SKP Securities Limited

Providing financial solutions for all

Balkrishna Industries Ltd.

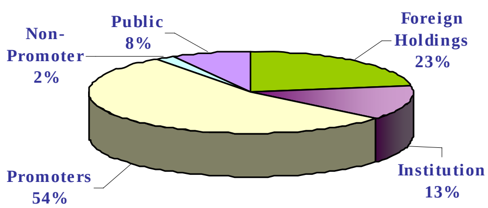
- Surging Ahead With Strong Grip

CMP Rs. 173.65 **Target Rs. 237** **Initiating Coverage-Accumulate**

Key Share Data

Face Value (Rs.)	10.00
Equity Capital (Rs. crs)	19.33
Market. Capitalization (Rs. crs)	336
52-wk High / Low (Rs.)	903 / 115
Average Yearly Volume	6654
BSE code	502355
NSE code	BALKRISIND
Reuters code	BLKI.BO
Bloomberg code	BIL.IN

Shareholding Pattern – 30th September 2008



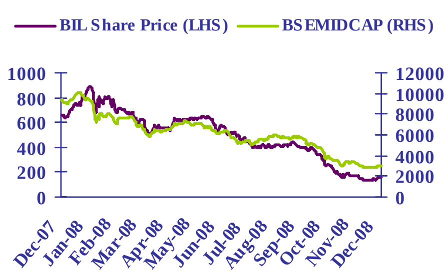
Financials (Consolidated) (Rs. crs)

	FY08	FY09E	FY10E	FY11E
Net Sales	1133.75	1327.51	1412.87	1546.82
Sales Gr	29%	17%	6%	9%
EBIDTA	226.14	275.37	309.82	351.89
PAT	111.67	118.75	144.61	173.51
PAT Gr	34%	6%	22%	20%
EPS (Rs.)	57.77	61.43	74.81	89.76
CEPS (Rs)	81.33	88.84	104.57	120.42

Key Financial Ratios

	FY08	FY09E	FY10E	FY11E
Div. yield	6%	6%	8%	10%
P/E	3.01	2.83	2.32	1.93
P/BV	0.80	0.66	0.54	0.44
P/Cash EPS	2.14	1.95	1.66	1.44
MCap/Sales	0.30	0.25	0.24	0.22
EV/EBIDTA	3.85	3.31	2.73	2.30
ROACE	23%	26%	27%	28%
ROE	27%	23%	23%	23%
EBITDM(%)	20%	21%	22%	23%
NPM (%)	10%	9%	10%	11%
Debt-Equity	1.31	1.20	0.87	0.73

Price comparison BIL v/s BSE Midcap



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Company Profile:

Balkrishna Industries Ltd (BIL), world's premier manufacturer of pneumatic tyres for special applications was incorporated on November 20, 1961. It focuses on the production of off-highway tyres that includes agricultural, industry, material handling, forestry, lawn and garden, construction and earth moving tyres. The company operates mainly in the business segment of tyres which by virtue becomes its core business. It's other businesses are fabric processing and paper manufacturing which has been transferred to its subsidiaries BKT Synthetic Ltd. and BKT Paper Mills Ltd.

Investment Rationale:

Major Focus on Agriculture segment

BIL mainly serves the agriculture segment in Europe. In Europe the farms are large and method scientific. As per Michelin estimates, it is expected that the radialisation in agriculture business - Europe will increase to 81% by 2012. This will act as a growth impetus for the company in near future.

Wide Range of Products

BIL operates in a niche segment of manufacturing and exporting Off-Highway Tyres. The company has a global market share of around 3%, which has been achieved through a range of around 1800 products. The company is looking forward to enhance the breadth of its offering, so that it becomes a single-source supplier to a range of customers worldwide.

Huge Distribution Network

BIL has strong global positioning which enables to ship its products to any corner of the world. Most of BILs export volume goes to Europe, followed by the US, Australia, the Middle East and Asia. Altogether it has 1700 SKUs offering a wide range of products. They sell around 10–12 per cent of the sales volume to vehicle OEMs, with the rest being sold to the aftermarket. In addition to distributors, the company also has their own representatives in the UK, US & Italy.

Margins better placed competitively

BIL leverages its strong product line and lower labour costs to compete with other global players in overseas markets. It uses India's combination of engineering skills and low labor and production costs to build its market share. On the labor side, the cost of Balkrishna's workers is just 5% of sales, compared with 33% for Western players. This helps the company to enjoy high operating margins as compared to its competitors.

