Apollo Tyres

(APLO.BO / APTY IN)

Rating	OUTPERFORM* [V]
Price (31 Aug 10, Rs)	71.95
Target price (Rs)	108.00[1]
Chg to TP (%)	50.1
Market cap. (Rs mn)	36,264.60 (US$ 770.52)
Enterprise value (Rs mn)	57,404
Number of shares (mn)	504.03
Free float (%)	39.35
52-week price range	81.30 - 41.45

**Stock ratings are relative to the relevant country benchmark.*
[1]Target price is for 12 months.
[V] = Stock considered volatile (see Disclosure Appendix).

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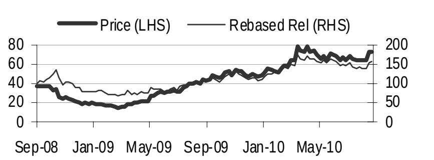
INITIATION

Structurally better

- **Initiate with OUTPERFORM:** We initiate coverage of Apollo Tyres with an OUTPERFORM rating and target price of Rs108, implying potential upside of 50% from current levels.
- **Conducive operating environment:** We believe that the Indian tyre industry is in midst of a very favourable supply-demand scenario and expect capacity utilisation levels to remain close to 100% for the next three years. The resultant pricing power is amply visible in both replacement market and, for the first time, with auto makers (OEMs). The recent margin trends, apparently hurt by record-high input costs, are significantly higher than previous episodes of such cost pressures and are likely to recover faster than that in previous cycles. The longer-term trends of improving mix, in terms of the user segment (increasing sales to passenger cars) and product type (truck radials) are supportive of sustainably enhanced profitability. Apollo Tyres is well positioned to capture these trends and grow its consolidated earnings 31% p.a. in FY11-13E. We also like its ambitious international strategy, supported by its two value-accretive acquisitions.
- **Pricing power and monetisation of investments to benefit:** We expect tyre manufacturers to increase prices further in the near future to pass on raw material cost inflation. Fall in rubber prices could also lead to better share price performance. However, further increase in rubber prices would hurt margins, at least temporarily. Apollo Tyres will also benefit from commercialisation of its new plant and the resultant operating leverage.
- **Rerating justified:** We set a target price of Rs108, valuing Apollo Tyres at an EV of 5.5x FY12 EBIDTA (9.4x FY12E EPS), in line with its global peers. We believe that its historical discount to global peers and the Indian market is not justified anymore, given the structural changes in the tyre industry. Apollo Tyres is one of the best ways to play the Indian economic cycle.

Share price performance



The price relative chart measures performance against the BOMBAY SE 30 SHARE SENSITIVE index which closed at 17971.12 on 31/08/10
On 31/08/10 the spot exchange rate was Rs47.07/US$1

Performance Over	1M	3M	12M
Absolute (%)	12.6	0.9	69.1
Relative (%)	12.0	-4.9	47.4

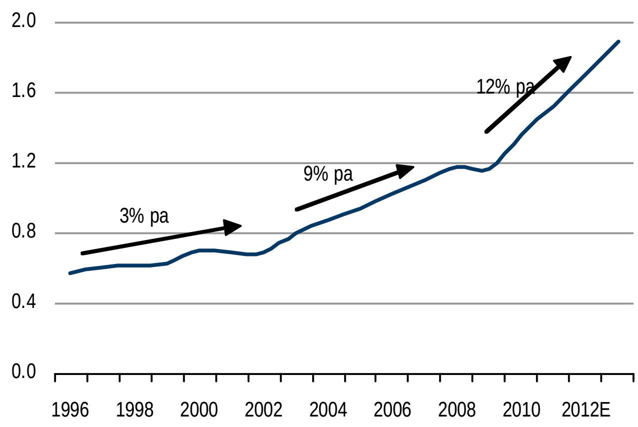
Financial and valuation metrics

Year	3/10A	3/11E	3/12E	3/13E
Revenue (Rs mn)	81,207.4	90,725.5	104,464.9	116,992.0
EBITDA (Rs mn)	11,748.8	10,258.4	13,781.1	16,041.9
EBIT (Rs mn)	9,206.5	7,458.4	10,349.1	12,128.9
Net income (Rs mn)	5,659.8	4,106.0	5,821.7	7,061.0
EPS (CS adj.) (Rs)	11.23	8.15	11.55	14.01
Change from previous EPS (%)	n.a.			
Consensus EPS (Rs)	n.a.	8.7	10.6	11.1
EPS growth (%)	306.7	-27.5	41.8	21.3
P/E (x)	6.4	8.8	6.2	5.1
Dividend yield (%)	1.0	1.0	1.4	1.7
EV/EBITDA (x)	4.2	5.6	4.1	3.3
P/B (x)	1.8	1.6	1.3	1.0
ROE	28.8	17.6	20.4	20.2
Net debt/equity (%)	69.0	90.6	70.3	49.9

Source: Company data, Thomson Reuters, Credit Suisse estimates.

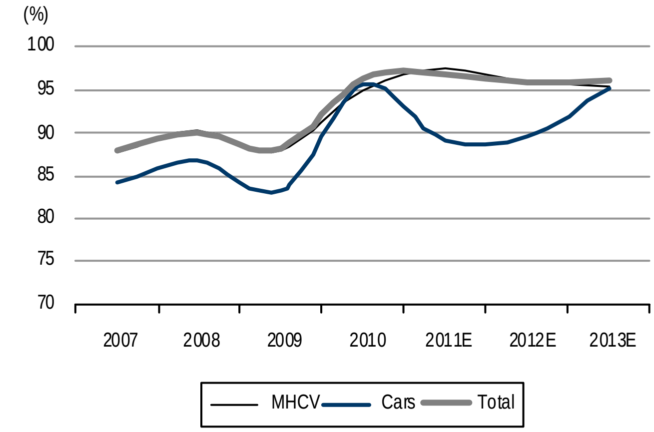
Focus charts

Figure 1: **Tyre demand poised for strong growth**



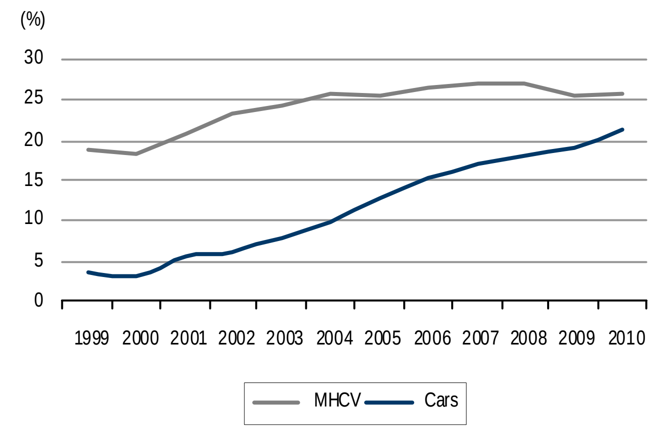
Source: ATMA, Credit Suisse estimates

Figure 2: **Capacity utilisation to remain high**



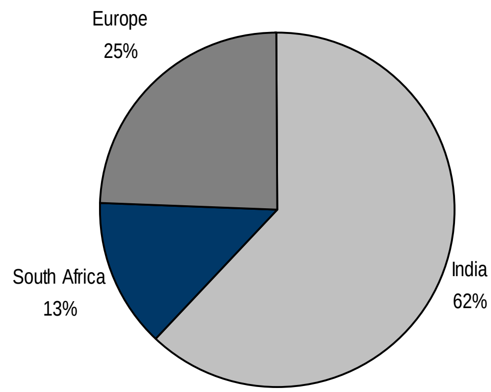
Source: ATMA, Company data, Credit Suisse estimates

Figure 3: **Apollo's market share has risen sharply**



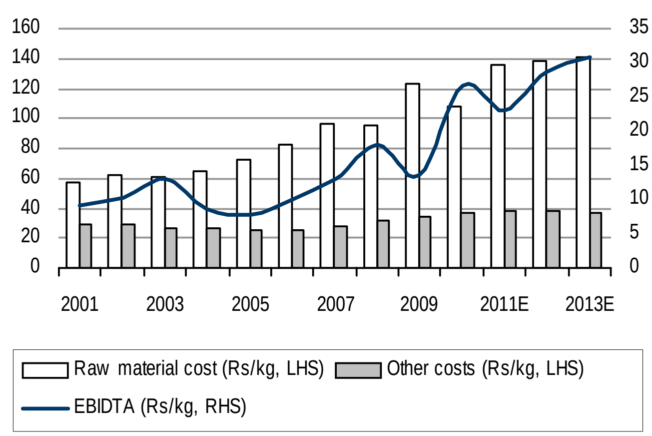
Source: Company data, Credit Suisse estimates

Figure 4: **Geographical breakdown of Apollo's revenue**



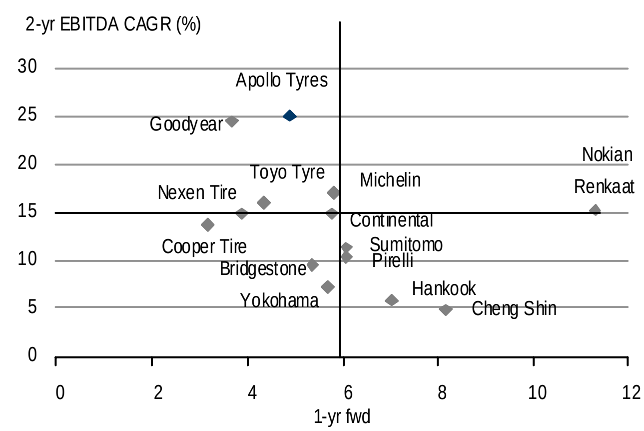
Source: Company data, Credit Suisse estimates

Figure 5: **Analysis of P&L on per kg basis**



Source: Company data, Credit Suisse estimates

Figure 6: **Global comparison**



Source: Bloomberg, Credit Suisse estimates

Structurally better

Apollo Tyres is set for strong growth, benefiting from: 1) strong auto sales growth, 2) strong replacement market growth on the back of the recent increase in the number of vehicles, 3) favourable supply-demand scenario, 4) commercialisation of its new plant and 5) successful integration of its recently-acquired subsidiaries. We believe Apollo Tyres is one of the best ways to play the auto boom in India.

Apollo Tyres is set for strong structural growth backed by growing auto sales, and the company's organic and inorganic expansion

Conducive operating environment

The Indian tyre industry is set to benefit from strong growth in demand for tyres, both from OEMs and replacement market. Our core thesis is premised on an acceleration in vehicle ownership, both passenger and commercial, driven by strong underlying economy growth. We expect total tyre demand (in tonnage terms) to grow 11.8% p.a. in FY10-13E, up from 7.3% p.a. in FY07-10. Supply expansion, on the other hand, will likely lag significantly, at least until FY13E, and especially in the crucial truck and bus segment. As a result, we expect industry utilisation levels to stay at high levels (90%-plus), boosting pricing power. Longer-term trends, in terms of higher proportion of sales to PV consumers and radialisation of truck tyres, are also supportive of better profitability. In the near term, we expect tyre manufacturers to overcome historically high input costs (rubber price) through price hikes and recover margins.

We expect total tyre demand (in tonnage terms) to grow 11.8% p.a. in FY10-13E, up from 7.3% p.a. in FY07-10. Supply expansion, on the other had, will likely significantly lag

Well positioned to capture the trend

Apollo Tyres is well positioned to participate in the profitable growth trends in the industry. While the company has increased share in all its segments, increase in passenger car radial market share is a clear demonstration of Apollo's brand and distribution strength. Apollo's significant investment in the truck radial facility is extremely well timed, in our view. We also like the company's international foray and expect both its recently-acquired subsidiaries to add significant value in the long term.

Apollo Tyres has a strong presence in its key segments and is well positioned to capture the growth trends in the industry

Investments done; benefits to follow

Over FY10-11E, Apollo Tyres would have made significant investments, both organic (new plant in India leading to 60% increase in domestic capacity) and inorganic (Europe). We expect the company to benefit from commercialisation of these investments. We forecast standalone ROE to recover from the cyclical low of 12.9% in FY11E (previous cyclical lows of about 5%) and sustain over 15% from FY12E, benefiting from commercialisation of its new plant and from improved industry dynamics. Indian operations will also be significantly cash flow positive from FY12E, post capacity expansion. The consolidated entity will likely benefit from normalisation of key subsidiaries. We forecast consolidated EBIDTA to grow 25% p.a. in FY11-13E and consolidated EPS to grow 31% in the same period.

We forecast standalone ROE to recover from cyclical low of 12.9% in FY11E (previous lows c5%) benefiting from commercialisation of its new plant and improved industry dynamics

Rerating justified

Apollo Tyres (and other Indian tyre stocks) has historically traded at lower-than-market multiples and at a large discount to global peers. With a significant improvement in industry supply-demand scenario, we expect tyre companies' pricing power to improve substantially, helping margins to break out of its commodity dependence. Moreover, we expect Apollo Tyres to improve its return ratios, benefiting from the commercialisation of recent investments. We set a target price of Rs108 per share, valuing Apollo Tyres at at an EV of 5.5x FY12E EBIDTA, in line with its global peers. At our target price, Apollo Tyres would trade at 9.4x FY12E, at a significant discount to market and auto sector multiples. We believe Apollo Tyres is one of the best ways to play the momentum in vehicle sales, as well as the Indian economy.

