Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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 20.57
Updated Jul 08, 2022

Medium Risk

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

Source: Morningstar

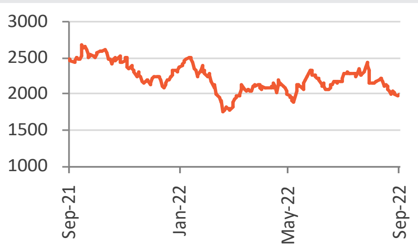
Company details

Market cap:	Rs. 38,818 cr
52-week high/low:	Rs. 2,724 / 1,682
NSE volume: (No of shares)	3.3 lakh
BSE code:	502355
NSE code:	BALKRISIND
Free float: (No of shares)	8.1 cr

Shareholding (%)

Promoters	58.3
FII	14.3
DII	11.2
Others	16.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-17.7	-11.5	14.1	-12.5
Relative to Sensex	-19.5	-17.6	5.5	-15.4

Sharekhan Research, Bloomberg

Balkrishna Industries Ltd

Growth prospects face adverse weather

Automobiles	Sharekhan code: BALKRISIND
Reco/View: Hold ↓	CMP: Rs. 2,008 | Price Target: Rs. 2,163 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We downgrade our ratings on Balkrishna Industries Ltd (Balkrishna) to Hold, with a 12-month PT of Rs.2,163. Stock trades at P/E multiple of 23.2x and EV/EBITDA multiple of 16.8x its FY2024E estimates.
- We have reduced Balkrishna's FY23E and FY24E earnings by 15.9% and 18.8% on account of rising concerns over Europe's crop yield and production, led by the severe heat wave and drought in various parts of Europe.
- EBITDA margins expected to remain under pressure, driven by unfavorable product mix and increase in other operating costs.
- Well geographically diversified portfolio, timely execution of capex plans, market share gains and entry into new markets continue to drive double digit revenue growth going forward, despite headwinds in European business.

The rising concerns over Europe's climatic conditions, led by the severe heat wave and drought, is expected to impact Balkrishna Industries Ltd.'s (Balkrishna's) Europe business, which constitutes over 55% of its overall revenue. The severe drought is affecting many parts in Europe, with the combined drought indicator (CDI), indicating 47% of Europe in warning conditions and 17% in alert conditions during the first ten days in August 2022. The extreme weather conditions will be directly impacting the yield and production of Europe's main crops, viz. grain maize, soybeans and sunflowers, by 12-16% of the last 5 years' average. Margins are expected to remain under pressure, led by unfavorable product mix and other operating costs (freight costs). The company is expected to mitigate partly, driven from its well geographically diversified portfolio and expected timely execution of capacity addition plans. Having built in the impact of Europe concerns, we reduce FY23E and FY24E earnings estimates by 15.9% and 18.8% respectively. Thus, we downgrade our rating to Hold with a reduced-price target of 2,163.

- **Concerns rises over Europe's severe drought:** The rising concerns over Europe's climatic conditions, led by the severe heat wave and drought, is expected to impact Europe's agriculture. Given Balkrishna's revenue exposure of ~55% to Europe region and volume exposure of ~66% to the farm segment, we expect downside risks to its revenue. However, we expect the company to mitigate partly the loss of revenue, driven by its well geographically diversified portfolio and expected timely execution of capacity addition plans.
- **Margins to remain under pressure in the medium term:** The company's EBITDA margins are expected to remain under pressure, led by an unfavourable product mix and other operating costs (freight costs). Also, the company makes its high margins from the farm segment, which has downside risks. We expect EBITDA margins to decline 200 bps to 21.9% in FY23E from 23.9% in FY22.
- **Capacity expansion on track:** The Capex programs remain on track with tyre capacity to increase up to 3.6 lakh MT by end-FY23. The commissioning of 55,000 MT of carbon black, along with the power plant is expected in Q3FY23, while the advanced carbon material for 30,000 MT is expected to commission by Q4FY23.

