Sharekhan
by BNP PARIBAS

Apollo Tyres

Demand headwinds to sustain

Sector: Automobiles
Result Update

	Change
Reco: **Hold**	↔
CMP: **Rs. 180**	
Price Target: **Rs. 185**	↑

↑ Upgrade ↔ No change ↓ Downgrade

Company details

Market cap:	Rs. 10,311 cr
52-week high/low:	Rs. 245/144
NSE volume: (No of shares)	29.7 lakh
BSE code:	500877
NSE code:	APOLLOTYRE
Sharekhan code:	APOLLOTYRE
Free float: (No of shares)	33.8 cr

Shareholding (%)

Promoters	40.9
Institutions	17.2
Corporate Bodies	5.6
Foreign	24.3
Public and Others	12.1

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	9.9	23.4	-6.2	-14.3
Relative to Sensex	2.6	13.4	-10.2	-26.5

Sharekhan Research, Bloomberg

Apollo Tyres Limited's (ATL) Q2FY2020 results missed our estimates as lower-than-anticipated topline growth coupled with increased depreciation and interest expenses led to net profit falling sharply by 55%. We expect topline growth to remain muted in near term, given demand headwinds in domestic CV OEMs. Domestic CV players have undertaken production cuts in October and November 2019, indicating weak demand. Moreover, European operations growth has moderated sharply given the fall in industry demand. Muted topline in intensive capex cycle (due to Hungary and new AP plant) would keep return ratios in single digits, thus preventing any re-rating. Moreover, ATL's valuations at 12.3x its FY2021 earnings are at the higher end of historical average multiples. Hence, we retain our Hold rating on the stock with a revised price target (PT) of Rs. 185.

Key positives

- Despite topline pressures, ATL managed to hold on to its margins in Q2FY2020 due to softening commodity prices.
- ATL expects commodity prices to further soften in Q3FY2020 and expects 2-3% reduction in the overall raw-material basket.

Key negatives

- Depreciation and interest expenses increased sharply by ~40% in Q2FY2020 due to adoption of Ind AS 116 (lease accounting) and increased debt levels.
- Domestic CV OEM demand is expected to remain under pressure with OEMs undertaking production cuts in October and November 2019 as well. European demand recovery is also uncertain in the near term.

Our Call

Demand to remain muted in the near term; Return ratios to remain under pressure; Retain Hold: ATL's demand pressures are expected to sustain in the near term, given weak CV OEM demand and drop in the European tyre industry. With muted demand in intensive capex cycle (due to Hungary and new AP plant), we expect ATL's ROCE to remain at 7-8%, which would prevent re-rating. Moreover, current valuation of 12.3x its FY2021 earnings is at the higher end of the long-term historical multiples, thus leaving limited scope of upside from current levels. We have retained our earnings estimates for ATL. We maintain our Hold rating on the stock with a revised PT of Rs. 185.

Key Risks

Prolonged weakness in domestic CV OEM demand and European operations could impact financials.

Valuation (Consolidated) — Rs cr

Particulars	FY17	FY18	FY19	FY20E	FY21E
Revenue	13,180.0	14,842.9	17,548.8	17,522.2	18,626.8
Growth (%)	11.2%	12.6%	18.2%	-0.2%	6.3%
EBIDTA (Rs. cr)	1,848.7	1,653.6	1,958.6	2,020.1	2,267.5
OPM (%)	14.0%	11.1%	11.2%	11.5%	12.2%
Adjusted PAT	1,099.3	723.9	879.7	654.7	839.0
% YoY growth	*2.2%*	*-34.2%*	*21.5%*	*-25.6%*	*28.2%*
Adjusted EPS (Rs.)	21.6	12.7	15.4	11.4	14.7
P/E (x)	8.3	14.2	11.7	15.7	12.3
P/B (x)	1.3	1.1	1.0	1.0	0.9
EV/EBITDA (x)	6.5	7.9	6.7	6.9	6.1
ROCE (%)	12.9	6.9	7.4	5.7	6.8
RONW (%)	15.1	7.4	8.8	6.3	7.6

