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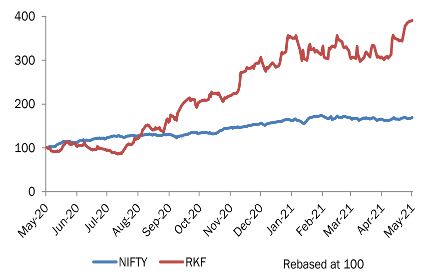
Ramkrishna Forgings Limited

18 May 2021

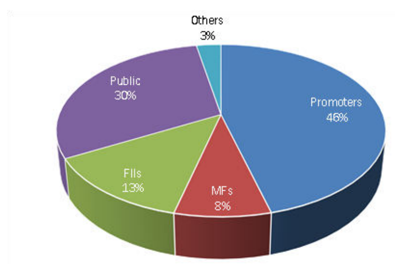
All set to forge ahead as end-market demand looks up — BUY

Sector	: Auto Ancillary
Target Price	: ₹802
Current Market Price	: ₹634
Market Cap	: ₹2,025 crore
52-week High/Low	: ₹670/141
Daily Avg Vol (12M)	: 1,09,962
Face Value	: ₹10
Beta	: 1.30
Pledged Shares	: 2.7%
Year End	: March
BSE Scrip Code	: 532527
NSE Scrip Code	: RKFORGE
Bloomberg Code	: RMKF IN
Reuters Code	: RKFO.NS
Nifty	: 15,108
BSE Sensex	: 50,193
Analyst	: Research Team

Price Performance



Shareholding Pattern



Initiating Coverage

Investment Summary

- Ramkrishna Forgings Limited (RKF) is a manufacturer of forged, rolled and machined components, supplying to OEMs and automotive part manufacturers.
- RKF's products are used across automotive and industrial applications. Almost 90% of the company's revenues come from the automotive sector (principally the CV segment) while exports account for 45% of revenues.
- The Indian CV industry is expected to be back on the growth path with buoyant demand in the medium term, enabled by policy initiatives and increase in demand for consumer and capital goods.
- The blip in global CV growth is temporary in nature as longer-term prospects remain intact. Going forward, infrastructure and construction projects, e-commerce, logistics and general industrial activities will boost demand for CV and, in turn, for components.
- Railways and infrastructure/construction projects will be the key drivers of RKF's sales to other verticals. The company expects to start shipping PV components by 2Q FY22.
- The shift towards electric mobility will not necessitate major design or technological modifications for RKF as a majority of its products are used in non-engine parts of automobiles such as steering systems and axles.
- RKF has almost concluded its current capex cycle as the capacity expansion carried out over the last couple of years is set to generate benefits for the business in the medium term. Management's strategy of driving the content per vehicle will enable sales to grow at a faster rate compared to the end-market growth. The RKF stock currently trades at an attractive forward P/E level of 14.2 FY23E EPS. Assigning a target multiple of 18.0x FY23E EPS, our valuation generates a price target of ₹802, informing a BUY rating with an upside potential of 26%.

Key Financial Metrics (Consolidated)

Rs lakh	FY19A	FY20A	FY21A	FY22E	FY23E
Operating revenue	1,93,108	1,21,647	1,28,893	1,63,179	2,00,220
Growth		*-37.0%*	*6.0%*	*26.6%*	*22.7%*
EBITDA	38,386	20,729	22,271	31,820	40,645
EBITDA margin	*19.9%*	*17.0%*	*17.3%*	*19.5%*	*20.3%*
PAT	12,011	970	2,067	7,762	14,247
PAT margin	*6.2%*	*0.8%*	*1.6%*	*4.8%*	*7.1%*
Diluted EPS (Rs)	36.75	2.97	6.44	24.28	44.56

Source: Company data; Khambatta Research

Company Profile

RKF is headquartered in Kolkata and has state-of-the-art plants in Jharkhand and West Bengal

Founded in 1981, Ramkrishna Forgings Limited (RKF) became a public limited company in May 1995. A manufacturer of forged, rolled and machined components, the company supplies to original equipment manufacturers (OEMs) and automotive part manufacturers. Headquartered in Kolkata, the company has state-of-the-art plants in Jharkhand and West Bengal in eastern India with a quality control setup of international standards.

