

December 15, 2022

Kirloskar Ferrous Industries Limited: Rating reaffirmed; outlook revised to Stable from Negative; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term - Fund-based - Term Loan	373.26	307.92	[ICRA]AA(Stable); reaffirmed and outlook revised to Stable from Negative
Long-term/Short-term – Fund-based	316.33	430.00	[ICRA]AA(Stable)/[ICRA]A1+; assigned/reaffirmed and outlook revised to Stable from Negative
Long-term/Short-term - Non-fund Based	860.00	1,830.00	[ICRA]AA(Stable)/[ICRA]A1+; assigned/reaffirmed and outlook revised to Stable from Negative
Commercial Paper	550.00	550.00	[ICRA]A1+; reaffirmed
Commercial Paper	100.00	-	[ICRA]A1+; reaffirmed and withdrawn
Non-Convertible Debentures	250.00	250.00	[ICRA]AA(Stable); reaffirmed and outlook revised to Stable from Negative
Long-term/Short-term - Unallocated	-	32.08	[ICRA]AA(Stable)/[ICRA]A1+; assigned
Total	2,449.59	3,400.00	

*Instrument details are provided in Annexure-1

Rationale

The revision in the outlook on the long-term rating of Kirloskar Ferrous Industries Limited (KFIL or the company) factors in the expected improvement in its credit metrics following the turnaround of operations of its subsidiary, ISMT Limited (ISMT; rated [ICRA]A-(Stable)/A2+). In Q1 and Q2 of FY2023, ISMT reported a YoY revenue growth of 30% and 25% respectively aided by increased volumes and realisations and the operations turned profitable at the operating and net levels owing to various cost-saving initiatives/corrective measures undertaken by the company. The debt coverage indicators of KFIL (consolidated including ISMT), which had moderated as on March 31, 2022, post the largely debt-funded acquisition of ISMT, would improve going forward, with an expected consolidated net debt vis-à-vis the operating profit ratio of 1.1 times as on March 31, 2023. The Board of Directors of KFIL and ISMT approved the Scheme of Arrangement and Merger of ISMT into KFIL w.e.f. April 01, 2023 (appointed date). The merger (subject to regulatory and other approvals) is likely to benefit KFIL in terms of increased scale of operations, expanded reach, product diversification, among others. The company's ability to further scale up operations of ISMT and improve profitability by reducing its power costs and other overheads remains key rating factors, going forward.

The ratings favorably factor in the established position of KFIL in the foundry-grade pig iron and ferrous castings business. The company is a part of the reputed Pune-based Kirloskar Group, which has a proven management track record. The ratings derive comfort from the backward integration achieved through coke oven plant and captive power generation, which in turn leads to cost savings. ICRA notes that once the Phase II of the coke oven and power plant gets operational in Q4 FY2023, it will lead to further cost savings and provide impetus to margins. The cost structure would also improve once the captive iron ore mines become operational.

In H1 FY2023, KFIL reported revenues of Rs. 2,108.4 crore with an operating profit margin (OPM) of 14.3% at the standalone level, despite the macro-economic headwinds and volatile price environment. While the consumption of high-cost coking coal impacted the profitability in the pig iron division in H1 FY2023, the same was largely offset by high margins in the castings division given the elevated sales realisations and healthy demand from key end-user industries such as automobile, tractor,

and diesel engines. In H2 FY2023, the profitability in the pig iron division is likely to improve given the sharp decline in coking coal prices, despite a decline in pig iron realisations. The strong demand in the castings division and elevated sales realisations will continue to support the operating performance of the company.

Besides the Phase II of coke oven and power plant, the company has capital expenditure (capex) plans in FY2023 and FY2024 to install bell-less top for blast furnaces and introduce pulverised coal injection (to reduce coke consumption and improve operational efficiency). Given the strong demand from the auto industry, the company also plans to increase its casting capacity by 40,000 MTPA¹ at Solapur (Maharashtra). The total capex outlay for the above is pegged has been ~Rs. 550 crore, of which ~Rs. 288 crore has been incurred in H1 FY2023 and largely funded through internal accruals. The balance capex of ~Rs. 262 crore will be incurred over H2 FY2023 and FY2024 and is expected to be largely funded through internal accruals. While these would keep the free cash flows under check in the near term, ICRA expects the cost savings from such projects to support the company's operating profitability in the medium-to-long term.

The ratings also factor in KFIL's established relationships with large original equipment manufacturers (OEMs). ICRA notes the high customer concentration in the castings segment, though it derives comfort from the fact that KFIL is the single source supplier in most of these cases, which leads to customer stickiness.

