July 07, 2022

L.G. Balakrishnan & Bros Limited: Ratings reaffirmed at [ICRA]AA(Stable)/ [ICRA] A1+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based	125.00	150.00	[ICRA]AA (Stable); reaffirmed
Short-term – Non-fund based facilities	100.00	100.00	[ICRA]A1+; reaffirmed
Long term – Unallocated	100.00	-	-
Fixed Deposit Programme	40.00	40.00	[ICRA]AA (Stable); reaffirmed
Total	**365.00**	**290.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings reaffirmation factors in L.G. Balakrishnan & Bros Limited's (LGB/the company) healthy financial risk profile and its established presence in the domestic two-wheeler (2W) chain segment. The company's revenue grew by 30.6% to Rs. 2,102.1 crore in FY2022 (PY: Rs. 1,609 crore), partly aided by improvement in its share of business with customers. Despite headwinds on the raw material front, the company's already-healthy operating margin improved further to 18.7% in FY2022 from 15.9% the previous year, 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. As a result, LGB's accruals improved to Rs. 293.0 crore in FY2022 from Rs. 213.9 crore in FY2021. LGB has remained net debt negative from FY2021 and its debt protection metrics are comfortable. Its interest coverage stood at 42.6 times in FY2022 (PY:23.4 times). Further, the company's liquidity position is strong, supported by Rs. 283.0 crore of unencumbered cash and bank balances and adequate buffer in working capital lines with an average working capital utilisation of 32.3% of sanctioned limits in the 12 months ended April 2022.

In FY2023, ICRA expects LGB's revenues to be supported by the underlying domestic 2W demand (which accounts for over 80% of its revenues) and anticipated healthy performance of the replacement segment, despite headwinds from the semiconductor shortage. The margins are likely to be supported by the recent correction in metal prices and sustenance of cost optimisation measures. Over the medium term, the company's revenue could be vulnerable to risks arising from the impending electrification of vehicles, due to minimal usage of chains in electric 2Ws in comparison to internal combustion driven 2Ws. However, the company's plans on product diversification, sizeable portion of revenues from the replacement segment and anticipated EV penetration of only 13-15% of new vehicle sales by FY2025 mitigate the risk to an extent. Despite the significant capex of Rs. 475.0 crore in total for the period FY2023-FY2025, the company's debt metrics are expected to remain comfortable with anticipated healthy accruals and in the likely absence of incremental debt funding.

Key rating drivers and their description

Credit strengths

Dominant market position in domestic 2W chain segment – LGB manufactures and markets chains and allied components (over 80% of operating income (OI) in FY2022) primarily for 2Ws and metal forming products (over 20% of OI in FY2022) for 2Ws, passenger vehicles (PVs) and commercial vehicles (CVs). The company remains an established player in the domestic 2W chain segment with market share of over 60%. It is a tier-I supplier and has healthy share of business across 2W OEMs.

Significant presence in replacement segment – The company derives over 35% of its revenues from the replacement segment. This insulates the company's revenues from downturns/lower production volumes in the domestic 2W space, similar to what was witnessed in FY2022. In the replacement market, the company sells chains and sprockets under the brand name, 'Rolon'.

Healthy operating margins, comfortable capital structure and strong liquidity – The company's operating profit margins (OPM) improved to 18.7% in FY2022 from 15.9% in FY2021 supported by cost optimisation initiatives. The company increased its proportion of power usage from low-cost renewable energy sources, automated a larger part of its operations and reduced its freight expenses through multiple measures, among others. As a result, LGB's accruals improved to Rs. 293.0 crore in FY2022 from Rs. 213.9 crore in FY2021, despite headwinds on the raw material front. Further, the company's liquidity position is strong, supported by Rs. 283.0 crore of unencumbered cash and bank balances and adequate buffer in working capital lines with an average working capital utilisation of 32.3% of sanctioned limits in the 12 months ended April 2022. LGB has remained net debt negative from FY2021 and its debt protection metrics are comfortable. LGB's interest coverage stood at 42.6 times in FY2022 (PY:23.4 times). Further, in the absence of incremental debt for capex, LGB's debt protection metrics are likely to remain comfortable going forward as well.

Credit challenges

Impending electrification of automotive industry may impact revenue – The move towards electrification of automobiles could impact the company's revenues over the medium to long-term owing to minimal usage of chains in electric 2Ws in comparison to internal combustion driven 2Ws. However, the company plans to diversify its products by re-entering into the industrial chains segment with the termination of a non-compete clause with an erstwhile JV partner. Further, LGB has been declared a successful applicant of the corporate insolvency process of RSAL Steel and Private Limited, whose acquisition would widen LGB's product portfolio. Coupled with sizeable portion of revenues from the replacement segment and anticipated EV penetration of only 13-15% of new vehicle sales by FY2025, it mitigates the risk to an extent.

High dependence on the 2W industry – LGB derives over 80% of its revenues from the domestic 2W industry and its revenues are susceptible to demand slowdown in the 2W market. However, the company's established presence, low client concentration risk and sizeable revenues from the replacement market mitigate the risk to an extent.

