



Bharat Forge

STOCK INFO.	BLOOMBERG
BSE Sensex: 19,243	BHFC IN
	REUTERS CODE
S&P CNX: 5,702	BFRG.BO

26 October 2007

Buy

Previous Recommendation: Buy

Rs337

Diluted Equity Shares (m)	237.3
52-Week Range (Rs)	396/254
1,6,12 Rel.Perf.(%)	5/-32/-55
M.Cap. (Rs b)	74.9
M.Cap. (US\$ b)	1.9

YEAR	NET SALES	S/a PAT	S/a EPS	Cons.	P/E	Cons.	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	EPS (Rs)	(X)	P/E (X)	(%)	(%)	SALES	EBITDA
3/07A	18,644	2,533	10.0	12.0	33.7	28.0	17.5	15.8	3.7	14.7
3/08E	22,736	2,518	9.9	12.5	33.9	26.9	17.9	15.4	3.4	14.2
3/09E	26,874	3,146	12.4	16.5	27.1	20.4	17.0	16.7	2.8	11.3

- Bharat Forge's standalone results for 2QFY08 are better than our expectations. Adj. PAT declined just 2.8% YoY to Rs605m v/s our estimate of Rs551m. EBITDA margin expanded 420bp QoQ to 24.6%.
- Net sales grew 25% YoY to Rs5.6b, driven by strong export growth of 41.3% YoY. Domestic sales displayed signs of revival, growing 13.6% YoY (after just 9% growth in 1QFY08).
- EBITDA margin expanded 420bp QoQ to 24.6%, though it declined 150bp YoY. The sequential margin expansion was due to lower raw material cost (45.2% of sales v/s 46.3% in 1QFY08) and significantly lower other expenditure (23.9% of net sales v/s 26.6% in 1QFY08). EBITDA grew 17.5% YoY and 36.7% QoQ to Rs1.4b. Over a period of time, the company plans to improve EBITDA margin by reducing costs and hedging its expenses against the dollar.
- Due to the commissioning of the new 12,500-ton line at Mundhwa and a new machining line, depreciation increased to Rs351m v/s Rs250m in 2QFY07. There was an extraordinary gain of Rs109m due to profit on translation of foreign currency loans.
- Consolidated revenues (excluding China JV) increased 7.7% YoY to Rs10.5b while EBITDA margin expanded 40bp YoY to 17%. Consolidated adj. PAT declined 3.2% YoY to Rs719m. The stock trades at 26.9x FY08E and 20.4x FY09E consolidated EPS. We maintain **Buy**.

QUARTERLY PERFORMANCE

	(Rs Million)									
	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	4,206	4,507	4,771	5,161	4,969	5,632	5,919	6,216	18,644	22,736
Change (%)	15.7	19.7	19.5	17.7	18.1	25.0	24.1	20.5	18.2	21.9
Total Expenses	3,132	3,330	3,532	3,917	3,956	4,249	4,439	4,657	13,912	17,302
EBITDA	1,073	1,177	1,239	1,243	1,012	1,383	1,480	1,559	4,732	5,434
As % of Sales	25.5	26.1	26.0	24.1	20.4	24.6	25.0	25.1	25.4	23.9
Change (%)	23.3	21.1	25.6	18.1	-5.7	17.5	19.4	25.4	21.9	14.8
Other Income	233	192	162	222	200	144	185	239	809	768
Interest	176	197	215	234	234	273	268	259	821	1,033
Depreciation	229	250	253	267	329	351	358	366	998	1,404
Extraordinary Expenses	101	0	22	0	0	0	0	0	124	0
Extraordinary Income	0	0	0	0	333	109	0	0	0	442
PBT	800	922	911	965	983	1,012	1,039	1,174	3,598	4,207
Tax	285	301	281	322	335	334	343	381	1,189	1,393
Effective Tax Rate (%)	35.6	32.6	30.9	33.4	34.1	33.0	33.0	32.5	33.0	33.1
PAT	515	622	630	643	648	677	696	792	2,409	2,814
Adj. PAT	616	622	652	643	425	605	696	792	2,533	2,518
Change (%)	29.9	20.1	22.4	21.3	-31.0	-2.8	6.7	23.3	23.3	-0.6

