

Buy

Apollo Tyres

Industry: Auto Components

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India Replacement demand to drive business, Europe a key monitorable

European Margins a miss, impacted the overall numbers in Q4

Apollo's standalone net sales slowed down to 6% yoy while falling by 3.1% qoq to ₹ 29.6bn. The yoy growth came on the back of a strong India replacement volume growth, out of which the Truck segment volumes grew at 8% and car segment volumes grew 7%. OEM segment sales remained in negative territory. On a sequential basis, volumes declined as OE segment declined much steeper. The company did not take any price change in Q4 though RM prices started to move down and they had rolled back a price hike last quarter. RM prices saw a drop of 3.7% qoq as the RM price basket showed a benign growth. Hence, at the EBITDA levels, margins improved to 11.8% marginally by 60 bps, while on a yoy basis they still saw a drop of 260 bps. Depreciation moved up by 26% yoy as AP plant ramp up is progressing. Lower tax rate and higher other income led to just an 8.2% yoy drop in profits, while qoq the profits jumped by 12.2% to ₹ 2.05 bn.

While standalone business was buoyed up by Replacement sales, the consolidated business was dragged down due to European business. Consolidated net sales grew by just 6% yoy and dropped by 9% qoq to ₹ 42.7 bn. Europe witnessed a volume drop in Q4 as against 7% growth in FY 19 (the European industry grew by only 1% in FY 19). This was on the back of overall fall across industry as demand remained weak. European sales dropped by 4% to Euro 128 mn while EBITDA margins were all time low at 6.1% despite pricing and product mix providing some respite. Low demand led to Hungary operations going a bit slow on production. Reifencomm operations revenues grew by 3%, while margins were at 1-2%. Overall EBITDA at consol levels therefore dropped to 9.9% from 12.8% yoy during the quarter, while FY EBITDA came down a bit at 12.5% as European EBITDA dropped at 8.8%. PAT adjusted for one of item of ₹ 1000 mn came in at ₹ 1.84 bn, a de-growth of 27% yoy and 29% qoy.

Management sounded upbeat on Replacement demand, expects OEM to recover later

Domestic demand for Apollo in Q4 was driven by a strong growth in Replacement segment, while OEM growth faltered. Total CV volumes were up by 8%, out of which Radial segment was much higher than the Bias one. PCR replacement was up by 7%, which was a strong sequential growth. OEM growth particularly remained negative on credit crunch and higher base of last year. Management expects strong recovery in H2 as the industry is expected to revive overall. 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 Q2 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. 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 FY 20, 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 14% between FY18-FY21E.

Management gives positive outlook on Europe as Hungary plant ramps up

Apollo's European operations grew at 6% yoy while falling by 24% qoq as demand falls. The company's market share remained flat at 3% as it gave up all the market share in Q4 which was gained in earlier quarters. The company went a bit slow on production from Hungary as demand slowed down in Q4 on overall European market conditions getting soft. Apollo produced 4.5 mn tyres from Netherlands while 2.1 mn tyres from Hungary in FY 19. The company has set an annual target to produce <4mn tyres from Netherlands and 3.5 mn tyres from Hungary in FY 20E with capacity of <4mn at Netherlands and 4.5 mn at Hungary. 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. Reifencomm posted a stable growth as per its size, but has a good 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. With recovery expected in FY 20E, and some OEM business wins just like they had from Audi in Q4, management targets about 15-16% volume growth in Europe for FY 20E.

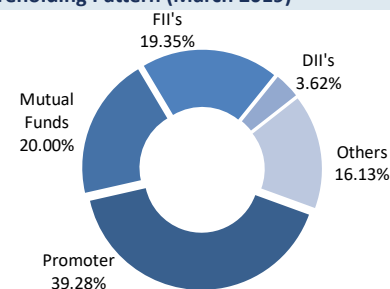
Stock Data

Rating	Buy
Current Market Price(₹)	189
12 M Price Target (₹)	223
Potential upside (%)	18
FV (₹)	1
Market Cap Full (₹ bn)	109
52-Week Range (₹)	299.80 / 182.20
BSE / NSE Code	APOLLTYRE / 500877
Reuters / Bloomberg	APLO.BO / APTY IN

What's Changed

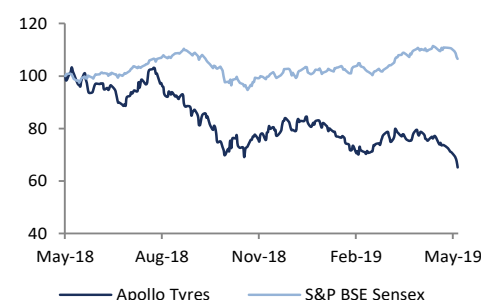
12 month Price Target (₹)	From 265 to 223
FY2020E EPS (₹)	From 22.7 to 19.7
FY2021E EPS (₹)	From 26.5 to 24.8

