Apollo Tyres (APOTYR)

ICICI direct Research

CMP: ₹ 115 | Target: ₹ 120 (5%) | Target Period: 12 months | HOLD

August 6, 2020

Double digit return ratios still some distance away…

Apollo Tyres (ATL) reported a relatively healthy operational performance in Q1FY21 given circumstances. Consolidated net sales were down 33.7% YoY (volume led) at ₹ 2,873 crore (APMEA i.e. largely India revenues down 42.1%, Europe revenues down 12%) EBITDA margins at 8.3% were down 490 bps QoQ. QoQ margin deterioration was largely due to 407 bps fall in gross margins although other expenses were controlled, falling 119 bps QoQ on percentage of sales basis. APMEA EBIT margins dipped 130 bps QoQ to 2% while losses in Europe expanded. Consequent consolidated loss after tax came in at ₹ 135 crore, accelerated by jump in interest costs (up ~101% YoY &~29% QoQ). The company received first tranche of CCPS investment by Emerald Sage amounting to ~₹ 540 crore, with the second tranche of similar amount set to be received by October 2020.

Higher than anticipated aftermarket rebound improves visibility

While we expected healthy aftermarket share to benefit tyre manufacturers including ATL in post Covid months amid gradual nature of ramp up in OEM production, strength of replacement offtake (possibly aided by pent up demand) has been a positive surprise. Management commentary shows high single digit YoY growth in both June, July, with all major vehicle categories seeing uptick. With aftermarket forming ~81% of overall mix in FY20, continued momentum would stand ATL in good stead on the domestic topline front in coming quarters. Notwithstanding ATL's healthy position in aftermarket, however, its high exposure to CV space (worst affected in ongoing automotive slowdown; CV-OEM forms ~15% of standalone revenues) stays an area of concern. In Europe, ATL continues to make steady progress on market share and product mix fronts, with share of ultra-high performance (UHP) tyres sought to be improved further, going forward. We build 3.7% India and 5.7% Europe sales CAGR in FY20-22E.

Peak net debt, capex spends behind us; FCF in sight

ATL's net debt levels ballooned from <₹ 300 crore in FY16 to ~₹ 6,000 crore in FY20 wherein it incurred substantial capex spend of > ₹ 10,000 crore combined in FY16-20. As a result, the company generated negative FCF in each of the past four years. However, with majority of Andhra Pradesh greenfield capex (₹ 2,200 crore out of ₹ 3,800 crore as of FY20) now behind us, we expect ATL to utilise future cash flows to lower debt levels and thereby improve net profitability. Our estimates place the company turning marginally FCF positive in FY21E and significantly so from the following year. Profitability is also set to be aided by cost initiatives in India and Europe, with Europe margins, in particular, seen benefitting markedly from lowering of staff costs in the Netherlands operations.

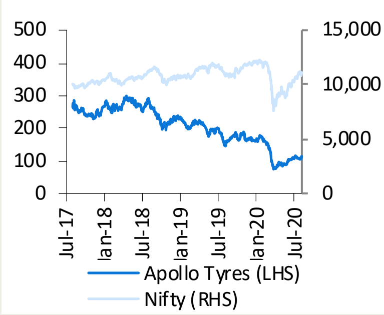
Valuation & Outlook

We expect sales, PAT CAGR at 4.2%, 8.9%, respectively, in FY20-22E. However, we do not expect return to double digit RoCE trajectory before FY23E courtesy bloated capital employed figures. Hence, we maintain **HOLD** rating, valuing it at ₹ 120 i.e. 5x EV/EBITDA on FY22E numbers.

