

Action Construction Equipment Ltd (ACCE IN)

Proxy to infrastructure / manufacturing, Action is here to stay..

INDIA | SMALL CAP | Meeting Highlights

Company background:

Action Construction Equipment Ltd (ACE) was established in 1995 and has a wide product portfolio across cranes, construction equipment, material handling equipment and agriculture equipment. It is a market leader in mobile and tower cranes. Its products are used across diversified sectors like infrastructure, construction, manufacturing, logistics and agriculture. The company has sales & service network over 100+ locations and 13 regional offices.

Why one should look at the company?

- The company / sector seems to be at sweet spot due to the Government's strong focus on roads, metros, water, airport etc and incentivizing local manufacturing through various sector specific policies. It would get additional thrust due to ongoing private capex across industries.
- The Cranes and Construction equipment (~80% of revenue) industry volume is expected to grow by 3x between FY20-30; translating to ~12% CAGR growth during the mentioned period.
- Defense and Exports (~8-10% of total revenue) are emerging opportunities for the company; it would grow higher than company's overall revenue growth.
- Multiple growth levers: 1) Volume growth led by industry tailwind, 2) increase in average realizations led by change in product mix & regulatory led pricing, 3) new capex for crawler cranes, 4) cross selling opportunity between cranes and Backhoe loader customers, 5) Exports & Defense and 6) Ghana project
- The operating margins would further improve due to 1) change in product mix; the higher capacity cranes typically have higher margins and 2) operating leverage with higher growth.
- Its strong business model is reflecting in strong balance sheet, low capex requirement, low working capital requirement and improving return ratios.

Major highlights

- Looking at the current favorable industry scenario, the growth momentum would continue in mid to long term period.
- The realization is also increasing for cranes (due to change in product mix), construction equipment segment (due to change in regulation) and higher contribution from exports market.
- The overall margins would increase as contribution from higher value added products would improve and operating leverage.
- Based on the management's assessment Rs. 5 bn of incremental revenue would expand the operating margins by 100-150 bps.
- Infrastructure and manufacturing constitutes ~60% and ~40% to total revenue respectively. The ratio could be 50:50 in coming future due ongoing strong momentum in private capex.
- Typically, it has 45-60 days of revenue visibility (ex. agriculture equipment) which is also due to short execution cycle. Looking at consistent order inflow the management expects FY24 revenue to be around Rs. 25bn.
- The company doesn't require significant capex for its incremental growth; it will spend Rs. 50-60 crs capex / pa.
- The company would continue to work on lean working capital cycle; normally it doesn't carry finished goods inventory except for top selling products like pick & carry cranes, tower cranes etc.

18 May 2023

Not Rated

CMP RS 449

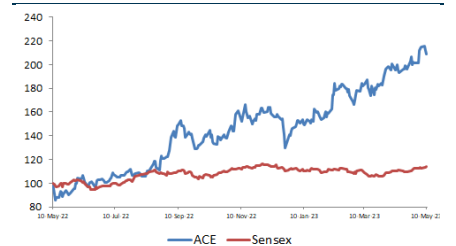
COMPANY DATA

O/S SHARES (MN) :	119.1
MARKET CAP (RS BN) :	53.5
MARKET CAP (USD MN) :	652.1
52 - WK HI/LO (RS) :	470 / 175
TRADING VOL. 3M (000) :	208
PAR VALUE (RS) :	2

SHARE HOLDING PATTERN, %

PROMOTERS :	66.7
FII / FPI :	5.6
DII / MF :	3.5
PUBLIC :	24.1
SHP as on March 2023	

