



# 5 MINUTE STOCK IDEA

BY SMART SYNC INVESTMENT ADVISORY SERVICES

## RACL GEARTECH LTD

### WHAT WE LIKE

#### STRONG MARKET POSITIONING:

The company has been one of the leading manufacturers of transmission gears and shafts for automotive and industrial applications since the 1980s & has a solid clientele including BMW, Kubota, ZF, KTM, and Schneider among others who have high-quality product requirements.

The company has historically passed on the cost increase of steel & forgings to the customers indicating some level of pricing power.

RACL GEARTECH LTD										
Rs Cr	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
EBITDA	14	16	15	15	18	32	43	52	58	83
EBITDA Margin	13%	15%	13%	13%	13%	17%	20%	25%	21%	23%

Further, owing to increased energy costs in the European market & China+1 trend, the company is getting good outsourcing opportunities owing to its lower costs & high precision levels.

#### HEALTHY PAST TRACK RECORD:

The company has been one of the biggest wealth creators in the past decade with 10-year Sales & PAT CAGR of 14% & 38%. The company has shown great ability to reinvest in the core business while improving its ROE levels subsequently owing to improving PAT margins profile from 3% to 10% (led by a higher share of exports to premium companies, production of high-quality precision components & economies of scale).

The management is guiding for a strong 25-30% CAGR in the coming 3 years.

Compounded Sales Growth		Compounded Profit Growth		Stock Price CAGR		Return on Equity	
10 Years:	14%	10 Years:	38%	10 Years:	54%	10 Years:	19%
5 Years:	21%	5 Years:	37%	5 Years:	96%	5 Years:	23%
3 Years:	19%	3 Years:	28%	3 Years:	130%	3 Years:	24%
TTM:	26%	TTM:	61%	1 Year:	120%	Last Year:	26%

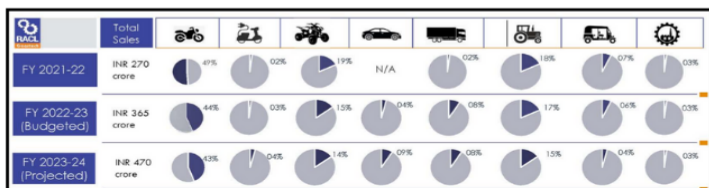
#### EXPERIENCED PROMOTER GROUP:

Mr. Gursharan Singh, a heads-on technical production guy has successfully managed the company for more than three and a half decades & biz has adequate succession planning in place.

The management team has shown prudent capital allocation skills (visible from its strong ROCE > 20%) wherein the company does a capex only if it receives a nomination letter (containing details of the supply schedule) which reduces the risk of scaling up its new capacities.

#### NEWER PRODUCT DEVELOPMENTS:

Although the majority of the revenue comes from 2W & 3W vehicles, along with Off-Road Vehicles, Agricultural Vehicles and Equipment, and Industrial Gear, the company took the step of producing Chassis, Suspension, and Steering Components and sub-assemblies for Passenger cars and Engine Gears for Heavy Commercial vehicles in FY21-22 & is also working on building components for propeller shafts & Yokes in Electric Vehicles, which will derisk the biz model & add to its growth prospects.



### WHAT WE DON'T LIKE

#### CLIENT CONCENTRATION RISK:

The top 5 clients contribute 60% of the overall revenues, which is a major risk. However, this risk is partly mitigated owing to the company being a preferential vendor coupled with its management strategy of not having exposure >15% of revenues on any one customer.

#### FOREX RISK:

This is a major risk considering exports contribute more than 75% of the total revenues. However, this is partially mitigated by the availment of export credit in foreign exchange coupled with early discounting of invoices with the banks.

#### ELONGATED WORKING CAPITAL CYCLE:

The company's cash conversion cycle stands at a mammoth 270 days due to:

- High inventory period led by 500+ SKUs & high stocking in warehouses near the plants of international clients to reduce transit time
- Higher receivables days led by a higher share of exports (3-4 months) vis-a-vis domestic (2 months)
- Lower creditor days of 1.5 months owing to early payment to get a cash discount

We at SSS Believe that a high inventory period can also be a source of entry barriers for new players & is thus not entirely a negative.

	Mar 2012	Mar 2013	Mar 2014	Mar 2015	Mar 2016	Mar 2017	Mar 2018	Mar 2019	Mar 2020	Mar 2021	Mar 2022	Mar 2023
Debtor Days	46	68	55	58	27	98	109	98	92	99	104	86
Inventory Days	131	173	184	230	219	230	251	206	222	254	230	318
Days Payable	95	160	200	160	116	138	158	123	102	169	119	126
Cash Conversion Cycle	83	82	39	128	130	193	202	181	212	184	215	278

#### GEOGRAPHICAL CONCENTRATION RISKS:

The company's major market -Europe (>50% revenues) is going through a huge slowdown. It is interesting to note that the company has continued to perform well on the exports front, however, it remains to be seen if this will sustain going forward.

#### BALANCE SHEET RISKS:

The company's capex requirements have far exceeded their CFO for the past few years, leading to high D/E levels of around 1 time. Given the capex plans of 250 Crs in the coming 3-5 years, it will be interesting to see how this will be funded considering any slowdown in exports can lead to a big impact on the bottom line owing to higher interest costs.

	Mar 2012	Mar 2013	Mar 2014	Mar 2015	Mar 2016	Mar 2017	Mar 2018	Mar 2019	Mar 2020	Mar 2021	Mar 2022	Mar 2023
Cash from Operating Activity +	-0	-4	6	4	10	9	5	19	33	39	11	60
Cash from Investing Activity -	-12	-7	-10	-2	-7	-5	-13	-31	-26	-40	-55	-76

Further, working capital financing can be a major risk given the long working capital cycle where its current working capital fund utilization levels (i.e.bank credit lines) stand at around 80%.

