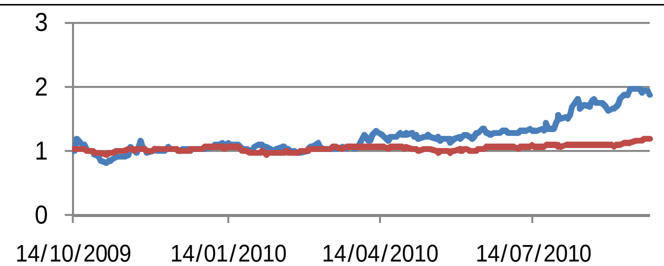
# M M Forgings Limited

**Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)**
B-2, 301/302, 3rd Floor, Marathon Innova, Off Ganpatrao Kadam Marg,
Lower parel (W), Mumbai - 400 013.
Tel - 3027 2300/01/02 (Fax) 3027 2303
Website : www.nirmalbang.com

# Stock Idea — MM Forgings Ltd.

| | |
|---|---|
| Recommendation | BUY |
| CMP (06/09/2010) | Rs. 116 |
| Sector | Auto Ancillary |
| Stock Details | |
| BSE Code | 522241 |
| NSE Code | MMFL |
| Bloomberg Code | MMFG IN |
| Market Cap (Rs. cr) | 139.88 |
| Free Float (%) | 39.6% |
| 52- wk HI/Lo | 128.0/50.5 |
| Avg. volume BSE/ NSE (Monthly) | 33,581 |
| Face Value | Rs.10 |
| Dividend payout (FY 2010/09) | 15% |
| Shares o/s (Crs) | 1.21 |

| Relative Performance | 1Mth | 3Mth | 1Yr |
|---|---|---|---|
| MM Forgings | 6.2% | 44.0% | 84.1% |
| Sensex | 7.9% | 11.9% | 18.8% |




| Shareholding Pattern as of 30/06/2010 | |
|---|---|
| Promoters Holding | 60.99% |
| Institutional (Incl. FII) | 12.01% |
| Corporate Bodies | 2.55% |
| Public & others | 24.45% |

Ashish Khetan – Research Analyst (+91 22 3027-2259)
ashish.khetan@nirmalbang.com
Aditya Powani – Research Associate (+91 22 3027-2241)
aditya.powani@nirmalbang.com

## Snapshot

MM Forgings (MMFL) was incorporated in 1946 as Madras Motors Limited as dealers of the Royal Enfield. MMFL forayed into the forging business with a forge shop in Singampunari, Tamil Nadu in 1974 with a capacity of 780 MT per annum. By mid eighties, company's forging business expanded steadily and capacity reached 3000 MT per Annum. Since then MMFL has grown its capacity by leaps and bounce. MMFL closed its dealership business in year 1990 to focus in forging business. In year 1991, the company launched a new state of the art forging facility at Viralimalai, Tamilnadu with a capacity of 3000 MT per annum.

Company renamed itself as "MM Forgings Limited" in year 1993. MM as Madras Motors stands to show the company's roots. In year 1994, MMFL had a major capacity addition at Viralimalai plant (Plant 2) to 12000 MT per annum with funding from the initial public offering and financial participation from major financial institutions. The company also got certified to ISO 9002:1994 in the same year by NQA, UK.

MM Forgings derives approximately 50-60% of its total revenues from the export markets primarily catering to the automotive space. With the economic environment improving globally, the company is expected to improve its operational efficiency. We expect the company to operate at a utilization rate of 75% of FY11 & at 86% for FY12.

## Valuation & Recommendation

We expect MMFL's sales to grow at a CAGR of 32% over a next two years whereas net profit is expected to grow at a higher CAGR of 53% during the same period, on account better utilization of capacity. We expect the company to earn an EPS of Rs. 18.07 in FY 2011 and Rs. 19.97 in FY 2012. At the CMP of Rs. 115 per share, MMFL is currently trading at a PE of 6.40x FY11E and 5.79x FY12E EPS and looks very attractive. The company has historically traded in the range of 6-10 except during the financial turmoil. Therefore, we believe that MMFL should be valued on a PE multiple of 9.0x. Based on our EPS of Rs. 18 for FY 2011 and a target multiple of 9.0x we arrive at target of Rs. 163. Consequently, we recommend a BUY rating on the stock with a target price of Rs. 163, indicating a potential upside of 41%.

