

## Bharat Forge

STOCK INFO. BLOOMBERG  
BSE Sensx: 8,122 BHFC IN  
REUTERS CODE  
S&P CNX: 2,468 BFRG.BO

18 October 2005

Buy

Rs326

Previous Recommendation: Buy

Equity Shares (m)	197.8
52-Week Range (Rs)	369/155
1,6,12 Rel.Perf.(%)	-1/1/58
M.Cap. (Rs b)	64.4
M.Cap. (US\$ b)	1.4

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
3/05A	12,191	1,616	8.2	29.4	39.8	14.5	36.5	30.0	5.6	20.8
3/06E	15,969	2,271	11.5	40.5	28.3	10.1	35.7	29.0	3.9	14.9
3/07E	20,252	2,958	15.0	30.2	21.8	7.1	32.6	30.0	3.0	11.3

Standalone

- ✍ Bharat Forge's (BFL's) 2QFY06 results are broadly in line with our expectations. The company posted a 37% YoY growth in PAT at Rs518m.
- ✍ BFL registered a 30% revenue growth to Rs3.8b in 2QFY06 driven by a 36% YoY increase in exports. BFL's EBITDA margins were 25.8% in 2QFY06 compared to 27.9% in 2QFY05 due to higher raw material cost.
- ✍ On a consolidated basis, total revenues grew 45% YoY to Rs7b and PAT grew 31% YoY to Rs612m. Consolidated EBITDA margins stood at 20.3% in 2QFY06 compared to 21.7% in 2QFY05.
- ✍ BFL is expanding domestic facilities and by end-FY06 total domestic forging capacity will be increased to 240,000 ton and global capacity to 0.5m ton per annum (US: 60,000 ton; India: 240,000 ton and Europe:200,000 ton).
- ✍ The recently acquired Swedish Imatra group is the largest manufacturer of front axle beams and second largest crankshaft producer in Europe.
- ✍ Within just two months of acquiring Imatra Forging group, the BFL group bagged a couple of new orders, from two of Imatra's top customers, in the value added machined component segment.
- ✍ BFL trades at a P/E of 21.1x FY06E and 16.1x FY07E on consolidated earnings. Considering high visibility of future growth, a firm road map to forge a global identity, setting up of its global technology centre and integration of the acquired companies, we maintain a **Buy** on the stock, with a target price of Rs347.

### QUARTERLY PERFORMANCE

(Rs Million)

	FY 05				FY 06				FY 05	FY 06E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
<b>Net Sales</b>	<b>2,568</b>	<b>2,902</b>	<b>3,109</b>	<b>3,613</b>	<b>3,635</b>	<b>3,766</b>	<b>3,822</b>	<b>4,746</b>	<b>12,191</b>	<b>15,969</b>
Change (%)	38.0	42.4	46.6	56.9	41.6	29.8	22.9	31.4	46.5	31.0
Total Expenses	1,878	2,091	2,233	2,715	2,750	2,795	2,714	3,401	8,917	11,737
<b>Operating Profit</b>	<b>690</b>	<b>810</b>	<b>875</b>	<b>898</b>	<b>885</b>	<b>971</b>	<b>1,108</b>	<b>1,344</b>	<b>3,274</b>	<b>4,232</b>
Change (%)	26.7	38.0	32.1	48.0	28.2	19.9	26.6	49.7	36.3	29.3
As % of Sales	26.9	27.9	28.2	24.9	24.4	25.8	29.0	28.3	26.9	26.5
Other Income	42	7	4	21	112	115	1	2	74	229
Interest	79	83	90	91	112	128	103	38	342	380
Depreciation	123	132	136	135	149	175	179	212	526	716
<b>PBT</b>	<b>530</b>	<b>603</b>	<b>654</b>	<b>693</b>	<b>736</b>	<b>783</b>	<b>828</b>	<b>1,097</b>	<b>2,480</b>	<b>3,365</b>
Tax	190	225	240	210	247	265	257	325	865	1,094
Effective Tax Rate (%)	35.9	37.2	36.7	30.3	33.5	33.8	31.0	29.7	34.9	32.5
PAT	340	378	414	483	489	518	571	771	1,616	2,271
<b>Adj. PAT</b>	<b>340</b>	<b>378</b>	<b>414</b>	<b>483</b>	<b>489</b>	<b>518</b>	<b>571</b>	<b>771</b>	<b>1,616</b>	<b>2,271</b>
Change (%)	29.4	28.9	25.4	33.4	43.9	36.8	37.9	59.6	29.4	40.6

