

Subdued performance, margin recovery on the anvil...

Balkrishna Industries (BIL) reported a disappointing set of Q1FY20 numbers. Standalone revenue at ₹ 1,194 crore was down 12.4% YoY, led by 9.6% drop in volumes to 51,304 MT. EBITDA margins at 22.4% declined 125 bps QoQ tracking an increase in employee costs and other expenses as a percentage of sales. Consequent PAT came in at ₹ 176.0 crore (down 23.6% YoY). BIL declared an interim dividend of ₹ 2/share and announced an abeyance of greenfield US capex amounting to US\$100 million (20,000 MT per annum) on account of the muted overseas demand scenario.

Demand concerns persist, volumes seen tapering!

BIL is an export-oriented player with a niche presence in the off-highway tyre (OHT) segment, deriving ~49% revenues from Europe, ~17% from US, ~22% from India and the rest from other countries including Australia and New Zealand. Agriculture and industry, mining & construction form the two major end user segments, with volume growth outlook for the company tied to global agriculture and economic growth prospects. With the emergence of irregular weather patterns in key Europe markets and slowing global economic activity (marred by ongoing tariff war concerns), BIL's FY19 volume growth was at 6% YoY vs. 16% YoY each in FY17 & FY18. The management remains hopeful of posting 3-5% volume growth in FY20E. However, 9.6% YoY decline in Q1FY20 showcase the challenges ahead. Given the continued muted global trade sentiment, we believe the company would clock modest 2.2% volume CAGR to 2.2 lakh MT over FY19-21E.

Capex abeyance to shore up return ratios!

BIL had earlier outlined plans of setting up a greenfield manufacturing facility in the US for 20,000 MT per annum at a cost of up to US\$100 million. However, it has now decided to keep in abeyance the capex citing business uncertainties brought on by difficult macroeconomic conditions and volatile climate patterns. We view this development positively, as the expansion marked a departure from BIL's traditional strength (harnessing cost arbitrage to address niche export markets) and would have strained its healthy return ratios in initial years. The deferral removes this short-term overhang, with the rest of the planned capex (~₹ 1,150 crore) remaining on track.

Valuation & Outlook

We expect sales, EBITDA and PAT to grow at 0.6%, 2.6% & 4.2% CAGR, respectively, in FY19-21E. Deferral of capex, while a prudent step by the management, highlights the demand challenges faced by BIL in the overseas markets. Growth challenges look set to stay for the medium term. We value the company at 16x its FY21E EPS of ₹ 43.9 to arrive at a target price of ₹ 700 per share. We maintain our **HOLD** rating on the stock.



Particulars

Particular	Amount
Market Capitalization	₹ 14208.8 Crore
Total Debt (FY19) (₹ Crore)	829.6
Cash & Investments (FY19) (₹ Crore)	819.4
EV (₹ Crore)	14,219.1
52 week H/L (₹)	1467 / 691
Equity capital (₹ crore) (FY19)	₹ 38.7 Crore
Face value (₹)	₹ 2

Key Highlights

- A 9.6% volume drop leads to 12.4% decline in revenues in Q1FY20
- Margins at 22.4% lowest in eight quarters, hurt by negative operating leverage
- Management maintains 3-5% volume growth guidance for FY20E and announces abeyance on US greenfield capex of US\$100 million
- Demand prospects remain muted, but subdued raw material prices as well as backward integration would aid margin recovery
- Maintain HOLD with revised target price of ₹ 700/share; valuing at 16x P/E on FY21E EPS of ₹ 43.9/share

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Key Financial Summary

Key Financials	FY17	FY18	FY19	FY20E	FY21E	CAGR (FY19-21E)
Net Sales	3,788.3	4,464.5	5,244.5	4,962.2	5,306.3	0.6%
EBITDA	1,131.9	1,106.7	1,311.1	1,230.0	1,381.1	2.6%
EBITDA Margins (%)	29.9	24.8	25.0	24.8	26.0	
Net Profit	715.1	739.3	782.0	765.1	848.4	4.2%
EPS (₹)	37.0	38.2	40.5	39.6	43.9	
P/E	19.9	19.2	18.2	18.6	16.7	
RoNW (%)	20.2	18.1	16.7	14.6	14.3	
RoCE (%)	23.0	21.5	20.4	18.6	19.3	

