JM JainMatrix Investments

A quality Report by JainMatrix Investments

RACL Geartech – Gearing up for Growth	**16th Aug 2021** **CMP: ₹482**
Sector: Auto Ancillary **Small Cap - Mkt cap of 520 Cr.** **Advice: BUY with a May 2023 target of ₹740, a 54% gain in 2 years**	

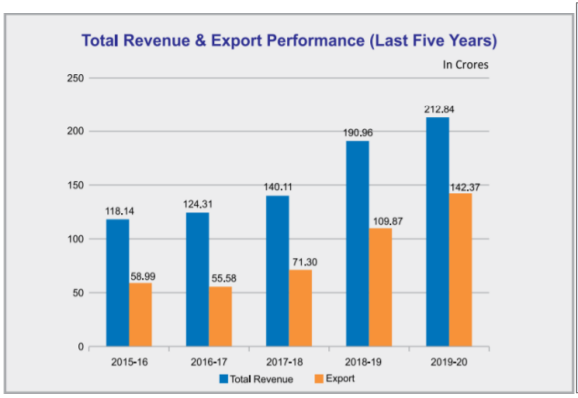
- **Summary:** The Auto & Auto ancillary sectors in India are a fast growing & globally competitive.
- **Why RACL:** It has a good client roster and a high quality perception in automotive gears. RACL works closely with customers to develop new products per specifications, and so should have sticky relationships, and be able to grow with its clients. Older clients have worked as strong reference for RACL, for new clients. The business segment mix indicates a lower cyclicity in revenues. While revenues are small at ₹204 crores, there is ample room to grow for RACL.
- **Why Now:** In the last 3 years, RACL has grown much faster than the domestic industry. It has customers in India and abroad, and in fact exports are higher. RACL is undertaking high capital expenditure, of ₹50 Cr. preparing for visible high growth.
- RACL looks overvalued, but a high growth in the next 3-4 years easily justifies a BUY at CMP.
- **Key Risks**: 1) Covid related disruptions, in the factories as well as customer demand 2) High receivables 3) Client concentration 4) Rising commodity prices can impact margins.
- **Opinion**: BUY with a May 2023 target of ₹740, a 54% gain in 2 years

Other Auto sector reports

- Indian Automobile Sector – A Solid Portfolio
- Motherson Sumi Systems – Global Auto Ancillary Growth

RACL Geartech – Description and Profile

- RACL Geartech Ltd. is a leading automotive gear manufacturer located in New Delhi.
- In FY'21, RACL had an income of ₹203.61 Cr. from Revenue as compared to ₹212.33 Cr. in FY'20. RACL PAT is ₹23.38 Cr. as compared to ₹16.98 Cr. in FY'20. See Fig 1(a).



