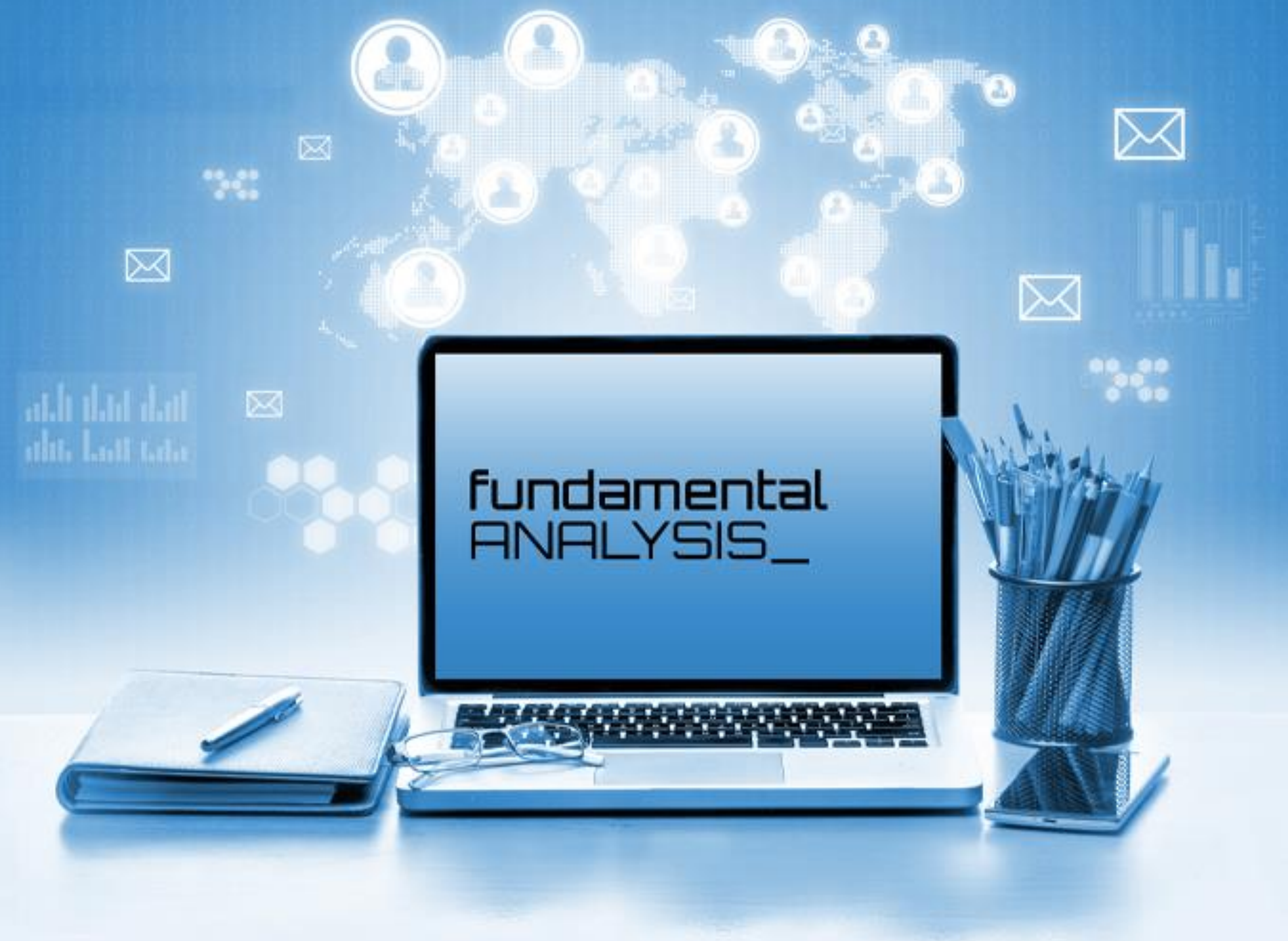
Stock Update

Alicon Castalloy Ltd.