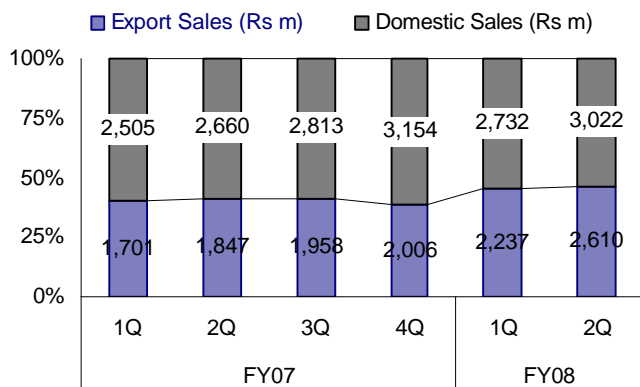
E: MOST Estimates

Lower domestic sales growth, but exports robust

Net sales grew 25% YoY to Rs5.6b, driven by strong export growth of 41.3%. Domestic sales displayed signs of revival, growing 13.6% YoY (after just 9% growth in 1QFY08). We believe the trend witnessed in 1QFY08, wherein export growth was driven by sales to geographies like Europe and China (exports from Indian entity) has been maintained in 2QFY08 as well, while US sales are still facing a slowdown.

Domestic sales growth has been impacted by the slowdown in the domestic CV industry; the management had previously indicated that the industry volumes should pick up in 2HFY08. Ahead, entry into the LCV space and higher supplies to passenger vehicles are expected to be major growth drivers. Completion of capex, improved capacity utilization levels, and receipt of customer approvals would help boost sales, as the industry scenario improves in 2HFY08.

BHARAT FORGE: QUARTER-WISE SALES BREAK-UP



Source: Company/Motilal Oswal Securities

Bharat Forge is aggressively moving into the non-automotive space, for which it is incurring capex of Rs3.5b. The non-automotive segments that it is tapping are aerospace, oil & gas exploration, energy, railways & locomotives, marine activities, infrastructure, solar, wind, thermal power equipments, etc. Entry into the non-automotive space will further de-risk the company’s business model and this

segment is expected to contribute up to 40% of global revenues by FY11 (17% in FY07 and 25% in FY09E).

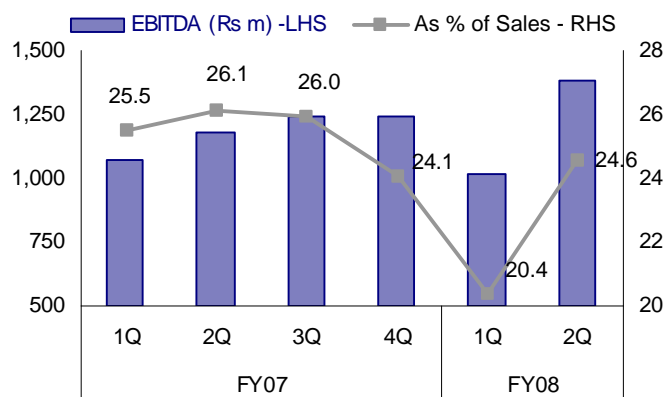
Bharat Forge has recently been awarded three long-term orders of over US\$50m each/year – two in the non-automotive space and one in the automotive space. Non-automotive orders would start contributing to consolidated revenues in 2HFY09, as capacity gets operational.

EBITDA margin improves sequentially

EBITDA margin expanded 420bp QoQ to 24.6%, though it declined 150bp YoY. The sequential margin expansion was due to lower raw material cost (45.2% of sales v/s 46.3% in 1QFY08) and significantly lower other expenditure (23.9% of net sales v/s 26.6% in 1QFY08). EBITDA grew 17.5% YoY and 36.7% QoQ to Rs1.4b. Over a period of time, the company plans to improve EBITDA margin by reducing costs and hedging its expenses against the dollar.

