

Outperformance poised to continue, upgrade to BUY

Balkrishna Industries (BIL) posted healthy Q4FY20 results. Standalone revenue for the quarter came in at ₹ 1,357 crore (up 0.5% YoY), on the back of 4.7% rise in volumes to 57,966 MT. Margins declined 198 bps sequentially to 27.4% on account of 329 bps gross margin deterioration (largely led by year-end inventory adjustments), even as employee costs and other expenses declined 54 bps and 77 bps, respectively. Consequent PAT came in at ₹ 257.3 crore (up 39.3% YoY), tracking a rise in margins on a yearly basis, an increase in other income and decline in tax outgo. BIL commissioned Phase II of carbon black plant (80,000 MT) during Q4FY20.

Demand drivers in place for sustained strength in volumes

BIL stands apart from the rest of the tyre pack in respect of its business model (niche export-oriented player in off highway tyre i.e. OHT segment, serving agri & OTR industries), with Europe (51%) and North America (17%) forming 68% of revenues (India comprises ~20% of topline; BIL has ~5-6% market share domestically). For BIL, agri: OTR product mix is at 61:35, with replacement demand forming 75% of overall pie. BIL's export focus helped it comprehensively outperform domestic tyre manufacturers in Q4FY20, with volumes growing 4.7% YoY to 57,966 MT – its highest quarterly tonnage till date. Uptick in agri demand, in particular - across Europe and North America as well as India (relatively stable farm incomes) are seen aiding continued strength in volumes, going forward. The management's outlook on demand is positive, hoping to match FY20 performance during FY21E despite Covid disruption over the past few months. Agri retail is back to pre-pandemic levels, pointing to relatively quicker recovery being on the cards. We build 4.5% volume CAGR in FY20P-22E to 2.2 lakh MT.

Margin improvement set to accelerate

BIL would utilise its carbon black plant (Phase I of 60,000 MT completed; Phase II of 80,000 MT commissioned in Q4FY20) for internal consumption needs (~55,000 MT at present output levels) and sell the surplus in the open market (25% EBITDA margins, ahead of industry). It expects the backward integration move alone to aid margins by 100-150 bps during FY21E and play an important role in bringing gross margins to 58-60% over the longer term. Coupled with softness in prices of key raw materials (natural rubber, crude derivatives) as well as continued volume support, we expect margins to rise to 29.4% by FY21E and to 30% by FY22E.

Valuation & Outlook

BIL's structural margin accretive efforts along with expected resilience in volumes and long term debt free B/S and healthy cash flow generation merit significant premium in valuations over peers, in our view. With bulk of capex slated to be complete in FY21E, BIL will generate healthy FCF in FY22E. Hence, we upgrade BIL from HOLD to **BUY** with a revised target price of ₹ 1,450, valuing it at 25x FY22E EPS of ₹ 58.2.

Key Financial Summary

Key Financials	FY18	FY19	FY20P	FY21E	FY22E	CAGR (FY20E -22E)
Net Sales	4,464.5	5,244.5	4,782.5	4,833.9	5,628.4	8.5%
EBITDA	1,106.7	1,311.1	1,249.3	1,419.6	1,688.1	16.2%
EBITDA Margins (%)	24.8	25.0	26.1	29.4	30.0	
Net Profit	739.3	782.0	945.0	898.9	1,125.2	9.1%
EPS (₹)	38.2	40.5	48.9	46.5	58.2	
P/E	32.4	30.7	25.4	26.7	21.3	
RoNW (%)	18.1	16.7	18.8	16.5	18.8	
RoCE (%)	22.4	20.4	18.5	18.8	22.0	

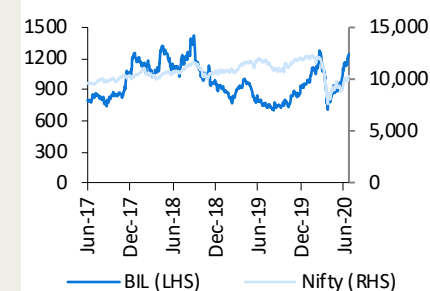
Source: Company, ICICI Direct Research



Particulars

Particular	Amount
Market Capitalization (₹ crore)	23,971
Total Debt (FY 20P) (₹ Crore)	862.2
Cash & Inv (FY 20P) (₹ Crore)	396.6
EV (₹ Crore)	24,436.9
52 week H/L (₹)	1298 / 678
Equity capital (₹ crore) (FY 20P)	38.7
Face value (₹)	2.0

