Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Balkrishna Industries Ltd

Challenging times ahead; Maintain Hold

Automobiles	Sharekhan code: BALKRISIND

Reco/View: Hold ↔ | CMP: **Rs. 1,978** | Price Target: **Rs. 2,163** ↔

↑ 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 20.57

Updated Jul 08, 2022

Medium Risk

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

Source: Morningstar

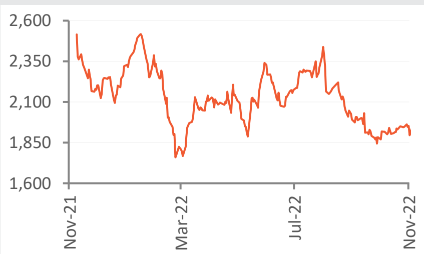
Company details

Market cap:	Rs. 38,238 cr
52-week high/low:	Rs. 2,537 / 1,682
NSE volume: (No of shares)	3.9 lakh
BSE code:	502355
NSE code:	BALKRISIND
Free float: (No of shares)	8.1 cr

Shareholding (%)

Promoters	58.3
FII	13.0
DII	18.9
Others	9.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.8	-9.9	0.4	-22.2
Relative to Sensex	-6.5	-14.3	-13.6	-24.9

Sharekhan Research, Bloomberg

Summary

- We maintain our Hold rating on Balkrishna Industries Limited (BKT), with a 12-month PT of Rs. 2,163 due to concerns over Europe's crop yield and production and expensive valuations. The stock trades at a P/E multiple of 22.9x and EV/EBITDA multiple of 16.6x its FY2024E estimates.
- Q2FY2023 results were above expectations, led by better-than-expected volume growth, partially offset by RM headwinds.
- EBITDA margin is expected to remain under pressure, driven by unfavourable product mix and increased 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.

Balkrishna Industries Limited's (BKT) Q2FY2023 results were above expectations, led by better-than-expected volume growth, partially offset by raw-material (RM) headwinds. Net revenue grew by 31.9% y-o-y (up 2.2% q-o-q) during Q2FY2023. EBITDA and PAT declined by 14.5% y-o-y (down 2.4% q-o-q) and 35% y-o-y, respectively. Management continues to remain positive on the demand side for its products and expects market share gains in India and North America, while it highlighted the geopolitical risks in European regions. The current achievable capacity will reduce to 3,35,000 MTPA and will increase back to 3,60,000 MTPA by H1FY24 post commissioning of the Waluj brownfield project. Management was unable to give guidance for FY2023E volume due to a challenging macro environment. Margins are expected to remain under pressure, led by unfavourable 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. We maintain our Hold rating on BKT, with a 12-month price target (PT) of Rs. 2,163 due to concerns over Europe's crop yield and production and expensive valuations. The stock trades at P/E multiple of 22.9x and EV/EBITDA multiple of 16.6x its FY2024E estimates.

Key positives

- Net revenue grew by 31.9% y-o-y (up 2.2% q-o-q) during Q2FY2023, led by 24.7% growth in India and 31.8% in America sales, partially offset by a 0.4% decline in Europe sales and 7.8% decline from RoW.
- Capex programmes remain on track with tyre capacity to increase up to 3.6 lakh MT by end-FY2023. The commissioning of a 55,000 MT carbon black capacity, along with power plant, is expected in Q3FY2023, while the advanced carbon material for 30,000 MT is expected to be commissioned by Q4FY2023.

Key negatives

- EBITDA margin contracted by 80bps q-o-q to 16.4% in Q2FY2023, led by elevated commodity prices and high logistics costs.

Management Commentary

- The current achievable capacity will stand reduced to 3,35,000 MTPA and will increase back to 3,60,000 MTPA by H1FY2024 post commissioning of the Waluj brownfield project.
- The company expects to see a sustained uptick in demand for BKT tires in India and North America, while the company has highlighted concerns about European region.
- Management was unable to give FY2023E volume guidance due to the challenging macro environment. Margins are expected to remain under pressure, led by unfavourable product mix and other operating costs (freight costs).

Our Call

Valuation – Maintain Hold rating with unchanged PT Rs. 2,163: BKT has well-diversified revenue streams in terms of geography, segments, and channels. The company is undergoing a capex programme 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. Capex programme remains on track with tyre capacity to increase up to 3.6 lakh MT by end-FY2023. Commissioning of 55,000 MT carbon black along with the power plant is expected in Q3FY2023, while the advanced carbon material for 30,000 MT is expected to commission by Q4FY2023. We expect it difficult for the company to achieve its earlier volume guidance, given the rise in business risks for European region. Given BKT's revenue exposure of ~55% to European region and volume exposure of ~66% to the farm segment, we expect downside risks to its revenue. We maintain our Hold rating on BKT, with a 12-month PT of Rs. 2,163 due to concerns over Europe's crop yield and production and expensive valuations. The stock trades at a P/E multiple of 22.9x and EV/EBITDA multiple of 16.6x its FY2024E estimates.

