"CEAT Limited
4Q FY '23 Earnings Conference Call"
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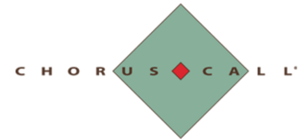

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MODERATOR: **MR. RONAK MEHTA – JM FINANCIAL INSTITUTIONAL SECURITIES**

Moderator: Ladies and gentlemen, good day, and welcome to the CEAT Limited Q4 FY '23 Earnings Conference Call hosted by JM Financial Institutional Securities. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference, please signal an operator by pressing star then zero on your touchtone phone. Please note that this conference has been recorded. I now hand the conference over to Mr. Ronak Mehta from JM Financial Institutional Securities. Thank you, and over to you, Mr. Ronak.

Ronak Mehta: Yes. Hello, everyone. Very good evening to all. I hope you all and your families are keeping safe and feeling well. I would like to thank the management of CEAT for giving us this opportunity to host this call. Today, we have with us Mr. Anant Goenka, Vice Chairman; Mr. Arnab Banerjee, MD and CEO; and Mr. Kumar Subbiah, CFO. With this, I would like to hand over the call to Mr. Anant Goenka for his opening remarks. Over to you, sir.

Anant Goenka: Yes. Thank you. Good afternoon, everyone, and a warm welcome to CEAT Q4 FY '23 Earnings Call. I'm Anant Goenka, and joining on this call, we have Arnab Banerjee, MD and CEO; and Kumar Subbiah, CFO in this call with us. As you are all aware, there's been a change in CEAT management effective April 1, wherein Arnab has taken over as MD and CEO of CEAT, while I remain associated in the capacity of Vice Chairman of CEAT. It's my pleasure to introduce Arnab to this forum. Arnab has been associated with CEAT in multiple roles since 2005 and lastly, as the Chief Operating Officer.

Over the last 10 years, he has been the co-architect in CEAT's transformation journey, in establishing multiple growth engines at CEAT, reimagining the distribution network, our brand positioning and recall, strengthening the product portfolio, setting up manufacturing capacities, etcetera. I'm sure under his able leadership, we will see these engines working at their full potential, making CEAT a much stronger and highly efficient organization. I thank all of you for the support that you have extended to me over all these years and we look forward to your continued support at CEAT.

I'll now hand over the call to Arnab for his comments.

Arnab Banerjee: Thank you very much, Anant, and good afternoon, everyone. It's my pleasure to interact with all of you on this platform. I will be taking you through the business updates for the quarter. And thereafter, we'll hand over the call to Kumar for his remarks on financial performance. Post that, we shall open the floor for question and answers.

So let me start with volume performance. Q4 was a strong quarter for us in terms of overall performance. We saw a healthy quarter-on-quarter growth in volume across markets. Growth in replacement volumes was 5%. OEM volumes grew by 8% and export volumes recovered by an encouraging 15% over Q3 FY '23. Overall volume grew by 7% over Q3.

On the replacement side, commercial category has done good. Truck bus, particularly truck bus radial, saw double-digit growth over last quarter. Healthy demand momentum in farm tyres

continued into quarter 4 as well. Demand uptick in passenger segments was relatively moderate. On the OEM side, commercial tyre, specialty farm and specialty showed higher growth quarter-on-quarter, followed by 2-wheeler.

Exports saw fairly broad-based volume recovery, though the volumes are still far from the levels we have seen a few quarters ago. On a year-on-year basis, quarter 4 volumes were up healthy 6% despite the high base.

If you look at the whole year, then we witnessed 11% volume growth over FY '22. OEM segment grew exceptionally well, coming from a low base. We've seen strong traction win both commercial and passenger segment. On the replacement side, we made good progress in passenger side in line with our medium-term vision of market leadership in the category. Growth in other categories was relatively moderate. Exports were impacted by multiple macro challenges like the war in Ukraine, currency depreciation, dollar availability in some markets and impending recession in developed markets like EU.

Now coming to demand outlook. Current domestic demand looks stable. We are keeping our fingers crossed on the sustained demand uptick going to quarter 1. There has been a sustained trust in government led infrastructure spend on the back of strong tax collections, coupled with increased visibility of private sector investments which have good demand boosters. On the other hand, inflation led stress across markets, especially rural markets, along with erratic weather patterns may have the ability to deflate demand.

2-wheelers, we expect to move in line with rural recovery. Truck and bus segment should see growth in line with growth in economy and infrastructure push, which is continuing. On the passenger side, we are hopeful of carrying our momentum into next year.

OEM volume growth should remain strong, especially in commercial and passenger segment. 2-wheeler segment maybe bit lower in OEM going forward. Growth, however, will moderate over high base of FY '23 is what we feel.

