CD EquisearchPvt Ltd

CHANGING DIMENSIONS
CD EQUISEARCH

July 7, 2022

MM Forgings Ltd. (MMFL)	
No. of shares (m)	24.14
Mkt cap (Rscrs/$m)	2144/270.2
Current price (Rs/$)	888/11.2
Price target (Rs/$)	1080/13.6
52 W H/L (Rs.)	989/645
Book Value (Rs/$)	232/2.9
Beta	0.9
Daily NSE volume (avg. monthly)	27040
P/BV (FY23e/24e)	3.2/2.7
EV/EBITDA (FY23e/24e)	10.1/9.1
P/E (FY23e/24e)	18.1/16.4
EPS growth (FY22/23e/24e)	96.9/28.9/10.8
OPM (FY22/23e/24e)	18.3/18.3/18.3
ROE (FY22/23e/24e)	17.0/18.8/17.8
ROCE (FY22/23e/24e)	9.3/10.6/10.3
D/E ratio (FY22/23e/24e)	1.2/1.1/1.0
BSE Code	522241
NSE Code	MMFL
Bloomberg	MMFG IN
Reuters	MMFO.NS

Shareholding Pattern%	
Promoters	56.3
MFs / Banks /FIs	19.6
Foreign Portfolio Investors	0.8
Govt. Holding	-
Public& Others	23.3
Total	**100.0**

As onMarch 31, 2022

Recommendation

BUY

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Company Overview

MM Forgings is a manufacturer of automotive components. It manufactures steel forgings in raw, semi-machined and fully machined stages in various grades of carbon, alloy, micro-alloy and stainless steels.

Quarterly Highlights

- As per the data published by SIAM, after having sharply corrected for two years from its peak in FY19, sales in both the passenger and commercial vehicles sectors have rebounded in FY22 on a low base, while the 2-wheeler sector, yet again has posted a third year of double-digit decline. Similarly, revenues for MM Forgings, which derives over 80% of its top-line from CV players, in FY20 was impacted by slowdown in the auto industry especially in domestic market, while FY21 was impacted by covid-19 led demand disruption. However, the cyclical upswing in FY22 provided much needed respite that allowed it to rake in overall turnover of Rs. 1104.64 crs, a growth of 52.2% year-over-year. Export sales booking, which accounts for almost 50% of the total mix, grew by over 50% in the concluding fiscal.
- Operating profits in FY22 also grew apace the top-line raking in Rs. 201.74 crs, a growth of 66.3% as against Rs. 121.29 crs in the prior fiscal. However, consequent inflation in commodity prices, especially steel which grew by some 30% last year, to some extent impacted profits. Though helped by a lower base, operating margin in FY22 improved by some 150 bps to 18.3%, yet sequential decline of 150 bps in Q4FY22 shows some challenges in passing on of price increases to OEMs. Moreover, despite record volume offtake in FY22, the company seems to have benefited little from its operating leverage.
- The stock currently trades at 18.1x FY23e EPS of Rs. 49.01 and 16.4x FY24e EPS of Rs. 54.29. Earnings growth in the coming years rests on the premise that the cyclical upswing in the commercial vehicle market would gain pace without being much tapered by the fears of global recession. Moreover, growing forays into the machining business, new product approvals by the OEMs and rising volume offtake in existing ones would also play a major role in determining the next leg of growth. Earnings in FY23 are expected to grow by some 29%, before advancing by 10.8% to Rs. 131.06 crs in FY24 (vs. Rs. 91.76 crs in FY22). Yet, near unpredictability of CV cycle globally could have adverse ramifications on our earning projections. On balance, we assign buy rating on the stock with target price of Rs 1080 (previous target Rs 936) based on 20x FY24e earnings.

