JK Tyre & Industries Ltd(JKIL)

-Valuations Attractive

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JK Tyre & Industries Ltd– Investment Snapshot

(as on Feb 15, 2017)

Recommendation :- BUY

Maximum Portfolio Allocation :- 5%

Investment Phases & Buying Strategy

1st Phase (Now) of Accumulation :- 80%

Current Accumulation Range :- 115-120 Rs

JK Tyre & Industries is our typical Multibagger stock, which is a Good Investment due to the enormous growth opportunities in sector primarily due to decrease in raw material cost and capacity additions which is likely to bear fruit. The business model is robust with good pricing power which will deliver superior returns in the long run.

Core Investment Thesis :

The company is in the Tyre space which has been growing at a fast clip due to steep fall in the price of raw materials. The company has also acquired Birla Tyres which will strengthen its position in the two-wheeler segment.

Current Market Price – Rs.117

Current Dividend Yield – 2.15%

Bloomberg / Reuters Code –JKI. IN/ JKIN.NS

BSE / NSE Code – 530007/JKTYRE

Market Cap (Rs. Cr) – 2634

P/E - 6.53

Face Value – Rs.2

52 Week High / Low – Rs. 161.40 / Rs.73.80

Promoter's Holding – 52.34%
Other Holdings -47.66%

Key Investment Highlights

1.) ***Presence in a growing segment :-*** Company caters to the Tyre Industry which has been growing rapidly which provides immense opportunities to the companies in the sector.

2)***Acquisition to drive growth-*** Company has acquired Birla Tyres which will strengthen its position in the two -wheeler market.

3.) ***Strong Pricing Power :-*** Company has strong pricing power as the economy is bound to grow which will increase demand

4.) ***Growing segments:-*** The company which was deriving major revenues from the Bus and Truck segment is diversifying into other segments.

5) ***Lower raw material cost :-*** The company is likely to benefit from low price of its raw material namely rubber due to increase in supplies.

6.) ***Growing End User Industry :-*** Company is likely to benefit from the growth of the end user industries which will in turn drive demand for tyres.

7.) ***Increasing capacity Additions:-*** Company is increasing its capacity which will result in increase in revenues and profitability

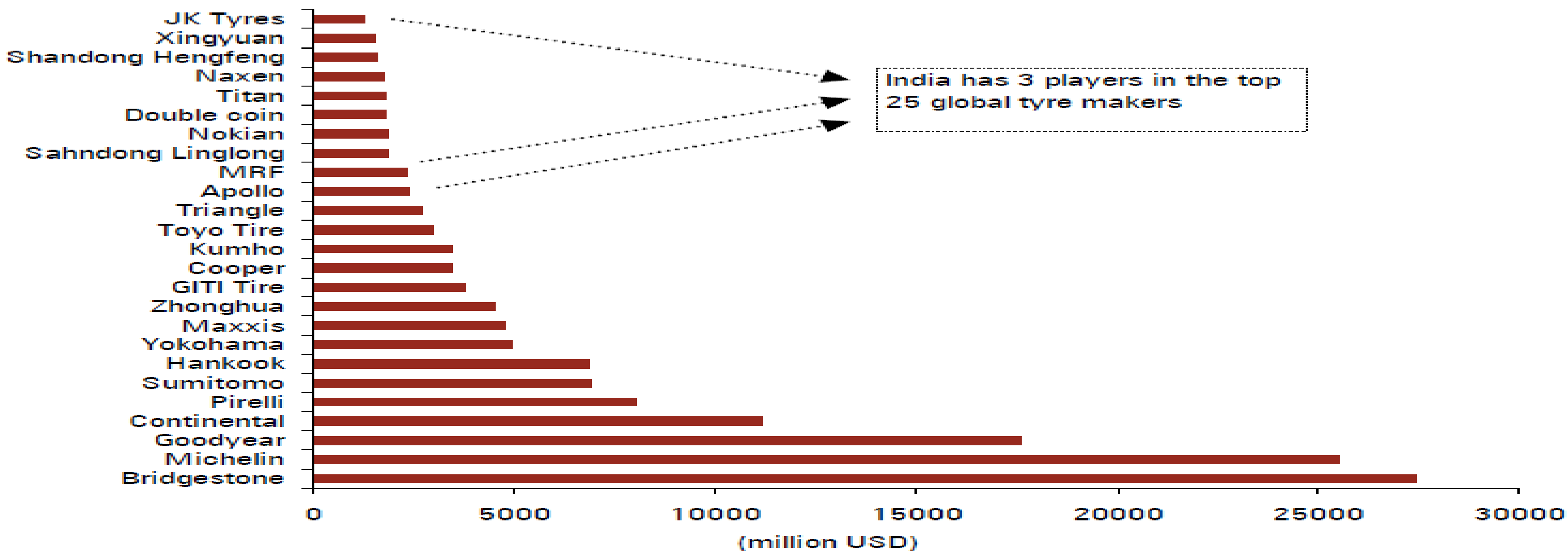
8) ***Increase in Radial Tyres:-*** The company is likely to benefit from increase in radial tyres as the company was the pioneer in the segment.

9.) ***Management/ Corporate Governance :-*** The company has a good management and adhere to strong corporate governance norms. The company is run professionally by a team of professionals who have a strong understanding of the business and have a strong vision about its business.

10.) ***Valuations :-*** In spite of so many advantages, the company is quoting at reasonable valuations for the Quality of this stock which has a strong operating performance and provides revenue visibility.

Industry Opportunity & Potential - An Overview

Global Tyre Industry



Global Tyre companies by revenue

•On the demand side, major manufacturers' commentary suggests automotive tyre demand will grow ~4-5% in volume terms.

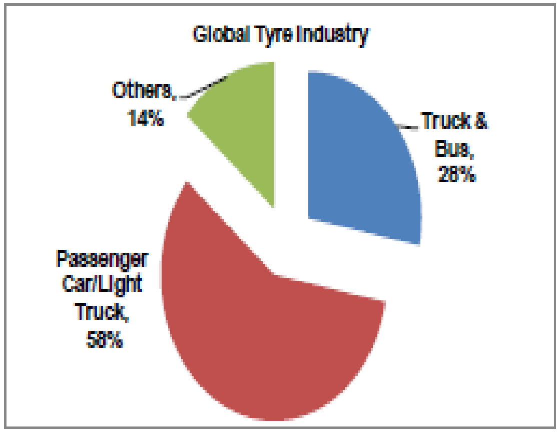
• The global market volumes would be split with demand rising well in the North American region while Europe and Japan would remain sluggish.

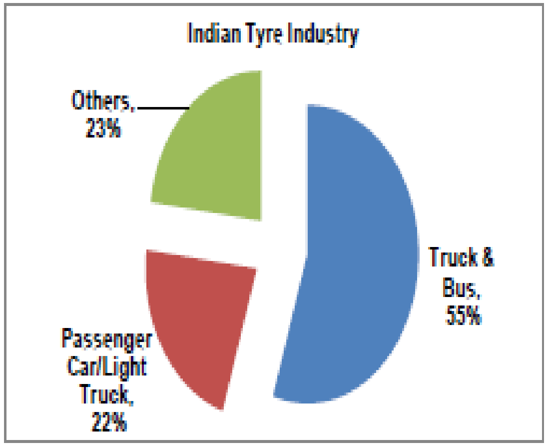
•In terms of product categories, the passenger cars and utility vehicles category represented a majority of the global tyre market, in terms of sales value, in FY14, followed by the M&HCVs category, which contributed to ~28% of the global tyre sales.

Indian Tyre Industry

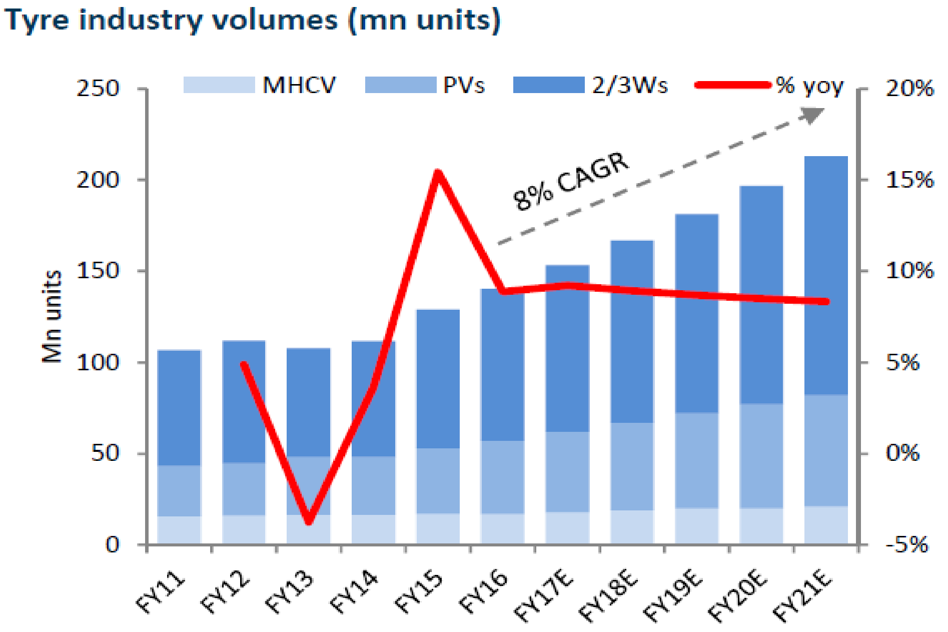
- Indian Tyre Industry – over ₹ 50000 Crs. (US $ 8 Bn) (2015-16)
- Commercial Tyre segment (Truck/Bus & LCVs)
  - *About 75% (by value) of total tyre market*
- Exports *to over 100 countries*
- Radialisation
  - ***Car tyres – over 98%***
  - ***Truck tyres – about 44% (OEM -72%)***
- Top 5 global tyre players - present in Indian Market
- 3 / 4 top Indian players dominate the markets