RKF supplies to various industry sectors/segments such as automotive, railways, farm equipment, bearings, energy, power, construction, and earth moving and mining in India and international markets. The company is also a critical safety item supplier for screw coupling, bolster suspension, side frame keys, and draw gear assembly for railway coaches and wagons. RKF is a preferred supplier to OEMs such as Tata Motors, Ashok Leyland, VE Commercial and Daimler in India and Volvo, Mack Trucks, Iveco and Ford in international markets. It is a global supplier of components to Tier 1 axle manufacturers such Dana, Sisamex, Meritor and American Axles. RKF received NABL accreditation for its laboratory in 2011 while having key industry certifications such as ISO 14001, TS 16949 and OSHAS 18001.

Products

RKF manufatures machine components primarily for the commercial vehicle (CV) segment of the automotive sector. It also supplies a smaller part of its overall production for non-automotive applications. The company is set to enter the passenger vehicle (PV) vertical during FY22. RKF's products can be categorised into rolled, forged and machined components in line with the manufacturing process employed to make these. These components are used in automotive systems such as steering systems and axles and other engineering applications.

Management Profile

RKF is led by a strong management team comprising promoters working in executive roles and professionals. Leadership at the topmost level is provided by the company's Chairman and Managing Director.

The founder-promoter of RKF, Mr. M P Jalan is an alumnus of the prestigious BITS Pilani

Mahabir Prasad Jalan, Chairman: Mr. Mahabir Prasad Jalan is the promoter of RKF and an experienced technocrat and entrepreneur. Mr. M P Jalan has acquired over 45 years' experience in the forgings industry after starting his career from the shop floor and eventually launching his first independent venture as Managing Partner of Tribeni Steel Forgings in 1974. Since founding RKF in 1981, he has been leading the organisation and has spearheaded the company's expansion projects and the introduction of new technologies. Mr. M P Jalan is an alumnus of the prestigious BITS Pilani, graduating in Mechanical Engineering in 1970.

Naresh Jalan, Managing Director: Mr. Naresh Jalan possesses 20 years' experience in the forging industry. He has successfully led RKF in its high-growth path by consistently expanding its international presence while also developing the domestic business, thereby achieving robust and quality revenue growth. Mr. Naresh Jalan has an MBA in Finance and Marketing.

Selected domestic automotive clients | **Selected domestic non-automotive clients**

Source: Company data

Selected international automotive clients | **Selected international non-automotive clients**

Source: Company data

Peer Comparison

RKF competes with a number of players in the domestic and international markets. Here we have chosen three of its domestic listed peers, which operate in broadly similar spaces but their product portfolios and markets are not necessarily identical.

Mahindra CIE is a leading supplier of truck forgings in Europe

Mahindra CIE Automotive: A subsidiary of the CIE Automotive group of Spain, Mahindra CIE is a multi-technology automotive components supplier based out of India. Mahindra CIE is a leading supplier of truck forgings in Europe, a leading manufacturer of niche axle and engine ductile iron castings, and a global player in light vehicle crankshafts. The company is headquartered in Mumbai.

MM Forgings: MM Forgings is a manufacturer and supplier of forgings to the automotive sector. In the export market, the company supplies to North American and European OEMs. It is headquartered in Chennai.

Steelcast: Steelcast is a manufacturer and supplier of steel and alloy castings to OEMs across sectors such as earth-moving, mining, construction equipment, railways, steel, cement, power, energy and general engineering. The company is headquartered in Bhavnagar, Gujarat.

