Sharekhan
by BNP PARIBAS

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Stock Update

Balkrishna Industries

Strong Q2; growth momentum to sustain

Automobiles	Sharekhan code: BALKRISIND	Result Update

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: **Buy**	↔
CMP: **Rs. 1,453**	
Price Target: **Rs. 1,800**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

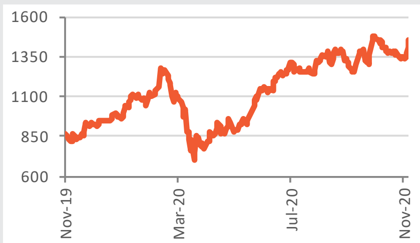
Company details

Market cap:	Rs. 28,079 cr
52-week high/low:	Rs. 1,515 / 678
NSE volume: (No of shares)	8.01 lakh
BSE code:	502355
NSE code:	BALKRISIND
Free float: (No of shares)	8.06 cr

Shareholding (%)

Promoters	58.3
FII	13.0
DII	22.3
Others	6.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.3	7.6	62.4	67.7
Relative to Sensex	-4.8	0.9	29.2	64.7

Sharekhan Research, Bloomberg

Summary

- We retain Buy rating on the stock of Balkrishna Industries Ltd (BKT) with revised PT of Rs 1,800.
- Q2 results were ahead of estimates across parameters; BKT posted best ever quarterly volumes; OPM rose 540 bps yoy to 32.8%
- BKT is witnessing strong demand traction particularly agri segment and has raised FY21 volumes guidance to marginal growth from flat expected earlier; market share gains to continue
- Margin to sustain at higher levels driven by operating leverage, better product mix and favourable Euro/INR realisation; expect margins to be at higher end of historical average of 28-30%.

Q2FY21 results beat ours as well as the street's expectations across parameters. BKT posted highest ever quarterly volumes of 61,224 MT (growth of 36% y-o-y). Volumes beat our estimates of 55,106 MT. Strong agricultural demand across geographies and market share gains led to robust volume growth. Operating margins improved 540 bps y-o-y to 32.8% (ahead of our estimates of 31.9%) driven by soft commodity prices, operating leverage due to strong topline growth and better mix. Net profit at Rs. 339 crore was ahead of our estimates of Rs. 272 crore. Given the strong Q2 volume performance, BKT raised its FY21 volume guidance to marginal growth as compared to flat volumes expected earlier. BKT is expected to continue gaining market share driven by new product introductions and entry in new geographies. We expect strong double-digit growth to resume from FY22 driven by pick-up in economic growth and continued market share gains. Higher margins are expected to sustain driven by operating leverage, better mix and favourable Euro-INR movement.

Key positives

- Q2 volumes were highest ever for BKT at 61,244 MT, beating ours as well as the street's estimates.
- Operating margins improved by 540 bps y-o-y to 32.8%, exceeding our estimates. Soft commodity prices, operating leverage and a better product mix led to margin improvement.
- Given strong volume growth in Q2, BKT has raised its FY21 volumes guidance to marginal growth as compared to flat volumes earlier.

Key negatives

- BKT stated that rising COVID-19 cases have led to lockdown in key countries of Europe. As of now, economic activities continue as dealerships are allowed to remain open, but if the cases surge and stricter restrictions are imposed than it could have impact on demand.

Our Call

Valuation – Raise estimates; retain Buy rating with revised PT of Rs. 1,800: Q2FY21 results beat estimates with highest ever quarterly volumes posted by the company. BKT is witnessing strong demand traction and has raised its FY21 volume guidance to marginal growth from flat levels expected earlier. Margins are expected to sustain at higher levels driven by a better product mix, operating leverage and favourable Euro-INR movement. We have raised our earnings estimates by 4-6% driven by better-than-expected Q2 results and increase in volume guidance. BKT is among the few tyremakers which are net debt-free and have among the highest profitability (margins in excess of 25%) and return ratios (18-22%). At CMP, the stock is trading at 17.5x its FY2023 earnings, but we believe premium valuations are sustainable in view of industry's best financial metrics and strong growth prospects. We recommend Buy with revised price target (PT) of Rs. 1,800.

Key Risks

Prolonged COVID-19 infections can impact volumes. Adverse currency movement especially INR-Euro can impact financials.