E: MOST Estimates

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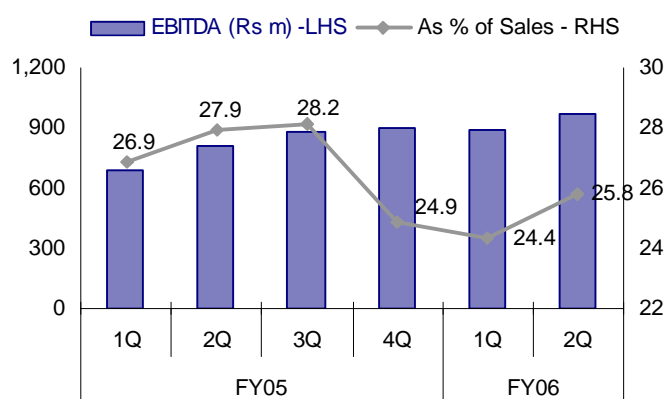
### Exports maintain growth in 2QFY06

BFL registered a 30% revenue growth to Rs3.8b in 2QFY06 driven by a 36% YoY increase in exports and a 26% YoY increase in domestic sales. We expect the strong sales momentum to continue in 2HFY06 as well.

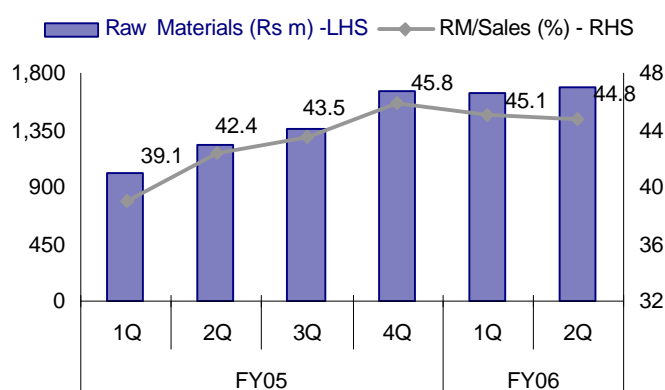
### Operating performance under pressure

BFL's operating margins at 25.8% in 2QFY06 were higher QoQ than the 24.4% margins in 1QFY06 but lower YoY than the 27.9% margins in 2QFY05. This was due to higher raw material cost (an increase of 240bp on a YoY basis) and an increase in staff cost.

EBITDA MARGIN: UNDER PRESSURE



RAW MATERIAL COST: RISING STEADILY



Source: Company / Motilal Oswal Securities

However, with commodity prices easing in 2QFY06, we do not expect raw material costs to increase from the current levels.

BFL reported a huge increase in other income at Rs115m. As a result of the strong topline growth and higher other income, BFL reported a PAT of Rs518m, an increase of 37% YoY.

### Consolidated PAT - 18% higher than standalone

Total revenues grew 45% YoY to Rs7b and PAT grew 31% YoY to Rs612m. Consolidated PAT in 2QFY06 stands 18% higher than standalone profits, compared to 23% higher in 2QFY05. On a consolidated basis, EBITDA margins stood at 20.3% in 2QFY06 compared to 21.7% in 2QFY05.

CONSOLIDATED EARNINGS (RS M)

	2QFY06	2QFY05	% CH.
Total Income	6,981	4,823	44.7
EBITDA	1,414	1,044	35.4
EBITDA Margin (%)	20.3	21.7	
PAT	612	465	31.3

Source: Company / Motilal Oswal Securities

### Capacity expansion on track

In 2QFY06, BFL enhanced its forging capacity from 130,000 ton to 200,000 ton per annum. It also commissioned heavy duty crankshaft machining lines catering to two global engine manufacturers and also commissioned four front axle beam machining lines. BFL is expanding domestic facilities and by end-FY06 total domestic forging capacity will be increased to 240,000 ton and global capacity to 0.5m ton per annum (US: 60,000 ton; India: 240,000 ton and Europe:200,000 ton).

### Global technology center in place in Germany

The BFL management is very excited about the recent commencement of its much-awaited global center of excellence for product engineering in Germany. BFL is the first company from a low cost country to set up such a center in Europe. The center will greatly enhance BFL's reputation as a product development company. It will allow BFL to transform into a development partner with global OEMs. This step will greatly enhance realizations as it will help BFL produce higher value products.

BFL is currently working with several OEM customers as a development partner and has assured orders for life time contracts for several car and CV platforms.

