Stock Update

LG Balakrishnan & Bros. Ltd.

September 18, 2023

LG Balakrishnan & Bros. Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Auto Ancillaries	Rs 1047	Buy in Rs 1040-1060 band & add more on dips in Rs 920-940 band	Rs 1150	Rs 1225	2-3 quarters

HDFC Scrip Code	LGBALAEQNR
BSE Code	500250
NSE Code	LGBBROSLTD
Bloomberg	LGBB IN
CMP Sep 15, 2023	1046.9
Equity Capital (Rs cr)	31.4
Face Value (Rs)	10
Equity Share O/S (cr)	3.1
Market Cap (Rs cr)	3286
Book Value (Rs)	434.9
Avg. 52 Wk Volumes	90,100
52 Week High (Rs)	1237.6
52 Week Low (Rs)	606.9

Share holding Pattern % (Jun, 2023)	
Promoters	33.9
Institutions	21.5
Non Institutions	44.7
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:

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.

Over the last couple of quarters, we have witnessed strong growth in domestic 2W sales. Although FY23 posted seven-year low volumes, the tide seems to be turning, driven by higher rural sales. LGBB has passed on most of the material inflation and cooling of raw material prices should aid in margin expansion. Revival in economy and increasing preference for personal mobility gives us confidence that 2W sales could remain strong in the next few quarters. Entry into industrial chains segment would reduce LGBB's dependence on automobile sector de-risking its revenue. NCLT has approved the resolution plan for RSAL which could widen the company's portfolio. RSAL offers low carbon, cold rolled, electrical, and mild steel products.

On August 16, 2022, we had released a Stock Update report (Link) with a recommendation to 'Buy on dips in Rs 675-685 band and add more on dips in Rs 607-617 band' for base case fair value of Rs 770 and bull case fair value of Rs 838 in 2-3 quarters. The bull case target was achieved on within the time frame.

Valuation & Recommendation:

Considering better demand prospects in domestic and exports market, entry into industrial chains, completion of RSAL takeover and increasing aftermarket sales, we continue to remain bullish on the prospects of the company in the medium term. The management has guided for 10% volume growth and a conservative margins of 15-17% in FY24. We expect LGBB's revenue/EBITDA/PAT to grow at 9/12/14% CAGR over FY23-FY25, led by increasing share of business with existing customer and higher aftermarket sales. We believe investors can buy the stock on dips in the band of Rs 1040-1060 and add more on dips to Rs 920-940 band (9.5x FY25E EPS) for a base case fair value of Rs 1150 (11.75x FY25E EPS) and bull case fair value of Rs 1225 (12.5x FY25E EPS) over the next 2-3 quarters.

Financial Summary

Particulars (Rs cr)	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)	FY22	FY23	FY24E	FY25E
Operating Income	539	559	-3.6	581	-7.3	2,102	2,203	2,379	2,641
EBITDA	88	105	-16.4	107	-18.1	388	384	421	478
APAT	58	60	-4.0	71	-18.9	229	237	264	307
Diluted EPS (Rs)	18.3	19.1	-4.0	22.6	-18.9	72.8	75.5	84.3	97.9
RoE (%)						22.7	19.0	18.0	18.1
P/E (x)						14.4	13.9	12.4	10.7
EV/EBITDA (x)						8.0	7.9	6.9	5.6

(Source: Company, HDFC sec)

Q1FY24 Result update

LGBB posted subdued results for Q1FY24 with topline growth of 3.4% YoY to Rs 539cr. Revenue from transmission segment increased 2.8% YoY to Rs 414cr while metal forming division witnessed growth of 5.3% to Rs 125cr. Revenue mix between transmission and metal forming segments stood at 77:23. EBITDA for the quarter grew by 3% to Rs 88cr while EBITDA margin was stable at 16.3%. On a sequential basis EBITDA margin declined 80bps. Adj. PAT grew by 12.6% YoY to Rs 57cr and PAT margin expanded 90bps to 10.7%.

Operating margin is expected to be maintained at 15-17%. Competitive pressure in the US subsidiary has led to higher operating expenses. However, turnover has not increased proportionately.