Standalone figures in Rs crs	FY20	FY21	FY22	FY23e	FY24e
Income from operations	727.29	725.65	1104.64	1292.00	1445.00
Other Income	18.51	21.59	18.57	21.84	22.32
EBITDA (other income included)	143.70	142.89	220.31	257.73	286.92
PAT after EO	46.23	46.61	91.76	118.31	131.06
EPS(Rs)	19.15	19.31	38.01	49.01	54.29
EPS growth (%)	-43.2	0.8	96.9	28.9	10.8

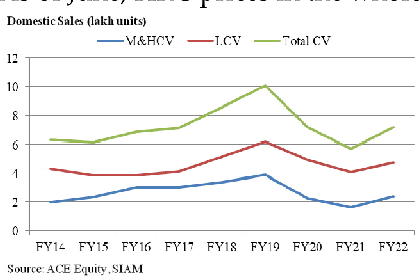
Outlook & Recommendation

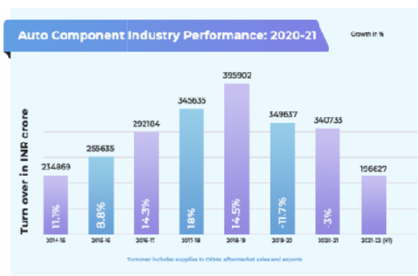
Industry Overview

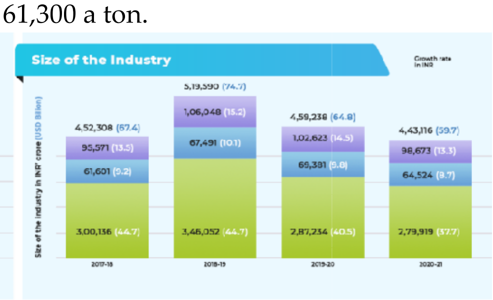
The Federation of Automobile Dealers Associations (FADA) in its near-term outlook has warned to remain cautious for any further recovery in auto sales in the near term. Vinkesh Gulati, FADA President, reckons that Indian auto industry during May continued its flattish run for the 3rd consecutive month with still not on growth trajectory as far as pre-covid levels are concerned. The CV segment after a long cyclical downturn which began post the announcement of axle load norms in 2018 is now witnessing demand recovery as all sub-categories continue to inch north. With re-opening of educational institutions, buses are showing good traction. However, there has been a recent shift towards higher-end vehicles in PVs and 2-wheelers due to the rising income inequality with the average lower-middle income group been much worse hit.

Recently, prices of metals are falling fast on rising fears of a recession in the world's top industrial economies, especially the United States, while central bankers continue to tighten monetary policy to fight inflation. End-user industries for steel, which is the prime raw material for the metal forging industry, continue to remain on the side-lines amid expectation of further decline in steel prices. The major problem here seems to be the lackluster demand in domestic markets. RBI is of the view that further ratcheting up of geopolitical tensions and likelihood of prolonged supply chain disruptions impart sizeable upside risks to the inflation trajectory.

Steel producers are not just cutting production but are also preponing their maintenance shutdown work at some facilities to restrict the rising inventory levels and keep the plant future-ready. As per some industry sources, while earlier producers used to keep 2-3 days of stock, now there is 15-20 days of inventory left. Prices of the benchmark product hot-rolled coil (HRC) started picking up from Rs 38,750 a ton in the first week of August 2020 to reach its peak at Rs 78,800 a ton in the first week of April this year. Though now it has started retreating back due to government imposition of 15% export duty on exports of steel from May. As of June, HRC prices in the wholesale market of Mumbai stand at Rs 61,300 a ton.







