

Balkrishna Industries

Weak demand outlook to remain an overhang

BKT's Bhuj facility is its largest facility in India spread over 270 acres of land; it has a total capacity of 140k MT pa and its key highlights include 1) a captive power plant; 2) a captive carbon black plant with 200k MT pa capacity; 3) expandable capacity at the same location by around 150k MT p.a.; 4) close proximity to a port; and 5) housing colony set-up for attracting talent. On the demand front, the near-term outlook remains weak as distributors continue to liquidate stock in a bid to avoid overstocking in a weak macro. This is likely to continue for a couple of quarters and management is hopeful of a demand recovery by H2FY24. On the margin front, management expects about 200bps improvement YoY in the near term with major benefit likely in H2. While its long-term aspirations (10% global market share over 3-4 years from current 5-6% and 26-28% margin guidance) remain intact, lack of near-term demand visibility would continue to remain an overhang for the stock, especially given that the stock hasn't corrected much despite adverse macro. Also, despite factoring in most positives, the stock at 24x FY25E appears expensive. Reiterate **REDUCE** with an unchanged TP of INR 2,083.

- **Near-term headwinds remain:** Management has maintained that the near-term demand outlook for its key markets remains subdued as distributors continue to liquidate inventory levels. While the normal inventory is at 45-60 days, dealers still have 70 days of stock with them. Thus, inventory liquidation is likely to continue for a few more months, which would keep offtake from BKT under check. Management is hopeful that dispatches should improve by H2. Given that logistics and input costs have declined, management expects about 200bps margin improvement in the near term. We have currently factored in 6%/14% volume growth for FY24 / 25E and EBITDA margins to improve to 24%/26% for FY24/FY25 from 20% in FY23.
- **Long-term growth aspirations intact:** BKT continues to maintain its target to achieve a 10% global market share in the next 3-4 years, from the current level of 5-6%, and it is very confident of the same. Given that BKT's market share in the agri segment (especially in Europe) is much higher than the overall market share of 5-6%, management expects the OTR segment to be one of the key growth drivers for the company, going forward. While Europe is largely an agrarian market, some of the other regions where BKT is targeting to push its large OTR tyres include North America, Eastern Europe, Australia and Asia, including India. These regions have strong demand for mining tyres. Further, management continues to provide 26-28% margin guidance in the long term.
- **Valuation and view:** Despite factoring in most positives, the stock at 24x FY25E appears expensive. Maintain **REDUCE** with an unchanged TP of INR2,083 – valued at 22x FY25 EPS.

Financial Summary

YE Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Net Revenues	57,399	84,187	1,00,725	1,01,449	1,15,396
EBIDTA	18,095	21,825	20,286	24,348	30,003
EBITDA margins	31.5	25.9	20.1	24.0	26.0
Adj. PAT	11,554	14,107	10,786	14,233	18,302
EPS (Rs)	59.8	73.0	55.8	73.6	94.7
P/E (x)	38.2	31.3	40.9	31.0	24.1
EV / EBITDA (x)	24.0	20.4	22.3	18.2	14.6
RoCE (%)	21.7	20.4	13.5	16.9	19.9

Source: Company, HSIE Research

REDUCE

CMP (as on 10 Jul 2023)	INR 2,285
Target Price	INR 2,083
NIFTY	19,356

KEY STOCK DATA

Bloomberg code	BIL IN
No. of Shares (mn)	193
MCap (INR bn) / (\$ mn)	442/5,400
6m avg traded value (INR mn)	664
52 Week high / low	INR 2,525/1,796

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	14.8	4.3	(0.2)
Relative (%)	5.6	(4.4)	(20.1)

SHAREHOLDING PATTERN (%)

	Dec-22	Mar-23
Promoters	58.29	58.29
FIs & Local MFs	20.22	20.31
FPIs	12.12	12.42
Public & Others	9.04	8.98

Source : BSE

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We visited the Balkrishna Industries Bhuj plant over 7-8 July. Below are the KTAs of the same.

