Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Apollo Tyres Ltd

Strong beat, sanguine outlook

Automobiles	Sharekhan code: APOLLOTYRE
Reco/View: Buy ↔	CMP: Rs. 410	Price Target: Rs. 481 ↑

↑ 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 18.07

Updated Aug 08, 2023

Low Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 26,039 cr
52-week high/low:	Rs. 441/270
NSE volume: (No of shares)	23.7 lakh
BSE code:	500877
NSE code:	APOLLOTYRE
Free float: (No of shares)	39.8 cr

Shareholding (%)

Promoters	37.3
FII	22.1
DII	17.7
Others	22.8

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	7.8	-6.2	15.4	42.1
Relative to Sensex	9.3	-5.1	9.2	35.4

Sharekhan Research, Bloomberg

Summary

- Reported 160 bps q-o-q expansion in EBITDA margin at 18.5% against an estimate of 15.7%.
- Replacement demand is improving in the domestic market, and European markets are bottoming out.
- Given the firm's dominating position in the domestic TBR market, market share gain in the European market, emphasis on premiumisation, and the preference for profitability over simple volume growth, we retain our Buy recommendation on the stock with a revised PT of Rs. 481.
- Stock trades at P/E multiple of 11.9x and EV/EBITDA multiple of 6.3x its FY26 estimates

With the recovery in replacement demand in the Indian market and market share gain in the European market , Apollo Tyres (ATL) has reported strong set of operating numbers in Q2FY24 in support of gross margin expansion and contraction in other expenses. ATL is maintaining a strong focus on profitability and free cash flow rather than chasing market share gains at the expense of profitability. The key drivers for margin expansion are a better product mix, a favourable trend in raw material costs, and an operational efficiency.RM basket that was down by 2% on q-o-q basis in Q2Fy24 and translated into sharp EBITDA margin expansion. Revenue increased by 0.6% q-o-q to Rs 6280 cr (against an estimate of Rs 6505 cr), led by a 0.6% q-o-q decline in revenue from APMEA and a 4.3% q-o-q increase in income from Europe. EBITDA increased by 10.3% q-o-q to Rs 1160 cr (against estimate of Rs 1018 cr). EBITDA margin expanded by 160 bps q-o-q to 18.5% (against an estimate of 15.7%) on 60 bps q-o-q improvement in RM cost and 100 bps q-o-q contraction in other expenses as a percentage of sales. With this solid operating performance , the bottom-line bottom line grew by 16.8% q-o-q to Rs 474 cr (against an estimate of Rs 379 cr). 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 in the future.

Key positives

- It registered EBIT margin expansion in both European and APMEA business as the European business registered 150 bps q-o-q expansion in EBIT margin to 5.3% and APMEA business registered 140 bps q-o-q increase in EBIT margin to 15.0%.
- Overall 2% q-o-q reduction in RM basket translated into 160 bps q-o-q expansion in EBITDA margin.
- Replacement demand in the CV segment is returning.

Key negatives

- Replacement demand in PV segment demand in domestic replacement was flattish on yoy basis.
- Export was down on y-o-y basis, and the agri market continues to weaken in Europe.
- Raw material basket is expected to increase by 2-3% in Q3FY24.

Management Commentary

- Replacement demand in CV segment is expected to be strong in coming quarter.
- Continue to focus on profitability and no plan to chase volume growth at the cost of loss of profitability.
- Europen markets are bottoming out except in agri segment.

Our Call

Valuation – Maintain Buy rating with revised PT of Rs.481: Post reporting operating performance ahead of estimates the management has shared optimistic outlook for replacement demand in domestic market and indicated for initial sign of revival in the export markets. While the RM basket is expected to inch up by 2-3% in Q3Fy24 the management plans to mitigate it via judicious product mix and operational efficiency and then go for pricing action if require as it is not aiming to compromise with profitability for market share gain. Management expects the European market to recover gradually from H2FY2024 . In light of the current demand situation, management is not planning for any green field project in the near term and is focusing more on automation, digitization, and debottlenecking to improve production efficiency at its plants. While ATL has been continuously focusing on premium products and an improvement in the product mix, the soft RM cost trend along with its own cost- control initiatives are likely to support it in sustaining its high EBITDA margin. Given the firm's dominating position in the domestic TBR market, the fact that Vision 2026 is on track, emphasis on premiumisation, and the preference for profitability over simple volume growth, we continue to remain positive on the growth prospects of the company. Post incorporating Q2FY24 performance and introducing earning estimates for FY26 we retain our Buy rating on the stock with revised PT of Rs 481.

