CD Equisearch Pvt Ltd

CHANGING DIMENSIONS

Feb 23, 2023

L.G.Balakrishnan & Brothers Ltd.	
No. of shares (m)	31.4
Mkt cap (Rs crs/$m)	2112/254.9
Current price (Rs/$)	673/8.1
Price target (Rs/$)	739/8.9
52 W H/L (Rs.)	805/507
Book Value (Rs/$)	414/5.0
Beta	0.9
Daily volume (avg. monthly)	44620
P/BV (FY23e/24e)	1.6/1.4
EV/EBITDA (FY23e/24e)	4.6/4.1
P/E (FY23e/24e)	8.2/7.3
EPS growth (FY22/23e/24e)	85.9/12.1/13.1
OPM (FY22/23e/24e)	18.5/17.7/18.0
ROE (FY22/23e/24e)	24.0/21.4/20.2
ROCE(FY22/23e/24e)	22.6/20.3/19.3
D/E ratio (FY22/23e/24e)	0.1/0.1/0.1
BSE Code	500250
NSE Code	LGBBROSLTD
Bloomberg	LGBB IN
Reuters	LGB.NS

Shareholding pattern	%
Promoters	34.0
MFs / Banks / FIs	11.7
FPIs	9.5
Govt. Holding	0.0
Public & others	44.8
Total	**100.0**

As on Dec 31, 2022

Recommendation

HOLD

Analyst

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Company Brief

L G Balakrishnan (LGB) manufactures roller chains and undertakes metal forming, including warm & cold forging, fine blanking and machined parts.

Quarterly Highlights

- Barely unaffected by slowdown in exports, particularly in US markets, LGB's revenues nearly flat lined last quarter, while increases in employee costs and cost inflation precipitated 7.5% drop in operating profit to Rs 106.98 crs from Rs 115.67 crs. Whence, OPM shriveled to 18.4% from 20.2% in Q3 of previous fiscal. Despite more than doubling of other income, PBT declined by 1.8% to Rs 92.84 crs from Rs 94.62 crs, while post tax earnings (consolidated) advanced by 1.5%.

- Little surprisingly, LGB's transmission business accounts for much of the increase in earnings at a time when overall volumes (metal forming included) grew by little enthusing 7.8% in the first nine months of the current fiscal. With pass through mechanisms in place - though sometimes with a lag - transmission business EBIT margin all but flat lined to 18.4% in 9MFY23, at a time when its volumes grew by just 8%, thus underscoring improved pricing power. Despite pass through mechanisms in place, LGB does not seem to have any competitive advantage in sourcing main raw materials like steel.

- With marked acceleration in capex, particularly in Nagpur project for industrial chains, in H2 of current fiscal, LGB would be racing against time to invest some Rs 160 crs in the current fiscal, bulk of which would be channelized in the Nagpur project. With total capex of Rs 250 crs earmarked for the Nagpur project, LGB would probably spend Rs 125 crs in this project next fiscal before commissioning the project in H2 next fiscal; though we have not capitalized the project next year.

- The stock currently trades at 8.2x FY23e EPS of Rs 81.67 and 7.3x FY24e EPS of Rs 92.33. In view of lower revenue growth emanating from sluggish recovery in Indian two wheeler industry, we cut our current fiscal's earnings estimates by over 4%. Commencement of industrial chains plant would doubtlessly help stimulate revenues, though not without risk of subdued profitability in initial years of operation. Earnings are projected to grow by 13% next fiscal on stable margins and return on capital. Weighing odds, we assign hold rating on the stock with revised target of Rs 739 (previous target: Rs 682) based on 8x FY24e earnings, over a period of 6-9 months.