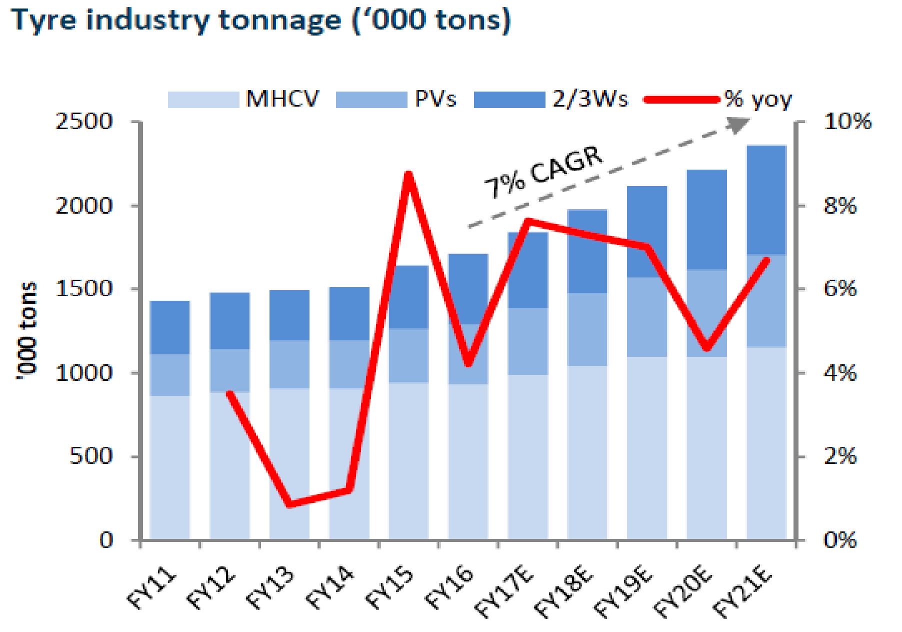
Revenue Segmentation





Tyre Industry Landscape



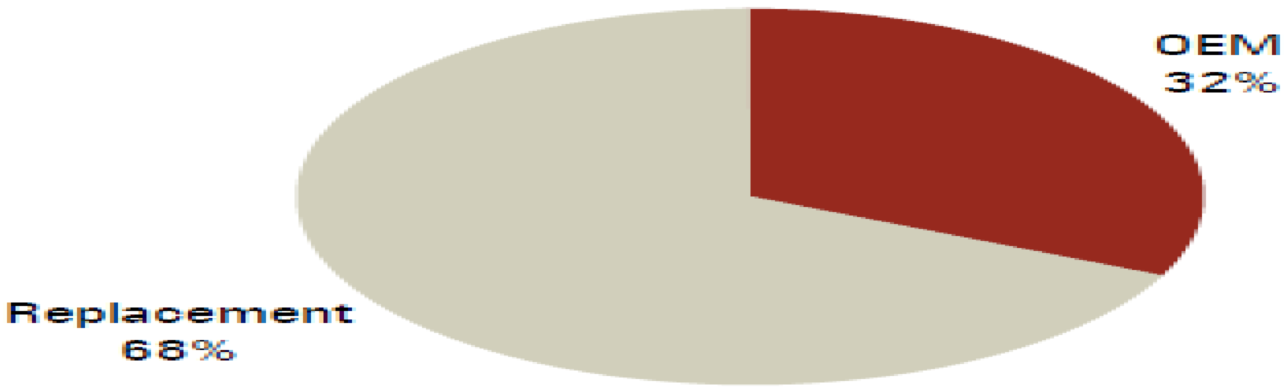


•The Indian tyre industry has grown by 4% in FY11-16 in terms of tonnage sold to 1.7mn tonnes from 1.4mn tonnes.

•With a volume contribution of 55%, the CV segment forms the largest chunk, but it has been sluggish with a five-year CAGR of just 2%; subdued economic activity not only meant weaker OEM sales but also lower movement of trucks leading to low wear and slower replacement demand

•The Passenger vehicle tyres have seen strongest demand offtake with a 8% CAGR, whereas two –wheeler demand CAGR was 6%.

OEM vs Replacement



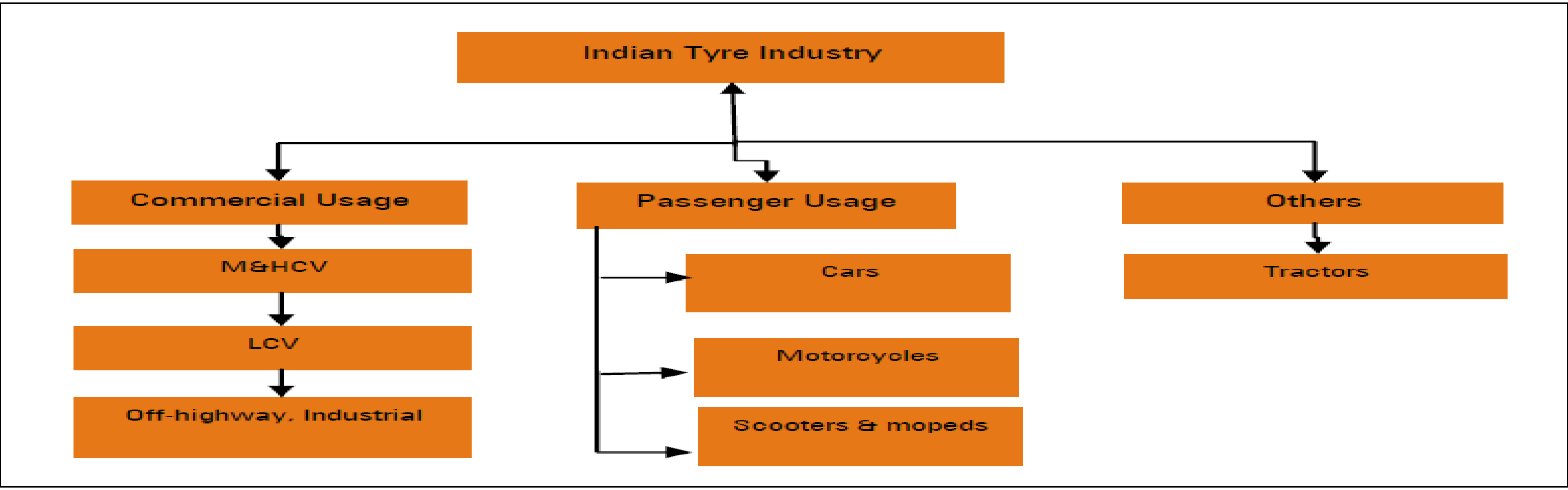
•The Tyre demand originates from two end-user categories, namely OEMs and the replacement segment with replacement and OEM segment contributing 68% and 32% respectively.

•Consumption by OEM's is dependant on fresh vehicle sales trend while the replacement segment is linked to economic growth, usage characteristics and replacement cycles.

•The demand from the replacement segment always dominates the Indian tyre market contributing ~68% of demand, in terms of tonnage.

• On an overall basis, growth has been ~2-3% from a tonnage perspective in the domestic market with the replacement market growing by about 6% which has enabled the tyre manufacturers to with stand de-growth of about 5% recorded by the OEM segment.

