

Sona BLW Precision Forgings Ltd.

IPO Note – 14th June 2021

Recommendation		SUBSCRIBE		BACKGROUND				
Price Band		Rs. 285 – 291		SBPF (Sona BLW Precision Forgings) is a leading automotive technology company designing, manufacturing and supplying highly engineered, mission critical automotive systems and components such as differential assemblies, differential gears, conventional and micro-hybrid starter motors, BSG systems, EV traction motors (BLDC and PMSM) and motor control units to automotive OEMs across US, Europe, India and China, for both electrified and non-electrified powertrain segments. SBPF is among the top 10 players globally in the overall differential bevel gear market and the starter motor market for PVs.				
Bidding Date		14 – 16 June						
BRLM		Kotak, Credit Suisse, JM, JP Morgan, Nomura						
Registrar		K Fintech						
Sector		Automobiles						
Minimum Retail Application				Details and Objects of the Issue				
Number of Shares		51		<ul style="list-style-type: none"> The total issue size is Rs. 5,550 Cr constituting (i) Offer For Sale of up to 18.04 Cr equity shares aggregating to Rs. 5,250 Cr by promoter group (Singapore VII Topco III, a Blackstone entity); and (ii) fresh issue of up to 1.03 Cr equity shares aggregating to Rs. 300 Cr. The offer shall constitute 32.7% of the post-offer paid-up equity capital of the company. SBPF shall utilise the proceeds from the fresh issue towards retiring debt. 				
Min. Application Money		Rs. 14,841						
Discount to retail		N.A		Investment Rationale				
Payment Mode		ASBA		<ul style="list-style-type: none"> Proxy play on value migration from ICE to EV. Share of EV segment has risen from nil to 14% within two years and is geared for exponential growth. Increased global market share of differential gears and starter motors to 5.0% and 3.0%, respectively in CY20 from 4.5% and 2.5% in CY19. Global share of EV differential assemblies was 8.7% in CY20 from nil earlier. Strong R&D & technological capabilities in hardware & software development. Stable financial performance reflecting counter-cyclical; with industry leading metrics. 				
Financials (Rs Cr)		FY20	FY21					
Total Income		1220	1566					
EBITDA		325	441					
PAT		222	225					
Valuations		Upper Band		Valuation and Recommendation				
Market Cap (Rs Cr)		16,974		There is no direct comparable peer to SBPF and thus we compare it with prominent Indian auto ancillaries as well as global auto ancillaries supplying certain EV parts. We observe that SBPF's margins and return ratios are well above peers. Considering these metrics along with the counter-cyclical nature of business owing to rising share of EV revenues (and scarcity premium due to lack of available EV plays in India), we expect the company to sustain its relatively higher valuations against peers. We recommend subscribing to the issue from a long term perspective.				
EPS		3.9						
P/E Ratio		75.4						
EV/ EBITDA		39.3						
Enterprise Value (Rs Cr)		17,311						
Post Issue Shareholding Pattern								
Promoters		67.3%						
Institutions		24.5%						
Public		8.2%						
Offer structure for different categories								
QIB (Including Mutual Fund)		75%						
Non-Institutional Investors		15%						
Retail		10%						
Post Issue Equity (Rs. in Cr)		583.3						
Issue Size (Rs in Cr)		5,550						
Face Value (Rs)		10						
Jehan Bhadha Reserch Analyst (+91 22 6273 8174) Jehankersi.bhadha@nirmalbang.com				Financials (Rs Cr)		FY19	FY20	FY21
				Net Revenues		1428	1220	1566
				Growth		17%	-15%	28%
				EBIDTA		412	325	441
				EBITDA Margins		28.9%	26.7%	28.2%
				PBT		326	228	300
				Growth		20%	-30%	32%
				PAT		213	222	225
				EPS		3.6	3.8	3.9
				ROCE		24%	17%	21%
EV/Sales		12.0	14.1	11.1				
EV/EBITDA		41.5	52.8	39.3				
P/E		79.7	76.6	75.4				
				Source: Company data, NBRR				

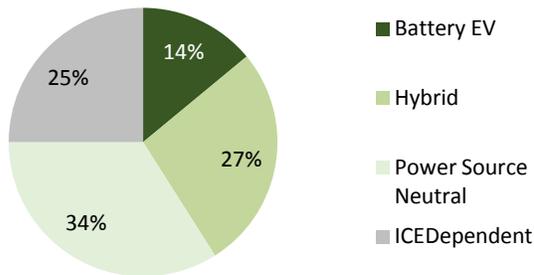
Sona BLW Precision Forgings Ltd.