Key Triggers

2W sales expected to recover in FY24

Sales of 2W are on a recovery path and the growth is expected to accelerate in FY24 after falling to seven-year low of 15.9mn units in FY23. Retail sales of two-wheelers rose for a third quarter in a row, indicating a turnaround in consumer sentiment in rural markets where demand has been under pressure the last couple of years amid a sharp increase in vehicle prices. Registrations of motorcycles, scooters and mopeds — a proxy for retail sales — increased by 2.9% to 4,033,331 units in Q1FY24, according to FADA. Several senior industry executives said better agricultural output, higher minimum support prices for farm commodities and availability of water for irrigation because of healthy reservoir levels would help increase the disposable income, and further improve the consumer sentiment, in rural India, a major market for LGBB.

LGBB looking to expand manufacturing capacities

LGBB 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 Q2FY24. 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.

Exports mix for this product category is likely to be higher as the global market is ~20x bigger than the domestic market. Global Industrial Roller Chain Drives market size was valued at US$ 2.91 Bn in 2021 and the total revenue is expected to grow at 3.8% through 2022 to 2029, reaching US$ 3.92 Bn. The market is fragmented and the vendors are deploying various organic and inorganic growth strategies to compete in the market. The growing end-user investments in APAC is likely to drive the industrial chain drives market growth.

Further, LGBB has been declared as a successful applicant of the corporate insolvency process of RSAL Steel and Private Ltd. This would be backward integration for the company and acquisition of this company would enhance the company’s margins. NCLT Mumbai bench has approved the resolution plan for RSAL and completion of the same (which is expected by Oct 2023) will 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.

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. It is a tier-I supplier and has healthy share of business across 2W OEMs with no OEM constituting more than 15% of LGBB’s topline. The company remains an established player in the domestic two-wheeler chain segment with market share of over 60% in OEM 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 (~30% of revenues in FY23), which helps partially mitigate the cyclicality 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.

Encouraging financial parameters
The increasing share of margin accretive replacement market has led to expansion in EBITDA margins from ~13% in FY17 to ~17.4% in FY23. We expect margins to remain ~16-18% range in FY23-FY25 driven by lower material costs and improved operating leverage. As of FY23, LGBB was net debt free. Consequently, lower finance expenses have driven improvement in return ratios in FY23 with RoCE/RoNW at 24.4/20.2% as compared to 20.3/16.8 in FY21.

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, Gudalur plant with capacity of 0.8 MW & Jalna plant with capacity of 0.83 MW.

The total renewable power consumption aggregates to 131 lakh units during FY23.

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.

Dependent 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 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 2019 quarter to 33.86% in June 2023 quarter. This does not inspire confidence among the minority shareholders about the future prospects of the company.

Forex fluctuations

LGBB exports about 12% of its sales and has some imports. However it is a net forex earner. Any sharp fluctuations in USD/Euro rates vis-à-vis INR could impact its revenue and margins.

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.

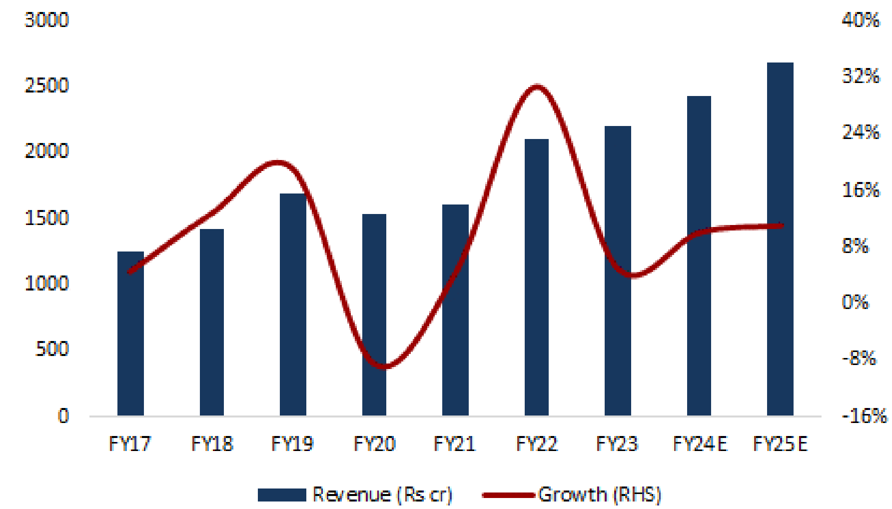
LGBB's tooling division is one of the most modern in the country. This division is equipped with sophisticated CNC wire cutting, spark erosion and Mikron CNC Boring machines for precision and complicated machining. The company has also set up an Application engineering Cell for designing, manufacturing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

