Sharekhan
by BNP PARIBAS

Apollo Tyres

Operationally strong quarter; valuations reasonable

Sector: Automobiles
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 90**	
Price Target: **Rs. 108**	↓

↑ Upgrade ↔ No change ↓ Downgrade

Company details

Market cap:	Rs. 5,168 cr
52-week high/low:	Rs. 206/74
NSE volume: (No of shares)	38.5 lakh
BSE code:	500877
NSE code:	APOLLOTYRE
Sharekhan code:	APOLLOTYRE
Free float: (No of shares)	33.8 cr

Shareholding (%)

Promoters	40.9
FII	22.9
DII	17.1
Others	19.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-1.7	-40.5	-45.3	-50.4
Relative to Sensex	-2.3	-16.9	-21.3	-29.5

Sharekhan Research, Bloomberg

Q4FY20 operating results of Apollo Tyres limited (ATL) were ahead of our as well as street estimates. The company posted better than expected margin performance. Despite a steep fall in the topline, margins improved driven by soft commodity prices and cost control measures. Going ahead, ATL expects replacement demand to pick up faster in both India and Europe once the lockdown norms are relaxed by the Governments. Resumption of business activity and increased usage of personal vehicles post CONVID-19 would drive replacement demand. ATL continues to outpace industry growth in both the geographies led by new product introductions and strengthening distribution reach. ATL is expected to deliver topline growth over the next two years in a challenging demand environment. Moreover, with soft commodity prices and sustained cost control measures, we expect margins to improve sharply and expect strong 33% earnings CAGR over FY20-22 period. Also, with renowned private equity firm Warbug Pincus subscribing to compulsorily convertible preference shares in March 2020 (convertible at price of Rs 171.4 per equity share as compared to CMP of Rs 90 and resulting in equity stake of ~10%) exudes confidence. Hence, we retain Buy rating on the stock.

Key positives

- ATL posted better than expected operating margins in Q4FY20 despite a steep fall in the topline. OPM at 13.2% improved 330 bps y-o-y and 110 bps q-o-q and was better than our as well as street estimates of 10.7%.
- ATL expects the commodity prices to remain soft. Further, benefits from commodity prices are expected to accrue in coming quarters which would aid margin expansion.
- ATL's commentary on faster recovery for the replacement demand in both Indian and European operations was encouraging. Further, ATL continues to outpace the industry in the aftermarket segment in both the geographies.

Key negatives

- The ATL topline was under pressure declining by 15% yoy in Q4FY20 impacted by COVID-19. Domestic operations revenues fell by 20% while the European operations revenues dipped by 4%.
- Depreciation and interest expenses rose sharply by 36% and 110% on a y-o-y basis and were higher than expectations.

Our Call

Valuations attractive; maintain Buy with revised PT of Rs 108: In order to factor the near-term weakness due to COVID-19, we have cut our FY2022 earnings estimates by 6%. ATL valuations at 7.4x FY22 earnings are lower than long term historical average of 10x. Further the, P/BV multiple of 0.5x is also luring. Hence, we retain Buy rating on the stock with a revised PT of Rs 108.

Key Risks

Prolonged Coronavirus infection in India and Europe and weak consumer sentiments.

Valuation Rs cr

Particulars	FY2018	FY2019	FY2020E	FY2021E	FY2022E
Revenues	14,842.9	17,548.8	16,327.0	14,802.7	16,854.5
Growth (%)	12.6%	18.2%	-7.0%	-9.3%	13.9%
EBIDTA (Rs cr)	1,653.6	1,958.6	1,911.4	2,081.2	2,430.5
OPM (%)	11.1%	11.2%	11.7%	14.1%	14.4%
Adjusted PAT	723.9	879.7	442.2	510.2	773.5
% YoY growth	-34.2%	21.5%	-49.7%	15.4%	51.6%
Adjusted EPS (Rs)	12.7	15.4	7.7	8.0	12.2
P/E (x)	7.1	5.9	11.6	11.2	7.4
P/B (x)	0.5	0.5	0.5	0.5	0.5
EV/EBITDA (x)	5.1	4.4	6.9	6.1	4.9
ROCE (%)	6.9	7.4	4.4	4.8	6.1
RONW (%)	7.4	8.8	4.3	4.8	6.4

