

May 11, 2020

Kirloskar Ferrous Industries Limited: Ratings assigned to enhanced amount

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper	100.00	100.00	[ICRA]A1+; outstanding
Fund-based - Term Loan	195.00	220.00	[ICRA]AA-(Stable); Assigned/Outstanding
Fund-based - Working Capital Facilities	455.00	455.00	[ICRA]AA-(Stable)/ [ICRA]A1+; outstanding
Non-fund Based - Working Capital Facilities	690.00	690.00	[ICRA] AA-(Stable)/ [ICRA]A1+; outstanding
Total	1,440.00	1,465.00	

*Instrument details are provided in Annexure-1

Rationale

The ratings derive comfort from the established position of Kirloskar Ferrous Industries Limited (KFIL) in foundry-grade pig iron manufacturing and ferrous castings. ICRA notes its backward integration measures to limit the price volatility in raw materials (iron ore and coking coal), which are expected to fructify in the near term, and healthy financial profile. The company is part of the reputed Pune-based Kirloskar Group with a proven management track record. The company had undertaken cost optimisation capital expenditure (capex) by installing a coke oven plant (for converting coal into coke), which is expected to reduce its exposure to the volatility in coke prices. The waste gas generated by the oven will be harnessed by a 20-MW power plant, which will generate additional power and fuel savings for the Hospet (Karnataka) facility. The coke oven plant was commissioned on March 31 1, 2020, and the power plant will become operational after the nationwide lockdown is lifted. The company was also declared as the preferred bidder for two iron ore mines in Karnataka, which will further facilitate cost control and ensure a regular iron ore supply. However, the company is still to receive all regulatory approvals to start the mines and is expecting to receive them in the current year. KFIL continues to have a comfortable capital structure with a low gearing of 0.2 time as on March 31, 2019, and adequate liquidity position characterised by modest cash accruals and sizeable unused bank lines.

ICRA also notes the impact of the novel coronavirus (COVID-19) outbreak on the company. Following the rapid proliferation of the disease around the globe, governments across geographies have resorted to lockdowns. ICRA expect the revenue to be significantly impacted by the nationwide lockdown in FY2021. However, expected cost saving in r material and power cost from the coke oven and power plant is expected to help KFIL generate adequate internal accruals and service its debt obligations.

The rating strengths are partially offset by the vulnerability of the operating margins to fluctuating raw material prices, given the commoditised nature of the business. The ratings are also constrained by the casting division's exposure to an inherent demand cyclicity in the key end-user segments (both commercial vehicle and tractor segments) that impacted past operating performance, and a relatively high customer concentration. However, this risk is mitigated to some extent by KFIL's established relationships with large original equipment manufacturers (OEMs) and its healthy share of their business. ICRA also notes KFIL's exposure to foreign currency movement,

given the sizeable imports; although, the company adopts conservative hedging policies to minimise the impact of any forex risk.

The Stable outlook on the [ICRA]AA- rating reflects ICRA's opinion that KFIL will continue to benefit from its long track record of operations, healthy financial risk profile, and extensive management experience.

Key rating drivers and their description

Credit strengths

One of the leading pig iron players in the domestic market - KFIL is one of the leading players in foundry-grade pig iron manufacturing and ferrous castings in the domestic market. It has an established performance record over the years. The company is a part of the reputed Pune-based Kirloskar Group, with a presence across diversified business segments and a proven management track record. The company has a competitive cost structure for pig iron manufacturing, because of the presence of its sinter plant and hot blast stoves.

Backward integration to enable control of raw material costs - The company has installed a coke oven plant to convert coal into coke, which will reduce its dependence on imported coke and exposure to volatility. In 2018, KFIL was declared the preferred bidder of two iron ore mines in Karnataka. This will ensure a regular supply of iron ore and fulfil a part requirement of raw material once the mines are functional. In the casting division, the Hospet foundry enjoys the benefit of backward integration in the form of ready availability of molten pig iron.

Established relationships with OEMs help increase casting volumes - KFIL enjoys established relationships with OEMs for its castings, as well as a healthy share of their businesses. Over the last few years, consistent addition of clients led to an improvement in the casting volumes. Coupled with an increasing share of machined casting, this will help the company improve the profitability of this division.

Comfortable debt protection metrics - KFIL maintained a strong financial profile with a gearing of 0.2 time and TD/OPBDITA of 0.6 time in FY2019. The company's liquidity profile also remained comfortable with modest accruals and sizeable unused bank lines, which further helped its financial flexibility. The company has undertaken sizable capex in FY2020, partly funded by debt, for its coke oven and 20-MW power plant. KFIL plans to defer its other capex plans related to capacity expansion till the demand improves in the industry. ICRA expects the company to maintain comfortable debt protection metrics in the medium term, supported by significant cost savings from these projects.

Credit challenges

Raw material price volatility and foreign currency movement risks - Raw materials account for a major portion of the operational cost for pig iron players, including KFIL, and are thus important determinants of profitability. Since the pig iron business is cyclical in nature, it is exposed to margin risks arising from temporary mismatches in the prices of raw materials and pig iron, causing volatility in profitability and cash flows. Going forward, the company's planned backward integration facilities will help reduce such a risk to an extent. Given the sizeable imports, KFIL's profitability remains exposed to foreign currency movements. The company, however, adopts conservative hedging policies to minimise the impact of forex volatility.

