MM Forgings

Forging the future

MM Forgings (MMFL) is one of the largest exporters of forgings from India with a capacity of 40,000MT (exports contributed ~70.0% to the revenue in FY2013). It is engaged in the manufacturing of steel forgings, catering to the forging requirements of almost all sections of industry including Automotive, Valve and Oil-field, Engineering and Off Highway segments, with a focus on commercial vehicle (CV) industry which contributed ~76.0% to the total revenue in FY2013. The company is now focusing on improving its operational efficiencies and increasing capacity utilization, providing the company an immense potential to grow.

Sufficient capacity to cater to improving demand across the globe
The company has a capacity of 40,000MT (last reported in FY2011). It is now focusing on optimum capacity utilisation to take advantage of the production capacities that it has created. The company mainly caters to the global market with a focus on the commercial vehicle industry and export focus on America and Europe. After the recession, the American economy is now seeing an upturn, and thus we are witnessing a growth in CV sales as well. In addition, the production in domestic CV industry grew by a CAGR of 22% over FY2008-12 and is expected to grow as a CAGR of 11% over FY2012-21E to 23.5lakh units. We expect this to provide enormous opportunities to the company.

Rupee depreciation against US$ to boost company's growth
The contribution of exports to the company's revenue has increased from 57.4% in FY2008 to 70.3% in FY2013. Given that USA and Europe are the major markets to which the company exports, the depreciating rupee against the US$ and Euro is a positive for the company. In addition, the Chinese currency, Yuan, has appreciated by 2.7% against the US$ in the past one year, while the INR has depreciated by 12.4% in the same period against the US$. This is providing the Indian players an added competitive advantage in the export markets.

Outlook and valuation: We expect MMFL to register a revenue CAGR of 13.9% over FY2013-16E to ₹534cr with an operating margin of 18.1% in FY2016E. The profit is expected to grow at a CAGR of 17.4% over the same period to ₹40cr in FY2016E. At the CMP, the company is trading at a PE of 3.0x FY2016E earnings. **On account of positive growth outlook and low valuation, we initiate coverage on the company with a Buy recommendation with a target price of ₹131 on a target PE of 4.0x FY2016E earnings.**

Key financials

Y/E March (₹ cr)	FY2012	FY2013	FY2014E	FY2015E	FY2016E
Net Sales	350	361	412	469	534
% chg	*28.7*	*3.1*	*14.1*	*13.9*	*13.9*
Adj. Net Profit	21	24	28	32	40
% chg	*(4.1)*	*14.7*	*13.0*	*16.9*	*22.4*
OPM (%)	17.3	16.0	18.1	18.1	18.1
EPS (₹)	17.7	20.3	22.9	26.8	32.8
P/E (x)	5.5	4.8	4.3	3.7	3.0
P/BV (x)	0.8	0.7	0.6	0.5	0.5
RoE (%)	15.2	15.1	15.1	15.8	17.1
RoCE (%)	14.2	12.7	13.3	15.0	16.6
EV/Sales (x)	0.7	0.6	0.6	0.5	0.4
EV/EBITDA (x)	4.1	4.0	3.0	2.6	2.3

Source: Company, Angel Research, Note: CMP as of March 14, 2014

BUY

CMP	₹98
Target Price	₹131
Investment Period	12 months

Stock Info	
Sector	Others
Market Cap (₹ cr)	118
Net debt (₹ cr)	115
Beta	0.8
52 Week High / Low	114/ 60
Avg. Daily Volume	3,754
Face Value (₹)	10
BSE Sensex	21,810
Nifty	6,504
Reuters Code	MMFO.BO
Bloomberg Code	MMFG IN

Shareholding Pattern (%)	
Promoters	59.5
MF / Banks / Indian FIs	14.3
FII / NRIs / OCBs	0.4
Indian Public / Others	25.9

Abs.(%)	3m	1yr	3yr
Sensex	5.6	11.4	18.3
MMFL	13.1	28.6	(8.8)

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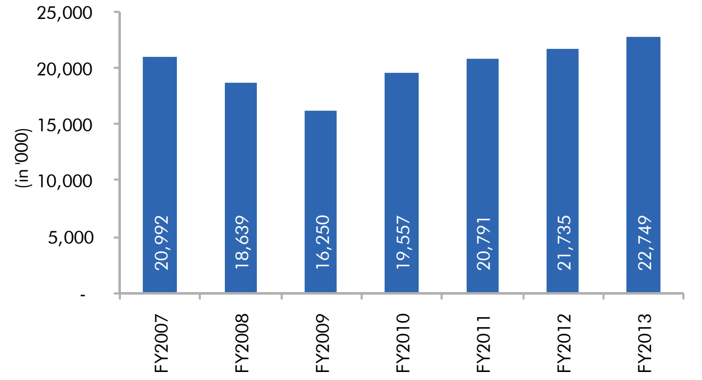
Investment arguments

