

Bharat Forge | BHFC IN

Weak quarter, near-term uncertainty continues

BHFC reported weak 1QFY17 numbers with adj standalone PAT at ₹1.3bn, c.17% below JMFe. While topline remained weak (-20% YoY), primarily due to slump in non-auto revenues and declining realisation, the adj EBITDA margin (on net sales) stood at 28%, c.170bps below JMFe on higher other expenses and staff costs. In the domestic market, growth was largely led by MHCV, while export markets were severely impacted by declining volumes/inventory de-stocking at NA truck OEMs and falling industrials (oil and gas) demand. While the management expects a sluggish FY17, they expect incremental growth to come from new segments (aerospace, defence) and further penetration into existing segments (PV, railways). We believe the weak demand environment and uncertain recovery (especially of industrial demand), increase the downside risks in the near term; maintain HOLD with a revised target price of ₹860 (22x FY18E EPS). Better-than-expected global CV demand and sharp recovery in global industrials are key risks to our view.

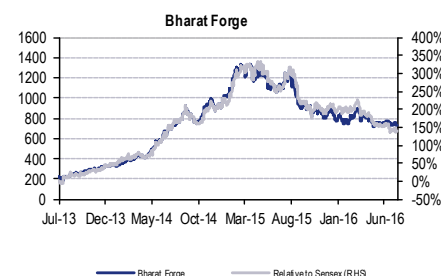
- **Weak 1QFY17:** Standalone tonnage declined 6% YoY to 49,098 tonnes, while the avg. realisation per ton slipped c.16% YoY on weak product mix. While dom. revenues (net) at ₹4.97bn came in 5% above JMFe, exports at ₹4.08bn (-40% YoY) came in 18.5% below JMFe, impacted by persistent weakness in NA CV and industrials demand. Net sales, at ₹9bn (-21% YoY), marks the fourth consecutive fall in quarterly revenues. EBITDA margin, at 28% (-440bps YoY), came c.170bps below JMFe impacted by higher other and staff costs. Adj. net profit stood at ₹1.31bn (-37% YoY). Subsidiaries' performance remained healthy with EBITDA at ₹492mn (7.8% margin) led by BF AT.
- **Subdued demand in near term, sequentially better 2QFY17:** During the conference call, the management highlighted that domestic demand remained healthy with 26% YoY growth in CV, even as PV demand (flat QoQ) was affected by diesel ban. Domestic industrials grew 13.4% YoY, driven by renewables, agriculture (tractor) and government. CV demand could witness a boost in 2HFY17 due to pre-buying ahead of BSIV rollout. NA CV demand is expected to normalize at current levels. BHFC is also seeing improving traction in the NA PV market. Europe declined largely due to weakness in industrials, even as CV demand holds and PV demand remains healthy. As per the management, the sequential sales decline is likely to get arrested from 2QFY17. New programmes (aerospace/railways) would effectively contribute from FY18/FY19. EBITDA margin is expected to remain in the 28-30% range.
- **Maintain HOLD:** BHFC has been facing a challenging environment impacted by a blend of global and domestic factors, which would keep earnings subdued in the near/medium term, in our view. Given the near-term demand challenges, we reiterate HOLD with a revised TP of ₹860 (22x FY18E EPS).

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Key data

Market cap (bn)	₹ 189.5 / US\$ 2.8
Shares in issue (mn)	232.8
Diluted share (mn)	232.8
3-mon. avg. daily val. (mn)	₹ 559.9/US\$ 8.4
52-week range	₹ 1293.0/682.0
Sensex/Nifty	28,079/8,683
₹/US\$	66.9

Daily performance



Shareholding pattern (%)

	Mar-16	Mar-15
Promoters	46.8	46.8
FII	15.9	16.2
DII	16.6	14.0
Public / others	20.7	23.1

JM Financial Research is also available on: Bloomberg - JMFR <GO>, Thomson Publisher & Reuters, S&P Capital IQ and FactSet

Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Exhibit 1: Financial summary

(₹ mn)

