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Why Baba Kalyani is Looking Beyond Auto Parts

First, he de-risked his auto-component business by diversifying its customer base. Then, he diversified by geographies. Over the last five years, Baba Kalyani is making Bharat Forge do more in sectors that have nothing to do with auto, reports Lijee Philip

Managing risk has been at the centre of many business moves made by Baba Kalyani in the past 15 years. The first was to actively look beyond the two customers that accounted for 60% of the revenues of Bharat Forge, his auto-component company that specialises in making forgings. The second—which played out in the middle of the last decade and catapulted Bharat Forge to the number two spot globally in its forging business—involved buying companies or setting up subsidiaries in big auto markets outside India.

In the last five years, a third kind of de-risking has been underway at Bharat Forge, and it has gone relatively unnoticed: selling forging products, and more, to clients outside the auto industry. In 2008-09, 28% of the revenues of its Indian operations came from non-auto segments—oil and gas, power, railways, defence, mining and construction, among others.

By 2012-13, this piece had increased to 39%, while proving to be a valuable counterpoint to the turmoil elsewhere in the group. "The target is to increase this to 60% in two years," says Baba Kalyani, chairman of the Kalyani Group, whose flagship is Bharat Forge. "We have built in a lot of resilience within our company."

Selling to non-auto clients is a diversification and de-risking move in some ways. "They are relatively less cyclical compared to its core business of supplying to commercial vehicle manufacturers, which sees sharper declines," says Surjit Arora, equity research analyst at Prabhudas Lilladher Institutional Equities, a brokerage.

> Bharat Forge's diversification into non-auto segments has proven to be a counterpoint to the turmoil elsewhere

Yet, the risk equation of such a diversification is not straight-forward. "Non-auto revenues are not sticky or predictable," says Mahantesh Sabarad, deputy research head at SBI Cap Securities. "Non-auto revenues in India are, typically, project orders that do not repeat. This is unlike auto forgings, which repeat every year."

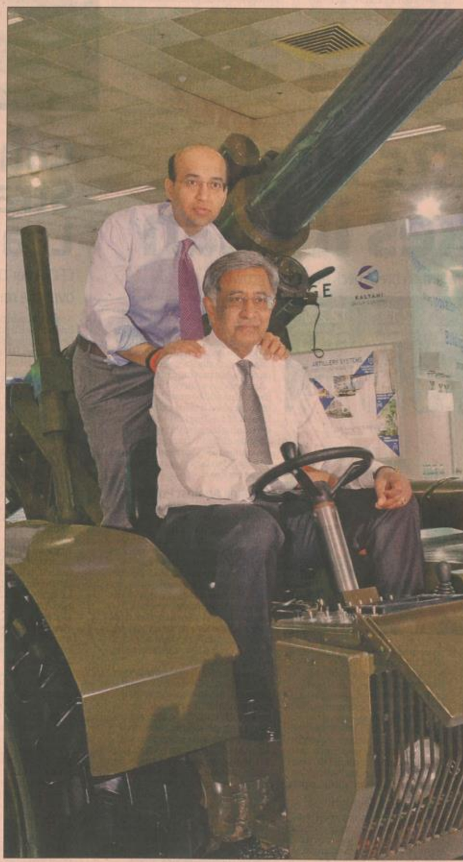
So, for example, the Rs 5,700 crore Bharat Forge is supplying machined crankshafts to the Indian Railways, and parts for wind turbines and those used in shale gas drilling equipment. "We plan to enter five or six new sectors in the coming years, with a plan to scale up each vertical to $100 million (about Rs 600 crore) in revenues, says Amit Kalyani, executive director, Bharat Forge.

Beyond Auto

Part of the thinking at Bharat Forge is about tapping into emerging opportunities and forecasting ahead. Take defence. "Ten years from today, we are very confident that India is going to emerge as a large exporter of defence products. Today, we are the largest importer of defence products," says Baba Kalyani. "That is the kind of inflexion point the country needs to see. And we are going to be a fairly important player in this."

At present, in the defence sector, Bharat Forge's joint venture with Israeli company Elbit Systems focuses on land systems—artillery and infantry equipment and tanks. About 18 months ago, without any order from the Indian Army, this joint venture started developing a 155 mm artillery gun. Explains Baba Kalyani: "Unlike automobiles, the last gun was developed 20 years back. Our guns are today's technology."