Price Chart



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Q4FY20 earnings conference call highlights

Management outlook/guidance and demand

- The management provided a relatively healthy outlook for the business in FY21E. It expects to clock similar volume numbers in FY21E as it did in FY20 i.e. ~2 lakh MT
- The management's positive guidance is backed by encouraging demand being observed across geographies on the agri side, with OTR demand seen being more stable
- BIL has regained dispatches to a large extent post the end of the lockdown period, with agri retail back to pre Covid levels. It has attained normalcy across all its manufacturing plants but is witnessing minor issues with respect to labour availability
- Present capacity utilisation level is at ~70%
- Carbon black facilities (140,000 MT) are running smoothly with third-party sales well accepted in the market

Revenues, costs and margins

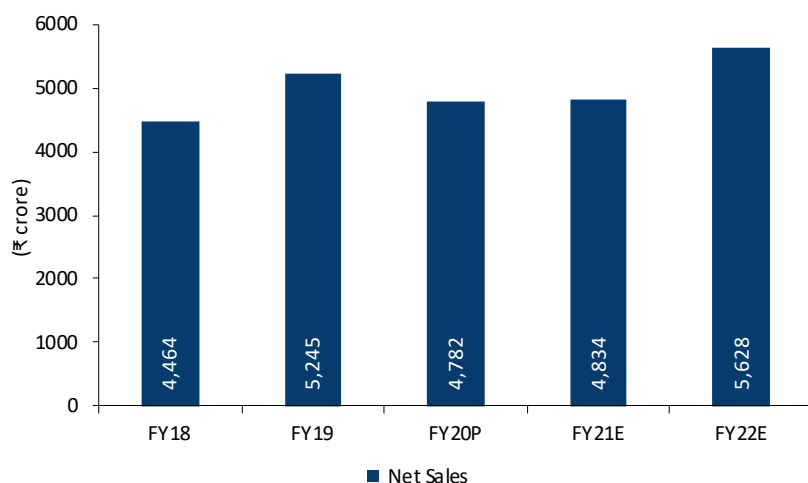
- Over the long term, BIL expects gross margins to improve substantially to ~58-60% of sales on the back of margin accretive factors like usage of captive carbon black, decline in RM costs and higher ASPs
- The company would need ~55,000-56,000 MT of carbon black to serve internal consumption needs at ~2 lakh MT volume level. The carbon black plant would service all of BIL's consumption needs. It expects backward integration to add ~100-150 bps to margins during FY21E. The management said that it clocks ~25% EBITDA margins in the carbon black business
- Long term EBITDA margins are seen at ~25-26% levels while near term margins are seen at ~28-30%
- Commodity costs declined from ₹ 101/kg in Q2FY20 to ₹ 98/kg in H2FY20. RM costs, however, rose sequentially on account of inventory adjustments. Prevailing RM costs are in declining mode
- ASPs declined QoQ on account of slightly adverse product mix and some discounts offered in the European markets. Going forward, BKT expects average blended realisations to be ~₹ 240-245/kg
- Natural rubber forms 35% of raw material costs, with crude derivatives forming ~60%
- Net forex gains for Q4FY20 were at ₹ 29 crore while for the full year FY20, it was at ₹ 131 crore
- Ocean freight expenses form 6-7% of exports revenue

