



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

Updated Dec 08, 2022

20.08

Medium Risk

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

Source: Morningstar

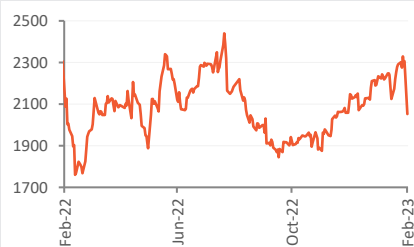
Company details

Market cap:	Rs. 38,238 cr
52-week high/low:	Rs. 2,451 / 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	12.5
DII	20.2
Others	9.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-7.3	4.6	-5.1	-10.5
Relative to Sensex	-8.0	6.9	-8.6	-13.8

Sharekhan Research, Bloomberg

Balkrishna Industries Ltd

Not out of woods yet, Maintain Hold

Automobiles

Sharekhan code: BALKRISIND

Reco/View: Hold



CMP: Rs. 2,053

Price Target: Rs. 2,163



Upgrade



Maintain



Downgrade

Summary

- Considering the near-term volatility in demand and challenging business situation in European market, we retain our Hold rating on the stock with target price of Rs 2,163. The stock trades at a P/E multiple of 22.9x and EV/EBITDA multiple of 16.0x its FY2025E estimates.
- Benefit of decline in freight cost was eaten away by high-cost raw material inventory in Q3FY23.
- Significant improvement would be led more by the volume uptick than a correction in input cost as the partial pass on of the cost benefit in a competitive market can't be ruled out.
- Given the end of large capex cycle and benign RM basket coupled with its brand equity the structural story is intact amidst near term clouds.

BJT reported Q3FY23 result way below estimates on account of destocking in the European market, high-cost inventory of raw materials and MTM loss. The benefit of a decline in freight cost was netted off by higher RM cost and hence EBITDA margin contracted on q-o-q basis. Revenue was 3.4% below estimates and EBITDA margin was 500 bps below estimates. Revenue declined by 20.8% q-o-q to Rs 2142 cr on account of 15.7% q-o-q decline in volumes and 6.0% q-o-q decline in ASPs. The decline in volume is attributed to ongoing destocking in the European market and the decline in ASPs was due to passing on of benefit of correction in freight cost to the customers. Freight cost as percentage of sales stood at 9.1% in Q3FY23 compared to 14.2% in Q2FY23. Despite correction in freight cost, the EBITDA margin contracted by 440 bps q-o-q to 12.0% due to 250 bps q-o-q contraction in gross margin. With MTM forex loss of Rs 166 cr the PAT declined by 75.3% q-o-q to Rs 99.6 cr. Going forward the management has indicated that the slight benefit of correction in RM basket and decline in freight rate would be visible in its operating performance in Q4FY23 and full benefit would be visible from Q1FY24 onwards. Considering the near-term volatility in demand and challenging business situation in the European market, we retain our Hold rating on the stock with target price of Rs 2,163. The stock trades at a P/E multiple of 22.9x and EV/EBITDA multiple of 16.0x its FY2025E estimates.

Key positives

- Freight cost as a percentage of sales come down from 14.2% in Q2FY23 to 9.1% in Q3FY23.
- Despite headwinds in the export market, BJT has maintained its market share stable (at 5-6%) and continue to aspire for a 10% global market share in the medium term.
- Large part of the capex cycle has been completed and the remaining capex is on track

Key negatives

- Volumes and ASPs declined by 15.7% q-o-q and 6.0% q-o-q respectively
- Other income came down by 80.9% q-o-q on account of MTM loss of Rs 166 cr

Management Commentary

- The dealer inventory is still high and hence destocking would continue in Q4FY23. The dealer inventory is expected to normalize by Q1FY24.
- The correction in RM basket and decline in freight rate may aid on 300 bps EBITDA margin in FY24
- Despite macro headwinds, BJT has maintained its EBITDA margin and price differential with the competitive products.

