Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Ramkrishna Forgings Ltd

Sustainable growth prospects

Auto Ancillary	Sharekhan code: RKFORGE

Reco/View: Buy	↔	CMP: Rs. 266	Price Target: Rs. 329	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

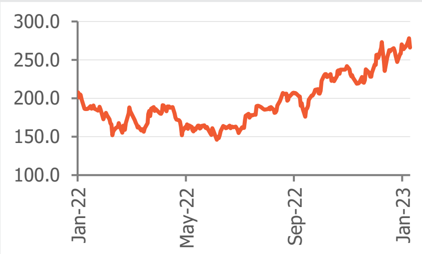
Company details

Market cap:	Rs. 4,253 cr
52-week high/low:	Rs. 285/ 145
NSE volume: (No of shares)	7.78 lakh
BSE code:	532527
NSE code:	RKFORGE
Free float: (No of shares)	8.6 cr

Shareholding (%)

Promoters	46.3
FII	13.6
DII	3.3
Others	36.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.1	16.7	71.8	27.9
Relative to Sensex	2.8	14.3	58.3	29.0

Sharekhan Research, Bloomberg

Summary

- Post registering stable gross margin on q-o-q basis the management has guided to sustain EBIDTA margin at 22% levels led by improvement in product mix and 15-20% growth in exports in FY24E.
- Scheduled capex of Rs 400-450 cr over FY23E&24E to achieve a revenue potential of Rs 5,000 cr on peak capacity utilization
- We maintain our Buy rating on Ramakrishna Forgings Limited (RKFL) with a revised PT of Rs.329, led by strong revenue growth, improving margin profile, and attractive valuations.
- The stock trades at attractive valuations of 9.7x P/E multiple and 5.3x EV/EBITDA multiple on FY2025E, respectively.

RK Forgings reported 24.1% y-o-y growth in revenue, led by 13.1% y-o-y growth in volumes and 9.6% y-o-y growth in ASPs. The company performed better in the export market compared to the domestic market. While export revenue grew by 25.6% y-o-y, domestic revenue grew by 22.3% y-o-y. Despite a 5% q-o-q decline in ASPS, the gross margin remains stable on q-o-q basis - led by a better product mix. During the quarter export revenue mix has improved to 43.4% compared to 42.1% in Q2FY23. With stable gross margin on a q-o-q basis the EBIDTA margin contracted by mere 20 bps q-o-q to 22.1. During the quarter, the forex gain stood at Rs 11 cr. Further, the management has guided to sustain the EBIDTA margin at around 22%. RKFL observes healthy demand across the geographies and looking for a 15-20% growth in exports in FY24E led by new client addition, new product launches and entry into new geographies. RKFL has scheduled a capex of Rs 400-450 cr over FY23E&24E. The company has announced an additional capacity expansion of 30% (~56,000 MT) to take its total installed capacity to 2,43,100 MT by Q2FY2024E to cater to demand from its new clients and business verticals. The management has guided for a revenue potential of Rs 5,000 cr at peak capacity utilization of new capacities as the company is investing in manufacturing new generation products. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 329.

Key positives

- In Q3FY23 the Export volume grew faster than domestic volumes, given that export volumes grew by 8% q-o-q (vs 2% growth in domestic volumes) and contributed 37.6% to the total volumes (v/s 36.2% in Q2FY23).
- Despite passing on RM cost reduction benefit in export markets (reflected in 5% q-o-q decline in blended ASPs), the gross margin stood flat (at 51.7%) on a q-o-q basis.
- RKFL received new contracts of Rs. 366 crores from 3 contracts during Q3FY2023 from various geographies and business verticals. Out of the three contracts, one contract pertains to EV project.
- This was the consecutive 4th quarter when RKFL reported EBIDTA margin above 22%. Further, the management has guided to sustain the EBIDTA margin at around 22% level.

Key negatives

- Blended ASPs declined by 5.0% q-o-q and effective tax rate stood at 35%. The management has guided that the effective tax rate would remain at 32% in Fy23.

