

Bharat Forge Ltd.

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Business fundamentals gaining strength

We met the management of BFL to examine the state of domestic and overseas business, seek clarity on JVs, recently announced fund raising, FCCB redemption and various other issues. While the initial feel remains cautious, we discovered that the challenging business environment has made BFL more determined on their future projects – be it auto or non-auto. Add to this, one area that in our view hold stupendous potential and hence a major trigger for BFL's growth outlook are the JVs with Alstom, Areva and NTPC – meant for aggressively capitalizing the opportunity the capital goods forging space offers (mainly Power). We believe BFL is a story meant for serious long term investors looking out for stability in the current euphoric environment, since many key strategic business decisions taken by BFL may not yield immediate financial results. In order to reflect normal economic environment, we shift our base for target price to FY11E and FY12E. Upgrade to Neutral with a 15-mth target price of Rs 305 (earlier Rs 140), at which the stock would trade at 10x avg. FY11e and FY12e EV/EBIDTA.

Domestic business stabilizing, overseas markets still mixed

Though on small scale, domestic demand is picking up MoM – leading to higher capacity utilization QoQ (at ~45% in Q2FY10 v/s 30-35% in Q1FY10). Overseas markets still remains mixed, with stable US and weak EU.

Non-auto capacity ramp up in FY11, to enjoy 3-4% better margin

BFL expects ramp up in new non-automotive capacities to take some time. FY11 would see strong contribution (50-55% capacity utilization) from these capacities that also enjoy 300-400bps higher operating margin (at about 27-28%). From a negligible contribution in FY09, we estimate this segment to form ~20% of BFL's standalone revenues in FY11E and ~22% in FY12E.

Operating margins set to revive strongly

BFL has worked very strongly on realigning the break-even levels in domestic and overseas operations, benefit of which management believes would be reflected once the production ramp up takes place over the next few quarters. Management seemed confident about retesting the 24-25% operating margin in the domestic business and at the same time targets double digit margin in subsidiaries.

JVs meant for capitalizing opportunities in Cap. Goods space

The next big opportunity that BFL looks forward to is the forging needs of capital goods sector (mainly power). With Alstom, BFL would have two JVs – one for T&G (49%) and other for Auxiliaries (51%); apart from JVs with Areva and NTPC. A better clarity on these JVs would emerge over the next 3-4 months.

Upgrade to Neutral/ Rs 274
 Target Rs 305 (+11%)

Sector (Relative to market)

OW	N	UW

Stock Rating

Buy	Neutral	Sell
> 15%	-15% to +15%	< -15%

This note should be read for:

- Business Update
- Change in estimates
- Change in Rating/Tgt Price

Bloomberg code : BHFC IN
 Reuters code : BFRG.BO
 www.bharatforge.com

BSE Sensex : 16853
 NSE Nifty : 5007

Company data

O/S shares :	223mn
Market cap (Rs) :	61bn
Market cap (USD) :	1269mn
52 - wk Hi/Lo (Rs) :	294 / 69
Avg. daily vol. (3mth) :	1.5mn
Face Value (Rs) :	2

Share holding pattern, %

Promoters :	44.0
FII / NRI :	7.7
FI / MF :	15.0
Non-Promoter Corp. Holdings :	11.1
Public & Others :	22.3

Price performance, %

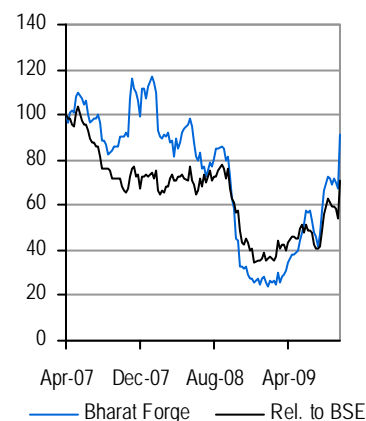
	1mth	3mth	1yr
Abs	20.9	81.6	43.6
Rel to BSE	15.1	67.5	15.0

Valuation summary

Y/E Mar, Rs mn	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Net Operating Income	46,523	47,740	35,851	49,310	58,475
Growth, %	11.3	2.6	(24.9)	37.5	18.6
EBIDTA	7,045	5,565	3,455	6,781	9,264
EBIDTA margin, %	15.1	11.7	9.6	13.8	15.8
MF Net Profit	2,804	1,919	51	2,294	3,823
MF EPS, Rs	12.6	8.6	0.2	9.1	15.2
EPS Growth, %	(5.7)	(31.6)	(97.6)	4,369.3	66.7
PER, x	21.8	31.8	1,346.0	30.1	18.1
EV/EBIDTA, x	10.4	14.2	21.1	10.7	7.6
EV/Net Sales, x	1.6	1.7	2.0	1.5	1.2
Price/Book Value, x	3.5	3.5	2.9	2.7	2.4
ROIC, %	10.0	5.9	(2.6)	7.2	11.1
ROE, %	17.3	11.1	0.2	9.3	14.1
Dividend Yield, %	1.3	0.4	0.4	0.5	0.7

