

September 29, 2022

NMDC Limited: Rating continues to remain under Watch with Negative Implications

Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|--|--------------------------------------|-------------------------------------|---|
| Proposed Non-Convertible Debenture (NCD) Programme | 4,476.20 | 4,476.20 | [ICRA]AAA@; Rating continues to remain under Watch with Negative Implications |
| NCD Programme | 523.80 | 523.80 | [ICRA]AAA@; Rating continues to remain under Watch with Negative Implications |
| Total | 5,000.00 | 5,000.00 | |

*Instrument details are provided in Annexure-1; @ - rating watch with negative implications

Rationale

The rating Watch with Negative Implications on NMDC Limited's (NMDC) rating reflects uncertainty over the debt servicing arrangement to be made by NMDC Iron & Steel Plant (NISP) in the initial period post its demerger. The demerger has been approved by the NMDC's board on August 27, 2020, and is at an advanced stage of implementation, subject to receipt of requisite regulatory approvals. While the debt servicing would be done by NMDC till the demerger, the obligation for the rated debt would shift to the new entity once the demerger is complete. This, in turn, would exert rating pressure on the rated debentures as the credit profile of NISP is likely to be much weaker than NMDC, as it does not have any track record in the steel industry. ICRA also believes that NISP would take some time in ramping up and stabilising its steel business and could therefore witness cash flow mismatches in the initial period post commissioning. Consequently, there will be a multi-notch downgrade of the rated debentures post the demerger. ICRA notes that the coupon rate on the rated debentures would be enhanced further by an additional 25 basis points for each notch of rating downgrade below AAA, and such enhanced coupon shall be payable effective from the date of the rating downgrade.

There have been significant delays in completion of the raw material handling system of the steel plant as a result of which the commissioning date has been deferred many times. The steel plant was earlier scheduled for commissioning in the fourth quarter (Q4) of FY2022 but was again delayed due to technical problems. However, the problem has subsequently been rectified, and ICRA understands that hot-rolled coils are slated to be produced from the steel plant by March 2023. While NMDC has made arrangement for smooth running of the plant, NISP's ability to demonstrate optimal asset sweating will remain a key monitorable.

The rating derives comfort from NMDC's status as the largest iron ore miner in India, with its mines having adequate reserve of high-quality ore and its strong capital structure and debt coverage indicators. The total reserves of its mines stood at around 1,738 million tonnes (mt) with an average Fe content of 62-65%. The company has an approved environmental clearance (EC) for 51.8 million tonnes per annum (mtpa) and produces more than 40 million tonnes (mt) of iron ore at present, which is around 17% of the total iron ore produced in India in FY2022. The long validity of NMDC's mining leases provides adequate revenue visibility and strengthens the operating profile of the company. The company posted its best-ever operating and financial performance in FY2022 with its profitability touching an all-time high, aided by superior realisations and record dispatches made, notwithstanding the impact of the additional royalty, which led to an additional expense of Rs. 5,084 crore

in the last fiscal. ICRA expects the absolute profitability of the company to moderate in the current fiscal due to a sharp correction in ore prices following the increase in export duty on iron ore¹ and the impact of additional royalty from mid-October 2022 on production made from the Kumaraswamy mines (lease deed execution is still underway). However, higher production target of around 46 mt in the current fiscal (against 42.2 mt in FY2022) will cushion the impact on the profitability to some extent. The rating also draws comfort from the company's Navratna status under the Ministry of Steel, Government of India (GoI), with the latter holding a 60.79% stake in the company as on June 30, 2022. Sovereign ownership and superior liquidity profile supported by a healthy unencumbered cash/bank balance of around Rs. 6,850 crore as on March 31, 2022, impart a high degree of financial flexibility. Nevertheless, ICRA notes that the company remains exposed to the cyclicity inherent in the steel industry and to regulatory risks associated with the mining operations.

