

**GNA AXLES Ltd IPO – The Globe beckons**

- Small Cap: Rs 444 crore Market cap
- Industry –Auto ancillary

- **Date:** 12<sup>th</sup> Sept 2016 and **IPO Period:** 14-16<sup>th</sup> Sept
- **IPO Price range:** Rs. 205-207
- **Advice:** Investors may **BUY** with a 2 year perspective



- **Overview:** GNAX is the leader domestically in Rear Axle mfg., supplying to tractors in India and commercial vehicles in exports.
- GNAX had FY16 revenues and profits of Rs 502 crores and Rs 26 cr. Revenue, EBITDA and PAT have grown 6.3%, 8.7% and 11.27% CAGR over 4 years.
- It has a good balance sheet, solid global presence and diversified business vertical segments.
- Valuations appear attractive. The asking PE at 12.1 times is lower than listed peers.
- However there are a few risks: intense competition and group companies in similar sectors.
- As an investment, the GNAX IPO is rated a medium risk, medium return type of offering.
- **Outlook:** Investors may Buy GNAX with a 2-3 year perspective.

Here is a note on GNA Axles Ltd. (GNAX).

**IPO highlights**

- IPO opens: Wed 16<sup>th</sup> Sept 2016 with Issue Price band: Rs. 205-207 per share.
- Shares offered to public: 63 lakhs of Face Value: Rs. 10, Market Lot is multiples of 70.
- The company is raising Rs 130 cr. through fresh issue of shares in the price band of Rs 205-207.
- The Post IPO share capital is Rs 21.5 cr. and Post-issue implied mkt. cap Rs 444 cr. (at Upper PB).
- The promoters of GNAX hold 100% stake, which post IPO this will fall to 70.7%.The IPO shares are available to QIBs, Non-institutional and Retail in ratio of 50:15:35.
- The main Objects of the Issue are: Purchase of plant and machinery (80 cr.); to meet working capital requirements (35 cr.) and general corporate purpose (14-15 cr.).

**Introduction**

- Incorporated in 1993, GNAX is an Punjab based auto component manufacturer for four wheelers supplying Rear Axles, Shafts, Spindles & other components to marquee clients. Fig 1.
- GNAX had revenues and profits of Rs 502 crores and Rs 26 cr. resp. in FY16.
- Its revenue, EBITDA and PAT have grown 6.3%, 8.7% and 11.27% CAGR over 4 years.
- It has two mfg. plants in Punjab, Hoshiarpur and Kapurthala, with capacity 23 lakh rear axles, 4 lakh shafts and 3 lakh spindles, operating at 80% utilization in FY16 (67% in FY15). It has 1,093 employees.
- In FY2016, the firm's mix of domestic and exports were 45% & 55% resp. Its OEM customers include Mahindra (M&M), John Deere, TAFE and tier 1 supplies to Auto. Axles, Meritor HVS AB and Dana.
- GNAX exports its products to various countries including USA, Sweden, Turkey, Brazil, Italy, Germany, Spain, Mexico, Japan, UK, France, China and Australia. Fig 3

- Leadership: Ranbir Singh is the ED & CEO, Rachhpall Singh is Chairman & ED; Gursaran Singh is MD.
- Top five Group Companies (based on turnover) of GNA Group are: GNA Gears Ltd.; GNA Udyog Ltd.; GNA Investments Ltd.; Amarsons Automotives Ltd.; and Gurunanak Transmission Punjab Ltd.



Fig 1 – GNA Axles Ltd Product Portfolio

### Business Model, News and Updates for GNAX

- As of FY16, GNAX commands 50% market share domestically. With capacity utilization high at 80% the firm intends to expand capacity in order to maintain its market share.
- The group is into education and started the GNA Institute of Management & Technology, with courses in design engineering (CAD-CAM), MBA, and courses in multimedia technologies like a diploma, a PG Diploma, B.Sc and M.Sc. (all Multimedia Tech), also BBA, and BCA.
- Award in 2015: GNAX received Best Supplier from TAFE and Best Quality from Escorts Agri Machinery.

