Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Company Update

Apollo Tyres Ltd

Rolling ahead on strong growth path

Automobiles	Sharekhan code: APOLLOTYRE
Reco/View: Buy ↔	CMP: Rs. 317
	Price Target: Rs. 372 ↑

↑ 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 26.73

Updated Aug 08, 2022

Medium Risk

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

Source: Morningstar

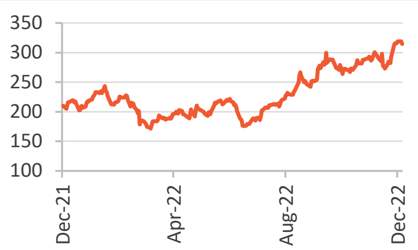
Company details

Market cap:	Rs. 20,133 cr
52-week high/low:	Rs. 303 / 165
NSE volume: (No of shares)	37.5 lakh
BSE code:	500877
NSE code:	APOLLOTYRE
Free float: (No of shares)	39.8 cr

Shareholding (%)

Promoters	37.3
FII	21.6
DII	19.6
Others	21.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.9	23.7	44.1	49.9
Relative to Sensex	6.5	18.3	31.8	43.2

Sharekhan Research, Bloomberg

Summary

- We maintain a Buy on Apollo Tyres Limited (ATL) with a revised PT of Rs. 372, led by expected market share gains by the company in key segments and markets and attractive valuations.
- ATL is expected to maintain its earnings growth momentum, by increasing focus on premium tyre sub-segments, maintaining dominancy in key segments in India and a firm capital allocation strategy.
- We expect ATL's earnings to clock a 43.1% CAGR during FY2022-FY2025E, driven by an 11% revenue CAGR and a 220-bps EBITDA margin expansion to 14.5% in FY2025E.
- Stock trades attractively at P/E multiple of 10.7x and EV/EBITDA multiple of 5.4x its FY2025E estimates.

We reiterate Buy rating on Apollo Tyres Limited's (ATL's), aided by improving OEM demand and expected faster growth in the replacement market. ATL is well-positioned to leverage market opportunities in India and abroad. ATL has been able to pass on costs to its retail and OEM customers very comfortably while maintaining robust revenue growth. We remain optimistic about the company's growth prospects and expect it to benefit from deleveraging of balance sheet, improving operating leverage and focusing on firm capital allocation and cash management going forward. Strong growth and a leadership position in key markets and segments will likely help ATL achieve long-term targets of $5 billion by FY2026.

- **Beneficiary of better automobile demand and global revenues:** We expect the domestic tyre industry to benefit from a recovery in automobile sales in rural and urban markets, driven by pent-up demand, preference for personal mobility amid COVID-19 and a 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 going forward.
- **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 and is building up a strong brand in India. The company is expected to increase its share of premium UHP and UUHP tyres to over 45% revenue contribution over the next 2 years versus its earlier guidance of achieving 45% share by FY2026. The share of premium tyres have been led by 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 $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. In addition, the company targets to be carbon-neutral by 2050, for which it has ramped its ESG activities. ATL has approached the end of a major capex cycle with a continued focus on brand building, marketing, and distribution network. The company has maintained its capex plans and the CAPEX is largely allocated towards de-bottlenecking existing capacities, digitalisation and judicious brownfield expansions company's growth in the medium term.

Our Call

Valuation – Maintain Buy rating with a revised PT of Rs. 372: Tyre demand has improved significantly in domestic and 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 will likely re-rate valuation multiples. The stock trades at attractive valuations at a P/E multiple of 10.7x and an EV/EBITDA multiple of 5.4x its FY2025E estimates. We retain a Buy rating on the stock with a revised PT of Rs. 372.