Valuations Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net sales (Rs crore)	5,335.5	4,897.5	5,610.2	6,476.8	7,428.7
Growth (%)	13.9	-8.2	14.6	15.4	14.7
EBITDA (Rs crore)	1,402.1	1,364.4	1,769.3	2,091.6	2,396.1
OPM (%)	26.3	27.9	31.5	32.3	32.3
PAT (Rs crore)	782.0	945.0	1,098.7	1,351.8	1,603.2
Growth (%)	5.8	20.8	16.3	23.0	18.6
FD EPS (Rs)	40.5	48.9	56.8	69.9	82.9
P/E (x)	35.9	29.7	25.6	20.8	17.5
P/B (x)	6.0	5.6	4.8	4.1	3.5
EV/EBITDA (x)	20.6	21.2	16.3	13.5	11.5
RoE (%)	16.7	18.8	18.7	19.6	19.7
RoCE (%)	20.3	18.4	21.4	22.8	23.4

Source: Company; Sharekhan estimates

Results beat estimates: Q2FY21 results were ahead of estimates across parameters. Topline grew strongly 40% y-o-y (compared to our estimates of 26% growth). BKT posted its highest-ever quarterly volumes of 61,224 MT which is growth of 36% y-o-y. Strong demand traction in the agricultural segment and market share gains led to robust volume growth. Realisation/tonne grew 3% y-o-y driven by better product mix and favourable Euro-INR realization. Operating margins improved sharply 540 bps y-o-y to 32.8% (better than our estimates of 31.9%). Gross profit margins improved 260 bps y-o-y to 60.6% driven by soft commodity prices and captive usage of carbon black. Also, operating leverage on back of strong growth in the topline led to margin improvement. EBIDTA at Rs 510 crore was ahead of estimates of Rs. 444 crore. BKT had tax credit in Q2FY20. Net profit grew 17% y-o-y to Rs 339 crore which was ahead of our estimates of Rs. 272 crore.

Demand traction strong; BKT raises FY21 volumes guidance: BKT stated that demand traction has been strong. Agricultural tyre demand has been robust across the geographies. BKT stated that OTR (construction, mining) tyre demand is stable. Volumes recovered strongly growing by 36% y-o-y in Q2 as compared to 26% y-o-y drop in Q1. As a result, BKT reported 3% y-o-y growth in H1FY21. Given the strong volumes growth in Q2, BKT has raised its FY21 volumes guidance to marginal growth (compared to flat volume guidance for FY21). We expect double-digit growth to resume from FY22 driven by pick-up in economic activities and market share gains driven by new launches and network expansion.

Margins to remain at higher end of historical range: BKT product mix is expected to improve given the increasing share of OTR tyres used in mining and construction. BKT has introduced 57-inch mining tyres and put up a dedicated capacity of 5,000 MT. Margins in OTR segment are marginally higher than agricultural segment. Moreover, BKT is expected to resume double-digit growth from FY22 driven by pick-up in economic activities and market share gains. Robust volume growth would provide benefits of operating leverage. Also, Euro/INR movement has been favourable with BKT expected to realise Rs. 85/Euro in H2FY21 as compared to Rs. 82.4/Euro in Q2FY21. In FY22, BKT expects to realise more than Rs. 85/euro, which would enable it to sustain margins. BKT margins are expected to remain at the higher end of the historical range of 28-30%.

Conference call highlights

- **Demand outlook:** BKT stated that demand continues to remain strong. Agricultural demand is strong across geographies while OTR segment demand is stable. Given a strong Q2FY21, BKT has raised FY21 volume outlook to marginal growth as compared to guidance of flat volumes earlier. BKT stated that marginal volumes growth guidance is conservative given the increasing restrictions in Europe on account of increase in COVID-19 cases.

- **Capacity expansion:** BKT is considering capacity expansion given the strong demand traction. BKT stated that it would consider brownfield expansion, modernisation/balancing equipment to augment capacity. The industry trend of shift towards high inch tyres would reduce the current achievable capacity from 3.05 lakh to 2.8 lakh units, which can be restored with balancing equipment and changes in machinery set up with some capex. The management is working on the details and would come out with a plan in the coming months. Current capacity would suffice growth for both FY22 and FY23.

- **Commodity prices:** BKT stated that natural rubber prices have risen and impact of the same would be felt in Q3FY21.

- **Forex realisations:** BKT realized Rs. 82.4/Euro in Q2FY21. BKT expects to realise Rs. 85/Euro in H2FY21. At the current Euro/INR rates, BKT expects to realise more than Rs. 85/Euro in FY22.

