

25 Sept, 2023

PICK OF THE MONTH

VOL-9, NO-04

Industry: Castings & Forgings

Nelcast Limited

BUY

CMP: Rs.147

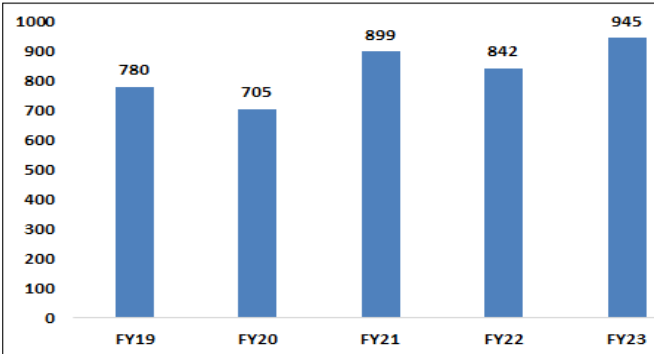
TARGET PRICE: Rs.210

TIME : 12 months

Auto Industry Overview: In FY23, PV/2W/CV segments grew by 27%/17%/34% y-o-y, led by healthy demand and the low base effect of the previous year. This demand momentum is expected to continue, but at a slower growth rate in FY24 due to the higher base of FY23, which is well seen through the numbers where the auto sector has been one of the best performers in 2023. The sceptical view due to fading pent-up demand and high vehicle costs has been replaced with lower input costs and price hikes that have driven the margins thereby leading to stable earnings growth.

The tractor demand had declined in FY22 due to delayed harvests and stagnant rural wage growth. However, FY23 turned out to be a strong year for the Indian tractor industry as the sales volumes touched an all-time high of 944,000 units. The industry reported growth of about 12% in FY23 as against the previous year, driven by rise in MSP, which led to an increase in farm income, as well as another year of above average monsoon. Coupled with this, technological advancements in high horsepower tractor range further contributed to the growth. Government initiatives regarding rural development, farm mechanization and high rural wages are likely to increase the tractor volume over the long term. In the current times, the tractor industry has come off a very high base of FY23; going ahead it is estimated that the industry would report a low single digit growth. Despite various positive growth enablers such as a good sowing Kharif season, increased Government spends on the rural front, multiple state elections etc, it would be more of a wait and watch situation for the industry from overall growth perse. *Reiterating, the domestic tractor industry growth is expected to remain moderate in FY24 due to a high base.* Slow rural demand and the impact of unseasonal rains can affect the demand scenario and needs to be closely watched.

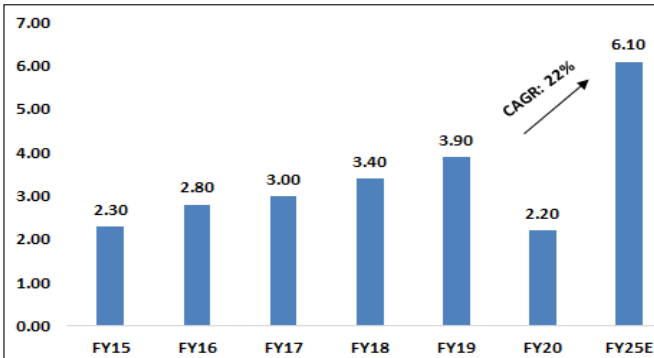
Exhibit 01: Indian Tractor Sales (units in thousands)



Source: Company, Progressive Research

In FY23, MHCVs grew by 49% y-o-y, and LCVs grew by 27% y-o-y. For FY24, the MHCV segment is anticipated to grow at a high single-digit rate whereas a mid-single-digit growth rate can be expected in the LCV segment on a y-o-y basis. Demand for passenger MHCV (buses) is expected to grow by ~30% y-o-y in FY24, led by replacement demand from educational institutions; a more or less similar growth momentum is expected even in FY25E, thereby indicating that the CV segment is on an up-cycle trend on a longer term basis. The heavy-duty trucks account for over 55% of the total MHCV sales in India and are expected to continue their dominance in the years to come; while the worst-affected segment during the pandemic i.e. the buses segment is predicted to be the fastest growing due to a low base effect.

