Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Apollo Tyres Ltd

On a firm track, optimism continues

Automobiles	Sharekhan code: APOLLOTYRE
Reco/View: Buy ↔	CMP: Rs. 338
	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 22.72

Updated Dec 08, 2022

Medium Risk

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

Source: Morningstar

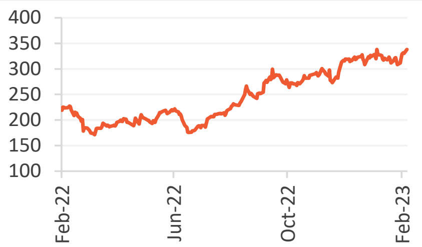
Company details

Market cap:	Rs. 21,466 cr
52-week high/low:	Rs. 343 / 165
NSE volume: (No of shares)	40.0 lakh
BSE code:	500877
NSE code:	APOLLOTYRE
Free float: (No of shares)	39.8 cr

Shareholding (%)

Promoters	37.3
FII	22.8
DII	17.1
Others	22.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.6	17.0	55.1	54.2
Relative to Sensex	5.9	17.7	48.7	51.4

Sharekhan Research, Bloomberg

Summary

- We maintain a Buy rating on Apollo Tyres Limited (ATL) with an unchanged PT of Rs. 372, led by the company's dominant position in its key markets and focus on premiumization.
- ATL reported Q3FY2023 performance ahead of estimates, led by correction in RM basket. Management has indicated that benefit of benign RM cost would continue in Q4FY2023.
- ATL continues to focus on profitable volume growth via offering quality products at premium products to sustain its operating performance.
- The stock trades attractively at a P/E multiple of 11.8x and EV/EBITDA multiple of 5.7x its FY2025E estimates.

Apollo Tyres Limited (ATL) reported Q3FY2023 performance ahead of estimates on account of raw-material (RM) cost benefit and its focus on profitable volume growth. Consolidated revenue was 6% above estimates and EBIDTA margin was 220 bps ahead of estimates. Consolidated revenue increased by 12.5% y-o-y to Rs. 6,423 crore and EBIDTA increased by 22.9% y-o-y to Rs. 913 crore. ATL's Q3FY2023 performance was driven by price hikes, improvement in product mix, and healthy demand from OEMs as it witnessed overall 4% decline in volumes in Indian business. Replacement demand was weak in the domestic market as both PCR and TBR segments registered an 8% y-o-y decline in replacement demand, while OEM demand grew by 30% y-o-y. The European market has been facing macro headwinds, though ATL has outperformed the market due to demand-supply mismatch, as the import form Russia in the European market has affected due to ongoing geopolitical issues. Dealer inventory in the European market is higher than normal levels, while the dealer inventory in the domestic market is under control. The raw-material basket contracted by 6% q-o-q and reflected in gross margin expansion. Consolidated EBITDA margin expanded by 230 bps q-o-q on account of 80 bps q-o-q expansion in gross margin and better cost control. Going forward, management has indicated for a mid-single digit decline in RM basket in Q4FY2023. We maintain our positive stance on ATL and believe it is well positioned to leverage market opportunities in India and abroad. ATL has been able to pass on the costs to its retail as well as OEM customers very comfortably while maintaining its robust revenue growth. We remain optimistic about the company's growth prospects and expect it to benefit from its strategy of deleveraging its balance sheet, improving operating leverage, focusing on firm capital allocation, and cash management going forward.

Key positives

- Standalone gross margin expanded by 300 bps and translated into 260 bps expansion in EBIDTA margin to 12.6%.
- In the standalone business, OEM business grew by 30% y-o-y and drove the overall performance as replacement demand was subdued in Q3FY2023.
- Revenue contribution from the premium segment (UHP and UUHP) has increased to 45% in Q3FY2023 from 42% in Q2FY2023 in the European business.
- Consolidated EBIDTA margin expanded by 230 bps q-o-q to 14.2% on account of 80 bps q-o-q expansion in gross margin.

Key negatives

- Replacement market growth slowed down in Q3FY2023. Domestic volumes declined by 4% y-o-y.
- The dealer inventory is high in European markets.

Management Commentary

- The correction in RM basket has benefited the company in Q3FY2023 and RM cost is likely to come down by mid-single digit in Q4FY2023.
- Though replacement demand was weak in the domestic market, replacement volumes are expected to recover in Q4FY2023.
- Volume pressure in the European market would continue in the near term, though ATL is trying to improve its market share and expects lower RM cost's benefit to reflect in the European market's performance in Q4FY2023.
- Management continues to focus on profitability via premiumization and better capacity utilization in place of plain vanilla volume growth.

