Balkrishna Industries

Focus on the non-core business to affect business profitability

Automobiles	Sharekhan code: BALKRISIND	Result Update

3R MATRIX

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Hold**	↓
CMP: **Rs. 1,666**	
Price Target: **Rs. 1,800**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 32,209 cr
52-week high/low:	Rs. 1,885 / 677.6
NSE volume: (No of shares)	9.23 lakh
BSE code:	502355
NSE code:	BALKRISIND
Free float: (No of shares)	8.1 cr

Shareholding (%)

Promoters	58.3
FII	15.5
DII	15.0
Others	11.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	9.9	30.3	38.7	70.3
Relative to Sensex	3.3	6.1	2.5	41.5

Sharekhan Research, Bloomberg

Summary

- Despite strong operational performance in Q3FY21, we are concerned that Balkrishna Industries Limited's (BKT) return ratios and EBITDA margins would decline in the medium-term, owing to significant capex commitment towards non-core business. Thus we downgrade the stock to Hold rating with a PT of Rs 1,800.
- BKT reported another strong quarter in Q3FY21 with PAT improving 42% y-o-y, aided by volume growth and margin expansion.
- The stock is trading at premium to its historical averages at P/E multiple of 20.4x and EV/EBITDA multiple of 14.2x its FY2023E estimates.

Balkrishna Industries Limited (BKT) reported another quarter strong operational performance, beating our earnings estimates. Net revenue grew by 26.5% y-o-y to Rs. 1,497 crore in Q3FY2021, largely driven by 26% volume growth at 59,810 MT tyres. Management has witnessed strong demand in the agriculture segment across geographies. In the other segments, the company witnessed demand recovery in most markets such as industrial, construction, and mining segment. EBITDA margin improved by 50 bps y-o-y to 31.3% in Q3FY2021, aided by cost reductions and operating leverage benefits. As a result, EBITDA grew by 28.5% y-o-y to Rs. 468 crore. Adjusted PAT increased by strong 42% y-o-y to Rs. 314 crore, aided by other income, partially offset by increased depreciation. The company has planned capex of Rs. 1,900 crore for the brownfield project to increase tyre capacity and carbon-black capacity at Bhuj plant. Moreover, BKT will use capex for automation and technology upgradation. We are concerned with the expected 75% increase in carbon black capacity, which would have significant surplus over BKT's captive use. Sales of carbon black to third party are expected to contribute considerably, which will impact the company's profitability and return ratios adversely over the medium term. Given the strong Q3FY21 volume performance, BKT has raised its FY2021 volume guidance for the FY2021 and expects FY2022E to be strong year as well. BKT is expected to continue gaining market share, driven by new product introductions and entry in new geographies. We expect strong double-digit volume growth in FY2022E, driven by pick-up in economic growth and continued market share gains. However, despite strong operational performance in Q3FY2021, we are concerned that BKT's return ratios and EBITDA margin would decline in the medium term, owing to significant capex commitment towards the non-core business. We expect return ratios to decline with RoE/RoCE declining by 180 bps/50bps from 18.9%/21.6% in FY2021E to 17.2%/21.1% in FY2025E respectively due to increased share of the non-core business. Moreover, we expect overall EBITDA margin to decline to 28%-29% over the next few years from 31%-32% currently. Thus, we are downgrading the stock to Hold with an unchanged price target (PT) of Rs. 1,800.

Our Call

Valuation – Downgrade to Hold with an unchanged PT of Rs. 1,800: BKT's Q3FY2021 results beat estimates with strong demand and operational performance. BKT is witnessing strong demand traction and has raised its FY2021 volume guidance and expects strong demand momentum to continue in FY2022. However, despite strong operational performance in Q3FY2021, we are concerned that BKT's return ratios and EBITDA margin would decline in the medium term, owing to significant capex commitment towards the non-core business. The stock has run up 70% in the past one year and has outperformed the broader market (NIFTY) by 41.5% during the same period, driven by strong offtake from OEMs, increased replacement demand, and margin expansion. The stock is currently trading at P/E of 20.4x and EV/EBITDA of 14.2x its FY2023E estimates. Valuations are at premium to its historical average. Thus, we are downgrading the stock to Hold with an unchanged PT of Rs. 1,800.

