



JOINDRE CAPITAL SERVICES LTD.

SEBI REGN NO. INH000002061 / INB 230766739 / INB 011107555

RESEARCH REPORT

20th Sept 2017

GNA AXLES LIMITED

NSE : GNA

Sector: AUTO COMPONENTS

BSE: 540124

View - BUY

CMP : Rs. 288

Target Price: Rs 375 (In next 12 to 15 mths)

BUSINESS BACKGROUND

Incorporated in 1993, G N A Axles Ltd is Punjab based manufacturer of rear axle shafts, other shafts and spindles used in on-highway and off-highway vehicular segments. GNAAL mainly manufactures and sells auto components for the four-wheeler industry. GNAAL has an annual installed capacity of 2.3mm for rear axle shafts, 0.3mm for spindles, and 0.4mm for other shafts. GAAL has a broad customer base in India and overseas. Its biggest customers include M&M, John Deere, TAFE , Automotive Axles Limited, Meritor HVS AB and Dana Limited. GNA has two manufacturing plants in districts Hoshiarpur and Kapurthala in Punjab. GNAAL made a IPO in Sept 2016 at a price of Rs 207.

INVESTMENT HIGHLIGHTS

Steady Financials for GNAAL as on Q1 FY18 –

GNAAL reported a steady set of Q1FY18 numbers with net sales at Rs 145.07 crs, as compared to a revenue of Rs 138.51 crs in Q1 last year, with EBIDTA placed at Rs 22.94 crs from Rs 22.44 crs in Q1 last year and the PAT in Q1 FY18 grew by 42% YoY to Rs 11.08 crs as compared to Rs 7.81 crs in Q1 last year.

For FY17 the company has recorded net income of Rs 513.40 crs, a EBIDTA of Rs 80.42 crs and a PAT of Rs 29.57crs.

GNAAL is a leading axle shafts player with long term customer relationships –

GNA manufactures a diverse range of rear axle shafts, other shafts and spindles for the on-highway segment, i.e. for LCVs, MCVs & HCVs and other transport vehicles such as buses. It also manufactures rear axle shafts and other shafts for the off-highway segment, i.e. for agricultural tractors and machinery, forestry & construction equipment, electric carts & other specialty vehicles used in the mining and defence sectors.

GNA has a large variety of rear axle shafts with the capacity to manufacture axle shafts of up to 165 kg input weight. Its customers include global OEMs and tier-1 suppliers like Dana Ltd, John Deere, Kubota Corporation & Meritor HVS AB, as well as leading Indian OEMs and tier-1 suppliers such as Claas India Pvt Ltd, TAFE, International Tractors, M&M, Automotive Axles (AAL) Escorts, Axles India

KEY DATA

FACE VALUE	Rs	10.00
DIVID YIELD %		NA
52 WK HI/LOW		299/171
NSE CODE		GNA
BSE CODE		GNA
MARKET CAP	RS	618 CRS

SHAREHOLDING PATTERN

PROMOTERS	-	70%
BANKS, MFs & DIs	-	11%
FIs	-	%
PUBLIC	-	19%

KEY FUNDAMENTALS

YE	FY18	FY19	FY20
Rev Gr%	15	18	18
EBIDTA Gr%	15	20	18
PAT Gr%	43	27	21
EPS Gr%	43	27	21
EPS (Rs)	20	25	30
ROE %	13	15	15
ROCE %	16	18	19
P/E(x)	15	11	9



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Diversified product portfolio & large customer base –

GNA will continue its focus on development of new products as well as expand its existing lines of products. For example, the company is currently developing products such as heavy axle shafts for off-highway segment. The company also intends to diversify its customer base.

Contribution from top five overseas customers has declined from 91.3% in FY15 to 80.2% in FY17. Over the past two or three years, GNA has acquired new customers for different product segments (in FY16 it started supplying rear axle shafts for HCVs to Dana Australia; in FY15, it started supplying rear axle shafts for HCVs to Meritor HVS Australia, it started supplying rear axle shafts for LCVs to Dana Brazil, it started supplying rear axle shafts for tractors TAFE are among others.

