

Buy

Apollo Tyres

Industry: Auto Components

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Domestic market growth strong despite OEM slowdown in Q3

Margins impacted by higher RM costs

Apollo's standalone net sales grew by 16% yoy and 0.5% qoq to ₹ 30.6bn. The yoy growth came on the back of 11% blended volume growth, out of which the TBR segment volumes grew at double digit yoy, while PCR de-grew in mid-single digit. OEM segment sales declined, however Replacement segment showed a double digit growth on a yoy basis. The company rolled back price hike of 2% (taken earlier in the quarter) viewing lower demand later. RM prices saw a hike of 13% yoy and 2% qoq on rubber price hike as well as fuel price surge during the quarter. Hence, at the EBITDA levels, profits fell by 6.6% yoy and 8.1% qoq to ₹ 3.4 bn and EBITDA margins dropped to 11.2% yoy, 280 bps yoy. Depreciation moved up by 20% yoy as Chennai plant ramp up is progressing. Lower tax rate and higher other income prevented a steep fall in bottomline. Adjusted net PAT at standalone business dropped by 10% yoy and 2% qoq to ₹ 1.83bn.

Consolidated net sales grew by 15.9% yoy and 11% qoq to ₹ 46.5 bn. Europe witnessed 8% yoy volume growth as against 5% industry growth. This was on the back of overall growth across segments vis-à-vis the industry, but still demand remained weak. European EBIT margins saw a good recovery on qoq basis, however it's still low at 4.3% (negative in Q2). High RM prices, costs at Hungary operations and weak demand still impacted European operations. Reifencomm operations revenues remained flat, while margins were at 7%, flat qoq. Overall EBIT at consol levels therefore dropped to 7.6% from 9.7% yoy but moved up from 6.7% qoq as sequential recovery was witnessed there. PAT adjusted for one of item of ₹ 600 mn came in at ₹ 2.6bn, a growth of 39% qoq and 5.2% yoy.

Demand outlook in the domestic markets expected to see recovery albeit at a low pace to start with

Domestic demand for Apollo in Q3 increased by 11% yoy on strong TBR Replacement growth, which grew in line with overall volume growth. Total CV volumes were up by 15%, while PCR volumes declined in lower single digit. OEM growth particularly remained negative on credit crunch and higher base of last year. Management expects strong recovery in February and March continuing with slight recovery in January. Expected infra structure push ahead of elections is expected to push the CV demand further. New launches on the PV side (18% of volumes) will continue to fuel PCR demand for Apollo. On the trucks side (62% volumes), due to BS VI implementation the demand may start moving up from Q1 FY20. Replacement demand on the TBR side, which was the highlight of the quarter is expected to move up on the OEM demand which was high 2-3 years back. Also the anti-dumping duty on Chinese tyres has led to a high Replacement demand, particularly in truck tyres. Management expects a double digit growth in FY 20 volumes on the back of both TBR and PCR demand. Apollo's AP Greenfield plant is expected to come on stream in Q4 of FY20, which would add 3000 tpd of PCR tyres and 15,000 tpd of TBR volumes. The ramped up Chennai plant is also expanding further by 10,000 TBR tpd, which would cater to the expected demand growth. We estimate Apollo's domestic topline to grow at a CAGR of 15% between FY18-FY21E.

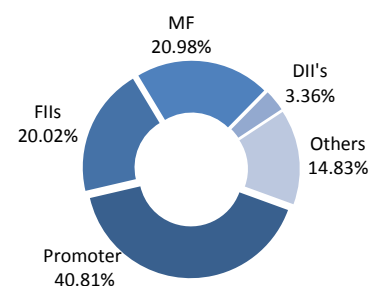
European operations to get a boost from Hungary capacity expansion, Reifencom and recovery in Vredestein operations

Apollo's European operations grew at 8% against 5% growth in the industry in Q3. The company gained market share as both the summer as well as winter tyres attracted robust demand. The company has ramped up capacity at Hungary plant which is currently at 8000 tpd of PCR tyres (planned to move up to 12,000 tpd by FY19E end) and 250 tpd of TBR tyres. Hungary, the Eastern European country has labour costs 50% lower than the Netherlands plant of Vredestein. Also, the manufacturing and transportation costs over there are very low, which will benefit Apollo's margins as capacity ramp up gains momentum. Through this plant the company plans to supply not only to Eastern Europe but also upto the US, the market which they are eyeing now. Reifencom has posted positive 7% margins in Q3, which is a good sign, though its contribution to the topline is small, it has a huge potential to grow given its continent wide sales and distribution network. As Hungary plant gains momentum and reaches full capacity, we expect the startup costs to come down and Europe business to contribute strongly and more profitably to the consol numbers.

