

BHARAT FORGE



“Bharat Forge Limited Q3 FY20 Earnings Conference Call”

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**Moderator:** Ladies and gentlemen, good day and welcome to the Bharat Forge Q3 FY20 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '\*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Amit Kalyani. Thank you and over to you.

**Amit Kalyani:** Good afternoon, ladies and gentlemen. This is Amit Kalyani. Thank you for joining us for our Q3 investor call. I have our finance team and investor relations team with me. I will take you through our numbers very quickly.

On the whole, we have had a pretty poor performance for the quarter driven largely by the downturn both in domestic industry as well as overseas in the industrial space. On the commercial vehicle side, we have seen a 25% de-growth over last year for exports, on the passenger car side we have seen a 15% growth over last year. On the industrial side on the aggregate we have seen about 50% de-growth over last year and exports are down by about 35% to about 635 crores. On the domestic market our commercial vehicles sectors down almost 60% over last year which is corresponding to the kind of downturn in the production in the last quarter. On the passenger vehicle side we are flat compared to last year.

On the industrial space, we are down by about 28% within which only in rail we have seen growth. We had a large defense business last year which was a contract we had received which has finished. So, that is no longer there. In spite of that on overall basis in industrial, we did about almost 200 crores in domestic. Our total domestic revenue was about 365 crores, 635 crores of export and total revenue just over 1,000 crores and total income for the quarter was about 1,076 crores which is about 36% lower than last year.

Our EBITDA margins were about 22.2%, this was lower than Q2. Looking on the sector wise, as I mentioned it was largely impacted by CVs and commodity sector such as oil and gas. Passenger vehicles was a bright spot, we expect that going ahead the passenger vehicle business will recover. In fact, this quarter we had less passenger car business than we should have had because of a strike at one of our customers which reduced demand because many of their plants were closed for up to 45 days. But that is normalized now, so we should see a growth in the exports of pass cars in Q4. Overall, we believe that the bottoming out has happened. And we are at the bottom of the trough right now, probably Q3 and Q4 will be at similar levels and from Q1 we should start seeing overall growth.

We are right now not sure of what is the impact of the coronavirus on the global automotive industry. What we believe from our customers having spoken to them all of last week is that everybody in Europe and the US has between 4 to 6 weeks of inventory. So, as long as this problem gets over within 4 to 6 weeks and they start shipping again and there is no border issues then there should not be a major impact on the overall automotive and global industries.

In terms of operating profits, we had an operating profit margin of 44.1% which is almost same as last year. So, it is we have worked very hard on cost reduction and we will further effect significant cost reductions by Q4 and this combined with some amount of tailwinds, we will see margins recovering once again to fairly decent numbers. That is in the second half of next year, by quarter 4 of next year we expect significant cost reductions to take place. In terms of subsidiaries, I am very sorry with the kind of performance we have had. There was a very steep decline in the European markets and that continues. So we have started a significant restructuring in our German operations where we are reducing manpower cost, reducing conversion, reducing all kinds of cost to a double digit percentage of revenue and hopefully by the end of next year again this should have been fully completed and also our new aluminum business will start kicking in.

I am very happy to report that between the aluminum forging plant, plus the fourth line that we have set up in Germany, plus one line that we have set up in our old German plant and the nominations that we have received for our US operations we have significant tie-up of business for a period of 5 to 7 years. So, this is something that will give a big flip to our European and overseas subsidiaries. It will change the entire complexion of the business as we convert more and more of our steel business to aluminum and downsize our steel business. It will reduce the fixed cost in the steel business and allow us to take advantage of the higher margins in the aluminum business and grow our business substantially.

Our Nellore plant is now online and we are starting billing from February. We have received orders from many companies now including both in India passenger car companies as well as global companies and by next year we should start seeing significant growth coming in this business. By next year I mean, 2021-2022. In term of e-mobility, we continue to make progress in terms of localizing variety of power electronic and control electronic products for both commercial vehicle industry, buses and pass cars and three-wheelers, including two-wheelers. We are as a company not undertaking any CAPEX for expansion of any capacities, we are pretty much operating at 50% capacity utilization. So, we have huge capacities available for any kind of growth that we can see. Also please remember that we are investing in strategic areas such as defense, R&D and our e-mobility business where we do not have revenues yet. But these are costs that are all being charged off to our P&L and as and when these business starts generating revenue and contribution you will see a substantial improvement in overall bottomline and EBITDA. Also we have had a, over the last 2 years about Rs. 11,000 increase in steel prices per ton so that has also over last 2 years inflated our topline and suppressed our bottomline because of the inflatory impact of steel prices.