Sufficient capacity to cater to improving demand across the globe

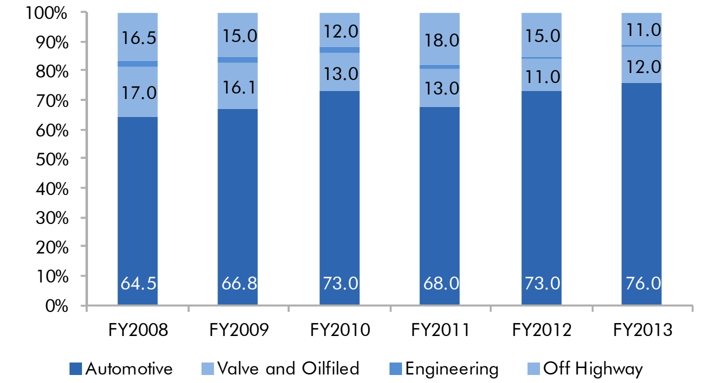
The company has a capacity of 40,000MT (last reported in FY2011). It is now focusing on optimum capacity utilisation to take advantage of the production capacities created by it. The company mainly caters to the global market with a focus on the CV industry.

Exhibit 1: Global CV sales



Source: OICA, Angel Research

Exhibit 2: Automotive segment's contribution increases in net sales

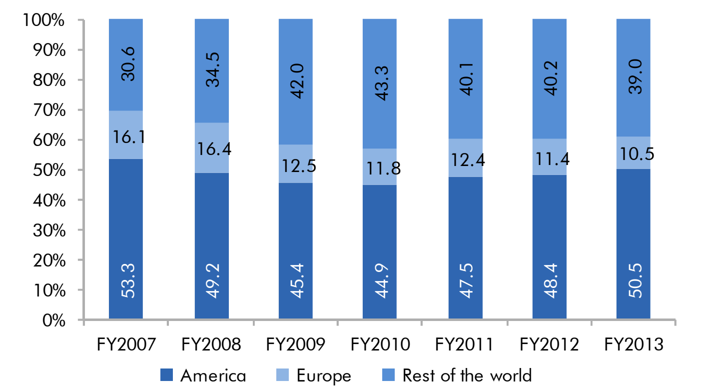


Source: OICA, Angel Research

The CV industry contributed 76.0% to the company's sales in FY2013. We expect the demand to improve going forward as the economy recovers. The company majorly exports to America and Europe. The American economy is now seeing an upturn, and thus we are witnessing a growth in CV sales as well. In FY2013, the CV sales grew by 9.0%. However, the scenario in Europe is still gloomy. The CV sales in Europe are still sluggish; however, UK, one of the major markets has shown some respite in the month of January and grew by 5.4% yoy.

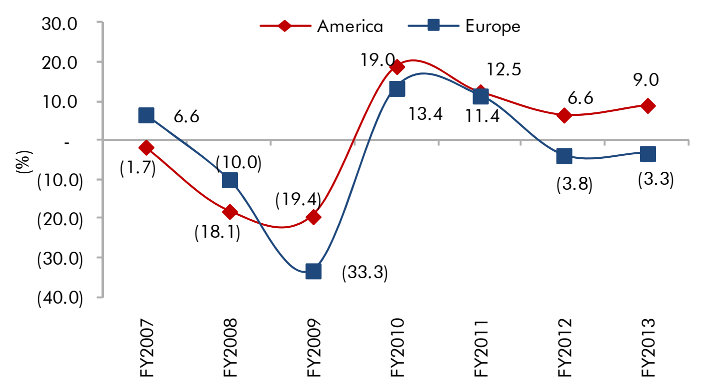
According to *Automotive Component Manufacturers Association* (ACMA), the production in domestic CV industry grew at a CAGR of 22% over FY2008-12 and is expected to grow at a CAGR of 11% over FY2012-21E to 23.5lakh units. We believe these factors provide MMFL a strong growth opportunity.

