CRISIL Ratings

Rating Rationale

August 30, 2023 | Mumbai

Kirloskar Brothers Limited

Long-term rating upgraded to 'CRISIL AA/Stable'; short-term rating reaffirmed

Rating Action

Total Bank Loan Facilities Rated	**Rs.1454 Crore**
Long Term Rating	**CRISIL AA/Stable (Upgraded from 'CRISIL AA-/Positive')**
Short Term Rating	**CRISIL A1+ (Reaffirmed)**

Rs.100 Crore Commercial Paper	**CRISIL A1+ (Reaffirmed)**

Note: None of the Directors on CRISIL Ratings Limited's Board are members of rating committee and thus do not participate in discussion or assignment of any ratings. The Board of Directors also does not discuss any ratings at its meetings.
1 crore = 10 million
Refer to Annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL Ratings has upgraded its rating on the long-term bank facilities of Kirloskar Brothers Limited (KBL) to **'CRISIL AA/Stable'** from 'CRISIL AA-/Positive' and reaffirmed its 'CRISIL A1+' rating on the short-term bank facilities and commercial paper programme of the entity.

The rating action follows a sustained improvement in the business risk profile of the KBL group (KBL consolidated with joint venture [JV], Kirloskar Ebara Pumps Ltd [KEPL; 'CRISIL A/Stable/CRISIL A1']), driven by an established market position with a shift towards the products segment, steady demand, healthy order execution, and benefits of strategic efficiency initiatives undertaken to improve profitability. This has led to increased revenue along with improved margins which is expected to continue over the medium term. Financial risk profile is also expected to remain strong over the medium term on the back of strong capital structure and debt protection metrics.

The KBL group has an established market position in the pumps business and has consistently transitioned its business towards product categories away from projects business (reduced to 3% in fiscal 2023 from 29% a decade ago), enjoys sizeable, consolidated order book (around Rs 3,471 crore as on June 30, 2023 for the KBL group) which provides good revenue visibility, and wide geographic reach through a strong distribution network. It undertook strategic initiatives including efficiencies to reduce direct and indirect costs, improve pass-through of raw material prices, thereby increasing profitability at international and domestic subsidiaries; this trend is expected to continue over the medium term.

Operating performance of the KBL group in fiscal 2023 improved significantly on-year basis, with consolidated operating income growing by 21% to Rs 3,971 crore and earnings before interest, tax, depreciation and amortisation (Ebitda) rising to Rs 429 crore at 10.8% margin from 7.4% in the previous fiscal. Healthy operating performance continued in the seasonally moderate first quarter of fiscal 2024, with the consolidated revenue of KBL (excluding KEPL) growing by 15% to Rs 900 crore with Ebitda margin of 12.2% as compared to 5.2% during the same period in fiscal 2023. CRISIL Ratings estimates the group will sustain healthy operating performance, with annual revenue growth of 6-8% and Ebitda margin at 9.5-10.0% over the medium term, driven by steady profitability at international and domestic subsidiaries.

Financial risk profile continued to improve in fiscal 2023, with the group remaining net debt free. Healthy cash accrual and moderate capital expenditure (capex), led to building-up on its liquid surplus to Rs 504 crore as on March 31, 2023 (Rs 359 crore in fiscal 2022) while total debt (for the group) reduced to Rs 253 crore (from Rs 375 crore in fiscal 2022). With steady operating performance, debt protection metrics are expected to improve with annual cash accrual of Rs 300+ crore against moderate annual capex of Rs 100-125 crore over the medium term.

The ratings continue to reflect the leadership position of KBL in the domestic pump market, its diversified revenue and improving operating efficiency. The rating is also supported by the strengthened financial risk profile. These strengths are partially offset by large working capital requirement and exposure to intense competition.

Analytical Approach

CRISIL Ratings has combined the business and financial risk profiles of KBL and its subsidiaries, as all the companies, collectively referred to as the KBL group, are under a common management, and have high operational and financial linkages. For the JV, KEPL, CRISIL Ratings follows a full consolidation wherein it combines business and financial risk profiles of KEPL, given the common management and high operational and financial linkages.