| Year | Net Sales (RS. Crs) | Growth % | EBITDA (Rs. Crs) | Margin % | PAT (Rs. Crs) | Margin % | EPS (Rs.) | P/E (x) | P/BV (x) |
|---|---|---|---|---|---|---|---|---|---|
| FY 2009 | 206.81 | 8.3% | 31.74 | 15.3% | 10.17 | 4.9% | 8.40 | 13.76 | 1.47 |
| FY 2010 | 158.44 | -23.4% | 22.46 | 14.2% | 10.42 | 6.6% | 8.61 | 13.43 | 1.35 |
| FY 2011E | 237.50 | 49.9% | 43.88 | 18.5% | 21.87 | 9.2% | 18.07 | 6.40 | 1.14 |
| FY 2012E | 275.86 | 16.2% | 51.65 | 18.7% | 24.16 | 8.8% | 19.97 | 5.79 | 0.97 |

## History

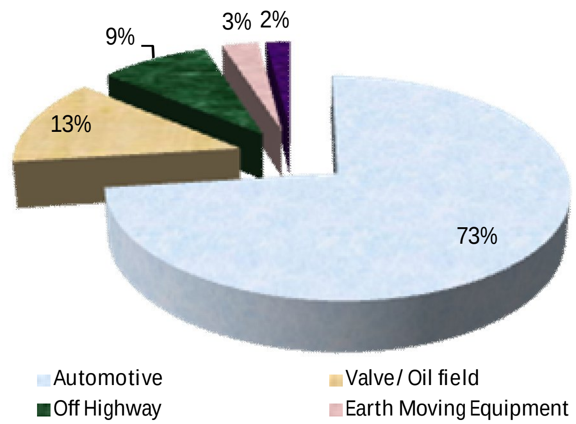
- **1945** — Incorporated as "The Madras Motors Ltd" to trade Royal Enfield Motors of U.K.
- **1974** — Forge Shop division started at Singampunari - 780 MTPA
- **1974-90** — Forging activities quickly overtake dealership as Plant 1 steadily reaches 3000 MTPA capacity by mid-eighties.
- **1990** — Last dealership of motorcyles (at Madras) closed down
- **1991** — Plant 2 commissioned at Viralimalai - 3000 MTPA
- **1993** — Renamed as MM Forgings Limited to reflect the company's line of activity.
- **1994** — Expansion of Plant 2 to 12000 MTPA with funding from IPO, IDBI & ICICI; ISO 9002 certified by NQA (now EAQA of UK)
- **1999** — QS 9000 certified by AQA; Take Over of Gears India, Chennai and established it as plant 3
- **2002** — Establishment of P4 with Roll Shop at Padappai, near Chennai to cater to the growing demands of customers for rolled forgings.; Commenced Wind Farm at Panakudi (Plant 5) in Tirunelveli District for generaling power.
- **2003** — Shifted Machine Shop to P4 to streamline operations. TPM kicked off at Plants 1 & 2
- **2004** — Major capacity expansion to 30,000 MT with addition of 4 Press lines and expansion of machining lines
- **2008-09** — Expanded capacity to 38,820 MT

The company's facilities are located at Singampunari, Viralimalia, Guindy and Karan in Chennai. The company's capacity as of FY 2010 stands at 33,320 MTPA.

| Location | State | Type |
|---|---|---|
| Singampunari (Plant 1) | Tamil Nadu | Individual forging Pieces |
| Viralimalia,T (Plant 2) | Tamil Nadu | Individual forging Pieces |
| Gears India (Plant 3) | Tamil Nadu | Individual forging Pieces |
| Padappai (Plant 4) | Tamil Nadu | Transmission shaft units |
| Panakudi (Wind Farm) | Tamil Nadu | Wind Power |

MMFL manufactures carbon and alloy steel forgings with product range including forging pieces weighing between 15-60 kgs. The company caters to the automotive, earth moving, engineering and oil industries. The company derives close to 3/4$^{th}$ of its total revenues from the automotive segment and is highly dependent on the fortunes of the auto industry as a whole.

