L G Balakrishnan & Bros

LGBL to benefit from 2W industry growth

BUY	
CMP	₹497
Target Price	₹605
Investment Period	12 Months

Stock Info	
Sector	Auto Ancillary
Market Cap (₹ cr)	780
Net Debt (₹ cr)	126
Beta	0.5
52 Week High / Low	535 / 77
Avg. Daily Volume	7,406
Face Value (₹)	10
BSE Sensex	26,421
Nifty	7,898
Reuters Code	LGB.BO
Bloomberg Code	LGBB@IN

Shareholding Pattern (%)	
Promoters	46.5
MF / Banks / Indian FIs	6.8
FII / NRIs / OCBs	0.0
Indian Public / Others	46.7

Abs. (%)	3m	1yr	3yr
Sensex	8.5	44.3	63.7
LGBL	80.3	533.3	266.0

Investment Arguments

Recovery in two-wheeler industry would benefit L G Balakrishnan & Bros (LGBL): During FY2014, the domestic sales of two-wheelers stood at ~14.8 million units (growing 7.3% yoy) and exports recorded sales of ~2.1 million units (growing 6.3% yoy). In the FY2013, the Indian two-wheeler industry reported a subdued volume growth. But in FY2014, the industry showed some recovery in the domestic (on back of strong rural demand and festive season sales) as well as export markets. During 1QFY2015, the two-wheeler industry has reported a strong growth of 15.5% due to recovery in domestic and export markets. We expect growth momentum in the two-wheeler industry to sustain owing to an anticipated recovery in the economy coupled with revival in the investment cycle. This would be on the back of the new pro-reforms government having come at the centre and on an expected decline in interest rates. We expect two-wheeler sales to improve going forward which would benefit auto ancillary companies like LGBL.

Capacity expansion at key clients would drive growth for LGBL: The company's automotive chains segment caters to the OEM market for two-wheelers. In the OEM segment (LGBL has a 70% market share in this segment), the company has tied up with leading two wheeler players like Bajaj Auto, Hero MotoCorp (HMCL), Honda Motorcycle and Scooter India (HMSI), TVS Motor, Yamaha Motor etc., all of which have good growth prospects. These OEMs are increasing their capacity and also entering newer geographies for export which would drive growth of the industry. Hence, going forward, we believe that expansion plans at various OEM clients would trigger volume growth for LGBL.

Outlook and Valuation: We forecast LGBL to report Net Sales CAGR of ~16% over FY2014-16E to ~₹1,484cr and Net Profit CAGR of ~12% during the same period to ₹79cr. At the current market price of ₹497, the stock trades at 11.7x and 9.9x its FY2015E and FY2016E EPS of ₹42.6 and ₹50.4, respectively. **Based on 12x FY2016E EPS, we arrive at a target price of ₹605 for LGBL, indicating an upside of ~22% from the current levels. Thus, we recommend a Buy on LGBL.**

Key financials

Y/E March (₹ cr)	FY2013	FY2014	FY2015E	FY2016E
Net sales	**956**	**1,109**	**1,276**	**1,484**
% chg	*4.8*	*15.9*	*15.1*	*16.4*
Net profit	**33**	**63**	**67**	**79**
% chg	*(26.0)*	*91.6*	*6.7*	*18.2*
EBITDA margin (%)	9.3	11.4	11.5	11.5
EPS (₹)	**20.8**	**39.9**	**42.6**	**50.4**
P/E (x)	23.8	12.4	11.7	9.9
P/BV (x)	3.0	2.5	2.1	1.8
RoE (%)	12.7	20.3	18.2	18.1
RoCE (%)	13.9	20.3	20.6	21.0
EV/Sales (x)	1.0	0.8	0.7	0.6
EV/EBITDA (x)	10.3	7.2	6.1	5.2

Source: Company, Angel Research, Note: CMP as of August 19, 2014

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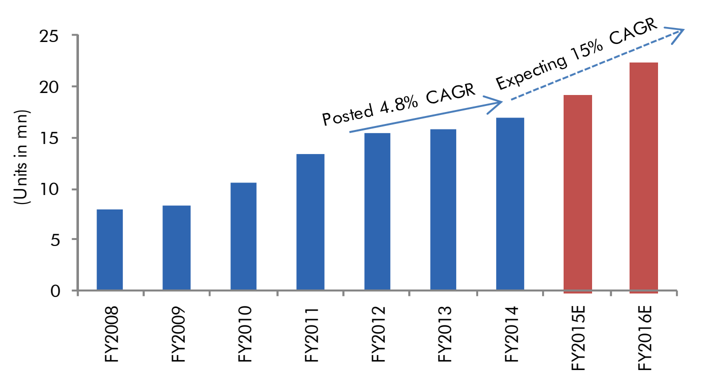
Investment Arguments