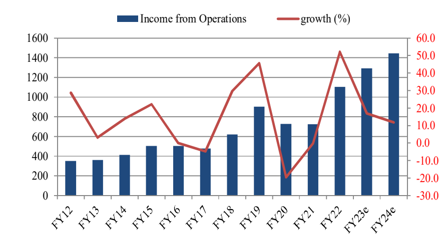
Source: ACE Equity, SIAM Source: ACMA Source: ACMA

Revenues of auto component suppliers in FY22 witnessed decent growth driven by demand from domestic OEMs, replacement and export volumes, though this volume growth comes on a relatively lower base. Moreover, as per ICRA, inability to completely pass through the cost inflation has dented margins of auto component suppliers in FY22, which have been the lowest in the last 5 years. Operating profits, however, have been higher despite dip in margins that has allowed tier-I and tier-II component suppliers to maintain comfortable liquidity position despite increase in debt levels. Capex as a percentage of income from operations in FY22 stood at some 5.9%, lower than pre-Covid levels of over 7.5%. ICRA estimates revenue growth in FY23 to be some 8-10% largely supported by easing of supply-chain issues and commodity inflation in later half of the fiscal.

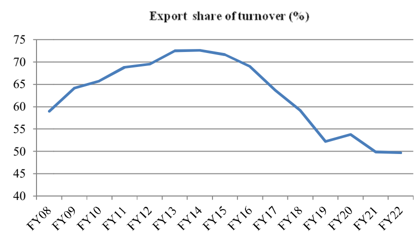
The Union budget 2022-2023 also laid down certain measures beneficial for the auto component sector. The extension of the ECLGS (Emergency Credit Line Guarantee Scheme) and its cover, revamping and infusion of funds into the Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE) scheme combined with the Raising and Accelerating MSME Performance (RAMP) program will help the auto component manufacturers stay relevant and competitive in the current business environment. Moreover, the union cabinet has announced the production-linked incentive (PLI) scheme for the automobile and auto components sector, for five years, commencing FY23 with a financial outlay of Rs. 25,938 crores introduced under Atmanirbhar Bharat 3.0 to boost domestic manufacturing of advanced automotive technology products and attract investments in the automotive manufacturing value chain.

Financials & Valuation

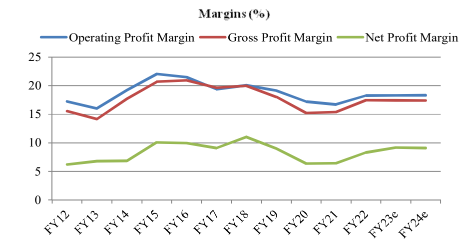
FY22 largely saw high demand scenario with low supplies given the semiconductor shortage, which is still plaguing the supply chains and expected to last few more months. Moreover, the recent Russia-Ukraine crisis has led to resurgence in input costs and further aggravated the demand supply mismatch thus elongating the waiting period. However, OEMs have not yet signaled any sharp production cuts; rather they are evaluating risk-mitigation strategies. In fact, especially the CV market in FY22 was supported by increased activity in road construction, mining and improved infrastructure spending that allowed overall sales volumes to stand at 7.17 lakhs, a growth of over 26%. Resting on this impressive upswing, MMF's sales volumes in the last fiscal grew impressively by over 30% to 62,700 tons.



Sources: M M Forgings Ltd; CD Equisearch

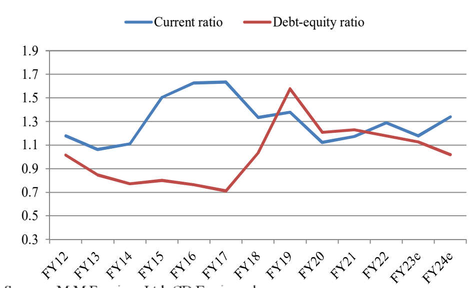


Source: M M Forgings Ltd.

