

BALKRISHNA INDUSTRIES

Sluggish volumes puncture sales

India Equity Research | Miscellaneous



Balkrishna Industries' (BKT) Q3FY13 top line of INR7bn (down 11% YoY) came in below our and consensus estimates. The disappointment was primarily due to 15.2% dip in volumes, which was somewhat compensated by better realisation and favourable currency movement. The company clocked 30,125MT volume with average realisation of INR234/KG (up 4% YoY). Softening rubber prices enabled it to post 22.1% (up 430bps YoY) EBITDA margin, ahead of our 21.5% estimate. Overall, management reiterated that the slowdown in Europe and US is impacting volumes and the company's order book, which shrunk to 2.5 months. However, BKT believes demand will not dip further and is positive of achieving the lower end of its FY13 volume guidance. Maintain 'BUY'.

Tepid volumes dent top line; lower costs boost margin

BKT's Q3FY13 top line of INR7.0bn (down 11% YoY, 21% QoQ) was below our INR8.9bn estimate. The disappointment was predominantly due to dip in volumes across geographies. The company's 30,125MT volume dipped 15% YoY, which was somewhat compensated by higher realisation (up 4% YoY). EBITDA margin at 22.1% was ahead of our 21.5% estimate primarily due to lower raw material cost (rubber prices correction). BKT reported adjusted PAT of INR889mn (excluding forex loss of INR144mn).

Capex on track, but slow down takes a toll on order book

BKT has started Phase I (10,000MT) of Bhuj facility and is planning to add another 15,000MT by FY13 end. Management believes, by FY15, the 120,000MT Bhuj facility will be up and running. However, due to slowdown in Europe and US the company's order book, which used to stand at ~4-5 months' sales until two quarters ago, has shrunk to 2.5 months of sales over the past two quarters. We cut our volume guidance 4% and 7% for FY13 and FY14, respectively, to factor in lower demand.

Outlook and valuations: Positive; maintain 'BUY'

We cut our FY14E earnings 6.3% to factor in slowdown in Europe and US, and lower visibility due to decline in order book. We value BKT at 9x standalone FY14E EPS of INR36.1 and arrive at target price of INR325 (INR345 earlier). We like the company's low cost business model and believe new capacity equips it to cater to a broader product spectrum. Hence, we maintain 'BUY' recommendation.

Financials (Consolidated)

(INR mn)

Year to March	Q3FY13	Q3FY12	% change	Q2FY13	% change	FY12	FY13E	FY14E
Net revenues	7,047	7,987	(11.8)	8,871	(20.6)	30,166	33,891	40,570
EBITDA	1,558	1,425	9.3	1,872	(16.8)	5,120	6,616	7,711
Reported net profit	744	729	2.1	719	3.6	2,689	3,320	3,518
Reported EPS (INR)	7.7	7.5	2.1	10.1	(23.9)	25.7	34.3	36.4
Diluted P/E (x)						9.4	7.6	7.2
EV/EBITDA (x)						6.6	6.6	5.7
ROAE (%)						27.3	26.2	22.2

* Quarterly numbers are on standalone basis

Edelweiss Research is also available on www.edelresearch.com, Bloomberg EDEL <GO>, Thomson First Call, Reuters and Factset.

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	None

MARKET DATA (R: BLK1, BO, B: BIL IN)

CMP	: INR 263
Target Price	: INR 325
52-week range (INR)	: 318 / 220
Share in issue (mn)	: 96.7
M cap (INR bn/USD mn)	: 25 / 468
Avg. Daily Vol. BSE/NSE ('000)	: 116.5

SHARE HOLDING PATTERN (%)

	Current	Q2FY13	Q1FY13
Promoters *	54.4	54.4	54.4
MF's, FI's & BKs	20.0	19.9	14.3
FII's	9.7	10.8	6.6
Others	16.0	14.9	24.7
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	(7.1)	(10.2)	(3.1)
3 months	(0.1)	1.5	1.5
12 months	1.7	11.1	9.4

