

J K INDUSTRIES LTD.

Increasing grip...

Q2 FY 2007 update

COMPANY DETAILS

Auditors	Lodha & Co.
CMD	Hari Shankar Singhania
Reg. Off	7 Council House Street Kolkata West Bengal - 700 001
Website	www.jktyre.com

SCRIP DETAILS

Market Capitalisation	Rs. 4.3 bn.
Book Value per share	Rs. 192
Equity Shares O/S (F.V. Rs.10)	30.8 mn.
Median Volumes (12 mths)	127,410 (BSE+NSE)
52 Week High/Low	Rs. 160 / 65
BSE Scrip Code	530007
NSE Scrip Code	JKINDUSTRY
Bloomberg Code	JKI@IN
Reuters Code	JKIN.BO

SHAREHOLDING PATTERN (%)

Qtr. Ended	Sep-06	Dec-06	Mar-07
Promoters	48.7	48.7	48.7
MFs/UTI/FIs	8.8	9.1	17.5
FII's/NRIs/OCBs	9.9	8.9	2.6
PCBs	19.6	18.3	16.6
Indian Public	13.0	15.1	14.6
Eq Shares (mn nos)	30.8	30.8	30.8

KEY FINANCIALS (STANDALONE)

Rs Mn	Quarter Ended			Year Ended (Sep)		
	Sep-06	Dec-06	Mar-07	2006	2007E	2008E
Net Sales	7,113	6,575	7,468	26,093	32,492	37,817
YoY Gr (%)	20.0	14.1	19.5	25.5	24.5	16.4
Op Profits	419	500	593	1,503	2,169	2,929
Op. Marg (%)	5.9	7.6	7.9	5.8	6.7	7.7
Net Profits	66	82	138	172	568	1,314
Eq Capital	308	308	308	308	308	308

KEY RATIOS

Year Ended (Sep)	EPS (Rs.)	ROCE (%)	RONW (%)	P/E (x)	EV/Sales (x)	EV/EBDIT (x)
2006	4.2	5.6	2.1	25.4	0.4	6.4
2007E	18.5	10.4	8.5	7.3	0.4	5.1
2008E	42.7	15.1	17.4	3.2	0.3	3.5

SUMMARY

- JK Industries (JKI) posted 20% YoY rise in sales to Rs 7.5 bn for Q2FY07. This was backed by a 12% improvement in realisations and 8% rise in volumes. The improvement in realisations was due to a price hike of 13-15% undertaken over the last 3-4 quarters.
- Raw material costs declined by 60 bps to 67.9% of net sales. This was primarily due to a slump in rubber prices to ~Rs 94/kg and a 5% decline in NTC fabric prices. However, carbon black prices were higher by ~15%.
- OPM improved by 290 bps to 7.9%. Despite higher capital charges, net profits rose by 231% & 24% QoQ to Rs 82 mn.
- The company has undertaken a capex of Rs 1.5 bn in FY06 & will be investing Rs 2 bn in FY08. This will take the overall capacity of the company to 8.8 mn units by end-FY07. The company is also adding capacity of 20k pa of high value OTR tyres in FY08.
- JKI underwent restructuring exercise, wherein it demerged the non-tyre business in FY02. It has now further restructured by hiving off investment portfolio of Rs 1.9 bn into a separate entity making J K Industries a pure play on the tyre business.
- Growth in the automotive industry coupled with strong replacement demand and growth in exports, should aid in volume growth. First mover advantage in T&B radials should be a significant positive going forward.*
- Additionally, easing raw material prices, rational industry pricing, increased contribution from high margin radial tyres and high capacity utilisation would help improve margins. Hence, we maintain our 'BUY' recommendation with a price target of Rs 225 on a one-year investment perspective.*

