

Bharat Forge

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,573	BHFC IN
	REUTERS CODE
S&P CNX: 3,116	BFRG.BO

24 May 2006

Buy

Rs349

Previous Recommendation: Buy

Equity Shares (m)	197.8
52-Week Range (Rs)	485/266
1,6,12 Rel.Perf.(%)	-8/-24/-34
M.Cap. (Rs b)	69.1
M.Cap. (US\$ b)	1.5

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/06A	15,779	2,070	8.2	28.0	42.7	9.9	28.9	16.5	4.3	17.6
3/07E	20,117	2,809	11.1	35.7	31.5	7.3	28.8	16.9	3.3	13.0
3/08E	24,526	3,415	13.5	21.6	25.9	5.5	26.4	18.4	2.6	10.2

Standalone, P/E on diluted basis

- 4QFY06 operating results were below expectation. YoY, revenues grew 21%; EBITDA was up 18%; PAT up 10%.
- Sales slowed during the quarter, registering 21% YoY growth. We expect sales to ramp up from 3QFY07, as BFL is expanding capacity from 160,000 tons as of March 2006 to 240,000 tons as of October 2006.
- EBITDA margins lower at 24% v/s 24.7% in 4QFY05. Margins were lower due to expenses incurred on components development for their new capacities that have not yet commenced. The lower margins, higher depreciation and interest costs led to PAT growth by merely 10% YoY to Rs530m. For FY06, standalone sales were Rs15.8b; EBITDA margin was at 24.7% (-220bp YoY) and PAT, at Rs2b, leading to EPS of Rs8.2.
- Consolidated sales were at Rs30.2b, (+51% YoY). EBITDA at Rs5.2b witnessed EBITDA margin of 17.3%, v/s 21.2% in FY05. PAT at Rs2.5b, grew by 25% YoY. This has resulted in diluted EPS of Rs10.1.
- Given that the entire capacities are presold, BFL will likely post Rs25b turnover from the Indian operations in FY08. Consolidated sales is estimated to cross the US\$1b level in FY08, resulting in a 27% CAGR increase in sales.
- After the successful JV with FAW, BFL plans to make its China operations the next export hub. Besides, the company is focusing on the non-automotive business to broad-base its revenues. It expects to raise revenue share from 17% of sales currently, to 25% over the next 3-4 years.
- We expect BFL to report EPS of Rs14.8 and Rs17.7 in FY07E and FY08E. BFL trades at a P/E of 23.6x FY07E and 19.7x FY08E on consolidated earnings. Given the bright prospects, high growth visibility and a clear road map for future growth, we maintain a **Buy** on the stock.

QUARTERLY PERFORMANCE

	(Rs Million)									
	FY05				FY06				FY05	FY06
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net Sales	2,568	2,902	3,109	3,613	3,635	3,766	3,994	4,384	12,191	15,779
Change (%)	38.0	42.4	46.6	56.9	41.6	29.8	28.5	21.4	46.5	29.4
Total Expenses	1,878	2,091	2,233	2,721	2,750	2,795	3,008	3,331	8,917	11,883
EBITDA	690	810	875	892	885	971	986	1,053	3,274	3,896
As % of Sales	26.9	27.9	28.2	24.7	24.4	25.8	24.7	24.0	26.9	24.7
Change (%)	26.7	38.0	32.1	47.0	28.2	19.9	12.7	18.1	36.3	19.0
Other Income	42	7	4	21	112	115	161	144	74	531
Interest	79	83	90	84	112	128	153	155	342	548
Depreciation	123	132	136	135	149	175	191	214	526	730
PBT	530	603	654	693	736	783	802	828	2,480	3,149
Tax	190	225	240	210	247	265	270	298	865	1,079
Effective Tax Rate (%)	35.9	37.2	36.7	30.3	33.5	33.8	33.6	36.0	34.9	34.3
Adj. PAT	340	378	414	484	489	518	533	530	1,616	2,070
Change (%)	29.4	28.9	25.4	33.5	43.9	36.8	28.6	9.6	29.4	28.1