Product category wise break up



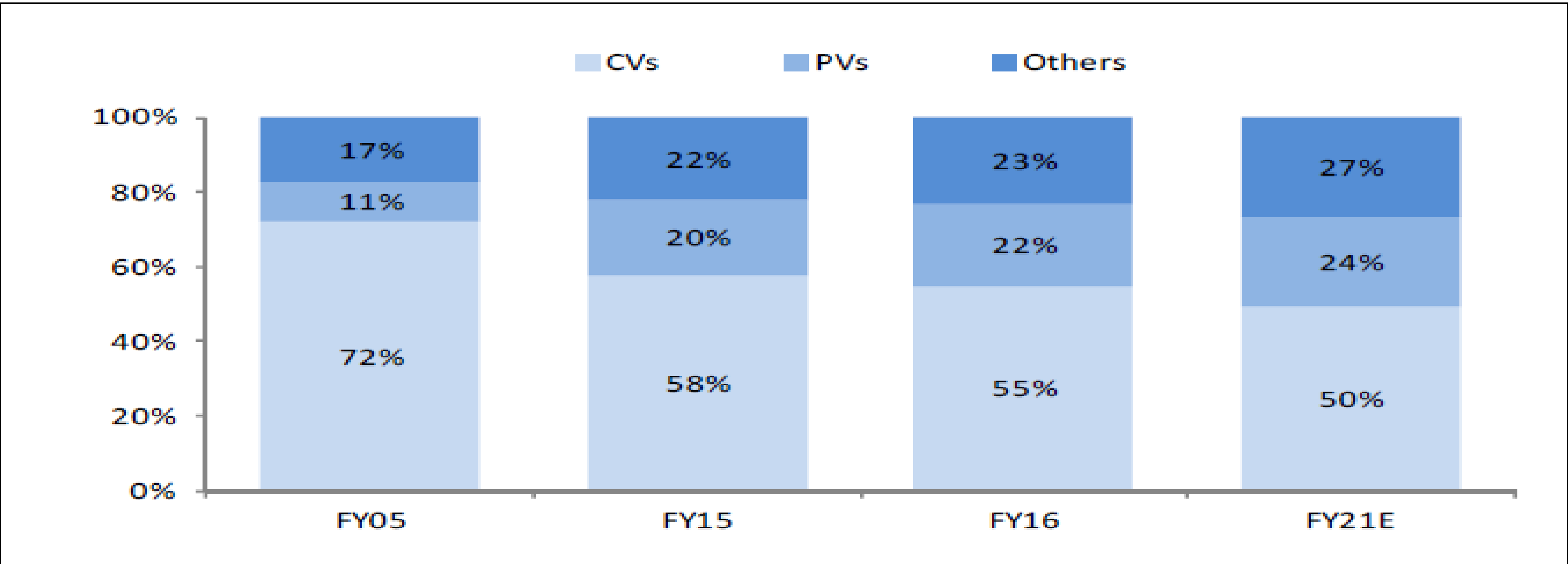
• The Indian tyre industry can be broadly divided into three broad product categories, namely, commercial vehicles (CV), passenger vehicles (PV), two-wheelers (2-W) and others.

• On the product side, the demand recovery is showing some signs of recovery that are being led by the M&HCV space with ~12% production growth.

•The PV segment recorded a ~3% YTD production growth and the Industry and leading companies believe that the segment is showing slow signs of a revival.

•In the 2-W segment, demand remains better off with ~13% YTD production growth among passenger usage while tractors and LCV are down 5% and 12% YTD.

CV Segment

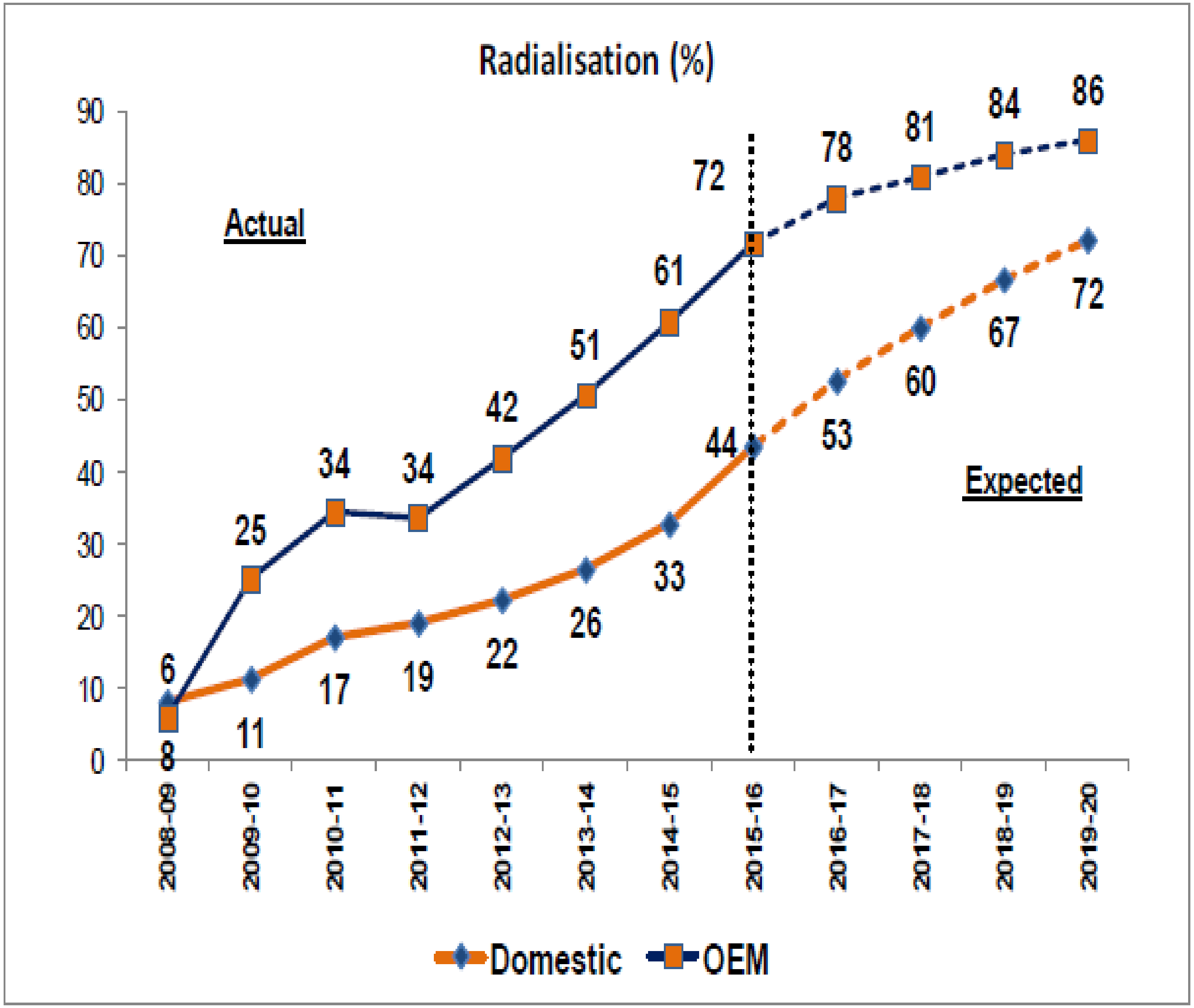


• The CV segment still forms over 55% of India's tyre demand, globally, this segment contributes a smaller 28% of industry volumes. The major discrepancy between global and Indian statistics is mainly because penetration of PVs is still very low in India (below 20 per 1000 people).

• The tyre industry should post a 6% tonnage CAGR until FY21, with the PV segment posting the highest CAGR of 8%, 2W at 7%, and CV segment the slowest at 4%.

•The Shift towards the passenger segment will help the industry to not only mitigate vagaries of cyclicality in the commercial vehicle industry, but also to boost margins as the CV segment is highly sensitive with higher price elasticity.

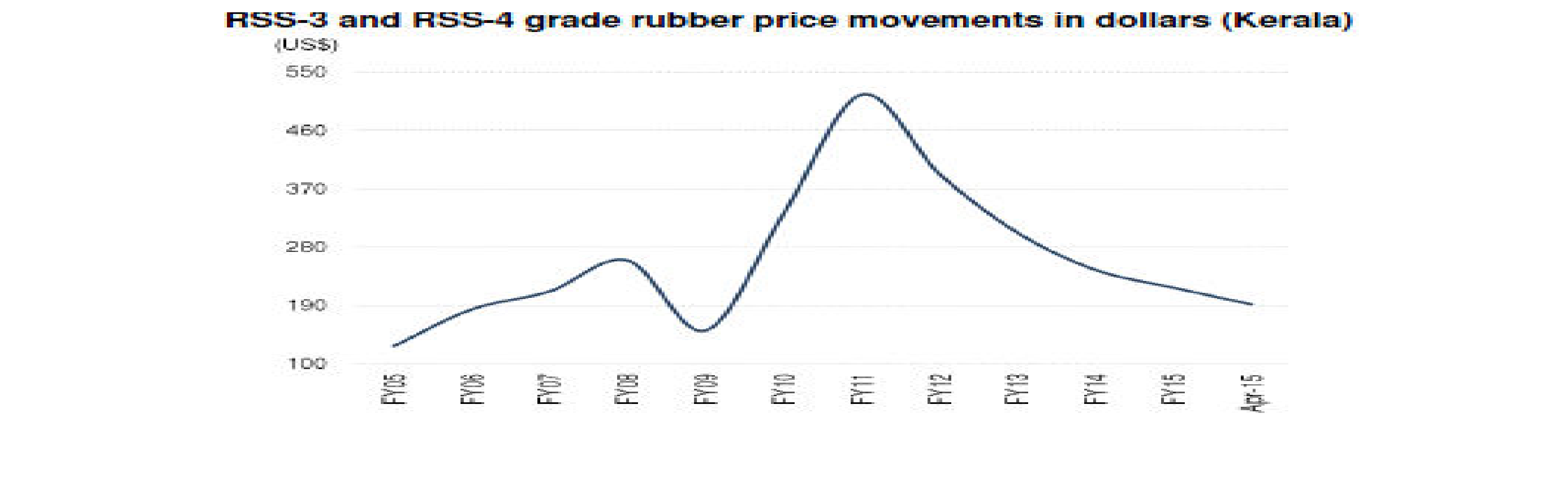
Truck & Bus Radialisation



Radialisation will be driven by :

