"CEAT Limited Q2 FY22 Results Conference Call"

October 26, 2021

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MODERATOR:	**MR. NITINN AGGARWALA– JM FINANCIAL**

Moderator: Ladies and gentleman, good day and welcome to the CEAT Ltd. Q2 FY22 Results Conference Call hosted by JM Financial. 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. Please note that this conference is being recorded. I now hand the conference over to Mr. Nitinn Aggarwala from JM Financial. Thank you and over to you sir.

Nitinn Aggarwala: Thank you Faizan. Good afternoon, everyone on behalf of JM Financial I would like to welcome you to 2Q FY22 Post results call of CEAT Ltd. We have with us the senior management team from the company, represented by Mr. Anant Goenka – Managing Director and Mr. Kumar Subbiah – Chief Financial Officer. I would like to thank the management for taking time out for this call. I would now like to handover the call to Mr. Anant Goenka for his initial remarks. Over to you Anant.

Anant Goenka: Thank you Nitinn. Good afternoon, everyone and a very warm welcome to CEAT's quarterly earning call and thank you all for your time in joining us today. I am Anant Goenka and I have with me our CFO – Mr. Kumar Subbiah on call with us.

I hope all of you are all well and as usual we will start with a few brief remarks from me and Kumar, post which we would be happy to take questions.

The quarter started on a relatively positive note on the demand side, as market started opening up post COVID wave 2. In the replacement market recovery was strong in the passenger segments with demand going back to normal levels. Commercial segments CV as well as the farm segment were relatively week. Overall, for us replacement volumes grew at about 23% sequentially, with a marginal decline of about 3% on a year-on-year basis. OEM volumes grew at about 35% sequentially and 17% year on year, largely because of a lower base. Semiconductor shortages continue to impact recovery in the passenger OEM segment. Exports have continued to do well for us with a sequential volume growth of about 10% and a year-on-year growth of almost 50%. Overall, we saw a sequential volume growth of about 23% and year on year growth of 9% during the quarter. The demand situation looks positive. On the other hand, costs have continued to rise. Our raw material basket went up by about 6.5% sequentially, on account of higher crude prices and logistical challenges resulting in higher freight rates. The increase was higher than our estimate of 5% at the beginning of the quarter. We took staggered price increases during the quarter to offset the impact, however these were not commensurate with the raw material inflation and hence our gross margin contracted by about 1.8% over quarter 1 levels. Higher volumes helped in better absorption of fixed costs, as a result our standalone EBITDA margin stood at 8.9% slightly higher than quarter 1. We ended our quarter with a standalone PAT of Rs. 36 crore.

Our OEM strategy is playing out well and we continue to strengthen this aspect of our business, we continue to do well on the passenger side as well as continue to be a preferred partner in 2 wheelers and 3 wheelers in the e-mobility space. We have also revamped our CEAT shoppes with a modern look and several customer friendly features, the new design has been rolled out in select cities from August onwards.

We continue to invest in marketing, we launched two major marketing campaigns this quarter, the Secura Drive for passenger car and UV Tyres featuring our brand ambassador Aamir Khan and CEAT Grip X3 for Two-Wheeler Tyers. Both campaigns are focused on reinforcing CEAT's safer mobility brand appeal.

IPL 2021 also resumed this quarter and we continue to remain associated with the event as strategic timeout partners.

On the Digital side our website was recognized as the best website of the year by CMO Asia. We continue to invest in digital as well as on ESG- Environment Social and Governance. On the sustainability part we have taken many internal initiatives on improving our sustainability and carbon footprint across the company.

On our diversity and inclusion journey, about 30% of our new recruits are women. We have also had our first batch of 7 transgender associates joining CEAT this quarter. With this I end our highlights and I will be happy to handover the call to Kumar.

Kumar Subbiah: Thank you Anant. Good afternoon, ladies and gentlemen and thanks for joining our Q2 earnings call. I will share some key financial data points with you all, post which we can enter the Q&A session.

