Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Balkrishna Industries Ltd

In-line Q2; inventory normalizing

Automobiles	Sharekhan code: BALKRISIND
Reco/View: Hold ↔	CMP: Rs. 2,566
	Price Target: Rs. 2,720 ↑

↑ 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 Updated Aug 08, 2023				22.23
Medium Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

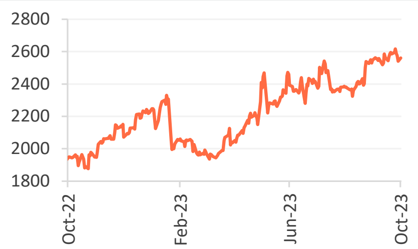
Company details

Market cap:	Rs. 49,605 cr
52-week high/low:	Rs. 2,645/1,801
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	12.5
DII	21.2
Others	7.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.4	6.3	22.9	33.7
Relative to Sensex	2.5	9.5	13.8	22.8

Sharekhan Research, Bloomberg

Summary

- Reported EBITDA at Rs 518 crore in Q2FY24 against estimate of Rs 509 crore.
- Management has guided for a stable demand scenario in H2FY24 compared to demand pattern in H1FY24.
- We retain our Hold rating on the Balkrishna Industries (BKT) with revised PT of Rs 2720 in hope of revival in demand in medium term and improvement in EBITDA margins on steady RM cost trend.
- Stock trades at P/E multiple of 23.6x and EV/EBITDA multiple of 14.9x its FY26 estimates.

Q2FY24 performance was in line with estimates as revenue, EBITDA and APAT exceeded estimates by mere 3.0%,1.5% and 1.9% respectively. Revenue increased by 5.0% q-o- q to Rs 2226 crore (Vs estimate of Rs 2,160) on the back of 5.0% q-o- q increase in volumes. Volumes growth in 5% q-o-q was supported by the spill over impact from Q1FY24 as its shipments were impacted due to cyclonic disruptions and hence the retail sales during the quarter lagged wholesales. EBITDA increased by 7.7% q-o-q to Rs 518 crore (against estimate of Rs 509 crore). EBITDA margin expanded by 60 bps q-o-q to 23.3% (against estimate of 23.6%) on the back of 100 bps q-o-q contraction in other expenses as percentage of sales, which was partly offset by 40 bps q-o-q contraction in gross margins. The unrealized forex gain stood at Rs. 25 crore in Q2FY24 against Rs 33 crore in Q1FY23. Adjusting to unrealized forex gain the APAT increased by 10.2% to Rs 316 crore against estimate of 312 crore. BKT has announced a second interim dividend of Rs. 4/ share (in addition to first interim dividend of Rs 4/ share). Further the management is observing a stable volume trajectory in H2FY24 and expects a marginal decline in volumes in FY24. BKT has increased its capex guidance from Rs 600 crore to Rs 900 crore for FY24 as it has has decided to set up a mould manufacturing capacity with a cash outflow of Rs 300 crore. The management is looking for a stable demand trajectory in H2FY24.

Key positives

- Other expenses as percentage of sales contracted by 100 bps on q-o-q basis and supported 60 bps q-o-q expansion in EBITDA margins.
- Volumes rose by 5% q-o-q as the shipments which were delayed due to cyclone in Q1FY24 have been recorded in Q2FY24.
- Announced a second interim dividend of Rs 4/ share (in addition to first interim dividend of Rs 4/ share).

Key negatives

- Gross margin contracted by 60 bps q-o-q to 23.3%.
- ASPs remain flat on q-o- q basis.

Management Commentary

- BKT Is aspiring for a 10% market share in the domestic market in medium term compared to 4-5% market share currently.
- Volume performance in H2FY24 is expected to be better in comparison to H1FY24.
- Raw material basket is likely to remain steady or increase marginally in Q3FY24.

Our Call

Valuation – Maintain Hold with unchanged PT Rs. 2720: Operating performance has been in line with estimates, given that the volume performance was supported by the spill over of inventory from Q1FY24. Going forward the management observes a stable demand scenario in the overseas market due to normalised inventory levels in the market. The Indian market is offering a long-term growth opportunity to the company and it is looking to expand its market share from 4-5% to 10% in medium term. The management assumes a steady RM cost trend and targeting to sustain EBITDA margins. While the EBITDA margin may expand in support of correction in RM basket, we believe that substantial revival in earning growth would be more dependent on volume recovery as the soft RM cost benefit can't be retained for a significant period of time due to competition and business sustainability. Along with the result BKT has announced a second interim dividend of Rs. 4/ share in addition to first interim dividend of Rs 4/ share. Post incorporating H1Fy24 performance and introducing FY26 estimates we retain our Hold rating on the stock with revised PT of Rs 2,720 in hope of revival in demand in medium term and improvement in EBITDA margins on steady raw material cost trend.

