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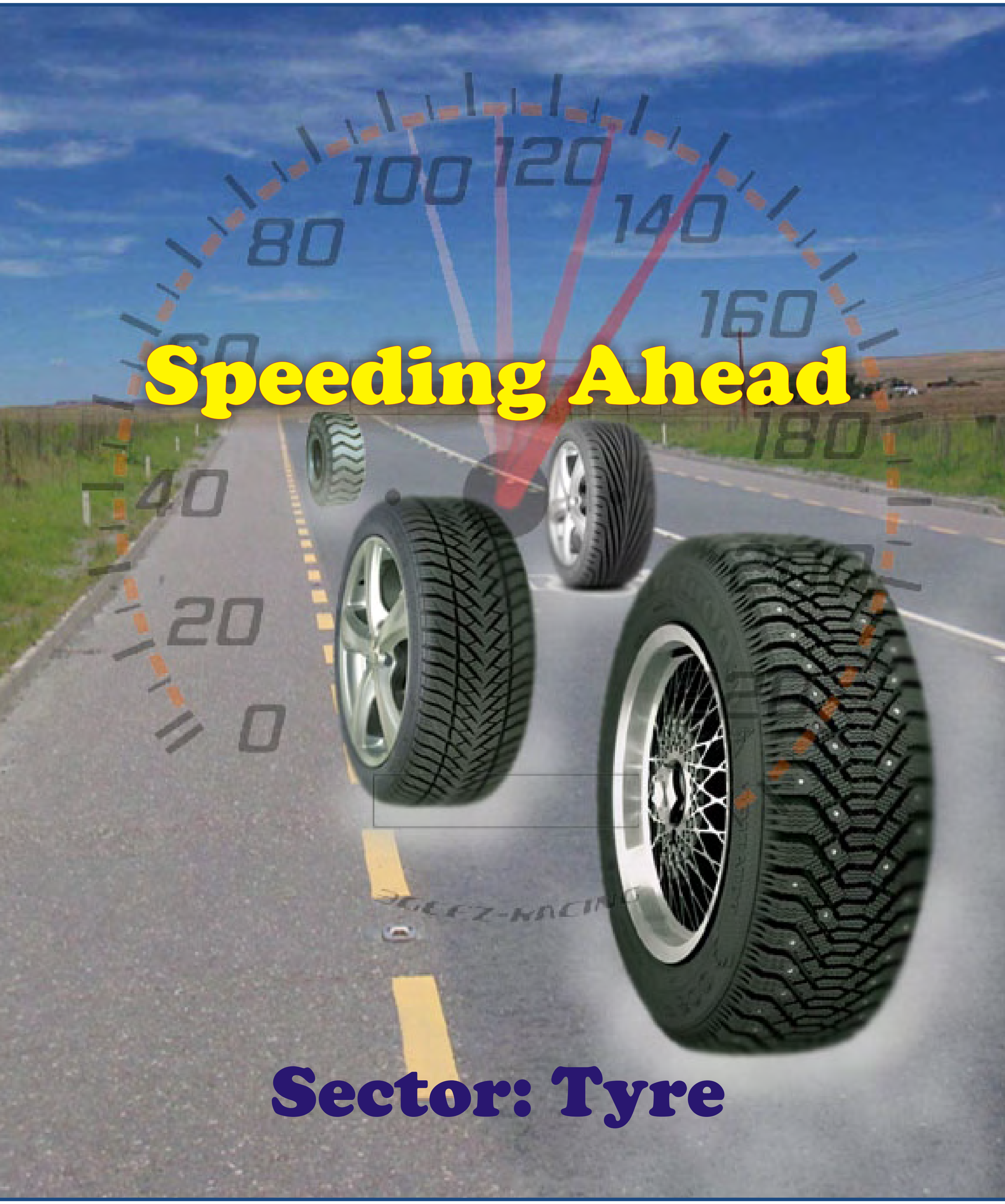

Speeding Ahead

Sector: Tyre

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April 2007

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Prices as on 30th March 2007

Executive Summary

The Rs 145bn tyre market is poised for sturdy growth driven by robust demand witnessed by the Automobile industry. The Indian Automobile industry has witnessed a CAGR of 15.8% in the past 5 years. We expect this industry to continue the growth momentum over next 5 years. Currently, the Indian automobile industry contributes 5% of India's GDP and this share is expected to increase to 10-12% in the next 10 years. India is soon emerging as an automobile outsourcing & manufacturing hub and this will be beneficial to all automobile segments viz. two wheeler, three wheelers, passenger cars, commercial vehicles and tractors. The growth in parent industry will translate into sustainable growth in the ancillary- tyre industry both in the OEM segment and replacement market.

Although, India's Tyre industry is highly fragmented with over 43 players, but the top 5 players in the industry dominate the market share while others have a minuscule share of the market. The top 5 Indian tyre manufacturers viz. MRF, Apollo, JK Industries, CEAT and Goodyear dominate 78% of India's tyre revenues. Most of the top players have diversified product portfolio and presence in all market segments viz. Replacement, OEM and Export market's. In the current scenario of rising demand for tyres, most companies have undertaken capacity additions to profit from the growing Auto industry.

Next five years to see capex of around Rs 30bn

The replacement cycle for Indian tyres has been elongated due to various factors such as improved road infrastructure, radilaisation, good quality tyres and ban on overloading affecting the replacement demand for tyres adversely. However, we still expect the Indian tyre industry to grow at a CAGR of 10.7% in the next five years mainly on account of the following reasons:

- **Huge investment in the parent industry**

  In the next 10 years viz (2006-2016) investment in auto industry is expected to be in the range of $35-40bn which is 4x the investments made in this industry in the past 60 years. Current size of Indian automotive industry is around $34bn and it is expected to witness a CAGR of 16% over the next 10 years and go up to $145bn by 2016. Further, the development of India as an outsourcing & manufacturing hub for automobile manufacturing would result in additional demand growth for the ancillary industries such as tyres.

- **Road infrastructure spend to the tune of Rs 758mn**

  In the next 3 years road infrastructure investment will witness a CAGR of 10.8% and is expected to be close to Rs 758bn. As the Golden Quadrilateral (GQ) is nearing completion (92% complete) a bulk of this investment will flow in the construction of NSEW corridor (only 12% of which is complete) which is to be completed by 2008 and other select road projects. Road infrastructure improvement will result in shift in cargo transport from railways to roads, which in turn will drive CV sales. Greater goods movement and increased traffic will result in higher demand for automobiles and greater traffic movement will result in more wear and tear of tyres. All these factors contribute positively to tyre demand both in the OEM and replacement market.

- **Changing sector dynamics:**

  In the past few years the tyre sector has been plagued with higher raw material cost, lower margins due to inability of tyre manufacturers to pass on cost increases to consumers, lack of bargaining power with OEM's and thus lower margins & profitability. All these factors resulted in lack of Capex in the tyre sector resulting in imbalance in supply situation. This has resulted in return of pricing power with industry. Thus the return of pricing power in conjunction with higher volumes, better margins on account of cooling off in raw material prices and strong demand from auto industry have all boosted the profitability of the sector.

Bolstered by these developments we expect the tyre industry to witness an investment of Rs 30bn in the next 5 years and grow at a CAGR of 10.7%. We expect the tyre production to rise from 66mn tyres in FY2006 to 121mn tyres by FY2008. Since 78% of the tyre market is controlled by top 5 player's viz. Apollo Industries, JK Industries, MRF, CEAT and Good Year India, we believe these companies will be at the forefront to exploit this opportunity. **We Initiate Coverage on the Tyre sector with a bullish outlook.**

Our Top Picks

We have covered 4 of the top 5 tyre manufacturers in the country. Given their expansion plans, return of pricing power, cooling off in raw material prices, diversified presence, brand name, scale and increasing demand for tyres we believe these companies are poised for growth and are trading at attractive valuations.

Apollo Tyres

Apollo Tyres Ltd (ATL), part of the Raunaq Group, is the second largest tyre manufacturer in the country with an overall market share of around 23% and ranks 15th in the world. The truck & bus tyre demand is expected to witness robust growth, ATL being the market leader in this segment is ideally poised to capitalize on the opportunity. At CMP of Rs 280, ATL trades at a P/E of 9.8x FY2008E and 8.5x FY2009E, and EV/EBIDTA of 4.4x FY2008E and 4.0x FY2009E on a standalone basis.

CEAT

CEAT Limited is a reputed player in the domestic and export tyre market and a part of the RPG group. CEAT has an overall market share of 12% and enjoys the position of the 4th largest tyre manufacturer in India. On the back of new expansions, improved product mix & productivity we expect CEAT to witness a Top Line and Bottom Line CAGR of 12.1% and 72.9% (FY2007E-FY2009E) respectively.

Goodyear India

Goodyear India Ltd (GIL) is one of the leading tyre company's with strong brand image and a market share of ~ 6%. GIL is a preferred tyre supplier to OEM's and a market leader in tractor segment. The company is incurring a capex of Rs 1.3bn to set up passenger car radial capacity and expanding its distribution reach. We expect GIL to witness a Top Line & Bottom Line CAGR of 15.6% and 20.9%(CY2006-CY2008E) respectively.

JK Industries

JK Industries Ltd(JKI) is the flagship company of the Hari Shankar Singhania Group. JKI is the 3rd largest player in the tyre industry controlling 16% of the market. The company has initiated a capex of Rs 2.3bn to add capacities in most of its operational segments. Being one of the leading players in the Indian tyre industry we expect JKI to witness a top line and bottom line CAGR of 30.1% and 99.3% respectively (2005-06 & 2007-08).

Exhibit 1: Financial and Valuation Matrix

	Sales (Rs mn)	OPM (%)	PAT (Rs mn)	NPM (%)	EPS (Rs)	P/E (x)	P/BV (x)	EV/EBITDA (x)	ROCE (%)	ROE (%)
Apollo Tyres *(CMP: Rs 280 Reco: Buy Target Price: 413)*										
FY2006	26,136	8.0	752	2.9	20.4	13.7	1.7	6.7	11.0	12.3
FY2007E	33,682	8.4	1110	3.3	23.9	11.7	1.3	5.1	12.4	11.3
FY2008E	38,202	8.9	1440	3.8	28.6	9.8	1.2	4.4	13.5	12.2
FY2009E	43,302	9.3	1662	3.8	33.0	8.5	1.0	4.0	13.0	11.8
CEAT *(CMP: Rs 107 Reco: Buy Target Price: 138)*										
FY2006	17,441	4.4	7	0.0	0.2	700.2	1.4	11.2	10.1	0.2
FY2007E	21,613	5.7	285	1.3	6.2	17.2	1.3	6.7	14.4	7.7
FY2008E	24,694	6.6	589	2.4	12.9	8.3	1.2	4.8	19.4	14.2
FY2009E	27,163	7.0	851	3.1	18.6	5.8	1.0	3.6	23.2	17.7
Goodyear India *(CMP: Rs 155 Reco: Buy Target Price: 200)*										
CY2005	6,875	3.5	88	1.3	3.9	39.7	4.0	14.8	10.5	9.8
CY2006P	8,287	7.4	452	5.5	19.6	7.9	2.7	5.8	26.4	33.5
CY2007E	9,713	8.1	571	5.9	24.7	6.3	1.9	4.6	24.9	29.7
CY2008E	11,071	8.0	660	6.0	28.6	5.4	1.4	4.0	24.2	25.6
JK Industries *(CMP: Rs 112 Reco: Buy Target Price: 155)*										
2004-05	20,786	5.5	168	0.8	2.4	47.1	0.5	10.5	4.4	1.1
2005-06E	25,897	5.8	170	0.7	3.9	28.6	0.6	8.3	6.6	2.0
2006-07E	31,492	6.6	404	1.3	13.1	8.5	0.6	6.0	8.9	6.5
2007-08E	37,935	6.8	675	1.8	21.9	5.1	0.5	4.7	11.2	9.9

Industry

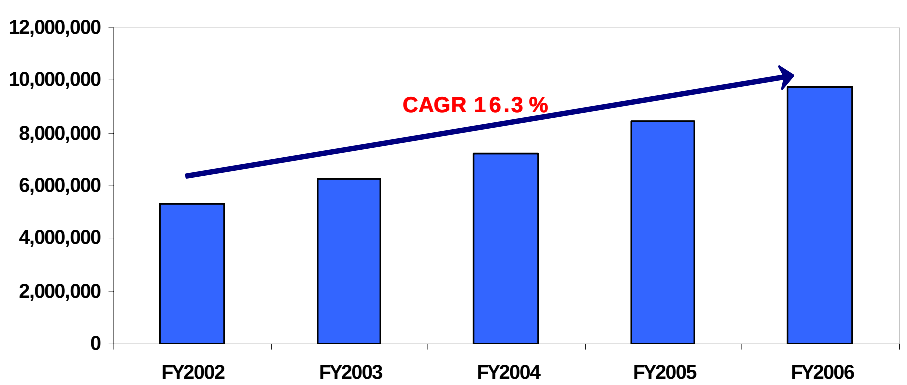
Tyre Industry Overview

The demand and growth of the tyre industry is dependant on factors like GDP growth, industrial and agricultural growth, infrastructure development and investment's in auto industry. Indian economy clocked an average rate of growth exceeding 8% during the last 3 years. Currently, the preliminary estimates indicate that Indian economy would grow at around 9.2% in FY2007, the highest GDP growth rate achieved ever. On the industrial growth front, industrial production peaked at 14.4% in November'06 and the figure as on January,2007 stands at 10.9%, mainly on the back of robust growth in the manufacturing sector. The manufacturing sector grew at a robust pace of 11.6% during April and January 2006.

Governments thrust on infrastructure development in the current five year plan has led to upcoming of various projects like Golden Quadrilateral (GQ) and NSEW corridor. This has resulted in better road connectivity and the government's thrust on infrastructure sector is likely to continue going ahead. We expect road infrastructure investment to witness a CAGR of 10.8% totalling to Rs 758bn in the next 3 years. All these developments have changed several dynamics of the Indian economy like increased level of employment, earning capacity, higher disposable income and in turn growth in consumerism. These changes are proving beneficial to the automobile industry as growth in demand is witnessed among all the automobile industry segments in the past 2-3 years. We expect this growth momentum in auto industry to continue in future on the back of roaring economy. The auto Industry is expecte dto witness investments to the tune of $35-40bn (2006-10).Since the fortunes of the tyre industry are positively co-related with that of the auto industry, we believe that tyre industry in India is suitably poised to capitalize on the opportunities.

The automobile industry in India has registered robust growth at CAGR of 16.3% in production over FY2002-06. The increased off take in the number of vehicles has resulted in buoyant demand for tyres, both in the OEM segment and replacement segment. The Tyre industry has registered a growth at 7.7% CAGR over the last decade. Previously demand for tyres was mainly from the replacement segment, but as the offtake of vehicles went up in the last 2-3 years good demand was also witnessed from OEM markets.

Exhibit 1: Automobile Production Trend

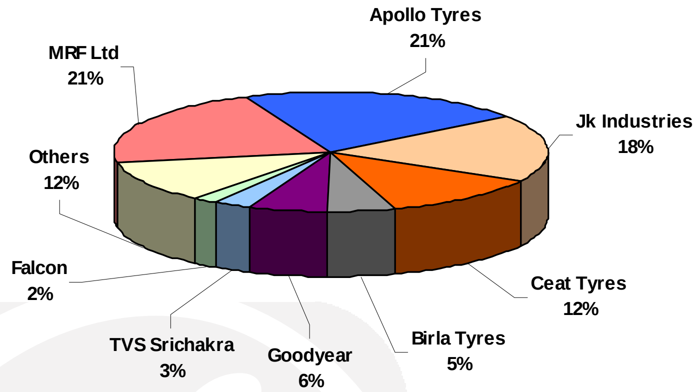


Source: ATMA & FQ Research

Dynamics of Indian Tyre Industry

The Indian tyre industry is estimated to be around Rs 145bn with an aggregate installed capacity of 77.2mn tyres. Despite having around 43 players operating in the industry, the industry is largely dominated by 5 players controlling around 78% of the market share in revenue terms.

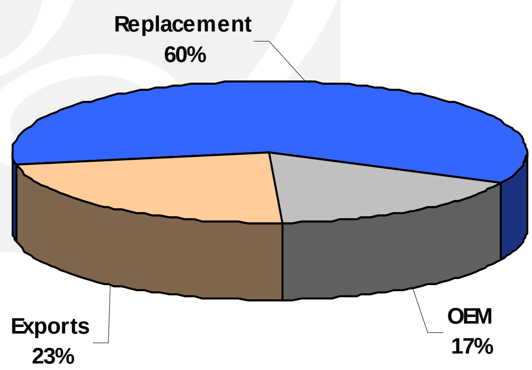
Exhibit 2: Market Share of tyre companies FY2006



Source: FQ Research & Industry

The top 5 players have a diversified product portfolio and have presence in all the three markets viz. OEM, replacement demand and exports. In revenue terms the replacement market is the major revenue contributing segment followed by exports and OEM market.

Exhibit 3: Segment wise Sales (FY2006)



Source: Cris infac

Product Profile

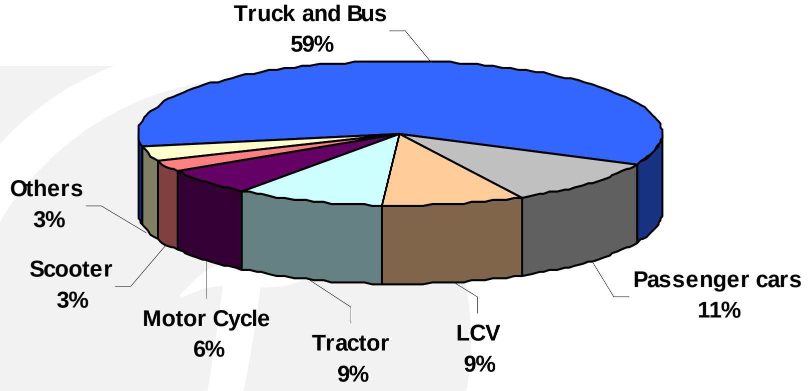
The product profile of the top 5 tyre companies can broadly be classified as follows :

- Medium and Heavy Commercial Vehicles (MHCV)
- Light Commercial Vehicles (LCV)
- Passenger Cars
- Multi-Utility Vehicles (MUV)
- Tractor Front
- Tractor rear

- Motor Cycle
- Scooter

Considering the total off-take of tyres in tonnage terms, the off-take of MHCV tyres is the largest followed by passenger car tyres. The truck and bus tyre off-take accounts for approximately 60% of the industry turnover, in value terms. In tonnage terms, tyre production registered a growth of 8.7%YoY in FY2006 as compared to FY2005. The Medium and Heavy Commercial Vehicle (MHCV) tyre segment registered a growth of 7.7%YoY while the Light Commercial Vehicle (LCV) and Passenger Car (PC) tyre segments registered a phenomenal growth of 14.8%YoY and 14.7%YoY respectively. Exports, on the other hand have not grown much, due to the slowdown in MHCV tyre exports and have recorded a 0.3%YoY growth in tonnage terms.