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Key highlights: Q3FY13

- Q3FY13 sales volume stood at 30,125MT compared to 35,534MT in Q3FY12, down 15.2% YoY and 19% QoQ.
- Management believes BKT will be able to achieve lower end of its 140,000-145,000MT FY13 guidance.
- Raw material prices stood at USD4,100/MT in Q3FY13. Management expects raw material prices to hover around the USD3,000-3,500MT range going forward.
- BKT maintains two months' inventory at a price of INR160-165/KG (i.e., USD3,000-3,100/MT taking conversion rate of 53).
- The company's gross debt stands at INR20bn and net debt at INR17bn as on date.
- Hedged for EUR at 70-71 for net exports for next 12 months. However, entire loan book is unhedged, which will come up for repayment post 2015.
- Out of overall capex of INR18bn, INR12.8bn has been spent as on December 2012.
- Phase 1 of Bhuj capacity (10,000MT) has come on stream in Q2FY13 and management expects additional 15,000MT to be operational by FY13 and total 120,000MT will be up and running by FY15. We believe that from FY15 BKT balance sheet should start deleveraging with most of the capex in place.

Key highlights: Q2FY13

- Q2FY13 sales volume stood at 37,152MT compared to 32,439MT in Q2FY12, up 14.5% YoY and 0.4% QoQ.
- Raw material prices have softened from the peak and currently hovering around USD3,500/MT. Management expects prices to move in a narrow range going forward.
- Cost of rubber in Q2FY13 stood at USD3,300/MT. BKT currently has two months of inventory at around USD3,300-USD3400/MT.
- Hedged for EUR at 70-71 for net exports for next 12 months. However, entire loan book is unhedged, which comes up for repayment post 2015.
- Out of overall capex of INR18bn, INR10.9bn has been spent as on October 31, 2012, and balance INR3bn will be spent in FY13E and the rest in FY14E.
- Entire 12,000MT of debottlenecking has come onstream.
- Phase 1 of Bhuj capacity has come onstream and the company has started manufacturing agricultural tyres from the plant. Will manufacture OTR tyres going forward.
- BKT has further tied up for USD100mn ECB at Libor plus 320bps compared with earlier loan of USD175mn taken in Q1FY12 at Libor plus 265bps. The blended cost for USD275mn ECB stands at Libor plus 285bps.
- Plan to increase share of OEM to 20% plus over next 2 to 3 years.

Chart 1: Sales break up region wise % (Q3FY13)

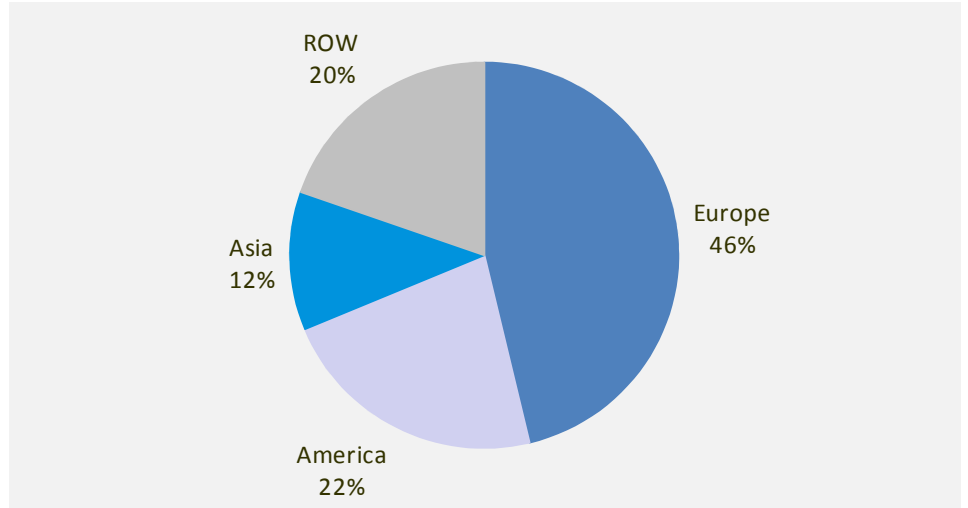


Chart 2: Sales break up usage wise % (Q3FY13)

