

Stock Update Steelcast Ltd.

October 31, 2022





Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Castings & Forgings	Rs 443.4	Buy in Rs 439-448 band and add more on dips in Rs 394-402 band	Rs 493	Rs 531	2 quarters

HDFC Scrip Code	STELTSEQNR
BSE Code	513517
NSE Code	STEELCAS
Bloomberg	STLCS IN
CMP Oct 28, 2022	443.4
Equity Capital (Rs Cr)	10.1
Face Value (Rs)	5
Equity Share O/S (Cr)	2.02
Market Cap (Rs Cr)	892.08
Book Value (Rs)	90.4
Avg. 52 Wk Volumes	10138
52 Week High	509.9
52 Week Low	238

Share holding Pattern % (Sep, 2022)	
Promoters	46.07
Institutions	0.02
Non Institutions	53.91
Total	100.0



* Refer at the end for explanation on Risk Ratings

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Our take:

Steelcast Ltd (SCL) is a leading manufacturer of steel & alloy steel castings in India and enjoys a premier position in steel casting industry. It is one of the few companies in India and globally manufacturing steel castings based on sand and shell casting process. SCL has wide range of casting products like carbon steel, low alloy steels, austenitic manganese steel and high chromium Ferro alloys. It caters to highly reputed multinationals clients both in India and abroad including Fortune 500 companies across various industrial sectors like Earth Moving, Mining & Mineral Processing, Locomotives, Cement, Transportation, Steel, defence, Ground Engaging Tools (GETs), Railroad, Construction etc. and also caters to a host of OEMs. The company has plans to increase its global presence in 15+ countries in the next 5 years from the current 11. In FY22, the company generated ~56% revenues from exports. With 240 parts in its product portfolio, the company has one of the largest product offering in India’s specialized castings sector.

The company is looking for further opportunities in other industrial segments and products. It has developed new products to cater to new segments and create a wide product portfolio for the existing customers. The management is continuously working towards the business plan to not only come out of the dependency on mining, earth moving and construction equipment industry but also to scale up the turnover in next 5 years through product development and business development. It has already developed in excess of 300 parts and looking to develop more than 100 parts in next 2-3 years.

In our Initiating Coverage report [\(Link\)](#) on Steelcast Ltd. Dated August 02, 2022, we had recommended to Buy in Rs 417-425 band and add more on dips at Rs 377-385 band for base case target of Rs 463 and bull case target of Rs 499 over next 2 quarters. The bull case target was achieved within the given time frame.

Valuation & Recommendation:

The company’s performance has improved in the last 2 quarters and the management has given decent guidance for both order book and revenue growth. We expect the company’s revenue and profitability to improve even as it has clear focus to reduce concentration to a particular segment. It will be focusing on railroad industries, to increase customer base and number of parts. Also, the company has received certification from the American Rail Road Industry. Going ahead, we could witness strong traction for SCL’s products with strong order book for the next few quarters. The company has signed a long-term supply agreement with a large Original Equipment Manufacturer in USA to supply steel castings for the Northern Rail-Road Industry. This new agreement will help the company to de-risk the business by reducing industry concentration and further consolidate its position in the overseas market. We expect SCL’s Revenue/EBITDA/PAT to grow at



~37%/41%/52% CAGR over FY22-FY24E backed by strong volume growth & healthy order book. The management expects volumes to increase to 16,000-16,500 tons in FY23E (vs 13,823 tons in FY22), and gradually expects it to increase to 21,000 tons in FY24E. Post the encouraging results in H1FY23, we have revised upwards our estimates for FY23E and FY24E.

We believe the base case fair value of the stock is Rs 493 (13x FY24E EPS) and the bull case fair value of is Rs 531 (14x FY24E EPS). Investors can buy the stock in Rs 439-448 band (11.7x FY24E EPS) and add more on dips in Rs 394-402 (10.5x FY24E EPS) band.

Financial Summary:

Particulars (Rs cr)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	FY21	FY22	FY23E	FY24E
Operating Income	121	77	56.5	116	4.8	158	302	465	566
EBITDA	28	18	57.9	24	17.7	32	64	104	127
APAT	18	10	79.1	14	24.4	12	33	61	77
Diluted EPS (Rs)	8.8	4.9	79.1	7.1	24.4	5.9	16.4	30.2	37.9
RoE-%						9.7	23.3	33.6	32.0
P/E (x)						74.7	27.0	14.7	11.7
EV/EBITDA (x)						28.8	15.0	9.1	7.0

(Source: Company, HDFC sec)

Q2FY23 Result Highlights:

Financial Performance:

The company posted encouraging numbers in Q2FY23. Revenue for the quarter stood at Rs 121.2 crores, up by ~57% YoY. Strong order book from customers across all industries has driven good volumes and better operational efficiencies. EBITDA during the quarter was at Rs 28.3 crores, up by ~58%. EBITDA margin for the quarter was at ~23.4%. Input prices were in line with the previous quarters during Q2FY23 but Steelcast Ltd has witnessed improved gross margins of 36%. PAT during the quarter was at Rs 17.6 crores, up by ~79% YoY. Rise in revenue and profitability growth was on the back of strong order book from customers across all industry and was driven by good volumes and better operational efficiencies.



