

December 29, 2023

Kirloskar Ferrous Industries Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term - Fund-based - Term Loan	697.82	670.69	[ICRA]AA(Stable); reaffirmed
Long-term/short-term – Fund-based Limits	400.00	365.00	[ICRA]AA(Stable)/[ICRA]A1+; reaffirmed
Long-term/short-term - Non-fund Based Limits	1,700.00	1,762.13	[ICRA]AA(Stable)/[ICRA]A1+; reaffirmed
Commercial Paper	550.00	550.00	[ICRA]A1+; reaffirmed
Non-Convertible Debentures	250.00	250.00	[ICRA]AA(Stable); reaffirmed
Total	3,597.82	3,597.82	

*Instrument details are provided in Annexure-I

Rationale

The ratings favourably factor in the established position of Kirloskar Ferrous Industries Limited (KFIL) in the foundry-grade pig iron and ferrous castings businesses. The company is a part of the reputed Pune-based Kirloskar Group, which has a proven management track record. The ratings derive comfort from the backward integration achieved at KFIL's manufacturing plant through coke oven plant and captive power generation, which leads to substantial cost savings. The cost structure would further improve once the captive iron ore mines become operational. The ratings factor in KFIL's established relationships with large original equipment manufacturers (OEMs). ICRA notes the high customer concentration in the castings segment, though it derives comfort from the fact that KFIL is the single source supplier in most of these cases, which leads to customer retention and repeat orders. The ratings also derive comfort from the comfortable consolidated financial profile of KFIL, marked by low gearing and satisfactory credit metrics.

Post management takeover by KFIL, ISMT Limited's (ISMT; rated [ICRA]A+(Stable)/[ICRA]A1) operational and financial performances recovered in FY2023, supported by availability of bank lines, which facilitated smooth trade and led to improved order inflows. Besides, the company undertook several cost-saving and efficiency improvement initiatives, which along with the benefit of operating leverage, led to a margin expansion in FY2023 and H1 FY2024. Its credit metrics also strengthened, as reflected by its total debt-to-operating profit ratio of 0.4 times as on March 31, 2023 (previous year [P.Y.] - 2.8 times) and 0.1 times as on September 30, 2023, and interest cover of 10.2 times in FY2023 (P.Y. - 5.7 times) and 31.9 times in H1 FY2024. ICRA expects ISMT's healthy credit metrics to sustain in FY2024 on the back of its focus on value-added/high margin products, debottlenecking activities and various cost and efficiency optimisation measures to be undertaken by the company (including setting up a solar power plant to reduce power cost). Going forward, the consolidated performance of KFIL is likely to be driven by improving operating and financial parameters of ISMT. ICRA also notes that the proposed merger of ISMT into KFIL (which is subject to regulatory and other approvals) is likely to benefit the combined entity in terms of increased scale of operations, vertical integration, expanded reach and product diversification, among others.

KFIL, over the last two to three years, undertook a debt-funded acquisition of ISMT and incurred substantial capital expenditure (capex), which led to elevated debt levels as on September 30, 2023 (with respect to the historical levels). Besides, in September 2023, KFIL acquired a 100% stake in Oliver Engineering Private Limited (OEPL) for ~Rs. 112 crore (debt-funded). OEPL manufactures simple castings with a capacity of 28,000 MTPA in Punjab. Being in the similar line of business, OEPL's acquisition provides KFIL entry into the North India market in the castings segment. OEPL's profitability and timely ramp-up of operations will be monitored closely. ICRA also notes that KFIL has substantial capex plans (at the consolidated level) of Rs.

600-800 crore per annum over the next two years towards installation of pulverised coal injection, capacity expansion, solar power project, setting up of alloy steel plant, debottlenecking, and other cost saving projects, which would keep its debt levels elevated. Along with high debt repayments of around Rs. 300 crore per annum in FY2024 and FY2025, these would keep its free cash flows under check. The company's ability to generate adequate returns on these investments will remain important.

The ratings are partially constrained by the vulnerability of the company's operating profit margin (OPM) to fluctuating raw material prices, given the commoditised nature of the pig iron business. The ratings are constrained by the casting division's exposure to the inherent demand cyclicality in the key end-user segments (both commercial vehicle and tractor segments). ICRA notes the company's exposure to foreign exchange (forex) movement, considering its sizeable imports of coking coal. However, the company adopts conservative hedging strategies to minimise the impact of the forex risk.