Bhuj plant background

- BKT announced a large-scale expansion in Bhuj in FY10 at a time when its total achievable production capacity was just about 144k MT p.a.
- Also, the largest plant at that time was Chopanki which had an area of about 20 acres.
- They had a market share at that time of just around 2-2.5%.
- With a long-term growth ambition in place, management set out to invest in a large-scale facility in Bhuj with an aim to move to a 10% market share in the long run.
- Just to highlight the scale of the plant, this plant has a total capacity of 140k MT pa and is spread over 270 acres of land bank and was set up at a project cost of Rs1800crs.
- Management has indicated that it can increase the capacity by another 150k MT p.a. at the same location by buying some additional land in the same area.

Fig1: Project Cost (status as of Q4FY12)

(in INR Bn)	Particulars	Cost	Remarks
Project Cost	Total Cost	18	Rs6.23bn; incurred till Mar12
Financed by	ECB Loan of USD275mn	13	USD175mn drawn in Q1FY12
	Internal Accruals	5	USD100mn tied up

Source: Company

Key advantages of Bhuj plant

- Given that bulk of BKT's products are exported, the proximity to Mundra port (60-65 km) was one of the key factors that led management to set up its facility in Bhuj.
- It had a plan to set up a 20 MW captive power plant in Bhuj. Both these factors have helped drive operational efficiencies at this plant.
- Other factors that were expected to help improve margins at Bhuj included: 1) the capability to produce large-sized mining tyres and 2) an improved radial mix. Today, no company in India has the capability to produce large diameter sizes of 49 and 57 inches, apart from BKT, as per management.

Some locational disadvantages at Bhuj

- Bhuj has witnessed earthquakes in the past. Hence, they have set up a facility which can resist up to 9 magnitude earthquakes without any damage. This facility can also survive wind speeds of up to 140-150 kmph
- This region is also prone to frequent power cuts. This was the reason management decided to set up a captive power plant
- Also, in order to attract talent to this location, management has set up a housing colony within the facility so that employees can shift with their families to this location

What was the need to set up a carbon black facility

- After natural rubber, carbon black is the next important ingredient in tyre manufacturing and forms almost 30% of the input material by weight.
- Also, India does not have a reliable source of carbon black available.

- For this reason, management decided to have a captive carbon black facility within Bhuj to have a reliable source of the right quality carbon black.
- As per management, its carbon black is now almost 10% better quality than the same available in India. Given this, apart from captive sourcing, they are also supplying carbon black to many of its global peers, which is a further reassurance of its quality.

Demand outlook

- Management indicated that the end market demand continues to remain challenging and the near-term outlook remains weak.
- They envisage some liquidity issues coming up.
- Distributors are on inventory liquidation mode currently. They currently have 70 days of inventory relative to the normal average of 45-60 days.
- This is likely to keep dispatches from BKT under check in the near term. Management is hopeful that dispatches should improve by H2 and they should be able to give some growth guidance by H2.

Long-term growth levers in place

- From a market share of 2-2.5% when they started Bhuj construction, BKT has now moved to a 5-6% market share globally.
- They continue to maintain their target to achieve a 10% global market share in the next 3-4 years and are very confident that they would be able to achieve the same. The long-term global industry growth assumption is likely to be stable at 3-5%.

Growth drivers for long term

- We understand that BKT's market share in the agri segment (especially in Europe) is much higher than the overall market share disclosed by the company of 5-6%. In fact, in France, BKT has a higher market share than even Michelin in the agri segment, despite it being Michelin's home market, which is commendable and is a testimony to its brand strength in key markets
- Thus, growing faster in the OTR segment is expected to be one of the key growth drivers for BKT, which would help it continue to outperform its end markets.
- While Europe is largely an agrarian market, some of the other regions where BKT is targeting to push its large OTR tyres include North America, Eastern Europe, Australia and Asia, including India. These regions have strong demand for mining tyres, as per management.
- BKT expects India to remain one of its key growth drivers for the foreseeable future.