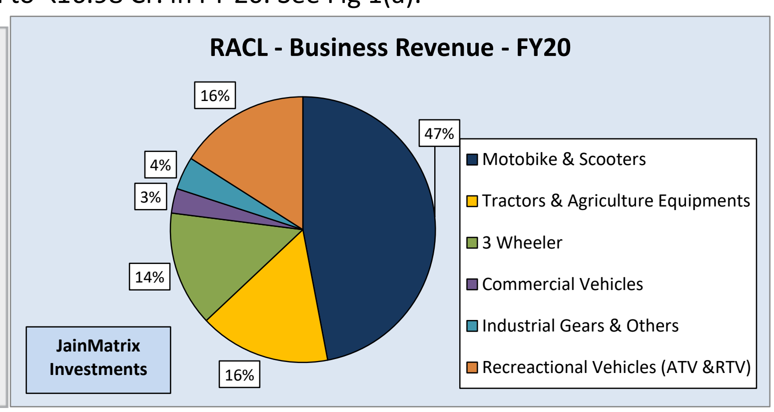


Fig 1(a): Revenue and Export Performance /Fig 1(b): Segment Revenue

- RACL is engaged in the business of making auto components like transmission gears and Shafts, Sub-assemblies, Precision Machined Parts and Industrial Components.
- RACL has mfg. units is located in Gajraula and Noida. Current Capacity utilization is 70-75%.
- Export sales of the RACL rose to 67.05%. Customer segments are mapped in Fig 1(b).
- RACL has invested over 74 Cr. in developing its mfg. unit stretched across an area of 8000 sq mts and comprising machines and equipment.
- RACL has already procured machinery and technology for BS6 & EV, which will allow the firm to smoothly transition into the new technologies.
- RACL has a long list of satisfied clients in countries like Japan, Germany, Italy, Switzerland, Austria, Thailand, UAE & Sri Lanka. See Fig 2(a).
- RACL is doing a 50 Cr. capex to venture into new segments i.e. EV, industrial gears for electrical switch gears, circuit breakers, winches and cranes. Auto Ancillary companies can do an Asset Turnover of 3-4X on fixed asset. The new capex can generate additional revenue of 200-250 Cr.
- RACL has 25 acres of surplus land within its existing plants, which can facilitate future capex.

Fig 2(a): Customers of RACL/ Fig 2(b): Products of RACL

- RACL is known for its high performance products, it has proven capabilities to achieve up to DIN grade 7 & JIS grade 4 gear accuracies with gear shaving process. See Fig 2(b).

- RACL has capabilities to produce complex gears & shafts up to DIN grade 5 or JIS grade 2 gear accuracies with state of the art FASSLER gear power honing process. (DIN is the short form for Deutsche Institut für Normung, or the German Institute for Standardization. On the other hand, JIS stands for Japanese Industrial Standards).
- RACL gives importance to quality, this uncompromising stand for excellence has been recognized and been awarded with ISO TS 16949 and ISO 14001 certifications.
- Current shareholding are Promoters 53%, MF/FII 0.1%, Retail/Individual 28.25%, HNI/Individual 6.49%, Other Public 11.84% and Others 0.01%.
- Key Leaders: Gursharan Singh (Age 59, CMD), Dev Raj Arya (Age 70, Director & CFO), Narinder Paul Kaur (Age 58, Non Exe. Non Ind. Director), Raj Kumar Kapoor (Age 67, Ind. director).

Industry Outlook:

- India became the #5 largest auto market in 2019 with sales reaching to 38.1 lakh units. It was the #7 largest maker of CVs in 2019.
- It has a vibrant domestic market for small cars and 2 wheelers, and the entire ecosystem had developed well from OEM, auto R&D/engineering services and auto ancillary manufacturers. Exports are also growing and offers good opportunity across the above 3 segments.
- However, the Indian auto sector registered a drop of nearly 18% in domestic sales in FY20. due to various amendments to emission norms, higher insurance costs, higher fuel prices and BS-VI shift. The Covid-19 outbreak has further added to woes for the industry.
- CRISIL Research projects domestic auto-component production revenues to decline by 15-17% in FY21. Volume demand from OEMs will decline by 13-24% across asset classes. Further, export demand is also expected to decline by 20% (in value terms) as more than 50% of our exports are to Europe and US and demand is expected to decline due to Covid-19 outbreak.
- The pandemic also paves the way for new opportunities in terms of other mobility verticals such as shared mobility, electric vehicles, connectivity solutions, after market, and vehicle leasing. Personal mobility modes will make a strong comeback. The demand for micro-mobility solutions, in particular, will surge in congested city environments.
- In the current context of Covid-19, the single or double seaters, like mopeds and scooters, offer riders better control over their health & wellness. Automakers are likely, therefore, to explore their potential as they attempt to draw up blueprints for a post-corona virus scenario.

Business Model, Events and Recent News

- In Apr’99, when Mr. Indu Kumar Pande was CMD, RACL had been badly affected due to low demand of vehicles and also due to a strike in a customer, Escorts Group for 4 months. The scale of losses was ₹5.4 cr., and there were few employees left in the company. But, due to one employee (Gursharan Singh) and his team’s persistence, RACL managed to survive. A few years later, Gursharan Singh met a potential client (Kubota, a leading Japanese player in tractors) on a flight and convinced them to give a small order. And that resulted in a recovery. RACL came out of BIFR in Nov’07. And they have turned around the business that had almost gone to the grave.
- RACL is growing in Gears & Shafts for Electric cars and Heavy CVs. In order to achieve plans, it is installing modern machinery and adopting advanced mfg. principles.

