Stock Note

JK Tyres and Industries Ltd

May 02, 2023

RETAILRESEARCH

JK Tyres and Industries Ltd

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Auto Ancillary	Rs. 178.60	Buy in the band of Rs 176 - 181 and add on dips in the band of Rs 158 - 161	Rs. 195.5	Rs. 211	2 - 3 quarters

HDFC Scrip Code	JKTYREEQNR
BSE Code	530007
NSE Code	JKTYRE
Bloomberg	JKI:IN
CMP Apr 28, 2023	178.6
Equity Capital (Rs cr)	49.3
Face Value (Rs)	2.0
Equity Share O/S (cr)	24.6
Market Cap (Rs cr)	4416.2
Book Value (Rs)	124.9
Avg. 52 Wk Volumes	2054627.1
52 Week High	213.5
52 Week Low	95.5

Share holding Pattern % (Mar 2023)	
Promoters	56.26
Institutions	8.86
Non Institutions	34.88
Total	100.00

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

JK Tyres and Industries is one of the leading tyre manufacturers globally. The company was a pioneer of radial technology in India and is a leader in the truck and bus radial (TBR) segment. It has 40+ years of experience in tyre manufacturing and has operations in 100+ countries around the world. The company has 12 manufacturing facilities – 9 in India and 3 in Mexico with a production capacity of 33 million tyres. It serves customers across the globe via its extensive distribution network of 6000+ dealers and increasing online presence.

To strengthen its product portfolio, it has recently launched low RRC tyres in PCR and TBR range and introduced smart tyres range for the EV SUVs. It has full range of EV tyres to cater to the various market segments. With softening input prices, healthy demand from OEMs on easing of supply pressures and improving performance of its international subsidiary, we expect the company to do well in the near term.

Valuation & Recommendation:

We expect JK Tyre's margins to improve on softening of raw material prices and price hikes taken in past quarters. Volume growth is expected on the back of easing of supply related headwinds for OEMs and better replacement demand in CVs. The company is operating at a healthy utilization rate and additional capacity is being added in the PCR and TBR segment. We expect company to report Revenue/EBITDA/PAT CAGR of 13%/17%/39% over FY22-25E. Improving return ratios and limited shocks on raw material front could enable rerating of the company.

We think the base case fair value of the stock is Rs 195.5 (9.5x FY25E EPS) and the bull case fair value is Rs 211.0 (10.25x FY25E EPS) over the next two-three quarters. Investors can buy the stock in the band of Rs 176 - 181 (8.7x FY25E EPS) and add more on dips in the band of Rs 158 – 161 (7.75x FY25E EPS).

Financial Summary

Particulars (Rs cr)	Q3FY23	Q3FY22	YoY-%	Q2FY23	QoQ-%	FY21	FY22	FY23E	FY24E	FY25E
Operating Income	3613	3076	17.5	3757	-3.8	9,102	11,983	14,679	16,044	17,376
EBITDA	339	273	24.1	297	14.1	1,306	1,073	1,277	1,508	1,703
APAT	67	54	23.9	50	34.6	331	201	265	426	536
EPS (Rs)	2.7	2.2	23.9	2.0	34.6	13.4	8.2	10.8	17.3	20.6
RoE-%						13.2	7.3	8.9	13.0	13.9
P/E (x)						13.3	21.9	16.6	10.3	8.7
EV/EBITDA						6.9	8.8	7.5	6.4	5.2

(Source: Company, HDFC sec)

Q3FY23 Result Review:

JK Tyre's Q3FY23 consolidated revenue grew 17.5% YoY to Rs. 3,613 Cr, as domestic revenue rose 15.1% YoY to Rs 3,106 cr and income from Mexico increased 16.7% YoY to Rs. 607 Cr. Volume and price increase contributed 4% and 14% YoY growth for sales, respectively. OEMs' share in revenue continued to grow to 24% in Q3FY23 vs. 21% in Q2FY23 and 16% in Q3FY22. At the same time, revenue declined 3.8% sequentially. The company also reported a 400 bps YoY and QoQ decline in exports share in revenue to 16%, owing to global headwinds.

