



## 3R MATRIX

	+	=	-
Right Sector (RS)	✓	✗	✗
Right Quality (RQ)	✓	✗	✗
Right Valuation (RV)	✓	✗	✗

+ Positive = Neutral - Negative

## Reco/View

Change

Reco: Buy



CMP: Rs. 138

Price Target: Rs. 160



Upgrade
 Maintain
 Downgrade

## Company details

Market cap: Rs. 7,883 cr

52-week high/low: Rs. 197/74

NSE volume:  
(No of shares) 38.5 lakh

BSE code: 500877

NSE code: APOLLOTYRE

Free float:  
(No of shares) 33.8 cr

## Shareholding (%)

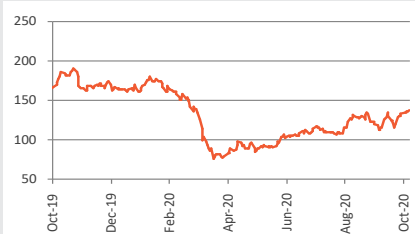
Promoters 41.8

FII 20.5

DII 16.7

Others 21.0

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	18.4	21.7	60.3	-17.0
Relative to Sensex	15.0	12.4	29.4	-22.2

Sharekhan Research, Bloomberg

## Summary

- We retain a Buy rating on Apollo Tyres Ltd (Apollo) with revised PT of Rs. 160; Strong 23% earnings CAGR likely over FY20-23.
- Demand has recovered significantly in both India and Europe led by Government Unlock measures and increased preference for personal transport. Apollo expected to post flat revenues in Q2FY21 as compared to 34% drop in Q1; FY22 likely to witness strong recovery.
- Employee restructuring at Vredestein and cost-control measures to improve margins in Europe; Apollo aims for 14-15% margins from 9-10% currently.
- We rollover our multiple to FY23 earnings. With a pick-up in earnings and tapering of the capex cycle, Apollo is expected to be FCFF positive from FY23. P/E of 9.4x FY23 earnings is lower than long-term historical average of 11x.

We recently interacted with the management of Apollo Tyres Ltd (Apollo) to get an update on the recent developments and growth outlook. Domestic demand (forming ~70% of revenues) has picked up. Domestic replacement demand has improved significantly driven by opening up of economy under Unlock measures, improving fleet utilisation levels and increased preference for personal transport. Replacement demand reported a 7-8% y-o-y growth in July with growth further increasing to double-digits in September 2020. Domestic OEM demand is also improving on a m-o-m basis with the passenger vehicle (PV) segment reporting double-digit growth in September 2020, while the fall in the CV segment has narrowed to 3% y-o-y. Apollo indicated that domestic business is likely to report a flat to marginal growth in Q2 as compared to a 41% y-o-y decline in Q1. Demand in Europe is also improving with passenger car tyre sales reaching 90% of pre-COVID levels in September 2020. Apollo has also commenced sales of truck tyres in Europe, which would provide additional growth avenue going ahead. Apollo expects flat to marginal decline in the European business in Q2FY21. We expect the company to clock a strong 23% earnings growth in Q2 driven by healthy recovery in revenues, soft commodity prices and better product mix. FY22 is likely to witness strong recovery driven by normalisation of economic activities and pent-up demand. The government's restriction on tyre imports is likely to benefit domestic players like Apollo. Employee restructuring and cost-control measures would lead to margin improvement in Europe. We expect Apollo to deliver a robust 23% earnings CAGR over FY20-23.

## Our Call

**Reasonable valuations; company to be FCFF positive from FY23; maintain Buy with revised PT of Rs. 160:** Tyre demand has improved significantly in both the domestic as well as European operations with the company expected to report flat volumes in Q2FY21. A strong recovery is likely in FY22, driven by normalisation of business activity. Apollo's margins are expected to improve driven by operating leverage and restructuring operations in Europe. We expect Apollo to clock a strong 23% earnings CAGR over FY20-23 period. We have introduced FY23 estimates in this note. With pick up in earnings and tapering of the capex cycle from FY23, Apollo is expected to be free cash flow to firm (FCFF) positive from FY23. Moreover, Apollo is currently trading at 9.4x FY23 earnings, which is lower than its long term historical average of 11x. We retain a Buy rating on the stock with revised PT of Rs.160 (as we rollover to FY23 earnings). Moreover, reputed private equity firm Warburg Pincus subscribing to compulsorily convertible preference shares in March 2020 (convertible at a price of Rs 171.4 per equity share and resulting in equity stake of ~10%) exudes confidence.