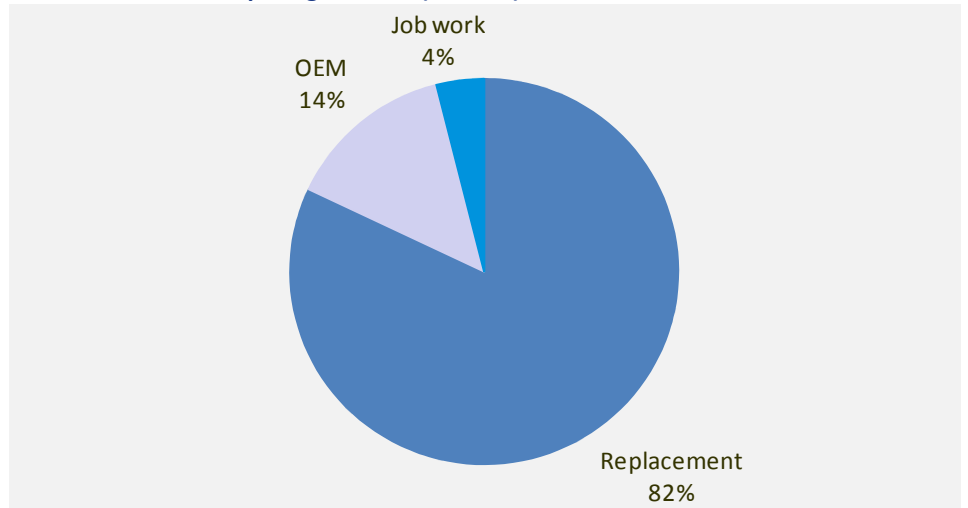
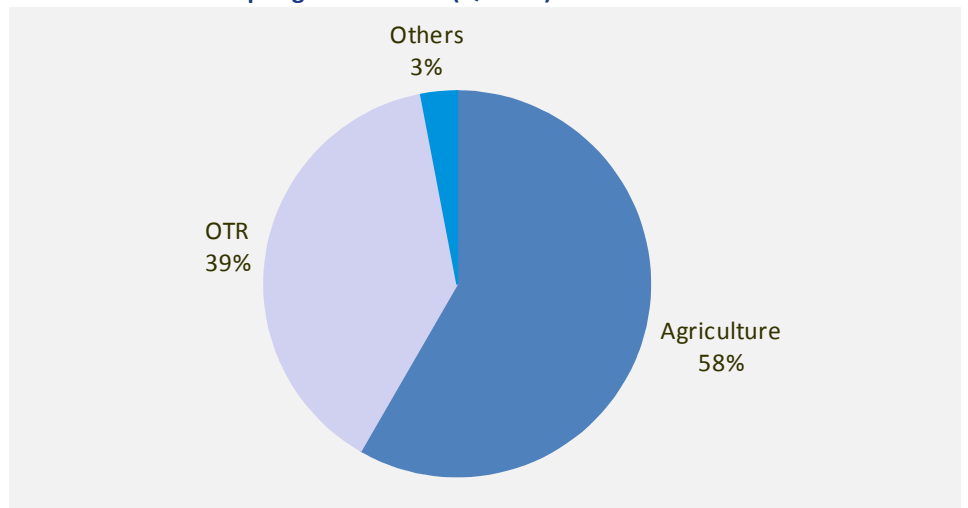
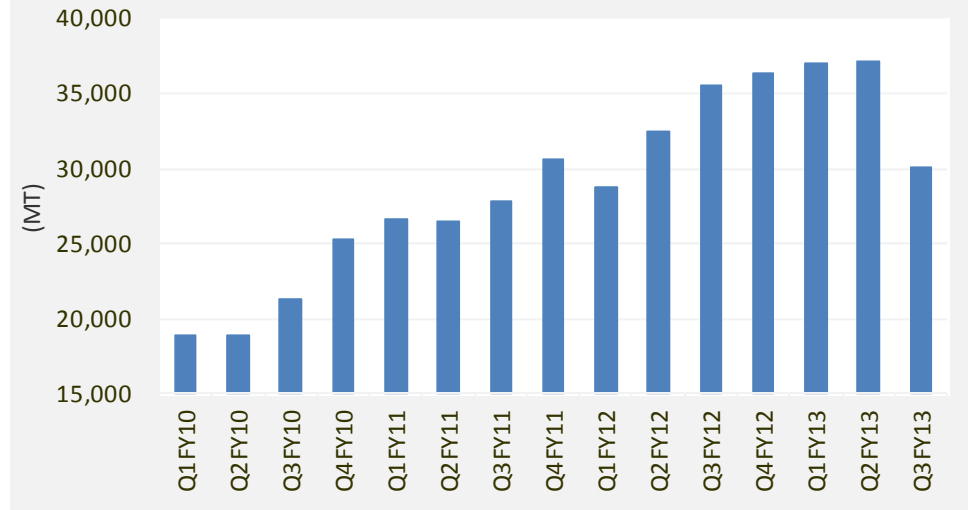