Exports may put up a stronger show and will be a key contributor for next year's growth. There has been an improvement in dollar availability in developing economies, recessionary sentiments prevailing in Europe and North America is also a reality. But for a quality value player like CEAT, it may provide an opportunity. As channel destocking gets over normal, export volumes should come. We are happy to inform that our newly launched truck bus radial tyres in Europe are seeing good traction. We are targeting to launch our passenger and truck bus radial tyres in U.S. markets as well by the end of FY '24. On the off highway side, we have continued to expand our channel and product basket. So all these initiatives, along with overall stability, will hopefully get our exports back on growth trajectory from the later part of FY '24.

Going on to margins. Our raw material basket costs reduced by approximately 8% to 9% over Q3. As a result, our EBITDA margin expanded by 422 basis points over Q3 to reach 12.9% on a stand-alone basis.

We were largely able to hold down our prices in the market, and hence, it's helped in the recovery of margins. On the basis of current purchases and pipeline, we expect raw material basket to move in a narrow band in Q1, maybe inching up slightly by quarter end. As always, we are watching the raw material price movement closely, and we'll take corrective actions if there's a sustained run-up in any of the base materials. China demand will be the key variable, especially for natural rubber.

Coming to capex. We incurred growth capex of around INR700 crores during FY '23, and we have managed to keep the spend within these limits. We have sufficient capacities at this moment to take care of near-term growth in most of our product segments. Hence, we are reducing capex requirement for FY '24. We expect growth capex to be around INR500 crores to INR550 crores for FY '24, which is largely towards Ambernath agri radial expansion and downstream assets in Chennai and Nagpur

Coming to marketing. CEAT was proud to get associated with the first edition of Women's Premier League as strategic timeout partner. We also launched an advertising campaign for CEAT scooter tyres around the same event, featuring our brand ambassador Harmanpreet Kaur. We remain associated with IPL as strategic timeout partner in the current edition as well and have launched a new campaign on SUV tyres during this event. We have taken a lead in developing new digital channels, be it our website presence in marketplaces. As a result, D2C sales contributed roughly 6% of our replacement sales in FY '23 in passenger's category with peak levels of 8% to 9% during the year.

Electrification is a big trend, especially in 2-wheeler tyres. In 2-wheeler OEMs, we continue to hold close to 50% share of business. We have significantly expanded our presence in electric vehicles in passenger segment as well, 4 premium electric vehicle models such as XUV400 by Mahindra, Citroen EV, MG ZS EV and MG Comet were launched with CEAT tyres (note: please read the statement corrected as - CEAT tyres got approved for 4 premium electric vehicle models such as XUV400 by Mahindra, Citroen E-C3, MG ZS EV and MG Comet), and we are waiting for more nominations. We are also the first tyre company in India to get OEM approval for EV specific range of tyres for commercial vehicles.

A few awards and recognitions. We are proud to receive 3 important recognitions from our OEM partners for FY '23 performance. We got the award for overall performance from Maruti Suzuki, Annual Supplier Excellence Award from Mahindra, Best Performance Award from Renault Nissan. CEAT Chennai and Ambarnath plants have received 5-star in occupational, health and safety audit by the British Safety Council. CEAT also featured amongst the top 25 in India's best workplaces in manufacturing by great places to work for 2023.

On sustainability, we continue our progress towards our sustainability vision for 2030. We achieved approximately 10% kind of reduction in overall carbon emissions per metric ton of production in FY '23 over FY '22. Currently, 33% of our plant power requirements are through renewable sources, vis-a-vis 26% in the previous year. We plan to increase this contribution further to 37% by the end of current fiscal. 12 additional products have received BEE 5-star rating for energy efficiency during quarter 4. As of now, 37 of our products are 5-star rated.

During the year, we also achieved 17% reduction in water consumption per metric ton, which is on top of a 29% reduction achieved in FY '22. About 24% of our natural rubber requirement was transported through alternate methods with lower carbon footprint.

So margins are inching back to normalcy after a long and difficult phase on the back of inflated commodity prices. There has been a sustained reversal in RM cost over the last few months, which gives us confidence on the margins remaining in a comfortable range in the near term. We have made remarkable progress on multiple fronts with product premiumization, stabilizing new capacities, Industry 4.0 practices, process improvements amongst others. As RM stability prevails, we will be able to demonstrate the effects of these initiatives in coming quarters in terms of margins as well as our return ratio. Our focus continues to be on improving the product profile in line with customer expectations, deepening impact in focused markets and bringing out efficiencies in operations on a sustainable basis aimed at making us resilient and stronger.

Now I would like to hand over the call to Kumar for his remarks.

