

Margins surprise positively...

Apollo Tyres (ATL) reported a healthy operational performance in Q4FY20. Total consolidated operating income came in at ₹ 3,610 crore, down 15.5% YoY (APMEA i.e. largely India revenues down 20.5% YoY to ₹ 2,474 crore, Europe revenues down 3.8% YoY to ₹ 1,164 crore). EBITDA was at ₹ 475 crore (up 11.9% YoY) with attendant EBITDA margins at 13.2% (up 110 bps QoQ). The sequential margin improvement was on account of a substantial 360 bps drop in raw material costs. Negative operating leverage, however, led to a rise in both employee costs as well as other expenses. Consequent PAT came in at ₹ 78, supported by deferral tax gains of ₹ 38 crore.

Healthy aftermarket slate to lend support

Over the past few quarters, we have been positive on pockets of the ancillary space that derive significant contribution from the aftermarket i.e. replacement channel. With the OEM pack now facing a gradual ramp up in supply post Covid-19 in addition to further stress on already subdued demand courtesy unprecedented slowdown in consumption and economic activity, our thesis has only gained strength. ATL is a prominent player in the replacement tyre market domestically (replacement share in total mix at ~65%), especially in radial car tyres (PCR) and radial M&HCV tyres (TBR, second largest player). Share of replacement demand in PCR, TBR are at 50%, 75%, respectively. Notwithstanding ATL's healthy position in aftermarket, however, its high exposure to the CV space (worst affected during ongoing automotive slowdown; recovery some way away and linked to meaningful pickup in infrastructure activity) remains an area of concern. In Europe, the company's steady progress in market share and product mix front is a positive, albeit overall market there remains low growth by nature. We build 1.3% India and 4.6% Europe sales CAGR over FY20P-22E.

Cost initiatives, product mix improvement to aid margins

While European operations (~30% of consolidated sales) already have a structurally lower margin profile, plant utilisation levels there and in India are expected to come under additional stress (especially in H1FY21E) on the back of slow resumption of manufacturing activities. However, the impact of lower capacity utilisation would be counteracted by improvement of channel mix in favour of aftermarket and cost rationalisation initiatives (ATL is targeting 20% reduction in fixed costs during FY21E). Benign prices of key inputs i.e. rubber and crude oil derivatives are an added tailwind. We build in 12.9% margins in FY21E and 13.8% margins in FY22E.

Valuation & Outlook

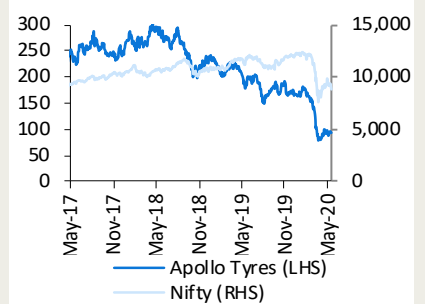
We expect sales, PAT CAGR at 2.3%, 0.9%, respectively, in FY20-22E. Despite likely benefits on margins front, the large net debt on books (~₹ 6,000 crore as of FY20P) and expected gradual nature of demand revival are seen inhibiting returns to double digit return ratios. Hence, we maintain **HOLD** on ATL, valuing it at ₹ 100 i.e. 4.5x EV/EBITDA on FY22E numbers.



Particulars

Particular	Amount
Market Capitalization	₹ 5263 Crore
Total Debt (FY 20P) (₹ Crore)	6,579.9
Cash & Inv. (FY 20P) (₹ Crore)	749.6
EV (₹ Crore)	11,093.2
52 week H/L (₹)	206 / 74
Equity capital	₹ 57.2 Crore
Face value	₹ 1

Price chart



Key Highlights

- Q4FY20 revenues fall 15.5% YoY tracking lower tonnage APMEA revenues down 20.5%, Europe sales down 3.4%.
- Consolidated margins up 110 bps QoQ on 360 bps gross margin expansion.
- Meaningful RoCE improvement some way away, although product mix improvement, fixed cost rationalisation and high aftermarket share are margin accretive
- Maintain HOLD with revised target price of ₹ 100 i.e. 4.5x FY22E EV/EBITDA