Natural Rubber (NR) slipping into the comfort zone

About 38% of NR is used in the manufacturing process of tyres. Since few months NR prices were rising tremendously due to which the margins of tyre companies were hampered. But now the NR prices had reversed its trend, thus hovering at USD 112 / 100 kgs as on Dec 9th 2008, down from its peak of USD 331 / 100 kgs. This will give some relief to the company.

Outlook & Recommendation:

At current market price of Rs. 174/-, the stock is trading at P/E 1.93x and EV/EBIDTA 2.30x of FY 11E earnings and EBIDTA respectively. **We recommend accumulate rating at our target price of 237 (36% upside) in 18 months, it would trade at 2.6x FY11E earnings.**

Speciality Tyres – Global Focus on Off Highway Tyres

The Off Highway Tyres (OHT) markets account for 12% of world sales. The entire market is mainly concentrated with the major three players – Michelin, Goodyear and Bridgestone altogether consisting of market share of about 55%. There are various applications of OHT, out of which the major ones are:

Major OHT Applications	Global Demand Drivers
Agriculture	➢ Increasing demand for food. ➢ Biofuel demand explosion. ➢ Changing food habits in emerging country. ➢ Farms are increasingly large due to reorganization, especially in Europe accompanied with declining farmers population.
Earthmovers	➢ Strong mineral and metal consumption, driven by developing countries.
Mining	➢ Booming business not only in the older mining regions (North and South America & Oceania) but also in Asia and Africa & the Middle East.
Quarrying	➢ Environmental regulations are driving underground mine development.
Construction	➢ Infrastructure development, handling equipment and civil engineering market offer bright prospects.
Other demand drivers	➢ Economic growth. ➢ Increasing radialisation. ➢ Replacement demand. ➢ Increase of freight to road transport, etc.

Segmentation of Tyre Market

The tyre market caters to three types of market:

- **Original Equipment Manufacturers (OEMs) :** Volumes depends on the tie ups of the manufacturer with the OE like Telco, Mahindra & Mahindra, Maruti, government & state transport undertakings, etc. Margins are lower in this business. Hence suppliers concentrate on volumes to spread out overheads.
- **Replacement Tyre Market (RT) :** The demand from Replacement market flows from the vehicles sold in the earlier years. Apart from this, the economic and industrial growth is the other key demand determinant. Margins are better in this segment as compared to the OEMs.
- **Export Market :** In order to avoid inventory pile ups, most of the major players have moved towards the export market. The margins are always less in this segment and therefore the volumes must be hiked to earn more.

Current Scenario seems to be challenging

Slowing down of economies might post Challenges

The above industries are mainly dependent on the economic growth of the countries. At present, economy of the developed countries have been slowed down but still some growth is seen in the emerging countries.

- **China had grown by 11%.**
- **Indian economy grew at 6.7%.**
- **Whereas Europe's – emerging countries had grown at 6%.**

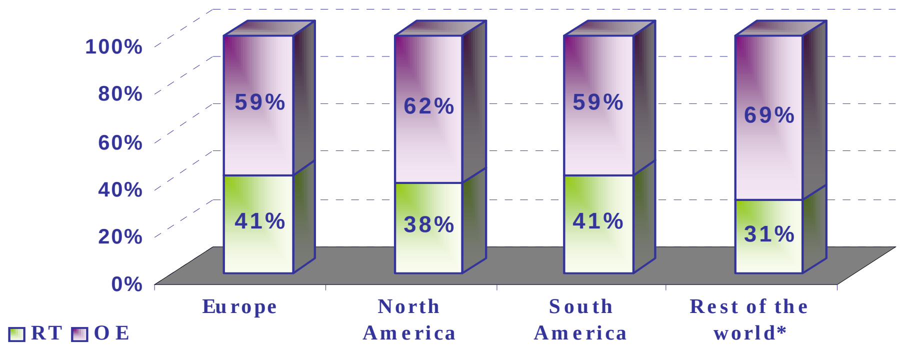
At present majority of the sectors are facing a downtrend. The slowdown has spread across the globe which might obstruct the growth of the OHT segment.

Industrial and construction Sectors

In the first six months of FY 09, the earthmover tyre demand remained strong. The demand in the mines and quarries segment also showed an uptrend but the slowdown in construction sector in Europe and North America, hampered the tyre demand.

Agricultural segment still remains unaffected

There was a sustained demand from Original Equipment Manufacturers (OEMs) for lead tractors. The replacement market grew slightly in Europe and was stable in North America during the current year FY 08.

