Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Apollo Tyres Ltd

Near term headwinds, valuation attractive

Automobiles	Sharekhan code: APOLLOTYRE
Reco/View: Buy ↔	CMP: **Rs. 192**
	Price Target: **Rs. 245** ↓

↑ 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 Feb 08, 2022

Medium Risk

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

Source: Morningstar

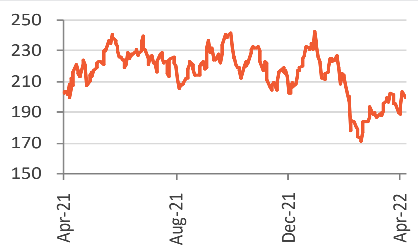
Company details

Market cap:	Rs. 12,194 cr
52-week high/low:	Rs. 250 / 165
NSE volume: (No of shares)	31.8 lakh
BSE code:	500877
NSE code:	APOLLOTYRE
Free float: (No of shares)	39.8 cr

Shareholding (%)

Promoters	37.3
FII	19.4
DII	20.1
Others	23.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.9	-18.0	-16.4	-4.3
Relative to Sensex	6.1	-11.2	-11.3	-21.5

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on Apollo Tyres Limited (ATL) with a revised PT of Rs. 245, led by the company's dominant positions in key markets, expected market share gains across segments, and attractive valuations.
- ATL is set to benefit from its strategy by deleveraging its balance sheet, improving operating leverage, and focus on firm capital allocation and cash management going forward.
- We expect ATL's earnings to grow by 31.3% CAGR during FY2021-FY2024E, driven by a 12.4% revenue CAGR and a 60 bps EBITDA margin expansion to 16% in FY2024E.
- The stock trades attractively at P/E multiple of 9.5x and EV/EBITDA multiple of 4.6x its FY2024E 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, which is expected to reap benefit going forward. ATL is to improve its OEM and replacement market sales, given the improvement in rural and semi-urban demand, coupled with improvement in economic activities in the medium term. The company is expected to improving its EBITDA margin, driven by deleveraging its balance sheet, improvement in operating leverage and focus on firm capital allocation and cash management going forward, despite raw material headwinds likely to continue. 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.

- **Beneficiary of improving automobile demand and global revenues:** We expect the domestic tyre industry to benefit from a recovery in automobile sales in rural and semi-urban markets, 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 going forward backed by higher OEM offtake and the ripple effect of OEM demand is likely to result in steady growth for the replacement demand.
- **Focus on improving product mix and brand building:** ATL is focusing 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, through new launches, brand building, and focus on increasing its presence in southwest Europe, while adding on to its healthy presence in western and central Europe.
- **Management remains committed to achieving long-term goals:** The management remains committed to 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. ATL is approaching the end of the capex cycle with a 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 FY2023E, the company is expected to operate ~70-80% capacity utilization, which gives the company the bandwidth to grow business for another 2-3 years at minimal Capex.

Our Call

Valuation – Maintain Buy rating with a revised PT of Rs. 245: 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, improving capacity utilisation, and focusing on firm capital allocation and cash management in the near term. Strong growth coupled with a leadership position in key markets and segments is likely to re-rate valuation multiples. The stock is trading at attractive valuations at P/E multiple of 9.5x and EV/EBITDA multiple of 4.6x its FY2024E estimates. We retain our Buy rating on the stock with a revised PT of Rs. 245.

Key Risks

Apollo derives about 30% of its revenue from its European operations, which exposes it to currency risks. Any adverse movement in the 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	2,449	3,382	3,878
OPM (%)	15.4	12.4	15.5	16.0
Adjusted PAT	734	596	1,284	1,660
% YoY growth	54.1	(18.8)	115.4	29.3
Adjusted EPS (Rs)	11.6	9.4	20.2	26.1
P/E (x)	16.6	20.5	9.5	7.3
P/B (x)	1.2	1.1	1.0	0.9
EV/EBITDA (x)	5.9	6.3	4.6	4.0
RoE (%)	7.2	5.6	11.3	13.2
RoCE (%)	6.5	4.9	8.4	10.0

Source: Company; Sharekhan estimates

Beneficiary of improving automobile demand and global revenues: We expect the domestic tyre industry to benefit from a recovery in automobile sales in rural and semi-urban markets, 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 going forward 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 an improved business outlook in the automotive segment in the medium term. The 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 by increasing the 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.

Positive outlook: Our channel checks with dealers suggest robust demand in the near term, led by pent up demand, despite a series of price hikes over the last year in the range of 10-12%. The dealers have increased their inventories due to expectations that the prices of tyres will be hiked. Other tyre companies have also taken price hikes.