Key Risks

BKT derives ~23% of its revenue from India, while it derives 49% from Europe, 15% from America, and 13% from rest of the world. Any adverse movement in the macro environment of these countries or forex fluctuation could impact the company's financial performance.

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	5,336	4,897	5,764	6,920	8,013
Growth (%)	13.9	(8.2)	17.7	20.1	15.8
EBIDTA	1,402	1,364	1,754	2,058	2,341
OPM (%)	26.3	27.9	30.4	29.7	29.2
Net Profit	782	945	1,113	1,358	1,577
Growth (%)	5.8	20.8	17.8	22.1	16.1
EPS	40.5	48.9	57.6	70.3	81.6
P/E	41.2	34.1	28.9	23.7	20.4
P/BV	6.9	6.4	5.5	4.7	4.0
EV/EBIDTA	23.5	24.2	18.8	16.3	14.2
ROE (%)	16.7	18.8	18.9	19.6	19.4
ROCE (%)	20.3	18.4	21.6	22.9	23.0

Source: Company; Sharekhan estimates

Despite strong operational performance, we are concerned about significant capex towards the non-core business: BKT reported strong performance across the parameter. During the concall, the company announced a new capex upcycle of Rs. 1,900 crore over a period of 18-24 months, with significant Rs. 650 crore towards the increase in capacity of carbon black from achievable capacity of 1,15,000 MTPA to 2,00,000 MTPA. We are concerned with this significant expansion in carbon black, as we believe the planned capex would be much higher than the captive requirement. This would lead to an increase in third-party sales of carbon black. Domestic carbon black manufacturers typically generate EBITDA margin of 15%-16%, which is sharply lower to BKT's EBITDA margin profile of greater 30%. We expect the increasing share of revenue from carbon black would impact BKT's EBITDA margin and return ratios in the medium term.

Another quarter of strong performance: BKT reported another strong quarter, beating our earnings estimates by 13%. Net revenue grew by 26.5% y-o-y to Rs. 1,497 crore in Q3FY2021, largely driven by 26% volume growth at 59,810 MT. Management has witnessed strong demand in the agriculture segment across geographies. In other segments, the company witnessed demand recovering in most markets such as industrial, construction, and mining segment. EBITDA margin improved by 50 bps y-o-y to 31.3% in Q3FY2021, aided by cost reductions and operating leverage benefits. As a result, EBITDA grew by 28.5% y-o-y to Rs. 468 crore. Adjusted PAT increased by strong 42% y-o-y to Rs. 314 crore, aided by other income, partially offset by increased depreciation. The company has declared third interim dividend of Rs. 5 per share in Q3FY2021 and Rs. 7 per share for H1FY2021.

Positive guidance: With 9MFY2021 volumes of approximately 1,59,130 MT, management has increased its guidance for FY2021 sales volume of 215,000-220,000 MT. Management expects demand to remain strong even in FY2022. For 9MFY2021, the segmental revenue mix remained at 64% from agriculture, 33% from OTR, and balance 3% from others. Replacement demand continues to dominate the revenue share of 71%, while OEM's share remained at 25%. As per the geographical mix, Europe sales contributed 49%, India contributed 23%, America contributed 15%, and rest of the world contributed 13%.

Capex plan: The company has planned capex of Rs. 1,900 crore for the brownfield project to increase tyre capacity and carbon black capacity at Bhuj plant. Moreover, BKT will use capex for automation and technology upgradation. The brownfield tire project at Bhuj plant would add ~50,000 MTPA capacity, which is expected to be completed by H2FY2023. Post the brownfield capex, capacity of the tire plant will stand at 335,000 MTPA. This would require an investment of Rs. 800 crore. The company is planning to increase its capacity for carbon black and captive power. Capex cost of for this purpose would be Rs. 650 crore, which is expected to complete by H1FY2023. The third part of capex would be invested in modernisation, automation, and technology upgradation in its Bhuj and Gujarat plants. Capex cost for this purpose is estimated around Rs. 450 crore. Capex plans are embarked, given the current demand in the market, both domestic and global.

Key focus areas: Management continues to focus on market reach through existing sales channels, increased share of business in US markets by increasing supplies from India, expansion in the product portfolio by adding large-size tires, strengthening distribution channels within Indian markets, and reaching 100% capacity utilisation at its Bhuj plant.