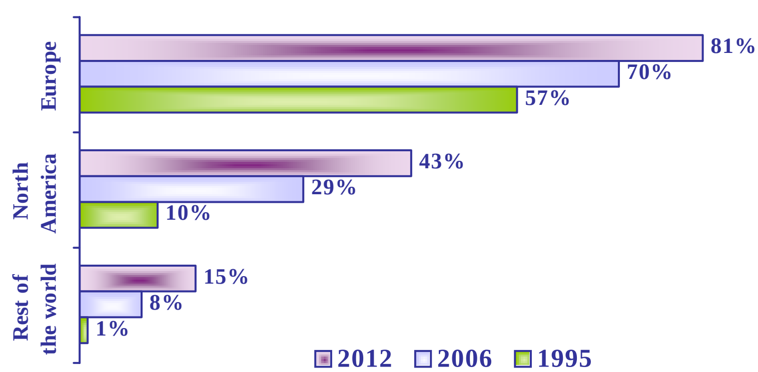


Source : Michelin Estimates 2008 (Drive Wheels) ** Excl. India & China*

Agri segment moving technical

There are substantial opportunities in the agriculture segment, to equip high-powered agricultural machinery, extra-large or highly compact equipment, and more of radial tyre applications. Radialisation of tyres is another positive development in the industry which has come as a new opportunity for various players in the tyre market. The benefit of additional mileage, fuel saving and improved driving being attached, radialisation has been increased worldwide. On the basis of technical progress in the farms, the scope of OHT will increase.

Trends towards radialization of Agricultural tire markets since 1995



Source : Michelin Fact book 2008 & SKP Research

The Company: A snapshot

Balkrishna Industries Ltd. (BIL) is a part of the Rs 1,200 crore Siyaram Poddar group. It is the world's premier manufacturer of pneumatic tyres for special applications, incorporated in November 20, 1961. The company operates mainly in the niche business segment of tyres. They mainly focus on the production of off-highway tyres that includes agricultural, industry, material handling, forestry, lawn and garden, construction and earth moving tyres.

BIL has three businesses under its roof – Tyre, Paper and Fabric. The core business is manufacturing of tyres, whereas the Fabric processing and manufacturing of paper/ paper board is looked after by its subsidiaries BKT Synthetic Ltd. and BKT Paper Mills Ltd. respectively.

Core Business – A Brief Overview

BIL's is mainly into manufacturing and export of Off Highway Tyres (OHT). The tyres segment contributes to about 87% share of its revenue, of which 84% of the tyres have been exported. The company mainly supply to Europe which constitute 65% of its total exports followed by US and other parts of the world.

BIL currently has 3% market share in $75 million global OHT market. Since past 3 years the company has grown at a CAGR of 43% whereas their operating margins were in the range of 16-18%. The total installed capacity of BIL as on FY 08 was 1.29 lakhs spread across the three plants in India – Bhiwadi, Chopanki and Waluj.

Non-Core Business – A Brief Overview

Fabric Processing Division

BKT Synthetic Ltd. undertakes job work from Siyaram Silk Mills (group company) having an annual installed capacity of 24 million meters. The business of the company is matured with a modest turnover of Rs. 31.25 crore and operating margins at 8.53% during FY 08.

Paper and Paper board Division

BKT Paper Mills Ltd. is into manufacturing of coated duplex / triplex boards with an annual installed capacity of 54000 metric tones. The division's turnover was at Rs. 124.36 crores with operating margins of 5% during FY 08.

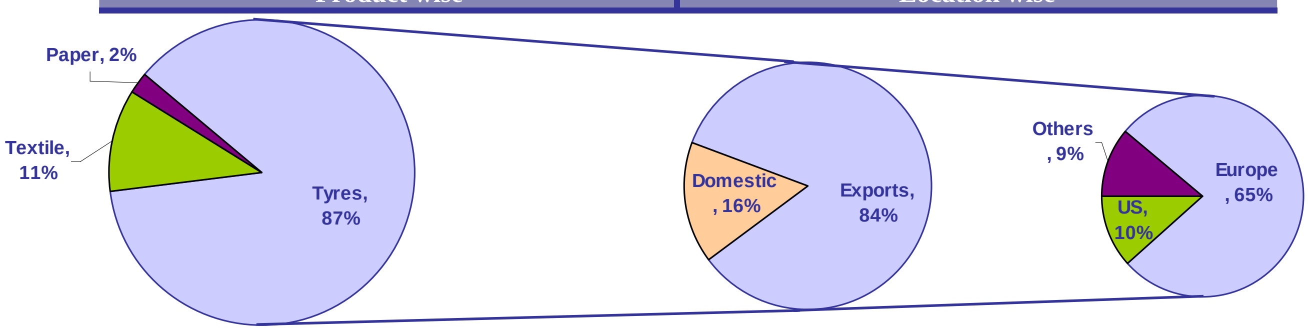
The company has transferred its Paperboard and Fabric processing business to its respective subsidiaries BKT Synthetic Ltd. and BKT Paper Mills Ltd. during FY 08 in order to focus on its core business.

