

October 10, 2024

COMPANY UPDATE | Sector: Automobile

Happy Forgings Ltd

Growth-centric capability expansion

Happy Forgings (HFL) management value proposition: 1) significant market share gains from HFL's best-in-class engineering capabilities, marked by rapid diversification & delivery of complex forged/machined components to auto/industrial segments 2) Constant focus on complex/critical parts and recent product additions to unlock new avenues: capability step-up from addition of 14k ton press line (in 3QFY23) helped expand product offerings from up to 90kgs to complex parts up to 250kg. 3) Brownfield capacity expansion projects on track in FY25; ramp up of 14k-ton press line for front axle beams (expected run rate for FY26 ~50k units) and large crankshafts. Further, a new 6.3k-ton press lines in 2QFY25, focused on farm and PV, is under trials. In FY26, another 10k-ton press line will help rebalance production and augment capacity. 4) Indicative order book of ~Rs6.5b-7b of which ~Rs1.5b for PVs, ~Rs2.5b for industrial, and ~Rs2.5b for CV (of which ~90% orders are for machining). New order wins in PV and industrials will help de-risk dependance on CV/tractors (~73% of revenues). Structural demand drivers like opening of India-centric global supply chain, and low revenue share of industrials and exports (vs peers) should trigger outperformance. The street has built in revenue/EBITDA/Adj.PAT CAGR of 18.8%/21.3%/28.7% for FY24-26E. Although execution and sustained revenue diversification are key success factors, we believe valuations at 37.3x/26.7x/20.6x FY25/26/27 bloom standalone EPS and partially price in the positives. Not rated.

Key takeaways from our interaction

Engineering niche enables revenue diversification & market share gains - HFL's management and engineering capabilities have helped it quickly diversify its revenue base as 1) contribution of machined products increased to ~87% as of 1QFY25 (vs 78% earlier), 2) share of industrials and exports increased to 12% (vs 4%) and to 20% (vs 13%). ~48% as of FY24, revenues are from Crankshafts, wherein HFL indicative market share would be close to half/one third in CVs/tractors, given high tolerances of product design, manufacturing capabilities, causing high entry barrier and limited competition.

Capabilities step-up to open new avenues - HFL is looking to add capacity in forging (brownfield expansion is underway for 10k ton press line while 6.3k ton press under trials and machining. Machining capacity utilization is (~85%) 52.5k tons currently; it is expected to move up to 61k-62k tons in phases. **Front axle beam** (new product) supplies are expected to start by end of FY25 and target is to reach ~45-50k beams by FY26 end (to start with 1-2k units/month and ramp up subsequently).

New order wins in PV and industrials to help de-risk CV/tractor dependance - HFL expects PV segment to contribute 4-5% by FY25E and >10% of the overall revenues in 3-4 years, led by ramp-up with existing customer (crankshaft and suspension parts) and new order win from North American customer, slated to start in FY26E. HFL is setting up 3.1k tons press line dedicated to PV segment while ramping-up SUV crankshaft supply to domestic customers, where it has close to one third SOB for a single platform.

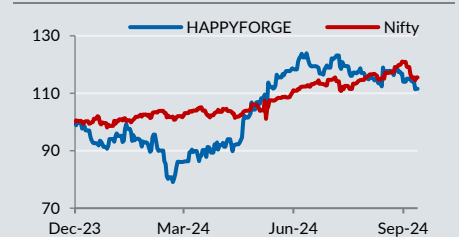
Opening up of global supply chain for India, a structural demand driver - With installation of 14k tons press line (in 3QFY23), HFL experienced a major influx of new order wins from the Industrial segment. The current utilization of this press line is 45-50% of peak potential utilization and it plans to ramp it up to 75-80% on the back of new order wins. HFL has made significant progress in exports as well by cross-selling products and expanding into new locations. HFL expect the share of exports in revenues to increase to >30% over 2-3 years (vs ~8%/20% in FY21/FY24). PV exports share to double to 4-5% by FY26 vs 2-3% currently.

| | |
|------------------|-------------|
| Reco | : NOT RATED |
| CMP | : Rs 1,136 |
| Target Price | : NA |
| Potential Return | : NA |