Source: ICICI Direct Research, Company

Exhibit 1: Variance Analysis

	Q1FY20	Q1FY20E	Q1FY19	YoY (%)	Q4FY19	QoQ (%)	Comments
Total Operating Income	1,193.5	1,403.7	1,362.4	-12.4	1,351.0	-11.7	Revenue drop led by 9.6% volume decline to 51,304 MT
Raw Material Expenses	575.0	692.2	638.2	-9.9	659.5	-12.8	
Employee Expenses	69.6	70.2	68.1	2.2	59.4	17.0	
Other expenses	281.1	318.7	298.5	-5.8	312.1	-9.9	
EBITDA	267.8	322.8	357.6	-25.1	320.0	-16.3	
EBITDA Margin (%)	22.4	23.0	26.2	-381 bps	23.7	-125 bps	Margin performance hurt by negative operating leverage, with overheads (staff costs and other expenses) both increasing as percentage of sales. Raw material cost benefit did not accrue to the extent expected despite currency tailwinds. Resulting margins were worst in eight quarters
Other Income	71.6	50.0	82.2	-12.9	40.2	78.3	
Depreciation	84.1	96.4	84.1	0.0	82.3	2.2	
Interest	1.8	3.5	3.3	-46.1	2.0	-11.8	
Tax	77.6	92.8	122.2	-36.5	91.1	-14.9	
PAT	176.0	180.1	230.3	-23.6	184.7	-4.7	PAT largely in line with estimates despite negative beat on topline and margins on account of lower than anticipated tax & depreciation and higher than anticipated other income
EPS	9.1	9.3	11.9	-23.6	9.6	-4.7	
Key Metrics							
Volume (MT)	51,304	57,322	56,754	-9.6	55,388	-7.4	
Realization (per/kg)	232.6	244.9	240.1	-3.1	243.9	-4.6	ASPs dragged by volume disappointment
RM/Sales	48.2	45.0	46.8	133 bps	48.8	-64 bps	
Gross Margin	51.8	55.0	53.2	-1.33	51.2	0.64	
Employee Expenses	5.8	5.3	5.0	0.83	4.4	1.43	
Other expenses	23.6	23.7	21.9	1.65	23.1	0.45	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY20E			FY21E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	5,527	4,962	-10.2	6,100	5,306	-13.0	Ongoing tough demand conditions prompt us to cut our outlook on volume and topline front
EBITDA	1,480	1,230	-16.9	1,714	1,381	-19.4	
EBITDA Margin (%)	26.8	24.8	-199 bps	28.1	26.0	-207 bps	Pricing scenario expected to remain competitive, negative operating leverage seen hurting margins. We build in some recovery in FY21E as backward integration benefits accrue
PAT	779	765	-1.8	888	848	-4.5	
EPS (₹)	40.3	39.6	-1.8	45.9	43.9	-4.4	

Source: Company, ICICI Direct Research

Exhibit 3: Assumptions

	Current		Earlier		Current		Comments
	FY18	FY19P	FY20E	FY20E	FY21E	FY21E	
Capacity (MT)	300,000	300,000	300,000	300,000	300,000	300,000	
Sales volume (MT)	199,213	211,261	211,221	221,042	220,822	235,784	Build in 0.6% CAGR in sales over FY19-21
Average realisation (₹/kg)	222	246	233	248	239	257	Muted volume offtake to affect ASPs amid low pricing power
Depreciation	311	333	362	387	409	427	