Peer Comparison: Key Financials Metrics, FY20

Rs crore	Ramkrishna Forgings	Mahindra CIE	MM Forgings	Steelcast
Revenue	1,216.5	6,050.1	752.8	191.5
EBITDA	207.3	501.6	132.2	34.2
EBITDA margin	*17.0%*	*8.3%*	*17.6%*	*17.9%*
PAT	9.7	106.4	41.7	8.0
PAT margin	*0.8%*	*1.8%*	*5.5%*	*4.2%*
Diluted EPS (Rs)	2.97	2.80	17.28	3.94
ROCE	6.5%	5.4%	9.0%	7.3%
ROE	1.1%	2.2%	9.5%	6.9%
Current market cap	2,080	6,765	1,153	282

Source: Company data; Bloomberg; Khambatta Research

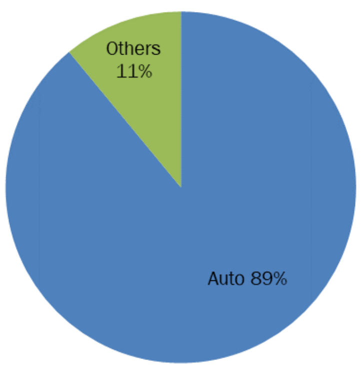
Investment Thesis

RKF generates almost 90% of its revenues from the automotive vertical

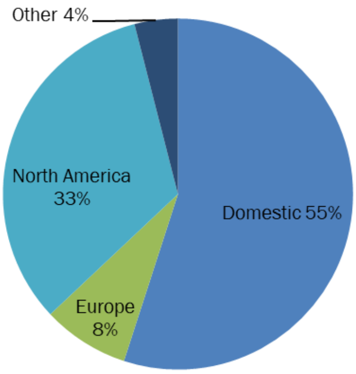
A leading forging company with substantial export earnings. RKF is a leading manufacturer and supplier of forged, rolled and machined parts used across automotive and industrial applications. The company's products are used in the automotive, earth-moving and mining, farm equipment, railway, oil exploration, steel manufacturing and general engineering sectors. The automotive vertical, generating almost 90% of overall revenues, constitutes the company's principal market where it primarily supplies to the CV segment. Through investments in capacity expansion, modernisation and latest technology, RKF has established itself as a preferred supplier status to leading OEMs across the globe and India. The company's capability to develop customised products has led to the creation of an exhaustive product portfolio, which has enabled the company to broaden its market and cross-sell to its existing customer base. RKF has successfully deepened its export market presence, resulting in de-risking of its business model by reducing its reliance on domestic sales as export revenues increased sharply from 29% to 39% of overall revenues between FY19 and FY20. Export revenues further increased to 45% in FY21. The company sells its products in the international markets of the US, Canada and Mexico in North America, Brazil in South America, Germany, Sweden, France, Spain, Italy and Turkey in Europe, and Australia, Bangladesh and Thailand in Asia-Pacific. RKF is a supplier to Tier-1 customers in the US and Europe as it engages with a number of other European OEMs with the objective of acquiring supply contracts in the coming years. North America is the largest export market contributing 33% of overall revenues while Europe contributes 8% and other geographies chipping in with another 4%.

RKF sells its products in the international markets of the US, Canada, Mexico, Brazil and Europe