EBITDA grew 24.1% YoY to Rs. 339 Cr and EBITDA margin came in at 9.4%, up 150 bps sequentially and up 50 bps YoY, due to softer input prices, effective cost-control, and price hikes taken by the management. At the same time, other expenses grew by 4.4% QoQ in Q3FY23, owing to elevated energy prices and higher capacity utilization. However, the company expects further softening of raw material prices, such as rubber and energy, to boost margins in the near term. PAT for the quarter stood at Rs. 67 Cr (+23.9% YoY and +34.6% QoQ).

Its domestic subsidiary, Cavendish, reported a revenue of Rs. 976 Cr in Q3FY23 (vs Rs. 982 Cr in Q2FY23 and Rs. 720 Cr in 3QFY22) up 36% YoY. EBITDA margin stood at 9.7% vs. 6.3% in Q2FY23. Cavendish capacity utilization stood at ~92% vs. 85% in Q2FY23.

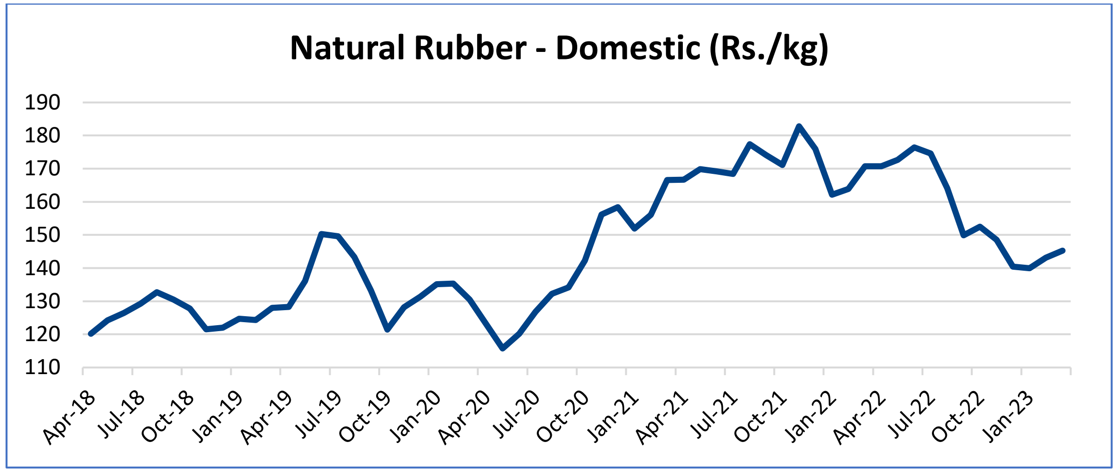
Key Triggers:

Softening raw material prices

Tyre companies had been facing continuous raw material inflation due to lower production of natural rubber, strong demand from China, and high crude prices. Import duties and restrictions, container shortages and high freight rates had also kept imported raw material cost expensive. Prices of rubber (natural and synthetic), carbon black and nylon tyre cord fabric, which had risen continuously for the past 7 – 8 quarters, have now stabilized/moderated since Q3FY23. Average price of domestic natural rubber for Q4FY23 has reduced ~15% YoY and

~4% QoQ, while prices of imported natural rubber have remained flat. Synthetic rubber prices are linked to crude and were down in Q4FY23. Price of carbon black is still up from previous year but has come down from prices prevailing in the past 3 quarters.

Easing of inflationary pressures on the raw material front will help the company expand its operating margin in Q4FY23 and Q1FY24. Price hikes taken by the company during the year were not sufficient to cover the steep rise in raw material costs and hence reduction in the raw material prices shall help in reducing the under recoveries. Government has increased duty on import of compounded rubber but the company management expects only a marginal impact. The company has plans to offset the impact through cost reduction measures including maximizing domestic procurement on a priority basis. Sustenance or decrease in raw material prices may drive profitability for JK Tyres and remains a key monitorable.