E: MOST Estimates

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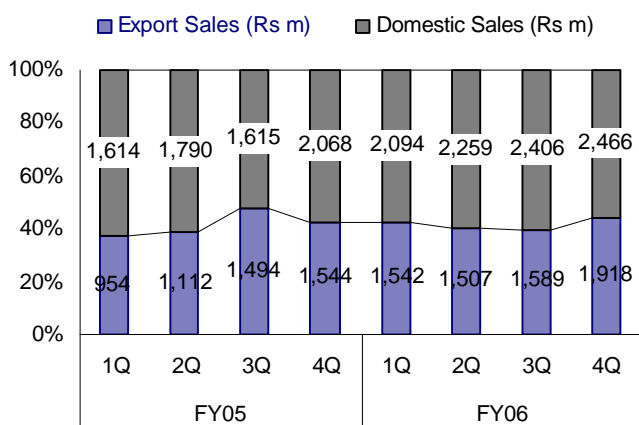
Sales momentum slows down: albeit temporarily

Sales momentum slowed during the quarter, with sales registering 21% YoY growth — the slowest over the past eight quarters. Exports grew 24% YoY at Rs1.9b, while domestic sales grew 19% YoY at Rs2.5b.

However, sales were affected owing to the existing capacities reaching full capacities. Capacity expansion is ongoing at Bharat Forge — it is increasing forging capacity from 160,000 tons per annum as of March 2006 to 240,000 tons as of October 2006. We expect sales to ramp up from 3QFY07, when the expansion plans will be complete.

For FY06, standalone sales were at Rs15.8b, a growth of 29% YoY.

SALES BREAKDOWN

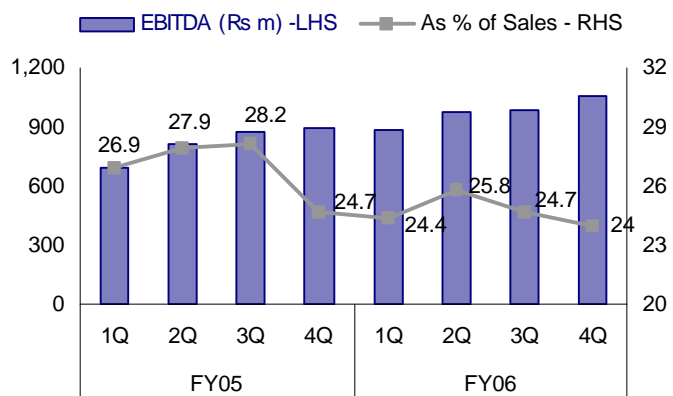


Source: Company/Motilal Oswal Securities

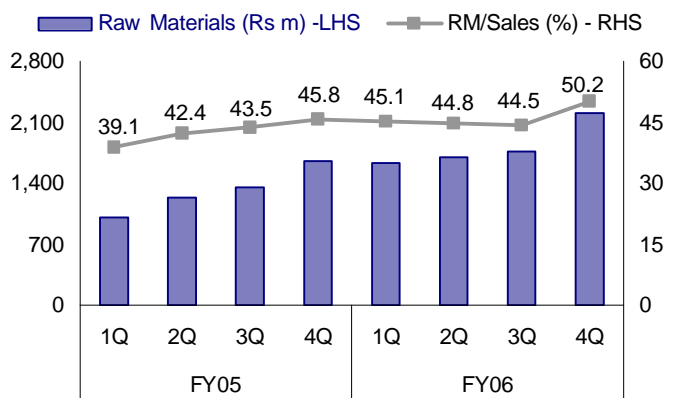
Operating performance under pressure

In 4QFY06, EBITDA margins were at 24% versus 24.7% in 4QFY05. EBITDA margins YoY have been under pressure due to higher raw material cost (an increase of 440bp YoY). Expenses were higher due to various reasons such as expenses relating to pre-production and components development for their new capacities, which have not yet commenced. As mentioned above, the new capacities will be on stream by mid-FY06, and sales performance should improve thereon.

EBITDA MARGINS UNDER SQUEEZE



RAW MATERIAL COST: SIGNIFICANTLY HIGHER IN 4QFY06



Source: Company/Motilal Oswal Securities

Standalone profit grew 10% – lower due to increase in capacity related costs

Bharat Forge reported EBITDA of Rs1b (+18% YoY). Other income at Rs144m was a substantial increase, mainly on account of interest earned on its idle GDR funds. Interest costs were higher at Rs155m, (compared with Rs84m in 4QFY05). Depreciation too was higher at Rs214m (Rs135m in 4QFY05), due to expanded capacities. The company incurred higher tax related expenses – tax rate was 36% in 4QFY06 v/s 30% in 4QFY05.