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Key Financial Summary

	P	FY21E	FY22E	CAGR (FY20E-22E)		
Net Sales	14,840.5	17,548.8	16,327.0	14,653.5	17,100.0	2.3%
EBITDA	1,651.3	1,958.9	1,915.6	1,883.1	2,351.6	10.8%
EBITDA Margins (%)	11.1	11.2	11.7	12.9	13.8	
Net Profit	723.9	680.0	476.4	135.9	484.8	0.9%
EPS (₹)	12.7	11.9	8.3	2.4	7.6	
P/E	7.3	7.7	11.0	38.7	12.1	
RoNW (%)	7.4	8.3	4.8	1.2	4.3	
RoCE (%)	7.7	8.0	4.8	3.5	6.1	

Exhibit 1: Variance Analysis

(₹ crore)	Q4FY20	Q4FY20E	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	Comments
Total Operating Income	3,610	3,498	4,274	(15.5)	4,400	(17.9)	Topline came in marginally ahead of estimates tracking higher reported sales in the APMEA region
Raw Material Expenses	1,902	1,880	2,485	(23.5)	2,477	(23.2)	RM costs came in substantially lower at 52.7% of sales, down 360 bps, primarily tracking benign commodity prices
Employee Expenses	602	596	618	(2.7)	644	(6.6)	
Other expenses	631	639	746	(15.4)	745	(15.2)	Other expenses came in higher at 17.5% of sales, up 60 bps QoQ
EBITDA	475	382	425	11.9	534	(10.9)	
EBITDA Margin (%)	13.2	10.9	9.9	323 bps	12.1	104 bps	EBITDA margins came in at a three year high tracking lower than anticipated RM costs partially limited by higher employee and other expenses as a percentage of sales
Depreciation	314	278	231	35.6	283	10.9	
Interest	91	71	43	110.1	67	35.6	
Other income	(2)	6	49	(104.9)	17.8	(113.5)	
Tax	(10)	10	14	(169.6)	27	(136.7)	Tax rate for the quarter came in negative tracking tax gains on re-assessment of deferred tax asset/liability
PAT	78	30	84	(7.3)	173.9	(55.2)	
EPS (₹)	1.4	0.5	1.5	(7.3)	3.0	(55.2)	
Key Metrics							
Revenue (₹ crore)							
APMEA	2,474	2,258	3,114	(20.5)	2,811	(12.0)	Indian operations reported marginally better sales
Europe	1,164	1,239	1,210	(3.8)	1,626	(28.4)	Europe operations reported muted performance but were ahead of industry
EBIT Margin (%)							
APMEA	7.2	NA	8.6	(140) bps	8.5	(130) bps	
Europe	(2.6)	NA	(1.5)	(110) bps	2.6	(520) bps	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ crore)	FY21E			FY22E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	15,232	14,653	-3.8	16,963	17,100	0.8	Muted outlook for OEM volume over FY20-22E leads to downward revision in our sales estimates for FY21E. Healthy replacement market, however, will limit declines
EBITDA	1,882	1,883	0.1	2,181	2,352	7.8	
EBITDA Margin (%)	12.4	12.9	50 bps	12.9	13.8	90 bps	Muted commodity prices lead us to upgrade our margin estimates, which are partially constrained by negative operative leverage at play due to lower volumes
PAT	211	136	-35.4	445	485	9.0	
EPS (₹)	3.7	2.4	-35.4	7.0	7.6	9.0	Increase in interest & depreciation charge to P&L to drastically impact profitability at the PAT level in FY21E

Source: Company, ICICI Direct Research

Conference Call Highlights

Management guidance/outlook and demand

- **The company sees YoY revenue decline in FY21E (both in India as well as Europe),** largely on account of OEM segment weakness
- In initial weeks post partial lockdown relaxations, the strength of replacement demand uptick across segments (heavier in PCR) has positively surprised ATL. Currently, it is witnessing 50% of normalised sales in May
- ATL is not seeing any downtrading in initial India replacement sales in favour of retreaded or imported tyres