Particulars

Particular	Amount
Market Capitalization	₹ 6579 Crore
Total Debt (FY 20) (₹ Crore)	6,763.9
Cash & Inv. (FY 20) (₹ Crore)	749.6
EV (₹ Crore)	12,592.9
52 week H/L (₹)	197 / 74
Equity capital	₹ 57.2 Crore
Face value	₹ 1

Price chart



Key Highlights

- Q1FY21 revenues fell 33.7% YoY tracking fall in volumes. APMEA revenues down 43%, Europe sales down 12%
- Consolidated margins down 490 bps QoQ to 8.3% in Q1FY21
- OEM channel stays laggard. Healthy aftermarket demand, however, improves top line visibility
- Reduced capex, debt levels, going forward, positives. However, double digit RoCE trajectory still some distance away
- Maintain HOLD with revised target price of ₹ 120 i.e. 5x FY22E EV/EBITDA

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Result Update

ICICI Securities – Retail Equity Research

Key Financial Summary

Key Financials	FY18	FY19	FY20	FY21E	FY22E	CAGR (FY20-22E)
Net Sales	14,840.5	17,548.8	16,327.0	15,731.5	17,743.1	4.2%
EBITDA	1,651.3	1,958.9	1,915.6	2,050.1	2,476.8	13.7%
EBITDA Margins (%)	11.1	11.2	11.7	13.0	14.0	
Net Profit	723.9	680.0	476.4	281.0	565.5	8.9%
EPS (₹)	12.7	11.9	8.3	4.9	8.9	
P/E	9.1	9.7	13.8	23.4	12.9	
RoNW (%)	7.4	8.3	4.8	2.5	4.9	
RoCE (%)	7.7	8.0	4.7	4.7	6.6	

Source: ICICI Direct Research, Company

Exhibit 1: Variance Analysis

(₹ crore)	Q1FY21	Q1FY21E	Q1FY20	YoY (%)	Q4FY20	QoQ (%)	Comments
Total Operating Income	2,873	1,954	4,331	(33.7)	3,610	(20.4)	Topline came in ahead of estimates tracking robust replacement demand in India & European markets
Raw Material Expenses	1,631	959	2,453	(33.5)	1,902	(14.3)	RM costs looks optically higher tracking more than anticipated usage of finished goods inventory
Employee Expenses	537	515	642	(16.3)	602	(10.7)	
Other expenses	468	375	762	(38.5)	631	(25.8)	Other expenses came in lower at 16.3% of sales
EBITDA	237	105	475	(50.1)	475	(50.1)	
EBITDA Margin (%)	8.3	5.4	11.0	271 bps	13.2	-491 bps	EBITDA margins came in ahead of estimates tracking lower than anticipated decline in sales and limited impact of negative operating leverage
Depreciation	309	296	267	15.6	314	(1.5)	
Interest	117	85	58	100.7	91	28.5	Interest came in higher tracking commissioning of new greenfield plant in AP & increase in gross debt on account of maintaining healthy liquidity in crisis
Other income	27	14	28	(2.4)	-2.4	(1,218.5)	
Tax	(28)	(66)	35	(178.5)	-10	176.0	
PAT	(135)	(196)	142	(195.1)	77.9	(272.9)	PAT came in at negative ₹ 135 crore vs. our estimates of negative ₹ 196 crore
EPS (₹)	(2.4)	(3.4)	2.5	(195.1)	1.4	(272.9)	
Key Metrics							
Revenue (₹ crore)							
APMEA	1,818	1,183	3,142	(42.1)	2,474	(26.5)	Sales decline in domestic operations was limited to 42% tracking similar decline in volumes
Europe	1,090	770.9	1,239	(12.0)	1,164	(6.3)	In Europe, 12% decline YoY factors in currency benefits as Euro denominated sales were down 28% YoY, largely volume driven in nature
EBIT Margin (%)							
APMEA	2.0	NA	7.5	550) bps	7.2	(520) bps	EBIT margins stood negative at European operations amidst double digit decline in sales volume
Europe	(8.3)	NA	(1.0)	730) bps	(1.2)	(710) bps	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

