

Low Risk Bet On Continued Momentum In Medium & Heavy Commercial Vehicles Cycle



Gandhi Special Tubes Ltd (GST)

Current Price : **INR 380**
Market Cap : **INR 525 Cr**
Recommendation : **BUY**
Portfolio Allocation : **5%**
Expected Returns : **~23% CAGR**
Industry : **Auto Ancillary**

Flash Investment Note

12th-Jun-2018

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Vibrant Matrix

Vibrant Matrix

<p style="text-align: center;"><u>Business</u> (Expected Strong Momentum; High Quality)</p> <p>Growth Momentum</p> <ul style="list-style-type: none"> Revenues of GST is linked with M&HCV segment. They grew at a CAGR of 23.6% in FY09-12 in line with 27.6% CAGR in volumes of M&HCV segment. However, post FY12 there was a slowdown in M&HCV segment leading to fall in volumes of M&HCV and revenues of GST From FY12-18, volumes of M&HCV grew at CAGR of 0.7% and revenues of GST had grown at a CAGR 2.1% M&HCV segment bottomed out in 2015 and we expect the growth to continue and see double digit growth in next two years <p>Business Quality (High)</p> <ul style="list-style-type: none"> Fuel Injection Tubes being critical component for, trust factor has to be established with OEM's, leading to high switching cost GST is a dominant player and controls more than 70% market share in fuel injection tubes for M&HCV segment GST has maintained operating margins above 25% even in difficult periods while median operating margins in auto ancillary industry are between 9-10% Pre tax RoCE's of 20%+ during its history of 20 years even during difficult times As of FY18 GST had earned pre tax ROCE and ROE of 50% & 26% respectively. ROE is diluted due to presence of significant cash holdings (maintained upwards of 100 cr). For FY18 GST had revenues of INR 113 cr, EBITDA of 41 cr. & PAT of 33 cr. 	<p style="text-align: center;"><u>Management Quality</u> (Above Average)</p> <ul style="list-style-type: none"> We have judged the management of GST Ltd as above average on a combination of how they have run the business and how they have treated the minority shareholders In terms of business, management's competence could be reflected in GST Ltd high RoCE for the past 20 years, even during the worst year, they were able to make pre-tax RoCE of 20% and were free cash flow positive. They have also maintained operating margins above 25% even in difficult times compared to auto ancillary industry's median operating margins of 9-10%. They have never diluted equity Management has been minority shareholder friendly in terms of sharing the wealth On average GST had paid 60-70% of free cash flow in form of dividends and have maintained dividend even in difficult time. In FY18, GST completed buyback of 8.80 lacs equity shares for INR 44 crs & declared INR 9 / share dividend for FY18, thus returning total cash of ~57 crores
<p style="text-align: center;"><u>Valuation</u> (Fair)</p> <p>Gandhi Special Tubes Ltd currently trades at ~15.7x LTM PE on post tax basis</p> <ul style="list-style-type: none"> Gandhi Special Tubes Ltd is currently trading ~15.7x PE multiple which is below its 5 year as well as 3 year median multiples At current price of INR 380, GST Ltd is available at ~2.3% dividend yield GST Ltd is maintaining > INR 103 crore of cash on its balance sheet which is ~20% of its current market cap of INR 525 Cr 	<p style="text-align: center;"><u>Trigger</u> (Exists)</p> <p>Pickup in M&HCV segment</p> <ul style="list-style-type: none"> We expect M&HCV segment to grow at double digits for next two years driven by the following factors <ul style="list-style-type: none"> Regulatory changes like ban on overloading, scrappage policy, implementation of BS VI leading to pre-buying etc. Pickup in infra linked spend by government/private players Structural changes in the industry with GST implementation <p>Corporate Action Relating to Usage of Cash</p> <ul style="list-style-type: none"> Efficient utilization of cash for propositions like higher dividend, buyback of shares, acquisition etc. will be positive for shareholders

Company Snapshot

Gandhi Special Tubes Ltd – Company Snapshot

- Gandhi Special Tubes Ltd (GST) formerly known as Gandhi Special Tubes 07 Ltd was set up by Gandhi group in technical collaboration with Benteler of Germany in 1985 for manufacturing precision seamless tubes and welded steel tubes. Benteler supplied the technology, machinery and helped in installation and commissioning of the plant
- GST is an OEM approved tier-2 supplier of seamless tubes, which are eventually used by M&HCV OEM's like Tata Motors, Ashok Leyland and M&M as fuel injection tubes
- Tubes manufactured by GST are also used in hydraulics, refrigeration and other engineering applications
- Apart from tubes, GST also manufactures Cold Formed Tube Nuts for Fuel Injection Tube Assemblies as well as Hydraulic Tube Assemblies
- The tubes and nuts manufacturing plant situated at Halol, Gujarat
- GST owns a total of ~5.3 MW of wind power capacity in Gujarat and Maharashtra. In Gujarat, the wind power generated is consumed captively while in Maharashtra, the wind power is sold to the state grid.
 - In Gujarat Wind power plant is situated at Bhogat, Navadara & Kuchchh (Gujarat). In Maharashtra it is situated at Sangli
- As of FY18, GST had posted
 - Revenues of INR ~ 117 crores
 - EBITDA of INR ~41 crores
 - PAT of INR ~33 crores
- Revenue breakup for FY17 is as follows Seamless tubes (~73%), Welded tubes (~18%), Cold formed nuts/ scrap (~7%), Wind power (~2%)

Gandhi Special Tubes Ltd – Company Snapshot

Product range of the company includes:

- **Small Diameter Welded Steel Tubes:** These tubes find applications mainly in refrigeration and automobile industry.
- **Cold Drawn Seamless Steel Tubes:** These tubes find applications in high pressure fuel injection tubings and hydraulic tubings.
- **Cold Formed Nuts:** These nuts finds application in fuel injection tube assemblies, hydraulic & other tube assemblies, which act as an auxiliary unit for its seamless tube segment.



Investment Thesis

GST Ltd – Investment Thesis

- More than 60% of overall revenues of GST come from Seamless tubes. Large proportion of these seamless tubes are used as fuel injection tubes in Medium and Heavy Commercial Vehicles. Therefore, revenues of GST have moved in line with M&HCV cycle historically.
- M&HCV cycle has shown turnaround over last couple of years and we believe next two years will also be good with double digit growth in M&HCV industry sales volumes which will indirectly benefit Gandhi Special Tubes
- The growth in M&HCV segment over next two years will be driven by
 - Regulatory changes like ban on overloading, scrappage policy, implementation of BS VI leading to pre-buying etc.
 - Pickup in government / private players spending linked to infrastructure
 - Structural changes in the industry with implementation of GST
- We expect Gandhi Special tubes to post 10-15% revenue growth in next couple of years in line with M&HCV cycle. GST doesn't need to do any capex to cater to this growth as it had expanded its capacity in 2013.
- The capex in 2013 coincided with the downcycle in M&HCV, due to which margins of GST suffered due to low capacity utilization. With 10%-15% sales growth, we expect bottom line to grow at ~15%-20% due to improvement in margins from current 36% to ~40%+ as utilization increases.
- At CMP of INR 380, we are getting an opportunity to buy Gandhi Special Tubes below its 5 year median PE multiple
 - Currently, GST is trading at ~15.7x PE compared to 5 Yr Median PE of ~17x
- Even if we don't assume any PE rerating, we can expect ~15%-20% compounded returns excluding dividends.