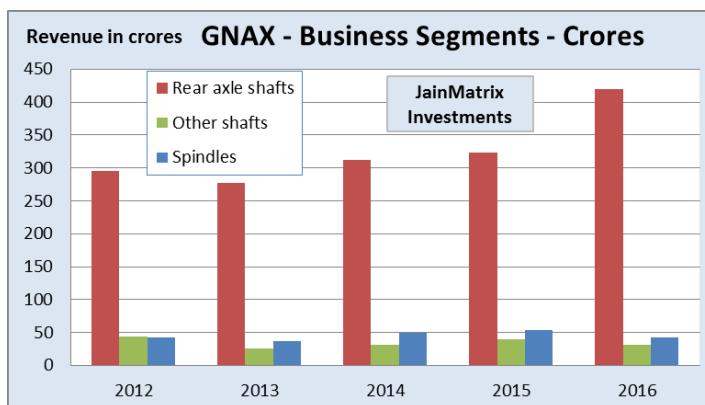


Fig 2 – Business Segments

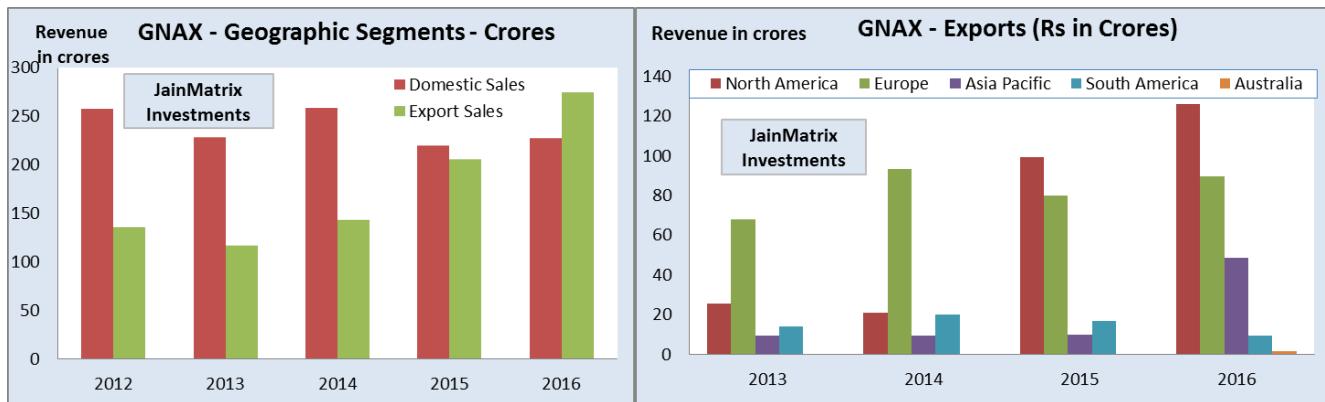


Fig 3 – Revenue Segments

Fig 4 – Exports

- GNAX has been reporting margin improvements over five years due to effective cost management.
- They have two mfg. facilities: Unit I located in Hoshiarpur and Kapurthala, Punjab. Both are ISO/TS 16949:2009 certified for mfg. of rear axle shafts, other shafts and spindles for auto applications.
- GNAX plans to increase its geographical reach, as exports constitute 55% of the company's total revenue. The firm 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 mfg. advantages in India, a diversified product portfolio, strong growth in the US and newer international geographies.
- GNAX received a CRISIL BBB+ (stable) rating on long term and CRISIL A2 on short term instruments.

### Indian Auto Ancillaries Industry

- Indian auto ancillary industry is a growing fast, riding on the success of the automotive sector.
- Indian auto component industry clocked a turnover of Rs 2.34 lakh cr. (\$38.5 billion) in FY15.
- Auto components may become the 3rd largest globally by 2016 with 5% of global sales.
- The autocomp sector recorded a CAGR of 7.8% during the period of 2008-14. In FY15, auto component sales grew 11%, compared with 3% in FY13 and FY14, showing a recovery.
- Manufacturing expertise, low labour costs, availability of skilled labour and high quality consciousness among Indian vendors are the key strengths.
- India is also developing as a global mfg. hub for two wheelers and small cars, with robust domestic demand and global export opportunities. Many auto MNCs are setting up here.
- Outlook: Cooling inflation, growth in urban disposable incomes, and lower interest rates would boost car & bike sales. With an economic recovery, demand for CVs will increase.
- Auto sector sales are likely to bounce back strongly in the next 2 years, because of improved investment cycles, disposable income and consumer sentiments.

### Financials of GNAX

- GNAX's revenue, EBITDA and PAT grew 6.3%, 8.7% and 11.27% CAGR over the last 4 years.
- The revenue growth has grown steadily and the margins of GNAX are stable. See Fig 5.
- GNAX has low net profit margin of 5.16%. The RoCE stands at 20.8% and RoE at 20.7%. This is good.
- Operating profit margins have grown after FY14 and net profit margins recovered after FY13.
- GNAX net worth has grown at 17% CAGR in the past 5 years with FY16 ROE of 20.7% and ROCE at 20.8%, which are expected to improve further as the flagging domestic business picks up.