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.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Revenues	20,948	24,568	25,874	27,810	29,984
Growth (%)	20.4	17.3	5.3	7.5	7.8
EBIDTA	2,574	3,314	4,214	4,551	4,953
OPM (%)	12.3	13.5	16.3	16.4	16.5
Adjusted PAT	644	1,082	1,686	1,910	2,182
% YoY growth	-32.7	67.9	55.9	13.3	14.3
Adjusted EPS (Rs)	10.1	17.0	26.6	30.1	34.4
P/E (x)	40.4	24.1	15.4	13.6	11.9
P/B (x)	2.2	2.0	1.8	1.6	1.4
EV/EBITDA (x)	12.3	9.4	7.4	6.9	6.3
RoE (%)	5.5	8.4	11.7	11.8	12.0
RoCE (%)	5.1	7.6	9.9	10.1	10.4

Source: Company; Sharekhan estimates

India Business

- In Q2 FY24 the demand rose in oem and replacement segment netted by muted export volumes on you basis . Replacement and OEM demand grew in excess of double digit . PV demand was flat and CV grew by double digit on yoy basis. Though export demand is also showing some sign of revival as export volumes grew by 7% on qoq basis. overall volume growth was 5% yoy and pricing action was stable inQ2 FY24.
- Good signs of volume growth in CV segment
- Rm cost trend is reversed, would be netted off by price mix, product mix and operating efficiency.
- Reduced prices in truck bias segment only to react on competition.
- ATL has been a leader in CV segment and now leader in PV segment on launch of Vredestein brand in premium segment
- RM basket may increase by 2-3% in q3FY24.
- Capacity utilization in truck segment stands at 75% and in PV segment at 80 %.

Europe

- Market remains subdued in Q2Fy24 as PV mkt declines by 7% yoy and CV market declined by 9% yoy .However Appollo is performing better than matket and gained market share in PV segment.
- Going forward European market is looking good in Q3FY24.
- Europe business : Revenue b: Euro 169 mn (18% up qoq), EBITDA : Euro 24 mn .
- Europe has bottomed out and expect a positive demand curve going forward.
- ATL was lacking certain skus and now demand would revive on availability of SKUs.
- CV cycle would see uptick in coming quarters . The inventory in PV segment is normal, while Inventory in agri side is slightly high.
- No plan to gain market share via price cut.
- UUHP basket is 44% of over sales from 35% earlier.

Margin driver

- Cost saving : constant work is going on cost saving and whole focus on enriching product mix. Only going for profitable growth and not chasing market share at the cost of profitability.
- Focussing on upsizing the tyres in India and Europe is supporting the rise in profitability.
- ATL is price leader in PV segment.
- Vredestein is competing with premium brands in India.

Capex :

- Not looking for any kind of growth capex in next 1-2 years . Looking to increase capacity via debottlenecking backed by digital solutions.

Others

- Overall RM inventory stands 2.5 to 3.5 weeks.
- Not dependent on single supplier and pricing is fixed on quarterly basis.
- Per kg RM cost trend in Q2 FY24: Natural rubber : 160, Synthetic rubber: 145,Carbon black : 114
- Overall, 2% fall in RM basket on qoq basis.
- If RM would go up by 5% it needs to take 3% price hike.

OHT segment

- ATL has converted some existing capacity in OHT.
- Currently OHT market is facing headwinds in the American and European market.
- Strategically building up business in OHT segment and would gradually increase market share going forward.
- OHT share in overall revenue : 12% in Indian busines and 13% in European business.

