June 28, 2021

TRL Krosaki Refractories Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Limits – Term Loan	260.00	205.00	[ICRA]AA(Stable); Reaffirmed
Fund-based Limits – Working Capital Facilities	237.00	237.00	[ICRA]AA(Stable); Reaffirmed
Non-Fund based Limits	170.24	170.24	[ICRA]A1+; Reaffirmed
Commercial Paper	75.00	75.00	[ICRA]A1+; Reaffirmed
Total	742.24	687.24	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of the ratings factors in TRL Krosaki Refractories Limited's (TRL) leadership position in the domestic refractory market with a wide product portfolio of high-quality refractories, strong brand image and a large and reputed client base. In spite of a sharp contraction in demand for refractories during the first half of FY2021, given the sharp fall in production of steel, cement, copper, aluminium, and glass owing to reduced economic activities following the pandemic, the full-year volume decline in sales of its own manufactured refractories was marginal. This was aided by a sharp recovery in demand from the end-consuming industries towards the second half of FY2021 and addition of new customers in certain refractory segments. However, the contribution levels declined sharply across most refractory segments (notwithstanding a decline in raw material prices, which was lower than the decline in refractory prices) owing to a significant correction in refractory prices in the first half of FY2021, given the challenging operating environment prevailing then. The operating profit margins declined by around 500 basis points year-on-year to ~6% in FY2021 due to reduced contribution levels. In line with the deterioration in profitability, the company's debt protection metrics have also moderated in FY2021 though the same still remained comfortable on an absolute basis. TRL's cost competitiveness in certain categories of refractories due to its captive raw material sources and long-term arrangements with key raw material suppliers also support the operating profile of the company. The ratings also favourably factor in the significant operational and management synergies of TRL with its parent, Krosaki Harima Corporation (KHC, in which Nippon Steel Corporation, rated Baa2 (Stable) by Moody's, holds a 42.9% stake). TRL's growth has been supported by technology assistance provided by its parent in the high precision and margin accretive tap hole clay and flow control refractory segments. The company is also setting up capacity for alumina-graphite refractory, a high-margin product used in the steel-making process, with assistance from KHC. The facility is expected to be operational by the end of FY2022, which would support revenue growth and strengthen the operating profile by aiding in margin expansion.

The long-term rating, however, continues to be constrained by the exposure of the company to the cyclicality inherent in the steel industry (although the outlook of the steel industry remains favourable at present) as ~65% of its revenues is earned through sales to steel companies. Moreover, the pricing power of the refractory players, including TRL, is limited due to the fragmented industry structure with surplus capacity in certain refractory segments and competition from imported refractories on the back of low duty protection, giving easy market access to large and established overseas refractory manufacturers. ICRA, however, notes that the focus on Cost Per Tonne (CPT) contracts and Refractory Engineering Management Services (REMS) business resulted in a differentiated competitive position for the company. Moreover, an increase in the sales volume of products used as consumables in the steel making process considerably lowered the risk of the business model due to reduced dependence on project-related business. The ratings also factor in TRL's exposure to fluctuations in supply and prices of raw materials, particularly for basic refractories, which are largely imported from China.

The Stable outlook is underpinned by ICRA's expectations that TRL would continue to maintain its strong position in the domestic refractory business. With additional capacities likely to be operational by the end of FY2022, which includes the high-margin alumina-graphite refractory, ICRA expects TRL to grow steadily over the medium term while strengthening its operating profile.

Key rating drivers and their description

Credit strengths

Market leader in the domestic refractory market, a reputed client base – TRL is the largest manufacturer of refractory products in India. It has a comprehensive range of refractory products covering all grades and shapes for industries like steel, copper, cement, aluminium, glass and other non-ferrous industries. TRL is among the largest manufacturers of dolomite refractories in the world and the only manufacturer in India. It is also the leading supplier of silica refractories for coke ovens and glass industry worldwide. The company has a reputed client base, which includes renowned entities like Tata Steel Ltd. (TSL), Steel Authority of India Ltd. (SAIL), JSW Steel Ltd. etc. The company gets repeat orders from its reputed clientele, reflecting TRL's acceptable quality of refractory products. Moreover, the reputed client base reduces counterparty risk to a large extent.

Financial profile characterised by healthy capital structure, coverage metrics and liquidity position – TRL's capitalisation (gearing of 0.4 times and TOL/TNW of 1.2 times as on March 31, 2021) and coverage metrics (interest coverage of 6.9 times and Total Debt/OPBDITA of 2.4 times in FY2021) remain comfortable on an absolute basis, although there has been some moderation in the coverage metrics in FY2021 vis-à-vis FY2020. This is despite a drop in operating profitability in FY2021 and TRL's ongoing debt-funded expansion, the benefits of which are yet to flow in. The liquidity profile remains healthy with undrawn working capital lines of ~Rs.473 crore as on March 31, 2021.

Strong parentage with significant operational and management synergies – TRL derives significant operational and management synergies from its parent, KHC, a global leader in the refractories business. TRL's growth has been supported by technology assistance provided by its parent in the high precision and margin accretive tap hole clay and flow control refractory segments. Moreover, a 42.9% of KHC's equity is held by Nippon Steel Corporation, a global integrated steel producer. KHC holds a 77.62% stake in TRL at present, after purchasing TSL's stake in the company in December 2018.

