Wealth Discovery
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COMPLETE WEALTH MANAGEMENT SOLUTIONS !

# Indag Rubber

| 19 Nov 2015 | CMP | INR 195 |
|---|---|---|
| Initiating Coverage (BUY) | Target Price | INR 257 |

| Stock Details | |
|---|---|
| Industry | Auto Tyres & Rubber |
| Bloomberg Code | IDR:IN |
| BSE Code | 509162 |
| Face Value (Rs.) | 2.00 |
| Market Cap. (Rs. Mn) | 5,118.75 |
| 52wk. High/Low (Adjusted) ( (Rs.) | 229.00 / 137.99 |

| Shareholding Pattern Jun '15 | |
|---|---|
| Promoter (%) | **74.76** |
| FII (%) | 0.43 |
| DII (%) | 0.01 |
| Public - Other (%) | **24.80** |
| No. of Share Outstanding (mn) | 26.25 |

| Valuation Summary | FY 14A | FY 15A | FY 16E | FY 17E |
|---|---|---|---|---|
| P/E (x)* | 05.40 | 15.63 | 16.00 | 19.00 |
| EV/EBITDA (x)* | 3.76 | 11.41 | 11.51 | 12.13 |
| P/BV (x)* | 1.44 | 3.98 | 3.89 | 3.64 |

**Based On CMP on Reco Date for FY 15 and Market Price as on 1st Apr is taken for FY14*

| Key Financial | | | | |
|---|---|---|---|---|
| Rs. Mn | FY 14A | FY 15A | FY 16E | FY 17E |
| Net Sales | 2,322 | 2,419 | 2,758 | 2,880 |
| EBITDA | 387 | 442 | 525 | 539 |
| Net Profit | 276 | 326 | 384 | 355 |
| EPS (Rs.)* | 10.5 | 12.4 | 14.6 | 13.5 |

**Aadjusted for stock split of 5:1 in FY16*

| Key Ratios | FY 14A | FY 15A | FY 16E | FY 17E |
|---|---|---|---|---|
| EBITDA Margin (%) | 16.7 | 18.3 | 19.0 | 18.7 |
| EBIT Margin (%) | 15.6 | 17.5 | 18.1 | 17.9 |
| Net Pro. Margin (%) | 11.9 | 13.5 | 13.9 | 12.3 |
| Debt/Equity (x) | 0.00 | 0.00 | 0.00 | 0.00 |
| RoNW (%) | 29.8 | 28.2 | 26.8 | 20.7 |
| RoCE (%) | 29.3 | 28.0 | 26.8 | 20.6 |

**One Year Price / Volume**



**Divya Sood (Research Analyst)**
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**We recommend 'BUY' on Indag Rubber for a target of INR 257 - valuing the company at P/E of 19.0x FY17E Earning.**

## GROWTH TO BE DRIVEN BY:

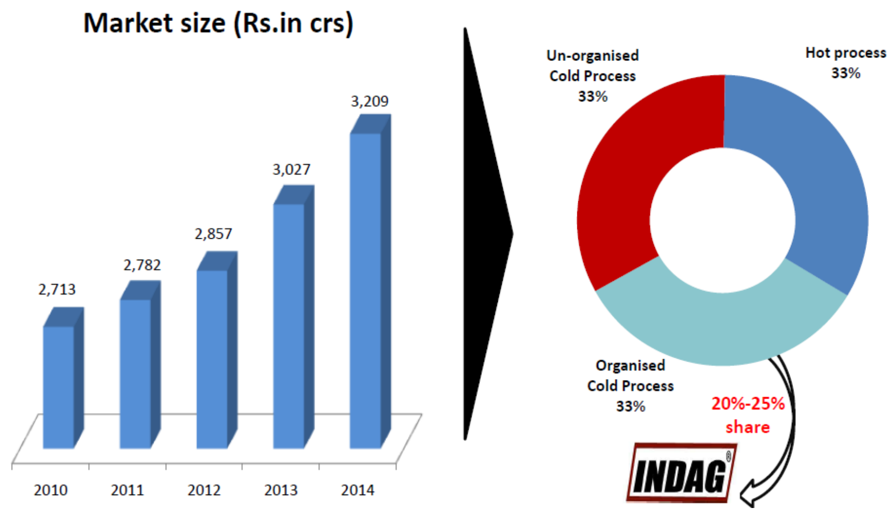
- **Shift in trend from unorganized to organized sector and Indag is best placed to gain market share**
- **Lower penetration levels suggest huge potential for growth**
- **Increase in Commercial Vehicle (CV) sales: CV sales expected to grow at double digit in FY16 also**
- **Increase in Radialisation in CV segment**
- **Focus on expansion of distribution network**
- **Capacity Expansion – To Grab Opportunities**
- **Consistent operating margin improvement**

