Sharekhan
by BNP PARIBAS

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Stock Update

Apollo Tyres Limited

Riding on robust margin expansion

Automobiles	Sharekhan code: APOLLOTYRE	Result Update

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		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 244**	
Price Target: **Rs. 290**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

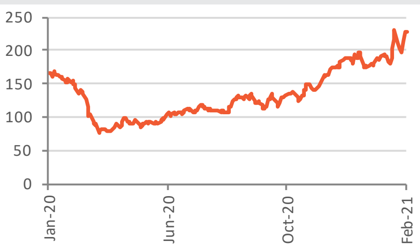
Company details

Market cap:	Rs. 15,496 cr
52-week high/low:	Rs. 255 / 74
NSE volume: (No of shares)	104.8 lakh
BSE code:	500877
NSE code:	APOLLOTYRE
Free float: (No of shares)	33.8 cr

Shareholding (%)

Promoters	37.6
FII	20.8
DII	13.9
Others	27.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	26.4	60.8	109.9	36.6
Relative to Sensex	21.4	34.4	76.7	13.2

Sharekhan Research, Bloomberg

Summary

- We maintain Buy rating on Apollo Tyres Limited (ATL) with a PT of Rs. 290, factoring strong traction in business outlook and an upgrade in earnings estimates.
- Q3FY2021 results were better than expected as EBITDA margins rose sharply.
- On back of strong operational performance, we have upgraded our earnings estimates by 55%/49% for FY22E/FY23E, largely driven by a 220 bps/280 bps EBITDA margin expansion to 16.4%/17.4%, respectively, to reflect a sharp increase in operational improvements in the company.
- The stock trades attractively at P/E multiple of 10.2x and EV/EBITDA multiple of 5x its FY2023E estimates.

Q3FY2021 results exceeded expectations with a robust improvement in EBITDA margin. Net revenue grew by 17.1% y-o-y at Rs. 5,501 crore, led by strong tyre demand in India and Europe. Domestic revenue grew by 22.7% y-o-y and 16.4% q-o-q at Rs. 3,449 crore, while revenue from Europe grew 7.5% y-o-y and 27.3% q-o-q to Rs. 1,747 crore. Growth was driven by strong offtake from OEMs as well as a solid recovery in the replacement market. OPM stood at 19.2%, rising sharply by 707 bps y-o-y and 297 bps q-o-q, aided by price hikes, cost reductions and operating leverage benefits. Gross margins improved by 383 bps y-o-y to 47.5% in Q3, aided by price hikes and raw material rationalisation, despite a rise in prices of key raw materials. Other expenditure as a percentage of sales improved 180 bps y-o-y at 15.1% in Q3FY21, which further helped improve OPM. As a result, consolidated PAT grew by 158.4% y-o-y and 26.7% q-o-q to Rs. 449 crore. We expect tyre industry to be natural benefactor of the sharp recovery in automobile sales. Automobile sales have witnessed a broad-based recovery across segments after the COVID-19 lockdown, 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 the OEM demand, likely to result in a steady growth for the replacement demand. ATL is well-positioned to gain market share in India and Europe, given its strong brand, R&D, technology and distribution network. Led by strong operational performance, we have upgraded our earnings estimates by 55%/49% for FY22E/FY23E, largely driven by a 220 bps/280 bps rise in EBITDA margins to 16.4%/17.4%, respectively, to reflect a sharp increase in margins. Return ratios are expected to improve significantly with RoE expected to improve from 4.8% in FY20 to 12.6% in FY23E while ROCE is expected to improve from 4.7% in FY20 to 9.5% in FY2023. We maintain a Buy on Apollo Tyres on strong business outlook and operational improvement.

Our Call

Valuation – Maintain Buy rating with revised 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 utilization of more than 90% and a focus on firm capital allocation and cash management. The stock is trading at attractive P/E multiple of 10.2x and EV/EBITDA multiple of 5x its FY2023E estimates. We retain a Buy on the stock with the revised PT of Rs. 290.