Exhibit 02: Indian MHCV Sales (units in lakhs)



Source: Company, Progressive Research

SNAPSHOT				
52 week H / L		Mcap (INR mn)		
147/72		12,750		
Face value: 2				
BSE Code		NSE CODE		
532864		NELCAST		
Annual Performance				
(Rs mn)	FY21	FY22	FY23	FY24E
Total Revenue	6,150	9,273	12,640	14,683
EBITDA	464	581	794	954
EBITDA (%)	7.5	6.3	6.3	6.5
Other Income	49	96	164	164
Interest	172	258	312	337
Depreciation	217	226	240	240
PBT	123	193	405	541
PAT	90	144	300	390
Equity (Rs mn)	174	174	174	174
EPS (INR)	1.0	1.7	3.4	4.5
Quarterly Performance				
Parameters (Rs mn)	Sept-22	Dec-22	Mar-23	Jun-23
Sales (Net)	3,285	3,270	3,132	2,928
EBITDA	269	146	188	193
EBITDA (%)	8.2	4.5	6.0	6.6
Other Income	31	67	20	36
Interest	80	81	84	79
Depreciation	58	61	65	59
PAT	122	53	45	72
Equity (Rs mn)	174	174	174	174
Ratio Analysis				
Parameters (Rs mn)	FY21	FY22	FY23	FY24E
EV/EBITDA (x)	30.7	25.7	18.6	15.4
EV/Net Sales (x)	2.3	1.6	1.2	1.0
M Cap/Sales (x)	2.1	1.4	1.0	0.9
M Cap/EBITDA (x)	27.5	21.9	16.1	13.4
Debt/Equity (x)	0.6	0.7	0.7	0.7
ROCE (%)	5.0	7.5	11.6	13.8
Price/Book Value (x)	3.0	2.9	2.7	2.5
P/E (x) (TTM)	34.1	39.2	44.3	32.1
Shareholding Pattern as on 30th June, 2023				
Parameters	No of Shares		%	
Promoters	65,134,249		74.8	
Institutions	1,202,186		1.3	
Public	20,664,765		23.7	
TOTAL	87,001,200		100.0	

Source: Annual Report, Progressive Research

Note: Data calculated as on 22nd Sept, 2023

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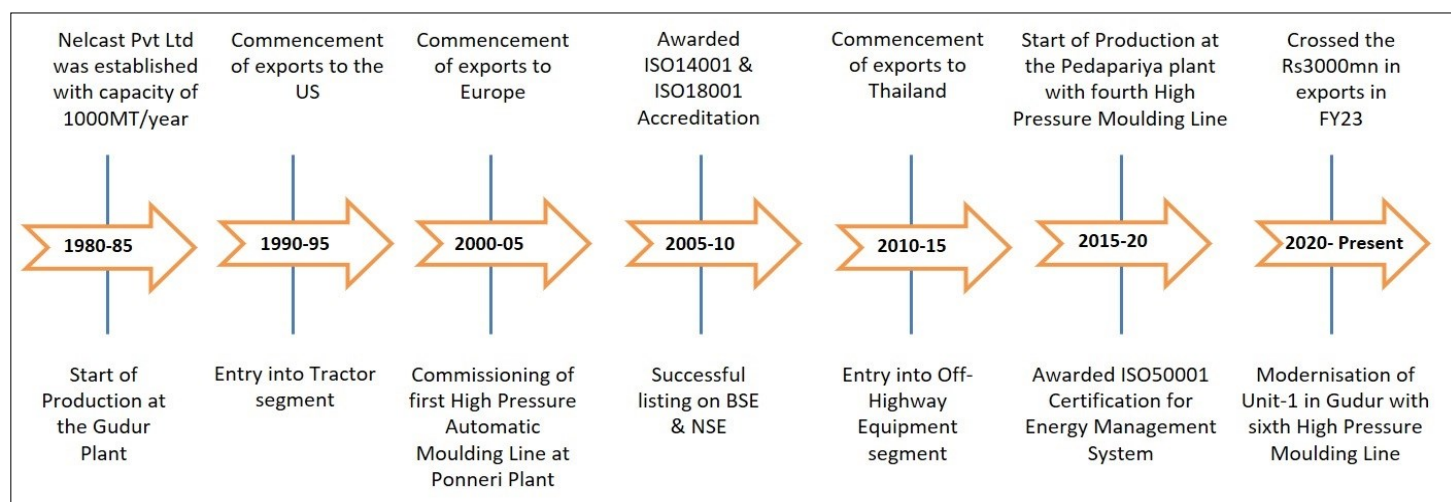
CMP: Rs.147