PRICE Vs. SENSEX



Source: Phillip Capital India Research

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- Direct revenue from the government was negligible; the exposure was restricted to tender business from various government agencies and authorities. In last few quarters the defense led revenue is picking up.
- Defense constitutes ~3-4% of total revenue, which could increase to 8-10% over next few years. The company is supplying customized cranes, forklifts, Multipurpose tractors, Tele handlers and special mobile equipment etc
- Exports constitute ~7-8% of its total revenue. The management expects its contribution to reach ~10% by FY24 due to 1) stronger penetration in existing markets and 2) entering in the new markets.
- Higher contribution from defense and export would help the company to mitigate the business cyclicity related to the domestic market.
- As per estimates 50% of customers are overlapping for cranes and construction equipment. ACE has just started the cross selling; it can provide good fillip to the company for its incremental growth.
- Except agriculture equipment segment, all other three segments have smart mix between direct sales and sales through channel partners. Due to it, the channel inventory would be minimal. In agriculture segment it would be on demand production.
- The company introduces new products at periodical interval; it has two R&D centers at Faridabad and Palwal. It is the first Indian company to develop indigenously designed electric mobile cranes.
- Ghana project: ACE's role is to build the plant and supply CKD to the Ghana plant; the revenue potential could be Rs. 2-3 bn which would be recurring in nature.
- Inorganic opportunity: The company is looking for appropriate opportunity to strengthen its backward integration like foundry / engine parts, hydraulic components or any products where it can strengthen its current positioning.
 - The acquisitions may not add to the topline, but it would help to enhance the overall margins.
- FY23 revenue growth could be 28-30% and 15-20% for FY24.

Segment wise highlights:

Cranes – Segment overview

Product Range	Mkt Share	ASP	Capacity	FY21	FY22	9M FY23	Remarks
% of total sales				64.4%	60.3%	70.7%	User industries: Infrastructure, Construction, Manufacturing, Logistics, real estate
Volume				4558	5329	4627	
Sales (Rs. Crs)				7902	11033	10922	
EBIT (Rs. Crs)				872.4	1286.7	1553.2	
EBIT %				11.0%	11.7%	14.2%	Competitors: Escorts, Liebherr, Potain, Palfinger and some Chinese cos
Realization (Rs lacs / pcs)				17.34	20.70	23.60	
Pick & Carry crane	63%	18 Lacs	9-30 T				Used for a wide range of lifting needs
Lorry loaders Crane	No 2		6-50T				Truck mounted Cranes. No 2 in addressed market
Self-Erecting Tower Crane	75-80%	21 lacs	24-36M height				Lifting, shifting, concreting and erection for low to medium height projects
Crawler Crane	Mkt Leader	110-160 lacs	25-75 T				For heavy lift applications Mkt leader in addressed market
Truck Crane	No 3	70-100 lacs	25-60 T				High mobility on road and off-road cranes
Fixed Tower Crane	63%+	60-65 lacs	5-25T				Lifting, shifting, concreting and erection jobs for heights upto 300 meter

Source: Company, Phillip Capital

- ACE is a market leader in most of the segments they are operating. It would strengthen its positioning in 1) new generation crane and 2) Crawler cranes.
- The industry is expected to grow by ~ 3x from its FY20 level of 7000 units / year to 22K units by FY27E.

- Based on the end application, the useful life of cranes is around 8-10 years.
- Typically for the segment the customer breakup between hirer and direct customers would be 60:40%.
- ACE is the largest manufacturer of pick and carry cranes in upto 30T category in the world.
- The higher contribution from new generation / multi activity cranes would increase the overall realizations and thus gross margins for the segment.
- The Tower crane was earlier introduced through a JV with a Chinese company, post cessation of agreement, the company is dominating the segment with ~63%+ market share.
- There is a noteworthy trend of elevated construction which is driving demand for crawler / heavier cranes. The segment is dominated by some Chinese players as no Indian company is present in heavier crane segment.
- The company has recently added crane with capacity of 180T and are spending Rs. 35-40 crs to expand the facility. At full capacity utilization it can generate Rs. 200-300 crs to the top line.
- Truck and crawler crane is dominated by Chinese players, ACE was a late entrant in the product categories but with recent expansion in Crawler crane it can gain market share from the competition.