Our Call

Valuation – Maintain Hold rating with unchanged PT Rs. 2,163: Post reporting disappointed performance in Q3FY23 the management has refrained from sharing any specific volume outlook for the near term a highlighted that destocking may continue in the European market in Q4FY23 though at lower pace and significant restocking would begin from Q1FY24. With the massive capex cycle is behind and BJT's market share in broadly stable in global market, we remain positive on BJT 's structural growth story. Despite the correction in the RM basket, we believe BJT's operating performance would remain under pressure and a significant revival would be visible on the return of operating leverage led by volume uptick as the company would have to partially pass on the soft input cost to the end customer to remain competitive in the market. Considering the near-term volatility in demand and challenging business situation in the European market, we retain our Hold rating on the stock with a target price of Rs 2,163. The stock trades at a P/E multiple of 22.9x and EV/EBITDA multiple of 16.0x its FY2025E estimates.

Key Risks

BJT 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	FY25E
Revenues	5,758	8,267	9,636	11,186	12,301
Growth (%)	17.6	43.6	16.6	16.1	10.0
EBITDA	1,786	1,976	1,663	2,234	2,585
OPM (%)	31.0	23.9	17.3	20.0	21.0
Net Profit	1,155.4	1,410.7	1,183.2	1,468.9	1,733.2
Growth (%)	22.3	22.1	-16.1	24.2	18.0
EPS (Rs.)	59.8	73.0	61.2	76.0	89.7
P/E	34.3	28.1	33.5	27.0	22.9
P/BV	6.7	5.9	5.3	4.6	4.0
EV/EBITDA	22.6	21.0	25.0	18.6	16.0
ROE (%)	19.5	21.1	15.7	17.0	17.3
ROCE (%)	22.1	25.3	18.7	20.6	21.2

Source: Company; Sharekhan estimates

Destocking would continue in Q4FY24: The volume performance in Q3FY23 is due to ongoing destocking in the European market. While the retail demand is steady but dealers are delaying the orders due to an improvement in shipment time and expectation of a reduction in prices due to correction in RM basket. The destocking would continue in Q4FY23 also but at lower rate. Currently, BKT is not observing any pricing pressure in the export markets. The dealer inventory situation is expected to be normalized by Q1FY24.

EBITDA margin to improve by 300 bps in FY24: Despite the correction in RM basket, BKT reported a contraction in gross margin due to high-cost inventory. The management assumes that the benefit of the soft raw material cost would start reflecting in its financials from Q4FY23 and full benefit would be visible in Q1FY24. Considering the soft RM basket and correction in freight cost the management foresees a 300-bps expansion in EBITDA margin in FY24.

No major capex is lined up yet: The larger part of the capex cycle has already been completed except the capex on carbon black plant. The company has incurred a capex of Rs 1300 crore in 9M FY23 and assumes a marginal capex in Q4FY24. The capex is expected to be in the range of Rs 350 cr to Rs 400 cr in FY24. The capex for advanced carbon material is on track.

Others highlights

- ♦ The demand environment is stable in India, steady in USA and volatile in European region. The demand in agri segment has impacted more than that of industrial segment.
- ♦ BKT's market share is largely stable and BKT's pricing is at 12-15% discount to competition.
- ♦ Net forex loss for Q3FY23 stood at Rs.880mn vs Rs.80mn gain in Q3FY22.
- ♦ Currently carbon black segment is contributing 5% to the topline.

Results (Standalone)

Particulars	Q3FY23	Q3FY22	YoY%	Q2FY23	QoQ%
Revenues	2,142	2,030	5.5	2,704	-20.8
Total operating expenses	1,885	1,587	18.8	2,260	-16.6
EBITDA	257	443	-42.0	445	-42.1
Depreciation	145	115	26.6	134	8.1
Interest	14	2	659.8	4	215.5
Other income	43	112	-61.4	226	-80.9
PBT	142	439	-67.7	532	-73.3
Tax	42	110	-61.7	128	-67.1
Reported PAT	100	328.6	-69.7	404	-75.3
Adjusted PAT	100	329	-69.7	404	-75.3
Adjusted EPS	5.2	17.0	-69.7	20.9	-75.3

Source: Company; Sharekhan Research

Key ratios (Standalone)

Particulars	Q3FY23	Q3FY22	YoY (bps)	Q2FY23	QoQ (bps)
Gross margin (%)	46.9	52.4	-550	49.4	-250
EBITDA margin (%)	12.0	21.8	-980	16.4	-440
Net profit margin (%)	4.7	16.2	-1,150	14.9	-1,030
Effective tax rate (%)	29.8	25.1	470	24.1	560

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Indian and US markets is 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 the ripple effect, 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 the European region due to severe drought and heat waves.

