Sharekhan by BNP PARIBAS

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Stock Update

Alicon Castalloy Ltd

Q2 results below expectation, solid earnings visibility

Automobiles	Sharekhan code: ALICON
Reco/View: Buy ↔	CMP: Rs. 782 / Price Target: Rs. 1,056 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

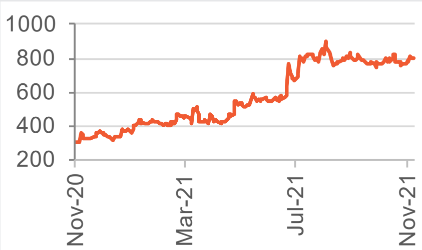
Company details

Market cap:	Rs. 1,218 cr
52-week high/low:	Rs. 948 / 305
NSE volume: (No of shares)	39,488
BSE code:	531147
NSE code:	ALICON
Free float: (No of shares)	0.7 cr

Shareholding (%)

Promoters	55.9
FII	0.0
DII	9.7
Others	34.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.3	-7.4	51.0	164.6
Relative to Sensex	5.4	-15.6	28.9	126.0

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on Alicon Castalloy Limited (Alicon) with an unchanged PT of Rs. 1,056, factoring long-term revenue visibility, given its robust strong order book.
- Alicon's Q2FY2022 results were below expectations, marred by lower sales and higher-than-expected contraction in EBITDA margin.
- We have maintained our earnings estimates to build in the company's multi-year order wins and increased share of high-margin machined components going forward.
- The stock trades attractively at P/E multiple of 11.4x and EV/EBITDA multiple of 5.9x its FY2023E estimates.

Alicon Castalloy Limited's (Alicon) Q2FY2022 results were below expectations, marred by lower sales and higher-than-expected EBITDA margin contraction. Net revenue increased by 30.9% y-o-y to Rs. 267.8 crore in Q2FY2022, driven by recovery in automobile sales. EBITDA margin improved 100 bps q-o-q to 9.1% in Q2FY2022, largely due to operating leverage benefits and cost reductions. However, EBITDA margin was lower than our expectations. On a y-o-y basis, EBITDA margin contracted by 460 bps in Q2. As a result, EBITDA and PAT declined by 7% y-o-y and 42.9% y-o-y to Rs. 24.3 crore and Rs. 3 crore, respectively. Management witnessed demand uptrend across domestic markets. On the international front, most key export geographies in the US and Europe reported healthy auto sales, led by steady demand and stable currency in key markets. We expect Alicon to benefit from the improved business outlook from automotive and non-automotive segments, given its multi-year order wins and recovery expected in demand. Management has given an optimistic outlook on revenue growth over the next couple of years, given robust new order wins. The company's new order book stands at Rs. 3,000 crore, which will be executable over the next 4-5 years. Given the size of the current order book and Alicon's established relationship with its clients, we believe the company has a high degree of revenue visibility going forward. We maintain our positive stance on Alicon's business outlook and a Buy rating on the stock.

Key positives

- Robust new order book size of Rs. 3,000 crore to be executable over the next five years with Rs. 600 crore-700 crore incremental revenue every year.

Key negatives

- EBITDA margin for Q2FY2022 was lower than expectation at 9.1%, representing 100 bps q-o-q improvement but a 460 bps y-o-y decline.
- Chips shortage and volatile input prices impacted growth during Q2FY2022.

