Precision Camshafts Ltd. (PCL). : Strong and quality play in Camshafts business, "SUBSCRIBE"

22nd January, 2016

Incorporated on June 8, 1992, PCL is one of the world's leading manufacturer and supplier of camshafts, a critical engine component, in the passenger vehicle segment. The company supplies over 150 varieties of camshafts for passenger vehicles, tractors, light commercial vehicles and locomotive engine applications. PCL is techno savvy and use different technologies in their engineering and manufacturing operations including shell sand molding process technology, special (AI203/ ceramic sand care) technology and GBQII process technology which provides them a cost competitive advantage among their competitors. PCL operates through two state-of-the-art manufacturing facilities - an EOU unit and a domestic unit – both situated at Solapur, Maharashtra. As on September 30, 2015, the company had total manufacturing capacity of 13.38 million camshaft castings per annum from foundries and 2.22 million machined camshafts per annum from the machine shops. 70% of the company's revenue comes from export of camshafts to various OEMs directly and indirectly globally. As of FY15, the company has supplied over 58 million units of camshafts in the last ten fiscals and has serviced various customers across different geographies.

Rightly placed to tap global opportunity

Global market for PV camshafts is estimated to be 100mn units worth over Rs 70bn. Globally the market for camshafts is oligopolistic in nature with only 4-5 major players limiting the size of competition in the hands of a select few. Key competitors include ThyssenKrupp, Federal Mogul Goetze, Linamar, and Mahle AG. Camshaft is one of the five critical components of an engine, hence historically, OEMs used to cast and machine camshafts in house. With increasing volumes and focus on lowering costs, OEMs have majorly outsourced casting, but a large part of machining is still done in house. Three prevalent technologies for manufacturing camshafts are – chilled iron cast (40% of market), assembled camshafts (30%) and chilled ductile iron cast (30%). Precision mainly caters to the chilled iron cast segment and has only recently forayed into the other value added technologies.

One of the leading suppliers and long term relationship with marquee clients

PCL is one of the leading suppliers of camshaft with 9% share of the global passenger vehicle camshaft market. The company has established healthy long term relationships with all the major global OEMs like Ford Motors, General Motors, Hyundai, Maruti Suzuki, Toyota etc. and a widespread marketing network across the geographies. Ford and General Motors are its largest customers contributing to over 32% (each) of its revenues; exports to Europe constitute +40% of its revenues.

Orderbook driven capex to drive profitable growth

PCL is expanding its capacity for ductile camshafts and assembled camshafts. The management is also planning foray into manufacturing and supply of sliding cams and cam modules as a part of expansion strategy. The company has recently entered into a technological tie-up with EMAG group of Europe(German machining and tooling Process Company, for transfer of certain know-how and technology for manufacturing assembled camshafts. This technology is the most popular technology with ~80% of market share in the respective segment) to foray into assembled camshafts (30% of the total market). The company intends to increase its revenue share from fully machined camshafts (+30% margins) as realizations are ~3x of camshaft castings (15-18% margins). As the revenue share from higher value added products increases, PCL should witness a healthy rise in profitability going ahead.

Decent financial performance

Geographically diverse business has reported revenue CAGR of 18.16% and net profit CAGR of 37.09% through FY11-FY15. Sales realization per camshaft has also improved from Rs. 375.26 in FY11 to Rs. 489.28 in H1FY16. At the upper end of the price band of Rs. 186, the IPO is valued at 28x FY15 post issue EPS.

With due consideration to factors like a) leading supplier of camshafts for passenger vehicle engines in India and globally, b) state-of-the-art manufacturing facilities, technology innovation and engineering expertise, c)long term relationships with marquee global OEMs, d) strong competitive entry barriers in camshafts business, e) strong orderbook from Ford Motors, f) decent past financial performance, g) positive cash flow from operations over last four years, we believe the premium valuations are justified and recommend investors to "SUBSCRIBE" the issue .

Issue date	Jan. 27 - 29, 2015
Issue size	Rs. 4100 mn. at upper end of the price band
Type of issue	Fresh Issue: Rs. 2,399 mn Offer for sale of Rs. 1701.9 mn equity Shares at upper end of price band
Face Value	Rs. 10
Price Band	Rs. 180 – 186 per share
Lot size	80 equity Shares
Issue structure	QIB: 50%, Retail: 35% Non – Institutional: 15%
Post issue eq. shares	94.7 mn shares
Post issue market cap	Rs. 17.6 bn at upper price band
Book Running Lead Managers	SBI Capital, HDFC Bank, IIFL
Registrar to the issue	Link Intime India Pvt. Ltd.