So that is really all that I wanted to say, we have been trying to make sure that our inventories at the end customers and anywhere abroad are under control. We do not want inventories and working capital to get tied up so we are very consciously managing our inventories and managing our cash flow. We continue to have strong cash flow, we have strong balance sheet, we have almost 1,900 crores of cash and we have the ability to take advantage of any upturn or any strategic weakness in any of our competition by stepping in and supplying their products through our capacities. I think FY20 is almost behind us and I think it is one of the worst years

that I can remember. I am fairly confident that we see better times ahead, we have a stronger connection and contacts with our customers especially as they move and transition their business towards the e-mobility future, there is a lot that we are looking to do for them and also the subsidiaries transitioning to a more aluminum chassis component and strategic chassis component technology business bodes well for the subsidiaries and I am fairly confident that this will once in for all in the next 1.5 years to 2 years completely change the phase and nature of our overseas subsidiaries with healthy returns and ratios.

So, ladies and gentlemen, I will be happy to answer your calls now. I do not have anything more to say, so.

**Moderator:** Thank you very much. We will now begin the question and answer session. The first question is from the line of Kapil Singh from Nomura Securities. Please go ahead.

**Kapil Singh:** Firstly, I wanted to check you mentioned that Q4 may be similar to Q3 did I get that, right?

**Amit Kalyani:** Yes.

**Kapil Singh:** I am saying normally there is seasonality that Q4 has much higher truck production, so we are not expecting that?

**Amit Kalyani:** Yes, upto this year because of the BS-IV to BS-VI transition nobody wants to build BS-IV vehicles and get stuck with them not being sold. So, that is the problem. That what our customers are saying to us. And there is still inventory in the market of about 18,000-19,000 trucks. So, they have to first liquidate inventory and then build and sell new vehicles.

**Kapil Singh:** And sir, in the overseas business also we expect it to be at the same level on the both trucks as well as oil and gas?

**Amit Kalyani:** Yes, overseas also we expect overall the business to be very similar to Q3. On top of everything else we have this whole coronavirus business which is difficult sitting in India to understand what is the impact of that but 30% of the global supply chain for manufactures goods comes out of China. And about 20% of manufactured goods are purchased by China. So, if you put stop on it for 30 to 45 days it is quite a big impact.

**Kapil Singh:** So, secondly I wanted to check on something more structural that you have talked about in terms of electric vehicles, e-mobility and also power electronics. Just if you could talk about what are the competitive strengths in this business and how is this business different in terms of return ratios, etc. I mean, some of the things that we would like to understand is for example in forging business we need to set up a big capacity up front and that turns out to be a competitive advantage as well. So, here do you need to do a lot of CAPEX for R&D? Or how you are thinking about it?

**Amit Kalyani:** What we are doing is, we have created a capability of power and control electronics which is basically DC/DC converters AC/DC converters, inverters, onboard chargers, battery packs,

through the various investments we have made. Now the first company is a company called Refu, which we acquired 50% of. Now this company makes power and control electronics for non-automotive, but not on-highway vehicles. So they supply to this big cranes and to all kinds of speciality vehicles and equipment's, high end power electronics and control electronics including vehicle that are used for towing aircraft in airports, etc. So, very demanding application and now what we are doing is we are taking their capability and using India engineering and cost base, expanding the, let us say the offering moving it down into the automotive space, whether it is a commercial vehicle or pass car space. Similarly with our investment in Tevva, we are taking their battery technology and their BMS technology and adapting that to various opportunities that we have in India, say for basically for buses and ILCVs. One of the problems on the electric side was that till today the electric FAME 2 incentives are only applicable to two-wheelers, three-wheelers and passenger cars. The passenger car electric is going to be a global solution. Nobody is going to look at local solutions. But if we look at three-wheelers and two-wheelers, three-wheelers have already started with local solutions. There are lots of electric three-wheelers on the road in UP, Bihar, Haryana, Madhya Pradesh which are low cost three-wheelers. So, we expect that as regulations come into these markets these will have to move to standardized solutions that need safety norms which are at least local if not global in standards. So, this is where we see an opportunity. Similarly, with buses and light trucks getting covered by FAME 2, which will happen very shortly. We expect that a lot of the municipal buses will become electric because as a part of this whole CO2 mitigation and pollution mitigation, the government has taken a policy decision to move towards electric buses in the city. So, these are 2 big growth drivers and today's electric buses are largely imports, the whole case, assembles it into a bus and sell it under different names. So both, Ashok Leyland, Tata and others want to address this, and we are engaged with them in a conversation about providing them solutions for where our solutions fit their needs. So, that is how we see this capability. The capability we are offering is both at a component level and at an integration level. Tevva has extremely strong integration capability and that is what we bring to the table.