The Stable outlook on [ICRA]AA rating reflects ICRA's expectation that despite subdued performance in the pig iron division in the near term, the credit profile of KFIL will remain adequately supported by stable performance in the castings division and improving performance of ISMT.

Key rating drivers and their description

Credit strengths

Status as one of the leading pig iron players in the domestic market and a healthy market share in castings segment; backward integrated operations – KFIL is one of the leading manufacturers of foundry grade pig iron and ferrous castings in the domestic market. As per the company's management, KFIL has a healthy market share of 22-25% in the foundry grade pig iron and 19-20% in the castings segment. The company is a part of the reputed Pune-based Kirloskar Group, which has presence across diversified business segments and a proven management track record. The company has also diversified its product offerings with acquisition of ISMT, one of India's leading manufacturers of seamless tubes. The company has a competitive cost structure for pig iron manufacturing because of its sinter plant, coke oven plant, captive power plant and hot blast stoves, which support its margins. The company has two iron ore mines, which were bagged in 2018 at a competitive premium of 36.7% and 55.5%, respectively. However, the mines are not operational due to pending clearances from the authorities. Once the mines become operational, the landed cost of iron ore will reduce, leading to a further improvement in KFIL's cost structure.

Established relationships with OEMs – KFIL mainly caters to large casting requirements (more than 50 kg) of tractor, commercial vehicle (CV) and utility vehicle (UV) and diesel engine segment and has a market share of 19-20%, as per the management. It has a reputed customer base and a long experience of dealing with OEMs, resulting in repeat orders.

Synergies in the form of forward integration and product diversification arising out of ISMT's acquisition; improving performance of ISMT – With the acquisition of ISMT in March 2022, KFIL has forward integrated into seamless tubes and increased the share of value-added products in its portfolio. ISMT is among the largest seamless tubes manufacturers in India. Its product profile is diversified as it produces seamless tubes in the range of 6 to 273 mm diameter. ISMT has customers in the automobile, bearing, power, oil and gas, boiler, general engineering, and hydraulic segments, among others.

Post management takeover by KFIL and one-time settlement with lenders in March 2022, ISMT's operational and financial performances recovered, supported by availability of bank lines (which facilitated smooth trade and led to improved order inflows). This also enabled the company to reduce its cost of procurement. Besides, the company undertook several efficiency improvement and cost-savings initiatives, which along with the benefit of the operating leverage helped it in margin expansion. In FY2023, ISMT reported revenues of Rs. 2,585 crore, reflecting a 19% YoY growth (aided by higher volumes and sales realisations) and its OPM increased to 8.6% from 3.5% in FY2022. In H1 FY2024, while the company reported 6% YoY revenue growth, its OPM increased to 14.4%, led by improved gross margins, focus on value-added/high margin/remunerative products, various cost efficiency measures, debottlenecking, among others. Its credit metrics strengthened, as reflected in its total debt-to-operating profit ratio of 0.1 times as on September 30, 2023, compared to 0.4 times as on March 31, 2023, and interest cover of 31.9 times in H1 FY2024 compared to 10.2 times in FY2023. ICRA expects ISMT's credit metrics to remain

robust in the near-to-medium term despite large capex towards solar power projects. ISMT's OPM would further improve once the solar power plant phase I becomes operational by the end of FY2024.

Comfortable financial profile – The consolidated financial profile of KFIL remains comfortable with a gearing of 0.4 times (FY2023 – 0.3 times) and net debt-to-operating profit ratio of 1.2 times as on September 30, 2023 (FY2023 – 1.1 times), and an interest cover of 7.8 times in H1 FY2024 (FY2023 – 9.0 times). Despite large capex plans and elevated debt levels, ICRA expects KFIL's robust capital structure and comfortable credit metrics to sustain in FY2024 on the back of stable performance in the castings division, focus on value-added/high margin products, debottlenecking activities and various cost and efficiency optimisation measures to be undertaken by the company (including setting up a solar power plant to reduce power cost at ISMT). Improving operational and financial parameters of ISMT would drive the performance of KFIL at the consolidated level with an expected net debt-to-operating profit ratio in the range of 1-1.2 times as on March 31, 2024.

