BOBCAPS
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FIRST LIGHT

22 January 2021

RESEARCH

Kajaria Ceramics | Target: Rs 780 | –2% | REDUCE

Margins surprise positively

Bajaj Auto | Target: Rs 2,800 | –24% | SELL

Operating performance healthy but unsustainable

JK Tyre & Industries | Target: Rs 70 | –39% | SELL

Good Q3 but rising RM cost and poor sales mix to hurt margins

SUMMARY

Kajaria Ceramics

Kajaria Ceramics (KJC) posted an above-expected Q3FY21 with 13% YoY revenue growth and volumes up 11%. EBITDA margins rose 670bps YoY to 21.7% due to lower fuel, employee and other costs, enabling EBITDA/PBT growth of 63%/89% YoY. Management expects volume growth of 20-25%/15% in FY22/FY23 with margins sustainable at 20%. We raise FY21-FY23 earnings 11-19% and roll over to a new Mar'22 TP of Rs 780 (vs. Rs 585), valuing the stock at a revised 30x P/E (vs. 28x). Retain REDUCE on limited upside.

Click here for the full report.

Bajaj Auto

Bajaj Auto's (BJAUT) Q3FY21 revenue was in line with projections. EBITDA margin at 19.4% came in ahead of our estimate due to better operating efficiencies and lower staff expense. EBITDA grew 27% YoY and adj. PAT was up 23% to Rs 15.6bn. We expect operating performance to come under pressure given steep RM cost increases coupled with a likely QoQ drop in volumes. We continue to model for a muted 2% earnings CAGR over FY20-FY23. Our Mar'22 TP stays at Rs 2,800, set at 15x one-year forward EPS. Retain SELL.

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	900
GAIL	Buy	155
Petronet LNG	Buy	330
TCS	Buy	3,710
Tech Mahindra	Buy	1,040

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	3,600
Greenply Industries	Buy	150
Laurus Labs	Buy	410
Transport Corp	Buy	300
Mahanagar Gas	Sell	750

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.08	(1bps)	13bps	(69bps)
India 10Y yield (%)	5.92	1bps	1bps	(72bps)
USD/INR	73.03	0.2	0.7	(2.6)
Brent Crude (US$/bbl)	56.08	0.3	7.3	(11.3)
Dow	31,188	0.8	3.3	6.9
Shanghai	3,583	0.5	5.5	17.1
Sensex	49,792	0.8	6.0	21.1
India FII (US$ mn)	**19 Jan**	**MTD**	**CYTD**	**FYTD**
FII-D	(25.3)	(685.7)	(685.7)	(4,779.3)
FII-E	115.8	2,562.7	2,678.4	32,654.2

Source: Bank of Baroda Economics Research

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JK Tyre & Industries

JK Tyre (JKI) surprised positively on both revenue and earnings in Q3FY21, led by strong replacement demand as well as above-expected gross margins which could stem from low-cost inventory. Revenue increased 26% YoY and operating margin expanded 700bps YoY to 18.1%. We continue to believe that rising input costs will put significant pressure on gross margins and adversely affect earnings. We retain our TP of Rs 70 based on 7x Mar'23E EPS and maintain SELL.

Click here for the full report.

REDUCE
TP: Rs 780 | ∀ 2%

KAJARIA CERAMICS | Construction Materials | 21 January 2021

Margins surprise positively

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Kajaria Ceramics (KJC) posted an above-expected Q3FY21 with 13% YoY revenue growth and volumes up 11%. EBITDA margins rose 670bps YoY to 21.7% due to lower fuel, employee and other costs, enabling EBITDA/PBT growth of 63%/89% YoY. Management expects volume growth of 20-25%/15% in FY22/FY23 with margins sustainable at 20%. We raise FY21-FY23 earnings 11-19% and roll over to a new Mar'22 TP of Rs 780(vs. Rs 585), valuing the stock at a revised 30x P/E (vs. 28x). Retain REDUCE on limited upside.