Several expenses incurred due to the expanded capacities led to PAT growing by just 10% YoY at Rs530m. For the full year FY06, PAT grew 28% YoY to Rs2b. This has resulted in an EPS of Rs8.2.

Consolidated PAT

Total revenues grew 1% QoQ to Rs9.7b and PAT grew 10% QoQ to Rs688m. Consolidated PAT in 4QFY06 is 30% higher than standalone profits. On a consolidated basis, EBITDA margins were at 17.2% in 4QFY06 compared with 16.1% in 3QFY06.

For FY06, consolidated sales were at Rs30.2b, which is a growth of 51% YoY. EBITDA at Rs5.2b witnessed a margin of 17.3% compared with 21.2% in FY05. PAT at Rs2.5b witnessed growth of 25% at Rs2.5b. This has resulted in a diluted EPS of Rs10.1.

CONSOLIDATED RESULT (RS M)

	4QFY06	FY06
Total Income	9,666	30,189
EBITDA	1,666	5,227
EBITDA Margins (%)	17.2	17.3
PAT	688	2,505
PAT Margin (%)	7.1	8.3

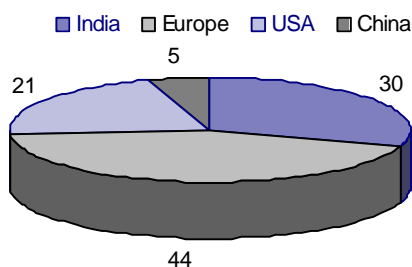
Source: Company/Motilal Oswal Securities

Bharat Forge has broad-based revenue, both in terms of geographic spread and product basket. Bharat Forge derives 44% of its revenues from Europe and 30% from India. In terms of product spread, 46% of its revenues arise from commercial vehicles and 27% from passenger cars, while that from non-automotives is 17%. Hence, the company is not overly reliant on any one segment or product for its revenue.

Currently, China accounts for just 5% of the company’s revenue. This contribution will move up, once Bharat Forge’s newly formed JV with FAW, China becomes operational.

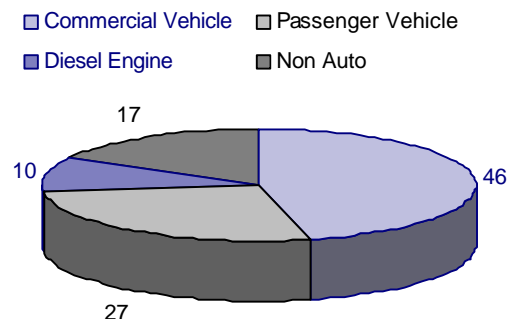
BREAK UP OF CONSOLIDATED REVENUE (%)

GLOBAL REVENUE - GEOGRAPHIC BREAK UP (%)



Source: Company/Motilal Oswal Securities

GLOBAL REVENUE - PRODUCT-WISE BREAK UP (%)



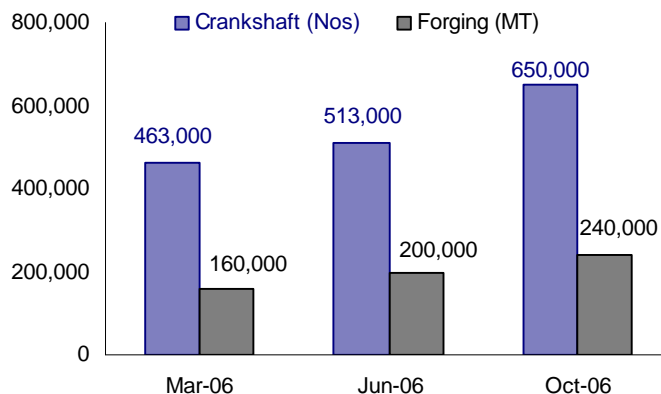
Source: Company/Motilal Oswal Securities

Capacity expansion: on track to October 2006

BFL’s capacity expansion plan is on stream. Of the total 240,000 tons per annum forging capacity, only 160,000 tons is operational currently. The balance, 80,000 tons will come on stream by October 2006 (see exhibit below). Similarly, machining capacity will also increase to 650,000 units per annum by October 2006, from the current 463,000 units.

