Angel Broking
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January 31, 2015

Indag Rubber

Revival in CV volumes to fuel IRL's growth

ACCUMULATE

CMP	₹897
Target Price	₹992
Investment Period	12 Months

Stock Info	
Sector	Rubber-Retreading
Market Cap (₹ cr)	471
Net Debt (₹ cr)	(43)
Beta	0.9
52 Week High / Low	1,100 / 212
Avg. Daily Volume	2,614
Face Value (₹)	10
BSE Sensex	29,183
Nifty	8,809
Reuters Code	IDGR.BO
Bloomberg Code	IDR@IN

Shareholding Pattern (%)	
Promoters	74.8
MF / Banks / Indian FIs	0.0
FII / NRIs / OCBs	1.0
Indian Public / Others	24.3

Abs. (%)	3m	1yr	3yr
Sensex	6.7	42.4	73.1
IRL	25.0	281.6	471.2

Investment Arguments

Indag Rubber (IRL) to benefit from recovery in commercial vehicle industry: IRL manufactures pre-cured tread rubber and ~90% of its revenue comes from the commercial vehicle (CV) industry. The company would be a beneficiary of improving CV OEM sales hereon, as the retreading revenues accrue with a lag of 5-6 month of new vehicle sales; retreading of new tyres is undertaken after 50,000km of the vehicle's running, which typically happens in six months.

During FY2013 and FY2014, the CV industry reported disappointing volumes owing to slow down in GDP growth and commercial activities which is also reflected in company's performance (top-line de-growth of ~1% in FY2014). In 9MFY2015, medium and heavy commercial vehicles (MHCVs) volumes have witnessed a recovery; also, there has been a recovery in light commercial vehicle (LCV) volumes with they showing relatively lower de-growth in 9MFY2015 compared to FY2014. This has been partly reflected in IRL's 3QFY2015 revenues and further benefits would be visible hereon given the improving economic cycle. We expect growth momentum to continue in the CV segment (about 8% volume CAGR over FY2014-2017E) which would also be reflected in IRL's revenues (we expect ~10% CAGR top-line growth over the same period).

Lower penetration level to drive growth: Penetration level of retreading is lower in India as compared to other developed regions like USA, Europe etc. In India, the penetration level of retreading is at ~40% compared to 100% in USA and ~80% in Europe as stated by the company. We believe that going forward, penetration of retreading would increase on back of growth in road freight with improvement in economic activity, improving road infrastructure, and growing radialisation; demand for retreading will rise as new radial tryes are expensive and retreading would prove to be a cheaper alternative towards increasing the life of the tyres.

Outlook and Valuation: We expect IRL to report a net sales CAGR of ~10% over FY2014-17E to ~₹311cr and net profit CAGR of ~11% over the same period to ₹37cr. At the current market price of ₹897, the stock trades at a PE of 14.9x and 12.7x its FY2016E and FY2017E EPS of ₹60.1 and ₹70.8, respectively. **We initiate coverage on the stock with an Accumulate recommendation and target price of ₹992, based on 14x FY2017E EPS, indicating an upside of ~11% from the current levels.**

Key financials

Y/E March (₹ cr)	FY2014	FY2015E	FY2016E	FY2017E
Net sales	**232**	**235**	**268**	**311**
% chg	*(1.2)*	*1.3*	*14.0*	*16.0*
Net profit	**28**	**30**	**32**	**37**
% chg	*10.3*	*7.7*	*6.3*	*17.8*
EBITDA margin (%)	16.0	16.6	16.6	16.6
EPS (₹)	**52.5**	**56.5**	**60.1**	**70.8**
P/E (x)	17.1	15.9	14.9	12.7
P/BV (x)	4.6	3.7	3.1	2.6
RoE (%)	26.7	23.4	20.8	20.6
RoCE (%)	33.7	28.7	27.2	26.7
EV/Sales (x)	1.8	1.7	1.5	1.2
EV/EBITDA (x)	11.5	10.5	9.0	7.5

