Tyre Industry

Institutional Equity Research

Sector Initiating | September 13, 2017

Smooth Treading Ahead on Improving Outlook

Conducive Environment for OEMs Augurs Well

With the dwindling transitory impact of demonetisation/GST roll-out and shift in emission standard to BS-IV from BS-III along with the government's vision to double farm income by 2022, we envisage that the domestic tyre industry is set to witness a healthy growth trajectory, going ahead. Moreover, a normal monsoon, recovery in demand from a normalised environment, growth in rural sales and a low base in the second half of last fiscal should help the sector to report good volume growth in ensuing years, in our view. We believe the domestic tyre manufacturers would witness >10% volume growth in next two to three years.

Likely Anti Dumping Duty on Chinese Tyres – A Key Catalyst

A likely imposition of Anti Dumping Duty on import of Chinese Truck & Bus Radial (TBR) tyres would enable the domestic players to enhance market share as well as boost their margins with a level playing pricing environment. Notably, prices of Chinese TBR tyres are currently ~10-15% lower than the domestic TBR tyres, which makes the domestic business unviable. Looking ahead, we expect a meaningful reduction in Chinese imports (40-50%) from the peak owing to low profitability, which would offer a better opportunity to the domestic tyre manufacturers i.e. Apollo Tyres, JK Tyre etc.

Replacement Demand Continues to Drive Growth

As per our estimates, the replacement segment continues to dominate the Indian tyre market with contribution of ~69% to the total demand. The major reason for high replacement share is due to the fact that the number of registered vehicles/annual sales remains at ~10x at ~200mn registered vehicles (industry estimates) vis-à-vis ~20-25mn annual vehicle sales. On the backdrop of 11% CAGR in automobile production over last 15 years and the need for tyre replacement post average life of 3-4 years, we envisage the contribution of replacement demand to overall pie would increase further.

Cost Basket to Remain Benign

Looking ahead, we believe that rubber prices – the key raw material accounting for >60% of total input cost – to remain under control on the back of less likelihood of any sharp up-tick in crude prices and healthy production outlook for domestic natural rubber. Further, a significant reduction in rubber prices from the high of Feb-Mar'17 (which has already corrected by 20-30%) will aid the domestic tyre manufacturers to report better margin from the current quarter onwards, as the prevailing prices are 5-10% lower on sequential comparison.

Initiate Coverage on Tyre Industry; Apollo Tyres Top Pick

We initiate coverage on the Indian Tyre Industry as we expect the sector to witness a healthy traction ahead on the back of improving outlook of domestic OEM industry, growing road connectivity across the country and rising aspiration of middle class population. Further, with benign raw material prices and likely benefits from possible imposition of Anti Dumping Duty on Chinese TBRs, we expect Indian tyre manufacturers to report better numbers, going ahead.

Notably, the overall tyre sector trades at a low P/E multiple. We see scope for rerating of the sector (like Battery sector, which has high exposure to lucrative after-market segment and trades at 80-100% premium to tyre sector) owing to easing competitive intensity, better pricing environment after imposition of Anti Dumping Duty, change in product-mix and likely improvement in return ratios.

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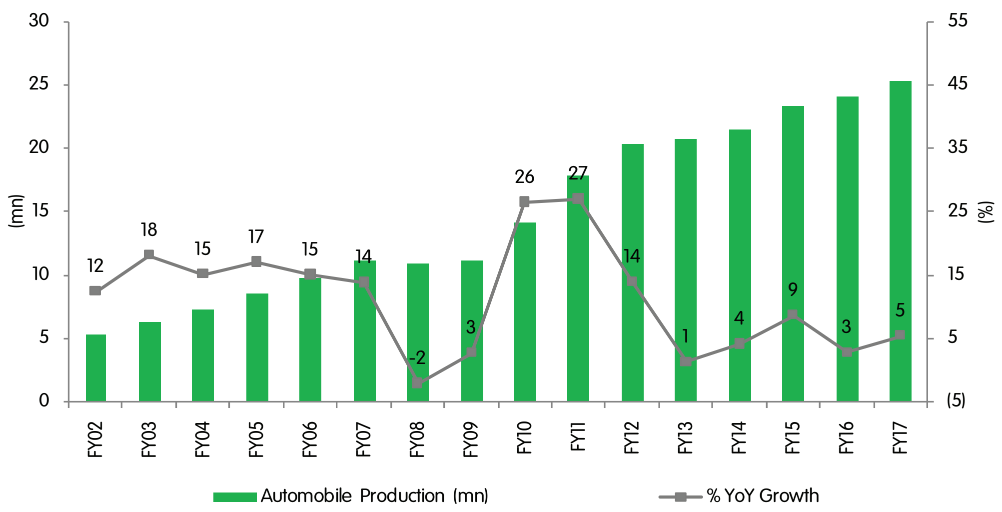
Key Investment Arguments

Improving Outlook for OEMs Bodes Well for Tyre Industry

We envisage the domestic tyre industry to witness a healthy growth trajectory on the back of diminishing impact of demonetisation/GST roll-out and the government's vision to double the farm income by 2022. Despite witnessing sluggishness in 2HFY17, the automobile production grew by 5.4% YoY in FY17 mainly aided by 9.4% YoY and 5.8% YoY growth in Passenger Vehicle (PV) and Two-wheeler segment, respectively. However, the Commercial Vehicle (CV) segment, which commands a larger pie in tyre consumption, grew by mere 3% YoY.

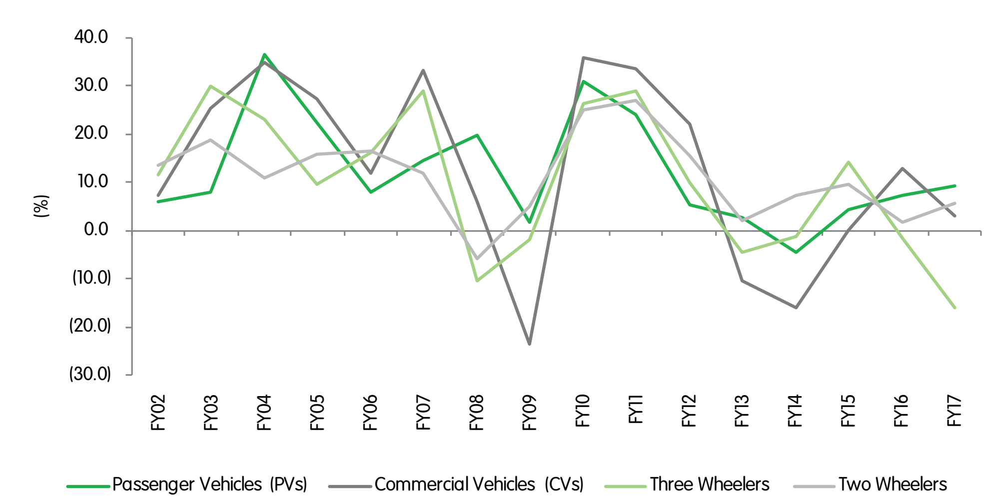
Looking ahead, we believe that a normal monsoon, recovery in demand, growth in rural sales and a low base in 2HFY17 should help the sector to report better volume growth in ensuing years. Further, PV segment – which was least affected by the demonetisation – is expected to continue the strong growth momentum owing to improving affordability and rising aspiration of Indian middle class.

Exhibit 1: Automobile Production and Growth



Source: Industry, RSec Research

Exhibit 2: Segmental Production Growth in OEM



Source: Industry, RSec Research

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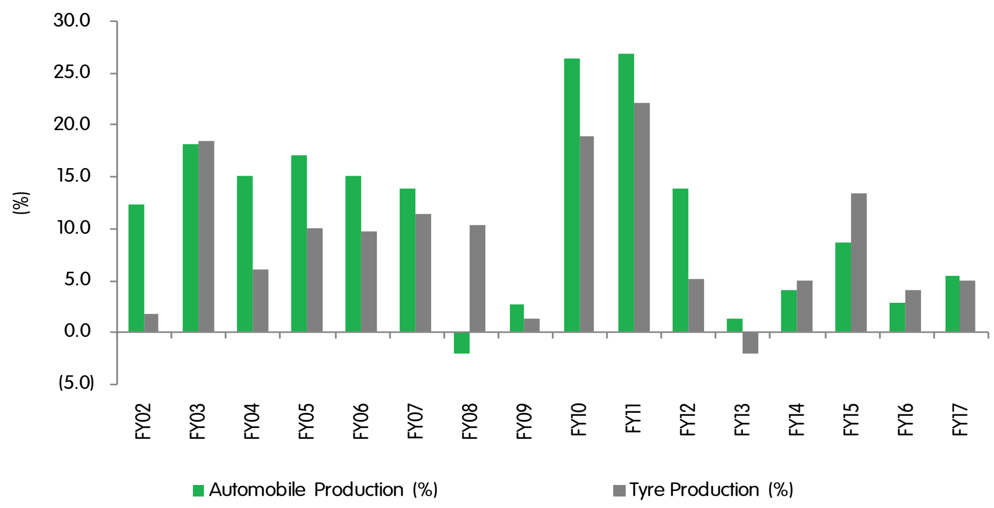
Automobile industry is still in a developing phase, as India accounts for 18 vehicles per 1,000 people as against 69 vehicles per 1,000 people in China and 786 in the USA. Though the OEMs account for ~31% of total domestic tyre consumption, there is a direct co-relation between tyre consumption and OEM production growth. The production figures of last 15 years reflect that while the tyre production witnessed a 9% CAGR over FY02-FY17, the OEM production registered 11% CAGR during the same period.

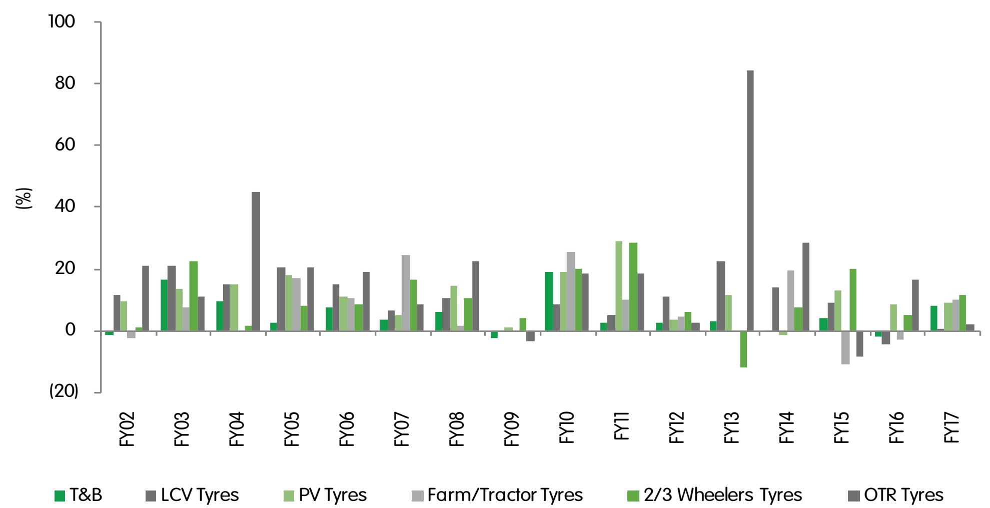
Notably, CV segment accounts for ~55% of India's tyre demand, while globally, this segment contributes ~25-30% to the industry volume. Low penetration of PVs in India vis-à-vis other countries is the prime reason for variation. Going forward, we foresee the PV segment to post robust volume growth due to a recovery in rural markets and growing aspiration of middle class people in urban and semi-urban areas.