TARGET PRICE: Rs.210

TIME : 12 months

About the Company: Incorporated in 1982, Nelcast Limited (Nelcast) is the largest manufacturer of ductile iron castings and amongst the top 10 producers of grey iron castings with an installed capacity of 1,60,000 metric tons/year. The company supplies castings for commercial vehicles (CVs), tractors, off-highway vehicles and railways. Nelcast is a leading supplier to several marquee OEMs (Tata Motors, Ashok Leyland, TAFE, Eicher Tractors (TMTL), Volvo-Eicher Commercial Vehicles, SAME Tractors, Escorts Tractors, International Tractors (ITL), Daimler India, Caterpillar, etc.) Tier-1 (Automotive Axles, American Axles, Dana, Rane Madras, Rane-TRW, ZF India, etc.) as well as export customers (Meritor, American Axles, Daimler, Dana, Comer, ZF Industries etc.). Besides a strong positioning in the domestic market; the company has a rapidly growing presence spread across North America, Europe and Southeast Asia as well (with over 25-30% of its overall revenues generated from the export markets). The company has one subsidiary NC Energy Limited which has not commenced its commercial operations yet. Nelcast adheres to IATF 16949 quality standards and continuously strives to achieve world class quality and has also been awarded with ISO14001 & ISO45001 certifications for implementing Health, Safety & Environmental Management Systems. The company has manufacturing plants at Gudur and Pedapariya in Andhra Pradesh, and Ponneri in Tamil Nadu. It is the only casting manufacturer with a product range from 0.5-400kg. The company is chaired by Mr. D. Sessa Reddy and has Mr. P. Deepak as its Managing Director.

Exhibit 03: Milestone



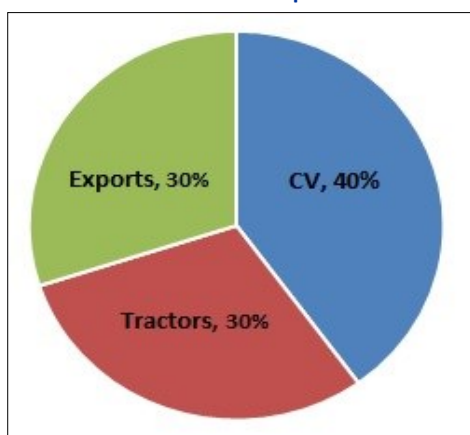
Source: Company, Progressive Research

Investment Rationale:

(A) Growth Pillars:

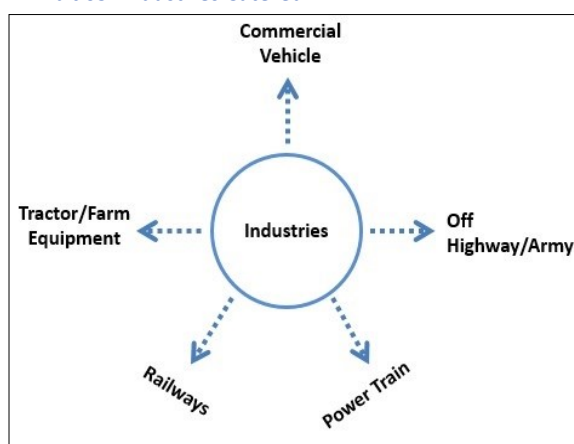
(a) **Business Profile:** The two major contributing segments (~70% of the sales) include the MHCV (contributes ~40% of the total revenues) and tractors (contributes ~30% of the total revenues); while the exports account for ~30% of the revenue pie. In the CV space, the Management is bullish on the opportunities from the tippers with increasing focus on infrastructure segment, shallow mining activities etc. As far as the tractors segment is concerned, the entire tractor body is made up of castings and hence is one of the key contributing segments for Nelcast. TAFE is the key client for the company with some other clients like Sanedo, Escorts, Sonalika etc.