December 24, 2021



RETAILRESEARCH

Alicon Castalloy Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Auto Ancillaries	Rs 830	Buy in Rs 825-840 band & add more on dips to Rs 735-750 band	Rs 920	Rs 995	2 quarters

HDFC Scrip Code	ALICAS
BSE Code	531147
NSE Code	ALICON
Bloomberg	ALIC IN
CMP Dec 23 , 2021	830.1
Equity Capital (Rs cr)	8.1
Face Value (Rs)	5.0
Equity Share O/S (cr)	1.6
Market Cap (Rs cr)	1337
Book Value (Rs)	263.5
Avg. 52 Wk Volumes	35,500
52 Week High (Rs)	998.8
52 Week Low (Rs)	323.0

Share holding Pattern % (Sep, 2021)	
Promoters	55.7
Institutions	9.5
Non Institutions	34.8
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

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Our Take:

Alicon Castalloy Ltd. (ACL) operates one of the largest aluminium foundries in India supplying frugal engineering solutions mainly to the automobile space. It is a leading manufacturer of aluminium castings supplying its products to the Indian and European markets. The company has won significant orders in the last 4-6 quarters and has an outstanding order book of ~Rs 3150cr from new products implying an annual revenue of ~Rs 625cr from these. New orders are expected to support faster recovery over medium term. With the share of EV gaining strength gradually, we believe an increasing share of revenue would be contributed by EV parts. ACL has increased its revenue target from EV to 36% by FY26 from its earlier target of 25%.

Various initiatives taken by the Government is likely to drive higher demand for EVs thereby increasing the need for aluminium parts to reduce the weight of vehicles. Successful completion of fund raising exercise by QIP issue and preferential issue to Promoters and foreign collaborators (in June and Aug 2021 @ Rs 540 and Rs 563 respectively raising a total of Rs 110cr) has enabled ACL to reduce financial cost and improve leverage. It also has strong financial and technological support of Enkei, Japan (leading 2W/PV wheel manufacturer with 7 decades of experience).

On May 24, 2021, we had initiated coverage on the stock (Link) with a recommendation to 'Buy at LTP and add on dips to Rs 445-450 band' for base case fair value of Rs 584 and bull case fair value of Rs 629. The stock had achieved our base case target on May 24 and bull case target on July 1, 2021.

Financial Summary

Particulars (Rs cr)	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	FY21	FY22E	FY23E	FY24E
Net sales	268	205	30.9	211	27.1	849	1,077	1,303	1,557
EBITDA	24	26	-7.0	17	42.3	83	97	137	187
APAT	3	5	-42.9	-4	-171.9	-2	15	51	91
Diluted EPS (Rs)	1.9	3.8	-50.6	-3.0	-162.9	-1.4	9.5	32.1	57.3
RoE (%)						-0.6	4.0	11.1	17.7
P/E (x)						NA	87.4	25.8	14.5
EV/EBITDA (x)						19.5	15.8	11.0	7.8

(Source: Company, HDFC sec)

Valuation & Recommendation:

We expect ACL's business to turn around in FY22E supported by strong order wins over the last 4-6 quarters and build on the momentum over the next two years. Revenue/EBITDA of the company is expected to grow at CAGR of 22/31% over FY21 to FY24E and PAT as the company ramps up the production of recent order wins. We believe investors can buy the stock in the band of Rs 825-840 and add on dips to Rs 735-750 band (14.5x Dec-23E EPS) for a base case fair value of Rs 920 (18x Dec-23E EPS) and bull case fair value is Rs 995 (19.5x Dec-23E EPS) in the next two quarters.

Recent Developments

Q2FY22 Result Update

ACL reported robust numbers for Q2FY22 on partial recovery in demand as many customers had ramped up their production by the end of Q1. Net revenue increased by 30.9% YoY to Rs 268cr, driven by recovery in automobile sales and increased pricing due to higher raw material costs. Exports accounted for ~25% of revenues and Auto Division contribute to 94%. EBITDA however declined by 7% YoY to Rs 24cr due to lower gross margins as raw material inflation gets passed on with a lag. EBITDA margin declined 370bps YoY but improved 100bps sequentially to 9.1%, on account of better operating leverage. The company reported PAT of Rs 3cr vs loss of Rs 4cr in Q1FY22.

Net debt stood at Rs 235cr with net debt-equity ratio of 0.55x. The company has reduced its capex to Rs 60cr for FY22 from Rs 90cr expected earlier as further wave of pandemic and semiconductor shortage has led to disruption in supply chain. Capacity utilization was 60-65% which is expected to increase to 70-75% in H2FY22. The management guided for EBITDA margin to be in the range of 13-15% for FY22 as shortage of semiconductor eases and there is a ramp up in production in the coming quarters.