Exhibit 4: Tyre Off-take- Segment-wise



Source: Company; FQ research

Exhibit 5: Product-wise revenue Breakup

(In %)	MHCV	LCV	Car	Tractor	Two Wheelers	Others
MRF Ltd	54	9	8	9	13	7
Apollo Tyres	75	10	6	8	0	1
JK Industries	76	8	8	5	0	3
Ceat Tyres	64	11	4	7	7	7
Goodyear	36	3	17	39	0	5
TVS Srichakra	0	0	0	0	87	13

Source: FQ Research

The tyre industry faces huge competition, price & cost pressures which adversely impact's its profitability. We believe the high entry barriers, changing industrial dynamics, growing economy and rising investments in auto industry provide a fillip to the tyre industry. The zooming auto industry, with sales growing at a CAGR of 15.8% during the 2002-06 period, has driven the growth in the tyre industry keeping both the OEM and replacement demand buoyant.

The total number of vehicles on the road is constantly swelling, on the back of an increase in road-transportation, which would gain more momentum once projects like the GQ and NSEW Corridor are completed.

Demand drivers

The demand and fortunes of Indian Tyre industry are directly linked to the growth in the Indian Automobile Industry. In the past few years there has been massive increase in the demand for automobiles and thereby creating a strong demand for the Tyre industry. The Auto Industry sales have witnessed a CAGR of 15.8% (2002-06) which has percolated into rising demand for Tyres from both OEM and replacement segments. Auto Industry is expected to witness inflows of $ 35-40bn in the next 10 years (2006-10).

Exhibit 6: Tyre Requiremnt For Various Segments

Vehicle Type	Avg. No. of Tyres
Truck/Bus	9
Passenger Car	5
Jeep	5
LCV	6
Tractor Front	2
Tractor rear	2
Scooter	3
Motorcycle	2
Moped	2

Source: Company

Further, we expect huge growth in demand for Tyres with sustainable GDP growth of over 8%, rising agricultural and industrial production, rising vehicle demand, infrastructure development, increased road transportation and road projects like the GQ and NSEW Corridor projects all leading to sustained growth in vehicle demand. This rising vehicular demand is the back bone for the growth of tyre industry. In the past two years the OEM production has grown by 15.8% which will now generate demand for tyre replacement's, thus driving demand for tyres. We continue to expect sustained growth in demand for tyres with continuing growth in OEM sales driven by rising consumer income and increasing propensity to consume.

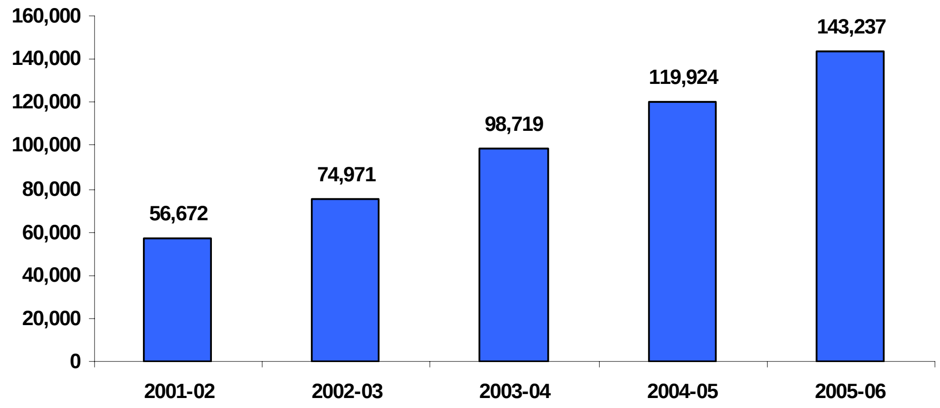
Rising vehicular demand from all segments

a. LCV

LCV tyres offtake has witnessed a CAGR of 17.1% between FY2002 to FY2006. Replacement demand is the major contributor to growth in this segment and accounts for 50% of the total production. Export markets contribute nearly 30% of the total off take and the balance being contributed by OEM. Within the country we can see a definite rise in demand for LCV's with most companies looking at regional distribution and movement of its goods. This has resulted in a spurt in demand for vehicles suited for short distance good's movement.

However, the low rate of retreading, rising radialization and increasing replacement demand within this segment will ensure strong demand from this segment. We expect this segment to witness a CAGR of approximately 15% in the next five years.

Exhibit 7: LCV Domestic Sales Trend (in units)



Source: SIAM & FQ Research

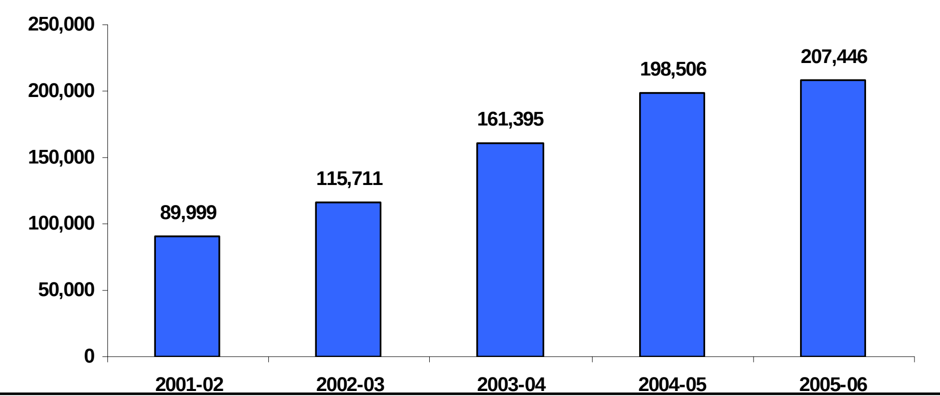
b. Trucks & Buses

Truck and Bus segment comprising of Medium and Heavy Commercial Vehicles (MHCV) accounts for the largest consumption chunk for the Automobile Tyre Segment. This segment contributes to nearly 60% of the total tyre off take in tonnage terms. This segment has witnessed a CAGR of 7.3% (2001-02 to 2005-06).

Within this segment the replacement demand accounts for 65% of the MHCV tyre off take. We expect a surge in demand from the replacement segment due to rising sales of MHCV's in the past which will translate into increase in replacement demand from this segment. In addition the rising domestic trade, improved infrastructure and projects like the GQ, NSEW Corridor etc and increased wear and tear of existing vehicles will spurt demand for tyres.

However, the increase in Multi Axle Vehicles and ban on overloading etc will reduce the wear and tear of the tyres which will give more scope for retreading and in turn reduce the replacement demand. Despite the decline in frequency of replacement we expect the overall demand to grow due to rising vehicular volumes. This segment is expected to grow at a CAGR of 7% in the next five years.

Exhibit 8: MHCV Domestic Sales Trend (in units)



Source: SIAM & FQ Research

c. Two Wheelers & Three Wheelers

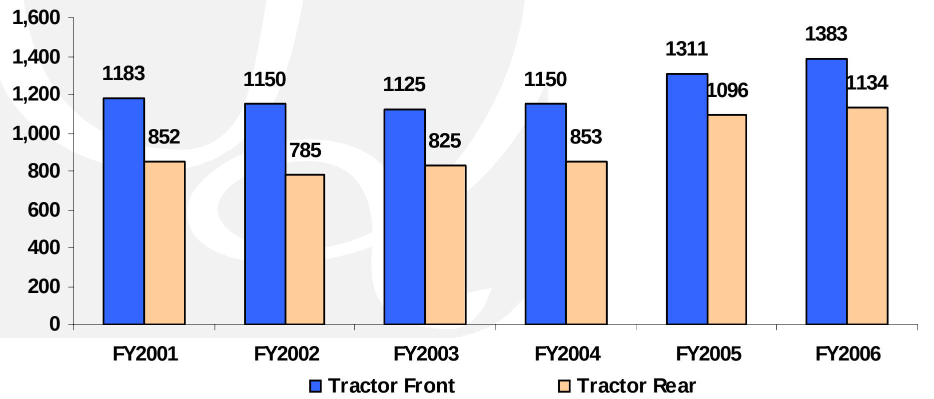
Two and three wheelers constitute only 8.7% of the total demand for tyres in the country. Of the total demand in this segment, motor cycles demand constitutes approximately 60% of the total demand. This market has been growing at a rate of around 13% and we expect this segment to continue growing at this pace. The major demand driver in motorcycle segment is the OEM market which contributes 72.6% of the total demand for motorcycle tyres. Whereas in the case of scooters the replacement demand forms a bigger chunk of the total demand at 58%, the balance being contributed by OEM demand. However, with rising sales of gearless scooters and three-wheelers, OEM demand for scooter tyres is also expected to rise in future.

d. Tractors

Demand for tractors is expected to surge in future given the government's thrust on improving the agricultural output and increase in planned expenditure for the same in the recent budget. Increasing awareness regarding the use of modern techniques of farming among the farmers will also trigger tractor sales growth in years to come. Tractor tyres demand contributes 9.1% of the Commercial vehicle tyres demand.

In this segment exports contribute 4%, Replacement demand constitutes 50% and the balance being contributed by OEM demand. Despite this segment showing modest growth in the past we foresee positive developments in this segment to drive volumes in this segment.

Exhibit 9: Tractor Sales (in units)

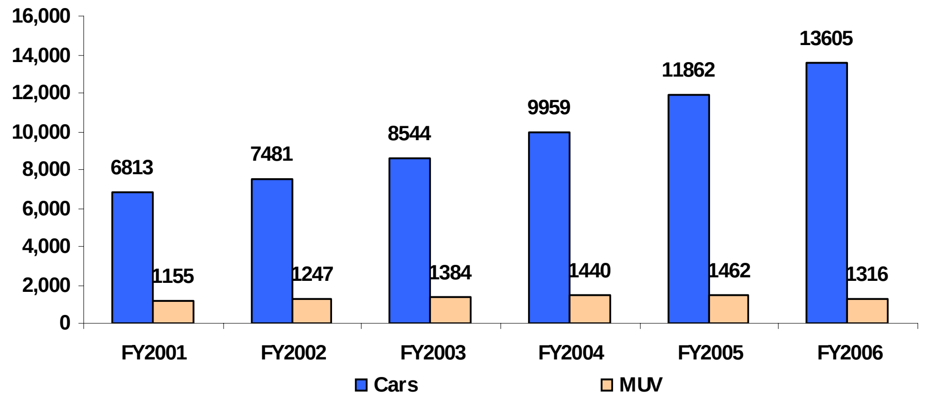


Source: SIAM & FQ Research

e. Cars

We expect the production of cars and MUV to rise with rising population levels and increasing disposable income. This will result in increased demand for new cars and MUV's. The rising demand is expected to percolate down to drive the demand for car and MUV tyres in the OEM and replacement markets. Also, the volume increase in MUV's and Cars will also translate into a strong demand from the replacement segment. Most tyre manufactures are setting up new radial tyre capacities and with increasing awareness about benefits of radial tyres we expect the radialisation in this segment to increase from 90% to 100% in the next five years. This segment is unique in the sense that the demand from OEM segment forms a significant proportion (37%) of the total demand and thus tyre demand from this segment should track the vehicle production trend. Improving road infrastructure will result in more usage of cars for longer distance travelling thereby driving replacement demand. Also, with 90% of cars in the OEM market fitted with radial tyres, per unit realization in the aftermarket is expected to get a boost.

Exhibit 10: Cars & MUV Sales (in units)



Source: SIAM & FQ Research

Tyre Target Markets

Replacement demand spurring growth

Replacement Market Demand is primarily driven by the population of vehicles on the roads and the replacement frequency of tyres. This segment constitutes approximately 60% of the demand for Tyres. We believe that the growth observed in OEM demand and increasing number of vehicles plying on the road will result in a spurt in the replacement demand.

The replacement frequency is dependant on a lot of factors like:

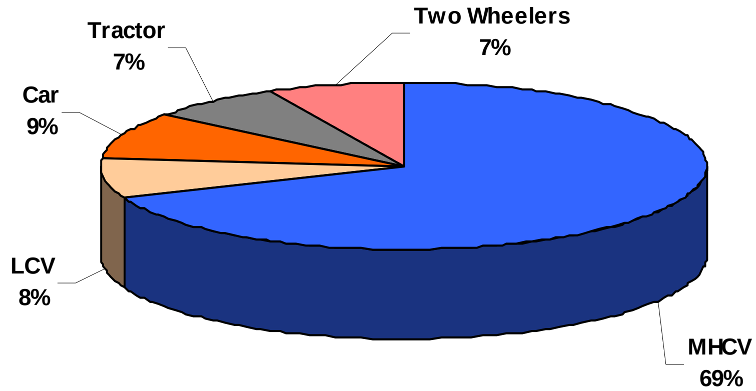
- The road conditions on which the vehicles ply
- The average life of the tyre viz the maximum distance they can carry
- The load that the vehicle carries
- The choice between replacement and re-treading

One of the major reasons why most tyre manufacturers are concentrating on this segment is because the potential demand is huge and the margins are better in this segment as compared to the OEM segment. The replacement demand also differs across vehicle segments due to varying uses of the vehicles and different life spans of the tyres. For example, the average life span of a Truck tyre is 40-45,000Kms and get replaced within a year, whereas the life span of car and two wheeler tyres will be much longer than trucks around 2-4 years.

Retreading is a major threat to the rising demand from the replacement segment. As the life of a retreaded tyre increases by around 60-70% of a new tyre life, whereas the cost involved is only 20-25%. The quality of a retreaded tyre deteriorates, but since it is economical to retread the tyres, this is a preferred option especially in the passenger car segment. However in the LCV / MHCV segment retreading depends on the operators. Most large transporters would preferably opt for replacement rather than retreading as the break down costs is huge. But small operators who operate on short distances may opt for retreading option.

Further, increased radialisation and improved quality of passenger cars have increased the life of tyres there by elongating the replacemnt cycle and dampening the replacement demand for passenger car tyres.

Exhibit 11: Segmental distribution of Replacement demand for Tyres

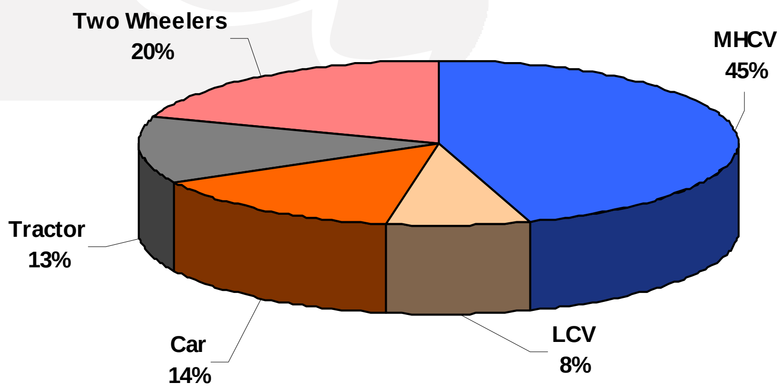


Source: ATMA

Original Equipment Market (OEM)

OEM demand refers to the demand for tyres from the automobile manufacturers for new vehicles produced. This segment constitutes only 23% of the total demand for tyres. The margins in this segment are very low as compared to the replacement market. The automobile manufacturers try and squeeze the tyre prices, thereby eating into the margins of Tyre Manufacture. In the recent past, with the growth in auto sales OEM demand has also been on a consistent uptrend. Auto sales have been growing at a CAGR of 15.8% during 2002-06, which has driven the growth in the tyre industry keeping the OEM demand buoyant. The auto industry is expected to grow in double digits going forward. This in turn is expected to drive the demand for tyres from OEM segment. In India the share of road cargo is only 65% as compared to 84% share of roadways in Europe. However, with improvement in road infrastructure via projects like GQ and NSEW corridor etc. under implementation, there will be further transition from rail to road freight. This in turn will drive demand for MHCV escalating the demand for tyres from OEM's.

Exhibit 12: Segmental distribution of OEM demand for Tyres

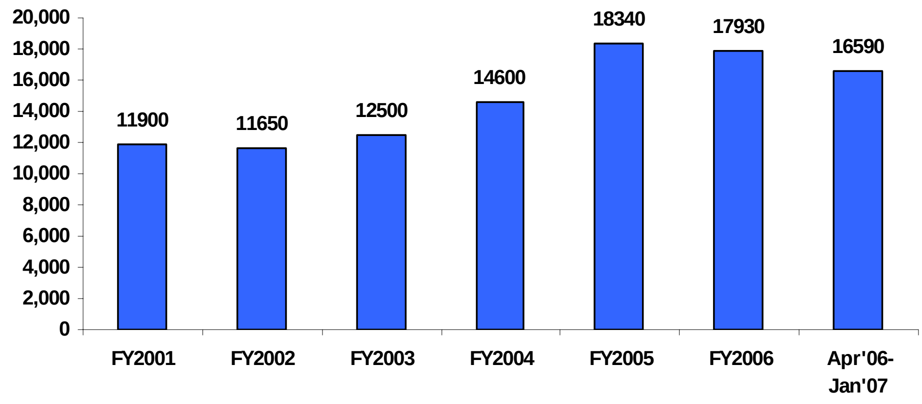


Source: ATMA

Export Market

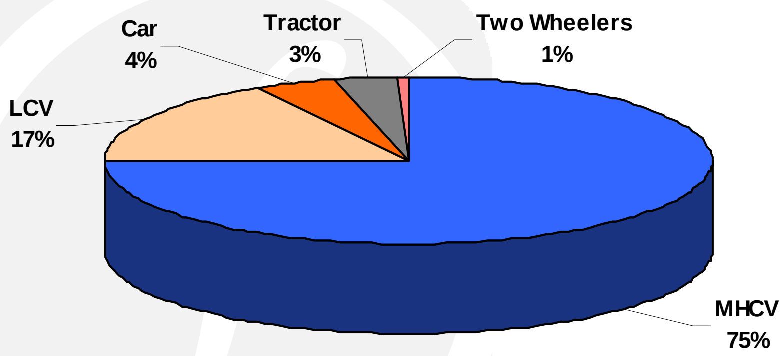
This segment constitutes 17% of the total market for tyres. Indian tyre manufacturers have been exporting tyres to over 100 countries. The exports of Indian tyres have been rising consistently in the past and have grown at a CAGR of 8.5% (2001-06). The exports from MHCV and LCV segment form the major chunk of tyre exports constituting 75% and 16% respectively of the total tyre exports. Tyre exports from India are expected to rise given the rising demand from overseas markets and various incentives given by Indian government.

Exhibit 13: Exports Trend (Rs mn)



Source: ATMA

Exhibit 14: Segmental distribution of tyre exports



Source: ATMA

Raw Material Prices

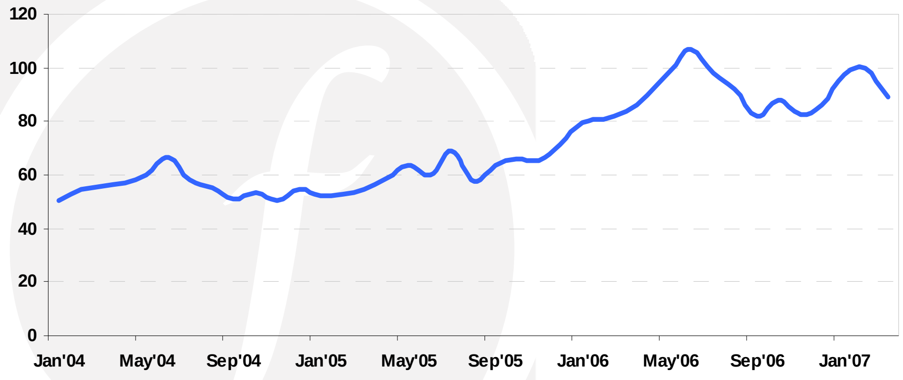
Raw material cost is an essential component in the cost structure of tyre industry constitutes ~ 65% of the total sales, thus becoming the key determinant for the industries margin and profit growth. The key inputs used in the manufacture of tyres include Nylon Tyre Cord Fabric (NTCF), Carbon Black, Natural Rubber, SBR, PBR and others. The tyre industry has been adversely impacted by the increase in raw material cost over the past three years (FY2003-05) resulting in a squeeze in industrys OPM's because of their inability to pass on this increase to end users via increase in tyre prices thus dampening the realizations of the industry. Off late there has been some cooling off in raw material prices and companies have also taken some price hikes there by improving their cost economics and in turn profitability.

