Initiating Coverage

Federal-Mogul Goetze (India) Ltd.

September 30, 2022

RETAILRESEARCH

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Federal-Mogul Goetze (India) Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Auto Ancillaries	Rs 319	Buy in Rs 316-322 band and add on dips to Rs 271-277 band	Rs 354	Rs 380	2-3 quarters

HDFC Scrip Code	FEDMOGEQNR
BSE Code	505744
NSE Code	FMGOETZE
Bloomberg	FMGI IN
CMP Sep 29, 2022	319.1
Equity Capital (Rs cr)	55.6
Face Value (Rs)	10
Equity Share O/S (cr)	5.6
Market Cap (Rs cr)	1768
Book Value (Rs)	157.4
Avg. 52 Wk Volumes	95100
52 Week High (Rs)	334.0
52 Week Low (Rs)	202.4

Share holding Pattern % (Jun, 2022)	
Promoters	75.0
Institutions	1.9
Non Institutions	23.1
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst
Atul Karwa
atul.karwa@hdfcsec.com

Our Take:

Federal-Mogul Goetze (India) Ltd. (FMGIL) has a long track record of operations in the piston and piston rings business with a reputed customer base and a diversified revenue stream across multiple original equipment manufacturers (OEMs) and aftermarket. The company has access to managerial and technological expertise of its parent resulting in lower R&D spends. It is the market leader in diesel pistons, piston rings and valves and #2 in pistons overall. FMGIL reported its highest ever quarterly sales numbers in Q1FY23 driven by increased volumes and price hikes taken by the company. Softening of raw material prices and freight rates are likely to enhance the operating margins going forward. Automobile sales are on an uptrend as the economy recovers from the effects of the pandemic.

FMGIL is a debt free company with a strong liquidity position and is able to comfortably meet its capex requirement through internal accruals. It had cash and cash equivalents of Rs 187cr at the end of FY22. Considering the strong liquidity position and cash generation the management has assured it would take up the matter with the parent regarding dividend distribution.

The ultimate parent company Tenneco has been acquired by Pegasus Holdings III, LLC – an affiliate of Apollo Global Management. The acquirer has to come out with an open offer which is likely in H2FY22 and the indicative price is Rs 275. The current market price is ~Rs 320 and we believe the open offer may not solicit any major response.

Valuation & Recommendation:

FMGIL is the 2nd largest player in the organized market of pistons and piston rings in India with more than 30% market share. Its parent, Tenneco is one of the world's largest designers, manufacturers and marketers of rise performance and clean air products and systems for automotive and commercial vehicle original equipment markets and the aftermarket. It has comfortable financial profile and has a slew of new launches lined up. We expect FMGIL to record growth in revenues and PAT 19/35% CAGR over FY22-FY24. We think investors can buy the stock in the band of Rs 316-322 and add on dips to Rs 271-277 band (15.5x FY24E EPS) for a base case fair value of Rs 354 (20x FY24E EPS) and bull case fair value of Rs 380 (21.5x FY24E EPS) over the next 2-3 quarters. At the CMP of Rs 319.1, it is trading at 18.1x FY24E EPS.

Financial Summary

Particulars (Rs cr)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY21	FY22	FY23E	FY24E
Operating Income	402	319	26.1	356	13.0	1,107	1,343	1,625	1,901
EBITDA	47	36	29.2	49	-4.4	125	163	192	228
APAT	20	11	84.2	21	-3.6	27	54	75	98
Diluted EPS (Rs)	3.6	1.9	84.2	3.7	-3.6	4.9	9.7	13.4	17.7
RoE (%)						3.3	6.4	8.2	9.8
P/E (x)						65.0	32.8	23.7	18.1
EV/EBITDA (x)						12.5	9.7	8.1	6.6

(Source: Company, HDFC sec)

Q1FY23 Result Update

FMGIL recorded its highest ever quarterly revenue in Q1FY23. It reported consolidated revenue of Rs 402cr, a growth of 26.1% YoY. Growth was mainly driven by the growth in domestic market as exports were impacted by slowdown in US and European markets, reducing the export share to 9% of the total revenue from 14% in FY22. EBITDA was up 29.2% YoY to Rs 47cr as increased capacity utilization led to operating leverage. EBITDA margin expanded 30 bps to 11.7%. However, on a sequential basis EBITDA declined 4.4% and margin compressed ~210bps impacted by steep rise in commodity and global supply chain disruption resulting in significant increase in freight expense. PAT grew 84.2% YoY to Rs 20cr.

