Kalyani Steels Limited

October 08, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating1	Rating Action
Long Term Bank Facilities	150.00	CARE AA; Stable (Double A; Outlook: Stable)	Reaffirmed
Long Term / Short Term Bank Facilities	41.99 (enhanced from Rs.33.00 crs)	CARE AA; Stable / CARE A1+ (Double A ; Outlook: Stable / A One Plus)	Reaffirmed
Short Term Bank Facilities	500.00	CARE A1+ (A One Plus)	Reaffirmed
Long Term Bank Facilities	0.00	-	Withdrawn
Total Facilities	691.99 (Rs. Six Hundred Ninety-One Crore and Ninety-Nine lakhs only)		
Commercial Paper - Proposed	75.00 (Rs. Seventy Five Crore only)	CARE A1+ (A One Plus)	Reaffirmed

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of long term and short term ratings to the bank facilities and proposed commercial program 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 & alloy steel. The ratings derives strength from its stable revenues and profitability margins though expected to be temporarily impacted due to COVID-19, its robust capital structure and comfortable debt coverage metrics. 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 above rating strengths are, however, tempered by company's modest scale of operations, presence in highly cyclical steel industry; end user being automobile industry, lack of any backward integration in the form of captive iron ore and coal mines, susceptibility to significant volatility in raw material prices & foreign exchange rates, and exposure to the group companies in the form of investments.

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 total operating income and/or profitability leading to net cash accruals below Rs.100 crores 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 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 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 six years.

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

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 top five clients contributed 65-75% of the total sales during FY20. Kalyani Group companies accounted for ~65% of total revenue in FY20.

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 two suppliers representing concentration risk. 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 nil (0.02) debt to equity and overall gearing (including LC backed creditors) of 0.19x (0.27x) as on March 31, 2020 (2019). KSL has been improving its capital structure y-o-y through scheduled repayment of foreign currency term loans (ECB) coupled with accretion of substantial profits to reserves. Currently, there are no outstanding term loans or any planned debt funded capital expenditure program in the medium term. The fund based working capital utilization is also minimal. The net worth of the company stood at Rs.962.71 crore as on March 31, 2020 as against Rs.888.40 crore as on March 31, 2019. The gearing when adjusted to investments in group companies also stayed strong (adjusted overall gearing of 0.22x) as on March 31, 2020.
PBILDT interest coverage though moderated to 10.08x in FY20 from 27.02x in FY19 on account of loss due to adverse foreign currency exchange movement, continued to remain comfortable. Total debt/Gross Cash Accrual was 1.12x in FY20 (taking into account the letter of credit backed trade payables), improving from 1.42x in FY19.

Modest scale of operations albeit stable revenue and profitability partially offset by impact of COVID-19 & economic downturn: KSL has modest scale of operations with Total Operating Income (*TOI*) registering a de-growth in FY20 (FY refers to the period April 1 to March 31) by 14.24% year-on-year (Y-o-Y) to Rs.1210.85 crore on account of downturn in the automotive segment, particularly in commercial vehicle segment.
The company benefits from economies of scale with capacity utilization of rolling mill shop in between (89-93% though FY16-FY19). Even though, with decline in capacity utilization to about 66% in FY20 due to domestic and global slowdown, KSL improved its profitability margin majorly on account of improvement in gross margins. The company's PBILDT (PAT) margins have remained in between 14.90-21.05% (8.20-11.32%) over the past 5 fiscal years through FY20. KSL's PBILDT margin improved by 232 bps in FY20 over FY19 to 17.72% majorly on account of lower raw material (51.57% of TOI in FY20 vs 55.87% in FY19) and consumable costs (7.81% of TOI in FY20 vs 8.92% in FY19) partially offset by employee and other manufacturing, administrative and selling costs. 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 (~65-75%), with Bharat Forge Limited and Kalyani Technoforge Limited being the largest customers having significant presence in auto sector. Furthermore, restrictions to control spread of COVID-19, had resulted in fall in TOI in Q1FY21 (refers to the period April 1 to June 30) to Rs.131.22 crore from Rs.348.26 crore in Q1FY20 and Rs.279.31 in Q4FY20. Even though, the company witnessed significant decline in scale in Q1FY21 compared to Q1Y20 i.e. about 62%, the PBILDT (PAT) margin stayed healthy at 18.60% (10.50%).
Economic downturn is expected to impact the revenue generation in FY21 and extent of the same shall remain a key rating monitorable.

