

Stock Update

LG Balakrishnan & Bros. Ltd.

August 16, 2022





| Industry | LTP | Recommendation | Base Case Fair Value | Bull Case Fair Value | Time Horizon |
|------------------|--------|--|----------------------|----------------------|--------------|
| Auto Ancillaries | Rs 725 | Buy on dips in Rs 675-685 band & add more on dips to Rs 607-617 band | Rs 770 | Rs 838 | 2-3 quarters |

| | |
|------------------------|------------|
| HDFC Scrip Code | LGBALAEQNR |
| BSE Code | 500250 |
| NSE Code | LGBBROSLTD |
| Bloomberg | LGBB IN |
| CMP Aug 12, 2022 | 725.2 |
| Equity Capital (Rs cr) | 31.4 |
| Face Value (Rs) | 10 |
| Equity Share O/S (cr) | 3.1 |
| Market Cap (Rs cr) | 2274 |
| Book Value (Rs) | 360.7 |
| Avg. 52 Wk Volumes | 261,200 |
| 52 Week High (Rs) | 736.0 |
| 52 Week Low (Rs) | 399.3 |

| Share holding Pattern % (Jun, 2022) | |
|-------------------------------------|-------|
| Promoters | 34.3 |
| Institutions | 19.3 |
| Non Institutions | 46.4 |
| 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:

LGBB has posted decent results for Q1FY23. There was pressure on margin due to material inflation, as LGBB has passed on most of the material inflation but it had to absorb some of the expenses. The recent correction in steel prices should provide some respite on the margin front. FY23 2W sales have been on a strong wicket so far with Hero Motocorp and TVS Motors witnessing 24% and 30% YoY volume growth during Apr-Jul 2022. Revival in economy and increasing preference for personal mobility gives us confidence that 2W sales would remain strong in the next few quarters. Entry into industrial chains segment would reduce LGBB's dependence on automobile sector de-risking its revenue. Resolution for RSAL under IBC would widen the company's portfolio and could add ~Rs 1000cr to the topline. RSAL offers low carbon, cold rolled, electrical, and mild steel products.

LG Balakrishnan & Bros (LGBB) mainly caters to 2W industry and operates in 2 segments 1) Transmission products which includes chains, sprockets, tensioners, belts and brake shoe which contributes ~80% of overall revenue – mainly catering to 2W 2) Metal forming products consisting of fine blanking for precision sheet metal parts, machined components and wire drawing products contributing ~20% of overall revenue. It is a dominant player with strong leadership position in automotive chains in the Indian 2-wheeler industry.

On April 11, 2022, we had initiated coverage on the stock ([Link](#)) with a recommendation to 'Buy in Rs 595-605 band & add more on dips to Rs 525-535 band' for base case fair value of Rs 672 and bull case fair value of Rs 720. The base case target was achieved on July 6 and bull case target on August 10, 2022.

Valuation & Recommendation:

Given the strong growth in domestic 2W market, we continue to remain bullish on the prospects of the company in the medium term. Its replacement sales will keep growing given the large base of 2W and offset some concerns due to the imminent threat of EV in 2W that use minimal transmission products. We expect LGBB's revenue/EBITDA/PAT to grow at 13/9/8% CAGR over FY22-FY24, led by revival in the 2W market. We believe investors can buy the stock on dips in the band of Rs 675-685 (7.5x FY24E EPS) and add more on dips to Rs 607-617 band (6.75x FY24E EPS) for a base case fair value of Rs 770 (8.5x FY24E EPS) and bull case fair value of Rs 838 (9.25x FY24E EPS) over the next 2-3 quarters.