Outlook

- Replacement momentum has been strong and hence looking for double digit growth on yoy basis in replacement demand in near term.
- Expect recovery in domestic markets in CV segment in coming quarters.
- Expects demand to recover European markets as demand in PV segment is bottoming out in European market though agri segment is still facing headwinds.
- Can go for price hike if required to save margins on rise in cost.
- Continue to drive industry 4.0.implementation and focus on data backed capacity utilization.
- Continue to focus on brand building exercise.
- India : CV demand is coming back, PV : OE side is showing double digit growth, replacement demand in PV would be better in q3 and q4
- Keep on investing in R&d but would continue to chase profitable growth via catering premium segment. No plan to go back to mass market segment heavily.
- Continue to invest in R&D and brand building exercise.
- Interest cost would come down in coming quarters
- Q3 FY24 is also expected to be better.
- Continue to be judicious on capex and looking for a profitable volume growth.

Change in estimates Rs cr

Particulars	Earlier		New		% change		Introduction
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY26E
Revenue	27,537	29,684	25,874	27,810	-6.0%	-6.3%	29,984
EBITDA	3,970	4,427	4,214	4,551	6.1%	2.8%	4,953
EBITDA margin	14.4%	14.9%	16.3%	16.4%			
PAT	1,503	1,817	1,686	1,910	12.2%	5.1%	2,182
EPS	23.7	28.6	26.6	30.1	12.2%	5.1%	34.4

Source: Company, Sharekhan Research

Results (Consolidated) Rs cr

Particulars	Q2FY24	Q2FY23	% YoY	Q1FY24	% QoQ
Revenue	6,280	5,956	5.4	6,245	0.6
Total Expenses	5,120	5,244	(2.4)	5,193	(1.4)
EBITDA	1,160	712	62.9	1,051	10.3
Depreciation	360	349	3.4	362	(0.5)
Interest	133	132	0.6	135	(2.0)
PBT	680	238	185.3	576	18.0
Tax	206	44	367.8	179	14.6
Share Of profit from Associates	0.15	0.10	NA	0.04	NA
Reported PAT	474	194	143.9	397	19.5
Adj Net Profit	474	194	143.9	406	16.8
Adjusted EPS (Rs)	7.5	3.1	143.9	6.4	16.8

Source: Company, Sharekhan Research

Key ratios (Consolidated)

Particulars	Q2FY24	Q2FY23	YoY (bps)	Q1FY24	QoQ (bps)
Gross margin (%)	45.7	38.9	680	45.0	60
EBIDTA margin (%)	18.5	12.0	650	16.8	160
Net profit margin (%)	7.6	3.3	430	6.5	110
Effective tax rate (%)	30.3	18.5	1,180	31.1	(90)

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 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. Further sharp correction in RM basket augurs well for the surge in profitability.

