Apollo Tyres (APOTYR)

ICICI direct Research

CMP: ₹ 170 | Target: ₹ 180 (6%) | Target Period: 12 months | HOLD

November 6, 2019

Result Update

Aftermarket, benign RM costs to support earnings…

Apollo Tyres (ATL) reported mixed results in Q2FY20. Consolidated revenues dipped 6.4% YoY to ₹ 3,986 crore (APMEA down 10.3%, Europe up 3.5%) Consolidated EBITDA margins came in at 10.8% (down 13 bps QoQ), with 30 bps gross margin expansion driving the performance. APMEA EBIT margins dropped 120 bps QoQ to 6.3% while that of Europe declined 220 bps to -3.2%. Consequent consolidated PAT was at ₹ 83 crore (down 43.1% YoY), impacted by lower other income and increase in depreciation costs. ATL said it would be issuing ₹ 500 crore worth of non-convertible debentures on a preferential allotment basis.

Stable replacement demand to mitigate muted OEM volumes

ATL is a differentiated player in the tyre pack, with diversified presence across geographies and segments (as of FY19:- India 70%, Europe 29%; CV 50%, PV 37%, off highway 10%). While fresh vehicle sales remain muted in India and globally, consumable suppliers like ATL enjoy steady state support from replacement demand. Replacement segment for ATL (~66% of India sales mix) grew 6% in H1FY20 vs. 40% fall in OEM volumes (22% of India sales mix). We expect this trend to continue over the medium term given short replacement cycles for heavily used consumables like tyres (especially on CV side) and healthy OEM industry production in FY16-19 (CV segment volume CAGR 12.2%, PV segment volume CAGR 5.1%). In Europe, we expect ATL to gain further market, continuing its outperformance (YTD car volume growth 5% vs. 3% industry decline).

Benign input prices, greenfield ramp up to aid margins!

The margin profile at tyre players including ATL has a close correlation with prices of key raw materials viz. rubber & crude derivatives (refer Exhibit 6). Natural rubber and carbon black prices have dipped recently from those seen in Q2FY20 while the outlook on these materials remain muted. Further, the company's Andhra Pradesh plant is slated to commence production in June 2020, with the Hungary plant also slated to reach ~70% utilisation in FY20E. Incremental volume support from this greenfield capex and soft input price scenario is seen lending support to margins, going forward.

Valuation & Outlook

ATL is slated to exit expansionary mode and has guided for peaking out of debt levels by FY20E and deferring a portion of planned Andhra Pradesh facility capex. While return ratios are slated to remain muted given extent of recent capex and ongoing demand challenges, historically controlled interest outgo provides comfort. We expect sales, PAT to grow at a CAGR of 2.7%, 0.6%, respectively, in FY19-21E. We maintain our **HOLD** rating with a revised target price of ₹ 180 i.e. 6.5x EV/EBITDA on FY21E estimates.

apollo TYRES

Particulars

Particular	Amount
Market Capitalization	₹ 9725 Crore
Total Debt (FY19) (₹ Crore)	4,930.7
Cash & Investments (FY19) (₹ Crore)	562.5
EV (₹ Crore)	14,092.9
52 week H/L (₹)	245 / 144
Equity capital	₹ 57.2 Crore
Face value	₹ 1

Key Highlights

- Consolidated sales declined 6.4% YoY in Q2FY20 tracking 45% decline in sales in its OEM segment, domestically
- Margins dipped 13 bps QoQ to 10.8%, with gross margins rising 30 bps amid muted commodity prices
- Stable aftermarket demand, benign input prices and incremental volume support from greenfield facilities to aid performance, going ahead
- Maintain HOLD with revised target price of ₹ 180

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ICICI Securities – Retail Equity Research

Key Financial Summary

Key Financials	FY17	FY18	FY19	FY20E	FY21E	CAGR (FY19-21E)
Net Sales	13,180.0	14,840.5	17,548.8	17,303.9	18,504.8	2.7%
EBITDA	1,846.4	1,651.3	1,958.9	2,082.7	2,438.5	11.6%
EBITDA Margins (%)	14.0	11.1	11.2	12.0	13.2	
Net Profit	1,098.6	723.9	680.0	591.8	688.2	0.6%
EPS (₹)	19.2	12.7	11.9	10.3	12.0	
P/E	8.9	13.4	14.3	16.4	14.1	
RoNW (%)	15.1	7.4	8.3	5.7	6.3	
RoCE (%)	13.6	7.7	8.0	5.8	6.7	