Exhibit 3: Growth of Tyre Production and OEM Production over the years



Source: Industry, RSec Research

Exhibit 4: Segmental Tyre Production Growth (%)



Source: Industry, RSec Research

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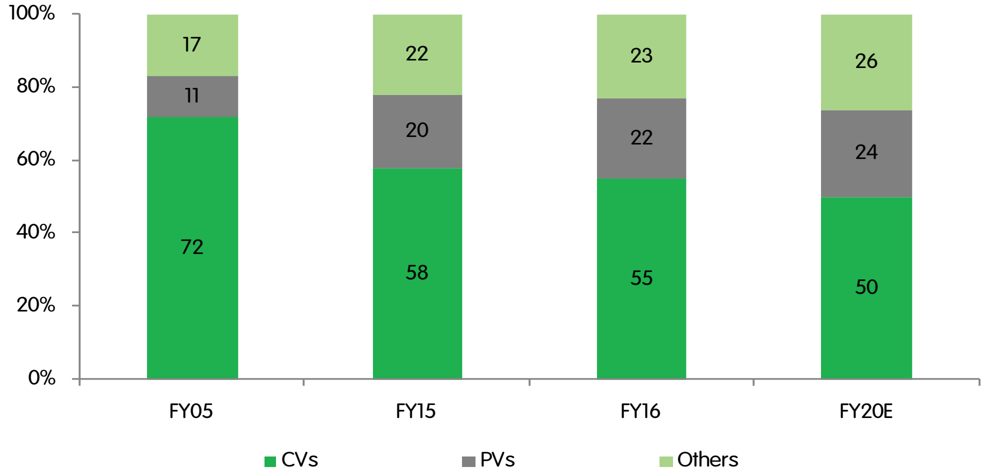
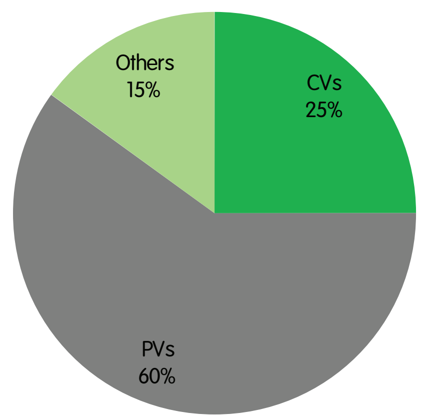
Exhibit 5: CVs form the dominent share in Industry's revenue



Source: Industry, RSec Research

Exhibit 6: Industry Mix- Globally



Source: Industry, RSec Research

Growth Drivers: Looking ahead, we foresee following factors to drive OEM growth in ensuing years.:-

- **Revival in Rural Demand:** Hike in Minimum Support Price (MSP) for agricultural produce in last year (especially for Kharif crops), favourable monsoon, gathering pace of remonetisation, farm loan waivers and improvement in farm yield are expected to drive two-wheeler, CV and tractor volume. We expect these segments to register a double digit growth through FY17-FY20E.
- **Low Interest Rate:** A lower interest rate scenario is always considered to be a boon for the automobile industry. Further, the RBI's constant endeavour to keep inflation at moderate level in FY18 and urgency to revive private capex in the country are likely to keep interest rate favourable, which will in-turn boost the demand for the OEMs across segments.
- **New Models:** As several OEMs are scheduled to launch new models in the current and next fiscal, we foresee a decent volume growth, as historically new models drive volume growth for the industry.
- **Improved Road Connectivity:** With the government's mission to develop 41kms road per day progressing well to accomplish the envisioned target, we envisage most villages will be connected to the highways in the next 2-3 years. This will lead to increased volumes of CVs and PVs, which account for the maximum tyre consumption.

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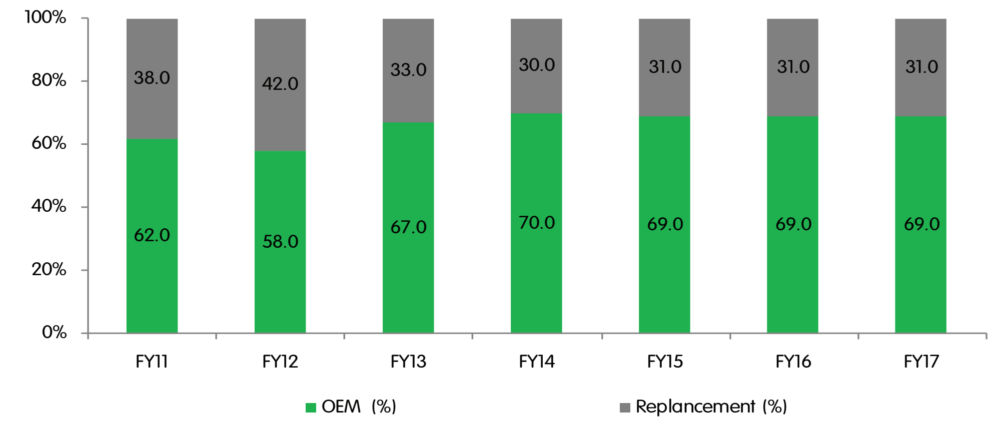
Replacement Demand – Remains a Major Consumption Source

As per our estimates, the replacement segment continues to dominate the Indian tyre market with contribution of ~69% to the total demand. The major reason for high replacement share is due to the fact that the number of registered vehicles/annual sales remains at ~10x at ~200mn registered vehicles (industry estimates) vis-à-vis ~20-25mn annual vehicle sales. On the backdrop of 11% CAGR in automobile production over last 15 years and the need for tyre replacement post average life of 3-4 years, we envisage the contribution of replacement demand to overall pie would increase further.

Radialisation – Keeps on Gathering Pace

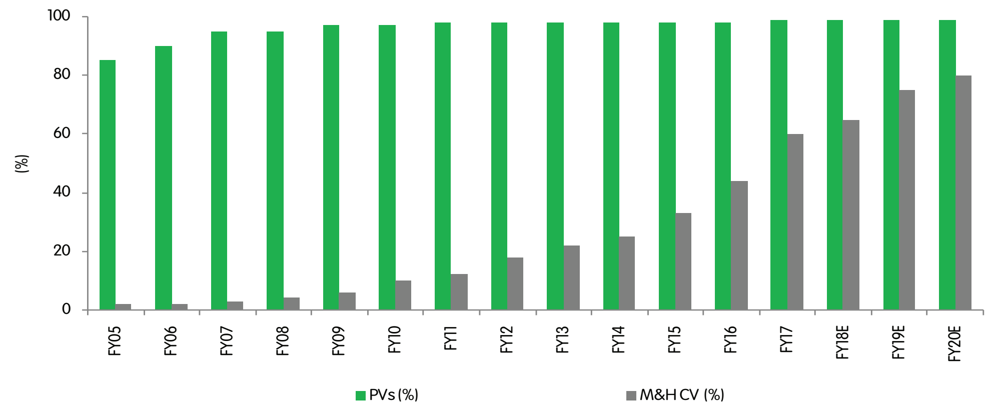
Though cross-ply tyres are still widely accepted in India due to its adaptability on poor road conditions, radial tyres are consistently gaining ground on the back of the inherent benefits. Over the last few years, India has seen an increased adaption of radial tyre technology. Though India has achieved ~100% radialisation in the PV tyre segment, the country still has a lot of growth potential in the CV and two-wheeler segments. On the backdrop of increase in R&D spending by the domestic tyre manufacturers for making cost-effective radial tyres, coupled with growing low-cost Chinese imports, the process of radialisation of CV and two-wheeler segments is expected to happen at a faster pace. Looking ahead, we expect radialisation would account to ~80% of the CV segment from the current level of 40% by FY20E. A shift towards radialisation is margin accretive for the tyre manufacturers as these tyres command a pricing premium of 30-50% vis-à-vis cross-ply tyres.

Exhibit 7: Replacement and OEM Contribution



Source: Industry, RSec Research

Exhibit 8: A snapshot of Radialisation Trend in PVs and CVs



Source: Industry, RSec Research

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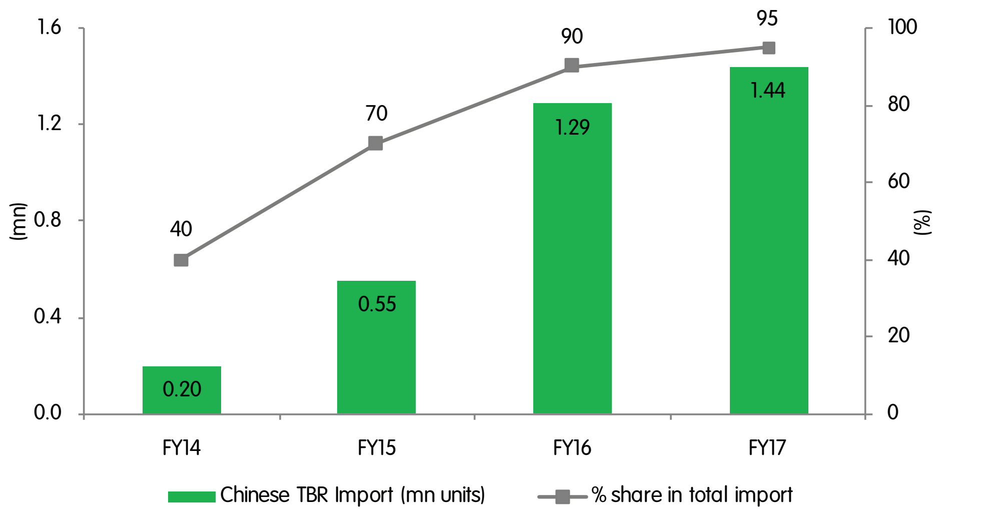
Chinese Import Threat Persists; Anti Dumping Duty May Change Equation

Over the past couple of years, the domestic tyre industry has been facing consistent threat from Chinese imports. Notably, average monthly import of Chinese TBR tyres has registered a whopping 94% CAGR over FY14-FY17 to 1.2lakh units/month in FY17 from 16,400units/month in FY14 (peaked at 1.5 lakh units/month before demonetisation). Consequently, the share of Chinese imports has increased to 95% in FY17 from 40% in FY14.

The significant surge in Chinese imports can be attributed to: (a) high anti-dumping duties in the USA; (b) relaxation of anti-dumping duty in India in Sept'14; (c) price differential of 30-40%; and (d) cash transactions at small retailer and dealer level.

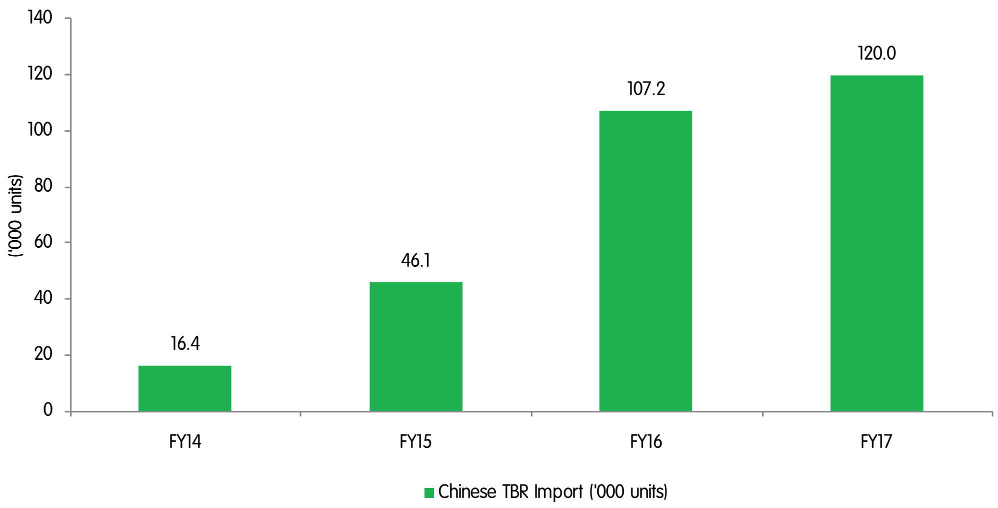
Notably, import of TBR tyres from China declined drastically post demonetisation, as the monthly import volume reduced to <1lakh. Small private operators have been dominating the tyre imports business in India mostly using unscrupulous trade practices and hence, a sudden cash crunch in the system impacted the import volume. However, as remonetisation steadily gathered pace, Chinese imports began to increase to reach >1.2lakh units/month level currently.

