

October 10, 2019

L.G. Balakrishnan & Bros Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
FD Programme	40.00	40.00	MAA(Stable); Reaffirmed
Fund-based -Term Loan	80.25	80.25	[ICRA]AA(Stable); Reaffirmed
Fund-based - Working Capital Facilities	100.00	100.00	[ICRA]AA(Stable); Reaffirmed
Short term: Non-fund Based facilities	100.00	100.00	[ICRA]A1+; Reaffirmed
Total	320.25	320.25	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation favourably factors in L.G. Balakrishnan & Bros Limited's (LGB) healthy financial performance (consolidated) over the years characterised by comfortable capital structure and coverage metrics with gearing and interest coverage at 0.3 times and 16.7 times, respectively, as on March 31, 2019. LGB's long presence, diversified client base encompassing all major original equipment manufacturers (OEMs) in the domestic two-wheeler (2W) market support the ratings. Its established presence in the replacement market, which helps partially mitigate the cyclicity 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 such as Bajaj Auto Limited, TVS Motor Company Limited, India Yamaha Motor Private Limited, Royal Enfield and Honda Motorcycle and Scooter India Private Limited. The company is in the process of revoking the bank guarantee extended to the 19.3% listed associate company entity LGB Forge Limited, although impact of the same of LGB's financial profile is minimal.

The ratings, however, remain constrained by LGB's high dependence on the 2W industry (with over 95% of revenues coming from this segment) and the muted immediate term demand outlook for the same. The 2W industry is estimated to de-grow by 5-7% in volumes in FY2020. The ratings also consider the intense competition from other domestic incumbents which impacts the pricing power with OEMs. Competition from OE spares in the replacement markets is also high. Moderate pricing power with OEMs due to the stiff competition and volatility in commodity prices exposes the profit margins to volatility. However, the cost-plus pricing mechanism and quarterly price pass with negotiation mitigates the risk to an extent.

The Stable outlook on the [ICRA]AA/[ICRA]MAA rating reflects ICRA's opinion that LGB will continue to benefit from its diversified client profile and dominant market position in the domestic automotive chain with reputed 2W OEMs and the replacement markets.

Key rating drivers

Credit strengths

Long presence in domestic automotive chains industry, diversified client profile and dominant market position – LGB has witnessed a five-year CAGR growth of 8.7% for the year ending FY2019, aided by healthy uptick in volumes in the 2W industry and its long presence, established relationships with reputed OEMs like Bajaj Auto Limited, TVS Motor Company Ltd, India Yamaha Motor Private Limited, Royal Enfield and Honda Motorcycle and Scooter India Private Limited, with which it has a healthy share of business.

Strong presence in replacement market for automotive chains helps mitigate cyclical risks – In the replacement market, the company sells chains and sprockets under the brand name Rolon. The company derives considerable portion of revenues from the replacement market insulating the company's revenues from cyclicalities in the Indian 2W industry, to an extent.

Healthy financial risk profile characterised by comfortable capital structure, healthy debt protection metrics and adequate liquidity position – LGB's revenues grew by 19% in FY2019, supported by growth in transmission and metal forming divisions. The revenues declined by 6.0% YoY in Q1 FY2020 to Rs. 367.8 crore amid the slowdown in the 2W market. Operating margins remained healthy despite the decline by 130 bps to 12.6% in FY2019 and further by 190 bps YoY to 10.9% in Q1 FY2020, primarily on account of higher raw material costs and employee expenses.

However, LGB's capital structure and coverage metrics remained comfortable with gearing, total debt/OPBDITA and interest coverage at 0.3 times, 1.0 times and 16.7 times, respectively as on March 31, 2019. The company's liquidity position is also adequate with buffer available in the working capital limits.

Credit challenges

High dependence on 2W (motorcycle) industry and immediate term muted demand outlook – LGB is highly dependent on the 2W industry with over 95% of revenues coming from this segment. Further, the demand outlook for the Indian 2W industry is muted and the industry is estimated to witness 5-7% de-growth in volumes in FY2020. However, LGB's long presence, diversified client base and healthy share of business encompassing all the major OEMs in the domestic 2W market and its established presence in the replacement market partially mitigates this risk.

Moderate bargaining power and pricing flexibility with OE customers; intense competition and adverse fluctuation in raw material prices limit margin expansion – Stiff competition from other manufactures of automotive chains and metal forming parts limits the company's pricing power. To mitigate competitive risks, LGB has been diversifying its product profile within the 2W segment and with each customer. Further, its margins are susceptible to variations in commodity prices such as steel and iron. The pass through of costs in case of any spike happens with a lag of a quarter and only beyond a threshold, which creates pressure on margins at times. However, the cost-plus pricing mechanism mitigates the risk to an extent.