## VALUATIONS AND VIEW:

As recovering economy, we expect recovery in commercial vehicle (CV) volumes in the domestic market. A recovery in CV volumes will aid the company considering that ~85% of Indag's revenue comes from the medium & heavy commercial vehicle (MHCV) segment and ~5% of its revenue comes from the light commercial vehicle (LCV) segment. Further, the company would improve its volume growth in the treading segment on back of growth in road freight with growth in economic activity, increase in organized players' market share, its strong distribution network, its increase in capacity and with its strong branding. However, on the bottom-line front, we are not expecting a proportionate growth as the excise duty benefits would subside and removal of available rebate of 30% in Income Tax post FY2016, thus impacting the earnings.; we value the business at 19x FY17E EPS and recommend a BUY rating on the stock with a target price of INR 257 per share.

## Shift in trend from unorganized to organized sector:

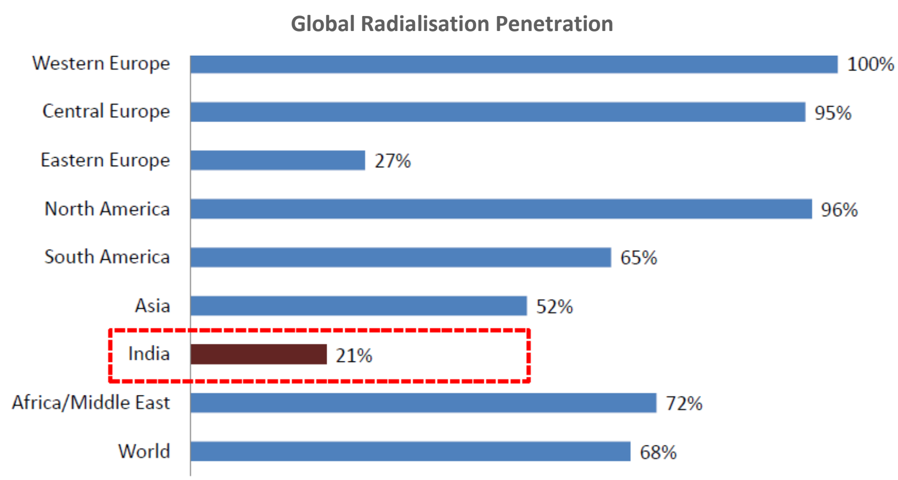
The current tread manufacturing industry's size is of ~`3,209cr, almost equally shared by unorganized and organized players. The tread manufacturing industry grew at a CAGR of ~5% over FY2011-14. Going forward, we believe the industry would outperform its historical growth, owing to improved economic activity and increase in penetration levels considering that the current penetration levels are lower than in developed countries. Further, we also believe that the organized sector would gain market share from unorganized players due to shift in consumer preference for quality retreading products. Also, implementation of the GST, going forward, could reduce the pricing gap between organized and unorganized players, thereby rendering the organized players' pricing equally attractive.




Hence, we believe that Indag is best placed to gain market share on back of better product quality, with it being a strong brand in the segment, and with it having a wide distribution network. Currently the company has 20-25% market share in the organized cold process market.

## Lower penetration levels suggest huge potential for growth:

Penetration level of retreading is lower in India as compared to other developed regions like USA, Europe etc. In India, the penetration level of retreading is at ~20%-30% compared to 96% in USA and ~100% in Europe, as stated by the company. We believe that going forward, penetration of retreading would increase on back of growth in road freight with improvement in economic activity, improving road infrastructure, and growing radialisation; demand for retreading will rise as new radial tryes are expensive and retreading would prove to be a cheaper alternative towards increasing the life of the tyres.

