

October 5, 2017

RE-INITIATING REPORT

Alicon Castalloy Limited

VOL-3, NO-17

BUY

CMP: Rs.533

TARGET PRICE: Rs.750

TIME : 12 months

REINITIATION REPORT

We had initiated coverage on the Alicon Castalloy Limited on July 25, 2016 (Vol-2 No-12) at the price of Rs288 and target of Rs450. Post our coverage, the stock has breached our initial as well as revised target of Rs600 to hit a new high of Rs651. With the recent Annual Report FY17, the conviction in the recommendation stands strong post the analysis. We thereby re-initiate a fresh BUY call on the stock at CMP of Rs533 and target of Rs750 over a horizon of 12 months.

About the Company:

Alicon Castalloy Limited (Alicon) is an established aluminium foundry involved in the manufacturing of very complex aluminium castings for automotive as well as non-automotive customers. These customers are spread across the domestic as well as international boundaries. Alicon is a global company involved in design, engineering, casting, machining, painting and surface treatment of aluminium components. The company amalgamates the best of European engineering, Japanese quality and Indian ingenuity to produce exceptional and innovative aluminium casting products. Thus, it is aptly placed to offer end-to-end solutions across the entire value chain. The company takes advantage of its upgraded technology and state-of-art plants (two in Pune, one in Haryana (Binola) and one in Europe-Slovakia).

Positives for the company from a Macro Point of view:

(a) Very few large foundries in the Indian foundry industry are modern and competitive; majority of them (informal ones) are using outdated and older technology. If the nation has to grow economically, the major sectors which contribute towards the nation's IIP and GDP (which have been a laggard over the few years) have to provide a turnaround. Many of these laggards are dependent on the metal cast intermediaries products for sectors such as automobiles, tractors, railways, machine tools, sanitary, pipe fittings, defence, aerospace, earth moving, textile, cement, electrical, power machinery, pumps / valves, wind turbine generators, etc.

(b) The current government has formulated new reforms for the manufacturing sector and so new manufacturing policies have been created. These policies will also create jobs for a healthy economic growth. Since metal castings are used by many manufacturers, the role of foundries is becoming crucial. Thus, if the manufacturing sector is supposed to grow, it will be hand in hand with the growth of the foundry industry.

(c) A lot of stimulus has already been provided by the government for Make in India and we are actually seeing traction by a lot of foreign investors and investments, eager to pump in money in India. This essentially will lead to (technical) tie-ups or joint ventures and benefit the industrial growth in India in a win-win situation. Many Japanese firms have already ventured into India, as they see potential for growth on Indian soil.

INVESTMENT RATIONALE

(A) Growing stronger by the day:

On the automotive front, in India, the group specializes in component manufacturing for the two-wheeler and four-wheeler industry. Its major products include cylinder heads and manifolds. After getting a grip in the Indian markets, the company is now approaching the global market for supplies of these products. It is learnt that many components have been sent to international four-wheeler manufacturers. There are huge untapped opportunities for Alicon in the automotive OEMs space in the overseas markets. Having realized that, the group is looking at capturing these opportunities in the next two to three years by using their base capabilities and leveraging relationships with existing customers.

Alicon has ambitious plans to become one of the top 5 foundries (innovation and technology) across the globe by FY20-21. The company is already in the process of filling (process) patent; which will help it garner better recognition in the auto ancillary sector. The company has been consolidating efforts to gear-up in order to tap new sectors of growth. They have identified 16 product segments (some of which they were already into) where they intend to grow; some of these include cylinder heads for 2-wheelers as well as 4-wheelers, AMT base plates, defence, hybrid or electric vehicles etc.

Please Turn Over

SNAPSHOT				
52 week H / L	Mcap (INR mn)			
651 / 330	6,533			
Face value: 5				
BSE Code	NSE CODE			
531147	ALICON			
Annual Performance				
(Rs mn)	FY15	FY16	FY17	FY18E
Sales (Net)	7,136	7,489	7,728	8,498
EBITDA	709	778	868	977
EBITDA (%)	10	10	11	11
Other Income	22	32	37	37
Interest	180	223	265	288
Depreciation	261	267	273	304
PBT	290	320	368	423
PAT	199	222	262	296
Equity	55	61	61	61
EPS (INR)	18	18	21	24
Quarterly Performance				
Parameters (Rs mn)	Sept-16	Dec-16	Mar-17	Jun-17
Sales (Net)	2,074	1,746	2,065	1,973
EBITDA	225	192	251	208
EBITDA (%)	11	11	12	11
Other Income	7	11	19	24
Interest	65	64	76	74
Depreciation	69	69	66	74
PAT	70	50	89	61
Equity (Rs mn)	61	61	61	61
Ratio Analysis				
Parameters (Rs mn)	FY15	FY16	FY17	FY18E
EV/EBITDA (x)	11.2	10.4	9.9	8.9
EV/Net Sales (x)	1.1	1.1	1.1	1.0
M Cap/Sales (x)	0.9	0.9	0.8	0.8
M Cap/EBITDA (x)	9.2	8.4	7.5	6.7
Debt/Equity (x)	1.3	1.2	1.4	1.2
ROCE (%)	30	28	26	26
Price/Book Value (x)	4.6	4.6	3.7	3.3
P/E (x)	29.6	29.4	25.0	22.1
Share Holding Pattern as on 30th June 2017				
Parameters	No of Shares		%	
Promoters	87,01,413		71%	
Institutions	394		0%	
Public	35,54,415		29%	
TOTAL	1,22,56,222		100%	