Kumar Subbiah: Thank you, Arnab. Good afternoon, ladies and gentlemen, and thank you for joining our quarter 4 earnings call. I'll share some financial data points with you all, post which we can enter Q&A session.

First on revenue. Our consolidated revenue for the quarter stood at INR 2,875 crores, a quarter-on-quarter growth of about 5.4% driven by volumes and year-on-year growth of about 10.9%, which has both price growth as well as volume growth. FY '23 was the third successive year of healthy double-digit growth revenue growth this year. During the year, we crossed an important milestone of INR10,000 crores and ended the year with a consolidated net revenue of INR11,315 crores, growing by about 20.8% in FY ‘23 over FY '22. We are happy to share with you that we have scaled up our revenue by 1.7 times pre-COVID levels that is helping us to utilize the additional capacities that we have added in the last 3 years.

Coming to gross margins, raw material scenario remained supportive during the quarter, yielding about 8% to 9% reduction in RM basket cost versus quarter 3. As a result of lower raw material prices and maintaining of our final product prices, we have reached our desirable gross margin range of about 40%. RM prices have been operating in a brand since the last couple of months. There has been some increase in the domestic natural rubber prices and some of the petrochemical derivatives that may have some impact on the RM prices towards the later part of quarter 1.

Having said that, the global macro remain volatile with multiple variables at play, expectations of a global economic slow down is keeping a check on inflation for now. But geopolitical situation can take unexpected turns, creating short-term supply challenges and price spurts like was seen in case of crude recently. We are not seeing any clear direction in China on demand. So we will continue to keep a close watch and RM situation and see how it evolves over the next few months and quarters.

Now coming to our capex. We spent about INR210 crores of total capex during the quarter. That includes about INR128 crores of project capex. Our capex for the year, overall capex for the

year was about INR890 crores, largely in line with our broad guidance of about INR900 crores for the quarter. In FY '24, we would like to keep our total capex in the range of about INR700 crores to INR750 crores, out of which our project and growth capex is expected to be in the range of INR500 crores to INR550 crores. For the sake of clarity, our regular capex consists of moulds, plant maintenance, R&D, IT, digital and efficiency improvement projects.

Coming to debt. We are happy to share with you that we were able to reduce our inventory by additional INR100 crores during quarter 4. Our payables also increased in line with our purchases during the quarter, and hence, our net working capital reduced sharply by about INR221 crores in quarter 4 versus quarter 3, and overall, on a full year basis, about INR170 crores, largely driven by lower inventories, higher payables and efficiencies in receivables. Our quality of working capital has steadily improved in the last few years. Consistent improvement in our cash flow processes covering all elements of working capital, normal capex, project capex and operating costs has got efficiency in overall cash flow management that contributed in managing our debt and leverage ratios as well.

Our consolidated debt as of 31st March 2023 stood at INR 2093 crores, a reduction of about INR252 crores in quarter 3. Our year-end debt of INR2,093 crores is marginally lower than the debt level of INR2,097 crores as of end of previous year. This, in one way, means that we have managed all our capital expenditure of about close to INR900 crores in the year only from our internal accruals. We are glad to inform you that we ended the year with a healthy debt-to-EBITDA level of 2.1 and debt equity of 0.6.

Now coming to expenses. Our employee costs increased by 17% quarter-on-quarter due to higher level of activities in our factories and our provisions towards leaving catchment are raging out of some settlements signed with our employees in two of our factories and some provisions relating to performance-related incentives. Our marketing spend also increased during the quarter on new campaigns, participation in WPL and initial bits of IPL. This advertisement spend is likely to increase in quarter 1 as we have a larger presence around the IPL during the year.

Coming to depreciation and interest costs. Depreciation for the quarter increased versus quarter 3 due to capitalization of assets arising out of commissioning of our assets in our new factories. We expect our quarter 4 levels of depreciation to be there in the next 1 to 2 quarters. Our interest expenses remained similar to quarter 3 level. Effective interest rate increased by about 10 basis points in quarter 4 versus quarter 3. We expect interest rates to increase progressively anywhere in the range of 30 to 50 basis points in the FY '24.

Coming to EBITDA, our consolidated EBITDA stood at INR875 crores, highest absolute EBITDA that we have achieved during the quarter with a margin of about 13.1%, an expansion of about 458 basis points over the previous quarter. Our consolidated profit for the quarter stood at about INR132.42 crores, which compares favorably with previous quarter as well as previous year.

And we'd like to share with you that Board in the meeting yesterday approved a final dividend of about 120% for the year, and the same would be paid to shareholders on obtaining approval from our shareholders. And we also like to inform you that we are awarded best risk management

company in auto-ancillary sector by CNBC 18 and ICICI Lombard recently. It is an affirmation of our robust risk management process. This is the second time that we have been awarded this award in the last 4 years. Thank you.