Operational Performance:

Particulars (Rs cr)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	FY22	FY21	YoY (%)
Production (MT)	3609	3666	-1.6	3425	5.4	13263	7599	74.5
Sales (MT)	3986	3141	26.9	3973	0.3	12026	7472	60.9

(Source: Company, HDFC sec)

Key concall highlights

- Capacity utilization in Q2FY23 stood at ~53%. The management expects the capacity utilization to be around ~57% in FY23 and in the range of ~70-75% in FY24E.
- The current debt-equity ratio stands at 0.25 for H1FY23. The company remains long term debt free and does not intend to raise any long-term debt in the near future.
- The management highlighted that Steelcast would only be the 2nd company in India to have certification from the US Railroad authority, for supplying castings to US for North American railroad. The approval from Association of American Railroad(AAR) is at advanced stage and supply expected to commence from Q3FY23.
- Sales volume during the quarter was at ~4000 tons. The management expects to reach 16,000-16,500/21,000 tons by end of FY23E/FY24E respectively.
- Even though there are recessionary fears in Europe & US, the management doesn't expect any slowdown from its end user segments in the near term as its customers are asking to keep the capacities ready and strong demand is visible.
- The prototype development for its Japanese customers is ready and serial supplies have started from the month of September. In next 3-6 months Japan would be the 3rd largest country for the company's exports after USA & Germany and it would contribute around ~10-15% of its total exports in a couple of years from now.
- There would be a downward revision of ~1-2% in export prices due to softening of input prices. Exports to Europe will witness a price correction of ~7% due to euro weakening against rupee from Oct 01, 2022.
- Current order book stands at Rs 135-140 crores which is to be executed in the next 3-4 months.
- The company is developing aerial bombs and tracks for tanks in defense segment and expects good demand in the next financial year.
- The management said it would be selling to US Railroad about ~14% of its total capacity by end of FY26E.
- Commissioning of 4.5 MW hybrid power plant & 5 MW solar power plant is on track and will be commissioned before end of FY23 and will be operational from Apr'23 onwards.
- Exports during the quarter were 63% of sales vs 62% in Q2FY22 and 63% in Q1FY23.



Key developments & triggers:

Long term supply agreement with large OEM for North American rail industry

The company has signed a long-term supply agreement with a large Original Equipment Manufacturer in USA to supply steel castings for the Northern Rail-Road Industry. The steel castings which are to be supplied in this agreement are in advance stage of development and has a potential to generate additional revenues of Rs. 75-80 crores in next 2-3 years starting from FY23 and peaking in FY25. Thereafter, it has a potential to generate Rs. 75-80 crores on an annual basis. Supply under this agreement will commence from Q3FY23 onwards. The company has obtained the required approvals and has also applied for re-certification which will be completed within the next few months. This new agreement will help the company to de-risk the business by reducing industry concentration and further consolidate its position in the overseas market. Considering the company's high-quality standards with on-time deliveries, the management is confident to have a long-term association with this customer.

Clear focus on De-Risking business

The company plans to de-risk its business to reduce dependency on one particular sector and hence it has forayed into new business segments like Railways, Electro Locomotive, Defence and Ground Engaging Tools (GETs). In past few quarters, dependency on Earth moving/Mining sector has reduced and revenue from other sectors has increased. Company is making constant endeavors to contribute to defence of the nation by partnering with the Indian Defence units. This effort is continuing and we expect improvement in Steelcast's sales to this sector considering the Government push through schemes like Atmanirbhar Bharat, Make in India etc. It already has purchase orders from Indian defence units and it plans to complete these pending orders in FY23. The company has also obtained Aerospace Certification from Germany which will help in exploiting German markets. The management anticipates share of revenue from Mining and Earth Moving to decline in next 2-3 years. The long term supply agreement with large OEM in North America will help to establish its position in Rail-Road industry. The company has exposure to core industrial sectors like Earth Moving, Mining & Mineral Processing, Locomotives, Cement, Transportation, Steel etc and is placed to benefit from Capex/infra spend in India and other countries going forward.