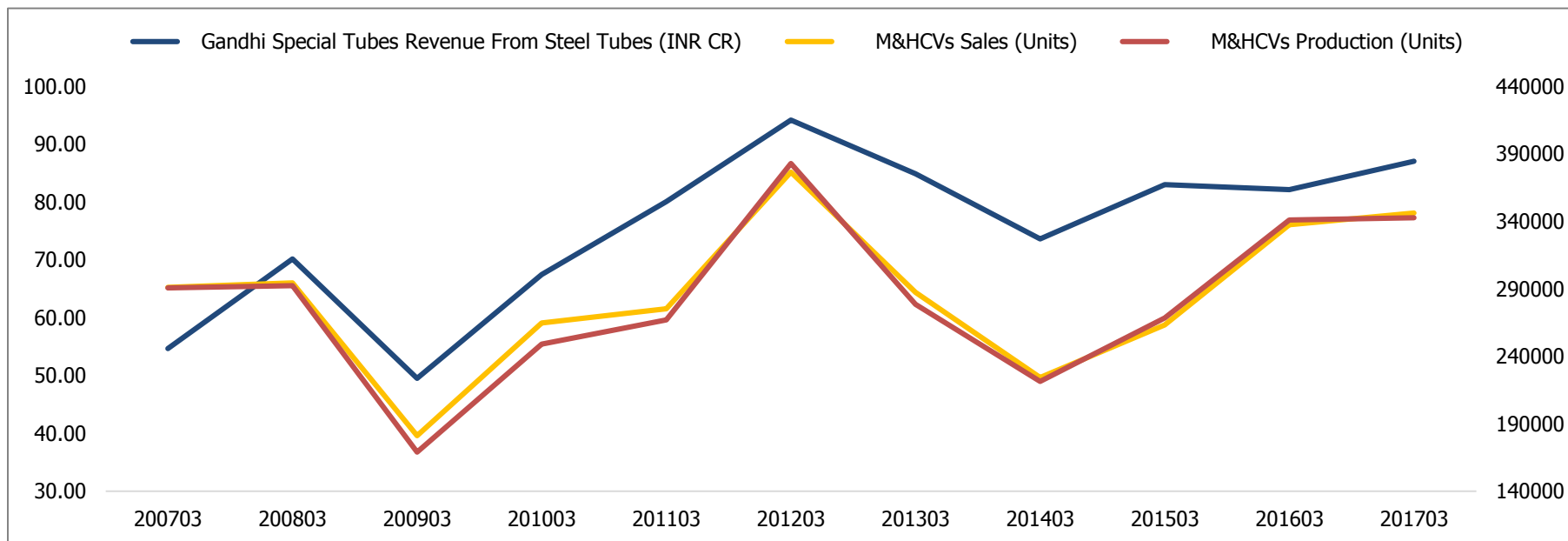
GST Ltd – Investment Thesis

- Moreover, Company is debt-free and has Net cash of ~INR 74/Share (~20% of M.Cap).
- The management is extremely minority shareholder friendly and has consistently rewarded shareholders by paying dividends and doing buyback.
 - With minimal capex requirements in next two years we expect further buybacks and dividends.
- In FY18, Gandhi Special Tubes declared a dividend of INR 9 per share translating into healthy dividend yield of ~2.3%. It also did a buyback of INR 44 crores at INR 500 per share in FY18, thus returning a total cash of ~57 crores
- Considering the above factors, we believe Gandhi Special Tubes is a better proxy to play the M&HCV cycle compared to OEM's like Tata Motors, Ashok Leyland etc. Unlike OEM's which have low operating margin and leveraged balance sheet, Gandhi Special Tubes has maintained on an average 35%+ operating margins and is net cash positive. With a market share of ~70-80% in the fuel injection tubes, it effectively caters to all the major M&HCV OEM's.
- Therefore we recommend to allocate ~5% of the portfolio to GST. At current price of INR 380, GST is available at ~2.3% dividend yield. Revival in demand for M&HCV should drive growth in revenue and profits for GST. Efficient utilization of cash for acquisitions / dividend / buyback is another trigger. Downside is protected by strong balance sheet, cash on books > INR 103 crore which is ~20% of its current market cap of INR 525 Cr
- **Key risks that can impact investment thesis**
 - Delay in revenue growth
 - Contraction in margins
 - Removal of import duty
 - Non-diversified revenue base

M&HCV Volumes & GST Co-Relation

M&HCV & GST Co-relation

Due to seamless tubes contributing majority of the sales, GST revenues have followed the path of Medium & Heavy commercial Vehicles Cycle as can be seen from the chart below



- Revenues of GST tracks M&HCV cycle. From FY09-12, topline for GST grew at a CAGR of 23.8% in line with 27.6% volume growth in M&HCV volumes.
- During, FY12-15 GST revenues have de-grown by 18% in line with 30% de-growth in M&HCV
- However, In FY16 Revenues for GST were Flat despite M&HCV segment showing a growth of 28%, mainly on account of lower steel prices leading to drop in realisation
- Going forward we expect GST revenues to mirror the M&HCV segment volume growth

Drivers of Growth in M&HCV Segment

Growth in M&HCV will be driven by combination of Regulatory changes and Structural changes

Tailwinds

- Higher government's infrastructure spending and revival in mining and construction activities
- Revival in Private Capex : Investment proposals from private sector picked up materially for the first time in FY17 since FY13, they were higher by 53% YoY
- Increase in import & export activities leading to higher demand for commercial vehicles

Regulatory Changes

- Restrictions on overloading
- **Scrappage policy**: We believe scrappage policy can be implemented by more states, where more than 10 years old truck are banned from plying
- With implementation of BS-VI norms post April-20, we expect cost of vehicles to increase meaning fully which can lead to strong pre buying in FY20
- **Import duty on Seamless tubes of ~30%**

Structural changes

- Shift of focus from overloading to speed delivery
 - Post-GST, the travel time across routes has declined considerably leading to shift of focus to speedy delivery rather than overloading. This will lead to increase in demand of M&HCV in spite of same freight demand
- **Warehousing Consolidation**
 - Warehousing consolidation is picking up post GST, this can lead to a trade off between warehousing and transportation cost, which could spark a new trend of 'inventory-on-wheels'.
- **Availability of input tax credit** on purchases of trucks could spur new truck purchases as opposed to used trucks
- **Implementation of the truck body code** could lead to higher demand of fully built vehicles

Business Overview & Financials

Revenue Growth & Operating Margins

High Teens Revenue Growth 5 Years of Stagnant Topline

- After stagnant revenues from FY12 to FY17. GST has shown revenue growth of 16.8% in FY18 from INR 97.6 Cr in FY17 to INR 113.9 crores
- Higher revenue growth was due to favorable changes in regulation relating to norms for M&HCV segment which helped in volumes coming back to 2012 levels