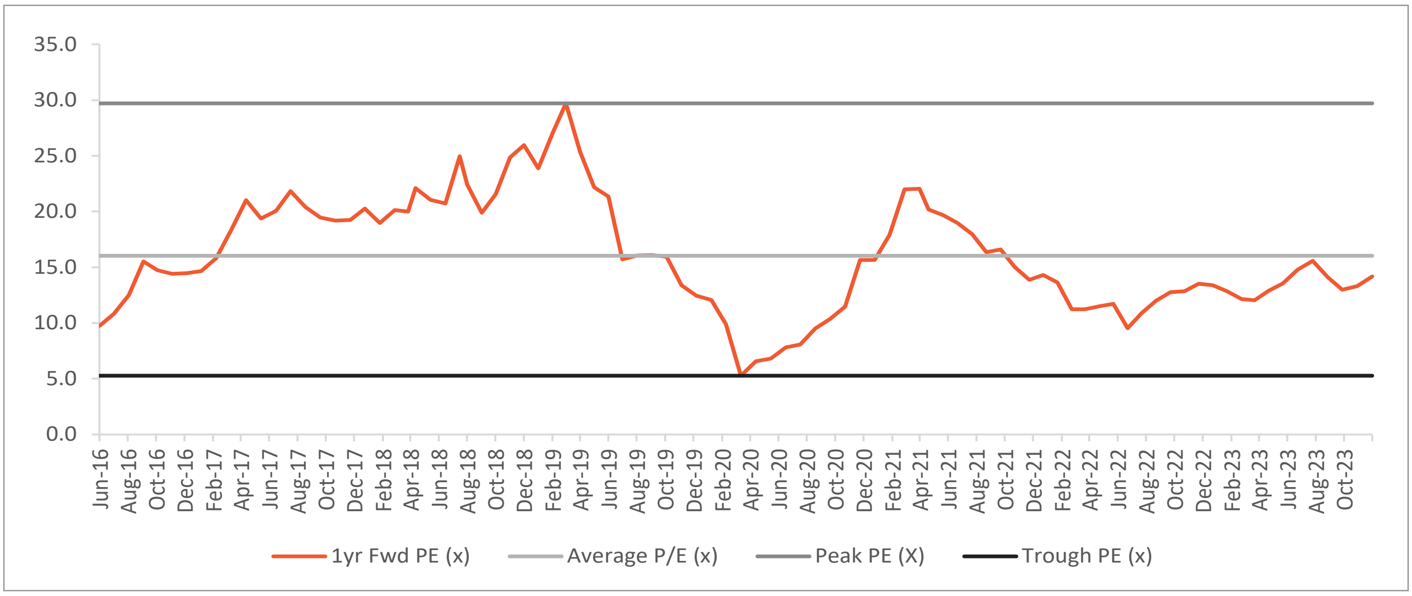
■ Company outlook - Convincing strategy to achieve a profitable growth model

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. The replacement volumes are expected to recover with a 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 revised PT of Rs.481

Post reporting operating performance ahead of estimates the management has shared optimistic outlook for replacement demand in domestic market and indicated for initial sign of revival in the export markets. While the RM basket is expected to inch up by 2-3% in Q3Fy24 the management plans to mitigate it via judicious product mix and operational efficiency and then go for pricing action if require as it is not aiming to compromise with profitability for market share gain. Management expects the European market to recover gradually from H2FY2024 . In light of the current demand situation, management is not planning for any green field project in the near term and is focusing more on automation, digitization, and debottlenecking to improve production efficiency at its plants. While ATL has been continuously focusing on premium products and an improvement in the product mix, the soft RM cost trend along with its own cost- control initiatives are likely to support it in sustaining its high EBITDA margin. Given the firm's dominating position in the domestic TBR market, the fact that Vision 2026 is on track, emphasis on premiumisation, and the preference for profitability over simple volume growth, we continue to remain positive on the growth prospects of the company. Post incorporating Q2FY24 performance and introducing earning estimates for FY26 we retain our Buy rating on the stock with revised PT of Rs 481.

One-year forward P/E (x) band



Source: 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. APMEA business contributes about 67% to revenue, while European business contributes about 29%. With its recent entry into the two-wheeler space, ATL has become a full-fledged tyre player across automotive categories, including passenger vehicles, commercial vehicles, and two-wheelers. The OEM segment contributes about 23% to revenue, while the replacement segment accounts for of 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 acquiring businesses in Europe, which has opened new markets for the company and strengthened its R&D capabilities globally. ATL is expected to gain market share in other segments and 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 the specialisation of the Dutch plant (through a significant uptick in cost competitiveness, given ramping up production in Hungary), cost reductions through the 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 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
Gaurav Kumar	Chief Financial Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Sunrays Properties & Investments Co Pvt Ltd	31.83%
2	Emerald Sage Investment Ltd	9.93%
3	HDFC Asset Management Co Ltd	8.68%
4	White Iris Investment Ltd	8.04%
5	Classic Industries & Exports Ltd	2.94%
6	Kotak Mahindra Asset Management Co Ltd/India	2.93%
7	Norges Bank	2.33%
8	Vanguard Group Inc/The	2.28%
9	Mehta Ashwin Shantilal	2.23%
10	PTL Enterprises Ltd	1.69%

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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