Stock data (as on Oct 9, 2024)

| | |
|-------------------------|------------------|
| Nifty | 24,982 |
| 52 Week h/l (Rs) | 1,300 / 813 |
| Market cap (Rs/USD mn) | 1,08,180 / 1,289 |
| Outstanding Shares (mn) | 94 |
| 6m Avg t/o (Rs mn): | 63 |
| Div yield (%): | 0.1 |
| Bloomberg code: | HAAPYFOR IN |
| NSE code: | HAPPYFORGE |

Stock performance



| | 1M | 3M | 1Y |
|-----------------|--------|--------|-----|
| Absolute return | (1.9%) | (9.8%) | N/A |

Shareholding pattern (As of June'24)

| | |
|----------|-------|
| Promoter | 78.6% |
| FII+DII | 18.9% |
| Others | 2.5% |

Financial Summary

| Y/E DEC (Rs mn) | FY22 | FY23 | FY24 |
|-----------------|-------|--------|--------|
| Sales | 8,600 | 11,965 | 13,582 |
| EBITDA | 2,309 | 3,409 | 3,875 |
| Adj. PAT | 1,423 | 2,087 | 2,430 |
| Adj. EPS (INR) | 15.1 | 22.2 | 25.8 |
| EPS Gr. (%) | 64.6 | 46.7 | 16.4 |
| BV/Sh. (INR) | 88 | 110 | 171 |
| RoE (%) | 19.9 | 23.5 | 18.7 |
| RoCE (%) | 14.0 | 17.7 | 14.1 |
| Payout (%) | - | - | - |
| P/E (x) | 79.6 | 54.3 | 49.1 |
| P/BV (x) | 14.4 | 11.5 | 7.4 |
| EV/EBITDA (x) | 52.7 | 35.6 | 30.8 |
| Div. Yield (%) | 0.0 | 0.0 | 0.0 |

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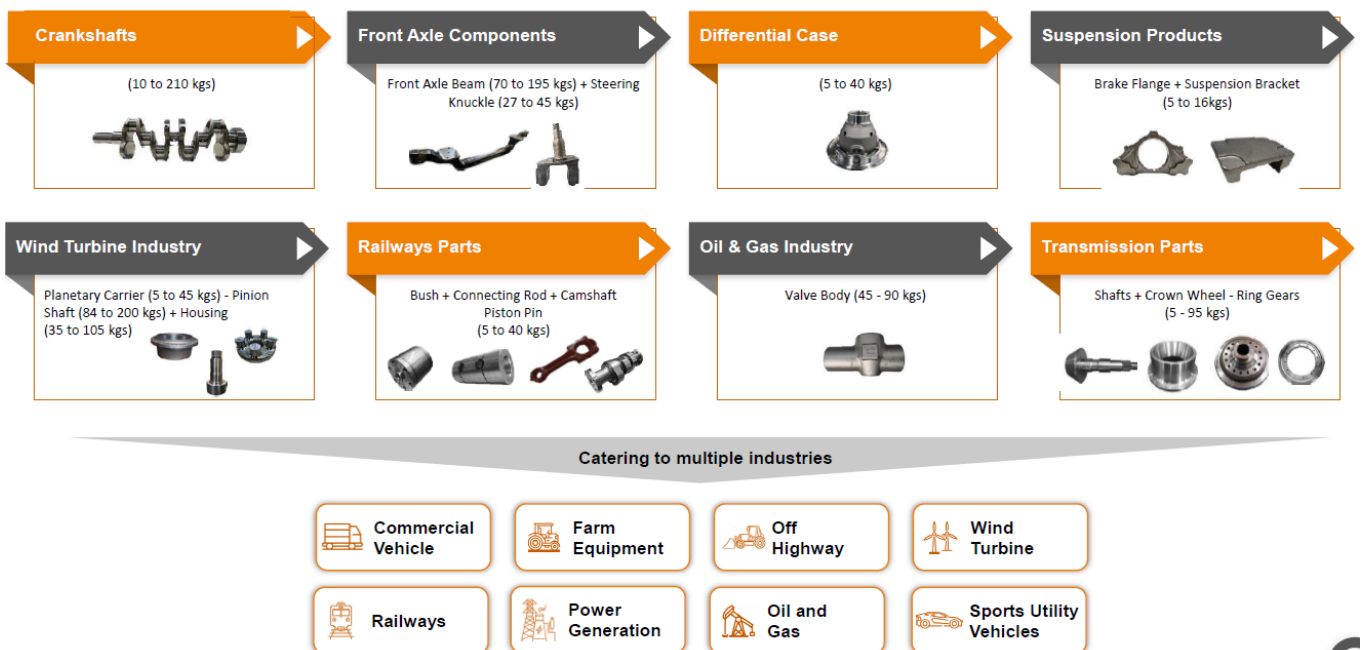
Other takeaways:

- **Growth guidance – signs of improvement in off-highway segments visible, CV is yet to see volume recovery.** Believe, the impact of favorable general election outcome is yet to be visible on the MHCV segment and expect the same to be flattish YoY. However, seeing signs of recovery in off-highway segment with revision in production guidance by end customers. Have not seen any cancellation/delay in order execution due to prevailing macro situation.
- **Growing Exports** - Exports form ~20% in FY24 (of which 8-9% is deemed exports). Expect exports to be >30% over 2-3 years (vs ~8%/20% in FY21/FY24). Indicated exports margins are 4-5% more than domestic supply. European farm and wind sectors were under stress and de-growing by 30%-35%. In North America, most programs are new and involve replacements, so it anticipates strong demand for these projects moving forward. Currently, the focus is on higher orders in Europe, and working on North American orders for the PV and farm sectors. HFL is developing more parts for new clients and the opportunity window is significant, but not working on Class 8 yet. The share of North American orders is expected to increase significantly after 4Q in the coming years.

Segment wise scenario:

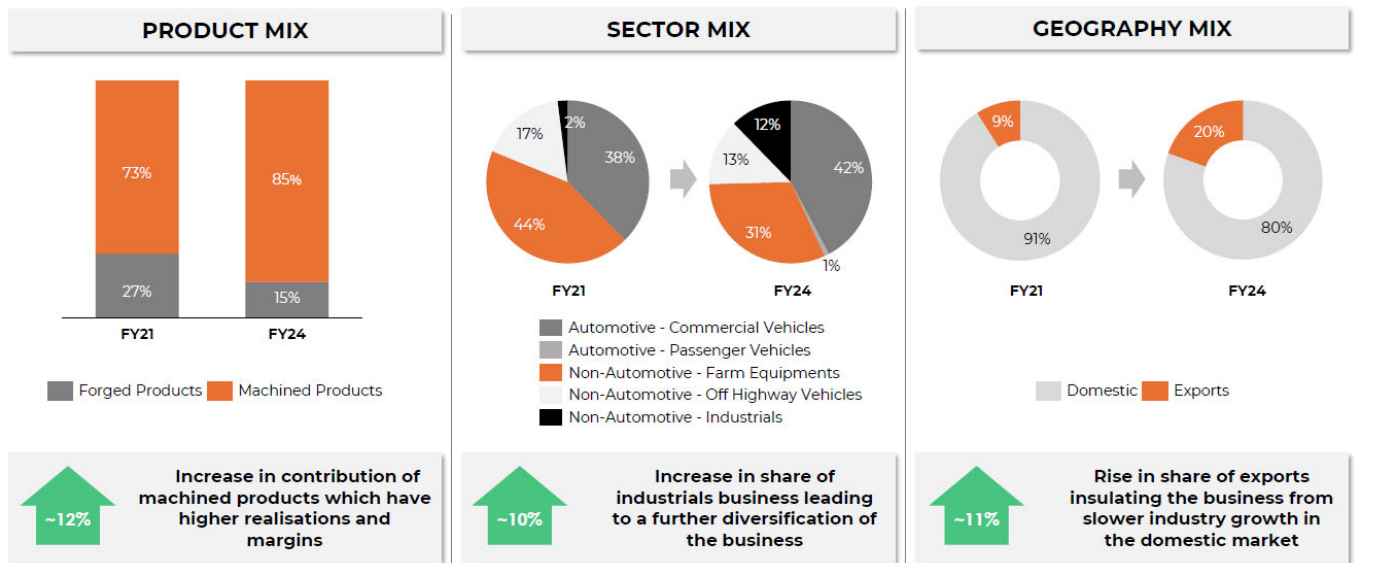
- **Industrial** - Management expects the industrial mix to be ~18%-20% over the next two quarters, with ongoing developments in the wind sector potentially boosting it to 25%-26% next year. On gensets, the company has already executed and received the approvals, but the capacity and the ramp up will start from third quarter.
- **Defense** - Expect to gain some business which are currently under approval stage.
- **Capex** - HFL has guided a capex of ~Rs2-2.5b for FY25/26/27 each. About 40-45% of the incremental capex would be for PVs in-line with new programs won. The management indicated scope for additional capex of ~Rs5b for next 3 years if certain large projects such as heavy axles (for OH and industrial) is expected to come though.