ICRA also notes the favourable ruling by the Supreme Court, which has allowed private sale of iron ore mined in Karnataka without the need for e-auctions through the Monitoring Committee route, thus benefitting NMDC, which operates two mines in the state, having a peak-rated capacity of 14 mtpa. As a result, the bottom line of the company will be positively impacted, given that the Monitoring Committee was deducting 10% of the sales proceeds towards the reclamation and rehabilitation plan. Besides, the working capital cycle will shorten as the company was previously receiving full payments with a lag. In addition, the Supreme Court's recent decision to enhance Karnataka's annual iron ore production ceiling for category A/B mines to 50 mtpa from 35 mtpa is expected to support NMDC's near-term investment plans, including the proposed enhancement in capacity of the Kumaraswamy mine to 10 mtpa from 7 mtpa.

Key rating drivers and their description

Credit strengths

Status as the largest iron ore mining company in India – NMDC, incorporated in 1958, is the largest iron ore miner in India with its mines having adequate reserve of good quality ore. Its total reserves stand at around 1,738 mt. At present, it produces more than 40 million tonnes (mt) of iron ore, which is around 17% of the total iron ore produced in India in FY2022. The company has seven iron ore mines in four different locations – Kirandul, Bachel (in Chhattisgarh), Donimalai and Kumaraswamy (in Karnataka) with the existing EC-approved capacity of 51.8 mtpa. The lease of the Chhattisgarh mines has been extended till FY35-FY37. Meanwhile, the lease of the Karnataka-based mines, Donimalai, is valid up to November 2038, and Kumaraswamy up to October 2042 (lease deed execution is still underway). The long validity of the mining leases provides adequate revenue visibility and strengthens the operating profile of the company.

Significant sovereign ownership and strategic importance to the GoI – NMDC is a flagship company under the Ministry of Steel, with a Navratna status. The GoI has a 60.79% ownership in NMDC as on June 30, 2022 and the company has strategic importance to the Government, given its status as the largest iron ore producer in India.

Superior liquidity profile – NMDC's financial risk profile has remained comfortable over the years, as reflected by its comfortable capital structure (with a gearing of 0.2 times as on March 31, 2022), consistent track record of strong cash flow from operations, and superior liquidity profile. Despite regular dividend payouts, NMDC's unencumbered cash/bank balance remained healthy at around Rs. 6,850 crore as on March 31, 2022.

Healthy profitability owing to high-margin iron ore mining business – NMDC's operating profitability remained strong in the range of 49-57% during the last four fiscals mainly on account of its low-cost mining operations and high grade of iron ore deposits. The average Fe grade of NMDC's Bailadila mines stood at 64-65% and that of Donimalai and Kumaraswamy mines at

¹ In May 2022, export duty increased from 30% to 50% on iron ore grade above 58% Fe; also a 50% export duty (from nil earlier) was imposed on iron ore grade below 58% Fe

62-63%. In addition, NMDC's recent lease extensions have been made at significantly lower revenue shares² with the state governments compared to the levels discovered in mine auctions, which further give NMDC a strong competitive advantage. Notwithstanding the impact of the additional royalty, which led to an extra expense of Rs.5,084 crore, the company posted its best-ever operating and financial performance in FY2022 with the profitability touching an all-time high, aided by superior realisations and record dispatches. ICRA expects the absolute profitability of the company to moderate in the current fiscal due to a sharp correction in ore prices following the increase in export duty to 50% from 30% on iron ore grade above 58% Fe and imposition of 50% duty on iron ore grade below 58% Fe coupled with the impact of the additional royalty from mid-October 2022 for the production done from the Kumaraswamy mines, following its renewal in the new allocation regime. However, the increased targeted production level will cushion the impact on the profitability to some extent.

Credit challenges

Transfer of debt servicing liability to NISP, which would have a weaker credit profile – NMDC has set up a 3-mtpa steel plant at Nagarnar (i.e. NISP). Out of total project cost of Rs. 21,940 crore, the company has incurred capex of Rs. 20,380 crore till March 31, 2022 and the remaining would be incurred in the current fiscal. While the major part of the capex has been funded by equity, the company is proposing debt funding of Rs. 5,000 crore (including the rated NCD of Rs. 523.8 crore and rupee term loan of Rs. 4,476.2 crore), of which around Rs.1,668 crore has already been drawn down till March 31, 2022. The debt servicing would be done by NMDC till the demerger, but the obligation for the rated debt would shift to the new entity once the demerger is complete. This would exert rating pressure on the rated debentures as the credit profile of NISP is likely to be much weaker than NMDC as it does not have any track record in the steel industry. While Mecon Limited³ will be supported by reputed OEMs like Primetals, Danieli Corus, and BHEL⁴ during the ongoing commissioning phase, which mitigates the operating risks to an extent, NISP's ability to demonstrate optimal asset sweating will remain a key monitorable. ICRA notes that NISP's blast furnace size (4,506 cum) is among the largest in India, which at the full utilisation level, would permit a much higher quantum of hot metal production than required in the downstream finished steel capacity, enabling it to divert the additional volumes as pig iron sales.