Key Risks

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

Valuations (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	17,549	16,327	17,127	19,622	21,336
Growth (%)	18.2	(7.0)	4.9	14.6	8.7
EBIDTA	1,959	1,916	2,631	3,213	3,703
OPM (%)	11.2	11.7	15.4	16.4	17.4
Adjusted PAT	880	476	734	1,164	1,522
% YoY growth	21.5	(45.9)	54.1	58.5	30.8
Adjusted EPS (Rs)	15.4	8.3	11.6	18.3	24.0
P/E (x)	15.9	29.3	21.1	13.3	10.2
P/B (x)	1.4	1.4	1.5	1.4	1.2
EV/EBITDA (x)	9.4	9.6	7.0	5.7	5.0
RoCE (%)	7.4	4.7	6.6	8.0	9.5
RoE (%)	8.9	4.8	7.2	10.6	12.6

Source: Company; Sharekhan estimates

Q3FY2021 results much ahead of expectations on solid operational performance: Q3FY2021 results exceeded expectations with a robust improvement in EBITDA margin. Net revenue grew by 17.1% y-o-y at Rs. 5,501 crore, led by strong tyre demand in India and Europe. Domestic revenue grew by 22.7% y-o-y and 16.4% q-o-q at Rs. 3,449 crore, while revenue from Europe grew 7.5% y-o-y and 27.3% q-o-q to Rs. 1,747 crore. Growth was driven by strong offtake from OEMs as well as a solid recovery in the replacement market. OPM stood at 19.2%, rising sharply by 707 bps y-o-y and 297 bps q-o-q, aided by price hikes, cost reductions and operating leverage benefits. The company hiked prices by 2-3% in December 2020 in the replacement market and expects to undertake another round of price hike by the end of the Q4FY21. The gross profit margin improved 383 bps y-o-y to 47.5% in Q3, aided by price hikes and raw material rationalisation, despite the rise in prices of key raw materials. The other expenditure as a percentage of sales improved 180 bps y-o-y at 15.1% in Q3FY21, which further helped in improving operating profit margins. As a result, the consolidated PAT grew by 158.4% y-o-y and 26.7% q-o-q to Rs. 449 crore. The company has recorded one time exceptional expenses of Rs. 601 crore in Q2FY21 and thus, has no impact on Q3FY21 results. The exceptional expenses related to employee benefits and write off / impairment of certain assets amounting to Rs. 466 crore and Rs. 129 crore respectively, for its subsidiary company Apollo Vredestein B.V in Netherlands.

Sharp recovery in the automobile sector to fuel demand for tyres: We expect the tyre industry to benefit from a sharp recovery in automobile sales. The automobile sector has witnessed broad-based recovery across the segment after the COVID-19 lockdown, except three-wheelers segment and late recovery of M&HCVs segment, 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 a steady growth for the replacement demand. We expect tyre sector gain from the successful implementation of the scrappage policy, particularly the M&HCV tyre segment. The government is expected to roll out the scrappage policy for vehicles older than 15 years. Given the shorter replacement cycle for M&HCV tyres, the scrappage policy would encourage fleet owners to scrap older vehicles, which would increase the utilisation of existing vehicles, and lead to the subsequent purchases of new vehicles, thereby supplementing the replacement demand. The tyre industry will benefit from the truck & bus segment in the medium-term, aided by improvement in economic activities.

Beneficiary of improved business outlook: We expect ATL to benefit from the improved business outlook from automotive segments in the medium term. The structural demand for domestic tyres remain intact driven by increasing preference for personal mobility, improving fleet utilisation, rising consumption of petrol/diesel and normalisation of economic activities. The company has gained market share by ~300 bps in truck & Bus tyres, ~350 bps in PV tyres and ~500 bps in tractor tyres. The company's market shares in truck & bus tyres, and passenger car tyres stood at 31% and 22%, respectively during April-October 2020. The 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 sized 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.

Focus on improving ROE: ATL's management has set out three key strategy in the medium term – deleveraging balance sheet, increasing capital utilization more than 90% and focus on firm capital allocation and cash management. The company will leverage its strong brand, R&D, technology and distribution network to increase its market share and improve profitability.

European business picking up: The European business (forming 30% of revenues) demand is also improving, after tough conditions emerged in Q3FY21, on the back of a second wave of COVID-19. The company performance was less impacted as the tyres stores were open.