We can now open the floor for Q&A.

Moderator: Thank you very much. The first question is from the line of Ashutosh Tiwari from Equirus Securities.

Ashutosh Tiwari: Firstly, on the volume side, in fourth quarter, you mentioned it's a 6% growth Y-o-Y.

Arnab Banerjee: Yes.

Ashutosh Tiwari: Can you provide the breakup of the same, like between OEM replacement expose how it is for the quarter and also for the full year, Y-o-Y growth?

Arnab Banerjee: Yes. Y-o-Y replacement is around 5%. OEM would be higher at about 20%. And exports, we have de-grown by around 11%.

Ashutosh Tiwari: And for the full year?

Arnab Banerjee: And for the whole year, the same figure should be around 6%, 33% and negative 3%.

Ashutosh Tiwari: Okay. And how is the like replacement market, 5% growth or 6% for the full year, which segments have done well? Like is it the PCR has done very well or how the 2-wheeler and truck segment basically in this?

Arnab Banerjee: For the whole year?

Ashutosh Tiwari: Yes, yes.

Arnab Banerjee: For the whole year, I think PCR, PCR has definitely done well in the replacement segment. 2, 3-wheeler has middled in terms of single-digit growth in the replacement segment. And off-highway, of course, has done quite well. And truck bus growth has been moderate in replacement segment for the full year.

Ashutosh Tiwari: Ok and the 33% growth in OEM volumes. This is driven by mainly PCR. Is that the largest on of this?

Arnab Banerjee: In OEM, we have had a resurgence in our market share and acceptance for our truck bus radial category, especially towards the second half of the year. And that has primarily led the entire OEM growth for FY '24 over FY '23. And off-highway also has moved up significantly in OEM for the last year.

Ashutosh Tiwari: Okay. And we were running, I think the TBR capsid a pretty high deflation level. And we have not mentioned any capex for that in FY '24. So how will you manage that growth in that TBR category in '24?

Arnab Banerjee: Yes. So TBR, we have grown, but there is a significant amount of upside still left in Halol, which will provide us growth in the immediate term. So we are still having a wait-and-watch kind of stand on TBR. There are two things. One is the capacity utilization in Halol, there is headroom there. And secondly, we are also looking at the product mix and the margin profile of the entire basket of TBR and we'll continue to wait and watch until we take a call on further investment in TBR.

Ashutosh Tiwari: What is the utilization level in TBR last year, full year or maybe Q4?

Arnab Banerjee: Utilization level has inched up to around 80% in Halol right now.

Ashutosh Tiwari: Okay. And lastly, on the capex side, you mentioned INR700 crores to INR750 crores capex for the full year, that would mean that our debt should start declining from this year meaningfully.

Kumar Subbiah: Yes. I think it should not largely. We have 1 or 2 things that will happen next year also. For example, from a cash flow standpoint, we didn't have any cash outflow with respect to income tax last year. And however, we may see some higher than ETR impact on cash flow in the coming year. There could be some dividend outflow. So we are watching it. And in some cases, materials, raw materials and finished goods, we have gone a little bit below or normal norms. So we may have to normalize it. So ideally, there should not be any significant increase in debt levels. But if we are able to contain a INR700 crores to INR750 crores level, we should largely be able to maintain at the current level.

Moderator: Thank you. The next question is from the line of Joseph George from IIFL. Please go ahead.

Joseph George: At the industry margin or individual tyre makers margins. So we have seen margins go up and down over the years depending on -- primarily depending on how raw material prices have moved. And if you went back 2 or 3 quarters and when we have checked with your target has been to get to a 12% to -- sorry, 10% to 12% kind of EBITDA margin. Now we have already reached beyond that.

Now so my question is, when you think about upcoming quarters or maybe the medium term rather than the next 1 or 2 quarters, what is the margin band that you would like to settle at? I mean because, as I said, historically, it's gone up and down, but there is a target margin that typically companies have, which is a kind of a sweet spot, which you would like to stay in. So what is that band according to you?

Arnab Banerjee: Yes. So this quarter has been good. And looking at the next quarter, let's say, quarter 1, we expect the raw material, first of all, to move in a narrow band. So in terms of the realization, also, we -- it's a competitive industry. There has been no significant erosion of realization yet. There have been some minor discounting here and there, which is happening right through the year. So we expect the margin to stabilize over the next couple of quarters, at least in low double-digit kind of range. And that will be the spot we would like to maintain continuously over the quarter.

Moderator: Thank you. The next question is from the line of Chirag Shah from White Pine Investment Management. Please go ahead.

