KEMS Forgings Limited

December 20, 2018

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term – Fund-based (OD)	20.00	25.00	[ICRA]BBB (Positive) reaffirmed; Outlook revised to Positive from Stable
Short Term – Fund-based	8.65	3.65	[ICRA]A3+; reaffirmed
Total	**28.65**	**28.65**	

*- Instrument details are provided in Annexure-1.

Rationale

The revision in outlook on the long-term rating considers KFL's healthy revenue growth in FY2018 and H1 FY2019, driven by robust demand from the end-user industries and better sales realisation. The ratings draw comfort from the extensive experience of the promoters and the management in the forging industry coupled with strong association with its reputed clientele, which support KFL's long-term business sustainability and growth prospects. Besides, the company's ability to pass on any increase in raw material prices to most of its customers resulted in steady contribution levels over the years. The ratings factor in KFL's regular capex towards capacity addition and improvement in capacity utilisation over the last three years, driven by new product development, new customer addition and higher business traction from the existing customers. ICRA takes cognisance of KFL's recent steps towards improving its working capital cycle through efficient inventory management and better collection cycle, which are likely to reduce its working capital requirements.

The ratings are, however, constrained by the company's moderate scale of operations that restrict operational and financial flexibility to some extent. The ratings are also constrained by deterioration in the capital structure and the coverage indicators on account of sizeable debt-funded capital expenditure incurred in FY2018. Although the company has been making efforts to diversify its revenue streams by adding new customers, the customer concentration risks remain moderately high with top-five customers accounting for ~54% of the revenues in FY2018. Further, KFL's operations continue to remain exposed to cyclicality in the automobile and construction equipment sectors as these contribute to more than 85% of the total revenues. Going forward, KFL's ability to conclude the capex within the budgeted cost and time and achieve healthy revenue growth supported by adequate utilisation of the enhanced capacity would be the key rating sensitivities.

Outlook: Positive

The Positive outlook reflects ICRA's expectation that the company will be able to generate healthy cash accruals in the near to medium term, supported by enhancement in capacity, diversification of product offerings and stable demand outlook for the end-user segments. The ratings may be upgraded if the company is able to achieve healthy utilisation levels for the enhanced capacity, resulting in growth in revenue and profits on expected lines. Conversely, the outlook may be revised to Stable if any significant reversal in the industry dynamics leads to slowdown in sales, or higher-than-anticipated capital expenditure or deterioration in the working capital cycle weakens the debt metrics of the company.

Key rating drivers

Credit strengths

Established track record of the promoters in the forging business – KEMS Forgings Limited, incorporated in 1970 as Sree Lakshmi Industrial Forge and Engineers Limited, was acquired by the existing promoters in 1990 and renamed it to KFL in 2010. Mr. S. K. Gandhi, the Chairman of the company, has over four decades of experience in the steel industry through KFL and its Group entities, KEMS Auto Components Limited (KACL) and Southern Steels and Forgings (SSF). Long track record of the company in manufacturing forged components and the presence of an experienced management are expected to drive KFL's growth.

Healthy growth in revenues in FY2018 and the current fiscal – KFL recorded a healthy revenue growth in FY2018 (~20% YoY) and in H1 FY2019, driven by higher volumes from the existing customers, new customer additions and better sales realisation.

Established business relationships with reputed clientele – KFL's long-term association and healthy business relationship with the original equipment manufacturers (OEMs) and tier-1/tier-2 suppliers in the automobile and construction equipment segments lend business support. Moreover, KFL's ability to add new customers and develop new components coupled with stable long-term demand prospects for its key end-user industries, support growth prospects.

Pass-through clauses for changes in raw material prices – The company's operating margins remained range bound between 9% and 11% over the last few years, and marginally improved to 9.5% in FY2018 from 9.0% in FY2017. KFL's margins are protected from raw material price fluctuation risk, backed by pass-through arrangements with its customers. With the company entering into open access solar power purchase arrangement at a lower cost in August 2018, its operating profitability and cash accruals are expected to improve going forward.