Windmill

BIL also has a windmill plant under its umbrella located at Rajasthan. The power generated from the plant is used for its captive consumption, as such there is no revenue generated from operation of the plant. The plant has the annual power generating capacity of 5 MW with 6912231 KWH units generated during FY 08.

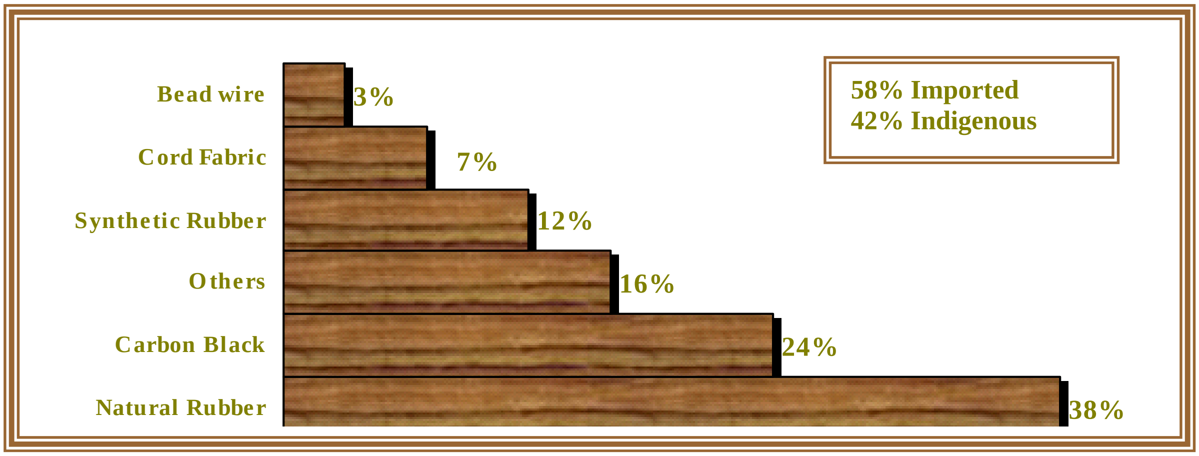
Revenue Mix as on March 2008:

Product wise	Location wise



Source : Company data & SKP Research

Raw Material Mix:

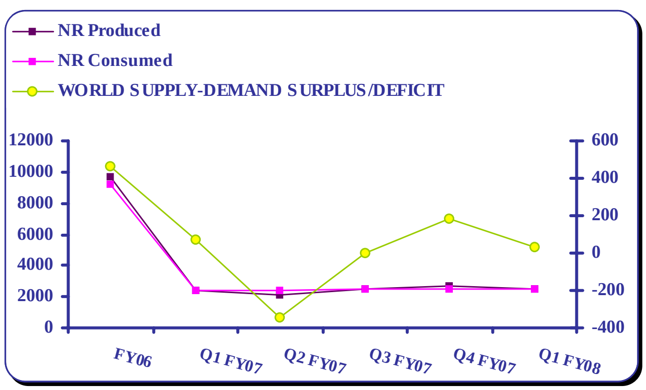


Source :Company & SKP Research

Natural Rubber - A review

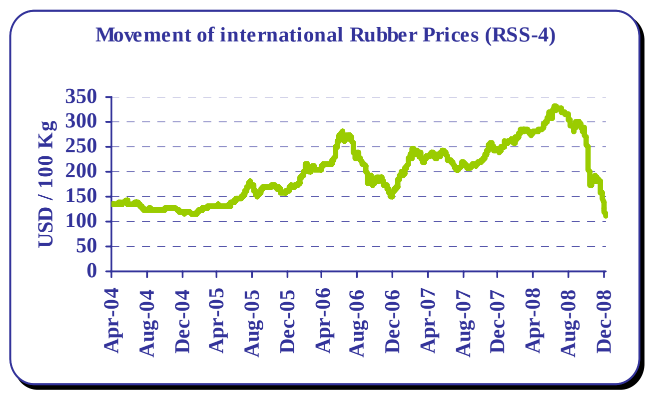
Natural rubber is the major raw material used in the tyre manufacturing process. The world economies are slowing down due to the global recession stepping in. Due to this, the demand for most of the commodities has gone down driving down their prices. During FY 08-09, the natural rubber (NR) prices has broken down to USD 112.40 / 100 Kg on Dec 9th 2008 from the peak of USD 330.50 / 100 Kg on June 16th 2008.

NR Demand - Supply Scenario



Source : International Rubber Steady Group (IRSG) & SKP Research

NR Price Movement



Source :Capitaline & SKP Research

Investment Arguments

NR prices slipping under the comfort zone

The tyre industry is raw material intensive. Therefore, any fluctuations in raw material prices directly affect the profitability of tyre companies. Since most of these raw materials are petroleum based, their prices fluctuate with the international prices of petroleum products. The main raw materials for tyre are rubber (natural or synthetic or mixture of both), carbon black, nylon tyre cord and rubber chemicals.

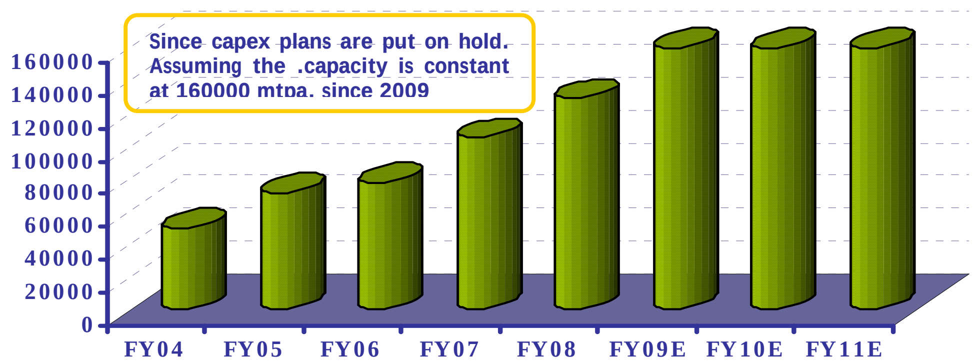
Except natural rubber, the costs of all other raw materials in tyre production are related to crude oil prices. The major raw material used in manufacturing process is natural rubber. At present the prices of NR has been tremendously eased down, has reached its lowest level of $ 112 / 100 Kgs. Due to this, the cost of the company will come down drastically. Since BIL has already accumulated NR inventory levels upto Dec 08 at an average rate of Rs. 135/- per kg, the impact of downward sloping prices of NR will be seen in the last quarter FY 09. *With crude oil prices declining accompanied by easing NR prices, the operating cost of BIL will reduce thereby expanding its bottomline.*

Capex Plans on Hold – A sound movement

The company has been on its continuous verge of expansion. Apart from its regular capex of around Rs. 25 crore, it had planned to spend Rs. 180 crs during FY 09 towards

- Increase in mixing and production capacities.
- Setting up warehouse facilities.
- De-bottlenecking and upgrading its existing facilities.
- The company also planned to set up a green-field tyre plant into Special Economic Zone (SEZ) to increase the production capacity to about 75000-80000 mtpa by FY10.

Capacity break-up



Source :Company & SKP Research

Looking at the current scenario, the company had put the capex plan on hold and decided to resume the same once the situation stabilizes. Till date the company incurred a total capex of Rs. 40 crore and the entire amount is financed through internal accruals.

One stop – shop supplier

Balkrishna Industry operates in a niche segment of manufacturing and exporting Off-Highway Tyres. The company has a global market share of around three per cent, which has been achieved through a range of around 1800 products. The wide product range covering nearly all segments of OTR tyres is the company's main strength. The company is looking forward to offer a wide variety of specialty tyres and enhance the breadth of its offering, so that it moves closer to its ultimate ambition of growing its market share and becoming a single-source supplier to a range of customers worldwide.