First one is on revenue, our consolidated net revenue for the quarter stood at Rs. 2,452 crore in rupee terms, the sequential growth of 29% and year on year growth of about 24%. The revenue growth was driven by volume and favorable product and category mix. On gross margin, our raw material cost continues to raise and impact our gross margins which stood at 37%, a sequential decline of about 203 basis points. Our blended raw material cost went up by about 6.5% in quarter 2 versus quarter 1. We took price hikes to the tune of anywhere between 4 and 5% during the quarter, across most categories and segments. The price increases taken so far are not sufficient to cover unprecedented commodity inflation we have seen in this financial year and there is a need for further increases in the coming months to absorb the cost increases. Raw material scenario still remains challenging. As per our current market understanding, we expect our blended raw material costs to go up by another 4% in quarter 3 versus quarter 2.

I will come to debt, CAPEX and working capital. Our debt during the quarter increased by about Rs. 219 crore on a sequential basis, largely driven by CAPEX, payment of our annual dividend and increase in the inventory levels and deters. We incurred a total CAPEX of Rs. 226 crore during the quarter, which includes approximately about Rs. 150 crore towards our capacity expansion projects and our project CAPEX outlook for the current year still remains at around Rs. 1000 crore.

Our operating working capital increased by about little over Rs. 100 crore in the last quarter, largely due to higher inventory levels, both in raw material as well as finished goods and also increase in receivables arising out of higher scale of operations. We are taking steps to reduce both finished goods and raw material inventory in quarter 3. Operational expenses during the quarter as a percentage of turnover was lower compared to quarter 1 largely on account of higher scale of operations. Our advertisement costs returned to normal levels, increasing by about 70% over the previous quarter due to full scale resumption of our marketing efforts and as well as IPL event that happened in quarter 3. Employee cost declined by 3% sequentially which is largely driven by reduction in some of the COVID norms related expenses. We continued our effort to optimize our operating cost, along with some scale benefit we are able to manage our EBITDA margin at quarter 1 levels. Our consolidated EBITDA stood at Rs. 225 crore in terms of percentage, about 9.2%.

Coming to depreciation and interest cost during the quarter we recognized right of use assets under IndAS 116, aggregating about Rs. 61 crore on the rental arrangements, with CFAs, DCs and OEM godowns. The same is accounted with effect from April 2021 with necessary accounting being done in the current quarter. While this does not have any impact on our profit before tax, it has led to higher depreciation to the extent of Rs. 20.45 crore during the quarter, as it includes the depreciation for quarter 1 and the approximate impact on a quarterly basis about Rs. 10 crore and other expenses has come down equivalent to the same number. Due to the above, our overall depreciation for the quarter moved up from about Rs. 96 crore to Rs. 121 crore. Since our debt has increased during the quarter, the finance cost has also gone up from about Rs. 46 crore in quarter 1 to around Rs. 50 crore during the quarter.

During the quarter in the month of September on approval of by the shareholders of our organization, we disbursed dividend to the tune 180% of our share capital, amounting to Rs. 73 crore. Our consolidated profit for the quarter stood at Rs. 42.28 crore and our effective tax rate for the quarter stood at 27%. And we would also like to update you on the credit rating, in the month of September. Our annual credit assessment was carried out by India Ratings and we were affirmed credit rating of AA for long term and A1+ for short term with stable outlook.

With this now, let us open the floor for Q&A. Thank you.

Moderator: Thank you very much. The first question is from the line of Jinesh Gandhi from Motilal Oswal. Please go ahead.

Jinesh Gandhi: My first question pertains to the demand outlook, so do we expect the momentum which we have seen in the replacement market to continue in the second half, given that passenger vehicle demand continues to be strong, particularly in the replacement side? And any trends which you have seen on CVs and farm side?

Anant Goenka: Yes, Hi Jinesh. We are seeing an increased, a good demand on the passenger side, this is in the replacement segment both two-wheeler and passenger car are looking good. Commercial vehicle has been slow still and will take some time to pick up. Particularly for us on the truck-bias side we are seeing a slowdown, whereas radial we are seeing an uptake in terms of demand. Farm has also been under little bit of pressure, last year's base was very high, farm demand both between OEM and replacement was kind of highest ever levels, so maybe on a higher base there is some relative year on year pressure on the farm side as well. On the OEM side we are finding commercial vehicles picking up much better than last year, whereas there is some pressure on the passenger car and on the two-wheeler side because of the chip shortage issue and overall, two-wheeler demand is slowing down. So, I think this is the overall outlook. Exports has generally have been very strong all through the year, however container availability, freight rate increase is a challenge but we are managing to show good growth despite these challenges.