Strong demand but margins could come under pressure: Q3FY2021 results were better than expected on strong demand and solid EBITDA margin expansion. Despite the strong demand and growth expected over the next few years, we expect return ratios to decline with RoE/RoCE to decline by 180 bps/50bps from 18.9%/21.6% in FY2021E to 17.2%/21.1% in FY2025E, due to increased share of the non-core business. We expect EBIDTA margin to decline by 120 bps from 30.4% in FY2021E to 29.2% in FY2023E.

Q3FY2021 Results (Standalone) Rs cr

Particulars	Q3FY21	Q3FY20	YoY %	Q2FY21	QoQ %
Revenues	1,496.6	1,183.5	26.5	1,551.8	-3.6
EBITDA	468.4	364.5	28.5	509.7	-8.1
EBITDA margins (%)	31.3	30.8	50 bps	32.8	(155 bps)
Depreciation	101.9	94.9	7.5	101.2	0.7
Interest	1.7	1.9	(7.6)	3.4	(49.6)
Other income	51.4	7.1	627.6	45.4	13.2
PBT	416.1	274.8	51.4	450.5	-7.6
Tax	102.2	54.2	88.8	111.0	-7.9
PAT	313.9	220.7	42.2	339.5	-7.5
Reported PAT	3.1	(11.5)	-127.1	(3.9)	-180.0
EPS	16.2	11.4	42.2	17.6	-7.5

Source: Company; Sharekhan Research

Outlook and Valuation

Sector outlook - Strong recovery from FY2022

We expect the tyre industry to be the natural benefactor of the sharp recovery in automobile sales. The automobile sector has witnessed broad-based recovery across the segment after the COVID-19 lockdown, driven by pent-up demand, preference for personal mobility amid COVID-19, and faster-than-expected recovery in infrastructure, mining, and other economic activities. The tyre industry is well positioned to gain momentum in the medium term, backed by higher OEM offtake and the ripple effect of the OEM demand, which is likely to result in steady growth for replacement demand. The scenario in Europe and Americas is also recovering but currently stands below the pre-COVID levels. The rolling out of COVID-19 vaccination programmes in many countries are keeping overall outlook positive for the coming months following the respective approval of various vaccines.

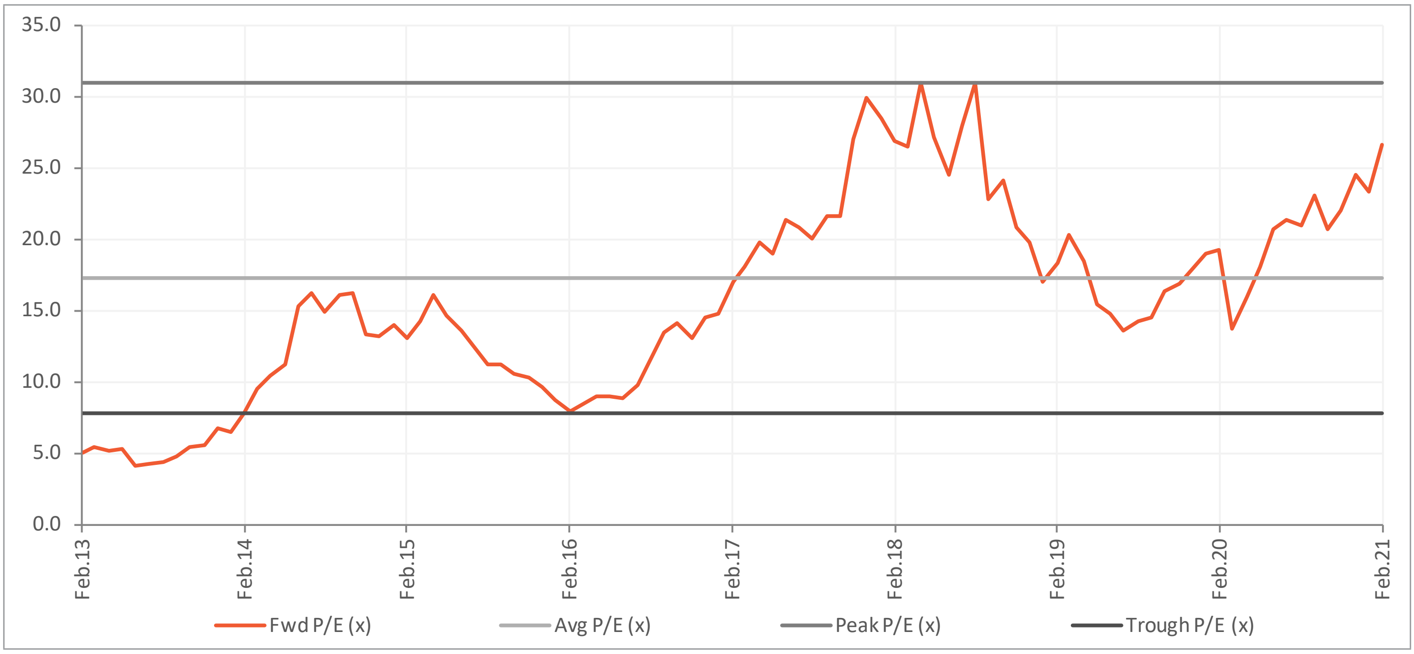
Company outlook - Strong demand but margins and return ratios to decline

