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Advisory Desk

TVS Srichakra Ltd.

BUY	
CMP	₹355
Target Price	₹468
Investment Period	12 Months

TVS Srichakra Ltd. (TVSSL), a part of TVS Group, is a leading manufacturer of two and three-wheeler tyres with a 25% market share. Two-wheeler demand growth (~16% yoy YTD) continues to be insulated from the current slowdown in the automobile sector. Given this growth and increased installed capacity of automotive tyres by 170% to 3.3cr units over FY2009-11, TVSSL's volume is expected to grow at a CAGR of 11% over FY2011-13E. Also, the promoters have increased their stake in the company from 39.5% in June 2007 to 44.4% in June 2011, demonstrating their confidence in the company's future growth outlook. We recommend Buy on TVSSL with a target price of ₹468, based on a target PE of 5x for FY2013E.

Investment rationale

Better performance of two-wheeler sales to drive the company's volume

Two-wheeler domestic sales have witnessed growth of ~16% yoy YTD. Being into the manufacturing of two and three-wheeler tyres, TVSSL is not much exposed to the risks of demand slowdown, as the two-wheeler segment continues to be insulated from the current slowdown in the automobile sector and is expected to grow at a CAGR of 13% over FY2011-13E. Backed by this and increased capacity utilisation, we expect the company's volume to grow at a CAGR of 11% over FY2011-13.

Increase in capacity utilisation to drive operating leverage

TVSSL has increased its installed capacity of automotive tyres by 170% to 3.3cr units over FY2009-11. This capacity increase is expected to drive the operating leverage for the company. However, capacity utilisation is only 48% (as of March 2011), which is expected to increase to 59% over FY2011–13E.

Increase in promoters' stake – A positive for the company

The company's promoters have increased their share from 39.5% in June 2007 to 44.4% in June 2011. This consistent increase in their share in the company is a good signal for investors, as it demonstrates the confidence of promoters in the company's future growth outlook.

Outlook and valuation

At ₹355, the stock is trading at 4.8x and 3.8x its FY2012E and FY2013E earnings, respectively. We expect the company's revenue and profit to witness CAGRs of 22% and 35%, respectively, on the back of the expected increase in capacity utilisation, which will result in an 11% CAGR in volumes over FY2011–13E. We recommend Buy on TVSSL with a target PE of 5x for FY2013E and a target price of ₹468 for an investment period of 12 months.

Key financials

Year	Sales (₹ cr)	OPM (%)	PAT (₹ cr)	EPS (₹)	RoE (%)	P/E (x)	P/BV (x)	EV/ EBITDA (x)	EV/ Sales (x)
FY2011	1,085	8.4	39	51.2	34.4	6.9	2.4	5.7	0.5
FY2012E	1,430	8.6	56	73.7	35.1	4.8	1.7	4.5	0.4
FY2013E	1,607	9.2	72	93.5	32.2	3.8	1.2	3.6	0.3

Source: Company

Investment arguments

Better performance of two-wheeler sales to drive volumes

Two-wheeler domestic sales have witnessed growth of ~16% yoy YTD, whereas M&HCVs grew by 7.1% and passenger vehicles grew only by 1.9% for the same period. As TVSSL is largely into the two and three-wheeler tyres segments, it has not been exposed to demand slowdown. The two-wheeler segment continues to be insulated from the current slowdown in the automobile sector and is expected to grow at a CAGR of 13% over FY2011-13E. Based on this growth and increased capacity utilisation, we expect the company's volume to grow at a CAGR of 11% over FY2011-13.