Financial Summary

| Particulars (Rs cr) | Q1FY23 | Q1FY22 | YoY (%) | Q4FY22 | QoQ (%) | FY21 | FY22 | FY23E | FY24E |
|---------------------|--------|--------|---------|--------|---------|-------|-------|-------|-------|
| Operating Income | 521 | 393 | 32.7 | 559 | -6.8 | 1,609 | 2,102 | 2,333 | 2,695 |
| EBITDA | 85 | 61 | 38.8 | 105 | -18.9 | 253 | 388 | 401 | 461 |
| APAT | 51 | 33 | 55.2 | 60 | -14.7 | 133 | 246 | 241 | 284 |
| Diluted EPS (Rs) | 16.3 | 10.5 | 55.2 | 19.1 | -14.7 | 42.5 | 78.4 | 76.6 | 90.6 |
| RoE (%) | | | | | | 16.8 | 24.5 | 19.6 | 20.0 |
| P/E (x) | | | | | | 17.1 | 9.3 | 9.5 | 8.0 |
| EV/EBITDA (x) | | | | | | 8.7 | 5.4 | 5.1 | 4.1 |

(Source: Company, HDFC sec)

Q1FY23 Result update

Revenues of the company increased by 32.7% YoY to Rs 521cr driven by 33% growth in Transmission segment to Rs 402cr. Metal Forming segment grew by 31% YoY to Rs 119cr. On a sequential basis revenue declined by 9.4%. EBITDA grew by 39% YoY to Rs 85cr and EBITDA margin expanded 72bps to 16.3% YoY as operating leverage kicked in with higher capacity utilisation but fell sequentially by 250 bps. PAT increased by ~77% YoY to Rs 51cr and PAT margin expanded 142bps to 9.8%.

The management has guided for revenue growth of 10% in FY23. Export turnover is 12% and the remaining is domestic sales. Operating margin is expected to be maintained at 15-17%. The company has passed on most of the price increase but had to absorb ~1-1.5% of sales.

Key Triggers

Long standing presence in the domestic automotive chains industry

LGBB has long-standing presence and established relationships with reputed OEMs like Bajaj Auto, TVS Motor, Yamaha, Royal Enfield and HMSI with whom the company enjoys high market share. LGBB's long presence, diversified client base encompassing all major original equipment manufacturers (OEMs) in the domestic two-wheeler (2W) market ensures revenue visibility. The company remains an established player in the domestic two-wheeler chain segment with market share of over 60% and ~50% in the replacement market. Over the years it has improved its share of business with the OEMs. Its established presence in the replacement market (~27/37%/35% of revenues in FY20/FY21/FY22), which helps partially mitigate the cyclicity in OEM volumes to an extent.

Over the years, LGBB improved its margins aided by several cost optimisation measures including higher proportion of power usage from low-cost renewable energy sources, automation of a larger part of operations and reduction in freight expenses, among others.



2W sales expected to recover in FY23

2W sales were muted for FY22 coming on the back of high base of last year. Volumes were also impacted due to high RM inflation driving the cost of ownership higher. With negligible impact of the third wave of the pandemic in India, lockdowns have been eased and growth momentum is expected to pick up again. Ratings agency India Ratings has forecast a growth of 5-8% for 2W sales in FY23. A low base, healthy rural cash flows, and continued preference for personal mobility would support two-wheeler demand in the coming years.

Large captive power generation resulting in cost savings

LGBB has installed 22 number of windmills with a total rated capacity of 7.16 MW. The total number of units of energy generated from these windmills was around 96.58 lakhs units which were used for captive consumption. Also the Company has installed 3 number of ON GRID ground mounted solar power plants for a rated capacity of 100 KW each. Further LGBB has installed Roof Top Solar system at one of Coimbatore plant with capacity of 1.45 MW and Gudalur plant with capacity of 0.8 MW & Jalna plant with capacity of 0.83 MW. The number of units generated through this solar system was around 42.29 lakhs units which were used for captive consumption.

LGBB looking to expand manufacturing capacities

LGB is setting up a new plant in Nagpur to manufacture industrial chains, conveyor chains, automotive components and assemblies. The plant is expected to commence production in Q1FY24. The company has significant capex plans of Rs 200cr in FY23, Rs 150cr in FY24 and Rs 125cr in FY25, predominantly for product diversification, capacity enhancement partly through debottlenecking and maintenance capex. The same is likely to be funded through internal accruals. Further, LGBB has been declared as a successful applicant of the corporate insolvency process of RSAL Steel and Private Limited and acquisition of this company would widen the company's product portfolio.

LGBB remains net debt negative. The capex plans of the company could lead to gradual derisking of its business and organic volume and value growth over the next 2-5 years.

