

## Precision Camshafts

IPO Note – Valuations expensive; Neutral

### Investment Rationale:

#### Amongst largest camshaft player with long term client relationship

PCL is one of the world's leading manufacturers and suppliers of passenger vehicle camshafts producing about 150 different varieties. Over the last five years, PCL has almost doubled its market share and currently commands about 8-9% of the global passenger vehicle camshaft market. PCL has developed long term relationship of over 10 years with global OEM's and, is the preferred supplier with General Motors, Ford Motors, Hyundai, Maruti Suzuki and Tata Motors.

#### Increased outsourcing of machining by OEM's coupled with new plant to trigger growth:

There is a growing trend of outsourcing camshaft machining amongst the global OEM's. As per the industry estimates, currently ~35% of camshafts are machined in house by the OEM's. Given the high capex involved in setting up the machining facilities (machining typically has asset turnover of 1x), OEM's are increasingly outsourcing the machining operations. Further, the proposed new ductile iron camshaft machining plant would broaden the product profile for PCL.

### Investment concern:

**Currency risks and client concentration:** PCL derives about 80% of revenues from exports with Euro and GBP constituting major revenue currencies thus exposing it to risk of adverse currency movement. Further, General Motors and Ford form about 35% of the revenues each leading to client concentration.

**Outlook and Valuation:** PCL return ratios are likely to be impacted over the next two years on account of raising of capital and low capacity utilisation of the plant initially. Further PCL is exposed to currency risks and higher client concentration.

On the price to earnings per share (EPS; post-IPO) front, the company is valued at 25.8x 1HFY2016 annualized numbers, while a larger and more diversified player in a similar business, Bharat Forge is trading at a similar multiple of 25.1x FY2016 estimated numbers despite better ROE. Also, another player in forgings business like Ramkrishna Forgings with a better ROE is trading at steep discount to PCL. Further, PCL is trading at a higher EV/Sales multiple of 3.6x as compared to 2.7x and 2.2x of Bharat Forge and Ramkrishna Forgings respectively despite competitors having diverse product profile and far bigger size as compared to PCL. **Hence we recommend Neutral on the issue given the expensive valuations.**

### Key Financials

Y/E March (₹ cr)	FY2014	FY2015	1HFY16
Net Sales	467	532	253
Net Profit	13	62	34
OPM (%)	13.4	26.5	28.6
EPS (₹)	1.6	7.6	4.2
P/E (x)*	116.0	24.4	-
P/BV (x)*	8.7	6.5	-
EV/Sales (x)*	4.1	3.5	-
EV/EBITDA (x)*	30.7	13.2	-

Source: Company, Angel Research; Note: \*The above numbers are considering subscription at the upper end of the price band

## NEUTRAL

Issue Open: January 27, 2016

Issue Close: January 29, 2016

### Issue Details

Face Value: ₹10

Present Eq. Paid up Capital: ₹81.8cr

Fresh Issue\*\*: 1.29cr Shares

Offer for sale: 0.92cr Shares

Post Eq. Paid up Capital: ₹94.7cr

Market Lot: 80 Shares

Fresh Issue (amount): ₹240cr

Price Band: ₹182-186

Post-issue implied mkt. cap ₹1,724cr\*-1,762cr\*\*

Note: \*at Lower price band and \*\*Upper price band

### Book Building

QIBs	60%
Non-Institutional	15%
Retail	35%

### Post Issue Shareholding Pattern(%)

Promoters Group	63.5
MF/Banks/Indian Fls/Flls/Public & Others	36.5

### Bharat Gianani

+91 22 3935 7800 Ext: 6817

bharat.gianani@angelbroking.com

## Company background

Precision Camshafts Ltd (PCL) was incorporated in 1992 and is based in Solapur, Maharashtra. PCL, promoted by Mr Yatin Shah is one of the world's leading manufacturer and supplier of passenger vehicle camshafts commanding a global market share of about 8-9%. Camshaft is a critical engine component as camshaft's design impacts the engine's power, efficiency, mileage and emission. PCL supplies over 150 varieties of camshafts for passenger vehicles, tractors, light commercial vehicles and locomotive engine applications from its manufacturing facilities in Solapur, Maharashtra. PCL currently has two state-of-the-art manufacturing facilities – an EOU unit and a domestic unit – both situated at Solapur, Maharashtra. PCL's manufacturing capacity is 13.38 million camshaft castings per annum and 2.22 million machined camshafts per annum. PCL key customers include global car makers viz General Motors, Ford Motors, Hyundai, Maruti Suzuki, Tata Motors and Mahindra and Mahindra. PCL derives majority of the revenues (80%) from exports whilst the rest is derived from the domestic market.