Ticker/Price	KJC IN/Rs 795
Market cap	US$ 1.7bn
Shares o/s	159mn
3M ADV	US$ 3.8mn
52wk high/low	Rs 840/Rs 296
Promoter/FPI/DII	48%/24%/29%

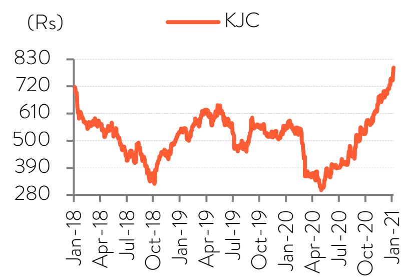
Source: NSE

Double-digit tile volume growth: KJC's Q3 revenue increased 13% YoY with tile volumes rising 10.5% YoY whereas sanitaryware & faucets grew 36%. Growth was driven primarily by tier-2-and-below cities with metros returning to 70-75% of pre-Covid sales in the quarter. Management has guided for volume growth of 20-25% in FY22 (on a low FY21 base) and thereafter 15% for the next few years.

Operating margins expand: EBITDA margins swelled 670bps YoY to 21.7% due to higher gross margins (+170bps YoY) and lower employee (–190bps) and other expenses (–315bps). EBITDA/PBT thus grew 63%/89% YoY. Management has guided for sustainable 20% operating margins backed by lower A&P cost and operating leverage benefits. We believe margins face headwinds in the near term due to rising gas prices and normalisation of other expenses such as travelling – these may be partly mitigated by operating leverage as volumes rise.

Maintain REDUCE: We raise FY21-FY23 earnings by 11-19% to factor in above-expected volume and margin guidance, while resetting our target P/E to 30x (from 28x) – in line with the 5Y average. Rolling valuations forward, we have a revised Mar'22 TP of Rs 780 (earlier Rs 585). Though we like KJC, current valuations of 30.7x FY23E EPS offer limited upside – maintain REDUCE.

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	29,562	28,080	26,594	32,220	37,095
EBITDA (Rs mn)	4,495	4,159	4,766	5,811	6,838
Adj. net profit (Rs mn)	2,314	2,553	2,770	3,470	4,121
Adj. EPS (Rs)	14.6	16.1	17.4	21.8	25.9
Adj. EPS growth (%)	(1.2)	10.3	8.5	25.3	18.8
Adj. ROAE (%)	15.8	15.5	15.9	19.1	21.6
Adj. P/E (x)	54.6	49.5	45.6	36.4	30.7
EV/EBITDA (x)	28.3	30.3	26.2	21.5	18.3

Source: Company, BOBCAPS Research

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TRUST | INNOVATION | EXCELLENCE

SELL
TP: Rs 2,800 | ∀ 24%

BAJAJ AUTO | Automobiles | 21 January 2021

Operating performance healthy but unsustainable

Bajaj Auto's (BJAUT) Q3FY21 revenue was in line with projections. EBITDA margin at 19.4% came in ahead of our estimate due to better operating efficiencies and lower staff expense. EBITDA grew 27% YoY and adj. PAT was up 23% to Rs 15.6bn. We expect operating performance to come under pressure given steep RM cost increases coupled with a likely QoQ drop in volumes. We continue to model for a muted 2% earnings CAGR over FY20-FY23. Our Mar'22 TP stays at Rs 2,800, set at 15x one-year forward EPS. Retain SELL.

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Operating performance ahead of estimates: At Rs 89.1bn, Q3 revenue grew 17% YoY, in line with our estimate. EBITDA margin at 19.4% was better than our projection of 16.7% led by operating efficiencies and lower staff costs (as a percentage of sales). EBITDA was 15% ahead of our forecast at Rs 17.3bn (+27% YoY) and adj. PAT grew 23% YoY to Rs 15.6bn.

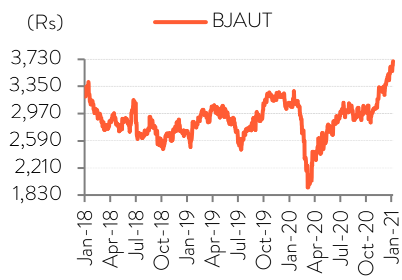
RM costs a concern: With global markets opening up, BJAUT expects steady momentum in exports going ahead. But the sharp rise in prices of key inputs such as aluminium and steel is likely to weaken gross margins by >300bps in Q4 from Q3 levels of 29.2%. The company took price hikes of ~1% in Q3 followed by a further >1% increase in 2Ws during Jan'21 to mitigate the RM cost but would require further hikes to fully pass on the impact. We believe this pass-through would lag cost pressures, undermining operating performance.