Exhibit 04: Revenue Breakup



Source: Company, Progressive Research

Exhibit 05: Industries Catered



Source: Company Website, Progressive Research

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Investment Rationale:
(A) Growth Pillars (contd.):

(b) Strong Customer Base: Nelcast has a distinguished customer base that includes OEMs and Tier 1 companies across the segments of CV, tractor, OHV, railways and PV. Over the years, Nelcast has developed long standing, extensive relationships with customers and is amongst the preferred suppliers/partners to the top global as well as the Indian customers. It is a trusted partner and a supplier with long-standing strategic relationships with TAFE, Tata Motors, Ashok Leyland, Volvo-Eicher Commercial Vehicles, Same Deutz-Fahr India, Daimler, Automotive Axles, Dana, American Axles & Manufacturing, Comer Industries, Meritor, Wabtec, ZF. The company closely works with several customers in terms of new product development, quality improvement which builds the necessary trust and confidence from its valued customers. Thus, as newer and more advanced castings are developed, the company has an edge over the competition due to its diverse capabilities.

Exhibit 06: Customers Across The Auto Segments

CV	Tractors	OHV	Railways	SUV/Car Components	Power Train Components
Tata Motors	TAFE	Ashok Leyland	Vossloh	American Axle & Manufacturing	Tata Motors
Ashok Leyland	Escorts	Caterpillar	Faiveley		VECV
VECV	SAME DEUTZ FAHR	Comer Industries			Ashok Leyland
Daimler	Eicher Tractors	DANA			
Meritor		AxleTech			
DANA		Tata Motors			
Automotive Axles		Automotive Axles			
American Axle & Manufacturing					

Source: Company, Progressive Research

Besides having a wide customer base across several industries and geographies, Nelcast also prides itself as being regarded as a one stop shop for the customers by being able to supply castings of several different grades and sizes. The different material grades produced include

- (i) all standard grades of grey & ductile iron,
- (ii) highly pearlitic grey iron for brake disc applications,
- (iii) high silicon-molybdenum ductile Iron for high temperature exhaust manifolds,
- (iv) all grades of Austempered ductile iron (ADI- a form of ductile iron that has high strength and ductility due to its microstructure controlled through heat treatment) in-house heat treatment facility, strengthened ferritic grades of ductile iron,
- (v) ductile iron castings with strong impact properties at low temperatures for railway braking & windmill applications. The weight range for ductile iron is around 1.5-200kg while that of grey iron is ~35-250kg,
- (vi) Nelcast has the ability to produce components from 50 parts/month to 30,000 parts/month and the components can be supplied as rough castings or fully machined sub-assemblies through in-house facilities and tie-ups with top machining vendors

(c) Product Range: Nelcast is one of the largest manufacturers of Spheroidal Graphite (SG) iron castings in India, SG castings are stronger than GI castings. The advantages of SG iron include its versatility, cost efficiency and the best combination of overall properties viz. high ductility and high tensile strength, excellent machinability, internal soundness, and close grain structure. In the past 40 years, the use of SG iron has grown rapidly, mainly through conversions from grey and malleable iron castings and steel castings, forgings and fabrications and also through its use in new components. SG casting segment has very few players, as technology and experience act as entry barriers. *The casting process consists of pouring of injecting molten metal into a mould containing a cavity with the desired shape of the casting.* As indicated by the Management, there have been customers who have tried China castings but came back to Nelcast due to quality issues. *China, therefore, is unlikely to be a competition for quality SG castings. (China is the global leader in castings with 43% market share and annual production of 35mn tons. India is a distant number two with around 9% market share and annual production of 7-8mn tons.)* Nelcast manufactures around 200 different castings in SG and grey iron cylinder blocks, flywheels, flywheel housings, housings, hubs, spring shackle, brackets, transmission case, axle housings, exhaust manifolds etc. that find application in the CV and tractor segments. It is a one-stop shop for its customers for grey iron, ductile iron and ADI ranging from 0.5kg to 400kg. The product profile for MHCV segment includes wheel hubs, brake drums, axle housing, shackles and brackets. In the CV segment, there are three main product range namely **power differential carrier** (commanding 90% market share), **rear suspension carrier** (70% market share) and **bogie suspension bracket** (70% market share). These contribute to almost 50% of the total CV contribution of 38-40% to the overall topline. These products have the advantage of being EV agonistic.

