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INVESTMENT IDEA

LG Balakrishnan & Bros Ltd

13th September, 2022

Industry: Auto Components & Equipments

Recommendation: Buy

CMP Rs: 774

Key Data

BSE Code	500250
NSE Code	LGBBROSLTD
52 Week High (Rs)	797
52 Week Low (Rs)	404
Market Cap (Rs Cr)	2430
Face Value	5

Industry Snapshot

Customers	Open
Market Presence	Global
Govt Regulations	Medium
Msearch View	Positive

Shareholding June 2022

Promoters	34.32%
Public	65.68%

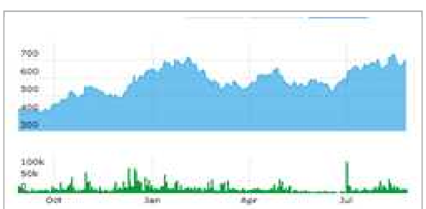
Promoters/ Management

Mr B Vijayakumara	MD & Chairman
Mr N Rengaraj	CFO
Mr P Prabakaran	Chairman
Mr Rajiv Parthasarathy	Director

Key Ratios

PE	8.96
PB	2.12
EPS	84
ROE	23.70%
ROCE	29%

Price Chart



Research Analyst

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About the Company:

L.G. Balakrishnan & Bros Ltd is a major manufacturer of chains, sprockets and metal formed parts for automotive applications. The company's manufacturing is divided in 2 business segments - transmission, metal forming and others. Presently, the company has 23 manufacturing facilities located across India in Coimbatore, Karur, Mysore, Bangalore, Pune, Gurugram, Chennai, Uttarakhand, Alwar. It stands as the premier manufacturer of automotive chains under the popular brand name 'ROLON' and also caters to export, after market and spares segments.

Investment Rationale:

1) Superior Position in the two-wheeler chain segment & Long Established Relationship with reputed OEM's- LGB is the no.1 OEM supplier for Two wheelers, Passenger Vehicle (PV) and Commercial Vehicle (CV) with more than 50% market share in the automobile chain segment. The company has two business segments – Transmission and Metal forming products. It has diversified customer base and long standing relationship with the OEM's.

2) Product Diversification: LGB plans to diversify its products by entering into industrial chains segment and the company is setting up a new plant in Nagpur to manufacture industrial chains, conveyor chains, auto components and assemblies. The plant is expected to be commissioned by early FY2024. This would also help LGB to capture further opportunity in its export segment.

3) Disciplined Capital Expenditure – The company has major plans to do capital expenditure of Rs 200 crore in FY2023, Rs 150 crore in FY2024, and Rs 125 crore in FY2025 which aims at product diversification by entering into the industrial chain segment, value added products in the automobile segment and debottlenecking of old plants. With earmarked CAPEX of Rs 475 crore in next 3 years we believe that the company will be able to generate additional revenue of Rs 800-850 crore after the coming years. The capex is likely to be funded through internal accruals as company is net debt free and this will help company to grow organically in terms of both value and volume in next 3-5 years.

4) Significant presence in the replacement segment – LGB has around 50% of the market share in the replacement segment. The margins of the company have increased from 10% in FY2019 to 18.5% in FY2022 even during the weak automobile demand from the last 3 years in the automobile industry as the contribution from replacement segment in the total revenue has increased from 25% in FY2019 to 35% in FY2022 which reduces their dependence on the OEMs and improves the profitability of the company.

5) Backward Integration - LGB was declared as a successful bidder of the corporate insolvency process of RSAL Steel Private Limited. This acquisition would help LGB to reduce their cost as steel is the major raw material required by the company and in turn maintain and expand their profitability margins.

6) Adoption of renewable energy to reduce cost- LGB has been investing in the windmills and solar power plants. Further, there are more proposals to setup solar system in other manufacturing units. This will help the company to reduce the power & fuel cost and improve the operating margin of the company.

