July 19, 2019

# KIOCL Limited: [ICRA]AA-(Stable)/A1+ assigned

## Summary of rating action

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

**Instrument details are provided in Annexure-1*

## Rationale

The assigned ratings take into account KIOCL Limited's (KIOCL) status as a *Mini Ratna* company under the Ministry of Steel, Government of India (GOI) with the latter holding 99.06% stake as on March 31, 2019, and its robust liquidity position, with unencumbered cash balance of Rs. 1,569 crore as on March 31, 2019. Comfortable liquidity, coupled with KIOCL's debt-free status at present, impart it a high degree of financial flexibility. The ratings also factor in KIOCL's healthy revenue growth during the past two fiscals, supported by improved pellet demand from overseas markets, which led to a rise in capacity utilisation. Given the iron ore supply disruption in Brazil and Australia, and reducing inventories at China's ports, ICRA expects the export demand for pellets to remain strong in the near term, which would result in a further rise in KIOCL's revenues in FY2020. The ratings also take into consideration the long track record of the company in iron ore mining/pellet manufacturing business and extensive experience of its management, which in turn has resulted in additional revenue stream in the form of mineral exploration and Operation & Maintenance (O&M) contracts for NMDC Limited and Odisha Mining Corporation Limited.

The ratings, however, are constrained by the company's adverse cost structure for pellet business due to elevated freight charges. This is because of restriction on export of pellets manufactured using iron ore procured from Karnataka, which necessitates procurement from Chhattisgarh, Odisha and overseas markets. Furthermore, in 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 spread between prices of iron ore fines and pellets, which have witnessed significant volatility in the past with minimum spread of Rs. 1,640 per metric tonne (MT) in April 2016 and maximum spread of Rs. 5,890 per MT in September 2018. Due to these factors, the company's operating margins remained under pressure with the company incurring operating losses during FY2012-FY2018 period. The ratings are also tempered by its non-operational pig iron division, which remains a drag on the company's business return indicators. Going forward, the company has plans to set up a coke oven plant and a ductile iron (DI) pipe unit at an estimated cost of Rs. 833 crore to be funded by debt of Rs. 599 crore and internal accruals of Rs. 234 crore. While this capex is expected to revive its pig iron operations, it would also expose the company to project implementation risks given that the company has no track record of setting up coke oven or DI pipe manufacturing facilities. Moreover, once the DI pipe unit becomes operational, the fixed price lowest bidder (L-1)-based nature of the DI pipe business would keep KIOCL's realisations under check. ICRA notes that KIOCL has been allotted an iron ore mine in Devadari range in the Bellary district of Karnataka but the same is not operational as forest clearance, environment clearance and consent from the state pollution control board are awaited. Till the time the captive iron ore mine becomes operational, KIOCL would remain exposed to risks associated with price volatility and raw material availability.

In FY2019, a large dividend pay-out of Rs. 60 crore coincided with a share buyback of Rs. 214 crore, which resulted in a dip in cash and bank balances to Rs. 1,569 crore as on March 31, 2019 from Rs. 1,863 crore as on March 31, 2018. Any such large dividend pay-out or share buyback in future could affect KIOCL's liquidity position and hence remains a key rating sensitivity. Furthermore, the company has capex plans of Rs. 1,433 crore in the near-to-medium term towards development of mines (Rs. 600 crore) and backward/forward integration of existing pig iron division (Rs. 833 crore). In addition to this, the company is also planning to set up a 2 million tonnes per annum (mtpa) pellet plant in joint venture with Rashtriya Ispat Nigam Limited with a capital cost of Rs. 1,025 crore. Any such large capex outgo could also affect the company's liquidity and remains a credit monitorable.

## Outlook: Stable

The 'Stable' outlook 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 revival of the pig iron division, the company's financial risk profile would remain adequate owing to its strong net worth. The outlook may be revised to 'Positive' if the company continues to achieve healthy revenue growth and/or a significant improvement in profitability results in better-than-anticipated return indicators. The outlook may be revised to 'Negative' in case of a significant reversal in the industry conditions and/or in case of any major cash outflow towards dividends/share buyback.

## Key rating drivers

## Credit strengths

**Healthy revenue growth and improved capacity utilisation** - KIOCL's operating income witnessed a healthy growth in the last three years to Rs. 1,888 crore in FY2019 from Rs. 877 crore in FY2017. This was driven by improved pellet demand from overseas markets, as reflected from an increase in exports to 1.5 million tonnes (mt) in FY2019 from 0.9 mt in FY2017, and led to improved capacity utilisation, which stood at 64% in FY2019. The rise in exports, coupled with uptrend in pellet price resulted in an increase in KIOCL's average realisation from Rs. 6,263 per MT in FY2017 to Rs. 8,262 per MT in FY2019. In addition to pellet sales, the company also undertakes O&M contracts for other pellet manufacturers and earned revenues of Rs. 35 crore in FY2019. Going forward, the expected rise in pellet exports from India due to supply disruption in Brazil and Australia would result in further growth in revenues in the near term.

**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. Despite share buyback of Rs. 214 crore in FY2019, KIOCL's unencumbered cash balance remained healthy at Rs. 1,569 crore as on March 31, 2019 (Rs. 1,863 crore as on March 31, 2018). While the proposed capex of Rs. 833 crore towards forward and backward integration of the pig iron division would be part-funded through term loans of Rs. 599 crore, the capital structure would remain healthy owing to KIOCL's strong net worth.

