ICRA

Kirloskar Ferrous Industries Limited

November 13, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper	100.00	100.00	[ICRA] A1+; reaffirmed
Term loan	0.00	60.00	[ICRA] AA- (stable); reaffirmed
Fund Based Facilities	455.00	455.00	[ICRA] AA- (stable)/[CRA] A1+; reaffirmed
Non-Fund Based Facilities	690.00	690.00	[ICRA] AA- (stable)/[CRA] A1+; reaffirmed
Unallocated	11.00	0.00	-
Total	**1256.00**	**1305.00**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed a long-term rating of [ICRA] AA- (pronounced ICRA AA minus) with a Stable outlook to the Rs. 60 crore term loan facility of Kirloskar Ferrous Industries Limited. ICRA has also reaffirmed the long-term rating of [ICRA]AA- (pronounced ICRA double A minus) with a Stable outlook and the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) for the Rs. 455.00 crore fund-based and the Rs. 690.00 crore non-fund based bank facilities. ICRA has reaffirmed the short-term rating of [ICRA] A1+ for the Rs. 100.00 crore commercial paper programme of Kirloskar Ferrous Industries Limited. (KFIL)

Rationale

The ratings reaffirmation derive comfort from the established position of KFIL in foundry grade pig iron manufacturing and ferrous castings, backward integration measures to limit the price volatility in raw materials (iron ore and coking coal) which are expected to fructify in the medium term coupled with healthy financial profile. The company is a part of the reputed Pune-based Kirloskar Group with a proven management track record. ICRA notes the healthy ferrous castings demand outlook for the tractor and automotive segment, which forms majority of the end-user segment for KFIL's ferrous castings division. The ratings also factor in the established relationships with original equipment manufacturers (OEMs) for manufactured castings along with the healthy share of business. KFIL's operating income witnessed healthy growth of 35% in FY2018 led by increase in pig iron and foundry volumes. The company is undertaking cost optimisation capital expenditure by installing a coke oven plant (convert coal into coke) that is expected to reduce the company's exposure to the volatility in coke prices. This waste gas emitted by the oven will be harnessed by a 20 MW power plant that will result in additional power and fuel savings for the Hospet (Karnataka) facility. The company was also declared as the preferred bidder in the iron ore mine auction in Karnataka that will further facilitate cost control and ensure regular supply of iron ore. Moreover, the foundry in Hospet enjoys the benefits of backward integration in the form of ready availability of molten pig iron. The company continues to have a comfortable capital structure with low gearing of 0.1x as on March 31, 2018 and comfortable liquidity position characterised by modest cash accruals and sizeable unused bank lines.

The rating strengths are partially offset by vulnerability of the operating margins to fluctuating raw material prices, given the commoditised nature of the business. The operating margins of the company remained volatile in Q1 FY2018 owing to sudden increase in raw material prices though recovered in the ensuing quarters as they were passed with lag effect. With capital expenditure of Rs. 250.0-300.0 crore expected over the next two years that will be partly funded through debt, the gearing, coverage ratios and cash flows will be impacted to some extent, although remain comfortable. KFIL also faces client concentration risk in the ferrous castings division with its top customer driving ~37% of the foundry revenues (44% of foundry revenues in FY2017) with the top five customers accounting for ~76% of the casting revenues. However, the client concentration risk is mitigated to some extent by a healthy share of business with key clients and addition of new clients over the years. ICRA also notes the company's exposure to foreign currency movement, given the sizeable imports; although the company adopts conservative hedging policies to minimise the impact of forex risk.

Outlook: Stable

ICRA believes KFIL will continue to benefit from its healthy financial profile and the extensive experience of its management. The outlook may be revised to Positive if operating efficiencies improve, increase in share of value-added castings and sustained growth in accruals. The outlook may be revised to Negative if cash accrual is lower than expected due to continued fluctuations in raw material prices.

Key rating drivers

Credit strengths

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

Healthy casting demand outlook; established relations with OEMs – In the casting division, the company primarily caters to the passenger vehicle (PV), tractor and commercial vehicle (CV) segments. With healthy demand outlook of the CV and the tractor segment in the near to medium term, the revenue growth prospects for the casting division remains healthy. Coupled with increasing share of value-added castings, this is expected to improve the profitability of the division, going forward. KFIL has established relations with OEMs for castings manufactured and has a healthy share of their business. In the past few years, consistent addition of new clients has led to the improvement in casting volumes.

