

SELL

TP: Rs 90 | ▼ 28%

JK TYRE & INDUSTRIES

Auto Components

21 May 2021

Balance sheet concerns, margin headwinds ahead; maintain SELL

JK Tyre's (JKI) Q4FY21 revenue increased 6% QoQ to Rs 29bn while operating margin contracted 260bps QoQ to 15.5%, albeit beating our estimate of 13.8% due to an above-expected gross margin. Adj. PAT dipped 6% QoQ to Rs 1.9bn. We continue to build in a 300bps hit on FY22-FY23 gross margins vs. that reported in Q4. Despite JKI's deleveraging efforts, we remain concerned about balance sheet health. We raise FY22/FY23 EPS 43%/31% to build in interest cost savings and a lower tax rate. Our Mar'22 TP thus moves to Rs 90 (vs. Rs 70). SELL.

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Operating performance beats estimates: At Rs 29.3bn (+6% QoQ), revenue was in line with our estimate, but EBITDA margin came in 170bps ahead at 15.5% led by above-estimated gross margin. Below-expected interest and tax expenses further supported adj. PAT of Rs 1.8bn (Rs 1.3bn est.).

Margin headwinds ahead; deleveraging continues: Management expects a further 10-12% QoQ rise in RM cost in Q1FY22 after an estimated ~10% increase in Q4. We continue to build in a 300bps hit on FY22-FY23 gross margins vs. that reported in Q4. Improved working capital management led to net debt reduction of Rs 9.3bn to Rs 45bn in FY21 and a 15% decline in interest cost. Management aims to further reduce 45% of long-term debt by FY24.

Retain SELL: We retain FY22/FY23 revenue and gross margin forecasts but revise EBITDA margin estimates up ~30bps each on structural cost-saving measures and improved operating efficiency. We also factor in interest and tax savings (~Rs 800mn in annual interest savings vs. previous estimates), which spurs our FY22/ FY23 EPS upgrade of 43%/31%. Our Mar'22 TP thus rises to Rs 90 (vs. Rs 70) – we continue to value the stock at 7x FY23E EPS, which is a 60% discount to peers to account for the high leverage. Maintain SELL as valuations remain rich at 16x/10x FY22E/FY23E EPS.

Ticker/Price	JKI IN/Rs 126
Market cap	US\$ 423.0mn
Shares o/s	246mn
3M ADV	US\$ 2.5mn
52wk high/low	Rs 147/Rs 49
Promoter/FPI/DII	56%/3%/1%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
Total revenue (Rs mn)	103,699	87,249	91,022	104,021	115,831
EBITDA (Rs mn)	10,251	9,876	13,064	10,678	12,133
Adj. net profit (Rs mn)	1,706	2,567	2,819	1,961	3,097
Adj. EPS (Rs)	6.9	10.4	11.4	8.0	12.6
Adj. EPS growth (%)	137.9	50.4	9.8	(30.4)	57.9
Adj. ROAE (%)	7.0	10.6	10.1	6.6	9.6
Adj. P/E (x)	18.1	12.1	11.0	15.8	10.0
EV/EBITDA (x)	8.4	8.8	6.4	7.0	5.6

Source: Company, BOBCAPS Research | P – Provisional

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FIG 1 – QUARTERLY PERFORMANCE – CONSOLIDATED

