February 06, 2023

NMDC Steel Limited: [ICRA]A Rating Watch with Developing Implications; assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Non-Convertible Debenture (NCD) Programme	523.80	[ICRA]A Rating Watch with Developing Implications; assigned
Proposed NCD Programme	0.20	[ICRA]A Rating Watch with Developing Implications; assigned
Total	**524.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating assigned to NMDC Steel Limited (NSL) factors in its status as a central public sector undertaking (CPSU) with the Government of India (GoI) having a 60.79% equity ownership. ICRA understands that NSL would continue to receive operational and managerial support from NMDC Limited till it is divested by the GoI. ICRA notes that NSL has been demerged from NMDC Limited with effect from October 13, 2022 and its 3.0-million-tonne-per-annum (mtpa) steel plant is at an advanced stage of completion, having a targeted commissioning date of end-March 2023. This largely mitigates the execution risk. The plant will use modern/advanced steel making technology, with packages for critical elements like blast furnace, sinter plant, steel melt shop, and thin slab caster/rolling mill, supplied by reputed European equipment suppliers. ICRA believes that NSL's energy efficient systems, high level of process automation, captive power generation capacity of 100 MW[1] and competitive grid tariffs would not only enhance its cost competitiveness once the plant ramps up its production but would also ensure uninterrupted operations. In addition, long-term iron ore sourcing arrangement with NMDC Limited would ensure steady availability of high-grade iron ore, helping improve hot metal productivity and lower blast furnace fuel rates.

Post commissioning, the day-to-day operations of the steel plant will be managed by MECON Limited (MECON, a GoI entity rated at [ICRA]BBB/Stable/[ICRA]A2). While MECON has a long track record in the design and consultancy of steel projects, it lacks experience in the operation and maintenance of large integrated steel plants, exposing NSL to operational and stabilisation risks. The company's ability to ramp up production and achieve operating parameters would remain a key monitorable from the credit perspective. The rating is also constrained by the significant time and cost over-runs witnessed by NSL in the past, which has delayed its completion schedule by 6-7 years and increased the budgeted project cost by 40-45%. These are likely to keep its return on capital employed at moderate levels. That said, a conservative project funding structure with an estimated project gearing of ~0.3 times would keep the company's annual debt servicing requirement at a manageable level. While over 30% of NSL's product mix is expected to come from the sale of value-added/ special steel products, the company remains exposed to commercial and marketing risks as the products are yet to be established in the market and customer approvals from OEMs are pending. The rating also reflects the inherent cyclicality associated with the steel sector, which exposes the company to volatility in its earnings.

The GoI has announced its decision to divest 50.79% of its stake in NSL and has invited bids on December 1, 2022 with the last date for submission of express of interest (EOI) being January 27, 2023. As indicated in the Preliminary Information Memorandum (PIM) for inviting the bids, the remaining 10% equity stake will be offered to NMDC Limited post the divestment, which has been considered favourably by ICRA. The announced divestment results in uncertainty over the ownership structure and strategic direction for the company in the medium term. The rating has been placed on Watch with Developing Implications owing to this uncertainty. ICRA will closely monitor developments in this regard and finalise its views once more clarity emerges.

[1] 35-40% of the power requirement being met from process gasses.

Key rating drivers and their description

Credit strengths

Status as a majority-owned GoI entity; managerial/ operational support from NMDC Limited till NSL gets divested – NSL mirrors the ownership structure of NMDC Limited after the de-merger, with the GoI owning 60.79% of the entity's equity stake. Additionally, managerial/ operational support is available to NSL from NMDC Limited for managing operations till the closure of divestment. In addition, NMDC has provided non-current interest-free advance of Rs. 1,233 crore to NSL on flexible repayment terms, representing the cumulative investment, which has been made for the steel plant from its internal resources post April 1, 2021.

Advanced stage of commissioning partly mitigates execution risk – The plant is ready to start commercial operations by March 31, 2023 with all the major packages being ready (except the lime and dolomite plant), including operationalisation of one coke oven unit from October 28, 2022. The second coke oven unit is scheduled to start coke production from end-February 2023. As on date, capex of around Rs. 1,500 crore is pending, which is set to incurred by the end of the current fiscal.

Long-term iron ore sourcing arrangement with NMDC Limited ensures steady availability of high-grade iron ore, helping improve hot metal productivity and lower fuel rates – NSL has signed a 10-year agreement with NMDC Limited for procuring high-grade iron ore (lumps and fines) with an average Fe content of 65%, which is valid till March 31, 2032. Additionally, proximity to the NMDC mines in Chhattisgarh will lead to a lower freight cost for NSL, leading to significant cost efficiencies. Lower freight and higher quality of material will support cost competitiveness.