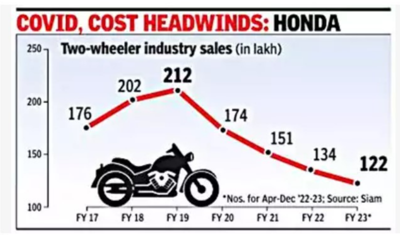
Consolidated (Rs crs)	FY20	FY21	FY22	FY23e	FY24e
Income from operations	1542.83	1608.99	2102.09	2278.64	2499.30
Other Income	22.49	20.59	34.78	30.44	21.36
EBITDA (other income included)	209.78	274.37	424.12	434.62	472.12
Profit after MI & associate profit	76.89	122.96	228.62	256.39	289.85
EPS(Rs)	24.49	39.17	72.83	81.67	92.33
EPS growth (%)	-15.9	59.9	85.9	12.1	13.1

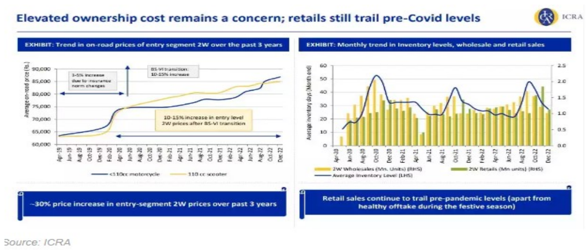
Outlook & Recommendation

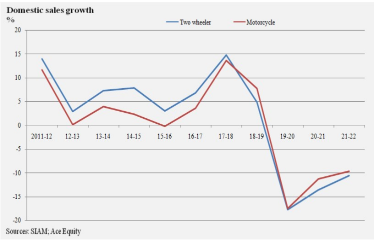
Two wheeler industry

Despite well nigh elimination of Covid -19 globally, the woes of Indian two wheeler industry has barely waned as it is yet to recover lost ground. After hitting dispatches of 21.2 mn units in 2018-19, the industry has seen sharp descend in sales with the industry logging 13.4 mn units last fiscal and projected to do around 15 mn units this fiscal. Notwithstanding Covid induced demand stress, cost escalations - mainly in the affordable segment - are largely blamed for sclerosis in demand.

Atsushi Ogata, President and CEO of Honda Motorcycle, believes that affordability has been hit hard in price -sensitive category, which has led to withdrawal by many entry-level buyers, especially those in rural and semi-urban areas. As an instance he cites example of Activa scooter whose price has seen huge increase in past five years. With no small increases in entry level prices, the purchasing power of the consumers at the bottom end of the pyramid has been impacted. Ogata, however, reckons that the two wheeler industry can start creating new highs in sales only around 2028-29. Yet he feels that the current momentum in industry is expected to continue and he two-wheeler sector is expected to grow over 10% on a year-on-year basis, though high fuel prices and vehicle prices are some of the headwinds.







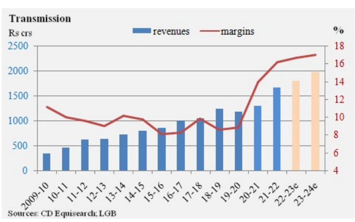
Source: SIAM

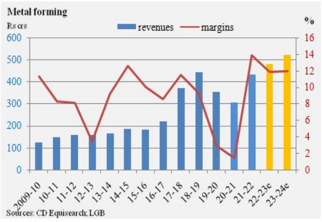
Source: ICRA

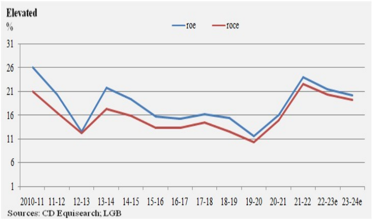
Industry capacity utilization rates have been abysmal to say the least - 50% by some estimate - thus underscoring risks of higher inflation prolonging demand recovery. HMSI is no different for it churned out just 3.9 mn units in 2021-22 at a time when its production peaked at 5.8 mn units in 2021-22. Otaga posits that although the overall economy is getting back to normal, the rural demand is yet to bounce back. Industry growth estimates of rating agency ICRA are no different for it expects 9-12% growth during FY23 and 6-9% next fiscal with a recovery to FY19 peak volumes at least 2-3 years away.