Savings in power cost due to hybrid and solar power plant

The company has entered into a 25 years power purchase agreement through wind & solar hybrid power project to be set up in Gujarat region in captive consumption mode of hybrid capacity of 4.5 MW and a Special Purpose Vehicle (SPV) is created for the same. The management expects to receive power from this hybrid plant by Jan'23. There are about six other companies which will be drawing power from this hybrid power park. The investment (share of Steelcast) for this project is about Rs 4.5 crores and could result in annual guaranteed savings of about Rs 6 crores. The company has also planned to put up an exclusive 5 megawatts solar power park with an investment of about Rs 22 crores. There the saving would be another Rs 4.25 crores and the management expects to receive power from this plant by April'23. Both these plants will meet around ~80% of its total power requirement and balance ~20% requirement will continue to be met through the state electricity board.



Strong Volume growth visibility in next 2-3 years

We expect the volumes to grow in next 3 years as the company plans to add new clients and also from increase in orders from its existing clients. The capacity utilization in Q1FY23 stood at ~53%. The management is targeting capacity utilization of around ~90% with sales volume of 25,000-26,000 tons by FY26. Though the management doesn't have any immediate plans to increase its capacity, the time required to put up a green field facility is about 2 years' time. Based on various factors, it would decide by end of CY23 for any new capacity addition. On the current product mix, the full capacity will be around 28,500 tons and as the product mix changes it can go up to 30,000 tons also. The company takes around 9-12 months to execute an order for a new customer. Capex for FY23 is pegged at Rs 18cr for debottlenecking and adding certain machining capacities to further enhance the value addition apart from the power plants. The company incurred capex of about Rs 29cr in FY22 without any additional term loan. Its product prices are cheaper by ~25% as compared to US and European markets due to lower labour costs, freight and other related costs. The company largely exports on Ex-Works basis which results in avoiding uncertainty on account of freight costs and shipping delays.

Key risks & concerns:

Highly dependent on earth moving equipment industry: SCL has significant revenue concentration towards earth moving equipment industry which in turns derives demand from the cyclical mining and infrastructure/construction sectors contributing ~53% of the total revenue in FY22 which results in high degree of volatility in its operating performance. SCL's performance had been adversely impacted due to downturn in end-user industry demand.

Customer & geographical concentration risk: ~98% of the company's revenues in FY22 were derived from customers of ten years or more although individual companies of these groups in different geographies do not show high concentration. ~91% of the company's revenues were derived from its five largest customer groups though these consists of several group companies in different countries that may not decide to cut purchases from Steelcast at the same time.

Volatility in prices of raw materials: Steel scrap and ferro alloys are the key raw materials required for manufacturing of castings, being commodity items, prices of these raw materials are usually volatile in nature. There is a rise in input costs since Jun'20 onwards. However, SCL has price variation clauses in the orders from its major customers wherein company can pass on significant raw material price fluctuations to its customers, which mitigates risk associated with volatility in raw material prices to certain extent. Steelcast also uses Natural Gas as a fuel; prices of natural gas have been on the up lately. This can impact its margins unless these are easily passed over to the customers.



Forex exchange fluctuations: More than ~50% of the total revenue is generated from exports. It is exposed to foreign exchange fluctuation risk to a great extent. The company leaves the outstanding forex exposure open and any sharp rupee appreciation (vs the Euro or USD) will have a sharp negative impact on its margins.

Price variation with lag of quarter: Price variations are done after a lag of a quarter and due to this some volatile quarters may see sharp fall or rise in margins.

About the company:

The Company is engaged in the business of steel castings since 1960. It commenced as a partnership firm and was converted into a private limited company in 1972 that became a public limited company in 1994. The Company was promoted by Mr Manmohan Fulchand Tamboli along with his brother Mr Bipin Fulchand Tamboli and is presently being stewarded by Mr Chetan Manmhoan Tamboli, supported by family members. Steelcast manufactures steel & alloy steel castings, addressing the needs of Original Equipment Manufacturers (OEM) across the mining & mineral processing, earth moving, cement, steel plants, valves & pumps, thermal & hydro power, electro locomotive, oil field, aerobridge, general engineering and shipping sectors. Its R&D Laboratory is approved by the Department of Science & Technology, Government of India. The company is headquartered in Bhavnagar (Gujarat) with its manufacturing facility located in the same city. Alang, Asia's biggest ship recycling yard, is just 50 km away and a major source of scrap raw material. Gujarat is a power surplus state with the Company's own 66KV power transmission station with 10MW power readily available.