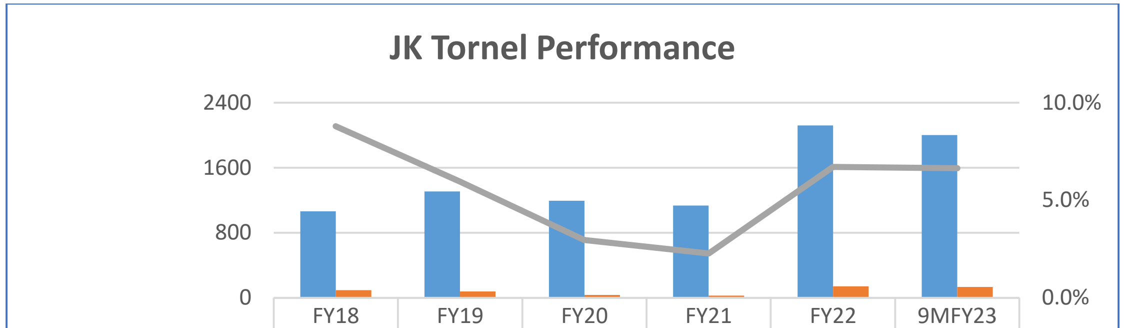
(Source: Rubber Board, Company, HDFC sec)

Improvement in performance of subsidiaries

During Q3FY23, JK Tornel (Mexican subsidiary) achieved a turnover of RS. 608 Cr as compared to Rs. 521 Cr in Q3FY22, registering a growth of 17%. EBITDA stood at Rs. 48 Cr vis-a-vis Rs. 46 Cr in the corresponding quarter. Q3 is generally a muted quarter on account of lower number of working days due to Christmas holidays in December. In addition, exports demand was impacted in North American and Latin American markets due to macroeconomic headwinds and dealers clearing their high cost inventory. However, the management expects global demand situation to improve amidst easing in inflationary pressures in the coming quarters.

JK Tornel is the largest tyre supplier to all the mass merchandisers in Mexico - Walmart, Soriana, Chedraui, Elektra, Coppel, CASA Ley, Suburbia and Comercial Mexico. The company also commands the highest PCR market share in the PCR replacement market with a share of over 12%. JK Tornel received Best Supplier Award by both Walmart and Soriana out of 300-plus suppliers in home and essentials category. The company has also achieved the status of being highest seller of tyres on online platform with a market share of 50%.

The management expects to increase market share in the passenger car radial tyres over the next 2 – 3 years. Market for truck and bus radials is de-growing. As a result, the company is focusing on expanding and diversifying in the industrial and farm tyres segment.



	FY18	FY19	FY20	FY21	FY22	9MFY23
Revenue (in Cr)	1065	1309	1191	1133	2119	2002
PBIT (in Cr)	94	78	35	26	142	133
PBIT (%)(RHS)	8.8%	5.9%	3.0%	2.3%	6.7%	6.6%

(Source: Company, HDFC sec)