Source: Company, Angel Research, Note: CMP as of January 30, 2015

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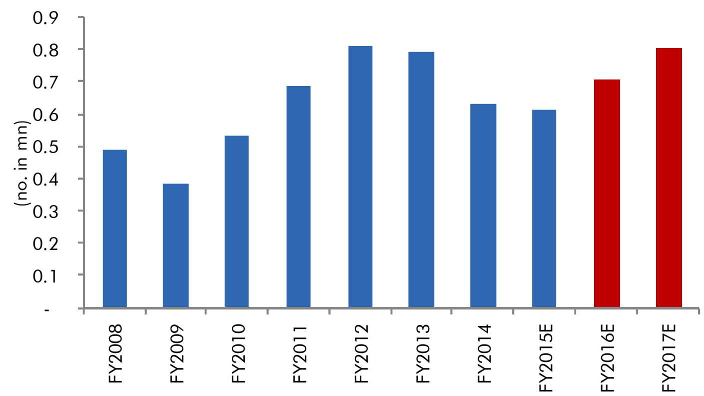
Investment Arguments

Indag Rubber (IRL) to benefit from recovery in commercial vehicle industry

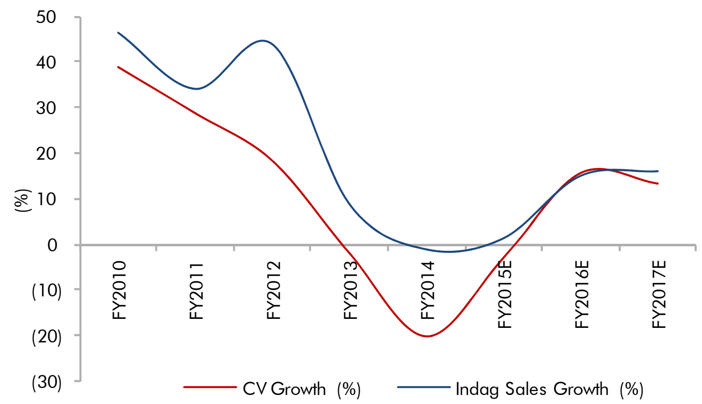
The CV industry in India compromises of two segments (a) MHCV and (b) LCV. During FY2013 and FY2014, the CV industry reported disappointing volumes due to slowdown in GDP growth and commercial activities. In 9MFY2015, the MHCV segment showed recovery in volume growth, ie of ~10% yoy as against a ~25% yoy de-growth for FY2014, owing to an improving economy. However, LCVs volumes have failed to grow although they have posted a lower de-growth of ~13% yoy for 9MFY2015 as against a ~18% yoy de-growth for FY2014.

Exhibit 1: CV Industry (domestic) trend



Source: SIAM, Angel Research,

Exhibit 2: CV Industry & IRL sales growth projection



Source: SIAM, Angel Research

We expect the CV industry to report a healthy ~8% CAGR over FY2014-17E

Considering momentum in policy reforms, fall in inflation, and anticipation of further rate cuts by the Reserve Bank of India (RBI), we believe that the investment cycle and commercial activities in the country will get a boost. This would lead to improvement in GDP growth in FY2016 and FY2017, which in turn will assist growth in the CV segment, ie mainly the LCV segment, which is currently underperforming. Also, considering the overall improvement in demand for MHCVs as well as lower de-growth in LCV volumes during 9MFY2015, we expect the CV industry to report a healthy ~8% CAGR over FY2014-17E.

MHCVs (mainly trucks and buses) account for the largest chunk of the company's sales (85%) followed by LCVs at 5%, and the balance is accounted by others segments

