Tata Steel Limited

July 09, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper	6,000.00	6,000.00	[ICRA]A1+ outstanding
Commercial Paper	-	9,000.00	[ICRA]A1+ assigned
Total	**6,000.00**	**15,000.00**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has assigned the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus)[1] to the Rs. 9,000-crore[2] commercial paper programme of Tata Steel Limited (TSL). ICRA also has short-term rating of [ICRA]A1+ outstanding on the Rs. 6,000 commercial paper programme of TSL.

Rationale

The rating reaffirmation takes into account TSL's large scale of operations globally, and its status as a leading producer of high-quality steel with significant vertical integration and captive raw material linkages for its Indian operations, which not only imparts cost-efficiency, but also partially hedges the company's profits against volatility in raw material prices. TSL's captive mines meet 100% and 30% of the company's domestic iron ore and coking coal requirements respectively, giving the company a distinct competitive advantage over peers. The rating also takes into consideration TSL's diverse product portfolio in the flat and long product categories, characterised by a high share of value-added and branded products, which supports higher margins and strengthens TSL's operating profile. TSL has been able to ramp-up and stabilise operations at its Kalinganagar plant from a capacity utilisation of 56% in its first year of operation in FY2017 to 84% in FY2018, helping the company lower its operating leverage. Apart from higher volumes at Kalinganagar, the steady rise in domestic and global steel prices led to a strong 32.9% year-on-year (YoY) growth in OPBITDA[3] from the Indian operations in FY2018. In FY2019, ICRA expects TSL's operating profits from the domestic operations to grow further, supported by the continued buoyancy in steel prices, an expected lower volatility in coking coal prices, and a healthy growth rate of around 6% expected in the domestic steel demand.

The Tata Steel Group has charted an aggressive domestic expansion plan to double its domestic steelmaking capacity from the current level of 13 million tonne per annum (mtpa) in the next five years. Given this growth plan, the company has actively participated in the ongoing stressed asset resolution process of steel companies. TSL has emerged as the winning bidder for Bhushan Steel Limited (BSL) and has completed the acquisition of a 72.65% controlling stake in this 5.6 mtpa integrated flat steel producer. With a bid value of Rs. 35,232.6-crore, being funded through a mix of external debt to internal resources at a ratio of 0.9:1 times, the acquisition led to a substantial drawdown of TSL's cash and liquid investment portfolio. ICRA notes that TSL has also submitted a bid to acquire Bhushan Power & Steel Limited's (BPSL's) 3.0 mtpa integrated steel plant. Following the outcome of the legal proceedings, if TSL emerges as the winning bidder for BPSL as well, the same would run-down the company's liquid investment portfolio further, and lead to a significant

[1] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*
[2] *100-lakh = 1-crore = 10 million*
[3] *Operating profit before interest, tax, depreciation, amortisation*

increase in consolidated debt levels. However, ICRA believes that TSL's liquidity would continue to be supported by the strong cash accruals from the domestic steel business, and the limited debt repayment commitments in the near term. In addition, TSL's access to callable partly paid shares accumulating to Rs. 3598-crore, largely undrawn working bank capital lines, along with its strong financial flexibility, as demonstrated by its debt refinancing ability, further support its liquidity profile.

In FY2018, TSL's consolidated gearing and Total debt/OPBITDA remained at elevated levels of 1.5 times (as on March 31, 2018) and 3.9 times respectively. The company's substantial ongoing large inorganic acquisitions, and the 5-mtpa Kalinganagar brownfield expansion are expected to exert pressures on the free cash flows, leverage, and coverage indicators in the medium-term. However, these growth plans provide an opportunity to have a greater footprint in the growing domestic market, as well as realise synergy benefits through business integration. BSL has an attractive product portfolio in the high-margin flat product segment, with a substantial presence among institutional customers spread across the automotive, white-goods and engineering sectors. That said, the gradual ramp-up of BSL's capacity utilisation rates (from the prevailing low level of less than 55%[4]) are expected to help the Tata Steel Group consolidate its domestic market share in flat products from 20% in FY2018 to an estimated 28%[5] in FY2019. The growing market share in the flat product category is expected to continue following the commissioning of the 5 mtpa Kalinganagar phase II. TSL would remain exposed to project risks in the interim construction period. However, the company's experience in developing and operating large scale steel plants across locations mitigate such risks to a large extent.

