Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Balkrishna Industries Ltd

Guidance revised upwards; Upgrade ratings to Buy

Automobiles	Sharekhan code: BALKRISIND
Reco/View: Buy ↑	CMP: Rs. 2,246 / Price Target: Rs. 2,700 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 20.61

Updated Oct 08, 2021

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

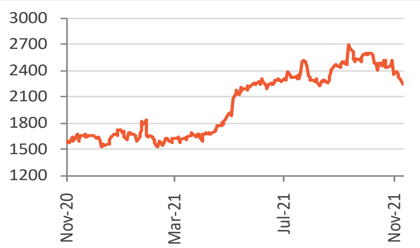
Company details

Market cap:	Rs. 43,419 cr
52-week high/low:	Rs. 2,724 / 1,515
NSE volume: (No of shares)	4.0 lakh
BSE code:	502355
NSE code:	BALKRISIND
Free float: (No of shares)	8.1 cr

Shareholding (%)

Promoters	58.3
FII	15.4
DII	12.6
Others	13.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-13.0	-2.5	18.5	42.8
Relative to Sensex	-7.7	-7.3	-1.5	7.9

Sharekhan Research, Bloomberg

Summary

- We upgrade our rating on Balkrishna Industries Limited's (Balkrishna) to Buy with a revised PT of Rs. 2,700 given robust outlook and earnings growth. The stock trades at P/E multiple of 21.6x and EV/EBITDA multiple of 15.1x its FY2023E estimates.
- For Q2FY2022, Balkrishna's results were below expectations on the operational front, however management has revised volume guidance upwards.
- We expect strong double-digit volume growth in FY2022E, driven by infrastructure creation and pick-up in economic activity and continued market share gains.
- We expect earnings to report a 31.8% CAGR during FY2021-FY2023E, mainly driven by volume growth.

Balkrishna Industries Limited (Balkrishna) reported lower-than-expected operational performance, led by increased raw-material price and higher freight rates. Net revenue grew by 32.1% y-o-y to Rs. 2,050 crore in Q2FY2022, driven by 18.8% volume growth at 72,748 MT of tyres and 11.2% improvement in average realisation. Average realisation improved by price hikes and a better product mix. Management has witnessed strong demand in the agriculture segment across geographies. In other segments, demand has seen an uptick because of increased commodity prices, infrastructure creation, and pick-up in economic activity. EBITDA margin declined by 350 bps q-o-q to 25.4% in Q2FY2022 due to rise in raw-material costs and increased freight rates. As a result, EBITDA and adjusted PAT improved by 2% y-o-y and 11.1% y-o-y to Rs. 519 crore and Rs. 377 crore, respectively. The company would be incurring cumulative capex of Rs. 2,250 crore for the Brownfield project to increase tyre capacity and increase carbon-black capacity at Bhuj plant. Moreover, Balkrishna will use capex for automation and technology upgradation and installation of new machineries in the old Walnuj plant. Given a strong outlook for the automobile industry and improved economy activities, Balkrishna has increased its volume growth guidance to 20-25% in FY2022 and expects margins to be at 28-30% on a sustainable basis. The company continues to maintain its target to achieve 10% global market share in tyres in the medium term from 7-8% currently. We expect Balkrishna to gain market share, driven by product launches and entry in new geographies. We expect strong double-digit volume growth in FY2022E, driven by infrastructure creation and pick-up in economic activity and continued market share gains. We have upgraded our earnings estimates and rating to Buy on the stock with a revised PT of Rs. 2,700.

Key positives

- Quarterly volumes rose to record highs at 72,748 MT, led by robust growth across segments and geographies.

Key negatives

- EBITDA margin declined by 350 bps q-o-q to 25.4% in Q2FY2022 due to rise in raw-material costs and increased freight rates.

Management Commentary

- Volume growth guidance revised upwards to 20-25% in FY2022E on strong demand outlook from 10-17% growth earlier.
- Robust demand led to continued operations at old Walnuj plant with additional capex of Rs. 350 crore for installation of latest machineries, replacement ofcertain machineries, upgradation of certain systems, and some portion of civil work.