Key Triggers

Automobile sector expected to grow in double digits

The Indian automobile sector has been facing many challenges over the last few years such as slowing economy growth, soaring crude prices, semiconductor shortages and supply chain disruptions. Despite these challenges the automotive industry is showing signs of reaching the pre-pandemic levels of sales volume. India's automotive market is poised for single to double-digit growth across segments – from commercial vehicles (CVs) and tractors, to passenger vehicles and two-wheelers – as demand and supply-side problems even out. While CVs are expected to benefit from strong replacement demand, the two-wheeler and tractor segments are expected to gain from a recovery in the rural economy.

Commercial vehicle sales are poised to improve from August as fleet operators are likely to complete purchases during the festive season. Fleet operators were delaying replacing or adding to their existing fleet due to high fuel and commodity prices, but now the effect of stabilizing commodity prices, especially steel, is expected to arrest the rise in commercial vehicle prices in the second quarter of this fiscal year, boosting demand for vehicles. Commercial vehicle sales at 225,000 units for the June quarter (Q1FY23) were marginally below the peak volume of 230,000 units seen in the June quarter of FY19.

Margins to improve on back of lower commodity and freight costs

FMGIL has been facing the brunt of increased commodity costs and high freight rates. Operating margins, although increased by 30bps YoY in Q1FY23, were lower by 40bps sequentially as gross margins shrunk from by ~500bps to 59.2%. Prices of steel has been falling lately due to poor demand in domestic and export markets and postponement of projects. Month-on-month prices have declined by 3–4% with HRC prices now being in the range of Rs 58,000–59,000 per tonne in Aug'22; amongst the lowest so far in 2022, and over 25% fall from the peak they commanded earlier this year. Decline in input costs would help the company improve its operating margins as it has not been able to pass on the entire increase in costs. Further the company is recovering the lag in passing the inflation and has also increased its prices from July 1, 2022 in the aftermarket.

China+1 strategy could drive higher exports

The pandemic disrupted supply lines for most of the world. However, due to the higher dependence on China, many companies are still facing supply disruptions on account of repeated lockdowns in the country. Western economies are looking to develop an alternate source to China and India with is strong manufacturing base is among the most preferred countries. Government of India is also looking to promote manufacturing in India through various PLI schemes. FMGIL, being a subsidiary of Tenneco, could see increased exports and deemed export orders in the coming years. The company earns higher margins on exports as compared to domestic sales.

New launches to aid market share growth

FMGIL has a strong win rate in the new vehicles expected to be launched in the next year. Manufacturers have claimed a backlog of ~700,000 booked vehicles. The new launches from Toyota-Maruti combine and Mahindra have witnessed strong interest. The move towards SUVs also bodes well for the company as it leads to higher content per vehicle.

Strong parentage of Federal-Mogul Group (FMG) and dominant market position

Federal Mogul Holdings Limited, Mauritius is the immediate holding company of FMGIL, having a shareholding of 60.05% in the company. The ultimate holding company of the group, Federal Mogul LLC, was acquired by Tenneco Inc., USA in October, 2018. Tenneco is one of the world's largest designers, manufacturers and marketers of rise performance and clean air products and systems for automotive and commercial vehicle original equipment markets and the aftermarket. FMGIL continues to have an established market position in the domestic piston and piston rings business. This is further strengthened by continuous support received by the company from the parent group, Federal Mogul Group in the form of technical and managerial expertise and financial assistance. FMGIL is the 2nd largest player in the organized market of pistons and piston rings in India with more than 30% market share.

