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Apollo Tyres Ltd.

EQUITY REPORT

March 21, 2014

BSE Code:	500877	NSE Code:	APOLLOTYRE	Reuters Code:	APLO.NS	Bloomberg Code:	APTY:IN

Apollo Tyres Ltd, with its corporate headquarter in Gurgaon, India, is in the business of manufacture and sale of tyres since its inception in 1972. Over the years, the company has grown manifold, establishing its footprint across the globe. The company has manufacturing presence in Asia, Europe and Africa, and exports to over 100 countries including some of the most evolved markets of Europe and America. It is the second largest tyre manufacturer in India and one of the top 16 global tyre manufacturing companies with a total installed capacity of 1,785 MT/Day, over 16,000 employees, and 9 manufacturing facilities across 3 continents & 6 key brands.

Investor's Rationale

- Termination of Cooper deal is a positive sign for the company, as the deal would have strained the consolidated balance sheet (acquisition cost of USD 2.5 bn mainly funded through debt) and would have resulted in increase in interest burden of around USD 180-200 mn.

- Launch of 4G series tyres in India gives the company an advantage to expand its product portfolio and cater to low, mid and high end vehicle segment. Also, company recently launched its premium European brand "vredestein" in India to cater high end vehicle as sales of high end vehicles witnessed double digit growth, as against passenger vehicles, which is highly impacted by slowdown. Further, the company plans to launch around 10-12 new products in the passenger vehicle segment to cater wider vehicle category over the next two years.

- Correction in the prices of natural rubber over the last one year have given the company a significant advantage in terms of profits. We expect this weakness to continue which augurs well for the profitability. Natural rubber prices have already corrected by 9% QoQ in December quarter and prices are already down 24% YoY for the current fiscal. The benefits of lower rubber prices and higher production capacity would be well reflected in the performance of the company in the coming quarters.

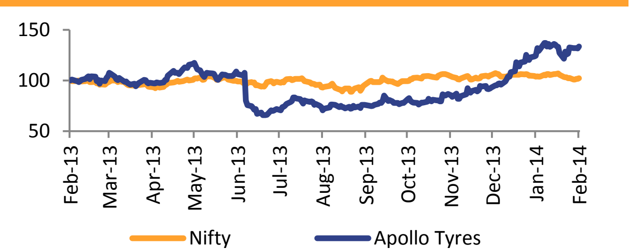
- Apollo Tyres is looking at forging partnerships with vehicle manufacturers at the global level. Incidentally they have already penned a deal with Volkswagen (VW) to be the global Original Equipment (OE) supplier to Volkswagen for the Passat. The partnership is expected to grow as Apollo does cater to a number of VW products in different markets.

Market Data	
Rating	**BUY**
CMP (₹)	143
Target (₹)	**175**
Potential Upside	~22%
Duration	Long Term
Face Value (₹)	1.0
52 week H/L (₹)	144.2/54.6
Adj. all time High (₹)	144.2
Decline from 52WH (%)	0.8
Rise from 52WL (%)	161.9
Beta	0.9
Mkt. Cap (₹bn)	72.1
Enterprise Value (₹bn)	91..6

Fiscal Year Ended

Y/E	FY12A	FY13A	FY14E	FY15E
Revenue (₹bn)	121.5	127.9	138.2	149.2
EBITDA (₹bn)	4.1	6.1	8.2	9.3
Net Profit (₹bn)	0.5	0.5	0.5	0.5
Adj EPS (₹)	8.1	12.2	16.4	18.4
P/E (x)	17.6	11.8	8.7	7.8
P/BV (x)	2.5	2.1	1.8	1.5
EV/EBITDA (x)	8.2	6.3	4.9	4.4
ROCE (%)	12.8	15.9	18.3	18.5
ROE (%)	14.5	18.0	20.5	19.9

One year Price Chart



Shareholding Pattern (%)	Dec'13	Sep'13	Diff.
Promoters	43.50	43.50	0
FII	28.94	33.48	(4.54)
DII	9.21	8.04	1.17
Others	18.35	14.98	3.37

Apollo Tyres is the second largest tyre manufacturer in India with a total installed capacity of 1,785 MT/Day.

