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DEMOCRATIZING WEALTH CREATION

UPSTREAM PICK

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Company Name	:	**BALKRISHNA INDUSTRIES**
BSE Code	:	**502355**
Time Duration	:	**2 years**
CMP	:	**₹919.95 (as on 07 Mar., 2019)**
Target Price	:	**₹1240**

Our Upstream Pick for the month of March is Balkrishna Industries. The company is primarily engaged in specialty off-highway tyre segment, which consists of agriculture, industrial, construction, earthmoving, mining, port, lawn and garden and all-terrain vehicle tyres (ATVs), etc. On the geographical front, the revenue mix comprised of Europe-47%, US-18%, India-21% and RoW-14%. The revenue mix stood at exports 17%, domestic 83% and the company aims to improve the same to 20:80 in the coming years. The company enjoys around 5% market share in the global market.

OEMs comprise 26% of the total revenue, whereas replacement demand comprises 72%. Also, on the OEM front, the company has a diversified client base resulting in less dependency on any single client.

The tyre industry in India has been on a recovery mode. The domestic industry is growing led by good demand seen in the replacement segment. As Balkrishna Industries' majority revenue is driven by tyre replacement segment, we see this company in a sweet spot. Also, its supply of tyres is diversified across various sectors, thereby reducing its risk confined only to commercial automobile sector. Also, the demand for its products is robust for which it has initiated extensive expansion plans. Through this expansion, we expect a turnaround in its operations in the near term. Hence, we see this company as our Upstream Pick.

Expanding footprints in USA

The company is planning to set up a greenfield plant having capacity of 20,000 MTPA at an investment of USD 100 million in the US. This capex will be funded by a mix of internal accruals and local debt and is likely to commence in FY21E. This plant will help the company to strengthen its partnership with the existing OEMs and also open new opportunities to tie-up with new clients in the neighbouring countries by providing them fast delivery.

Relocation of Waluj plant

The company is planning to relocate the operations of its Waluj plant (current capacity 30,000 MTPA) in the near vicinity on a greenfield basis by incurring capex of around Rs 500 crore. With this, the company also intends to set up a co-generation plant and in-house warehouses. The plant is of major significance as the company serves its major OEMs and distributors in South India through this plant. The existing plant will continue to operate till the new plant becomes operational. The new plant is likely to become operational by FY21E.

Backward integration of carbon black plant

The price of carbon black, which contributes 10% to the total raw material cost, has increased to Rs.85/kg in Q3FY19 from Rs.75/kg in Q2FY19. To deal with the rising price of carbon black, the company is planning to become self-reliant. For this, the company is planning to enhance its carbon black plant capacity to 140,000 MTPA (current capacity 60,000 MTPA) by investing Rs 425 crore. The entire capex plan will be funded through internal accruals and debt. The first phase would be operational by FY19-end and the remaining would be operational by FY21. Post commencement of this plant, this would lead to savings in operating costs by 100-125 bps. The plant will also supply to the US plant's carbon black requirements.

Bhuj plant: Mixing plant, warehouse and new OTR tyre capacity

The total capex planned for Bhuj plant is Rs 500 crore and is mainly for three activities: one, construction of mixing plant, which will mainly cater to the company's proposed plant in the US; the additional construction of warehouse as its existing warehouse has already peaked out; and lastly, to create an additional capacity of 5,000 MTPA for large-sized all-steel OTR (off the road) radial tyres.

Risk of rising costs

The company's raw materials majorly comprise of crude derivatives, carbon black, rubber, etc. So, any unfavourable volatility in the prices of these materials may cause adverse impact on the company's performance. However, the management expects the raw material costs to remain at the current levels. Also, the company has been aggressively spending on advertisements since last three quarters, which is likely to put some pressure on the margins.

Financial performance

Looking at the recently concluded quarter Q3FY19, the standalone revenue came in at Rs. 1205.59 crore as against Rs. 1106.31 crore in the corresponding quarter last year, registering 9% yoy increase. This jump was partially offset by 6% drop in sales volumes. The EBITDA for the quarter rose by 3.8% yoy to Rs. 300.89 crore as against Rs. 289.99 crore in the corresponding quarter last year, with a corresponding margin contraction of 125 bps. EBITDA margin for the quarter stood at 25%. The PAT for the quarter came in at Rs. 144.7 crore as against Rs. 189.5 crore in the corresponding quarter last year, a decline of 24% yoy. This was due to MTM loss of Rs 34 crore vs gain of Rs 11 crore in Q3FY18. The management has given its FY19 volume guidance at 210,000-220,000 MTPA with a downward bias.

Industry scenario

Tyre industry is known for its capital-intensive structure where 60% to 65% of the revenues is raw material cost. The Indian tyre industry had a mixed performance in FY18. The Indian tyre industry has witnessed raw material cost pressure for the last two years, led by rising rubber and crude oil prices. Indian tyre market is positively related to the replacement segment, which contributes around 70% of the total revenues.