Encouraging financial parameters

The increasing share of margin accretive replacement market has led to expansion in EBITDA margins from ~13% in FY17 to ~18.5% in FY22. We expect margins to remain ~17% range in FY23-FY24. Healthy accruals, even during the pandemic, resulted in prepayment of borrowings along with strengthening of its already healthy capital structure and debt metrics. As of FY22, LGBB was net debt free. Consequently, lower finance expenses have driven improvement in return ratios in FY22 with RoCE/RoNW at 29.4/24.5% as compared to 20.3/16.8 in FY21.



Risks & Concerns

High dependence on the 2W (motorcycle) industry and client concentration risks.

LGBB is highly dependent on the two-wheeler industry with ~80% of revenues coming from this segment. Its long standing relationship with OEMs and strong presence in replacement market mitigates the risk to an extent.

Dependant on economic growth in the country

The automotive sector is directly dependent on the general economic conditions in both Indian and in other key global markets. Prolonged slowdown like the one witnessed currently could impact revenue and profit growth of the company.

Introduction of electric vehicles

The move towards electrification of automobiles might impact the company's revenues over the medium to long term due to minimal usage of chains in electric 2W in comparison to internal combustion driven 2W. However, the company has plans to diversify its products by re-entering into industrial chains with ending of a non-compete clause with an erstwhile JV partner. Also the anticipated EV penetration of only 13-15% of new vehicle sales by FY25 mitigate the risk to an extent.

High commodity prices

Sustained high level of commodity prices can have an adverse impact of the operating performance of the company. Moderate pricing power with OEMs due to the stiff competition and volatility in commodity prices exposes the profit margins to volatility. However, the price pass through with negotiation mitigates the risk to an extent.

Fall in promoters' stake

The promoters' stake in LGBB has been falling gradually over the last few years from 48.25% in June 19 quarter to 34.32% in Dec 21 quarter. This does not inspire confidence among the minority shareholders about the future prospects of the company.



Company Background:

LGBB, one of the leading companies in South India was established way back in 1937. Started with a fleet of 250 buses, LGBB grew into India's leading Roller chain manufacturer. Since then it has come a long way, keeping in pace with the technological advancements and meeting its customer needs with newer & innovative solutions. Today, LGBB stands proud as the premier manufacturer of automotive chains under the popular brand name 'ROLON' and also caters to export, after market and spares segments.

The company has 23 manufacturing facilities spread across Tamil Nadu, Maharashtra, Uttarakhand, Karnataka, Haryana, Rajasthan and Pondicherry in India and one facility in the USA, at the consolidated level, all ISO 9001 certified by Underwriters Laboratories Inc., USA. Three of the manufacturing facilities along with the central functions have been registered to ISO/TS 16949 by UL, USA.

LGBB has the advantage of vertical integration in all its product lines. Right from procurement of the raw material to the finished product, LGBB has installed comprehensive QC cycles. To maintain control over quality standards LGBB has all critical manufacturing in-house. This includes a steel rolling division to produce cold rolled steel strips, wires and strips with profiles.

LGBB's tooling division is one of the most modern in the country. This division is equipped with sophisticated CNC wire cutting, spark erosion and Mikron CNC Boring machines for precision and complicated machining. The company has also set up an Application engineering Cell for designing, manufacturing and supplying chains for special applications and specific needs.

The products of the company can be classified under two segments i.e. Transmission and Metal Forming.

