

GNA Axles Limited

IPO Note – Attractive on Valuations: Subscribe

GNA Axles Ltd (GNAAL) is a Punjab based manufacturer of rear axle shafts, other shafts and spindles used in on-highway vehicular (including LCVs, MCVs, HCVs, bus etc) and off-highway vehicular (agricultural tractors and machinery, forestry, construction equipment, mining etc) segments. In FY2016, the company's revenue mix was constituted by domestic and export segments in the proportion of ~45% and ~55% respectively. GNAAL's customers include OEMs such as Mahindra & Mahindra, John Deere, Tractors and Farm Equipment (TAFE) and tier 1 suppliers to OEMs such as Automotive Axles, Meritor HVS AB and Dana. The company has two manufacturing facilities, both of which are located in Punjab. It exports products to various countries across America, Europe and Asia Pacific.

Strong recovery in tractor segment to drive growth: 70% of the company's domestic revenue comes from the tractor segment where it holds an ~50% market share. In the last two years, we have seen de-growth in the tractor industry due to poor monsoons which has resultantly impacted GNAAL's domestic revenue growth. However, during 5MFY2017, we saw a strong (~19% yoy) recovery at major tractor players, thanks to the optimal monsoon this year. Going forward we expect the company's domestic revenue to improve on the back of strong recovery in the tractor segment.

Strong global footprint: GNAAL's export revenue is constituted by America (~49%), Europe (~33%), the Asia Pacific (~18%), and the balance is accounted by Australia. Exports constitute ~55% of the company's total revenue. The company's major clients include Meritor HVS AB, John Deere, Transaxle Manufacturing of America, Dana Ltd and Kubota Corporation. The company reported a strong ~33% export revenue CAGR over FY2013-16; we expect continuation of healthy growth over the next 2-3 years on the back of low cost manufacturing advantages in India, the company's diversified product portfolio, strong growth in the US market and with the company tapping newer international geographies.

Consistent operating margin improvement: GNAAL has consistently been reporting margin improvement over the last five years on back of its effective cost management strategy and higher composition of exports in the revenue mix which entail better margins vis-a-vis the domestic market. The company has reported operating margin improvement from 13.0% in FY2012 to 16.2% in FY2016. Going forward, we expect GNAAL to continue to deliver a healthy performance on the operating front.

Outlook & Valuation: In terms of valuations, the pre-issue P/E works out to 12.1x its FY2016 earnings (at the upper end of the issue price band) which is lower compared to its peers (Talbro Engineering is trading at 19.5x its FY2016 earnings). Also, GNAAL has a better margin and ROE profile than its comparable peers. **Considering high export revenue composition, expected recovery in domestic sales and the company's market leadership position in the tractor segment; plus, given the relatively attractive valuation proposition, we recommend a SUBSCRIBE on the issue.**

SUBSCRIBE

Issue Open: September 14, 2016
 Issue Close: September 16, 2016

Face Value: ₹10

Present Eq. Paid up Capital: ₹15.2cr

Fresh Issue: 0.63cr Shares

Offer for sale:-NA

Post Eq. Paid up Capital: ₹21.5cr

Market Lot: 70 Shares

Issue (amount): ₹129*-130cr**

Price Band: ₹205-207

Post-issue implied mkt. cap ₹440cr*- 444cr**

Note: *at Lower price band and **Upper price band

Book Building

| | |
|-------------------|-----|
| QIBs | 50% |
| Non-Institutional | 15% |
| Retail | 35% |

Post Issue Shareholding Pattern(%)

| | |
|--|------|
| Promoters Group | 70.7 |
| MF/Banks/Indian FIs/FII's/Public & Others | 29.3 |