Liquidity position: Adequate

LGB's liquidity is adequate with healthy fund flow from operations over the years. The company's fund flow from operations stood at Rs. 156 crore in FY2019. Its average working capital utilisation was moderate at 56% of the sanctioned limits and 19% of the drawing power for the 12-month period August 2018 to July 2019. Going forward, LGB has repayment obligations of Rs. 39.8 crore¹ in FY2020, Rs. 26.2 crore in FY2021 and Rs. 26.2 crore FY2022. The company's anticipated accruals, along with unused fund-based facilities and cash balances, are adequate for the capex requirements and repayment obligations over the medium term.

Rating sensitivities

Positive triggers – ICRA could upgrade LGB's rating if the company demonstrates a sustained improvement in profitability with RoCE at more than 25% on a sustained basis.

Negative triggers – Negative pressure on LGB's rating could arise if the debt levels continue to rise with increase in working capital requirements or on account of higher-than-estimated capex, resulting in deterioration of total debt/OPBITDA over 1.5 times on a sustained basis. Any significant decrease in the top line beyond the estimates could also exert pressure on the ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Suppliers
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of L.G. Balakrishna & Bros Limited; As on March 31, 2019, the company has one subsidiary and one associate company

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 2W industry. The company markets its chains and sprockets under the brand Rolon. The company has 23 manufacturing facilities spread across Tamil Nadu, Maharashtra, Uttarakhand, Karnataka, Haryana and Rajasthan in India and one facility in the USA. The company derives 74% of revenues from the transmission segment (where it manufactures sprockets and automotive chains) and 26% of revenues from the metal forming segment (fine blanking, wire drawing and machining).

¹ Minor portion of foreign currency repayments converted to Rs. based on best available estimates

The consolidated operations of LGB includes, subsidiary LGB USA Inc. and 25% associate company (M/s. Renold Chain India Private Limited). ICRA has also considered the corporate guarantee extended to the debt facilities of its Group company LGB Forge Limited. However, the company is in the process of revoking the bank guarantee extended to LGB Forge Limited.

LGB standalone accounts for 94% of consolidated revenues, 97% of consolidated PAT and 92% of consolidated debt in FY2019.

Key financial indicators (Consolidated, audited)

	FY2018	FY2019
Operating Income (Rs. crore)	1,418.0	1,688.0
PAT (Rs. crore)	88.5	96.6
OPBDIT/OI (%)	13.9%	12.6%
RoCE (%)	21.1%	20.1%
Total Outside Liabilities/Tangible Net Worth (times)	0.7	0.8
Total Debt/OPBDITA (times)	0.6	1.0
Interest Coverage (times)	16.5	16.7
DSCR	3.3	2.7

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current Rating (FY2020)		Rating	Rating History for the Past 3 Years					
		Amount Rated	Amount O/s		FY2019	FY2018	FY2017			
				10-Oct-2019	13-Dec-2018	07-Sep-2018	23-May-2018	10-Apr-2017	22-Sep-2016	
1	Term Loan	Long Term	80.25	64.4	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
2	Fund-based facilities	Long Term	100.00		[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	Medium Term	40.00		[ICRA]MAA (Stable)	[ICRA]MAA (Stable)	[ICRA]MAA (Stable)	[ICRA]MAA- (Stable)	[ICRA]MAA- (Stable)	[ICRA]MAA- (Stable)

Amount in Rs. crore

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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term loan 1	FY2012		FY2020	11.25	[ICRA]AA (Stable)
NA	Term loan 2	FY2015		FY2020	7.78	[ICRA]AA (Stable)
NA	Term loan 3	FY2016		FY2020	11.22	[ICRA]AA (Stable)
NA	Term loan 4	FY2018		FY2024	50.00	[ICRA]AA (Stable)
NA	Fund-based facilities	NA	NA	NA	100.00	[ICRA]AA (Stable)
NA	Non-fund-based facilities	NA	NA	NA	100.00	[ICRA]A1+
NA	Fixed Deposit	NA	NA	NA	40.00	MAA (Stable)

Source: L.G. Balakrishnan & Bros Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name [^]	Ownership	Consolidation Approach
LGB USA, INC	77.01%	Full Consolidation
Renold Chain India Private Limited	25.0%	Equity Method

[^]the annexure does not include the list of indirect subsidiaries/associates which are otherwise consolidated as part of direct subsidiaries/associates

Analyst Contacts

Subrata Ray

+91 22 6114 3408

subrata@icraindia.com

Pavethra Ponniah

+91 44 4596 4314

pavethrap@icraindia.com

Prem Tej Reddy T

+91 44 4297 4323

t.reddy@icraindia.com

Relationship Contact

Jayanta Chatterjee

+91 80 4332 6401

jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: info@icraindia.com

Website: www.icra.in

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87

Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,

Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,

Bangalore + (91 80) 2559 7401/4049

Ahmedabad+ (91 79) 2658 4924/5049/2008

Hyderabad + (91 40) 2373 5061/7251

Pune + (91 20) 2556 0194/ 6606 9999

© Copyright, 2019 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents