

CMP: ₹ 160

Target: ₹ 190 (19%)

Target Period: 12 months

BUY

February 6, 2023

Margins to further improve amid benign RM prices; inexpensive valuations merit upgrade...

About the stock: JK Tyre (JKT) is a leading tyre manufacturer with annual capacity pegged at 6.2 lakh MT. It serves various automotive segments via India, Mexico plants with dominance in truck/bus radial (TBR) space domestically.

- FY22 segment mix – truck/bus ~55%, PCR ~26%, 2-W, 3-W ~4%
- FY22 channel mix – aftermarket ~59%, OEM ~20%, exports ~21%

Q3FY23 Results: The company reported a healthy performance in Q3FY23.

- Consolidated net sales were down 3% QoQ to ₹ 3,613 crore
- EBITDA margins rose 148 bps QoQ to 9.4%
- Consequent PAT was at ₹ 65.6 crore, up 28% QoQ

What should investors do? JKT's share price has de-grown at ~2% CAGR over the past five years (~₹ 177 in February 2018), underperforming the Nifty Auto index.

- We upgrade JKT from HOLD to **BUY** tracking further margin improvement on the anvil on benign raw material prices (crude derivatives, natural rubber) amid healthy domestic demand with timely capex to aid growth

Target Price and Valuation: Introducing FY25E, we now value JKT at ₹ 190 i.e., 5.25x EV/EBITDA on average of FY24-25E numbers (earlier target price ₹ 180).

Key triggers for future price performance:

- Indigenous research led innovation and premiumisation of the product profile and development of technologically sophisticated products like smart tyres, puncture-guard tyres and EV-specific tyres that offer extremely low rolling resistance and increase efficiency
- Fund raising for upcoming capex requirement for expanding capacity amid promising growth prospects in the domestic auto industry
- Focus on deleveraging B/S, debt seen declining by ~₹ 1,000 crore by FY25E
- Building in the visible positives, we build 12% CAGR net sales in FY22-25E with margins seen at 11% in FY25E. Return ratios are seen turning to 15% in that timeframe with debt: equity to fall to ~1x by FY25E

Alternate Stock Idea: Besides JKT, in our auto coverage we like Apollo Tyres.

- Focused on sweating of assets, calibrated capex spends and RoCE focus
- BUY with a target price of ₹ 350



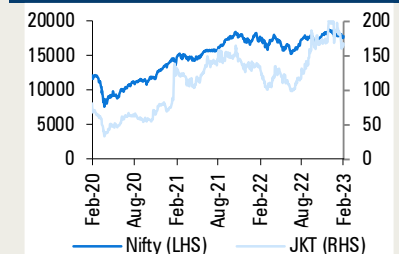
Particulars

Particular	₹ crore
Market Capitalization	3,940.0
Total Debt (FY22)	5,115.2
Cash & Investments (FY22)	175.7
EV (₹ Crore)	8,879.6
52 week H/L (₹)	214 / 95
Equity capital (₹ crore)	₹ 49.3 Crore
Face value (₹)	₹ 2

Shareholding pattern

	Mar-22	Jun-22	Sep-22	Dec-22
Promoter	56.3	56.3	56.3	56.3
FII	8.2	7.4	7.2	7.5
DII	1.2	1.2	1.2	1.3
Other	34.4	35.2	35.3	35.0

Price Chart



Recent event & key risks

- Posted healthy Q3FY23 results
- **Key Risk:** (i) Lower than anticipated margin recovery in near term amid competitive market intensity, (ii) Muted global cues limiting growth at foreign operations (Mexico)