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Exhibit 1: Key Financial

| Y/E March (₹ cr) | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 |
|-------------------|-------------|------------|------------|-------------|-------------|
| Net Sales | 399 | 349 | 404 | 430 | 509 |
| % chg | - | (12.5) | 15.8 | 6.5 | 18.2 |
| Net Profit | 17 | 5 | 13 | 22 | 26 |
| % chg | - | (71.6) | 175.6 | 62.8 | 20.2 |
| OPM (%) | 13.0 | 12.6 | 12.6 | 14.0 | 16.2 |
| EPS (₹) | 11.2 | 3.2 | 8.7 | 14.2 | 17.1 |
| P/E (x) | 18.5 | 65.2 | 23.7 | 14.5 | 12.1 |
| P/BV (x) | 4.3 | 4.0 | 3.4 | 2.8 | 2.3 |
| RoE (%) | 23.0 | 6.1 | 14.5 | 19.1 | 18.8 |
| RoCE (%) | 26.9 | 16.9 | 16.4 | 15.4 | 22.4 |
| EV/Sales (x) | 1.0 | 1.2 | 1.1 | 1.0 | 0.8 |
| EV/EBITDA (x) | 7.5 | 9.4 | 8.4 | 7.3 | 5.1 |

Source: Company, Angel Research; Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

Company background

GNAAL is a Punjab based manufacturer of rear axle shafts, other shafts and spindles used in on-highway and off-highway vehicular segments. The company manufactures a range of rear axle shafts, other shafts, and spindles for the on-highway segment vehicles, including light commercial vehicles, medium commercial vehicles, and heavy commercial vehicles, as well as other transport vehicles, such as buses. It also offers a range of rear axle shafts and other shafts for the off-highway segment, which include agricultural tractors and machinery, forestry and construction equipment, electric carts, and other specialty vehicles used in mining and defense sectors.

In FY2016, the company's revenue mix was constituted by domestic and export segments in the proportion of ~45% and ~55% respectively. Its customers include OEM's such as Mahindra & Mahindra, John Deere, Tractors and Farm Equipment (TAFE) and tier 1 suppliers to OEMs such as Automotive Axles, Meritor HVS AB and Dana.

The company exports its products to various countries including the United States, Sweden, Turkey, Brazil, Italy, Germany, Spain, Mexico, Japan, the United Kingdom, France, China, and Australia. It has two manufacturing facilities: Unit I located in village Mehtiana, district Hoshiarpur, Punjab and Unit II located at village Gulabgarh Jattan, district Kapurthala, Punjab. Both of its manufacturing facilities are ISO/TS 16949:2009 certified for manufacture of rear axle shafts, other shafts and spindles for automotive applications.

Exhibit 2: Product portfolio



1.5 kg - 3 kg 5 kg - 8 kg
Axle Shafts for MUVs



LCVs in 1.56" range < 15 kg
HCVs in 1.66" range < 20 kg
Axle Shafts for CVs



20 kg - 40 kg



50 kg - 65 kg

Axle Shafts for Specialty Vehicles



Drive Shafts



Power Take-off & Transmission Shafts



Counter Power Take-off Shafts



Hydraulic Lift Shafts



Spindles for Heavy Commercial Vehicles



Spindles for Specialty Vehicles

Source: Company, Angel Research

Issue details

The company is raising ₹129-130cr through fresh issue (0.63cr share) of equity shares in the price band of ₹205-207. The fresh issue will constitute ~29% of the post-issue paid-up equity share capital of the company assuming the issue is subscribed at the upper end of the price band.

Exhibit 3: Shareholding pattern

| Particulars | Pre-Issue | | Post-Issue | |
|----------------|-------------------|---------------|-------------------|---------------|
| | No. of shares | (%) | No. of shares | (%) |
| Promoter group | 15,165,400 | 100.0% | 15,165,400 | 70.7% |
| Others | - | - | 6300000 | 29.3% |
| Total | 15,165,400 | 100.0% | 21,465,400 | 100.0% |

