

Balkrishna Industries (BIL IN)

Target Price **Rs1,006**
 Current Price **Rs1,174**
 % Downside **14%**

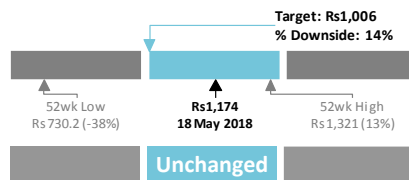
The Scoop: Positives Fully Priced In

Automobiles & Components

India

21 May 2018

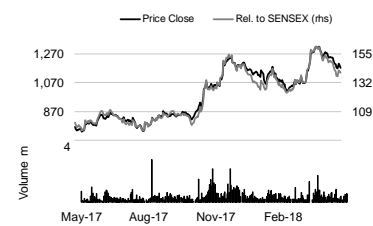
NEUTRAL



Basic Share Information

Market cap	Rs226.9b / US\$3.34b
Daily traded value (3mth)	US\$7.75m
Shares outstanding	193.3m
Free float	41.7%
Net debt-to-equity	14.5%
1 yr high	Rs1,321
1 yr low	Rs730.2
Foreign shareholding	17.6%
Share price date	18 May 2018

Price/Volume



Source: Bloomberg

	1mth	3mth	12mth
Absolute	-10.2%	4.3%	54%
Absolute USD	-13.3%	-1.5%	46.8%
Relative to SENSEX	-11.7%	1.8%	39.5%



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What event has happened?

Balkrishna Industries' (BIL IN; BKT) Q4 FY3/18 net earnings at Rs1.9bn were in line with our estimates. However, while revenue growth was ahead of our estimates, EBITDA margins were lower than our expectations.

Why is it significant?

In Q4, BKT posted an impressive 17% YoY volume growth (+9% QoQ) and comfortably beat its full year volume guidance by achieving 199,213 metric ton (versus guidance of 190-195k metric ton for FY3/18). However, EBITDA margin of 28.4% for Q4 was lower than our estimate of 30% primarily due to higher other expenses in Q4. Management indicated that barring quarterly fluctuations, other expenses should remain at these levels (20.4% of net sales for FY3/18) going forward. Further, rising input cost pressure (especially crude) continues to be a cause for concern. However, we believe the impact of these cost pressures is likely to be offset by: 1) improved volume outlook for BKT, 2) INR depreciation against Euro, which would aid improved blended average realization.

Implications for our earnings forecast?

We factor in BKT to post 12% volume CAGR over FY3/19–20. Further, for reasons highlighted above, we expect EBITDA margin to stabilize at the current level for FY3/19 and improve by 50bps in FY3/20 as its backward integration project kicks in. However, given a lower-than-expected margin in H2 and anticipated cost pressures in FY3/19 which would limit margin upside, we have now lowered our earnings estimates by 4% each over FY3/19 and FY3/20.

How do valuations look now?

Currently trading at 22x FY3/20 EPS, BKT appears fairly valued to us given our estimate of an 18% net earnings CAGR over FY3/19–20. We roll forward our target price and now value BKT at 18x June 2020 EPS of Rs56 (from earlier FY3/20), which translates to 1x PEG. We believe our target multiple for BKT at 1x PEG is justified, given long-term demand visibility, its sustainable competitive advantage over peers, its debt-free status from FY3/19 onwards, no need for capacity addition at least for next 4–5 years, strong FCF generation and improving dividend payout in the coming years (up from 17% in FY3/18 to our estimate of 20% by FY3/20). We reiterate our NEUTRAL rating on BKT but marginally raise our target price to Rs1,006 per share (earlier Rs1,001 per share). A sharp rise in input costs (especially crude) would be the main downside risk while higher demand than we currently expect from the US and Europe would be the main upside risk to our earnings.

What is distinctive about our stock view?

While BKT certainly deserves to trade at a premium over other domestic tyre peers given its unique positioning, we believe current valuation at 22x FY3/20 earnings, factors in all the positives and leaves limited upside potential.

