Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Apollo Tyres Ltd

On a steady track

Automobiles	Sharekhan code: APOLLOTYRE
Reco/View: Buy ↔	CMP: Rs. 217	Price Target: Rs. 290 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 28.15

Updated Oct 08, 2021

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

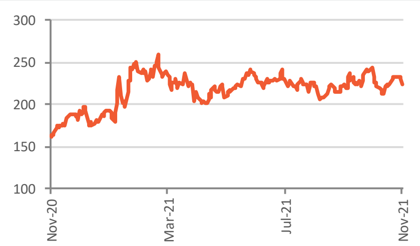
Company details

Market cap:	Rs. 13,782 cr
52-week high/low:	Rs. 261 / 170
NSE volume: (No of shares)	42.8 lakh
BSE code:	500877
NSE code:	APOLLOTYRE
Free float: (No of shares)	39.8 cr

Shareholding (%)

Promoters	37.3
FII	20.5
DII	19.6
Others	22.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-7.7	-1.0	1.1	38.9
Relative to Sensex	-4.2	-8.2	-21.4	2.1

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on Apollo Tyres Limited (ATL) with an unchanged PT of Rs. 290, led by the company's dominant positions in key markets, expected market share gains across segments, and attractive valuations.
- Q2FY22 results beat our expectations, led by better-than-expected improvement in operational performance.
- ATL is set to benefit from its strategy by deleveraging its balance sheet, capital utilization of more than 90%, and focus on firm capital allocation and cash management in the medium term.
- The stock trades attractively at P/E multiple of 9.1x and EV/EBITDA multiple of 4.5x its FY2023E estimates.

Apollo Tyres Limited (ATL) is well positioned to leverage the market opportunity in India and globally. Over the past decade, the company has made significant investments in brand building, plant infrastructure and R&D capability. The company is expected to benefit from its strategy by deleveraging its balance sheet, capital utilization of more than 90% and focus on firm capital allocation and cash management in the medium term. Q2FY22 results beat our expectations, led by better-than-expected improvement in operational performance. Consolidated net revenues were up 18.6% y-o-y to Rs 5,077 crore, driven by 25% growth in India business and 6% (in Euro terms) growth in Europe business. EBITDA margin for Q2FY22 stood at 12.6%, an improvement of 20 bps q-o-q, led by robust operational performance of Europe business. The rise in COVID cases in third wave in Europe could be a concern in the near-term, but we believe it's a transient phase and sales will recover post the normalization of the third wave. . We continue to remain positive on ATL given the recovery in OEM sales and expected improvement in aftermarket sales. Strong growth coupled with a leadership position in key markets and segments is likely to help ATL to achieve its long-term targets of US$ 5bn by FY2026. We re-iterate our Buy rating in the stock with unchanged price target of Rs 290.

Key positives

- The volume recovery was witnessed across the regions, with Indian and European sales up 25% y-o-y and 6% y-o-y.
- The company has been to pass on costs to its clients, but with a lag of one quarter. EBITDA margin for Europe business 760 bps y-o-y to 17.6% in Q2FY22, driven by operating leverage benefits, price hikes of 4-6% and better product mix.

Key negatives

- EBITDA margin of Indian operation contracted by 860 bps y-o-y to 10.3% in Q2, led by steep inflation of raw material and energy costs, partially offset by price hikes of 3-7% in replacement segments.

Management Commentary

- The management has maintained its long-term targets to achieve revenue of US$5 billion by FY2026, EBITDA margin profile to reach at least 15%, ROCE of 12-15%, and net debt to EBITDA of less than 2x.
- The capex remains in line with the earlier guidance.

Our Call

Valuation – Maintain Buy rating with an unchanged PT of Rs. 290: Tyre demand has improved significantly in both the domestic as well as European operations. ATL is well positioned to gain market share in India and Europe, given its strong brand, R&D, technology, and distribution network. We expect the company to benefit from its strategy by deleveraging its balance sheet, capital utilisation of more than 90%, and focus on firm capital allocation and cash management in the near term. The rise in COVID cases in third wave in Europe could be a concern in the near-term, but we believe it's a transient phase and sales will recover post normalization of the third wave. A Strong growth coupled with a leadership position in key markets and segments is likely to re-rate valuation multiples. We expect ATL's earnings to report robust 44% CAGR during FY2021-FY2023E, driven by a 12.9% revenue CAGR and a 160 bps EBITDA margin expansion to 17% in FY2023E. The stock is trading at attractive valuations at P/E multiple of 9.1x and EV/EBITDA multiple of 4.5x its FY2023E estimates. We retain our Buy rating on the stock with an unchanged PT of Rs. 290.

