Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Ramkrishna Forgings Ltd

Strong CV business outlook

Automobiles	Sharekhan code: RKFORGE	Result Update

Stock Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 817**	
Price Target: **Rs. 940**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

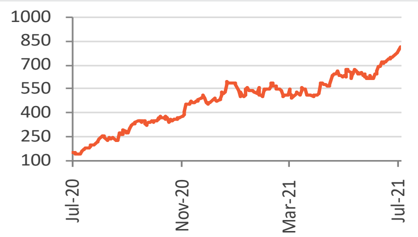
Company details

Market cap:	Rs. 2,613 cr
52-week high/low:	Rs. 832 / 141
NSE volume: (No of shares)	1.0 lakh
BSE code:	532527
NSE code:	RKFORGE
Free float: (No of shares)	1.7 cr

Shareholding (%)

Promoters	46.0
FII	16.2
DII	6.9
Others	30.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	32.2	60.5	37.6	447.8
Relative to Sensex	31.2	50.1	30.8	408.3

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on Ramkrishna Forgings Limited (RKFL) with a revised PT of Rs. 940, led by a strong commercial vehicle (CV) business outlook in India, Europe, and North America and an earnings upgrade.
- Q1FY2021 results were ahead of our expectations, aided by EBITDA margin expansion on a richer product mix and price hikes.
- Earnings to report a strong 146% CAGR over FY2021-FY2023E, driven by a 26.5% CAGR in domestic revenue, 38.6% CAGR in export revenue, and a 170 bps rise in EBITDA margin over FY2021-FY2023E.
- The stock trades at P/E multiple of 15.4x and EV/EBITDA multiple of 7.2x its FY2023E estimates.

We retain our Buy rating on Ramkrishna Forgings Limited (RKFL) with a revised PT of Rs. 940, led by a strong commercial vehicle (CV) business outlook in India, Europe, and North America and an earnings upgrade. The company's Q1FY2022 results were ahead of expectations, led by robust growth in exports and EBITDA margin expansion, driven by richer product mix. Net revenue for Q1FY2022 stood at Rs. 412.9 crore versus expectation of Rs. 388 crore, driven by 15% q-o-q growth in exports. However, domestic revenue was hurt by lockdown restrictions and a 41.3% q-o-q decline to Rs 190 crore. As a result, overall revenue declined by 20.3% q-o-q. Improved product mix helped average realisation (Rs. per tonne) to improve by 12.5% q-o-q to Rs. 1,88,478 per tonne. Exports were driven by overall growth in North America and European markets. Export mix of North America, Europe, and other countries stood at 70:27:3 in Q1FY2022 as against 76:20:4 in Q4FY2021. EBITDA margin for Q1FY2022 expanded by 230 bps q-o-q to 23.1%, led by improved product mix. As a result, EBITDA and PAT declined by 11.5% q-o-q and 31.1% q-o-q to Rs. 95.3 crore and Rs. 24.6 crore, respectively. Management was optimistic on growth prospects, expecting recovery in domestic CV markets, while there was continued growth momentum in North America and Europe truck markets. We see strong underlying demand for the domestic commercial vehicle industry and expect strong improvement in M&HCV sales to continue, driven by rise in e-commerce, agriculture, infrastructure, and mining activities post normalisation of COVID-19. Demand for global truck markets is buoyant, aided by increasing traction for Class 8 truck order books. RKFL is committed to grow its business profitably and de-risk its business model through diversifying into new geographies, sectors, and widening its product portfolio. Counterparty risks are low due to established business position of RKFL's customers from domestic and export markets, and criticality of the components manufactured. We expect RKFL's earnings to report a strong 146% CAGR over FY2021-FY2023E, driven by a 26.5% CAGR in domestic revenue, 38.6% CAGR in export revenue, and a 170 bps rise in EBITDA margin over FY2021-FY2023E. Considering strong growth prospects of RKFL, we retain our Buy rating on the stock.

Key positives

- The company has received Parts Product Approval Process (PPAP) clearance and confirmation to launch Euro 15 million (Rs. 132 crore) from a European OEM.
- Exports grew by 15% q-o-q in Q1FY2022 to Rs. 218.2 crore.
- EBITDA margin expansion of 230 bps q-o-q to 23.1% in Q1FY2021, driven improved product mix and price hikes.