Exhibit 1: HFL's product offerings for base business at par with peers



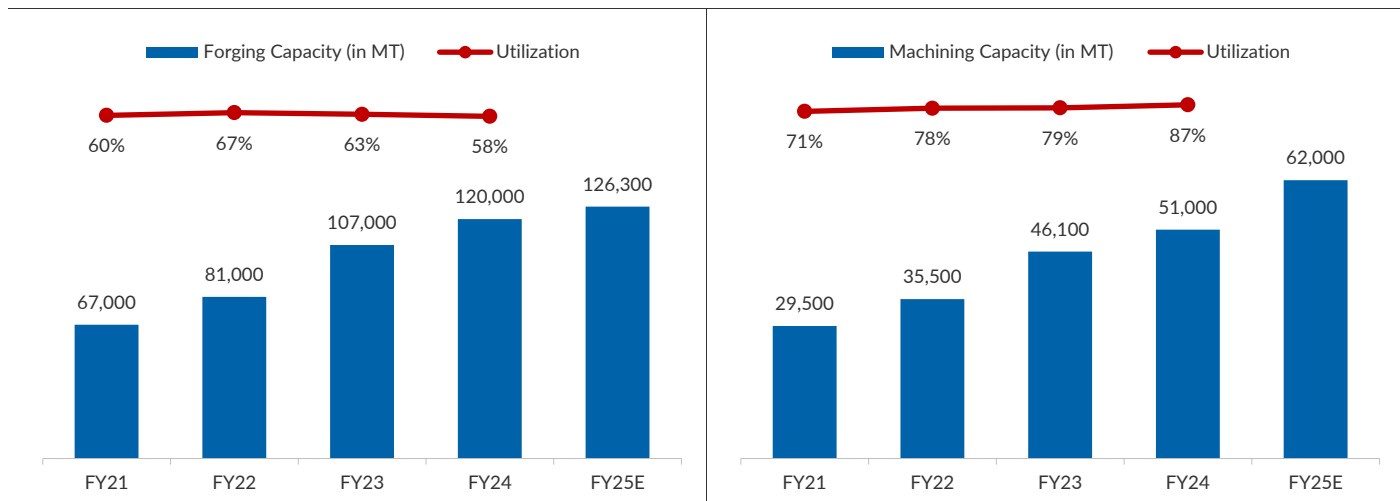
Source- Company, YES Sec

Exhibit 2: Diversification underway led by increasing focus on industrial & exports