We see margins for Apollo Tyres breaking out of their commodity dependence, given the vastly improving industry dynamics. We set a target price of Rs108, valuing Apollo Tyres at an EV of 5.5x FY12E EBIDTA, in line with its global peers

Financial summary

Figure 7: Apollo Tyres – consolidated P&L

(Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
Net sales	49,841	81,207	90,725	104,465	116,992
Raw material costs	34,003	45,808	55,170	62,881	70,553
Employee cost	4,150	10,885	12,191	13,296	14,505
Other expenses	7,526	12,766	13,106	14,507	15,892
EBITDA	4,161	11,749	10,258	13,781	16,042
Depreciation	1,285	2,542	2,800	3,432	3,913
EBIT	2,876	9,206	7,458	10,349	12,129
Interest costs	973	1,154	1,600	1,950	1,900
Other income	230	214	270	290	310
PBT	2,134	8,266	6,128	8,689	10,539
Tax	742	2,607	2,022	2,867	3,478
PAT	1,392	5,660	4,106	5,822	7,061
EPS	2.8	11.2	8.1	11.5	14.0

Source: Company data, Credit Suisse estimates

Figure 8: Apollo Tyres – consolidated balance sheet

(Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
Share capital	504	504	504	504	504
Reserves	12,992	19,174	22,839	28,073	34,399
Shareholder's funds	13,496	19,678	23,343	28,577	34,904
Debt	8,907	17,072	24,629	23,593	20,893
Deferred tax liability	1,942	2,514	2,514	2,514	2,514
Total liabilities	24,345	39,264	50,487	54,685	58,311
Net fixed assets	16,833	29,786	40,986	44,554	47,641
Goodwill	235	1,175	1,175	1,175	1,175
Investments	48	59	59	59	59
Inventory	6,302	9,929	11,502	12,963	14,430
Sundry debtors	2,247	7,869	8,906	10,278	11,524
Cash & Bank balances	3,621	3,490	3,490	3,490	3,490
Other current assets	2,059	2,416	2,735	3,156	3,539
Sundry creditors	5,470	11,976	14,423	16,439	18,445
Other current liabilities	1,532	3,483	3,942	4,550	5,101
Total assets	24,345	39,264	50,487	54,685	58,311

Source: Company data, Credit Suisse estimates

Figure 9: Key ratios

	FY09	FY10	FY11E	FY12E	FY13E
Growth					
Sales growth (%)	6	63	12	15	12
EBITDA growth (%)	(30)	182	(13)	34	16
PAT growth (%)	(48)	307	(27)	42	21
Margins					
EBITDA margin (%)	8	14	11	13	14
PBT margin (%)	4	10	7	8	9
Adjusted PAT margin (%)	3	7	5	6	6
Key metrics					
ROCE (%)	12	23	15	19	21
ROE (%)	10	29	18	20	20
Net debt to equity (x)	0.4	0.7	0.9	0.7	0.5

Source: Company data, Credit Suisse estimates

Conducive operating environment

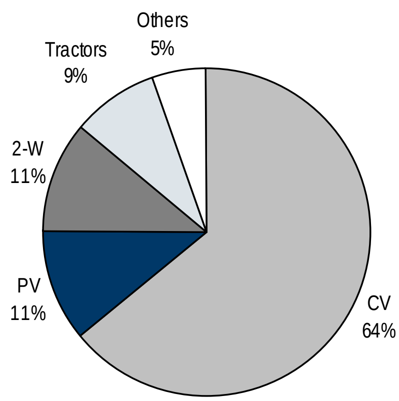
The Indian tyre industry is set to benefit from strong growth in demand for tyres, both to OEMs and replacement market. Our core thesis is premised on acceleration of vehicle ownership, both passenger and commercial, driven by strong underlying economy growth. We expect total tyre demand (in tonnage terms) to grow 11.8% pa in FY10-13E, up from 7.3% pa in FY07-10. Supply expansion, on the other had, will likely significantly lag, at least until FY13E and especially in the crucial truck and bus segment. As a result we expect industry utilisation levels to stay at elevated levels (90+%) boosting pricing power. Longer-term trends, in terms of higher proportion of sales to PV consumers and radialisation of truck tyres are also supportive of better profitability. In the near-term, we expect tyre manufacturers to overcome historically high input costs (rubber price) through price hikes and recover margins.

We expect total tyre demand (in tonnage terms) to grow 11.8% p.a. in FY10-13E, up from 7.3% p.a. in FY07-10. Supply expansion, on the other had, will likely significantly lag.

Strong demand outlook

The Indian tyre market is mainly accounted for by commercial vehicle (CV) tyres, especially trucks and buses (T&B). However, car and two-wheeler tyres have been the fastest growing segments.

Figure 10: **Split of demand in India**

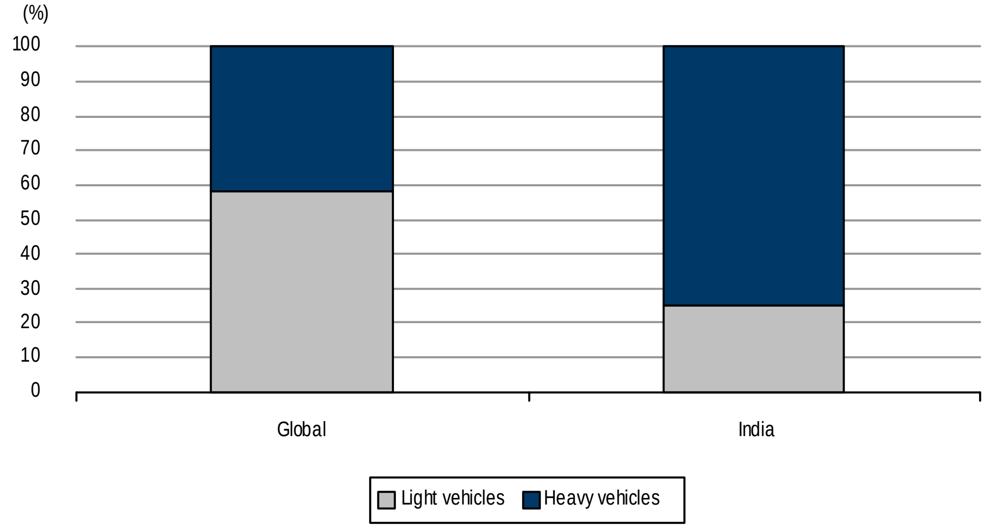


Source: ATMA, Credit Suisse estimates

The high contribution of heavy vehicles to tyre industry is typical of tyre markets in developing countries. However, as the economy progresses, growth in new car significantly outpaces that of new trucks and growth in average distances travelled by cars outpaces growth in distances travelled by heavy vehicles.

The high contribution of heavy vehicles to the tyre industry is typical of tyre markets in developing countries

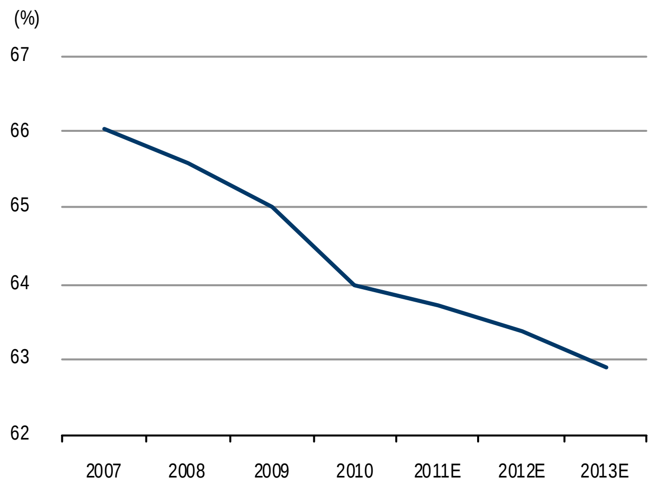
Figure 11: Heavy vehicles dominate Indian tyre demand …



Source: Michelin Factbook, ATMA, Credit Suisse estimates

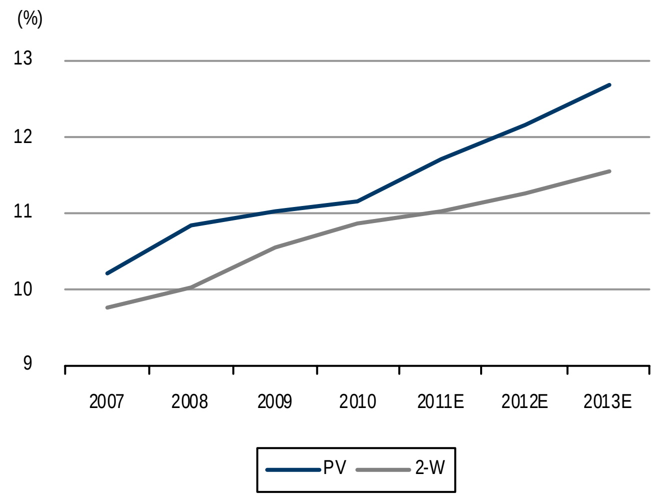
In keeping with international trends, we expect the contribution of passenger vehicles (cars and two-wheelers) to increase and that of commercial vehicles to gradually decline.

Figure 12: …but CV's contribution will likely fall …



Source: ATMA, Credit Suisse estimates

Figure 13: … as passenger vehicles' contribution rises

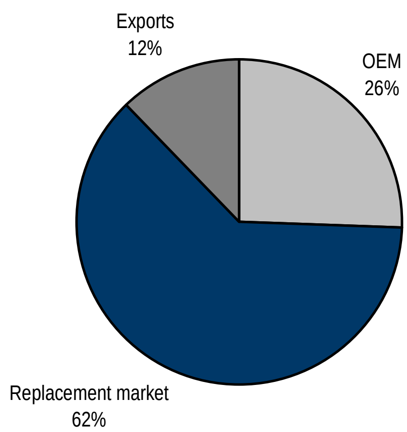


Source: ATMA, Credit Suisse estimates

The tyre market can also be segmented according to the buyer. Vehicle manufacturers (OEMs) are institutional clients with great bargaining power. OEMs account for nearly a fourth of tyre demand in India. The next segment of buyers is the end user, when the user replaces the tyres. The replacement market is roughly 63% of the Indian tyre market. India is one of the large producers of cross ply truck and bus tyres, which find large markets abroad. Exports account for 13% of total sales.

OEMs are institutional clients with significant bargaining power and account for nearly a fourth of tyre demand

Figure 14: **Market-wise division of demand**

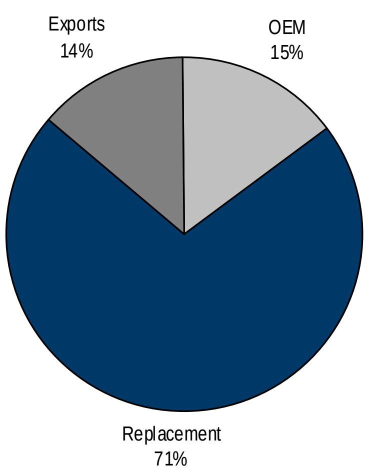


Source: ATMA, SIAM, Credit Suisse estimates

Given the short replacement cycle in trucks, replacement market forms a very large portion this segment

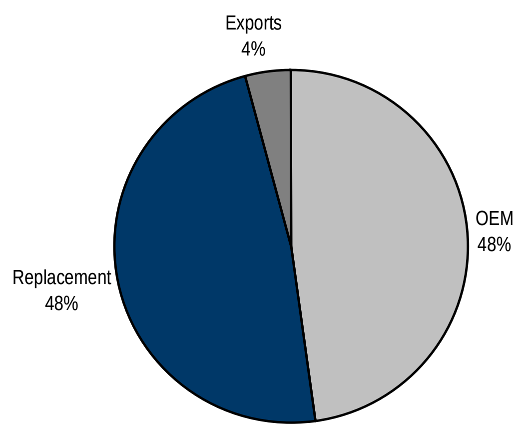
Given the high intensity usage, truck tyres need to be replaced every six months (on an average) while a typical car tyre is replaced once in three years. Consequently, the replacement market forms a much larger portion of the T&B market than the PV market.

Figure 15: **Replacement market dominates the T&B market**



Source: ATMA, SIAM,, Credit Suisse estimates

Figure 16: **Evenly distributed in PV segment**

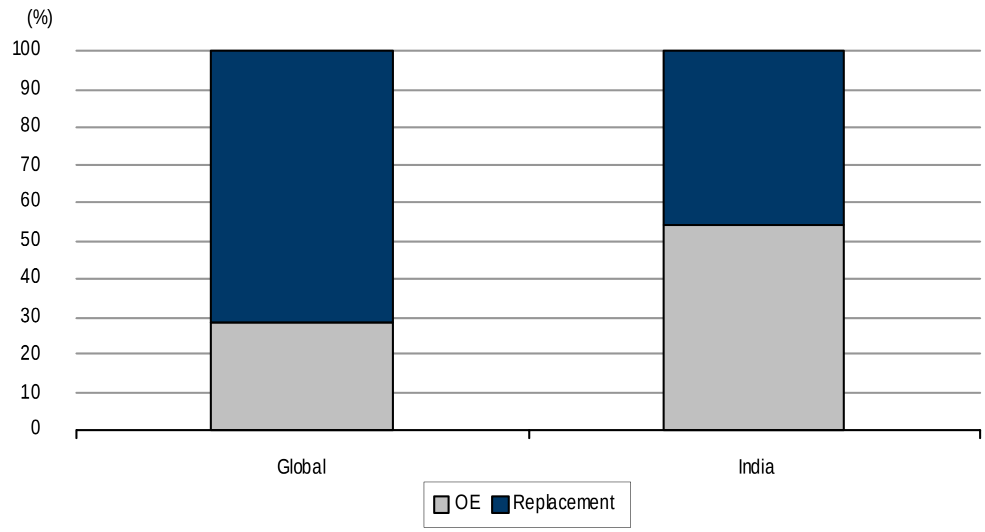


Source: ATMA, SIAM,, Credit Suisse estimates

Even in the light vehicle segment, dependence on OEMs will reduce in the longer term as the population of vehicles on the road increases

However, even in the light vehicle segment, dependence on OEMs will reduce in the longer term as the population of vehicles on the road increases. Average distance travelled per vehicle also tends to increase as the economy progresses. We see India trending gradually towards the global mix of OEM and replacement.