Backward integration to enable control of raw material costs – Increasing coke and iron ore prices adversely impacted the margins of KFIL in FY2018. The company is installing a coke oven plant to convert coal into coke, which will reduce its dependence on imported coke and exposure to volatility. In September 2018, KFIL was declared as the preferred bidder of an iron ore mine in Karnataka that will ensure regular supply of iron ore and fulfil part requirement of raw material once the mine is functional. In the casting division, the Hospet foundry enjoys the benefit of backward integration in the form of ready availability of molten pig iron.

Comfortable capital structure and liquidity profile – KFIL has a comfortable capital structure with no long-term debt and a low gearing of 0.1x as on March 31, 2018. The liquidity profile of the company remains comfortable with modest accruals and sizeable unused bank lines that further helps the financial flexibility of the company. KFIL has been generating positive free cash flows during the last three years. The capital and coverage ratios are expected to remain comfortable despite debt funded capex plans in the medium term for capacity expansion.

Credit challenges

Raw material price volatility risk – Owing to the commoditized nature of the business, the operating margins of the company remain vulnerable to fluctuations in raw material prices as witnessed in FY2018. The operating margins of the company had significantly reduced in Q1 FY2018 on account of a sharp increase in coke costs. However, the margins partially recovered in the ensuing quarters due to increased realisations of pig iron (pass through of same with lag effect) and stabilisation of raw material costs. In H1 FY2019, the operating margins improved to 9.9% (6.2% in H1 FY2018) led by moderation in raw material prices and improvement in pig iron market prices led by higher demand for same.

Client concentration risk in the casting division – The company faces client concentration risk in the casting division. The top customer contributes ~37% to its casting revenues, while the share of its top five customers is ~76%. However, the company has a healthy share of business with its key customers, and in the past few years, it has added new clients to its portfolio. This mitigates the client concentration risk to some extent.

Foreign currency movement risk – Given the sizeable imports, the profitability of the company remains exposed to foreign currency movement. The company, however, adopts conservative hedging policies to minimise the impact of forex volatility.

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

Links to applicable criteria:

Rating Methodology for Entities in the Ferrous Metals Industry
Corporate Credit Rating Methodology

About the company:

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

Key financial indicators (audited)

	FY2017	FY2018	H1 FY2019
Operating Income (Rs. crore)	1275.9	1725.4	1036.6
PAT (Rs. crore)	87.8	38.0	37.5
OPBDIT/OI (%)	13.6%	6.7%	9.9%
RoCE (%)	18.6%	9.2%	19.2%
Total Debt/TNW (times)	0.2	0.1	0.2
Total Debt/OPBDIT (times)	0.6	0.6	0.5
Interest coverage (times)	16.5	10.6	13.7

Note- All numbers including FY2017 have been stated as per Indian Accounting Standards (IND AS) enforced since April 01, 2018

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 Nov 2018	Date & Rating Oct 2018	Chronology of Rating History for the Past 3 Years: Date & Rating in FY2018 Sept 2017	Date & Rating in FY2017 Aug 2016	Date & Rating in FY2016 Aug 2015
Fund based facility	Long-term/ Short-term	455.00	455.00	[ICRA] AA- (stable)/ [ICRA] A1+; reaffirmed	[ICRA] AA- (stable)/ [ICRA] A1+	[ICRA] AA- (stable)/ [ICRA] A1+	[ICRA] AA- (stable)/ [ICRA] A1+	[ICRA] AA- (stable)/ [ICRA] A1+
Term Loan	Long term	60.00	60.00	[ICRA] AA- (stable)			[ICRA] AA- (stable)	[ICRA] AA- (stable)
Unallocated	Long-term	-	-	-	[ICRA] AA- (stable)	[ICRA] AA- (stable)	-	-
Non-fund based facility	Long-term/Short-term	690.00	690.00	[ICRA] AA- (stable)/ [ICRA] A1+; reaffirmed	[ICRA] AA- (stable)/ [ICRA] A1+	[ICRA] AA- (stable)/ [ICRA] A1+	[ICRA] AA- (stable)/ [ICRA] A1+	[ICRA] AA- (stable)/ [ICRA] A1+
Commercial paper	Short Term	100.00	100.00	[ICRA] A1+; reaffirmed	[ICRA] A1+	[ICRA] A1+	[ICRA]A1+	[ICRA]A1+

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	Commercial Paper	NA	NA	-	100.00	[ICRA] A1+
NA	Term Loan 1	Apr 2018	7.25%	Apr 2020	15.00	[ICRA] AA- (stable)
NA	Term Loan 2	Jun 2018	8.75%	May 2022	45.00	[ICRA] AA- (stable)
NA	Working Capital Facility	NA	NA	NA	455.00	[ICRA] AA- (stable)/ A1+
NA	Non-Fund Based Facility	NA	NA	NA	690.00	[ICRA] AA- (stable)/ A1+

Source: Company

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About ICRA Limited:

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Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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