(Rs mn)	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)	FY21	FY20	YoY (%)
Net Revenues	29,273	17,948	63.1	27,693	5.7	91,022	87,249	4.3
Total Income (A)	29,273	17,948	63.1	27,693	5.7	91,022	87,249	4.3
Operating Expenses:								
Raw materials consumed	17,808	10,254	73.7	15,814	12.6	54,687	53,370	2.5
Employee Expenses	2,665	2,340	13.9	2,656	0.3	9,227	9,232	0.0
Other Expenses	4,253	3,280	29.7	4,219	0.8	14,044	14,772	(4.9)
Total Expenditure (B)	24,726	15,873	55.8	22,689	9.0	77,959	77,373	0.8
EBITDA (A-B)	4,547	2,074	119.2	5,004	(9.1)	13,063	9,876	32.3
Other Income	174	83	108.4	67	158.3	431	284	51.7
Depreciation	957	1,023	(6.4)	978	(2.2)	3,867	3,778	2.3
EBIT	3,764	1,135	231.6	4,093	(8.0)	9,627	6,381	50.9
Finance Costs	1,053	1,348	(21.9)	1,065	(1.1)	4,659	5,490	(15.1)
PBT before excep items	2,711	(213)	(1375.0)	3,028	(10.5)	4,969	891	457.3
Exceptional items	95	(611)	(115.5)	402	(76.4)	375	(1,059)	(135.4)
PBT after excep items	2,806	(824)	(440.5)	3,430	(18.2)	5,344	(168)	(3290.1)
Tax expense	845	(355)	(338.5)	1,123	(24.7)	2,009	(1,658)	(221.2)
Share of Associates	(11)	(58)	-	(2)	-	(25)	(77)	(67.4)
Reported PAT	1,950	(528)	(469.4)	2,305	(15.4)	3,309	1,413	134.2
Adjusted PAT	1,855	84	2118.4	1,903	(5.6)	2,935	2,472	18.7
EPS (Rs)	7.9	0.4	2048.6	8.4	(5.6)	12.7	10.9	16.3

Source: Company, BOBCAPS Research

FIG 2 – KEY PARAMETERS

(%)	Q4FY21	Q4FY20	YoY (bps)	Q3FY21	QoQ (bps)	FY21	FY20	YoY (bps)
Gross Margin	39.2	42.9	(371)	42.9	(373)	39.9	38.8	109
EBITDA Margin	15.5	11.6	398	18.1	(254)	14.4	11.3	303
EBIT Margin	12.9	6.3	653	14.8	(192)	10.6	7.3	326
PBT Margin	9.3	(1.2)	1,044	10.9	(167)	5.5	1.0	444
Tax Rate	30.1	43.0	(1289)	32.7	(261)	37.6	NA	NA
Adj PAT Margin	6.3	0.5	587	6.9	(54)	3.2	2.8	39

Source: Company, BOBCAPS Research

Earnings call highlights

- JKI expects a 10-12% QoQ increase in raw material cost during Q1FY22 and plans to mitigate this by taking price hikes (marginal hike effected in April), moving to premium products and raising operating efficiencies.
- Management anticipates strong pent-up demand from H2FY22 while H1 could be sluggish.
- Capacity utilisation for all plants was high, averaging ~97% during the quarter.
- Mexico plant restructuring is complete and the Q4 EBITDA margin looks sustainable. Management intends to further improve margins at this unit.
- Net debt reduced by Rs 9.3bn to Rs 45bn as of Mar'21. Management intends to reduce this by a further Rs 6bn in FY22 and by a total of Rs 15bn over FY22-FY24.
- Capex for FY22 is guided at Rs 2bn which includes maintenance capex of Rs 1bn. The company intends to incur capacity expansion capex of ~Rs 2bn over the next 24-30 months towards debottlenecking, which should add 10% to existing capacities.
- Per management, the blended tax rate on a consolidated basis would be 29-30% in FY22 (Cavendish has moved to a newer tax regime while JKI standalone is continuing with the older one).

Valuation methodology

We retain our FY22/FY23 revenue and gross margin forecasts but revise EBITDA margin estimates up by ~30bps each given structural cost-saving measures and improved operating efficiency. We also factor in interest cost and tax savings (~Rs 800mn in annual interest savings vs. previous estimates), which spurs our FY22/FY23 EPS upgrade of 43%/31%. We now expect JKI to post a revenue/EBITDA/adj. PAT CAGR of +13%/–4%/+5% over FY21-FY23.

Capacity utilisation for most tyre companies stood at 75-85% in FY21. While all its peers have aggressive capex plans for the next two years, JKI intends to focus on improving its balance sheet (though this may come at the risk of losing revenue and market share). Given the company's sustained high leverage (current D/E ratio of 1.5x, ~4x the industry average), we continue to value the stock at a steep ~60% discount to peers – i.e. at 7x FY23E EPS, in line with the last 10-year mean. Post estimate revision, our Mar'22 target price rises to Rs 90 (vs. Rs 70). Maintain SELL as valuations remain rich at 10x FY23E EPS.

