"CEAT Limited Q1 FY23 Earnings Conference Call"

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MODERATOR: **MR. JAY KALE – ELARA SECURITIES PRIVATE LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the CEAT Q1 FY23 Earnings Conference Call hosted by Elara Securities Private 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 this conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Jay Kale from Elara Securities Private Limited. Thank you. And over to you, sir.

Jay Kale: Thank you. Good evening, everyone. On behalf of Elara Securities Limited, I welcome you to the Q1FY23 Results Conference Call of CEAT Limited. From the management side, we have Mr. Anant Goenka – Managing Director and Mr. Kumar Subbiah – Chief Financial Officer of CEAT Limited.

I would now like to hand over the call to Mr. Anant for his opening remarks. Over to you, sir.

Anant Goenka: Thank you, Jay, and good afternoon, everyone. A very warm welcome to CEAT's Q1FY23 earnings call and thank you everyone for your interest in CEAT.

I am Anant Goenka, and we have our CFO, Kumar Subbiah with us on the call.

As usual, we will start with brief remarks from me, and Kumar, and post which we will be happy to take questions and answers.

For Q1FY23 on financial performance, the quarter saw strong demand in the auto segment as some of the supply constraints eased out. As a result, we saw some strong demand uptick in the OEM segment.

In the replacement segments too, we saw some good demand uptick with some improvement in the macroeconomic situation. Replacement volumes for CEAT recovered largely led by passenger segment.

Most of the surface mobility trends remained above pre-COVID levels in the quarter. Tractor demand saw strong growth versus last quarter, while truck and bus was flattish on a relatively higher base.

Overall, replacement volumes grew at about 8% quarter-on-quarter.

OEM demand remains strong across segments and volumes grew by about 16% on a quarter-on-quarter basis.

Tractor segment here too saw the highest increase, a part of which were seasonal followed by last mile and passenger car segment.

Export volumes were flattish because largely on a higher base. Our focus geographies of Europe and North America continued to show strong growth. Overall, our volumes grew at a healthy 7.5% on a quarter-on-quarter and more than 30% versus Quarter 1 last year which was a COVID impacted quarter.

Current demand environment remains positive with normalcy returning across most segments. Monsoon also has been satisfactory so far which we hope will boost rural sentiments, which has been under a little bit of pressure. Inflation has however continued to hurt our bottom line.

Our raw material basket cost further increased by about 4% on a quarter-on-quarter basis which was towards the higher end of our guidance, primarily led by crude derivatives and a little bit price increase of rubber as well. Crude has shown some signs of stability since the last few weeks.

However, we will see some inflation spilling over to Quarter 2 as oil prices remained well over $110 per barrel throughout Quarter 1. We expect a further increase of about 2 to 3% in our raw material basket in Quarter 2. Due to inflation, lowering effective price increases as well as some adverse market mix with higher OEM contribution, our gross margin contracted by about 1.6% over Quarter 4 level.

We continue to maintain tight controls on our operating expenses. Marketing costs went up a little bit because majority of IPL matches were held in the quarter and CEAT remained associated as a Strategic Timeout Partner.

We also got associated with the Women's T20 Challenge as the Strategic Timeout Partner, which we signed in the last Quarter 2.

EBITDA margin for the quarter stood at about 5.9%, partially aided by higher volumes. We ended the quarter with standalone PAT of about Rs. 2.5 crores versus Rs.13 crores in Quarter 4 of last year.

On CAPEX, we are monitoring our cash flows closely. Given uptick in volumes, we maintain our growth guidance, our growth CAPEX guidance at about 750 crores for FY23. Priority will be given to the more profitable OHT segment, some amount of debottlenecking that is under plan and profit improvement projects.

Our OHT segment is ramping up as per plans. We are currently operating at about 67 tons per day which will go up to 80 tons per day by October in our Ambernath plant, which premix primarily manufactures radials for off-highway tyre.

On the OEM business, our associations with OEMs continue to improve. We have started supplying to the Ola EV scooter. We also had our first EV launch in the LCV category with Tata Ace. We are working closely with all major EV OEMs and expect to benefit from higher volume growth in the segment, especially two-wheeler EV due to our early mover advantage.

Our operations in Sri Lanka showed commendable resilience during the quarter amidst a highly challenging environment. Volumes have declined as expected. However, our factory continues to operate profitably.

We got some notable recognition during the quarter. Maruti awarded CEAT for overall performance as tyre supplier in the last year. We were ranked 27th by Great Place to Work in India for the last year which is an improvement of three places from 30th rank last year. We also got the Jamnalal Bajaj award for Fair Business Practices for the year in the manufacturing category.

We launched our new passenger platform for Europe called Winter Drive Sport, which is specifically designed to deliver high-speed and control in snow conditions. We now have a complete range of winter tyres for EV.

We also commissioned 70 Megawatts of solar capacity at Bhandup, Ambernath and Nagpur plants. Four of our plants have got enabled for biofuel for boiler operation and we are implementing this initiative at other plants as well. This substantially increases our commitment towards sustainability and a large share of our power is now coming in from renewable sources.

The automotive sector is showing green shoots of recovery after a few challenging years due to multiple headwinds on demand as well as the supply side.

On the raw material side also, we have seen stabilization of raw material prices over the next few months along with price hikes in Q2 and some reduction in raw material prices that we expect in Quarter 3. We feel this may be the end of the worst in terms of margins for the tyre industry.

With this, I will hand over the call to Kumar.

Kumar Subbiah: Thank you, Anant. Good afternoon, ladies and gentlemen, and thank you for joining us in a Q1FY23 Earnings Call.