Covid-19 commentary

- ATL estimated ₹ 500 crore in lost sales during March 2020 on account of the pandemic outbreak
- All plants are operational; **Kerala plants are at ~70% utilisation levels, Gujarat & Chennai plants at ~40% utilisation at present**
- The company has received <€2 million worth of benefits from Netherlands government by way of subsidised wage bill. It has applied for some other benefits related to deferment of tax payments

Revenues, costs and margins

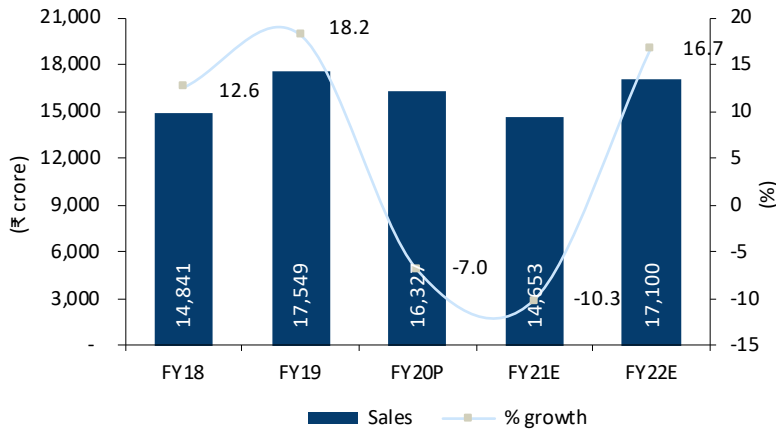
- For FY20, India revenue declined 7% YoY while Europe revenues rose 3% YoY.
- **Entire India revenue drop in Q4FY20 (~20%) was volume-led,** while pricing remained stable. For the quarter, replacement sales were down 6% YoY, driven by 35% decline in March. Before that, January and February sales had grown at 10% YoY. India OEM sales were down > 40%.
- Europe Q4FY20 sales amounted to €123 million and witnessed an improvement in pricing and product mix. PCR volumes fell 14% YoY for the quarter but remained flattish for the full year. ATL continued to outperform the industry (volumes down 6% YoY)
- Reifen revenues in Q4FY20 were at €26 million (down 2% YoY). Full year FY20 sales rose 3% YoY to €164 million. Further, in Europe, sales of Ultra High Performance (UHP) tyres improved to 30% in overall mix vs. 26% last year and grew in double digits during the quarter
- For Q4FY20, India EBITDA margins rose 140 bps QoQ to 14.4% & Europe EBITDA margins remained broadly unchanged at 9.4%
- During Q4FY20, total input costs were at ₹ 120/kg (down 3 % QoQ). Prices of key raw materials (per kg) – Natural rubber ₹ 140, synthetic rubber ₹ 110, fabric ₹ 240, carbon black ₹ 85
- **ATL is targeting 20% reduction in fixed costs during FY21E,** with travel, freezing of new recruitment, freezing of wage hikes, sharp lowering of sales and promotion expenses, etc. outlined as some areas being worked upon
- In India, the company expects to realise further 3% benefit in raw material costs till Q2FY21E. RM to sales ratio in Europe was at ~40% and has a higher linkage to crude oil. The company expects Europe to realise sharper input cost benefit in coming months

Others

- ATL has further reduced capex by ₹ 400 crore. **For FY21E, India capex is seen at ₹ 1,000-1,100 crore, while Europe capex is seen at €20 million**
- The company has received first tranche of payment from the Warburg Pincus deal on April 22
- **Net debt levels as of March 2020 were at ₹ 6,000 crore** (vs. ₹ 5,500 crore as of Q3FY20)
- Tax deferral benefit in Q4FY20 was one time in nature, and was on account of higher advance tax paid earlier on assumptions of better profitability and lower capitalisation than what took place
- Replacement demand forms 80% of Europe sales in general and ~98% of PCR sales in particular