Low reliance on external debt for capex reduces annual debt servicing requirement – Funding of the budgeted capex of Rs 22,223 crore is majorly done through NMDC's internal resources with only Rs. 5,000 crore (project gearing of ~0.3 times) being planned to be funded from external debt. Out of the capital cost of ~Rs. 20,700 crore incurred till September 30, 2022, only Rs. 2,474 crore of loans (~12% of the cost incurred) has been availed. Low reliance on external debt reduces the annual debt servicing requirement and would support the credit metrics once operations stablise.

State-of-the-art plant with high level of automation, energy efficient systems and captive power generation to support cost competitiveness – Major project packages for blast furnace, sinter plant, steel melt shop and thin slab caster/rolling mill have been developed by European OEMs with joint ventures though reputed Indian contractors, which have equipped the plant with a high level of automation, and energy efficient systems. NSL's downstream finished steel unit (consisting of thin slab caster and in-line rolling) is expected to lead to significant savings in energy costs as it eliminates the requirement of reheating of slabs needed before rolling, which is the case in older steel plants. In addition, as NSL will have the second largest blast furnace in the country, it is also expected to benefit from process efficiencies emanating from the large scale.

NSL has the capability to captively generate 100 MW of power with 80 MW coming from its mixed gas turbine, which will utilise process gasses (from coke oven, blast furnace and LD converter) and the balance 20 MW coming from the top recovery turbine in its blast furnace. Overall, 35-40% of the overall power requirement will be met captively with the balance planned to be sourced from the Chhattisgarh State Electricity Board (CSEB) through a dedicated transmission line. As the in-house cost of captive power generation will be minimal, the overall blended power cost is expected to be very competitive for the plant.

Value-added/ special steel products in the portfolio is expected to support realisations – The basic oxygen furnace (BOF) is equipped with a ladle furnace and RH degasser, which enables development of high-grade steel products. NSL's primary product for sale will be high-grade HRC, which has applications across various industries. Few areas of its applications include LPG cylinders, auto components, bridges, steel structures, ships, large diameter pipes (API grade), storage tanks, boilers, railway wagons, pressure vessels and electrical equipment.

Credit challenges

Significant time and cost over-runs in the past – The capex was conceived in 2008, land acquisition of 1,930 acre was completed in August 2010, and the work started in CY2011. The original estimated project cost was Rs. 15,525 crore and the commissioning date was June 2015. ICRA understands that the project got delayed primarily due to poor infrastructure in the region, which is a forest area with limited rail and road connectivity, and prolonged delay in completion of the raw material handling system, which was supposed to be completed by February 2014. Given the delays, the project cost was revised upward to Rs. 21,940 crore. At present, the project completion cost is likely to be Rs. 22,223 crore (including the capitalised interest cost) with an expected commissioning by March 31, 2023.

Exposed to operational and stabilisation risks given the lack of track record of NSL and O&M contractor in steel plant operations – The operations and management (O&M) for the first three years would be taken up by Mecon Limited (MECON, rated [ICRA]BBB/Stable/[ICRA]A2) which is a GoI enterprise. MECON has an established track record in the design and consultancy of large-scale steel projects, however, this will be their first O&M project for an integrated steel plant. As MECON lacks experience in this area, NSL is exposed to operational and stabilisation risks. ICRA, however, notes that MECON has assembled a team of experienced professionals, who have relevant experience in running steel plants in the country, which mitigates such risks to an extent.

Exposed to commercial and marketing risks as the product is yet to be accepted in the market and customer approvals are pending – Being a newly commissioned plant, NSL is exposed to commercial and marketing risks during the initial period in FY2024. As NSL's product is yet to accepted in the market, and customer approvals are pending, at this juncture, NSL will be dependent on NMDC for supporting the distribution of steel products. Moreover, in the interim period, before NSL is able to independently onboard customers, the by-products, semis (pig iron and defective steel), and commodity grades of HRC are being planned to be sold through the Mjunction online auction platform. NSL is yet to approach OEMs and other end users for necessary certification requirements for value-added products and the same is being planned to be completed in due course of time

Environment and Social Risks

Steel manufacturing is an energy intensive process and requires a substantial use of fossil fuels, which results in greenhouse gas emissions, industrial waste generation, and environmental pollution. Increasing regulatory requirements to reduce greenhouse gas emissions and stricter air pollution standards may lead to higher costs for manufacturers in the medium term. NSL has made efforts towards sustainable steel production at its new steel plant, which include zero-liquid discharge, utilisation of waste-gases to generate power, and energy efficient upstream and downstream units. Minimising the adverse impact on environment can reduce the possibility of unfavourable regulatory actions. Further, NSL faces the risk of flood and drought, which can affect its minerals availability.