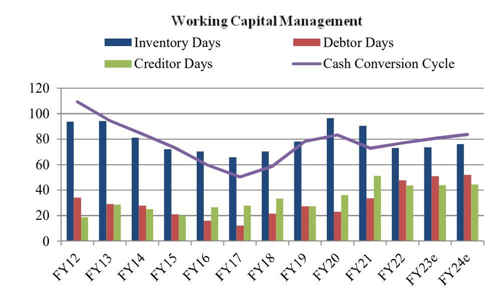


Sources: M M Forgings Ltd; CD Equisearch

Given the increasing share of machining in its product profile,MMF could incur a little below Rs. 300 crs as capex in the current fiscal. Some Rs. 200 crs would be spent this fiscal in building machining capacities, while rest Rs. 100 crs would spent on debottlenecking forging capacities and adding a forging press. Machining content currently forms some 51% of the sales mix when compared to 43% level of FY21. Given rising focus on machining products, the company could spend another Rs. 100 crs as capex in FY24. Moreover, with interest coverage ratio rising to 5.9 from 2.8 in FY21, the company maintains comfortable liquidity position to raise more debt and fund its capex plan. The amount stuck in its working capital requirements improved significantly this year that allowed it to generate higher operating cash flows.



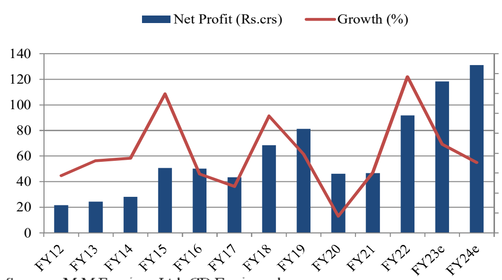
Sources: M M Forgings Ltd; CD Equisearch



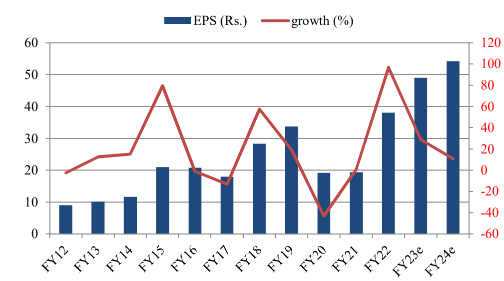
Sources: M M Forgings Ltd; CD Equisearch

Exports over the past five years have grown at a CAGR of some 13%, yet risks abound not least due to increased volatility in foreign exchange markets and brewing crisis in Europe which has the potential to hit exports. Most of company's debt, which is in foreign currency, to some extent hedges its forex exposures. Meanwhile, growing backlog in US class-8 trucks on account of semiconductor shortages has extended the waiting period in USA to over 10 months impacting MMFL's volumes.

While fears of recession have clouded the near-term outlook, a buoyant CV market could help MMF to rake in overall top-line of Rs. 1292 crs in FY23 (vs. Rs. 1104.64 crs in FY22) that would grow by some 12% to Rs. 1445 crs in FY24. Given that the company commands little purchasing power from its raw materials supplier, its profitability is highly susceptible to volatility in material prices. Yet factoring in recent cooling in steel prices, operating profits could grow by 17.1% to Rs. 236.25 crs in FY23 and by 12.0% in FY24. OPMs in FY23 would flat-line to 18.3%. The rise in revenues on account of improving capacity utilization is expected to keep fixed asset turnover at elevated levels (1.8 in FY23 and 1.8 in FY24). Better earnings visibility would improve ROCE to 10.6% this fiscal as against 9.3% in FY22, though this reading is barely impressive by any stretch of imagination.