Exhibit 3: Geographical contribution in CV sales



Source: Company, Angel Research

Exhibit 4: CV sales pattern in America and Europe

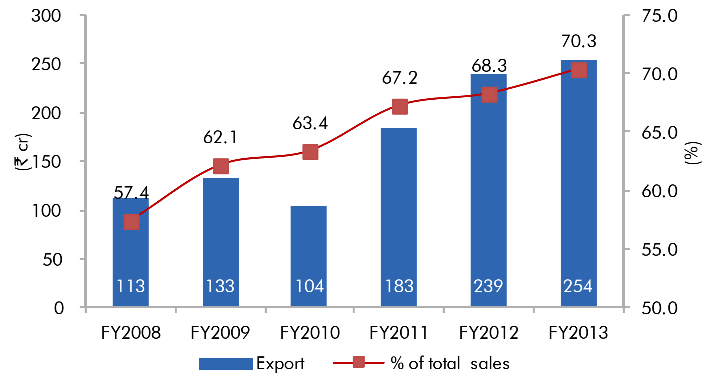


Source: Company, Angel Research

Rupee depreciation against US$ to boost company's growth

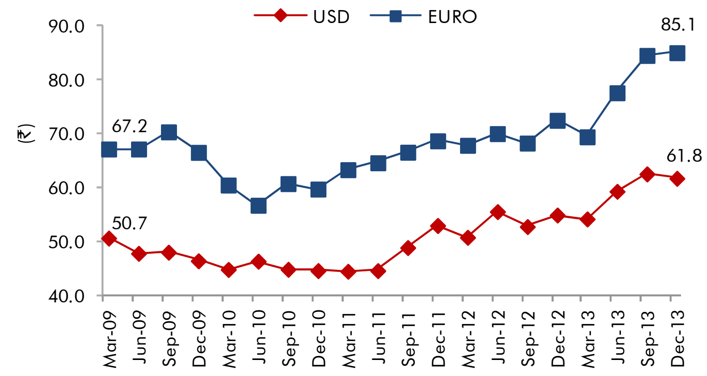
The contribution of exports to the company's revenue has increased from 57.4% in FY2008 to 70.3% in FY2013. Given that USA and Europe are the major markets to which the company exports, the depreciating rupee against the US$ and Euro is a positive for the company. We do not expect any correction in the same in the near term.

Exhibit 5: Increasing contribution of exports



Source: Company, Angel Research

Exhibit 6: Depreciating rupee – an advantage



Source: Company, Angel Research

Further, the appreciation of the Yuan is an additional advantage for Indian exports. The Chinese currency, Yuan, has appreciated by 2.7% against the USD in the past one year, however, the INR has depreciated by 12.4% in the same time against US$ which is providing the Indian players an added advantage in the export market.

Financials

Exhibit 7: Key assumptions

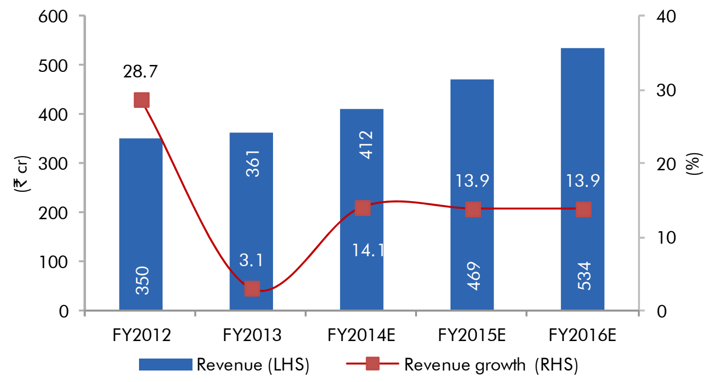
Y/E March	FY2014E	FY2015E	FY2016E
Global CV sales	23,886,810	25,200,585	26,586,617
yoy growth (%)	5.0	5.5	5.5
Total operating Income (₹ cr)	412	469	534
yoy growth (%)	14.1	13.9	13.9