Management Commentary

- Management witnessed demand uptrend across domestic markets, driven by increased spending and consumption, especially post the lockdowns and a shift towards new high-tech vehicles, and personal mobility preference among other factors.
- On the international front, most key export geographies in the US and Europe reported healthy auto sales, led by steady demand and stable currency in key markets.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 1,056: Alicon is likely to benefit from the multi-year order wins, which are expected to contribute significantly going forward. We have maintained our earnings estimates, given the company's multi-year order wins and increased share of high-margin machined components. We expect Alicon's business to turnaround in FY2022E by registering PAT of Rs. 62.8 crore in FY2022E and a subsequent 70.7% PAT growth in FY2023E, driven by a revenue CAGR of 39% during FY2021-FY2023E and a 430 bps EBITDA margin expansion to 14.1% in FY2023E from 9.8% in FY2021. The stock is trading at an attractive P/E multiple of 11.4x and EV/EBITDA multiple of 5.9x its FY2023E estimates. Given strong revenue visibility, we maintain Buy on the stock with an unchanged price target (PT) of Rs. 1,056.

Key Risks

Alicon has a significant exposure to international markets. Any slowdown or cyclical downturn in any of the locations, where it has a strong presence, can impact its business and profitability.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenues	849	1,213	1,638	2,048
Growth (%)	(11.3)	43.0	35.0	25.0
EBIDTA	83	164	228	289
OPM (%)	9.8	13.5	13.9	14.1
Net Profit	(2)	63	107	149
Growth (%)	NA	NA	70.7	38.9
EPS	(1.4)	40.3	68.8	95.6
P/E	NA	19.4	11.4	8.2
P/BV	3.5	3.4	2.8	2.2
EV/EBIDTA	15.2	8.2	5.9	4.5
ROE (%)	-0.6	17.7	24.3	26.6
ROCE (%)	5.9	19.1	26.2	30.1

Source: Company; Sharekhan estimates

Q2 results below expectations: Alicon's Q2FY2022 results were below expectations, marred by lower sales and higher-than-expected EBITDA margin contraction. Net revenue was up 30.9% y-o-y to Rs. 267.8 crore in Q2FY2022, driven by recovery in automobile sales. On the international front, most key export geographies in the US and Europe reported healthy auto sales led by steady demand and stable currency in key markets. EBITDA margin improved by 100 bps q-o-q to 9.1% in Q2FY2022, largely due to operating leverage benefits and cost reductions. However, EBITDA margin was lower than our expectations. On a y-o-y basis, EBITDA margin contracted by 460 bps in Q2. As a result, EBITDA and PAT declined by 7% y-o-y and 42.9% y-o-y to Rs. 24.3 crore and Rs. 3 crore, respectively. Depreciation increased by 10.2% y-o-y and 3.4% q-o-q to Rs. 13.1 crore. During the quarter, the company has booked 17 parts from 8 customers, which includes four parts in the domestic customers and 13 parts from export customers. Revenue mix for the quarter included 94% for automotive and 6% for non-automotive business, while 75% for domestic and 25% for exports.

Optimistic commentary from management: Management has an optimistic outlook on revenue growth over the next couple of years, given robust new order wins. The company's new order book stands at Rs. 3,000 crore, which will be executable over the next five years. New order book comprises 60% domestic and 40% export business. Management expects the electric vehicle (EV) business mobility to improve to 9% of total revenue in FY2022E from current 8% in FY2021. Management witnessed demand uptrend across domestic markets, driven by increased spending and consumption, especially post the lockdowns and a shift towards new high-tech vehicles, and personal mobility preference among other factors. However, supply-side issues due to chip shortages and volatile input prices weighed down the pace of growth. Capacity utilisation was 60-65% during Q2FY2022; management expects to improve its capacity utilisation to 75-80% in FY2022E. From a business standpoint, Alicon continues to institute cost-rationalisation initiatives and has undertaken optimum working capital measures to conserve cash flows and ensure steady profitability. Management expects to benefit from the shift to personal mobility catalysed by the pandemic, preference for green vehicles (hybrid and EV), staggered introduction of vehicle scrappage policy, thrust on higher fuel efficiency, cost-optimisation, and light-weight of products.

