

INVESTMENT NOTE

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**HERMES: FROM CRANKSHAFTS TO TITANIUM FORGINGS, INNOVATION DRIVES
BHARAT FORGE**

Innovation is not exclusive to the digital world or to well-known start-up ecosystems in the US. It is an increasingly important force in the growth of Indian manufacturer Bharat Forge, resulting in its globally recognised forging and metallurgical expertise and focus on advanced technologies, says Kunjal Gala, senior analyst at Hermes Emerging Markets.

Industry leader

Bharat Forge has evolved from a maker of low-cost but critical auto components for the domestic market in the 1960s into a global provider of advanced end-to-end engineering solutions in which it designs, engineers, manufactures, tests and validates products. Based in Pune, Maharashtra, it has manufacturing centres in India, Germany, France and Sweden, and sells products into North America, Europe, China, Brazil, Russia and Australia. This scale has enabled it to surpass smaller, regionally-focused competitors and achieve a dominant position in the global forging industry – particularly since customers with in-house manufacturing operations are phasing out forging and now prefer to source products from global suppliers. Through innovative thinking and processes, it is furthering its expertise in manufacturing forged components for the automotive industry while expanding into other sectors, from energy and railways to mining and aerospace.

Growth drivers

In February, we visited Bharat Forge's manufacturing facility and R&D centre, and spoke with Baba Kalyani, chairman and managing director, to understand the strategy guiding the company. In India, the company is poised to benefit from greater railway, industrial and energy investment. The company's joint venture with Alstom, a French company being acquired by GE, to manufacture steam turbines, is a critical part of the US conglomerate's ambitions and is resulting in a strong order book for Bharat Forge. In other developments, its business supplying the North American commercial-vehicle sector is expanding at the expense of smaller competitors, it has won an order from Boeing to supply titanium forgings, and it recently became the first indigenous provider of crankshafts to Indian railway locomotives. Bharat Forge aims to develop five vertical businesses outside of its core automotive presence and is confident of achieving \$100mn in annual revenues within each of them over the next few years.

Into the future

As a growing and profitable global business, Bharat Forge is investing heavily in R&D. In our discussion, Kalyani said the company's margins are primarily driven by new products and technology, and its focus on innovation began more than a decade ago through its partnership with the Indian Institute of Technology, one of the country's leading institutes for engineering studies. It has established an advanced manufacturing testing lab to focus not only on its mainstay products, such as crankshafts and steam turbines, but also on higher-value-adding capabilities like 3D printing and laser technologies. This facility has been set up in a benchmarking joint venture with GE, through which both companies will share results. Bharat Forge has already determined the list of products that it intends to manufacture 10 years from now, when it expects to be operating several 3D printers.

Our position

Bharat Forge is currently our 10th-largest holding relative to the benchmark and has performed exceptionally well since we invested. Its valuation is currently high, which is a short-term risk, but we see tangible evidence of the management team's strategy taking effect. We expect the company to grow strongly in the medium term and thereby rapidly reduce its earnings multiple. We believe that India – like China, Indonesia, Poland and Mexico – is an emerging market that is implementing progressive economic reforms that should support sustainable growth in the future, and this long-term change should further benefit the company.

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For further information, please contact:

Hermes Investment Management

Jeannie Dumas

+44 (0)20 7680 2152

jeannie.dumas@hermes-investment.com

Melanie Bradley

+44 (0)20 7680 2218

melanie.bradley@hermes-investment.com

Notes to Editors:

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We believe in **Excellence, Responsibility and Innovation**

- **Excellence:** We aspire to excellence in everything we do. This manifests itself most visibly in our investment performance. We will only offer products to our clients where we believe there is a strong investment thesis and where we can deliver sustainable alpha.
- **Responsibility:** We believe it is our responsibility to lead discussion and debate about the fiduciary responsibilities of fund managers to our clients, their stakeholders and, ultimately, society at large. We have always sought positive engagement with the firms in which we invest.
- **Innovation:** We have the entrepreneurial culture to identify forward-looking products that meet those needs, along with the resources and speed-to-market mentality to develop them rapidly.

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Hermes' investment solutions include:

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- **Real Estate:** Segregated, Unitised, Debt, UK, US Residential, European, UK PRS
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