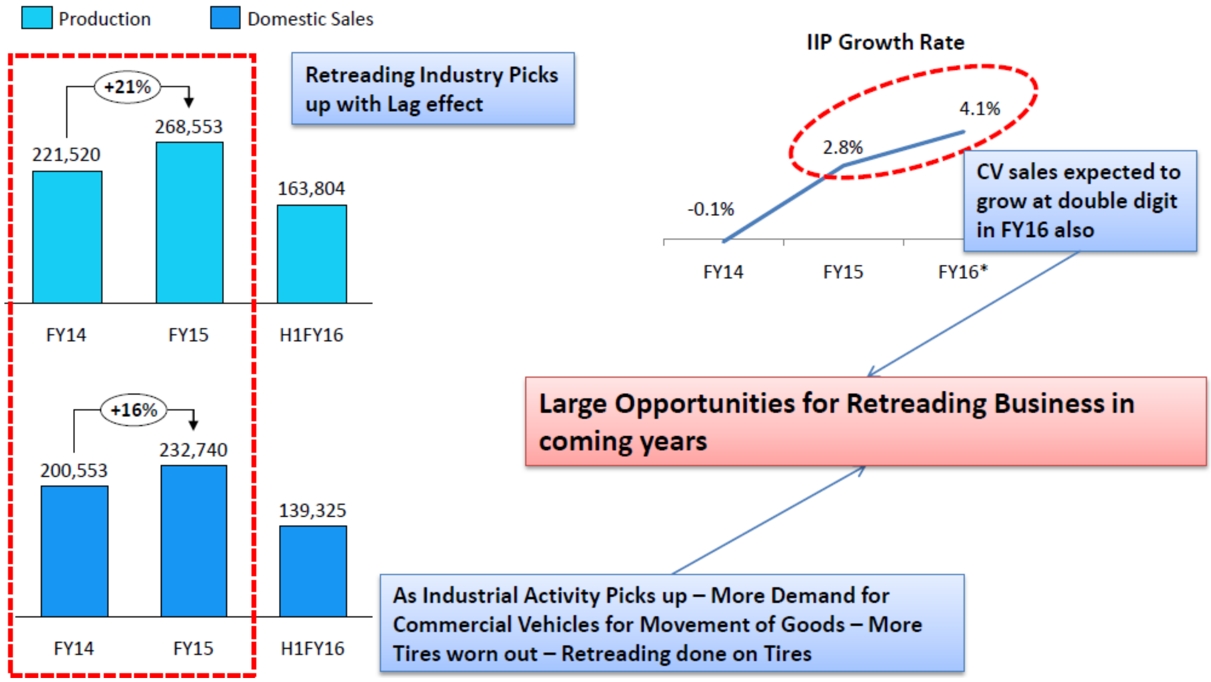


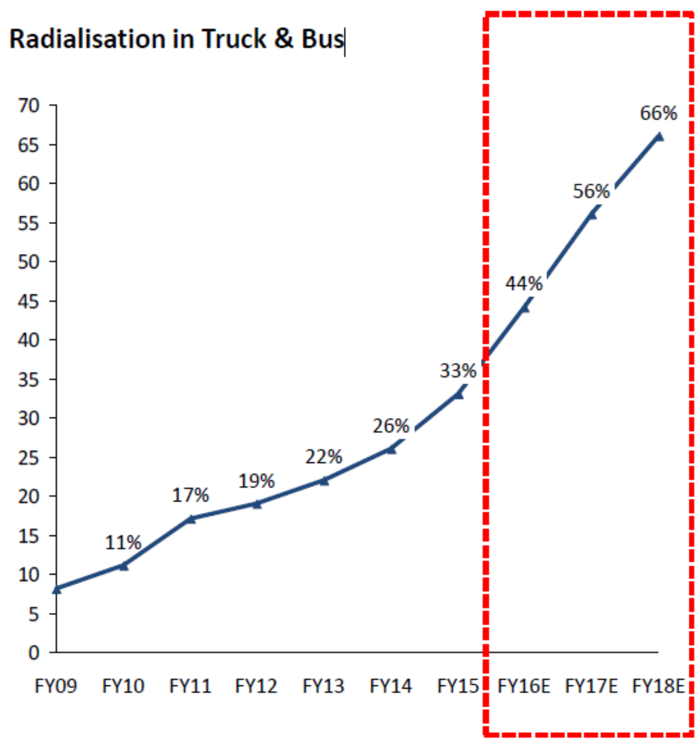

Current Radialisation in India is expected to be in the range of 20%-30% and expected to increase to 45% - 50% in next 3 years.