Financial story in charts

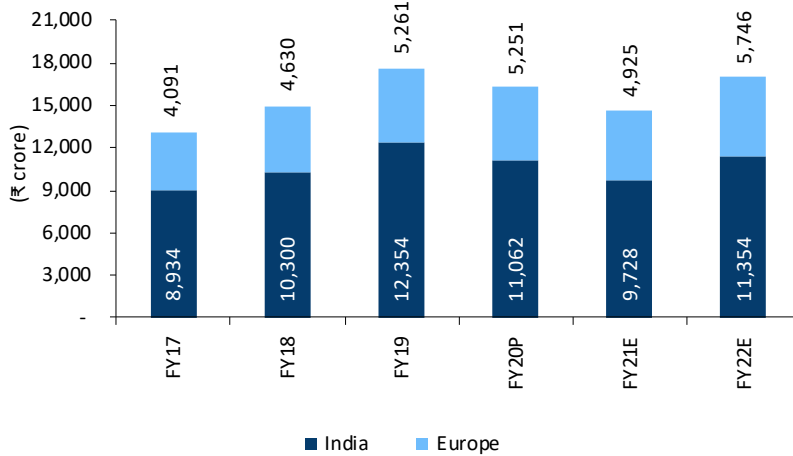
Exhibit 3: Topline trend



Supported by healthy replacement demand, consolidated ATL sales are expected to grow at 2.8% CAGR over FY20P-22E

Source: Company, ICICI Direct Research

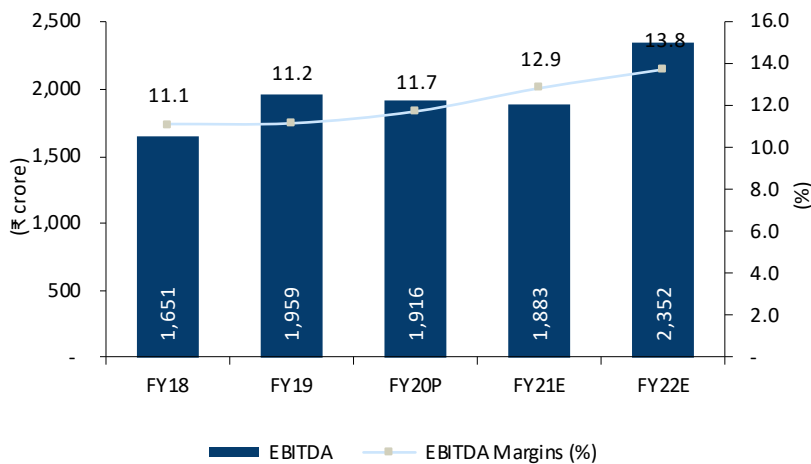
Exhibit 4: Geography-wise breakup of revenues



India revenues are seen growing at 1.3% CAGR, hampered by weakness in OEM segment (~35% of overall demand) – particularly on the CV side. Europe sales are expected to grow at 4.6% CAGR owing to market share gains and product mix improvement

Source: Company, ICICI Direct Research

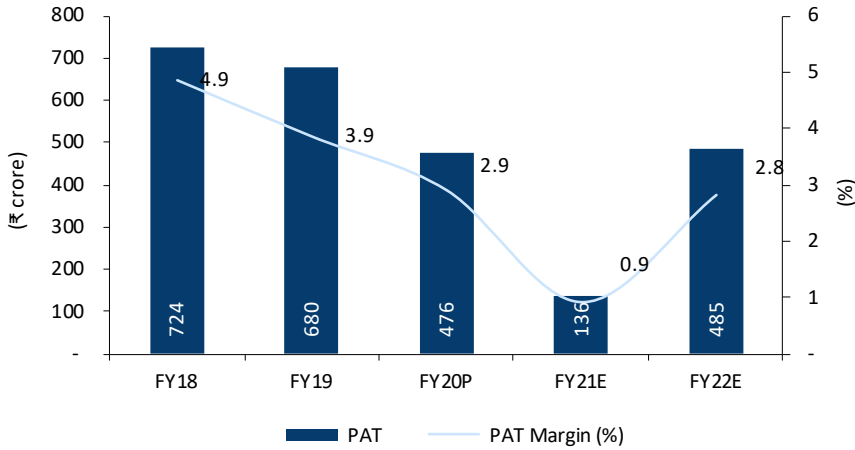
Exhibit 5: EBITDA and EBITDA margin trend



We expect margins to remain broadly resilient on the back of increase in share of replacement sales and gradual uptick in capacity utilisation levels both in India as well as Europe. EBITDA is seen growing at 10.8% CAGR over FY20P-22E.

