

Initiating Coverage RACL Geartech Ltd.

December 30, 2022





Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Auto Ancillaries	Rs 715	Buy in Rs 710-725 band & add more on dips in Rs 640-655 band	Rs 785	Rs 855	2-3 quarters

HDFC Scrip Code	RACGEAEQNR
BSE Code	520073
NSE Code	NA
Bloomberg	RAC IN
CMP Dec 29, 2022	715.3
Equity Capital (Rs cr)	10.8
Face Value (Rs)	10
Equity Share O/S (cr)	1.1
Market Cap (Rs cr)	771
Book Value (Rs)	135.4
Avg. 52 Wk Volumes	8700
52 Week High (Rs)	811.0
52 Week Low (Rs)	444.4

Share holding Pattern % (Sep 2022)	
Promoters	53.4
Institutions	0.1
Non Institutions	46.5
Total	100.0



HDFCsec Retail research
stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

RACL Geartech Ltd. (RGL) is one of the leading automotive gear manufacturers in India. It has created a niche market to cater to clients who need an excellent quality product at value based pricing structure & 100% on-time performance. The company focuses on manufacturing high quality unique products which fetch a higher margin. The company has also made a name in the international market by exporting around 65-70% of its products across developed economies like Germany, Japan, Switzerland, Italy, USA, Austria, Thailand among others. RACL is catering to the world's top brands like BMW, KTM, Kubota, BRP Rotax, Piaggio & Yamaha to name a few.

RGL has also ventured into chassis, suspension and steering components and sub-assemblies for passenger cars and engine gears for heavy commercial vehicles in FY22. The company expects share for PV/HCV products to increase from 0/2% currently to 9/8% over the next 2 years. Recently RGL added ZF as a customer, which is among the largest car parts suppliers in the world. It has been getting increasing orders from ZF. Capacity expansion is done only after receiving firm orders curtailing idle capacity and protecting the company from taking unnecessary debt. RGL targets to become a Rs 500cr company by FY25 (vs Rs 271cr in FY22).

Valuation & Recommendation:

RGL has maintained a strong and profitable growth track record. We expect RGL's Revenue/EBITDA/PAT to grow at 20/22/19% CAGR over FY22-FY25E, led by increased demand from existing customers and addition of new clients. We believe investors can buy the stock in Rs 710-725 band and add on dips in Rs 640-655 band (18.5x Sep'24E EPS) for a base case fair value of Rs 785 (22.5x Sep'24E EPS) and bull case fair value of Rs 855 (24.5x Sep'24E EPS) over the next 2-3 quarters.

Financial Summary

(Rs cr)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	FY22	FY23E	FY24E	FY25E
Operating Income	87.7	69.0	27.1	78.2	12.1	271.2	347.2	409.7	467.0
EBITDA	20.3	15.4	32.2	15.1	35.1	57.1	75.3	90.1	104.6
APAT	9.9	6.5	51.4	6.0	63.4	23.9	29.7	35.1	40.3
Diluted EPS (Rs)	9.2	6.0	51.4	5.6	63.4	22.2	27.5	32.5	37.3
RoE-%						19.9	20.4	19.9	19.0
P/E (x)						32.3	26.0	22.0	19.2
EV/EBITDA (x)						16.3	12.9	11.0	9.6

(Source: Company, HDFC sec)



Q2FY23 Result Review

RGL reported strong numbers for Q2FY23 with highest ever quarterly consolidated revenue of Rs 88cr, up by 27% YoY led by strong demand from existing customers and addition of new customer ZF in June-July. EBITDA increased by 32% YoY to Rs 20cr and EBITDA margin expanded 90bps to 23.2% on account of lower material costs. PAT for the quarter came in at Rs 10cr, up 51% YoY while PAT margin expanded 181bps to 11.3%. New capacity utilisation was to the tune of 70%.

Key updates

Established player in transmission gears and shafts for automotive and industrial applications

RGL is engaged in the business of manufacturing of transmission gears and shafts for automotive and industrial applications since 1980s. The company has renowned Original Equipment Manufacturers (OEMs) in the auto as well as industrial segment as its long-standing customers. It has an established relationship with some of the leading global original equipment manufacturers (OEMs) which cater to the premium segment. RGL's business risk profile has improved over the years by adding new customers, by increasing its product portfolio and entering into new segments of automobile industry. The addition in customer base was supported by supply of quality products while adhering to international standards laid down by international quality assessment team.