Source: Company, Sharekhan estimates

Operating performance marginally below estimates; Higher depreciation and interest expenses led to PAT miss: ATL's operating results were marginally below expectations, but net profit missed estimates. Revenue dropped by 6% y-o-y to Rs. 3,986 crore, driven by 10% fall in APMEA business (mainly India) on account of the steep fall in OEM demand. Revenue of the European business grew marginally by 3% y-o-y. Operating margin dropped marginally by 20 BPS y-o-y to 10.8% and was in line with our estimate of 11%. EBIDTA dropped by 7% y-o-y to Rs. 432 crore but was lower than our estimate of Rs. 455 crore. While raw-material prices softened, they were offset by negative operating deleverage (due to fall in topline), leading to marginal drop in margins. EBIT margin of the APMEA business dropped by 250 BPS y-o-y, while margin of the European business declined by 140 BPS y-o-y. Depreciation expenses increased by 40% y-o-y due to commissioning of the new plant, while interest expenses increased by 40% y-o-y due to higher debt levels. Net profit at Rs. 83 crore declined by 55% y-o-y and was lower than our estimate of Rs. 130 crore.

Topline growth to remain under pressure; ATL cuts capex: ATL's topline growth is expected to remain muted in near term. Domestic OEM demand forming about 25% of the topline is expected to remain in the declining trend, given slowing economic growth and impact of axle load norms. Leading OEMs have highlighted sales pressures and have undertaken production cuts in October and November 2019, pointing at demand stress. ATL has cut domestic market capex and the new AP plant would be ramped up slowly. ATL has reduced domestic capex guidance by Rs. 600 crore over the next two years (capex plan for the next two years is Rs. 4,400 crore). Further, revenue of ATL's European operations moderated substantially in H1FY2020 to low single-digit growth (compared to double-digit growth in FY2019), driven by fall in the European tyre industry's volumes. As per management, European industry's recovery remains uncertain. We expect ATL's consolidated topline growth to register low single-digit growth of 3% over the next two years.

Conference call highlights

- **Domestic demand scenario:** ATL expects the domestic CV OEM demand to continue to remain under pressure. Domestic replacement demand is expected to continue growing in mid single digits.
- **European demand scenario:** The European tyre industry's growth turned negative in 9MCY2019, falling by 3%. ATL indicated European market recovery is uncertain in the near term.
- **Commodity prices:** ATL expects commodity prices to soften in Q3FY2020 and expects 2-3% fall in overall commodity prices.
- **Pricing action:** ATL did not take any pricing action in the domestic market in Q2FY2020. In the European market, ATL undertook price hike of 5% in H1FY2020 in the truck segment (truck segment's contribution to overall revenue is 4-5%) but did not take any pricing action in the PV segment.
- **Capex guidance:** In wake of slowdown in the domestic market, ATL has cut its capex guidance by Rs. 600 crore (capex guidance earlier was Rs. 4,400 crore). ATL indicated that the new AP plant would commence operations in Q4FY2020 but the ramp up would be slow.
- **Debt levels:** ATL's gross debt increased from Rs. 4,500 crore in FY2019 to Rs. 6,000 crore in H1FY2020. ATL indicated that debt levels would peak out by the end of FY2020.
- **Return ratios:** ATL's ROCE fell from 13% in FY2017 to 7-8% in FY2019, given huge investments in Hungary plant and capex for the new AP plant. With demand pressures continuing, return ratios are expected to remain under stress.