Jinesh Gandhi: And with respect to the price hikes, you indicated 4-5 % price hikes taken in second quarter, I am presuming average would be lower considering the timing differences and expecting, so have we taken any further increases in October?

Anant Goenka: Yes, we have taken about 2.5% in two-wheeler tyres and couple of percentage points in passenger car as well and about 3% in farm. Some of this has been taken in the middle of October and some of it will be taken in end of October, so 29th to the 1st of November will be on passenger car and farm, whereas 2-wheeler 2.5% has already been taken.

Jinesh Gandhi: Okay and after this price increase, another 2-3% under recovery on account of commodity cost inflation or it would higher than that?

Anant Goenka: So, we expect about 3.5-4% increase in raw material in quarter 3, that requires approximately about a slightly under 3% price increase to equate that, so yes maybe another couple of percentage points are needed because TBV or truck radial is not included in what has been taken, so we do need at least a percentage and a half to 2% price increase between November 1st and December to equate that.

Jinesh Gandhi: Okay understood and thirdly, clarification on the depreciation part, so Kumar you indicated it is about Rs. 10 crore the difference because of accounting issue, I mean Rs. 10 crore moving out of Other Expenses and coming to depreciation, is that right?

Kumar Subbiah: Yes, on a quarterly that is the impact but in the current quarter we have done it effective 1st of April, so current quarter has Rs. 20 crore in it but going forward it will be about Rs. 10 crore per quarter.

Jinesh Gandhi: Okay and any sense on what would be our normalized run rate of depreciation, maybe say for FY23, give that by then we will be having a large part of our capacities fully operational?

Kumar Subbiah: Okay, see current quarter, first I will explain current quarter and then I will also give you a broad outlook. Current quarter our depreciation is about Rs. 120 crore and just to make sure that it is comparable, you will have to remove about Rs. 10 crore because it includes Rs. 10 crore relating to earlier quarter, then the number comes down to about Rs. 110 crore for the current quarter. In the current year we would still incur CAPEX as per the original plan which we will cover it separately, and depreciation is linked to the assets that we capitalize, so I expect depreciation to, in the event that we go ahead with all the CAPEX and capitalize all the assets, etc. another Rs. 15-20 crore kind of depreciation impact could come in the next financial year, progressively.

Jinesh Gandhi: Okay, so additionally Rs. 115-120 crore, over …

Kumar Subbiah: Rs. 15-20 crore, over and above the current quarter, per quarter.

Jinesh Gandhi: Okay and last question on our current utilization rate, so can you share where are we with respect to utilization in key segments?

Anant Goenka: Yes, utilization levels are relatively strong, we have done well in all the new capacities that we have setup in Ambernath, which is off-highway tyre, we are nearly fully utilized, there has been small expansion that we did a few months ago. Passenger car, we are also quite well utilized, Chennai is ramping up, Halol is fully utilized in passenger car segment and Chennai is ramping up as we speak. I would say we are today at about 80% utilization. The area where we are underutilized is in truck-bias and truck radial also, we are ramping up.

Jinesh Gandhi: Okay and on the two-wheeler side?

Anant Goenka: Two-wheeler's demand is looking good; we are over 80% utilization. Around 85-ish%.

Moderator: Thank you. The next question is from the line of Amin Surani from JP Morgan. Please go ahead.

Amin Surani: My first question was on the gross margins, so would you say that almost all of it is because of raw materials or is that there is an angle of revenue mix also because if I look at your revenue mix, your replacement share has come down significantly, first half this year over first half of last year, so is the gross margin also because of this mix change or is it entirely due to the raw material pressure?

Anant Goenka: No, it will be because of both but I will say this year we have come back to a normal mix. Last year, if you recollect, post-COVID, both OEM and exports were at a very low level because of closures and shutdowns that were happening whereas replacement market bounced back very well. So, to that extent, replacement was a much higher share than normal. So, this quarter, I would say, it is more of a normal mix where replacement would be approximately closer to about 60% of our sales, OEM will be closer to 25% - 26% and export would be the balance. So roughly that is how would be the normal kind of mix in today's terms. So, some amount, yes would be because of the mix and some amount is raw material as well.

