The Kolhapur Steel Limited

March 11, 2020

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term Bank Facilities	2.81	**CARE BBB-; Stable (Triple B Minus ; Outlook: Stable)**	Assigned
Long-term/Short-term Bank Facilities	7.19	**CARE BBB-; Stable/CARE A3 (Triple B Minus; Outlook: Stable/ A Three)**	Assigned
Total facilities	**10.00 (Rs. Ten crore only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of 'The Kolhapur Steel Limited' (TKSL) derives comfort from its strong parentage of Kirloskar Brothers Limited (KBL), demonstrated financial support from the parent company, in the form of inter-corporate loans and extended corporate guarantee towards TKSL's debt obligations.

The rating strengths, however, are constrained by modest scale of operations and operating losses, weak capital structure and debt coverage metrics and susceptibility to volatility in raw material prices.

However, ratings also factors in the management's concrete plan to turn around TKSL's operations through appointing third party consultant to turnaround the business which is expected to yield benefits for the company and achieve sustainable business going forward.

Rating Sensitivities

Positive Factors

- Sustained improvement in scale of operations and operating profits leading to positive cash accruals to service its debt obligations
- Improvement in interest coverage to about 2 times or higher
- Improvement in capital structure with positive net worth and overall gearing to 2 times or lower

Negative Factors

- Change in stance of parent company's management with regards to providing business and financial support to TKSL

Detailed description of the key rating drivers

Key Rating Strengths

Strong Parentage

TKSL is a subsidiary of Kirloskar Brothers Limited (KBL, holding 99.74%) which is one of the leading manufacturer and exporter of pumps catering the requirements of sectors such as oil and gas, defense and marine, water resource management, irrigation, power, distribution and construction. TKSL acts as a backward integrated unit for KBL, from where required castings are procured, however on an arm's length basis. TKSL derives around 60%-70% of revenue from Kirloskar group entities including KBL. In addition, around 50% of the TKSL's installed capacity is reserved for KBL and group. The board of directors chaired by KBL's key personnel, aids in sound decision making and the management's concrete plan to revive the operations at TKSL by appointing third party consultant is expected to result in achieving benefits and sustainable business going forward.

Financial support from the parent

KBL acquired TKSL in 2007 to procure quality steel castings required to manufacture pumps. However, TKSL has had reported cash losses in the past and the working capital along with debt obligations were met through funding support from KBL in the form of either equity or inter-corporate loan infusion. In FY20 as well, KBL has infused significant funds in TKSL in the form of unsecured loans and is expected to do so in the near future to fund the losses along with repayment of working capital term loans. Additionally, KBL has extended corporate guarantee to the bank facilities of TKSL. Going forward, continued financial support from KBL to TKSL is a key rating monitorable.

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

Key Rating Weaknesses

Modest Scale of operations and Operating Losses
Scale of operation has had been modest since acquisition in 2007 by KBL. Total operating income (TOI) was seen in the range of Rs.30 crore – Rs.46 crore during FY15-FY19. TKSL registered a Total operating income (TOI) of Rs.36.14 crore in FY19 as against 46.06 crore in FY18. Over the past five years, the capacity utilization has been below 50% on account modest orders from KBL and other group entities. On account of low capacity utilization, the company has been unable to absorb fixed costs and lead to operating losses. However, in FY18, the company was able to turn profitable due to relatively higher orders from KBL leading to better capacity utilization, regardless of that the same couldn't be sustained. Added pressure on operating profit margin in FY19 on account of rise in raw material prices, wage revision and power and fuel cost further exacerbated the performance. CARE Ratings believes that TKSL's scale of operation will continue to remain modest over the medium term and operational losses are estimated during FY20 as well.

