Research Update:

# Tata Steel Rating Lowered To 'B+' On Expected Rise In Leverage; Outlook Negative

**April 14, 2020**

PRIMARY CREDIT ANALYST

**Harshada Patwardhan**
Singapore
+ 65 6597 6152
harshada.patwardhan@spglobal.com

SECONDARY CONTACT

**Neel Gopalakrishnan**
Singapore
+ 65-6239-6385
neel.gopalakrishnan@spglobal.com

## Rating Action Overview

- We expect COVID-19 related disruptions and the consequent economic slowdown to result in India-based Tata Steel Ltd.'s credit metrics being weaker than our previous expectations.
- Our expected leverage and other key metrics for Tata Steel over at the next 12-18 months are no longer consistent with a 'BB-' rating.
- On April 14, 2020, S&P Global Ratings lowered its long-term foreign currency issuer credit rating on Tata Steel and subsidiary ABJA Investment Co. Pte. Ltd., and the issue rating on various U.S.-dollar denominated senior unsecured notes ABJA has issued, to 'B+' from 'BB-'.
- The negative outlook reflects risks of further weakening in Tata Steel's credit profile if the effect of economic conditions and lower commodity prices are more prolonged than our current expectations.

## Rating Action Rationale

The downgrade mainly reflects our expectation that the improvement in Tata Steel's earnings and financial profile, on which the 'BB-' rating was based, is unlikely to materialize in the next 12-18 months. This is mainly due to COVID-19 related disruptions and the consequent economic effects.

Even before recent developments, Tata Steel's earnings in the first nine months of fiscal 2020 (ended March 31, 2020) had underperformed our expectations. However, meaningful price hikes between December 2019 and March 2020, together with a seasonally stronger January–March quarter meant there was still potential for the company's financial profile to improve. We now see this as unlikely.

We expect Tata Steel's leverage, measured by debt to EBITDA, to be in the 6x-8x range in fiscals 2020 and 2021. This is up from 3.3x as of March 2019 and our previous expectation of around 5x in fiscal 2020 and 4x in fiscal 2021. We expect funds from operations (FFO) to debt to be around 5% in both fiscals 2020 and 2021 (previous expectation was around 10%). These metrics are no longer representative of a 'BB-' rating. We also expect EBITDA interest cover to be below 2x in fiscal 2021.

We see a more significant impact on Tata Steel's credit profile coming from its higher cost

European operations. While both the company's Europe plants (in the U.K. and Netherlands) are still running, they are doing so at reduced capacity. In our base case, we assume depressed volumes for at least one quarter, followed by a recovery to more normal levels. Overall, we currently assume around 15%-20% lower volumes in fiscal 2021 relative to fiscal 2020. While the company has taken cost reduction initiatives over the past year, a sharp drop in volumes together with pricing pressure will likely lead to a material EBITDA level loss. Some form of support from both Netherlands and U.K. governments is possible (for example, wage subsidy) and could partly mitigate the losses but it is difficult to quantify such benefits at this point.

We expect the company's Indian operations to be more resilient to these developments due to their relative cost competitiveness. At this point, we have only assumed a marginal 7%-10% reduction in EBITDA in fiscal 2021 relative to fiscal 2020. We recognize there is downside risk to this due to the significant slowdown in economic activity expected (our economists have lowered fiscal 2020 GDP growth to 3.5% from 6.2% previously).

On the positive side, Tata Steel has adequate liquidity going into this downturn. With proactive refinancing, especially at the Tata Steel Europe level, the company has no major debt repayments due. On a consolidated basis, only around US$250 million is due in each of the next two fiscal years. Tata Steel reported cash of around Indian rupee (INR) 52 billion (around US$700 million) as of December 2019. The company also has good financial flexibility as part of the Tata group. Financial flexibility is reflected in the company's strong banking relationships and good reputation in the capital markets.

## Outlook

The negative outlook mainly reflects our view that a more prolonged weakness in operating conditions than we currently expect could lead to further deterioration in Tata Steel's credit profile. This is particularly likely to arise if weak market conditions persist for longer in Europe, especially from the auto sector. The Indian operations could also see a sharper drop in profitability compared to our base case.

### Downside scenario

We could lower the rating on Tata Steel if, in our view, its credit profile remains pressured for longer than we currently expect. Indicators of such a scenario include EBITDA interest coverage remaining well below 2x on sustained basis.

### Upside scenario

We could revise the outlook back to stable if the impact of the economic slowdown is less than our current expectation. A recovery in credit metrics such that EBITDA/interest increases above 2x would be supportive of such action.