Source: Company, Angel Research

Revenue to grow on the back of global CV industry recovery

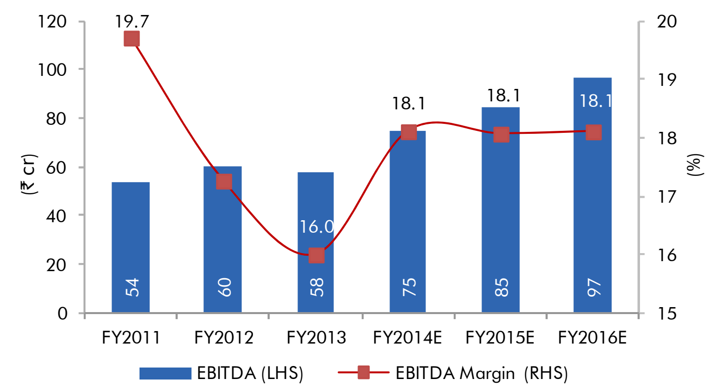
The company has witnessed a CAGR growth of 30.0% over FY2009-13 while the global CV industry's sales contracted by 38.8% during the same period. The current capacity of the company is of 40,000MT and it is continuously focusing on increasing capacity utilization level to take advantage of the production capacities created by it. On the back of recovery trends visible in the CV industry across the globe and the company's strong relationship with its customers, we expect the company to successfully ramp up capacity utilization and witness strong top-line growth. We expect the revenue for the company to grow at a CAGR of 13.9% over FY2013-16E to ₹534cr.

Exhibit 8: Improving CV sales to drive volume



Source: Company, Angel Research

Exhibit 9: Improving operational efficiencies to aid margin growth

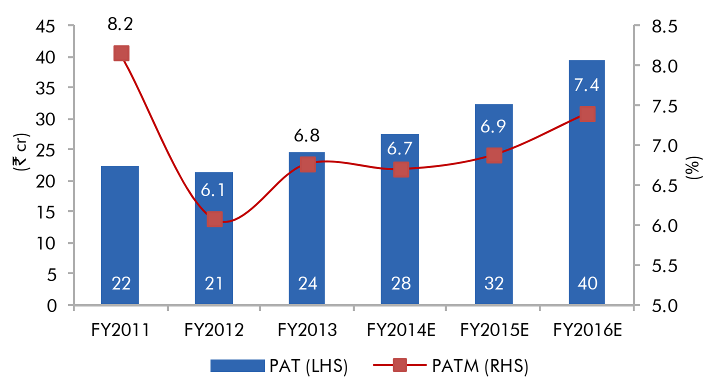


Source: Company, Angel Research

On the back of different energy conservation methods undertaken by the company, its power and fuel costs are expected to reduce over FY2013-16E from 12.8% to 11.0% of net sales. In addition, continuous efforts are being made on conservation of raw material by improving design and layout of dies leading to reduction in raw material consumption. Also, the company is able to pass on the changes in steel prices to the customers.

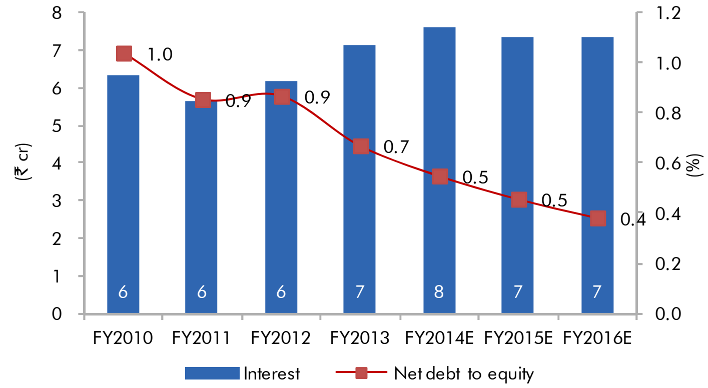
We believe that with improving operational efficiencies and increasing capacity utilization, the operating margin will improve by 210bp over FY2013-16E at 18.1%. We expect the debt of the company to be offloaded marginally leading to a lower interest cost going forward. Consequently, we expect the profit to grow at a CAGR of 17.4% over FY2013-16E to ₹40cr.

Exhibit 10: PATM to improve



Source: Company, Angel Research

Exhibit 11: Net debt to equity to decrease



Source: Company, Angel Research

Exhibit 12: Relative valuation (Trailing twelve months)

Company	Mcap (₹ cr)	Sales (₹ cr)	OPM (%)	PAT (₹ cr)	EPS (₹)	RoE (%)	P/E (x)	P/BV (x)	EV/Sales (x)	EV/ EBITDA (x)
M M Forgings	287	387	18.3	28	23.5	13.7	4.2	0.6	3.1	0.6
Ramkrishna Forgings	118	364	13.3	4	1.6	3.7	69.5	0.9	13.7	1.8
Ahmednagar Forgings	398	1,607	24.6	148	40.3	11.3	2.7	0.4	5.3	1.3