Source: Company, Angel Research

Objects of the offer

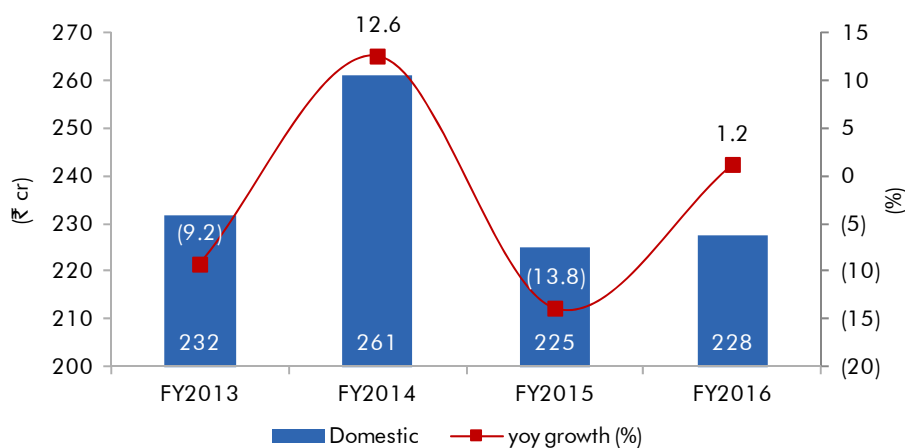
- ~₹80cr will be used for purchase of plant & machinery.
- ~₹35cr will be used for funding working capital requirements.
- The balance will be used for general corporate purposes.

Investment rationale

Company to benefit from expected CV segment growth

Going forward, we expect strong growth in commercial vehicle sales on back of improvement in industrial activity and the government's focus on speeding up execution of infrastructure projects in the country. Further, implementation of the GST is expected to expedite the evolution of the hub-and-spoke model for transportation, which will create increased demand for LCVs and HCVs, thus benefitting the company.

Exhibit 4: Flat growth in domestic revenue over FY2013-16

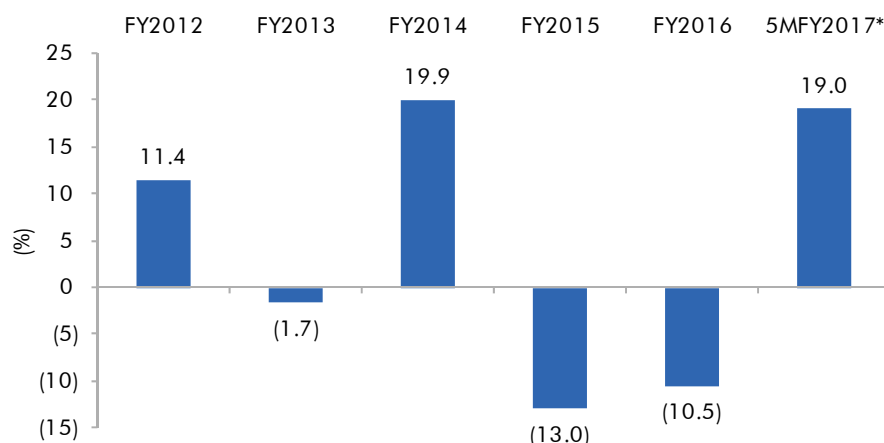


Source: Company, Angel Research

Recovery in tractor segment to drive growth

70% of the company's domestic revenue comes from the tractor segment where it holds an ~50% market share. In the last two years, we have seen de-growth in the tractor industry due to poor monsoons which has resultantly impacted GNAAL's domestic revenue growth. However, during 5MFY2017, we saw a strong (~19% yoy) recovery at major tractor players, thanks to the optimal monsoon this year. Going forward we expect the company's domestic revenue to improve on the back of strong recovery in the tractor segment.

Exhibit 5: Domestic tractor sales trend

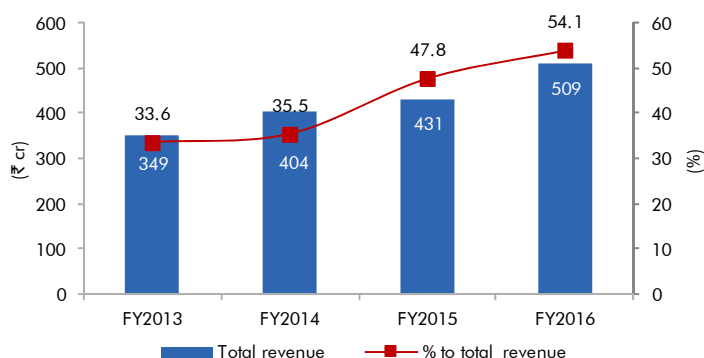


Source: Company, Angel Research Note: * Sales volume of M&M & Escorts which cover more than 50% market share.