Company Background

SBPF is one of India’s leading automotive technology companies, designing, manufacturing and supplying highly engineered, mission critical automotive systems and components such as differential assemblies, differential gears, conventional and micro-hybrid starter motors, BSG systems, EV traction motors (BLDC and PMSM) and motor control units to automotive OEMs across US, Europe, India and China, for both electrified and non-electrified powertrain segments. As per the Ricardo Report, in CY20, SBPF was among the top 10 players globally in the differential bevel gear market. Company is also expected to be among the top 10 global starter motor suppliers based on its exposure to the PV segment in CY20, according to the same report. SBPF have been gaining global market share across products to reach a share of 5.0% for differential bevel gears, 3.0% for starter motors and 8.7% for BEV differential assemblies, in CY20.

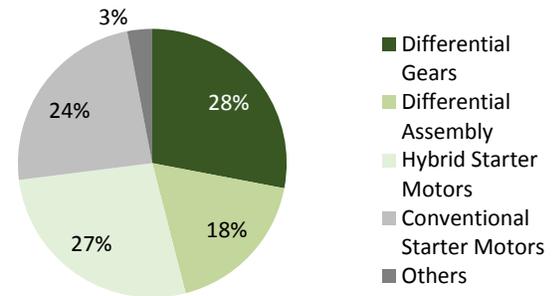
SBPF has nine manufacturing and assembly facilities across India, China, Mexico and USA, of which six are located in India, from where it supplies its products to six out of the top 10 global PV OEMs, three out of the top 10 global CV OEMs and seven out of the top eight global tractor OEMs by volume. SBPF derived 75% of revenue from overseas markets, including 36% in North America, 27% in Europe and 8% in China and 25% from India, for FY21.

Exhibit 1: Revenue Mix by Powertrain (FY21)



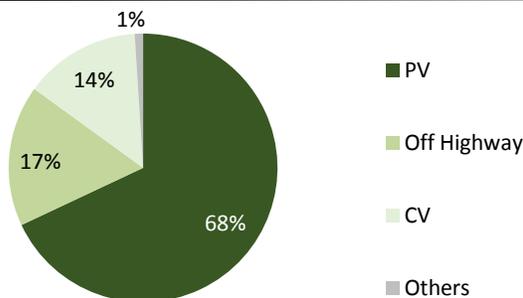
Source: RHP

Exhibit 2: Product Mix (FY21)



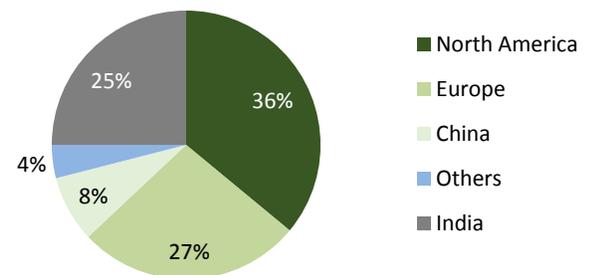
Source: RHP

Exhibit 3: Revenue Mix by Vehicles (FY21)



Source: RHP

Exhibit 4: Geographic Mix (FY21)