Amin Surani: Okay and if I look at your other expenses, so if I look at first half this year of a first half last year; it seems that there is almost no benefit coming from operating levels because obviously revenues have grown substantially because of the low base of last year but other expenses have almost kept in line instead of, so, is that something happening there or was there some extra savings which happened last year because of the lockdown, which are coming back now and how should we look at these operating leverage playing out as the revenues grow further from here?

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

Kumar Subbiah: Yes. One of the big ones, I will call out. First one is that, in the quarter 1 of last financial year, there was no IPL, one and number two, our advertisement cost was zero because of during COVID period we did not spend anything. Similarly, in factories and all other locations, we had kept it almost as minimum as possible. We did not run the plant in quarter 1. See, in the way you see the profit and loss of accounting, you know, during the quarter if you produce and incur cost, it would come as a cost but it will get adjusted in the closing stock value, that is what normally happens. So there has been an increase in finished goods inventory also if you look at first six months or the next three months, so that is also another effect. So mainly because of higher level of marketing cost. If you remove the advertisement portion and look at operating cost as a percentage of turnover, actually there is a drop.

Amin Surani: Okay, fair enough, this is helpful.

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

Shalini Vasanta: Hi Sir, so we have seen our debt levels go up across both, shorter and long term. So, could you give us the CAPEX guidance for the next year and what sort of peak debt numbers can we expect over the next 12 to 18 months?

Kumar Subbiah: See, in the current year, in the first six months or the last three months, approximately about Rs. 220 crore is an increase in our debt level and part of it is due to capex, and we also had in the current quarter, that is in quarter 2, payment of about Rs. 73 crore of dividend, which is not a recurring event, it happens once a year. Number 2, the working capital, particularly, the inventory has also moved up in quarter 2, so these are two reasons. In the past, till whole of last year almost, we were able to deliver reduction in absolute working capital whereas in last two quarters or so, there has been an increase in working capital, something which we are going to focus a little more in quarter 3 to deliver some reduction. As far as CAPEX is concerned and our expected CAPEX for the current year is approximately about Rs. 1000 crore; project CAPEX approximately. And we have already spent a little over Rs. 300 crore in the first six months, balance amount is what we would be spending and as far as the following year is concerned, while we do not have any revised outlook. We will get to know the expected CAPEX over the next financial year during our annual plan, exercise that we normally do in the quarter 4, beginning of quarter 4 but assuming that the same CAPEX would be around Rs. 700 crore to 800 crore in the next financial year, that would be the quantum of CAPEX that we will have in the whole of next financial year and current year I indicated to you, if we are aiming for about Rs. 1000 crore and little over Rs. 300 crore has been spent. So that is the kind of outlook that we have for CAPEX.

Shalini Vasanta: Thank you, Sir and on the debt levels, what sort of peak debt number can we see during this period?

Kumar Subbiah: Okay, difficult to talk about the next financial year. And due to lower cash profits in the first six months and also on account of increase in working capital, our debt level has increased in the first six months of the year, contrary to what happened. So, our debt level, as of 30th September, is very equivalent to where we were in June 30th, 2020, so we have gone back to that particular level. Looking in terms of peak debt you know, as of now, we do not intend to cut our CAPEX significantly for the next six months of the year, as of now that is what our plan is but it depends on how the current quarter goes during the course of the quarter, we may still review and take necessary steps. We expect debt to go up by few hundred crore, exact amount we are not able to tell you because it is linked to amount of our operating performance and operating cashflows but certainly in the current financial year, in the balance six months of the year, it could go up by few hundred crore.

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

Chirag Shah: Hi, thanks for the opportunity. So Anant, I just missed the opening comments. Just wanted to first understand the volume growth for the quarter.

Anant Goenka: Our volume growth year-on-year on quarter-on-quarter?

Chirag Shah: Either way, so you can share in.

Anant Goenka: 23% was our volume growth quarter-on-quarter and year-on-year was about 9%.

Chirag Shah: Okay, 23% q-on-q, thanks for this. My second question is on competitive intensity in general. So, there were some apprehensions, six months or nine months back; Maxxis coming in, in two wheelers and Apollo Tyers also trying to find a foot hold. After nine, twelve months of those, **as** their entry**,** what is the scenario today? Has profitability for the industry come down marginally or profitability is intact and there could be some market share loss amongst players, that is how industry is stabilizing?