## Company Description

Tata Steel is one of the largest steel producers globally with an annual crude steel capacity of about 33 million tons--about 19 million tons in India and 10.5 million tons in Europe. Its India operations benefit from domestic access to iron ore although it still has to supplement its coal needs with imports. The company's business position is a mix of low-cost highly efficient steelmaking capacities in India that serve a high-growth market and high cost capacities in Europe.

## Our Base-Case Scenario

- India's annual GDP growth of 3.5% for fiscal 2021 and 7.3% for 2022.
- Volumes of 15 million tons-16 million tons in India and 7 million tons-8 million tons in Europe in fiscal 2021 versus expected 17 million tons and 9 million tons in fiscal 2020, respectively.
- EBITDA/ton of around INR10,000 in fiscal 2021 (including Bhushan Steel). European operations to report negative EBITDA in the range of US$400 million-US$500 million.
- Capital expenditure (capex) of around US$700 million and US$900 million in fiscals 2021 and 2022, respectively (both down from around US$1 billion earlier). Company has further flexibility to defer capex, if needed.
- No significant shareholder distributions over the next 12-24 months.

Based on these assumptions, we arrive at the following credit measures:

- EBITDA margin of about 10%-12% between fiscals 2020 and 2022 against 19.6% in fiscal 2019.
- FFO-to-debt ratio of around 5%-7% between fiscals 2020 and 2022.
- Negative free operating cash flow of around INR20 billion-INR25 billion in fiscal 2020 and INR10 billion-INR20 billion in fiscal 2021 before turning marginally positive in fiscal 2022.

## Liquidity

We assess Tata Steel's liquidity to be adequate. We expect liquidity sources to cover liquidity uses by more than 1.2x over the next 12 months.

On a fully consolidated basis for the 12 months starting December 2019, we expect principal sources of liquidity to be:

- Cash and short-term investments of INR52 billion.
- Long-term committed facilities of about INR25 billion.
- Forecasted FFO of about INR50 billion.

Uses of liquidity include:

- Scheduled debt maturities of about INR47 billion (including uncommitted short-term debt facilities).
- Minimum capex of about INR45 billion.

## Issue Ratings - Subordination Risk Analysis

### Capital structure

Tata Steel's capital structure consists of about INR969 billion of reported debt (excluding finance leases), INR358 billion secured debt, and INR611 billion unsecured debt as of March 2019.

We rate US$2.3 billion of debt issued by its financing subsidiary ABJA. Tata Steel guarantees part of this debt.

### Analytical conclusions

We rate the foreign currency bonds totaling US$3.0 billion issued by ABJA 'BB-', the same as the issuer credit rating on ABJA. We rate the issuances the same because Tata Steel primarily operates in India, a jurisdiction where we believe the priority of claims in a theoretical bankruptcy is highly uncertain.

## Ratings Score Snapshot

Issuer Credit Rating: B+/Negative/--

Business risk: Satisfactory

- Country risk: Moderately high
- Industry risk: Moderately High
- Competitive position: Satisfactory

Financial risk: Highly Leveraged

- Cash flow/Leverage: Highly Leveraged

Anchor: b+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: b+

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, 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
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017

- 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

**Downgraded; CreditWatch/Outlook Action**

| | To | From |
|---|---|---|
| **Tata Steel Ltd.** | | |
| **ABJA Investment Co. Pte. Ltd.** | | |
| Issuer Credit Rating | B+/Negative/-- | BB-/Stable/-- |

**Downgraded**

| | To | From |
|---|---|---|
| **ABJA Investment Co. Pte. Ltd.** | | |
| Senior Unsecured | B+ | BB- |

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

Research Update:

# Tata Steel UK Holdings Downgraded To 'B' On Weakening Performance, Outlook Negative

**April 14, 2020**

PRIMARY CREDIT ANALYST

**Harshada Patwardhan**
Singapore
+ 65 6597 6152
harshada.patwardhan
@spglobal.com

SECONDARY CONTACT

**Neel Gopalakrishnan**
Singapore
+ 65-6239-6385
neel.gopalakrishnan
@spglobal.com

## Rating Action Overview

- TSUKH's operating performance is likely to remain weak over the next 12 months due to tough operating conditions following COVID-19 related disruptions.
- We expect Tata Steel to continue to provide timely support, if required, to TSUKH, which is a 100% owned subsidiary.
- On April 14, 2020, S&P Global Ratings lowered its rating on TSUKH to 'B' from 'B+' in line with the rating action on its parent, Tata Steel. The short term rating on TSUKH remains 'B'.
- The negative outlook reflects the outlook on Tata Steel. Our outlook reflects the risk that Tata Steel's credit metrics could weaken further if the impact of the economic slowdown is more than our current expectations.