New programs to drive incremental revenue

RGL has bagged some significant programs over the last couple of quarters which has the potential to significantly increase its revenue potential over the coming years. Some of the important programs bagged by the company are:

- Chassis components from ZF for a European Luxury Car Manufacturer. SOP has started, investments common with the capacity already installed for ZF BMW project.
- Steering Shafts for Rear Steering Actuator from ZF for Porsche. SOP to start middle of next year.
- Chassis Components from ZF for BMW. It is a high volume part with projected annual volume upto 700k/year.
- Transmission Components from ZF for a resourcing project. SOP to start middle of next year.
- Entire transmission assembly for a 440cc Italian motorbike being launched in India. SOP middle of next year.
- Harvester Combine parts for Escorts Kubota. SOP to start by next year 2023.

It is also in discussion with one of the largest European car manufacturer for direct supplies for electric vehicle platform.

European energy crisis – blessing in disguise

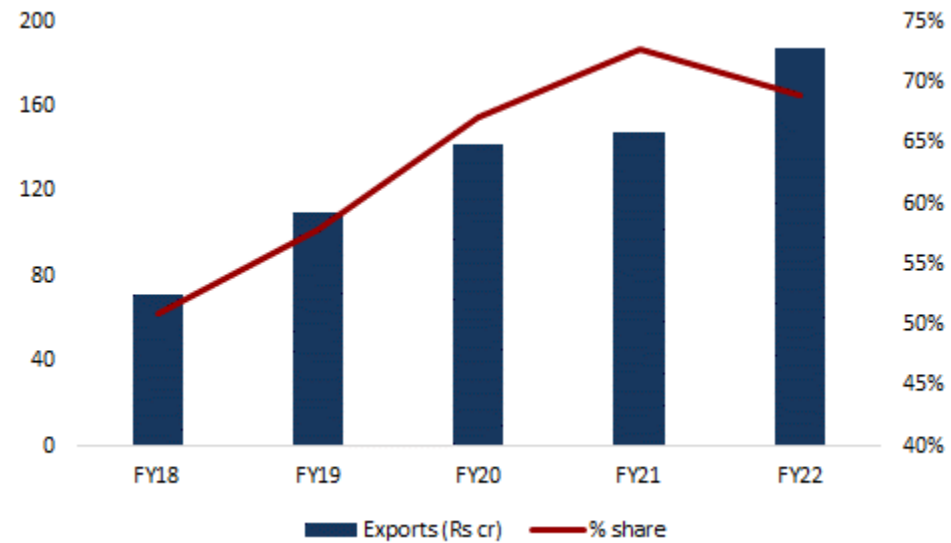
The energy crisis which has hit European nations could prove to be a blessing in disguise for companies like RGL. The cost of production of parts have increased by a multiple of 4-5x for many Europe based companies. These parts were being produced in-house as it required a high level of precision and durability. Many companies who were producing critical products in-house are now looking to outsource. RGL could benefit out of this as it has experience in manufacturing niche products requiring high precision levels and at lower costs.



Growing exports despite pandemic slowdown

Despite the slowdown in the automotive and industrial segments induced by the pandemic over FY21 and FY22, RGL's revenue remained strong aided by growing exports. While the overall revenue increased by 18% CAGR over FY18-FY22, exports grew by 27% CAGR. The share of exports in the overall revenue pie stood at 69% in FY22 as compared to 51% in FY18. The growing share indicates the capabilities of the company to cater to premium OEM through its niche product portfolio.

Export growth trend



(Source: Company, HDFC Sec)

Capacity expansion only after receiving firm order

RGL undertakes capacity expansion only after it has revenue visibility. This curtails the idle time of the plant and protects the margins as the company does not have to lower rates to keep the plant running. Since it is into niche and high precision product manufacturing, catering to the premium segment, clients prefer quality of product and are not in a hurry. This strategy ensures judicious and justified capital expenditure and prevents the company from taking unnecessary debts. RGL has laid out a Rs 60cr capex plan for FY23 and aims an asset turn of 2 over the medium term.



