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by HIMALI PATEL

FORGING ITS WAY AHEAD TO SUCCESS

Bharat Forge is a name to reckon with in the auto industry and despite a downturn, it has kept the bearings running smoothly

In 2008, the whole world was under a global crisis and things weren't any different for the world's largest forging company either, the Baba Kalyani-led Bharat Forge. The company, which manufactures a wide range of high performance components for the automotive and industrial sector, reported a dip in profit of 81 per cent to ₹58 crore for FY09 against FY08 following a dip in its global order book from the automotive forging business. But while most peer companies became busy in cost-cutting, BFL chose to diversify to the non-auto segment.

After seven years, notwithstanding an uncertain demand environment in FY14 that led to volume decline in the automotive sector, *per se*, BFL reported over two-fold jump in its consolidated net profit at ₹498.53 crore for the 2014 fiscal. The company saw huge growth in its bottomline due to improvement in its operating profit margin which grew by 30.1 per cent during the quarter ended March 2014.

So, what led to the turnaround? And is this a sure-shot booster shot? **Diversification is the key.** BFL is today valued in the market at approximately ₹13,137.40 crore. It has also seen massive growth over the past five years. Its consolidated revenues have seen a compounded annual growth of 19 per cent to ₹6,716.12 crore in FY14. In addition, it has successfully diversified to other sectors such as oil and gas, power, railways, defence, mining and construction. BFL has also focused in expanding its market and has set up subsidiary companies in the overseas market. Says Mudit Goyal, senior research analyst, equity technicals, SMC Investments & Advisors: "Geographical diversification and focus on increasing the revenue contribution from export helped BFL to report robust performance in a scenario of sluggish domestic economic growth."

If one compares BFL's domestic and export business revenues, the former declined by 3 per cent in FY14, whereas its export revenues from the different subsidiaries grew at stronger pace by 16.5 per cent on a standalone basis on the back of traction in the non-auto segment.

Incidentally, the company's plans at product diversification and geographical diversification have not failed to achieve its tasks of de-risking. The company's emphasis on de-risked business model led to the opening up of several opportunities in a large global market segment. Consequently, large investments were made and capacity creation plans were rolled out for non-automotive forging operations in India.

Says Piyush Jain, equity research analyst, Morningstar India: "BFL realised that playing in one segment can prove cyclical. So, they actively started supplying components towards industrial segment as well". At present, BFL's non-auto business accounts for 36 per cent of the topline, including global opportunities in many industrial segments.

Powering up finances. Improved capacity utilisation as well as contribution of non-auto and cost control, has led to improvement in BFL's margins from 21.7 per cent to 25.4 per cent between FY09 and FY14. Further, BFL managed to reduce its debt by 8 per cent in FY14 on a yearly basis. Says Surjit Arora, research analyst, institutional equities, Prabhudas Lilladher: "Given the strong free cash flow generation of ₹800 crore-900 crore per year over the next two years, we believe the company would be almost debt-free."

To restructure its finances, BFL recently discontinued its operations at Bharat forge USA and exited the loss making joint venture with China FAW. Says Yaresh Kothari, research analyst, auto and auto ancillary, Angel Broking: "Over the last 2-3 years, BFL has taken several measures towards cost cutting and rationalising the production in an effort to bring down the breakeven level. These helped it to restructure its business."

"Once we become a supplier to a global OEM, we ensure that as the relationship matures, we are able to cater to their requirement in various geographies."

AMIT B. KALYANI

EXECUTIVE DIRECTOR, BHARAT FORGE

Fierce competition. Forging players such as Amtek Auto and Mahindra CIE are BFL's key competitors. But in terms of scalability, BFL is placed much higher. To start with, BFL has successfully diversified its product business both in the domestic and international market. It has also reported strong order intake in Europe and Asia Pacific. Lastly, the non-automotive sector now contributes 36 per cent of its revenue. Therefore, many experts believe that BFL faces less competitive threat from any of the domestic player presently.

However, the global market forms around 70 per cent major chunk of BFL's revenues. Further, the global market has witnessed an increase in automobile component suppliers across the world, which has led to global capacity creation. Says Jain: "The problem arises when the domestic automobile demand doesn't grow in line with capacity creation outside India. Then, the competition intensifies and BFL could face pressure from both markets." That means, if the slowdown continues, there is always the room for increase in competition even from the existing domestic players.

Calculating risk. As far as domestic business is concerned, BFL is heavily dependent on the commercial vehicle segment. So, any delay in pick-up in demand could impact its earnings. On the overseas front, BFL has overall higher impact on the CV side. So, a slowdown in the CV segment in India and overseas will have an impact on its fortunes.

Also note that BFL has a heavy industrial exposure in many segments across multiple geographies.

