KALYANI

BHARAT FORGE

Bharat Forge Limited

Q2 FY07 Earnings Update

17th October 2006

Financial Highlights Q2

Combined financial statement

The combined financial statement for the Q2 FY 2007 for Bharat Forge & its Wholly Owned Global Subsidiaries is as follows:

Table 1 ***Rs. Million***

Particulars	**Q2 FY 2007**	**Q2 FY 2006**	**Growth %**
Revenue Within India ***(Including Other Income)***	2852	2374	20.1
Global Revenue ***(Including Other Income)***	7049	4608	53.0
Total Revenue	9901	6982	41.8
EBIDTA	1800	1415	27.2
EBIDTA %	***18.2%***	***20.3%***	
Profit Before Taxation	1118	966	15.7
Profit after Taxation	742	612	21.2

Revenue of Q2 FY 2007 includes the revenue from Bharat Forge America (Inc) USA (BFA) and Bharat Forge Kilsta AB group based in Sweden & Scotland. The revenue of the corresponding quarter previous year include only BFA which was acquired in June 2005.

The Company has achieved a strong growth, both in top-line as well as EBIDTA & PBT. The EBIDTA margin continues to be strong at 18.2% despite the quarter having significantly lesser working days due to annual vacations in the Europe.

- Margins of Indian operations have improved on the back higher capacity utilization, initiatives on cost reduction, superior product mix with higher proportion of fully machined components & successful progressive ramp up of the Heavy Duty Engine Part (HDEP) programs for the global customers.
- Margins in German operations continue to be strong.
- The BFA & BFK Group have continued their performance as per the plan.
- This quarter, our European & American operations have annual vacations, during which they undertake annual maintenance. On account of this the quarter has fewer working days & higher annual maintenance cost. As such, the quarter of June - September is not reflective of the Annual operations.

China Operations

China operations offer significant opportunity to the company to address the large and rapidly growing Chinese automotive market. Immediately after the acquisition of the majority stake in the JV with FAW, the company embarked upon a three pronged approach to address this opportunity involving:

- **Integration initiatives**

  There has been a significant two way traction between the China operations and the operations in India and the company's other global subsidiaries. The purpose behind these initiatives has been to enhance the technical capability and competence of China JV to the global standards of quality, productivity and efficiency. Under this program the technical staff from BFL's global operations is interacting with the China JV employees on a regular basis through a structured program.

- **Productivity and Efficiency Improvement.**

  In this the company has identified the key target areas for improvement. These include:
    - Equipment productivity
    - Material Cost
    - Manufacturing and process improvement.

  These initiatives offer tremendous potential to reduce costs and have already started yielding early results. These will be accelerated in the coming quarters to enable the JV to address the large automotive market where the quality norms are rapidly undergoing change. Going forward, these initiatives will build the capability to position the JV as the competitive cost sourcing base for the global demand.

- **Market Development**

  The third key initiative is to aggressively tie up new business and new products where the focus will be on the high value products. The JV has already started achieving initial success in its business tie up.

Bharat Forge Stand alone Financials

Table 2 ***Rs. Million***

Particulars	**Q2 FY 2007**	**Q2 FY 2006**	**Growth %**
Domestic Revenue	2660	2259	17.8
Export Revenue	1847	1507	22.6
Other Income	192	115	
Total Revenue	4699	3881	21.1
EBIDTA	1369	1086	26.1
EBIDTA %	***29.1***	***28.0***	
Profit Before Taxation	922	782	17.9
PBT %	***19.6***	***20.1***	
Profit after Taxation	622	518	20.0

Revenue

- Domestic revenue witnessed good growth on the back of
  - Continued strong traction with all the major players in the Medium & Heavy commercial vehicle segment.
  - Higher penetration in the market presently addressed by the company in the Light Commercial Vehicle segment.
  - Gaining market share in the passenger car business with the key players in the industry.
  - Gaining market share in the Tractor & Agro Equipment business with two key players in the industry.
- Exports have demonstrated a growth of 22.6%, primarily on account of
  - Growth in the traditional US chassis component business in line with the growth in the market.
  - Significant ramp up in the Heavy Duty Engine Part business in the US.
  - Commencement of ramp of the Medium Duty Engine Part business in the Europe with two global customers.
  - Significant ramp up in the Passenger Car Engine Part business, both in the Europe and USA.