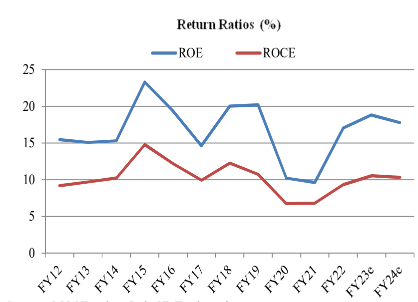


Sources: M M Forgings Ltd; CD Equisearch

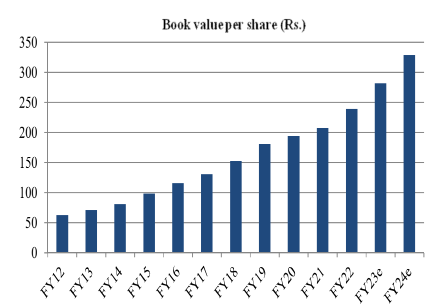


Sources: M M Forgings Ltd; CD Equisearch

The stock currently trades at 18.1x FY23e EPS of Rs. 49.01 and 16.4x FY24e EPS of Rs. 54.29. The pickup in machining products is due to the fact that OEMs have now started to directly source machined ancillaries and are hiving off their captive machining facilities. Since a handful of clients contribute to the majority of top-line of MMFL, incremental growth seems likely to come from existing clients. Moreover, MMF commands no envious pricing power from its OEM clients and no major EV order is in its pipeline. With no major aftermarket to cater to and very high replacement period for most of its products, next leg of scaling in business would likely come from growing the markets of its existing products rather than new product development. In fact, the higher replacement period of its products- in some cases extending to more than 15 years- could act as a deterrent to business scaling. Focus on cost reduction could help it get round the dwindling state of Indian automobile sector. On balance, we assign buy rating on the stock with target price of Rs 1080 (previous target Rs 936) based on 20x FY24e earnings over a period of 9-12 months. For more info, refer to our October report.



Sources: M M Forgings Ltd; CD Equisearch



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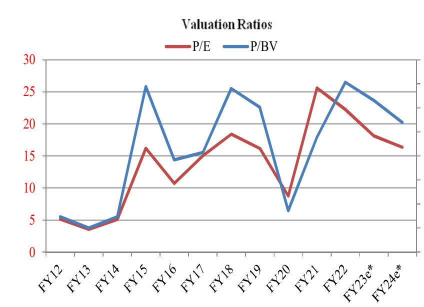


Sources: M M Forgings Ltd; CD Equisearch; *forward multiple

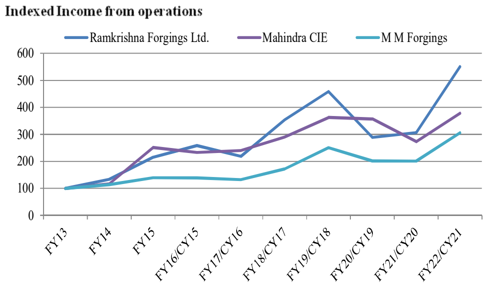
Cross Sectional Analysis

Company	Equity*	CMP	MCAP*	Sales*	Profit*	OPM (%)	NPM (%)	IntCov	ROE (%)	Mcap/Sales	P/BV	P/E
M M Forgings	24	888	2144	1140	90	18.3	7.9	5.6	17.2	1.9	3.8	23.8
Ramkrishna Forgings	32	164	2618	2320	198	22.3	8.5	3.6	20.3	1.1	2.4	13.2
Mahindra CIE	379	233	8830	8786	545	11.7	6.2	15.2	38.6	1.0	5.4	16.2

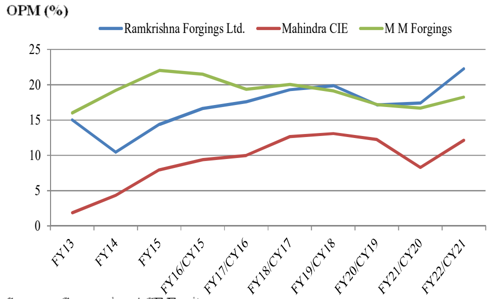
*figures in crores; calculations on ttm basis; based on consolidated data.

Driven by a pleasing unit sales realization growth of over 18% in both domestic and export markets, RKFL’s standalone revenues in Q4FY22 grew by almost 32% to Rs. 683.24 crs year-over-year. Exports markets, with a volume growth of over 9% in the quarter, accounted for 38.3% of the overall mix. With capacity utilization at over 81%, operating profits grew by 40.3% to Rs. 151.02 crs when compared with Rs 107.67 crs in the same quarter a year ago. Moreover, the company managed to bag three new contracts aggregating Rs. 144 crs in Q4FY22 and more recently a multi-year export order (annual worth Rs. 105crs) from a leading trailer manufacturer in USA.