Financials:

Income Statement

(Rs cr)	FY20	FY21	FY22	FY23E	FY24E
Net Revenues	201	158	302	465	566
Growth (%)	-36.9	-21.4	91.5	54.0	21.6
Operating Expenses	163	126	238	362	439
EBITDA	37	32	64	104	127
Growth (%)	-36.4	-15.5	101.8	62.9	22.1
EBITDA Margin (%)	18.6	20.0	21.1	22.3	22.4
Depreciation	16	14	18	20	22
Other Income	0	1	0	2	3
EBIT	22	19	46	85	107
Interest expenses	5	4	2	3	5
PBT	17	16	45	82	103
Tax	9	4	11	21	26
PAT	8	12	33	61	77
Share of Asso./Minority Int.	0	0	0	0	0
Adj. PAT	8	12	33	61	77
Growth (%)	-68.1	50.7	176.8	83.6	25.7
EPS	3.9	5.9	16.4	30.2	37.9

Balance Sheet

As at March	FY20	FY21	FY22	FY23E	FY24E
SOURCE OF FUNDS					
Share Capital	10	10	10	10	10
Reserves	108	119	146	197	262
Shareholders' Funds	118	129	157	208	272
Minority Interest	0	0	0	0	0
Total Debt	30	14	63	73	93
Net Deferred Taxes	10	8	7	7	8
Other Non-curr. Liab.	5	2	0	2	4
Total Sources of Funds	162	153	226	290	377
APPLICATION OF FUNDS					
Net Block & Goodwill	105	97	109	103	99
CWIP	0	1	5	2	1
Investments	0	0	0	0	70
Other Non-Curr. Assets	14	11	12	18	22
Total Non-Current Assets	119	109	125	123	192
Inventories	23	26	62	88	104
Debtors	28	51	75	111	127
Cash & Equivalents	2	1	2	28	29
Other Current Assets	24	5	12	18	22
Total Current Assets	77	83	151	245	281
Creditors	10	14	36	56	70
Other Current Liab & Provisions	24	25	14	23	27
Total Current Liabilities	35	39	50	79	97
Net Current Assets	42	44	101	166	184
Total Application of Funds	162	153	226	290	377



Cash Flow Statement

(Rs Cr)	FY20	FY21	FY22	FY23E	FY24E
Reported PBT	17	16	45	82	103
Non-operating & EO items	0	0	0	-4	-2
Interest Expenses	4	3	1	3	5
Depreciation	16	14	18	20	22
Working Capital Change	7	1	-51	-40	-17
Tax Paid	-10	-3	-13	-21	-26
OPERATING CASH FLOW (a)	34	29	0	41	84
Capex	-6	-4	-33	-12	-17
Free Cash Flow	28	25	-33	29	67
Investments	0	0	0	0	-70
Non-operating income	0	1	0	0	0
INVESTING CASH FLOW (b)	-6	-4	-33	-12	-87
Debt Issuance / (Repaid)	-15	-9	-18	10	20
Interest Expenses	-5	-3	-1	-3	-5
FCFE	9	13	-52	36	12
Share Capital Issuance	0	0	0	0	0
Dividend	-5	-1	-5	-10	-13
Others	0	0	0	0	0
FINANCING CASH FLOW (c)	-25	-14	-25	-4	3
NET CASH FLOW (a+b+c)	4	12	-58	26	0

One Year Price Chart:



Key Ratios

Particulars	FY20	FY21	FY22	FY23E	FY24E
Profitability Ratios (%)					
EBITDA Margin	18.6	20.0	21.1	22.3	22.4
EBIT Margin	10.8	12.2	15.3	18.3	19.0
APAT Margin	4.0	7.6	11.0	13.1	13.6
RoE	6.9	9.7	23.3	33.6	32.0
RoCE	13.8	13.3	25.6	34.1	33.3
Solvency Ratio (x)					
Net Debt/EBITDA	0.8	0.4	1.0	0.4	0.5
Net D/E	0.2	0.1	0.4	0.2	0.2
PER SHARE DATA (Rs)					
EPS	3.9	5.9	16.4	30.2	37.9
CEPS	11.9	12.8	25.2	40.2	48.9
BV	58.2	63.6	77.3	102.5	134.3
Dividend	0.6	1.4	3.2	5.0	6.2
Turnover Ratios (days)					
Debtor days	77.3	92.2	76.5	73.0	76.8
Inventory days	42.8	56.3	52.7	58.7	61.9
Creditors days	24.2	28.3	30.0	36.0	40.6
VALUATION (x)					
P/E	112.5	74.7	27.0	14.7	11.7
P/BV	7.6	7.0	5.7	4.3	3.3
EV/EBITDA	24.8	28.8	15.0	9.1	7.0
EV / Revenues	4.6	5.8	3.2	2.0	1.6
Dividend Yield (%)	0.1	0.3	0.7	1.1	1.4
Dividend Payout (%)	15.2	22.7	19.2	16.6	16.3

(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. These 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 cyclicity 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.

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