L.G. Balakrishnan & Bros Limited

September 07, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
FD Programme	40.00	40.00	MAA(Stable); upgraded from MAA-(Stable)
Fund-based -Term Loan	72.25	72.25	[ICRA]AA(Stable); upgraded from [ICRA]AA-(Stable)
Fund-based - Working Capital Facilities	80.00	80.00	[ICRA]AA(Stable); upgraded from [ICRA]AA-(Stable)
Short term: Non-fund Based facilities	85.00	85.00	[ICRA]A1+; reaffirmed
Total	**277.25**	**277.25**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has upgraded the long-term ratings outstanding on the Rs. 72.25 crore[1] term loan facilities and Rs. 80.00 crore fund based long term facilities of L.G. Balakrishnan & Bros Limited (LGB/the company)[2] to [ICRA]AA (pronounced ICRA double A) from [ICRA]AA- (pronounced ICRA double A minus). The outlook on the long-term ratings is Stable. ICRA has reaffirmed the short-term ratings outstanding on the Rs. 85.00 crore non-fund-based facilities at [ICRA]A1+ (pronounced ICRA A one plus). ICRA has also upgraded medium-term ratings outstanding on the Rs. 40.00 crore fixed deposit programme to MAA (pronounced M double A) from MAA- (pronounced as M double A minus). The outlook on the medium-term ratings is Stable.

Rationale

The upgrade in the ratings reflect the sustained improvement in the company's financial performance over the years. LGB's long-standing presence, diversified client base encompassing all the major Original Equipment Manufacturers (OEMs) in the domestic two-wheeler market and its established presence in the replacement market which helps partially mitigate the cyclicality in OEM volumes further underpins the ratings. LGB's business risk profile is strong with its established market position in the domestic automotive chain industry and its high share of business with several OEMs. During FY2018, revenues grew by a healthy YoY by 12.7%; operating and net margins improved by 70bps and 30bps to 13.8% and 6.2% respectively supported by cost control initiatives and lower interest cost. Going forward, with the two-wheeler industry expected to grow at 8-10% during FY2019 and the company's strong clientele, LGB's revenue growth is expected to be robust.

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[1] *100 lakh = 1 crore = 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

The ratings take comfort from LGB's strong financial profile characterised by comfortable capital structure and coverage metrics; and sound liquidity position. Supported by accruals adequate to fund growth and capex until FY2018, debt levels dropped (Rs. 108.4 crore as of March 31, 2018 compared to Rs. 134.5 crore as of March 31, 2017), which coupled with growth in earnings have led to an improvement in the company's debt protection metrics with gearing and Interest coverage at 0.2 times and 18.5 times respectively, in March 2018. Apart from sanctioned undrawn lines of Rs. 30 crores of long-term debt as at July 2018, the company has sufficient buffer on its working capital limits (with utilisation minimal at 9.5% of limits and 2.8% of drawing power during the 19-month period ending July 2018).

The ratings, however, remain constrained by the intense competition from other domestic incumbents which impacts pricing power with OEMs. Competition from OE spares in the replacement markets (which accounts for ~26% of the company's revenues during FY2018) is also high. The company has extended financial support in the form of a corporate guarantee to its 19.3% associate - LGB Forge Limited (LGB Forge) which continues to record weak numbers, however no incremental support is expected to be extended to LGB Forge going forward. LGB also faces high dependence on the two-wheeler industry with over 95% of revenues coming from this segment. Moderate pricing power with OEMs due to the high competition and volatility in commodity prices exposes the profit margins to volatility however, the company has price pass-through clauses with few customers.

The company has chalked out a partially debt funded capex plan of Rs. 175 crores for FY2019 which includes the setting up of a Greenfield plant in SIPCOT, Chennai; this is expected to be commissioned by Q3 FY2019. While this entails incremental debt, ICRA does not anticipate any deterioration in the capital structure of the company.

Outlook: Stable

ICRA believes LGB will continue to benefit from its diversified client profile and dominant market position in the domestic automotive chain with reputed two-wheeler OEMs and the replacement markets. The outlook may be revised to Positive if substantial growth in revenue and profitability is achieved while maintaining its capital structure. The outlook may be revised to Negative if financial profile weakens owing to lower than expected cash accrual, or if any major debt funded capital expenditure.

Key rating drivers

Credit strengths

Long standing presence in the domestic automotive chains industry, diversified client profile and dominant market position supports business growth- LGB has registered a compound annual growth rate (CAGR) of ~6.5% between FY2015 and FY2018 aided by its long-standing presence and established relationships with reputed OEMs like Bajaj Auto Limited, TVS Motor Company Ltd, India Yamaha Motor Private Limited, with which the company enjoys high market share.

Strong presence in the replacement market for automotive chains helps mitigate cyclical risks in the automotive OE industry to an extent - In the replacement market, the company sells chains and sprockets under the brand name of "Rolon". During FY2018 this accounted for 26% of total sales of the company and the segment grew moderately by 8.7% owing to softer demand during the good and service tax (GST) transition period. Despite softer growth the presence in the replacement market partially insulates the company's revenues from the cyclicalities in the Indian two-wheeler industry, to an extent.