Anant Goenka: There has been some marginal drop in profitability in two-wheelers, I would say this was about, at one time about four years ago there was quite a substantial drop on relative basis when there was a price drop taken at that point of time. And once again, I would say relatively in the last year, two-wheeler has seen a smaller price increase than other categories but overall, we are happy with where we stand, in terms of our market share. We have only maintained or gained our market share in the two-wheeler space and we have also increased or have a very strong presence in the two-wheeler EV space with respect to market share. It is higher in the EV space than even in the regular industry. So, to that extent, I would say comparative intensity is the same in two-wheelers versus other categories, it is no different, in fact maybe marginally less just because you have more players in the passenger-car space.

Chirag Shah: And on the two-wheeler EV side, what kind of market share you would be having today?

Anant Goenka: See, still relatively much smaller market, but it would be over 50% levels.

Chirag Shah: Secondly, just question for Subbiah; on this operating leverage, so we should assume that the costs have now normalized, right? And from hereon if volume ramp-up happens, operating leverage should be visible?

Kumar Subbiah: Yes true. Even in the current quarter, operating cost, if you exclude advertisement costs, which could vary depending on when IPL happens, etc., we have seen that leverage, so going forward should the turnover go beyond Rs. 2400 crore and you would see that with the leverage on operating cost as a percentage of turnover.

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

Nishit Jalan: Hi sir, thank you for the opportunity. My first question is on the price increase; you talked about 4% to 5% price increase in second quarter, so was it, were you able to take price increase across all the segments; two-wheeler, TBVs, TB Bias, TB radials?

Anant Goenka: Yes, this is the average across categories.

Nishit Jalan: So, Sir, my question primarily was on the two-wheeler side, because that was one segment where we are seeing lesser price increase, especially on the motor cycle side of it. So just wanted to check whether we have been able to take price increase and it has been followed by our peers, so are we able to pass on the cost hike in that segment because which was not happening until a few quarters back?

Anant Goenka: So, the 4.5% price increase includes some amount of motor cycle as well as again a price increase in two-wheeler on middle of October by another 2.5%.

Nishit Jalan: In October, when you have taken price increase on two-wheeler, it is also on the motor cycle or it is largely on the scooter side of it?

Anant Goenka: Both.

Nishit Jalan: So basically, the key here is, what I am trying to understand is, are you seeing any specific segment where the competitive intensity is much higher and where price increases are becoming a little more difficult. I can see that in October, you talked about the price increase in PV two-wheeler in farm but not in CVs. So, do you think, any specific segment, where the intensity is higher, price increases are more difficult or do you think, it is relatively fine now, given the kind of cost pressure, is looking?

Anant Goenka: So, I can share with you, a little bit on the demand side, I am not sure of the price increase directly reflects on demand but I would say that demand side, CV replacement is still under some amount of stress. Particularly, Truck-Bias but in the other segments, so there is sometimes we do not take the price increase exactly at the same time. Some maybe in July, some maybe in August, so it is relatively okay spread-out.

Nishit Jalan: Got it and just one more thing. On the Truck-Radial side you had setup capacity, you are setting up more capacity, earlier we used to have a low-single digit kind of a market share, where would we be on both the Truck-Radial side and also on the passenger-vehicle side in terms of a broad range of market share?

Anant Goenka: So, on the Truck-Radial side, yes our market share was somewhere around 5% kind of numbers in the past, this would have come up to about 8% to 9% levels and on the passenger-car side, from about 11% -12%, we would be at about a 15% kind of market share today.

Nishit Jalan: And this 15% would be more skewed towards OEMs rather than replacement because we were trying to penetrate OEMs much more aggressively?

Anant Goenka: No, we are kind of mixed at the same level at the industry, so about 40-45% being sold to OEM and about 55-60% getting sold to replacement in the passenger segment.

Moderator: Thank you. The next question is from the line of Jay Kale from Elara Capital.

Jay Kale: Sir my first question was regarding the volume growth you mentioned, if I am not wrong, you mentioned that the replacement growth was at the flattish, to minor decline and the OEM growth was pretty strong 30+ %, one is that correct? And two, if that is correct then how do you see the replacement growth, is it a case where last year if I remember correct, the replacement there was a lot of pent up demand and the inventory levels of the dealers were also quite low and hence Q2 had seen a substantial growth on the retail as well as the wholesale side for CEAT as well as the industry and hence on that extremely high base we are kind of flattish now, so in that context how would we be one year prior to that levels, are we at least at those levels or are we having a growth on those levels? And going forward how do you see this Y-O-Y growth for replacement of the second half of FY22, because last time we had seen second quarter and third quarter extremely high growth, one because of the pent up as well as the Chinese restriction of imports happening? So, if you could just throw some light on the replacement trajectory.