	Mar-16A	Mar-17A	Mar-18A	Mar-19E	Mar-20E	Trend
Total turnover (Rsm)	33,374	38,724	47,095	53,920	61,455	■ ■ ■ ■ ■ ■
Operating profit (Rsm)	6,208	9,121	10,403	12,176	14,315	■ ■ ■ ■ ■ ■
Pre-tax profit (Rsm)	6,655	10,558	11,185	13,155	15,476	■ ■ ■ ■ ■ ■
Net income to ord equity (Rsm)	4,386	7,152	7,393	8,748	10,323	■ ■ ■ ■ ■ ■
Net profit growth	(10.3%)	63.1%	3.4%	18.3%	18.0%	■ ■ ■ ■ ■ ■
P/E (x)	51.74	31.73	30.69	25.94	21.98	■ ■ ■ ■ ■ ■
Adj EV/EBITDA (x)	18.46	12.20	12.70	10.97	9.28	■ ■ ■ ■ ■ ■
P/B (x)	8.16	6.39	5.54	4.72	4.03	■ ■ ■ ■ ■ ■
ROE	17.3%	22.6%	19.3%	19.7%	19.8%	■ ■ ■ ■ ■ ■
Dividend yield	0.2%	0.3%	0.5%	0.6%	0.8%	■ ■ ■ ■ ■ ■
EPS HTI old (Rs)	22.69	37.00	39.65	47.16	55.62	■ ■ ■ ■ ■ ■
EPS HTI New (Rs)	22.69	37.00	38.24	45.26	53.40	■ ■ ■ ■ ■ ■
Consensus EPS (Rs)	28.04	35.71	39.40	51.10	63.18	■ ■ ■ ■ ■ ■
HTI EPS vs Consensus	(19.1%)	3.6%	(2.9%)	(11.4%)	(15.5%)	■ ■ ■ ■ ■ ■

Source: Company data, Bloomberg, HTI estimates

Click [here](#) to download the working model

Q4 tonnage growth has been ahead of our estimate

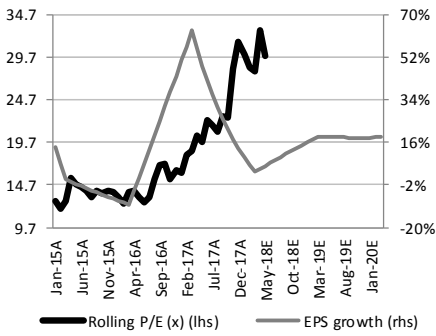
Higher than expected other expenses hurt margins QoQ

Quarterly Performance

	FY17			FY18		
	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
Mn INR						
Tonnage sold (MT)	40,415	46,149	46,327	49,331	49,553	54,002
yoy growth (%)	14.9	18.4	7.0	15.9	22.6	17.0
Average realisation (Rs / MT)	228,336	217,326	218,613	225,913	234,357	241,984
yoy growth (%)	8.6	-3.1	2.4	-0.4	2.6	11.3
Net sales	9,082	10,329	10,593	11,820	11,613	13,068
yoy (%)	20.6	1.6	8.8	24.2	27.9	26.5
Raw material cost	3,584	4,718	5,232	5,482	5,048	5,737
<i>% of sales</i>	39.5	45.7	49.4	46.4	43.5	43.9
Employee cost	562	595	587	596	615	689
<i>% of sales</i>	6.2	5.8	5.5	5.0	5.3	5.3
Other expenses	1,896	2,002	1,982	2,017	2,500	2,936
<i>% of sales</i>	20.9	19.4	18.7	17.1	21.5	22.5
Total Expenditure	6,042	7,316	7,801	8,096	8,163	9,362
EBIDTA	3,040	3,014	2,792	3,724	3,450	3,706
% of net sales	33.5	29.2	26.4	31.5	29.7	28.4
Other Income	370	157	293	150	227	87
Depreciation	788	751	755	777	799	783
EBIT	2,622	2,420	2,330	3,097	2,878	3,010
yoy growth (%)	74.1	11.2	-0.5	-8.6	9.8	24.4
Interest	49	53	51	26	19	34
PBT	2,573	2,367	2,278	3,071	2,859	2,976
% of net sales	28.3	22.9	21.5	26.0	24.6	22.8
yoy growth (%)	88.8	12.3	0.1	-8.1	11.1	25.7
Tax	718	993	747	1,042	964	1,040
Tax rate (%)	27.9	41.9	32.8	33.9	33.7	34.9
Reported PAT	1,855	1,375	1,531	2,030	1,895	1,936
yoy growth (%)	94.0	1.7	2.7	-16.6	2.1	40.8
Adjusted PAT	1,805	1,445	1,631	2,098	1,785	2,086
yoy growth (%)	213.2	-43.4	-17.2	1.2	-1.1	44.4

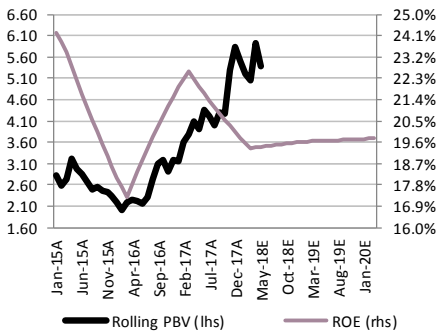
Source: Company data

P/E (x) vs EPS Growth (%)



