Kesoram Industries Limited

September 11, 2019

Ratings

Facilities	Amount (Rs. Crore)	Rating[1]	Rating Action
Long/Short-term Bank Facilities	720	**CARE BB+/CARE A4+; (Double B Plus/A Four Plus) (Credit watch with developing implications)**	**Continues on credit watch with developing implications**
Short-term Bank Facilities	551	**CARE A4+; (A Four Plus) (Credit watch with developing implications)**	**Continues on credit watch with developing implications**
Total	**1,271 (Rupees One Thousand Two Hundred and Seventy One crore only)**		

Details of facilities in Annexure-1

Detailed Rationale and Key Rating Drivers

The ratings assigned to the bank facilities of KIL continue to remain constrained by the weak capital structure and debt coverage indicators amidst losses incurred in the past mainly due to operating losses in the tyre division and high capital charge. The quantum of losses, however, had reduced in FY19 (refers to the period April 1 to March 31) with improvement in performance of the both the tyre division and cement division. The ratings also take note of the continued improvement in operating performance with generation of cash profits from Q4FY19 onwards.

The ratings continue to factor in the exposure to volatility in raw material prices & high competition in the tyre segment, exposure to group companies and cyclicality in the cement industry.

The above weaknesses are partially offset by the established track record of the company along with demonstrated support of the promoters to the company and operational efficiency of the cement division.

As articulated by the management, the promoters are expected to infuse equity of Rs.425 crore by October 2019 and Rs.175 crore in FY21 in the tyre division to support operations and for completing the ongoing project for passenger car radial unit.

Ability of the company to sustain improving trend in its profitability, timely infusion of equity as envisaged, improvement in capital structure and any further increase in group company exposure remain the key rating sensitivities.

Further, the ratings assigned to KIL continue to remain under credit watch with developing implications as the Board of Directors of KIL, at its meeting held on December 4, 2018 had approved the demerger of the tyre division into Birla Tyres Limited (BTL). The company is in the process of obtaining the various necessary regulatory approvals. Post demerger, BTL will be listed with its shareholding pattern being same as KIL. The appointed date of such demerger will be Jan.1, 2019.

The tyre division which is being demerged contributed about 33% of the revenue in FY19. However, it incurred a loss before interest and tax of Rs.107.84 crore in FY19 as against a profit before interest and tax of Rs.259.77 crore earned by the cement division which KIL will continue to operate. Further, with the demerger of the tyre division, the debt level in KIL is expected to reduce.

CARE will take a final view on the ratings once the demerger process is completed and exact implications of the above demerger on the credit risk profile of KIL are clear.

Detailed description of the key rating drivers

Key Rating Weaknesses

Weak capital structure and debt coverage indicators

The company adopted IND-AS from April 1, 2017 and the networth stood at Rs.845.87 crore as on March 31, 2017 vis-à-vis Rs.193.29 crore as on March 31, 2017 (under previous IGAAP). The increase in networth was primarily due to fair valuation gain on fixed assets. Further, despite receipt of balance amount from conversion of warrants of Rs.9.19 crore in FY19 and decrease in total debt outstanding as on March 31, 2019 vis-à-vis March 31, 2018, the overall gearing deteriorated from 5.04x as on March 31, 2018 to 6.40x as on March 31, 2019 due to erosion of networth on account of losses in FY19. The debt coverage indicators remained weak and the company met its obligations timely through recovery of loans and advances given to group companies, stretching of payments to creditors and optimization of inventory level.

The total debt had reduced to Rs.3392.46 crore as on March 31, 2019 from Rs.3520.41 crore as on Dec.31, 2018 on account of reduction in working capital borrowings. Improvement in capital structure and debt coverage indicators will remain key monitorables.

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

Continued losses in tyre division

In the tyre segment, KIL's aggregate installed capacity is around 21.65 lakh tyres per annum. Its product portfolio consists of mainly Truck/Bus Tyre, 2/3 wheelers tyres, Light commercial vehicle tyres. Replacement market accounts for around 70% of the total sales of tyre division. KIL sells tyres (under the brand name of Birla tyres).

Although operating loss of tyre division had decreased in FY19, the profitability remains impacted due to sale of low margin Truck & Bus bias tyres and stiff completion from the established players in the industry. The quantum of losses in the division had reduced q-o-q in Q4FY19 and Q1FY20.

The Company is setting up a Passenger Car Radial tyre Unit of 80 MT per day at Balasore unit at an estimated project cost of Rs.950 crore out of which it has already incurred around Rs.788 crore.

As articulated by the management, the promoters are expected to infuse equity of Rs.425 crore by October 2019 and Rs.175 crore in FY21 in the tyre division to support operations and for completing the ongoing project for passenger car radial unit.

Risk of volatility in raw material prices

KIL sources majority of natural rubber from the open market which has witnessed volatility in the recent past. Consequently, the performance of KIL depends upon the ability to procure natural rubber at competitive prices. Further, there has been significant volatility in prices of other raw materials such as synthetic rubber, carbon black and coal (purchased from market as there is no linkage).