FIG 3 – REVISED ESTIMATES

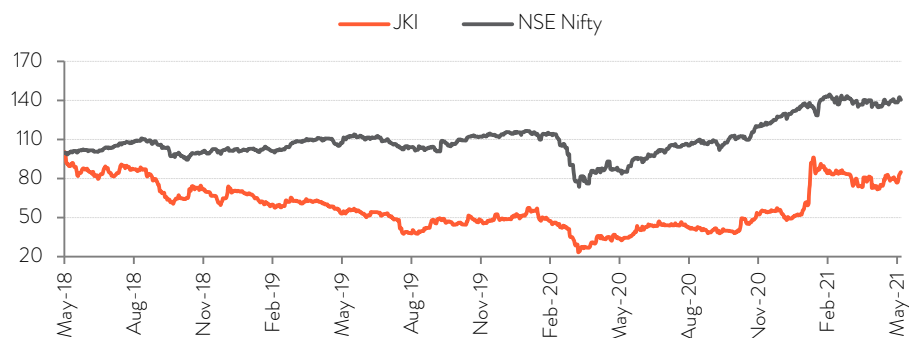
(Rs mn)	New		Old		Change (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Revenues	104,021	115,831	104,012	115,118	0.0	0.6
EBITDA	10,678	12,133	10,408	11,785	2.6	3.0
OPM (%)	10.3	10.5	10.0	10.2	26bps	24bps
Interest cost	4,112	3,850	4,826	4,703	(14.7)	(18.1)
Adj. PAT	1,961	3,097	1,376	2,367	42.5	31.0
EPS (Rs)	8.0	12.6	5.6	9.6	42.5	31.0

Source: Company, BOBCAPS Research

FIG 4 – PEER COMPARISON

Company	CEAT	APTY	JKI	MRF
D/E FY21 (x)	0.4	0.4	1.5	0.1
Interest coverage FY21 (x)	3.5	2.3	1.3	5.2
Capex over FY22-23 (Rs bn)	26.0	48.0	6.0	52.0
ROCE FY17-21 Avg. (%)	11.5	6.8	6.8	11.4
ROE FY17-21 Avg. (%)	13.3	9.0	10.8	12.6
P/E FY17-21 Avg. (x)	14.0	16.0	7.0	22.0
D/E FY17-21 Avg. (x)	0.4	0.5	2.4	0.2
Capex FY17-21 Avg. (Rs bn)	43.7	156.3	43.6	182.0

Source: Company, BOBCAPS Research

FIG 5 – RELATIVE STOCK PERFORMANCE

Source: NSE

Key risks

Upside risks to our estimates include:

- faster growth in MHCV tyres which will impact our revenue forecasts, and
- softening in natural rubber or crude derivative prices which will positively affect margins.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Total revenue	103,699	87,249	91,022	104,021	115,831
EBITDA	10,251	9,876	13,064	10,678	12,133
Depreciation	3,157	3,778	3,867	4,058	4,168
EBIT	7,915	6,381	9,627	6,914	8,274
Net interest income/(expenses)	(5,211)	(5,490)	(4,659)	(4,112)	(3,850)
Other income/(expenses)	821	284	431	294	309
Exceptional items	231	(1,059)	375	0	0
EBT	2,936	(168)	5,344	2,802	4,425
Income taxes	942	(1,658)	2,009	841	1,327
Extraordinary items	0	(95)	116	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	1,937	1,508	3,193	1,961	3,097
Adjustments	(231)	1,059	(375)	0	0
Adjusted net profit	1,706	2,567	2,819	1,961	3,097

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Accounts payables	15,990	16,884	15,741	18,241	20,752
Other current liabilities	5,776	10,467	14,312	15,772	16,182
Provisions	223	1,196	1,117	0	0
Debt funds	57,575	51,241	40,163	38,163	35,163
Other liabilities	4,817	6,055	7,060	7,060	7,060
Equity capital	492	493	493	493	493
Reserves & surplus	23,713	23,768	27,285	29,089	31,815
Shareholders' fund	24,206	24,261	27,777	29,582	32,307
Total liabilities and equities	108,587	110,103	106,171	108,818	111,464
Cash and cash eq.	1,697	1,365	1,721	1,742	1,513
Accounts receivables	19,451	18,484	15,754	19,379	21,262
Inventories	16,891	16,178	17,893	18,524	19,993
Other current assets	6,419	6,025	6,733	7,125	7,616
Investments	1,312	1,402	1,470	1,470	1,470
Net fixed assets	62,276	63,888	62,551	60,993	59,825
CWIP	2,698	2,772	2,864	2,400	2,600
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(4,101)	(2,030)	(3,221)	(3,221)	(3,221)
Other assets	1,945	2,018	405	405	405
Total assets	108,587	110,103	106,171	108,818	111,464