Positioning relative to peers

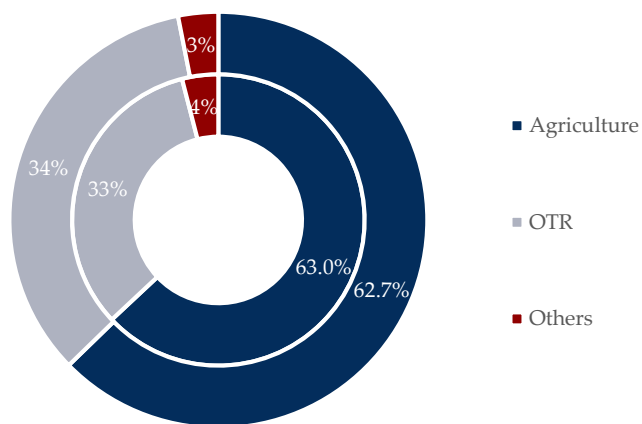
- About a decade back, if the market leader's pricing was pegged at 100, BKT's pricing was around 60. However, on the back of improving its quality as well as working on establishing its brand recall in end markets, BKT has now been able to position its products at 80-85 in the global market, relative to market leaders.
- Hence, they are not worried about competition rising in India from traditional Indian tyre peers. BKT believes its brand is positioned at a premium to India's peers in the OTR/agri segment in India. Also, their USP of having 3200 SKUs would continue to remain their sustainable competitive advantage in the long run.
- Management also believes that they are at the peak of price differential to global leaders at around 15%. They expect it to at best fall down to a 12% differential in the

coming years but they would like to maintain that differential with global leaders in the long run in order to continue to outperform the market.

Margin guidance

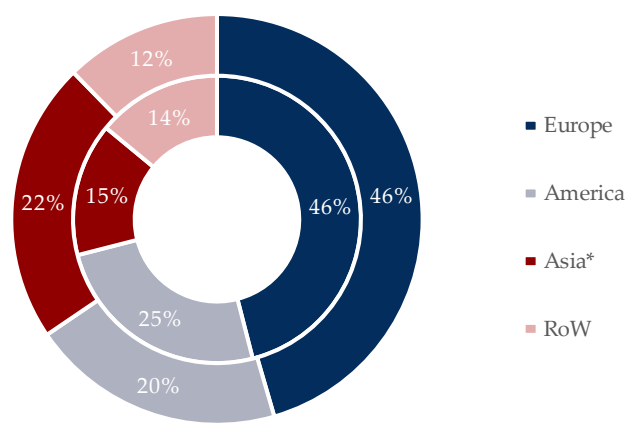
- Management believes that, incrementally, the cost cannot be a lever which would continue to help them gain market share as production costs in India are gradually rising.
- They would continue to work on establishing BKT’s brand across key regions globally. As a result, management has indicated that they would continue to invest in sports sponsorships for global/local events.
- Given that logistics costs have come down and rubber has cooled off, management expects about 200bps margin improvement in the near term.
- Management continues to guide for 26-28% margin guidance in the long term.

Fig2: Segmental Revenue Mix



Inner circle: FY12 and Outer Circle is FY23
Source: Company

Fig3: Geographic Revenue Mix



Inner circle: FY12 and Outer Circle is FY23
*Asia in FY12 includes India and in FY23 represent only India
Source: Company

Financials

Income Statement

Year to March (INR mn)	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Net Revenues	53,350	48,975	57,399	84,187	1,00,725	1,01,449	1,15,396
Growth (%)	12.8	-8.2	17.2	46.7	19.6	0.7	13.7
Material Expenses	24,628	21,268	23,028	37,786	49,558	48,493	53,659
Employee Expenses	2,636	2,858	3,259	3,804	4,042	4,261	4,616
Other Operating Expenses	11,799	11,035	13,017	20,772	26,840	24,348	27,118
EBITDA	14,286	13,814	18,095	21,825	20,286	24,348	30,003
EBITDA Margin (%)	26.8	28.2	31.5	25.9	20.1	24.0	26.0
Depreciation	3,326	3,680	4,062	4,438	5,566	6,012	6,733
EBIT	10,961	10,133	14,034	17,387	14,719	18,336	23,270
Other Income (Including EO Items)	962	1,168	1,375	2,236	248	1,242	1,490
Interest	98	73	98	79	456	601	358
PBT	11,825	11,228	15,310	19,545	14,511	18,977	24,403
Tax (Incl Deferred)	4,010	1,779	3,756	5,438	3,725	4,744	6,101
RPAT	7,815	9,450	11,554	14,107	10,786	14,233	18,302
EO (Loss) / Profit (Net Of Tax)	0	0	0	0	0	0	0
APAT	7,815	9,450	11,554	14,107	10,786	14,233	18,302
APAT Growth (%)	5.7	20.9	22.3	22.1	-23.5	32.0	28.6
Adjusted EPS (Rs)	40.4	48.9	59.8	73.0	55.8	73.6	94.7
EPS Growth (%)	5.7	20.9	22.3	22.1	-23.5	32.0	28.6

