

January 21, 2008

Rating	Under Performer
Price	Rs310
Target Price	Rs298
Implied Upside	-3.8%
Sensex	17,605

(Prices as on January 21, 2008)

**Trading Data**

Market Cap. (Rs bn)	69.0
Shares o/s (m)	222.7
Free Float	82.9%
Avg. Daily Vol ('000)	200.5
Avg. Daily Value (Rs m)	69.2

**Major Shareholders**

Promoters	40.6%
Foreign	15.2%
Domestic Inst.	27.4%
Public & Others	16.8%

**Stock Performance**

(%)	1M	6M	12M
Absolute	(8.5)	1.8	(15.9)
Relative	(0.4)	(11.3)	(40.1)

Price Performance (RIC: BFRG.BO, BB: BHFC IN)



Source: Bloomberg

■ **Results:** Bharat Forge reported lower than expected sales growth of 16.7% YoY to Rs5,567m primarily on account of lower exports. Operating margin at 24.5%, although lower at 147bps, was flat on sequential basis. With a dip in margin and lower other income, PAT was down 7.6% YoY to Rs582m.

■ **Capex update:** The company's Baramati plant and the open-forge unit for non-auto components are on schedule and is expected to commence operations towards the end of Q4FY09 and Q1FY10 respectively. As part of its foray into the capital goods sector, it will invest in a JV with NTPC for manufacturing equipments for the sector in which it is expected to have majority stake.

■ **Valuation:** Almost 60% of the company's revenue comes from the commercial vehicle industry. The current slowdown in the CV industry, both in India and US, would mean that the company's topline growth would be muted as both these regions contribute to 47% of the company's sales. The US CV industry is expected to recover only by Q2CY08.

At the ruling market price of Rs310, the stock trades at 19.4x FY09E EPS of Rs16.0 and at 14.5x FY10E EPS of Rs21.3. The valuation seems to have factored in the future potential for now. Hence, we maintain Underperformer rating on the stock.

Key financials (Y/e March)	FY07	FY08E	FY09E	FY10E
Revenues (Rs m)	18,644	22,610	28,091	34,714
Growth (%)	18.2	21.3	24.2	23.6
EBITDA (Rs m)	4,676	5,602	7,022	8,877
PAT (Rs m)	2,477	2,881	3,835	5,115
EPS (Rs)	10.3	12.0	16.0	21.3
Growth (%)	19.7	16.3	33.2	33.4
Net DPS (Rs)	3.5	3.2	3.2	3.2

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08E	FY09E	FY10E
EBITDA margin (%)	25.1	24.8	25.0	25.6
RoE (%)	20.0	19.7	21.3	22.8
RoCE (%)	11.9	12.0	13.3	15.0
EV / sales (x)	4.1	3.5	2.7	2.1
EV / EBITDA (x)	16.4	14.0	11.0	8.1
PE (x)	30.0	25.8	19.4	14.5
P / BV (x)	5.2	4.3	3.5	2.8
Net dividend yield (%)	1.1	1.03	1.03	1.03

Source: Company Data; PL Research

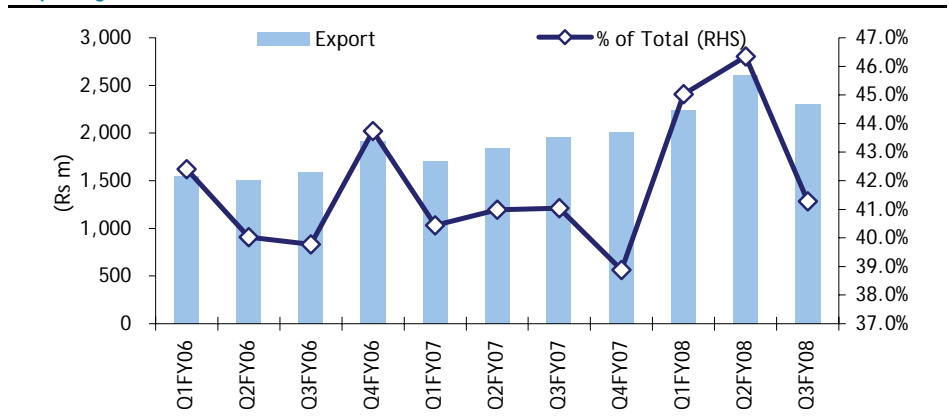
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## Highlights

### Lower exports limits topline growth

Bharat Forge reported lower than expected sales growth of 16.7% YoY to Rs5,567m (we had expected 29.6% growth, led by 38% increase in exports), primarily on account of lower exports. While the domestic growth of 16% YoY to Rs3,721m was in line with our expectations, exports grew only 17.4% YoY in Q3 after registering a 37% YoY growth in H1FY08. Exports to total sales were down at 41.3% as against 46.3% in Q2FY08. Slowdown in exports has been primarily on account of sharp fall in production of more than 40% witnessed by the US CV industry.

#### Export growth slows down

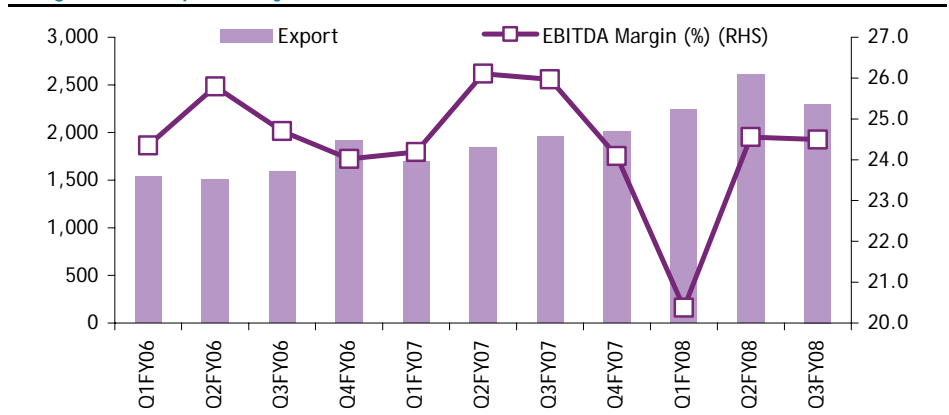


Source: Company Data, PL Research

### Margins maintained

Although operating margin at 24.5% was 147bps lower, it was flat sequentially. Lower export mix resulted in lower losses from currency fluctuations and hence stable margins.

