April 02, 2021

Kems Forgings 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	27.65	27.65	[ICRA]BBB (Stable); reaffirmed
Short-term: Non-fund based facilities	1.00	1.00	[ICRA]A3+; reaffirmed
Total	**28.65**	**28.65**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation in ratings factor in Kems Forgings Limited's (KFL) extensive experience of promoters and its strong association with its marquee clientele, who have been giving consistent repeat business. Besides, the company's ability to pass on any increase in raw material prices to most of its customers resulted in steady operating margins over the years.

The ratings, however, are constrained by the vulnerability of KFL's revenue to economic environment and capex cycle in the underlying consuming sectors. Accordingly, the ratings are constrained by the company's significant exposure to the cyclical automotive and construction sector, which accounts for a substantial portion of its sales. Nevertheless, it has been diversifying its revenue by foraying into other sectors. KFL's performance in FY2020 and FY2021 was impacted owing to demand slowdown in the end-user industry, coupled with pandemic-related demand slowdown in the initial quarters. Nevertheless, KFL showed an improvement in sales from H2 FY2021 and is expected to book a healthy growth in FY2022 on the back of increased orders from the existing clients and addition of new clients. ICRA takes note of deterioration in its financial profile owing to debt-funded capacity expansion undertaken by the company over the last four fiscals. However, given the subdued demand from the automotive industry, the capacity utilisation levels and return on capital employed in FY2021 will be lower than anticipated. Further, the ratings take into account the exposure of the company's profitability to fluctuations in key raw material prices (steel prices), forex movements and the intense competition in the industry.

Key rating drivers and their description

Credit strengths

Established track record of promoters in forging industry – KFL, incorporated in 1970 as Sree Lakshmi Industrial Forge and Engineers Limited, was acquired by the existing promoters in 1990 and renamed it to KFL in 2010. Mr. S. K. Gandhi, the Chairman of the company, has over four decades of experience in the steel industry through KFL and its Group entities, Kems Auto Components Limited (KACL) and Southern Steels and Forgings (SSF). The company's established track record in manufacturing forged components and the presence of an experienced management team are expected to drive its growth.

Established relationships with reputed clientele – KFL's long-term association and healthy business relationship with the original equipment manufacturers (OEMs) and tier-1/tier-2 suppliers in the automobile and construction equipment segments support its business sustainability. Moreover, its ability to add new customers and develop new components, coupled with stable long-term demand prospects for its key end-user industries, support growth prospects.

Moderate margin profile – KFL's financial profile continues to remain healthy characterised by improved margins and healthy capital structure. The margins witnessed a marginal improvement to 10.06% in FY2020 from 9.32% in FY2019 and expected to remain stagnant as the company has the ability to pass on any change in input price to its customers. However, the profitability is still exposed to fluctuations in key raw material prices (steel prices), forex movements, etc. Similarly, its ROCE stood at 14.78% in FY2020.

Credit challenges

High sector concentration risk with decline in revenues in FY2021 and 9M FY2021 – A significant portion (~75% in FY2020) of the company's revenue is derived from the automobile and construction equipment (including hydraulics) segments, leading to industry concentration risks. As a result, the company's revenues remain vulnerable to cyclical downturns in end-user industries. The slowdown in the domestic automobile industry over FY2020 and 9M FY2021 resulted in significant decline in volumes. Nevertheless, KFL showed an improvement in sales from H2 FY2021. The expected recovery and the growing diversity of KFL's end-user industry augur well going forward.

Substantial client concentration risk – KFL faces moderate customer concentration risk with the top five customers constituting about 64% of its total sales in FY2020. However, the risk is partially mitigated on account of resilient business ties with the fundamentally strong customers and acquisition of new customers.

Moderation in coverage metrics owing to substantial debt-funded capacity expansion and Covid-19 impact – The company has undertaken significant amount of capital expenditure over FY2018, FY2019 and FY2020 towards enhancing its capacity. In 9M FY2021, it has incurred significant debt-funded capex towards construction of corporate office and a guest house. The leverage metrics stood modest with TD/OPBIDTA at 3.00 times and Debt/Equity of 0.98 times as on March 31, 2020 compared to 2.45 times and 1.48 times, respectively, as on March 31, 2019. Its debt coverage stood comfortable with interest coverage at 5.20 times, DSCR at 1.98 times as on March 31, 2020. However, with the likely Covid-19 impact on the company's operations in FY2021, debt coverage is expected to moderate further. Moreover, the company has sizeable repayments in FY2022 against which it has earmarked part of the funds, which lends comfort.