Focus on exports from India –

GNA believes that an export oriented strategy will continue to offer it business advantages. The company intends to leverage the low cost advantages of manufacturing in India. GNA has seen an increasing trend in export sale over the past three to four years. The company has over the years focused more on export market. Its revenue share has increased gradually over the past three or four years. Export revenue contribution has increased from 35% in FY12 to 55% in FY17.

The company exports rear axle shafts across the world with North America & Europe accounting for 45% & 33% of its export revenue, respectively. Other geographies, Asia Pacific and South America region account for 18% and 3% of export revenue, respectively.

Exports are likely to grow by 25-30%+ in the coming year with North America leading the way as Class VIII trucks have been showing healthy growth YoY. Greater focus will be on growing exports further.

Class 8 trucks should see healthy double-digit growth rates until 2019 –

Class-8 truck orders saw a sharp 36% drop in 2016 mainly as the ISM new orders and freight shipments remained in the negative territory which led to sharp inventory correction by OEMs. With steady improvement in the ISM New Orders Index and a pick up in freight demand, the Class-8 orders have seen a sharp jump of 42% YTD-CY17.

This segment should report healthy double-digit growth rates until 2019. Historically, the Class-8 industry has seen a 3-5 years of growth cycle before falling off and we believe the industry is in its early days of recovery, and this is beneficial for GNAAL which has a large exposure to this product segment.

GNAAL's ongoing capex plans are on schedule –

GNAAL has already incurred a capex of Rs 20 crs which has expanded the total capacity from 3m pieces to 3.5m pieces (0.4m in Axle shafts and 0.1 in spindles).

Further Rs 60 crs will be expended in FY18E, augmenting the capacity to 4m pieces. At peak utilization, this will result in an incremental turnover of Rs 2.5bn with an additional working capital requirement of Rs 40 crs. All of this will be funded by way of IPO monies and internal accruals.



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GNAAL is also planning a further expansion going ahead –

GNAAL is also planning to venture in production of axles for LCV and SUVs for both domestic and international markets for which it has already bought land for Rs 30 crs and will invest further Rs 20-30 crs in machinery. Commercial production is expected to start from FY20.

GNAAL is targeting to generate revenues of Rs 1bn in the initial stage (ie in FY21). Existing customers such as M&M, Automotive Axle and Dana Corp will continue to remain their clients in these segments as well.

GNAAL plans to reduce its long term debt –

As of March 2017, long term debt stood at Rs 46 crs of which it plans to repay Rs 20 crs each in FY18E and FY19E. When this happens we expect GNAAL to reduce its interest cost quite significantly as overall interest burden is around Rs 12-13 crs. In fact the company has already started the process of repayment since last year with interest costs down at Rs 12.52 crs in FY17 from Rs 16.29 crs last year.

GNAAL enjoys a reasonably good balance sheet and both Topline and Bottomline growth is likely to remain strong going ahead –

GNAAL has a reasonably good balance sheet with net debt of around Rs 46 crs as on FY17 as compared to a tangible networth of Rs 296 crs as on March 2017.

We expect that going ahead overall bottomline growth in the next 3 years starting FY17 onwards should easily increase at a CAGR of 25-30% and with capex being funded largely from internal accruals and hence going ahead we believe that net cash flows generated will remain healthy going ahead.

What is GNAAL's key USP vis a vis other players –

Firstly GNAAL is a large player in the axle shaft market

Secondly GNAAL has a expansion plan to invest Rs 80 crs in new machining facility the effect of this which will be reflected fully in FY19 numbers

Thirdly GNAAL enjoys global customers like Dana, Merritor and several other large Tractor players

Also GNAAL is a large approved OEM vendor to large domestic OEMs like Mahindra, TAFE, Tata Motors, Automotive Axles (AAL) Escorts, Axles India.

Exports accounted for 55% of revenues in 2016-17 and key markets for GNAAL exports include the US, and Latin American Markets



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Overall the Axles Shafts market both in the Global and Domestic markets looks good over the next 2-3 years –

We expect the domestic and export market to remain in a healthy shape with growth remaining in strong double digits.