### Recent acquisition successfully completed in the quarter

BFL acquired the company Imatra Kilsta AB (AKB); along with its wholly owned subsidiary, Scottish Stamping. The acquired group is the largest manufacturer of front axle beams and second largest crankshaft producer in Europe. It has manufacturing facilities at two locations - Karlskoga Sweden and Aye, Scotland. It has press lines ranging from 2,500 ton to 16,000 ton, allowing it to produce a variety of forged parts based on each customer's unique requirements.

A profit making company, Imatra had revenues of Rs5.80b in CY04 and a workforce of 600 employees. It is a leading supplier to commercial and passenger vehicle manufacturers such as Volvo, Scania, SAAB, DAF, Perkins, MAN and IVECO among others.

The Vartsilla group decided to sell off Imatra, which was a profitable unit as its operations did not fit into the group's overall strategy, as the group was engaged in the manufacture of heavy engines. The increased competition in the industry segments which Imatra addressed (front axle beams and crankshafts) was another reason the Vartsilla group cited for exiting the business.

### Post acquisition, BFL emerges as a global leader in European market

The acquisition gives BFL a strong footing in the European market in all the product segments where it is a leader such as axle beams and crankshafts required for commercial vehicles, diesel engines and passenger cars. The acquisition also completes BFL's business model to form Global Dual shore capability, which has resulted in new order wins for BFL.

### Dual shore model helps BFL in new order wins

The Dual Shore Capability model is working very well for BFL. In just two months of the recent acquisition of Imatra

Forging group, the BFL group bagged a couple of new orders, from two of Imatra's top customers, in the value added machined component segment. This is due to BFL's presence in multiple locations in various geographies.

### Valuation and view

We continue to remain extremely positive on BFL's dual shoring model and global vision. It is increasingly in sight of its ambition of reaching revenues of \$1b (Rs44.5b) by FY08. In fact, we believe it may achieve its target earlier than expected. The recent initiatives of the global technology center and its acquisitions make BFL a world leader in its class.

BFL remains a preferred vendor for several global OEMs and is the lowest cost producer with the highest technological capabilities – a combination which is difficult to beat. Hence, we remain extremely positive on its growth prospects in the future.

On a standalone basis, BFL trades at 28.3x FY06E and 21.8x FY07E EPS of Rs11.5 and Rs15; 10.1x FY06E and 7.1x FY07E book value; and at an EV of 14.9x FY06E and 11.3x FY07E EBITDA.

#### CONSOLIDATED EARNINGS (RS M)

	2005	2006E	2007E
Consolidated Sales	19,934	33,137	42,919
Consolidated EBITDA	4,446	5,834	7,525
EBITDA Margin (%)	22	18	18
Consolidated Net Profit	2,010	3,055	4,010
Consolidated EPS (Rs)	10.2	15.4	20.3

Source: Motilal Oswal Securities

On a consolidated basis, BFL trades at 21.1x FY06E and 16.1x FY07E EPS of Rs15.4 and Rs20.3, respectively. We estimate the aggregate EPS of these entities at Rs.3.9 for FY06 and Rs.5.3 for FY07, adding 34% and 35% to the standalone EPS in FY06 and FY07, respectively.

Given the bright prospects, high growth visibility and clear road map for future growth, we maintain a **Buy** on the stock with a target price of Rs 347.

## Bharat Forge: an investment profile

### Company description

Bharat Forge (BFL) is the second largest forging manufacturer in the world. Its acquisition of Carl Dan Pedenghaus has left the company only second to Thessian Krup. Primarily focused on automobile forgings, BFL is a near monopoly in the commercial vehicle forging segment in India and has substantial geographic distribution of sales.

### Key investment arguments

- BFL's addressable market opportunity stands at US\$10b per annum and BFL is targeting a share of US\$1b by FY08, nearly twice its existing turnover. We believe BFL is well placed to more than double its existing 5% market share in three years and has a clear road map to achieve this.
- Forgings and casting by the mere nature of the manufacturing process are very popular outsourcing items.

### Key investment risks

- Aggressive inorganic growth strategy might lead to increased debt levels or further equity dilution.

### Recent developments

- BFL has acquired Imatra Group, a Swedish auto parts manufacturer with a strong presence in the heavy commercial segment.