I'll share some further financial data points with you all, post which we can enter a Q&A session.

First, on revenue, our consolidated revenue for the quarter stood at Rs2,818 crores, a sequential growth of 9% and 48% year-on-year and the growth was mix of both volume and price in both the cases.

Quarter 1 of last year was also impacted by COVID wave two, and hence the numbers are not fully comparable.

Now, coming to gross margin and the pricing hike, the momentum in the raw material inflation continued in Quarter 1 impacting our gross margins, which stood at 31.7%.

Our blended raw material cost went up around 4% versus Quarter 4 of previous year. We could take a blended price increase of about 2% during the course of the quarter and the price increases were largely effected in commercial and passenger categories, passenger car categories. There were some price increases in exports and OEM as well neutralizing the impact of raw material costs in those categories.

However, the increases are not sufficient to cover RM inflation. So, our gross margin declined quarter-on-quarter.

The quarter saw crude oil prices largely hovering around $110 to $120 and mostly on the higher end of the range impacting the prices of crude derivatives.

The natural rubber prices remained range bound both in the international as well as in the local market. There has been some correction in crude oil prices in the last two weeks. It's currently hovering around $105 per barrel and the impact of that could be more felt in the next quarter as there is always a lag of about two to three months in terms of raw material prices reflecting the movement and feed stock prices.

The rupee depreciation from around Rs. 76 to a dollar to around Rs. 80 a dollar in the last 2 to 3 months will have some adverse impact on raw material cost but a favorable impact on export realization.

As per our current estimate, we expect our blended raw material cost to go up in the range of 2 to 3% in Quarter 2 versus Quarter 1. We would still need to take more price increases in the coming quarter and hope for some correction in the input prices.

Now, coming to debt, CAPEX and working capital, we continue to optimize on our working capital. Our working capital came down by about Rs. 130 crores during the quarter and we incurred total CAPEX of about Rs. 250 crores including the routine which we largely funded through internal accruals which is a combination of reduction in working capital and cash profit made during the quarter.

Our gross debt stood at Rs. 2,139 crores more or less similar level as it was as of 31st March 2012. Our project CAPEX outlook remains at Rs. 750 crores for the year. In addition to that, we will have a normal routine CAPEX to the tune of about Rs. 200 crores.

We are keeping a close watch on our debt levels, which are still within our internal thresholds.

We, as regard to the operational expenses, we exercised strong controls during the quarter yielding some benefits of scale. Other than higher marketing costs on account of IPL, increase in other costs were largely linked to higher level of activities. Despite this, operating costs, that is manpower as well as other expenses put together, went up by about 7% versus previous quarter which was lower than our overall growth in revenue.

Coming to EBITDA, our consolidated EBITDA stood at Rs. 171 crores with a margin of about 6.1%, a contraction of production of 145 basis points over previous quarter.

Depreciation during the quarter was at similar levels. Our interest expenses declined marginally during the quarter due to lower average debt level maintained throughout the quarter. We are closely watching the debt market situation. While we have managed the Quarter 1 without any impact on account of increase in interest rates, however, we expect our interest rate to go progressively from Quarter 2 based on the movement in interest rates.

In the Annual General Meeting held on 28th of June, the shareholders approved dividend of 25%, and the same has been since paid in July.

With this, we can now open the floor for Q&A. Thank you.

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

Ashutosh Tiwari: So, firstly, on this replacement growth quarter-on-quarter mentioned 8% growth is there for truck was flat. That means that other segment would have grown in double digit. So, is it that across the board, there was a double-digit growth in two-wheelers, passenger vehicle and all?

Anant Goenka: That's right. So, we did see very strong growth in passenger car particularly, and two-wheeler also saw a strong double-digit growth.

Ashutosh Tiwari: Okay. Secondly, if you look at exports growth in last year, there was strong growth in PCR as well for us YOY. I think PCR has done really well last year in exports and OTR obviously you mentioned. So, what we are, like, say, what has happened over there, what we have done in last two, three years? Why the export growth is so strong in the PCR segment along with OTR? And secondly, part of that is that now we are seeing heat waves in Europe. Will the demand for OTR get impacted from this? Any views on that?

Anant Goenka: Okay. So, the main thing in the export side that was two things happen. One is that there is anti-dumping duties that have been imposed on Chinese tyres, and I think, but more than that it was our focus on exports because for Europe or US you need to develop an entire range of tyres to supply. You cannot just have whatever you make in India and try and sell that in Europe. So, you need various platforms of tyres, whether it is, you know, van tyres or all season or winter, summer, high-performance tyres, and that takes some time and a fair amount of investment to grow. So, we have been working on that for the last five years. CEAT is also a well-known brand in Europe, particularly Italy and Spain. So, with that PCR, Europe has been a focus area for us, and that has resulted in good growth primarily for us in the passenger segment.

Similarly, OTR also we have been developing tyre. So, OTR, of course, we have been selling in Europe for a long period of time, but, again, with radial tyres coming in and range completion makes us very attractive for distributors and we've seen also overall good growth in the off-highway tyre segment. So, with that, we've seen good traction on the exports side.

With respect to the heat wave, certainly, a hotter condition results in good demand. It's difficult to say whether that will really have an additional effect because on the other side, there is also talk of a recession in EU. We feel we are well positioned to grow in EU but difficult to say what will have a larger impact in terms of recessionary impact that we are expecting as well as the heat wave. But we are optimistic about continued growth in the next say few quarters.

We also launched our truck radial tyres for Europe in the last quarter. That also will grow over some time.