EBIDTA Margin

The EBIDTA margin has improved from 28.0% to 29.1% after absorbing a significantly higher charge on account of higher cost of Power & fuel on the back of high crude prices.

This has been accomplished through a combination of:

- Control over the raw material costs.
- Superior product mix with higher element of machined components.
- Operating leverage achieved on the ramp up of the new forging and machining capacity.

Finance Costs

Table 3 ***Rs. Million***

Particulars	**Q2 FY 2007**	**Q2 FY 2006**
Total Revenue	4699	3881
Interest as % to Total Revenue	4.19%	3.30%
Depreciation as % to Total Revenue	5.31%	4.52%
Total Finance Cost	**9.50%**	**7.82%**

Profit before Taxation (PBT)

The operating leverage achieved out of the combination of higher capacity utilization and better product mix has nearly entirely offset the effect of about 1.7% on account of higher fixed finance costs resulting in a very marginal drop in PBT from 20.1% to 19.6%

The progressive increase in topline with result in a higher flow down into the profitability, giving a positive impetus to the margin.

Review of Business

Following table will summarize the geographical distribution of the company's revenue streams in Q2 & H1 of FY 07 against that in the corresponding previous periods.

Table 4 ***Rs. Million***

Particulars	Q2 FY 07	Q2 FY 06	Growth %	H1 FY 07	H1 FY 06	Growth %
India	2852	2374	*20.1*	5591	4580	*22.1*
USA	1245	769	*61.9*	2417	1420	*70.2*
Europe	557	504	*10.5*	1019	1032	*(1)*
Asia Pacific	45	234	-	110	596	-
Total	4699	3881	*21.1*	9137	7628	*19.8*

Indian Market & business opportunities

The first half of FY 07 has witnessed a good growth in the Indian automotive industry.

Table 5 ***No.***

Particulars	H1 FY 2007	H FY 2006	Growth %
Passenger Cars	738,137	622,766	**18.5**
Medium & Heavy CV	134,192	100,527	**33.5**
LCV – Presently Addressed	55,457	57,670	**-3.8**
Total Addressed Automotive Market	927,786	780,963	**18.8**
LCV – Not Presently Addressed	47,654	19,594	
Total CV Market	**975,440**	**800,557**	**21.8**

Base source: SIAM
Classification between addressed and not addressed: Company information

The company has continued to engage in a strategic manner with all the key players in the industry with the domestic revenue growing in line with the market growth. The company has gained market share in the passenger car and tractor segment.

Outlook

The Indian Automotive market is expected to continue to show moderate to good growth over next one year on the back of implementation of overloading norms, recommencement of infrastructure spend and buoyancy in the economy in general. BFL is extremely well placed to realize the business opportunity emerging out of the same.

USA

USA continues to be a market of strategic importance for the company. However, over the past one year, the company has qualitatively de-risked its business in the US with increased revenue from high value & high value added products. This has put the company in an advantageous position to better respond to the cyclical trends in the US market. Following table will bring out the changing revenue distribution for the company in the US market.

Table 6 *Rs. Million*

Particulars	H1 FY 07	%	H1 FY 06	%	Growth
Heavy Truck Chassis comp	1408	58	1206	85	16.7%
Heavy Duty Crankshafts (HDEP)	551	23	71	5	7.76 times
Passenger Car Crankshafts	213	9	8	1	27 times
Non automotive	245	10	135	9	81.5%
Total	**2417**		**1420**		

- Company is moving up in the value chain in the traditional chassis component business with higher proportion of fully machined components.
- Company is rapidly gaining market share in both HDEP and passenger car crankshaft business.
- Company is presently working as development partner for several new generation platforms in the HDEP segment. These engines are slated for serial launches in 2008 onwards. As these platforms get launched it will further accelerate company's growth in the HDEP business segment.
- Company has commenced production for railway applications in the non-automotive space in addition to the continued focus on the hydro carbon exploration segment.