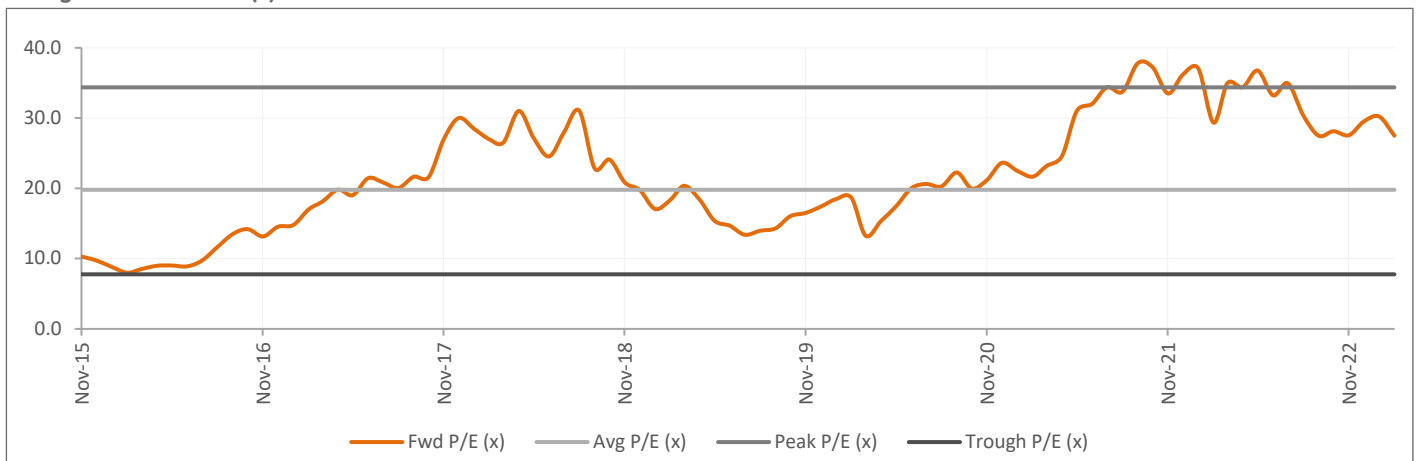
■ Company Outlook – Cautious outlook on demand, focus on profitability

BKT continue to be a dominant player in the global OHT segment supported by its strong distribution network, quality of product and relatively low-cost production, however, BKT is expected to face demand headwinds in near term owing to ongoing destocking in the European market. The company expects that correction in the RM basket and decline in freight cost would help it register better operating performance from Q1FY24 onwards. The US market is performing better than that of the European market. In Europe, agri segment has more impact than the industrial segment. The company has already withdrawn its volume guidance for FY23 and looking for a capacity of 360,000 MT by H1FY24.

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

Post reporting disappointing performance in Q3FY23 the management has refrained from sharing any specific volume outlook for near term a highlighted that destocking might continue in the European market in Q4FY23 though at lower pace, and significant restocking would begin from Q1FY24. With the massive capex cycle behind and BKT's market share in broadly stable in the global market, we remain positive on BKT 's structural growth story. Despite correction in RM basket, we believe BKT's operating performance would remain under pressure, and significant revival would be visible on return of operating leverage led by volume uptick as the company would have to partially pass on the soft input cost to the end customer to remain competitive in the market. Considering the near-term volatility in demand and challenging business situation in the European market, we retain our Hold rating on the stock with a target price of Rs 2,163. The stock trades at a P/E multiple of 22.9x and EV/EBITDA multiple of 16.0x its FY2025E 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	2,053	28.1	33.5	27.0	21.0	25.0	18.6	25.3	18.7	20.6
Apollo Tyres	331	32.6	21.5	13.9	9.1	7.2	6.1	5.4	7.5	9.3

Source: Company, Sharekhan estimates

About company

BKT is one of the leading manufacturers of over-the-highway tyres. The company makes tyres 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 the end of 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 the 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 the 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	LIC	3.9
5	HDFC AMC	2.7
6	Kotak Mahindra AMC	2.4
7	Mirae Asset Global Investments Co	2.0
8	Norges Bank	1.9
9	Government Pension Fund	1.6
10	Rishabh Sureshkumar Poddar	1.4

Source: Bloomberg

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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 deteriorating 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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