Our Call

Valuation – Downgrade to Hold rating with revised PT Rs. 2,163: Balkrishna has well-diversified revenue streams in term of geography, segments and channels. The company is undergoing a capex program of Rs. 1,800 crore towards ramping up production over the next 2-3 years, investing in capacity expansion, backward integration, automation and modernization of its plants. The Capex programs remain on track with tyre capacity to increase up to 3.6 lakh MT by end-FY23. Commissioning of 55,000 MT carbon black, along with power plant is expected in Q3FY23, while the advanced carbon material for 30,000 MT is expected to commission by Q4FY23. The management has earlier given FY23E volume guidance of 320,000-330,000MT, implying 11-14% y-o-y growth in FY23E. We expect it difficult for the company to achieve the volume guidance, given the rise in business risks for Europe region. Given Balkrishna's revenue exposure of ~55% to Europe region and volume exposure of ~66% to farm segment, we expect downside risks to its revenue. Having built in the impact of Europe concerns, we reduce FY23E and FY24E earnings estimates by 15.9% and 18.8% respectively. The stock is available at comfortable valuations of P/E of 23.2x and EV/EBITDA of 16.8x on its FY24E. We downgrade our rating to Hold with a reduced-price target of 2,163.

Key Risks

Balkrishna derives ~21% of its revenue from India, while it derives ~55% from Europe, ~20% from America, and the balance from the rest of the world. Any adverse movement in the macro environment of these countries or forex fluctuation could impact the company's financial performance.

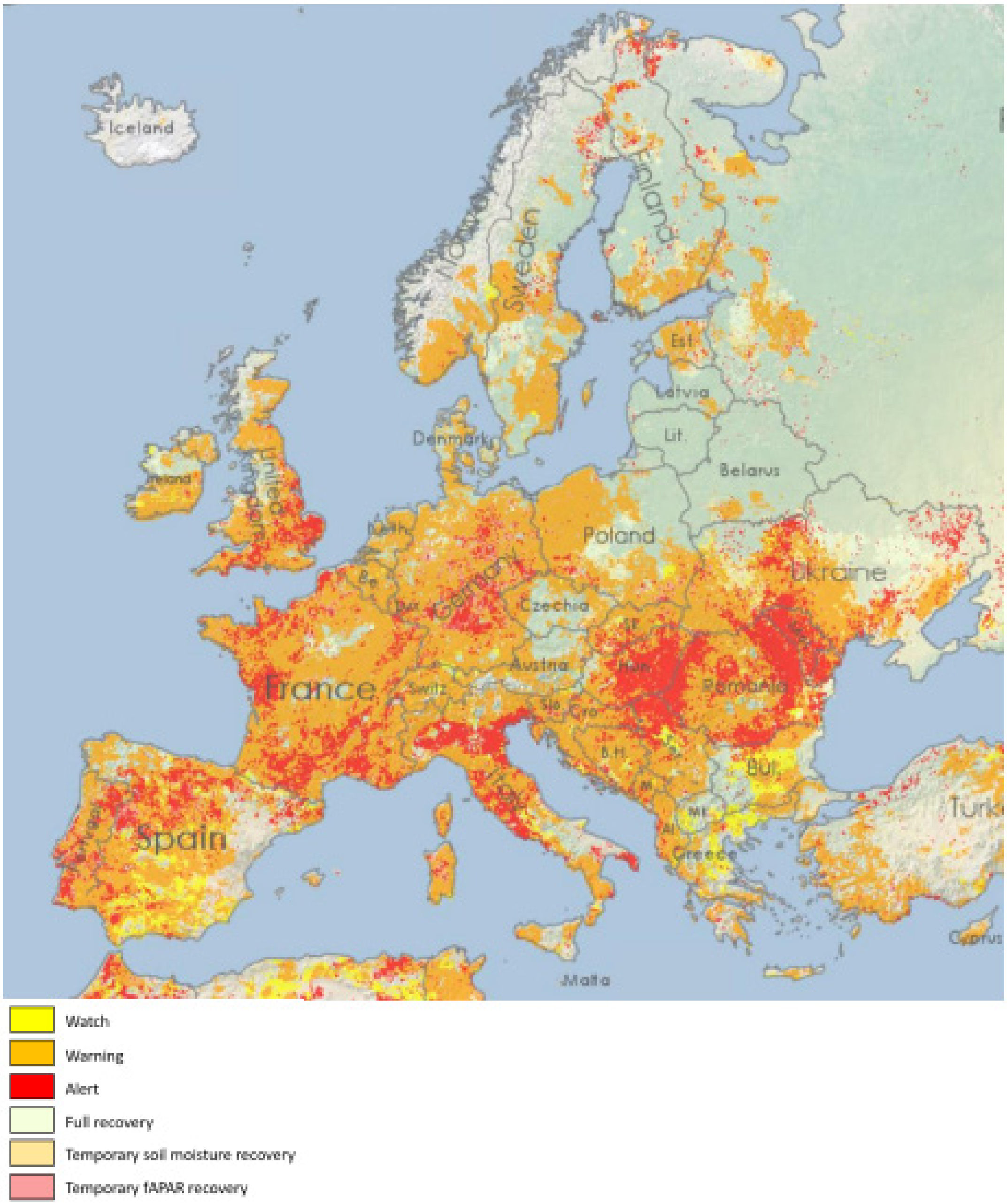
Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenues	5,758	8,267	9,481	10,745
Growth (%)	17.6	43.6	14.7	13.3
EBIDTA	1,786	1,976	2,081	2,407
OPM (%)	31.0	23.9	21.9	22.4
Net Profit	1,155	1,411	1,382	1,672
Growth (%)	22.3	22.1	(2.1)	21.0
EPS	59.8	73.0	71.5	86.5
P/E	33.6	27.5	28.1	23.2
P/BV	6.6	5.8	5.0	4.3
EV/EBIDTA	22.1	20.5	19.5	16.8
ROE (%)	19.5	21.1	17.9	18.5
ROCE (%)	22.1	25.3	21.2	22.3