Capacity Expansion

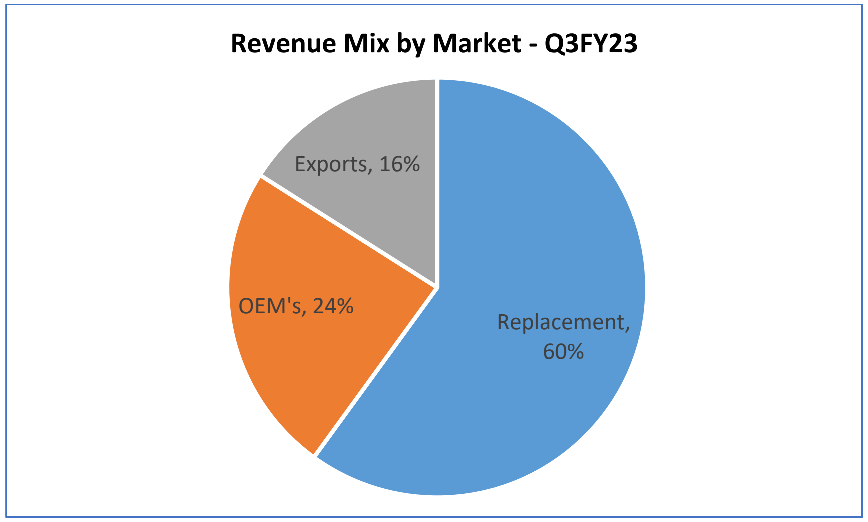
Average capacity utilisation during Q3FY23 was 88% with radial capacity at even higher utilisation. JK tyres has already announced capacity expansion plans, which are under implementation stage and progressing well. The total amount of capex will be deployed in two projects - one for PCR capacities in JK Tyres for Rs. 530 Cr and the other one is in the TBR for Rs. 260 Cr in Cavendish Industries. The capacity increase is about 16-17% in PCR and ~10% in overall TBR capacity. The capex will be funded by a combination of debt and internal accruals in the ratio of 1.5:1. The company has also issued $30 million worth compulsorily convertible debentures (CCD) on preferential basis to International Finance Corporation. These CCDs will bear interest @ 6% p.a. compounded cumulatively on a quarterly basis and will be converted into shares at Rs. 180.50 per CCD within 18 months from the date of allotment. These CCDs will give IFC a 5.58% stake in the company. The investment will be used to partly finance the expansion of manufacturing capacities and strengthen the capital structure of the company.

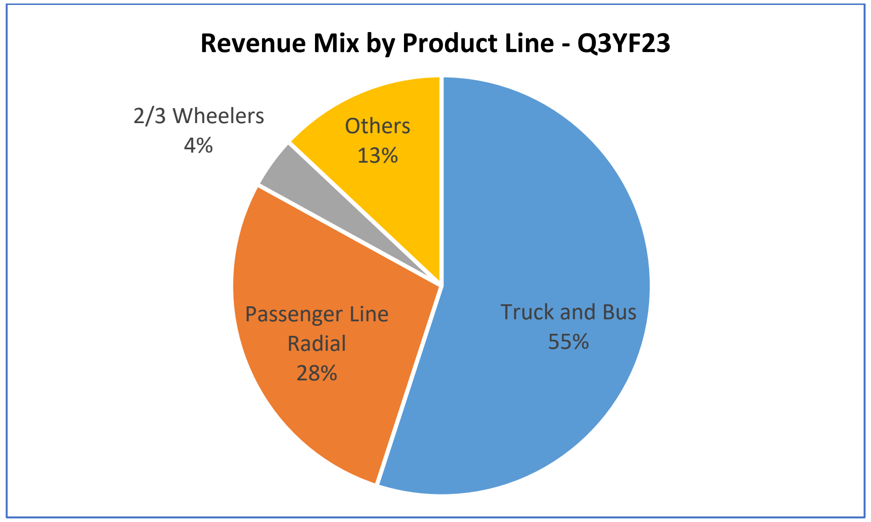
Healthy domestic demand

The domestic automotive sector has a significant potential of growth, driven by aggressive stance of government to improve infrastructure spend, higher fleet utilization and implementation of the scrappage policy. Demand in the personal vehicle space will be driven by higher disposable incomes of the middle class. Further, agriculture output will also foster well for the rural demand.

Almost 55% of the revenue that the company generates is from the truck and bus segment, and about 28% from the passenger car segment. 2/3 wheelers contribute only about 5%. This revenue mix will benefit the company, as demand for CV's is picking up due to the increasing freight movement and pick up in core industry, while 2 wheelers and rural demand is facing a slowdown. Structurally too, the vehicles in the MHCV segment have gone for higher tonnage leading to higher number of tyres per axle/per vehicle, which is a positive for the company. Replacement demand is also expected to come back in this segment as core industries pick up. The plants are operating at ~90% capacity.

Demand from OEMs has been healthy and is expected to grow at a decent pace. Replacement demand, which had slowed down due to price hikes and financial stress faced by fleet operators due to higher interest rates and tightening credit, has also bounced back in March 2023 and is expected to continue in Q1YF24.





