution to

Anant Goenka: They are largely flat I would say. On PCUV there was a little bit of a slowdown on the replacement. But I would say overall, it's been flat. And on the two and three wheeler also marginal drop on a QonQ basis, about 3% to 4% kinds of levels.

Chirag Shah: And would this be a one off attributable to this Omicron wave or there is something else that we need to look in to it for the sequential slowdown?

Anant Goenka: Sequential slowdown was primarily seen only after say December 10th now, I would say. So, too difficult to attribute I think Omicron effect really started coming around maybe what, December 20th or so. So, some amount I would attribute to Omicron, rest of it I would say that is there any other reason, no, nothing else, I think specifically to say. It's only largely just lower travel, lower footfalls in cities because of Omicron. But the good thing is we have gained share in the passenger car segment and at least maintained share in the Two-Wheeler segment.

Chirag Shah: So, if I have to ask you from your past experience this kind of price hikes that we have seen across I am not saying trucks but your Two-Wheelers and PCR. I would think we have not seen this kind of hike over last 8 to 10 years, contiguous hike of double-digit hike or more around 15% to 16% price hikes. In the past, we have seen demand getting affected directly or indirectly because of such price hikes. Do you think that are we reaching that tipping point now?

Anant Goenka: I don't have an answer to that. I would say that there are so many aspects, and what kind of impact, I mean, in the end, the tyre is something which people need to replace, and it can get delayed by two, three months' time or four months' time maximum, but it is a product which is needed by the consumer to change.

Chirag Shah: Just one last clarification, you mentioned in the opening remarks Subbiah mentioned together that import transit period has now come down to pre-COVID levels from as high as 60 days. Is this a new normal we should assume or there was some one off event which lead to that or it was even low as, even if it is around 30 to 35 days, is this a new normal?

Kumar Subbiah: Yes, I think so. I think it went up substantially. Now it's come back to normal, new normal means it's currently at pre-COVID level. So, I think it should be taken as a normal at least -- Southeast Asia to India, it's kind of come back to normal levels.

Moderator: Thank you. The next question is from the line of Mukesh Saraf from Spark Capital. Please go ahead.

Mukesh Saraf: Most of my questions are answered, just wanted to check on the sequential volume decline on the replacement side. You had mentioned 4.5% overall how would that be say for the truck and bus, because truck and bus obviously YoY you said is 20% decline?

Anant Goenka: Replacement truck and bus has been largely flattish sequentially, right it is about kind of I would say largely flattish. Truck radial has come down a little bit, whereas truck bias has been flattish.

Mukesh Saraf: I mean, obviously, November, December, we have seen some ease on diesel costs etc. for fleet operators. So, like you mentioned that they have now passed on some of these earlier cost hikes for them. So, have you started seeing some improvement in these volumes around December or January with respect to replacements?

Anant Goenka: No, not yet at this point of time. I think we are seeing a similar kind of demand situation in January as we are in as in say, November, December.

Mukesh Saraf: And just lastly your market shares on the replacement side again, truck and bus it hasn't changed much on the bias and radial side of it or do you think radial side of it, there's been some loss in market share?

Anant Goenka: No, we would have largely maintained our market share. I don't think there's any change on the CV side also, we are a relatively low market share. So, on a low base, we have maintained at that level.

Moderator: Thank you. The next question is from the line of Siddhartha Bera from Nomura. Please go ahead.

Siddhartha Bera: On this market share when you have said that in the PVs also you have sort of gained some base, what will be the number we are at now for PV say for Two-Wheelers in the replacement?

Anant Goenka: So, Passenger Vehicle, we will be at about 14% to 15% kind of levels. And in the case of Two-Wheeler somewhere about 27% to 28% market share.

Siddhartha Bera: As per your internal targets, any ambitions you have for this Passenger Vehicle segment to where it can go up to say in the medium term?

Ananta Goenka: Yes, we will be looking at 17% to 20%, at least a 5% shift.

Siddhartha Bera: For the overall volumes, like last time you had said you were looking at a low single digit type of growth for the FY22. So, next, year factoring in these catalysts of higher OHT and Exports, what will be a number you will be targeting internally for the overall volumes?

