



MRF LTD. - "BUY"

3rd September, 2009

STOCK DETAILS

Particulars	Details
BSE Code	500290
Current Market Price	Rs. 4152.20
Market Capitalisation	Rs. 17,605 mn
Face Value	Rs. 10
Book Value	Rs. 2,634
52 Wk High (BSE)	Rs. 4947.70 – (28 Jul' 09)
52 Wk Low (BSE)	Rs. 1501 – (06 Mar 09)

COMPANY PROFILE

It was incorporated as a private limited company in 1960 to take over the business of a partnership firm called the Madras Rubber Factory, started by late Shri K. M. Mammen Mapillai. The company began as a manufacturer of rubber products and then later on moved to manufacture tyre in 1961 with a maiden public issue in 1963.

ABOUT THE BUSINESS

It has marked its leadership in the manufacturing of extensive range of superior quality tyres, pretreads, conveyor belts and polyurethane paints spread across its 7 production facilities in southern India located at Ponda in Goa, Medak in Andhra Pradesh, Arakonam, Tiruvatiyyur and Gummidipoondia in Tamil Nadu, Kottayam in Kerala, Pondicherry. It exports its products to over 75 countries globally.



MRF Tyres has consistently been chosen as OEM (Original Equipment Manufacturers) fitment by almost every major car manufacturer in India. It enjoys the highest brand preference for superior quality, appearance and performance. By these virtues, today it is the market leader with the largest market share in almost every segment of the tyre industry.

To meet the changing dynamics of the automobile industry, it has launched MRF Revz, India's 1st bike radial tyre and MRF ZVTV, the radial tyre for new generation cars for improved speed, performance, fuel efficiency, comfort and handling.

MRF's Product Portfolio:

- 1) Tyres for Cars, Jeeps and Utility vehicles
- 2) Tyres for LCV (Light Commercial Vehicles) & MHCV (Medium and Heavy Commercial Vehicles)
- 3) Tyres for Two wheelers
- 4) Farm service Tyres
- 5) Aircraft tyres
- 6) High performance bias and radial tyres
- 7) Inner tubes
- 8) Conveyor belts
- 9) Speciality Coatings

The company derives 95% of revenues from tyres and tubes business while other segments like Conveyor belts and Speciality Coatings contribute 5% of total revenues.

MRF's Clients:

Maruti, Tata Motors, Honda Sael Cars India, Mahindra and Mahindra, Volvo, Hero Honda, Bajaj Auto

MRF's Capacity Expansion:

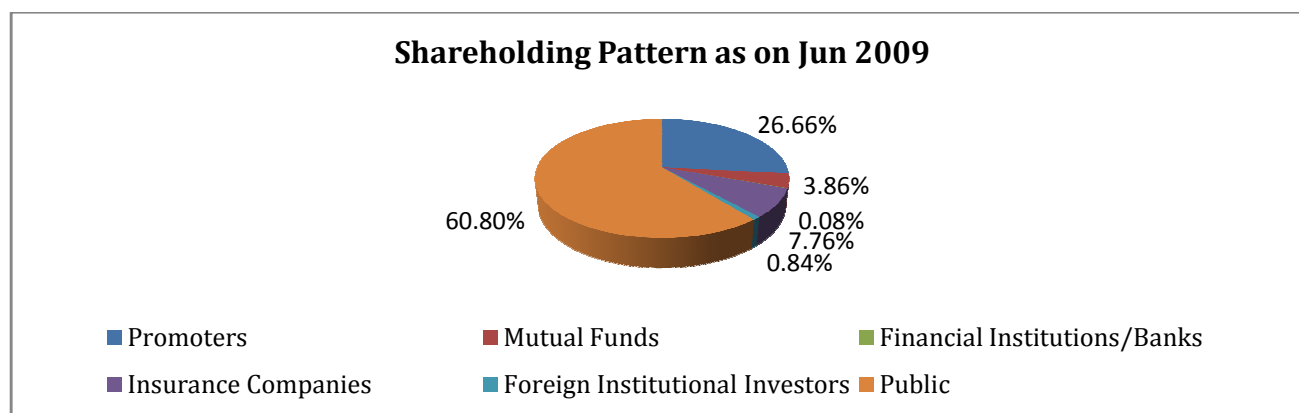
MRF has invested in an ongoing capex of ~ Rs. 9000 mn to setup a new plant at Perambalur near Trichy with an initial capacity of 350,000 radial tyres per annum (1st Phase – Q3 FY 09) which will be scaled upto 1,050,000 radial tyres per annum in 2nd Phase