- RACL is fully prepared for EV and one of their customers is going into EV mass production in 1-2 months. RACL is hopeful that by next year, business shall be 3-4% in EV segment, even though the market share of EVs today is less than 1%.
- RACL has recently entered into the car segment, and bagged an order with BMW for a top end model. And this will be a futuristic hybrid car, which is being launched in 2022.
- **Client Wins:** RACL bagged TVS as a customer. TVS and BMW have entered into a JV for a 350 CC Motorbike, wherein RACL shall be the supplying some components.
- RACL have added Kawasaki India as customer.
- RACL added Escorts Kubota as a new customer in India. They have been working with Kubota since 2004 and now they have formed a JV. RACL has start supplies to them this year.
- RACL have added CF Moto which is a Chinese company and they have a (JV) with KTM and KTM is a big customer for RACL in Austria. Now KTM has entered Chinese market with CF Moto for a new project and RACL are the supplier for the transmission parts.
- RACL have Moto Guzzi, which is a Piaggio Company that makes high end smart sport bikes. Piaggio was already one of their big customers and now RACL will supply the group company.
- Another big addition to RACL customer list is ZF which is one of the biggest auto component mfg. firms. RACL shall be supplying chassis components to ZF. This is part of RACL diversification strategy as these parts shall be for cars segment. Also, ZF will remain a big customer because it has bagged 2-3 more projects from them for different end customers and new projects.
- RACL have further added MAN Trucks.
- RACL are aligned for future mobility solutions. They have adequate infrastructure in the form of Gear Grinding machines. RACL Gear Honing machines play a very important role in controlling the NVH and noise parameters in Electric mobility.
- RACL shall also be supplying some critical components for both electric and hybrid cars.
- RACL existing customers have launched some electric projects, and have a very minuscule presence as of now, but are moving into this.
- RACL have a vision of ₹500 Cr. turnover by 2025 and the team is working towards their target.

Stock Evaluation, Performance and Returns

Fig 3(a) - Price History

- We can see that from a low of ₹15.31 in June'15, to a high of ₹586.8 in July'21, the share has gained, generating high returns. 6 Yr. CAGR is 83.6%, which is good. See Fig 3(a).
- RACL has risen 5.97X in the last 1 year itself.

