FIRST LIGHT

06 August 2020

RESEARCH

[Sector Report] Automotive Tyres

Safe hub in current storm

Astral Poly Technik | Target: Rs 975 | +3% | REDUCE

Lockdown-hit quarter

SUMMARY

Automotive Tyres

Despite recent setbacks, we expect the Indian tyre industry to grow at a 7% CAGR to ~Rs 720bn during FY20-FY23. Unlike other auto ancillaries, this industry is largely immune to the losses caused by Covid-19 due to its strong dependence on India's massive replacement market (~70% of sales). Rising aftermarket sales and benign rubber prices are also likely to assist margins. Most tyre manufacturers have cut capex plans for FY21 which will minimise balance sheet pressure. Our top picks in the sector are APTY, TVSS and JKI.

Click here for the full report.

Astral Poly Technik

Astral Poly Technik's (ASTRA) Q1FY21 consolidated revenue declined at a slower pace than expected, posting 33% YoY contraction as the lockdown induced a 31% drop in pipe volumes. Pipe/adhesive revenues fell 32%/37% YoY. EBITDA margins slipped 190bps YoY to 13.4%, resulting in EBITDA/PBT declines of 42%/64% YoY. Management refrained from guiding for FY21 due to Covid-19 but is hopeful of business normalisation by September. We raise FY21 earnings by 7% (FY22 unchanged) and roll to a new Sep'21 TP of Rs 975 (from Rs 850).

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TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	4,000
Cipla	Buy	690
GAIL	Buy	150
Petronet LNG	Buy	305
Tech Mahindra	Buy	780

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,950
Chola Investment	Buy	280
Laurus Labs	Buy	1,200
Transport Corp	Buy	240
Mahanagar Gas	Sell	710

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.51	(5bps)	(16bps)	(115bps)
India 10Y yield (%)	5.83	(1bps)	(7bps)	(56bps)
USD/INR	75.05	0	(0.5)	(6.0)
Brent Crude (US$/bbl)	44.43	0.6	3.8	(24.6)
Dow	26,828	0.6	3.9	3.1
Shanghai	3,372	0.1	6.9	21.4
Sensex	37,688	2.0	4.6	1.9
India FII (US$ mn)	**3 Aug**	**MTD**	**CYTD**	**FYTD**
FII-D	(27.7)	(27.7)	(14,555.4)	(4,795.9)
FII-E	1,003.5	1,003.5	(284.7)	6,318.3

Source: Bank of Baroda Economics Research

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AUTOMOTIVE TYRES

05 August 2020

Safe hub in current storm

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Despite recent setbacks, we expect the Indian tyre industry to grow at a 7% CAGR to ~Rs 720bn during FY20-FY23. Unlike other auto ancillaries, this industry is largely immune to the losses caused by Covid-19 due to its strong dependence on India's massive replacement market (~70% of sales). Rising aftermarket sales and benign rubber prices are also likely to assist margins. Most tyre manufacturers have cut capex plans for FY21 which will minimise balance sheet pressure. Our top picks in the sector are APTY, TVSS and JKI.

Steady replacement demand to fuel growth: Following 5% demand growth over the past six years, we now expect domestic tyre demand to log a 7% revenue CAGR through FY20-FY23 to ~Rs 720bn – growth will be aided by a steady uptick in the replacement market, a likely rebound in OEM demand during FY22 and the continued decline in cheap Chinese truck & bus radial (TBR) imports due to heavy duties.

Resilient in the face of Covid-19: Over 70% of revenues for the Indian tyre industry are linked to the replacement market, where demand is largely insulated from Covid-19 headwinds. We estimate that the replacement demand will grow at 8% CAGR over FY20-FY23.

Benign rubber prices to assist margins: Natural rubber comprises 44% of the raw material cost for tyre companies, implying that its price movement is a key determinant of profitability. Prices of crude oil and natural rubber are more a function of geopolitical issues than pure demand and supply. Due to the pandemic, we believe that demand shortage in the broader market would keep natural rubber prices benign over the near term.