Wider Coverage – Easier Reach

Today, Balkrishna Tyres has strong global positioning which enables the company to ship its products to any corner of the world. The company has a marketing and distribution tie-up in each country which not only enables it to sell its products, but also promote its brand abroad. In India, BIL supplies to almost all the leading manufacturers who use OTR tyres. Most of BILs export volume goes to Europe, followed by the USA, Australia, the Middle East and Asia. They sell around 10–12 per cent of the sales volume to vehicle OEMs, with the rest being sold to the aftermarket. In addition to distributors, the company also has their own representatives in the UK, Italy and the USA.

Low Cost Resources to help BIL increase its market share

The tyre business is too fragmented, too low-volume, and too labor-intensive. BIL leverages its strong product line and lower labour costs to compete with other global players in overseas markets. It uses India's combination of engineering skills and low labor and production costs to build its market share. On the labor side, the cost of Balkrishna's workers is just 5% of sales, compared with 33% for Western players.

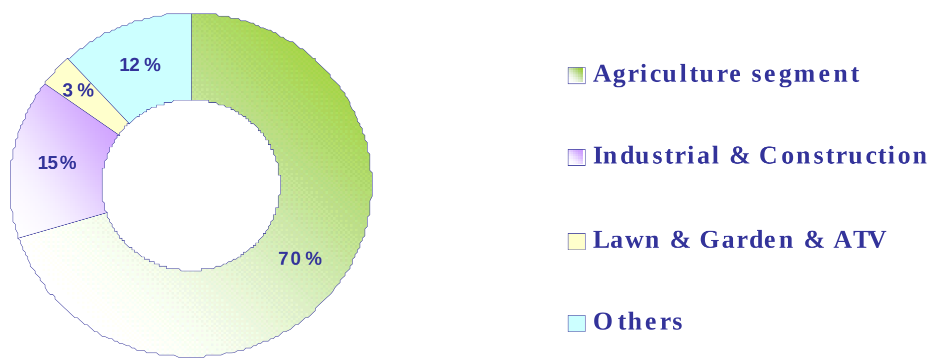
Balkrishna also has easy and cheaper access to raw material both domestically and internationally. India being the world's third-largest producer of rubber, the company can procure NR at lower rates. Also there is no duty on raw material imports. The company has the option to utilize the cheapest source to procure its raw materials. This will help the company to sell its products at competitive rates and increase its market share.

Major Focus on Agriculture Segment – A support in tough times

BIL mainly caters to the agriculture segment in Europe. In Europe, the farms are increasingly large due to reorganization accompanied with declining farmers population. These farms are turning methods scientific, requiring tractors with different tyre types for agri-businesses like grapevine cultivation and orchid farming. Here the scope of Balkrishna increases, as even if the economy will be on the verge of slowdown, there will always be demand for food, indirectly enhancing the sale of tyres.

Secondly, the economy is moving towards radialisation. The farms are turning sophisticated. Going forward, it is estimated by Michelin that, radialisation in tyres segment will increase to 81% by 2012. This will serve an encouraging factor for the company.

Segment wise Tyres Sales Break - up



Source :Company & SKP Research

Stable margins – Higher than its competitors

Since the company's operating cost is quite lower, it can sell it's product at competitive rates, thereby expanding its market share. It also enjoys the benefit of passing of increased cost to the end user, incase of any fluctuations in the raw material prices. Apart from this the majority of revenue comes from Europe (in Euros). We have seen more volatility in the Rupee-Dollar currency movement than the Euro-Rupee movement. This act as a positive point which keeps BILs margins stable. We expect the EBIDTA margins in tyre business to move in the range of 20% - 22% during FY 08 – FY 11.

Key Concerns

Volatile natural rubber and crude oil prices

Prices of natural rubber, carbon black and the nylon tyre cord directly affects the prices of the tyre since these inputs constitute of 60% of the total cost. Variable cost is very high leading to thin profit margins. Any hike in crude oil and rubber prices will directly impact the margins of the company.

FCCB

The company has raised 4.5% FCCB during the previous year aggregating to USD 22 million with premium of 1.5% p.a. payable on cumulative basis on redemption date (Dec 31st, 2010). The bonds are convertible at a price of Rs. 1,375 by applying a pre-determined exchange rate of Rs. 45.66 per USD.

Looking at the current situation, we expect the FCCBs will not convert on the maturity date and the redemption will be met through internal accruals. We have considered the effect of the same in the financials of the company.

Other Risks:

- Slowdown in the economy and related sectors.
- Fluctuation in currency movement.

Peer Comparison

In India, there is no company specialized in producing specialty tyres. The firms in the Indian tyre industry cater to the car, truck and bus markets, and specialty tyres segment. There is no domestic player concentrating on manufacture of specialty tyres.