FINANCIAL HIGHLIGHTS

Particulars (Rs. In millions)	FY 08	FY 09E	FY 10E
Sales	50,465	56,409	60,922
EBITDA	4,106	6,824	7,663
EBITDA Margin	8.13%	12.1%	12.58%
Net Profit	1,434	2,594	3,098
PAT Margin	2.84%	4.58%	5.07%
No. of Equity Shares (mn)	4.24	4.24	4.24
EPS	338	612	731
EPS growth	(16%)	81%	19%
P/E (x)	12.88	7.11	5.95
Book Value (Rs.)	2,634	3,223	3,930
Price/Book Value	1.51	1.29	1.06

SHAREHOLDING PATTERN AS ON JUNE 2009





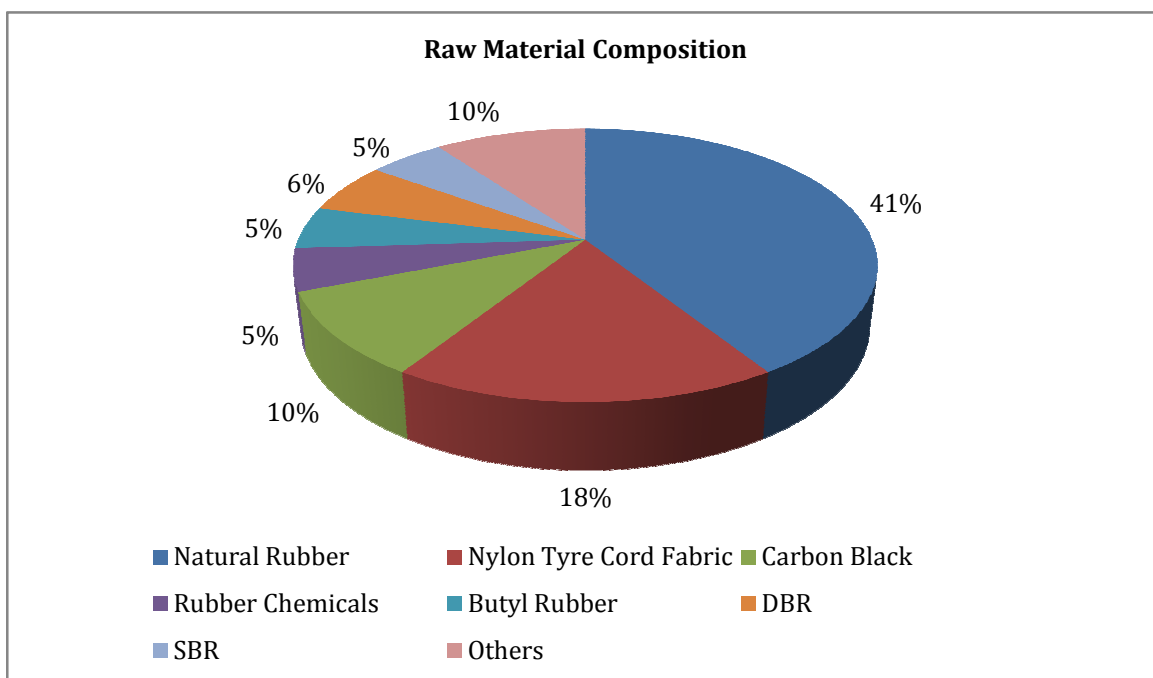
COMPETITIVE STRENGTHS OF THE COMPANY:

- 1) **Leading Market share:** MRF is the market leader in the Indian Tyre industry with a market share of 24%, followed by Apollo Tyres at 21%, JK Tyre at 18% and Ceat at 13%.
- 2) **Better product mix:** It has a better product mix as its market share in the MHCV category is above 50% compared to its peers like Apollo, Ceat, and JK whereas in passenger cars and light commercial vehicles it accounts for a 10% share in the overall product mix.
- 3) **Sales Mix:** 60% of its revenues come from the replacement market, 30% from the OEM market, and 10% from exports.
- 4) **Early mover advantage:** To meet the changing dynamics of the automobile industry, it has recently launched MRF Revz, India's 1st bike radial tyre and MRF ZVTV, the radial tyre for new generation cars for improved speed, performance, fuel efficiency, comfort and handling. MRF in India is the only company that has brought aviation tyre technology. MRF Aero Muscle tyre has been approved by CEMILAC (Center for Military Airworthiness & Certification) for the Chetak / Cheetah helicopters - aviation tyres that meet international quality standards.



RISK & CONCERNS:

- 1) **Import of Chinese Tyres:** In recent years, MRF had to fight stiff competition from import of cheap Chinese Tyres. China is cost competitive in tyre due to tax exemptions and subsidies on power costs. Chinese tyres were fast winning customers in the replacement market. Radial Tyres imported from China were nearly 30% cheaper than those manufactured in India and had captured over 10% market share.
- 2) **Higher Input Costs:** Natural rubber and Nylon cord fabrics are the most critical raw materials as it accounts for >50% of total raw material cost. Since most of the raw materials are crude derivatives, a rise in crude prices has a negative impact on margins.



Source: Automotive Tyres Manufacturing Association

- 3) **Poor Monsoons:** Poor monsoons can take the air out of the growth of tyre makers since lower farm output would reduce freight movement.



RISK MITIGATION:

Curb on Imports - In November 2008, the government announced restrictions on Chinese Tyre imports and made import licence mandatory. Subsequently, the domestic sales of tyre companies have improved as imports from China plunged by 78%.

OVERVIEW OF TYRE INDUSTRY

Global Scenario

Global tyre market of over Rs. 6,000 bn (US\$ 120 bn) comprises of about 60% of Passenger Cars (PC) and LCV segments while Heavy Commercial Vehicles (HCV) segment accounts for approximately 27%. More than 60% of the automobile tyre market is shared by the top four global players.

Predominantly, Radial tyres are used in PC, LCV and HCV segments. The radialisation in PC is more than 95% and about 60% in LCV and HCV segments. The extent of radialisation in LCV and HCV is higher in developed countries.

Indian Scenario

According to Automotive Tyre Manufacturing Association, Tyre industry in India is currently valued at Rs. 220 bn. (US\$ 4.4 bn) Indian Tyre Industry is expected to grow at a CAGR of 6.5% in tonnage terms from 11.35 lakh MT for over the next 5 years and reach a size of Rs. 300 bn. The industry comprises of 10 major tyre companies which account for 95% of the tyre business. The tyre companies produce truck tyre and a range of non truck tyre.

Heavy and commercial vehicle segment is undergoing a change since multi – axle vehicles are more in demand and manufacturers are changing their product mix accordingly.

Radial tyres have shown significant increase in its usage every year. With the introduction of radial tyres, even technology has assumed significance. All cars introduced by foreign companies in the country ply on radial tyres.



In India, 95% of the tyres in the passenger car segment are radial tyre. The commercial vehicles viz., trucks and buses still run on ordinary non radial tyre and only 10 -12% of the segment is radial against the world average of 60%. However, this trend is likely to change in coming years. Usage of radial tyre is expected to reach 30% in Heavy Commercial Vehicles and 20% in LCVs in approximately three years due to improvement in road conditions and road projects coming up in 11th – 5 year plan.

Ministry for Roads, Transport and Highways has a target of adding 20 kms/day, 7000 km a year and 35,000 km by 2014.

The shift in usage of radial tyre is expected to be higher with the completion of golden quadrilateral highways connecting all metropolitan cities.



