Note on Steelcast Ltd

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1. **About**:
    a. Steelcast Ltd (SCL) is a leading manufacturer of steel & alloy steel castings in India and enjoys a premier position in steel casting industry.
    b. Original equipment sale are more than 99% of the sales.
    c. It is the largest high strength carbon steel player in India. Globally there are only 6-7 players in India - in China, Japan and USA. which have similar capacity as SCL.
        i. It is one of the few companies in India and globally manufacturing steel castings based on sand and shell casting process.
    d. With 240 parts in its product portfolio, the company has one of the largest product offering in India’s specialized castings sector
    e. Exports form ~65% of total sales with significant exposure in the US (40%) and Europe (40%)
    f. **Its product prices are cheaper by ~25-30%** as compared to US and European markets due to lower labour costs, freight and other related costs. (But they are not the cheapest)
    g. The company largely exports on Ex-Works basis which results in avoiding uncertainty on account of freight costs and shipping delays.
    h. Market size of 4-5 lakh crores with 3-4% market share
        i. The management said it makes tailor-made castings as per customer specifications and is highly labour intensive.
    i. SCL’s manufacturing facility is located at Bhavnagar (Gujarat) with total casting capacity of 30,000 metric tons per annum (MTPA).
        i. The company uses ‘no bake’, ‘no bake automated fast loop’ and ‘shell moulding’ casting processes for manufacturing carbon steel, low/high

alloy steel, Hadfield manganese steel and other superior grades of wear and abrasion resistant steel castings.

1. Mainly catering to the requirement of earthmoving equipment manufacturers, mining/mineral processing equipment manufacturers, general engineering manufacturers and other end user industries such as railways, thermal power, oil exploration, shipping, cement and steel plants.

j. The company produces steel and alloy casting in various weights from 2.5 Kg to 2,500 Kg through sand and shell moulding process and **has installed one of the best foundry equipment from M/s. IMF, Italy and M/s. OMEGA, UK** – that helps company in ensuring reproducibility at every workstation.

k. The company has designed and installed an agitating system in quench tank, one of the best in the country and at par with best practices in the world.

l. The company's facility is situated in Bhavnagar, Gujarat, which is a power surplus state and is well connected with major cities of Gujarat and other places through rail and road network.

   i. Skilled manpower in that region is easily available at low cost. Pipavav port is just 130kms away from its facility, which provides it great connectivity.

   ii. It is also connected through waterways with Hazira, Surat, which substantially reduces the distance of 370kms to just 60kms as it has regular availability of Ro-pax ferry services from Ghogha, Bhavnagar to Hazira, Surat. Gujarat Gas Ltd supplies natural gas through pipeline to the company for all its fuel requirements.

   iii. The company sources its major raw material at competitive price and high degree of purity, scrap from Alang, which is Asia's biggest ship recycling yard, situated at a distance of just 50kms from its facility.

   iv. Further, Gujarat is a power surplus state with the Company's own 66KV power transmission station with 10MW power readily available.

2. **Sector cater to:**

   a. industrial sectors like Earth Moving, Mining & Mineral Processing, Locomotives, Cement, Transportation, Steel, defence, Ground Engaging

Tools (GETs), Railroad, Construction etc. and OEMs

b. marquee clients are Bharat Earth Movers, Caterpillar, JCB, FL Smidth and various overseas clients.
c. In FY22, ~98% of the company's revenues were derived from customers of ten years or more.
    i. The company serviced the needs of more than 42 customers (engaged at least once in the last five years).
d. Company has 25-30 years of relationships with it customers and for on boarding a new customer it takes 9-12 months to develop and supply the parts.

3. **Earnings trigger:**
    a. De-risking dependency from mining, earth moving and construction equipment industry
        i. It has already developed in excess of 300 parts and looking to develop more than 100 parts in next 2-3 years.
        ii. forayed into new business segments like Railways, Electro Locomotive, Defence and Ground Engaging Tools (GETs)
            1. Defence: (Insignificant only 2-3 crs)
                a. It already has purchase orders from Indian defence units and it plans to complete these pending orders in FY23.
                b. The company has also obtained Aerospace Certification from Germany which will help in exploiting German markets.
            2. Railways:
                a. starting Q3FY23, Steelcast would start supplying to US Railroad with revenue potential of Rs ~75cr over the next two years.
                    i. 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.
                        1. Only two players who have certification from the US railroad who can supply castings to US for North American railroad from India.
                            a. Texmaco could be the other player.

b. **Margin Expansion:**

    i. Company has made two investments 4crs + 22crs.