- Cost - Benefit Ratio
- Road Development
- Overload Control
- User Education
- Retreading Infrastructure

Lower rubber prices - Margin Lever



• Rubber constitutes ~70% of the raw-material costs of a typical tyre company and weak prices of rubber will result in lower raw material cost which will enhance the margins of the company.

• The global outlook and soft off-take of China manufacturers on account of weak demand and the shift to “greener” tyres could result in lower demand for natural rubber, thereby holding prices low.

•The Plunge in crude oil prices brings down prices of synthetic rubber and other rubber chemicals. With the shale gas boom in the US oil prices are expected to be soft in the medium term which will result in lower synthetic rubber ad other rubber chemicals.

•The fall in crude oil prices has led to a fall in prices of crude derivatives (synthetic rubber), carbon black and caprolactum which is a feedstock for nylon-tyre-cord fabric.

JKIL – Investment Arguments

Company Snapshot

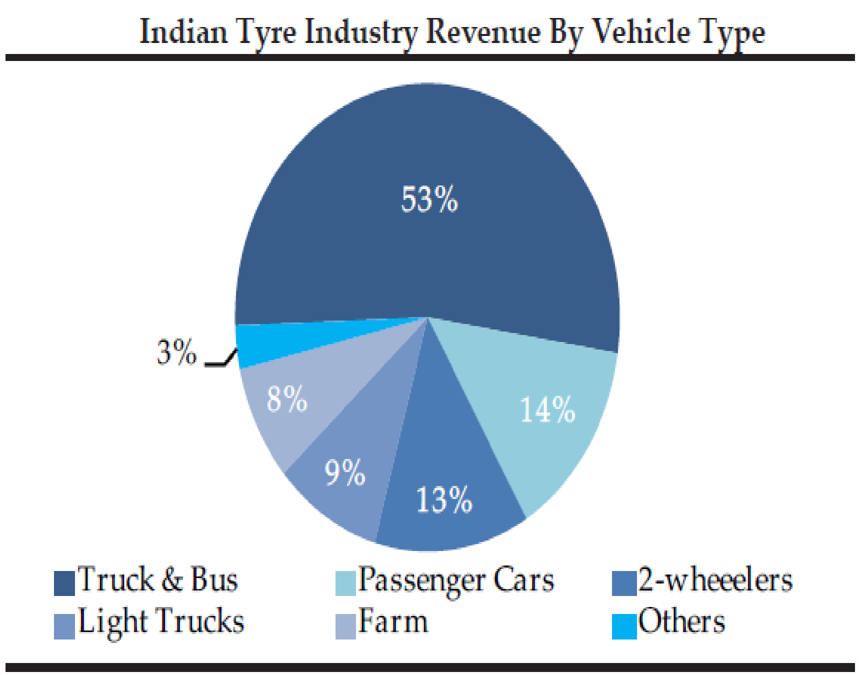
•JKIL is part of JK organisation is an Automotive Tyre, tube and flaps manufacturing company and is the leader in Radial tyre in India and manufactures passenger car tyres, commercial tyres, farm tyres and off the road tyres.

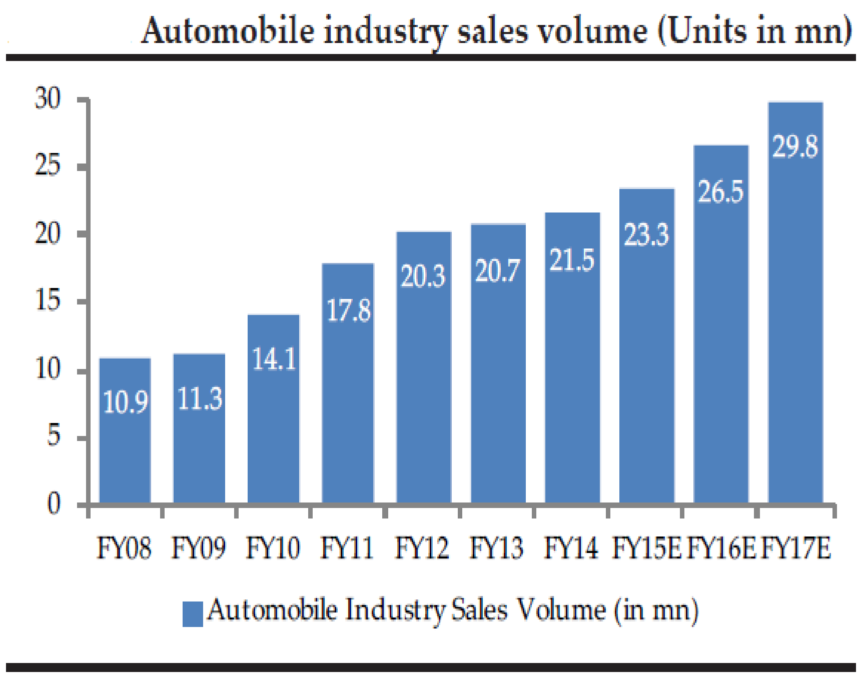
•JKIL has 6 domestic plants, 3 of them are located in Mysore, 1 in Banmore, 1 in Kankroli and 1 in Chennai .

•JKIL acquired the Mexican tyre major Tornel in 2008 along with their 3 Mexican plants, the company now has 9 plants with an installed capacity of 20.6 mn tyres p.a. in truck/ bus radials, passenger car radials and bias tyres segment.

•JKIL has a wide distribution network with 143 selling points and 4000+ dealers across India which has enabled the company to have Pan India presence.

Economic Growth - Key Driver





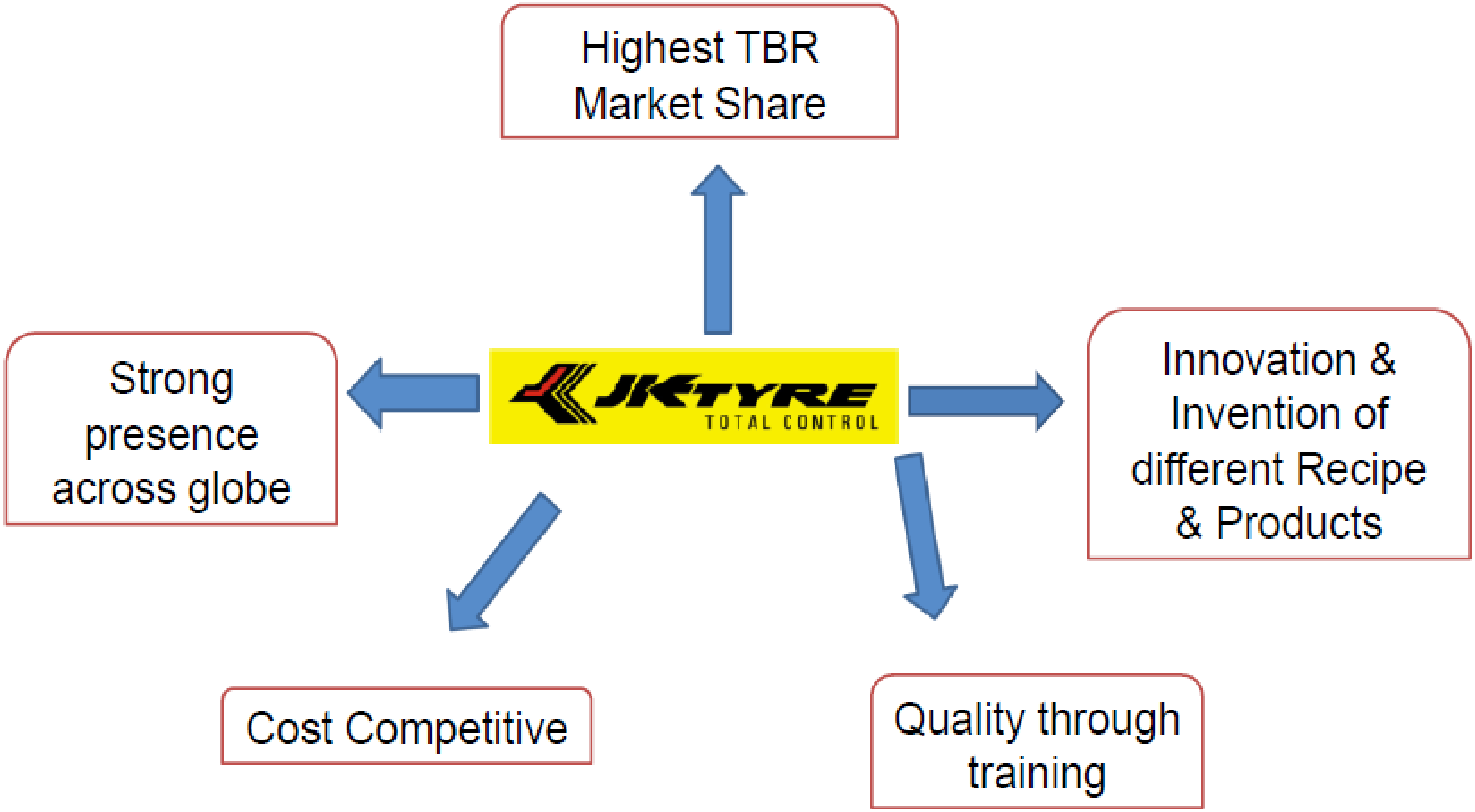
•Auto sales volume data indicated that sales were highest in FY15 in the last 5 years on account of increase in demand due to the improved industrial and consumer sentiments.