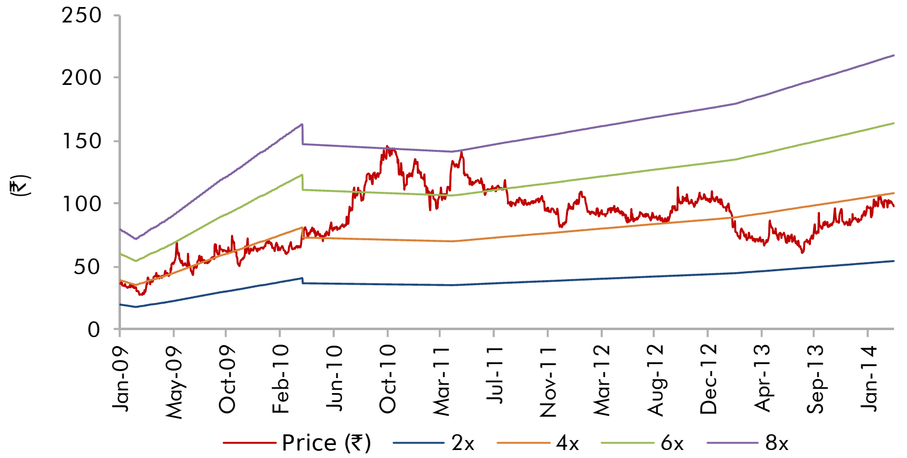
*Source: Company, Angel Research; * Bloomberg estimates*

Outlook and valuation: We expect MMFL to register a revenue CAGR of 13.9% over FY2013-16E to ₹534cr in FY2016E. On account of improving operational efficiencies and increasing capacity utilization, we expect the operating margin for the company to expand by 210bp over the same period to 18.1% for FY2016E. Consequently the profit is expected to grow at a CAGR of 17.4% over FY2013-16E to ₹40cr in FY2016E.

Given the company's increased capacity from 35,000MT in FY2007 to 40,000MT in FY2011 and improvement in the economy of its major export markets - America and Europe, we are positive on the company from a long term perspective.

At the CMP, the company is trading at a PE of 3.0x FY2016E earnings. **On account of positive growth outlook and low valuation, we initiate coverage on the company with a Buy recommendation with a target price of ₹131 at a target PE of 4.0x FY2016E earnings.**

Exhibit 13: One-year forward P/E band



Source: Company, Angel Research

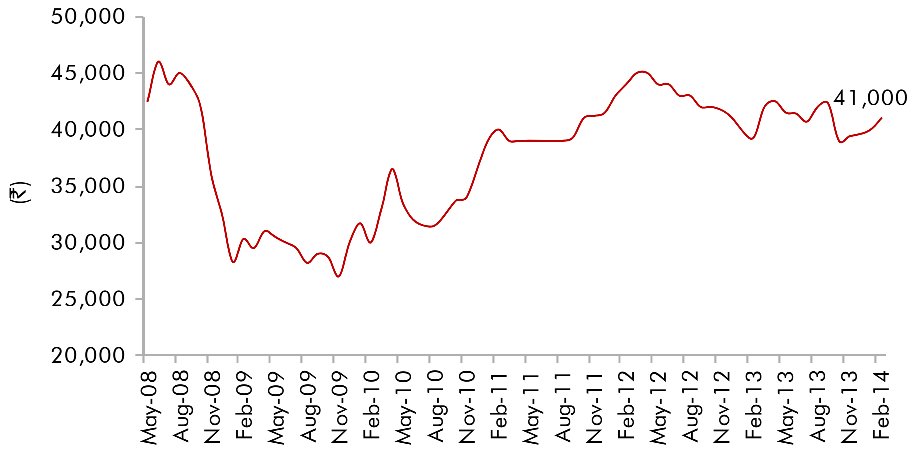
Concerns

Continued slowdown in CV industry: The company earns its major revenue from the CV industry, mainly in the US and Europe. Any prolonged slowdown in these economies can adversely affect the company's performance.

Adverse movement in currency: Rupee depreciation is an added advantage for the company. In case of any appreciation, the revenue of the company will be adversely affected.

Fluctuations in Steel price: Any substantial fluctuation in the steel price can lead to margin compression of the company.