### Valuation and view

- On a standalone basis, BFL trades at 28.3x FY06E and 21.8x FY07E EPS of Rs.11.5 and Rs.15; 10.1x FY06E and 7.1x FY07E book value; and at an EV of 14.9x FY06E and 11.3x FY07E EBITDA.
- On a consolidated basis, BFL trades at 16.1x FY07E EPS of Rs20.3. We estimate the aggregate EPS of these entities to add 35% to the standalone EPS in FY07.
- Given the bright prospects, we maintain **Buy** with a target price of Rs347.

### Sector view

- The auto ancillary sector is witnessing strong demand from global OEMs attempting to offshore components and reduce costs.
- Forgings and casting, due to the environmental and health norms associated with their manufacture, have been witnessing strong demand from global players.
- We maintain an overweight stance on the sector.

#### COMPARATIVE VALUATIONS

		BHARAT FORGE	TATA MOTORS
P/E (x)	FY06E	28.3	14.2
	FY07E	21.8	12.8
EPS Gr (%)	FY06E	40.5	13.5
	FY07E	30.2	10.8
RoE (%)	FY06E	35.7	28.2
	FY07E	32.6	26.3
EV/EBITDA (x)	FY06E	14.9	6.3
	FY07E	11.3	5.5

#### SHAREHOLDING PATTERN (%)

	SEP.05	JUN.05	SEP.04
Promoters	35.0	34.5	37.3
Domestic Institutions	12.7	12.4	14.2
FII's/FDIs	22.1	21.4	15.0
Others	30.2	31.7	33.6

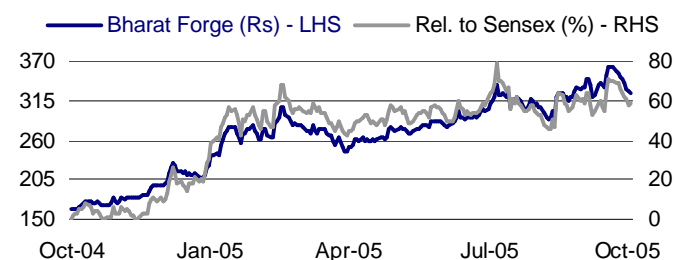
#### EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	11.5	11.0	4.7
FY07	15.0	13.5	11.1

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
326	347	6.6	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
<b>Net Sales</b>	<b>6,357</b>	<b>8,321</b>	<b>12,191</b>	<b>15,969</b>	<b>20,252</b>
Change (%)	50.2	30.9	46.5	31.0	26.8
<b>Total Income</b>	<b>6,357</b>	<b>8,321</b>	<b>12,191</b>	<b>15,969</b>	<b>20,252</b>
Expenditure	4,494	5,919	8,916	11,737	14,794
<b>EBITDA</b>	<b>1,864</b>	<b>2,402</b>	<b>3,275</b>	<b>4,232</b>	<b>5,458</b>
Change (%)	71.9	28.9	36.3	29.2	29.0
% of Net Sales	29.3	28.9	26.9	26.5	27.0
Depreciation	418	458	526	716	893
Interest & Finance Charges	408	324	342	380	434
Other Income	95	191	74	229	252
<b>PBT</b>	<b>1,133</b>	<b>1,812</b>	<b>2,481</b>	<b>3,365</b>	<b>4,383</b>
Tax	322	563	865	1,094	1,424
Effective Rate (%)	28.4	31.1	34.8	32.5	32.5
<b>PAT</b>	<b>811</b>	<b>1,249</b>	<b>1,616</b>	<b>2,271</b>	<b>2,958</b>
% of Net Sales	12.8	15.0	13.3	14.2	14.6
<b>Adj. PAT</b>	<b>811</b>	<b>1,249</b>	<b>1,616</b>	<b>2,271</b>	<b>2,958</b>
Change (%)	280.9	54.0	29.4	40.5	30.2

