Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Apollo Tyres Ltd

Raw material inflation dented margins

Automobiles	Sharekhan code: APOLLOTYRE

Reco/View: Buy	↔	CMP: Rs. 512	Price Target: Rs. 563	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Company details

Market cap:	Rs. 32,517 cr
52-week high/low:	Rs. 568/366
NSE volume: (No of shares)	27.3 lakh
BSE code:	500877
NSE code:	APOLLOTYRE
Free float: (No of shares)	39.8 cr

Shareholding (%)

Promoters	37.4
FII	14.5
DII	25.1
Others	23.1

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-2.1	6.7	-3.0	18.2
Relative to Sensex	-0.7	-0.6	-12.6	-0.4

Sharekhan Research, Bloomberg

Summary

- Missed EBITDA margin estimates by 160 bps and hence reported below estimated bottom-line.
- It needs an aggregate price hike of up to 5% to cover under recoveries due to rise in RM costs so far.
- We maintain a Buy on the stock with an unchanged PT of Rs. 563 in expectation of continuation of premiumisation trend in its model mix, rise in replacement demand and healthy market share gain in the European business.
- Stock trades at a P/E multiple of 15.5x and EV/EBITDA multiple of 7.4x its FY26 estimates.

Apollo (ATL) missed EBITDA margin estimates by 160 bps due to higher-than-expected other expenses and employee cost as slow growth in topline and RM cost pressure on q-o-q basis was expected. With unfavourable operating cost matrix AEBITDA /APAT came 8.5%/ 14.0% below estimates. Revenue increased by 1.4% y-o-y to Rs 6335 crore (against estimate of Rs 6211 crore) led by 5.5% y-o-y growth in revenue from APMEA as revenue from Europe has declined by 8.0% y-o-y. EBITDA declined by 13.5% y-o-y to Rs 909 crore (against estimate of Rs 994 crore). Despite a 50 bps y-o-y rise in gross margins, EBITDA margin shrunk by 250 bps y-o-y to 14.4% (against estimate of 16%) due to 70 bps / 220 bps expansion in employee costs/ other expenses as a percentage of sales. Though the gross margin has expanded y-o-y basis, the same contracted by 170 bps q-o- q due to rise in input costs. APAT has declined by 18.5% y-o-y to Rs 331 crore (against estimate of Rs 385 crore).

Key positives

- APMEA business grew 5.5% on a y-o-y basis.
- Gross margin expanded by 50 bps y-o-y.
- Overall volumes grew by mid-single digit rate in Q1FY25 in support of a double-digit growth in exports and mid-single digit growth in the replacement segment (TBR, PCR).

Key negatives

- European business grew 8% y-o-y
- Other expenses expanded by 220 bps as a percentage of sales.
- RM basket gone up by 5% QoQ in Q1FY25.

Management Commentary

- European business would grow by mid- to high-single digit rate in FY25.
- In Q2FY25, ATL has implemented a ~1% price hike to mitigate RM cost pressures and may need an additional 4% rise to offset inflation in Indian business.
- Management is continuing to look for profitable volume growth along with healthy cash flow and judicious capex.

Our Call

Valuation – Maintain BUY with an unchanged PT of Rs. 563: ATL's margins were primarily hit by a 5% q-o-q rise in RM costs, with expectations for further hikes in Q2FY25. The company anticipates some RM cost softening by Q4 and may require aggregate price hikes of over 5% to counter RM cost inflation. Other expenses rose due to advertising and EPR costs. Additional expenses are related to internal restructuring for long-term goals. While EBITDA margins are in pressure due to RM cost inflation and weakness in OEM segment, the company continue to target for a over 15% EBITDA margin in long term. Current TBR utilization is at 70%, and PCR capacity utilization is in the mid-80% range. The company does not foresee a need for aggressive capex in the near term. Going forward, the management expects an improvement in topline and margin performance in European business. European business is expected to grow by mid to high single-digit rate in FY25. The company anticipates an improvement in demand, driven by replacement demand and a recovery in the farm segment. It expects the replacement segment to grow by high single-digits in FY25. Post factoring in Q1FY2025 performance in our earnings estimates, we maintain a Buy on the stock with an unchanged PT of Rs. 563 in expectation of continuation of premiumisation trend in its model mix, a rise in replacement demand and healthy market share gains in the European business.