Ashutosh Tiwari: Sorry. Missed the last sentence.

Anant Goenka: Yes. We also launched truck radial tyres for Europe and that will grow over time as well.

Ashutosh Tiwari: So, just lastly one thing. Somebody in the industry also mentioned that Chinese tyres apart from this duty have also suffered because of the higher freight cost increase in China to US and other market freight rates versus India. Is that correct? Like if the freight rates come down, Chinese tyre volumes will increase in these markets?

Anant Goenka: If, sorry, if freight rates come down from China to these countries?

Ashutosh Tiwari: Yes, that increase is probably higher than what we see from India to these markets.

Anant Goenka: Kumar, would you like to share anything on this?

Kumar Subbiah: No, generally there has been some downward correction in freight rates but specific question I am not able to get. Maybe we will come back to this question later.

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

Jinesh Gandhi: Anant, my question is on RM cost. So, while 2Q will see some impact which you indicated of 2% to 3% but the commodity prices remain where they are today. Do we expect gross margins to start improving from 3Q?

Anant Goenka: Yes. We believe so that gross margins should start getting better from Quarter 3. One is stabilization, and then, of course, there's been always a lack of price increase. So, we do expect further price increases to come in in Quarter 2 and some amount we have already taken in the month of July and we are looking at taking some more in August, September. So, we expect improvement in gross margins going forward.

Jinesh Gandhi: Okay. And what kind of price increases were taken in July?

Anant Goenka: In the month of July, it varies across categories. I would say about just about 1% or so in motorcycle, scooter, couple of percentage points in PCUV, over 10% price increase in three-wheelers, about 2 to 3 percentage points on truck radial and Last Mile commercial vehicles etc. So, these are the approximate price increases we have taken in July and then further increase is expected in August, end of the month August onwards.

Jinesh Gandhi: Okay. And after the August price increases, we should be largely covering the RM cost inflation as well.

Anant Goenka: Yes, I think we will surely cover what we are expecting in Quarter 2 and some amount of Quarter 1 too that we fell short on.

Jinesh Gandhi: And second question pertains to the demand on the replacement side. So, how has been the trend on the replacement market? You indicated a strong double-digit growth in two-wheelers and PCR. This is on YOY basis is what you are indicating on, again it is on QoQ basis.

Anant Goenka: Yes. So, we are seeing good demand on both. So, YOY, of course, growth has been at much higher levels because of Quarter 1 of last year being a kind, I think it was wave two of COVID that was there.

Jinesh Gandhi: Right.

Anant Goenka: So, on that growth levels are 30%, 40% and, therefore, that's not really fair to take as a base but and therefore I would say QoQ is more relevant at this point of time and even on a quarter-on-quarter basis, we are seeing a good growth on the replacement side. I am talking about double-digit in PCUV, maybe 20% plus in PCUV kind of category, you know, 15% plus levels in two-wheeler and as I shared elderly about the flattish truck, bus kind of demand on replacement side.

Jinesh Gandhi: Right. In replacement in truck and bus, is it primarily bias which we saw declining in radial is still growing or both the segments are flattish?

Anant Goenka: No. Bias is showing a negative trend whereas truck radial is a positive.

Jinesh Gandhi: And lastly, with respect to, the question is for Kumar. On the debt side of the Rs. 2140 crores of debt which we took how much of that would be fixed rate debt?

Kumar Subbiah: See, yes. I'll broadly break this, you know, debt into long-term and short-term. But nothing is fixed here except portion which would be about Rs. 300 crores kind of a number which is in the form of NCD. Others get adjusted because, for example, long-term loan interest rates are linked to revision or subject to revision. So, balance amount is all will vary. In general, we have tried to keep it as six months kind of a reset, one year kind of a reset. So, other than that, all the others will undergo a change over a period of time.

Jinesh Gandhi: And luckily on the INR side, the USD/INR depreciation which we are talking of, on net basis, we should be that it should be, it should be negative for us, right? Because the imports would be relatively higher than exports. Is that the right understanding?

Kumar Subbiah: Yes. You are right. Your understanding is right.

Jinesh Gandhi: Okay. And any number which you can share about how much are direct, indirect import content, indirect in terms of linkages to import with international prices?

Kumar Subbiah: See raw material prices on import is linked to US dollar plus local materials also sometimes benchmark or the import parity prices. Okay. In terms of effect, I think 70% would be the net effect on our P&L.

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

Nishit Jalan: Sir, my question is also on the RM cost side. Historically, what we have seen is some of the crude derivatives whether it's synthetic rubber or carbon black or nylon cord fabric, they tend to go up with a lag of up to two quarters also compared to crude prices. So, how is the trend that you are seeing there? And when do you think, do you think that by 2Q it will pick out given $100 kind of a crude or we might see further increase over there because given the lagged impact that we see and do you have any, are there any concerns around availability of these, these raw materials because demand is going up? So, are we seeing any concerns on the availability side as demand is going up? And how are we looking at the lagged impact of crude?

Anant Goenka: Kumar, would you like to?

Kumar Subbiah: See, as of now crude impact, direct impact on raw materials is direct with respect to carbon black where CBFS is the feed stock. Largely, the correlation between crude and CBFS almost 90%. So, in the event that crude oil prices come down, it tends to come down because it's an output from the refinery. So, therefore, it tends to move. But as you mentioned about other derivatives, like synthetic rubber which gets produced from butadiene or nylon fabric where charcoal is an input. Okay. There could be a lag, okay, about three to six months. Sometimes a demand supply situation of those derivatives could also play a role. As crude started correcting more from the beginning of July, okay, we will keep observing the market and so we expect some correction in the prices of these derivatives in due course of time. It may not be in the same proportion in which the crude oil has corrected.