Msearch View

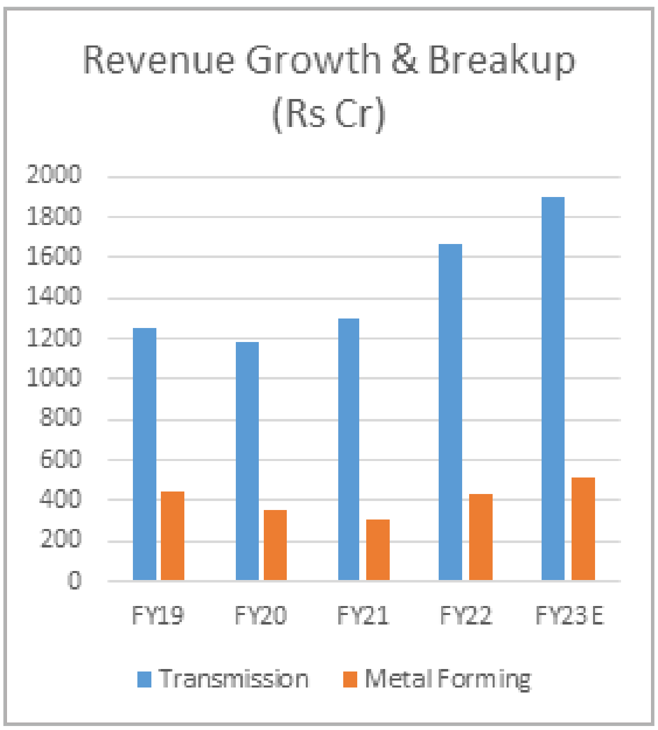
We initiate coverage in LGB with buy rating at the current levels. We believe that LGB should benefit from the revival in the automobile industry due to its dominant market position and diversified product offering. Based on our assessment, the company is trading at 7x of FY24E EPS and given the growth levers in the export markets and capex lined up for next 2-3 years, we believe the company is ripe for re-rating and the stock can deliver a 25% CAGR for the next 3 years.

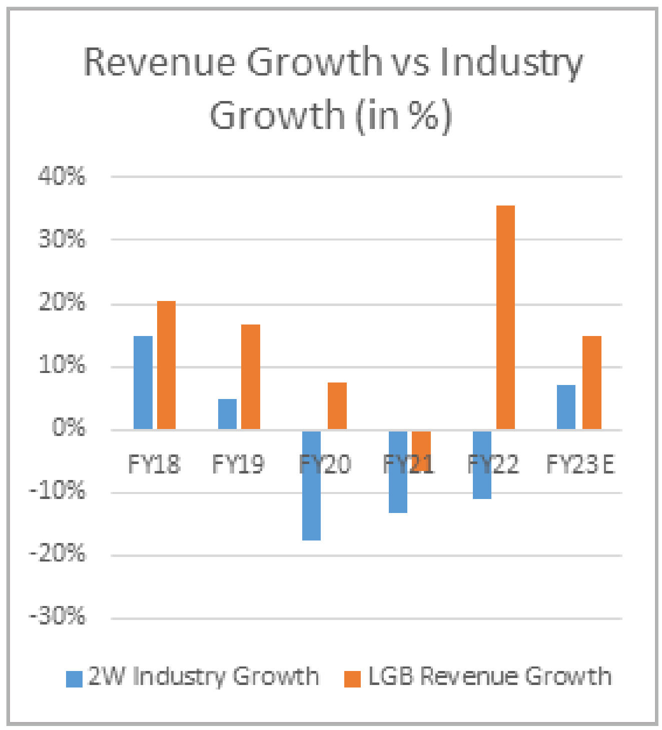
INVESTMENT RATIONALE

1) **Superior Position in the two-wheeler chain segment & Long Established Relationship with reputed OEM's-** LGB is the no.1 OEM supplier of drive chains for Two wheelers, Passenger Vehicle (PV) and Commercial Vehicle (CV) with more than 50% market share. The company has two business segments – Transmission and Metal forming products.

REVENUE (in Cr)	FY19	FY20	FY21	FY22	FY23E
Transmission	1,247	1,188	1,302	1,670	1,904
Metal Forming	441	354	307	432	512

Source: Capital Line, Msearch





Source: Capital Line, Msearch

We expect topline growth of 15% in FY23 on the back of strong demand, upcoming festive season and normal monsoon.