## Rating Action Rationale

We lowered the rating on Tata Steel UK Holdings Ltd. (TSUKH) following a similar action on its parent, Tata Steel Ltd., given the continued strong linkage between the subsidiary and the parent.

The operating performance of the European subsidiary deteriorated in fiscal 2020 (ended March 31, 2020), mainly due to weaker steel prices and lower demand from the auto sector. We earlier expected EBITDA of about £140 million by the end of fiscal 2020 gradually increasing to £300 million annually in fiscals 2021 and 2022. However, in the present economic slowdown we believe the company's profitability will remain weak and underperform our previous expectations.

The company's high fixed costs and sizable dependence on the automobile sector will likely result in the company reporting sizable EBITDA level losses, at least in fiscal 2021. Some form of support from both Netherlands and U.K. governments is possible (e.g., wage subsidy) and could partly mitigate the losses. But it is difficult to quantify such benefits at this point.

On the positive side, TSUKH has no significant debt maturities in the near term. It recently refinanced its external debt and converted shareholder loans to equity. We assume capital expenditure (capex), given carbon-emissions related regulatory costs and maintenance of facilities, will remain at about £250 million annually over the next two years.

We expect Tata Steel to provide timely support for debt obligations at TSUKH, if needed. Tata Steel also remains focused on improving operating efficiencies at TSUKH by implementing cost-restructuring initiatives. The final rating on TSUKH benefits from one notch support from its parent linkage.

## Outlook

The negative outlook on TSUKH reflects that on its parent, Tata Steel, and is driven by our view that prolonged weakness in operating conditions beyond our current expectations could lead to further deterioration in Tata Steel's credit profile.

### Downside scenario

We will lower the rating on TSUKH if: (1) we lower the rating on Tata Steel; or (2) Tata Steel shows signs of reducing support to TSUKH.

### Upside scenario

We would revise the outlook to stable following a similar change to the outlook on the parent, Tata Steel, provided that the parent's support and relationship with TSUKH remains unchanged, and TSUKH's funding gap has not materially worsened from current levels.

## Company Description

TSUKH, through its subsidiary TSNH, is the holding company for Tata Steel's European steelmaking operations. TSUKH, through TSNH, has an aggregate 10.5 million tons per annum (MTPA) of saleable steel capacity split across two blast furnace sites (Port Talbot UK: 3.5 MTPA and IJmuiden, Netherlands: 7 MTPA) as well as several rolling mills and color coating/galvanizing facilities across Europe. Tata Steel has supported the company in the past through periodic equity support to help finance its cash flow deficits.

## Our Base-Case Scenario

### Assumptions

- Negative real GDP growth of 2% in 2020 recovering to positive 3 % in 2021 in the Eurozone. Steel demand will follow the GDP trend.
- TSUKH's steel production will be about 7 million-8 million tons in the next two years
- EBITDA/ton will be negative in fiscals 2021 and 2022 affected by the economic slowdown and weak automobile market conditions.
- We expect capex at TSUKH to average about £250 million over the next two years in line with actual spending in the past.

## Key metrics

- Ratio of funds from operations (FFO) to debt will be negative over fiscals 2021-2022.

## Liquidity

We believe TSUKH has less-than-adequate liquidity. We expect TSUKH's sources of liquidity on a stand-alone level to fall short of its uses over the next 12 months.

However, we expect the company to continue to receive funding support in the form of subordinated loans from parent Tata Steel, which will help maintain TSUKH's liquidity.

The sources and uses discussed below are for the 12 months to March 31, 2021.

Principal liquidity sources:

- Credit facilities of around €150 million as of March 2020

Principal liquidity uses:

- Negative FFO of about £550 million over the next 12 months.
- No debt maturities--the company repaid tranche A of SFA loan and refinanced the rest, about €1.75 billion.
- Capex of about £250 million

## Ratings Score Snapshot

Issuer credit rating: B/Negative/B

Business risk: Weak

- Country risk: Very low
- Industry risk: Moderately high
- Competitive position: Weak

Financial risk: Highly leveraged

- Cash flow/Leverage: Highly leveraged

Anchor: b-

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Less than adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable ratings analysis: Neutral

- Stand-alone credit profile: b-Group influence: Strategically important (+1 notch)

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, 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
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

**Downgraded; CreditWatch/Outlook Action; Ratings Affirmed**

| | To | From |
|---|---|---|
| **Tata Steel UK Holdings Ltd.** | | |
| Issuer Credit Rating | B/Negative/B | B+/Stable/B |