Duty Structure:

Trade Policy on Tyres:

All categories of Tyre can be exported freely. Raw materials required for the manufacturing of tyre can be imported except for Carbon Black.

Custom Duty on Tyres

Normal rate of Basic Customs Duty – Most Favoured Nations (MFN)	10%
Preferential/concessional Customs Duty under Trade Agreements	
*Asian Pacific Trade Agreement (formerly known as Bangkok Agreement)	8.60%
*Indo Sri Lanka Free Trade Agreement	Nil
SAPTA (SAARC Preferential Trading Agreement)	Nil
	5%**
*India Singapore Comprehensive Economic Cooperation Agreement	2.5%

* Import from Bangladesh, Bhutan, Maldives and Nepal

** Import from Pakistan and Sri Lanka

Anti Dumping Duty

Tyres for Cars – 8.5%

Tyres for Trucks – 8.6%

Excise Duty – 8%

Source: Automotive Tyres Manufacturing Association



INDUSTRY GROWTH DRIVERS

- 1) **Growth in Auto sales:** Tyre sales are directly correlated to sale of vehicles. Auto sales have improved over the last 8 months especially in LCV & MHCV segment. The following growth matrix describes the same:

Company	PV	LCV	M & HCV	Tractors
Maruti	Growth(%): 18% Aug: 09 84,808 Jan: 09 71,779	-	-	-
Tata Motors	Growth(%): 7% Aug: 09 20,048 Jan: 09 18,665	Growth(%): 55% Aug: 09 18,644 Jan: 09 12,044	Growth(%): 79% Aug: 09 11,118 Jan: 09 6,222	-
Mahindra	Growth(%): 20% Aug: 09 17,100 Jan: 09 14,285	Growth(%): 31% Aug: 09 658 Jan: 09 503	-	Growth(%): 53% Aug: 09 10,594 Jan: 09 6,931

