

November 24, 2017

## Kems Forgings Limited

### Summary of rated instruments

Instrument*	Rated Amount (in crore)	Rating Action
Long Term – Fund Based (Overdraft)	20.00	[ICRA]BBB (Stable); Assigned
Short Term – Fund Based	8.65	[ICRA]A3+; Assigned
<b>Total</b>	<b>28.65</b>	

\*Instrument details are provided in Annexure-1

### Rating action

ICRA has assigned a long-term rating of [ICRA]BBB (pronounced ICRA triple B) to the Rs. 20.00-crore overdraft facilities and a short-term rating of [ICRA]A3+ (pronounced ICRA A three plus) to the Rs. 8.65-crore fund-based facilities of Kems Forgings Limited (KFL or the company)<sup>1</sup>. The outlook on the long-term rating is ‘Stable’.

### Rationale

The assigned ratings take into account the longstanding experience of the promoters and the management in the steel forging industry coupled with the established association with reputed clientele, which support the long term business sustainability and growth prospects of the company. The ratings factor in the healthy growth in operating income over the last few years driven by new product development, new customer addition and higher business traction from the existing customers. In addition, the favourable long term demand prospects of the automobile and construction equipment industries, which are the primary end users for KFL, further support growth prospects. The ratings also take into consideration the ability of the company to maintain stable operating profitability margins over the years, despite volatility in the input costs, aided by an effective pass-through of raw material price variations to its customers.

The ratings are, however, constrained by the moderate scale of operations of the company that restrict operational and financial flexibility and the high customer concentration with the top five customers accounting for ~58% of the revenues in FY2017. The ratings also take into account the expected deterioration in the capital structure and the coverage indicators on account of the debt-funded capital expenditure incurred in FY2018. While ICRA expects KFL to continue to add forging capacity on a regular basis in order to grow its volumes, however, any further major debt-funded capex will remain critical from credit perspective. Further, ICRA notes that the operations continue to remain exposed to cyclicity in the end user industries. Going forward, the company’s ability to diversify its product offerings to other segments and acquire new customers, resulting in improvement in scale in a profitable manner, as well as manage its working capital optimally shall be the key rating sensitivities.

<sup>1</sup> For complete rating scale and definitions, please refer to ICRA's website [www.icra.in](http://www.icra.in) or other ICRA Rating Publications

## Key rating drivers

### Credit strengths

- **Experience of the promoters in the forging business** – Kems Forgings Ltd. (KFL), incorporated in 1970, as Sree Lakshmi Industrial Forge and Engineers Limited, was acquired by the existing promoters in 1990 and renamed to KFL in 2010. The ratings derive comfort from the long track record of the company in manufacturing forged components and the presence of experienced management to spearhead the growth.
- **Established business relationships with reputed clientele** - Long-term association and healthy business relations of the company with the original equipment manufacturers (OEMs) and tier-1/tier-2 suppliers in the automobile and construction equipment segments lends business support. Moreover, favourable long-term demand prospects of the construction equipment and automobile industries, which are the primary end users for KFL, support growth prospects.
- **Pass through clauses for changes in raw material prices** - KFL's margins are protected from raw material price fluctuation risk backed by price pass-through arrangements with its customers.
- **Healthy growth in revenues over the last few years** - The operating income of the company has grown at a CAGR of ~17% over FY2014-17 driven by new product introduction, new customer addition and higher volumes from the existing customers. Nevertheless, the current scale of operations for the company remains moderate limiting operational and financial flexibility to an extent.