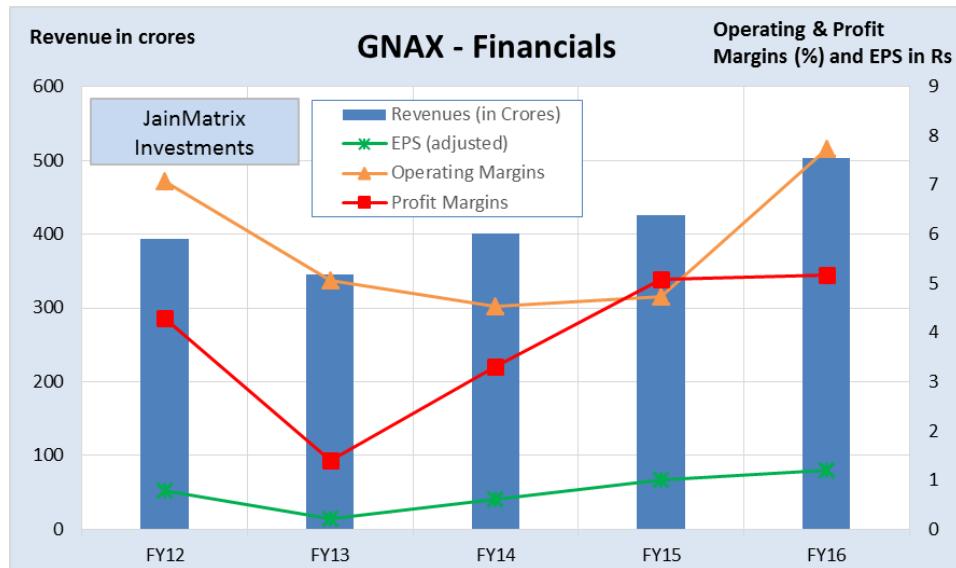


Fig 5 – GNAX financials

- GNAX has not declared dividends preceding the filing of this Red Herring Prospectus.
- GNAX has reduced its debt equity ratio over the last four years from 1.4 in FY15 to 0.9 in FY16.
- GNAX has been able to generate Free Cash Flow from the last two years, a big positive. Fig 6.

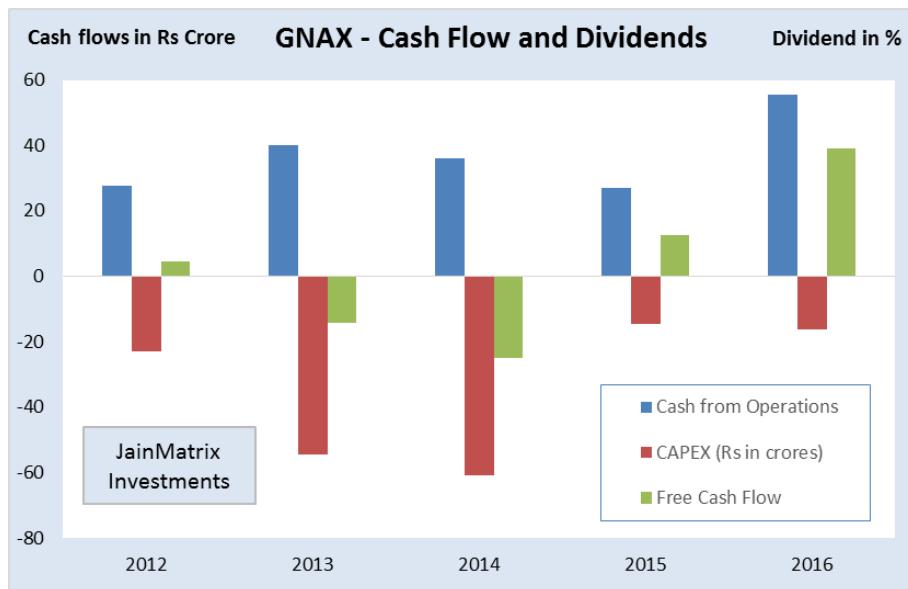


Fig 6 – GNAX cash flows

### Benchmarking

We benchmarked GNAX against peer firms like Talbros Engineering, Gabriel, JBM Auto, etc. See Fig 7. We do not directly compare with Motherson Sumi as it is a much larger company.

- GNAX appears to be available at reasonable valuations in terms of PE and P/B is average.
- The 3-year CAGR sales and profits are better than peers.
- It is good on RoCE and RoNW parameters.
- GNAX has not declared any dividends in any of the Fiscals preceding. Debt is high but not excessive.