Source: Company, ICICI Direct Research

Conference Call Highlights

Management outlook/guidance and demand

- According to BIL, the market conditions remain challenging. However, it reiterated FY20E volume growth guidance of 3-5%, hopeful of pent up demand in H2FY20E as channel inventory normalises (currently ~50% of normal levels)
- Q1FY20 volume de-growth of 9.6% was against the backdrop of 25-30% decline at the industry level. The company largely protected volumes in the US and remains hopeful of outperforming industry, going ahead
- Decision on abeyance of US capex was undertaken in view of tough business conditions. The management does not envision capex coming back to be on the anvil in the foreseeable future. It indicated that BIL would continue serving US-based clients from India
- The management reiterated its confidence in BIL's core competitive advantages (staff costs at 5-6% of sales vs. ~27% at peers and distribution costs at 4-5% of sales vs. ~16% at peers) persisting, going ahead

Sales, costs and margins

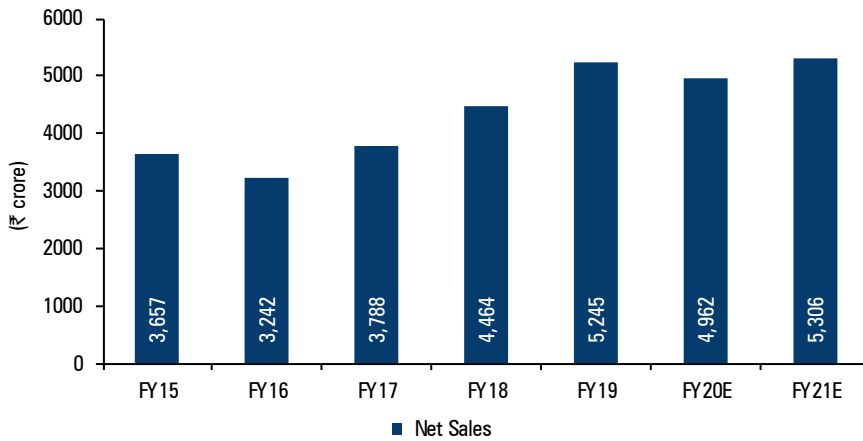
- BIL expects to realise accelerated benefits on the input cost front in coming quarters given a slide in crude and rubber prices, with these commodity tailwinds benefitting margins
- Benefit of carbon black plant – phase 1 commercial production commencement is seen accruing from Q2FY20E onwards
- Ramp up of large sized mining tyres (~₹ 350 crore of total Bhuj plant capex) would further aid margins as product mix improves
- ASPs were down during Q1FY20 largely on account of unfavourable currency movement (Euro realisation at 78 vs. ~81 earlier) and pass through of softer raw material prices. (raw material cost = ₹ 111/kg)

Others

- Capex guidance (including maintenance capex) for FY20E & FY21E was at ₹ 600 crore and ₹ 500-550 crore, respectively
- OTR : agri : others mix for the quarter was at 36:60:4, with OTR volumes having risen 10% YoY (largely from mining applications)
- In terms of geographies, Europe accounted for 49% of revenues with US and India forming 17% and 22%, respectively
- OEM: replacement mix was at 27:71

Financial story in charts

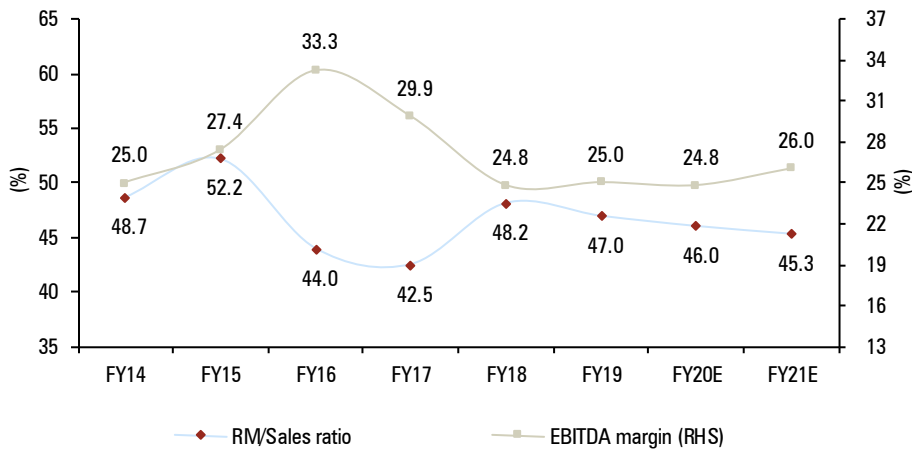
Exhibit 4: Top line trend



We expect sales to grow at a CAGR of 0.6% over FY19-21E led by 2.2% CAGR volume growth during this time