May 29, 2007

Sensex : 14508

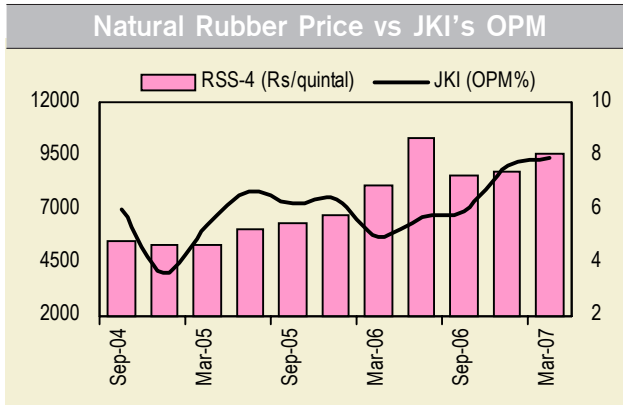
Nifty : 4293

CMP : Rs 135

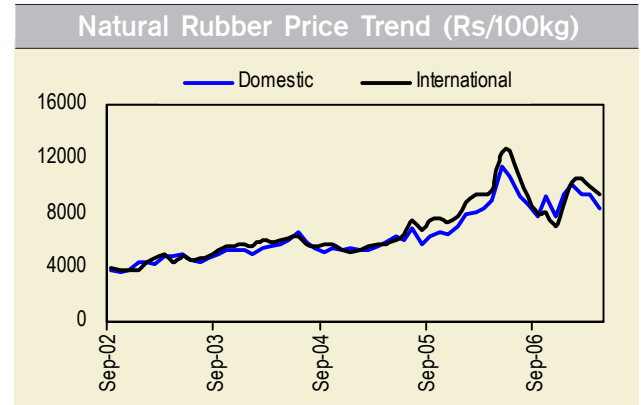
Recomm : BUY

The performance of the company was in line with expectations on volumes, realisations & profitability fronts in Q2FY07. Revenues rose by 20% YoY to Rs 7.5 bn on back of a sharp improvement in realisations by 11.6% and a volume growth of 8%.

Raw material cost, which has been the key concern for the company declined by 60 bps to 67.9% of net sales. Though natural rubber prices were higher by 17% at Rs 94/kg due to the policy of sourcing 2 months of rubber, effective cost of sourcing was approximately Rs 89/kg (excluding freight cost of Rs 10/kg).



Source : PINC Research



Source : Rubber board, PINC Research

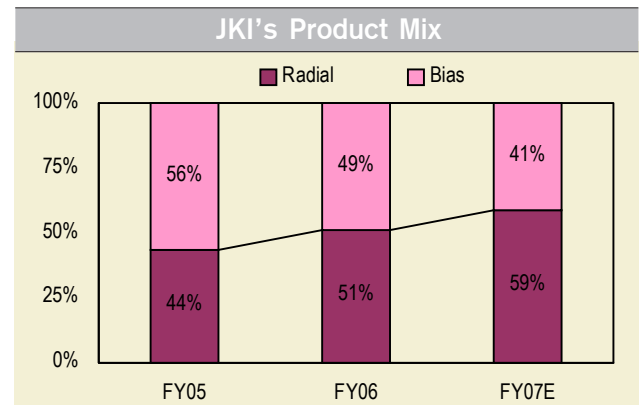
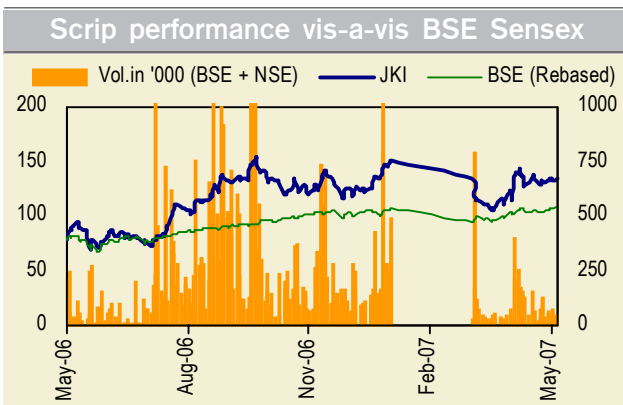
Improvement in realisations was primarily due to the price hikes undertaken by the company across the board to the tune of 13-15% over the last 3-4 quarters. Offtake of T&B radial tyres continued to be robust and JKI is operating at 95% utilisation of its total T&B radial capacity of 0.37 mn units. This has led to further improvement in company's average realisations owing to the higher contribution of radials in net sales.

Volume growth was led by the OEM segment, which saw an improvement in volumes on back of growth in automotive sales. However, volume growth was subdued to some extent due to the sharp increase in tyre prices resulting in postponement of replacement demand.

Also, NTC Fabric prices (imported) were lower by ~5% at Rs 197/kg. However, the sourcing cost for the company was lower at Rs 191/kg due to a mix of imports & domestic sourcing (Rs 183/kg), which helped push operating margins upwards. However, carbon black sourcing cost was higher at Rs 57/kg.

Staff cost declined by 70 bps to 5.5% of net sales. Other expenditure declined by 160 bps on account of savings in power & fuel cost, stores & spares as well as administrative expenses.

