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KENNAMETAL

July 18, 2022

Ref: Sec/Sto/2022/07/03

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

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 July 18, 2022, 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 July 18, 2022 issued by the Credit Rating Agency.

Kindly take the same on record.

Thanking You.

Yours Truly,
For **Kennametal India Limited**

Naveen Chandra. P.

Naveen Chandra P
General Manager – Legal & Company Secretary

Encl.: As above

India Ratings Assigns Kennametal India 'IND AA-'; Outlook Stable

Jul 18, 2022 | Others

India Ratings and Research (Ind-Ra) has assigned Kennametal India Limited (KIL) a Long-Term Issuer Rating of 'IND AA-'. The Outlook is Stable.

Analytical Approach: Ind-Ra has taken a consolidated view of KIL and its wholly owned subsidiary Widia India Tooling Pvt. Ltd. (WITPL), and has notched up the rating on account of the strong operational and strategic ties between KIL and its 75% parent, Kennametal Inc. (KMI; Fitch Ratings Issuer Default Rating 'BBB'/Stable).

The rating reflects KIL's 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 moderate size of KIL's operations on the back of its presence in the fragmented cutting tools market.

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 are appointed by the shareholders of the company and key managerial personnel are appointed by the board of KIL on the recommendation of nomination and remuneration committee and KMI.. The company's performance is also reviewed by KMI on a monthly basis. The company benefits from KMI's manufacturing and marketing efficiency, international presence, R&D capabilities, and support in the sourcing of raw materials such as tungsten, tantalum and cobalt. Around 60% of KIL's purchases are from KMI and group companies.

Although KIL contributed only 6% to KMI's sales and EBITDA at the consolidated level during June 2021, India has been one of the strategically important markets 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 manufacturing customised, special purpose machines. The company follows July to June financial year, in line with the parent.

Strong Credit Metrics: KIL exhibited strong credit metrics over FY18-FY21, with a net cash position and an interest coverage above 30x, due to its ability to generate strong cash flows owing to robust EBITDA generation. KIL reported EBITDA of above INR1.0 billion during this period, barring in FY20 (INR0.7 billion) when COVID-19 affected the top line (fell 25% yoy) leading to a lower absorption of fixed costs. However, this recovered during FY21 on the back of improved capacity utilisation.

During 9MFY22, KIL had nil interest expenses owing to nil debt utilisation. Ind-Ra expects the credit metrics to have remained strong over FY22, and to follow suit in FY23, amid the absence of any large debt-funded capex 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 machining solutions (MSG), which contributed 86% and 14%, respectively, to the consolidated revenue during 9MFY22 (FY21: 87%, 13%). 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 (FY21: 78%, FY20: 81%), the remaining comes from the customers in the US, Europe, China and other countries. Also, KIL has plans for expansion of the MSG segment to other South East Asian countries. The company supplies its products to more than 1,500 customers globally, thereby limiting itself from customer concentration risk. Also, the top 10 customers did not contribute to a significant part of total revenue during 9MFY22 and FY21.

Healthy EBITDA Margins: Considering the industrial usage of KIL’s products and customised special purpose machines, KIL commands healthy margins. The consolidated EBITDA margin was in the range of 10%-15% during FY18-FY21 and improved to 18.5% during 9MFY22 (9MFY21: 14.6%), due to improved margins for both the segments on the back of a better absorption of fixed costs, owing to an increase in the capacity utilisation with a regular execution of orders in hand. Ind-Ra expects the margins to have remained in the range of 15%-17% in FY22, could be rangebound in FY23, constrained by the company’s presence in the inflationary commodity market and ability to pass on increases in raw material prices to customers in the absence of signed agreements for price escalation mechanism.

Liquidity Indicator – Adequate: Over the 12 months ended April 2022, KIL did not utilise its fund-based limits, but utilised its non-fund-based limits at an average of 47%. KIL has been using own cashflows for working capital management, resulted in nil working capital debt utilisation during the past four years. KIL had an unencumbered cash balance of INR1.3 billion at FYE21 (FYE20: INR0.5 billion). KIL's cash flow from operations (CFO) increased to INR1.7 billion in FY21 (FY20: INR0.4 billion; FY19: INR0.8 billion) on account of improved profitability and favourable changes in its working capital. Also, the free cash flow (FCF) turned positive at INR1.0 billion in FY21 (FY20: negative INR0.2 billion, FY19: negative INR0.5 billion) even as the company incurred capex of INR263 million and paid out a dividend of INR440 million. In FY22, Ind-Ra expects the CFO and FCF to have remained positive but moderated, due to the increased inventory levels. KIL had modest capex plans in FY22 towards incremental capacity additions, which will remain so in FY23 and continue to be funded through internal accruals. In FY22, the company is also likely to have paid out dividends in line with industry average and as per its internal dividend policy. However, the liquidity is likely to have remained strong in FY22 which could continue in FY23, backed by the high cash balance and the availability of unutilised credit lines. Moreover, KIL has strong financial flexibility by being a part of the Kennametal group. At 9MFY22, the company had nil debt.

Moderate Scale of Operations due to Fragmented Industry and Niche Market of MSG: KIL's revenue grew at a CAGR of 5.4% over FY17-FY21, in line with country’s manufacturing activities. However, the revenue declined 25% yoy during FY20 due to the COVID-19 outbreak. Revenue growth over FY17-FY21 was primarily supported by the regular addition of customers, product launches as per the industry’s requirement and partly due to price revisions. The revenue grew 21% yoy to INR8.5 billion during FY21, primarily due to the low base of FY20 stemming from the COVID-19-led disruptions. During 9MFY22, the company’s revenue was up 12.5% yoy to INR7.2 billion due to lockdown relaxations and orderbook maintenance by the addition of customers. Ind-Ra opines the revenue would have increased

10%-14% yoy in FY22, but will grow only 4%-7% yoy in FY23, owing to the slowdown in the automobile and transportation sector due to the elongated semi-conductor chip shortage, fragmented nature of the industry with the presence of unorganised players and niche market of MSG.

Exposure to Cyclical Nature of Industries: KIL's products are primarily used in industries such as automobile, transportation, energy, steel, infrastructure and aerospace where 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.

Amalgamation of Widia India Tooling Private Limited (WITPL; 100% subsidiary): Under KIL's global restructuring programme, its board of directors approved a scheme of amalgamation between WITPL and KIL on 4 December 2020. The company has transferred all of its property, plant and equipment, employees and creditors to KIL and ceased its operations with effect from 1 January 2021. The company is awaiting the approval from the National Company Law Tribunal for the next course of action. The Widia brand will continue to exist but will be offered to customers from KIL.

Exposure to Forex and Input Price Volatility: KIL imports about 80% of the raw materials from its group companies and some third parties. However, the intergroup purchases are major (60%) and are transacted in the India rupee. The purchases from third parties are with an open-market position and the payments are made within 60 days from the date of the receipt of the raw material. Hence, any increase in foreign currency rates could lead to a contraction in KIL's margins. However, this risk is significantly offset by export sales. Furthermore, although there were no signed agreements with customers for passing on increased raw material prices, KIL so far has protected its margins based on negotiations with customers; this is reflected in its stable gross margins of around 47% over FY18-FY21.

Standalone Financials: In 9MFY22, KIL's standalone revenue was INR7.2 billion (FY21: INR8.1 billion, 9MFY21: INR6.0 billion), EBITDA was INR1.3 billion (INR1.2 billion, INR0.8 billion). Interest coverage was 400x in FY21 (FY20: 55x), and the company was net cash positive in FY21 and FY20.

Rating Sensitivities

Positive: Significant growth in the revenue or 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 revenue, EBITDA margins 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

Company Profile

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).

CONSOLIDATED FINANCIAL SUMMARY

Particulars	FY21	FY20
Revenue (INR billion)	8.5	7.0

Reported EBITDA (INR billion)	1.3	0.7
Reported EBITDA margin	15.3	10.1
Interest coverage (x)	436	37.3
Net leverage (x)	Net cash	Net cash
Source: KIL, Ind-Ra		

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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Complexity Level of Instruments

Not applicable.

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