And with respect to your second question on, you know, whether there is any impact on account of increase in demand, we are not seeing any significant increase in demand of these commodities. Okay. So, therefore, from that point of view, any change in prices on account of demand is unlikely to be there on these products. That is our view.

Nishit Jalan: Okay. Just one follow-up. So, obviously, raw material has been a challenge which has been impacting our margins quite significantly. So, we might stabilize or the margins of fall might stabilize. But when do you think? Do you think that there is enough pricing power for you guys to go back to the double-digit kind of a margin? And in the past, we have seen sometime that while you were taking price increase, some of the other players were not following suit, and there were some lag and all sort of things. So, are you starting to see a price increase from across the players, especially in the two-wheeler or in the motorcycle segment? Do you think that price increases are happening at a rapid pace now? And do you think that there is a possibility of we going back to double digit kind of a margin? Does the industry have enough pricing power on that one?

Anant Goenka: No, absolutely. I think, we have to go up to double-digit margin. There is always a little bit of a lag that happens that you've seen and we will cover up for the lag going forward as raw material prices stabilize. There can be continued pressure but I think things would get better and we will move to double-digit margin going forward in the longer term. I think there are some announcements. We understand are made in the market for price increases. But we will certainly look at it from a raw material perspective. We benchmark different products with different players in the market in terms of our pricing strategy in addition to seeing how our costs are going up. So, on a balance basis, we will take a call on some price increases. But certainly, we do expect price increases to happen, particularly on the passenger space in the next say a month, month and a half time.

Nishit Jalan: Just one more question. I think, you are doing a very good job in terms of top line and volume growth and all. Well, there is no direct industry data which kind of comes in, what will be your sense in terms of a broad market share range that you have across the major segments now, passenger vehicle, two-wheeler, TBR, TBB. Just a broad range. I know there is no exact data which is available, but compared to let's say two, three years back where you would be now, I would assume that you would have seen a good bit of a market share increase. So, if you can give any color on that, that would be very useful.

Anant Goenka: Yes. So, see, if you were to look at the top three most important segments for us, I would say two-wheeler, we would be somewhere between a 28% to 30% market share. Passenger car, we would have gained market share. We would be at about say 14%, 15% kind of market share levels today and on the truck side, we would be at about 8% on truck radial, may be about 12% on truck bias kind of categories. So, that's approximately, I guess, but I agree that data is not there and difficult for us to estimate. But we can estimate approximately.

Nishit Jalan: That's good. There are two small follow-ups. When you say anti-dumping duty is imposed on Chinese tyre that you were talking European market or you were talking about other markets as well? And secondly, on OHT side, what would be the number of SKUs that we have ramped up to currently? And how should, how do we see that going ahead?

Anant Goenka: Yes. I was talking. The question was relating to Europe. So, yes, it was pertaining to Europe and on number of SKUs, I can get back to you on the number of SKUs, if that's okay.

Nishit Jalan: I have another small question. If you look at your employee cost has been flattish now for almost eight quarters, while our revenue has ramped up, our volume has ramped up, and we have added new capacity as well. So, just wanted to understand is it because of the VRS scheme that you have been giving or the hikes have been very low. And another question would be that once you commissioned the existing capacity, right, where are we in terms of utilization front? Or what kind of revenue run rate on annual basis assuming the current pricing or whatever that is, we can do with the current capacity? Just wanted to understand whether we would need to invest on further capacity expansion, because the growth is very, very strong for us?

Anant Goenka: Right. So, we do have enough upside on capacity. We currently have nearly about 15% - 18% upside opportunity on the passenger space. Truck radial too we just completed a debottlenecking of Halol plant. There too we have enough capacity upside and two-wheeler, there is only downstream investment that needs to be done and a little bit on people and training. So, to that extent, we have enough upside in terms of capacity at this point of time, I would say, at least for the next year and a half or so. So, if we have to look at any further capacity, we don't need to take a decision most likely for the next six months or so on any of the categories except off-highway tyres, which we are continuing to expend at this point of time. On employee costs, our increment cycles start from July onwards. So, there can be a small increase in employee costs from July onwards on employee costs and yes, we do keep doing VRS on a regular basis that keeps the cost of our older plants a little bit in check but growth and inflation to a certain extent has been high and to that extent, employee costs has not gone up. So, as a percentage of sale at latest, employee cost has been under better control in the last say year, year-and-a-half time.

Nishit Jalan: Okay. So, if I understand you correctly--

Anant Goenka: Our number of SKUs, we would be at about 750 number of SKUs in the off-highway tyre space.

Nishit Jalan: Okay. So, if I understand you correctly, on the capacity front, you said that roughly between 20% to 25% increase can be possible. So, if you were at about 2800 crores top line in this quarter, so maybe you can go towards a 3,500 crores kind of a quarterly top line. Now this matter depends also on the price increases but at a ballpark number, that is the kind of, so 14,000 odd crores kind of like a top line you can do based on your current plans and current capacity. Once you start approaching towards a 90% utilization number, you will have to go for another CAPEX, right. Is that, is that understanding, correct?

Anant Goenka: Approximately, I would say about 15 to 20% upside in volume terms.

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

Siddhartha Bera: Sir, my first question is on the demand side. You have said like first quarter we have seen a very good recovery in the passenger vehicle and two-wheeler segment. So, how do you see the trends going ahead in the current quarter and all because some of, so just wanted to understand whether this is, there is some seasonal element to the recovery or this is more sustainable type of volume trends we continue to see for the year?