Anant Goenka: You are absolutely right, so last year same time replacement grew at a much faster pace and continued its growth trajectory into Q3 and Q4. To that extent we are on a high base and therefore replacement growth on a year-on-year basis will be possibly at a low single digit kind of numbers at this time, the more important thing is our mix, so we will be selling in my view more of passenger car segment which has been our focus area, truck radial also we expect to grow much better versus last year, where we will see a dip was truck-bias, so if you compare even versus the year before that, usually truck-bias is a segment where there is shift in radialization is happening, you see truck-bias generally being flat to negative but last year truck-bias was at maybe record high levels or some 5-6 year high levels. So to that extent, truck-bias is what is letting slower levels of growth because it is a high value or high volume kind of category on its own. So that is a big shift we have seen from last year to this year. But overall, on a year-on-year basis, growth in replacement will be a little bit lower at an overall level, led by truck-bias showing negative growth.

Jay Kale: Understood and in terms of your TB OEM market share, you had aggressive plans of having market share gains in the OEM segment, how would you see that currently in terms of are those incremental orders largely in the base from here if we should settle, we should largely grow in line with the industry or you still believe over the next one or two years, you can significantly grow higher than the industry on the passenger car OEM tyre segment?

Anant Goenka: No, we do feel quite confident on OEM market share on the passenger side, we would be at 15%+ levels with respect to market share in the passenger car space largely, so we do feel quite happy with that we hare. For example we were part of the new Mahindra Bolero, launched on our tyre in the last month or so, so to that extent we are entering new OEMs and gaining market share in OEM side.

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

Nishant Vass: Small clarification to the response to your earlier question, so is it right to assume when you mentioned that the utilisation of bias is down, this is primarily the truck-bias impact which might be at like underlying demand slowdown issue or you think that there is pent up on the bias side that has happened and that is an ongoing issue? So, is it a demand driven drop or it is just a pent up getting fulfilled and then the incremental demand?

Anant Goenka: So, it is largely because of high base of last year which to me was a little bit abnormal, if you look as I said on a year-on-year basis, truck bias has been flat to maybe somewhere between 0 to -5% growth every year because radial tyres is what is growing at a faster pace. So last year truck-bias saw that substantial growth, people were moving more maybe towards the value segment because of the uncertainty that was happening, some amount of pent up demand last year where truck radial capacities could not be supplied, so truck-bias was also selling very well. Now that has normalized and therefore we are seeing good growth in the truck radial segment but truck-bias has gone back to its normal rate of negative growth to a certain extent. If you take into account last year's very high growth it is therefore showing substantially higher negative growth in this year.

Nishant Vass: So, what is truck radial growth at roughly today?

Anant Goenka: The truck radial would be growing at least for us at possibly 20% levels, I can just get back to you on the exact number but year-on-year we would be at 20-25%+ growth.

Nishant Vass: Understood. Second question is on your marketing spends and your trajectory on that, I heard Kumar saying that you have gone up like 70% quarter on quarter, so with sale improving in quarter 3 what is your thoughts on marketing spends, you also mentioned the CEAT shoppes have revamped up, so can you shed some light on how you are thinking about those spends, this year and potentially next year?

Anant Goenka: Yes, so marketing we generally try and maintain it at similar levels as a percentage of sales, there can be a minor change here and there but we are continuing to invest in cricket in IPL. So some amount of IPL was held into October as well, so there will be some amount of the IPL cost impact with respect to October, but our marketing spend will not go up as a percentage of sales. It will be at similar kind of levels is what we would like to maintain it at.

Nishant Vass: So, when you say similar, you would say similar to pre-COVID percentage that you have done?

Anant Goenka: Yes, as a percentage of sales will continue at that level.

Nishant Vass: Third question is I think you or Kumar can answer is on the people cost side. I think I heard Kumar mentioned about COVID spends not recurring, so can you remind us what was that spend for last quarter? And what is your trend of people cost that we should expect growing at?

