MOODY'S RATINGS

Rating Action: Moody's Ratings affirms Tata Steel's Baa3 rating; outlook remains stable

28 Aug 2024

Singapore, August 28, 2024 -- Moody's Ratings (Moody's) has affirmed Tata Steel Ltd.'s Baa3 issuer rating and maintained the stable outlook.

"The rating affirmation and stable outlook reflect our expectation that the structural improvement in Tata Steel's earnings over the next two years will mitigate the risks associated with new state taxes on mining activities in India and developments at its operations in Europe, amid challenges in the broader steel sector," says Hui Ting Sim, a Moody's Ratings Assistant Vice President and Analyst.

RATINGS RATIONALE

Tata Steel's earnings will structurally improve over the next two years as the commissioning of its brownfield expansion at Kalinganagar in India (Baa3 stable) later this year leads to higher sales volume, and the closure of its loss-making upstream assets in United Kingdom (UK, Aa3 stable) improves profitability. The company has already closed one of its two UK blast furnaces in July and plans to close the other in September.

We expect Tata Steel's consolidated EBITDA will climb to around INR290 billion in fiscal 2024-25 (ending March 2025) and INR380 billion in fiscal 2025-26, from INR241 billion in fiscal 2023-24. Our forecasts assume that Tata Steel's India operations will generate EBITDA per ton of INR14,700-INR15,300 ($175-$185) in fiscal 2024-25 and fiscal 2025-26 before state mining taxes, which aligns with the company's 8-year average. We also expect the addition of five million tons per annum (mtpa) of production capacity at Kalinganagar will gradually lift Tata Steel's steel deliveries in India to around 23 million tons by fiscal 2025-26 from 20 million tons in fiscal 2023-24.

In addition, EBITDA at Tata Steel's operations in Europe will increase over the next two years, turning from slightly negative in fiscal 2024-25 to around INR30 billion in fiscal 2025-26. Profitability at Netherlands will recover following losses incurred in fiscal 2023-24 from operational disruptions due to a relining of its blast furnace. Losses at its UK operations will also recede after the closure of its loss-making blast furnaces.

Tata Steel faces challenges on multiple fronts. There is uncertainty about its planned investment to build an electric arc furnace (EAF) in the UK. They had a nonbinding agreement with the UK government to establish a £1.25 billion EAF, including up to £500 million in grants, but this is now under negotiation following a change in government. Without the grant, Tata Steel may reconsider the EAF project and assess the viability of maintaining its downstream assets. This could result in reduced capital spending over the next two years, though restructuring costs could rise if downstream assets are shut down. Our projections assume Tata Steel will go ahead with the UK investment, leading to INR150 billion-INR160 billion in annual capital spending for fiscal 2024-25 and 2025-26. Tata Steel is also in discussions with the government in Netherlands (Aaa stable) about investments to replace its existing blast furnaces in the country.

In the June quarter, India's steel market faced pressure from strong import competition and high raw material costs, despite robust demand fueled by government infrastructure projects. Tata Steel's adjusted EBITDA per ton in India dropped to INR14,233 from INR15,382 in fiscal 2023-24. Domestic supply is expected to grow significantly in the next two years as several brownfield expansion projects in India, including Tata Steel's 5 mtpa expansion in Kalinganagar, ramp up production. Additionally, Europe's upcoming Carbon Border Adjustment Mechanism in 2026 may lead to more steel being diverted to Asia, increasing price competition.

The recent Supreme Court rulings on state taxes for mining activities in India will also weigh on Tata Steel's earnings and cash flows. Going forward, the company will incur additional operating costs from state taxes for its iron ore and coking coal production. At the same time, the company will have to pay retrospective taxes in instalments over 12 years from 1 April 2026. Tata Steel has prudently earmarked contingent liabilities for state taxes since 2005. The company recorded INR173.47 billion ($2.1 billion) of contingent liabilities for mining activities in Odisha in its financial statements as of 30 June 2024. On 14 August, it said it is assessing the financial impact of the Supreme Court rulings.