Y/E March	FY15A	FY16A	FY17E	FY18E	FY19E
Net sales	76,247	76,465	78,775	96,919	112,808
Sales growth (%)	13.5	0.3	3.0	23.0	16.4
EBITDA	14,408	14,745	14,823	17,900	20,915
EBITDA (%)	18.9	19.3	18.8	18.5	18.5
Adjusted net profit	7,198	7,087	7,262	9,154	11,367
EPS (₹)	30.9	30.4	31.2	39.3	48.8
EPS growth (%)	243.8	-1.5	2.5	26.1	24.2
RoIC (%)	17.3	15.0	14.8	18.4	21.8
RoE (%)	23.5	20.2	19.2	21.3	22.8
P/E (x)	26.3	26.7	26.1	20.7	16.7
Price/Book value (x)	5.5	5.3	4.7	4.1	3.5
EV/EBITDA (x)	14.0	13.7	13.2	10.6	8.7

Source: Company data, JM Financial. Note: Valuations as of 5/08/2016

■ Other key conference call highlights:

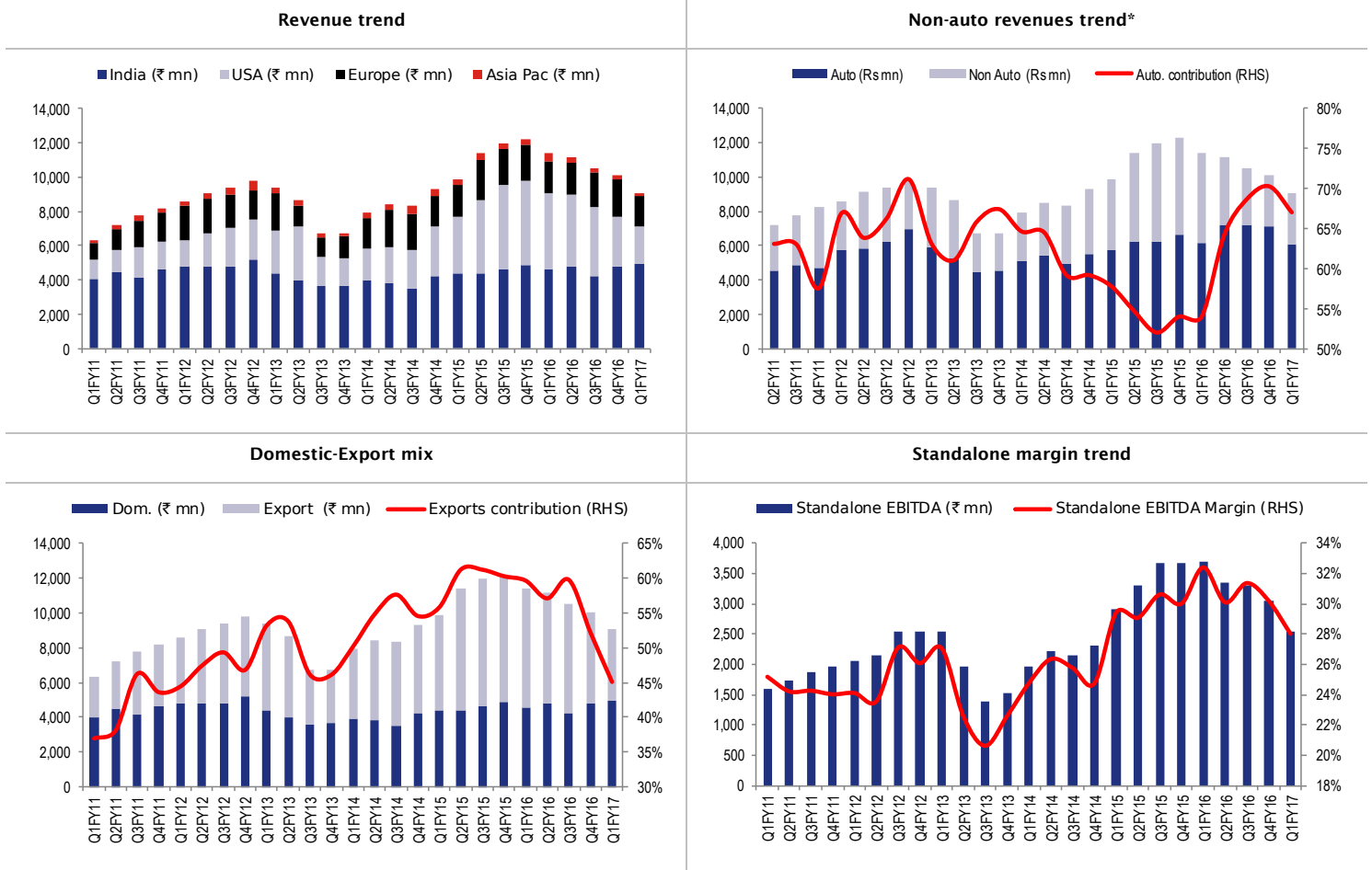
- i. Overall exports declined 40% YoY in 1QFY17 with commodity/oil and gas/CV exports declining 45%/70%/33% YoY respectively.
- ii. Railway business that currently stands at Rs100mn would likely scale to Rs 250-300mn per quarter by CY17/CY18. Aerospace would begin to grow meaningfully in CY17 and accelerate from CY18 onwards.
- iii. In the US market, BHFC is yet to see meaningful pick up with PACCAR (CV OEM) even as they continue to gain market share in the US PV market on a new order win for engine components.
- iv. Machining contributed to 45-50% of revenues in 1QFY17 down from 51-52% earlier.
- v. Overall utilization level stands at 65-67% levels with Baramati plant at over c.50% levels and Pune plant at 65-70% levels.
- vi. Standalone Capex for FY17 is expected to be c.₹2.5bn while the same was ₹ 5.5bn in FY16 (including carry forward from prior years).