•Major Original Equipment Manufacturers (OEM’s) in the automobile industry are on the verge of expansion which necessitates an increase in demand for tyres in the coming years.

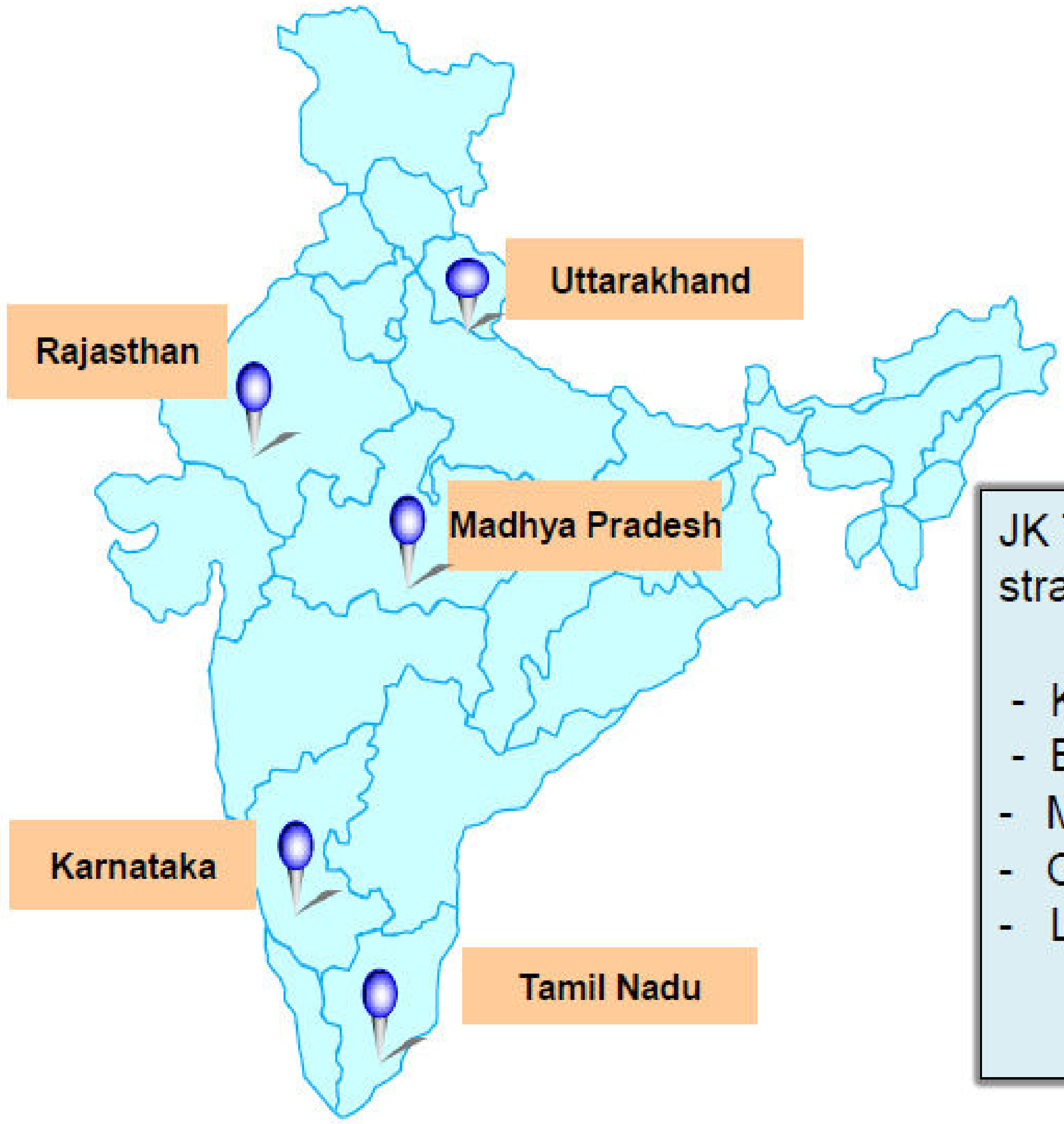
• Around 53% of the tyre industry’s revenue comes from truck and bus tyres and JKIL being the leader in the radial segment is expected to benefit a lot from the revival of commercial and passenger vehicle industry.

Key Strengths

KEY STRENGTHS



Manufacturing Locations



JK Tyre has 9 modern plants in India - strategically located at:

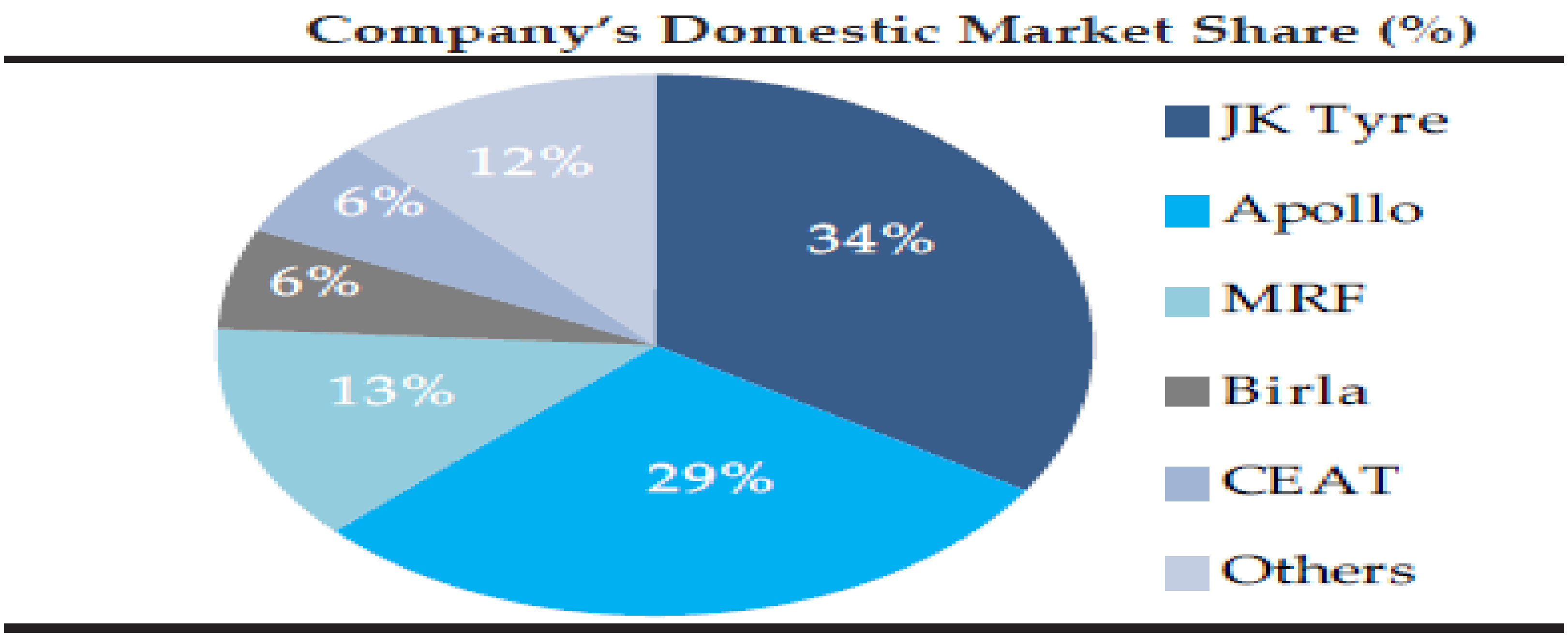
- Kankroli, Rajasthan
- Banmore, Madhya Pradesh
- Mysore, Karnataka -3
- Chennai, Tamil Nadu
- Laksar, Haridwar, Uttarakhand. - 3