Recovery in two-wheeler industry would benefit LGBL

During 1QFY2015, the two-wheelers industry has reported a strong growth of 15.5% due to strong recovery in domestic and export markets

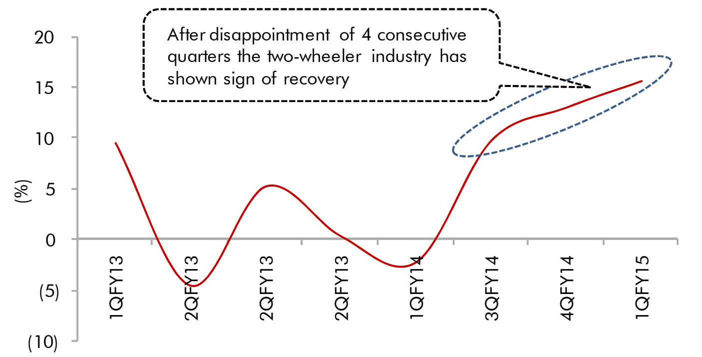
India has been amongst the fastest growing two-wheeler markets in the world in the last five years. For FY2014, domestic sales of two-wheelers stood at ~14.8 million units (a 7.3% yoy growth) and exports recorded sales of ~2.1 million units (a 6.3% yoy growth). In the FY2013, the Indian two-wheeler industry reported a subdued volume growth owing to slow down in the domestic economy, higher inflation and increase in fuel prices. Further, overall two wheelers export numbers were also subdued. However, the Indian two-wheeler industry showed some recovery in domestic (on back of strong rural demand and festive season sales) as well as export markets in FY2014. During 1QFY2015, the two-wheeler industry has reported a strong growth of 15.5% due to recovery in domestic and export markets.

Exhibit 1: Two wheeler Industry trend



Source: SIAM, Angel Research

Exhibit 2: Recovery in two wheeler volume growth

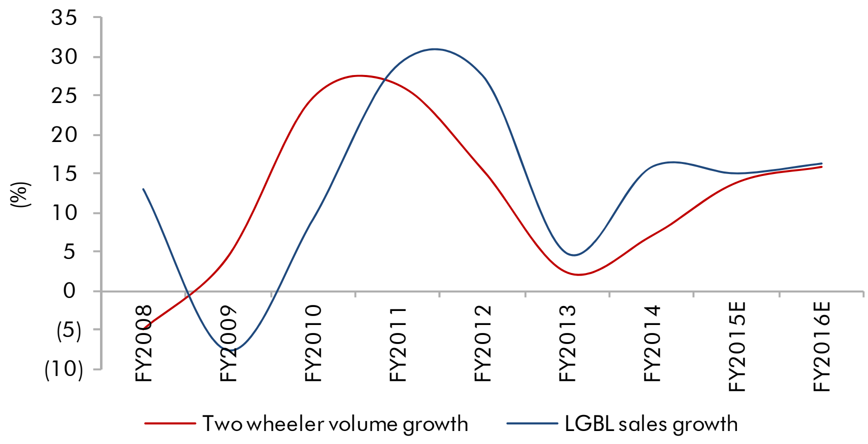


Source: SIAM, Angel Research

We expect the Indian two-wheeler industry to report a healthy ~15% CAGR over FY2014-16E

Considering the domestic two-wheeler industry's growth and improvement in demand in the domestic and export markets (Indian two-wheeler OEMs are expanding in new geographical regions like Africa and Latin America) in the last three quarters, we expect the Indian two-wheeler industry to report a healthy ~15% CAGR over FY2014-16E. Also, with the formation of the new government at the centre, we expect inflationary pressures to subside, thus leading to lower interest rates. This coupled with anticipation of increase in personal disposable incomes (due to recovery in the domestic economy) would create a positive sentiment for India consumers. Further, moderate two-wheeler penetration levels in the country compared to other emerging markets, strong urbanization and under-developed public transport system will provide a boost to the domestic two-wheeler industry.