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Key Financial Summary

Key Financials	FY19	FY20	FY21	FY22	5 year CAGR (FY17-22)	FY23E	FY24E	FY25E	3 year CAGR (FY22-25E)
Net Sales	10,369.9	8,724.9	9,102.2	11,983.0	9.3%	14,822.5	15,657.8	16,794.5	11.9%
EBITDA	1,114.1	987.6	1,306.3	1,073.3	-1.1%	1,338.7	1,692.7	1,854.1	20.0%
EBITDA Margins (%)	10.7	11.3	14.4	9.0		9.0	10.8	11.0	
Net Profit	176.4	150.8	319.4	210.0	-11.0%	278.5	528.0	642.2	45.2%
EPS (₹)	7.8	6.1	13.0	8.5		11.3	20.3	24.7	
P/E	20.6	26.1	12.3	18.8		14.1	7.9	6.5	
RoNW (%)	7.7	6.5	11.9	7.4		9.0	14.2	15.1	
RoCE (%)	9.2	7.4	11.8	8.1		10.5	13.5	15.0	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

Q3FY23 Results

- Among geographies, de-growth for the quarter was led by Mexican geography. India revenues de-grew 1% QoQ to ₹ 3,106 crore while Mexico operations posted a decline of 16% to ₹ 607 crore (seasonal in nature)
- The company has also announced preferential issuance of compulsory convertible debentures (6%) to International Finance Corporation (IFC) aggregating to ₹ 240 crore convertible in equity shares at ₹ 180.5/share
- On the margin front, gross margins expanded 330 bps sequentially. India EBIT margins recovered ~196 bps QoQ to 6.9%, with Mexico EBIT margins down ~150 bps QoQ to 5.6%

JKT- ESG Disclosure Score*			
Score	FY20	FY21	FY22
Environmental	23.6	31.0	39.7
Social	23.6	23.6	21.0
Governance	84.9	84.9	89.9
Overall ESG Score	44.1	46.5	50.3

Source: Bloomberg, ICICI Direct Research, *Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures

Q3FY23 Earnings Conference Call highlights

- Total installed capacity was at 6.2 lakh MT i.e. ~3.3 crore tyres annually with corresponding capacity utilisation for Q3FY23 at 88% with utilisation at radial tyre type at ~90%
- Export from India was at ₹ 484 crore vs. ₹ 514 crore in Q2FY23 vs. ₹ 458 crore in Q1FY23
- During the quarter, CV demand remained strong, primarily led by M&HCV space primarily led by strong underlying fundamentals. The company also informed about strong demand from domestic auto OEMs. Overall, the company remained optimistic on domestic demand riding on structural positive levers like scrappage policy, healthy fleet utilisation whereas tractor is expected to witness good demand amid healthy monsoons
- JK Tormel Mexico revenue for Q3FY23 was at ₹ 608 crore vs. ₹ 512 crore in Q3FY22. EBITDA was at ₹ 48 crore vs. ₹ 46 crore in Q3FY22. The management said Q3 was generally muted due to lower working days and seasonality impact. Further, demand from North American and Latin American region stayed muted amid uncertain global cues
- Volume growth during the quarter was at ~4% YoY whereas commodity led price hike was ~14% YoY. Replacement segment volume growth in India during the quarter was at ~8% YoY
- Cavendish revenue for Q3FY23 was at ₹ 976 crore, higher compared to ₹ 982 crore at Q2FY23. Margins at Cavendish were at 9.7% vs. 6.3% in Q2FY23. Utilisation was at ~92% vs. ~82% in Q2FY23
- Net debt was at ~₹ 4,900 crore vs. ~₹ 5,000 crore in Q2FY23
- Brownfield capex spend remains unchanged at ~₹ 766 crore. Out of proposed capex, PCR, TBR capacity to increase 16%, 10%, respectively

Anti-dumping duty imposed by Government of India on Chinese imported TBR tyre has ceased to be effective from December 2022. Minimal impact was witnessed as the domestic market is saved through CVD

JK Tormel remained largest supplier to large supermarket chains like Walmart, etc., in Mexico and enjoys a leadership position in the PCR replacement segment @12%, with online market share at 50%

During the quarter, the company launched low RRC in PCR & TBR and smart tyre in the UV PCR segment

During the quarter, the company took ~1-2% hike and further expects margin to improve in the coming quarter amid declining commodity prices

Peer comparison

Exhibit 1: Peer Comparison (tyres)