Key Triggers

Electric mobility seeing strong traction in India

There has been a strong traction in the adoption of EV, especially in the 2W/3W segment. EV sales have crossed the figure of 30,000 units for the first time in Sep'21 and 40,000 units in Nov'21. These registrations are mainly driven by electric 2W and passenger-type electric 3W, which together account for more than 90% of total registrations. Union road, transport and highways minister Nitin Gadkari said that cumulatively 870,141 electric vehicles have been registered in India.

With the growth in electric vehicles (EV) and the thrust of Government towards faster adoption of EVs, ACL is focusing on technology agnostic parts, which would be used in both i.e. internal combustion engines (ICE) and EVs like chassis, suspension body part of the vehicle. The addition of batteries increases the total weight of the electric vehicle which drains the batteries faster. So OEMs are going for low weighting of vehicles to extract more mileage from a single charge. In 2W, ACL expects aluminium content to increase from 3.1 Kg to an average of 17-18 Kg and in 4W from 30-35 Kg to 100 Kg. This would entail 2-2.5 fold increase in aluminium requirement in converting from ICE to EV. ACL being one of the largest auto ancillary companies in the aluminium space will benefit out of this.

Supportive regulations and policies by Government

The Government is in favour of faster adoption of electric vehicles to reduce the dependence on crude oil imports. It has been incentivising investments towards electric vehicles and purchase of such vehicles. In Sep'21, it announced the PLI scheme for automobiles, auto component and drone industry with an outlay of Rs 26,058cr. This scheme is additional to the already launched PLI for Advanced Chemistry Cell, which is of Rs 18,100cr and Faster Adaption of Manufacturing of Electric Vehicles (FAME) scheme of Rs 10,000cr to boost manufacturing of electric vehicles in India. Cumulative incentives being offered across the 3 schemes would be amounting to Rs 54,100cr targeting both the demand and the supply side.

Capacity utilisation set to improve

Due to the recent slowdown in the automobile industry, capacity utilisation of ACL has come down to 60-65% in Q2FY22. With the improved visibility due to recent win orders, utilisation is expected to increase to 70-75% in H2FY22. Prior to Covid ACL was working at 80-85% capacity utilisation.

Significant order wins to enhance topline growth

During Q2FY22 ACL has added 17 parts from 8 customers, 4 parts from the domestic customers like Honda Motorcycles, Piaggio, and Dana Corporation and 13 parts from export customers like JLR, MAHLE, Renault, Dana Corporation, and Tata AutoComp and a new logo addition of Scania in the EV division.

In the ICE segment, it added 6 parts with a breakthrough order win from Renault in France which has opened more avenues for growth in a new European market. Additionally, it has also received an opportunity from a critical CAC tanks as a resourcing project for another European location. In the structural segment, it added new parts from JLR UK and entered into a new segment in two-wheelers with Piaggio. In EV segment, it added 9 parts with order wins from Dana for an existing location and a new location – Mexico, MAHLE for another new location – Spain and 5 parts from new customer Scania.

Working with leading players on key projects to expand EV products

ACL is working with Tata Motors through TACO who are developing and supplying the battery packs and motors for EV platform to Tata Motors. TACO is correctly sourcing components from China in a CKD mode, but due to FAME-4 regulations, they plan to transition to local suppliers before end of FY22. ACL has got the RFQ for more than 15 parts from TACO and it is in an advanced stage for getting nominated for these parts by Dec'21. Its portfolio with Dana stands expanded to 48 parts. It has also engaged with ARRIVAL, a leading global EV company and has a RFQ for 40 components.

Growing size of order book

ACL had an outstanding order book of ~Rs 3150cr of new products to be executed over the next 5 years implying an annual sales of ~Rs 625cr with an increasing share coming from EV ecosystem. Based on a strong momentum, it has raised its revenue share target from EV to 36% by FY26 and has an aspirational target of 45% by FY26.