Source: Company, ICICI Direct Research

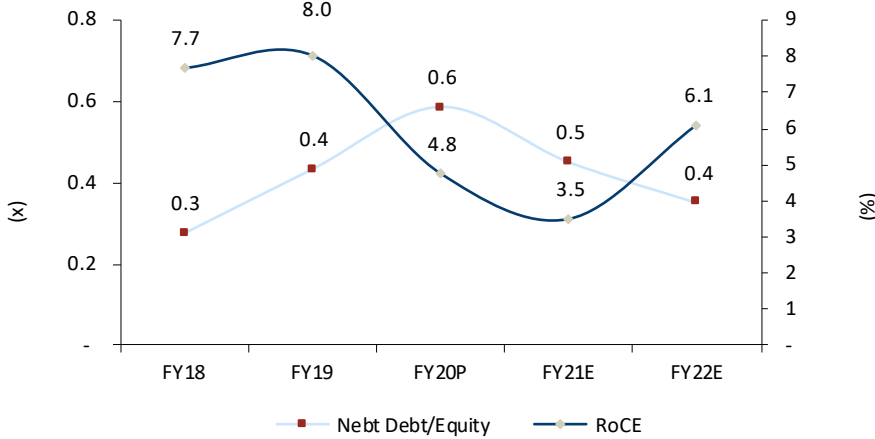
Exhibit 6: Trend in profitability



Profitability, on the other hand, is seen remaining under check on account of elevated levels of interest and depreciation. We expect 0.9% PAT CAGR over FY20P-22E

Source: Company, ICICI Direct Research

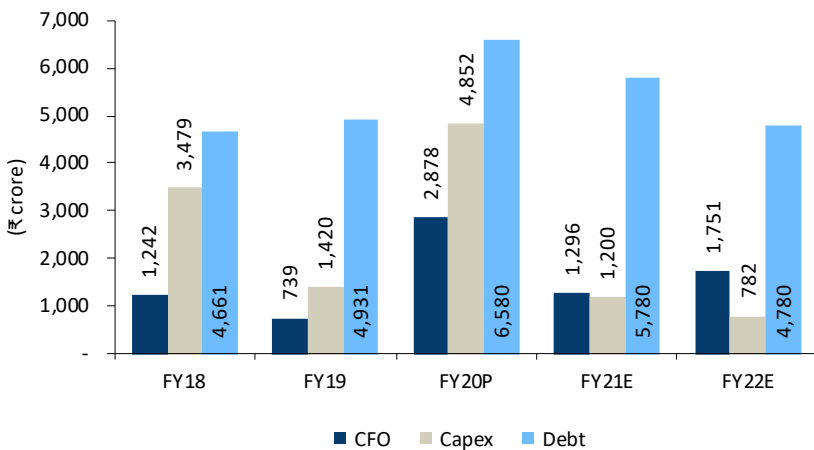
Exhibit 7: Trend in RoCE



We expect peak debt levels to be behind us and assume that recent fund infusion would be used to retire existing borrowings. Nevertheless, given the large leverage on books, single digit RoCE levels seem the new normal.