## Key Risks

Prolonged COVID-19 infections can affect volumes. Adverse currency movements, especially in the INR-Euro pair can impact financials.

## Valuation

Rs cr

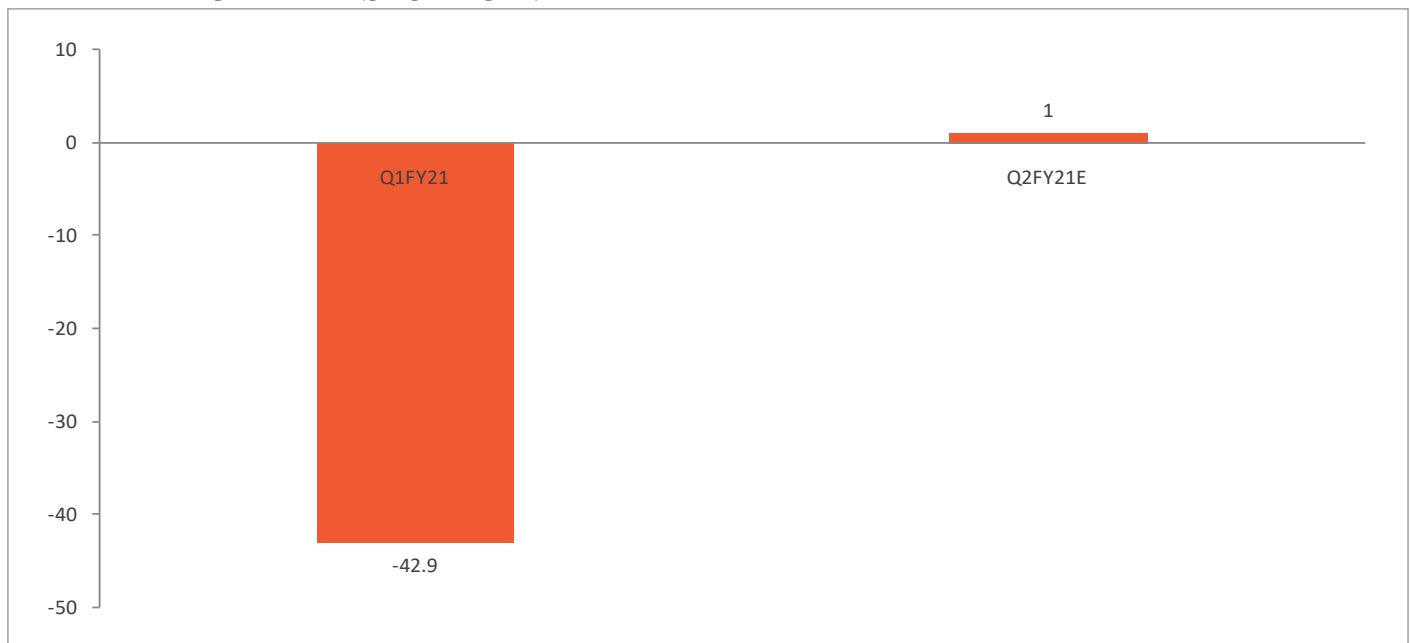
Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	17,548.8	16,327.0	15,623.2	17,859.1	20,030.2
Growth (%)	18.2%	-7.0%	-4.3%	14.3%	12.2%
EBIDTA (Rs cr)	1,958.6	1,911.4	1,979.7	2,373.8	2,702.1
OPM (%)	11.2%	11.7%	12.7%	13.3%	13.5%
Adjusted PAT	879.7	442.2	374.9	673.9	922.7
% YoY growth	21.5%	-49.7%	-15.2%	79.7%	36.9%
Adjusted EPS (Rs)	15.4	7.7	6.6	10.6	14.5
P/E (x)	8.9	17.7	20.9	12.9	9.4
P/B (x)	0.8	0.8	0.8	0.7	0.7
EV/EBITDA (x)	5.7	6.7	6.8	5.1	4.2
ROCE (%)	7.3	4.0	3.8	5.1	6.3
RONW (%)	8.8	4.5	3.7	5.7	7.4