Dominant market position

#2 Overall
#1 Diesel Pistons

#1 Overall

#1 Overall

(Source: Company, HDFC sec)

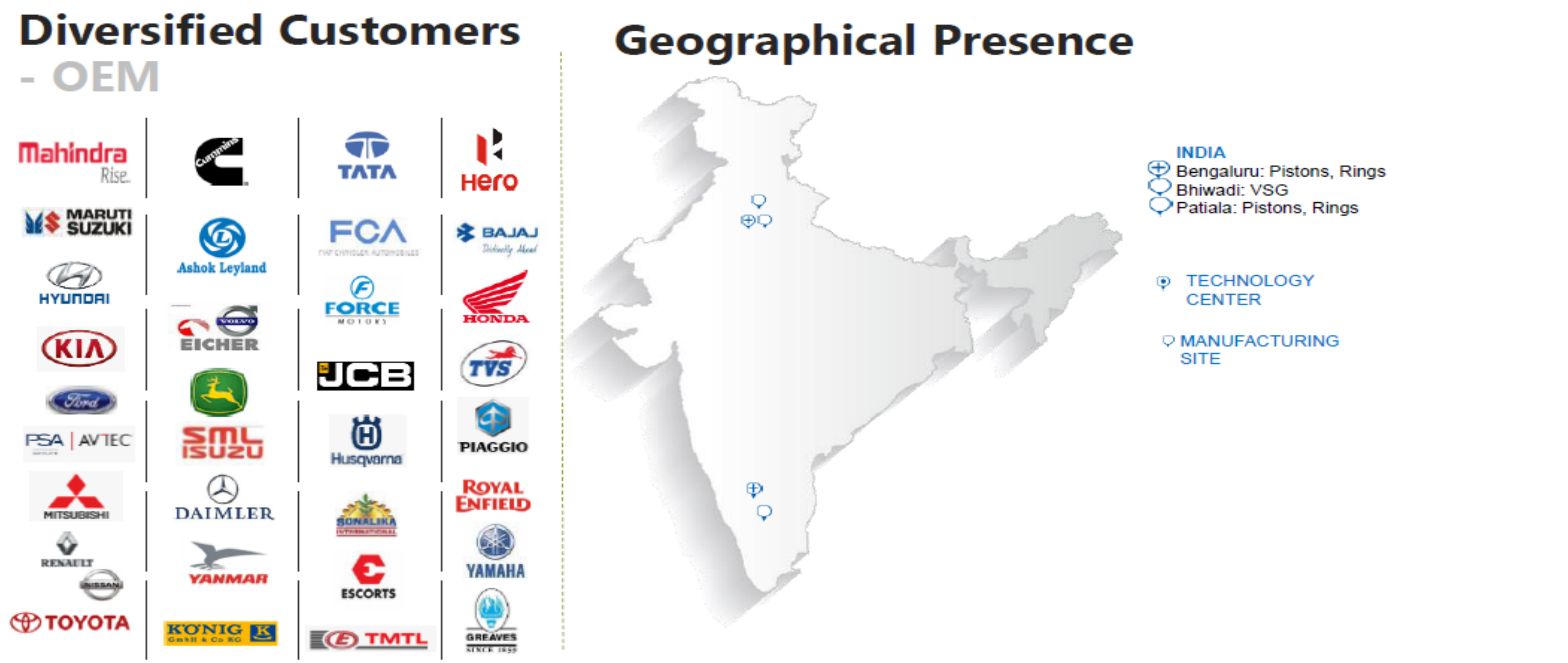
Comfortable financial profile

FMGIL is a debt free company as it doesn't have any long-term debt obligations and working capital limits are also broadly unutilized while the company's consolidated net-worth stood healthy at nearly Rs 876cr as of FY22. With strong cash balances, it can comfortably meet its capex requirement through internal accruals. Return ratios were also on an improving trajectory after sharp decline in FY20-FY21 Going forward, FMGIL's capital structure is expected to remain comfortable on account of the company's large net worth base and no debt funded capex plans.

Reputed customer base and diversified revenue stream marked by OEMs and aftermarket

FMGI's key customers include leading automobile players in India like Mahindra & Mahindra Limited, Bajaj Auto Limited, Maruti Suzuki India Limited, Tata Motors Limited, Hero MotoCorp Limited and Ashok Leyland Limited providing a well-diversified customer base. In addition to OEMs, the group also has presence in replacement market. FMGIL's top ten customers contribute ~50% of gross sales thereby reflecting reasonably satisfactory diversification in customer base. The company has presence across varied segments including Passenger Vehicles (28% of FY22 sales), 2/3W (12%), CV and off-highway (33%) and aftermarket (27%) which insulated it from significant impact of slowdown in any single segment. Nonetheless, the company has high dependence on automobile sector which has impacted its operating performance over the last couple of years.