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 a strong capacity to drive growth going forward. ATL is approaching the end of Capex cycle with a 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 FY2023E, the company is expected to operate ~70-80% 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.

Thrust on digitalisation, branding, and R&D: Digitalisation and branding is the company's key enablers for growth. ATL has invested significantly in building up the brand, plant infrastructure, and R&D capability over the past decade. The company has invested in building tyre capacity in India and Europe. In the past few years, the company's focus has been ramping up capacity in plants situated in Chennai, Hungry, and Andhra Pradesh. ATL's has two key brands viz., Apollo Tyres and Vredestein in India. The company has a strong recall for both brands. The company has gradually increased its focus on brand building, marketing, and customer engagement, by increasing it spending to 2% of revenue in FY2021 from ~1% in FY2014. It has been institutionalising marketing platforms (Manchester United and ISL) for brand building, the brand ambassadorship of Sachin, and creation of communities such as Bad Road Buddies.

Management remains committed to achieving long-term goals: The management remains committed to 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. ATL's management was confident of achieving targets, as the company is well-positioned to enter into the growth phase through optimising processes and delivering differentiating products. The company has made significant investments in building brand, plant infrastructure, distribution, and R&D capability over the past decade. The Management reiterated that the company will continue to focus on core and profitable business. term 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 digitisation, 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 the passenger vehicle segment and benefits of specialization in Dutch plant.

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, through new launches, brand building, and focus on increasing its presence in south west Europe, while adding on to its healthy presence in west and central Europe.

Market share gains: The company has a leadership position in the truck and bus segment, which is the largest market segment in the country. Also, the company holds the top position in the passenger vehicle segment. ATL has improved its market share across the segments in India as well as Europe markets. The company has expanded its distribution footprint significantly over the last two years, with increasing touchpoints in rural markets by more than four times. The Vredestein brand continues to hold its dominant position in the fast-growing PCLT segment in Europe. The company is gaining a share in focused categories such as UHP/UUHP PCR, TBR, agri in the overseas markets. It has gained 17 bps in the UHP segment and 41 bps in the TBR segment.

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. The raw material headwinds are expected to remain in the medium term, which we have built in our earnings model. We expect ATL's earnings to grow by 31.3% CAGR during FY2021-FY2024E, driven by a 12.4% revenue CAGR and a 60 bps EBITDA margin expansion to 16% in FY2024E. 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, despite raw maw material headwinds persist. Return ratios are expected to improve significantly, with ROE expected to improve from 7.2% in FY2021 to 13.2% in FY2024E, while ROCE is expected to improve from 6.5% in FY2021 to 10% in FY2024E.

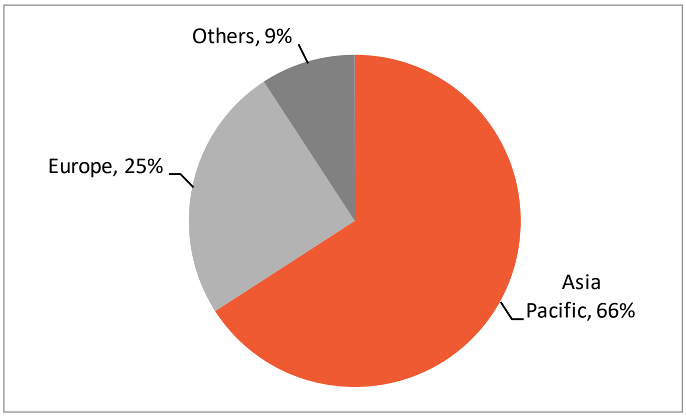
Change in Estimates Rs cr

Particulars	Revised		Earlier		% Change	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Revenue	19,784	21,813	19,784	21,813	-	-
EBITDA	2,449	3,382	3,183	3,702	(23.1)	(8.6)
EBITDA margin (%)	12.4	15.5	16.1	17.0	(370 bps)	(150 bps)
PAT	596	1,284	1,141	1,522	(47.8)	(15.6)
EPS (Rs)	9.4	20.2	18.0	24.0	(47.8)	(15.6)