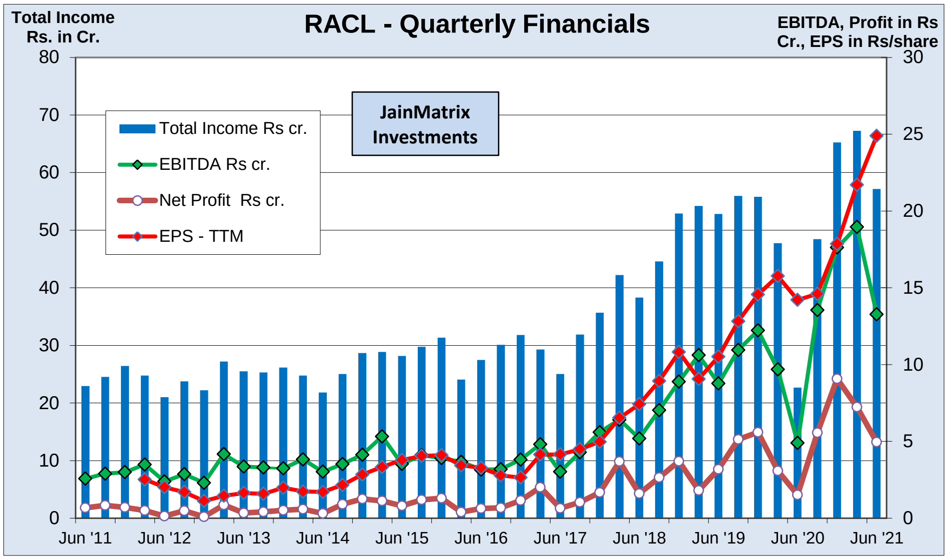


Fig 3(b) – Financials

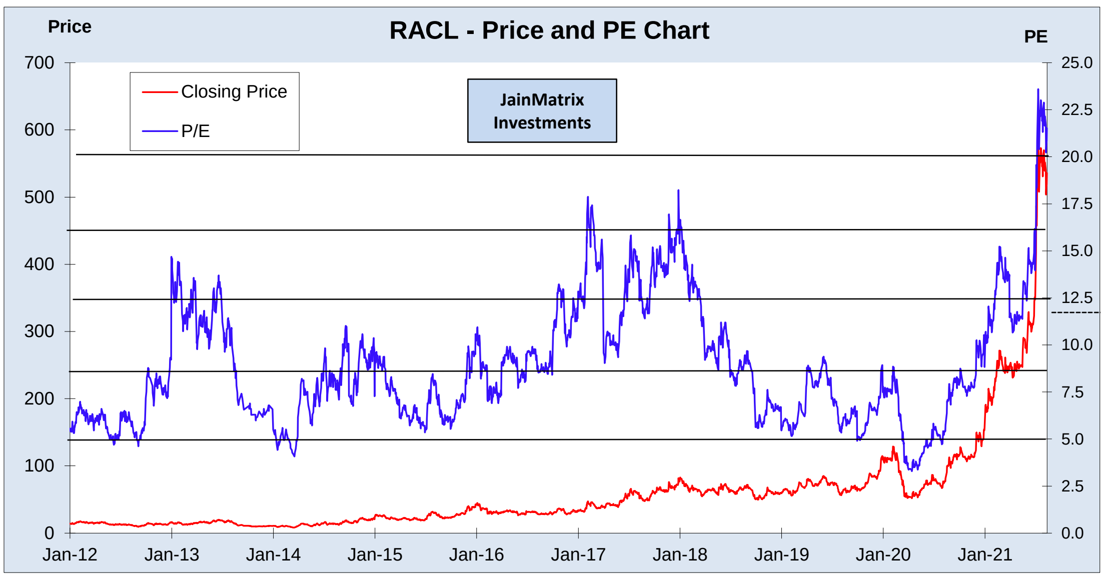
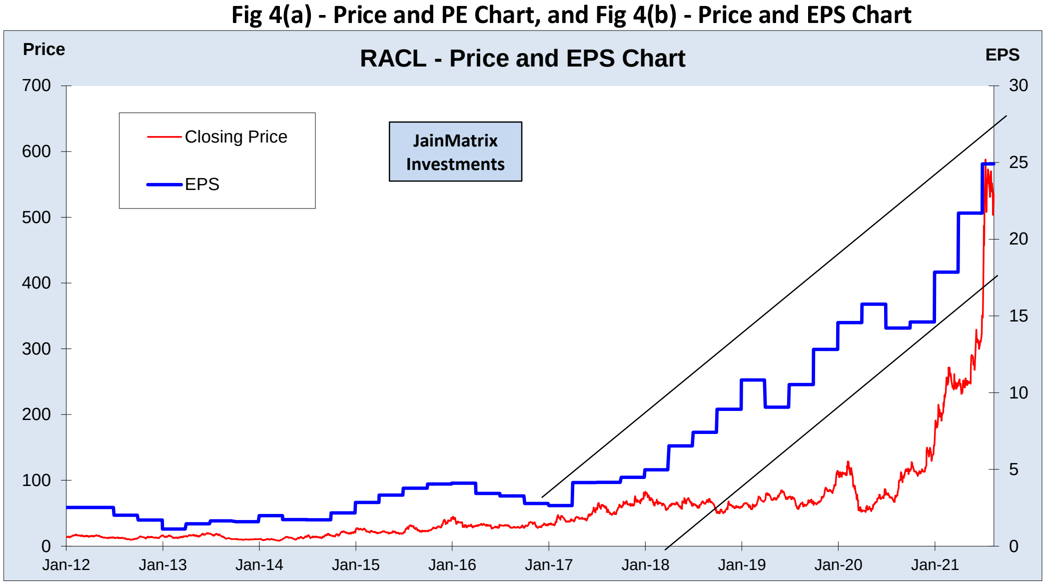