**Kapil Singh:**

Is it possible to quantify what is the content that we can supply?

**Amit Kalyani:**

The content for vehicle will be significantly higher than the content for vehicle that we see today. But let it first start, we are still a little away from that.

**Moderator:**

Thank you. The next question is from the line of Puneet Gulati from HSBC. Please go ahead.

**Puneet Gulati:**

Can you help me understand why the trading subsidiary reporting a negative EBITDA at this quarter as well? How should we think about this?

**Kedar Dixit:**

So this also includes intercompany eliminations and there is a dividend which was declared by UK entity to India. So that gets eliminated in consolidation. So and then that is no more an income for the group. So, I think you have not taken that cognizance and that is the reason you are seeing a loss at trading entity.

- Puneet Gulati:** No, I am looking at the table 10 in your report which talks about EBITDA of 2,128 for Q3 and then there is a standalone EBITDA of 2,394. So just trying to understand why was the gap there?
- Kedar Dixit:** Yes, so as I mentioned that also includes intercompany profit elimination. So, whatever inventory, which is unsold inventory so we need to eliminate profit on that. So, that is the impact.
- Puneet Gulati:** It was a negative number last quarter also. So I was wondering, 2 consecutive quarters of unsold inventory there?
- Kedar Dixit:** See, basically when your volumes go down substantially and suddenly there is time for liquidation of inventory.
- Puneet Gulati:** Then in this quarter, we reported 3 additional subsidiaries if you can give some more color there. One is this Eternus Performance Materials, there is Kalyani Center for Precision Technology and Kalyani Precision Machining. What are these 3 into?
- Amit Kalyani:** This Kalyani Centre for Precision technology is a new plant we have set up in Maharashtra where we have got some machining business for a short period of time for the next 3-4 years where we have hired a facility and we have set up a plant, independent plant to take care of that new business. Eternus Performance is a defense related startup where they make carbon fiber product and carbon and composite products which we have invested a small stake in. And the third subsidiary that Precision Machining is a subsidiary we have incorporated for machining operations of the forging that we make in US.
- Puneet Gulati:** And last time you also mentioned that the new Nellore plant will now be housed under a separate subsidiary?
- Amit Kalyani:** No, we could not do that. It's a part of Bharat Forge itself.
- Puneet Gulati:** And any guidance on FY21 CAPEX?
- Amit Kalyani:** So, FY21 organic CAPEX is almost nothing, only whatever CAPEX is done last year there are some payments for that which will be done.
- Puneet Gulati:** Some number there?
- Amit Kalyani:** The payment for last year will be about 250 crores.
- Puneet Gulati:** And then there will be some maintenance CAPEX?
- Amit Kalyani:** Maintenance CAPEX will be about 100 crores.
- Moderator:** Thank you. The next question is from the line of Ronak Sarda from Systematix. Please go ahead.

**Ronak Sarda:** Sir, you mentioned we should see some growth coming back from FY21. Based on the current scenario would you be able to highlight which segment?

**Amit Kalyani:** We will see growth on pass car, we expect commercial vehicle also to grow and we expect our industrial business to grow because the de-stocking should be over. So, we expect some growth to come there as well.

**Ronak Sarda:** This is mainly the non-auto exports industrial you mean oil and gas space.

**Amit Kalyani:** Yes.

**Ronak Sarda:** The second question was on the non-auto exports only. I mean, we have seen some sequential decline again this quarter as well. Anything specific to highlight here or this is one of?

**Amit Kalyani:** No, just further de-stocking and look at the crude oil prices. They have softened right now and are somewhere in the region of \$52 to \$54.

**Ronak Sarda:** So, that is the impact mainly for the softening?

**Amit Kalyani:** Yes.

**Ronak Sarda:** And if I look at the class 8 production for the last few months, our decline has obviously been much more than what the production decline has been?

**Amit Kalyani:** No, our decline has not been more than the production decline. Our decline is in line with the production decline.

**Ronak Sarda:** So, is de-stocking over, I mean in the export CVs or should we see some further de-stocking in next quarter as well?

**Amit Kalyani:** No, actually on the export side there is expectation in the second half it should improve a little bit. Right now, markets are quite slow. But they are at a same level as what we saw in Q3.

**Ronak Sarda:** And sir finally on defense, there are some news that Saudi Arabia is looking at our systems?

**Amit Kalyani:** No see, I do not want to comment on any individual country or customer. All I will say is that we had a fantastic response to our products at the DefExpo. And we are very hopeful that we should definitely see export business coming in the next 12 to 18 months.

**Ronak Sarda:** Sir any regular defense business other than the guns?

**Amit Kalyani:** For the products that we have showcased this time besides guns are vehicles, armored protected vehicles, we have unmanned vehicles, bullet proof vehicles. We have a variety of different products that we have showcased this time in the Defense Expo, including some very interesting drones for carrying goods and cargo. So, we have a drone which can carry 65 kilos of cargo up

to 6,000 meters in altitude. So, you want to send some emergency supplies or medical supplies or food or radio whatever to someone behind the line this can be done remotely.

**Ronak Sarda:** And sir last question on the Nellore facility. Can you highlight how will the ramp-up be over the next 12 months?

**Amit Kalyani:** So we start billing in that facility this month. We will have very small revenue this year, next year we will see a growth in revenue. But it is really in 2022-2023 when we should see a very significant jump in revenue.

**Ronak Sarda:** So, initially it would be more of domestic business, exports business?

**Amit Kalyani:** No, we have got both. Actually our first customer was an export customer.

**Ronak Sarda:** So, it is a mix of both.

**Amit Kalyani:** It is a mix of both. It is about 70% domestic, 30% exports right now.

**Ronak Sarda:** And since you could not separate it out, it would be taxed at 25%?

**Amit Kalyani:** Yes. For the time being, yes.

**Moderator:** Thank you. The next question is from the line of Riken Gopani from Infina Finance. Please go ahead.

**Riken Gopani:** Firstly, I would like to just understand the underlying trends in the export non-auto segment. In Q1 when we had seen the revenue decline sharply and that was outlined as a de-stocking quarter as well. This quarter that performance is even weaker than that. So, if you could highlight what exactly are the trends there and also outline, is it a base that we are at these levels or how should we look at it in the next year?

**Amit Kalyani:** See, our big exports is to the oil and gas to the US which is for shale. Now this is a business which is a switch on switch off business. It is not like a deep sea well where you cannot switch it off once you switch it on. So, if the oil prices decline beside below a certain point then they turn off the well, if the oil prices go up they turn on the well. In addition to that in the Texas and Permian Basin, they also have a problem of pipelines to take the oil and gas out. The pipelines are currently under construction. So, today it causes them a lot of money to truck the oil and gas away. As the pipeline come on stream their cost of transportation will come down and therefore it will also give a little more stability to the operations over there.

**Riken Gopani:** So, the current weakness is entirely attributable to that segment and are there any segments which are supporting it positively?

**Amit Kalyani:** So, there is a segment of construction and mining equipment that also is related to this. Because there is a lot of power gen equipment and pumping equipment that is used in this which are made

by companies like Caterpillar, Cummins, MTU and others. So, directly or indirectly oil and gas has the big impact on these sectors.

**Riken Gopani:** So, it is fairly OK to assume that it would be linked to crude prices?

**Amit Kalyani:** Yes. It is linked to crude prices.

**Riken Gopani:** And from next year onwards we were talking about another client being added.

**Amit Kalyani:** Yes, so we have got 2 new clients. One which we announced last year, one more this year and we have also added some new products. So, once that is through we should have additional growth.

**Riken Gopani:** So, when do we see ramp up of these 2 new clients happening?

**Amit Kalyani:** That ramp up will happen over the next year.

**Riken Gopani:** And the second question which I had was in your comments you were outlining that we may also have the potential to benefit if there is somebody who is wanting to shift capacities or look for an alternate supplier. In our segments where is it that we have players from China as a larger competition?

**Amit Kalyani:** So, there is still very large manufacturing in-house, if we look at Europe. Most European OEM has large in-house manufacturing. Some of them, even at the passenger car company we would have forging in-house. And all of them have machining in-house. So, all of this one day is going to come out.

**Riken Gopani:** It is not something related to China is what you are relating to?

**Amit Kalyani:** No, it could also be related to China, related to other geographies, Italy and many other geographies but the easiest one to go after is the domestic, what is made in-house.

**Moderator:** Thank you. The next question is from the line of Jinesh Gandhi from Motilal Oswal Securities Ltd. Please go ahead.