BKT's Q3FY2021 results were better than expectations on strong demand and solid EBITDA margin expansion. Despite the strong demand and growth expected over the next few years, we expect return ratios to decline with RoE/RoCE to decline by 180 bps/50bps from 18.9%/21.6% in FY2021E to 17.2%/21.1% in FY2025E due to increased share of the non-core business. We expect EBIDTA margin to decline by 120 bps from 30.4% in FY2021E to 29.2% in FY2023E.

Valuation - Downgrade to Hold with unchanged PT of Rs. 1,800

BKT is witnessing strong demand traction and has raised its FY2021 volume guidance and expects strong demand momentum to continue in FY2022. However, despite strong operational performance in Q3FY2021, we are concerned that BKT's return ratios and EBITDA margin would decline in the medium term, owing to significant capex commitment towards the non-core business. The stock has run up 70% in the past one year and has outperformed the broader market (NIFTY) by 41.5% during the same period, driven by strong offtake from OEMs, increased replacement demand, and margin expansion. The stock is currently trading at P/E of 20.4x and EV/EBITDA of 14.2x its FY2023E estimates. Valuations are at a premium to its historical average. Thus, we are downgrading the stock to Hold with an unchanged PT of Rs. 1,800.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Balkrishna Industries	28.9	23.7	20.4	18.8	16.3	14.2	18.9	19.6	19.4
Apollo Tyres	21.1	13.3	10.2	7.0	5.7	5.0	6.6	8.0	9.5

Source: Company, Sharekhan estimates

About company

BKT is one of the leading manufacturers of over-the-highway tires. BKT makes tyres that are used in various applications, including agricultural, construction, and industrial vehicles as well as earthmoving, port, mining, ATV, and gardening. BKT is a global player present in Europe, US, and India. While European markets account for ~49% of sales, US and India account for 16% and 19% of sales, respectively. The company has a well-spread distribution network that supports sales to 160 countries. BKT has three manufacturing plants in India – in Aurangabad and Bhuj (western India), Bhiwadi, and Chopanki (in North India). In addition to this, the company operates a mold plant in Dombivli (near Mumbai). The current achievable production capacity across all plants stands at 3,00,000 MTPA, comprising a widespread product portfolio of 2,700 SKUs.

Investment theme

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Key Risks

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Additional Data

Key management personnel

Arvind Poddar	Chairman & Managing Director
Rajiv Poddar	Joint Managing Director
Vipul Shah	Wholetime Director & Company Secretary
Madhu Sudan Bajaj	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Poddar Rajiv A	27.7
2	VKP Enterprises LLP	25
3	NA	7.4
4	HDFC Asset Management Co Ltd	6.5
5	Poddar Khushboo	3.9
6	MODI MANOJ H	3.9
7	Mirae Asset Global Investments Co	2.8
8	Amansa Holdings Pvt Ltd	1.7
9	Norges Bank	1.5
10	GOVERNMENT PENSION FUND - GLOBAL	1.5

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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