Source: ICICI Direct Research, Company

Exhibit 1: Variance Analysis

(₹ crore)	Q2FY20	Q1FY20E	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	Comments
Total Operating Income	3,986	4,194	4,257	(6.4)	4,331	(8.0)	Topline came in lower than our estimates tracking 12.5% volume decline in Indian operations
Raw Material Expenses	2,244	2,398	2,423	(7.4)	2,453	(8.5)	Raw material costs came in lower (56.3% of sales) tracking lower crude derivatives prices mainly carbon black on a QoQ basis (down by ₹ 5/kg)
Employee Expenses	594	635	607	(2.1)	642	(7.4)	
Other expenses	715	735	760	(5.8)	762	(6.1)	Other expenses came in a tad higher than our estimates at 17.9% of sales
EBITDA	432	426	467	(7.5)	475	(9.0)	
EBITDA Margin (%)	10.8	10.2	11.0	-14 bps	11.0	-13 bps	Margins were ahead of estimates primarily tracking beat on gross margins, which were up 30 bps QoQ
Depreciation	274	251	196	39.7	267	2.6	
Interest	64	64	46	38.8	58	9.5	Interest expense came in on expected lines
Other income	4	30	12	(67.4)	27.5	(85.4)	
Tax	15	37	51	(71.1)	35	(57.9)	
PAT	83	104	146	(43.1)	141.6	(41.3)	PAT came in lower tracking higher depreciation charge and lower other income incidence
EPS (₹)	1.5	1.8	2.6	(43.1)	2.5	(41.3)	
Key Metrics							
Revenue (₹ crore)							
APMEA	2,828	2,919	3,151	(10.3)	3,142	(10.0)	
Europe	1,222	1,275	1,181	3.5	1,239	(1.3)	Revenues in European operations were up 3.5% YoY. Apollo is primarily present in the replacement market overseas
EBIT Margin (%)							
APMEA	6.3	NA	8.8	(250) bps	7.5	(120) bps	
Europe	(3.2)	NA	(0.7)	(70) bps	(1.0)	(40) bps	Europe division margins came in disappointing at -3.2%

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

	FY20E			FY21E			
(₹ Crore)	Old	New	% Change	Old	New	% Change	Comments
Revenue	18,657	17,304	-7.3	19,873	18,505	-6.9	Muted demand in the domestic and global markets leads us to downward revise our sales estimates for FY20E & FY21E
EBITDA	2,129	2,083	-2.2	2,358	2,439	3.4	
EBITDA Margin (%)	11.4	12.0	62 bps	11.9	13.2	131 bps	Benign raw material prices, largely natural rubber and crude derivatives, to aid margin recovery, going forward
PAT	846	592	-30.1	950	688	-27.6	
EPS (₹)	14.8	10.3	-30.3	16.7	12.0	-27.8	Increase in depreciation charge amid commissioning of new plants as well as adoption of new accounting standards and lower other income took a toll on net profitability

Source: Company, ICICI Direct Research

Conference call highlights

Management outlook/guidance and demand

- India tonnage fell by 12.5% YoY (trucks down 14%, cars down 11%) during the quarter, driven by 45% OEM drop (truck OEM down 60%, car OEM down 40%). Total replacement sales grew 6% YoY (truck-bus radial i.e. TBR up 5%; truck bus bias i.e. TBB marginally negative).
- While CV OEM sales continued to struggle in October, car OEM sales witnessed some uptick. ***The company informed that its interaction with clients indicates that volume declines in India might have bottomed out.***
- Given steep 45% decline in Indian OEM sales for H1FY20, channel mix stands at 66% replacement, 22% OEM (vs. 30% earlier) & 12% exports. Domestic segment mix is at 60% trucks (35% TBR, 25% TBB), 8% light trucks, 20% cars, rest others
- ATL's Europe car radial volumes grew 5% YTD against 3% decline in industry, resulting in some market share gains. ATL expects industry to grow ~1% YoY (CY19) given upcoming seasonally strong winter period
- ATL's Europe product mix is at one-third each for summer, all-season and winter tyres, vs. 20% all-season presence for the industry. All-season segment continued to see a good response
- ATL would commence supplies to two premier European OEMs over the next few quarters. Currently, OEM forms ~3% of Europe volumes (7 million)