Chart 3: Sales break up segment wise % (Q3FY13)



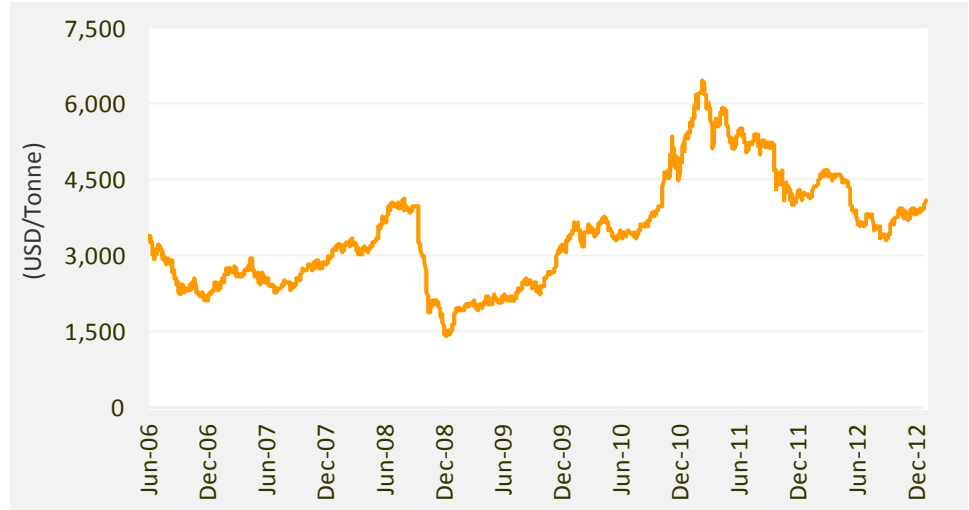
Source: Company, Edelweiss research,

Chart 4: Quarterly volume trend



Source: Company, Edelweiss research

Chart 5: International rubber prices



Source: Bloomberg, Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q3FY13	Q3FY12	% change	Q2FY13	% change	YTD13	FY13E	FY14E
Net revenues	7,047	7,987	(11.8)	8,871	(20.6)	24,231	33,891	40,570
Raw material	3,873	4,488	(13.7)	5,055	(23.4)	13,636	19,768	23,710
Staff costs	262	175	49.4	248	5.9	761	1,118	1,359
Other expenses	1,354	1,898	(28.7)	1,696	(20.1)	4,833	6,388	7,789
Total expenditure	5,489	6,562	(16.3)	6,999	(21.6)	19,230	27,275	32,859
EBITDA	1,558	1,425	9.3	1,872	(16.8)	5,001	6,616	7,711
Depreciation	272	209	30.4	254	7.2	756	1,214	1,826
Other income	4	7	(42.0)	11	(61.9)	20	50	63
Interest	43	144	(70.2)	61	(29.5)	368	498	698
Profit before tax	1,246	1,079	15.5	1,568	(20.5)	3,897	4,955	5,251
Tax	357	350	1.9	590	(39.5)	1,299	1,635	1,733
Core profit	889	729	22.0	978	(9.1)	2,598	3,320	3,518
Extraordinary items	145	-		(259)	(155.9)	(114)	-	-
PAT	744	729	2.1	719	3.6	2,484	3,320	3,518
Equity capital (FV INR 10)	193	193		193		193	193	193

As % of net revenues								
Raw material	55.0	56.2		57.0		56.3	58.3	58.4
Employee cost	3.7	2.2		2.8		3.1	3.3	3.4
Other expenses	19.2	23.8		19.1		19.9	18.9	19.2
EBITDA	22.1	17.8		21.1		20.6	19.5	19.0
Reported net profit	10.6	9.1		8.1		10.2	9.8	8.7

*Quarterly numbers are standalone numbers

Change in Estimates

	FY13E			FY14E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	33,891	35,374	(4.2)	40,570	44,749	(9.3)	Due to cut in volumes by 4% & 7% for FY13 and FY14 respectively
EBITDA	6,616	6,751	(2.0)	7,711	8,499	(9.3)	Topline line reduction impact.
EBITDA Margin	19.5	19.1		19.0	19.0		Slight improvement due to correction in rubber prices
Core profit	3,320	3,291	0.9	3,518	3,753	(6.3)	
PAT Margin	9.8	9.3		8.7	8.4		
Capex	10,233	10,233	0.0	3,450	3,450	0.0	