Strong global footprint

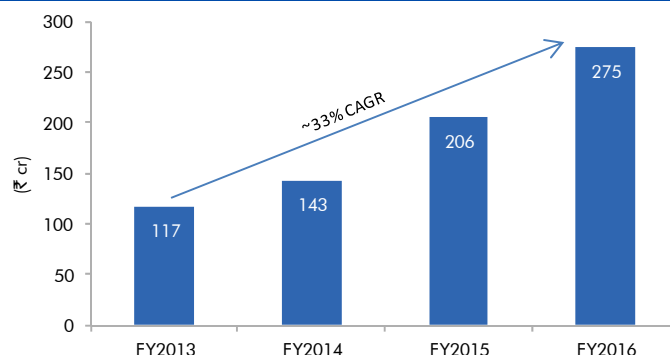
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Exhibit 6: Export % to total revenue



Source: Company, Angel Research

Exhibit 7: Historical export growth



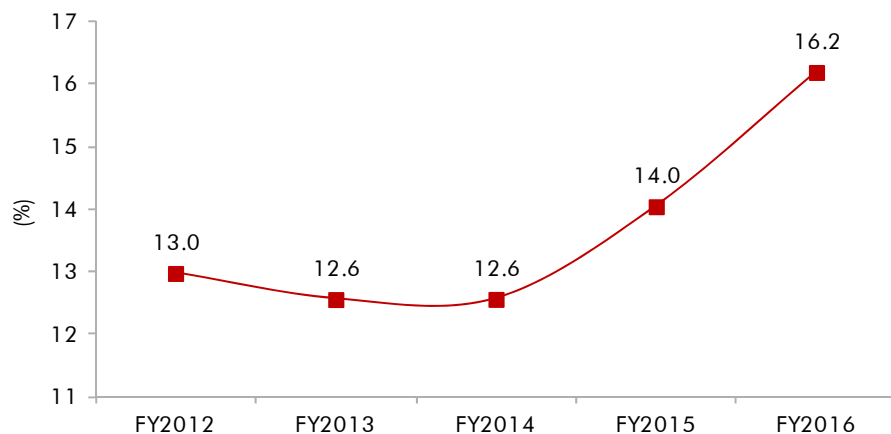
Source: Company, Angel Research

Consistent operating margin improvement

GNAAL has been consistently reporting margin improvement over the last five years on back of its effective cost management strategy. It has been following measures such as adopting value engineering at die making to reduce the cost of input material, optimising tool consumption by using designated tools for designated processes, and shifting from furnace oil/diesel to electricity to minimise the burning losses in forging. Further, certain of its forging facilities have been robotised to increase capacity utilisation. Moreover, the company derives ~55%

revenue from exports which entail higher margins compared to the domestic market. The company has reported operating margin improvement from 13.0% in FY2012 to 16.2% in FY2016. Going forward, we expect GNAAL to continue to deliver a healthy operating performance.

Exhibit 8: Historical operating margin trend



Source: Company, Angel Research

Outlook and Valuation

In terms of valuations, the pre-issue P/E works out to 12.1x its FY2016 earnings (at the upper end of the issue price band) which is lower compared to its peers (Talbro Engineering is trading at 19.5x its FY2016 earnings). Also, GNAAL has a better margin and ROE profile than its comparable peers. **Considering high export revenue composition, expected recovery in domestic sales and the company's market leadership position in the tractor segment; plus, given the relatively attractive valuation proposition, we recommend a SUBSCRIBE on the issue.**

Exhibit 9: Comparative Valuation

| Pre issue valuation ^ | | P/E (x) | P/BV (x) | ROE (%) | EV/Sales (x) | EV/EBITDA (x) |
|-----------------------|--------|------------|-------------|------------|-----------------|------------------|
| GNAAL | FY2016 | 12.1 | 2.3 | 18.8 | 0.8 | 5.1 |
| Talbro Engineering | FY2016 | 19.5 | 1.8 | 9.4 | 0.6 | 8.9 |

Source: RHP, Bloomberg; Note: ^ based on price at upper band & pre-market cap

Risks

Intense competition and lack of pricing power: Fewer entry barriers and high competition have resulted in a low pricing power in the industry.

