Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Balkrishna Industries Ltd

Challenges continue

Automobiles	Sharekhan code: BALKRISIND		
Reco/View: Hold ↔	CMP: **Rs. 2,371**	Price Target: **Rs. 2,446** ↔	

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Balkrishna Industries Limited reported EBITDA margin at 22.7% in Q1FY24 against our estimate of 22.2% on soft raw-material cost trend.
- Management has guided a challenging business environment in exports in Q2FY2024, although destocking is largely over.
- We maintain our Hold rating on the stock with an unchanged PT of Rs. 2,446 in expectation of a revival in export volumes in FY2025.
- The stock trades at a P/E multiple of 25.7x and EV/EBITDA multiple of 16.4x.

Balkrishna Industries Limited (Balkrishna) missed our top-line and bottom-line estimates, but reported EBITDA margin above our estimates on account of healthy gross margin expansion. Further, the company's performance in Q1FY2024 was impacted by the cyclonic environment. Bhuj plant was shut for five days and shipments were impacted due to the cyclone. Revenue declined by 8.5% q-o-q to Rs. 2,120 crore (against our estimate of Rs. 2,480 crore) due to a 7.5% q-o-q decline in volumes and a 1.1% q-o-q dip in ASPs. EBITDA increased by 2.2% q-o-q to Rs. 481 crore (against estimate of Rs. 550 crore). EBITDA margin expanded by 240 bps q-o-q to 22.7% (against our estimate of 22.2%) on account of a 270 -bps expansion in gross margin and correction in freight cost. Other income increased by 92% q-o-q to Rs. 104 crore. Unrealized forex gain stood at Rs. 33 crore. Reported PAT grew by 22.2% q-o-q to Rs. 312.3 crore. Excluding the unrealised forex gain, APAT increased by 13.4% q-o-q to Rs. 287 crore (against our estimate of Rs. 322 crore). Along with the result, the company has announced an interim dividend of Rs. 4/share. Management has indicated for a challenging business environment for Q2FY2024 in export markets due to heat waves and recessionary fears, while it assumes that destocking has largely been over in most markets and global inventories are reaching normal levels. Although raw-material (RM) cost and ocean freight have been coming down, the company would have to pass on the soft input cost to end-customers to remain competitive in the market. Hence, the return of operating leverage led by volume recovery would be more necessary than a mere correction in input cost for return of EBITDA margin in the previous upcycles. We retain our Hold rating on the stock.

Key positives

- Gross margin expanded by 270 bps q-o-q to 51.8% and resulted in a 240-bps q-o-q expansion in EBITDA margin.
- Other income increased by 92% q-o-q to Rs. 104 crore on account of MTM gain.
- Cash in books increased from Rs. 2,075 crore in Q4FY2023 to Rs. 2,245 crore in Q1FY2024.

Key negatives

- Volumes declined by 7.5% q-o-q due to the cyclonic environment and ASPs came down by 1.1% due to pass on of lower input costs to customers.
- Employee cost as a percentage of sales expanded by 90 bps q-o-q to 5% In Q1FY2024.

Management Commentary

- Q2FY2024 appears to be challenging for volume performance due to seasonality, recessionary fears, and heat waves in export markets.
- De-stocking in overseas markets is largely over and global inventories are reaching normal levels.
- Management continues to aspire for a 10% market share in the global OHT market in the next 3-4 years from 5-6% currently.

Our Call

Valuation – Maintain Hold rating with an unchanged PT Rs. 2,446: In Q1FY2024, while volume performance was impacted by the cyclonic environment, operating performance improved on a sequential basis due to soft RM cost and correction in freight cost. Further, management indicated that destocking in the global market is receding, but it assumes a challenging situation in export markets in Q2FY24 due to heat waves and recessionary fears. Balkrishna has been passing on the correction in input cost and lower freight cost to customers and, hence, ASPs may come down going ahead. However, management continues to focus on EBITDA margin improvement. While EBITDA margin may expand in support of correction in the RM basket, we believe a substantial revival in earnings growth would be more dependent on volume recovery as soft RM cost benefit cannot be retained for a significant period due to competition and business sustainability. We cut down our earnings estimates for FY2024 by 10.6% and retain FY2025 estimates in hope that the business cycle would revive by FY2025. Hence, we maintain our Hold rating on the stock with an unchanged PT of Rs. 2,446 in expectation of a revival in export volumes in FY2025