Healthy demand in non-auto segment

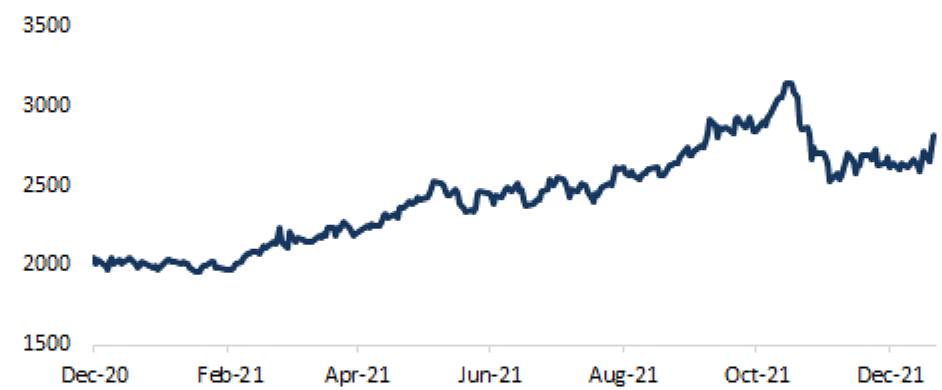
In the non-auto segment ACL is witnessing a healthy growth in demand across the sectors such as Defence, Aerospace, Agriculture, and Energy and the momentum is expected to strengthen in the quarters ahead. Currently, orders in defence sector to supply the wheels for the battle tank is nearing completion. Backed by ACL's efficiency and work quality, it has been called for the tender for refurbishing of 129 battle tanks which corresponds to 3,870+ wheels and the tender will be closed by the end of Dec'21. It is looking to further penetrate with existing clients like Siemens, GE, IR and Honeywell Automation to get orders from global locations from the same platform. It is aiming to reach 7-8% of total revenue from non-auto segment in FY23 and ~14% over the next 3 years.

Risks & Concerns

Raw material price volatility

The key raw material for the company is aluminium. The prices of aluminium have been very volatile in recent months. Inability of the company to pass on any increase in raw material prices in time could impact its profitability. In Q2FY22, the gross profits of ACL rose less than the revenue.

LME Aluminium prices ($/tonne)



(Source: Bloomberg, HDFCsec)

High dependence on automobile industry

ACL derives ~90-95% of its revenues from the automobile industry and thus is highly dependent on it. Although it is looking to diversify by launching new products in the non-auto space, this will take time.

Working capital intensive operations

The operations of the company require huge working capital. Inventory and receivable days have been rising over the last five years. Although current ratio has improved somewhat in FY21, working capital needs would need to be monitored closely. Exports sales involve higher debtor days.

Constantly operating at low asset turns and inability to improve margins has resulted in lower return ratios

ACL has been constantly operating an asset heavy business with heavy fixed cost at a low utilisation and has been unable to improve realisations and product mix where margins are higher. Inability of the company to get into high margin niche categories or newer technologies like High pressure die-casting (HPDC) for heavy tonnage products could lead to stagnation in its margin profile.

New products might take time to scale up

A significant part of the growth is expected to come from new product development. Failure to scale up the new products could slow down the growth momentum.

Technological disruption - Demand for older products (ICE based) may get impacted

Technology is changing very fast and the products of the company could become obsolete if any competitor comes up with a superior product. If EV sales pick up significantly then the demand for its older products like cylinder heads, crankshafts, engine brackets could get impacted.

EV takes longer time to become popular

ACL is betting on significant portion of revenue coming from EV related sales. However, if EV take longer time to become popular then the expected growth in revenue would get delayed.

Disruptions due to Covid/supply side issues

Disruptions/lockdowns in India and in export markets due to Covid variants could result in slower revenue growth for ACL. Also supply-side issues due to chip shortages and volatile input prices can weigh on the pace of growth.

Company Background:

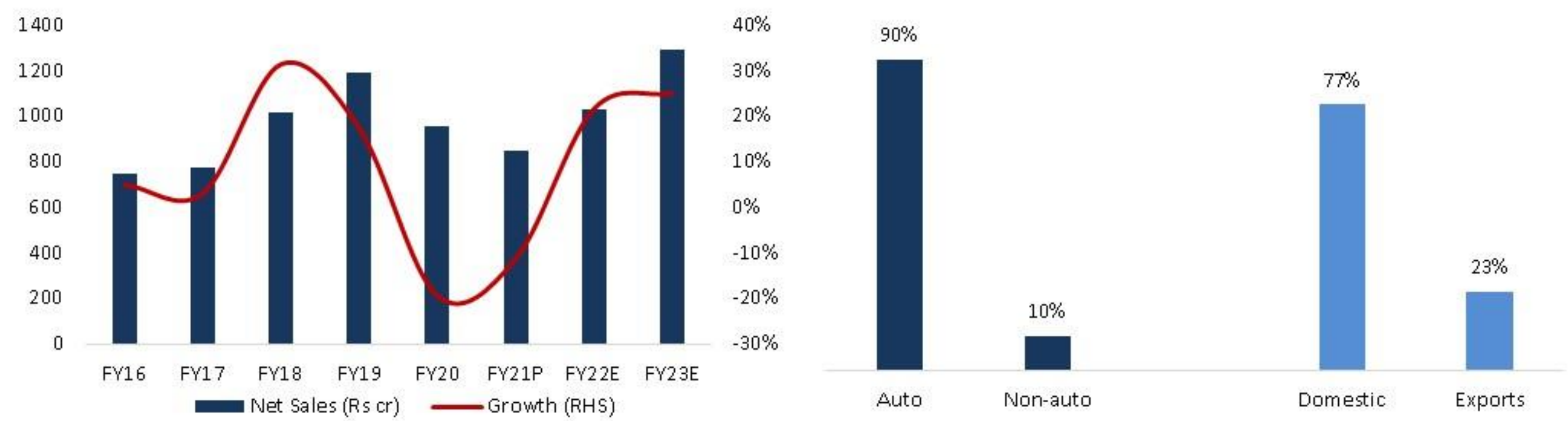
ACL is a leading manufacturer of aluminium castings. It manufactures cylinder heads, support brackets, intake manifolds, crankshafts, and engine brackets, for use in the auto industry. The company was established as a JV between Pegasus Castalloy and Enkei Corporation, Japan (one of the largest manufacturers of alloy wheels in the world). Owing to sustained losses the wheels division was hived off as a separate entity i.e. Enkei Wheels in 2009 and the castings business was renamed to ACL in Dec'10.

Clients include key Indian auto OEMs as well as auto and engineering OEMs in the European market through its subsidiaries. ACL serves clients in Europe and the US through its European subsidiary Illichmann Castalloy. It has 3 manufacturing units in India at Pune and Binola and one manufacturing plant at Slovakia.

ACL is part of the Alicon Group, a global consortium of companies engaged in Rapid Prototyping, Designing, In-house Tool Manufacturing, Engineering, Die Casting, Machining and Assembly, Painting and Surface Treatment of Aluminium Components. Leveraging its core competencies, the Group is one of the largest integrated aluminium casting manufacturers globally.

In FY21, 77% of the revenues were from the domestic market and exports accounted for 23% of sales. Besides automotive ACL has a presence in infrastructure, defence agricultural machinery, oil & gas and aerospace. Automobile industry contributed to 90% of sales in FY21.

Revenue trend and breakup (FY21)



(Source: Company, HDFCsec)

Financials

Income Statement

(Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
Net Revenues	**957**	**849**	**1077**	**1303**	**1557**
Growth (%)	***-19.5***	***-11.3***	***26.9***	***21.0***	***19.5***
Operating Expenses	851	765	980	1166	1370
EBITDA	**106**	**83**	**97**	**137**	**187**
Growth (%)	***-27.7***	***-21.5***	***16.5***	***41.2***	***36.6***
EBITDA Margin (%)	***11.1***	***9.8***	***9.0***	***10.5***	***12.0***
Depreciation	44	49	52	53	55
Other Income	3	3	4	5	5
EBIT	**65**	**37**	**49**	**88**	**137**
Interest expenses	39	36	28	19	14
PBT	**25**	**1**	**21**	**69**	**123**
Tax	8	3	5	18	31
PAT	**17**	**-2**	**15**	**51**	**91**
Share of Asso./Minority Int.	0	0	0	0	0
Adj. PAT	**17**	**-2**	**15**	**51**	**91**
Growth (%)	***-67.8***	***-111.3***	***NA***	***238.3***	***78.4***
EPS	12.4	-1.4	9.5	32.1	57.3