Exposure to cyclicality in steel sector – Iron ore is used as an input in the steel manufacturing process. NMDC, like other iron ore miners, remain exposed to the cyclicality inherent in the steel sector. A prolonged downturn in the steel industry might put pressure on NMDC's production levels and impact its cash flows. ICRA also notes that the major part of the company's iron ore output is sold to three customers viz. ArcelorMittal Nippon Steel India, Rashtriya Ispat Nigam Limited and JSW Steel Limited, exposing it to high sales concentration risk. However, the counterparty credit risk remains low.

Exposure to regulatory risks related to mining business – NMDC remains exposed to the regulatory risks associated with the mining business. ICRA notes that the Donimalai iron ore mine was non-operational between November 2018 and February 2021 post the expiry of its mining lease. While the lease was renewed in February 2021, the company lost production of ~15 mt between November 2018 and February 2021. The mining lease for the Kumaraswamy mines, which was scheduled to expire in October 2022, has already been renewed (lease deed execution is still underway). ICRA notes that going forward, the risk of timely lease renewal of NMDC's operating mining leases is minimal given the March 28, 2021 amendment of the Mines and Mineral Regulation (Development) Act, which brings in an enabling policy framework which eliminates the discretion exercised by state governments to renew the mining leases of public sector companies. In the new regime, NMDC is eligible for renewal

²As per the amended Mines and Mineral Regulation (Development) Act, 22.5% additional premium is being levied by the state governments of Chhattisgarh and Karnataka for NMDC's Kirandul, Bachel and Donimalai mines. This is w.e.f. Q4 FY2021. As against the same, average auction premiums in Odisha have generally remained above 100%

³ Mecon Limited, a leading firm engaged in the design, engineering, and consultancy projects in the steel sector, has been awarded the contract to commission and operate the steel plant for a period of three years

⁴ Bharat Heavy Electricals Ltd

of its existing leases for 20 years upon the expiry of the current lease period, subject to payment of an additional royalty of 22.5%.

Liquidity position: Superior

NMDC's liquidity position remains superior, supported by its healthy cash generation from the mining business. While the company has NCDs of Rs. 523.8 crore and a term loan of around Rs.1,145 crore outstanding on its books as on March 31, 2022, repayment obligations will only start from FY2024. ICRA expects the company's liquidity profile to remain very comfortable given the consistent track record of strong cash flow from operations from the mining business, availability of large unencumbered cash balances of Rs. 6,850 crore as on March 31, 2022, and adequate buffer in the form of unutilised credit lines.

Rating sensitivities

Positive factors – Not applicable

Negative factors – Pressure on the rating outstanding on the NCD instruments (which would be transferred to NISP) would emerge post the planned demerger due to a significantly weaker standalone credit profile of NISP compared to NMDC. NMDC's rating could also be downgraded in case of a sustained deterioration in profitability due to a sharp correction in iron ore prices.

Analytical approach

| Analytical Approach | Comments |
|---------------------------------|---|
| Applicable Rating Methodologies | Corporate Credit Rating Methodology Rating Methodology for Mining Entities Rating Methodology for Entities in the Ferrous Metals Industry |
| Parent/Group Support | Not applicable |
| Consolidation/Standalone | For arriving at the ratings, ICRA has considered the consolidated financials of NMDC Limited. As on March 31, 2022, NMDC Limited had 6 subsidiaries, 5 joint venture companies and 5 associate companies. These have been enlisted in Annexure-2. |

About the company

NMDC, incorporated in 1958, is under the administrative control of the Ministry of Steel, GoI. Mr. Sumit Deb is the Chairman and Managing Director of the company. NMDC is involved in the exploration of a wide range of minerals including iron ore, copper, rock phosphate, lime stone, dolomite, gypsum, bentonite, magnesite, diamond, tin, tungsten, graphite, beach sands etc. and is also the largest iron ore producer in India. At present, it produces more than 40 million tonnes (mt) of iron ore from Bailadila Deposit-14/11/14 NMZ, Bailadila Deposit-5, 10 (Chhattisgarh), Donimalai and Kumarswamy Iron Ore Mines (Karnataka).