CRISIL Ratings has also adjusted retention receivables outstanding for more than a year in the project segment, against networth and trade receivables, because they are slow moving, and a substantial amount of Rs 177 crore as on March 31, 2023, has been outstanding for more than two years.

Please refer Annexure - List of entities consolidated, which captures the list of entities considered and their analytical treatment of consolidation.

Key Rating Drivers & Detailed Description

Strengths:

- **Leadership position in the domestic pump market and diversified revenue**
  The KBL group is one of the largest centrifugal pump manufacturers in India, with a leading market share. Revenue is diversified across segments, as the group caters to multiple sectors, including agriculture, oil and gas, defence, industrial, and building and construction, including the smallest to some of the largest and complex pumping solutions in the world. The diversified end-user base mitigates the adverse impact of slowdown in any segment. The group has 11 plants, of which five are abroad helping it cater to a global customer base in 100+ countries. These plants are strategically located across trading blocks and well suited to cater to expanding geographic presence with reduced turnaround time in a cost-efficient way.

  Geographically, the company has been increasing its presence in the overseas markets, resulting in share of international revenues increasing to ~25% of total group revenue. The key markets include Europe, the U.S., Africa and Southeast India. Besides, some of the growth in international markets has also come through acquisitions, which enabled KBL to widen its product offerings and enhance technological capabilities. At its international subsidiaries, the company has undertaken various steps to maintain and improve profitability including manpower and marketing cost reductions and focus on high margin and off-market/spares orders; it also undertook steps to diversify away from the cyclical sectors by focusing on recurring revenue stream by growing revenue share from the Framework Contracts and Subscription Platform.

  It undertook strategic initiatives including efficiencies to reduce direct and indirect costs, improve pass-through of incr ease in raw materials which led to improvement in profitability at international and domestic subsidiaries; this trend is expected to continue over the medium term. The company has undertaken value engineering at product level to reduce product weight, improve power efficiencies, introduced on-line monitoring of pump performance, introduced advanced manufacturing technologies such as three-dimensional printing, artificial intelligence, virtual reality, and Internet of Things, which help maintain product competitiveness in the market. Besides, its downsized and efficient manpower management, centralised procurement, dynamic pricing mechanism, focus on increasing share of higher-margin products and spares should help sustain margins over the medium term.

- **Strengthened financial risk profile**
  The KBL group's financial risk profile has improved over time, supported by better operating performance and healthy cash accrual. It continued to be net debt free since fiscal 2021, with gross debt of Rs 253 crore as of March 2023 (Rs 375 crore as of March 2022) and cash surplus of Rs 504 crore (Rs 505 crore). The company has prepaid its domestic term loans amounting Rs 82 crore as of March 2023 during the first quarter of fiscal 2024. Its gross debt to Ebitda ratio improved to 0.59 time as on March 31, 2023 from 1.54 times a year ago, while the interest coverage ratio rose to 12.45 times in fiscal 2023 from 8.03 times in the previous fiscal. With continued improvement in the operating performance in fiscal 2024, debt protection metrics should improve further. Cash accrual of Rs 300+ crore should be adequate to meet moderate capex of Rs 100-125 crore annually and debt obligation of Rs 15-20 crore over the next few years.

Weaknesses:

- **Large working capital requirement**
  The working capital cycle remains stretched because of large receivables (Rs 807 crore as on March 31, 2023, including Rs 177 crore retention receivables), particularly in the projects business, and moderate inventory holding period. Gross current assets (excluding cash) were 159 days as on March 31, 2023, and are expected at similar levels over the medium term. Progress in execution of projects and collection of retention money stuck in these projects will continue to be monitored.

- **Susceptibility to intense competition**
  The domestic pumps industry is highly fragmented and has several unorganised players. Organised players, including KBL, face tremendous pressure in maintaining market share and profitability, as cost-sensitive consumers in the small pumps segment give more importance to affordability than brand equity. Moderate ability to pass-on price increase in raw materials results in fluctuations in the Ebitda margin, given the large share (55-60%) of material cost in its cost structure. However, the dynamic pricing mechanism and built-in cost escalation clause in most of the large pump orders, provides some offset. As also seen in the past, low prices of key raw materials including pig iron and copper in fiscal 2021 drove the Ebitda margin peaking to 9.8% with a subsequent decline in fiscal 2022 to 7.4%. Company continues to be susceptible to intense competition and price fluctuations in raw material prices.