### Credit weaknesses

- **Sector concentration risk** - Significant portion (>90%) of the company's revenues is derived from the automobile and construction equipment (including hydraulics) segments leading to industry concentration risks. It makes the company vulnerable to cyclical business downturns in end user industries, accentuating the risk of demand volatility.
- **High customer concentration** - The company faces high customer concentration with the top five customers constituting about 58% of the company's total sales in FY2017, however, the risk is mitigated to an extent on account of resilient business ties with the fundamentally strong customers.
- **Debt funded capital expenditure may weaken the capital structure and coverage indicators in the near term** - In FY2018, the company has availed a loan of Rs. 12.0 crore from for funding the capital expenditure towards purchase of a plot for setting up its own office building in future, apart from other loans availed to fund the capacity expansion. The additional debt availed is expected to weaken the capital structure and coverage indicators of the company in the near term. However, low average funding cost and favourable repayment tenor provides comfort. The ability of the company to ramp up the operations in a timely manner would be critical for maintaining healthy coverage indicators going forward.

**Analytical approach:** For arriving at the rating, ICRA has applied its rating methodologies as indicated below.

### Links to applicable criteria

[Corporate Credit Rating –A Note on Methodology](#)

**About the company:**

Kems Forgings Limited is part of the Gandhi Group, established in the year 1964 as a steel marketing company in Kolkata. The companies within the group include Southern Steels and Forgings (SSF), Kems Auto Components Limited (KACL) and KFL. Mr. S.K. Gandhi, the managing director, Mr. Manish Gandhi (finance and production director), Mr. Kushal Gandhi (sales and marketing director) and Mr. Deepak Gandhi (procurement director) along with family and group companies hold 100% equity stake in KFL as on March 31, 2017. Incorporated in 1970, as Sree Lakshmi Industrial Forge and Engineers Limited, was acquired by the existing promoters in 1990 and renamed to KFL in 2010. KFL is engaged in manufacturing steel forgings primarily catering to the automotive and construction equipment industries. KFL has three manufacturing facility located in Attibele and Hoskote area of Bangalore and Sriperumbudur in Chennai with combined installed capacity of 29,500 MT (Metric Tons) per annum. KACL is engaged in manufacturing of precision machine components and assemblies for the automotive industry. SSF is engaged in trading of steels and is the authorized distributor and dealer for Rashtriya Ispat Nigam Limited, Visvesvaraya Iron and Steel Company Limited, Gerdau Steel India Private Limited and JSW Steel Limited in South India.

In FY2017, the company reported a net profit of Rs. 5.12 crore on an operating income of Rs. 187.78 crore, as compared to a net profit of Rs. 2.82 crore on an operating income of Rs. 158.06 crore in the previous year.

**Key Financial Indicators**

	<b>FY2016</b>	<b>FY2017</b>
	<b>Audited</b>	<b>Audited</b>
Operating Income (Rs. crore)	158.06	187.78
PAT (Rs. crore)	2.82	5.12
OPBDIT/ OI (%)	10.75%	8.98%
RoCE (%)	14.49%	14.77%
Total Debt/ TNW (times)	1.63	1.26
Total Debt/ OPBDIT (times)	3.06	2.76
Interest coverage (times)	2.51	3.42
NWC/ OI (%)	19.45%	19.73%

*OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress); NWC: Net Working Capital*

**Status of non-cooperation with previous CRA:** Not Applicable

**Any other information:** Not applicable

**Rating history for last three years:**
**Table:**

S.No	Instrument	Current Rating			Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. Crore)	Month-year & Rating in FY2018	Month-year & Rating in FY2017	Month-year & Rating in FY2016	Month-year & Rating in FY2015
				November 2017	-	-	-
1	Overdraft	Long Term	20.00	[ICRA]BBB (Stable)	-	-	-
2	Bill Discounting	Short Term	8.65	[ICRA]A3+	-	-	-

**Complexity level of the rated instrument:**

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website [www.icra.in](http://www.icra.in)

**Annexure-1**  
**Instruments details**

<b>Name of the instrument</b>	<b>Date of Issuance/ Sanction</b>	<b>Coupon rate</b>	<b>Maturity Date</b>	<b>Size of the issue (Rs. crore)</b>	<b>Current Rating and Outlook</b>
Overdraft	-	-	-	20.00	[ICRA]BBB (Stable)
Bill Discounting	-	-	-	8.65	[ICRA]A3+

Source: KFL



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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.

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