Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

GNA Axles Ltd

Weak Q3, but outlook positive

Automobiles	Sharekhan code: GNA
Reco/View: BUY ↔	CMP: Rs. 558	Price Target: Rs. 720 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↑	

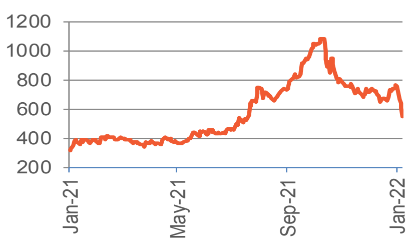
Company details

Market cap:	Rs. 1,198 cr
52-week high/low:	Rs. 1,107 / 339
NSE volume: (No of shares)	1.88 lakh
BSE code:	540124
NSE code:	GNA
Free float: (No of shares)	0.70 cr

Shareholding (%)

Promoters	67.5
FII	2.0
DII	10.1
Others	20.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-24.5	-48.3	17.5	73.0
Relative to Sensex	-29.8	-49.8	2.1	45.7

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on GNA Axles Limited (GNA) with a revised PT of Rs. 720, led by positive CV and farm sector outlook in India and globally.
- Q3FY2022 results were below expectations, marred by weak class-8 truck sales and muted growth in domestic tractors.
- While remaining positive on the company's growth prospects in the medium term, we have the built the impact of near-term slowdown in demand and accordingly cut our FY22E and FY23E estimates by 16.2% and 12.3% respectively.
- The stock is trading below its historical average multiples at P/E of 10.1x and EV/EBITDA of 5.9x of its FY2023 estimates.

GNA Axles Limited (GNA) posted a weak performance in Q3FY2022, led by 14.7% lower sales than expectations and a 170 bps sharper contraction in EBITDA margins than expected. Weak class 8 truck sales (led by supply constraints) and muted growth in tractor segment led to GNA's lower revenue, while margins were hurt due to negative operating leverage. The company reported a PAT of Rs16.7 crore in Q3FY22, which is a decline of 37.4% y-o-y and 31.9% q-o-q. However, we maintain our positive stance on the company and expect revenues and profitability to come back in Q4FY2022. The company has exposure to domestic tractors and CV markets, which are expected to remain buoyant going forward. Management expects to see 30-35% growth in FY2022E, driven by global sales and recovery in domestic markets. The recent correction of ~30% in the stock price provides a comfortable valuation for fresh positions. We reiterate our Buy rating on the stock.

Key positives

- The gross margins improved 120 bps q-o-q to 30.5% in Q3FY22.

Key negatives

- The company's revenue was impacted by weak class 8 truck sales, led by supply constraints, and muted growth in domestic tractor segment (due to high base).
- EBITDA margin declined 150bps q-o-q to 12.8% in Q3FY22, due to higher other expenditures, partially offset by lower employee expenses and expansion in gross margins.

Revision in estimates – We have the built the impact of near-term slowdown in demand and accordingly cut our FY22E and FY23E estimates by 16.2% and 12.3% respectively. GNA's earnings are likely to post a robust 29.8% CAGR from FY2021-FY2023E, driven by a 24.3% revenue CAGR and sustainable EBITDA margins above 16%.

Our Call

Valuation – Maintain Buy with a revised PT of Rs.720: GNA is expected to witness strong traction from domestic and global original equipment manufacturers (OEMs), driven by recovery in US's and Europe's CV market and India's tractor market. The outlook remains positive with strong recovery expected from FY2022E and FY2023E, driven by the normalisation of economic activities. Operating profit margin (OPM) would expand due to operating leverage and cost-control measures. The stock has corrected ~30% in last one month, on concerns of rising COVID cases globally. We believe the company's valuations are comfortable at P/E multiple of 10.1x and EV/EBITDA multiple of 5.9x of its FY2023E estimates. We reiterate our Buy rating on the stock with a revised PT of Rs.720.

Key Risks

GNA's revenue is heavily dependent on US and European markets, so any material change in these markets can impact its revenue and profitability. Moreover, rise in COVID pandemic (omicron) in India and globally may restrict movement and adversely impact our earnings estimates.