Source: Company; Sharekhan estimates

### Domestic demand picking up; expect flat to marginal growth in Q2; restriction on tyre imports to benefit Apollo:

Apollo Tyres Ltd (Apollo) has stated that domestic demand (forming 70% of overall revenues) has picked up. With unlocking measures announced by the government and opening up of the economy, replacement demand has gained momentum. Improving fleet utilisation and increased preference for personal transport has aided replacement demand for commercial vehicles and passenger vehicles, respectively. Domestic replacement segment (70% of domestic revenues) has been buoyant with the company reporting 7-8% y-o-y growth in July 2020. Replacement segment growth further accelerated to double-digits in September 2020. Moreover, domestic OEM demand (35% of domestic revenues) is improving month-on-month basis driven by improving economic activity, and strong rural sentiments. Passenger vehicle (PV) volumes have grown in strong double-digits in September 2020 while the decline in CV sales has narrowed to 3% in September 2020. Apollo Tyres expects the domestic business to report flat to marginal growth in Q2FY21 as compared to about 40% y-o-y drop in Q1FY21. Moreover, recent restrictions on tyre imports are likely to benefit domestic players like Apollo. Tyre imports constitute about 5% of overall imports and domestic players are likely to gain market share.

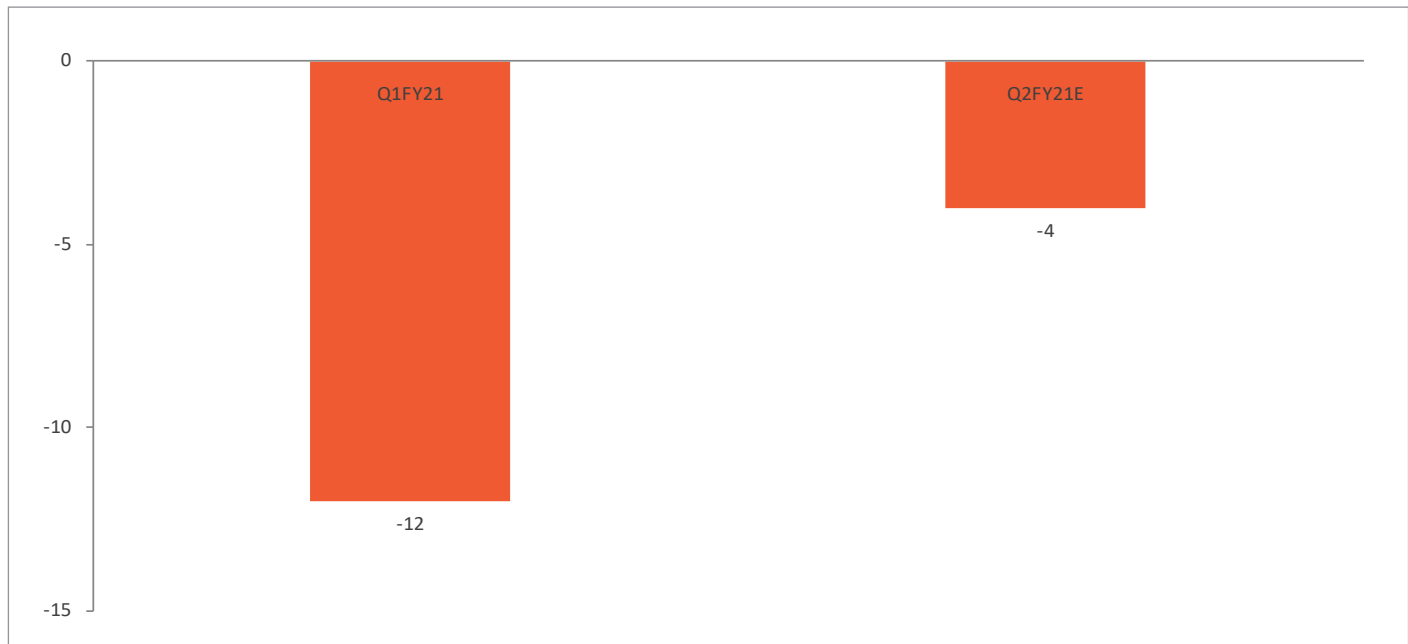
Domestic revenue growth trend (y-o-y change %)