Key Risks

BKT derives 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 Rs cr

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Revenues	8,267	9,811	9,231	10,752	12,418
Growth (%)	43.6	18.7	-5.9	16.5	15.5
EBIDTA	1,976	1,716	2,151	2,688	3,229
OPM (%)	23.9	17.5	23.3	25.0	26.0
Net Profit	1,383	1,144	1,303	1,700	2,103
Growth (%)	21.2	-17.2	13.8	30.5	23.7
EPS (Rs.)	71.5	59.2	67.4	88.0	108.8
P/E (x)	35.9	43.3	38.1	29.2	23.6
P/B (x)	7.2	6.5	5.8	5.0	4.3
EV/EBITDA (x)	25.4	29.6	23.5	18.4	14.9
ROE (%)	20.0	15.1	15.2	17.3	18.4
ROCE (%)	15.1	10.3	11.3	13.2	14.5

Source: Company; Sharekhan estimates

H1FY24: Volume performance

- Volume performance in H1FY24 has been impacted due to ongoing destocking in the export markets, heat waves and recessionary fears. Total volumes in H1FY24 stood at 137,794 MT against 301,181 MT in FY23.
- Segment wise volume break-up: Agriculture: 58.2%, OTR: 38.5%, Others : 3.3%
- Channel-wise volume break-up: Replacement : 71.5% , OEM : 26.5%, Others : 2.0%
- Geography-wise volume break-up: Europe : 45.1%, America : 16.6%,India :28.6%,RoW :9.7%

Capex: Increased capex guidance from Rs 600 crore to Rs 900 crore for Fy24

- BKT has increased its capex guidance from Rs 600 crore to Rs 900 crore for FY24 as it has taken up new project for mould manufacturing capacity.
- It has earmarked a Rs 300 crore for mould manufacturing capacity.
- New investment on mould manufacturing capacity would enhance number of SKUs and would give it a control on the quality of the products.
- The company has completed a capex of Rs 595 crore in H1FY24.
- The advanced carbon black project is running as per schedule and would be completed by H2FY25.
- Further, the company envisages for a new capacity expansion project at Bhuj in small patches as it need additional capacities to enhance its market share in global markets.

Indian market: Long-term growth opportunity

- Indian market contributed 28.6% to the total revenue in H1FY24.
- Though BKT has lately started catering to the Indian market but has been receiving healthy response in the market.
- BKT has been catering to Indian market for last 6 years and gained 4-5% market share in the domestic market.
- BKT has been aspiring for a 10% kind of market share in the domestic market.
- The management claims that Indian business offers the margins similar to that of its global business.

Demand trend in overseas markets: likely to be stable in H2Fy24

- Destocking in the overseas market is stabilizing but the business confidence has yet to recover fully.
- The management assumes that the volume trends in H2FY24 may be better than that of H1FY24.
- While the worst is over in the end user segment the uncertainty is continue to due to ongoing geopolitical issues.
- Inventory levels are normalized to 2-3 months level.

Change in estimates Rs cr

Particulars	New		Earlier		% change		Introduction
	FY24E	Fy25E	FY24E	Fy25E	FY24E	Fy25E	Fy26E
Revenue	9,231	10,752	9,406	11,115	(1.9)	(3.3)	12418
EBITDA	2,151	2,688	2,192	2,779	(1.9)	(3.3)	3229
EBITDA margin (%)	23.3	25.0	23.3	25.0			26
PAT	1,303	1,700	1,350	1,785	(3.5)	(4.8)	2103
EPS (Rs)	67.4	88.0	69.8	92.4	(3.5)	(4.8)	109

Source: Company, Sharekhan Research

Results (Standalone) **Rs cr**

Particulars	Q2FY24	Q2FY23	YoY %	Q1FY24	QoQ %
Revenues	2,226	2,704	-17.7	2,120	5.0
Total operating expenses	1,707	2,260	-24.4	1,639	4.2
EBITDA	518	445	16.6	481	7.7
Depreciation	159	134	18.3	154	3.2
Interest	23	4	430.9	21	10.0
Other income	107	226	-52.7	104	3.2
PBT	444	532	-16.6	411	8.1
Tax	108	128	-15.5	98	10.4
Reported PAT	335.4	403.8	-16.9	312.3	7.4
Adjusted PAT	316	367	-13.7	287	10.2
Adjusted EPS	16	19	-13.7	15	10.2

Source: Company, Sharekhan Research

Key ratios (Standalone)

Particulars	Q2FY24	Q2FY23	YoY (bps)	Q1FY24	QoQ (bps)
Gross margin (%)	51.4	49.4	200	51.8	-40
EBIDTA margin (%)	23.3	16.4	690	22.7	60
Net profit margin (%)	14.2	13.6	70	13.5	70
Effective tax rate (%)	24.4	24.1	30	23.9	50

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Indian tyre market is recovering, destocking likely to complete soon in 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 a broad-based recovery across segments, driven by pent-up demand, preference for personal mobility and a 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. Further the destocking in overseas market is likely to complete soon, given overseas markets are observing destocking due to reduction in overseas transportation due to increase in availability of containers.