OPM surged by 290 bps to 7.9% and operating profits rose by 88% to Rs 593 mn. While finance cost rose by 15% to Rs 217 mn, depreciation rose by 11% to Rs 191 mn, on back of new investments. Net profits surged by 206% to Rs 138 mn.



Source : Company, PINC Research

In FY07, we expect volume growth of 10-12% for JKI, led by a robust offtake in the aftermarket, even as growth in OEM market might be sluggish. Growth in the replacement market will be led by the robust increase witnessed in automotive industry over the past 5 years coupled with deferred replacements over the past 3-4 quarters due to rise in tyre prices.

JKI has been running at more than 90% capacity utilisation for 4-6 quarters. In Q1FY07, it has expanded PC radial & LCV bias capacity by 0.5 mn & 0.3 mn tyres respectively taking the total capacity to 8.1 mn. It is looking at further increasing capacities of PC radial by 0.7 mn tyres which will take the total capacity to 8.8 mn units in Jun'07.

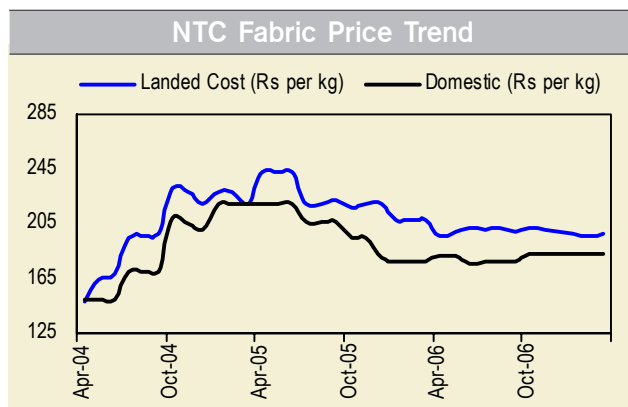
The company also intends to enter OTR tyres in a significant way and plans to add capacity of 20k tyres p.a. of high value tyres (~Rs 50k-Rs 60k) in FY08.

We expect robust offtake of T&B radial tyres to continue in FY07 on the back of increasing radialisation, especially in multi-axle vehicles alongwith first mover advantage for which it currently enjoys >75% market share in the segment. We also expect strong growth in PC radials and LCV tyres on back of incremental capacity along with further capacity additions of 0.7 mn tyres expected in Jun'07.

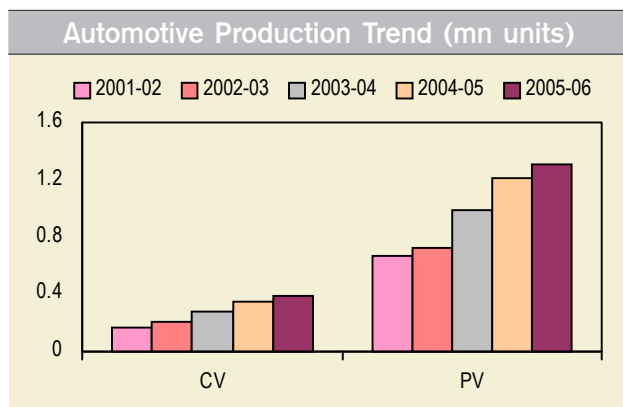
We expect realisations to improve by 13-15% due to the price hikes undertaken, richer product mix and possibility of further pricing actions. Consequently, we expect revenues to rise by 25% to Rs 32.5 bn in FY07.

Raw Material Outlook

Natural rubber prices have declined from Rs 103/kg in Apr-Jun'06 to Rs 86/kg in Jul-Sep'06 and are at Rs 90/kg currently.