Currency fluctuation: 55% of the company's revenues come from exports; cross-currency headwinds could impact the company's earnings going forward.

Client concentration risk: The top five and the top ten clients of the company account for ~50% and ~80% of the revenues, respectively, thus exposing the company to the risk of client concentration.

Profit & Loss Statement

| Y/E March (₹ cr) | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 |
|-------------------------------|-------------|------------|------------|-------------|-------------|
| Total operating income | 399 | 349 | 404 | 430 | 509 |
| % chg | | (12.5) | 15.8 | 6.5 | 18.2 |
| Total Expenditure | 347 | 305 | 353 | 370 | 426 |
| Raw Material Consumed | 269 | 234 | 274 | 279 | 318 |
| Personnel Expenses | 14 | 16 | 19 | 21 | 24 |
| Others Expenses | 64 | 55 | 60 | 70 | 85 |
| EBITDA | 52 | 44 | 51 | 60 | 82 |
| % chg | | (15.3) | 15.8 | 19.0 | 36.3 |
| (% of Net Sales) | 13.0 | 12.6 | 12.6 | 14.0 | 16.2 |
| Depreciation & Amortisation | 12 | 14 | 17 | 23 | 27 |
| EBIT | 39 | 30 | 33 | 37 | 55 |
| % chg | | (23.2) | 10.6 | 12.0 | 47.4 |
| (% of Net Sales) | 9.9 | 8.7 | 8.3 | 8.7 | 10.9 |
| Interest & other Charges | 12 | 13 | 15 | 17 | 16 |
| Other Income | 0 | 0 | 0 | 1 | 0 |
| (% of PBT) | 0.1 | 0.7 | 1.3 | 2.7 | 1.1 |
| Recurring PBT | 28 | 18 | 18 | 21 | 39 |
| % chg | | (36.7) | 4.7 | 12.3 | 89.5 |
| Extraordinary Expense/(Inc.) | - | - | - | - | - |
| PBT (reported) | 28 | 18 | 18 | 21 | 39 |
| Tax | 11 | 13 | 5 | (1) | 13 |
| (% of PBT) | 39.2 | 72.7 | 28.2 | (4.1) | 34.0 |
| Reported PAT | 17 | 5 | 13 | 22 | 26 |
| % chg | - | (71.6) | 175.6 | 62.8 | 20.2 |
| (% of Net Sales) | 4.2 | 1.4 | 3.3 | 5.0 | 5.1 |
| Basic EPS (₹) | 11.2 | 3.2 | 8.7 | 14.2 | 17.1 |
| Fully Diluted EPS (₹) | 11.2 | 3.2 | 8.7 | 14.2 | 17.1 |
| % chg | - | (71.6) | 175.6 | 62.8 | 20.2 |

Balance Sheet

| Y/E March (₹ cr) | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 |
|-----------------------------|------------|------------|------------|------------|------------|
| SOURCES OF FUNDS | | | | | |
| Equity Share Capital | 15 | 15 | 15 | 15 | 15 |
| Reserves & Surplus | 59 | 63 | 76 | 98 | 123 |
| Shareholders Funds | 74 | 79 | 92 | 113 | 138 |
| Total Loans | 73 | 100 | 113 | 130 | 108 |
| Other long term liabilities | - | - | 16 | - | - |
| Deferred Tax Liability | 3 | 11 | 13 | 6 | 4 |
| Total Liabilities | 150 | 190 | 233 | 249 | 250 |
| APPLICATION OF FUNDS | | | | | |
| Gross Block | 161 | 194 | 248 | 285 | 301 |
| Less: Acc. Depreciation | 66 | 58 | 79 | 126 | 153 |
| Net Block | 95 | 137 | 169 | 160 | 147 |
| Investments | - | - | - | - | 0 |
| Current Assets | 172 | 181 | 213 | 267 | 299 |
| Inventories | 53 | 53 | 61 | 92 | 91 |
| Sundry Debtors | 85 | 87 | 111 | 122 | 162 |
| Cash | 1 | 1 | 1 | 0 | 1 |
| Loans & Advances | 13 | 15 | 15 | 23 | 18 |
| Other Assets | 21 | 25 | 25 | 30 | 27 |
| Current liabilities | 118 | 128 | 149 | 178 | 196 |
| Net Current Assets | 54 | 54 | 64 | 89 | 103 |
| Mis. Exp. not written off | - | - | - | - | - |
| Total Assets | 150 | 190 | 233 | 249 | 250 |