Exhibit 3: Correlation between 2W volumes and LGBL's top-line performance



Source: Company, Angel Research

LGBL has ~70% market share in the OEM segment

LGBL has a strong brand - 'ROLON' in the automotive chains segment which contributes by ~65% to the company's revenue. In automotive chains, the company has a ~70% market share in the OEM segment and around ~50% market share in the replacement segment. Thus, we believe that LGBL is best placed to take advantage of an expected recovery in the two-wheeler industry.

Moreover, over the last 7 years, we have witnessed a strong correlation between volume growth in the two wheeler industry and sales growth of LGBL. We expect this trend to continue going forward. Thus, in our view, LGBL would benefit from a recovery in two-wheeler volumes going forward.

Capacity expansion at key clients would drive growth for LGBL

The company has tied up with leading two-wheeler OEMs like Bajaj Auto, Hero MotoCorp (HMCL), Honda Motorcycle and Scooter India (HMSI), TVS motor, Yamaha Motor etc

The company's automotive chains segment caters to the OEM market for two-wheelers. In the OEM segment (LGBL has a 70% market share in this segment), the company has tied up with leading two-wheeler manufacturers like Bajaj Auto, Hero MotoCorp (HMCL), Honda Motorcycle and Scooter India (HMSI), TVS Motor, and Yamaha Motor among others, all of which have good growth prospects. These major two-wheeler OEMs are increasing their capacity and also entering into new geographies, which would drive the industry's growth going forward. On a similar account, the replacement market is also doing well.

HMCL is expected to start construction of its proposed fifth plant at Halol in Gujarat soon, where the company will invest up to ₹1,100cr. The plant is expected to go on stream in FY2016 with an annual capacity of 1.8 million units of two-wheelers. Going forward, the expansion plan of HMCL will lead to an increase in its production capacity from 7.7 million units currently to 9.5 million units once the plant becomes operational.

In the last three years, HMSI has grown from one plant to three plants, and now the company has plans to increase its production capacity in India from 4.6 million units to 5.8 million units. The company's fourth plant will come up near Ahmedabad, which will have an annual capacity of 1.2 million units; the plant is expected to go running by FY2015.

Further, Yamaha is also investing money to increase its production capacity from 1mn units currently to 2.8mn units by 2QFY2015E.

Going forward, we believe that expansion plans at various clients like HMCL, HMSI, Yamaha, etc. would trigger volume growth for LGBL.

Exhibit 4: Upcoming expansion plans of clients

(Units)	Current Capacity	Expected Capacity	Total Capacity	Entry in newer markets
Bajaj Auto	5.8mn	0.2mn	6.0mn	Argentina, Turkey, Afghanistan, Lebanon, Guinea, Togo, Mali, Burkina Faso and Liberia
Hero MotoCorp	7.7mn	Gujarat - 1.8mn	9.5mn	Asia, Africa and South America
Honda Motorcycle and Scooter India	4.6mn	Gujarat -1.2mn	5.8mn	Latin Americans and Africa
Yamaha Motor	1mn	Chennai -1.8mn	2.8mn	US and Japan

Source: *Company, Angel Research*

Other automotive products to contribute to revenue growth

LGBL also manufactures products for LCVs, cars/jeeps, three wheelers, trucks and tractors

Apart from two-wheelers (automotive chains), the company also manufacturers products for LCVs, cars/jeeps, three-wheelers, trucks and tractors. For these vehicles, the company supplies products like timing B belts, vari speed belts, cogged belts, poly v belts etc. Further, the company is also supplying break shoe to automobile industry. We believe that the company has a healthy diversified product portfolio in the automobile segment. Also, LGBL is also surging ahead to become a metal forging company, concentrating on hot, warm & cold forging, blanking, fine blanking & precision machined parts etc. The metal forming division caters to clients such as Bajaj Auto, Brakes India, Hero Honda, Kalyani Brakes, Larsen & Toubro, Bosch, and TVS Motor Company.