Exhibit 1: Domestic sales of automobiles (April–August) (in'000)

	FY2011	FY2012	*% Change*
Passenger vehicles	959	977	*1.9*
M&HCVs	121	130	*7.1*
Three-wheelers	200	200	*(0.3)*
Two-wheelers	4,621	5,358	*15.9*
Total	5,901	6,664	*12.9*

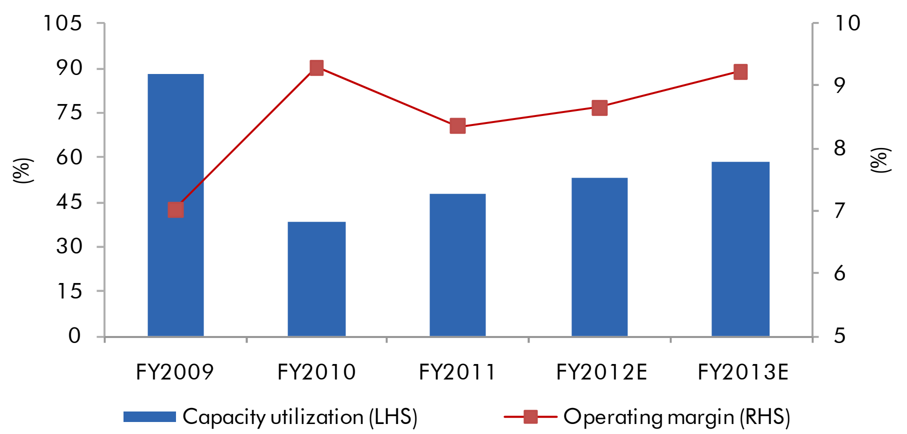
Source: SIAM

TVSSL is in a position to pass on any increase in rubber prices to consumers as it is the second largest manufacturer in the segment and is considered to be a premium brand.

Increase in capacity utilisation to drive operating leverage

TVSSL has set up a new plant at Pantnagar, Uttarakhand, (production started in July 2009) and has increased the capacity at its Madurai plant. This led to a significant increase of 170% in its installed capacity of automotive tyres to 3.3cr units over FY2009-11.

Exhibit 2: Operating leverage to drive margin



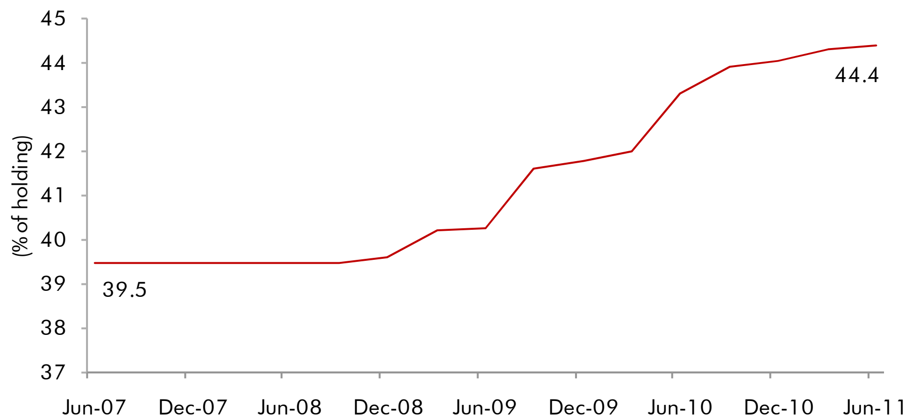
Source: Company, Angel Research

However, capacity utilisation is only 48% for tyres (as of March 2011). The company has a significant opportunity in terms of increasing its capacity utilisation to historical levels. We expect capacity utilisation to increase to 59% over FY2011–13E and improve the company's operating leverage. This will increase the operating margin by 87bp to 9.2% in FY2013 from 8.4% in 2011.

Increase in promoters' stake – A positive for the company

The company's promoters have increased their share from 39.5% in June 2007 to 44.4% in June 2011. This consistent increase in their share in the company is a good signal for investors, as it demonstrates the confidence of promoters in the company's future growth outlook.