- **Rubber :**Rubber is the single largest constituent forming close to 50% of the Tyre weight, raw material cost and value. The rubber used in teh manufacture of tyres is a mix of natural rubber and synthetic rubber. The mix of the same depends on the application and road conditions. Natural rubber prices have been on the upswing since FY2002 and the tyre company's took two consecutive price hikes in FY2002 and FY2003. However, the rubber prices continued their uptrend and the industry was unable to pass on the increase in raw material cost to its consumers denting its realisations and profitability in FY2005 and FY2006.

In FY2006 the consumption of natural rubber grew by 8.2% whereas the production grew by 5.5%. Exports of natural rubber from India have been on the rise. This in turn has resulted in a demand supply mismatch thereby resulting in an increase in rubber prices. Adverse weather conditions in China, Thailand and Malaysia during 2005 and 2006 affected rubber production.Infact, even in India monsoons adversely impacted most rubber producing regions.

These developments impacted the international and domestic rubber crop thereby resulting in an unprecedented increase in international and domestic rubber prices. The current prices of RSS-4 (rubber mostly used for tyre production) have declined to Rs 87.3 after crossing the Rs 100 mark. The recent decline in rubber prices in the international and domestic market, point to the fact that the present high rubber prices cannot be sustained. This decline in rubber prices will only add to bottom line's of tyre companies. We expect the rubber prices to stabilize around Rs 85 to Rs 90 levels in the medium term.

Exhibit 15: Rubber price trend

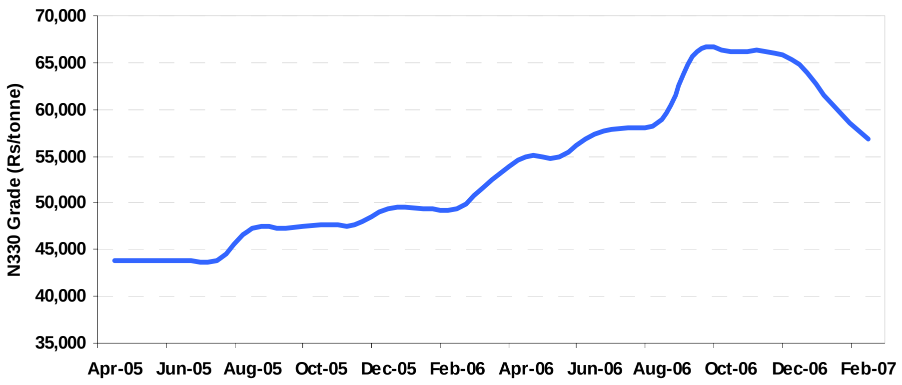


Source: Rubber Board & FQ Research

- **Carbon Black :** Carbon black is used as a reinforcing agent for rubber and imparts rigidity and rolling resistance to the tyres. Carbon Black is used in the manufacture of tyres along with Rubber, SBR and PBR. Carbon Black forms approximately 12% of the tyre industries raw material cost. The tyre industry accounts for around 65% of the consumption of carbon black in India. In India there are only three players dominating the carbon black industry viz. Phillips Carbon Black, Indian Rayon and Cabot India.

The domestic production of Carbon Black is not sufficient to meet domestic demand and is thus imported. Carbon Black Feed Stock (CBFS) a petroleum by-product is the primary raw material used in the manufacture of Carbon Black. CBFS prices have moved in sync with the crude oil prices and thus eventually impacting the input costs for tyre industry. CBFS prices have been rising in the past 3 years reaching a high of $ 340/ MT and with the recent cool off in oil prices(which have been on the upswing) the CBFS prices have fallen down to $255/MT. This decline in CBFS prices will reduce the input cost for tyre manufacturers thereby adding to their operating margins.

Exhibit 16: Carbon Black(N330 grade) price trend

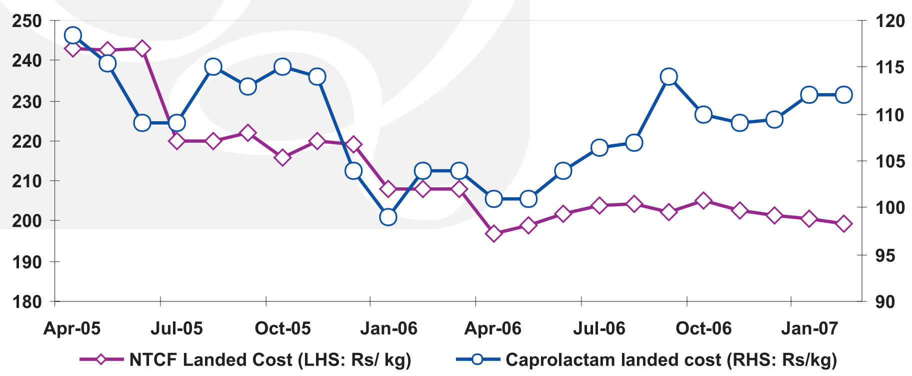


Source: Bloomberg & FQ Research

- **Nylon Tyre Chord Fabric (NTCF):** NTCF accounts for approximately 23% of the tyre manufacturer's raw material cost. The principal feedstock used for the manufacture of NTCF is caprolactam, which accounts for 53% of NTCF's total cost. The price of NTCF is determined by the trends in NTCF demand-supply and ruling caprolactam prices.

  Domestic caprolactum prices are determined by international prices and are announced on a quarterly basis. Due to the demand supply mismatch of NTCF and rising caprolactum feedstock prices, the domestic NTCF prices advanced by 7.5% in FY2006 whereas the international prices advanced by 15.2% during the same period. We expect the domestic caprolactam prices to remain stable due to cheaper imports from China.

Exhibit 17: NTCF & Caprolactum price trend



Source: Bloomberg & FQ Research

- **Styrene Butadiene Rubber (SBR):** Demand for SBR is mostly met through imports because the domestic production of SBR is highly insufficient. SBR accounts for 3% of the raw material cost of tyre industry, whereas the tyre industry accounts for over 60% of SBR consumption. SBR is a derivative of petroleum and thus its prices are positively correlated with crude oil price movement. SBR is used along with natural rubber in different proportions to increase the life of tyres as it is more wear resistant than Natural Rubber. SBR is largely used in passenger car tyres (mainly radials), followed by MHCV tyres. There is a demand supply mismatch in the local market for SBR. However, with new SBR capacities coming in (mainly from Reliance) this situation is expected to improve.

- **Poly Butadiene Rubber (PBR):** PBR is used along with SBR in the manufacture of tyres and accounts for 5% of tyre manufacturers raw material cost. 80% of the demand for PBR comes from the tyre industry and thus prices of PBR are linked to the fortunes of tyre industry. IPCL is the sole producer of PBR in India meeting nearly 90% of domestic demand for PBR. Despite IPCL's expansion of PBR capacity, Indian tyre manufacturers will continue to depend on imports because of robust rise in demand for PBR and lack of domestic supplies.

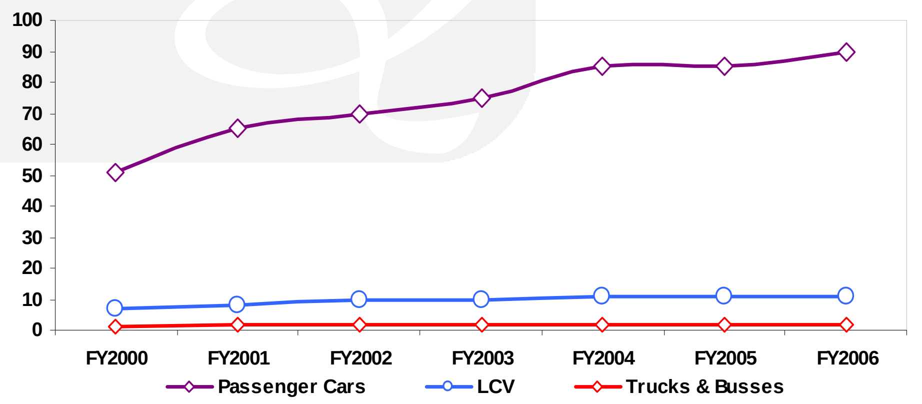
Radialization to radiate growth

Radial tyres provide various benefits as compared to cross ply tyres like more mileage, fuel savings, longevity and better smooth driving. These are the main factors due to which radialisation in the passenger car segment has increased in the past 5 years from 70% in FY2002 to 90% in FY2006. This is expected to reach 100% in the next few years.

However, this has not been the case in other segments like MHCV and LCV where the level of radialization is as low as 2%(world average 65%) and 11% respectively. The low penetration in these segment's is because of higher costs, overloading, lack of vehicle maintenance, older vehicles produced in the country and poor quality of roads. Further, there is lack of initiative on the part of OEM's and Tyre manufacturers to manufacture radial tyres in these segments. Besides, consumers lack awareness about the economic benefits of radial tyres. Thus, the rate of growth of radialisation in commercial vehicle segment is not likely to grow at any lightening pace from here on.

But, there are some interesting developments that will certainly aid the growth in radialisation of LCV's and MHCV. Like the recent supreme court ruling to ban overloading, projects like GQ & NSEW corridor etc. and improvement of road infrastructure in general will help improve the level of radialisation in the commercial vehicle segment.

Exhibit 18: Radialisation trend among segments



Source: SIAM & FQ Research

Branding power - Indian market poses high entry barrier

The Indian tyre industry is largely dominated by top 5 players accounting for over 78% of the total tyre industry turnover. The top four players control more than 85% of the truck and bus segment. The sector is highly capital intensive and technology sensitive, thus research & development and technology play a crucial role in the industry. Tie-ups with international players provide an added advantage. The key differentiator in the highly competitive and commoditized tyre industry is technology,R&D capabilities, distribution & service network and branding which act as an entry barrier.

Increasing acceptance of radial tyres in the passenger vehicle segment and growing competition in all segments of tyre industry have warranted effective branding, expanding customer contact points through exclusive sales outlets and increased dealer network.

In addition, all leading players like Apollo, MRF and JK industries have increased their advertising and promotional spend to increase their brand visibility and capture more market share.

Taking into consideration the technological sensitivity, capital intensive nature of the industry, branding & service infrastructure we believe there are sufficient entry barriers for new players to establish their position in the Indian market. Thus the Indian Tyre market continues to be dominated by top 5 players.

Exports- Outsourcing could be the next biggest trend

Exports have been one of the key growth drivers of the tyre industry. It has been growing at a consistent pace of 11% in the past five years. Due to rising demand for tyres in the global markets and government assistance to Indian tyre manufacturers in the form of export incentives, export of tyres are expected to be a major thrust area. India exports tyres to over 65 countries across the globe.

Further, globally the tyre industry has been facing problems of eroding operational profitability thereby forcing them to look at alternative low cost manufacturing sources to cater to their existing markets. As a result global tyre manufacturers have been exploring various arrangements in low cost countries. For instance: Apollo and MRF had tie ups with Michelin, JKI with Continental, while Goodyear India is a subsidiary of Goodyear Tire & Rubber, USA. Like in most manufacturing industries Indian Tyre manufacturers also face competition from China. However, we are still competitive enough to explore the outsourcing opportunities offered in the global tyre market and grow its volumes.

Improving road infrastructure to drive volumes

In India the rail to road cargo penetration is still lingering around the 35:65 mark whereas in the developed countries roadways controls 84% of the cargo movement in the country. Indian road network supports 85% of the passenger traffic movement within the country. The Indian road network is insufficient to support our economic growth making it imperative for the Indian government to expand and improve the quality of Indian Roadways.

India's inadequate highway and trunk road infrastructure needed some development and thus the government formed the National Highway Authority of India(NHAI) and framed the National Highway Development Programme (NHDP) to develop National Highways. Their mandate includes two prized projects of GQ and NSEW corridor. In addition, they are assigned the responsibility of upgrading National highways to convert them into 4 and 6 lanes, converting single laned highways into 2 laned highways, converting four laned highways into six laned highways, construct expressways connecting important industrial and commercial towns and cities and constructing ring roads and flyovers. These projects imply construction and development of a minimum road length of 50,146Kms. Besides other state level projects continue to develop the road network within the state.

These projects are expected to improve the quality of highways, roads and trunk routes radically. This in turn will result in higher throughput of goods through road transport, increase demand for high quality vehicles which in turn will drive demand for better and improved tyres including radials.

Reduction of import duty on inputs

Indian tyre manufacturers import their raw material requirement due to insufficient domestic supply, creating a demand supply mismatch. The union budget of FY2007 reduced the peak custom duty on the raw materials used in the manufacture of Tyre. Thereby reducing the rising pressure on input costs for tyre manufacturers. Custom duty on raw materials like SBR, PBR and NTCF has been reduced to 12.8% from 15.3%. Similarly the customs duty on carbon black has been reduced from 15.3% to 10.2%, natural rubber from 20.4% to 20%, synthetic rubber from 15.3% to 12.8% and on caprolactam (raw material for NTCF) from 15.3% to 10.2%.

Concerns

i. Vulnerable to changing commodity cycle

The fortunes of the tyre industry are interlinked with the ruling raw material prices. As raw material cost constitutes 65% of the turnover in tyre industry. Like all commodity businesses tyre industry will face cost pressures in the event of rising prices of key raw materials namely natural & synthetic rubber, carbon black and NTCF. To aggravate the grievance of tyre manufacturers they are unable to pass on the increase in raw material prices by increasing their realizations. This may result in a huge dent in the profitability of tyre manufacturers.

ii. Imports

Tyres industry in India faces serious competition from imports. India has free trade agreements with many countries, which results in reduction or elimination of import duties and tariffs.

Cheaper imports from China, South Korea, Japan, Thailand and Indonesia which sell at very low prices in India pose a threat to the domestic tyre industry. This is the outcome of preferential agreements with ASEAN countries, under which the customs duty on imports from these countries stands at 15% as compared to 20% otherwise.

iii. Chinese imports even bigger threat

Chinese tyre imports cost approximately 25% cheaper as compared to Indian tyres. This has helped them to capture 5% market share in India. However, we believe that Chinese tyres cannot effectively compete with the domestically manufactured tyres as the life and quality of these tyres is significantly lower than Indian tyres.

iv. Slowdown in economy and consequently vehicular demand

The demand for tyres is highly dependant on the country's economic health. The movement of goods within the country from the manufacturing and agricultural sectors will determine the demand for vehicles, thereby driving the OEM and replacement market for tyres.

Though India has been growing at over 8% in the past two years and India's GDP is expected to grow at over 8% in the near future, any slowdown in economic growth will adversely impact the goods movement. This can adversely impact the growth in OEM and replacement demand.

v. High Selling & Distribution expenses a further burden

In addition to the burden of a high proportion of raw material cost the tyre manufacturers are also faced with marketing and distribution expenses to the tune of 9% of sales. With the replacement market forming a major chunk of the demand for tyres, selling and distribution efforts are a necessity in this competitive industry. The increasing competition in the tyre industry has warranted increased advertising & selling expenditure for creation of brands and pushing volumes, expanding distribution network through- authorized sales agents, sales outlets and increased number of customer contact points.

vi. Highly geared companies – rising interest rates to squeeze PAT margins

Two problems inherent in the tyre industry are high raw material cost and high capital intensive industry. The capital required to set up a new 1.2mn units per annum cross ply plant is approximately Rs 4.5bn while the radial facility would require a cost of Rs 5.6bn. Higher working capital requirement, lower margins and lower returns on capital employed generally lead the tyre manufacturers to leverage their balance sheet.

vii. Retreading

Retreading is one of the major hindrances in the growth of aftermarket demand for tyres. Retreading costs only 20-25% of the cost of a new tyre and increases the life of the tyre by 60-70%. Retreading increases the life of tyres and thus delays the replacement cycle. In India retreading market is well spread and since it is cost effective, price sensitive customers prefer retreading over replacement there by adversely impacting aftermarket tyre sales.

Exhibit 19: Retreading cost economics

	Unit	Cross Ply	Extra Heavy Cross Ply	Radial
Price Per MHCV Tyre	Rs.	9,500	10,925	12,500
Life of New Tyre	Kms	55,000	55,000	100,000
Retreading Possible	Times	3	2	3
Cost Per retreading	Rs.	2,250	2,250	2,500
Total cost of retread	Rs.	6,750	4,500	7,500
Cost of casing	Rs.	5,750	5,750	5,750
Incr. in life of tyres	Kms	60,000	40,000	60,000
Total Life of Tyres	Kms	115,000	95,000	160,000
Total cost of retread	Rs.	22,000	21,175	25,750
Cost/1,000 Kms.	Rs.	191	223	166

Source: Crisinfac

Future Outlook

The future of the tyre industry critically hinges on the growth of the automobile industry, which is expected to be healthy in the short term. This will significantly contribute to rise in demand from OEM segment and eventually find its way into the replacement market. The strong growth sustained by the auto sector in the last 3 years, will drive replacement demand for tyres now. The prospects of tyre exports from India appear healthy, following efforts by Indian companies to increasingly enter into outsourcing agreements with tyre producers in South-East Asia, Eastern Europe and Latin America. Strong export demand coupled with increase in domestic demand and healthy growth in vehicle production is expected to result in a robust growth in tyre production and sales.

We are overweight on the tyre sector and believe the stocks are available at attractive valuation's. Tyre sector offers good revenue visibility as investment in the parent industry are expected to be in the range of $ 35-40bn in the next 10 years. Correspondingly, the investment in the tyre sector is expected to be in the range of Rs 30bn in the next five years. The tyre majors are scaling up their capacities fast in anticipation of this opportunity. We believe that tyre players are well placed to exploit the benefits of increasing road infrastructure spend and rising vehicular demand. We have picked four companies that we believe are well placed and are trading at attractive valuations.

Exhibit 20: Finquest Coverage Universe

Company Name	CMP (Rs)	Recommendation	Target Price (Rs)	Upside (%)
Apollo Tyres	280	BUY	413	48
CEAT	107	BUY	138	29
Good Year India	155	BUY	200	29
JK Industries	112	BUY	155	38

Source: FQ Research

Companies

Apollo Tyres

Initiating Coverage - Sector: Tyre

Apollo Tyres

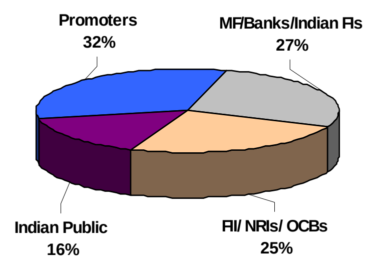
Buy

CMP: Rs 280 | **Target Price: Rs 413**

Key Data

Market Cap (Rs bn)	10.7
Market Cap (US$ mn)	246.1
52 WK High / Low	387 / 194
Avg Daily Volume	41216
Face Value (Rs)	10
BSE Sensex	13072
Nifty	3822
BSE Code	500877
NSE Code	APOLLOTYRE
Reuters Code	APLO.BO
Bloomberg Code	APTY IN

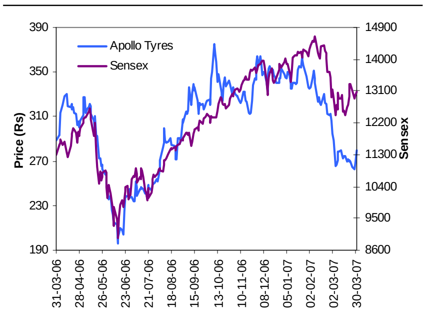
Shareholding Pattern (%)



Price Performance (%)

	Absolute	Relative
3 Months	(20.7)	(15.5)
6 Months	(13.8)	(18.8)
12 Months	(3.1)	(19.0)

Apollo Tyres vs BSE



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Apollo Tyres Ltd (ATL) part of the Raunaq Group, is the 2nd largest tyre manufacturer in the country with an overall market share of around 23% and ranks 15th in the world. ATL is the market leader in Truck & Bus (T&B) segmentand is ideally poised to capitalise on the sustainable growth in this segment inthe near future.