Weak capital structure and debt coverage metrics
TKSL posted net losses in last four out of the five fiscal years through FY19 in the range of on account of modest orders leading to below average capacity utilization. Accumulated losses over the years resulted in negative net worth. Despite infusion of funds by KBL, the capital structure is expected to remain weak in the near term, as these are treated as debt (inter-corporate loans). Further, on account of operating losses, interest coverage and total debt/ gross cash accrual are estimated to be in negative indicating weak debt coverage metrics. Further, no equity infusion is expected over the near to medium term constraining the financial flexibility of the company.

Susceptibility to volatility in raw material prices
The key raw material of the company – Steel scrap and Ferro alloys, are highly volatile in nature. Furthermore, large portion of orders usually doesn't have escalation clause built in, which keeps its operating efficiency vulnerable to the movements in raw material prices.

Liquidity: Stretched
TKSL's liquidity is constrained by cash losses, high working capital limits utilization and modest cash & bank balances. However, the liquidity is supported by financial support of parent, KBL. TKSL incurred cash loss of about Rs.6.39 crore in FY19 and is expected to incur cash losses in FY20 as well. However, the repayment obligations of working capital term loan of about Rs.1.25 crore are expected to be met by fund infusion from the parent. Fund infusion to the tune of ~Rs.10 crore in FY20, further eased the liquidity position. The company relies largely on working capital utilization as indicated by average utilization of working capital limits of nearly 73% for the past 12 months ended November 30, 2019. Operating cycle of the company for FY19 was seen at 31 days as against 6 days in FY18. Over the years, TKSL has been able to manage the operating cycle below 40 days mainly on account of garnering better credit terms with the suppliers. The company gets open credit of around 90 days which is partially on account of its strong parentage. In FY19, average creditors period stood at 100 days as against 86 days in FY18.

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: Consolidation and Factoring Linkages in Ratings

About the Company
The Kolhapur Steel Limited (TKSL) is the subsidiary of Kirloskar Brothers Limited (KBL, holding 99.74% stake). TKSL which has its manufacturing facility located at Shiroli, Kolhapur (Maharashtra), was established on May 26, 1965 by Agashe family. It was taken over by KBL in September 2007 and is currently managed by C M Mate (Chairman) and Ravindra Samant (Managing Director) who also hold key positions in the parent company, KBL. TKSL is engaged in the manufacturing mild steel and stainless steel castings which are used in various end user sectors like pumps, valves, turbines (steam and hydro), marine, rubber machinery, mining and general engineering. TKSL has a total production capacity of 6000 MTPA producing castings weighing in range of 300kg to 14000 kg (single piece).

Covenants of rated instrument / facility: *Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3*

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	46.06	36.14
PBILDT	2.55	-5.48
PAT	0.27	-7.62
Overall gearing (times)	NM	NM
Interest coverage (times)	2.14	NM

A: Audited; NM: Not Meaningful

Status of non-cooperation with previous CRA: None

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
Fund-based - LT-Working capital Term Loan	-	-	2022	2.81	CARE BBB-; Stable
LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	-	-	-	5.00	CARE BBB-; Stable / CARE A3
LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	-	-	-	2.19	CARE BBB-; Stable / CARE A3

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.	Fund-based - LT-Working capital Term Loan	LT	2.81	CARE BBB-; Stable	-	-	-	-
2.	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	LT/ST	5.00	CARE BBB-; Stable / CARE A3	-	-	-	-
3.	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	LT/ST	2.19	CARE BBB-; Stable / CARE A3	-	-	-	-

Annexure 3: Detailed explanation of covenants of the rated facilities

Name of the Instrument	Detailed explanation
A. Financial covenants (Major)	
I. Ownership/management covenant	Parent Kirloskar Brothers Limited will maintain shareholding of at least 76% holding in the borrower throughout the tenure of the WCTL. KBL will maintain the funds already infused in the borrower in the form of equity or quasi equity in the form of equity or preference shares or any other instruments throughout the tenure of the facility
II. Contractual comfort	Corporate guarantee of KBL in a form and manner acceptable to bank
B. Non-financial covenants	NA

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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