Exhibit 3: Promoters' stake

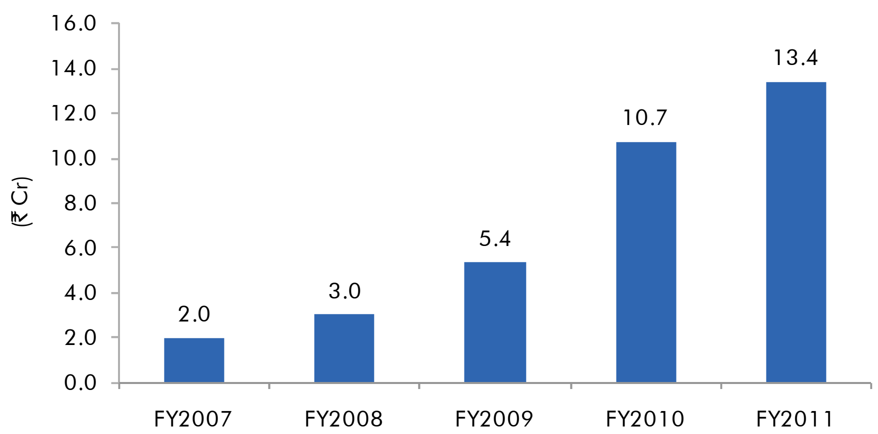


Source: Company

Branding

TVSSL is aggressively focusing on brand-building exercises to strengthen the quality of its dealer network and improve its market share in the after sales business. The company doubled its advertisement cost in FY2010; and in FY2011, the company further increased it by 25% to ₹13.4cr.

Exhibit 4: Advertisement cost



Source: Company

Competition

TVSSL has a market share of 25% (in FY2011) in the two and three-wheeler tyre segments, next to MRF – who is the leader with a 28% market share. Other players in the same segment include CEAT and Falcon Tyres.

On the valuation front, TVSSL enjoys the highest RoE among other players in the tyre manufacturing industry. With a PE of 4.8x and 3.8x for FY2012E and FY2013E, respectively, TVSSL looks very attractive among its peers.

Exhibit 5: Relative valuation

Company	Year	Sales (₹ cr)	OPM (%)	PAT (₹ cr)	EPS (₹)	ROE (%)	P/E (x)	P/BV (x)	EV/ EBITDA (x)	EV/ Sales (x)
TVSSL	2012E	1,430	8.6	56	73.7	35.1	4.8	1.7	4.5	0.4
TVSSL	2013E	1,607	9.2	72	93.5	32.2	3.8	1.2	3.6	0.3
Goodyear	CY2011E	1,510	8.0	75	32.5	23.0	9.9	2.3	3.9	0.3
Goodyear	CY2012E	1,744	10.9	123	53.3	28.8	6.0	1.7	2.0	0.2
MRF	SY2011E	10,026	8.1	292	688.0	14.9	10.2	1.5	6.3	0.5
MRF	SY2012E	11,743	10.1	462	1088.8	19.3	6.5	1.2	4.4	0.4
Apollo Tyres	2012E	11,112	9.5	342	7.0	11.6	8.8	1.1	5.1	0.9
Apollo Tyres	2013E	12,710	10	469	9.0	15.0	6.4	1.0	4.3	0.9

Source: Company, Angel Research

Financials

Exhibit 6: Key assumptions

	2012E	2013E
Volume growth (%)	10.6	11.1
Average realisation growth (%)	16.0	1.0
Change in raw-material prices (%)	25.0	(4.0)

Source: Company, Angel Research

Volume growth at an 11% CAGR over FY2011–13E

TVSSL significantly increased its installed capacity of automotive tyres by 170% to 3.3cr units over FY2009-11 to meet up with the increasing demand of two and three-wheeler tyres. We expect sales of two-wheelers and three-wheelers in the industry to grow at a CAGR of 13% over FY2011–13E. Further, we expect the company's volume to grow at a CAGR of 11% over the same period on the back of the above-mentioned factors and considering replacement demand.