The company has been catering to all major original equipment manufacturers (OEMs) in the domestic two-wheeler (2W) markers such as Bajaj Auto, TVS Motors, Yamaha, Royal Enfield & Honda. The company has diversified customer base and long withstanding relationship with all the OEM's which helps them to mitigate the risk and dependency on some OEM's.

2) **Product Diversification:** LGB currently caters to automobile industry mainly to two wheeler industry.

AUTOMOTIVE CHAIN

SPROCKET

CHAIN TENSIONERS

FINE BLANKING

PRECISION MAKING

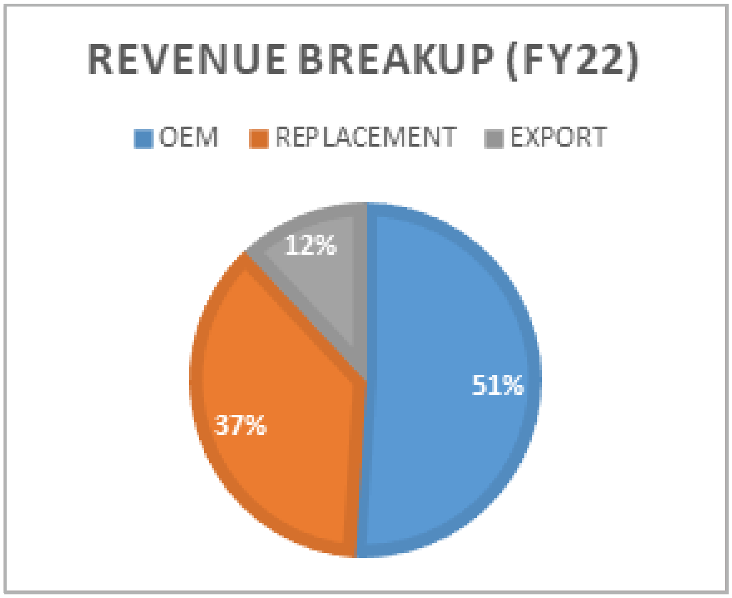
AUTOMOTIVE BELTS

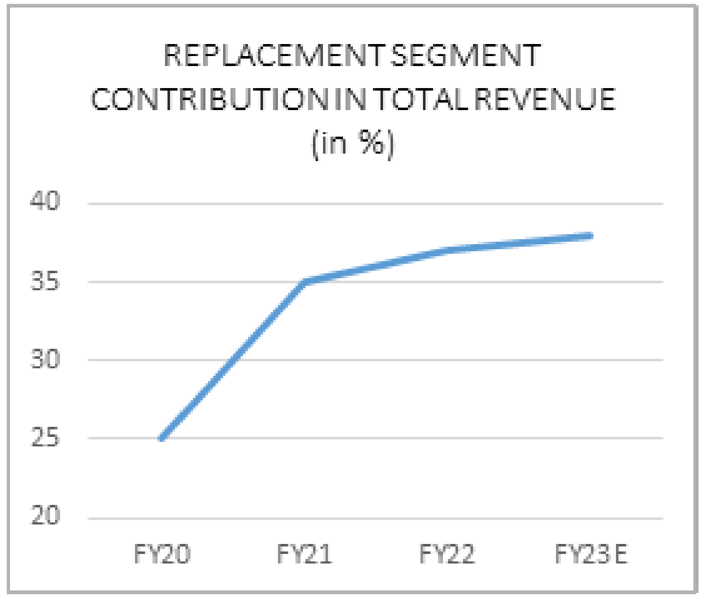
Source: Company's Website

LGB plans to diversify its products by re-entering into industrial chains with ending of a non-compete clause with an erstwhile JV partner and the company is setting up a new plant in Nagpur to manufacture Industrial Chains, Conveyor Chains, auto components and assemblies. The plant is expected to be commissioned by Q1 of FY2024. This helps company to reduce their dependency on performance of automobile industry and improve their profitability margins.

3) **Disciplined Capital Expenditure led to higher profitability -** The company has done capex of Rs. 225 crores in FY2022 and it has plans to do capex of Rs 200 crore in FY2023, Rs 150 crore in FY2024, and Rs 125 crore in FY2025 primarily for capacity enhancement through additions and debottlenecking, product diversification. The capex is likely to be funded through internal accruals as company is net debt free and this will help company to grow organically in terms of both value and volume in next 3-5 years. With earmarked CAPEX of Rs 475 crore in next 3 years and average asset turnover ratio of 1.75, we believe the company will be able to generate additional revenue of Rs 800-850 crore after the FY2024.

4) **Significant presence in the replacement segment–** Company has around 50% of the market share in the replacement segment. The company has derived 51% of their total revenue from OEM segment, 37% from the replacement segment & 12% from the exports. Company's revenue from the replacement segment has increased from 25% in FY2020 to 35% in FY2022 which reduces their dependence on the OEMs.



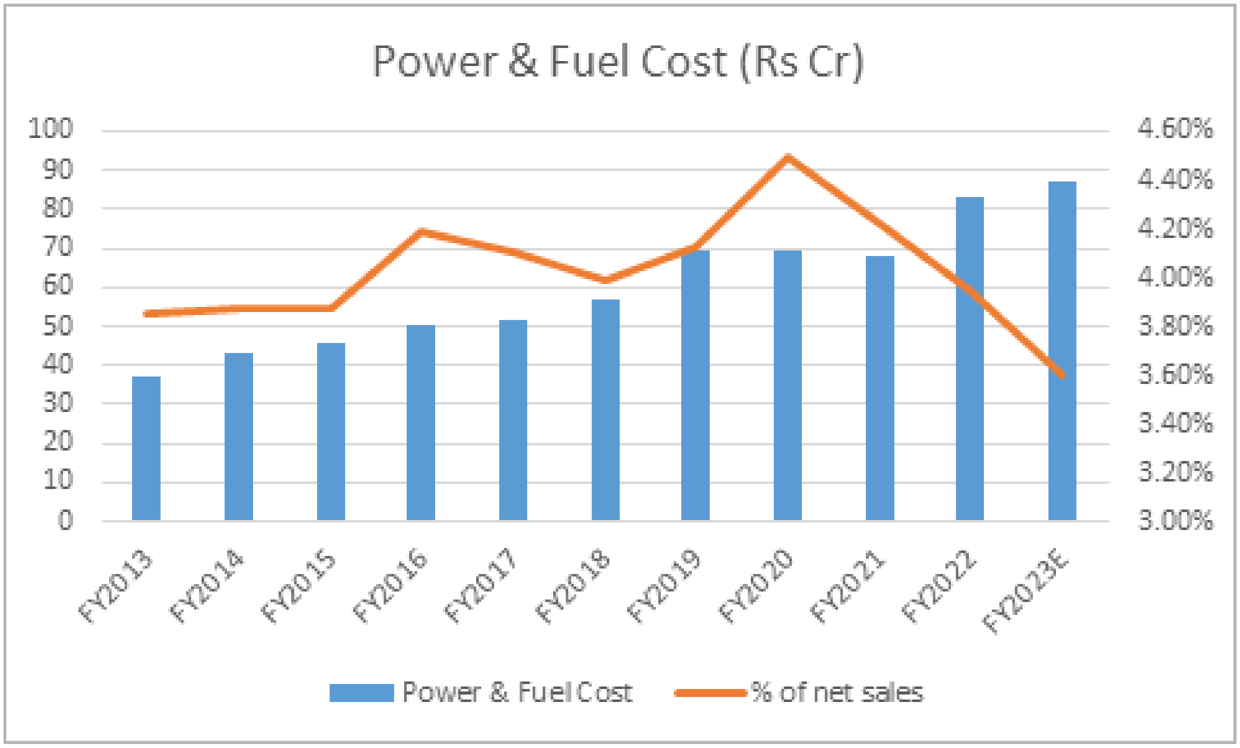


Source: Capital Line, Msearch

In last 3 years, Domestic sales of two-wheeler have gone down but still company was able to perform better because of the replacement segment. Margins on the replacement segment are also high as compared to OEM sales. The company has a market share of 50% in the replacement segment and this helps company to reduce their dependence on OEM's and improve profit margins.