Key Risks

BKT 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	FY21	FY22	FY23E	FY24E
Revenues	5,758	5,758	8,267	10,130	11,504
Growth (%)	17.6	17.6	43.6	22.5	13.6
EBIDTA	1,786	1,786	1,976	2,430	2,924
OPM (%)	31.0	31.0	23.9	24.0	25.4
Net Profit	1,155	1,155	1,411	1,643	2,059
Growth (%)	22.3	22.3	22.1	16.5	25.3
EPS	59.8	59.8	73.0	85.0	106.5
P/E	36.2	36.2	29.7	25.5	20.3
P/BV	7.1	7.1	6.2	5.2	4.3
EV/EBIDTA	23.8	23.8	22.1	17.9	14.7
ROE (%)	19.5	19.5	21.1	20.6	21.3
ROCE (%)	22.1	22.1	25.3	24.4	25.8

Source: Company; Sharekhan estimates

Key takeaway of BKT's Q2FY2023 conference call

- **Q2FY2023 results:** BKT's Q2FY2023 results were above expectations, led by better-than-expected volume growth, partially offset by RM headwinds. Net revenue grew by 31.9% y-o-y (up 2.2% q-o-q) during Q2FY2023. EBITDA and PAT declined by 14.5% y-o-y (down 2.4% q-o-q) and 35% y-o-y, respectively. Volume declined by 5% q-o-q in 2QFY2023, led by a 5% q-o-q decline in the OTR segment and agricultural segment's volumes. The increase in ASPs on a q-o-q basis is driven by benefit of USD appreciation, favourable product mix (higher mix of large inch mining tyres), 2% positive impact from higher sales of carbon black to third parties, and benefit of price hikes.
- **Concerns rise over Europe's severe drought:** The rising concerns over Europe's climatic conditions, led by severe heat wave and drought, are expected to impact BKT's Europe business, which constitutes over 55% of its overall revenue.
- **Margins to remain under pressure in the medium term:** The company's EBITDA margin is expected to remain under pressure, led by an unfavourable product mix and other operating costs (freight costs). Moreover, the company makes its high margins from the farm segment, which has downside risks. We expect EBITDA margin to decline by 200 bps to 21.9% in FY2023E from 23.9% in FY2022.
- **Capex plans:** The company is undergoing a capex programme 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. Moreover, management was unable to give FY2023E volume guidance due to a challenging macro environment. Margins are expected to remain under pressure, led by unfavourable product mix and other operating costs (freight costs). Capex programmes remain on track with tyre capacity to increase up to 3.6 lakh MT by end-FY2023. Commissioning of 55,000 MT carbon black, along with the power plant, is expected in Q3FY2023, while the advanced carbon material for 30,000 MT is expected to be commissioned by Q4FY2023. In FY2023, the company would invest ~Rs. 900 crore towards total capex, as per the announced capex.
- **Key focus areas:** 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 outlook for the tyres markets remains positive. Concerns in European markets related to climate conditions remain strong and need to be monitored.

Results (Standalone) Rs cr

Particulars	Q2FY23	Q2FY22	YoY%	Q1FY23	QoQ%
Revenues	2,704.3	2,049.8	31.9	2,646.3	2.2
Total operating expenses	2,259.8	1,529.9	47.7	2,190.8	3.1
EBITDA	444.5	519.9	-14.5	455.5	-2.4
Depreciation	134.1	108.5	23.6	126.2	6.2
Interest	4.3	1.8	138.1	2.7	57.3
Other income	226.0	133.1	69.8	102.3	120.8
PBT	532.1	542.7	-1.9	428.8	24.1
Tax	128.3	165.5	-22.4	109.1	17.6
Reported PAT	8.4	12.8	-35.0	(8.5)	-198.8
Adjusted PAT	403.8	377.2	7.0	319.7	26.3
Adjusted EPS	20.9	19.5	7.0	16.5	26.3

Source: Company; Sharekhan Research

Key ratios (Standalone) Rs cr

Particulars	Q2FY23	Q2FY22	YoY (bps)	Q1FY23	QoQ (bps)
Gross margin (%)	49.4	54.7	-540	52.0	-270
EBIDTA margin (%)	16.4	25.4	-890	17.2	-80
EBIT margin (%)	11.5	20.1	-860	12.4	-100
Net profit margin (%)	14.9	18.4	-350	12.1	280
Effective tax rate (%)	24.1	30.5	-640	25.4	-130

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 normalisation 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 agriculture demand in European region due to severe drought and heat waves.