Sales, costs and margins

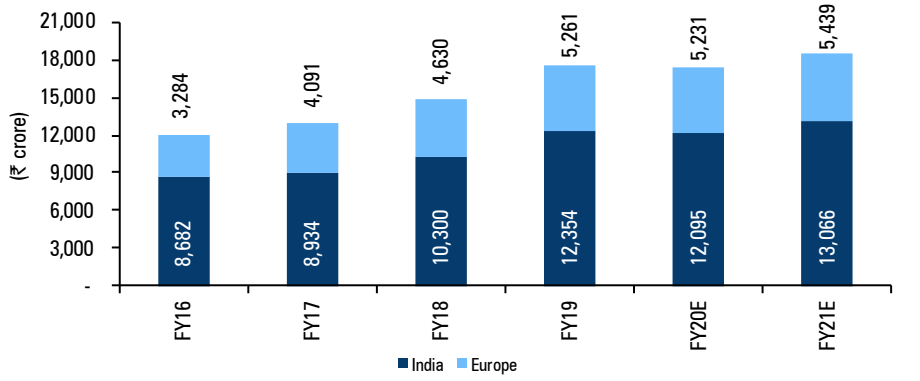
- ***APT targeting double digit margins in Europe for FY21E***
- The company expects input costs to decline 2-3% QoQ in Q3FY20E
- Prices in European industry have come off by ~3% given growth challenges. The company undertook a 5% price hike in European truck tyre business and still witnessed healthy growth
- Europe EBIT margins were hurt by higher depreciation costs related to Hungary plant, higher marketing expenses and lower prices
- Landed raw material prices for the quarter were – 145 natural rubber, 110 synthetic rubber, 85 carbon black; 128 total (all ₹/kg basis)
- Europe and Reifen revenues were at €129 million (up 6%) & €30 million (up 10%), respectively

Other

- ***ATL would be deferring ₹ 600 crore worth of Andhra Pradesh facility greenfield capex (equally split over FY20E & FY21E).*** With this, India capex guidance is at ~₹ 2,400 crore & ~₹ 1,400 crore for FY20E & FY21E, respectively. Corresponding Europe capex guidance was at € 40 million and €25 million, respectively
- Net debt was at ~₹ 5,900 crore as of Q2FY20, with ***debt levels expected to peak out in March 2020.***
- The Hungary plant would produce ~3 million units in FY20 & ~4 million units in FY21E (peak capacity 4.5 million units). Netherlands plant peak capacity is at ~5 million units, with current utilisation at ~80%. Capacity utilisation is at ~70% (5-10% decline across categories)

Financial story in charts

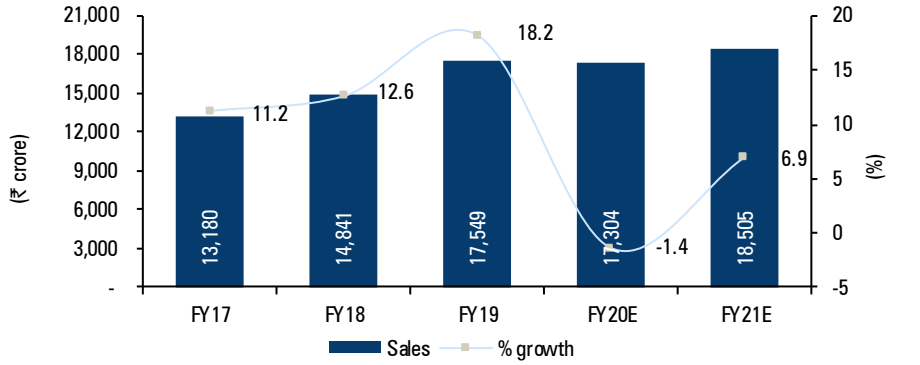
Exhibit 3: Geography wise revenue trend



We estimate ~1.4% CAGR (India) and ~3.8% CAGR (Europe) volume growth during FY19-21E

