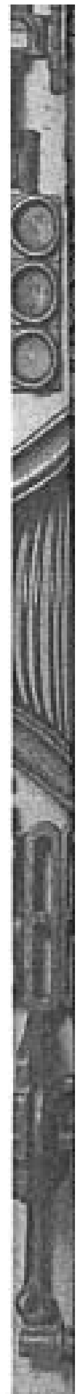
Auto's Ancillary Czar

There are auto component vendors, and then there is Baba Kalyani. His Bharat Forge is already the world's #2 forgings maker and now, with a string of acquisitions, he's going after the global markets. PRIYA SRINIVASAN



WALK INTO THE latest addition to the Bharat Forge manufacturing facilities in Mundhwa, Pune—a machining unit for heavy crankshafts (used in commercial vehicles)—and you could be forgiven for wondering if the company had diversified into some kind of laboratory-based business such as life sciences. Inside the air-conditioned facility are fully automated production lines, and if you are looking for the components they churn out, you would need to peer through glass encasing atop lines of computer screens that flash a plethora of graphs and figures. As for the shop floor workers, there are just a handful, and each one of them is busy staring into screens, occasionally tweaking some piece of equipment. The unit, which produces Rs 110-crore worth of crankshafts annually, can be manned by all of seven people. "See that grinding unit?" points out Bharat Forge's Chairman and Managing Director, Baba Kalyani, who's taken time out of his daily shopfloor walk to point out a few things to this reporter, "well, that has been supplied by a German manufacturer whose service personnel are available 24/7. All I need to do is send out a query from that terminal over there and someone sitting in the Black Forest region of Germany will have the problem sorted out within five minutes."

A 56-year-old auto components vendor getting excited over technology might seem odd. But Kalyani's got good reason to be, and the fact that he studied mechanical engineering at the Massachusetts Institute of Technology (MIT), US, is only part of it. The more important reason is that today, in the highly fragmented auto components industry still characterised by mom-and-pop units, Kalyani has been able to emerge way out of the crowd. He's already the second largest forgings manufacturer in the world (second only to Germany's ThyssenKrupp) and is on his way to becoming an important global tier-I vendor with full service capability, including design, development and manufacture of core

TRAILBLAZING ACQUISITIONS

Since 2000, Baba Kalyani has been on an acquisition spree.

2000

COMPANY:
Kirkstall Forge (UK)

DEAL SIZE:
£3 million (Rs 20.1 crore)

STRATEGIC BENEFITS:
Got 10 key customers such as DaimlerChrysler and Renault, shifted production to India, with £10 million in annual exports

2003

COMPANY:
Carl Dan Peddinghaus (CDP)

DEAL SIZE:
£29 million (Rs 220.4 crore)

STRATEGIC BENEFITS:
Entry into European passenger car market and specialisation in chassis components and steering knuckles for cars

All figures have been converted using exchange rates prevailing in respective years components such as engine and chassis parts. Over the last five years, he's spent more than Rs 500 crore, acquiring companies in countries such as the UK, US and Germany (See *Trailblazing Acquisitions*).

Apparently, he's just got started on his acquisition spree. When BT went to press, there were reports (denied by Bharat Forge) of Kalyani eyeing the light vehicle aftermarket of its US-based partner, ArvinMeritor. In any case, Kalyani plans to set up three more hi-tech units like the crankshaft facility over the next 18 months. Investors, meanwhile, are lapping up the Bharat Forge stock—never mind that net margins are down due to poor profitability of the acquired companies. Since July last year, the stock has doubled in price. Says one longtime company tracker and analyst: "People thought (Kalyani) was crazy when he went on a technology binge about a decade ago and installed one of the most expensive presses—a 15,000-ton capacity one for Ashok Leyland. But he was always ahead of the curve when it came to technology. The company has become to auto ancillaries what Infosys is to technology."

Baba Kalyani: Gunning for the global big league

PHOTOGRAPHS BY UMESH GOSWAMI

Tier-I Play

The comparison is telling. Just as Infosys is considered a proxy for the IT industry, Bharat Forge has now

2004

COMPANY:
CDP Aluminiumtechnik (CDP AT)
DEAL SIZE:
€6.3 million (Rs 35.91 crore)
STRATEGIC BENEFITS:
Got a foothold in production of lighter components, for which there is a growing market

2005

COMPANY:
Federal Forge
DEAL SIZE:
$9.1 million (Rs 40.04 crore)
STRATEGIC BENEFITS:
Obtained a manufacturing presence in North America and a significant leg-up for the company's dual shoring model

2005

COMPANY:
Imatra Kilsta AB and its subsidiary Scottish Stampings
DEAL SIZE:
€45.4 million* (Rs 241.15 crore)
STRATEGIC BENEFITS:
Further strengthens the company's dual shoring and full-service supply capability across core engine and chassis components for cars and trucks

*The deal size is market estimate and not a company figure established itself as the auto components bellwether. And it is the company's focus on technology that has set it apart from among the 150-odd forgings companies in the country. And, again, it is the focus on technology that will take it towards its ambitious goal of being a billion-dollar company by 2007-08. How?

To answer that, one needs to understand the shift that's happening in the global automotive industry. Because of rising costs, capacity glut and stiffer competition, the carmakers who traditionally dominated the markets (think General Motors, Ford and DaimlerChrysler) are under tremendous pressure to cut costs. That pressure, inevitably, is being passed on to parts suppliers, forcing them to either seek cheaper manufacturing locations or shut shop.

That's one reason why manufacturing units in Europe and, to an extent, the US, are up for sale at bargain prices, and consulting firm McKinsey estimates outsourcing potential at $20-25 billion (Rs 88,000 crore to Rs 1,10,000 crore) over the next 10 years. Says Kalyani: "Indian companies have become competitive, they have bridged the gap on quality but still retain the low-cost structure, while the global players are under tremendous pressure. Many of them will be taken over by companies with a lower cost structure."

For a vendor like Bharat Forge, snapping up such companies makes eminent sense. It already has low-cost manufacturing advantage, which means that a significant part of the production can be moved to India. What it doesn't have is the high-end technology and the all-important OE (read: the vehicle manufacturer) relationship. While M&As can be risky, the other option, which is to get customers and then start building manufacturing capacity for them, is equally risky.

There's another reason why a greenfield investment (unless it's for the existing customers) is no more a realistic option. Says a senior auto components industry executive: "There's absolutely no lead time available in this business anymore. OEs expect you to start delivering the moment they place the orders." And, of course, they need a local face wherever their factory is, so having a front-end helps immensely.

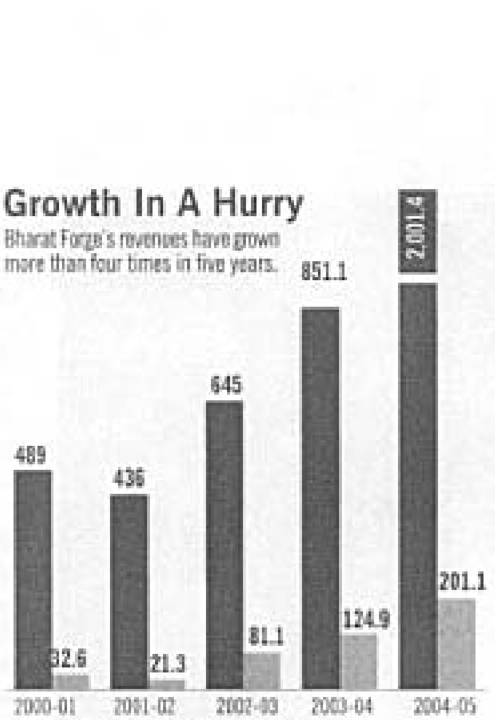
"Betting The House"

It is to Kalyani's credit that he understood the importance of technology early on. In 1972, when he returned from MIT to join his father's six-year-old forgings company, he must have seen a disconnect between India's closed automotive industry and America's still-roaring Detroit giants. "My first idea was to assimilate technology in the company as fast as possible," recalls Kalyani. While the young engineer expected cynicism, the first few years turned out to be a breeze. He first went about reorganising business processes for increased production, and between 1972 and 1975, Bharat Forge doubled production every year. "That generated an energy in the company and was motivating for everyone," he says.

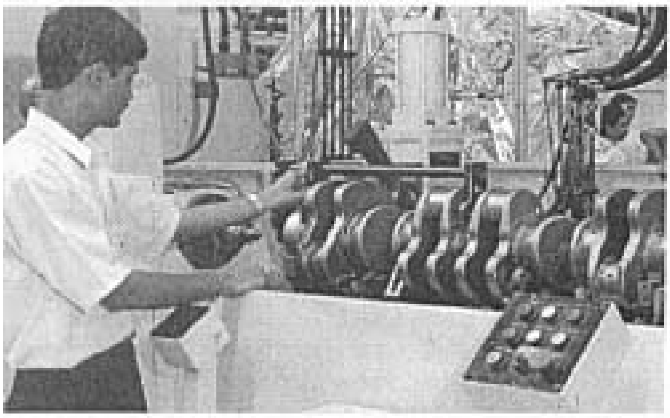
In the late 70s, Kalyani felt the need for technological sophistication

Growth In A Hurry

Bharat Forge's revenues have grown more than four times in five years.



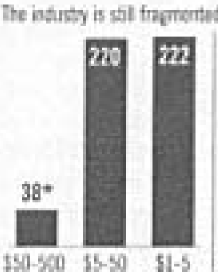
Figures in Rs crore ■ Total Income ■ PAT
*Consolidated figures: On a stand-alone basis, Bharat Forge had a total income of Rs 1,276.50 crore and PAT of Rs 161.60 crore last year



Not So Small

The Indian auto components industry is bigger than it seems.

The industry is still fragmented...