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Investment Rationale:

(c) Product Range (contd.):

For the **tractor segment**, the company supplies transmission cases, centre housing, rear axle housing and hydraulic lift cover. It also supplies ribbed plates and brake discs used in metro rail projects and railways. The overall differentiated product portfolio that witnessed transition from manufacturing basic products to specializing in medium to high complexity products, allows Nelcast to generate high margins and also compete against the local and Chinese suppliers. The company has been awarded works for many **new products** where there is lot of work in progress related to product samples, testing, and some of the products are awaiting the launch date. One of these products is Nelcast's first entry into the light vehicle segment in the North American market as a 20kilo component for its customer American Axle for the Chevy Colorado series of trucks and GMC Sierra trucks. Another new product is the **fork lift axle** which was earlier only sourced from China but now will be India manufactured by Nelcast. This product is majorly for the US market with potential of ~4000 fork lifts/month (weighs ~40kg). There have been some delays with the launch of this key product offering for Nelcast.

Exhibit 07: Key Product Offerings

Commercial Vehicles	Tractors	Off Highway Equipment	Railways	Passenger Vehicles
				
				
				

Source: Company PPT, Progressive Research

EV Opportunity:

The key products catering to the CV space of the company are EV agonistic. Electrification in the HV segment is also expected to be significant. On the flip, EV in tractors can be challenging with regard to the electricity charging in rural areas being difficult; however faster absorption is anticipated in the 2W as well as the PV segments of the industry. Also with EV, the casting content/axle goes up as the axle has the role of holding electric motor in its place, which stands to benefit Nelcast. The company has won some EV class 8 programs which is under development and can contribute substantially in times to come. The Management is of the opinion that this upcoming transition can be beneficial especially on the MHCV side.

(B) Strategic Manufacturing Locations:

The company has three state-of-the-art plants located at Gudur, Ponneri and Pedapariya which are in close proximity (37-140km) from the city of Chennai which is well connected to Europe, Middle-East and Southeast Asia. It is also a major manufacturing hub with several leading global automotive companies which serve both as a key customer base and a reliable source of steel scrap (critical raw material for the company). Gudur is also widely considered as the best source of silica sand for the foundry processes. In addition to this, the plants are closely located to both Krishnapatnam and Chennai seaports which facilitates easy accessibility to customers in the USA, Italy, Belgium, Sweden, France, Germany, Thailand etc. In Q1FY24, the total production stood at 19,500MT with ~50% capacity utilization. The total installed capacity stands at 1,60,000MT/year which can be further enhanced by 50,000MT within the existing plants with minimal investment.

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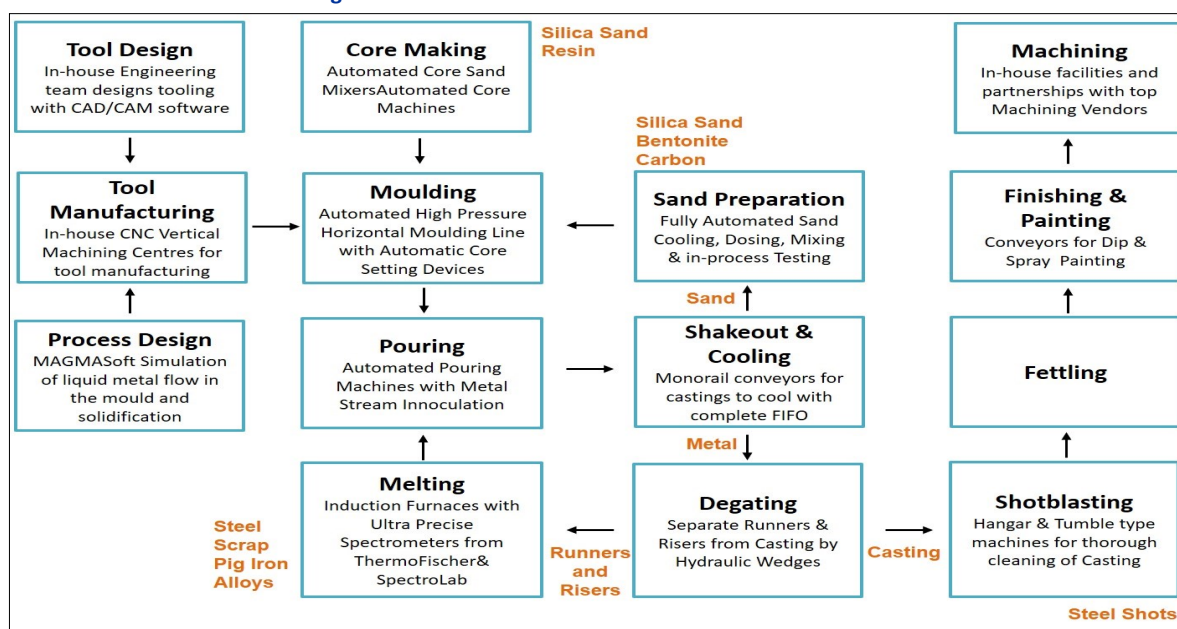
(B) Strategic Manufacturing Locations (contd.):