Our Call

Valuation – Maintain Buy rating with an unchanged PT of Rs. 372: In the domestic market, while OEM demand has been strong, replacement demand is lagging. ATL has been focussing on profitable volume growth via offering quality products at premium prices without losing market share. Correction in the RM basket is benefiting it and management assumes a mid-single digit correction in the RM basket in Q4FY2023. 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, 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 a P/E multiple of 11.8x and an EV/EBITDA multiple of 5.7x its FY2025E. We retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 372.

Key Risks

ATL 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
Revenue	17,376	20,948	23,981	26,813	28,717
Growth (%)	6.4	20.6	14.5	11.8	7.1
EBIDTA	2,777	2,574	3,245	3,799	4,176
OPM (%)	16.0	12.3	13.5	14.2	14.5
Adjusted PAT	958	644	977	1,509	1,818
% YoY growth	101.1	(32.7)	51.7	54.4	20.5
Adjusted EPS (Rs.)	15.1	10.1	15.4	23.8	28.6
P/E (x)	22.4	33.3	22.0	14.2	11.8
P/B (x)	2.0	1.9	1.8	1.6	1.5
EV/EBITDA (x)	8.6	9.2	7.3	6.3	5.7
RoE (%)	9.3	5.9	8.5	12.1	13.1
RoCE (%)	7.8	5.4	7.5	9.3	10.5

Source: Company; Sharekhan estimates

Standalone business: Replacement demand has yet to come: Replacement demand was weak in the domestic market as PCR and TBR witnessed 8% y-o-y decline in volumes. Performance was largely driven by price hikes and volumes mix, as overall volumes declined by 4% y-o-y. The OEM segment registered strong growth, while export demand was subdued in Q3FY2023. The OEM segment registered 30% y-o-y growth; however, exports fell by 25% y-o-y. ATL undertook a 3% hike in the PCR segment in Q3FY2023E. Management assumes recovery in the replacement market in Q4FY2023, led by stable pricing and introduction of new products in the market. Despite headwinds, the company is focussing on profitability, hence given away some volumes due to poor profitability. Given the weakness in the market, the company is largely focussing on healthy capacity utilization and premiumization in its product offerings. Standalone revenue mix in 9MFY2023 – PV: 21%, T&B: 58%, OHT: 8%, LCV: 8%, and others: 4%.

European business: The near term is challenging: European business registered 7% y-o-y growth in revenue to Euro 180 mn and 490 bps y-o-y contraction in EBIDTA margin to 15.4%. The company has performed better than the industry, as it gained market share in European markets. Overall demand environment is subdued in Europe as dealers are carrying high inventory. ATL focuses 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 has increased its share of premium UHP and UUHP tyres to ~45% in Q3FY2023 from 42% in Q2FY2023. Management assumes that the business environment would continue to remain challenging in the near term.

Others:

- **RM price in Q3FY2023** – Synthetic Rubber was Rs. 185/kg, carbon black was Rs. 130/kg, Nylon tyre fabric was Rs. 190/kg, and Natural Rubber Rs. 175/kg.
- **Capacity** – TBR : 80%, PCR India 80%, PCR; Europe; 90%
- **Capex guidance** – The company has incurred capex of Rs. 450 crore in India and Euro 20 mn in Europe. Management has guided for capex of Rs. 600 crore in India and Euro 30 mn for Europe in FY2023.
- 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.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	% YoY	Q2FY23	% QoQ
Revenue	6,423	5,707	12.5	5,956	7.8
Total Expenses	5,509	4,965	11.0	5,244	5.1
EBITDA	913	743	22.9	712	28.3
Depreciation	354	344	2.9	349	1.7
Interest	142	108	31.1	132	7.5
PBT	424	307	38.1	238	77.8
Tax	132	83	58.0	44	199.3
Share Of profit from Associates	0	0	NA	0	NA
Reported PAT	292	224	30.7	194	50.2
Adjusted Net Profit	292	224	30.7	194	50.2
Adjusted EPS (Rs.)	4.6	3.5	30.7	3.1	50.2

Source: Company, Sharekhan Research

Key Ratios (Consolidated)

Particulars	Q3FY23	Q3FY22	YoY (bps)	Q2FY23	QoQ (bps)
Gross margin (%)	39.7	40.0	(30)	38.9	80
EBIDTA margin (%)	14.2	13.0	120	12.0	230
Net profit margin (%)	4.5	3.9	60	3.3	130
Effective tax rate (%)	31.1	27.2	390	18.5	1,260

Source: Company, Sharekhan Research

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	% YoY	Q2FY23	% QoQ
Revenue	4,247	3,792	12.0	4,252	(0.1)
Total Expenses	3,698	3,447	7.3	3,815	(3.0)
EBITDA	548	345	58.9	437	25.4
Depreciation	354	344	2.9	349	1.7
Interest	142	108	31.1	132	7.5
PBT	209	66	215.1	113	84.0
Tax	71	17	317.1	33	117.9
Reported PAT	138	49	179.6	81	70.2
Adjusted Net Profit	138	49	179.6	81	70.2
Adjusted EPS (Rs.)	2.2	0.8	179.6	1.3	70.2

