Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Apollo Tyres Ltd

Distinct focus on margin

Automobiles	Sharekhan code: APOLLOTYRE

Reco/View: Buy	↔	CMP: Rs. 368	Price Target: Rs. 429	↑

↑ 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

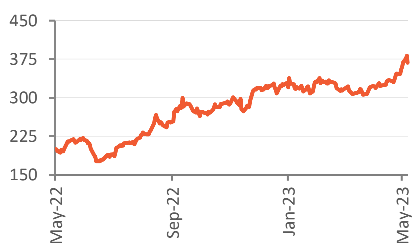
Company details

Market cap:	Rs. 23,372 cr
52-week high/low:	Rs. 383 / 167
NSE volume: (No of shares)	29.6 lakh
BSE code:	500877
NSE code:	APOLLOTYRE
Free float: (No of shares)	39.8 cr

Shareholding (%)

Promoters	37.3
FII	22.4
DII	17.8
Others	22.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	14.4	11.7	27.3	84.0
Relative to Sensex	11.0	8.3	24.3	73.1

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on Apollo Tyres Limited (ATL) with a revised PT of Rs. 429, in expectation of a 140 bps EBITDA margin expansion in the next two years, its dominant position in the domestic TBR segment, and focus on profitability over plain vanilla volume growth.
- Both APMEA and European businesses have been registering EBIT margin for three consecutive quarters, despite challenging business scenarios.
- ATL continues to focus on profitable volume growth via offering quality products at premium products to sustain its operating performance.
- The stock trades at a P/E multiple of 12.9x and EV/EBITDA multiple of 6.5x its FY2025E estimates.

In Q4FY2023, Apollo Tyres Limited (ATL) reported higher-than-expected operating performance, largely led by sequential revenue growth in the APMEA business, soft raw-material basket, and lower tax provisions. While consolidated revenue was in line with estimates, EBITDA margin came 120 bps above estimates. Revenue declined by 2.7% q-o-q to Rs. 6,247 crore (vs. estimate of Rs. 6,220 crore), largely due to a 12.1% q-o-q decline in revenue from the European business as APMEA business reported a 3.3% q-o-q increase in revenue. The soft raw-material basket resulted in a 370-bps q-o-q expansion in gross margin to 43.4%; hence, EBITDA margin expanded by 180 bps q-o-q to 16%. During the quarter, the effective tax rate stood at 18.8% against 31.1% in Q3FY2023. With the sharp surge in operating performance and low tax provisions, APAT increased by 40% q-o-q to Rs. 409 crore (vs. Our estimate of Rs. 321 crore). The company has also announced a dividend of Rs. 4.5/share, including a special dividend of Rs. 0.5/share for FY2023. Despite weak revenue performance, European business has reported a 110-bps q-o-q expansion in EBITDA margin to 9.0%. Similarly, APMEA region has reported a 330-bps q-o-q expansion in EBIT margin to 11.0%. This was the third consecutive quarter when both European business and APMEA region reported sequential improvement in EBIT margin. 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, and focusing on firm capital allocation and cash management going forward.

Key positives

- Led by soft RM cost, gross margin expanded by 370 bps q-o-q to 43.4% and translated into a 180-bps q-o-q expansion in EBITDA margin to 16%.
- Effective tax rate stood at 18.8% in Q4FY2023 against 31.1% in Q3FY2023 and supported bottom-line growth.
- Both APMEA and European businesses reported EBITDA margin expansion on account of soft raw-material basket. APMEA region reported a 330-bps q-o-q expansion in EBIT margin to 11.0% and European business reported a 110-bps q-o-q expansion in EBIT margin to 9%.

Key negatives

- European business reported a 12.1% q-o-q decline in revenue, while APMEA business reported mere 3.3% q-o-q increase in revenue.
- Volumes were flat in India on a q-o-q basis, while volumes in the European business were sluggish.