Customer and Manufacturing base



(Source: Company, HDFC sec)

Open Offer

Pegasus Holdings III, LLC, made an open offer to buy 25.02% of the fully diluted voting share capital of the company. The open offer was triggered due to the merger between Pegasus Merger Co. and Tenneco Inc., the ultimate holding company of FMGIL. Tenneco Inc. on 23 February 2022, entered into an agreement to merge with Pegasus Merger Co., a corporation established under the laws of Delaware ("Merger Sub") and a direct wholly owned subsidiary of Pegasus Holdings III, LLC (the "Parent"). Effective upon the closing of the transactions, Merger Sub will merge with and into Tenneco Inc., with Tenneco Inc. continuing as the surviving corporation and a direct wholly owned subsidiary of the Parent.

Tenneco holds a 100% stake in Federal-Mogul Mauritius and Federal-Mogul Germany under subsidiaries. Federal-Mogul Mauritius and Federal-Mogul Germany are the promoter companies of Federal-Mogul India. Promoter holds a 74.98% stake in Federal-Mogul India. Pegasus will hold a 74.98% stake in Federal-Mogul India after the merger of Pegasus Merger Co and Tenneco Inc. The open offer is at Rs 275 per share. The letter of offer is likely to come in the second half of the year.

After Tenneco had acquired Federal Mogul in Apr'18, the new promoter had arrived at an open offer price of Rs 400 per share based on independent valuation reports. The market regulator had directed the promoter to revise upwards the open offer price by over 50% to Rs 608.5, based on valuation report submitted by Haribhakti & Co., another independent valuer. SAT had upheld SEBI's order and the open offer was finally completed at a price of Rs 667.5 (including interest) in Jan'20.

Risks & Concerns

Vulnerable to cyclicality in demand from OEMs

FMGIL supplies to OEMs across segments and is exposed to the cyclicality in them. Volumes may remain partly constrained due to the continuing supply challenges in semiconductors and also the sharp increase in retail fuel prices.

Elevated commodity and fuel prices

Elevated commodity prices and rising fuel costs are impacting the cash flows of truck operators. As petrol and diesel prices have risen significantly in the past year it may impact demand if truck operators are not able to pass on the increased cost.

Rising vehicle prices

Vehicle prices have increased to accommodate rising commodity prices and regulatory requirements, especially emission norms. Further tightening of emission norms for tractors and CV would drive prices higher.

Absence of dividend

The company has not paid any dividend since 2005 despite making decent profits. The management has said it is committed to consider this dividend and the distribution this year, but pointed out that capex and working capital needs have increased due to increase in volumes.

Rapid adoption of EV

Products manufactured by FMGIL are not used in EV. Consequently, ~40% of its revenues is exposed to rapid adoption of EV in the medium term.

Company Background:

FMGIL was established in 1954 as a joint venture with Goetze-Werke of Germany, which was owned by Federal-Mogul LLC, one of the leading manufacturers of automotive components in the world. Based in Gurugram (Haryana, India), FMGIL engages in manufacture, supply and distribution of automotive components in India and internationally. It mainly offers pistons, piston rings, piston pins, valve seats, valve guides. It is the largest manufacturer of pistons and piston rings in India. The company caters to automotive, heavy-duty, motorcycles, energy, industrial, power generation, railway & defence industries. FMGIL manufactures world class products at its state of the art manufacturing facilities located at Patiala (Punjab), Bangalore (Karnataka) and Bhiwadi (Rajasthan).

FMGIL operates as a subsidiary of Tenneco Inc. post Tenneco's acquisition of Federal-Mogul LLC. Globally, Tenneco has 4 business groups viz. Performance Solutions, Motorparts, Clean Air and Powertrain. FMGIL's products substantially falls under 'Powertrain' business group.

