

## Indag Rubber

19 Nov 2015

Initiating Coverage (BUY)

CMP

INR 195

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 1<sup>st</sup> 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

\*Adjusted 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



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:

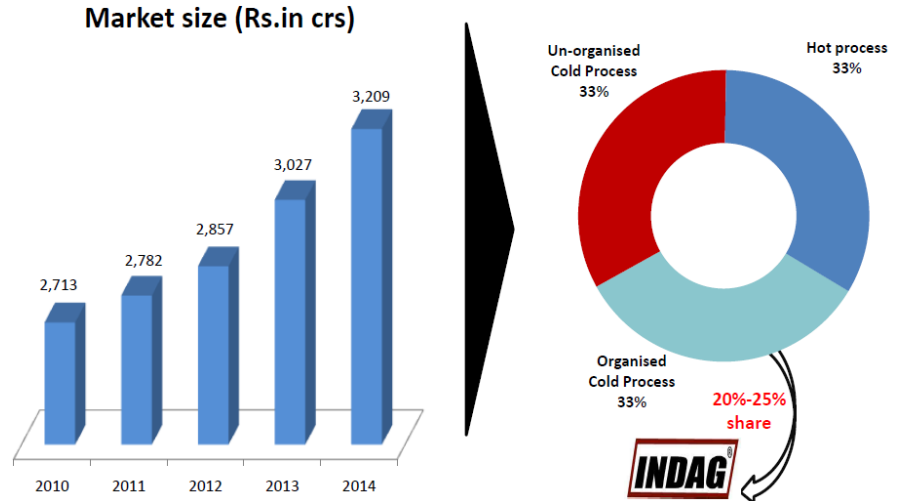
- Shift in trend from unorganized to organized sector and Indag is best placed to gain market share
- Lower penetration levels suggest huge potential for growth
- Increase in Commercial Vehicle (CV) sales: CV sales expected to grow at double digit in FY16 also
- Increase in Radialisation in CV segment
- 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 trading 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:

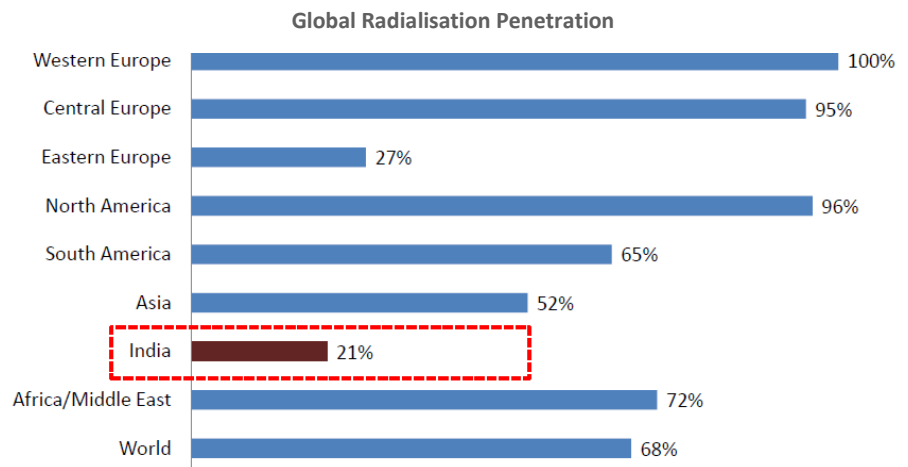
The current tread manufacturing industry's size is of ~3,209cr, almost equally shared by unorganized and organized players. The tread manufacturing industry grew at a CAGR of ~5% over FY2011-14. Going forward, we believe the industry would outperform its historical growth, owing to improved economic 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 tries are expensive and retreading would prove to be a cheaper alternative towards increasing the life of the tyres.



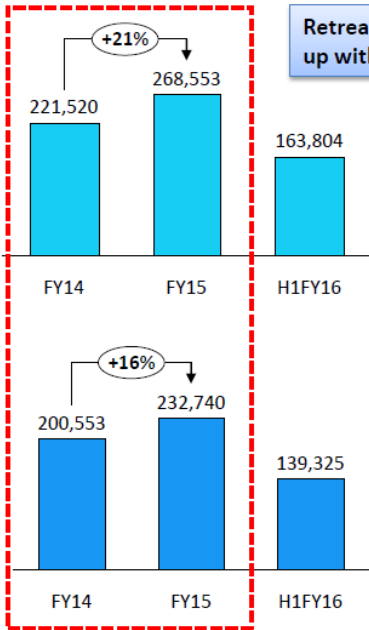
Current Radialisation in India is expected to be in the range of 20%-30% and expected to increase to 45% - 50% in next 3 years.

### 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.

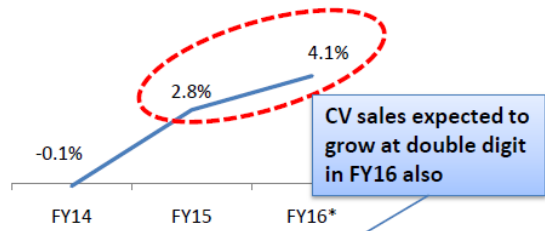
Radialisation in Truck & Bus has a growth rate of 33% during FY 15 and it is expected to achieve a rate of growth of 44% in FY 16. As radialisation increases in CV segment it will help to trigger growth in retreading industry.