Ananta Goenka: So, I think volume is difficult to give a specific number, I would say a couple of base effect issues will be there on or positives will be there that there was a Wave II in this year which had a little bit of a lower situation in Q1. So, to that extent, there is an again maybe another say 3 to 4% impact in the year will come because of that. There will be an inflationary impact also of maybe 3% to 4% that can come in. So, that itself at a value and volume will be maybe 5% to 6% and then say if you look at 8% to 10% growth in volume terms is at least what we should look at maybe even higher.

Siddhartha Bera: And lastly on the margins front so if we looked at in terms of the hierarchy will it be fair to say that in Two-Wheelers replacement will be highest followed by passenger car replacement. How to understand this hierarchy for you on a steady state basis?

Anant Goenka: Yes, I think it will be Two-Wheeler and OHT will be the highest margin followed by passenger and then followed by commercial vehicle.

Siddhartha Bera: And any broad range if you can share, highest to these?

Anant Goenka: No, we can broadly say that this is how it is in the replacement segment, OEM across the board will be relatively low, substantially lower, and Exports will be not very different from replacement at an overall level.

Moderator: Thank you. The next question is from the line of Kashyap Jhaveri from Emkay Investment. Please go ahead.

Kashyap Jhaveri: In earlier comments you mentioned about being aspirational margins of 12% to 14%. Now, assuming that 1.5% cost increase, which is in Q4 is, I mean, just assuming that that is the last that we would see at least in near future, that 12% aspirational margins would require roughly about 7% to 7.5% price increase further, would that be right assumption?

Anant Goenka: Yes, it will be a mix of price increase and your mix change.

Kashyap Jhaveri: So, I mean if product mix remains same as Q3, it would require about 7% or 7.5% kind of change?

Anant Goenka: That's right, assuming mix remains the same --. I think product mix and market mix both we have to move towards more profitable areas. So, I think that will result in hopefully a differential with competition and differential from the average norm of say 10%. And the balance will come from price increase so 5% to 6% additional price increase. If you take 1.5% further inflation into this quarter then that may become, as I say, from 5% to 6%, maybe.

Kashyap Jhaveri: Now, that 5% to 6% over and above whatever we have done till, I mean, if I look at overall price increase would total up to about 17% to 18% kind of a number, while that number may look very large on standalone basis if one were to look at, but if I look at about three or three and a half kind of inflation total increase in the tyre prices would be just about amounting to about 5% to 6%. Why is there so much of resistance across all the players to sort of do this when the number on let's say a slightly longer term is not that large for market to digest. Given that our own volumes are now sort of, though they have declined QonQ but still one of the highest ever in our history as yet. Why is so much resistance across all the players?.

Anant Goenka: I don't have an answer to that. But all I can say is that the last 12 months has been about 15% which is fairly high. But yes, if you spread it out over two years time I mean that number two years or three years, it will come down. Last 10 years there has been no inflation, zero. So, in the end it's just competitive pressures and I don't have an answer to explain why it is happening.

Kashyap Jhaveri: And did I hear correct when you mentioned that there has been no loss of market share, even after all these price increases for us across all the product line?

Anant Goenka: Yes because the price increase has been across the board right. And I would say we have gained market share on the passenger car and UV. The balance we would have largely maintained our market share.

Moderator: Thank you. The next question is from the line of Vishal from Svan Investment. Please go ahead.

Vishal: Just confirm two points, sir. Your TBR capacity you said in Chennai will add approximately around 140 TPD if I am not wrong. So, by the end of this expansion, what will be the overall capacity for TBR you will have in terms of TPD?

Anant Goenka: No, I said it will add about 40,000 tyres per day, in tonnes per day, I will get back to you. I said it will add. We are at 140,000 tyres per month is our current capacity in Halol or shortly it will be, it will be our peak capacity at Halol. Another 40,000 tyres will get added which is about 45 tonnes per day.

Moderator: Thank you. The next question is from the line of Disha Seth from Anvil Shares. Please go ahead.

Disha Seth: I just wanted to ask that 20% to 25% sales drop in truck, bus replacement, plug bias the trend should continue, no. It is overall the industry scenario that the bias is coming out and radialization is picking up. That is not because of the higher base right?

Anant Goenka: No so bias will continue to come down absolutely you are right. But I am saying overall CV market, you have to look at it at an overall level so that will continue to grow.