Source: Company, ICICI Direct Research

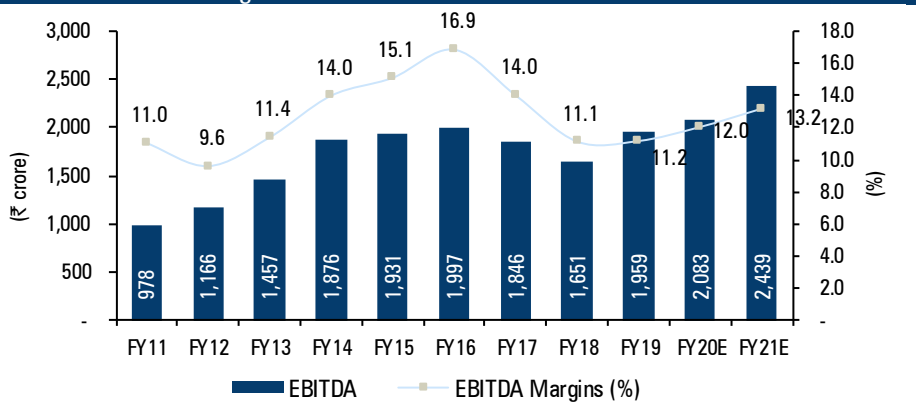
Exhibit 4: Consolidated revenue trend



We expect sales to grow at a CAGR of 2.8% over FY19-21E

Source: Company, ICICI Direct Research

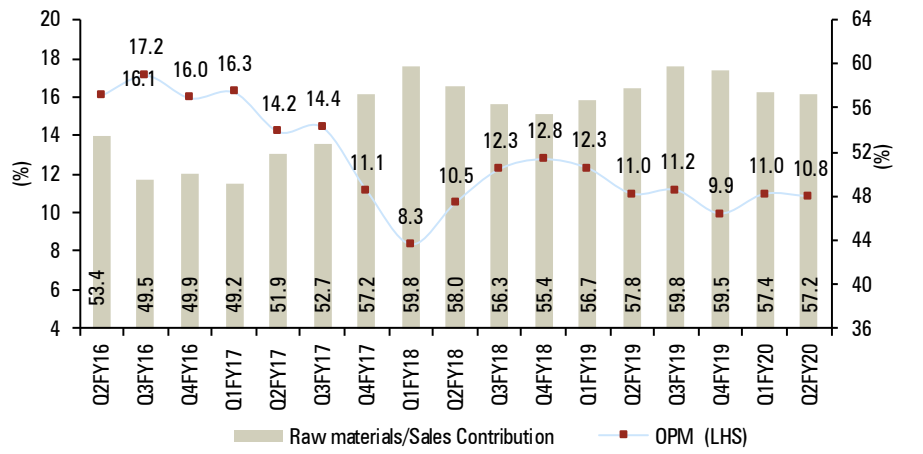
Exhibit 5: EBITDA margin trend



We expect EBITDA margins at 12.0% and 13.2%, in FY20E and FY21E, respectively

Source: Company, ICICI Direct Research

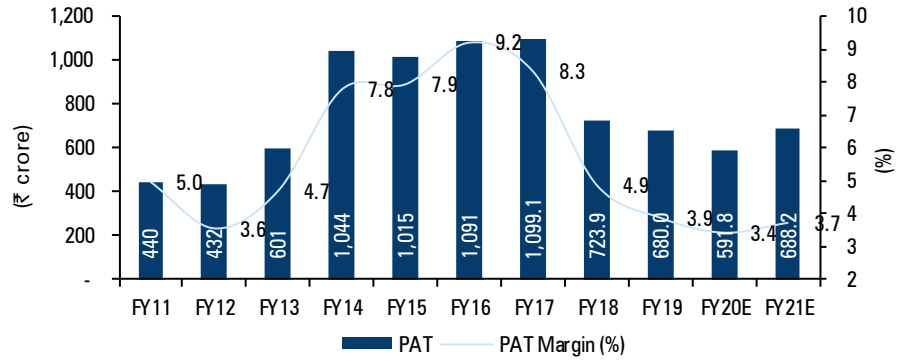
Exhibit 6: Margin movement with RM trend



Source: Company, ICICI Direct Research

Movement in prices of rubber and crude oil has a prominent impact on the margin trajectory at tyre companies including ATL