Source: Company, MF Global India Research Estimates

Price vs. Sensex

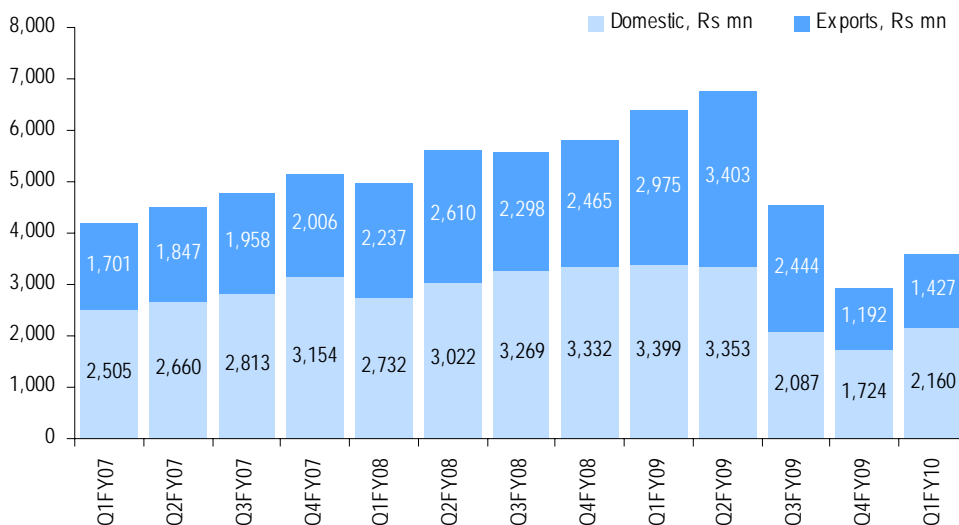


Source: Bloomberg, MF Global India Research

Domestic business stabilizing, overseas markets still mixed

Being primarily exposed to CV industry in India, BFL has started witnessing some stability in demand from OEMs. Though on small scale, demand is picking up MoM – leading to higher capacity utilization QoQ (now at ~45% in Q2FY10 v/s 30-35% in Q1FY10). Overseas markets still remains mixed, with stable US and weak EU. According to management it would be difficult to gauge the quantum of recovery in any overseas market, but there are encouraging signals of possible ramp up in outsourcing from more global OEMs (especially from EU). As a result, BFL stands to gain from this even if the global recovery takes time. BFL expect exports to do much better by Q4FY10.

Domestic & Exports



Source: Company, MF Global India Research

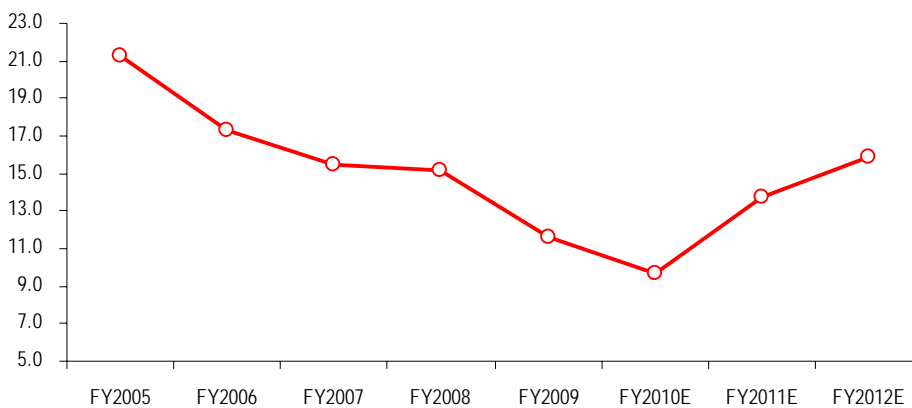
Non-auto capacity ramp up in FY11, to enjoy 3-4% better margin

After being hit by severe global meltdown in H1CY10, BFL expects ramp up in new non-automotive capacities (~1.05 lakh tonnes between Mundhwa and Baramati) to take some time. According to management, FY11 would see strong contribution (with about 50-55% capacity utilization) from these capacities that also enjoy 300-400bps higher operating margin (at about 27-28%) compared to the automotive business. These capacities would primarily cater to heavy duty forging needs of high growth sectors like Aerospace, Oil & Gas, Marine, etc. From a negligible contribution in FY09, we estimate this segment to form ~20% of BFL's standalone revenues in FY11E and ~22% in FY12E.