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

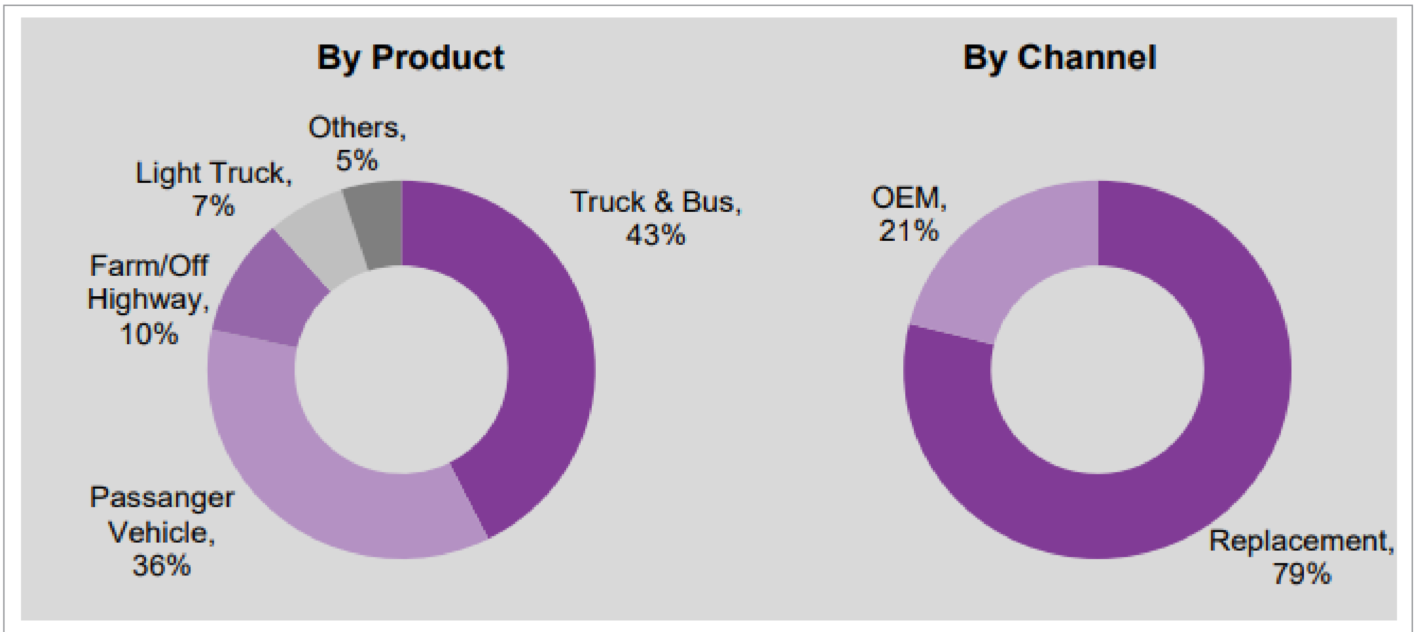
Particulars	FY21	FY22	FY23E	FY24E	FY25E
Revenues	17,376	20,948	23,981	26,813	28,649
Growth (%)	6.4	20.6	14.5	11.8	6.8
EBIDTA	2,777	2,574	3,245	3,799	4,147
OPM (%)	16.0	12.3	13.5	14.2	14.5
Adjusted PAT	958	644	1,182	1,601	1,888
% YoY growth	101.1	(32.7)	83.4	35.5	17.9
Adjusted EPS (Rs)	15.1	10.1	18.6	25.2	29.7
P/E (x)	21.0	31.2	17.0	12.6	10.7
P/B (x)	1.9	1.8	1.7	1.5	1.3
EV/EBITDA (x)	8.1	8.8	6.9	5.9	5.4
RoE (%)	9.3	5.9	10.2	12.6	13.3
RoCE (%)	7.8	5.4	7.7	9.6	10.6

Source: Company; Sharekhan estimates

Beneficiary of better automobile demand and global revenues: We expect the domestic tyre industry to benefit from a recovery in automobile sales in rural, and 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 going forward.

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 and is building up a strong brand in India. The company is expected to increase the revenue share of premium UHP and UUHP tyres to more than 45% over the next 2 years versus its earlier guidance of achieving a 45% share by FY2026. The share of premium tyres has been led by 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. . The company has increased its share of premium UHP and UUHP tyres to ~42% in Q2FY23 from 39% in Q2FY22.

Diversified revenue streams (consolidated revenue mix) helping ATL to maintain steady growth momentum



Source: Company Data; Sharekhan Research

Thrust on digitalisation, branding and R&D: Digitalisation and branding are the company's key growth drivers. 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, Hungary 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 2-2.5% of revenue currently from ~1% in FY2014. It has been institutionalising marketing platforms (Manchester United and ISL) for brand building, the brand ambassadorship of Sachin Tendulkar and creation of communities such as Bad Road Buddies.

Market share gains: The company has a leadership position in the truck and bus segment, which is the largest market segment in the country. In addition, the company holds the top position in the passenger vehicle segment. ATL has improved its market share across the segments in Europe markets. It has expanded its distribution footprint significantly over the last two years, 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, and agri in the overseas markets.