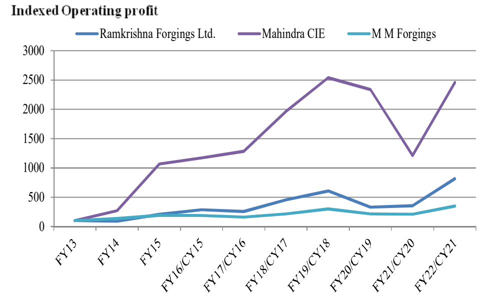
Largely driven by raw material price increases, MCIE consolidated sales in Q1CY22 grew by 18.2% to Rs. 2588.36 crs as against Rs. 2189.40 crs in the corresponding period of the previous year. MCIE India, accounting for almost 50% of the overall mix, grew by 14.8% on a y-o-y basis, while MCIE Europe grew by 21.6%. Due to difficult business environment in Europe worsened by Ukrainian conflict,operating profits for the quarter exhibited a tepid growth of 3.5% to Rs. 296.93 crs, yielding OPMs of 11.5%, down by 163 bps year-over-year. Though sequential margins improvements of almost 170 bps shows decent performance in domestic markets. The company has reckoned that three projects namely focus on EV orders, digitalization and automation, and optimizing energy costs through renewable power are progressing well.



Sources: Companies, ACE Equity;FY13=100



Sources: Companies, ACE Equity



Sources: Companies, ACE Equity;FY13=100

Note: Graphs on standalone or consolidated data as applicable; Mahindra CIE changed its financial year to calendar year in 2015.

Financials

Standalone Quarterly Results

Figures in Rs crs

	Q4FY22	Q4FY21	% chg	FY22	FY21	% chg
Income From Operations	**313.56**	**284.95**	**10.0**	**1104.64**	**725.65**	**52.2**
Other Income	6.61	3.35	97.4	18.57	21.59	-14.0
Total Income	**320.17**	**288.30**	**11.1**	**1123.22**	**747.24**	**50.3**
Total Expenditure	260.34	229.34	13.5	902.91	604.35	49.4
EBITDA (other income included)	**59.83**	**58.96**	**1.5**	**220.31**	**142.89**	**54.2**
Interest	6.15	8.02	-23.3	27.31	31.22	-12.5
Depreciation	15.11	16.73	-9.7	60.11	56.73	5.9
PBT	**38.57**	**34.21**	**12.8**	**132.90**	**54.93**	**141.9**
Tax	9.37	4.07	130.1	41.14	8.32	394.2
PAT	**29.20**	**30.14**	**-3.1**	**91.76**	**46.61**	**96.9**
Extraordinary Item	-	-	-	-	-	-
Adjusted Net Profit	**29.20**	**30.13**	**-3.1**	**91.76**	**46.61**	**96.9**
EPS (Rs)	12.09	12.48	-3.1	38.01	19.31	96.9

Income Statement

Figures in Rs crs

	FY20	FY21	FY22	FY23e	FY24e
Income From Operations	**727.29**	**725.65**	**1104.64**	**1292.00**	**1445.00**
Growth (%)	-19.5	-0.2	52.2	17.0	11.8
Other Income	18.51	21.59	18.57	21.48	22.32
Total Income	**745.80**	**747.24**	**1123.22**	**1313.48**	**1467.32**
Total Expenditure	602.10	604.35	902.91	1055.75	1180.40
EBITDA (other income included)	**143.70**	**142.89**	**220.31**	**257.73**	**286.92**
Interest	33.05	31.22	27.31	32.54	35.46
Depreciation	53.23	56.73	60.11	67.45	76.71
PBT	**57.42**	**54.93**	**132.90**	**157.75**	**174.75**
Tax	11.19	8.32	41.14	39.44	43.69
PAT	**46.23**	**46.61**	**91.76**	**118.31**	**131.06**
Extraordinary Item	0.00	0.00	0.00	-	-
Adjusted Net Profit	**46.23**	**46.61**	**91.76**	**118.31**	**131.06**
EPS (Rs)	19.15	19.31	38.01	49.01	54.29