Manufacturing facilities

Location	Area (acres)	Products
Patiala, Punjab	60	Pistons, Pins and Rings
Bangalore, Karnataka	50	Pistons, Pins and Rings
Bhiwadi, Rajasthan	5.5	Valve Seats & Valve guides

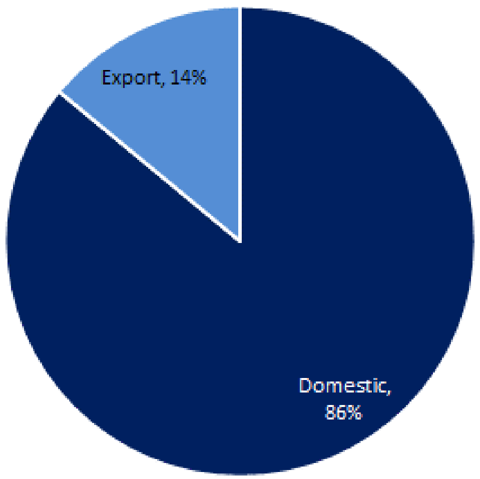
(Source: Company, HDFC sec)

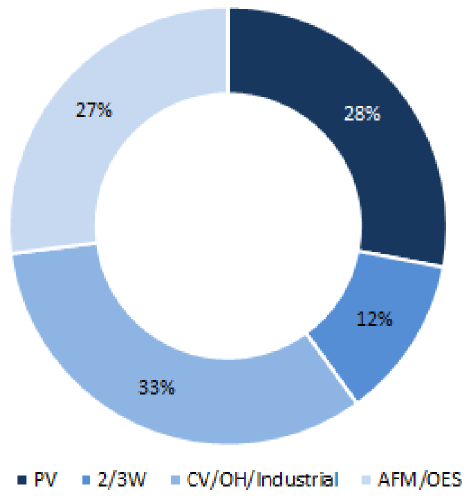
Subsidiaries

Federal-Mogul TPR (India) Ltd.

The Company in technical collaboration with Teikoku Piston Ring Co. Ltd, Japan and Federal Mogul UK Investments Limited, a group company of Tenneco Inc., USA, manufactures steel rings used in passenger vehicles automobiles. At the end of FY22, 51% of the shares of the Company are held by FMGIL, 40% held by Teikoku Piston Ring Co. Ltd and 9% held by Federal Mogul UK Investments Limited, a group company of Tenneco Inc., USA.

Sales breakup (FY22)





(Source: Company, HDFC sec)

Financials

Income Statement

(Rs cr)	FY20	FY21	FY22	FY23E	FY24E
Net Revenues	**1085**	**1107**	**1343**	**1625**	**1901**
Growth (%)	***-19.1***	***2.0***	***21.3***	***21.0***	***17.0***
Operating Expenses	956	982	1180	1433	1673
EBITDA	**130**	**125**	**163**	**192**	**228**
Growth (%)	***-42.5***	***-3.3***	***30.0***	***17.6***	***19.0***
EBITDA Margin (%)	***11.9***	***11.3***	***12.1***	***11.8***	***12.0***
Depreciation	93	84	87	91	94
Other Income	13	11	9	13	13
EBIT	**50**	**53**	**85**	**114**	**147**
Interest expenses	3	2	4	5	5
PBT	**47**	**8**	**81**	**109**	**142**
Tax	8	3	22	29	38
PAT	**39**	**5**	**59**	**80**	**104**
Share of Asso./Minority Int.	-6	-4	-5	-5	-6
Adj. PAT	**33**	**27**	**54**	**75**	**98**
Growth (%)	***-62.8***	***-16.0***	***97.9***	***38.3***	***31.5***
EPS	5.8	4.9	9.7	13.4	17.7

Balance Sheet

As at March (Rs cr)	FY20	FY21	FY22	FY23E	FY24E
SOURCE OF FUNDS					
Share Capital	56	56	56	56	56
Reserves & Surplus	762	765	820	895	993
Shareholders' Funds	**818**	**821**	**876**	**951**	**1049**
Minority Interest	66	66	68	73	79
Total Debt	0	0	0	0	0
Net Deferred Taxes	9	-5	3	3	3
Other Non-curr. Liab.	0	9	8	10	12
Total Sources of Funds	**893**	**891**	**955**	**1037**	**1143**
APPLICATION OF FUNDS					
Net Block & Goodwill	555	547	528	570	615
CWIP	42	29	48	36	22
Investments	0	0	2	27	62
Other Non-Curr. Assets	37	41	58	70	82
Total Non Current Assets	**634**	**617**	**636**	**702**	**780**
Inventories	195	187	186	245	276
Debtors	196	265	266	303	338
Cash & Equivalents	124	213	187	205	210
Other Current Assets	26	33	66	56	72
Total Current Assets	**541**	**697**	**704**	**808**	**896**
Creditors	198	290	305	334	365
Other Current Liab & Provisions	85	133	80	140	169
Total Current Liabilities	**282**	**423**	**385**	**474**	**533**
Net Current Assets	259	274	319	335	363
Total Application of Funds	**893**	**891**	**955**	**1037**	**1143**

