August 28, 2020

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 Loans	120.25	100.00	[ICRA]AA(Stable); Reaffirmed
Fund-based - Working Capital Facilities	125.00	125.00	[ICRA]AA(Stable); Reaffirmed
Short term: Non-fund Based facilities	100.00	100.00	[ICRA]A1+; Reaffirmed
Total	**385.25**	**365.00**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of ratings factors in L.G. Balakrishnan & Bros Limited's (LGB) healthy and stable financial performance (consolidated) over the years characterised by comfortable capital structure and coverage metrics with gearing and interest coverage at 0.2 times and 11.5 times, respectively, as on March 31, 2020. 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 (~27% of revenues in FY2020), which helps partially mitigate the cyclicality in OEM volumes to an extent, 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 ratings, however, remain constrained by LGB's high dependence on the 2W industry with ~85% of revenues coming from this segment for FY2020 (balance comes from passenger vehicles, commercial and heavy vehicles) and the muted immediate term demand outlook for the auto industry due to the Covid-19 pandemic. While the 2W segment has exhibited some recovery post Q1FY2021, ICRA expects the Indian 2W industry to report a decline of 16-18% during FY2021. 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 price passthrough 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 its presence in the replacement markets.

Key rating drivers and their description

Credit strengths

Long-standing presence in domestic automotive chain industry, diversified client profile and dominant market position – LGB has witnessed a five-year CAGR growth of 8.7% for the period ending FY2019, aided by healthy uptick in volumes in the 2W industry; its long standing presence in the Indian replacement markets and its 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. During FY2020, while the company maintained its market share in the Indian 2W industry at about 75%, weakness in OEM offtake lead to a 8.6% decline in revenues. The company's largest customer, Bajaj Auto Limited accounted for ~19% of revenues in FY2020.

Strong presence in the replacement market for automotive chains helps mitigate cyclical risks –The company derives ~27% of its revenues from the replacement market insulating the company's revenues from cyclicality in the Indian 2W industry, to an extent. In the Indian replacement market, the company sells chains and sprockets under its established brand name Rolon.

Healthy financial risk profile characterised by comfortable capital structure, healthy debt protection metrics and adequate liquidity position – LGB's capital structure and coverage metrics remained comfortable with gearing at 0.2 times and total debt/OPBDITA at 0.7 times as on March 31, 2020 and interest coverage at 11.5 times for FY2020. The company's liquidity position is also adequate with sufficient buffer available in the working capital limits. LGB's revenues de-grew by 8.6% in FY2020 owing to the impact of the pandemic towards the end of Q4 and the slowdown in the auto industry. However, despite a 130 bps YoY decline to 12.6% in FY2019 and 40 bps YoY decline to 12.2% in FY2020, operating margins remained healthy. Revenues during FY2021 are expected to degrow by 15-20%, given the weak Q1. Although commodity prices are expected to stay accommodative during FY2021, negative operating leverage is expected to impact margins. However, financial performance is expected to revive in FY2022 with recovery in demand.

Credit challenges

High dependence on 2W (motorcycle) industry and immediate term muted demand outlook – LGB is highly dependent on the 2W industry with over 85% of revenues coming from this segment for FY2020. (balance comes from passenger vehicles, commercial and heavy vehicles). There is also a muted immediate term demand outlook for the auto industry due to the Covid-19 pandemic. While the 2W segment has exhibited some recovery post Q1FY2021, ICRA expects the Indian 2W industry to report a decline of 16-18% during FY2021. 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 to an extent.

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 cost increases in case of any spike happens with a lag and only beyond a threshold, which creates pressure on margins at times.

Liquidity position: Adequate

LGB's liquidity has remained adequate with healthy fund flow from operations over the years, to the tune of Rs. 140 crore. Its average working capital utilization was moderate at 29% of sanctioned limits of Rs.125 Crore and 18% of drawing power for April 2019- June 2020. The company's sanction of fund-based limits further increased to Rs.125 crore in December 2020. Going forward, LGB has repayment obligations of Rs. 27.3 crore in FY2021, Rs. 29.7 crore in FY2022 and Rs. 23.8 crore FY2023 and capex plans of ~Rs. 35 crore in FY2021, Rs.50 crore in FY2022 and Rs. 70 crore in FY2023. The company is considering a term loan of Rs. 100 crore to refinance some of its existing repayments and boost short term liquidity. Draw-down plans for this loan have not been finalised yet. 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. Balakrishnan & Bros Limited; as on March 31, 2020, the company has one subsidiary and two step-down subsidiaries

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 77% of revenues from the transmission segment (where it manufactures sprockets and automotive chains) and 23% of revenues from the metal forming segment (fine blanking, wire drawing and machining).The consolidated operations of LGB includes, subsidiary LGB USA Inc. The company disposed its 25% associate company M/s. Renold Chain India Private Limited in FY2020. ICRA has also considered the corporate guarantee extended to the debt facilities of its Group company LGB Forge Limited (rated [ICRA]AA(CE)(Stable), [ICRA]A1+(CE)). LGB standalone accounts for 94% of consolidated revenues, 112% of consolidated PAT and 88% of consolidated debt in FY2020.

Key financial indicators (Consolidated, Audited)

	FY2019	FY2020
Operating Income (Rs. crore)	1,688.0	1,542.8
PAT (Rs. crore)	99.6	91.3
OPBDIT/OI (%)	12.6%	12.2%
PAT/OI (%)	5.7%	5.8%
Total Outside Liabilities/Tangible Net Worth (times)	0.8	0.6
Total Debt/OPBDIT (times)	1.0	0.7
Interest Coverage (times)	16.7	11.5

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years					
		Type	Amount Rated	Amount Outstanding	Rating	FY2020		FY2019			FY2018
					28-Aug-2020	30-Dec-2019	10-Oct-2019	13-Dec-2018	07-Sep-2018	23-May-2018	10-Apr-2017
1	Term Loan	Long Term	100.0	74.25	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
2	Fund-based facilities	Long Term	125.0		[ICRA]AA (Stable)	[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	100.0		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Fixed Deposit	Medium Term	40.0		MAA (Stable)	MAA (Stable)	MAA (Stable)	MAA (Stable)	MAA (Stable)	MAA- (Stable)	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. Cr)	Current Rating and Outlook
NA	Term loan 1	FY2020		FY2024	30.00	[ICRA]AA (Stable)
NA	Term loan 2	FY2020		FY2024	26.25	[ICRA]AA (Stable)
NA	Term loan 3	FY2020		FY2025	18.00	[ICRA]AA (Stable)
NA	Unallocated limits	-		-	25.75	[ICRA]AA (Stable)
NA	Fund-based facilities	NA	NA	NA	125.00	[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	95.29%	Full Consolidation

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

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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.

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For more information, visit www.icra.in

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