5) **Backward Integration in Production Process -** LGB has been declared as a successful applicant of the corporate insolvency process of RSAL Steel Private Limited. The input required by LG Balakrishnan is the ultimate output of the RSAL Steel Private Limited. This will help the company to reduce their raw material cost and eventually improve the EBITA margins and overall profitability of the company.

6) **Adoption of renewable energy to reduce cost -** LGB has installed 22 number of windmills with a total rated capacity of 7.16 MW and the total number of units of energy generated from these windmills was around 96.58 lakh units. LGB 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 and it has installed 3 number of ON GRID ground mounted solar power plants for a rated capacity of 100 KW each. This will help company to reduce power cost and increase profitability of the company.



Source: Capital Line, Msearch

RISK

1) **Commodity Inflation:** The commodity prices have been in northward movement in last few months due to geopolitical situations which affects the operating profits of the company and also the company has moderate pricing power with OEMs due to the competition and passing on the increased cost becomes a challenge and adds on to the risk. LGB's primary raw material is Steel, the prices of steel are currently consolidating after the government increased the export duty to 15% which will benefit the company in terms of profitability in next quarter.

2) **Reliance on Two-wheeler industry:** Company’s 80% of the total revenue comes by catering 2w industry and this industry hasn’t done well in last 3 years. However, the company’s established presence, low client concentration and sizeable portion of revenues from the replacement segment mitigate the risk to an extent.

3) **Foreign Currency Risk –** The company earns 10-12% of their total revenue from exports. Any adverse fluctuations in the currencies would affect the revenues and ultimately the profits of the company.

INCOME STATEMENT

Rs. in Crores

Particulars	FY20	FY21	FY22	FY23E	FY24E
Net Revenues	1,543	1,609	2,103	2,397	2,757
Growth (%)	-8%	4%	31%	14%	15%
Operating Expense	-1,357	-1,356	-1,714	-1,936	-2,227
EBITDA	186	253	389	461	530
Growth (%)	-10.1%	36%	54%	18%	15%
EBITDA Margin	12.07%	15.72%	18.51%	19.23%	19.23%
Depreciation	-79	-83	-83	-84	-88
Other Income	4	7	12	14	17
EBIT	111	177	318	391	459
Interest Expense	-15	-10	-8	-9	-11
Exceptional Item	19	14	23	-	-
PBT	115	180	332	382	448
Tax	-25	-47	-86	-85	-99
PAT	90	133	247	297	349
PAT Margin	5.84	8.26	11.72	12.38	12.66
Share of Associates/Minority Int	2	1	0	1	0
Adjusted PAT	92.13	133.84	246.54	297.90	349.04
Growth (%)	-8.0%	45%	84%	21%	17%
EPS	29.34	42.62	78.51	94.87	111.16

Source: Company, Capital Line, Msearch

BALANCE SHEET

Rs. in Crores

Particulars	FY20	FY21	FY22	FY23E	FY24E
SOURCES OF FUNDS :					
Share Capital	31	31	31	31	31
Reserves Total	675	848	1101	1275	1554
Total Shareholder Funds	706	879	1132	1306	1585
Minority Interest	4	2	2	3	2
Total Debt	92	59	90	102	114
Net Deferred Taxes	12	14	13	14	14
Total Sources of Fund	**814**	**954**	**1238**	**1425**	**1715**
APPLICATION OF FUNDS :					
Net Block	584	552	508	602	655
Capital Work in Progress	9	6	15	15	15
Investments	41	87	104	260	503
Other Non-Current Assets	21	24	28	33	38
Total Non-Current Assets	634	646	655	877	1173
Inventories	290	301	436	450	502
Sundry Debtors	175	247	294	342	399
Cash and Bank	5	146	287	230	163
Other Current Assets	28	17	37	36	43
Total Current Assets	497	711	1053	1058	1107
Less : Current Liabilities and Provisions					
Creditors	247	351	275	432	495
Other Current Liabilities & Provisions	70	52	196	78	70
Total Current Liabilities	317	403	471	510	565
Net Current Assets	180	308	582	548	542
Total Application of Funds	814	954	1238	1425	1715