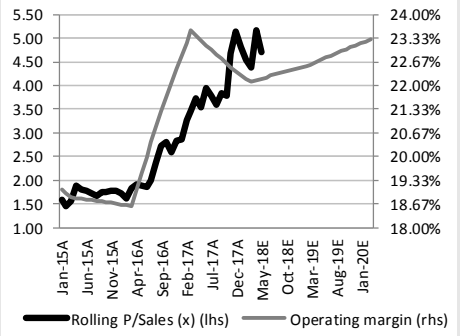
Source: Company data, Bloomberg, HTI estimates

P/B (x) vs ROE



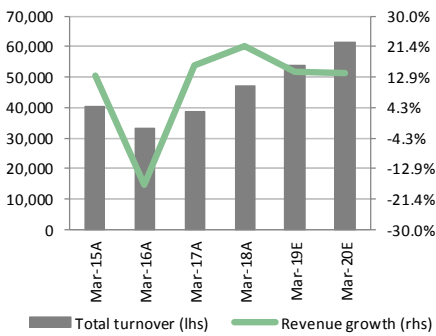
Source: Company data, Bloomberg, HTI estimates

PSR (x) vs OPM (%)



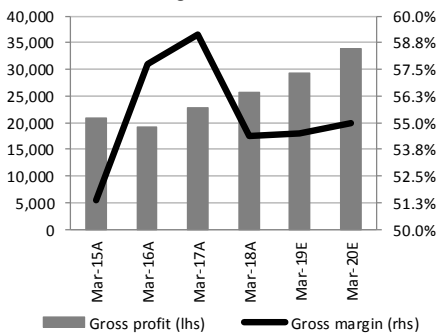
Source: Company data, Bloomberg, HTI estimates

Turnover and Growth



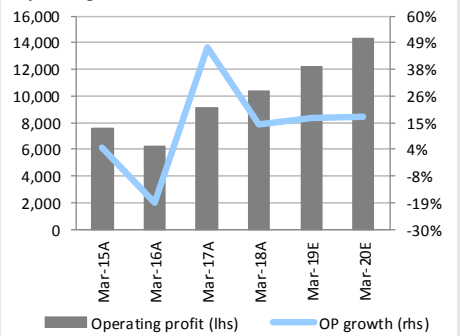
Source: Company data, Bloomberg, HTI estimates

Gross Profit and Margin



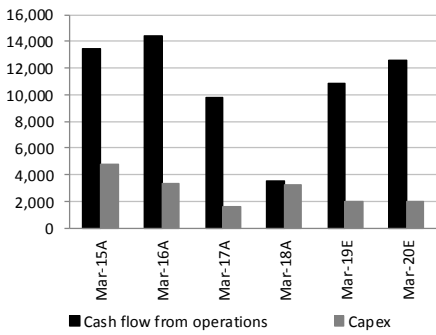
Source: Company data, Bloomberg, HTI estimates

Operating Profit and OP Growth



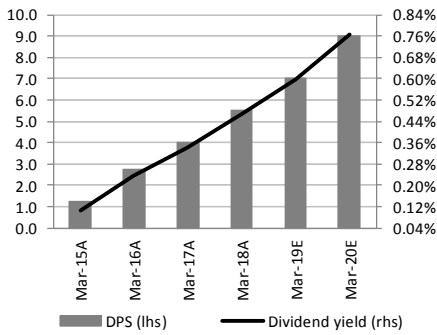
Source: Company data, Bloomberg, HTI estimates

CF from operations vs Capex (Rsm)



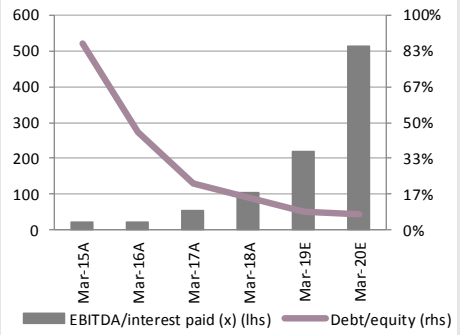
Source: Company data, Bloomberg, HTI estimates

Dividend Payout and Yield (Rs)



