Kalyani Steels Limited

December 07, 2021

Ratings

Facilities/Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term Bank Facilities	150.00	CARE AA; Stable (Double A; Outlook: Stable)	Reaffirmed
Long-term Bank Facilities	181.99 (Enhanced from 41.99)	CARE AA; Stable (Double A; Outlook: Stable)	Revised from CARE AA; Stable / CARE A1+ (Double A; Outlook: Stable / A One Plus)
Short-term Bank Facilities	500.00	CARE A1+ (A One Plus)	Reaffirmed
Total Bank Facilities	**831.99 (Rs. Eight hundred thirty one crore and ninety nine lakh only)**		
Commercial Paper	75.00	CARE A1+ (A One Plus)	Reaffirmed
Total Short-term Instruments	**75.00 (Rs. Seventy five crore only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of the ratings of Kalyani Steels Limited (KSL) continues to factor in its strong promoter group (Pune-based Kalyani group), with long and established track record of over four decades in the manufacturing of forging and engineering quality carbon and specialty steel. The ratings derive strength from its robust capital structure, comfortable debt coverage metrics, stable profitability margins with increasing revenues in H1FY22. The company benefits from established selling arrangements with approved vendor status from major original equipment manufacturers (OEMs) and arrangement with suppliers for procurement of raw material albeit absence of long-term contracts. The ratings also derive comfort from the backward integration project of 200,000 TPA coke oven plant and 17 MW waste heat power plant project being undertaken by the company to reduce dependence on coke.

The above rating strengths are, however, tempered by the company's modest scale of operations, presence in the cyclical steel industry; the end-users being automobile, oil and natural gas, energy, railway, defence, bearing industry, etc, susceptibility to significant volatility in raw material prices & foreign exchange rates, exposure to the group companies in the form of investments and lack of any backward integration in the form of captive iron ore and coal mines.

Key Rating Sensitivities

Positive Factors- Factors that could lead to positive rating action/upgrade:

- Significant and sustained improvement in the scale of operations on the back of improvement in the credit profile of the group companies with which KSL shares substantial trade linkages.

Negative Factors- Factors that could lead to negative rating action/downgrade:

- Decline in the total operating income and/or profitability leading to net cash accruals below Rs.100 crore on a sustained basis
- Deterioration in the credit profile of the group companies with which KSL shares substantial trade linkages.
- Delayed realization of debtors from the group companies.
- Increased financial leverage indicated by overall gearing ratio of 0.65x or more

Detailed Description of the key rating drivers

Key Rating Strengths

Strong promoter group coupled with long track record in iron & steel industry

KSL is a part of the Kalyani group and is spearheaded by Mr B.N Kalyani in the strength of Chairman. He is also the Chairman and Managing Director (CMD) of Bharat Forge Limited. The Kalyani group, established in mid 1960s, has wide capabilities across varied industries including Engineering, Automotive, Industrial, Renewable Energy, Urban Infrastructure and Specialty Chemicals. In a span of more than four decades, KSL has grown from being a primary iron and steel manufacturer to a preferred steel supplier for engineering, auto, seamless tubes, etc., companies mainly catering to forging industry

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

serving the auto and allied sectors. The promoters are supported by a team of professionals including, Mr RK Goyal (MD) and Mr Balmukand Maheshwari (CFO) who are associated with KSL since more than eight years.

Established selling arrangements

KSL was promoted as backward integration unit of the Kalyani group from which majority of the requirements for the group companies is met through KSL. Moreover, long-standing relationship with major OEMs along with approved vendor status continues to garner KSL with repeat orders. The Kalyani group companies accounted for around 53% of the total revenue in FY21 (refers to the period April 1 to March 31).

Arrangement with suppliers for procurement of raw material albeit absence of long-term contracts continues

KSL has diversified raw material procurement source wherein raw materials are procured both from the domestic and overseas market. The key raw materials used by KSL include coke/coke fines, iron ore/iron ore fines and ferro alloys. However, majority of the raw materials have been sourced from few suppliers representing concentration risk; but the risk is partially mitigated as the company takes quotes from various suppliers before placing orders. Furthermore, KSL has not entered into any long-term contracts with the suppliers.

Robust capital structure and comfortable debt coverage metrics

Capital structure of KSL remained robust with 0.02 (nil) debt to equity and overall gearing (including LC backed creditors) of 0.22x (0.19x) as on March 31, 2021 (2020). The overall gearing marginally increased on account of ECB taken by the company during FY21 to fund the projected capital expenditure of Rs.211 crore. As on March 31, 2021, the company has long-term debt of Rs.18.37 crore. The debt is projected to increase further, however, the overall gearing is expected to remain comfortable. The fund-based working capital utilization is also minimal. The net worth of the company stood at Rs.1,153.42 crore as on March 31, 2021, as against Rs.962.71 crore as on March 31, 2020. The gearing when adjusted to investments in group companies also stayed strong (adjusted overall gearing of 0.25x) as on March 31, 2021.