Intense competition and fragmented industry structure – The company operates in a highly fragmented industry, characterised by intense competition, given the low entry barriers in the industry, which limits the margins and scale.

Liquidity position: Adequate

KFL's liquidity is **adequate** supported by moderate cash flow from operations of Rs. 17.85 crore, which is used towards capex and debt repayment. The average utilisation of working capital limits stood moderate at 50% during November 2019 to December 2020 depicting a modest unutilised buffer. The company has sizeable repayment obligation in FY2022 towards supplier credit loan and has earmarked sufficient deposits against the same to support liquidity. KFL's capex are likely to be on hold pending substantial demand revival.

Rating sensitivities

Positive factors – ICRA could upgrade KFL's ratings if the company demonstrates healthy growth in operating income (OI) and improvement in profit margins on a sustained basis, leading to improved debt protection metrics. Specific credit metrics that could lead to an upgrade in ratings include TD/OPBDITA of less than 2.3 times on a sustained basis.

Negative factors – Negative pressure on KFL's ratings may arise, if any significant reduction in the company's revenues and profitability weakens the debt coverage indicators. The ratings may be downgraded if any increase in working capital intensity impacts the liquidity position, or any sizeable debt-funded capital expenditure weakens the capital structure and debt coverage indicators. Specific credit metrics that could lead to a downgrade in ratings include DSCR of less than 1.4 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone

About the company

Incorporated in 1970 as Sree Lakshmi Industrial Forge and Engineers Limited, it was acquired by the existing promoters in 1990 and was renamed to KFL in 2010. KFL is a part of the Gandhi Group, which includes Southern Steels and Forgings (SSF) and Kems Auto Components Limited (KACL). Mr. S.K. Gandhi, the Chairman, Mr. Manish Gandhi, the Managing Director, Mr. Kushal Gandhi (Marketing and Sales Director) and Mr. Deepak Gandhi (Procurement Director), along with family and Group companies, held 100% equity stake in KFL as on September 30, 2019.

KFL manufactures steel forgings, primarily catering to the automotive and construction equipment industries. At present, it has three manufacturing facilities located in Attibele and Hoskote area of Bangalore and Sriperumbudur in Chennai with a combined installed capacity of 39,000 metric tonnes (MT) per annum. The company had set up its fourth unit at Hosur in Tamil Nadu with an installed capacity of 12,000 MT per annum, which is under trail production from December 2020. It reported an OI of Rs. 137.8 crore with an OPBITDA of Rs. 14.6 crore in 9M FY2021 on a provisional basis.

Key financial indicators (audited)

AMSL (Reported)	FY2019	FY2020
Operating Income (Rs. crore)	292.00	219.83
PAT (Rs. crore)	12.29	10.99
OPBDIT/OI (%)	9.32%	10.06%
RoCE (%)	19.60%	14.78%
Total Outside Liabilities/Tangible Net Worth (times)	1.81	1.53
Total Debt/OPBDIT (times)	2.45	3.00
Interest Coverage (times)	5.54	5.20
DSCR (times)	2.11	1.98

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work in Progress); DSCR: (PBIT + Mat Credit Entitlements - Fair Value Gains through P&L - Non-cash Extraordinary Gain/Loss)/(Interest + Repayments made during the Year)

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 as on Dec 31, 2020 (Rs. crore)	Date & Rating in	Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018
					02-April-2021	11-Feb-20	20-Dec-18	24-Nov-17
1	Overdraft	Long term	27.65	-	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Positive)	[ICRA]BBB (Stable)
2	Bill Discounting	Short term	-	-	-	-	[ICRA]A3+	[ICRA]A3+
3	Bank Guarantees	Short term	1.00	-	[ICRA]A3+	[ICRA]A3+	-	-

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 click here

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	Overdraft	-	-	-	27.65	[ICRA]BBB (Stable)
NA	Bank Guarantee	-	-	-	1.00	[ICRA]A3+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Consolidation Approach
NA	NA

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