Key Risks

Balkrishna derives a significant part of its revenue from exports markets. 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	FY23	FY24E	FY25E
Net sales (Rs cr)	5,758	8,267	9,811	9,406	11,115
Growth (%)	17.6	43.6	18.7	-4.1	18.2
EBITDA (Rs cr)	1,786	1,976	1,716	2,192	2,779
OPM (%)	31.0	23.9	17.5	23.3	25.0
APAT (Rs cr)	1,141	1,383	1,144	1,350	1,785
Growth (%)	20.8	21.2	-17.2	18.0	32.2
AEPS (Rs)	59.0	71.5	59.2	69.8	92.3
P/E (x)	40.2	33.2	40.1	33.9	25.7
P/B (x)	7.6	6.6	6.0	5.3	4.6
EV/EBITDA (x)	25.3	23.5	27.4	21.4	16.4
RoE (%)	19.0	20.0	15.1	15.6	18.0
RoCE (%)	16.9	15.1	10.3	13.0	13.8

Source: Company; Sharekhan estimates

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 22.23

Updated Jun 08, 2023

Medium Risk

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

Source: Morningstar

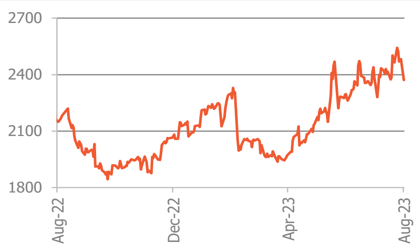
Company details

Market cap:	Rs. 45,836 cr
52-week high/low:	Rs. 1,801 /2,568
NSE volume: (No of shares)	2.9 lakh
BSE code:	502355
NSE code:	BALKRISIND
Free float: (No of shares)	8.1 cr

Shareholding (%)

Promoters	58.3
FII	12.4
DII	21.0
Others	8.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.8	9.0	11.6	-0.5
Relative to Sensex	-3.1	2.2	0.4	-14.0

Sharekhan Research, Bloomberg

Q1FY2024 performance: Volumes impacted by the cyclonic environment; Margins improved q-o-q due to low RM cost

- Volume performance in Q1FY2024 was impacted by the cyclonic environment. While the company's Bhuj plant was shut for five days, shipments were impacted for 10 days.
- High-cost RM has been fully utilised and now the benefit of lower RM cost has already started flowing through the financials. Hence, gross margin expanded by 270 bps q-o-q to 51.8%.
- A large part of the correction in freight cost has already been passed on to customers.
- Other expenses as a percentage of sales contracted by 60 bps q-o-q to 24.1% more due to correction in freight cost. Freight cost as a percentage of sales contracted to 4.5% from 5.7%.
- Forex gain during the quarter stood at Rs. 38 crore, including unrealised gain of Rs. 33 crore.
- Segment wise volume mix : Agriculture : 58.5%, OTR : 37.8%, Others : 3.7%
- Channel-wise volume mix : Replacement: 71.8%, OEM: 26%, Others: 2.3%
- Geography-wise volume mix: Europe: 44.8%, USA: 15.3%, Inda: 31.3%, ROW: 8.6%
- Gross debt: Rs. 2,861 crore (75% of the debt is working capital related)
- Cash in books: Rs. 2,245 crore
- Interim dividend: Rs. 4/share
- Capacity utilisation in the carbon black plant is 80-85%.