Exhibit 9: A snapshot of Chinese TBR Import



Source: Industry, RSec Research

Exhibit 10: Surge in Avg. Monthly Import of Chinese TBR



Source: Industry, RSec Research

Favourable Factors to Curb Chinese Competition: The following factors may favour domestic tyre manufacturers against Chinese imports, in our view.

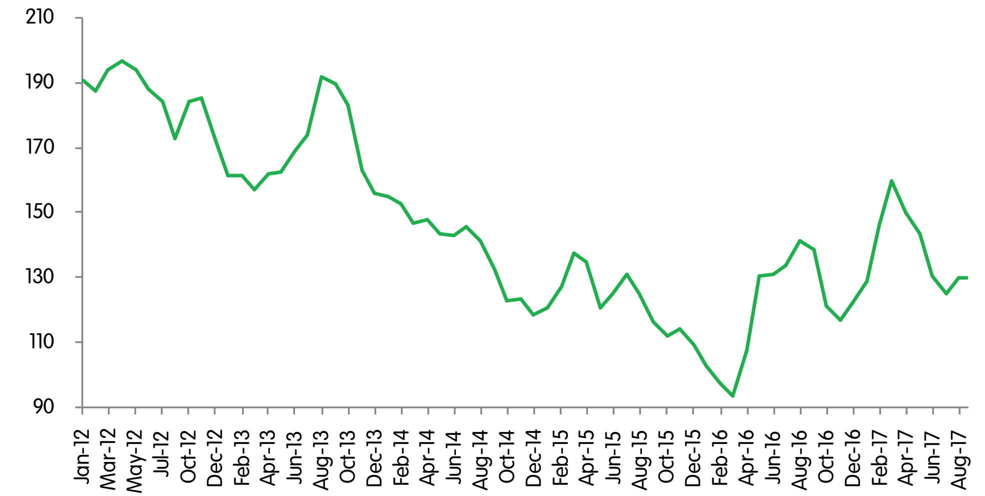
- **Implementation of Anti Dumping Duties on Chinese TBR Tyres:** The Directorate General of Anti-dumping & Allied Duties (DGAA) has recommended imposition of Anti Dumping Duty of US$245-452/tonne on TBR tyres imported from China. We believe that the implementation of the same would be positive for Indian TBR manufacturers (like Apollo Tyres) as it would narrow the current pricing gap of 10-15% between Chinese and Indian TBR tyres, which will help the Indian manufacturers to enhance their market share. The proposed Anti Dumping Duty is expected to be implemented post clearance from the Finance Ministry.
- **GST Roll-out:** The Goods & Services Tax (GST) was rolled out across the country with effect from July 01, 2017. We believe that GST will gradually lead to better tax compliance and discourage small traders to do cash trades. An improvement in tax compliance may not prompt small operators to push the Chinese brands given the absence of extra margins.
- **Conducive Environment in Europe & USA:** Recent relaxation in Anti Dumping Duty on Chinese goods by the US led to higher volume flow to the US. We believe the continuation of this relaxation in duty and a pick-up in economic activity in other key European countries may potentially lead to a slowdown in imports from China.

Rubber Prices Likely to Remain Benign – A Key Margin Booster

Rubber prices play a big role in determining the margin profile of tyre manufacturers, as rubber constitutes ~60% of the total raw material cost. Notably, the correction in rubber prices in the last couple of years benefitted the domestic tyre manufacturers. Meanwhile, rubber prices have witnessed a sharp correction to the tune of 20-30% since Feb'17 owing to concerns over rising inventory and a significant spurt in output in Thailand post floods.

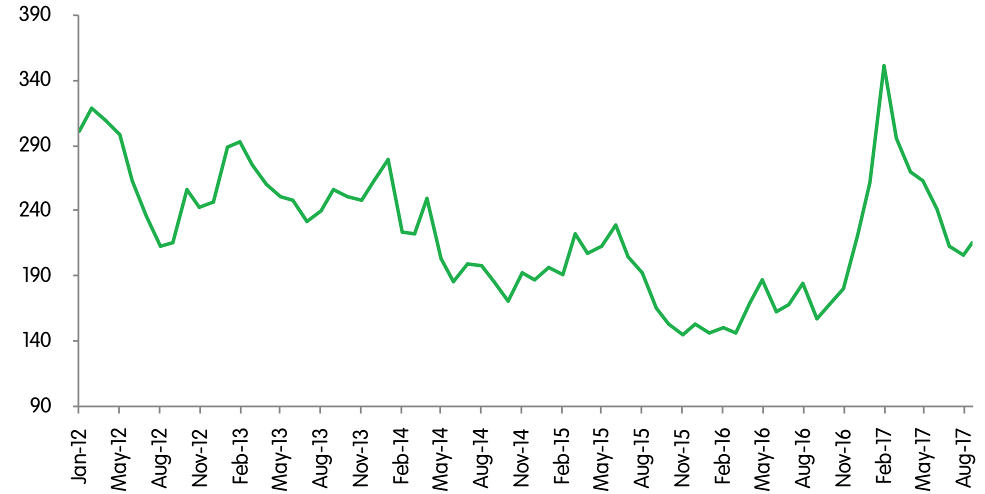
Though domestic tyre manufacturers felt the pinch of higher input cost in 1QFY18, as prices are higher on a yearly comparison, we foresee improvement in their margins in ensuing quarters owing to recent correction in the rubber prices both in domestic and international markets. Looking ahead, we expect that rubber prices would remain favourable for the domestic tyre manufacturers and are unlikely to witness any significant upsurge hereon on the back of increased production of natural rubber (+23% YoY in FY17) in India. Moreover, the output scenario is expected to sustain, going forward owing to promotional efforts initiated by the Rubber Board and implementation of Rubber Production Incentive Scheme (RPIS) by the Kerala Government. Further, the expected 16% growth in natural rubber output in FY18 to 0.8mnT, persistent of rising inventory in major rubber producing nations and gradual shift to greener tyres augur well for the domestic tyre manufacturers as well.

Exhibit 11: NR- RSS-4 Price- Kottayam (Rs/kg)



Source: Industry, RSec Research

Exhibit 12: Tokyo Rubber Price (JPY/kg)



Source: Industry, RSec Research

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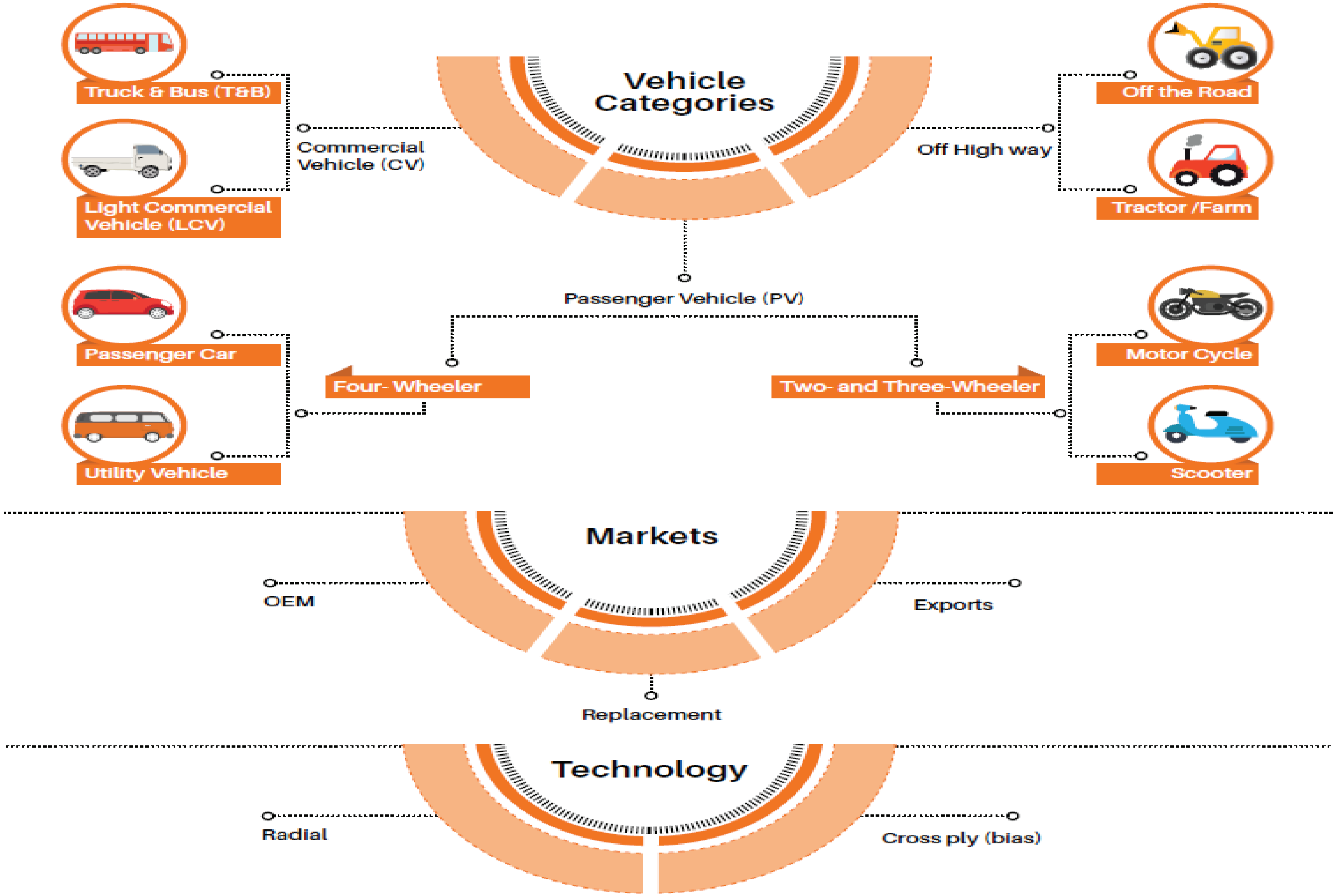
Annexure: Broad Segmentation of Tyre Industry



Source: Industry

Company Section

	CMP	Target Price	Rating	Revenue		EBITDA Margin (%)		PAT		P/E (x)		RoE (x)	
(Rs mn)	(Rs)	(Rs)		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
CEAT	1,778	2,030	BUY	64,659	72,041	9.5	11.6	3,051	4,258	23.6	16.9	12.0	14.9
Apollo Tyres	263	350	BUY	154,734	186,666	12.6	15.6	9,379	13,987	14.3	9.6	12.2	16.0
JK Tyres	154	180	BUY	83,968	93,112	10.2	14.0	734	4,412	47.6	7.9	3.5	19.2

CEAT

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Expansion and Change in Product Mix Holds the Key

Thrust on TBR & PCR Segments to Drive Growth

Having made a formidable presence in 2W tyre segment in India (2nd largest player after MRF with 30% market share), CEAT is targeting TBR and PCR segment aggressively for future growth. Presently, CEAT enjoys a market share of 9% and 4% for PCR and TBR segments, respectively, which can be improved in light of growing demand of these vehicles. Notably, TBR tyres enjoy ~25% market share in the domestic tyre industry. Envisaging limited scope of further gain in overall market share due to the presence of players i.e. Apollo Tyres, Maxxis, JK Tyre putting new capacities and aggressively pursuing for two-wheeler tyre segment, CEAT has realised the void in its portfolio and decided to invest Rs10bn to take its TBR capacity to 200TPD from 80TPD in ensuing fiscals. Further, CEAT is targeting to build up a quality portfolio in the PCR segment with world-class products in order to gain acceptance and market share in this highly competitive segment. We expect revenue contribution from PCR and TBR segment to reach 33% and 14%, respectively by FY19E.