Sales Break up as of FY 2010

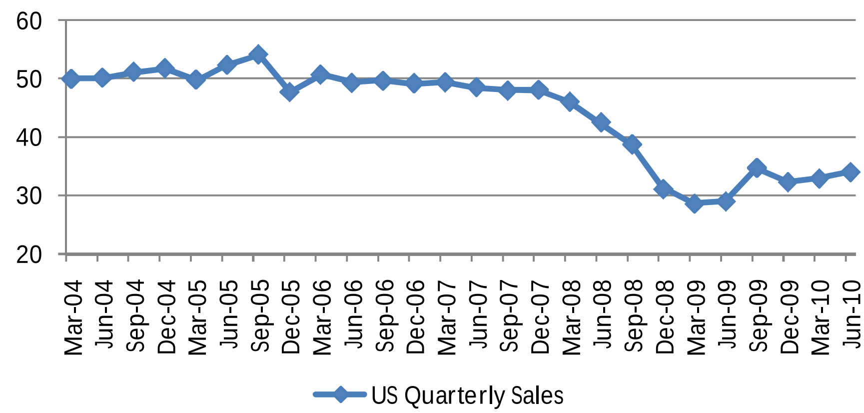



## Investment Positives

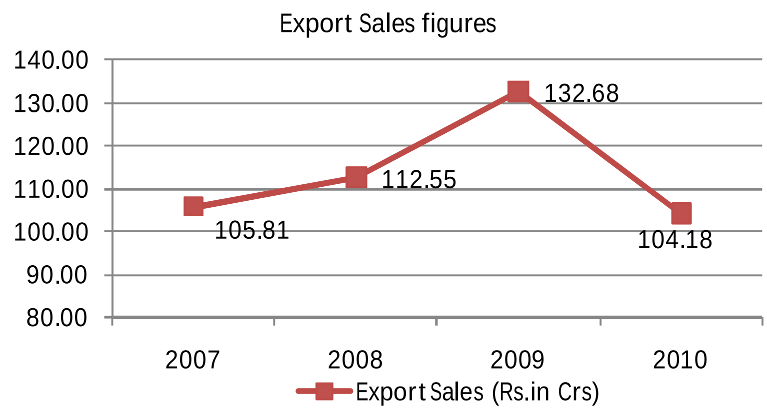
*Demand for auto to remain robust*

The Demand for Global Automobiles continues to remain strong over the past few quarters after the sharp drop witnessed in 2009. The Demand from the US market seems to remain steady after the spike seen in August 2009 with the introduction of Cash for Clunkers scheme to stimulate the industry. With the economy improving, the demand is expected to increase going forward. The graph below demonstrates that the US auto sales are increasing steadily for last 3 quarters.

US Quarterly Sales




MM Forgings derives close to 50-60% of its total revenue from exports primarily catering to the large auto manufacturers in the US and Europe. With the economy improving over the last few quarters, demand is expected to remain firm going forward. MMFL is one of the largest exporters of forgings and we believe that the company is well poised for significant growth and can increase its market share, going forward.




The automotive industry has emerged as one of the prominent manufacturing sectors of the Indian economy, contributing as much as 4% to the total GDP. Going forward, the auto industry is expected to grow at 14% in FY 2011. This buoyant growth in the automotive sector will boost the demand for auto components. MM Forgings with more than 475 components under its portfolio is expected to get huge growth opportunities.