Company Description

BKT is the flagship company of the Siyaram Group and was incorporated in 1961. It is the holding company of Balkrishna Paper Mills, Balkrishna tyres and Balkrishna Synthetic. The company's success story began in 1995, when it entered into production of cross ply offhighway tires. Its product was instantly accepted in European and North American markets. With the help of persistent and intensive market research coupled with ever expanding production capabilities, BKT is currently one of the world's leading manufacturers of OTH tyres and boasts of a product range of more than 1,900 SKUs for agricultural, industrial, construction and earthmoving applications. The company is present in more than 120 countries and derives ~90% of its revenue through exports and has ~3.5% market share in the OHT segment

BKT is the main brand name while it sells tractor radial tyres under brand Agrimax (agriculture) and steel radial OTR tyres under the brand Earthmax (OTR segment). Its continuous focus on R&D has helped it develop over 120-150 new SKUs every year, coupled with the world's fastest turnaround time of 8-10 weeks for new product development.

Investment Theme

Balkrishna Industries (BKT) is a niche play on the off highway tyres (OHT) segment with 3.5% global market share. Given capacity constraint and robust order book, BKT has chalked out an aggressive capex plan to increase achievable capacity from 1, 44,000 MTPA to 2,76,000 MTPA, increase of ~90%. The total investment for this capacity expansion is expected to be INR18.5 bn, of which USD275mn will be funded through ECB and balance through internal accruals. The expansion will help company grow at 30% p.a. compared to industry growth of 5-6%, thereby enhancing its market share (from 3.5% to 5% by FY15E).

BKT derives 80% revenue from the replacement market wherein margins are 3-5% higher than OEMs. The company has strong global network comprising 200 distributors across 120 countries catering to the replacement market.

Key Risks

Natural and synthetic rubber is major constituent of tyres and accounts for ~50% of raw material cost. Hence, any sudden spike in rubber prices could affect the company's margin, as it may not be able to pass on the entire hike to customers.

Concentrated geographical exposure.

The company has chalked out a massive capex plan of around INR18.5bn for the next two years and hence any delay can affect the growth plans going forward.

BKT derives 90% of its revenue through exports with 47% EUR and 43% in USD, exposing it to the risk of currency fluctuation. Hence any sharp depreciation/appreciation of rupee might impact earnings.

Threat from domestic and MNC competitors.

Financial Statements

	FY12	FY13E	FY14E	FY15E
Macro				
GDP(Y-o-Y %)	6.5	5.5	6.5	7.0
Inflation (Avg)	8.8	7.8	6.0	6.0
Repo rate (exit rate)	8.5	7.5	6.8	6.0
USD/INR (Avg)	47.9	54.5	54.0	52.0
Company - Segment wise volumes				
Achievable Capacity (MT)	144,000	181,000	231,000	276,000
Sales volumes (MT)	133,040	137,420	165,920	193,740
Capacity utilisation %	92.4	75.9	71.8	70.2
Volume growth %	19.3	3.3	20.7	16.8
Realisation - Tyre (INR/Kg)	210	230	230	230
Natural rubber (INR/Kg)	186	184	184	184
Cost assumptions				
Raw Material % Revenue	60.2	58.3	58.4	58.8
Power and fuel % Revenue	4.6	4.7	5.0	5.0
Employee exp % Revenue	3.1	3.3	3.4	3.4
Other Expenses % Revenue	15.0	14.2	14.2	14.2
Financial assumptions				
Capex (INR mn)	7,049	10,233	3,450	450
Net borrowings (INR mn)	13,394	18,158	18,373	14,262
Depreciation rate %	7.4	7.0	7.0	7.0
Interest rate %	3.6	3.6	3.6	3.6
Tax rate %	32.8	33.0	33.0	33.0
Receivables (days)	50	56	55	55
Inventory (days)	93	93	85	86
Payables (days)	35	40	38	40
Cash conversion cycle (days)	108	109	102	101

