Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Ramkrishna Forgings Ltd

Inline performance, sanguine guidance

Auto Ancillary	Sharekhan code: RKFORGE
Reco/View: **Buy** ↔	CMP: **Rs. 325** / Price Target: **Rs. 406** ↑

↑ 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		↔	

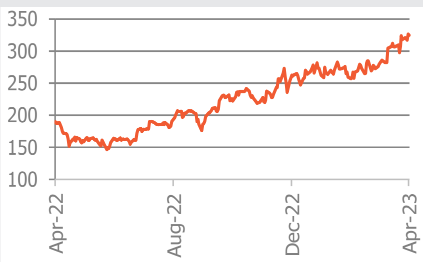
Company details

Market cap:	Rs. 5,196 cr
52-week high/low:	Rs. 331/ 145
NSE volume: (No of shares)	6.7 lakh
BSE code:	532527
NSE code:	RKFORGE
Free float: (No of shares)	8.4 cr

Shareholding (%) (March, 2023)

Promoters	47.4
FII	14.8
DII	4.8
Others	33.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	17.7	22.1	40.4	70.2
Relative to Sensex	12.2	21.3	36.8	63.4

Sharekhan Research, Bloomberg

Summary

- We maintain a Buy rating on Ramakrishna Forgings Limited (RKFL) with a revised PT of Rs. 406, led by a 17% EBITDA CAGR, expectation of fall in debt, successful commissioning of new capacities and execution of its strong order book.
- With in-line delivery, the management reiterated a 15-20% volume growth guidance for FY24E and hopes to sustain high margins.
- The Railways project, which would begin from FY27E onwards, will offer a sustainable diversification opportunity.
- Stock trades at attractive valuations of 11.9x P/E multiple and 6.6x EV/EBITDA multiple on FY2025E, respectively.

Ramkrishna Forgings' (RKFL) Q4FY23 operating performance was in line with estimates. While revenue and EBITDA were 6.4% and 5.5% above estimates, respectively, reported PAT came in line with estimates. As a result of higher-than-expected topline performance, EBITDA margin came in close to our estimates. Though gross margins were dull, EBITDA margin expanded by 40 bps q-o-q to 22.5% on account operating leverage and saving on freight cost. RKFL has reported 16% q-o-q growth in PAT at Rs 67 crore- in line with our expectations. After an in-line operating performance, the management has maintained its guidance of 15-20% tonnage growth in FY24E on the back of its strong order book and addition of 56,000 MT capacity in H1FY24E. With this new capacity addition, the total capacity would reach to 243,100 MT in H1FY24E. The management is aiming to sustain EBITDA margin at higher levels and looking for standalone debt to come down in coming years. The Railway project in consortium is expected to commence operation by Q4FY26 and the deliveries are expected to begin from FY27E. We maintain a Buy on the stock with upside revised target price of Rs 406.

Key positives

- Despite a challenging environment, the volumes increased by 15.6% q-o-q on the back of 18.1% q-o-q and 11.4% q-o-q jump in domestic and export volumes respectively.
- EBITDA margin expanded by 40 bps q-o-q to 22.5% on the back of operating leverage and correction in freight rates.
- This was the fifth consecutive quarter when the EBITDA margin came above 22% and the management has guided us to sustain EBITDA margin at higher levels.

Key negatives

- In Q4FY23, gross margins contracted by 180 bps q- o-q to 49.8% on account of weak product mix as management continuously reiterated that most of its contracts are backed by raw material cost pass-through clause.
- Blended ASPs were down by 4.4% q-o-q on account of 8.2% q-o-q decline in ASPs in export market and 0.9% q-o-q decline in ASPs in the domestic market.
- Effective tax rate stood at 34.7% due to deferred tax charges. The management has guided for a tax rate of 25% from FY24E onwards.

Management Commentary

- Despite a challenging business environment, the management has shared optimistic outlook for FY24E backed by strong order book and addition of new capacity in H2FY24E.
- The Railways business in consortium would begin deliveries from FY27E and offers a long-term sustainable business opportunity.
- The management has reiterated its guidance of 15-20% volume growth in FY24E and aims to sustain EBITDA margin at higher levels.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 406: After reporting in-line performance the management has guided for a strong performance in FY24 backed by a strong order book and commissioning of new capacities by the end of H1FY24E. The management reiterated its guidance of 15-20% volume growth in FY24E and targets to sustain EBITDA margins at higher levels. While US class 8 truck order trend has been volatile, the management has indicated that larger part of order slots has been booked and it has been catering to multiple platforms of global CV segment. Further it has been receiving new orders and adding customers to mitigate customer-related risks. In a consortium, it has won a large order to supply wheels to Railway segment, which would begin from FY27E onwards. The successful Railways project would offer healthy opportunity for a sustainable revenue and diversification in our view. We maintain a Buy rating on the stock with an upward revised price target of Rs. 406 (8xFY25E EV/EBITDA) on factoring 17% EBITDA CAGR, 36% PAT CAGR over FY23-25E backed by its strong order book visibility and addition of new capacities. The stock trades at a P/E multiple of 11.9x and EV/EBITDA multiple of 6.6xits FY25E estimates.