Anant Goenka: No, we are seeing an overall positive demand environment at this point of time. There is a little bit of seasonality. Usually, summer months are higher selling months for us. Monsoon months are a little bit on the lower side but at an overall level, if you look year-on-year kind of or standardized kind of levels Quarter 2 versus Quarter 2, I think growth will continue to be strong going forward. There is a little bit of pressure on the rural side. Rural demand hasn't picked up to that extent fully but I think we are in a good position on PCUV, on two-wheeler as well.

Siddhartha Bera: So, in two-wheeler, for example, we have continued to see the sort of service growth in the past and that also has not happened in the past. So, do you think that has changed now? The two-wheeler demand is looking much more resilient currently and you are more confident of taking price hike because we, if I look at there is not much of a growth from OE. So, just wanted to understand where, from where this increment is coming from the replacement?

Anant Goenka: Right. So, yes, two-wheeler demand, I'd say that Quarter 3 and Quarter 4 of last year was quite a bit lower. If you look at the numbers before that were a little bit better. We've seen some shrinkage in the overall market over the last few years on two-wheeler side. I think this is beginning to expand a little bit again, and we're hopeful for things to continue to be positive going forward. With positive monsoon also, I think that should result in better uptick of two-wheeler demand.

Siddhartha Bera: And second thing is on the pricing again. So, we have been sort of having supplying to most of the new launches which are happening in more on the both the EV two-wheelers as well as car. So, I just wanted to understand in terms of margins or pricing, will it be at par at the current model which we are supplying or because these are new launches, so it would be slightly lower?

Anant Goenka: So, with respect to price increase in the replacement segment, we do hope to see price increases coming in. On the OEM side, it varies from a, so since these are new launches, each pricing has their own respective strategy. I'll not be able to share much details with you but most of them, I'd say 70 to 80% of our relationships are linked to raw material price shifts. So, if there is a price increase, raw material increase or decrease, that gets passed on to the customers as well.

Siddhartha Bera: And sir, asking questions on the cost side, sir. Basically, in the current quarter you said that you had this IPL cost. How much will it be for the current Quarter 1?

Anant Goenka: So, it would be about 15% higher in Quarter 1. Our marketing cost for Quarter 1 would be 15% or so higher than our normal say standard month.

Siddhartha Bera: Okay. But on an annual basis, do you think you will be, I mean, closer to may be the levels of 2, 2.5%, which you have done in the past? Or can it go higher?

Anant Goenka: No, we will maintain our ratio of revenue to marketing expense approximately the same over the course of the year. There can be little bit on a quarter-on-quarter some differences because of events or certain sponsorships etc., that are there but beyond that we want to maintain it as a percentage of sale.

Siddhartha Bera: And last question is on the interest rates, sir, like you said it will get reset for because the rates are rising. So, what will be your blended interest rates on the debt currently?

Anant Goenka: Kumar, would you like to take that?

Kumar Subbiah: Yes. Currently our average interest rate is around 6.5% as of now covering both short term as well as long term.

Moderator: Thank you. Our next question is from the line of Hitesh Arora from Unifi Capital. Please go ahead.

Hitesh Arora: Yes. Could you just remind me of what is the on an average basis, what is the, you know, price hike you are picking in July, what was that number?

Anant Goenka: I will not have the exact number but I will say approximately it would be 1% to 2% on an average.

Hitesh Arora: On average. And how much you are planning to take in August, September you said?

Anant Goenka: We've not yet announced anything yet. We still have to take a decision internally. I think, there will be price increases but that still has to be decided. In my view, it can be maybe 4% plus levels.

Hitesh Arora: So, that will be like significant number compared to what you have taken on regular intervals. I think, in the part you have taken in the range of 1 to 2%.

Anant Goenka: That's right.

Hitesh Arora: You are looking at something like 4%. Okay.

Anant Goenka: It would vary quite a lot from a category-to-category level once again.

Hitesh Arora: Of course, yes. But on a weighted average closer to 4.

Anant Goenka: Yes, we don't know that number. I would say that we still have to take a call internally.

Hitesh Arora: Just one more thing. See under the sports side, we've benefited from this, the whole China plus one thing, but the western world will be seeing lot of inflation and you know, for politicians, inflation is very sensitive. So, they have been talking down of bringing tariffs what they had put in, you know. So, tariffs, again, China, they are talking of bringing it down, and they have done it in some categories already. So, how do you see that as impacting your side of the business? I mean, you've gained from that, those tariffs in the past but once those come out given inflation confirmed in the West, you will probably have a negative impact. Any thoughts there?

Anant Goenka: No, I'm very confident of maintaining margins even if tariffs come off. I think we've established ourselves as a good quality brand offered at very attractive prices as well, and there is a certain segment positioning that say we would be standing at. So, at a, from competitive perspective, you have certainly the tier one players at a certain level, you know, the Michelin and Pirelli etc., followed by Koreans and Indian players and then the Chinese at the lowest level. So, to that extent, I feel quite confident that margins, that we will be able to maintain market share irrespective of tax impact.

Moderator: Thank you. Our next question is from the line of Manish H from Nirmal Bang. Please go ahead.

Moderator: I'm sorry. As this participant is not responding to us, we will move to the next question, which is from the line of Basudeb Banerjee. Please go ahead.

Basudeb Banerjee: I have a few questions. One, the 2% to 3% raw mat basket increase for Q2 with the currency adjusted, what you mentioned in the beginning of the quarter.

Anant Goenka: Yes.