Income statement		(INR mn)			
Year to March	FY12	FY13E	FY14E	FY15E	
Net revenue	30,166	33,891	40,570	47,077	
Materials costs	18,175	19,768	23,710	27,678	
Gross profit	11,992	14,123	16,860	19,399	
Employee costs	937	1,118	1,359	1,577	
Other Expenses	5,935	6,388	7,789	9,039	
Total operating expenses	25,047	27,275	32,859	38,294	
EBITDA	5,120	6,616	7,711	8,783	
Depreciation & Amortization	864	1,214	1,826	2,155	
EBIT	4,256	5,403	5,885	6,628	
Other income	40	50	63	79	
Interest expenses	292	498	698	638	
Profit before tax	4,004	4,955	5,251	6,070	
Provision for tax	1,315	1,635	1,733	2,003	
Net profit	2,689	3,320	3,518	4,067	
Shares outstanding (mn)	97	97	97	97	
Diluted EPS (INR)	27.8	34.3	36.4	42.1	
CEPS (INR)	36.8	46.9	55.3	64.4	
Dividend per share (INR)	1.5	2.0	2.4	2.4	

Common size metrics		FY12	FY13E	FY14E	FY15E
Year to March					
Operating expenses		22.8	22.1	22.6	22.6
Cost of goods sold		60.2	58.3	58.4	58.8
Interest expenditure		1.0	1.5	1.7	1.4
EBITDA margins		17.0	19.5	19.0	18.7
Net profit margins		8.9	9.8	8.7	8.6

Growth ratios (%)		FY12	FY13E	FY14E	FY15E
Year to March					
Revenues		41.5	12.3	19.7	16.0
EBITDA		73.8	29.2	16.6	13.9
Net profit		38.3	23.4	6.0	15.6
EPS		38.3	23.4	6.0	15.6

Balance sheet		(INR mn)			
As on 31st March	FY12	FY13E	FY14E	FY15E	
Equity capital	193	193	193	193	
Reserves & surplus	10,908	14,001	17,248	21,044	
Shareholders funds	11,101	14,194	17,441	21,237	
Short term debt	7,694	7,693	7,693	2,693	
Long term debt	9,398	11,898	12,898	12,898	
Borrowings	17,092	19,592	20,592	15,592	
Deferred tax liability	667	667	667	667	
Sources of funds	28,860	34,453	38,699	37,495	
Tangible assets	8,712	16,498	23,172	21,917	
Intangible assets	19	19	19	19	
CWIP (incl. intangible)	4,767	6,000	950	500	
Total net fixed assets	13,498	22,517	24,141	22,436	
Non current investments	25	25	25	25	
Current Investments	-	-	-	-	
Cash and equivalents	3,698	1,434	2,219	1,330	
Inventories	4,985	5,037	6,041	7,052	
Sundry debtors	4,900	5,571	6,558	7,610	
Loans and advances	6,015	4,278	5,077	5,258	
Other current assets	258	333	430	463	
Total current assets (ex cash)	16,159	15,219	18,106	20,383	
Trade payable	2,197	2,112	2,793	3,261	
Others current liabilities	2,323	2,630	2,998	3,418	
Total current liabilities &	4,520	4,742	5,791	6,679	
Net current assets (ex cash)	11,639	10,477	12,315	13,704	
Uses of funds	28,860	34,453	38,699	37,495	
Book value per share (INR)	114.8	146.9	180.4	219.7	

Free cash flow		(INR mn)			
Year to March	FY12	FY13E	FY14E	FY15E	
Net profit	2,689	3,320	3,518	4,067	
Depreciation	864	1,214	1,826	2,155	
Others	35	498	698	638	
Gross cash flow	3,589	5,032	6,042	6,859	
Less: Changes in WC	2,832	1,143	1,838	1,389	
Operating cash flow	757	3,888	4,204	5,470	
Less: Capex	7,029	10,233	3,450	450	
Free cash flow	(6,273)	(6,344)	754	5,020	

Cash flow metrics		FY12	FY13E	FY14E	FY15E
Year to March					
Operating cash flow		757	3,888	4,204	5,470
Investing cash flow		(6,879)	(7,928)	(3,450)	(450)
Financing cash flow		9,699	1,775	31	(5,909)
Net cash flow		3,576	(2,265)	785	(889)
Capex		(7,029)	(10,233)	(3,450)	(450)
Dividends paid		(170)	(226)	(271)	(271)