Financials & Valuation

Despite modest recovery in Indian two wheeler industry over the next few years, LGB is pulling out all stops to spur its business growth. From boosting exports to increasing revenue share of aftermarket to launching new products like industrial chains, LGB has its hand full over the next few years. It is racing against time to commence the industrial chains project in Nagpur with an investment of Rs 250 crs by the second half of next fiscal; though we have not capitalized the project next fiscal expecting commissioning delays.

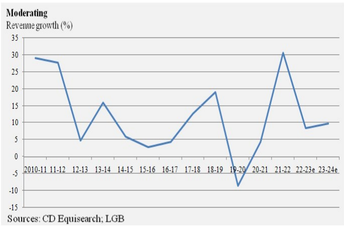


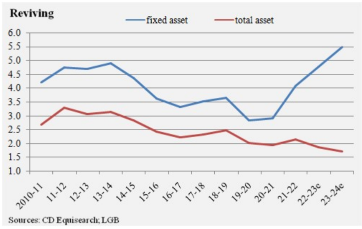




Yet LGB's overall volume growth would struggle to surpass 10% next fiscal not least due to slowdown in exports, particularly US, and increasing competition in the aftermarket. Entrenched raw material inflation has withered dispatches at the entry level of the Indian two wheeler industry in last few years and has shown little signs of let off. By some report, the price of entry level two wheeler has shot up by 40% in the last three -four years, thus hindering business scaling for two-wheeler manufactures, whose wares already suffers from lengthened cycle of repeat purchases.

In view of barely rapid industry growth, margin expansion holds key - either through product innovation or new launches or cost optimization. With increased revenue share of both exports and aftermarket in the transmission business in last few years, margins have discernibly expanded - from 12.4% in FY19 to 18.5% in FY22. Yet further expansion would not be without challenges given headwinds in export growth. OPM as a consequence is estimated to well nigh flat line to 18% next fiscal.





The stock currently trades at 8.2x FY23e EPS of Rs 81.67 and 7.3x FY24e EPS of Rs 92.33. Earnings are estimated to grow in mid teens next fiscal driven by high single digit growth in volumes in both transmission and metal forming business. Increased self reliance in machine building business has potential to prop ROE. Despite little revenue recognition from industrial chains business next fiscal, ROE would stabilize over 20%. Weighing odds, we assign hold rating on the stock with revised target of Rs 739 (previous target: Rs 682) based on 8x FY24e earnings, over a period of 6-9 months. For more info, refer to our May report.

Cross Sectional Analysis

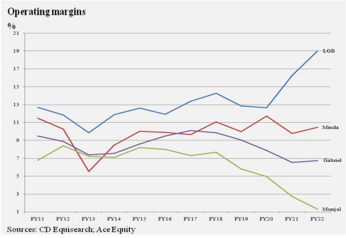
Company	Equity*	CMP	Mcap*	Sales	PAT*	OPM[a]	NPM[a]	Int Cov.	ROE[a]	Mcap / sales	P/BV	P/E
Gabriel	14	158	2275	2919	126	6.8	4.3	44.7	15.7	0.8	2.7	18.1
LG Bala	31	673	2112	2239	248	17.9	11.1	43.4	20.9	0.9	1.6	8.5
Minda Corp	48	195	4673	4173	217	10.9	5.4	9.1	16.6	1.1	3.4	21.5
Munjal Showa	8	91	362	1238	23	1.9	1.9	115.2	3.7	0.3	0.6	15.5

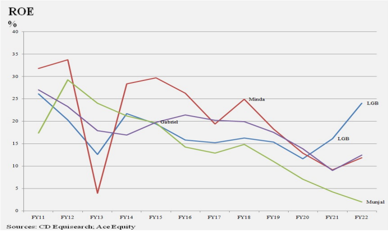
*figures in crores; a:calculations on ttm basis
Companies not truly comparable due to product dissimilarity

