



Balkrishna Industries Ltd

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Business Background

Balkrishna Industries Limited was started by Dharaprasad Poddar in 1988 and is currently one of the world's leading manufacturers of 'Off Highway Tyres under the brand name of 'BKT'. Balkrishna serves a niche segment of Agricultural, Construction, Industrial, Earth-mover and ATV tyres. Balkrishna Industries exports more than 90% of its tyres and has a presence in more than 120 countries across all the continents.

The company has 4 manufacturing facilities in India – Aurangabad (Maharashtra), Bhiwadi (Rajasthan), Chopanki (Rajasthan) and Bhuj (Gujarat). The latter is under construction (expected to be completed by the year 2016). They have an in-house mould shop in Dombivali, Maharashtra, for the designing and development of moulds requirement in the manufacture of tyres. The total production capacity as on November 2012 was 166,000 mtpa.

Balkrishna Industries is currently run by Dharaprasad's nephew, Arvind Poddar: Chairman and Managing Director of the company. Till the year 2006, the business was run by Arvind Poddar's brother in law Mr. Mahensaria. The control was passed on to the Poddar family after a power struggle. The Mahensaria family is the founder/promoter of Alliance Tyre Group.

Highlights

- Out of the total revenues of over Rs. 3000 Cr (FY-13), 63% is earned from the Agricultural segment which caters to tractors, trailers and forestry vehicles and 34% is earned from OTR (Off-the-road) segment which caters to Industrial, Construction and Earthmoving vehicles.

- Geographically, 46% over the revenue is earned from Europe, 25% from Americas, 15% from Asia Pacific and 10% from India (all of which is from the OTR segment).
- Most of the revenue (82%) is generated through aftermarket sales, whereas OEM accounts for 14%. The rest (4%) is attributed to Off-Take.
- CAGR of revenue for the past 5 years is 28% and CAGR of 5-Year Net Profit is 25%.
- Dividend yield is generally low at around 0.5% to 0.6%; mostly due to the continuous reinvestment in the business.
- Total capex expected in the next couple of years (including FY 12-13) is Rs. 1800 Cr on a net block of Rs. 873 Cr. Out of this capex, Rs. 1300 Cr has been borrowed and the rest will be funded through internal accruals.
- The main raw material is Natural Rubber, which accounts for 46% of the total raw materials costs; Synthetic Rubber (22%), Carbon Black (12%) Tyre Cord/Fabrics (9%) are the other raw materials that the company requires. 80% of the raw materials are imported.
- Balkrishna Paper Mills is a wholly-owned subsidiary of Balkrishna Industries Limited which manufactures wide variety of coated Duplex Boards in Thane, Maharashtra. It generates around 200 Cr in revenue but has a very small contribution (0.15%) to the bottom line.

Shareholding Pattern

Holder	Percentage Share
Promoters	58.3
MF and UTI	19.72
FII	10.27
Indian Public	8.19
Others	3.52

Select Financial Data

Measure	FY-13*	FY-12	FY-11	FY-10
Sales	3202	3,016	2,192	1,563
PAT	356	268	194	219
NPM(%)	11.1	8.9	8.9	14
Financial Leverage	1.51	2.8	2.5	2.5
Asset Turnover	0.85	1.1	1.1	1.1
ROE(%)	28	27	25	38
CFO(cr)	-	75	72	209
BVPS	148.5	115	89	70**
EPS	36.8	27.8	20.1	22.6

*Standalone Data (Accounts for over 94% of total sales)