Others

- BIL spent ₹ 761 crore on capex in FY20, with FY21E capex spend estimated at ₹ 600 crore (of which ₹ 500 crore would be for completing Bhuj and Waluj facilities outlay)
- Europe, North America, India formed 58%, 15%, 18% of Q4FY20 sales, respectively. For full year FY20, the mix was at 51%, 17%, 20%, respectively
- Agri : OTR : lawn/garden mix for Q4FY20 was at 65 : 32 : 3 and for full year FY20 was at 61: 35: 4, respectively
- OEM channel forms ~25% of BIL's sales, with aftermarket forming ~75%. At the industry level, the same is at ~45-50% OEM and ~50-55% aftermarket
- France's market share has improved by 220 bps, with advertising spends helping raise brand equity. India market share is at ~5-6%
- BIL sources ~10-12% of its raw material needs from China. However, it has developed credible alternative sources and is well placed in case any trade restrictions are imposed on imports from China
- Effective tax rate, going forward, is guided at 25.2%

Financial story in charts

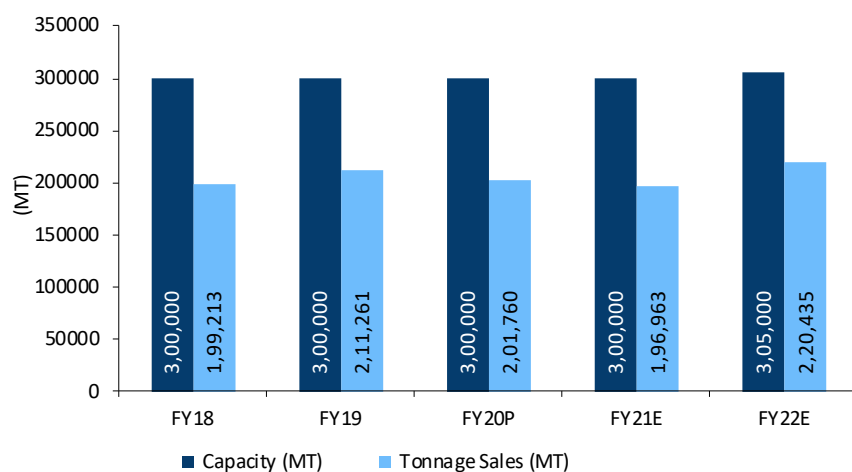
Exhibit 1: Topline trend



We expect sales to grow at a CAGR of 8.5% over FY20P-22E

Source: Company, ICICI Direct Research

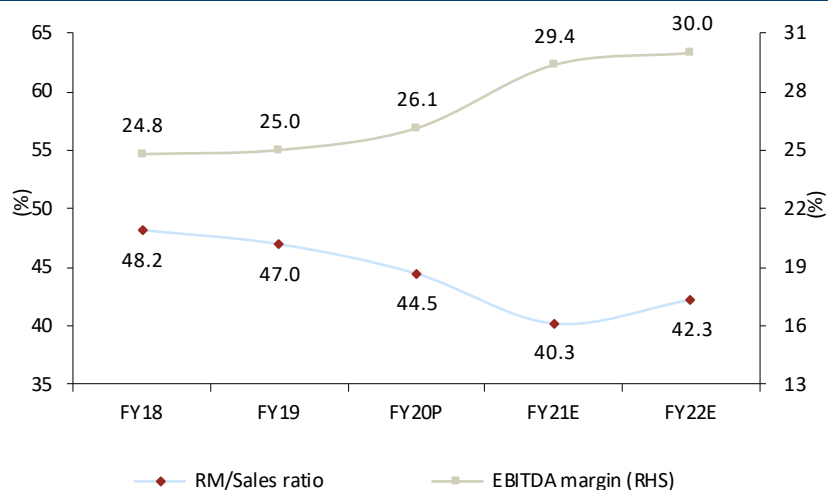
Exhibit 2: Capacity and volume trend



We expect tonnage volumes to grow at 4.5% CAGR over FY20P-22E to 2.2 lakh MT

Source: Company, ICICI Direct Research

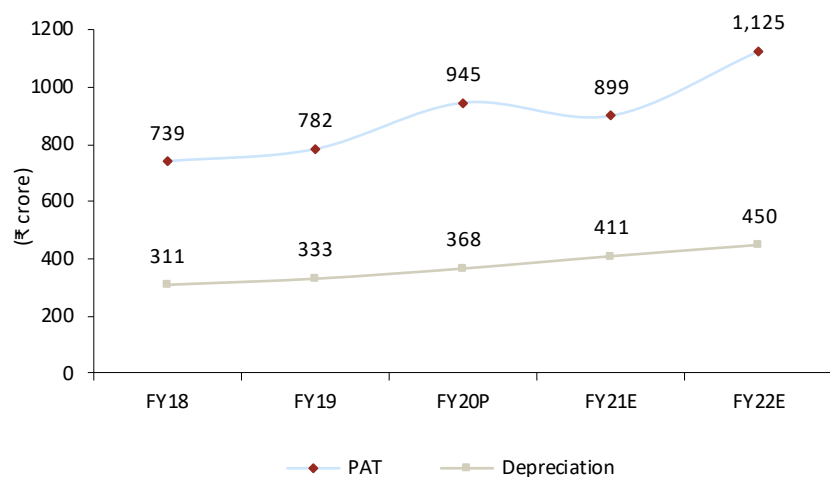
Exhibit 3: Trend in EBITDA margins



Margins are seen improving to 29.4% by FY21E and thereafter to 30% in FY22E amid backward integration benefits, soft commodity prices and better operating leverage

Source: Company, ICICI Direct Research

Exhibit 4: Trend in profitability



PAT is seen growing at 9.1% CAGR over FY20P-22E to ₹ 1,125 crore despite rise in depreciation costs on account of higher capitalisation of assets

Source: Company, ICICI Direct Research

Exhibit 5: Valuation Summary

