October 29, 2021

KIOCL Limited: Ratings reaffirmed

Summary of rating action

Instrument^	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term fund based	1.00	0.00	-
Long term/short term non-fund based	504.00	475.00	[ICRA]AA- (Stable)/ [ICRA]A1+ reaffirmed
Long term/short term unallocated	545.00	575.00	[ICRA]AA- (Stable)/ [ICRA]A1+ reaffirmed
Total	**1,050.00**	**1,050.00**	

^Instrument details are provided in Annexure-1

Rationale

The reaffirmation of ratings considers KIOCL Limited's (KIOCL) status as a Miniratna company under the Ministry of Steel, Government of India (GoI) with the latter holding a 99.03% stake as on September 30, 2021, and its debt-free status at present, which imparts a high degree of financial flexibility. Moreover, KIOCL's sovereign ownership is expected to give it access to need-based funding support from the GoI. The ratings also factor in the company's comfortable financial risk profile and robust liquidity position, with an unencumbered cash balance of Rs. 1,455 crore as on March 31, 2021. ICRA notes that while the company has plans to undertake debt-funded capex projects towards development of captive mines, setting up pellet/beneficiation plants and revive the pig iron division, its strong net worth, healthy liquidity, and expected margin expansion from the new projects would keep the capital structure and debt-protection metrics at comfortable levels. The ratings also consider the long track record of the company in iron ore mining/pellet manufacturing businesses and the extensive experience of its management. These resulted in additional revenue stream in the form of mineral exploration contracts from the GoI and the Government of Karnataka (GoK), and Operation & Maintenance (O&M) contracts from NMDC Limited and Odisha Mining Corporation Limited.

The ratings, however, are constrained by the company's adverse cost structure for the pellet business due to elevated freight charges. This is because of restriction by the Supreme Court on export/inter-state sale of pellets manufactured using iron ore from Karnataka, which necessitates iron ore sourcing from Chhattisgarh at elevated inbound freight charges. Besides, in the absence of a beneficiation plant, KIOCL is dependent on costlier iron ore fines with high Fe content. The ratings also factor in the sensitivity of the company's profitability to the spread between prices of iron ore fines and pellets, which have witnessed significant volatility in the past. The ratings are also tempered by its non-operational pig iron division, which remains a drag on the company's business return indicators. The company has plans to set up a coke oven plant and a ductile iron (DI) pipe unit at an estimated cost of Rs. 837 crore, having a project gearing of 2 times. While this capex is expected to revive its pig iron operations, it would also expose the company to project implementation risk as the company has no track record of setting up coke oven or DI pipe manufacturing facilities. Considering operational challenges due to the Covid-19 pandemic and re-tendering of various equipment procurement process as per the GoI's Atmanirbhar Bharat Abhiyan, ICRA expects the commissioning of these projects to be delayed. However, ICRA notes that KIOCL has been allotted a 2 million tonne per annum (mtpa) iron ore mine in Devadari range in the Bellary district of Karnataka. While the environment and forest clearances are in place, signing of the mining lease is pending. Once the lease is granted, the company plans to incur capex of Rs. 1,500-2,000 crore towards mine development and setting up of a beneficiation-cum-pelletisation plant. In the interim period, till the captive iron ore mine becomes operational, KIOCL would remain exposed to the risks associated with price volatility and raw material availability. The ratings also factor in sizeable contingent liabilities of Rs. 657 crore, which if crystallised, could adversely impact the financial risk profile of KIOCL.

The Stable outlook on the [ICRA]AA- rating reflects ICRA's expectation that KIOCL would continue to benefit from the extensive experience of its management in pellet manufacturing business and the company's established market position in India and abroad. Notwithstanding the large capital expenditure envisaged in the near term towards captive mines and revival of the pig iron division, the company's financial risk profile would remain comfortable owing to its strong liquidity.