Source: Company, Sharekhan Research

**European business picking up; Apollo commences dispatches of truck tyres:** Apollo's European business (forming 30% of revenues) demand is also improving. With Government unlock measures, the passenger car tyre replacement demand is gaining momentum. As per management, passenger car tyre reached 90% of pre-COVID levels in September 2020 as compared to about 75-80% of Pre-COVID levels in Q1FY21. Also, Apollo has recently commenced dispatches of truck tyres which would offset the decline in the passenger vehicle segment. Truck tyres would provide an incremental growth opportunity for Apollo and the company has initially started supplies in replacement market. Apollo has a capacity of 55 tonnes per day (tpd) for the truck segment as compared to a capacity of 250 tpd for passenger cars. For Q2, Apollo expects flat to marginal de-growth in European operations. We expect Apollo to continue gaining market share in Europe.

European business growth trend (y-o-y change %)



Source: Company, Sharekhan Research

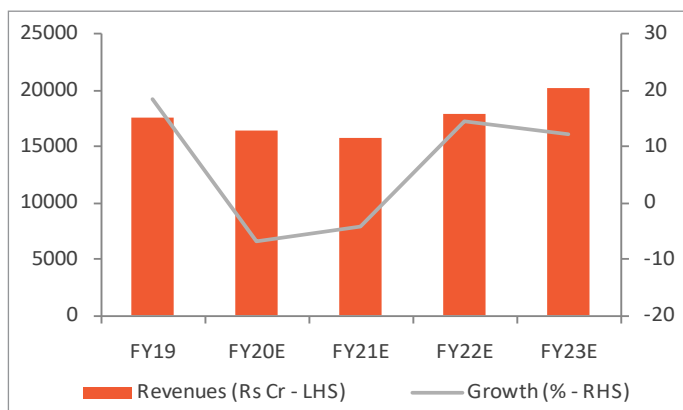
#### Restructuring measures in Vredestein and cost-control measures to boost Europe business margins:

Apollo Tyres has undertaken a restructuring exercise in its Vredestein manufacturing facility in Europe. As per the management, the Vredestein plant will only focus on high-performance passenger cars and agricultural tyres. The production of mass-market car tyres would be shifted to relatively low-cost locations such as Hungary and India. As a result, about 529 people in Vredestein plant would be redundant which would result into savings to the tune of Euro 40-50 million. Apollo expects the restructuring exercise to majorly complete by the end of FY21, with benefits likely to be witnessed by FY22. Also, Apollo is undertaking cost-control initiatives such as reducing travelling and promotion expenses, reduction in fixed costs and freight and logistics expenses. Apollo is aiming for margins of 14-15% over the medium term as compared to about 9-10% currently.

**Expect strong performance in Q2; Net Profit likely to grow 23% y-o-y:** Demand has improved in both domestic (due to healthy replacement demand and recovery in OEM sales) as well as European businesses (due to recovery in passenger car demand coupled with commencement of truck tyres). We expect Apollo Tyres' revenues to be flat in Q2FY21 (as compared to 34% y-o-y drop in Q1). Operating margins are expected to improve 280 bps y-o-y driven by soft commodity prices and better product mix (higher share of replacement segment). We expect Apollo's EBIDTA to grow 24% y-o-y and Net Profit to grow by 23% y-o-y in Q2FY21.

