

June 12, 2020

LGB Forge Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term - Fund Based/CC	17.00	17.00	[ICRA]AA(CE)(Stable); Reaffirmed
Short Term - Non Fund Based	10.00	10.00	[ICRA]A1+(CE); Reaffirmed
Total	27.00	27.00	

*Instrument details are provided in Annexure-1

Rating Without Explicit Credit Enhancement [ICRA]BBB

Note: The (CE) suffix mentioned alongside the rating symbol indicates that the rated instrument/facility is backed by some form of explicit credit enhancement. Earlier, the rating symbol for this instrument/facility used to be accompanied by the (SO) suffix. The change in suffix is not to be construed as a change in rating. This rating is specific to the rated instrument/facility, its terms and its structure and does not represent ICRA's opinion on the general credit quality of the entity concerned. The last row in the table above also captures ICRA's opinion on the rating without factoring in the explicit credit enhancement

Rationale

The ratings are based on the strength of the corporate guarantee (CG) provided by L.G. Balakrishnan & Bros Limited (LGB /the guarantor; rated [ICRA]AA(Stable)/MAA/Stable/A1+) for LGB Forge Limited's (LGB Forge/the company) rated limits. The Stable outlook on the rating reflects ICRA's outlook on the rating of the guarantor, LGB.

Adequacy of credit enhancement

For assigning the ratings, ICRA has assessed the attributes of the guarantee issued by LGB in favour of the said instruments. The guarantee is legally enforceable, irrevocable and unconditional and covers the entire amount and tenor of the rated instruments. Taking cognisance of the above, ICRA has assigned ratings of [ICRA]AA(CE)(Stable)/[ICRA]A1+(CE) to the said instruments against the unsupported rating of [ICRA]BBB. If the ratings of the guarantor undergo a change in future, the same would have a bearing on the ratings of the aforesaid instruments. The ratings of these instruments may also undergo a change in a scenario whereby, in ICRA's assessment, there is a change in the strength of the business linkages between the guarantor and the rated entity or there is a change in the reputation sensitivity of the guarantor to a default by the rated entity or there is a change in the strategic importance of the rated entity for the guarantor.

Salient covenants related to the credit enhancement, as specified in the guaranteed documents

- » The company shall not declare dividend for any year except out of profits of the current year and subject to no default in payment/repayment obligation to the bank and prior written approval of the bank
- » During the currency of the loan, the Guarantor/Borrower will not, without bank's permission (a) Do a share buyback, (b) Formulate any scheme of amalgamation or reconstruction, (c) Avail any loan; and/or stand as surety or guarantor for any third-party liability or obligation
- » The company shall not repay monies brought in by the promoters/directors/principal shareholders and their friends and relatives by way of deposits/loans/advances. Further the rate of interest, if any, payable on such deposits/loans/advances should be lower than the rate of interest charged by the bank on its credit facilities

- » If the rating of the instrument falls below A+ (TR) or (SO), the bank shall have right to review and revise the applicable interest rate and charges

Credit strengths

CG provided by LGB towards LGB Forge Limited's rated bank facilities – The ratings derive comfort from the irrevocable and unconditional CG extended by LGB towards LGB Forges' rated facilities.

Improved capitalisation and coverage metrics post rights issue in January 2019 – Owing to the equity infusion of Rs 26.5 crore in Q4 FY2019 and low working capital intensity, LGB Forges' debt had considerably moderated in FY2019, leading to improvement in capitalisation and coverage metrics, with gearing of 0.3x (PY: 4.9x) and total debt/OPBITDA of 1.1x (PY: 9.3x) as on March 31, 2019. Its interest coverage and DSCR were at 1.9 times (PY: 0.6 times) and 1.4 times (PY: 0.4 times) respectively for FY2019. The metrics have further improved in 9M FY2020, with interest coverage and DSCR at 2.7 times and 1.4 times respectively.

Credit challenges

Weak demand outlook for the automotive industry to lead to moderation in revenues – LGB Forge is primarily engaged in the manufacturing of hot and cold forged components for automotive and industrial clients, with the automotive segment contributing to around 90% of its revenues. The outbreak of the Covid-19 pandemic has resulted in lockdowns across many countries, leading to supply chain disruptions and sharp demand slowdown. While the strength of the eventual recovery will be contingent on the duration and breadth of the Covid-19 pandemic, a relatively prolonged period of curtailed automotive demand is likely, as consumers stay wary of large discretionary spending in times of uncertainty.

Intense competition from larger/unorganized players – LGB Forge is a small player in the highly fragmented forging industry. Apart from a few organised players (including large players), the unorganised sector also plays a major role in the forging industry. This alongside, cheaper imports from China are also a constant threat for this segment. Though LGB Forges' scale of operations is relatively low, its ability to provide an entire range of services ranging from forging to machining under one roof is its competitive advantage. Also, the availability of tool design and integrated heat treatment facility which are crucial in the forging business are also key strengths for LGB Forge.

High customer concentration risk – LGB Forge has high client concentration with its top three customers contributing ~42% of revenues for H1 FY2020 (as per unaudited financials). The company's efforts to cut loss making/low profit customers had decreased its customer concentration to 42% in H1 FY2020 from 70% in FY2017. With new customer additions (BorgWarner Cooling Systems Pvt. Ltd. and Poclairn Hydraulics Pvt. Ltd.) since FY2018 and customer profile consisting of Tier I OEM suppliers, mitigates the risk to an extent.