	Mkt Cap*	EPS	P/E*	P/BV*	OPM	ROCE
Apollo Tyres Ltd.	977.76	4.40	5.50	0.77	9.27%	24%
Balkrishna Industries Ltd.	**330.64**	**57.77**	**3.53**	**0.80**	**16.00%**	**23%**
Ceat Ltd.	137.99	42.72	51.01	0.28	7.09%	20%
MRF	844.69	147.78	5.84	0.75	6.16%	18%

Source :Company & SKP Research ** as on Dec 22nd, 2008*

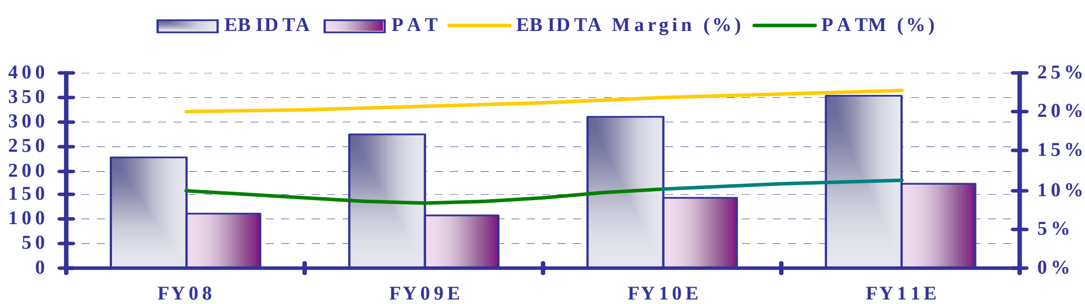
Financial Outlook

EBIDTA and PAT to grow at CAGR of 16% & 15% respectively, for a period 2008-2011

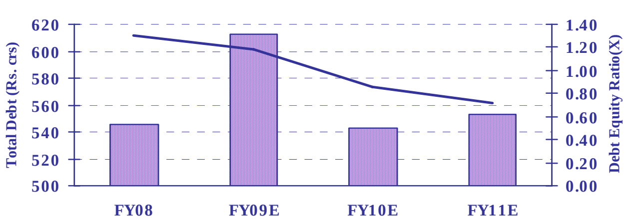
The company had currently halted the capacity expansion plans due to further slowdown expected to step in. Since the raw material prices are easing with no more capacity coming further, we expect revenues from tyres segment to grow at a CAGR 13% during 2008-2011.

BIL enjoys the highest margins among its global peers due low cost labour and cheaper access to raw materials in India. The operating margins are expected to grow in the range 17% - 19% whereas net profit margin should grow in the range 9% - 11%. We expect 16% EBIDTA CAGR and 15% net earnings CAGR for BIL over 2008 - 2011.

Trend in Profitability Margins



Source: Company & SKP Research



Debt –Equity Ratio to reach below 1 by FY 2011

The company has no major capex in the coming year. It is not planning to borrow further debt due to temporary halt on its capex plans. Assuming, BIL not to undertake further capex, repay its outstanding debts and redeem its FCCB, we expect that the company debts will stand in the books at Rs. 553 crs by FY 2011, thus pulling down its debt equity ratio to 0.73.

Valuations & Outlook

At current market price of Rs. 174/-, the stock is trading at a P/E of 2.83x, 2.32x & 1.93x of FY 09E, FY 10E and FY 11E earnings Rs. 61.43, Rs. 74.81 and Rs. 89.75 respectively. We value the stock at Rs. 212/- implying an average P/E 2.36x of FY 11 earnings.

The stock is trading at EV/EBIDTA of 3.31x, 2.73x and 2.30x of FY 09E, FY 10E and FY 11, EBIDTA of Rs. 275.37 crs, Rs. 309.82 crs and Rs. 351.89 respectively. We value the stock at Rs. 261/- implying an average EV/EBIDTA of 2.80x of FY 11 EBIDTA.

We thereby initiate coverage on Balkrishna Industries Ltd. and recommend accumulate rating with a target price of Rs. 237/- (36% upside) in 18 months based on the average of both P/E and EV/EBIDTA valuations.