Construction equipment – segment overview

Product Range	Mkt Share	ASP	Capacity	FY21	FY22	9M FY23	Remarks
% of total sales				10.9%	9.6%	10.9%	User industry: Infrastructure, Construction, Mining, Manufacturing 85-90% of revenue from Backhoe Loader Competition: JCB, CAT, Tata Hitachi etc
Volume				585	532	496	
Sales (Rs. Crs)				1337	1762	1686	
EBIT (Rs. Crs)				67.9	93.8	122.7	
EBIT %				5.1%	5.3%	7.3%	
Realization (Rs mn / pcs)				22.85	33.12	33.99	
Backhoe Loader	2-3%	19 lacs					Used for digging, moving, grading and loading earth and other aggregates.
Wheel Loader							
Tandem Vibratory roller / Soil Compactor		20 lacs	3.5-9T / 10-12 T				Used to compact aggregates and ground compaction / stabilisation
Motor Grader		55 lacs	100-173 HP				Used for Levelling and Grading aggregate layers in Road Construction
Pilling Rig		200-300 lacs	60-600 KN				A large track-mounted drill used in foundation projects

Source: Company, Phillip Capital

- Majority of revenue is contributed from Backhoe Loader (BHL).
- The average life of BHL is 6-7 years
- The segment was a drain on its balance sheet earlier but now it is contributing to the bottom line. It would further improve due to its focus on export market.
- JCB is the market leader with majority market share in Backhoe Loader. Presently, ACE has only 2-3% market share in that category. ACE's products are sold at 15-20% discount to market leader's BHL.
- Typically for the segment the customer breakup between hirer and direct customers would be 85:15%.
- The migration from BS III to BS IV is like a generation change as the OEMs have to work on mechanical to electronic components. ACE has tied up with Indian company for migration where as JCB had adopted its European technology, so its price increase is higher than ACE's equipment.
- Post implementation of BS IV / CEV IV, the cost of BHL has increased by 15-20%; it would increase ACE's competitiveness in the market as the pricing difference in comparison to JCB increased further.
- Due to its insignificant market share in BHL segment, the company's volume growth is significantly higher than industry growth. In FY23 expected growth rate is 35-40%; the growth momentum would continue in near term.

Material Handling Equipment:

Product Range	Mkt Share	ASP	Capacity	FY21	FY22	9M FY23	Remarks
% of total sales				8.4%	8.3%	7.6%	User Industries: Manufacturing, Logistics, Defense, Ports, Infrastructure, Aviation Competitor: Kion, Godrej, Toyota etc
Volume				1068	1418	946	
Sales (Rs. Crs)				1028	1521	1178	
EBIT (Rs. Crs)					182.0	148.4	
EBIT %				0.0%	12.0%	12.6%	
Realization (Rs mn / pcs)				9.63	10.73	12.45	
Forklift Trucks	19%	9-10 lacs					Used to lift and move materials over short distances
Warehousing Equipment		50K-5Lacs					Equipment to perform tasks such as loading, unloading & stacking etc

Source: Company, Phillip Capital

- Majority of Material handling equipment are used for Manufacturing and Logistics functions.
- The emergence of retail and e-commerce is driving the warehousing segment which in turn increases the demand for forklifts and other warehousing equipment.
- In forklift segment, it has 26% market share for the category they are present vs 19% for overall market.
- Warehousing equipment is a small segment; the company has to offer the equipment along with forklift to fulfill customer's requirements.