Beneficiary of improved business outlook: We expect Alicon to benefit from the improved business outlook from automotive and non-automotive segments, given strong pent-up demand in the domestic business likely to span across the business post normalisation of the second wave. Moreover, execution of Alicon's multi-year order wins is expected to contribute significantly from FY2022, which provides strong growth visibility going forward. Alicon expects new orders to commence from FY2022 and gradually ramp up in subsequent years. Share of value-added machined parts is expected to increase with the execution of new orders, which would improve the overall product mix. Alicon expects share of the four-wheeler business segment to increase from 36% currently to 51% over the next four to five years. The company is also working to increase the share of EV business. The company has built a portfolio of over 65 live parts in the EV business, which the company expects would contribute 25% to overall revenue by FY2026E from 5% currently. It would be supplying battery and transmission housings to its existing EV customers and plans to increase new customers. Alicon is targeting customers in the US and Europe for increased EV business.

Established aluminium casting auto-component player: Alicon is expected to benefit from its established market position in the aluminium casting auto component sector, driven by established client relationships and operations in India, Austria, and Slovakia. The company is expected to benefit from strong growth prospects of its key clients such as Hero MotoCorp, Bajaj Auto, and Maruti Suzuki. Alicon has diversified its customer concentration by garnering businesses from new customers and has improved its top five customer concentration from 61% in FY2011 to less than 30% in FY2020.

Share of non-automotive business to increase: Alicon aims to increase the share of non-automotive business from 9% currently to about 14% over the next three to four years. The company is also targeting increased share of business with existing customers such as Siemens, TAFE, and John Deere. For the defence segment, the company is working on new product introductions such as tank wheel hubs and ventilator parts used in tank missiles.

Robust earnings growth outlook: Alicon is likely to benefit from the multi-year order wins, which are expected to contribute significantly going forward.. We have maintained our estimates given the company's multi-year order wins and increased share of high-margin machined components. We expect Alicon's business to turnaround in FY2022E by registering PAT of Rs. 62.8 crore in FY2022E and subsequent 70.7% PAT growth in FY2023E, driven by a revenue CAGR of 39% during FY2021-FY2023E and a 430 bps EBITDA margin expansion to 14.1% in FY2023E from 9.8% in FY2021.

Results (Consolidated) Rs cr

Particulars	Q2FY22	Q2FY21	% yoy	Q1FY21	% qoq
Net Sales	267.8	204.6	30.9	210.7	27.1
Total operating costs	243.5	178.4	36.4	193.6	25.7
EBIDTA	24.3	26.2	(7.0)	17.1	42.3
Depreciation	13.1	11.9	10.2	12.7	3.4
Interest	7.5	9.2	(18.6)	8.6	(12.7)
Other Income	0.9	0.6	66.6	0.9	(0.4)
PBT	4.7	5.6	(17.0)	-3.2	NA
Tax	1.6	0.3	395.6	1.0	67.9
Reported net profit	3.0	5.3	(42.9)	-4.2	NA
Adjusted net profit	3.0	5.3	(42.9)	-4.2	NA
Adjusted EPS	1.9	3.8	(50.7)	-3.0	NA

Source: Company; Sharekhan Research

Key Ratios (Consolidated)

Particulars	Q2FY22	Q2FY21	% yoy	Q1FY21	% qoq
Particulars	Q2FY22	Q2FY21	YoY (bps)	Q1FY21	QoQ (bps)
Gross margin (%)	47.4	52.0	(460)	50.2	(280)
EBIDTA margin (%)	9.1	12.8	(370)	8.1	100
EBIT margin (%)	4.2	7.0	(280)	2.1	210
Net profit margin (%)	1.1	2.6	(150)	(2.0)	NA
Effective tax rate (%)	35.2	5.9	2,930	(30.3)	NA

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – Strong recovery from FY2022

Automotive demand declined in FY2020 due to slowing economic growth, higher cost of ownership due to mandatory insurance, safety regulations, and implementation of BS-VI emission norms. Growth in FY2021 was affected by economic slowdown on account of COVID-19. After two consecutive years of decline, we expect FY2022E to be a strong year. We expect a strong bounce back in automobile demand post normalisation of the second wave of COVID-19. Agri-based policies proposed in the budget are likely to augur well for the industry. We expect the strongest recovery in commercial vehicles in FY2022 and FY2023, driven by improvement in economic activities. Low interest rates and improvement in financing availability are likely to augur well for the industry. We remain positive in tractors, four-wheeler, and two-wheeler segments. Strong volume growth would drive up earnings as well as valuation multiples. Moreover, EV adoption is the fastest in Europe, which is likely to be positive for Alicon. We retain our Positive view on the sector.