Key negatives

- Domestic revenue declined by 41.3% q-o-q to Rs. 190 crore, impacted by lockdown restrictions during COVID-19 wave 2.

Our Call

Valuation - Maintain Buy with a revised PT of Rs. 940: We are expecting CV demand to pick up in India as the economy normalises. The outlook of North America and Europe remains positive. Positive CV demand in India, North America, and Europe is highly beneficial for the company such as RKFL, which has a strong domestic and export revenue mix of 55:45 in niche markets. Moreover, the timing is favourable, as global automakers and tier-1 suppliers are scouting for alternative sourcing hubs outside China. The Indian government is offering various incentives such as PLI scheme, Make-in-India, and Atmanirbhar Bharat Mission, which will provide a strong platform for automobile suppliers such as RKFL. We believe RKFL has a strong global footprint and is serving to leading OEMs, not only in the automotive segment but other sectors as well. We expect RKFL to gain market share internationally, as it has completed its major capex. We have increased our earnings estimates for FY2022E and FY2023E by 10% and 7.7%, respectively, driven by new order wins and margin expansion. The stock is available below its historical average multiples at P/E of 15.4x and EV/EBITDA of 7.2x on its FY2023E estimates. We reiterate our Buy rating on the stock with a revised PT of Rs. 940.

Key Risks

RKFL is exposed to the cyclicality inherent in CV and steel industries. Moreover, geographically diversified business poses forex fluctuation risks. RKFL is well hedged to cover forex movement in any direction from -5% to +5%.

Valuation (Standalone) Rs cr

Particulars	FY20	FY21	FY22E	FY23E
Revenues	1,112	1,288	1,788	2,246
Growth (%)	(38.5)	15.9	38.8	25.6
EBIDTA	204	230	339	439
OPM (%)	18.3	17.8	18.9	19.5
Net Profit	10	28	102	169
Growth (%)	(91.9)	190.3	265.6	65.3
EPS	3.0	8.8	32.0	52.9
P/E	276.7	93.3	25.5	15.4
P/BV	3.0	2.9	2.6	2.3
EV/EBIDTA	15.5	13.7	9.3	7.2
ROE (%)	1.1	3.2	10.9	15.8
ROCE (%)	4.1	4.7	7.5	10.3

Source: Company; Sharekhan estimates

Key Conference Call Highlights

EBITDA margin exceeds expectation in Q1FY2022: RKFL's Q1FY2022 results were ahead of expectations, led by robust growth in exports and EBITDA margin expansion, driven by a richer product mix. Net revenue for Q1FY2022 stood at Rs. 412.9 crore versus expectation of Rs. 388 crore, driven by 15% q-o-q growth in exports. However, domestic revenue was hurt by lockdown restrictions and declined by 41.3% q-o-q to Rs. 190 crore. As a result, overall revenue declined by 20.3% q-o-q. Improved product mix helped average realisation (Rs. per tonne) to improve by 12.5% q-o-q to Rs. 1,88,478 per tonne. Exports were driven by overall growth in North America and European markets. Export mix of North America, Europe, and other countries stood at 70:27:3 in Q1FY2022 as against 76:20:4 in Q4FY2021. EBITDA margin for Q1FY2022 expanded by 230 bps q-o-q to 23.1%, led by improved product mix. As a result, EBITDA and PAT declined by 11.5% q-o-q and 31.1% q-o-q to Rs. 95.3 crore and Rs. 24.6 crore, respectively.

Near-term outlook: Near-term outlook remains strong in domestic as well as export markets. Q2FY2022 is likely to see recovery in domestic revenue, led by recovery in CV sales, while exports are expected to remain strong. Exports sales remain unaffected to COVID-19 as RKFL's export destinations in Europe such as The Netherlands, Germany, and Belgium got less impacted as compared to other countries in EU region. Management expects a considerable pick up in CV demand from Q2, followed by the festive season's demand in Q3. The European truck market is continuing to recover, with new registrations expected to rebound by 18% this year, after a 27% plunge in 2020. Supply-side delays following disruptions and shortages will slow the upward trend, but order books suggest the recovery will last into 2022.

