

Initiation

Wealth Research

L.G. Balakrishnan & Bros. Ltd.

Dominant player to rise on motorcycle revival

BUY

L.G. Balakrishnan Ltd. (LGB) is the largest producer of transmission chains (~68% of its revenue) primarily for the motorcycle segment. They are also present in other transmission components and metal formed parts (fine blanking) mainly for the automotive sector (~26% of revenue). Exports account for 8-10% of revenue. LGB has a dominant 70% market share in the domestic motorcycle OEM (Original Equipment Manufacturer) segment for transmission chains and 50% share in the aftermarket segment through its flagship brand 'Rolon'. We believe that as a market leader in chains, LGB is best positioned to benefit from the expected recovery in motorcycle sales in India. Further, major OEMs in India are expanding their capacity which should lead to higher demand for LGB chains. Going ahead, we estimate PAT CAGR of 14.5% over FY2015-17E. The stock is currently trading at 9.5x P/E and 5x EV/EBITDA on FY2017E basis and appears attractive. We initiate coverage with a BUY rating and a target price of Rs662, valuing it at 12x its FY2017E EPS.

Dominance in aftermarket offers stability: The addressable market for transmission parts in the aftermarket segment is much larger than the OEM market as these parts are usually replaced every 3 years. The addressable size of aftermarket sales is also set for expansion due to rapid growth in motorcycle sales during prior years. Currently, LGB is the leading player in the aftermarket segment with its 'Rolon' brand (~27% of its revenue) for its transmission products like chains, sprockets tensioners and others. Further, the company also supplies these products to OEMs for sale in the aftermarket segment under the OEMs brand name (~8% of revenue). This aftermarket segment offers a steady source of revenue that will help counter the swings in the OEM cycle over the long term.

Recovery in motorcycle sales to boost LGB: Going forward, we expect the domestic motorcycle market to see a revival in demand on the back of higher economic growth, rise in disposable incomes and increased rural spending. LGB also stands to benefit from the rise in status of India as an export hub for motorcycles. While the domestic motorcycle industry has expanded at a CAGR of 7.9% over FY2010-15, the corresponding CAGR in motorcycle exports over the same period has been a robust 15.3%. As motorcycle makers like Bajaj, Hero and Honda continue to penetrate new markets around Africa, Latin America and Asia, exports are increasingly becoming a strong source of sales growth for motorcycle OEMs. Further, key clients like Bajaj Auto and Hero MotoCorp have announced capacity expansion plans that should result in increased orders for LGB.

Healthy financials: We forecast net profit CAGR of 14.5% over FY2015-17E on the back of 1) Reduced capital expenditure going forward leading to improving operational leverage, 2) Stabilization in interest costs as LGB could use operating cash flows to reduce debt (currently Rs157 crore), 3) Favorable revenue mix with increased share of higher margin transmission segment, 4) Minimization of losses in Light commercial vehicle (LCV) trading business and 5) Improving profit margins from overseas subsidiaries.

Risk factors: 1) Volatile raw material prices 2) Slowdown in motorcycle sales

Valuation: We expect LGB's revenue CAGR of 11.2% over FY2015-17E on the back of steady aftermarket sales, revival in motorcycle demand and capacity expansion on the part of its key clients like Bajaj and Hero. The stock is currently trading at 9.5x P/E and 5.0x EV/EBITDA on FY2017E basis and appears attractive. We initiate coverage on the stock with a BUY rating and a target price of Rs662, valuing it at 12x its FY2017E EPS.

Financial Summary - Consolidated

Y/E Mar (Rs Cr.)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj. PAT	YoY (%)	EPS (Rs)	P/E (x)	EV/EBITDA(x)	RoE (%)
FY2013A	956	4.8	89	9.3	33	(26.0)	20.85	25.0	7.6	25.2
FY2014A	1,109	15.9	126	11.4	62	89.2	39.45	13.2	10.6	11.6
FY2015A	1,173	5.8	142	12.1	66	6.7	42.08	12.4	6.9	19.6
FY2016E	1,289	9.9	158	12.2	71	7.0	45.03	11.6	6.0	18.0
FY2017E	1,450	12.5	181	12.5	87	22.5	55.17	9.5	5.0	19.1

Source: Company, Centrum Wealth Research

Recommendation

Current Market Price (Rs)	522
Target Price (Rs)	662
Potential upside (%)	27
Sector Relative to Market	In-Line
Stock Relative to Sector	Outperform

Stock Information

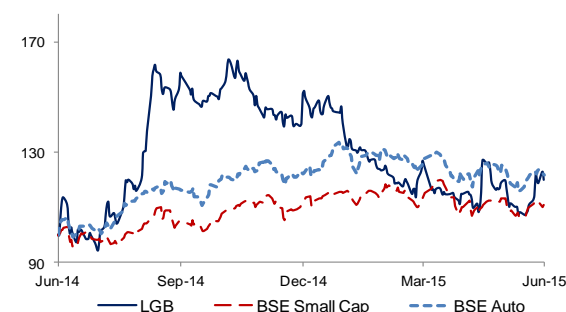
BSE Code	500250
NSE Code	LGBBROSLTD
Face Value (Rs/ share)	10
No. of shares (Cr.)	1.6
Market Cap (Rs Cr.)	819
Free float (Rs Cr.)	434
52 Week H / L (Rs)	764 / 400
Avg. Daily turnover (12M, Rs Cr.)	1.7

Shareholding Pattern (%)

	Mar-15	Mar-14
Promoters	46.51	45.70
FII	0.04	0.01
DII	11.39	5.24
Others	42.06	49.05

Source: Bloomberg, Centrum Wealth Research

1 year Indexed Performance



Source: Bloomberg, Centrum Wealth Research

Price Performance (%)

	1M	3M	6M	12M
LGB	0.8	(5.5)	(20.6)	18.5
BSE Small Cap	(2.2)	(2.1)	(1.1)	10.8
BSE Auto	(2.7)	(3.6)	(0.4)	21.7

Source: Bloomberg, Centrum Wealth Research

Pranoy Kurian, Research Analyst

Siddhartha Khemka, VP Research

Centrum Wealth Research is also available on:

Bloomberg: CBWM <GO>.

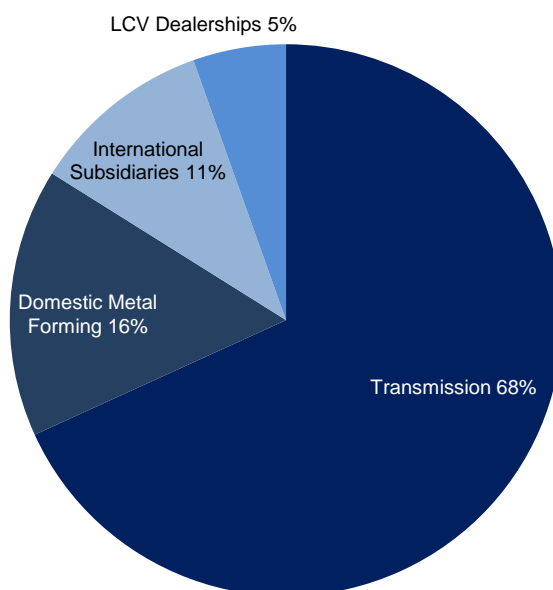
Thomson Reuters, Capital IQ and Factset

About the company

L.G. Balakrishnan & Bros Ltd (LGB) is an automotive supplier that primarily produces transmission products - chains, sprockets & tensioners for motorcycles, belt shoes for the 2 Wheelers (2W) industry and belts (timing/cogged/poly) for the overall automotive industry. They also manufacture metal formed parts (fine blanking) for various segments of the automotive industry (Passenger Vehicles (PV), Commercial Vehicles (CV) and 2W) as well as for industrial clients. LGB has manufacturing units (~20) in Delhi, Tamil Nadu, Uttarakhand, Karnataka and Maharashtra. The company has a presence in LCV dealerships and has two international subsidiaries – GFM LLC and LGB USA.

The company also has an associate called Renold Chain India Private Limited (listed as non-current investment of Rs10.3 crore as of FY2014) which is in the business of industrial chain systems. It uses the 'Rolon' brand name as well. It was formed as a joint venture between Renold PLC, UK (leading global supplier of industrial chains) and LGB in 2008. It caters to the domestic industrial chain market.

Exhibit 1: Revenue breakup by segment for FY2015



Source: Company, Centrum Wealth Research

LGB's segments

- 1) **Transmission Products** - LGB's Transmission product line comprises of chains, sprockets, belts, tensioners, and brake shoes. This segment accounts for ~68% of the firm's consolidated net sales. The firm has a ~70% market share of the OEM segment along with a ~50% share of the replacement segment. LGB has its own brand called 'Rolon' that it uses in the aftermarket segment.

~60% of the transmission chains' divisions' revenue is derived from the OEM segment, while the rest (~40%) is accounted for by the replacement/aftermarket segment (via LGB's own Rolon brand). Sales to OEM's also include replacement/aftermarket supplies however; these are sold under the OEM brand name (accounts for ~12% of transmission revenue). Therefore the OEM:Replacement split is ~48:52.

- 2) The **Metal Forming** division is subdivided into Fine Blanking and Machining Components. In FY2015, this segment grew by 16% YoY and accounted for ~16% of consolidated revenue.
 - a) Fine Blanking - produces precision sheet metal parts for motorcycle and PVs.
 - b) Machining components and wire drawing products - These products are supplied primarily to the automotive industry, with the rest being supplied to various industrial clients. Additionally, a part of the output is used for captive purposes to lower raw material costs.

- 3) **International subsidiaries** – LGB has two subsidiaries, BCW V Tech India (100% holding) - which manufactures machined components for export markets and LGB USA Inc. (74.2% stake).

In 2012, LGB had acquired GFM LLC - a US based metal stampings company (purchased via its subsidiary LGB USA) for ~\$5.5 million. As of FY2014, LGB USA has a 90.9% stake in GFM, (via holding company GFM Acquisition LLC). GFM's core competency lies in precision metal stamping techniques. GFM manufactures fine blanked metal stampings for seat mechanisms to OEMs such as BMW and Lamborghini. In FY2014, GFM had a turnover of ~Rs110 crore, while BCW recorded revenue of ~Rs11 crore. In FY2015, the revenue from subsidiaries grew ~3% to Rs125 crore.

- 4) **LCV Dealerships** - LGB has an LCV dealership business for Tata Motors with 20 outlets spread largely in south India. For FY2015, LGB's revenues from the LCV trading segment accounted for ~5.4% of sales as compared to 13.8% of sales in FY2013 (as the segment revenue declined by ~40% YoY). LGB's LCV trading revenue has now declined by 58% over FY2013-15. In FY2015, revenues were Rs64 crore, and the segment reported a loss of Rs6.7 crore.

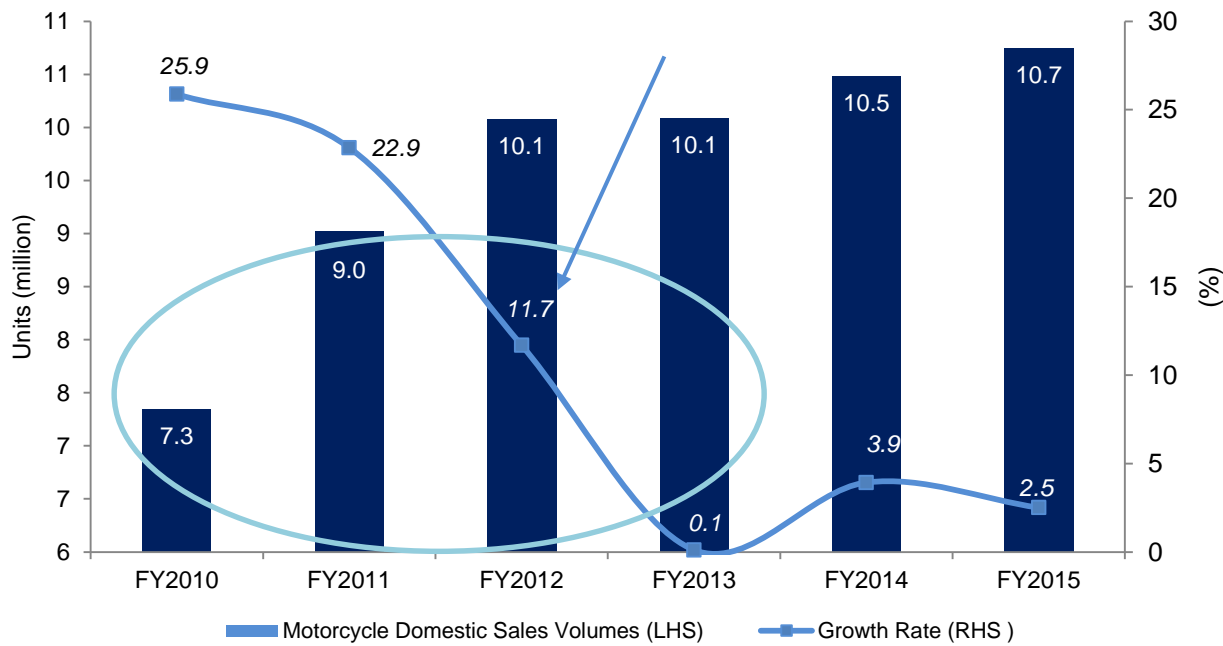
Dominance in aftermarket offers stability

LGB derives ~27% of its revenue from the aftermarket segment. Further, the company also supplies these products to OEMs for sale in the aftermarket segment under the OEMs brand name (~8% of revenue). The aftermarket segment offers a steadier source of revenue that helps counter the swings in the OEM cycle over the long term.

The addressable market for transmission parts in the aftermarket segment is much larger than the OEM market. Transmission products like chain and sprockets for motorcycles usually have to be changed approximately every 3 years over the life of the vehicle, which gives players like LGB opportunities for more over the product lifecycle.

Further, the aftermarket segment is related to the volume of motorcycle sales in prior years and to the total number of vehicles on the road. This means LGB's aftermarket sales are uncorrelated to the current level of OEM sales, which offers important diversification benefits to the company.

Exhibit 2: Likely addressable aftermarket segment – Motorcycles sold from 2010-2013



Source: SIAM, Centrum Wealth Research

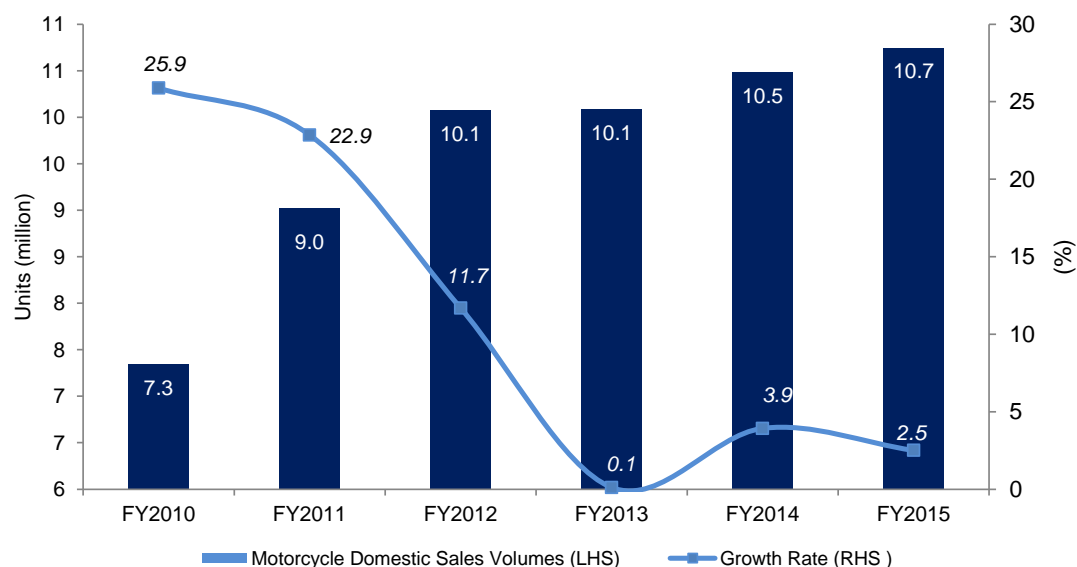
Revival in motorcycle sales

LGB is a dominant player in the motorcycle automotive chains segment and has a 70% market share in the OEM segment. LGB also supplies to the overall 2W and PV market via its Metal forming division.

Domestically, motorcycle sales have been growing at a subdued pace due to rural demand being impacted on account of lower agricultural output and slow economic growth, among other factors. However, over FY2015 industry growth has been increasing, with total motorcycle sales increasing by 4.3% YoY. Long term, we expect the domestic motorcycle market to grow at a robust pace on the back of higher economic growth, stronger consumer demand and rise in rural incomes.

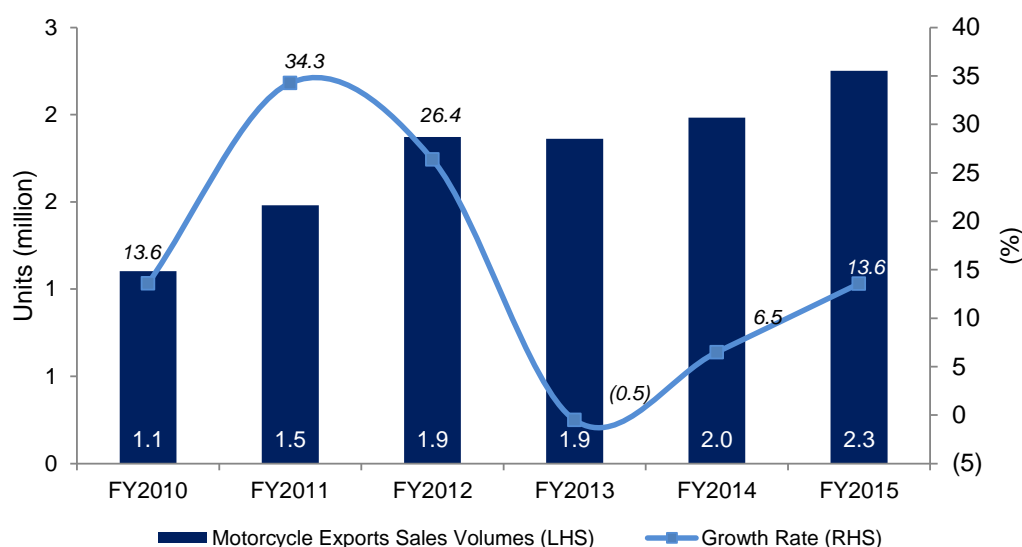
LGB also stands to benefit from the rise in status of India as an export hub for motorcycle. While the domestic motorcycle industry has expanded at a CAGR of 7.9% over FY2010-15, the corresponding CAGR in motorcycle exports over the same period has been a robust 15.3%. As motorcycle makers like Bajaj, Honda and others continue to penetrate new markets around Africa, Latin America and Asia, exports are increasingly becoming a strong source of sales growth for motorcycle OEMs.

Exhibit 3: Motorcycle Domestic Sales



Source: SIAM, Centrum Wealth Research

Exhibit 4: Motorcycle Export Sales



Source: SIAM, Centrum Wealth Research

Key clients to increase orders on capacity expansion

LGB is the primary supplier to Bajaj Auto (Bajaj) and Honda Motorcycles and Scooters India (HMSI), while also being a key supplier to Hero MotorCorp (Hero), India Yamaha Motor (Yamaha) and TVS Motors (TVS).

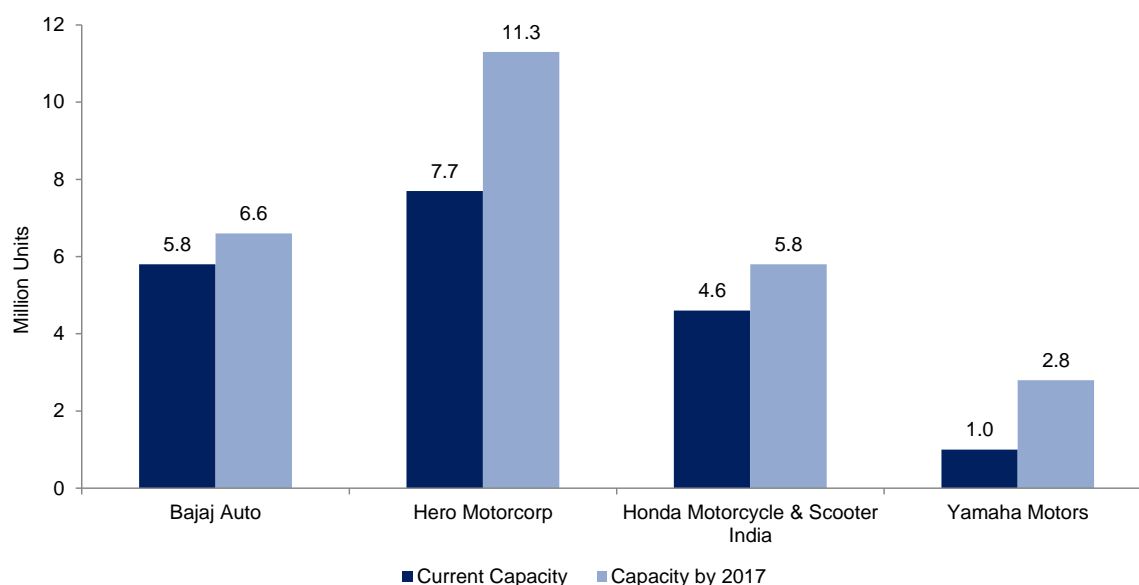
The leading domestic motorcycle OEMs have announced capacity expansion plans over the next few fiscals on an expectation of a demand revival in the domestic economy. The planned capacity expansion is meant to target both the domestic market as well as export markets, where OEMs are expanding into new geographical regions. Thus, going forward, we expect that these capacity expansion plans will lead to increased production on the part of motorcycle OEMs that should result in increased orders for LGB for both its primary chains business as well as other 2W component sales.

Bajaj has three plants, two at Waluj and Chakan in Maharashtra and one plant at Pant Nagar in Uttaranchal with an annual capacity of ~6 million units. Bajaj has announced plans to set up an additional plant in Chakan with an initial capacity of 0.6 million units annually. The plant is expected to come on stream by FY2017E and will take Bajaj's total capacity to 6.6 million units a year. The bulk of the capacity addition will be aimed at motorcycle production (mainly Pulsars).

Hero currently has an installed production capacity of ~7.7 million units annually, which is spread out over its 4 plants at Dharuhera, Gurgaon, Haridwar and Neemrana. Hero is setting up two more plants in Gujarat and Andhra Pradesh which will each have a production capacity of ~1.8 million units annually. The Gujarat plant is expected to begin production in FY2016E, while the plant in Andhra Pradesh is expected to come on stream later. Thus, Hero's new plants should result in it increasing its production capacity from ~7.7 million units currently to ~11.3 million units by ~FY2018E. Of this new capacity addition ~1/3rd is earmarked for new scooters, with rest for motorcycles.

HMSI has a current production capacity of ~4.6 million units generated from 3 plants in India – Manesar in Haryana, Tapukara in Rajasthan and Narsapura in Karnataka. HMSI has set up a fourth plant that is located at Vithalapur, Gujarat, which will have a production capacity of 1.2 million units annually. This Gujarat plant will come on stream in H1FY2016E. Additionally HMSI has invested Rs585 crore to increase the capacity of the Narsapura plant by 0.6 million units annually by end of FY2016E. Cumulatively, this will result in Honda having an annual capacity of 6.4 million units by FY2017E. While part of the capacity will be aimed at its scooter segment, the rest will be focused on its "CBR" range of motorcycles.

Exhibit 5: 2W Clients expanding capacity



Source: Industry, Centrum Wealth Research

Capacity expansion plans

LGB is in the process of setting up a new plant at Jalna, Maharashtra which will produce transmission chains as well as metal forming products. The total cost of the plant will be in the range of Rs150-160 crore. The bulk of the capex (~Rs100 crore) has already been incurred in FY2015. The plant is expected to commence production by FY2017E. Besides this, LGB has no further significant capex plans.

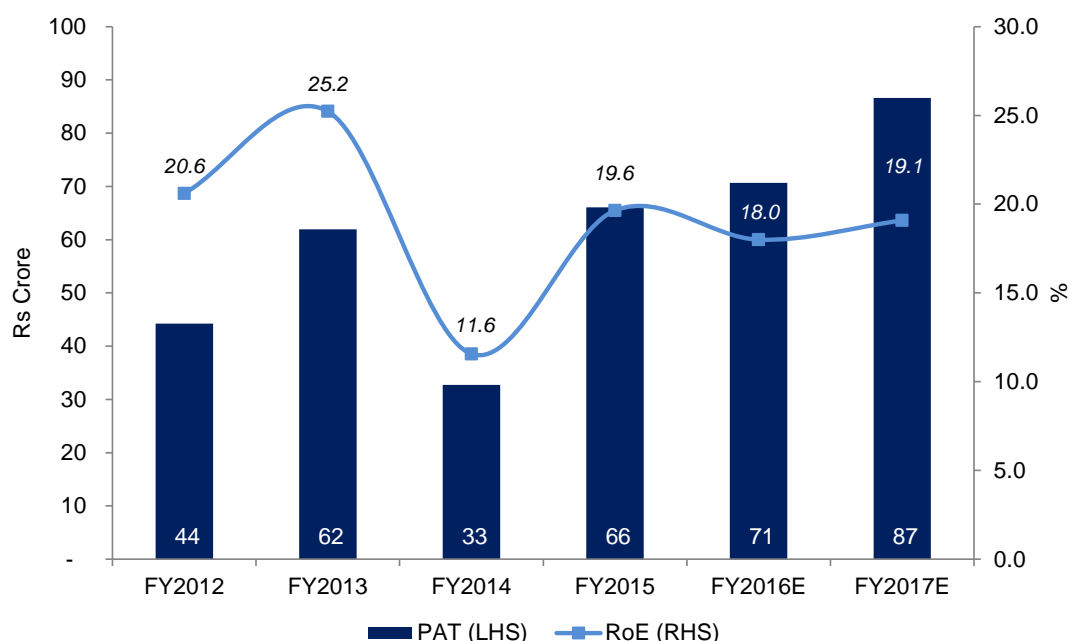
Financials likely to improve going ahead

LGB's RoE dipped in FY2014 to 11.6% after 3 consecutive years of staying above >20%. However, in FY2015, RoE's improved to 19.6% on the back of strong operating margins. We expect RoEs to remain at a healthy level of 18-19% over FY2016-17E.

As of March 31, 2015, LGB's debt stood at Rs157 crore. With estimated operational cash flows of Rs115 crore and Rs125 crore in FY2016E and FY2017E, respectively, we believe LGB could repay its debt significantly and improve its debt-equity ratio to 0.2x in FY2017E (0.4x in FY2015).

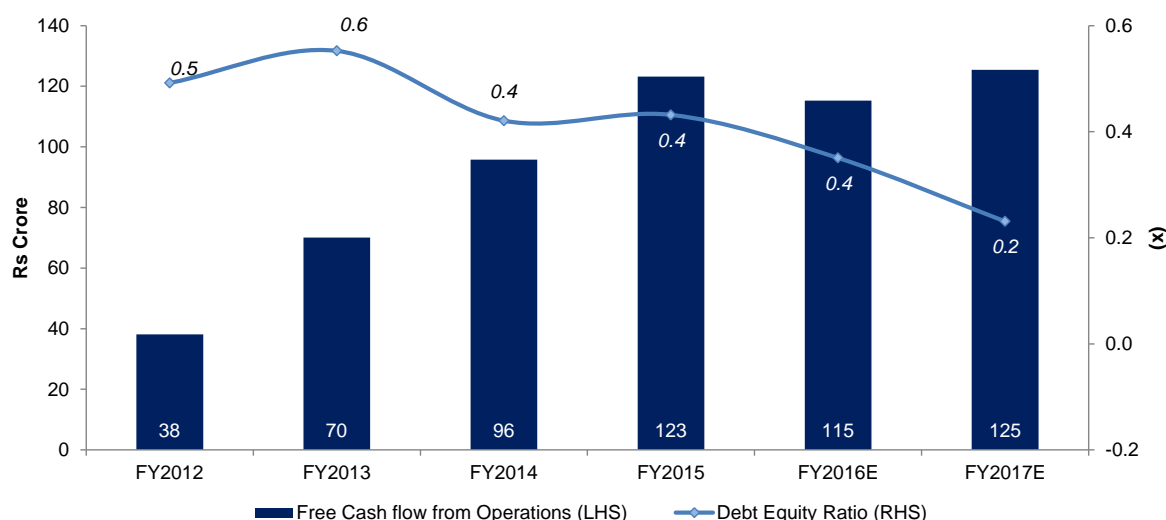
With debt reduction, the resultant interest savings could improve profitability of the company. As a result, we expect interest coverage ratios as well as Earning before Tax (EBT) margins to improve significantly by FY2017E.

Exhibit 6: Healthy RoEs on strong PAT growth



Source: Company, Centrum Wealth Research

Exhibit 7: Robust free cash flow to reduce leverage



Source: Company, Centrum Wealth Research

Quarterly performance

For Q4FY2015 on a standalone basis, revenue grew by 2.6% YoY to Rs267 crore. EBITDA grew by 7.1% YoY to Rs30 crore with the margins expanding by 48bps YoY to 11.4% on the back of lower raw material costs (down 39bps as a % of revenue). Net profit decreased by 5% YoY to Rs13 crore. EPS for the quarter stood at Rs8.3 as against Rs8.8 in Q4FY2014.

Exhibit 8: Standalone Quarterly Performance

Y/E Mar (Rs Cr.)	Q4FY14	Q1FY15	Q2FY15	Q3FY15	Q4FY15
Revenue	260	250	267	264	267
Growth YoY (%)	7.4	12.1	6.8	3.8	2.6
Cost of raw material	124	117	122	120	126
% of sales	47.6	46.9	45.9	45.5	47.2
Employee Expense	32	31	32	34	33
% of sales	12.4	12.2	12.2	12.9	12.2
Other expense	76	71	76	78	78
% of sales	29.1	28.4	28.4	29.7	29.2
EBITDA	28	31	36	31	30
EBITDA margins (%)	10.9	12.5	13.5	11.9	11.4
Depreciation	8	9	10	9	9
Interest	4	4	4	4	4
Other Income	0.4	1	0.4	1	1
PBT before excep.item	17	18	22	19	18
Excep. Item Gain/(Loss)	-	-	7	-	-
PBT	17	18	29	19	18
Tax	3	3	7	5	5
Tax rate (%)	17.6	17.2	25.4	24.8	28.0
Reported PAT	14	15	22	14	13
Adj. Excep Item	-	-	(5)	-	-
Adj. PAT	14	15	17	14	13
Growth YoY (%)	53.4	73.3	12.8	(14.9)	(5.0)
PAT margins (%)	5.3	6.1	6.2	5.5	4.9

Source: Company, Centrum Wealth Research

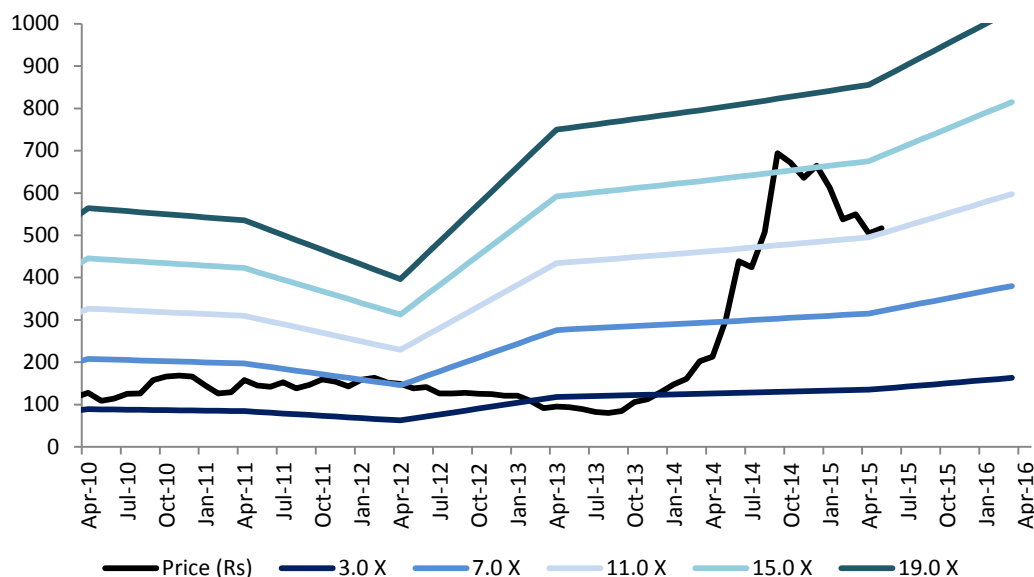
Risk Factors

- **Higher raw material costs:** Given that raw material costs account for between ~47% of LGB's sales, any volatility in these commodities could have a negative impact on the company.
- **Continued slowdown in motorcycle sales:** A lack of recovery in motorcycle sales will slow LGB's growth.

Valuation

We expect LGB to see revenue CAGR of 11.2% over FY2015-17E on the back of steady aftermarket sales, revival in motorcycle demand and capacity expansion on the part of its key client's like Bajaj and Hero. Further, we forecast operating margins to be at ~12.5% in FY2017E. At the CMP, LGB trades at 9.5x its FY2017E EPS of Rs55.2. We initiate coverage on the stock with a BUY rating and a target price of Rs662, valuing it at 12x its FY2017E EPS.

Exhibit 9: One year forward P/E trend



Source: Company, Centrum Wealth Research

Exhibit 10: Relative Valuation – Market leaders in domestic automotive Segment

Company	CMP	MKT. CAP	FY2015	MCap to	OPM (%)		RoE (%)		P/E	
	(Rs)	(Rs Cr)	Revenue	Sales(x)	FY2016E	FY2017E	FY2016E	FY2017E	FY2016E	FY2017E
LGB	522	819	1,173	0.7	12.2	12.5	18.0	19.1	11.6	9.5
SUPRAJIT	122	1,458	609	2.4	16.3	16.9	27.4	29.4	19.4	14.7
SETCO	243	649	458	1.4	14.6	16.4	19.5	26.4	14.9	8.8

Source: LGB, SETCO - Centrum Wealth Research Estimates, Suprajit – Bloomberg Consensus Estimate; Stock Price data as of 30 June 2015

Technical View on L.G. Balakrishnan & Bros. Ltd

- L.G. Balakrishnan & Bros. Ltd. has been trending sideways since the past many weeks and while its long term structure is bullish, in trading terms the scrip has been forming a lower low setup with resistance currently visible near 550 while support is evident near 450.
- In case of a breach of 450, the scrip can be expected to move down further towards 380-400 range while a move beyond 550 will open an upside towards 700 in 3 months thereafter.
- The overall oscillator and moving average setup though is suggesting a higher probability of an eventual breakout for the scrip and aggressive traders can thus initiate long positions for the abovementioned target with stop loss below 450.

Exhibit 11: Technical Chart



Source: Company, Centrum Wealth Research

Financial Summary - Consolidated

Income Statement

Y/E Mar (Rs Cr)	FY2013	FY2014	FY2015	FY2016E	FY2017E
Revenue	956	1,109	1,173	1,289	1,450
Growth %	4.8	15.9	5.8	9.9	12.5
Raw Material	511	545	550	608	686
% of sales	53.4	49.2	46.9	47.2	47.3
Personnel expenses	100	134	150	162	180
% of Sales	10.5	12.1	12.8	12.6	12.4
Manufact. & Other Exp.	256	303	331	361	403
% of Sales	26.8	27.3	28.3	28.0	27.8
EBIDTA	89	126	142	158	181
EBIDTA margin %	9.3	11.4	12.1	12.2	12.5
Depreciation	30	33	39	46	50
Interest	23	18	18	19	16
Other Income	4	5	3	4	4
PBT	40	80	87	97	119
Excep. Item Gain/(Loss)	-	-	7	-	-
PBT after exceptional item	40	80	94	97	119
Provision for tax	8	15	20	24	30
Effective tax rate %	19.1	18.6	21.8	25.0	25.0
PAT	33	65	73	73	89
Minority Interest/Share of Assoc.	0.1	(3)	(2)	(2)	(2)
Reported PAT	33	62	71	71	87
Adj. Excep. Item	-	-	(5)	-	-
Adj NPAT	33	62	66	71	87
Growth %	(26.0)	89.2	6.7	7.0	22.5
PAT margin (%)	3.4	5.6	5.6	5.5	6.0

Source: Company, Centrum Wealth Research

Balance Sheet

Y/E Mar (Rs Cr)	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Share capital	8	8	16	16	16
Reserves & surplus	251	300	349	405	471
Total shareholder's fund	258	308	365	421	487
Minority Interest	5	10	13	16	19
Loan fund	143	129	157	147	112
Deferred tax liability	18	17	17	17	17
Total capital employed	425	464	551	600	635
Net fixed assets	231	264	351	375	375
Investments	19	17	18	9	3
Cash and bank	10	6	7	22	36
Inventories	196	208	231	258	290
Debtors	124	146	148	161	181
Loans and advances	39	47	49	51	57
Other Current Assets	3	1	2	2	2
Total current assets	372	408	437	494	567
Current lia. and provisions	197	225	254	278	310
Net current assets	175	183	183	216	257
Total assets	425	464	551	600	635

Source: Company, Centrum Wealth Research

Cash Flow

Y/E Mar (Rs Cr)	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Net Profit Before Tax	40	80	87	97	119
Depreciation	30	33	39	46	50
Others	19	15	16	15	13
Change in working capital	(12)	(15)	1	(19)	(27)
Tax expenses	(8)	(17)	(20)	(24)	(30)
Cash flow from Ops	70	96	123	115	125
Capex	(62)	(67)	(127)	(70)	(50)
Other investing activities	(1)	7	2	13	10
Cash flow from Invest	(63)	(60)	(125)	(57)	(40)
Proceeds from Eq. capital	6	(0.5)	(1)	-	-
Borrowings/ (Repayments)	30	(14)	28	(10)	(35)
Dividends paid	(15)	(6)	(13)	(15)	(20)
Interest paid	(23)	(18)	(18)	(19)	(16)
Cash flow from financing	(3)	(39)	(4)	(43)	(71)
Net Cash Flow	5	(4)	(6)	15	14

Source: Company, Centrum Wealth Research

Key Ratios

Y/E Mar	FY2013	FY2014	FY2015E	FY2016E	FY2017E
Return ratios (%)					
RoE	25.2	11.6	19.6	18.0	19.1
RoCE	20.2	11.5	16.2	15.1	16.3
Turnover Ratios (days)					
Inventory	74.8	68.3	71.7	73.0	73.0
Debtors	47.4	48.1	46.0	45.6	45.6
Creditors	45.5	48.2	48.6	48.5	48.5
Fixed asset (x)	2.5	2.5	2.2	2.0	2.1
Solvency Ratio (x)					
Debt-equity	0.6	0.4	0.4	0.4	0.2
Interest coverage	5.5	2.8	5.9	6.2	8.6
Per share (Rs)					
Adj EPS	20.9	39.5	42.1	45.0	55.2
BVPS	164.7	196.1	232.3	268.0	310.3
CEPS	39.9	60.3	67.2	74.2	87.1
Dividend Ratios					
DPS (Rs)	3.8	6.0	7.0	8.0	11.0
Dividend Yield (%)	0.7	1.1	1.3	1.5	2.1
Dividend Payout (%)	20.9	17.8	18.1	20.8	23.3
Valuation (x)					
P/E	25.0	13.2	12.4	11.6	9.5
P/BV	3.2	2.7	2.2	1.9	1.7
EV/EBIDTA	7.5	10.5	6.8	6.0	5.0
EV/Sales	1.0	0.8	0.8	0.7	0.6

Source: Company, Centrum Wealth Research

Appendix

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