Positive outlook: On domestic demand outlook, the management is cautiously optimistic. The correction in input prices should help the company further to expand its EBITDA margin in the medium term. The management has maintained its long-term targets to achieve revenue of $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 company maintains its capex target for FY23 at Rs. 900 crore for Indian business and Euro 40mn for European facilities. The CAPEX is primarily allocated towards de-bottlenecking existing capacities, digitalisation and judicious brownfield expansions. ATL's capacity utilisation during Q2FY23 was 76% for India and 89% for European facilities.

ATL's geography-wise production capacity (MT/day)

Facility Locations	FY2018	FY2019	FY2020	FY2021	FY2022
India	1,543	1,727	1,732	1,848	1,932
Chennai	629	810	799	826	826
Peranbra	319	312	311	303	303
Limda	500	508	506	546	546
Kalamassery	95	97	115	114	114
Chinnapandur - New				58	142
Europe and America	187	388	279	318	318
Enshcede, Netherlands	187	184	149	163	163
Gyongyose	-	204	131	154	154
Total	**1,872**	**2,115**	**2,011**	**2,166**	**2,166**

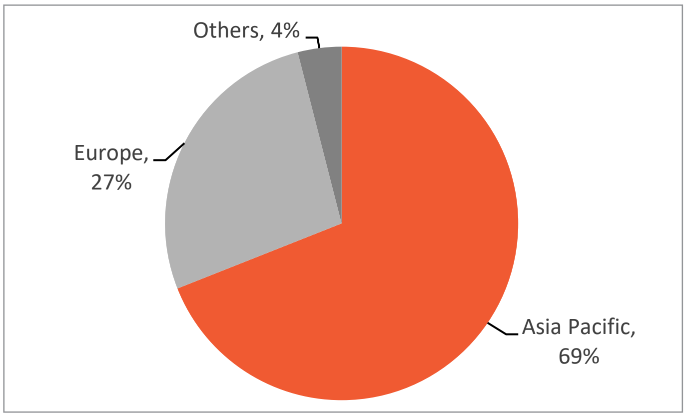
Source: Company; Sharekhan estimates

Management remains committed to long-term goals: The management remains committed to long-term targets to reach revenue of $5 billion by FY2026, EBITDA margins of 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 the growth phase through optimising processes and delivering differentiating products. The company has invested significantly 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. The near-term focus will be on increasing business through product differentiation, enhancing penetration in new markets (both domestic and exports), brand-building, R&D investments, and ramping up capacity. Key drivers for improving margins would be increasing share of premium products, cost control, rationalisation, 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.

Maintain Estimates: We maintain our estimates for Apollo Tyres. We expect ATL's earnings to clock a 43.1% CAGR during FY2022-FY2025E, driven by an 11% revenue CAGR and a 220 bps EBITDA margin expansion to 14.5% in FY2025E. Revenue growth is expected on back of robust domestic demand, increasing international penetration and improving replacement demand. The rationalisation of operational costs, improving product mix and increasing utilization capacity to help margins to improve in the medium term.

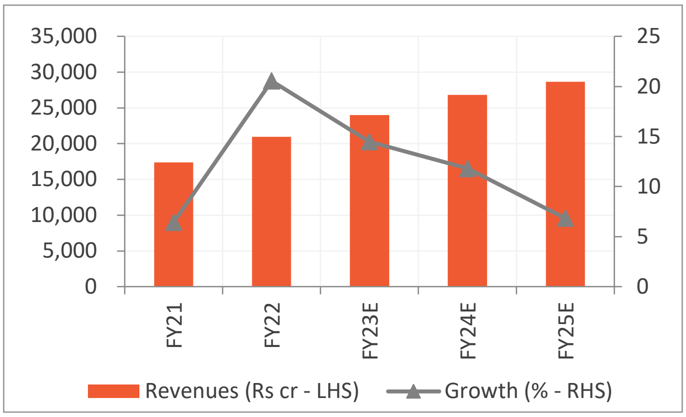
Financials in charts

Geographical Mix (%)