Investment Argument

- ATL has a strong presence in the Commercial Vehicle (CV) tyres replacemnt market. The CV replacement demand is likely to pick up on the back of higher off-take of CV's in the past few years. ATL is well poised to take advantage of the upcoming replacement demand boom.
- ATL has managed to become the 3rd largest player in the Passenger Car Radial (PCR) tyre segment. The company has been able to achiev this position backed by a strong distribution network and focus on R&D.
- ATL has set its footprints in international market by aquiring Dunlop Tyres (DT), South Africa. We expect ATL's export contribution to rise from current 9% to around 15% in next 3-4 years. On the back of several synergies from its overseas acquisiton. The company will continue to scout for similar opportunities in future.
- With a view to keep pace with the increasing demand and increase in radialisation in T&B segment, ATL has chalked out a greenfield expansion plan in Tamil Nadu. With ATL's capacity likely to become operational by July 2008, we believe ATL will be ideally placed to take advantage of the opportunity provided by the T&B radial segment.

Valuations

At CMP of Rs 280, ATL trades at a P/E of 9.8x FY2008E and 8.5x FY2009E, and EV/EBIDTA of 4.4x FY2008E and 4.0x FY2009E on a standalone basis. We have valued ATL's stand alone business at Rs 363 per share and Dunlops business at Rs 50 per share. **We Initiate Coverage on the stock with a 'Buy' recommendation and 12-month Target Price of Rs 413.**

Key Financials

Y/E March (Rs mn)	FY2006	FY2007E	FY2008E	FY2009E
Net Sales	**26,136**	**33,682**	**38,202**	**43,302**
% chg	*16.9*	*28.9*	*13.4*	*13.3*
Net Profit	**752**	**1,110**	**1,440**	**1,662**
% chg	*5.6*	*47.7*	*29.7*	*15.5*
EPS (Rs)	**20.4**	**23.9**	**28.6**	**33.0**
EBITDA Margin (%)	8.0	8.4	8.9	9.3
P/E (x)	13.7	11.7	9.8	8.5
P/CEPS (x)	7.1	6.5	5.8	5.1
ROE (%)	12.3	11.3	12.2	11.8
ROCE (%)	11.0	12.4	13.5	13.0
P/BV (x)	1.7	1.3	1.2	1.0
EV/EBITDA (x)	6.7	5.1	4.4	4.0

Source: Company; FQ Research

Company Background

Apollo Tyres Limited (ATL) is a flagship company of Raunaq Group. Incorporated in 1972, the company is engaged in the manufacture and sale of automobile tyres, tubes and flaps. The company is the second largest tyre manufacturer in the country with an overall market share of around 23% and ranks 15th in the world. ATL is the market leader in the Truck and Light Truck tyres, the largest segment in the country. The company has three manufacturing facilities in India with a total installed capacity of 750 MT per day. ATL, recently acquired 100% stake in Dunlop tyres South Africa, with a view to increase its focus on the export front. The company has strong hold on the replacement market and derives majority of its revenue from the same. ATL's clientele include various OEM players like Maruti , M&M, Tata Motors etc.

Manufacturing Facilities

ATL acquired 100% stake in Dunlop Tyres, South Africa, effective from 21st April, 2006. Post acquisition ATL has 6 manufacturing facilities out of which four are in India (two in Kerala and one each in Gujarat and Maharashtra) and one each in South Africa and Zimbabwe.

Exhibit 1: Appolo's Global Capacities

Location	No. of plants	Capacity
India	4 plants	750 tonnes/day
South Africa	1 plant	150 tonnes/day
Zimbabwe	1 plant	30 tonnes /day
Total	6 plants	930 tonnes/day

Source: Company, FQ Research

Exhibit 2: Product profile

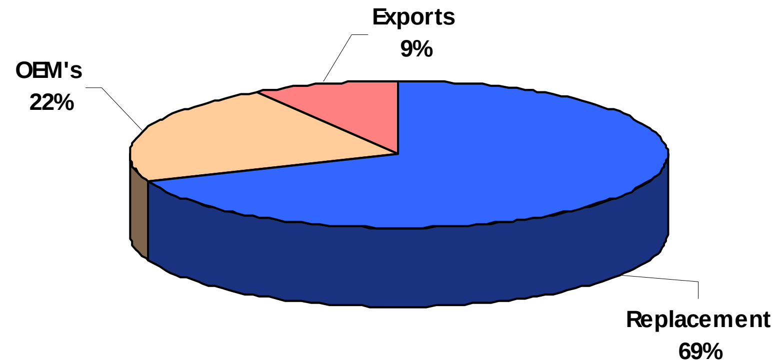
Tyre category	Types
Truck	Bias and Radial
Light Truck	Bias and Radial
Passenger Car	Radial and Bias (upto "Z" rated)
Farm	Bias and Radial
OTR	Bias

Source: Company, FQ Research

Largest distribution network in India

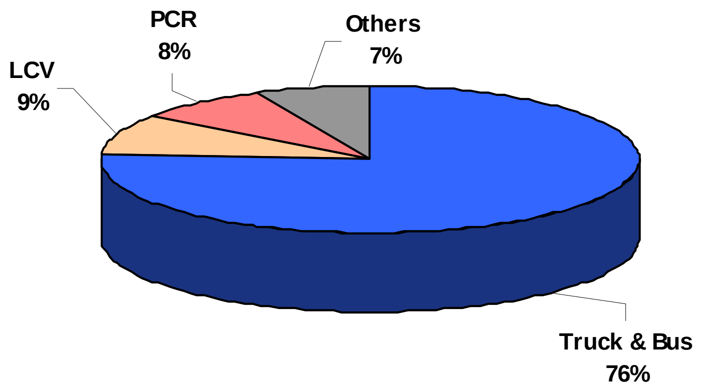
ATL has the largest distribution network in the country as compared to its peers. ATL currently has around 4,000 dealers in India out of which around 2,000 are sole distributors of ATL tyres.

Exhibit 3: Revenue break-up – India



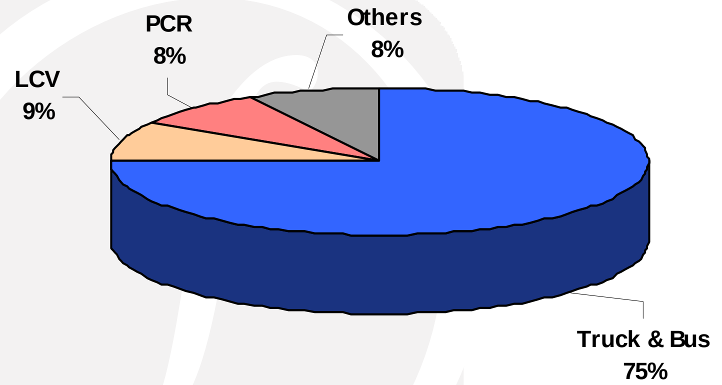
Source: Company; FQ research

Exhibit 4: Category-wise Revenue Break-up



Source: Company; FQ research

Exhibit 5: Total tonnage breakup



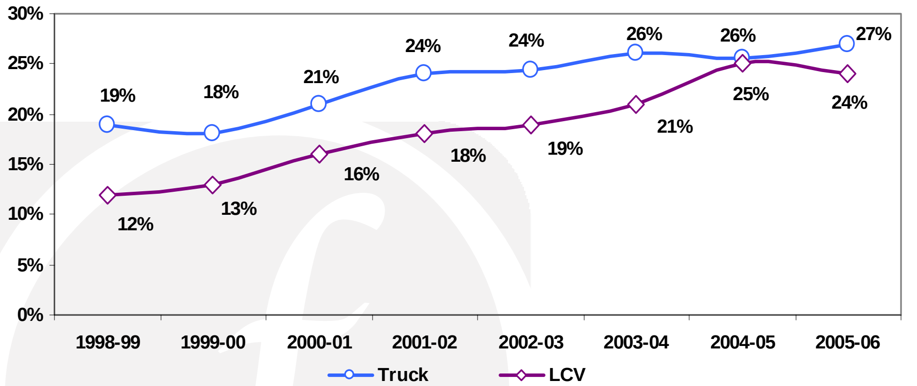
Source: Company; FQ research

Investment Rationale

Leader in the Truck and Light Truck tyres - the largest segment in the country

Apollo is the market leader in the Truck and Bus tyre segment with a market share of around 27%, both in replacement market and OEM market. Also, in the LCV segment ATL is the market leader with 24% market share. ATL's replacement segment contributes around 46% of the domestic industry turnover with 29% share from Truck and Bus tyres and 27% from LCV tyres. With a strong presence in the growing replacement market of CV tyres, ATL is well poised to take advantage of the upcoming replacement demand boom.

Exhibit 6: Apollo's rising market share

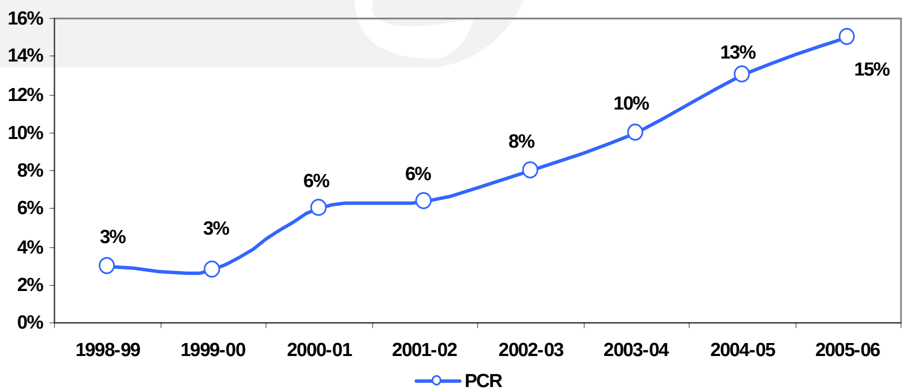


Source: Company; FQ research

PCR segment of ATL catching up

ATL has managed to capture market share at decent pace over the past few years in the PCR segment. In the replacement market of PCR tyres, ATL is at third position with a market sahre of around 15% market share following Bridgestone and MRF.

Exhibit 7: Passenger Car expanding footprints



Source: Company; FQ research

In order to catch up with the rising trend of radialisation and tubeless tyres in the PCR segment, ATL has taken several initiatives viz:-

1) Ramping up Radial capacities at its existing facilities and also setting up of manufacturing facility for PCR radial tyres at its upcoming Tamil Nadu Plant.

2) ATL has indigenously developed a tubeless passenger car tyre naming "Apollo Acelere". It is a premium 'H-rated' tubeless and tube type car radial.

With improving qualities of road and increasing awareness about safety we expect the tubeless tyre demand to pick up going ahead. Currently around 90% of the PCR tyre sales are accounted by radial tube tyres while the balance is from tubeless tyres.

Creating global visibility….

With a view to take advantage of possible synergies and increase its presence in the international market ATL acquired 100% stake in Dunlop Tyres, South Africa with effect from 21st April 2006. With this acquisition 3 additional facilities (two in South Africa and one in Zimbabwe) came under Apollo's control. The total installed capacity at these three locations is around 180 tonnes/day. Besides gaining access to the Dunlops's overseas markets , ATL is expected to derive business and technological synergies from this acquisition.

Synergies from Dunlop acquisition

- Stronger positioning in global market - manufacturing presence in 3 countries
- Product rationalisation leading to optimisation
- Combined purchasing power
- Technical learnings & best practices from each other
- Joint Research & Development to assist in product upgrade
- Possibility for further global Alliances & Acquisitions

Increased concentration on exports

ATL plans to increase its global presence through the inorganic route by acquiring businesses or by forming joint ventures. Proper execution of its overseas expansion plans would help ATL in improving its export share in future. Currently exports contribute around 9% of the total revenues of ATL. Taking into consideration its current acquisition of DT, South Africa and its strategy to increase its overseas presence inorganically. We believe that ATL's export share to total revenues could rise to 15% from the current level of 9% in the next three years.

Technological Prowess- an added advantage

Strong focus on R&D activities is a must especially in an Industry like tyre which faces cut-throat competition and is technologically sensitive. We believe that ATL's continuing thrust on R&D would provide it a competitive edge in the industry. ATL has expressed its desire to set up a R&D facility in Germany. The R&D facility would be a stepping stone towards strengthening the company's existing alliance with a German University viz. Leipzig Institute of Polymer Science. ATL also plans to do a similar exercise with two other Universities in Germany. These initiatives are quite similar to some of the global players like Michelin. ATL is also working with Indian Institutes such as National Institute of Design, Ahmedabad and IIT Kharagpur for design and development of rubber technology.

Expansion plans

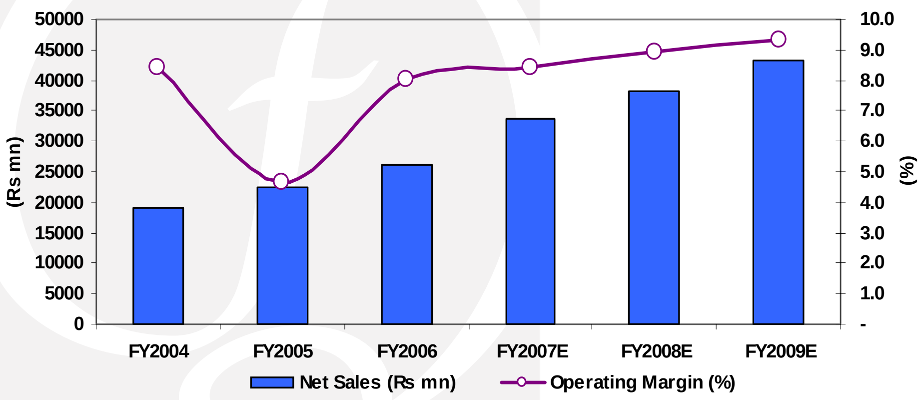
With a view to keep pace with the increasing demand and the likely increase in radialisation in T&B segment, ATL has chalked out a greenfield expansion plan in Tamil Nadu. The new capacity which is likely to be operational by July 2008, will be utilized for manufacturing of Truck & Bus radial tyres and also to some extent for manufacturing passenger car radial tyres. ATL plans to fund the 1st phase of the expansion through internal accruals and warrants issued to promoters. The company will initiate production at this facility with an intial production capacity of 100 tonnes /day. We expect the use of radial tyres in the T&B segment to grow from the present 2% to around 10% in the next five years. With ATL's capacity likely to become operational by July 2008, we believe taht ATL is well poised to take advantage of this shift in use of radial T&B tyres.

Financials

Improving sales and operating margins.

ATL, along with the other tyre manufacturers, was able to pass on the increased costs of raw material in FY2007 by introducing price hikes. With volume growth likely to pick up in the replacement segment, we expect ATL's standalone net sales to increase at a CAGR of 18.4% over FY2006-FY2009E. On the margin front, we believe that ATL is in a position to command better prices than its peers and this is evident from the fact that it has registered highest operating margins over the past few years. With crude hovering around US $60 per barrel and stability expected in rubber prices, we expect ATL's standalone margins to improve from around 8.4% in FY2007 to 8.9% and 9.3% in FY2008 and FY2009 respectively.

Exhibit 8: Revenue & Margin Trend



Source: Company; FQ research

Valuation

At CMP of Rs 280, ATL trades at a P/E of 9.8x FY2008E and 8.5x FY2009E, and EV/EBIDTA of 4.4x FY2008E and 4.0x FY2009E on a standalone basis. At a P/E of 8.5x FY2009E EPS of 32.9 we have valued ATL's stand alone business at Rs 363 per share.

We have valued the business of its 100% subsidiary Dunlop Tyres separately. Considering the FY2009E expected earnings of around Rs 313mn, we expect Dunlops's EPS to be around Rs 6.2 (considering full dilution of ATL equity capital). At a P/E of 8x FY2009E EPS, we value Dunlops business at Rs 50 per share.

We Initiate Coverage on the stock with a 'Buy' recommendation and 12-month Target Price of Rs 413 which translates into annualized returns of 48%.