Exhibit 14: Steel price



Source: Angel Research, Bloomberg

Company background

MM Forgings (MMFL) was incorporated in 1946 as Madras Motors Ltd. and was renamed MM Forgings Ltd. in the year 1993. It is engaged in the manufacturing of steel forgings, with a work force of 1,105 employees. It manufactures steel forgings in raw, semi-machined and fully machined stages in various grades of Carbon, Alloy, Micro-Alloy and Stainless Steels in the weight range of 0.20Kg to 60Kg. The Company caters to the forging requirements of almost all sections of the industry – Automotive, Valve and Oil-filed, Engineering and Off Highway.

The company's manufacturing plants are located at Singampunari-Pasumpon Muthuramalingam District, Viralimalai-Pudukkottai District and Karainaithangal Village- Kanchipuram District, all in Tamil Nadu. The company has its Wind Farm at Panakudi Village- Tirunelveli District and at Meenakshipuram, Theni District and the power generated is used for captive use.

Further the company earns ~70% of its sales from exports, mainly to the US and Europe.

Industry

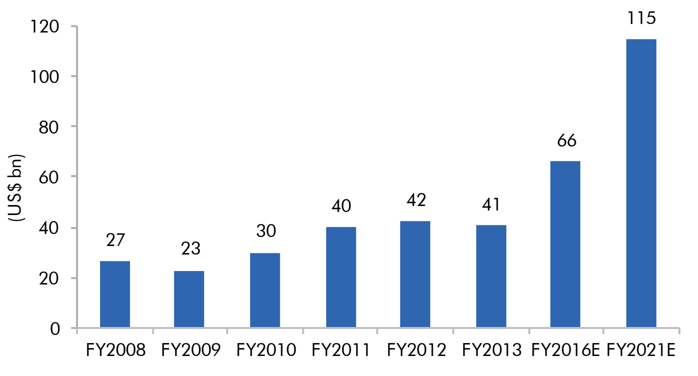
Global forging industry

According to a report by ResearchMoz, a New York based market research firm, the global forging industry is expected to grow at a CAGR of 9.4% over FY2012-16E, and the automotive industry is believed to be the major factor contributing in this growth. It further states that the global forging industry is sourcing forged products from countries where manufacturing costs are low.

Domestic auto component and forging industry

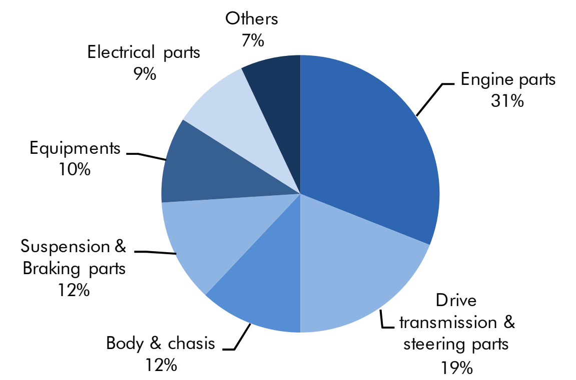
According to ACMA estimates, the domestic auto component industry has grown at a CAGR of 12% over FY2008-12 and is expected to grow at a CAGR of 14% over FY2013-21E to US$115bn in FY2021E.

Exhibit 15: Auto Component Industry Profile - Turnover



Source: ACMA, Angel Research

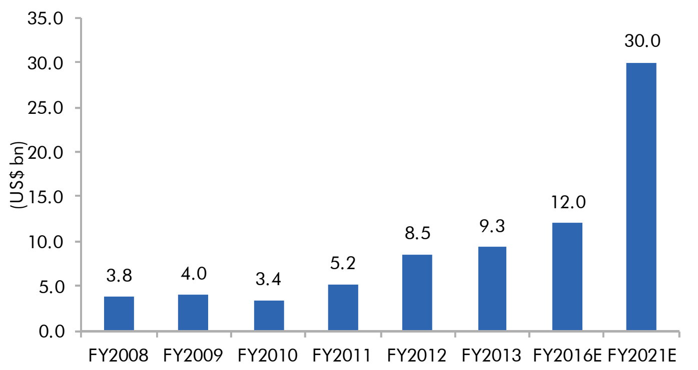
Exhibit 16: Auto component industry product profile (2012)



Source: ACMA, Angel Research

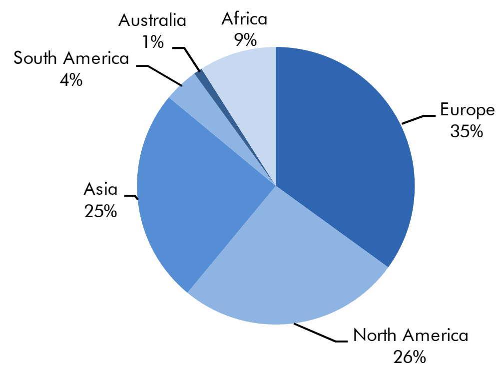
Also, the export of auto components is expected to grow at a CAGR of 16% over FY2013-21E. In value terms the export is expected to grow from US$9bn to US$30bn over the same period.