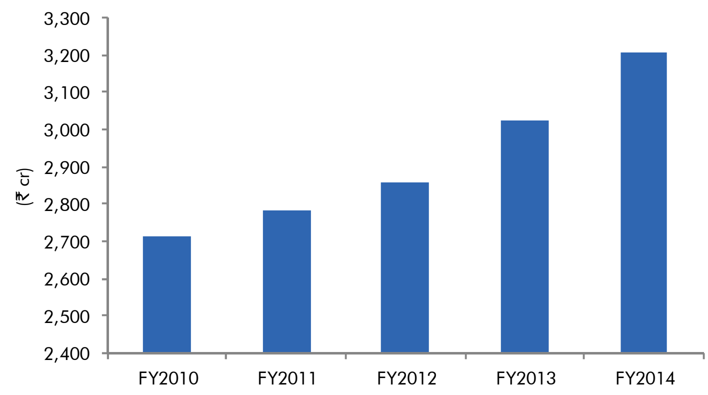
IRL caters to various segments including CVs, tractors, and the off-the-road (OTR) in retreading manufacturing. MHCVs (mainly trucks and buses) account for the largest chunk of its sales (85%) followed by LCVs at 5%, and the balance is accounted by others segments. Thus, we believe that IRL is best placed to take advantage of an expected recovery in the CV industry. Moreover, over the last six years, we have witnessed a strong correlation between volume growth in the CV industry and volume growth of IRL. The benefits at IRL's end will be accrued with a lag effect of 5-6 months as generally retreading of new tyres is undertaken after 50,000km. We expect this trend to continue going forward. Thus, in our view, IRL would benefit from a recovery in the CV industry, going forward.

The current tread manufacturing industry's size is of ~₹3,200cr, almost equally shared by unorganized and organized players

Growth to be driven by shift in trend from unorganized to organized sector

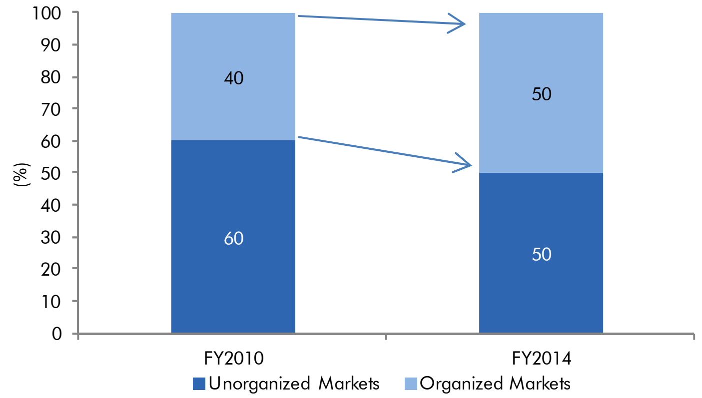
The current tread manufacturing industry's size is of ~₹3,200cr, almost equally shared by unorganized and organized players. The tread manufacturing industry grew at a CAGR of ~5% over FY2011-14. Going forward, we believe the industry would outperform its historical growth, owing to improved economic activity and increase in penetration levels considering that the current penetration levels are lower than in developed countries. Further, we also believe that the organized sector would gain market share from unorganized players due to shift in consumer preference for quality of retreading products. Also, implementation of the GST, going forward, could reduce the pricing gap between organized and unorganized players, thereby rendering the organized players' pricing equally attractive.

Exhibit 3: Tread Manufacturing Industry



Source: Company, Angel Research

Exhibit 4: Market share gain by organized players



Source: Company, Angel Research

Currently the company has 20-22% market share in the organized cold process market

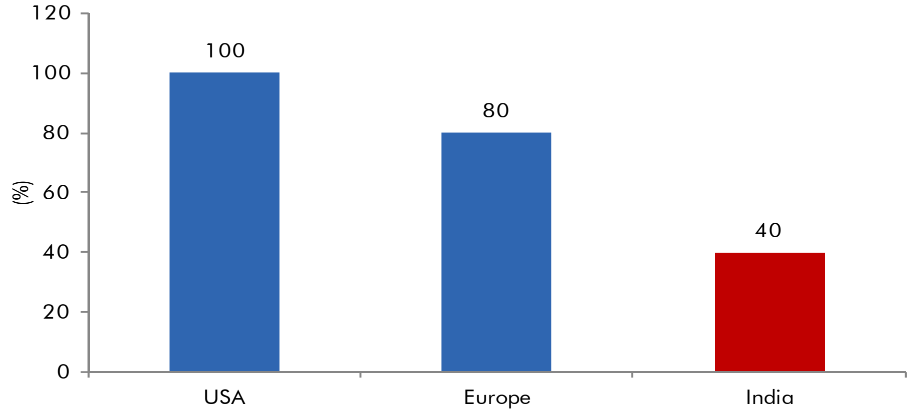
Hence, we believe that IRL is best placed to gain market share on back of better product quality, being a strong brand in the segment, and with it having a wide distribution network. Currently the company has 20-22% market share in the organized cold process market.