Management Commentary

- Management remains positive on new order inflows and expects to maintain the growth momentum.
- RKFL is looking for a 15-20% export growth in FY24 led by new client addition, entry into new geographies and new product launches.
- The company expects to sustain its EBITDA margin at current levels of 22%, led by an increased share of value-added products and moving towards machining and assembling, which are high-margin businesses.
- Management is positive on its foray into new segments such as oil and gas, electric vehicles, and railways to drive growth going forward.
- With commissioning on new capacities (~56,000 MT), the peak revenue potential would reach to Rs 5,000 cr

Revision in estimates – We have increased our revenue estimates by 5-6% for FY24E and FY25E to consider benefit of capex program and execution of the orderbook. We have gradually improved EBITDA margins above 22%, driven by product mix and operating leverage. Given the capex program, we have increased depreciation and interest charges.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 329: RKFL has scheduled a capex of Rs 400-450 cr over FY23E &FY24E and guided for a potential revenue of Rs 5,000 cr on peak capacity utilization and aiming to sustain EBITDA margin at 22%. Along with RKFL is endeavouring to increase the non-auto revenue mix to 30% (currently 19%) and 3-3.5% (currently 2%) revenue contribution from EV segment. The management is optimistic on its export business and guided for a 15-20% growth in export revenue in FY24. With robust plans for organic growth driven by healthy response from export markets, RKFL has been strategically building up inorganic growth prospects. RKFL has acquired 51% stake in TSUYO to expand its EV product portfolio and its bid has been accepted to turn around JMT Auto. We expect RKFL to gain market share internationally, given its ability to provide an attractive value proposition to its customers. The stock is available at attractive valuation multiples of P/E of 9.7x and EV/EBITDA of 5.3x on its FY2025E. We reiterate our Buy rating on the stock with a revised price target (PT) of Rs. 329.

Key Risks

RKFL is exposed to the cyclicality inherent in the CV and steel industries. Moreover, geographically diversified businesses pose forex fluctuation risks. RKFL is well hedged to cover forex movement in any direction from -5% to +5%. If the chip shortage situation further aggravates, this may impact our estimates adversely.

Valuation (Consolidated)

Rs cr

Particulars	FY2021	FY2022	FY2023E	FY2024E	FY2025E
Revenues	1,288	2,281	2,939	3,468	4,051
Growth (%)	15.9	77.1	28.8	18.0	16.8
EBIDTA	230	526	649	776	910
OPM (%)	17.8	23.0	22.1	22.4	22.5
Net Profit	28	207	239	329	438
Growth (%)	190.3	638.7	15.7	37.8	32.9
EPS	1.8	12.9	15.0	20.6	27.4
P/E	151.9	20.6	17.8	12.9	9.7
P/BV	4.8	3.9	3.3	2.7	2.1
EV/EBIDTA	20.8	9.1	7.4	6.2	5.3
ROE (%)	3.2	21.0	20.2	23.0	24.6
ROCE (%)	4.7	13.2	13.1	15.0	17.1

