Kalyani Steels Limited

October 31, 2018

Ratings

Facilities	**Amount (Rs. crore)**	**Rating[1]**	**Rating Action**
Long-term Bank Facilities	192.41 (reduced from 235.60)	**CARE AA; Stable (Double A; Outlook: Stable)**	**Reaffirmed**
Short-term Bank Facilities	500.00	**CARE A1+ (A One Plus)**	**Reaffirmed**
Total Facilities	**692.41 (Rupees Six Hundred Ninety Two crore and Forty one lakh only)**		
Commercial Paper-Proposed#	75.00 (**Rupees Seventy Five Crore Only**)	**CARE A1+ (A One Plus)**	**Reaffirmed**

Details of instruments/facilities in Annexure-1
 # carved out of sanctioned working capital limits of the company.

Detailed Rationale & Key Rating Drivers

The reaffirmation of ratings assigned to the bank facilities and short-term debt instrument programe of Kalyani Steels Limited (KSL) continues to derive strength from the strong parentage of the Kalyani Group, Pune promoted by Mr. B. N. Kalyani coupled with the long and established track record of KSL of over four decades in the manufacturing of forging & engineering quality carbon & alloy steel. The ratings also takes cognizance of arrangement with suppliers for procurement of raw material albeit absence of long term contracts, selling arrangements are in place, increase in total operating income in H1FY19 (refers to the period April 01 to September 30), above average capital structure and debt coverage indicators as on March 31, 2018 and healthy liquidity in the form of investments in mutual funds.
The rating strengths however are tempered by marginal decline in total operating income in FY18 (refers to the period April 01 to March 31), weakened profitability margins in FY18 and H1FY19, exposure to group companies in the form of equity shares and debentures though reduced marginally as on March 31, 2018, exposure to volatility in the prices of iron ore and coke due to the regulatory risk pertaining to the mining activities and working capital intensive nature of operations which are partially offset by availability of credit line in terms of unutilized working capital limits.
Going forward, any large incremental debt funded capital expenditure by KSL deteriorating its capital structure and debt coverage indicators from current levels shall remain key rating sensitivity. In addition, any further exposure to group companies shall remain key rating monitor able. The ability of the company to increase its scale of operations, as envisaged along with the improvement in its profitability is also crucial from credit perspective.

Detailed description of the key rating drivers
Key Rating Strengths
Experienced promoter group with long track record in iron & steel industry: KSL being a part of Kalyani Group is spearheaded by Mr. B.N Kalyani in the strength of Chairman. The Kalyani Group, established in mid 1960s has wide experience in high technology, engineering & manufacturing capability across critical sectors including as Engineering Steel, Automotive, Industrial, Renewable Energy, Urban Infrastructure and Specialty Chemicals. The promoters are supported by team of professionals including, Mr. Ravindra Kumar Goyal (Managing Director) and Mr. Balmukand Maheshwari (Chief Financial Officer) who are associated with KSL since more than five years.

Arrangements for procurement of raw material are in place however absence of any long term contracts*:* KSL has diversified raw material procurement source where in raw materials are procured both from the domestic and overseas market. The key raw materials used by KSL includes coke/coke fines and iron ore/iron ore fines. Further, diversified supplier base is also evident from the fact that the single largest supplier constitutes around 18% of the total raw-material requirement with top 5 suppliers supplying 25% of the total requirement of KSL during FY18 which is in line with FY17. The key suppliers of raw materials for KSL are Noble Resources Limited, IMR Resources India Private Limited, Avani Resources Pte Limited and National Mineral Development Corporation.

Selling arrangements and marketing strategy: The company has continued focus on niche segments such as critical components in automotive and engineering (contributing 80% of the total sales in FY18), where the products range is less susceptible to global market fluctuations. The top 5 clients contribute 66.03% of the total sales during FY18 including, Bharat Forge Limited (BFL), Kalyani Technoforge Limited (KTL), Bharat Heavy Electricals Limited, Bill Forge Private Limited

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

and Jindal Saw Limited. In addition, sales to group companies which are also the top 2 clients for FY18 i.e. BFL and KTL have accounted 57.36% of the total sales in FY18 as compared to 35% in FY17.

Above average capital structure and debt coverage metrics as on March 31, 2018: Capital structure of KSL has remained comfortable with debt to equity and overall gearing below unity as on March 31, 2018. While the debt to equity has improved to 0.08x as on March 31, 2018 (0.15x as on March 31, 2017); overall gearing has improved to 0.43x as on March 31, 2018 (0.51x as on March 31, 2017). Further as on September 30, 2018, while debt to equity has improved to 0.05x; overall gearing has improved to 0.25x. The leverage position of the company has been improving y-o-y on account of repayment of foreign currency term loans coupled with accretion of profits to reserves. Further, KSL has comfortable debt risk metrics with term debt/GCA at 0.39x in FY18 (0.54x in FY17) and total debt/GCA at 2.24x in FY18 (1.76x in FY17). Total debt/GCA has weakened in FY18 on account of decline in profit levels in turn reduced GCA level compared to FY17. However, during H1FY19, term debt/GCA has improved to 0.28x and total debt/GCA has improved to 1.35x.

Key Rating Weaknesses

Marginal decline in total operating income coupled with weakened profitability during FY18 and H1FY19: KSL has reported marginal decline in total operating income by 1.62% to Rs. 1401.84 crore in FY18 from Rs. 1424.99 crore in FY17. KSL's majority of the revenues (90%-97% of the total income) are contributed by the rolled products. Further, during FY18, the sales from exports have increased to Rs. 58.40 crore (Rs. 20.10 crore in FY17) backed by sales of 5,568 MT (3,974 MT in FY17) of steel in international markets.