Apollo Tyres – 2nd largest tyre manufacturer of India

Apollo Tyres Ltd is the second largest tire manufacturer in India and one of the top 16 global tyre manufacturing companies with a total installed capacity of 1,785 MT/Day, over 16,000 employees, and 9 manufacturing facilities across 3 continents & 6 key brands. The company has manufacturing presence in Asia, Europe and Africa, and exports to over 100 countries including some of the most evolved markets of Europe and America. The company's joint venture with Michelin, France for producing dual branded truck & bus radial tyres in India is the market leader in the category. The company is in technical collaboration with General Tire International Company USA and produces some of India's most advanced tyres for trucks, tractors, light commercial vehicles and cars. Mahindra and Mahindra and TAFE are its major OEM clients.

Witnessed healthy performance in Q3FY'14

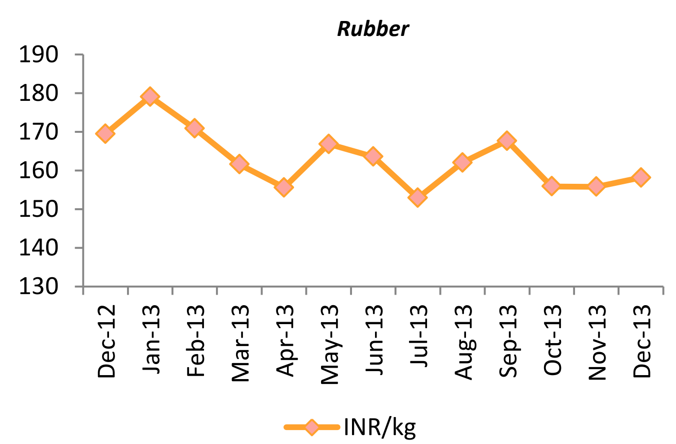
The tyre maker registered a massive rise in its consolidated net profit by 87.15% YoY to ₹3.4 bn in Q3FY'14 helped by benefits accruing from a better product portfolio. Net sales of the company surged 8.01% YoY to ₹34.75 bn backed by improved and expanded product range in key markets. Further, margin expansion at European and South African business further strengthened the performance. It was reported that the consolidated EBITDA margins surprised positively and stood at 16%, up 410bps YoY (282bp QoQ).

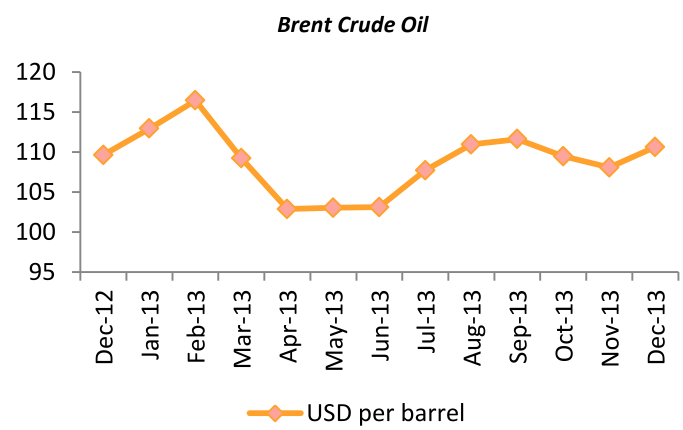
Raw material prices continued sliding

The raw material prices declined by about 7% YoY dragged by weakness in the global economy, particularly China, US, Europe and India. Rubber, which constitutes about 60-65% of the total raw material cost, declined by around 7% in December 2013 from a year ago period, while carbon black and other chemicals, which together constitute about 20% of the total raw material cost, are the byproduct of crude, thereby their price are linked with international crude oil prices.

Brent Crude price was marginally up by 90 bps to USD 110.6 per barrel in December 2013 as against USD 109.6 per barrel a year ago period. Also, recent strengthening of Rupee against the USD would help the company to contain the key input (natural rubber) cost, bulk of which is imported, to some extent.