Credit challenges

Moderate capital structure and coverage indicators – In FY2018, KFL incurred significant debt-funded capex towards capacity expansion and purchase of a commercial plot for setting up its own office building. With this, the capital structure and debt protection metrics deteriorated in FY2018, notwithstanding the improved profitability and cash accruals. With the planned capex of ~Rs. 20.0 crore (to be funded in a 3:1 debt: equity ratio) to be incurred in FY2019 towards setting up of a forging unit at Hosur in Tamil Nadu, capacity expansion at its existing units and construction of office building, the capital structure and the coverage indicators are likely to remain moderate in the near term. However, healthy accruals, low average funding cost and favourable repayment tenure provide some comfort. KFL's ability to ramp up its operations in a timely manner would be important for maintaining healthy profitability and coverage indicators, going forward.

Sector concentration risk – A significant portion (>85%) of the company's revenue is derived from the automobile and construction equipment (including hydraulics) segments, leading to industry concentration risks and 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 54% of its total sales in FY2018. However, the risk is partially mitigated on account of resilient business ties with the fundamentally strong customers and consistent addition of new customers.

Liquidity Position

KFL's liquidity position remains adequate with positive fund flow from operations in FY2018 and moderate fund-based working capital utilisation of 83% of the sanctioned limits and 65% of drawing power during October 2017 to September 2018. However, with significant capex towards capacity expansion and purchase of commercial plot, the free cash flows stood negative in FY2018. Notwithstanding a substantial capex outgo in FY2019 primarily towards capacity addition and sizeable debt repayment obligations, KFL's liquidity position is likely to remain adequate, supported by fresh term loan sanction of Rs. 15.0 crore in FY2019 and healthy cash accruals.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Auto Component Suppliers
Parent/Group Support	Not Applicable
Consolidation / Standalone	The ratings are based on standalone financial profile of the company

About the company:

KEMS Forgings Limited, a part of the Gandhi Group, was established in 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 Chairman, Mr. Manish Gandhi, the Managing Director, Mr. Kushal Gandhi (Marketing and Sales Director) and Mr. Deepak Gandhi (Procurement Director) along with family and Group companies hold 100% equity stake in KFL as on September 30, 2018. Incorporated in 1970 as Sree Lakshmi Industrial Forge and Engineers Limited, it was acquired by the existing promoters in 1990 and was renamed to KFL in 2010.

KFL manufactures steel forgings, primarily catering to the automotive and construction equipment industries. At present, KFL has three manufacturing facilities located in Attibele and Hoskote area of Bangalore and Sriperumbudur in Chennai with a combined installed capacity of 37,600 MT (metric tonne) per annum. The company is setting up its fourth unit at Hosur in Tamil Nadu with an installed capacity of 12,000 MT per annum, which is likely to commence operations from April 2019. KACL manufactures precision machine components and assemblies for the automotive industry. SSF trades in steel products and is an authorised 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 FY2018, the company reported a net profit of Rs. 5.1 crore on an operating income of Rs. 225.4 crore compared to a net profit of Rs. 2.8 crore on an operating income of Rs. 187.8 crore in the previous year.

Key financial indicators (Audited)

	FY 2017	FY 2018
Operating Income (Rs. crore)	187.8	225.4
PAT (Rs. crore)	2.8	5.1
OPBDIT/ OI (%)	9.0%	9.5%
RoCE (%)	14.8%	16.7%
Total Debt/ TNW (times)	1.3	1.5
Total Debt/ OPBDIT (times)	2.8	3.1
Interest coverage (times)	3.4	4.0

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs crore)	Date & Rating Dec 2018	Chronology of Rating History for the past 3 years Date & Rating in FY2018 Nov 2017	Date & Rating in FY2017 -	Date & Rating in FY2016 -
1	Fund-based facilities (OD)	Long Term	25.0	-	**[ICRA]BBB (Positive)**	[ICRA]BBB (Stable)	-	-
2	Fund-based facilities (BD)	Short Term	3.65	-	**[ICRA]A3+**	[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

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	Overdraft	NA	NA	NA	25.00	[ICRA]BBB (Positive)
NA	Bill Discounting	NA	NA	NA	3.65	[ICRA]A3+

Source: KFL

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