### Exhibit 1: Manufacturing unit details (EOU unit Solapur)

	Foundry/shops	Capacity	FY15 Capacity utilisation
Camshaft castings	Four foundries	12 mn	80.47%
Machined camshafts	Two machine shops	1.86 mn	54.67%

Source: Company, Angel Research

### Exhibit 2: Manufacturing unit details (Domestic unit Solapur)

	Foundry/shops	Capacity	FY15 Capacity utilisation
Camshaft castings	One foundry	1.38 mn	33.32%
Machined camshafts	One machine shop	0.36 mn	57.56%

Source: Company, Angel Research

## Issue details

The company is raising ₹240 cr through fresh issue of equity shares in the price band of ₹182-186. In addition, the issue also consists of offer for sale of 91.5 lakh shares of which 61.5 lakh shares will be offered by the promoter entities and 30 lakh shares by other investors. The fresh issue will constitute 13.62% of the post-issue paid-up equity share capital of company assuming the issue is done at the upper price band.

### Exhibit 3: Shareholding pattern

Particulars	Pre-Issue		Post-Issue	
	No. of shares	(%)	No. of shares	(%)
Promoter group	66,706,400	81.5	60,206,400	63.5
Others	15,135,200	18.5	34,538,426	36.5
Total	81,841,600	100.0	94,744,826	100.0

Source: Company, Angel Research

### **Objects of the offer**

- Investing ₹200 cr for establishment of a machine shop for ductile iron camshafts at the Solapur EOU
- General corporate purposes

### **Key investment rationale**

#### **Amongst largest camshaft player having long term relationship with global clients**

PCL is one of the world's leading manufacturers and suppliers of camshafts in the passenger vehicle segment producing about 150 different varieties of camshafts. Over the last five years, PCL has almost doubled its market share and currently commands about 8-9% of the global passenger vehicle camshaft market. PCL has developed long term relationships of over 10 years with global OEM's and, is the preferred supplier with marquee global automakers such as General Motors, Ford Motors, Hyundai, Maruti Suzuki and Tata Motors.

#### **Increased outsourcing of machining by OEM's provides growth opportunity**

There is a growing trend of outsourcing manufacturing of camshafts amongst the global OEM's. Automakers like General Motors, Ford Motors, Hyundai and FIAT have outsourced majority of their camshaft production. As per the industry estimates, currently ~35% of camshafts are machined in house by the OEM's. Given the high capex involved in setting up the machining facilities (machining typically has asset turnover of 1x), OEM'S are increasingly outsourcing the machining operations. PCL is likely to benefit from increasing outsourcing practices by the automakers.

#### **Broadening product profile provides new growth avenue**

PCL currently manufactures cast iron camshafts which currently constitute about 40% of the overall camshaft market. PCL is utilizing most of the IPO proceeds to set up a machining facility for ductile iron camshafts. As per industry estimates, about 20% of the overall camshaft market is ductile iron. As per PCL, the ductile iron capacity it is setting up already has confirmed orders from the OEM's. Thus, the proposed facility would enable PCL to significantly address its addressable market and provide additional growth avenue going ahead.

## Key investment concerns

### Growth to be back ended with the new machined plant being operational only in FY18

The majority of the IPO proceeds (about ₹200) is being utilized by PCL in setting up a ductile camshaft machining plant at Solapur EOU. PCL has already received approval from the existing OEM's for this upcoming facility. The plant is being set up at an investment of ₹230 cr and is expected to be the key revenue driver for PCL. At full utilization levels, the plant is expected to generate revenues of about ₹225 cr (based on Asset Turnover of about 1x of the machining unit).