Cash Flow Statement

| Y/E March (₹ cr) | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|
| Profit before tax | 28 | 18 | 18 | 21 | 39 |
| Depreciation | 12 | 14 | 17 | 23 | 27 |
| Change in Working Capital | (14) | 2 | (10) | (26) | (10) |
| Interest / Dividend (Net) | 11 | 12 | 15 | 15 | 15 |
| Direct taxes paid | (9) | (5) | (4) | (6) | (16) |
| Others | (0) | (0) | (0) | (0) | (0) |
| Cash Flow from Operations | 28 | 40 | 36 | 27 | 55 |
| (Inc.)/ Dec. in Fixed Assets | (23) | (54) | (61) | (14) | (16) |
| (Inc.)/ Dec. in Investments | - | - | - | - | - |
| Cash Flow from Investing | (23) | (54) | (61) | (14) | (16) |
| Issue of Equity | | | | | |
| Inc./(Dec.) in loans | 5 | 27 | 39 | 3 | (24) |
| Dividend Paid (Incl. Tax) | - | - | - | - | - |
| Interest / Dividend (Net) | (10) | (12) | (15) | (16) | (15) |
| Cash Flow from Financing | (5) | 15 | 24 | (13) | (39) |
| Inc./(Dec.) in Cash | (1) | 1 | (1) | (0) | 0 |
| Opening Cash balances | 1 | 1 | 1 | 1 | 0 |
| Closing Cash balances | 1 | 1 | 1 | 0 | 1 |

Key Ratio

| Y/E March | FY2012 | FY2013 | FY2014 | FY2015 | FY2016 |
|------------------------------|--------|--------|--------|--------|--------|
| Valuation Ratio (x) | | | | | |
| P/E (on FDEPS) | 18.5 | 65.2 | 23.7 | 14.5 | 12.1 |
| P/CEPS | 10.7 | 17.0 | 10.2 | 7.0 | 5.9 |
| P/BV | 4.3 | 4.0 | 3.4 | 2.8 | 2.3 |
| Dividend yield (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| EV/Sales | 1.0 | 1.2 | 1.1 | 1.0 | 0.8 |
| EV/EBITDA | 7.5 | 9.4 | 8.4 | 7.3 | 5.1 |
| EV / Total Assets | 1.4 | 1.3 | 1.1 | 1.0 | 0.9 |
| Per Share Data (₹) | | | | | |
| EPS (Basic) | 11.2 | 3.2 | 8.7 | 14.2 | 17.1 |
| EPS (fully diluted) | 11.2 | 3.2 | 8.7 | 14.2 | 17.1 |
| Cash EPS | 19.3 | 12.2 | 20.2 | 29.4 | 35.0 |
| Book Value | 48.6 | 51.8 | 60.4 | 74.4 | 91.2 |
| Returns (%) | | | | | |
| ROCE | 26.9 | 16.9 | 16.4 | 15.4 | 22.4 |
| Angel ROIC (Pre-tax) | 27.0 | 17.0 | 16.4 | 15.5 | 22.5 |
| ROE | 23.0 | 6.1 | 14.5 | 19.1 | 18.8 |
| Turnover ratios (x) | | | | | |
| Asset Turnover (Gross Block) | 2.5 | 1.8 | 1.6 | 1.5 | 1.7 |
| Inventory / Sales (days) | 49 | 55 | 55 | 78 | 66 |
| Receivables (days) | 78 | 91 | 101 | 103 | 116 |
| Payables (days) | 86 | 113 | 111 | 125 | 117 |
| WCC (ex-cash) (days) | 40 | 33 | 45 | 56 | 65 |

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