Prudent & Timely Capacity Expansion Bode Well

Over the last two years, CEAT has been prudently expanding its capacity with a view to reducing dependence on the outsourcing partners. It has set up a Greenfield plant in Nagpur (for two-wheelers and three-wheelers) and expanded the capacity of Halol plant (PC/UV) over the past one year. Planned investment to the tune of Rs28bn for expansion in PC radials, two-wheelers and TBR tyres capacity in next couple of years, will aid CEAT to increase its capacity by 21% over FY17-FY19E. The total capacity is expected to reach at 1,240TPD by FY19E

Foray into OHT Segment to Strengthen Overseas Biz

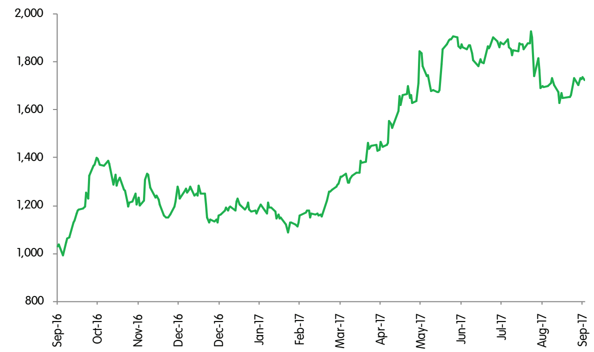
Foray into high-margin Off Highway Tyres (OHT) segment with a capacity of 100TPD (40TPD in Phase-I) is likely to strengthen CEAT's position in the international market, which was adversely affected due to supply of Chinese tyres and higher level of radialisation over the years. Currently, CEAT is in the process of rolling out OHT tyres and testing the European market. As Ceat is confident about the product quality, it would ramp-up production capacity shortly. We believe the foray into OHT segment would be margin accretive for the Company.

Outlook & Valuation

CEAT's margin was impacted in 1QFY18 on account of GST roll-out and significant surge in input cost. Notably, GST-led inventory de-stocking (up to 50-60%) led to poor volume in 1Q, while higher fixed cost dragged its margins. However, we expect improvement in volume and margin front from 2QFY18 onwards with the diminishing impact of GST roll-out and recent price correction in raw material prices. Looking ahead, CEAT is expected to witness a healthy traction on account of new capacities, improvement in product-mix, unique promotional campaigns, sound distribution reach and robust brand equity. **We expect CEAT's revenue and earnings to register 12% and 9% CAGR, respectively through FY17-FY19E. We initiate our coverage on CEAT with a BUY recommendation with a Target Price of Rs2,030 (19x June'19 EPS).**

BUY			
CMP* (Rs)			1,778
Target Price (Rs)			2,030
Upside/ (Downside) (%)			14
Bloomberg Ticker			CEAT IN
Market Cap. (Rs bn)			72
Free Float (%)			49
Shares O/S (mn)			41
Share price (%)	**1 mth**	**3 mth**	**12 mth**
Absolute performance	5.3	(6.6)	72.3
Relative to Nifty	1.4	(11.5)	58.5
Shareholding Pattern (%)		**Mar'17**	**Jun'17**
Promoter		50.8	50.8
Public		49.2	49.2

1 Year Stock Price Performance



*Note: * CMP as on Sept 12, 2017*

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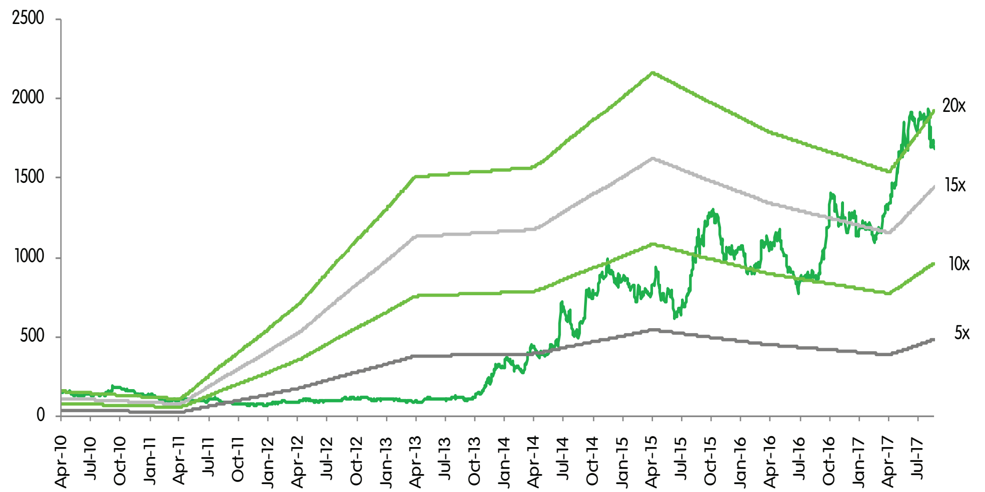
Key Risks

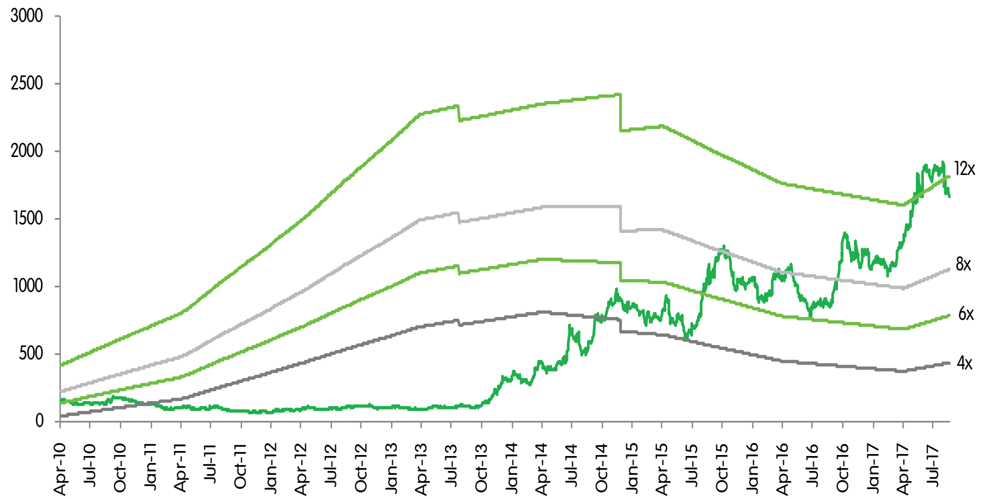
- Intensifying competition.
- Sharp up-tick in the prices of natural rubber and other raw materials.
- Significant slump in OEM sales.
- Absence of imposition of Anti Dumping Duty on Chinese TBR tyres.

Exhibit 1: PE Band



Source: Industry, RSec Research

Exhibit 2: EV/EBITDA Band

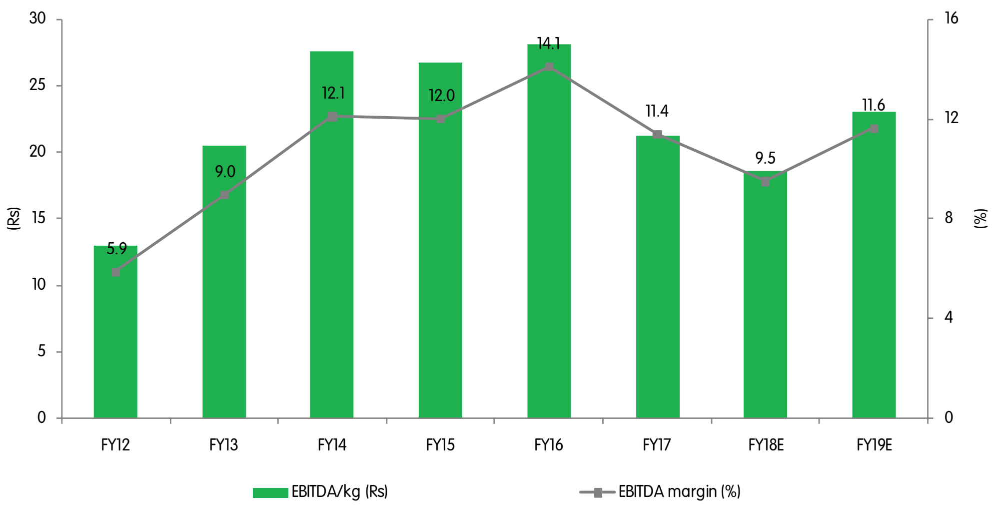


Source: Industry, RSec Research

Company Overview

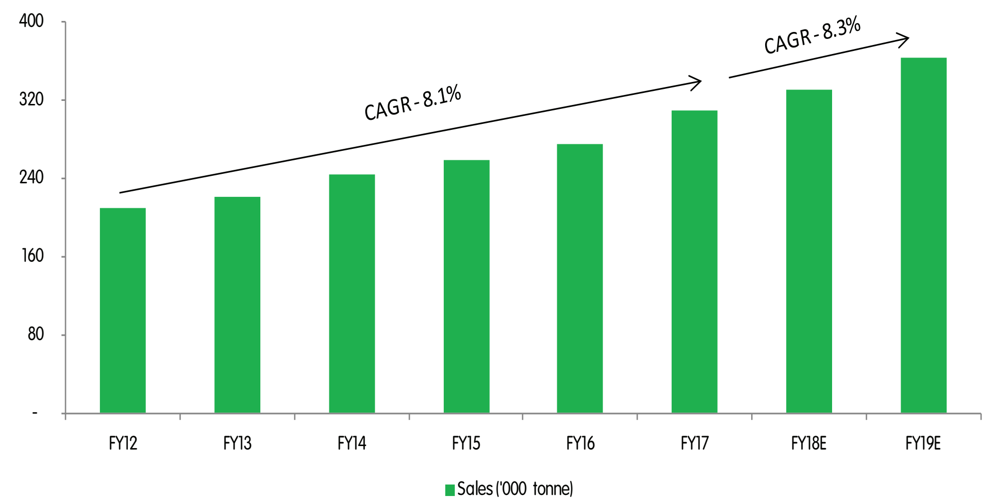
CEAT – the flagship company of the RPG Group – is one of the leading tyre manufacturers in India, which offers best-in-class tyres across categories. The Company has three manufacturing facilities in Maharashtra (Bhandup, Nashik & Nagpur) and one manufacturing facility in Gujarat (Halol). The Company meets close to two-thirds of its production through in-house manufacturing and secures the rest from several outsourcing partners on conversion cost and bought-out basis. It also operates in Sri Lanka through a 50:50 JV, named CEAT Kelani Holdings Company. Through its subsidiary company, CEAT has initiated construction of an Off-Highway Tyre plant at Ambernath (Maharashtra). CEAT enjoys a market share of 12% in India's tyre market and manufactures over 95,000 tyres per day. It has invested heavily for developing a state-of-the-art R&D centre at Halol to enable a funnel of innovative new products. Further, CEAT has a distribution network of 4,500 dealers and over 450 exclusive franchisees. Its products are sold in over 100 countries with strong brand recall.