EV share to increase

RGL currently has a share of ~2% in the 2W EV segment. It has got new orders for 2W EV and the company is in advanced talks with some EV makers. It expects its share from 2W EV to increase from 2% to ~4% by FY24.

High end luxury OEMs as their clientele

Due to its niche manufacturing capabilities RGL is preferred supplier for some of the luxury OEMs like BMW, Kubota, DANA, Lamborgini in international markets & Honda, Yamaha, KTM & Piaggio in domestic markets. Such marquee clients speaks volumes of management quality, technological edge & strong execution capabilities. In 2 wheelers RACL is mainly present in high end racing bikes. In trucks, MAN and Scania are recent addition to customer list.

Key clients



(Source: Company, HDFC Sec)



Risks & Concerns

Slowdown in automobile industry

RGL supplies mainly to automobile manufacturers and the share of industrial gears is small. Any slowdown in the automobile industry could impact its growth. RGL's hands are tied down with the handling this automotive growth, and hence it has not been able to focus on industrial segment although it is working with the top brands in the world like GE.

Currency fluctuations

RGL derives ~65-70% of its revenues from supplies to overseas clients which has been increasing. Any adverse changes in the exchange rate could impact earnings of the company. With its customers also it has Foreign Exchange and Raw Material Indexation. Which saves RGL from large moves in raw material and forex rates.

Raw material price volatility

Sharp increase in raw material prices could hurt its performance as there is a lag effect in passing on the increase to its clients.

Susceptibility to pricing pressure from OEMs and peers

GIL may not able to pass on the increase in costs easily to OEMs and remains susceptible to increasing competition in the auto component segment, and pricing pressures from auto OEMs.

Slowdown in Europe could impact RGL's growth as Europe (55% of sales) is a big market for them.

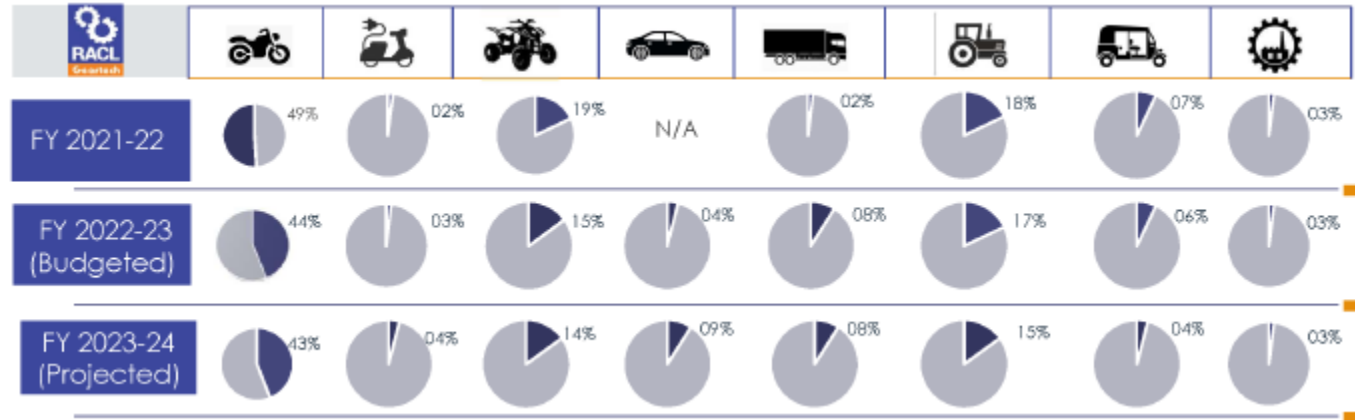
Company Background:

RGL (formerly Raunaq Automotive Components Limited) was incorporated in 1983 and is engaged in the business of manufacturing of transmission gears and shafts for automotive and industrial applications. The company was initially promoted by the Raunaq Group. However, due to financial difficulties the company was referred to Board for Industrial and Financial Reconstruction (BIFR) in 2001. Post-restructuring and with a new management team under leadership of Mr Gursharan Singh (CMD), RGL came out of the BIFR purview in November 2007. The company has also expanded into sub-assemblies, industrial Gears for electrical switch Gears and Circuit Breakers, Winches and Cranes.