Exhibit 17: Auto Component Industry Profile - Exports



Source: ACMA, Angel Research

Exhibit 18: Export destination



Source: ACMA, Angel Research

The Indian forging industry was valued at ₹25,000cr (May, 2013) and looking at the auto component industry's future growth forecasts, it is expected that the production of forgings will be at ~ ₹37,000cr by FY2015E. The forging industry has installed capacity of 3.8mn tonne/year with a capacity utilisation rate of 75%.

Profit and loss statement

Y/E Mar. (₹ cr)	FY2012	FY2013	FY2014E	FY2015E	FY2016E
Net Sales	350	361	412	469	534
Other operating income	-	-	-	-	-
Total operating income	350	361	412	469	534
% chg	*28.7*	*3.1*	*14.1*	*13.9*	*13.9*
Net Raw Materials	147	154	176	201	229
% chg	*49.6*	*4.9*	*14.0*	*14.2*	*14.0*
Power and Fuel	45	46	46	52	59
% chg	*30.5*	*2.7*	*0.1*	*12.8*	*12.8*
Personnel	28	31	39	45	51
% chg	*0.7*	*11.8*	*26.7*	*13.9*	*13.9*
Other	70	72	76	87	99
% chg	*20.2*	*2.6*	*5.6*	*13.9*	*13.9*
Total Expenditure	290	303	337	384	437
EBITDA	60	58	75	85	97
% chg	*12.7*	*(4.4)*	*29.1*	*13.6*	*14.1*
(% of Net Sales)	*17.3*	*16.0*	*18.1*	*18.1*	*18.1*
Depreciation	23	21	35	37	40
EBIT	37	37	40	48	57
% chg	*10.5*	*(1.9)*	*7.9*	*20.3*	*19.7*
(% of Net Sales)	*10.7*	*10.1*	*9.6*	*10.1*	*10.7*
Interest & other Charges	6	7	8	7	7
Other Income	7	1	4	4	5
(% of Net Sales)	*2.1*	*0.1*	*0.9*	*0.9*	*0.9*
Recurring PBT	31	30	32	40	49
% chg	*10.7*	*(5.5)*	*7.7*	*26.2*	*23.3*
PBT (reported)	39	30	35	44	54
Tax	12	6	8	12	15
(% of PBT)	*30.7*	*18.6*	*22.2*	*27.2*	*27.2*
PAT (reported)	27	24	28	32	40
Extraordinary Expense/(Inc.)	5	0	0	0	0
ADJ. PAT	21	24	28	32	40
% chg	*(4.1)*	*14.7*	*13.0*	*16.9*	*22.4*
(% of Net Sales)	*6.1*	*6.8*	*6.7*	*6.9*	*7.4*
Basic EPS (₹)	17.7	20.3	22.9	26.8	32.8
Fully Diluted EPS (₹)	17.7	20.3	22.9	26.8	32.8
% chg	*(4.1)*	*14.7*	*13.0*	*16.9*	*22.4*

Balance sheet

Y/E Mar. (₹ cr)	FY2012	FY2013	FY2014E	FY2015E	FY2016E
SOURCES OF FUNDS					
Equity Share Capital	12	12	12	12	12
Reserves& Surplus	140	160	181	205	233
Shareholders' Funds	**152**	**172**	**193**	**217**	**246**
Total Loans	133	117	111	111	111
Other Long Term Liabilities	1	1	1	1	1
Long Term Provisions	0	0	0	0	0
Deferred Tax (Net)	10	11	11	11	11
Total liabilities	**296**	**300**	**315**	**339**	**368**
APPLICATION OF FUNDS					
Gross Block	369	398	438	464	497
Less: Acc. Depreciation	181	202	237	275	314
Net Block	**188**	**196**	**201**	**190**	**182**
Capital Work-in-Progress	3	4	4	5	5
Goodwill	-	-	-	-	-
Investments	0	0	0	0	0
Long Term Loans and adv.	-	-	-	-	-
Other Non-current asset	12	17	20	23	32
Current Assets	**137**	**146**	**155**	**195**	**232**
Cash	1	1	2	5	10
Loans & Advances	27	39	38	56	72
Inventory	85	71	82	91	101
Debtors	23	34	33	42	48
Other current assets	-	-	-	-	-
Current liabilities	44	63	65	74	84
Net Current Assets	**94**	**83**	**90**	**121**	**148**
Misc. Exp. not written off	-	-	-	-	-
Total Assets	**296**	**300**	**315**	**339**	**368**