Cyclical nature of cement industry

Cement industry is highly cyclical in nature and depends largely on the economic growth of the country. There is a high degree of correlation between the GDP growth and the growth in cement consumption. Cement being a cyclical industry goes through phases of ups and downs, and accordingly impacts the unit realisations. In FY19 demand was strong in the Southern states especially Tamil Nadu and Kerala as these states were affected by natural disaster which led to large scale reconstruction. Demand from retail segment led to an increase in prices of cement across these market especially in Q4FY19.

Exposure to group companies

The company has an exposure of Rs.840.68 crore which is 158.56% of the networth as on March 31, 2019 (Rs.938.06 crore as on March 31, 2018) in its group companies. Further, KIL has also provided corporate guarantee of Rs.225 crore as on March 2019 as against Rs.550 crore as on March 31, 2018 to its wholly owned subsidiary Cygnet Industries Limited. Any further increase in group company exposure will remain a key rating sensitivity.

Key Rating Strengths

Long & established track record of the company

KIL, part of B. K. Birla group of companies, was set up in the year 1919 and has been operating over the last ten decades. Late Mr. B. K. Birla, the promoter of KIL, was an eminent industrialist who was on the Board of KIL since 1940. After the demise of Mr. B.K. Birla in July 2019, Smt. Manjushree Khaitan (daughter of B. K. Birla) was re-designated as the Chairman from executive Vice Chairperson and will continue to be the Non-executive director of KIL. As on June.30, 2019, the promoters' stake in KIL is around 53.13%. Out of the above, 23.82% shares of the company held by a group entity are pledged against borrowings.

Operational efficiency of cement division by way of limestone mines and captive power plant

In the cement segment, KIL sells both PPC and OPC. The ratio of OPC and PPC is around 60:40. KIL sells cement under the brand name 'Birla Shakti' and has presence in Western and Southern regions of the country. KIL sources limestone from its two leasehold mines (one each at both the locations). The limestone reserves at both the mines extend beyond economic life of the respective plants. The said mines are located in proximity of the clinker plants, thereby enabling the company to optimize cost. Cement production, being power intensive, KIL needs uninterrupted supply of power which is ensured by the CPPs installed at its plant locations (aggregate capacity 93MW), which meets the entire annual power requirement of the cement unit. The cheaper cost of power generated in CPPs vis-à-vis power from GRID reduces power cost leading to improvement in operational efficiency of the company.

Improvement in operating revenue in FY19 with cash profits from Q4FY19 onwards

KIL's total operating income improved by around 8% in FY19 to Rs.3,896.39 crore from Rs.3,606.87 crore in FY18 on the back of improved capacity utilization in cement division (87.53% in FY19 as against 73.79% in FY18). The company generated operating profit of Rs.217.37 crore in FY19 vis-à-vis operating loss of Rs.53.53 crore in FY18 with improved realization from cement division. PBILDT/MT for cement division improved to Rs.540/MT in FY19 as against Rs.391/MT in FY18. Further the PBILDT/MT improved to Rs.1056/MT in Q1FY20.

The company incurred losses from the tyre division due to which overall loss was reported in FY19. The loss before exceptional items reduced to Rs.266.20 crore in FY19 (Rs.390.29 crore in FY18) despite reduction in other income from

Rs.212.71 crore in FY18 to Rs.87.96 crore in FY19. The other income of Rs.212.71 crore in FY18 primarily includes Rs.129.86 crore as penalty (for non-performance of the contract by a vendor) and interest income of Rs.65.97 crore on capital advances. The company incurred exceptional cost of Rs.75.23 crore in FY18 (provision for entry tax of Rs.41.37 crore and VRS scheme (Tyre employees) of Rs.33.86 crore) vis-à-vis no exceptional cost in FY19. Consequently, the net losses decreased during the year and the company reported cash loss of Rs.121.17 crore in FY19 (Rs.337.29 crore in FY18). However KIL reported cash profit in Q4FY19 and Q1FY20 on account of improved realization from cement division.

Liquidity: Stretched
The liquidity position of the company is stressed on account of continuous losses. KIL had debt repayment of Rs.118.75 crore and losses of Rs.254.25 crore in FY19 and the same has been met through support extended by the promoters (Rs.9.19 crore), recovery of loans and advances given to group entities (Rs.258 crore) and balance through increase in creditor days and optimization of inventory levels. The company had average fund based utilization of ~89% for the twelve month ended June 30, 2019 with ~Rs.18 crore of free cash and bank balance as on March 31, 2019. The company has significant debt repayment of ~Rs.196 crore in FY20 for which promoter support in the form of equity infusion is envisaged as mentioned earlier (on page 5) in view of cash losses.