The financial implications of the state taxes remain uncertain as several key mining states such as Karnataka and Odisha have yet to confirm their mineral tax schemes. Our forecasts assumed that state taxes will reduce Tata Steel's EBITDA per ton in India by INR750. The final retrospective tax bill amount is unclear, hence, we have yet to incorporate retrospective taxes in our forecasts.

We estimate that Tata Steel's adjusted debt will be INR945 billion-INR965 billion in fiscal 2024-25 and fiscal 2025-26. Earnings growth will drive a decline in the company's debt/EBITDA to 2.5x by 2025-26, against its downgrade trigger of 4.0x. Thus, we expect the company has some buffers in its financial profile to absorb some downside risks. Furthermore, Tata Steel has the flexibility to adjust its capital spending if required to protect its balance sheet.

Tata Steel's Credit Impact Score (CIS) of CIS-2 reflects our view that: (1) the company's rating is currently at the same level as India's sovereign rating, and we are unlikely to rate the company higher than the sovereign, since Tata Steel's credit profile is highly linked to India's economic cycles; and (2) its parent, Tata Sons, will provide support if needed, which mitigates the impact of environmental and social risks on the rating.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATING

Tata Steel's Baa3 rating is currently at the same level as India's sovereign rating. Given Tata Steel's credit profile is closely tied to India's economic cycles, we are unlikely to rate the company higher than the sovereign. Hence, Tata Steel's rating can be upgraded only if India's sovereign rating is upgraded, and the company's fundamental credit profile improves to be consistent with a higher rating.

An improvement in Tata Steel's fundamental credit profile will require the company to maintain conservative financial metrics through the cycle, with good liquidity and strong credit metrics of debt/EBITDA of less than 3.0x and EBIT/interest higher than 4.0x on a sustained basis.

On the other hand, a downgrade of India's sovereign rating to Ba1 will lead to a downgrade of Tata Steel's rating, even if there is no deterioration in its financial profile.

A deterioration in Tata Steel's fundamental credit profile may not automatically result in a downgrade of its rating, if we assess that its parent has the ability and willingness to provide extraordinary support, hence keeping its rating at the same level. Tata Steel's fundamental credit profile could weaken if the company pursues aggressive debt-funded growth or high shareholder returns, indicating a higher risk tolerance. Indicators of a deterioration by one notch include debt/EBITDA above 4.0x or EBIT/interest lower than 3.0x-3.5x on a sustained basis.

RATING METHODOLOGY

The principal methodology used in this rating was Steel published in November 2021 and available at https://ratings.moodys.com/rmc-documents/356428 . Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

COMPANY PROFILE

Tata Steel Ltd. is the world's 10th-largest steel producer with manufacturing facilities in India (21.6 mt), the UK (5 mt), the Netherlands (7.0 mt) and Southeast Asia (1.7 mt) in 2023. The company is currently winding down its crude steel manufacturing facilities in the UK.

Tata Steel reported consolidated revenues and EBITDA of INR2.3 trillion ($28 billion) and INR241 ($2.9 billion), respectively, during fiscal 2023-24.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions .

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Hui Ting Sim
Asst Vice President - Analyst
Corporate Finance Group
Moody's Investors Service Singapore Pte. Ltd.
71 Robinson Road #05-01/02
Singapore, 068895
Singapore
JOURNALISTS: 852 3758 1350
Client Service: 852 3551 3077

Jacintha Poh
Associate Managing Director
Corporate Finance Group
JOURNALISTS: 852 3758 1350
Client Service: 852 3551 3077

Releasing Office:
Moody's Investors Service Singapore Pte. Ltd.
71 Robinson Road #05-01/02
Singapore, 068895
Singapore
JOURNALISTS: 852 3758 1350
Client Service: 852 3551 3077

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