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 pig iron business. The ratings are constrained by the casting division's exposure to the inherent demand cyclicity in the key end-user segments (both commercial vehicle and tractor segments) that had impacted its past operating performance. ICRA notes the company's exposure to foreign currency movement, considering its sizeable imports of coking coal. However, the company adopts conservative hedging strategies to minimise the impact of the forex risk.

ICRA has reaffirmed and withdrawn rating assigned to Rs. 100-crore commercial paper programme of KFIL. The rating is withdrawn in accordance with ICRA's policy on withdrawal at the request of the company as there is no amount outstanding against the rated instrument.

Key rating drivers and their description

Credit strengths

Status as one of the leading pig iron players in the domestic market and a healthy market share in castings segment – KFIL is one of the leading manufacturers of foundry grade pig iron and ferrous castings in the domestic market. As per the company's management, KFIL has a healthy market share of 40-42% in the foundry grade pig iron and 19-20% in the castings segment. The company is a part of the reputed Pune-based Kirloskar Group, which has presence across diversified business segments and a proven management track record. The company has a competitive cost structure for pig iron manufacturing because of its sinter plant, coke oven plant (phase II under progress), captive power plant and hot blast stoves which support its margins. The company has diversified its product offerings with acquisition of ISMT, which is one of India's leading manufacturers of seamless tubes.

Backward integration achieved through coke and captive power generation – KFIL commissioned a 200,000-MTPA coke oven plant in FY2020 and a 20-MW captive power plant in FY2021. The coke oven plant reduced KFIL's dependence on external coke purchase by 50% of its total requirement. The captive power generated from the waste heat coming out of the coke oven plant and benefit from coke oven resulted in significant cost savings of ~Rs. 80-100 crore in FY2021. The company is in the process of setting up an additional 200,000-MTPA coke oven plant (by Q4 FY2023) along with a 20-MW power plant at Koppal (Karnataka), which will make it self-sufficient in coke and power requirement. KFIL had commissioned a sinter plant at Hiriyur (Karnataka) in 2021, which reduced its dependence on high-cost lump iron ore. The company has two iron ore mines, which

¹metric tonnes per annum

were bagged in 2018 at a competitive premium of 36.7% and 55.5% respectively. However, the mines are not operational due to pending clearances from the government authorities. Once the mines become operational, this will reduce the landed cost of iron ore, leading to a further improvement in KFIL's cost structure.

Established relationships with OEMs – KFIL mainly caters to large casting requirements (more than 50 kg) of tractor, commercial vehicle (CV) and utility vehicle (UV) and diesel engine segment and has a market share of 19-20% as per the management. It has a reputed customer base and a long experience of dealing with OEMs, resulting in repeat orders.

Synergies in the form of forward integration and product diversification arising out of ISMT's acquisition – With the acquisition of ISMT in March 2022, KFIL has forward integrated into seamless tubes and increased the share of value-added products in its portfolio. ISMT is among the largest seamless tubes manufacturers in India. Its product profile is diversified as it produces seamless tubes in the range of 6 to 273 mm diameter. ISMT has customers in the automobile, bearing, power, oil and gas, boiler, general engineering, and hydraulic segments, among others. In Q1 and Q2 of FY2023, ISMT reported a YoY revenue growth of 30% and 25% respectively aided by increased volumes and realisations. The operations turned profitable at the operating and net levels owing to various cost saving initiatives/corrective measures undertaken by the company. The Board of Directors of KFIL and ISMT have approved the Scheme of Arrangement and Merger of ISMT into KFIL w.e.f. April 01, 2023 (appointed date). The merger (subject to regulatory and other approvals) is likely to benefit KFIL in terms of increased scale of operations, expanded reach, product diversification, among others.

Credit challenges

High debt levels due to debt-funded acquisition of ISMT – In March 2022, KFIL acquired 51.25% stake in ISMT through preferential allotment of equity shares for Rs. 476 crore. KFIL also extended unsecured loan of Rs. 194 crore to ISMT. The total consideration of Rs. 670 crore was largely funded by debt. While KFIL's debt coverage indicators (consolidated including ISMT) had moderated as on March 31, 2022, due to such large debt-funded acquisition, they are likely to improve going forward, with an expected consolidated net debt vis-à-vis operating profit ratio of 1.1 times as on March 31, 2023. Going forward, the company's ability to further ramp up ISMT's operations by increasing capacity utilisation levels, improve profitability by reducing its power costs and achieve the desired operating parameters would be key monitorable.

Exposure to volatility in raw material prices – Raw materials account for a major part of the operational cost for pig iron players, including KFIL, and are thus important determinants of profitability. As the pig iron business is cyclical in nature, it is exposed to margin risks arising from the temporary mismatches in the prices of raw materials and pig iron, causing volatility in profitability and cash flows. Nonetheless, backward integration through coke and iron ore would mitigate the risk to some extent. ICRA also notes that given the sizeable coking coal imports, KFIL's profitability remains exposed to foreign currency movements. The company, however, adopts conservative hedging strategies to minimise the impact of forex volatility.

