

Research Update:

Tata Steel Rating Raised To 'BBB' On Reassessment Of Group Support; Outlook Stable

August 20, 2024

Rating Action Overview

- We see improving strategic cohesiveness between Tata Sons Pte Ltd. (unrated) and its group entities, as well as among the group entities. We now believe the potential of extraordinary support from Tata Sons for the group entities is greater than what we previously thought.
- We revised upward our view of group support for Tata Steel Ltd. to strategically important from moderately strategic.
- On Aug. 20, 2024, S&P Global Ratings raised its issuer credit ratings on Tata Steel and its subsidiary ABJA Investment Co. Pte. Ltd. to 'BBB' from 'BBB-'. We also raised the long-term issue rating on the senior unsecured notes that ABJA issued to 'BBB' from 'BBB-'. At the same time, we removed the ratings from CreditWatch with positive implications, where we placed them on June 13, 2024.
- The stable outlook on Tata Steel reflects our expectation of a recovery in its credit metrics over the next 12-18 months, backed by higher output in India and lower losses in the U.K. We expect the company's ratio of funds from operations (FFO) to debt to stay above 25% on a sustained basis.

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Rating Action Rationale

The potential of extraordinary support from Tata Sons for Tata Steel is greater than what we previously thought. Our reassessment considers factors such as the increased strategic cohesiveness among the group companies, a gradual increase in ownership levels, and improving operational linkages among the subsidiaries.

Tata Sons led negotiations with the U.K. government to secure financial support for the restructuring of Tata Steel's U.K. facility. The parent also has strong influence over Tata Steel's financial strategy of deleveraging. The company prioritized debt reduction over shareholder distributions during periods of strong cash flow generation.

We believe the group has become more cohesive in the past few years. Tata Sons is driving its operating companies to explore synergies within the group. For example, Tata Steel recently

entered into an agreement with Tata Power Co. Ltd. to set up a solar-wind hybrid plant with close to 1 gigawatt of capacity. This plant will supply round-the-clock renewable power to Tata Steel's operations in eastern India.

We no longer explicitly reflect the benefits of ongoing group influence in our assessment of Tata Steel's stand-alone credit profile (SACP). Our previous SACP assessment incorporated a one-notch uplift for the ongoing group support and an additional one-notch rating uplift for potential extraordinary support from Tata Sons.

While Tata Steel continues to benefit on an ongoing basis from being part of the Tata group, particularly through enhanced funding access, our three-notch rating uplift from the SACP now fully captures the strength of group support. Hence, we no longer separately apply a notch up for ongoing support in the SACP.

Tata Steel's ownership structure and contribution to the group credit profile limit a higher assessment. While we expect strong extraordinary group support to be available mainly in times of stress, a lack of majority ownership and Tata Steel's small contributions to the cash flow and portfolio value of Tata Sons constrain a higher assessment of group support. Tata Steel accounts for 10% of Tata Sons' portfolio value and 16% of the latter's EBITDA.

Normalizing European operations and higher volumes from India will gradually improve credit metrics. The European business remains a drag on Tata Steel's profitability. It has contributed to higher volatility at Tata Steel than its peers more recently. We expect breakeven EBITDA for this business in fiscal 2025 (year ending March 31) against losses of Indian rupee (INR) 70 billion in fiscal 2024.

Our forecast assumes lower operating losses in the U.K. after the business closes its second blast furnace in September 2024. Tata Steel's Dutch plant will also offset the company's U.K. losses during the year, with the recent ramp-up of its relined blast furnace.

India EBITDA could improve over the next 12-18 months on the back of additional volumes from Kalinganagar. While domestic steel prices remain under pressure from cheaper Chinese imports, lower coking coal costs should help keep EBITDA per ton at INR15,000-INR16,000.

Our base case assumes a ratio of FFO to debt of 25% for Tata Steel in fiscal 2025, up from about 11% in fiscal 2024. The ratio could have been more than 20% in fiscal 2024 with more normal European operations. It could increase to more than 30% in fiscal 2026 as the full benefits of Kalinganagar Phase 2 expansion kick in.

We will monitor the retrospective mining tax, which could increase leverage beyond our base case. India's recent court ruling on the retrospective mining tax could result in sizable liabilities for Tata Steel. The state government had demanded total taxes of about INR170 billion as of June 30, 2024. While the company is still assessing the financial impact of the ruling, the retrospective taxation could weaken its credit metrics. This is because we would likely consider the liabilities in aggregate as debt even if it pays them in several instalments.

On the other hand, liquidity will not be immediately affected. This is because Tata Steel will stagger its payments over 12 years starting April 1, 2026.

Tata Steel can be rated above the sovereign. This is because steel is a global commodity with limited domestic dependence. The company's presence in the steel industry can help it maintain adequate liquidity during a period of sovereign stress, in our view.

Outlook

The stable outlook on Tata Steel reflects our expectation that the company's credit metrics will recover over the next 12-18 months, backed by higher output volumes in India and lower losses in the U.K. We expect the FFO-to-debt ratio to remain above 25% on a sustained basis.

Downside scenario

We are likely to lower our rating on Tata Steel if earnings decline materially due to continued losses in the U.K. or if the company pursues any large debt-funded expansion. In such a scenario, we would expect the FFO-to-debt ratio to remain below 25% consistently.