Figure 17: **Demand distribution in light vehicles**



Source: Michelin Factbook, ATMA, Credit Suisse estimates

Growth across all segments

In the near term, we expect strong growth across all key segments. The all important T&B segment is completely dependent on the strength of the economy. Growth in the replacement market is inevitably linked to growth in the movement of road freight, which is a direct derivative of the growth in the economy. We have a very positive view on commercial vehicle sales and expect the growth phase, which began less than a year ago, to continue at least until FY14.

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We have an equally strong view of growth in the car market. India is set to enter a phase of exponential growth in car sales as the country enters the motorisation phase of the economy. India is set to cross the US$3000 per capita (PPP) barrier, which is the income at which motorisation has taken off in many other countries. Demographics, changing income profile, culture of car ownership, and fall in prices of entry level cars could be the key drivers of non-linear growth. We forecast around 20% p.a. growth over the next few years.

We also expect car demand to accelerate as India approaches the per capita income level (US$3,000 PPP) when motorisation levels took off in many other countries

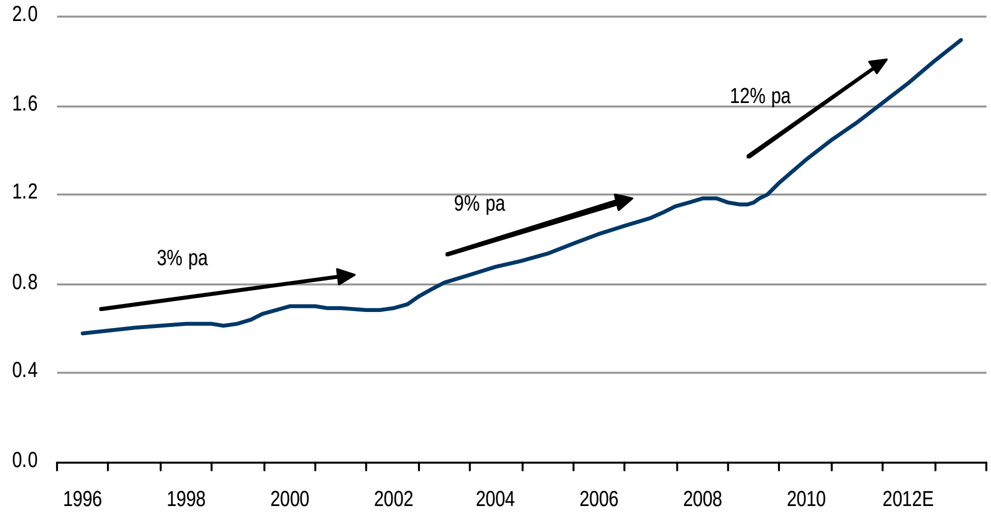
Figure 18: **Key growth assumptions**

(%)	2008	2009	2010	2011E	2012E	2013E
T&B sales	-1.1	-34.0	29.8	23.0	15.0	12.0
T&B replacement	8.6	13.5	14.6	10.0	10.0	10.0
Car sales	14.9	7.0	25.6	25.0	20.0	20.0
Car replacement	15.8	-3.2	21.0	12.0	12.0	12.0
Two-wheelers	10.6	3.8	20.0	14.0	14.0	14.0
Tractors	-2.9	5.3	25.5	8.0	8.0	8.0
Others	11.7	-4.6	9.3	11.9	11.7	11.8
Total	7.5	-1.2	16.2	12.4	11.6	11.4

Source: ATMA, Credit Suisse estimates

Given the different sizes and value of tyres sold to different segments, we believe it makes more sense to look at the tonnage of tyre sales rather than the number of tyres sold. As a benchmark, an average T&B tyre weighs about 51 kgs, while a car tyre weighs about 7 kgs. Using the broad benchmarks, we estimate the total market, estimated at 1.4 mn MT to grow at 11.8% p.a. over FY10-13, based on the assumptions above.

Figure 19: Demand (in mn metric tons) set to grow faster than ever



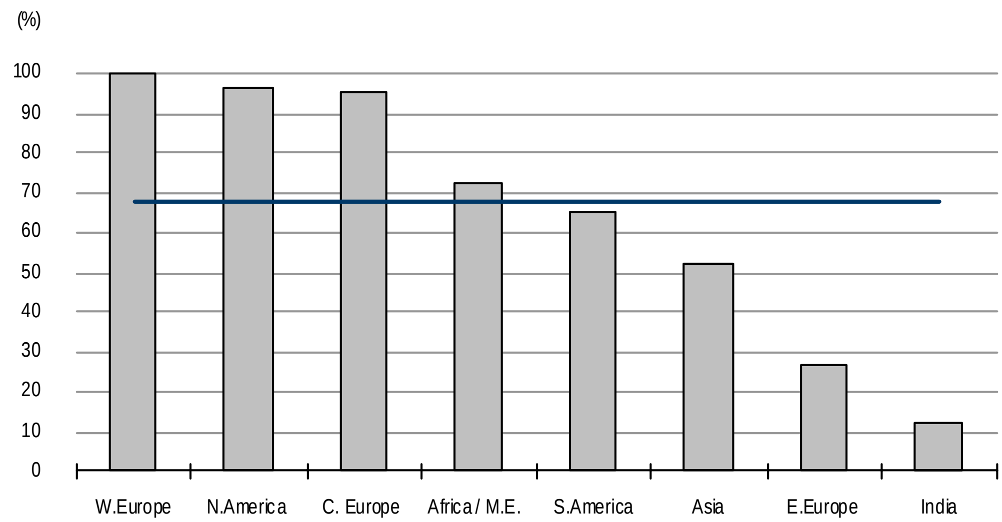
Source: ATMA, Credit Suisse estimates

Radialisation in the T&B segment

India has among the lowest levels of radialisation of all large tyre markets in the world. While radialisation in passenger cars is over 90%, radialisation in T&B remains at a low of approximately 10%.

While radialisation in passenger cars is over 90%, it is at a low of around 10% in T&B

Figure 20: Radialisation in the T&B segment



Source: Michelin Factbook, ATMA, Credit Suisse estimates

Reasons for low radialisation in the T&B segment

There are multiple reasons for low penetration. We note a few important ones:

1) Supply – for legacy reasons, domestic tyre manufacturers have had capacity only in cross-ply tyres. Without a minimum operating scale, costs of radial tyre production would have been prohibitively expensive. Thus, manufacturers never really pushed for radialisation, even though there are distinct long-term advantages for the maker and for the user.

Radial tyre production is more capital intensive and requires a minimum operating scale to be feasible

2) Overloading – overloading was a very prevalent practice in India until recently, and was a key determinant of operator profitability. While still a reality, it is less so now, especially after court intervention against the practice. Radial tyres are not conducive for overloading and thus were not viable in the past.

Radial tyres are not conducive for overloading, a practice widely followed in the past

3) Quality of road infrastructure – radial tyres are best used on well maintained concrete roads, while quality of road infrastructure has only recently improved.

4) Low quality of trucks – operators focused purely on short-term economics in purchase of trucks and associated parts. Technology of trucks was poor. However, this has changed drastically in the recent past, and with it the inclination to buy better parts, including better tyres, has increased.

Technology improvements and inclination to buy good quality parts are very recent trends in the industry

Radial tyres are cost effective, under the right conditions

Under the right conditions, i.e., for trucks carrying rated loads on metalled roads, radial tyres deliver significant savings. While radial tyres cost about 20% more than bias tyres, radials last for nearly 40% more kilometres as do bias tyres and deliver 5-7% fuel savings. A simple calculation would suggest that the truck operator could save over Rs55,000 p.a. on such a truck. To put it in perspective, this would be about 1.2x the monthly instalment on a four-year loan.

While radial tyres cost more, they provide significant savings of over Rs55,000 p.a. (about 1.2x the monthly instalment on a four-year loan)

Figure 21: **Savings from usage of radials in a 25 MT vehicle (10 tyres per truck)**

	Radial	Cross ply
Distance travelled per year (KM)	100,000	100,000
Fuel efficiency (KMPL)	3.7	3.5
Fuel consumed (L)	27,211	28,571
Cost of fuel (Rs/L)	1,006,803	1,057,143
Savings in fuel (Rs)	50,340	
Life of tyre (KM)	126,000	90,000
Number of tyres replaced per annum	7.9	11.1
Price of tyre (Rs)	14,400	12,000
Annual tyre cost (Rs)	114,286	133,333
Savings (Rs)	19,048	
Cost of maintenance (Rs/annum)	79,365	66,667
Savings (Rs)	-12,698	
Total savings (Rs)	**56,689**	

Source: Credit Suisse estimates

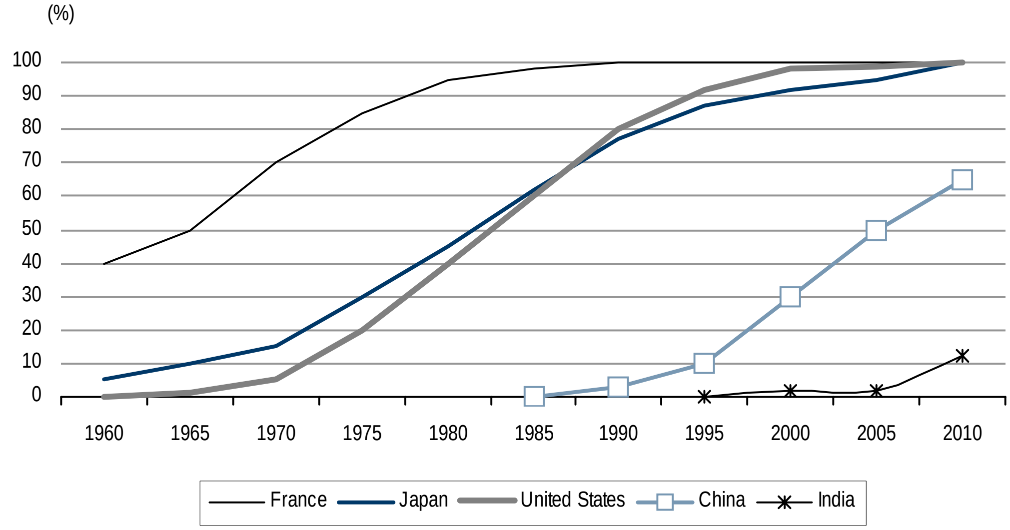
It needs to be pointed out, however, that the right conditions for radialisation are not necessarily prevalent all over the country. As mentioned earlier, there are parts of the country where overloading is still common. This renders radials economically unviable in such regions (savings from overloading far outweigh benefits of radialisation). Moreover, outside the main highways, quality of roads is still poor, which makes maintenance of radials much more expensive and worse, leads to higher downtimes.. However, the trend in all these factors is supportive of rapid radialisation.

However, all necessary conditions for viability of radial tyres are not being met currently – though the trend is encouraging

India could possible follow the same pattern of radialisation seen in other markets. Typically, radialisation took off about 10 years from the time a proper highway infrastructure development commenced. Manufacturers expect radialisation to reach 25% in five years, up from 10% now.

Manufacturers expect radialisation to reach 25% in 5 years, up from 10% now

Figure 22: Radialisation trend in T&B in India – triggered by road infrastructure



Source: Bekeart Annual Report,, Credit Suisse estimates

Supply increasing but not fast enough

As explained earlier, we believe radialisation rates could pick up in India under the right conditions. More importantly, however, all tyre makers firmly believe that the future of the T&B segment is in the radial segment. Consequently, none of the manufacturers are making any new investments in the cross-ply segment. There has been no new plant in the cross-ply segment for the last many years. Consequently, manufacturers have squeezed out most of the efficiency gains possible from the existing plants, and thus very little incremental utilisation can be achieved from these plants.

With all tyre manufacturers focused on capturing the radialisation trend, there is little investment in the cross-ply segment.

