

India Ratings Upgrades Tata Steel to 'IND AA+'; Outlook Stable

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India Ratings and Research (Ind-Ra) has upgraded Tata Steel Limited's (TSL) Long-Term Issuer Rating to 'IND AA+' from 'IND AA'. The Outlook is Stable. The instrument-wise rating actions are as follows:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Bank facilities*	-	-	-	INR277.81	IND AA+/Stable/IND A1+	Long-term rating upgraded; short-term rating affirmed
Non-convertible debentures (NCDs)*	-	-	-	INR151.51	IND AA+/Stable	Upgraded
Commercial paper(CP)	-	-	Up to 180 days	INR150	IND A1+	Affirmed
Proposed non-fund-based limit#	-	-	-	INR5 (increased from INR3.87)	IND AA+/Stable /IND A1+	Long-term rating upgraded; short-term rating affirmed

*Details in Annexure

#Yet to be issued

ANALYTICAL APPROACH: Ind-Ra continues to take a consolidated view of TSL and its 161 subsidiaries to arrive at the ratings owing to the strong operational and strategic linkages among them. Also, the ratings are supported by linkages with and the strong financial flexibility of its sponsor Tata Sons Private Ltd (IND AAA/Stable).

The upgrade reflects Ind-Ra's expectation that, despite likely aggregate capex of about INR220 billion, TSL's consolidated adjusted net leverage (adjusted debt net of cash/EBITDAR) would improve and hover between 1.0x-2.0x in FY22 and FY23 (FY21: 2.7x; FY20: 6.0x), as significant cash flow generation would lead to reduction in its consolidated gross debt.

KEY RATING DRIVERS

Debt Reduction: TSL reduced its consolidated gross debt by INR213 billion in FY21, and further by about INR110 billion in 1HFY22. TSL has notified Ind-Ra of a target net leverage ratio of around 2.5x on a sustained basis at a consolidated level. The management has indicated that the 5 million tonnes (mt) brownfield expansion at Kalinganagar will be completed by FYE24, and the balance INR170 billion of the initial outlay of INR240 billion will be spent over FY22-FY24. The agency has considered interest-bearing customer advances worth INR63 billion (at FYE21) as debt. TSL remains open to any inorganic growth opportunity in the long-products segment. The agency has not assumed cash outflows resulting from any acquisition for its analysis, given the absence of any clear plans for the same.

Strong Operating Cash flows: Ind-Ra expects TSL's operating cash flows to improve substantially over the near term (FYE21: INR375.2 billion; FYE20: INR127.5 billion, FYE19: INR184.4 billion), led by robust demand and profitability, and the consequent deleveraging in FY22. Prices of coking coal, a key raw material, increased considerably in 1HFY22 and could adversely impact the spreads in 2HFY22 spreads if metal prices are not hiked to a commensurate extent. TSL benefits from a captive supply of iron ore, which typically accounts for 20%-30% of the steel-making cost; this limits the impact of cost of inflation on the margins.

With the gradual recovery from the impact of pandemic-led issues in 1QFY22, and assuming there would not be any major business disruptions due to the omicron variant of COVID-19, demand momentum from end-user industries, including infrastructure, real estate and automobiles, is likely to result in sustained high utilisation levels in 2HFY22. The agency expects the strong cash flow generation to continue over the next six-to-12 months, on the back of structural tailwinds. Furthermore, the commissioning of TSL's cold rolled mill and pellet plant in FYE22 will bolster the profitability in FY23.

Liquidity Indicator - Adequate: The agency expects TSL's liquidity to be supported by strong cash accruals and on-balance sheet liquidity of INR90 billion at end-September 2021. Also, TSL had an unused working capital line of about INR65 billion and an unused capex limit of INR30 billion at end-September 2021. TSL's scheduled annual consolidated repayments stand at a meagre INR6.6 billion for the rest of FY22, and about INR30 billion in FY23. TSL's overseas group entities and European operations (Tata Steel Europe Ltd (TSE)) typically have high refinancing requirements; however, the repayment of TSE's term debt is due only in FY26. Furthermore, Ind-Ra expects the refinancing needs to reduce on the back of likely further debt reduction. The agency expects capex outflows of INR110 billion each in FY22 and FY23 to be partly funded by debt.