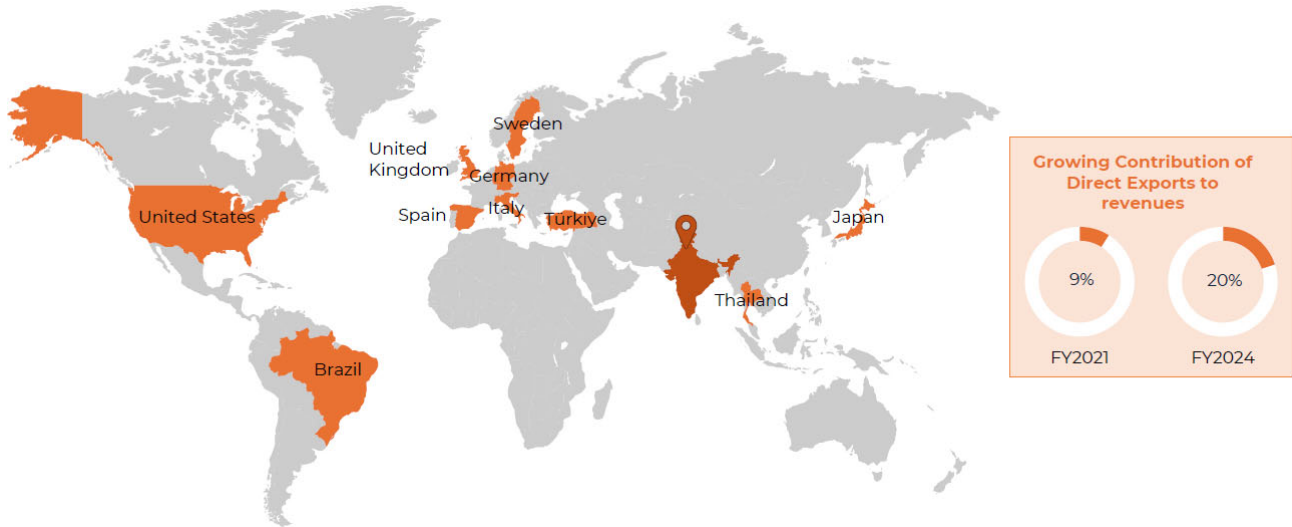
Source- Company, YES Sec

Exhibit 3: Continued capacity expansion to drive growth



Source- Company, YES Sec

Exhibit 4: Exports growth opportunities stay high for base business



Source- Company, YES Sec

Exhibit 5: Global growth opportunities stay high for base business

| Volumes & Realisation | Particulars | FY20 | FY21 | FY22 | FY23* | FY24 | CAGR (FY20-FY24) |
|-----------------------|----------------------------|--------|--------|--------|--------|--------|------------------|
| | Finished goods volume (MT) | 32,284 | 35,534 | 42,777 | 50,656 | 55,379 | 14% |
| | Realisation/Kg (Rs.) | 173 | 165 | 201 | 232 | 245 | 9% |
| | EBITDA/Kg (Rs.) | 44 | 45 | 54 | 63 | 70 | 12% |

| Key Financials | Particulars | FY20 | FY21 | FY22 | FY23# | FY24 | CAGR (FY20-FY24) |
|----------------|-------------------------|------|------|------|-------|-------|------------------|
| | Revenue from operations | 558 | 585 | 860 | 1,173 | 1,358 | 25% |
| | Gross profit | 309 | 333 | 472 | 622 | 762 | 25% |
| | EBITDA | 142 | 159 | 231 | 317 | 388 | 28% |
| | PAT | 80 | 86 | 142 | 191 | 243 | 32% |

Source- Company, YES Sec

FINANCIALS

Exhibit 6: Balance Sheet

| Y/E March (Rs mn) | FY20 | FY21 | FY22 | FY23 | FY24 |
|-------------------------------------|--------------|--------------|---------------|---------------|---------------|
| Equity Share Capital | 89 | 90 | 179 | 179 | 188 |
| Eq. Share Warrants & App. Money | 0 | 0 | 0 | 0 | 0 |
| Preference Capital | 0 | 0 | 0 | 0 | 0 |
| Total Reserves | 5,495 | 6,362 | 7,697 | 9,704 | 15,937 |
| Net Worth | 5,585 | 6,452 | 7,876 | 9,883 | 16,125 |
| Minority Interest | 0 | 0 | 0 | 0 | 0 |
| Total Loans | 1,049 | 1,535 | 2,404 | 2,185 | 1,430 |
| Deferred Tax Liabilities | 210 | 202 | 229 | 230 | 316 |
| Capital Employed | 6,845 | 8,188 | 10,509 | 12,299 | 17,871 |
| Gross Block | 3,322 | 5,063 | 5,839 | 8,569 | 9,858 |
| Less: Accum. Deprn. | 569 | 918 | 1,293 | 1,800 | 2,433 |
| Net Fixed Assets | 2,753 | 4,145 | 4,546 | 6,770 | 7,425 |
| Goodwill | 10 | 11 | 16 | 15 | 60 |
| Capital WIP | 1,084 | 394 | 2,123 | 748 | 1,219 |
| Total Investments | 0 | 0 | 4 | 0 | 1 |
| Curr. Assets, Loans&Adv. | 2,693 | 3,374 | 4,256 | 4,900 | 7,421 |
| Inventory | 757 | 1,216 | 1,840 | 1,696 | 2,242 |
| Account Receivables | 1,379 | 1,658 | 2,220 | 3,081 | 3,569 |
| Cash and Bank Balance | 558 | 278 | 15 | 3 | 1,174 |
| Loans and Advances | 0 | 1 | 2 | 3 | 7 |
| Other Current Assets | 0 | 222 | 179 | 117 | 430 |
| Curr. Liability & Prov. | 786 | 576 | 790 | 963 | 988 |
| Account Payables | 359 | 379 | 442 | 477 | 555 |
| Other Current Liabilities | 421 | 178 | 321 | 448 | 388 |
| Provisions | 6 | 19 | 27 | 38 | 45 |
| Net Current Assets | 1,907 | 2,798 | 3,466 | 3,937 | 6,433 |
| Deferred Tax assets | 0 | 0 | 0 | 0 | 0 |
| Other Non Current Assets | 1,092 | 840 | 354 | 830 | 2,733 |
| Appl. of Funds | 6,845 | 8,188 | 10,509 | 12,299 | 17,871 |