Source: Company, ICICI Direct Research

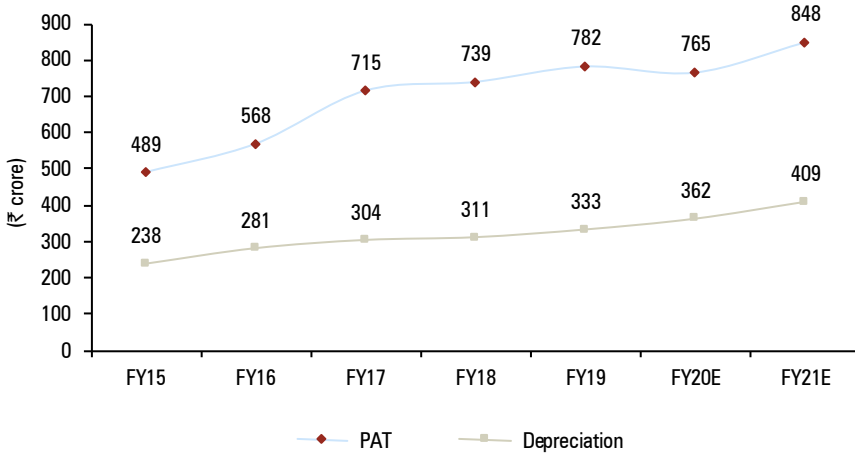
Exhibit 5: Input costs and EBITDA margin trend



EBITDA margins are expected to dip in FY20E to 24.8% and thereafter stage a recovery towards 26.0% in FY21E on the back of benign raw material costs and benefits from backward integration