Key Risks

Apollo derives about 30% of its revenue from its European operations, which exposes it to currency risks. Any adverse movement in INR-Euro pair would affect financial performance.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenues	17,127	19,784	21,813	24,306
Growth (%)	4.9	15.5	10.3	11.4
EBIDTA	2,631	3,183	3,702	4,238
OPM (%)	15.4	16.1	17.0	17.4
Adjusted PAT	734	1,141	1,522	1,927
% YoY growth	54.1	55.4	33.3	26.7
Adjusted EPS (Rs)	11.6	18.0	24.0	30.3
P/E (x)	18.8	12.1	9.1	7.2
P/B (x)	1.3	1.2	1.1	1.0
EV/EBITDA (x)	6.4	5.3	4.5	4.0
RoE (%)	7.2	10.5	12.7	14.3
RoCE (%)	6.5	7.8	9.3	10.9

Source: Company; Sharekhan estimates

Better-than-expected results in Q2FY22: Q2FY22 results beat our expectations, led by better-than-expected improvement in operational performance. Consolidated net revenues were up 18.6% y-o-y to Rs 5,077 crore, driven by a 25% growth in India business and 6% (in Euro terms) growth in Europe business. EBITDA margin for Q2FY22 stood at 12.6%, an improvement of 20 bps q-o-q, led by robust operational performance of Europe business. EBITDA margin for Europe business 760 bps y-o-y to 17.6% in Q2FY22, driven by operating leverage benefits, price hikes of 4-6% and better product mix. EBITDA margin of Indian operation contracted by 860 bps y-o-y to 10.3% in Q2, led by steep inflation of raw material and energy costs, partially offset by price hikes of 3-7% in replacement segments. EBITDA and PAT declined 8.2% y-o-y and 51% y-o-y to Rs 638 crore and Rs174 crore respectively.

Positive outlook: The management expects the demand to remain strong in the near term, led by pent up demand, despite series of price hikes over the last one year in the range of 6-9%. The management has maintained its long-term targets to achieve revenue of US$5 billion by FY2026, EBITDA margin profile to reach at least 15%, ROCE of 12-15%, and net debt to EBITDA of less than 2x. The capex remains in line with the earlier guidance.

Achievable long-term goals: The management has laid down its long-term targets to achieve revenue of US$5 billion by FY2026, EBITDA margin profile to reach at least 15%, ROCE of 12-15%, and net debt to EBITDA of less than 2x. Targets set up by the company are optimistic, as achieving a revenue target of US$5 billion over the next five years would imply a 16.7% revenue CAGR as compared to 7.7% revenue CAGR during FY2016-FY2021. ATL's management were confident of achieving targets, as the company is well positioned to enter into the growth phase through optimizing processes and deliver differentiating products. Near-term focus will be on increasing business through product differentiation, enhancing penetration in new markets (both domestic and exports), investments in brand building, R&D, and ramping up capacity. Key drivers for improving margins would be increasing share of premium products, cost control, rationalization, thrust on digitization, rationalization of raw-material sourcing, and focus on FCF, capex, and balance sheet. The company has also discussed its efforts on raising focus on sustainability, technology, and innovation. In the Europe business, the company will continue to focus on improving profitability through gaining market share in ultra-premium segments, improving product mix in passenger vehicle segment and benefits of specialization in Dutch plant.

Well positioned to leverage attractive market opportunity: ATL is well positioned to leverage the market opportunity in India and globally. Over the past decade, the company has made significant investments in brand building, plant infrastructure and R&D capability. The company has a leadership position in multiple sub-segments and has strong capacity to drive the growth going forward. ATL is approaching end of capex cycle with continued focus on brand building, marketing, and distribution network. The company is operating at ~85-90% capacity utilization. With the planned capacity expansion by end of FY2022E, the company is expected to operate ~65-70% capacity utilization, which gives the company to grow business for another 2-3 years at minimal capex. The current strategy is to increase free cash flow generation, improve return ratios and gain market shares across segments.

Sharp recovery in the automobile sector to fuel tyre demand: We expect the tyre industry to benefit from a sharp recovery in automobile sales post the normalisation of the economy, driven by pent-up demand, preference for personal mobility amid COVID-19, and faster-than-expected recovery in infrastructure, mining, and other economic activities. The tyre industry is well positioned to gain momentum in the medium term backed by higher OEM offtake and the ripple effect of OEM demand is likely to result in steady growth for the replacement demand. We expect Apollo Tyres Limited (ATL) to benefit from improved business outlook from the automotive segment in the medium term. Demand scenario for domestic tyres remains intact, driven by increasing preference for personal mobility, improving fleet utilisation, rising consumption of petrol/diesel, and normalisation of economic activities. Import restrictions have helped the company to increase its market share, especially in the tyre segment >14-inch size. The company is focusing on improving its product mix through increasing share of large-size tyres (>14-inch) and premium tyres. ATL is likely to benefit from its strong R&D and technology and its global experience in selling premium tyres, competing with No.1, and No. 2 players in Europe.

Increase in share of UHP/UUHP segments: ATL is focussing on increasing its share of premium tyres, i.e. UHP/UUHP segments, in Europe and US markets. The Vredestein brand is an established premium tyre brand in Europe. The company aims to increase its share of premium UHP and UUHP tyres to 40% revenue contribution over the next five years by FY2026 from 34-35% in FY2021, through new launches, brand building, and focus on increasing presence in southwest Europe, while adding on to its healthy presence in west and central Europe.

Robust earnings growth expected: We have maintained the company's estimates for volume growth, margins, and earnings. We expect the company to gain market share going forward due to its competitive position in both trucks and passenger vehicle segments. We expect ATL's earnings to post a robust 44% CAGR during FY2021-FY2023E, driven by a 12.9% revenue CAGR and a 160 bps EBITDA margin expansion to 17% in FY2023E. The company's margins are likely to be supported by operating leverage, improving product mix and likely benefit from exports to Europe with PLI benefits. Return ratios are expected to improve significantly, with ROE expected to improve from 4.8% in FY2020 to 12.7% in FY2023E, while ROCE is expected to improve from 4.7% in FY2020 to 9.3% in FY2023E.

Results (Consolidated) Rs cr

Particulars	Q2FY22	Q2FY21	Y-o-Y %	Q1FY22	Q-o-Q %
Revenue	5,077	4,283	18.6	4,584	10.8
Total Expenses	4,439	3,588	23.7	4,018	10.5
EBITDA	638	695	(8.2)	567	12.6
Depreciation	340	331	2.7	340	(0.2)
Interest	104	117	(11.2)	105	(0.9)
PBT	219	(315)	NA	161	35.8
Tax	45	(69)	NA	34	35.4
Share Of profit from Associates	0	0	NA	0	NA
Reported PAT	174	(246)	NA	128	36.0
Adj Net Profit	174	355	(51.0)	128	36.0
Adjusted EPS (Rs)	2.7	6.2	(55.9)	2.0	36.0

Source: Company; Sharekhan Research

Key Ratios (Consolidated) Rs cr

Particulars	Q2FY22	Q2FY21	YoY (bps)	Q1FY22	QoQ (bps)
Gross margin (%)	41.4	55.6	(1,410)	42.8	(130)
EBIDTA margin (%)	12.6	16.2	(370)	12.4	20
EBIT margin (%)	5.9	8.5	(260)	4.9	90
Net profit margin (%)	3.4	8.3	(490)	2.8	60
Effective tax rate (%)	20.7	21.9	(110)	20.8	(10)

Source: Company; Sharekhan Research

Results (Standalone) Rs cr

Particulars	Q2FY22	Q2FY21	Y-o-Y %	Q1FY22	Q-o-Q %
Revenue	3,650	2,910	25.4	3,220	13.3
Total Expenses	3,274	2,362	38.6	2,886	13.4
EBITDA	376	548	(31.4)	334	12.8
Depreciation	340	331	2.7	340	(0.2)
Interest	104	117	(11.2)	105	(0.9)
PBT	123	308	(60.2)	89	38.1
Tax	33	82	(59.4)	21	57.8
Reported PAT	90	227	(60.4)	68	32.0
Adj Net Profit	90	227	(60.4)	68	32.0
Adjusted EPS (Rs)	1.4	4.0	(64.3)	1.1	32.0