        1. Q2FY23: “Commissioning a power plant of hybrid nature 4.5 megawatt and solar of 5 megawatt. Both these plants are likely to be commissioned by March 23 with a total investment of about 27 crores and savings of about 10 crores.”

    ii. It will fulfil 80% of their power requirement and this alone can lead to 22-24% jump in PAT.

        1. Current requirement only, as the utilization level will increase they will need to buy more electricity from State.

        2. Power cost is about 8% of our total cost, and KWH price to state electricity board is about Rs. 8.5 per unit.

    iii. From 2019 to 2021 business revenues went half but the business margins weren’t affected rather increased by 1%.

        1. Except in 2015, margins have been very stable.

c. **Operating Leverage:**

    i. Capacity utilization at 53% for Q2FY23

    ii. The capacity utilization in FY22 stood at ~49% vs ~29% in FY21.

    iii. The management is targeting capacity utilization of around 90-96% with sales volume of 27,500 tons by FY26.

        1. 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

    iv. 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.

        1. Based on various factors, it would decide by end of CY23 for any new capacity addition.

d. **Rationalization plan:**

    i. This resulted in reduced manpower cost per unit by increasing productivity, reduced demand for power. It also introduced purchase of power through open market access saving in cost.

ii. The company was able to reduce consumption of few of its key raw materials and also reduction in internal rejections averaging less than ~4% which was earlier around ~6%.

iii. It also reduced its throughput time for processing of castings- thus unlocking of capital from working capital needs.

1. Working capital cycle of 100 days down from 143 days before.

e. **Order Book**

i. Rs.135-140 crs.

1. firm orders are given in a cycle of 3 to 4 months but customers ask them to keep the capacity reserve and share visibility of forward 15-18 months.

f. **Capex**

i. Capex for FY23 is pegged at Rs 18cr for debottlenecking and adding certain machining capacities to further enhance the value addition.

ii. The company incurred capex of about Rs 29cr in FY22 without any additional term loan.

iii. Management will consider Capex only after reaching higher levels of capacity maybe around FY25/26.

g. The company has repaid its long term debt totaling to Rs 22 crores in FY22. The increase in business activities has led to increase in short term borrowings to Rs 63 crores. It plans to reduce its working capital loan by end of FY23 despite the expected jump in revenues.

4. **Competition:**

a. In the Indian market, it competes one of the steel casting making company belonging to Sanmar group in South India which has a similar foundry capacity, however it is operating at a much lower capacity utilization catering mainly to Oil & Gas industry.

b. Apart from Sanmar, it faces some competition from Simplex Castings, Gujarat Intrux, PTC Industries, Magna Electro Castings, Bhilai Engineering Corporation etc.

c. Concentrated profit pool: (Q1FY23)

Ishika: What is actually helping us in getting the orders of locomotives like the order we have received from US so what actually helped us getting that order?

Chetan Tamboli: See one is the kind of facilities we have there may not be many players like us. I would imagine not more than 6-7 players who would have complete integrated facilities like we have a), b) we have been supplying to this host of OEMs across the world so there is a good reference for the company in terms of qualities and deliveries and if anybody looks at India, and wants to source from India then within India we would be the top one, two, three players and plus our sales team also is very aggressive in finding customers and trying to see what their needs are and what our capabilities are, so all these sectors put together, we are able to penetrate in this advanced market.

it a continuous casting because looking at the industries that you cater to does not look like these are high volume casting that you make? So, just wanted to understand is it the continuous line casting that you have or is it more like customized castings where you cater to a specific application, you do the designing and then do the casting?

Chetan Tamboli: I think the later part of your statement is correct. These are all tailor-made castings made to customers engineering drawings with their specifications. You cannot call this as a continuous casting process.

Hitesh: In that case is there too much of a manual intervention in the sense is it too labor-intensive?

Chetan Tamboli: Yes, this is a labor-intensive plant. We are now close to 1,450 people and this kind of industry does need a lot of human involvement. Unlike you have like forgings or you have aluminum die-casting where it is more or less automated.

Hitesh: In that case how easy or difficult it is to really have a scale because in that case even the capacity that you just spoke about 30,000 or 28,500, that capacity is not really, you cannot look at on a linear basis because depending on the number of products that we have or the kind of switch-overs that we have from one product to another, the capacity may not really translate into the numbers during a particular year, is this understanding right?

Chetan Tamboli: Absolutely, this is a steel foundry. We are making lot of niche products with the niche markets. It is not like forgings or iron castings where the numbers run into thousands, its completely automated. These are all specially tailored made products and facilities like us are only 5-6 in the world now. That is why we have preference over other smaller players.

5. Guidance:

a. Ending FY23 with 16,000-16,500 tons volume and 21,000 tons for FY24.