Source: RHP

Investment Rationale

Proxy play on value migration from ICE to EV

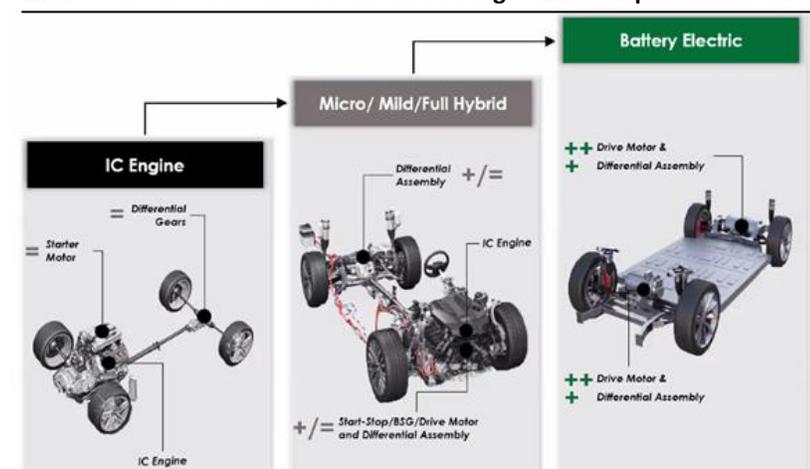
While EV sales as a percentage of total global vehicle sales was 3.3% in CY20, **14% of SBPF sales was derived from the EV market during FY21**. Among the available propulsion technologies, **Battery EV has been the fastest growing segment at a CAGR of approximately 46% between CY15-20 and is expected to grow at a CAGR of 36% over CY20-25**. SBPF has increased its sales to the EV market at a CAGR of 244% from Rs. 17 Cr FY19 to Rs. 206 Cr in FY21. SBPF supplies differential assemblies, differential gears, EV Traction Motors to customers in US, China and India, for use in hybrid and battery electric passenger vehicles, hybrid and battery electric light commercial vehicles, electric two-wheelers and electric three-wheelers. **The cost of gear assembly for an EV is 1.5-2x that of an ICE vehicle**. The company's global market share of EV differential assemblies in CY20 was 8.7%.

Exhibit 5: Vehicle Mix (FY21)

	FY19	FY20	FY21
Battery EV	17	23	206
Growth		34%	781%
Mix	1%	2%	14%
Hybrid	233	348	398
Growth		50%	14%
Mix	17%	29%	27%
Power Source Neutral	641	492	513
Growth		-23%	4%
Mix	47%	42%	34%
ICE Dependent	474	317	373
Growth		-33%	18%
Mix	35%	27%	25%
Total (Non-Proforma)	1365	1180	1489
Growth		-14%	26%

Source: RHP

Exhibit 6: Powertrain evolution is increasing realization per vehicle



SBPF has been awarded 15 development programs for EV systems and components by 10 different customers as at March, 2021, of which active production process has commenced for 8 programs and regular production is yet to commence for 7 programs. Thus we expect Battery EV segment revenue to continue its exponential growth in FY22 as well.

