ICRA

June 08, 2022

KIOCL Limited: Ratings reaffirmed; outlook revised to Negative from Stable

Summary of rating action

Instrument^	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term/short term non-fund based	475.00	475.00	[ICRA]AA-/[ICRA]A1+ reaffirmed; Outlook revised to Negative from Stable
Long term/short term Untied Limits	575.00	575.00	[ICRA]AA-/[ICRA]A1+ reaffirmed; Outlook revised to Negative from Stable
Total	**1,050.00**	**1,050.00**	

^Instrument details are provided in Annexure-1

Rationale

The revision in the outlook on the long-term rating of KIOCL Limited (KIOCL) factors in the impact of recently announced hefty levies on export of iron ore pellets. On May 21, 2022, the Government of India (GoI) imposed an export duty of 45% (from nil earlier) on pellets to rein in rising prices and contain inflation. As exports accounted for more than 95% of KIOCL's total sales in FY2022, the export duty is likely to severely impact KIOCL's cost-competitiveness in the export markets, in turn adversely impacting profitability and capacity utilisation levels. While the company's sizeable liquid investments provide adequate cushion to any near-term challenges, operating under a prolonged export duty regime could weaken its liquidity position and would remain a key monitorable from the credit perspective.

The ratings continue to factor in KIOCL's status as a Miniratna company under the Ministry of Steel, GoI with the latter holding a 99.03% stake as on March 31, 2022, and its debt-free status at present, which imparts a high degree of financial flexibility. Moreover, KIOCL's sovereign ownership is expected to give it access to need-based funding support from the GoI. The ratings also factor in the company's comfortable financial risk profile and healthy liquidity position, with an unencumbered cash balance of Rs. 1,107.6 crore as on March 31, 2022. The ratings also consider the long track record of the company in iron ore mining/pellet manufacturing businesses and the extensive experience of its management.

The ratings, however, are constrained by the company's adverse cost structure for the pellet business due to elevated freight charges as the company sources a large part of its iron ore requirement from Chhattisgarh. Besides, in the absence of a beneficiation plant, KIOCL is dependent on costlier iron ore fines with high Fe content. ICRA however notes that the recent favourable verdict of the Hon'ble Supreme Court for allowing the export of iron ore from Karnataka would allow KIOCL the flexibility to party source its ore requirement from nearby mines in Karnataka, in turn leading to some savings in freight costs. 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 is in the process of setting up a coke oven plant and a ductile iron (DI) pipe unit at an estimated cost of Rs. 837 crore, having 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. The ratings also factor in sizeable contingent liabilities of Rs. 657 crore[1] as on March 31, 2021, which if crystallised, could adversely impact the financial risk profile of KIOCL.

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[1] Includes forest development tax (FDT) levied by the Government of Karnataka and distance based charges (DBC) by South-Western Railway and East Coast Railways. Both the matters are subjudice.

Key rating drivers and their description

Credit strengths

Large sovereign ownership imparts a high degree of financial flexibility – KIOCL is a flagship company under the Ministry of Steel, GOI, with the Miniratna status. The GOI has a 99.03% ownership in KIOCL. The large sovereign ownership imparts a high degree of financial flexibility to the company, and gives it access to need-based funding support from the Government.

Comfortable financial risk profile – The financial risk profile of KIOCL has remained comfortable over the years, as reflected by its debt-free status and healthy liquidity profile. Notwithstanding large cash outflows towards dividend, KIOCL's unencumbered cash balance remained healthy at Rs. 1,107.6 crore as on March 31, 2022 (Rs. 1,455 crore as on March 31, 2021) supported by a robust 26% revenue growth and a healthy operating profit margin of 12.6% in FY2022. Nonetheless, the project gearing of 2 times for the ongoing capex of Rs. 837 crore towards forward and backward integration of the pig iron division would increase the debt levels. This, coupled with the severe impact on profits and cash-flows following the 45% duty on pellet export, could impact the financial risk profile and would remain a key credit monitorable from the credit perspective.