Key financial indicators (Audited)

| Consolidated financials (Ind AS) | FY2021 | FY2022 | Q1 FY2023 [^] |
|--|---------|---------|------------------------|
| Operating Income (Rs. crore) | 15370.1 | 25881.7 | 4767.1 |
| PAT (Rs. crore) | 6247.1 | 9392.0 | 1467.8 |
| OPBDIT/OI (%) | 57.2% | 48.6% | 39.8% |
| PAT/OI (%) | 40.6% | 36.3% | 30.8% |
| Total Outside Liabilities/Tangible Net Worth (times) | 0.3 | 0.3 | - |
| Total Debt/OPBDIT (times) | 0.4 | 0.5 | - |
| Interest Coverage (times) | 522.9 | 322.1 | 123.8 |

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; [^]Unaudited

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

| | Instrument | Current Rating (FY2023) | | | | Chronology of Rating History for the past 3 years | | | | |
|---|--------------|-------------------------|--------------------------|---------------------------------|------------------|---|-------------------------|-------------|-------------------------|-------------|
| | | Type | Amount Rated (Rs. crore) | Amount Outstanding (Rs. crore)* | Date & Rating on | Date & Rating in FY2022 | Date & Rating in FY2021 | | Date & Rating in FY2020 | |
| | | | | | Sep 29, 2022 | | Sep 30, 2021 | Oct 1, 2020 | | Sep 7, 2020 |
| 1 | Proposed NCD | LT | 4,476.20 | - | [ICRA]AAA@ | [ICRA]AAA@ | [ICRA]AAA@ | [ICRA]AAA& | [ICRA]AAA (Stable) | |
| 2 | NCD | LT | 523.80 | 523.80 | [ICRA]AAA@ | [ICRA]AAA@ | [ICRA]AAA@ | - | - | |

Amount in Rs. crore; *As on Mar 31, 2022; LT – Long Term

@ - Rating Watch with Negative Implications; & - Rating Watch with Developing Implications

Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|------------|----------------------|
| NCD | Simple |

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, are available on ICRA's website: www.icra.in

Annexure-1: Instrument details

| ISIN | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (RS Crore) | Current Rating and Outlook |
|--------------|-----------------|-----------------------------|-------------|-----------------|-------------------------|----------------------------|
| NA | Proposed NCD | - | - | - | 4,476.20 | [ICRA]AAA@ |
| INE584A08010 | NCD | August 28, 2020 | 7.3% | August 28, 2025 | 523.80 | [ICRA]AAA@ |

Source: Company

@ - Rating Watch with Negative Implications

Annexure-2: List of entities considered for consolidated analysis

| Company Name | Ownership | Consolidation Approach |
|--|-----------|------------------------|
| J&KMDC Limited | 95.86% | Full consolidation |
| Legacy Iron Ore Limited | 90.02% | Full consolidation |
| Karnataka Vijaynagar Steel Limited | 100% | Full consolidation |
| NMDC Steel Limited | 100% | Full consolidation |
| NMDC-CSR Foundation | 100% | Full consolidation |
| NMDC-SARL (*) | 100% | Full consolidation |
| NMDC-CMDC Limited | 51% | Full consolidation |
| Jharkhand National Mineral Development Corporation Limited | 60% | Full consolidation |
| Bastar Railway Private Limited | 51% | Full consolidation |
| KOPANO-NMDC Minerals (PTY) Limited | 50% | Full consolidation |
| Krishnapatnam Railway Co. Limited | 6.40% | Equity method |
| International Coal Ventures Private Limited | 25.94% | Equity method |
| Neelachal Ispat Nigam Limited | 10.10% | Equity method |
| Romelt-SAIL (India) Limited (*) | 25% | Equity method |
| Chhattisgarh Mega Steel Limited | 26% | Equity method |

Source: Company; (*) – Under Closure

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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