Raw Material Price Trend





Strengthening its product offering further in the Indian market, Apollo Tyres has launched its premium European brand, Vredestein in India. Vredestein brand, known for its designer and high quality tyres, is entering India primarily to cater to the luxury vehicles, premium luxury sedans and SUVs

Product portfolio revival to gain greater market share

Making an addition to its product offering, Apollo Tyres launched its premium European brand, Vredestein in India. Vredestein is acknowledged for its designer and high quality tyres and is entering India with tyre sizes of 15” to 20”, primarily catering to the luxury vehicles, premium luxury sedans and SUVs, with speeds upto 240 to 300 kph. Vredestein brand would complement the existing product range from Apollo Tyres in the passenger vehicle tyres space.

The new range will target high-end cars in the country and the company is eying a monthly sale of around 5,000 tyres to start off in the after-market replacement segment. The total size of passenger car tyres in the after-market segment in India is around 14 lakh units per month, of which 70,000 is the premium car segment. Vredestien has a production capacity of around 7 million tyres per annum at its plant in Holland.

Eventually, the company aims at manufacturing them in India but until then the tyres will be manufactured at the Holland facility. Vredestein tyres will be distributed in India through a set of partners mostly in the tier I and tier II cities. These premium tyres would be sold through multi-branded outlets, including existing Apollo Zones.

Peer Comparison

(Consolidated)	CMP*(₹)	EPS(FY13) (₹)	Book Value Per Share (FY13)(₹)	EBITDA Margin (FY13)	PAT Margin (FY13)
Apollo Tyres	143	12.2	67.5	11.4%	4.8%
CEAT	434	31.1	217	9.0%	2.4%
JK Tyre	170	25.7	181	9.0%	3.0%
MRF	22,301	1,366.0	6,746	10.6%	4.8%

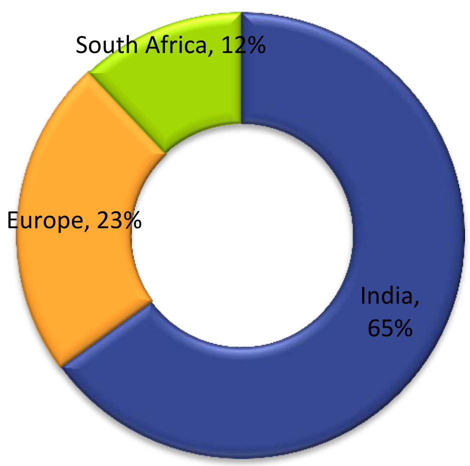
Transaction with Sumitomo Rubber Industries (SRI) will translate into strengthened distribution network across Africa

Focus on strengthening distribution network in Africa

Apollo Tyres Ltd strike a deal with Sumitomo Rubber Industries (SRI), where in SRI will take over Apollo Tyres South Africa (ATSA) including the Ladysmith passenger car tyre plant and Dunlop brand rights in 32 countries of Africa for USD 60 million. However, Apollo has retained the Durban plant, which manufactures Truck & Bus Radial (TBR) tyres and Off Highway tyres (OHT) used in the mining and construction industries. Apollo Tyres will continue to sell Apollo, Vredestein and Regal branded tyres in Africa. Both the companies will also undertake contract manufacturing of their respective brands at each other’s facility to have locally manufactured products available for the market. So this will result in economies of scale and efficiency for both the companies and thus resulting in lower fixed cost per unit.

Using South Africa as the base, the company will now focus on brands where its own global rights, which the company has already been selling in South Africa for the past few years, for the African and Latin American markets.

Geographical revenue segmentation (FY13)



European operations far ahead....

European operations offset the impact of slowdown in India and South Africa on the operating profits front.

Due to the slowdown in the major economies, the contribution of the OEM segment declined to 24% in FY13 as against 27% in FY12. However, replacement segment went up to 76% from 73% last year as a result of a slowdown in OEM. Product mix remains stable. European operations offset the impact of slowdown in India and South Africa on the operating profits front. EBIT for the European operations stood at 14.5% for FY13, highest among geographies.