Exhibit 7: TVSSL's volume growth

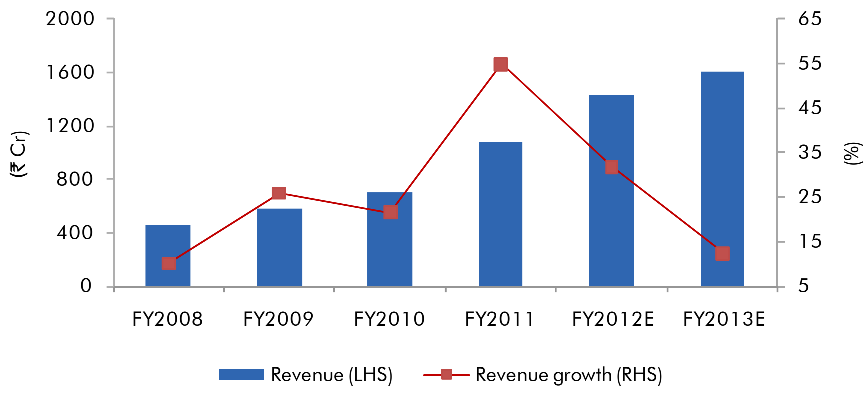
	FY2008	FY2009	FY2010	FY2011	FY2012E	FY2013E
Vehicle population growth (%)	10.1	9.8	11.3	12.9	12.8	12.7
Volume growth for TVSSL (%)	1.0	9.6	15.5	27.1	10.6	11.1

Source: Company, Angel Research

Revenue to grow at a 22% CAGR over FY2011–13E

TVSSL's revenue is expected to grow at a 22% CAGR over FY2011–13E to ₹1,607cr as volume is expected to post an 11% CAGR over the same period.

Exhibit 8: Revenue and revenue growth



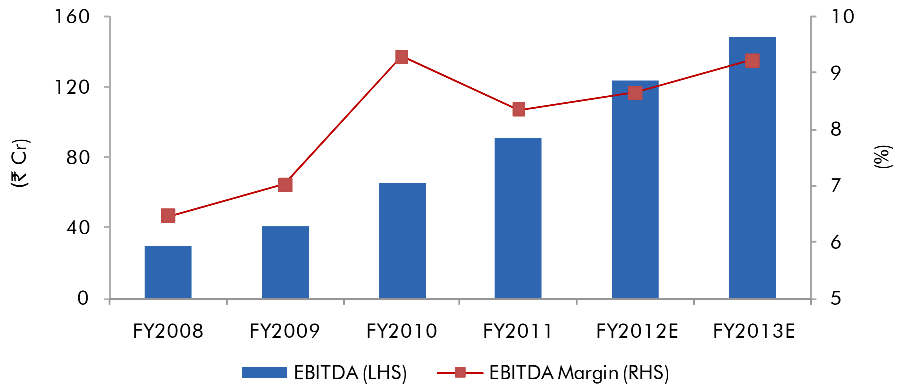
Source: Company, Angel Research

Profit to grow at a 35% CAGR for FY2011–13E

The company's operating profit margin is expected to improve by 87bp to 9.2% in FY2013E from 8.4% in FY2011, mainly on the back of increased capacity utilisation from 48% to 59% over FY2011–13E.

The company's rubber consumption is lower vis-à-vis the industry's average rubber consumption i.e., 57% of sales vis-à-vis industry average of 61%, which gives the company an edge over its peers in terms of getting affected by any increase in rubber prices. Also, TVSSL is in a position to pass on any increase in rubber prices to consumers and maintain its operating margin as it is the second largest manufacturer in the segment and is considered to be a premium brand.