Production Domestic Sales



Retreading Industry Picks up with Lag effect

IIP Growth Rate

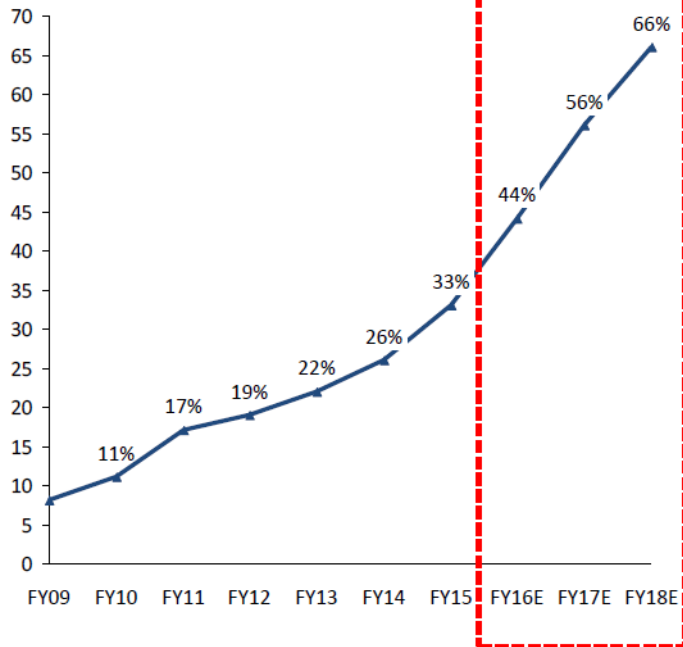


CV sales expected to grow at double digit in FY16 also

Large Opportunities for Retreading Business in coming years

As Industrial Activity Picks up – More Demand for Commercial Vehicles for Movement of Goods – More Tires worn out – Retreading done on Tires

Radialisation in Truck & Bus



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

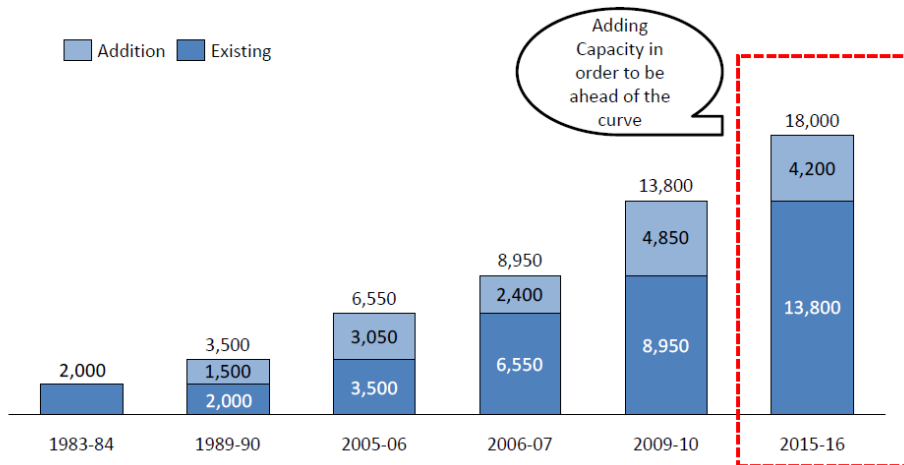
**No Overloading & Proper Maintenance of Vehicles** - Will help to reduce Casing Failure, which is pre-condition for Tire Retreading

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.

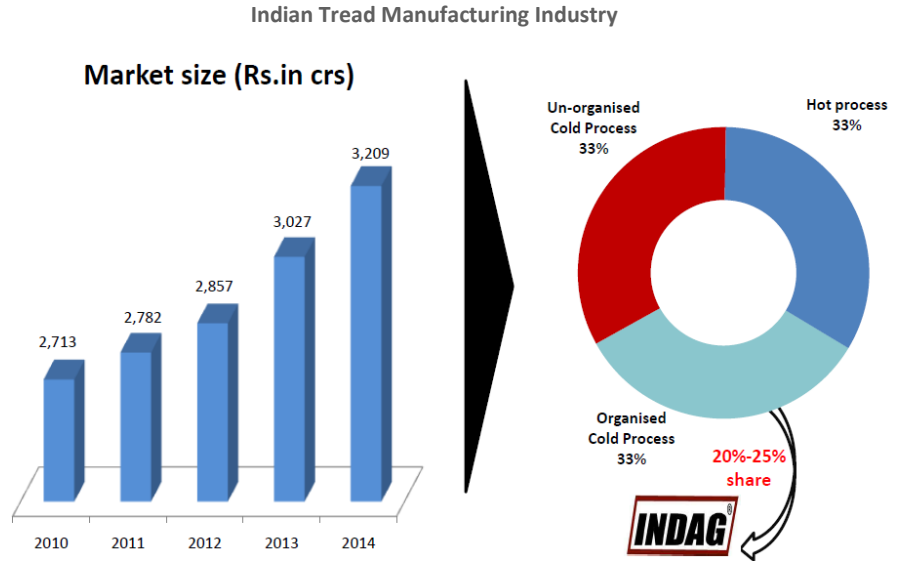
**Subside of excise benefit and tax rebate:** Currently Indag has been availing a 100% excise benefit and 30% rebate on income tax. Post FY 16 the excise benefit and the tax rebate will be subsided and it will impact the operating and profit margin of the company.

## 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 mismatched 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.



**Buy new Tire**      **OR**      **Retread the same Old Tire**

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	3Q 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
Minority 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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1.Analyst ownership of the stocks mentioned above	No
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