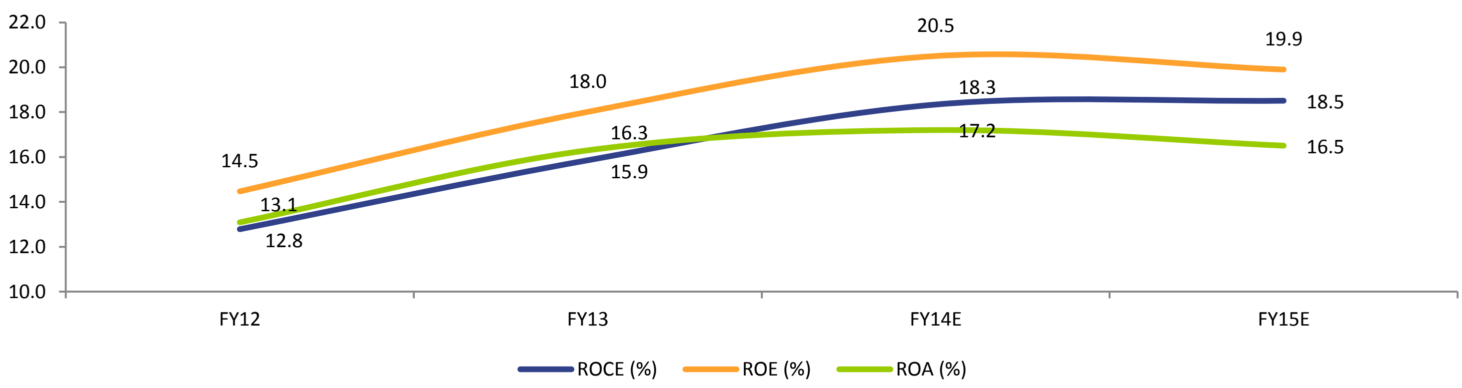
India: Sales grew by 4% YoY to ₹85.08 bn in FY13 led by a marginal increase in volume. EBIT margin for full year improved from 6.1% to 8.6%. YoY, growth of 235 bps.

South Africa: On the South African operations front, company reported a sales growth of over 15% YoY to ₹14.97 bn in FY13. The company reported an operating loss of ₹14 mn in FY13 as against a loss of ₹433 mn in FY 12.

European operations: On full year basis, sales were nearly ₹29.90 bn, up by 5% over last year and EBIT margin for the same stood at 14.5% as against 13.6% a year ago period, a growth of around 90bps.

Capacity utilization for the year ended March 2013 in India is about 75%, Europe at about 85% and South Africa has been nearly at 70% levels.

Return ratios to stay elevated

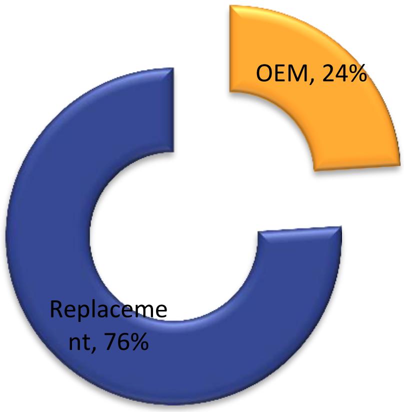


Apollo launches 4G range of passenger car tyres; plans 10-12 new products in the passenger vehicle category in the next 2 years

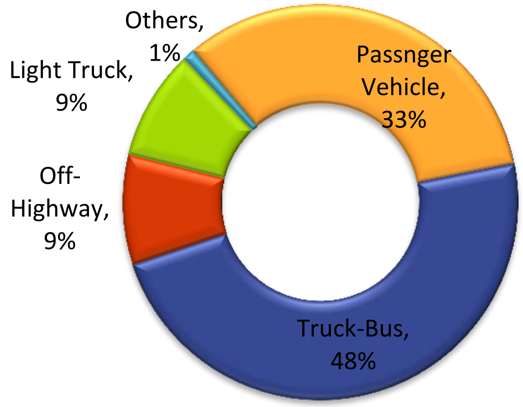
Apollo launched 4G range of passenger car tyres; plans 10-12 new products in the passenger vehicle category in the next 2 years

Apollo Tyres has launched new 4G range of tyres 'Aspire 4G, Alnac 4G and Amazer 4G' in three different variants, which are specifically designed for mini, compact and premium compact four-wheelers in India. The Aspire 4G is high performance tyres with Y and W speed ratings and is available in 16" and 17" sizes. According to Apollo, these fourth generation of tyres are the most technologically advanced tyres from their portfolio. Apollo Alnac 4G has been particularly designed for mid-size and executive car segments in India and has a speed rating of V and H (available in 15" and 16" sizes). The third range of tyre, Amazer 4G is designed for cars in the mini, compact and premium compact segments and available in 12" – 14" sizes. Further, in a move to keep up with the introduction of newer and bigger cars in India and to step up ways to boost sales revenue amidst weak consumer sentiment due to high interest rates, high fuel prices and an ongoing economic slowdown, Apollo Tyres is planning 10-12 new products in the passenger vehicle category in the next 2 years.