Financial outlook

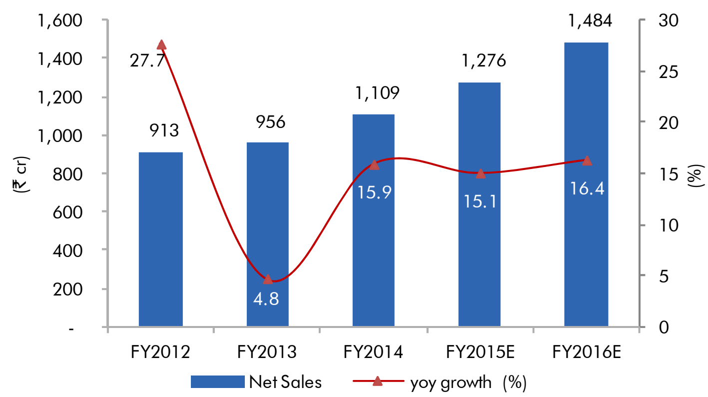
Going forward, we believe that LGBL would register a healthy sales CAGR of ~16% over FY2014-16E

LGBL has reported sales CAGR of ~10% over FY2012-14. During FY2013, the company was unable to perform well due to the overall slowdown in the two-wheeler industry, which affected overall OEM sales volume of the company. Going forward, we expect LGBL to register a healthy sales CAGR of ~16% over FY2014-16E supported by healthy sales volume in the OEM segment due to strong recovery in the two-wheeler industry. Further, the company is making efforts to increase its distribution network to aid its replacement market sales. Moreover, the company's other segments are also doing well and are expected to post healthy sales numbers. Hence, we expect LGBL's revenue to grow by ~15% and ~16% in FY2015E and FY2016E respectively.

We expect LGBL to report a ~12% CAGR in PAT over FY2014-16E

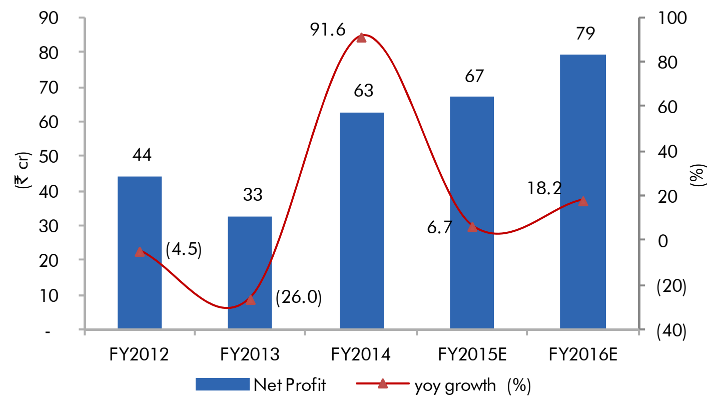
We expect LGBL to report a ~12% CAGR in PAT over FY2014-16E on the back of decent revenue growth, stable material costs (not much pressure seen on input costs going forward) and better operational performance. Further, we expect interest costs to be stable going forward (as there is no major capex plan) and also expect a lower tax rate in FY2015 and FY2016 (according to the Management the company would get tax exemption for the next two years as the company's manufacturing plant is in a special economic zone).