Chirag Shah: So first a clarification, you indicated for full year this year replacement demand. Two-wheeler has seen a decline of how much...

Kumar Subbiah: You're referring to replacement or…

Chirag Shah: Replacement.

Arnab Banerjee: Replacement demand in 2-wheeler, we have grown -- we have not declined.

Chirag Shah: Grown by...

Arnab Banerjee: Single-digit growth.

Chirag Shah: Single-digit growth.

Arnab Banerjee: Yes, full year.

Chirag Shah: Okay. Sir, my question is on the OTR side, how are you looking at that side? Any update, anything you would like to share incremental over there?

Arnab Banerjee: We are expanding the Ambernath plant, which manufactures agri radial, which is the most profitable part of the business. We have also put in some additional capacity in Bhandup for the bias range of agriculture and OTR. So this will lead to sustained growth in both domestic as well as export market in OTR. We are looking at range expansion also putting in new products, which is very important for success in the business. And we are looking at getting into more OEMs and increasing the share of existing OEMs globally as we go forward. So the outlook is pretty positive, both margin-wise as well as volume-wise.

Chirag Shah: Sir, what kind of expansion you're looking actually was? And when can we expect a sharp increase in the pace of expansion and exports, a lot of trial orders; a lot of efforts would have gone through over the last few years. So when can we expect the next leg to take shape?

Arnab Banerjee: So the expansion in the next couple of quarters, we will see at least 20% of the capacity getting installed further. And the order book is good, so the sales will also catch up fast with the expansion in Ambernath. So we'll go to about 105-odd tons per day in Ambernath, which will further expand to about 150-plus tons per day by the end of the year.

Chirag Shah: Okay. We go to 150 tons. Okay. And what kind of SKU additions you're looking at, you alluded to that you want to do this on range expansion. So what SKUs we are looking to add, if you can have it.

Arnab Banerjee: Yes. So we have around 750-odd SKUs total about 300 of radial, bias about 250-odd then OTR also about 200-odd. And in the quarter that has gone by, we have added about 20-odd SKUs and 20 more will get added in quarter 1 as well. So this is across product range we are getting into

new areas also. So we're getting into forestry also in future, for example. We have got into lawn and garden turf range. We've got into a agro industrial application. So we are getting to newer and newer niche applications, which have got these kind of SKUs and the margins are also good.

Chirag Shah: And I resume all this is for export market, right, sir?

Arnab Banerjee: These are all for export markets.

Chirag Shah: Okay. And in terms of size-wise, anything, any thought, any thinking that you have?

Arnab Banerjee: Size-wise, specifically, maybe we'll come back on that.

Chirag Shah: Okay. Okay. Thank you all.

Moderator: Thank you. The next question is from the line of Kuber Chauhan from Anand Rathi. Please go ahead.

Kuber Chauhan: Two questions from my side. You talked about different kind of campaigns and expense which you have done in FY '23. So could you talk more about what's -- I mean what's your funding for FY '24 regarding ad spends and how you are taking it? And second question is on the RM prices. So we have seen crude getting from a peak of around $123 per ton has been crude has been fallen. So what's your outlook on that and also on the rubber prices.

Arnab Banerjee: Yes. I'll take the first question first. So we have been maintaining a steady kind of investment in marketing at the rate of around 2% of turnover. It's been around that for the last year, and it will be around 2% again for the coming year in FY '24. So that will continue, and we didn't reduce it substantially even during forward. So that has been a continuous investment on the brand, which will happen. As far as crude is concerned, Kumar, would you like to.

Kumar Subbiah: No. See, crude went up to, as you said, about $120-plus and now hovering in the range of close to about $75, okay. Normally, what goes into the raw material that is used in tyres as crude derivatives. So for example, synthetic rubber has a derivative called butadiene and nylon fabric as a derivative called caprolactam -- so similarly, Carbon Black as CBFS. So what we have observed is while CBFS, which is a direct refined product has moved largely in line with the crude. With respect to synthetic rubber derivatives and fabric derivative, they have not corrected to the extent of correction in the prices of crude. And therefore, we have not seen the kind of reduction that we saw in crude with respect to these materials, one.

Number two, rupee has also depreciated, by about 9% to 10%. So when we have -- when we import these materials or when it is import parity cost, that also takes away the impact of fall in crude to that extent. And therefore, the question is that crude derivatives and raw material prices have not fallen in line with the fall in crude oil prices from peak to the current level.

Kuber Chauhan: Okay. About rubber, anything? Are you witnessing any kind of a correction in number prices?