Upside scenario

An upgrade will require Tata Steel to demonstrate a track record of operating at lower leverage. This will cushion the company from industry downcycles and increasing growth ambitions. A sustained FFO-to-debt ratio of more than 35% would indicate such a scenario.

An upgrade would also be contingent on the Tata group's creditworthiness not being a constraint on Tata Steel's rating.

Company Description

Tata Steel is one of the larger steel producers globally, with an annual crude steel capacity of close to 35 million tons. Of this, about 21.6 million tons is based in India, 10 million tons in Europe, and 1.7 million tons in Thailand. The company is in the process of adding five million more tons of capacity in India. This could be ready by the second half of fiscal 2025.

Tata Steel is part of the Tata group, with Tata Sons owning about 33% of the company.

Our Base-Case Scenario

Assumptions

- Sales volumes of about 31 million tons in fiscal 2025. India to account for 21.5 million tons. Volumes to increase to about 33 million tons in fiscal 2026. India to account for more than 24 million tons as Kalinganagar Phase 2 ramps up.
- Some moderation in domestic steel prices in fiscal 2025, mainly due to weak pricing in international markets.
- Annual capital expenditure (capex) of INR160 billion-INR170 billion in fiscal 2025-2026, mainly for Kalinganagar Phase 2 expansion and the replacement of blast furnaces in the U.K. with an electric arc furnace.
- No outsized shareholder distributions or acquisitions over the next 12-24 months.

Key metrics

Tata Steel Ltd.--Forecast summary

Industry sector: metals

(Mil. INR)	Fiscal year ended March 31				
	2023a	2024a	2025e	2026f	2027f
Revenue	2,433,527	2,291,708	2,307,300	2,479,366	2,562,583
EBITDA	338,812	238,416	329,582	414,186	451,513
Funds from operations (FFO)	219,516	97,281	220,571	269,749	298,064
Capital expenditure (capex)	138,514	175,574	160,000	170,000	180,000
Debt	800,928	886,263	890,663	876,194	790,069
Cash and short-term investments (reported)	169,873	94,089	120,000	120,000	139,190
Adjusted ratios					
Debt/EBITDA (x)	2.4	3.7	2.7	2.1	1.7
FFO/debt (%)	27.4	11.0	24.8	30.8	37.7
EBITDA margin (%)	13.9	10.4	14.3	16.7	17.6

INR--Indian rupee. All figures include S&P Global Ratings adjustments' unless stated as reported. a--Actual. e--Estimate. f--Forecast.

Liquidity

We assess Tata Steel's liquidity as adequate. Liquidity sources will likely be about 1.4x liquidity uses on a consolidated basis over the 12 months ending June 30, 2025. The company has good on-balance-sheet liquidity to take care of near-term debt maturities.

Tata Steel has strong financial flexibility as an Indian blue-chip company. The company has good access to capital markets and strong banking relationships. This reflects its association with the Tata group. We believe support from the group will be forthcoming if needed, which will reinforce Tata Steel's liquidity position.

Key liquidity sources include:

- Cash and cash equivalents of INR108 billion as of June 30, 2024.
- FFO of about INR213 billion that we estimate for the next 12 months.
- Unutilized working capital limits of INR16 billion available beyond 12 months.
- Working capital inflow that we estimate at about INR55 billion for the next 12 months.
- An unutilized sanctioned term loan facility of INR95 billion.

Key liquidity uses include:

- Debt maturities of INR279 billion over the next 12 months.

- Minimum capex of INR80 billion during this period.

Covenants

Tata Steel remained in compliance with its covenants as of March 31, 2024.

Issue Ratings – Subordination Risk Analysis

Capital structure

As of March 31, 2024, Tata Steel had about INR815.7 billion of debt. Of this, about INR60.9 billion was secured.

Tata Steel accounted for about INR405.6 billion of the total debt on a stand-alone basis. ABJA accounted for about INR166.8 billion of U.S. dollar bonds. Of this, debtholders recently redeemed about INR83 billion.

Analytical conclusions

We rate the outstanding foreign-currency bonds totaling about US\$1 billion that ABJA issued 'BBB'. This is the same as the long-term issuer credit rating on ABJA.

We treat ABJA as a core subsidiary of Tata Steel and equalize the ratings on ABJA with those on Tata Steel. We rate the issuances the same as the issuer credit ratings because Tata Steel primarily operates in India. This is a jurisdiction where we believe the priority of claims in a theoretical bankruptcy is highly uncertain.

Ratings Score Snapshot

Issuer Credit Rating	BBB/Stable/--
Business risk:	Satisfactory
Country risk	Moderately High
Industry risk	Moderately High
Competitive position	Satisfactory
Financial risk:	Significant
Cash flow/leverage	Significant
Anchor	bb+
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Neutral (no impact)

Issuer Credit Rating	BBB/Stable/--
Comparable rating analysis	Negative (-1 notch)
Stand-alone credit profile:	bb
Entity status within group	Strategically important (+3 notches from SACP)

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Six Tata Group Entities Placed On CreditWatch Positive On Possible Increase In Group Support, June 13, 2024

Ratings List

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Upgraded; CreditWatch/Outlook Action

	To	From
Tata Steel Ltd.		
ABJA Investment Co. Pte. Ltd.		
Issuer Credit Rating	BBB/Stable/--	BBB-/Watch Pos/--
ABJA Investment Co. Pte. Ltd.		
Senior Unsecured	BBB	BBB-/Watch Pos

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