Exhibit 2. Quarterly financial results (standalone)

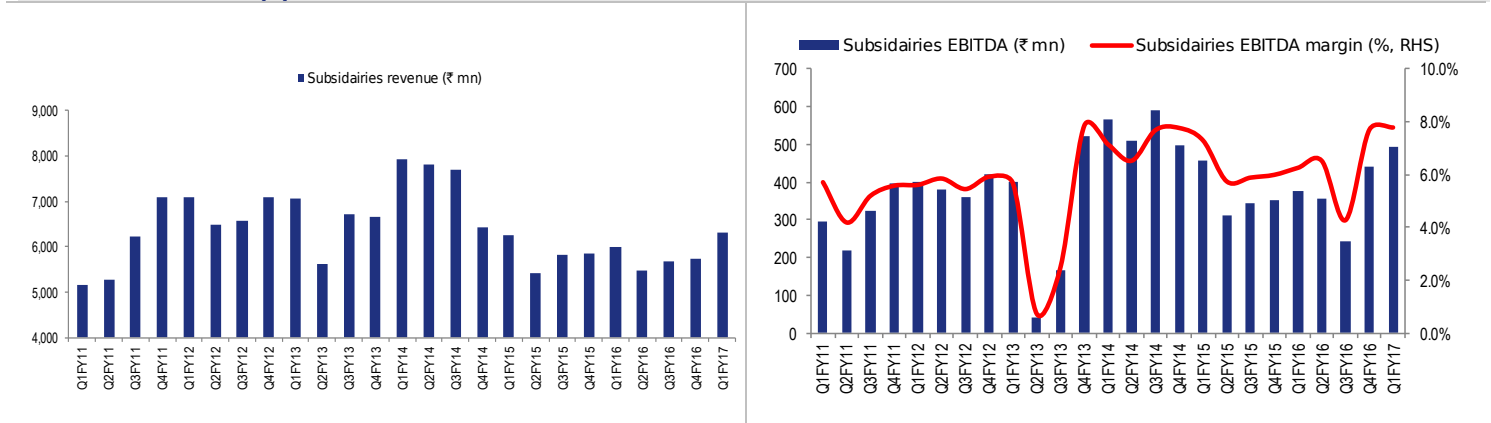
(₹ mn)

