**Kennametal India Limited**
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KENNAMETAL

**October 21, 2024**

Ref: Sec/Sto/2024/10/03

**Corporate Relationship Department**
**BSE Limited**
Phiroze Jeejeebhoy Towers Dalal Street,
Mumbai – 400001

**Subject: Disclosure under Regulation 30 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 - Credit Rating**
**Ref: [Scrip code: 505890] - Kennametal India Limited**

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Dear Sir / Madam,

Pursuant to Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, this is to inform you that India Ratings & Research (the "**Credit Rating Agency**"), vide their report dated October 21, 2024, have assigned Kennametal India Limited (the "**Company**"), a Long-Term Issuer Rating of '**IND AA-' and the Outlook is Stable**.

Enclosed herewith the rating report dated October 21, 2024 issued by the Credit Rating Agency.

Kindly take the same on record.

Thanking you.

For **Kennametal India Limited**
ANUPRIYA GARG
Digitally signed by ANUPRIYA GARG
Date: 2024.10.21 18:07:30 +05'30'

**Anupriya Garg**
**Legal Counsel (Region) & Company Secretary**

**Encl.: As above**

India Ratings & Research
A Fitch Group Company

# India Ratings Affirms Kennametal India at ‘IND AA-’/Stable

Oct 21, 2024 | Industrial Products

India Ratings and Research (Ind-Ra) has affirmed Kennametal India Limited's (KIL) Long-Term Issuer Rating at ‘IND AA-’. The Outlook is Stable.

## Details of Instruments

| Instrument Type | Date of Issuance | Coupon rate | Maturity date | Size of Issue (million) | Rating assigned along with Outlook/Watch | Rating Action |
|---|---|---|---|---|---|---|
| Long-Term Issuer Rating | - | - | - | - | IND AA-/Stable | Affirmed |

## Analytical Approach

Ind-Ra continues to take a standalone view of KIL while notching up its ratings by one notch on account of the strong operational and strategic ties between KIL and its 75% parent, Kennametal Inc. (KMI; Fitch Ratings Ltd; Issuer Default Rating: ‘BBB’/Stable).

## Detailed Rationale of the Rating Action

The affirmation reflects KIL’s continued strong credit profile and profitability and its robust linkages with the parent. However, the rating is constrained by the cyclical nature of end-user segments and the fragmented nature of the cutting tools market, which constrains KIL’s medium scale of operations. The company begins its financial year from July, in line with the parent.

## List of Key Rating Drivers

### Strengths

- Strong operational and strategic ties with parent
- Strong credit metrics
- Diversified revenue across end-use segments, countries and customers
- Improved EBIDTA margins likely to sustain

### Weaknesses

- Medium scale of operations due to fragmented industry and niche market of machining solutions (MSG)
- Working capital-intensive business operations
- Exposure to cyclical nature of industries

## Detailed Description of Key Rating Drivers

**Strong Operational and Strategic Ties with Parent:** KIL has been supported by KMI in terms of research and development (R&D), technology, key decision making and managerial guidance since its acquisition from the WIDIA group in 2002-2003. All the seven directors of KIL have been appointed by the shareholders of the company and key managerial personnel have been appointed by the board of KIL on the recommendation of the nomination and remuneration committee and KMI. Also, the company’s performance is reviewed by KMI on a monthly basis. The company benefits from KMI’s manufacturing and marketing efficiency, international presence, research and development [R&D] capabilities, and support in the sourcing of raw materials such as tungsten, tantalum and cobalt.

KIL contributed only around 6% to KMI’s consolidated sales and around 5% to the consolidated EBITDA in FY24.

However, India continues to be a strategically important market for KMI in terms of customer base, geographical diversification, cost efficient market and R&D activities. Also, KIL is the only company in the group that manufactures customised, special purpose machines.

**Strong Credit Metrics:** KIL exhibited strong credit metrics over FY18-FY24, with a sustained net cash position and an interest coverage of over 30x (FY24: 270x; FY23: 640x), due to its ability to generate strong cash flows owing to robust EBITDA generation. During FY18-FY24, KIL reported an EBITDA of above INR1,500 million (FY24: INR1,713 million; FY23: INR1,515 million), barring FY20 (INR709 million), when COVID-19 had affected the top line (fell 25% yoy) leading to a lower absorption of fixed costs. However, the EBITDA recovered subsequently and has remained robust since then on the back of improved capacity utilisation.

During FY24, KIL had interest expenses of INR6 million owing to the lease liabilities and other statutory interest obligations. Ind-Ra expects the credit metrics to remain strong over FY25-FY26, amid the absence of any large debt-funded capex plans and KIL's ability to manage the working capital requirements through internal cash flows.

**Diversified Revenue Across End-Use Segments, Countries and Customers**: KIL primarily operates in two segments - hard metal products (HMP) and MSG, which contributed 87% and 13%, respectively, to the net revenue during FY24 (FY23: 86%, 14%). However, the end-use segments vary across sectors, including automobile, transportation, defence, aerospace, gas, energy, infrastructure, earthworks and general engineering. Furthermore, although KIL’s revenue is majorly concentrated in India (FY24: 84%, FY23: 83%, FY22: 77%), the remaining comes from customers in the US, Europe, China and other countries. Also, in the MSG business, KIL plans to expand to other south-east Asian countries, which is likely to reduce the risk of lower demand from the Chinese automobile market. The company supplies its products to more than 1,500 customers globally, thereby mitigating customer concentration risk. Also, the top 10 customers did not contribute more than 20% to the total revenue during FY23-FY24.

**Improved EBIDTA margins Likely to Sustain:** KIL commands healthy margins owing to the industrial usage of its products and customised special purpose machines. The EBITDA margin ranged between 12%-18% during FY18-FY24 (FY24: 15.6%; FY23: 14.1%; FY22: 18.1%). The EBIDTA margins strengthened in FY24 owing to softening of raw material prices, the cost control mechanism implemented by the company, and better internal efficiencies.

Ind-Ra expects the margins to range between 15%-16% in FY25 and FY26, because of a continued decline in raw material prices and benefits of internal efficiencies. However, the margins shall remain constrained by the company’s presence in the inflationary commodity market and its limited ability to pass on the increases in raw material prices to customers in the absence of any signed agreements for price escalation mechanism; this shall remain a key rating monitorable.

**Medium Scale of Operations due to Fragmented Industry and Niche MSG Market:** KIL's revenue grew at a CAGR of about 6% over FY18-FY24, largely led by growth in the hard metal segment, regular addition of customers, product launches as per the industry’s requirement, and price revisions. The revenue grew 2% yoy to INR10,999 million in FY24 (FY23: up 9% yoy to INR10,771 million). The revenue growth moderated during FY24 due to headwinds from the Chinese market, a key geography for its MSG business segment. Ind-Ra expects the revenue growth to range between 7%-8% yoy over FY25-FY26, mainly on account of the MSG segment’s healthy order book position, which is largely driven by the domestic market and provides healthy revenue visibility for the next 12-14 months. The revenue growth could be constrained by muted growth from the export market on account of weaker demand from Europe and the US. Sustained improvement in the scale of operations along with continued healthy operating profitability would remain a key rating monitorable.

**Working Capital-Intensive Business Operations:** The operations of the company are working capital-intensive, as reflecting in a stretched net working capital cycle of 155 days in FY24 (FY23: 124 days; FY22: 135), largely on account of inventory days of 148 days (113 days; 142) and debtor days of 59 days (48 days; 50 days). The inventory days have been high as the company has to keep higher stock of raw materials, majority of which is imported and requires a higher lead time to reach India. Inventory days had reduced in FY23 because of lower stock holding levels, resulting from a one-time shift towards modern equipment.

The working capital requirements of the business continue to be supported by the credit extended by suppliers and internal cash accruals generated by the company. However, the operations of the company are likely to remain working capital-intensive, given its internal policy to maintain inventory of 120-150 days. Sustained lower reliance on external debt amid a sustained improvement in the scale of operations would therefore remain a key rating sensitivity factor.

**Exposure to Cyclical Nature of Industries:** KIL’s products are primarily used in industries such as automobile, transportation, energy, steel, infrastructure and aerospace, wherein demand is cyclical and dependent on the economy. KIL's operating performance, therefore, is likely to remain sensitive to the performance of these industries. Furthermore, the company's performance moves in tandem with the country's capital cycle as the end-user segments of the products are largely capex-intensive industries.

## Liquidity

**Adequate:** KIL did not utilise its fund-based limits over the 12 months ended August 2024, but it utilised its non-fund-based limits at an average of 51% over the same period. KIL has been using own cash flows for working capital management, resulting in nil working capital debt utilisation during the past six years. KIL had an unencumbered cash balance of INR1,128 million at FYE24 (FYE23: INR892 million). The cash flow from operations  was largely stable at INR1,152 million in FY24 (FY23: INR1160 million).  Despite capex of INR294 million and the company paying out dividend of INR659 million, the free cash flow remained positive at INR199 million in FY24 (FY23: INR242 million) due to healthy operating profitability and efficient control over the working capital cycle.

Ind-Ra expects the cash flow from operations and free cash flows to remain positive during FY25-FY26 on the back of stable profitability and the absence of any large capex plans. KIL has modest capex plans for FY25-FY26 towards incremental capacity additions, which will continue to be funded through internal accruals. During FY25-FY26, the company is also likely to pay out dividends in line with industry average and as per its internal dividend policy. Moreover, KIL has strong financial flexibility by being a part of the Kennametal group. At FYE24, the company had nil debt, and had only lease liabilities of INR30 million (FYE23: INR27 million).

## Rating Sensitivities

**Positive:** Significant growth in the profitability while maintaining the linkages with the ultimate parent and maintaining the net leverage below 1.5x on a sustained basis could lead to a positive rating action.

**Negative:** Developments that could, individually or collectively, lead to a negative rating action include:
- deterioration in the profitability and/or the working capital cycle on a sustained basis
- the net leverage exceeding 2.5x on a sustained basis
- any weakening of KIL’s linkages with KMI
- significant weakening of KMI’s credit profile

## About the Company

Formed in 1964, KIL is a 75% subsidiary of KMI. It manufactures carbide tools and special-purpose machines for automotive, transportation, defence, railways, infrastructure, energy and general engineering segments. KIL has a manufacturing unit in Bengaluru, Karnataka.

## Key Financial Indicators

| Particulars | FY24 | FY23 |
|---|---|---|
| Revenue (INR million) | 10,999 | 10,771 |
| EBITDA (INR million) | 1,713 | 1,515 |
| EBITDA margin (%) | 15.6 | 14.1 |
| Interest coverage (x) | 285.5 | 757.5 |
| Net leverage (x) | n.m | n.m |
| Source: KIL, Ind-Ra<br>n.m: not meaningful | | |

## Status of Non-Cooperation with previous rating agency

Not applicable

## Rating History

| Instrument Type | Rating Type | Rated Limits (million) | Current Ratings/Outlook | Historical Rating/Outlook | |
|---|---|---|---|---|---|
| | | | | 17 October 2023 | 18 July 2022 |
| Issuer rating | Long-term | -- | IND AA-/Stable | IND AA-/Stable | IND AA-/Stable |

## Complexity Level of the Instruments

Not applicable

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## APPLICABLE CRITERIA AND POLICIES

**Parent and Subsidiary Rating Linkage**

**Evaluating Corporate Governance**

**Corporate Rating Methodology**

**The Rating Process**