July 24, 2020

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

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Long term fund based | 1.00 | 1.00 | [ICRA]AA- (Stable) reaffirmed |
| Long term/short term non-fund based | 504.00 | 504.00 | [ICRA]AA- (Stable)/A1+ reaffirmed |
| Long term/short term unallocated | 545.00 | 545.00 | [ICRA]AA- (Stable)/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) robust liquidity position, with an unencumbered cash balance of Rs. 1,530 crore as on March 31, 2020 and favourable demand prospects in the export market, supported by buoyant demand from China, which in turn would keep KIOCL's export volumes healthy. The company reported export volumes of 2.0 million tonnes (mt) in FY2020, which was 16% of India's total pellet export in that fiscal. In the current fiscal, while the domestic demand for pellets is likely to remain subdued because of the Covid-19 pandemic related disruption, KIOCL's export sales momentum continued due to healthy demand from China, which reported a 10% growth in iron ore imports during 6M CY2020. The ratings continue to favourably factor in KIOCL's status as a Miniratna company under the Ministry of Steel, Government of India (GOI) with the latter holding a 99.06% stake as on March 31, 2020, and its debt-free status at present, which impart it with a high degree of financial flexibility. The ratings also consider the long track record of the company in iron ore mining/pellet manufacturing business and the extensive experience of its management, which in turn 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 on export of pellets manufactured procuring iron ore from Karnataka, which necessitates procurement from Chhattisgarh, Odisha and overseas markets. 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, with 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. 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. 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 by about a year. 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 and environment clearances are awaited. KIOCL would remain exposed to the risks associated with price volatility and raw material availability till the captive iron ore mine becomes operational.

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 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

**Strategic importance to the GOI** – KIOCL is a flagship company under the Ministry of Steel, GoI, with the Miniratna status. The GOI has a 99.06% ownership in KIOCL. The company is of strategic importance to the Government as it is one of the largest pellet exporters having a 16% share in India's total pellet exports in FY2020.

**Favourable demand from export market** – KIOCL reported export sales of 2.0 mt in FY2020. While the weakness in demand in the current fiscal due to the pandemic impacted domestic sales, KIOCL's export revenues were supported by buoyant pellet demand from China. China's iron ore imports in the first half of CY2020 grew by almost 10% and its procurement from India has remained elevated in the last few months due to supply disruption from Brazil.

**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. 1,530 crore as on March 31, 2020 (Rs. 1,569 crore as on March 31, 2019). While the proposed capex of Rs. 837 crore towards forward and backward integration of the pig iron division would have a project gearing of 2 times, the capital structure would remain healthy owing to KIOCL's strong net worth.

**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 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 not only improves KIOCL's competitive position, but also provides it with an alternate revenue stream in the form of mineral exploration and O&M contracts. In FY2020, the company was awarded mineral exploration contracts of Rs. 105 crore from the GoI and the GoK.

## 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 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. Thus, KIOCL reported operating losses of Rs. 17.7 crore in FY2020 despite favourable pellet prices.

**Non-operational pig iron division** – KIOCL has a 216,000-metric-tonnes-per-annum pig iron division, which has been non-operational since 2010. In FY2020, the division reported a loss of Rs. 19.0 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 price risks in absence of captive iron ore mines –** 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. While the company has already received the approval for mining plan, the start of mining operations is contingent upon receipt of various other approvals and would take some more time. The total capex towards development of mines would be ~Rs. 600 crore.

## Liquidity position: Strong

KIOCL does not have any debt on its books. Notwithstanding a dividend payment of Rs. 43.5 crore during the last fiscal, KIOCL's liquidity remained **strong** with an unencumbered cash and liquid investments of Rs. 1,530 crore and undrawn non-fund based limits of ~Rs. 470 crore as on March 31, 2020. 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 capex of Rs. 837 crore, which would have a project gearing of 2 times. Despite addition of term loans in the near term due to 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 on the same.

## Rating sensitivities

**Positive triggers -** 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 if the OPBDITA (excluding other income) to interest expense ratio remains above 7.0 times on a sustained basis and/or the Debt to OPBDITA (excluding other income) ratio remains below 1.5 times on a sustained basis.

**Negative triggers -** 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 OPBDITA (excluding other income) to interest expense ratio remains below 4.0 times on a sustained basis.

## 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 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.

In FY2020, KIOCL reported a net profit of Rs. 43.5 crore on an operating income of Rs. 1,937.7 crore. In FY2019, KIOCL reported a net profit of Rs. 111.9 crore on an operating income of Rs. 1,887.7 crore.

## Key financial indicators

| | FY2019 | FY2020 |
|---|---|---|
| Operating Income (Rs. crore) | 1887.7 | 1937.7 |
| PAT (Rs. crore) | 111.9 | 43.5 |
| OPBDIT/OI (%) | 4.2% | -0.9% |
| PAT/OI (%) | 5.9% | 2.2% |
| | | |
| Total Outside Liabilities/Tangible Net Worth (times) | 0.2 | 0.2 |
| Total Debt/OPBDIT (times) | 0.0 | -7.0 |
| Interest Coverage (times) | 99.0 | -1.8 |

*Note: OPBDIT: Operating Profit before Depreciation, Interest and Taxes; Source: KIOCL*

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

## Any other information: None

## Rating history for past three years

| | Instrument | Current Rating (FY2021) | | | | Rating History for the Past 3 Years | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Rated | Amount Outstanding | Rating | FY2020 | FY2019 | FY2018 |
| | | | | | 24-Jul-2020 | 19-Jul-2019 | - | - |
| 1 | Cash credit | Long term | 1.00 | - | [ICRA]AA- (Stable) | [ICRA]AA- (Stable) | - | - |
| 2 | Letter of credit/bank guarantee | Long term/Short term | 504.0 | - | [ICRA]AA- (Stable)/A1+ | [ICRA]AA- (Stable)/A1+ | - | - |
| 3 | Unallocated | Long term/Short term | 545.0 | - | [ICRA]AA- (Stable)/A1+ | [ICRA]AA- (Stable)/A1+ | - | - |

*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 | 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+ |

*Source: KIOCL*

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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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