Order wins: The company has received PPAP clearance and confirmation to launch Euro 15 million (Rs. 132 crore) from a European OEM. The order is to be implemented over the next three years, starting from July 2021, distributed equally. The company expects incremental revenue to come from FY2023E, as the approval and other processes would take some time. The company has been able to create significant in-roads in the European CV market, strengthening the company's exports order book further. The company has made a significant foray in mining and excavator segments in the domestic market. The company has restarted its sales to South America Markets s (S.A.) as S.A. shows rebound in economy.

Chips shortage: RKFL continues to see robust export order, despite chips shortage globally. The company's clients have continued to maintain their production schedule. Also, the company has exposure to M&HCVs, where chips/semi-conductor usage are low as compared to passenger vehicles.

Price hikes and margins outlook: During Q1FY22, RKFL took price hikes from its clients to mitigate the impact of rise in raw material prices. Exports realisation is expected to improve q-o-q led by price hikes and favourable product mix. As a result, EBITDA margin in Q1FY22 was strong, despite lower volumes.

Capex update: RKFL maintain its capex plan and expect to increase its installed capacity to 1,87,000 MTPA by September 2021. The capacity has been ramped up to 1,77,200 MTPA. The peak annual revenue post the planned capex would ~Rs 2,800 crore, which is about 2.2x of FY2021 revenues. The company has added 7000T press line. With the commissioning of Hollow Spindle Line, 7000T Press Line along with Fabrication facilities for coach shells for LHB coaches till Q1 FY22 and further with commissioning of additional press line of 2000T (warm forging) which will enhance the forging capacity by 9900 Tons in Q2 FY22. With this addition the total capacity of the company will be 1,87,100 tons per annum and will mark an end to the company's current capex cycle. The company is operating at 70-80% capacity utilisation. Management expects capex of Rs. 100 crore in FY2022.

Railways division: RKFL is expected to post substantial growth from railways from FY2023. The quarterly run-rate is expected to remain in-line with Q4FY2021 over the next few quarters, with a drop in revenue in Q1FY2022.

PV business update: RKFL continues to build its capability in the PV segment. The company would be supplying to its existing clients and build a brand in the PV segment and would then focus on PV OEMs across the globe.

Focus on product development and new markets: The company's key focus areas are new product development and higher geographical penetration. RKFL expects export contribution to be 55-60% over the next 3-4 years from 45% in FY2021. The company is open to grow inorganically by acquiring companies that have aligned their product portfolio to its current portfolio.

Results (Standalone) Rs cr

Particulars	Q1FY22	Q1FY21	YoY %	Q4FY21	QoQ %
Revenues	412.9	115.9	256.4	517.9	(20.3)
EBITDA	95.3	(1.5)	NA	107.7	(11.5)
EBITDA margins (%)	23.1	(1.3)	NA	20.8	230 bps
Depreciation	38.8	22.3	73.9	36.7	6.0
Interest	20.3	18.1	11.6	18.3	10.7
Other income	0.8	0.6	28.6	2.2	(63.9)
PBT	37.0	(41.4)	NA	54.9	(32.6)
Tax	12.4	(14.9)	NA	19.3	(35.5)
Adjusted PAT	24.6	(26.5)	NA	35.7	(31.0)
Reported PAT	24.6	(26.5)	NA	35.7	(31.0)
Adjusted EPS	7.7	(8.2)	NA	11.2	(31.0)

Source: Company Data; Sharekhan Research

Outlook and Valuation

■ Sector view - Strong underline demand for CV in India, North America, and Europe

We see a strong underlying CV demand domestically. Lockdowns and restrictions posed by state governments due to the sudden spike in COVID cases in wave-2 have hit footfalls and retail sales. We expect this to be a temporary issue and expect the situation to normalise from Q2FY2022. We expect strong improvement in M&HCV sales to continue, driven by rise in e-commerce, agriculture, infrastructure, and mining activities post normalisation of COVID-19. Global demand for trucks is buoyant, aided by increasing traction in class 8 truck order books. Freight economy continues to enjoy broad-based strength, evident in freight rates that have remained at or near record levels for months. While demand remains stronger for both medium and heavy-duty vehicles, the industry's ability to tackle that backlog has been affected by a series of issues such as chip shortages, steel output, and plastic resin availability. Most global OEMs and auto components suppliers maintain a positive outlook for the CV industry.