Year Ending March	2011	2012	2013	2014	2015	2016	2017	CAGR 5 yr	2018	Growth 1 yr
Revenues From Operations (INR cr)	92	107	96	84	92	91	98	(1.7%)	114	17%
Volumes Of M&HCV segment (000)	275	376	287	224	263	338	346	(1.7%)	384	11%

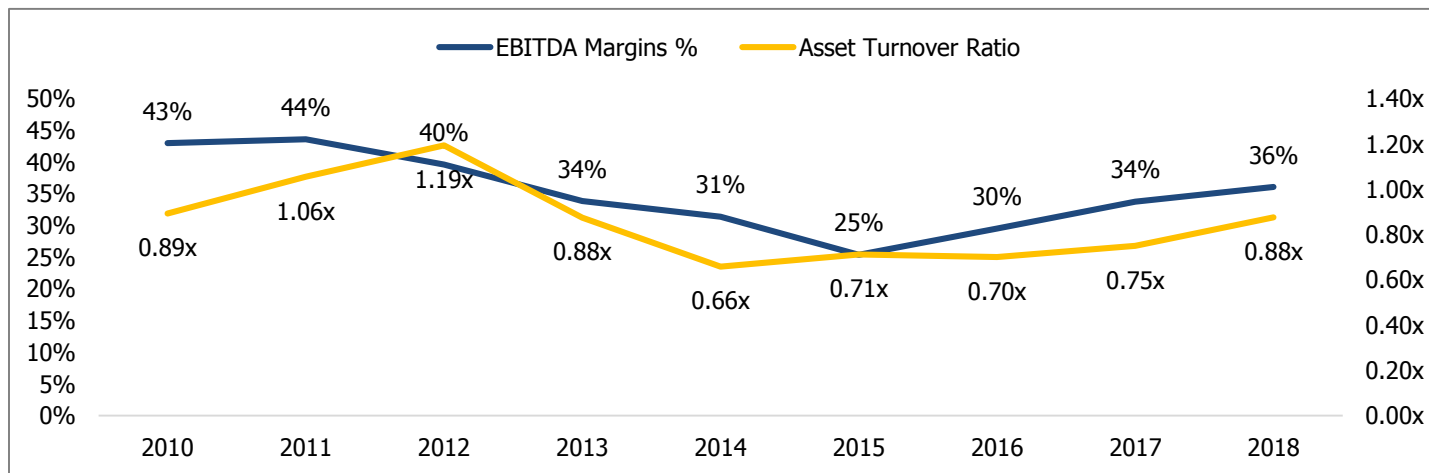
Operating Margins to expand with higher capacity utilization

- Company had increased its gross block by ~40% from 2012 to 2014, however sales de-grew by 22% from FY12-14 due to slowdown in M&HCV segment. This resulted in lower asset turnover of 0.66x in 2014 compared to ~1.1x in 2011 & **EBITDA margins also contracted from 40% in FY12 to 31% in FY14**
- With revival in M&HCV segment from 2015 onwards, GST revenues have also grown, which resulted in improvement of asset turnover from 0.71x in FY15 to 0.88x in FY18 and **EBITDA margins expanding from 25% in 2015 to 36% in 2018.**
- We believe further pick up in M&HCV volumes will lead to double digit growth in revenues for GST and improved capacity utilization will lead to EBITDA margins expanding above 40%

Revenue Growth & Operating Margins

GST EBITDA Margins Can Reach 40%+ With Increase in Utilization

Year Ending March	2010	2011	2012	2013	2014	2015	2016	2017	2018
Gross Block (INR cr)	86.9	87.4	89.2	109.6	126.7	129.0	130.1	130.0	130.0
Revenues From Operations (INR cr)	77.7	92.2	106.5	95.9	83.5	91.9	91.2	97.6	113.9
EBITDA Margins %	43%	44%	40%	34%	31%	25%	30%	34%	36%
Asset Turnover Ratio	0.89x	1.06x	1.19x	0.88x	0.66x	0.71x	0.70x	0.75x	0.88x
Volumes Of M&HCV segment ('000s)	265	275	376	287	224	263	338	346	384