Source: Company, YES Sec

Exhibit 7: Income statement

| Y/E March (Rs mn) | FY20 | FY21 | FY22 | FY23 | FY24 |
|--------------------------------------|--------------|--------------|--------------|---------------|---------------|
| Total Income from Operations | 5,581 | 5,850 | 8,600 | 11,965 | 13,582 |
| Change (%) | | 4.8 | 47.0 | 39.1 | 13.5 |
| Raw Materials | 2,345 | 2,573 | 4,358 | 5,477 | 5,966 |
| Employees Cost | 491 | 490 | 687 | 878 | 1,145 |
| Other Expenses | 1,176 | 1,256 | 1,721 | 2,168 | 2,596 |
| Total Expenditure | 4,156 | 4,262 | 6,292 | 8,556 | 9,707 |
| % of Sales | 74.5 | 72.9 | 73.2 | 71.5 | 71.5 |
| EBITDA | 1,424 | 1,587 | 2,309 | 3,409 | 3,875 |
| Margin (%) | 25.5 | 27.1 | 26.8 | 28.5 | 28.5 |
| Depreciation | 284 | 358 | 377 | 542 | 647 |
| EBIT | 1,140 | 1,230 | 1,931 | 2,868 | 3,228 |
| Intrest Charges | 251 | 118 | 72 | 125 | 118 |
| Other Income | 68 | 59 | 61 | 57 | 134 |
| PBT before share of associate | 958 | 1,171 | 1,920 | 2,800 | 3,244 |
| Extraordinary Exp | 0 | 0 | 0 | 0 | 0 |
| PBT after share of associate | 958 | 1,171 | 1,920 | 2,800 | 3,244 |
| Total Tax | 159 | 306 | 498 | 713 | 814 |
| Tax Rate (%) | 16.6 | 26.2 | 25.9 | 25.5 | 25.1 |
| Minority Interest | - | - | - | - | - |
| Reported PAT | 799 | 864 | 1,423 | 2,087 | 2,430 |
| Adjusted PAT | 799 | 864 | 1,423 | 2,087 | 2,430 |
| Change (%) | | 8.1 | 64.6 | 46.7 | 16.4 |
| Margin (%) | 14.3 | 14.8 | 16.5 | 17.4 | 17.9 |

Source: Company, YES Sec

Exhibit 8: Cash Flow Statement

| Y/E March (Rs mn) | FY20 | FY21 | FY22 | FY23 | FY24 |
|----------------------------------|----------------|--------------|----------------|----------------|----------------|
| OP/(Loss) before Tax | 965 | 1,171 | 1,920 | 2,800 | 3,244 |
| Depreciation | 284 | 358 | 377 | 542 | 647 |
| Interest & Finance Charges | 213 | 75 | 64 | 119 | 41 |
| Direct Taxes Paid | (249) | (339) | (431) | (638) | (839) |
| (Inc)/Dec in WC | 473 | (825) | (1,088) | (779) | (1,230) |
| CF from Operations | 1,686 | 440 | 843 | 2,044 | 1,864 |
| Others | 1 | 59 | (40) | 51 | 27 |
| CF from Operating incl EO | 1,687 | 499 | 803 | 2,095 | 1,890 |
| (Inc)/Dec in FA | (1,010) | (917) | (1,908) | (1,745) | (1,936) |
| Free Cash Flow | 677 | (418) | (1,105) | 350 | (46) |
| (Pur)/Sale of Investments | 305 | 0 | 0 | 0 | 0 |
| Others | (483) | 330 | 252 | 20 | (2,758) |
| CF from Investments | (1,189) | (587) | (1,657) | (1,725) | (4,694) |
| Buyback of shares | 0 | 0 | 0 | 0 | 3,810 |
| Inc/(Dec) in Debt | (383) | 351 | 893 | (251) | (755) |
| Interest Paid | (117) | (254) | (68) | (119) | (130) |
| Dividend Paid | 0 | 0 | 0 | 0 | (116) |
| Others | 0 | 0 | 0 | 0 | 0 |
| CF from Fin. Activity | (500) | 97 | 825 | (370) | 2,809 |
| Inc/Dec of Cash | (2) | 8 | (29) | (0) | 5 |
| Opening Balance | 22 | 20 | 29 | 0 | 0 |
| Bank Balance | 537 | 249 | 14 | 3 | 1,168 |
| Closing Balance | 558 | 278 | 15 | 3 | 1,174 |