Fig 4(a) - Price and PE Chart, and Fig 4(b) - Price and EPS Chart



- RACL has posted net profit of ₹23.38 Cr. for Mar'21 as against profit of ₹16.98 Cr. for Mar'20.
- In Q1 FY22, RACL overall sales, EBITDA and profits were -15.0%, -30.0% and -31.5%. This is partly because of start of new financial year. On a YoY basis, the sales, EBITDA and profits were up 152.3%, 171.4% and 228.5%, up sharply due to the covid lockdown in Q1FY21. See Fig 3(b).
- RACL has reported EPS of ₹ 24.90 for Jun'22 as compared to ₹14.2 for Jun'20.
- In the Price and PE chart, Fig 4a, we can see that RACL PE ratio has a historical average of 12.5 times and range of 5-20 times. PE today is 19.4 times post Q1FY22 results, which is high and so the share appears overvalued. EPS has risen sharply over 4 years – see Fig 4b.
- Cash flow from operations is growing steadily over 3 years. However, investments too have risen sharply, so FCF of RACL has declined by FY21.
- Net Debt to Equity has reduced a little from 0.87x in Mar'20 to 0.8X in Mar'21.
- RACL has declared an equity dividend of 10% amounting to ₹1/Share.

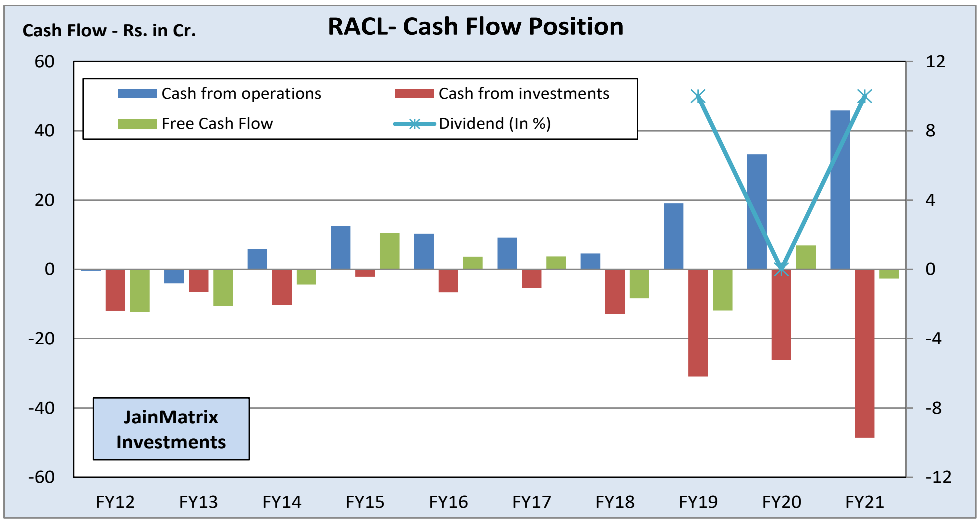


Fig 5(a) – Cash Flow

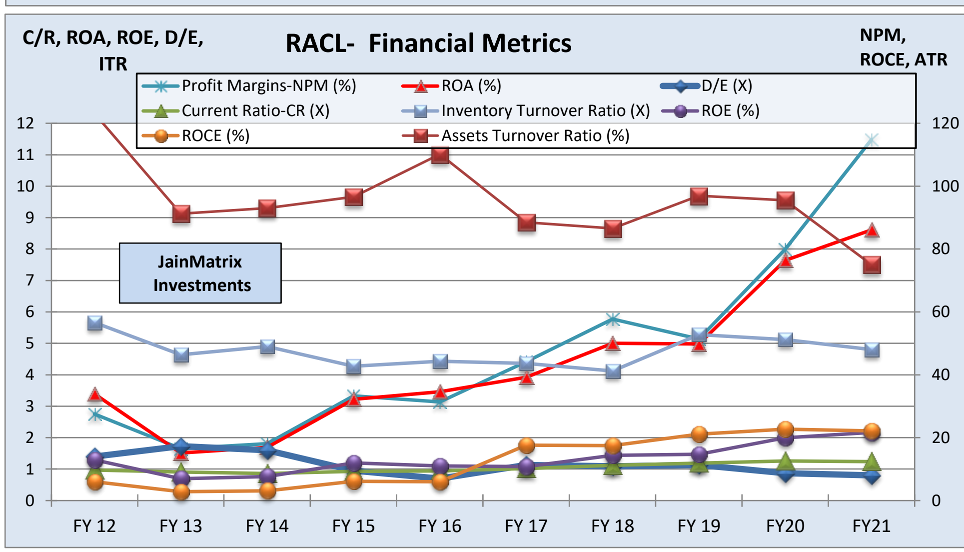


Fig 5(b) – Financial metrics

- See Fig. 5(b) for Financial Metrics, profit margins have increased from FY20 as demand grew.
- Inventory Turnover ratio have declined throughout the years due to Covid-19 pandemic.
- Asset Turnover ratio have declined 78.77% due to covid-19 pandemic.