EBITDA Margins

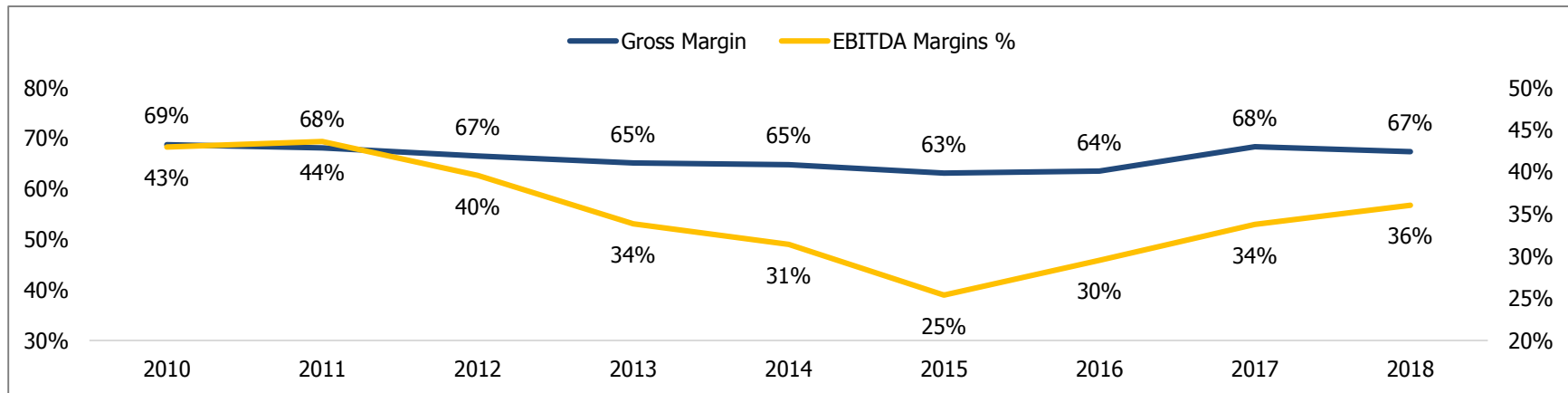
Median Range for 10 yrs

25th Percentile	32%
50th Percentile	35%
75th Percentile	41%

Competitive Advantage

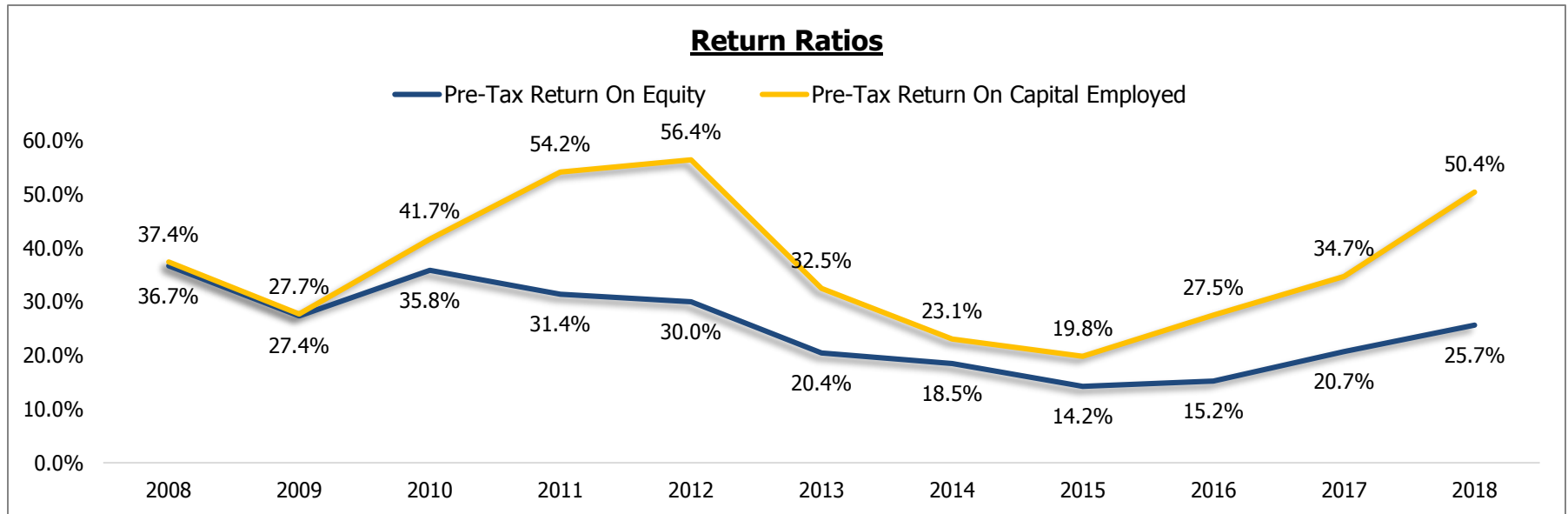
Critical Functionality of the Product Combined With Low Cost As % Of Vehicle Means Customers Don't Have Incentive To Switch Leading To Pricing Power & Strong Margins For GST

- GST manufactures fuel injection tubes which are used for transferring fuel from fuel tank to combustion chamber (inside engine). It is a very critical component for smooth working of the vehicle.
- Fuel injection tubes being a critical component and low value compared to overall value of the end product, an OEM would not risk buying this products from others suppliers for cutting costs. Due to high cost attached to failure, there is stickiness for the incumbent suppliers.
- Historically, **Gross margins have moved in tight range of 63%-69% which shows its pricing power. EBITDA margins have moved in the range of 25-44% and are a function of capacity utilization.** Even during difficult times company has posted 25% EBITDA margins while median auto ancillary industry's EBITDA margins are of 9-10%. This shows GST has considerable competitive advantage.



Return Ratios – Pre-Tax RoCE & ROE

High Return Ratios Vindicate Competitive Advantage of Gandhi Special Tubes; Even in the worst time GST delivered a pre-tax RoCE of ~20%. ROE is lower than ROCE due to cash on B/S



- Return ratios have moved in line with M&HCV cycle, peaking in 2012 bottoming out in 2015. We expect return ratios to improve in line with revival of M&HCV segment driven by both margin expansion and capital employed turnover
- GST is has been a net cash company since 2009, therefore, pre-tax ROE lags behind pre-tax ROCE

Free Cash Flow & Dividend Pay-out

During FY12 to FY17, GST has generated free cash flow of ~112 crores; More than 70% of the FCF has been paid as dividends highlighting minority shareholder friendliness of the management

Year Ending March (INR Cr)								
	2011	2012	2013	2014	2015	2016	2017	Cumulative
Cash Flow from Operations	28	27	27	14	15	29	21	159
Capital Expenditure	(1.2)	(2.5)	(27.4)	(9.8)	(3.7)	(1.0)	(1.2)	(46.8)
Dividend Paid	(8.6)	(10.2)	(10.2)	(10.3)	(13.3)	(13.3)	(15.9)	(81.9)
Cash Flow Retained	18.1	14.4	(10.9)	(6.5)	(2.2)	14.3	3.6	30.8

Historical Dividends

Year End	Dividend per Share(Rs)	Dividend Yield %	Un.Adj.Close Price (Rs.)	Dividend Amount (cr)	Face Value(Rs)	Dividend %
Mar-2017	9.00	2.69	334.00	13.23	5.00	180.00
Mar-2016	7.50	3.73	201.20	11.02	5.00	150.00
Mar-2015	7.50	2.96	253.40	11.02	5.00	150.00
Mar-2014	6.00	4.27	140.50	8.82	5.00	120.00
Mar-2013	6.00	3.93	152.85	8.82	5.00	120.00
Mar-2012	6.00	4.59	130.70	8.82	5.00	120.00
Mar-2011	5.00	4.85	103.15	7.35	5.00	100.00
Mar-2010	2.50	2.80	89.15	7.35	5.00	50.00
Mar-2009	2.50	7.14	35.00	3.67	5.00	50.00
Mar-2008	2.50	2.74	91.40	3.67	5.00	50.00

GST is paying ~INR 9 per Share dividend for FY18 from internal accruals even after executing Buyback of INR 44 cr

Financial Projections & Return Analysis

GST- Projections (Base)

Year Ending March; INR Cr	2017	2018	2019E	2020E	2021E	2022E	2023E	CAGR
Base Case								(18-20E)
Revenue	97.6	113.9	128.7	146.7	161.4	174.3	195.2	13.5%
Revenue growth	0.0%	16.7%	13.0%	14.0%	10.0%	8.0%	12.0%	
EBITDA	33.0	41.0	47.4	56.4	63.6	69.8	80.3	17.3%
EBITDA margin	33.8%	36.0%	36.8%	38.5%	39.4%	40.1%	41.1%	
D&A	4.50	3.90	4.37	4.08	3.91	5.27	6.10	2.3%
D&A as % Revenues	4.6%	3.4%	3.4%	2.8%	2.4%	3.0%	3.1%	
EBIT	28.5	37.1	43.0	52.3	59.7	64.6	74.2	18.8%
EBIT margin	29.2%	32.6%	33.4%	35.7%	37.0%	37.0%	38.0%	
Net income	29.8	33.5	39.1	46.8	53.1	57.5	66.1	18.2%
Net income margin	30.5%	29.4%	30.4%	31.9%	32.9%	33.0%	33.9%	
Earnings per share	20.3	24.2	28.3	33.9	38.4	41.6	47.8	18.2%
Key Ratios								
	2017	2018	2019E	2020E	2021E	2022E	2023E	
Pre-Tax ROCE	15.9%	20.9%	21.4%	22.4%	22.1%	20.8%	20.7%	
Pre-Tax ROE	16.6%	18.9%	19.4%	20.1%	19.7%	18.5%	18.4%	

In our Base case, we expect Revenue CAGR of 13.5% over FY19-20 and EBITDA margin to expand to 38.5% in FY2020 driven by operating leverage

Exit PE Multiple: 15x

Expected Share Price at Exit - Base Case					
Exit PE	2019E	2020E	2021E	2022E	2023E
10.0x	283	339	384	416	478
13.0x	368	441	500	541	622
15.0x	425	508	576	624	717
18.0x	510	610	692	749	861
20.0x	566	678	769	833	957

