ICRA

September 28, 2017

Tata Steel Limited

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Commercial Paper Programme	6,000.00	[ICRA]A1+; Assigned
Total	**6,000.00**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has assigned a short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs. 6,000.00-crore[1] commercial paper programme of Tata Steel Limited (TSL or the company)[2].

Rationale

The assigned rating takes into account the status of TSL as a leading producer of high quality steel with significant vertical integration for its Indian operations, which impart cost efficiency. The rating also reflects commissioning and ramp-up of Kalinganagar phase I operations at a time when both international and domestic steel prices have moved up (24% and 5% increase since March 2017), which is likely to result in better profitability and cash accruals in the near to medium term. The rating also favourably factors in TSL's captive iron ore and coking coal mines, which meet the company's 100% and 36% of iron ore and coking coal requirements in India, providing raw material cost advantage due to low-cost mining operations. This also partly insulates its domestic profitability from volatility in raw material prices. The rating also takes into consideration a diverse product portfolio of TSL with a high share of branded products and retail solutions and auto grade steel, which strengthens its operating profile. ICRA notes that the share of such value-added products is likely to increase further with the ramp-up of Kalinganagar plant in the current year. The rating also draws comfort from the comfortable liquidity profile of TSL with cash, liquid investments and undrawn credit lines of over Rs. 23,000 crore as on June 30, 2017 and its strong financial flexibility as reflected from its demonstrated ability to refinance loans at competitive interest rates. Although the cash balance also included £550 million, which was paid towards settlement of BSPS in Q2FY2018, liquidity profile of TSL is supported by the fact that its consolidated debt repayments in FY2018 and FY2019 remain low. TSL's working capital intensity of operations also remains low due to high bargaining power against its customers and its letter of credit backed payments to suppliers with higher usance periods. However, proposed consolidated capex of Rs. 7,000 crore in FY2018 and aggressive expansion plans for Indian business are likely to keep TSL's free cash flows under check.

In TSL's operations in Europe, while a divestment of long-products business in FY2017 and speciality steel division in UK in May 2017 has reduced the stress on Tata Steel Europe's profitability, successful restructuring of the British Steel Pension Scheme (BSPS) in the current year has improved the long-term viability of its UK operations. ICRA notes that the recent memorandum of understanding (MoU) signed with thyssenkrupp AG to form a 50:50 joint venture (JV) offers significant synergy benefits associated with a large scale of operations and also allows TSL to transfer its debt of € 2.5 billion out of its total external debt of € 3.0 billion at Tata Steel Europe subject to the signing of definitive agreements and anti-trust approvals before the proposed closure date scheduled in December 2018 or March 2019. However, since the residual debt of the offshore entities would be largely serviced by the dividend payouts of the said JV, the ability of the JV to generate adequate profits and reap the stated synergy benefits remains a key credit monitorable going forward.

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[1] *100 lakh = 1 crore = 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

The rating is, however, constrained by an aggressive capital structure of TSL at a consolidated level and likely sustenance of the same in the medium term, given the proposed expansion plans to double the capacity in the domestic steel business. ICRA also notes that the profitability of international operations of TSL has remained volatile, with the UK business continuing to report losses, which adversely impacts its consolidated financial risk profile. The rating also takes into account the risks arising from operating in the highly regulated iron ore and coal mining industry, as reflected in the instances of mining restrictions in FY2015 and FY2016, and compensation to be paid towards excess mining of iron and manganese ore in Odisha as per the order of the Honourable Supreme Court in August 2017.

Key rating drivers

Credit strengths

- **Large scale of operations globally with a wide distribution reach** – TSL has a strong market share in Eastern and Northern regions of India and its capacity utilisation rates for its 13 million tonnes per annum (mtpa) domestic capacity are upwards of 90% at present. Globally, TSL stood as the tenth largest steel producer in CY2016 with crude steel production of 24.5 mt.
- **Captive iron ore and coking coal mines, which provide cost efficiency and partly insulates the profitability of domestic operations from the volatility in raw material prices –** TSL India procures 100% of its iron ore requirement and around 36% of its coking coal requirement from its captive mines. As a result, TSL's domestic profitability has remained partly insulated from the volatility in raw material prices, coking coal in particular, in recent times. This also results in cost efficiency in TSL's Indian operations, since these raw materials account for a majority of the total cost of steel making. The mining license for iron ore and coal mines are valid till the year 2030, while the same for its chrome ore mines are valid till 2020.
- **Diversified product mix with a presence in both flats and longs; healthy share of branded products in the sales mix strengthens operating profile –** TSL's product mix is dominated by branded products and retail solutions, which typically fetch a premium over commodity grades, and its share in the company's total sales stood at 48% in Q1FY2018. In the current year, with the ramp-up of the Kalinganagar plant that produces high-quality auto-grade steel products, the share of value-added products in the sales mix is likely to increase further.
- **Successful restructuring of the BSPS and a JV with thyssenkrupp AG, having potential synergy benefits associated with a larger scale of operations –** In order to reduce volatility of a large pension fund based on defined benefits scheme, TSL delinked the BSPS from its UK operations in September 2017 after offering a payment of £550 million and a 33% anti-embarrassment stake in Tata Steel UK (TSUK) to BSPS Trustees. Tata Steel UK has also agreed to sponsor a proposed new pension scheme (BSPS II), subject to certain qualifying conditions. The new scheme would have lower future annual increases than the BSPS, with improved funding position and lower risk for Tata Steel UK. In addition, an MoU signed with thyssenkrupp AG for a 50:50 JV is likely to result in synergy benefits associated with shared infrastructure and resources. This would also enable transfer of TSUK's debt of € 2.5 billion to the JV.
- **Comfortable liquidity profile and strong financial flexibility –** TSL's cash, liquid investments and undrawn credit lines stood at over Rs. 23,000 crore as on June 30, 2017 which provides a strong cushion to the liquidity profile. ICRA notes that the said cash balance also included £550 million, which was paid towards settlement of BSPS in Q2FY2018. As against this, TSL's consolidated debt repayments in FY2018 and FY2019 remain low in absolute terms. The company's demonstrated ability to refinance debt at favourable interest rates is also a source of its financial flexibility. TSL's working capital intensity of operations also remains low, which supports the overall liquidity. However, proposed consolidated capex of Rs. 7,000 crore in FY2018 and aggressive expansion plans for the Indian business are likely to keep TSL's free cash flows under check.

Credit weaknesses

- **Consolidated financial profile characterised by a leveraged capital structure and moderate debt coverage indicators –** TSL's consolidated debt remains elevated at Rs. 83,014 crore as on March 31, 2017 due to its acquisition of Corus Group Plc in 2007, loss-making UK business operations and a green-field capex on Kalinganagar project, which in turn kept the consolidated gearing high at 2.11 times. Given the proposed plans of doubling the steel capacity in India in the next five years, debt levels of TSL are likely to remain high in the medium term at least.
- **Volatile profitability of international operations and loss making operations of UK business, both of which adversely impact consolidated financial risk profile -** TSL's UK operations continue to report losses due to various factors such as a lack of captive raw material sources, intense competition, high employee costs and overheads. South East Asia operations of TSL also suffer from high competition and weak demand. However, Netherlands operations remain more efficient and profitable. Going forward, divestment of long-products and speciality steel business and restructuring of operations in Europe are likely to improve the profitability of TSL.
- **Exposure to regulatory risks, given the presence in highly regulated iron ore and coal mining business –** Due to regulatory issues in FY2015 and FY2016, TSL's iron ore mining operations were disrupted and the company resorted to external purchases during that period. Also, the company is required to pay a compensation of Rs. 614 crore towards excess mining of iron and manganese ore in Odisha following the order of the Honourable Supreme Court.

Analytical approach: For arriving at the ratings, ICRA has taken a consolidated view of TSL and its subsidiaries and has also applied its rating methodologies as indicated below.

Links to applicable criteria:
Rating Methodology for entities in the Ferrous Metals Industry
Corporate Credit Rating Methodology

About the company:
Tata Steel Limited (TSL), a part of the widely diversified Tata Group, manufactures iron and steel products. TSL's key products include hot rolled coils/sheets, cold rolled coils/sheets, mild steel galvanised plain/corrugated/colour-coated coils/sheets, steel billets, bars and rods, among others. In addition to different varieties of steel, it is also a large producer of ferro-chrome products. TSL has an annual crude steel production capacity of 27.5 million tonnes per annum (mtpa) with 13 mtpa of crude steel capacity in India and the remaining capacity mainly in Europe. Tata Steel Europe was formed by the takeover of the erstwhile Corus Group Plc by TSL. The company also has operations in Thailand and Singapore.

On a standalone basis, the company reported a net profit of Rs. 506 crore on an operating income of Rs. 12,971 crore in Q1FY2018, as compared to a net profit of Rs. 3,445 crore on an operating income of Rs. 47,993 crore in FY2017. On a consolidated basis, TSL reported a net profit of Rs. 933 crore on an operating income of Rs. 29,557 crore in Q1FY2018 against a net loss of Rs. 4,169 crore on an operating income of Rs. 112,299 crore in FY2017.

Key Financial Indicators (Audited)

Consolidated financials	FY2016	FY2017
Operating Income (Rs. crore)	101,965	112,299
PAT (Rs. crore)	-497	-4,169
OPBDIT/ OI (%)	7.8%	15.1%
RoCE (%)	4.7%	3.4%
Total Debt/ TNW (times)	1.84	2.11
Total Debt/ OPBDIT (times)	10.29	4.88
Interest coverage (times)	1.81	3.24
NWC/ OI (%)	13%	8%

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress);
NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:

Table:

S. No.	**Instrument**	**Current Rating (FY2018)**				**Chronology of Rating History for the past 3 years**		
		Type	**Amount Rated (Rs. crore)**	**Amount Outstanding (Rs Crore)**	**Date & Rating**	**Date & Rating in FY2017**	**Date & Rating in FY2016**	**Date & Rating in FY2015**
					September 2017	**-**	**-**	**-**
1	Commercial Paper Programme	Short Term	6,000.00		**[ICRA]A1+**	**-**	**-**	**-**

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1

Instrument Details

ISIN No	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Commercial Paper Programme	-	-	-	6,000.00	[ICRA]A1+

Source: the company

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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.

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