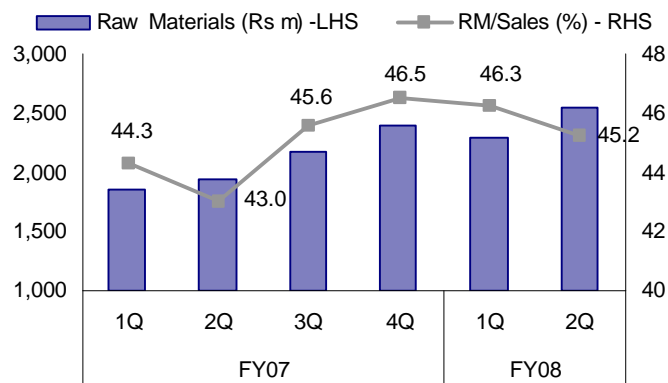
Due to the commissioning of the new 12,500-ton line at Mundhwa and a new machining line, depreciation increased to Rs351m v/s Rs250m in 2QFY07. There was an extraordinary gain of Rs109m due to profit on translation of foreign currency loans. This resulted in the company reporting PAT of Rs677m, while the adj. PAT was Rs605m.

EBITDA MARGIN IMPROVES...



Source: Company/Motilal Oswal Securities

... ON LOWER RM/SALES...

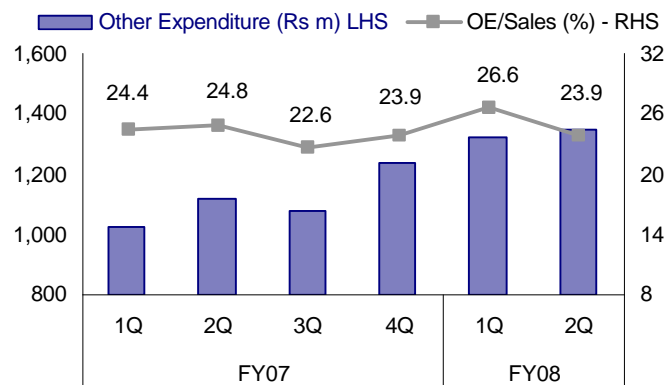


CONSOLIDATED PERFORMANCE (RS M)

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08
Net Sales	9,878	9,709	10,174	11,098	10,614	10,452
Growth (%)	54.8	41.4	8.2	16.6	7.5	7.7
EBITDA	1,591	1,607	1,670	1,726	1,466	1,776
Growth (%)	28.6	23.7	21.0	13.6	-7.8	10.5
EBITDA margin (%)	16.1	16.6	16.4	15.6	13.8	17.0
Reported PAT	781	742	770	800	804	791
Growth (%)	23.7	21.4	22.7	16.3	3.0	6.6
Adj. PAT	848	742	785	800	581	719
Growth (%)	36.6	21.4	25.1	16.3	-31.5	-3.2

Note: Excluding China JV Source: Company/Motilal Oswal Securities

... AND LOWER OTHER EXPENDITURE



Source: Company/Motilal Oswal Securities

China JV: future growth driver

Bharat Forge is positive with regard to its China JV, FAW Bharat Forge (Changchun) Co, which commenced operations during 2QFY07. This venture has a 100,000-ton capacity. The plant would cater to various product requirements – both in commercial vehicles and passenger vehicles, and it would have the capability to produce various sizes of forgings. Currently, it does not have any machining facility, but this is likely to be set up once operations stabilize. 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 would enable Bharat Forge to become the largest forging components player in China.

Consolidated PAT declines 3.2% YoY

Consolidated revenues (excluding China JV) increased 7.7% YoY to Rs10.5b while EBITDA margin expanded 40bp YoY to 17%. Consolidated adj. PAT declined 3.2% YoY to Rs719m.

Valuation and view

We remain positive on Bharat Forge’s dual shore model and management’s global vision. 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. The stock trades at 26.9x FY08E consolidated EPS of Rs12.5 and 20.4x FY09E consolidated EPS of Rs16.5. We maintain **Buy**.

Bharat Forge: an investment profile

Company description

Bharat Forge is the second largest forging manufacturer in the world, second only to Thyssen Krupp. Primarily focused on automobile forgings, Bharat Forge has a broad based product mix. The company also has substantial geographic distribution of sales and production facilities; its 9 manufacturing plants are spread across 6 countries.