Acquisition

CAVENDISH **Laksar (Haridwar)**

- JK Tyre & Industries acquired Cavendish Industries ..effective 13th April, 2016
- CIL acquisition gives **JK Tyre strategic entry into 2/3 Wheeler Category**
- Product line : TBB tyres, TBR tyres, 2-3W tyres, Tractor tyres, Tubes &Flaps
- Capacity **– 100 lacTyres p.a.** →
  - Truck Bias: 17.5 Lacs
  - Truck Radial: 12 Lacs
  - Non-Truck Bias: 7.5 Lacs
  - 2/3 Wheeler : 63 Lacs
- Laksar plant is an excise benefit zone -excise exemption of 10 years (upto 2020)

Market Leader – Domestic Truck & Bus Radials

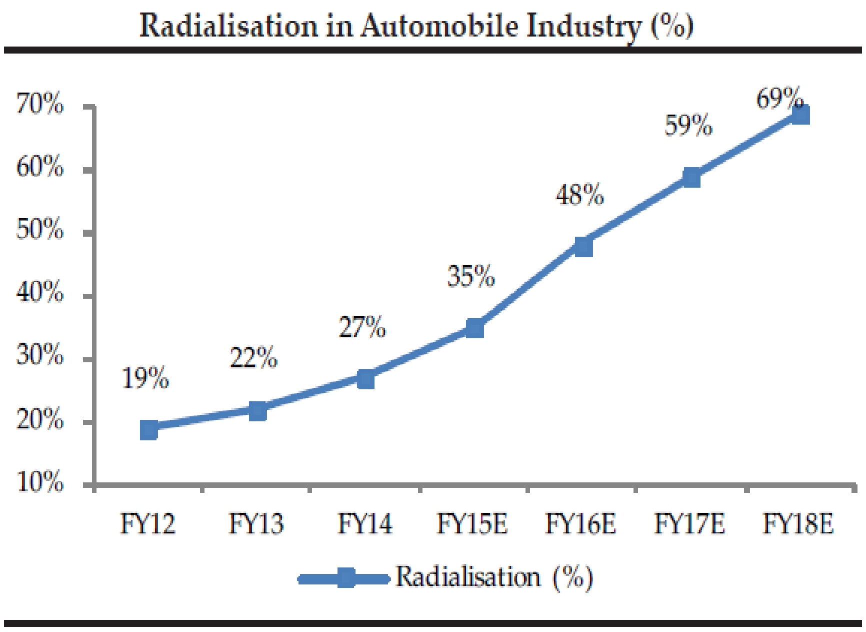


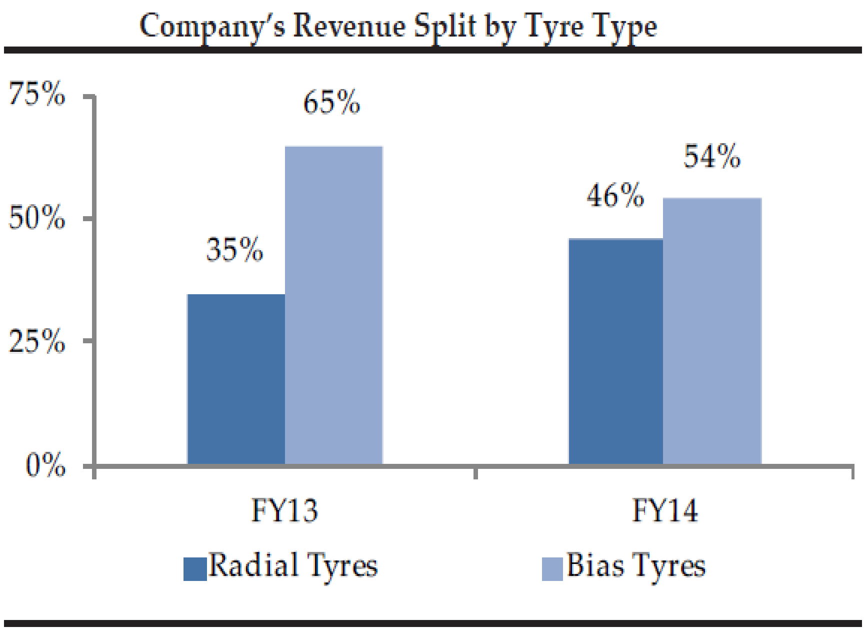
•JKIL is the leader in Truck/Bus Radial Tyres segment with 34% domestic market share along with 30% market share in LCV's segment .

•JKIL is a pioneer in the implementation of radialisation in the tyre industry and this is likely to result in enhanced market share in the medium term.

• JKIL has partnered with Maruti Celerio and began its commercial supplies to Honda Motors for its Brio and Amaze cars and its high performance radial tyres have been approved by Daimler Benz, Eicher and Tata Motors .

Increasing Radial Revenues





•JKIL is a major beneficiary of radialization which has increased from 6% in FY08 to about 27% in FY14 which is further expected to increase to about 69% in FY18.

•JKIL's share of radial tyres revenue has increased to 46% in FY14 as against 35% in FY13 which is further expected to be 50:50 ratio by FY17

• in the domestic market, radial tyres are being used only in the passenger car segment while the rest of them still stick to the cross ply variety. However globally radialization is the norm and this will benefit the company as it is the number 1 radial player.

Chennai Tyre Plant

Chennai Tyre Plant - New Green Field all Radial plant

- State-of-the -art technology plant
- Designed for Industry lowest steam consumption
- Manpower productivity 50% higher than other plants
- Located in high green belt area
- State-of-the-art mixing capability for high performance OEM requirements
- Capacity :
  - ✓ PCR - 30 lac tyres p.a.
  - ✓ TBR - 4 lac tyres p.a
- Further expansion of
  - ✓ PCR – 15 lac tyres p.a.
  - ✓ TBR - 8 lac tyres p.a

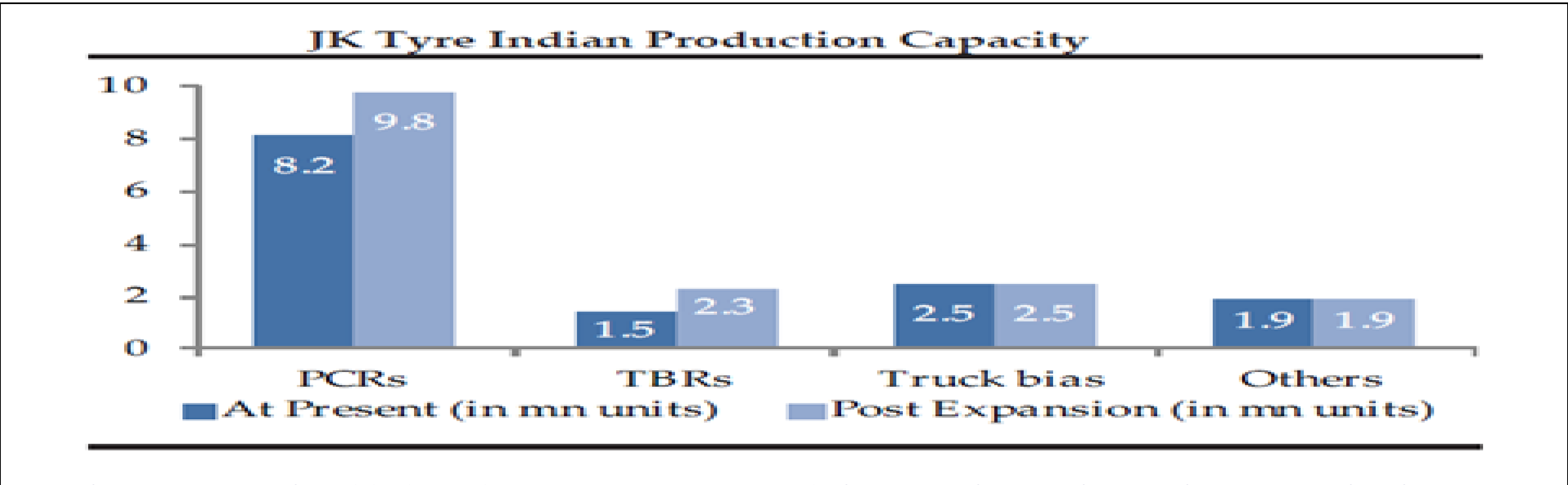
.....under commissioning, production from Q2 FY16..to be ramped in phases