Stock Data

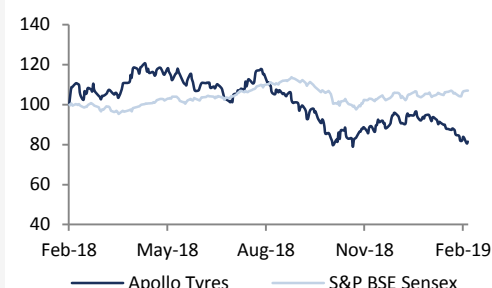
Rating	Buy
Current Market Price(₹)	199
12 M Price Target (₹)	265
Potential upside (%)	33
FV (₹)	1
Market Cap Full (₹ bn)	112
52-Week Range (₹)	307 / 192
BSE / NSE Code	APOLLOTYRE / 500877
Reuters / Bloomberg	APLO.BO / APTY IN

Shareholding Pattern (December 2018)



YE Mar	FY18	FY19E	FY20E	FY21E
Revenues (₹ bn)	148	170	192	220
EBITDA (%)	11.1%	11.1%	12.1%	12.5%
PAT (%)	4.9%	4.8%	5.9%	6.1%
EPS (₹)	14.4	18.2	22.7	26.5
EPS growth (%)	-34.1%	26.7%	24.5%	17.0%
P/E (x)	14.1	11.1	8.9	7.6
P/B (x)	1.0	1.0	0.9	0.8
EV/EBITDA (x)	9.0	8.6	7.6	6.9
ROCE (%)	7.7%	8.1%	8.8%	9.4%
ROE (%)	7.4%	8.7%	9.9%	10.6%
Dividend yield (%)	1.2%	1.4%	1.7%	2.0%

Relative Price Performance



RM costs to provide tailwinds hereon

Though the company is incurring higher capex (outlook of ₹ 25-30bn for next year) in AP, Chennai and Hungary, the Hungary plant ramp up may bring down the costs substantially. The recently turned positive operations of Reifencor may also assist the European margins as it is zero capital intensive. According to management's guidance, RM prices are expected to be benign hereon. NR prices which had gone up significantly in Q2 and Q3 due to Kerala floods are expected to come down with further ease in the situation there. Also with slight reduction in fuel prices, the SR costs are also expected to move down. The company rolled back the 2% price hike taken in Q3 as they witnessed slow demand. Still, realizations moved up by 5% on better product mix tilted towards TBR. In the European markets, the dependence on NR is less (32-33% of sales v/s >55% in India) and the markets display a good price discipline, due to which we are less worried of this business. We foresee traction in margins going forward and estimate 11%/12.1%/12.5% EBITDA margins in FY19E/20E/21E respectively on the conservative side.

Q3FY19 Result Highlights

All fig in ₹ mn	Q3 FY19	Q2 FY19	% qoq	Q3 FY18	% yoy
Total revenues	47,182	42,573	11%	40,500	16%
Raw material expenses	27,852	24,231	15%	22,602	23%
Operating & Manufacturing Expenses	7,572	7,598	0%	7,632	-1%
Employee Cost	6,484	6,071	7%	5,303	22%
EBITDA	5,274	4,673	13%	4,963	6%
EBITDA margins	11.2%	11.0%	20 bps	12.3%	(110 bps)
Depreciation	2,011	1,962	2%	1,513	33%
Other income adjusted	332	123	170%	464	-28%
EBIT	3,595	2,834	27%	3,914	-8%
Interest	485	461	5%	411	18%
PBT	3,109	2,373	31%	3,503	-11%
Tax	529	512	3%	1,050	-50%
Adj Profit After Tax	2,580	1,861	39%	2,453	5%

Source: Company, LKP Research

Outlook and valuation

Strong demand in the medium to long term on the truck side, particularly Replacement and through levers such as infrastructure and regulatory (BS VI implementation in FY20) on the OEM side, and new launches on the PV business. Mining revival itoo bodes well for the TBB tyres. Radialization lies there for Apollo as the company is expanding its Chennai TBR capacity and demand for the high margin TBR tyres is wide spread now. On the European business, Vredestein is witnessing a steady recovery, while Hungary Greenfield stands as the biggest opportunity to ramp up sales and at the same time save bulk of the costs. Although the company is incurring high capex for its new plant at AP, the net debt to equity according to us will not move above a comfortable 0.65-0.7x though the company may raise debt for the same given the cash rich position of Apollo. On margins front, a benign outlook on RM costs may result in improvement in margins hereon. On valuation front, the stock looks very attractive at 7.6x times FY 21E earnings post the recent fall in the stock price. Maintain our BUY rating on the stock with a target price of ₹ 265 (10x times FY 21E earnings).

Financials
Income statement

YE Mar (₹.mn)	FY 18	FY 19E	FY20E	FY21E
Total Revenues	1,48,405	1,70,158	1,92,131	2,19,683
Raw Material Cost	83,954	97,429	1,09,080	1,23,573
Employee Cost	21,566	23,157	25,521	29,186
Other Exp	26,371	30,678	34,355	39,442
EBITDA	16,514	18,894	23,175	27,482
EBITDA Margin(%)	11.1%	11.1%	12.1%	12.5%
Other income	1165	2025	2300	2600
Depreciation	5,925	6,943	8,218	9,368
Interest	1629	1615	1860	2484
PBT	10,125	12,361	15,397	18,229
PBT Margin(%)	6.8%	7.3%	8.0%	8.3%
Tax	2,884	3,186	3,972	4,868
Adj PAT	7,241	8,175	11,426	13,363
Adj PAT Margins (%)	4.9%	4.8%	5.9%	6.1%
Exceptional items	0.0	1000.0	0.0	0.0
PAT	7241	9175	11426	13363
PAT Margin (%)	4.9%	5.4%	5.9%	6.1%