Key Risks

RKFL is exposed to the cyclicality inherent in the CV and steel industries. Moreover, geographically diversified businesses pose geopolitical risks.

Valuation (Standalone) Rs cr

Particulars	FY2021	FY2022	FY2023P	FY2024E	FY2025E
Revenues	1,288	2,285	3,001	3,511	4,096
Growth (%)		77.4	31.3	17.0	16.7
EBIDTA	230	527	668	786	920
OPM (%)	17.8	23.1	22.3	22.4	22.5
Net Profit	28	207	236	349	438
Growth (%)		638.3	14.1	48.1	25.6
EPS	1.7	12.9	14.7	21.8	27.4
P/E	185.8	25.2	22.1	14.9	11.9
P/BV	5.8	4.7	3.9	3.2	2.5
EV/EBIDTA	27.1	12.7	9.5	7.9	6.6
ROE (%)	3.2	20.8	19.5	23.5	23.8
ROCE (%)	4.3	11.9	11.9	15.9	17.6

Source: Company; Sharekhan estimates

Key highlights of the Q4FY2023 conference call

Q4FY23 performance: in line with expectations

- Revenues increased by 11% q-o-q to Rs 835 cr (vs estimate of Rs 785 cr) on account of 15.6% q-o-q increase in volumes and 4.4% q-o-q decline in ASPs. During the quarter the domestic business grew faster than export business.
- While domestic volumes increased by 18.1% q-o-q , the domestic volumes increased by 11.4% q-o-q.
- Despite strong revenue performance the gross margin contracted by 180 bps q-o-q due to weak product mix. However, EBITDA margin expanded by 40 bps q-o-q to 22.5% on account of operating leverage and correction in freight cost, given other expenses as % of sales contracted by 260 bps q-o-q.
- The EBITDA margins are least impacted due to change in steel prices lead by pass through clauses.
- With this, operating performance the PAT increased by 16% q-o-q to Rs 67 cr, in line with our estimate.

Railway business in JV: Likely to begin delivery from FY27E

- RKFL would have a 51% stake in the JV and would invest Rs 180 cr as equity participation over next three years. The JV has received an order from Railway to supply 80,000 units wheels per year for 20 years.
- The JV would set up a greenfield plant by Q4FY26 and the supply is expected to begin from FY27. The JV would incur a capex of Rs~ 1200 crore. Breakeven volumes are expected to be at 40,000 units.
- While the Railway would have a requirement of 80,000 units/ annum the JV plant is assuming to set up a plant with capacity of 200,000 units/ annum and looking to sell excess capacity to private players in domestic as well as the global market.
- The company is expecting that the JV would have business potential of around Rs 25,000 cr to Rs 28,000 cr over 20 years. While detailed project cost and operations are yet to be worked the company is looking for a margins from the JV to be similar to that its standalone EBITDA margins.

Warm forging segment likely to deliver higher margins

- The company has already started supplying warm forged products to the domestic as well as in export markets for CV segment. Further RKF L is looking to cater to light vehicle market also. The warm forging business is at a nascent stage and RKFL is looking for a strong growth in next 2 years in the segment.
- RKFL is looking for a 100- 150 bps more EBITDA margin in warm forging business from traditional forging business in next six months.

New orders

- The company has renewed its long-term contract with an existing customer in North America. The new contract also includes some new additional products.
- During the year RKFL has won an order of worth over Rs. 700 crore, largely constituted by new customers.

Acquisition of GMT and ACIL:

- Acquisition of GMT and ACIL would be dependent on the completion of legal processes.
- RKFL assumes a capex of Rs 200 crore would be needed for a modernization of the GMT's and ACL's plants.

Others

- RKFL has been supplying to many kind of CVs in USA and not too much dependent on order book trend in US class 8 truck orders.
- RKFL is aiming to cater to electric PV segment in domestic market.
- To save energy cost the company is setting up a inhouse solar power project with an investment of Rs 35 crore.