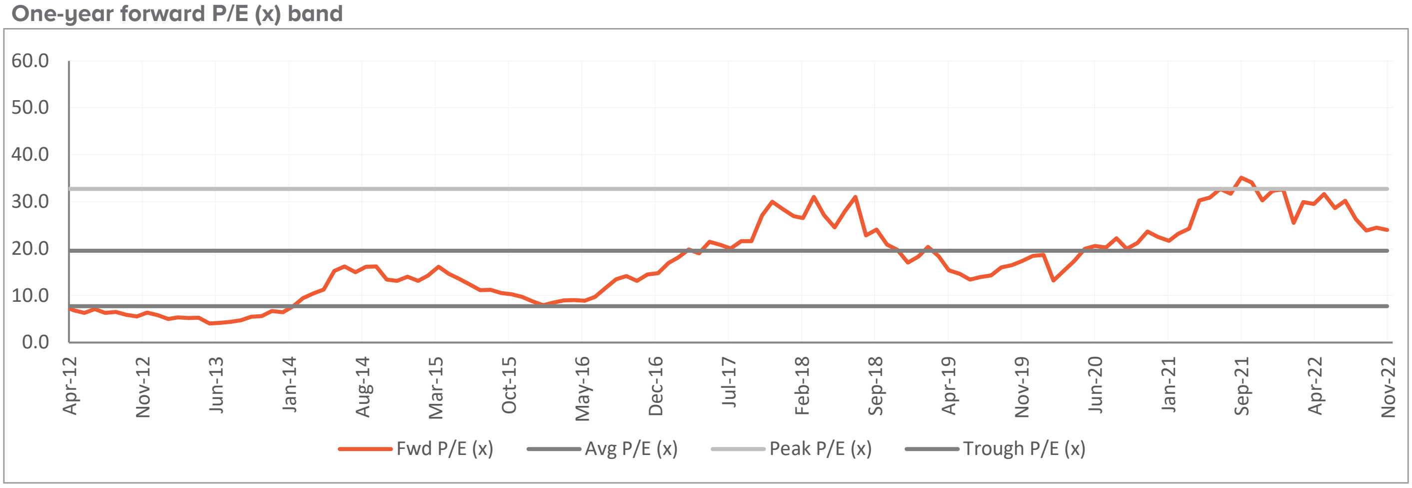
■ Company Outlook – Management is confident, while we remain cautious

The company's management has given volume growth guidance of 10.8-14% in FY2023E on strong demand, while margins are expected to improve, led by product mix and operating leverage benefits. Further, 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 European region. Given BKT's revenue exposure of ~55% to the European region and volume exposure of ~66% to the farm segment, we expect downside risks to its revenue. Having built in the impact of European concerns, we reduce our FY2023E and FY2024E earnings estimates by 15.9% and 18.8%, respectively.

■ Valuation – Maintain Hold rating with unchanged PT Rs. 2,163

BKT has well-diversified revenue streams in terms of geography, segments, and channels. The company is undergoing a capex programme 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. Capex programme remains on track with tyre capacity to increase up to 3.6 lakh MT by end-FY2023. Commissioning of 55,000 MT carbon black along with the power plant is expected in Q3FY2023, while the advanced carbon material for 30,000 MT is expected to commission by Q4FY2023. We expect it difficult for the company to achieve its earlier volume guidance, given the rise in business risks for European region. Given BKT's revenue exposure of ~55% to European region and volume exposure of ~66% to the farm segment, we expect downside risks to its revenue. We maintain our Hold rating on BKT, with a 12-month PT of Rs. 2,163 due to concerns over Europe's crop yield and production and expensive valuations. The stock trades at a P/E multiple of 22.9x and EV/EBITDA multiple of 16.6x its FY2024E estimates.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	Rs/Share	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Balkrishna Industries	1,978	27.1	27.7	22.9	20.2	19.2	16.6	25.3	21.2	22.3
Apollo Tyres	276	27.2	14.8	10.9	7.8	6.2	5.3	5.4	7.7	9.6

Source: Company, Sharekhan estimates

About company

BKT 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. BKT 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-FY2023.

Investment theme

BKT 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 into new geographies. The company is self-reliant in carbon black along with multiple sourcing arrangements for other raw materials, which keep its margins firm. The company has a robust balance sheet strength and strong cash on books. Rising concerns over Europe's climatic conditions, led by the severe heat wave and drought, are expected to impact earnings in the medium term.

Key Risks

BKT 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 & 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	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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by BNP PARIBAS

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