Source: Company; Sharekhan estimates

Concerns rises over Europe's severe drought: The rising concerns over Europe's climatic conditions, led by severe heat wave and drought, is expected to impact Balkrishna Industries Ltd.'s (Balkrishna's) Europe business, which constitutes over 55% of its overall revenue. The severe drought is affecting many partsof Europe, with the combined drought indicator (CDI), indicating 47% of Europe in warning conditions and 17% in alert conditions during the first ten days in August 2022. As per the GDO report of the Europe region, the severe drought affecting many regions of Europe since the beginning of the year has been further expanding and worsening as of early August. Dry conditions are related to a wide and persistent lack of precipitation combined with a sequence of heat waves from May onwards. This has led to a severe impact on summer crops' yields. The impact on crops is severe this year as drought and heat waves have coincided with the sowing season and water reservoir levels in many places are also too low. The extreme weather conditions will be directly impacting the yield and production of Europe's main crops, viz. grain maize, soybeans, and sunflowers, by 12-16% of the last 5 years average.

Rise in warning and alert condition in many parts in Europe region



Source: Global Drought Observatory (GDO); Sharekhan Research

Rivers across all the other countries experiencing low flows in some sections

Source: Global Drought Observatory (GDO); Sharekhan Research

Margins to remain under pressure in the medium term: The company's EBITDA margins are expected to remain under pressure, led by an unfavourable product mix and other operating costs (freight costs). Also, the company makes its high margins from the farm segment, which has downside risks. We expect EBITDA margins to decline 200 bps to 21.9% in FY23E from 23.9% in FY22.

Cut estimates to build in the impact of Europe's rising concern over climate conditions: The company has given earlier the FY23E volume guidance at 3,20,000 – 3,30,000 MT, reflecting 10.8-14.3% volume growth. We expect it difficult for the company to achieve the volume guidance, given the rise in business risks for Europe region. Given Balkrishna's revenue exposure of ~55% to the Europe region and volume exposure of ~66% to the farm segment, we expect downside risks to its revenue. Having built in the impact of Europe concerns, we reduce FY23E and FY24E earnings estimates by 15.9% and 18.8% respectively. Also, US is facing inflationary trends which may put pressure on revenue. The management expects some relief in raw material prices from Q4FY23, and further expects its logistics costs to soften from the end of Q3FY23 or early Q4FY23. The OHT industry continues to see higher offtake on account of healthy demand across mining and agriculture markets, as BKT brand is continuing to gain market share. But we expect rising risks to the business, given the unfavourable changes in Europe's climatic conditions.