	Sales Growth		EPS Growth		PE	EV/EBITDA	RoNW	RoCE
	(₹ cr)	(%)	(₹)	(%)	(x)	(x)	(%)	(%)
FY 18	4,464	17.8	38.2	3.4	32.4	21.8	18.1	22.4
FY 19	5,245	17.5	40.5	5.8	30.7	18.3	16.7	20.4
FY 20P	4,782	-8.8	48.9	20.8	25.4	19.6	18.8	18.5
FY 21E	4,834	1.1	46.5	(4.9)	26.7	17.1	16.5	18.8
FY 22E	5,628	16.4	58.2	25.2	21.3	14.0	18.8	22.0

Source: Bloomberg, ICICI Direct Research

Financial Summary

Exhibit 6: Profit and loss statement ₹ crore				
(Year-end March)	FY19	FY20P	FY21E	FY22E
Total operating Income	5,244.5	4,782.5	4,833.9	5,628.4
Growth (%)	17.5	-8.8	1.1	16.4
Raw Material Expenses	2,462.8	2,126.8	1,946.3	2,378.5
Employee Expenses	263.6	285.8	297.2	310.4
Other Expenses	1,206.9	1,120.5	1,170.8	1,251.4
Total Operating Expenditure	3,933.4	3,533.2	3,414.3	3,940.3
EBITDA	1311.1	1249.3	1419.6	1688.1
Growth (%)	18.5	-4.7	13.6	18.9
Depreciation	332.6	368.0	410.9	450.3
Interest	9.8	7.3	6.9	6.6
Other Income	214.2	248.8	199.9	273.0
PBT	1183.0	1122.8	1201.7	1504.3
Total Tax	401.0	177.9	302.8	379.1
Reported PAT	782.0	945.0	898.9	1125.2
Growth (%)	5.8	20.8	-4.9	25.2
EPS (₹)	40.5	48.9	46.5	58.2

Source: Company, ICICI Direct Research

Exhibit 7: Cash flow statement ₹ crore				
(Year-end March)	FY19	FY20P	FY21E	FY22E
Profit after Tax	782.0	945.0	898.9	1,125.2
Add: Depreciation	332.6	368.0	410.9	450.3
(Inc)/dec in Current Assets	-141.3	135.9	-7.1	-216.4
Inc/(dec) in CL and Provisions	-217.8	42.2	-27.7	94.9
CF from operating activities	755.5	1491.1	1275.0	1454.0
(Inc)/dec in Investments	-280.5	412.4	-25.0	-490.0
(Inc)/dec in Fixed Assets	-714.0	-848.8	-600.0	-200.0
Others	256.4	-502.6	-52.0	-81.5
CF from investing activities	-738.1	-939.0	-677.0	-771.5
Inc/(dec) in loan funds	211.1	32.6	-100.0	-100.0
Dividend paid & dividend tax	-186.2	-465.5	-483.3	-580.0
Others	-12.4	-130.1	0.0	0.0
CF from financing activities	12.5	-563.0	-583.3	-680.0
Net Cash flow	30.0	-10.9	14.7	2.6
Opening Cash	26.4	56.4	45.5	60.2
Closing Cash	56.4	45.5	60.2	62.7