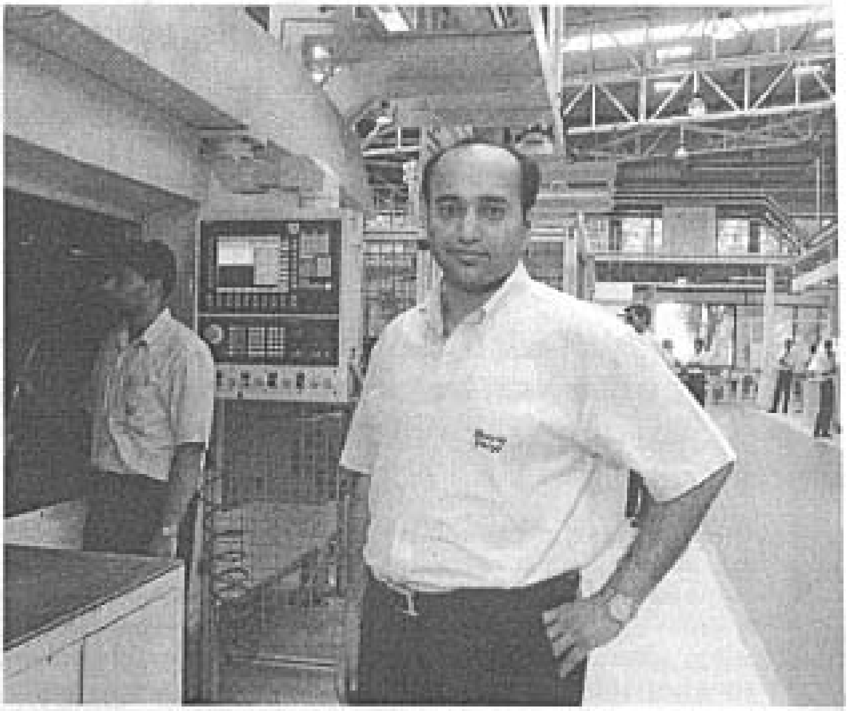
*Indicates number of firms in the revenue band

	...but revenues...	...exports	...and investments are clipping
2001-02	4,470	578	2,300
2002-03	5,430	760	2,645
2003-04	6,730	1,020	3,100
2004-05*	8,700	1,400	3,950

*Component embedded in exported vehicles is $1.2 billion
Figures in $ million

in the existing product mix of crankshafts, axles and steering knuckles. To develop technology from scratch was near impossible, so Kalyani roped in foreign collaborators like Rockwell International and Bendix Corporation for axles and brake systems, respectively. "The industry fragmentation meant that we had to use technology to differentiate ourselves," explains Kalyani.

The strategy paid off. By the early 80s, Bharat Forge had started exporting to more sophisticated Russian markets, and by the middle of the decade, when the Japanese light commercial vehicle (LCV) wave came, it began to manufacture to the exacting standards of Japanese OEs. "The Japanese experience taught me that simply low cost of labour would not get us nowhere. We needed to get technology to drive this business," says Kalyani.



Amit Kalyani: The MIT grad helps drive the company's M&A strategy

The first steps towards modernisation were taken in 1989. It's a phase that Baba Kalyani's 30-year-old son Amit, also an MIT alumnus, refers to as one where they "bet the house". It's easy to see why. The company invested Rs 150 crore in technology when its revenues were about as much. Precisely what they invested in was Wein Garten Screw Press alongside CAD/CAM systems and IT infrastructure to cater to the new production lines, and bringing in new talent that could work on this infrastructure. This was clearly the single point when the company broke away from all its competitors. "The media had said I was going to bring the company down at the time, but it turned out to be the best thing we had done; it propelled our move into the US market," says Kalyani.

Exports started to pick up in the 90s and proved a lifesaver when the domestic market went into a tailspin in the mid-90s. However, even today, Bharat Forge is largely dependent on the auto sector and that does worry some analysts. "Also, due to low entry barriers, it's easy for new entrants to set up shop, though we don't see Bharat Forge facing any serious competition in the next three to four years, given its scale and technical prowess," says Chirag Shah, an analyst at Quantum Information Services.

The New Landscape

Just the same, Kalyani isn't taking any chances. Derisking is the new mantra, and it has two components to it: Acquire customers across the world and service them from as many points as possible (hence, acquisitions in the UK and the US). Kalyani even has a name for this strategy: It's called dual-shoring, meaning that Bharat Forge can split manufacturing for overseas customers between India and a plant closer to them to boost their comfort level. The company's existing manufacturing facilities span eight locations, of which just two are in India. That means half of the company's manufacturing happens outside India, but customers have the option of asking for dual shoring. To further strengthen its derisking model, the company plans to either acquire or build a new facility in China by the end of the year.

Spreading out facilities is important for another reason. Bharat Forge wants to participate with its customers at the product development level. To that end, it has set up a technology development centre in Germany, with focus on product development and engineering, validation and R&D.

At present, Bharat Forge racks up over Rs 500 crore in annual exports (45 per cent of its revenues), but the figure is clipping at 40 per cent a year. Add the revenues of newly-acquired companies like Imatra Kilsta AB and its subsidiary Scottish Stampings (besides other planned acquisitions and greenfield projects), Bharat Forge expects to do $750 million (Rs 3,300 crore) in exports on revenues of $1 billion (Rs 4,400 crore) by 2007-08. Unlike in the early 90s, nobody is laughing at Kalyani's plans. ■