Revenue segmentation (FY13)



Product wise segmentation (FY13)



Consolidating R&D to become a USD 6 bn tyre company by 2016

Focus on improving R&D facilities to create synergy and greater alignment to the company's growth aspirations

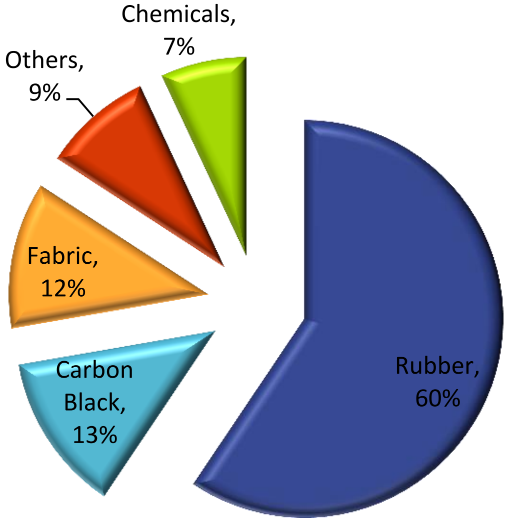
With an aim to bring cutting-edge technology and innovation in the development of car and van tyres of the future and also to strengthen its relationship with the global OEMs, Apollo Tyres has opened World-class global R&D center in Enschede, the Netherlands. The Global R&D Centre will serve as a hub for the development and testing of car and van tyres for all product brands -- Apollo, Vredestein and Dunlop (32 countries in Africa) -- of the company. According to the company, the Global R&D Centre is an important milestone in its journey to become a USD 6 bn tyre company by 2016. In order to achieve this vision, the company plans to ramp up the R&D spend to 3% of its sales revenue. The company has also restructured its R&D team, across its 3 key geographies, to create synergy and greater alignment to the company's growth aspirations; and to generate speed and relevance while entering new markets. The company is bringing together its R&D resources comprising almost 250 people in Africa, Europe and India to create two global R&D hubs – Enschede the Netherlands for Car & Van tyres and Chennai, India for Commercial Vehicle tyres.

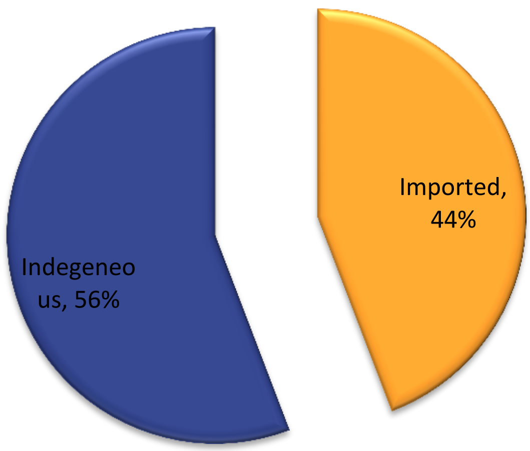
Indian tyre industry gaining momentum as imports from China decline

Growth in the Indian tyre industry continued following decline in imports from China led by reduction in export subsidy and increasing cost inflation.

After witnessing a CAGR of 19% in import growth, tyre imports, especially from China, have declined considerably in the last two fiscals. This is on the back of reduction in export subsidies and increasing cost inflation in China leading to erosion of price competitiveness of Chinese tyres and significant rupee depreciation narrowing the price differential between imported and domestic tyres. Further, the ramp up of domestic capacities backed by massive domestic investments and slowdown in the domestic OEM market has also supported the moderation in tyre imports.

Raw Material Composition





Key Concerns

- Raw material price volatility: Natural rubber is an agricultural commodity and subject to price volatility and production concern. While most other raw material is linked to crude oil prices and is affected by volatility in crude prices. Both natural rubber and crude prices are controlled by external factors.
- Tyre industry is dependent on economic growth, reviving of investment cycle, higher purchasing power in rural areas and controlled inflation.
- Higher interest rates dampen the demand outlook of the automobile industry as a whole thereby reducing the OEM demand for tyres.
- Increased competition from global players like Michelin and Bridgestone in India, particularly in truck-bus radial tyre category.