IRR Summary - Base Case					
Exit PE	2019E	2020E	2021E	2022E	2023E
10.0x	(30.9%)	(6.2%)	0.4%	2.4%	4.9%
13.0x	(3.9%)	8.6%	10.3%	9.8%	10.8%
15.0x	15%	17.6%	16.1%	14.0%	14.2%
18.0x	45%	30.1%	23.9%	19.6%	18.6%
20.0x	65%	38.0%	28.6%	22.9%	21.2%

GST 5 yrs PE multiple

25 th Percentile	14.9x
Median	17.1x
75 th Percentile	21.3x

GST – Projections (Bull Case)

Year Ending March; INR Cr	2017	2018	2019E	2020E	2021E	2022E	2023E	CAGR
Bull Case								(18-20E)
Revenue	97.6	113.9	131.0	151.9	170.2	187.2	213.4	15.5%
Revenue growth	0.0%	16.7%	15.0%	16.0%	12.0%	10.0%	14.0%	
EBITDA	33.0	41.0	50.0	60.9	70.2	76.9	90.2	21.9%
EBITDA margin	33.8%	36.0%	38.2%	40.1%	41.3%	41.1%	42.3%	
D&A	4.50	3.90	4.63	4.39	4.26	6.13	7.38	6.1%
D&A as % Revenues	4.6%	3.4%	3.5%	2.9%	2.5%	3.3%	3.5%	
EBIT	28.5	37.1	45.4	56.5	65.9	70.8	82.9	23.4%
EBIT margin	29.2%	32.6%	34.7%	37.2%	38.8%	37.8%	38.8%	
Net income	29.8	33.5	41.0	50.3	58.3	62.7	73.3	22.6%
Net income margin	30.5%	29.4%	31.3%	33.1%	34.3%	33.5%	34.3%	
Earnings per share	20.3	24.2	29.7	36.4	42.2	45.4	53.0	22.6%
Key Ratios								
	2017	2018	2019E	2020E	2021E	2022E	2023E	
Pre-Tax ROCE	15.9%	20.9%	22.3%	23.7%	23.5%	21.7%	21.7%	
Pre-Tax ROE	16.6%	18.9%	20.2%	21.1%	20.8%	19.2%	19.2%	

In our Bull case, we expect Revenue CAGR of 15.5% over FY19-20 and EBITDA margin to expand to 40.1% in FY2020 driven by operating leverage

Exit PE Multiple: 18x

Expected Share Price at Exit - Bull Case					
Exit PE	2019E	2020E	2021E	2022E	2023E
10.0x	297	364	422	454	530
13.0x	386	473	548	590	690
15.0x	446	546	633	681	796
18.0x	535	655	759	817	955
20.0x	594	728	844	908	1,061

IRR Summary - Bull Case					
Exit PE	2019E	2020E	2021E	2022E	2023E
10.0x	(26.6%)	(2.3%)	3.8%	4.8%	7.2%
13.0x	2.0%	13.0%	14.0%	12.3%	13.2%
15.0x	22%	22.4%	20.0%	16.6%	16.7%
18.0x	53%	35.4%	28.1%	22.3%	21.2%
20.0x	75%	43.6%	33.0%	25.8%	23.9%

GST 5 yrs PE multiple

25 th Percentile	14.9x
Median	17.1x
75 th Percentile	21.3x

GST- Projections (Bear)

Year Ending March; INR Cr	2017	2018	2019E	2020E	2021E	2022E	2023E	CAGR
Bear Case								(18-20E)
Revenue	97.6	113.9	126.4	141.6	152.9	162.1	178.3	11.5%
Revenue growth	0.0%	16.7%	11.0%	12.0%	8.0%	6.0%	10.0%	
EBITDA	33.0	41.0	45.8	53.2	58.5	62.7	70.5	13.9%
EBITDA margin	33.8%	36.0%	36.3%	37.6%	38.3%	38.7%	39.5%	
D&A	4.50	3.90	4.37	4.08	3.82	4.77	5.22	2.3%
D&A as % Revenues	4.6%	3.4%	3.5%	2.9%	2.5%	2.9%	2.9%	
EBIT	28.5	37.1	41.5	49.1	54.7	57.9	65.3	15.1%
EBIT margin	29.2%	32.6%	32.8%	34.7%	35.8%	35.7%	36.6%	
Net income	29.8	33.5	37.8	44.1	48.9	52.1	58.8	14.7%
Net income margin	30.5%	29.4%	29.9%	31.1%	32.0%	32.1%	33.0%	
Earnings per share	20.3	24.2	27.4	31.9	35.4	37.7	42.6	14.7%
Key Ratios								
	2017	2018	2019E	2020E	2021E	2022E	2023E	
Pre-Tax ROCE	15.9%	20.9%	20.7%	21.4%	20.9%	19.5%	19.3%	
Pre-Tax ROE	16.6%	18.9%	18.9%	19.2%	18.7%	17.5%	17.4%	

In our Bear case, we expect Revenue CAGR of 11.5% over FY19-20 and EBITDA margin to expand to 37.6% in FY2020

Exit PE Multiple: 13x

Expected Share Price at Exit - Bear Case					
Exit PE	2019E	2020E	2021E	2022E	2023E
10.0x	274	319	354	377	426
13.0x	356	415	460	490	553
15.0x	411	478	531	566	639
18.0x	493	574	637	679	766
20.0x	548	638	708	754	851

IRR Summary - Bear Case					
Exit PE	2019E	2020E	2021E	2022E	2023E
10.0x	(33.7%)	(9.3%)	(2.5%)	(0.2%)	2.4%
13.0x	(7.8%)	5.0%	7.1%	6.9%	8.2%
15.0x	10%	13.7%	12.7%	11.0%	11.4%
18.0x	39%	25.8%	20.3%	16.5%	15.7%
20.0x	58%	33.4%	24.9%	19.8%	18.3%

GST 5 yrs PE multiple

25 th Percentile	14.9x
Median	17.1x
75 th Percentile	21.3x

Gandhi Special Tubes – Expected Returns

Expected Returns of 23% CAGR Over Two Years; Exit In Mar-20

Particulars	FY18	FY20E		
		Base	Bull	Bear
PAT (cr)	33.5	46.8	50.3	44.1
<i>Expected Growth</i>		<i>18%</i>	<i>23%</i>	<i>15%</i>
Exit PE Multiple		15.0x	18.0x	13.0x
Market Cap		702	905	573
Share Count (cr)		1.4	1.4	1.4
Per Share Value (INR)		508.0	655.2	414.9
Cumulative DPS Received (INR)		18.0	18.0	18.0
Net Per Share Value		526.0	673.2	432.9
Probability		50%	30%	20%
Weighted Average Share Price			552	
Expected Returns			23.0%	

Dividend

- GST had consistently paid dividend and we expect it to continue going forward. We have assumed dividend of INR 9 per share for next two years

Multiple Rationale

- We have taken lower multiples compared to historical as earnings were depressed. We have taken PE multiple of 15x in Base case which is below our 5yr median of 17x, PE multiple of 18x in Bull case which is below our 5 yrs 75th percentile of 20x and PE multiple of 13x in Bear case which is below 25th percentile of 14x

4QFY18 Result Update

Recent Result Update – 4QFY18

Revenues grew 30% yoy driven by 18% volume growth in M&HCV segment; However, PAT de-grew fell due to higher opex which included certain one-off expenses related to buyback and CSR