Revenue split by vertical



Revenue split by geography

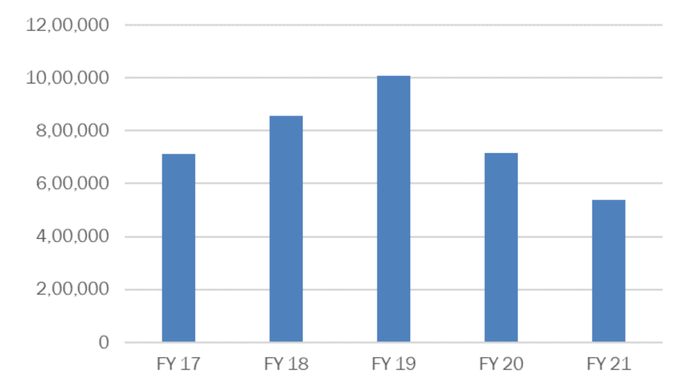


Source: Company data

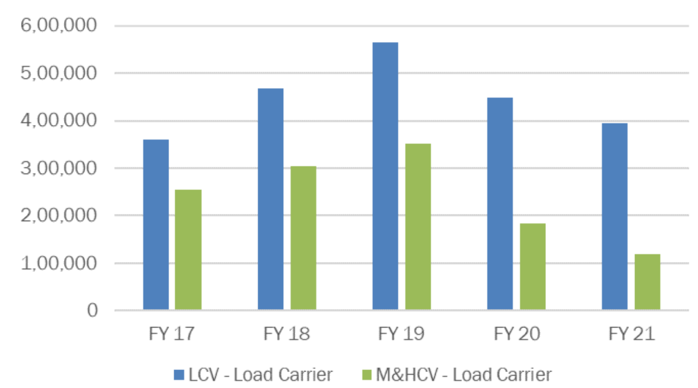
The Indian CV segment has strong growth potential in the medium-to-long term. Truck sales in India witnessed a y-o-y degrowth of 17% in CY19. The Indian automotive sector in general and the CV segment in particular encounter many challenges such as policy changes, supply chain issues, cash flow concerns and resource availability. With sales of 7,17,688 units in FY20, CV volumes were estimated to fall by 25% (lower end) to 5,38,266 units in FY21 according to the CV consultancy firm Race Innovations. Heavy- and medium-duty truck (HDT/MDT) sales are expected to decline by 35% to 38% while light duty truck (LDT) sales are seen to decrease by 12% to 15% in FY21. *(Source: www.motorindiaonline.in).*

The key future drivers for the CV segment will include vehicle scrapping policy implementation, systems to monitor overloading, electric vehicle (EV) deployment with infrastructure development, production-linked incentives, incentivising purchase of non-polluting vehicle, and financial support packages. The logistics sector is going through a transformational journey as structural reforms and disruptions boost demand for products and services across the value chain. Digital technology, shared mobility and leasing models are expected to drive servitization in the CV sector where the value-addition by the market will be measured in terms of outcome as a service as opposed to the traditional product sales model. Race Innovations forecasts a CAGR of 6% to 7% for the CV segment over FY22 to FY25. OEMs' share of exports is expected to increase from the current 9% to 10% of total production to 25% to 30% by FY25 as India is set to become a major export hub for vehicles, allied components, accessories and ancillaries to meet the expanding global demand. Being a leading supplier to OEMs and auto parts companies, the strong growth outlook for the Indian CV segment bodes well for RKF.

Total CV sales volume in India



CV sales volume in India by category



Source: Auto Punditz; Race Innovations; Khambatta Research

North America is the largest geographical market with a share of 65% of the global CV segment

Global CV industry fundamentals are intact and present robust growth potential in the medium term. The largest region in the global CV market is North America with a share of 65% of the overall market followed by Asia-Pacific, which accounted for 20% of the global market in CY20. Eastern Europe was the smallest region in the global commercial vehicle market. The CV market witnessed a fall in sales due to the COVID-19 pandemic and the ensuing lockdowns and restrictions, plant closures, an overall decline in industrial activity, and a temporary slump in demand. North America saw a production decline of approximately 30% in Classes 4-8 during CY20. Europe's production of CV fell by approximately 20% with Italy and the UK in Western Europe and Poland in Central Europe witnessing the steepest slide. In Asia-Pac, the CV segment in the larger economies of China, Japan, India and South Korea was projected to go down by 25% in CY20.