Shareholding Pattern (March 2019)



YE Mar	FY 18	FY 19	FY 20E	FY 21E
Revenues (₹ bn)	148	175	192	220
EBITDA (%)	11.1%	11.2%	12.0%	12.5%
PAT (%)	4.9%	3.9%	5.2%	5.7%
EPS (₹)	14.3	17.5	19.7	24.8
EPS growth (%)	-34.3%	21.9%	13.0%	25.7%
P/E (x)	13.2	10.8	9.6	7.6
P/B(x)	1.0	0.9	0.9	0.8
EV/EBITDA (x)	8.6	7.3	6.6	5.8
ROCE(%)	7.7%	8.0%	8.7%	9.9%
ROE(%)	7.4%	8.8%	9.1%	10.5%
Dividend yield (%)	1.3%	1.4%	1.6%	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 steady state 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, which have already started to be so from Q4. NR prices which had gone up significantly in Q2 and Q3 due to Kerala floods are expected to be coming down with further ease in the situation there. Also with slight reduction in fuel prices, the SR costs are also expected to move down. In such scenario, the company can afford to take a price cut to enhance volumes and maintain margins. 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. With Hungary plant ramp-up and demand expected to be a bit better than Q4 in FY 20E, we expect an improvement in margins hereon with an estimate of 12%/12.5% EBITDA margins in FY20E/21E respectively.

Q3FY19 Result Highlights

All fig in ₹ mn	Q4 FY19	Q3 FY 19	% qoq	Q4 FY18	% yoy
Total revenues	42,737	47,182	-9%	40,313	6%
Raw material expenses	24,850	27,852	-11%	22,053	13%
Operating & Mfg. Expenses	7,460	7,572	-1%	7,072	5%
Employee Cost	6,181	6,484	-5%	6,035	2%
EBITDA	4,246	5,274	-19%	5,153	-18%
EBITDA margins	9.9%	11.2%	(120 bps)	12.8%	(290 bps)
Depreciation	2,313	2,011	15%	1,768	31%
Other income adjusted	485	332	46%	437	11%
EBIT	2,418	3,595	-33%	3,822	-37%
Interest	434	485	-11%	475	-9%
PBT	1,984	3,109	-36%	3,347	-41%
Tax	144	529	-73%	843	-83%
Adj Profit After Tax	1,840	2,580	-29%	2,504	-27%

Source: Company, LKP Research

Outlook and valuation

Strong replacement demand on the truck as well as car side, and levers such as infrastructure and regulatory drivers (BS VI implementation in FY 20) on the OEM side (from H2), along with new launches on the PV business with global entrants as well coming in, may keep the domestic tyre industry buoyant. Mining revival also bodes well for TBB tyres. Radialization is picking up well (60% up from 50% couple of years ago) for Apollo as the company is expanding its Chennai TBR capacity and demand for the high margin TBR tyres is also expanding very aggressively. On the European business, Vredestein slowed down in Q4, while the 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 0.5-0.6x although 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. We prune down our estimates on weak Europe and domestic OEM concerns. However, we maintain BUY with a reduced target price of ₹ 223 (9x times FY 21E earnings).

Financials
Income statement

YE Mar (₹ mn)	FY 18	FY 19	FY 20E	FY 21E
Total Revenues	148,405	175,488	192,131	219,683
Raw Material Cost	83,954	101,265	109,506	124,386
Employee Cost	21,566	24,562	25,681	28,954
Other Exp	26,371	30,075	33,928	38,978
EBITDA	16,514	19,586	23,016	27,365
EBITDA Margin(%)	11.1%	11.2%	12.0%	12.5%
Other income	1142	1231	1550	1760
Depreciation	5,925	8,126	9,284	9,949
Interest	1629	1810	1928	2150
PBT	10,102	10,881	13,354	17,026
PBT Margin(%)	6.8%	6.2%	7.0%	7.8%
Tax	2,884	2,082	3,415	4,536
Adj PAT	7,218	6,799	9,940	12,493
Adj PAT Margins (%)	4.9%	3.9%	5.2%	5.7%
Exceptional items	0.0	2000.0	0.0	0.0
PAT	7218	8799	9940	12493
PAT Margin (%)	4.9%	5.0%	5.2%	5.7%