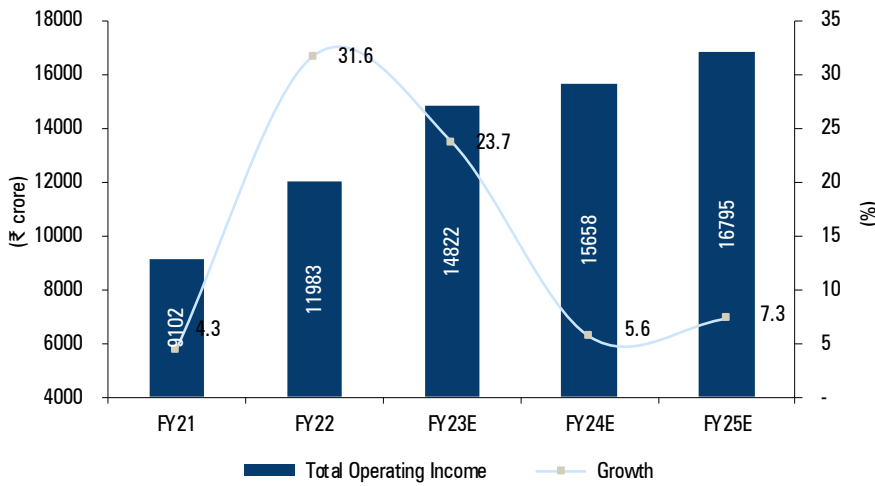
Company	CMP	TP	Rating	Mcap ₹ crore	EBITDA margin (%)			Debt to Equity (x)			RoCE (%)			EV/EBITDA (x)		
	₹	₹			FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Apollo Tyres (APOTYR)	339	350	Buy	21,528	12.3	13.1	15.4	0.5	0.4	0.3	6.3	9.6	13.9	10.1	7.8	5.8
Balkrishna Inds (BALIND)	2,294	2,200	Buy	44,347	23.9	18.0	23.6	0.4	0.3	0.2	15.9	12.5	19.9	23.3	24.7	16.1
JK Tyre (JKTYRE)	160	190	Buy	3,940	9.0	9.0	10.8	1.8	1.7	1.3	8.1	10.5	13.5	8.3	6.8	5.1

Source: Company, ICICI Direct Research

We have a BUY rating on the above tyre coverage companies primarily tracking benign raw material prices leading to healthy gross margin expansion and consequent healthy operating margin profile. In the present report, we upgrade **JK Tyre** to BUY and find comfort in valuations and debt reduction at the company over the next two years.

Financial story in charts

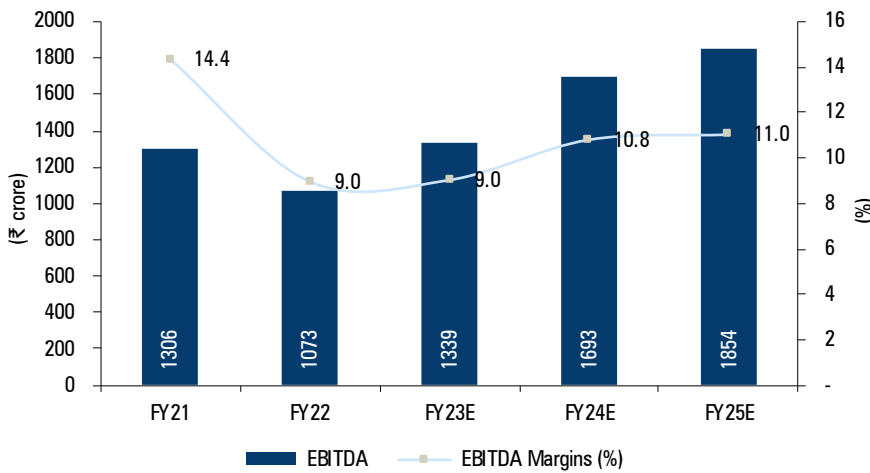
Exhibit 2: Topline trend



We expect sales to grow at a CAGR of 11.9% over FY22-25E to ₹ 16,795 crore in FY25E

