Stock Update

RACL Geartech Ltd.

May 12, 2023

RETAILRESEARCH

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RACL Geartech Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Auto Ancillaries	Rs 985	Buy in Rs 975-995 band and add on dips in Rs 880-900 band	Rs 1081	Rs 1166	2-3 quarters

HDFC Scrip Code	RACGEAEQNR
BSE Code	520073
NSE Code	NA
Bloomberg	RAC IN
CMP May 11, 2023	985.2
Equity Capital (Rs cr)	10.8
Face Value (Rs)	10
Equity Share O/S (cr)	1.1
Market Cap (Rs cr)	1062
Book Value (Rs)	155
Avg. 52 Wk Volumes	6,500
52 Week High (Rs)	998.5
52 Week Low (Rs)	444.4

Share holding Pattern % (Mar 2023)	
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 to 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.

Besides gears, 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. RGL added ZF as a customer in FY23, which is among the largest car parts suppliers in the world. ZF has plans to increase sourcing from India by 10x over the next 7-8 years. Capacity expansion is done only after receiving firm orders curtailing idle capacity and protecting the company from taking unnecessary debt. The management has guided for Rs 470cr revenue for FY24 and Rs 365cr in FY23.

On December 30, 2022, we had initiated coverage on the company (Link) with a recommendation to ‘Buy in Rs 710-725 band & add more on dips to Rs 640-655 band’ for base case fair value of Rs 785 and bull case fair value of Rs 855 in 2-3 quarters. Both our targets were achieved within the given timeframe.

Financial Summary

(Rs cr)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	FY22	FY23E	FY24E	FY25E
Operating Income	96.9	74.8	29.5	87.7	10.5	271.2	358.0	465.4	553.8
EBITDA	23.4	16.1	45.5	20.3	15.3	57.1	80.2	106.6	127.4
APAT	12.0	7.5	59.0	9.9	21.3	23.9	38.1	51.1	61.4
Diluted EPS (Rs)	11.1	7.0	59.0	9.2	21.3	22.2	35.3	47.4	56.9
RoE-%						19.9	25.5	26.6	25.0
P/E (x)						44.4	27.9	20.8	17.3
EV/EBITDA (x)						21.4	15.8	12.2	10.4

(Source: Company, HDFC sec)

Valuation & Recommendation:

RGL has maintained a strong and profitable growth track record. The company has committed capex of Rs 60cr in FY24 and additional expenditure of Rs 250cr over 4 years in UP. We expect RGL's Revenue/PAT to grow at 27/37% 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 975-995 band and add on dips in Rs 880-900 band (15.5x FY25E EPS) for a base case fair value of Rs 1081 (19x FY25E EPS) and bull case fair value of Rs 1166 (20.5x FY25E EPS) over the next 2-3 quarters.

Q3FY23 Result Review

RGL reported its highest ever quarterly sales of Rs 97cr in Q3FY23, up by 29.5% YoY led by strong demand from existing customers and increasing demand from ZF. EBITDA increased by 45.5% YoY to Rs 23cr and EBITDA margin expanded 270bps to 24.2% on account of lower material costs. PAT for the quarter came in at Rs 12cr, up 59% YoY while PAT margin expanded 230bps to 12.4%. New capacity utilisation was to the tune of 70%.

Recent Developments

Increased sourcing by ZF Group

The ZF group has drown out a very ambitious plan to source their components from India. Currently, ZF is sourcing products worth $300mn from India. Their target by 2030 is to source ~$3bn from India, in next 7-8 years. RGL had made its foray into passenger vehicles in 2021 through ZF. RGL is working on many projects which it has got through ZF which could have significant potential in the coming years.

Growth resurgence in European Automotive market

Auto sales in Europe increased for a seventh straight month in Feb'23, aided by strong growth in the U.K. and Spain and improving supply chains. Shortages of semiconductors and other components are becoming less of a problem and strong pent-up demand is likely to drive growth. LMC Automotive's regular monthly sales report raises its Western Europe forecast a bit for 2023 to a gain of 7.9% to 10.96 million sedans and SUVs, up from its previous month's forecast of plus 7.8%. Europe accounts for ~55% of the company's revenue.

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.

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 2W, 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)

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.

UP Government has announced incentive for investment in the state wherein 20% of the investments would be given back as subsidy over a period of 12 years. RGL is looking to invest Rs 250cr over the next 4 years which would entail a subsidy of ~Rs 4cr over 2026-2038.

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 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.