Basudeb Banerjee: Yes. Second thing, sir, as you said replacement and OEM volume growth sequentially of roughly 7.5%, 8%, 9% revenue growth, which means price increase or mix change of 1.5%-odd in 1Q and as against raw mat increase in last Q of around 4%. So, typically, if you look at raw mat sales being 70% odd, so which means price hike would have been 3% and it came in at 1.5% and one of the reason of the gross margin decline is that. So, just wanted to understand what has changed post Q1 where such muted price hikes against steep raw mat increase, whereas vice versa in Q2 onwards raw mat increase is now normalizing and your price hike has accelerated. So, subjectively, how to look at that? What is driving that higher price hike now?

Anant Goenka: Okay. I think one is that volume has been overall better for us at least. So, growth is looking attractive. I think we are in a position to take better price increases. Besides that, I would say, nothing else has really changed. I think price increases, further price increases have been quite a bit overdue. We have had lower margins for quite some time. So, to that extent, we just need to cover up the lag. That's all.

Basudeb Banerjee: Sure. That's great. And last thing that in Q1, was there any major shift towards OEM mix? How much was the shift? Revenue mix?

Anant Goenka: Yes. There was a shift towards OEM mix. The OEM segment grew the fastest amongst all categories. I mean, in terms of mix, I think OEM would have been about 30% and replacement just a little bit over 50% and then the balance international business.

Basudeb Banerjee: And this OEM mix would have been increased how much, sir, sequentially?

Anant Goenka: About two percentage points.

Basudeb Banerjee: Sure. And one more question if I can chip in from Kumar sir. Sir, in 1Q where working capital reversal of 130 crores had to take care of the Rs. 250 crore CAPEX and for full year as you said project plus maintenance together is Rs. 950-1000 crore. If I look at EBITDA margin reaching some double-digit figures, then only quarterly PAT moves ahead of Rs. 100 crore levels in general. So, at 6, 8% of margin level, the depreciation of Rs. 110 crore a quarter, still Rs. 250 crore of cash flow per quarter looks pretty high. So, any debt level you were seeing end of fiscal 23? Till which it is fine from your side, sir?

Kumar Subbiah: No, I think going by what you said and as per our working also, during the course of the year, our debt level will move up because our free cash flow would be negative. Okay. And our operating cash flow would not be adequate to take care of the CAPEX part of it. But generally, overall our threshold is in case of debt equity would be below 1 and debt EBITDA we try to keep it around 3. Okay. So, therefore, whenever we have some challenges around that, that is when we try to use other levers, which includes even relooking at our CAPEX. Okay. So, therefore, we would like to keep our debt level in line with that. In the event there is any shortfall in EBITDA, okay, we would review CAPEX.

Basudeb Banerjee: Yes. So, debt equity on one is very much within control. So, that wouldn't be an issue at all. Sure. Thanks, sir.

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

Chirag Shah: So, two, three questions I have. One is a broader question that you indicated that gross margins should improve from Q3 onwards. My question is, internally, how do you look at the business? Do you look at gross profit per ton or you like to focus on gross margins? That is the first question that I have and related to that is historically, versus the historical gross profit per ton benchmarks, do we expect those numbers to actually inch up significantly, given that our revenue per ton would have seen significant improvement over the last two years given that the prices have gone up?

Anant Goenka: Okay. So, we look at gross margin percentage at least internally when we discuss. We don't look at gross margin per ton and that is what we would like to ideally work towards maintaining or improving.

Chirag Shah: Okay. Second question is, I missed the impact on this net currency impact that Kumar sir was indicating, you know, net of import, export and that he had indicated. I just wonder if you can repeat that, it would be helpful, sir.

Anant Goenka: Yes. Sure. Kumar?

Kumar Subbiah: When we indicated the RM, raw material cost, okay, we have assumed the impact of currency but needless to mention, whenever we place orders on import, we do hedge them. Okay. So, therefore, whatever is going to be the cost based on whatever odd import orders that we have hedged and whatever is likely to be bought from the local market, we have taken into consideration. So, therefore, that, that estimate considers the impact of currency as far as Quarter 2 is concerned.

Chirag Shah: Last year, the two-wheeler demand both OEM and replacement, what are the initial signs you are getting? Is it improving or it is largely the base you said which is making numbers looking good?

Anant Goenka: So, on the two-wheeler side, I mean, one is, of course, you can't compare on a year-on-year basis because last year was a very, very low. So, again that we are talking about, you know, growth levels of 40% plus kind of levels. But even on a quarter-on-quarter basis, both on OEM and replacement we are seeing volume and value growth both. So, to that extent, that indication certainly is more positive. To a certain extent, of course, we had a lot of challenges every quarter here and there with Omicron and various kind of closures that happened. All of that seems to have stabilized and come to an end. You know, this quarter was also a little bit of the marriage season, Monsoon kind of getting stabilized and better in the last 20, 30 days all across the country. I think these are some positive signs and then the entire inflationary impact on two-wheeler that had happened in the last, I would say, year, year and a half because of increased safety norms etc., that also would have possibly stabilized, and now people would be looking at buying two-wheelers once again.

Chirag Shah: Would it be right, would it be right to say that versus initial expectation, the volume or outlook is actually better than what you were initially looking at? That would be a right statement? Over last two, three months, would that be the right way of looking at two-wheeler demand?

Anant Goenka: Yes, I'd say that the demand has been better than we expected, specially looking at what, you know, Quarter 3, if I remember, right, December, Jan, Feb were pretty challenging it with respect to overall industry growth perspective, but things have been better at this point of time.