Balance Sheet

Figures in Rscrs

	FY20	FY21	FY22	FY23e	FY24e
Sources of Funds					
Share Capital	24.14	24.14	24.14	24.14	24.14
Reserves & Surplus	444.16	476.22	553.50	656.12	770.28
Total Shareholders' Funds	**468.31**	**500.36**	**577.64**	**680.26**	**794.42**
Long Term Debt	334.70	297.32	346.19	403.02	413.32
Total Liabilities	**803.01**	**797.68**	**923.83**	**1083.27**	**1207.74**
Application of Funds					
Gross Block	1150.08	1171.42	1263.84	1470.20	1620.20
Less: Accumulated Depreciation	497.18	553.91	614.01	681.46	758.18
Net Block	**652.91**	**617.51**	**649.83**	**788.74**	**862.02**
Capital Work in Progress	8.71	17.47	36.35	100.00	50.00
Investments	4.88	4.88	32.88	32.88	32.88
Current Assets, Loans & Advances					
Inventory	130.73	168.60	192.75	232.56	260.10
Trade Receivables	12.46	121.67	166.41	193.80	216.75
Cash and Bank	174.36	187.06	224.55	155.57	252.91
Other current assets	23.67	28.59	30.91	34.18	38.38
Total CA & LA	**341.22**	**505.91**	**614.62**	**616.11**	**768.14**
Current Liabilities	303.87	416.82	452.52	499.24	549.00
Provisions-Short term	0.00	14.55	24.48	23.69	24.90
Total Current Liabilities	**303.87**	**431.37**	**477.00**	**522.93**	**573.90**
Net Current Assets	37.35	74.55	137.62	93.18	194.24
Net Deferred Tax	-29.81	-30.88	-35.17	-39.70	-42.13
Net long term assets	128.96	114.16	102.31	108.17	110.72
Total Assets	**803.01**	**797.68**	**923.83**	**1083.27**	**1207.74**

Key Financial Ratios

	FY20	FY21	FY22	FY23e	FY24e
Growth Ratios (%)					
Revenue	-19.5	-0.2	52.2	17.0	11.8
EBITDA	-24.0	-0.6	54.2	17.0	11.3
Net Profit	-43.2	0.8	96.9	28.9	10.8
EPS	-43.2	0.8	96.9	28.9	10.8
Margins (%)					
Operating Profit Margin	17.2	16.7	18.3	18.3	18.3
Gross Profit Margin	15.2	15.4	17.5	17.4	17.4
Net Profit Margin	6.4	6.4	8.3	9.2	9.1
Return (%)					
ROCE	6.8	6.8	9.3	10.6	10.3
ROE	10.2	9.6	17.0	18.8	17.8
Valuations					
Market Cap/ Sales	0.6	1.6	1.8	1.7	1.5
EV/EBITDA	5.5	11.3	11.3	10.1	9.1
P/E	8.7	25.6	22.3	18.1	16.4
P/BV	0.9	2.4	3.5	3.2	2.7
Other Ratios					
Interest Coverage	2.7	2.8	5.9	5.8	5.9
Debt Equity	1.2	1.2	1.2	1.1	1.0
Current Ratio	1.1	1.2	1.3	1.2	1.3
Turnover Ratios					
Fixed Asset Turnover	1.2	1.1	1.7	1.8	1.8
Total Asset Turnover	0.9	0.9	1.3	1.3	1.3
Debtors Turnover	15.9	10.8	7.7	7.2	7.0
Inventory Turnover	3.8	4.0	5.0	5.0	4.8
Creditor Turnover	10.1	7.1	8.4	8.3	8.2
WC Ratios					
Debtor Days	23.0	33.7	47.6	50.9	51.9
Inventory Days	96.5	90.4	73.0	73.5	76.2
Creditor Days	36.2	51.3	43.7	43.8	44.4
Cash Conversion Cycle	83.3	72.9	77.0	80.6	83.6