Analytical approach: Standalone

Applicable Criteria
Criteria on assigning Outlook and credit watch to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Financial ratios – Non-Financial Sector
Rating Methodology-Manufacturing Companies
Rating Methodology - Cement Industry

About the Company
KIL, part of the B. K. Birla group of companies, is a diversified conglomerate engaged in manufacturing of tyres & tubes and cement. However, after demise of Mr. B.K. Birla in July 2019, KIL re-designated Smt. Manjushree Khaitan (daughter of B.K. Birla) as the Chairman of the company. The primary products are tyre (majorly into Truck & Bus Segment- T& B) and cement, which accounted for 33% and 67% respectively of gross turnover in FY19. KIL's cement manufacturing units have an aggregate capacity of 7.25 million tonnes per annum (MTPA) and are located in Karnataka & Andhra Pradesh. The tyre manufacturing facility of the company is located at Balasore, Orissa, having an installed capacity to produce 21.65 lakh tyres per annum.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	3,606.87	3896.39
PBILDT	-53.53	217.27
PAT	-463.52	254.25
Overall gearing (times)*	5.04	6.40
Interest coverage (times)	NM	0.50

A: Audited
**Total debt includes security deposit from dealers for the purpose of calculation of overall gearing.*

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

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
Non-fund-based - ST-BG/LC	-	-	-	551.00	CARE A4+ (Under Credit watch with Developing Implications)
Fund-based - LT/ ST-CC/Packing Credit	-	-	-	720.00	CARE BB+ / CARE A4+ (Under Credit watch with Developing Implications)
Fund-based - ST-Term loan	-	-	-	0.00	Withdrawn

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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Term Loan-Long Term	LT	-	-	-	-	-	1)Withdrawn (08-Jun-16)
2.	Non-fund-based - ST-BG/LC	ST	551.00	CARE A4+ (Under Credit watch with Developing Implications)	-	1)CARE A4+ (Under Credit watch with Developing Implications) (15-Mar-19) 2)CARE A3+ (Under Credit watch with Developing Implications) (13-Dec-18) 3)CARE A3+ (Under Credit watch with Developing Implications) (22-May-18)	1)CARE A2+ (Under Credit watch with Negative Implications) (20-Feb-18) 2)CARE A2+ (Under Credit watch with Negative Implications) (25-Jan-18) 3)CARE A2+ (Under Credit watch with Negative Implications) (21-Nov-17) 4)CARE A2+ (25-Sep-17) 5)CARE A1 (12-Jul-17)	1)CARE A1 (14-Oct-16) 2)CARE A1 (08-Jun-16)
3.	Fund-based - LT/ ST-CC/Packing Credit	LT/ST	720.00	CARE BB+ / CARE A4+ (Under Credit watch with Developing Implications)	-	1)CARE BB+ / CARE A4+ (Under Credit watch with Developing Implications) (15-Mar-19) 2)CARE BBB / CARE A3+ (Under Credit watch with Developing Implications) (13-Dec-18) 3)CARE BBB / CARE A3+ (Under Credit	1)CARE A- / CARE A2+ (Under Credit watch with Negative Implications) (20-Feb-18) 2)CARE A- / CARE A2+ (Under Credit watch with Negative Implications) (25-Jan-18) 3)CARE A- / CARE A2+ (Under Credit	1)CARE A / CARE A1 (14-Oct-16) 2)CARE A / CARE A1 (08-Jun-16)

						watch with Developing Implications) (22-May-18)	watch with Negative Implications) (21-Nov-17) 4)CARE A-; Negative / CARE A2+ (25-Sep-17) 5)CARE A; Negative / CARE A1 (12-Jul-17)	
4.	Preference Shares-Convertible Prefrence Shares	LT	-	-	-	-	1)Withdrawn (12-Jul-17)	1)CARE BBB+ (RPS) (14-Oct-16) 2)CARE BBB+ (RPS) (08-Jun-16) 3)CARE BBB+ (RPS) (Under Credit Watch) (12-Apr-16)
5.	Commercial Paper	ST	-	-	-	-	-	1)Withdrawn (30-Jun-16) 2)CARE A1 (08-Jun-16)
6.	Fund-based - LT-Term Loan	LT	-	-	-	1)Withdrawn (22-May-18)	1)CARE A- (Under Credit watch with Negative Implications) (20-Feb-18) 2)CARE A- (Under Credit watch with Negative Implications) (25-Jan-18) 3)CARE A- (Under Credit watch with Negative Implications) (21-Nov-17) 4)CARE A-; Negative (25-Sep-17) 5)CARE A; Negative (12-Jul-17)	-
7.	Fund-based - ST-Term loan	ST	-	-	-	1)CARE A4+ (Under Credit watch with Developing Implications) (15-Mar-19) 2)CARE A3+ (Under Credit watch with Developing Implications) (13-Dec-18) 3)CARE A3+ (Under Credit watch with Developing Implications) (22-May-18)	-	-

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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