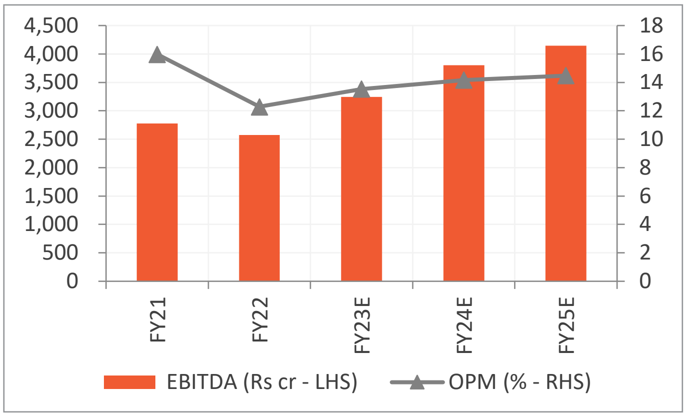
Source: Company, Sharekhan Research

Revenue and Growth Trend



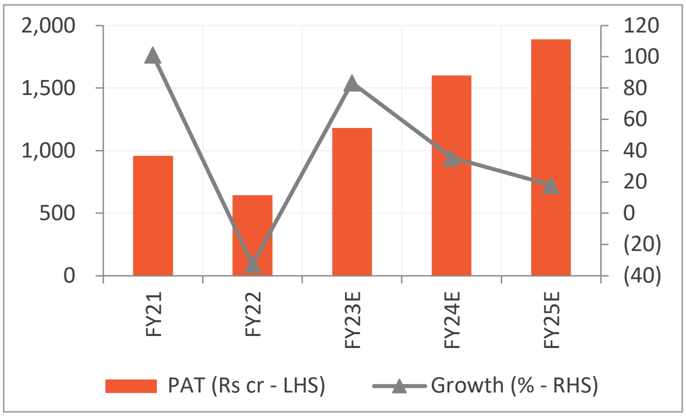
Source: Company, Sharekhan Research

EBITDA and OPM Trend



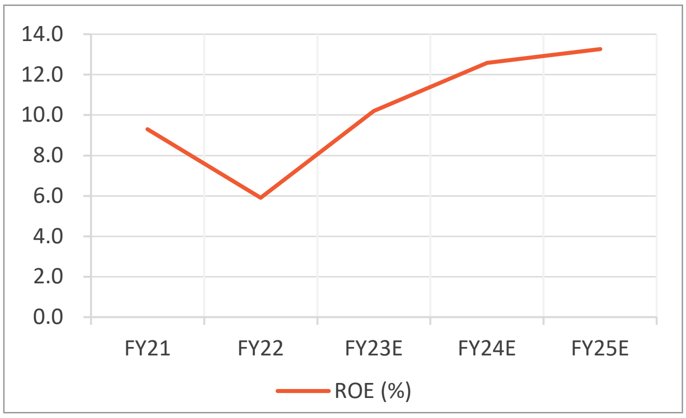
Source: Company, Sharekhan Research

Net Profit and Growth Trend



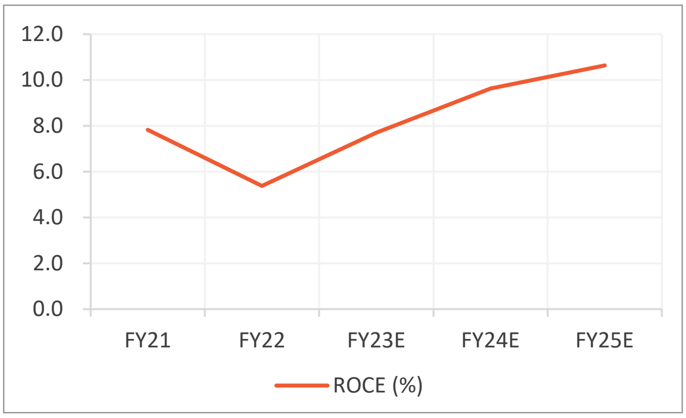
Source: Company, Sharekhan Research

RoE Trend



Source: Company, Sharekhan Research

RoCE Trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Strong recovery eyed

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 in the future, backed by higher OEM offtake. The ripple effect of OEM demand is likely to result in steady growth for the replacement demand.