Change in estimates Rs cr

Particulars	Revised		Earlier		% Change	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	9,481	10,745	10,130	11,504	(6.4)	(6.6)
EBITDA	2,081	2,407	2,430	2,924	(14.4)	(17.7)
EBITDA margin (%)	21.9	22.4	24.0	25.4	(160 bps)	(260 bps)
PAT	1,382	1,672	1,643	2,059	(15.9)	(18.8)
EPS (Rs)	71.5	86.5	85.0	106.5	(15.9)	(18.8)

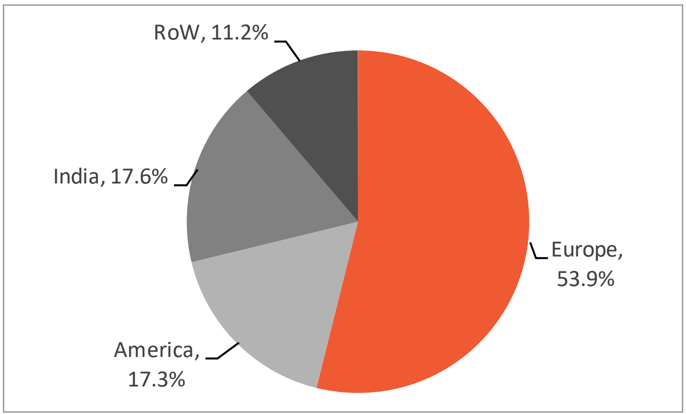
Source: Company Data; Sharekhan Research

Capex plans: The company is undergoing a capex program of Rs. 1,800 crore towards ramping up production over the next 2-3 years, investing in capacity expansion, backward integration, automation, and modernisation of its plants. The capex programs remain on track with tyre capacity to increase up to 3.6 lakh MT by end-FY23. Commissioning of 55,000 MT carbon black, along with power plant is expected in Q3FY23, while the advanced carbon material for 30,000 MT is expected to commissioned by Q4FY23. In FY23, the company would invest ~Rs. 900 crore towards total capex, as per the announced capex.

Key focus areas: The management continues to focus on market reach through existing sales channels, increased share of business in US markets by rising supplies from India, expansion in the product portfolio by adding large-size tyres, strengthening distribution channels within Indian markets and reaching a 100% capacity utilisation at its Bhuj plant. We remain positive for Indian and US regions, where the outlook for tyres markets remain positive. The concerns in Europe markets related to climate conditions remain strong and need to be monitored.

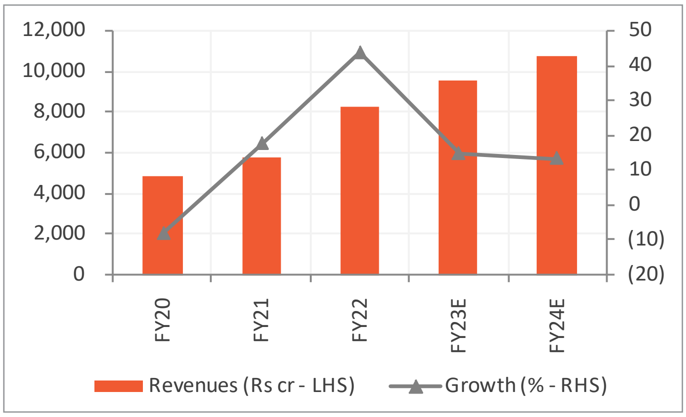
Financials in charts

Geographical Mix (%)