Liquidity: Strong
Cash and equivalents (of the group) stood at Rs 504 crore as on March 31, 2023 , including bank deposits and mutual fund investments. Cash accrual is expected at about Rs 300 crore per annum, sufficient to meet moderate capex of about Rs 100-125 crore annually and long-term debt obligation of Rs 15-20 crore each in fiscals 2024 and 2025. The company has prepaid its domestic term loans amounting Rs 82 crore as of March 2023 during the first quarter of fiscal 2024. Utilisation of the fund-based limit was negligible in the six months through June 2023 and may remain minimal over the medium term.

ESG profile
CRISIL Ratings believes that KBL's environment, social, and governance (ESG) profile supports its already strong credit risk profile.

The pumps industry has a high impact on the environment, given the manufacturing process, raw m aterials sourcing, supply chain, and end-usage. Also, due to its nature of operations, the sector affects the local community and has various occupational health hazards associated with it. KBL is focused on mitigating its environmental and social risks.

Key ESG highlights
- KBL targets to inventorise Scope 1, 2 & 3 emissions for all plants by fiscal 2025.
- By fiscal 2026, KBL intends to generate green energy for the group companies to the tune of 20% over and above current capacity.
- Through consistent efforts and strategies, KBL has successfully reduced its greenhouse gas emissions (Scope 1 &2) to 25,390 total carbon dioxide in fiscal 2023 from 30,000 in fiscal 2020. Besides, it has also reduced energy and water consumption as well as waste generation.
- It targets for zero reportable accident year on year. Its loss-time injury frequency rate in fiscal 2023 stood at 0.31.
- The governance structure is characterised by 63% of the board comprising independent directors. However, there is no split in the chairman and CEO positions. KBL has a committee at the board level to address investor grievances and put out extensive disclosures.

There is growing importance of ESG among investors and lenders. The commitment of KBL to ESG principles will play a key role in enhancing stakeholder confidence, given its high share of international operations and access to both domestic and foreign capital markets.

Outlook: Stable
The credit risk profile of KBL will continue to benefit from the established market position of the group in the pumps business and improving operating profitability. The company is also expected to sustain its healthy financial risk profile with prudent capital spend.

Rating Sensitivity factors
Upward factors
- Significant revenue growth per annum with operating margin above 11-12%, benefitting cash generation
- Maintenance of healthy financial risk profile with continued improvement in debt protection metrics, supported by prudent capital spending
- Substantial recovery of retention receivables , leading to a significant increase in cash flow and an improved working capital cycle

Downward factors
- Weaker-than-anticipated operating performance, with operating margin below 7-8% on a sustained basis
- Material debt-funded capex or acquisitions, wea kening the debt protection metrics on a sustained basis
- Increasing retention receivables from the projects business, impacting cash flow and stretching the working capital cycle

About the Group
The KBL group, including KEPL, is India's largest manufacturer and exporter of pumps. It caters to the oil and gas, defence and marine, water resource management, irrigation, power distribution, and construction sectors. Revenue of Rs 3,971 crore in fiscal 2023 (of the group) includes non-domestic revenue share at ~26%, with about 3% share coming from project segments. As on March 31, 2023, ~66% stake is held by the promoters including Mr Sanjay Kirloskar, Ms Pratima Sanjay Kirloskar, and Kirloskar Industries Ltd. Consolidated order book stood at Rs 3,020 crore as on June 30, 2023.

Key Financial Indicators (including KEPL)

Particulars	Unit	2023	2022
Revenue	Rs crore	3971	3285
Profit after tax (PAT)	Rs crore	260	110
PAT margin	%	6.5	3.4
Adjusted debt / adjusted net worth	Times	0.19	0.35
Interest coverage	Times	12.45	8.03

Any other information: Not applicable

Note on complexity levels of the rated instrument:
CRISIL Ratings` complexity levels are assigned to various types of financial instruments and are included (where applicable) in the 'Annexure - Details of Instrument' in this Rating Rationale.