Healthy earnings growth visibility following completion of the ongoing expansion plan, which includes high-margin products – Additional capacities are expected to be operational by the end of FY2022, including the high-margin alumina-graphite refractory and increased capacities for the basic, dolomite and tap hole segments. These would support TRL's revenue growth going forward and strengthen the operating profile by aiding in margin expansion.

Credit challenges

Exposure to cyclicality inherent in the steel industry – TRL is exposed to the cyclicality inherent in the steel industry (although the outlook of the steel industry remains favourable at present) as it earns ~65% of its revenues through sales to the steel companies. However, an increase in the sales volume of products used as consumables in steel making considerably reduced the risk of the business model due to lower dependence on project-related business.

Intense competition in the industry – The pricing power of the refractory players in India, including TRL, is limited owing to the fragmented industry structure with surplus capacity in certain refractory segments and competition from imported refractories on the back of low-duty protection, giving easy market access to large and established overseas refractory manufacturers. Besides, intensifying competition from large and established foreign refractory manufacturers operating out of India constrains pricing power to an extent. ICRA, however, notes that the focus on CPT contracts and REMS business resulted in a differentiated competitive position for the company. TRL has taken over the management of some of the smaller domestic refractory manufacturers through management and buyback contracts to consolidate its position in a fragmented Indian industry.

Exposure to fluctuations in supply and prices of raw materials – The company imports a large portion of its raw materials, particularly for basic refractories, from China. There have been supply disruptions in the past, leading to elevated raw material prices, due to pollution control measures in China. While TRL's long-term relationships resulted in stable supply linkages, any disruption in supply may result in an increase in raw material prices, going forward, impacting the profitability of the company.

Liquidity position: Adequate

TRL's liquidity position has been assessed as **adequate** with undrawn working capital lines of ~Rs.473 crore as on March 31, 2021 and healthy fund flow from operations expected over the medium term. Against these sources of cash, the company has a total capex commitment of around Rs.130-140 crore in FY2022, to be funded by term loans of Rs.65 crore. TRL has debt repayment obligations of Rs.38.80 crore in FY2022 (including Rs.5 crore of repayments related to loan raised in the current fiscal). ICRA expects the company to be able to comfortably meet the equity portion of its capex commitment, meet the additional working capital requirements due to an anticipated increase in its scale of operations, service its debt obligations and yet be left with sufficient liquidity buffer in the form of unutilised credit lines.

Rating sensitivities

Positive factors – ICRA may upgrade TRL's rating if a sustained improvement in end-user demand and realisations lead to a significant increase in turnover and profit margins of the company. The specific trigger for an upgrade would be RoCE above 25% on a sustained basis.

Negative factors – Pressure on TRL's ratings may arise if profitability and cash accruals are lower than expected due to volatility in raw material prices and weak demand from end-user industries. The specific trigger for the downgrade would be RoCE below 15% on a sustained basis and/or the interest coverage ratio remains below 7 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of TRL.

About the company

TRL Krosaki Refractories Limited (TRL) was initially established in 1958 under the name of Tata Refractories Limited as a joint venture between Tata Steel Limited (TSL) and Didier Werke AG of Germany. Gradually, Didier exited the operations and TSL had the majority stake of 51%.TSL increased its stake in the company to 77.46% between FY2006 and FY2010. In May 2011, TSL sold a 51% stake in the company to Krosaki Harima Corporation (KHC) of Japan, a subsidiary of Nippon Steel Corporation and a leading global player in flow control refractories. The company was subsequently renamed as TRL Krosaki Refractories Limited in 2011. On December 31, 2018, TSL sold its entire 26.62% stake to KHC, thereby raising KHC's stake in the company to 77.62%.

Key financial indicators (Audited)

TRL Standalone	FY2020	FY2021
Operating Income (Rs. crore)	1652.9	1423.9
PAT (Rs. crore)	100.7	44.5
OPBDIT/OI (%)	10.9%	6.0%
PAT/OI (%)	6.1%	3.1%
Total Outside Liabilities/Tangible Net Worth (times)	1.2	1.2
Total Debt/OPBDIT (times)	1.3	2.4
Interest Coverage (times)	10.9	6.9

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation;

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 of Mar 31, 2021 (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019	
					Jun 28, 2021	Jun 29, 2020	Jun 17, 2019	Jan 24, 2019	Aug 3, 2018
1	Fund-based– Term Loan	Long-term	205.00	135.24	[ICRA]AA(Stable)	[ICRA]AA(Stable)	[ICRA]AA(Stable)	-	[ICRA]AA- (Stable) Withdrawn
2	Fund-based– Working Capital Facilities	Long-term	237.00	-	[ICRA]AA(Stable)	[ICRA]AA(Stable)	[ICRA]AA(Stable)	[ICRA]AA- &	[ICRA]AA- (Positive)
3	Non-Fund based Limits	Short-term	170.24	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+ &	[ICRA]A1+
4	Commercial Paper	Short-term	75.00		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+ &	[ICRA]A1+

&: Rating watch with developing implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based Limits – Term Loan	Simple
Fund-based Limits – Working Capital Facilities	Simple
Non-Fund based Limits	Very simple
Commercial Paper	Very simple

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 analysing 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	Term Loan	FY2020	NA	FY2025	205.00	[ICRA]AA (Stable)
NA	Fund-based Limits – Working Capital Facilities	NA	NA	NA	237.00	[ICRA]AA (Stable)
NA	Non-Fund based Limits	NA	NA	NA	170.24	[ICRA]A1+
NA	Commercial Paper – Unplaced	NA	NA	7-365 days	75.00	[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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