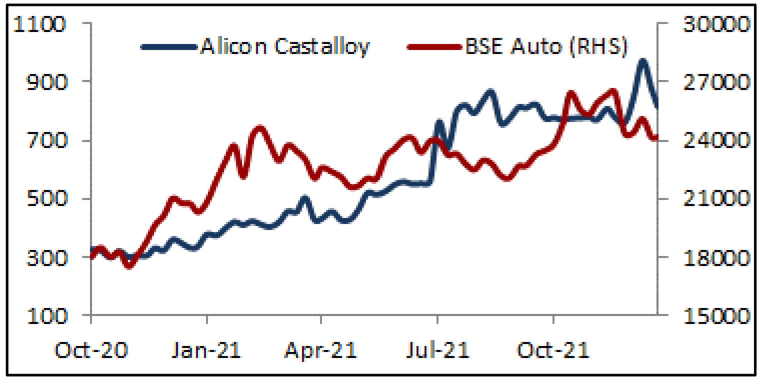
Balance Sheet

As at March (Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
SOURCE OF FUNDS					
Share Capital	7	7	8	8	8
Reserves	308	310	431	473	545
Shareholders' Funds	**315**	**317**	**439**	**481**	**553**
Borrowings	336	317	212	167	112
Net Deferred Taxes	27	28	28	28	28
Other Non-curr. Liab.	6	3	4	5	6
Total Source of Funds	**683**	**664**	**682**	**680**	**698**
APPLICATION OF FUNDS					
Net Block & Goodwill	368	363	371	359	355
CWIP	23	28	18	37	56
Investments	26	29	34	40	48
Other Non-Curr. Assets	23	27	31	38	45
Total Non-Current Assets	**417**	**420**	**423**	**436**	**458**
Inventories	106	126	130	136	149
Trade Receivables	338	323	369	389	418
Cash & Equivalents	9	20	5	7	10
Other Current Assets	31	18	26	31	23
Total Current Assets	**484**	**487**	**529**	**563**	**600**
Trade Payables	152	156	183	218	247
Other Current Liab & Provisions	66	86	87	102	112
Total Current Liabilities	**218**	**243**	**270**	**319**	**360**
Net Current Assets	266	244	260	244	240
Total Application of Funds	**683**	**664**	**682**	**680**	**698**

Cash Flow Statement

(Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
PBT	25	1	21	69	123
Non-operating & EO items	-8	2	-3	-6	-6
Interest Expenses	38	35	28	19	14
Depreciation	43	46	52	53	55
Working Capital Change	-31	29	-31	18	6
Tax Paid	-11	-2	-5	-18	-31
OPERATING CASH FLOW (a)	**57**	**112**	**61**	**136**	**161**
Capex	-70	-49	-50	-60	-70
Free Cash Flow	-13	63	11	76	91
Investments	0	0	0	0	0
Non-operating income	2	2	0	0	0
INVESTING CASH FLOW (b)	**-68**	**-47**	**-50**	**-60**	**-70**
Debt Issuance / (Repaid)	55	-19	-105	-45	-55
Interest Expenses	-38	-35	-28	-19	-14
FCFE	6	11	-122	12	22
Share Capital Issuance	0	0	110	0	0
Dividend	-9	0	-3	-10	-19
Others	-2	1	0	0	0
FINANCING CASH FLOW (c)	**6**	**-54**	**-26**	**-74**	**-88**
NET CASH FLOW (a+b+c)	**-4**	**12**	**-15**	**2**	**3**

Price chart



Key Ratios

	FY20	FY21	FY22E	FY23E	FY24E
Profitability Ratios (%)					
EBITDA Margin	11.1	9.8	9.0	10.5	12.0
EBIT Margin	6.8	4.4	4.5	6.8	8.8
APAT Margin	1.8	-0.2	1.4	3.9	5.9
RoE	5.5	-0.6	4.0	11.1	17.7
RoCE	10.4	5.8	7.6	13.6	20.9
Solvency Ratio (x)					
Net Debt/EBITDA	3.1	3.6	2.1	1.2	0.5
Net D/E	1.0	0.9	0.5	0.3	0.2
PER SHARE DATA (Rs)					
EPS	12.4	-1.4	9.5	32.1	57.3
CEPS	44.3	33.7	42.2	65.5	92.0
BV	228.5	227.7	275.5	301.6	346.9
Dividend	1.3	0.0	2.0	6.0	12.0
Turnover Ratios (days)					
Inventory days	129	142	117	106	95
Debtor days	43	50	43	37	33
Creditors days	64	66	58	56	55
VALUATION (x)					
P/E	67.2	-600.2	87.4	25.8	14.5
P/BV	3.6	3.6	3.0	2.8	2.4
EV/EBITDA	15.6	19.5	15.8	10.8	7.6
EV/Revenues	1.7	1.9	1.4	1.1	0.9
Dividend Yield (%)	0.2	0.0	0.2	0.7	1.4
Dividend Payout (%)	10.1	0.0	21.1	18.7	20.9

(Source: Company, HDFC sec)

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.