Agriculture Equipment:

Product Range	Mkt Share	ASP	Capacity	FY21	FY22	9M FY23	Remarks
% of total sales				16.3%	21.8%	10.8%	Agriculture and Haulage application Competitive market with many players, but dominated by 4-5 major players like Mahindra & Mahindra, TAFE, Kubota, VST, New Holland
Volume				4271	4085	2854	
Sales (Rs. Crs)				2002	3980	1672	
EBIT (Rs. Crs)				240.5	125.8	42.4	
EBIT %				12.0%	3.2%	2.5%	
Realization (Rs mn / pcs)				4.69	9.74	5.86	
Tractor		6 lacs	35-90 HP				Used for agricultural activities, construction and industrial haulage
Track Combine	No 2						
Wheel harvester		18 lacs	62-102 HP				A machine designed to harvest a variety of grain crops
Rotovator		0.7 lac					A tractor-drawn implement which is mainly used for seed bed preparation

Source: Company, Phillip Capital

- Agriculture equipment is concentrated markets with top 5-6 companies (like M&M, Kubota, TAFE, ITL etc) dominate the market and then it would be small players like VST Tillers, ACE etc.
- The market leaders have a strong legacy in market so they would continue to dominate the market.
- The segment is dealer / distribution driven; the channel partners would give them some projection based on prevailing industry scenario.
- ACE's multipurpose tractors are approved in Defense department for which all the leading companies had bid in particular tender.

Ghana Project:

- It's a Rs 200 crs project which would be financed by Exim bank, the plant would be owned by Republic of Ghana
- ACE's role is to build the plant and to run the plant in initial period. The Completely Knocked Down (CKD) would be supplied from India to the Ghana plant.
- The project has a recurring revenue potential of ~Rs. 200-300 crs; the margins could be higher than its current business.

Key things to monitor:

- Continuation of infrastructure and manufacturing activities at ground level.
- The management is actively looking for some inorganic opportunities in similar product range, which may help them to strengthen its market positioning or improve the operating margins.
- Operating / EBIT margins in construction and agriculture equipment is lower than margins in Crane and Material Handling segments; any margin improvements in these segments would improve the overall margins.

Outlook and View:

ACE is a direct proxy for spending in infrastructure, manufacturing and construction related activities. Looking at uptick in its key user industries and ACE's strong market share (especially in crane segment) we believe that the growth momentum will continue for the company. Even though such companies / industries would fall under cyclicals but looking at the government's focus on manufacturing and infrastructure along with globally prevailing sentiments of "China + 1" or "Europe + 1", India seems to be favorably placed; we expect it to be a structural play over next 5-10 years.

We expect company to grow at 15-20% CAGR in mid to near term due to 1) expected industry volume growth of ~12%+ and 2) increase in average realizations. At CMP the stock is trading at 34x TTM PE.

Financials
Income Statement

Rs. Mn	FY19	FY20	FY21	FY22
Net sales	13425.3	11562.3	12271.5	16295.8
Growth %	23.6%	-13.9%	6.1%	32.8%
Total expenses				
Raw Material Cost	9797.0	7944.9	8560.1	11711.1
Employee costs	584.4	568.2	543.5	716.4
Other Manufacturing Cost	2066.1	2133.6	1978.3	2353.8
EBITDA	977.8	915.6	1189.6	1514.5
Growth %	6.9%	-6.4%	29.9%	27.3%
EBITDA margin (%)	7.3%	7.9%	9.7%	9.3%
Depreciation	117.5	130.1	139.4	154.1
EBIT	860.3	785.5	1050.2	1360.4
Interest	115.2	146.6	122.3	137.5
Other income	97.1	41.5	153.1	150.2
PBT	842.2	680.4	1081.0	1373.1
Exceptional items	0.0	0.0	0.0	0.0
Less: Taxation	281.8	155.6	283.2	323.0
PAT	560.2	524.7	797.9	1050.0
Growth %	7.6%	-6.3%	52.1%	31.6%
PAT margin (%)	4.2%	4.5%	6.5%	6.4%
Wtd. Avg. Shares (Crns)	113.5	113.5	113.5	119.1
EPS	4.8	4.6	7.0	8.8