Exhibit 5: Projected Net Sales growth trend



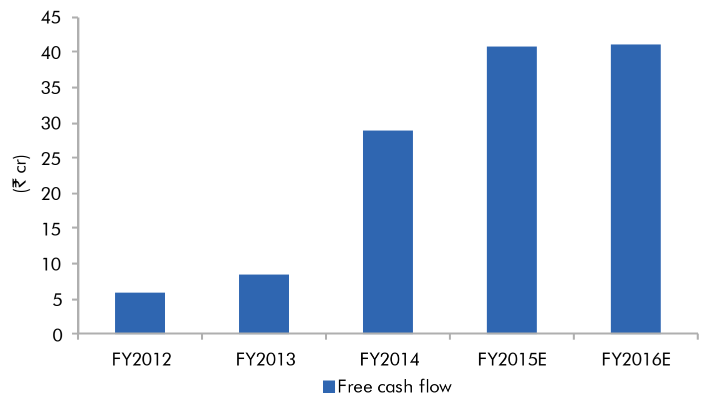
Source: Company, Angel Research

Exhibit 6: Projected Net Profit growth trend



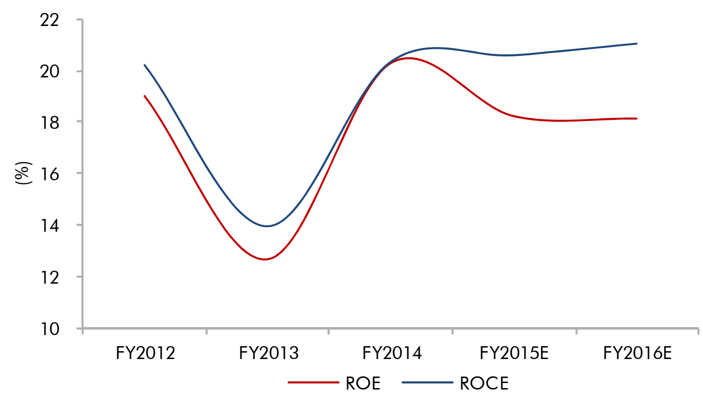
Source: Company, Angel Research

Exhibit 7: Strong free cash flow generation



Source: Company, Angel Research

Exhibit 8: ROE and ROCE trend



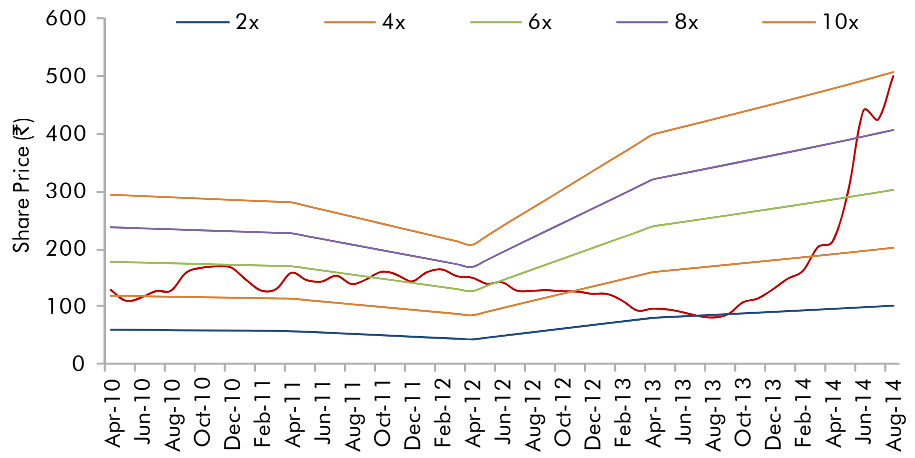
Source: Company, Angel Research

Outlook and Valuation

LGBL is a market leader in two-wheeler automotive chains with ~70% market share in the OEM segment. The two-wheeler industry is showing signs of recovery, both in terms of domestic sales as well as exports. This will lead to recurring business opportunity for auto ancillary companies like LGBL. Going ahead, the company would improve its volume growth in the automotive chains segment driven by healthy volume growth at key clients like HMCL, HMSI, Yamaha, TVS Motor and others (owing to upcoming capacity expansion plans and new launches).

We forecast LGBL to report Net Sales CAGR of ~16% over FY2014-16E to ~₹1,484cr and Net Profit CAGR of ~12% during the same period to ₹79cr. At the current market price of ₹497, the stock trades at 11.7x and 9.9x its FY2015E and FY2016E EPS of ₹42.6 and ₹50.4, respectively. **Based on 12x FY2016E EPS, we arrive at a target price of ₹605 for LGBL, indicating an upside of ~22% from the current levels. Thus, we recommend a Buy on LGBL.**

Exhibit 9: One-year forward P/E band



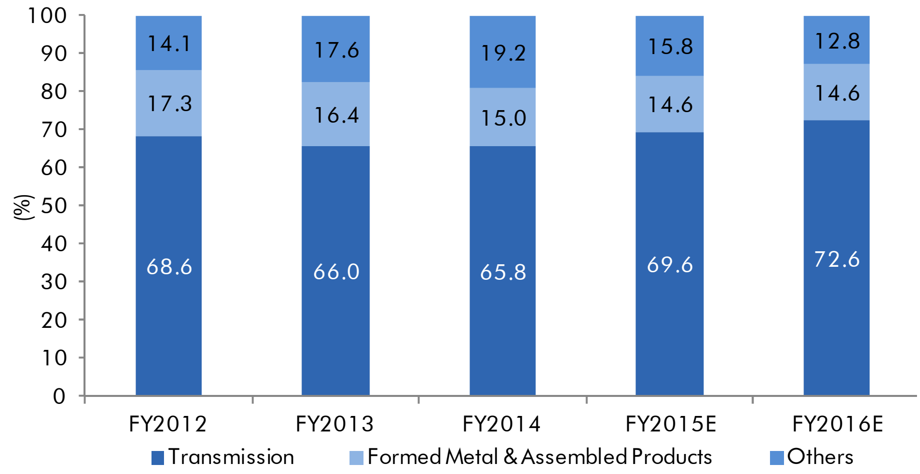
Source: Company, Angel Research

The downside risks to our estimates include 1) any increase in input costs (i.e. steel, iron, etc.) could negatively impact profitability, and 2) Downturn in the automobile industry could affect business growth.