Credit challenges

Substantial debt-funded investments undertaken recently; large capex plans – KFIL, over the last three years, undertook a debt-funded acquisition of ISMT for Rs. 476 crore (in March 2022) and incurred substantial capital expenditure (partly debt funded), which led to elevated debt levels as on September 30, 2023 (with respect to the historical levels). In September 2023, KFIL acquired a 100% stake in OEPL for ~Rs. 112 crore, which was largely debt funded. ICRA also notes that KFIL has substantial capex plans of Rs. 600-800 crore per annum (at the consolidated level) over the next two years towards pulverised coal injection, capacity expansion, solar power project, setting up of alloy steel plant, debottlenecking and other cost saving projects, which would keep its debt levels elevated. Coupled with high debt repayments of around Rs. 300 crore per annum in FY2024 and FY2025, these would keep the company's free cash flows under check. Going forward, the company's ability to ramp up the operations of the acquired assets by increasing capacity utilisation levels, improving profitability and achieving desired operating parameters would be key monitorable.

Exposed to volatility in raw material prices – Raw materials account for the major part of the operational cost for pig iron players, including KFIL, and are thus important determinants of profitability. As the pig iron business is cyclical in nature, it is exposed to margin risks arising from the temporary mismatches in the prices of raw materials and pig iron, causing volatility in profitability and cash flows. Nonetheless, backward integration through coke and iron ore would mitigate the risk to some extent. ICRA also notes that given the sizeable coking coal imports, KFIL's profitability remains exposed to forex currency movements. The company, however, adopts conservative hedging strategies to minimise the impact of forex volatility.

Casting division's performance exposed to inherent cyclicality in key end-user segments – KFIL's casting division derives around 80% of its sales from CV and tractor segments, both of which are exposed to the inherent demand cyclicality. Any sustained demand weakness from its key end-user segments, as witnessed in the past, could adversely impact its revenues and earnings profiles.

Environmental and Social Risks

Environmental risks – The steel industry faces several environmental risks, especially related to carbon emissions. KFIL is making conscious efforts to minimise wastage in materials and processing requirements by initiatives such as yield improvement, casting weight reduction and waste elimination by implementing appropriate technologies. The company continuously monitors and tracks the usage of natural resources. Energy audits are conducted every year by the third party and appropriate actions are taken on audit findings to optimise energy consumption, considering conservation of natural resources. The company has also installed a 11-MW solar power plant at Solapur and 100-KW roof top solar unit at Koppal administrative building to promote green energy.

Social risks – Social risks for ferrous entities arise from the health and safety aspects of employees involved in the mining and manufacturing activities. Casualties/accidents at the operating units due to gaps in safety practices could lead to production outages and invite penal action from regulatory bodies. On the social front, the company addresses the needs of associated

communities by taking sustainable initiatives in the areas of health and hygiene, education, environment, infrastructure and rural development.

Liquidity position: Adequate

KFIL's liquidity is **adequate**, with average unutilised fund-based limits of around Rs. 134 crore during the 12-months ended in October 2023 (with commensurate drawing power). Besides, ISMT's fund-based working capital limits of Rs. 145 crore (with adequate drawing power) largely remain unutilised. ICRA expects the company's consolidated cash flows to remain healthy at around Rs. 700 crore each year in FY2024 and FY2025 and meet the debt repayment obligations and a major portion of the capex requirement. The company's debt repayment obligations in FY2024 and FY2025 stand in the range of Rs. 300-350 crore per annum while the capex would be around Rs. 600-700 crore in FY2024 and Rs. 700-800 crore in FY2025 (at the consolidated level). The consolidated cash flows would be driven by a substantial increase in cash generation at ISMT on the back of continued healthy revenue growth and improvement in profitability.

Rating sensitivities

Positive factors – ICRA could upgrade KFIL's long-term rating if there is a substantial growth in its revenues and profitability while maintaining healthy debt coverage indicators. Specific credit metric that could lead to a rating upgrade includes consolidated net debt-to-operating profit ratio remaining below 0.5 times on a sustained basis.

Negative factors – Pressure on KFIL's ratings could arise if any sharp decline in KFIL's revenues and profits adversely impacts its debt coverage indicators and/or the liquidity position. Specific credit metric that could lead to ratings downgrade includes consolidated net debt-to-operating profit ratio remaining above 1.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Iron and Steel
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of KFIL. As on September 30, 2023, KFIL had two subsidiaries and 11 step-down subsidiaries, details of which are mentioned in Annexure II.