Long track record and experienced management – KIOCL started its pellet operation in 1987 and has an established market presence in India and abroad. 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 improves KIOCL's competitive position and provides it with an alternative revenue stream in the form of mineral exploration and O&M contracts.

Credit challenges

Export duty on pellet to adversely impact profitability and capacity utilisation – On May 21, 2022, the GoI imposed a steep 45% duty (from nil earlier) on export of iron ore pellet. This is a major dampener for merchant pellet exporters like KIOCL and could potentially render pellet exports unviable at current prices. As exports accounted for more than 95% of KIOCL's total sales in FY2022, in case the company has to operate under a prolonged duty regime, KIOCL's profits and cash flows are likely to be adversely impacted, and its liquidity profile could also come under pressure, given the large capital commitments.

Adverse cost structure – KIOCL procures iron ore mainly from Chhattisgarh. 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. Additionally, the high employee cost remains a drag on the profit margins. While the company reported healthy profits in FY2021 and FY2022 despite the adverse cost structure due to remunerative pellet prices, the company's ability to absorb cost pressures in case of a sharp correction in pellet prices remains limited due to elevated freight cost associated with iron ore procurement. For commodity business, an adverse cost structure remains a key concern from the rating perspective. ICRA however notes that the recent favourable verdict of the Hon'ble Supreme Court for allowing the export of iron ore from Karnataka would allow KIOCL the flexibility to party source its ore requirement from nearby mines in Karnataka, in turn leading to some savings in freight costs.

Loss-making pig iron division – KIOCL has a 2,16,000-mtpa pig iron division, which has been non-operational since 2010. In FY2022, the division reported a loss of Rs. 25 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 risk associated with volatility in iron ore and pellet prices – 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. The company has recently received environmental and forest clearances for Devadari and is awaiting the signing of mining lease. Once the lease is granted, it will start the mining activity, which has the potential to significantly bring down the company's overall operating cost. The company also plans to set up a 2-mtpa iron ore beneficiation and pellet plant in the next two-three years, which will consume the ore extracted from the Devadari mines. ICRA expects the commissioning and ramp up of mines and the pellet plant would result in sizeable cost savings in future.

Liquidity position: Adequate

KIOCL does not have any debt on its books at present. Notwithstanding a dividend outflow of Rs. 159.2 crore in FY2022, KIOCL's liquidity remained **adequate** with an unencumbered cash and liquid investments of Rs. 1,107.6 crore as on March 31, 2022 supported by healthy profit generation in FY2022. However, the expected decline in profitability following the imposition of the export duty would impact the cash flows from operations in the current fiscal. This, coupled with large capital outlays could impact KIOCL's liquidity profile going forward.

Rating sensitivities

Positive factors – Given the Negative outlook, a rating upgrade in the near term is unlikely. However, the outlook could be revised to Stable if KIOCL improves its profitability supported by healthy realisations and/or improving cost structure.

Negative factors – Pressure on the rating may emerge in case the company remains loss-making for a prolonged period, thereby adversely impacting the liquidity. Moreover, any large dividend pay-outs and/or share buybacks, adversely affecting the liquidity profile could also lead to rating downgrade.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Ferrous Metals Industry
Parent/Group Support	Parent: Government of India The assigned rating factors in the expectation of a need-based financial support by the Government to the rated entity.
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.

Key financial indicators

Consolidated financials (Ind AS)	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)
Operating Income (Rs. crore)	1937.7	2383.6	3006.5
PAT (Rs. crore)	43.5	301.2	313.4
OPBDIT/OI (%)	-0.9%	15.0%	12.6%
PAT/OI (%)	2.2%	12.6%	10.4%
Total Outside Liabilities/Tangible Net Worth (times)	0.2	0.2	0.2

Consolidated financials (Ind AS)	FY2020 (Audited)	FY2021 (Audited)	FY2022 (Audited)
Total Debt/OPBDIT (times)	-7.0	0.3	0.3
Interest Coverage (times)	-1.8	24.1	31.1