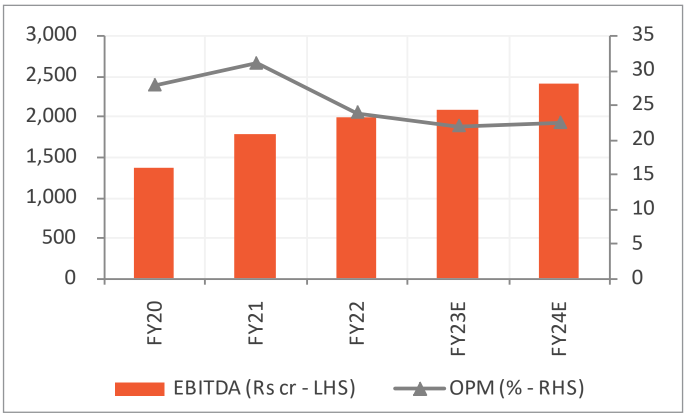
Source: Company, Sharekhan Research

Revenue and Growth Trend



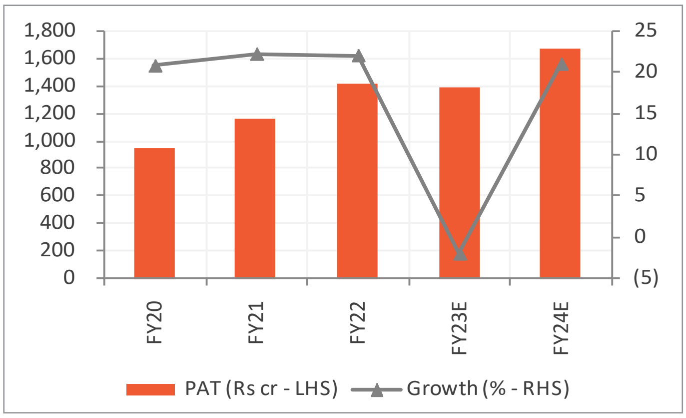
Source: Company, Sharekhan Research

EBITDA and OPM Trends



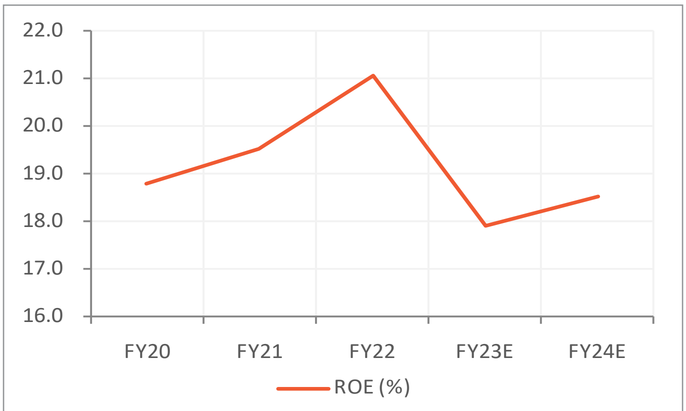
Source: Company, Sharekhan Research

PAT and Growth Trends



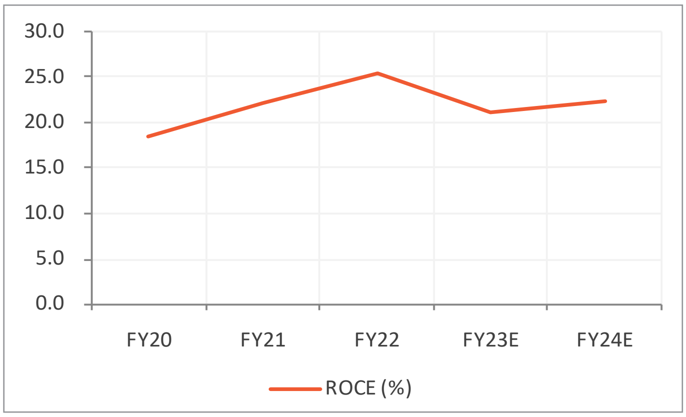
Source: Company, Sharekhan Research

ROE Trend



Source: Company, Sharekhan Research

ROCE (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector view - Indian and US markets are positive, while concerns rise in the European region**

We expect the domestic tyre industry to naturally benefit from the sharp recovery in automobile sales post normalization of the economy in India. The automobile sector has witnessed broad-based recovery across segments, 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 the Americas is also recovering significantly, with sales and volumes nearing pre-COVID levels. However, we remain concerned about the agriculture demand in Europe region due to severe drought and heat waves.