Balance Sheet (Consolidated)

(₹million)	FY12A	FY13A	FY14E	FY15E
Share Capital	504.1	504.1	504.1	504.1
Reserve and surplus	27,823.6	33,396.8	39,621.0	46,021.6
Monies received against Convertible Warrants	-	107.8	107.8	107.8
Net Worth	**28,327.7**	**34,008.6**	**40,232.8**	**46,633.5**
Minority Interest	7.6	-	-	-
Loans	25,496.9	22,816.4	22,607.0	21,477.0
Provisions	5,177.2	5,883.7	6,818.6	6,818.6
Current Liability	20,458.0	17,345.7	24,067.0	27,677.0
Net deferred tax liability	4,050.5	4,937.9	5,367.5	5,367.5
Other long term liabilities	390.9	273.3	197.8	197.8
Capital Employed	**83,908.8**	**85,265.6**	**99,291.3**	**1,08,171.7**
Fixed assets	43,543.7	44,891.5	46,238.3	47,625.4
Goodwill	1,337.7	1,436.1	1,701.8	1,701.8
Investments	158.2	545.8	659.1	659.1
Loans & Advances	5,548.1	4,794.4	5,764.6	6,456.3
Current Assets	33,296.0	33,587.7	44,905.1	51,706.7
Deferred tax assets	25.1	10.1	12.3	12.3
Other Assets	0.0	0.0	10.2	10.2
Capital Deployed	**83,908.8**	**85,265.6**	**99,291.3**	**1,08,171.7**

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Revenue	**1,21,532.9**	**1,27,946.3**	**1,38,182.0**	**1,49,236.6**
Operating Expenses	1,09,871.9	1,13,379.7	1,20,182.5	1,29,797.1
EBITDA	**11,661.0**	**14,566.6**	**17,999.5**	**19,439.5**
Depreciation	3,256.0	3,965.6	4,203.5	4,539.8
EBIT	293.8	(168.6)	0.0	0.0
Other Income	8,111.2	10,769.6	13,796.0	14,899.7
Interest	2,872.9	3,127.7	3,284.1	2,955.7
PBT	326.4	944.5	944.5	944.5
Tax	5,564.7	8,586.4	11,456.4	12,888.5
Minority Interest	1,443.5	2,448.4	3,207.8	3,608.8
Net Profit	**4,121.2**	**6,138.0**	**8,248.6**	**9,279.7**

Key Ratios (Consolidated)

Y/E	FY12A	FY13A	FY14E	FY15E
EBITDA Margin (%)	9.6	11.4	13.0	13.0
EBIT Margin (%)	6.7	8.4	10.0	10.0
NPM (%)	3.4	4.8	6.0	6.2
ROCE (%)	12.8	15.9	18.3	18.5
ROE (%)	14.5	18.0	20.5	19.9
EPS (₹)	8.1	12.2	16.4	18.4
P/E (x)	17.6	11.8	8.7	7.8
BVPS (₹)	56.2	67.5	79.8	92.5
P/BVPS (x)	2.5	2.1	1.8	1.5
EV/Operating Income (x)	0.8	0.7	0.6	0.6
EV/EBITDA (x)	8.2	6.3	4.9	4.4

Valuation and view

The demand for the tyres in the domestic business is expected to remain sluggish with subdued volumes in CV and passenger sales going forward. However, we expect the margins for the company to expand with stable raw material prices coupled with an increase in the share of high margin replacement market. We believe modest revenue growth in the South African operations but the Europe operation, which have been hit due to slowdown in auto sales, is yet to witness a revival. Further, the termination of Apollo-Cooper deal is expected to be positive for Apollo tyres. We expect that with no further capital expenditure to ramp-up capacity, the company will be able to generate positive free cash flow in the coming quarters.

At the current CMP of ₹143, Apollo Tyres is attractively placed at EV/EBITDA of ~4.4xFY15E. Considering the above aspects, we rate the stock as 'BUY' with a target price of ₹175, a potential upside of ~22% for the coming 12 months.

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