(Source: Company, HDFC sec)

Risks and Concerns:

Penalty for alleged cartelization in the past

CCI had imposed a penalty of Rs. 1,788 Cr on 5 major tyre companies including Rs. 309.95 Cr on JK Tyre in the matter of alleged cartelization. However, the NCLAT has directed the competition commission to pass a fresh order, citing the need to re-examine arithmetical and inadvertent errors as well as to review the penalty to save the domestic tyre industry.

Regulatory risk

Companies have to comply with various emission norms and safety standards. Any new norms or tightening of existing norms could make existing technology redundant and require the company to incur capex. Further, any changes in government policies for the auto sector as a whole can have an impact on the company.

Competition

Any increase in competitive intensity is a negative for the company. Discounts given by other manufacturers to dealers invariably lead to a price war and lower margins for the industry as a whole. Excess capacity may result in competitive pressures. Apart from the Indian manufacturers, the company has to compete with cheap Chinese imports as well. The government has presently levied CVD on imports from China, which helps the domestic tyre industry.

Commodity Price Fluctuation

Raw material constitutes a huge cost (~60%) in the tyre industry. Rubber, Carbon Black, Nylon Cord, and synthetic rubber are all commodity products whose prices fluctuate throughout the year. Adverse and sudden movements in the price of these commodities will have an adverse impact on the bottom line. Full cost pass through is difficult and usually affects the demand.

Adverse Currency movement

The company imports a significant amount of raw material and earns income from exports. It has also taken foreign currency loans. While natural hedge partially mitigates the risk, foreign exchange volatility could affect the margins of the company.

Economic Slowdown

55% of the revenue is generated from Truck and Bus tyres. Replacement demand as well as demand from CV OEMs may take a hit leading to lower revenues and profitability in case of an economic slowdown. An economic slowdown will also lead to lower disposable income in the hands of the middle class and thus affect the passenger car segment as well.

High debt

Consolidated debt as on Sep 30, 2022 stood at Rs. 5,323.01 Cr of which long term debt was Rs. 2,470 Cr. Short term debt is on account of increased working capital intensity due to increased raw material prices and increase in topline. Debt to Equity has decreased from 2.2x in FY20 to 1.8x in FY22 but remains on the higher side. The company is also funding the capacity expansion by taking further debt in in the ratio of 1.5:1. The management has a plan to reduce debt by repaying Rs. 400 – 500 Crs annually. Debt will also reduce by Rs. 240 Cr as the compulsorily convertible debentures issued to IFC will be converted into equity.

Losses in Cavendish Industries pulling down consolidated profits

While the company has managed to achieve operating profitability in Cavendish Industries Limited (CIL), CIL has incurred a loss after tax for the past 5 years except for FY21, which was a very good year for the tyre industry as a whole. Loss after tax has increased from Rs. 29 Cr in FY19 to Rs. 65 Cr in FY22 and remains a drag on the consolidated profits.

Poor return ratios

Return on Net worth for the past 5 years has been below 10% except for FY21 where the return was 13.2%. This is due to low FA/Sales ratio (~1.4x – 1.7x) and low PAT margins (less than 2%) in the past 5 years. Profitability will increase as utilization and profits increase and rerating may be possible if the return on net worth exceeds the cost of capital.