- M&HCV Volumes grew by 18% YoY from 1,10,666 units in Q4FY17 to 1,30,082 in Q4FY18
- Revenues followed M&HCV segment and grew by ~30% to INR ~28.0 cr (vs INR 21.6 cr in 4QFY17)
- EBITDA grew at lower rate of ~15.2% to 8.7 cr in 4QFY18 (vs INR 7.5 cr in 4QFY17) due to ~49% yoy growth in SG&A
 - SGA included one-off expenses related to buyback and CSR activities; Should normalize going forward
- EBITDA margins stood at 30.9% in 4QFY18 lower by 380 bps yoy and 660 bps qoq
- PAT de-grew by ~1.3% to INR 6.7 cr (vs INR 6.8 cr in 4QFY17) due to lower other income
 - Other income was lower by ~INR 0.75 cr in 4QFY18 and stood at INR 1.7 cr (2.5 cr in 4QFY17)
- For full year FY18, net revenues grew by 16.7% to ~INR 114 and PAT grew ~14.7% to 33.6 crores
- For FY18, GST has declared final dividend of INR 9 per share and also concluded buyback of ~INR 44 cr @ INR 500/share
- As of Mar-18, Cash & Equivalents stood at INR ~103 cr.
- GST currently trade at ~16x PE multiple based on Mar-18 PAT of INR 33.6 cr

GST– Quarterly Financials (Standalone)

Year Ending March; INR Cr	FY17		FY18				Growth		LTM		Growth
Income Statement	Q3	Q4	Q1	Q2	Q3	Q4	YoY	QoQ	Mar-17	Mar-18	YoY
Total Operating Revenue	22.1	21.6	28.0	29.8	28.1	28.0	29.5%	(0.3%)	97.4	113.9	17.0%
Raw Material Cost	7.8	6.2	9.1	9.0	9.2	9.1			31.2	36.5	17.1%
Change in Inventory	(0.7)	0.9	0.3	0.0	0.1	0.2			(0.5)	0.7	
COGS	7.0	7.0	9.5	9.1	9.3	9.3	32.5%	(0.4%)	30.7	37.2	21.0%
Gross Profit	15.1	14.6	18.6	20.7	18.8	18.7	28.1%	(0.3%)	66.7	76.8	15.1%
Employee Cost	1.7	1.7	2.0	2.3	2.1	2.0	17.3%	(5.7%)	7.2	8.4	15.3%
SG & A	6.6	5.4	6.1	7.1	6.1	8.1	49.3%	31.8%	26.5	27.3	3.1%
EBITDA	6.7	7.5	10.5	11.4	10.5	8.7	15.2%	(17.9%)	32.9	41.1	24.8%
Depreciation	1.1	1.1	1.0	1.0	1.0	1.0	(13.6%)	(3.1%)	4.5	3.9	
EBIT	5.6	6.4	9.5	10.4	9.6	7.7	20.1%	(19.4%)	28.5	37.2	30.7%
Other Non Operating Income	1.5	2.5	2.5	2.4	1.6	1.7	(30.6%)	4.9%	9.1	8.3	
PBT (Before Exceptional Items)	7.1	8.9	12.0	12.9	11.2	9.4	6.1%	(15.8%)	37.6	45.5	21.1%
Tax	1.0	2.0	3.2	4.2	1.9	2.7	30.9%	42.8%	8.3	11.9	
<i>Effective Tax Rate</i>	<i>14.3%</i>	<i>23.0%</i>	<i>26.5%</i>	<i>32.5%</i>	<i>16.7%</i>	<i>28.4%</i>	23.4%	69.7%	<i>22.1%</i>	<i>26.2%</i>	
PAT	6.1	6.8	8.8	8.7	9.3	6.7	(1.3%)	(27.6%)	29.3	33.6	14.7%

GST – Margin Analysis (Standalone)

Margins Analysis - Quarterly

Year Ending March	FY17		FY18				Absolute Change		LTM		Change
Margin Analysis	Q3	Q4	Q1	Q2	Q3	Q4	YoY	QoQ	Mar-17	Mar-18	YoY
Gross Margin	68.2%	67.5%	66.3%	69.6%	66.8%	66.8%	(0.7%)	0.0%	68.5%	67.4%	(1.1%)
EBITDA	30.5%	34.7%	37.5%	38.3%	37.5%	30.9%	(3.8%)	(6.6%)	33.8%	36.1%	2.3%
EBIT	25.4%	29.6%	34.0%	35.0%	34.0%	27.5%	(2.1%)	(6.5%)	29.2%	32.7%	3.4%
Profit Before Tax	32.2%	41.0%	42.9%	43.2%	39.8%	33.6%	(7.4%)	(6.2%)	38.6%	39.9%	1.4%
PAT attributable to Equity	27.6%	31.5%	31.5%	29.2%	33.1%	24.0%	(7.5%)	(9.1%)	30.0%	29.5%	(0.6%)
Cost Analysis as % Revenue	Q3	Q4	Q1	Q2	Q3	Q4	YoY	QoQ	Mar-17	Mar-18	YoY
Cost of Goods Sold	31.8%	32.5%	33.7%	30.4%	33.2%	33.2%	0.7%	(0.0%)	31.5%	32.6%	1.1%
Employee Benefit Expense	7.8%	7.8%	7.2%	7.6%	7.4%	7.0%	(0.7%)	(0.4%)	7.4%	7.3%	(0.1%)
SG & A	29.9%	25.1%	21.6%	23.7%	21.9%	28.9%	3.8%	7.0%	27.2%	24.0%	(3.2%)

Recommendation

Recommendation

- Gandhi Special Tubes Ltd is a bet on the continuation of momentum in M&HCV cycle. It is more preferable to ride the M&HCV cycle through GST than directly investing in OEM's because of the former having higher operating margins and strong balance sheet. Gandhi special tubes is a lower risk proxy to play the M&HCV cycle
- Gandhi Special Tubes is a niche auto ancillary company enjoying operating margins above 30% at EBITDA level compared to median operating margins of 9-10% for a typical auto ancillary company
- We expect top line growth of ~12%-15% until FY20 driven by further improvement in M&HCV segment and bottom line to grow between 15-20% due to expansion in margins with increased capacity utilization
- The company currently trades at ~15.7x PE. In our base case returns will come from earnings growth and in bull case additional upside from re-rating is expected. On a probability weighted basis, we expect 23% compounded returns for a holding period of ~2 years. In our bull case we expect 35% compounded returns over two years
- At current price of INR 380, GST is available at ~2.3% dividend yield. Our downside is protected by strong balance sheet, cash on books >INR 103 cr which is ~20% of its current market cap of INR 525 Cr. Efficient utilization of cash for propositions like acquisition, higher dividend or buyback, will be positive for shareholders
- The key risk to the investment thesis are
 - Delay in revenue growth and subsequent margin expansion
 - Removal of import duty on seamless tubes
 - Non-diversified revenue base
- **We recommend to allocate ~5% of portfolio to Gandhi Special Tubes Ltd**