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. 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 the Vredestein plant would be redundant which would result into savings to the tune of Euro 40-50 million. ATL expects the restructuring exercise to mainly complete by the end of FY21, with major benefits likely to be witnessed from FY22. Moreover, ATL has undertaken cost control initiatives such as reducing travelling and promotion expenses, reduction in fixed costs and freight and logistics expenses. The company expects margins to improve by 14-15% over the medium term. ATL expects a payback of less than 2 years from this restructuring activity. Moreover, ATL plans to launch its Vredestein brand of tyres in India starting January 2021, targeting premium cars in the replacement segment. The company sees a favourable opportunity to sell 'Made in India' Vredestein tyres for Mercedes, BMW and other premium sedans, the requirements of which are currently met through imports. The premium tyre segment in India comprises of 10% of the overall tyre market and is a high-margin business.

Robust earnings growth in medium term: Q3FY2021 results were better-than-expected on solid improvement in EBITDA margin. With a strong recovery in the automotive volumes coupled with strong margin expansion, we have increased our earnings estimates by 55%/49% for FY22E/FY23E, largely driven by a 220 bps/280 bps expansion in EBITDA margins to 16.4%/17.4% respectively to reflect sharp increase in margins for the company. Return ratios are expected to improve significantly with ROE expected to improve from 4.8% in FY20 to 12.6% in FY23E while ROCE is expected to improve from 4.7% in FY20 to 9.5% in FY2023.

Results Q3FY21 Rs cr

Particulars	Q3FY21	Q3FY20	YoY %	Q2FY21	QoQ %
Revenue	5,154	4,400	17.1	4,283	20.3
Total Expenses	4,164	3,866	7.7	3,588	16.1
Operating Profit	989	534	85.4	695	42.4
OPM%	19.2	12.1	707 bps	16.2	297 bps
PBT	621	201	208.7	(315)	NA
Tax	171	27	530.1	(69)	NA
Share Of profit from Associates	0	0	-50.0	0	-81.8
Adj Net Profit	449	174	158.4	355	26.7
Reported PAT	449	174	158.4	(246)	NA
Adjusted EPS (Rs)	7.1	3.0	132.7	6.2	14.1

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook - Strong recovery from FY2022

We expect the tyre industry to be natural benefactor of the sharp recovery in automobile sales. The automobile sector has witnessed broad-based recovery across the segment after the COVID-19 lockdown, except three-wheelers segment and late recovery of M&HCV sales, 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 the OEM demand, likely to result in a steady growth for the replacement demand.

■ Company outlook - Strong earnings growth; Upgraded earnings estimates.

Q3FY2021 results exceeded expectations with a robust improvement in EBITDA margin. Net revenue grew by 17.1% y-o-y at Rs. 5,501 crore, led by strong tyre demand in India and Europe. Domestic revenue grew by 22.7% y-o-y and 16.4% q-o-q at Rs. 3,449 crore, while revenue from Europe grew 7.5% y-o-y and 27.3% q-o-q to Rs. 1,747 crore. Growth was driven by strong offtake from OEMs as well as a solid recovery in the replacement market. OPM stood at 19.2%, rising sharply by 707 bps y-o-y and 297 bps q-o-q, aided by price hikes, cost reductions and operating leverage benefits. On the back of strong operational performance, we upgrade our earnings estimates by 55%/49% for FY22E/FY23E, largely driven by a 220 bps/280 bps EBITDA margin expansion to 16.4%/17.4%, respectively to reflect sharp increase in margins for the company. The return ratios are expected to improve significantly with RoE expected to improve from 4.8% in FY20 to 12.6% in FY23E, while RoCE is expected to improve from 4.7% in FY20 to 9.5% in FY2023.

■ Valuation - Maintain Buy rating with revised PT of Rs. 290:

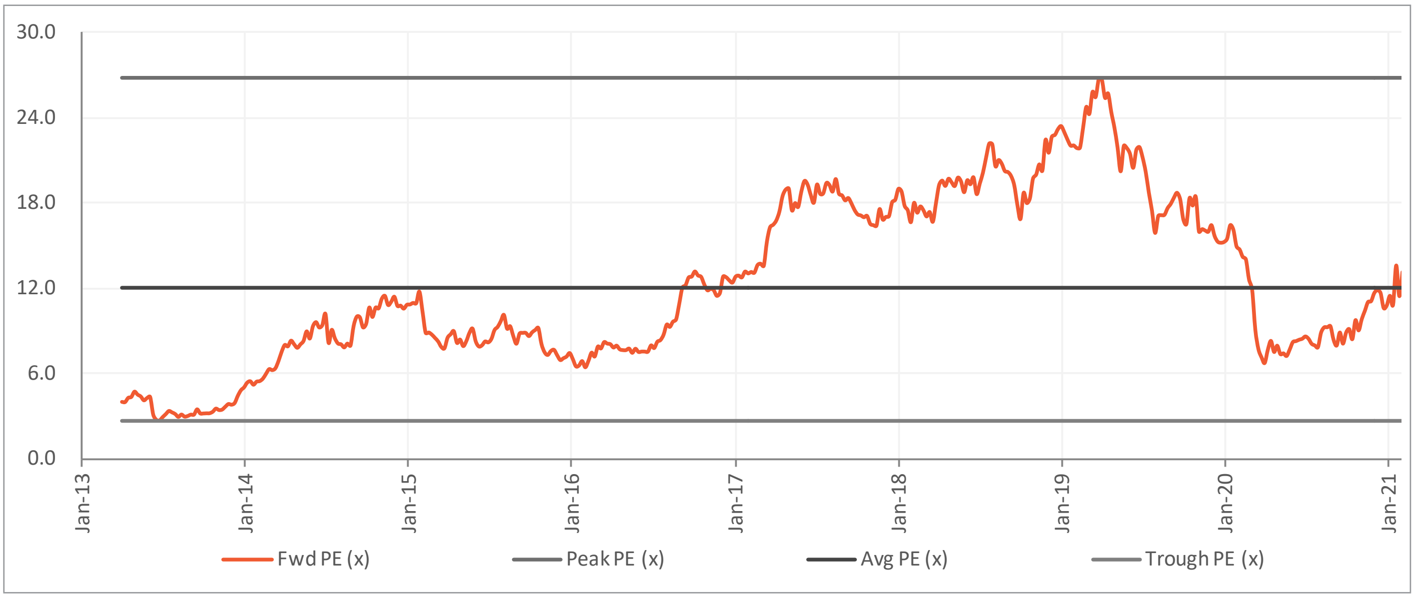
Tyre demand has improved significantly in both the domestic as well as European operations. ATL is well-positioned to gain market share in India and Europe, given its strong brand, R&D, technology and distribution network. We expect the company to benefit from its strategy by deleveraging its balance sheet, capital utilization of more than 90% and a focus on firm capital allocation and cash management. The stock is trading at attractive P/E multiple of 10.2x and EV/EBITDA multiple of 5x its FY2023E estimates. We retain a Buy on the stock with the revised PT of Rs. 290.

Target Price Calculation

	Rs./ Share
FY23E EPS (Rs. per share)	24.0
Target P/E Multiple (x)	12.1
Target Price	290
Upside (%)	19

Source: Company; Sharekhan Research

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Apollo is the second largest tyre manufacturer in India. Apollo 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 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 Tyres Limited (ATL) reported much better-than-expected Q3FY2021 results on solid improvement in EBITDA margin. Net revenue grew by 17.1% y-o-y at Rs. 5,501 crore, led by strong demand for tyres in India and Europe. The domestic revenue grew by 22.7% y-o-y and 16.4% q-o-q at Rs. 3,449 crore, while revenue from Europe grew 7.5% y-o-y and 27.3% q-o-q to Rs.1,747 crore. The growth was driven on back of strong offtake from OEMs as well as solid recovery in replacement markets. The operating profit margin for the Q3FY21 stood at 19.2% showing a strong improvement of 707 bps y-o-y and 297 bps q-o-q, aided by price hikes, cost reductions and operating leverage benefits. We expect ATL to benefit from the improved business outlook from automotive segments in the medium-term. The structural demand for domestic tyres remain intact driven by increasing preference for personal mobility, improving fleet utilisation, rising consumption of petrol/diesel and normalisation of economic activities. We have revised our earnings estimates substantially to reflect strong EBITDA margin expansion in the quarter. The stock is attractively valued at P/E of 10.2x and thus we maintain our Buy rating on the stock.

Key Risks

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

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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Neeraj consultants	12.9
2	HDFC Asset Management Company	7.0
3	Apollo Finance group	7.0
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	3.0
10	Classic Auto Tubes Ltd	2.7

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

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