Source: Company, Sharekhan Research

Key Ratios (Standalone)

Particulars	Q3FY23	Q3FY22	YoY (bps)	Q2FY23	QoQ (bps)
Gross margin (%)	32.7	30.2	250	29.7	300
EBIDTA margin (%)	12.9	9.1	380	10.3	260
Net profit margin (%)	3.2	1.3	190	1.9	130
Effective tax rate (%)	34.1	25.8	830	28.8	530

Source: Company, Sharekhan Research

Outlook and Valuation

Sector view - Strong recovery eyed

We expect the domestic tyre industry to benefit from 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.

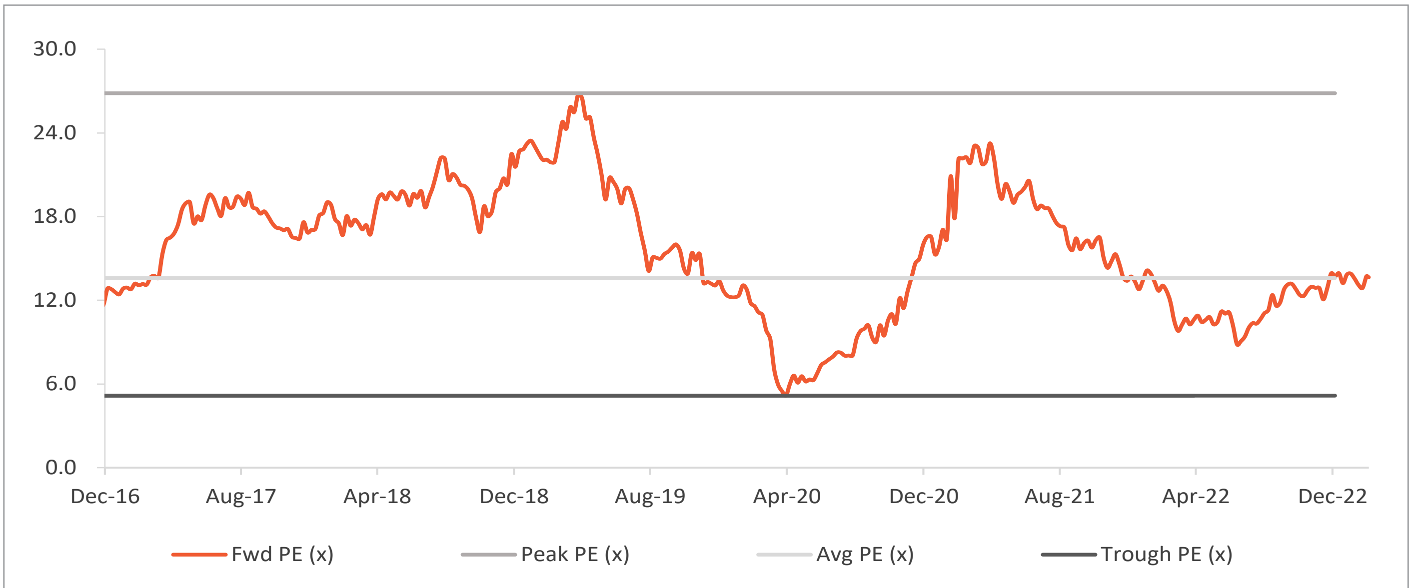
Company outlook - Convincing strategy to achieve a profitable growth model

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. Replacement volumes are expected to recover with recovery in macro-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 an unchanged PT of Rs.372

In the domestic market, while OEM demand has been strong, replacement demand is lagging. ATL has been focussing on profitable volume growth via offering quality products at premium prices without losing market share. Correction in the RM basket is benefiting it and management assumes a mid-single digit correction in the RM basket in Q4FY2023. 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, 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 a P/E multiple of 11.8x and an EV/EBITDA multiple of 5.7x its FY2025E. We retain our Buy rating on the stock with an unchanged 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	338	33.3	22.0	14.2	9.2	7.3	6.3	5.4	7.5	9.3
Balkrishna Industries	2,300	31.5	32.2	26.6	23.4	22.2	19.1	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 the 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
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	Apollo Finance Ltd.	12.1
3	Emerald Sage Investment	9.9
4	HDFC Trustee Company	8.6
5	White Iris Investment	8.0
6	Classic Industries & Exports Ltd.	2.8
7	Government Pension Fund Global	2.3
8	Mehta Ashwin Shantilal	2.1
9	Vanguard Group	1.9
10	PTL Enterprises	1.7

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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