Appendix

GST – Profit & Loss Statement

Appendix

Year Ending March; INR Cr	2012	2013	2014	2015	2016	2017	2018	CAGR		
Income Statement	Standalone							5 Yr	3 Yr	1 Yr
Total Operating Revenue	106.5	95.9	83.5	91.9	91.2	97.6	113.9	3.5%	7.4%	16.8%
Raw Material Cost	37	32	31	35	30	31	36			
Change in Inventory	(1.7)	1.3	(1.9)	(1.3)	2.8	(0.3)	0.7			
COGS	35.7	33.5	29.4	33.9	33.3	30.9	37.2	2.1%	3.1%	20.2%
Gross Profit	70.9	62.5	54.1	58.0	57.9	66.7	76.8	4.2%	9.8%	15.2%
Employee Cost	2.5	7.1	4.8	5.8	6.3	7.3	8.4	3.2%	13.0%	15.0%
SG & A	26.1	22.9	23.1	28.9	24.7	26.4	27.3	3.6%	(1.8%)	3.3%
Processing Charges	2.0	2.2	2.1	3.3	3.3	4.2				
Electricity & Power	9.3	10.8	12.3	14.2	11.3	12.4				
Stores, spare parts and tools consumed	7.7	6.3	5.1	7.3	5.4	5.3	Not Available			
Administrative and repairs	6.0	2.4	2.3	2.6	2.5	2.9				
Other Expenses	1.2	1.2	1.3	1.5	2.3	1.7				
EBITDA	42.2	32.5	26.2	23.3	26.9	33.0	41.1	4.8%	20.8%	24.7%
Depreciation	4.5	4.3	4.9	5.0	4.7	4.5	3.9			
EBIT	37.7	28.1	21.3	18.4	22.2	28.5	37.2	5.8%	26.5%	30.5%
Other Non Operating Income	2.3	0.7	6.1	2.2	0.4	6.1	8.3			
PBT (Before Exceptional Items)	41.6	30.8	29.1	22.8	25.2	37.1	45.5	8.1%	25.9%	22.4%
Tax	11.9	8.7	11.8	7.0	6.7	7.4	11.9			
<i>Effective Tax Rate</i>	<i>28.5%</i>	<i>28.3%</i>	<i>40.6%</i>	<i>30.7%</i>	<i>26.4%</i>	<i>20.0%</i>	<i>26.2%</i>			
PAT	29.8	22.1	17.3	15.8	18.5	29.7	33.6	8.8%	28.6%	12.8%

GST – Working Capital

Working Capital Analysis

Year Ending March	2012	2013	2014	2015	2016	2017	2018	Median
Working Capital Efficiency	2012	2013	2014	2015	2016	2017	2018	5yr
Inventory Days	220.6	233.1	293.0	299.6	186.4	287.5	196.8	287.5
Receivables Days	55.6	56.2	66.3	49.2	62.8	59.3	62.3	62.3
Payable Days	19.7	17.4	24.2	12.8	10.4	10.4	15.9	12.8
Cash Conversion Cycle (Days)	256.5	271.9	335.0	336.0	238.8	336.5	243.2	335.0

Working Capital Trend (INR Crores)	2012	2013	2014	2015	2016	2017	2018	5Yr CAGR
Inventory	21.6	21.4	23.6	27.8	17.0	24.3	20.0	-1.3%
Net Receivables	16.2	14.8	15.2	12.4	15.7	15.9	19.5	5.7%
Payables	1.9	1.6	2.0	1.2	0.9	0.9	1.6	0.3%
Net Working Capital	35.9	34.5	36.8	39.0	31.7	39.3	37.9	1.9%

Working Capital Trend % Revenues	2012	2013	2014	2015	2016	2017	2018	5yr
Receivables as % Revenue	15.2%	15.4%	18.2%	13.5%	17.2%	16.3%	17.1%	17.1%
Payables as % COGS	5.4%	4.8%	6.6%	3.5%	2.9%	2.9%	4.4%	3.5%
Inventory as % Revenues	20.2%	22.3%	28.2%	30.3%	18.6%	24.9%	17.6%	24.9%
NWC as % Revenues	33.7%	36.0%	44.1%	42.5%	34.8%	40.3%	33.2%	40.3%

GST – Margins Analysis

Margin Analysis – Annual

Year Ending March	2012	2013	2014	2015	2016	2017	2018	Median
Margin Analysis								5 Yr
Gross Margin	66.5%	65.1%	64.8%	63.1%	63.5%	68.3%	67.4%	64.8%
EBITDA	39.6%	33.8%	31.4%	25.4%	29.5%	33.8%	36.1%	31.4%
EBIT	35.4%	29.3%	25.5%	20.0%	24.4%	29.2%	32.7%	25.5%
Profit Before Tax	39.1%	32.1%	34.9%	24.8%	27.6%	38.1%	39.9%	34.9%
PAT attributable to Equity	28.0%	23.0%	20.7%	17.2%	20.3%	30.5%	29.5%	20.7%

Cost Analysis as % Revenue

Cost of Goods Sold	33.5%	34.9%	35.2%	36.9%	36.5%	31.7%	32.6%	35.2%
Employee Benefit Expense	2.4%	7.4%	5.8%	6.3%	6.9%	7.4%	7.3%	6.9%
SG & A	24.5%	23.9%	27.6%	31.4%	27.1%	27.1%	24.0%	27.1%
Processing Charges	1.9%	2.3%	2.5%	3.6%	3.6%	4.3%		3.6%
Electricity & Power	8.7%	11.3%	14.7%	15.4%	12.4%	12.7%		13.7%
Stores, spare parts and tool	7.2%	6.5%	6.1%	7.9%	5.9%	5.4%	Not Available	6.0%
Administrative and repairs	5.6%	2.5%	2.7%	2.8%	2.7%	3.0%		2.8%
Other Expenses	1.2%	1.3%	1.5%	1.7%	2.5%	1.8%		1.7%
Depreciation	4.2%	4.5%	5.9%	5.4%	5.2%	4.6%	3.4%	5.2%
Interest Expense	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Exceptional Profit / (Expenses)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

GST – Return Ratios

Return Ratios

Year Ending March	2011	2012	2013	2014	2015	2016	2017	2018	Median
Du Pont Analysis	2014-18								
PBT Margin	40.6%	39.1%	32.1%	34.9%	24.8%	27.6%	38.1%	39.9%	34.9%
PAT Margin	28.5%	28.0%	23.0%	20.7%	17.2%	20.3%	30.5%	29.5%	20.7%
Asset Turnover	0.7x	0.7x	0.6x	0.5x	0.5x	0.5x	0.5x	0.6x	0.5x
Asset Turnover (Without Financial investment)	1.2x	1.3x	0.9x	0.8x	0.8x	0.9x	1.0x	1.2x	0.9x
Leverage (Assets/ Equity)	1.1x	1.1x	1.1x	1.1x	1.1x	1.1x	1.1x	1.1x	1.1x
Leverage (Assets/ Total Equity)	1.1x	1.1x	1.1x	1.1x	1.1x	1.1x	1.1x	1.1x	1.1x
Pre-Tax Return On Equity	31.4%	30.0%	20.4%	18.5%	14.2%	15.2%	20.7%	25.7%	18.5%
Post-Tax Return On Equity	22.0%	21.5%	14.6%	11.0%	9.9%	11.2%	16.6%	18.9%	11.2%
EBIT Margin	38.5%	35.4%	29.3%	25.5%	20.0%	24.4%	29.2%	32.7%	25.5%
Capital Employed Turnover	1.4x	1.6x	1.1x	0.9x	1.0x	1.1x	1.2x	1.5x	1.1x
Pre-Tax Return On Capital Employed	54.2%	56.4%	32.5%	23.1%	19.8%	27.5%	34.7%	50.4%	27.5%