Tyre Building Machine


Triplex Extruder


Tyre Curing Press

Capacity expansion to drive growth



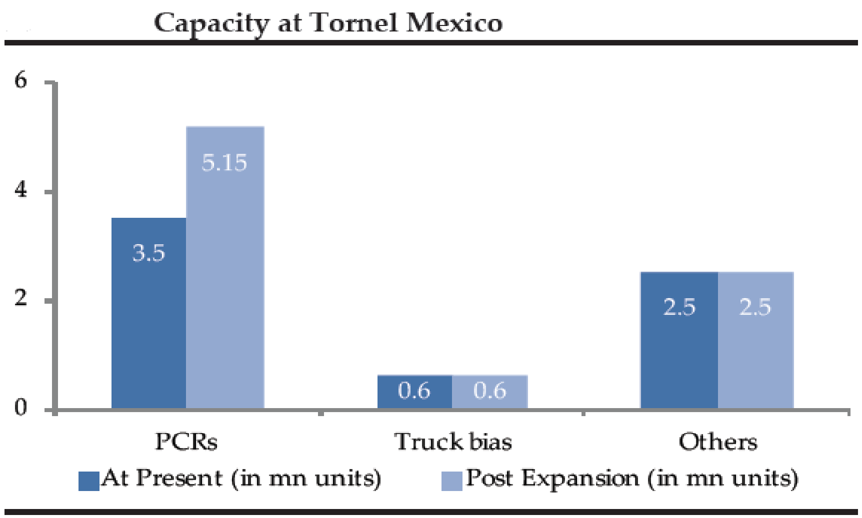
•JKIL has consistently added production capacities in radial tyres in line with its volume growth. The Present production capacity stands at around 20.6 mn units p.a. with around 900 tons per day with 6.6 mn units of tyres capacity in its Mexican subsidiary Tornel.

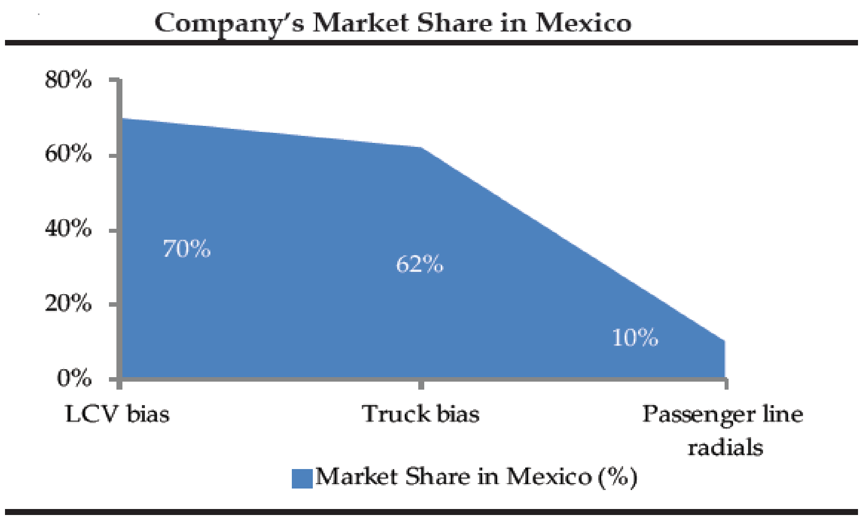
•Average capacity utilization is at around 100% in TBR category in India and around 85-90% in PCR category, whereas it is at 60%-70% in Mexico.

•JKIL has carried out brown field expansion at its Chennai plant in passenger car radial segment of around 1.64 million units p.a., TBR segment by around 0.8 million units and in Mexico of around 1.65 million units in passenger car radials.

•JKIL total production capacity is expected to be around 24.7 million units p.a with around 1,100 tons per day. Production from the Mexican operations is expected to commence around Q4FY17.

Tornel Subsidiary





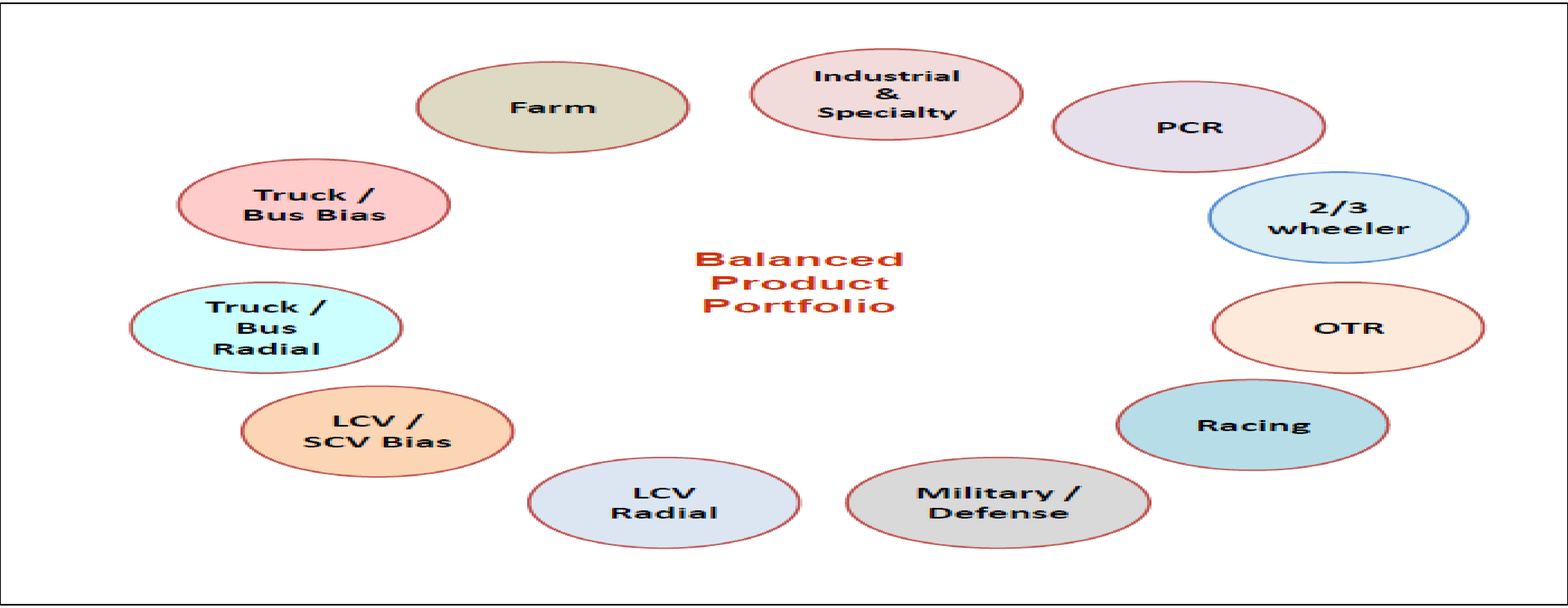
•JKIL through its subsidiary Tornel, has over 70% market share in Light Commercial Vehicles (LCVs) bias, 62% market share in truck bias and around 10% market share in passenger line radials.

•Tornel's revenue contribution to the total consolidated revenue has increased from 19% in FY12 to around 23% in FY14, which can be attributed towards its enhanced capacity utilization from 40% to 70%.

•The company expect the share of Mexico revenue to contribute to around 26% by FY17E due to its increasing concentration on OEMs such as Chrysler & Volkswagen for Car tyres, Nissan for Light Truck Radial tyres & John Deere for Farm tyres .

•Tornel is in the process of increasing its PCR capacity by another 50% i.e., around 1.65 million units in passenger car radials which will take it to the total capacity in PCR to 5.15 mn units p.a. Post this expansion, the total capacity at Mexico will be over 8.25 mn units p.a. in PCR, truck bias and other tyres segments .

Diversified Product Portfolio



•JKIL has a diversified product portfolio consisting of truck/bus radials, passenger car radial, Off The Road (OTR's) and other industrial tyres in the bias category.

•JKIL derives 69% of its consolidated revenue comes from truck segment, whereas passenger car radial contributes around 5%.

• As trucks contribute 69% of revenues any slowdown in the M&HCV segment will adversely impact the company. It is towards this end that the company is diversifying its product portfolio to mitigate any adverse impact due to slow down in any segment.

Diversified customer base

Car	Truck	Tractor	OTR	Partnerships in Offing
India/Mexico				
JK Tornel, Mexico	JK Tornel, Mexico - LTR	India/Mexico		

•JKIL generates over 22% of its revenue from OEMs, 63% from replacement market and around 15% from exports sales.

•JKIL has consistently added OEMs and supplies to almost all OEMs in the Car, Truck, Tractor and OTR categories.

• JKIL has around 120 one stop retail & tyre care outlets called JK Tyre Steel Wheels which generate significant portion of PCR sales.

•JKIL's products are sold from over 140 distributors in over 100 countries spread across 6 continents.