Source: Company, ICICI Direct Research

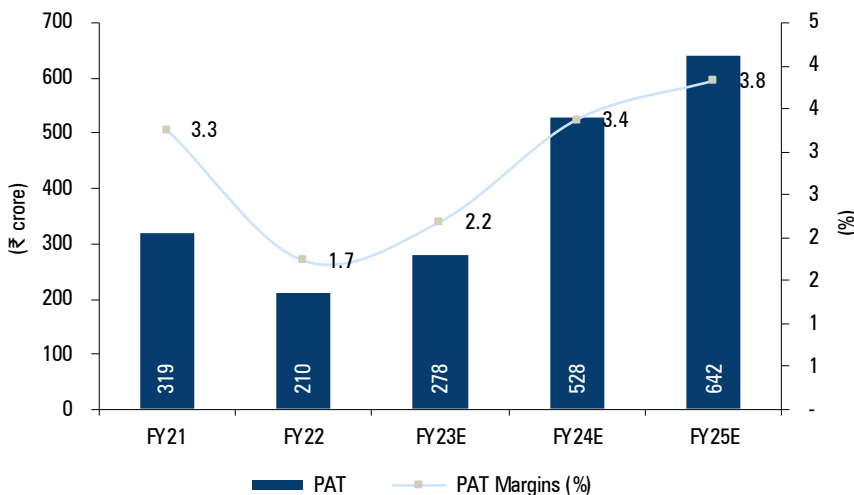
Exhibit 3: Margin trend



Margins are expected at 11% by FY25E vs. 9% expected in FY23E

Source: Company, ICICI Direct Research

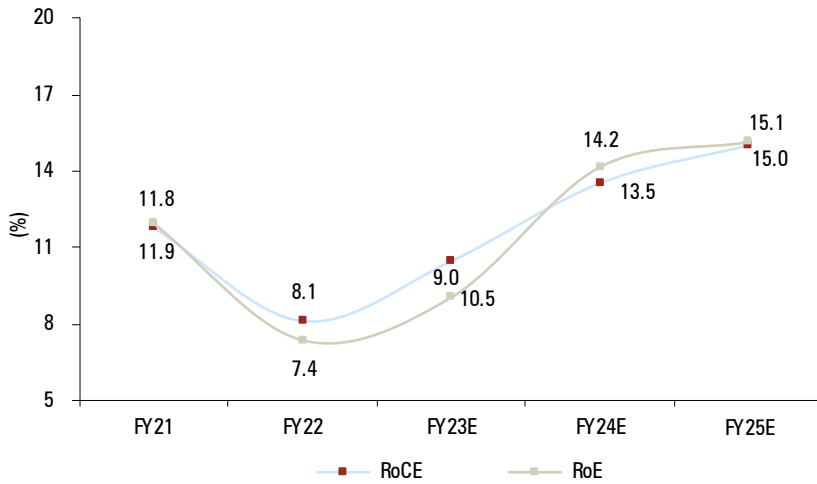
Exhibit 4: Trend in profitability



PAT is expected to grow at 45.2% CAGR over FY22-25E, albeit on a very low base

Source: Company, ICICI Direct Research

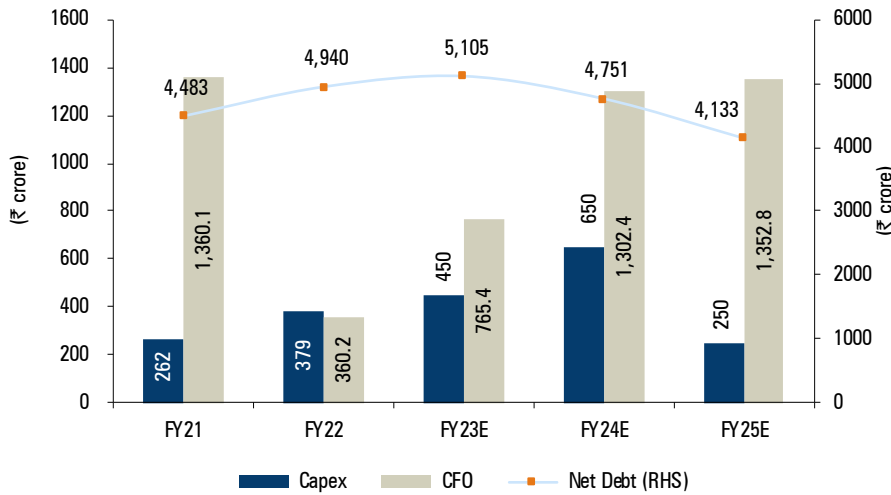
Exhibit 5: Trend in return ratios



Return ratios are seen rising to ~15% by FY25E

Source: Company, ICICI Direct Research

Exhibit 6: Debt, capex and CFO trend



Net debt is seen declining to the ~₹ 4,100 crore mark by FY25E amid limited capex spend in FY24-25E and expectations of robust CFO generation

Source: Company, ICICI Direct Research

Exhibit 7: Valuation Summary

	Sales (₹ cr)	Growth (%)	EPS (Diluted) (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY19	10,369.9	25.4	7.8	167.1	20.6	8.6	7.7	9.2
FY20	8,724.9	(15.9)	6.1	(21.3)	26.1	9.5	6.5	7.4
FY21	9,102.2	4.3	13.0	111.8	12.3	6.4	11.9	11.8
FY22	11,983.0	31.6	8.5	-34.2	18.8	8.3	7.4	8.1
FY23E	14,822.5	23.7	11.3	32.6	14.1	6.8	9.0	10.5
FY24E	15,657.8	5.6	20.3	79.9	7.9	5.1	14.2	13.5
FY25E	16,794.5	7.3	24.7	21.6	6.5	4.4	15.1	15.0

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 8: Profit and loss statement		₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E	
Total operating Income	11,983.0	14,822.5	15,657.8	16,794.5	
Growth (%)	31.6	23.7	5.6	7.3	
Raw Material Expenses	8,039.3	10,144.5	10,315.6	11,039.5	
Employee Expenses	1,065.4	1,200.2	1,306.2	1,398.6	
Other Expenses	1,805.1	2,139.0	2,343.2	2,502.3	
Total Operating Expenditure	10,909.7	13,483.8	13,965.1	14,940.4	
EBITDA	1073.3	1338.7	1692.7	1854.1	
Growth (%)	-17.8	24.7	26.4	9.5	
Depreciation	385.4	407.6	446.2	478.6	
Interest	419.1	452.7	473.2	429.2	
Other Income	36.6	31.7	39.1	42.0	
Exceptional Items	-3.6	71.7	0.0	0.0	
PBT	305.4	510.1	812.4	988.3	
Total Tax	108.7	159.4	284.4	345.9	
PAT	210.0	278.5	528.0	642.2	
Growth (%)	-34.2	32.6	89.6	21.6	
EPS (₹)	8.5	11.3	20.3	24.7	

Source: Company, ICICI Direct Research

Exhibit 9: Cash flow statement		₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E	
Profit after Tax	210.0	278.5	528.0	642.2	
Add: Depreciation & Int	804.5	860.3	919.4	907.9	
(Inc)/dec in Current Assets	-1,240.0	-858.2	-339.1	-461.4	
Inc/(dec) in CL and Provisions	585.7	484.8	194.1	264.1	
CF from operating activities	360.2	765.4	1302.4	1352.8	
(Inc)/dec in Investments	14.3	-10.0	-10.0	-10.0	
(Inc)/dec in Fixed Assets	-379.1	-450.0	-650.0	-250.0	
Others	1.4	30.6	61.9	84.2	
CF from investing activities	-363.5	-429.4	-598.1	-175.8	
Issue/(Buy back) of Equity	0.0	0.0	2.7	0.0	
Inc/(dec) in loan funds	458.7	175.0	-350.0	-600.0	
Dividend paid & dividend tax	-36.9	-49.3	-116.8	-129.8	
Others (incl Interest costs)	-416.6	-452.7	-235.8	-429.2	
CF from financing activities	5.2	-326.9	-699.9	-1159.0	
Net Cash flow	1.9	9.1	4.4	18.0	
Opening Cash	173.8	175.7	184.8	189.1	
Closing Cash	175.7	184.8	189.1	207.1	