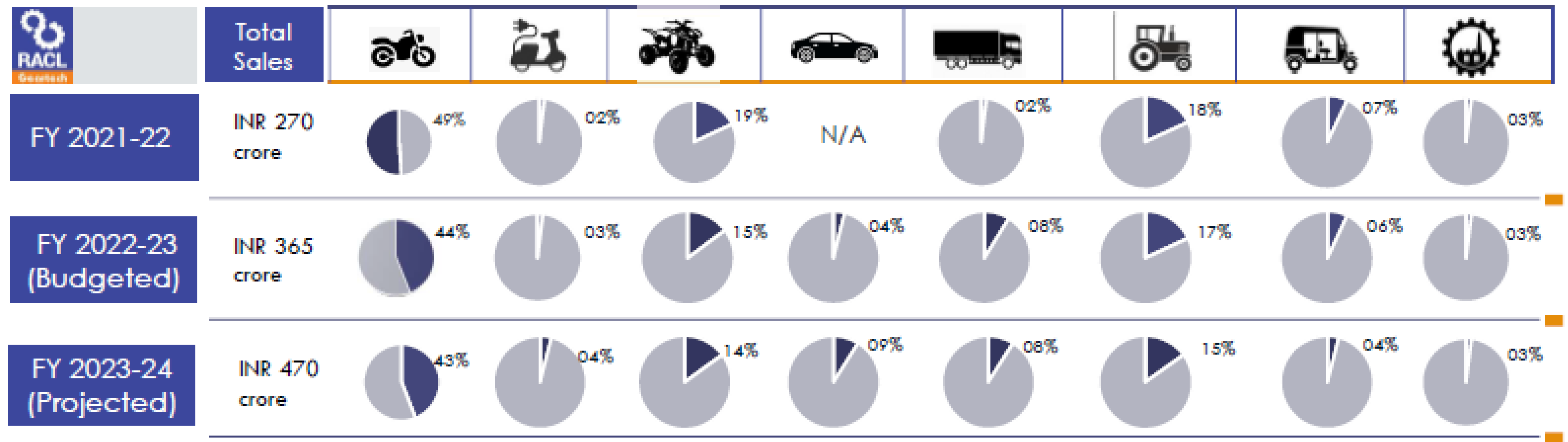
Slowdown in Europe could impact RGL's growth as Europe (55% of sales) is a big market for them.

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.

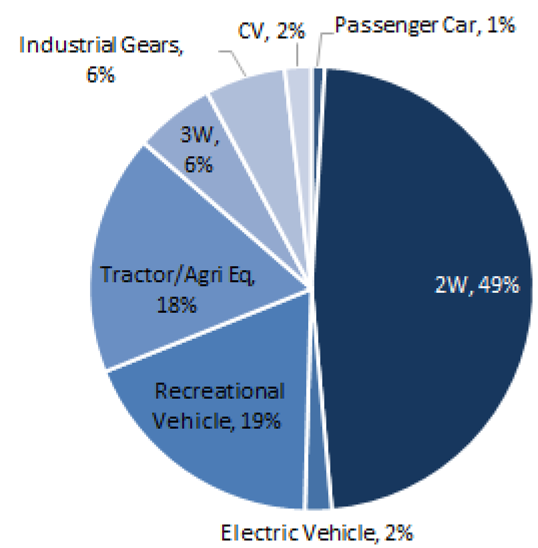
RGL has two manufacturing locations, one is in Noida and the other one is in Gajraula which is the mother plant. It has got three warehouses in Europe. Overall, RGL supplies over 900 different parts to 22 active customers. RGL has an overseas subsidiary RACL Geartech GmbH Austria.

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**	**358.0**	**465.4**	**553.8**
Growth (%)	***-4.1***	***33.2***	***32.0***	***30.0***	***19.0***
Operating Expenses	152.6	214.1	277.8	358.8	426.5
EBITDA	**51.0**	**57.1**	**80.2**	**106.6**	**127.4**
Growth (%)	***24.1***	***12.0***	***40.3***	***32.9***	***19.5***
EBITDA Margin (%)	***25.1***	***21.1***	***22.4***	***22.9***	***23.0***
Depreciation	16.4	15.7	18.9	22.6	26.9
Other Income	4.1	3.9	10.7	9.8	9.4
EBIT	**38.7**	**45.3**	**72.0**	**93.7**	**109.9**
Interest expenses	8.5	12.4	21.1	25.4	27.8
PBT	**30.2**	**32.9**	**50.9**	**68.3**	**82.0**
Tax	6.7	9.0	12.8	17.2	20.7
Adj. PAT	**23.5**	**23.9**	**38.1**	**51.1**	**61.4**
Growth (%)	***38.4***	***1.8***	***59.3***	***34.1***	***20.1***
EPS	19.9	22.2	35.3	47.4	56.9

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	156.9	205.5	263.9
Shareholders' Funds	**109.0**	**131.4**	**167.7**	**216.3**	**274.6**
Total Debt	106.1	161.8	221.8	271.8	278.8
Net Deferred Taxes	5.3	6.7	6.7	6.7	6.7
Other Non-curr. Liab.	2.3	1.6	2.1	2.7	3.2
Total Sources of Funds	**222.7**	**301.6**	**398.3**	**497.6**	**563.4**
APPLICATION OF FUNDS					
Net Block & Goodwill	141.4	177.5	215.6	253.9	307.5
CWIP	0.8	3.9	2.0	1.0	0.5
Investments	0.0	0.0	15.0	15.0	15.0
Other Non-Curr. Assets	9.2	7.5	10.0	12.9	15.4
Total Non Current Assets	**151.5**	**189.0**	**242.5**	**282.9**	**338.4**
Inventories	42.5	56.7	78.5	104.6	121.4
Debtors	55.2	76.9	100.0	127.5	144.2
Cash & Equivalents	0.8	0.7	5.8	16.4	1.9
Other Current Assets	22.3	27.8	37.1	49.0	57.9
Total Current Assets	**120.7**	**162.2**	**221.4**	**297.5**	**325.3**
Creditors	28.1	29.2	35.3	44.6	56.1
Other Current Liab & Provisions	21.4	20.5	30.3	38.1	44.2
Total Current Liabilities	**49.5**	**49.6**	**65.6**	**82.8**	**100.3**
Net Current Assets	71.2	112.6	155.8	214.7	225.1
Total Application of Funds	**222.7**	**301.5**	**398.3**	**497.6**	**563.4**