Valuation (Consolidated) Rs cr

Particulars	FY2021	FY2022E	FY2023E	FY2024E
Net Sales	890	1,173	1,374	1,613
Growth (%)	(2.1)	31.9	17.1	17.4
EBIDTA	144	170	218	260
OPM (%)	16.2	14.5	15.9	16.1
Recurring PAT	71	87	119	149
Growth (%)	33.9	22.6	37.4	25.3
EPS (Rs)	32.9	40.3	55.4	69.4
PE (x)	17.0	13.8	10.1	8.0
P/BV (x)	2.4	2.0	1.7	1.5
EV/EBIDTA (x)	9.2	7.8	5.9	4.7
ROE (%)	13.9	14.8	17.2	18.2
ROCE (%)	15.3	16.6	20.2	21.6

Source: Company; Sharekhan estimates

Q3FY2022 results were below expectations: GNA posted a weak performance in Q3FY2022, led by 14.7% lower sales than expectations and a 170 bps sharper contraction in EBITDA margins than expected. Net revenue was up by 9.1% y-o-y at Rs. 301 crore, driven by weak class 8 truck sales (led by supply constraints owing to chips shortage), and muted growth in domestic tractor segment (due to high base). EBITDA margin declined 150bps q-o-q to 12.8% in Q3FY22, due to higher other expenditures, partially offset by lower employee expenses and expansion in gross margins. On y-o-y basis, the EBITDA margin contracted 470 bps in Q3FY2022. The gross margins improved 120 bps q-o-q to 30.5% in Q3FY22. The company reported a PAT of Rs16.7 crore in Q3FY22, which is a decline of 37.4% y-o-y and 31.9% q-o-q.

Management expectations: Earlier to Q3FY22 results, the management has guided for 30-35% revenue growth in FY2022, driven by robust export markets and recovery in domestic markets. The company is currently operating at 70-75% capacity utilisation and does not plan any major capex in the medium term. The company will prefer to increase capacity by ~10% through debottlenecking.

GNA to continue to gain market share in CV exports: GNA's CV export business has grown strongly with the company growth outpacing the industry. The export business registered a strong 27% CAGR over FY2016-FY2020.

SUV segment to provide incremental growth opportunity: GNA's foray into the SUV segment would act as an incremental growth driver going forward. GNA would supply SUV axle shafts to its existing CV customers (in export markets) who are already in the SUV business. Entry into the SUV segment would not only provide an additional growth avenue but will also de-risk its business model by reducing the cyclicality of the CV segment. Further, the company plans to move into the domestic SUV segment in the second phase.

Earnings cut owing to near term challenges: We maintain our positive stance on the company and expects revenues and profitability to come back in Q4FY2022. The company has exposure to domestic tractors and CV markets, which are expected to remain buoyant going forward. We have the built the impact of near-term slowdown in demand and accordingly cut our FY22E and FY23E estimates by 16.2% and 12.3% respectively. GNA's earnings are likely to post a robust 29.8% CAGR from FY2021-FY2023E, driven by a 24.3% revenue CAGR and sustainable EBITDA margins above 16%.

Change in estimates Rs cr

Particulars	Revised		Earlier		% Change	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Revenue	1,173	1,374	1,173	1,440	-	(4.6)
EBITDA	170	218	192	241	(11.6)	(9.3)
EBITDA margin	14.5	15.9	16.4	16.7	(190 bps)	(80 bps)
PAT	87	119	103	136	(16.2)	(12.3)
EPS	40.3	55.4	48.1	63.2	(16.2)	(12.3)

Source: Company Data; Sharekhan Research

Results (Consolidated) Rs cr

Particulars	Q3FY22	Q3FY21	%YoY	Q2FY22	%QoQ
Revenues	301.3	276.0	9.1	339.8	-11.3
Total Expenses	262.8	227.9	15.3	291.3	-9.8
EBIDTA	38.5	48.2	-20.1	48.4	-20.5
Depreciation	12.6	10.2	23.8	12.6	0.2
Interest	2.8	2.2	23.9	3.0	-6.8
Other Income	0.0	0.3	-100.0	0.0	-100.0
PBT	23.1	36.0	-35.8	32.9	-29.8
Tax	6.4	9.4	-31.3	8.4	-23.4
Adjusted PAT	16.7	26.6	-37.4	24.5	-31.9
EPS	7.8	12.4	-37.4	11.4	-31.9

Source: Company Data; Sharekhan Research

Key Ratios (Consolidated)