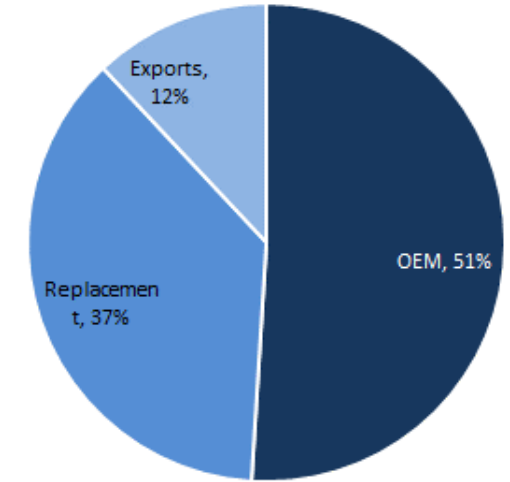
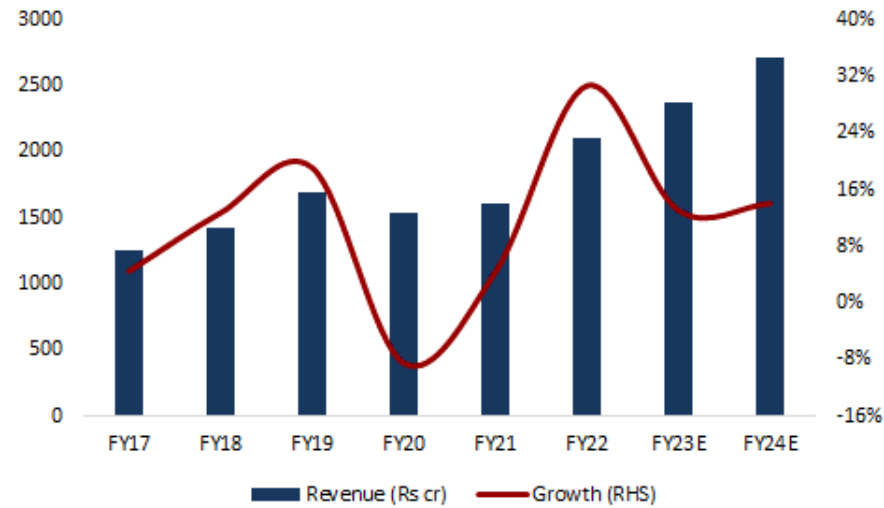
Transmission: The transmission segment manufactures motorcycle and moped chains, heavy duty chains and timing chains. It also manufactures sprockets, tensioners, belts and brake shoes.

Metal Forming: Metal Forming division deals with the Fine Blanking, Machined Components and Wire Drawing. LGBB acquired Fine Blanking technology in Mid '80s for manufacturing Chain plates. It further extended its fine blanking division as a separate manufacturing during the late '90s, to cater to high OEM demands for Fine Blanked components. Today, LGBB is a leading Fine Blanking Manufacturer having about 25 Fine Blanking Presses in operation.

The company derived 51% of its revenues from the OEM segment, 37% from the replacement segment and 12% of its revenues from exports in FY22. The company has a subsidiary, LGB USA Inc., which manufactures fine blanking products.



Revenue growth and breakup (FY22)



(Source: Company, HDFC sec)

Segmental information

| (Rs cr) | Q1FY23 | Q1FY22 | YoY (%) | Q4FY22 | QoQ (%) | FY22 | FY21 | YoY (%) |
|------------------------|--------|--------|---------|--------|----------|------|------|----------|
| Segment Revenue | | | | | | | | |
| Transmission | 402 | 302 | 33.1 | 444 | -9.4 | 1670 | 1302 | 28.2 |
| Metal Forming | 119 | 90 | 31.5 | 115 | 3.5 | 432 | 307 | 40.8 |
| EBIT | | | | | | | | |
| Transmission | 54 | 35 | 52.6 | 74 | -28.9 | 271 | 182 | 48.9 |
| Metal Forming | 18 | 11 | 59.4 | 19 | 220.4 | 60 | 4 | 1313.5 |
| EBIT Margin (%) | | | | | | | | |
| Transmission | 13.4 | 11.7 | 172 bps | 16.6 | -318 bps | 16.2 | 14.0 | 225 bps |
| Metal Forming | 15.4 | 12.7 | 270 bps | 16.2 | -73 bps | 13.9 | 1.4 | 1253 bps |