We expect the full impact of these capacities to accrue from 3QFY07. Given that the entire capacities are presold, we expect Bharat Forge to post Rs25b turnover from Indian operations in FY08. This will be an increase of 25% CAGR in sales over FY06-FY08.

CAPACITY DETAILS



Source: Company/Motilal Oswal Securities

China JV – future growth driver

Bharat Forge is positive with regard to its China JV. The venture set up with FAW Corporation, will have a capacity of 100,000 tons per annum. The plant will cater to various product requirements – both in commercial vehicles and passenger vehicles, as well as it would have the capability to produce various sizes of forgings. The plant currently does not have any machining facility, but this is likely to be set up once operations are stabilized. The current turnover is US\$50m (Rs2.3b) with the plant working at 40% capacity. Hence, there is strong potential to ramp up operations. The JV will enable Bharat Forge to become the largest forging components player in China.

The potential from China is substantial, as it is amongst the largest automotive markets in the world. In order to be a global player, a presence in China is essential. Moreover, China will also be a low-cost manufacturing hub for Bharat Forge's exports. It plans to make China along with India, the manufacturing base for its global locations. Hence, the share of China will increase from 5% of sales currently to 15% over the next 2-3 years.

Focus on non-automotive business

The non-automotive business, which comprises the industrial and oil and gas sector currently accounts for 17% of sales. Due to the ongoing capex in the Indian economy and large-scale global oil and gas exploration activities, Bharat Forge expects strong growth in this segment. Forgings are used in several industrial applications such as in turbines for power plants, in parts for aeroplanes, in machine parts for the steel and cement equipment and in rigs for oil exploration.

Orders from this business segment typically comprise large scale forgings (above 100kg), but in small quantities. Hence, the margins are higher than in the automotive business. Bharat Forge plans to increase its turnover from the non-automotive segment to 25% from the current 17% over the next 3-5 years.

Bharat Forge raises FCCBs of US\$80m

Bharat Forge has raised FCCB of US\$80m in April 2006. This is over and above the US\$220m raised in April 2005 in the form of FCCBs and the US\$28m that they have raised via conversion of warrants. Hence, the total amount raised would be US\$328m (Rs13.6b). This should result in a total dilution of 22.7% on its existing share capital of Rs396m.

DETAILS OF FUND RAISED

	(US\$ M)	(RS M)	DILUTION (%)
Apr-05 (FCCB)	220	10,000	17.5
Oct-05 (Warrants)	28	1,250	2.4
Apr-06 (FCCB)	80	3,600	2.8
Total	328	13,600	22.7

Source: Company/Motilal Oswal Securities

Bharat Forge is always on the lookout for acquisitions, which is evident from the five companies it has acquired over the past two years. The company has recently raised the US\$80m to keep its war chest ready for further acquisitions, which may come up in the future. It is eyeing the American market for further buyouts as it has limited presence there.

ACQUISITION HISTORY

	COMPANY	ACQUISITION AMOUNT (RS M)	ANNUAL T/O (RS B)
Jan. 2004	CDP, Germany	1,680	8.1
Dec. 2004	CDP AT, Germany	360	2.0
Jun. 2005	Federal Forge, USA	396	2.6
Sep. 2005	Imatra Kilsta, Sweden	2,500	5.8
Dec. 2005	FAW Bharat Forge Changchun Ltd., China	NA	2.3

Source: Company/Motilal Oswal Securities

Valuation and view

We remain positive on Bharat Forge's dual shore model and management's global vision. We believe the company will cross revenues of US\$1b by FY08. The recent initiatives of the global technology center, its acquisitions and the recently formed JV with FAW, China, make Bharat Forge a world leader in its class.

After setting up its dual shore model, Bharat Forge is successfully leveraging its capability in winning customers. It currently has relationships with 35 global OEMs and has development partner status with several of them.

We expect Bharat Forge to report EPS of Rs14.8 and Rs17.7 in FY07E and FY08E. Bharat Forge trades at a P/E of 23.6x FY07E and 19.7x FY08E on consolidated earnings. Given the bright prospects, high growth visibility and a clear road map for future growth, we maintain a **Buy** on the stock.

