August 31, 2023

KIOCL Limited: Ratings Reaffirmed

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	530.00	[ICRA]A+ (Negative)/ [ICRA]A1; Reaffirmed
Long-term/short-term -Untied limits	575.00	520.00	[ICRA]A+ (Negative)/ [ICRA]A1; Reaffirmed
Total	**1,050.00**	**1,050.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating reaffirmation factors in the deterioration in KIOCL Limited's (KIOCL) financial risk profile due to operating losses in FY2023 and expected continuation of the trend in FY2024 as well. Key factors for this underperformance include regulatory disruptions in the last fiscal following the imposition of a 45% export duty on pellets, subsequent steep correction in pellet prices amid uncertain global economic outlook and steel demand slowdown in China in the current fiscal. The ratings also factors in KIOCL's sizeable upcoming capex plans, which adversely impacts the liquidity and credit metrics in the medium term. ICRA notes that as the operating environment deteriorated following the imposition of export duty in May 2022, KIOCL's average pellet realisations declined to Rs. 10,397/MT[1] in FY2023 from Rs. 14,397/MT in FY2022, thus showcasing a YoY decline of 28%. While the duty has been revoked in November 2022, the uncertain steel demand growth prospects outside of India have kept KIOCL's pellet realisations muted at Rs. 9,400/MT in July 2023, which are expected to lead to cash losses unless realisations improve meaningfully, going forward. The company's free cash and liquid investments (excluding encumbered cash) have depleted by ~80% in the past five years to Rs. 392.5 crore as on March 31, 2023, from Rs. 1,863.4 crore as on March 31, 2018. The company is expected to incur a capex of ~Rs. 300 crore in FY2024[2], which, along with the cash losses, is expected to further diminish the free cash and liquid investments to ~Rs. 250-300 crore as on March 31, 2024. While KIOCL's large upcoming capex plans for the coke oven plant and restarting of the blast furnace operations[3] to revive KIOCL's pig iron business, expose the company to execution risks, it would also be exposed to stabilisation and commercial risks, as the company has a limited track record in this line of business.

ICRA favourably notes that the key regulatory clearances of EC[4], FC[5], and ML[6] required before starting mining at the Devadari iron ore mine site has been received and production is expected to begin from mid-FY2025. Timely operationalisation and ramping up of this greenfield iron ore mine would be a key determinant for KIOCL's path to profitability. This is because the mine has been awarded under the allotment route, entailing low revenue share with the state government, and therefore is expected to lead to substantial savings due to a gradual reduction in external iron ore purchase. With KIOCL's pellet business suffering from the structural-cost disadvantages associated with high operating leverage, suboptimal plant efficiency parameters due to vintage nature of the plant, and costlier external iron ore purchases from NMDC additionally entailing elevated logistics costs, the investment in captive mine development partly addresses the issues of cost inefficiency of the

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[1] *MT: Metric Tonne*
[2] *FY2024 capex includes the cost to be incurred for procuring vertical pressure filter, modernisation/upgradation of the existing property, plant and equipment, and capex towards captive iron ore mine and coke oven plant*
[3] *Restarting of blast furnace operations and setting up of Waste Heat Recovery Boiler (WHRB) power plant (which will generate power from the hot flue gases generated by the coke oven plant) will be undertaken by the company along with the JV partner as per the Expression of Interest notification published by KIOCL on its website and based on the feedback received from the management of KIOCL (Link for notification). Therefore, clarity on the JV partner, risk-sharing between KIOCL and the JV partner, and capital requirement for KIOCL is awaited*
[4] *Environmental Clearance*
[5] *Forest Clearance*
[6] *Mining Lease*

pellet business. Any material time and cost overruns in operationalising the Devadari iron ore mine can weaken KIOCL's business risk profile and exert further rating pressure. The ratings also factor in the sensitivity of the company's profitability to the spreads between prices of iron ore fines and pellets, which have witnessed significant volatility in the past.

For part-financing its growth plans, the company has drawn down ~Rs. 30 crore, out of Rs. 558 crore of term loan sanctioned for setting up of the coke oven and Ductile Iron (DI) pipe plant in Mangaluru as on July 28, 2023. However, ICRA understands that the DI pipe project has been kept on hold. Also, the operationalisation of the blast furnace unit and setting up of the WHRB plant are in the nascent stages, as KIOCL is looking for JV partners to assist them in this project. Therefore, with only the iron ore mine and coke oven projects underway at present, the borrowing levels of the company are expected to remain modest over the near term. The net debt stood at Rs. 144.9 crore as on March 31, 2023 and is expected to be negative at Rs. 111.5 crore as on March 31, 2024. 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, 2023, thus imparting 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 outlook continues to be Negative on the long-term rating of [ICRA]A+ due to the significant correction in pellet prices in FY2024 so far, which, along with KIOCL's adverse cost structure, is expected to keep its profitability metrics at subdued levels, till the time the company is able to operationalise the Devadari iron ore mine or the operating environment improves, leading to an expansion of spreads between pellet and iron ore prices.