Source: Company, ICICI Direct Research

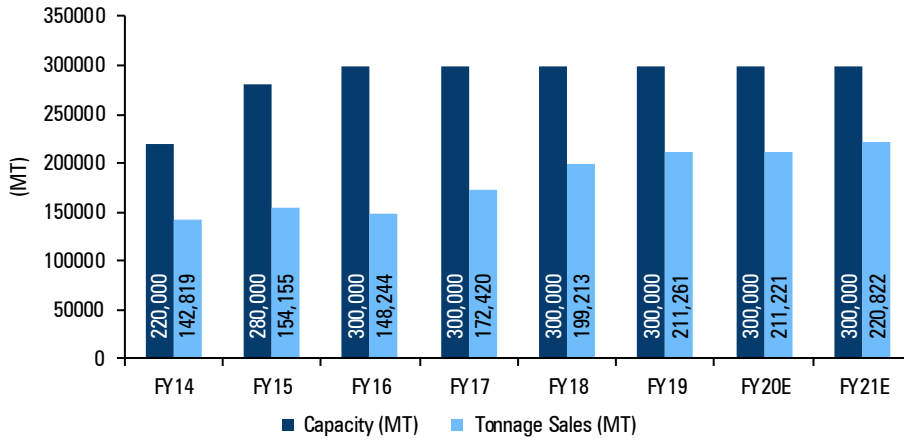
Exhibit 6: Profitability trend



We expect PAT to grow at 4.2% CAGR over FY19-21E to ₹ 848 crore

Source: Company, ICICI Direct Research

Exhibit 7: Capacity and utilisation levels



We expect volumes to grow at 2.2% CAGR over FY19-21E to 2.2 lakh MT

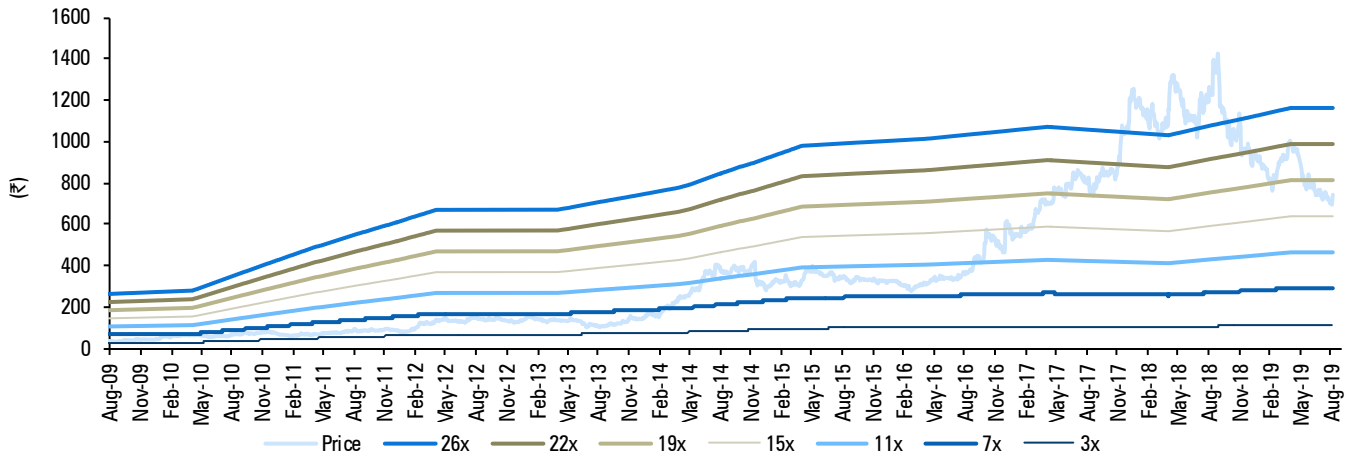
Source: Company, ICICI Direct Research

Exhibit 8: Valuation Summary

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY17	3,788	16.9	37.0	26.0	19.9	12.8	20.2	23.0
FY18	4,464	17.8	38.2	3.4	19.2	12.8	18.1	21.5
FY19	5,245	17.5	40.5	5.8	18.2	10.8	16.7	20.4
FY20E	4,962	(5.4)	39.6	(2.2)	18.6	11.3	14.6	18.6
FY21E	5,306	6.9	43.9	10.9	16.7	9.8	14.3	19.3

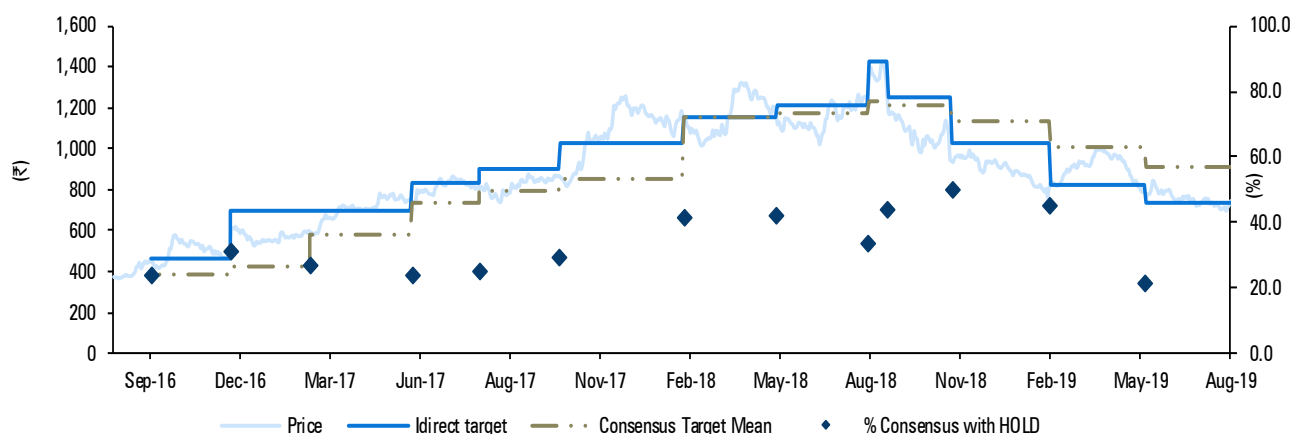
Source: Bloomberg, ICICI Direct Research