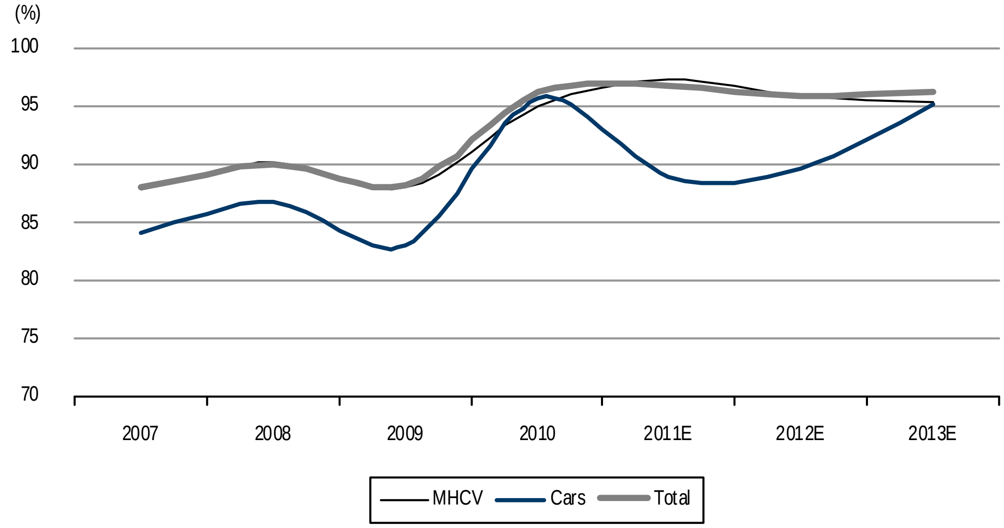
There is significant investment in the T&B radial segment. We expect the number of manufacturers in this segment to increase to seven in the next three years. There was just one domestic maker until recently. The industry capacity will increase from less than 1 mn tyres per annum to over 6.5 mn tyres per annum by FY13E.

We expect T&B radial capacity to increase from less than 1 mn tyres p.a. to over 6.5 mn p.a. by FY13

We note, however, that the total capacity addition in the T&B segment will just about keep pace with the increase in industry demand. Utilisation levels will likely remain high at least until FY13E, if not further. In the car radial segment, however, we expect capacity addition ahead of demand in FY11, beyond which supply addition will likely lag that of demand growth. Industry utilisation rates will likely drop in FY11E before recovering from FY12E. The overall supply-demand scenario, however, will likely remain benign for the next few years.

Utilisation levels in T&B will likely remain high at least until FY13E. In the car radial segment, though, we expect capacity addition ahead of demand

Figure 23: Capacity utilisation



Source: ATMA, Company data, Credit Suisse estimates

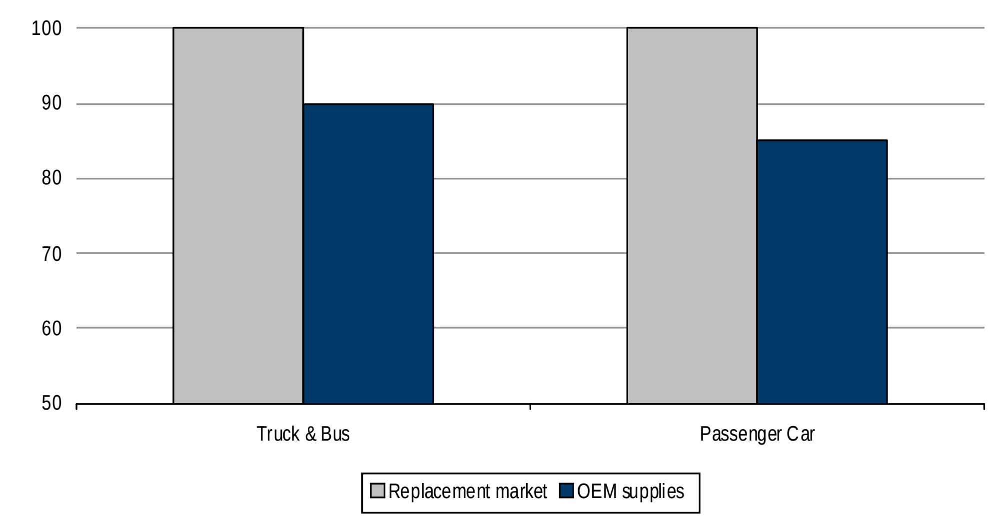
Industry utilisation level important determinant of pricing power

The industry capacity utilisation levels are by far the most important determinant of industry's pricing power. For example, there is a capacity shortage in the system currently and that is reflecting in the price increases seen in the market. For a change, tyre makers are also enjoying some kind of pricing power with the OEMs.

Historically, OEM segments have been the least profitable segment. OEM buyers are large buyers with significant negotiating leverage. Tyre companies have also used supply contracts with OEMs, especially for large selling and successful models, as an entry strategy into the replacement market (a significant portion of car owners replace tyres with the same brand). However, with a tight supply scenario, we expect the profitability in the OEM supplies to also increase. We estimate that the differential between replacement market prices and OEM supplies, especially in the T&B segment, have likely shrunk 300-400 bp in the last one year.

Historically, the OEM segment has been the least profitable segment. Given the tight supply-demand scenario, though, tyre makers are enjoying some pricing power with OEMS for the first time

Figure 24: Relative pricing between replacement market and OEM supplies



Source: Company data, Credit Suisse estimates

Here is our estimate of the order of profitability in the industry.

Figure 25: **Segments in order of profitability**

Segments	Comment
Off the road tyres	Small quantity, non-standardised, high RoCE
PV replacement	Brand conscious market; high marketing spends, high margins
CV replacement	Distribution and dealer driven
Exports	
CV OEM	Cyclical margins; threat from Chinese imports
PV OEM	Low margins, but key to replacement market share

Source: Company data, Credit Suisse estimates

Two other factors that would influence profitability margins

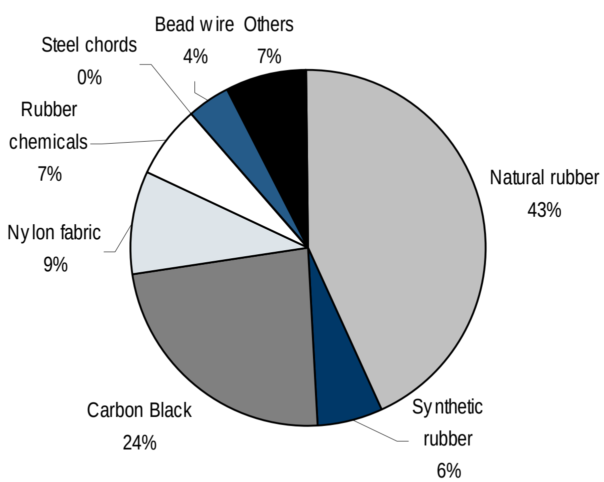
Other than the user mix, we expect two other factors to influence margins, margin volatility and return ratios.

Impact of radials on margins

The first is the shift towards radials. Radial facilities are more capital intensive than cross-ply (though exact comparison is tough in the absence of new cross-ply plants), but also generate higher revenue per unit of capacity (20% better pricing) and have slightly higher margins 200-300 bp. More importantly, global experience suggests that price stickiness and willingness of consumers to pay for strong brands backed up by technology are higher in the case of radials than in the case of cross-ply. We also note that the input basket for radials is not as natural rubber centric as is the case with cross-ply, which has historically been a hostage to rubber prices.

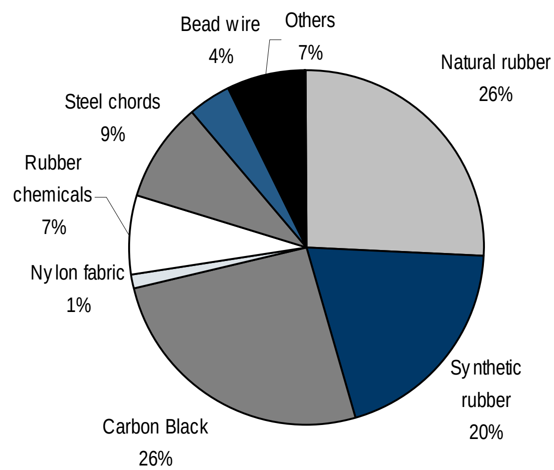
Anecdotally, price inelasticity and brand loyalty has been higher in the case of radials than in cross-ply tyres

Figure 26: **Cost structure – cross-ply tyre**



Source: Company data, Credit Suisse estimates

Figure 27: **Cost structure – radials**



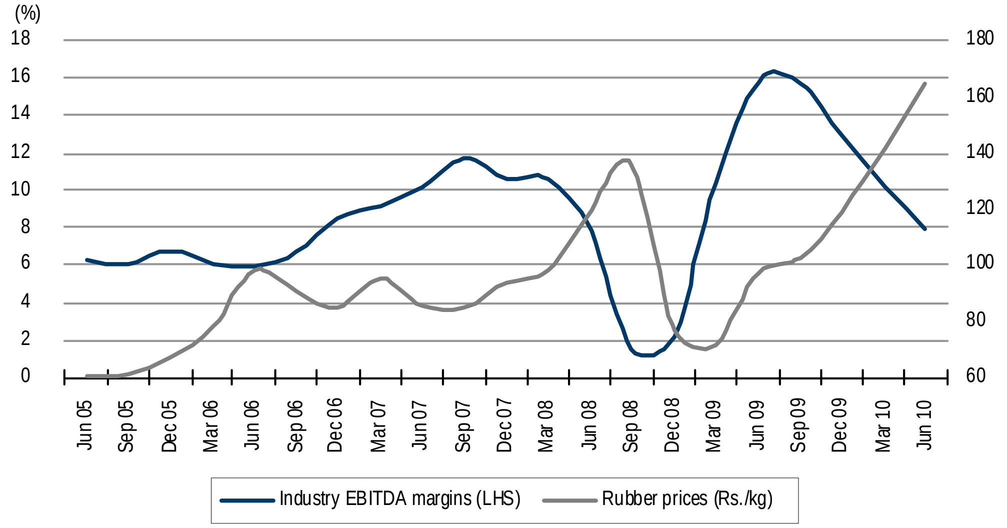
Source: Company data, Credit Suisse estimates

Unprecedented volatility in rubber prices. but note the pricing power

Rubber prices have had a very wild swing in profitability in the recent past, going from excess supply to short supply in a matter of less than 12 months. Owing to the nature of the commodity, we take no call on the prices going forward (we have assumed it to be at current levels). What we would highlight, however, is that margins for the industry in the June quarter, when rubber prices averaged Rs165/kg, were similar to what they were six quarters ago when rubber averaged Rs70/kg. Essentially, margins are likely to bottom out at substantially higher levels in the current cycle compared to previous cycles.

While rubber prices continue to remain volatile, margins for the industry are likely to bottom at significantly higher levels in the current cycle compared to previous cycles

Figure 28: **Relationship between rubber price and industry margins**



Source: Company data, Credit Suisse estimates

Well positioned to capture the trend

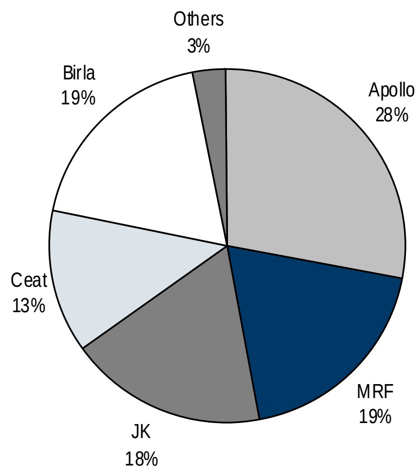
Apollo Tyres is well positioned to participate in the profitable growth trends in the industry. While the company has increased share in all its segments, increase in passenger car radial market share is a clear demonstration of Apollo's brand and distribution strength. Apollo's significant investment in the truck radial facility is extremely well timed, in our view. We also like the company's international foray and expect both its recently acquired subsidiaries to add significant value in the long-term.

Apollo Tyres has a strong presence in its key segments and is well positioned to capture the growth trends in the industry

Dominant player in the domestic market

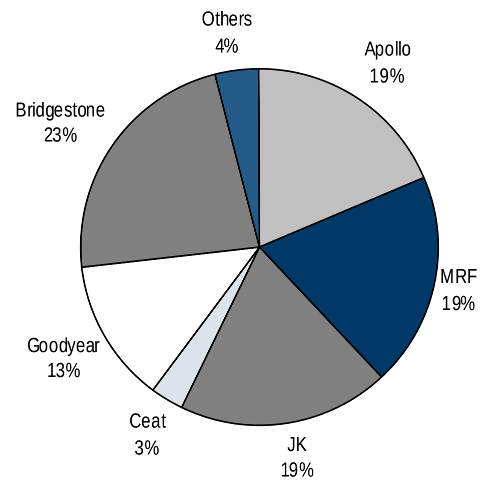
Over the last few years, Apollo Tyres has established an enviable manufacturing and distribution scale in the key T&B and passenger vehicle segments. Apollo is a key OEM supplier to all the main auto manufacturers in both these segments.