**Strategic importance to the GOI** - KIOCL is a flagship company under the Ministry of Steel, GOI, with *Mini Ratna* status. The GOI has 99.06% ownership in KIOCL. The company is of strategic importance to the government as it is one of the largest pellet exporters having 17% share in India's total pellet exports in FY2019.

**Long track record and experienced management** – KIOCL started its pellet operation in 1987 and has established market presence in India and abroad. Currently, it is the second largest merchant pellet plant in India with annual capacity of 3.5 mtpa. The company's senior management has extensive experience in iron ore mining and pellet manufacturing business, which not only improves KIOCL's competitive position, but also provides it an alternate revenue stream in the form of mineral exploration and O&M contracts.

## Credit challenges

**Adverse cost structure** – KIOCL procures iron ore mainly from Odisha and Chhattisgarh, as there is a restriction on export of pellets manufactured from iron ore procured from Karnataka. This results in elevated freight cost and keeps KIOCL's operating profitability weak. Furthermore, in the absence of a beneficiation plant, the company is dependent on costlier iron ore fines with high Fe content. Due to these factors, despite favourable pellet prices, KIOCL's operating profitability remained low at 4.2% during FY2019.

**Non-operational pig iron division** – KIOCL has a 216,000-metric-tonnes-per-annum (MTPA) pig iron division which is non-operational since 2010. During FY2019, the division reported losses of Rs. 17.9 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 the 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. 833 crore. KIOCL's ability to restart the pig iron division thereby entering value-added segment of DI pipes would remain a key monitorable.

**Exposure to price risks in absence of captive iron ore mines –** KIOCL does not have any operational captive iron ore mines and relies on NMDC Limited for a major part of 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. The company has recently entered into a contract with Emirates Steel Industries for supply of 0.5 mtpa pellets at fixed spread over the landed cost of imported iron ore fines. This, in turn, would mitigate the price risks to some extent. 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. While the company has already received the approval for mining plan, the start of mining operations is contingent of receipt of various other approvals and would still take some time. The total capex towards development of mines would be ~Rs. 600 crore.

## Liquidity Position

KIOCL does not have any debt on its books. Notwithstanding share buyback of Rs. 214 crore and dividend of Rs. 60 crore during the last fiscal, KIOCL's liquidity remained robust with unencumbered cash and liquid investments of Rs. 1,569 crore and undrawn non-fund based limits of Rs. 369 crore as on March 31, 2019. However, any such large dividend pay-outs/share buybacks in future can affect KIOCL's liquidity profile, given that the company is also planning to incur a capex of Rs. 833 crore, which would be part-funded through term loans of Rs. 599 crore. The said loans would have a tenure of 10 years and annual repayment of Rs. 60 crore. Given the large cash balances and healthy interest income earned on the same, ICRA expects the company to comfortably service these future interest and principal payments even in case of a cash flow mismatch from the new business operations.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| Applicable Rating Methodologies | Corporate Credit Rating Methodology<br>Entities in the Ferrous Metals Industry |
| Parent/Group Support | Not applicable |
| Consolidation / Standalone | Standalone |

## About the company:

KIOCL is a flagship company under the Ministry of Steel, GOI, with *Mini Ratna* 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 at 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 stockyard to vessel. Recently, KIOCL has also ventured into O&M services.

In FY2019, KIOCL reported net profit of Rs. 111.9 crore on an operating income of Rs. 1887.7 crore. During FY2018, KIOCL reported a net profit of Rs. 81.5 crore on an operating income of Rs. 1602.1 crore.

## Key Financial Indicators

| Standalone financials | FY2018 | FY2019 |
|---|---|---|
| Operating Income (Rs. crore) | 1602.1 | 1887.7 |
| PAT (Rs. crore) | 81.5 | 111.9 |
| OPBDIT/ OI (%) | -2.6% | 4.2% |
| RoCE (%) | 4.1% | 8.9% |
| | | |
| Total Debt/ TNW (times) | 0.0 | 0.0 |
| Total Debt/ OPBDIT (times) | 0.0 | 0.0 |
| Interest coverage (times) | -84.3 | 99.0 |
| NWC/ OI (%) | 15.8% | 16.3% |

*Note: OPBDIT: Operating Profit before Depreciation, Interest and Taxes; RoCE (Return on Capital Employed): Profit before Interest and Tax (PBIT)/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work-in Progress); NWC: Net Working-Capital; Source: KIOCL*

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for last three years:

| | Instrument | Current Rating (FY2020) | | | | Chronology of Rating History for the past 3 years | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Rated (Rs. crore) | Amount Outstanding (Rs Crore) | Date & Rating July 2019 | Date & Rating in FY2019 | Date & Rating in FY2018 | Date & Rating in FY2017 |
| 1 | Cash credit | Long Term | 1.00 | - | [ICRA]AA- (Stable) | - | - | - |
| 2 | Letter of credit/bank guarantee | Long Term/Short Term | 504.0 | - | [ICRA]AA- (Stable)/A1+ | - | - | - |
| 3 | Unallocated | Long Term/Short Term | 545.0 | - | [ICRA]AA- (Stable)/A1+ | - | - | - |

## 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 No | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| NA | Cash credit | - | - | - | 1.00 | [ICRA]AA- (Stable) |
| NA | Letter of credit/bank guarantee | - | - | - | 504.0 | [ICRA]AA- (Stable)/A1+ |
| NA | Unallocated | - | - | - | 545.0 | [ICRA]AA- (Stable)/A1+ |

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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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