Key rating drivers and their description

Credit strengths

Large sovereign ownership imparts a high degree of financial flexibility – KIOCL is a flagship company under the Ministry of Steel, GOI, with the Miniratna status. The GOI has a 99.03% ownership in KIOCL. The large sovereign ownership imparts a high degree of financial flexibility to the company, and gives it access to need-based funding support from the Government.

Comfortable financial risk profile – The financial risk profile of KIOCL has remained comfortable over the years, as reflected by its debt-free status and strong liquidity profile. KIOCL's unencumbered cash balance remained healthy at Rs. 1,455 crore as on March 31, 2021 (Rs. 1,530 crore as on March 31, 2020). A sharp rise in pellet prices resulted in a 23% revenue growth in FY2021 and a 140% YoY revenue growth in Q1 FY2022, and ICRA expects KIOCL to report a strong earnings growth in FY2022. The operating margin improved to 15% in FY2021 (against operating losses reported in FY2020) and 27.6% in Q2 FY2022, resulting in an improved financial risk profile. The project gearing of 2 times for the proposed capex of Rs. 1,500-2,000 crore towards development of Devadari mines and setting up associated pellet/beneficiation, and an additional Rs. 837 crore towards forward and backward integration of the pig iron division would increase the debt levels. However, capital structure and coverage metrics would remain comfortable given the healthy net worth, sizeable on-balance sheet liquidity, and the expected cost savings and new earnings streams from these capex initiatives.

Long track record and experienced management – KIOCL started its pellet operation in 1987 and has an established market presence in India and abroad. It is the second largest merchant pellet plant in India, with an annual capacity of 3.5 million tonnes per annum (mtpa). The company's senior management has extensive experience in iron ore mining and pellet manufacturing business, which improves KIOCL's competitive position and provides it with an alternative revenue stream in the form of mineral exploration and O&M contracts. As on March 31, 2021, the company had Rs. 115 crore mineral exploration related work in hand.

Credit challenges

Adverse cost structure – KIOCL procures iron ore mainly from Chhattisgarh as there is a restriction on export/inter-state sale of pellets manufactured from iron ore procured in Karnataka. This results in an elevated freight cost and keeps KIOCL's operating profitability weak. Besides, in the absence of a beneficiation plant, the company is dependent on costlier iron ore fines with high Fe content. Additionally, the high employee cost remains a drag on the profit margins. While the company reported healthy profits in FY2021 and Q1 FY2022 despite the adverse cost structure due to remunerative pellet prices, the company's ability to absorb cost pressures in case of a sharp correction in pellet prices remains limited due to elevated freight cost associated with iron ore procurement. For commodity business, an adverse cost structure remains a key concern from the rating perspective.

Loss-making pig iron division – KIOCL has a 2,16,000-mtpa pig iron division, which has been non-operational since 2010. In FY2021, the division reported a loss of Rs. 22 crore, and remains a drag on KIOCL's overall profitability. Given the volatility in prices of met coke, which is a key input in blast furnace, and limited demand for pig iron in the nearby region, the company is planning to set up a coke oven plant and a DI pipe unit at an estimated cost of Rs. 837 crore. KIOCL's ability to restart the pig iron division, thereby entering the value-added segment of DI pipes, would remain a key monitorable.

Exposure to risk associated with volatility in iron ore and pellet prices – KIOCL does not have any operational captive iron ore mines and relies heavily on NMDC Limited for its iron ore requirement. This exposes the company to risks associated with price volatility and raw material availability. ICRA notes that the prices of iron ore fines and pellets have witnessed significant volatility in the past, and the spread between these two remains a key determinant of a pellet plant's profitability. In January 2017, the Government of Karnataka allotted KIOCL an area of 470 hectare for mining of iron and manganese ore in Devadari range in the Bellary district. The company has recently received environmental and forest clearances for Devadari and is awaiting the signing of mining lease. Once the lease is granted, it will start the mining activity, which has the potential to significantly bring down the company's overall operating cost. The company also plans to set up a 2-mtpa iron ore beneficiation and pellet plant in the next two-three years, which will consume the ore extracted from the Devadari mines. ICRA expects the commissioning and ramp up of mines and the pellet plant would result in sizeable cost savings in future.