Figure 29: **Leader in the T&B tyre segment**



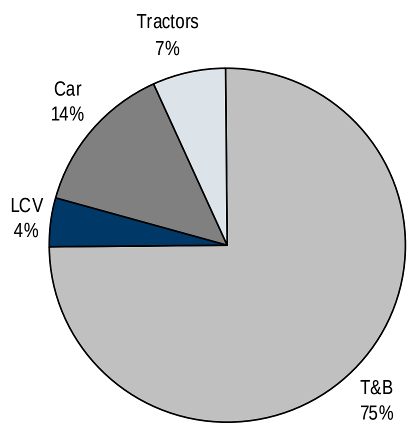
Source: Company data, Credit Suisse estimates

Figure 30: **Strong player in the passenger vehicle segment**



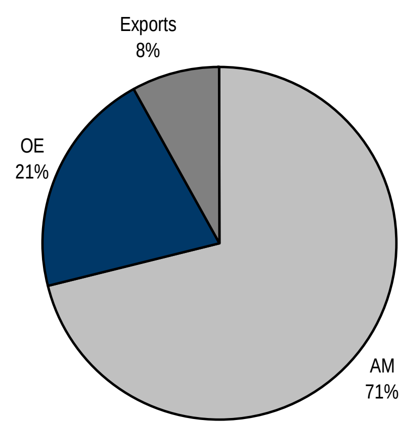
Source: Company data, Credit Suisse estimates

Figure 31: **Indian operation revenues dominated by the T&B segment …**



Source: Company data, Credit Suisse estimates

Figure 32: **... and replacement market sales**

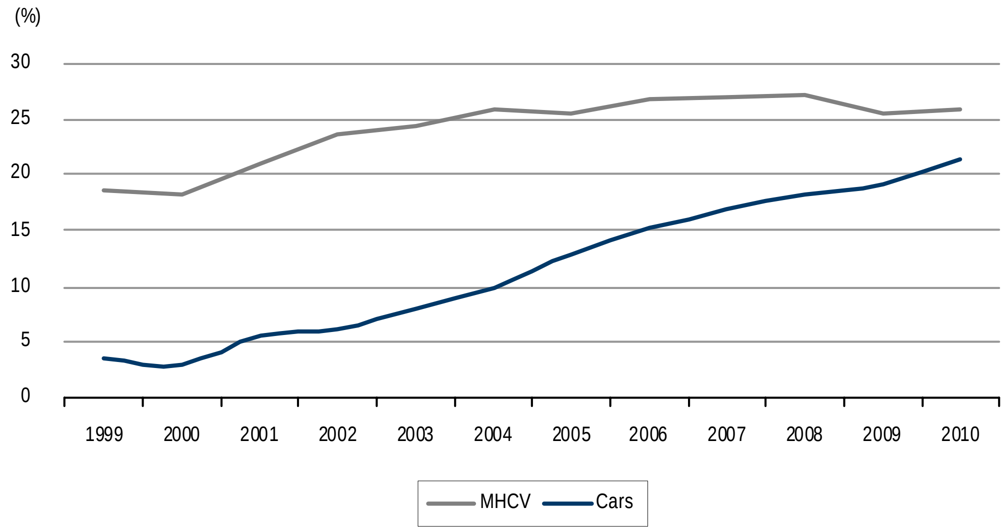


Source: Company data, Credit Suisse estimates

Increasing share across key segments

Less than a decade ago, Apollo was an insignificant player in the passenger car segment and a relatively small player in the T&B segment. However, this has changed significantly.

Figure 33: Apollo's market share trend in India



Source: Company data, Credit Suisse estimates

During the same period, Apollo's pricing power relative to the segment leader has also improved. Apollo's products used to sell at 4-5% discount to the then market leader. Currently, Apollo's products sell at a marginal premium to its nearest competitors.

Apollo's pricing power has also improved from a 4-5% discount to segment leader to a premium now

Apollo's increased its share through aggressive expansion of distribution reach (key for T&B segment). Apollo leveraged the resultant scale to its advantage in pushing through car tyre sales. The company also worked aggressively on developing OEM relationships, which formed the basis for an increase in share in the replacement market subsequently.

Apollo now has the brand and the reach to sustain the current market share level. Incremental share moves will depend on investing in the right growth markets. The new Chennai plant is a step in that direction.

Chennai plant expansion

Apollo recently commissioned greenfield capacity at Chennai, which entails a total investment of Rs23 bn. Capacity at this plant, which would produce a mix of passenger car and truck radials, is expected to reach 500 TPD by FY14 from an average of 100 TPD in FY11. While the truck radial capacity (around 400 TPD) is intended for domestic consumption, the passenger car radial capacity would be used to cater to domestic market as well as to the European markets. Apollo recently launched Apollo branded tyres in Europe using Vredestein's distribution network. At full capacity, the Chennai plant would be able to produce 2.7 mn T&B radials (over 1/3rd of industry capacity then) and about 5.5 mn car radials.

At full capacity, the new Chennai plant would be able to produce 2.7 mn T&B radials (over 1/3rd of industry capacity then) and about 5.5 mn car radials

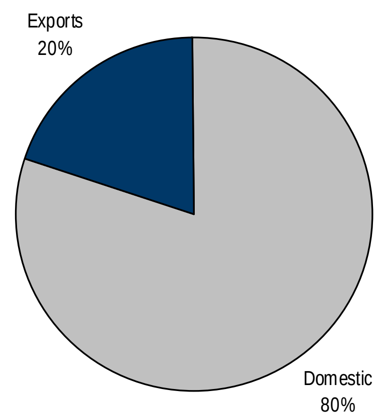
International subsidiaries

Apollo South Africa

Apollo acquired Dunlop's operations in South Africa (SA) in 2006 in an all-cash deal amounting to Rs2.9 bn. With manufacturing facilities at two main locations, Apollo S.A. has close to 180 TPD of capacity (about 50% each of light and heavy vehicles). Exports constitute close to 20% of revenue and mainly cater to Europe. The company manufactures radial tyres for most segments including passenger cars, light commercial

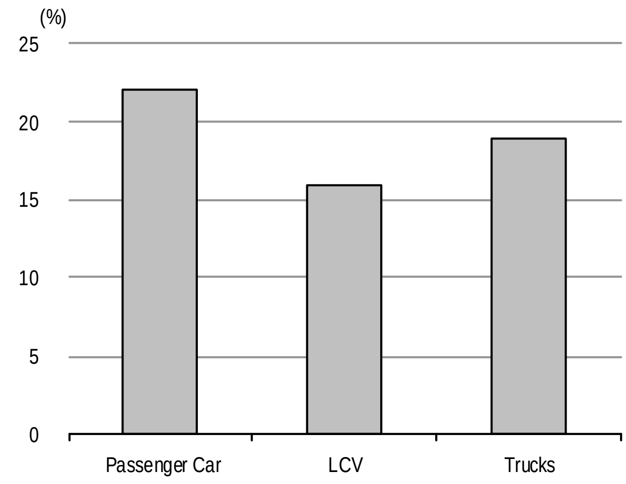
Apollo S.A. has 180 TPD of capacity and caters to both passenger and commercial vehicle radials vehicles, as well as trucks. Dunlop SA is a strong player in the domestic market, with more than 20% share in the passenger cars segment.

Figure 34: Revenue split



Source: Company data, Credit Suisse estimates

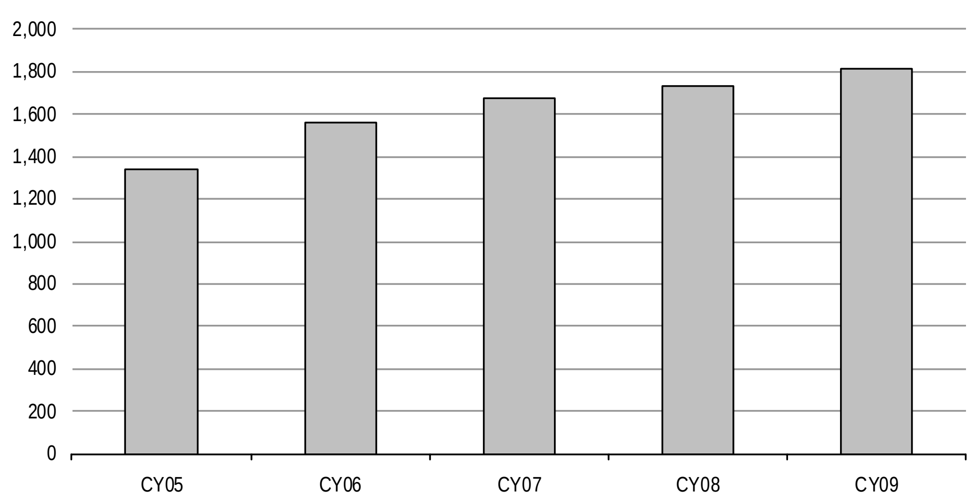
Figure 35: Market share in various segments



Source: Company data, Credit Suisse estimates

While revenue from Apollo SA have been relatively stable (four-year CAGR of 8%), the volatility in currency (ZAR vs INR) impacts reported numbers. We note that currency has been particularly volatile in the last few years (ZAR vs INR -12% in 2007, -8% in 2009, and +17% in 2010).

Figure 36: Revenue from Apollo South Africa (rand mn)



Source: Company data, Credit Suisse estimates

Underlying profitability, though, has shown a significant improvement, with EBITDA margins having expanded 450 bp over FY08-10.

Figure 37: Profitability of SA operations has improved

Rs mn	2007	2008	2009	2010
Revenues	10,098	10,069	9,176	10,941
Growth (%)		*-0.3*	*-8.9*	*19.2*
EBITDA	976	1,411	1,041	2,020
Margins (%)	*9.7*	*14.0*	*11.3*	*18.5*
Growth (%)	*44.5*	*44.5*	*-26.2*	*93.9*
PAT	175	515	317	1,107
Growth (%)		*194.8*	*-38.6*	*249.4*

Source: Company data, Credit Suisse estimates

The African plants are now operating at a utilisation of about 85%. We expect the African operations to grow on the back of a recovery in the South African economy. We are building in about 8% growth in sales in our models.

We expect the African operations to grow on the back of recovery in the economy and build in 8% sales growth

Apollo has derived and will derive other benefits from its South African operations: 1) access to technology – T&B radial and off-the road vehicle tyres, 2) access to Dunlop SA's European and African distribution network, and 3) combined raw material procurement.

Vredestein in Europe

Apollo made its second international foray in 2009, with the acquisition of Vredestein Banden in Netherlands for Rs2.5 bn. The company was acquired during the bankruptcy sale by its parent, Amtel – Vredestein, which was the largest tyre manufacturer in Russia. After posting losses in 2008, the company is again profitable with a strengthening balance sheet – debt levels have nearly halved since the time of acquisition (now at Rs3.8 bn).

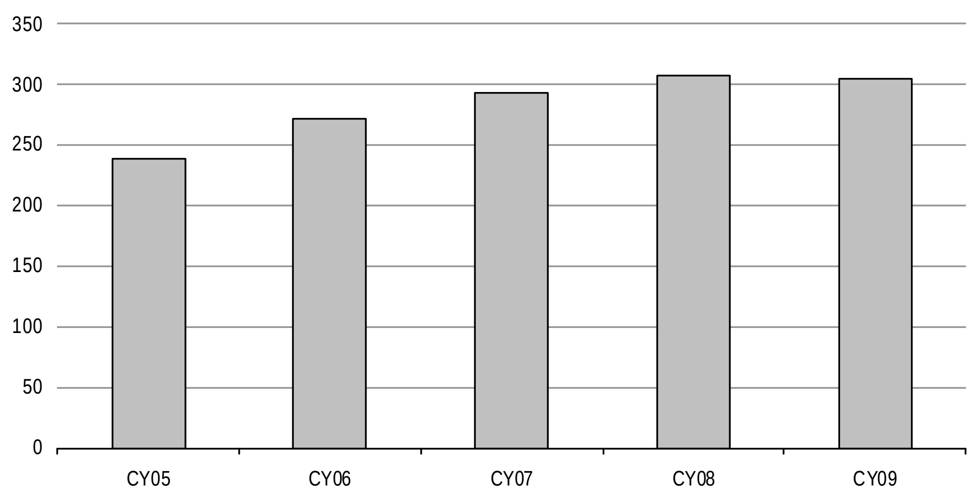
Apollo acquired Vredestein in Europe in 2009, which has seen an improvement in profitability and balance sheet strength

Figure 38: Vredestein acquired at a reasonable valuation

(Rs mn)	Amount at the time of acquisition
Equity	2,500
Debt	7,500
EV	10,000
CY08 Sales	19,556
EV/Sales	0.51
Sustainable EBITDA margins (%)	12
EV/EBITDA	4.3

Source: Company data, Credit Suisse estimates

Figure 39: Revenue at Vredestein (euro mn)



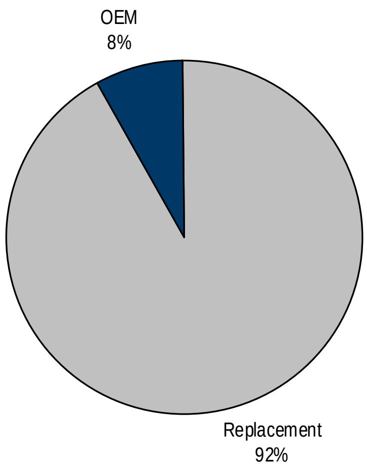
Source: Company data, Credit Suisse estimates

Vredestein is a niche player in the car radials segment with a capacity of 5.5 mn tyres (150 TPD). The company specialises in ultra high performance tyres, especially winter tyres, which constitute a third of its revenue. In the last 12 months, the company sold 5 mn tyres (2% share of the European market), of which winter tyres were 1.5 mn (4% share of the winter tyre market in Europe).

Vredestein is a niche player in the car radials segment with a capacity of 5.5 mn tyres (150 TPD)

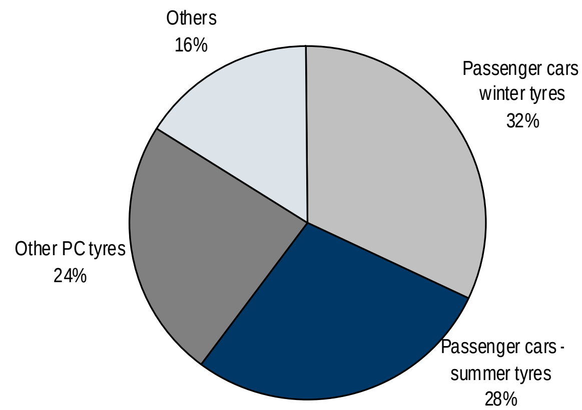
It has two main brands – *Vredestein* in the premium segment, and *Maloya,* which falls in the value segment. Replacement market sales constitute over 90% of its revenue which, in combination with its premium product mix, leads to high margins in the business despite the scale disadvantage.

