Autos & Auto Parts | India

# Bharat Forge BHFC IN

BUY

NOMURA

NOMURA STRUCTURED FINANCE SERVICES PRIVATE LIMITED, INDIA

## RESULTS FIRST LOOK

**BHFC announced 2QFY12 PAT of INR1.06bn marginally above our and consensus estimates. Overall revenues rose by 26.5% yoy, driven by 57.6% yoy growth in export revenues. Non-auto revenues grew 24% yoy; revenues from new facilities recorded robust growth of 81% yoy. The company expects to continue its growth momentum in the non-auto business as it is still in the ramp-up phase. Management expects 15-25% volume growth in CVs in the US and Europe in FY13F based on feedback from customers. Maintain Buy.**

**Price target: 343.0 INR** **Price (09 Nov 2011): 283.15 INR**

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## In-line 2QFY12 results

- **Earnings vs. our Forecast:** **IN LINE**

**Likely Impact:**

- **Earnings Estimates:** **NO CHANGE**
- **Dividend Estimates:** **NO CHANGE**
- **Price Target:** **NO CHANGE**
- **Long-term View:** **CONFIRMED**

### Takeaways from the conference call

- Realizations increased by 4.6% qoq largely due to better product mix and currency benefits and partly due to pass-thru of higher raw material costs to the customers.
- Management sounded optimistic on growth in the export markets in FY13F; the company expects 15-25% growth in CVs in the US and Europe in FY13F.
- The company expects to continue strong growth in non-auto business going ahead as well. Currently, capacity utilization in the non-auto segment is around 50-55%, and the company expects to increase it to ~80% in the next 12-18 months. The Oil & Gas, Rail & Marine and Construction sectors are key growth drivers in the segment currently.
- Export incentives have come down to 3% from 6% post the reduction in duty drawback rates effective Oct-11; this can impact PAT by INR90mn per quarter based on current run rate of export revenues, in our view.
- During the quarter, other income included INR65-70mn of forex gains; there was a one-off expense of around INR20-25mn in overseas subsidiaries.
- The company expects to incur capex of INR3bn over the next 2 years; a large part of this would be towards value-added machining facilities in the non-auto segment.
- As a policy, the company hedges around 50% of expected revenues over the next 1 year.
- In 2QFY12, capacity utilization in India was 75-80% and around 52% in the overseas markets.

### Key result highlights

- The new facilities contributed INR1.8bn in 2QFY12 compared to INR1.0bn in 2QFY11
- Tonnage volumes increased 1.5% qoq to 53,740
- ASP/ton came in at INR169,332 up 4.6% qoq
- Revenue growth came in at 26.5% yoy driven by 57.6% yoy growth in exports revenues
- RM/sales came in at 45.2% compared to our estimate of 45%
- Employee cost/sales was 7% compared to our estimate of 6.8%
- Mfg exp/sales came in at 17.4% compared to our estimate of 17.2%
- As a result, EBITDA margins were 23.7%, lower than our estimate of 24.3%
- Wholly owned subsidiaries had a PBT of INR40mn in the quarter as compared to a INR17mn loss in 2QFY12.

Exhibit 1: Comparison with consensus

| | INR m | | | % difference from | |
|---|---|---|---|---|---|
| **INR mn** | **Actual** | **Consensus** | **Nomura** | **Consensus** | **Nomura** |
| Net Sales | 9,100 | 9,108 | 8,967 | -0.1% | 1.5% |
| EBITDA | 2,154 | 2,269 | 2,177 | -5.1% | -1.1% |
| Margin | 23.7% | 24.9% | 24.3% | | |
| Net Profit | 1,064 | 1,010 | 1,039 | 5.3% | 2.4% |

Source: Company data, Bloomberg, Nomura estimates

Exhibit 2: 2QFY12 earnings review

| **INR mn** | **2QFY11** | **1QFY12** | **2QFY12** | **QoQ** | **YoY** | **2QFY12F** |
|---|---|---|---|---|---|---|
| Production (tons) | 46,140 | 52,959 | 53,740 | 1.5 | 16.5 | 55,368 |
| Realization/tonne (INR) | 155,761 | 161,950 | 169,332 | 4.6 | 8.7 | 161,950 |
| **Net Sales** | **7,187** | **8,577** | **9,100** | 6.1 | 26.6 | **8,967** |
| (Inc)/dec Stock | (134) | 29 | (86) | | | - |
| Consumption of RM | 3,441 | 3,821 | 4,201 | | | - |
| Net RM cost | 3,307 | 3,851 | 4,116 | 6.9 | 24.5 | 4,035 |
| Other Expenditure | 473 | 578 | 613 | 6.1 | 29.7 | 604 |
| Manufacturing Expenses | 1,177 | 1,473 | 1,584 | 7.5 | 34.6 | 1,540 |
| Employee Cost | 489 | 591 | 633 | 7.2 | 29.4 | 611 |
| **Total Cost** | **5,446** | **6,493** | **6,946** | | | **6,790** |
| **Operating Profit** | **1,741** | **2,084** | **2,154** | 3.3 | 23.7 | **2,177** |
| %YoY | 70.0% | 31.3% | 23.7% | | | 25.0% |
| **OPM** | **24.2%** | **24.3%** | **23.7%** | | | **24.3%** |
| Other Income | 86 | 147 | 207 | | | 148 |
| Adj. Other income | 86 | 147 | 207 | | | 148 |
| Interest | 320 | 300 | 310 | | | 300 |
| Depreciation | 490 | 517 | 539 | | | 517 |
| Exceptional/Forex Inc/(exp) | - | - | - | | | - |
| **PBT** | **1,017** | **1,414** | **1,512** | **6.9** | **48.6** | **1,508** |
| Tax | 336 | 440 | 448 | | | 469 |
| **Net Profit** | **681** | **974** | **1,064** | 9.2 | 56.1 | **1,039** |
| **EPS Basic** | **2.9** | **4.2** | **4.6** | | | **4.5** |
| Adj. PAT | 681 | 974 | 1,064 | 9.2 | 56.1 | 1,039 |
| Adj. EPS | 2.9 | 4.2 | 4.6 | | | 4.5 |