Source: Company, Capital Line, Msearch

CASH FLOW STATEMENT

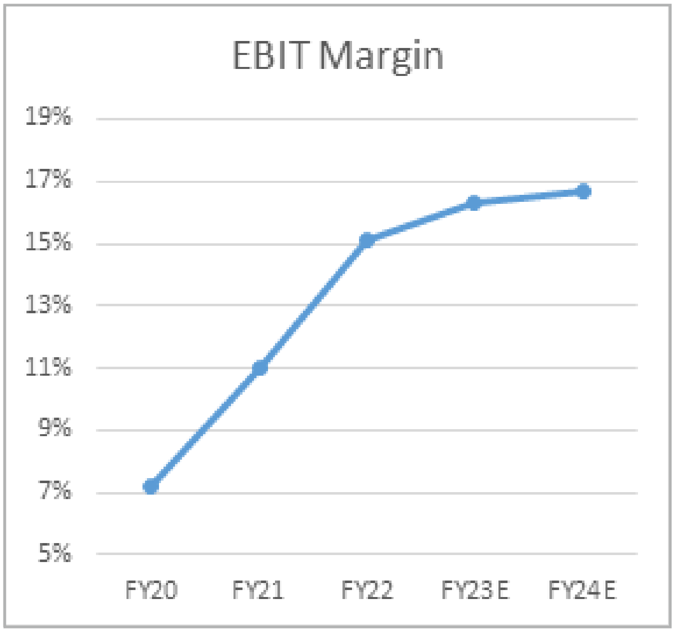
(Rs Cr)	FY20	FY21	FY22	FY23E	FY24E
Operating Cash Flow (a)	203	211	202	336	357
Investing Cash Flow (b)	-55	-121	-182	-200	-150
Financing Cash Flow (c)	-153	-33	-22	-55	-65
Net Cash Flow (a+b+c)	-5	57	-2	81	142