RGL has two manufacturing locations, one is in Noida and the other one is in Gajraula which is the mother plant. It has got three warehouses in Europe. Overall, RGL supplies over 900 different parts to 22 active customers. RGL has an overseas subsidiary RACL Geartech GmbH Austria.

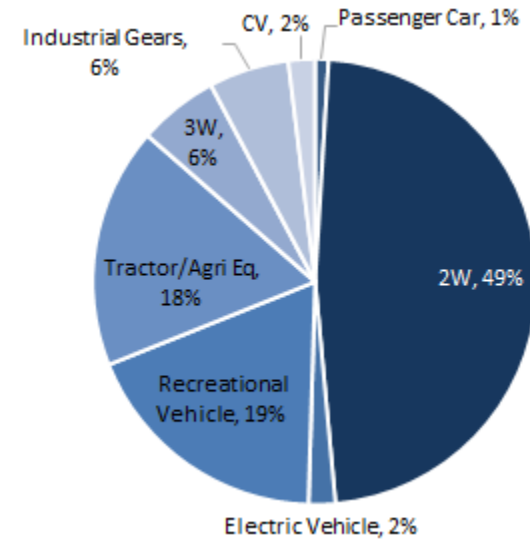


Customer segmentation and market share



(Source: Company, HDFC Sec)

Revenue breakup (FY22)



(Source: Company, HDFC Sec)



Financials

Income Statement

(Rs cr)	FY21	FY22	FY23E	FY24E	FY25E
Net Revenues	203.6	271.2	347.2	409.7	467.0
Growth (%)	-4.1	33.2	28.0	18.0	14.0
Operating Expenses	152.6	214.1	271.8	319.5	362.4
EBITDA	51.0	57.1	75.3	90.1	104.6
Growth (%)	24.1	12.0	31.8	19.6	16.1
EBITDA Margin (%)	25.1	21.1	21.7	22.0	22.4
Depreciation	16.4	15.7	19.9	23.9	27.7
Other Income	4.1	3.9	5.2	6.1	7.0
EBIT	38.7	45.3	60.6	72.3	83.9
Interest expenses	8.5	12.4	20.9	25.4	30.1
PBT	30.2	32.9	39.7	46.9	53.8
Tax	6.7	9.0	10.0	11.8	13.6
Adj. PAT	23.5	23.9	29.7	35.1	40.3
Growth (%)	38.4	1.8	24.2	18.1	14.8
EPS	19.9	22.2	27.5	32.5	37.3

Balance Sheet

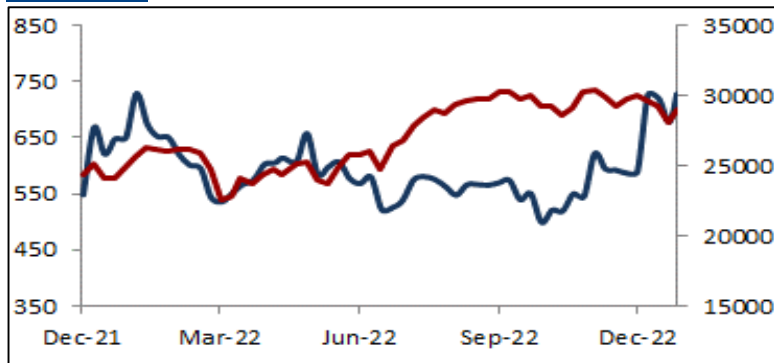
(Rs cr)	FY21	FY22	FY23E	FY24E	FY25E
SOURCE OF FUNDS					
Share Capital	11.8	10.8	10.8	10.8	10.8
Reserves	97.3	120.6	148.9	182.3	220.6
Shareholders' Funds	109.0	131.4	159.7	193.1	231.4
Total Debt	106.1	161.8	221.8	276.8	324.8
Net Deferred Taxes	5.3	6.7	6.7	6.7	6.7
Other Non-curr. Liab.	2.3	1.6	2.0	2.4	2.7
Total Sources of Funds	222.7	301.6	390.3	479.0	565.7
APPLICATION OF FUNDS					
Net Block & Goodwill	141.4	177.5	214.6	236.6	259.4
CWIP	0.8	3.9	2.0	1.0	0.5
Investments	0.0	0.0	0.0	50.0	100.0
Other Non-Curr. Assets	9.2	7.5	9.7	11.4	13.0
Total Non Current Assets	151.5	189.0	226.2	299.0	372.9
Inventories	42.5	56.7	76.1	92.0	102.4
Debtors	55.2	76.9	97.0	112.2	121.5
Cash & Equivalents	0.8	0.7	18.6	5.5	4.7
Other Current Assets	22.3	27.8	36.0	43.1	48.8
Total Current Assets	120.7	162.2	227.7	252.9	277.4
Creditors	28.1	29.2	34.2	39.3	47.3
Other Current Liab & Provisions	21.4	20.5	29.3	33.6	37.2
Total Current Liabilities	49.5	49.6	63.6	72.9	84.6
Net Current Assets	71.2	112.6	164.1	180.0	192.8
Total Application of Funds	222.7	301.5	390.3	479.0	565.7