Kumar Subbiah: The rubber prices in the international prices is largely stable for the last 2 months. If you were to convert international prices into rupees per kg, it's hovering around INR150 to INR151 per

kg for the last 2, 3 months. Local natural rubber prices went down to around INR140 per kg in January and February. In the last 2 months, it's been steadily going up as we speak today and some around INR150 to INR153 per kg. So there is some increase in natural -- local natural rubber prices. International ruble prices have been constant in the last 2 months in terms of rupees per kg.

Kuber Chauhan: Understood. That's it from my side. Thank you, and wish all the best.

Moderator: Thank you. The next question is from the line of Sachin Kasera from Svan Investment. Please go ahead.

Sachin Kasera: Yes. Congrats for a good set of numbers. A couple of questions. One, how do you see your mix of OEM, replacement and exports in '24 versus '23?

Arnab Banerjee: So the mix is about 51, 32, 18 currently, replacement OEM exports. We are putting in a lot of effort towards global sales and exports, both in specialty as well as truck bus radial and passenger categories. So this 18% is going to improve. And this 18% is good for us in terms of EBITDA accretion. We are also putting in effort to improve our market share in truck bus radial and passenger tyres in replacement. So this -- we are looking at almost 1.5x market share gain in truck bus radial, and we are looking at moving towards market leadership in passenger radial. So it may not happen in the next -- in FY '24, but we will move close to it. So coupled with these 2 initiatives, and we'll maintain our business in OEMs because passenger radial has got and as well as truck bus radial got a huge replacement benefit in the replacement market. A significant amount of customers replace the tyres fitted by the OEM in their cars or even in truck. So we will maintain the business in OEM, and therefore, this ratio is going to gradually increase over the years, and it will improve towards replacement and international business in the current financial year.

Sachin Kasera: So going for next 2 years, the share of replacement export in overall revenue price should increase from where it is today.

Arnab Banerjee: Exactly.

Sachin Kasera: Okay. Secondly, you also mentioned in the opening remarks that one of the focus area is to improve the return ratios. So now that probably we have seen the worst of the margins, and we're starting with some improvement. Over the next 1 to 2 years, what type of expirations we are having in terms of incurring return ratios.

Kumar Subbiah: Equity return? Sorry...

Anant Goenka: Yes, I'm talking about the ROE and ROCE.

Sachin Kasera: ROE, ROC whichever you would like to comment on.

Kumar Subbiah: Okay. Okay. We focus a lot on ROCE. I'm sure from equity shareholders' point of view, ROE is also an important part. Okay. Normally, I think I'll tell you philosophically, what we do is whenever we get any capital proposal approved, we look at some payback of about 6 to 7 years

as our upper end. That's the level at which we would generally like to take any of the capital proposals. That would normally translate to ROCE in the range of 12% to 15%. That is the range at which we expect. Obviously, it happens with after year 2 or year 3, depending on when the project gets completed. So our ambition in terms of return on capital employed is in that range of about 12% to 15% progressively.

Sachin Kasera: Okay. Sir, just a more structural and a follow-up on this. When we look at the overall auto ancillary as a sector, we are very much in terms of a B2C, largely 70% of our revenue comes from B2C. There are a lot of potentials which are primarily B2B and the consistent deliver ROEs of ROCEs of 20% plus -- so do you see this more as a structural issue with the entire industry where because of whatever you mean talk of competitive visions and whatever other things maybe, the industry structurally makes much lower ROCE versus despite being a predominantly a B2C industry versus some of the other component guys or avenues we consider make 20 despite being primarily a B2B player.

Arnab Banerjee: Yes. So in our industry, the margins and the ROCE financially is primarily delivered from replacement and international market because margins are structurally lower in OEM. However, to get that margin from the replacement and international markets, especially domestic replacement market, it is imperative to do the OEM business at this margin because a) entire technology development for the future happens through OEMs that there's a lead that the OEM has, for example, nowadays, it's electric vehicles and the tyres are different for electric vehicles.

And number two is that, as I mentioned earlier, there's a significant amount of stickiness with the customer when they replace the tyre in replacement market if there's an OE fitted tyre of CEAT, there is a significant likelihood that the customer will go for the same tyre. So the margin, therefore, holistically recovers from the replacement business. Our entire international business is currently replacement business. And in future, when we have to increase our stakes in international business, we may have to get into OEMs in international also to kick-start further premiumization into bigger cars and getting the higher-margin business and replacement, OEM entry may also be required there. So as the overall construct, we get our ROCE and margins from the replacement business.

Okay. And one additional point is, since you are comparing one industry versus the other. One of the important drivers or levers for ROCEs that asset turnover, okay, in the entire industry, structurally, the asset turnover is a little on the lower side. And it takes -- once you put up an investment because of very high upstream investment, okay, it starts paying off after year 3 or year 4. So you'll have to invest and upstream in the beginning. Downstream will happen over a period of time. This may not be necessarily be applicable for some of the other auto ancillary industry that you have in mind when you indicated 20%, 30% kind of an ROCE.