*Capacity Utilization to provide growth going forward*

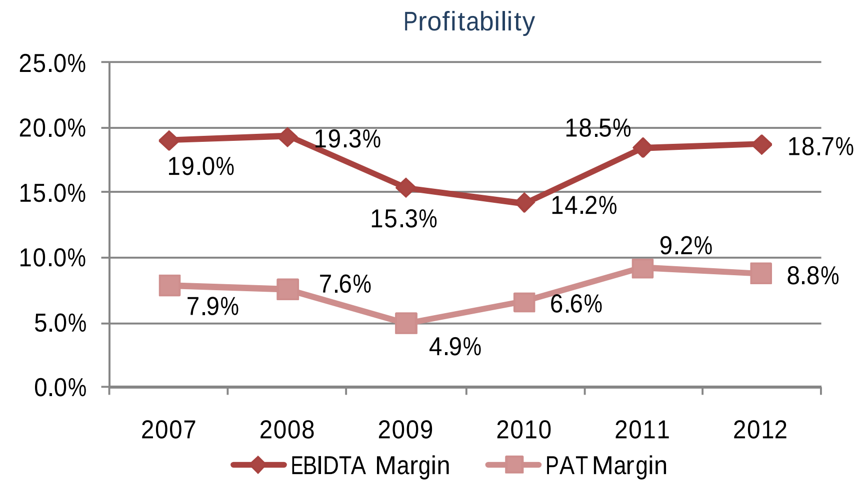
MM Forgings has a Production capacity of 33,320 MT. The company witnessed lower capacity utilization in FY 2009 & 2010 on the backdrop of the slowdown witnessed in the auto sector due to the global recession. The company generates close to 75% of its sales from this segment. The demand has picked up from Q3 & Q4 of FY 2010 and expected to remain robust.

| Financial Year | 2007 | 2008 | 2009 | 2010 | 2011E | 2012E |
|---|---|---|---|---|---|---|
| Production Capacity | 28,000 | 28,000 | 33,320 | 33,320 | 33,320 | 33,320 |
| | | | | | | |
| Sales (Mt) | 20,564 | 22,234 | 19,718 | 16,598 | 25,000 | 28,750 |
| Capacity Utilization | 73% | 79% | 59% | 50% | 75% | 86% |
| | | | | | | |

The management has indicated that utilization rate is expected to remain higher in the range of 75-80% with the rebound in the demand for auto. The auto manufacturer's carry forging inventory for 3-4 months which results in a lag in demand. Going forward, the demand for forging is expected to increase as the auto manufacturers continue to expand the capacity to meet the ever increasing demand after the recovery in the economy. Moreover company has strong relationships with its customers and has not lost any customer during the slowdown which should enable the company to easily ramp up the utilization rates and record strong top-line growth.

*Higher utilization to boost margins*

We expect the company's utilization to increase to around 75% in FY 2011 which will enable the company to improve its overall EBITDA margin. The company has enjoyed EBIDA Margins of 19-20% in FY 2007 & FY 2008 before the slowdown. However, EBITDA margin fell in the range rand of 14-15% during last couple of years as the demand vanished and the company continued to incur higher fixed costs. With the increase in utilization rate we expect the company to generate economies of scale and expect the margin to bounce back to levels of 2007 and 2008. Furthermore we expect the PAT margins to improve during next couple of years.




## Risk Factors

*Slowdown in the Automobile Industry*

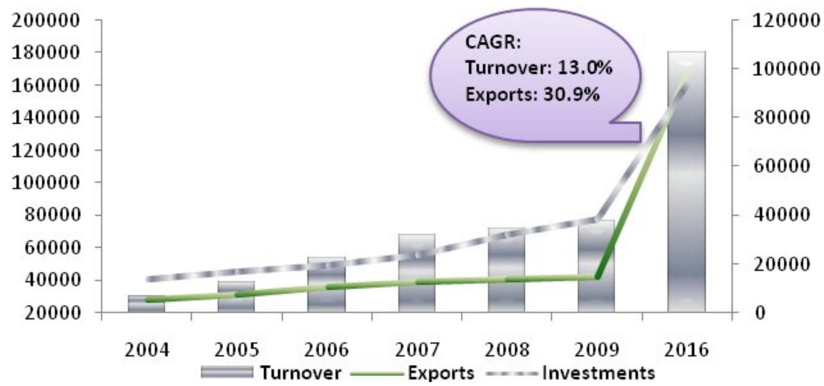
MM Forgings is highly dependent on the automobile industry, deriving close to 75% of the revenue from this vertical. The management indicated that due to higher inventory buildup of forgings in the second half of FY 2009; the demand stood lower in Q1 & Q2 of FY 2010. The demand has seen a pick up from Q3 & Q4 & similar demand is expected going forward in FY 2011 & FY 2012. However, if we see a slump in demand of automobiles, the revenues for the company would decline considerably.

