

## Baba Kalyani: Creating an engineering giant

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Bharat Forge is known mostly as the global forging major and India's largest exporter of auto component. It is a truly global group. Seventy five percent of its revenue comes from outside India and not just via exports but from businesses located across the world. In five years from now, it is most likely going to change. Bharat Forge, the auto component company, is in the process of transforming itself into an engineering giant.

*It's been a year of trial by fire at Bharat Forge. Close to 80% of the company's Rs 4,800 crore revenues is earned outside India and most of it through the sale of automotive forgings. The collapsing global auto industry hurt Bharat Forge's core business hard whereas the economic downturn squeezed the non-automotive segment. In FY09, net profit dropped to 80% to just Rs 58 crore, but the worst is yet to come.*

*Here is a verbatim transcript of the exclusive interview with [Baba Kalyani](#), GK Agarwal, Subodh Tandale and Amit Kalyani on CNBC-TV18. Also watch the accompanying video.*



[Baba Kalyani](#), the Chairman and Managing Director of Bharat Forge said, "Last year was challenging but I think the worst year is going to be this fiscal. Although we are beginning to see bottoming out in India and the economy here beginning to catch up but in terms of global markets in this business 09 calendar year would probably be the most difficult and most challenging."

**Q: So it's going to get worse from here on before it gets better is what you are saying. How much worse?**

**[Baba Kalyani](#):** The problem is that in 2007 even till middle of 2008, everybody was working on the basis that the markets will grow. So everybody was buying a little more than they were consuming and now you have this huge inventory overhang. The inventory overhang is going to take a lot of auto companies something like four to five quarters to get rid of and then you will really start seeing real demand. So at a component level what we are seeing right now is two factors. One is the market has shrunk, the total output of the industry has shrunk and buying has shrunk even more because of the inventory overhang.

**Q: What are some of the signs you are going to look for to judge whether the environment is truly improving or not? Is it going to be things like the rundown in inventory levels or things like that?**

**[Baba Kalyani](#):** There is a very large overhang of inventory and they are coming down. Our estimate is that inventories will come down to almost let's say just the basic operational level by end of this year. So you will start seeing purchasing or quantities almost double by end of this year even if the sales remain at current level. So we will see volume growth. It may not be the same levels as 2007 but quite substantial volume growth from where we are today and that's a very clear sign. Now where will it go going forward that's anybody's guess? Our intelligent guess is that it will take a long time maybe four to five years for the industry to get back to the peak levels of 2007-2008. So you will see this industry coming back to something like 80-85% off its peak levels which for us is very good.

**Q: In the next three or four years?**

**[Baba Kalyani](#):** No. Let's say by the middle or end of 2010.

**Q: And that's where the global market, as far as the Indian commercial vehicle market goes what's your outlook because I know one of the companies that we profiled on the series is Ashok Leyland and Seshasayee was saying, "I am finally seeing signs of a turn around" so you are hopeful that are you seeing the same?**

**[Baba Kalyani](#):** Yes. We are seeing the same signs of a turnaround. We are beginning to see higher demand but it is not still at the level of 2007 or 2008. It came down 60-65% so it's now coming back but its still 30-40% below where it was. But my gut feel is that with whatever steps the government has taken the last stimulus package before the election—the December-January stimulus package—I think that has had some impact on the commercial vehicle business. The bus demand has gone up because of the urban renewal mission programme, which is beginning to bite in. Infrastructure spending will bite in and create demand for vehicles. So we are very optimistic about the commercial vehicle industry at least in India.

*In 1999, Bharat Forge focused on exports to reinvent itself into a global player. Four years ago it adopted the merger and acquisition (M&A) route to expand to 12 manufacturing locations across six countries. Now, the very existence of some of its international subsidiaries like Bharat Forge America and Scottish stampings is under threat.*

"I don't think I would have done things differently. Nobody forecasts it that the global economy is going to go through such a large meltdown. Now, if we were to do this exercise, starting today, we would again do the same exercise except that you would get businesses that have already restructured to today's market situations. We bought businesses that were structured for the demand levels that existed at that time and which was a growing demand and okay what does mean, it means you have to restructure your businesses you need to downsize your businesses," **[Baba Kalyani](#)** said.