Source: Company, ICICI Direct Research

Exhibit 10: Balance Sheet		₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E	
Liabilities					
Equity Capital	49.3	49.3	51.9	51.9	
Reserve and Surplus	2,799.1	3,028.3	3,676.9	4,189.3	
Total Shareholders funds	2848.3	3077.5	3728.8	4241.2	
Total Debt	5,115.2	5,290.2	4,940.2	4,340.2	
Deferred Tax Liability	405.1	427.0	451.1	483.8	
Other non-current liabilities	821.2	867.6	916.5	983.0	
Minority Interest	99.2	99.2	99.2	99.2	
Total Liabilities	9289.1	9761.5	10135.7	10147.5	
Assets					
Gross Block	10,626.9	10,926.9	11,776.9	12,026.9	
Less: Acc Depreciation	4,192.2	4,599.8	5,046.1	5,524.7	
Net Block	6434.7	6327.1	6730.8	6502.2	
Capital WIP	100.6	250.6	50.6	50.6	
Total Fixed Assets	6,535.2	6,577.6	6,781.4	6,552.7	
Investments	132.8	142.8	152.8	162.8	
Inventory	2,432.6	2,842.7	3,002.9	3,220.9	
Debtors	1,979.9	2,436.6	2,573.9	2,760.7	
Loans and Advances	208.8	147.2	155.5	166.7	
Other current assets	536.9	590.0	623.3	668.5	
Cash	175.7	184.8	189.1	207.1	
Total Current Assets	5,333.9	6,201.2	6,544.6	7,024.0	
Creditors	2,188.5	2,639.6	2,788.4	2,990.8	
Provisions	17.4	21.0	22.2	23.8	
Other current liabilities	752.7	782.8	826.9	887.0	
Total Current Liabilities	2,958.6	3,443.5	3,637.5	3,901.6	
Net Current Assets	2375.3	2757.7	2907.1	3122.4	
Others	235.8	242.8	207.6	222.7	
Application of Funds	9289.1	9761.5	10135.7	10147.5	

Source: Company, ICICI Direct Research

Exhibit 11: Key ratios					
(Year-end March)	FY22	FY23E	FY24E	FY25E	
Per share data (₹)					
EPS	8.5	11.3	20.3	24.7	
Cash EPS	24.2	27.9	37.5	43.2	
BV	115.7	125.0	143.7	163.4	
DPS	1.5	2.0	4.5	5.0	
Cash Per Share	7.1	7.5	7.3	8.0	
Operating Ratios (%)					
EBITDA Margin	9.0	9.0	10.8	11.0	
PBIT / Net sales	5.7	6.3	8.0	8.2	
PAT Margin	1.7	2.2	3.4	3.8	
Inventory days	74.1	70.0	70.0	70.0	
Debtor days	60.3	60.0	60.0	60.0	
Creditor days	66.7	65.0	65.0	65.0	
Net Working Capital days	67.7	65.0	65.0	65.0	
Return Ratios (%)					
RoE	7.4	9.0	14.2	15.1	
RoCE	8.1	10.5	13.5	15.0	
RoIC	8.4	11.0	13.9	15.4	
Valuation Ratios (x)					
P/E	19.0	12.2	7.9	6.5	
EV / EBITDA	8.3	6.8	5.1	4.4	
EV / Net Sales	0.7	0.6	0.6	0.5	
Market Cap / Sales	0.3	0.3	0.3	0.2	
Price to Book Value	1.4	1.3	1.1	1.0	
Solvency Ratios					
Debt/Equity	1.8	1.7	1.3	1.0	
Current Ratio	2.3	2.3	2.3	2.3	
Quick Ratio	1.2	1.2	1.2	1.2	

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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