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 a 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 is expected to give KIOCL access to need-based funding support from the GoI.

Low absolute debt levels support leverage indicators – The company's borrowing levels are expected to remain modest over the near term, as only the iron ore and coke oven projects are underway at present. The operationalisation of the blast furnace unit and setting up of the WHRB plant are in the nascent stages as KIOCL is looking for JV partners to assist them in this project. The net debt stood at Rs. 144.9 crore as on March 31, 2023 and is expected to be negative at Rs. 111.5 crore as on March 31, 2024. The leverage indicator of TOL/TNW[7] stood comfortable at 0.5 times as on March 31, 2023, and is expected to improve to 0.3 times as on March 31, 2024, on the back of a modest debt level.

For part-financing its growth plans, the company has drawn down ~Rs. 30 crore, out of Rs. 558 crore of term loan sanctioned for the setting up of the coke oven and ductile iron (DI) pipe plant in Mangaluru as on July 28, 2023. However, ICRA understands that the DI pipe project has been kept on hold. KIOCL operates its pellet plant on the land taken on lease from the New Mangalore Port Trust and the payables under this lease liability are classified as total outside liabilities in the balance sheet as per IndAS 116.

Expected commissioning of the upcoming iron ore mine under the allotment route will lead to significant improvement in cost competitiveness – At present, KIOCL procures iron ore mainly from NMDC Chhattisgarh, resulting in elevated raw material and freight costs. Further, this exposes the company to risks associated with price volatility and raw material availability. The captive Devadari iron ore mines of KIOCL have received the key regulatory clearances of EC, FC, and ML required before starting mining and production is expected to begin from mid-FY2025. Timely operationalisation and ramping up of this greenfield iron ore mine would be key determinants for KIOCL's profitability. This is because the mine has been awarded under the allotment route, entailing low revenue share with the state government, and therefore, is expected to lead to substantial savings due to a gradual reduction in external iron ore purchase. With KIOCL's pellet business suffering from the structural-cost disadvantages associated with high operating leverage, suboptimal plant efficiency parameters due to vintage nature of the plant, and costlier

[7] *Total Outside Liabilities/Tangible Net Worth*

external iron ore purchases from NMDC additionally entailing elevated logistics costs, the investment in captive mine development partly addresses the issues of cost inefficiency of the pellet business. Any material time and cost overruns in operationalising the Devadari iron ore mine can weaken KIOCL's business risk profile and exert further rating pressure.

Credit challenges

Adverse cost structure leading to frequent loss-making operations – The current cost structure of KIOCL comprises high fixed-employee cost, driven from the inoperative blast furnace operations, in turn leading to higher operating leverage. The elevated freight costs associated with procuring iron ore mainly from NMDC in Chhattisgarh, through multi-modal logistics, keeps KIOCL's operating profitability weak. Frequent breakdowns in the factory's operations, vintage machinery/equipment and corrosion of the plant & machinery due to its proximity to the sea, leads to higher conversion cost for KIOCL in comparison to more-efficient industry players. Besides, in the absence of a beneficiation plant, the company is dependent on costlier iron ore fines with high Fe content. The company's ability to remain profitable by absorbing cost pressures in case of a sharp correction in pellet prices or regulatory actions by the GOI (like imposition of export duty in FY2023), remains limited due to its high-cost operations at present. However, the company's ability to operationalise the captive iron ore mine in mid-FY2025, is expected to structurally lower its operating costs and remains critical to report profits across business cycles.

Sizeable upcoming capex will lead to project execution risks and deterioration of liquidity; however, net leverage (Net Debt/OPBDITA) expected to remain moderate, going forward- The company's free cash and liquid investments (excluding encumbered cash) have depleted by ~80% in the past five years to Rs. 392.5 crore as on March 31, 2023, from Rs. 1,863.4 crore as on March 31, 2018. The company is expected to incur a capex of ~Rs. 300 crore in FY2024[8], which, along with the cash losses, is expected to further diminish the free cash and liquid investments to ~Rs. 250-300 crore as on March 31, 2024. This significant deterioration in the liquidity buffer, which has been providing cushion to KIOCL during periods of losses, remains a credit negative. While KIOCL's large upcoming capex plans for the coke oven plant and restarting the blast furnace operations to revive KIOCL's pig iron business expose the company to execution risks, it would also be exposed to stabilisation and commercial risks as the company has a limited track record in this line of business. KIOCL is expected to report operating losses in FY2024. However, given the limited dependence on external borrowings, with the company being expected to gradually swing back to operating profits from FY2025 onwards following the start of captive mining operations, the net leverage (Net Debt/OPBDITA) ratio is expected to remain moderate at ~0.4-1.5 times in FY2025/FY2026.