For long, the industry has been demanding that the government create a level-playing field against the low-cost Chinese tyre imports. This year, the government imposed an anti-dumping duty on the import of radial tyres used in buses and trucks from China for five years. The implementation of GST also helped in creating a better market.

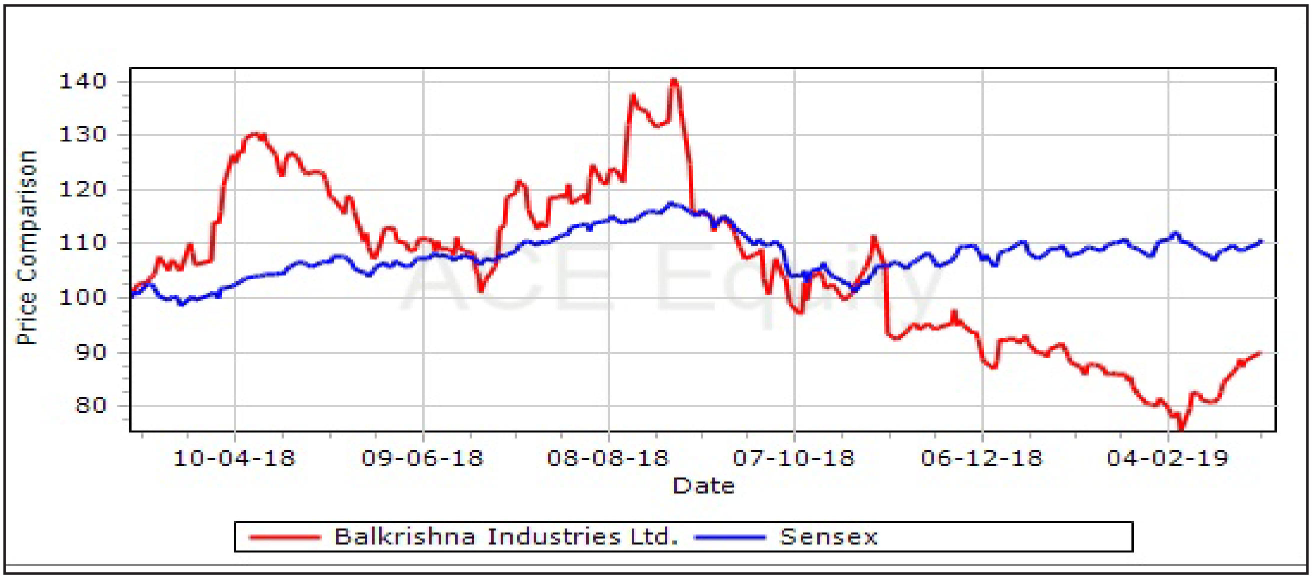
Valuation & outlook

The company is trading at a TTM P/E of 22.23x with TTM EPS of Rs. 40.91. The company continues to explore all the avenues, with penetration into existing market within India as well as outside India, extending relationship with OEMs and expanding its product range. Going ahead, the planned capex on greenfield expansions and backward integration would start generating benefits once these plants become operational. Also, the raw material prices are stable and the management also expects the prices to remain at current levels. However, any unfavourable change in commodity prices and heavy spend on promotion will remain a concern. Despite massive capex plans, the D/E stood at 0.20x, which lends financial stability. Considering all the above factors, we see a potential upside of 35% with a target price of Rs 1240 over a period of two years.

Inc/Exp Statement(Standalone) (Rs in Crore)

Description	201803	201703	201603	201503	201403
Net Sales	4447.28	3727.85	3222.51	3779.91	3576.71
Total Income	4783.49	3977.46	3371.47	4059.71	3590.55
Total Expenditure	3339.64	2595.92	2384.01	3045.36	2682.82
PBIDT	1443.85	1381.54	987.46	1014.34	907.73
PAT	739.25	715.58	438.57	488.81	488.37
Dividend %	400.00	400.00	275.00	120.00	100.00
Adj. EPS(Rs)	38.24	37.02	22.69	25.29	25.26

Quarter On Quarter (Standalone) (Rs in Crore)					
Particulars	201812	201809	Q on Q Var%	201712	Y on Y Var%
Net Sales	1205.59	1325.48	-9.05	1106.31	8.97
Total Expenditure	937.07	992.85	-5.62	816.32	14.79
PBIDT (Excl OI)	268.52	332.63	-19.27	289.99	-7.40
PAT	144.70	222.31	-34.91	189.50	-23.64
PBIDTM% (Excl OI)	22.27	25.10	-11.27	26.21	-15.03
PBIDTM%	25.04	31.95	-21.63	33.24	-24.67
PATM%	12.00	16.77	-28.44	17.13	-29.95
Adj. EPS(Rs)	7.49	11.50	-34.87	9.80	-23.57



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