	1QFY17 As per Ind AS	1QFY16 As per Ind AS	% YoY	1QFY16 As per GAAP	% YoY	1QFY17E As per GAAP	% A/E
Net Sales	9,044	11,388	-20.6	11,285	-19.9	9,721	-7.0
EBITDA	2,535	3,692	-31.3	3,590	-29.4	2,891	-12.3
EBITDA margin (on net sales)	28.0	32.4	-439bps	31.8	-378bps	29.7	-171bps
Other income	256	299	-14.3	288	-11.1	220	16.5
Interest	170	213	-20.1	213	-20.1	200	-14.9
Depreciation	740	749	-1.2	643	15.1	650	13.8
PBT	1,882	3,030	-37.9	3,023	-37.7	2,261	-16.8
Tax	570	944	-39.6	940	-39.4	678	-16.0
Tax rate (%)	30.3	31.2	-86bps	31.1	-82bps	30.0	30bps
PAT (adjusted)	1,312	2,086	-37.1	2,082	-37.0	1,583	-17.1
PAT margin	14.5	18.3	-381bps	18.5	-395bps	16.3	-178bps

Source: Company, JM Financial.

Exhibit 3. Standalone financial performance trends

Source: Company, JM Financial *Estimates for non-auto revenues in Q4FY16

Exhibit 4. Subsidiary performance trends

Source: Company, JM Financial; *Includes China till 3QFY14

Company background

- Bharat Forge Limited (BHFC), a Pune based Indian multinational company, is a technology-driven global leader in metal forming having trans-continental presence across a dozen manufacturing locations; it serves several sectors, including automobile, power, oil & gas, rail & marine, aerospace and construction & mining. BHFC, a part of the Kalyani Group that is a US\$2.5bn conglomerate with 10,000 global work force, today has the largest repository of metallurgical knowledge in the region and offers full-service supply capability to its global marquee customers from conceptualisation to product design, engineering, manufacturing, testing and validation.

With manufacturing facilities spread across India, Europe and China, it is the largest manufacturer of forgings globally. Bharat Forge manufactures a wide range of safety and critical components for the automotive & industrial sector and is a leading manufacturer of powertrain & chassis components with market leadership in all major markets.

Revenue variables	(Units)				
Y/E March	FY15A	FY16A	FY17E	FY18E	FY19E
Total revenues	76,247	76,465	78,775	96,919	112,808
Standalone revenues	45,480	43,054	44,214	55,107	64,149
as % of total revenues	59.6	56.3	56.1	56.9	56.9
Subsidiary revenues	30,767	33,411	34,561	41,812	48,659
As % of total	40.4	43.7	43.9	43.1	43.1

Source: Company, JM Financial

Investment rationale

- BHFC has matured from being a mere supplier of forged components to a preferred technology-driven development partner for customers in India and abroad. Apart from several large Indian companies, global auto/industrial majors such as Daimler, Caterpillar, Cummins and Cameron partner with BHFC from product conceptualisation to designing, manufacturing and product testing/validation; signifying value addition offered by the company, also reflected in its India EBIDTA margins (now at 28–30%).
- Over the years, BHFC has strategically diversified into non-auto businesses. While focus on the non-auto vertical has helped the company scale up its non-auto share in standalone revenues, the same has come under pressure in the past 12 months.
- While demand in the domestic business remains healthy (barring a few industrial segments), exports continue to suffer impacted by the steep decline in demand from North American class 8 trucks and shale gas. The management's resolve to improve subsidiary profits appears encouraging to us. Overall, demand in the near term would remain sluggish impacted by a multitude of external factors with a possible revival in 2HCY17 and beyond; this would be led by new products and scaling up of new opportunities in aerospace, defence and 'Make-in-India'.

Key risks

- Better-than-expected global CV demand and sharp recovery in global industrials.