Profit & Loss Statement Rs mn

Y/E March	FY2006	FY2007E	FY2008E	FY2009E
Net Sales	**26136**	**33682**	**38202**	**43302**
% chg	*16.9*	*28.9*	*13.4*	*13.3*
Total Expenditure	24858	31796	35795	39257
EBIDTA	**2165**	**2836**	**3407**	**4045**
(% of Net Sales)	*8.0*	*8.4*	*8.9*	*9.3*
Other Income	204	150	250	250
Depreciation& Amortisation	728	880	980	1100
Interest	577	520	620	820
PBT	**1064**	**1586**	**2057**	**2375**
(% of Net Sales)	*4.1*	*4.7*	*5.4*	*5.5*
Tax	282	476	617	712
(% of PBT)	*26.5*	*30.0*	*30.0*	*30.0*
PAT	**782**	**1110**	**1440**	**1662**
Extraordinary Item	29.7	0.0	0.0	0.0
Adj PAT	**752**	**1110**	**1440**	**1662**
% chg	*5.6*	*47.7*	*29.7*	*15.5*

Balance Sheet Rs mn

Y/E March	FY2006	FY2007E	FY2008E	FY2009E
SOURCES OF FUNDS				
Equity Share Capital	383	464	504	504
Reserves& Surplus	5,957	9,391	11,311	13,543
Shareholders Funds	**6,340**	**9,855**	**11,815**	**14,047**
Total Loans	7,500	6,000	6,750	9,110
Deffered Tax Liability	1,052	1,102	1,247	1,400
Total Liabilities	**14,892**	**16,957**	**19,812**	**24,557**
APPLICATION OF FUNDS				
Gross Block	13,106	15,031	17,212	23,485
Less: Acc. Depreciation	4,699	5,579	6,559	7,659
Net Block	**8,407**	**9,451**	**10,653**	**15,825**
Capital Work-in-Progress	779	1,475	2,500	554
Investments	**5**	**26**	**44**	**104**
Current Assets	11,961	13,296	15,332	19,001
Current liabilities	6,263	7,291	8,717	10,928
Net Current Assets	**5,698**	**6,005**	**6,614**	**8,073**
Misc expd	**3**	**-**	**-**	**-**
Total Assets	**14,892**	**16,957**	**19,812**	**24,557**

Cash Flow Statement Rs mn

Y/E March	FY2006	FY2007E	FY2008E	FY2009E
Profit before tax	1,064	1,586	2,057	2,375
Depreciation	728	880	980	1,100
Change in Working Capital	2,353	307	609	1,459
Direct taxes paid	282	476	617	712
CF from Operations	**(843)**	**1,684**	**1,810**	**1,304**
Inc./ (Dec.) in Fixed Assets	841	1,740	2,227	3,226
Free Cash Flow	**(1,684)**	**(56)**	**(417)**	**(1,923)**
Inc/ (dec) in investment	(540)	20	19	60
Issue of Equity/ Preference	-	81	40	-
Inc/ (dec) in loans	2,062	(1,500)	750	2,360
Dividend Paid (Incl. Tax)	-	36	18	-
Others	1,371	855	(100)	(200)
CF from Financing	**3,433**	**(528)**	**708**	**2,160**
Inc./(Dec.) in Cash	1,209	(564)	310	297
Opening Cash balances	**1,104**	**2,314**	**1,750**	**2,060**
Closing Cash balances	**2,314**	**1,750**	**2,060**	**2,357**

Key Ratios

Y/E March	FY2006	FY2007E	FY2008E	FY2009E
Valuation Ratio (x)				
P/E	13.7	11.7	9.8	8.5
P/E (Cash EPS)	7.1	6.5	5.8	5.1
P/BV	1.7	1.3	1.2	1.0
EV / Sales	0.6	0.4	0.4	0.4
EV / EBITDA	6.7	5.1	4.4	4.0
Per Share Data(Rs)				
EPS	20.4	23.9	28.6	33.0
Cash EPS	39.4	42.9	48.0	54.8
DPS	4.5	4.5	4.5	4.5
Book Value	165.4	212.4	234.4	278.7
Returns(%)				
ROE	12.3	11.3	12.2	11.8
ROCE	11.0	12.4	13.5	13.0
Dividend Payout	25.5	22.1	32.0	32.0
Operating Ratio(%)				
Raw Material / Sales (%)	73.6	72.2	71.0	70.5
Inventory(Days)	58.6	51.9	53.4	59.9
Debtors (Days)	24.5	24.5	24.5	24.5
Debt / Equity (x)	0.5	0.4	0.3	0.4

CEAT Ltd

Initiating Coverage - Sector: Tyre

CEAT Ltd

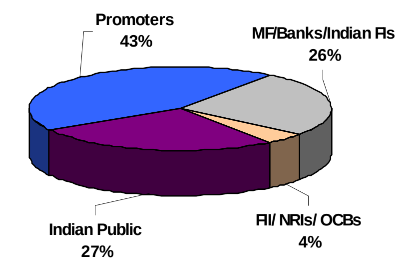
Buy

CMP: Rs 107 | **Target Price: Rs 138**

Key Data

Market Cap (Rs bn)	4.9
Market Cap (US$ mn)	112.4
52 WK High / Low	162 / 62
Avg Daily Volume	206435
Face Value (Rs)	10
BSE Sensex	13072
Nifty	3822
BSE Code	500878
NSE Code	CEAT
Reuters Code	CEAT.BO
Bloomberg Code	CEAT IN

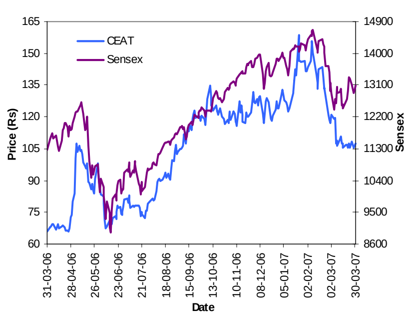
Shareholding Pattern (%)



Price Performance (%)

	Absolute	Relative
3 Months	(13.4)	(8.2)
6 Months	(11.1)	(16.1)
12 Months	63.2	47.3

CEAT vs BSE



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CEAT Limited is a reputed player in the domestic and export tyre market and a part of the RPG group. CEAT has an overall market share of 12% and enjoys the position of the 4th largest tyre manufacturer in India. On the back of new expansions, improved product mix & productivity we expect CEAT to witness a Top Line and Bottom Line CAGR of 12.1% and 72.9% (FY2007E-FY2009E) respectively.

Investment Argument

- CEAT Ltd has chalked out a capex plan of Rs 450mn to take advantage of the rising demand for Tyres from all segments. Capacity addition along with de-bottlenecking, improved product mix and focus on export market will help the company to expand its volumes along with improved realisations and margins.
- CEAT's current investment book comprises of holdings in many of its RPG group listed companies.The company has recently obtained board consent to sell off 7 acres of land which is expected to fetch Rs 800-850mn. At current prices, the value of its investment & land book works out to Rs 4.8bn translating into a per share value of Rs 26 after a discount of 75%.
- Currently, CEAT is the only tyre company paying Octroi to the Maharashtra State Government @1.5%. The State Government is likely to abolish the tax which would add 1.5% directly to the company's bottom line.

Valuations

We expect CEAT's revenues to grow at a CAGR of 12.1% given the strong growth opportunities in the speciality tyres segment, return of pricing power, improved product mix & productivity and improved margins contributing positively to the bottom Line. **At the CMP Rs 107 the stock is trading at 8.3x and 5.8x its FY2008E and FY2009E EPS of Rs 12.9 and Rs 18.6 respectively. We initiate coverage with a BUY on CEAT with a price target of Rs 138 providing an upside of 29%.**

Key Financials

Y/E March (Rs mn)	FY2006	FY2007E	FY2008E	FY2009E
Net Sales	**17441**	**21613**	**24694**	**27163**
% chg	*13.8*	*23.9*	*14.3*	*10.0*
Net Profit	**7**	**285**	**589**	**851**
% chg	*-*	*-*	*106.8*	*44.5*
EPS (Rs)	0.2	6.2	12.9	18.6
EBITDA Margin (%)	4.4	5.7	6.6	7.0
P/E (x)	700.2	17.2	8.3	5.8
P/CEPS (x)	21.3	8.2	5.3	4.1
RoE (%)	0.2	7.7	14.2	17.7
RoCE (%)	10.1	14.4	19.4	23.2
P/BV(x)	1.4	1.3	1.2	1.0
EV/EBITDA	11.2	6.7	4.8	3.6

Source: Company; FQ Research

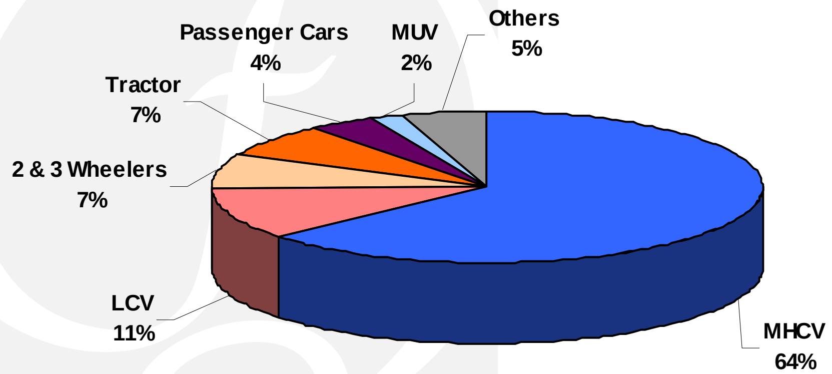
Company Background

CEAT Ltd was established in 1958 in collaboration with the Tata group and was later taken over by the RPG group. The company has two manufacturing facilities one in Bhandup and the other in Nashik both in Maharashtra. Ceat has an overall market share of 12% and ranks 4th in the Indian tyre industry. CEAT is making conscious efforts to tap the export market more aggressively with the manufacture and marketing of specialty tyres. The company enjoys a good brand name in the domestic market and is a well known player in export market, exporting to more than 100 countries.

The company has long standing business relations with various reputed OEMs like TATA Motors, Ashok Leyland, Mahindra & Mahindra, Maruti, L&T, Eicher, Swaraj Mazda, Caterpillar, Bajaj Tempo, Piaggio, Hero Honda, HMSI (wholly owned subsidiary of Honda Motors, Japan) and TVS Motors.

CEAT caters to various business segments like Heavy-duty Trucks and Buses, Light Commercial Vehicles, Earthmovers, Forklifts, Tractors, Trailers, Cars, Motorcycles & Scooters, Auto-rickshaws. The product mix for the company is as follows:

Exhibit 1: Segmental profile



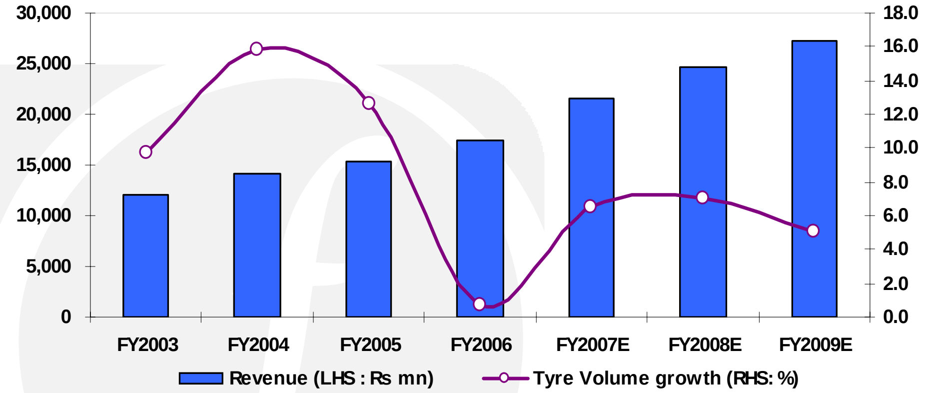
Source: Company; FQ research

Investment Rationale

Capacity additions to add volumes

CEAT has chalked out a Rs 450mn expansion plan to take advantage of the rising demand for tyres from all segments. The company is setting up a 65MT radial capacity, doubling it's giant OTR capacity and modernizing its facility at Bhandup. Planned expansion and modernization along with de-bottlenecking will not only help expand volumes but also help in improving CEAT's margins because radial tyres fetch better realizations. CEAT plans to further scale up its capacities for radial (truck, LCV and PCR) by 2010, grass root plant for specialty tyres to tap the export market. The Nashik expansion and product rationalization is set to increase its overall operating capacity. They have a further Rs 3.5bn capex lined up over the next 2-3 years.

Exhibit 2: Revenue & Volume growth trend



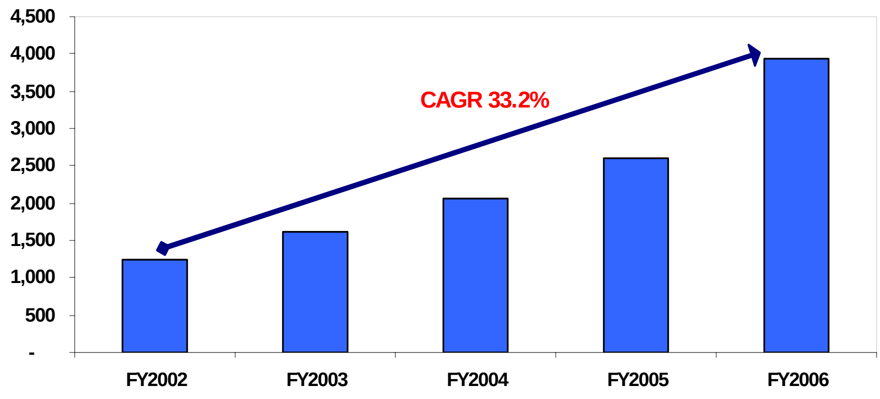
Source: Company; FQ research

Specialty segment adding spice with exports

CEAT currently exports tyres to over 70 countries, and has earned export revenues of Rs 3.9bn in FY2006 a 51% growth over FY2005. The company has reported exports of Rs 3.3bn in 9MFY2007 a growth of 13% over the corresponding quarter last year. The realizations in the export market are much higher than the domestic market.

Specialty tyres has a huge global market and the demand in this market is growing significantly. Essentially, the specialty tyre business is a low volume business which keeps big international players uninterested making it a very attractive opportunity to tap for CEAT. The margins earned in the specialty tyre business and export businesses are much higher than in other tyres. CEAT is making efforts to increase the contribution of specialty tyres in its revenues, primarily OTR tyres. CEAT has currently allocated 50 tonne of capacity for specialty tyres which will be scaled up to 100 tonne.

Exhibit 3: Export trend



Source: Company; FQ research

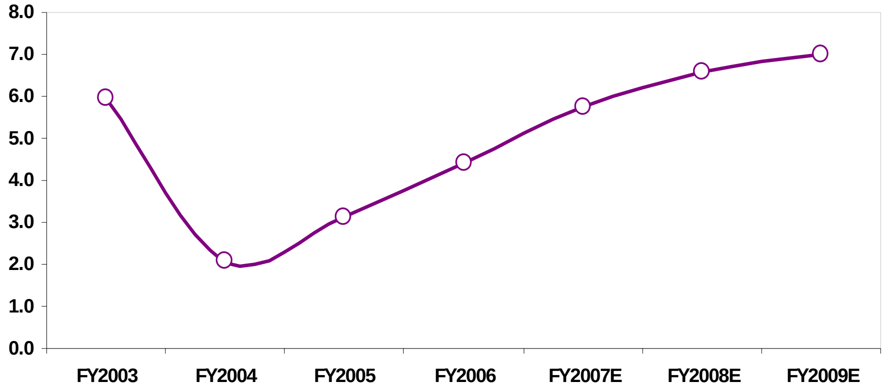
Price hikes taking the lead... to protect its OPM

The Indian tyre manufacturers have been facing cost push and effectively margin pressure in the last three years mainly due to rising crude and rubber prices. Further, CEAT has been less cost efficient than other competitors and thus having lower margins as compared to other players in the industry. CEAT has undertaken various initiatives to improve its productivity and margins like reengineering its tyre designs, de-bottlenecking of manufacturing process, improving utilization levels and rationalizing manpower costs. Going forward the company is expected to continue these initiatives. As a result CEAT has been successful in squeezing its costs despite rising raw material prices as a result the company has been able to expand its OPM which is evident from 160bps YoY rise in OPM in Q3FY2007 to 7.8%.

Further, in the recent past the company has been pro active in raising prices of its tyres. As a result CEAT has taken 6 price hikes in the past 10 months. The company has hiked prices by approximately 14% in this period.

Since the tyre industry is a highly competitive and price elastic industry, players in this segment try and gain market share through unwarranted price reductions and avoiding price hikes. However, the companies have realized that they cannot sustain their business at such low profitability and thus the management expects more rationale behavior from industry players and is thus confident of achieving OPM's close to 8% in the next 18-24 months. We expect the company to clock OPM of 7.7% in FY2008E and 8.0% in FY2009E.

Exhibit 4: OPM trend



Source: Company; FQ research

JV in Sri Lanka making steady progress

CEAT's Sri Lanka Joint Venture (50% stake) by the name of Associated Ceatkelani ventures is a market leader in the bias segment with a market share of 50%. It also exports LCV and passenger car radials from Sri Lankan plant to the Indian market taking advantage of the free trade area benefits between India and Sri Lanka. The JV registered a modest top line growth of 7% in FY2006. It is currently implementing a capacity expansion project for manufacture of 26,000 passenger car radial tyres per month. We expect the contribution from this JV to improve significantly on account of improved productivity and foray into radial tyres. CEAT receives royalty, dividend and technical fees from this JV.

Huge land bank and investment book capping the downside

CEAT's current investment book comprises of holdings in many of its RPG group listed companies. At current prices, the value of its investment book works out to Rs 4bn translating into a per share value of Rs 87. We donot expect the company to sell off this investment as most of these investments are in group companies, however some value unlocking may be possible in the event of demerger into an investment arm as observed from the trend in recent times. Further, the company has recently obtained board consent to sell off 7 acres of the total 33 acres of surplus land at its Bhandup facility. We expect this land to fetch the company Rs 800-850mn translating into a per share value of Rs 18. Thus the effective value of the investment book and the land to be sold cumulates to Rs 105, providing an additional cushion to investors.

Exhibit 5: Investment and land bank valuation

Investment	No Of Shares	Cost	Curr Inv Value
CESC	2,056,794	160.1	777
CFL Capital Fin.	3,837,500	17.3	8
Harr. Malayalam	728,150	80.9	49
K E C Internatio	3,128,298	363.3	1611
K E C infra	3,128,298	0	69
Phillips Carbon	1,903,114	121.9	234
RPG Cables	2,200,280	32.1	84
RPG Life Science	1,064,560	107.9	96
RPG Transmission	2,282,000	182	447
Saregama India	253,444	6.6	49
Zensar Technolgs	2,222,138	34.8	539
Total Investment value		**1107**	**3963**
Investment value/Share (A)			**87**
Land Value			
- Area (Acres)		7	
- Value (Rs mn/ Acre)		120	
Total Land Value			840
Land value/Share (B)			**18**
Total Investment & Land Bank/Share (A+B)			**105**

Source: Company

Octroi tax abolition may add 1-2% to bottom line

CEAT is the only tyre company to pay Octroi at the rate of 1.5% because of its plant located in the state of Maharashtra. However, the Maharashtra State Government is expected to abolish the tax which will directly reflect in the bottom line and should further boost the margins of the company.