Figure 40: **Vredestein mostly caters to the replacement market**



Source: Company data, Credit Suisse estimates

Figure 41: **High-performance passenger car tyres form a majority of the revenue**



Source: Company data, Credit Suisse estimates

Given the unusually prolonged winter in Europe, FY10 was an exceptional year for Vredestein in terms of margins and profitability, which likely reached their peak (21% EBITDA margins in 4Q10).

Vredestein operates at near 100% utilisation currently, and thus volume growth will likely be muted. We do not expect Apollo to invest in increasing capacity in Europe. Instead, we expect Apollo to augment European sales by outsourcing to India and South Africa. The Chennai plant will be a key ingredient in this strategy.

We expect Apollo to augment European sales by outsourcing to India and South Africa

Investments done; benefits to follow

Over FY10-11E, Apollo Tyres would have made significant investments, both organic (new plant in India leading to 60% increase in domestic capacity) and inorganic (Europe). We expect the company to benefit from commercialisation of these investments. We forecast standalone RoE to recover from a cyclical low of 12.9% in FY11E (previous cyclical lows about 5%) and sustain over 15% from FY12E, benefiting from the commercialisation of its new plant and from improved industry dynamics. Indian operations will also be significantly cash flow positive from FY12E, post capacity expansion. The consolidated entity will likely benefit from normalisation of key subsidiaries. We forecast consolidated EBIDTA to grow 25% p.a. in FY11-13E and consolidated EPS to grow 31% in the same period.

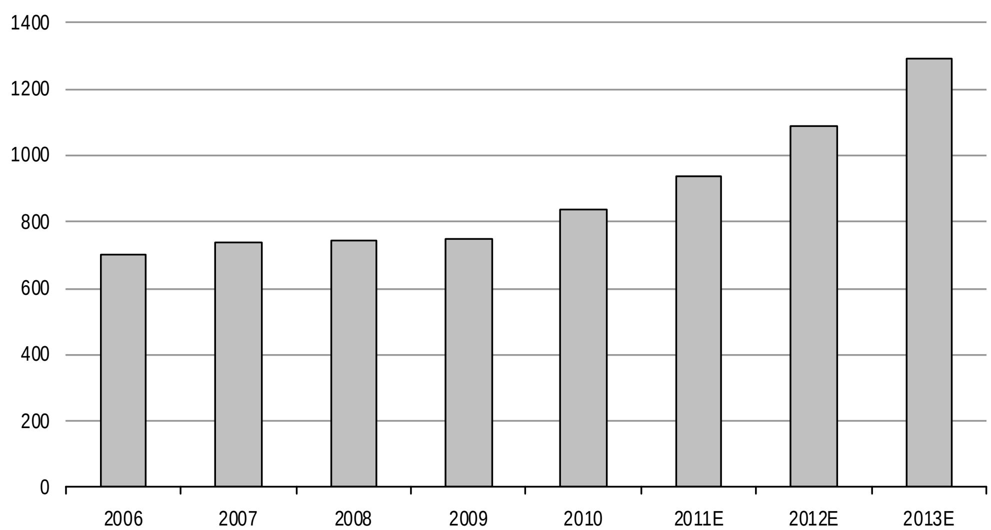
We forecast standalone RoE to recover from a cyclical low of 12.9% in FY11E and sustain over 15% from FY12E, as it monetises recent investments and benefits from improved industry dynamics

Significant capacity addition – bulk of capex done

Apollo Tyres has invested in a new greenfield facility after many years. In the context of its existing balance sheet, the new plant is large in size. The company's total capacity will increase nearly 60%, while the size of gross block will increase about 80% in FY10-13E.

Apollo's capacity is set to increase nearly 60%, while gross block will increase about 80% in FY10-13E

Figure 42: Apollo's capacity is expected to increase nearly 60% by FY2013 (MT/day)



Source: Company data, Credit Suisse estimates

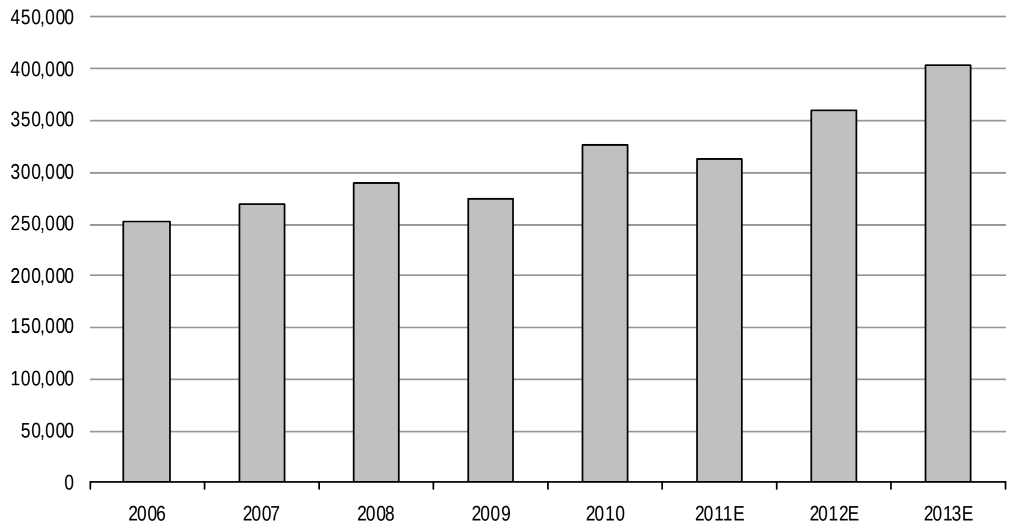
However, we note that the bulk of the capex in the Indian operations has already been done, and the remainder of investments in the Chennai plant will be completed by end-FY11E. Thus, FY11E marks the peak of Apollo Tyre's Indian operations. We expect capex to drop to less than Rs5 bn p.a. from FY12E, down from the FY11E peak of Rs12 bn.

However, the bulk of the capex is done, and FY11E likely marks the peak of investments in domestic operations

With the expanded capacity, especially in T&B radials, Apollo Tyres is in pole position to outpace the market. However, we note that production volumes in FY11E are likely to be down due to loss of production in one of its manufacturing facilities due to a strike by the workforce. We estimate Apollo Tyres to have lost about 25,000 MT of production during the year, nearly 8% of FY10's production. The company is in a position to make up for some of the loss in 2H as it ramps up operations at its Chennai plant. However, we expect full year volumes to decline 4%. We forecast a strong revival in production from FY12E, with volumes growing about 15%, ahead of market's growth of about 12%.

Production volumes in FY11E are likely to be down (about 4%) due to a strike at one of its manufacturing facilities, despite the commissioning of the new plant

Figure 43: **Production volumes (in MT)**



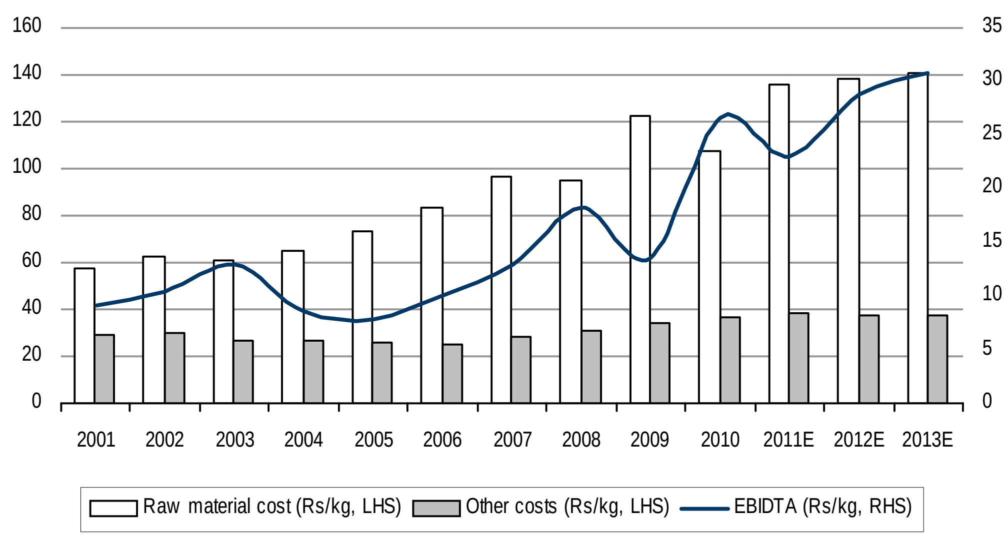
Source: Company data, Credit Suisse estimates

Expanding profitability

As explained earlier, we prefer to look at volumes in tonnage rather than in absolute units of sales. We look at margins on a per kg basis rather than in percentage terms, as the latter is misleading in an environment of inflation-led price changes. As noted earlier, industry margins are in good shape despite a sharp increase in commodity costs. As seen in the chart below, we expect EBIDTA per kg to be only marginally down from the record highs of FY10 and increase sharply from FY12E on the back of a better mix, improved pricing power, and the commercialisation of its Chennai plant.

We expect EBIDTA/kg to marginally decline from the highs of FY10 and increase sharply from FY12E on the back of a better mix, improved pricing, and the commercialisation of the new plant

Figure 44: **Analysis of P&L on a per kg basis**



Source: Company data, Credit Suisse estimates

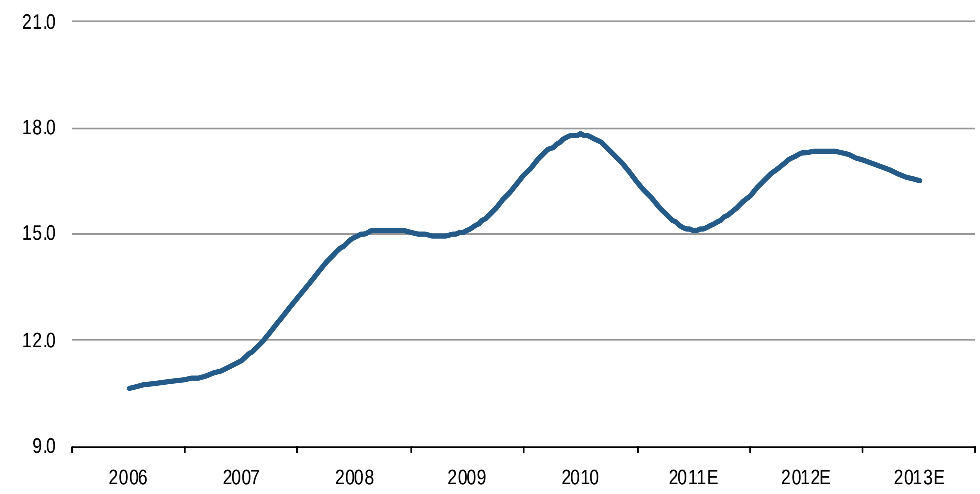
Figure 45: **Domestic P&L**

(Rs mn)	2008	2009	2010	2011E	2012E	2013E
Volume (MT)	290,000	273,575	326,739	313,669	360,720	404,006
Net sales	36,939	40,704	50,366	55,874	66,826	76,342
RM/sales (%)	65.9	72.2	63.0	68.8	67.6	67.4
EBIDTA	4,641	3,248	7,837	6,515	9,362	11,269
Operating margin (%)	12.6	8.0	15.6	11.7	14.0	14.8

Source: Company data, Credit Suisse estimates

We also expect a commensurate increase in the return ratios. However, the yearly ROCE trend tends to be volatile. The recent sharp jump in gross block further temporarily depresses the return ratios. To overcome these issues, we have presented a three-year average RoCE, which we believe gives a better idea of the trend in return ratios.

Figure 46: **Three-year trailing average RoCE of Indian operations**



Source: Company data, Credit Suisse estimates

Subsidiary performance – moderate growth

We expect moderate growth in both the overseas subsidiaries. The South African operations are just coming out of the recessionary trends faced by the auto markets there, and we expect utilisation rates to pick up from mid-80s to close to 90%. On the other hand, the Dutch subsidiary is in the midst of a very strong year and has been operating at close to 100% utilisation. Cumulatively, we expect sales to grow 13% in FY11, in part boosted by 45 days of additional sales from the Dutch subsidiary (the acquisition was in mid-May last year). Margins will likely take a marginal hit due to high commodity prices, especially in the South African market.