*Concentration on Exports*

MMFL derives 50-60% of its revenues from the export markets of which 60% comes from the US & remaining 40% from the European markets. The adverse exchange rate movements can deteriorate the growth and lead to a deviation from our estimates.

## Automotive Components Industry

Of the total global auto components trade of US$ 185 billion, India's share is estimated at 0.4% at the end of 2009. The ACMA-McKinsey Vision 2015 document estimates the potential for the Indian auto component industry to be US$ 40-45 billion by 2015. Of this, 50% is expected to come from exports.




*Source: ACMA, BS, Nirmal Bang Research*

India is estimated to have the potential to become one of the top five auto component economies by 2025 with the investments growing at a CAGR of 13.5% from 2009-2016. The industry has been experiencing a high growth rate of 20% over the period 2004-09 and is expected to grow at a rate of 13% over the period 2009-16. Similarly, while growth rate of exports has been 21.2% during 2004-09, the growth rate is expected to grow by 30.9% during 2009-14. Considering the growth opportunity on offer in the industry and the fact that MMFL is one of the largest exporters of forgings we believe that company is poised for significant growth and can increase its market share.

## Peer Comparison

We have compared MMFL with Kalyani Forgings (Kalyani) as both the companies are involved in forgings business .During FY 2010; MMFL outperformed its peers in terms of margins. MMFL has recorded EBITDA margin of 14% for FY 2010 compared to Kalyani's 12% for the same period. On the valuations front also the company looks attractive as compared to peers. MMFL is currently trading at a PE of 14.17x based on FY 2010 EPS which is lower than Kalyani's PE of 21.76x.

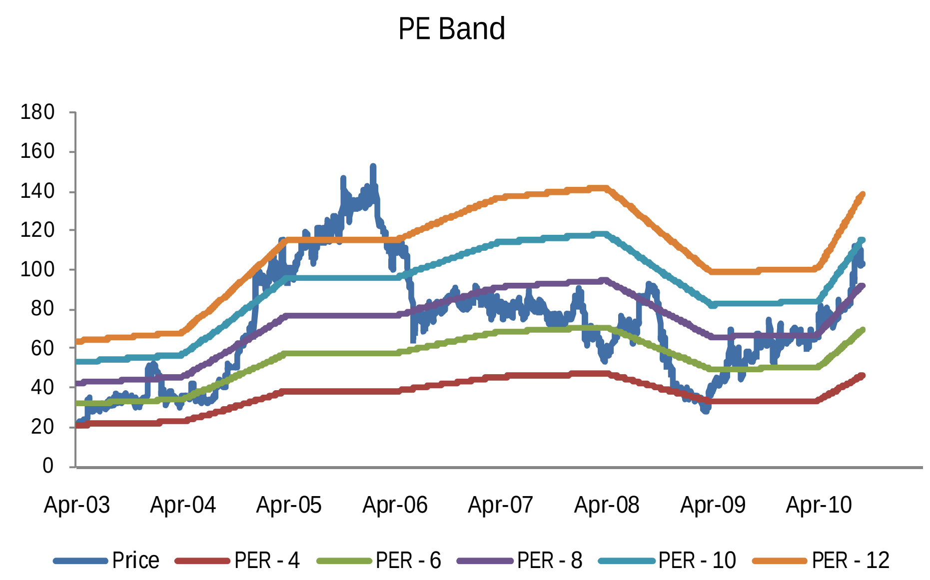
| Company | Sales | EBITDA | Margin | EPS | Price | PE | M.Cap | EV | EV/Sales | P/BV |
|---|---|---|---|---|---|---|---|---|---|---|
| MMFL | 158.44 | 22.46 | 14% | 8.61 | 115.6 | 13.43 | 139.876 | 248.13 | 1.57 | 1.35 |
| Kalyani Forgings | 175.3 | 21.5 | 12% | 9.1 | 202.3 | 22.23 | 73.6 | 133.9 | 0.76 | 1.00 |

Rs in Crores (TTM)

Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)
B-2, 301/302, 3rd Floor, Marathon Innova, Off Ganpatrao Kadam Marg,
Lower parel (W), Mumbai - 400 013.
Tel - 3027 2300/01/02 (Fax) 3027 2303
Website : www.nirmalbang.com