CONSOLIDATED EARNINGS (RS M)

	2005	2006E	2007E	2008E
Profit & Loss				
Sales	19,934	30,189	42,107	48,539
EBITDA	4,266	5,227	7,066	8,423
<i>EBITDA Margin (%)</i>	<i>21.4</i>	<i>17.3</i>	<i>16.8</i>	<i>17.4</i>
Net Profit	2,010	2,505	3,742	4,485
Cons. EPS (diluted) - (Rs)	10.2	10.1	14.8	17.7
<i>EPS Growth (%)</i>		<i>-0.8</i>	<i>45.9</i>	<i>19.8</i>

Source: Company/Motilal Oswal Securities

Bharat Forge: an investment profile

Company description

Bharat Forge is the second largest forging manufacturer in the world. Its recent acquisitions have positioned the company only second to Thessian Krup. Primarily focused on automobile forgings, Bharat Forge has a broad-based product mix. The products have substantial geographic sales distribution.

Key investment arguments

- ✍ BFL's addressable market opportunity stands at US\$10b p.a. and the company is targeting a share of US\$1b by FY08. We believe BFL is well placed to more than double its existing 5% share in three years and has charted a clear road map to achieve this.
- ✍ BFL is broad-basing its revenue, by focusing on the non-automotive sector. Within the automotive sector as well, it derives revenues from various segments – PVs and CVs. Hence, BFL is not overly dependent on any one segment for its revenues.
- ✍ Forgings and castings, by the mere nature of the manufacturing process, are popular outsourcing items.

Key investment risks

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

Recent developments

- ✍ BFL has raised FCCBs of US\$80m in April 2006.

Valuation and view

- ✍ We expect BFL to report EPS of Rs14.8 and Rs17.7 in FY07E and FY08E. BFL trades at a P/E of 23.6x FY07E and 19.7x FY08E on consolidated earnings.
- ✍ Given the bright prospects, high growth visibility and a clear road map for future growth, we maintain a **Buy** on the stock.

Sector view

- ✍ The auto ancillary sector is witnessing strong demand from global OEMs attempting to offshore components and reduce costs.
- ✍ Forgings and castings, due to environmental and health norms, have been witnessing the strongest demand from global players.
- ✍ We maintain an Overweight stance on the sector

COMPARATIVE VALUATIONS

		BHARAT FORGE	AMTEK	AUTO TATA	MOTORS
P/E (x)	FY07E	31.5	13.3	17.7	
	FY08E	25.9	11.2	14.9	
EPS Gr (%)	FY07E	35.7	24.8	20.2	
	FY08E	21.6	18.9	18.7	
RoE (%)	FY07E	28.8	25.2	28.2	
	FY08E	26.4	25.6	27.3	
EV/EBITDA (x)	FY07E	13.0	7.3	9.1	
	FY08E	10.2	5.9	7.5	

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	35.8	35.3	37.6
Domestic Institutions	10.5	12.5	12.5
FII's/FDIs	24.5	22.5	17.7
Others	29.2	29.7	32.2

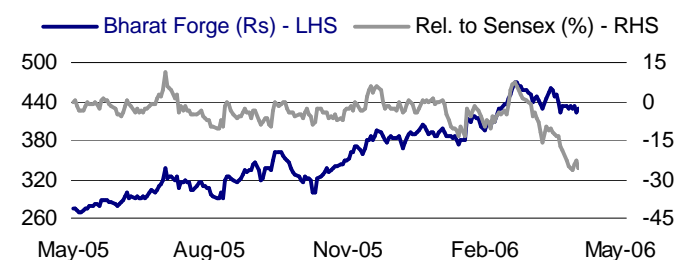
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	14.8	14.4	2.8
FY08	17.7	17.7	0.3

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
349	450	28.9	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Net Sales	8,321	12,191	15,779	20,117	24,526
Change (%)	30.9	46.5	29.4	27.5	21.9
Total Income	8,321	12,191	15,779	20,117	24,526
Expenditure	5,919	8,916	11,883	14,907	18,137
EBITDA	2,402	3,275	3,896	5,210	6,389
Change (%)	28.9	36.3	19.0	33.7	22.6
% of Net Sales	28.9	26.9	24.7	25.9	26.1
Depreciation	458	526	730	905	1,008
Interest & Finance Charges	324	342	548	713	713
Other Income	191	74	531	568	585
PBT	1,812	2,481	3,149	4,161	5,254
Tax	563	865	1,079	1,352	1,839
Effective Rate (%)	31.1	34.8	34.3	32.5	35.0
PAT	1,249	1,616	2,070	2,809	3,415
Change (%)	54.0	29.4	28.0	35.7	21.6
% of Net Sales	15.0	13.3	13.1	14.0	13.9
Adj. PAT	1,249	1,616	2,070	2,809	3,415
Change (%)	54.0	29.4	28.0	35.7	21.6