Lower penetration levels suggest huge potential for growth

The penetration level in India is at ~40% compared to almost 100% in USA and ~80% in Europe

Penetration level of retreading is lower in India as compared to other developed regions like USA, Europe etc. In India, the penetration level of retreading is at ~40% compared to 100% in USA and ~80% in Europe as stated by the company. We believe that going forward, penetration of retreading would increase on back of growth in road freight with improvement in economic activity, improving road infrastructure, and growing radialisation; demand for retreading will rise as new radial tryes are expensive and retreading would prove to be a cheaper alternative towards increasing the life of the tyres.

Exhibit 5: Global data of penetration level in retreading



Source: Company, Angel Research

Focus on expansion of distribution network

Currently, the company has more than 100-150 dealers, 500-600 retreaders, 25 depots pan India and the number is growing rapidly

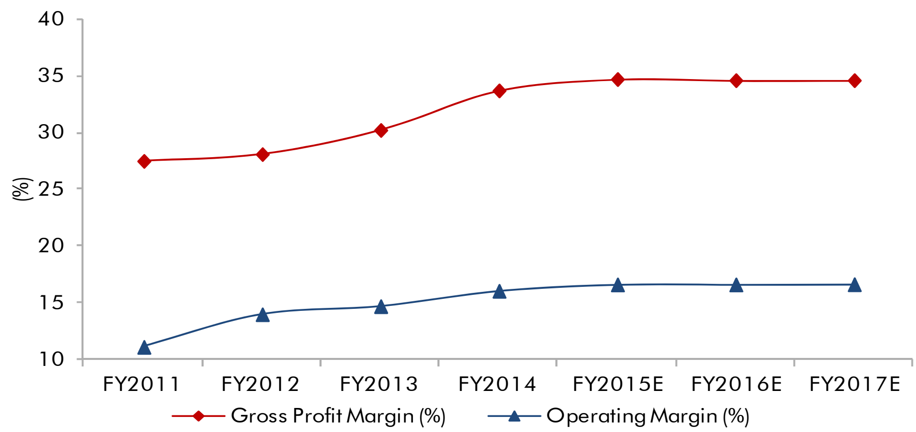
To push sales, the company is continuously focusing on increasing dealerships for its products. Currently, the company has more than 100-150 dealers, 500-600 retreaders, 25 depots pan India and the number is growing rapidly. In the last 2-3 years, the company is increasing its distribution network by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

Consistent operating margin improvement

IRL *has reported a 60-70bp margin improvement in 9MFY2015*

IRL has consistently been reporting margin improvement over the last four years on back of its effective cost management strategy including cost savings in raw materials through research & development (R&D). The company has reported operating margin improvement from 11.1% in FY2011 to 16.0% in FY2014. Also the company has report a 60-70bp margin improvement in 9MFY2015. We believe that going forward, the company would continue to deliver a healthy performance on the operating margin front on the back of lower natural rubber and crude prices and owing to its effective cost management strategy. However, we have conservatively not factored in any improvement in the operating performance in our model as the margin is at its peak level.

Exhibit 6: Gross profit margin & Operating margin trend



Source: Company, Angel Research

Outlook and Valuation

Going ahead, we expect IRL to report a top-line CAGR of ~10% over FY2014-17E to ~₹311cr

Going ahead, we expect IRL to report a top-line CAGR of ~10% over FY2014-17E to ~₹311cr owing to recovery in CV volumes in the domestic market with ~85% of IRL's revenue coming from the MHCV segment and ~5% of revenue coming from the LCV segment. Growth in CV volumes will lead to recurring business opportunities for companies like IRL. Going ahead, the company would improve its volume growth in the treading segment on back of growth in road freight with growth in economic activity, increase in organized players' market share, strong distribution network, and a strong brand. The company is in the process of expanding capacity by 4,000MT in FY2016.