CRISIL Ratings will disclose complexity level for all securities - including those that are yet to be placed - based on available information. The complexity level for instruments may be updated, where required, in the rating rationale published subsequent to the issuance of the instrument when details on such features are available.

For more details on the CRISIL Ratings` complexity levels please visit www.crisilratings.com. Users may also call the Customer Service Helpdesk with queries on specific instruments.

Annexure - Details of Instrument(s)

ISIN	Name of instrument	Date of allotment	Coupon rate (%)	Maturity date	Issue size (Rs crore)	Complexity level	Rating assigned with outlook
NA	Cash Credit	NA	NA	NA	200	NA	CRISIL AA/Stable
NA	Letter of credit & Bank Guarantee	NA	NA	NA	1150	NA	CRISIL A1+
NA	Commercial paper	NA	NA	7-365 days	100	Simple	CRISIL A1+
NA	Proposed Long Term Bank Loan Facility	NA	NA	NA	104	NA	CRISIL AA/Stable

Annexure – List of entities consolidated

Names of Entities Consolidated	Extent of Consolidation	Rationale for Consolidation
Kirloskar Brothers International B V	Full	Subsidiary
The Kolhapur Steel Ltd	Full	Subsidiary
Karad Projects and Motors Ltd	Full	Subsidiary
Kirloskar Corrocoats Pvt Ltd	Full	Subsidiary
Kirloskar Ebara Pumps Ltd	Full	45% JV in similar business

Annexure - Rating History for last 3 Years

	Current			2023 (History)		2022		2021		2020		Start of 2020
Instrument	Type	Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Fund Based Facilities	LT	304.0	CRISIL AA/Stable		--	29-09-22	CRISIL AA-/Positive	29-10-21	CRISIL AA-/Positive	29-10-20	CRISIL AA-/Stable	CRISIL AA-/Negative
			--		--		--		--	06-07-20	CRISIL AA-/Stable	--
Non-Fund Based Facilities	ST	1150.0	CRISIL A1+		--	29-09-22	CRISIL A1+	29-10-21	CRISIL A1+	29-10-20	CRISIL A1+	CRISIL A1+
			--		--		--		--	06-07-20	CRISIL A1+	--
Commercial Paper	ST	100.0	CRISIL A1+		--	29-09-22	CRISIL A1+	29-10-21	CRISIL A1+	29-10-20	CRISIL A1+	CRISIL A1+
			--		--		--		--	06-07-20	CRISIL A1+	--

All amounts are in Rs.Cr.

Annexure - Details of Bank Lenders & Facilities

Facility	Amount (Rs.Crore)	Name of Lender	Rating
Cash Credit	**21**	**ICICI Bank Limited**	**CRISIL AA/Stable**
Cash Credit	**16**	**Canara Bank**	**CRISIL AA/Stable**
Cash Credit	**90**	**Bank of India**	**CRISIL AA/Stable**
Cash Credit	**33**	**HDFC Bank Limited**	**CRISIL AA/Stable**
Cash Credit	**25**	**Citibank N. A.**	**CRISIL AA/Stable**
Cash Credit	**15**	**Axis Bank Limited**	**CRISIL AA/Stable**
Letter of credit & Bank Guarantee	**550**	**Bank of India**	**CRISIL A1+**
Letter of credit & Bank Guarantee	**120**	**HDFC Bank Limited**	**CRISIL A1+**
Letter of credit & Bank Guarantee	**130**	**ICICI Bank Limited**	**CRISIL A1+**
Letter of credit & Bank Guarantee	**100**	**Exim Bank**	**CRISIL A1+**
Letter of credit & Bank Guarantee	**225**	**Canara Bank**	**CRISIL A1+**
Letter of credit & Bank Guarantee	**25**	**Axis Bank Limited**	**CRISIL A1+**
Proposed Long Term Bank Loan Facility	**104**	**Not Applicable**	**CRISIL AA/Stable**

Criteria Details

Links to related criteria
[CRISILs Approach to Financial Ratios]
[Rating criteria for manufaturing and service sector companies]
[CRISILs Bank Loan Ratings - process, scale and default recognition]
[CRISILs Criteria for rating short term debt]
[CRISILs Criteria for Consolidation]

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