Source: Company, ICICI Direct Research

Exhibit 8: CFO, capex and debt levels at ATL



While ATL continues to generate healthy CFO, relatively heavy capex spends remain

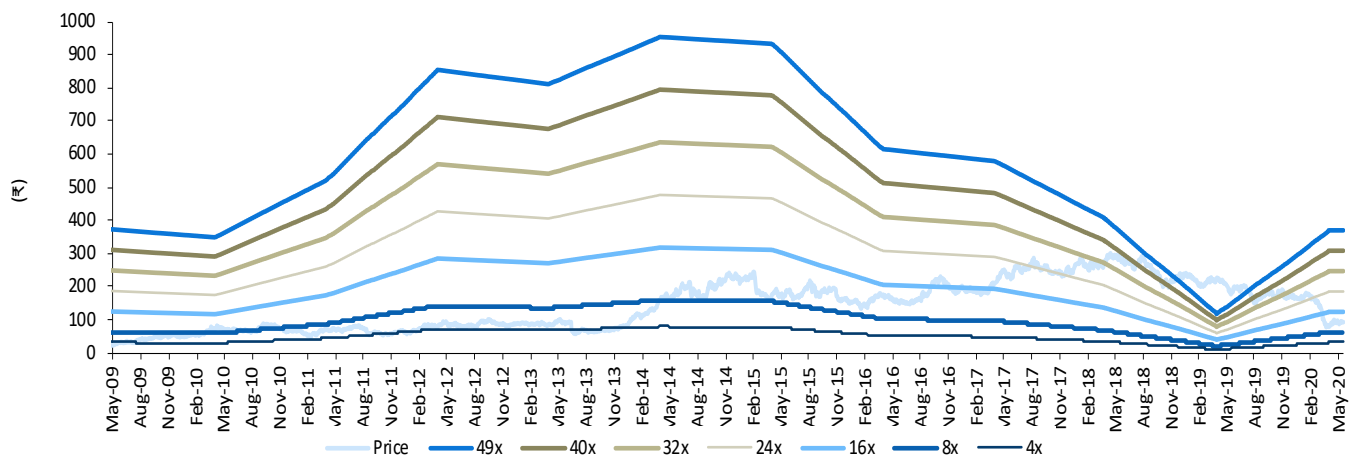
Source: Company, ICICI Direct Research

Exhibit 9: Key valuation metrics

	Sales	Growth	EPS	Growth	PE	EV/EBITDA	RoNW	RoCE
	(₹ cr)	(%)	(₹)	(%)	(x)	(x)	(%)	(%)
FY 18	14,841	12.6	12.7	(34.1)	7.3	4.8	7.4	7.7
FY 19	17,549	18.2	11.9	(6.1)	7.7	4.9	8.3	8.0
FY 20P	16,327	(7.0)	8.3	(29.9)	11.0	5.8	4.8	4.8
FY 21E	14,653	(10.3)	2.4	(71.5)	38.7	5.4	1.2	3.5
FY 22E	17,100	16.7	7.6	221.3	12.1	4.2	4.3	6.1

Source: Bloomberg, ICICI Direct Research

Exhibit 10: Apollo Tyres currently trading at two year forward P/E of ~12x



Source: Bloomberg, ICICI Direct Research

Financial Summary

Exhibit 11: Profit and loss statement				
	₹ crore			
(Year-end March)	FY19	FY20P	FY21E	FY22E
Total operating income	17,548.8	16,327.0	14,653.5	17,100.0
Growth (%)	18.2	-7.0	-10.3	16.7
Raw Material Expenses	10,126.2	9,075.5	7,707.0	9,180.0
Employee Expenses	2,456.2	2,482.2	2,400.9	2,543.2
Other Expenses	3,007.5	2,853.7	2,662.4	3,025.1
Total Operating Expenditure	15,589.9	14,411.3	12,770.4	14,748.4
EBITDA	1,958.9	1,915.6	1,883.1	2,351.6
Growth (%)	18.6	-2.2	-1.7	24.9
Depreciation	812.7	1,138.1	1,318.8	1,368.0
Interest	181.1	280.8	432.6	382.8
Other Income	123.1	46.9	50.0	47.3
PBT	888.2	543.6	181.7	648.2
Exceptional items	200.0	0.0	0.0	0.0
Total Tax	208.3	67.2	45.8	163.3
Reported PAT	680.0	476.4	135.9	484.8
Growth (%)	-6.1	-29.9	-71.5	256.7
EPS (₹)	11.9	8.3	2.4	7.6