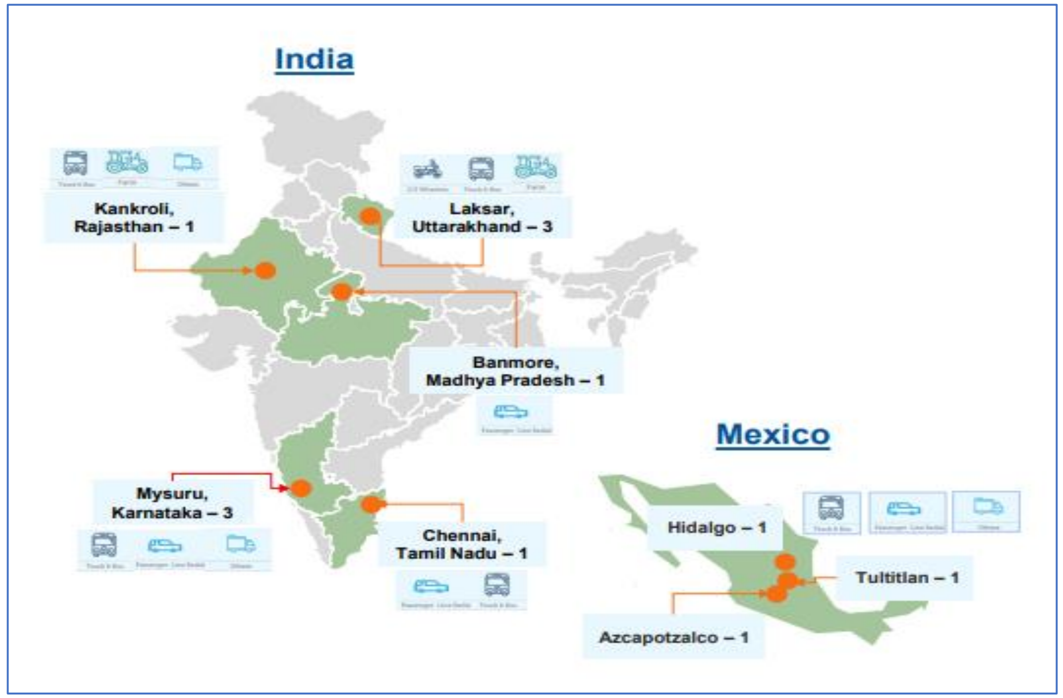
About the company:

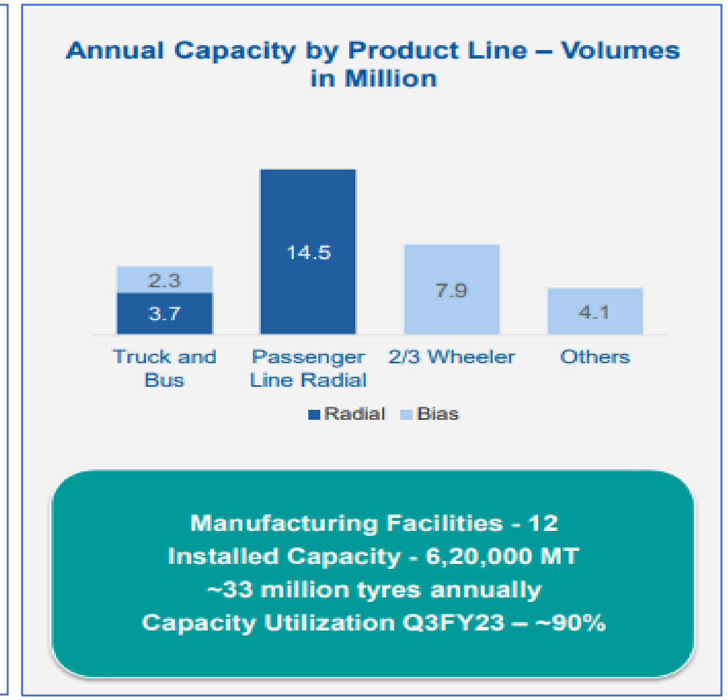
JK Tyre was incorporated as a private limited company in West Bengal in February 14, 1951. Until March 31, 1970, the company was engaged in the managing agency business. Thereafter, the company decided to undertake manufacturing activities and obtained a letter of intent in February 1972 for the manufacture of automobile tyres and tubes.

It is the flagship company of JK Organisation and one of India’s foremost tyre manufacturers. The company is also amongst the top 25 manufacturers in the world. Pioneers of radial technology, the Company produced the first radial tyre in 1977 and is currently the market leader in Truck Bus Radial segment. The Company provides end-to-end solutions across segments of passenger vehicles, commercial vehicles, farming, Off-the-Road and two & three-wheelers.

