

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.

Mayur Milak | Nishant Chowhan, CFA
 research@bobcaps.in

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.

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

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.

STOCK PERFORMANCE



Source: NSE

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.

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

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE – CONSOLIDATED

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	9MFY21	9MFY20	YoY (%)
Net Revenues	27,693	21,998	25.9	22,748	21.7	61,749	69,301	(10.9)
Total Income (A)	27,693	21,998	25.9	22,748	21.7	61,749	69,301	(10.9)
Operating Expenses:								
Raw materials consumed	15,814	13,470	17.4	13,327	18.7	36,879	43,116	(14.5)
Employee Expenses	2,656	2,377	11.7	2,154	23.3	6,563	6,892	(4.8)
Other Expenses	4,219	3,709	13.7	3,718	13.5	9,791	11,492	(14.8)
Total Expenditure (B)	22,689	19,556	16.0	19,198	18.2	53,233	61,500	(13.4)
EBITDA (A-B)	5,004	2,442	104.9	3,550	40.9	8,517	7,802	9.2
Other Income	67	73	(7.6)	117	(42.3)	257	201	28.2
Depreciation	978	928	5.4	965	1.3	2,910	2,756	5.6
EBIT	4,093	1,586	158.0	2,702	51.5	5,864	5,246	11.8
Finance Costs	1,065	1,361	(21.8)	1,235	(13.7)	3,605	4,142	(13.0)
PBT before excep items	3,028	225	1,244.5	1,467	106.4	2,258	1,104	104.5
Exceptional items	402	8	4,860.5	207	94.0	280	(448)	(162.5)
PBT after excep items	3,430	233	1,370.1	1,674	104.9	2,538	656	286.6
Tax expense	1,123	117	863.2	585	92.0	1,164	(1,303)	(189.3)
Share of Associates	(2)	(14)	-	8	-	(15)	(19)	-
Reported PAT	2,305	103	2,139.7	1,097	110.1	1,360	1,941	(30.0)
Adjusted PAT	1,903	95	1,907.2	890	113.9	1,080	2,389	(54.8)
EPS (Rs)	8.4	0.4	1,907.2	3.9	113.9	4.8	10.5	(54.8)

Source: Company, BOBCAPS Research

FIG 2 – KEY PARAMETERS

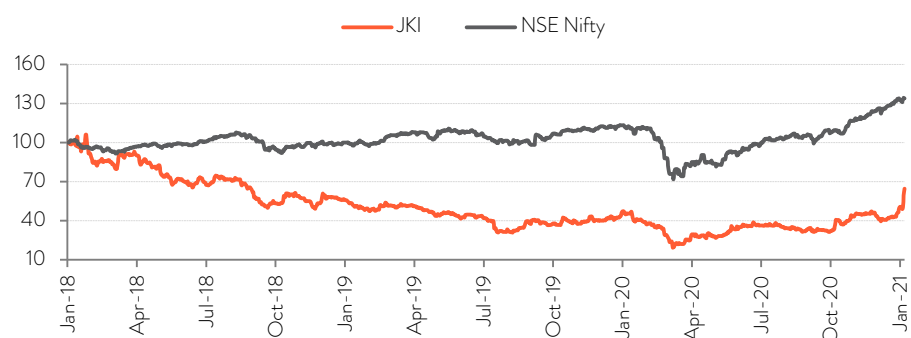
(%)	Q3FY21	Q3FY20	YoY (bps)	Q2FY21	QoQ (bps)	9MFY21	9MFY20	YoY (bps)
Gross margin	42.9	38.8	413	41.4	148	40.3	37.8	249
EBITDA margin	18.1	11.1	697	15.6	246	13.8	11.3	253
EBIT margin	14.8	7.2	757	11.9	290	9.5	7.6	193
PBT margin	10.9	1.0	991	6.4	449	3.7	1.6	206
Tax rate	32.7	50.0	(1,723)	34.9	(219)	45.9	(198.5)	24,438
Adj PAT margin	6.9	0.4	644	3.9	296	1.7	3.4	(170)

Source: Company, BOBCAPS Research

Valuation methodology

JKI'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. Maintain SELL.

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Faster growth in MHCV tyres will lend upsides to our revenue estimates.
- Softening of natural rubber or crude derivative prices will positively affect margins.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	103,699	87,249	87,018	104,012	115,118
EBITDA	10,251	9,876	11,239	10,408	11,785
Depreciation	3,157	3,778	3,867	4,023	4,199
EBIT	7,915	6,381	7,722	6,666	7,867
Net interest income/(expenses)	(5,211)	(5,490)	(4,672)	(4,826)	(4,703)
Other income/(expenses)	821	284	351	280	280
Exceptional items	231	(1,059)	280	0	0
EBT	2,936	(168)	3,330	1,840	3,164
Income taxes	942	(1,658)	1,332	464	797
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	1,937	1,413	1,998	1,376	2,367
Adjustments	(231)	1,059	(280)	0	0
Adjusted net profit	1,706	2,472	1,718	1,376	2,367