We expect the company to report an 11% CAGR over FY2014-17E

On the bottom-line front, we expect the company to report an 11% CAGR over FY2014-17E on account of healthy top-line growth and operating margin and with higher other income (Cash + Investment at ~₹54cr on balance sheet which are likely to increase further). Moreover, the company is also asset light, has zero debt, and is able to post a healthy return ratio, which make the balance sheet all the more attractive.

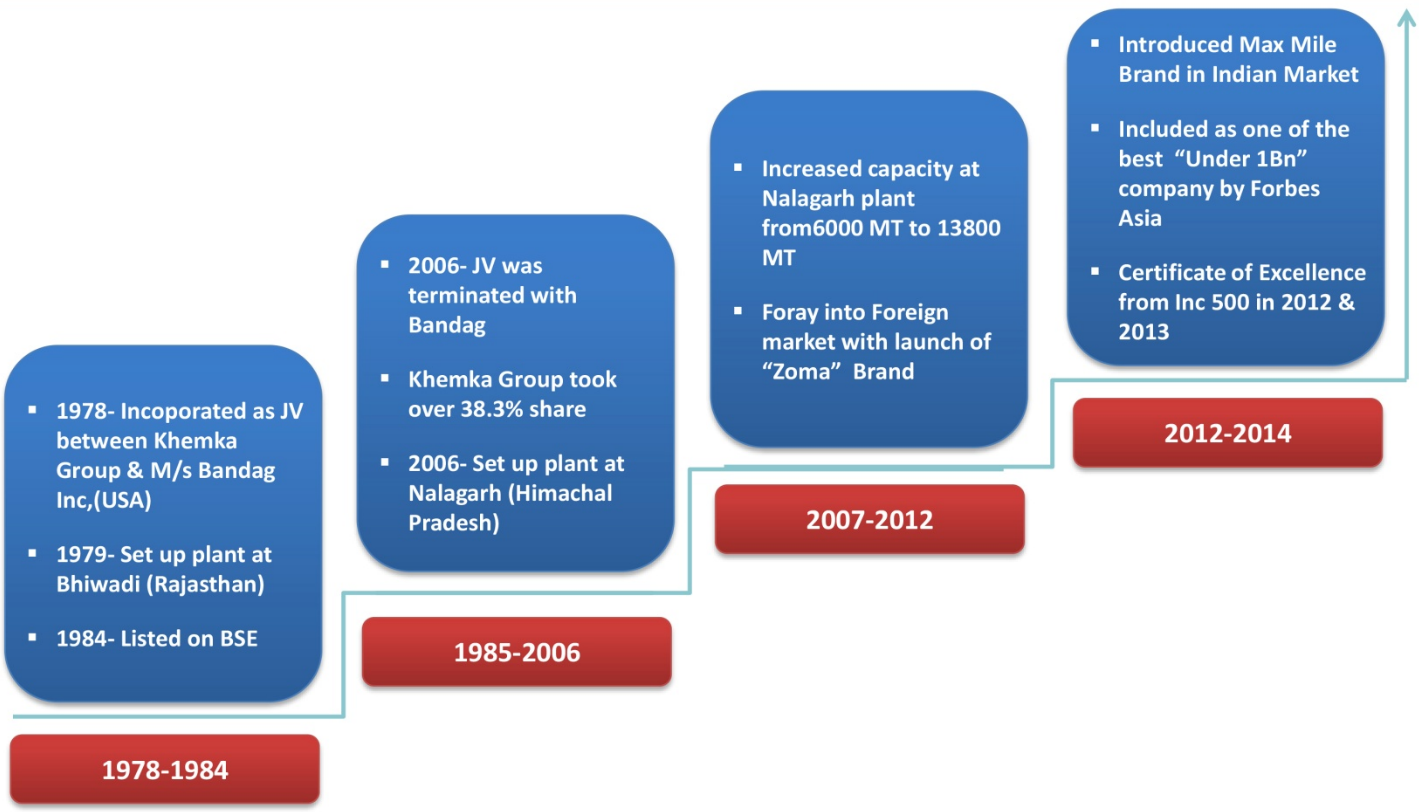
At the current market price of ₹897, the stock trades at a PE of 14.9x and 12.7x its FY2016E and FY2017E EPS of ₹60.1 and ₹70.8, respectively. We initiate coverage on the stock with an Accumulate recommendation and target price of ₹992, based on 14x FY2017E EPS, indicating an upside of ~11% from the current levels.