Casting division performance is exposed to inherent cyclicity in key end-user segments – KFIL's casting division derives around 90% of its sales from CV and tractor segments both of which are exposed to the inherent demand cyclicity. Any sustained demand weakness from its key end-user segments, as witnessed in the past, could adversely impact its revenues and earnings profiles.

Environmental and Social Risks

The steel industry faces several environmental risks especially related to carbon emissions. KFIL is making conscious efforts to minimise wastage in materials and processing requirements by initiatives such as yield improvement, casting weight reduction and waste elimination by implementing appropriate technologies. The company continuously monitors and tracks the usage of natural resources. Energy audits are conducted every year by the third party and appropriate actions are taken on audit findings to optimise the energy consumption considering conservation of natural resources. The company has also installed a 10-MW solar power plant at Solapur and 100-KW roof top solar unit at Koppal administrative building to adopt green energy.

Social risks for ferrous entities arise from the health and safety of employees involved in the mining and manufacturing activities. Casualties/accidents at operating units due to gaps in safety practices could not only lead to production outages, but also invite penal action from regulatory bodies. On the social front, the company addresses the needs of associated communities by taking sustainable initiatives in the areas of health and hygiene, education, environment, infrastructure, and rural development.

Liquidity position: Adequate

KFIL's liquidity is **adequate**, with average unutilised fund-based limits of around Rs. 125 crore during the 12-month ended in October 2022 (with commensurate drawing power) and healthy cash flows of around Rs. 400 crore expected in FY2023. The cash generation in the business will be mainly utilised towards meeting capex requirements and debt repayments. In FY2023, the company has capex plans of Rs. 400-450 crore (out of which ~Rs. 288 crore was incurred in H1 FY2023) and debt repayment obligations of ~Rs. 82 crore. The company's debt repayment obligations in FY2024 and FY2025 stand at ~Rs. 238 crore and ~Rs. 201 crore respectively while capex for both the years would be around Rs. 350-400 crore per annum. ICRA expects the company's cash flows to remain healthy at over Rs. 400-450 crore each year in FY2024 and FY2025 and meet the debt repayment obligations and a major portion of the capex requirement. Besides, ISMT has partly debt-funded capex plan of Rs. 305 crore to set up a 70-MW solar power plant in FY2024. ISMT's cash flows are expected to be around Rs. 120 crore in FY2023 and around Rs. 150 crore in FY2024. ISMT's largely unutilised fund-based working capital limits of Rs. 145 crore (with adequate drawing power) provide cushion to the liquidity.

Rating sensitivities

Positive factors - ICRA could upgrade KFIL's ratings if there is a substantial growth in its revenues and profitability while maintaining healthy debt coverage indicators. Specific credit metric that could lead to ratings upgrade includes consolidated net debt-to-operating profit ratio remaining below 0.5 times on a sustained basis.

Negative factors - Pressure on KFIL's ratings could arise if any sharp decline in KFIL's revenues and profits adversely impacts its debt coverage indicators and/or the liquidity position. Specific credit metric that could lead to ratings downgrade includes consolidated net debt-to-operating profit ratio remaining above 1.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Entities in the Ferrous Metals Industry Policy on Withdrawal of Credit Ratings
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of KFIL and ISMT.

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, transmission parts and different types of housings required by automobile, tractor, and diesel engine industries. KFIL's plants in Koppal (Karnataka), Solapur (Maharashtra) and Hiriyur (Karnataka) have a combined casting capacity of 150,000 MTPA and a combined pig iron capacity of ~600,000 MTPA. In March 2022, KFIL acquired a 51.25% stake in ISMT to facilitate forward integration into seamless tubes.

Key financial indicators

Consolidated financials	FY2021 (Audited)	FY2022 (Audited)	H1 FY2023 (Reported*)
Operating Income (Rs. crore)	2,038.1	3,748.3	3,276.4
PAT (Rs. crore)	302.1	299.7	213.1
OPBDIT/OI (%)	22.6%	17.4%	12.2%
PAT/OI (%)	14.8%	8.0%	6.5%
Total Outside Liabilities/Tangible Net Worth (times)	0.9	1.0	0.9
Total Debt/OPBDIT (times)	0.6	1.8	1.3
Interest Coverage (times)	18.3	22.1	8.8

Source: Company; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

All ratios as per ICRA calculations; FY2021 numbers are standalone and ISMT was consolidated only from March 10, 2022