	FY21E			FY22E			
(₹ Crore)	Old	New	% Change	Old	New	% Change	Comments
Revenue	14,653	15,732	7.4	17,100	17,743	3.8	More than anticipated replacement demand leads us revise our sales estimates upwards for FY21E & FY22E
EBITDA	1,883	2,050	8.9	2,352	2,477	5.3	
EBITDA Margin (%)	12.9	13.0	13 bps	13.8	14.0	16 bps	EBITDA margins are seen firm in double digit trajectory primarily tracking limited decline in volumes and associated negative operating leverage amidst benign raw material prices (crude derivatives)
PAT	136	281	106.6	485	565	16.6	
EPS (₹)	2.4	4.9	106.6	7.6	8.9	16.6	Upward revision in sales and margin estimates leads to healthy upward revision in PAT estimates for FY21-22E

Source: ICICI Direct Research

Conference Call Highlights

Management guidance/outlook and demand

- **ATL expects domestic replacement demand to remain strong in coming months, with July continuing Q1FY21 strength. All segments performed well during the past month. On the OEM side, it is witnessing uptick in PCR volumes**
- **ATL expects to post sequential growth in Europe, going ahead, and retain focus on costs. It expects to operate at 90% of normal levels in Europe during Q2FY21E**
- **The management said that rebound in India replacement demand had been much higher than expected.** July India volumes posted high single digit YoY growth
- Decline in topline in Q1FY21 was almost entirely due to Covid disruption. However, the demand situation improved significantly after April with pricing environment remaining stable. OEM segment demand remains far below last year's levels, however. Replacement volumes were down 25% YoY in Q1FY21 but up 10% YoY in June. **Farm segment performed the best, followed by trucks.** PCR and 2-W segments are also seeing good demand traction now. ATL feels it has gained share on the replacement side
- OEM as proportion of overall channel mix fell to 7% in India during Q1FY21. ATL does not expect it to go back to the usual 20-30% levels before Q3FY21E
- **India utilisation levels as of June 2020 were at ~66%**
- Placing tyre imports under restricted list is expected to benefit PCR more vs. TBR as imports form ~15% of that segment
- Europe revenues for Q1FY21 were at €90 million. ATL gained market share in TBR and PCR segments (PCR industry volumes down 32%)

Revenues, costs and margins

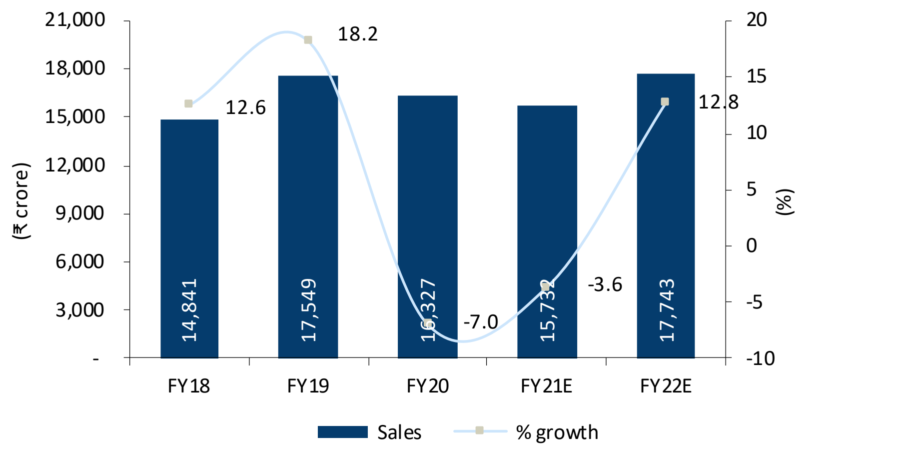
- Reifen revenues grew 14% YoY during Q1FY21 with margins placed at ~5%
- ATL achieved significant reduction in controllable SG&A expenses during Q1FY21 (via digital product launches, reduced consultation, etc). Deferral of wage hikes, salary reductions for top level management and focus on logistics costs are some other cost related initiatives being practised by the company. **Of the overall cost efforts, some portion of savings on transport, marketing spends and dealer costs look sustainable**
- **The company reduced Netherlands headcount by 528 employees. It expects savings from the exercise to be worth ~€ 40-50 million per annum (i.e. ~₹ 450 crore).** A good portion of these savings are expected to flow into margins and improve cost competitiveness from FY22E onwards. Some part of Netherlands production would be shifted to Hungary and India
- Raw material prices during Q1FY21 (₹/kg) – natural rubber 139, synthetic rubber 105, carbon black 66, steel cord 139. They fell by 3% QoQ in Q1FY21. **The company expects 1-2% QoQ softening of raw material costs in Q2FY21E before rising back to Q1FY21 levels in the following quarter**
- Interest costs were higher QoQ as the company borrowed during the quarter to ensure adequate liquidity
- The company received ~€6 million in wage support from Netherlands government during Q1FY21