Source : PINC Research

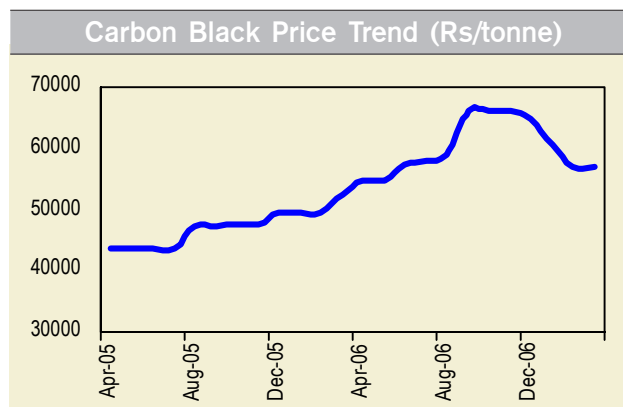


Source: PINC Research

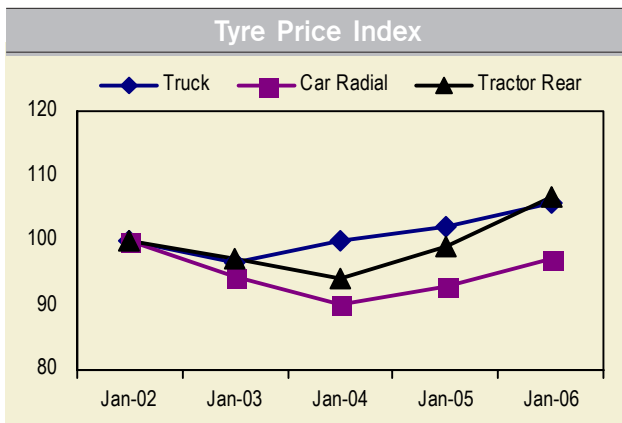
This was primarily led by a 7% rise in rubber production as compared to a relatively slower 2.2% rise in consumption over the past 12 months. As the company sources two months of natural rubber, the effect of lower natural rubber prices were reflected during the quarter. We expect effective sourcing cost to be at Rs 95-100/kg (including freight of Rs 8-9/kg).

Domestic NTC fabric prices have been declining for the past 12-18 months from the peak of Rs 243/kg in Jun'05 to Rs 183/kg currently, where they have stabilised. However, due to a demand-supply imbalance in the domestic markets, sourcing of NTC Fabric is done from international markets where landed cost is higher by ~8%. We expect domestic NTC Fabric prices to be in the range of Rs 175-190/kg with an 8-10% premium in the international markets.

Prices of other raw materials viz. carbon black, SBR & PBR are linked to crude oil prices. While prices of SBR & PBR have been steady, carbon black prices have surged by 15% in the Jan-Mar'07 period.



Source : PINC Research



Source : CRIS Infac, PINC Research

JK Inds. segment-wise capacity (mn tyres)			
Year Ended	Sep'05	Sep'06	Sep'07
Truck & Bus - Bias	2.53	2.53	2.53
Truck & Bus - Radial	0.26	0.37	0.37
Cars & LCVs - Bias	0.75	0.75	0.75
Cars & LCVs - Radial	2.52	3.42	4.80
Others	0.32	0.32	0.32
Total	6.37	7.38	8.76

Source: Company

Fall in crude oil prices from \$80/bbl to the current \$65/bbl should result in a fall in crude-linked inputs. As the effect comes with a lag, we expect lower sourcing cost for the same for the next 2-3 quarters. Resultantly, we expect raw material cost to decline by 120 bps.

We expect other expenditure to rise by 40 bps to 19.9% of sales on back of higher sales promotion & advertising due to competition intensifying with possibility of efficient appropriation of fixed costs on a higher revenue base. We expect operating margins of the company to improve by 70 bps to 6.5% in FY07 on back of lower raw material cost.

The company has expanded its capacity from 6.4 mn units in FY05 to 7.4 mn units in FY06, and plans to further expand to 8.8 mn units in FY07.

JKI is further adding 20k units of high-value OTR tyres for use in construction & material handling equipment in FY08. There is a shortage of OTR tyres used in construction equipment and we expect JKI to capitalise on this opportunity once the capacity comes on stream. The capex incurred for the expansion was Rs 1.5 bn in FY06 and a further Rs 2 bn is expected in FY08.

The company has borrowed additional debt of Rs 1.6 bn for the expansion. It had a debt of Rs 9.9 bn as on Dec'06, segregated into Rs 5.4 bn of term loans & Rs 4.5 bn of WC loans.

We believe, with strong cash accruals, the company will pay off a portion of the debt in FY07, resulting in marginally lower finance cost. However, we expect depreciation to increase on the back of investment in capacity expansions (Rs 1.5 bn in FY06, Rs 650 mn & Rs 1.4 bn in FY07 & FY08 respectively).

JKI has restructured its business, wherein the investments of Rs 1.9 bn have been hived off into a separate company. Each shareholder holding 4 shares of JKI, received 3 shares of JKI (tyre co.) and 1 share of the investment company.

The book value of the new company is ~Rs 200/share. We expect this new company to be listed at 18-20% of its market value of investments as in case of recent listings of other investment companies.