■ Company outlook - Beneficiary of strong demand and margin improvement

We expect RKFL to benefit from the CV upcycle across geographies – India, North America, and Europe, led by improved prospects of CV globally. Global OEMs and tier-1 suppliers maintain a positive outlook for the CV segment. RKFL is committed to grow its business profitably and de-risk its business model through diversifying into new geographies, sectors, and widening its product portfolio. Counterparty risks are low due to established business position of RKFL's customers from domestic and export markets, and criticality of the components manufactured. We expect RKFL to be a beneficiary of improving demand. The company's focus on increasing share of value-added and critical components will help improve realisations and EBITDA margin.

■ Valuation - Maintain Buy with a revised PT of Rs.940

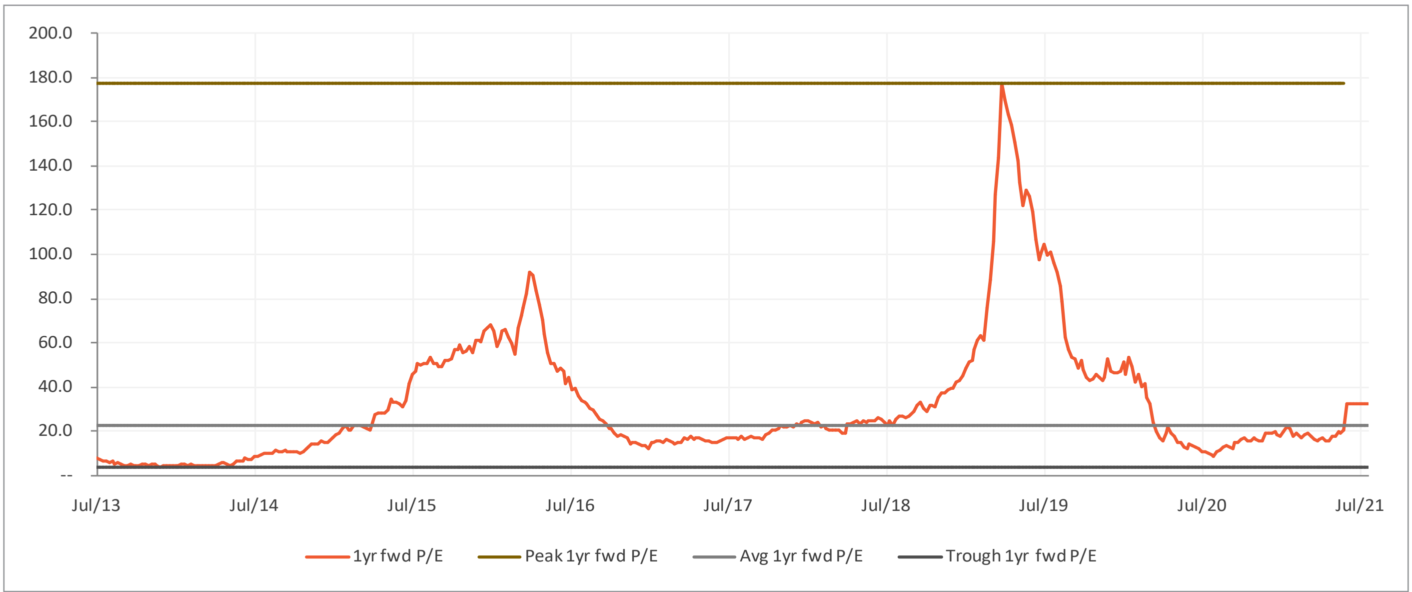
We are expecting CV demand to pick up in India as the economy normalises. The outlook of North America and Europe remains positive. Positive CV demand in India, North America, and Europe is highly beneficial for the company such as RKFL, which has a strong domestic and export revenue mix of 55:45 in niche markets. Moreover, the timing is favourable, as global automakers and tier-1 suppliers are scouting for alternative sourcing hubs outside China. The Indian government is offering various incentives such as PLI scheme, Make-in-India, and Atmanirbhar Bharat Mission, which will provide a strong platform for automobile suppliers such as RKFL. We believe RKFL has a strong global footprint and is serving to leading OEMs, not only in the automotive segment but other sectors as well. We expect RKFL to gain market share internationally, as it has completed its major capex. We have increased our earnings estimates for FY2022E and FY2023E by 10% and 7.7%, respectively, driven by new order wins and margin expansion. The stock is also available below its historical average multiples at P/E of 15.4x and EV/EBITDA of 7.2x on its FY2023E estimates. We reiterate our Buy rating on the stock with a revised PT of Rs. 940.