## Increase in Commercial Vehicle (CV) sales and also increase in Radialisation in CV segment:

Domestic sales of commercial vehicles is growing at a CAGR of ~16% during FY14-15. During the FY 15 the total domestic sales of CV was 232,740 and it was 139,325 during the first half of the FY 16. As CV sales expected to grow more than 16% in coming years, retreading industry also picks up with lag effect.

Radialisation in Truck & Bus has a growth rate of 33% during FY 15 and it is expected to achieve a rate of growth of 44% in FY 16. As radialisation increases in CV segment it will help to trigger growth in retreading industry.




*Radialisation requires: Better Road conditions, No overloading & Proper Maintenance of Vehicles*

***Better Road Conditions*** *- Faster vehicles, running on radials will consume tyres more frequently, narrowing the gap in retreading time by covering larger distances in shorter durations*

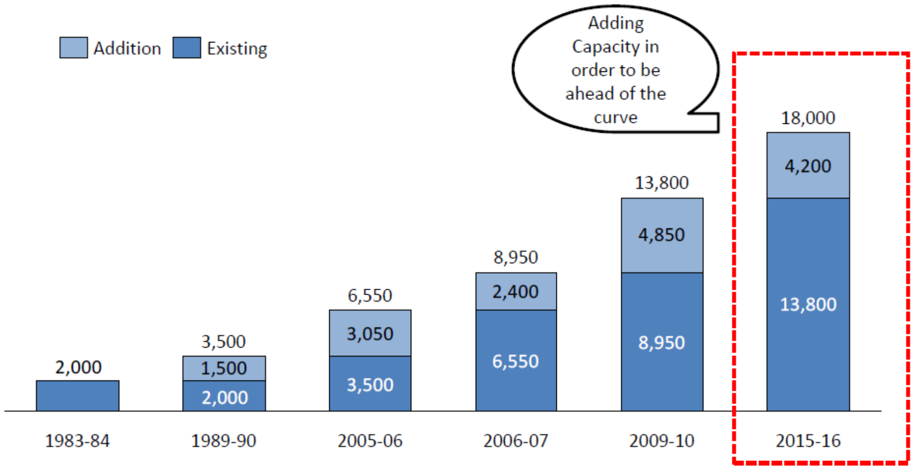
***No Overloading & Proper Maintenance of Vehicles*** *– Will help to reduce Casing Failure , which is pre-condition for Tire Retreading*

## Focus on expansion of distribution network:

To push sales, the company is continuously focusing on increasing dealerships for its products. Currently, the company has more than 100-150 dealers, 500-600 retreaders, 25 depots pan India and the number is growing rapidly. In the last 2-3 years, the company is increasing its distribution network at an average of 10%. Going forward too, the company is expected to continue to grow its distribution network at a similar rate.

**Capacity Expansion – To Grab Opportunities:**

Presently the company has installed capacity of 13,800 MTPA and capacity expansion of 4,200 MTPA will be completed by FY16, Brownfield Expansion with Total Capex of Rs.7 crs.




## Consistent operating margin improvement:

Indag has consistently been reporting margin improvement over the last five years on back of its effective cost management strategy including cost savings in raw materials through R&D. The company has reported operating margin improvement from 11.1% in FY2011 to 18.3% in FY2015. We believe that going forward, the company would continue to deliver a healthy performance on the operating margin front on the back of lower natural rubber and crude prices and owing to its effective cost management strategy. However, we have been conservative in factoring improvement in operating performance in our model.

## RISK & CONCERNS:

**Competition from the unorganized sector and delay in GST implementation:** Although Indag has superior brand image in the industry and has maintained a high quality as compared to its competitors, still in Indian market unorganized sector has a equal share of market penetration as organized player due to their high market coverage and price differentiation due to local tax effect. Implementation of GST will help in narrowing the tax gap and thus reduce the price gap, but delay in GST will have a negative impact on the pricing side.