The downside risks to our estimates include 1) increase in competition from unorganized players would impact overall growth of the company 2) any increase in input costs (ie increase in natural rubber and crude oil prices, etc.) could negatively impact profitability, and 3) lower-than-expected CV volume growth could affect business growth.

Company Background

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

Exhibit 7: Company Profile



Source: Company, Angel Research

Profit & Loss Statement

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Total operating income	216	235	232	235	268	311
% chg	*44.0*	*8.8*	*(1.2)*	*1.3*	*14.0*	*16.0*
Total Expenditure	186	201	195	196	224	259
Cost of Materials	156	164	154	154	175	204
Personnel	11	13	15	17	20	25
Others	20	23	26	25	28	31
EBITDA	30	35	37	39	45	52
% chg	*81.3*	*14.4*	*7.9*	*4.8*	*14.0*	*16.1*
(% of Net Sales)	*14.0*	*14.7*	*16.0*	*16.6*	*16.6*	*16.6*
Depreciation & Amortisation	2	2	3	3	3	3
EBIT	28	32	35	36	41	48
% chg	*89.1*	*15.0*	*8.4*	*4.6*	*13.7*	*16.7*
(% of Net Sales)	*12.9*	*13.6*	*15.0*	*15.5*	*15.4*	*15.5*
Interest & other Charges	1	0	0	0	0	0
Other Income	0	1	1	3	4	5
(% of PBT)	*0.2*	*3.1*	*4.0*	*8.1*	*8.5*	*9.4*
Share in profit of Associates	-	-	-	-	-	-
Recurring PBT	27	33	36	39	45	53
% chg	*98.0*	*21.8*	*9.5*	*9.6*	*14.2*	*17.8*
Prior Period & Extraord. Exp./(Inc.)	-	-	-	-	-	-
PBT (reported)	27	33	36	39	45	53
Tax	6	8	8	10	14	16
(% of PBT)	*22.7*	*24.1*	*23.5*	*24.8*	*30.0*	*30.0*
PAT (reported)	21	25	28	30	32	37
ADJ. PAT	21	25	28	30	32	37
% chg	*94.1*	*19.6*	*10.3*	*7.7*	*6.3*	*17.8*
(% of Net Sales)	*9.6*	*10.6*	*11.9*	*12.6*	*11.8*	*11.9*
Basic EPS (₹)	39.8	47.6	52.5	56.5	60.1	70.8
Fully Diluted EPS (₹)	39.8	47.6	52.5	56.5	60.1	70.8
% chg	*94.1*	*19.6*	*10.3*	*7.7*	*6.3*	*17.8*

Balance Sheet

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015E	FY2016E	FY2017E
SOURCES OF FUNDS						
Equity Share Capital	5	5	5	5	5	5
Reserves& Surplus	56	76	98	122	146	175
Shareholders Funds	**62**	**82**	**103**	**127**	**152**	**181**
Total Loans	1	-	-	-	-	-
Deferred Tax Liability	1	2	2	2	2	2
Total Liabilities	**64**	**83**	**105**	**129**	**154**	**183**
APPLICATION OF FUNDS						
Gross Block	44	44	45	48	56	61
Less: Acc. Depreciation	20	21	22	25	28	32
Net Block	**24**	**23**	**23**	**23**	**28**	**30**
Capital Work-in-Progress	0	0	4	4	4	4
Investments	**1**	**27**	**40**	**51**	**60**	**70**
Current Assets	62	60	66	79	92	114
Inventories	34	32	32	34	40	49
Sundry Debtors	21	21	26	27	32	39
Cash	2	2	3	10	11	15
Loans & Advances	2	2	3	3	3	4
Other Assets	4	4	3	4	5	7
Current liabilities	24	28	29	29	31	35
Net Current Assets	**39**	**33**	**37**	**50**	**61**	**78**
Deferred Tax Asset	**0**	**0**	**1**	**1**	**1**	**1**
Mis. Exp. not written off	-	-	-	-	-	-
Total Assets	**64**	**83**	**105**	**129**	**154**	**183**