Exhibit 3: Opeational Performance Overview



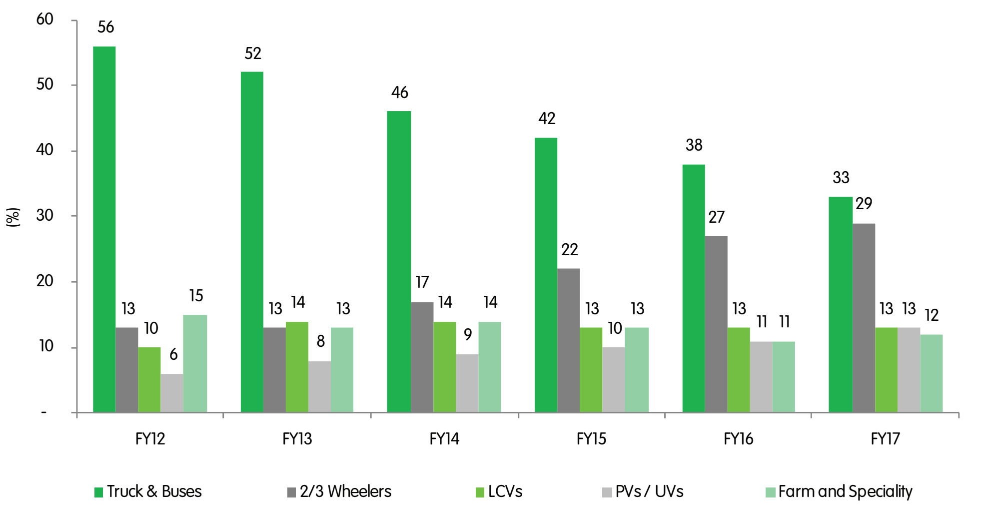
Source: Company, RSec Research

Exhibit 4: Sales volume overview in tonnage



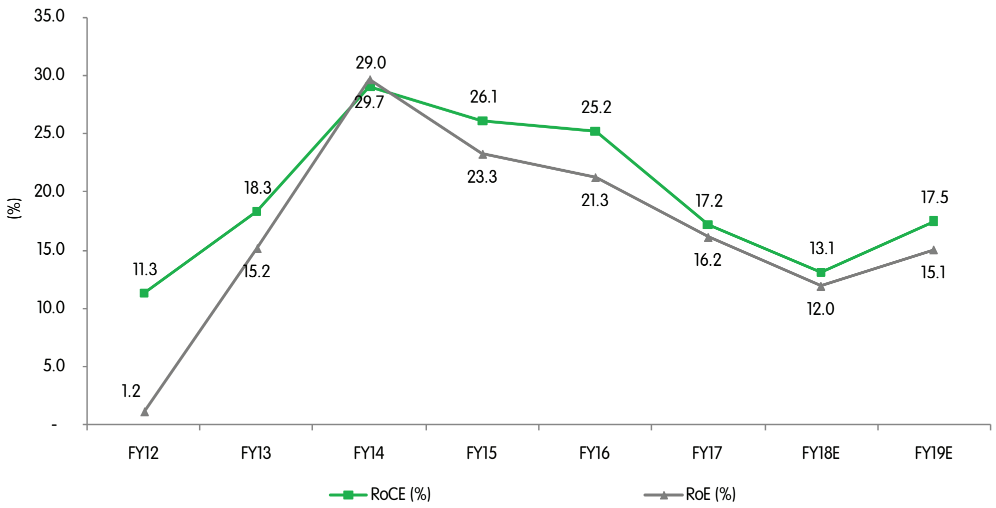
Source: Company, RSec Research

Exhibit 5: Revenue Mix (%)



Source: Company, RSec Research

Exhibit 6: Huge capex led to decline in ratios but still appears deent



Source: Company, RSec Research

Profit and Loss Statement

Y/E March (Rs mn)	FY16	FY17	FY18E	FY19E
Income	**54,836**	**57,665**	**64,659**	**72,041**
% yoy growth		5.2	12.1	11.4
Operting Expenses	47,103	51,097	58,509	63,657
EBITDA	**7,732**	**6,568**	**6,149**	**8,384**
EBITDA Margin (%)	**14.1**	**11.4**	**9.5**	**11.6**
Depreciation & Amortization	1,077	1,431	1,703	1,916
Finance Cost	949	817	998	1,067
Other Income	277	186	196	205
PBT before excep items	5,983	4,506	3,643	5,606
Exceptional Item	(114)	(133)	-	-
PBT	**5,869**	**4,373**	**3,643**	**5,606**
Tax	1,873	1,064	911	1,682
% Tax	31.9	24.3	25.0	30.0
Net Profit	**3,995**	**3,309**	**2,732**	**3,924**
% yoy growth		(17.2)	(17.4)	43.6
Share of Profit from JVs	361.8	283.7	297.9	312.8
Minority Interest	(18.2)	(19.2)	(20.2)	(21.2)
Net Profit- Reported	**4,375**	**3,612**	**3,051**	**4,258**
Net Profit- Adjusted	**4,413**	**3,656**	**3,051**	**4,258**
Net Profit Margin (%)	8.0	6.3	4.7	5.9

Balance Sheet

Y/E March (Rs mn)	FY16	FY17	FY18E	FY19E
Sources of Funds				
Share Capital	405	405	405	405
Reserves & Surplus	20,143	23,745	26,310	30,083
Total Shareholder's funds	20,547	24,150	26,715	30,487
Non-Controlling Interests	322	291	271	250
LT Borrowings	5,879	8,524	9,824	10,024
Total NC Liabilities	8,218	11,626	12,964	13,230
ST Borrowings	335	580	700	400
Trade Payables	6,353	7,582	8,244	9,213
Other Fin. Liabilities	3,786	4,075	4,430	4,951
Other Curr. Liabilities	993	1,069	1,163	1,299
ST Provisions	470	538	585	654
Deferred Revenue	8	8	8	8
Current Tax Liabilities (Net)	368	226	226	226
Current Liabilities	12,314	14,079	15,357	16,752
Total Liabilities	**41,080**	**49,854**	**55,036**	**60,469**
Application of Funds				
Gross Fixed Assets- Tangible	21,394	27,017	30,617	34,217
Less: Acc. Depreciation	1,073	2,492	4,195	6,111
Net Fixed Assets	20,321	24,525	26,422	28,106
CWIP	2,982	3,193	4,693	6,100
Total NC Assets	26,147	31,434	34,968	38,257
Inventories	6,397	9,435	10,259	11,464
Sundry Debtors	5,935	6,138	6,674	7,458
Current Investment	402	643	675	709
Other Current Assets	1,451	1,695	1,843	2,060
Other Fin. Assets	89	137	149	167
Cash Balances	137	240	336	220
Bank Balance	494	119	119	119
ST Loans & Advances	28	13	14	15
Toal Current Assets	**14,932**	**18,420**	**20,068**	**22,212**
Total Assets	**41,080**	**49,854**	**55,036**	**60,469**

CEAT

Cash Flow Statement

Y/E March (Rs mn)	FY16	FY17	FY18E	FY19E
PBT	**5,869**	**4,373**	**3,643**	**5,606**
Depreciation	1,077	1,431	1,703	1,916
Finance Costs	949	817	998	1,067
Others	(8)	(83)	20	21
Net Change in Working Capital	**820**	**(2,174)**	**(459)**	**(663)**
Direct Tax	(1,686)	(1,017)	(911)	(1,682)
Net Cash from Operating Activities	**7,021**	**3,347**	**4,995**	**6,266**
Capex	(7,381)	(5,877)	(5,101)	(5,009)
Sale / (Purchase) of Investments/Assets	2,383	(363)	(32)	(34)
Others	672	806	298	313
Net Cash used in Investing Activities	**(4,326)**	**(5,434)**	**(4,836)**	**(4,730)**
Inc/(Dec) in Borrowings	(925)	3,310	1,420	(100)
Divi. on Equity Shares paid (Including DDT)	(979)	(7)	(485)	(485)
Interest Paid	(930)	(765)	(998)	(1,067)
Others	(429)	(347)	-	-
Net Cash used in Financing Activities	**(3,264)**	**2,191**	**(64)**	**(1,653)**
Net Increase/ (Decrease) in Cash	**(569)**	**104**	**96**	**(116)**

Key Ratios

Y/E March	FY16	FY17	FY18E	FY19E
Valuation Ratio (x)				
P/E	16.4	19.9	23.6	16.9
P/CEPS	14.2	15.2	16.2	12.3
P/BV	3.5	3.0	2.7	2.4
EV/EBIDTA	10.1	12.3	13.3	9.8
EV/Sales	1.4	1.4	1.3	1.1
Dividend Payout (%)	19.9	-	13.3	9.5
Dividend Yield (%)	1.2	-	0.6	0.6
Per Share Data (Rs)				
EPS (Basic)	108.2	89.3	75.4	105.3
EPS (Diluted)	108.2	89.3	75.4	105.3
CEPS	125.4	117.2	109.7	144.4
DPS	21.5	-	10.0	10.0
Book Value	508	597	660	754
Returns (%)				
RoCE	25.2	17.2	13.1	17.1
RoE	21.3	16.2	12.0	14.9
Turnover ratios (x)				
Asset Turnover (Gross block)	2.6	2.1	2.1	2.1
Inventory (days)	40	61	61	61
Receivables (days)	38	40	40	40
Payables (days)	40	49	49	49
WCC (days)	38	52	52	52
Solvency ratios (x)				
D/E (x)	0.3	0.4	0.4	0.3
Current Ratio (x)	1.2	1.3	1.3	1.3

Apollo Tyres

Institutional Equity Research

Sector Initiating | September 13, 2017

On Right Track; Re-rating on the Cards

CVs Radialisation; A Key Growth Driver

Apollo Tyres (ATL) currently enjoys ~28% market share in the TBR segment. As radialisation forms only 45% of domestic TB tyre market, we see a significant scope for radialisation in the domestic CV segment, which would benefit manufacturers like ATL, going forward. We expect ATL's market share in radial tyre segment to improve on the back of capacity expansion to meet the rising demand. Notably, ATL commissioned Phase-I of radial capacity (incremental 3,000 units) in 3QFY17. Further, the domestic tyre industry has again started seeing pressure from China due to gathering pace of remonetization. Despite lower import volume of Chinese TBR tyres following demonetisation (as the imports are largely cash-based), the Chinese market share has reached to 90%. We believe that likely imposition of Anti Dumping Duty on Chinese imports would benefit companies like ATL the most. The Management expects decent growth in domestic market on the back of capacity expansion and demand recovery in both OEM and replacement segment, going forward.

Likely Traction in European Operations in Sight

After seeing headwinds in last two years, ATL's European operations started witnessing traction on the back of strong brand equity and acquisition of Reifencom, (one of the leading tyre retail organisations in Germany with more than 37 stores). However, start-up cost (due to commencement of Hungary plant) dragged European performance in 1QFY18, which may continue for the next 3-4 quarters. Looking ahead, with the likely pick-up in utilisation from the new unit and possible improvement in price as no new capacity is coming up in the region except for Korea-based Nexen, we expect ATL's European operations to witness improvement.

Anti-Dumping Duty on Chinese TBR Tyres – A Big Catalyst

Likely imposition of Anti Dumping Duty of $245/tonne to $452/tonne (as proposed by DGAA) on Chinese TBR tyres is expected to benefit ATL the most. We believe that the imposition of Anti Dumping Duty on Chinese tyres would be positive for the Indian TBR manufacturers owing to: (a) likely reduction in pricing gap (which is currently 10%-12% lower than Indian TBR tyres); and (b) likely increase in the market share of the domestic players. As per the Company, though the import volume of Chinese TBR tyres has reduced (from high of 1.5lakh/month as of Oct'16) due to demonetisation, the import volume continues to be as high as ~1.0 lakh/month. It expects import volumes to go down to 75,000/month with the imposition of Anti Dumping Duty, thereby providing better volume growth opportunity for the domestic manufacturers.