GST – Balance Sheet

Balance Sheet – Equity & Liabilities

Year Ending March; INR Crores	2011	2012	2013	2014	2015	2016	2017	2018
Balance Sheet	Standalone							
Shareholder's Equity								
Share Capital	7.3	7.3	7.3	7.3	7.3	7.3	7.3	6.91
Reserves & Surplus	111.9	131.5	143.3	150.3	152.7	158.0	171.8	170.3
Shareholder's Equity	119.2	138.8	150.6	157.6	160.1	165.4	179.2	177.2
Total Equity	119.2	138.8	150.6	157.6	160.1	165.4	179.2	177.2
Non-Current Liabilities								
Deferred Tax Liabilities (Net)	4.4	4.4	4.3	6.5	7.1	7.4	7.4	8.1
Long Term Provisions	1.4	1.5	2.8	2.5	2.7	2.8	2.9	3.1
Total Non Current Liabilities	5.8	5.9	7.1	9.0	9.8	10.2	10.3	11.1
Current Liabilities								
Trade Payables	1.0	1.9	1.6	2.0	1.2	0.9	0.9	1.6
Advances from Customers	0.3	0.2	0.2	0.2	0.3	0.4	0.4	0.0
Other Current Liabilities	3.8	4.2	4.4	2.2	2.2	3.0	3.6	6.1
Short Term Provisions	0.4	0.1	0.1	1.4	0.4	0.2	2.0	1.3
Total Current Liabilities	5.5	6.4	6.3	5.7	4.0	4.6	6.9	9.0
Total Liabilities	11.3	12.3	13.4	14.6	13.8	14.8	17.2	20.2
Total Equity & Liabilities	130.5	151.1	164.0	172.3	173.9	180.2	196.4	197.4

GST – Balance Sheet

Balance Sheet – Assets

Year Ending March; INR Crores	2011	2012	2013	2014	2015	2016	2017	2018
Balance Sheet	Standalone							
Non-Current Assets								
Net Block	37.9	35.5	52.0	64.2	62.5	59.0	55.2	51.4
Non-current investments	49.5	57.8	38.6	41.4	59.7	62.0	79.8	80.5
Total Non-Current Assets	89.5	96.2	100.8	107.0	123.8	123.1	135.6	132.0
Current Assets								
Inventories	18.8	21.6	21.4	23.6	27.8	17.0	24.3	20.0
Trade Receivables	15.7	16.4	14.9	15.3	12.7	16.1	16.3	19.5
Current Investments	1.9	10.1	22.5	22.2	5.6	19.6	14.0	18.3
Cash and Bank Balances	2.2	4.2	2.8	1.8	2.1	3.0	3.2	4.5
Short-term loans and advances	1.9	1.8	0.6	1.3	0.9	0.6	1.9	0.7
Other current assets	0.6	0.8	1.0	1.1	0.9	0.8	0.9	2.4
Total Current Assets	41.1	54.9	63.2	65.3	50.1	57.1	60.7	65.4
Total Assets	130.5	151.1	164.0	172.3	173.9	180.2	196.4	197.4

GST– Cash Flow Statement

CFS – Cash Flow from Operating Activity

Year Ending March; INR Crores	2011	2012	2013	2014	2015	2016	2017
Cash Flow Statement							
Cash Flow From Operating Activities							
Profit Before Tax	37.4	41.7	30.8	29.1	22.8	25.2	37.2
Adjustment For Depreciation & Amortization	4.7	4.5	4.3	4.9	5.0	4.7	4.5
Adjustment For Provision (Written Back) / Created	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjustment For Non Operating (Income) / Expense	(2.0)	(4.0)	(2.5)	(7.8)	(4.2)	(2.9)	(8.2)
Other Adjustments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pre-Tax CFO Before WC Changes	40.2	42.2	32.6	26.2	23.5	27.0	33.4
Change in Trade & Other Receivables	(1.2)	(0.9)	2.5	(1.3)	3.3	(2.6)	0.0
Change in Inventories	(0.7)	(2.7)	0.2	(2.2)	(4.2)	10.8	(7.4)
Change in Trade & Other Payables	0.6	1.3	1.2	(2.2)	(0.4)	1.0	0.6
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adustment For Working Capital Changes	(1.3)	(2.3)	3.8	(5.7)	(1.4)	9.1	(6.7)
Pre-Tax CFO After WC Changes	38.9	39.9	36.4	20.5	22.1	36.1	26.7
Direct Taxes Paid	(11.0)	(12.8)	(9.6)	(6.9)	(7.4)	(7.6)	(5.9)
Net Cash Flow From Operations	27.9	27.1	26.7	13.6	14.7	28.5	20.8

GST – Cash Flow Statement

CFS – Cash Flow from Investing & Financing Activity

Year Ending March; INR Crores	2011	2012	2013	2014	2015	2016	2017
Cash Flow Statement							
Cash Flow From Investing Activities							
Capex (Purchase of Fixed Assets)	(1.2)	(2.5)	(27.4)	(9.8)	(3.7)	(1.0)	(1.2)
Divestment of Fixed Assets	0.0	0.1	0.1	0.0	0.0	0.0	0.2
Net (Investment) / Divestment In Financial Assets	(20.4)	(14.3)	7.4	3.6	0.4	(15.9)	(6.2)
Income From Financial Assets	1.9	1.8	2.1	1.8	2.2	2.6	2.6
Investments / Loan given to subsidiary or associate cor	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Cash Flow From Investing	(19.7)	(14.9)	(17.9)	(4.3)	(1.1)	(14.4)	(4.6)
Cash Flow From Financing Activities							
Net Proceeds from Issuance of Equity	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Increase / (Decrease) Borrowings	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividend Paid	(8.6)	(10.2)	(10.2)	(10.3)	(13.3)	(13.3)	(15.9)
Financial Expenses	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Cash Flow From Financing	(8.6)	(10.2)	(10.2)	(10.3)	(13.3)	(13.3)	(15.9)

GST – Latest Share Holding Pattern

Share Holding trend by Category

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Apr-18*	Change QoQ
Total of Promoter and Promoter Group	73.3%	73.3%	73.3%	73.3%	73.3%	73.3%	73.3%	73.3%	73.3%	(0.01%)
Institutions	3.9%	4.0%	4.1%	4.2%	4.4%	4.3%	4.3%	1.9%	1.9%	(0.02%)
Non-Institutions	22.8%	22.8%	22.6%	22.5%	22.3%	22.4%	22.4%	24.8%	24.9%	0.03%

**Note: Buyback of 8,80,000 shares got concluded on 03-April-2018. Therefore Shareholding pattern shown above on Apr-18 is post buyback pattern*

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