The company had a debt:equity of 1.1 in FY06. Post restructuring, Rs 1.9 bn will be transferred from reserves (revaluation reserve) to the new company. We expect the debt:equity ratio to increase to 1.5x in FY07 with improvement to 1.2x in FY08 post repayment of debt.

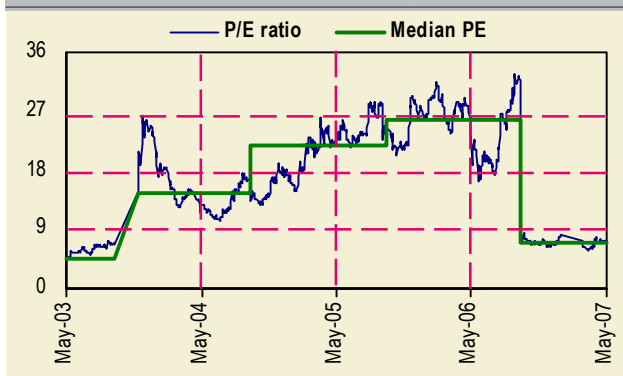
The growth in the automotive industry coupled with strong replacement demand and growth in exports, should aid volume growth. First-mover advantage in T&B radials should be a significant positive going forward. Additionally, easing raw material prices, rational industry pricing, increased contribution from high-margin radial tyres and high capacity utilisation would help improve margins.

At the CMP of Rs 135, the stock trades at a P/E of 7.5x, EV/Sales of 0.4x and EV/EBIDT of 5.1x discounting its FY07E numbers. Considering the attractive valuations, significant discount to its peers and turnaround in fortunes of tyres industry, we maintain our 'BUY' recommendation with a price target of Rs 225 on a one-year investment perspective. We also expect additional prospects of value unlocking on listing of investment company shares.

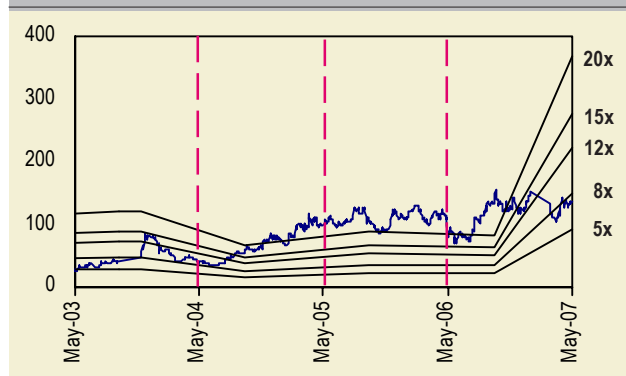
Financial results for the quarter & half year ended Mar 31, 2007 (Standalone)

Particulars (Rs mn)	Quarter Ended			Half Year Ended			Yr Ended
	31/03/07	31/03/06	Gr %	31/03/07	31/03/06	Gr %	30/09/06
Gross Income	8,486	7,068	20.1	15,920	13,591	17.1	29,524
<i>Less: Excise Duty</i>	1,018	818		1,877	1,580		3,430
Net Sales	7,468	6,250	19.5	14,043	12,012	16.9	26,094
Expenditure	6,876	5,935	15.8	12,951	11,327	14.3	24,591
(Inc.) / Dec. stock-in-trade	179	(275)		(445)	(703)		(916)
Materials	4,892	4,554	7.4	9,946	8,797	13.1	18,856
Staff Cost	414	392	5.7	826	764	8.1	1,562
Other expenditure	1,390	1,264	10.0	2,624	2,469	6.3	5,090
Operating profit	593	315	88.0	1,093	684	59.7	1,503
Other Income	31	91	(65.4)	51	106	(51.9)	187
PBDIT	624	406	53.7	1,144	790	44.7	1,689
Interest	217	189	14.7	418	355	17.7	761
Depreciation	191	172	10.8	378	342	10.7	710
PBT & Extra Ord. Items	217	45	381.3	347	93	272.5	218
Extra Ord Inc / Exp	-	-		-	-		-
PBT	217	45	381.3	347	93	272.5	218
Provision for current tax	-	-		-	24		43
Provision for deferred tax	71	-		114	-		(6)
Provision for FBT	8	-		15	-		9
Net Profit	138	45	205.6	219	70	214.5	172
Equity Capital	308	375		308	375		308
Reserves (excl. rev. res.)	-	-		-	-		5,609
EPS for the period (Rs)	4.5	1.2		7.1	1.9		5.5
Book Value (Rs)	-	-		-	-		192
OPM (%)	7.9	5.0		7.8	5.7		5.8
NPM (%)	1.8	0.7		1.6	0.6		0.7
Expend. (% of net sales)							
Raw materials (adj.)	67.9	68.5		67.7	67.4		68.8
Staff costs	5.5	6.3		5.9	6.4		6.0
Other expenses	18.6	20.2		18.7	20.6		19.5

