ECONOMCIS TIMES N.D 16/8/18

VOLUME PUSH With 85% of revenue from overseas, a declining rupee benefits the company; hike in production guidance points to volume growth in key markets

Balkrishna to Retain Edge on Higher Volume, Rupee Fall

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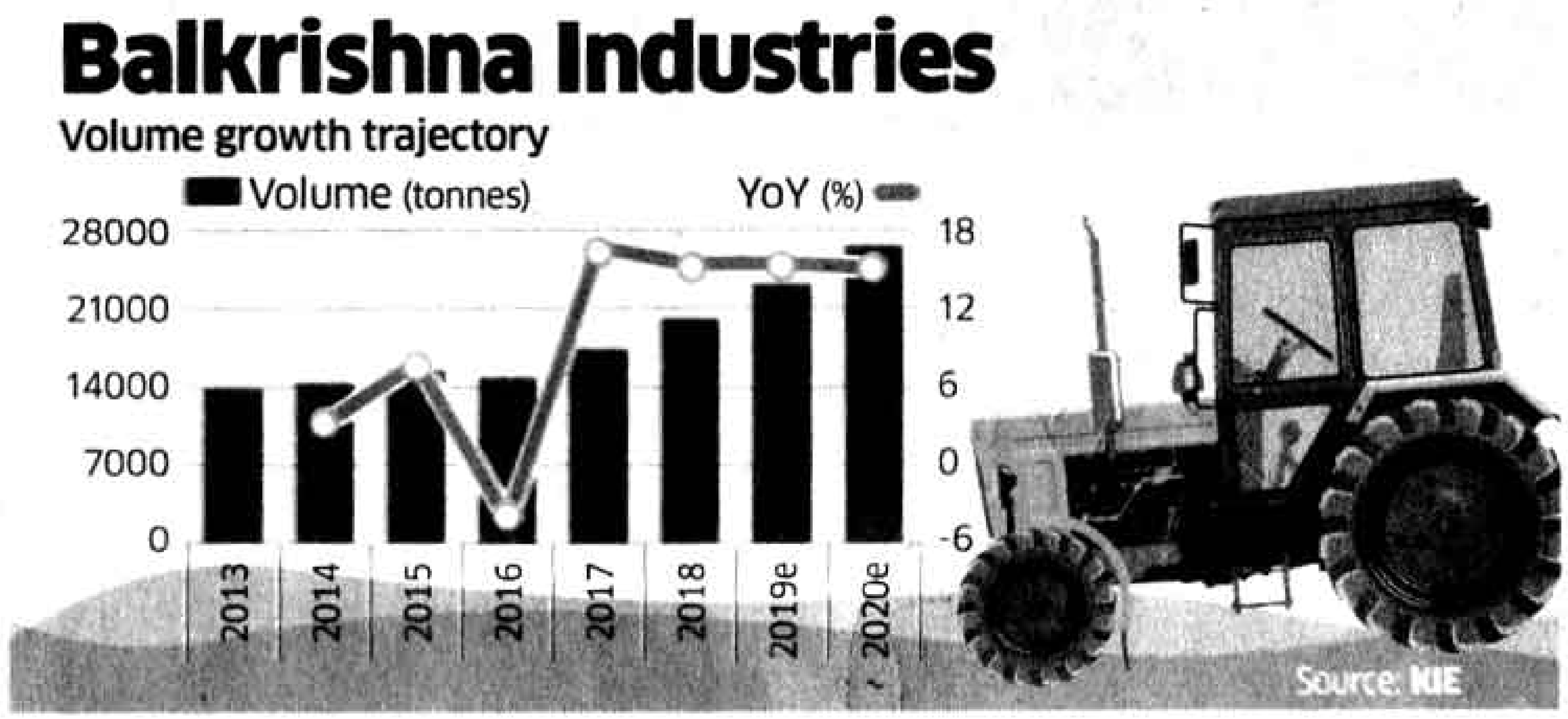
ET Intelligence Group: The premium price-earnings multiple of Balkrishna Industries, a maker of off-highway tyres (OHT) used in agriculture equipment and mining, is likely to sustain because of an upward revision in the production guidance for the current fiscal year and better realisation of its products due to rupee depreciation.

Balkrishna earns about 85% of revenue from overseas by supplying OHT to replacement markets as well as vehicle makers. Therefore, the fall in the rupee could boost projected earnings.

It has raised its production volume guidance to 225,000-230,000 tonnes after the June quarter earnings from the earlier guidance of 220,000 tonnes. The current volume guidance implies volume growth of 12-15%. Volumes grew 23% in the first quarter of the current fiscal. This means if the company maintains its current quarterly run-rate in the next three quarters, it will achieve the stated guidance.



Volume growths in the US, Europe and the local market were 64%, 11% and 30% in the June quarter. The agriculture segment volumes grew 21%, supported by improvement in demand from European vehicle makers. Volumes of off-road tyres (OTR), used in industrial applications such as mining, rose 29% after the company's higher sized mining tyres got an encouraging response overseas.

The revenue growth trajectory of the OHT segment of global players such as Michelin, Titan International and Trelleborg indicates underlying demand. Balkrishna Industries' revenue growth has been more than that of global players for the last four quarters. This suggests that the company has been able to gain market share.

The Street has been pricing in volume growth of 15% each for the current and next fiscal years. This appears plausible given the recovery in the global OHT industry, rising share of revenue from OTR and incremental revenues from leading vehicle makers where recently it becomes an approved vendor.

Besides the underlying demand for OHT tyres, the company's net realisation is likely to improve from the rupee depreciation. In the June quarter, although volume grew 23%, the net realisation rose 12.9% YoY to Rs 249 per kilogram. The growth in net realisation is the result of currency benefit and better product mix. Better realisation and volume growth expanded the company's operating margin to 29.1% in the June quarter, a gain of 500 basis points on a YoY basis.

The Street has been penciling in EBITDA margin of 30% for the next two fiscal years. Margins will be further supported after its first phase of carbon plant is commissioned at the end of the current fiscal year. The carbon black plant will backward-integrate the company's process and potentially add 100-150 basis points to operating margin.

The Stock is trading at 20 times its one year forward earnings. The valuation has been in-line with that for Indian automakers and at 18% premium to its long-term average. With two years volume visibility and stable margins in the medium term, the valuation is likely to sustain.