

SELL

TP: Rs 140 | ▼ 43%

APOLLO TYRES

| Auto Components

| 04 February 2021

Positives priced in; maintain SELL

Apollo Tyres (APTY) delivered an operational beat in Q3FY21. Consolidated revenue grew 17% YoY to Rs 51.5bn, EBITDA margin expanded 700bps to 19.2%, and adj. PAT increased 155% YoY to Rs 4.5bn. In our view, positives in the form of domestic volume growth and a better performance in Europe are priced in, even as inflation in natural rubber (up ~30% over the last three months) and crude derivatives is likely to squeeze margins. We find current valuations at 28x FY23E EPS rich and maintain SELL.

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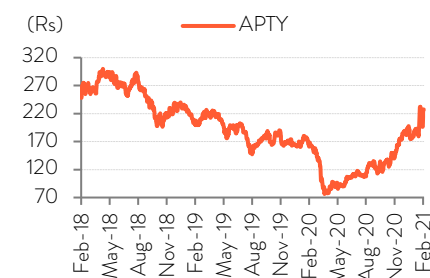
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Strong operating performance: Consolidated Q3FY21 revenue was 15% ahead of our estimate at Rs 51.5bn (+17% YoY), mainly owing to better volume growth in the replacement segment and revenue from European operations. Sequential gross margin expansion of 125bps (vs. a 350bps decline expected) and higher operating efficiencies further augmented the EBITDA margin which expanded 700bps YoY to 19.2%. Adj. PAT surged 2.5x to Rs 4.5bn.

Ticker/Price	APTY IN/Rs 244
Market cap	US\$ 1.9bn
Shares o/s	572mn
3M ADV	US\$ 36.9mn
52wk high/low	Rs 256/Rs 73
Promoter/FPI/DII	41%/23%/17%

Source: NSE

Surge in commodity prices to erode earnings: With the >30% rise in both rubber and Brent crude prices from Q2FY21 levels, we anticipate gross margin deterioration for tyre companies (see our recent report [Spiking RM costs to puncture earnings](#)). To mitigate this impact, players will have to effect price hikes of over 15% which looks difficult. APTY took a price increase of ~2% in Dec'20 and management alluded to further hikes by end-Q4. We bake in a decline of ~180bps YoY in APTY's FY22 gross margin, resulting in a drop in operating margin and earnings.

STOCK PERFORMANCE

Source: NSE

Valuations full – maintain SELL: The stock has rallied 75% during the last three months and is now trading at 28x FY23E EPS. In our view, most of the optimism over volumes, margins and Europe sales is in the price. We maintain our TP of Rs 140 (16x Mar'23E EPS) and our rating at SELL on expensive valuations.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	175,488	163,270	169,402	194,327	212,751
EBITDA (Rs mn)	17,762	19,155	24,480	23,709	25,948
Adj. net profit (Rs mn)	6,798	4,764	6,023	4,831	5,489
Adj. EPS (Rs)	15.4	8.3	10.4	7.6	8.6
Adj. EPS growth (%)	(6.1)	(29.9)	26.4	(27.8)	13.6
Adj. ROAE (%)	6.8	4.8	5.3	4.1	4.5
Adj. P/E (x)	15.9	29.3	23.4	32.1	28.2
EV/EBITDA (x)	9.9	9.5	7.8	8.2	7.5