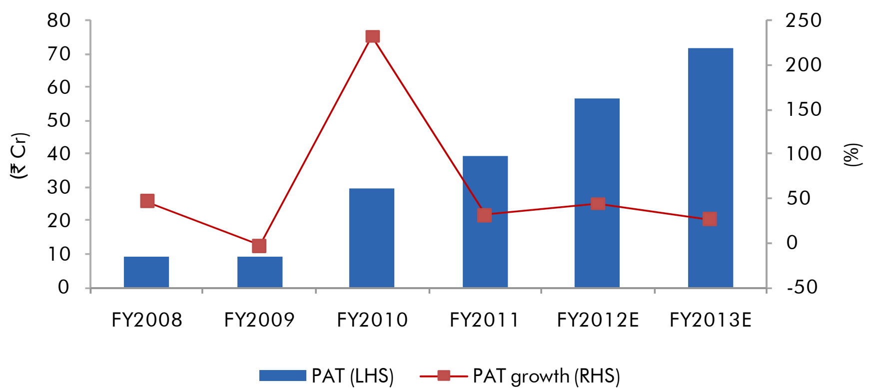
Exhibit 9: EBITDA and EBITDA margin



Source: Company, Angel Research

The interest cost of for the company stood at ₹30cr at a rate of 11.6% for FY2011. Considering the increase in the interest rates for the past 18 months, we have assumed an interest rate of 13.5% for FY2013E on a conservative basis. Given the company's revenue growth and improved operating margin, we expect TVSSL's profit to grow at a 35% CAGR to ₹72cr over FY2011–13E.

Exhibit 10: PAT and PAT growth



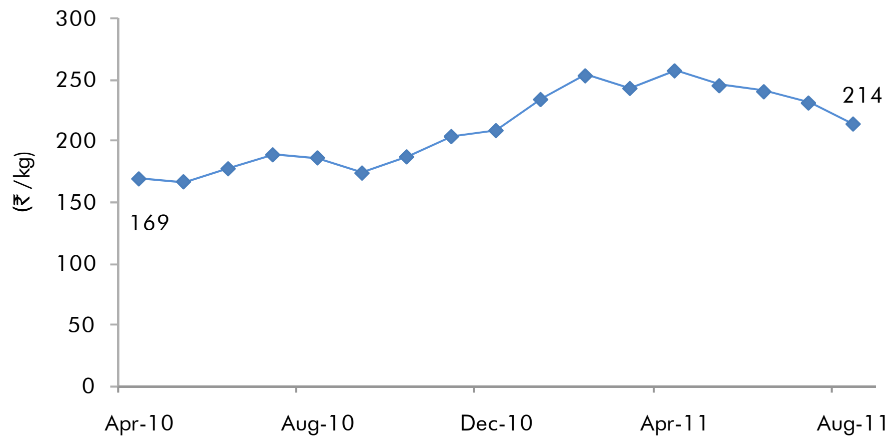
Source: Company, Angel Research

Risks

Further rise in raw-material prices

Rubber, the key raw material of the company, witnessed a price rise of 59% from ₹169/kg in April 2010 to ₹244/kg in March 2011.

Exhibit 11: Rubber prices



Source: Rubber Board

Though rubber prices are witnessing a downtrend from April 2011, any further price rise may pressurise the company's operating margin. Due to a difference in mix, rubber cost is typically 30% lower for TVSSL than other tyre companies.

Sensitivity analysis of EPS

The sensitivity analysis reflects the changes in EPS w.r.t. the percentage change in rubber price and realisation. On our assumption of 4% decrease in rubber price and 1% increase in realisation, the EPS for FY2013E stands at ₹93.5. However, if rubber price goes down by 10% and realisation increases by 10%, EPS can grow to ₹223; but if rubber price goes up by 10% with the same increase in realisation, EPS will be ₹97.