We expect sales to grow 13% in FY11, in part boosted by 45 days of additional sales from the Dutch subsidiary, followed by the 8% growth over FY11-13E

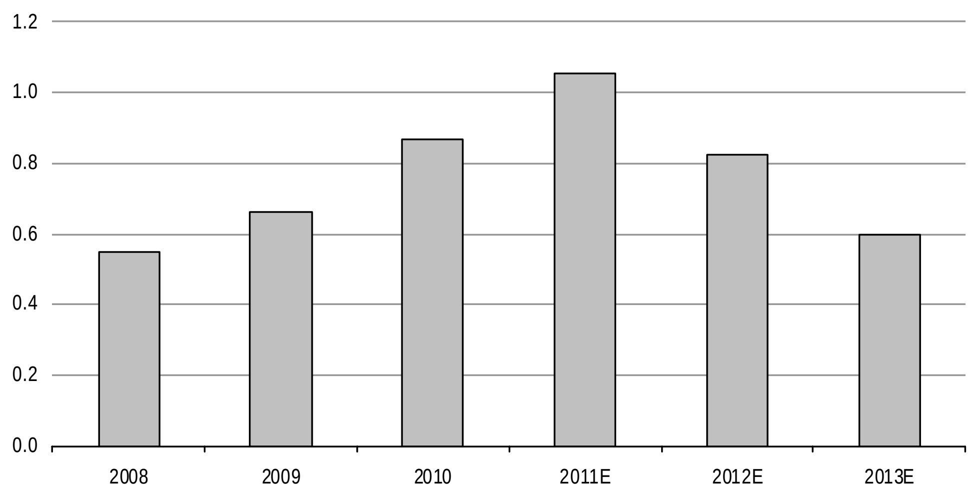
Figure 47: **Subsidiaries to grow at a moderate pace**

(Rs mn)	2008	2009	2010	2011E	2012E	2013E
Revenue	9,973	9,136	30,842	34,851	37,639	40,651
Growth (%)	*-1.0*	*-8.4*	*237.6*	*13.0*	*8.0*	*8.0*
% of consolidated sales	*21.3*	*18.3*	*38.0*	*38.4*	*36.0*	*34.7*
EBITDA	1,283	914	3,911	3,743	4,419	4,772
Margins (%)	*12.9*	*10.0*	*12.7*	*10.7*	*11.7*	*11.7*
Growth (%)	*44.5*	*-28.8*	*328.0*	*-4.3*	*18.1*	*8.0*
% of consolidated EBITDA	*21.7*	*22.0*	*33.3*	*36.5*	*32.1*	*29.7*

Source: Company data, Credit Suisse estimates

Cash flows will likely improve once the investment phase is over. We expect Apollo Tyres to utilise the free cash flows to reduce its debt. We forecast net consolidated debt to increase from Rs13.6 bn in FY10 to Rs21 bn in FY11E before falling to Rs17 bn in FY13E. The trend in net debt/equity will be similar, as seen below.

Figure 48: Consolidated debt to equity



Source: Company data, Credit Suisse estimates

Rerating justified

Apollo Tyres (and other Indian tyre stocks) have historically traded at lower than market multiples and at a large discount to their global peers. With a significant improvement in industry supply-demand scenario, we expect tyre companies' pricing power to improve tremendously, helping margins to break out of their commodity dependence. Moreover, we expect Apollo Tyres to improve its return ratios, benefiting from the commercialisation of recent investments. We set a target price of Rs108 per share, valuing Apollo Tyres at an EV of 5.5x FY12E EBIDTA, in line with its global peers. At our target price, Apollo Tyres would trade at 9.4x FY12E, at a significant discount to market and auto sector multiples. We believe Apollo Tyres is among the best ways to play the momentum in vehicle sales as well as the Indian economy.

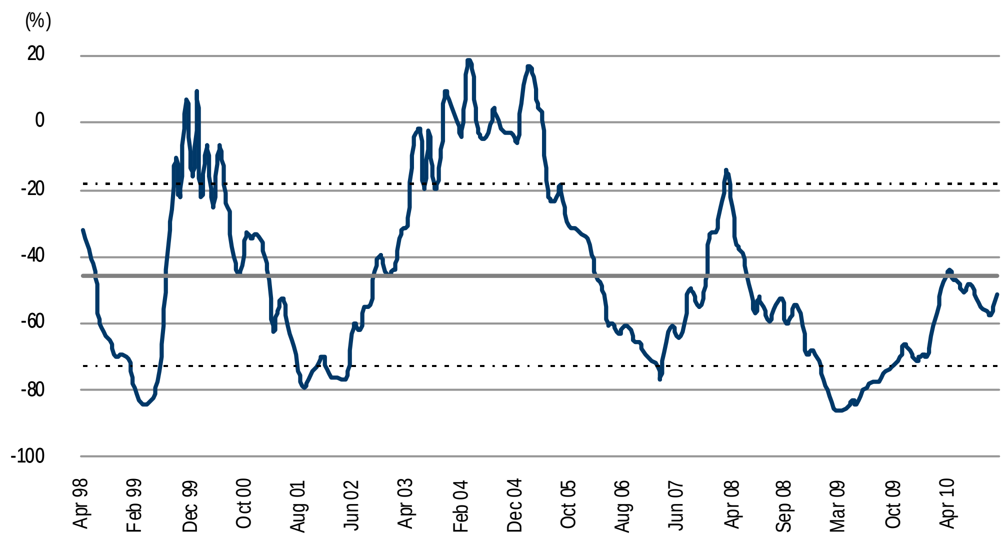
We see margins for Apollo Tyres breaking out of their commodity dependence, given the vastly improving industry dynamics. We set a target price of Rs108, valuing Apollo Tyres at an EV of 5.5x FY12E EBIDTA, in line with its global peers

Trading at a discount to the Indian market

Apollo Tyres has historically traded at a significant discount to the Indian market. The tyre industry was seen as extremely cyclical, with low pricing power (especially with OEMs), and was hostage to the volatility in rubber prices (limited pricing power). We believe these factors are not as valid any longer and expect the tyre industry to maintain reasonable margins and RoCE even in a high commodity cost environment. In such a scenario, we believe such a large discount to the market is unwarranted, especially given the forecast earnings growth in the near term.

The tyre industry has been historically seen as extremely cyclical, with low pricing power and high linkage to rubber prices, which is set to change, in our view

Figure 49: **Apollo currently trades at a 50% discount to market (one-year forward P/E)**



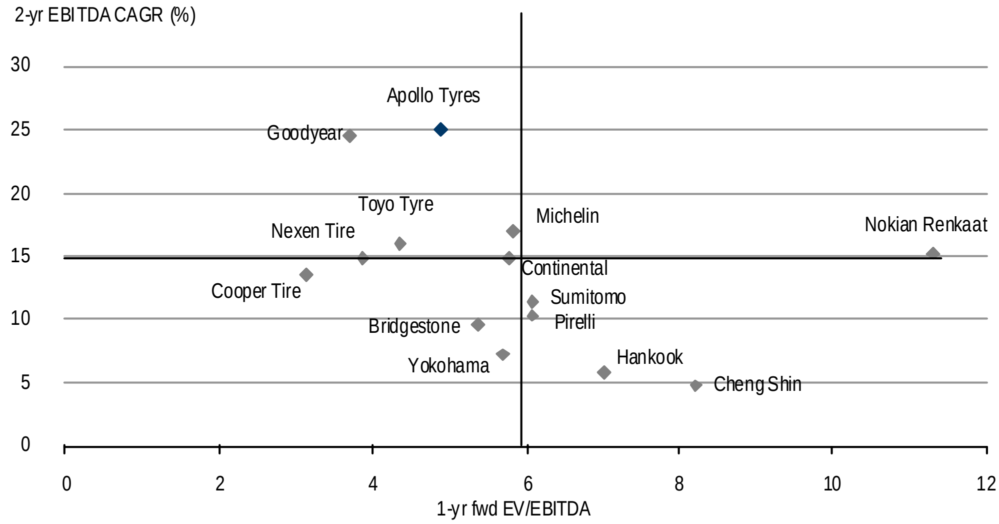
Source: MSCI India, Bloomberg, Credit Suisse estimates

Trading at a discount to global peers

Indian tyre stocks have also traded at a discount to global peers due to the perceived lack of pricing power and lack of strong brands. Again, as we have argued in the earlier sections, the Indian tyre market is catching up with global trends and offers significantly higher growth prospects. In this context, we believe that market leaders such as Apollo Tyres deserve to trade at least in line with peer multiples, if not higher.

The Indian tyre market is catching up with global trends and offers significantly higher growth prospects

Figure 50: Apollo inexpensive relative to global peers



Source: Bloomberg consensus, Credit Suisse estimates

Target price based on global peer multiples

We set our target price of Rs108 based on the global peer average EV/EBIDTA multiple of 5.5x on FY12E EBIDTA. At our target price, Apollo Tyres will trade at 9.4x FY12E EPS.

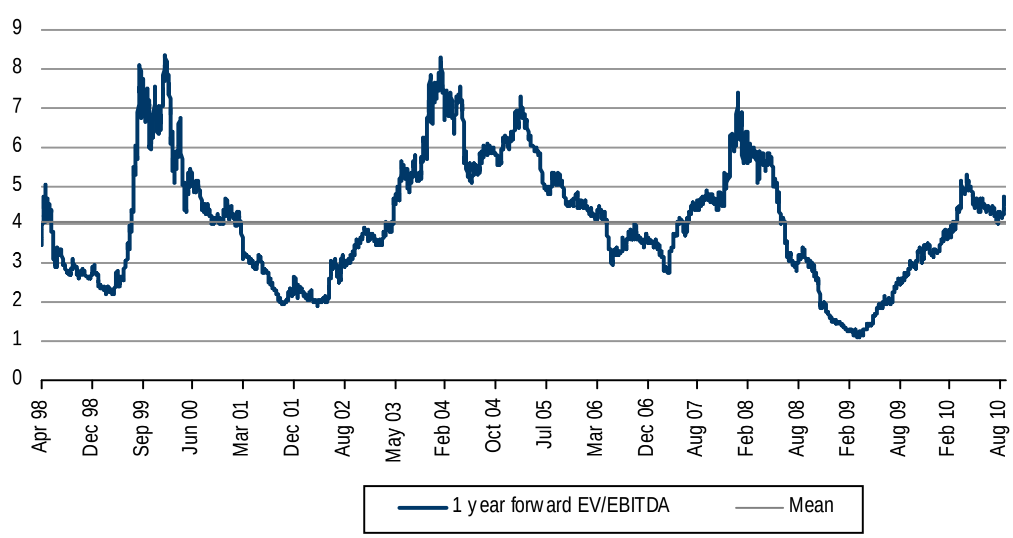
Figure 51: Target price calculation

FY12 EBIDTA (Rs mn)	13,781
EV/EBIDTA (x)	5.5
EV (Rs mn)	75,796
Less FY11 net debt (Rs mn)	21,139
Target equity value (Rs mn)	54,657
Target price (Rs)	108
Implied P/FY12E EPS (x)	9.4

Source: Company data, Credit Suisse estimates

We note that the historic average EV/EBIDTA multiple for Apollo Tyres has been a little over 4x. The markedly improved environment makes a re-rating justified.

Figure 52: Historic EV/EBIDTA multiple chart



Source: Company data, Bloomberg, Credit Suisse estimates

Risks – tyre imports

India imports roughly 1.3 mn truck tyres every year, up from less than 0.2 mn just five years ago (43% CAGR), driven mainly by radial T&B tyres. These tyres, mostly imported from China and Thailand, sell at a considerable discount (about 15-20%) to domestic tyres despite the anti-dumping duty on both bias as well as radial tyres. We note that the import duty on rubber in China is much lower at 7.5% (vs 20% in India), which gives significant leverage to Chinese manufacturers in terms of pricing export products.

India imports roughly 1.3 mn truck tyres (9-10% of production), which has risen sharply over the last five years (CAGR of 43%)

Given the huge price differential, the government has repeatedly imposed bans and anti-dumping duties on truck tyre imports.

Figure 53: **Chronology of measures taken with respect to tyre imports**

Date	Event
Oct-06	Anti-dumping duty on Chinese and Thai T&B bias tyres
Nov-08	Radial tyre imports come under restricted list
Feb-10	Dumping duty of up to US$99 per a set of bus and truck radial tyres (including tubeless) from China and Thailand
May-10	Removal of import restriction on truck radials imposed in November 2008

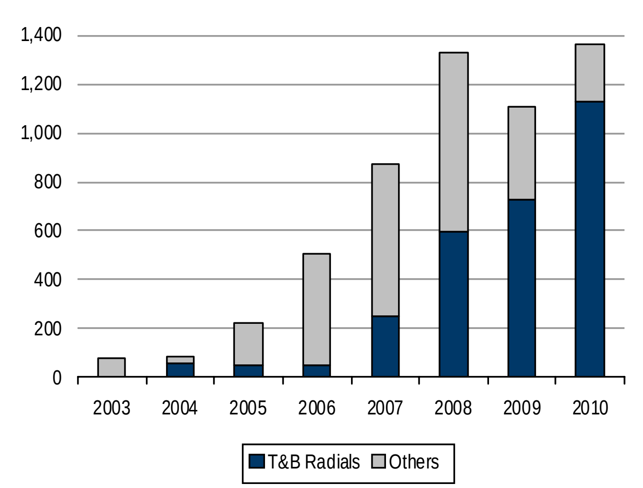
Source: Government notifications, Media reports, Credit Suisse estimates

In 2008, the government placed truck radials under the 'restricted' import list, which required companies to obtain a licence to import these tyres instead of the free import regime earlier. This requirement, though, has been recently relaxed given the tight supply-demand situation in this particular segment.