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
Share Capital	677	677	596	596	596
Equity Capital	377	377	396	396	396
Preference Capital	300	300	200	200	200
Reserves	1,038	1,836	3,830	5,769	8,479
<b>Net Worth</b>	<b>1,715</b>	<b>2,512</b>	<b>4,426</b>	<b>6,364</b>	<b>9,075</b>
Deferred Tax	780	806	812	1,140	1,567
Loans	3,236	2,856	4,179	5,429	5,429
<b>Capital Employed</b>	<b>5,730</b>	<b>6,173</b>	<b>9,416</b>	<b>12,933</b>	<b>16,071</b>
Gross Fixed Assets	7,697	8,220	9,477	13,829	17,128
Less: Depreciation	3,270	3,708	4,213	4,929	5,823
<b>Net Fixed Assets</b>	<b>4,427</b>	<b>4,512</b>	<b>5,264</b>	<b>8,900</b>	<b>11,304</b>
Capital WIP	139	877	2,769	375	375
Investments	0	344	383	383	383
<b>Curr. Assets, L &amp; Adv.</b>	<b>4,014</b>	<b>5,228</b>	<b>7,848</b>	<b>12,720</b>	<b>13,850</b>
Inventory	1,264	1,331	1,861	2,061	2,613
Sundry Debtors	813	1,001	1,431	1,638	2,077
Cash & Bank Balances	233	86	281	6,675	7,986
Loans & Advances	1,704	2,366	3,611	2,347	1,173
<b>Current Liab. &amp; Prov.</b>	<b>2,963</b>	<b>4,869</b>	<b>6,892</b>	<b>9,488</b>	<b>9,886</b>
Creditors	1,354	1,865	1,939	4,258	4,309
Other Liabilities	218	126	404	424	487
Acceptances	620	1,389	1,975	1,975	1,975
<b>Net Current Assets</b>	<b>1,051</b>	<b>360</b>	<b>956</b>	<b>3,232</b>	<b>3,965</b>
<b>Application of Funds</b>	<b>5,731</b>	<b>6,174</b>	<b>9,416</b>	<b>12,933</b>	<b>16,071</b>

E: MOST Estimates; Standalone

RATIOS					
Y/E MARCH	2003	2004	2005	2006E	2007E
<b>EPS</b>	<b>4.3</b>	<b>6.6</b>	<b>8.2</b>	<b>11.5</b>	<b>15.0</b>
<b>EPS Consolidated</b>	<b>-</b>	<b>-</b>	<b>10.2</b>	<b>15.4</b>	<b>20.3</b>
Cash EPS	6.5	9.1	10.8	15.1	19.5
Book Value per Share	9.1	13.3	22.4	32.2	45.9
DPS	14	2.3	3.1	3.2	3.3
Payout %	314	38.3	38.1	28.0	22.0
<b>Valuation (x)</b>					
P/E		49.1	39.8	28.3	21.8
P/E Consolidated		-	32.0	21.1	16.1
Cash P/E		35.9	30.1	21.6	16.7
EV/EBITDA		26.7	20.8	14.9	11.3
EV/Sales		7.7	5.6	3.9	3.0
Price to Book Value		24.4	14.5	10.1	7.1
Dividend Yield (%)		0.7	1.0	1.0	1.0
<b>Profitability Ratios (%)</b>					
RoE	47.3	49.7	36.5	35.7	32.6
RoCE	26.9	34.6	30.0	29.0	30.0

Leverage Ratio					
Debt/Equity (x)	19	11	0.9	0.9	0.6

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
OP/(Loss) before Tax	1,446	1,944	2,749	3,516	4,565
Interest/Div. Received	95	191	74	229	252
Depreciation & Amort.	418	458	526	716	893
Direct Taxes Paid	458	-537	-858	-766	-997
(Inc)/Dec in Wkg. Capital	91	544	-401	4,118	579
Other Items	-703	27	-161	303	404
<b>CF from Op. Activity</b>	<b>1,804</b>	<b>2,627</b>	<b>1,928</b>	<b>8,117</b>	<b>5,695</b>
(Inc)/Dec in FA+CWIP	-508	-1,281	-3,170	-1,957	-3,298
(Pur)/Sale of Invest.	0	-344	-40	0	0
<b>CF from Inv. Activity</b>	<b>-508</b>	<b>-1,625</b>	<b>-3,210</b>	<b>-1,957</b>	<b>-3,298</b>
Issue of Shares	100	0	1,055	0	0
Inc/(Dec) in Debt	-587	-380	1,323	1,250	0
Interest Paid	-408	-324	-342	-380	-434
Dividends Paid	-255	-478	-616	-636	-652
<b>CF from Fin. Activity</b>	<b>-1,150</b>	<b>-1,182</b>	<b>1,420</b>	<b>234</b>	<b>-1,086</b>
<b>Inc/(Dec) in Cash</b>	<b>139</b>	<b>-146</b>	<b>195</b>	<b>6,394</b>	<b>1,311</b>
Add: Beginning Balance	93	233	86	281	6,675
<b>Closing Balance</b>	<b>232</b>	<b>87</b>	<b>281</b>	<b>6,675</b>	<b>7,986</b>

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**Bharat Forge**

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|--|----|
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| 2. Group/Directors ownership of the stock    | No |
| 3. Broking relationship with company covered | No |

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