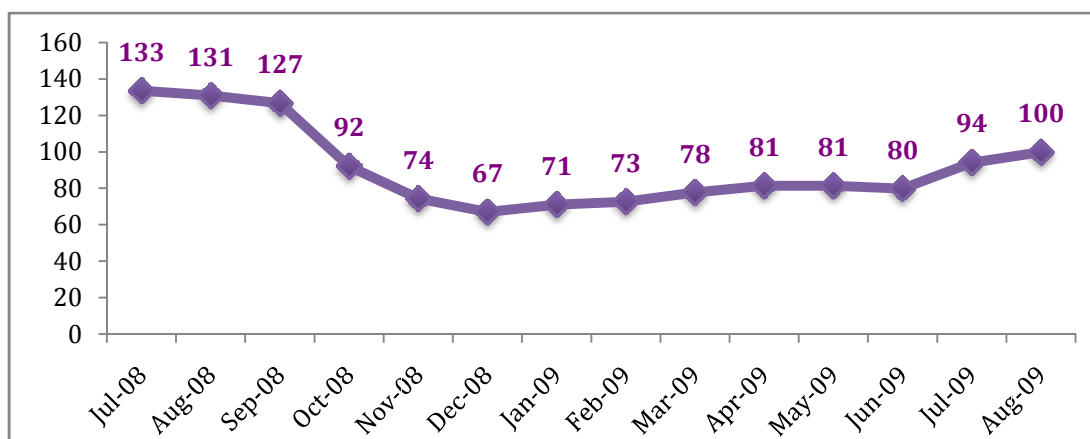


INDUSTRY GROWTH DRIVERS

- 2) **Replacement demand:** A majority of tyre sales in the commercial vehicle section are from replacement market. Trucks and Buses tyres form 70% of the tyre sales in India of which 80% is from the replacement demand (as there is a need to replace tyres after 65,000 kms). The market for replacement tyres contributes around 75% of total sales for tyre makers. In fiscal 2009, of the total 12.83 million truck and bus radial tyres produced in India, 8.99 million tyres were sold in the replacement segment.
- 3) **Thrust on infrastructure development:** Government is focusing on the development of infrastructure particularly inter – city roads. Stepping up allocation for National Highways Development Programme (NHDP) will provide the much-needed impetus to the developmental pace of national highways.
- 4) **Stabilising rubber prices:** Raw materials form the major component of tyre manufacturing cost. Rubber prices of both Natural and synthetic rubber are seeing a stabilising trend which would result in lower input costs for tyre companies which would improve their margins. The rubber prices were highly volatile in CY 2008. While in H1 FY 09 the rubber prices were scaling new heights both in the international and domestic market, from Oct onwards the prices started cooling down. It is currently at Rs. 100 per kg from a peak of Rs. 133 per kg in Jul 2008. Industry would earn remunerative if rubber prices stay ~Rs. 90 per kg.

Rubber prices per kg

Source: Rubber Board of India





FINANCIALS - Income Statement – (Rs. in millions)

Particulars	FY 08	FY 09E	FY 10E
Sales	50,465	56,409	60,922
Other Operating Income	46	-	-
Expenditure			
(Increase)/Decrease in inventory	(896)	1,598	(460)
Manufacturing expenses	35,506	35,620	40,420
Other Expenses	11,795	12,367	13,299
EBITDA	4,106	6824	7,663
Depreciation	1,702	2,300	2,550
EBIT	2,404	4,524	5,113
Interest	663	794	700
Other Income	361	200	225
Profit before Tax	2,102	3,930	4,638
Less: Tax	694	1,336	1,540
Profit after Tax	1,409	2,594	3,098
Excess Provision for taxation of earlier years written back	26	-	-
Net Profit after tax & EI	1,434	2,594	3,098
EPS (Rs.)	338	612	731



Balance Sheet – (Rs. in millions)

LIABILITIES	FY 08	FY 09E	FY 10E
Share Capital	42.4	42.4	42.4
Reserves and Surplus	11,127	13,622	16,620
Secured Loans	5,774	4,571	-
Unsecured Loans	6,151	4,365	2,730
Minority Interest	0.5	0.5	0.5
Deferred Payment Credit	569	0	0
Net Deferred Tax Liability	99	99	99
Total	23,763	22,700	19,492
ASSETS	FY 08	FY 09E	FY 10E
Fixed Assets	24,273	28,710	30,710
Less: Depreciation	15,574	17,874	20,424
Net Fixed Assets	8,699	10,836	10,286
CWIP	4,437	2,000	-
Investments	643	643	643
Current Assets, Loans & Advances (A)	19,943	18,364	19,541
Current Liabilities & Prov. (B)	9,959	9,143	10,978
Net Current Assets: (A) – (B)	9,984	9,221	8,563
Total - ASSETS	23,763	22,700	19,492



Cash Flow Statement – (Rs. in millions)

Particulars	FY 08	FY 09E	FY 10E
Operating Cash Flow before Working Capital Changes	4,501	6,823	7,663
Net Cash Flow from Operating Activities (A)	2,699	6,322	7,349
Net Cash Flow from Investing Activities (B)	(5,673)	(1,800)	225
Net Cash Flow from Financing Activities (C)	3264	(4135)	(6789)
Increase/(Decrease) in cash & cash equivalents during the year	290	387	785
Cash and Cash Equivalents at the beginning of the year	736	1026	1,413
Cash and Cash Equivalents at the end of the year	1,026	1,413	2,198