Median PE v/s Daily PE



PE Band



Year Ended September (Figures in Rs Mn)

Income Statement	2005	2006	2007E	2008E	Cash Flow Statement	2005	2006	2007E	2008E
Revenues	20,786	26,093	32,492	37,817	PBT & Extraord. items	34	218	818	1,662
<i>Growth %</i>	8.3	25.5	24.5	16.4	Depreciation	637	709	741	760
Total Expenditure	19,635	24,583	30,322	34,888	Interest & Div. Income	(49)	(33)	(200)	(250)
Operating Profit	1,151	1,511	2,169	2,929	Interest Paid	668	791	810	757
Interest & Dividend Income	-	-	-	-	Tax Paid	(12)	(51)	(109)	(208)
Other Income	193	176	200	250	Deferred Revenue Expd.	25	38	-	-
EBDIT	1,344	1,687	2,369	3,179	Misc Exp & Extra ordinary items	(46)	(56)	-	-
(-) Depreciation	637	709	741	760	(Inc.)/Dec. in WC	(397)	(1,159)	(345)	(943)
(-) Interest	673	762	810	757	Cash from Operations	859	456	1,715	1,777
PBT & Minority Interest	34	216	818	1,662	Net Capital exp.	(977)	(1,125)	(845)	(355)
(-) Tax Provision	(133)	48	249	348	Net Investment	93	69	(35)	(100)
(+) Prior Period Adj.	79	-	-	-	Interest & Div Recd.	61	40	200	250
Net Profits	89	168	568	1,314	Cash from Investing Act.	(823)	(1,016)	(680)	(205)
Fully Diluted Eq. Sh. O/S (mn nos.)	37	31	31	31	Issue of Equity shares	-	36	-	-
Book Value (Rs)	209	192	200	231	Share Premium	-	342	-	-
Basic E.P.S. (Rs)	4.5	5.5	18.5	42.7	Change in Loans (incl. FCCBs)	740	1,133	(439)	(500)
Diluted E.P.S. (Rs)	4.5	5.5	18.5	42.7	Interest paid	(712)	(834)	(810)	(757)
					Equity Div. paid (incl. tax)	(85)	(86)	(77)	(92)
					Cash from Financing Act.	(57)	591	(1,326)	(1,349)
					Inc/(Dec) in Cash	(21)	32	(291)	224
Balance Sheet	2005	2006	2007E	2008E	Key Ratios	2005	2006	2007E	2008E
<i>Equity Share Capital</i>	375	308	308	308	EBIDTA Margins (%)	6.5	6.5	7.3	8.4
<i>Reserves & Surplus</i>	7,451	5,609	5,841	6,802	ROACE (%)	4.4	6.2	10.6	15.5
Net Worth	7,826	5,917	6,148	7,110	ROANW (%)	1.1	2.8	9.2	18.5
Total Borrowings	8,305	9,439	9,000	8,500	Sales/Total Assets (x)	1.3	1.7	2.1	2.4
Deferred Tax Liability (Net)	(31)	(16)	124	264	Debt:Equity (x)	1.1	1.6	1.5	1.2
Capital Employed	16,101	15,340	15,272	15,873	Current Ratio (x)	1.2	1.3	1.3	1.4
Fixed Assets	11,740	12,242	11,890	11,420	Debtors (Days)	63.1	71.0	57.1	57.3
Capital WIP	616	225	420	225	Inventory (Days)	45.4	54.7	46.4	48.6
Goodwill	-	-	-	-	Working Capital (Days)	17.1	26.8	21.7	28.4
Net Current Assets	1,115	2,167	2,220	3,387	EV/Sales (x)	0.5	0.5	0.4	0.3
Investments	2,500	615	650	750	EV/EBIDT (x)	7.9	7.5	5.3	3.7
Misc. Exp (not w/off)	129	92	92	92	P/E (x)	30.8	25.2	7.5	3.2
Total Assets	16,101	15,340	15,272	15,873	P/BV (x)	0.66	0.72	0.69	0.60

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