While, the realizations have increased by ~5%, the raw material costs have increased by 32% during FY18 over FY17. Hence, the operating profit margin of the company has got affected significantly and reduced to 14.90% in FY18 (against 21.05% in FY17); while the PAT margin has declined to 8.20% in FY18 (against 10.98% in FY17).

During H1FY19 (Provisional), KSL has achieved total operating income of Rs. 713.67 crore (y-o-y growth by 8.80%) with PAT of Rs. 56.59 crore (y-o-y growth by 4.58%). However, while, the PBILDT margin declined by 95 bps to 14.98% (y-o-y) and PAT margin declined by 32 bps to 7.93% (y-o-y). Fall in margins are mainly on account of high raw material cost expenses which would be pass on to the clients with some time lag.

Exposure to the group companies in the form of investments as on March 31, 2018: KSL has invested in various group companies in the form of equity shares, preference shares and debentures. The exposure to group companies has remained at Rs.162.02 crore as on March 31, 2018 (20.73% of the net worth as on March 31, 2018) as against Rs.167.59 crore as on March 31, 2017 (24.02% of the net worth as on March 31, 2017). Furthermore, KSL had extended corporate guarantee to the tune of Rs.83.57 crore as on March 31, 2017 on behalf of KCSL to Carpenter Technology Corporation (CTC), USA towards purchase of shares for USD 12.62 million which stands NIL as on March 31, 2018.

Exposure to volatility in raw material prices: Raw material consumption is the single largest cost component for KSL (constituting about 49.02% of total cost of sales in FY18 as against 36.13% of total cost of sales in FY17). Further, the company maintains an inventory level of 40-50 days. The key raw materials used by the company are iron ore/iron ore fines; coke/coke fines, fluxes like limestone and dolomite, ferro alloys and scrap.

Any volatility in iron ore and coal prices has a direct impact on the product costs, translating into inherent volatility in operating margins. KSL imports coke for its entire requirement, while iron ore are fully procured from domestic market.

Cyclicality inherent in the steel industry albeit, stable industry outlook and growth prospects: 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. The growth in the Indian steel sector has been driven by domestic availability of raw materials such as iron ore and cost effective labor. India's steel production grew by 3.1% on a y-o-y basis to 105 million tons during the financial year 2017-18 backed by 7.9% growth in consumption during the year. The increase in output however is slower compared to 11.9% y-o-y growth reported by the industry during 2016-17 when production stood at 101.8 million tons.

Analytical approach: Standalone

Applicable Criteria

[Criteria on assigning Outlook to Credit Rating]
[CARE's Policy on Default Recognition]
[Criteria for Short Term Instruments]
[Factoring Linkages in Rating]
[Financial Ratios-Non Financial Sectors]
[Rating Methodology Manufacturing Companies]
[Rating Methodology-Steel Companies]

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 is 6 lakh metric tonne per annum (MTPA). The manufacturing facilities are shared with Mukand Limited (ML, part of Bajaj Group) with KSL holding 41.38% of the assets and ML holding the remaining.

Brief Financials (Rs. crore)	FY17 (A)	FY18 (A)	H1FY19 (Prov.)
Total operating income	1424.99	1401.84	713.67
PBILDT	300.00	208.89	106.94
PAT	156.48	114.88	56.59
Overall gearing -including Acceptances / Creditors on LC (times)	0.51	0.43	0.25
Interest coverage (times)	31.15	24.19	39.75

A: Audited; Prov: Provisional

Status of non-cooperation with previous CRA: ICRA has suspended rating assigned to the bank facilities of KSL and the commercial paper on account of ICRA's inability to carry out a rating surveillance in the absence of the requisite information from the company.

Any other information: Not Applicable

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

Note on complexity levels of the rated instrument: *CARE 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.*

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Annexure-1: Details of Instruments/Facilities

Name of the Instrument	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+
Fund-based - LT-External Commercial Borrowings	-	-	June 2019	42.41	CARE AA; Stable
Commercial Paper-Proposed	-	-	-	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 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
1.	Fund-based - LT-Cash Credit	LT	150.00	CARE AA; Stable	-	1)CARE AA; Stable (18-Aug-17)	1)CARE AA (28-Oct-16) 2)CARE AA (13-May-16)	-
2.	Non-fund-based - ST-BG/LC	ST	300.00	CARE A1+	-	1)CARE A1+ (18-Aug-17)	1)CARE A1+ (28-Oct-16) 2)CARE A1+ (13-May-16)	-
3.	Non-fund-based - ST-BG/LC	ST	200.00	CARE A1+	-	1)CARE A1+ (18-Aug-17)	1)CARE A1+ (28-Oct-16) 2)CARE A1+ (13-May-16)	-
4.	Commercial Paper-Proposed	ST	75.00	CARE A1+	-	1)CARE A1+ (18-Aug-17)	1)CARE A1+ (28-Oct-16) 2)CARE A1+ (13-May-16)	-
5.	Fund-based - LT-External Commercial Borrowings	LT	42.41	CARE AA; Stable	-	1)CARE AA; Stable (18-Aug-17)	1)CARE AA (28-Oct-16) 2)CARE AA (13-May-16)	-

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CIN - L67190MH1993PLC071691