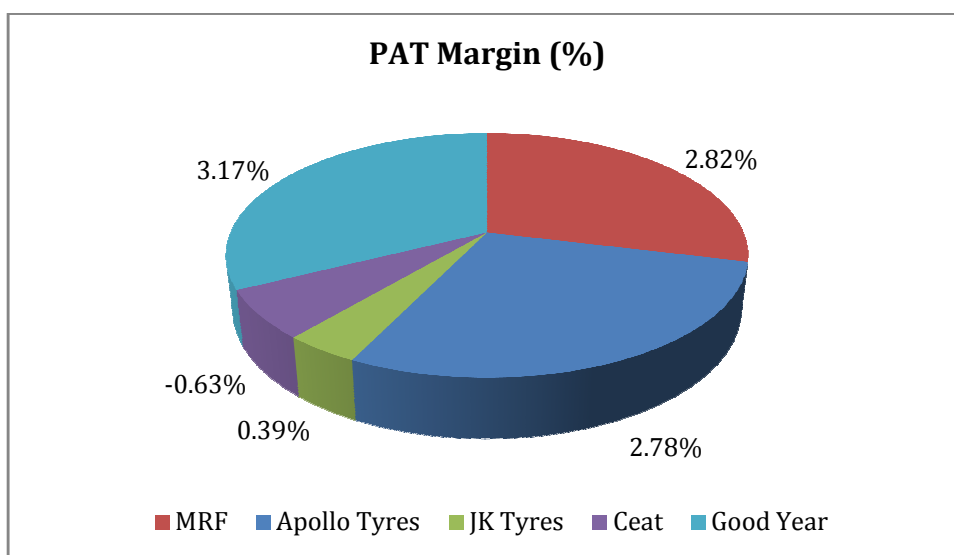
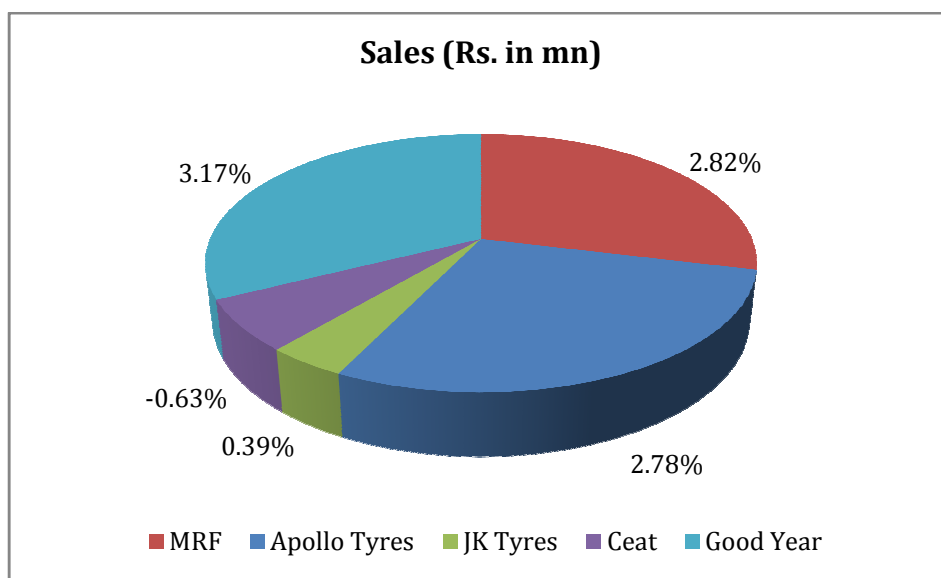