Source- Company, YES Sec

Exhibit 9: Growth and Ratio matrix

| Y/E March | FY20 | FY21 | FY22 | FY23 | FY24 |
|-------------------------------|-------|-------|-------|-------|-------|
| Basic (INR) | | | | | |
| EPS | 17.9 | 19.3 | 15.9 | 23.3 | 25.8 |
| Cash EPS | 24.2 | 27.3 | 20.1 | 29.4 | 32.7 |
| BV/Share | 124.8 | 144.2 | 88.0 | 110.4 | 171.2 |
| DPS | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Payout (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Valuation (x) | | | | | |
| P/E | 70.9 | 65.5 | 79.6 | 54.3 | 49.1 |
| Cash P/E | 52.3 | 46.4 | 62.9 | 43.1 | 38.8 |
| P/BV | 10.1 | 8.8 | 14.4 | 11.5 | 7.4 |
| EV/Sales | 21.5 | 20.6 | 14.1 | 10.1 | 8.8 |
| EV/EBITDA | 84.1 | 75.9 | 52.7 | 35.6 | 30.8 |
| Dividend Yield (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| FCF per share | 15.1 | -9.3 | -12.4 | 3.9 | -0.5 |
| Return Ratios (%) | | | | | |
| RoE | 14.3 | 14.4 | 19.9 | 23.5 | 18.7 |
| RoCE (post-tax) | 14.7 | 11.6 | 14.0 | 17.7 | 14.1 |
| RoIC | 18.3 | 12.1 | 17.1 | 18.5 | 15.6 |
| Working Capital Ratios | | | | | |
| Fixed Asset Turnover (x) | 1.7 | 1.2 | 1.5 | 1.4 | 1.4 |
| Asset Turnover (x) | 0.8 | 0.7 | 0.8 | 1.0 | 0.8 |
| Inventory (Days) | 49 | 76 | 78 | 52 | 60 |
| Debtor (Days) | 90 | 103 | 94 | 94 | 96 |
| Creditor (Days) | 23 | 24 | 19 | 15 | 15 |
| Leverage Ratio (x) | | | | | |
| Current Ratio | 3.4 | 5.9 | 5.4 | 5.1 | 7.5 |
| Interest Cover Ratio | 4.6 | 10.4 | 27.0 | 23.0 | 27.4 |
| Net Debt/Equity | 0.1 | 0.2 | 0.3 | 0.2 | 0.0 |

Source: Company, YES Sec

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In adopting Rule 15a-6, the SEC sought "to facilitate access to foreign markets by U.S. institutional investors through foreign broker-dealers and the research that they provide, consistent with maintaining the safeguards afforded by broker-dealer registration." [Rule 15a-6 Adopting Release at 54 FR 30013; see also Registration Requirements for Foreign Broker-Dealers, Exchange Act Release No. 25801 (June 14, 1988), 53 FR 23645 (June 23, 1988)].

DISCLOSURE OF INTEREST

Name of the Research Analyst : Deep Shah, Meghna Gundu

The analyst hereby certifies that opinion expressed in this research report accurately reflect his or her personal opinion about the subject securities and no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendation and opinion expressed in this research report.

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BUY: Upside greater than 20% over 12 months

ADD: Upside between 10% to 20% over 12 months

NEUTRAL: Upside between 0% to 10% over 12 months

REDUCE: Downside between 0% to -10% over 12 months

SELL: Downside greater than -10% over 12 months

NOT RATED / UNDER REVIEW

Analyst signature

Analyst signature

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