Cumulative Financial Data

Figures in Rs crs	FY16-18	FY19-21	FY22-24e
Income from operations	1601	2357	3842
Operating profit	325	420	703
EBIT	237	311	561
PBT	206	221	465
PAT	162	174	341
Dividends	31	43	47
Sales growth (%)	-	47.2	63.0
PAT growth (%)	-	7.6	95.9
OPM (%)	20.3	17.8	18.3
GPM (%)	20.2	16.3	17.4
NPM (%)	10.1	7.4	8.9
Interest coverage	7.7	3.4	5.9
ROE (%)	17.8	13.4	17.6
ROCE (%)	10.5	8.8	10.1
Debt-Equity ratio*	1.0	1.2	1.0
Fixed asset turnover	1.8	1.6	1.7
Total asset turnover	1.2	1.2	1.3
Debtors turnover	12.5	8.8	7.6
Creditors turnover	9.5	8.1	8.4
Inventory turnover	4.2	4.4	4.9
Debtor days	29.3	41.4	48.2
Creditor days	38.2	45.1	43.6
Inventory days	87.5	83.1	74.8
Cash conversion cycle	78.6	79.3	79.4
Dividend payout ratio (%)	19.0	24.6	13.8

FY 16-18 implies three year period ending fiscal 18; *as on terminal year

Barely anemic recovery in the commercial vehicle space and strong dispatches in machining volumes explains much of the 63.0% rise in cumulative income from operations during FY22-24e when compared to that in the preceding three year period. Due to brutal volatility in raw material prices, this revenue growth would be accompanied by stable margins preventing the company to benefit from the operating leverage despite decent pickup in volumes. Though improving profitability would aid in improving interest coverage ratio to 5.9 in the projected period (vs. 3.4 in FY19-21), but fixed asset turnover is estimated to hardly rise (see table).

MMFL's ROE would barely remain suppressed for it is expected to rise to 17.6% in FY22-24e as compared to 13.4% in FY19-21 (see table) not least due to better earnings visibility and higher utilization of assets (see table). Higher debtor days and early payment of credit to suppliers would be counterbalanced by better management of inventory, leading to barely any change in cash conversion cycle (see table). Moreover, falling dividend payout ratio would help the company in financing its capex program.

Financial Summary- US Dollar denominated

million $	FY20	FY21	FY22	FY23e	FY24e
Equity capital	3.2	3.3	3.2	3.0	3.0
Shareholders' funds	62.1	68.1	76.2	85.7	100.1
Total debt	75.1	83.7	89.7	96.6	102.1
Net fixed assets (including CWIP)	87.8	86.4	90.5	112.0	115.0
Investments	0.6	0.7	4.3	4.1	4.1
Net current assets	5.0	10.1	18.2	11.7	24.5
Total assets	106.5	108.5	121.9	136.5	152.2
Revenues	102.6	97.8	148.3	162.9	182.1
EBITDA	20.3	19.3	29.6	32.5	36.2
EBDT	15.6	15.0	25.9	28.4	31.7
PBT	8.1	7.4	17.8	19.9	22.0
PAT	6.5	6.3	12.3	14.9	16.5
EPS($)	0.27	0.26	0.51	0.62	0.68
Book value ($)	2.57	2.82	3.16	3.55	4.15

Income statement figures translated at average rates; balance sheet at year end rates; projections at current rates (Rs 79.33/$).
All dollar denominated figures are adjusted for extraordinary items.

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buy: >20%	accumulate: >10% to ≤20%	hold: ≥-10% to ≤10%	reduce: ≥-20% to <-10%	sell: <-20%

Exchange Rates Used- Indicative

Rs/$	FY19	FY20	FY21	FY22
Average	69.89	70.88	74.20	74.51
Year end	69.17	75.39	73.50	75.81

All $ values mentioned in the write-up translated at the average rate of the respective quarter/ year as applicable. Projections converted at current exchange rate. Cumulative dollar figure is the sum of respective yearly dollar value.