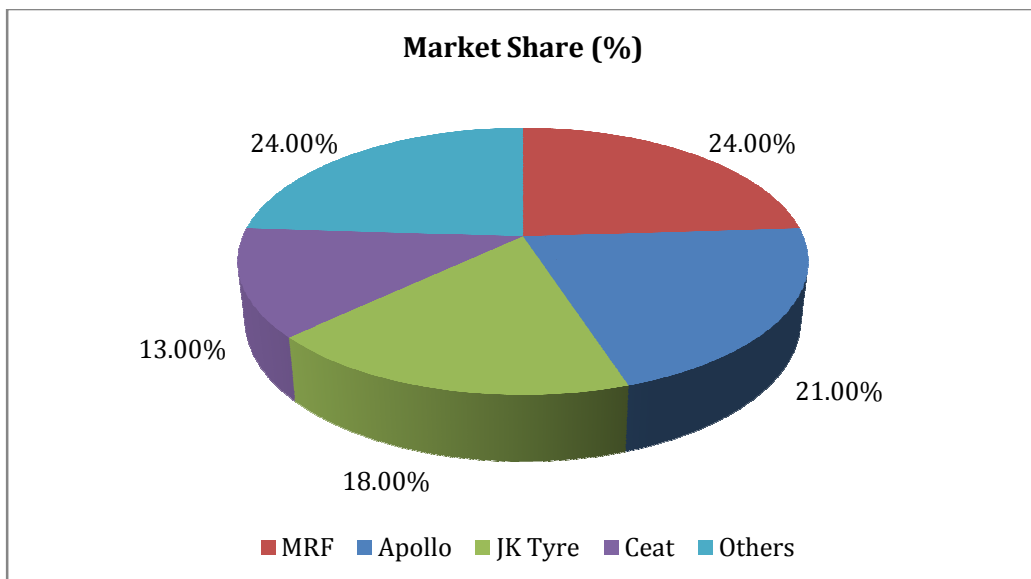
RATIO ANALYSIS

Particulars (Rs. In millions)	FY 08	FY 09E	FY 10E
EBITDA Margin	8.13%	12.10%	12.58%
PAT Margin	2.82%	4.58%	5.07%
EV/Sales	0.58	0.46	0.31
EV/EBITDA	7.15	3.81	2.48
ROE (%)	12.84%	18.98%	18.59%
ROCE (%)	13.09%	20.82%	27.25%
Fixed Assets Turnover Ratio (times)	6.60	5.77	5.77
Interest Coverage Ratio (times)	3.63	5.7	7.3
Inventory days	61	59	51
Debtors days	42	39	37
Creditors days	55	58	60
Non Cash Working Capital/Sales (times)	0.18	0.14	0.10



PEER ANALYSIS







Peer Valuations

Company	CMP (3 rd Sept, 2009)	EPS (TTM)	P/E	Interest Coverage Ratio	P/BV	Face Value (Rs.)
MRF	4,152.2	443.15	9.37	3.56	1.58	10
Apollo Tyres	42.70	3.06	13.95	3.67	1.59	1
Ceat	150.15	16.01	9.37	(0.25)	1.06	10
Good Year	166.85	19.62	8.50	16.68	2.45	10

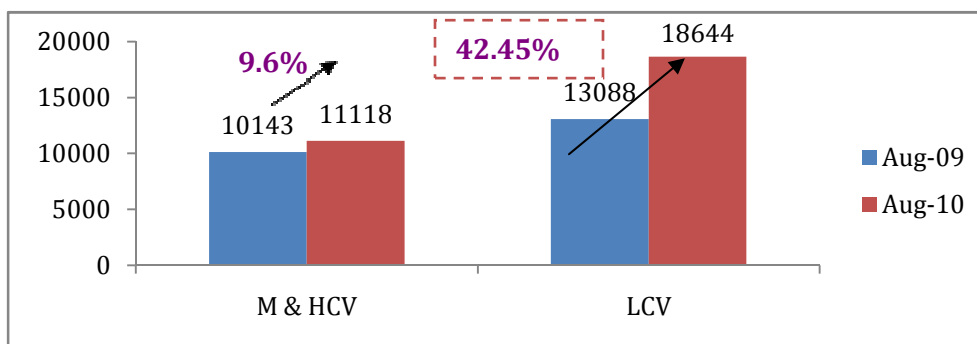


INVESTMENT RATIONALE

- 1) **Signed an agreement with Tata Motors to supply radial tyres for Nano Cars:** MRF has been chosen by Tata Motors to supply radial tyres for its newly launched small car 'Nano'. MRF currently supplies 10,000 tyres per month to Tata Motors for Nano. Unless other cars, 'Nano' will have a different set of tyres for front and back wheels. Tata Motor's Sanand Plant Capacity near Ahmedabad (Initial Capacity of 2.5 lakh Nano cars) is expected to be fully operational by Jan 2010. The Nano cars manufactured at this plant will drive growth for MRF tyres. Currently, the Nano car bookings stand at 203,000
- 2) **Turnaround in Commercial Vehicles segment to drive growth:** MRF is a preferred tyre supplier to Tata Motors LCV & M&HCV segment.

Tata Motors Commercial Vehicles segment had been experiencing de-growth in M&HCV segment. There was 18.8% decline in sales to 37,284 units in FY 2009 as compared to 45,932 in FY 08.