■ Company outlook – Strong earnings growth

We expect Alicon to benefit from the improved business outlook from automotive and non-automotive segments, given recovery in demand due to normalcy of economic activities. In addition, the execution of Alicon's multi-year order wins would commence from FY2022, which provides strong growth visibility going forward. Alicon expects new orders to commence from FY2022 and gradually ramp up in the subsequent years. Alicon is expected to benefit from its established market position in the aluminium casting auto component sector, driven by established client relationship and operations in India, Austria, and Slovakia. The company is expected to benefit from the strong growth prospects of its key clients such as Hero MotoCorp, Bajaj Auto, and Maruti Suzuki.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 1,056

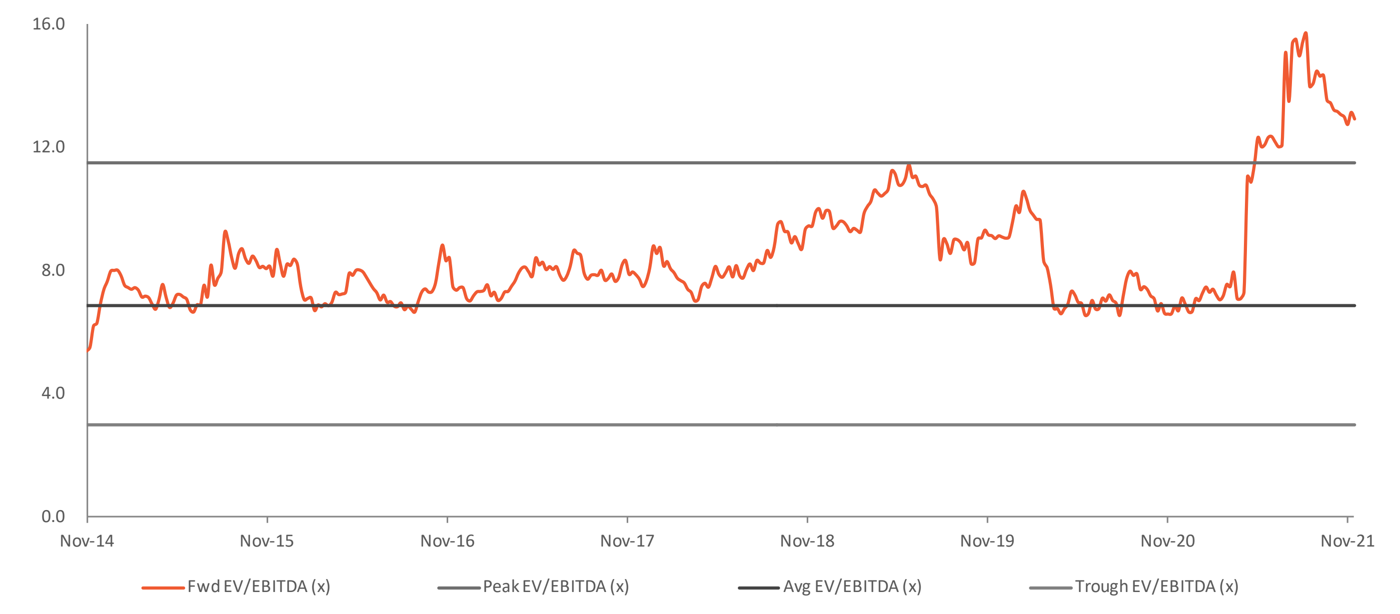
Alicon is likely to benefit from the multi-year order wins, which are expected to contribute significantly going forward. . We have maintained our earnings estimates, given the company's multi-year order wins and increased share of high-margin machined components. We expect Alicon's business to turnaround in FY2022E by registering PAT of Rs. 62.8 crore in FY2022E and a subsequent 70.7% PAT growth in FY2023E, driven by a revenue CAGR of 39% during FY2021-FY2023E and a 430 bps EBITDA margin expansion to 14.1% in FY2023E from 9.8% in FY2021. The stock is trading at an attractive P/E multiple of 11.4x and EV/EBITDA multiple of 5.9x its FY2023E estimates. Given strong revenue visibility, we maintain Buy on the stock with an unchanged PT of Rs. 1,056.