A global force, JK Tyre is present in 105 countries with over 180 Global distributors. The Company has 12 globally-benchmarked ‘sustainable’ manufacturing facilities - 9 in India and 3 in Mexico – that collectively produce around 35 million tyres annually. The Company also has a strong network of over 4000 dealers and 500+ dedicated Brand shops called as Steel Wheels and Xpress Wheels. JK Tyre is also synonymous with motorsport in the country.

JK Tyre has a state-of-the-art global research and technology centre – the Raghupati Singhania Centre of Excellence - in Mysore. The Centre houses some of the world's finest technologies and techniques, thereby, adding to the larger efforts of the Company to put India on the global innovation map. The Hari Shankar Singhania Elastomer and Tyre Research Institute (HASETRI) - which fulfils need for globally competitive technologies for tyres and polymers and the JK Tyre Tech Centre, a hub for new product development catering to current and emerging needs of customers.





(Source: Company, HDFC sec)

Peer comparison

	Mcap (Rs. Cr)	Sales				EBITDA Margin (%)				PAT				RoE (%)				P/E (x)			
		FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E
JK Tyres	4398	11983	14679	16044	17376	9.0	8.7	9.4	9.8	200	265	426	536	7.3	8.9	13.0	13.9	21.9	16.6	10.3	8.7
MRF	37700	19317	22926	24946	26667	10.6	9.8	13.0	13.7	669	738	1325	1775	4.9	5.0	9.2	10.3	56.4	53.2	23.8	20.2
Apollo Tyres	22057	20581	24173	26888	29498	12.5	13.1	14.0	14.5	645	995	1616	2083	5.5	7.6	11.9	13.8	34.3	22.1	13.6	10.6
CEAT	6331	9363	11301	12314	13328	7.6	7.9	10.3	10.9	71	160	406	514	2.2	4.9	11.1	12.6	89.2	36.6	14.7	11.6

(Source: Bloomberg, Company, HDFC sec)

Financials

Income Statement

(Rs Cr)	FY21	FY22	FY23E	FY24E	FY25E
Net Revenues	**9102**	**11983**	**14679**	**16044**	**17376**
Growth (%)	***4.3***	***31.6***	***22.5***	***9.3***	***8.3***
Operating Expenses	7796	10910	13402	14536	15673
EBITDA	**1306**	**1073**	**1277**	**1508**	**1703**
Growth (%)	***32.3***	***-17.8***	***19.0***	***18.1***	***12.9***
EBITDA Margin (%)	***14.4***	***9.0***	***8.7***	***9.4***	***9.8***
Depreciation	387	385	403	418	473
Other Income	43	37	35	24	26
EBIT	**963**	**724**	**909**	**1114**	**1256**
Interest expenses	466	419	454	442	410
PBT	**534**	**309**	**418**	**672**	**846**
Tax	201	109	153	246	310
PAT	**333**	**200**	**265**	**426**	**536**
Share of Asso./Minority Int.	-3	1	0	0	0
Adj. PAT	**331**	**201**	**265**	**426**	**536**
Growth (%)	***134.2***	***-39.2***	***31.6***	***60.8***	***25.9***
EPS	13.4	8.2	10.8	17.3	20.6