Source: Company; Sharekhan estimates

Operating results significantly ahead of estimates; leads to PAT beat: Apollo Tyres Q4FY20 operating results were significantly ahead of our as well as street estimates driven by better than anticipated margin performance in difficult demand environment. Consolidated Revenues declined 15% y-o-y (were slightly below estimates) driven by a 20% fall in the domestic market. Domestic revenues dipped on account of transition from BS4 to BS6 emission norms and impact of lockdown due to COVID-19 impact. European operations revenues dipped marginally by 4% y-o-y due to weak demand environment. Apollo Tyres however surprised positively on the margin front reporting margin expansion on both a y-o-y and a q-o-q basis despite a double-digit fall in the topline. OPM at 13.2% improved 330 bps y-o-y and 110 bps q-o-q and were ahead of our estimates of 10.7%. Softening commodity prices and cost control measures led to better than expected margins. Depreciation expenses increased sharply 35% y-o-y due to the commencement of the new AP plant while interest expenses more than doubled to Rs 91 cr due to increased debt which offset the benefits of strong operating performance to a large extent. Apollo Tyres realised tax credit of Rs 10 cr during the quarter compared to tax expense of Rs 14 cr in corresponding quarter. Net Profit at Rs 78 cr was ahead of our estimates of Rs 67 cr.

Demand picking up; replacement segment expected to recover faster: Automotive industry witnessed zero sales in the month of April 2020 as Government announced lockdown to contain COVID-19. However, the demand environment is gradually picking up after Government announced resumption of business activities post 20th April 2020. Although the lockdown (to contain the impact of COVID-19) remains, Government has allowed industries and business to resume with requisite safety protocols. Most of the OEMs have restarted operations and production is gradually picking up. Also, ATL stated that the underlying replacement demand forming about 70% of domestic revenues (except passenger vehicles) is strong and would recover fast. ATL is ramping up capacity and would reach 50% utilisation by May 2020 and further improve utilisation in June 2020. Also, the replacement market in Europe (80% of revenues) is expected to pick up with the Governments easing lockdown restrictions and people preferring personal transport. While FY21 will be impacted by COVID-19 we expect sharp recovery in FY22. Overall, we expect ATL topline to grow in low single digits over the FY20-22 period.

Margins to improve on soft commodity prices and cost control: In Q4FY20, ATL margins at 13.2% improved on both y-oy and qoq basis despite the fall in the topline mainly driven by soft commodity prices and cost control initiatives by the company. ATL expects the commodity prices (both natural rubber and crude) to remain soft. ATL expects the raw material basket to decline further by about 3% from the levels witnessed in Q4FY2020 which would augment margins further. Also, ATL is undertaking several cost control measures (both employees and overhead expenses) which would help in margin improvement. We have factored 270 bps margin improvement for ATL over the next two years.

Conference call highlights

- **Demand environment:** ATL stated while the OEM demand continues to witness pressure on account of COVID-19, the replacement demand is picking up and is expected to recover fast as compared to the OEM segment. Due to COVID-19 impact, both the India and Europe operations are likely to witness de-growth.
- **Market share:** ATL stated that it continues to gain market share in the domestic replacement market driven by new product launches and strengthening of its distribution network.
- **Ramp up of operations:** ATL witnessed zero sales and production in domestic market in April 2020 owing to the lockdown announced to contain COVID-19. The company has resumed operations and would reach 50% utilisation in May 2020 with further ramp up in June 2020.
- **Commodity prices:** ATL expects the commodity prices to remain soft. ATL expects further 3% reduction in commodity basket from Q4FY20 levels.
- **Distribution network:** ATL stated that out of its total dealerships in India, about 30-40% are exclusive Apollo dealers while the rest are multi branded. ATL stated that dealerships are gradually opening up after obtaining requisite approvals from the respective state Governments.
- **UHP tyres:** ATL stated that the share of ultrahigh performance tyres in Europe has improved from 26% in FY19 to about 30% in FY20 leading to a better mix.
- **Capex:** Owing to weak near-term demand on account of COVID-19, company has reduced FY21 domestic capex by about Rs 400 crores. Revised capex guidance for FY21 stands at Rs 1,000-1,100 cr.
- **Allotment of CCPS to private equity firm:** ATL stated that allotment terms of compulsorily convertible preference shares (CCPS) to Warbug Pincus remain unchanged.