Exhibit 12: Impact on EPS w.r.t. % chg. in realisation and rubber price

(% chg. in Realization)	(% chg. in Rubber prices) -10%	-4%	0%	10%	20%	30%
-10%	19.4	-18.5	-43.7	-106.7	-169.7	-232.8
0%	121.2	83.4	58.2	-4.9	-67.9	-130.9
1%	131.4	**93.5**	68.3	5.3	-57.7	-120.7
10%	223.0	185.2	160.0	97.0	33.9	-29.1
20%	324.8	287.0	261.8	198.8	135.8	72.7
30%	426.7	388.8	363.6	300.6	237.6	174.6

Source: Company, Angel Research

Slowdown in the two-wheeler automobile segment

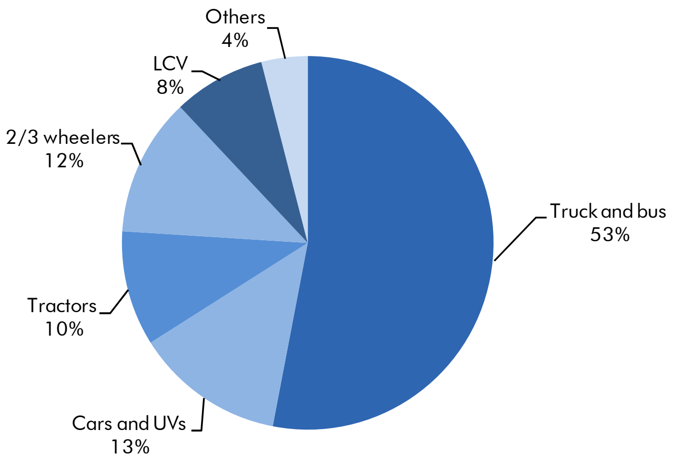
Any slowdown in the domestic sales of two wheelers may pose a risk to the company as tyre demand (OE segment) is directly dependent on automobile demand.

Tyre industry in India

According to Crisil Research, the Indian tyre industry is estimated at ₹29,000cr (as of June 2011), registering a CAGR of 16% over FY2007–11. The industry has an aggregate installed capacity of 13.7cr units and production of 9.7cr units of tyres (FY2009–10). The industry has three segments: original equipment (OE) (26%), replacement (63%) and exports (11%).

The industry's margins are directly linked to raw-material cost, as it constitutes 66% of sales turnover and 70% of operational cost. In FY2011, the industry's operating margin declined by 450–480bp from 13.4% in FY2009–10 because of the sharp increase of 66% in natural rubber prices in the domestic market. In contrast, price realisation for the same period was 17–19%, which was insufficient to sustain margins.

Exhibit 13: Industry segments (As of March 2011)



Source: Crisil Research

Two-wheeler and three-wheeler tyre industry

The two and three-wheeler tyre industry is expected to grow at a CAGR of 13% over FY2011–13E. MRF is the leader in this segment, with a market share of 28% followed by TVSSL (25%).

Exhibit 14: Market share of two and three-wheeler tyres (FY2011)

Company	Market share (%)
MRF Ltd.	28
TVS Srichakra Ltd.	25
Falcon Tyres Ltd.	18
Ceat Ltd.	8
Others	21

Source: Crisil Research

The company

TVSSL is part of the TVS Group. The company is a leading manufacturer of two and three-wheeler tyres and enjoys a market share of 25% (FY2011). The company manufactures a complete range of two and three-wheeler tyres for the domestic market. For the export market, the company manufactures industrial pneumatic tyres, farm and implements tyres, skid steer tyres, multipurpose tyres and floatation tyres, among others. TVSSL's manufacturing units are located at Madurai, Tamil Nadu and Pantnagar (Uttarakhand). The company has a total installed capacity of 330lakh units of tyres (as of March 2011).

In FY2010, TVSSL setup a new plant at Pantnagar, Uttarakhand, (production started in July 2009) and increased the capacity at its Madurai plant. This resulted in a significant increase of 170% in its installed capacity of automotive tyres to 3.3cr units in FY2011 from FY2009.

With a network of over 2,050 dealers and 20 warehouses across the country, the company is a major supplier to TVS Motors, Hero MotoCorp, Bajaj Auto and India Yamaha Motor. Exports constitute 11% of the company's net sales, which includes exports to the US, Europe, Africa, South America and Southeast Asia.