Outlook: Optimism continues

- The global CV market is strong and has been offering strong growth opportunity to RKFL. The management continue to maintain its guidance of 15%-20% tonnage growth inFY24E.
- Backed by a strong order book , the management is looking for strong growth in its performance in FY24E.
- Standalone business' debt would continue to decline from current levels due to healthy cash flow generation. The standalone debt is expected to come down by Rs 150 cr to Rs 200 cr per annum in coming years.
- Effective tax rate would be 25% in FY24E.
- New capacity of 20,000 MT would be added from Q1FY24E and and total 56,000 MT would be added in H1FY24E.
- The management aims to sustain EBIDTA margin at current levels.

Change in estimates

	New		Earlier		% change	
Particulars	**FY24E**	**FY25E**	**FY24E**	**FY25E**	**FY24E**	**FY25E**
Revenue	3,511	4,096	3,468	4,051	1.2	1.1
EBITDA	786	920	776	910	1.2	1.1
EBITDA margin (%)	22.4	22.5	22.4	22.5		
PAT	329	438	329	438	-	-
EPS	21.8	27.4	20.6	27.4	5.8	(0.0)

Source: Company; Sharekhan Research

Q4FY2023 results (Standalone) — Rs cr

Particulars	Q4FY23	Q4FY22	YoY%	Q3FY23	QoQ%
Revenues	835	683	22.3	752	11.0
Total operating expenses	647	532	21.6	586	10.4
EBITDA	188	151	24.6	166	13.2
Depreciation	56	46	22.1	49	13.8
Interest	32	26	21.5	30	7.6
Other income	2	-	-	1	110.8
PBT	102	79	29.2	89	15.5
Tax	35	(7)	-	31	14.6
Reported PAT	67	87	(22.9)	58	16.0
Adjusted PAT	67	87	(22.9)	58	16.0
Adjusted EPS	4.2	5.4	(22.9)	3.6	16.0

Source: Company; Sharekhan Research

Key Ratios (Standalone) — Rs cr

Particulars	Q4FY23	Q4FY22	YoY (bps)	Q3FY23	QoQ (bps)
Gross margin (%)	49.8	51.6	-180	51.7	-180
EBIDTA margin (%)	22.5	22.1	40	22.1	40
Net profit margin (%)	8.0	12.7	-470	7.7	30
Effective tax rate (%)	34.7	(9.4)	4,410	35.0	-30

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – CV industry is on path of cyclical recovery

We see strong underlying demand for CVs domestically. We expect strong improvement in M&HCV sales to continue, driven by rise in e-commerce, agriculture, infrastructure, and mining activities. 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 a 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 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. 406:

After reporting in-line performance the management has guided for a strong performance in FY24E backed by strong order book and commissioning of new capacities by the end of H1FY24E. The management reiterated its guidance of 15-20% volume growth in FY24E and targets to sustain EBITDA margin at higher levels. While US class 8 truck order trend has been volatile, the management has indicated that larger part of order slots has been booked and it has been catering to multiple platforms of global CV segment. Further, it has been receiving new orders and adding customers to mitigate customer related risks. In a consortium it has won a large order to supply wheels to Railway segment, which would begin from FY27E onwards. The successful Railway project would offer healthy opportunity for a sustainable revenue and diversification in our view. We expect EBITDA and PAT to growth with 17% CAGR and 36% CAGR over FY23-25E. We maintain a Buy rating on the stock with upward revised target price of Rs 406 (8xFY25EV/ EBITDA). The stock trades at P/E multiple of 11.9x and EV/EBITDA multiple of 6.6xits FY25 estimates.

One-year forward EV/EBITDA (x) band

Source: 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	325	25.1	21.7	15.8	10.9	8.8	7.4	13.2	13.1	15.0
GNA Axles	825	20.0	13.9	12.1	10.7	8.2	7.0	12.8	15.8	15.5

Source: Company Data; Sharekhan Research

About the 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 generates 79% of its revenue from Auto segment and 21% of its revenue from non-auto segment. Further its revenue is well diversified on geography wise as Europe, North America and Asia accounts for 15%, 25% and 60% of its revenue respectively (in FY23).

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, 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's export sales are highly working capital intensive because of the large receivable cycle, particularly for export sales.
- If the chips shortage situation further aggravates, this may impact our estimates adversely.

Additional Data

Key management personnel

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

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Riddhi Portfolio Pvt Ltd	23.7
2	Eastern Credit Capital Pvt Ltd	13.5
3	Ramkrishna Rail & Infra Pvt Ltd	4.1
4	Massachusetts Institute of Technology	3.8
5	Bhanshali Lata	3.3
6	Aditya Birla Sun Life Asset Management Co Ltd	2.9
7	Bhanshali Akash	2.5
8	Old Bridge Capital MGMT Pvt Ltd	2.5
9	Blue Daimond Properties Pvt Ltd	2.4
10	Baillie Gifford & Co	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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