RACL Geartech Ltd.

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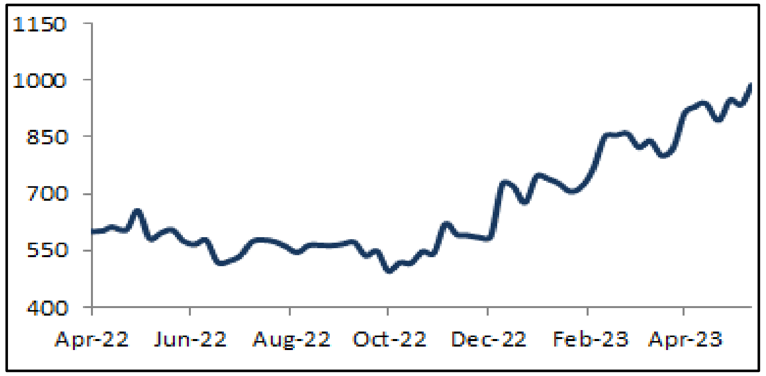
Cash Flow Statement

(Rs cr)	FY21	FY22	FY23E	FY24E	FY25E
Reported PBT	24.0	23.4	50.9	68.3	82.0
Non-operating & EO items	-0.4	0.0	-1.9	-2.4	-1.9
Interest Expenses	8.5	12.4	21.1	25.4	27.8
Depreciation	16.4	15.7	18.9	22.6	26.9
Working Capital Change	-16.4	-47.2	-38.2	-48.2	-24.8
Tax Paid	6.9	7.6	-12.8	-17.2	-20.7
OPERATING CASH FLOW (a)	**39.0**	**11.8**	**37.9**	**48.5**	**89.4**
Capex	-48.6	-55.9	-55.0	-60.0	-80.0
Free Cash Flow	-9.6	-44.1	-17.1	-11.5	9.4
Investments	0.0	0.0	-15.0	0.0	0.0
Non-operating income	0.0	0.0	0.0	0.0	0.0
INVESTING CASH FLOW (b)	**-48.6**	**-55.9**	**-70.0**	**-60.0**	**-80.0**
Debt Issuance / (Repaid)	19.2	56.3	60.0	50.0	7.0
Interest Expenses	-8.5	-12.3	-21.1	-25.4	-27.8
FCFE	1.2	-0.1	6.8	13.1	-11.4
Share Capital Issuance	0.0	0.0	0.0	0.0	0.0
Dividend	-1.1	0.0	-1.8	-2.5	-3.0
Others	0.0	0.0	0.0	0.0	0.0
FINANCING CASH FLOW (c)	**9.7**	**44.0**	**37.1**	**22.1**	**-23.8**
NET CASH FLOW (a+b+c)	**0.1**	**-0.1**	**5.0**	**10.6**	**-14.5**

Price chart



Key Ratios

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Profitability Ratios (%)					
EBITDA Margin	25.1	21.1	22.4	22.9	23.0
EBIT Margin	19.0	16.7	20.1	20.1	19.8
APAT Margin	11.5	8.8	10.6	11.0	11.1
RoE	24.2	19.9	25.5	26.6	25.0
RoCE	20.7	17.8	21.1	21.4	21.1
Solvency Ratio (x)					
Net Debt/EBITDA	2.1	2.8	2.7	2.4	2.2
Net D/E	1.0	1.2	1.3	1.2	1.0
Per Share Data (Rs)					
EPS	19.9	22.2	35.3	47.4	56.9
CEPS	33.9	36.7	52.8	68.3	81.8
BV	92.5	121.8	155.4	200.5	254.5
Dividend	1.0	1.0	1.7	2.3	2.8
Turnover Ratios (days)					
Debtor days	98	89	90	89	90
Inventory days	75	67	69	72	74
Creditors days	42	39	33	31	33
VALUATION (x)					
P/E	49.4	44.4	27.9	20.8	17.3
P/BV	10.7	8.1	6.3	4.9	3.9
EV/EBITDA	22.9	21.4	15.8	12.2	10.4
EV / Revenues	5.7	4.5	3.5	2.8	2.4
Dividend Yield (%)	0.1	0.1	0.2	0.2	0.3
Dividend Payout (%)	5.0	4.5	4.8	4.9	4.9

(Source: Company, HDFC sec)

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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 cyclicality 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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