Operating margins set to revive strongly

BFL has worked very strongly on realigning the break-even levels in domestic and overseas operations, benefit of which management believes would be reflected once the production ramp up takes place over the next few quarters. Management seemed confident about retesting the 24-25% operating margin in the domestic business and at the same time targets to touch the double digit margin in overseas subsidiaries. Though we believe more in scaling up the domestic margins, pulling up margins in overseas subsidiaries to double digit would be a tasking process and may take longer than expected.

EBIDTA Margins (Cons.)



Source: Company, MF Global India Research Estimates

FCCB redemption in April'10 not a threat to cash flow

Of the total outstanding FCCB worth \$183.4 million, about 56% (\$103.5 million) is scheduled for redemption in April'10. This translates into an outgo of close to Rs 6.4 billion (@ INR/\$ of Rs 48). BFL held a cash balance of Rs 4.88 billion as at March 2009 and would generate a cash of close to Rs 2.1 billion (net of Capex and WC); keeping in mind that the company has frozen capex for FY10 and at the same time has undertaken serious measures to control WC. We do not see any material cash flow pressure/crisis for BFL due to the FCCB redemption in April'10, supported by strong revival in cash flows from FY11.

JVs meant for capitalizing opportunities in Cap. Goods space

As discussed in the annual report 2009 as well, the next big opportunity that BFL looks forward to is the forging needs of capital goods sector. Here, power seems to be the focus area for BFL and rightly so, as India gears up for huge investment in the power space over 11th and 12th five-year plans by both – public and private players. As per MF Global India Capital Goods analyst Mr. Amit Mahawar, the BFL-Alstom JV could be treated as one of the most competitive one. With Alstom, BFL would have two JVs – one for T&G (49% stake) and other for Auxiliaries (51% stake). Apart from this, the other two JVs are with Areva (heavy duty forging for nuclear/thermal power plants) and NTPC (BOP equipments). A better clarity on these JVs would emerge over the next 3-6 months. According to perspectives gathered from industry sources, the target business segments under the JVs hold significant potential due to technological entry barriers and humongous investment plans by public and private players. Recently, BFL announced fund raising of \$150 million for its long term capital requirements. In our view, the investments into these JVs could be a key objective of the said fund raising. We have assumed a 13% equity dilution on account of raising \$150 million.

Business fundamentals gaining strength, upgrade to Neutral

BFL's focus and intent towards non-automotive businesses, along with JV partners like Alstom and NTPC, in our view, is a new journey for BFL. From being a large auto component supplier BFL is now in a transformation phase to become a world class forging supplier for critical automotive and non-automotive applications. In a way, the company has embarked upon another challenge of proving the world of its capabilities and vision. We envisage a robust business model in the making, where the major risk would be of timely execution. The strategic decisions undertaken by BFL today may not reflect into financial results in the near future. Thus, we believe BFL is a story meant for serious long term fundamental investors looking out for stability, especially in the current euphoric environment. In order to reflect normal economic environment, we shift our base for target price to FY11E and FY12E. Upgrade to Neutral with a 15-mth target price of Rs 305 (earlier Rs 140), at which the stock would trade at 10x avg. FY11E and FY12E EV/EBIDTA.

Q1FY10 Results (Standalone)

Rs mn	Q1FY10	Q1FY09	Q4FY09
Net Sales	3,586	6,374	2,916
<i>Growth, %</i>	<i>(43.7)</i>	<i>28.3</i>	<i>(49.7)</i>
Operating Expenses	2,838	4,814	2,489
EBITDA	749	1,560	427
<i>Growth, %</i>	<i>(52.0)</i>	<i>54.1</i>	<i>(70.3)</i>
<i>Margin, %</i>	<i>20.9</i>	<i>24.5</i>	<i>14.6</i>
Depreciation	384	377	309
EBIT	365	1,182	118
<i>Growth, %</i>	<i>(69.1)</i>	<i>73.0</i>	<i>(89.1)</i>
<i>Margin, %</i>	<i>10.2</i>	<i>18.5</i>	<i>4.0</i>
Interest	254	195	295
Non-op Other Inc	52	121	153
Pre-tax profit	163	1,108	-24
Tax	5	149	352
MF PAT	158	959	-377
<i>Growth, %</i>	<i>(83.5)</i>	<i>204.6</i>	<i>(155.1)</i>
EO items: Gains/(Losses)	-149	-693	988
Net Profit	9	266	611
MF EPS (Rs)	0.7	4.3	-1.7
Unadj. shares (m)	223	223	223
Wtd avg shares (m)	223	223	223

