

September 25, 2023

Kanishk Steel Industries Limited: Ratings upgraded

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Cash Credit	22.50	30.00	[ICRA]BBB- (Stable); upgraded from [ICRA]BB+ (Stable)
Letter of Credit	48.50	41.00	[ICRA]A3; upgraded from [ICRA]A4+
Untied Limits	20.50	-	-
Term Loan	-	20.50	[ICRA]BBB- (Stable); upgraded from [ICRA]BB+ (Stable)
Total	91.50	91.50	

*Instrument details are provided in Annexure-I

Rationale

The ratings upgrade reflects Kanishk Steel Industries Limited's (KSIL/company) ongoing initiatives to enhance its cost-competitiveness, which include setting up of captive windmills (10.5 MW is operational and an additional 7.5 MW is in the pipeline), billet hot charging facility to eliminate reheating and in turn reducing fuel costs, and significant enhancement of the captive billet capacity to 1 lakh TPA¹ (from 0.27 lakh TPA) to reduce costlier external purchases. ICRA expects that the benefits of these cost-reduction measures are expected to fully flow in from Q4 FY2024, which are likely to support the company's overall earnings. Additionally, KSIL is also looking to expand the finished steel capacity by 43% to 1 lakh TPA towards the end of the current fiscal, which would support a meaningful growth in the overall earnings from FY2025. While these ongoing capex plans are expected to lead to a temporary increase in the leverage levels in the current fiscal, the competitive capital cost, along with the targeted cost-takeout measures are expected to enhance the company's ability to withstand cyclical downturns over the medium-to-long term. The ratings consider the established presence of KSIL and experience of the promoters in the steel industry, spanning over two decades. KSIL's operating profits witnessed a sharp contraction in FY2023, as declining steel prices and elevated input costs had affected profit margins. However, ICRA believes that the company's earnings outlook over the near term remains favourable, supported by healthy demand from the domestic infrastructure space, declining raw material costs, ramping up of newly enhanced capacities, and the structural cost benefits gradually flowing into the profit and loss account.

However, the ratings continue to be constrained by the high degree of geographical concentration of KSIL's operations in the southern region of the country and intense competition in the fragmented and commoditised long steel market, partly limiting its pricing flexibility. ICRA notes that KSIL's operations are vulnerable to the inherent industry cyclicality, which often results in volatility in raw material and product prices. The company also imports a part of its scrap requirement, which further exposes the company to fluctuations in exchange rates.

The Stable outlook on the long-term rating reflects the healthy steel demand growth in KSIL's addressable markets, which, along with the structural cost savings/efficiency improvement initiatives, is expected to lead to yet another year of healthy earnings growth for KSIL in FY2024.

¹ Tonne per annum

Key rating drivers and their description

Credit strengths

Established presence and extensive experience of the promoter – KSIL is a part of the OPG Group, which has an established presence in steel manufacturing and power generation businesses. Established presence of more than two decades, coupled with a stable customer base, which includes large public-sector entities like Bharat Heavy Electricals Limited (BHEL), Larsen and Toubro Limited (L&T) etc. lend stability to its operations.

Sizeable structural cost savings to flow in going forward supported by an increase in share of captive power generation, upcoming billet hot charging facility, and a reduction in costlier external billet purchases – The company is on a trajectory to enhance its cost competitiveness by taking measures like setting up of captive windmills (10.5 MW is operational and an additional 7.5 MW is in the pipeline), which would enable KSIL to meet a significant portion of its power requirements captively, setting up billet hot charging facility to eliminate reheating and in turn reducing fuel costs, and significantly enhancing the captive billet capacity to 1 lakh TPA (from 0.27 lakh TPA) to reduce costlier external purchases. ICRA expects that the benefits of these cost-reduction measures are expected to fully flow in from Q4 FY2024, which are likely to support the overall earnings.

Competitive capital cost for the ongoing expansion project is expected to increase the rebar capacity by 43% from Q4 FY2024, which, along with cost savings initiatives, is expected to support earnings growth, going forward – KSIL's capital cost for windmills is competitive through purchase of already operational windmills at a lower cost per MW (~Rs. 4 per MW). Additionally, for the MS billet expansion, the capital cost is significantly lower than the benchmark costs. The company is procuring a part of the machinery from an insolvency auction of assets and lower set-up costs with availability of land in the existing premises and minimal civil costs for erection of the facility. Additionally, KSIL is looking to expand the finished steel capacity by 43% to 1 lakh TPA towards the end of the current fiscal, which would support a meaningful growth in the overall earnings from FY2025. While these ongoing capex plans are expected to lead to a temporary increase in the leverage levels in the current fiscal, competitive capital cost, along with the targeted cost-takeout measures are expected to enhance the company's ability to withstand cyclical downturns, improving its earning potential over the medium-to-long term.

Credit challenges

High geographical concentration risk – The company's operations are mainly concentrated in the southern India, exposing it to geographical concentration risk. A slowdown in steel demand in its key addressable markets could lead to an overall decline in its revenues and profits in the future.

Susceptibility of margins to raw material price fluctuations, foreign exchange rate fluctuation risks and exposure to cyclicity inherent in the steel industry – KSIL's operations are raw material intensive with raw materials and consumables consumption accounting for 80-90% of its operating income over the last two fiscals. The company imports a part of its scrap requirement, which further exposes the company to fluctuations in exchange rates. Also, the domestic steel industry is cyclical in nature and is likely to keep the cash flows volatile for steel players, including KSIL. The company's operations are vulnerable to any adverse change in the demand-supply dynamics in the construction sector, especially in southern India.