## Valuation & Recommendation

We believe that MMFL's sales to grow at a CAGR of 32% over a next two years whereas net profit is expected to grow at a higher CAGR of 53% during the same period, on account better utilization of capacity. We expect the company to earn an EPS of Rs. 18.07 in FY 2011 and Rs. 19.97 in FY 2012. At the CMP of Rs. 115 per share, MMFL is currently trading at a PE of 6.40x FY11E and 5.79x FY12E EPS and looks very attractive. The company has historically traded in the range of 6-10 (as shown in the PE Band below) except during the financial turmoil. Therefore, we believe that MMFL should be valued on a PE multiple of 9.0x. Based on our EPS of Rs. 18 for FY 2011 and a target multiple of 9.0x we arrive at target of Rs. 163. Consequently, we recommend a BUY rating on the stock with a target price of Rs. 163, indicating a potential upside of 41%.




Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)
B-2, 301/302, 3rd Floor, Marathon Innova, Off Ganpatrao Kadam Marg,
Lower parel (W), Mumbai - 400 013.
Tel - 3027 2300/01/02 (Fax) 3027 2303
Website : www.nirmalbang.com

## Stock Idea — MM Forgings Ltd.

| Profitability (Rs. In Cr) | FY09A | FY10A | FY11E | FY12E |
|---|---|---|---|---|
| Net Sales | 206.8 | 158.4 | 237.5 | 275.9 |
| YoY growth | 8% | -23% | 50% | 16% |
| Operating exp | 175.1 | 136.0 | 193.6 | 224.2 |
| EBITDA | 31.7 | 22.5 | 43.9 | 51.6 |
| Dep | 16.4 | 11.6 | 18.3 | 19.3 |
| Op Income | 15.4 | 10.9 | 25.6 | 32.3 |
| Interest | 8.8 | 6.2 | 6.6 | 6.4 |
| Other Income | 7.6 | 7.1 | 7.8 | 8.6 |
| Other Adjustments | -0.5 | -0.2 | 0.0 | 0.0 |
| PBT | 13.7 | 11.6 | 26.9 | 34.5 |
| Tax | 3.5 | 1.2 | 5.0 | 10.4 |
| PAT | 10.2 | 10.4 | 21.9 | 24.2 |
| Adj PAT | 10.2 | 10.4 | 21.9 | 24.2 |
| Shares o/s (Crs.) | 1.21 | 1.21 | 1.21 | 1.21 |
| EPS | 8.4 | 8.6 | 18.1 | 20.0 |
| Adj EPS | 8.4 | 8.6 | 18.1 | 20.0 |
| Cash EPS | 21.9 | 18.2 | 33.2 | 36.0 |

| Quarterly (Rs. In Cr) | Sep.09 | Dec.09 | Mar.10 | Jun.10 |
|---|---|---|---|---|
| Net Sales | 33.2 | 42.6 | 50.2 | 55.6 |
| EBITDA | 3.0 | 6.8 | 9.3 | 9.2 |
| Dep | 2.2 | 3.0 | 4.0 | 4.5 |
| Op Income | 0.7 | 3.9 | 5.3 | 4.7 |
| Interest | 1.5 | 1.5 | 1.3 | 1.3 |
| Other Income | 2.4 | 1.2 | 1.6 | 1.8 |
| PBT | 1.6 | 3.5 | 5.6 | 5.2 |
| Tax | 0.0 | 0.2 | 1.0 | 0.3 |
| PAT | 1.6 | 3.3 | 4.6 | 4.9 |
| Other Adjustments | 0.0 | 0.0 | 0.0 | 0.0 |
| EPS (Rs.) | 1.3 | 2.7 | 3.8 | 4.1 |

| Performance Ratio | FY09A | FY10A | FY11E | FY12E |
|---|---|---|---|---|
| Sales growth (%) | 8.3% | -23.4% | 49.9% | 16.2% |
| EBITDA margin (%) | 15.3% | 14.2% | 18.5% | 18.7% |
| Adj.PAT margin (%) | 4.9% | 6.6% | 9.2% | 8.8% |
| RoNW | 10.7% | 10.0% | 17.8% | 16.8% |