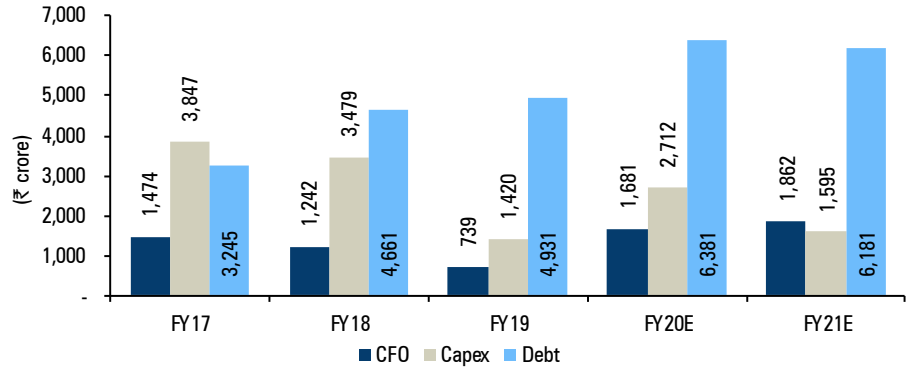
Exhibit 7: Profitability trend



Source: Company, ICICI Direct Research

We build in modest PAT CAGR of 0.9% (excluding exceptional items) over FY19-21E to ₹ 688 crore

Exhibit 8: Trend in CFO, capex and debt



Source: Company, ICICI Direct Research

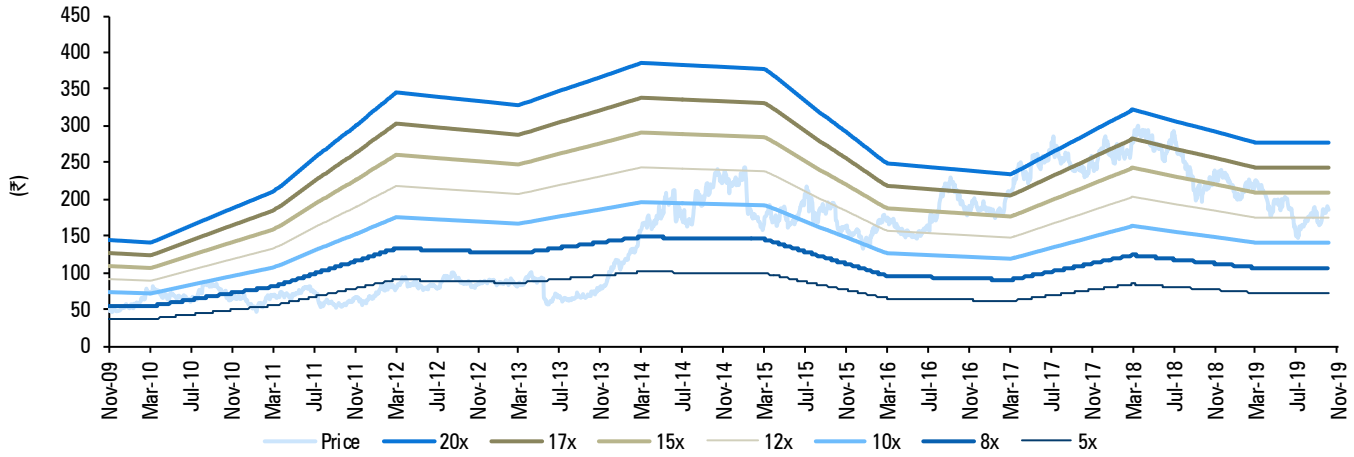
Debt is expected to peak out in FY20E, with ₹ 600 crore worth of capex planned initially now deferred

Exhibit 9: Valuation Summary

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY17	13,180	11.2	19.2	(2.2)	8.9	6.6	15.1	13.6
FY18	14,841	12.6	12.7	(34.1)	13.4	7.5	7.4	7.7
FY19	17,549	18.2	11.9	(6.1)	14.3	7.2	8.3	8.0
FY20E	17,304	(1.4)	10.3	(13.0)	16.4	7.5	5.7	5.8
FY21E	18,505	6.9	12.0	16.3	14.1	6.3	6.3	6.7