Margins susceptible to increase in raw material prices – LGB's primary raw material is steel, whose price increased substantially in FY2022. However, the company's cost optimisation measures mitigated the impact of raw material price increase during the year. Also, LGB was able to reduce the lag in passing on raw material price increases down to a month from two to three months earlier. Going forward, LGB is likely to benefit from improved operating leverage and sustenance of cost saving initiatives. The recent softening of steel prices is also likely to provide some relief. The company is a net exporter and, hence, would not be impacted by the depreciation of the INR against the USD.

Liquidity position: Strong

LGB's liquidity is strong with healthy cash flow from operations of Rs. 171.3 crore in FY2022 and unencumbered cash and bank balances of Rs. 283.0 crore as on March 31, 2022. The company has adequate buffer in its working capital lines with an average working capital utilisation of 32.3% of sanctioned limits and 15.1% of drawing power for the period May 2021–April 2022. Further, the company has enhanced its working capital lines from Rs. 125 crore to Rs. 150 crore recently. Going forward, LGB (at the consolidated level) has minimal repayment obligations of Rs. 4.8 crore in FY2023, Rs. 14.6 crore in FY2024 and Rs. 6.7 crore in FY2025 for its existing term loans and fixed deposits. The company has significant capex plans of Rs. 200.0 crore in FY2023, Rs. 150.0 crore in FY2024 and Rs. 125.0 crore in FY2025, predominantly for product diversification, capacity enhancement partly through debottlenecking and maintenance capex. The same is likely to be funded through internal accruals. Overall, ICRA expects LGB to be able to meet its medium-term commitments through internal sources of cash and yet be left with sufficient cash surplus.

Rating sensitivities

Positive factors – ICRA could upgrade LGB's rating if the company demonstrates significant growth in its scale of operations and sustained improvement in profitability, along with product diversification. Specific metrics that could lead to an upgrade would be RoCE improving above 25% on a sustained basis.

Negative factors – Negative pressure on LGB's rating could arise if the company's net debt levels increase significantly, resulting in deterioration of net debt/OPBITDA over 1.5 times on a sustained basis. Any significant decrease in the top line beyond estimates owing to electrification of vehicles could also exert pressure on the ratings.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Components Suppliers
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are based on the consolidated financial profile of the L. G. Balakrishnan & Bros Limited and its subsidiaries as mentioned in Annexure-2.

About the company

With a presence for over six decades, LGB is among the largest manufacturers of 2W automotive chains in India (marketed under the brand, 'Rolon'). It derived close to 80% of its revenues in FY2022 from chains and allied products and the rest from the metal forming segment. In terms of its business segments, 2Wconstitutes over 80% of its consolidated revenues, while over 35% comes from the replacement segment. The company has a subsidiary, LGB USA Inc., which manufactures fine blanking products. LGB (standalone) accounted for 96% of the consolidated revenues and 90% of the consolidated debt in FY2022. The company has 23 manufacturing facilities across Tamil Nadu, Maharashtra, Uttarakhand, Karnataka, Haryana, Rajasthan and Pondicherry in India and one facility in the US, at the consolidated level.

Key financial indicators (audited)

Consolidated	FY2021	FY2022
Operating income	1,609.0	2,102.1
PAT	132.8	245.7
OPBDIT/OI	15.9%	18.7%
PAT/OI	8.3%	11.7%
Total outside liabilities/Tangible net worth (times)	0.6	0.5
Total debt/OPBDIT (times)	0.3	0.3
Interest coverage (times)	23.4	42.6

Amount in Rs crore; Source: Company, ICRA Research; Financial ratios in this document are ICRA adjusted figures and may not be directly comparable with results reported by the company in some instances; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; total debt includes lease liabilities

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)			Chronology of Rating History for the past 3 years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2022 (Rs. crore)	Date & Rating in FY2023		Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	
					Jul 07, 2022	Jun 13, 2022	Aug 30, 2021	Aug 28, 2020	Dec 30, 2019	Oct 10, 2019
1	Term Loan	Long term	-	-	-	-	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Fund-based facilities	Long term	150.00	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
3	Non-fund based facilities	Short term	100.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Fixed Deposit	Long term	40.00	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	MAA(Stable)	MAA(Stable)	MAA(Stable)	MAA(Stable)
5	Unallocated	Long term	-	-	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)			

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fixed Deposits	Simple
Fund based facilities	Simple
Non-fund Based facilities	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fixed Deposit	2016	6.0-8.5%	2025	40.00	[ICRA]AA(Stable)
NA	Fund-based facilities	NA	8.3-10.9%	NA	150.00	[ICRA]AA(Stable)
NA	Non-fund based facilities	NA	NA	NA	100.00	[ICRA]A1+

Source: *Company*

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
LGB USA, Inc	96.00%	Full Consolidation
GFM Acquisition LLC^	98.47% by LGB USA, Inc	Full Consolidation
GFM LLC^	100.00% by GFM Acquisition LLC	Full Consolidation

^step down subsidiaries

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