GKW LIMITED

CREDIT ENHANCED PREFERENCE SHARE ISSUE OF GKW LIMITED

ICRA has assigned a conditional A1+ (SO) rating to the Rs. 805 million preference share programme of GKW Ltd (GKW), credit enhanced through a put option given by Graphite India Limited (GIL). The rating is the highest credit quality rating assigned by ICRA for the short term. The letters SO in parenthesis suffixed to a rating symbol stand for Structured Obligation. An SO rating is specific to the rated issue, its terms, and its structure. SO ratings do not represent ICRA's opinion on the general credit quality of the issuers concerned.

The A1+(SO) rating is based on the strength of the put option to the preference shareholder given by GIL, which would constitute an irrevocable binding obligation on GIL to buy from the option buyer the preference shares, by paying the option price. The option price payable will be the aggregate of the face value of the shares, pre-determined applicable premium and the pro-rata dividend. The rating is subject to the fulfilment of all conditions under the structure and review of documentation pertaining to the transaction by ICRA.

GKW, a K.K.Bangur group company, was declared a BIFR company in April 2000. The Draft Rehabilitation Scheme (DRS) approved by the BIFR for GKW entails infusion of Rs. 1226 million for full and final settlement with secured creditors, employee rationalization and enhancement of working capital for operating units. To fund the rehabilitation scheme, the BIFR has approved an issue of equity shares (upto Rs 300 million) and preference shares (upto Rs 1250 million). The proposed issue of Rs 805 million redeemable preference shares is redeemable at the end of one year.

GIL, another K.K.Bangur group company, will give a put option to the preference shareholder, the invocation of which shall constitute an irrevocable binding obligation on GIL to buy from the option buyer the preference shares, by paying the option price. The rating is conditional upon the preference shareholder invoking the put option within one year of the date of allotment of preference shares. The transaction structure ensures that the rating of the credit enhanced preference shares reflects the short-term credit quality of GIL.

Note on Graphite India Limited: Graphite has an outstanding short term rating of A1+ rating by ICRA. The rating reflects GIL's dominant position in the domestic graphite electrode industry and increasing penetration in export markets, moderate gearing levels, profitable operations of its recently acquired group company Conradty AG in Germany, and the recent commissioning of its expansion project at its Durgapur plant during the ongoing upturn in the industry, which is likely to result in higher profits for the company in the short term. The rating however takes into consideration the risks arising on account of cyclicality in the graphite electrode industry, a possible reduction in duty entitlement passbook (DEPB) benefits for domestic players and a significant increase in international prices of certain key raw materials; all of which would have an adverse impact on GIL going forward. The rating also takes into account the increase in working capital intensity in GIL's operations on account of an increase in its capacity following the recent commissioning of its project and the rise in key raw material prices.

Graphite electrodes are used as consumables in the electric steel making process. Technological improvements have resulted in lower consumption rates of electrodes per tonne of steel produced, although a gradual increase in steel production through the electric arc furnace route has offset the risks arising from lower specific consumption to some extent. Strong demand from the steel industry has resulted in a significant improvement in international electrode prices since 2003-04. ICRA believes that the high realisations are likely to sustain in the short term given the current firm order-books of graphite electrode manufacturers. Although the favourable impact of better realisations on GIL's profits would be limited by a decline in DEPB rates, the extent is likely to be moderate because of the advance licensing scheme for neutralisation of import duty would still be available to the company. The steel business as also derived businesses like graphite electrodes remains cyclical in nature. Further, with both availability and prices of certain key raw materials becoming an area of concern, ICRA believes that the graphite electrode industry including GIL would remain susceptible to raw material price risks.

The European Commission imposed a 15.7% anti-dumping duty in May 2004 (confirmed in September 2004) on GIL's exports to the European Union. ICRA expects this to adversely impact GIL's profitability in future. However, during 2004-05, GIL acquired the assets of Conradty AG, a German company with a 18,000 MT of electrode capacity, which had become insolvent in 2002. With Contradty able to service the EU markets, GIL would be able to reduce its exports to the EU, thereby limiting the adverse impact of the anti-dumping duty to an extent. Although a likely decline in DEPB rates and higher export realisations of electrodes reduce the possibility of similar action by other countries, ICRA feels that this also would remain an area of concern in future.

GIL has been able to consolidate its position in the global market and currently supplies to a large number of countries mainly based on its competitive cost structure and improved quality. The cost advantage is primarily derived out of significantly lower labour costs compared with industry leaders producing in the developed countries, improved production efficiency following a large modernisation project in the late 1990s and availability of captive power plants which meet GIL's own requirements to some extent. ICRA expects the advantage to be sustainable in the long term. GIL has also been able to upgrade its technological capabilities continuously and progress towards production of higher diameter electrodes, which are increasingly demanded by steel producers.

In 2004-05, GIL registered a net profit of Rs 480.0 million on a turnover of Rs 5.1 billion compared with a profit of Rs. 513.2 million and a turnover of Rs. 5.1 billion in the previous year. Fresh debt for part funding of the project and higher working capital requirements resulted in an increase in GIL's gearing level to 0.62 time as on March 31, 2005 from 0.43 time as on March 31, 2004. However, despite this weakening, overall gearing of GIL still remained conservative at an absolute level. Consequently, GIL's cash from operations has been strong relative to its debt servicing requirements as reflected by its comfortable levels of interest cover and net cash accrual / total debt of about 7.03 time and 21% respectively in 2004-05. The company reported a net profit of Rs. 353.8 million on a turnover of Rs. 4.43 billion during the period April – December 2005.

Profile of GKW

GKW was incorporated in 1931, as a private limited company, which was later on converted into public limited company in 1956. It is a multi product company with capacity to manufacture various products like high speed and alloy steels, mild steel pressed components, high tensile, precision grade bolts and nuts, screws, rivets, wheels, stampings, transformer laminations and special fasteners for automotive, general engineering, fertilizers, chemicals, petrochemical, railways and electrical appliances. However over the last five years the company has ceased to manufacture most of the products and is currently manufacturing only screws, rivets and safety pins, high speed steel and alloy steel. The promoters and public hold 42% and 33% respectively of the equity capital of GKW, while the balance is held by institutions, private corporate bodies and NRIs. GKW was registered as a BIFR company in April 2000 and is currently going through the rehabilitation scheme which entails meeting the liabilities of secured creditors and labour as well as infusion of working capital.

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KEY FINANCIALS

Key Financials	FY 05	FY 04	FY 03
Net Sales	754.7	654.4	573.3
Operating Income (OI)	765.8	668.9	592.3
OPBDIT	-3.4	-33.3	-83.0
PAT	-235.9	-254.8	-277.1
Equity Capital	296.7	296.7	296.7
Net Worth	-975.4	-741.8	-489.1
PAT/OI	-30.8%	-38.1%	-46.8%
PBIT/(Total Debt+Net Worth+Def Tax Liability)	-16.1%	-16.9%	-18.2%
OPBDIT/Int & Financial Charges	-0.02	-0.20	-0.55
Net Cash Accruals/Total Debt	-0.11	-0.13	-0.17
Total Debt/Net Worth	-1.44	-1.68	-2.32
Current Ratio	0.32	0.29	0.30

Note: Amounts in Rs. Million

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