Source: Company, HSIE Research

Balance Sheet

Year to March (INR mn)	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Share Capital - Equity	387	387	387	387	387	387	387
Reserves	46,401	49,894	59,686	68,859	75,505	85,485	97,988
Total Shareholders Funds	46,787	50,281	60,072	69,246	75,891	85,872	98,375
Total Debt	8,293	8,612	8,934	24,426	32,539	27,539	23,539
Net Deferred Taxes	3,255	1,783	2,035	2,509	2,413	2,413	2,413
Total Liabilities	58,336	60,676	71,041	96,180	1,10,844	1,15,824	1,24,327
Net fixed assets	27,861	31,914	32,478	39,068	52,784	52,772	56,039
Capital work-in-progress	5,854	5,856	8,555	12,584	13,916	13,916	13,916
Investments	10,831	11,488	15,046	19,766	21,081	26,081	27,581
Total Non-current Assets	44,546	49,257	56,079	71,418	87,781	92,769	97,536
Cash & Equivalents	556	455	571	353	378	435	920
Inventories	7,130	5,804	9,093	16,394	15,924	16,038	18,969
Debtors	5,681	6,492	7,301	10,977	12,535	12,785	14,227
Other Current Assets	6,385	5,304	7,357	9,430	6,106	6,413	6,736
Total Current Assets	19,752	18,055	24,322	37,153	34,943	35,671	40,853
Creditors	3,565	3,610	6,335	8,075	4,866	4,900	5,574
Other Current Liabilities & Provns	2,397	3,026	3,027	4,315	7,014	7,716	8,487
Total Current Liabilities	5,962	6,636	9,361	12,391	11,880	12,616	14,061
Net Current Assets	13,790	11,419	14,961	24,763	23,063	23,055	26,791
Total Assets	58,336	60,676	71,041	96,180	1,10,844	1,15,824	1,24,327

Source: Company, HSIE Research

Cash Flow

Year to March (INR mn)	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Reported PBT	10,961	10,133	14,034	17,387	14,719	18,336	23,270
Interest Expenses	962	1,168	1,375	2,236	248	1,242	1,490
Depreciation	3,326	3,680	4,062	4,438	5,566	6,012	6,733
Working Capital Change	-3,759	2,270	-3,426	-10,020	1,725	65	-3,250
Tax Paid	-4,044	-3,251	-3,504	-4,964	-3,821	-4,744	-6,101
Others	-120	-1,295	1,523	479	-1,048	0	0
OPERATING CASH FLOW (a)	7,327	12,706	14,062	9,556	17,390	20,910	22,142
Capex	-7,367	-7,734	-7,325	-15,056	-20,615	-6,000	-10,000
Free Cash Flow (FCF)	-41	4,972	6,737	-5,500	-3,225	14,910	12,142
Investments	202	-657	-3,558	-4,720	-1,314	-5,000	-1,500
INVESTING CASH FLOW (b)	-7,166	-8,392	-10,884	-19,776	-21,929	-11,000	-11,500
Debt Issuance/(Repaid)	2,108	318	322	15,492	8,114	-5,000	-4,000
Interest Expenses	-98	-73	-98	-79	-456	-601	-358
FCFE	1,969	5,217	6,961	9,913	4,433	9,309	7,785
Dividend	-1,860	-4,661	-3,286	-5,412	-3,093	-4,253	-5,799
FINANCING CASH FLOW (c)	149	-4,415	-3,063	10,001	4,564	-9,853	-10,157
NET CASH FLOW (a+b+c)	310	-101	116	-219	25	57	486
EO Items, Others	246	556	455	571	353	378	435
Closing Cash & Equivalents	556	455	571	352	378	435	920