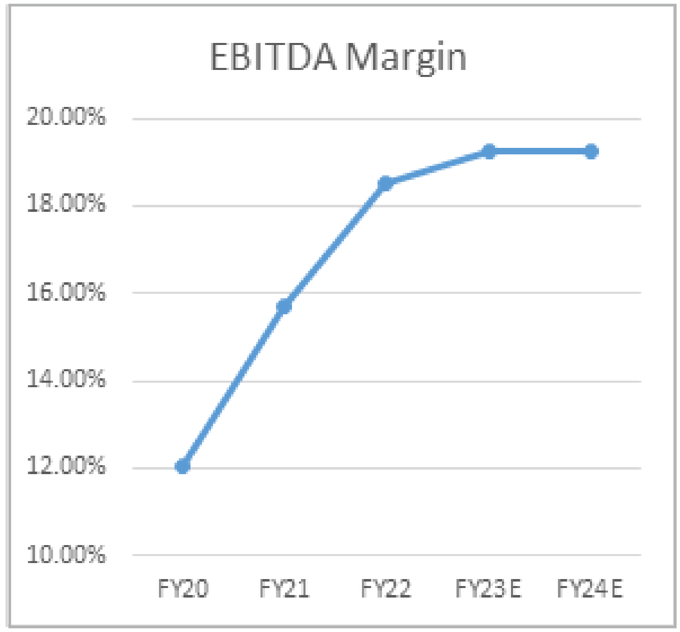
Source: Company, Capital Line, Msearch

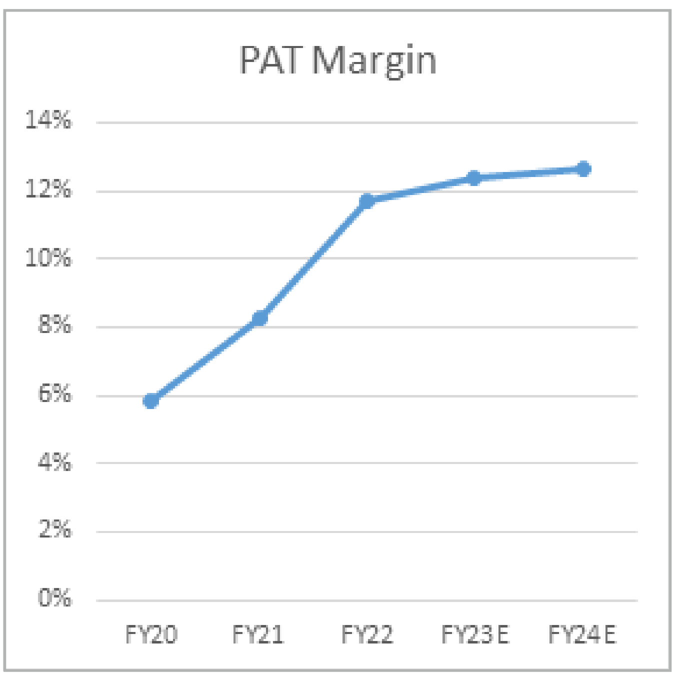
RATIO

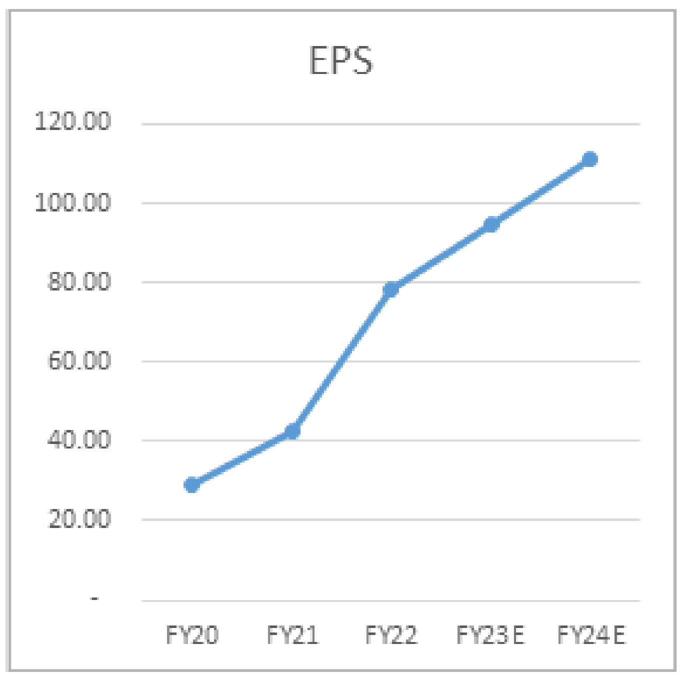
	FY20	FY21	FY22	FY23E	FY24E
Growth Ratios					
Revenue (%)	-8.6	4.3	30.6	14.0	15.0
EBITDA (%)	-10.1	37.0	53.8	18.4	15.0
Net Profit (%)	-15.9	60.0	85.9	20.8	17.2
EPS(%)	-15.9	60.0	85.9	20.8	17.2
Margins					
EBITDA Margin (%)	12.1	15.8	18.5	19.2	19.2
EBIT Margin (%)	7.2	11.0	15.1	16.3	16.7
PAT Margin (%)	5.8	8.3	11.7	12.4	12.7
Return					
ROCE (%)	10.3	15.0	22.5	27.4	26.8
ROE (%)	11.6	16.1	24.0	22.7	22.0
Other Ratios					
Interest Coverage	6.8	16.2	38.0	43.4	41.7
Debt-Equity	0.2	0.1	0.1	0.1	0.1
Current Ratio	1..7	1.6	1.9	2.1	2.0
WC Ratios					
Debtor Days	46.8	47.8	46.9	49.0	49.0
Inventory Days	80.3	79.6	78.5	69.0	64.0
Creditors Days	68.0	68.3	57.0	54.0	62.0
Cash Conversion Cycle	59.1	59.1	68.4	76.3	51.0

Source: Company, Capital Line, Msearch









Source: Capital Line, Msearch

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Msearch's Recommendation (Absolute Performance) Buy: > 20% within the next 12 Months
Accumulate: 5% to 20% within the next 12 Months Sell : < -20% within the next 12 Months

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