Source: Company, MF Global India Research

Q1FY10 Results (Consolidated)

Rs mn	Q1FY10	Q1FY09	Q4FY09
Total Income	6,090	13,238	6,273
<i>Growth, %</i>	<i>(54.0)</i>	<i>(46.1)</i>	<i>22.4</i>
Profit After Tax	-214	1,103	-806
<i>Growth, %</i>	<i>na</i>	<i>134.0%</i>	<i>na</i>
Extra-Ordinary Items	-248	-693	1010
Reported PAT	-461	409	203
Rep. EPS (Rs)	-2.1	1.8	0.9

Source: Company, MF Global India Research

FINANCIALS

Income Statement

Y/E Mar, Rs mn	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Net Inc from Operations	46,523	47,740	35,851	49,310	58,475
<i>Growth, %</i>	11.3	2.6	(24.9)	37.5	18.6
Operating Expenses	39,478	42,176	32,396	42,529	49,211
EBITDA	7,045	5,565	3,455	6,781	9,264
<i>Growth, %</i>	9.0	(21.0)	(37.9)	96.3	36.6
<i>Margin, %</i>	15.1	11.7	9.6	13.8	15.8
Depreciation	2,271	2,517	2,570	2,973	3,084
EBIT	4,774	3,047	885	3,808	6,180
<i>Growth, %</i>	4.2	(36.2)	(71.0)	330.3	62.3
<i>Margin, %</i>	10.3	6.4	2.5	7.7	10.6
Net Interest Expense	1,269	1,291	1,315	1,406	1,533
Non-operating items	782	687	510	660	750
Pre-tax profit	4,286	2,443	80	3,063	5,397
Tax provided	1,589	696	170	858	1,619
Profit After Tax	2,697	1,747	-90	2,205	3,778
(-) Minority Interest	(105.9)	(176.1)	(141.3)	(88.4)	(45.6)
Net Profit	2,803	1,923	51	2,294	3,823
MF Net Profit (Post MI)	2,804	1,919	51	2,294	3,823
<i>Growth, %</i>	(5.7)	(31.6)	(97.3)	4,369.3	66.7
EO items: Gains/(Losses)	211	-1336	-627	0	0
Reported Net Profit (Post MI)	3,014	587	(576)	2,294	3,823
Unadj. shares (m)	223	223	252	252	252
Wtd avg shares (m)	223	223	252	252	252

Cash Flow

Y/E Mar, Rs mn	FY2008	FY2009	FY2010E	FY2011E	FY2012E
PBT	4,286	2,443	80	3,063	5,397
Depreciation, amortisation	2,271	2,517	2,570	2,973	3,084
Chg in working capital	-2,070	-2,980	777	-2,962	-2,941
Total taxes paid	-1,437	-207	-50	-674	-1,349
Other operating activities	211	-1,336	-627	0	0
Cash flow from operating activities (a)	3,261	437	2,750	2,399	4,191
Capital expenditure	-6,433	-6,808	-654	-913	-1,245
Chg in investments	-915	2,986	-998	-2,000	-3,000
Other investing activities	522	131	-	-	-
Cash flow from investing activities (b)	-6,826	-3,691	-1,652	-2,913	-4,245
Free cash flow	-3,565	-3,254	1,098	-514	-54
Equity raised/(repaid) & Share Premium	-100	-23	7,350	0	0
Debt raised/(repaid)	-1,352	5,364	870	-4,133	395
Dividend (incl tax)	-912	-260	-295	-442	-590
Other financial activities	216	301	0	0	0
Cash flow from financing activities (c)	-2,641	4,954	7,925	-4,576	-195
Net chg in cash	-6,206	1,700	9,023	-5,090	-249