Valuations

We expect CEAT's revenues to grow at a CAGR of 12.1% given the strong growth opportunities in the speciality tyres segment, return of pricing power, improved product mix & productivity and improved margins contributing positively to the Bottom Line. At the CMP Rs 107 the stock is trading at 8.3x and 5.8x its FY2008E and FY2009E EPS of Rs 12.9 and Rs 18.6 respectively. With its land and investment valued at Rs 26.3/share (after MTM discount of 75%), the stock provides an investment opportunity to Buy a Tyre stock at an effective price of Rs 81 at a multiple of 4.4x its FY2009E EPS. **We initiate coverage with a BUY on CEAT with a price target of Rs 138 providing an upside of 29%.**

Exhibit 6: Target Price Estimation

PARAMETERS		VALUATION RATIONALE
EPS	18.6	Strong growth led by capacity addition and improved product mix resulting in improved margins
P/E	6.0	Discount to Average Sector P/E(x) as a result of comparatively lower operational performance
Core Business Fair Value	111.8	Based on stand alone operational performance
Investments & Land	105	Investment book & Land Bank carried at cost price with huge hidden premium
Discount @ 75%	26.3	Discount to the average marked to market
Target Price	138	

Source: Company

Profit & Loss Statement

Rs mn

Y/E March	FY2006	FY2007E	FY2008E	FY2009E
Net Sales	**17,441**	**21,613**	**24,694**	**27,163**
% chg	*13.8*	*23.9*	*14.3*	*10.0*
Total Expenditure	16,668	20,375	23,070	25,264
EBIDTA	**773**	**1,239**	**1,625**	**1,899**
(% of Net Sales)	*4.4*	*5.7*	*6.6*	*7.0*
Other Income	226	204	198	222
Depreciation& Amortisation	224	310	331	351
Interest	723	701	599	480
PBT	**52**	**432**	**892**	**1,290**
(% of Net Sales)	0.3	2.0	3.6	4.7
Tax	47	147	303	439
(% of PBT)	*90.0*	*34.0*	*34.0*	*34.0*
PAT	**5**	**285**	**589**	**851**
Add/(Less): Extarord. Items	1.8	-	-	-
Adj PAT	**7**	**285**	**589**	**851**
% chg	-	-	*106.8*	*44.5*

Balance Sheet

Rs mn

Y/E March	FY2006	FY2007E	FY2008E	FY2009E
SOURCES OF FUNDS				
Equity Share Capital	457	457	457	457
Reserves& Surplus	3,033	3,266	3,699	4,342
Shareholders Funds	**3,490**	**3,723**	**4,156**	**4,798**
Total Loans	4,176	4,126	3,526	2,826
Deffered Tax Liability	140	150	162	174
Total Liabilities	**7,806**	**7,999**	**7,844**	**7,799**
APPLICATION OF FUNDS				
Gross Block	11,068	11,491	11,811	12,091
Less: Acc. Depreciation	3,851	4,161	4,492	4,842
Net Block	**7,217**	**7,330**	**7,319**	**7,248**
Capital Work-in-Progress	43	20	200	20
Investments	**1,278**	**1,278**	**1,278**	**1,478**
Current Assets	5,393	6,957	7,713	8,586
Current liabilities	6,125	7,585	8,667	9,533
Net Current Assets	**(732)**	**(629)**	**(953)**	**(948)**
Miscellaneous Expenses	-	-	-	-
Total Assets	**7,806**	**7,999**	**7,843**	**7,799**

Cash Flow Statement

Rs mn

Y/E March	FY2006	FY2007E	FY2008E	FY2009E
Pre tax cash from operations	60	547	1,037	1,431
Other income/prior period ad	228	204	198	222
Net Cash before Tax	288	752	1,235	1,653
Tax	(47)	(147)	(303)	(439)
Cash profits	241	605	932	1214
Change in Working Capital	(222)	439	313	251
Free Cash Flow	**20**	**1,044**	**1,245**	**1465**
(Add)/Dec in fixed assets	(2,040)	(400)	(500)	(100)
(Add)/Dec in Investments	630	-	-	(200)
(Inc)/Dec in Loans/adv	4,622	(151)	(111)	(89)
Investing Activities	**3,212**	**(551)**	**(611)**	**(389)**
Inc/(Dec) in debt	(330)	(50)	(600)	(700)
Inc/(Dec) in equity/premium	105.8	-	-	-
Add/(red) to res-Spl.item	(2,924)	-	-	-
Dividends	-	(52)	(156)	(208)
CF from Financing	**(3,148)**	**(102)**	**(756)**	**(908)**
Inc./(Dec.) in Cash	84	390	(123)	168
Opening Cash balances	312	396	787	664
Closing Cash balances	396	787	664	831

Key Ratios

Y/E March	FY2006	FY2007E	FY2008E	FY2009E
Valuation Ratio (x)				
P/E	700.2	17.2	8.3	5.8
P/E (Cash EPS)	21.3	8.2	5.3	4.1
P/BV	1.4	1.3	1.2	1.0
EV / Sales	0.5	0.4	0.3	0.3
EV / EBITDA	11.2	6.7	4.8	3.6
Per Share Data (Rs)				
Diluted EPS	0.2	6.2	12.9	18.6
Diluted Cash EPS	5.0	13.0	20.1	26.3
DPS	-	1.0	3.0	4.0
Book Value	76.4	81.5	91.0	105.0
Returns (%)				
ROE	0.2	7.7	14.2	17.7
ROCE	10.1	14.4	19.4	23.2
Dividend Payout (%)	-	18.3	26.5	24.5
Operating Ratio				
Raw Material / Sales (%)	69.5	68.9	68.5	68.2
Inventory (days)	38.4	38.0	38.0	38.0
Debtors (days)	53	53	53	53
Debt / Equity (x)	1.2	1.1	0.8	0.6

Goodyear India Ltd

Initiating Coverage - Sector: Tyre

FINQUEST
YOUR FINANCIAL GOAL. OUR QUEST

Goodyear India Ltd

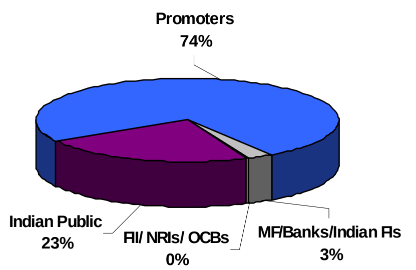
Buy

CMP: Rs 155 | **Target Price: Rs 200**

Key Data

Market Cap (Rs bn)	3.6
Market Cap (US$ mn)	82.2
52 WK High / Low	207 / 54
Avg Daily Volume	31145
Face Value (Rs)	10
BSE Sensex	13072
Nifty	3822
BSE Code	500168
NSE Code	GOODYEAR
Reuters Code	GDYR.BO
Bloomberg Code	GDYR IN

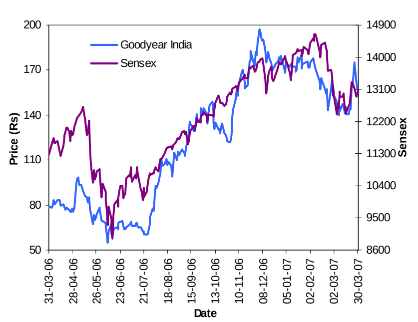
Shareholding Pattern (%)



Price Performance (%)

	Absolute	Relative
3 Months	(13.2)	(8.1)
6 Months	7.5	2.6
12 Months	96.5	80.6

Good Year India vs BSE



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Goodyear India Ltd (GIL) is one of the leading tyre company with strong brand image and around 6% market share. GIL is a preferred tyre supplier to OEM's and a market leader in tractor segment.

Investment Argument

- With governments increased focus on agricultural development and an increase in planned agricultural expenditure, we believe that tractor segment will be one of the major beneficiaries. GIL being the market leader in this segment is likely to be a key beneficiary.
- GIL has a distinct recognition of being a preferred supplier to most of the OEM's. With tyre demand from OEM segment likely to rise at a CAGR of around 10% over the next 5 years, we believe that GIL would see decent volume growth from OEM's
- GIL is expanding its passenger car radial capacity from 4,500 units/day to 10,000 units/day with a planned capex of Rs 800mn. This capacity is expected to get fully operational by 2008. Driven by the expansions and value addition we expect GIL to witness a Top Line CAGR of 15.6% (2006-2009E).
- To garner a larger pie of the lucrative replacement market, Goodyear India has announced plans to expand its dealer network. The company plans to invest Rs 500mn to set up 300 'shop-in-shop' exclusive retail outlets across India. GIL has already set up 50 such outlets in 2006 and will add another 250 such outlets by 2008.

Valuations

At CMP 155, the stock trades at 6.3x CY2007E EPS of Rs 24.7 and 5.4x CY2008E EPS of Rs 28.6. **We initiate coverage with a BUY recommendation and a Target Price of Rs 200.**

Key Financials

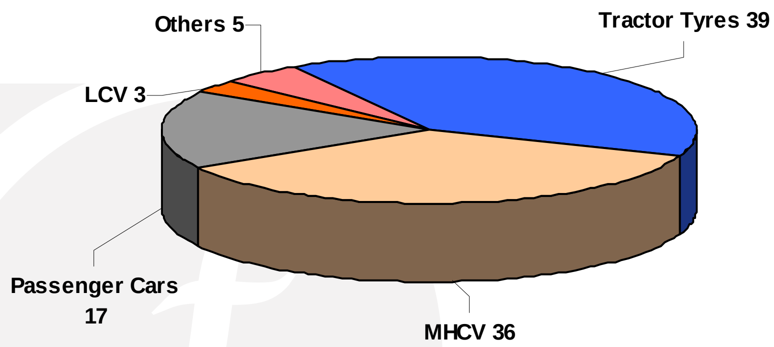
Y/E Dec. (Rs mn)	CY2005	CY2006P	CY2007E	CY2008E
Net Sales	**6,875**	**8,287**	**9,713**	**11,071**
% chg	*8.2*	*20.5*	*17.2*	*14.0*
Net Profit	**88**	**452**	**571**	**660**
% chg	*16.8*	*413.7*	*26.3*	*15.7*
EPS (Rs)	**3.9**	**19.6**	**24.7**	**28.6**
EBITDA Margin (%)	3.5	7.4	8.1	8.0
P/E (x)	39.7	7.9	6.3	5.4
P/CEPS (x)	15.8	6.4	5.2	4.5
ROE (%)	9.8	33.5	29.7	25.6
ROCE (%)	10.5	26.4	24.9	24.2
P/BV (x)	4.0	2.7	1.9	1.4
EV/EBITDA (x)	14.8	5.8	4.6	4.0

Source: Company; FQ Research

Company Background

Goodyear India Ltd, incorporated as Goodyear Tire and Rubber Company (India), acquired its present name in 1961 when it became a public limited company. Goodyear India has a technical-cum-financial collaboration with Goodyear Tire and Rubber Company, USA. The American parent (which holds 74% equity stake) is among the top three players in the world. GIL manufactures tyres and rubber goods used by the automobile industry, at its plant located in Ballabgarh, Uttar Pradesh and Aurangabad in Maharashtra. Goodyear's product profile includes ultra large earthmover tyres, which are import substitutes, power tread passenger radial tyres, light and medium commercial truck tyres, farm tyres, automotive tyres, etc, which are marketed under the Goodyear brand.

Exhibit 1: Product Mix



Source: Company; FQ research

GIL has significant presence in the OEM market supplying tyres to majority of the leading players. It is trying to expand its presence in the replacement market through innovative distribution initiatives. Only 10% of GIL's revenue's are contributed by exports. This is largely on account of its parent Goodyear Tire and Rubber Company having a significant presence in international markets. Thus, GIL is largely dependent on domestic tyre industry for its revenues.

Investment Arguments

Market Leader in Tractor Tyre Segment

GIL is the market leader in the tractor tyre segment with market share of 23% in tractor front tyres and ~25% in tractor rear tyres segment. This segment contributes around 39% of the company's revenues. We expect the demand for tractors to surge in future given governments thrust on improving the agricultural output and increase in planned expenditure for the same in the recent budget. Increasing awareness regarding the use of modern techniques of farming among farmers will also trigger tractor sales growth in years to come. Being a market leader in this segment, we expect GIL to benefit significantly from these likely changes. GIL manufactures Tractor tyres along with other tyres for various segments at the Ballabgarh plant in Haryana. In the tractor segment, GIL is an original equipment supplier to Punjab Tractors, TAFE, Escorts, ITL, and Eicher.

OEM supplier to various manufacturers

GIL is the sole tyre manufacturer in India that supplies tyres to all the car manufacturers in the country and thus figures amongst the top radial tyre producers in the country. The company has been a pioneer in introducing tubeless radial tyres in the passenger car segment.

GIL has a rich clientele in the passenger car segment which includes Maruti, Telco, Mahindra & Mahindra, Ford, Fiat and many more. Similarly, in T&B segment it's esteemed customers include OEMs like Tata Motors, Ashok Leyland and Swaraj Mazda. Even in the OTR segment it is a major supplier to the likes of Coal India Ltd, Escorts, L&T, TISCO and some major steel plants in the country.

All set to capture the boom in luxury car market

With the rising income and aspiration level's in the Indian economy, we can see a spurt in demand for high end luxurious cars in India. GIL has rolled out a new range of tyres under the brand 'Excellence' designed specially for the premium segment. The target market for the same being executives in the age group of 35-65 years.

The series will be available for most luxury car models including Hyundai Sonata, Honda Accord, Honda Civic, Skoda Octavia, Mercedes E, C and S Class and Audi A4, A6 and TT among others and will come in 10 variants. The product will initially cater to luxury passenger car owners in metros such as Delhi, Mumbai, Bangalore and the mini metros.

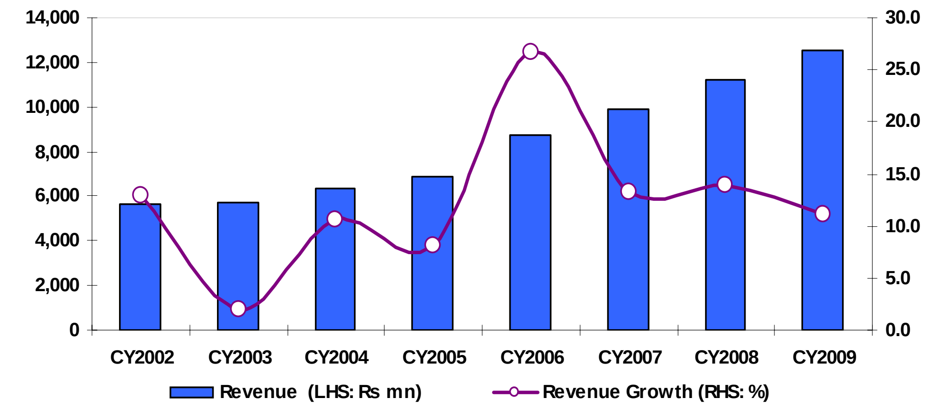
GIL will initially import the tyres from China and depending on the response, manufacture the same at it's Aurangabad facility.

Expansion Plans for Passenger car segment

GIL control's 10% of the Passenger Car segment and it constitutes 17% of its revenues. GIL is now focused on the passenger car market with value-added services and diverse product range. Thus, the company has initiated a Rs 800mn expansion plan to expand its production capacity at Aurangabad in Maharashtra. The company's Passenger tyre capacity will increase from 4,500 units per day to 10,000 units per day. The additional capacity is expected to go on stream in 2008.

With the said expansion the company is hoping to cash in on the rising replacement demand (in addition to demand from OE segment) from quality conscious customers due to increased awareness among consumers, bigger vehicle base and tyre wear and upsizing. Driven by the expansion and value addition we expect GIL to witness a Top Line CAGR of 15.6% (CY2006-2008E).

Exhibit 2: Revenue trend



Source: Company; FQ research

Expanding its distribution network

To garner a larger pie of the lucrative replacement market, Goodyear India has announced plans to expand its dealer network. The company plans to invest Rs 500mn to set up 300 'shop-in-shop' exclusive retail outlets across India. GIL has already set up 50 such outlets in 2006 and will add another 250 such outlets by 2008. These stores would offer customers a wider choice and offer value added products and services like wheel alignment & balancing, advise on tyre maintenance, offer accessories such as alloy wheels, provide car-care products including car perfumes, car wash and tyre shine etc.

Valuation

The OEM market in India is expected to witness a CAGR of around 10% over the next 5 years. Considering GIL's dominant position in the OEM market we believe GIL is ideally placed to capitalise on this growth. GIL is enhancing its distribution network through the set up of exclusive shop-in-shop's, this will help the company to expand its footprints in the growing replacement market. We believe these developments will help the company post a top line and bottom line CAGR of 15.6% and 20.9% respectively (CY2006-09E). At CMP 155, the stock trades at 6.3x CY2007E EPS of Rs 24.7 and 5.4x CY2008E EPS of Rs28.6. **We initiate coverage with a BUY recommendation and a Target Price of Rs 200.**

Profit & Loss Statement Rs mn

Y/E Dec.	CY2005	CY2006P	CY2007E	CY2008E
Net Sales	**6875**	**8287**	**9713**	**11071**
% chg	*8.2*	*20.5*	*17.2*	*14.0*
Total Expenditure	6633	7672	8931	10185
EBIDTA	**242**	**614**	**782**	**886**
(% of Net Sales)	*3.5*	*7.4*	*8.1*	*8.0*
Other Income	92	140	154	180
Depreciation& Amortisation	139	108	123	140
Interest	90	91	112	115
PBT	**105**	**555**	**701**	**811**
(% of Net Sales)	*1.5*	*6.7*	*7.2*	*7.3*
Tax	17	103	130	150
(% of PBT)	*15.8*	*18.55*	*18.6*	*18.6*
PAT	**88**	**452**	**571**	**660**
% chg	*4.9*	*413.7*	*26.28*	*15.7*
Extraordinary Item	2.2	0.0	0.0	0.0
Adj PAT	**90**	**452**	**571**	**660**

Balance Sheet Rs mn

Y/E Dec.	CY2005	CY2006P	CY2007E	CY2008E
SOURCES OF FUNDS				
Equity Share Capital	231	231	231	231
Reserves& Surplus	666	1,118	1,689	2,349
Shareholders Funds	**896**	**1,348**	**1,919**	**2,580**
Total Loans	950	1,100	1,350	1,250
Deffered Tax Liability	-	-	-	-
Total Liabilities	**1,846**	**2,448**	**3,269**	**3,830**
APPLICATION OF FUNDS				
Gross Block	2,360	2,710	3,110	3,410
Less: Acc. Depreciation	1,346	1,454	1,577	1,717
Net Block	**1,014**	**1,256**	**1,533**	**1,693**
Capital Work-in-Progress	58	50	100	150
Investments	**113**	**113**	**213**	**327**
Current Assets	2,417	3,140	3,714	4,294
Current liabilities	1,766	2,131	2,311	2,665
Net Current Assets	**651**	**1,009**	**1,403**	**1,629**
Misc expd	**10**	**20**	**20**	**30**
Total Assets	**1,846**	**2,448**	**3,269**	**3,830**

Cash Flow Statement Rs mn

Y/E Dec.	CY2005	CY2006P	CY2007E	CY2008E
Profit before tax	105	555	701	811
Depreciation	139	108	123	140
Change in Working Capital	134	358	394	226
Direct taxes paid	17	103	130	150
Cash Flow from Operations	**94**	**202**	**300**	**574**
Inc./ (Dec.) in Fixed Assets	19	234	327	210
Free Cash Flow	**75**	**(32)**	**(27)**	**364**
Inc/ (dec) in investment	-	-	100	114
Issue of Equity/ Preference	86	452	571	660
Inc/ (dec) in loans	37	150	250	(100)
Dividend Paid (Incl. Tax)	-	-	-	-
Others	136	(243)	(543)	(642)
Cash Flow from Financing	**259**	**359**	**277**	**(82)**
Inc./(Dec.) in Cash	334	327	150	168
Opening Cash balances	**390**	**724**	**1,051**	**1,201**
Closing Cash balances	**724**	**1,051**	**1,201**	**1,369**

Key Ratios

Y/E Dec.	CY2005	CY2006P	CY2007E	CY2008E
Valuation Ratio (x)				
P/E	39.7	7.9	6.3	5.4
P/E (Cash EPS)	15.8	6.4	5.2	4.5
P/BV	4.0	2.7	1.9	1.4
EV / Sales	0.5	0.4	0.4	0.3
EV / EBITDA	14.8	5.8	4.6	4.0
Per Share Data (Rs)				
EPS	3.9	19.6	24.7	28.6
Cash EPS	9.9	24.3	30.1	34.7
DPS	-	-	-	-
Book Value	38.9	58.4	83.2	111.8
Returns (%)				
ROE	9.8	33.5	29.7	25.6
ROCE	10.5	26.4	24.9	24.2
Dividend Payout	-	-	-	-
Operating Ratio				
Raw Material / Sales (%)	73.2	76.3	75.0	75.0
Debtors (days)	51.3	51.3	53.0	54.0
Creditors (days)	80.0	80.0	77.0	78.0
Debt / Equity (x)	1.1	0.8	0.7	0.5

J K Industries Ltd

J K Industries Ltd

Buy

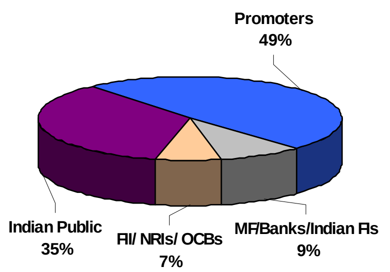
Initiating Coverage - Sector: Tyre

CMP: Rs 112	**Target Price: Rs 155**

Key Data

Market Cap (Rs bn)	3.4
Market Cap (US$ mn)	79.0
52 WK High / Low	160 / 65
Avg Daily Volume	181655
Face Value (Rs)	10
BSE Sensex	13072
Nifty	3822
BSE Code	530007
NSE Code	JKTYRE
Reuters Code	JKIN.BO
Bloomberg Code	JKI IN

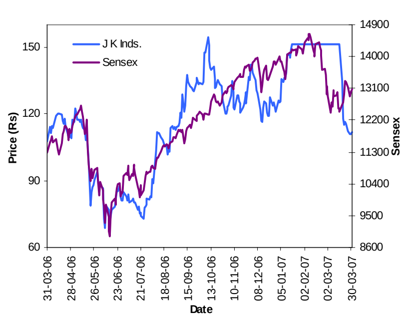
Shareholding Pattern (%)



Price Performance (%)

	Absolute	Relative
3 Months	(7.7)	(2.5)
6 Months	(16.5)	(21.5)
12 Months	3.9	(12.0)

J K Industries vs BSE



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JK Industries Ltd (JKI) is the flagship company of the Hari Shankar Singhania Group. JKI is the 3rd largest player in the tyre industry controlling 16% of the market. The company has initiated a capex of Rs 2.3bn to add capacities in most of its operational segments. Being one of the leading players in tyre industry we expect JKI to benefit significantly from the rising tyre demand.