Disha Seth: But so every quarter or every year-on-year we will see this bias capacity coming down and we can see the drop in sales because of that bias. But it is not because of the demand that is where I am coming from?

Anant Goenka: So, bias is coming down if you look at a year-on-year basis even I spoke about data of the overall CV segments on a year-on-year basis for Q3. So, for Q3 last year was a very high base because we saw a 25% growth on a year-on-year basis from FY20 to FY21 and now into FY22, we are therefore seeing a drop in CV demand. Not only bias but I would say on average across the board led by bias.

Disha Seth: And for PCR replacement how is the demand momentum since the Omicron wave has peaked out and things are improving? PCR replacement, OEM and Two-Wheeler replacement OEM?

Anant Goenka: The Two-Wheeler OEM is under pressure, actually last quarter also there was a fair amount of cut that was taken by the Two-Wheeler OEM. So, to that extent that is continuing. Two-Wheeler replacement is stable, it is steady I would say, it's not down versus say previous quarter it is quite steady.

Disha Seth: PCR, OEM and replacement?

Anant Goenka: PCR, OEM I think was affected because of this chip shortage as that eases it will pick up, because I think the order base is pretty strong for the passenger car player.

Disha Seth: And replacement the momentum in Q4 looks good?

Anant Goenka: Positive I would say right now Q4, maybe as I said latter half of Jan, early part of December, some impact of Omicron in the cities is there. But I think that will again, come down as Omicron kind of ends. I would say, we are still kind of going through the wave. Hopefully in another 15 to 20 days things will be better.

Moderator: Thank you. The next question is from the line of Anand from B&K Securities. Please go ahead.

Anand: I just wanted to check given the current realizations, after all the capacity expansion what is the kind of target revenue potential that we have from the capacity? And not only that are the new capacities also kind of achieving a similar asset turnover or the investment is getting costlier?

Anant Goenka: A lot of our large capital investments that we had planned is coming to an end. So, we had planned about Rs. 3500 crores I think we have about another Rs. 1000 crores that is left over the course of the next say 12 to 15 months time means another maybe Rs. 100 or Rs. 150 crores in this year another Rs. 700 to Rs. 800 crores into next year. So, it is more of the balance CAPEX that is left, we will be doing about Rs. 100 or Rs. 150 crores into debottlenecking, which is already also getting spent as we speak. So, a large part of the Greenfield expansion is over.

Now, whatever will happen is more likely to be more brownfield and therefore, that will help. And then we have enough headroom to grow. So, we will have enough CAPEX for another 25% growth going forward. So passenger car, truck radial, except for OHT we will have enough headroom for the next say a year and a half to two years. So, very little plan for next year for any new CAPEXs except small CAPEX in OHT.

Anand: That means we will have to for the next round of CAPEX probably from FY24, is that right?

Anant Goenka: Yes, we will wait and watch in terms of how the demand situation unfolds, how things turn out at that point, but it's largely the latter half of the CAPEXs left for us which will happen in the coming year.

Asset turnover as I said, should get better, I mean there will be with steel inflation, etc. with machinery get expensive as we go forward, that could have some impact, but tyre prices are also inflating to a certain extent. But besides that asset turnover should improve because we are doing largely only brownfield so you don't have land, you will have much less building costs that will be there, more about machinery and all that you will have to be putting in at least for the next phase of say PCR and TBR etc.

Anand: I mean, just in terms of you know, the ratio I am just looking at, if we put an investment of Rs. 100 crores can our revenues be Rs. 120 to Rs. 130 crores from the investment or will it be only 1x?

Anant Goenka: No, it will be between 1 and 1.25 absolutely right. Two-Wheeler will be higher. But passenger car will be close to 1 or 1.1, maybe TBR is a little bit on the higher side maybe again, 1.2 to 1.25 type levels.

Moderator: Thank you. Ladies and gentlemen, that was the last question for today. I would now like to hand the conference back to the Management for closing comments.

Anant Goenka: Thank you all for your interest in CEAT and for your time this morning. I look forward to catching up with you again next quarter. Take care and stay safe. Thank you, everyone.

Moderator: Thank you. On behalf of Kotak Securities Limited we conclude today's conference. Thank you all for joining, you may not disconnect your lines.