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement				
	₹ crore			
(Year-end March)	FY19	FY20P	FY21E	FY22E
Profit after Tax	680.0	476.4	135.9	484.8
Add: Depreciation	812.7	1,138.1	1,318.8	1,368.0
(Inc)/dec in Current Assets	-205.6	434.4	352.7	-731.1
Inc/(dec) in CL and Provisions	-548.5	828.8	-511.7	629.4
CF from operating activities	738.6	2877.8	1295.8	1751.1
(Inc)/dec in Investments	1,339.0	0.0	0.0	0.0
(Inc)/dec in Fixed Assets	-1,419.7	-4,851.9	-1,200.0	-782.0
Others	-561.3	1,167.2	-171.9	251.3
CF from investing activities	-642.0	-3684.7	-1371.9	-530.7
Issue/(Buy back) of Equity	0.0	0.0	0.0	6.3
Inc/(dec) in loan funds	269.5	1,649.3	-800.0	-1,000.0
Dividend paid & dividend tax	-237.6	-205.9	-114.4	-200.2
Others	-164.7	-449.6	1,030.0	-26.3
CF from financing activities	-132.8	993.8	115.6	-1220.2
Net Cash flow	-36.1	186.9	39.5	0.1
Opening Cash	598.8	562.7	749.6	789.0
Closing Cash	562.7	749.6	789.0	789.2

Source: Company, ICICI Direct Research

Exhibit 13: Balance Sheet				
	₹ crore			
(Year-end March)	FY19	FY20P	FY21E	FY22E
Liabilities				
Equity Capital	57.2	57.2	57.2	63.5
Reserve and Surplus	9,982.6	9,872.8	9,894.3	11,252.6
Total Shareholders funds	10,039.8	9,930.0	11,031.5	11,316.1
Total Debt	4,930.7	6,579.9	5,779.9	4,779.9
Deferred Tax Liability	823.1	747.7	671.1	783.1
Total Liabilities	16,591.0	18,968.6	19,035.2	18,663.1
Assets				
Gross Block	17,808.7	22,558.7	24,380.7	25,162.7
Less: Acc Depreciation	6,924.9	8,063.0	9,381.8	10,749.8
Net Block	10,883.9	14,495.7	14,998.9	14,412.9
Capital WIP	1,520.1	1,622.0	1,000.0	1,000.0
Total Fixed Assets	12,404.0	16,117.7	15,998.9	15,412.9
Investments	6.0	19.4	19.4	19.4
Goodwill on consolidation	199.3	213.5	213.5	213.5
Inventory	3,484.1	3,206.9	2,890.5	3,373.1
Debtors	1,154.7	939.9	963.5	1,124.4
Loans and Advances	42.8	43.5	39.0	45.6
Other current assets	484.7	541.6	486.1	567.2
Cash	562.7	749.6	789.0	789.2
Total Current Assets	5,729.0	5,481.5	5,168.2	5,899.5
Creditors	2,248.3	2,309.1	2,007.3	2,342.5
Provisions	251.7	274.4	238.5	278.4
Total Current Liabilities	2,500.0	2,583.5	2,245.9	2,620.8
Net Current Assets	3,229.0	2,898.0	2,922.4	3,278.7
Application of Funds	16,591.0	18,968.6	19,035.2	18,663.1