Management Commentary

- Management continues to focus on profitable growth and is strategically focussing on capacity debottlenecking in the near term in place of setting up of a large greenfield project at least the next two years.
- In the Indian market, replacement demand is expected to improve by high single digit or double digit in FY2024.
- Management has shared a sluggish outlook for the European market in the near term and is hoping for recovery from H2FY2024; however, it has been gaining market share and is looking to sustain its EBITDA margin in European business.

Our Call

Valuation – Maintain Buy rating with a revised PT of Rs. 429: ATL has reported above-estimated performance in Q4FY2023 and is looking to sustain higher EBITDA margin, as it has been focussing on premium products and is aiming for profitable volume growth. With a focus on high return ratios and increased margins, the company is focussing more on capacity utilisation via debottlenecking and is looking to follow a capex-light strategy for the next two years. While ATL has been gaining market share in European markets, it has shared a sluggish outlook for European markets in the near term and is hoping for recovery from H2FY2024. While ATL has been continuously focussing on premium products and improvement in the product mix, the soft raw-material cost trend along with its own cost-control initiatives are likely to support it in sustaining high EBITDA margin. We have built in a 29.6% earnings CAGR on account of 140 bps q-o-q EBITDA margin expansion and 9.9% revenue CAGR over FY2023-FY2025E. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 429 in expectation of a 140 bps EBITDA margin expansion in the next two years, its dominant position in the domestic TBR segment, and focus on profitability over plain vanilla volume growth.

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	FY23P	FY24E	FY25E
Revenues	17,397	20,948	24,568	27,537	29,684
Growth (%)	6.6	20.4	17.3	12.1	7.8
EBIDTA	2,797	2,574	3,314	3,970	4,427
OPM (%)	16.1	12.3	13.5	14.4	14.9
Adjusted PAT	958	644	1,082	1,503	1,817
% YoY growth	101.1	-32.7	67.9	39.0	20.9
Adjusted EPS (Rs)	15.1	10.1	17.0	23.7	28.6
P/E (x)	24.4	36.3	21.6	15.5	12.9
P/B (x)	2.0	2.0	1.8	1.6	1.5
EV/EBITDA (x)	10.5	11.3	8.6	7.2	6.5
RoE (%)	8.4	5.5	8.4	10.6	11.4
RoCE (%)	6.6	5.1	7.6	9.1	9.8

Source: Company; Sharekhan estimates

Indian business: Registered 300 bps expansion in EBITDA margin

- Indian business reported a 2.8% q-o-q increase in revenue and 300 bps q-o-q expansion in EBITDA margin to 15.9%, led by healthy growth in the OEM segment and better product mix.
- While ATL has not taken any price hike in Q4FY2024, its operating performance was supported by prior price hikes, soft raw-material cost trend, and improved product mix.
- The company witnessed an early sign of recovery in replacement demand as OEM sales have continued to be healthy.
- ATL expects to sustain higher EBITDA margin in the near term due to soft commodity cost trend and its cost-control programs.

European business: Sluggish outlook, focus on margins

- European business has reported a 12.1% q-o-q decline in revenue and reported 110 bps q-o-q expansion in EBIT margin to 9.0%.
- Despite a 13% y-o-y decline in passenger car and light truck tyre (PCLT) segment, ATL has gained 50 bps y-o-y market share in the PCLT segment. Further, it has gained 90 bps y-o-y market share in the OHT segment.
- ATL's product mix is continuing to be strong as the UHP/ UUHP segment constituted 43% of the PCLT volumes.
- The company has been focusing on maintaining a high EBITDA margin in the European business.

Capex: Scheduled capex plan of Rs. 1,100 crore for FY2024E

- The company is not planning a significantly high capex for the near term and aiming to follow the capex-light model for the next two years.
- It scheduled capex of Rs. 1,100 crore for FY2024, which would largely be related to maintenance and debottlenecking and not growth capex.
- Out of the total capex of Rs. 1,100 crore, ATL has earmarked Rs. 680 crore for India business and the rest is for the European business.