Top picks: We prefer Apollo Tyres (APTY) and JK Tyre (JKI) given their higher revenue exposure to the replacement market and robust earnings growth compared to peers – initiate with BUY ratings on both stocks. We also like MRF (ADD) for its all-round leadership and strong balance sheet. In the two-/ three-wheeler segments, we prefer TVS Srichakra (TVSS: BUY) over CEAT (REDUCE), as we expect CEAT to deliver negative returns over the next three years, besides clocking a significant increase in its borrowings despite reduced capex. We also initiate coverage on Balkrishna Industries (BIL) with REDUCE as valuations look rich.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
APTY IN	108	135	BUY
BIL IN	1,310	1,300	REDUCE
CEAT IN	868	830	REDUCE
JKI IN	65	85	BUY
MRF IN	60,975	67,000	ADD
SRTY IN	1,410	1,780	BUY

Price & Target in Rupees | SRTY IN = TVSS |
All closing prices as of 3 Aug 2020

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REDUCE
TP: Rs 975 | ⮝ 3%

ASTRAL POLY TECHNIK | Plastic Products | 05 August 2020

Lockdown-hit quarter

Astral Poly Technik's (ASTRA) Q1FY21 consolidated revenue declined at a slower pace than expected, posting 33% YoY contraction as the lockdown induced a 31% drop in pipe volumes. Pipe/adhesive revenues fell 32%/37% YoY. EBITDA margins slipped 190bps YoY to 13.4%, resulting in EBITDA/PBT declines of 42%/64% YoY. Management refrained from guiding for FY21 due to Covid-19 but is hopeful of business normalisation by September. We raise FY21 earnings by 7% (FY22 unchanged) and roll to a new Sep'21 TP of Rs 975 (from Rs 850).

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Lockdown hits volume growth: Pipe volumes decreased 31% YoY in Q1 due to the lockdown, prompting a 33% YoY decline in consolidated revenue to Rs 4bn (albeit bettering our estimate). Standalone PVC pipe/adhesive revenues decreased 32%/37% YoY. As per management, business in July has been better than June with a reduced 4% YoY volume decline in pipes and 26% YoY value growth in adhesives. Construction activity has picked up from July and management anticipates normalisation of business activity by September.

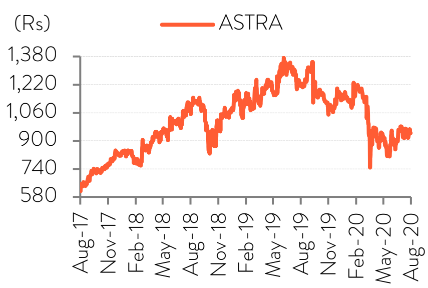
Margins decline: ASTRA's operating margins contracted 190bps YoY to 13.4% as lower gross margins (–165bps) and higher employee cost (+345bps) offset a reduction in other expense (–320bps YoY) – this drove an EBITDA/PBT fall of 42%/64% YoY. Pipe EBITDA margins decreased 65bps YoY to 14.8% whereas adhesive margins shrank 600bps to 8.4% due to negative operating leverage.

Maintain REDUCE on high valuations: We increase our FY21 PAT estimate by 7% due to the above-estimated Q1 but keep FY22 forecasts unchanged. Though we like ASTRA for its strong brand name, wide reach and robust pipe portfolio, valuations at 46.8x FY22E P/E remain rich. Maintain REDUCE as we roll forward to a revised Sep'21 TP of Rs 975 (from Rs 850), set at an unchanged 42x one-year forward P/E.

Ticker/Price	ASTRA IN/Rs 950
Market cap	US$ 1.9bn
Shares o/s	151mn
3M ADV	US$ 2.0mn
52wk high/low	Rs 1,369/Rs 746
Promoter/FPI/DII	56%/19%/25%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
Total revenue (Rs mn)	25,073	25,779	24,376	30,543	36,554
EBITDA (Rs mn)	3,853	4,429	3,721	5,117	6,330
Adj. net profit (Rs mn)	1,992	2,479	1,979	3,057	3,916
Adj. EPS (Rs)	13.2	16.5	13.1	20.3	26.0
Adj. EPS growth (%)	17.4	24.4	(20.2)	54.5	28.1
Adj. ROAE (%)	17.4	17.8	12.5	17.3	19.4
Adj. P/E (x)	71.9	57.7	72.4	46.8	36.6
EV/EBITDA (x)	37.6	32.7	38.7	27.9	22.5

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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