Several of these diversifications are partnerships. There is, for example, a strategic alliance with Swedish defence and security company Saab. Similarly, in energy, it has a JV with French major Alstom; their plant in Sanand, Gujarat, is expected to start producing parts for wind turbine-generators from 2015-16. Currently, says Baba Kalyani, it has orders for five units of 660 MW turbo-generator sets, worth about Rs 5,000 crore.



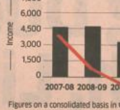
GUNS BLAZING: Baba Kalyani and son Amit Kalyani are looking at defence in a big way. Bharat Forge's JV with Israeli company Elbit Systems focuses on artillery, infantry equipment and tanks

Life Beyond Auto

NON-AUTO REVENUES (%)

	2008-09	2012-13
Indian operations	28	39
Consolidated	21	28

FINANCIAL PERFORMANCE



Figures on a consolidated basis in ₹cr Source: Company

SEGMENTS

	2002-03	2012-13
Auto	• Commercial vehicles • Passenger vehicles	• Commercial vehicles • Passenger vehicles • Utility vehicles
Non-auto	• Oil & gas • General Engineering	• Oil & gas • General engineering • Rail & marine • Construction & mining

Sabarad makes a distinction between making forgings for non-auto industries and the kind of products Bharat Forge wants to do in defence and wind energy. "Non-auto forgings are related diversifications as they require near similar engineering and execution capabilities," he says. "However, foraying into capital goods and infrastructure business segments is entirely unrelated and requires a different mindset."

Buying And Selling

Changing mindsets is nothing new to Bharat Forge. In 1997, 60% of the company's sales were coming from two domestic players. So, it started pushing on exports to drive growth, and had five customers by 2000. "But we wanted to have the Daimlers, GMs and Fords in our customer list, and aspired to be one of the top five forging companies globally," says Baba Kalyani. And that led to another mindset and strategy change.

Wanting to be close to customer plants and in big markets, it started buying strong companies, with a presence in Europe, US and China, but which were in some kind of distress and available at reasonable valuations. Between 2004 and 2007, it bought five companies in four countries. And it set up a joint venture in China. "The period from 2002 to 2007 was probably our best period," says Baba Kalyani. "We created a strategy to build global scale, footprints in each of the geographies and dramatically built our international business."

According to Baba Kalyani, the European acquisitions, after an initial period of difficulty, have worked well. But some of the others have not panned out as anticipated, partly because of the crippling squeeze caused by the 2008 financial crisis. "We were very vulnerable, unprepared and went into a financial crisis," he says.

Bharat Forge shut its US subsidiary in December 2012, though it is now looking to get back again, something that could happen in the next three to six months. "Wherever we have wholly-owned companies, we are doing quite okay, except the US," says Baba Kalyani. "In the US, we didn't have scale and without scale it's difficult to operate. It was a small outfit of $20 million and in the UAW (a labour union) belt, where wages were high. The cost equation didn't work. So, now, we are going south, where costs are more competitive."

China, which it targeted as a low-cost manufacturing base, was also a bugbear, plagued by differences in partner priorities and work culture. Even after eight years, its JV with FAW Group was making losses and operating at just 40% of capacity. This January, Bharat Forge sold its stake in that JV, for roughly the amount it invested over the years. "Our objectives were different," says Baba Kalyani, of its Chinese partner. "We are in the component business, they are in the vehicle business. It's like a marriage going bad."

Looking Ahead

Yet, there are takeaways from these mis-adventures, and Baba Kalyani is quick to turn the spotlight to them. "A lot of my people, management and manufacturing team now have a lot of knowledge about China," he says. "The next time it will be a lot easier and we won't make the same mistakes on how to choose a partner, in which areas and how do we structure the business."

> Capital goods and infrastructure require a different engineering mindset

The other learning is on the virtues of diversification, which is seeing the company go from a geographical focus to a product/customer focus. "Margins in non-auto business are higher by 300-400 basis points (3-4 percentage points)," says Arora of Prabhudas Lilladher Institutional Equities. "This is mainly because of higher realisations and customised/specialised products."

Overall, Bharat Forge is in better shape than before. It has cut off troublesome subsidiaries. It has cut costs and organised production better. "We have been able to reduce inventory levels from about 50 days to less than three weeks, over the last three years, "says Kalyani.

It has also consolidated its European assets. Sahil Kedia, analyst at Barclays, reckons all this will lower its break even from the current utilisation of 62%. And Nishant Vass, analyst at ICICI Securities, sees it turning cash positive in 2014-15. And then, there are the new pieces, beyond auto. "Built in new capabilities and with these new opportunities—railways, energy, power and defence—the future looks far better than what it looked in 2008," concludes Kalyani.

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