Particulars	Q3FY22	Q3FY21	YoY (bps)	Q2FY22	QoQ (bps)
Gross margin (%)	35.0	37.0	(200)	33.8	120
EBIDTA margin (%)	12.8	17.4	(470)	14.2	(150)
EBIT margin (%)	8.6	13.8	(520)	10.5	(200)
Net profit margin (%)	5.5	9.7	(410)	7.2	(170)
Effective tax rate (%)	27.8	26.0	180	25.5	230

Source: Company Data; Sharekhan Research

Outlook and Valuation

■ Sector outlook – Buoyant demand for CV and farm sector

We see a strong underlying demand for CVs domestically. We expect the strongest recovery in the CV segment in FY2022 and FY2023, driven by improved economic activities, low interest rate regime, and better financing availability. We expect strong improvement in M&HCV sales to continue, driven by rise in e-commerce, agriculture, infrastructure, and mining activities. Global demand for trucks is expected to remain buoyant, aided by increasing traction in class 8 truck order books. Most global OEMs and auto component suppliers maintain a positive outlook for the CV industry. Moreover, domestic tractor markets are expected to remain buoyant because of higher farm income, good Rabi harvesting, and expectation of strong monsoon this year.

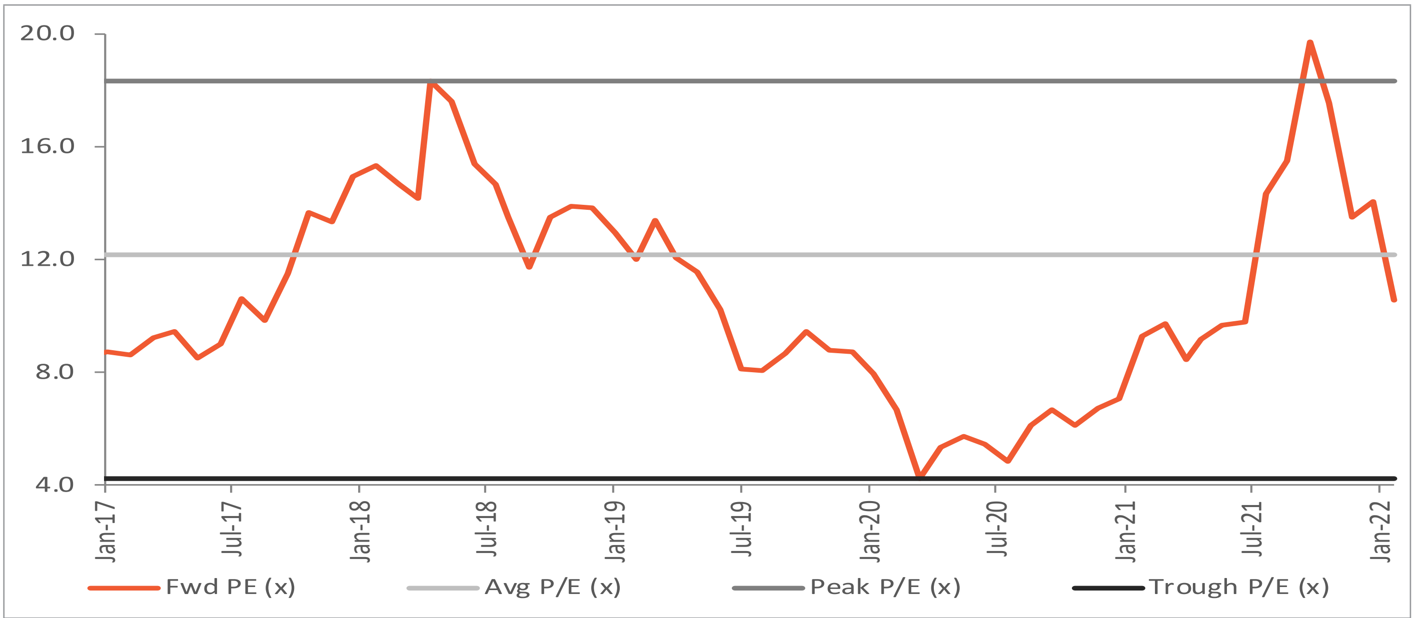
■ Company outlook – Strong earnings growth

We expect GNA to benefit from the CV upcycle across geographies – India, North America, and Europe, led by improved prospects of CV globally. Global OEMs and tier-1 suppliers maintain a positive outlook for the CV segment. GNA has been gaining market share in exports due to comparatively low-cost advantage. The company has been winning higher business from clients, driven by establishing product reliability and quality. Moreover, a foray into SUV provides an incremental growth opportunity for GNA. The company would supply to existing export CV customers who also manufacture SUV. The company has a strong long-term revenue visibility, given its strong relationships with OEMs, both in India and globally. We expect GNA's earnings to post a 38.6% CAGR from FY2021-FY2023E, driven by a 27.2% revenue CAGR and a 50-bps improvement in EBITDA margin.