Source: Company, Sharekhan Research

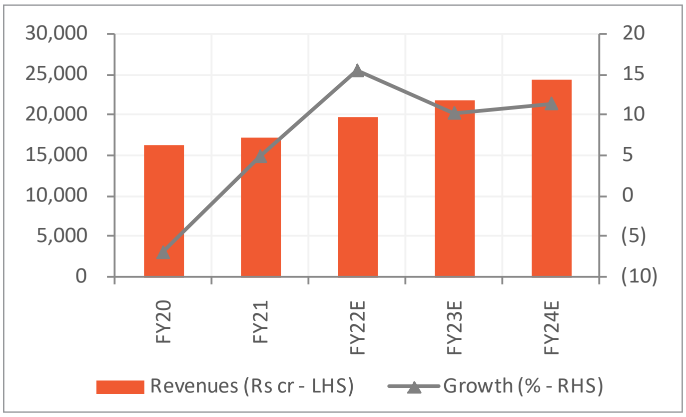
Financials in charts

Geographical Mix (%)



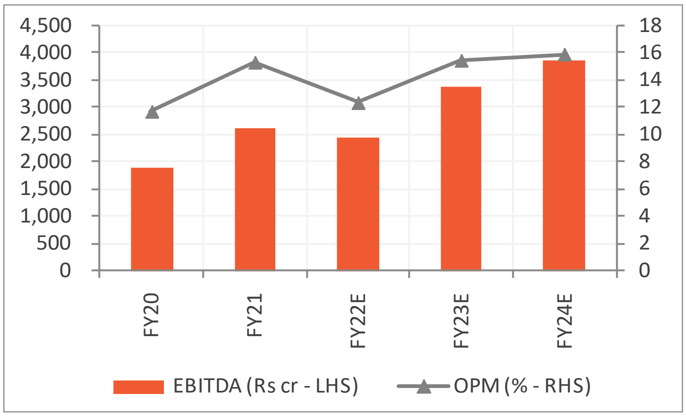
Source: Company, Sharekhan Research

Revenue and Growth Trend



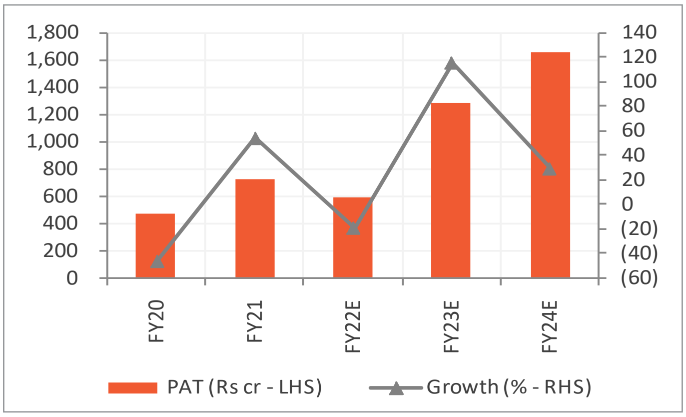
Source: Company, Sharekhan Research

EBITDA and OPM Trend



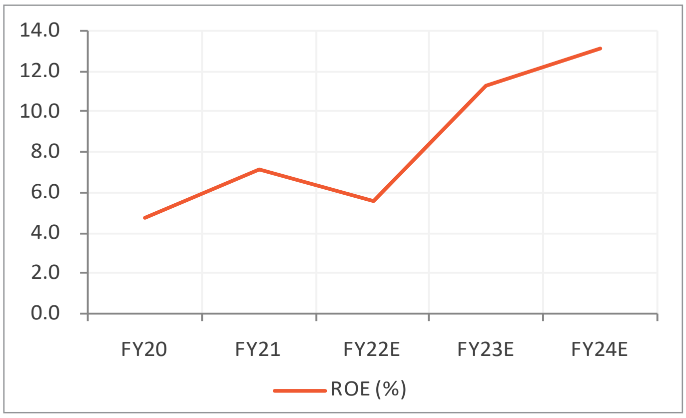
Source: Company, Sharekhan Research

Net Profit and Growth Trend



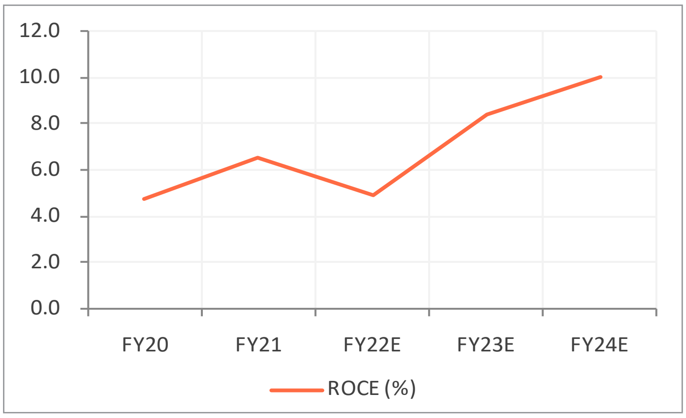
Source: Company, Sharekhan Research

RoE Trend



Source: Company, Sharekhan Research

RoCE Trend



Source: Company, Sharekhan Research

Outlook and Valuation

Sector view - Strong recovery

We expect the domestic tyre industry to benefit from a recovery in automobile sales in rural and semi-urban markets, 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 going forward backed by higher OEM offtake and the ripple effect of OEM demand is likely to result in steady growth for the replacement demand.