Investment Argument

- JKI has expanded its PC radial tyre capacity from 2.5mn units p.a. to 3.2mn units p.a., Truck radial tyre capacity to 0.35mn units and the bias tyre truck capacity to 2.6mn units p.a. On the back of these expansions we expect JKI to witness a Top Line and Bottom Line CAGR of 21% and 136% respectively (2005-06 & 2007-08E).
- JKI is the 2nd largest player in the Truck & Bus (T&B) segment (biggest contributor in volumes). The company's marketing prowess and capacity additions will help JKI to maintain its leadership in T&B radial segment and tap the growing demand for bias truck tyres in India as well.
- The company has a strong global distribution network spread across 60 countries. JKI's tyre brands viz JK tyres and Vikrant are well recognised in several global markets. JKI is the largest tyre exporter from India dominating 30% of market share.
- JKI has been a fore runner as far as technological development and quality are concerned with significant focus on R&D. JKI has a technological tie up with Continental AG, one of the largest tyre manufacturers in the world.

Valuations

The buoyancy in OEM demand and replacement demand in conjunction with capacity additions undertaken by JKI will aid volume growth for JKI. JKI being a dominant player in most of the segments will be the fore runner to take advantage of these developments. **At CMP the stock trades at 8.5x 2006-07E EPS of Rs 13.1 and 5.1x 2007-08E EPS of Rs 21.9. We initiate coverage with a BUY rating and a 12 month target price of Rs 155.**

Key Financials

Y/E Sept. (Rs mn)	2004-05	2005-06P	2006-07E	2007-08E
Net Sales	**20786**	**25897**	**31492**	**37935**
% chg	*8.3*	*24.6*	*21.6*	*20.5*
Net Profit	**89**	**120**	**404**	**675**
% chg	*(27.5)*	*35.4*	*235.5*	*67.2*
EPS (Rs)	**2.4**	**3.9**	**13.1**	**21.9**
EBITDA Margin (%)	5.5	5.8	6.6	6.8
P/E (x)	47.1	28.6	8.5	5.1
P/CEPS (x)	3.9	3.0	2.3	1.9
RoE (%)	1.1	2.0	6.5	9.9
RoCE (%)	4.4	6.6	8.9	11.2
P/BV(x)	0.5	0.6	0.6	0.5
EV/EBIDTA	10.5	8.3	6.0	4.7

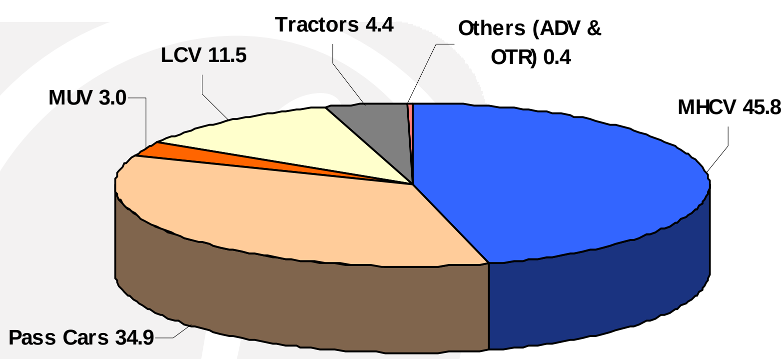
Source: Company; FQ Research

Company Background

JK Industries Ltd (JKI) is a leading manufacturer of Automobile tyres in India. JKI is the flagship company of the Hari Shankar Singhania group which has a diversified presence in various businesses such as Pharma, Sugar, Agri genetics and Tyres. In 2002-03, as a part of a group restructuring exercise the non tyre businesses were demerged from the company and JKI now holds investments in these group companies. The company is currently undergoing another round of restructuring exercise by transfering its investments into a separate company by the name of Netflier Technologies Ltd.

JKI has four tyre manufacturing plants located at Rajasthan, Madhya Pradesh and Karnataka with a capacity of 7.4mn units. Besides being a dominant player in the lucrative Truck and Bus segment the company also has presence in the passenger cars, LCVs and tractor tyres.

Exhibit 1: Product mix(2005-06)



Source: Company; FQ research

JKI is one of the major exporters of tyres from India covering a wide geographical area of 60 countries and accounting for nearly 30% of India's total tyre exports. In order to facilitate and promote the same, the company has three fully owned subsidaries in the foreign market, namely JK International-UK, JK Asia Pacific - Hong Kong and JK Asia Pacific (S) Pte Ltd. The company recently undertook a massive expansion of 1.2mn units in 2005-06 and would be adding another1 mn units by the end of March 2007. The capital outlay for the said expansions would be Rs 2.3bn. JKI has a technological tie up with Continental AG, Germany (the 4th largest tyre manufacturer in the world) for providing modern technology.

Investment Arguments

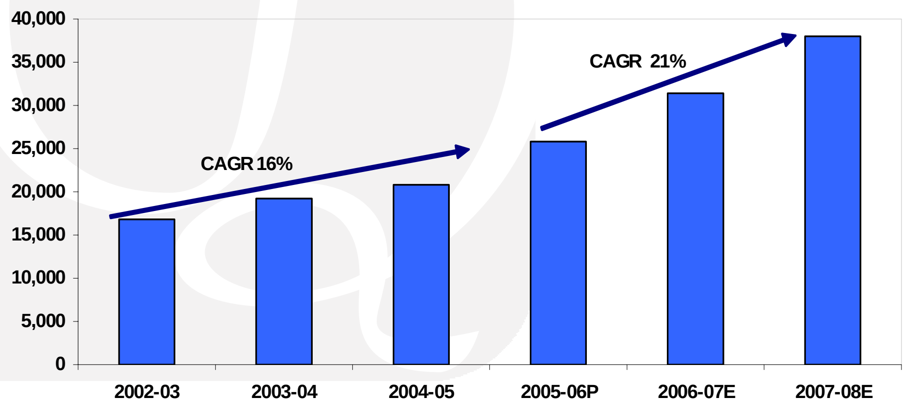
Augmenting Capacities to drive growth

JKI in the past three years has been running its plant at optimum capcity utilization levels. The company has chalked out a capital outlay of Rs 2.3bn for expansion and modernization of its facilities. The company, recently finished the first bout of its expansions wherein they have expanded their manufacturing capacity from 6.3mn units p.a to 7.5mn units p.a.

These expansion entails an increase in passenger car radials capacity by 0.72mn units and LCV radials by 0.28mn units, this will be further scaled up by 1.09mn units. These expansions will take JKI total manufacturing capacity up to 8.7mn units p.a. Further, JKI is also adding 20,000 high end OTR tyres to its repetoire and will commision its operation by March,2008. The total capex of Rs 2.3bn will be funded through debt of Rs 1.6bn, preferential allotment to promoters of Rs 400mn and the balance through internal accruals.

In 2005-06 the company's tyre sales volumes have expanded by 12.59%YoY driven by capacity additions. JKI witnessed robust volume expansion in most of its key segments like MHCV, Passenger cars and LCV tyres which grew by 15.2%YoY, 15.8%YoY and 17.5%YoY respectively. We believe that the strong volume growth driven by capacity additions and improving product mix will help JKI's top line to expand at CAGR of 21% (in the next two years) from Rs 25.8bn in 2005-06 to Rs 37.9bn in 2007-08E.

Exhibit 2: Revenue Growth



Source: Company; FQ research

Strong presence across all major segments

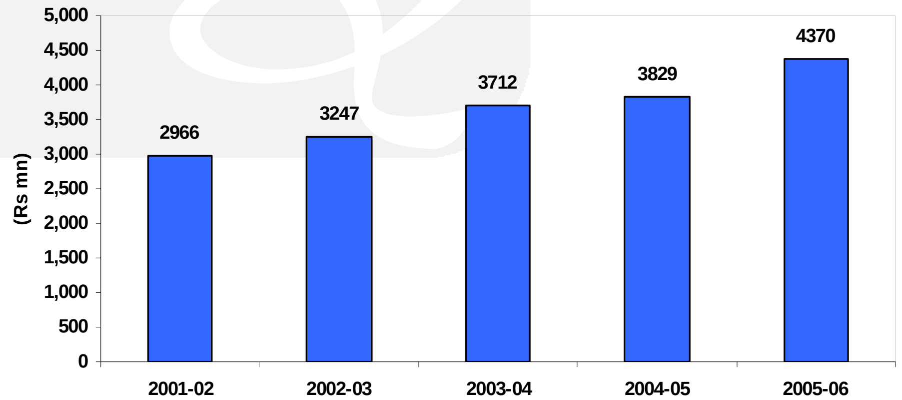
- **Truck & Bus segment (T&B):** JKI is a leading player in the truck and bus segment with 24% market share closely following the market leader Apollo Tyres (28%). This segment contributes nearly 45% of the companys top line. JKI has a capacity of 2.6mn units p.a (increased from 2.3mn units p.a) for T&B bias tyres and in the T&B radial capacity of 0.35mn units p.a. (increased from 0.24mn units p.a). Even though, the truck and bus radial market in India is at a primitive stage, in future this segment should witness steady growth. JKI is a market leader in the T&B radial market with a dominant share of over 50%. The company markets its tyres under two brands viz. JK – bias tyres and Vikrant- radial tyres. The companys marketing prowess and capacity additions will help JKI to maintain its leadership in the T&B radial segment and meet the growing demand for radial truck tyres in India.

- **Passenger Car Tyres:** The passenger car radial tyre segment contributes close to 35% of JKI's revenues and has a capacity of 3.42mn radial tyres. The company is again a close second to MRF (17%) with a market share 16% in thsi segment. In the last three years the company has increased its car radial capacity by almost 2.5x. JKI markets its passenger car radials under the name of Ultima XP and Jet. The company has been agressively marketing its tyres in the OEM segment and was named the single source vendor of the Maruti Swift car. JKI will benefit significantly from the rising demand in the OEM and replacement market.
- **LCV tyres:** This segment contributes 7% in JKI's total revenue pie and is fourth largest player.
- **Other segments:** Other segments including MUV, ADR, OTR and tractors contribute a miniscule portion to the companys revenues. In the tractor's front and rear tyre segment JKI's share stands at 9% and 13% respectively. It also manufactures ADR and OTR tyres with a capacity of 0.32mn units p.a. The company is planning to expand its OTR capacity, with the addition capacity of 20,000 units of highly specialised OTR tyres by March 2008. The company, continued thrust on development of new sizes of products and quality has helped to expand its market share and grow its revenues in these segments also.

Export's continue to be a focus area

JKI has been consistently growing its exports and we expect this growth momentum to continue going forward due to increased emphasis on exports. Due to company's strong global distribution network and presence across 60 countries JK tyres is a well recognised brand in several global markets. JKI dominates the Indian Tyre export with ~30% of India's total tyre exports and is the largest exporter of tyres from the country. The company also undertakes outsourcing activities from China for International & Chinese markets in its own brands.

Exhibit 3: JK Industries Exports

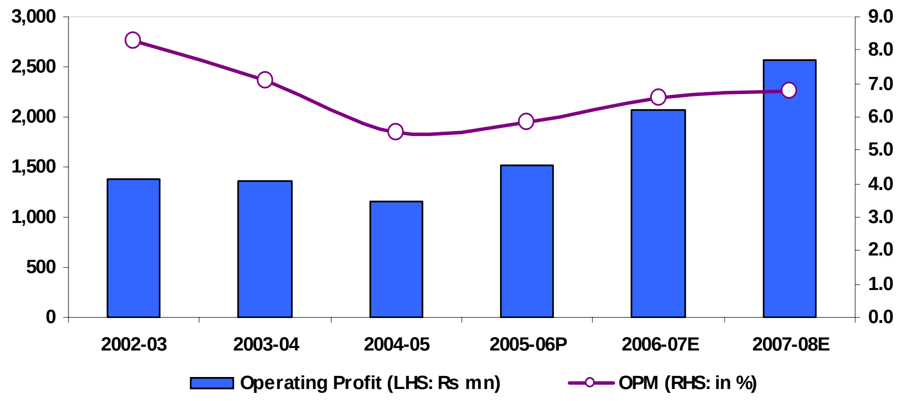


Source: Company; FQ research

Improved realizations and slowdown in cost push to drive margins

JKI has been a technology leader and continues to maintain its technology leadership. We believe that the raw material prices viz. Natutral rubber, carbon black and NTCF have peaked and should stabilize from these levels. The company's innovation,improved productivity, stabilisation of raw material prices and improved product mix to result in better realizations margin expansion. We expect the companys operating profit to witness a CAGR of 30% (2005-06 to 2007-08E) and expand to Rs 2.6bn from the current Rs 1.5bn. We expect the company OPM's to expand from 5.8% (2005-06) to 6.8% (2007-08E).

Exhibit 4: Operating Profit & Margin trend



Source: Company; FQ research

Equity restructuring

JKI recently went through a restructuring exercise, wherein it is hiving off the investments into a separate company by the name of Netflier Technologies Ltd (NTL). As a result JKI will now be having only the core business of manufacture and marketing of Tyres. Under, the scheme of arrangement each shareholder of JK industries Ltd will receive 3 shares of JKI and 1 share of NTL for every 4 shares currently held. The investments will be transferred to NTL at book value.

Research & Development at the fore front

JKI has been a fore runner as far as technological development and quality are concerned with significant focus on R&D. The company, is the pioneer of radial technology in India and have established many firsts in the industry and continues to do so. This is also evident from the fact that the company is a leader in the Radial Truck tyre market, where the level of radialisation in India is abysmally low at 2%. JKI consistently undertakes extensive R&D activity as well as through adoption of latest technology from its collaborator, Continental AG will assist the company to accelerate its growth prospects.

Valuation

The buoyancy of the OEM demand and replacement demand in conjunction with the capacity additions undertaken by JKI will aid volume growth for JKI. Changing product mix, return of pricing power and stabilization of raw material prices will augur well for the Tyre industry. JK industries being a dominant player in most of the segments will be at the fore front to take advantage of these developments. We expect JKI to witness a Top Line and Bottom Line CAGR of 21% and 136% over 2005-06P and 2007-08E. This translates into an annualised EPS of Rs 21.9 2008-09E. **At CMP the stock trades at 8.5x 2006-07E EPS of Rs 13.1 and 5.1x 2007-08E EPS of Rs 21.9. We Initiate Coverage with a BUY rating and a Target Price of Rs 155.**

Profit & Loss Statement Rs mn

Y/E Sept.	2004-05	2005-06P	2006-07E	2007-08E
Net Sales	**20,786**	**25,897**	**31,492**	**37,935**
% chg	*8.3*	*24.6*	*21.6*	*20.5*
Total Expenditure	19,635	24,385	29,420	35,374
EBIDTA	**1,151**	**1,512**	**2,072**	**2,561**
(% of Net Sales)	*5.5*	*5.8*	*6.6*	*6.8*
Other Income	193	205	48	51
Depreciation& Amortisation	637	709	726	820
Interest	673	791	817	827
PBT	**34**	**218**	**577**	**965**
(% of Net Sales)	*0.2*	*0.8*	*1.8*	*2.5*
Tax	(133)	48	173	289
(% of PBT)	*(387.2)*	*21.8*	*30.0*	*30.0*
PAT	**168**	**170**	**404**	**675**
Add/(Less): Extarord Items	(78.7)	(49.7)	-	-
Adj PAT	**89**	**120**	**404**	**675**
% chg	*(27.5)*	*35.4*	*235.5*	*67.2*

Balance Sheet Rs mn

Y/E Sept.	2004-05	2005-06P	2006-07E	2007-08E
SOURCES OF FUNDS				
Equity Share Capital	375	308	308	308
Reserves& Surplus	7,451	5,609	5,926	6,496
Shareholders Funds	**7,826**	**5,917**	**6,233**	**6,803**
Total Loans	8,305	9,439	9,389	9,189
Deffered Tax Liability	113	-	-	-
Total Liabilities	**16,244**	**15,356**	**15,622**	**15,992**
APPLICATION OF FUNDS				
Gross Block	19,387	20,842	21,348	21,568
Less: Acc. Depreciation	7,647	8,600	9,326	10,146
Net Block	**11,740**	**12,242**	**12,021**	**11,422**
Capital Work-in-Progress	616	225	20	200
Investments	**2,500**	**615**	**665**	**845**
Current Assets	8,125	10,135	12,380	14,928
Current liabilities	7,010	7,969	9,482	11,422
Net Current Assets	**1,115**	**2,167**	**2,898**	**3,506**
Miscellaneous Expenses	**273**	**108**	**19**	**20**
Total Assets	**16,244**	**15,356**	**15,622**	**15,992**

Cash Flow Statement Rs mn

Y/E Sept.	2004-05	2005-06P	2006-07E	2007-08E
Pre tax cash from operations	357	774	1,344	1,732
Other income/prior period ad	115	156	48	51
Net Cash before Tax	472	929	1,392	1,783
Tax	133	(48)	(173)	(289)
Cash profits	605	882	1219	1493
Change in Working Capital	237	(948)	(418)	(187)
Free Cash Flow	**842**	**(66)**	**800**	**1,306**
(Add)/Dec in fixed assets	(757)	(820)	(300)	(400)
(Add)/Dec in Investments	22	1,886	(50)	(180)
(Inc)/Dec in Loans/advances	(102)	(72)	(276)	(318)
Investing Activities	**(837)**	**994**	**(626)**	**(898)**
Inc/(Dec) in debt	798	1,134	(50)	(200)
Inc/(Dec) in equity/premium	-	(66.7)	-	-
Add/(red) to res-Spl.item	(750)	(1,875)	-	-
Dividends	(75)	(88)	(88)	(105)
CF from Financing	**(27)**	**(895)**	**(138)**	**(305)**
Inc./(Dec.) in Cash	(21)	32	37	103
Opening Cash balances	382	361	393	430
Closing Cash balances	361	393	430	533

Key Ratios

Y/E Sept.	2004-05	2005-06P	2006-07E	2007-08E
Valuation Ratio (x)				
P/E	47.1	28.6	8.5	5.1
P/E (Cash EPS)	5.2	3.9	3.0	2.3
P/BV	0.5	0.6	0.6	0.5
EV / Sales	0.6	0.5	0.4	0.3
EV / EBITDA	10.5	8.3	6.0	4.7
Per Share Data (Rs)				
Diluted EPS	2.4	3.9	13.1	21.9
Diluted Cash EPS	21.5	28.6	36.7	48.6
DPS	-	2.5	2.5	3.0
Book Value	208.9	192.2	202.4	221.0
Returns (%)				
ROE	1.1	2.0	6.5	9.9
ROCE	4.4	6.6	8.9	11.2
Dividend Payout (%)	84.3	72.9	21.7	15.6
Operating Ratio				
Raw Material / Sales (%)	67.2	69.6	68.9	68.6
Inventory (days)	42.9	51.9	52.5	52.5
Debtors (days)	72	67	68	68
Debt / Equity (x)	1.1	1.6	1.5	1.4