Key investment arguments

- ✎ Bharat Forge's addressable market opportunity stands at US\$10b per year and the company is well placed to aggressively increase its global market share.
- ✎ The company is broad-basing its revenue base, by focusing on non-automotive sector. Within the automotive sector as well, it derives revenues from various segments – PVs and CVs. Hence, it is not overly dependant on any one segment for its revenues.
- ✎ Its China JV with FAW Corp would help tap the tremendous potential offered by China.
- ✎ 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.

COMPARATIVE VALUATIONS

		BHARAT FORGE	AMTEK AUTO
P/E (x)	FY08E	26.9	15.3
	FY09E	20.4	13.3
EPS Gr (%)	FY08E	4.2	28.9
	FY09E	31.8	15.3
RoE (%)	FY08E	17.9	19.9
	FY09E	17	18.7
EV/EBITDA (x)	FY08E	14.2	8.8
	FY09E	11.3	7.1

SHAREHOLDING PATTERN (%)

	SEP.07	JUN.07	SEP.06
Promoter	40.2	39.4	35.9
Domestic Inst	14.9	13.6	12.5
Foreign	17.0	18.1	23.6
Others	27.9	28.9	28.0

Recent developments

- ✎ FAW Bharat Forge (Changchun) Co commenced operations during 2QFY07. This has improved Bharat Forge's accessibility and visibility in the Chinese market.
- ✎ Bharat Forge has signed an MoU with the Maharashtra State Government to jointly develop a multi-product Special Economic Zone near Pune. This SEZ is expected to attract investments of Rs250b and will be set up through a SPV wherein Bharat Forge will hold 74% stake.

Valuation and view

- ✎ The stock trades at 26.9x FY08E and 20.4x FY09E consolidated EPS. We maintain **Buy** with a target price of Rs357.

Sector view

- ✎ Auto ancillary sector is witnessing strong demand from global OEMs attempting to offshore components and reduce costs.
- ✎ Forgings and casting due to environmental and health norms have been witnessing the strongest demand from global players.
- ✎ We maintain an overweight stance on the sector.

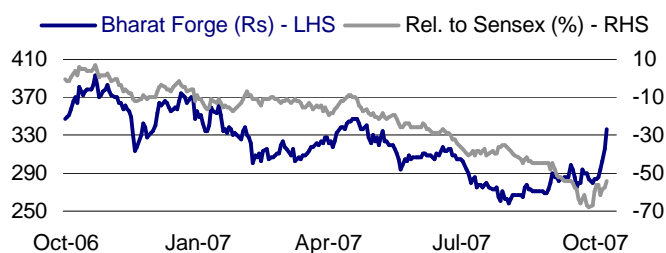
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	12.5	14.8	-15.4
FY09	16.5	18.2	-9.5