All the above contribute towards effectively insulating BFL from the cyclicalities of the automotive industry and ensure sustained growth.

Europe

The European market demonstrated a steady growth in the period January – August 2006 against the corresponding period previous year. Following table will highlight the same

Table 7 No.

Particulars	Jan – Aug 2006	Jan – Aug 2005	%
Passenger Cars	10,436,300	10,395,924	0.4
LCV	1,367,923	1,308,696	4.5
M& HCV	438,816	429,298	2.2
Total	**12,243,039**	**12,133,918**	**0.9**

The company commenced ramp up of two of its new programs for supply of fully machined medium duty crankshafts. The ramp up of the passenger car engine component program has also achieved good progress.

The company sees strong opportunities in the European markets on the back of

- Acceleration in the ramp up of the medium duty engine component programs.
- Acceleration in the program for Passenger Car engine component.
- Commencement of new HDEP program.
- Increasing engagement with the customers in the development initiatives through the Center of Excellence.

The company has all the necessary factors viz. strong product capability across engine and chassis components, customer relationships, manufacturing capability and Engineering capabilities to realize the opportunities in the quarters to come.

China

Off-take from the China market was significantly lower than the corresponding quarter previous year. The China market is beginning to demonstrate early signs of revival and the company expects a steady resumption of business in the coming quarters. BFL's position in China continues to be strong with its existing relationship with the top two automotive groups in China as well as having the manufacturing base in China.

The company, over the period, has not only de-risked by spreading its revenue across the geographies but also qualitatively de-risked each geography by addressing multiple products & customers, consistently gained market share and enhanced its status from a Component supplier to Development Partner. These factors will lend a long –term resilience to the company's revenue streams.

Strategic Focus and way forward

Non Automotive Business – A Huge Opportunity

Forged & Machined components required by the non – automotive applications are a significant global opportunity. BFL is focusing on key high value high value added products in this business.

Energy Sector

The present global capacity of non conventional energy generation is about 59 GW. As per the conservative estimates of Global Wind Energy Council (GWEC)* it is slated to increase by at least 6 times over next two decades. This is on the back of three major factors

- Environmental concerns
- Significant enhancement in the efficiency of the Wind turbines.
- Rising fuel costs leading to higher cost of conventional energy.

These turbines need several key forged components. BFL has capability in the material sciences as well as high end design and engineering capabilities. BFL is presently a major supplier to the Wind energy sector in India and through this expansion program will focus on the international market.

In addition, the traditional energy sector is also set for a strong growth in the years to come. This will lead to the large demands for forged and machined components. BFL has existing business relationships in this field and has already pre sold part of the production to be done on the new capacity with the global customers.

Aerospace Sector

Aerospace and Aviation sector is also set for a major growth. As per the estimates of Boeing*, the passenger and freight growth is expected to be 4.9% and 6.1% respectively through 2025. This translates into the global aircraft fleet expanding from present level of 17300 to close to 36000.

All these aircrafts need critical and safety components made of forgings.

This growth in the global aviation industry, coupled with the major order placement by the Indian companies with off set programs present tremendous opportunity for the company in the years to come.

***Source:** *www.boeing.com & www.gwec.net*

Hydro Carbon Exploration

World over the hydro carbon (both oil & gas) exploration initiatives are intensifying. After the land based oilfields the exploration is now increasing in the sub – surf (undersea) operations. These operations need high pressure components which are typically manufactured through forging process.

BFL is presently engaged in this business globally. Over the years, BFL has achieved significant capabilities in this field, both for design and engineering as well as material capabilities through the steel mills within the group.

These are niche components which are high value added and BFL has the capability to deliver these components in fully machined condition.

The existing strong position in this business gives BFL a position of strength to address the growing global opportunity.

Besides the above, BFL will also be focusing on the key infrastructure and core sectors such as marine applications, mining & metals etc.

Investment& business potential

BFL will invest an amount of approximately Rs. 3.50 billion (USD 75 Million) in setting up State of the Art capacity which will include capacity to manufacture large open & closed die forged components and also matching capacity to machine these components. These funds will be invested out of the internal accruals of the company.

Table 8

Equipment capability	**Type of Products and industry addressed**	**Location**	**Capacity**	**Estimated Start of Production**
Closed Die Forging Equipment	Large components for the Energy sector, hydro carbon exploration sector & transportation sector including aerospace	Baramati	40,000 MT	Mid 2008
Open Forging Press line	Components for Wind Turbine components, Mining & metal industry applications & General Engineering Applications	Mundhwa Pune	60,000 MT	End 2008
Machining Capacity for the above	Supply of value added products.	Baramati	12,000 No.	End 2008

The company well placed to its existing business and the related design, engineering & manufacturing capabilities, to substantially scale up the operations in the non – automotive business to create a niche in this high value, high value added business. The company is targeting additional annual revenue of USD 225 million from this business over the next five years. The company has already entered into long-term contracts with global customers for products that will be made in this facility to partly pre sell the capacity. The company will be completing the installation of the equipment over next 24 months and will use this time to effectively pre sale the entire capacity before the commencement of the commercial production.

In addition, the company will be actively pursuing the opportunities for inorganic growth in the non automotive component business. This will enable the company to:

- Accelerate customer acquisition
- Get rapid access to the world class technology
- Speed up market penetration.

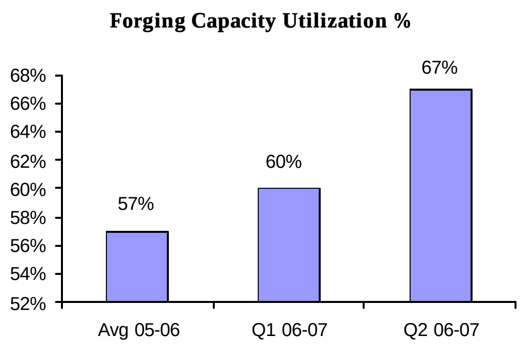
New Business with global customers - A Major Point of Inflection

The company is presently in the final stages of closing four large new long term contracts with global customers. These contracts are for annual value in excess of USD 50 million each. These contracts will strengthen BFL's strategic positioning with its key global customers through a significantly higher engagement and would prove to be a major point of inflection to the next level of relationship in their outsourcing process. The company expects to sign these contracts by end of financial year 2007.

Ramp up of Capacity

BFL's capacity ramp up is progressing well with significant improvement in the capacity utilization, exports and sale in fully machined condition.

Capacity Utilization *
Chart 1



Exports
Chart 2
CAGR of 30%

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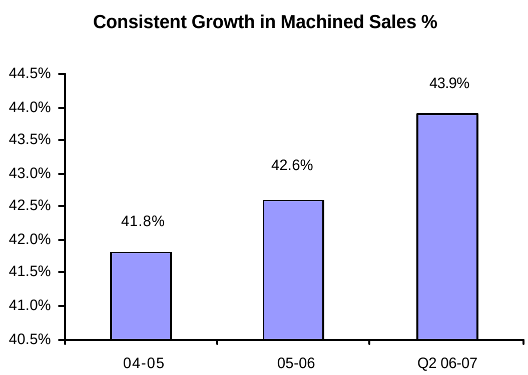
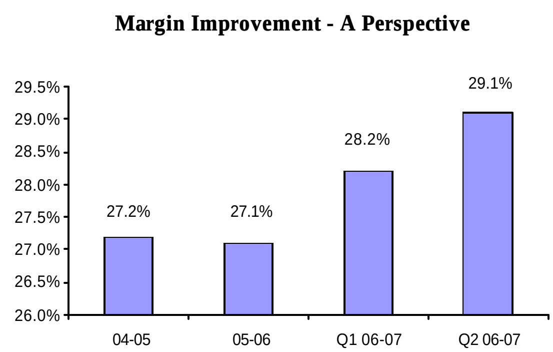
Sale in fully machined condition (MT)
Chart 3



Growing EBIDTA Margins
Chart 4



The above is the manifestation of the successful ramp up of the new capacity. From here onwards we would be focusing on completing the balance capacity commissioning, both in forging and machining & ramp up of the same in line with the customer's development protocol.;

* ***All capacity utilization calculated wrt eventual capacity of 240,000 TPA***

Establishment of Center for Advanced Technology and Center for Leadership Development – A key to sustained growth

Center for Advanced Technology

As a part of its quest to become a technology led manufacturer of high end highly engineered forged & machined components, the company is setting up a Center for Advanced technology with following key objectives:

- Establish capability to develop state of the art engineering solutions from concept design to testing & validation.
- Focus on the automotive domain with products such as Powertrain, steering, cassis systems and components.
- Engineering solution provision for significantly lower time to market.