Source: Company; Sharekhan Research

Key Ratios (Standalone) Rs cr

Particulars	Q2FY22	Q2FY21	YoY (bps)	Q1FY22	QoQ (bps)
Gross margin (%)	32.6	42.2	(970)	34.2	(160)
EBIDTA margin (%)	10.3	18.8	(850)	10.4	(10)
EBIT margin (%)	1.0	7.5	NA	(0.2)	120
Net profit margin (%)	2.5	7.8	NA	2.1	30
Effective tax rate (%)	26.9	26.5	50	23.6	340

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – Strong recovery post opening of up economy

We expect the tyre industry to be a natural benefactor of the sharp recovery in automobile sales post normalisation of economy. The automobile sector has witnessed a broad-based recovery across the segment after the COVID-19 wave-2 lockdowns, driven by pent-up demand, preference for personal mobility amid COVID-19, and faster-than-expected recovery in infrastructure, mining, and other economic activities. The tyre industry is well positioned to gain momentum in the medium term, backed by higher OEM offtake and ripple effect of the OEM demand, likely to result in steady growth for replacement demand.

■ Company outlook – Convincing strategy to achieve a profitable growth model

ATL's management has laid down its long-term targets to achieve revenue of US$5 billion by FY2026, EBITDA margin profile to reach at least 15%, ROCE of 12-15%, and net debt to EBITDA of less than 2x. Moreover, the company has maintained revenue growth guidance of 20-22% for FY2022E, driven by expected recovery in volumes post normalisation of economic activities. The overseas business is expected to do well because of richer product mix and gradual capacity additions. The company expects cost pressure to remain firm in the near term with raw-material prices expected to rise further by high single digit in Q1FY2022 on a q-o-q basis. Management has re-iterated its policy of profitable business growth. The company may take price hikes to partially mitigate the rise in input costs. Moreover, the company's cost-reduction measures would continue to help in improving margins. Because of strong operational performance, we expect ATL's earnings to post a robust 44% CAGR during FY2021-FY2023E, driven by a 12.9% revenue CAGR and a 160 bps EBITDA margin expansion to 17% in FY2023E. Return ratios are expected to improve significantly with ROE expected to improve from 4.8% in FY2020 to 12.7% in FY2023E, while ROCE is expected to improve from 4.7% in FY2020 to 9.3% in FY2023E.

■ Valuation – Maintain Buy rating with unchanged PT of Rs. 290

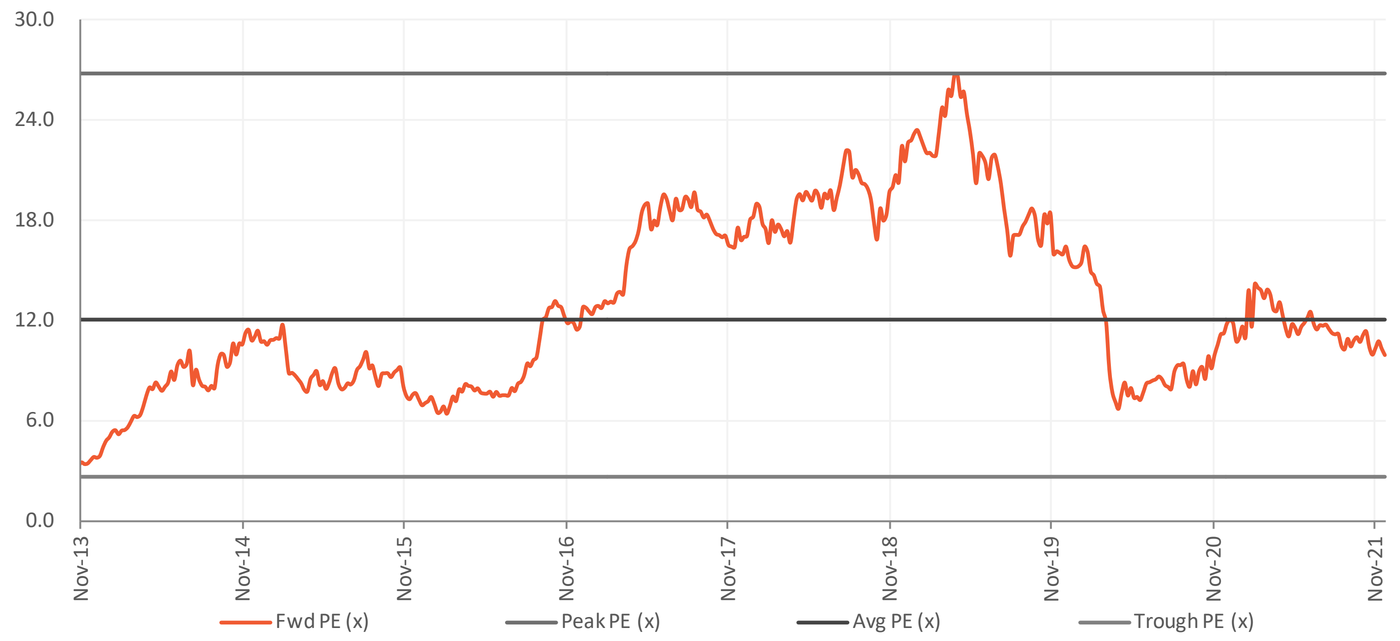
Tyre demand has improved significantly in both the domestic as well as European operations. ATL is well positioned to gain market share in India and Europe, given its strong brand, R&D, technology, and distribution network. We expect the company to benefit from its strategy by deleveraging its balance sheet, capital utilisation of more than 90%, and focus on firm capital allocation and cash management in the near term. The rise in COVID cases in the third wave in Europe could be a concern in the near-term, but we believe it's a transient phase and sales will recover post normalization of wave -3. Strong growth coupled with a leadership position in key markets and segments is likely to re-rate valuation multiples. We expect ATL's earnings to report robust 44% CAGR during FY2021-FY2023E, driven by a 12.9% revenue CAGR and a 160 bps EBITDA margin expansion to 17% in FY2023E. The stock is trading at attractive valuations at P/E multiple of 9.1x and EV/EBITDA multiple of 4.5x its FY2023E estimates. We retain our Buy rating on the stock with an unchanged PT of Rs. 290.