- RoCE and RoE are in good range i.e., above 15%.
- RoA have increased to 12.69% as the demand grows and company expands its operation.

Benchmarking and Financial Projections

- In this exercise, we benchmarking RACL with listed peers of auto ancilliary sector. See Fig 6.

Particulars	RACL	JTEKT India	LG Balakrishnan	Shanthi Gears	Rane Madras	Bharat Gears	Shivam Auto	The Hi-Tech Gear	ZF Steering Gear
Sales (Rs. in Cr.)	203	1,332	1,608	215	1,267	503	487	745	201
EBITDA (Rs.in Cr.)	55	100	269	35	93	37	81	93	45
Net Profit (Rs. in Cr.)	23.0	13.0	132.0	20.0	-61.0	-7.0	-22.0	28.0	8.0
Market Cap (Rs in Cr.)	582	2,835	1,526	1,405	602	119	257	602	451
PE (x)	19.36	175.31	7.19	48.37	-7.81	-8.85	-8	11.26	0
Price to Book Value (x)	2.45	3.44	1.09	4.11	2.99	0.93	1.59	1.01	0.92
Debt to Equity Ratio (x)	0.8	0.06	0.07	0	1.99	1.21	3.38	1.16	0.08
EBITDA Margin (%)	19.01	1.89	10.97	12.09	-2.24	2.58	6.62	7.68	3.49
Net Profit Margin (%)	11.53	1.02	8.25	9.35	-4.82	-1.53	-4.62	3.86	4.39
RoCE (%)	22.21	3.84	18.82	10.88	-6.9	7.55	8.68	8.66	1.84
Return on Equity (%)	21.74	1.95	15.17	8.5	-33.61	-10.43	-19.93	8.97	2.34
Inventory Turnover Ratio(x)	4.8	10.22	5.34	2.76	7.96	5.57	5.51	8.18	5.37
Dividend Yield (%)	0.19	0.13	2.04	0.82	0	0	0	0.62	0
3 Yr CAGR Sales (%)	14.7	-6.33	6.52	0.33	-4.78	-0.36	-6.44	-0.2	-31.11
3 Yr CAGR Profit (%)	49.21	-54.61	22.5	-15.99	58.88	10.55	327.98	-8.3	-56.64
Asset Turnover ratio (x)	75.03	142.83	118.53	66.23	122.79	131.12	66.36	80.84	43.24