Chirag Shah: Yes. This would be both for OEM and replacement both, right? This broader directional commentary?

Anant Goenka: That's right. Higher in the replacement side, slow on the, relatively a lesser on the OEM side. It's all about the double-digit growth on replacement, single digit, high single-digits in OEM.

Moderator: Thank you. Our next question is from the line of Karan Kokane from Ambit Capital. Please go ahead.

Karan Kokane: I just had few questions. So, first was on, you know, the growth in exports. Obviously, we've seen very good growth in exports. In FY21, the mix was 14%. 22, it has moved out to 20, and even now we're seeing good growth. So, do you have any medium-term aspiration in terms of export mix?

Anant Goenka: So, I think export mix at least in the near term is looking to be stable because of good growth on replacement and OEM as well at this point of time. Also, global recession impact may be higher in international markets than what we are seeing in India. India may feel some of these pressures of interest rates and GDP growth impacts relatively lesser than maybe Europe and then US and other countries over time. So, I think from a mix perspective, we expect to maintain our mix on the export side. It will not grow at least in the near, I mean, I feel in the near term, say, next six months or so. After that, but in terms of our focus, our focus on exports continues to be high. It is relatively a good margin category for us. OHT business is something which we are far optimistic about and going to go in. Even passenger car and truck radial are areas of growth for us on exports. But the momentum that we are seeing domestically, when you ask about mix, I think the mix will be stable.

Karan Kokane: And the second question is on CAPEX. So, obviously, this year you said that, you know, project CAPEX will be around 750 crores and 200 crores of maintenance CAPEX. I wanted some clarity on FY24 CAPEX. So, once this expansion is done in Chennai, so will we see a significant drop in CAPEX for say FY24? How are how looking at CAPEX for FY24?

Anant Goenka: So, at this point, we had at one time announced the expansion of truck radial tyres of two phases. We had postponed or scrapped phase, the second phase at this point of time. Phase 1 we had delayed to October which we may further delay a little bit because we still have enough capacity in our Halol plant. Besides that, we have no further CAPEX that we have planned except for some amount of off-highway tyres. So, to that extent there, I think truck radial is still to be a decision still to be taken based on demand situation and we can update you possibly in the next quarter call. Besides that, we have off-highway tyres and then the routine CAPEX that will happen. This is what we have at this point of time which is an overall may be some drop next year from this year. Kumar, anything you'd like to add here?

Kumar Subbiah: No. Anant largely covered the, we would be completing the first, this one specialty, our Ambernath radial capacity expansion by first half of next year. With that, first phase will be over. But as you mentioned that we don't have any big CAPEX plans unless we go beyond the current plans as far as OTR radial is concerned. Truck and bus radial, we'll update may be in the next call. You've covered it well, Anant.

Anant Goenka: Yes.

Kumar Subbiah: Nothing more to add.

Moderator: Thank you. Our next question is from the line of Subhadeep Mishra from UTI Mutual Fund. Please go ahead.

Subhadeep Mishra: If I heard you correctly, you guided for a debt to EBITDA of 3x. But if I look at your credit rating report from Clear Ratings and India Ratings, they have given a negative trigger at 2.5 to 2.6x. So, is the, I mean, can we expect some rating downgrade, credit rating downgrade or something like that? Because they are writing for 2.5x, 2.6x whereas you guided for 3x?

Anant Goenka: Kumar, anything you would like to?

Kumar Subbiah: In all our engagements and interactions with credit rating agencies, okay, and also on our projections, we have kept, you know, when we said 3, that is kind of a threshold beyond which we don't want to cross and sometimes the revenue generation happens after you complete the CAPEX which is evident even in the last few quarters in terms of revenue growth. We don't expect any downgrading to happen as far as credit rating is concerned and we would be happy to engage with our credit rating agencies and which we do once a quarter with them. So, we are not expecting any downgrade as far as credit rating is concerned. Last year we ended at 2.9 and this year we are still keeping threshold upper limit as 3 and in the event our operating performance improves in the balance quarters of the year, we don't have to even cross the threshold. So, that's the way we are looking at it.

Moderator: Thank you. Our next question is from the line of Disha Sheth from Anvil. Please go ahead.

Disha Sheth: Sir, wanted to ask that when you are saying that you are expecting good volume outlook going forward even in Q2, so the mix is skewed towards OEM or replacement as we are seeing more growth in OEM? And second question, if you can tell even in the mix of truck and bus, passenger, two-wheeler, where is the more growth and volume growth coming from?

Anant Goenka: Right. So, in Quarter 1, we saw OEM clearly at the highest growth and that trend is looking to continue, particularly as chip shortage is easing out, and so to that extent, I think, OEM, we expect to grow the fastest followed by replacement and then international business. And in terms of category level growth, we are seeing higher growth in PCUV on two-wheelers and then third, on the truck side at an overall across category level.

Disha Sheth: Okay. And sir, so more of OEM mix may impact the margins. Am I getting it right?

Anant Goenka: Yes. It can have a temporary impact, I mean, in terms of our mix margin, but hopefully, we will be able to take that, I mean, that will have a positive impact in the longer term. So, we will continue to invest on in terms of OEM growth. We are fine with that. I think at, we have enough capacity as well. So, at an absolute level, we expect to see to be no negative impact on profitability. It will overall help plant utilization levels and efficiency as well.

Disha Sheth: Sir, over a course of three years, we expect the mix to remain same, right? Or you want to make a higher mix of OEM or 30:50:20?

