

Tyre stocks wobble as margin pain persists

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Shares of tyre manufacturers, including Apollo Tyres Ltd, MRF Ltd, and Ceat Ltd, have plunged by 16%, 9%, and 17%, respectively, so far in CY22. This is not without reason. Tyre makers have not yet seen any bright spots on the demand or the margin front and continue to fight input cost inflation. The continued surge in raw material prices is making it tough for these companies to avoid margin compression.

For the sector, raw material consumption cost has risen by more than 5% sequentially in Q4FY22 (till 28 February), according to an analysis by JM Financial Institutional Securities Ltd. Year-on-year, costs have risen by 22%. "Our analysis suggests that to maintain healthy margins, tyre companies would have to hike prices further in the replacement segment by 6-8%," JM Financial's analysts said in a report on 8 March.

As such, auto ancillary companies can directly pass on commodity inflation via contracts with original equipment manufacturers (OEMs). Analysts reckon tyre companies have resorted to price hikes around 15% so far in FY22 to cope with rising costs, though this casts a shadow on the already subdued demand. However, clearly, this would not suffice.

The ongoing Russia-Ukraine conflict has led to a surge in crude oil prices, affecting tyre makers, as crude derivatives account for a major portion of raw materials used by them. According to ICICI Securities, for every 10% increase in crude oil price, about 200 basis points of increase in price is required to remain gross margin neutral. One basis point is one-hundredth of a percentage point.

On the positive side, one key input, natural rubber, has remained comparatively stable. Average domestic natural rubber prices in Q4FY22 (till 28 February) have declined by 8% sequentially.

Meanwhile, investors would closely track how the demand plays out amid

Increasing stress

The JM Tyre RM index shows that prices of raw materials used to manufacture tyres have grown by 5% sequentially and 22% year-on-year in Q4FY22.



*Q4FY22 index gives the average of January and February. Source: JM Financial Institutional Securities Ltd

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such steep price hikes given that a recovery in demand is yet to be seen. In Q3FY22, tyre makers experienced muted domestic OEM and agricultural demand and that momentum has not seen an upside. JM Financial's analysts pointed out their tyre-focused channel checks across dealers indicate that replacement market demand for two-wheeler and passenger cars turned weak during Q4FY22 so far, while sales in the truck and bus seg-

ment continued to remain muted. This is because of restrictions on personal mobility imposed in January to contain the spread of coronavirus, financial stress among fleet operators, and price hikes.

Further, rising inflation would mean there could be limited disposable income for consumers. This might favour replacement demand to an extent. "Amid increasing cost of ownership, new vehicle sales may get dampened. But replacement sales may continue to be relatively strong, if customers defer their new vehicle purchase," said Jay Kale, ana-

lyst, Elara Securities (India) Pvt. Ltd. Meanwhile, an escalation in the conflict in Ukraine or supply chain disruptions could be key risks for stocks in the tyre manufacturing sector, while a drop in crude prices would offer respite. "We expect margin to recover to sustainable level only in H2FY23 (if raw material basket consumption cost sustains/moderates)" the JM Financial report added.

IN PERILOUS TIMES

TYRE makers have hiked prices around 15% so far in FY22 but this casts a shadow on subdued demand

INVESTORS would track how demand plays out amid price hikes as it has not yet been seen to recover

AN escalation in the Ukraine war or a supply chain failure remains a risk for tyre stocks

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Having said that, there is hope of recovery in replacement demand as covid cases subside. This would mean schools, colleges, and offices will re-open, necessitating mobility. Additionally, increased