Destocking is close to over

- Destocking in most of the export market has been gradually easing out
- Inventory levels are reaching normal levels.
- The end-user demand is intact in most markets

Outlook: Q2FY2024 appears challenging

- While management has not shared the full-year outlook, it indicated Q2FY2024 to be a challenging quarter due to recessionary fears and heat waves.
- The spill over benefit of volumes from Q1FY2024 to Q2FY2024 would neutralise, as Q2FY2024 used to be a seasonally weak quarter.
- Management observes demand headwinds in both of its key export destinations (Europe and USA) and in both OTR and agri segments.
- RM prices are likely to remain stable from here.
- The company has been passing on the lower RM cost benefit to customers and, hence, ASPs may come down from current levels (likely to be Rs. 300/kg-Rs. 305/kg by the end of the year).
- Management has maintained its capex guidance of Rs. 550-600 crore (including maintenance capex of Rs. 250-300 crore) for FY2024.
- Balkrishna is aspiring for a marker share of 10% in the global OHT market in the next 3-4 years from 5-6% currently.
- Demand in the domestic market is appearing better.
- EBIDTA margin would improve in the long term on recovery in volumes and improvement in the product mix.

Change in estimates Rs cr

Particulars	New		Earlier		% change	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Revenue	9,406	11,115	10,701	11,904	(12.1)	(6.6)
EBITDA	2,192	2,779	2,440	2,821	(10.2)	(1.5)
EBITDA margin (%)	23.3	25.0	22.8	23.7		
PAT	1,350	1,785	1,511	1,784	(10.6)	0.1
EPS (Rs.)	69.8	92.3	78.2	92.3	(10.6)	0.1

Source: Company, Sharekhan Research

Results (Standalone) Rs cr

Particulars	Q1FY24	Q1FY23	YoY%	Q4FY23	QoQ%
Revenues	2,120	2,646	-19.9	2,318	-8.5
Total operating expenses	1,639	2,191	-25.2	1,847	-11.3
EBITDA	481	455	5.7	471	2.2
Depreciation	154	126	21.8	151	1.5
Interest	21	3	659.1	25	-16.8
Other income	104	102	1.3	54	92.0
PBT	411	429	-4.3	348	17.9
Tax	98	109	-9.9	93	5.9
Reported PAT	312.3	319.7	-2.3	255.6	22.2
Adjusted PAT	287	300	-4.4	253	13.4
Adjusted EPS	14.9	15.5	-4.4	13.1	13.4

Source: Company; Sharekhan Research

Key ratios (Standalone)

Particulars	Q1FY24	Q1FY23	YoY (bps)	Q4FY23	QoQ (bps)
Gross margin (%)	51.8	52.0	-30	49.1	270
EBIDTA margin (%)	22.7	17.2	550	20.3	240
Net profit margin (%)	13.5	11.4	220	10.9	260
Effective tax rate (%)	23.9	25.4	-150	26.6	-270

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Indian tyre market is recovering, destocking likely to complete soon in the overseas market

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, 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 a ripple effect of the same, which are likely to result in steady growth for replacement demand. Further, de-stocking in the overseas market is likely to complete soon, given overseas markets are observing de-stocking due to a reduction in overseas transportation because of increased availability of containers.