Standalone profit and loss account

Y/E March (₹ cr)	FY2008	FY2009	FY2010	FY2011	FY2012E	FY2013E
Gross sales	520	643	753	1,181	1,557	1,749
Less: Excise duty	62	67	53	96	126	142
Net Sales	458	576	701	1,085	1,430	1,607
Other operating income	-	-	-	-	-	-
Total operating income	**458**	**576**	**701**	**1,085**	**1,430**	**1,607**
% chg	-	*25.8*	*21.6*	*54.9*	*31.8*	*12.3*
Net Raw Materials	304	390	432	691	940	1,047
% chg		*28.2*	*10.6*	*60.0*	*36.2*	*11.4*
Other Mfg costs	28	37	56	89	106	119
% chg		*32.2*	*48.9*	*60.0*	*18.6*	*12.3*
Personnel	35	42	54	84	103	116
% chg		*20.8*	*26.9*	*57.7*	*22.0*	*12.3*
Other	61	66	95	130	157	177
% chg		*8.1*	*43.9*	*37.7*	*20.6*	*12.3*
Total Expenditure	429	536	636	995	1,306	1,459
EBITDA	**30**	**40**	**65**	**91**	**124**	**148**
% chg	-	*36.6*	*60.8*	*39.3*	*36.4*	*19.9*
(% of Net Sales)	*6.5*	*7.0*	*9.3*	*8.4*	*8.6*	*9.2*
Depreciation& Amort.	9	10	12	16	22	24
EBIT	**21**	**31**	**53**	**75**	**102**	**124**
% chg	-	*49.0*	*74.2*	*40.5*	*36.4*	*21.8*
(% of Net Sales)	*4.5*	*5.3*	*7.6*	*6.9*	*7.1*	*7.7*
Interest & other Charges	**11**	**19**	**16**	**30**	**36**	**38**
Other Income	4	1	6	12	14	16
(% of sales)	*0.9*	*0.2*	*0.8*	*1.1*	*1.0*	*1.0*
Recurring PBT	**9**	**12**	**38**	**45**	**66**	**86**
% chg	-	*25.3*	*221.6*	*20.0*	*46.8*	*30.0*
Extraordinary Exps./(Inc.)	0	(0)	-	(0)	-	-
PBT (reported)	**14**	**13**	**43**	**57**	**81**	**102**
Tax	4	4	14	18	24	31
(% of PBT)	*32.3*	*31.9*	*31.2*	*31.5*	*30.0*	*30.0*
PAT (reported)	**9**	**9**	**30**	**39**	**56**	**72**
ADJ. PAT	**9**	**9**	**30**	**39**	**56**	**72**
% chg	-	*(3.0)*	*232.4*	*31.4*	*44.1*	*26.9*
(% of Net Sales)	*2.0*	*1.6*	*4.3*	*3.6*	*3.9*	*4.5*
Basic EPS (₹)	**12**	**12**	**39**	**51**	**74**	**94**
Fully Diluted EPS (₹)	**12**	**12**	**39**	**51**	**74**	**94**
% chg	-	*(3.0)*	*232.4*	*31.4*	*44.1*	*26.9*
Dividend	3	3	8	10	10	10
Retained Earning	7	6	22	30	47	62