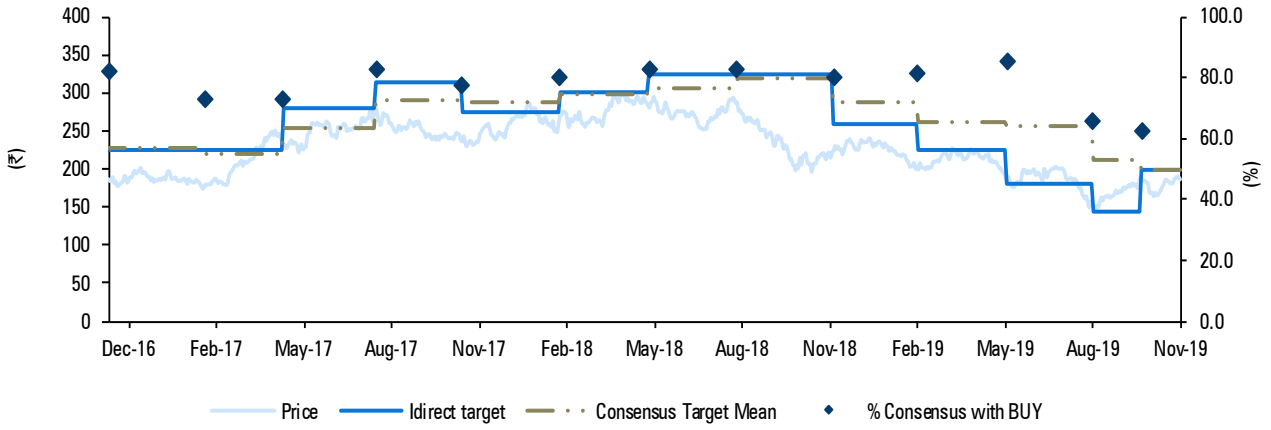
Source: Bloomberg, ICICI Direct Research

Exhibit 10: Apollo Tyres currently trades at two year forward P/E multiple of ~14x



Source: Reuters, ICICI Direct Research

Exhibit 11: Recommendation history vs. consensus



Source: Reuters, ICICI Direct Research

Exhibit 12: Top 10 shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	Neeraj Consultants Pvt. Ltd.	30-Sep-19	12.9	73.8	0.00
2	Apollo Finance, Ltd.	30-Sep-19	7.1	40.8	0.00
3	White Iris Investment Ltd	30-Sep-19	7.1	40.5	12.55
4	HDFC Asset Management Co., Ltd.	30-Sep-19	6.6	38.0	0.29
5	Sunrays Properties & Investment Company Pvt. Ltd.	30-Sep-19	6.3	36.3	0.00
6	Franklin Templeton Asset Management (India) Pvt. Ltd.	30-Sep-19	5.6	31.8	-1.50
7	Sacred Heart Investment Company Pvt. Ltd.	30-Sep-19	4.3	24.4	0.00
8	ICICI Prudential Asset Management Co. Ltd.	30-Sep-19	3.4	19.7	5.54
9	Motlay Finance Pvt. Ltd.	30-Sep-19	3.0	16.9	0.00
10	Classic Auto Tubes, Ltd.	30-Sep-19	2.7	15.5	0.00

Source: Reuters, ICICI Direct Research

Exhibit 13: Recent activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
White Iris Investment Ltd	+32.28M	+12.55M	T. Rowe Price Hong Kong Limited	-10.22M	-3.98M
ICICI Prudential Asset Management Co. Ltd.	+14.24M	+5.54M	HSBC Global Asset Management (India) Private Limited	-6.11M	-2.19M
Kenstar Investment & Finance Pvt. Ltd.	+5.36M	+1.84M	Franklin Templeton Asset Management (India) Pvt. Ltd.	-3.86M	-1.50M
Amit Dyechem Pvt. Ltd.	+4.01M	+1.56M	Mirae Asset Global Investments (Hong Kong) Limited	-3.90M	-1.21M
RBC Global Asset Management (UK) Limited	+1.07M	+0.41M	J.P. Morgan Asset Management (Hong Kong) Ltd.	-3.18M	-0.99M

Source: Reuters, ICICI Direct Research

Exhibit 14: Shareholding pattern

(in %)	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19
Promoter	40.6	40.8	40.9	40.9	40.9
FII	21.0	20.0	19.4	23.7	23.9
DII	21.8	22.6	21.9	17.5	17.2
Others	16.6	16.6	17.9	17.9	18.1

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 15: Profit and loss statement ₹ crore

(Year-end March)	FY18	FY19	FY20E	FY21E
Total operating Income	**14,840.5**	**17,548.8**	**17,303.9**	**18,504.8**
Growth (%)	12.6	18.2	-1.4	6.9
Raw Material Expenses	8,395.5	10,126.2	9,633.9	10,228.6
Employee Expenses	2,156.6	2,456.2	2,533.8	2,635.5
Other Expenses	2,637.1	3,007.5	3,053.5	3,202.2
Total Operating Expenditure	13,189.3	15,589.9	15,221.2	16,066.3
EBITDA	**1,651.3**	**1,958.9**	**2,082.7**	**2,438.5**
Growth (%)	-10.6	18.6	6.3	17.1
Depreciation	592.6	812.7	1,124.8	1,295.3
Interest	162.9	181.1	249.6	282.6
Other Income	116.5	123.1	57.0	59.6
PBT	**1012.3**	**888.2**	**765.4**	**920.1**
Exceptional items	0.0	200.0	0.0	0.0
Total Tax	288.4	208.3	173.6	231.9
Reported PAT	**723.9**	**680.0**	**591.8**	**688.2**
Growth (%)	-34.1	-6.1	-13.0	16.3
EPS (₹)	**12.7**	**11.9**	**10.3**	**12.0**

Source: Company, ICICI Direct Research

Exhibit 16: Cash flow statement ₹ crore

(Year-end March)	FY18	FY19	FY20E	FY21E
Profit after Tax	**723.9**	**680.0**	**591.8**	**688.2**
Add: Depreciation	592.6	812.7	1,124.8	1,295.3
(Inc)/dec in Current Assets	-682.6	-205.6	0.2	-358.5
Inc/(dec) in CL and Provisions	607.8	-548.5	-35.6	237.1
CF from operating activities	**1241.6**	**738.6**	**1681.1**	**1862.2**
(Inc)/dec in Investments	-944.6	1,339.0	0.0	0.0
(Inc)/dec in Fixed Assets	-3,479.0	-1,419.7	-2,712.0	-1,595.0
Others	450.2	-561.3	-180.2	208.0
CF from investing activities	**-3973.4**	**-642.0**	**-2892.2**	**-1387.0**
Issue/(Buy back) of Equity	6.3	0.0	0.0	0.0
Inc/(dec) in loan funds	1,416.6	269.5	1,450.0	-200.0
Dividend paid & dividend tax	-219.3	-237.6	-223.1	-240.3
Others	1,790.4	-164.8	0.0	0.0
CF from financing activities	**2994.0**	**-132.9**	**1226.9**	**-440.3**
Net Cash flow	**262.2**	**-36.3**	**15.8**	**34.9**
Opening Cash	336.6	598.8	562.5	578.3
Closing Cash	**598.8**	**562.5**	**578.3**	**613.2**

Source: Company, ICICI Direct Research

Exhibit 17: Balance Sheet ₹ crore

(Year-end March)	FY18	FY19	FY20E	FY21E
Liabilities				
Equity Capital	57.2	57.2	57.2	57.2
Reserve and Surplus	9,719.4	9,982.6	10,351.2	10,799.2
Total Shareholders funds	**9,776.6**	**10,039.8**	**10,408.4**	**10,856.4**
Total Debt	4,661.2	4,930.7	6,380.7	6,180.7
Deferred Tax Liability	838.9	823.1	811.6	867.9
Total Liabilities	**16,152.1**	**16,591.0**	**18,389.1**	**18,737.9**
Assets				
Gross Block	15,640.9	17,808.7	19,290.8	22,635.8
Less: Acc Depreciation	6,112.2	6,924.9	8,049.6	9,345.0
Net Block	**10,867.8**	**10,883.9**	**11,241.2**	**13,290.9**
Capital WIP	2,268.2	1,520.1	2,750.0	1,000.0
Total Fixed Assets	13,136.0	12,404.0	13,991.2	14,290.9
Investments	1,342.5	6.0	6.0	6.0
Goodwill on consolidation	206.1	199.3	199.3	199.3
Inventory	2,945.4	3,484.1	3,413.4	3,650.3
Debtors	1,435.0	1,154.7	1,232.6	1,318.1
Loans and Advances	75.7	42.8	42.2	45.1
Other current assets	504.6	484.7	478.0	511.1
Cash	**598.8**	**562.5**	**578.3**	**613.2**
Total Current Assets	5,559.5	5,728.8	5,744.4	6,137.9
Creditors	2,447.1	2,248.3	2,228.2	2,382.8
Provisions	338.1	251.7	249.5	266.8
Total Current Liabilities	2,785.2	2,500.0	2,477.6	2,649.6
Net Current Assets	2,774.3	3,228.8	3,266.8	3,488.3
Application of Funds	**16,152.1**	**16,591.0**	**18,389.1**	**18,737.9**