Key Ratios

YE Mar (₹.mn)	FY 18	FY 19E	FY20E	FY21E
Per Share Data (₹)				
Adj. EPS	14.4	18.2	22.7	26.5
CEPS	31.0	26.1	30.0	39.0
BVPS	144.6	194.0	209.5	228.7
DPS	2.5	2.5	2.7	3.4
Growth Ratios(%)				
Total revenues	12.6%	14.7%	12.9%	14.3%
EBITDA	-10.6%	14.4%	22.7%	18.6%
PAT	-34.1%	12.9%	39.8%	17.0%
EPS Growth	-34.1%	26.7%	24.5%	17.0%
Valuation Ratios (x)				
PE	14.1	11.1	8.9	7.6
P/CEPS	26.1	30.0	39.0	45.1
P/BV	1.0	1.0	0.9	0.8
EV/Sales	1.0	1.0	0.9	0.9
EV/EBITDA	9.0	8.6	7.6	6.9
Operating Ratios (Days)				
Inventory days	110.3	115.0	120.0	122.0
Receivable Days	52.5	50.0	48.0	47.0
Payables day	30.8	32.0	34.0	36.0
Net Debt/Equity (x)	0.48	0.58	0.65	0.68
Profitability Ratios (%)				
ROCE	7.7%	8.1%	8.8%	9.4%
ROE	7.4%	8.7%	9.9%	10.6%
Dividend payout	-17.1%	-15.0%	-15.0%	-15.0%
Dividend yield	1.2%	1.4%	1.7%	2.0%

Balance sheet

YE Mar (₹ mn)	FY 18	FY 19E	FY 20E	FY 21E
SOURCES OF FUNDS				
Equity Share Capital	572	572	572	572
Reserves & Surplus	97,194	1,04,993	1,14,705	1,26,064
Total Networkth	97,766	1,05,565	1,15,277	1,26,636
Total debt	45,756	58,756	71,756	84,756
Deferred tax liabilities	8,388	8,388	8,388	8,388
Current liabilities				
Short term borrowings	7,455	8,955	10,455	11,955
Trade payables	24,470	23,309	25,267	28,288
Other current liabilities	14,312	13,112	11,912	10,712
Short term provisions	3,381	4,662	5,790	7,222
Total Current Liabilities	49,618	50,038	53,424	58,177
Total shareholder equity & Liab	2,01,528	2,22,747	2,48,845	2,77,957
APPLICATION OF FUNDS				
Net block	95,287	98,344	1,05,126	1,10,758
Capital WIP	22,682	32,682	37,682	42,682
Intangible Assets	7,041	8,541	10,041	11,541
Long term Investments	54	996	1,196	1,396
Goodwill	2,060	2,380	2,700	3,020
Deferred tax assets	955	1,185	1,415	1,645
Long term loans and advances	4,460	5,660	6,460	7,360
Total non current assets	1,32,539	1,49,787	1,64,619	1,78,401
Current Assets				
Cash and Bank	5,931	6,341	7,040	10,069
Inventories	29,453	30,697	35,862	41,304
Sundry Debtors	14,350	14,918	17,897	21,667
Loan, Advances & others	5,045	6,527	8,949	12,037
Other Current Assets	14,208	14,477	14,478	14,479
Total Assets	2,01,528	2,22,747	2,48,845	2,77,957

Cash Flow

YE Mar (₹ mn)	FY 18	FY 19E	FY 20E	FY 21E
PBT	10,123	12,361	15,397	18,229
Depreciation	5,925	6,943	8,218	9,368
Interest	5,925	6,943	8,218	9,368
Chng in working capital	3,127	-4,642	-8,682	-9,049
Tax paid	-2,464	-3,186	-3,972	-4,868
Other operating activities	-1,153	0	0	0
Cash flow from operations (a)	17,197	13,090	12,822	16,165
Capital expenditure	-30,672	-20,000	-20,000	-20,000
Chng in investments	-49	2,226	2,226	2,226
Other investing activities	-7,907	-3,790	-3,776	-3,876
Cash flow from investing (b)	-38,628	-21,564	-21,550	-21,650
Free cash flow (a+b)	-21,431	-8,474	-8,728	-5,485
Inc/dec in borrowings	15,037	13,000	13,000	13,000
Dividend paid (incl. tax)	-1,837	-1,376	-1,714	-2,005
Other financing activities	1,513	-1,615	-1,859	-2,482
Cash flow from financing (c)	26,045	10,009	9,427	8,513
Net chng in cash (a+b+c)	4,614	1,536	699	3,029
Closing cash & cash equiv	191	4,806	6,341	7,040
Adj. Closing cash & cash eqvts	4,806	6,341	7,040	10,069

Source: Company, LKP Research

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