Price Target Calculation — Rs cr

	Rs./ Share
FY2023E EPS (Rs. per share)	24.0
Target P/E Multiple (x)	12.1
Target Price (Rs.)	290
Upside (%)	27

Source: Company Data; Sharekhan Research

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	Rs/ Share	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Apollo Tyres	217	18.8	12.1	9.1	6.4	5.3	4.5	6.5	7.8	9.3
Balkrishna Industries	2,246	37.6	25.5	21.6	24.7	17.7	15.1	22.1	27.6	27.1

Source: Company, Sharekhan estimates

About company

ATL is the second largest tyre manufacturer in India. ATL is a 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 two-wheeler space, ATL has become a full-fledged tyre player present 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

ATL is one of the leading tyre companies in India, with a leadership position in the largest truck and bus tyre segment. The company is also one of the leading players in passenger vehicle segment in India. Over the past few years, ATL has been increasing its presence globally and acquired businesses in Europe, which has not only opened new markets for the company but has also strengthened its R&D capabilities globally. ATL is expected to gain market share in other segments and in multiple geographies (e.g. Vredestein in passenger vehicles and Apollo in truck and bus segments), driven by strong brand, R&D, technology, and distribution network. In addition, the company will operationally improve its margin, aided by specialisation of Dutch plant (through significant uptick in cost competitiveness, given ramping up production in Hungary), cost reductions through digitalisation of its businesses, and improvement in passenger vehicle mix.

Key Risks

ATL derives about 30% of its revenue from European operations, which exposes it to currency risks. Any adverse movement in INR-Euro pair would impact its financial performance.

Additional Data

Key management personnel

Onkar Singh Kanwar	Chairman and Managing Director
Mr Neeraj Kanwar	Vice Chairman and Managing Director
Sunam Sarkar	President and Chief Business Officer
Gaurav Kumar	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Sunrays Properties & Investment	19.9
2	Emerald Sage Investment	9.9
3	White Iris Investment	8.0
4	Hdfc Trustee Company	7.9
5	Osiatic Consultants & Investments	6.2
6	Apollo Finance Ltd.	5.9
7	Classic Industries & Exports Ltd.	2.9
8	Custodian A/c - Ashwin Shantilal Mehta	2.1
9	Ptl Enterprises	1.6
10	Icici Prudential Equity Savings Fund	1.6

Source: Bloomberg

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 detoriating 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

Sharekhan

by BNP PARIBAS

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