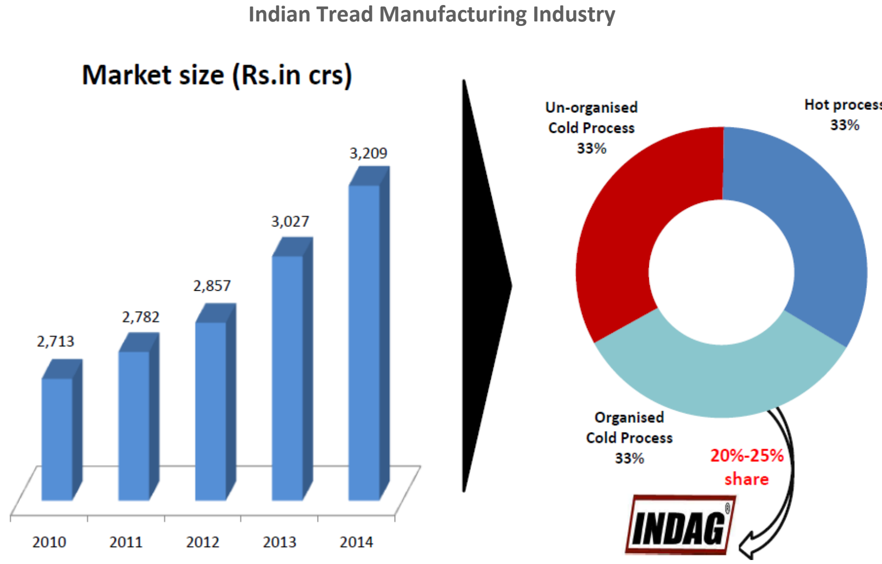
**Subside of excise benefit and tax rebate:** Currently Indag has been availing a 100% excise benefit and 30% rebate on income tax. Post FY 16 the excise benefit and the tax rebate will be subside and it will impact the operating and profit margin of the company.

## COMPANY BACKGROUND:

Indag Rubber is an India-based company. The company manufactures pre-cured tread rubber, unvulcanized rubber strip gum, universal spray cement, tire envelopes, repair gum, and other accessories and equipment for the tyre retreading industry. Close to 90% of the company's revenue is generated from the sale of pre-cured tread. Indag Rubber distributes its range of products under the company’s three major brands, which include Indag, Zoma and Maxmile. The company also has an exports business which contributes 2-3% to the total revenue. The company’s manufacturing plant is at Nalagarh, Himachal Pradesh with a capacity of 13,800MT for tread rubber, 1,800MT for rubber strip gums, and 1,800KL for rubber cement.

## INDUSTRY OVERVIEW:

Retreading is the recycling of worn tyres. Sound casings which are undamaged, and which have retained their strength by being used at correct loads and pressures are selected. The old tread remaining is buffed off and new tread rubber is securely bonded to the casing in a method similar to the manufacture of a new tyre. with proper maintenance and care a retreaded tyre can provide the same amount of service as a comparable new tyre. A retreaded tyre, properly maintained, is much safer and far more reliable than a bald or near bald tyre, a damaged or mis-matched tyre, a tyre injured by age, lack of air pressure or overheating. Retreading can provide savings of 25% to 50% on the cost of a comparable new tyre. Retreads are a safe, affordable, economical and environmentally friendly alternative to a new tyre when it is properly maintained and driven at legal and sensible speeds which take into consideration weather, road conditions and potential behavior of other motorists.




Truck tyre retreading is now a major part of the retreading industry in India. More than one million are produced each year and at least 60% of truck tyres in service are retreads. This could not happen if they were not safe, reliable and economical. As retreads can reduce tyre costs by up to 50%, without retreading, transport costs in all areas and for most products would be much higher. Successful truck fleet managers understand that correct air pressure in tyres is their best insurance against tyre casing failure. They also know that stringent casing inspection standards and a good retread factory and supplier are keys to their success.