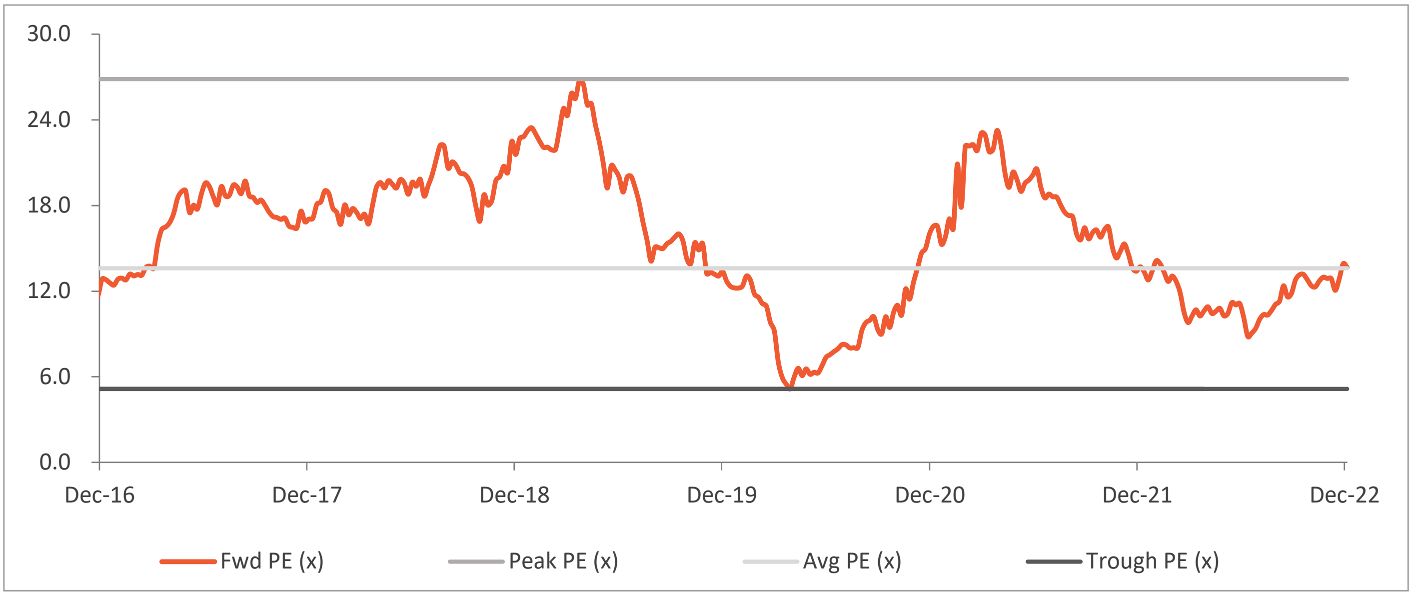
■ Company outlook - Convincing strategy to achieve a profitable growth model

The management has laid down its long-term targets to achieve revenue of US$5 billion by FY2026, an 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 an expected volume recovery post normalization of economic activities. The overseas business is expected to do well because of a richer product mix and gradual capacity additions.

■ Valuation - Maintain Buy rating with a revised PT of Rs. 372

Tyre demand has improved significantly in domestic and 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 de-leveraging its balance sheet, improving capacity utilisation, and focusing on firm capital allocation and cash management in the near term. Strong growth coupled with leadership position in key markets and segments will likely re-rate valuation multiples. The stock trades at attractive valuations at a P/E multiple of 10.7x and an EV/EBITDA multiple of 5.4x its FY2025E estimates. We retain our Buy rating on the stock with a revised PT of Rs. 372.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	CMP (Rs/ Share)	P/E (x)			EV/EBITDA (x)			ROCE (%)		
		FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Apollo Tyres	317	31.2	17.0	12.6	8.8	6.9	5.9	5.4	7.7	9.6
Balkrishna Industries	2,082	28.5	29.1	24.1	21.3	20.2	17.4	25.3	21.2	22.3

Source: Company; Sharekhan Research

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 India's leading players in the passenger vehicle segment. Over the past few years, ATL has been increasing its presence globally and acquired businesses in Europe, which has opened up new markets for the company and 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 a strong brand, R&D, technology, and distribution network. In addition, the company will operationally improve its margin, aided by specialisation of Dutch plant (through a significant uptick in cost competitiveness, given ramping up production in Hungary); cost reductions through the digitalization 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 the 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	8.9
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	Government Pension Fund Global	2.1
9	Ptl Enterprises	1.7
10	Franklin India Prima Fund	1.1

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

Know more about our products and services

For Private Circulation only

Compliance Officer: Ms. Binkle Oza; Tel: 022-61150000; email id: complianceofficer@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com.

Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O/ CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.