Financial tables (consolidated)

Profit & loss						(₹ mn)
Y/E March	FY15A	FY16A	FY17E	FY18E	FY19E	
Net sales (Net of excise)	76,247	76,465	78,775	96,919	112,808	
Growth (%)	13.5	0.3	3.0	23.0	16.4	
Other operational income	0	0	0	0	0	
Raw material (or COGS)	28,837	26,017	29,344	37,459	43,713	
Personnel cost	9,051	9,456	9,656	11,603	13,518	
Other expenses (or SG&A)	23,952	26,247	24,952	29,958	34,661	
EBITDA	14,408	14,745	14,823	17,900	20,915	
EBITDA (%)	18.9	19.3	18.8	18.5	18.5	
Growth (%)	40.3	2.3	0.5	20.8	16.8	
Other non-op. income	1,368	1,336	1,414	1,450	1,595	
Depreciation and amort.	3,624	4,187	4,428	4,749	4,979	
EBIT	12,151	11,893	11,809	14,600	17,530	
Add: Net interest income	-1,356	-1,403	-1,435	-1,523	-1,292	
Pre tax profit	10,795	10,491	10,374	13,077	16,238	
Taxes	3,587	3,408	3,112	3,923	4,872	
Add: Extraordinary items	428	-587	0	0	0	
Less: Minority interest	11	-5	0	0	0	
Reported net profit	7,625	6,500	7,262	9,154	11,367	
Adjusted net profit	7,198	7,087	7,262	9,154	11,367	
Margin (%)	9.4	9.3	9.2	9.4	10.1	
Diluted share cap. (mn)	233	233	233	233	233	
Diluted EPS (₹)	30.9	30.4	31.2	39.3	48.8	
Growth (%)	243.8	-1.5	2.5	26.1	24.2	
Total Dividend + Tax	2,099	2,101	2,724	3,269	3,269	

Source: Company, JM Financial

Balance sheet						(₹ mn)
Y/E March	FY15A	FY16A	FY17E	FY18E	FY19E	
Share capital	466	466	466	466	466	
Other capital	0	0	0	0	0	
Reserves and surplus	33,976	35,292	39,569	45,326	53,302	
Networth	34,442	35,758	40,035	45,792	53,767	
Total loans	23,645	25,179	25,179	23,179	19,179	
Minority interest	-20	-36	-36	-36	-36	
Sources of funds	58,067	60,900	65,178	68,934	72,910	
Intangible assets	537	554	554	554	554	
Fixed assets	56,446	70,166	77,444	80,856	85,127	
Less: Depn. and amort.	30,697	35,366	39,794	44,543	49,523	
Net block	26,287	35,354	38,203	36,866	36,158	
Capital WIP	8,586	5,828	1,162	2,021	2,128	
Investments	4,955	8,037	9,037	10,037	11,037	
Def tax assets/- liability	-1,638	-1,831	-1,985	-2,182	-2,411	
Current assets	42,511	40,261	48,261	58,326	67,855	
Inventories	10,339	11,826	14,028	17,260	20,089	
Sundry debtors	8,535	11,485	10,791	13,277	15,453	
Cash & bank balances	6,820	4,755	10,027	13,033	16,081	
Other current assets	8,803	5,315	5,847	6,431	7,074	
Loans & advances	8,015	6,880	7,568	8,325	9,158	
Current liabilities & prov.	22,634	26,749	29,501	36,134	41,858	
Current liabilities	19,648	24,619	27,157	33,556	39,023	
Provisions and others	2,987	2,130	2,343	2,578	2,835	
Net current assets	19,876	13,512	18,761	22,192	25,997	
Others (net)	0	0	0	0	0	
Application of funds	58,067	60,900	65,178	68,934	72,910	