Note: All the data is calculated as per Market Price on 04th Oct 2017.

INVESTMENT RATIONALE (contd.)

If one carefully goes through the annual report of FY16, the company had already mentioned their intentions to work for e-mobility, e-vehicles and hybrid vehicles and or parts. Thereby, with the current focus on electric vehicles, Alicon sits in a sweet spot.

Product innovation is what Alicon always strives for. The company is currently working towards a new concept of manufacturing products with thin-walled castings, the main advantage of the same will be towards reducing the weight of the castings and thus the weight of the vehicles (e-vehicles or hybrids), which is also the need of the hour.

The company has started manufacturing Automatic Manual Transmission (AMT) base plates. These are very complex parts made in India for the first time. The market for AMTs is expected to extend to cover 40% of passenger cars over the next three years.

(B) Get set go (Ready for a leap):

Alicon is dedicated to the principles of PQCDMMSE (Productivity, Quality, Cost, Delivery, Development, Management, Safety and Environment) and is continuously scaling the quality matrix through deployment of Kaizen. Needless to mention again, Alicon is a one-stop solution for designing, engineering, casting, machining & assembly, painting and surface treatment of aluminium in India. In the segment for two wheelers, Honda Motorcycle and Scooter India, Hero Motocorp, Bajaj Auto, Royal Enfield and Suzuki Motorcycles, Polaris USA, KTM Austria are some of the top customers; while Maruti Suzuki India, Honda motors, Tata Motors, Mahindra & Mahindra and Renault, Daimler, USA, are some of the top customers in the four-wheeler segment. Nearly 90% of the revenues for the company comes from the automotive segment. The products manufactured by the company are not just restricted to the automotive segment, but the products list has spread its wings across non-automotive segments as well.

The company has been working with Renault over the past few years. There are few launches anticipated by Renault in the current year as well as next year; Alicon can be benefitted by the same in the immediate as well as the long run.

The current capacity utilization of the company is around 70-75%. The company intentionally keeps some capacity idle, which can be ramped-up in case of impromptu orders from OEMs. Keeping this in mind, the company has been adding tangible assets. Alicon has identified land in Khed district in Pune. This can be used to solve the issue of saturating capacity.

Disruption in technology is one of the biggest challenges across the globe. In such a situation it is better to have a vision and clarity of what lies ahead for growth; the ones who want to stay ahead of the curve are constantly working hard towards improvisation and Alicon is one amongst them. The company had indicated its endeavor to seize the opportunities in hybrid or electric vehicles (in FY16), which is proving correct in the current scenario for FY17-18. A lot of companies have now started thinking on the prospects of electric vehicles, wherein Alicon had anticipated the change in technology very much ahead of time and started working on the potential components nearly a year and a half ago. This clearly indicates the strength of research and development which the team of Alicon is involved in. Some technology and design innovations in FY2016-17 include developing and producing: Cylinder head for Renault Nissan, Coolant Collector for Daimler USA, Eco manifold for Maruti Suzuki, Oil Sump for Jaguar Land Rover UK, Engine parts for Honda Cars, Cylinder Heads for Aftermarket, Intake manifold for Toyota, CAC tank for Modine Scania Trucks and Crankcase for Polaris Hi-end Motorbike Indian.

Exhibit 1- Automotive: Bridge Fork Top



Exhibit 2- Automotive: Intake Manifold



INVESTMENT RATIONALE (contd.)
Exhibit 3– Automotive: CAC Tanks



Exhibit 4– Automotive: Cylinder Head



Exhibit 5– Automotive: Engine and Transmission Brackets



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INVESTMENT RATIONALE (contd.)