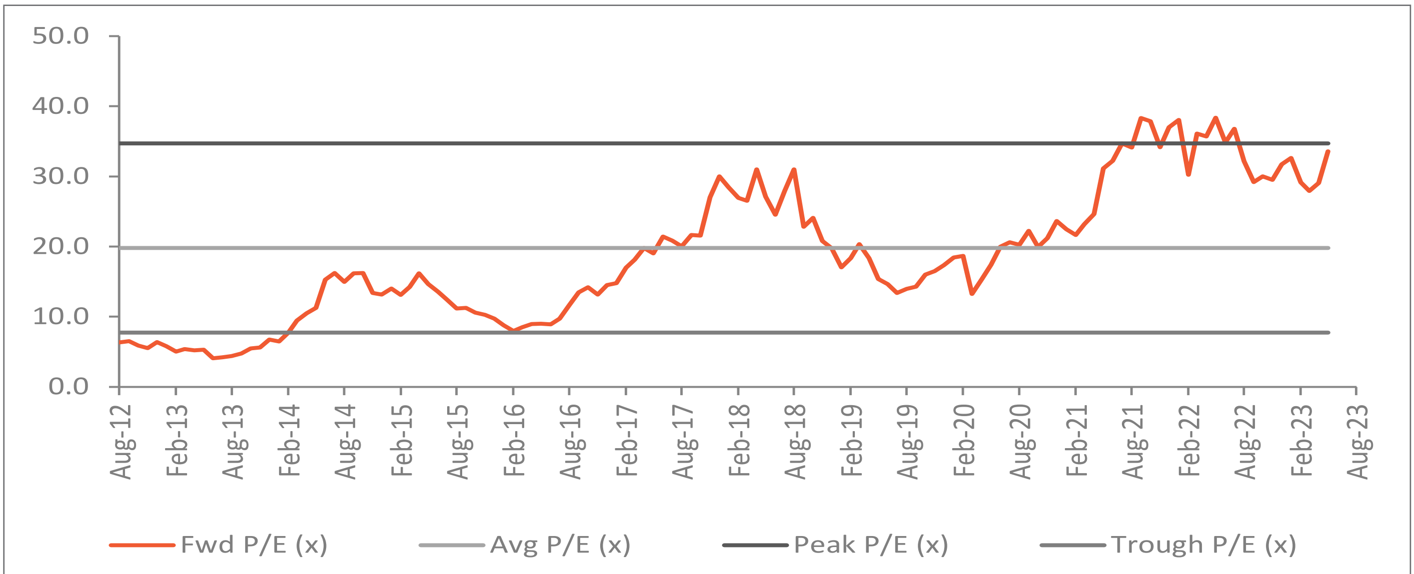
■ Company Outlook – Cautious outlook on demand, focus on profitability

The company continues 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, the company is expected to face demand headwinds in the near term owing to the ongoing destocking in the European market. The company expects correction in the RM basket and a decline in freight cost would help it in registering better operating performance in FY2024. The U.S. market is performing better than the European market. In Europe, impact on the agri segment has been more than that on the industrial segment. Manufacturing capacity has reached 360,000 MT/annum.

■ Valuation – Maintain Hold rating with a revised PT Rs. 2,446

In Q1FY2024, while volume performance was impacted by the cyclonic environment, operating performance improved on a sequential basis due to soft RM cost and correction in freight cost. Further, management indicated that destocking in the global market is receding, but it assumes a challenging situation in export markets in Q2FY24 due to heat waves and recessionary fears. Balkrishna has been passing on the correction in input cost and lower freight cost to customers and, hence, ASPs may come down going ahead. However, management continues to focus on EBITDA margin improvement. While EBITDA margin may expand in support of correction in the RM basket, we believe a substantial revival in earnings growth would be more dependent on volume recovery as soft RM cost benefit cannot be retained for a significant period due to competition and business sustainability. We cut down our earnings estimates for FY2024 by 10.6% and retain FY2025 estimates in hope that the business cycle would revive by FY2025. Hence, we maintain our Hold rating on the stock with an unchanged PT of Rs. 2,446 in expectation of a revival in export volumes in FY2025.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	Rs/Share	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
Balkrishna Industries	2,371	40.1	33.9	25.7	27.4	21.4	16.4	10.3	13.0	13.8
Apollo Tyres	434	25.5	18.3	15.2	9.9	8.3	7.4	7.6	9.1	9.8

Source: Company, Sharekhan estimates

About the 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. The company is a global player present in Europe, U.S., and India. While European markets account for ~50% of sales, U.S. and India account for 18% and 21% 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 – 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 manufacturing capacity has reached 3.6 lakh MT by end-FY2023.

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 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. Rising concerns related to the European market may impact its performance in the near term.

Key Risks

Given Balkrishna follows an export-oriented business model, any adverse movement in the macro environment of overseas markets 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	Executive Director
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	25.0
3	Life Insurance Corp of India	4.3
4	Poddar Khushboo	3.9
5	HDFC Asset Management Co Ltd	2.7
6	Kotak Mahindra Asset Management Co Ltd/India	2.5
7	Norges Bank	1.7
8	Poddar Rishabh Sureshkumar	1.4
9	Vanguard Group Inc	1.4
10	BlackRock Inc	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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Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/ CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

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