Key Ratios

YE Mar	FY 18	FY 19	FY 20E	FY 21E
Per Share Data (₹)				
Adj. EPS	14.3	17.5	19.7	24.8
CEPS	31.0	26.1	29.6	38.1
BVPS	144.6	194.0	199.2	216.0
DPS	2.5	2.5	2.6	3.0
Growth Ratios(%)				
Total revenues	12.6%	18.2%	9.5%	14.3%
EBITDA	-10.6%	18.6%	17.5%	18.9%
PAT	-34.3%	-5.8%	46.2%	25.7%
EPS Growth	-34.3%	21.9%	13.0%	25.7%
Valuation Ratios (x)				
PE	13.2	10.8	9.6	7.6
P/CEPS	26.1	29.6	38.1	44.5
P/BV	1.0	0.9	0.9	0.8
EV/Sales	1.0	0.8	0.8	0.7
EV/EBITDA	8.6	7.3	6.6	5.8
Operating Ratios (Days)				
Inventory days	106.2	116.1	127.0	132.0
Receivable Days	50.9	42.7	39.0	36.0
Payables day	29.8	21.9	20.0	20.0
Net Debt/Equity (x)	0.48	0.48	0.51	0.54
Profitability Ratios (%)				
ROCE	7.7%	8.0%	8.7%	9.9%
ROE	7.4%	8.8%	9.1%	10.5%
Dividend payout	-17.1%	-15.0%	-15.0%	-15.0%
Dividend yield	1.3%	1.4%	1.6%	2.0%
PEG	0.9	0.6	0.5	0.4
EPS Growth	15.4	18.4	19.4	20.4

Balance sheet

YE Mar (₹ mn)	FY 18	FY 19	FY 20E	FY 21E
SOURCES OF FUNDS				
Equity Share Capital	572	572	572	572
Reserves & Surplus	97,194	99,826	108,275	118,894
Total Networkth	97,766	100,398	108,847	119,466
Total debt	45,755	49,637	57,637	65,637
Deferred tax liabilities	8,388	8,231	8,231	8,231
Current liabilities				
Short term borrowings	7,455	3,743	3,743	3,743
Trade payables	24,470	22,483	20,529	21,667
Other current liabilities	14,312	13,423	12,223	11,023
Short term provisions	3,381	2,517	2,517	2,517
Total Current Liabilities	49,618	42,166	39,012	38,950
Total shareholder equity and Liabilities	201,527	200,432	213,727	232,284
APPLICATION OF FUNDS				
Net block	95,287	108,837	114,877	119,928
Capital WIP	22,682	15,200	20,200	25,200
Intangible Assets	7,041	6,900	6,900	6,900
Long term Investments	35	60	60	60
Goodwill	2,060	1,993	1,993	1,993
Deferred tax assets	955	525	525	525
Long term loans and advances	4,480	9,629	9,629	9,629
Total non current assets	132,540	143,144	154,184	164,235
Current Assets				
Cash and Bank	5,991	5,626	5,683	5,117
Inventories	29,453	34,840	38,102	44,984
Sundry Debtors	14,350	11,546	10,528	12,037
Loan, Advances & others	5,045	4,847	4,737	5,417
Other Current Assets	14,152	427	427	427
Total Assets	201,527	200,432	213,727	232,284

Cash Flow

YE Mar (₹ mn)	FY 18E	FY 19P	FY 20E	FY 21E
PBT	10,123	10,881	13,354	17,026
Depreciation	5,925	8,126	9,284	9,949
Interest	5,925	8,126	9,284	9,949
Chng in working capital	3,127	(5,790)	(5,288)	(9,132)
Tax paid	(2,464)	(2,082)	(3,415)	(4,536)
Other operating activities	(1,153)	(5,218)	5,707	0
Cash flow from operations (a)	17,197	7,727	21,569	15,458
Capital expenditure	(30,672)	(2,518)	(32,000)	(20,000)
Chng in investments	(49)	0	0	0
Other investing activities	(7,907)	(5,077)	5,907	0
Cash flow from investing (b)	(38,628)	(7,595)	(26,093)	(20,000)
Free cash flow (a+b)	(21,431)	132	(4,524)	(4,542)
Inc/dec in borrowings	15,037	3,882	8,000	8,000
Dividend paid (incl. tax)	(1,837)	(1,320)	(1,491)	(1,874)
Other financing activities	1,513	(1,874)	(1,928)	(2,150)
Cash flow from financing (c)	26,045	688	4,581	3,976
Net chng in cash (a+b+c)	4,614	820	57	(566)
Closing cash & cash equivalents	191	4,806	5,626	5,683
Adj. Closing cash & cash eqvts	4,806	5,626	5,683	5,117

Source: Company, LKP Research

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