Sachin Kasera: Sure. So should we, if you look from a medium term, next 3 to 5 should be like as of now, 15% is like the upper end beyond as of now, practically difficult for us to look sustainably better ROC.

Arnab Banerjee: We have significant upside in our installed capacity. So there is scope for operating leverage in this year itself and in the coming years. We have upside in capacity in 2-wheelers, which is a

high-margin business for us. We are investing in capacities in number. We have upside in passenger. Again, it's a high-margin business for us. And as I mentioned, we are upside in TBR as well. So right now, our capex is tapering down in FY '24, whereas we are looking for growth. So ROCE definitely will see an uptrend during the next 4 quarters.

Sachin Kasera: Sure. So just a follow-up on this, sir, what type of utilization we would have on an average in FY '23? And on an overall basis, what type of leverage we have in terms of people utilization is improving to better ROCEs.

Arnab Banerjee: Yes. So our largest factory is Halol, where we are utilizing close toward 80% and we are at similar levels in, let's say, Bhandup and Nagpur. So 3 of our factories. Ambernath is in an expansion stage as we shared, which will progressively go up to about 150 tons. Chennai, we have some more headroom left. We are at about mid-60s kind of utilization. So that kind of sums up for you. Mostly, it is 75% to 80%, and we still have headroom left in most of the plants.

Sachin Kasera: Sure. And just one last question for...

Moderator: Sorry to... Mr. Kasera may we request that you return to the question queue for any follow-up questions. The next question is from the line of Basudeb Banerjee from ICICI Securities Limited. Please go ahead.

Basudeb Banerjee: Couple of questions, sir. I just missed you said Halol TBR utilization at 80% or overall Halol utilization 80%.

Arnab Banerjee: Overall and TBR are both at around 80%.

Basudeb Banerjee: Sir, just to understand, like sequentially, I can see your gross margin being up 550 basis points. So just wanted to understand the overall math of how raw mat basket for you has moved sequentially because 1/3 will be passed on to OEM. So residual 2/3 helped 550 basis point gross margin. So just to understand for the quarters coming ahead with slight increase in natural rubber, as you said, but still how much the raw mat basket benefit you got? And any other benefit like lower inventory or something else beyond just overall portfolio.

Kumar Subbiah: So okay. In the quarter 4, our raw material costs were lower by about 8% to 9% versus quarter 3. So therefore, that's one of the reasons for our gross margin expansion. In our overall pricing with respect to OEMs, raw material costs, both ways, when it goes up as well as when it goes down, it gets reflected in our final product prices. However, it varies depending on the category, the recipe and things like that with a 1 quarter lag. So therefore, when the raw material prices come down, we may pass it on with 1 quarter lag under and the reverse is also true. So that is what it is. So going into quarter 1, okay, it's possible that some part of the raw material costs, we may have some implications on pricing with OEMs. Obviously, it depends on the category. The impact of 9% is not uniform for all categories and all our customers. So that correction will happen. And otherwise, the mix will have some impact on gross margin, mix of category mix as well as our customer mix will have some implications with respect to this. Assuming raw material prices remain the same and realization remained the same. Okay, Arnab had indicated, our margin should be at double digit, maybe low end of the double digit. That's the way we see.

Moderator: Thank you. The next question is from the line of Disha Sheth from Anvil Shares & Stock. Please go ahead.

Disha Sheth: Sir, if you can throw some light on demand outlook for the coming year and quarter, if you can throw some light?

Arnab Banerjee: Yes. So the summer months are usually good months demand-wise overall. But just looking at the whole year, first, we talk about the OEMs. The commercial vehicle players are doing well, and we expect the OE demand for truck bus radials to be good in single digits and generally mirroring the GDP growth pattern. And similarly, in replacement also, truck bus tyre demand will be in strong single-digit kind of growth through the year. Summer may be a little higher, a bit lower in the monsoons, but will average out like that.

Passenger car tyre demand in OEM is showing some bullishness. We're bullish with some new vehicles coming up, EV coming up. So they have crossed their pre-COVID level already pretty strongly. So we expect that to continue in the OEM. Replacement demand also will be in somewhat single-digit kind of growth because of the past OEM trend, replacement follows that trend with a 2, 3-year lag, but positive, positive single-digit growth because of new roads are coming up, people are traveling more. People have gone back to private vehicle usage. And so that's replacement.