Kumar Subbiah: Yes, approximately spending about Rs. 5-6 crore per quarter on an incremental basis due to some COVID related SOPs that we had to adhere to in our manufacturing locations and that amount came down in the month of September onwards. If things are okay under normal conditions, we would be spending much less, for example we are providing transport facilities and the number of people sitting in the buses were far lower, maybe 50% of what it was earlier, etc. So some of them we have relaxed a bit in quarter 2 and third also in quarter 2, little lower level of production towards the later part of quarter 2, so leading to some reduction in employee cost particularly on the contractual side. But for you to make your own estimates, you can always assume quarter 1 as the base and as and when we add people in factories and some annual increase, so about Rs. 175 crore is a kind of a number that we saw in quarter 1. As well as the current year is concerned in that range Rs. 175-180 crore could be a normal kind of a number at a higher level of operations in our manufacturing locations.

Nishant Vass: And on this capitalization of new facilities coming on next year, would that meaningfully increase or should be nominal increase?

Kumar Subbiah: The amount of employee cost that we capitalize is very small, if the employee cost increases only when we add people for us, so whenever we ramp up production. In general we tend to add people 6 months before the real requirement, so from that point of view we will keep adding people but capitalization will have limited relevance, more of commissioning of plants and ramping up production is what will impact. As we are already into the end of first month of quarter 3, the impact of employee in terms of additional people in the current financial would be limited, but next year if you see more need for ramping up production in new locations, you will see an increase. We also have an annual increment cycle starting from 1st of July, so that increase also needs to be built in, so approximately Rs. 175-180 crore kind of an assumption for the current year for the balance two quarters is a reasonable estimate.

Nishant Vass: And Kumar my last question is on your interest cost side with your credit ratings also slightly improving on, what are your thoughts on your interest cost side, the working capital will also get a little stretched on the first half, how are you thinking about that in the second half of the year, potentially next year?

Kumar Subbiah: We made good progress in bringing the interest rate down, overall our cost of capital has undergone an improvement in the last 12 months. Whether it is long term or short term we are generally able to borrow money at a competitive rate of interest comparable to credit rating of companies one notch higher or two notches higher than us. I think what is taking the absolute interest cost up is because of increase in overall debt and while we are seeing an average rate of interest is coming down, so our plan is to bring in back some efficiency in working capital in the current quarter particularly on the inventory side and improve our operating cash flow during the current quarter but as we intend to spend close to about Rs. 1000 crore of CAPEX during the financial year, from that point of view we expect our overall debt to move up by few Rs. 100 crores in quarter 4, so that may lead to higher amount of interest cost but interest rate could still remain at the current level. Absolute interest cost could go up by about 10-12% over the current pace.

Moderator: Thank you. The next question is from the line of Disha Sheth from Anvil Share and Stocks. Please go ahead.

Disha Sheth: Sir since we are concentrating more on OEM over a long term will our margins get affected because..

Anant Goenka: Yes, so we are not concentrating more on OEM or so, We are going to focusing both on OEM, replacement as well as export market, infact the exports market for us is grown at the highest pace this year but as we move more and more to the passenger segment or move more means we aim for higher market share there, we expect the category mix to be favorable and therefore we feel that net-net it will be margin accretive, despite having 40% or so sale in OEM and 60% sale in the replacement passenger segment.

Disha Sheth: Okay, so overall for the company over the next 3 years what mix we are looking for replacement OEM and exports?

Anant Goenka: We would be looking at about 60% share in replacement, similar levels. 25% in OEM and 15% export approximately.

Disha Sheth: Okay and sir just wanted a clarification, can you please repeat the replacement and OEM growth for current quarter, quarter on quarter and year on year?

Anant Goenka: Yes, for the replacement market year on year growth was 9%, overall was about 23%, replacement I would like to repeat again, overall replacement volumes grew by 23% on a quarter-on-quarter basis, with 3% decline on a year-on-year basis. OEM volumes grew at 35% sequentially and 17% on a year-on-year basis. And exports grew at about 10% on a quarter-on-quarter basis and year on year at about 50%.

Disha Sheth: Okay and overall volume growth is 23% quarter-on-quarter and 9% year-on-year?

Anant Goenka: That is right.