Source: Company; Sharekhan estimates

Key highlights of the Q3FY2023 conference call

- **Optimistic on domestic CV segment:** The management is optimistic about the growth prospects of the domestic CV segment and assumes that the CV segment will continue to maintain its growth trajectory in the near term.
- **New order won:** The company has received 3 new orders of cumulatively worth of Rs 366 cr. Out of these three new orders one pertains to the EV project.
- **Exports to grow by 15-20 % in FY24:** The management assumes that it will maintain its export growth in the North American market and is confident about better growth prospects in the European market. Backed by new orders, new customers and new geographies, the management has guided for a 15-20% growth in exports in FY24E.
- **Scheduled Rs 400 -450 cr Capex:** With new orders in hand and to improve content per vehicle RKFL has scheduled a capex of Rs 400-450 cr over FY23E and FY24E. It has earmarked Rs 250 cr for capex in FY23E and Rs 150-200 cr for capex in FY24E.
- **New capacities to drive the profitability further:** The management is targeting to add additional capacity of 56kMT by the end of Q2FY2024. With this new capacity the total capacity would reach at 241k MT, and its revenue potential would reach to Rs 5,000 cr on peak capacity utilization compared to its reported revenue of Rs 2,281 cr in FY2022. The management has guided that the new capacities would deliver better EBIDTA margins due to the addition of next-generation cold and hot forging contents for export markets.
- **EV opportunity:** RKFL is continuing to look to expand its EV portfolio and targeting for a 3- 3.5% revenue contribution from the EV segment in the medium term. Currently EV segment is contributing ~2% to its standalone topline. The company has acquired 51% stake in TSUYO and likely to infuse Rs 80 cr in acquired business over the period.
- **JMT auto - new avenue of growth:** NCLT has approved the RKFL's bidding for turnaround of JMT auto at a cost of Rs 125 cr. Out of Rs 125 cr, RKFL would have to pay Rs 70 cr upfront and rest of the amount in next 4 years. Though the acquisition timeline is still uncertain the management has guided for an investment of Rs 70 cr in JMT and looking for a peak revenue potential of Rs 450-500 cr in JMT's business compared to JMT's peak revenue of Rs 370 cr.

Other highlights:

- Railway segment is expected to do well in Q4FY23.
- The company has partially passed on the benefit of correction in RM cost to the customers in export market.
- Current debt stood at Rs 1,286 cr and is likely to reduce debt further by Rs 50 cr in Q4FY23.
- The company is aspiring for an auto; non-auto revenue mix of 70;30 compared to the current mix of 81:19.
- The effective tax rate in FY2023 would be 32%

Q3FY2023 results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Revenues	752.3	606.1	24.1	762.5	(1.3)
Total operating expenses	586.0	465.8	25.8	592.5	(1.1)
EBITDA	166.3	140.2	18.6	170.1	(2.2)
Depreciation	48.9	45.1	8.5	49.6	(1.4)
Interest	29.6	26.3	12.7	27.8	6.4
Other income	0.8	1.7	(51.8)	0.6	36.0
PBT	88.6	70.5	25.6	93.2	(5.0)
Tax	31.0	25.4	21.9	29.3	5.9
Reported PAT	57.6	45.1	27.6	63.9	(9.9)
Adjusted PAT	57.6	45.1	27.6	63.9	(9.9)
Adjusted EPS	3.6	2.8	27.6	4.0	(9.9)

Source: Company; Sharekhan Research

Key Ratios (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Gross margin (%)	51.7	53.8	(210)	51.7	(10)
EBIDTA margin (%)	22.1	23.1	(100)	22.3	(20)
EBIT margin (%)	15.6	15.7	(10)	15.8	(20)
Net profit margin (%)	7.7	7.4	20	8.4	(70)
Effective tax rate (%)	35.0	36.0	(100)	31.4	360

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Strong underline demand for CV in India and North America, While Europe is expected to recover

We see strong underlying demand for CV domestically. 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, though order book in the few months was impacted, led by chips shortage issue. While demand remains stronger for both medium-duty and heavy-duty vehicles, the industry's ability to tackle that backlog has been affected by a series of issues such as chip shortage, steel output, and plastic resin availability. Most of the global OEMs and auto component suppliers maintain a positive outlook for the CV industry.