Our Call

Valuation – Upgrade to Buy rating with a revised PT of Rs. 2,700: Balkrishna is witnessing strong demand traction and has increased its volume guidance to 20-25% in FY2022 from 10-17%. The company has capex plan of Rs. 1,900 crore towards ramping up production over the next 2-3 years, investing in capacity expansion, backward integration, automation, and modernisation of plants. We have fine-tuned our estimates and increased earnings estimates by 8.4% for FY2022E and 7.7% for FY2023E. Rise in COVID cases in the third wave in Europe could be a concern in the near term, but we believe it is a transient phase and sales will recover post normalisation of the third wave. We expect Balkrishna's earnings to report a 31.8% CAGR during FY2021-FY2023E, largely driven by volume growth. The stock has corrected by 13% in the last past one month, providing a good opportunity for investors to buy the stock. Thus, we have upgraded our rating on the stock to Buy with a revised price target (PT) of Rs. 2,700, given robust outlook and earnings growth. The stock trades at P/E multiple of 21.6x and EV/EBITDA multiple of 15.1x its FY2023E estimates.

Key Risks

Balkrishna derives ~23% of its revenue from India, while it derives 50% from Europe, 15% from America, and 13% from rest of the world (FY2021). Any adverse movement in the macro environment of these countries or forex fluctuation could impact the company's financial performance.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	5,758	8,032	9,370	10,467
Growth (%)	17.6	39.5	16.7	11.7
EBIDTA	1,786	2,517	2,919	3,238
OPM (%)	31.0	31.3	31.2	30.9
Net Profit	1,155	1,700	2,007	2,292
Growth (%)	22.3	47.1	18.1	14.2
EPS (Rs.)	59.8	87.9	103.8	118.6
P/E	37.6	25.5	21.6	18.9
P/BV	7.3	6.0	4.9	4.0
EV/EBIDTA	24.7	17.7	15.1	13.4
ROE (%)	19.5	23.5	22.6	21.2
ROCE (%)	22.1	27.6	27.1	25.9

Source: Company; Sharekhan estimates

Lower-than-expected operational performance: Balkrishna reported lower-than-expected operational performance, led by increased raw-material price and higher freight rates. Net revenue grew by 32.1% y-o-y to Rs. 2,050 crore in Q2FY2022, driven by 18.8% volume growth at 72,748 MT of tyres and 11.2% improvement in average realisation. Average realisation improved due to by price hikes and a better product mix. Management has witnessed strong demand in the agriculture segment across geographies. In other segments, demand has seen an uptick because of increased commodity prices, infrastructure creation and pick-up in economic activity. EBITDA margin declined by 350 bps q-o-q to 25.4% in Q2FY2022 because of rise in raw-material costs and increased freight rates. As a result, EBITDA and adjusted PAT improved by 2% y-o-y and 11.1% y-o-y to Rs. 519 crore and Rs. 377 crore, respectively. During October 2021, the company raised long-term finance of Rs. 500 crore in the form of non-convertible debentures having face value of Rs. 10 lakh per debenture.

Positive guidance: Management has revised its guidance for FY2022E to 20-25% volume growth from 10-17% growth earlier. Moreover, the company expects margins to sustain at 28-30% from 31% in FY2021. However, the company expects raw-material prices to remain firm in the near term, expecting ~2% input cost inflation. For H1FY2022, segmental revenue mix remained at 65.8% from agriculture, 30.9% from OTR, and balance 3.3% from others. Replacement demand continues to dominate with revenue share of 70.3%, while original equipment manufacturers' (OEMs)_ share remained at 26.7% and other channels at 3% in H1FY2022. As per the geographical mix, Europe sales contributed 54%, India contributed 17.3%, America contributed 16.7%, and ROW contributed 12%.

Capex plan: The company has increased its capex by Rs. 350 crore to cumulative capex of Rs. 2,250 crore for the Brownfield project to increase tyre capacity and carbon black capacity at Bhuj plant. Moreover, Balkrishna will use capex for automation and technology upgradation. Robust demand led to continued operations at old Walnuj plant with additional capex of Rs. 350 crore for installation of latest machineries, replacement of certain machineries, upgradation of certain systems, and some portion of civil work. The Brownfield tyre 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 tyre 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 for this purpose would amount to Rs. 650 crore, which is expected to be completed by H1FY2023. The third part of capex would be invested in modernisation, automation, and technology upgradation at its Bhuj and Gujarat plants. Capex cost for this purpose is estimated around Rs. 450 crore. Capex plans are embarked, given the current market demand, 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 tyres, strengthening distribution channels within Indian markets, and reaching 100% capacity utilisation at its Bhuj plant.

Strong demand to drive growth: The company continues to maintain its target to achieve 10% global market share in tyres in the medium term from ~6% currently. Excluding China, the company has a global market share of 7-8%. We expect Balkrishna to gain market share, driven by new product introductions and entry into new geographies. We expect strong double-digit volume growth in FY2022E, driven by infrastructure creation, pick-up in economic activity, and continued market share gains. We have increased our volume estimates by 8.4% and 7.7% for FY2022E and FY2023E, respectively, at the upper end of capacity utilisation. We expect BKT's earnings to report a 31.8% CAGR during FY2021-FY2023E, largely driven by volume growth.

Results (Standalone) Rs cr

Particulars	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)
Revenue	2,049.8	1,551.8	32.1	1,828.1	12.1
Total operating expenses	1,529.9	1,042.1	46.8	1,300.4	17.6
EBITDA	519.9	509.7	2.0	527.7	-1.5
Depreciation	108.5	101.2	7.2	104.1	4.2
Interest	1.8	3.4	(46.6)	2.1	(14.6)
Other income	133.1	45.4	193.2	78.2	70.1
PBT	542.7	450.5	20.5	499.7	8.6
Tax	165.5	111.0	49.0	153.5	7.8
Reported PAT	12.8	(3.9)	-429.2	(2.4)	-632.8
Adjusted PAT	377.2	339.5	11.1	346.2	9.0
Adjusted EPS (Rs.)	19.5	17.6	11.1	17.9	9.0

Source: Company, Sharekhan Research

Key ratios (Standalone)

Particulars	Q2FY22	Q2FY21	YoY (bps)	Q1FY22	QoQ (bps)
Gross margin (%)	54.7	60.6	-590	57.2	-250
EBIDTA margin (%)	25.4	32.8	-750	28.9	-350
EBIT margin (%)	20.1	26.3	-630	23.2	-310
Net profit margin (%)	18.4	21.9	-350	18.9	-50
Effective tax rate (%)	30.5	24.6	580	30.7	-20

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Strong recovery from FY2022

We expect the domestic tyre industry to naturally benefit from the sharp recovery in automobile sales post normalisation of the economy. The automobile sector has witnessed broad-based recovery across segments after 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 ripple effect of the same, which are likely to result in steady growth for replacement demand. The scenario in Europe and Americas is also recovering significantly, with sales and volumes nearing pre-COVID levels. The rolling out of COVID-19 vaccination programmes in many countries is keeping the overall outlook positive.

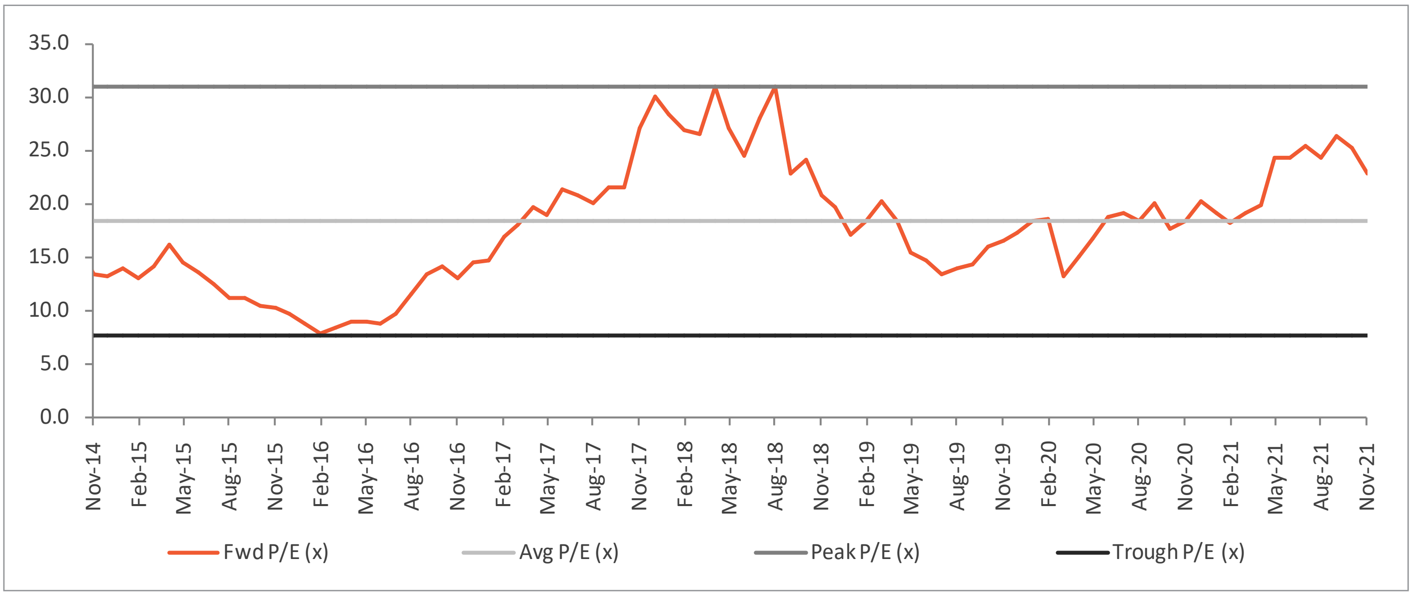
■ Company outlook - Strong demand and margin profile

The company reported another quarter of strong operational performance in FY2021, driven by robust volume growth and margin. Management has given positive guidance for FY2022E, expecting 10-17% volume growth and margins sustaining 28-30% going forward. The company continues to maintain its target to achieve 10% global market share in tyres in the medium term from ~6% currently. We expect Balkrishna to gain market share, driven by product launches and entry into new geographies. We expect BKT's earnings to report a 27% CAGR during FY2021-FY2023E, largely driven by volume growth, with EBITDA margin declining to 30.4% in FY2023E from 31% in FY2021.

■ Valuation - Upgrade to Buy rating with a revised PT of Rs. 2,700

Balkrishna is witnessing strong demand traction and has increased its volume guidance to 20-25% in FY2022 from 10-17%. The company has capex plan of Rs. 1,900 crore towards ramping up production over the next 2-3 years, investing in capacity expansion, backward integration, automation, and modernisation of plants. We have fine-tuned our estimates and increased earnings estimates by 8.4% for FY2022E and 7.7% for FY2023E. Rise in COVID cases in the third wave in Europe could be a concern in the near term, but we believe it is a transient phase and sales will recover post normalisation of the third wave. We expect Balkrishna's earnings to report a 31.8% CAGR during FY2021-FY2023E, largely driven by volume growth. The stock has corrected by 13% in the last past one month, providing a good opportunity for investors to buy the stock. Thus, we have upgraded our rating on the stock to Buy with a revised price target (PT) of Rs. 2,700, given robust outlook and earnings growth. The stock trades at P/E multiple of 21.6x and EV/EBITDA multiple of 15.1x its FY2023E estimates.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Company	CMP (Rs)	P/E (x)			EV/EBITDA (x)			ROCE (%)		
		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Balkrishna Industries	2,246	37.6	25.5	21.6	24.7	17.7	15.1	22.1	27.6	27.1
Apollo Tyres	217	18.8	12.1	9.1	6.4	5.3	4.5	6.5	7.8	9.3

Source: Company, Sharekhan estimates

About company

Balkrishna is one of the leading manufacturers of over-the-highway tyres. The company makes tyres that are used in various applications, including agricultural, construction, and industrial vehicles as well as earthmoving, port, mining, ATV, and gardening. Balkrishna is a global player present in Europe, US, and India. While European markets account for ~50% of sales, US and India account for 15% and 23% of sales, respectively. The company has a well-spread distribution network that supports sales to 160 countries. The company 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 mould 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

Balkrishna is one of the leading tyre companies, having a well-diversified product portfolio, spread across niche segments, including agriculture, industrial, construction, earthmoving, mining, port, lawn and garden, and ATV tyres. The company has superior margin and return ratio profiles to its domestic counterpart due to its product positioning and strong hold in overseas market. The company has built a resilient business model and is expected to emerge as a stronger global player. The company aims to achieve 10% market share globally in the tyres market, with new product launches and expansion in new geographies. The company is self-reliant in carbon black along with multiple sourcing arrangements for other raw materials, which keeps its margins firm. The company has robust balance sheet strength and strong cash and cash equivalents at Rs. 1,475 crore as of FY2021-end. Management has recently increased its capex commitment for carbon black, which will lead to sale of excess carbon black to third party. We believe this will impact the company's margin and return ratio profile in the long run.

Key Risks

Balkrishna derives ~23% of its revenue from India, while it derives 49% from Europe, 15% from America, and 13% from ROW (FY2021). Any adverse movement in the macro-environment of these countries or forex fluctuation could impact the company's financial performance.

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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Rajiv A Poddar	27.7
2	Vkp Enterprises	25.0
3	Khushboo Rajiv Poddar	3.9
4	Rishabh Sureshkumar Poddar	1.4
5	Hdfc Trustee Co	4.2
6	Kotak Esg Opportunities Fund	2.4
7	Dsp Quant Fund	1.9
8	Government Pension Fund Global	1.6
9	Hdfc Life Insurance Company Limited	1.5
10	Mirae Asset Equity Savings Fund	1.4

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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