*based on limited review of auditor

Status of non-cooperation with previous CRA – Not Applicable

Any other information: None

Rating history for past three years

Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years						
	Type	Amount Rated (Rs. Cr.)	Amount Outstanding (Rs. Cr.)	Date & Rating in	Date & Rating in FY2022		Date & Rating in FY2021			Date & Rating in FY2020	
				Dec 15, 2022	Dec 23, 2021	Sep 13, 2021	Mar 01, 2021	Oct 05, 2020	May 11, 2020	Dec 13, 2019	Sep 09, 2019
1 Commercial Paper	ST	550.00	309.40*	[ICRA]A1+	[ICRA]A1+	-	-	-	-	-	-
2 Commercial Paper	ST	100.00	-	[ICRA]A1+; withdrawn	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3 Term Loan	LT	307.92	307.92*	[ICRA]AA (Stable)	[ICRA]AA (Negative)	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
4 Cash Credit/ WCDL	LT/ST	430.00	-	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Negative)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA- (Positive)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+
5 Letter of Credit and Bank Guarantee	LT/ST	1,830.00	-	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA (Negative)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA- (Positive)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+
6 Non-Convertible Debentures	LT	250.00	250.00*	[ICRA]AA (Stable)	[ICRA]AA (Negative)	-	-	-	-	-	-
7 Unallocated Limits	LT/ST	32.08	-	[ICRA]AA (Stable)/ [ICRA]A1+	-	-	-	-	-	-	-

Amount in Rs. crore; LT – Long-term; ST – Short-term; *As on December 08, 2022

Complexity level of the rated instrument

Instrument	Complexity Indicator
Long Term - Fund Based - Term Loan	Simple
Long Term/Short Term - Fund Based	Simple
Long Term/Short Term - Non-Fund Based	Very Simple
Commercial Paper	Very Simple
Non-Convertible Debentures	Very Simple
Long Term/Short Term - Unallocated	Not Applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: [Click Here](#)

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Cr.)	Current Rating and Outlook
NA	Long Term - Fund Based - Term Loan	FY2019	6.30-7.88%	FY2026	307.92	[ICRA]AA(Stable)
NA	Long Term/Short Term - Fund Based	-	-	-	430.00	[ICRA]AA(Stable)/[ICRA]A1+
NA	Long Term/Short Term - Non-Fund Based	-	-	-	1830.00	[ICRA]AA(Stable)/[ICRA]A1+
NA	Long Term/Short Term - Unallocated	-	-	-	32.08	[ICRA]AA(Stable)/[ICRA]A1+
INE884B14440	Commercial Paper	08-Mar-22	5.75%	08-Mar-23	104.50	[ICRA]A1+
INE884B14473	Commercial Paper	02-Jun-22	6.85%	27-Feb-23	125.00	[ICRA]A1+
INE884B14465	Commercial Paper	02-Jun-22	6.50%	09-Dec-22	80.00	[ICRA]A1+
Not placed	Commercial Paper	-	-	-	240.50	[ICRA]A1+
Not placed	Commercial Paper	-	-	-	100.00	[ICRA]A1+; reaffirmed and withdrawn
INE884B08012	Non-Convertible Debentures	10-Mar-22	6.65%	10-Mar-24	125.00	[ICRA]AA(Stable)
INE884B08020	Non-Convertible Debentures	10-Mar-22	6.65%	10-Mar-25	125.00	[ICRA]AA(Stable)

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure-2: List of entities considered for consolidated analysis

Sr.	Entity Name	Ownership	Consolidation Approach
1	Kirloskar Ferrous Industries Limited	Rated entity	Full consolidation
2	ISMT Limited	Subsidiary	Full consolidation
3	ISMT Enterprises SA	Step-down subsidiary	Full consolidation
4	Structo Hydraulics AB	Step-down subsidiary	Full consolidation
5	ISMT Europe AB	Step-down subsidiary	Full consolidation
6	Indian Seamless Inc	Step-down subsidiary	Full consolidation
7	Tridem Port and Power Company Private Limited	Step-down subsidiary	Full consolidation
8	Nagapattinam Energy Private Limited	Step-down subsidiary	Full consolidation
9	PT ISMT Resources	Step-down subsidiary	Full consolidation
10	Best Exim Private Limited	Step-down subsidiary	Full consolidation
11	Success Power and Infraprojects Private Limited	Step-down subsidiary	Full consolidation
12	Marshall Microware Infrastructure Development Company Private Limited	Step-down subsidiary	Full consolidation

ANALYST CONTACTS

Jayanta Roy

+91 33 7150 1100

jayanta@icraindia.com

Priyesh Ruparelia

+91 22 6169 3328

priyesh.ruparelia@icraindia.com

Sakshi Suneja

+91 22 6169 3349

sakshi.suneja@icraindia.com

Rishabh Mundada

+91 20 6606 9920

rishabh.mundada@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee

+91 80 4332 6401

jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45



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