- **New product introductions to continue:** BKT stated it has been developing 100 new SKU (stock keeping units) every year and would continue to introduce new products in order to gain market share.

- **Carbon black capacity:** BKT stated that currently 80% of the production of the carbon black is used for captive consumption. BKT sold about 20% of production outside.

- **Margin guidance:** BKT stated that long term operating margin guidance remains at 28-30%.

- **Inventory levels:** BKT stated that inventory with dealers is still lower than normal. Given the strong demand traction, dealer inventories are running low. While inventories are higher as compared to Q1FY21 levels, they are still below normal.

- **Price hikes:** BKT stated that company is still considering decision to raise prices in wake of rising rubber costs. It has not yet taken any pricing action.
- **Focus on OTR segment:** BKT stated it is focusing on OTR (construction, mining segment) and aims to increase the proportion of OTR tyres in its portfolio. Currently OTR tyres contribute about 33% of overall volumes.
- **Expansion in new markets:** BKT stated it is working on further strengthening its distribution network in new markets of Asia, Australia, African and South America which would enable it to grow its overall market share.
- **Net Debt-free status:** BKT stated it continues to remain debt free at the Net level. Current debt stands at Rs. 816 crore while cash & cash equivalents stand at Rs. 1,299 crore.
- **Interim dividend:** The board declared second interim dividend of Rs. 4/share in Q2FY21. In Q1FY21 dividend announced was at Rs. 3/share.

Results Rs cr

Particulars	Q2FY21	Q2FY20	YoY%	Q1FY21	QoQ%
Revenues	1,551.8	1,107.2	40.2	941.7	64.8
EBITDA	509.7	303.5	68.0	243.6	109.2
EBITDA margins (%)	32.8	27.4	540 bps	25.9	690 bps
Depreciation	101.2	90.8	11.5	99.6	1.6
Interest	3.4	1.7	94.8	2.4	40.1
Other income	45.4	44.7	1.4	20.3	123.7
PBT	450.5	255.7	76.2	161.9	178.3
Tax	111.0	(35.3)	-414.4	40.1	177.2
PAT	339.5	291.0	16.7	121.8	178.7
EPS	17.6	15.1	16.7	6.3	178.7

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View - Steady growth industry with high entry barriers

Global OTH is a steady growth industry with historical average growth rates of 3-5%. Considering about twothirds of the demand coming from the replacement segment, the industry has steady growth with relatively less volatility. Moreover, the industry has high entry barriers and is characterised as 'large varieties low volume' segment as players need to maintain a large number of stock keeping units (SKU) due to diverse end-user requirements. The industry is also capex intensive, which acts as another entry barrier.

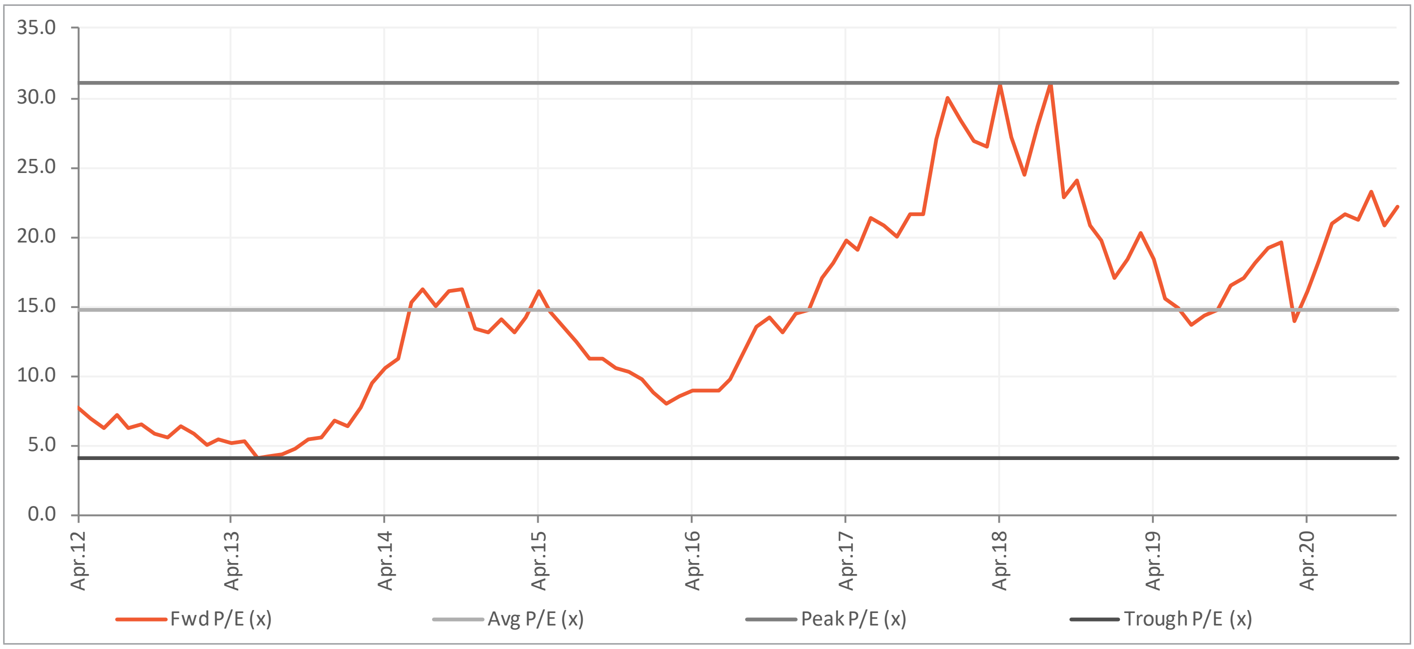
■ Company outlook - Robust scalable model; BKT to continue outpacing the industry