Particulars	GNA Axles IPO	Talbros Engineering	Gabriel India	Precision Camshafts	JBM Auto	Motherson Sumi
Revenues (FY16)	508.9	139.0	1,438.2	438.1	1,517.8	38,395.2
EBITDA (FY16)	38.9	11.7	131.2	134.5	196.5	3746.1
Profits (FY16)	26.0	3.4	75.6	55.1	52.0	1272.1
PE (x)	12.10	19.39	21.81	21.56	20.3	30.02
Price to Book Value (x)	2.30	1.83	4.45	1.82	2.62	10.28
3 Yr CAGR Sales (%)	13.2	0	6.07	0	9.03	14.9
3 Yr CAGR Profit (%)	75.3	0	20.68	0	16.92	42.35
Debt to Equity Ratio (x)	0.9	0.51	0.03	0.47	1.53	1.52
EBITDA Margin (%)	16.26	8.37	9.12	30.7	12.95	9.76
Net Profit Margin (%)	5.16	2.42	5.23	12.53	3.45	3.32
Return on Equity (%)	20.7	9.9	21.33	14.72	19.29	46.52
RoCE (%)	20.8	15.65	26.19	17.42	15.71	26.15
Dividend Yield (In %)	0	0	1.02	0.7	0.79	0.76

Exhibit 7 – Benchmarking

### Positives for GNAX and the IPO

- GNAX is a leader in the sector for axle shafts in India (SOURCE – CRISIL). The company has diverse product range of axle shafts and spindles. GNAX has manufacturing facilities with good capacity and modern machinery.
- GNAX's export revenue is growing strongly and is a positive. It is also present in domestic and exports, and this is an advantage and reduces cyclical risks.
- The axle shaft and spindle manufacturing industry has high competition with 5-6 active players. GNA competes with Talbros Engg, Kross Mfg, Embross Autocomp and SPM Autocomp System in this space.
- GNAX has strong long term customer relationships and diversified customer base with good engineering, product development and technological capabilities.
- The IPO pricing is attractive. At the upper band of Rs 207/share, GNAX's asking price P/E is 12.1 times which is lower than Talbros Engg (19.4 times) and other peers.
- GNAX has been reporting margin improvement over the last five years.
- GNAX adopted various cost saving measures such as adopting value engineering, optimizing tool consumption and shifting from furnace oil/diesel to electricity to minimize the losses in forging.
- GNAX is expected to continue 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.
- Dominates the domestic tractor segment where it holds a 50% market share. In the last two years, we have seen de-growth in the tractor industry due to poor monsoons which has impacted GNAX's. However this year we are seeing a strong (19% yoy) recovery at major tractor players, thanks to the good monsoon this year FY16. The company's domestic revenue is expected to improve.
- Implementation of the GST is expected to benefit GNAX.

### Risks and Concerns

- GNAX bears a client concentration risk, with top five and the top ten clients of the company account for 50% and 80% of the revenues. However this is not a worry, as it's a small firm focused on B2B.

- Other promoter group companies, GNA Gears Ltd, GNA Udyog Ltd, Amarsons Automotives Ltd and Guru Nanak Transmission Punjab Ltd are engaged in business similar to GNAX. These are unlisted entities. The business overlap can be detrimental to shareholder interest in GNAX.
- Since exports generate majority of the revenue, currency fluctuations could have an adverse effect.
- The INR has firmed up against the USD and this situation is expected to continue.
- There is high competition in the Automobile Ancillary market from new Indian firms and MNCs.
- Fewer entry barriers and high competition have resulted in a low pricing power in the industry.
- Key raw material, Steel, prices although are a pass through, it affects the company with a lag and hence the company financials are susceptible to volatile movement in Steel prices.
- The auto sector is first to be affected, in both economic upturns and downturns. However at this stage we feel that the Indian market is on a recovery path.
- The location of its two plants in Punjab acts a geographical limitation to service its clients.
- GNAX requires higher debt to fund the working capital requirements in rapidly growing exports.
- Petition against the company for winding up for non-payment of dues to RMG Alloys Limited.
- The proposed utilization of the IPO proceeds towards meeting the working capital requirements is based on our internal management estimates, and may be subject to change based on various factors, some of which are beyond our control.
- GNAX does not own its trademark and the use of this trademark is restricted to some products.
- The Brexit event recently caused volatility in forex and has affected global markets. This is an example of global business risks.

### Overall Opinion

- India is an emerging hub of auto and auto ancillary products. Evidence of costs rise in China too convinces us that India has ample opportunity as a fair cost quality supply base.
- In terms of valuations, the IPO pricing is attractive. At a PE of 12.10 times, it looks cheaper than other auto mid/ small caps. Also, GNAX has a better margin and ROE profile than its comparable peers.
- The domestic sectors are tractors and commercial vehicles, and these are expected to do well in the next few years.
- 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.
- As an investment, the GNAX IPO is rated a medium risk, medium return type of offering.
- Investors may Buy GNAX with a 2 year perspective.

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