October 05, 2020

Kirloskar Ferrous Industries Limited: Ratings reaffirmed

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+; reaffirmed
Fund-based - Term Loan	220.00	220.00	[ICRA]AA-(Stable); reaffirmed
Fund-based - Working Capital Facilities	455.00	455.00	[ICRA]AA-(Stable)/[ICRA]A1+; reaffirmed
Non-fund Based - Working Capital Facilities	690.00	690.00	[ICRA] AA-(Stable)/[ICRA]A1+; reaffirmed
Total	**1,465.00**	**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 the 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. It had undertaken cost optimisation capital expenditure (capex) in FY2020 by installing a coke oven plant (for converting coal into coke), which is expected to reduce its exposure to the volatile 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 Koppal (Karnataka) plant. The company is also expected to benefit from the allocation of two iron ore mines in Karnataka in the medium term with respect to cost control and regular iron ore supply. KFIL continues to have a comfortable capital structure with a low gearing of 0.4 times as on March 31, 2020, and adequate liquidity position characterised by adequate cash accruals and sizeable unused bank lines.

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

The ratings are partially offset by the vulnerability of the company's operating margins to fluctuating raw material prices, given the commoditised nature of the business. The ratings are constrained by the casting division's exposure to the inherent demand cyclicality in the key end-user segments (both commercial vehicle and tractor segments) that impacted its past operating performance, along with a relatively high customer concentration risk. However, this risk is mitigated to some extent by KFIL's established relations with large original equipment manufacturers (OEMs) and healthy share of business. ICRA notes KFIL's exposure to foreign currency movement, considering its sizeable imports of raw materials. However, the company adopts conservative hedging policies to minimise the impact of forex risk.

The Stable outlook on the rating reflects ICRA's opinion that KFIL will continue to benefit from its established 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 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 track 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. It 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 commissioned 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 through e-auction of iron ore mines conducted by the Government of Karnataka for two iron ore mines situated 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 Koppal foundry enjoys the benefit of backward integration in the form of ready availability of molten pig iron.

Favourable financial risk profile – KFIL maintained a strong financial profile with a gearing of 0.4 times and TD/OPBDITA of 1.4 times in FY2020. The company's liquidity profile remains comfortable with modest accruals and sizeable unused bank lines, which further help its financial flexibility. It has undertaken sizeable capex in FY2020, partly funded by debt, for coke oven and 20-MW power plant, which has impacted the debt protection metrics. However, the same remains healthy. ICRA expects the company to maintain comfortable debt protection metrics in the near to 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. The backward integration facilities available with the company, mitigates the 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 about ~89% of sales from commercial vehicle and tractor segments, which are both exposed to the inherent demand cyclicality. Any sustained weak demand from its key end-user segments, as witnessed in the recent past, 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 ~22% of its casting revenues, while the top five customers drive ~70% of the same. However, KFIL has a healthy share of business with its key customers. Over the last few years, it has added new clients to its portfolio. This mitigates the client concentration risk to some extent.

Liquidity position: Adequate

KFIL's liquidity is **adequate** with expected healthy cash flow from operations of nearly Rs. 180.0-200.0 crore, a capex commitment of about Rs. 250 crores in FY2021 (which will be partly funded by debt) and moderate working capital utilisation levels. It has debt repayments of Rs. 70.5 crore in FY2021.

Overall, ICRA expects KFIL to be able to meet its near-term commitments through internal as well as external sources of cash, and yet be left with sufficient cash surpluses.

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 is lower than 1.5 times on a sustained basis.

Negative triggers – Negative pressure on KFIL's ratings could arise due to weakening of profitability and liquidity owing 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 capacity of 1,50,000 metric tonne per annum (MTPA). It has a combined pig iron capacity of 3,91,400 MTPA at its Koppal plant.

In FY2020, as per the audited financials, the company reported a net profit of Rs. 112.4 crore on an operating income (OI) of Rs. 1,849.7 crore compared to a net profit of Rs. 98.1 crore on an OI of Rs. 2,159.2 crore in the previous year. In Q1 FY2021, as per the limited reviewed financials, it reported a net loss of Rs. 17.1 crore on an OI of Rs. 213.0 crore.

Key financial indicators (audited)

	FY2019	FY2020
Operating Income (Rs. crore)	2,159.2	1,849.7
PAT (Rs. crore)	98.1	112.4
OPBDIT/OI (%)	9.9%	11.7%
PAT/OI (%)	4.5%	6.1%
Total Outside Liabilities/Tangible Net Worth (times)	1.1	1.2
Total Debt/OPBDIT (times)	0.6	1.4
Interest Coverage (times)	13.0	12.5

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	Previous Rating	FY2020		FY2019		FY2018
					5-oct -2020	11-May-2020	13-Dec-2019	9-Sep-2019	13-Nov-2018	4-Oct-2018	21-Sep-2017
1	Commercial Paper	Short Term	100.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	Term Loan	Long Term	220.0	202.9	[ICRA]AA-(Stable)	[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+	[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+	[ICRA]AA-(Stable)/ [ICRA]A1+

Source: Company;Amount in Rs. crore; Amount outstanding as on June 30,2020

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	7.45%	May- 2022	30.00	[ICRA]AA-(Stable)
NA	Term Loan 2	Apr-2019	7.90%	Mar-2024	70.00	[ICRA]AA-(Stable)
NA	Term Loan 3	Aug-2019	6.77%	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	7.15%	Aug-2024	30.00	[ICRA]AA-(Stable)
NA	Term Loan 6	Mar-2020	7.15%	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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About ICRA Limited:

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