Healthy financial risk profile characterised by comfortable capital structure with adequate debt-protection metrics and sound liquidity position - Steady growth in the metal forming and transmission division supported revenue growth of 12.7% during FY2018, despite the weakness in the replacement markets (during the good and service tax (GST) transition period). With lower debt funded capital expenditure and significant drop in debt level (Rs. 108.4 crore as of March 31, 2018 compared to Rs. 134.4 crore as of March 31, 2017) during FY2018, LGB's capital structure is comfortable with gearing, Total debt/OPBDITA and coverage at 0.2 times, 0.6 times and 18.5 times, respectively as on March 2018.The company's liquidity position is also comfortable with healthy accruals and buffer available in the working capital limits (with utilisation at 9.5% of limits and 2.8% of drawing power during the 19-month period ending July 2018).

Credit challenges

Support extended to its loss-making associate company (LGB Forge)- The company has extended corporate guarantees to its associate company LGB Forge (for Rs.27.0 crore against which the debt outstanding is Rs.14.3 crore as on March 31, 2018); incremental support to LGB Forge from LGB is not expected. Adjusted for the guarantee, the gearing continues to be strong at 0.2 times as of March 31, 2018. LGBFL recorded an operating income of Rs. 100.1 crore (growth of 20.4% over FY2017) and a net loss of Rs.3.2 crore in FY2018.

Expansion plans with the set up of a new greenfield capacity; partly debt funded –The company is envisaging a capital expenditure of Rs. 175 crores in FY2019 towards modernization and augmenting facilities across divisions. Of this, Rs. 80 crores are towards setting up a manufacturing facility in SIPCOT, Chennai to cater to customers like Royal Enfield, Daimler, Hitachi etc. The capital expenditure will be funded through Rs. 45.0 crore debt and balance through internal accruals.

Moderate bargaining power and pricing flexibility with the OE customers, high competition and adverse fluctuation in raw material prices limits margin expansion- The company continues to face stiff competition from other manufactures limiting its pricing power. To mitigate competitive risks, LGB has been diversifying its product profile within the two-wheeler segment and with each customer. Further, the company's margins are susceptible to variations in commodity prices such as steel and iron (RM/OI% increased to 44.2% in FY2018 compared to 41.1% in FY2017), however, with increasing share of products from higher margin products like transmission chains for passenger cars and other metal forming products, the operating margins grew by 70 bps in FY2018 compared to FY2017.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:

Corporate Credit Rating Methodology

Rating Methodology for Auto Component Manufacturers

About the company:

Established in 1937 by Mr. LRG Naidu, LGB, started out as a partnership firm operating bus transport routes in Tamil Nadu. LGB, the flagship company of the group, is the largest manufacturer of automotive chains in India which it supplies to all major domestic OEMs in the two-wheeler industry. Marketing its chains and sprockets under the proprietary brand "Rolon", the company caters to ~70% of the Indian two-wheeler OEM market and ~50% of the replacement market. The company has 22 manufacturing facilities in India and one facility in the USA.

The consolidated operations of LGB includes, subsidiary LGB USA Inc. and 25% associate company (M/s. Renold Chain India Private Limited). During July 2018, LGB obtained the approvals from National Company Law Tribunal (NCLT) for the amalgamation of BCW V Tech India P Limited. Accordingly, the accounts of the company are merged with the accounts of BCW V Tech India P Limited with effect from April 01, 2017.

LGB standalone accounts for 92% of consolidated revenues, 90% of consolidated PAT and 83% of consolidated debt during FY2018.

Key financial indicators (audited)

Consolidated	FY2017	FY2018
Operating Income (Rs. crore)	1,258.6	1,418.0
PAT (Rs. crore)	74.1	88.5
OPBDIT/OI (%)	13.1%	13.8%
RoCE (%)	18.3%	20.9%
Total Debt/TNW (times)	0.3	0.2
Total Debt/OPBDIT (times)	0.8	0.6
Interest coverage (times)	11.4	18.5

Source: Company, ICRA research; OPBDITA: Operating Profit before Depreciation, Interest and Taxes;
PAT: Profit After Tax; RoCE: Return on Capital Employed; TNW: Tangible Net Worth;
NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating September 2018	Chronology of Rating History for the Past 3 Years: Date & Rating in FY2019 May 2018	Date & Rating in FY2018 April 2017	Date & Rating in FY2017 Sep 2016
1	Term Loan	Long Term	72.25	**49.97**	**[ICRA]AA (Stable)**	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**
2	Fund based - Cash credit	Long Term	80.00	-	**[ICRA]AA (Stable)**	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**	**[ICRA]AA- (Stable)**
3	Non-Fund based facilities	Short Term	85.00	-	**[ICRA] A1+**	**[ICRA] A1+**	**[ICRA] A1+**	**[ICRA] A1+**
4	Fixed Deposit	Medium Term	40.00	-	**MAA (Stable)**	**MAA- (Stable)**	**MAA- (Stable)**	**MAA- (Stable)**

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term loan 1	FY2012	8.6%	FY2020	11.25	[ICRA]AA (Stable)
NA	Term loan 2	FY2015	8.5%	FY2020	7.78	[ICRA]AA (Stable)
NA	Term loan 3	FY2016	8.5%	FY2020	10.94	[ICRA]AA (Stable)
NA	Term loan 4	FY2018	8.6%	FY2024	42.28	[ICRA]AA (Stable)
NA	Cash Credit	NA	NA	NA	80.00	[ICRA]AA (Stable)
NA	Non-fund-based facilities	NA	NA	NA	85.00	[ICRA]A1+
NA	Fixed Deposit	NA	NA	NA	40.00	MAA(Stable)

Source: L.G. Balakrishnan & Bros Limited

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About ICRA Limited:

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