Others

- Andhra Pradesh greenfield plant has started PCR production with TBR production set to commence from September 2020. Capex for the same is set to be completed by FY22E (₹ 2,200 crore already incurred till FY20), with only maintenance capex set to be incurred after that. **The company expects to generate significant FCF from FY23E onwards**
- **For FY21E, India capex is expected at ₹ 1,050 crore (of which ₹ 600-700 crore is for Andhra Pradesh greenfield) while Europe capex is expected at ~₹ 200 crore**
- Maintenance capex for India and Europe was at ~₹ 250-300 crore and ~₹ 150-200 crore, respectively
- **Net debt as of June 2020 was at ~₹ 5,200 crore (vs. ₹ 6,000 crore as of March 2020), with net debt to EBITDA at 3.1x. Consolidated gross debt was at ₹ 7,500 crore while standalone gross debt was at ₹ 5,800 crore**

Financial story in charts

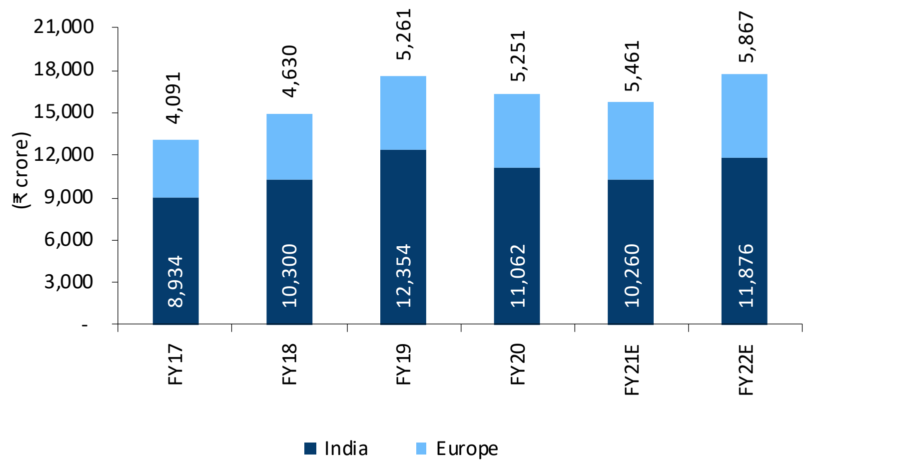
Exhibit 3: Topline trend



Source: Company, ICICI Direct Research

Supported by healthy replacement demand, consolidated ATL sales are expected to grow at 4.2% CAGR over FY20-22E

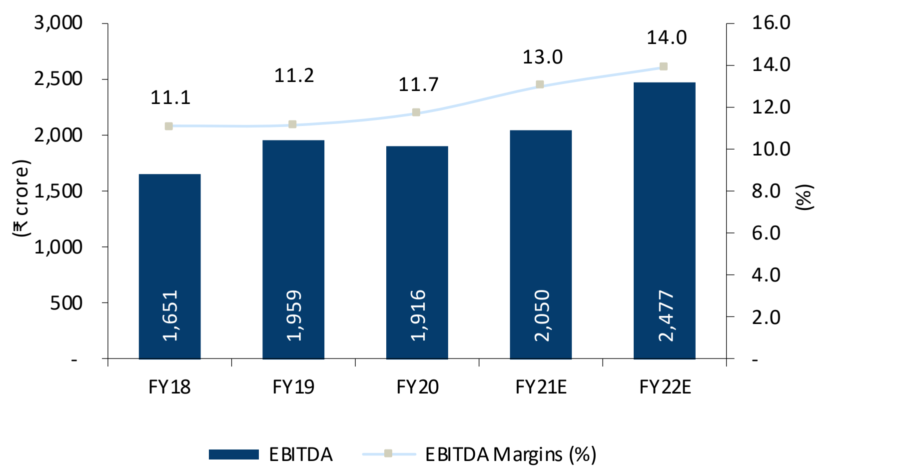
Exhibit 4: Geography-wise breakup of revenues



Source: Company, ICICI Direct Research

India revenues are seen growing at 3.7% CAGR. Europe sales are expected to grow at 5.7% CAGR

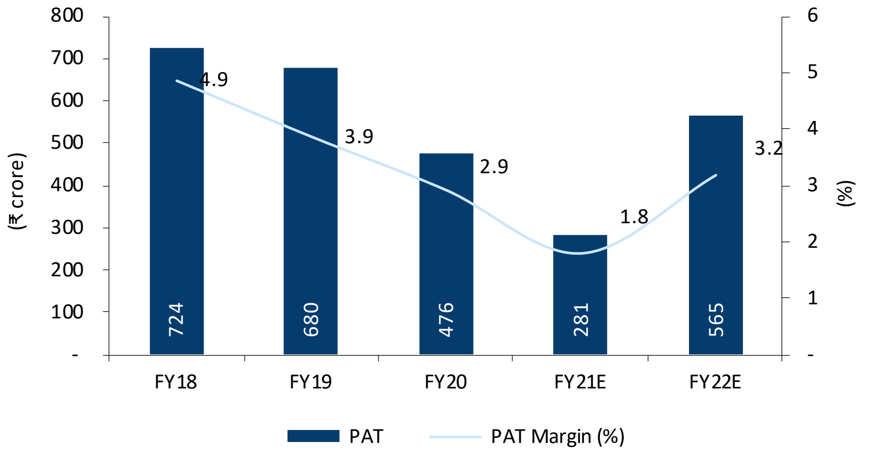
Exhibit 5: EBITDA and EBITDA margin trend



Source: Company, ICICI Direct Research

We expect margins to steadily improve and reach 14% levels by FY22E, supported by some volume growth as well as cost initiatives in India as well as in Europe. Savings of staff costs in Netherlands is expected to push Europe margins significantly higher

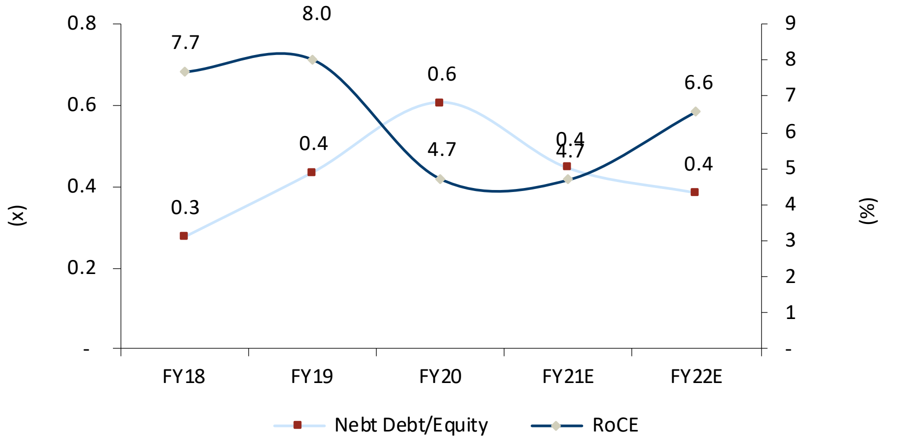
Exhibit 6: Trend in profitability



Source: Company, ICICI Direct Research

Profitability expected to grow at 8.9% CAGR over FY20-22E

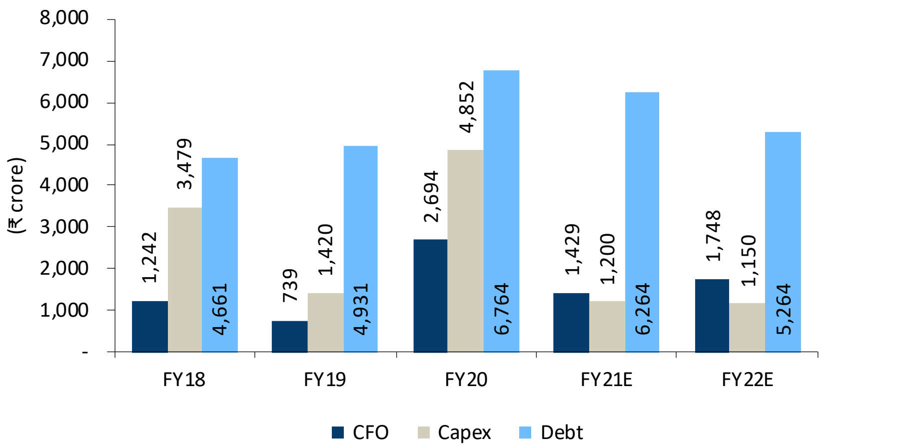
Exhibit 7: Trend in RoCE



Source: Company, ICICI Direct Research

We expect peak debt levels to be behind us. Nevertheless, given the large capital employed on books, single digit RoCE levels are seen persisting for some more time

Exhibit 8: CFO, capex and debt levels at ATL



Source: Company, ICICI Direct Research

With peak capex levels a thing of the past, we expect ATL to incrementally reduce debt and post positive FCF going forward

Exhibit 9: Key valuation metrics

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY18	14,841	12.6	12.7	(34.1)	9.1	5.6	7.4	7.7
FY19	17,549	18.2	11.9	(6.1)	9.7	5.6	8.3	8.0
FY20	16,327	(7.0)	8.3	(29.9)	13.8	6.6	4.8	4.7
FY21E	15,732	(3.6)	4.9	(41.0)	23.4	5.6	2.5	4.7
FY22E	17,743	12.8	8.9	81.3	12.9	4.7	4.9	6.6

Source: Bloomberg, ICICI Direct Research

Exhibit 10: Shareholding pattern

(in %)	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Promoter	40.9	40.9	40.9	40.9	41.7
FII	23.7	23.7	24.9	22.9	19.7
DII	17.5	17.5	16.6	17.1	18.2
Others	17.9	17.9	17.6	19.2	20.5

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 11: Profit and loss statement ₹ crore

(Year-end March)	FY19	FY20	FY21E	FY22E
Total operating Income	**17,548.8**	**16,327.0**	**15,731.5**	**17,743.1**
Growth (%)	18.2	-7.0	-3.6	12.8
Raw Material Expenses	10,126.2	9,075.5	8,563.0	9,852.1
Employee Expenses	2,456.2	2,482.2	2,339.1	2,251.2
Other Expenses	3,007.5	2,853.7	2,779.2	3,163.1
Total Operating Expenditure	15,589.9	14,411.3	13,681.4	15,266.3
EBITDA	**1,958.9**	**1,915.6**	**2,050.1**	**2,476.8**
Growth (%)	18.6	-2.2	7.0	20.8
Depreciation	812.7	1,138.1	1,258.5	1,375.1
Interest	181.1	280.8	459.2	403.5
Other Income	123.1	46.9	61.0	57.7
PBT	**888.2**	**543.6**	**393.4**	**756.0**
Exceptional items	200.0	0.0	0.0	0.0
Total Tax	208.3	67.2	112.4	190.5
Reported PAT	**680.0**	**476.4**	**281.0**	**565.5**
Growth (%)	-6.1	-29.9	-41.0	101.2
EPS (₹)	**11.9**	**8.3**	**4.9**	**8.9**