Exhibit 9: Currently trading at ~16.7x FY21E EPS, above its long term average multiple



Source: Reuters, ICICI Direct Research

Exhibit 10: Recommendation history vs. consensus



Source: Reuters, ICICI Direct Research

Exhibit 11: Top 10 shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	Poddar (Rajiv Arvindkumar)	30-Jun-19	27.7	53.6	0.00
2	VKP Enterprises, L.L.P.	30-Jun-19	25.0	48.2	0.00
3	HDFC Asset Management Co., Ltd.	30-Jun-19	7.4	14.3	0.00
4	Poddar (Khushboo Rajiv)	30-Jun-19	3.9	7.6	0.00
5	Amansa Capital Pte Ltd.	30-Jun-19	1.7	3.4	0.01
6	Norges Bank Investment Management (NBIM)	30-Jun-19	1.5	3.0	0.00
7	HDFC Life Insurance Company Limited	30-Jun-19	1.5	3.0	0.16
8	Poddar (Rishabh Sureshkumar)	30-Jun-19	1.4	2.8	0.00
9	Mirae Asset Global Investments (India) Pvt. Ltd.	31-Mar-19	1.2	2.3	0.00
10	UTI Asset Management Co. Ltd.	30-Jun-19	1.1	2.1	-0.29

Source: Reuters, ICICI Direct Research

Exhibit 12: Recent activity

Buys			Sells		
Investor name	Value (\$mn)	Shares(mn)	Investor name	Value (\$mn)	Shares(mn)
HDFC Life Insurance Company Limited	1.76	0.16	American Century Investment Management, Inc.	-19.54	-1.36
Reliance Nippon Life Asset Management Limited	0.56	0.05	Florida State Board of Administration	-4.28	-0.30
PPFAS Asset Management Private Limited	0.22	0.02	UTI Asset Management Co. Ltd.	-3.20	-0.29
BlackRock Institutional Trust Company, N.A.	0.16	0.02	Invesco Asset Management (India) Private Limited	-2.94	-0.27
DSP Investment Managers Pvt. Ltd.	0.14	0.01	IDFC Asset Management Company Private Limited	-2.12	-0.19

Source: Reuters, ICICI Direct Research

Exhibit 13: Shareholding pattern

(in %)	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Promoter	58.3	58.3	58.3	58.3	58.3
FII	15.8	14.3	12.6	11.5	10.6
DII	12.5	12.9	13.6	15.0	16.0
Others	13.5	14.5	15.5	15.2	15.1

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 14: Profit and loss statement				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Total operating Income	4,464.5	5,244.5	4,962.2	5,306.3
Growth (%)	17.8	17.5	-5.4	6.9
Raw Material Expenses	2,149.9	2,462.8	2,283.5	2,403.5
Employee Expenses	248.8	263.6	282.0	295.9
Other Expenses	959.2	1,206.9	1,166.8	1,225.8
Total Operating Expenditure	3,357.8	3,933.4	3,732.2	3,925.2
EBITDA	1106.7	1311.1	1230.0	1381.1
Growth (%)	-2.2	18.5	-6.2	12.3
Depreciation	311.3	332.6	362.2	408.6
Interest	13.1	9.8	8.6	9.0
Other Income	336.2	214.2	280.3	312.2
PBT	1118.5	1183.0	1139.4	1275.8
Total Tax	379.2	401.0	374.3	427.4
Reported PAT	739.3	782.0	765.1	848.4
Growth (%)	3.4	5.8	-2.2	10.9
EPS (₹)	38.2	40.5	39.6	43.9