**Adjusted For Splits

Risks/Negatives

- Arvind Poddar is the Managing Director of the company as well as the Chairman of the board. Hence, he has complete control over the company and there is little check on him. Furthermore, in the year 2011-2012, he received a commission of Rs. 4 Cr in cash, whereas from an investor's point of view, stock options would have been a better alternative.
- The Board currently comprises of 6 independent directors and 7 Non-independent directors.
- Increase in rubber prices can narrow the margins. However, macro research suggests oversupply of rubber which may lead to further decrease in rubber prices in near future.
- Global slowdown may keep the demand for tyres suppressed, even though the effect will on BKT will be mitigated as the company operates mainly in the replacement market and Agricultural segment, which tend to have a relatively sticky demand.
- Part of the debt (Rs. 395 Cr) taken for the capex is repayable on demand. Even though it is borrowed at a low cost of 2%, the bank can call it all back if the financial condition of the company weakens.
- The sales growth for FY-13 has been around 15%, which is lesser than the 35-40% it achieved in the previous 2 years. However, the earnings growth has been impressive even in FY2013, increasing around 30% from last year, due to the easing of rubber prices and foreign currency transactions gains.
- The company does not make as much cash as we would like: CFO has been below the Net Income for the past few years, mainly due to rising inventories and trade receivables. However, for the current year (FY-13), inventories have reduced by nearly 10% and trade receivables have increased by a mere 6%, which suggests that the quality of earnings is improving.
- Alliance Tyres is one of their competitors, led by the same Mahensaria family that once led Balkrishna Industries. Alliance has a manufacturing facility in Israel, and another one in Chennai. They are also involved in contract manufacturing from China and Taiwan. Alliance enjoys the similar benefits of low labor cost and is also export oriented. The number of SKUs is around 200 compared to BKT's 2000. However, in around 3-4 years time, Alliance may become a strong competitor. It should also be noted that BKT currently has a global market share of around 5%, and therefore, Alliance will probably not cut into BKT's current market share but into BKT's future growth rate.
- There are other competitors such as Starmaxx which sell less expensive tyres than BKT, but the quality of the tyres is inferior as well.

Valuation

The valuation takes into account the expected capex for the planned expansion in the next couple of years, the interest payment on the debt and also the principal payment of the amortizing loans taken by the company.

Allowing for a margin of safety, we believe that the intrinsic value of equity is Rs. 3246 Cr and a target price of 335 is achievable. From a current market price of 230, this represents a return of 45%.

The company is currently selling at an earnings multiple of 6.5 and a price to book value of 1.7.

Year	FY13	FY14	FY15	FY16	FY17	FY18
Sales	3,855	4,549	5,276	5,910	6,500	7,020
PAT	308	364	422	473	520	562
FCFE	-272	-106	-28	23	70	562

Investment Rationale

- Balkrishna Industries has strong fundamentals with consistently attractive ROE and margins.
- The company is one of the lowest cost producers of tyres due to the low labor cost (around 3%) compared to other international companies (20-30%). It is worth noting that tyre manufacturing is a capital and labor intensive industry.
- Balkrishna is able to price their products at 20-30% discount to that of the major tyre manufacturers and still manage an operating margin of around 20%, which happens to be 5-10% higher than its competitors. Hence the company is able to cut into the market share of the other established players and still earn higher profits.
- The promoter share has increased over the last year from 54.37% to 58.3%, which indicates their confidence in the prospects of the business. In

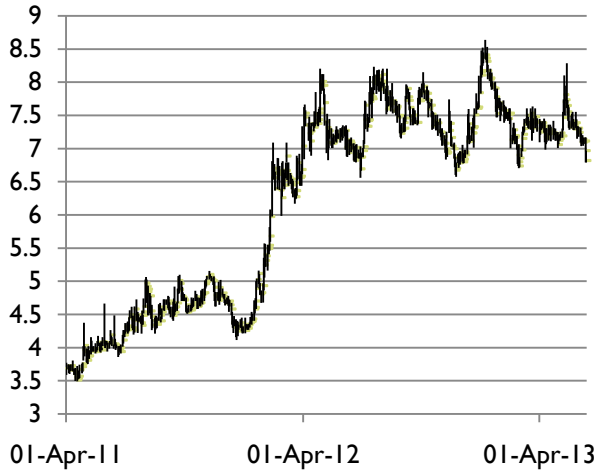
addition, the stock has been rewarding for the investors and has provided a return of over 100% in the last 2 years and over 250% return in the last 5 years.