Market share: Looking for profitable volume growth

- In the Indian market, ATL has gained market share in the domestic TBR segment, while it underperformed in the PV tyre segment.
- Despite following a capex-light strategy, the company aims to maintain its dominant position in India and indicates that additional capacity would come up via debottlenecking. We understand that the company is ready to shift export-oriented capacities towards the Indian market in case of a sharp surge in demand.

Consolidated revenue mix in FY2023

- Geography-wise revenue mix: APMEA: 67%, Europe: 29%, Others: 4%
- Channel-wise revenue mix: OEM: 23%, Replacement: 77%
- Segment-wise revenue mix: Truck and Bus: 43%, passenger vehicles: 37%, farm: 10%, light truck: 6%, others: ~5%

Capacity utilisation

- India: 76%
- Europe: 82%

Outlook: looking for profitable volume growth

- Replacement demand in India has been coming back and management is looking for high single-digit to double-digit growth in the replacement segment in FY2024.
- The European market has yet to recover, and management shares a sluggish outlook for the near term, while it hopes that recovery in the European market would come from H2FY2024.
- Raw-material prices are likely to remain stable in the near term and would benefit the company in registering healthy margins.
- The company has been looking for profitable volume growth and would strategically give away low-margin volumes.
- 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.

Change in estimates

	Earlier		New		% change	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Volumes	26813	28717	27,537	29,684	2.70%	3.40%
Revenue	26813	28717	27,537	29,684	2.7%	3.4%
EBITDA	3799	4,176	3,970	4,427	4.5%	6.0%
EBITDA margin	14.2%	14.5%	14.4%	14.9%		
PAT	1509	1,818	1,503	1,817	-0.4%	-0.1%
EPS	23.8	28.6	23.7	28.6	-0.4%	-0.1%

Source: Company; Sharekhan Research

Results (Consolidated) Rs cr

Particulars	Q4FY23	Q4FY22	% YoY	Q3FY23	% QoQ
Revenue	6,247	5,578	12.0	6,423	(2.7)
Total Expenses	5,249	4,952	6.0	5,509	(4.7)
EBITDA	998	626	59.4	913	9.3
Depreciation	372	375	(0.8)	354	5.1
Interest	139	128	8.7	142	(2.1)
PBT	526	160	228.5	424	24.3
Tax	99	47	112.2	132	(24.7)
Share Of profit from Associates	0.1	0.1	-	0.03	-
Reported PAT	427	114	276.3	292	46.3
Adj Net Profit	409	114	260.3	292	40.0
Adjusted EPS (Rs)	6.4	1.8	260.3	4.6	40.0

Source: Company; Sharekhan Research

Key Ratios (Consolidated)

Particulars	Q4FY23	Q4FY22	YoY (bps)	Q3FY23	QoQ (bps)
Gross margin (%)	43.4	39.8	360	39.7	370
EBIDTA margin (%)	16.0	11.2	480	14.2	180
Net profit margin (%)	6.5	2.0	450	4.5	200
Effective tax rate (%)	18.8	29.2	(1,030)	31.1	(1,220)