About the company

KFIL, incorporated in 1991, is a part of the Pune-based Kirloskar Group. KFIL manufactures pig iron and ferrous castings such as cylinder blocks, cylinder heads, transmission parts and different types of housings required by automobile, tractor, and diesel engine industries. KFIL's plants in Koppal (Karnataka), Solapur (Maharashtra) and Hiriyur (Karnataka) have a combined casting capacity of 1,70,000 MTPA and a combined pig iron capacity of ~6,09,000 MTPA. In March 2022, KFIL acquired a 51.25% stake in ISMT to facilitate forward integration into seamless tubes. In September 2023, KFIL acquired a 100% stake in Oliver Engineering Private Limited to increase its presence in the castings segment in North India.

Key financial indicators (Consolidated)

	FY2022 (Audited)	FY2023 (Audited)	H1 FY2024 [^]
Operating Income	3,748.3	6,418.2	3,062.2
PAT	299.7	437.3	174.6
OPBDIT/OI	17.4%	13.4%	15.0%
PAT/OI	8.0%	6.8%	5.7%
Total Outside Liabilities/Tangible Net Worth (times)	1.1	0.9	0.8
Total Debt/OPBDIT (times)	1.9	1.1	1.3
Interest Coverage (times)	22.0	9.0	7.8

Source: Company; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; All ratios as per ICRA's calculations; [^]based on limited review of auditor

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current Rating (FY2024)				Chronology of Rating History for the past 3 years							
	Type	Amount Rated (Rs. Cr.)	Amount Outstanding (Rs. Cr.)	Date & Rating on		Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021			
				Dec 29, 2023	Nov 02, 2023		Dec 15, 2022	Dec 23, 2021	Sep 13, 2021	Mar 01, 2021	Oct 05, 2020	May 11, 2020
1 Commercial Paper	ST	550.00	200.00*	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2 Term Loan	LT	670.69	670.69*	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Negative)	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
3 Cash Credit/WCDL	LT/ST	365.00	-	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Negative)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA- (Positive)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+
4 Letter of Credit and Bank Guarantee	LT/ST	1,762.13	-	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Negative)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA- (Positive)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+
5 Non-Convertible Debentures	LT	250.00	250.00*	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Negative)	-	-	-	-	-
6 Unallocated Limits	LT/ST	-	-	-	-	[ICRA]AA (Stable)/ [ICRA]A1+	-	-	-	-	-	-

Amount in Rs. crore; LT – Long-term; ST – Short-term; *As on December 20, 2023

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term - Fund Based - Term Loan	Simple
Long-term/Short-term - Fund Based	Simple
Long-term/Short-term - Non-fund Based	Very Simple
Commercial Paper	Very Simple
Non-Convertible Debentures	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 are available on ICRA's website: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Cr.)	Current Rating and Outlook
NA	Long-term - Fund Based - Term Loan	FY2019	7-9%	FY2029	670.69	[ICRA]AA(Stable)
NA	Long-term/Short-term - Fund Based	-	-	-	365.00	[ICRA]AA(Stable)/[ICRA]A1+
NA	Long-term/Short-term - Non-fund Based	-	-	-	1,762.13	[ICRA]AA(Stable)/[ICRA]A1+
INE884B14507	Commercial Paper	08-Nov-23	7.40%	29-Dec-23	100.00	[ICRA]A1+
INE884B14499	Commercial Paper	27-Jul-23	7.65%	27-Mar-24	100.00	[ICRA]A1+
Not placed	Commercial Paper	-	-	-	350.00	[ICRA]A1+
INE884B08012	Non-Convertible Debentures	10-Mar-22	6.65%	10-Mar-24	125.00	[ICRA]AA(Stable)
INE884B08020	Non-Convertible Debentures	10-Mar-22	6.65%	10-Mar-25	125.00	[ICRA]AA(Stable)