#### Margins flat sequentially



Source: Company Data, PL Research



## PAT growth down 7.6% YoY

Other Income at Rs156m was lower than expected (Rs253m in Q2FY08). With a dip in margin and lower other income, PAT was down 7.6% YoY to Rs582m.

## Estimates revised, FY10 estimates introduced

We have marginally revised our topline estimates for FY08 by 1.6% due to slower than anticipated growth in exports while maintaining our PAT estimates for FY08. However, for FY09, we reduce our topline estimates by 11.4%, primarily as the Baramati plant for non-automotive forgings would be operational only by Q4FY09. Hence, we have not considered any major contribution from that plant in our estimates for the year.

### Estimates revised

	Revised estimates		Earlier estimates		% revision	
	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E
Net sales (Rs m)	22,610	28,091	22,989	31,701	(1.6)	(11.4)
Adj. PAT (Rs m)	2,881	3,835	2,872	4,243	0.3	(9.6)
EPS (Rs)	12.0	16.0	12.0	17.7	0.3	(9.6)

We are introducing estimates for FY10. The new plant in Baramati as well as the open-die forge is expected to commence operations from Q4FY09. Hence, the full year effect is expected only in FY10. We expect a topline growth of 23.6% in FY10 to Rs34.7bn and PAT growth of 33% to Rs5.1bn on the back of improved margins of 25.6%.



## Valuation

Bharat Forge has been traditionally trading at a reasonable premium to its other peers primarily due to its large scale, quality management and global reach. The one year forward rolling PE chart indicates that BFL has been trading at an average 24.1x in the last 1 year.

### 1yr forward PE Chart



Source: PL Research

Almost 60% of the company's revenue comes from the CV industry. The current slowdown in the CV industry, both in India and the US, would mean that the company's topline growth would be muted as both these regions contribute 47% of the company's sales. The US CV industry is expected to recover only by Q2CY08.

At the ruling market price of Rs310, the stock trades at 19.4x FY09E EPS of Rs16.0 and at 14.5x FY10E EPS of Rs21.3. The valuation seems to have factored in the future growth potential for now. Hence, we maintain Underperformer rating on the stock.



## Q3 FY08 Result Overview

(Rs m)

Y/e March	Q3FY08	Q3FY07	YoY gr. (%)	Q2FY08	9MFY08	9MFY07	YoY gr. (%)
Net Sales	5,567	4,771	16.7	5,632	16,168	13,484	19.9
<b>Expenditure</b>							
Raw Material	2,484	2,255	10.1	2,632	7,419	6,143	20.8
Change in Stock	(12)	(80)	(84.9)	(84)	(100)	(166)	
<i>as % of net sales</i>	44.4	45.6		45.2	45.3	44.3	
Personnel Cost	381	278	37.1	354	1,072	797	34.6
<i>as % of net sales</i>	6.8	5.8		6.3	6.6	5.9	
Mfgr. Expenses	984	838	17.4	934	2,813	2,374	18.5
<i>as % of net sales</i>	17.7	17.6		16.6	17.4	17.6	
Other Expenses	367	242	51.8	414	1,205	903	33.4
<i>as % of net sales</i>	6.6	5.1		7.3	7.5	6.7	
Total Expenditure	4,204	3,532	19.0	4,249	12,409	10,051	23.5
<b>EBITDA</b>	<b>1,364</b>	<b>1,239</b>	<b>10.1</b>	<b>1,383</b>	<b>3,759</b>	<b>3,433</b>	<b>9.5</b>
<i>EBITDA margin (%)</i>	24.5	26.0		24.6	23.2	25.5	
Depreciation	353	252	40.0	351	1,033	731	41.4
<b>EBIT</b>	<b>1,010</b>	<b>987</b>	<b>2.4</b>	<b>1,032</b>	<b>2,726</b>	<b>2,702</b>	<b>0.9</b>
Net interest	294	215	36.6	273	801	588	36.3
Non-operating Income	156	162	(3.9)	253	942	586	60.6
<b>PBT</b>	<b>872</b>	<b>933</b>	<b>(6.6)</b>	<b>1,012</b>	<b>2,867</b>	<b>2,701</b>	<b>6.1</b>
Total tax	290	303	(4.3)	334	959	889	7.9
<i>Total Tax rate %</i>	33.3	32.5		33.0	33.5	32.9	
<b>Adj. Profit after tax</b>	<b>582</b>	<b>630</b>	<b>(7.6)</b>	<b>677</b>	<b>1,907</b>	<b>1,812</b>	<b>5.3</b>



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#### PL's Recommendation Nomenclature

<b>BUY</b>	: > 15% Outperformance to BSE Sensex	<b>Outperformer (OP)</b>	: 5 to 15% Outperformance to Sensex
<b>Market Performer (MP)</b>	: -5 to 5% of Sensex Movement	<b>Underperformer (UP)</b>	: -5 to -15% of Underperformance to Sensex
<b>Sell</b>	: <-15% Relative to Sensex		
<b>Not Rated (NR)</b>	: No specific call on the stock	<b>Under Review (UR)</b>	: Rating likely to change shortly

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