However, as per the management the plant is likely to commence production only in early FY2018. Also, the management indicated that the ramp up at the new plant would only be gradual and the full utilization levels would be reached only in FY2020. We expect the utilisation levels to remain subdued in FY2018 and expect the growth to be back ended

### Currency risks and client concentration

PCL derives about 80% of the revenues from export markets which exposes it to currency risks. Most of PCL revenues are denominated in Euro and GBP. Favourable currency movements (weakening of INR against the Euro and GBP) have been one of the key factors enabling PCL to pose strong double digit growth historically. However, recent appreciation of INR against Euro and GBP has impacted the topline of PCL. (PCL 1HFY16 annualised revenues show a 5% decline). Any adverse movement in the currency is likely to have significant impact on PCL revenues.

Further PCL has relatively higher client concentration with the two large global OEM's (General Motors and Ford) accounting for 35% of the revenues each. Any disruptions/market share loss in any of the OEM's have the potential to significantly impact PCL operations.

### Expensive valuation

During FY2015, PCL reported a top-line of ~₹532cr and a bottom-line of ~₹62cr. For 1HFY2016, the company has reported a top-line of ₹253cr and a net profit of ₹34cr.

On the price to earnings per share (EPS; post-IPO) front, the company is valued at 25.8x 1HFY2016 annualized numbers, while a larger and more diversified player in a similar business, Bharat Forge is trading at a similar multiple of 25.1x FY2016 estimated numbers despite better ROE. Also, another player in forgings business like Ramkrishna Forgings with a better ROE is trading at steep discount to PCL. Further, PCL is trading at a higher EV/Sales multiple of 3.6x as compared to 2.7x and 2.2x of Bharat Forge and Ramkrishna Forgings respectively despite competitors having diverse product profile and far bigger size as compared to PCL. **Hence we recommend Neutral on the issue given the expensive valuations.**

**Exhibit 4: Comparative Valuation**

Post issue valuation ^	PCL*	RFL*	BFL#
P/E (x)	25.8	16.6	25.1
P/BV (x)	3.4	2.4	4.9
EV/Sales (x)	3.6	2.2	2.7
EV/EBIDTA (x)	12.7	10.5	13.4
ROE (%)	13.0	14.4	21.1
ROIC (%)	20.2	13.4	20.0

Source: Company, Angel Research; Not: \*based on 1HFY16 annualised nos; # based on FY16 estimated numbers; ^ based on price at upper band

**Risks to upside**

Favourable currency movement (depreciation of INR against Euro and GBP) has boosted PCL's export realization historically (exports form 80% of overall revenues) and has been the key contributor to growth. However, over the last one year INR has been on the appreciation trend viz a viz the above currencies thereby impacting the revenues. Any reversal in the exchange rates (INR depreciation against the Euro and the GBP) is likely to boost PCL realization and would be a key upside risk to our estimates.

**Profit & Loss (consolidated)**

Y/E March (₹ cr)	FY2014	FY2015	1HFY2016
<b>Total operating income</b>	<b>467</b>	<b>532</b>	<b>253</b>
<b>Total Expenditure</b>	<b>405</b>	<b>392</b>	<b>181</b>
Cost of Materials	153	168	73
Personnel Expenses	114	69	29
Others Expenses	138	155	78
<b>EBITDA</b>	<b>62</b>	<b>141</b>	<b>72</b>
(% of Net Sales)	13.4	26.5	28.6
Depreciation & Amortisation	28	41	22
<b>EBIT</b>	<b>47</b>	<b>110</b>	<b>61</b>
(% of Net Sales)	10.1	20.6	24.1
Interest & other Charges	13	11	6
Other Income	13	10	10
(% of PBT)	1.3	0.2	2.6
<b>Recurring PBT</b>	<b>35</b>	<b>99</b>	<b>55</b>
Prior Period & Extraordinary Expense/(Inc.)	-	-	-
<b>PBT (reported)</b>	<b>35</b>	<b>99</b>	<b>55</b>
Tax	21	36	21
(% of PBT)	62.0	36.8	38.5
<b>PAT (reported) before MI</b>	<b>13</b>	<b>62</b>	<b>34</b>
Minority interest	-	-	-
<b>PAT after MI (reported)</b>	<b>13</b>	<b>62</b>	<b>34</b>
(% of Net Sales)	2.8	11.7	13.5
<b>Basic EPS (₹)</b>	<b>1.6</b>	<b>7.6</b>	<b>4.2</b>