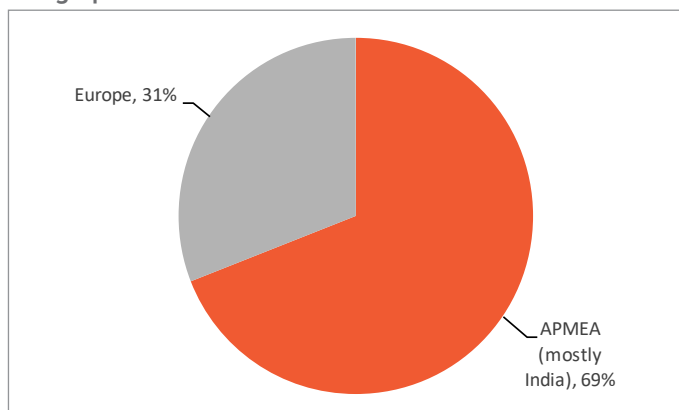
## Financials in charts

### Revenue trend



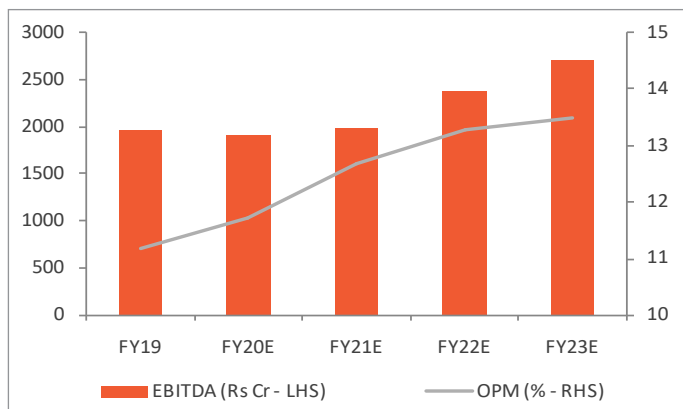
Source: Company, Sharekhan Research

### Geographical mix



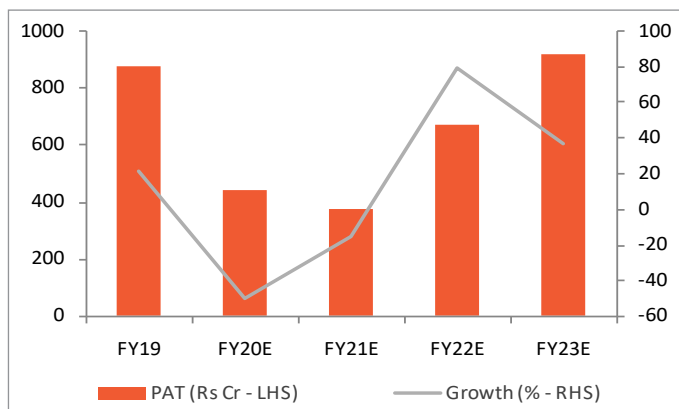
Source: Company, Sharekhan Research

### EBITDA-OPM



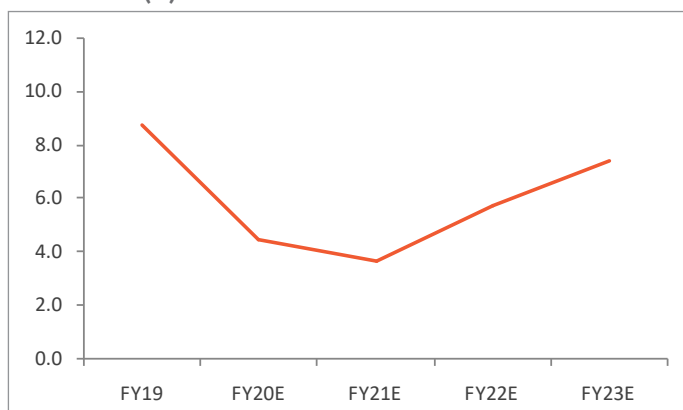
Source: Company, Sharekhan Research

### Net Profit trend



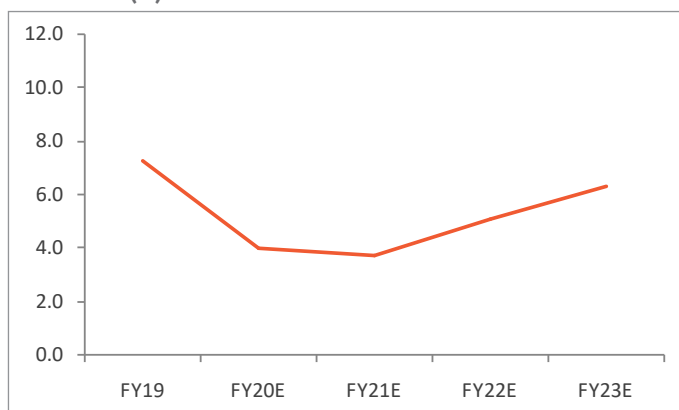
Source: Company, Sharekhan Research

### ROCE trend (%)



Source: Company, Sharekhan Research

### ROE trend (%)



Source: Company, Sharekhan Research

## Outlook and Valuation

■ **Sector view - Steady-growth with healthy demand prospects; recent import restrictions to benefit domestic players:** The Indian tyre industry has clocked