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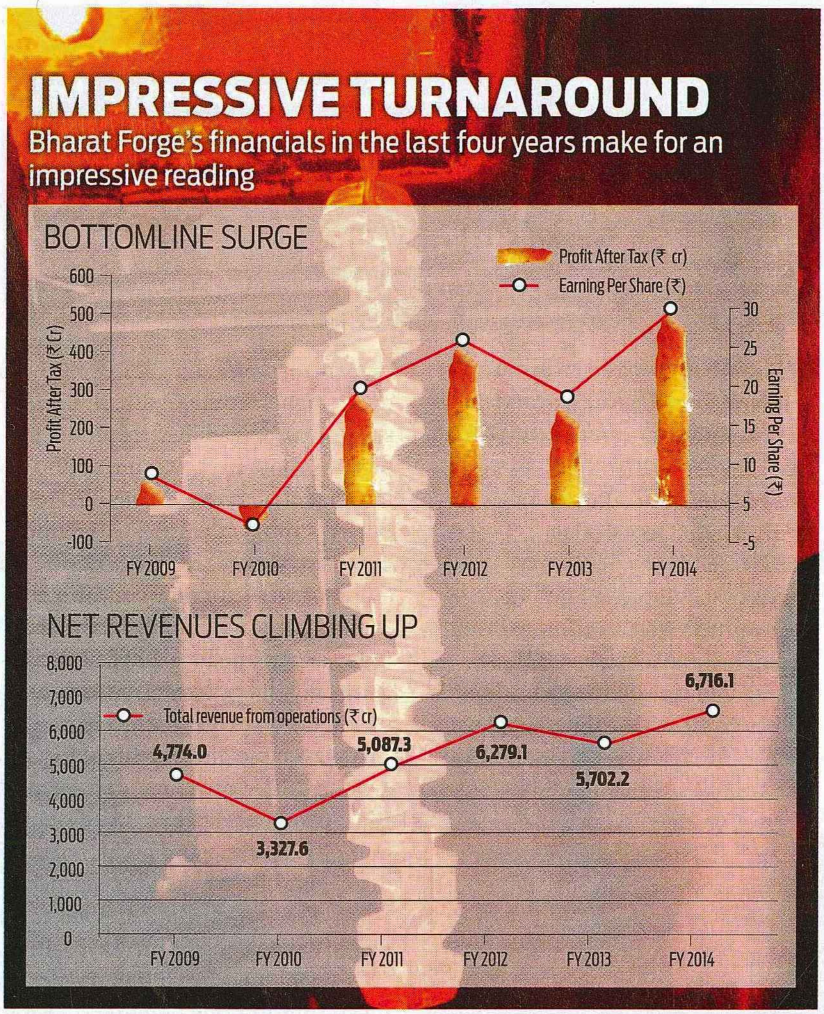

In other words, if there is a global downturn as happened during 2008, BFL's earnings would be at risk. Says Arora, "Global slowdown is a key risk as 70 per cent of the consolidated revenues is outside India."

Experts, however, believe that given the vast diversification, the slowdown cannot happen at one go. Says Jain: "The company's diversified portfolio acts as a counter during the downturn in the economy for them. If there is slowdown in one or two areas, they will be shielded with another vertical."

Can the recipe for success keep delivering? With the expected revival in the economy, BFL is expected to receive more order from sectors such as power, construction, mining and auto, which bodes good for the company. Says Jain: "Though the domestic industry is still struggling, the global automobiles companies are doing very well. This has now aided company to bag more orders."

Given its wide diversification, BFL can expect more order across segments and geographies from new and existing customers. It recently won a prestigious multi-year contract worth €250 million (₹2,047.66 crore) from a German OEM. Says Amit B. Kalyani, executive director, BFL: "Once we become a supplier to a global OEM, we ensure that as the relationship matures, we are able to cater to their requirement in various geographies." For instance, a relationship with an OEM which started in Europe has extended over the years to North America, Asia and India. These have enabled a highly de-risked customer base and more reach in various geographies. BFL's main market, the medium commercial vehicle (MCV) and HCVs saw a steep drop of 21 per cent in FY14 on account of slowdown in industrial activity in India.

According to the latest ICRA report, MCV and HCV sales are expected to recover from H2 of FY15. Says Goyal: "Developed economies (the US and Europe) are on a growth path. It is expected that the operational performance will get better in the time ahead." Adds Kalyani: "On the CV side, the growth will come by way of new product development aimed at enhancing our wallet share with the customers while continuing to focus on market share gains and new geographic penetration."

BFL's robust business model has helped it win investors' confidence, which has led to an increase in the shareholders value. The stock has more than doubled in the last one year. Says Arora: "We foresee another 15-20 per cent upside from the current levels of its stock price and expect return on equity (ROE) to improve from the current 16 per cent to 21 per cent over the next two years." BFL's stock price hit a 52-week high on the back of robust March 2014 quarterly earnings and optimistic statement from the management on its future growth prospect. The stock price rose by about 130 per cent from 1 January 2013 to 23 June 2014. With the improvement in business, the return on capital employed (ROCE) should only improve from here on.

Final Call. A key strength of BFL is its investments in research and development (R&D), which is delivering solutions to its marquee customers across geographies. Given BFL's well-diversified business across various verticals with a dynamic product offering, it seems to be having a lot going for it.

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