Anant Goenka: No, that is not a long-term view. So, I'd say that, of course, this is how we are seeing OEM growth at this point of time. Because of the chip shortage easing off, it seems strong and on CV versus last year or continued growth on the CV side. So, all categories are kind of doing relatively better on OEM side and therefore, that's resulting in growth, but this will, of course, at some point of time stabilize at a certain level and other categories will see higher growth over time. So, I don't see long-term mix undergoing any change.

Disha Sheth: And sir, when you said that overall price hike was 1.5% in this quarter and volume was 8%, there was no mix impact, right?

Anant Goenka: So, there would have been a minor adverse mix impact on our net realization because of OEM being a little bit higher but if I recollect that would have been net of inflation impact. The number that we would have shared would have been net of that.

Disha Sheth: Okay. And sir, and overall scheme of things since the OHT is also increasing with the capacity coming in and OHT has a much higher margin than other tyres, so that will also have a positive impact, no? How much can be the OHT share going forward since we are expanding only in that segment?

Anant Goenka: So, OHT share, we are today at about seven, approximately 65, 70 tons per day today production. This is for the month but that is continuously, say, going up. It will go up to about 80 tons per day by November or so and then there is some shift that we are doing in our older plants also towards bias tyre. So, yes, there will be a shift towards off-highway. Beyond that as we fully utilize the 80 tons per day, we will look at further expansion going forward. So, that mix will shift. Today, I would say the overall mix of tractor and OTR would be somewhere around 15% of our sales. This is not all high margins. So, for example, domestic tractor is not high margin, but approximately that 15% should further go up. It was maybe closer to 13-14% last quarter, maybe 15% this quarter. So, some improvement will come in going forward.

Moderator: Thank you. Our next question is from the line of Ashutosh Tiwari from Equirus Securities. Please go ahead.

Ashutosh Tiwari: Firstly, we had got Rs. 156 crores of subsidy last year from the state government's grants and all versus Rs. 31 crores in FY21. So, are you seeing the same run rate will continue in this quarter as well, like Rs. 40 crores per quarter is continuing?

Anant Goenka: Yes. Kumar, would you like to take that?

Kumar Subbiah: Last year Chennai being the second year of operations, okay, so a lot of incentives and there is also some backlog in other factories where fiscal benefit was more received in the last year. We don't expect fiscal benefit to sustain at that level. Okay. So, it had benefits relating to earlier period that we received some portion of it we received in the last year.

Ashutosh Tiwari: Right. What levels it will probably settle in this year? Any range?

Kumar Subbiah: Currently, we are conservative with respect to accrual of that income in our books. Okay. So, only after we get certain confirmation or approval, we do recognize them in our books. It could be around half of what we have taken, what you said just now, but it depends on the timely receipt of approvals for us to accrue the benefit.

Ashutosh Tiwari: That, that subsidy amount, grant amount is booked in this quarter or not any amount is active?

Kumar Subbiah: Some portion wherever there is a certainty, our accounting policy is that if that benefit comes only after the approval, we accrue them on approval. If there is any certainty where approval is not required, we recognize it. Same in the current quarter that went by, in Quarter 1, small portion of the fiscal benefit is accrued.

Ashutosh Tiwari: Even, even that is a contributor to some kind of your margin compression quarter-on-quarter. The previous quarter you recorded higher subsidy, this quarter low subsidy, right?

Kumar Subbiah: It's not that the amount, the total amount that you mentioned was received in the previous quarter. It was received in the previous year.

Ashutosh Tiwari: So, I am saying that Q4 would have been a higher amount than what you received in Q1, right? So, that would have also contributed to some kind of margin compression quarter-on-quarter.

Kumar Subbiah: True. It is part of our gross margin. So, therefore, to that extent, it is also true that Quarter 1 accrual was lower than Quarter 4 accrual. So, therefore, that also played to some extent in the gross margin.

Ashutosh Tiwari: Okay. And secondly, we mentioned that in TBR segment through debottlenecking we increase your capacity. So, what kind of increase has happened now? What is the capacity of TBR overall versus earlier?

Anant Goenka: So, today, we are at about 140,000 tyres per month approximately capacity. Really producible capacity may be 130, 135, but as our people get trained, we can take it up to 140, and maybe over time maybe between 140 and 150 depending on how much we are able to stretch the capacity.

Ashutosh Tiwari: And just lastly, what is the producible capacity? How much we are operating at? This TBR capacity?

Anant Goenka: About 115,000 tyres approximately. Kumar, would you like to add?

Kumar Subbiah: Approximately.

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

Jinesh Gandhi: Hi. Just one clarification. Kumar, this debt which you mentioned, how much of that would be foreign currency debt?

Kumar Subbiah: No, all are Indian currency debt only. We don't have any foreign currency debt in our books.

Jinesh Gandhi: Okay. So, then this 6.5% average cost of debt seems to be quite low. So, is this what we had based on what comes to P&L or this one is our actual cash cost?

Kumar Subbiah: See, this is a combination of both short-term as well as long-term. Okay. And so short-term interest rates are 5.5% at this point in time. Okay. Longer-term interest rates are around 7.5%. Not all of that has yet come in as of now because in case of one year reset, the rate of interest revision will happen. So, the average rate of interest for the quarter is approximately 6.5.

Moderator: Thank you very much. Ladies and gentlemen, due to time constraints, that was the last question. I now hand the conference over to the management for closing comments.

Anant Goenka: Thank you very much for your interest in CEAT and look forward to catching up once again next quarter same time. Thank you.

Moderator: Thank you very much, members of the management team. Ladies and gentlemen, on behalf of Elara Securities Private Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.