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE – CONSOLIDATED

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	9MFY21	9MFY20	YoY (%)
Net Revenues	51,538	43,997	17.1	42,827	20.3	123,099	127,169	(3.2)
Total Income (A)	51,538	43,997	17.1	42,827	20.3	123,099	127,169	(3.2)
Operating Expenses:								
Raw materials consumed	27,039	24,769	9.2	23,014	17.5	66,360	71,736	(7.5)
Employee Expenses	6,826	6,445	5.9	6,233	9.5	18,429	18,805	(2.0)
Other Expenses	7,779	7,448	4.4	6,632	17.3	19,095	22,223	(14.1)
Total Expenditure (B)	41,644	38,662	7.7	35,879	16.1	103,885	112,764	(7.9)
EBITDA (A-B)	9,894	5,335	85.4	6,948	42.4	19,214	14,405	33.4
Other Income	636	178	257.1	384	65.4	1,289	493	161.5
Depreciation	3,273	2,830	15.7	3,308	(1.1)	9,673	8,244	17.3
EBIT	7,257	2,684	170.4	4,024	80.3	10,831	6,653	62.8
Finance Costs	1,049	673	55.9	1,167	(10.1)	3,388	1,896	78.7
PBT before excep items	6,208	2,011	208.7	2,857	117.3	7,443	4,757	56.5
Exceptional loss/ (profit)	55	-	NA	59	(6.7)	115	-	NA
PBT after excep items	6,153	2,011	205.9	2,797	119.9	7,328	4,757	54.1
Tax expense	1,715	272	530.1	798	114.9	2,236	772	189.8
Reported PAT	4,438	1,739	155.2	1,999	122.0	5,092	3,985	27.8
Adjusted PAT	4,493	1,739	158.4	2,059	118.3	5,207	3,985	30.6
Adj EPS (Rs)	7.8	3.0	155.2	3.5	122.0	8.9	7.0	27.8

Source: Company, BOBCAPS Research

FIG 2 – KEY PARAMETERS – CONSOLIDATED

(%)	Q3FY21	Q3FY20	YoY (bps)	Q2FY21	QoQ (bps)	9MFY21	9MFY20	YoY (bps)
Gross margin	47.5	43.7	383	46.3	127	46.1	43.6	250
EBITDA margin	19.2	12.1	707	16.2	297	15.6	11.3	428
EBIT margin	14.1	6.1	798	9.4	468	8.8	5.2	357
PBT margin	12.0	4.6	747	6.7	537	6.0	3.7	231
Tax rate	27.9	13.5	1434	28.5	(66)	30.5	16.2	1429
Adj PAT margin	8.7	4.0	477	4.8	391	4.2	3.1	110

Source: Company, BOBCAPS Research

Earnings call highlights

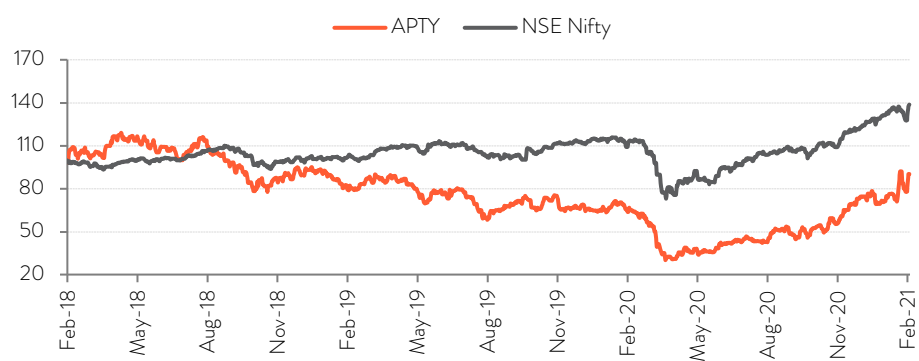
- Demand in India continues to be steered by the replacement market as well as reviving OEM offtake. European demand was affected by the second wave of Covid-19.
- Revenue from European operations totalled EUR 136mn in Q3 with EBITDA at EUR 18mn and margins of 13%.
- Blended raw material cost was at Rs 120/kg in Q3 broken down as follows: natural rubber at Rs 140/kg, synthetic rubber at Rs 115/kg, steel cord at Rs 150/kg and carbon black at Rs 65/kg.
- The company took a price hike of 2-3% in Dec'20 to mitigate the raw material cost impact. Management is planning another price increase by the end of Q4FY21, supported by healthy on-ground demand and its strong brand position.
- APTY plans to launch its 'Vredestein' brand in India in FY22 to cater to the premium car tyre segment.
- For Apr-Oct'20, APTY held 31% market share in the truck segment and 22% share in PVs.
- Management intends to incur capex of Rs 16bn in FY21 which would increase overall capacities by 10%.
- Andhra plant expansion is on track and will result in capacities to manufacture 15k car tyres and 3k truck tyres per day. Capacities at the plant can be tripled in future before planning any greenfield expansion.
- Net debt stood at Rs 38bn as at end-Q3 (vs. Rs 46bn in FY20) and net debt/EBITDA was at 1.6x.