The government has recently relaxed import restrictions on truck radials which were imposed in 2008

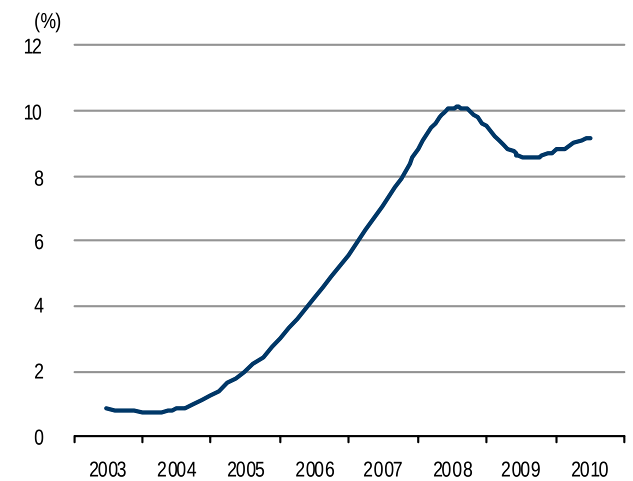
However, we note that despite these measures, the import of T&B radials has continuously increased, and growth was especially sharp in FY10 (+55% YoY). This coincided with, and likely accelerated due to recent developments in the US, where the government has imposed heavy tariffs on Chinese tyre imports for a three-year period starting September 2009.

Figure 54: **Radial T&B imports continued to rise despite duties and bans ('000 units)**



Source: Ministry of Commerce, Credit Suisse estimates

Figure 55: **T&B imports constitute 9-10% of total domestic production**



Source: Ministry of Commerce, ATMA, Credit Suisse estimates

Cheap imports from China pose a threat to the pricing power of domestic players, and the risk becomes especially significant when rubber prices are high. However, we highlight that this is mostly restricted to OEM sales, since most Chinese maunfacturers lack the necessary distribution and after-sales service network to compete effectively in the replacement market.

Valuation comparables

Figure 56: **Valuation comparables**

				Target		Mkt cap	P/E (x)			P/B (x)			EV/EBITDA (x)			ROE (%)		
Company	**Ticker**	**FX**	**Rating**	**price**	**Price**	**(US$ mn)**	**FY11E**	**FY12E**	**FY13E**	**FY11E**	**FY12E**	**FY13E**	**FY11E**	**FY12E**	**FY13E**	**FY11E**	**FY12E**	**FY13E**
Apollo Tyres	APTY IN	INR	O	108	74	794	9.1	6.4	5.3	1.6	1.3	1.1	4.9	3.7	3.2	17.6	20.4	20.2
JK Tyres	JKI IN	INR	N.R.		171	150	4.3	3.6	n.a.	0.7	0.6	n.a.	3.8	3.2	n.a.	16.2	18.6	n.a.
Ceat Tyres	CEAT IN	INR	N.R.		155	114	6.2	4.4	n.a.	0.8	0.7	n.a.	5.4	4.0	n.a.	12.9	16.0	n.a.
Bridgestone	5108 JT	JPY	N.R.		1,478	14,285	13.9	11.5	9.9	1.0	0.9	0.9	5.3	4.8	4.4	7.2	8.4	9.2
Sumitomo	5110 JT	JPY	N.R.		776	2,426	12.3	9.5	8.0	1.0	1.0	0.9	6.0	5.3	4.9	8.5	9.9	11.0
Yokohama	5101 JT	JPY	N.R.		384	1,564	11.9	9.1	7.9	0.8	0.7	0.7	5.6	5.1	4.9	6.4	7.8	8.2
Toyo Tyre	5105 JT	JPY	N.R.		167	505	8.7	6.3	5.3	0.5	0.5	0.5	4.3	3.8	3.2	7.0	9.2	10.0
Michelin	ML FP	EUR	U	46	60	11,460	13.7	9.9	8.1	1.5	1.4	1.2	5.9	4.9	4.3	8.6	12.2	14.0
Pirelli	PC IM	EUR	N.R.		5	3,249	22.8	12.5	10.0	1.2	1.2	1.1	6.1	5.5	5.0	(0.0)	10.3	11.7
Continental	CON GY	EUR	O	52	49	12,462	11.1	8.7	6.8	1.9	1.6	1.4	5.9	5.1	4.5	8.9	12.4	-
Nokian Renkaat	NRE1V FH	EUR	N.R.		23	3,779	18.6	15.2	12.6	3.4	3.0	2.5	11.8	9.9	8.9	19.6	20.4	21.4
Delticom AG	DEX GY	EUR	N.R.		43	653	22.1	18.9	16.4	9.6	9.0	8.4	13.7	11.6	10.0	48.7	60.8	74.2
Goodyear	GT US	USD	N.R.		9	2,245	20.7	6.0	4.0	1.2	2.0	1.7	3.6	2.7	2.3	13.3	40.7	43.0
Cooper Tire	CTB US	USD	N.R.		16	995	7.3	6.9	6.1	1.7	1.6	1.3	3.0	2.7	2.3	31.8	27.1	27.1
Titan Intl	TWI US	USD	N.R.		10	358	36.6	17.0	10.1	n.a.	n.a.	n.a.	6.2	4.8	3.2	13.0	n.a.	n.a.
Cheng Shin	2105 TT	TWD	N	67	65	4,168	12.5	12.3	11.5	2.8	2.5	2.2	8.0	7.7	7.3	22.4	20.1	19.0
Kenda Rubber	2106 TT	TWD	N.R.		32	623	10.2	8.4	n.a.	1.7	1.4	n.a.	6.1	5.3	n.a.	19.1	20.1	n.a.
Nexen Tire	002350 KS	KRW	N.R.		6,880	551	7.1	5.8	5.2	1.4	1.1	0.9	3.9	3.4	3.0	21.6	21.8	19.9
Hankook	000240 KS	KRW	N.R.		26,400	3,391	9.6	8.7	8.3	1.7	1.4	1.2	7.1	6.7	6.3	19.4	18.4	16.6
Guizhou Tyre	000589 CH	CNY	N.R.		12	458	16.2	13.5	12.9	1.9	1.7	1.5	9.4	8.5	8.0	11.8	13.5	13.4
Xingda Intl	1899 HK	HKD	N.R.		6	1,061	10.1	9.6	8.5	1.7	1.4	1.2	6.0	5.3	4.6	18.0	16.2	15.9

Source: Company data, Credit Suisse estimates

Financials

Figure 57: **Apollo Tyres consolidated P&L**

Year ending March	2009	2010	2011E	2012E	2013E
Net sales	49,841	81,207	90,725	104,465	116,992
Change (%)	*6.2*	*62.9*	*11.7*	*15.1*	*12.0*
Expenditure					
Total RM	34,003	45,808	55,170	62,881	70,553
% of Net sales	*68.2*	*56.4*	*60.8*	*60.2*	*60.3*
RM/unit					
Employee cost	4,150	10,885	12,191	13,296	14,505
Change (%)	*-5.8*	*162.3*	*12.0*	*9.1*	*9.1*
% of Net sales	*8.3*	*13.4*	*13.4*	*12.7*	*12.4*
Other expenses	7,526	12,766	13,106	14,507	15,892
Total expenses	45,679	69,459	80,467	90,684	100,950
EBITDA	**4,161**	**11,749**	**10,258**	**13,781**	**16,042**
Change (%)	*-29.8*	*182.3*	*-12.7*	*34.3*	*16.4*
% of Net sales	*8.3*	*14.5*	*11.3*	*13.2*	*13.7*
Depreciation	1,285	2,542	2,800	3,432	3,913
EBIT	2,876	9,206	7,458	10,349	12,129
Interest costs	973	1,154	1,600	1,950	1,900
Other income	230	214	270	290	310
Profit before tax	2,134	8,266	6,128	8,689	10,539
Tax	742	2,607	2,022	2,867	3,478
Effective rate (%)	*34.8*	*31.5*	*33.0*	*33.0*	*33.0*
Profit after tax	1,392	5,660	4,106	5,822	7,061
Change (%)	*-48*	*307*	*-27*	*42*	*21*
% of Net sales	*2.8*	*7.0*	*4.5*	*5.6*	*6.0*
Dividend	227	378	378	504	630
Payout (%)	*19*	*8*	*11*	*10*	*10*
EPS (Rs)	2.76	11.23	8.15	11.55	14.01

Source: Company data, Credit Suisse estimates

Figure 58: **Apollo Tyres consolidated balance sheet**

Year ending March	2009	2010	2011E	2012E	2013E
Sources of funds					
Share capital	504	504	504	504	504
Equity capital	504	504	504	504	504
Reserves	12,992	19,174	22,839	28,073	34,399
Networth	13,496	19,678	23,343	28,577	34,904
Deferred tax	1,942	2,514	2,514	2,514	2,514
Loans	8,907	17,072	24,629	23,593	20,893
Secured loans	6,368	14,465	22,022	20,986	18,286
Unsecured loans	2,539	2,607	2,607	2,607	2,607
Capital employed	**24,345**	**39,264**	**50,487**	**54,685**	**58,311**
Application of funds					
Gross fixed assets	22,840	55,628	69,628	76,628	83,628
Less: Depreciation	8,822	31,203	34,003	37,435	41,348
Net fixed assets	14,019	24,425	35,625	39,193	42,280
Capital WIP	2,814	5,360	5,360	5,360	5,360
Investments	48	59	59	59	59
Goodwill	235	1,175	1,175	1,175	1,175
Curr.assets, L & adv.	14,230	23,704	26,633	29,886	32,983
Inventory	6,302	9,929	11,502	12,963	14,430
No. of days	*50*	*52*	*52*	*52*	*52*
Sundry debtors	2,247	7,869	8,906	10,278	11,524
No. of days	*15*	*34*	*34*	*34*	*34*
Cash & bank balances	3,621	3,490	3,490	3,490	3,490
Loans and advances	2,059	2,416	2,735	3,156	3,539
Current Liab. & Prov.	7,001	15,459	18,366	20,989	23,546
Creditors	5,470	11,976	14,423	16,439	18,445
No. of days	*59*	*95*	*95*	*95*	*95*
Other liabilities	391	1,146	1,298	1,497	1,679
Provisions	1,141	2,337	2,645	3,052	3,422
Net current assets	7,228	8,245	8,267	8,898	9,437
Application of Funds	**24,345**	**39,264**	**50,487**	**54,685**	**58,311**

Source: Company data, Credit Suisse estimates

Figure 59: Apollo Tyres consolidated cash flow statement

Year ending March	2009	2010	2011E	2012E	2013E
OP/(Loss) before tax	2,876	9,206	7,458	10,349	12,129
Interest/Div. received	230	214	270	290	310
Depreciation and amort.	1,285	2,542	2,800	3,432	3,913
Direct taxes paid	-556	-2,034	-2,022	-2,867	-3,478
(Inc)/Dec in wkg capital	317	-1,148	-22	-630	-539
CF from Op. activity	4,152	8,781	8,484	10,573	12,335
Other items	-19	-939	0	0	0
CF after EO Items	4,133	7,842	8,484	10,573	12,335
(Inc)/Dec in FA+CWIP	-5,117	-15,495	-14,000	-7,000	-7,000
(Pur)/Sale of invest.	4	-11	0	0	0
CF from Inv. activity	-5,113	-15,506	-14,000	-7,000	-7,000
Issue of shares	545	963	0	0	0
Inc/(Dec) in debt	2,446	8,164	7,557	-1,036	-2,700
Interest paid	-973	-1,154	-1,600	-1,950	-1,900
Dividends paid	-265	-441	-441	-588	-735
CF from Fin. Activity	1,754	7,533	5,516	-3,573	-5,335
Inc/(Dec) in cash	774	-131	0	0	0
Add: beginning balance	2,847	3,621	3,490	3,490	3,490
Closing balance	3,621	3,490	3,490	3,490	3,490

Source: Company data, Credit Suisse estimates

Companies Mentioned *(Price as of 31 Aug 10)*
Apollo Tyres (APLO.BO, Rs71.95, OUTPERFORM, TP Rs108.00)

Disclosure Appendix

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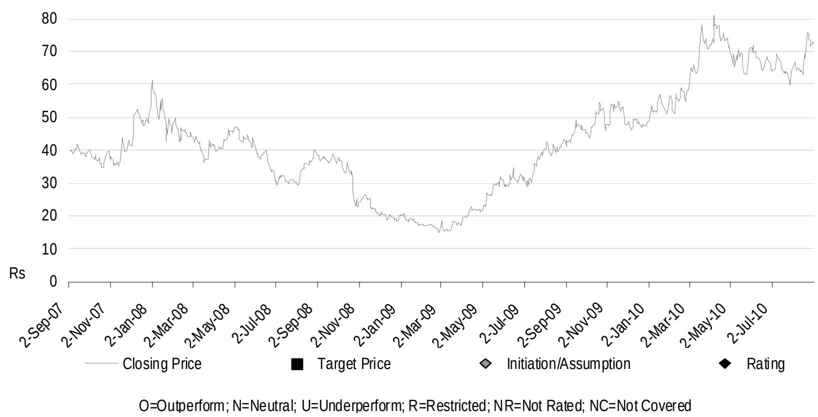
3-Year Price, Target Price and Rating Change History Chart for APLO.BO

APLO.BO Date	Closing Price (Rs)	Target Price (Rs)	Rating	Initiation/ Assumption



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Price Target: (12 months) for (APLO.BO)

Method: Our target price of Rs 108 for Apollo Tyres is based on enterprise value (EV) of 5.5x FY12E earnings before interest, tax, depreciation and amortisation (EBIDTA), in-lne with global peers. We prefer valuing tyre stocks by enterprise value to earnings before interest, tax, depreciation and amortisation (EV/EBIDTA) due to the cyclical nature of the business.

Risks: Risks to our target price of Rs 108 for Apollo Tyres include 1) slowdown in the auto industry 2) unexpected and prolonged shut-downs or strikes at any of its manufacturing which would impact volumes temporarily 3) sharp and unprecedented rise in rubber prices which would impact margins 4) significant increase in cheap tyre imports which could lead to market disruption

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