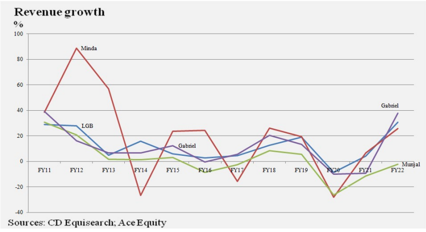
To stay ahead of the innovation curve, Gabriel plans to set up a state of the art technology centre at Chakan that will allow it to strengthen its design and engineering capabilities. To enhance exports, the company plans to leverage relationships with global OEMs operating in India to penetrate their global operations, besides focusing on increasing presence in aftermarket of Latin America, Africa and North America. For first nine months of the current fiscal, OEM supplies accounted for 69% of its exports while the balance came from aftermarket.

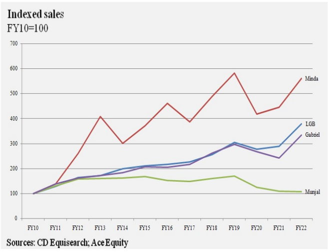
Munjal Showa feels that possible transition of automobile industry towards hybrid and electric vehicles will lead to disruption in automobile industry, which in turn would influence the product portfolios of auto component manufacturers. To stay relevant and competitive, auto component manufacturers would have to align their portfolios accordingly. Munjal also reckons that this alignment will see rationalization of product portfolio and even consolidation in different product segments in auto component manufacturing industry.

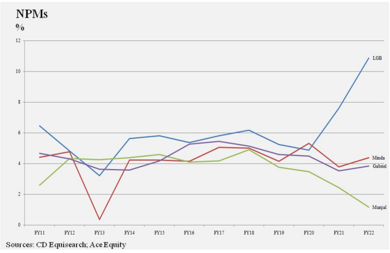
Given improving outlook Minda remains cautiously optimistic on the domestic auto industry while exports are expected to remain challenging on back of global headwinds and emerging challenges. Minda's new domestic business across segments in Q3 was aided by new product launches and increase in wallet share of existing customers. For mechatronics and aftermarket, the growth was supported by strong domestic demand and increase in wallet share of existing clients, while information & connected systems saw exports getting adversely impacted due to geo-political disturbances in certain geographies.











Financials

Quarterly Results -Consolidated

Figures in Rs crs

	Q3FY23	Q3FY22	% chg.	9MFY23	9MFY22	% chg.
Income from operations	**581.03**	**573.91**	**1.2**	**1679.96**	**1543.20**	**8.9**
Other Income	7.46	2.65	181.4	26.76	26.43	1.3
Total Income	**588.50**	**576.57**	**2.1**	**1706.72**	**1569.63**	**8.7**
Total Expenditure	474.05	458.24	3.5	1385.93	1259.60	10.0
PBIDT (other income included)	**114.44**	**118.32**	**-3.3**	**320.79**	**310.02**	**3.5**
Interest	1.72	2.54	-32.2	4.28	5.72	-25.1
Depreciation	19.88	21.16	-6.1	59.26	62.62	-5.4
PBT	**92.85**	**94.62**	**-1.9**	**257.24**	**241.69**	**6.4**
Tax	20.65	23.48	-12.1	59.44	59.54	-0.2
PAT	**72.20**	**71.14**	**1.5**	**197.80**	**182.15**	**8.6**
Minority interest	0.05	0.06	-11.5	0.27	0.20	37.1
Net profit after MI	**72.15**	**71.08**	**1.5**	**197.53**	**181.95**	**8.6**
Extraordinary Item	1.18	0.00	-	9.25	13.29	-30.3
Adjusted Net Profit	**70.97**	**71.08**	**-0.1**	**188.28**	**168.66**	**11.6**
EPS (F.V. 10)	22.61	22.64	-0.1	59.98	53.73	11.6

Segment Results

Figures in Rs crs

	Q3FY23	Q3FY22	% chg.	9MFY23	9MFY22	% chg.
Segment Revenue						
Transmission	463.39	464.30	-0.2	1323.90	1225.52	8.0
Metal forming	117.64	109.61	7.3	356.06	317.68	12.1
Total	**581.03**	**573.91**	**1.2**	**1679.96**	**1543.20**	**8.9**
Segment EBIT						
Transmission	85.35	86.61	-1.5	217.35	196.67	10.5
Metal forming	11.73	13.47	-12.9	43.40	41.63	4.2
Total	**97.08**	**100.08**	**-3.0**	**260.75**	**238.30**	**9.4**
Interest	1.72	2.54	-32.2	4.28	5.72	-25.1
Unallocable exp	2.51	2.92	-13.9	-0.78	-9.11	-91.4
PBT	**92.85**	**94.62**	**-1.9**	**257.24**	**241.69**	**6.4**

Financials

Income Statement - Consolidated

Figures in Rs crs

	FY20	FY21	FY22	FY23e	FY24e
Income from operations	**1542.83**	**1608.99**	**2102.09**	**2278.64**	2499.30
Growth (%)	-8.6	4.3	30.6	8.4	9.7
Other Income	22.49	20.59	34.78	30.44	21.36
Total Income	**1565.32**	**1629.58**	**2136.87**	**2309.08**	**2520.66**
Total Expenditure	1355.54	1355.22	1712.75	1874.46	2048.54
EBITDA (other income included)	**209.78**	**274.37**	**424.12**	**434.62**	**472.12**
Interest	16.28	10.93	9.22	8.99	9.24
EBDT	**193.49**	**263.43**	**414.90**	**425.63**	**462.88**
Depreciation	78.66	83.32	83.22	79.97	86.00
Tax	24.72	47.27	85.94	79.50	86.68
Net profit	**90.12**	**132.84**	**245.74**	**266.16**	**290.20**
Minority interest	-0.35	-0.61	0.27	0.32	0.35
Associate profit	1.16	-	-	-	-
Net profit after MI&AP	**91.63**	**133.46**	**245.48**	**265.84**	**289.85**
Extraordinary item	14.74	10.50	16.85	9.45	-
Adjusted Net Profit	**76.89**	**122.96**	**228.62**	**256.39**	**289.85**
EPS (Rs.)	24.49	39.17	72.83	81.67	92.33

Segment Results

Figures in Rs crs

	FY20	FY21	FY22	FY23e	FY24e
Segment Revenue					
Transmission	1188.36	1302.06	1669.89	1798.90	1978.79
Metal forming	354.47	306.93	432.20	479.74	520.52
Net sales	**1542.83**	**1608.99**	**2102.09**	**2278.64**	**2499.30**
Segment EBIT					
Transmission	105.58	181.66	270.56	300.48	336.39
Metal forming	9.99	4.25	60.16	57.00	62.46
Sub Total	**115.58**	**185.91**	**330.72**	**357.48**	**398.86**
Unallocable exp (net of income)	-14.50	-4.25	-9.32	3.74	13.63
Interest	15.24	10.04	8.36	8.09	8.34
PBT	**114.84**	**180.12**	**331.68**	**345.66**	**376.88**

Consolidated Balance Sheet

Figures in Rs crs

	FY20	FY21	FY22	FY23e	FY24e
SOURCES OF FUNDS					
Share Capital	31.39	31.39	31.39	31.39	31.39
Reserves	674.75	848.00	1101.07	1359.54	1596.02
Total Shareholders Funds	**706.14**	**879.39**	**1132.46**	**1390.93**	**1627.42**
Minority Interest	4.04	1.72	2.06	2.38	2.73
Long term debt	95.12	31.90	31.76	26.76	21.76
Total Liabilities	**805.30**	**913.01**	**1166.28**	**1420.07**	**1651.91**
APPLICATION OF FUNDS					
Gross Block	809.41	856.03	891.29	940.84	1015.84
Less: Accumulated Depreciation	224.73	303.73	382.81	462.79	548.78
Net Block	**584.68**	**552.30**	**508.48**	**478.05**	**467.05**
Capital Work in Progress	8.89	6.33	14.55	125.00	250.00
Investments	19.58	62.94	104.30	144.03	144.03
Current Assets, Loans & Advances					
Inventory	289.69	301.28	435.78	421.55	462.37
Sundry Debtors	174.61	246.65	293.78	319.01	349.90
Cash and Bank	5.02	146.44	286.55	330.31	410.31
Other Assets	28.10	38.13	37.27	39.67	42.27
Total CA & LA	**497.41**	**732.50**	**1053.37**	**1110.53**	**1264.86**
Current liabilities	300.16	439.73	514.45	495.06	532.85
Provisions	0.46	0.39	0.31	0.31	0.31
Total Current Liabilities	**300.62**	**440.12**	**514.76**	**495.37**	**533.17**
Net Current Assets	196.79	292.38	538.61	615.16	731.69
Net Deferred Tax (net of liability)	-12.45	-14.12	-13.40	-17.00	-17.00
Other Assets (Net of liabilities)	7.81	13.18	13.75	74.84	76.14
Total Assets	**805.30**	**913.01**	**1166.28**	**1420.07**	**1651.91**

Key Financial Ratios

	FY20	FY21	FY22	FY23e	FY24e
Growth Ratios					
Revenue (%)	-8.6	4.3	30.6	8.4	9.7
EBIDTA (%)	-10.1	37.0	54.2	5.2	11.8
Net Profit (%)	-15.9	59.9	85.9	12.1	13.1
EPS (%)	-15.9	59.9	85.9	12.1	13.1
Margins					
Operating Profit Margin (%)	12.1	15.8	18.5	17.7	18.0
Gross Profit Margin (%)	11.3	15.5	18.7	18.1	18.5
Net Profit Margin (%)	4.9	7.6	10.9	11.3	11.6
Return					
ROCE (%)	10.3	15.0	22.6	20.3	19.3
ROE (%)	11.6	16.1	24.0	21.4	20.2
Valuations					
Market Cap / Sales	0.3	0.6	0.8	0.9	0.8
EV/EBIDTA	3.3	3.4	3.7	**4.6**	4.1
P/E	6.5	7.8	7.4	8.2	7.3
P/BV	0.7	1.2	1.6	1.6	1.4
Other Ratios					
Interest Coverage	6.8	16.2	34.5	38.1	41.8
Debt-Equity Ratio	0.2	0.1	0.1	0.1	0.1
Current Ratio	1.7	1.6	1.9	2.0	2.1
Turnover Ratios					
Fixed Asset Turnover	2.8	2.9	4.1	4.8	5.5
Total Asset Turnover	2.0	1.9	2.1	1.9	1.7
Debtors Turnover	7.8	7.6	7.8	7.4	7.5
Inventory Turnover	4.5	4.6	4.6	4.4	4.6
Creditors Turnover	5.4	5.3	6.4	7.1	7.8
WC Ratios					
Debtor Days	46.8	47.8	46.9	49.1	48.8
Inventory Days	80.3	79.6	78.5	83.5	78.7
Creditor Days	68.0	68.3	57.1	51.2	46.8
Cash Conversion Cycle	59.1	59.1	68.4	81.3	80.8

Cumulative Financial Data

Figures in Rs crs	FY16-18	FY19-21	FY22-24e
Income from operations	3882	4840	6880
Transmission revenues	2925	3737	5448
Metal forming revenues	771	1102	1432
Transmission to total (%)	75.3	77.2	79.2
Transmission EBIT	257	395	907
Transmission EBIT margin (%)	8.8	10.6	16.7
Operating profit	495	650	1244
EBIT	355	432	1047
PBT	310	392	1019
PAT	219	291	776
Dividends	42	69	160
OPM (%)	12.8	13.4	18.1
NPM (%)	5.8	5.9	11.3
Interest coverage	7.8	10.8	38.1
ROE (%)	15.6	14.0	21.7
ROCE (%)	13.9	13.2	20.6
Debt-equity ratio*	0.2	0.1	0.1
Fixed asset turnover	3.6	3.4	4.6
Total asset turnover	2.4	2.2	1.9
Debtors turnover	7.6	7.3	7.7
Inventory turnover	4.7	5.0	4.9
Creditors turnover	5.1	5.4	7.0
Debtors days	48.0	49.9	47.5
Inventory days	78.2	72.5	74.2
Creditor days	71.6	67.9	52.0
Cash conversion cycle	54.7	54.4	69.7

FY16-18 implies two years ending fiscal 18; *as on terminal year;

Steady revenue growth coupled with higher product realizations would explain much of scarcely lackluster growth in cumulative revenues during FY22-24e period when compared to that the previous three year period (see table). Galvanized by favorable product mix in the transmission business (increasing revenue of aftermarket and exports) and cost optimization initiatives (solar power one of a kind), transmission business margin (EBIT) would barely stay suppressed for it is estimated to jump to 16.7% during FY22-24e period from 10.6% , thus resurrecting overall OPM to 18.1% from 13.4% (see table). Hardly hindered by slow recovery in Indian two-wheeler industry, LGB's cumulative post tax earnings would grow nearly threefold during the projected three year period.

If not for some delays in commissioning of industrial chains plant - expected to commission in second half of next fiscal, though we have not considered revenues in our FY24 projections - ROE would have shown further increases from the projected 21.7%. Increasing operating cash flows would help it finance planned capex of some Rs 350 crs, thus further propelling its interest coverage ratio - 38.1 in FY22-24 period from 10.8 in FY19-21. With decreasing creditor days, the cash conversion cycle may inch upwards to some 70 days from 54 days.

Financial Summary – US dollar denominated

	FY20	FY21	FY22	FY23e	FY24e
Equity capital	4.2	4.3	4.1	3.8	3.8
Shareholders funds	91.7	113.3	141.1	159.5	187.3
Total debt	17.7	11.4	13.2	12.3	12.9
Net fixed assets (incl CWIP)	76.8	73.9	67.0	70.8	84.6
Investments	2.6	8.6	13.8	17.4	17.4
Net current assets	26.1	35.5	64.8	67.8	81.1
Total assets	104.9	117.9	145.6	163.0	190.2
Revenues	217.7	216.8	282.1	275.1	301.7
EBITDA	26.8	35.1	53.9	51.0	57.0
EBDT	24.5	33.6	52.6	49.9	55.9
PBT	13.4	22.4	41.5	40.2	45.5
Profit after MI	10.8	16.6	30.7	30.9	35.0
EPS($)	0.35	0.53	0.98	0.99	1.11
Book value ($)	2.92	3.61	4.50	5.08	5.97

income statement figures translated at average rates; balance sheet and cash flow at year end rates; projections at current rates (Rs 82.84/$). All dollar denominated figures are adjusted for extraordinary items.

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buy: >20%	accumulate: >10% to ≤20%	hold: ≥-10% to ≤10%	reduce: ≥-20% to <-10%	sell: <-20%

Exchange Rates Used- Indicative

Rs/$	FY18	FY19	FY20	FY21	FY22
Average	64.45	69.89	70.88	74.20	74.51
Year end	65.04	69.17	75.39	73.50	75.81

All $ values mentioned in the write-up translated at the average rate of the respective quarter/ year as applicable. Projections converted at current exchange rate. Cumulative dollar figure is the sum of respective yearly dollar value.