Valuation methodology

We expect APTY’s India revenue to register a 9% CAGR over FY21-FY23 and its European subsidiary to grow at 7%. Overall, we project a revenue/EBITDA/PAT CAGR of +12%/+3%/–4% for the company.

The stock has rallied 75% during the last three months and is now trading at 28x FY23E EPS. In our view, most of the optimism over volumes, margins and Europe sales is in the price. We maintain our Mar’22 target price of Rs 140, set at an unchanged 16x Mar’23E P/E, and retain SELL on expensive valuations.

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Above-expected volume growth can improve profitability and enhance operating performance.
- A meaningful decline in rubber and crude oil prices can support operating margins and impact our profitability estimates.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	175,488	163,270	169,402	194,327	212,751
EBITDA	17,762	19,155	24,480	23,709	25,948
Depreciation	8,127	11,381	13,051	14,235	15,471
EBIT	10,868	8,243	13,129	11,074	12,176
Net interest income/(expenses)	(1,986)	(2,808)	(4,550)	(4,616)	(4,838)
Other income/(expenses)	1,232	469	1,700	1,600	1,700
Exceptional items	2,000	0	(59)	0	0
EBT	10,881	5,434	8,520	6,459	7,339
Income taxes	2,083	670	2,556	1,628	1,849
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	8,798	4,764	5,964	4,831	5,489
Adjustments	(2,000)	0	59	0	0
Adjusted net profit	6,798	4,764	6,023	4,831	5,489

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	22,102	23,090	24,313	31,015	29,104
Other current liabilities	8,960	16,980	13,367	20,171	17,596
Provisions	3,466	4,421	7,446	6,036	6,256
Debt funds	49,304	65,799	62,373	62,373	68,373
Other liabilities	7,975	15,433	15,433	15,433	15,433
Equity capital	572	572	572	635	635
Reserves & surplus	99,826	98,728	113,166	116,726	120,843
Shareholders' fund	100,398	99,300	113,738	117,361	121,478
Total liabilities and equities	192,206	225,023	236,669	252,388	258,240
Cash and cash eq.	5,627	7,496	9,307	6,132	4,315
Accounts receivables	11,547	9,399	12,705	13,603	13,829
Inventories	34,841	32,069	33,880	38,865	40,423
Other current assets	5,275	8,282	8,470	9,716	9,574
Investments	60	194	194	194	194
Net fixed assets	117,540	154,484	161,433	173,198	179,727
CWIP	15,393	16,420	14,000	14,000	13,500
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(7,707)	(7,032)	(7,032)	(7,032)	(7,032)
Other assets	9,630	3,711	3,711	3,711	3,711
Total assets	192,205	225,023	236,669	252,388	258,240

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	16,925	16,145	19,015	19,066	20,961
Interest expenses	1,986	2,808	4,550	4,616	(4,838)
Non-cash adjustments	(1,232)	(469)	(1,700)	(1,600)	(1,700)
Changes in working capital	(13,466)	25,253	(4,671)	4,967	(5,905)
Other operating cash flows	(1,929)	(286)	59	0	0
Cash flow from operations	2,284	43,451	17,253	27,048	8,518
Capital expenditures	(13,988)	(49,352)	(17,580)	(26,000)	(21,500)
Change in investments	13,365	(134)	0	0	0
Other investing cash flows	1,232	469	1,700	1,600	1,700
Cash flow from investing	609	(49,017)	(15,880)	(24,400)	(19,800)
Equities issued/Others	0	0	10,800	0	0
Debt raised/repaid	2,693	16,494	(3,426)	0	6,000
Interest expenses	(1,986)	(2,808)	(4,550)	(4,616)	(4,838)
Dividends paid	(2,069)	(4,310)	(2,386)	(1,208)	(1,372)
Other financing cash flows	(1,896)	(1,941)	0	0	0
Cash flow from financing	(3,258)	7,435	439	(5,824)	(210)
Changes in cash and cash eq.	(365)	1,869	1,811	(3,175)	(11,492)
Closing cash and cash eq.	5,627	7,496	9,307	6,132	4,315