The short-term rating also considers TSL's low and volatile profitability from the European and South-East Asian operations, as indicated by an EBITDA[6] of US$ 59/MT and US$ 27/MT of deliveries respectively in FY2018, against a much higher US$ 202/MT of deliveries from the Indian operations during the same period. However, following the successful resolution of the UK pension scheme, TSL has signed a definitive 50:50[7] joint venture (JV) agreement with thyssenkrupp AG on June 30, 2018, paving the way for the formation of the second-largest steelmaker in Europe. ICRA views the deconsolidation of the low-margin European steel business, and subsequent deleveraging of Euro 2.5 billion debt on non-recourse basis to be positive to the Tata Steel Group's credit profile. Going forward, successful integration of the two companies, crystallisation of annual synergy benefits of Euro 400-500 million, and a steady dividend payment track record from the JV would remain important considerations for TSL's overall profits.

The short-term rating also incorporates TSL's exposure to regulatory risks, given its presence in the highly regulated iron ore and coal mining operations, and its exposure to forex risks, given that around 70% of the consolidated debt (as on March 31, 2018) is denominated in foreign currency, whereas around 76% of the consolidated FY2018 EBITDA is generated from the Indian operations of TSL and its subsidiaries. ICRA however notes that the close linkages between dollar movements and steel prices provides a natural hedge to TSL, partly mitigating forex risks. Going forward, a time-bound scale-up in operations of the acquired facilities, as well as completion of the European JV formalities would remain key moniterables.

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[4] *Source: Ministry of Steel Annual Report*

[5] *Without considering BPSL acquisition*

[6] *Earnings before interest, tax, depreciation, amortisation*

[7] *TSL would have an economic interest of 45% in the JV, given that TSL has given thyssenkrupp warrants equivalent to 10% of the equity capital which can be monetised through secondary sale during an IPO*

Key rating drivers

Credit strengths

Large scale of operations globally with a wide distribution reach - TSL has a strong market share in the Eastern and Northern regions of India and its capacity utilisation rate for its 13 mtpa domestic capacity remain upwards of 95% at present. Globally, TSL stood as the tenth largest steel producer in CY2017, with crude steel production of 24.1 mt.

Captive iron ore and coking coal mines 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 30% 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 major share of the total cost of steel making.

Diversified product mix with a presence in both flats and longs - TSL has a diversified product portfolio in the flat and long product categories, characterised by a high share of value-added and branded products. In FY2018, around 53% of the sale volume were made in the value-added product categories.

Signing of a definitive JV agreement with thyssenkrupp AG, having potential synergy benefits associated with a larger scale of operations – On June 30, 2018, TSL signed a definitive 50:50[8] joint venture (JV) agreement with thyssenkrupp AG, paving the way for the formation of the second largest steelmaker in Europe with annual deliveries of 21 mt. ICRA views the deconsolidation of the low-margin European steel business, and subsequent deleveraging of Euro 2.5 billion debt on non-recourse basis to be positive to the Tata Steel Group's credit profile.

Strong accruals from Indian business and high financial flexibility to support liquidity profile – The acquisition of BSL and the potential acquisition of BSPL is expected to lead to a significant run-down of the Group's outstanding cash and liquid investment balance. However, TSL's liquidity would continue to be supported by the strong cash accruals from the domestic steel business, the limited debt repayment commitments in the near term, TSL's largely undrawn working capital bank lines, its strong refinancing ability, and its access to callable partly paid shares accumulating to Rs. 3598-crore.

