Kennametal India Limited
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October 17, 2023

Ref: Sec/Sto/2023/10/03

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

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 17, 2023, 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 17, 2023 issued by the Credit Rating Agency.

Kindly take the same on record.

Thanking you.

Yours truly,
For **Kennametal India Limited**

Naveen Chandra Prakash
Digitally signed by Naveen Chandra Prakash
Date: 2023.10.17 11:41:04 +05'30'

Naveen Chandra P
General Manager – Legal & Company Secretary

Encl.: As above

India Ratings Affirms Kennametal India at 'IND AA-'/Stable

Oct 17, 2023 | 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.

ANALYTICAL APPROACH : Ind-Ra has changed its rating approach from consolidated to taking a standalone view of KIL as its earlier wholly owned subsidiary Widia India Tooling Pvt. Ltd. (WITPL) has been merged with KIL with effect from 17 October 2022. The agency continues to notch up KIL's 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 around 6% to the sales and around 5% to the EBITDA of KMI at the consolidated level during the year ended June 2023, 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-FY23, 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 an EBITDA of above INR1,000 million during this period, barring in FY20 (INR709 million) when COVID-19 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 FY23, KIL had interest expenses of INR2 million owing to the lease liabilities. Ind-Ra expects the credit metrics to remain strong over FY24-FY25, 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 machining solutions (MSG), which contributed 86% and 14%, respectively, to the net revenue during FY23 (FY22: 85%, 15%). 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 (FY23: 83%, FY22: 77%, FY21: 78%), 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 more than 20% to the total revenue during FY23 and FY22.

EBITDA Margins Declined in FY23; Likely to Rise FY24 Onwards: Considering the industrial usage of KIL's products and customised special purpose machines, KIL commands healthy margins. The EBITDA margin was in the range of 12%-18% during FY18-FY22, and moderated yoy to 14.1% during FY23 (FY22: 18.1%). In FY23, the margins were affected mainly on account of the one-time expenses incurred towards the shifting of manufacturing facilities and machines to a larger modern plant within the same factory premises and due to the under absorption of fixed costs, owing to a decrease in the capacity utilisation to correct the inventory. Furthermore, the margins were impacted by a weak demand from China, the company's key geography for the MSG segment, which contributed about 14% (FY22: 15%) to revenues in FY23. Ind-Ra expects the margins to remain in the range of 14%-15% in FY24-25, 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.

Liquidity Indicator – Adequate: Over the 12 months ended September 2023, KIL did not utilise its fund-based limits, but utilised its non-fund-based limits at an average of 35%. KIL has been using own cashflows for working capital management, resulting in nil working capital debt utilisation during the past six years. KIL had an unencumbered cash balance of INR892 million at FYE23 (FYE22: INR634 million). The cash flow from operations (CFO) increased to INR1,160 million in FY23 (FY22: INR507 million) on account of favourable changes in its working capital. Also, the free cash flow (FCF) turned positive at INR242 million in FY23 (FY22: negative INR670 million), even as the company incurred capex of INR478 million and paid out a dividend of INR440 million, due to an increase in the CFO and a reduction in both capex and dividend outflow during the year. Ind-Ra expects the CFO and FCF to remain positive in FY24-FY25 on the back of stable profitability and no large capex plans over the medium term. KIL has modest capex plans for FY24-FY25 towards incremental capacity additions, which will continue to be funded through internal accruals. During FY24-FY25, 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 FY23, the company had nil debt, but only lease liabilities of INR27 million (FY22: nil).

Moderate Scale of Operations due to Fragmented Industry and Niche Market of MSG: KIL's revenue grew at a CAGR of about 12% over FY21-FY23, largely led by growth in the hard metal segment. However, the revenue growth moderated during FY23 due to the headwinds from the Chinese market, a key geography for its MSG business segment. Revenue growth over FY18-FY23 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 9% yoy to INR10,771 million (FY22: INR9,907 million, up 16% yoy during FY23. Ind-Ra expects the revenue growth to remain in the range of 8%-9% yoy over FY24-25, led by growth in the hard metal segment which is likely to grow higher than the industry as per company's management, but remain constrained due to the uncertainty of growth in the MSG business segment in China.

Elongated Working Capital Cycle: Although improved on a yoy basis, the working capital cycle for the company continues to be fairly long at around 124 days (FY22: 135 days). While the company has rationalised its inventory holding of both raw materials and finished goods, the same remained elongated at 113 days in FY23 (FY22: 142 days). The reduction in inventory days was offset by a simultaneous reduction in the payable days to 38 in FY23 (FY22: 58). Ind-Ra expects KIL's working capital cycle to remain at 120-125 days over FY24-FY25 due to the company's policy of keeping finished goods inventory for about 45 days and raw material inventory for about 90-120 days as it is imported via the sea route. The company's working capital cycle is also on the longer side than its peers' in the similar rating category and will remain a key monitorable for the agency.

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 National Company Law Tribunal, Bengaluru bench delivered an order on 17 October 2022 sanctioning the scheme of merger which was received on 16 November 2022. Hence, though the wholly owned subsidiary ceased to exist, the Widia brand will continue to exist but will be offered to customers from KIL itself.

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 75 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 the increased raw material prices, which is based on negotiations with customers, this is reflected in its weakening of gross margins to about 44% in FY23 (FY22: around 50%).

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
- weakening of credit profile of 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).

FINANCIAL SUMMARY

Particulars	FY23	FY22
Revenue (INR million)	10,771	9,907
Reported EBITDA (INR million)	1,515	1,789
Reported EBITDA margin	14.1	18.1
Interest coverage (x)	757.5	NA
Net leverage (x)	Net cash	Net cash
Source: KIL, Ind-Ra		

Non-Cooperation with previous rating agency

Not applicable

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.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

Rating History

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

Complexity Level of Instruments

Not applicable

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APPLICABLE CRITERIA

Parent and Subsidiary Rating Linkage

Evaluating Corporate Governance

Corporate Rating Methodology

The Rating Process