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement ₹ crore

(Year-end March)	FY19	FY20	FY21E	FY22E
Profit after Tax	**680.0**	**476.4**	**281.0**	**565.5**
Add: Depreciation	812.7	1,138.1	1,258.5	1,375.1
(Inc)/dec in Current Assets	-205.6	434.4	116.7	-687.4
Inc/(dec) in CL and Provisions	-548.5	644.8	-227.6	494.8
CF from operating activities	**738.6**	**2693.8**	**1428.6**	**1748.0**
(Inc)/dec in Investments	1,339.0	0.0	0.0	0.0
(Inc)/dec in Fixed Assets	-1,419.7	-4,851.9	-1,200.0	-1,150.0
Others	-561.3	1,167.2	-111.2	156.6
CF from investing activities	**-642.0**	**-3684.7**	**-1311.2**	**-993.4**
Issue/(Buy back) of Equity	0.0	0.0	0.0	6.3
Inc/(dec) in loan funds	269.5	1,833.3	-500.0	-1,000.0
Dividend paid & dividend tax	-237.6	-205.9	-114.4	-200.2
Others	-164.7	-449.6	1,030.0	-26.3
CF from financing activities	**-132.8**	**1177.8**	**415.6**	**-1220.2**
Net Cash flow	**-36.1**	**186.9**	**533.1**	**-465.6**
Opening Cash	598.8	562.7	749.6	1,282.6
Closing Cash	**562.7**	**749.6**	**1282.6**	**817.0**

Source: Company, ICICI Direct Research

Exhibit 13: Balance Sheet ₹ crore

(Year-end March)	FY19	FY20	FY21E	FY22E
Liabilities				
Equity Capital	57.2	57.2	57.2	63.5
Reserve and Surplus	9,982.6	9,872.8	10,039.3	11,478.3
Total Shareholders funds	**10,039.8**	**9,930.0**	**11,176.5**	**11,541.8**
Total Debt	4,930.7	6,763.9	6,263.9	5,263.9
Deferred Tax Liability	823.1	747.7	720.4	812.6
Total Liabilities	**16,591.0**	**19,152.6**	**19,815.6**	**19,463.1**
Assets				
Gross Block	17,808.7	22,558.7	24,380.7	26,030.7
Less: Acc Depreciation	6,924.9	8,063.0	9,321.5	10,696.6
Net Block	**10,883.9**	**14,495.7**	**15,059.2**	**15,334.1**
Capital WIP	1,520.1	1,622.0	1,000.0	500.0
Total Fixed Assets	12,404.0	16,117.7	16,059.2	15,834.1
Investments	6.0	19.4	69.4	119.4
Goodwill on consolidation	199.3	213.5	213.5	213.5
Inventory	3,484.1	3,206.9	3,017.0	3,500.0
Debtors	1,154.7	939.9	1,034.4	1,166.7
Loans and Advances	42.8	43.5	41.9	47.3
Other current assets	484.7	541.6	521.8	588.6
Cash	**562.7**	**749.6**	**1,282.6**	**817.0**
Total Current Assets	5,729.0	5,481.5	5,897.8	6,119.6
Creditors	2,248.3	2,309.1	2,155.0	2,430.6
Provisions	251.7	274.4	256.1	288.8
Total Current Liabilities	2,500.0	2,583.5	2,411.1	2,719.4
Net Current Assets	3,229.0	2,898.0	3,486.7	3,400.2
Application of Funds	**16,591.0**	**19,152.6**	**19,815.6**	**19,463.1**