**Balance Sheet**

Y/E March (₹ cr)	FY2014	FY2015	1HFY2016
<b>SOURCES OF FUNDS</b>			
Equity Share Capital	4	82	82
Reserves & Surplus	170	152	187
<b>Shareholders Funds</b>	<b>174</b>	<b>234</b>	<b>269</b>
Minority Interest	-	-	-
Total Loans	185	186	180
Deferred Tax Liability	15	11	10
Other long term liability	-	1	2
<b>Total Liabilities</b>	<b>374</b>	<b>432</b>	<b>461</b>
<b>APPLICATION OF FUNDS</b>			
Fixed Assets	229	231	243
Capital Work-in-Progress	5	16	9
Investments	62	62	62
Other non current assets	3	3	3
Long term loans & adv	6	12	10
Current Assets	207	271	276
Inventories	44	44	49
Sundry Debtors	112	105	99
Cash	34	95	102
Loans & Advances	14	20	18
Other Assets	3	7	7
Current liabilities	138	163	142
<b>Net Current Assets</b>	<b>69</b>	<b>108</b>	<b>134</b>
<b>Deferred Tax Asset</b>	<b>0</b>	<b>0</b>	<b>1</b>
<b>Total Assets</b>	<b>374</b>	<b>432</b>	<b>461</b>

### Cash flow statement

Y/E March (₹ cr)	FY2014	FY2015	1HFY2016
Profit before tax	35	99	55
Depreciation	28	41	22
Change in Working Capital	(25)	14	(15)
Interest / Dividend (Net)	9	4	0
Others	43	(7)	1
Taxes paid	(11)	(32)	(25)
<b>Cash Flow from Operations</b>	<b>78</b>	<b>120</b>	<b>38</b>
(Inc.)/ Dec. in Fixed Assets	(47)	(66)	(18)
(Inc.)/ Dec. in Investments	(54)	(37)	(46)
Others	2	6	6
<b>Cash Flow from Investing</b>	<b>(100)</b>	<b>(98)</b>	<b>(57)</b>
Issue of Equity	1		
Inc./ (Dec.) in loans	48	12	(13)
Dividend Paid (Incl. Tax)	(0)	(0)	
Interest / Dividend (Net)	(10)	(10)	(4)
<b>Cash Flow from Financing</b>	<b>39</b>	<b>2</b>	<b>(17)</b>
Inc./ (Dec.) in Cash	17	24	(36)
<b>Opening Cash balances</b>	<b>13</b>	<b>30</b>	<b>54</b>
Exchange rate difference on foreign cash	(1)	0	1
<b>Closing Cash balances</b>	<b>30</b>	<b>54</b>	<b>18</b>

### Key Ratios

Y/E March	FY2014	FY2015
<b>Valuation Ratio (x)</b>		
P/E (on FDEPS)	116.0	24.4
P/CEPS	37.2	14.7
P/BV	8.7	6.5
EV/Sales	4.1	3.5
EV/EBITDA	30.7	13.2
EV / Total Assets	5.1	4.3
<b>Per Share Data (₹)</b>		
EPS (Basic)	1.6	7.6
EPS (fully diluted)	1.6	7.6
Cash EPS	5.0	12.7
Book Value	21.3	28.6
<b>Turnover ratios (x)</b>		
Asset Turnover	1.2	1.2
Inventory / Sales (days)	34.0	30.4
Receivables (days)	87.6	71.9
Payables (days)	100.9	100.5
Working capital cycle (days)	27.3	9.0



Research Team Tel: 022 - 39357800

E-mail: [research@angelbroking.com](mailto:research@angelbroking.com)

Website: [www.angelbroking.com](http://www.angelbroking.com)

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