Casting division performance exposed to inherent cyclicality in key end-user segments - KFIL's casting division derives ~90% of sales from its commercial vehicle and tractor segments, which are both exposed to inherent

demand cyclicality. Any sustained weak demand from its key end-user segments, as witnessed in recent months, would adversely impact its revenues and earnings profile.

Client concentration risk in casting division - The company faces client concentration risk in the casting division. The top customer generates ~29% of its casting revenues, while its top five customers drive ~74% of the same. However, the company has a healthy share of business with its key customers, and in the last few years, it added new clients to its portfolio. This mitigates the client concentration risk to some extent.

Liquidity position: Adequate

KFIL's liquidity is adequate with unutilised working capital limits of about Rs. 57 crore as of March 31, 2020, and cash and cash equivalent of about Rs. 5.8 crore as of end February 2020. The company's fund flow from operations in FY2021 will be supported by expected cost saving from its coke oven and new 20-MW power plant, which will cushion the impact of the ongoing nationwide lockdown on accruals to an extent. KFIL has debt repayments of Rs. 70.5 crore due in FY2021.

Overall, ICRA expects KFIL to be able to meet its near-term commitments through internal as well as external sources of liquidity.

Rating sensitivities

Positive triggers - ICRA could upgrade KFIL's rating if its capex plans achieve the desired level of returns with ROCE above 20% and TD/OPBITDA lower than 1.5 times on a sustained basis.

Negative triggers - Negative pressure on KFIL's ratings could arise if profitability and cash accrual are lower than expected due to volatility in raw material prices and weak demand for automotive castings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Ferrous Metals Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on standalone financial statements of the rated entity.

About the company

KFIL, incorporated in 1991, is a part of the Pune-based Kirloskar Group. KFIL manufactures pig iron, and ferrous castings such as cylinder blocks, cylinder heads, and transmission parts, and different types of housings required by automobile, tractor and diesel engine industries. KFIL's plants in Koppal (Karnataka) and Solapur (Maharashtra) have a combined casting manufacturing capacity of 1,50,000 metric tonne per annum (MTPA). It also has a combined pig iron manufacturing capacity of 3,91,400 MTPA at its Koppal plant. KFIL has three steam turbines with a total power cogeneration capacity of 11.5 MW in its Koppal facility, and a newly installed 10-MW solar power plant at its Solapur facility, which became operational in October 2018.

In FY2019, as per the audited financials, the company reported a net profit of Rs. 98.1 crore on an operating income of

Rs. 2,159.2 crore, as compared to a net profit of Rs. 38.0 crore on an operating income of Rs. 1,765.2 crore in the previous year. In H1 FY2020, as per the unaudited financials, the company reported net profit of Rs. 31.6 crore on an operating income of Rs. 947.9 crore.

Key financial indicators (audited)

	FY2018	FY2019	H1 FY2020
Operating Income (Rs. crore)	1,765.2	2,159.2	947.9
PAT (Rs. crore)	38.0	98.1	31.6
OPBDIT/OI (%)	6.6%	10.3%	9.3%
RoCE (%)	9.2%	22.7%	15.9%
Total Outside Liabilities/Tangible Net Worth (times)	1.0	1.1	1.1
Total Debt/OPBDIT (times)	0.6	0.6	1.4
Interest Coverage (times)	10.6	13.5	8.9
DSCR (excluding short-term debt)	9.2	10.9	4.9

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Type	FY2021		Rating History for the Past 3 Years					
			Amount Rated	Amount Outstanding	Current Rating	FY2020		FY2019		FY2018
						11-May-2020	13-Dec-2019	9-Sep-2019	13-Nov-2018	4-Oct-2018
1	Commercial Paper	Short Term	100.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	Term Loan	Long Term	220.0	220.0	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)
2	Cash Credit/WCDL	Long Term/ Short Term	455.0	-	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+
4	Letter of Credit and Bank Guarantee	Long Term/ Short Term	690.0	-	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+	[ICRA]AA-(Stable)/[ICRA]A1+

Amount in Rs. crore

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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Commercial Paper	NA	NA	-	100.00	[ICRA]A1+
NA	Term Loan 1	June-2018	8.70%	May- 2022	30.00	[ICRA]AA-(Stable)
NA	Term Loan 2	Apr-2019	8.90%	Mar-2024	70.00	[ICRA]AA-(Stable)
NA	Term Loan 3	Aug-2019	8.25%	Jul-2023	20.00	[ICRA]AA-(Stable)
NA	Term Loan 4	Oct-2019	8.10%	Sep-2023	30.00	[ICRA]AA-(Stable)
NA	Term Loan 5	Nov-2019	8.15%	Aug-2024	30.00	[ICRA]AA-(Stable)
NA	Term Loan 5	Mar-2020	7.85%	Sep-2024	40.00	[ICRA]AA-(Stable)
NA	Fund based Bank Facilities	NA	NA	NA	455.00	[ICRA]AA-(Stable) [ICRA]A1+
NA	Letter of Credit and Bank Guarantee	NA	NA	-	690.00	[ICRA]AA-(Stable) [ICRA]A1+

Source: Kirloskar Ferrous Industries Limited

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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