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	15,990	16,884	17,499	18,029	20,172
Other current liabilities	5,776	10,467	10,529	14,027	13,800
Provisions	223	1,196	0	0	0
Debt funds	57,575	51,241	49,241	49,241	46,741
Other liabilities	4,817	6,055	6,055	6,055	6,055
Equity capital	492	493	493	493	493
Reserves & surplus	23,713	23,768	25,628	26,812	28,847
Shareholders' fund	24,206	24,261	26,121	27,305	29,340
Total liabilities and equities	108,587	110,103	109,444	114,656	116,107
Cash and cash eq.	1,697	1,365	2,419	2,984	1,956
Accounts receivables	19,451	18,484	17,880	19,948	21,762
Inventories	16,891	16,178	15,496	17,098	17,662
Other current assets	6,419	6,025	6,437	6,839	6,939
Investments	1,312	1,402	1,402	1,402	1,402
Net fixed assets	62,276	63,888	63,020	63,997	63,798
CWIP	2,698	2,772	2,800	2,400	2,600
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(4,101)	(2,030)	(2,030)	(2,030)	(2,030)
Other assets	1,945	2,018	2,018	2,018	2,018
Total assets	108,587	110,103	109,444	114,656	116,107

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	5,093	5,191	5,865	5,400	6,565
Interest expenses	5,211	5,490	4,672	4,826	4,703
Non-cash adjustments	(821)	(284)	(351)	(280)	(280)
Changes in working capital	(2,046)	9,796	354	(43)	(562)
Other operating cash flows	(244)	0	0	0	0
Cash flow from operations	7,194	20,193	10,541	9,902	10,426
Capital expenditures	(3,621)	(5,464)	(3,028)	(4,600)	(4,200)
Change in investments	(30)	(91)	0	0	0
Other investing cash flows	763	(131)	351	280	280
Cash flow from investing	(2,888)	(5,686)	(2,677)	(4,320)	(3,920)
Equities issued/Others	1,969	0	0	0	0
Debt raised/repaid	(538)	(6,334)	(2,000)	0	(2,500)
Interest expenses	(5,211)	(5,490)	(4,672)	(4,826)	(4,703)
Dividends paid	(340)	(208)	(137)	(193)	(331)
Other financing cash flows	202	(2,806)	0	0	0
Cash flow from financing	(3,917)	(14,839)	(6,810)	(5,018)	(7,534)
Changes in cash and cash eq.	390	(331)	1,054	564	(1,028)
Closing cash and cash eq.	1,697	1,365	2,419	2,984	1,956

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	6.9	10.0	7.0	5.6	9.6
Adjusted EPS	6.9	10.0	7.0	5.6	9.6
Dividend per share	1.4	0.7	0.6	0.8	1.3
Book value per share	92.8	94.7	102.2	107.0	115.3

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	0.8	1.0	0.9	0.7	0.7
EV/EBITDA	8.2	8.6	7.2	7.4	6.4
Adjusted P/E	16.7	11.5	16.6	20.7	12.0
P/BV	1.2	1.2	1.1	1.1	1.0

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	58.1	(1474.1)	51.6	74.8	74.8
Interest burden (PBT/EBIT)	37.1	(2.6)	43.1	27.6	40.2
EBIT margin (EBIT/Revenue)	7.6	7.3	8.9	6.4	6.8
Asset turnover (Revenue/Avg TA)	121.9	103.8	106.8	126.8	139.8
Leverage (Avg TA/Avg Equity)	4.0	3.6	3.4	3.2	3.0
Adjusted ROAE	8.0	10.7	7.1	5.3	8.6

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	25.4	(15.9)	(0.3)	19.5	10.7
EBITDA	41.3	(3.7)	13.8	(7.4)	13.2
Adjusted EPS	137.9	44.9	(30.5)	(19.9)	72.0
Profitability & Return ratios (%)					
EBITDA margin	9.9	11.3	12.9	10.0	10.2
EBIT margin	7.6	7.3	8.9	6.4	6.8
Adjusted profit margin	1.6	2.8	2.0	1.3	2.1
Adjusted ROAE	7.0	10.2	6.6	5.0	8.1
ROCE	6.3	7.6	5.7	6.1	7.1
Working capital days (days)					
Receivables	61	79	76	66	66
Inventory	55	69	66	57	55
Payables	75	112	118	97	95
Ratios (x)					
Gross asset turnover	0.9	1.1	1.2	1.0	1.0
Current ratio	2.0	1.5	1.5	1.5	1.4
Net interest coverage ratio	1.5	1.2	1.7	1.4	1.7
Adjusted debt/equity	2.5	2.2	2.0	1.9	1.6

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)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): JK TYRE & INDUSTRIES (JKI IN)



B – Buy, A – Add, R – Reduce, S – Sell

Rating distribution

As of 31 December 2020, out of 88 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 43 have BUY ratings, 14 have ADD ratings, 6 are rated REDUCE and 25 are rated SELL. None of these companies have been investment banking clients in the last 12 months.

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2025. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations

expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities — that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.