Pritesh Chheda: The 16,000-ton visibility are you reasonably confident on that since last year has passed and quarter is on or there is an element of uncertainty there as well?

Chetan Tamboli: Two things are happening simultaneously the world economy as you all know there is a downtrend and people are talking about recession in Europe and US either before end of the year or maybe early next year, but the segments we are in the customers are very bullish there we do not see any downtrend at least in the near future.

Nilesh Doshi:	The first question is again extending the previous question especially from the Europe are we seeing the demand at a similar level especially from the inquiry side and the volume side?
Chetan Tamboli:	Yes, though we supply in Europe, but the facilities of the customers in Europe they cater worldwide. If Europe is in recession does not necessarily mean that our customers in Europe will slow down or things like that. As of now, as I said earlier things are happening simultaneously where we are seeing/reading more about slowdown in US, Europe and elsewhere in the world, but our end user segments are quite upbeat and they do not see any slowdown at least in the near future they are asking us to keep capacities ready and so at least I can say for the current year there should not be any effect on us.

Priyank Parekh:	And so you must have answered this thing like how our visibility vis-a-vis the slowdown in Europe and America, but if I have to put it differently like except India entire world is facing slowdown some sort of some or other way some things are not looking good, how we see ourselves in such scenario?
Chetan Tamboli:	As I said before all the end user segments where we cater are very optimistic going forward and if you see all the end user industries they are all capital based industry. So, while there is a slowdown there is also another talk about government spending going up and government spending channelizing into capital goods. So, this might be the reason where there maybe overall slowdown, but not in our end user industry. If you see the industry as we cater in it is part of the presentation which have uploaded last night. So, once you see those end user industry and if the premise what I am saying is true that the funds will be channelized through those end user industries then slowdown may not happen in these industry.
Priyank Parekh:	And from our end users how much visibility we are seeing like how much confident they are for next 12 months for next 2 years, 3 years how much confident they are?
Chetan Tamboli:	I already responded this before at least for the current financial year we do not expect any slowdown and they see a reasonably good visibility for next financial year also. So, it should not affect us, but we will have to wait and see what happens.

Rajesh Jain:	But for FY2024 you have already given something around 70% to 75% capacity utilization is it based on a better order from them or it is still under slightly lesser than what you had planned in mind?
Chetan Tamboli:	It is a combination of several factors a) these are indications from our existing customer b) we have an ongoing drive of developing new parts, which as and when they are developed it converts into additional sales, 3) approval from the US Rail Road Association for supplying to the US railroad 4) the new industries we are entering they would also get converted and those parts also would get converted into serial supply, so these are all combination of various factors and indication from all our customers on that basis this is the plan.

b. Management guidance of Rs.500crs revenues for FY23 with similar margins of 23%.

   i. if this is achieved then either volume or realization should go up, as just 16500 tons of volume will only achieve 414crs of revenue

6. **Risks**
    a. Dependance on on few sectors: In 2013 mining was 84% currently it is 25% and likely to go to 23% in FY26.
    b. Concentration risk: top 15 will be about 65% of the sales and top five 35%-40%.
    c. Volatility in prices of raw materials:
        i. Steel scrap and ferro alloys are the key raw materials
        ii. Natural Gas as fuel
    d. Forex risk
    e. Order book cancellation: In 2014 company had done that large CAPEX and suddenly all orderbook vanished in a very short period of time as customers started cancelling due to poor market conditions.
7. **Valuation**

Tons estimate taken from concalls						
Realization estimate taken as reduction of 3% from FY23						
						Estimate Not included
	FY22	FY23	FY24	FY25	FY26	a. 11cs Cost saving from Power Plant
Tons	12000	16500	21000	25200	27000	b. Bull case utlization => 17100 tons (FY23) + 22500 tons (FY24)
Realization (Rs.)	2,51,155	243620	243620	243620	243620	c. Q2FY23 at 23.5% + Operating Leverage will improve margins further
Sales (crs)	301	401	511	613	657	
EBITDA Margins	21%	21%	21%	21%	21%	
EBITDA	63.21	84.21	107.31	128.73	137.97	
Projections as per sales guidance						
Sales	301	500	600			
EBITDA Margins	21%	23%	23%			
EBITDA	63.21	115	138			
Outstanding Shares	2.02					
Current EPS	16.44					
FY26 - EPS	50					
PE Multiple	20					
Share price	1000					
Market cap	2020					

8. **Technical view**
    a. Trading near 63 DEMA and bottom of the trendline.
        i. Attempted to breakout of the base on 12th Dec 2022 but failed later due to poor market conditions.

Source: Concalls, Annual Reports, HDFC Sec. Report, etc.

— Arjun Badola (@badola_arjun)