Cashflow Statement

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Profit before tax	27	33	36	39	45	53
Depreciation	2	2	3	3	3	3
Change in Working Capital	(9)	5	(5)	(5)	(11)	(13)
Interest / Dividend (Net)	1	(1)	(1)	0	0	0
Direct taxes paid	(5)	(7)	(8)	(10)	(14)	(16)
Others	(1)	(0)	(0)	0	0	0
Cash Flow from Operations	**16**	**32**	**25**	**27**	**24**	**27**
(Inc.)/ Dec. in Fixed Assets	(6)	(1)	(4)	(3)	(8)	(5)
(Inc.)/ Dec. in Investments	(1)	(26)	(13)	(11)	(9)	(10)
Cash Flow from Investing	**(6)**	**(27)**	**(17)**	**(14)**	**(17)**	**(15)**
Issue of Equity	0	0	0	0	0	0
Inc./(Dec.) in loans	(6)	(1)	0	0	0	0
Dividend Paid (Incl. Tax)	(2)	(4)	(5)	(6)	(7)	(8)
Interest / Dividend (Net)	(1)	(0)	(1)	(0)	(0)	(0)
Cash Flow from Financing	**(9)**	**(5)**	**(6)**	**(6)**	**(7)**	**(8)**
Inc./(Dec.) in Cash	0	0	1	7	0	4
Opening Cash balances	**1**	**2**	**2**	**3**	**10**	**11**
Closing Cash balances	**2**	**2**	**3**	**10**	**11**	**15**

Key Ratios

Y/E March	FY2012	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Valuation Ratio (x)						
P/E (on FDEPS)	22.6	18.9	17.1	15.9	14.9	12.7
P/CEPS	20.3	17.1	15.7	14.5	13.5	11.6
P/BV	7.6	5.8	4.6	3.7	3.1	2.6
Dividend yield (%)	0.7	0.9	1.1	1.3	1.4	1.7
EV/Sales	2.2	1.9	1.8	1.7	1.5	1.2
EV/EBITDA	15.6	12.8	11.5	10.5	9.0	7.5
EV / Total Assets	5.4	4.0	3.2	2.6	2.2	1.8
Per Share Data (₹)						
EPS (Basic)	39.8	47.6	52.5	56.5	60.1	70.8
EPS (fully diluted)	39.8	47.6	52.5	56.5	60.1	70.8
Cash EPS	44.2	52.3	57.3	61.7	66.2	77.5
DPS	6.0	8.0	10.0	11.3	12.6	15.6
Book Value	117.3	155.5	196.3	241.5	289.0	344.3
Returns (%)						
ROCE	44.3	39.3	33.7	28.7	27.2	26.7
Angel ROIC (Pre-tax)	45.8	60.3	58.2	55.5	51.1	50.4
ROE	33.9	30.6	26.7	23.4	20.8	20.6
Turnover ratios (x)						
Asset Turnover (Gross Block)	8.9	10.1	10.1	10.1	9.6	10.5
Inventory / Sales (days)	57	49	50	53	55	57
Receivables (days)	36	33	40	42	44	46
Payables (days)	26	22	21	20	19	18
WC cycle (ex-cash) (days)	67	60	69	75	80	85

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DISCLAIMER

Disclosure of Interest Statement	**Indag Rubber**
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Returns):	*Buy (> 15%)*	*Accumulate (5% to 15%)*	*Neutral (-5 to 5%)*
	Reduce (-5% to -15%)	*Sell (< -15%)*	

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