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios				
(Year-end March)	FY19	FY20P	FY21E	FY22E
Per share data (₹)				
EPS	11.9	8.3	2.4	7.6
Cash EPS	26.1	28.2	25.4	29.2
BV	175.5	173.6	192.8	178.2
DPS	3.3	3.0	2.0	3.5
Cash Per Share	9.8	13.1	13.8	12.4
Operating Ratios (%)				
EBITDA Margin	11.2	11.7	12.9	13.8
PBT / Net sales	6.5	4.8	3.9	5.8
PAT Margin	4.7	2.9	0.9	2.8
Inventory days	72.5	71.7	72.0	72.0
Debtor days	24.0	21.0	24.0	24.0
Creditor days	46.8	51.6	50.0	50.0
Return Ratios (%)				
RoE	8.3	4.8	1.2	4.3
RoCE	8.0	4.8	3.5	6.1
RoIC	8.0	4.5	3.1	5.5
Valuation Ratios (x)				
P/E	6.3	11.0	38.7	12.1
EV / EBITDA	4.9	5.8	5.4	4.2
EV / Net Sales	0.5	0.7	0.7	0.6
Market Cap / Sales	0.3	0.3	0.4	0.3
Price to Book Value	0.5	0.5	0.5	0.5
Solvency Ratios				
Debt/Equity	0.5	0.7	0.5	0.4
Current Ratio	2.1	1.8	1.9	1.9
Quick Ratio	0.7	0.6	0.7	0.7

Source: Company, ICICI Direct Research

Exhibit 15: ICICI Direct coverage universe (Auto & Auto Ancillary)

Sector / Company	CMP	TP	Rating	M Cap	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)		(₹ Cr)	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Apollo Tyre (APOTYR)	92	100	Hold	5,263	8.3	2.4	7.6	11.0	38.7	12.1	5.8	5.4	4.2	4.8	3.5	6.1	4.8	1.2	4.3
Ashok Leyland (ASHLEY)	42	55	Buy	12,294	1.2	1.7	3.2	36.1	24.8	13.1	10.8	9.4	6.4	6.0	7.0	11.9	4.7	5.7	10.4
Bajaj Auto (BAAUTO)	2,550	2,500	Buy	73,789	163.9	146.4	158.6	15.6	17.4	16.1	11.4	12.2	10.6	20.5	22.6	22.5	21.2	17.4	17.2
Bharat Forge (BHAFOR)	275	320	Hold	12,803	10.8	7.0	12.7	25.4	39.1	21.7	13.3	15.3	11.4	8.4	6.3	9.4	9.4	5.7	9.8
Eicher Motors (EICMOT)	13,000	16,870	Hold	35,438	737.9	687.6	838.2	17.6	18.9	15.5	13.3	13.4	10.5	22.9	19.6	20.5	19.1	15.6	16.4
Escorts (ESCORT)	830	860	Hold	10,174	39.6	40.8	50.3	21.0	20.3	16.5	13.6	12.9	10.3	18.9	13.3	14.2	14.2	10.1	11.1
Exide Industries (EXIIND)	150	160	Buy	12,750	9.4	7.6	9.4	15.9	19.7	15.9	8.8	10.0	8.3	16.4	12.8	14.7	12.9	9.6	11.1
Hero Moto (HERHON)	2,000	2,500	Buy	39,940	175.3	118.3	156.4	11.4	16.9	12.8	8.8	10.4	7.9	26.4	20.2	24.6	21.6	15.7	19.1
M&M (MAHMAH)	400	415	Buy	49,728	33.8	15.8	23.5	11.9	25.4	17.0	8.3	12.7	9.2	11.7	6.3	8.9	9.6	5.0	7.1
Maruti Suzuki (MARUTI)	4,850	4,650	Reduce	1,46,509	187.1	138.4	194.4	25.9	35.0	24.9	15.3	18.0	12.7	7.4	4.8	7.9	11.7	8.2	10.6
Minda Industries (MININD)	275	300	Buy	7,211	7.0	7.6	11.8	39.2	36.0	23.3	12.6	11.3	9.0	11.3	11.8	15.0	11.5	11.6	15.4
Tata Motors (TATMOT)	83	85	Hold	30,337	-9.1	-2.4	9.1	NM	NM	9.1	4.1	4.1	3.3	4.6	5.7	8.5	0.0	2.6	9.3

Source: Bloomberg, ICICI Direct Research

RATING RATIONALE

ICICI Direct endeavors to provide objective opinions and recommendations. ICICI Direct assigns ratings to its stocks according to their notional target price vs. current market price and then categorizes them as Buy, Hold, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock

Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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