Fig 6 - Benchmarking

- RACL PE ratio and P/B ratio looks high compare to peers, so it appears overvalued.
- RACL RoE is 21.78% and RoCE is 22.21 which is high and impressive. Leadership is also seen in the ratios of EBITDA & profit margin. Sales and profit growth look impressive and high within the group. ATR is fair. ITR and Dividend yield look average.
- Putting this together, RACL appears in a good phase of high growth and good margins all resulting in fine return ratios.
- **Projection**s: The financials for RACL are projected till FY23.
- The basis for projection of Financials is 1) Management vision for 2025 revenues 2) A lowering followed by stabilization of operating and profit margins.

	Mar '19	Mar '20	Mar '21	Mar '22 E	Mar '23 E
Sales Turnover - crores	190	212	204	255	319
EBITDA - crores	32	42	55	59	80
Net Profit - crores	10	17	23	23	32
Earnings Per Share - Rs	1.0	1.6	2.2	21.3	29.6
PE (at current Price)				25.3	18.2

Fig 7 – Financial Projections

Strengths and Opportunities

- Growth has been 14-49% CAGR in Revenues, EBITDA and profits in the last 3 years, in a tough external environment. With macros improving post covid, RACL may be able to grow faster.
- RACL's manpower optimization and interest cost saving resulted in higher profitability in FY21.
- In FY21, number of employees has grown to 800 from 479, indicating strong growth plans.
- By FY22, 3-4% of RACL revenue will be from EV components. The EV trend can accelerate also.
- RACL has a very good industry mix in its sales. RACL has major contribution (80%) from 2 wheeler sports bikes, Tractors & Recreational Vehicles (ATV & RTV), these segments should be least disrupted by EV. This a positive sign.
- 70% of revenues are exports with better margins. Growth prospects are good with these firms.

- Current factory capacity utilization is 70-75% which is good and profitable for a mfg. firm.
- RACL is investing in capacities every year, and so will be able to handle high growth in sales.
- RACL is generating ₹45 Cr. of Cash Flow from Operations annually, which means current debt can be repaid in 2 years and company can be debt free by FY23.
- RACL was doing loose auto component 5-7 years back and now they are doing sub-assemblies and assemblies for customers, thus they have moved up the value chain.

Risks and Concerns

- The disruptions in India market due to BSV1 and high tax, as well as covid, have created a highly uncertainty & disruptive atmosphere.
- RACL is quite small compared to several Indian competitors in a similar auto components space, and may face high competition and peer pressure in future.
- Auto sector is highly cyclical. While now it's in a recovery stage post covid, it may see a fall in the next 3-4 years.
- RACL receivables days are higher (90-100 days) compared to peers as RACL is located in North India, and it takes time for material to reach the port, and 60 days from the bill of lading is the minimum payment time for export business.
- High Debt/Equity is another risk to future prospects.

Opinion, Outlook and Recommendation

- The Auto and Auto ancillary sectors in India are a fast growing globally competitive sector.
- In the last 3 years, RACL has grown much faster than the domestic industry. It has customers in India and abroad, and in fact exports are higher. The business segment mix indicates a lower cyclicity in revenues. The customer profile is quite impressive with good MNC clients. While revenues are small at ₹204 cr., there is ample room to grow for RACL.
- RACL works closely with customers to develop new products per specifications, and so should have sticky relationships, and be able to grow with its clients. Older clients have worked as strong reference for RACL, for new business.
- RACL is undertaking high capital expenditure, of ₹50 Cr. preparing for visible high growth.
- RACL looks overvalued, with a PE of 19.4, but a high growth in 3-4 years justifies a BUY at CMP.
- Key Risks are: 1) Covid related disruptions, in the factories as well as customer demand 2) High receivables 3) Client concentration 4) Rising commodity prices can impact margins.
- BUY with a May 2023 target of ₹740, a 54% gain in 2 years.

Disclosures and Disclaimer

The price projection of RACL is basis the financial projections in Fig 7 and a PE of 25 times for future, based on analyst judgement.