After wages and fuel, tyres represent the third largest cost outlay for most vehicle fleet budgets. Whether you are a motorist, a taxi driver, a courier service, a tradesman, a farmer, a bus operator, a large truck fleet or a single truck owner, big business or small business or Government Department, City or Shire Council, you must control and reduce costs in today's tough economic climate. Retreading saves money and reduces costs

## FINANCIAL OVERVIEW

| Q1 FY16 Performance Highlight (Standalone Basis) | | | | | | | |
|---|---|---|---|---|---|---|---|
| (in Million) | 2Q FY15 | 32Q FY15 | 4Q FY15 | 1Q FY16 | 2Q FY16 | YoY (%) | QoQ (%) |
| Revenue | 58.34 | 59.75 | 65.79 | 64.12 | 71.04 | 21.77% | 10.79% |
| Other Income | 1.99 | 0.48 | 0.63 | 1.36 | 1.29 | | |
| Total Income | 60.33 | 60.22 | 66.42 | 65.49 | 72.33 | 19.89% | 10.44% |
| Expenditure | -48.06 | -50.08 | -54.27 | -52.57 | -58.73 | | |
| *As a % of Sales* | *82.38%* | *83.82%* | *82.49%* | *81.99%* | *82.67%* | | |
| Interest | -0.03 | -0.02 | -0.09 | -0.04 | -0.06 | 100.00% | 50.00% |
| PBDT | 12.24 | 10.12 | 12.06 | 12.88 | 13.54 | | |
| *As a % of Sales* | *20.98%* | 16.94% | 18.33% | 20.09% | *19.06%* | | |
| Depreciation | -0.59 | -0.57 | -0.57 | -0.65 | -0.68 | | |
| PBT | 11.66 | 9.56 | 11.49 | 12.23 | 12.86 | 10.29% | 5.15% |
| *As a % of Sales* | *19.99%* | *16.00%* | *17.46%* | *19.07%* | *18.10%* | | |
| Tax | -2.9 | -2.13 | -2 | -4.2 | -4.22 | 45.52% | 0.48% |
| Net Profit | 8.76 | 7.43 | 9.48 | 8.03 | 8.64 | -1.37% | 7.60% |
| *As a % of Sales* | *15.02%* | *12.44%* | *14.41%* | *12.52%* | *12.16%* | | |
| Equity | 5.25 | 5.25 | 5.25 | 5.25 | 5.25 | 0.00% | 0.00% |
| EPS (Rs) | 16.68 | 14.16 | 18.07 | 3.06 | 3.29 | -80.28% | 7.52% |
| CEPS (Rs) | 17.8 | 15.23 | 19.15 | 3.31 | 3.55 | | |
| OPM % | 21.03 | 16.98 | 18.47 | 20.15 | 19.15 | | |
| NPM % | 15.01 | 12.44 | 14.42 | 12.53 | 12.16 | | |

## Income Statement

| Y/E Mar (Rs mn) | FY 12A | FY 13A | FY 14A | FY 15A | FY 16E | FY 17E | FY 18E |
|---|---|---|---|---|---|---|---|
| **Net Sales** | **2,161** | **2,346** | **2,322** | **2,419** | **2,757** | **2,880** | **3,283** |
| Other Operating Income | - | - | - | - | - | - | - |
| **Expenditure** | **1,861** | **2,007** | **1,951** | **2,010** | **2,268** | **2,383** | **2,716** |
| **EBITDA** | **301** | **339** | **371** | **409** | **489** | **497** | **567** |
| Depreciation | 23 | 25 | 25 | 20 | 24 | 25 | 25 |
| **EBIT** | **277** | **314** | **346** | **389** | **465** | **472** | **542** |
| Interest Expenses | 9 | 2 | 2 | 2 | 2 | 3 | 3 |
| **PBT** | **268** | **313** | **344** | **387** | **462** | **469** | **539** |
| Tax | 61 | 79 | 85 | 95 | 114 | 157 | 182 |
| Other Income | 2 | 16 | 16 | 34 | 35 | 42 | 47 |
| Extraordinary Items | - | - | - | - | - | - | - |
| **Net Income Before Adjustment** | 209 | 250 | 275 | **326** | 384 | 355 | 405 |
| Monority Int./Income from Assoc. | - | - | - | - | - | - | - |
| **Adjusted PAT** | **209** | **250** | **275** | **326** | **384** | **355** | **405** |