Key Risks

A sharp rise in raw material prices and its inability to pass on increased cost to customers would affect OPM. Delay in demand recovery post election in the domestic market would hit overall growth.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24	FY25E	FY26E
Revenues	20,948	24,568	25,378	26,768	28,236
Growth (%)	20.4	17.3	3.3	5.5	5.5
EBIDTA	2,574	3,314	4,447	4,261	4,870
OPM (%)	12.3	13.5	17.5	15.9	17.2
Adjusted PAT	644	1,082	1,799	1,715	2,104
% YoY growth	-32.7	67.9	66.3	-4.7	22.7
Adjusted EPS (Rs)	10.1	17.0	28.3	27.0	33.1
P/E (x)	50.5	30.1	18.1	19.0	15.5
P/B (x)	2.8	2.5	2.3	2.1	1.9
EV/EBITDA (x)	14.8	11.4	8.1	8.5	7.4
RoE (%)	5.5	8.4	12.9	11.1	12.1
RoCE (%)	5.1	7.6	11.2	9.7	10.6

Source: Company; Sharekhan estimates

Indian business

- The management appears to be grappling with balancing profitability and market share amidst competitive pressures.
- Q1FY25 was challenging with muted operating performance. Margins were affected by raw material (RM) cost inflation.
- Overall volumes grew by mid-single digit rate in Q1FY25 in support of double-digit growth in exports and mid-single digit growth in replacement segment (TBR, PCR). The OEM segment registered a mid-single-digit decline. ATL has seen weakness in truck OEM segment, though recovery is expected in the second half of FY25.
- As per the management's assessment, the company may have lost market share in the truck segment, with a market share of 28-29% in the truck segment and 20% in the PCR segment in FY24.
- ATL will begin supplying a German PV manufacturer in India and is enhancing its product portfolio to improve profitability. However, the company does not compete in the bus segment within CVs, which saw better growth industry-wide this quarter.
- Current TBR utilization is at 70%, and PCR capacity utilization is in the mid-80% range. The company does not foresee a need for aggressive capex in the near term.
- In Q2FY25, ATL has implemented a ~1% price hike to mitigate RM cost pressures and may need an additional 4% increase to offset inflation. A 2% price hike in the PV segment and a 1% increase in the CV segment were implemented in Q1FY25, along with a 0.7% increase to cover EPR costs in May.
- During the quarter, commodity prices were Rs. 180/kg for rubber, Rs. 180/kg for synthetic rubber, and Rs. 120/kg for carbon black.

Europe business

- European business has registered marginal volume growth (1%) and reported a revenue at Euro 146 million and EBITDA at Euro 20 million.
- No major pricing action was taken in the European business as competition has also not driven up prices in the market.
- The European constitutes less proportion of natural rubber than the Indian business and hence would have a delayed impact of rise in natural rubber prices on margins.
- Going forward, the management expects an improvement in topline and margin performance in European business.
- European business is expected to grow by mid to high single digit rate in FY25.

Outlook:

- The management is continuing to look for profitable volume growth along with healthy cash flow and a judicious capex.
- Long-term margin target remains above 15% but in the immediate near term the margins may remain soft due to RM cost pressure.
- Gross margins would deteriorate in Q2FY25 also .It requires a price hike of upto 5% to cover up the increase in RM cost.
- Volume trends are expected to be better in coming months in replacement market.
- ATL anticipates an improvement in demand driven by replacement demand and recovery in the farm segment. It expects the replacement segment to grow by high single digits in FY25.

Results (Consolidated) Rs cr

Particulars	Q1FY25	Q1FY24	% YoY	Q4FY24	% QoQ
Revenue	6,335	6,245	1.4	6,258	1.2
Total Expenses	5,426	5,193	4.5	5,230	3.7
EBITDA	909	1,051	(13.5)	1,028	(11.5)
Depreciation	370	362	2.1	388	(4.8)
Interest	107	135	(21.0)	115	(6.7)
PBT	423	576	(26.6)	563	(24.8)
Tax	121	179	(32.5)	209	(42.0)
Share Of profit from Associates	0.03	0.04	NA	0.11	NA
Reported PAT	302	397	(23.9)	354	(14.7)
Adj Net Profit	331	406	(18.5)	377	(12.3)
Adjusted EPS (Rs)	5.2	6.4	(18.5)	5.9	(12.3)

Source: Company, Sharekhan Research

Key Ratios (Consolidated)

Particulars	Q1FY25	Q1FY24	YoY (bps)	Q4FY24	QoQ (bps)
Gross margin (%)	45.5	45.0	50	47.2	(170)
EBIDTA margin (%)	14.4	16.8	(250)	16.4	(210)
Net profit margin (%)	5.2	6.5	(130)	6.0	(80)
Effective tax rate (%)	28.6	31.1	(250)	37.1	(850)

Outlook and Valuation

■ Sector Outlook – Strong recovery eyed

We expect the domestic tyre industry to benefit from a recovery in automobile sales in rural and semi-urban markets, driven by pent-up demand, preference for personal mobility and faster-than-expected recovery in infrastructure, mining, and other economic activities. The tyre industry is well positioned to gain momentum in the future, backed by higher OEM offtake. The ripple effect of OEM demand is likely to result in steady growth for the replacement demand. Further sharp correction in RM basket augurs well for the surge in profitability.