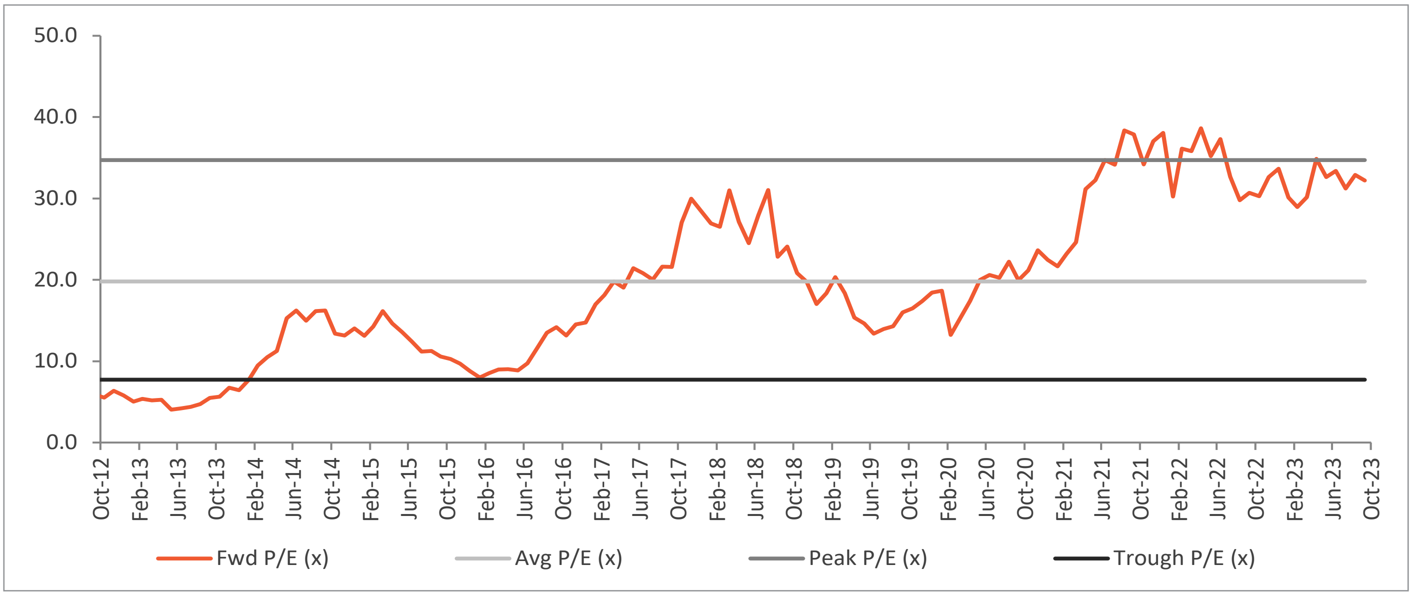
■ Company outlook - Focus on profitability

BKT 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 BKT is expected to face demand headwinds in the near term owing to ongoing destocking in European market. The company expects that correction in the raw material basket and decline in freight cost would help it in registering better operating performance in FY24. The US market is performing better than that of European market. In Europe agri segment has more impacted than industrial segment. The manufacturing capacity has reached to 360,000 MT/ annum.

■ Valuation - Maintain Hold rating with unchanged PT Rs. 2720

Operating performance has been in line with estimates, given that the volume performance was supported by the spill over of inventory from Q1FY24. Going forward the management observes a stable demand scenario in the overseas market due to normalised inventory levels in the market. The Indian market is offering a long-term growth opportunity to the company and it is looking to expand its market share from 4-5% to 10% in medium term. The management assumes a steady RM cost trend and targeting to sustain EBITDA margins. While the EBITDA margin may expand in support of correction in RM basket, we believe that substantial revival in earning growth would be more dependent on volume recovery as the soft RM cost benefit can't be retained for a significant period of time due to competition and business sustainability. Along with the result BKT has announced a second interim dividend of Rs. 4/ share in addition to first interim dividend of Rs 4/ share. Post incorporating H1Fy24 performance and introducing FY26 estimates we retain our Hold rating on the stock with revised PT of Rs 2,720 in hope of revival in demand in medium term and improvement in EBITDA margins on steady raw material cost trend.

One-year forward P/E (x) band



Source: Sharekhan Research

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 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 – 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 manufacturing capacity has reached 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 Rising concerns related with European market may impact its performance in near term.

Key Risks

Given BKT follows export oriented business model and hence 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 and Managing Director
Rajiv Poddar	Joint Managing Director
Vipul Shah	Executive Director
Madhu Sudan Bajaj	President (Commercials) and Chief Financial Officer

Source: Company

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	4.7
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	1.7
9	Vanguard Group Inc	1.4
10	MOSL AMC	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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