Balance Sheet

Rs. Mn	FY19	FY20	FY21	FY22
Equity capital	234.6	227.0	227.0	238.2
Reserves	4140.8	4199.4	5005.8	7303.0
Net worth	4375.5	4426.4	5232.7	7541.2
Minority Interest + others	2.9	3.0	2.6	2.4
Current Liabilities	3936.2	4635.4	4935.7	5110.1
Non Current Liabilities	554.5	471.2	381.8	170.0
Total liabilities	8869.0	9536.0	10552.9	12823.7
Net block	3280.3	3998.3	4173.4	4399.3
Investments	576.1	401.6	434.3	1910.0
Others	815.0	339.3	290.2	473.8
Current assets				
Inventories	2128.9	2706.9	2660.5	3333.7
Debtors	1441.1	1473.3	2246.8	1887.2
Cash	114.2	92.7	365.1	143.1
Other Current assets	513.4	523.9	382.6	676.4
Total Assets	8869.0	9536.0	10552.9	12823.7

Source: Ace Equity, Phillip Capital
Cash Flow

Rs. Mn	FY19	FY20	FY21	FY22
Pre - tax profit	842.1	680.3	1081.1	1373.0
Depreciation + other Adj.	207.1	304.2	270.3	314.2
Change in WC	-110	-340.7	-250.7	-268.8
Total Tax Paid	-218.8	-164	-240.1	-328.8
Cash Flow from Operating activities	720.4	479.8	860.6	1089.6
Capital Expenditure	-245.3	-872.6	-438.3	-397.2
Change in Investments	-74.1	170.6	-12.7	-1587.4
Others	52.9	505.9	288.8	-30.3
Cash Flow from Investing activities	-266.6	-196.0	-162.3	-2014.8
Change in Equity				1355.2
Change in Debt	-140.1	347.8	-277.6	-466.1
Others + Dividends	-296.4	-682.0	-125.8	-235.4
Cash Flow from Financing activities	-436.5	-334.3	-403.4	653.6

Valuation Ratios

	FY19	FY20	FY21	FY22
EPS	4.8	4.6	7.0	8.8
Book NAV / Share	37.3	39.0	46.1	63.3
DPS	0.5	0.5	0.5	0.6
Growth Ratios				
Net Sales	23.6	-13.9	6.1	32.8
EBITDA	8.1	-11.0	40.3	24.0
PAT	7.7	-6.3	52.1	31.6
Return Ratios				
ROA	6.6	5.7	7.9	9.0
ROE	13.7	11.9	16.5	16.4
ROCE	20.1	16.3	21.8	22.6
Turnover Ratios				
Asset Turnover (x)	1.6	1.3	1.2	1.4
Receivable Days	42.7	46.0	55.3	46.3
Inventory Days	48.6	76.3	79.8	67.1
Payable Days	76.3	104.8	138.8	107.8
Liquidity Ratios				
Current Ratio	1.1	1.0	1.2	1.4
Interest Cover (x)	8.3	5.6	9.8	11.0
Total Debt / Equity (%)	0.1	0.2	0.1	0.0
Valuation Ratios				
PER (x)	24.1	7.5	22.0	27.3
Price / Book (x)	3.1	0.9	3.4	3.8
Price / Sales (x)	1.0	0.3	1.4	1.8
EV / Sales (x)	1.0	0.4	1.4	1.8
EV / EBITDA (x)	12.9	4.9	13.2	17.2

Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year. We have different threshold for large market capitalisation stock and Mid/small market capitalisation stock. The categorisation of stock based on market capitalisation is as per the SEBI requirement.

Large cap stocks

Rating	Criteria	Definition
BUY	$\geq +10\%$	Target price is equal to or more than 10% of current market price
NEUTRAL	$-10\% > \text{to} < +10\%$	Target price is less than +10% but more than -10%
SELL	$\leq -10\%$	Target price is less than or equal to -10%.

Mid cap and Small cap stocks

Rating	Criteria	Definition
BUY	$\geq +15\%$	Target price is equal to or more than 15% of current market price
NEUTRAL	$-15\% > \text{to} < +15\%$	Target price is less than +15% but more than -15%
SELL	$\leq -15\%$	Target price is less than or equal to -15%.

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