Consolidated Financials for FY March (figs. in Crore):

Income Statement

Financial Year	FY08	FY09E	FY10E	FY11E
Net sales	1133.75	1327.51	1412.87	1546.82
growth (%)	*29%*	*17%*	*6%*	*9%*
EBIDTA	226.14	275.37	309.82	351.89
EBIDTA margin (%)	*20%*	*21%*	*22%*	*23%*
Depreciation	45.56	52.99	57.54	59.29
EBIT	180.58	222.38	252.28	292.60
EBIT margin (%)	*16%*	*17%*	*18%*	*19%*
Interest	26.69	46.44	40.24	37.45
Interest Coverage (x)	6.77	4.79	6.27	7.81
Other Income	15.32	3.98	7.06	7.73
EBT	169.20	179.93	219.11	262.88
Tax	58.92	61.17	74.50	89.38
Effective tax rate(%)	*35%*	*34%*	*34%*	*34%*
PAT	111.67	118.75	144.61	173.51
PAT margin (%)	*10%*	*9%*	*10%*	*11%*
Shares o/s (Rs. crs)	1.93	1.93	1.93	1.93
EPS (Rs.)	57.77	61.43	74.81	89.75
Cash EPS (Rs.)	81.33	88.84	104.57	120.42
Dividend Per Sh. (Rs.)	10.50	10.50	13.46	17.95

Balance Sheet

Financial Year	FY08	FY09E	FY10E	FY11E
Equity Capital	19.33	19.33	19.33	19.33
Reserves	397.90	492.91	607.06	739.97
Networth	417.24	512.25	626.40	759.31
Secured Loan	361.62	419.93	446.93	489.30
Unsecured Loan	183.55	192.55	95.58	63.29
Deferred Tax Liab.	44.21	44.21	44.21	44.21
Total Liabilities	**1006.62**	**1168.93**	**1213.13**	**1356.11**
Net Fixed Assets	450.70	554.62	562.08	527.80
Capital WIP	131.90	40.00	0.00	0.00
Investments	3.90	11.92	18.99	41.93
Cash	10.30	36.52	33.51	80.23
Accounts receivable	207.86	268.76	307.10	382.18
Inventories	200.55	241.01	266.61	299.51
Loan & Advances	300.82	352.20	374.84	410.38
Total Curr. Assets	719.71	898.66	982.23	1172.46
Payables	110.25	140.09	153.16	187.73
Tot.al Curr. liab. & Prov.	299.59	336.26	350.18	386.08
Net Current Assets	420.12	562.40	632.05	786.38
Total Assets	**1006.62**	**1168.93**	**1213.13**	**1356.11**

Cash Flow Statement

Financial Year	FY08	FY09E	FY10E	FY11E
Profit before Tax	173.28	179.93	219.11	262.89
Add: Depreciation, Int. & Other Expenses	56.56	99.43	97.78	96.74
Net changes in WC, tax interest	-183.66	-177.24	-147.15	-197.00
Cash flow from operating activities	**44.91**	**102.12**	**169.73**	**162.62**
Capital expenditure	-169.36	-65.00	-25.00	-25.00
Investments, Sales of FA, Div. Recd & others	-0.33	-8.02	-7.08	-22.94
Cash flow from investing activities	**-169.69**	**-73.02**	**-32.08**	**-47.94**
Cash flow from financing activities	**130.37**	**-2.88**	**-140.66**	**-67.97**
Net Increase/Decrease in Cash & Cash Equivalents	**5.59**	**26.22**	**-3.01**	**46.71**
Opening Cash Balance	5.32	10.30	36.52	33.51
Cash & cash equivalents	**10.30**	**36.52**	**33.51**	**80.23**

Key Ratios

Financial Year	FY08	FY09E	FY10E	FY11E
Valuation Ratios				
P/E	3.01	2.83	2.32	1.93
P/BV	0.80	0.66	0.54	0.44
P/Cash EPS	2.14	1.95	1.66	1.44
EV/EBIDTA	3.85	3.31	2.73	2.30
EV/Sales	0.77	0.69	0.60	0.52
Earnings Ratios				
Div. yield	6%	6%	8%	10%
OPM (incl. Other inc.)	17%	17%	18%	19%
ROACE	23%	26%	27%	28%
ROE	27%	23%	23%	23%
DPR	18%	17%	18%	20%
Balance Sheet Ratios				
Current Ratio	1.71	1.60	1.55	1.49
Debt/Equity	1.31	1.20	0.87	0.73
Debtor days	69	73	83	90
Creditor days	48	58	65	70
Inventory Days	76	85	93	95
Cost Analysis				
RM/Sales	57%	56%	55%	54%
Average Cost of Debt	5%	8%	7%	7%

SKP Securities Ltd (Member of NSE & BSE)

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