PBILDT interest coverage and total debt/gross cash accrual remained comfortable at 43.24x and 1.11x in FY21 from 10.08x and 1.12x in FY20, respectively.

Modest scale of operations albeit stable revenue and profitability

KSL has modest scale of operations with total operating income (TOI) witnessing marginal growth in FY21 (refers to the period April 1 to March 31) of 0.57% year-on-year (Y-o-Y) to Rs.1,217.73 crore on account of increasing demand from the automotive segment from H2FY21.

KSL improved its profitability margin majorly on account of improvement in gross margins. The company's PBILDT (PAT) margins have remained in between 14.90% and 24.04% (8.2% and 15.59%) over the past five fiscal years through FY21. KSL's PBILDT margin improved to 24.04% in FY21 from 18.93% in FY20 majorly on account of lower raw material and consumable costs. The company is undertaking a backward integration project amounting to Rs.211 crore, to set up a new 200,000 TPA coke oven plant and 17-MW waste heat power plant. The project is expected to be commissioned by September 2022 which shall lead to reduction in cost of production with further improvement in profitability.

The company's profitability is partially constrained by its lack of backward integration in the form of any captive operational iron ore and coking coal mine or any long-term supply contracts with miners/ suppliers. Majority of the company's revenue is generated through group companies (around 53%), with Bharat Forge Limited and Kalyani Technoforge Limited being the largest customers having significant presence in auto sector. Furthermore, during H1FY22, the company earned a PAT of Rs.132 crore on a total revenue of Rs.875 crore.

Key Rating Weaknesses

Cyclicality inherent in the steel and end-user industries coupled with competition from unorganized players

Steel is a highly capital-intensive industry which is cyclical in nature. Its growth is intertwined with the growth of the economy at large and, in particular, the steel-user industries such as automobile, housing, infrastructure, and others. KSL generates about 80% of revenue from auto segment which is also affected by economic cycles. Also, the customers of KSL remain vulnerable to pricing pressures from large OEMs which in turn may have adverse impact on profitability margins. Furthermore, competition plays a role in the profitability of steel manufacturer mainly arising out of unorganized players and Chinese imports. However, KSL, being in niche segment providing specialty steel, remain immune to competition from unorganised players.

Susceptibility to volatility in raw material prices and forex risk

Raw material consumption is the single-largest cost component for KSL (constituting about 45.23% of the total sales in FY21 as against 48.09% of total sales in FY20). The key raw materials used by the company are iron ore/iron ore fines; coking coal/ coke fines, fluxes like limestone and dolomite, ferro alloys and solid charge. Coking coal and iron ore prices fluctuate globally on a demand-supply basis which generally impact the profitability margins. Though the company has pass-through arrangements with the customers, on occasions there is a risk of lag in the mechanism. Furthermore, part of the raw material requirements is imported, thus exposing to foreign currency exchange risk since the company does not hedge its imports. However, the risk is partially mitigated as the same is factored in pricing while placing orders.

Exposure to the group companies in the form of investments
KSL has invested in various subsidiaries/group companies in the form of investments in equity shares, preference shares and debentures. The exposure to group companies was at Rs.144.21 crore as on March 31, 2021 (12.50% of the net worth as on March 31, 2021).

Industry outlook
India is the second-largest crude steel producer in the world. India's crude steel production fell by 5.59% and finished steel production was flat at 95.12 MT in FY21 against 102.62 MT in FY20. Domestic steel demand was impacted by a slowdown in manufacturing activities during H1FY21 due to Covid-19 pandemic. However, post lockdown, the global commodity markets witnessed a sharp rebound with a continuous increase in prices. While the demand recovery, especially in China and other economies, was on the back of substantial government stimulus, the lockdowns and restrictions caused significant supply-side headwinds in terms of difficulty in procurement and movement of key raw materials resulting in reduced production across steel mills. The double whammy effect resulted in one of the sharpest and perhaps the fastest recoveries in the global steel prices, which was considered beyond the market's expectation. CARE Ratings expects the domestic steel demand to grow at a compounded annual growth rate (CAGR) of about 7.5% during the next 2-3 years. CARE Ratings further expects net sales realization to remain healthy. As far as volumes growth is concerned, demand improvement and the low base effect of FY21 is likely to help improve the volumes of the domestic players. The solvency ratios of steel companies are expected to improve on account of accretion to net worth and healthy cash accruals along with continuous reduction in debt levels.

Liquidity: Strong
KSL is expected to generate healthy gross cash accruals against nil repayment obligations for the next two years. Furthermore, KSL had free cash and bank balance of Rs.625.12 crore as on March 31, 2021. Additional liquidity cushion is available in the form of largely unutilized lines of credit. The company has availed a short-term loan of Rs.150 crore during FY21. The average fund-based working capital utilization for the last 12 months through August 2021 was nil. This was majorly on account of managing working capital requirements through internal accruals and creditors' support backed by letter of credit.