Robust Demand Outlook: The agency expects the domestic consumption growth to continue in FY22, underpinned by demand growth from construction, real estate, automobiles and consumer durables segments, high government spending on infrastructure and the availability of credit support demand growth in these end-user segments. Similarly, export opportunities are likely to remain strong, backed by China's removal of export rebate amid the capacity moderation to address environmental concerns. TSL's standalone export sales were close to 15% of the overall sales in 1HFY22 (FY21: 18.5%). However, the agency expects a normalisation of metal prices and moderation in per tonne margins during 2HFY22 due to weak international prices, raw material cost deflation and improved domestic demand-supply dynamics. The agency estimates TSL's average EBITDA/tonne to for the India operations to rise to INR25,000-INR26,000 in FY22 (FY21: INR17,700) and subsequently normalise to INR14,000 in FY23.

Scale and Integration: TSL has resumed its brownfield expansion of 5mt, with a timeline of commercialising the same by FYE24. Its domestic sales mix has improved post the acquisition of Bhushan Steel Ltd (renamed Tata Steel BSL Ltd (TSBSL)) and the steel division of Usha Martin Limited (IND A/Stable) over FY20-FY21. Furthermore, the integration of the acquired assets and the steady share of branded/value-added products as a proportion to domestic sales (FY21: 38%, FY20: 39%) has enabled TSL to post strong cash flows in India.

TSL's domestic operations are well-integrated, with its captive power and mining operations, which meet 100% of its iron ore requirements and about 29% of its metallurgical coal requirements (excluding TSBSL and Usha Martin). The integration has enabled TSL (India operations) to be among the low-cost steel producers in the world, according to the management. TSL's standalone profile is stronger than the consolidated profile. In FY21, TSL's standalone revenue was INR648.7 billion (FY20: INR604 billion), EBITDA was INR218 billion (INR149) and interest coverage (operating EBITDA/interest expense) was 6.4x (4.9x), against the consolidated revenue of INR1,563 billion (INR1490 billion), EBITDA of INR308 billion (INR180.2 billion) and interest coverage of 4.1x (2.4x). The standalone revenue accounted for 43% of the consolidated revenue, while the standalone EBITDA constituted 83% of the consolidated EBITDA.

Strong Performance of European Operations: The European operations had reported EBITDA losses during FY20-FY21, against a blended EBITDA per tonne of about INR5,900 in FY19. However, the per tonne EBITDA turned positive at INR4,834 in 4QFY21 and increased to INR10,900 in 1HFY22 due to increased spreads; the per tonne EBITDA is likely to remain positive over the near term due to reduced competitive intensity in the international market. TSL continues to focus on turning TSE's assets profitable. TSE's operations, which face stiff competition from imports, are not backward-integrated and have high operational overheads, leading to sharp volatility in margins. Moreover, the European operations need continuous modernisation capex to meet the environmental standards. According to the management, it is primarily the UK operations of 3mt capacity (of the total 10mt capacity under TSE) that has been a drag on cash flows due to weaker spreads. TSL has proposed to separate the UK operations from TSE as part of restructuring the European operations.

In FY21, about 31% of the consolidated sales volumes came from the European operations. The European operations had production capacity of 9.6mt (10.26mt) in FY21, with 3.0mt-3.5mt from the UK assets. With the Kalinganagar expansion, the stronger domestic sales mix would be strengthened, thereby mitigating the negative impact of the volatile European cash flows on the consolidated cash flows.

Inherent Industry Risk: The domestic steel sector is characterised by demand cyclicality, volatility in raw material and metal prices, high regulatory risk, and the risk of imports. The sector participants typically have high operating and financial leverage, large working capital requirements, and large-sized debt capital funding of the capex. Domestic steel producers are substantially dependant on imports of coking coal, and hence, any supply-side issue could have a material impact on utilisations and profitability. In addition, the metal prices are heavily dependent on international prices, as the domestic market is open for imports. Anti-dumping duty from China is temporarily suspended. China has been a key exporter in international market in the recent past and is roughly about 50% of the global production. As such any changes in its economic policies impacting infrastructure spending or easing of environmental norms can materially impact the metal prices.

RATING SENSITIVITIES

Positive: Reducing exposure to loss-making overseas units, sustained positive free cash flows at European operations, leading to lower refinancing requirements at overseas group entities, and the consolidated adjusted net leverage falling below 2.0x, on a sustained basis, may lead to a positive rating action.

Negative: Sustained weak profitability of the European operations, substantial debt-led acquisitions and or higher-than-expected capex outflows, leading to the consolidated adjusted net leverage exceeding 3.0x, on a sustained basis, would lead to a negative rating action.