Source: Company, ICICI Direct Research

Exhibit 18: Key ratios

(Year-end March)	FY18	FY19	FY20E	FY21E
Per share data (₹)				
EPS	12.7	11.9	10.3	12.0
Cash EPS	23.0	26.1	30.0	34.7
BV	170.9	175.5	182.0	189.8
DPS	3.0	3.3	3.3	3.5
Cash Per Share	10.5	9.8	10.1	10.7
Operating Ratios (%)				
EBITDA Margin	11.1	11.2	12.0	13.2
PBT / Net sales	7.1	6.5	5.5	6.2
PAT Margin	4.9	4.7	3.4	3.7
Inventory days	72.4	72.5	72.0	72.0
Debtor days	35.3	24.0	26.0	26.0
Creditor days	60.2	46.8	47.0	47.0
Return Ratios (%)				
RoE	7.4	8.3	5.7	6.3
RoCE	7.7	8.0	5.8	6.7
RoIC	8.5	8.0	6.6	6.8
Valuation Ratios (x)				
P/E	13.4	11.7	16.4	14.1
EV / EBITDA	7.5	7.2	7.5	6.3
EV / Net Sales	0.8	0.8	0.9	0.8
Market Cap / Sales	0.7	0.6	0.6	0.5
Price to Book Value	1.0	1.0	0.9	0.9
Solvency Ratios				
Debt/Equity	0.5	0.5	0.6	0.6
Current Ratio	1.8	2.1	2.1	2.1
Quick Ratio	**0.7**	**0.7**	**0.7**	**0.7**

Source: Company, ICICI Direct Research

Exhibit 19: ICICI Direct Research coverage universe (Auto & Auto Ancillary)

Sector / Company	CMP			M Cap	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating	(₹ Cr)	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Apollo Tyre (APOTYR)	170	180	Hold	9725	11.9	10.3	12.0	14.3	16.4	14.1	7.5	7.5	6.3	8.0	5.8	6.7	8.3	5.7	6.3
Ashok Leyland (ASHLEY)	77	75	Hold	22603	6.8	5.8	6.2	11.4	13.2	12.4	5.8	6.3	5.8	26.9	22.7	22.2	24.3	18.8	18.1
Bajaj Auto (BAAUTO)	3267	3300	Hold	94523	161.6	175.0	189.0	19.6	18.1	16.7	14.9	13.9	11.9	21.0	19.5	25.9	19.9	20.6	19.8
Bharat Forge (BHAFOR)	465	515	Buy	21640	22.2	23.5	24.9	21.0	19.7	18.7	11.5	11.5	10.8	17.9	16.0	16.3	19.1	17.6	16.9
Eicher Motors (EICMOT)	21689	18175	Hold	59123	808.1	907.0	1029.4	26.8	23.9	21.1	13.4	12.6	10.9	32.5	27.3	25.2	24.8	22.5	21.1
Exide Industries (EXIIND)	192	230	Buy	16320	9.9	12.3	14.1	19.3	15.6	13.6	10.6	8.5	7.5	18.4	20.8	20.5	12.9	15.5	15.7
Hero Moto (HERHON)	2700	3110	Buy	53919	169.5	195.0	182.9	15.9	13.8	14.8	10.0	10.5	9.7	37.1	30.1	29.8	26.3	23.9	23.0
M&M (MAHMAH)	520	660	Buy	64646	38.6	44.0	34.2	13.5	11.8	15.2	10.0	9.4	9.4	17.3	14.7	13.2	14.1	11.6	10.3
Maruti Suzuki (MARUTI)	7396	6420	Reduce	223418	248.3	212.7	257.9	29.8	34.8	28.7	17.1	21.7	17.6	16.3	9.4	11.5	16.3	12.9	14.3
Tata Motors (TATMOT)	175	175	Hold	54330	-84.6	-2.3	8.9	-2.1	-76.4	19.6	4.0	4.0	3.5	5.4	7.7	8.9	7.1	0.0	10.8

Source: Reuters, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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