Price Target Calculation

Particulars	Rs/Share
FY23E EPS	52.9
Target P/E Multiple (x)	17.8
Target Price	940
Upside (%)	15

Source: Company Data; Sharekhan Research

One-year forward P/E (x) band



Source: Company Data; Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBITDA (x)			ROCE (%)		
		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Ramkrishna Forgings Limited	817	93.3	25.5	15.4	13.7	9.3	7.2	4.7	7.5	10.3
Bharat Forge Limited	785	NA	66.8	38.7	43.0	27.7	18.9	4.2	9.0	14.6
GNA Axles	551	16.8	14.8	12.9	9.1	7.8	6.7	15.3	15.6	16.5

Source: Company Data; Sharekhan Research

About company

RKFL, head quartered in Kolkata, is one of the leading forging companies in India catering to requirements of OEMs and tier-1 auto-component suppliers worldwide. RKFL, incorporated in 1981, commenced operations in 1984, primarily as a forging manufacturer for Indian Railways. The company started manufacturing from two facilities located in and around Jamshedpur and another small unit near Kolkata. The company has now scaled up its capacity to ~1,52,500 MTPA. The company has five facilities, of which four are located in Jamshedpur and one in Liluah. RKFL's existing forging facility comprises hammer forge and up-setter forge with a total capacity of 46,000 MTPA and a ring-rolling unit with a capacity of 24,000 MTPA. In addition, the company has four press lines having a cumulative capacity of ~80,000 MTPA. The company is running a capacity expansion programme, which would further increase cumulative installed capacity to 1,87,000 MTPA by September 2021. The company has a marquee global customer base of 17 OEMs, including Tata Motors, Ashok Leyland, VE Commercials, and tier-I companies.

Investment theme

RKFL is a proxy play for CV upcycle in India and internationally. We are expecting the CV upcycle in India to coincide with that of North America and Europe. This point of conjunction would be highly beneficial for the company such as RKFL, which has a strong domestic and export revenue mix of 55:45, operating in niche markets. Moreover, the timing becomes impeccable, as global auto makers and tier-1 suppliers are scouting for alternative sourcing hubs outside China. The Indian government is offering various incentives such as PLI scheme and Make-in-India and Atmanirbhar Bharat Mission, which will provide a strong platform for automobile suppliers such as RKFL. We believe RKFL has a strong credential global footprint and is serving to leading OEMs, not only in the automotive segment but also other sectors. We expect RKFL to gain market share internationally, as it has completed its major capex.

Key Risks

- RKFL is exposed to the cyclicality inherent in CV and steel industries. Moreover, geographically diversified business poses forex fluctuation risks. RKFL is well hedged to cover forex movement in any direction from -5% to +5%.
- RKFL's export sales are highly working capital intensive because of the large receivable cycle particularly for export sales.

Additional Data

Key management personnel

Ms. Anjali Singh	Executive Chairperson
Mr. Manoj Kolhatkar	Managing Director
Mr. Jagdish Kumar	Group President & Group CFO
Mr. Rishi Luharuka	Chief Financial Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Riddhi Portfolio	23.5
2	Eastern Credit Capital	13.5
3	Aditya Birla Sun Life	5.7
4	Ramkrishna Rail And Infrastructure Private Limited	4.1
5	Massachusetts Institute Of Technology	3.8
6	Pacific Horizon Investment	3.3
7	Lata Bhanshali	3.3
8	Akash Bhanshali	2.5
9	International Finance Corporation	2.4
10	Blue Daimond Properties Pvt Ltd	2.3

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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