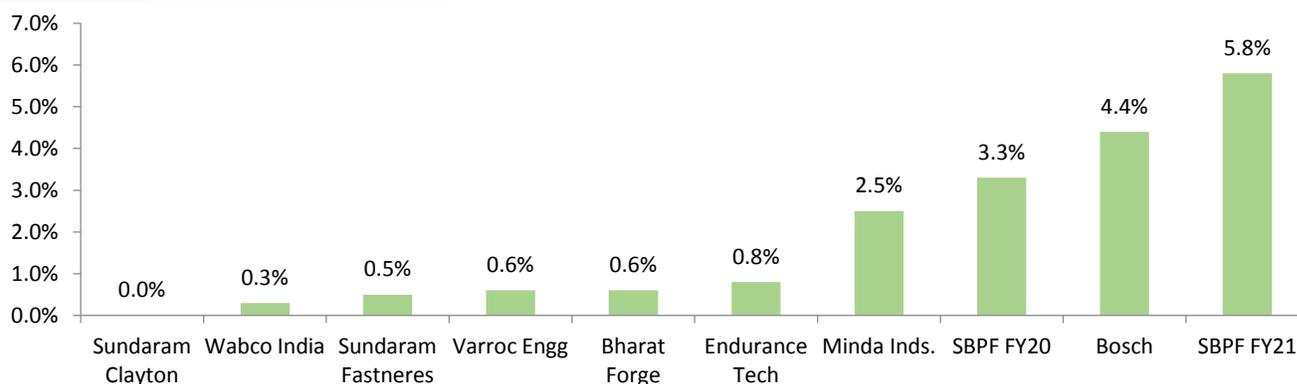
Increasing global market share

SBPF increased its global market share of differential gears and starter motors to 5.0% and 3.0%, respectively in CY20 from 4.5% and 2.5% in CY19. The global market share of EV differential assemblies was 8.7% in CY20 from nil earlier. As part of its strategy, the company intends to penetrate the European market for supplying differential assemblies and differential gears, where the company currently has limited market share for its driveline products. SBPF also plans to expand presence in China for supply of micro-hybrid starter motors for PVs and LCVs as well as 48V BSG systems for hybrid PVs, as the company expects to benefit from China's growing position as a leading market for EV manufacturers. As part of the growth strategy, the company set-up an assembly plant in China in 2015 and Mexico in 2017, with an aim to capture higher market share in the Chinese and North American markets.

Strong research & development and technological capabilities in hardware & software development

SBPF has developed strong in-house capabilities to deliver evolving green technologies for future mobility, with an aggregate expenditure on R&D of Rs. 156 Cr over FY19-21. The R&D expenditure amounted to 1.7%, 3.3% and 5.8% as a percentage of revenue for the years FY19,20 and 21, respectively. In comparison, average spend of the top ten listed auto component players was 0.9% over FY18-20. As at March 31, 2021, SBPF had 186 on-roll employees engaged in R&D activities, representing approximately 15.4% of the total on-roll manpower, with 16 software engineers focused on R&D.

Exhibit 7: R&D expenditure as % of revenue for FY20



Source: RHP

The company's R&D capabilities are further strengthened by digital simulations, testing and validation facilities located at three R&D centers in India (Gurugram, Chennai and MM Nagar), which are approved by the Govt's Department of Scientific and Industrial Research. They are equipped with modern facilities including, design software such as Creo, MotorSolve BLDC, ANSYS, MSC ADAMS, KISSsoft, Gear PRO, hyperMILL, Siemens Solid Edge, Siemens NX, Siemens SPEED, FRENCO, UGNX and Nastran and equipment for white light scanning, coordinate measuring machines, 3D printing, silicon molding and an electronic and endurance testing laboratory.

A critical component of all electrified systems is embedded software. Most innovations in the EV and AV space will be software and electronics enabled. As vehicle software becomes the key differentiator, building expertise in software and electronics will become essential if auto-component suppliers need to be competitive. SBPF develops the base software implementing global standards such as ASPICE, MISRA, AUTOSAR, and ISO26262. Its highly efficient Field Orientated Control ("FOC") algorithm ensures that the motor/generator consistently operates in an efficient band, leading to significant improvements in fuel efficiency and reduction in CO2 emissions in hybrids, and higher range in EVs. Further, functional safety ("FuSa") is a critical requirement for all electrified systems, and Cybersecurity, OBD, and over the air updates ("OTA"), have become essential. SBPF is developing software products aligned to such market and OEM requirements.

Further, for the driveline systems and components, SBPF has developed proprietary gear design software. The software generates micro- geometries to meet the specific requirements of its customers and allows it to design gear tooth profile with minimal constraints and high flexibility. This flexibility to modify the geometry is fundamental to its core strength of precision-forging technology, which enables it to design and make tools and dies in-house and other precision forging process technology allows to develop gears with higher power density, which is critical for the powertrains of EVs. The R&D capabilities are further supported by the intellectual property rights that company has. It holds assignment of license rights in relation to eight patents in USA. It has been granted one patent in USA, one patent in China and one patent in the United Kingdom and is awaiting 21 patent approvals in India.