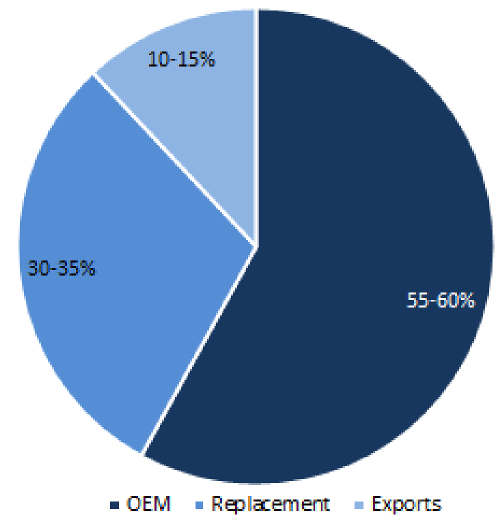
The products of the company can be classified under two segments i.e. Transmission and Metal Forming.
Transmission: The transmission segment manufactures motorcycle and moped chains, heavy duty chains and timing chains. It also manufactures sprockets, tensioners, belts and brake shoes.

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 58% of its revenues from the OEM segment, 30% from the replacement segment and 12% of its revenues from exports in FY23. The company has a subsidiary, LGB USA Inc., which manufactures fine blanking products.

Revenue growth and breakup (FY23)





(Source: Company, HDFC sec)

Segmental information

(Rs cr)	Q1FY24	Q1FY23	YoY (%)	Q4FY24	QoQ (%)	FY23	FY22	YoY (%)
Segment Revenue								
Transmission	414	402	*2.8*	408	*1.5*	1732	1670	*3.7*
Metal Forming	125	119	*5.3*	115	*8.3*	471	432	*9.1*
EBIT								
Transmission	67	54	*23.3*	69	*-66.2*	286	271	*5.8*
Metal Forming	13	18	*-31.4*	12	*-368.2*	55	60	*-8.4*
EBIT Margin (%)								
Transmission	16.1	13.4	*267 bps*	16.9	*-79 bps*	16.5	16.2	*33 bps*
Metal Forming	10.1	15.4	*-537 bps*	10.1	*-7 bps*	11.7	13.9	*-223 bps*

Financials

Income Statement

(Rs cr)	FY21	FY22	FY23	FY24E	FY25E
Net Revenues	**1609**	**2102**	**2203**	**2379**	**2641**
Growth (%)	***4.3***	***30.6***	***4.8***	***8.0***	***11.0***
Operating Expenses	1356	1714	1819	1958	2163
EBITDA	**253**	**388**	**384**	**421**	**478**
Growth (%)	***35.8***	***53.6***	***-1.3***	***9.8***	***13.5***
EBITDA Margin (%)	***15.7***	***18.5***	***17.4***	***17.7***	***18.1***
Depreciation	83	83	79	85	89
Other Income	7	12	23	25	29
EBIT	**177**	**317**	**327**	**361**	**418**
Interest expenses	10	8	7	7	6
PBT	**180**	**332**	**340**	**354**	**412**
Tax	47	86	88	89	104
PAT	**133**	**246**	**252**	**265**	**308**
Adj. PAT	**123**	**229**	**237**	**264**	**307**
Growth (%)	***60.6***	***85.3***	***3.6***	***11.7***	***16.2***
EPS	39.3	72.8	75.5	84.3	97.9

Balance Sheet

As at March (Rs cr)	FY21	FY22	FY23	FY24E	FY25E
SOURCE OF FUNDS					
Share Capital	31	31	31	31	31
Reserves & Surplus	848	1101	1334	1542	1786
Shareholders' Funds	**879**	**1132**	**1365**	**1573**	**1818**
Minority Interest	2	2	2	3	3
Total Debt	59	90	93	73	53
Net Deferred Taxes	14	13	17	17	17
Total Sources of Funds	**954**	**1238**	**1478**	**1666**	**1891**
APPLICATION OF FUNDS					
Net Block & Goodwill	552	509	487	541	545
CWIP	6	15	32	22	29
Investments	87	132	292	340	483
Other Non-Curr. Assets	24	28	158	86	79
Total Non Current Assets	**646**	**655**	**810**	**903**	**1057**
Inventories	301	436	400	456	492
Debtors	247	294	272	339	355
Cash & Equivalents	146	287	348	349	403
Other Current Assets	17	37	43	46	51
Total Current Assets	**712**	**1053**	**1063**	**1190**	**1300**
Creditors	351	275	210	254	289
Other Current Liab & Provisions	52	196	185	172	176
Total Current Liabilities	**403**	**471**	**395**	**426**	**466**
Net Current Assets	308	582	668	764	834
Total Application of Funds	**954**	**1238**	**1478**	**1666**	**1891**

