10TH NOV 2023

5 MINUTE STOCK IDEA

BY SMART SYNC INVESTMENT ADVISORY SERVICES

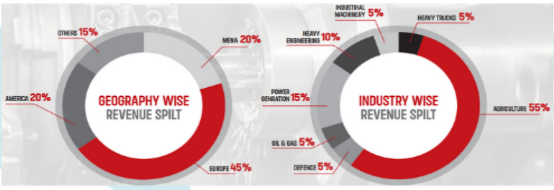
BALU FORGE INDUSTRIES LTD

WHAT WE LIKE

STRONG MARKET POSITIONING:

The company has over 3 decades of experience in precision engineering & is engaged in the manufacturing of finished and semi-finished crankshafts and forged components. The company has maintained a strong ROCE of **20%+ led by~**

- **R&D:** The company despite it smaller scale of operation has an R&D team of 45 employees led by annual investments of 2-4% of sales in R&D activities, which enables it to manufacture highly complex products that help in fetching Operating Margins of 20-22% & develop newer products.
- **Diversified revenue base:** The company services 25+ OEM's catering to different industries & its geographical mix is fairly diversified providing stability to the biz model.



- **Backward Integrated:** The company has backward integrated from machining to forging as well which will lead to lower costs & stronger competitive positioning.
- **Improved working capital cycle:** Working capital days improved from 177 days in FY23 to 135 days in H1FY24 .

HEALTHY TRACK RECORD & FUTURE PROSPECTS:

The company (erstwhile Amaze Entertech Limited) post reverse merger with Balu India in FY20-21 has performed exceedingly well led by product additions like heavy-duty

Compounded Sales Growth	
10 Years:	%
5 Years:	%
3 Years:	%
TTM:	67%

Compounded Profit Growth	
10 Years:	%
5 Years:	%
3 Years:	%
TTM:	113%

Stock Price CAGR	
10 Years:	%
5 Years:	30%
3 Years:	27%
1 Year:	278%

Return on Equity	
10 Years:	%
5 Years:	%
3 Years:	%
Last Year:	22%

Its strong growth prospects are a function of~

- **Capex:** The company is increasing machining capacity from 18,000 MTPA to 32,000 MTPA in Belgaum after acquiring a land of 13 acres (existing land~8 Acres in Belgaum +1-UAE), this capex is expected to commercialise in Q4FY24 & will lead to higher margins. Further, post acquisition of Mercedez Benz machining facility in Germany, capacity will further increase by 15,000 MTPA on commercialisation.
- **Industry tailwinds:** Company caters to industries like Railways, Defense,Agriculture, Power generation & industrial machinery which is seeing extraordinary capex cycle.
- **Optionalities:** Owing to potential addition of newer products in EV value chain like EV charging stations as well as other products like Lithium Ion battery, Lead acid recycling, Hydrogen storage, Powertrain sub-assemblies for CV, components for railways among others.

As a result the management is guiding for a strong 25% growth in FY24 with OPM% of 20-23% .

WHAT WE DON'T LIKE

RAW MATERIAL VOLATILITY RISK:

The major raw material- steel and aluminum which are very volatile in nature & can hurt OPM%. While Balu Forge Industries Ltd is able to pass on price increase to customers, any significant movement in the price of raw material and a lag in passing on price fluctuations to customers can impact profitability.

FOREX RISK:

This is a major risk considering exports contribute more than 90% of the total revenues. This risk came into forefront in FY23 wherein company reported a foreign exchange loss of around 5 Crs which increased its other expenses.

ELONGATED WORKING CAPITAL CYCLE:

The company's cash conversion cycle stands at around 150 days due to:

- High inventory period of 60-80 days led by higher SKU's
- Higher receivables days of 150-180 days due to business requirements and maintains an inventory of 60-80 days due to diversified product portfolio.

We at **SSS** Believe that a high inventory period can also be a source of entry barriers for new players while a higher receivable periods is also at times natural for a growing B2B biz, however, given the provisions for credit loss of 9 Crs made by the company, it looks like a major risk.

	Mar 2021	Mar 2022	Mar 2023
Debtor Days	156	165	235
Inventory Days	66	70	56
Days Payable	157	75	105
Cash Conversion Cycle	**65**	**160**	**186**

It is worthwhile to note that the company's cashflow generation has also been extremely poor as a result of a higher working capital cycle

	Mar 2021	Mar 2022	Mar 2023
Cash from Operating Activity -	17	-58	12
Profit from operations	17	37	61

GEOGRAPHICAL CONCENTRATION RISKS:

The company's major market ~Europe (45% revenues) & America (20% revenues) is going through a huge slowdown, which can hurt company's growth prospects. It is important to note that this risk materialized in FY23 with revenues from exports growing at only 6%. However, this risk is partly mitigated with growing share of domestics (from 5% to 12%).

BALANCE SHEET RISKS: :

The company's capex & acquisitions have far exceeded their CFO for the past few years while its working capital situation has led to poor CFO, leading to several rounds of fund raising with the latest being issue of close to 200 Crs worth of warrants to promoters (34 Crs & non-promoters (158 Crs).

	Mar 2021	Mar 2022	Mar 2023	Sep 2023
Share Capital +	69	82	83	100

This has further led to dilution of promoter's equity from 69% to 56% in a span of 2 years, & is thus a major risk.

Note: Its working capital fund utilization has also been pretty high as per credit rating reports