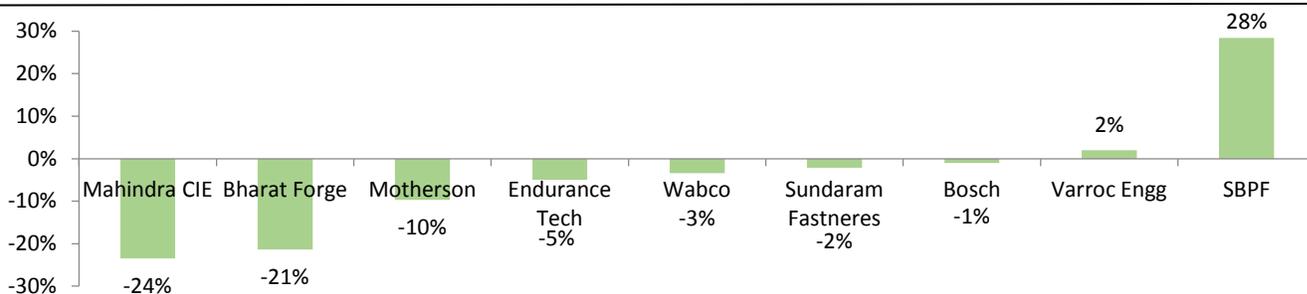
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Stable financial performance reflecting counter-cyclicity; with industry leading metrics

Owing to the structural growth in EV market, SBPF continued to grow in FY21 despite the overall auto industry being in a downcycle for most part of the year. This kind of counter cyclicity built into the business model of an auto company is rare to come across in India, which remains primarily an ICE market. Based on the technological intensity involved in the development and manufacturing process leading to low competitiveness combined with the criticality of products like differential gears/assemblies and starter motors, we observe that SBPF commands superior EBITDA margins compared to other auto ancillary companies. This is further demonstrated in the company's best in class ROCE.

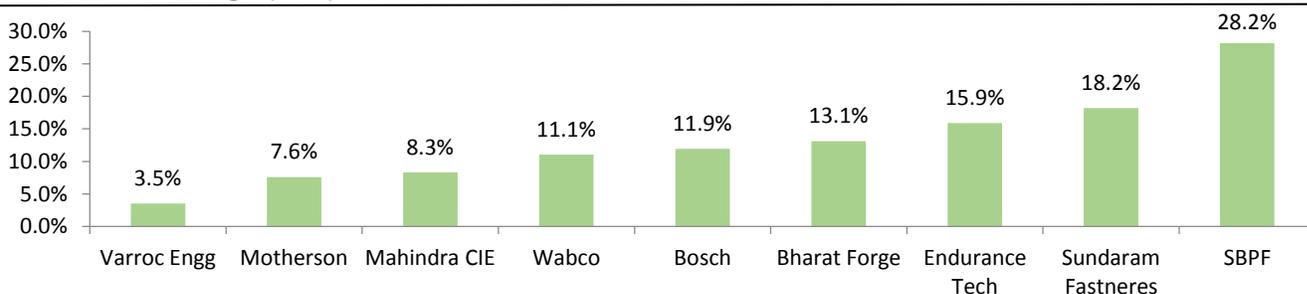
[Note: SBPF witnessed revenue degrowth of 15% in FY20 as (i) auto industry witnessed downturn leading to ICE segment revenue declining by 33%; (ii) revenue from EV segment was miniscule at Rs. 23 Cr in FY20, thus EV segment did not have any material impact on total revenue growth. EV revenues have now grown to Rs. 206 Cr in FY21 and thus FY20 type degrowth does not look likely for the company in future]

Exhibit 8: Revenue Growth in FY21 demonstrates counter cyclicity due to rising mix of EV revenues