Gudur Plant: Started commercial production in 1985. It exclusively produces ductile iron castings for CV, tractor, off-highway and railways. The plant produces all grades of ductile iron including ADI a form of ductile iron that has high strength and ductility due to its microstructure controlled through heat treatment and solution strengthened ferritic ductile iron. The current casting production capacity of the plant is 60,000MT/year. For Q1FY24, the capacity utilization was little above 50%

Ponneri Plant: Started commercial production in 1996. The plant produces approximately 80% grey iron castings and 20% ductile iron castings for different catered segments. The current casting production capacity of the plant is 40,000MT/year. For Q1FY24, the capacity utilization was close to 90%

Pedapariya Plant: this is the newest addition and the plant started commercial production in 2018. The plant exclusively produces ductile iron castings for CV, tractor, off-highway and railways. It produces all grades of ductile iron including ADI and solution strengthened ferritic ductile iron. The current casting production capacity of the plant is 60,000MT/year. Line 1 has the capacity of 18,000MT while Line 2 (2.1m/1.2m; 60 moulds/hr capability) capacity stands at 42,000MT. The capacity utilization of the new unit stood at 21% in Q1FY24, with improvement expected from Q2 onwards

Exhibit 08: Basic Manufacturing Process



Source: Company PPT, Progressive Research

(C) Key Trigger-Exports: India is one of the key suppliers in the global automotive supply chain. Sourcing machined castings from India is now becoming an attractive option for many global customers. Nelcast is among the few companies capable of meeting the requirements of top global OEMs & Tier 1 companies. Currently, Nelcast exports machined castings to reputable corporations in North America, Europe and Southeast Asia. Exports are majorly to OHV/CV and Tractor OEMs. Export revenues witnessed an exponential growth trajectory from Rs27mn reported in FY15 to current levels of Rs3,300mn in FY23. Compared to the domestic market, although with cons (payment days of 120-140; costs associated with quality checks), the export market is more lucrative. The domestic market fetches Ebitda/kg to the tune of Rs10 while the exports can reach up to Rs15 kind of levels. The global factors are well aligning with India being the best option for casting supplies. With regard to Class 8 trucks in the US, Nelcast has captured ~20% of the market share (the total requirement recently was ~3,00,000 which were manufactured translating into ~70,000/month where Nelcast has manufactured ~20,000 currently) through the forward and rear differential carriers. In terms of Class 5/6/7 types, ~2,50,000 are manufactured annually by the company where the total market requirement was ~8,40,000-8,70,000 for the differential carriers which translated into ~21-23% of the market share with scope to grow further. The US market conditions of reduction in capacities, labour shortage, change in regulations of foundries have been positive for Nelcast to gain market share in spite of the logistic disruption in Covid times. The strategy of targeting the local US suppliers has played well for the overall growth of exports for the company. There are some issues related to the labour class in the European markets which also translates into good opportunities for Nelcast. The Management believes, the exports market will grow and gradually contribute ~40% to the total revenues. The Management has ambitious export targets of ~Rs4bn in FY24 and anticipates to double the same over the next 2-3 years. Going forward, strong demand and further growth in exports is expected due to a strong order backlog and easing supply chain constraints.