Analytical approach: Standalone

Applicable Criteria
Policy on default recognition
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments
Steel

About the Company
Incorporated in 1973, Kalyani Steels Limited (KSL) is a part of the Pune (Maharashtra)-based Kalyani group. The company is spearheaded by Mr B. N Kalyani, who is the chairman of the Kalyani Group of companies. The manufacturing facility of KSL are located at Ginigera village, dist. Koppal (Karnataka). KSL is a leading manufacturer of forging and engineering quality carbon and alloy steel which caters to the requirement of various segments, viz., automotive, oil & gas, energy, bearings, seamless tubes, railways, etc. The company is a preferred steel supplier for engineering, automotive, seamless tube and primary aluminium industry used in the automobile and engineering industries. KSL has a state-of-the-art integrated manufacturing facility spread across 375 acres located at Hospet. The total installed capacity (Hospet Steels Limited) is around 7 lakh Metric Tonne Per Annum (MTPA). There is a strategic alliance between KSL and Mukand Limited (ML, part of the Bajaj group) where the manufacturing facilities are shared, with KSL holding 41.38% of the assets and ML holding the remaining.

Brief Financials (Rs. crore)	FY20 (A)	FY21 (A)	H1FY22(UA)
Total operating income	1210.85	1217.73	874.89
PBILDT	229.21	292.73	205.69
PAT	137.12	190.30	131.73
Overall gearing (times)- Including lease liabilities	0.19	0.22	NA
Interest coverage (times)	10.08	43.24	30.88

^Includes acceptances/ Creditors on LC

A: Audited; UA: Unaudited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Covenants of rated instrument / facility: Please refer Annexure-3

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit		-	-	-	150.00	CARE AA; Stable
Non-fund-based - ST-BG/LC		-	-	-	300.00	CARE A1+
Non-fund-based - ST-BG/LC		-	-	-	200.00	CARE A1+
Term Loan-Long Term		-	-	March 2026	181.99	CARE AA; Stable
Proposed Commercial Paper-Commercial Paper (Standalone)		-	-	7-365 days	75.00	CARE A1+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1	Fund-based - LT-Cash Credit	LT	150.00	CARE AA; Stable	-	1)CARE AA; Stable (08-Oct-20)	1)CARE AA; Stable (30-Sep-19)	1)CARE AA; Stable (31-Oct-18)
2	Non-fund-based - ST-BG/LC	ST	300.00	CARE A1+	-	1)CARE A1+ (08-Oct-20)	1)CARE A1+ (30-Sep-19)	1)CARE A1+ (31-Oct-18)
3	Non-fund-based - ST-BG/LC	ST	200.00	CARE A1+	-	1)CARE A1+ (08-Oct-20)	1)CARE A1+ (30-Sep-19)	1)CARE A1+ (31-Oct-18)
4	Commercial Paper-Commercial Paper (Standalone)	ST	75.00	CARE A1+	1)CARE A1+ (07-Oct-21)	1)CARE A1+ (08-Oct-20)	1)CARE A1+ (30-Sep-19)	1)CARE A1+ (31-Oct-18)
5	Fund-based - LT-External Commercial Borrowings	LT	-	-	-	1)Withdrawn (08-Oct-20)	1)CARE AA; Stable (30-Sep-19)	1)CARE AA; Stable (31-Oct-18)
6	Term Loan-Long Term	LT	181.99	CARE AA; Stable	-	1)CARE AA; Stable / CARE A1+ (08-Oct-20)	1)CARE AA; Stable / CARE A1+ (30-Sep-19)	-

Annexure-3: Detailed explanation of covenants of the rated instrument / facilities- NA

Annexure 4: Complexity level of various instruments rated for this company

Sr. No	Name of instrument	Complexity level
1	Commercial Paper-Commercial Paper (Standalone)	Simple
2	Fund-based - LT-Cash Credit	Simple
3	Non-fund-based - ST-BG/LC	Simple
4	Term Loan-Long Term	Simple

Annexure 5: Bank Lender Details for this Company

To view the lender-wise details of bank facilities please **click here**

Note on complexity levels of the rated instrument: *CARE Ratings has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

Contact us

Media Contact
Name – Mradul Mishra
Contact no. – +91-22-6837 4424
Email ID – mradul.mishra@careratings.com

Analyst Contact
Group Head Name – Hitesh Avachat
Group Head Contact no.- 9004860007
Group Head Email ID- Hitesh.avachat@careratings.com

Relationship Contact
Name: Saikat Roy
Contact no.: 022-67543404/136
Email ID: saikat.roy@careratings.com

About CARE Ratings:
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