Exposure to risks associated with volatility in iron ore and pellet prices – KIOCL's profitability is exposed to the sensitivity of the company's profitability to the spreads between prices of iron ore fines and pellets, which have witnessed significant volatility in the past. Regulatory actions by the GOI, like the imposition of export duty in FY2023, also tempers the company's business risk profile. Exports accounted for more than 95% of KIOCL's total sales in FY2022, and the imposition of export duty in May 2022 led to unviability of export sales during FY2023, due to a worsening of cost competitiveness, which in turn adversely impacted the profitability and capacity utilisation levels.

Environmental and Social Risks

Environmental considerations - Pellet manufacturing process requires 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 manufacturers in the medium term. KIOCL has proactively taken steps to address various environmental issues like increase in green cover in the plant area, adoption of energy-conservation measures, transition to renewable sources of power by setting up rooftop and ground-based solar plants, and investments in energy-efficient systems/lighting, which have helped control the company's overall greenhouse gas emissions. Inability to appropriately address environmental risks can lead to regulatory actions from the Government, thus potentially impacting the operations of the company.

Social considerations - Social risks for pellet 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

[8] FY2024 capex includes the cost to be incurred for procuring vertical pressure filter, modernisation/upgradation of the existing property, plant and equipment, and capex towards captive iron ore mine and coke oven plant

production outages for steel manufacturers like KIOCL 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

KIOCL's liquidity remained **adequate,** with free cash and liquid investments (excluding encumbered cash) of Rs. 392.5 crore as on March 31, 2023. However, the expected operating losses and large capex plans in FY2024 are likely to further drain the free cash and liquid investments to ~Rs. 250-300 crore as on March 31, 2024. While KIOCL is expected to swing back to profits from FY2025, however, the company's free cash flows are expected to remain in the negative territory in both FY2024 and FY2025 due to the ongoing capex, which would continue to exert pressure on the liquidity profile.

Rating sensitivities

Positive factors – Timely commissioning and stabilisation of the upcoming capex, leading to commensurate returns and improvement in the leverage metrics/liquidity profile may lead to a change in outlook to Stable from Negative.

Negative factors – Delay in the timely commissioning and ramp-up/stabilisation of the iron ore mine, coke oven and blast furnace, or if the company remains loss-making for a prolonged period, or any large dividend payouts and/or share buybacks, thereby adversely impacting the liquidity profile, may lead to a ratings downgrade. The ratings could also come under pressure, if the actual capex is significantly higher-than-the-budgeted amounts, leading to weaker-than-expected leverage metrics.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Parent: Government of India The assigned ratings factor in the expectations of 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 a 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, with an installed capacity of 3.5 mtpa, is in Mangaluru, Karnataka. Apart from the pellet unit, it also has a blast furnace (currently not in operations) to produce foundry-grade pig iron and a reclaimer to load pellets directly from the stockyard to the vessel. KIOCL has diversified into Operation & Maintenance services along with mineral exploration pertaining to its various core areas of expertise.

Key financial indicators (audited)

Standalone	FY2022	FY2023
Operating income	3,012.1	1,543.4
PAT	313.4	(97.7)
OPBDIT/OI	12.9%	(10.6%)
PAT/OI	10.4%	(6.3%)
Total outside liabilities/Tangible net worth (times)	0.2	0.5
Total debt/OPBDIT (times)	0.3	(3.3)
Interest coverage (times)	31.3	(12.0)

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

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. crore)	Amount outstanding as of March 31, 2023 (Rs. crore)	Date & rating in FY2024		Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					August 31, 2023	August 07, 2023	June 8, 2022	Oct 29, 2021	Jul 24, 2020
1	Long term/short term - non-fund based - Letter of credit/bank guarantee	Long Term/Short Term	530.00	-	[ICRA]A+ (Negative)/ [ICRA]A1	[ICRA]A+ (Negative)/ [ICRA]A1	[ICRA]AA- (Negative)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+
2	Long term/short term - Untied Limits	Long Term/Short Term	520.00	-	[ICRA]A+ (Negative)/ [ICRA]A1	[ICRA]A+ (Negative)/ [ICRA]A1	[ICRA]AA- (Negative)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+
3	Cash Credit	Long Term	-	-	-	-	-	-	[ICRA]AA- (Stable)

Amount in Rs. crore

Complexity level of the rated instruments

Instrument	Complexity Indicator
Non-fund based - 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 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	**Long term/short term non-fund based - Letter of credit/bank guarantee**	NA	NA	NA	530.00	[ICRA]A+ (Negative)/ [ICRA]A1
NA	**Long term/short term -Untied Limits**	NA	NA	NA	520.00	[ICRA]A+ (Negative)/ [ICRA]A1

Source: Company

Annexure II: 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.

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