Turnaround in commercial vehicles segment.....



However, Q1 FY10 saw a turnaround on account of economy picking up which is expected to recover at a greater pace. **Tata Motors M&HCV volumes grew by 9.6% to 11,118 units (Aug 2009) from 10,143 units (Aug 2008), the first positive growth in over a year.** Tata Motors LCV volumes posted a growth after nearly a year. **The LCV space posted a strong Y-o-Y growth of 42.45% from 13,088 units in Aug 2008 to 17,750 units in Aug 2009.**



INVESTMENT RATIONALE

3) Impact of Rubber Prices:

Particulars	Rubber (Rs. per kg)	Rice	Total Raw Material Expenditure (% of sales)	Net Profit Margin (%)
Sept - 08	Rs. 130			
Dec -08	Rs. 77.8		79.24%	(2.82)%
March - 09	Rs. 73.8		56.68%	4.87%
June - 09	Rs. 80.8		53.48%	8.69%
Aug -09	Rs. 99.8		66.05%	

Source: Rubber Board of India, Company Results

Note: Effect of Raw Materials acquired would be seen in the results of the next quarter.

Raw materials acquired (rubber in Sept 08 at Rs. 130 per kg is reflected in Results of Dec - 08 and same is the case with quarters from there onwards)

We expect the rubber prices to stabilize at levels of Rs. 100 per kg. In the event of any price rise in the future, we believe MRF would be in a position to pass on the rising costs to the OEMs and final consumers in the replacement market.

4) Savings in interest cost due to repayment of debt: Interest coverage ratio is likely to improve from meager 3.63% (FY 08) to 7.3% (FY 10E) mainly due to improved operating cash flows from higher revenues and lower raw material cost. Company is almost through with its capex at Trichy plant and is now utilizing its internal accruals to retire its debt. A significant savings of ~Rs. 94 mn will directly translate into higher bottom line.



COMMENTS

MRF has shown a dramatic turnaround in Q3 Sept. FY 09. Company got the benefit of rubber prices falling to ~Rs. 73/kg in Qtr ending June 09. However prices have risen since then and have now stabilized at Rs. 100/kg. Tyre companies enjoy a healthy EBITDA margins when rubber prices are ~Rs. 85 – 90 per kg. MRF has cleared its inventory accumulation in Q3 FY 09. From Q2 FY10, we expect volume growth to accelerate due to rise in OEM sales to Tata Motors with its Sanand Plant (Nano Plant) facility fully operational by Jan 2010. On July 09, it has for the first time since the start of economic slowdown shown growth in sale of commercial vehicles which is a very strong indicator of economic revival. Overall sales for Passenger Vehicles have improved. Global economic revival has added momentum in the domestic economy which has led to increased auto sales, leading to increased demand for tyres from OEMs.

VALUATION

Sales for Sept. FY 09E is likely to register a 12% growth from Rs. 50,645 mn (FY 08) to Rs. 56,409 mn (FY 09E). It has already registered 9 months sales (Oct. 08 to June 09) to Rs. 41,959 mn. In line with the volume growth, PAT is likely to improve from Rs. 1,409 mn (FY 08) to 2,594 mn (FY 09 E). Nine months PAT is Rs. 1,561 mn, lower nine months profits is mainly due to loss of Rs. 383 mn in Q1 FY 09 due to higher raw material cost and lower sales due to depressed economic activity prevalent during that period. EPS for FY 09E is likely to improve to Rs. 612/- from Rs. 338/- (FY 08) and thereafter to Rs. 731/- in FY 10E. MRF being a market leader in tyre sector is quoted at a mouth watering Price/Book Value of 1.06x (BV – Rs. 3,930/- FY 10E).

It is currently traded at a P/E of 6.78x and 5.68x of FY 09E and FY 10E earnings which we believe is available very cheap for an investment horizon of 12 – 18 months.

In our opinion this stock deserves merit and we assign a **“BUY”** based on a P/E 11x FY 10E earnings of Rs. 731/- with a price target of Rs. 8,041/-



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