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios

(Year-end March)	FY19	FY20	FY21E	FY22E
Per share data (₹)				
EPS	11.9	8.3	4.9	8.9
Cash EPS	26.1	28.2	26.9	30.6
BV	175.5	173.6	195.4	181.7
DPS	3.3	3.0	2.0	3.5
Cash Per Share	9.8	13.1	22.4	12.9
Operating Ratios (%)				
EBITDA Margin	11.2	11.7	13.0	14.0
PBT / Net sales	6.5	4.8	5.0	6.2
PAT Margin	4.7	2.9	1.8	3.2
Inventory days	72.5	71.7	70.0	72.0
Debtor days	24.0	21.0	24.0	24.0
Creditor days	46.8	51.6	50.0	50.0
Return Ratios (%)				
RoE	8.3	4.8	2.5	4.9
RoCE	8.0	4.7	4.7	6.6
RoIC	8.0	4.5	4.4	5.9
Valuation Ratios (x)				
P/E	7.9	13.8	23.4	12.9
EV / EBITDA	5.6	6.6	5.6	4.7
EV / Net Sales	0.6	0.8	0.7	0.7
Market Cap / Sales	0.4	0.4	0.4	0.4
Price to Book Value	0.7	0.7	0.6	0.6
Solvency Ratios				
Debt/Equity	0.5	0.7	0.6	0.5
Current Ratio	2.1	1.8	1.9	1.9
Quick Ratio	**0.7**	**0.6**	**0.7**	**0.7**

Source: Company, ICICI Direct Research

Exhibit 15: ICICI Direct coverage universe (Auto & Auto Ancillary)

Sector / Company	CMP	TP		M Cap	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)	Rating	(₹ Cr)	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Apollo Tyre (APOTYR)	**115**	**120**	**Hold**	**6,579**	**8.3**	**4.9**	**8.9**	**13.8**	**23.4**	**12.9**	**6.6**	**5.6**	**4.7**	**4.7**	**4.7**	**6.6**	**4.8**	**2.5**	**4.9**
Ashok Leyland (ASHLEY)	49	58	Hold	14,343	0.8	0.1	2.1	60.1	733.0	23.8	13.9	19.9	10.0	5.6	2.2	8.6	4.7	0.3	8.0
Bajaj Auto (BAAUTO)	2,990	3,210	Hold	86,522	176.2	136.9	173.5	17.0	21.8	17.2	13.6	16.5	12.1	23.8	23.3	26.6	25.6	17.9	20.2
Bharat Forge (BHAFOR)	404	300	Hold	18,809	7.5	0.0	10.0	53.9	NM	40.4	19.2	35.7	17.8	7.7	2.2	8.2	7.8	0.0	8.6
Eicher Motors (EICMOT)	21,678	18,070	Hold	59,094	670.4	495.4	690.9	32.3	43.8	31.4	25.3	31.8	22.5	22.5	15.9	19.1	18.3	12.2	14.9
Escorts (ESCORT)	1,120	1,300	Buy	13,729	39.6	46.1	54.5	28.3	24.3	20.5	18.9	16.0	13.4	18.9	15.0	15.2	14.2	11.2	11.8
Exide Industries (EXIIND)	158	180	Buy	13,430	9.7	6.3	8.9	11.8	18.0	12.9	9.7	12.0	9.3	15.7	10.3	13.5	13.4	8.2	10.7
Hero Moto (HERHON)	2,704	2,500	Hold	53,999	181.9	109.8	147.6	14.9	24.6	18.3	12.1	16.1	11.7	26.5	18.7	23.2	22.7	14.5	17.9
M&M (MAHMAH)	610	600	Buy	75,835	10.7	28.4	39.7	57.0	21.5	15.4	12.5	13.3	9.8	13.0	11.1	14.2	6.4	9.5	12.0
Maruti Suzuki (MARUTI)	6,560	5,300	Reduce	1,98,164	187.1	124.9	203.4	35.1	52.5	32.2	22.4	30.6	18.8	7.4	3.5	8.2	11.7	7.4	11.1
Minda Industries (MININD)	282	320	Buy	7,394	5.9	2.8	9.6	47.7	99.8	29.3	13.3	15.0	10.2	10.6	6.6	12.7	10.3	5.1	13.6
Tata Motors (TATMOT)	117	115	Hold	42,764	-32.8	-24.6	7.4	NM	NM	15.7	4.8	5.0	3.3	1.4	1.1	6.8	-18.7	-16.5	4.8

Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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