**Amit Kalyani, Executive Director, Bharat Forge**, said, “Too much growth is not good for you that is one thing and when you are growing keep your eye on at what cost are we growing. Sometimes when you tend to grow too fast, you tend to lose focus of a lot of key metrics because your customers are breathing down your neck they are always pushing you for more and at what cost are you doing that more.”

Further, [Baba Kalyani](#), said, “We were kind of carried away of just simply growing our business, call it market share or just topline numbers. The smarter thing to have done would have been to plan for ‘x’ percentage of this growth on a base capacity basis and then create flexible capacity for 25-30% of the demand. Then the pain is much less because the flexible capacity you can get rid of that flexible capacity in 10 days or you can shut it down. You got dedicated capacity it takes anywhere between six to 12 months, depending on the geography you are in, to downsized it because you have to give notices to people where there's certain contractual time, there's a certain negotiation with unions etc. So, I think this is the only lesson, the only hard lesson that we have learnt and we are going to implement this going forward. That we are going to create flexible capacities which will deal with the markets ups and downs in a much easier manner financially than the pain we are going through today.”

**Q: Many of your subsidiaries are still struggling, partly because of the external environment and partly because like you said, when you bought them they were in a fattened state and not lean and mean. Is there likely to be any asset restructuring on your end?**

[Baba Kalyani](#): We have done. As a matter of fact, a large part of our re-structuring in Europe and the US is already finished. We have taken a very aggressive position in terms of where we see the demand coming. So we have re-structured to like 50% levels. In the US we have restructured to maybe even less than 50% levels because the peculiar play in the US with the small truck business which I think is going to go down quite substantially. So we have done this and that's restructuring as far as we are concerned.

**Q: Is it going to mean in asset sales of any kind?**

[Baba Kalyani](#): No. We are not selling any assets.

**Q: Are you likely to shut down any of your subsidiaries?**

[Baba Kalyani](#): We might because we just have too much capacity. When you go to 50% capacity it just doesn't make sense to keep all your plants running. But we haven't made that decision yet we will make that decision.

**Q: Which of the regions look the weakest?**

[Baba Kalyani](#): In Europe we have six plants in Europe and we could do with five instead of six. It doesn't really make any sense. But we have not made that decision yet. We will make that decision once we get a little more clarity from our customers.



**GK Agarwal, Deputy Managing Director, Bharat Forge,** said, “It made sense to have small operations at some locations for certain reasons but if that business is so low now, that it does not make sense to continue it is better to combine it with something else.”

**Q: Would you like to give some illustrations of that?**

**GK Agarwal:** For instance we have been some issues with the volumes being very low at Scottish Stampings in UK. It is a single press operation. Thus, that is an operation that could possibly get reorganized.



**Subodh Tandale, Executive Director, Bharat Forge,** said, “We are looking at optimising our large presses in Europe, we are looking at may be optimising our passenger car production in Europe and North America.”

**Q: How much have you been able to reduce costs by?**

**Subodh Tandale:** On an average we have been able to reduce costs in a region of anywhere between 10 to 12%.

**Q: In the last one year?**

**Subodh Tandale:** I would say six months.

**Q: Is there more headroom?**

**Subodh Tandale:** Our intention is to try and do at least 50% of that in the next one year.

*A new 2008 facility to forge a 27 tonne ingate into a sugar mill crusher by a 4000 ton open die press is the result of a change in strategy four years ago when Bharat Forge decided to apply it's metals, forging, machining and surface treatment abilities to the non automotive sector since then the company has signed up three joint ventures with NTPC, Alstom and Areva and invested Rs 500 crore in two new facilities. It hopes to push the contribution of non auto revenue from 18% last fiscal to 50% in FY12.*