Source: Company, JM Financial

Cash flow statement						(₹ mn)
Y/E March	FY15A	FY16A	FY17E	FY18E	FY19E	
Reported net profit	7,625	6,500	7,262	9,154	11,367	
Depreciation and amort.	2,092	4,669	4,428	4,749	4,979	
-Inc/dec in working cap.	-3,799	534	1,030	682	461	
Others	-191	-16	0	0	0	
Cash from operations (a)	5,728	11,688	12,720	14,585	16,807	
-Inc/dec in investments	3,057	-3,082	-1,000	-1,000	-1,000	
Capex	-5,798	-10,978	-2,612	-4,271	-4,378	
Others	-3,943	3,765	-1,007	-1,107	-1,218	
Cash flow from inv. (b)	-6,684	-10,295	-4,618	-6,379	-6,596	
Inc/-dec in capital	2,083	-3,083	-260	-128	-122	
Dividend+Tax thereon	-2,099	-2,101	-2,724	-3,269	-3,269	
Inc/-dec in loans	3,572	1,533	0	-2,000	-4,000	
Others	-7	193	154	197	228	
Financial cash flow (c)	3,549	-3,458	-2,830	-5,200	-7,163	
Inc/-dec in cash (a+b+c)	2,593	-2,065	5,272	3,006	3,048	
Opening cash balance	4,227	6,820	4,755	10,027	13,033	
Closing cash balance	6,820	4,755	10,027	13,033	16,081	

Source: Company, JM Financial

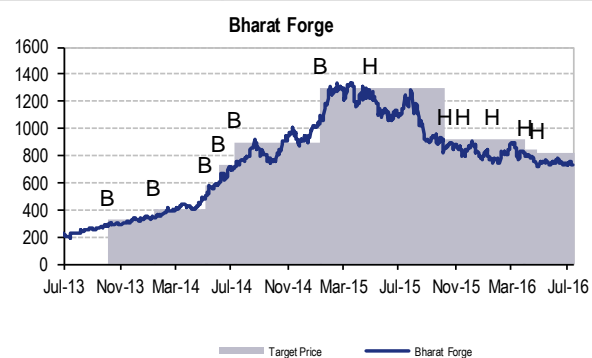
Key ratios					
Y/E March	FY15A	FY16A	FY17E	FY18E	FY19E
BV/Share (₹)	147.9	153.6	171.9	196.7	230.9
ROIC (%)	17.3	15.0	14.8	18.4	21.8
ROE (%)	23.5	20.2	19.2	21.3	22.8
Net Debt/equity ratio (x)	0.3	0.3	0.2	0.0	-0.1
Valuation ratios (x)					
PER	26.3	26.7	26.1	20.7	16.7
PBV	5.5	5.3	4.7	4.1	3.5
EV/EBITDA	14.0	13.7	13.2	10.6	8.7
EV/Sales	2.6	2.6	2.5	2.0	1.6
Turnover ratios (no.)					
Debtor days	41	55	50	50	50
Inventory days	49	56	65	65	65
Creditor days	249	345	338	327	326

Source: Company, JM Financial

History of earnings estimates and target price

Date	FY16E EPS (₹)	% Chg.	FY17E EPS (₹)	% Chg.	Target Price	% Chg.
28-Oct-13					330	
5-Feb-14	26.1				400	21.2
28-May-14	31.1	19.2			575	43.8
26-Jun-14	33.9	9.0			725	26.1
31-Jul-14	36.0	6.2			900	24.1
3-Feb-15	40.8	13.3	50.6		1,300	44.4
21-May-15	41.3	1.2	50.9	0.6	1,300	0.0
30-Oct-15	34.0	-17.7	42.1	-17.3	925	-28.8
8-Dec-15	34.0	0.0	42.1	0.0	925	0.0
10-Feb-16	33.2	-2.4	38.3	-9.0	925	0.0
21-Apr-16	32.7	-1.5	34.1	-11.0	845	-8.6
18-May-16	30.5	-6.7	32.7	-4.1	820	-3.0

Recommendation history



APPENDIX I

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(Formerly known as JM Financial Institutional Securities Private Limited)

Corporate Identity Number: U65192MH1995PLC092522

Member of BSE Ltd. and National Stock Exchange of India Ltd. and Metropolitan Stock Exchange of India Ltd.

SEBI Registration Nos.: BSE - INZ010012532, NSE - INZ230012536 and MSEI - INZ260012539, Research Analyst - INH000000610

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