■ Valuation – Maintain Buy with a revised PT of Rs.720

GNA is expected to witness strong traction from domestic and global original equipment manufacturers (OEMs), driven by recovery in US's and Europe's CV market and India's tractor market. The outlook remains positive with strong recovery expected from FY2022E and FY2023E, driven by normalisation of economic activities. Operating profit margin (OPM) would expand due to operating leverage and cost-control measures. The stock has corrected ~30% in last one month, on the concerns of rising COVID cases globally. We believe the company's valuations are comfortable at P/E multiple of 10.1x and EV/EBITDA multiple of 5.9x of its FY2023E estimates. We reiterate our Buy rating on the stock with a revised PT of Rs.720.

One-year forward P/E (x) band



Source: Company Data; Sharekhan Research

Peer Comparison

Particulars	CMP (Rs / Share)	P/E (x)			EV/EBITDA (x)			RoCE (%)		
		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
GNA Axles	558	17.0	13.8	10.1	9.2	7.8	5.9	15.3	16.6	20.2
Gabriel India	140	36.9	20.0	15.8	17.3	11.0	8.7	11.8	17.8	20.0
Greaves Cotton	229	337.7	68.4	30.9	63.7	34.2	18.5	3.8	14.9	21.0
Mayur Uniquoters	531	27.1	19.6	15.8	17.3	12.5	9.8	20.6	24.0	25.7

Source: Company Data; Sharekhan Research

About company

GNA is one of the leading manufacturers of rear axle shafts, spindles, and splined shafts. GNA has a large variety of axle shafts ranging from 1.5kg to 65kg and capacity to produce up to 165kg, producing about 2 million axle shafts annually. Rear axle shafts account for 82.7% of revenue, while spindles and drive shafts account for 11.6% and 5.7% of revenue, respectively. The company primarily caters to the requirements of CVs and tractor segments in the domestic and exports markets. CV domestic sales constitute 5% of the company's total sales, while CV exports constitute 50% of sales. Similarly, tractor domestic sales constitute 40%, while tractor exports account for 6% of the company's sales.

Investment theme

GNA is witnessing demand improvement in both domestic as well as export markets. In the domestic market, tractor demand has recovered strongly with double-digit growth reported in FY2021. Increased Kharif sowing and good monsoons have resulted in higher income for farmers. In export markets, truck demand is improving in both key markets of US and Europe. Truck sales have almost reached pre-COVID levels of February 2020. USA Class 8 truck orders have also risen on both y-o-y and m-o-m basis over the past three quarters, which indicates a strong recovery in truck demand going ahead. With normalisation of economic activities, we expect revenue to grow in strong double digits in FY2022. Moreover, GNA is expected to continue gaining market share in exports, driven by product quality, low-cost advantage, and financial distress of competitive players in export markets. Foray into the SUV business would also drive exports. Return ratios are expected to improve significantly, driven by demand improvement, minimal capex, and reduction in debt. Hence, we reiterate our Buy rating on GNA.

Key Risks

- GNA's revenue is heavily dependent on US and European markets, so any material change in these markets can impact its revenue and profitability.
- The reoccurrence of COVID pandemic in India may put a restriction on movement and can adversely impact our earnings estimates for the company.
- If GNA is unable to pass on rising steel prices to its OEMs, it can impact its profitability.

Additional Data

Key management personnel

Mr Gursaran Singh	Executive Chairman
Mr. Jasvinder Singh	Executive Vice Chairman
Mr Ranbir Singh	CEO & Whole time Director
Mr Maninder Singh	Additional Director
Mr Rakesh Kumar Gupta	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Jasvinder Singh Seehra	15.3
2	Ranbir Singh	14.9
3	Gurdeep Singh	14.6
4	Maninder Singh	11.4
5	Gursaran Singh	8.1
6	HDFC Asset Management Co	6.1
7	Sundaram Mutual Fund	2.0
8	IDFC Emerging Business	1.5
9	Kuwin Seehra	1.0
10	Keerat Seehra	1.0

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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