Source: Company, ICICI Direct Research

Exhibit 15: Cash flow statement				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Profit after Tax	739.3	782.0	765.1	848.4
Add: Depreciation	311.3	332.6	362.2	408.6
(Inc)/dec in Current Assets	-238.3	-141.3	75.6	-106.8
Inc/(dec) in CL and Provisions	-276.6	-217.4	-27.7	37.1
CF from operating activities	535.8	755.9	1175.2	1187.2
(Inc)/dec in Investments	-161.0	-143.5	-75.0	-150.0
(Inc)/dec in Fixed Assets	-277.7	-714.0	-600.0	-525.0
Others	256.1	119.5	-38.9	-113.6
CF from investing activities	-182.6	-738.0	-713.9	-788.6
Inc/(dec) in loan funds	67.7	-5.4	-250.0	-200.0
Dividend paid & dividend tax	-128.0	-186.2	-186.2	-186.2
Others	-64.8	-12.1	0.0	0.0
CF from financing activities	-125.1	-203.7	-436.2	-386.2
Net Cash flow	228.0	-185.8	25.1	12.4
Opening Cash	13.7	241.7	55.9	81.0
Closing Cash	241.7	55.9	81.0	93.5

Source: Company, ICICI Direct Research

Exhibit 16: Balance Sheet				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Liabilities				
Equity Capital	38.7	38.7	38.7	38.7
Reserve and Surplus	4,056.3	4,640.0	5,218.9	5,881.1
Total Shareholders funds	4095.0	4678.7	5257.6	5919.8
Total Debt	835.0	829.6	579.6	379.6
Deferred Tax Liability	329.0	325.5	325.5	325.5
Minority Interest / Others	0.0	0.0	0.0	0.0
Total Liabilities	5280.6	5867.5	6196.4	6658.6
Assets				
Gross Block	3,693.8	3,940.3	4,825.8	5,550.8
Less: Acc Depreciation	898.8	1,231.3	1,593.6	2,002.2
Net Block	2795.0	2709.0	3232.2	3548.6
Capital WIP	118.0	585.4	300.0	100.0
Total Fixed Assets	2,913.0	3,294.4	3,532.2	3,648.6
Investments	1,358.8	1,157.0	1,160.3	1,285.3
Inventory	594.0	713.0	679.8	726.9
Debtors	502.0	568.1	543.8	581.5
Loans and Advances	102.0	61.9	58.5	62.6
Cash	241.7	55.9	81.0	93.5
Other current assets	165.5	277.0	273.3	258.6
Total Current Assets	1,605.2	1,675.9	1,636.4	1,723.1
Creditors	397.0	356.6	339.9	363.4
Provisions	7.0	7.4	7.1	7.6
Other current liabilities	687.6	376.0	198.6	187.9
Total Current Liabilities	1,091.6	740.0	545.6	558.9
Net Current Assets	513.6	935.9	1090.8	1164.1
Others	197.2	273.5	302.9	291.7
Application of Funds	5280.6	5867.5	6196.4	6658.6

Source: Company, ICICI Direct Research

Exhibit 17: Key ratios				
(Year-end March)	FY18	FY19	FY20E	FY21E
Per share data (₹)				
EPS	38.2	40.5	39.6	43.9
Cash EPS	54.3	57.7	58.3	65.0
BV	211.8	242.0	272.0	306.2
DPS	5.5	8.0	8.0	8.0
Cash Per Share	12.5	2.9	4.2	4.8
Operating Ratios (%)				
EBITDA Margin	24.8	25.0	24.8	26.0
PBT / Net sales	17.8	18.7	17.5	18.3
PAT Margin	16.6	14.9	15.4	16.0
Inventory days	48.6	49.6	50.0	50.0
Debtor days	41.0	39.5	40.0	40.0
Creditor days	32.5	24.8	25.0	25.0
Return Ratios (%)				
RoE	18.1	16.7	14.6	14.3
RoCE	21.5	20.4	18.6	19.3
RoIC	18.3	22.9	18.1	18.4
Valuation Ratios (x)				
P/E	19.2	18.2	18.6	16.7
EV / EBITDA	12.8	10.8	11.3	9.8
EV / Net Sales	3.2	2.7	2.8	2.5
Market Cap / Sales	3.2	2.7	2.9	2.7
Price to Book Value	3.5	3.0	2.7	2.4
Solvency Ratios				
Debt/EBITDA	0.8	0.6	0.5	0.3
Debt / Equity	0.2	0.2	0.1	0.1
Current Ratio	3.7	4.4	4.4	4.4
Quick Ratio	2.2	2.5	2.5	2.5