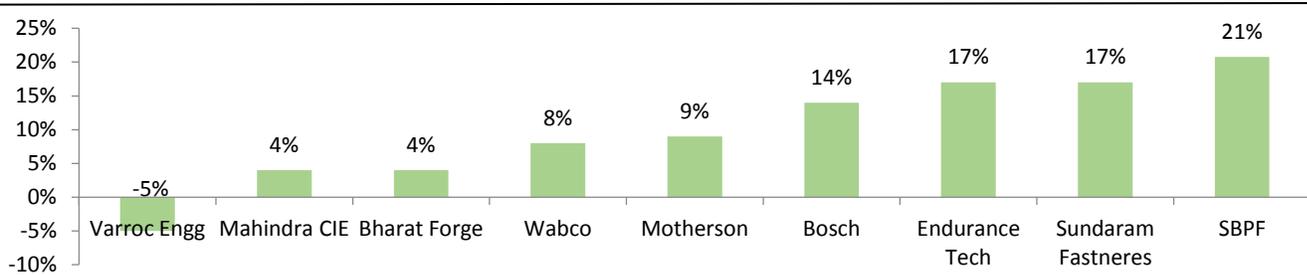
Source: RHP

Exhibit 9: EBITDA Margin (FY21)



Source: RHP

Exhibit 10: ROCE (FY21)



Source: RHP

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Concerns

High dependence on the automotive industry which is cyclical in nature: SBPF's business is entirely dependent on vehicle sales and production by primarily large automotive OEMs. The sales, volumes and prices for vehicles are influenced by the cyclical nature of demand for these products and the regulatory environment. However, with incremental growth coming from the EV segment which has increased to 14% of revenue in a matter of two years and is likely to increase significantly, any future slowdown in automobiles would be offset by the growth in EV segment.

High dependence on top 3 clients: The company derived 45% of revenue from its top 3 clients in FY21. Loss of sales to any of them due to loss of contracts, loss of market share of these clients, adverse change in financial condition of such customers, including due to possible bankruptcy or other financial hardships could have an adverse impact on the business of SBPF.

Valuation and Recommendation

There is no direct comparable peer to SBPF and thus we compare it with prominent Indian auto ancillaries as well as global auto ancillaries supplying certain EV parts. We observe that SBPF's margins and return ratios are well above peers. Considering these metrics along with the counter-cyclical nature of business owing to rising share of EV revenues (and scarcity premium due to lack of available EV plays in India), we expect the company to sustain its relatively higher valuations against peers. **We recommend subscribing to the issue from a long term perspective.**

Exhibit 11: Domestic Auto Ancillaries

FY21 Figures	Bharat Forge	Mahindra CIE	Sundaram Fasteners	Endurance Technologies	Motherson Sumi	Varroc Engg.	BOSCH	WABCO	Average	Sona BLW
Revenue	6,336	6,050	3,644	6,547	57,370	11,303	9,716	1,864	12,854	1,566
CAGR (FY18-20)	-9%	-2%	-2%	1%	1%	3%	-6%	-10%	-3%	9%
Gross Margin	58%	54%	61%	45%	43%	34%	41%	39%	47%	59%
EBITDA Margin	13.1%	8.3%	18.2%	15.9%	7.6%	3.5%	11.9%	11.1%	11.2%	28.2%
Asset Turns (x)	0.6	0.9	1.2	1.6	2.5	2.1	1.0	0.9	1.4	0.9
ROCE - FY19	20%	14%	27%	25%	17%	13%	25%	23%	21%	24%
ROCE - FY20	7%	11%	16%	21%	12%	3%	18%	11%	12%	17%
ROCE - FY21	4%	4%	17%	17%	9%	-5%	14%	8%	9%	21%
EV/Sales (FY21)	6.3	1.6	5.0	3.2	1.5	0.6	4.0	6.4	3.6	11.1
P/E on FY19 EPS (Upcycle)	34.2	17.0	38.2	42.7	49.3	12.3	29.1	45.9	33.6	79.7
P/E on FY20 EPS (Downcycle)	100.9	24.0	53.8	37.4	68.1	NA	71.7	81.6	56.8	76.6
P/E (FY21) Downcycle Year	Negative	79.7	48.6	40.7	76.4	Negative	96.6	124.9	NA	75.4