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	15.4	8.3	10.4	7.6	8.6
Adjusted EPS	15.4	8.3	10.4	7.6	8.6
Dividend per share	3.0	3.0	4.2	1.9	2.2
Book value per share	175.5	173.6	198.8	184.8	191.3

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	1.0	1.1	1.1	1.0	0.9
EV/EBITDA	9.9	9.5	7.8	8.2	7.5
Adjusted P/E	15.9	29.3	23.4	32.1	28.2
P/BV	1.4	1.4	1.2	1.3	1.3

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	80.9	87.7	70.0	74.8	74.8
Interest burden (PBT/EBIT)	100.1	65.9	64.9	58.3	60.3
EBIT margin (EBIT/Revenue)	6.2	5.0	7.8	5.7	5.7
Asset turnover (Revenue/Avg TA)	112.9	96.5	91.1	100.5	106.3
Leverage (Avg TA/Avg Equity)	1.6	1.7	1.7	1.7	1.7
Adjusted ROAE	8.9	4.8	5.6	4.2	4.6

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	18.2	(7.0)	3.8	14.7	9.5
EBITDA	6.5	7.8	27.8	(3.1)	9.4
Adjusted EPS	(6.1)	(29.9)	26.4	(27.8)	13.6
Profitability & Return ratios (%)					
EBITDA margin	10.1	11.7	14.5	12.2	12.2
EBIT margin	6.2	5.0	7.8	5.7	5.7
Adjusted profit margin	3.9	2.9	3.6	2.5	2.6
Adjusted ROAE	6.8	4.8	5.3	4.1	4.5
ROCE	5.7	4.3	4.9	4.3	4.5
Working capital days (days)					
Receivables	27	23	24	25	24
Inventory	67	75	71	68	68
Payables	85	91	93	91	90
Ratios (x)					
Gross asset turnover	1.1	1.5	1.6	1.5	1.5
Current ratio	1.7	1.3	1.4	1.2	1.3
Net interest coverage ratio	5.5	2.9	2.9	2.4	2.5
Adjusted debt/equity	0.5	0.7	0.5	0.5	0.6

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

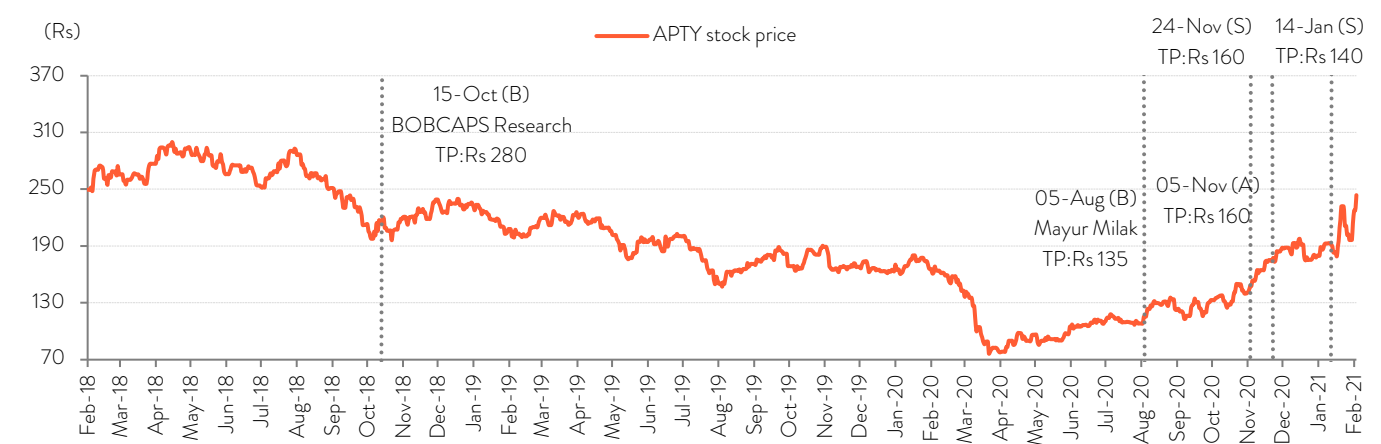
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): APOLLO TYRES (APTY IN)



B – Buy, A – Add, R – Reduce, S – Sell

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