Liquidity position: Strong

KIOCL does not have any debt on its books. Notwithstanding a dividend payment of Rs. 43.5 crore (corresponding to FY2020 period) and share buyback of Rs. 188.9 crore (including taxes) in FY2021, KIOCL's liquidity remained **strong** with an unencumbered cash and liquid investments of Rs. 1,455 crore. However, any large dividend payouts/share buybacks in future can affect KIOCL's liquidity profile, given that the company is also planning to incur a large capex of Rs. 837 crore for the pig iron forward and backward integration and Rs. 1,500-2,000 crore for mining and pellet/beneficiation units, which would result in a project gearing of 2 times. Though KIOCL may avail term loans in the near-to-medium term to fund this capex, ICRA expects the company to comfortably service its future interest and principal payments, even in case of a cash flow mismatch from the new business operations, on the back of its large cash balances and healthy interest income earned from the same.

Rating sensitivities

Positive factors – ICRA could upgrade KIOCL's rating in case of an improvement in cost structure, supported by a reduction in iron ore transportation expense. ICRA could also upgrade the rating in case of commissioning and quick ramp-up of captive iron ore mines resulting in a sustainable cost advantage.

Negative factors – Pressure on the rating may emerge in case of a significant fall in demand and realisations in the export market or any large dividend payout or a share buyback, affecting the liquidity profile. ICRA could also downgrade the rating if the net-debt-to-OPBDITA remains greater than 1.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Ferrous Metals Industry
Parent/Group Support	Parent: Government of India The assigned rating factors in the financial support by the Government to the rated entity, should there be a need.
Consolidation/Standalone	Standalone

About the company

KIOCL is a flagship company under the Ministry of Steel, GoI, with Miniratna status. It was incorporated in April 1976. It is an export oriented unit with expertise in iron ore mining, filtration technology and production of high quality pellets. Its pellet unit, having an installed capacity of 3.5 mtpa, is located in Mangaluru, Karnataka. Apart from the pellet unit, it also has a blast furnace to produce foundry grade pig iron and a reclaimer to load pellets directly from the stockyard to the vessel. Recently, KIOCL has also ventured into O&M services.

Key financial indicators

Consolidated financials (Ind AS)	FY2020 (Audited)	FY2021 (Audited)	Q1 FY2022 (Provisional)
Operating Income (Rs. crore)	1937.7	2383.6	1041.4
PAT (Rs. crore)	43.5	301.2	215.9
OPBDIT/OI (%)	-0.9%	15.0%	27.6%
PAT/OI (%)	2.2%	12.6%	20.7%
Total Outside Liabilities/Tangible Net Worth (times)	0.2	0.2	NA
Total Debt/OPBDIT (times)	-7.0	0.3	NA
Interest Coverage (times)	-1.8	24.1	114.1

Source: Company; P – Provisional; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; Source: KIOCL

Status of non-cooperation with previous CRA – Not Applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Oct 29, 2021	Jul 24, 2020	Jul 19, 2019	-
1	Cash credit	LT	0.00	-	-	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	-
2	Letter of credit/bank guarantee	LT/ST	475.00	-	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	-
3	Unallocated	LT/ST	575.00	-	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	-

Amount in Rs. crore; LT – Long Term; ST – Short Term

Complexity level of the rated instrument

Instrument	Complexity Indicator
Letter of credit/bank guarantee	Very Simple
Unallocated	Not applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Letter of credit/bank guarantee	-	-	-	475.00	[ICRA]AA- (Stable)/ [ICRA]A1+
NA	Unallocated	-	-	-	575.00	[ICRA]AA- (Stable)/ [ICRA]A1+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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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.

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

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