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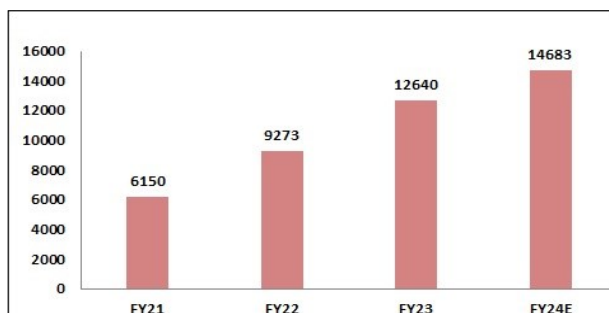
After an extended slowdown witnessed in the auto sector, FY23 turned out to be a good year for the industry led by strong demand. This significant recovery invariably turned out to be beneficial for Nelcast with revenues being reported at Rs12640mn in FY23; growth of 36.3%. The growth was supported by strong volume growth, improved product mix and better realisations (especially in the exports business). As far as Q1FY24 is concerned, the revenues were impacted mainly due to the slowdown in the tractor segment and an overall decrease in the volumes which came in at 19,145T as against 20,158T in Q1FY23 and 20,620T in Q4FY23. On the flip, volumes for FY23 stood at ~85,000T and the management expects to scale it up to ~95,000T in FY24 and 115,000 to 120,000T in FY25E. Volume is expected to be driven by the increasing infra spend, growth in exports and new product launches. Based on this the current capacity utilization stands at ~50% which is expected to reach ~80% over the next 2-3 years. For FY23, the **Ebitda/kg** stood at 11.3 while for Q1FY24 it was 11.7 (y-o-y it was impacted due to divergence in international and domestic raw material prices; however, q-o-q there was improvement mainly due to increased exports contribution and better realisations). For the domestic markets the Ebitda/kg is generally expected to be in the range of ~Rs10 while that of the exports market is estimated to be ~Rs15 (depending on the costs/variable costs, volumes product mix) for FY25. Management is anticipating, the margins to improve gradually which will be led by the domestic raw material prices stabilizing, better utilization as well as the increase in exports revenues. Increased utilizations and higher volumes would lead to an uptick in the ROCE for Nelcast.

On the **capex front**, the company majorly has a maintenance capex of ~Rs150mn/year. The current debt stands at Rs1950mn with 9.25% interest cost. The company has already repaid a **term debt** of Rs73.8mn; has another repayment of ~Rs262.4mn due and anticipates to repay ~Rs300mn over the next 2 years. The ECB debt currently stands at Rs590mn, which is fully hedged. Going ahead, the Management anticipates the MHCV segment to report a strong growth backed by increased infra spends thereby leading to more demand for tippers (having a material contribution to the overall topline and possess a very high casting content requirement). Additionally, the company expects new launches to contribute materially in FY24 and anticipates the export business to scale up further in the coming year. In a further impetus to the overall sector as a whole, the GOI has launched PLI scheme for the automobile and the auto component industry for a period of 5 years which will provide the necessary push to be cost competitive in the global market.

Risks and Concerns:

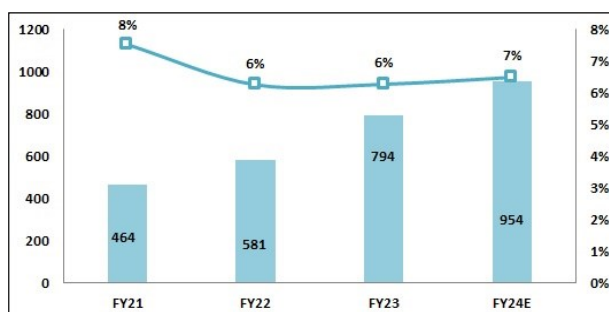
- Adverse **economic conditions** and slowdown in the user segments (CVs and tractors) could impact the performance of the company
- Sharp increase in **scrap prices** could impact the profitability of the company in the short term as it has a pass through but with a lag of 2-3 months. Volatility in prices of major raw material i.e. steel scrap along with ferro silicon magnesium and other inputs like power, fuel, bentonite, steel shots, etc. required in the manufacturing process can impact the margins
- Technology** plays a critical role in the manufacturing of castings. Stringent quality requirements of customers like Tata Motors, Mahindra & Mahindra, overseas clients, etc. require adherence to latest technology and consistency in quality. Failure to keep abreast of latest technology may affect the quality (and price) of products and delivery schedules placing the company at a disadvantage as compared to its competitors