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis

Sr.	Entity Name	Ownership	Consolidation Approach
1	Kirloskar Ferrous Industries Limited	Rated entity	Full consolidation
2	ISMT Limited	Subsidiary	Full consolidation
3	Oliver Engineering Private Limited (w.e.f. September 29, 2023)	Subsidiary	Full consolidation
4	ISMT Enterprises SA	Step-down subsidiary	Full consolidation
5	Structo Hydraulics AB	Step-down subsidiary	Full consolidation
6	ISMT Europe AB	Step-down subsidiary	Full consolidation
7	Indian Seamless Inc	Step-down subsidiary	Full consolidation
8	Tridem Port and Power Company Private Limited	Step-down subsidiary	Full consolidation
9	Nagapattinam Energy Private Limited	Step-down subsidiary	Full consolidation
10	PT ISMT Resources	Step-down subsidiary	Full consolidation
11	Best Exim Private Limited	Step-down subsidiary	Full consolidation
12	Success Power and Infraprojects Private Limited	Step-down subsidiary	Full consolidation
13	Marshall Microware Infrastructure Development Company Private Limited	Step-down subsidiary	Full consolidation
14	Adicca Energy Solutions Private Limited	Step-down subsidiary	Full consolidation

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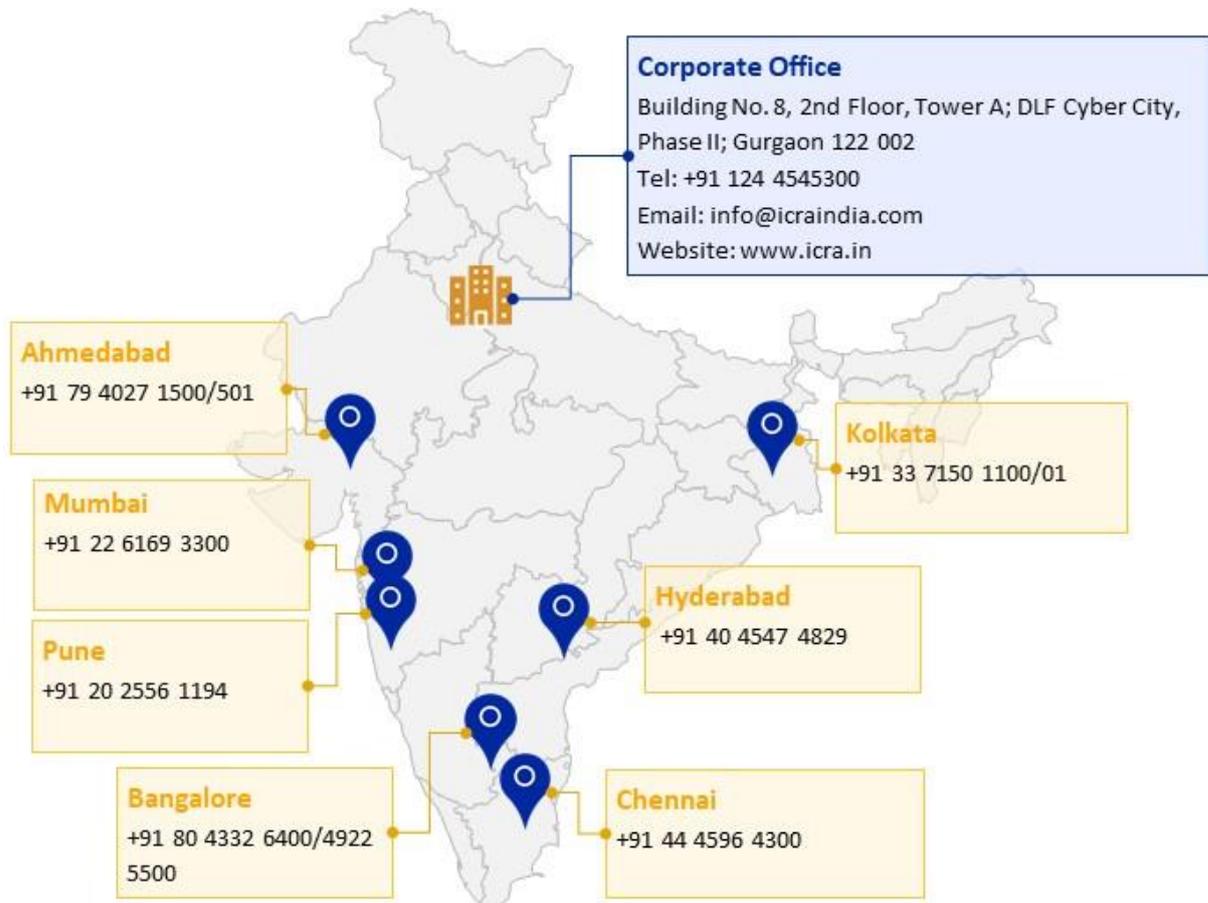
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