Results table (Consolidated) Rs cr

Particulars	Q2FY20	Q2FY19	%YoY	Q1FY20	%QoQ
Revenue	3,985.8	4,257.4	(6.4)	4,331.3	(8.0)
Total Expenses	3,553.8	3,790.2	(6.2)	3,856.4	(7.8)
EBITDA	432.0	467.2	(7.5)	474.9	(9.0)
EBITDA margin (%)	10.8%	11.0%	(20 bps)	11.0%	(20 bps)
Other income	4.0	12.3	-67.4	27.5	-85.4
Depreciation	274.2	196.2	39.7	267.3	2.6
Interest	64.0	46.1	38.8	58.4	9.6
PBT	97.9	237.2	-58.7	176.7	-44.6
Less: Tax	14.8	51.2	-71.1	35.1	-57.9
Reported PAT	83.1	146.0	-43.1	141.6	-41.3
Exceptional (Expense) / Income	0.0	(40.0)	-	0.0	
Adjusted PAT	83.1	186.0	-55.3	141.6	-41.3
EPS (Rs.)	1.6	3.7	-55.3	2.8	-41.3

Source: Company

Segmental Table

Particulars	Q2FY20	Q2FY19	%YoY	Q1FY20	%QoQ
Segmental Revenue (Rs. cr)					
APMEA (Asia pacific, Middle East and Africa)	2,827.8	3,151.4	-10.3	3,142.0	-10.0
Europe (Europe and America)	1,222.3	1,181.4	3.5	1,238.8	-1.3
Others	840.1	988.1	-15.0	649.9	29.3
Total	**3,985.8**	**4,257.4**	**-6.4**	**4,331.3**	**-8.0**
Segmental EBIT (Rs. cr)					
APMEA (Asia Pacific, Middle East and Africa)	178.0	277.8	-35.9	234.6	-24.1
Europe (Europe and America)	(39.6)	(21.0)	NA	(29.9)	NA
Others	24.1	33.6	-28.2	26.1	-7.4
Total	**162.5**	**290.4**	**-44.0**	**230.7**	**-29.6**
EBIT Margin (%)					
APMEA (Asia Pacific, Middle East and Africa)	6.3	8.8	(250) bps	7.5	(120) bps
Europe (Europe and America)	(3.2)	(1.8)	(140) bps	(2.4)	(80) bps
Others	2.9	3.4	(50) bps	4.0	(110) bps
Total	**3.3**	**5.5**	**(220) bps**	**4.6**	**(130) bps**