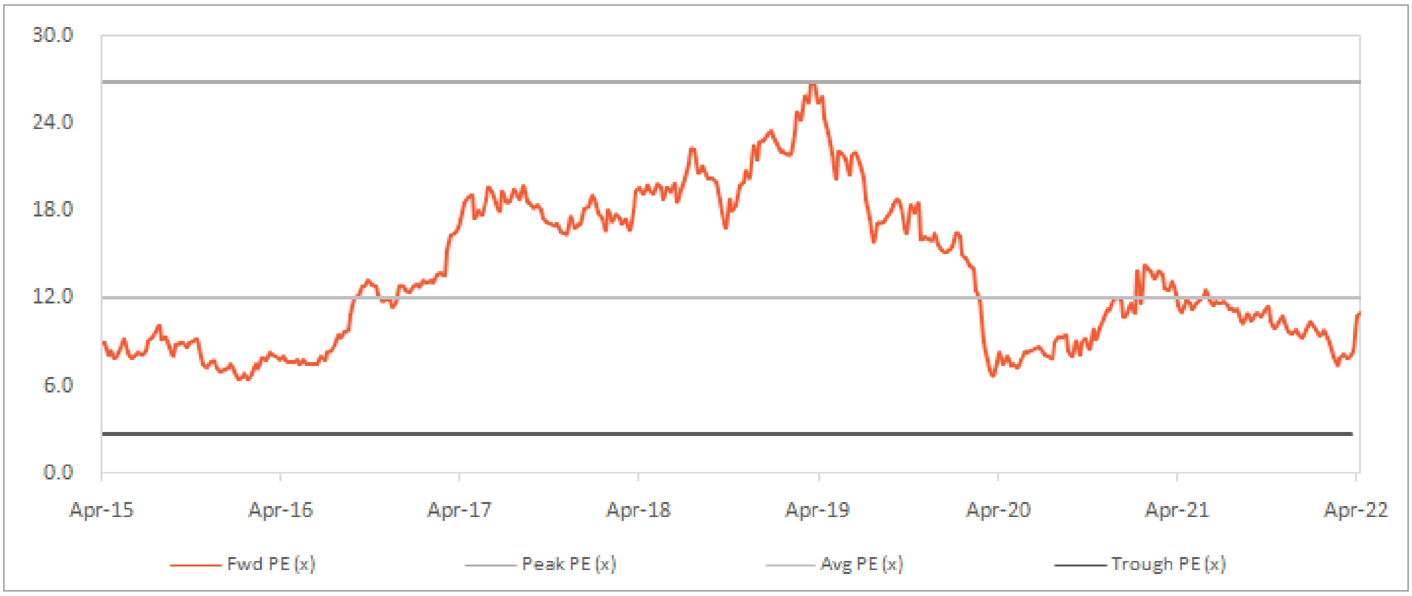
Company outlook - Convincing strategy to achieve a profitable growth model

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.

Valuation - Maintain Buy rating with a revised PT of Rs. 245

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, improving capacity utilisation, and focus on firm capital allocation and cash management in the near term. Strong growth coupled with a leadership position in key markets and segments is likely to re-rate valuation multiples. The stock is trading at attractive valuations at P/E multiple of 9.5x and EV/EBITDA multiple of 4.6x its FY2024E estimates. We retain our Buy rating on the stock with a revised PT of Rs. 245.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	CMP (Rs)	P/E			EV/EBITDA			ROCE (%)		
		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Apollo Tyres	192	16.6	20.5	9.5	5.9	6.3	4.6	6.5	4.9	8.4
Balkrishna Industries	2,036	34.1	23.2	19.6	22.4	16.1	13.7	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 up 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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Sunrays Properties & Investment	19.9
2	Emerald Sage Investment	9.9
3	Hdfc Trustee Company	8.3
4	White Iris Investment	8.0
5	Osiatic Consultants & Investments	6.2
6	Apollo Finance Ltd.	5.9
7	Classic Industries & Exports Ltd.	2.8
8	Custodian A/c - Ashwin Shantilal Mehta	2.1
9	Ptl Enterprises	1.7
10	Icici Prudential Equity Savings Fund	1.5

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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