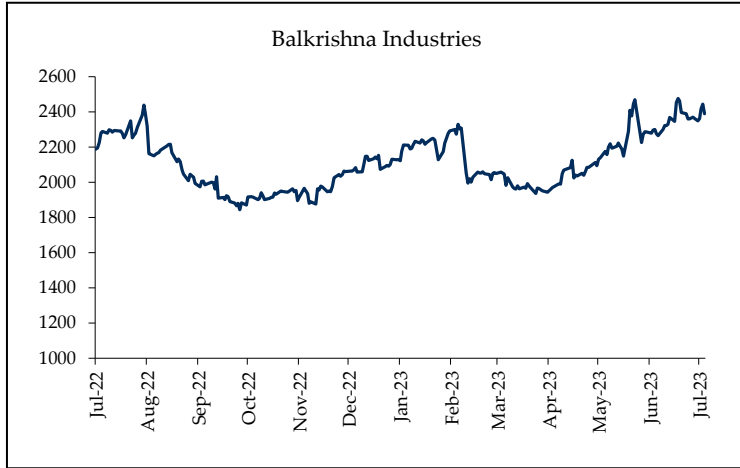
Source: Company, HSIE Research

Key Ratios

Year to March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
PROFITABILITY (%)							
GPM	53.8	56.6	59.9	55.1	50.8	52.2	53.5
EBITDA Margin	26.8	28.2	31.5	25.9	20.1	24.0	26.0
APAT Margin	14.6	19.3	20.1	16.8	10.7	14.0	15.9
RoE	16.7	18.8	19.2	20.4	14.2	16.6	18.6
RoIC (or Core RoCE)	13.3	14.3	16.1	15.0	10.6	12.1	14.5
RoCE	20.4	18.6	21.7	20.4	13.5	16.9	19.9
EFFICIENCY							
Tax Rate (%)	33.9	15.8	24.5	27.8	25.7	25.0	25.0
Fixed Asset Turnover (x)	0.9	0.8	0.8	0.9	0.9	0.9	0.9
Inventory (days)	67	60	84	96	72	72	72
Debtors (days)	39	48	46	48	45	45	45
Payables (days)	53	62	100	78	36	36	36
Cash Conversion Cycle (days)	53	47	30	66	82	82	82
Debt/EBITDA (x)	0.6	0.6	0.5	1.1	1.6	1.1	0.8
Net D/E (x)	0.2	0.2	0.1	0.4	0.4	0.3	0.2
Interest Coverage (x)	112	139	143	221	32	31	65
PER SHARE DATA (Rs)							
EPS	40	49	60	73	56	74	95
CEPS	58	68	81	96	85	105	130
Dividend	8	20	17	28	16	22	30
Book Value	242	260	311	358	393	444	509
VALUATION							
P/E (x)	56.5	46.7	38.2	31.3	40.9	31.0	24.1
P/BV (x)	9.4	8.8	7.4	6.4	5.8	5.1	4.5
EV/EBITDA (x)	30.7	31.7	24.0	20.4	22.3	18.2	14.6
EV/Revenues (x)	1.6	1.7	1.4	1.1	1.0	0.9	0.7
OCF/EV (%)	1.7	2.9	3.2	2.1	3.8	4.7	5.1
FCF/EV (%)	0.0	1.1	1.5	-1.2	-0.7	3.4	2.8
FCFE/Mkt Cap (%)	0.4	1.2	1.6	2.2	1.0	2.1	1.8
Dividend Yield (%)	0.4	0.9	0.7	1.2	0.7	1.0	1.3

Source: Company, HSIE Research

1 Yr Price movement



Rating Criteria

BUY: >+15% return potential

ADD: +5% to +15% return potential

REDUCE: -10% to +5% return potential

SELL: >10% Downside return potential

Balkrishna Industries: Company Update

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