Valuations Appear Attractive: Valuation Discount to Shrink

ATL is expected to witness a decent scalability in its business with the expected pick-up in demand environment, as the Company is investing more in diversified and rapid growth areas. In the aftermath of initial headwinds in the form of GST roll-out, switch to BS-IV emission norms and demonetisation, the Management expects demand to recover, going forward. We expect ATL's revenue and earnings to witness a 19% and 13% CAGR, respectively through FY17-FY19E. Current valuations at 14.7x and 9.8x FY18E and FY19E look attractive and the stock is trading at a discount of 30-40% compared to its peers at CMP. **We initiate our coverage on ATL with a BUY recommendation with a Target Price of Rs350 (12x June'19 EPS).**

BUY			
CMP* (Rs)			263
Target Price (Rs)			350
Upside/ (Downside) (%)			33
Bloomberg Ticker			APTY IN
Market Cap. (Rs bn)			134
Free Float (%)			55.9
Shares O/S (mn)			509
Share price (%)	**1 mth**	**3 mth**	**12 mth**
Absolute performance	2.3	1.6	23.9
Relative to Nifty	(1.6)	(3.3)	10.2
Shareholding Pattern (%)		**Mar'17**	**Jun'17**
Promoter		44.2	44.2
Public		55.9	55.9

1 Year Stock Price Performance

*Note: * CMP as on Sept 12, 2017*

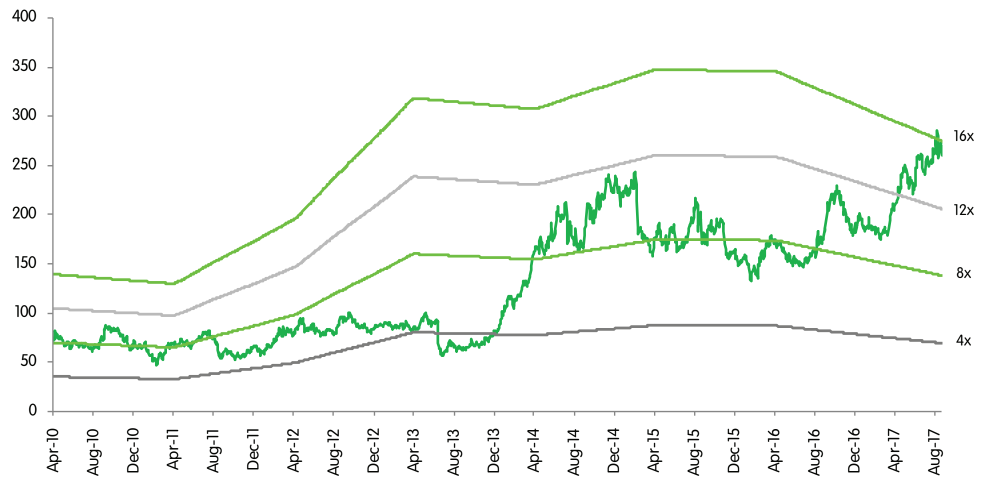
Apollo Tyres

Sector Initiating | September 13, 2017

Key Risks

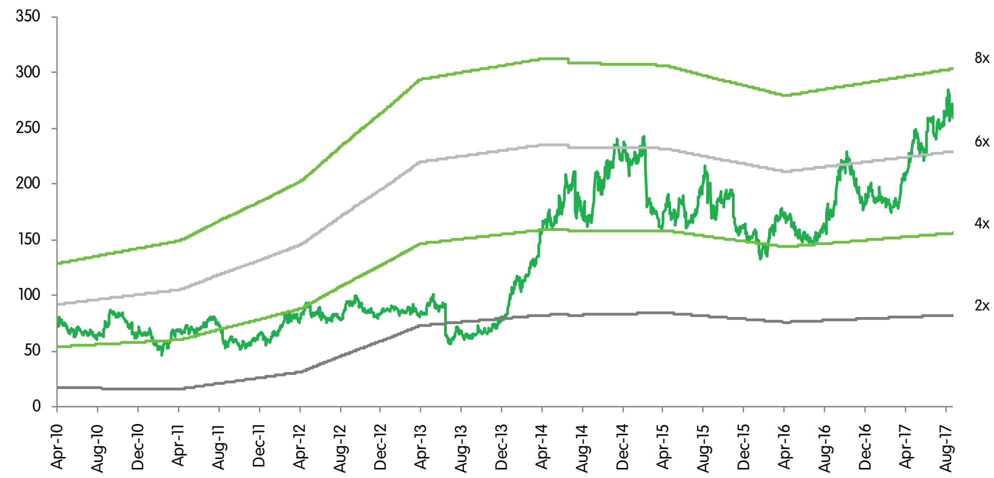
- Intensifying competition.
- Sharp up-tick in the prices of natural rubber and other raw materials.
- Significant slump in OEM sales.
- No Anti Dumping Duty on Chinese TBR tyres

Exhibit 1: PE Band



Source: Industry, RSec Research

Exhibit 2: EV/EBITDA Band



Source: Industry, RSec Research

Apollo Tyres

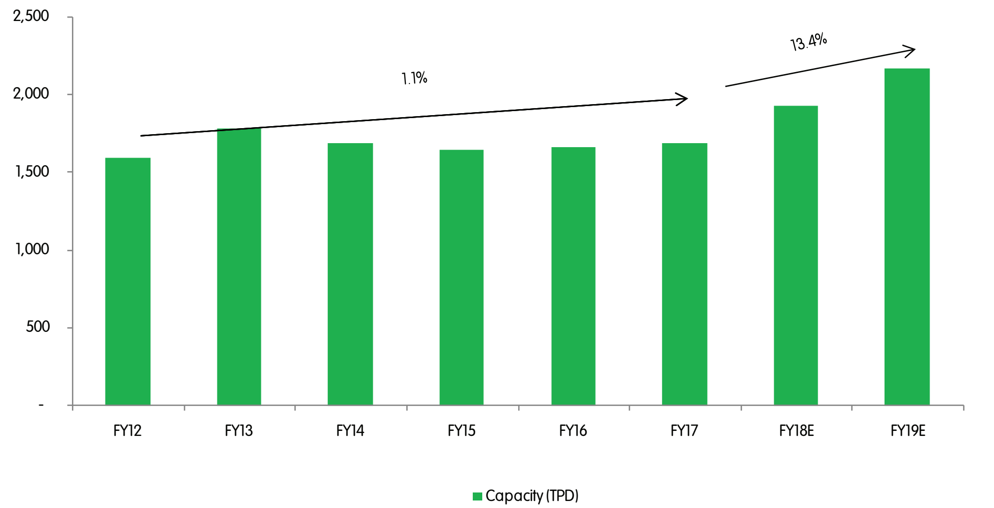
Institutional Equity Research

Sector Initiating | September 13, 2017

Company Overview

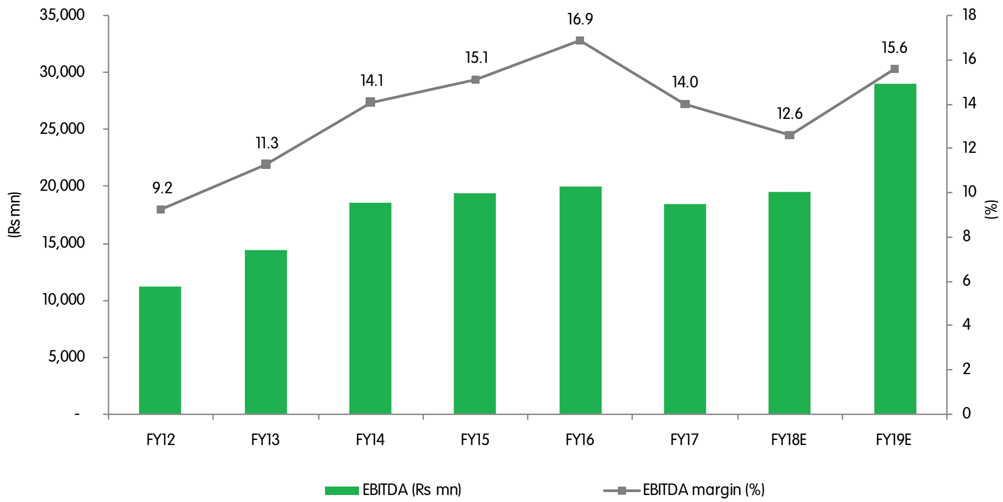
Apollo Tyres – founded in 1972 – is the 17th biggest tyre manufacturer in world. Its first plant was commissioned in Perambra (Kerala). The Company now has 4 manufacturing units in India, 1 in the Netherlands and 1 in Hungary. It has a network of nearly 5,000 dealerships in India, out of which more than 2,500 are exclusive outlets. It gets 69% of its revenues from India, 26% from Europe and 5% from other geographies. ATL forayed into two-wheeler tyre segment with contract manufacturing in Mar'16. It signed an MoU with the Andhra Pradesh Government In Nov'16 to set up a new factory in the state to manufacture tyres for two-wheelers and pick-up trucks.

Exhibit 3: Capacity growth over the years in tonnage



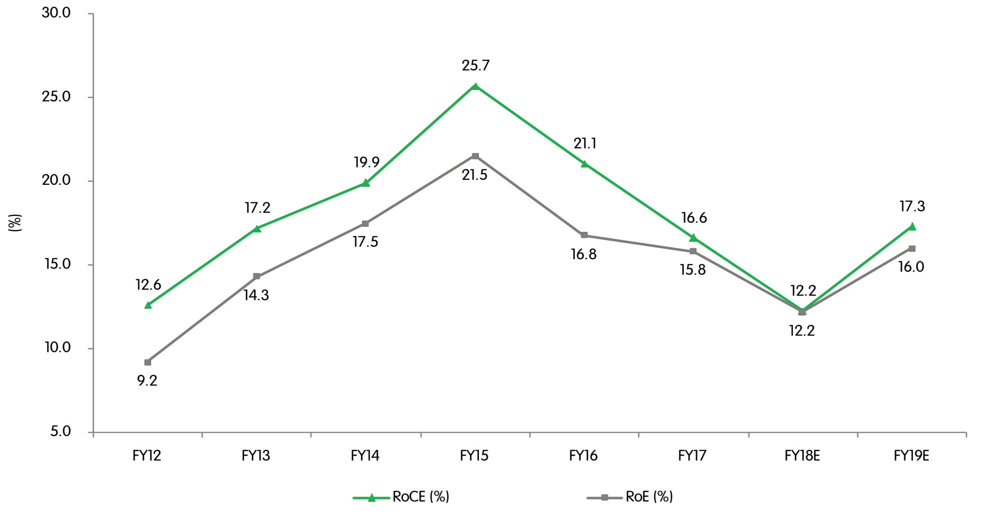
Source: Company, RSec Research

Exhibit 4: Opeational Performance Overview



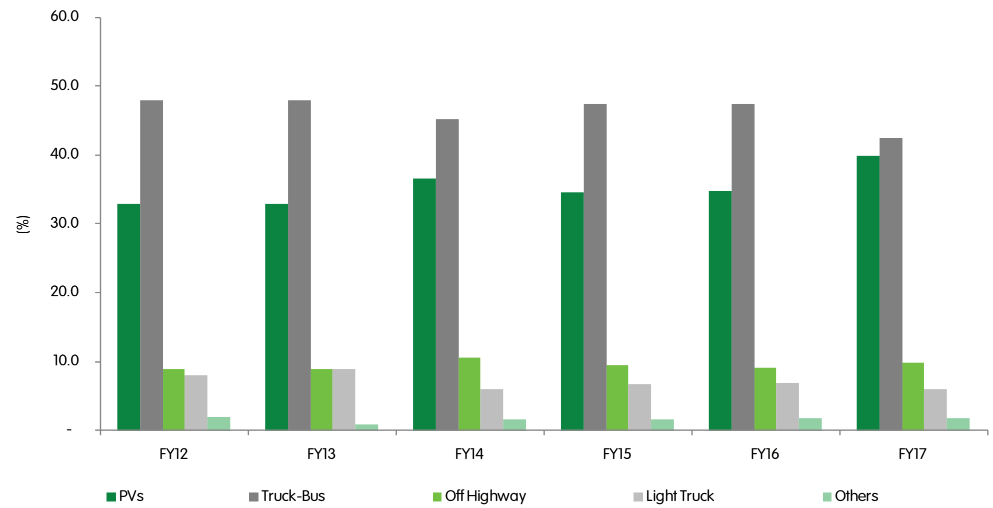
Source: Company, RSec Research

Exhibit 5: Higher capex drags return ratios; Expecting improvement hereon



Source: Company, RSec Research

Exhibit 6: Revenue Mix (%)