Source: Company

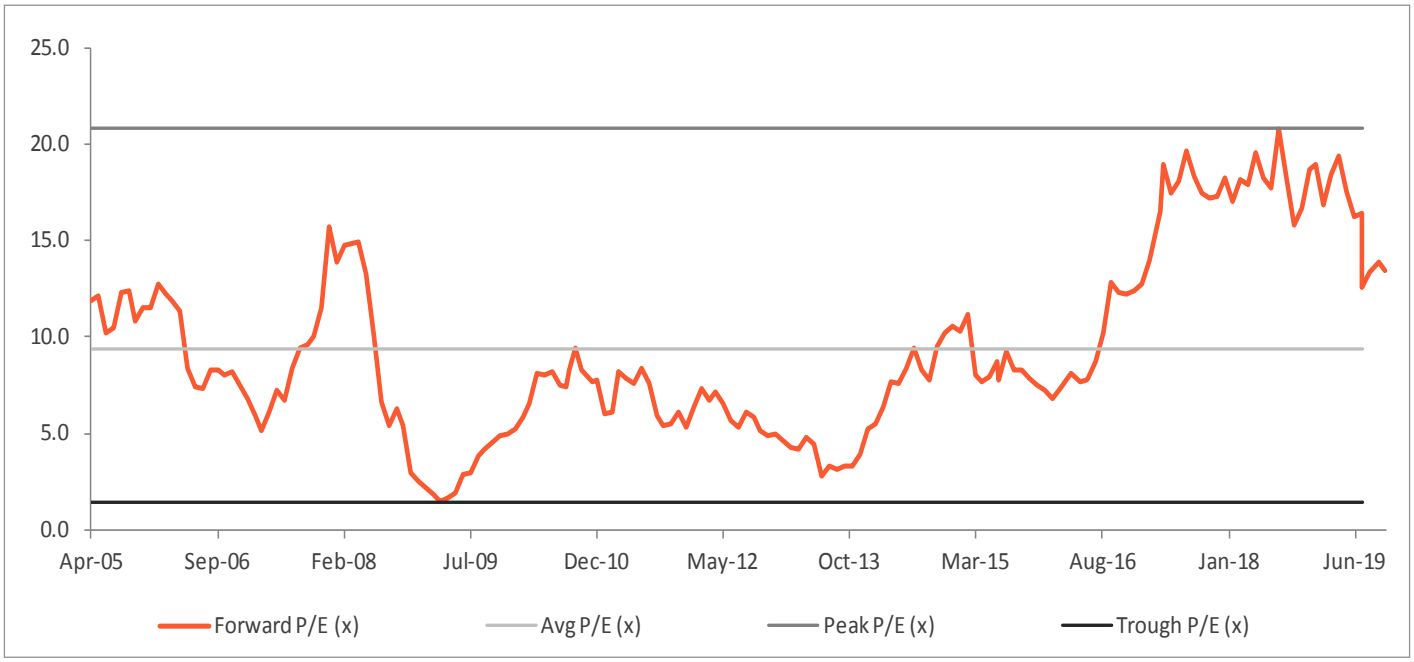
Outlook

Demand pressures to sustain; Return ratios to remain in single digits: ATL's topline is expected to remain under pressure given the slowdown in domestic CV OEM segment and decline in the European tyre industry. With low single-digit topline growth in intensive capex cycle (due to Hungary and the new AP plant) would continue to put pressure on return ratios. ATL's ROCE is expected to remain in single digits at 7-8%, which would prevent re-rating.

Valuation

Retain estimates; Maintain Hold rating with a revised PT of Rs. 185: We have retained our earnings estimates for ATL for FY2021. Demand pressures are expected to remain in the medium term. Post the 10% run-up in the stock price in the past one month, the stock is currently trading at 12.3x its FY2021 earnings, which is at the higher end of its long-term historical average, thus leaving limited scope of upside from current levels. We retain our Hold rating on the stock with a revised PT of Rs. 185.

Forward P/E band (x)



Source: Sharekhan Research

About company

ATL is the largest Indian tyre manufacturer. ATL is a fairly 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 2W space, ATL has become a full-fledged tyre player having presence across automotive categories viz. passenger vehicles, commercial vehicles and two wheelers. The OEM segment contributes about 27% to FY2019 revenue, while the replacement segment accounts for the balance 73%.

Investment theme

ATL is one of the leading tyre companies having a dominant market share in both the commercial vehicle and passenger vehicle space. ATL is present in India and Europe markets. Demand outlook across markets has deteriorated and is likely to adversely impact ATL. Given the weak demand environment in domestic markets, ATL's India revenue growth is likely to moderate drastically. Moreover, slow GDP and IIP would further add to woes. The European car market has also declined in Q1FY2020 and a substantial revival seems tough. Consequently, ATL's consolidated revenue growth is expected to moderate sharply in FY2020. Given the increase in depreciation and interest charges, ATL's earnings are expected to decline by 17% in FY2020.

Key Risks

- ATL derives about 30% of its revenue from European operations. Hence, the company is exposed to currency risks. Any adverse movement in INR-Euro would impact the financial performance.
- Crude oil and natural rubber form about 65% of the raw-material basket. Prices of both are linked to international movement and are highly volatile. Any sudden spike in raw-material costs could adversely impact profitability.

Additional Data

Key management personnel

Onkar S Kanwar	Chairman & Managing Director
Neeraj Kanwar	Vice Chairman & Managing Director
Gaurav Kumar	Chief Financial Officer
Sunam Sarkar	President & Chief Business Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Neeraj consultants	12.91
2	Franklin Resources Inc	7.05
3	Apollo Finance Group Ltd	6.95
4	HDFC Asset Management Co Ltd	6.9
5	SUNRAYS PROPERTIES & INV	6.35
6	WHITE IRIS INVESTMENT LTD	4.88
7	SACRED HEART INVESTMENT CO	4.27
8	ICICI Prudential Asset Management	3.29
9	Motlay Finance Pvt Ltd	2.96
10	Classic Auto Tubes Ltd	2.71

Source: Bloomberg

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