Results Rs cr

Particulars	Q4FY20	Q4FY19	%YoY	Q3FY20	%QoQ
Revenue	3,610.1	4,273.7	(15.5)	4,399.7	(17.9)
Total Expenses	3,135.1	3,849.1	(18.5)	3,866.2	(18.9)
EBITDA	475.0	424.6	11.9	533.5	(11.0)
EBITDA margin (%)	13.2%	9.9%	330 bps	12.1%	110 bps
Other income	-2.4	48.5	NA	17.8	NA
Depreciation	313.7	231.4	35.6	283.0	10.9
Interest	91.2	43.4	110.2	67.3	35.6
PBT	67.7	198.4	-65.8	201.1	-66.3
Less: Tax	-10.1	14.4	NA	27.2	NA
Reported PAT	77.9	84.0	-7.3	173.9	-55.2
Exceptional (Expense) / Income	0.0	-100.0	-	0.0	
Adjusted PAT	77.9	184.0	-57.7	173.9	-55.2
EPS (Rs)	1.5	3.6	-57.7	3.4	-55.2

Source: Company; Sharekhan Research

Segmental Rs cr

Particulars	Q4FY20	Q4FY19	%YoY	Q3FY20	%QoQ
Segmental Revenues (Rs cr)					
APMEA (Asia pacific, Middle East and Africa)	2,474.2	3,113.7	-20.5	2,811.4	-12.0
Europe (Europe and America)	1,163.8	1,209.8	-3.8	1,625.7	-28.4
Others	491.1	686.6	-28.5	597.0	-17.7
Total	**3,610.1**	**4,273.7**	**-15.5**	**4,399.7**	**-17.9**
Segmental EBIT (Rs cr)					
APMEA (Asia pacific, Middle East and Africa)	178.0	266.5	-33.2	209.4	-15.0
Europe (Europe and America)	(29.8)	(46.5)	NA	42.2	NA
Others	10.8	19.0	-42.9	20.4	-46.9
Total	**159.0**	**239.0**	**-33.5**	**272.0**	**-41.6**
EBIT Margin (%)					
APMEA (Asia pacific, Middle East and Africa)	7.2	8.6	(140 bps)	7.4	(20 bps)
Europe (Europe and America)	(2.6)	(3.8)	120 bps	2.6	(520 bps)
Others	2.2	2.8	(60 bps)	3.4	(120 bps)
Total	**3.9**	**4.8**	**(90 bps)**	**5.4**	**(150 bps)**