The company is planning to establish the world class facility & has already recruited talent. The Center is expected to be operational by end 2007.

Center for Leadership Development

As a part of its strategy to develop the necessary people capability, BFL has started several initiatives on the training & development front. These include:

- Apprentice training program
- Manufacturing engineering degree program
- Program for Senior management for leadership development
- Program to harness on a sustained basis the required engineering skill sets.

The company has already started tying up with collages and educational institutes to hire talent while the students are in the third year of their degree program.

These programs are focused not only on enhancing the skill sets but also qualitatively enhance the education & learning of the employees.

Buoyed by the initial success of these programs, BFL is now taking active steps to intensify these initiatives. With this objective, BFL is setting up a Center for Leadership Development.

This center will consist of world class infrastructure to train upto 1,000 employees at the same time including residential courses for intensive training.

The Center for Leadership Development will be operational by end 2007.

Conclusion

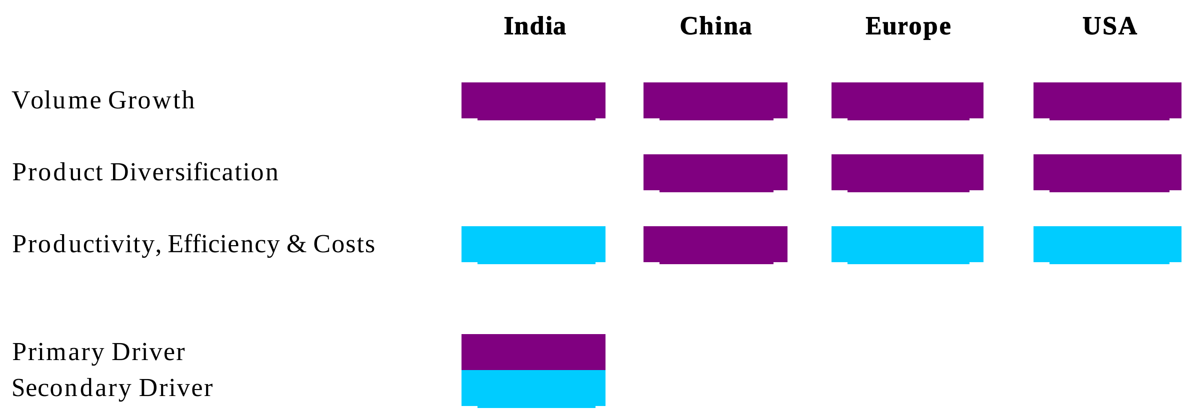
- **Margin have improved significantly**

  The company's margins have improved back to the healthy levels of 28-29% on the back of progressive capacity ramp up, higher proportion of value added sales & initiatives to reduce costs of key inputs.

- BFL's engagement with the global customers is deepening dramatically with major long term contracts on the anvil. This will prove to be a point of inflection to the next of relationship with the global customers.

- The company is targeting a EBIDTA margin to reach 20% in next 2-3 years from the present level of 18% on a significantly higher revenue & has identified key drivers for each manufacturing operation.

Table 9



- BFL has lent a significant resilience to its revenue stream across the global through product diversification and deeper customer traction through technology and engineering led development partnership for the new generation product developments.

- Progressive ramp up, sustained focus on costs, progressive increase in the value added business and focus on high value, high value added non automotive component business will ensure that the pace of growth will accelerate in the coming quarters.

- The Center for Advanced Technology and the Center for Leadership development will ensure availability of critical technology and engineering inputs and management capability on a sustained basis, which will fuel the next level of growth for the company.