Cash flow statement

Y/E Mar. (₹ cr)	FY2012	FY2013	FY2014E	FY2015E	FY2016E
Profit before tax	39	30	35	44	54
Depreciation	23	21	35	37	40
Change in Working Capital	(1)	10	(6)	(28)	(22)
Direct taxes paid	(12)	(6)	(8)	(12)	(15)
Others	(1)	2	(4)	(4)	(5)
Cash Flow from Operations	**48**	**57**	**53**	**37**	**53**
(Inc.)/Dec. in Fixed Assets	(66)	(30)	(40)	(27)	(33)
(Inc.)/Dec. in Investments	-	(0)	-	-	-
(Incr)/Decr In LT loans & adv.	(2)	(5)	(3)	(4)	(9)
Others	9	6	4	4	5
Cash Flow from Investing	**(59)**	**(30)**	**(39)**	**(26)**	**(37)**
Issue of Equity	-	-	-	-	-
Inc./(Dec.) in loans	21	(17)	(6)	-	-
Dividend Paid (Incl. Tax)	(4)	(4)	(4)	(4)	(4)
Others	(6)	(7)	(3)	(4)	(7)
Cash Flow from Financing	**11**	**(28)**	**(13)**	**(8)**	**(11)**
Inc./(Dec.) in Cash	0	(0)	1	2	5
Opening Cash balances	**1**	**1**	**1**	**2**	**5**
Closing Cash balances	**1**	**1**	**2**	**5**	**10**

Key ratios

Y/E Mar.	FY2012	FY2013	FY2014E	FY2015E	FY2016E
Valuation Ratio (x)					
P/E (on FDEPS)	5.5	4.8	4.3	3.7	3.0
P/CEPS	2.7	2.6	1.9	1.7	1.5
P/BV	0.8	0.7	0.6	0.5	0.5
EV/Net sales	0.7	0.6	0.6	0.5	0.4
EV/EBITDA	4.1	4.0	3.0	2.6	2.3
EV / Total Assets	0.9	0.8	0.7	0.7	0.6
Per Share Data (₹)					
EPS (Basic)	17.7	20.3	22.9	26.8	32.8
EPS (fully diluted)	17.7	20.3	22.9	26.8	32.8
Cash EPS	36.8	37.8	51.9	57.5	65.7
DPS	3.0	3.0	3.0	3.0	3.0
Book Value	125.8	142.6	159.8	179.5	203.4
DuPont Analysis					
EBIT margin	10.7	10.1	9.6	10.1	10.7
Tax retention ratio	0.7	0.8	0.8	0.7	0.7
Asset turnover (x)	1.3	1.3	1.4	1.5	1.6
ROIC (Post-tax)	10.0	10.5	10.6	11.3	12.6
Cost of Debt (Post Tax)	3.5	4.7	5.3	4.9	4.9
Leverage (x)	0.9	0.7	0.6	0.5	0.4
Operating ROE	15.6	14.5	13.5	14.3	15.7
Returns (%)					
ROCE (Pre-tax)	14.2	12.7	13.3	15.0	16.6
Angel ROIC (Pre-tax)	14.4	13.0	13.6	15.4	17.2
ROE	15.2	15.1	15.1	15.8	17.1
Turnover ratios (x)					
Asset TO (Gross Block)	1.0	0.9	1.0	1.0	1.1
Inventory / Net sales (days)	78	79	68	67	66
Receivables (days)	34	29	29	33	33
Payables (days)	50	64	70	70	70
WC cycle (ex-cash) (days)	96	88	75	79	87
Solvency ratios (x)					
Net debt to equity	0.9	0.7	0.6	0.5	0.4
Net debt to EBITDA	2.2	2.0	1.5	1.3	1.0
Int. Coverage (EBIT/ Int.)	6.1	5.1	5.1	6.4	7.6

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DISCLAIMER

Disclosure of Interest Statement	**M M Forgings**
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Returns):	*Buy (> 15%)*	*Accumulate (5% to 15%)*	*Neutral (-5 to 5%)*
	Reduce (-5% to -15%)	*Sell (< -15%)*	

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