a healthy CAGR of 7% y-o-y over the last decade. With lower automotive OEM penetration and rising per capita income, OEM sales are expected to grow by 7-8% over the medium term which would benefit domestic tyre industry. Moreover, with about 60-65% of tyre industry revenues come from the replacement segment, which is steady. Owing to higher share of replacement, the tyre industry is relatively less cyclical as compared to OEM segment. We expect tyre industry to continue 7-8% CAGR growth over the medium term. Further with the government restricting tyre imports, we expect domestic players to benefit.

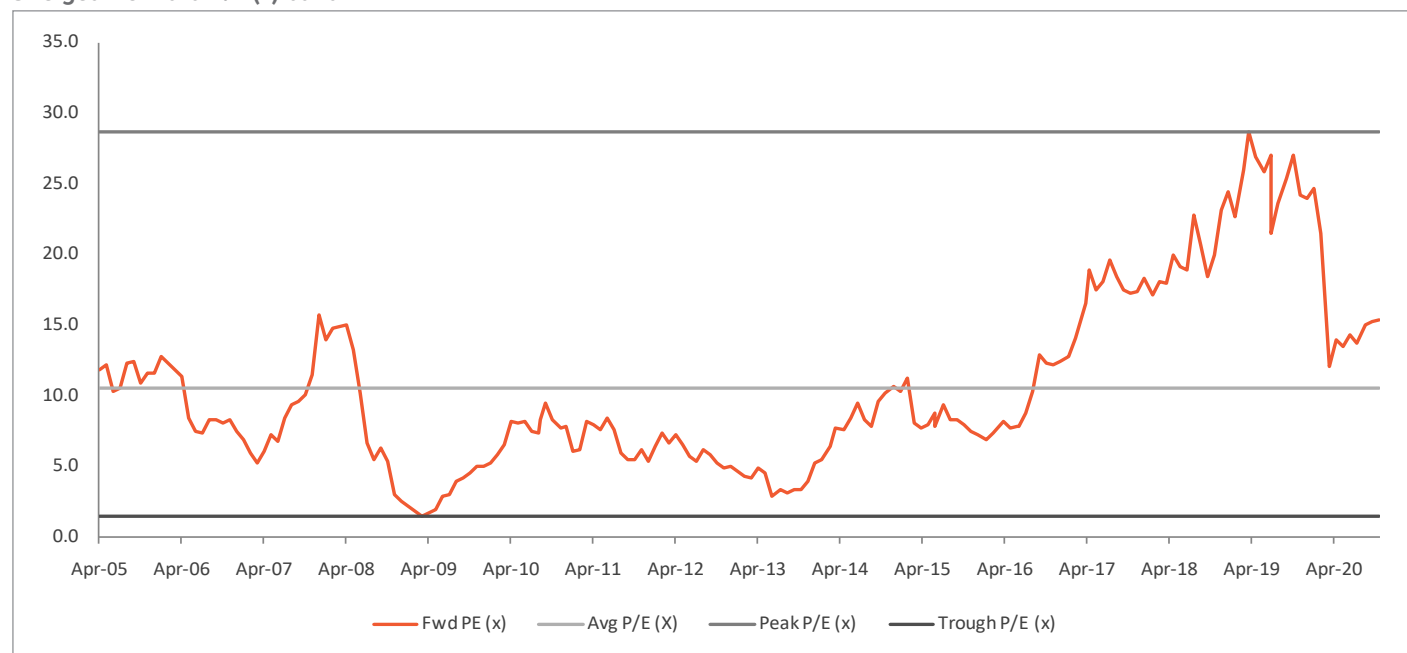
■ **Company outlook - Second-largest domestic tyre player; expanding presence in Europe provides growth opportunity**