Distribution Network

141 JK Tyre Selling Points

4000 Dealers across India – 1000 exclusive

+

24 JK Tyre Truck Wheels

Fully equipped Tyre service centre

For enhancing customer experience by offering Total Tyre Solution

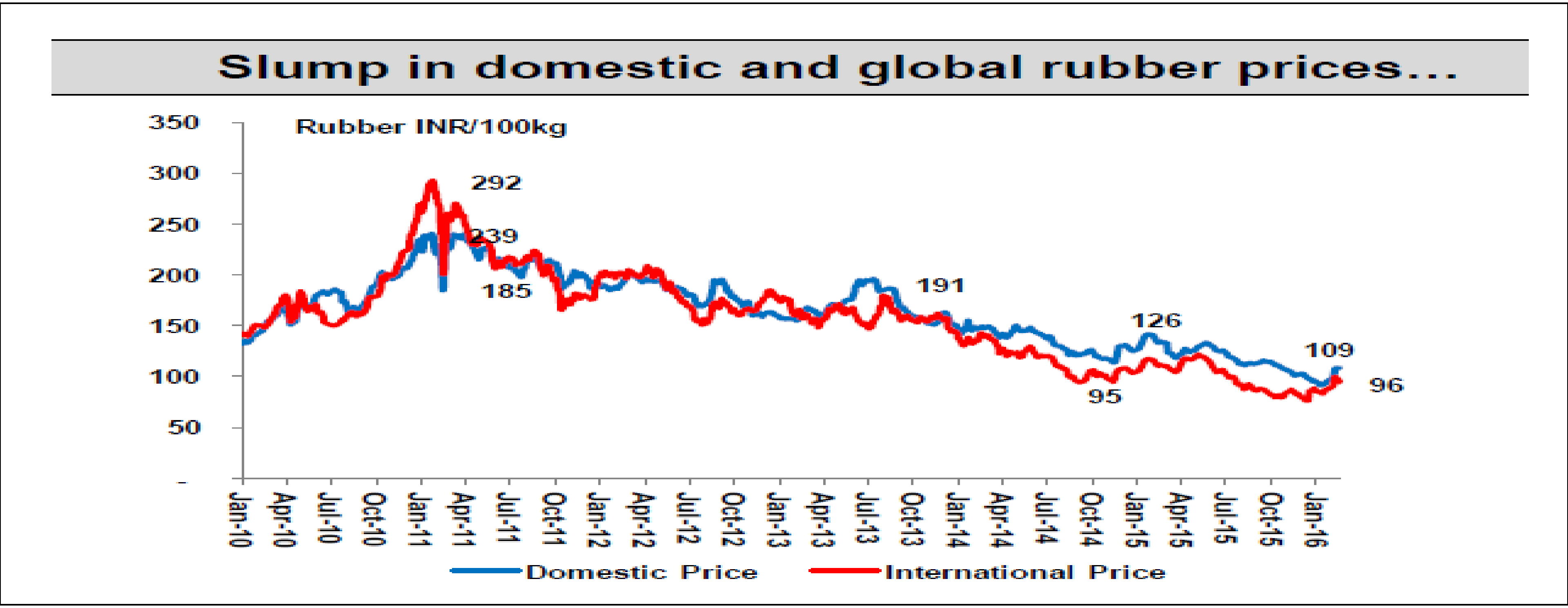
Over 160 JK Tyre Steel Wheels

Exclusive Passenger Car Tyre Retailing

Over 1100 Fleet Management

Direct Partnership with Fleet Owners

Weak rubber prices = Enhanced Margins



•JKIL has benefitted from lower Global prices of rubber this year due to oversupply and worries about lower rubber demand from China, which is large consuming country.

•JKIL's average domestic natural rubber price per kg which is a major raw material component comprising of 58%-64% of total raw material cost for the company has decreased from Rs 190 in FY11 to Rs 120 in FY16.

• The lower cost of materials has resulted in the Cost of Materials consumed as a percentage of total sales to decrease from 71.4% in FY11 to 63.9% in FY16 which in turn has improved company's gross margins from 29% in FY11 to 36% in FY16.

P&L

Consolidated Profit & Loss account(Rs.Cr)	Mar '12	Mar '13	Mar '14	Mar '15	Mar '16
Income					
Sales Turnover	7,451.98	7,556.56	8,260.97	8,042.85	7,637.63
Excise Duty	504.88	571.33	609.21	659.14	684.51
Net Sales	6,947.10	6,985.23	7,651.76	7,383.71	6,953.12
Other Income	-43.31	11.85	-41.2	-30.03	-31.06
Stock Adjustments	-83.18	52.76	38.45	-83.23	-6.13
Total Income	6,820.61	7,049.84	7,649.01	7,270.45	6,915.93
Expenditure					
Raw Materials	5,128.80	4,953.87	5,025.02	4,576.05	3,946.10
Power & Fuel Cost	275.02	274.3	292.74	277.51	263.38
Employee Cost	502.37	590.28	754.97	728.85	780.69
Miscellaneous Expenses	628.87	601.53	746.17	787.31	815.32
Total Expenses	6,535.06	6,419.98	6,818.90	6,369.72	5,805.49
Operating Profit	328.86	618.01	871.31	930.76	1,141.50
PBDIT	285.55	629.86	830.11	900.73	1,110.44
Interest	187.5	232.75	276.2	257.41	245.37
PBDT	98.05	397.11	553.91	643.32	865.07
Depreciation	121.05	132.82	179.47	157.77	196.11
Profit Before Tax	-23	264.29	374.44	485.55	668.96
PBT (Post Extra-ord Items)	-23	264.29	374.44	485.55	668.96
Tax	15.22	67.47	118.82	161.66	215.68
Reported Net Profit	-38.22	196.82	255.62	323.89	453.28
Earning Per Share (Rs)	-9.31	47.94	62.26	14.28	19.98

Balance Sheet

Consolidated Balance Sheet(Rs.Cr)	Mar '12	Mar '13	Mar '14	Mar '15	Mar '16
Sources Of Funds					
Total Share Capital	41.06	41.06	41.06	45.36	45.36
Equity Share Capital	41.06	41.06	41.06	45.36	45.36
Share Application Money	0	0	12.37	0	0
Reserves	714.26	865.39	1,043.69	1,355.65	1,703.12
Networth	755.32	906.45	1,097.12	1,401.01	1,748.48
Secured Loans	1,729.81	2,257.04	2,262.15	2,478.44	2,516.40
Unsecured Loans	292.36	277.66	243.84	230.98	153.3
Total Debt	2,022.17	2,534.70	2,505.99	2,709.42	2,669.70
Total Liabilities	2,777.49	3,441.15	3,603.11	4,110.43	4,418.18
Application Of Funds					
Gross Block	3,453.09	4,464.56	4,664.07	4,816.03	6,051.43
Less: Accum. Depreciation	1,583.53	1,750.13	1,973.74	2,114.73	2,298.38
Net Block	1,869.56	2,714.43	2,690.33	2,701.30	3,753.05
Capital Work in Progress	765.15	76.2	177.1	830.32	105.72
Investments	100.69	103.87	115.44	140.26	154.78
Inventories	781.85	933.75	936.79	875.03	872.52
Sundry Debtors	1,008.54	1,049.94	1,335.08	1,434.58	1,402.71
Cash and Bank Balance	104.93	140.1	236.25	190.58	139.43
Total Current Assets	1,895.32	2,123.79	2,508.12	2,500.19	2,414.66
Loans and Advances	509.78	544.26	551.62	731.75	916.35
Total CA, Loans & Advances	2,405.10	2,668.05	3,059.74	3,231.94	3,331.01
Current Liabilities	2,189.01	1,866.42	2,179.35	2,455.99	2,441.69
Provisions	174	254.98	260.15	337.4	484.69
Total CL & Provisions	2,363.01	2,121.40	2,439.50	2,793.39	2,926.38
Net Current Assets	42.09	546.65	620.24	438.55	404.63
Total Assets	2,777.49	3,441.15	3,603.11	4,110.43	4,418.18

Concerns & Reasoning

1.) Unexpected steep increase in raw material prices :

Natural rubber, which forms ~60% of total raw material costs, has been moving down over the past two years. Any unanticipated shortfall in rubber production or increase in stockpiling to support prices is likely to lead to higher RM expenses, which would hurt margins.

2.) Pricing discipline is broken :

The tyre industry has maintained a strong pricing discipline over the past two years in a falling demand scenario and declining raw material prices, and any change in industry dynamics on the pricing front is likely to lead to a decline in ASPs and other promotional expenses, which will adversely impact margins.

3.) Slowdown in Industrial activity :

With current capacity utilization levels in Indian operations at ~85%, the management has undertaken a huge capex programme. However, a continued slowdown in industrial activity levels is likely to see margins heading southwards as conversion and labour costs continue to rise.

THANK YOU