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Equity Capital	377	396	405	405	405
Reserves	1,836	3,830	6,560	9,131	12,309
Net Worth	2,512	4,426	7,165	9,737	12,914
Deferred Tax	806	812	958	1,372	1,740
Loans	2,856	4,179	14,217	17,807	17,807
Capital Employed	6,173	9,416	22,339	28,916	32,461
Gross Fixed Assets	8,220	9,477	13,829	17,128	19,707
Less: Depreciation	3,708	4,213	4,929	5,835	6,845
Net Fixed Assets	4,512	5,264	8,900	11,292	12,862
Capital WIP	877	2,769	375	375	400
Investments	344	383	383	383	383
Curr.Assets, L & Adv.	5,228	7,848	22,075	26,679	29,903
Inventory	1,331	1,861	2,036	2,596	3,165
Sundry Debtors	1,001	1,431	1,618	2,063	2,516
Cash & Bank Balances	86	281	16,074	20,846	23,343
Loans & Advances	2,366	3,611	2,347	1,173	880
Current Liab. & Prov.	4,869	6,892	9,438	9,857	11,131
Creditors	1,865	1,939	4,208	4,280	5,218
Other Liabilities	126	404	424	487	512
Acceptances	1,389	1,975	1,975	1,975	1,975
Net Current Assets	360	956	12,638	16,822	18,773
Miscellaneous Expenditures	81	43	43	43	43
Application of Funds	6,174	9,416	22,339	28,916	32,461

E: M0St Estimates; Standalone

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
Diluted EPS	6.6	8.2	8.2	11.1	13.5
Diluted EPS Cons.			10.1	14.8	17.7
Cash EPS	9.1	10.8	13.8	18.3	21.8
Book Value per Share	13.3	22.4	35.3	48.0	63.7
DPS	2.3	3.1	3.0	3.0	2.9
Payout %	38.3	38.1	29.0	22.0	17.0
Valuation (x)					
P/E (Diluted)		42.7	42.7	31.5	25.9
P/E Consolidated (Diluted)		34.4	34.5	23.6	19.7
Cash P/E		32.2	25.3	19.1	16.0
EV/EBITDA		22.2	17.6	13.0	10.2
EV/Sales		6.0	4.3	3.3	2.6
Price to Book Value		15.6	9.9	7.3	5.5
Dividend Yield (%)		0.9	0.8	0.9	0.8
Profitability Ratios (%)					
RoE	49.7	36.5	28.9	28.8	26.4
RoCE	34.6	30.0	16.5	16.9	18.4
Turnover Ratios					
Debtors (Days)	41	40	35	35	35
Asset Turnover (x)	13	13	0.7	0.7	0.8
Leverage Ratio					
Debt/Equity (x)	1.1	0.9	2.0	1.8	1.4

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
OP/(Loss) before Tax	1,944	2,749	3,166	4,305	5,381
Interest/Div. Received	191	74	531	568	585
Depreciation & Amort.	458	526	730	905	1,008
Direct Taxes Paid	-537	-858	-933	-938	-1,471
(Inc)/Dec in Wkg. Capital	578	-363	4,111	588	546
CF from Op. Activity	2,634	2,127	7,605	5,429	6,049
(Inc)/Dec in FA+CWIP	-1,281	-3,170	-1,971	-3,298	-2,603
(Pur)/Sale of Invest.	-344	-40	0	0	0
CF from Inv. Activity	-1,625	-3,210	-1,971	-3,298	-2,603
Inc./(Dec) in Networth	27	913	1,270	382	344
Inc/(Dec) in Debt	-380	1,323	10,038	3,590	0
Interest Paid	-324	-342	-548	-713	-713
Dividends Paid	-478	-616	-600	-619	-582
CF from Fin. Activity	-1,155	1,278	10,160	2,640	-950
Inc/(Dec) in Cash	-146	195	15,793	4,772	2,497
Add: Beginning Balance	233	86	281	16,074	20,846
Closing Balance	87	281	16,075	20,845	23,343



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Bharat Forge

- | | |
|--|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |

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