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

Ashutosh Tiwari: If I look at your presentation in the first half, the farm has contributed 11% of sales versus 7% last year and Specialty has contributed 4% of sales versus 7% last year, while we have said that farm has not done well, and Specialty has done very well, so is there any mistake over there in the ppt?

Anant Goenka: I think there was a change in classification that we did, if I recollect right. Can I get back to you on this, there was a change in classification where we kept some part of farm outside and we may have done that.

Ashutosh Tiwari: Okay so this Specialty is only exports you mean to say?

Anant Goenka: So, the farm exports have been reclassified from Specialty to Farm in FY22. Earlier the farm exports was part of Specialty Tyres.

Ashutosh Tiwari: Okay, I got it. Secondly, on this working capital increase in the first half, is it more driven by raw material inventory or finished goods have gone up more?

Kumar Subbiah: It is a combination of both and both have gone up and almost in equal proportion. Part of this increase is also because the value has gone up but the balance part is the volume of inventory that we are holding has also increased over 31st March, so the increase has happened on both.

Ashutosh Tiwari: Okay and you plan to bring it down in the second half?

Kumar Subbiah: Yes, that is true.

Ashutosh Tiwari: Okay and lastly can you provide some colour on the inventory dealers has it been normal or more than normal, how are you looking at it?

Anant Goenka: It would be at market rate is what we try and maintain it, I do not recollect the percentage right now but we can get back to you on that. Kumar do you remember?

Kumar Subbiah: Anant there is no change in the level of inventory with the dealers, there has not been any change, any significant change in the quantum of inventory that the dealers hold in the given period.

Ashutosh Tiwari: And on the TBR side you mentioned 25% volume growth, so is it like we are doing well because of the lower market share, or the market has also done decently well in TBR in the last quarter?

Anant Goenka: Sorry, how has the market done in TBR in the last quarter in the replacement segment?

Ashutosh Tiwari: Yes, you mentioned that 25% growth Y-O-Y in TBR volumes, so is it because of our market share though that is why we are doing well or even market have done better in the TBR?

Anant Goenka: I think both cases, but we had a relatively lower base, so we would have done better than the market with respect to overall growth. We grew well, a lot of the growth also came from OEM growth, so OEM base last year was very low, so it was led by OEM, followed by exports and then by replacement.

Ashutosh Tiwari: So, is the TBR replacement volumes up Y-O-Y for us?

Anant Goenka: Yes, it is up, strong double digit.

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

Siddhartha Bera: On the RM side I just wanted to understand, current commodity where crude prices are up sharply, so the RM inflation as you were indicating of 4-5% factors in the current prices or you think based on the current rates, there can be more cost pressure going ahead, even after this?

Anant Goenka: So, currently as I said in quarter 3 we are seeing about a 4% ish kind of price increase, overall on a raw material basket, there can be a little bit going on from quarter 3 to quarter 4 as well, so everything is not reflected yet, because there is a little bit of a lag between crude and what is in our crude derivative products, so that may reflect in quarter 4.

Siddhartha Bera: Okay got it and second is on the price increase side, so if I see on a Y-O-Y basis we have seen a very sharp increase in the prices, so do you think from here on basically there is some impact which may happen on the demand side because we have to again take more price increases to offset the commodity cost pressure, so any thoughts you have, if you can share? And any segment where you think the demand might get impacted because of this?

Anant Goenka: Yes. I think it is a difficult answer to give. I do feel that there is pressure on fleet operators because of tyres, when the crude raw material pricing, their profitability has got hit, now how much will it affect demand because overall economy has relatively bounced back, people need tyres, so maybe there can be some amount of retreading or delayed purchase a little bit but difficult to quantify what will happen.

Siddhartha Bera: Got it at least on the consumer side, do you think there will be longer replacement cycles, or anything which some of these things can come into, which can affect demand or you do not think there is much of a possibility on the consumer side?

Anant Goenka: No, I am little doubtful on the consumer side, I think the commercial segment is little bit more sensitive and passenger car should be okay.

Moderator: Thank you. Ladies and gentlemen that was the last question. I would now like to hand the conference over to the management for closing comments.

Anant Goenka: Thank you all very much for your interest in CEAT and your time today. We look forward to seeing you once again same time next quarter and do stay safe and take care. Thank you very much.

Moderator: Thank you. Ladies and gentlemen on behalf of JM Financial that concludes this conference. Thank you for joining us and you may now disconnect your line.