Maintain SELL: Assuming a 13% decline in FY21 sales, we project a volume CAGR of 1% for BJAUT over FY20-FY23. Operating margins are likely to come off from current levels given RM cost pressure. We build in a revenue/EBITDA/PAT CAGR of 5%/5%/2% over our forecast period and retain our Mar'22 TP of Rs 2,800, set at an unchanged 15x FY23E EPS.

Ticker/Price	BJAUT IN/Rs 3,703
Market cap	US$ 14.7bn
Shares o/s	289mn
3M ADV	US$ 37.1mn
52wk high/low	Rs 3,807/Rs 1,789
Promoter/FPI/DII	54%/14%/9%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	302,500	299,187	276,627	315,247	350,681
EBITDA (Rs mn)	49,820	50,962	47,520	52,215	58,776
Adj. net profit (Rs mn)	46,752	50,999	45,639	49,365	54,366
Adj. EPS (Rs)	152.2	176.2	157.7	170.6	187.9
Adj. EPS growth (%)	14.9	9.1	(10.5)	8.2	10.1
Adj. ROAE (%)	22.9	24.5	21.5	20.7	20.4
Adj. P/E (x)	24.3	21.0	23.5	21.7	19.7
EV/EBITDA (x)	21.4	20.7	22.4	20.1	17.7

Source: Company, BOBCAPS Research

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TRUST | INNOVATION | EXCELLENCE

SELL
TP: Rs 70 | ∀ 39%

JK TYRE & INDUSTRIES | Auto Components | 21 January 2021

Good Q3 but rising RM cost and poor sales mix to hurt margins

JK Tyre (JKI) surprised positively on both revenue and earnings in Q3FY21, led by strong replacement demand as well as above-expected gross margins which could stem from low-cost inventory. Revenue increased 26% YoY and operating margin expanded 700bps YoY to 18.1%. We continue to believe that rising input costs will put significant pressure on gross margins and adversely affect earnings. We retain our TP of Rs 70 based on 7x Mar'23E EPS and maintain SELL.

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Strong Q3: At Rs 27.7bn (+26% YoY), consolidated revenue was 15% ahead of our estimate aided by strong traction in the farm and MHCV segments. EBITDA margin surprised positively at 18.1% (11.5% expected), which we believe was due to a higher MHCV tyre sales and low-cost inventory. Adj. PAT for the quarter came in at Rs 1.9bn.

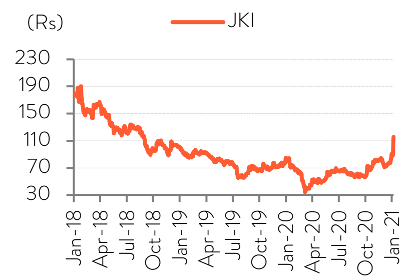
Surge in commodity prices and adverse sales mix to erode earnings: With the >30% spike in both rubber and Brent crude prices from Q2FY21 levels, we anticipate gross margin deterioration for tyre companies. Also, higher MHCV tyre sales to OEMs expected in FY22 will have an adverse impact on blended margins. To mitigate the RM cost impact, players will have to effect price hikes of over 15%, which looks difficult. We factor in ~260bps YoY contraction in JKI's FY22 gross margin, resulting in a decline in operating margin and earnings.

Maintain SELL: The company's high leverage will continue to weigh on ROE and ROCE despite strong demand. Management believes rising input costs could pressure margins. We model for EBITDA margin shrinkage to 10.2% by FY23 and project a revenue/EBITDA/adj. PAT CAGR of 15%/3%/26% over FY21-FY23. Our Mar'22 TP remains at Rs 70, set at an unchanged 7x FY23E EPS. SELL.

Ticker/Price	JKI IN/Rs 116
Market cap	US$ 390.4mn
Shares o/s	246mn
3M ADV	US$ 5.3mn
52wk high/low	Rs 125/Rs 32
Promoter/FPI/DII	56%/3%/1%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	103,699	87,249	87,018	104,012	115,118
EBITDA (Rs mn)	10,251	9,876	11,239	10,408	11,785
Adj. net profit (Rs mn)	1,706	2,472	1,718	1,376	2,367
Adj. EPS (Rs)	6.9	10.0	7.0	5.6	9.6
Adj. EPS growth (%)	137.9	44.9	(30.5)	(19.9)	72.0
Adj. ROAE (%)	7.0	10.2	6.6	5.0	8.1
Adj. P/E (x)	16.7	11.5	16.6	20.7	12.0
EV/EBITDA (x)	8.2	8.6	7.2	7.4	6.4

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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