Intense competition from the highly fragmented and commoditised steel market – The company is in the commoditised structural steel business, characterised by intense competition in the secondary steel sector, which limits the pricing flexibility of the players, including KSIL. As raw material costs play a crucial indicator of profitability, the margins remain susceptible to a large increase in raw material prices, which may not match with a commensurate increase in realisation of products sold, going forward.

Environmental and Social Risks

Environmental considerations – Steel manufacturing is an energy intensive process and requires substantial use of fossil fuels, which results in greenhouse gas emissions, industrial waste generation, and environmental pollution. Increasing regulatory

requirements to reduce greenhouse gas emissions and stricter air pollution standards may lead to higher costs for steel manufacturers in the medium term. This in turn leads to a greater focus on reducing the carbon footprint through various technological interventions, like increasing the share of renewables in the energy mix, increasing the share of steelmaking through the electrical route, transition to green hydrogen technologies, decrease in fuel rate in furnaces, and setting up carbon capture utilisation and storage units, to name a few. With many of these emerging low-carbon technologies yet to achieve commercial viability, this transition could entail a significant investment for metal manufacturers. Further, KSIL faces the risk of physical climate change from floods and drought in the form of disruption in raw material availability due to extreme weather events and impact on water availability due to drought.

Social considerations – Social risks for steel manufacturers manifest from health and safety aspects of employees involved in the manufacturing activities. Casualties/ accidents at the operating units due to gaps in safety practices could lead to production outages for steel manufacturers like KSIL and invite penal actions from regulatory bodies. The sector is exposed to labour-related risks and risks of protests/social issues with local communities, which might impact expansion/modernisation plans. Also, the adverse impact of environmental pollution in nearby localities could trigger local criticism.

Liquidity position: Adequate

KSIL's liquidity position is adequate, supported by the cash flows from operations for the current fiscal being expected to be sufficient to meet its annual long term repayment obligation of Rs. 4.31 crore in FY2024. The liquidity profile is further supported by unutilised fund-based limits of ~Rs. 20 crore as of August 2023. Utilisation of working capital limits stood at a moderate level in the past 12 months (average utilisation level of 29%) owing to efficient receivables management by the company.

Rating sensitivities

Positive factors – ICRA may upgrade KSIL's ratings if it improves its scale of operations and profit margins while maintaining comfortable debt coverage metrics. Specific credit metric that may lead to an upgrade of KSIL's ratings include Total Debt to OPBDITA reaching below 2.5 times on a sustained basis.

Negative factors – ICRA may downgrade KSIL's ratings if there is a pressure on the profitability metrics. Further, KSIL's ratings could also be downgraded if its liquidity position weakens due to higher-than-expected capex. Specific credit metric that may lead to a downgrade of KSIL's ratings include DSCR decreasing below 1.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Ferrous Metal Entities
Parent/Group Support	Not Applicable
Consolidation/Standalone	Standalone financial statement of the issuer

About the company

Incorporated in 1995, KSIL manufactures structural steel products. The company has an installed rolling mill capacity of 70,000 tonnes per annum (TPA; being enhanced to 1,00,000 TPA). KSIL is backward integrated with facilities to manufacture MS ingots (viz., induction furnaces with an installed capacity of 27,000 TPA, being expanded to 1,00,000 TPA in FY2024). The company also trades in TMT bars. KSIL is a part of the OPG Group of Companies, which is involved in steel and power businesses.

Key financial indicators (audited)

KSIL (Standalone)	FY2022	FY2023
Operating income	314.2	402.2
PAT	26.3	9.5
OPBDIT/OI	5.7%	2.4%
PAT/OI	8.4%	2.4%
Total outside liabilities/Tangible net worth (times)	0.7	0.8
Total debt/OPBDIT (times)	1.0	5.1
Interest coverage (times)	11.0	8.0

Source: KSIL Audited Financials; Amount in Rs crore; 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	Type	Current Rating (FY2024)		Chronology of Rating History for the past 3 years			
		Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2023 (Rs. crore)	Date & Rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
				Sep 25, 2023	Jun 30, 2022	-	Mar 19, 2021
1 Cash Credit	Long term	30.00	-	[ICRA]BBB- (Stable)	[ICRA]BB+ (Stable)	-	[ICRA]BB+ (Stable)
2 Letter of Credit	Short term	41.00	-	[ICRA]A3	[ICRA]A4+	-	[ICRA]A4+
3 Untied Limits	Short term	-	-	-	[ICRA]A4+	-	[ICRA]A4+
4 Term Loan	Long term	20.50	20.50	[ICRA]BBB- (Stable)			

Complexity level of the rated instruments

Instrument	Complexity Indicator
Cash Credit	Simple
Letter of Credit	Very Simple
Term Loan	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 are available on ICRA's website: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	30.00	[ICRA]BBB- (Stable)
NA	Letter of Credit	NA	NA	NA	41.00	[ICRA]A3
NA	Term Loan	March 2023	NA	FY2030	20.50	[ICRA]BBB- (Stable)

Source: Company

Annexure II: List of entities considered for consolidated analysis – Not Applicable

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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.

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Branches



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