Target Price Calculation

Particulars	Rs cr
FY2023E EBITDA	227.7
Target EV/EBITDA Multiple (x)	8.5
EV	1,935
Net Debt	291
Target Price (Rs./Share)	1,056
Upside (%)	35

Source: Company Data; Sharekhan Research

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP (Rs / Share)	P/E (x)			EV/EBITDA (x)			RoCE (%)		
		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Alicon Castalloy	782	NA	19.4	11.4	15.2	8.2	5.9	5.9	19.1	26.2
Gabriel India	142	37.5	20.3	16.0	17.6	11.1	8.9	11.8	17.8	20.0
GNA Axles	745	22.6	15.5	11.8	12.0	8.9	7.0	15.3	19.2	22.1
Lumax Auto Tech	143	20.1	14.4	11.0	9.5	7.1	5.5	12.8	14.6	16.5

Source: Company, Sharekhan estimates

About company

Alicon is a pioneer in low-pressure die casting (LPDC) and gravity die-casting (GDC). The company caters to requirements of the domestic as well as overseas clients and has a well-diversified base of marquee clients. Cylinder head is one of the key products manufactured by the company and accounts for a lion's share of its revenue. Other products manufactured include brackets, crankcase, head cover, manifold, and brackets. Around 90% of Alicon's revenue comes from the auto segment, while the non-auto segment constitutes the remaining 10%. The company derives around 80% of its revenue from domestic operations, while 20% is constituted by exports, which includes overseas business.

Investment theme

Alicon is expected to benefit from the improved business outlook from automotive and non-automotive segments, given demand recovery due to normalcy of economic activities. In addition, the execution of Alicon's multi-year order wins would commence from FY2022, which provides strong growth visibility going forward. Alicon expects new orders to commence from FY2022 and gradually ramp up in subsequent years. Alicon is expected to benefit from its established market position in the aluminium casting auto component sector, driven by established client relationship and operations in India, Austria, and Slovakia. The company is expected to benefit from the strong growth prospects of its key clients such as Hero MotoCorp, Bajaj Auto, and Maruti Suzuki. We expect Alicon's business to turnaround in FY2022E and benefit from its multi-year order wins. We maintain our positive stance on Alicon's business outlook.

Key Risks

- Alicon has significant exposure to international markets. Any slowdown or cyclical downturn in any of the locations, where it has a strong presence, can impact its business and profitability.

Additional Data

Key management personnel

Shailendrajit Rai	Managing Director
Rajeev Sikand	Group CEO
Vimal Gupta	Group CFO
Andreas Heim	Managing Director – ILLICHMANN

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Nastic Trading Llp	48.6
2	Enkei Corporation	14.1
3	Shailendrajit Charnjit Rai	6.0
4	Rajeev Sikand	4.0
5	U. C. Rai Holdings Private Limited	2.5
6	Pamela Trading Llp	2.1
7	Skyblue Trading And Investments P Ltd	1.8
8	Vimal Gupta	1.8
9	Nirav Mahendra Sheth	1.0
10	Mithras Trading Llp	0.9

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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