Cohesion MK Best Ideas

The India Diaries

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Cohesion
Accessing India's Growth

In the last India Diaries, I touched on the excitement surrounding **Wockhardt** and its potentially transformational drug Zaynich. It is pleasing to report that the share price of Wockhardt has responded very positively, increasing substantially in value over the last few months and contributing meaningfully to our strong recent performance. It also serves as a reminder that whilst we can have exceptionally high conviction that an investment will deliver, we can't always be certain as to the timing of when other investors will see the value that we have identified.

RK Forgings: A Twenty-Year Story of Patience, Partnership and Compounding

Some of the best investment stories are not built on dramatic headlines. They are built over decades, through enduring partnerships, disciplined management and consistent execution. RK Forgings is one such story.

When RK Forgings listed on the stock market in 2004, few could have imagined the remarkable journey that lay ahead. Since its IPO more than two decades ago, the company has delivered 25%+ annual compound earnings growth, translating into a share price return of around ninety times for long-term shareholders. Madhu Kela has been invested in RK Forgings since the very beginning. More importantly, he has developed a relationship with the founding family that spans three generations. It is a relationship built not simply on capital, but on trust, shared ambition and long-term thinking.

That continuity became particularly evident during a meeting I had with the senior management of RK Forgings. Mr Chaitanya Jalan, who now runs the business alongside his father Mr Naresh Jalan, looked across at my eleven-year-old son, Henry, and smiled.

"When I was your son's age," he said, "I used to sit on my father's knee outside a tea shop in India while Madhu discussed the future of the company with our Chairman Mr Mahabir Jalan."

It was a wonderful illustration of how enduring great business relationships can become. Decades ago, those conversations centred on strategy, capital allocation and the long-term direction of the business. Today, the next generation is leading the company, but the philosophy remains remarkably consistent.

That philosophy has transformed RK Forgings from a domestic forging supplier into one of India's leading engineered manufacturing businesses. While the company is still best known for forgings, it has steadily built an integrated manufacturing platform spanning castings, precision machining, fabrication, railway components and industrial products. Rather than supplying individual parts, it is increasingly supplying complex engineered assemblies across commercial vehicles, passenger vehicles, railways, mining, energy and industrial markets. This integration matters. Few competitors possess expertise across forging, casting, machining and fabrication under one roof, supported by in-house design and tooling capabilities. That enables RK Forgings to manufacture increasingly complex components, deepen relationships with global OEMs and move steadily up the value chain. Importantly, growth is no longer driven solely by winning new customers. Existing customers continue to award the company a greater share of components per vehicle as its technical capabilities expand, creating a powerful compounding effect that is often overlooked by the market.

Source of data: Invexa Capital

Past performance is not indicative of future results.

The business has also become significantly less risky over time. A decade ago, revenues were concentrated among a handful of domestic and North America based commercial vehicle customers. Today the company serves hundreds of customers across India, North America and Europe, while expanding into railways, mining, construction equipment, oil & gas and other industrial markets. In effect, management has systematically reduced almost every major source of concentration risk while simultaneously increasing the complexity and value of what the business produces.

These capabilities are particularly valuable against today's global backdrop. Automotive manufacturers continue to diversify supply chains beyond China while outsourcing an increasing proportion of complex component manufacturing to trusted partners. Companies with deep engineering expertise, long-standing customer relationships and global manufacturing credentials stand to benefit disproportionately from that structural shift.

Over the last three years RK Forgings has invested more than ~US$ 315m (INR 3,000 cr+) expanding capacity, integrating acquisitions and building entirely new manufacturing capabilities. Installed production capacity has almost doubled, making this the largest investment programme in the company's history. While these investments temporarily depressed returns and increased leverage, much of that heavy lifting has now been completed.

That creates an important inflection point. The last three years were investment years. The next few years are likely to be monetisation years.

With much of the required manufacturing infrastructure already in place, future growth should increasingly come from higher utilisation rather than new factories. As production volumes rise, incremental revenues can be generated from an existing asset base, creating meaningful operating leverage, stronger free cash flow and a rapidly improving balance sheet. At the same time, the company has secured a record order book that provides unusually good revenue visibility over the coming years.

Historically, RK Forgings has often traded at a valuation discount to the market leader in the forging sector. Today, that discount has widened considerably despite the company having a much smaller market capitalisation and, arguably, stronger medium-term growth prospects. That disconnect between business quality and market valuation is precisely what we as investors seek.

The past twelve months have undoubtedly been challenging, but importantly, each of the issues affecting the business appears temporary rather than structural.

The first challenge related to inventory management. The company acted decisively to resolve the issue, with the founding family injecting their own capital to strengthen the balance sheet. Existing shareholders were not diluted, demonstrating management's willingness to stand behind the business.

The second challenge came from uncertainty surrounding international tariffs. While this created concern across the market, the practical impact on RK Forgings proved much less severe than many feared. The company did not lose customers, nor did it experience a permanent loss of business. Instead, customers simply reduced inventory levels while awaiting greater clarity on tariff policy. Much of RK Forgings' export business was already routed through Mexico, leaving it better insulated than many investors appreciated. As uncertainty has eased, customer ordering patterns have begun returning to normal.

The third challenge was entirely external. Geopolitical tensions in the Middle East, including Iran's attack on Qatar and concerns surrounding the Strait of Hormuz, disrupted energy markets and raised fears over natural gas supplies. Management responded with impressive speed, accelerating the electrification of manufacturing processes that had previously relied on natural gas. Their ability to adapt operationally once again demonstrated the execution capability that has characterised the business for decades.

Taken together, these issues pushed the share price almost fifty percent below its peak reached roughly eighteen months earlier. Yet none of them fundamentally altered the long-term investment case. Since bottoming out, the stock has shown strong signs of recovery, and we believe there is potentially significant runway ahead.

If anything, the backdrop may now be improving. Commercial vehicle markets in India, Europe and North America all appear to be emerging from cyclical downturns at roughly the same time. For a company entering that recovery with its largest-ever manufacturing footprint, a record order book and a far more diversified business than in previous cycles, the earnings power over the next several years could look very different from the recent past.

Great businesses rarely travel in straight lines. Even exceptional companies experience periods when short-term concerns dominate market thinking. For patient investors, those moments often provide the greatest opportunities.

RK Forgings has spent more than two decades quietly compounding value. The relationships endure, the management continues to think like owners, and the manufacturing platform they have spent years building is only now beginning to reveal its full earnings potential. With its competitive advantages intact, its end markets improving and its valuation still well below historical levels, the next chapter may prove every bit as compelling as the last.

Source of data: Invexa Capital

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For further information:

Website: www.cohesion-am.com

Email: investor@cohesion-am.com

Mobile/WhatsApp: +971 555 102 622

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