Source: Company, RSec Research

Apollo Tyres

Sector Initiating | September 13, 2017

Profit and Loss Statement

Y/E March (Rs mn)	FY16	FY17	FY18E	FY19E
Income	**118,486**	**131,800**	**154,734**	**186,666**
% yoy growth		11.2	17.4	20.6
Operting Expenses	98,511	113,336	135,246	157,609
EBITDA	**19,975**	**18,464**	**19,487**	**29,057**
EBITDA Margin (%)	**16.9**	**14.0**	**12.6**	**15.6**
Depreciation & Amortization	4,268	4,618	5,984	7,334
Finance Cost	926	1,029	1,498	2,266
Other Income	680	1,541	500	525
PBT before excep items	15,461	14,359	12,506	19,981
Exceptional Item	478	-	-	-
Share of Loss in JVs	(32)	(3)	-	-
PBT	**15,906**	**14,355**	**12,506**	**19,981**
Tax	4,677	3,365	3,126	5,994
% Tax	29.4	23.4	25.0	30.0
Net Profit- Reported	**11,230**	**10,990**	**9,379**	**13,987**
YoY Growth (%)		(2.1)	(14.7)	49.1
Net Profit- Adjusted	**11,071**	**10,990**	**9,379**	**13,987**

Balance Sheet

Y/E March (Rs mn)	FY16	FY17	FY18E	FY19E
Sources of Funds				
Share Capital	509	509	509	509
Reserves & Surplus	65,537	72,390	80,533	93,283
Total Shareholder's funds	66,046	72,899	81,042	93,792
LT Borrowings	6,493	21,559	29,559	27,559
Total NC Liabilities	16,019	35,286	44,172	43,514
ST Borrowings	7,399	10,886	12,886	12,386
Trade Payables	15,432	17,318	19,847	23,678
Other Fin. Liabilities	4,224	8,946	10,252	12,231
Other Curr. Liabilities	2,658	2,553	2,926	3,491
ST Provisions	3,292	4,043	4,633	5,527
Current Tax Liabilities (Net)	1,469	1,074	1,074	1,074
Current Liabilities	34,473	44,819	51,618	58,387
Total Liabilities	**116,538**	**153,005**	**176,832**	**195,693**
Application of Funds				
Gross Fixed Assets- Tangible	**99,862**	**115,578**	**163,578**	**178,578**
Less: Acc. Depreciation	54,302	55,196	61,180	68,514
Net Fixed Assets	45,559	60,382	102,398	110,063
CWIP	9,694	28,723	5,000	4,000
Goodwill	1,982	1,774	1,774	1,774
Total NC Assets	70,517	102,910	122,212	130,355
Inventories	19,391	26,455	30,319	36,171
Sundry Debtors	10,843	11,275	12,922	15,416
Current Investment	5,018	3,944	4,142	4,349
Other Current Assets	3,504	4,601	5,273	6,291
Other Fin. Assets	810	411	471	562
Cash Balances	5,900	3,309	1,389	2,435
Bank Balance	42	60	60	60
ST Loans & Advances	37	39	45	53
Toal Current Assets	**45,545**	**50,095**	**54,620**	**65,337**
Other Non-Current Assets	**476**	**-**	**-**	**-**
Total Assets	**116,538**	**153,005**	**176,832**	**195,693**

Apollo Tyres

Sector Initiating | September 13, 2017

Cash Flow Statement

Y/E March (Rs mn)	FY16	FY17	FY18E	FY19E
PBT	**15,906**	**14,355**	**12,506**	**19,981**
Depreciation	4,268	4,618	5,984	7,334
Finance Costs	926	1,029	1,498	2,266
Others	(829)	(958)	-	-
Net Change in Working Capital	**3,207**	**(6,755)**	**(1,468)**	**(2,224)**
Direct Tax	(3,914)	(3,264)	(3,126)	(5,994)
Add: Exceptional Item	1,661	-	-	-
Net Cash from Operating Activities	**21,225**	**9,025**	**15,393**	**21,363**
Capex	(16,213)	(33,190)	(24,380)	(14,106)
Sale / (Purchase) of Investments/Assets	(6,734)	1,629	(198)	(208)
Others	119	2,142	-	-
Net Cash used in Investing Activities	**(22,828)**	**(29,419)**	**(24,578)**	**(14,314)**
Inc/(Dec) in Borrowings	(298)	20,841	10,000	(2,500)
Divi. on Equity Shares paid (Including DDT)	(1,302)	(1,237)	(1,237)	(1,237)
Interest Paid	**(947)**	**(658)**	**(1,498)**	**(2,266)**
Net Cash used in Financing Activities	**(2,547)**	**18,946**	**7,265**	**(6,003)**
Effect of FXs out of consolidation	**60**	**(640)**	**-**	**-**
Net Increase/ (Decrease) in Cash	**(4,089)**	**(2,088)**	**(1,920)**	**1,047**

Key Ratios

Y/E March	FY16	FY17	FY18E	FY19E
Valuation Ratio (x)				
P/E	12.1	12.2	14.3	9.6
P/CEPS	8.6	8.6	8.7	6.3
P/BV	2.0	1.8	1.7	1.4
EV/EBIDTA	7.1	8.8	9.0	5.9
EV/Sales	1.2	1.2	1.1	0.9
Dividend Payout (%)	9.2	9.3	10.9	7.3
Dividend Yield (%)	0.8	0.8	0.8	0.8
Per Share Data (Rs)				
EPS (Basic)	21.7	21.6	18.4	27.5
EPS (Diluted)	21.7	21.6	18.4	27.5
CEPS	30.4	30.7	30.2	41.9
DPS	2.0	2.0	2.0	2.0
Book Value	130	143	159	184
Returns (%)				
RoCE	21.1	16.6	12.2	17.3
RoE	16.8	15.8	12.2	16.0
Turnover ratios (x)				
Asset Turnover (Gross block)	1.2	1.1	0.9	1.0
Inventory (days)	54	78	78	78
Receivables (days)	30	33	33	33
Payables (days)	43	51	51	51
WCC (days)	41	60	60	60
Solvency ratios (x)				
D/E (x)	0.1	0.4	0.5	0.4
Current Ratio (x)	1.3	1.1	1.1	1.1

JK Tyre & Industries

Institutional Equity Research

Sector Initiating | September 13, 2017

Balance Sheet De-leveraging – A Key Catalyst

Leadership in TBR to Pay off More

JK Tyre & Industries (JKT) enjoys a leadership position in the M&HCV TBR tyre segment with >31% market share, while its market share stands at 12% in PCR tyre segment. Looking ahead, we expect JKT to benefit the most in the event of a possible slowdown in import of Chinese TBR tyres following the imposition of Anti Dumping Duty proposed by the Government. As per industry data, ~74% of tyres supplied to the M&HCV OEMs are radial tyres, while radialisation stands at mere 47% including replacement market. As per industry estimates, the OEMs radialisation is expected to reach 82% level, while the overall radialisation is likely to touch 73% level by FY21, which provides a healthy business opportunity for JKT in ensuing years.

Cavendish Acquisition Proves to be Strategic in Many Counts

Acquisition of 64% stake in Cavendish Industries (CIL) – a unit of BK Birla Group's Kesoram Industries – in Apr'16 for Rs21.7bn has provided JKT a strategic foray into the fast growing 2/3W tyre segment (6.3mn units). The acquisition has increased JKT's capacity to produce 8.8mn tyres / 470TPD (6.3mn 2/3W, 0.7mn TBB, 1.2mn TBR, 0.7mn others) at Laksar (Haridwar). The deal also boosted JKT's capacity to produce TBR tyres. With the CIL acquisition JKT's overall domestic capacity has increased by as much as 40-45%. Notably, 2/3 wheeler production capacity can be increased in future too in order to meet growing demand if necessary.

De-leveraging Likely as Huge Capex Completed

JKT had undertaken a series of capex programmes either to maintain its market share or diversification over last three years. For instance, it has increased its Chennai plant capacity in 2014. Further, it has enhanced its TBR and PCR capacity by 0.8mn and 1.8mn units, respectively in 2016 and also acquired CIL in the last year. Further, its Mexico capacity (PCR) was also increased to 5mn units with a capex of US$22mn. As huge capex programme has already been completed, we expect improving utilisation with low capex to aid JKT to de-leverage its balance-sheet, going forward. We expect JKT to generate FCF of Rs19.7bn and debt repayment to the tune of Rs11bn in the next two years.

Re-rating on the Cards; Initiate with BUY

JKT trades at a lower multiple compared to its peers mainly due to the high debt on its books. Unlike 1QFY18, we expect JKT's performance to improve from current quarter onwards owing to likely pick-up in sales volume and low input prices. Further, expected pick-up in utilisation and no meaningful capex will result in balance-sheet de-leveraging in coming quarters, which may warrant a re-rating. **We initiate coverage on JKT with a BUY recommendation and Target Price of Rs180 (6.5x EBITDA FY19E).**

BUY			
CMP* (Rs)			154
Target Price (Rs)			180
Upside/ (Downside) (%)			17
Bloomberg Ticker			JKI IN
Market Cap. (Rs bn)			34.9
Free Float (%)			47.7
Shares O/S (mn)			227
Share price (%)	**1 mth**	**3 mth**	**12 mth**
Absolute performance	5.5	(13.3)	8.4
Relative to Nifty	1.6	(18.2)	(5.4)
Shareholding Pattern (%)		**Mar'17**	**Jun'17**
Promoter		52.3	52.3
Public		47.7	47.7

1 Year Stock Price Performance

*Note: * CMP as on Sept 12, 2017*

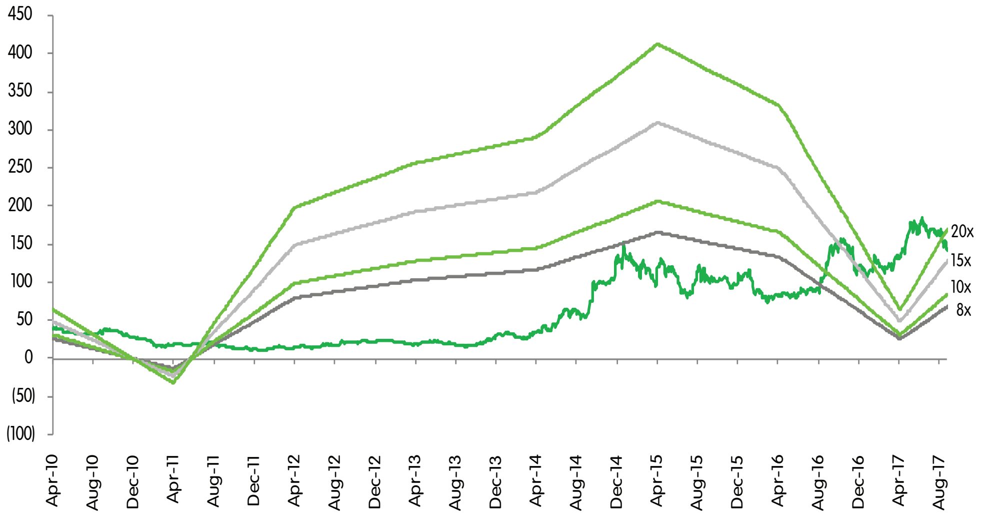
JK Tyre & Industries

Sector Initiating | September 13, 2017

Key Risks

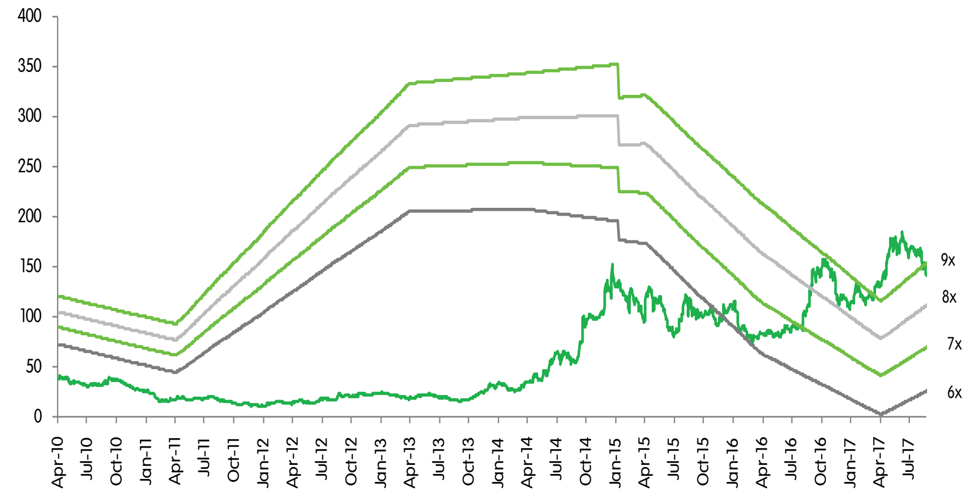
- Intensifying competition.
- Sharp up-tick in the prices of natural rubber and other raw materials.
- Significant slump in OEM sales.
- Absence of imposition of Anti Dumping Duty on Chinese TBR tyres.