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

Status of non-cooperation with previous CRA – Not Applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					June 8, 2022	Oct 29, 2021	Jul 24, 2020	Jul 19, 2019
2	Letter of credit/bank guarantee	LT/ST	475.00	-	[ICRA]AA-(Negative)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+
3	Untied Limits	LT/ST	575.00	-	[ICRA]AA-(Negative)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+	[ICRA]AA-(Stable)/ [ICRA]A1+

Amount in Rs. crore; LT – Long Term; ST – Short Term

Complexity level of the rated instrument

Instrument	Complexity Indicator
Letter of credit/bank guarantee	Very Simple
Untied Limits	Not applicable

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 analyzing 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	Letter of credit/bank guarantee	-	-	-	475.00	[ICRA]AA- (Negative)/ [ICRA]A1+
NA	Untied Limits	-	-	-	575.00	[ICRA]AA- (Negative)/ [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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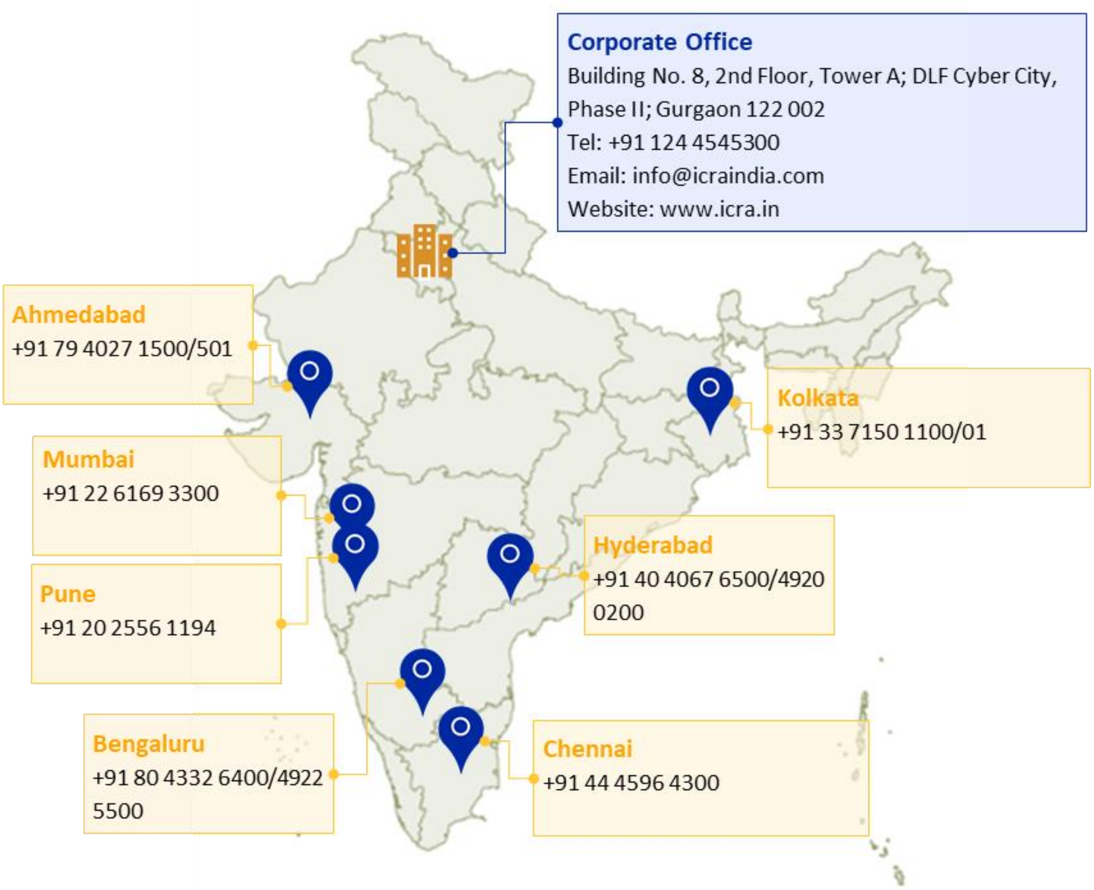

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