Kennametal India Limited

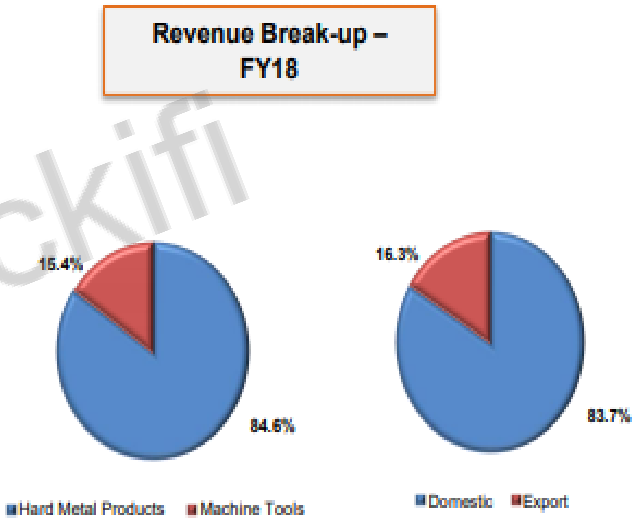
KENNAMETAL

1) About:

Kennametal India Limited (KIL) is a subsidiary of Kennametal Inc which holds 75% stake in the company. KIL is engaged in manufacturing of tools and engineered products for metal working, mining, construction and other engineering applications.

It has established market position as the **largest player in the carbide tools industry in India**.

Business Segments:



a) Hard Metal and Hard Metal Products (contributed to 85% of company's revenues during FY18)

- In the hard metal and hard metal product segment, KIL has industrial, infrastructure and WIDIA segment.
- Industrial segments mainly cater to industries like steel, automobiles etc. while infrastructure caters to segments like mining, construction etc. while WIDIA also caters to the industrial segment.

b) Machining Solutions (Contributed to 15% of company's revenues during FY18)

- Machining solutions is only catered by KIL. i.e. it is exclusive to India
- In the machining solution group, the company manufactures customized machines, primarily catering to automobile original equipment manufacturers (OEMs). This division follows an in-house designing and outsourced manufacturing model.
- Around 40% products are customized and remaining are standard tools.

Served Markets by the company:

a) Automotive production (In specific 2W, PV, LCV)
b) MHCV
c) Tractors production
d) Steel production
e) Aerospace, Defence and Railways

f) Capital investments in manufacturing including Greenfield facilities
g) Oil, Gas, Energy & Mining

- KIL is largely dependent on automobiles. (Autos contribute 60% of sales)
- Railways, Aerospace and defence are small areas for Kennametal currently but are growing well.
- Some of the segments like aerospace, oil & gas, mining, defence and railways and even private capex are reviving which should help in growth of the business.
- **End users of the Company's products include manufacturers, metalworking suppliers, machinery operators and processors engaged in a diverse array of industries. (*B2B)**

2) Industry:

- The growth of the cutting tool industry is aligned with the automotive industry which is the largest consumer of cutting tools
- Markets have settled down after GST implementation and are on growth path now. Also, GST helped in getting rid of unorganized players operating in cutting tools segment, thereby reducing sale of spurious products.
- Also, with the 'Make in India' initiative, a lot of new investment is happening in aerospace, defence and railways sectors. This will ensure good growth of the cutting tool industry in the coming years.
- **Raw Material:**
  The main raw material used in cutting tools is Tungsten carbide which is not available in India. Hence the industry is dependent on imports of cutting tools and raw materials.
- **Competitive Landscape:**
  The major competitors of the company are Sandvik and Iscar. Sandvik and Kennametal both claim to be the market leaders in the machine tools segment with 25 – 27% market share each with Iscar holding around 15 – 20% market share. The rest of the market share is held by imports from Europe and other Asian players.

3) Investment Case:

a) Kennametal is going into the marketplace with **dual brands.** (To make company more agile and competitive)

- This would allow KIL to bid for projects separately using WIDIA and Kennametal brand
- As part of this effort KIL is forming a wholly owned subsidiary for sale of "WIDIA" brand products.
- WIDIA is going to be the focus brand for the company in future.

- **WIDIA brand Strategy:**

  WIDIA was an old brand in India and had a leadership position in in the past. Since it has a strong brand recall, KIL is planning to increase sales and distribution for WIDIA and increase the reach. There is lot of focus on channel partner development and availability of products through increasing distribution reach.

  Alexander who is the board of KIL is responsible for WIDIA at global level wants to make India the global hub for Kennametal Inc for WIDIA manufacturing.

b) Support from parent, **Kennametal Inc, USA**

KIL receives technological and managerial support from Kennametal Inc, the world's second-largest manufacturer of carbide tools. KIL has benefitted from synergies with Kennametal Inc's manufacturing and marketing efficiency, international presence, R&D capabilities, and support in sourcing of raw materials, such as tungsten, tantalum, and cobalt. Besides, KIL has been gradually expanding its customer base, and providing clients with access to high-precision tools sourced from other Kennametal Inc. units.

c) Market leader, Strong Brand, Wide product range, Superior tech expertise & wide distribution network

KIL is focused on offering solutions leveraging its superior products and technology to address the requirements of the existing and emerging industries. Initiatives started in earlier years such as NOVO, Productivity optimization, Component specific solutions and D2C (direct delivery to customers) are being developed further.

d) Actions taken by KIL to grow topline:

- Focus on core business to drive profitable growth
- Channel partner development initiatives with digitally enabled support
- Diversify end markets: Aero, Defense, Railways added focus
- Focus on Hardmetals Exports tools

e) Actions taken by company to secure the bottom line:

- Initiatives focused around productivity improvement
- Explore other opportunities on energy & other resources for cost savings
- Efficient procurement of raw material

f) Operational effectiveness + Cost optimization initiatives to become competitive in the marketplace:

- Power purchase from Solar Power Producers (Company has saved 41 Lakhs in Electricity costs)
- Investments in augmentation of Capacity & Productivity (60 Cr Capex is underway for in Plant & Machinery and other productivity linked Equipment / Instruments, during the year)

- Optimum utilization of manufacturing capacities (The strategy is to build capacity to address the demand from the domestic market and to utilize any surplus capacity for export)
- KIL is exploring options to locally manufacture some of the product groups being imported. These efforts are expected to result in cost benefit and improved margins in the long term.
- Launch of new product range (**The sales from such new products launched over the last five years today constitute 40% of total current year Hard Metal Product sales.**)
- Rationalization in manpower through Voluntary Separation/Retirement Schemes for Officers and Workmen which have resulted in cost savings and increase in productivity.
- KIL has initiated steps to recover some of the inflationary cost increases by way of productivity improvement and enhanced market realizations for its products.

g) Strong Financials

- KIL has been successful in sustaining and growing market share across segments without sacrificing profitability.

LAST 5 YEARS NUMBERS

Parameter	Jun-15	Jun-16	Jun-17	Jun-18	Jun-19
Sales	570.25	570.29	651.85	793.12	927
Receivables	110.88	119.39	110.16	126.35	144.5
% Sales	19%	21%	17%	16%	16%
EBITDA	60	46	58	101	136
EBITDA %	11%	8%	9%	13%	15%
Other Income	12.01	8.9	0.73	0.03	14
Depreciation	25.65	24.11	28.26	28.11	28
Interest	0	0	0	0	0
Profit before tax	46.41	30.71	30.36	73	122
Tax	12.89	9.97	5.99	20.74	36
Net Profit after Tax	33.52	20.74	24.37	52.26	86
NPM%	6%	4%	4%	7%	9%

- **CAPEX:**

Company is primarily incurring **capex for expansion and modernization.**

This year KIL to do **capex of Rs.60 crore**. The capex will be to add capacities, modernize existing capacities and for capability upgradation.

It is important to note that the Capex is done with internal accruals only.

Parameter	Jun-14	Jun-15	Jun-16	Jun-17	Jun-18	Total 5 Yrs	CAGR
Capex	7.85	13.47	39.99	54.3	54.07	169.68	62%

➢ **Operating leverage is playing in company's favour**

Operating leverage and other cost cutting measures leading to improvement in profitability margins:

➢ **Strong financial risk profile:**

- Healthy liquid surplus
- Absence of debt
- Comfortable capital structure
- Improving efficiency ratios.

Parameter	Jun-14	Jun-15	Jun-16	Jun-17	Jun-18	CAGR
Receivable days	61.24	65.15	68.62	60.19	54.42	-3%
Payable Days	40	39	47	48	50	6%
Inventory days	59	56.61	62	58	60.55	1%
Working capital days	80.57	82.46	82.67	69.11	64	-6%
Cash + Investments (CI+NCI)	**56.6**	**94.79**	**66.54**	**93.95**	**95.25**	14%
Total Debt(D)	0	0	0	0	0	
Total Equity(E)	333.4	361.63	377.08	393.91	438.76	
D/E	0	0	0	0	0	
ROE	5.25	9.65	5.6	6.32	12.55	24%
ROCE	6	13	8	7	17	30%
ROA	2.85	5.27	3.02	3.36	6.56	23%

4) Key Risks:

➢ **Susceptibility to volatile raw material prices and forex rates.**
Since over 70% of the raw materials and components (including traded goods) are imported, while the exports are significantly lower, operating margin remains susceptible to movement in forex rates. Historically, only a portion of raw material price hikes has been passed on to customers.

Parameter	Jun-14	Jun-15	Jun-16	Jun-17	Jun-18	Total 5 Yrs	CAGR
Sales	545.13	570.25	570.29	651.85	793.12	5367.7	10%
Expenses	494	510	524	594	692	2814	9%
Raw Material Cost %	53%	52%	53%	53%	53%		

*Investors should keep an eye on raw material cost as a % of total expenses.

- **Most of the end user industries are cyclical in nature.**
  Customers are mainly from capital-intensive industries, such as automobile, energy, steel and aerospace where demand is cyclical, and dependent on the economy. KIL's operating performance is, therefore, expected to remain sensitive to the performance of global and Indian economies and the capex levels in end-user industries.
- Since significant part of sales come from auto industry, Government's efforts at bringing about FAME (**Faster Adoption & Manufacturing of Hybrid and Electric Vehicles**) is another potential area of concern as this would impact the conventional automotive segment and by extension, the demand for KIL's products as well.
- **High intensity of competition from existing as well as new Asian players entry into the marketplace → Pressure on pricing power.**

5) **View:**

- KIL is a good business with strong operating cash flow & solid balance sheet
- Initiatives for margin improvement are well defined and are on track
- **Expected revival in capex cycle going ahead**, will help company become more profitable and competitive.
- **Along with consistent capex and steady set of numbers, we believe it is a solid addition to the portfolio on every dip in between Rs. 950- 990.**

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