We believe the blip in growth in the CV industry is temporary in nature as longer-term prospects remain intact. Going forward, infrastructure and construction projects, e-commerce, logistics and general industrial activities will boost demand for transportation of consumer/capital goods and construction materials, driving the CV industry in turn. Technological advances and disruptions seen by the CV industry in the last decade are expected to continue further and will be a key driver for the industry's growth in the years to come. The shift towards electric mobility and more stringent emission regulations will drive investment in electric vehicles (EVs) by OEMs. The shift of major global players such as Daimler, Toyota and Volvo toward EVs is likely to result in robust growth opportunities for automotive component suppliers over the coming years. The global CV market, estimated at US$ 719.1 bn in CY20, is expected to grow by 9.1% y-o-y to US$ 784.6 bn in CY21. Thereafter it is forecast to expand at a CAGR of 10.0% to reach US$ 1,132.6 bn by FY25 *(source: www.marketwatch.com)*.

In the non-CV space, management is bullish on railways and PV, the latter being a new vertical for the company

RKF looks to benefit from promising opportunities in other verticals, albeit on a smaller scale. While the automotive vertical (which currently comprises only the CV segment) contributes a large majority of RKF's revenues, 11% of revenues came in from other verticals in FY21. Besides automotive, the other end-markets that RKF supplies to include railways, earth moving and mining, farm equipment, energy, steel and general engineering (with revenues from earth moving and mining, and farm equipment are subsumed in the automotive vertical). Privatisation of passenger train operations and metro rail projects across the country are expected boost demand for RKF's products as management looks to be optimistic about its prospects in the railway vertical. Tractor sales witnessed good traction during FY21 and is expected to continue doing so with the central government's goal of doubling farm income, facilitated by various enabling schemes for the farm sector. Favourable policies and various government programmes to boost the infrastructure sector will drive demand for earth-moving and construction equipment, which, in turn, will benefit component manufacturers like RKF. The medium-to-long term view for the railways, farm and infrastructure sectors in India is buoyant, presenting robust potential for RKF. The company's plans of entering the passenger vehicle (PV) segment of the automotive market are likely to be realised in 2Q FY22.

RKF operates 6 state-of-the-art manufacturing facilities in eastern India with an installed capacity of 1.6 lakh tons.

Notwithstanding near-term blips, RKF will benefit from bouyant demand and an expanded manufacturing capacity in the medium term. RKF operates 6 state-of-the-art manufacturing facilities in eastern India with a total installed capacity of 1,60,200 tons. Five of these plants are in Jharkhand while one is in West Bengal. The company has established quality control processes and systems of internationally-accepted standards, a critical requirement for a manufacturer with significant international sales. RKF has nearly concluded its current capex cycle as the capacity expansion carried out over the last couple of years is set to generate benefits for the business in the medium term. Management expects the operations and supply chain to normalise by the end of 1Q FY22 as covid-related restrictions start easing out and sales is driven by demand side buoyancy. The semiconductor shortage situation has not affected RKF significantly, although it has had some impact in the Class 8 segment in North America. However, management expects the supply blip to alleviate over the next few months with capacity coming online in Japan.

With respect to the shift towards electric mobility, a majority of RKF's products are used in non-engine parts of automobiles such as steering systems and axles, which will not be requiring any major design or technological modifications.

Valuation

The RKF stock currently trades at an attractive forward P/E level of 14.2 FY23E EPS

At 18.0x FY23E EPS, we rate RKF a BUY with a target price of ₹802 and an upside potential of 26%. After the first half of FY21 was significantly affected by covid-driven lockdown/restrictions, demand slump and supply chain challenges, RKF reported improved performance in the second half. With a capacity utilisation of 21% and 49% in 1Q FY21 and 2Q FY21, utilisation levels increased sharply to 83% in 3Q FY21 and subsequently to 93% in 4Q FY21. The company delivered a strong fourth-quarter performance to end the financial year on a strong note, marked by annual sales growth and margin improvement on a y-o-y basis. Going forward, sustained improvements in the demand environment in the international markets, especially in North America will lead to the growth momentum picking up further. The pent-up demand in the domestic market will drive order uptake as restrictions gradually ease off with the covid second wave peaking out. Management's strategy of driving the content per vehicle will enable sales to grow at a faster rate compared to the end-market growth. The company can ramp up capacity utilisation from current/rated levels through continuous productivity enhancements as demand accelerates further. The RKF stock currently trades at an attractive forward P/E level of 14.2 FY23E EPS. Assigning a target multiple of 18.0x FY23E EPS, our valuation generates a price target of ₹802, informing a BUY rating with an upside potential of 26%.