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Net income + Depreciation	5,093	5,286	7,060	6,019	7,265
Interest expenses	5,211	5,490	4,659	4,112	3,850
Non-cash adjustments	(821)	(284)	(431)	(294)	(309)
Changes in working capital	(2,046)	9,796	5,549	(1,805)	(922)
Other operating cash flows	(244)	0	359	0	0
Cash flow from operations	7,194	20,288	17,196	8,032	9,884
Capital expenditures	(3,621)	(5,464)	(2,622)	(2,036)	(3,200)
Change in investments	(30)	(91)	(68)	0	0
Other investing cash flows	763	(131)	547	294	309
Cash flow from investing	(2,888)	(5,686)	(2,144)	(1,742)	(2,891)
Equities issued/Others	1,969	0	0	0	0
Debt raised/repaid	(538)	(6,334)	(11,078)	(2,000)	(3,000)
Interest expenses	(5,211)	(5,490)	(4,659)	(4,112)	(3,850)
Dividends paid	(340)	(216)	(225)	(157)	(372)
Other financing cash flows	202	(2,892)	1,265	0	0
Cash flow from financing	(3,917)	(14,933)	(14,697)	(6,269)	(7,221)
Changes in cash and cash eq.	390	(331)	356	21	(229)
Closing cash and cash eq.	1,697	1,365	1,721	1,742	1,513

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21P	FY22E	FY23E
Reported EPS	6.9	10.4	11.4	8.0	12.6
Adjusted EPS	6.9	10.4	11.4	8.0	12.6
Dividend per share	1.4	0.7	0.9	0.6	1.5
Book value per share	92.8	94.7	108.5	115.8	126.9

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21P	FY22E	FY23E
EV/Sales	0.8	1.0	0.9	0.7	0.6
EV/EBITDA	8.4	8.8	6.4	7.0	5.6
Adjusted P/E	18.1	12.1	11.0	15.8	10.0
P/BV	1.4	1.3	1.2	1.1	1.0

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21P	FY22E	FY23E
Tax burden (Net profit/PBT)	58.1	(1530.5)	52.7	70.0	70.0
Interest burden (PBT/EBIT)	37.1	(2.6)	55.5	40.5	53.5
EBIT margin (EBIT/Revenue)	7.6	7.3	10.6	6.6	7.1
Asset turnover (Revenue/Avg TA)	121.9	103.8	116.3	138.9	155.1
Leverage (Avg TA/Avg Equity)	4.0	3.6	3.1	2.7	2.5
Adjusted ROAE	8.0	11.1	11.3	7.1	10.4

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
YoY growth (%)					
Revenue	25.4	(15.9)	4.3	14.3	11.4
EBITDA	41.3	(3.7)	32.3	(18.3)	13.6
Adjusted EPS	137.9	50.4	9.8	(30.4)	57.9
Profitability & Return ratios (%)					
EBITDA margin	9.9	11.3	14.4	10.3	10.5
EBIT margin	7.6	7.3	10.6	6.6	7.1
Adjusted profit margin	1.6	2.9	3.1	1.9	2.7
Adjusted ROAE	7.0	10.6	10.1	6.6	9.6
ROCE	6.3	7.6	7.7	6.5	7.8
Working capital days (days)					
Receivables	61	79	69	62	64
Inventory	55	69	68	64	61
Payables	75	112	109	93	96
Ratios (x)					
Gross asset turnover	0.9	1.1	1.1	1.0	0.9
Current ratio	2.0	1.5	1.4	1.4	1.4
Net interest coverage ratio	1.5	1.2	2.1	1.7	2.1
Adjusted debt/equity	2.5	2.2	1.5	1.3	1.1

Source: Company, BOBCAPS Research

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



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

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