Cash Flow Statement

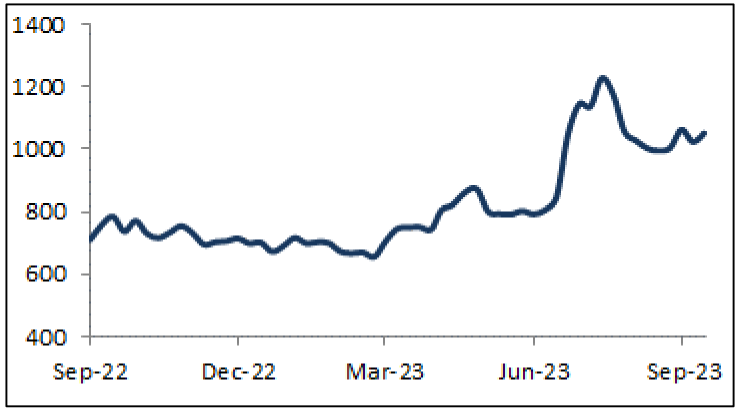
(Rs cr)	FY21	FY22	FY23	FY24E	FY25E
PBT	180	332	340	354	412
Non-operating & EO items	-17	-4	-21	73	8
Interest Expenses	10	8	7	7	6
Depreciation	83	83	79	85	89
Working Capital Change	15	-135	-152	-96	-18
Tax Paid	-46	-82	-86	-89	-104
OPERATING CASH FLOW (a)	**226**	**202**	**167**	**334**	**393**
Capex	-26	-48	-76	-130	-100
Free Cash Flow	200	155	91	204	293
Investments	0	0	2	-120	-150
Non-operating income	-84	-134	-84	0	0
INVESTING CASH FLOW (b)	**-110**	**-182**	**-157**	**-250**	**-250**
Debt Issuance / (Repaid)	-48	19	-1	-20	-20
Interest Expenses	-9	-7	-5	-7	-6
FCFE	60	33	3	58	117
Share Capital Issuance	0	0	0	0	0
Dividend	0	-31	-47	-57	-63
Others	-3	-3	-5	0	0
FINANCING CASH FLOW (c)	**-60**	**-23**	**-58**	**-83**	**-89**
NET CASH FLOW (a+b+c)	**57**	**-2**	**-48**	**1**	**54**

Key Ratios

	FY21	FY22	FY23	FY24E	FY25E
Profitability Ratios (%)					
EBITDA Margin	15.7	18.5	17.4	17.7	18.1
EBIT Margin	11.0	15.1	14.8	15.2	15.8
APAT Margin	7.7	10.9	10.8	11.1	11.6
RoE	15.6	22.7	19.0	18.0	18.1
RoCE	20.3	29.4	24.4	23.2	23.7
Solvency Ratio (x)					
Net Debt/EBITDA	-0.3	-0.5	-0.7	-0.7	-0.7
Net D/E	-0.1	-0.2	-0.2	-0.2	-0.2
PER SHARE DATA (Rs)					
EPS	39.3	72.8	75.5	84.3	97.9
CEPS	65.9	99.3	100.8	111.4	126.4
BV	280.1	360.7	434.9	501.2	579.1
Dividend	10.0	15.0	16.0	18.0	20.0
Turnover Ratios (days)					
Inventory	48	47	47	47	48
Debtor	67	64	69	66	66
Creditors	68	54	40	36	38
VALUATION (x)					
P/E	26.6	14.4	13.9	12.4	10.7
P/BV	3.7	2.9	2.4	2.1	1.8
EV/EBITDA	12.6	8.0	7.9	6.9	5.6
EV/Revenues	2.0	1.5	1.4	1.2	1.0
Dividend Yield (%)	1.0	1.4	1.5	1.7	1.9
Dividend Payout (%)	25.4	20.6	21.2	21.4	20.4

(Source: Company, HDFC sec)

Price chart



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 cyclicality 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.

ATUL JAGDISH KARWA

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Disclosure:
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