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 cyclical in nature. 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.

Susceptibility to volatility in raw material prices and forex risk

Raw material consumption is the single largest cost component for KSL (constituting about 63.61% of total cost of sales in FY20 as against 66.04% of total cost of sales in FY19). 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 scrap. 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, about 40% of the raw

material requirements are imported, thus exposing to foreign currency exchange risk since the company does not hedge its imports.
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 remains to be a challenge.

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.144.69 crore as on March 31, 2020 (15.03% of the net worth as on March 31, 2020). During FY20, the company provided for impairment in investments of Rs.7.3 crs in one of its subsidiary.

Industry outlook
CARE expects domestic steel demand to witness steady improvement on opening up of the economy. Demand for steel during the short to medium term period is likely to be supported by automobile and pipes manufacturing sector, improving infrastructure activity (including the railway and metro projects) along with the construction sector (road and bridges construction). However, demand recovery from the real estate sector is likely to take a longer time. Higher exports, improving realizations and lower raw material prices is likely to support the profitability margins of players grappling with contraction in domestic demand owing to the pandemic.

Liquidity: Strong
KSL is expected to generate healthy gross cash accruals against nil repayment obligations. Furthermore, KSL had free cash and bank balance of Rs.359.59 crore and liquid investments (Equity & Mutual funds) of Rs.32.77 crore as on March 31, 2020. Additional liquidity cushion is available in the form of largely unutilized lines of credit. The average fund based working capital utilization for the last 12 months through August 2020 was about 5% only. 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
Criteria on assigning 'outlook' and 'credit watch'
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Financial ratios – Non-Financial Sector
Rating Methodology - Manufacturing Companies
Rating Methodology - Steel Sector
Rating Methodology: Factoring Linkages in Ratings
Liquidity analysis of non-financial sector entities

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 ~7 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) (Standalone)	FY19 (A)	FY20 (A)	Q1FY21 (UA)
Total operating income	1411.99	1210.85	131.22
PBILDT	217.40	229.21	24.34
PAT	132.05	137.12	8.77
Overall gearing (times)^	0.27	0.19	NA
Interest coverage (times)	32.81	10.08	18.32

^Including Acceptances / Creditors on LC
A: Audited UA: Unaudited

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 as per press release dated June 23, 2016.

Any other information: Not applicable

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

Covenants of rated instrument / facility: *Not applicable*

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

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	-	-	-	0.00	Withdrawn
LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	-	-	-	41.99	CARE AA; Stable / CARE A1+
Commercial Paper (Standalone)	-	-	-	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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Cash Credit	LT	150.00	CARE AA; Stable	-	1)CARE AA; Stable (30-Sep-19)	1)CARE AA; Stable (31-Oct-18)	1)CARE AA; Stable (18-Aug-17)
2.	Non-fund-based - ST-BG/LC	ST	300.00	CARE A1+	-	1)CARE A1+ (30-Sep-19)	1)CARE A1+ (31-Oct-18)	1)CARE A1+ (18-Aug-17)
3.	Non-fund-based - ST-BG/LC	ST	200.00	CARE A1+	-	1)CARE A1+ (30-Sep-19)	1)CARE A1+ (31-Oct-18)	1)CARE A1+ (18-Aug-17)
4.	Commercial Paper-Commercial Paper (Standalone)	ST	75.00	CARE A1+	-	1)CARE A1+ (30-Sep-19)	1)CARE A1+ (31-Oct-18)	1)CARE A1+ (18-Aug-17)
5.	Fund-based - LT-External Commercial Borrowings	LT	-	-	-	1)CARE AA; Stable (30-Sep-19)	1)CARE AA; Stable (31-Oct-18)	1)CARE AA; Stable (18-Aug-17)

6.	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	LT/ST	41.99	CARE AA; Stable / CARE A1+	-	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 the Instrument	Complexity Level
1.	Commercial Paper-Commercial Paper (Standalone)	Simple
2.	Fund-based - LT-Cash Credit	Simple
3.	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	Simple
4.	Non-fund-based - ST-BG/LC	Simple

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

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