Source: Company data, Nomura estimates

Exhibit 3: Key ratios

| **Cost Ratios (%)** | **2QFY11** | **1QFY12** | **2QFY12** | **QoQ** | **YoY** | **2QFY12F** |
|---|---|---|---|---|---|---|
| RM/Sales | 46.0 | 44.9 | 45.2 | 0.3 | -0.8 | 45.0 |
| Mfg Expenses/Sales | 16.4 | 17.2 | 17.4 | 0.2 | 1.0 | 17.2 |
| Other Exp/ Sales | 6.6 | 6.7 | 6.7 | 0.0 | 0.2 | 6.7 |
| Emp. Cost/sales | 6.8 | 6.9 | 7.0 | 0.1 | 0.2 | 6.8 |
| OPM | 24.2 | 24.3 | 23.7 | -0.6 | -0.6 | 24.3 |

Source: Company data, Nomura estimates

**Valuation Methodology and Investment Risks:** Please see below.

Note: Ratings and Price Targets are as of the date of the most recently published report (http://go.nomuranow.com/research/globalresearchportal) rather than the date of this email.

Results First Look is the analyst's preliminary interpretation of the results announcement. Our recommendation and earnings estimates are not beingchanged in this report. Any formal changes to our recommendation or earnings estimates will be made in a subsequent report, which may differ from the preliminary views expressed in this report.

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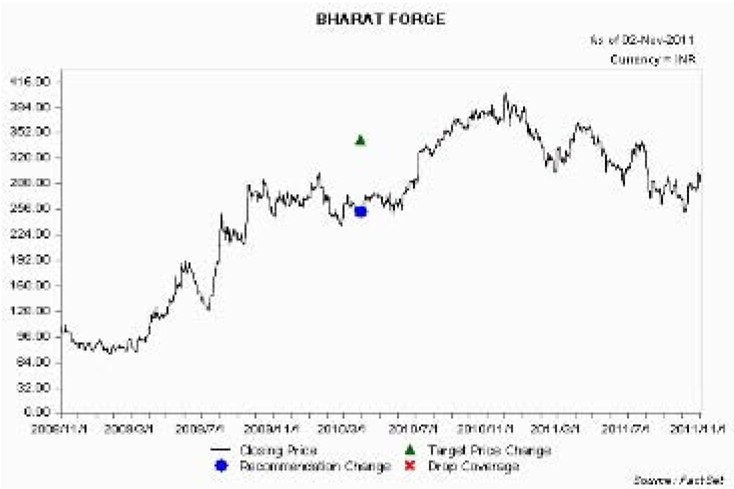
| Issuer name | Ticker | Price | Price date | Stock rating | Disclosures |
|---|---|---|---|---|---|
| Bharat Forge | BHFC IN | 283.15 INR | 09 Nov 2011 | Buy | |

### Previous Rating

| Issuer name | Previous Rating | Date of change |
|---|---|---|
| Bharat Forge | Not Rated | 30 Mar 2010 |

**Bharat Forge (BHFC IN)** **283.15 INR (09 Nov 2011)** Buy

Rating and target price chart (three year history)




| Date | Rating | Target price | Closing price |
|---|---|---|---|
| 30-Mar-2010 | | 343.00 | 253.60 |
| 30-Mar-2010 | Buy | | 253.60 |

For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** We value BHFC's standalone business at INR337, based on 10x EV/EBITDA. We value the subsidiaries at INR19.2 at book value (FY10F) of their investments. We have also reduced the present value of foreign currency convertible bonds (FCCB) redemption premium — INR13.80 — from our valuation. BHFC's share in the power equipment JV with Alstom is valued at INR40/share by Nomura's capital goods analyst Amar Kedia. Given the fact that company has not won any orders yet, we have not added this value to our target price.

**Risks that may impede the achievement of the target price** Risks to our investment view : Weakness in auto segment in India. We assume faster economic growth in FY11F. Nomura's GDP growth and IIP growth assumptions are 9% for both in FY11F. We believe that the auto sector in general will display healthy volume growth of nearly 15% in FY11F. Slower economic growth would cast a cloud over our estimates and view. Non-auto business in India. We assume BHFC will be able to ramp its non-auto business in FY11F. Our estimates would face downside risk if it does not. Global recovery remaining weak. We assume a recovery in auto sales in Europe and the US by FY12F. If the recovery does not happen, it could be difficult for BHFC's subsidiaries to become PBT positive. Delayed execution of power equipment venture with Alstom. While we have not added any potential value from the power equipment JV with Alstom, delayed execution could disappoint investors. We believe that management has a strong execution record and can execute this venture according to schedule.

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