Source: Company, ICICI Direct Research

Exhibit 18: ICICI Direct Coverage Universe (Auto & Auto Ancillary)

Sector / Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Amara Raja (AMARAJ)	628	590	Reduce	10721	28.3	31.1	33.8	22.3	20.3	18.6	11.0	9.7	8.7	21.2	21.0	20.5	14.5	14.3	14.0
Apollo Tyre (APOTYR)	161	145	Hold	9181	11.9	14.8	16.2	12.6	10.1	9.3	6.8	6.8	6.4	8.0	7.7	8.2	8.3	8.0	8.2
Ashok Leyland (ASHLEY)	62	70	Hold	18332	6.8	5.3	5.5	9.2	11.8	11.3	6.1	6.6	6.2	26.9	23.1	22.7	24.3	17.4	16.7
Bajaj Auto (BAAUTO)	2721	2360	Reduce	78735	161.6	160.5	168.7	15.4	15.5	14.8	11.0	10.3	9.4	21.0	19.2	25.3	19.9	19.1	18.1
Balkrishna Ind. (BALIND)	735	700	Hold	14209	40.5	39.6	43.9	18.2	18.6	16.7	10.8	11.3	9.8	20.4	18.6	19.3	16.7	18.6	19.3
Bharat Forge (BHAFOR)	394	535	Buy	32590	22.2	23.8	25.4	21.0	19.5	18.3	11.9	11.0	10.3	18.4	18.5	19.1	19.1	17.9	17.5
Bosch (MICO)	13308	15550	Reduce	40618	523.6	538.6	573.1	32.5	31.6	29.7	23.3	22.0	20.5	17.5	15.9	15.0	25.8	23.5	22.3
Eicher Motors (EICMOT)	16708	15875	Hold	45546	808.1	821.9	903.2	20.2	19.9	18.1	14.3	13.6	11.7	32.5	27.7	26.1	24.8	20.8	19.4
Escorts (ESCORT)	466	430	Reduce	4138	54.6	47.3	53.4	8.5	9.8	8.6	5.1	4.9	4.2	21.6	18.0	18.0	15.6	12.3	12.3
Exide Industries (EXIIND)	180	205	Hold	15258	9.1	11.2	12.4	18.1	16.1	14.6	10.6	8.5	7.6	18.4	20.9	20.9	12.9	14.2	14.2
Hero Moto (HERHON)	2626	2200	Hold	52449	169.5	187.4	175.5	13.6	12.3	13.1	8.4	8.2	7.4	37.1	32.0	31.5	26.3	22.5	22.1
JK Tyre & Ind (JKIND)	55	60	Hold	1253	7.8	3.4	9.1	7.3	16.8	6.3	6.3	6.8	5.6	10.2	7.9	10.1	10.3	3.5	8.9
Mahindra & Mahindra (MAHMAH)	520	570	Hold	64646	38.6	44.4	31.8	13.5	11.7	16.4	9.1	8.5	8.6	17.3	14.7	13.2	14.1	11.7	9.6
Mahindra CIE (MAHAUT)	155	230	Buy	5877	13.2	14.1	17.1	14.8	13.8	11.4	7.8	7.8	6.4	12.4	11.1	11.9	13.2	12.6	14.2
Maruti Suzuki (MARUTI)	5841	5000	Reduce	176445	248.3	221.2	250.0	22.8	25.5	22.6	12.3	13.6	11.6	16.3	12.0	13.0	16.3	13.4	13.9
Motherson (MOTSUM)	99	100	Hold	31311	5.1	4.6	5.6	20.6	22.6	18.8	7.7	7.5	6.1	13.2	11.7	14.6	14.7	12.4	13.7
Tata Motors (TELCO)	122	160	Hold	50934	-84.6	9.3	21.4	-1.8	16.1	7.0	3.9	3.6	3.1	5.4	9.1	11.3	7.1	9.8	15.4
Wabco India (WABTVS)	6086	6510	Hold	11544	148.8	157.7	178.3	41.7	39.3	34.8	26.6	24.5	21.5	15.9	14.5	14.3	23.0	21.4	21.0

Source: Reuters, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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