Financials

Income Statement

| (Rs cr) | FY20 | FY21 | FY22 | FY23E | FY24E |
|------------------------------|--------------|-------------|-------------|-------------|-------------|
| Net Revenues | 1543 | 1609 | 2102 | 2333 | 2695 |
| Growth (%) | -8.6 | 4.3 | 30.6 | 11.0 | 15.5 |
| Operating Expenses | 1357 | 1356 | 1714 | 1932 | 2234 |
| EBITDA | 186 | 253 | 388 | 401 | 461 |
| Growth (%) | -10.1 | 35.8 | 53.6 | 3.3 | 14.8 |
| EBITDA Margin (%) | 12.1 | 15.7 | 18.5 | 17.2 | 17.1 |
| Depreciation | 79 | 83 | 83 | 84 | 89 |
| Other Income | 4 | 7 | 12 | 14 | 19 |
| EBIT | 111 | 177 | 317 | 331 | 391 |
| Interest expenses | 15 | 10 | 8 | 9 | 12 |
| PBT | 115 | 180 | 332 | 322 | 379 |
| Tax | 25 | 47 | 86 | 82 | 95 |
| PAT | 90 | 133 | 246 | 240 | 284 |
| Share of Asso./Minority Int. | 2 | 1 | 0 | 1 | 0 |
| Adj. PAT | 92 | 133 | 246 | 241 | 284 |
| Growth (%) | -8.0 | 45.7 | 84.3 | -2.2 | 18.2 |
| EPS | 29.2 | 42.5 | 78.4 | 76.6 | 90.6 |

Balance Sheet

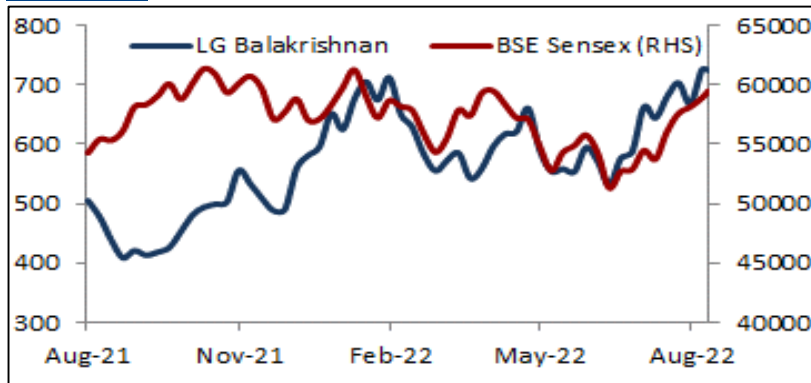
| As at March (Rs cr) | FY20 | FY21 | FY22 | FY23E | FY24E |
|-----------------------------------|------------|------------|-------------|-------------|-------------|
| SOURCE OF FUNDS | | | | | |
| Share Capital | 31 | 31 | 31 | 31 | 31 |
| Reserves | 675 | 848 | 1101 | 1285 | 1504 |
| Shareholders' Funds | 706 | 879 | 1132 | 1317 | 1535 |
| Minority Interest | 4 | 2 | 2 | 3 | 2 |
| Total Debt | 92 | 59 | 90 | 102 | 114 |
| Net Deferred Taxes | 12 | 14 | 13 | 13 | 13 |
| Total Sources of Funds | 814 | 954 | 1238 | 1434 | 1665 |
| APPLICATION OF FUNDS | | | | | |
| Net Block & Goodwill | 584 | 552 | 509 | 609 | 650 |
| CWIP | 9 | 6 | 15 | 15 | 15 |
| Investments | 41 | 87 | 132 | 262 | 502 |
| Other Non-Curr. Assets | 21 | 24 | 28 | 33 | 38 |
| Total Non Current Assets | 634 | 646 | 656 | 886 | 1167 |
| Inventories | 290 | 301 | 436 | 441 | 509 |
| Debtors | 175 | 247 | 294 | 332 | 391 |
| Cash & Equivalent | 5 | 146 | 287 | 224 | 129 |
| Other Current Assets | 28 | 17 | 37 | 32 | 37 |
| Total Current Assets | 497 | 712 | 1053 | 1029 | 1067 |
| Creditors | 247 | 351 | 275 | 416 | 495 |
| Other Current Liab & Provisions | 70 | 52 | 196 | 66 | 75 |
| Total Current Liabilities | 317 | 403 | 471 | 482 | 570 |
| Net Current Assets | 180 | 308 | 582 | 548 | 497 |
| Total Application of Funds | 814 | 954 | 1238 | 1434 | 1665 |