Profitability & efficiency ratios		FY12	FY13E	FY14E	FY15E
Year to March					
Gross profit margin (%)		39.8	41.7	41.6	41.2
ROAE (%)		27.3	26.2	22.2	21.0
ROA		12.1	10.5	9.6	10.7
Current ratio		4.4	3.5	3.5	3.3
Debt/EBITDA		3.3	3.0	2.7	1.8
Debt/Equity		1.5	1.4	1.2	0.7
Adjusted debt/equity		1.5	1.4	1.2	0.7
Interest coverage		14.6	10.8	8.4	10.4

Operating ratios		FY12	FY13E	FY14E	FY15E
Year to March					
Total asset turnover		1.4	1.1	1.1	1.2
Fixed asset turnover		2.8	1.9	1.7	2.0
Equity turnover		3.1	2.7	2.6	2.4

Valuation parameters		FY12	FY13E	FY14E	FY15E
Year to March					
Diluted EPS (INR)		27.8	34.3	36.4	42.1
Y-o-Y growth (%)		38.3	23.4	6.0	15.6
CEPS (INR)		36.8	46.9	55.3	64.4
Diluted PE (x)		9.4	7.6	7.2	6.2
Price/BV (x)		2.3	1.8	1.5	1.2
EV/Sales (x)		1.3	1.3	1.1	0.8
EV/EBITDA (x)		7.6	6.6	5.7	4.5
Dividend yield (%)		0.6	0.8	0.9	0.9

Peer comparison valuation

Name	Market cap (USD mn)	Diluted PE (X)		Price/BV (X)		ROAE (%)	
		FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Balkrishna Industries	467	7.6	7.2	1.8	1.5	26.2	22.2
Apollo Tyres	800	7.2	6.3	1.3	1.1	19.4	18.5
MRF	962	8.5	7.3	1.7	1.5	19.5	18.2
Goodyear	3460	6.6	5.5	4.6	2.4	61.0	59.0
AVERAGE		7.5	6.6	2.3	1.6	31.5	29.5

Source: Edelweiss research

Additional Data

Directors Data

Arvind Poddar	Managing Director	Rameshkumar Poddar	Non Independent - Non-Executive Director
Sachin Nath Chaturvedi	Non Independent - Non-Executive Director	Khurshed Doongaji	Non Independent - Non-Executive Director
Sanjay Asher	Non Independent - Non-Executive Director	Subhash Chand Mantri	Non Independent - Non-Executive Director
Ashok Saraf	Non Independent - Non-Executive Director	Laxmidas Merchant	Non Independent - Non-Executive Director
Anurag Poddar	Executive Director	Rajiv Poddar	Executive Director

Auditors - M/s. Jayantilal Thakkar & Co

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
HDFC Asset Management	9.42	Credit Suisse /Singapore	1.20
SBI Funds Management	1.95	PICTET & CIE	0.87
Prudential ICICI Asset Management	4.57	TATA Assets Mgmt.	0.84
Templeton Asset Mgmt	2.17	BNP Paribus Asset Mgmt.	0.29
Franklin Resources	1.61	BNP Paribas INV part	1.24

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
28 Jun 2012	Templeton Mutual Fund A/C Franklin India Flexicap Fund	Buy	600000	240.00
28 Jun 2012	Sbi Mutual Fund A/C Msfu-Ebf-81	Buy	1153081	240.00
28 Jun 2012	Reliance Capital Trustee Co Ltd A/C Reliance Long Term Equit	Buy	500000	240.00
28 Jun 2012	Prudential Icici Trust A/C-Icici Prudential Dynamic Plan	Buy	1250000	240.00
28 Jun 2012	Franklin Templeton Investment Funds	Buy	1270000	240.00
28 Jun 2012	Copa Cabana	Sell	9015516	240.03

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
30 Mar 2012	Vinod Kumar Poddar	Sell	67500.00
30 Mar 2012	Rajiv A Poddar	Buy	67500.00

**in last one year*

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Coverage group(s) of stocks by primary analyst(s):

AIA Engineering, Balkrishna Industries, Supreme Industries, Sintex Industries Ltd, Solar Industries, VIP Industries

Recent Research

Date	Company	Title	Price (INR)	Recos
13-Feb-13	AIA Engineering	Treading the right path; <i>Result Update</i>	328	Hold
08-Feb-13	VIP Industries	Lower CSD sales sting top line; <i>Result Update</i>	79	Hold
07-Feb-13	Solar Industries	Sluggish exports trip sales; <i>Result Update</i>	1069	Hold

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	118	46	17	181
* - stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	117	57	7	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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