Two-wheeler demand is dependent on both urban and rural demand. Here, we shift -- see some shift in growth of scooter tyres, maybe at the expense of motorcycle test. And the overall growth here will be lower single digits because a significant part of the economy in the small towns have not yet recovered post COVID from the income hit that they took because of inflation and because of loss of income, loss of jobs. So the non-farm part of the rural economy is yet to bounce back. As soon as – and we have seen some recovery basis, some indicators, including FMCG growth in last quarter -- last quarter 4. So if that happens, then two-wheelers may improve over the second half of next year of this year.

Disha Sheth: Q-o-Q growth, which we delivered volume growth this quarter, the momentum should continue into Q1 is what we see.

Arnab Banerjee: Yes, Q1 demand-wise is the most positive quarter. Actually, March is when the demand picks up, March to June is generally good in terms of seasonal demand uptick.

Disha Sheth: That's good. And the capex should be funded by internal approvals, right?

Kumar Subbiah: Sorry, capex would be?

Disha Sheth: Funded by internal accruals since we have a good cash flow because of margin expansion.

Kumar Subbiah: Now, as we indicated, we will have to normalize working capital. One, we see some outflow in the form of income tax, some outflow in the form of dividend and things like that. So if we are able to sustain this level of margin in the year, we should largely be able to manage through

internal accruals. A percentage or 2 drop in margins in the coming quarters may have marginal -- debt may marginally go up.

Disha Sheth: Okay. And exports, sir, I missed the point. You said it is 18% of sales. Since it has improved this quarter, you expect you said double-digit growth in exports due to lower base?

Arnab Banerjee: Yes. Exports thrust is continuing on all sectors. So we expect exports to do well in this quarter -- in the first quarter.

Disha Sheth: And we export generally off-highway tyres?

Arnab Banerjee: Off-highway tyre, passenger car radial as well as truck bus radial little bit.

Disha Sheth: And more exposures into Europe and Far East Africa?

Arnab Banerjee: Europe and Americas constitute about 45%, 46% of our total export.

Disha Sheth: Okay. Okay. So, sir, just to get a view Europe things are improving and your -- what you feel since the exports have improved double digits?

Arnab Banerjee: Europe, there's a headwind. There is a recessionary headwind, especially felt by the agri radial sector, which is where the weather has been playing for a long time. It is also being felt on PCR relatively there and TBR, we have just started. So wherever the reverse is true for U.S. where we see a lot of white spaces and scope for growth. So between U.S. and Europe, we expect to manage export through the next few quarters.

Disha Sheth: Okay. Thank you, sir. That's it from me.

Moderator: The next question is from the line of Abhishek from Dolat Capital Market Private Limited.

Abhishek: In terms of RM sourcing, how much import versus domestic mix?

Kumar Subbiah: See, it varies from month-to-month and quarter-to-quarter. But normally, it's about 55% import and 45% local. And some of the local materials also priced based on import parity.

Abhishek: But earlier it was used to be 65% domestic side. So have you changed any policy in terms of the RM sourcing?

Arnab Banerjee: No, we have not changed the policy. I don't know when it was 65% local. In fact, the local content has improved over last 3, 4 years because some new capacities got created in the synthetic rubber, which entirely was imported by the tyre industry. In case of natural rubber, it's possible that import would have gone up because the local availability is limited. It's only a sheet rubber. So as the industry has grown over the last 3, 4 years, it's possible that quantum of import is -- and also as a percentage of the total requirement would have undergone a change. It's purely because of the fact that locally is not available. As far as CEAT is concerned, we have moved down from around 65%, 70% to closer to 50% in the last 3 years -- 3, 4 years.

Abhishek: Okay. And how is the margin structure in the off-highway tyres, sir?

Arnab Banerjee: The margin structure is very good in Agri radials, which we export. It is at the highest level, it is very high double digit, I would say. And the domestic market is -- will be -- in quarter 4, it would be double digits. But overall, for the year would be high single digits, but a very differential margins in the export market.

Abhishek: So it is in the range of 17%, 18% or it is lower than that?

Arnab Banerjee: For agri radial, it would be more than that.

Abhishek: Okay. And as the other expenditure and the freight cost is going down. So can we expect that it will cross 20% kind of the mark in line with its peers?

Kumar Subbiah: No, I think we're not able to give any guidance with respect to margins going into this. Generally, it is expected to be higher than the margins of other categories of tyres, but we're not able to comment whether it will cross a certain level in the coming quarters.

Moderator: That was the last question for today. I would now like to hand the conference over to the management team for closing comments.

Arnab Banerjee: Yes. Thanks very much for attending this call, and I hope we have been able to answer all the queries satisfactorily. And we shall keep in touch going forward and see you at the end of next quarter. Thank you.

Moderator: Thank you. On behalf of JM Financial Institutional Securities, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.