BKT, with relatively low employee cost advantage, has a better cost structure compared to other players. BKT is able to price its products lower, enabling to gain market share. Moreover, with robust R&D and continuous new product developments, BKT would introduce products for newer applications. BKT has outpaced the OTH industry in the past decade and would continue to outgrow the industry. BKT is aiming to double its global market share to 10% over the next few years.

■ Valuation - Premium valuations to sustain; Retain Buy with revised PT of Rs. 1,800

Q2FY21 results beat estimates with highest ever quarterly volumes posted by the company. BKT is witnessing strong demand traction and has raised its FY21 volume guidance to marginal growth from flat levels expected earlier. Margins are expected to sustain at higher levels driven by a better product mix, operating leverage and favourable Euro-INR movement. We have raised our earnings estimates by 4-6% driven by better-than-expected Q2 results and increase in volume guidance. BKT is among the few tyremakers which are net debt-free and have among the highest profitability (margins in excess of 25%) and return ratios (18-22%). At CMP, the stock is trading at 17.5x its FY2023 earnings, but we believe premium valuations are sustainable in view of industry's best financial metrics and strong growth prospects. We recommend Buy with revised price target (PT) of Rs. 1,800.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

BKT is one of the leading manufacturers of OHT. BKT makes tyres that are used in various applications, including agricultural, construction, and industrial vehicles as well as earthmoving, port, and mining, ATV, and gardening. BKT is a global player present in Europe, US, and India. While the European markets account for ~49% of sales, US and India account for 16% and 19% of the sales, respectively. The company has a wellspread 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 mold plant in Dombivli (near Mumbai). The current achievable production capacity across all plants stands at 300,000 MTPA, comprising a widespread product portfolio of 2,700 SKUs.

Investment theme

BKT is a leading manufacturer of specialty and OHT with a global presence. Q2FY21 results beat ours as well as the street's expectations across parameters. BKT posted highest ever quarterly volumes of 61,224 MT (growth of 36% y-o-y). Volumes beat our estimates of 55,106 MT. Strong agricultural demand across geographies and market share gains led to robust volume growth. Given, the strong Q2 volume performance, BKT raised its FY21 volume guidance to marginal growth as compared to flat volumes expected earlier. We expect strong double-digit growth to resume from FY22 driven by pick-up in economic growth. Also, BKT is expected to continue gaining market share driven by new product introductions and entry in new geographies. BKT is working towards introducing new products across verticals such as agriculture and mining. Management expects to continue outpacing the global OTH industry and aims to double the market share to 10% over the next few years, which provides ample growth visibility. Margins are expected to be at higher end of 28-30% range driven by operating leverage, better mix and favourable currency movement.

Key Risks

Prolonged COVID-19 infection can impact volume growth. BKT derives about 85% of its revenue from export geographies and, hence, is exposed to currency risk, primarily that of INR-Euro. Any adverse currency movement would impact the company's financials.

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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