Company Background

L G Balakrishnan & Bros Ltd is an India-based company engaged in manufacturing of chains, sprockets and metal formed parts for automotive applications. It operates in three segments: Transmission, Metal Forming and Others. The company's Transmission products include chains, sprockets, tensioners, belts and brake shoe. The company's Metal Forming products include fine blanking for precision sheet metal parts, machined components and wire drawing products for internal use as well as for other chain manufacturing plants, spring steel suppliers, and umbrella manufacturers. The company's Others segment includes trading goods. The company's products are marketed under the Rolon brand. It has manufacturing units spread across Tamil Nadu, Maharashtra, Uttrakhand, Karnataka and Delhi.

Exhibit 10: Segment wise sales break up



Source: Company, Angel Research

Profit & Loss Statement

Y/E March (₹)	FY2011	FY2012	FY2013	FY2014	FY2015E	FY2016E
Total operating income	715	913	956	1,109	1,276	1,484
% chg	*29.0*	*27.7*	*4.8*	*15.9*	*15.1*	*16.4*
Total Expenditure	628	809	867	982	1,129	1,314
Cost of Materials	367	484	511	545	630	736
Personnel	66	88	100	134	158	189
Others	194	238	256	303	341	389
EBITDA	87	104	89	126	147	171
% chg	*18.5*	*19.1*	*(13.8)*	*41.2*	*16.3*	*16.4*
(% of Net Sales)	*12.2*	*11.4*	*9.3*	*11.4*	*11.5*	*11.5*
Depreciation& Amortisation	26	29	30	33	40	47
EBIT	61	75	59	93	106	123
% chg	*19.0*	*22.3*	*(20.6)*	*57.0*	*14.0*	*15.9*
(% of Net Sales)	*8.6*	*8.2*	*6.2*	*8.4*	*8.3*	*8.3*
Interest & other Charges	15	18	23	18	18	18
Other Income	2	2	4	5	5	5
(% of PBT)	*4.7*	*2.9*	*9.5*	*5.7*	*5.1*	*4.5*
Share in profit of Associates	-	-	-	-	-	-
Recurring PBT	48	59	40	80	93	110
% chg	*32.6*	*22.5*	*(31.5)*	*98.4*	*16.4*	*18.2*
Prior Period & Extr. Exp./(Inc.)	-	-	-	-	-	-
PBT (reported)	48	59	40	80	93	110
Tax	2	15	8	15	23	28
(% of PBT)	*3.8*	*24.9*	*19.1*	*18.6*	*25.0*	*25.0*
PAT (reported)	46	44	33	65	70	83
Add: Share of earnings of asso.	-	-	-	-	-	-
Less: Minority interest (MI)	-	-	(0)	2	3	4
PAT after MI (reported)	46	44	33	63	67	79
ADJ. PAT	46	44	33	63	67	79
% chg	*89.8*	*(4.5)*	*(26.0)*	*91.6*	*6.7*	*18.2*
(% of Net Sales)	*6.5*	*4.8*	*3.4*	*5.7*	*5.2*	*5.3*
Basic EPS (₹)	29.5	28.2	20.8	39.9	42.6	50.4
Fully Diluted EPS (₹)	29.5	28.2	20.8	39.9	42.6	50.4
% chg	*89.8*	*(4.5)*	*(26.0)*	*91.6*	*6.7*	*18.2*