**Jinesh Gandhi:** Steel price pass through impact in this quarter?

**Amit Kalyani:** It is the same as last quarter's level. So, it is not additional.

**Jinesh Gandhi:** And what would be our USD and our realization in this quarter?

**Amit Kalyani:** 71.

**Jinesh Gandhi:** And third question pertains to the oil and gas revenue trends. So, how it would be trending in third quarter versus second quarter?

- Amit Kalyani:** Down. Third quarter was lower than second quarter.
- Jinesh Gandhi:** But what would be the run rate now?
- Amit Kalyani:** It is about 25% lower than last quarter.
- Jinesh Gandhi:** And lastly, you have been talking about cost cutting initiatives. Any indication what are you targeting in terms of cost savings in India and what are the areas you are targeting?
- Amit Kalyani:** We are targeting every area both variable cost, fixed cost, conversion cost, energy, consumption, basically every area.
- Moderator:** Thank you. The next question is from the line of Basudeb Banerjee from Ambit Capital. Please go ahead.
- Basudeb Banerjee:** Just couple of things as you said that truck inventory is somewhere around 18,000-19,000 and if we look at monthly retailing of trucks it is somewhere around 10,000-11,000. So, which implies that till March there will be hardly any production? Is that right, sir?
- Amit Kalyani:** No, so what is happening is, if you see last 2-3 months bus production has increased. So chassis are being built for buses. Because you may have heard that there some 2,400 buses were ordered by one government and then other 4,000 by another entity. So, about 6,400-6,500 buses were placed. So, large part of the production has shifted towards buses right now.
- Basudeb Banerjee:** But this inventory number which you said is only trucks?
- Amit Kalyani:** It is largely trucks.
- Basudeb Banerjee:** So, basically till March BS-VI truck production will be very minimal and even BS-IV?
- Amit Kalyani:** BS-VI only will start in March. They will start because they will have to have some trucks in the dealerships before, by April one.
- Basudeb Banerjee:** And sir, at this juncture what is your utilization for India operations?
- Amit Kalyani:** It is less than 50%.
- Basudeb Banerjee:** And last thing is, in Q3 you said that metal prices for you were more or less same as Q2. So now we are almost half way through Q4, so what is the metal price? It is same even now?
- Amit Kalyani:** Yes.
- Moderator:** Thank you. The next question is from the line of Mumukshu Mandlecha from Emkay Global. Please go ahead.

**Mumukshu Mandlecha:** Sir, I just wanted to know like since we are close to base-VI transition, so what kind of increase in content per vehicle do you expect for CV segment? So, how do you see any new orders for new products?

**Amit Kalyani:** So, we have been making one product for the export market which is a pump housing for urea dosing. That product is now going to be used in India as well for these BS-VI trucks.

**Mumukshu Mandlecha:** Any orders for that as such?

**Amit Kalyani:** Yes, every truck has to have one off these.

**Mumukshu Mandlecha:** Sir, any traction for the new gears and transmission products for PV segment for both exports and domestic, sir?

**Amit Kalyani:** Yes so, we have got very significant share of business on the engine component side on a couple of OEM's, today the transmissions are still being imported. But in the next 2 years as they talk about localizing the transmission we will get opportunity there.

**Mumukshu Mandlecha:** Sir just wanted to give us a sense on how is the growth in like on railways and aerospace segment. So and what kind of traction we are getting?

**Amit Kalyani:** Railways has not much growth because the whole railway sectors shifted from diesel to electric. So, now the demand is only on the electric side and second sector that is in aerospace and I do think we are on track for growth from a small base last year. In 2 more years we should be at 20 plus million.

**Moderator:** Thank you. Ladies and gentlemen, as there are no further questions, I now hand the conference over to Mr. Amit Kalyani for closing comments.

**Amit Kalyani:** Thank you, ladies and gentlemen, for your time and attention. This is a difficult time but I think as a company we have come together to handle this and as our history shows every downturn we have come out stronger and fitter. So, I do not think it will be any different this time. We are putting a lot of efforts and focus on diversifying our product pool and expanding our customer and product portfolio in order to have a stronger recovery and a more sustainable business going forward. We are working on our balance sheet, we are working on our overseas subsidiaries and we have got good traction on our aluminum forging business overseas. So, this all should change the complexion of our overseas subsidiaries in the next 2 years. And overall generate better returns for all of us. Thank you very much and if you have any further questions in detail you may contact Mr. Rajagopalan or anybody from our finance team. Thank you.

**Moderator:** Thank you. Ladies and gentlemen, on behalf of Bharat Forge, that concludes this conference. Thank you for joining us and you may now disconnect your lines.