Exhibit 09: Revenue Trend (Rs in mn)



Source: Annual Reports, Progressive Research

Exhibit 10: Ebitda (Rs in mn) v/s Ebitda Margins Trend



Source: Annual Reports, Progressive Research

Exhibit 11: PAT (Rs in mn) v/s PAT Margins Trend



Source: Annual Reports, Progressive Research

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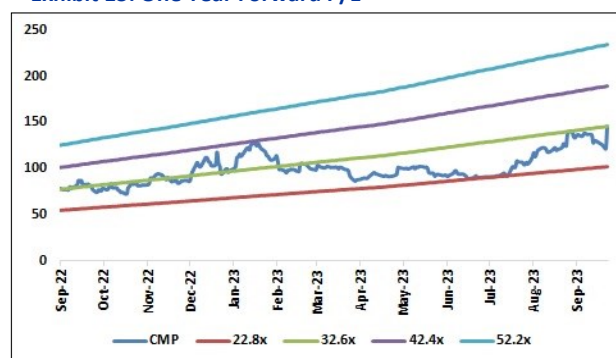
Outlook and Recommendations: Nelcast is one of India's largest manufacturers of SG iron castings as well as one of the key manufacturers of grey iron castings. The products offered by Nelcast find applications primarily in tractors & trailers, MHCVs, and Railways. Nelcast intends to remain a strong focused player for large/medium Auto and tractor castings both in India as well as on the global front where it enjoys a strong customer base translating into better profitability margins. The company strives to create a sustainable profitable growth by continuing to lay its focus on technology and quality while offering wide range of products to diversified segments and customers which also gives the company a competitive edge in the market as well. With the comeback of the Auto industry as a whole coupled with good growth prospects expected in the MHCV space Nelcast is bound to benefit in times to come. The Management is looking at favouring tailwinds with increasing demand in the economy which can propel the growth in revenue in the upcoming quarters due to increased infrastructure spends, pick-up in export markets, strong order backlog with marginal growth in tractors segment. Additionally, with new product launches and new technology introduction in the automobile industry (the backbone of the industry which are also the direct beneficiaries including) casting players like Nelcast are bound to benefit. From the industry perspective, we feel that the CV industry would deliver strong growth largely due to a pickup in agriculture and mining activities, rapid development of roads along with increase in government spend on infrastructure, increase in demand from e-commerce and logistics sector, ban on overloading in high tonnage vehicles, regulatory changes with shift in emission norms, implementation of the scrappage policy etc. can lead to strong growth in the CV industry going ahead and all these factor are poised to positively benefit Nelcast. As far as the segment related to tractors is concerned, post the sharp up move in FY23, some consolidation in the sector is expected with a stable growth outlook in FY24. The company has a strong customer reach and brand recall both in the domestic markets across segments as well as on the global front and some of the best of names in the industry are catered to by Nelcast. The team at Nelcast continuously works to develop new products (as per customer requirements) with stringent quality norms which gives the company an edge over completion (be it other companies in the same domain or be it China) as a key casting player. There are a number of opportunities steaming up in the EV space and Nelcast is pretty active in that segment while gearing up with new products/client additions, technological advancements etc. to be able to capitalize on these prospects. The company is working on increased production, better capacity utilizations, better Ebitda/kg with minimum capex requirements which can aid better debt servicing as well as report better return ratios going forward. Overall, the strong top-line growth, prudent product mix and strategy (for quality and reach), long standing relationship with different OEMs across different segments catered, places Nelcast in a strong position which can benefit the business with the unfolding of opportunities. We initiate a Buy on the stock for a target of Rs210 over 12 months.

Exhibit 12: Price v/s Nifty



Source: Ace Equity, Progressive Research

Exhibit 13: One Year Forward P/E



Source: Ace Equity, Progressive Research

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