Source: Company; Sharekhan Research

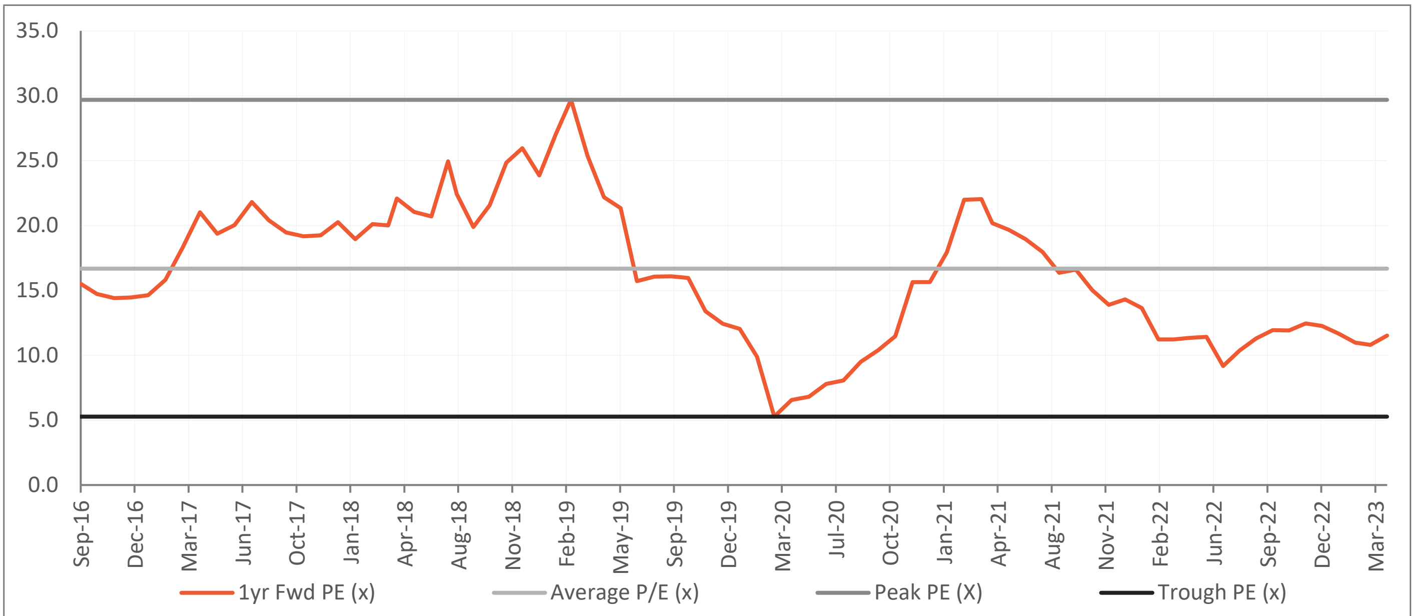
Outlook and Valuation

■ **Sector Outlook – 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, 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 replacement demand. Further, any sharp correction in the raw-material basket augurs well for the surge in profitability.

■ **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, 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 improve 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 a revised PT of Rs. 429:** ATL has reported above-estimated performance in Q4FY2023 and is looking to sustain higher EBITDA margin, as it has been focussing on premium products and is aiming for profitable volume growth. With a focus on high return ratios and increased margins, the company is focussing more on capacity utilisation via debottlenecking and is looking to follow a capex-light strategy for the next two years. While ATL has been gaining market share in European markets, it has shared a sluggish outlook for European markets in the near term and is hoping for recovery from H2FY2024. While ATL has been continuously focussing on premium products and improvement in the product mix, the soft raw-material cost trend along with its own cost-control initiatives are likely to support it in sustaining high EBITDA margin. We have built in a 29.6% earnings CAGR on account of 140 bps q-o-q EBITDA margin expansion and 9.9% revenue CAGR over FY2023-FY2025E. We maintain our Buy rating on the stock with a revised PT of Rs. 429 in expectation of a 140 bps EBITDA margin expansion in the next two years, its dominant position in the domestic TBR segment, and focus on profitability over plain vanilla volume growth.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	Rs/Share	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Apollo Tyres	368	36.3	21.6	15.5	11.3	8.6	7.2	5.1	7.6	9.1
Balkrishna Industries	2,200	30.1	35.9	29.0	22.4	26.7	19.9	25.3	18.7	20.6

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. APMEA business contributes about 67% to revenue, while the European business contributes about 29%. 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 23% to the company's revenue, while the replacement segment accounts for the balance 77%.

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
Mr Neeraj Kanwar	Managing Director
Gaurav Kumar	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Sunrays Properties & Investments Co Pvt Ltd	19.78%
2	Apollo Finance Group Ltd	12.06%
3	Emerald Sage Investment Ltd	9.93%
4	HDFC Asset Management Co Ltd	8.63%
5	White Iris Investment Ltd	8.04%
6	Classic Industries & Exports Ltd	2.94%
7	Kotak Mahindra Asset Management Co Ltd/India	2.68%
8	Norges Bank	2.33%
9	Vanguard Group Inc/The	2.22%
10	Mehta Ashwin Shantilal	2.13%

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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