Social risks for NSL arise from the health and safety aspects of employees involved in the mining and manufacturing activities. Casualties/ accidents at the operating units due to gaps in safety practices could lead to production outages and invite penal actions from regulatory bodies. Being a PSU, the company is expected to follow necessary steps to manage risks related to safety in the areas of process, contractor, road/rail, and occupational health while developing safety leadership capabilities. NSL is also exposed to labour-related risks and risks of protests/social issues with local communities, which might impact expansion/modernisation plans. However, as a part of its R&R (Resettlement & Rehabilitation) initiatives, the company has given employment to 750 land losers, which mitigates such risks to an extent.

Liquidity position: Adequate

NSL's liquidity position remains adequate with the undrawn bank lines of Rs. 2,526 crore as on September 30, 2022, which will give flexibility to draw additional debt[2] to tide over any cash flow timing mismatches during the initial period before the operations stabilize and start generating stable cash flows. NSL has input tax credits of Rs. 1,726 crore as GST paid on capital assets. Gradual refund of this amount following commencement of sales is also expected to support the liquidity position. However, NSL does not have any working capital lines, which are expected to be tied up before the expected commencement of commercial operations from March 31, 2023.

[2] The Rs. 4,476.2 crore of sanctioned rupee terms loan has an availability period till end-September 2023

Rating sensitivities

Positive factors – Rating may be upgraded following a timely ramp up and stabilization of operations of the steel plant leading to healthy operating margins and free cash generation. Rating may also be influenced by the credit profile of the incoming strategic investor.

Negative factors – Rating may be downgraded in case of further significant delay in the commissioning timeline and inability to stabilize operations leading to large cash losses for an extended period. Rating may also be influenced by the credit profile of the incoming strategic investor.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Ferrous Metals Industry
Parent/Group support	Parent/Group Company: Government of India (GoI) The GoI owns a 60.79% stake of NSL. ICRA also draws comfort from managerial and operational support available from NMDC Limited (A GoI entity) till the ownership is transferred to the new buyer
Consolidation/Standalone	The ratings are based on the standalone financials of NSL

About the company

NMDC Steel limited (NSL) was incorporated in October 2022 with an effective date of April 1, 2021. It is developing a 3.0-mtpa greenfield integrated steel plant, designed through the Blast Furnace-Basic Oxygen Furnace (BF-BOF) route at Nagarnar, near Jagdalpur, in Bastar district of Chhattisgarh. The plant is expected to be commissioned by March 31, 2023. NSL's greenfield steel plant will produce 2.9 mt of HR coils, sheets and plates per year. The HR plates produced in the plant will be used in the manufacturing of LPG cylinders, API grade pipes, bridges, steel structures, ships, large diameter pipes, storage tanks, boilers, railway wagons, automobiles and pressure vessels.

Key financial indicators

NMDC Steel Limited (Standalone)	H1FY2022	H1FY2023
Operating income	-	-
PAT	-	-
OPBDIT/OI	-	-
PAT/OI	-	-
Total outside liabilities/Tangible net worth (times)	0.12	0.30
Total debt/OPBDIT (times)	-	-
Interest coverage (times)	-	-

Source: Company; Project stage company; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amounts in Rs. Crore

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 as of January 30, 2023 (Rs. crore)	Date & rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
				Feb 6, 2023	-	-	-
NCD	Long Term	523.80	523.80	[ICRA]A Rating Watch with Developing Implications	-	-	-
Proposed NCD	Long Term	0.20	-	[ICRA]A Rating Watch with Developing Implications			

Complexity level of the rated instruments

Instrument	Complexity Indicator
NCD	Very Simple
Proposed NCD	Very Simple[3]

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: Click Here

[3] Complexity indicator is subject to change when the terms of the NCD are finalised

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE584A08010	**NCD**	August 28, 2020	7.30%[4]	August 28, 2025	523.80	[ICRA]A Rating Watch with Developing Implications
NA	**Proposed NCD**	-	-	-	0.20	[ICRA]A Rating Watch with Developing Implications

Source: Company-

Annexure II: List of entities considered for consolidated analysis: Not applicable

[4] Post the occurrence of the demerger event, the coupon rate shall be enhanced by 25 bps (over the base coupon rate of 7.30%) for each notch of rating downgrade below AAA category rating level

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About ICRA Limited:

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