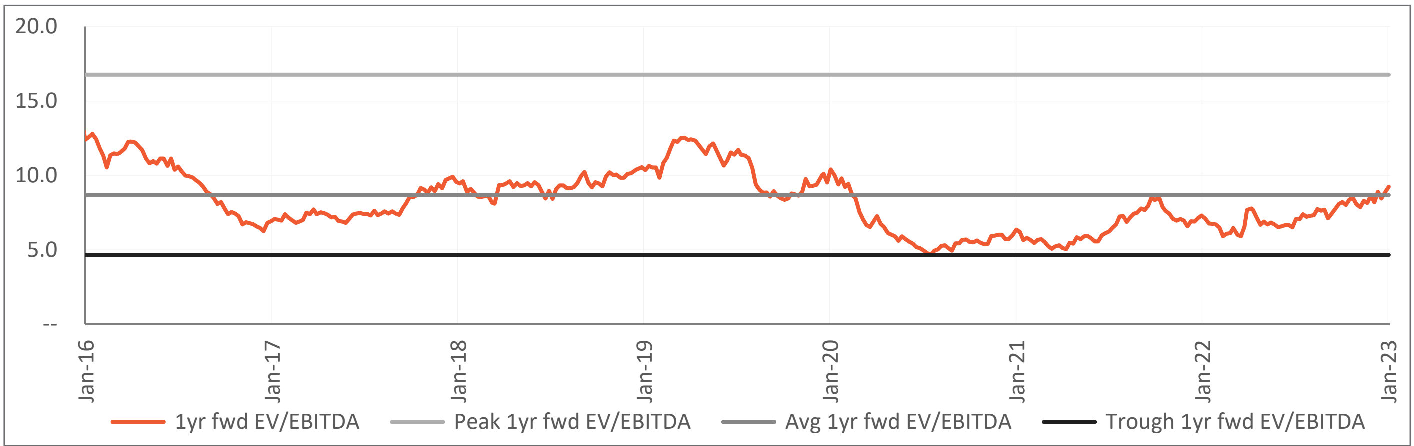
■ Company Outlook – Beneficiary of strong demand and margin improvement

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

■ Valuation – Maintain Buy with a revised PT of Rs. 329

RKFL has scheduled a capex of Rs 400-450 cr over FY23E&FY24E and guided for a potential revenue of Rs 5,000 cr on peak capacity utilization and aiming to sustain EBIDTA margin at 22%. Along with RKFL is endeavouring to increase non-auto revenue mix to 30% (currently 19%) and 3-3.5% (currently 2%) revenue contribution from EV segment. The management is optimistic on its export business and guided for a 15-20% growth in export revenue in FY24. With robust plans for organic growth driven by healthy response from export markets, RKFL has been strategically building up inorganic growth prospects. RKFL has acquired 51% stake in TSUYO to expand its EV product portfolio and its bid has been accepted to turnaround JMT Auto. We expect RKFL to gain market share internationally, given its ability to provide an attractive value proposition to its customers. The stock is available at attractive valuation multiples of P/E of 9.7x and EV/EBITDA of 5.3x on its FY2025E. We reiterate our Buy rating on the stock with a revised price target (PT) of Rs. 329.

One-year forward EV/EBITDA (x) band



Source: Company, Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	Rs/Share	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Ramkrishna Forgings Limited	266	20.6	17.8	12.9	9.1	7.4	6.2	13.2	13.1	15.0
Bharat Forge Limited	861	37.2	46.6	26.6	22.4	23.7	16.2	9.0	6.8	11.5
GNA Axles	705	17.1	12.8	10.6	9.2	7.3	6.0	17.4	20.3	21.0

Source: Company, Sharekhan estimates

About company

RKFL, headquartered 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 the 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 ~1,87,100 MTPA. The company has five facilities, of which four are located in Jamshedpur and one in Liluah. RKFL's existing forging facility comprises a 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 has a marquee global customer base of 17 OEMs, including Tata Motors, Ashok Leyland, VE Commercials, and Tier-1 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 in North America and Europe. This point of conjunction would be highly beneficial for a 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 automakers and Tier-1 suppliers are scouting for alternative sourcing hubs outside China. The Indian government is offering various incentives such as the 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 credential global footprint and is serving leading OEMs, not only in the automotive segment but also in 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 businesses pose 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

Mahabir Prasad Jalan	Chairman
Naresh Jalan	Managing Director & CEO
L K Khetan	Chief Financial Officer
Rajesh Mundhra	Company Affairs

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Riddhi Portfolio	23.7
2	Eastern Credit Capital	13.5
3	Ramkrishna Rail And Infrastructure Private Limited	4.1
4	Massachusetts Institute Of Technology	3.8
5	Aditya Birla Sun Life	2.9
6	Old bridge capital Mgmt	2.6
7	Bhansali Akash	2.5
8	Blue Daimond Properties Pvt Ltd	2.4
9	Baillie Gifford & co	2.4
10	Pacific Horizon Investment	2.4

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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