## Balance Sheet

| Y/E Mar (Rs mn) | FY 12A | FY 13A | FY 14A | FY 15A | FY 16E | FY 17E | FY 18E |
|---|---|---|---|---|---|---|---|
| Equity share capita | 53 | 53 | 53 | 53 | 53 | 53 | 53 |
| Reserves & surplus | 563 | 764 | 978 | 1,228 | 1,526 | 1,799 | 2,111 |
| Share Warrents | - | - | - | - | - | - | - |
| Misc Expenditure | - | - | - | - | - | - | - |
| **Net worth** | **616** | **817** | **1,031** | **1,280** | **1,579** | **1,852** | **2,163** |
| Minority Interest | - | - | - | - | - | - | - |
| Share Application Money | - | - | - | - | - | - | - |
| **Loan Funds** | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| Net deferred tax liability | 9 | 15 | 14 | 3 | 3 | 3 | 3 |
| Other Long-term Liabilities | - | - | - | - | - | - | 37 |
| Long-term Provisions | 2 | - | 1 | 1 | 1 | 2 | 2 |
| **Total Liabilities** | **627** | **831** | **1,046** | **1,284** | **1,583** | **1,856** | **2,205** |
| | | | | | | | |
| **Net block** | **244** | **237** | **271** | **266** | **257** | **250** | **243** |
| **Investment, Loan & Adv.** | **44** | **36** | **211** | **156** | **177** | **178** | **214** |
| **Total Current Assets** | **585** | **834** | **850** | **1,226** | **1,415** | **1,725** | **2,060** |
| **Current Liabilities & Provisions** | **247** | **276** | **287** | **366** | **268** | **298** | **313** |
| **Net Current Assets** | **338** | **558** | **564** | **860** | **1,147** | **1,427** | **1,747** |
| **Total Assets** | **626** | **832** | **1,047** | **1,285** | **1,582** | **1,857** | **2,205** |

## Cash Flow (Consolidated)

| Y/E Mar (Rs mn) | FY 15A | FY 16E | FY 17E | FY 18E |
|---|---|---|---|---|
| **Operating Cash Flow** | **308** | **189** | **236** | **265** |
| **Cash Flow from Investments** | **(232)** | **(57)** | **(41)** | **(80)** |
| **Cash Flow from Financing** | **(68)** | **(78)** | **(88)** | **(88)** |
| **Net Changes in Cash** | **7** | **54** | **106** | **97** |
| Opening Cash | 28 | 42 | 96 | 203 |
| **Closing Cash Balance** | **35** | **96** | **203** | **299** |

## Peer Comparison (Top 7 companies in the same business)

| Company | CMP (Rs) | P/E | Mcap (Rs Cr) | Div Yld (%) | NP Qtr (Rs Cr) | Qtr Profit Var (%) | Sales Qtr (Rs Cr) | Qtr Sales Var (%) | CMP/ BV |
|---|---|---|---|---|---|---|---|---|---|
| MRF | 39,530 | 10.7 | 16,761 | 0.13 | 461 | 45.38 | 3,327 | (0.97) | 2.8 |
| Apollo Tyres | 162 | 7.7 | 8,247 | 1.23 | 279 | (10.46) | 2,980 | (10.55) | 1.5 |
| Balkrishna Inds | 643 | 11.1 | 6,217 | 0.37 | 125 | 38.65 | 778 | (11.11) | 2.4 |
| CEAT | 1,056 | 10.5 | 4,272 | 0.95 | 115 | 40.88 | 1,348 | (1.55) | 2.3 |
| JK Tyre & Indust | 100 | 6.0 | 2,261 | 1.50 | 110 | 89.41 | 1,490 | (2.02) | 1.7 |
| TVS Srichakra | 2,740 | 13.3 | 2,099 | 1.23 | 49 | 86.87 | 518 | 6.40 | 5.6 |
| Goodyear India | 566 | 13.5 | 1,306 | 1.77 | 29 | 15.19 | 381 | (5.21) | 2.3 |
| **Indag Rubber** | **195** | **15.6** | **509** | **1.17** | **9** | **(1.37)** | **71** | **21.70** | **4.0** |

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