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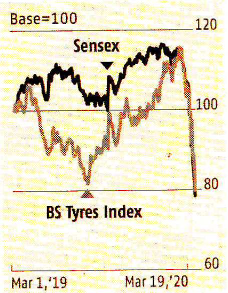
Lower raw material cost to help tyremakers

Higher share of replacement segment should help cushion demand drop



Compiled by BS Research Bureau

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While most auto component segments have been bearing the brunt of slowdown in the automobile sector, the tyre industry is expected to be less impacted than other auto suppliers. While falling demand in India and globally is expected to dent their despatches to customers (original equipment or OE makers), the replacement market and the sharply lower crude oil prices should help cushion the impact.

The domestic tyre industry is skewed towards the replacement segment, accounting for 67 per cent in tonnage terms and 56 per cent as far as volumes are concerned. This should help it to overcome the deep cyclicality of other auto segments, believe analysts.

K Srikumar, vice-president and co-head, corporate ratings, ICRA, expects a recovery in the replacement market in 2020-21 (FY21), supported by factors like improved rural demand on the back of better monsoon, first-rate water storage levels, and better consumer demand.

The other factor which should help tyremakers is the sharp reduction in crude oil prices. Derivatives of crude oil account for about half of the raw material costs of tyremakers. While the price of natural rubber, which accounts for over a third of raw material costs, is steady, analysts expect prices to be benign in the near term.

Analysts at Equirus Research believe margins are a bigger lever, compared to volumes, as far as earnings growth of domestic tyre companies is concerned. Tyremakers, according to the brokerage, do not pass on the full impact of raw material increase and decrease in the replacement market.

Most analysts expect volume recovery to happen in the second half of FY21, led by passenger vehicles and two-wheelers. Among the listed players, MRF and Ceat have lower dependence on truck tyres, compared to Apollo Tyres and JK Tyre.

MRF also has the lowest exposure to the OE segment, as it contributes about a fifth to its sales, compared to 29-30 per cent for Apollo and Ceat.

MRF and Balkrishna Industries are best placed as far as leverage is concerned, with negligible debt and superior cash position.

While the tyre segment is better placed than other auto suppliers, given the uncertainty on the demand front, investors should await visibility on volumes and replacement sector trends before considering an investment.