| Valuation Ratio | FY09A | FY10A | FY11E | FY12E |
|---|---|---|---|---|
| Price Earnings (x) | 13.8 | 13.4 | 6.4 | 5.8 |
| Price / Book Value (x) | 1.5 | 1.3 | 1.1 | 1.0 |
| EV / Sales | 1.21 | 1.57 | 0.99 | 0.78 |
| EV / EBIDTA | 7.89 | 11.05 | 5.38 | 4.15 |

| Financial Health (Rs. In Cr) | FY09A | FY10A | FY11E | FY12E |
|---|---|---|---|---|
| Share Capital | 12.1 | 12.1 | 12.1 | 12.1 |
| Reserves & Surplus | 83.4 | 91.7 | 110.7 | 132.0 |
| Share Holder's Funds | 95.4 | 103.7 | 122.8 | 144.1 |
| Total Loans | 111.4 | 114.3 | 111.7 | 106.9 |
| Deferred Tax Liabilities | 7.3 | 7.2 | 7.2 | 7.2 |
| Total Liabilities | 214.1 | 225.2 | 241.6 | 258.1 |
| Net Fixed Assets | 137.9 | 151.9 | 141.7 | 132.4 |
| Investments | 0.1 | 0.1 | 0.1 | 0.1 |
| Sundry Debtors | 16.7 | 28.9 | 35.8 | 41.6 |
| Cash & Bank | 0.9 | 6.1 | 15.5 | 32.2 |
| Loans & Advances | 28.1 | 24.5 | 28.5 | 33.1 |
| Inventories | 40.7 | 30.5 | 41.2 | 47.9 |
| Other Current Assets | 0.0 | 0.0 | 0.0 | 0.0 |
| Total CA | 86.4 | 90.1 | 121.0 | 154.8 |
| Curr Liab & Prov | 10.3 | 16.9 | 21.1 | 29.1 |
| Net Current Assets | 76.1 | 73.2 | 99.8 | 125.7 |
| Total Assets | 214.1 | 225.2 | 241.6 | 258.1 |

| Cash Flow (Rs. In Cr) | FY09A | FY10A | FY11E | FY12E |
|---|---|---|---|---|
| Operating | | | | |
| Net Profit | 14.1 | 11.8 | 26.9 | 34.5 |
| Other Adjustment | 7.8 | 6.9 | 2.6 | -2.5 |
| Change in WC | 1.2 | 8.1 | -17.2 | -9.1 |
| CF from Opeartion | 23.2 | 26.8 | 12.2 | 22.9 |
| Investment | | | | |
| Purchase/ Sale of Assets | -31.7 | -25.0 | -8.0 | -10.0 |
| Other Inv & Int | -9.3 | 10.1 | 7.8 | 8.6 |
| Total Inv | -41.0 | -14.8 | -0.2 | -1.4 |
| Financing | | | | |
| Increase/Decrease in Term | 17.8 | -6.7 | -2.6 | -4.8 |
| Total Financing | 17.8 | -6.7 | -2.6 | -4.8 |
| Net Chg. in Cash | -0.1 | 5.2 | 9.4 | 16.7 |
| Cash at beginning | 1.0 | 0.9 | 6.1 | 15.5 |
| Cash at end | 0.9 | 6.1 | 15.5 | 32.2 |

| Per Share Data | FY09A | FY10A | FY11E | FY12E |
|---|---|---|---|---|
| Reported EPS | 8.40 | 8.61 | 18.07 | 19.97 |
| Adjusted EPS | 8.40 | 8.61 | 18.07 | 19.97 |
| BV per share | 78.9 | 85.7 | 101.5 | 119.1 |
| Cash per share | 0.7 | 5.0 | 12.8 | 26.6 |
| Dividend per share | 1.50 | 1.50 | 2.00 | 2.00 |

**Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)**
B-2, 301/302, 3rd Floor, Marathon Innova, Off Ganpatrao Kadam Marg,
Lower parel (W), Mumbai - 400 013.
Tel - 3027 2300/01/02 (Fax) 3027 2303
Website : www.nirmalbang.com

Note