Relative Valuation: Price-to-Earnings

	High	Low	Average	Current
Ramkrishna Forgings	27.5	4.0	16.6	98.5
Mahindra CIE Automotive	31.6	6.6	18.2	63.5
MM Forgings	30.7	5.2	18.2	27.7
Steelcast	38.3	6.1	18.1	34.8

Note: Multiples since FY17; normalised to exclude upper-end outliers
Source: Bloomberg

Profit & Loss Account (Consolidated)

Rs lakh	FY19A	FY20A	FY21A	FY22E	FY23E
Revenue from operations	**1,93,108**	**1,21,647**	**1,28,893**	**1,63,179**	**2,00,220**
Growth		*-37.0%*	*6.0%*	*26.6%*	*22.7%*
Cost of goods sold	1,54,721	1,00,919	1,06,623	1,31,359	1,59,576
EBITDA	**38,386**	**20,729**	**22,271**	**31,820**	**40,645**
EBITDA margin	*19.9%*	*17.0%*	*17.3%*	*19.5%*	*20.3%*
Depreciation & amortization	12,106	12,054	11,670	11,936	11,948
PBIT	26,592	9,354	11,159	20,700	29,898
Interest expense	8,219	7,875	7,985	8,779	8,018
PBT	18,373	1,479	3,174	11,921	21,880
Tax expense	6,362	510	1,107	4,159	7,633
PAT	**12,011**	**970**	**2,067**	**7,762**	**14,247**
PAT margin	*6.2%*	*0.8%*	*1.6%*	*4.8%*	*7.1%*
Diluted EPS (Rs)	**36.75**	**2.97**	**6.44**	**24.28**	**44.56**

Source: Company data; Khambatta Research

Abridged Balance Sheet (Consolidated)

Rs lakh	FY19A	FY20A	FY21A	FY22E	FY23E
Total shareholders' equity	87,246	87,600	88,259	95,542	1,09,310
Total debt	82,041	88,080	1,13,520	1,08,724	94,271
Current liabilities	43,075	39,180	60,040	61,739	67,022
Total equity & liabilities	**2,20,049**	**2,22,879**	**2,70,441**	**2,75,230**	**2,80,474**
Fixed assets	1,24,349	1,39,356	1,51,599	1,58,426	1,60,176
Inventory	33,126	35,871	43,220	44,986	45,905
Trade receivables	50,959	34,269	56,881	58,118	60,340
Cash & cash equivalents	211	265	6,735	1,094	816
Total assets	**2,20,049**	**2,22,879**	**2,70,441**	**2,75,230**	**2,80,474**

Source: Company data; Khambatta Research

Ratio Analysis

	FY19A	FY20A	FY21A	FY22E	FY23E
ROA	5.5%	0.4%	0.8%	2.8%	5.1%
ROCE	18.9%	6.5%	6.8%	12.8%	17.9%
ROE	13.8%	1.1%	2.3%	8.1%	13.0%
Debt-to-equity ratio	0.94x	1.01x	1.29x	1.14x	0.86x

Source: Company data; Khambatta Research

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Key Risks

- The loss of one or more major customers can negatively impact our forecasts.
- Unanticipated technology disruptions in the automotive industry or its value chain can negatively impact our outlook and forecasts.
- Further severe waves of the COVID-19 pandemic or it remaining around for an extended period of time can potentially dampen demand and/or disrupt the supply chain, leading to the underperformance of our estimates.

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Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

Stock ratings

Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

Hold recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

Sell recommendations are expected to improve up to 5% or deteriorate, based on consideration of the fundamental view and the currency impact (where applicable).

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