“We were reaching a level of saturation in our automotive business. We had reached markets shares globally of 30-35% in most of our key operating product segments that to go beyond that would be a very high risk situation and very difficult to do. So we needed a new growth engine for ourselves and we created that. We also created that to de-risk ourselves from the cyclicity of the automotive business not from a financial meltdown—that was not the idea. But the automotive business has a four-year cycle because of new emission norms coming in every four years so new technology comes in every four years so new cycles happen. So we wanted to insulate ourselves from this cycle so we started on this strategy,” [Baba Kalyani](#) said.

Seconding his opinion, Amit Kalyani, said, “These are opportunities that are the beginning of Bharat Forge’s transformation from being seen as a components player

alone largely for the automotive sector transitioning into an engineering conglomerate where we use our knowledge of metals, metal energy, manufacturing and design engineering to become a capital good and engineering conglomerate. So this is the route and a path that we are on and I believe that this is the journey that the next five years will see.

**Q: What is the size of the business opportunity? What do you think realistically speaking you can do in five years?**

**Amit Kalyani:** When we had done our homework about three years ago we had seen that our automotive forging opportunity was roughly 30 billion globally for what we wanted to target and for the non-automotive, in the areas that we are talking about the opportunity is somewhere in the 30 to 40 billion range. If we are looking at similar market share of what we are trying to do then it will give us a size of business, which is roughly the same as our automotive business. At our peak year we did Rs 4,500 crore of revenue off even if we see 80% is automotive that is Rs 3,500 crore so in a five year period you have the opportunity to create that kind of a business.

**GK Agarwal:** The timing for these opportunities could be different. For instance, power is a fairly mature business in this country so long as we are ready, we are ready to supply. For example BHEL today imports all of its requirements from outside. The moment I'm ready, I will have large opportunity waiting out there.

**Q: How large?**

**GK Agarwal:** This opportunity could be almost Rs 1,000 crore a year.

**Q: So that brings to the question of scaling up—you need to be ready to be of a vital size in the next two years when, let's hope, the global economy has turned and therefore you need to be ready with that much more capacity. I know this one and the Baramati one, a recent ones that have come on line in that sense but resources are tough to come by, you have the FCCB to repay by FY11?**

**Baba Kalyani:** The difference is when we set up these capacities we set them up to world scale.

**Q: So you won't need to add more?**

**Baba Kalyani:** I can simply ramp up the output here three times.

*But till that happens automotive forgings will be the main stay at Bharat Forge. Sales to the commercial vehicle industry make for half the company's revenue. But that could reduce due to the sharp cuts in demand this year and growth in other businesses.*

**Baba Kalyani:** As far as commercial vehicles business is concerned, we don't see this market shrinking. In Europe, as I said, maybe 20% of the market will go down. But if you look at a past five-year average, we will still be at the same level or a better level for the next five years. In the past five years the US market has been at a very low level—almost at 60% level of the normal. We expect that market to kind of go up.

And I think in India and China these markets are increasing. So commercial vehicles we see opportunities and clearly have the capacity in place, we don't even have to add any capacity for the next five years for this market.

*Business with the passenger car industry makes for a fourth of Bharat Forge's revenue while that size will continue the contributing countries and cars will change.*

**Baba Kalyani**: In the passenger car business as far as we are concerned, we have three geographies that we must look at separately—China, India and the rest of the world. I think in China and India, we will continue to grow our passenger car business as the market grows. So I think we will be able to continue our market shares and continue to grow it. We are beginning to see this in China. As a matter of fact, we are now going to invest in some new facilities in China for passenger cars, for making some different components. For the rest of the world, the market will fall on the passenger car side. So this is one trend.