GNAAL is intending to be a strong focused player focusing on the large and medium Auto players both in India and Globally where it has a strong customer base and where it enjoys good profitability margins. Changes in Indian automobile industry directly impact Indian Axles shafts industry. Since the automobile industry is the main customer for the Axles shafts sector, the industry's continuous efforts in upgrading technologies and diversifying product range has enabled it to expand its base of customers to foreign markets

Key Triggers for GNAAL going ahead –

GNAAL expects strong improvement in the demand of Class 8 Trucks in North American Market

Also with the domestic Tractor industry doing well this should reflect in good domestic demand going ahead

Experienced Management and Skilled Employee Base:

Promoters of the company have an average of approximately 28 years' experience in engineering and auto-component sector and the Key Management Personnel are also experienced in the engineering industry. The majority of company's Key Management Personnel have been employed with the company for over ten years and have contributed towards growth of the company through their commitment and experience

The company places strong emphasis on engineering and product development to enhance its product range and improve its manufacturing processes. The company has in-house metallurgical and metrological laboratories. It has offered a number of cost reduction and value engineering proposals to its customers on the basis of in-house improvements in manufacturing processes which resulted in low input cost and low operation cost



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Business Outlook & Stock Valuation –

On a rough cut basis, in FY18, Revenue is expected to touch Rs 590 crs.

On the bottomline level we expect the company to record a PAT of Rs 42.5 crs in FY18E. Thus on a conservative basis, GNAAL should record a EPS of Rs 20 for FY18E. For FY19E and FY20E our expectation is that earnings traction for GNAAL will continue to remain strong wherein we expect a EPS of Rs 25 and Rs 30 respectively.

GNA manufactures a diverse range of rear axle shafts, other shafts and spindles for the on-highway segment, i.e. for LCVs, MCVs & HCVs and other transport vehicles such as buses. It also manufactures rear axle shafts and other shafts for the off-highway segment, i.e. for agricultural tractors and machinery, forestry & construction equipment, electric carts & other specialty vehicles used in the mining and defence sectors.

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We expect that going ahead overall bottomline growth in the next 3 years starting FY17 onwards should easily increase at a CAGR of 25-30% and with capex largely expected to be funded from internal accruals and hence we believe that net cash flows generated will remain healthy going ahead. The ROE and ROCE is also expected to improve to 14% and 15% and 18% and 19% by FY19 and FY20.

Going ahead we expect RKFL's earnings to grow at a 25-30% over FY17-20E led by a rising healthy Topline growth, prudent product shift strategy, and more importantly savings in interest costs as the company plans to repay some debt in the coming two years.

The GNAAL stock trades at a P/E of 11x and 9x based on FY19E and FY20E, which looks attractive considering its strong execution capability, consistent financial track record and healthy industry trends in the Axles Shafts sector where GNAAL looks poised to do well considering its size of operations, global clients, domestic clients and significant improvement expected from expanded capacities which will drive earnings ahead in the next 2-3 years.

Hence we believe that the GNAAL stock should be purchased at the current price for a price target of around Rs 375 over the next 12 to 15 months.



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FINANCIALS

For the Year Ended March RsCrS	FY17A	FY18E	FY19E	FY19E
Net Sales	513.4	590.41	696.68	822.09
EBIDTA	80.42	92.69	111.47	131.53
EBIDTA %	15.66	15.70	16.00	16.00
Interest	12.52	8.00	6.00	5.00
Depreciation	23.94	30.00	36.00	41.00
Non Operational Other Income	2.90	3.00	5.00	5.00
Profit Before Tax	46.86	57.69	74.47	90.53
Profit After Tax	29.57	42.5	54.00	65.1
Diluted EPS (Rs)	13.78	19.80	25.16	30.34
Equity Capital	21.46	21.46	21.46	21.46
Reserves	275.44	317.94	371.94	437.04
Borrowings	98.00	73.00	48.00	43.00
GrossBlock	134.27	174.27	194.27	214.27
Investments	0.66	0.66	0.66	0.66

Source Company our Estimates

KEY CONCERNS

Slowdown in the US Class-8 trucks

Loss of any existing Export orders could also impact GNAAL's profitability negatively



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