Source: RHP, NBRR

Exhibit 12: Global Auto Ancillaries having contribution from EV parts

CY20 Figures	Hota Industrial	Nidec Corp	AGC Inc	Gentex Corp	Average	Sona BLW
Revenue (Bn \$)	5.2	1.5	1.4	1.7	2.5	0.2
CAGR (FY18-20)	-8%	9%	-1%	-2%	-1%	9%
Gross Margin	23%	22%	25%	36%	26%	59%
EBITDA Margin	20.5%	7.2%	14.8%	29.9%	18.1%	28.2%
Asset Turns (x)	0.3	0.8	0.6	0.8	0.6	0.9
ROE - CY20	4%	6%	4%	19%	9%	17%
EV/Sales (CY20)	9.2	50.6	9.3	4.6	18.4	11.1
P/E (CY19) Normal Year		55.0	16.1	17.5	29.5	76.6
P/E (CY20) Downcycle Year	35.1	193.2	27.4	27.8	82.8	75.4

Source: RHP, NBRR

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Financials

P&L (Rs. Cr)	FY19	FY20	FY21
Net Revenue	1428	1220	1566
% Growth	17%	-15%	28%
Raw Materials	579	514	645
% of Revenues	40.5%	42.1%	41.2%
Employee Cost	124	122	147
% of Revenues	8.7%	10.0%	9.4%
Other expenses	313	259	333
% of Revenues	21.9%	21.2%	21.2%
EBITDA	412	325	441
EBITDA Margin	28.9%	26.7%	28.2%
Depreciation	72	78	97
Other Income	6	8	2
Interest	20	27	33
Exceptional loss			14
PBT	326	228	300
Tax	113	6	85
Tax rate	35%	3%	28%
Adjusted PAT	213	222	225
% Growth	24%	4%	2%
EPS (Post Issue)	3.6	3.8	3.9

Return Ratios	FY19	FY20	FY21
ROE (%)	17%	19%	17%
ROCE (%)	24%	17%	21%

Turnover Ratios	FY19	FY20	FY21
Debtors Days	70	70	97
Inventory Days	47	59	71
Creditor Days	36	35	52
Asset Turnover (x)	1.0	0.8	0.9

Valuation Ratios	FY19	FY20	FY21
Price/Earnings (x)	79.7	76.6	75.4
EV/EBITDA (x)	41.5	52.8	39.3
EV/Sales (x)	12.0	14.1	11.1
Price/BV (x)	2.3	2.5	2.2

Source: Company Data, NBRR

Balance Sheet (Rs. Cr)	FY19	FY20	FY21
Share Capital	898.3	47.7	573.0
Reserve & Surplus	362	1,130	731
Networth	1,260	1,178	1,304
Total Loans	160	302	363
Other non-curr liab.	18	53	72
Trade payable	139	116	224
Other Current Liab	264	201	212
Total Current Liab.	403	317	436
Total Equity & Liab.	1,841	1,851	2,175
Fixed Assets & CWIP	1,035	1,155	1,300
Inventory	184	196	306
Income Tax Assets	28	29	19
Other non Curr. assets	28	29	19
Cash	36	105	25
Debtors	273	234	417
Other Current assets	257	103	90
Total Assets	1,841	1,851	2,175
Cash Flow (Rs. Cr)	FY19	FY20	FY21
EBITDA	412	325	441
Provisions & Others	(2)	23	(38)
Op. profit before WC	410	349	403
Change in WC	(25)	0	(207)
Less: Tax	116	40	53
CF from operations	269	309	143
Addition to assets	(116)	(224)	(219)
(Purchase)/Sale of Plant	(18)	(729)	61
Interest Received	3	4	2
CF from Investing	(131)	(949)	(156)
Dividend Paid	(103)	(173)	(90)
Proceeds from equity issu	-	848	-
Proceeds from borrowing	(25)	54	48
Interest Paid	(18)	(20)	(25)
CF from Financing	(146)	708	(67)
Net Change in cash	(7)	69	(80)
Cash at beginning	43	36	105
Cash at end	36	105	25

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