The second trend is there is a trend towards smaller vehicles, smaller engines and smaller components. So if you calculate in weight, you are going to have less weight per car. Third, there is a trend in new technologies, whether it's electric, hybrid or whatever it is, we are beginning to see a lot of electric things happening. So these issues, on a global basis, you are not going to see an expansion in terms of numbers. The only way you can grow is consolidation and new technology. So our focus in the rest of the world is purely based on a consolidation strategy and new technology strategy.

**Q: When you say consolidation can you elaborate on that.**

**Baba Kalyani**: That's difficult to elaborate on but you know what I mean.

**Q: It was a question I was going to ask you towards the end?**

**Baba Kalyani**: Clearly the opportunities for consolidation are going to be there.

**Q: They already are right because of the shake out you've seen in the auto industry.**

**Baba Kalyani**: I think right now there are lots I get proposals everyday. But the baggage is still there. No one has defined a way to get rid of the baggage. Now that will happen once the whole picture about GM, Chrysler and its suppliers becomes a little more clearer and the courts and the Us government decides which way this whole thing is going to work.

**Q: So you still have appetite for consolidation.**

**Baba Kalyani**: It's going to happen.

**Q: Every business leader I know has overeaten when it comes to M&A?**

**Baba Kalyani**: I don't think I am actively looking for an M&A. But in our industry, which is a supply industry, where you are excess capacities because the demand itself has shrunk to a large extent without consolidation the industry would not survive. Let's face it.



**Subodh Tandale:** Asset sales are available but for relatively smaller companies. You know where you're looking at revenues anywhere between range of USD 50-80 million and upwards of about USD 150 million.

**Q: So what size would you be looking for?**

**Subodh Tandale:** Traditionally, we have looked at anywhere between USD 150-200 million as a size. But we are also looking at sectors which are different. We are also looking at non-automotive. So we are really not hung up on the ticket size at this point we are looking at it from more of an opportunity standpoint.

**Q: Which geographies do you see these opportunities in?**

**Subodh Tandale:** At this point we are seeing a lot of opportunities in Europe, in Germany and in the US. We are also looking at some of these deals in a way where we can look at a short-term approach, where we don't really need to go in for asset sales or purchases. We really want to go in for business books and you know use our capacity, either in India or overseas, to be able to address them.

**Q: So final question this is interesting, about 2 or 3 years ago all those Indian companies that lived the life of a frog in a well and chose to ignore the global world suffered because there was so much global growth and liquidity, your company prospered in a situation like that because you were out there making businesses in all these countries and now increasingly for many Indian companies the Indian market itself are on both counts A because it is growing while the rest of the world is not B this government is focused on making sure that middle India grows and that middle India can be a very big consumer we have no clue how big it can be right so suddenly all things have come back home - what does that take for you to re-focus or re-align your business and say we want it to be a global player, we went out there but now the domestic market is going to be equally important if not more who knows 5 years down the line.**

**Baba Kalyani:** For us you know the domestic market has always been important - it's not that we have ever treated it less important.

**Q: But 25% of you consolidated revenue?**

**Baba Kalyani:** But our market share with every customer is in excess of 60%. I think what has happened now with the government's approach in putting focus on infrastructure is a large part of the infrastructure play that was not available to companies like us is now going to be available - power sector for example. If you looked at the power sector for the last 25-30 years you had one company predominantly playing NTPC no or BHEL in manufactured products NTPC is the utility, power equipment manufacturer. Now suddenly this field is open to people like me and we will be there in that business. So 5 or 7 years from now I should be producing 5000 mw of turbine and generators. Now these opportunities are coming up. The same thing is happening with the nuclear opportunity.

**Q:** So finally 75% of your consolidated revenue comes from outside India, you're a globalised company, 5 years down the line could in quite likely be, I won't say the reverse, but half and half.

**Baba Kalyani:** I think it will be more than half and half—our India centric revenues will be more than 50%.