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
337	357	6.1	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Net Sales	12,191	15,779	18,644	22,736	26,874	
Change (%)	46.5	29.4	18.2	21.9	18.2	
Expenditure	8,916	11,898	13,912	17,302	20,317	
EBITDA	3,275	3,881	4,732	5,434	6,557	
Change (%)	36.3	18.5	21.9	14.8	20.7	
% of Net Sales	26.9	24.6	25.4	23.9	24.4	
Depreciation	526	730	998	1,404	1,510	
Interest & Finance Charges	342	548	821	1,033	1,044	
Other Income	74	531	809	768	691	
Non-recurring Expense	0	0	0	0	0	
Exceptional Expenses	0	-15	124	0	0	
Non-recurring Income	0	0	0	442	0	
PBT	2,481	3,149	3,598	4,207	4,695	
Tax	865	1,079	1,189	1,393	1,549	
Effective Rate (%)	34.8	34.3	33.0	33.1	33.0	
PAT	1,616	2,070	2,409	2,814	3,146	
Change (%)	29.4	28.0	16.4	16.8	11.8	
% of Net Sales	13.3	13.1	12.9	12.4	11.7	
Adj. PAT	1,616	2,055	2,533	2,518	3,146	
Change (%)	29.4	27.1	23.3	-0.6	24.9	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Equity Capital	396	445	445	445	445	
Reserves	3,830	11,097	13,196	15,217	17,936	
Net Worth	4,426	11,641	13,740	15,761	18,480	
Deferred Tax	812	967	1,323	1,602	1,912	
Loans	4,179	9,925	13,645	13,777	13,923	
Capital Employed	9,416	22,532	28,708	31,140	34,315	
Gross Fixed Assets	9,490	12,653	17,260	28,937	30,617	
Less: Depreciation	4,215	4,901	5,907	7,313	8,824	
Net Fixed Assets	5,275	7,752	11,353	21,625	21,793	
Capital WIP	2,759	3,707	375	400	400	
Investments	383	4,440	3,552	2,842	2,273	
Curr.Assets, L & Adv.	7,848	15,352	22,979	16,848	21,493	
Inventory	1,861	2,543	3,004	3,664	4,330	
Sundry Debtors	1,431	1,886	2,228	2,717	3,211	
Cash & Bank Balances	281	5,054	15,269	8,608	12,557	
Loans & Advances	3,611	4,957	2,479	1,859	1,394	
Current Liab. & Prov.	6,892	8,732	9,563	10,587	11,657	
Creditors	1,939	2,347	2,774	3,382	3,998	
Other Liabilities	404	288	331	348	365	
Acceptances	1,975	2,480	2,480	2,480	2,480	
Net Current Assets	956	6,620	13,416	6,261	9,836	
Miscellaneous Expenditure	43	13	13	13	13	
Application of Funds	9,416	22,532	28,708	31,140	34,315	

E: M OSt Estimates; Standalone

RATIOS						
Y/E MARCH	2005	2006	2007	2008E	2009E	
Basic (Rs)						
Diluted EPS	7.2	8.1	10.0	9.9	12.4	
Diluted EPS Cons.	8.9	9.9	12.0	12.5	16.5	
Cash EPS	10.8	12.6	15.3	19.0	20.9	
Book Value per Share	22.4	52.4	61.8	70.9	83.1	
DPS	3.1	3.4	3.5	2.8	3.3	
Payout %	38.1	41.4	36.3	25.2	26.5	
Valuation (x)						
P/E (Diluted)		41.5	33.7	33.9	27.1	
P/E Consolidated (Diluted)		34.0	28.0	26.9	20.4	
Cash P/E		26.7	22.0	17.7	16.1	
EV/EBITDA		19.4	14.7	14.2	11.3	
EV/Sales		4.8	3.7	3.4	2.8	
Price to Book Value		6.4	5.4	4.7	4.0	
Dividend Yield (%)		10	10	0.8	10	
Profitability Ratios (%)						
RoE	36.5	17.8	17.5	17.9	17.0	
RoCE	30.0	16.3	15.8	15.4	16.7	
Leverage Ratio						
Debt/Equity (x)	0.9	0.9	1.0	0.9	0.8	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
OP/(Loss) before Tax	2,749	3,151	3,734	4,030	5,048	
Interest/Div. Received	74	531	809	768	691	
Depreciation & Amort.	526	730	998	1,404	1,510	
Direct Taxes Paid	-858	-924	-832	-1,115	-1,239	
(Inc)/Dec in Wkg. Capital	-363	-861	3,419	494	374	
CF from Op. Activity	2,127	2,627	8,127	5,582	6,383	
(Inc)/Dec in FA+CWIP	-3,170	-4,156	-1,266	-11,701	-1,678	
(Pur)/Sale of Invest.	-40	-4,057	888	710	568	
CF from Inv. Activity	-3,210	-8,213	-378	-10,990	-1,109	
Inc./(Dec) in Networth	913	6,003	564	-84	405	
Inc/(Dec) in Debt	1,323	5,746	3,720	132	146	
Interest Paid	-342	-548	-821	-1,033	-1,044	
Dividends Paid	-616	-857	-875	-709	-832	
CF from Fin. Activity	1,278	10,344	2,589	-1,694	-1,325	
Inc/(Dec) in Cash	195	4,773	10,214	-6,660	3,949	
Add: Beginning Balance	86	281	5,054	15,269	8,608	
Closing Balance	281	5,054	15,269	8,608	12,557	



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Bharat Forge

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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