Balance Sheet

As at March (Rs Cr)	FY21	FY22	FY23E	FY24E	FY25E
SOURCE OF FUNDS					
Share Capital	49	49	49	49	52
Reserves	2623	2799	3027	3416	4173
Shareholders' Funds	**2673**	**2848**	**3076**	**3465**	**4225**
Minority Interest	106	99	99	99	99
Total Debt	4801	5220	5340	5314	4564
Net Deferred Taxes	322	318	318	318	318
Other Non-curr. Liab.	612	636	780	852	923
Total Sources of Funds	**8514**	**9122**	**9614**	**10049**	**10129**
APPLICATION OF FUNDS					
Net Block & Goodwill	6255	6435	6031	6703	6430
CWIP	286	101	567	101	50
Investments	147	133	133	133	133
Other Non-Curr. Assets	160	159	158	157	170
Total Non Current Assets	**6848**	**6827**	**6889**	**7093**	**6783**
Inventories	1789	2433	2896	3121	3237
Debtors	1575	1980	2425	2681	2999
Cash & Equivalents	174	176	98	55	109
Other Current Assets	554	746	845	879	905
Total Current Assets	**4092**	**5334**	**6264**	**6736**	**7250**
Creditors	1574	2189	2534	2681	2714
Other Current Liab & Provisions	853	850	1005	1099	1190
Total Current Liabilities	**2427**	**3038**	**3539**	**3780**	**3904**
Net Current Assets	1665	2296	2725	2956	3346
Total Application of Funds	**8514**	**9122**	**9614**	**10049**	**10129**

(Source: Company, HDFC sec)

Cash Flow Statement

(Rs Cr)	FY21	FY22	FY23E	FY24E	FY25E
Reported PBT	534	309	418	672	846
Non-operating & EO items	-117	-19	144	74	58
Interest Expenses	432	391	426	423	389
Depreciation	387	385	403	418	473
Working Capital Change	452	-650	-506	-275	-336
Tax Paid	-89	-70	-153	-246	-310
OPERATING CASH FLOW (a)	**1,598**	**346**	**731**	**1,066**	**1,120**
Capex	-160	-292	-466	-624	-150
Free Cash Flow	1,439	54	265	442	970
Investments	0	25	0	0	0
Non-operating income	26	23	28	19	21
INVESTING CASH FLOW (b)	**-134**	**-244**	**-438**	**-605**	**-129**
Debt Issuance / (Repaid)	-898	429	120	-26	-750
Interest Expenses	-471	-425	-454	-442	-410
FCFE	95	105	-40	-7	-169
Share Capital Issuance	0	0	0	0	263
Dividend	-17	-49	-37	-37	-39
Others	-54	-51	0	0	0
FINANCING CASH FLOW (c)	**-1,386**	**-46**	**-371**	**-505**	**-937**
NET CASH FLOW (a+b+c)	**78**	**56**	**-77**	**-44**	**55**

One Year Price Chart:

(Source: Company, HDFC sec)

Key Ratios

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Profitability Ratios (%)					
EBITDA Margin	14.4	9.0	8.7	9.4	9.8
EBIT Margin	10.6	6.0	6.2	6.9	7.2
APAT Margin	3.6	1.7	1.8	2.7	3.1
RoE	13.2	7.3	8.9	13.0	13.9
RoCE	12.9	9.3	11.0	13.0	14.3
Solvency Ratio (x)					
Net Debt/EBITDA	3.5	4.7	4.1	3.5	2.6
Net D/E	1.7	1.8	1.7	1.5	1.1
PER SHARE DATA (Rs)					
EPS	13.4	8.2	10.8	17.3	20.6
CEPS	29.1	23.8	27.1	34.3	38.7
BV	108.5	115.7	124.9	140.7	162.0
Dividend	2.0	1.5	1.5	1.5	1.5
Turnover Ratios (days)					
Debtor days	68.6	54.1	54.8	58.1	59.7
Inventory days	68.3	64.3	66.2	68.4	66.8
Creditors days	65.4	57.3	58.7	59.3	56.7
VALUATION					
P/E	13.3	21.9	16.6	10.3	8.7
P/BV	1.6	1.5	1.4	1.3	1.1
EV/EBITDA	6.9	8.8	7.5	6.4	5.2
EV / Revenues	1.0	0.8	0.7	0.6	0.5
Dividend Yield (%)	1.1	0.8	0.8	0.8	0.8
Dividend Payout (%)	14.9	18.4	13.9	8.7	7.3

(Source: Company, HDFC sec)

NIRMAM ANIL MEHTA

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HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

I,**Nirmam Mehta (ACA),** author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. SEBI conducted the inspection and based on their observations have issued advise/warning. The said observations have been complied with. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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Any holding in stock – **No**

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