Balance Sheet

Y/E March (₹ cr)	FY2011	FY2012	FY2013	FY2014	FY2015E	FY2016E
SOURCES OF FUNDS						
Share Capital	8	8	8	8	16	16
Reserves Total	189	225	251	301	351	420
Total Shareholders Funds	**197**	**233**	**258**	**309**	**367**	**436**
Minority Interest	-	-	5	10	10	10
Total Debt	118	138	168	150	150	150
Deferred Tax Liability	19	18	18	17	17	17
Total Liabilities	**334**	**388**	**450**	**486**	**544**	**613**
APPLICATION OF FUNDS :						
Gross Block	351	367	428	486	556	636
Less: Acc. Depreciation	160	171	200	231	272	319
Net Block	**191**	**197**	**228**	**255**	**284**	**317**
Capital Work in Progress	4	3	3	9	12	14
Investments	14	14	19	18	22	26
Current Assets	**271**	**341**	**372**	**408**	**454**	**512**
Inventories	154	193	196	208	227	252
Sundry Debtors	84	109	124	146	157	171
Cash and Bank	5	6	10	7	10	14
Loans and Advances	28	33	41	47	57	74
Other Assets	0	0	1	0	1	1
Current liabilities	146	166	172	204	228	257
Net Current Assets	**125**	**175**	**200**	**204**	**225**	**256**
Mis. Exp. not written off	-	-	-	-	-	-
Total Assets	**334**	**388**	**450**	**486**	**544**	**613**

Cashflow Statement

Y/E March (₹ cr)	FY2011	FY2012	FY2013	FY2014	FY2015E	FY2016E
Profit before tax	48	59	40	80	93	110
Depreciation	26	29	30	33	40	47
Change in Working Capital	(9)	(49)	(12)	(15)	(18)	(27)
Interest / Dividend (Net)	15	17	23	18	18	18
Direct taxes paid	3	(17)	(8)	(17)	(23)	(28)
Others	0	(1)	(3)	(3)	0	0
Cash Flow from Operations	82	38	70	96	111	121
(Inc.)/ Dec. in Fixed Assets	(67)	(30)	(58)	(61)	(73)	(82)
(Inc.)/ Dec. in Investments	(4)	-	(5)	0	(4)	(4)
Cash Flow from Investing	(72)	(30)	(63)	(60)	(77)	(86)
Issue of Equity	0	0	6	0	8	0
Inc./(Dec.) in loans	10	20	0	0	0	0
Dividend Paid (Incl. Tax)	(6)	(9)	(15)	(6)	(12)	(13)
Interest / Dividend (Net)	(15)	(18)	7	(33)	(26)	(18)
Cash Flow from Financing	(11)	(8)	(2)	(39)	(30)	(32)
Inc./(Dec.) in Cash	0	1	5	(4)	4	3
Opening Cash balances	5	5	6	10	7	10
Closing Cash balances	5	6	10	7	10	14

Key Ratios

Y/E March	FY2011	FY2012	FY2013	FY2014	FY2015E	FY2016E
Valuation Ratio (x)						
P/E (on FDEPS)	16.9	17.6	23.8	12.4	11.7	9.9
P/CEPS	10.8	10.7	12.5	8.2	7.3	6.2
P/BV	4.0	3.4	3.0	2.5	2.1	1.8
Dividend yield (%)	0.7	1.0	1.1	0.8	1.2	1.7
EV/Sales	1.2	1.0	1.0	0.8	0.7	0.6
EV/EBITDA	10.1	8.7	10.3	7.2	6.1	5.2
EV / Total Assets	1.8	1.6	1.5	1.3	1.2	1.0
Per Share Data (₹)						
EPS (Basic)	29.5	28.2	20.8	39.9	42.6	50.4
EPS (fully diluted)	29.5	28.2	20.8	39.9	42.6	50.4
Cash EPS	45.9	46.5	39.9	60.8	68.3	80.6
DPS	3.2	5.0	5.5	3.8	6.0	8.6
Book Value	124.5	146.5	163.0	195.2	232.0	276.1
Returns (%)						
ROCE	19.4	20.2	13.9	20.3	20.6	21.0
Angel ROIC (Pre-tax)	20.6	21.3	15.0	21.5	22.0	22.6
ROE	23.5	19.0	12.7	20.3	18.2	18.1
Turnover ratios (x)						
Asset Turnover (Gross Block)	2.0	2.5	2.2	2.3	2.3	2.3
Inventory / Sales (days)	79	77	75	68	65	62
Receivables (days)	43	44	47	48	45	42
Payables (days)	54	45	48	49	49	49
WC cycle (ex-cash) (days)	68	76	74	67	61	55

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DISCLAIMER

Disclosure of Interest Statement	**L G Balakrishnan & Bros**
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Returns):	*Buy (> 15%)*	*Accumulate (5% to 15%)*	*Neutral (-5 to 5%)*
	Reduce (-5% to -15%)	*Sell (< -15%)*	

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