Margins remain susceptible to raw material fluctuations – Steel constitutes to about 80% of the raw material requirement for LGB Forge in any given fiscal. While the margins remain susceptible to raw material price volatility, the company has a 100% pass through from the rise in steel prices with a lag of 1-2 months.

Liquidity position: Adequate (Guarantor - L.G. Balakrishnan & Bros Limited)

LGB's liquidity is adequate with healthy cash flow from operations of nearly Rs. 139 crore (in FY2020); cash and bank balances of Rs. 5.0 crore and undrawn working capital limits of ~Rs. 89 crore as on March 31, 2020. In relation to these sources of cash, LGB has debt repayment obligations of Rs. 26.2 crore in FY2021, Rs. 26.2 crore in FY2022, and Rs. 19.9

crore in FY2023, also remain modest. Overall, ICRA expects LGB to be able to meet its near-term commitments through internal as well as external sources of cash and yet be left with sufficient cash surplus.

Rating sensitivities

Positive triggers – The ratings could be upgraded if there is an improvement in the credit profile of the guarantor, L.G. Balakrishnan & Bros Limited.

Negative triggers – The ratings may be downgraded if there is a deterioration in the credit profile of the guarantor or weakening of the form of support extended by the guarantor, L.G. Balakrishnan & Bros Limited.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Approach for rating debt instruments backed by third-party explicit support
Parent/Group Support	Parent/Group Company: L.G. Balakrishnan & Bros Limited, rated [ICRA]AA(Stable)/MAA/Stable/A1+ The assigned rating for LGB Forge Limited is based on an unconditional, irrevocable corporate guarantee extended by LGB
Consolidation/Standalone	The rating is based on the company's standalone financials

About the company

LGB Forge Limited, incorporated in FY2009, is a small-scale forging company primarily engaged in the manufacturing of forged (range of hot, cold and warm forgings) and machined automotive components. In January-08, L G Balakrishnan and Bros Limited (LGB) de-merged its forging division into a separate company, LGB Forge w.e.f. April 01, 2008 to increase focus on the forging operations. LGB Forge continues to derive operational, management and financial support from LGB. LGB holds 12.2% stake in LGB Forge (as on March 31, 2020). LGB Forge's product portfolio consists of auto electric and transmission line components marketed to established tier I suppliers including Denso India and GKN driveline. Domestic market forms bulk of the company's business presently and the company has manufacturing facilities located at Coimbatore, Puducherry and Mysore. The forging operations of LGB Forge are supported by in-house machining and heat treatment facilities.

In June 2018, LGB Forge acquired a company in Pondicherry called M/s. Supreme Automec Private limited (SAPL). The acquired company was merged with LGB forge w.e.f. from July 2018. SAPL was an auto component manufacturer with forging and machining capabilities in Pondicherry.

Key financial indicators - LGB Forge Limited

	FY2018 (Audited)	FY2019 (Audited)
Operating Income (Rs. crore)	99.9	132.5
PAT (Rs. crore)	-3.2	2.1
OPBDIT/OI (%)	1.8%	7.3%
RoCE (%)	-0.1%	22.6%
Total Outside Liabilities/Tangible Net Worth (times)	12.8	1.6
Total Debt/OPBDIT (times)	9.3	1.1
Interest Coverage (times)	0.6	1.9
DSCR	0.4	1.4

Source: Annual reports; ICRA research

About the guarantor

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. and 25% associate company (M/s. Renold Chain India Private Limited). LGB standalone accounts for 94% of consolidated revenues, 112% of consolidated PAT and 88% of consolidated debt in FY2020.

Key financial indicators of the guarantor - L.G. Balakrishnan & Bros Limited

	FY2019 (Audited)	FY2020 (Audited ¹)
Operating Income (Rs. crore)	1,688.0	1,542.8
PAT (Rs. crore)	99.6	91.3
OPBDIT/OI (%)	12.6%	12.1%
RoCE (%)	20.1%	15.6%
Total Outside Liabilities/Tangible Net Worth (times)	0.8	0.6
Total Debt/OPBDIT (times)	1.0	0.5
Interest Coverage (times)	16.7	12.2
DSCR	2.7	3.2

Source: Annual reports; ICRA research;¹Adridged

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current Rating (FY2021) Type	Current Rating (FY2021)		Rating 12-Jun-2020	Rating History for the Past 3 Years		
		Amount Rated	Amount Outstanding		FY2020	FY2019	FY2018
1 Fund Based/CC	Long Term	17.00	17.00	[ICRA]AA(CE)(Stable)	-	[ICRA]AA(SO) 28-Mar-2019 (Stable)	[ICRA]AA-(SO) 23-Nov-2017 (Stable)
2 Non Fund Based	Short Term	10.00	10.00	[ICRA]A1+(CE)		[ICRA]A1+(SO)	[ICRA]A1+(SO)

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	Long Term - Fund Based/CC	NA	NA	NA	17.00	[ICRA]AA(CE)(Stable)
NA	Short Term - Non Fund Based	NA	NA	NA	10.00	[ICRA]A1+(CE)

Source: LGB Forge Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Not applicable		

Analyst Contacts

Subrata Ray

+91 22 6114 3408

subrata@icraindia.com

Pavethra Ponniah

+91 44 4596 4314

pavethrap@icraindia.com

Nareshkumar N

+91 44 4596 4313

nareshkumar.n@icraindia.com

Relationship Contact

Jayanta Chatterjee

+91 80 4332 6401

jyantac@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:

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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

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