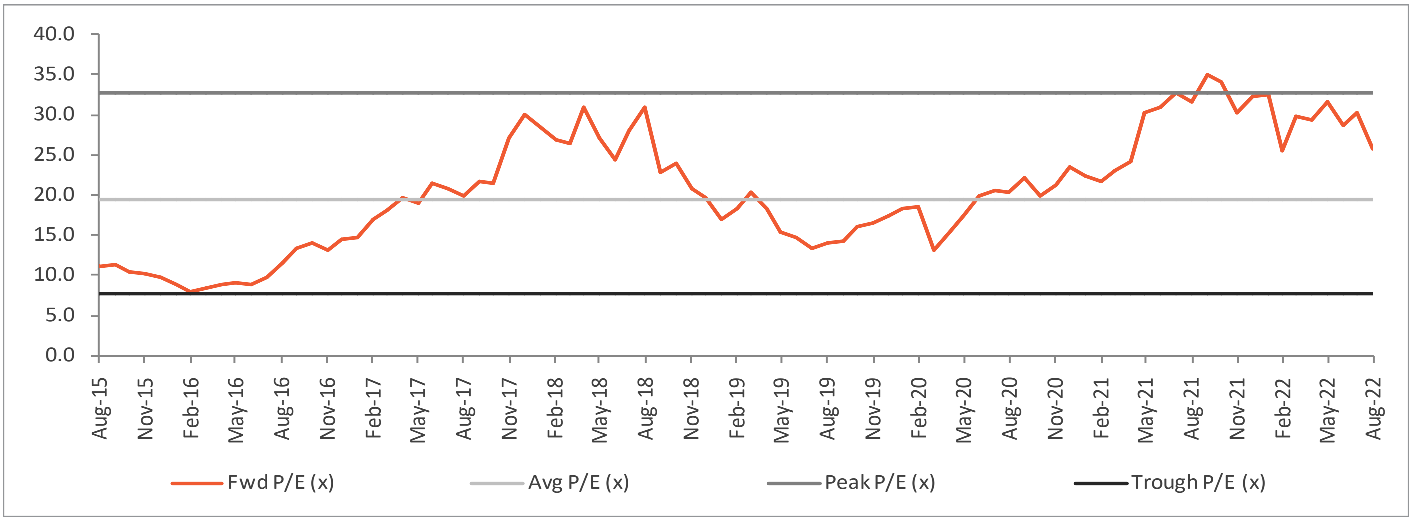
■ **Company outlook - Management is confident, while we remain cautious**

The company's management has given volume growth guidance of 10.8-14% in FY23E on strong demand, while margins are expected to improve led by product mix and operating leverage benefits. Further, the management expects margins to sustain 28-30% going forward. The company continues to maintain its target to achieve a 10% global market share in tyres in the medium term from ~6% currently. We expect it difficult for the company to achieve the volume guidance, given the rise in business risks for the Europe region. Given Balkrishna's revenue exposure of ~55% to the Europe region and volume exposure of ~66% to the farm segment, we expect downside risks to its revenue. Having built in the impact of Europe concerns, we reduce FY23E and FY24E earnings estimates by 15.9% and 18.8% respectively.

■ **Valuation - Downgrade to Hold rating with revised PT Rs. 2,163**

Balkrishna has well-diversified revenue streams in terms of geography, segments and channels. The company is undergoing a Capex program of Rs. 1,800 crores towards ramping up production over the next 2-3 years, investing in capacity expansion, backward integration, automation and modernization of its plants. The Capex programs remain on track with tyre capacity to increase up to 3.6 lakh MT by end-FY23. Commissioning of 55,000 MT of carbon black, along with the power plant is expected in Q3FY23, while the advanced carbon material for 30,000 MT is expected to commission by Q4FY23. The management has earlier given FY23E volume guidance of 320,000-330,000MT, implying 11-14% y-o-y growth in FY23E. We expect it difficult for the company to achieve the volume guidance, given the rise in business risks for the Europe region. Given Balkrishna's revenue exposure of ~55% to the Europe region and volume exposure of ~66% to the farm segment, we expect downside risks to its revenue. Having built in the impact of Europe concerns, we reduce FY23E and FY24E earnings estimates by 15.9% and 18.8% respectively. The stock is available at comfortable valuations of P/E of 23.2x and EV/EBITDA of 16.8x on its FY24E. We downgrade our rating to Hold with a reduced price target of 2,163.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	CMP (Rs/ Share)	P/E (x)			EV/EBITDA (x)			ROCE (%)		
		FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Balkrishna Industries	2,008	27.5	26.7	21.8	20.5	18.6	15.8	25.3	22.1	23.3
Apollo Tyres	275	27.1	14.8	10.9	7.8	6.2	5.3	5.4	7.7	9.6

Source: Company; Sharekhan Research

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 moulding plant in Dombivli (near Mumbai). The company is ramping up its capacity and expects tyre capacity to reach at 3.6 lakh MT by end-FY23.

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 stronghold 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 a 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 on the books. The rising concerns over Europe's climatic conditions, led by the severe heat wave and drought, is expected to impact the earnings in the medium term.

Key Risks

Balkrishna derives ~21% of its revenue from India, while it derives ~50% from Europe, ~20% from America, and the balance 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.

Additional Data

Key management personnel

Arvind Poddar	Chairman and Managing Director
Rajiv Poddar	Joint Managing Director
Vipul Shah	Wholetime Director andCompany Secretary
Madhu Sudan Bajaj	President (Commercials) and 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

Sharekhan

by BNP PARIBAS

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