Y/e 31 Mar (Rs. mn)	H1FY16	FY15	FY14	FY13
Revenue	2,534	5,324	4,674	3,588
Growth (%)	-	13.9	30.2	18.6
EBITDA	724	1,364	625	576
EBITDA Margin (%)	28.6	26.5	13.6	16
Reported PAT	341	624	131	239
PAT margin (%)	13.4	11.7	2.8	6.6
*Post issue EPS (Rs.)	3.6	6.59	1.38	2.52
P/E (x)	-	28	135	74
Equity Capital	818.42	818.42	40.92	30.92
Networth	2,692	2,337	1,740	1,105
RoE (%)	-	26.7	8	21.7
Adj. Book Value (Rs.)	28	25	18	12
P/BV (x)	-	7	10	16

Shareholding Pattern (%)	Pre Issue
Promoters group	81.51
Public & Others	18.49
Total	**100**

Research Analyst
Akash Jain, MBA (Financial Markets)

Corporate Off. : 408, Express Zone, "A" Wing, Cello – Sonal Realty, Near Oberoi Mall, Western Express Highway, Malad (East), Mumbai - 400 063. Tel : 91-22-67160400
mail : research@ajcon.net Website : www.ajcononline.com

Promoters background

PCL is promoted by Mr. Yatin Shah- the present Chairman and Managing Director, and Dr. Suhasini Shah, current -whole time director, who has over 20 years of experience in the critical engine component manufacturing and have established strong business relationships with marquee global Original equipment manufacturers ("OEMs"). The Promoters are first generation entrepreneurs who started the business of manufacturing of critical engine component in 1992. Company's key managerial persons have more than 19 years experiences in their respective fields.

Objects of the issue

The Objects of the offer are to raise Rs. 2,399 mn via fresh issue (out of which Rs. 200 mn would be spent on establishment of a machine shop for ductile iron camshafts at the EOU unit) and Offer for Sale of up to Rs. 1,701.9 mn equity shares. Offer for sale comprises of Promoter Selling Shareholders. The Company will not receive any proceeds from the offer.

Business Strategy

1) Expanding Company Product Mix

The company is diversifying and broadening its manufacturing capabilities from chilled cast iron camshafts to ductile iron camshafts and assembled camshafts. Company has secured orders from Ford Motors for supply of ductile iron camshafts, and is in the process of setting up a new machine shop at their EOU unit at Solapur, Maharashtra for which the industrial production is expected to start in fiscal 2017.

2) Improved emphasis on value added products namely fully machined camshafts

The company currently manufactures camshaft casting from their foundries which are then machined by their OEM customers in their captive facilities. They also manufacture semi-machined camshafts to tier I suppliers and fully-machined camshafts to OEMs. The semi-machined and fully machined camshafts are manufactured in their foundries at Solapur. The company seeks to expand their capacity to manufacture fully machined camshafts by setting up two new machine shops in Solapur, Maharashtra. In order to strengthen the business operations in Asia, PCL has entered into **two joint ventures with Ningbo Shenglong PCL Camshafts Co. Ltd. ("NSPCL") for machining of camshafts and PCL Shenglong (Huzhou) Specialised Casting Co. Ltd. for setting up a foundry in China.** The machine shop at Ningbo, China commenced production in April 2013 and the foundry at Huzhou City, China is currently under construction as on date.

3) Expansion through inorganic growth

The company seeks to acquire or make strategic investments in a company or business particularly in Europe which is engaged in the same business as their current business or is engaged in the manufacturing of critical component machining in which they have acquired significant domain knowledge based on their camshafts manufacturing experience.

Risks and Concerns

1) Historical growth was mainly driven by currency depreciation and not volumes
2) We believe return ratios will be hampered after net worth doubles post issue (ROEs will dilute to 13% in FY17).
3) The company depends on limited number of customers for significant portions of their revenues. The loss of one or more of their significant customers may adversely affect company's financial condition.
4) Volatility in the supply and pricing of the raw materials may have an adverse effect on their business and financial condition.
5) A significant portion of the company revenues are dependent on exports to their international customers. Any failure to fulfill the requirements may adversely affect the company revenues and cash flows. The company is also exposed to foreign currency exchange rate fluctuations.

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Research Analyst
Akash Jain, MBA (Financial Markets)

Corporate Off. : 408, Express Zone, "A" Wing, Cello – Sonal Realty, Near Oberoi Mall, Western Express Highway, Malad (East), Mumbai - 400 063. Tel : 91-22-67160400
mail : research@ajcon.net Website : www.ajcononline.com

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For research related queries contact:

Mr. Akash Jain – Vice President (Research) at research@ajcon.net, 022-67160431 (D)

CIN: L74140MH1986PLC041941

SEBI registration Number: INH000001170 as per SEBI (Research Analysts) Regulations, 2014.

Website: www.ajcononline.com

Corporate and Broking Division
408 - (4th Floor), Express Zone, "A" Wing, Cello – Sonal Realty, Near Oberoi Mall and Patel's, Western Express Highway, Goregaon (East), Mumbai – 400063. Tel: 91-22-67160400, Fax: 022-28722062

Registered Office:
101, Samarth, Off. Hinduja Hospital, 151 Lt. P.N. Kotnis Road, Mahim (West), Mumbai – 400016. Tel: 022-24460335/36/40

ASHOK KUMAR AJMERA

Digitally signed by ASHOK KUMAR AJMERA
DN: CN = ASHOK KUMAR AJMERA, C = IN, S = Maharashtra, O = Personal
Date: 2016.01.22 16:11:51 +05'30'