Source: Company; Sharekhan Research

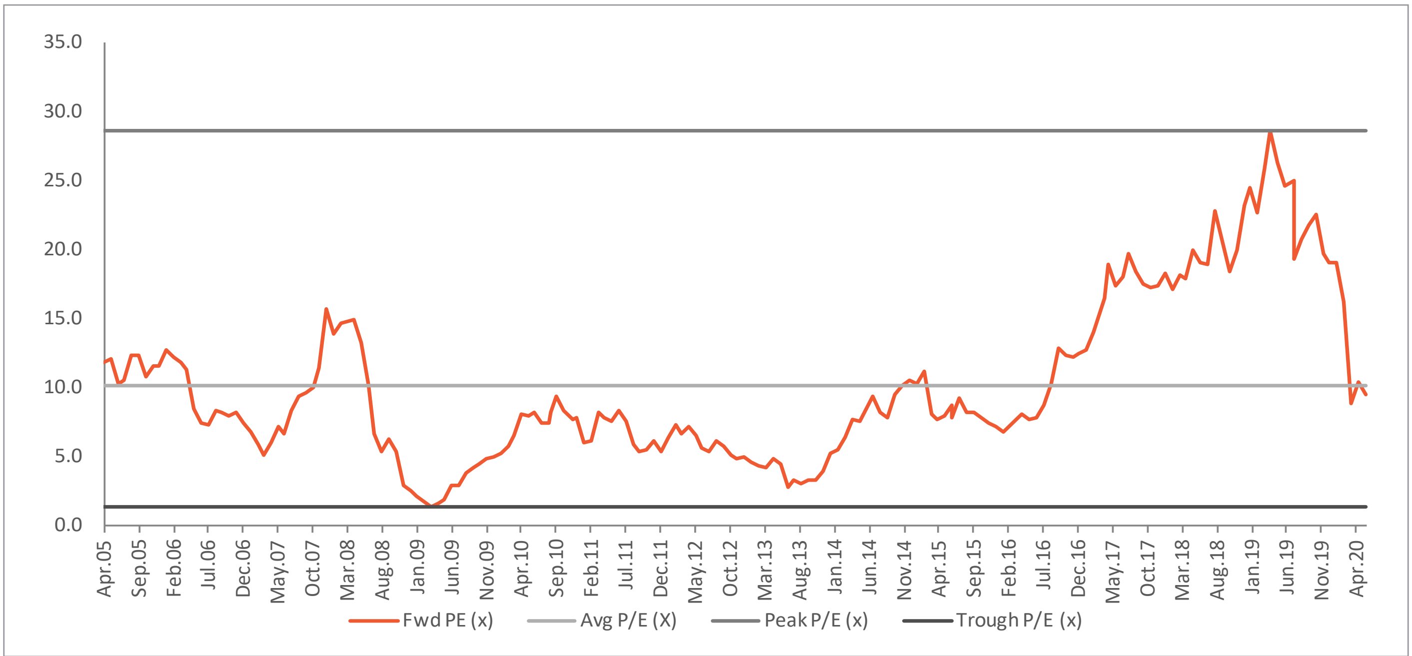
Outlook

Expect strong 33% earnings CAGR over FY20-22: ATL replacement demand is expected to recover fast as truck capacity utilisation picks up in the domestic market. Also, the replacement demand in the European market is expected to gain momentum as the Governments eases lockdown restrictions. While FY21 would witness decline on account of COVID-19, FY22 is likely to witness a sharp recovery. Overall, we expect revenues to grow over FY20-22 period. Also, margins are expected to improve given the soft commodity prices and cost control measures. We expect strong 33% earnings CAGR for ATL over the next two years.

Valuation

Cut estimates for FY22; valuations attractive; Retain Buy: In order to factor the near term weakness due to COVID-19, we have cut our FY2022 earnings estimates by 6%. ATL valuations at 7.4x FY22 earnings are lower than long term historical average of 10x. Also, P/BV multiple of 0.5x is also luring. Moreover, renowned private equity firm Warbug Pincus subscribing to compulsorily convertible preference shares in March 2020 (convertible at price of Rs 171.4 per equity share as compared to CMP of Rs 90) exudes confidence. Hence, we retain Buy rating on the stock with a revised PT of Rs 108.

One year forward P/E (x) band



Source: Sharekhan Research

About company

ATL is the largest Indian tyre manufacturer. ATL is a fairly diversified player present in India as well as Europe. Indian business contributes about 70% to revenue, while European business contributes about 30%. With its recent entry into the 2W space, ATL has become a full-fledged tyre player having presence across automotive categories viz. passenger vehicles, commercial vehicles and two wheelers. The OEM segment contributes about 27% to FY2019 revenue, while the replacement segment accounts for the balance 73%.

Investment theme

ATL is one of the leading tyre companies having a dominant market share in both the commercial vehicle and passenger vehicle space. ATL is present in India and Europe markets. The replacement segment forming about 75% of the revenues is expected to recover fast in both India and Europe as Governments ease lockdown restrictions and open business activities. ATL is expected to deliver growth over the next two years in a challenging demand environment. Margins are expected to improve on back of soft commodity prices and cost control initiatives. We expect strong 33% earnings CAGR over next two years. We retain Buy recommendation on the stock.

Key Risks

- ATL derives about 30% of its revenue from European operations. Hence, the company is exposed to currency risks. Any adverse movement in INR-Euro would impact the financial performance.
- Crude oil and natural rubber form about 65% of the raw-material basket. Prices of both are linked to international movement and are highly volatile. Any sudden spike in raw-material costs could adversely impact profitability.

Additional Data

Key management personnel

Onkar S Kanwar	Chairman & Managing Director
Neeraj Kanwar	Vice Chairman & Managing Director
Gaurav Kumar	Chief Financial Officer
Sunam Sarkar	President & Chief Business Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Neeraj consultants	12.90%
2	HDFC Asset Management Co Ltd	7.00%
3	Apollo Finance Group Ltd	7.00%
4	Franklin Resources Inc	6.70%
5	SUNRAYS PROPERTIES & INV	6.50%
6	WHITE IRIS INVESTMENT LTD	4.90%
7	SACRED HEART INVESTMENT CO	4.30%
8	ICICI Prudential Asset Management	3.20%
9	Motlay Finance Pvt Ltd	3.00%
10	Classic Auto Tubes Ltd	2.70%

Source: Bloomberg

Sharekhan
by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;