Source: Company, ICICI Direct Research

Exhibit 8: Balance Sheet ₹ crore				
(Year-end March)	FY19	FY20P	FY21E	FY22E
Liabilities				
Equity Capital	38.7	38.7	38.7	38.7
Reserve and Surplus	4,640.0	4,989.4	5,405.0	5,950.2
Total Shareholders funds	4678.7	5028.1	5443.6	5988.9
Total Debt	829.6	862.2	762.2	662.2
Deferred Tax Liability	325.5	178.3	178.3	178.3
Minority Interest / Others	0.0	0.0	0.0	0.0
Total Liabilities	5867.5	6126.3	6441.9	6887.2
Assets				
Gross Block	3,939.8	4,788.5	5,874.0	6,074.0
Less: Acc Depreciation	1,231.3	1,599.4	2,010.2	2,460.5
Net Block	2708.5	3189.1	3863.8	3613.5
Capital WIP	585.4	585.6	100.0	100.0
Total Fixed Assets	3,293.9	3,774.7	3,963.8	3,713.5
Investments	1,160.3	1,151.0	1,226.0	1,766.0
Inventory	713.0	580.4	596.0	693.9
Debtors	568.1	649.2	662.2	771.0
Loans and Advances	61.9	18.5	18.7	21.7
Cash	56.4	45.5	60.2	62.7
Other current assets	273.3	232.3	210.7	217.1
Total Current Assets	1,672.7	1,525.9	1,547.6	1,766.6
Creditors	356.6	361.0	331.1	385.5
Provisions	7.4	4.2	3.9	4.5
Other current liabilities	198.6	239.6	242.2	282.0
Total Current Liabilities	562.6	604.9	577.2	672.0
Net Current Assets	1110.0	921.1	970.5	1094.5
Others	302.9	279.1	281.2	312.6
Application of Funds	5867.5	6126.3	6441.9	6887.2

Source: Company, ICICI Direct Research

Exhibit 9: Key ratios				
(Year-end March)	FY19	FY20P	FY21E	FY22E
Per share data (₹)				
EPS	40.5	48.9	46.5	58.2
Cash EPS	57.7	67.9	67.8	81.5
BV	242.0	260.1	281.6	309.8
DPS	8.0	20.0	25.0	30.0
Cash Per Share	2.9	2.4	3.1	3.2
Operating Ratios (%)				
EBITDA Margin	25.0	26.1	29.4	30.0
PBT / Net sales	18.7	18.4	20.9	22.0
PAT Margin	14.9	19.8	18.6	20.0
Inventory days	49.6	44.3	45.0	45.0
Debtor days	39.5	49.6	50.0	50.0
Creditor days	24.8	27.6	25.0	25.0
Return Ratios (%)				
RoE	16.7	18.8	16.5	18.8
RoCE	20.4	18.5	18.8	22.0
RoIC	22.9	17.6	17.5	21.6
Valuation Ratios (x)				
P/E	30.7	25.4	26.7	21.3
EV / EBITDA	18.3	19.6	17.1	14.0
EV / Net Sales	4.6	5.1	5.0	4.2
Market Cap / Sales	4.6	5.0	5.0	4.3
Price to Book Value	5.1	4.8	4.4	4.0
Solvency Ratios				
Debt/EBITDA	0.6	0.7	0.5	0.4
Debt / Equity	0.2	0.2	0.1	0.1
Current Ratio	4.4	4.1	4.4	4.4
Quick Ratio	2.5	2.5	2.7	2.6

Source: Company, ICICI Direct Research

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Sell: <-15%



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