Exhibit 6– Automotive: Other Auto Components

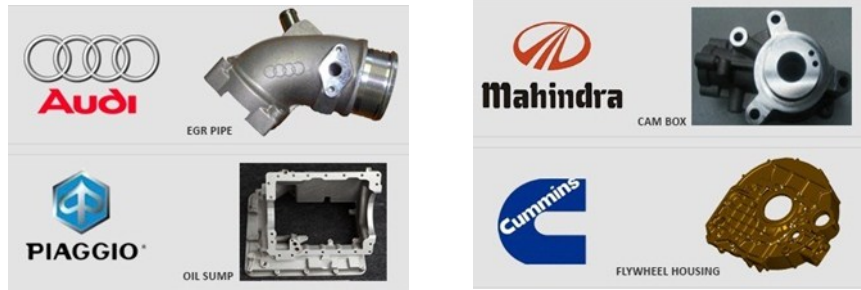
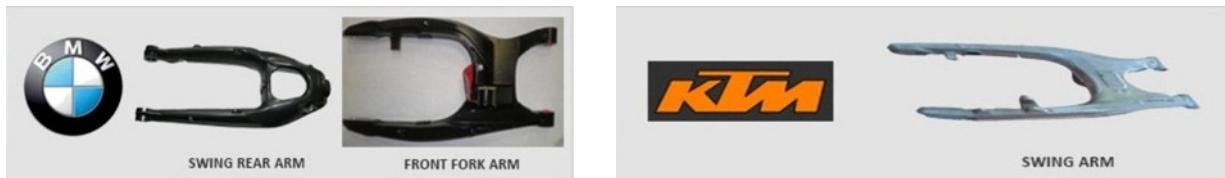


Exhibit 7– Automotive: Swing Arm



(C) Diverse presence:

Besides being the leading supplier for automobiles, the company is also gripping for other non-automotive segments as well. Although the company has confidence in the auto sector to do well in the years to come; Alicon is taking measures to insulate its business model from the vagaries of any one sector by catering to the requirements of the non-auto sector as well. The acquisition of Illichmann Castalloy– Europe has enabled Alicon to diversify into non-auto segments as part of its diversification and applying the de-risking strategy. In the segment of non-auto components, the company has little contributions towards components in the segments of agriculture, aero & marine, locomotive, infrastructure, energy, defence, medical & health etc. To further de-risk its operations, it is expanding the customer base, both in India and globally. In times to come, the exports market is expected to add stimulus to increasing the topline, so the company is already exploring more opportunities here. Currently the exports are nearly 7.39% and company intends to ramp-up the same to 20% by the 2020-2021.

Exhibit 8– Non- Automotive: Aero and Marine



Exhibit 9– Non- Automotive: Defence Components



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INVESTMENT RATIONALE (contd.)

Exhibit 10- Non- Automotive: Agriculture Components



Exhibit 11- Non- Automotive: Energy Components



Exhibit 12- Non- Automotive: Infrastructure Components

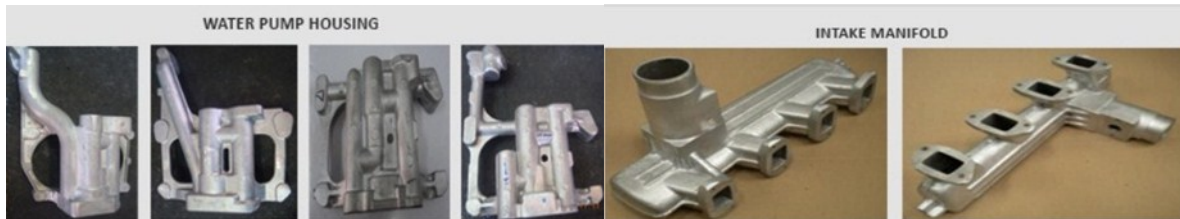


Exhibit 13- Non- Automotive: Locomotive Components



Exhibit 14- Non- Automotive: Healthcare



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Financials:

The company has been gradually increasing the dividend payout over the last few years. Monsoons have been averagely at 95% of the expectation this year; there can be a possibility of higher sales of two wheelers in the rural market as well as CV and LCV market which can be an added booster for the company. The effects of GST are more or less nil for the company. In times to come, the exports market will be a stimulus to increasing the topline, where the company is already exploring more opportunities.

Risks and concerns:

Disruption in technology is one of the biggest challenges faced by the company. Any industrial slowdown or sluggish business environment could impact the performance of the company. The fluctuating cost of raw material has always been a concern for Alicon; however a fluctuation in the prices is a pass-through to the customers. Competition from international OEM manufacturers is also a threat to the growth of the company. Moreover, the company is also subjected to fluctuations in the forex market.

Outlook and valuations:

The company stands strong and lucrative to benefit from the growth expected across the automotive as well as the above listed non-automotive sectors going forward. The company has been getting strong enquiries which indicates, their visibility is improving in the OEM markets. The conviction provided by the consistent trajectory growth of the company is immense. The same is also boosted by the interest of Enkei in the business; in May 2017, Enkei Corporation Japan, acquired 8.6lakh equity shares from Alicon at a price of Rs478; thus increasing their shareholding from 8.98% to 14.94%. We continue to maintain our stands and recommend a BUY on the stock with a (second revised target) price of Rs750 with a 12 month's perspective.

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