Exhibit 1: PE Band



Source: Industry, RSec Research

Exhibit 2: EV/EBITDA Band



Source: Industry, RSec Research

Company Overview

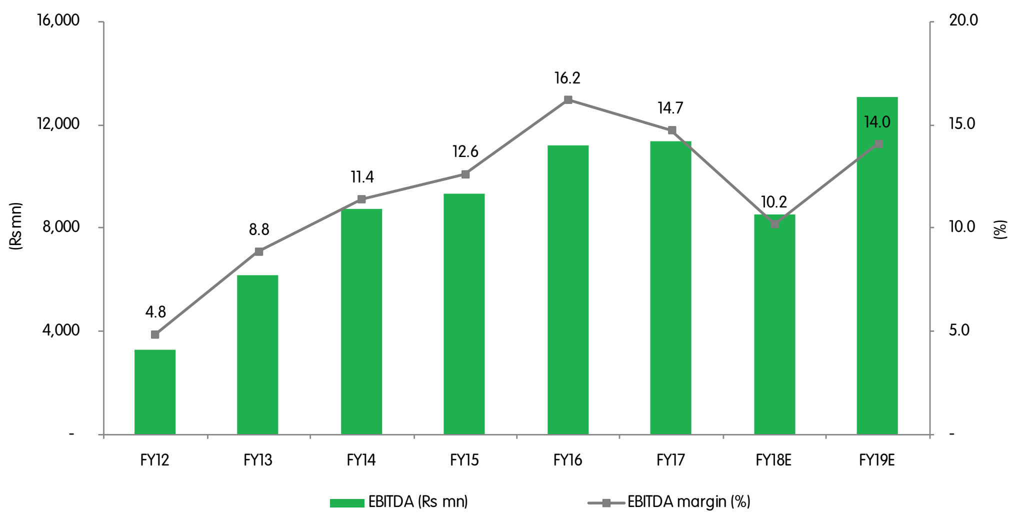
JK Tyre & Industries (JKT) – the flagship company of the JK Group – is one of India's leading tyre brands (pioneer in truck radials) and placed among the 25 largest tyre companies in the world. It started manufacturing tyres in 1977 with a capacity of 0.5mn tyres, which has grown to 33mn through organic and inorganic route. The Company is the market leader in TBR tyres (31% market share). It has 9 manufacturing plants in India, which are strategically located across the country – Mysuru, Banmore, Kankroli, Chennai and Haridwar and 3 in Mexico. As of FY17, JKT had 141 selling points pan-India to meet the growing needs of more than 4,000 dealers.

Exhibit 3: Capacity in Tonnage (TPD)

	FY17
JKT	1054
CIL	470
Total India	**1524**
Tornel, Mexico	300
Total Capacity	**1524**

Source: Industry, RSec Research

Exhibit 4: Operational Performance Overview

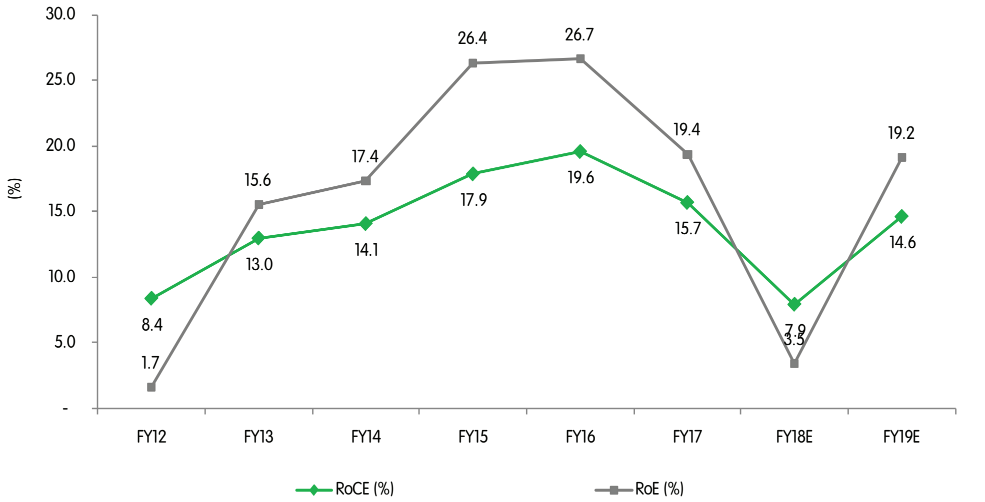


Source: Industry, RSec Research

JK Tyre & Industries

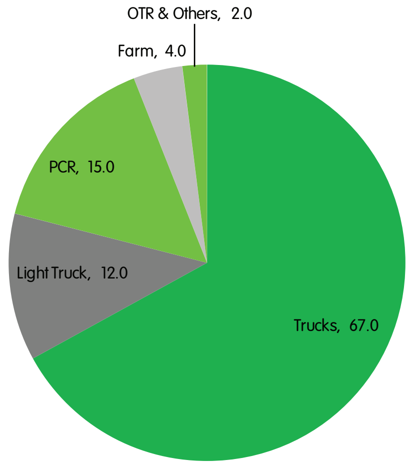
Sector Initiating | September 13, 2017

Exhibit 5: Return rations to improve in FY19 as huge capex is behind



Source: Industry, RSec Research

Exhibit 6: Revenue Mix- FY17 (%)



Source: Industry, RSec Research

JK Tyre & Industries

Sector Initiating | September 13, 2017

Profit and Loss Statement

Y/E March (Rs mn)	FY16	FY17	FY18E	FY19E
Income	**68,982**	**76,894**	**83,968**	**93,112**
% yoy growth		11.5	9.2	10.9
Operting Expenses	57,816	65,570	75,434	80,033
EBITDA	**11,166**	**11,324**	**8,535**	**13,079**
EBITDA Margin (%)	16.2	14.7	10.2	14.0
Depreciation & Amortization	2,161	2,913	2,957	3,019
Finance Cost	2,524	4,404	4,914	4,176
Other Income	242	654	393	423
PBT before excep items	**6,723**	**4,662**	**1,056**	**6,306**
Exceptional Item	(128)	691	-	-
PBT	**6,595**	**5,352**	**1,056**	**6,306**
Tax	2,027	1,554	317	1,892
% Tax	30.7	29.0	30.0	30.0
Net Profit	**4,568**	**3,798**	**739**	**4,414**
YoY Growth (%)		(16.9)	(80.5)	497.2
Share of Profit from Asso.	105.2	49.7	54.7	60.1
Less: Derecognition of Share in Profit of Associate	-	(37)	-	-
Minority Interest	-	56.6	59.4	62.4
Net Profit- Reported	**4,673**	**3,754**	**734**	**4,412**
Net Profit- Adjusted	**4,759**	**3,291**	**734**	**4,412**
Net Profit Margin (%)	6.9	4.3	0.9	4.7

Balance Sheet

Y/E March (Rs mn)	FY16	FY17	FY18E	FY19E
Sources of Funds				
Share Capital	454	454	454	454
Reserves & Surplus	17,061	19,194	19,246	22,975
Non-Controlling Interests	-	1,450	1,450	1,450
Total Shareholder's funds	17,514	21,098	21,150	24,879
LT Borrowings	15,487	35,703	30,903	25,903
Total NC Liabilities	24,711	46,882	42,587	38,133
ST Borrowings	11,113	18,057	17,857	16,857
Trade Payables	9,554	12,137	13,384	14,734
Other Fin. Liabilities	5,752	5,961	6,573	7,236
Other Curr. Liabilities	1,737	2,153	2,374	2,613
ST Provisions	316	300	331	364
Current Tax Liabilities (Net)	85	57	57	57
Current Liabilities	28,556	38,666	40,577	41,862
Total Liabilities	**70,781**	**106,646**	**104,314**	**104,874**
Application of Funds				
Gross Fixed Assets- Tangible	60,632	82,354	84,854	85,854
Less: Acc. Depreciation	23,102	24,410	27,367	30,387
Net Fixed Assets	37,531	57,944	57,487	55,468
Total NC Assets	43,082	66,043	64,254	62,347
Inventories	8,725	13,204	13,222	14,069
Sundry Debtors	14,027	17,946	18,510	19,406
Current Investment	189	-	-	-
Other Current Assets	2,056	2,342	2,582	2,843
Other Fin. Assets	1,155	3,304	3,643	4,011
Cash Balances	1,322	2,604	828	846
Bank Balance	73	349	349	349
ST Loans & Advances	-	700	772	850
Curr. Tax Assets (Net)	153	154	154	154
Toal Current Assets	**27,700**	**40,603**	**40,060**	**42,527**
Total Assets	**70,781**	**106,646**	**104,314**	**104,874**

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Cash Flow Statement

Y/E March (Rs mn)	FY16	FY17	FY18E	FY19E
PBT	6,595	5,352	1,056	6,306
Depreciation	2,161	2,913	2,957	3,019
Finance Costs	2,524	4,404	4,914	4,176
Others	108	(3,184)	(5)	(2)
Net Change in Working Capital	(757)	(7,117)	1,002	(31)
Direct Tax	(1,603)	(1,312)	(317)	(1,892)
Net Cash from Operating Activities	**9,030**	**1,057**	**9,608**	**11,577**
Capex	(5,588)	(2,787)	(788)	(700)
Sale / (Purchase) of Investments/Assets	163	(4,750)	-	-
Others	365	(816)	-	-
Net Cash used in Investing Activities	**(5,060)**	**(8,353)**	**(788)**	**(700)**
Inc/(Dec) in Borrowings	(1,309)	13,287	(5,000)	(6,000)
Dividend on Equity Shares paid (Including DDT)	(410)	(683)	(683)	(683)
Interest Paid	(2,505)	(4,305)	(4,914)	(4,176)
Net Cash used in Financing Activities	**(4,224)**	**8,300**	**(10,597)**	**(10,859)**
Net Increase/ (Decrease) in Cash	(254)	1,004	(1,777)	18

Key Ratios

Y/E March	FY16	FY17	FY18E	FY19E
Valuation Ratio (x)				
P/E	7.5	9.3	47.6	7.9
P/CEPS	5.2	5.2	9.4	4.7
P/BV	2.0	1.7	1.7	1.4
EV/EBITDA	5.6	7.8	10.0	6.1
EV/Sales	0.9	1.2	1.0	0.9
Dividend Payout (%)	7.3	15.1	77.2	12.9
Dividend Yield (%)	1.0	1.6	1.6	1.6
Per Share Data (Rs)				
EPS (Basic)	20.6	16.6	3.2	19.5
EPS (Diluted)	20.6	16.6	3.2	19.5
CEPS	29.7	29.6	16.3	32.8
DPS	1.5	2.5	2.5	2.5
Book Value	77	93	93	110
Returns (%)				
RoCE	19.6	15.7	7.9	14.6
RoE	26.7	19.4	3.5	19.2
Turnover ratios (x)				
Asset Turnover (Gross block)	1.1	0.9	1.0	1.1
Inventory (days)	46	66	60	58
Receivables (days)	74	90	84	80
Payables (days)	51	61	61	61
WCC (days)	70	95	83	77
Solvency ratios (x)				
D/E (x)	1.6	2.5	2.4	1.8
Current Ratio (x)	1.0	1.1	1.0	1.0

Tyre Industry

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Rating Guides

Rating	Expected absolute returns (%) over 12 months
BUY	>10%
HOLD	-5% to 10%
REDUCE	>-5%

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