Cash Flow Statement

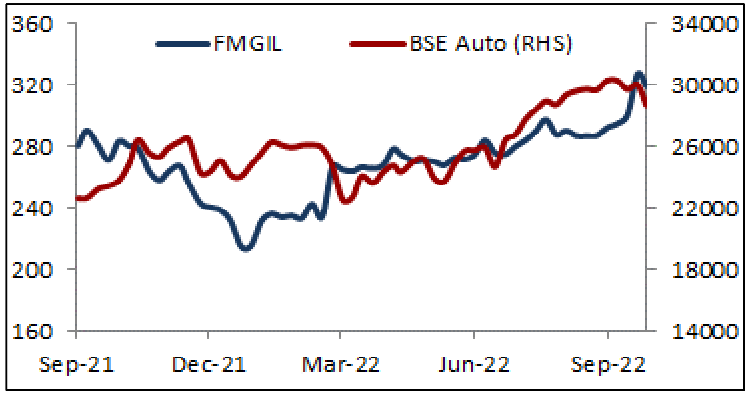
(Rs cr)	FY20	FY21	FY22	FY23E	FY24E
Reported PBT	47	8	81	109	142
Non-operating & EO items	-4	42	2	-10	-10
Interest Expenses	-1	-2	-1	5	5
Depreciation	93	84	87	91	94
Working Capital Change	78	40	-37	3	-24
Tax Paid	-21	-19	-20	-29	-38
OPERATING CASH FLOW (a)	**191**	**152**	**111**	**168**	**170**
Capex	-75	-59	-95	-120	-125
Free Cash Flow	117	94	17	48	45
Investments	0	0	-8	-25	-35
Non-operating income	-7	39	-27	0	0
INVESTING CASH FLOW (b)	**-81**	**-20**	**-130**	**-145**	**-160**
Debt Issuance / (Repaid)	-23	0	0	0	0
Interest Expenses	-3	-2	-3	-5	-5
FCFE	84	130	-22	19	5
Share Capital Issuance	0	0	0	0	0
Dividend	0	0	0	0	0
Others	-6	-6	-4	0	0
FINANCING CASH FLOW (c)	**-26**	**-2**	**-3**	**-5**	**-5**
NET CASH FLOW (a+b+c)	**84**	**130**	**-22**	**19**	**5**

Key Ratios

	FY20	FY21	FY22	FY23E	FY24E
Profitability Ratios (%)					
EBITDA Margin	11.9	11.3	12.1	11.8	12.0
EBIT Margin	4.6	4.8	6.3	7.0	7.7
APAT Margin	3.0	2.5	4.0	4.6	5.2
RoE	4.0	3.3	6.4	8.2	9.8
RoCE	6.1	6.5	10.0	12.5	14.7
Solvency Ratio (x)					
Net Debt/EBITDA	-1.0	-1.7	-1.1	-1.1	-0.9
Net D/E	-0.2	-0.3	-0.2	-0.2	-0.2
PER SHARE DATA (Rs)					
EPS	5.8	4.9	9.7	13.4	17.7
CEPS	22.5	19.9	25.4	29.7	34.6
BV	147.0	147.5	157.4	170.9	188.5
Dividend	0.0	0.0	0.0	0.0	0.0
Turnover Ratios (days)					
Inventory	73	76	72	64	62
Debtor	69	63	51	48	50
Creditors	63	80	81	72	67
VALUATION (x)					
P/E	54.6	65.0	32.8	23.7	18.1
P/BV	2.2	2.2	2.0	1.9	1.7
EV/EBITDA	12.7	12.5	9.7	8.1	6.6
EV/Revenues	1.5	1.4	1.2	1.0	0.8
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0
Dividend Payout (%)	0.0	0.0	0.0	0.0	0.0

(Source: Company, HDFC sec)

Price chart



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HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Murli V Karkera Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

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