■ Company Outlook – Convincing strategy to achieve a profitable growth model

The management has laid down its long-term targets to achieve revenue of US$5 billion by FY2026, an EBITDA margin profile to reach at least 15%, ROCE of 12-15%, and net debt to EBITDA of less than 2x. The replacement volumes are expected to recover with a recovery in macro-economic activities. Overseas business is expected to do well because of a richer product mix and gradual capacity additions.

■ Valuation – Maintain BUY with an unchanged PT of Rs. 563

ATL's margins were primarily hit by a 5% q-o-q rise in RM costs, with expectations for further hikes in Q2FY25. The company anticipates some RM cost softening by Q4 and may require aggregate price hikes of over 5% to counter RM cost inflation. Other expenses rose due to advertising and EPR costs. Additional expenses are related to internal restructuring for long-term goals. While EBITDA margins are in pressure due to RM cost inflation and weakness in OEM segment, the company continue to target for a over 15% EBITDA margin in long term. Current TBR utilization is at 70%, and PCR capacity utilization is in the mid-80% range. The company does not foresee a need for aggressive capex in the near term. Going forward, the management expects an improvement in topline and margin performance in European business. European business is expected to grow by mid to high single-digit rate in FY25. The company anticipates an improvement in demand, driven by replacement demand and a recovery in the farm segment. It expects the replacement segment to grow by high single-digits in FY25.Post factoring in Q1FY2025 performance in our earnings estimates, we maintain a Buy on the stock with an unchanged PT of Rs. 563 in expectation of continuation of premiumisation trend in its model mix, a rise in replacement demand and healthy market share gains in the European business.

Change in earning estimates (Rs cr)

Change in estimates	Earlier		New		% change	
	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Revenue	26,768	28,236	26,768	28,236	0.0%	0.0%
EBITDA	4,529	4,870	4,261	4,870	-5.9%	0.0%
EBITDA margin	16.9%	17.2%	15.9%	17.2%		
PAT	1,900	2,104	1,715	2,104	-9.7%	0.0%
EPS (Rs)	29.9	33.1	27.0	33.1	-9.7%	0.0%

Source: Company, Sharekhan Research

About the company

ATL is the second largest tyre manufacturer in India. ATL is a diversified player present in India as well as Europe. APMEA business contributes about 67% to revenue, while European business contributes about 29%. With its recent entry into the two-wheeler space, ATL has become a full-fledged tyre player present across automotive categories viz. passenger vehicles, commercial vehicles, and two-wheelers. The OEM segment contributes about 23% to revenue, while the replacement segment accounts for the balance 77%.

Investment theme

ATL is one of the leading tyre companies in India, with a leadership position in the largest truck and bus tyre segment. The company is also one of India's leading players in the passenger vehicle segment. Over the past few years, ATL has been increasing its presence globally and acquired businesses in Europe, which has opened new markets for the company and strengthened its R&D capabilities globally. ATL is expected to gain market share in other segments and in multiple geographies (e.g. Vredestein in passenger vehicles and Apollo in truck and bus segments), driven by a strong brand, R&D, technology, and distribution network. In addition, the company will operationally improve its margin, aided by specialisation of Dutch plant (through a significant uptick in cost competitiveness, given ramping up production in Hungary); cost reductions through the digitalization of its businesses, and improvement in passenger vehicle mix.

Key Risks

ATL derives about 30% of its revenue from European operations, which exposes it to currency risks. Any adverse movement in the INR-Euro pair would impact its financial performance.

Additional Data

Key management personnel

Onkar Singh Kanwar	Chairman
Mr Neeraj Kanwar	Managing Director
Gaurav Kumar	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Sunrays Properties & Investment Co	31.85
2	Emerald Sage Investment Ltd	9.93
3	HDFC Asset Management Co Ltd	9.38
4	Kotak Mahindra Asset Management Co	3.38
5	Classic Industries & Exports Ltd	2.94
6	Mehta Ashwin Shantilal	2.13
7	Republic of Singapore	1.91
8	Mirae Asset Global Investments Co	1.76
9	PTL Enterprises Ltd	1.69
10	Vanguard Group Inc/The	1.58

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/ weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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