- The company is currently building a new manufacturing facility at Bhuj, Gujarat. This addition will increase the production capacity by over 75%. Furthermore, the current expansion will consume 125 acres of the 280 acres they own. Hence, there is room for further expansion in the future which will come at cheaper costs.
- Research shows that BKT Tyres are preferred by many customers across the world in the replacement market due to the quality of the tyres at a cheaper price. They are generally categorized as “High Quality Imports” and the company has an improving brand.
- It operates in a segment which is characterized by low-volume and large-varieties market; hence there is a considerable barrier to entry as it can take a lot of time to develop the number of SKUs, in addition to the capital required. Furthermore, there has been a continuous focus on R&D and the company aims to add nearly 125 SKUs every year.

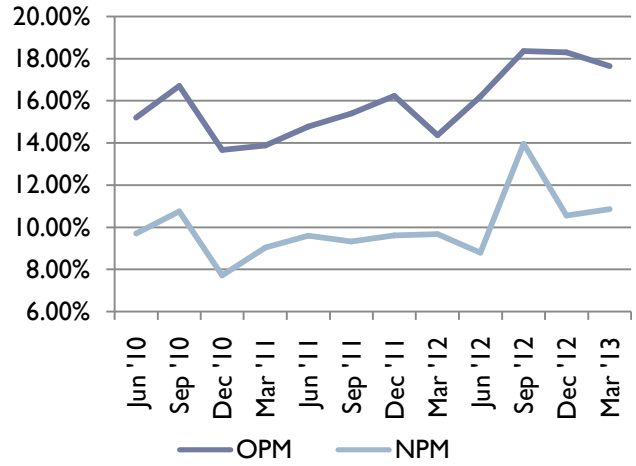
Conclusion

Balkrishna Industries has successfully gained market share from other established players for the past few years. And there is room for more of the same. Despite operating in a cyclical industry, it has managed to sustain growth by finding a niche segment for itself. Rapid expansion, for which the company has not taken excessive debt, will see around 30,000 mt capacity added in each of the next two years. As it reaches its full production capacity by FY16, there should be a gradual increase in the revenues and the profits of the company.

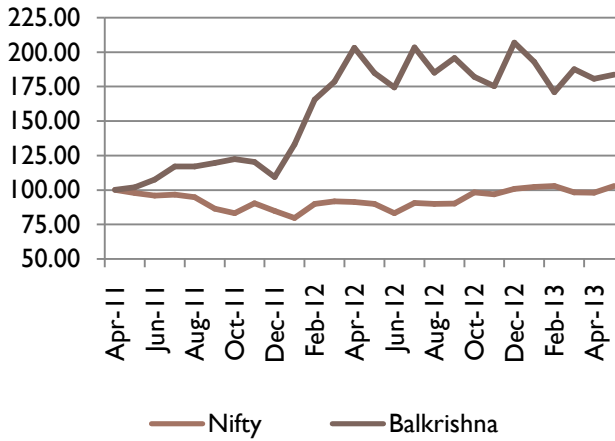
P/E Ratio Band



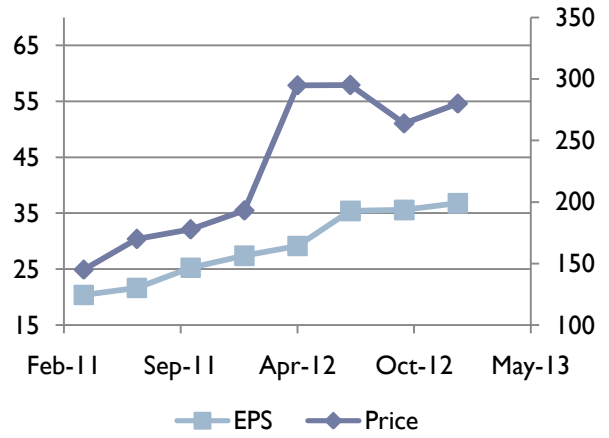
Operating and Net Profit Margins



Price Movement of Balkrishna v/s Nifty



Price Movement v/s EPS



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