Credit challenges

Aggressive debt-funded domestic growth plans to expose the company to execution risks, and exert pressure on the capital structure and debt coverage metrics in the medium term - The Tata Steel Group has actively participated in the ongoing stressed asset resolution process of steel companies. TSL has acquired a 72.65% controlling stake in BSL for a consideration of Rs. 35,232.6-crore, and has submitted a bid to acquire BPSL as well. These acquisitions are would lead to a significant increase in consolidated debt levels. In FY2018, TSL's consolidated gearing and Total debt/OPBITDA[9] remained at elevated levels of 1.5 times (as on March 31, 2018) and 3.9 times respectively. The company's substantial ongoing large inorganic acquisitions, and the 5-mtpa Kalinganagar brownfield expansion is expected to exert pressure on the free cash flows, leverage, and coverage indicators in the medium-term, and expose the company to project execution risks.

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[8] *TSL would have an economic interest of 45% in the JV, given that TSL has given thyssenkrupp warrants equivalent to 10% of the equity capital which can be monetised through secondary sale during an IPO*

[9] *Operating profits before interest, tax, depreciation, amortisation*

Volatile and low profitability from international operations – TSL has been reporting low and volatile profitability from the overseas European and South-East Asian operations. Profitability from TSL's UK operations is constrained by factors such as a lack of captive raw material sources, intense competition, high employee costs and overheads. The South-East Asian operations of TSL also suffer from high competition and weak demand. However, Netherlands operations remain more efficient and profitable.

Exposure to regulatory risks, given its presence in the highly regulated iron ore and coal mining businesses - Due to regulatory issues, TSL's iron ore mining operations witnessed disruption in FY2015 and FY2016, and the company resorted to external purchases during that period. Also, the company had 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.

Exposure to forex risks - Around 70% of TSL's consolidated debt (as on March 31, 2018) was denominated in foreign currency. This exposes TSL to forex risks, more so because of the reliance on Indian operations to partly service debt obligations of overseas subsidiaries. However, the close linkages between dollar movements and steel prices provide a natural hedge to TSL, partly mitigating forex risks.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:

Corporate Credit Rating Methodology

Rating Methodology for Entities in the Ferrous Metals Industry

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 33.1 million tonnes per annum (mtpa) with 18.6 mtpa of crude steel capacity in India and the remaining capacity in Europe and South-East Asia. Tata Steel Europe was formed by the takeover of the erstwhile Corus Group Plc by TSL.

In FY2018, the company reported a net profit of Rs. 17,762.81-crore on an operating income of Rs. 1,32,155.75-crore, compared to a net loss of Rs. 4,168.57-crore on an operating income of Rs. 1,12,299.42-crore in the previous year.

Key financial indicators

	FY2017	FY2018
Operating Income (Rs. crore)	1,12,299.42	1,32,155.75
PAT (Rs. crore)	-4,168.57	17,762.81
OPBDIT/OI (%)	15.15%	16.56%
RoCE (%)	3.44%	20.38%
Total Debt/TNW (times)	2.11	1.49
Total Debt/OPBDIT (times)	4.88	4.21
Interest coverage (times)	3.24	3.86

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
					Jul 2018	Sep 2017	-	-
1	Commercial Paper	Short Term	15,000	3,500	[ICRA]A1+	[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 Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating
INE081A14809	Commercial Paper	28-Jun-2018	NA	11-Sep-2018	500.00	[ICRA]A1+
INE081A14791	Commercial Paper	21-Jul-2018	NA	19-Sep-2018	1,500.00	[ICRA]A1+
INE081A14783	Commercial Paper	18-Apr-2018	NA	16-Jul-2018	1,500.00	[ICRA]A1+
-	Commercial Paper – Unissued	-	-	-	11,500.00	[ICRA]A1+

NA: Not Available

Source: NSDL Website

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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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