Standalone balance sheet

Y/E March (₹ cr)	FY2008	FY2009	FY2010	FY2011	FY2012E	FY2013E
SOURCES OF FUNDS						
Equity Share Capital	8	8	8	8	8	8
Preference Capital	-	-	-	-	-	-
Reserves& Surplus	51	57	78	106	153	215
Shareholders' Funds	**59**	**65**	**86**	**114**	**161**	**223**
Minority Interest	-	-	-	-	-	-
Total Loans	159	157	174	256	294	271
Deferred Tax Liability	8	8	8	10	10	10
Total Liabilities	**225**	**230**	**268**	**380**	**465**	**504**
APPLICATION OF FUNDS						
Gross Block	127	146	192	250	270	291
Less: Acc. Depreciation	64	74	80	95	117	141
Net Block	**63**	**72**	**112**	**155**	**153**	**151**
Capital Work-in-Progress	1	1	3	10	10	10
Lease adjustment	-	-	-	-	-	-
Goodwill	-	-	-	-	-	-
Investments	1	1	3	3	3	3
Current Assets	219	213	315	481	650	732
Cash	4	13	9	5	9	12
Loans & Advances	37	27	32	37	49	55
Inventory	94	65	155	264	348	391
Debtors	85	107	119	174	243	273
Current liabilities	59	57	166	269	351	392
Net Current Assets	**160**	**156**	**150**	**212**	**299**	**341**
Misc. Exp. not written off	-	-	-	-	-	-
Deferred tax assets	-	-	-	-	-	-
Total Assets	**225**	**230**	**268**	**380**	**465**	**504**

Key ratios

Y/E March	FY2008	FY2009	FY2010	FY2011	FY2012E	FY2013E
Valuation Ratio (x)						
P/E (on FDEPS)	29.3	30.2	9.1	6.9	4.8	3.8
P/CEPS	14.8	14.4	6.5	4.9	3.5	2.8
P/BV	4.6	4.2	3.2	2.4	1.7	1.2
Dividend yield (%)	1.0	1.0	2.8	3.5	3.5	3.5
EV/Sales	0.9	0.7	0.6	0.5	0.4	0.3
EV/EBITDA	14.3	10.2	6.7	5.7	4.5	3.6
EV / Total Assets	1.9	1.8	1.6	1.4	1.2	1.0
Per Share Data (₹)						
EPS (Basic)	12.1	11.7	38.9	51.2	73.7	93.5
EPS (fully diluted)	12.1	11.7	38.9	51.2	73.7	93.5
Cash EPS	24.0	24.6	54.3	71.8	101.9	124.7
DPS	3.5	3.5	10.0	12.5	12.5	12.5
Book Value	77.2	84.8	112.1	148.7	209.9	291.0
DuPont Analysis	-	-	-	-		
EBIT margin	4.5	5.3	7.6	6.9	7.1	7.7
Tax retention ratio	0.7	0.7	0.7	0.7	0.7	0.7
Asset turnover (x)	2.1	2.7	2.8	3.0	3.2	3.4
ROIC (Post-tax)	6.4	9.7	14.4	14.2	16.1	18.2
Cost of Debt (Post Tax)	4.8	8.2	6.2	7.9	8.5	9.9
Leverage (x)	2.6	2.2	1.9	2.2	1.8	1.1
Operating ROE	10.4	13.1	30.2	27.8	29.5	27.7
Returns (%)						
ROCE (Pre-tax)	9.1	13.3	19.9	19.7	21.9	24.7
Angel ROIC (Pre-tax)	9.4	14.3	21.0	20.7	23.1	26.0
ROE	15.6	13.8	34.7	34.4	35.1	32.2
Turnover ratios (x)						
Asset TO (Gross Block)	3.6	4.0	3.6	4.3	5.3	5.5
Inventory / Sales (days)	75	41	81	89	89	89
Receivables (days)	67	68	62	59	62	62
Payables (days)	50	39	95	99	98	98
WC cycle (ex-cash) (days)	124	90	74	70	74	75
Solvency ratios (x)						
Net debt to equity	2.6	2.2	1.9	2.2	1.8	1.1
Net debt to EBITDA	5.2	3.5	2.5	2.7	2.3	1.7
Int. Coverage (EBIT/ Int.)	1.8	1.6	3.4	2.5	2.9	3.3

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DISCLAIMER

Disclosure of Interest Statement	**TVS Srichakra**
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%)	