Balance Sheet

Y/E Mar, Rs mn	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Cash & bank	3,183	4,883	13,907	8,817	8,569
Marketable securities at cost	0	0	0	0	0
Debtors	6,718	5,313	4,420	6,079	7,209
Inventory	7,271	7,916	5,893	8,106	9,612
Loans & advances	6,354	5,784	6,301	6,942	8,523
Other current assets	1,255	1,420	1,939	2,083	2,256
Total current assets	21,598	20,433	18,553	23,210	27,600
Investments	2,988	2	1,000	3,000	6,000
Gross fixed assets	30,989	40,271	43,990	44,744	45,957
Less: Depreciation	13,228	15,594	18,164	21,137	24,221
Add: Capital WIP	5,850	3,226	161	320	351
Net fixed assets	23,611	27,902	25,986	23,927	22,087
Non-current assets	25,231	26,061	25,023	24,780	25,671
Total Assets	50,012	51,378	57,482	56,807	61,840
Current liabilities	11,361	8,538	7,100	8,739	10,112
Provisions	4,865	3,543	3,877	3,934	4,011
Total current liabilities	16,226	12,081	10,978	12,673	14,123
Non-current liabilities	16,544	21,908	22,778	18,645	19,040
Total liabilities	32,769	33,989	33,756	31,318	33,163
Paid-up capital	445	445	504	504	504
Reserves & surplus	16,096	15,989	22,409	24,261	27,494
Minority Interest	702	954	813	724	679
Shareholders' equity	17,243	17,388	23,726	25,489	28,677
Total Equity & Liabilities	50,012	51,378	57,482	56,807	61,840

Per-share data

	FY2008	FY2009	FY2010E	FY2011E	FY2012E
MF EPS (INR)	12.6	8.6	0.2	9.1	15.2
Growth (%)	-5.7%	-31.6%	-97.6%	4369.3%	66.7%
Book NAV/share (INR)	77.4	78.1	94.1	101.1	113.8
FDEPS (INR)	12.6	8.6	0.2	9.1	15.2
CEPS (INR)	22.8	19.9	10.4	20.9	27.4
CFPS (INR)	10.7	4.8	11.4	6.9	13.6
DPS (INR)	3.5	1.0	1.0	1.5	2.0

Financial structure

	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Operating cash flow/Total debt (x)	0.07	0.15	0.15	(0.21)	0.22
Total debt/Equity (x)	0.96	1.26	0.96	0.73	0.66
Net debt/Equity (x)	0.77	0.98	0.37	0.39	0.37

Profitability, Productivity, Liquidity and Valuation Ratios

	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Return on assets (%)	7.0	4.9	1.4	5.3	7.7
Return on equity (%)	17.3	11.1	0.2	9.3	14.1
Return on Invested capital (%)	10.0	5.9	-2.6	7.2	11.1
RoIC/Cost of capital (x)	0.8	0.5	-0.2	0.6	0.9
RoIC - Cost of capital (%)	-1.8	-6.5	-13.6	-4.7	-1.1
Return on capital employed (%)	12.5	8.1	2.1	7.2	10.1
Cost of capital (%)	11.8	12.4	11.0	11.9	12.2
RoCE - Cost of capital (%)	0.7	-4.3	-9.0	-4.7	-2.2
Asset turnover (x)	1.5	1.3	0.9	1.3	1.5
Sales/Total assets (x)	0.9	0.9	0.6	0.8	0.9
Sales/Net FA (x)	2.2	1.9	1.3	2.0	2.5
Working capital/Sales (x)	0.0	0.0	0.0	0.2	0.2
Fixed capital/Sales (x)	0.0	0.0	0.0	0.0	0.0
Receivable days	53	41	45	45	45
Inventory days	57	61	60	60	60
Payable days	105	74	80	75	75
Current ratio (x)	1.3	1.3	1.8	2.4	2.5
Quick ratio (x)	1.0	0.9	1.5	1.8	1.8
Interest cover (x)	3.8	2.4	0.7	2.7	4.0
Dividend cover (x)	3.6	8.6	0.2	6.1	7.6
PER (x)	21.8	31.8	1346.0	30.1	18.1
PCE (x)	12.0	13.8	26.4	13.1	10.0
PCF (x)	25.7	56.9	24.1	39.7	20.1
Price/Book (x)	3.5	3.5	2.9	2.7	2.4
Yield (%)	1.3	0.4	0.4	0.5	0.7
EV/Net sales (x)	1.6	1.7	2.0	1.5	1.2
EV/EBITDA (x)	10.4	14.2	21.1	10.7	7.6
EV/EBIT (x)	15.3	26.0	82.5	19.0	11.4
EV/NOPLAT (x)	24.3	36.4	-73.4	26.4	16.3
EV/CE	2.4	2.4	1.8	1.6	1.4
EV/IC (x)	2.4	2.2	1.9	1.9	1.8

Source: Company, MF Global India Research Estimates

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Rating Rationale

BUY and SELL recommendations are used to draw attention to stocks, which we believe are under-priced or over-priced by circa 15%, that is, price differential of +/- 15% between our price target and the market price. Stocks which do not achieve this price differential are NEUTRAL. Price targets are established in the context of a flat market.

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