Cash Flow Statement

(Rs cr)	FY21	FY22	FY23E	FY24E	FY25E
Reported PBT	24.0	23.4	39.7	46.9	53.8
Non-operating & EO items	-0.4	0.0	-1.7	-1.4	-1.3
Interest Expenses	8.5	12.4	20.9	25.4	30.1
Depreciation	16.4	15.7	19.9	23.9	27.7
Working Capital Change	-16.4	-47.2	-33.7	-29.0	-13.6
Tax Paid	6.9	7.6	-10.0	-11.8	-13.6
OPERATING CASH FLOW (a)	39.0	11.8	35.2	54.0	83.2
Capex	-48.6	-55.9	-55.0	-45.0	-50.0
Free Cash Flow	-9.6	-44.1	-19.8	9.0	33.2
Investments	0.0	0.0	0.0	-50.0	-50.0
Non-operating income	0.0	0.0	0.0	0.0	0.0
INVESTING CASH FLOW (b)	-48.6	-55.9	-55.0	-95.0	-100.0
Debt Issuance / (Repaid)	19.2	56.3	60.0	55.0	48.0
Interest Expenses	-8.5	-12.3	-20.9	-25.4	-30.1
FCFE	1.2	-0.1	19.3	-11.4	1.1
Share Capital Issuance	0.0	0.0	0.0	0.0	0.0
Dividend	-1.1	0.0	-1.4	-1.7	-1.9
Others	0.0	0.0	0.0	0.0	0.0
FINANCING CASH FLOW (c)	9.7	44.0	37.7	27.8	16.0
NET CASH FLOW (a+b+c)	0.1	-0.1	17.9	-13.1	-0.8

Price chart



Key Ratios

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Profitability Ratios (%)					
EBITDA Margin	25.1	21.1	21.7	22.0	22.4
EBIT Margin	19.0	16.7	17.5	17.7	18.0
APAT Margin	11.5	8.8	8.6	8.6	8.6
RoE	24.2	19.9	20.4	19.9	19.0
RoCE	20.7	17.8	18.0	17.0	16.4
Solvency Ratio (x)					
Net Debt/EBITDA	2.1	2.8	2.7	3.0	3.4
Net D/E	1.0	1.2	1.3	1.4	1.5
Per Share Data (Rs)					
EPS	19.9	22.2	27.5	32.5	37.3
CEPS	33.9	36.7	46.0	54.7	63.0
BV	92.5	121.8	148.0	179.0	214.5
Dividend	1.0	1.0	1.3	1.6	1.8
Turnover Ratios (days)					
Debtor days	98	89	91	93	94
Inventory days	75	67	70	75	78
Creditors days	42	39	33	33	33
VALUATION (x)					
P/E	35.9	32.3	26.0	22.0	19.2
P/BV	7.7	5.9	4.8	4.0	3.3
EV/EBITDA	17.2	16.3	12.9	11.0	9.6
EV / Revenues	4.3	3.4	2.8	2.4	2.2
Dividend Yield (%)	0.1	0.1	0.2	0.2	0.3
Dividend Payout (%)	5.0	4.5	4.7	4.9	4.8

(Source: Company, HDFC sec)



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclical of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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