Apollo Tyres is India's second-largest domestic tyre manufacturer having strong brand image and strong distribution network. Apollo is well poised to gain benefits from growth in the domestic tyre industry as well as recent restriction on tyre imports. Company's venture into the 2W segment is successful and is witnessing strong demand for its products. Business operations in Europe provide significant growth opportunity. Apart from enhancing distribution reach in the passenger car business, company has also ventured into production of truck tyres. We expect Apollo to continue to clock healthy growth over the medium term.

■ **Valuation - Reasonable valuations; company to be FCFF positive from FY23**

Tyre demand has improved significantly in both the domestic as well as European operations with the company expected to report flat volumes in Q2FY21. A strong recovery is likely in FY22, driven by normalisation of business activity. Apollo's margins are expected to improve driven by operating leverage and restructuring operations in Europe. We expect Apollo to clock a strong 23% earnings CAGR over FY20-23 period. We have introduced FY23 estimates in this note. With pick up in earnings and tapering of the capex cycle from FY23, Apollo is expected to be free cash flow to firm (FCFF) positive from FY23. Moreover, Apollo is currently trading at 9.4x FY23 earnings, which is lower than its long term historical average of 11x. We retain a Buy rating on the stock with revised PT of Rs. 160 (as we rollover to FY23 earnings). Moreover, reputed private equity firm Warburg Pincus subscribing to compulsorily convertible preference shares in March 2020 (convertible at a price of Rs 171.4 per equity share and resulting in equity stake of ~10%) exudes confidence.

### One-year forward P/E (x) band



Source: Sharekhan Research

## About company

Apollo is the second largest tyre manufacturer in India. Apollo 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, Apollo 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 revenue, while the replacement segment accounts for the balance 73%.

## Investment theme

Apollo is second largest domestic tyre player having healthy market share in both the commercial vehicle and passenger vehicle space. Apollo is present in India and Europe markets. The replacement segment forming about 70% of the revenues is recovering in both India and Europe as Governments ease lockdown restrictions and open business activities. Replacement demand reported positive growth on y-o-y basis in India while Europe has reached 90% of Pre-COVID levels in September 2020. FY22 is expected to witness strong recovery driven by normalisation of business activity and pent up demand. Margins are expected to improve on back of better product mix, cost control initiatives and restructuring at European operations. We expect strong 23% earnings CAGR over FY20-23 period. We retain Buy recommendation on the stock.

## Key Risks

- ♦ Prolonged COVID-19 infection resulting into weak consumer sentiments
- ♦ Apollo 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 derivatives and natural rubber form about 75% 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 Singh Kanwar	Chairman & Managing Director
Mr Neeraj Kanwar	Vice Chairman & Managing Director
Sunam Sarkar	President & Chief Business Officer
Gaurav Kumar	Chief Financial Officer

Source: Company

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Neeraj consultants	12.9
2	HDFC Asset Management Company	7
3	Apollo Finance group	7
4	Franklin Resources Inc	6.7
5	Sunrays Properties & Investments	6.5
6	White Iris Investment	4.9
7	SACRED HEART INVESTMENT CO	4.3
8	ICICI Prudential Asset Management	3.2
9	Motlay Finance Pvt Ltd	3
10	Classic Auto Tubes Ltd	2.7

Source: Bloomberg

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## Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research



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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: [compliance@sharekhan.com](mailto:compliance@sharekhan.com);

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