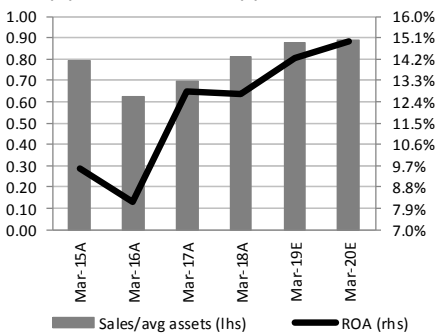
Source: Company data, Bloomberg, HTI estimates

Debt to Equity (%) and Interest Cover (x)



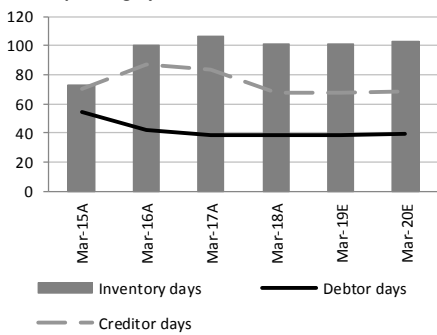
Source: Company data, Bloomberg, HTI estimates

ROA (%) and Asset Turnover (x)



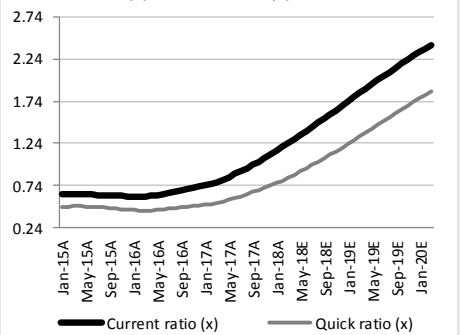
Source: Company data, Bloomberg, HTI estimates

Cash Operating Cycle



Source: Company data, Bloomberg, HTI estimates

Current Ratio (x) vs Quick Ratio (x)



Source: Company data, Bloomberg, HTI estimates

APPENDIX

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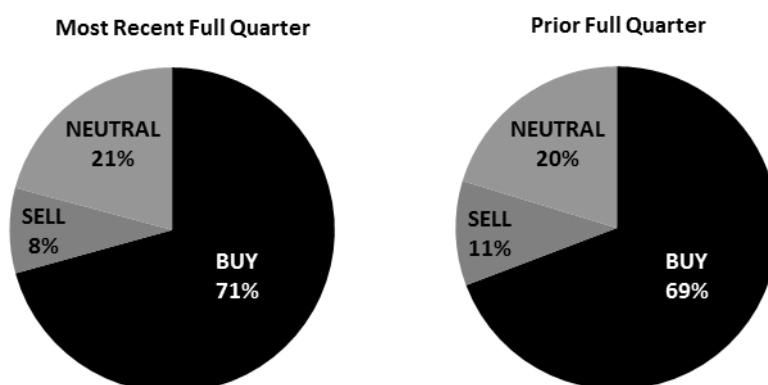
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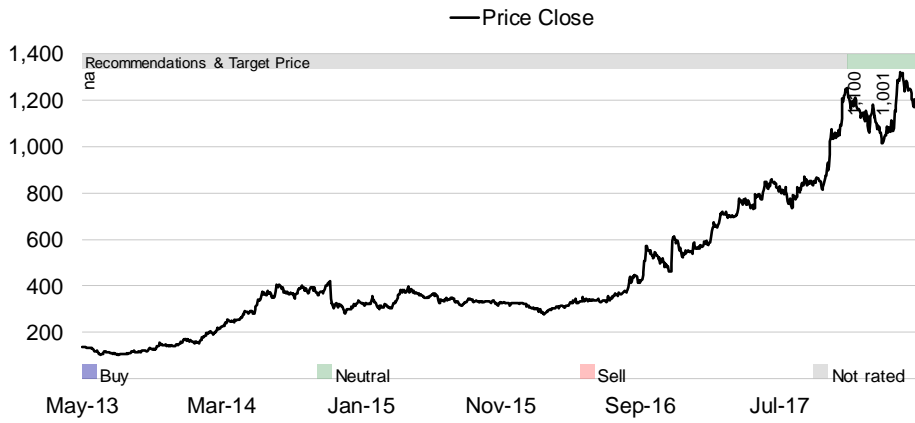
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Recommendation Chart



Date	Recommendation	Target (Rs)	Price (Rs)
2018-02-20	Neutral	1,001	1,106
2017-12-19	Neutral	1,100	1,245

Source: Company data Bloomberg, HTI estimates

Definitions for Key Investment Metrics

Business Growth

This is the metric which matches the top line in our report.

Business profit

This is the metric which best represents operating profit in our report

Shareholder Returns

Return on Equity

Balance Sheet Risk

Net Debt to Equity