MRF Ltd

MRF Ltd

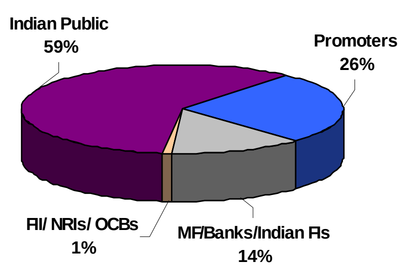
Not Rated

CMP: Rs 3341

Key Data

Market Cap (Rs bn)	14.2
Market Cap (US$ mn)	325.0
52 WK High / Low	4785 / 2025
Avg Daily Volume	2700
Face Value (Rs)	10
BSE Sensex	13072
Nifty	3822
BSE Code	500290
NSE Code	MRF
Reuters Code	MRF.BO
Bloomberg Code	MRF IN

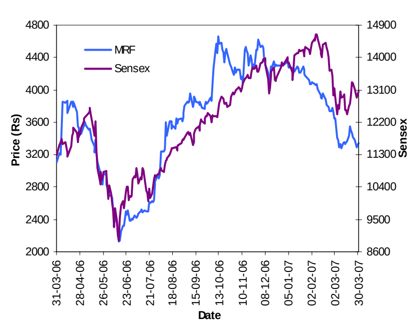
Shareholding Pattern (%)



Price Performance (%)

	Absolute	Relative
3 Months	(22.4)	(17.2)
6 Months	(12.9)	(17.9)
12 Months	7.7	(8.2)

MRF vs BSE



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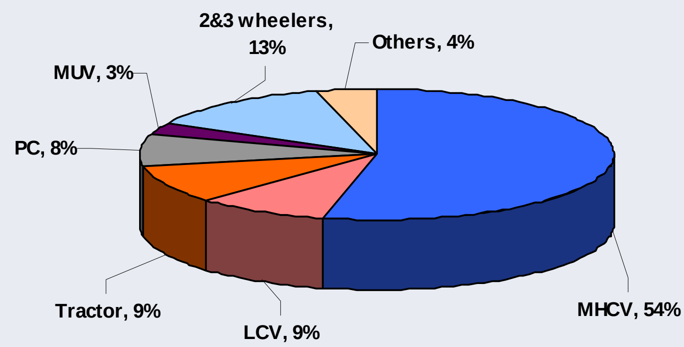
MRF Ltd.was incorporated in 1960 to take over the business of Madras Rubber Factory. MRF later went public in 1961. The company has its factories at Chennai, Arakkonam, Medak, Kottayam, Pondicherry, Gummidipoondi and Goa. The company manufactures tyres and tubes in collaboration with Mansfield Tyres and Rubber, US. Its products include Nylogrip, Zigma, Tyredrome, etc. Its subsidiary companies are MRF Corp and MRF International. The company exports tyres to over 75 countries worldwide.

Exhibit 1: MRF product mix



Source: Company; FQ research

Investment Argument

- **Market leader with focus on T&B segment**

  MRF is the market leader among the domestic tyre companies in India with an overall market share of 22% . The product portfolio of MRF is well diversified and covers all major segments. MRF has strong foothold in the Truck and Bus segment, the largest segment in the tyre industry, with a market share of around 19%. MRF has been consistently expanding its footprint in the T&B segment over the years. The company is also a leader in the passenger car segment with around 17% market share.

Key Financials

Y/E Sept. (Rs mn)	2002-03	2003-04	2004-05	2005-06
Net Sales	**21302**	**25336**	**29856**	**37245**
% chg	*18.4*	*18.9*	*17.8*	*24.7*
Net Profit	**1,174**	**288**	**403**	**799**
% chg	*49.6*	*(75.5)*	*40.0*	*98.2*
EPS (Rs)	**277**	**68**	**95**	**188**
EBITDA Margin (%)	7.5	4.4	5.3	6.2
P/E (x)	12.1	49.2	35.1	17.7
P/CEPS (x)	6.8	11.4	9.4	6.3
ROE (%)	16.7	4.0	5.3	9.7
ROCE (%)	17.8	5.6	6.6	9.5
P/BV (x)	2.0	2.0	1.9	1.7
EV/EBITDA (x)	10.0	14.1	10.9	7.2

Source: Company; FQ Research

- **Expansion Plans**

  MRF recently has planned a capital expenditure of Rs 5-6bn over the next two years to expand production capacities at its three factories at Puducherry, Medak and Arakonam respectively. This move follows the resurgence in demand for truck and light commercial vehicle tyres in the domestic market as well as a robust export market for radial tyres. The expansion is likely to be funded through internal accruals. As per the expansion plans, the capacity for radial tyres at the Puducherry unit may go up to 400,000 units/year from the present 300,000 units/year. At Medak, the capacity for trucks and light commercial vehicles will be scaled up from the present 80,000 units to 100,000 units, while in Arakonam, the company will increase two-wheeler's tyre capacity to 600,000 units from the present 500,000 units.

View & Valuations

MRF, with a strong brand image, pricing power and powerful presence in T&B segment is all set to capitalise and benefit from the demand boom likely to be witnessed in the domestic tyre industry. Considering its expansion plans, we believe MRF would be able to grab a decent share of the increasing future demand. **At the CMP of Rs 3,341 the stock trades at 17.7x FY2006 EPS of Rs 188.5 EV/EBITDA of 7.2x.**

Profit & Loss Statement

Rs mn

Y/E Sept.	2002-03	2003-04	2004-05	2005-06
Net Sales	**21302**	**25336**	**29856**	**37245**
% chg	*18.4*	*18.9*	*17.8*	*24.7*
Total Expenditure	19696	24214	28280	34933
EBIDTA	**1,605**	**1,122**	**1,575**	**2,313**
(% of Net Sales)	*7.5*	*4.4*	*5.3*	*6.2*
Other Income	1395	547	487	635
Depreciation& Amortisation	919	959	1103	1457
Interest	403	282	406	493
PBT	**1678**	**429**	**553**	**998**
(% of Net Sales)	*7.9*	*1.7*	*1.9*	*2.7*
Tax	504	141	150	199
(% of PBT)	*30.0*	*32.9*	*27.2*	*19.9*
PAT	**1,174**	**288**	**403**	**799**
Extraordinary Item	493	(262)	146	306
Adj. PAT	**681**	**550**	**257**	**493**
% chg	*(10.3)*	*(19.2)*	*(53.3)*	*92.1*

Balance Sheet

Rs mn

Y/E Sept.	2002-03	2003-04	2004-05	2005-06
SOURCES OF FUNDS				
Equity Share Capital	42	42	42	42
Reserves& Surplus	7,000	7,192	7,498	8,201
Shareholders Funds	**7,042**	**7,234**	**7,541**	**8,243**
Total Loans	4,726	5,604	7,100	7,289
Deffered Tax Liability	(55)	(37)	(16)	124
Total Liabilities	**11,713**	**12,801**	**14,624**	**15,656**
APPLICATION OF FUNDS				
Gross Block	12,967	14,105	16,359	18,897
Less: Acc. Depreciation	8,983	9,912	10,991	12,401
Net Block	**3,985**	**4,192**	**5,368**	**6,497**
Capital Work-in-Progress	521	1,240	1,520	663
Investments	**751**	**762**	**138**	**702**
Current Assets	9,753	10,538	11,742	12,887
Current liabilities	3,296	3,931	4,144	5,092
Net Current Assets	**6,457**	**6,607**	**7,598**	**7,794**
Misc exp	**-**	**-**	**-**	**-**
Total Assets	**11,713**	**12,801**	**14,624**	**15,656**

Cash Flow Statement

Rs mn

Y/E Sept.	2002-03	2003-04	2004-05	2005-06
Profit before tax	1,678	429	553	998
Depreciation	919	959	1,103	1,457
Change in Working Capital	1,013	150	992	196
Direct taxes paid	504	141	150	199
CF from Operations	**1,080**	**1,097**	**515**	**2,060**
Inc./ (Dec.) in Fixed Assets	350	927	1,456	271
Free Cash Flow	**730**	**170**	**(941)**	**1,789**
Inc/ (dec) in investment	(8)	11	(625)	565
Issue of Equity/ Preference	-	-	-	-
Inc/ (dec) in loans	323	878	1,496	189
Dividend Paid (Incl. Tax)	-	-	-	-
Others	(988)	(1,072)	163	(1,340)
CF from Financing	**(665)**	**(194)**	**1,659**	**(1,151)**
Inc./(Dec.) in Cash	58	(35)	93	73
Opening Cash balances	344	403	367	460
Closing Cash balances	403	367	460	533

Key Ratios

Y/E Sept.	2002-03	2003-04	2004-05	2005-06
Valuation Ratio (x)				
P/E	12.1	49.2	35.1	17.7
P/E (Cash EPS)	6.8	11.4	9.4	6.3
P/BV	2.0	2.0	1.9	1.7
EV / Sales	0.8	0.6	0.6	0.4
EV / EBITDA	10.0	14.1	10.9	7.2
Per Share Data (Rs)				
EPS	276.8	67.9	95.1	188.5
Cash EPS	493.6	294.1	355.3	532.0
DPS	20.0	20.0	20.0	20.0
Book Value	1,660.8	1,706.2	1,778.4	1,944.1
Returns (%)				
ROE	16.7	4.0	5.3	9.7
ROCE	17.8	5.6	6.6	9.5
Dividend Payout	7.2	29.4	21.0	10.6
Operating Ratio				
Raw Material / Sales (%)	65.7	68.5	71.2	70.2
Debtors (days)	67.9	57.4	56.5	52.9
Creditors (days)	46.1	42.1	39.0	42.7
Debt / Equity (x)	0.7	0.8	0.9	0.9

TVS Srichakra

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TVS Srichakra

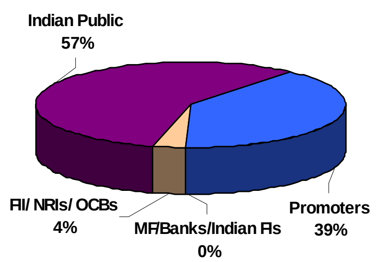
Not Rated

CMP: Rs 84

Key Data

Market Cap (Rs bn)	0.6
Market Cap (US$ mn)	14.8
52 WK High / Low	138 / 46
Avg Daily Volume	9506
Face Value (Rs)	10
BSE Sensex	13072
Nifty	3822
BSE Code	509243
NSE Code	TVSSRICHAK
Reuters Code	TVSC.BO
Bloomberg Code	-

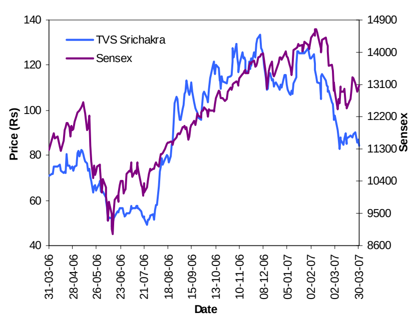
Shareholding Pattern (%)



Price Performance (%)

	Absolute	Relative
3 Months	(23.3)	(18.2)
6 Months	(22.1)	(27.1)
12 Months	18.9	3.0

TVS Srichakra vs BSE



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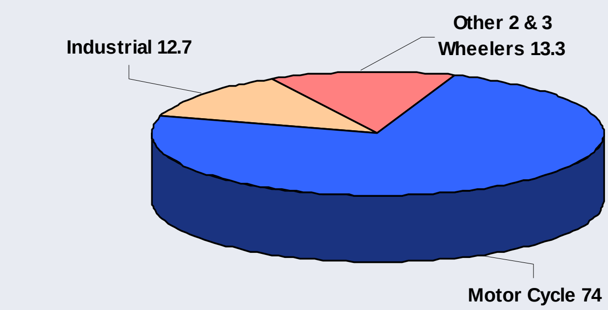
TVS Srichakra Ltd (TSCL) was established in 1982, with the brand TVS Tyres. It manufactures the complete range of tyres and tubes for mopeds, motorcycles, scooters and 3 wheelers. The company's manufacturing facility is located at Madurai, Tamil Nadu. The company is a global player exporting to USA, Europe, Africa, South America and South East Asia.

Exhibit 1: TVS Srichakra product mix



Source: Company; FQ research

Investment Argument

- **Market Leader in Motor Cycle tyres**

  TVS Srichakra has an overall market share of 2.8% and ranks seventh in the industry. However, in the 2 and 3 wheeler segment (including motor cycle) tyres segment, TSCL is the market leader with 28% market share followed by MRF 27% and Falcon 20%.

- **Motor Cycle tyres the major contributor**

  TSCL is largely concentrated on the manufacture of motor cycle tyres which contribute to 74% of its revenues the balance being equally split between other 2 & 3 wheeler tyres and industrial tyres. Effectively, 2 & 3 wheeler tyres contribute 87% of the

Key Financials

Y/E March (Rs mn)	FY2003	FY2004	FY2005	FY2006
Net Sales	**2081**	**2030**	**1987**	**2932**
% chg	*28.3*	*(2.4)*	*(2.1)*	*47.5*
Net Profit	**77**	**69**	**30**	**35**
% chg	*23.8*	*(11.5)*	*(56.8)*	*18.9*
EPS (Rs)	**10.1**	**8.9**	**3.9**	**4.6**
EBITDA Margin (%)	8.2	8.2	5.9	4.6
P/E (x)	8.3	9.4	21.8	18.3
P/CEPS (x)	5.0	5.2	6.4	6.3
RoE (%)	19.7	15.5	8.8	7.5
RoCE (%)	15.8	13.8	8.1	5.0
P/BV(x)	1.6	1.4	1.4	1.3
EV/EBITDA	5.0	5.0	7.3	10.4

Source: Company; FQ Research

company's revenues. TSCL reported an annual sales turnover of Rs 3.3bn and it has an installed capacity of 9.3mn tyres and tubes for the year 2005 - 2006.

- **Major contribution from OEM Segment**

  It has a prominent position in the OEM segment (65% of revenues) of the tyre segment and is a supplier to top 2 wheeler producers, including Bajaj, TVS Suzuki and Hero Honda. The replacement market accounts for about 30% of the turnover, and exports make up the balance.

- **Expansions in place**

  The company recently completed expansions adding 1.9mn tyre manufacturing capacity to take its total installed capacity to 9.3mn tyres. This expansion is at the opportune time considering the expected growth in domestic sales of 2 Wheeler industry to be around 16% in the next 3 years. We expect the motorcycles production to witness a CAGR of 19% during FY2007-09. Being the market leader in the motor cycle segment TSCL is ideally placed to benefit from this growth.

View & Valuation

We expect the two wheeler industry to witness strong growth in the next three years driven by increase in income levels and rising propensity to consume. Given TSCL's leadership position in the motor cycle tyres segment the company should witness robust growth in volumes. **At the CMP of Rs 84 the stock trades at 18.3x FY2006 EPS of Rs 4.6 EV/EBITDA of 10.4x.**

Profit & Loss Statement — Rs mn

Y/E March	FY2003	FY2004	FY2005	FY2006
Net Sales	**2,081**	**2,030**	**1,987**	**2,932**
% chg	*28.3*	*(2.4)*	*(2.1)*	*47.5*
Total Expenditure	1,911	1,865	1,870	2,796
EBIDTA	**170**	**166**	**117**	**136**
(% of Net Sales)	*8.2*	*8.2*	*5.9*	*4.6*
Other Income	22	13	18	21
Depreciation& Amortisation	52	55	59	66
Interest	20	19	14	27
PBT	**120**	**105**	**62**	**64**
(% of Net Sales)	*5.8*	*5.2*	*3.1*	*2.2*
Tax	42	36	20	27
(% of PBT)	*34.6*	*34.3*	*32.7*	*42.5*
PAT	**78**	**69**	**42**	**37**
Add/(Less): Extarord Items	(1.0)	(0.5)	(12.0)	(1.3)
Adj PAT	**77**	**69**	**30**	**35**
% chg	*23.8*	*(11.5)*	*(56.8)*	*18.9*

Balance Sheet — Rs mn

Y/E March	FY2003	FY2004	FY2005	FY2006
SOURCES OF FUNDS				
Equity Share Capital	77	77	77	77
Reserves& Surplus	322	369	394	413
Shareholders Funds	**399**	**446**	**470**	**490**
Total Loans	225	193	216	789
Deffered Tax Liability	57	55	67	70
Total Liabilities	**681**	**693**	**753**	**1,349**
APPLICATION OF FUNDS				
Gross Block	644	675	775	985
Less: Acc. Depreciation	304	357	413	477
Net Block	**340**	**318**	**362**	**508**
Capital Work-in-Progress	2	2	2	27
Investments	**12**	**22**	**11**	**13**
Current Assets	648	617	733	1,175
Current liabilities	328	271	358	375
Net Current Assets	**320**	**346**	**375**	**800**
Miscellaneous Expenses	**9**	**6**	**2**	**-**
Total Assets	**681**	**693**	**753**	**1,349**

Cash Flow Statement — Rs mn

Y/E March	FY2003	FY2004	FY2005	FY2006
Pre tax cash from operations	148	148	118	115
Other income/prior period ad	21	13	6	19
Net Cash before Tax	169	161	124	134
Tax	(42)	(36)	(20)	(27)
Cash profits	127	124	103	107
Change in Working Capital	(61)	(31)	(5)	(334)
Free Cash Flow	**66**	**94**	**98**	**(227)**
(Add)/Dec in fixed assets	(50)	(34)	(103)	(238)
(Add)/Dec in Investments	(38)	(41)	(117)	(320)
(Inc)/Dec in Loans/advances	11	3	(25)	(82)
Investing Activities	**(78)**	**(71)**	**(245)**	**(639)**
Inc/(Dec) in debt	(1)	(33)	23	573
Inc/(Dec) in equity/premium	-	-	-	-
Add/(red) to res-Spl.item	1	4	10	(1)
Dividends	(27)	(25)	(15)	(15)
CF from Financing	**(27)**	**(54)**	**18**	**557**
Inc./(Dec.) in Cash	1	(1)	(1)	10
Opening Cash balances	**12**	**13**	**12**	**11**
Closing Cash balances	**13**	**12**	**11**	**22**

Key Ratios

Y/E March	FY2003	FY2004	FY2005	FY2006
Valuation Ratio (x)				
P/E	8.3	9.4	21.8	18.3
P/E (Cash EPS)	5.0	5.2	6.4	6.3
P/BV	1.6	1.4	1.4	1.3
EV / Sales	0.4	0.4	0.4	0.5
EV / EBITDA	5.0	5.0	7.3	10.4
Per Share Data (Rs)				
Diluted EPS	10.1	8.9	3.9	4.6
Diluted Cash EPS	17.0	16.2	13.1	13.4
DPS	3.5	3.3	2.0	2.0
Book Value	52.1	58.2	61.4	63.9
Returns (%)				
ROE	19.7	15.5	8.8	7.5
ROCE	15.8	13.8	8.1	5.0
Dividend Payout (%)	34.2	36.7	36.8	41.9
Operating Ratio				
Raw Material / Sales (%)	57.9	59.1	61.0	67.6
Inventory (days)	30.7	36.4	40.2	39.3
Debtors (days)	56.5	64.4	68.8	62.2
Debt / Equity (x)	0.6	0.4	0.5	1.6

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Ratings (Returns)	Buy > 15%	Hold 0-15%	Sell > -10%