COMPANY PROFILE

TSL commenced operations in 1907, with the establishment of India's first integrated steel plant. At FYE21, TSL had a global crude steel production capacity of 32.3mtpa, spread across Jamshedpur (9.7mtpa), Kalinganagar phase I (3mtpa), South East Asia (2.2mtpa, discontinued), TSBSL (5mtpa) and Europe (12.4mtpa). TSL plans to add another 5mt capacity in Kalinganagar by FYE24. The company has presence across the entire value chain of steel manufacturing from mining and processing iron ore and coal to producing and distributing finished products. It offers a broad range of steel products including a portfolio of high value-added downstream products such as hot-rolled, cold-rolled, coated steel, rebars, wire rods, tubes and wires. The promoters, Tata Group, held 34.41% stake in TSL at end-September 2021.

FINANCIAL SUMMARY

Particulars	FY21	FY20
Revenue (INR billion)	1562.9	1489.7
EBITDA (INR billion)	308.3	180.1
EBITDA margin (%)	19.7	12.1
Gross EBITDA interest coverage	4.1	2.9
Total adjusted net leverage	2.5	5.9
Source: TSL, Ind-Ra		

RATING HISTORY

Instrument Type	Current Rating/Outlook			Hi				
	Rating Type	Rated Limits (billion)	Rating	9 June 2021	15 March 2021	13 April 2020	6 March 2020	1 November 20

Issuer rating	Long-term	-	IND AA+/Stable	IND AA/Positive	IND AA/Stable	IND AA/Negative	IND AA/Stable	IND AA/Stable
CP	Short-term	INR150	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+
NCDs	Long-term	INR151.51	IND AA+/Stable	IND AA/Positive	IND AA/Stable	IND AA/Negative	IND AA/Stable	IND AA/Stable
Bank facilities	Long-term/Short-term	IN INR282.81	IND AA+/Stable/IND A1+	IND AA/Positive/IND A1+	IND AA/Stable/IND A1+	IND AA/Negative/IND A1+	IND AA/Stable/IND A1+	IND AA/Stable/IND A1+

ANNEXURE

Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook
Fund-based cash credit limits	-	-	-	-	INR22,625 (increased from INR18.37)	IND AA+/Stable/IND A1+
Long-term debt (term loan)	-	-	-	April 2027	INR34,1 (reduced from INR96,5)	IND AA+/Stable
Non-fund-based limits	-	-	-	-	INR202,835(increased from INR145,83)	IND AA+/Stable/IND A1+
Non-fund-based limits**	-	-	-	-	INR5	IND AA+/Stable/IND A1+
#Fund-based cash credit limits	-	-	-	-	INR13,25	IND AA+/Stable/IND A1+
NCD	INE081A08223	March 2019	9.8359	March 2034	INR43,15	IND AA+/Stable
NCD	INE081A08298	May 2020	8,25	May 2023	INR10,0	IND AA+/Stable
NCD	INE081A08231	March 2020	7,7	March 2025	INR6,7	IND AA+/Stable
NCD- Floating	INE081A08264	April 2020	7,7	April 2023	INR10,0	IND AA+/Stable
NCD- Floating	INE081A08306	June 2020	8,08	June 2023	INR4,0	IND AA+/Stable
NCD- Floating	INE081A08280	April 2020	7,85	April 2023	INR5,0	IND AA+Stable
NCD	INE081A08272	April 2020	7,95	October 2023	INR5,0	IND AA+/Stable
NCD	INE081A08249	April 2020	7,85	April 2023	INR10,25	IND AA+/Stable
NCD	INE081A08256	April 2020	7,85	April 2023	INR5,1	IND AA+/Stable
NCD*					INR52,31	IND AA+/Stable

INR6 billion proposed fund-based and INR7,25 billion working capital facilities have been converted into fund-based cash credit amount.

** INR5 billion proposed long-term debt (term loan) have been converted into non-fund-based limit amount.

* Yet to be issued

BANK WISE FACILITIES DETAILS

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COMPLEXITY LEVEL OF INSTRUMENTS

Instrument Type	Complexity Indicator
NCDs	Low
Bank loans (short & long term facilities)	Low
CP	Low

For details on the complexity level of the instruments, please visit <https://www.indiaratings.co.in/complexity-indicators>.

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Applicable Criteria

[Corporate Rating Methodology](#)

[Short-Term Ratings Criteria for Non-Financial Corporates](#)

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