Cash Flow Statement

| (Rs cr) | FY20 | FY21 | FY22 | FY23E | FY24E |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|
| PBT | 115 | 180 | 332 | 322 | 379 |
| Non-operating & EO items | -15 | -17 | -4 | 1 | -3 |
| Interest Expenses | 14 | 10 | 8 | 9 | 12 |
| Depreciation | 79 | 83 | 83 | 84 | 89 |
| Working Capital Change | 43 | 15 | -135 | -34 | -46 |
| Tax Paid | -32 | -46 | -82 | -82 | -95 |
| OPERATING CASH FLOW (a) | 203 | 226 | 202 | 301 | 336 |
| Capex | -71 | -26 | -48 | -185 | -130 |
| Free Cash Flow | 133 | 200 | 155 | 116 | 206 |
| Investments | 15 | 0 | 0 | -125 | -235 |
| Non-operating income | 1 | -84 | -134 | 0 | 0 |
| INVESTING CASH FLOW (b) | -55 | -110 | -182 | -310 | -365 |
| Debt Issuance / (Repaid) | -99 | -48 | 19 | 12 | 12 |
| Interest Expenses | -14 | -9 | -7 | -9 | -12 |
| FCFE | 35 | 60 | 33 | -6 | -29 |
| Share Capital Issuance | 0 | 0 | 0 | 0 | 0 |
| Dividend | -38 | 0 | -31 | -57 | -66 |
| Others | -3 | -3 | -3 | 0 | 0 |
| FINANCING CASH FLOW (c) | -154 | -60 | -23 | -54 | -66 |
| NET CASH FLOW (a+b+c) | -5 | 57 | -2 | -63 | -95 |

Price chart



Key Ratios

| | FY20 | FY21 | FY22 | FY23E | FY24E |
|---------------------------------|-------|-------|-------|-------|-------|
| Profitability Ratios (%) | | | | | |
| EBITDA Margin | 12.1 | 15.7 | 18.5 | 17.2 | 17.1 |
| EBIT Margin | 7.2 | 11.0 | 15.1 | 14.2 | 14.5 |
| APAT Margin | 5.9 | 8.3 | 11.7 | 10.3 | 10.6 |
| RoE | 13.4 | 16.8 | 24.5 | 19.6 | 20.0 |
| RoCE | 13.6 | 20.3 | 29.4 | 25.1 | 25.5 |
| Solvency Ratio (x) | | | | | |
| Net Debt/EBITDA | 0.5 | -0.3 | -0.5 | -0.3 | 0.0 |
| Net D/E | 0.1 | -0.1 | -0.2 | -0.1 | 0.0 |
| PER SHARE DATA (Rs) | | | | | |
| EPS | 29.2 | 42.5 | 78.4 | 76.6 | 90.6 |
| CEPS | 54.2 | 69.1 | 104.9 | 103.5 | 119.0 |
| BV | 225.0 | 280.1 | 360.7 | 419.4 | 489.0 |
| Dividend | 5.0 | 10.0 | 15.0 | 18.0 | 21.0 |
| Turnover Ratios (days) | | | | | |
| Inventory | 47 | 48 | 47 | 49 | 49 |
| Debtor | 71 | 67 | 64 | 69 | 64 |
| Creditors | 60 | 68 | 54 | 54 | 62 |
| VALUATION (x) | | | | | |
| P/E | 24.8 | 17.1 | 9.3 | 9.5 | 8.0 |
| P/BV | 3.2 | 2.6 | 2.0 | 1.7 | 1.5 |
| EV/EBITDA | 12.7 | 8.7 | 5.4 | 5.1 | 4.1 |
| EV/Revenues | 1.5 | 1.4 | 1.0 | 0.9 | 0.7 |
| Dividend Yield (%) | 0.7 | 1.4 | 2.1 | 2.5 | 2.9 |
| Dividend Payout (%) | 17.1 | 23.5 | 19.1 | 23.5 | 23.2 |

(Source: Company, HDFC sec)



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 cyclical nature 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.

Disclosure:

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